FOR AGENDA

SM/10/31

February 9, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of Lesotho—Staff Report for the 2009 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2009 Article IV consultation with the Kingdom of Lesotho. The staff report, together with the response of the authorities (SM/10/32, 2/9/10), is part of the pilot on innovating Article IV consultations and is tentatively scheduled for discussion on **Monday, February 22, 2010.** 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 Ms. Morgan (ext. 37798) 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 Thursday, February 18, 2010; 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 2009 Article IV Consultation

Prepared by the staff representatives for the
2009 Article IV consultation with the Kingdom of Lesotho

Approved by Sharmini Coorey and Tom Dorsey

February 4, 2010

- **Mission:** November 4-18, 2009. The mission met with Finance and Development Planning Minister Thahane, Central Bank of Lesotho Governor Senaoana, other senior government officials, and representatives of the private sector and the donor community. Discussions were concluded on January 15.

- **Team**: Messrs. Thugge (head), Pastor and Gaertner, and Miss Morgan (all AFR). Ms. Lephoto (OED) and representatives of the World Bank also attended.

- Previous Fund advice included: (i) strengthening non-SACU revenues; (ii) containing the growth of recurrent spending; (iii) improving public expenditure management; and (iv) accelerating the pace of structural reforms to increase productivity. Progress has been made in consolidating non-SACU revenues, and the introduction of the IFMIS in early 2009 should help in public expenditure management. However, government spending has continued to increase sharply, and implementation of structural reforms has been slow.

- 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. Lesotho is a member of the Common Monetary Area (CMA) and the Lesotho loti is pegged at par to the South African rand, which is also legal tender in the country.

- Macroeconomic data have some shortcomings, but are broadly adequate for surveillance.

- Consultation cycle: Recommended to be held on the standard 12 month cycle.

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Glossary

AGOA	African Growth and Opportunity Act
CBL	Central Bank of Lesotho
CRP	Common Revenue Pool
CMA	Common Monetary Area
DBIs	Doing Business Indicators
DSA	Debt sustainability analysis
FIA	Financial Institutions Act
LHDA	Lesotho Highlands Development Authority
LHWP	Lesotho Highlands Water Project
LNDC	Lesotho National Development Corporation
MCC	Millennium Challenge Corporation
M	Maloti (plural for the loti, Lesotho's currency)
MoFDP	Ministry of Finance and Development Planning
MDGs	Millennium Development Goals
NBFIs	Non-bank Financial Institutions
OBFC	One-Stop Business Facilitation Centre
PAC	Project Appraisal Committee
PFM	Public Financial Management
SACU	Southern African Customs Union
SADC	Southern African Development Community
SACCs	Savings and Credit Cooperatives
VAT	Value-added Tax

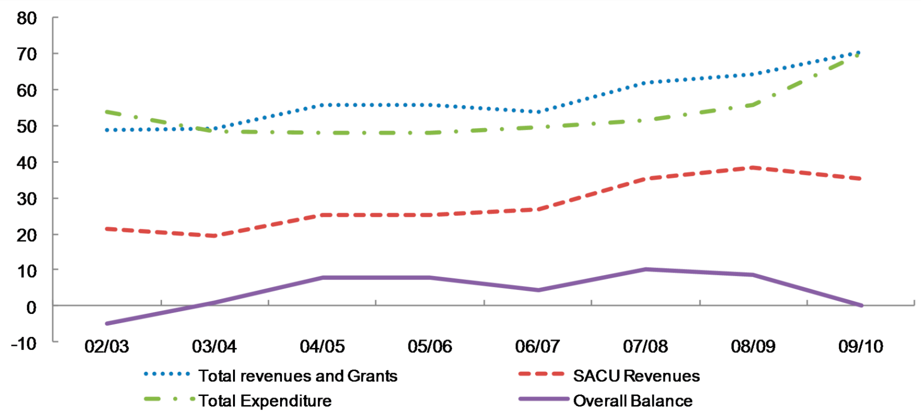
I. Background: The Rise and Fall of Southern African Customs Union (SACU) Revenues

An increase in SACU revenues over several years was followed by a marked expansion in government spending which peaked in 2009/10. The global economic crisis has led to a steep and unexpected reduction in SACU revenues and, as a result, current levels of government spending have become unsustainable.

A. A Prolonged Increase in SACU Revenues was Followed by a Significant Increase in Government Spending

1. **During the period 2004/05-2009/10, Lesotho's SACU revenues rose markedly driven by the economic boom and large imports in South Africa, and by a change in the SACU revenue-sharing formula in 2004/05 (Figure 1 and Annex 1).** SACU revenues rose from around 19 percent of GDP in 2003/04 to an estimated 35 percent of GDP in 2009/10. Non-SACU revenue remained broadly unchanged during 2004/05-2008/09, but rose noticeably in 2009/10.

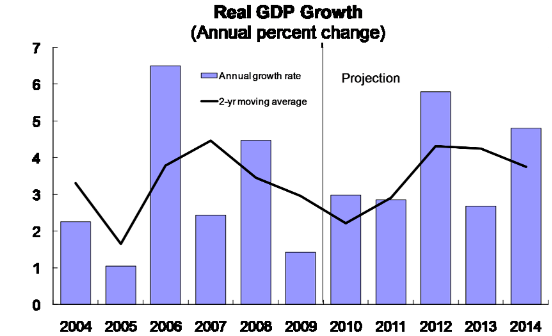
Figure 1. Southern African Customs Union (SACU) Revenues, Total Revenue and Grants, and Government Spending
(percent of GDP)



Sources: Lesotho authorities; and Fund staff estimates.

