

**FOR  
AGENDA**

SM/09/25  
Correction 1

February 5, 2009

To: Members of the Executive Board  
From: The Acting Secretary  
Subject: **Kingdom of Lesotho—Staff Report for the 2008 Article IV Consultation**

The attached corrections to SM/09/25 (1/26/09) have been provided by the staff:

**Factual Errors Not Affecting the Presentation of Staff's Analysis or Views**

- Page 9, Box 1, line 4:** for “Postal Bank, which provides”  
read “Postal Bank provides”  
**line 6:** for “to receive deposits.” read “to make loans.”  
**text table:** remove footnote “2/” and renumber footnote “3/” to “2/”  
**row “PostBank”, column 4:** for “No” read “Yes”  
**row “SACCOs,” columns 2 and 3:** for “43” and “0” read “...”  
**footnote 1/:** for “Include 16” read “In addition, there are 16”
- Page 11, text box:** “Annual percentage change; unless otherwise indicated” removed  
above “Real GDP” row “(Annual percentage change)” added  
above “Fiscal balance (including grants)” row “(Percent of GDP; unless  
otherwise indicated)” added
- Page 12, para. 10, line 4:** for “of population in” read “of the”
- Page 13, para. 12, line 7:** for “renovation, and”  
read “renovation of health facilities, and”
- Page 16, para. 20, line 5:** for “3.7 percent of GDP in 2009”  
read “3.7 percent of GDP in 2008”

- Page 18, Box 3, para. 2, lines 3–4:** for “no fabric mills”  
 read “a limited number of fabric mills”  
**text table, row “Textiles,” column “2008”:** for “452.4” read “454.4”  
**row “Percent of total exports,” column “2008”:** for “63.6”  
 read “63.8”
- Page 27, Table 5:** Data in row 5 for 2007, rows 9 and 10 for 2003, and rows 12, 13, 15, 16, 23, and 26 for 2003–07 have been changed to correct an earlier error.

### Typographical Errors

- Page 9, Box 1, line 7:** for “les.” read “less.”
- Page 10, Box 2, para. 4, line 2:** for “Liqhobong” read “Liqhobong”  
**line 3:** remove extra space before comma from “another ,”
- Page 11, para 8, line 1:** “s” removed from “remains”
- Page 19, text table, row 5:** for “provsions” read “provisions”
- Page 20, para. 29, line 6:** for “pubic” read “public”

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

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Att: (10)

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 Department Heads

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 provides bank-type services to the unbanked population and micro, small, and medium enterprises, but it is not authorized to make loans. Recently the government established a defined-contribution pension fund for government employees aged 40 years or less.

#### Assets of the Financial System

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

1/ In addition, there are 16 insurance brokers.

2/ 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, Liqhobong, 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

	2006	Est. 2007	Projected					
			2008	2009	2010	2011	2012	2013
	(Annual percentage change)							
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
	(Percent of GDP; unless otherwise indicated)							
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 remain 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).<sup>5</sup> The results suggest a need for continuing vigilance on the macro-economic front, and acceleration of structural reforms to ensure external sustainability.<sup>6</sup>

