FOR AGENDA

SM/09/25

January 26, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Kingdom of Lesotho—Staff Report for the 2008 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with the Kingdom of Lesotho, which is tentatively scheduled for discussion on **Monday, February 9, 2009**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Kingdom of Lesotho indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Thugge (ext. 39761) and Mr. Davoodi (ext. 36942) in AFR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, February 3, 2009; and to the African Development Bank and the European Commission, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

Staff Report for the 2008 Article IV Consultation

Prepared by the staff representatives for the
2008 consultation with the Kingdom of Lesotho

Approved by Robert Sharer and Anthony Boote

January 23, 2009

- **Date:** October 29–November 11, 2008. The mission met with Finance Minister Thahane, Central Bank Governor Senaoana, other senior government officials, and representatives of the private sector and the donor community.

- **Team**: Messrs. Thugge (head), Davoodi, Fontaine, and Torrez (all AFR). Ms. Lephoto (OED) and representatives of the World Bank also attended.

- Lesotho has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Articles of Agreement and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The Lesotho loti is pegged at par to the South African rand, which is also legal tender in the country.

- Data provision has some shortcomings, but is broadly adequate for surveillance.

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GLOSSARY

AGOA	African Growth and Opportunity Act
CBL	Central Bank of Lesotho
CRP	Common Revenue Pool
CMA	Common Monetary Area
DSA	Debt sustainability analysis
FIA	Financial Institutions Act
GSP	Growth Strategy Paper
IFAD	International Fund for Agricultural Development
LHWP	Lesotho Highland Water Project
MCC	Millennium Challenge Corporation
M	Maloti (plural for the Loti, Lesotho's currency)
MDGs	Millennium Development Goals
NBFIs	Nonbank Financial Institutions
PAC	Project Appraisal Committee
PEM	Public Expenditure Management
PPP	Public-Private-Partnership
PSIRP	Public Sector Improvement and Reform Program
RUFIP	Rural Financial Intermediation Program
SACU	Southern African Customs Union
SADC	Southern African Development Community
SACCOs	Savings and Credit Cooperatives

EXECUTIVE SUMMARY

Background and outlook

Over the past two years, Lesotho made significant progress in macro-economic performance although implementation of structural reforms has been slow. Lesotho now faces significant risks in the wake of the global financial crisis and economic downturn. Already, the Southern African Customs Union (SACU) receipts, which account for a large part of government revenue, have been revised down significantly; some textile factories have laid off workers owing to reduced demand in the key U.S. market and difficulties securing lines of credit; and one diamond mining company has already suspended operations amid a softening of diamond prices.

With lower SACU revenues, the fiscal surplus is expected to narrow in 2009 and the current account will register a deficit. Economic growth in 2009 is expected to fall below its recent historical average, but should recover in 2010. However, a more protracted global and regional downturn could postpone the timing and limit the size of the recovery.

Key policy issues

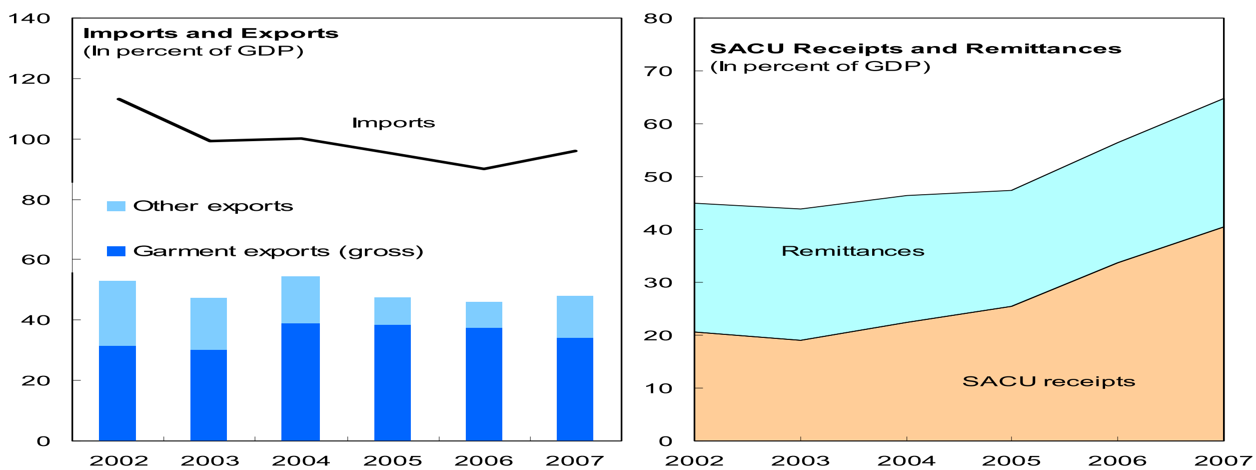
Given the downside risks to SACU revenues, the authorities agreed on the need to strengthen collection of non-SACU revenues, maintain fiscal discipline and improve prioritization of expenditures. They agreed to resuscitate the Project Appraisal Committee to strengthen the process of selection and evaluation of capital projects. They also agreed to form a high-level committee to fast-track implementation of structural reforms that should increase the growth potential, facilitate economic diversity and improve competitiveness.

To contain risks from the weakly-supervised nonbank financial institutions (NBFIs), the authorities agreed to amend the law on credit cooperatives and revise the Financial Institutions Act (FIA). The government has also closed down the operations of the largest Ponzi scheme and is awaiting a court decision to continue with its liquidation.

I. Background

1. **Lesotho is a small, highly open, landlocked country, with limited natural resources, and a narrow production and export base.** It has close economic ties with South Africa and its currency, the loti, is pegged to the rand**.** Aside from subsistence agriculture which employs a majority of the population, the garment sector, transfers from the SACU,[1] workers' remittances and lately the diamond sector also play an important role in employment, output, and exports (Figure 1). Lesotho is a member of the Common Monetary Area (CMA)[2] and the Southern African Development Community (SADC).

Figure 1. Openness and External Dependence



Source: Lesotho authorities.

2. **Economic growth has been erratic and social progress has been limited (Figure 2)**. Growth in per capita income averaged about 1½ percent a year during the period of 1997–2007, well below Lesotho's regional and international comparators. Poverty has declined modestly from 67 percent of households in 1994–95 to 57 percent in 2002–03, and income distribution is highly unequal. In May of this year and in response to the high food prices, the World Food Program began delivering food assistance to the population. It aims to distribute food to 155,000 vulnerable people in Lesotho each year until 2010. The HIV/AIDS epidemic continues to impact negatively on the economy, public service delivery and social development and threatens the achievement of the Millennium Development Goals (MDGs). Already, the country's ranking on the United Nations Human Development Index has deteriorated, falling from the bottom 33 percent of all countries in the early 1990s to the bottom 13 percent in 2007–08.

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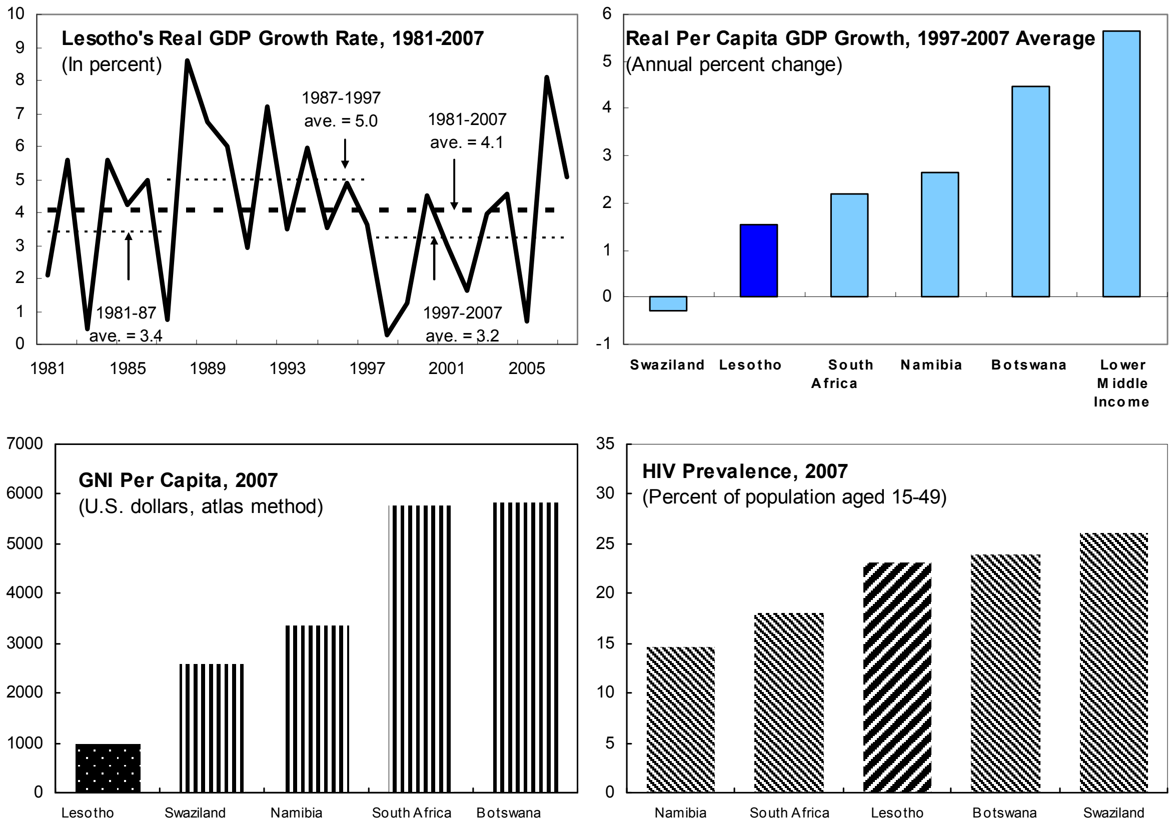
[1] Other members of the SACU are Botswana, Namibia, South Africa, and Swaziland.

[2] CMA consists of SACU members excluding Botswana.

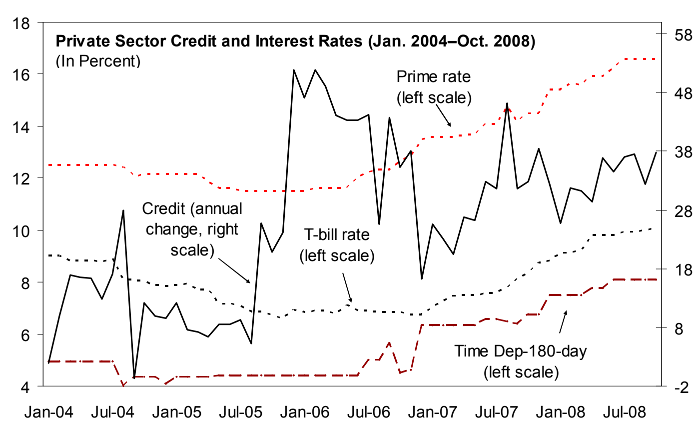
Figure 2. Growth, Income, and HIV/AIDS



Sources: Lesotho authorities; and the World Bank.