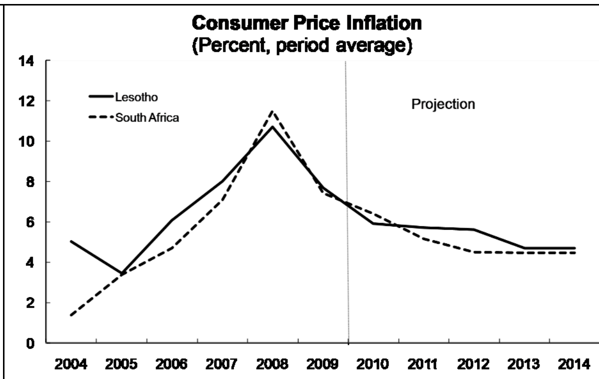
2. **Government spending during 2004/05-2007/08 lagged the increase in revenues and grants, but subsequently rose rapidly and is expected to surpass revenues in 2009/10.** With government outlays rising only gradually from about 48 percent of GDP in 2004/05 to 52 percent in 2007/08, and revenues rising sharply, sizable fiscal surpluses (averaging 10 percent of GDP) emerged which contributed to a marked increase in government deposits. However, expenditures rose rapidly in 2008/09 and 2009/10 bringing estimated total spending to an unprecedented level of 70 percent of GDP in 2009/10. This increase in spending reflected two consecutive general nominal wage increases of 15 percent and 8.5 percent; hiring in the education and health sectors; increased spending on social safety nets for vulnerable groups; and funding for the newly-established defined contribution pension scheme. For the first time in five years, Lesotho's fiscal position is estimated to shift to a deficit of 1 percent of GDP in 2009/10.

Figure 2. Lesotho: Recent Economic Developments and Outlook



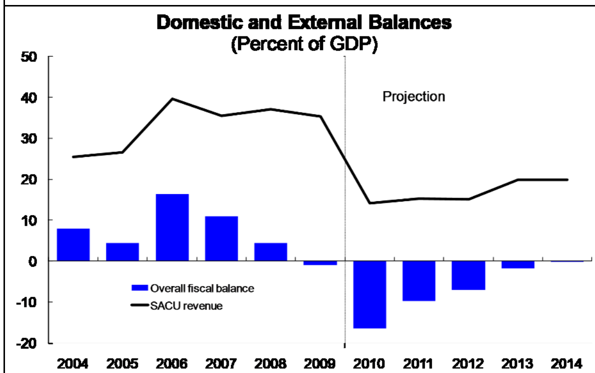
Sources: Lesotho authorities; and Fund staff estimates.

Real GDP growth has been erratic and narrowly based on sectors such as mining with limited linkages to the rest of the economy. Growth in 2012 and 2014 is expected to be driven by construction of the Metolong Dam and start-up of the water project (LHWP II), and recovery in mining.



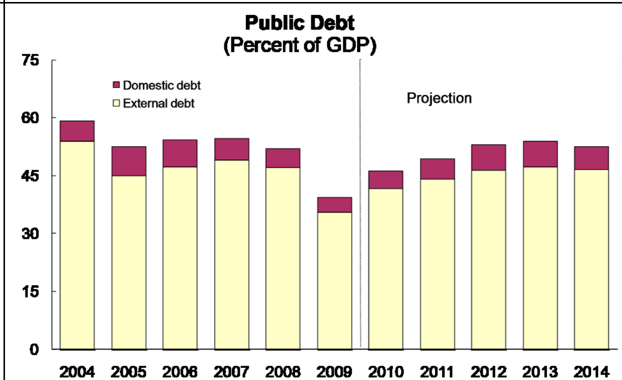
Sources: Lesotho authorities; and Fund staff estimates.

Inflation has decelerated since end 2008 due to moderate increases in international fuel and food prices, and is expected to be broadly in line with that of South Africa.



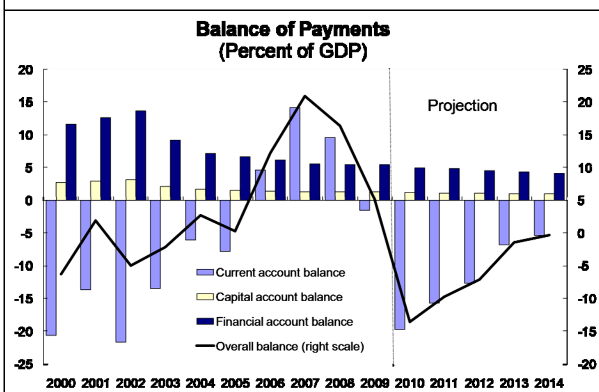
Sources: Lesotho authorities; and Fund staff estimates.

Sizable SACU revenues resulted in large fiscal surpluses during 2005-08. However, with sharply lower SACU revenues projected in the next three years, large fiscal deficits are expected.



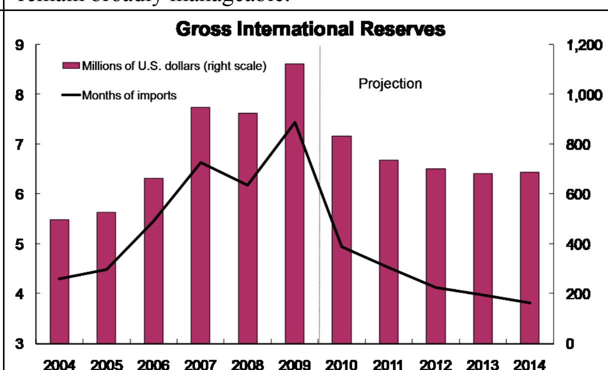
Sources: Lesotho authorities; and Fund staff estimates.

Public debt declined through 2009, but is expected to rise gradually thereafter in line with increased borrowing to finance emerging deficits. Nevertheless, public debt should remain broadly manageable.



Sources: Lesotho authorities and Fund staff estimates.

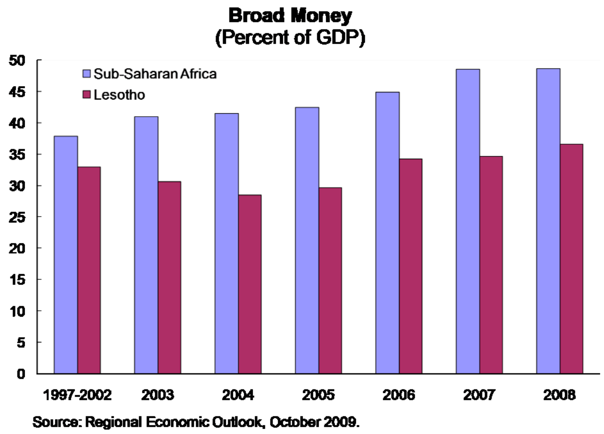
Large SACU receipts resulted in current account surpluses prior to 2009. As SACU revenues decline, large deficits are expected in the near term before narrowing to more sustainable levels by 2014.