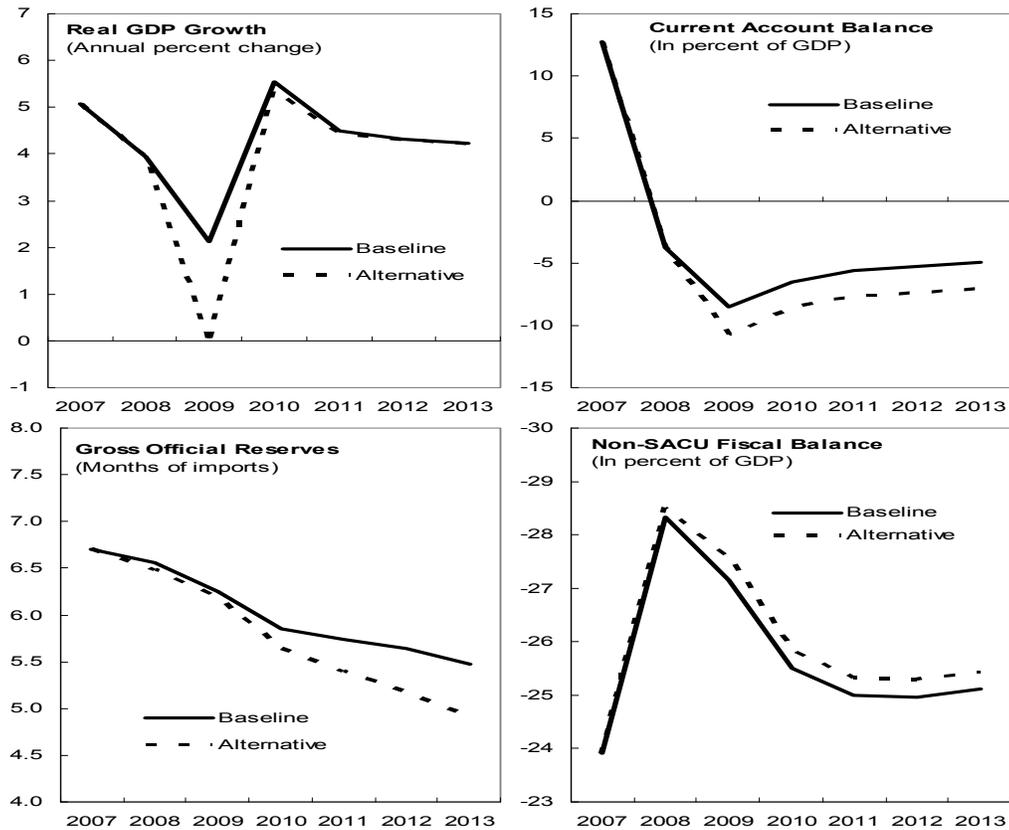
#### IV. POLICY DISCUSSIONS

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.

<sup>5</sup> 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.

<sup>6</sup> 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

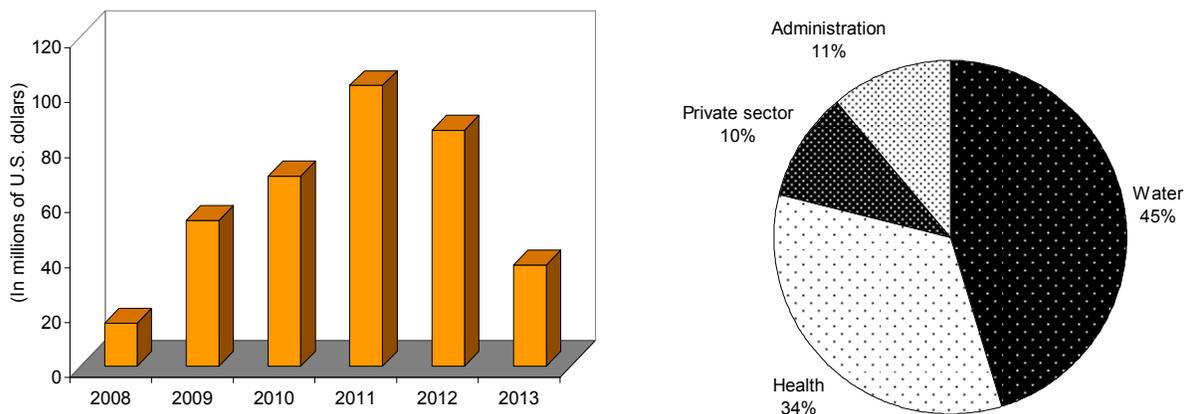
10. **Staff and authorities agreed that accelerating broad-based sustainable economic growth is needed to reduce poverty and inequality, and move toward achieving the MDGs.** The recent sharp declines, owing to drought and high cost of inputs, in agricultural production—the source of income for the 70 percent of the 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 of health facilities, 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 collateralization 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
<i>Of which:</i>									
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
<b>Memorandum item:</b>									
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.

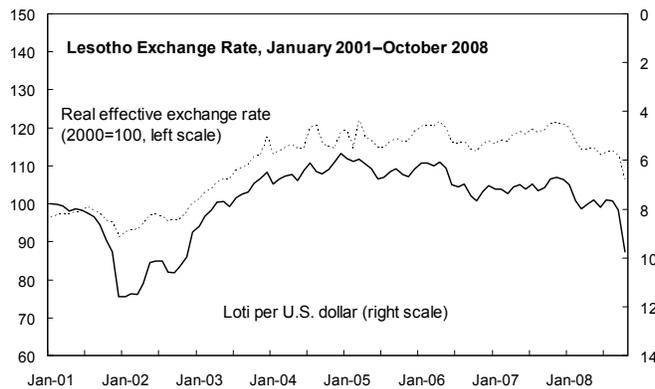
### C. Pursuing External Stability

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

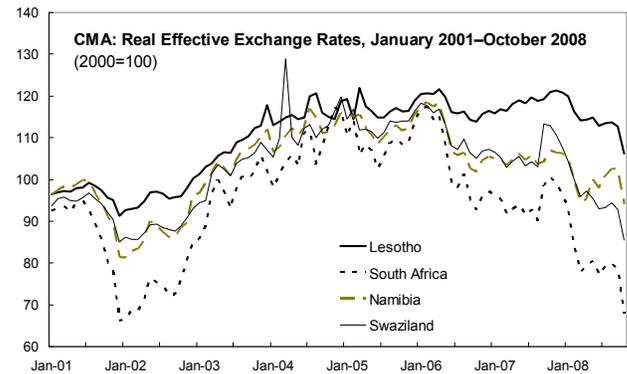
partner, South Africa. The main policy focus should be on fast-tracking the implementation of key structural reforms in order to enhance productivity and competitiveness.

**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.<sup>7</sup>**

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.