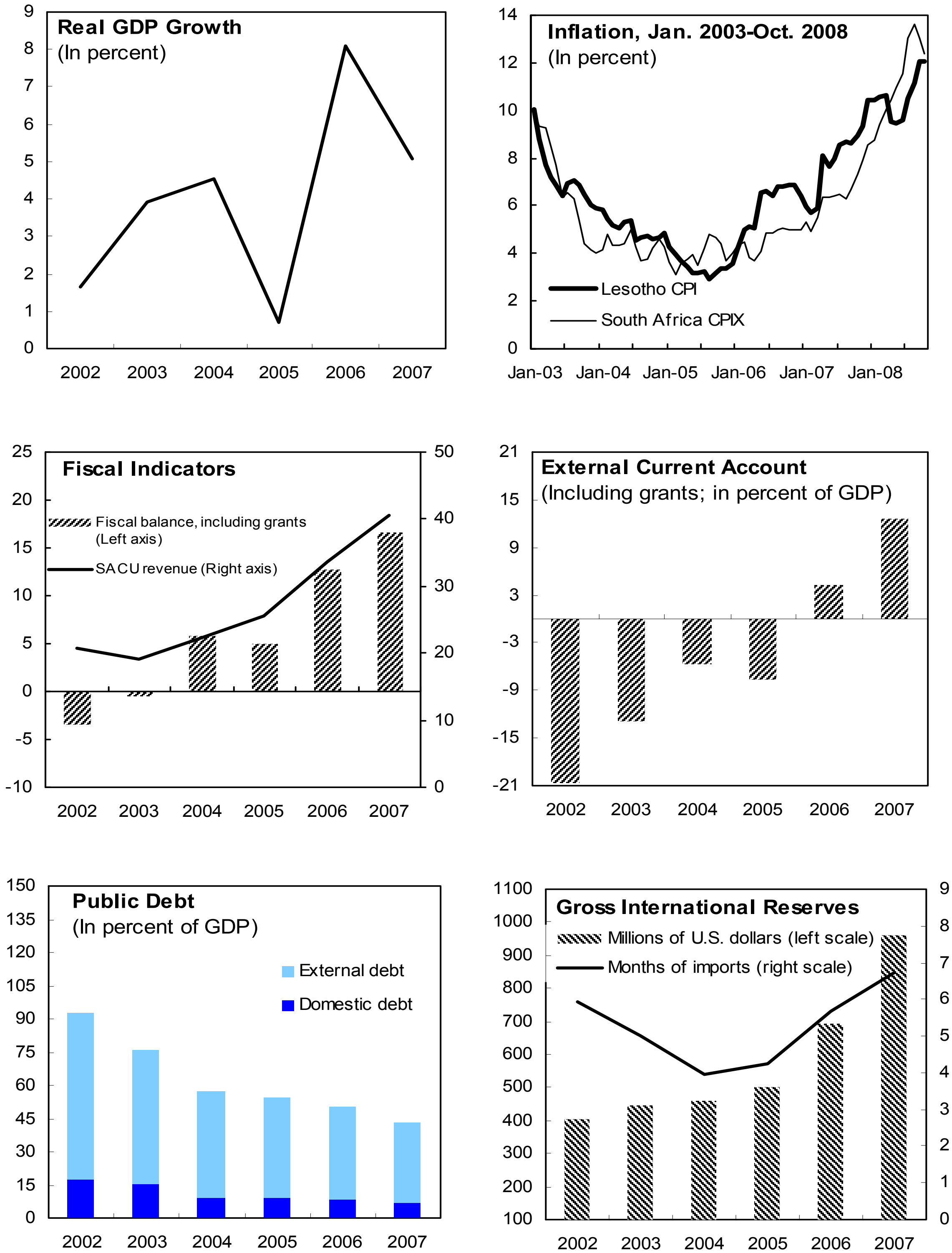
II. Recent Economic Developments

3. **Lesotho has made significant progress in macroeconomic performance** (Figure 3)**.** After a decade of low growth, economic activities surged above historical trends in the last two years, driven by mining, textile and construction sectors. The external current account registered sizable surpluses, reflecting high SACU revenues, workers' remittances, and exports of textiles and diamonds. As a result, gross international reserves was almost US$1 billion at end-2007 (equivalent to 6.7 months of imports), the highest level in Lesotho's history. Growth in broad monetary aggregates remains high, reflecting the continued accumulation of net foreign assets. The prime lending rate has increased in line with increases in South Africa.



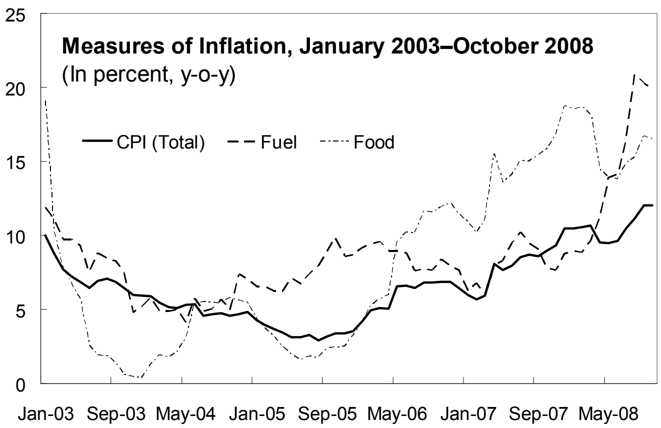
Sources: Lesotho authorities; and International Financial Statistics.

Figure 3. Recent Macroeconomic Performance



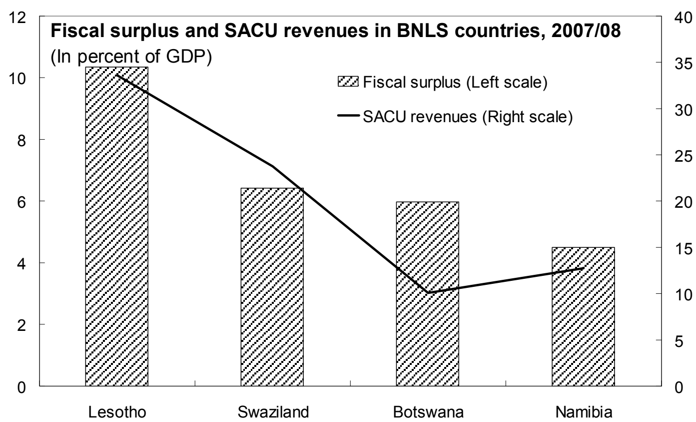
Sources: Lesotho authorities; and IMF staff estimates.

4. **As elsewhere, food and fuel prices have surged in Lesotho, driving the overall inflation up from 6.4 percent at end-2006 to 11.8 percent at end-November 2008.** Lesotho has generally passed-through international fuel and food prices to retail prices, and on April 1, 2008, tariffs for electricity, and public transportation were increased, in line with higher international energy prices and the increase in the price of electricity imported from South Africa. However, in order to boost food production, the 2008/09 budget provides guarantees of (M 105 million) to farmers, to be used for the purchase of inputs, leasing of machinery, and ploughing. The government plans to establish an Agricultural Development Fund over time for continued assistance to farmers. A supplementary budget provides funding (M 40 million) for a well-targeted cash-for-work program that reclaims land due to soil erosion.



Source: Lesotho authorities.

5. **Despite a marked increase in development spending, Lesotho recorded its fifth consecutive fiscal surplus in 2007/08 of 10.3 percent of GDP (the highest in the SACU countries) compared with a budgeted deficit of 2.8 percent of GDP.** This performance reflected higher-than-budgeted SACU receipts, bolstered by buoyant growth in value-added tax and double digit growth in income taxes, and underspending of both recurrent and development expenditure.



Sources: Lesotho authorities; and IMF staff estimates.

6. **Financial sector (Box 1) vulnerabilities stem from the weakly supervised NBFIs, and the emergence of Ponzi schemes.** The largest Ponzi scheme (MKM), has been closed but the final resolution of its identified liabilities remains an outstanding policy issue.[3] On September 23, 2008, the CBL provided to the public a summary of a confidential audit report that indicated that the MKM group is insolvent, with identified assets falling short of investors' original contributions by M300 million (2.7 percent of GDP).[4] There are so far no

[3] NBFIs have not operated any Ponzi schemes.

[4] The MKM's promised payout to investors (including interest) amounts to 9 percent of GDP.

discernible effects on financial intermediation from the collapse of the Ponzi scheme, but many poor individuals have suffered financial losses.

Box 1. Lesotho's Financial Sector

Lesotho's financial system comprises three South African-majority controlled commercial banks, with total assets equivalent to about 42 percent of GDP. NBFIs, with assets equivalent to 21 percent of GDP, comprise money lenders, insurance companies, private pension funds, unit trusts, and SACCOs. The state-owned Postal Bank, which provides bank-type services to the unbanked population and micro, small, and medium enterprises, but it is not authorized to receive deposits. Recently the government established a defined-contribution pension fund for government employees aged 40 years or les.

Assets of the Financial System

	Number of Institut.	Total Assets as of 2007: In Maloti Millions	Total Assets as of 2007: As Percentage of GDP	Accept Deposits	Supervised By
Banks	3	4,986	42	Yes	CBL
PostBank	1	121	1	No	CBL
Insurance companies and pension funds 1/	5	1,958	17	No	CBL
Money lenders 2/	100	...	...	No	CBL
SACCOs 3/	247	43	0	Yes	Min. of Trade & Ind.
Investment funds	3	333	3	No	CBL

1/ Include 16 insurance brokers.
2/ N/A data.
3/ There are 1,206 cooperatives, of which 941 are dormant and only 247 are active.

III. Outlook and Risks

7. **The global financial crisis has adversely affected Lesotho's near-term prospects (Box 2).** Real GDP growth is projected to slow down from 5.1 percent in 2007 to 3.9 percent and 2.1 percent in 2008 and 2009, respectively, owing to lower output in mining and textiles. However, as the global economy recovers, growth is expected to increase to a range of 4–5 percent in the medium term. The external current account deficit is expected to widen significantly to 8.5 percent of GDP in 2009 owing to reduced diamond and textile exports, remittances, and SACU revenues but then narrow to 5 percent in 2013 in line with the global recovery. Foreign direct investments are also anticipated to decline in 2009, resulting in an overall balance of payments deficit and a reduction in international reserves to 6-7 months of import cover. Balance of payments surpluses are projected beginning 2011, and international reserves are expected to stabilize at about 5½ months of import cover in the medium term.

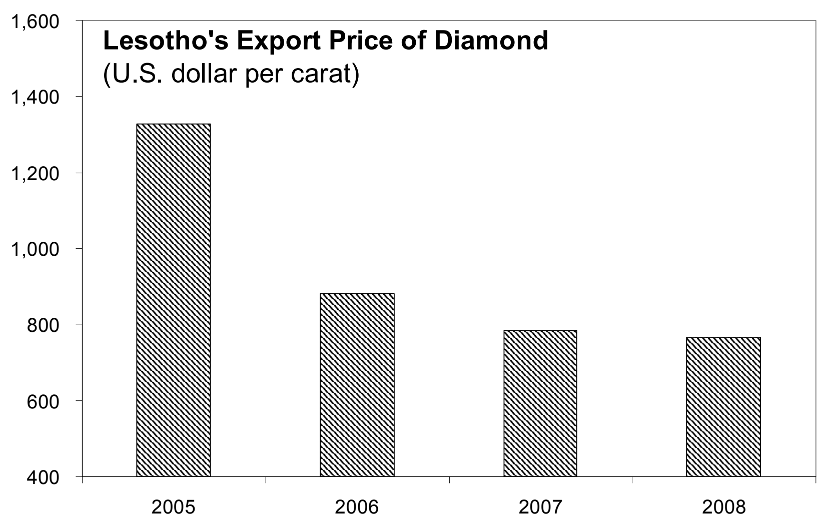
Box 2. Impact of the Global Financial Crisis and Downturn on Lesotho

Lesotho depends heavily on trade with South Africa and the United States that accounts for 69 percent and 19 percent of its total trade, respectively. The main transmission channels of the crisis include:

SACU Revenues: Slower growth in South Africa's economy reduces import demand, and thus customs duty, excise taxes and the amount of revenues transferred to Lesotho. Following the recent downward revision in South Africa's growth prospects, the projected SACU common revenue pool (CRP) was reduced by 6 percent in 2009, and by 15 percent in 2010–11. This has led to a significant revision of Lesotho's medium-term fiscal framework.