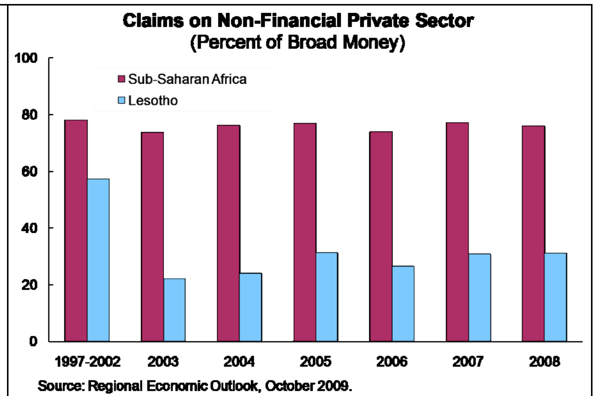
Sources: Lesotho authorities; and Fund staff estimates.

The strong external position facilitated a build up of international reserves to a comfortable level by 2009. However without additional external support, the expected worsening of the external position could reduce reserves below the CBL's target.

Figure 2. Lesotho: Recent Economic Developments and Outlook
(concluded)



Growth in broad money remained high..



…as did credit to the private sector. Financial intermediation remains low by regional standards.

B. Despite Large Current Account Surpluses, Competitiveness Remained a Major Challenge

3. **The sizeable increases in SACU revenues, supported by higher workers' remittances and exports of diamonds, resulted in large current account surpluses which facilitated a significant build-up of reserves.** The external current account shifted from a deficit of 8 percent of GDP in 2005 to surpluses averaging 9.5 percent of GDP between 2006 and 2008, leading to a large build-up of international reserves. However, lower export earnings in 2009 owing to the global economic crisis, along with higher levels of imports linked to increased government spending, are expected to result in a current account deficit of 1.5 percent of GDP. Capital inflows, including those from the Millennium Challenge Corporation (MCC), should finance this deficit and help further build-up reserves to US$1.1 billion at end-2009 (equivalent to 7.4 months of imports cover).[1] This is well above the amount of US$ 650-700 million targeted by the Central Bank of Lesotho (CBL) for stability of the exchange rate peg.

4. **Lesotho's exports of garments to the United States under the Africa Growth and Opportunity Act (AGOA) have been declining since 2006-07.** Increased competition from lower cost Asian producers, and more recently, the reduction in demand for garments from the United States in the aftermath of the global financial crisis, have resulted in layoffs in the textiles industry. As a result, Lesotho's share of apparel exports to the United States has declined significantly by over 35 percent since 2004 while the share for Asian countries has increased (Text Table 1).

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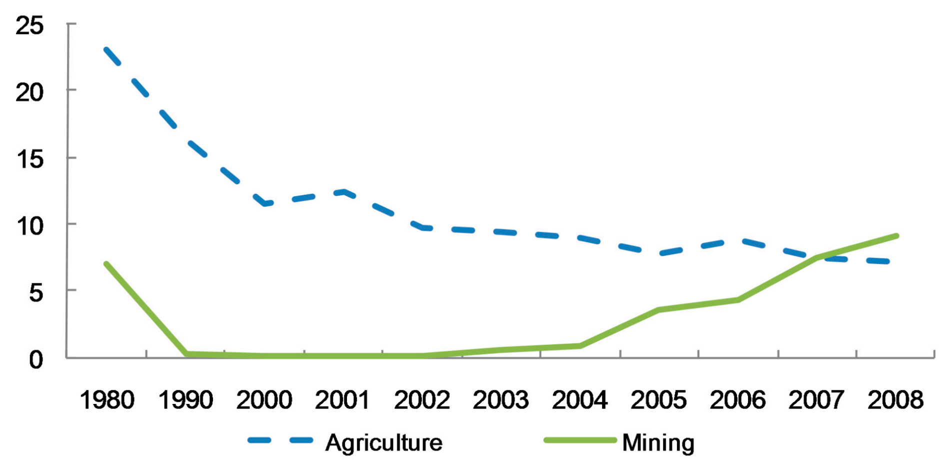
[1] The allocation of SDR 29.1 million has been added to reserves and has not been converted to other currencies.

Text Table 1: US Imports of Apparel (In percent of total US Apparel Imports)						
	2004	2005	2006	2007	2008	Oct. 2009
Sub-Saharan Africa	2.7	2.1	1.8	1.7	1.6	1.5
Kenya	0.4	0.4	0.4	0.3	0.3	0.3
Lesotho	0.7	0.6	0.5	0.5	0.5	0.4
Swaziland	0.3	0.2	0.2	0.2	0.2	0.2
Mauritius	0.4	0.2	0.2	0.2	0.1	0.2
China	13.8	22.0	25.9	30.8	32.0	37.2
Vietnam	4.0	4.0	4.5	5.9	7.3	8.0
Bangladesh	3.1	3.5	4.1	4.2	4.8	5.5
Source: US Department of Commerce.						

C. Narrowly-Based Growth has Contributed to Significant Social Challenges

5. **Real GDP growth in recent years has been relatively strong, but was largely confined to sectors that have limited linkages to the rest of the economy and modest impact on employment.** Real growth averaged 4.5 percent during 2006-08 driven largely by the mining sector before slowing to 1.4 percent in 2009 owing to the global economic crisis. Large remittances from South Africa also supported domestic consumption during 2006-08 but these fell significantly in 2009 as the South African economy contracted. The share in GDP of the low-labor content mining sector rose from 0.2 percent in 2000 to about 9.2 percent in 2008, at the expense of the more labor-intensive agriculture sector whose share declined from 11.6 percent to 7 percent over the same period (Figure 3). Agricultural production has been affected by high input costs, poor farming practices, and recurrent drought.