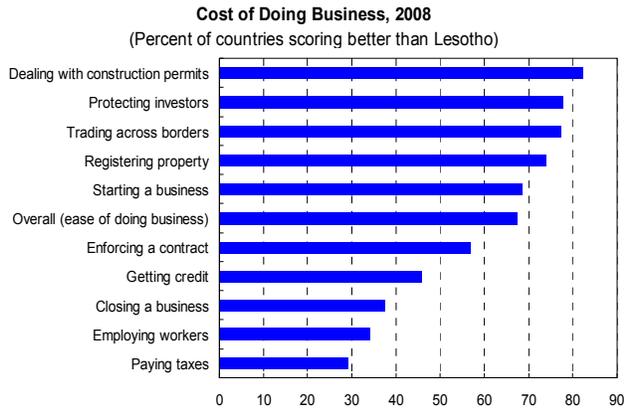
Sources: Lesotho authorities; and IMF staff estimates.



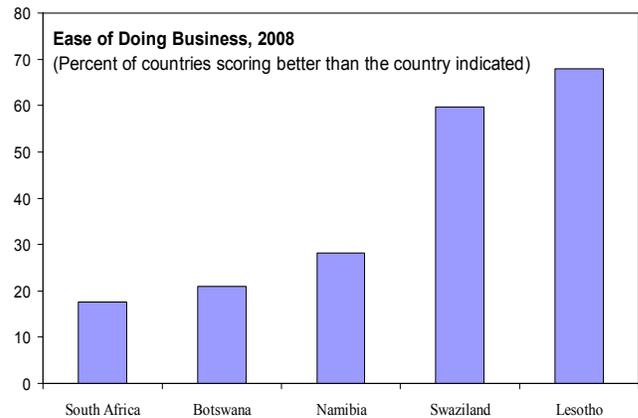
Source: INS.

**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 2008; 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.

<sup>7</sup> 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	...
<b>Lesotho</b>	<b>6.7</b>	<b>57.8</b>	<b>162.4</b>
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 a limited number of 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	454.4
Percent of total exports	59.7	64.1	71.4	81.1	81.1	70.9	63.8
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

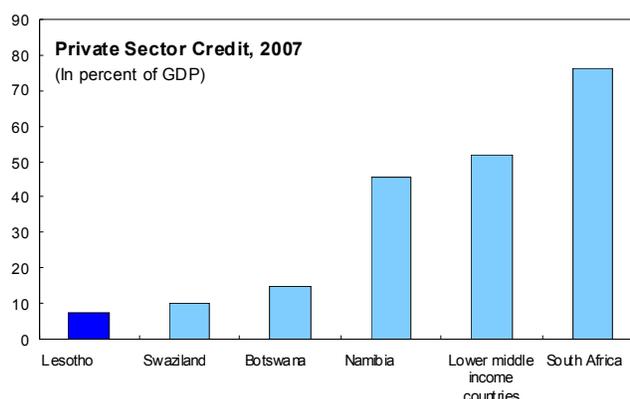
(In Percent)

	2006				2007				2008		
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
<b>Performance ratios</b>											
<b>Capital adequacy</b>											
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 provisions 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
<b>Asset quality</b>											
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
<b>Liquidity ratios</b>											
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
<b>Profitability ratios 1/</b>											
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
<b>Solvency ratios</b>											
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 constraints 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 public 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

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

(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007
<b>Financial indicators - testing</b>					
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	-17.6
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
<b>External indicators</b>					
Exports of goods and services (U.S. dollars, annual percent change)	33.4	48.9	-9.2	7.9	16.0
Imports of goods and services (U.S. dollars, annual percent change)	31.9	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	12.3	7.0	11.0	0.8	7.1
<i>Of which:</i> inward foreign direct investment	4.2	4.1	4.2	6.1	6.3
Net foreign assets 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)	128.4	224.1	199.5	273.3	338.3
Foreign liabilities of the banking sector (millions of U.S. dollars)	34.6	24.1	16.9	10.5	10.8
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/	69.5	55.4	45.5	40.9	37.4
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)	7.6	6.5	6.4	6.8	7.0
REER depreciation (-) (end of period, CPI-based)	17.1	0.7	-0.1	-2.2	3.6
<b>Memorandum items:</b>					
GDP (millions of U.S. dollars)	994	1,290	1,376	1,517	1,672
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
<b>Goal 1: Eradicate extreme poverty and hunger</b>				
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)	...	...	...	...
<b>Goal 2: Achieve universal primary education</b>				
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
<b>Goal 3: Promote gender equality and empower women</b>				
Proportion of seats held by women in national parliament (in percent)	132.0	...	117.5	113.5
Ratio of female to male enrollments in tertiary education	...	5.0	4.0	24.0
Ratio of female to male primary enrollment	130.0	...	153.0	119.0
Ratio of female to male secondary enrollment	122.0	...	104.0	100.0
Ratio of young literate females to males (percent ages 15–24)	142.0	...	131.0	127.0
Share of women employed in the nonagricultural sector (in percent of total nonagricultural employment)	...	44.1	...	...
<b>Goal 4: Reduce child mortality</b>				
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
<b>Goal 5: Improve maternal health</b>				
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)	...	...	...	...
<b>Goal 6: Combat HIV/AIDS, malaria, and other diseases</b>				
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
<b>Goal 7: Ensure environmental sustainability</b>				
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)	...	...	...	...
<b>Goal 8: Develop a global partnership for development</b>				
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
<b>Other</b>				
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.