Textiles. With the slow-down in the U.S. economy, export volumes from Lesotho have declined. In addition, as most of the garment factories are owned by firms in Asia, some of them are facing difficulties obtaining trade credit for input financing from their Asian banks, which have been affected by the global credit crunch.

Diamonds. Weak prices for diamonds and the global credit crunch have resulted in reduced production and exports of diamonds. Already one mining company, Lighobong, has suspended production and is reassessing its operations, and another , Kao, which is just beginning production, is looking for potential investors—a task that is difficult in the current environment.



Source: Lesotho authorities; Data for 2008 refer to January–September.

Worker remittances. Remittances from migrant workers, mainly from South Africa, account for about 20 percent of GDP. Already retrenchments in South Africa's mining industry in response to the global credit crunch may put over 9,000 jobs at risk, thus potentially affecting some 50,000 Basothos who work in South Africa's mines. A decline in remittances would reduce private consumption, lower growth and increase poverty.

Lesotho: Medium-Term Scenario, 2006–2013

(Annual percentage change; unless otherwise indicated)

		Est.	Projected					
	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP	8.1	5.1	3.9	2.1	5.5	4.5	4.3	4.2
Consumer price index (period average)	6.1	8.0	12.0	8.5	6.6	6.1	5.5	4.9
Fiscal balance (including grants)	12.7	16.5	8.9	3.4	3.9	5.7	5.9	5.8
Non-SACU fiscal balance	-21.0	-23.9	-28.3	-27.1	-25.5	-25.0	-25.0	-25.1
Current account balance (Incl. official transfers)	4.3	12.7	-3.7	-8.5	-6.5	-5.6	-5.3	-4.9
Gross official reserves								
Months of imports of goods and services	5.7	6.7	6.6	6.3	5.9	5.7	5.6	5.5

Sources: Lesotho authorities; and IMF staff estimates and projections.

8. **Considerable downside risks remains to the baseline outlook**. Staff considered the possible impact of a more protracted global financial crisis and economic downturn on Lesotho's economy by assuming a sustained reduction in the production of diamonds and textiles (Figure 4).[5] The results suggest a need for continuing vigilance on the macro-economic front, and acceleration of structural reforms to ensure external sustainability.[6]

IV. POLICY DISCUSSIONS

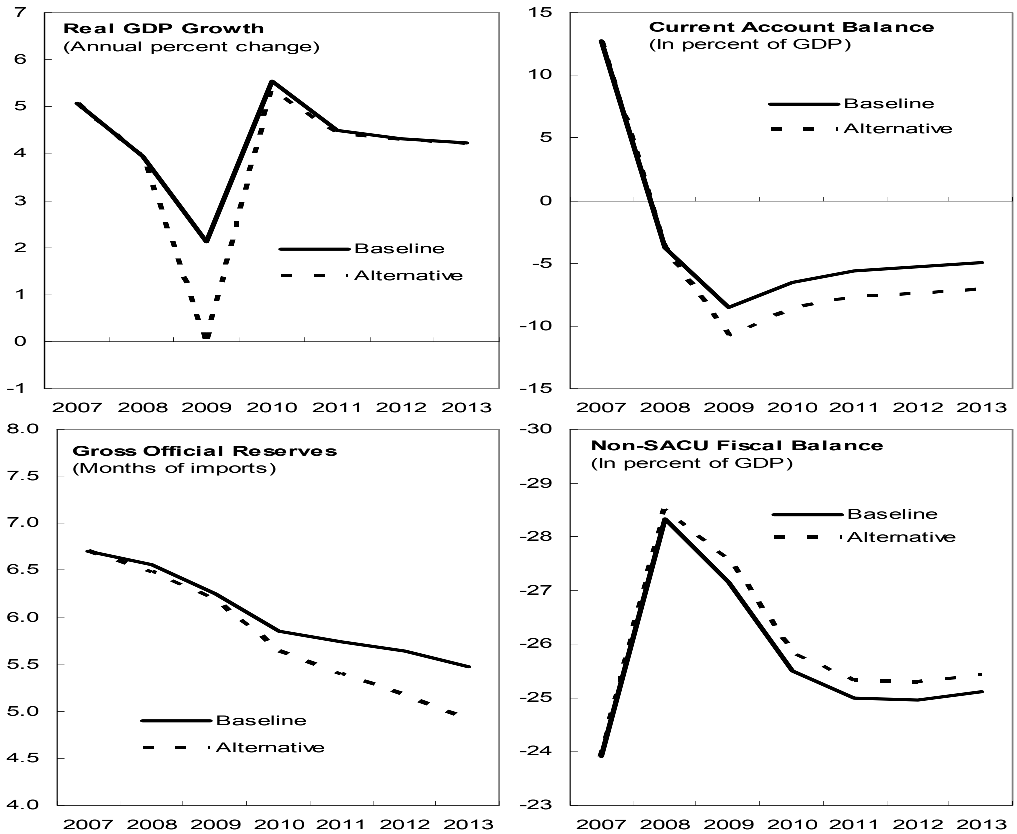
9. **Against the background of the global financial crisis, the discussions focused on policies to:**

- achieve sustained, broad based growth for poverty reduction;
- preserve fiscal sustainability and improve fiscal management;
- pursue external stability; and
- ensure financial stability and development.

[5] The baseline scenario assumes a contraction in mining and textile sectors (of 6–6 ½ percent) followed by a gradual recovery in 2010. The alternative scenario assumes a sustained reduction of 15 percent relative to the baseline scenario.

[6] The impact of lower SACU revenue is considered in the DSA.

Figure 4. Economic Impact of Lower Diamond and Textile Output



Sources: Lesotho authorities; and IMF staff estimates.

Implementation of Previous Fund Policy Advice

Fund staff and authorities have generally agreed on Lesotho’s main economic challenges. In the past, staff recommended containing recurrent expenditure in light of uncertain SACU revenues, vigorously implementing structural reforms, and taking prompt action to deal with the Ponzi schemes. The authorities’ containment of recurrent spending contributed to a substantial surplus in 2007–08, and they closed down the operations of the largest Ponzi scheme. However, the pace of structural reforms has generally been slow mainly due to capacity constraints.

A. Achieving Sustained and Broad-Based Growth

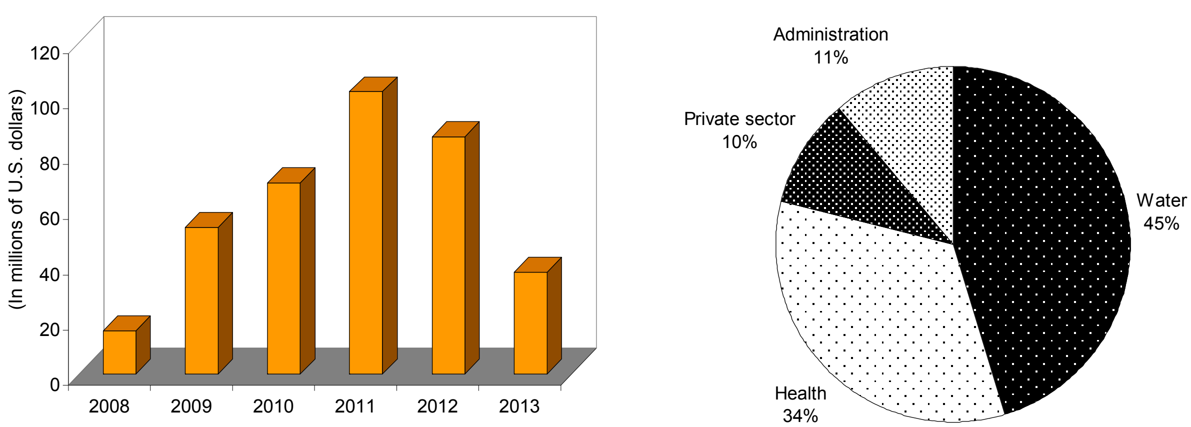
10. **Staff and authorities agreed that accelerating broad-based sustainable economic growth is needed to reduce poverty and inequality, and move toward achieving the MDGs.** The recent sharp declines, owing to drought and high cost of inputs, in agricultural production—the source of income for the 70 percent of population in rural population—may have exacerbated poverty and worsened income distribution. Staff welcomed, therefore, the government's intention to increase agriculture productivity with the support of the World

Bank, and to devise a long-term strategy to boost food production. Measures to address the HIV/AIDS pandemic, such as awareness campaigns and increased anti-retroviral therapies, are critical in supporting the development of human capital and increasing productivity in all sectors.

11. **Staff welcomed the focus in the authorities' draft Growth Strategy Paper (GSP) of identifying binding constraints on growth and improving the investment climate.** The GSP rightly emphasizes the importance of prudent macro-fiscal policies, an improved investment climate, enhanced property rights, land reforms, and better infrastructure as linchpins for accelerating pro-poor growth. Staff and the authorities agreed, that for Lesotho to become competitive, it will be critical to expedite the reforms being supported by the World Bank and the Millennium Challenge Corporation (MCC) in such areas as (i) improving the legal, judicial, and regulatory reforms; (ii) raising productivity through improvements in education and health; and (iii) enhancing access to financial services. Staff also noted that Lesotho could take advantage of its proximity to South Africa by deepening regional integration. The recent efforts to establish and operationalize the one-stop-shop are welcomed but closer integration with the relevant ministries is also needed for greater effectiveness.

12. **The implementation of projects supported by the MCC and the second phase of Lesotho Highland Water Project (LHWP) should support growth over the next five to ten years.** The MCC approved a grant of US$362.6 million (22 percent of 2007 GDP) under its compact program to assist Lesotho reduce poverty through sustained economic growth. The grant, which came into force in September 2008, has to be utilized within the next five years or Lesotho will lose the balance. The funds will be used to finance projects for provision of water, renovation, and development of the private sector. The grant has an administration component for monitoring and evaluation, compact management, and oversight. The second phase of LHWP (62 percent of 2007 GDP) is expected to start in 2012/13 and provides water and electricity to South Africa and Lesotho.

Distribution of MCC grant



13. **The current land tenure system unduly constrains development of agriculture, the financial sector, tourism, and manufacturing**. Lack of collaterization of land and clarification of land ownership rights weakens linkages between the agriculture and financial sector while restrictions on foreign ownership and long-term leasing of land reduce incentives for foreign investors to promote tourism and expand factory shells. While agreeing that land reform is important, the authorities noted that progress is likely to be time consuming as it requires consensus-building at the national level.