Figure 3. Changes in Composition of GDP, 1980-2008

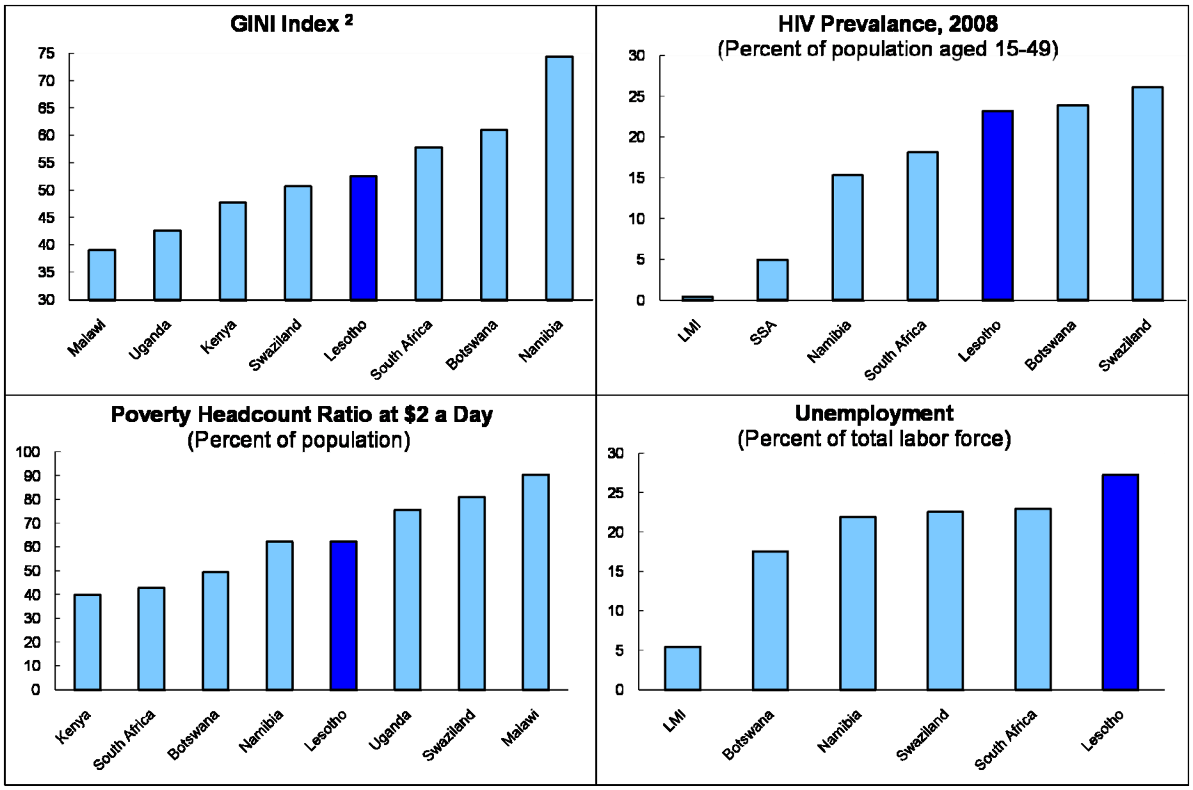


Sources: Lesotho authorities; and Fund staff estimates.

6. **The decline in agriculture has exacerbated poverty in the rural areas where a majority of Basotho make a living.** As a result, although recent growth has facilitated some progress on the social front, considerable challenges remain in reducing poverty,

unemployment and income inequality (Figure 4). In addition, the HIV/AIDS pandemic has not only hindered the pace of socio-economic development, but it also continues to negatively impact productivity and public service delivery, and threatens the achievement of the MDGs. These socio-economic challenges could be exacerbated by the global economic crisis, which is forecasted to reduce economic growth in 2009, with only a moderate recovery expected in the near term.

Figure 4. Lesotho: Social Indicators[1]



Source: World Development Indicators, 2009.
SSA stands for Sub-Saharan Africa, and LMI for lower middle income countries.

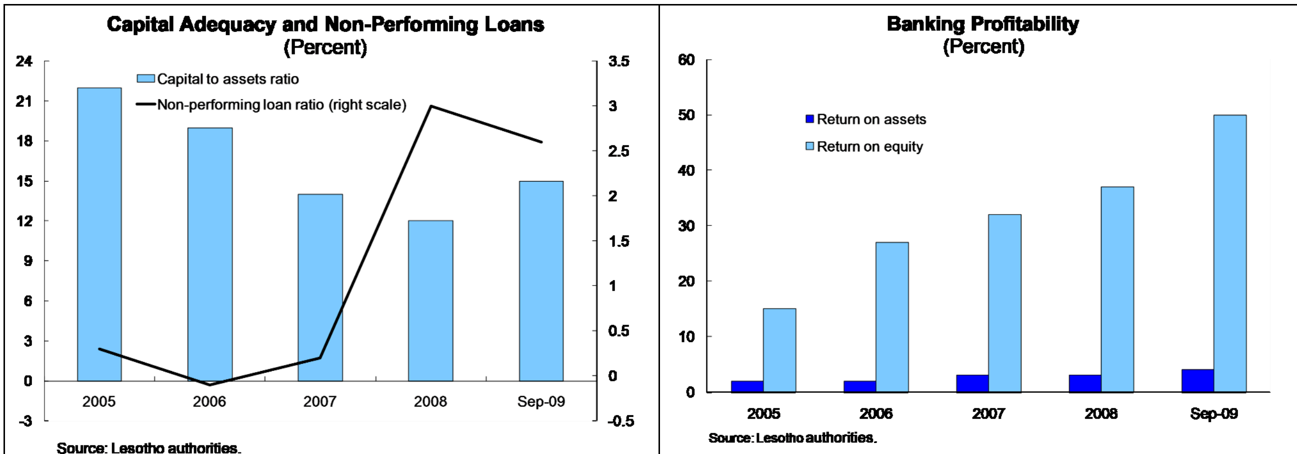
[1] Latest available year in all figures with no indication of date.
[2] 0 indicates perfect equality and 100 indicates perfect inequality.

D. The Financial Sector has Weathered the Global Financial Crisis and Progress was made in Financial Sector Reforms

7. **The financial sector appears to have weathered the global financial crisis relatively well.** The banking sector's liquidity, profitability and capitalization remain satisfactory, although with the slowdown of the economy in 2009, non-performing loans to households have risen, albeit from a very small base (Figure 5). Non-bank financial institutions (NBFIs) have been relatively more affected by the global crisis. Gross premiums in the insurance sector declined significantly between end-2007 and end-2008 in the context of slow economic growth, while the sector's profitability has also been eroded by the poor performance of international equity markets.

8. **Financial sector vulnerabilities stem mainly from weakly supervised NBFIs and the potential for re-emergence of Ponzi schemes.** The CBL is making progress in strengthening prudential regulations for banks and NBFIs, and efforts are underway to amend the Financial Institutions Act (FIA) to address gaps in the supervision of insurance brokers, pension funds and money lenders along international best practices. To address Ponzi schemes, the government has introduced an amendment to the FIA that deals with illegal financial schemes. In the meantime, the largest Ponzi scheme (MKM) remains closed and the government is awaiting a court ruling before proceeding to liquidate it.

Figure 5. Lesotho: Financial Sector Developments



The impact of the global financial crisis has been moderate on the banking system…

…and bank capitalization, profitability and liquidity remain adequate.

9. **The CBL has also been implementing a number of critical reforms with regard to anti-money laundering.** These include setting rules making it obligatory for commercial banks to report suspicious financial transactions to the CBL and implementing the "Know Your Customer" guidelines to seek information about the ultimate beneficiaries of bank accounts. The Anti-Money Laundering Act, which criminalizes money laundering and financing of terrorist activities, was approved in April 2008, and the establishment of a Financial Intelligence Unit is expected before the end of 2010.

E. The Steep Unexpected Fall in SACU Revenues Will Result in Unprecedented Fiscal and External Deficits and Significant Downside Risks Remain

10. **The lingering effects of the global economic crisis are expected to result in sharply lower SACU revenues and a substantial deterioration in Lesotho's fiscal and external positions.** Lower imports by South Africa are expected to result in dramatically lower SACU revenues (net of repayments to the Common Revenue Pool) by 21 percent of GDP in 2010/11 relative to 2009/10.[2] Although some recovery in SACU receipts is

[2] SACU repayments account for about 5 percent of GDP of the total reduction in SACU revenues in 2010/11 and for about 15 percent of GDP over the period 2010/11-2012/13.

anticipated, a permanent loss of SACU revenues is projected, stabilizing at a sustainable level of around 20 percent of GDP in the medium term. This is slightly below the levels (22 percent of GDP) prevailing prior to the change in the SACU formula in 2004/05 and the economic boom in South Africa.

11. This unexpected and sudden decline in revenues comes at a time when expenditures are at their highest historical level and will lead initially to large fiscal deficits (Text Table 2 and Figure 6). Under an unchanged policy scenario, Lesotho's fiscal position would deteriorate sharply to a deficit of about 22 percent of GDP in 2010/11 and average about 17.3 percent of GDP in 2011/12-2012/13.

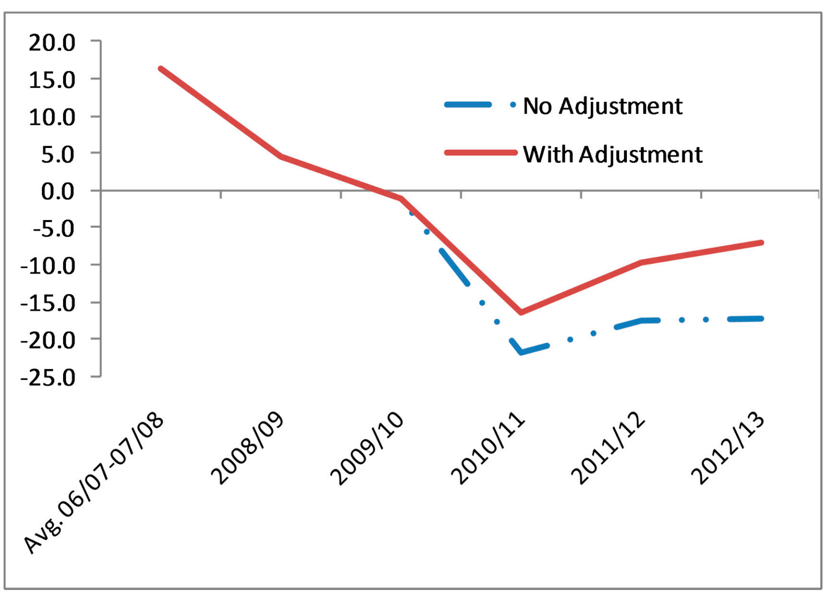
Text Table 2. Lesotho: Central Government Operations, 2008/09-2012/13

(In percent of GDP)