B. Preserving Fiscal Sustainability and Improving Fiscal Management

14. **The authorities agreed that Lesotho's public finances are vulnerable to downside risks to SACU revenues, which account for about two-thirds of its tax revenues.** Notwithstanding the recent downward revision in the CRP by South Africa, further reduction cannot be ruled out in the event of (i) a potential change in the SACU revenue-sharing formula; (ii) a further slow down in South Africa's economic growth; (iii) a reduction in the common external tariff rates due to trade liberalization; and (iv) the creation of a SADC customs union in 2010, which may change Lesotho's share of SACU revenues.

15. **Under unchanged policies and taking into account the authorities' projection for SACU revenues, the fiscal surplus will narrow from about 8½ percent of GDP in 2008–09—against a budgeted deficit of 3 percent of GDP—to a surplus of 1.8 percent of GDP in 2009–2010, but then rise as SACU revenues recover.** The sharp increase in

Lesotho: Fiscal Framework, 2007/08–2013/14

(In percent of GDP)

	Budget	Prel. Act.	Budget	Projection					
	2007/08	2007/08	2008/09	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Total revenue and grants	57.2	59.3	64.4	64.0	55.3	58.3	60.2	58.7	56.5
SACU revenue	31.8	33.6	37.6	38.4	27.9	30.0	30.9	30.9	30.9
Non-SACU revenue	21.2	24.2	21.7	23.4	23.3	23.2	23.2	23.2	23.2
Grants	4.1	1.5	5.1	2.2	4.1	5.1	6.0	4.6	2.4
Total expenditure and net lending	59.9	48.9	67.4	55.5	53.5	53.8	54.1	52.9	50.7
Of which:									
Current expenditure	44.1	38.5	51.5	44.7	39.9	39.6	39.0	38.5	38.1
Wages and salaries	14.5	13.4	15.8	13.7	13.5	13.4	13.3	13.2	13.2
Goods and services	14.3	11.5	16.9	13.7	13.7	13.7	13.7	13.7	13.7
Transfers and subsidies	12.2	11.2	17.7	16.5	11.9	11.7	11.3	10.9	10.6
Capital expenditure	16.0	10.6	16.0	10.9	13.6	14.3	15.1	14.4	12.7
Overall balance	-2.8	10.3	-3.0	8.5	1.8	4.5	6.1	5.9	5.8
Financing	2.8	-8.3	3.0	-8.5	-1.8	-4.5	-6.1	-5.9	-5.8
Statistical discrepancy	0.0	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:									
Non-SACU fiscal balance	-34.6	-23.3	-40.6	-29.9	-26.0	-25.5	-24.8	-25.0	-25.1

Sources: Lesotho authorities; and Fund staff estimates.

transfers in 2008–09 reflects full capitalization of the pension fund. In 2009-10 and beyond, non-SACU revenues are assumed to grow in line with nominal GDP. On the expenditure side, having already introduced a significant pension reform in the 2008–09 budget, which recognized the contingent liability (4½ percent of GDP) associated with the existing unfunded Defined Benefit Plan, the authorities do not intend to introduce any major expenditure policy changes. The wage bill, which is already one of the highest in sub-Saharan Africa, is expected to decline gradually in line with the implementation of the Public Sector Improvement and Reform Program (PSIRP). Over the medium term, the overall fiscal position is projected to remain in surplus, consistent with a stable non-SACU deficit (the overall fiscal balance excluding SACU revenues) of about 24–25 percent of GDP and a substantial reduction in the domestic debt-to-GDP ratio.

16. **Looking ahead, the fiscal policy challenge will be to respond effectively to a possible further deterioration in SACU revenues.** To mitigate against that risk, the government needs to strengthen non-SACU revenues and contain overall expenditures while at the same time shifting the allocation of resources toward development outlays that support growth. Implementation of these measures would permit a lower non-SACU deficit than projected under the unchanged policy scenario. Staff urged the government to avoid a further general wage increase and limit future recruitment to high priority areas. The authorities agreed that the current wage policy may not be sustainable, and emphasized that full implementation of the PSIRP remains a government priority.

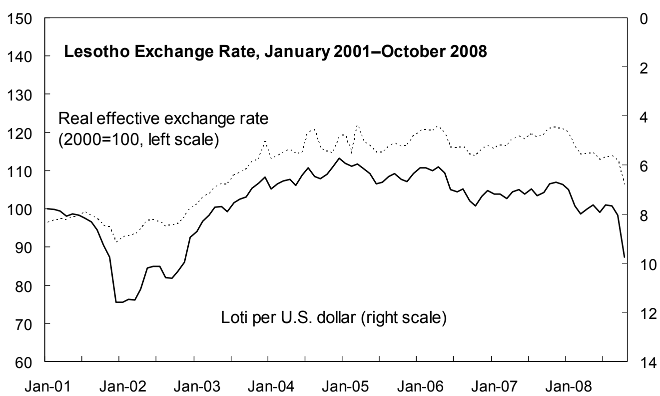
17. **Staff noted the government's intention to improve the public expenditure management (PEM) system and resuscitate the Project Appraisal Committee (PAC) to improve productivity of public investment.** The staff and the authorities agreed that the persistent underspending of the budget (10 percent of GDP in 2007/08) reflects primarily the formulation of budget on the basis of the previous year's budget appropriation rather than outturn. To address this problem, the authorities agreed to formulate future budgets, starting with the 2009/10 budget, on the basis of the expected outturn. They also intend to embark on staff training in order to remove capacity bottlenecks and fast-track the implementation of the new Integrated Financial Management Information System. A monitoring and reporting framework will also be considered with a view to enhancing accountability in the use of resources. The authorities are funding two investment projects under a Public-Private-Partnership (PPP). They are aware of the risks and challenges of PPPs and are monitoring their implementation in collaboration with the PAC. Staff urged that an appraisal framework be put in place to vet new PPP projects and thereby avoid assuming excessive contingent liabilities.

C. Pursuing External Stability

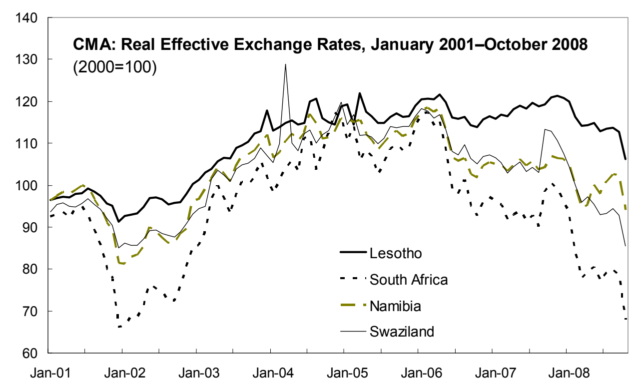
18. **Economic policies have been consistent with external stability.** The staff agreed with the authorities that the current exchange rate system should be maintained as it facilitates capital and current transactions with the country's most important economic

partner, South Africa. The main policy focus should be on fast-tracking the implementation of key structural reforms in order to enhance productivity and competitiveness.

19. **The assessment of the level of the real exchange rate was based on three approaches, the purchasing power parity approach adjusted for productivity differentials, the external sustainability approach, and the macro balance approach.**[7] Based on information through September 2008, the approaches suggested an overvaluation in the range of 5–11 percent. However, this has largely been offset since then by the depreciation of the loti by 13 percent through end-2008. Caution should be exercised in reaching a conclusion given weaknesses in data and the period of assessment. However, Lesotho's skewed trade pattern, with imports (mostly from South Africa) far exceeding exports (mainly to the United States), complicates the interpretation and usefulness of the standard real effective exchange rate for measuring competitiveness.



Sources: Lesotho authorities; and IMF staff estimates.



Source: INS.

20. **Lesotho scores poorly internationally and regionally on most measures of the cost of doing business that are critical to enhancing its competitiveness**. Already the government has extended financial support to one large textile company to prevent layoffs and other problems are emerging within the textile sector (Box 3). The current account deficit will widen further to 8½ percent of GDP in 2009 from 3.7 percent of GDP in 2009; and exports of textiles will fall throughout the projection period. Given Lesotho's real effective exchange rate is largely exogenous in light of the peg of the loti to the rand and with inflation closely tracking that of South Africa, the sustainability of the current account therefore depends crucially on pursuing competitiveness through rigorous implementation of structural reforms.

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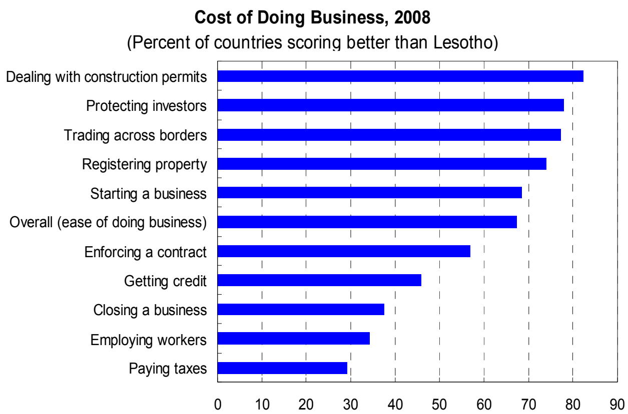
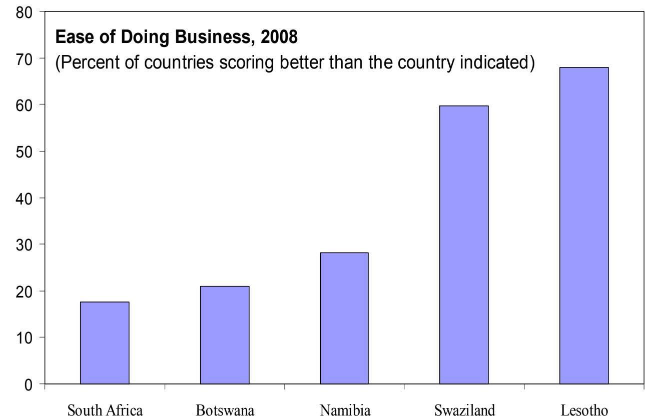
[7] These approaches and the key underlying assumptions are given in two 2007 IMF country reports on Lesotho (Reports no.08/135 and no.08/136).



Source: World Bank's Doing Business (2009).



21. **The authorities agreed that a continued build-up of international reserves depends in large part on the pursuit of a prudent fiscal stance despite declining SACU transfers.** This is particularly important given the falling level of exports (textiles and diamonds), and remittances. The authorities noted that their net international reserve, currently twice the target set by the CBL to support the exchange rate peg, is adequate, and that they would take appropriate measures, if needed, to ensure that objective is sustained.

Indicators of Reserve Adequacy at End-2007

(In percent unless otherwise indicated)

	Ratio of International Reserve to:		
	Imports of Goods and Services (In Months)	GDP	Broad Money
Botswana	28.0	78.6	181.4
Lower middle income countries	10.5	33.9	...
Lesotho	**6.7**	**57.8**	**162.4**
Sub-Saharan Africa (SSA)	5.7	16.9	37.2
Low income countries	5.5	16.6	...
South Africa	3.7	10.6	12.3
Swaziland	3.5	25.3	94.4
Nonresource intensive SSA	3.8	12.0	18.3
Namibia	2.8	10.7	20.1

Sources: World Economic Outlook; AFR's Regional Outlook; and staff estimates.

22. **With regard to external debt, the staff analysis shows that Lesotho's public and publicly guaranteed debt is sustainable, although there is a moderate risk of debt distress (see the Debt Sustainability Analysis Annex)**. There is therefore a need to continue pursuing prudent debt policies, including seeking loans on highly concessional terms.