	Actual 2008/09	Estimate 2009/10	No Adjust. 1/ 2010/11	With Adjust. 2/ 2010/11	No Adjust. 1/ 2011/12	With Adjust. 2/ 2011/12	No Adjust. 1/ 2012/13	With Adjust. 2/ 2012/13
Total revenue and grants	66.8	69.1	49.4	49.4	50.8	50.8	48.9	48.9
SACU revenue	37.1	35.3	14.2	14.2	15.3	15.3	15.1	15.1
Non-SACU Revenue	28.0	28.6	28.8	28.8	28.7	28.7	28.7	28.7
Grants	1.7	5.2	6.5	6.5	6.8	6.8	5.1	5.1
Total expenditure and net lending	62.4	70.2	71.3	65.9	68.3	60.6	66.0	56.0
Current expenditure	48.3	54.0	53.8	49.3	51.9	44.5	51.5	41.8
o/w Wages and salaries	15.3	18.1	18.4	17.0	18.7	15.6	18.6	13.9
o/w Goods and services	13.8	14.5	15.1	12.0	15.5	11.5	15.7	10.9
Capital expenditure	14.0	16.1	17.6	16.7	16.4	16.1	14.5	14.2
Overall balance, after grants	4.4	-1.1	-21.9	-16.5	-17.5	-9.8	-17.1	-7.1
Statistical discrepancy/Residual gap	2.9	0.0	21.7	0.0	17.1	0.0	16.7	0.0
Memorandum item:								
Non-SACU balance 3/	-32.7	-36.4	-36.1	-30.7	-32.8	-25.1	-32.2	-22.2

Sources: Ministry of Finance and Development Planning, and Fund staff estimates and projections.
1/ Scenario with no change in policies
2/ Scenario discussed and agreed with the authorities
3/ Overall balance excluding customs revenue (SACU)

Figure 6. Medium-Term Fiscal Position
(percent of GDP)



12. **The authorities intend to take immediate actions to constrain the growth of spending.** The government plans to reduce spending by 4.3 percent of GDP relative to 2009/10, but given the difficulty of further cuts in spending, particularly in light of the on-going economic slowdown, Lesotho's overall fiscal deficits are set to rise to an all time high of 16.5 percent of GDP in 2010/11. As SACU revenues recover and the proposed expenditure measures are implemented, the overall fiscal deficit should narrow and reach a balanced position by 2015/16. The non-SACU deficit is projected to decline to about 20 percent of GDP by 2014/15 broadly in line with levels prior to 2004/05.

13. **The external current account deficit is also expected to initially widen sharply in 2010-2011 owing to the lower SACU revenues, but to narrow thereafter as the fiscal adjustment takes place (Text Table 3 and Figure 7).** The current account deficit is expected to widen to 19.7 percent of GDP in 2010, however, as net SACU revenues recover and government spending is reduced, the deficit should narrow to about 5.4 percent of GDP by 2014. Gross international reserves are projected to remain at or above the CBL's reserve target for sustaining the loti peg to the rand through end-2012.

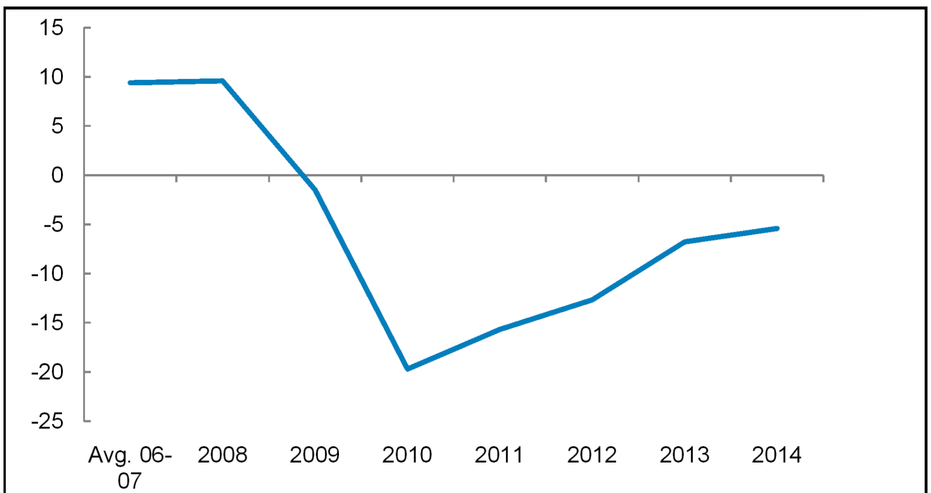
Text Table 3: Lesotho: Medium-Term Economic and Financial Indicators, 2007-2014

			Est.	Projections				
	2007	2008	2009	2010	2011	2012	2013	2014
	(Annual percentage change, unless otherwise indicated)							
Real GDP Growth	2.4	4.5	1.4	3.0	2.8	5.8	2.7	4.8
Consumer price index (period average)	8.0	10.7	7.7	5.9	5.7	5.6	4.7	4.7
Fiscal balance (including grants)	10.9	4.4	-1.0	-16.5	-9.8	-7.1	-1.7	-0.2
SACU Revenues 1/	35.5	37.1	35.3	14.2	15.3	15.1	19.8	19.8
Non-SACU fiscal balance 2/	-24.6	-32.7	-36.4	-30.7	-25.1	-22.2	-21.6	-20.0
Current account balance (incl. official transfers)	14.1	9.6	-1.5	-19.7	-15.7	-12.7	-6.8	-5.4
Gross official reserves (end of period)								
Months of imports of goods and services	6.6	6.2	7.4	4.9	4.5	4.1	4.0	3.8

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

1/ Net of SACU payments 2010-2013
2/ Fiscal balance excluding customs revenue (SACU)

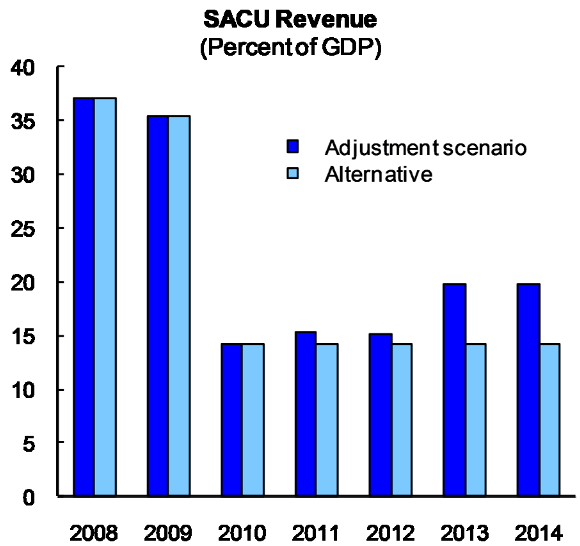
Figure 7. Medium-Term External Current Account Position
(percent of GDP)



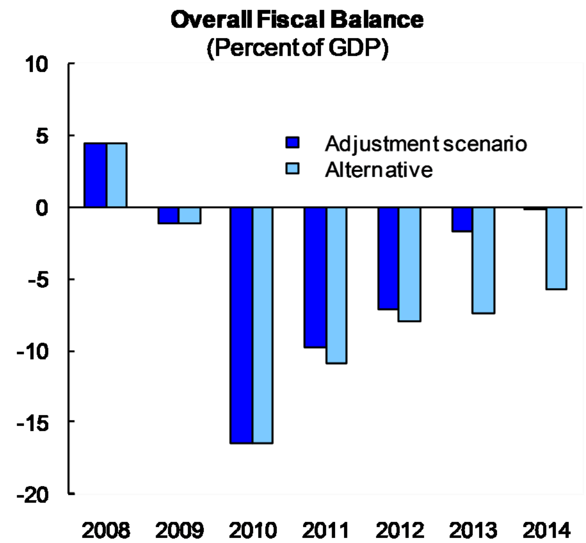
Source: Lesotho authorities; and Fund staff estimate.

14. Considerable downside risks to the outlook remain related to: (i) prospects for a global and regional economic recovery; (ii) delays in undertaking the needed fiscal adjustment; (iii) potentially lower SACU revenues than assumed in the baseline because of: a change in the SACU revenue-sharing formula, a reduction in the Common External Tariff rates due to trade liberalization, and the creation of a SADC customs union (Figure 8).

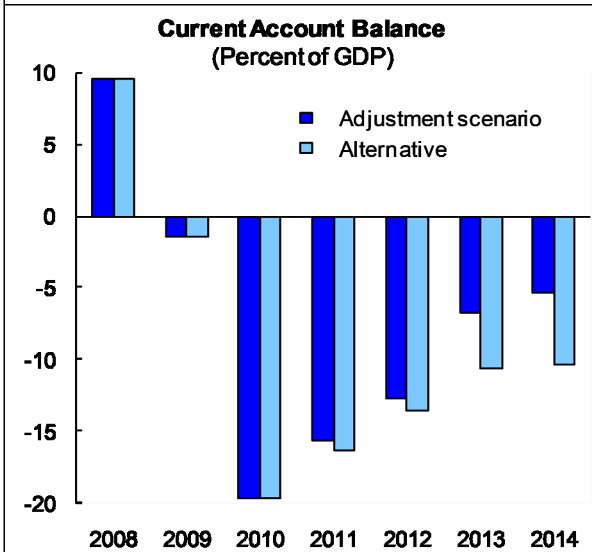
Figure 8. Economic Impact of a Stagnation in SACU Revenues



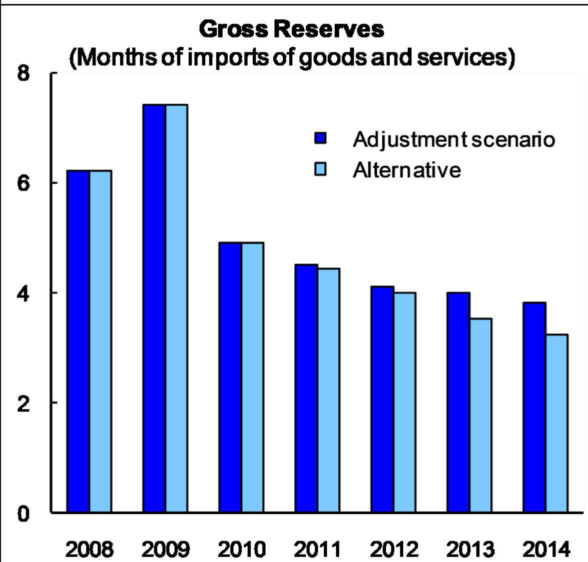
SACU revenues for alternative scenario are assumed to remain constant at their 2010 levels.



Unless additional fiscal adjustment is undertaken, fiscal deficits would widen significantly to unsustainable levels …



as would external current account deficits…



…and international reserves may drop well below the CBL's target for sustaining the peg.

II. Staff Assessment and Recommendations

15. Against this background, the consultation discussions focused on:[3]

- Measures for medium-term fiscal consolidation;
- Structural reforms to increase productivity and external competitiveness;
- Improving the investment climate to achieve sustained, broad-based growth for poverty reduction; and
- Further strengthening the financial sector to support economic development.

A. Fiscal Consolidation Will Rely Mainly on Reducing Expenditure to a Level Consistent with a Sustainable Level of Revenues

16. The staff concurs with the government on the urgent need to address the emerging large fiscal imbalances. This will require a judicious balance between financing measures and actions to prioritize and contain expenditures, particularly recurrent spending (Table 2). The fiscal savings accumulated in recent years provide some scope to draw down reserves to finance the deficits. In this regard, the staff supports the government's plan for a cautious drawdown of its deposits in amounts which do not jeopardize the CBL's international reserves position and the credibility of the loti peg to the rand. Other possible financing sources include new budget support from development partners and some domestic borrowing in the form of bond issuance. To ensure debt sustainability and preserve the exchange rate peg, the authorities would need to target a balanced budget as a medium-term anchor.

17. In light of the expected deterioration of the fiscal and external positions, the level of international reserves would fall below the CBL's target and recent levels of import coverage. The staff are, therefore, following up on the authorities' interest in a Fund-supported program. Such support would bolster reserves and strengthen the credibility of the loti peg. Given the need for medium-term fiscal consolidation and structural reforms, the staff is of the view that the Extended Credit Facility would be best suited for Lesotho.