Box 3. Challenges Facing the Textile Sector in Lesotho

Not since the expiration of the Multi Fiber Agreement on January 1, 2005 has there been so much pressure on the textile sector in Lesotho. With about two-thirds of its exports going to the United States, the industry has been hit hard by the recent downturn in the U.S. economy. Garment exports to the United States during the first 10 months of 2008 are down by 15 percent compared with the same period in 2007 and Lesotho's share of the U.S. market has fallen.

Among the many other challenges facing the sector is the unavailability of credit from Asia and the pending expiration of the third-country provision for sourcing inputs under the African Growth and Opportunity Act (AGOA) by 2012. This is of particular importance considering that Lesotho has no fabric mills and will have difficulty sourcing inputs from within the region. The sector is also weighed down by high labor and shipping costs, a shortage of factory shells, and the lack of basic infrastructure, such as water, communications and electricity services.

Lesotho: Textile Exports and Employment 2002–08

	2002	2003	2004	2005	2006	2007	2008
Textiles (in millions of U.S. dollars)	211.8	301.5	501.3	527.7	567.2	569.9	452.4
Percent of total exports	59.7	64.1	71.4	81.1	81.1	70.9	63.6
Employment 1/	34,125	46,635	45,034	40,813	41,535	41,149	40,939

Sources: Central Bank of Lesotho; and Lesotho National Development Corporation.

1/ Employment is for end-September 2008.

Responding to the challenges

Going forward, the challenge is to achieve international competitiveness in the face of strong expansion of Asian exports to their traditional export market in the United States, especially after 2008, when the bilateral agreements restricting Chinese exports expire. In spite of its relatively high unit labor costs compared to those of the Asian textile producing countries and longer turn-around time, trade preferences have helped Lesotho. However, there are no guarantees that the current benefits under the AGOA will last beyond 2012. Moreover, possible reductions in most-favored-nation tariffs in industrial countries under the current Doha Round of multilateral trade negotiations, could further reduce the preference margin for African exports, and adversely affect Lesotho's garment sector. It is essential, therefore, that key structural reforms be implemented quickly if Lesotho is to become competitive.

D. Ensuring Financial Stability and Development

23. **The banking sector seems to have weathered well the current global financial crisis thus far.** The three largely South-African-owned commercial banks continue to be well capitalized, liquid and profitable. However, there has been a slight increase in nonperforming loans, although these are still moderate and are fully provisioned. Some vulnerability may remain as bank's loan portfolios continue to be concentrated on a few borrowers. Staff welcomed the approval by Parliament of the Anti-Money Laundering

legislation and urged that the necessary regulations be issued and the Financial Intelligence Unit be put in place as quickly as possible.

Lesotho: Commercial Banks' Quarterly Performance Ratios, 2006–08

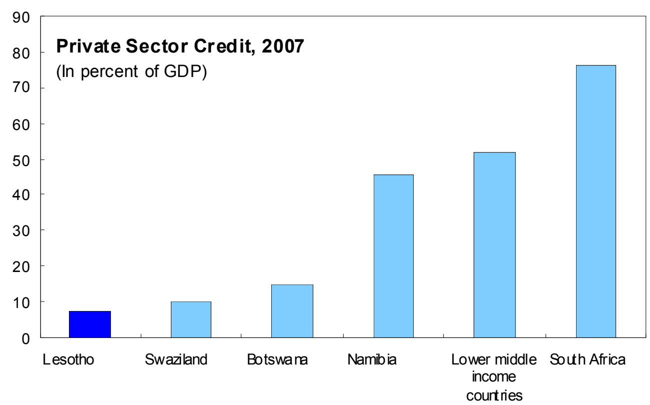
(In Percent)

	2006				2007				2008		
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
Performance ratios											
Capital adequacy											
Basel capital ratio	25.0	23.0	19.0	19.0	20.0	17.0	17.0	14.0	19.0	16.0	15.0
Total capital to assets	...	...	...	...	0.1	7.5	8.2	8.1	7.7	7.2	7.9
Nonperforming loans net of provsions to total capital	2.0	2.0	6.0	6.0	9.0	6.6	0.1	0.2	-0.8	-0.6	3.1
Top 20 exposures to total capital	84.0	63.0	98.0	117.0	116.0	148.7	143.3	124.4	124.8	132.6	139.3
Asset quality											
Loans to deposits ratio	30.0	17.0	30.0	26.0	26.0	29.4	31.3	28.7	31.4	30.0	34.6
Earning assets to total assets	94.0	95.0	94.0	95.0	95.0	93.3	96.0	93.6	102.7	97.0	91.5
Nonperforming loans to total loans	1.0	2.0	2.0	2.0	3.0	3.4	1.7	1.7	1.5	1.7	3.5
Reserve for losses to total loans	2.0	3.0	2.0	3.0	3.0	2.6	2.6	2.6	2.6	3.2	3.8
Reserve for losses to nonperforming loans	242.0	161.0	112.0	125.0	93.0	77.8	147.9	152.4	174.8	190.5	107.8
Liquidity ratios											
Liquid assets to total deposits	112.0	132.0	88.0	100.0	98.0	96.4	96.8	92.9	101.4	102.7	101.3
Available reserves to total deposits	6.0	6.0	5.0	4.0	5.0	7.7	4.3	5.3	2.0	3.3	7.7
Liquid assets to total assets	75.0	83.0	75.0	78.0	78.0	75.5	74.4	74.1	75.6	76.9	74.0
Current assets to total current liabilities	85.0	95.0	83.0	85.0	84.0	81.6	81.0	81.5	87.7	82.9	80.4
Profitability ratios 1/											
Net income to average total assets (return on assets)	1.0	1.0	2.0	2.0	1.0	1.2	1.8	2.6	0.8	1.6	2.4
Net income to average total equity (return on equity)	7.0	8.0	20.0	27.0	8.0	14.6	21.8	31.6	10.4	21.8	31.7
Net interest margin					0.0	2.7	3.8	5.5	1.7	3.3	5.0
Total expenses to total income	75.0	73.0	68.0	70.0	74.0	74.8	72.1	71.3	71.0	69.4	68.6
Solvency ratios											
Total debt ratio	12.0	12.0	10.0	7.0	8.0	7.5	8.2	8.1	8.2	7.2	7.9

Source: Central Bank of Lesotho.

1/ Since 2005, affected by the operations of two new banks.

24. **There continues to be a need to increase access to financial services for a large proportion of the underserved population including for small and medium-term enterprises.** Staff welcomed the efforts under way supported by the MCC and the International Fund for Agricultural Development (IFAD) under the Rural Financial Intermediation Program (RUFIP) to increase access to financial services, including by strengthening the institutional and operational framework of PostBank. Implementation of these reforms should deepen and enhance the efficiency of the financial sector.



Sources: World Economic Outlook; and International Financial Statistics.

25. **The extent of the operation of the SACCOs, which by law are permitted to take deposits from nonmembers, is not well known, and the quality of regulatory oversight, performed by the Ministry of Trade, is limited**. The authorities intend to repeal Article 68 of the Cooperative Societies Act of 2000 that allows deposit mobilization from nonmembers and may consider converting large SACCOs into commercial banks and placing them under the supervision of the CBL. They are also reviewing the legislation on NBFIs under the IFAD's RUFIP, and more broadly, intend to further strengthen the CBL's supervisory and regulatory authority of the financial sector and prevent emergence of new Ponzi-type schemes.

V. Staff Appraisal

26. **After two years of good performance, Lesotho's economy now faces significant downside risks owing to the international financial crisis**. Projections for SACU revenues have been revised downward significantly and demand for Lesotho's garments has fallen, as has the price of diamonds. The authorities should therefore fast track structural reforms and safeguard fiscal sustainability over the medium term.

27. **Broad-based growth will require prioritizing and implementing the reforms supported by the World Bank and the MCC.** The government's growth diagnostic study correctly recognizes a number of key constrains that hold growth in check, but it needs to prioritize and remove the key cross-cutting constraints. Of particular importance is land reform, which could help deepen the financial sector and serve as a catalyst for re-invigorating other sectors, such as tourism and manufacturing which are needed for sustaining growth and poverty reduction.

28. **Structural reforms need to be accelerated.** Consolidating the recent growth performance also requires determined effort to fast-track the implementation of other reforms to reduce the cost of doing business, improve the investment climate, and increase investment in human and physical capital. Implementing these reforms should also help diversify the economy, increase competitiveness and thereby help achieve external sustainability. To ensure implementation and close monitoring, staff recommends charging a high-level committee with the task of accelerating structural reforms, an approach that has worked in other countries.

29. **An appropriate fiscal policy strategy to mitigate risks from lower SACU revenues should be put in place.** It could include: (i) strengthening non-SACU revenues; (ii) containing recurrent spending by avoiding a general wage increase so as to create fiscal space for increased public investment; (iii) improving the entire process of selecting, monitoring, evaluating, and reporting progress on capital investment projects; (iv) making the budget a more effective tool for pubic policy by formulating it on an outturn basis rather than on unrealistic budget appropriations that do not advance transparency, accountability, and effective use of scarce resources; and (v) accelerating the civil service reform component

of the PSIRP, including by linking wage increases to performance and to qualified professionals within the health and education sectors.

30. **Staff commends the authorities on their recent decision to close the largest Ponzi scheme and notes that an early successful resolution would serve the country well**. It would allow regulators to focus on their core task of ensuring an efficient functioning of the formal financial sector that enhances access to finance and mobilizes resources for productive investment.

31. **Prompt action is needed to address vulnerabilities in NBFIs**. The amendments to the FIA to strengthen the supervision and regulatory role of the CBL over NBFIs need to be expedited. Staff therefore welcomes the intention to repeal Article 68 of the Cooperative Societies Act of 2000 that allows deposit mobilization from nonmembers.

32. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle**.

Table 1. Lesotho: Selected Economic and Financial Indicators, 2004–2013 1/

				Est.	Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	(Annual percentage change; unless otherwise indicated)									
National income and prices										
Real GDP	4.6	0.7	8.1	5.1	3.9	2.1	5.5	4.5	4.3	4.2
Real GNP	2.2	0.0	10.7	5.0	4.7	-2.0	4.2	3.8	3.9	4.0
Consumer price index (period average)	5.0	3.4	6.1	8.0	12.0	8.5	6.6	6.1	5.5	4.9
Consumer price index (end of period)	5.0	3.5	6.4	10.5	13.9	8.2	7.0	6.6	5.4	4.9
GDP (millions of maloti)	8,332	8,750	10,269	11,778	13,418	14,899	17,012	18,741	20,523	22,203
GNP (millions of maloti)	10,240	10,683	12,844	14,722	16,898	17,998	20,298	22,224	24,244	26,178
External sector										
Exports, f.o.b. 2/	49.2	-7.3	7.5	14.9	-11.4	-8.9	1.5	-0.3	-0.7	-0.2
Imports, f.o.b. 2/	31.0	1.0	4.6	17.3	5.2	-5.9	2.0	3.5	2.6	2.3
Nominal effective exchange rate 3/	0.5	-1.8	-3.6	0.6	...	...	...	...	...	...
Real effective exchange rate 3/	0.7	0.0	-2.2	3.6	...	...	...	...	...	...
Money and credit										
Net foreign assets 4/	22.4	12.4	73.2	66.0	...	...	...	...	...	...
Net domestic assets 4/	-19.1	-3.3	-37.9	-49.7	...	...	...	...	...	...
Credit to the government	-23.7	-8.3	-22.7	-52.0	...	...	...	...	...	...
Credit to the rest of the economy	2.5	10.3	4.3	9.4	...	...	...	...	...	...
Broad money	3.4	9.1	35.3	16.4	...	...	...	...	...	...
Velocity (GNP/average broad money)	4.4	4.3	4.2	3.9	...	...	...	...	...	...
Interest rate 5/	8.5	7.2	6.9	7.8	...	...	...	...	...	...
	(In percent of GDP; unless otherwise indicated)									
Investment and saving										
Investment	24.8	24.7	24.3	24.3	28.2	29.0	31.0	32.8	32.6	31.2
Public	7.5	7.8	7.1	9.8	10.8	13.1	14.1	14.9	14.6	13.1
Private	11.2	15.5	17.2	14.5	17.4	15.9	16.9	17.9	18.0	18.1
Lesotho Highlands Water Project	6.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross national savings (including remittances)	19.1	17.2	28.6	37.0	24.4	20.5	24.4	27.2	27.3	26.2
Public	13.4	12.7	19.7	26.2	19.6	16.4	17.9	20.6	20.4	18.9
Private	5.6	4.5	8.9	10.8	4.9	4.1	6.6	6.6	6.8	7.4
Government budget										
Revenue	47.8	50.4	57.6	63.5	60.7	54.0	52.5	53.9	54.1	54.2
Total grants	2.7	2.2	1.1	1.3	2.0	3.7	4.8	5.8	4.9	2.9
Total expenditure and net lending	44.7	47.6	45.9	48.3	53.9	54.4	53.5	54.0	53.1	51.3
Overall balance (excluding grants)	3.1	2.8	11.7	15.2	6.8	-0.3	-1.0	-0.1	1.0	2.9
Overall balance (including grants)	5.8	5.0	12.7	16.5	8.9	3.4	3.9	5.7	5.9	5.8
Government debt	57.4	54.5	50.3	42.9	52.4	43.1	39.6	37.3	36.1	35.5
Domestic debt	9.1	9.3	8.1	6.7	5.6	4.8	4.3	4.1	3.9	3.8
External debt	48.3	45.2	42.1	36.2	46.7	38.3	35.3	33.2	32.1	31.6
External debt-service ratio 6/	8.2	10.0	6.4	5.0	2.8	4.5	4.5	4.9	4.8	5.0
Balance of payment										
Current account balance (excl. official transfers)	-24.2	-28.6	-20.2	-24.8	-37.5	-36.9	-34.3	-34.8	-34.4	-33.8
Current account balance (incl. official transfers)	-5.7	-7.5	4.3	12.7	-3.7	-8.5	-6.5	-5.6	-5.3	-4.9
Gross official reserves (end of period)										
Millions of U.S. dollars	458	501	693	958	982	885	848	861	876	882
Months of imports of goods and services	4.0	4.3	5.7	6.7	6.6	6.3	5.9	5.7	5.6	5.5

Sources: Lesotho authorities; and IMF staff estimates and projections.

1/ Fiscal year beginning in April. All fiscal data are reported on a calendar basis.
2/ U.S. dollars.
3/ Based on partner-country data, new trade weights from 2004; a minus sign indicates a depreciation.
4/ Change in percent of broad money at the beginning of the period.
5/ The average effective rate on three-month treasury bills.

Table 2. Lesotho: Central Government Operations, 2005/06-2013/14 1/

(In millions of maloti)

	Act	Act.	Budget	Prel. Act.	Budget	Projection					
	2005/06	2006/07	2007/08	2007/08	2008/09	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Revenue	4,496	6,387	6,392	7,047	8,002	8,517	7,898	9,276	10,385	11,335	12,261
Tax revenue	4,006	5,787	5,817	6,331	7,268	7,790	7,094	8,384	9,395	10,252	11,086
Customs revenue (SACU) 2/	2,306	3,945	3,836	4,098	5,082	5,290	4,299	5,229	5,928	6,471	6,998
Noncustoms tax revenue	1,700	1,842	1,981	2,233	2,191	2,499	2,795	3,155	3,467	3,782	4,087
Income taxes	925	973	1,043	1,221	1,051	1,363	1,525	1,725	1,897	2,071	2,240
Sales tax / value-added tax (VAT)	656	715	805	848	961	1,012	1,138	1,274	1,395	1,518	1,637
Petrol levy	83	66	84	118	90	72	81	91	100	109	118
Other tax revenues	37	86	46	43	85	49	51	65	74	83	93
Nontax revenue	490	600	575	716	733	727	804	892	990	1,083	1,175
Water royalties	236	287	272	292	290	341	390	441	489	537	586
Interest received	8	5	7	7	8	6	6	6	6	6	6
Other nontax revenues	246	308	296	371	443	380	408	445	495	540	584
Grants	171	92	500	178	691	306	632	887	1,157	964	648
Of which: MCC	...	...	...	...	109	213	502	708	924	712	375
Total expenditure and net lending	4,291	4,860	7,225	5,965	9,096	7,657	8,248	9,379	10,379	11,069	11,597
Current expenditure	3,604	4,136	5,311	4,687	6,957	6,169	6,156	6,901	7,483	8,057	8,635
Wages and salaries	1,282	1,433	1,746	1,632	2,133	1,894	2,088	2,343	2,558	2,771	2,997
Interest payments	225	97	367	293	147	109	117	121	129	132	138
External	179	55	304	243	56	46	66	77	86	94	104
Domestic	46	41	62	50	91	63	50	44	42	38	34
Other expenditure	2,097	2,606	3,199	2,762	4,677	4,166	3,952	4,436	4,796	5,154	5,500
Goods and services	1,119	1,436	1,724	1,399	2,288	1,888	2,114	2,390	2,629	2,869	3,103
Transfer and subsidies	978	1,169	1,475	1,363	2,389	2,279	1,838	2,047	2,167	2,284	2,396
Pensions and gratuities	296	308	422	396	1,160	1,113	543	578	610	642	673
Subventions and transfers	682	862	1,053	967	1,229	1,166	1,295	1,468	1,557	1,643	1,723
Capital expenditure	697	733	1,924	1,291	2,157	1,498	2,101	2,488	2,906	3,022	2,972
Domestically funded	411.7	484.1	1,103.5	905.0	1,111.8	995.1	1,128.8	1,293.9	1,442.3	1,595.2	1,757.1
Externally funded	286	249	821	386	1,045	503	973	1,194	1,464	1,426	1,215
Grant funded	171	92	500	178	691	306	632	887	1,157	964	648
Of which: MCC	...	...	...	...	109	213	502	708	924	712	375
Loan funded	114	157	321	208	355	197	340	307	307	462	567
Net lending	-10	-9	-10	-13	-18	-10	-10	-10	-10	-10	-10
Overall balance, before grants	204	1,527	-833	1,082	-1,094	860	-350	-103	6	267	664
Overall balance, after grants	376	1,620	-334	1,261	-404	1,166	282	784	1,162	1,231	1,312
Non-SACU balance 3/	-1,930	-2,325	-4,170	-2,837	-5,486	-4,125	-4,017	-4,445	-4,766	-5,240	-5,687
Domestic balance 4/	659	1,822	282	1,698	-11	1,399	679	1,158	1,546	1,777	1,973
Total financing	-376	-1,517	334	-1,016	404	-1,166	-282	-784	-1,162	-1,231	-1,312
External financing	-277	-266	52	22	135	42	123	77	60	213	308
Loan drawings	114	157	321	208	355	197	340	307	307	462	567
Amortization	-391	-423	-269	-186	-220	-155	-217	-230	-247	-249	-260
Domestic financing	-99	-1,251	282	-1,038	269	-1,208	-405	-861	-1,222	-1,444	-1,619
Bank	-102	-1,248	…	-999	…	…	-291	…	…	…	…
Nonbank	3	-3	…	-39	…	…	-115	…	…	…	…
Statistical discrepancy	0	102	0	245	0	0	0	0	0	0	0

Table 2. Lesotho: Central Government Operations, 2005/06-2013/14 1/ (concluded)

(In percent of GDP; unless otherwise indicated)

	Act	Act.	Budget	Prel. Act.	Budget	Projection					
	2005/06	2006/07	2007/08	2007/08	2008/09	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Revenue	49.2	60.0	53.0	57.8	59.3	61.8	51.2	53.2	54.1	54.1	54.1
Customs revenue (SACU) 2/	25.3	37.1	31.8	33.6	37.6	38.4	27.9	30.0	30.9	30.9	30.9
Noncustoms tax revenue	18.6	17.3	16.4	18.3	16.2	18.1	18.1	18.1	18.1	18.1	18.0
Income taxes	10.1	9.1	8.7	10.0	7.8	9.9	9.9	9.9	9.9	9.9	9.9
Sales tax / value-added tax (VAT)	7.2	6.7	6.7	7.0	7.1	7.3	7.4	7.3	7.3	7.3	7.2
Petrol levy	0.9	0.6	0.7	1.0	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Other tax revenues	0.4	0.8	0.4	0.4	0.6	0.4	0.3	0.4	0.4	0.4	0.4
Nontax revenue	5.4	5.6	4.8	5.9	5.4	5.3	5.2	5.1	5.2	5.2	5.2
Water royalties	2.6	2.7	2.3	2.4	2.1	2.5	2.5	2.5	2.5	2.6	2.6
Interest received	0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other nontax revenues	2.7	2.9	2.5	3.0	3.3	2.8	2.6	2.5	2.6	2.6	2.6
Grants	1.9	0.9	4.1	1.5	5.1	2.2	4.1	5.1	6.0	4.6	2.9
Of which: MCC	...	...	...	...	0.8	1.5	3.3	4.1	4.8	3.4	1.7
Total expenditure and net lending	47.0	45.6	59.9	48.9	67.4	55.5	53.5	53.8	54.1	52.9	51.2
Current expenditure	39.5	38.8	44.1	38.5	51.5	44.7	39.9	39.6	39.0	38.5	38.1
Wages and salaries	14.0	13.5	14.5	13.4	15.8	13.7	13.5	13.4	13.3	13.2	13.2
Interest payments	2.5	0.9	3.0	2.4	1.1	0.8	0.8	0.7	0.7	0.6	0.6
External	2.0	0.5	2.5	2.0	0.4	0.3	0.4	0.4	0.5	0.4	0.5
Domestic	0.5	0.4	0.5	0.4	0.7	0.5	0.3	0.3	0.2	0.2	0.2
Other expenditure	23.0	24.5	26.5	22.7	34.6	30.2	25.6	25.4	25.0	24.6	24.3
Goods and services	12.3	13.5	14.3	11.5	16.9	13.7	13.7	13.7	13.7	13.7	13.7
Transfers and subsidies	10.7	11.0	12.2	11.2	17.7	16.5	11.9	11.7	11.3	10.9	10.6
Capital expenditure	7.6	6.9	16.0	10.6	16.0	10.9	13.6	14.3	15.1	14.4	13.1
Of which: domestically funded	4.5	4.5	9.2	7.4	8.2	7.2	7.3	7.4	7.5	7.6	7.8
Net lending	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Overall balance, before grants	2.2	14.3	-6.9	8.9	-8.1	6.2	-2.3	-0.6	0.0	1.3	2.9
Overall balance, after grants	4.1	15.2	-2.8	10.3	-3.0	8.5	1.8	4.5	6.1	5.9	5.8
Non-SACU balance 3/	-21.1	-21.8	-34.6	-23.3	-40.6	-29.9	-26.0	-25.5	-24.8	-25.0	-25.1
Domestic balance 4/	7.2	17.1	2.3	13.9	-0.1	10.1	4.4	6.6	8.1	8.5	8.7
Total financing	-4.1	-14.3	2.8	-8.3	3.0	-8.5	-1.8	-4.5	-6.1	-5.9	-5.8
External financing	-3.0	-2.5	0.4	0.2	1.0	0.3	0.8	0.4	0.3	1.0	1.4
Loan drawings	1.3	1.5	2.7	1.7	2.6	1.4	2.2	1.8	1.6	2.2	2.5
Amortization	-4.3	-4.0	-2.2	-1.5	-1.6	-1.1	-1.4	-1.3	-1.3	-1.2	-1.1
Domestic financing	-1.1	-11.8	2.3	-8.5	2.0	-8.8	-2.6	-4.9	-6.4	-6.9	-7.1
Bank	-1.1	-11.7	0.0	-8.2	0.0	0.0	-1.9	...	...	...	...
Nonbank	0.0	0.0	0.0	-0.3	0.0	0.0	-0.7	...	...	...	...
Statistical discrepancy	0	1.0	0.0	2.0	0	0	0	0	0	0	0
Memorandum items:											
Non-SACU balance	-21.1	-21.8	-34.6	-23.3	-40.6	-29.9	-26.0	-25.5	-24.8	-25.0	-25.1
GNP at current prices (Millions of maloti) 5/	10,683	12,844	13,961	14,722	16,994	16,898	17,998	20,298	22,224	24,244	26,178
GDP at current prices (Millions of maloti) 5/	9130.1	10646.43	12,052	12,188	13,501	13,788	15,427	17,445	19,187	20,943	22,651

Sources: Ministry of Finance, and Fund staff estimates and projections.

1/ Fiscal year from April to March.
2/ Adjustment receipts of M 330 million in 2005/06 included.
3/ Overall balance excluding customs revenue (SACU)
4/ Domestic balance excludes grants, foreign-financed capital spending, foreign interest payments, and exceptional factors.
5/ On a fiscal year basis.

Table 3. Lesotho: Balance of Payments, 2005–2013

			Est.	Projections					
	2005	2006	2007	2008	2009	2010	2011	2012	2013
				(In millions of U.S. dollars)					
Trade balance	**-656.6**	**-667.4**	**-799.0**	**-974.3**	**-937.9**	**-960.2**	**-1,019.0**	**-1,066.8**	**-1,106.8**
Exports, f.o.b.	650.7	699.5	804.0	712.4	649.0	658.6	656.8	652.3	651.1
Of which: garments	527.7	567.2	569.9	454.4	397.1	351.3	303.3	274.1	255.2
Imports f.o.b 1/	-1,307.3	-1,366.9	-1,603.0	-1,686.7	-1,586.9	-1,618.8	-1,675.7	-1,719.1	-1,757.9
Of which: garment inputs	-254.5	-273.6	-274.8	-219.1	-191.5	-169.4	-146.3	-101.1	-94.1
Services (net)	**-51.2**	**-36.0**	**-33.9**	**-54.8**	**-50.4**	**-50.1**	**-51.4**	**-51.4**	**-56.5**
Receipts	52.2	59.2	76.2	55.0	61.4	70.5	74.5	79.0	81.0
Of which: water royalties	18.1	18.4	20.4	23.9	26.1	28.5	30.6	32.7	33.5
Payments	-103.4	-95.2	-110.1	-109.8	-111.9	-120.6	-125.9	-130.4	-137.4
Income (net)	**304.0**	**380.2**	**417.9**	**420.6**	**355.7**	**363.6**	**372.1**	**385.8**	**402.1**
Labor income (net)	302.2	345.2	408.5	367.9	286.7	292.4	295.8	304.0	313.1
Receipts	319.1	356.6	429.5	379.2	309.5	325.5	333.5	348.1	358.3
Of which: miners' wages	253.8	292.8	365.7	321.8	255.3	263.1	266.9	276.2	284.6
Payments	-16.9	-11.4	-21.0	-11.3	-22.8	-33.1	-37.7	-44.1	-45.2
Investment income (net)	1.8	35.0	9.5	52.6	69.0	71.2	76.3	81.7	89.0
Receipts	50.3	56.1	86.5	70.4	90.1	94.7	101.4	108.2	117.2
Payments	-48.6	-21.2	-77.0	-17.8	-21.1	-23.5	-25.1	-26.4	-28.1
Of which: interest on debt	-37.9	-9.6	-64.0	-5.2	-7.8	-8.9	-9.6	-9.9	-10.7
Unrequited transfers	**300.3**	**389.1**	**628.0**	**547.8**	**487.1**	**523.8**	**586.3**	**619.2**	**650.0**
Official	289.7	371.6	627.0	546.8	486.1	522.7	585.3	618.2	648.9
SACU nonduty receipts	274.4	358.0	605.0	525.0	454.0	481.0	534.9	571.3	604.2
Rand compensation	11.5	11.5	12.6	12.0	12.4	12.7	13.0	13.3	13.6
Other	3.8	2.0	9.4	9.8	19.8	29.0	37.4	33.5	31.0
Private	10.6	17.5	1.0	1.0	1.0	1.0	1.0	1.1	1.1
Current account (including official transfers)	-103.5	65.9	212.9	-60.7	-145.6	-122.9	-111.9	-113.1	-111.1
Current account (excluding official transfers)	-393.3	-305.7	-414.1	-607.5	-631.7	-645.6	-697.2	-731.3	-760.0
Of which: LHWP 2/	-12.2	-7.3	-9.0	-0.2	0.0	0.0	0.0	0.0	0.0
Capital and financial account	**152.0**	**12.6**	**118.9**	**85.0**	**48.9**	**85.6**	**125.1**	**128.2**	**116.5**
Capital account (transfers received)	21.0	11.1	32.1	33.1	63.2	91.1	116.4	104.9	65.8
Financial account	131.0	1.5	86.7	51.9	-14.3	-5.5	8.7	23.3	50.7
Direct investment (excl. LHDA) 3/	57.3	92.0	105.7	87.7	66.7	85.9	105.5	125.8	132.2
Financing LHWP (net)	35.2	20.3	24.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	38.5	-110.8	-43.5	-35.8	-81.0	-91.5	-96.8	-102.5	-81.5
Assets	1.9	-89.1	-60.8	-63.0	-87.2	-98.6	-107.1	-112.1	-119.9
Liabilities	36.6	-21.7	17.3	27.2	6.2	7.1	10.3	9.6	38.4
Change in reserve assets	-43.2	-191.1	-265.1	-24.3	96.7	37.3	-13.2	-15.1	-5.4
Valuation adjustment	14.6	53.5	-17.4	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-19.9	59.1	-49.3	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:				(Percent of GDP, unless otherwise indicated)					
Trade balance	-47.7	-44.0	-47.8	-60.1	-54.9	-51.0	-50.9	-50.1	-49.3
Net remittances	22.0	22.8	24.4	22.7	16.8	15.5	14.8	14.3	13.9
Current account (including official transfers)	-7.5	4.3	12.7	-3.7	-8.5	-6.5	-5.6	-5.3	-4.9
Current account (excluding official transfers)	-28.6	-20.2	-24.8	-37.5	-36.9	-34.3	-34.8	-34.4	-33.8
Excluding LHWP	-29.0	-20.9	-25.4	-38.9	-38.5	-35.8	-36.3	-35.9	-35.3
Total SACU receipts (Millions of U.S dollars)	346.8	431.2	676.3	603.5	521.8	552.9	614.8	656.7	694.5
Gross official reserves (Millions of U.S. dollars)	501.4	692.6	957.7	981.9	885.3	848.0	861.1	876.2	881.6
Gross official reserves									
(Months of imports of goods and services)	4.3	5.7	6.7	6.6	6.3	5.9	5.7	5.6	5.5
Nominal GDP (USD millions)	1,376	1,517	1,672	1,622	1,710	1,883	2,003	2,127	2,246

Sources: Central Bank of Lesotho; and IMF staff estimates and projections.

1/ Adjusted for SACU duty receipts.
2/ Lesotho Highlands Water Project.
3/ Lesotho Highlands Development Authority.

Table 4. Lesotho: Monetary Survey, 2003–08

		December					September
	2002	2003	2004	2005	2006	2007	2008
	(In millions of maloti; unless otherwise indicated)						
Net foreign assets	3,891.1	3,496.3	4,012.0	4,306.9	6,205.3	8,520.6	10,015.8
Central bank	3,321.3	2,873.1	2,886.4	3,151.7	4,373.6	6,289.9	7,815.6
Commercial banks	569.8	623.2	1,125.6	1,155.2	1,831.7	2,230.7	2,200.2
Net domestic assets	-1,722.9	-1,198.4	-1,636.4	-1,714.3	-2,697.4	-4,439.1	-5,634.7
Domestic credit	747.2	340.5	-146.8	-100.5	-576.8	-2,071.1	-2,405.3
Claims on central government (net)	-317.5	-167.0	-712.1	-910.1	-1,498.8	-3,324.3	-3,939.2
Central bank	-1,066.0	-1,090.1	-1,197.8	-1,199.9	-1,973.9	-3,728.8	-4,318.5
Commercial banks	748.5	923.1	485.7	289.8	475.2	404.5	379.3
Claims on the rest of the economy	1,064.7	507.5	565.2	809.6	921.9	1,253.3	1,533.9
Other items (net)	-2,470.1	-1,538.9	-1,489.6	-1,613.9	-2,120.6	-2,368.1	-3,229.4
Money and quasi-money (M2)	2,168.2	2,297.9	2,375.5	2,592.6	3,507.9	4,081.5	4,381.1
Money	1,440.9	1,537.7	1,591.9	1,832.0	2,688.8	2,990.7	3,350.3
Of which:							
Currency outside dep. mon. banks	179.7	183.5	204.5	212.8	309.4	339.3	379.6
Demand deposits	1,261.3	1,354.2	1,387.4	1,619.3	2,379.4	2,651.4	2,970.7
Quasimoney	727.2	760.1	783.6	760.5	819.1	1,090.8	1,030.7
Of which:							
Time and savings deposits	727.2	760.1	783.6	760.5	819.1	1,090.8	1,030.7
	(Annual percent changes)						
Net foreign assets 1/	-66.4	-18.2	22.4	12.4	73.2	66.0	52.8
Central bank	-60.0	-20.7	0.6	11.2	47.1	54.6	44.6
Commercial banks	-6.4	2.5	21.9	1.2	26.1	11.4	8.2
Net domestic assets 1/	75.2	24.2	-19.1	-3.3	-37.9	-49.7	-36.5
Claims on central government (net)	15.6	6.9	-23.7	-8.3	-22.7	-52.0	-22.3
Claims on the rest of the economy	6.6	-25.7	2.5	10.3	4.3	9.4	9.1
Claims on the rest of the econ. (yearly change)	14.1	-52.3	11.4	43.2	13.9	35.9	28.8
Other items (net)	53.0	42.9	2.1	-5.2	-19.5	-7.1	-23.3
Money and quasimoney (M2) 1/	8.8	6.0	3.4	9.1	35.3	16.4	16.2

Sources: Central Bank of Lesotho; and IMF staff estimates and projections.

1/ Annual change in percent of beginning-of-year M2, unless otherwise indicated. September is year-on-year.

Table 5. Lesotho: Indicators of External Vulnerability, 2003–07

(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007
Financial indicators - testing					
Public sector debt 1/	76.2	57.4	54.5	50.3	49.1
Broad money (M2; annual percent change)	6.0	3.4	9.1	35.3	16.4
Private sector credit (annual percent change)	-25.7	2.5	10.3	4.3	9.4
Domestic credit	4.5	-1.8	-1.1	-5.6	-4.9
Treasury-bill yield (percent) 2/	12.0	8.5	7.2	6.9	7.8
Treasury-bill yield (real, percent) 3/	4.7	3.5	3.8	0.8	-0.2
External indicators					
Exports of goods and services (U.S. dollars, annual percent change)	34.0	48.9	-9.2	7.9	16.0
Imports of goods and services (U.S. dollars, annual percent change)	32.5	29.7	1.5	3.6	17.2
Current account balance	-12.8	-5.7	-7.5	4.3	12.7
Capital and financial account balance	16.8	5.3	7.9	-12.1	-8.5
Of which: inward foreign direct investment	3.7	3.6	4.1	6.2	6.1
Net foreign assests of the banking sector (millions of U.S. dollars)	93.8	199.9	182.6	262.8	327.6
Foreign assets of the banking sector (millions of U.S. dollars)	155.9	262.2	234.6	309.6	375.5
Foreign liabilities of the banking sector (millions of U.S. dollars)	62.0	62.3	51.9	46.8	47.9
Gross official reserves (millions of U.S. dollars)	446.5	458.2	501.4	692.6	957.7
Gross official reserves (months of imports of goods and services)	5.0	4.0	4.3	5.7	6.7
Ratio of reserve money to reserves (percent)	17.5	21.7	23.1	14.1	10.5
Ratio of broad money to reserves (percent)	77.5	92.1	81.7	72.7	62.6
Total external debt 4/	61.0	48.3	45.2	42.1	36.2
Ratio of total external debt to exports of goods and services (percent)	133.0	92.3	89.0	81.8	71.1
Nominal exchange rate (maloti per U.S. dollar, period average)	6.6	5.6	6.3	7.0	6.8
REER depreciation (-) (end of period, CPI-based)	17.1	0.7	-0.1	-2.2	3.6
Memorandum items:					
GDP (millions of U.S. dollars)	1,132.8	1,479.9	1,383.5	1,473.4	1,729.5
Nominal exchange rate (maloti per U.S. dollar, end-of-period)	6.6	5.6	6.3	7.0	6.8

Sources: Lesotho authorities; and IMF staff estimates and projections.

1/ National government debt.
2/ End of period.
3/ Backward-looking with actual consumer price index (CPI).
4/ Excludes private debt within the Common Monetary Area.

Table 6. Lesotho: Millennium Development Goals

	1990	1995	2000	2007
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (in percent)	54.0	54.0	35.0	37.0
Employment to population ratio, ages 15–24, total (in percent)	40.0	39.0	24.0	25.0
Income share held by lowest 20 percent	...	1.5	...	...
Malnutrition prevalence, weight for age (percent of children under 5)	...	...	15.0	16.6
Poverty headcount ratio at national poverty line (percent of population)	...	49.2	68.0	...
Prevalence of undernourishment (percent of population)	17.0	14.0	...	...
Vulnerable employment, total (percent of total employment)	...	...	...	...
Goal 2: Achieve universal primary education				
Literacy rate, youth female (percent of females ages 15–24)	...	...	...	...
Literacy rate, youth male (percent of males ages 15–24)	...	...	...	...
Persistence to last grade of primary, total (percent of cohort)	...	...	54.0	62.0
Primary completion rate, total (percent of relevant age group)	56.0	63.0	60.0	78.0
Total enrollment, primary (percent net)	...	...	78.0	75.0
Goal 3: Promote gender equality and empower women	**132.0**		**117.5**	**113.5**
Proportion of seats held by women in national parliament (in percent)	...	5.0	4.0	24.0
Ratio of female to male enrollments in tertiary education	130.0	...	153.0	119.0
Ratio of female to male primary enrollment	122.0	...	104.0	100.0
Ratio of female to male secondary enrollment	142.0	...	131.0	127.0
Ratio of young literate females to males (percent ages 15–24)	...	...	...	...
Share of women employed in the nonagricultural sector (in percent of total nonagricultural employment)	...	44.1	...	...
Goal 4: Reduce child mortality				
Immunization, measles (percent of children ages 12–23 months)	80.0	83.0	74.0	85.0
Mortality rate, infant (per 1,000 live births)	81.0	73.0	86.0	102.0
Mortality rate, under-5 (per 1,000)	101.0	91.0	108.0	132.0
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15–19)	...	94.0	91.0	77.0
Births attended by skilled health staff (percent of total)	...	50.0	60.0	...
Contraceptive prevalence (percent of women ages 15–49)	23.0	...	30.0	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	960.0
Pregnant women receiving prenatal care (in percent)	...	88.0	85.0	...
Unmet need for contraception (percent of married women ages 15–49)	...	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (percent of children under age 5 with fever)	...	...	...	...
Condom use, population ages 15–24, female (percent of females ages 15–24)	...	...	...	...
Condom use, population ages 15–24, male (percent of males ages 15–24)	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	184.0	323.0	553.0	635.0
Prevalence of HIV, female (percent ages 15–24)	...	...	...	14.9
Prevalence of HIV, total (percent of population ages 15–49)	...	...	23.9	23.2
Tuberculosis cases detected under DOTS (in percent)	...	59.0	72.0	79.0
Goal 7: Ensure environmental sustainability				
Annual freshwater withdrawals, total (percent of internal resources)	...	...	1.0	...
CO2 emissions (kg per PPP $ of GDP)	...	...	...	...
CO2 emissions (metric tons per capita)	...	...	...	...
Forest area (percent of land area)	0.0	...	0.0	0.0
Improved sanitation facilities (percent of population with access)	...	33.0	34.0	36.0
Improved water source (percent of population with access)	...	77.0	77.0	78.0
Marine protected areas, (percent of surface area)	...	...	...	...
Nationally protected areas (percent of total land area)	...	...	...	...
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	87.0	65.0	19.0	36.0
Debt service (PPG and IMF only, percent of exports of G&S, excl. workers' remittances)	4.2	6.1	11.3	4.0
Internet users (per 100 people)	...	0.0	0.2	3.5
Mobile phone subscribers (per 100 people)	...	...	1.1	22.7
Telephone mainlines (per 100 people)	0.8	1.0	1.2	2.7
Other				
Fertility rate, total (births per woman)	4.9	4.5	4.0	3.5
GNI per capita, Atlas method (current US$)	640.0	770.0	590.0	1,000.0
GNI, Atlas method (current US$) (billions)	1.0	1.3	1.1	2.0
Gross capital formation (percent of GDP)	52.7	60.6	42.6	36.1
Life expectancy at birth, total (years)	59.0	57.0	49.0	43.0
Literacy rate, adult total (percent of people ages 15 and above)	...	...	82.0	...
Population, total (in millions)	1.6	1.7	1.9	2.0
Trade (percent of GDP)	139.3	141.8	123.1	150.5

Source: World Development Indicators database.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Appendix I. Draft Public Information Notice

Draft Public Information Notice (PIN) No. 09/xx
FOR IMMEDIATE RELEASE

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with the Kingdom of Lesotho

On February 9, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of Lesotho.[1]

Background

Lesotho has made significant progress in macroeconomic performance but the pace of implementation of key structural reforms has been slow. After a decade of low growth, economic activity surged above historic trends, averaging 6.6 percent during 2006-07 driven by the mining, textile and construction sectors. However, poverty has seen only a modest decline, and the HIV/AIDS epidemic continues to impact negatively on the economy, public service delivery and social development, and threatens the achievement of the Millennium Development Goals (MDGs).

Large transfers from the Southern African Customs Union (SACU), together with workers' remittances and exports of textiles and diamonds, contributed to a sizable build-up of international reserves equivalent to 6.7 months of imports at end-2007. Inflation has surged from 6.4 percent at end-2006 to 11.8 percent at end-November 2008 owing mainly to the rise in food and fuel prices. Growth in broad monetary aggregates remains high, reflecting the continued accumulation of net foreign assets.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

In 2007/08, Lesotho recorded its fifth consecutive fiscal surplus reflecting buoyant SACU receipts, increases in value-added and income taxes as well as underspending of both recurrent and development expenditure. Debt indicators have also improved as the use of SACU receipts to retire nonconcessional debt contributed to a decline in the ratio of external debt-to-GDP to 36 percent at the end of 2007 from 85.5 percent in 2002.

Financial sector vulnerabilities stem from the weakly supervised nonbank financial institutions and the potential re-emergence of Ponzi schemes. The banking sector thus far appears not to have been seriously affected by the current global financial crisis.

The medium term economic outlook is somewhat clouded in the wake of the global financial crisis and economic downturn. Downside risks remain from a potential further decline in SACU revenues, and lower exports of textiles and minerals should the global economic downturn be protracted.

Executive Board Assessment

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Lesotho: Selected Economic and Financial Indicators, 2004-08 [1]

	2004	2005	2006	Est. 2007	Proj. 2008
	(Annual percent change, unless otherwise specified)				
Real Economy					
Real GDP growth	4.6	0.7	8.1	5.1	3.9
GDP at current market prices (millions of maloti)	8,332	8,750	10,269	11,778	13,418
Inflation (period average)	5.0	3.4	6.1	8.0	12.0
	(Percent of GDP)				
National Accounts					
Gross Domestic Investment	24.8	24.7	24.3	24.3	28.2
Gross national savings	19.1	17.2	28.6	37.0	24.4
Central Government					
Revenue and grants	50.5	52.6	58.7	64.8	62.7
Revenue	47.8	50.4	57.6	63.5	60.7
Total grants	2.7	2.2	1.1	1.3	2.0
Total expenditure and net lending	44.7	47.6	45.9	48.3	53.9
Overall balance (excluding grants)	3.1	2.8	11.7	15.2	6.8
Overall balance	5.8	5.0	12.7	16.5	8.9
	(Annual percent change, unless otherwise specified)				
Money and credit					
Net Domestic assets of the banking system [2]	-19.1	-3.3	-37.9	-49.7	-36.5
Money and quasi-money (M2)	3.4	9.1	35.3	16.4	16.2
	(Percent of GDP)				
External sector					
Current account balance					
Excluding official transfers	-24.2	-28.6	-20.2	-24.8	-37.5
Including official transfers	-5.7	-7.5	4.3	12.7	-3.7
External public debt [3]	48.3	45.2	42.1	36.2	46.7
External debt-service ratio [4]	8.2	10.0	6.4	5.0	2.8
Gross official reserves (end of period)					
In millions of U.S. dollars	458.2	501.4	692.6	957.7	981.9
In months of imports of goods and services	4.0	4.3	5.7	6.7	6.6

Sources: Lesotho authorities; and Fund staff estimates and projections.

[1] Fiscal year beginning in April. All fiscal data are reported on a calendar basis.
[2] Change in percent of M2 at the beginning of the period. Data for 2008 refer to end-September 2008.
[3] The depreciation of the loti had a significant effect on the debt-to-GDP ratio in 2008.
[4] In percent of exports of goods and services.