18. Since the financing measures noted above will help narrow the financing requirements, a return to fiscal sustainability will require consolidating non-SACU revenues and determined actions to curtail spending, particularly on the wage bill. Since non-SACU revenues are relatively high, the staff supports the authorities' intentions to

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[3] Recent improvements in administrative capacity and in strengthening of public institutions should assist in the implementation of these measures.

improve tax administration to enhance revenue collection especially at the borders, while improving the compliance rate for VAT and income tax collections. More importantly, the staff recommends that government contains the wage bill by eschewing general wage increases and restricting new recruitment to high-priority areas. In addition, the government should take advantage of the mandatory retirement scheme for civil servants which comes into effect in 2010/11 to reduce the size of the public service by carefully assessing whether the vacated positions can be eliminated without affecting efficient services delivery.

19. **Expenditure on goods and services and other recurrent spending has risen substantially in recent years and needs to be curtailed.** The staff urges the authorities to focus on cutting non-priority expenditures while taking care to safeguard spending on vulnerable groups and on key priority areas which are needed for sustained economic growth in the medium term. The limited fiscal space leaves little scope for introducing new expenditure policies. In this connection, the authorities' proposed spending ceilings for the 2010/11 budget are broadly in line with the staff's recommendation and should go a long way in addressing the fiscal imbalances.

20. **Improving public expenditure management will become even more critical in light of the reduced resources.** The staff, therefore, strongly supports the government's intention to formulate the 2010/11 budget on an outturn basis rather than on the basis of the previous year's budget. This will ensure more efficiency and improve budget execution as it will result in allocation of more resources to Ministries that have the capacity to execute their programs. It will also help narrow the gap between the budget and outturn, a key benchmark for Public Financial Management (PFM) assessment and for unlocking further budget support.

21. **The staff is encouraged by the government's efforts to improve the quality of capital expenditure.** With capital budget execution averaging 75 percent, there is need for closer scrutiny and monitoring of projects that are included in the budget. In this context, the staff welcomes the recent resuscitation of the Project Appraisal Committee (PAC), and the progress it has made in completing assessment of 10 infrastructure projects. The staff is encouraged by the PAC's commitment to recommend for inclusion in the budget only new projects that meet the government's development objectives of economic growth, poverty reduction, and the attainment of the MDGs.

22. **The staff's analysis shows that Lesotho could be at moderate risk of debt distress over the medium term under the baseline scenario.** Depending on the level of debt incurred for budget financing over the next 3-4 years, some debt indicators could rise above key threshold levels. This underscores the importance of persevering with the measures government is pursuing to ensure prudent fiscal policies and sound debt management (see the Debt Sustainability Analysis Annex).

B. Structural Reforms Should be Fast-Tracked in Order to Increase Productivity and External Competitiveness

23. The textile sector, which is an important source of employment and foreign exchange, faces significant challenges to remain competitive over the medium-term. Even in the event that the existing preferences under the AGOA are extended beyond their current expiration date of 2015, Lesotho will continue to face strong competition in the US market. Therefore, achieving long-term viability of the domestic textile industry will require significant efforts to improve productivity. This would reduce unit labour costs and allow Lesotho to compete more effectively with lower-cost and more efficient producers in Asia and Africa. It is also critical that the sector intensifies its efforts to diversify its products as well as the markets for its products.

24. The peg of the loti to the rand has served Lesotho well in facilitating transactions with South Africa and in helping maintain low inflation. However, in light of the recent appreciation of the loti against the US dollar, the staff's assessment of the real exchange rate suggests that the loti is moderately overvalued, assuming the fiscal adjustment is implemented as projected (Box 1). Given the desirability of maintaining the peg, there is no scope for external adjustment through the nominal exchange rate. To achieve external sustainability will therefore require fiscal consolidation, a fast-tracking of the implementation of key structural reforms to enhance productivity growth in tradables, wage restraint to reduce costs and improvement of infrastructure. In light of Lesotho's close proximity to South Africa and comparatively lower unit labour costs, efforts should be intensified to take advantage of this large market as a way of developing its manufacturing industry.

25. The staff recommends a cautious approach to direct intervention in the textile sector. In the staff's view, the government should adopt a more sustainable and holistic approach which avoids subsidizing selected companies, and is based on accelerating the pace of structural reforms to identify new sources of growth, employment, and export earnings. The global credit crunch created financing constraints for some textile firms that were unable to access trade finance through their parent companies in Asia. The staff notes the authorities' intention to set up a facility through the CBL to provide financing to the textile sector and would advice that once operational, the facility should be operated on market terms and should avoid extending unsustainable and distorting subsidies.

C. Broad-Based Growth and Poverty Reduction will Require Improving the Investment Climate and Undertaking Key Reforms

26. Strong broad-based economic growth is essential for a sustained reduction in poverty and inequality over the medium term. Therefore, the staff welcomes the government's broad-based growth strategy which emphasizes diversification into sectors such as tourism, agriculture, manufacturing and support for small and medium size enterprises as a way to achieve sustained growth and poverty reduction. At the same time, measures to address the HIV/AIDS pandemic (such as awareness campaigns and sustained antiretroviral treatment) are critical to raise life expectancy indicators, achieve gains in human development, and increase labour productivity.

27. The staff supports the government's objective of improving the investment climate by implementing the reforms supported by the World Bank and the MCC. Lesotho's ranking in the World Bank's Doing Business Indicators (DBIs) has deteriorated over the past three years, and compares unfavourably with that of other SACU member countries and other African countries, which are reforming at a faster pace. Effective implementation of the MCC's private sector component and the World Bank's ongoing Private Sector Competitiveness and Diversification Program, among other projects, should help reduce the cost of doing business and enhance Lesotho's regional and global competitiveness.

28. Lesotho's success in diversifying its economic base will depend on undertaking reforms that raise productivity and reduce the cost of doing business. The enactment of the Land Reform Bill and amendment of the Stamp Duty Act should facilitate the use of land as an economic asset and help improve access to bank credit with land being used as collateral. Major gains in lowering the cost of doing business could be attained by reducing delays in construction permits, better protection of investors, easing of trade across borders, and improving the operational aspects of the One-Stop Business Facilitation Centre (OBFC). In this regard, the staff recommends that a taskforce chaired by a senior official in the Ministry of Finance and Development Planning be charged with driving the reform agenda aimed at improving the investment climate.

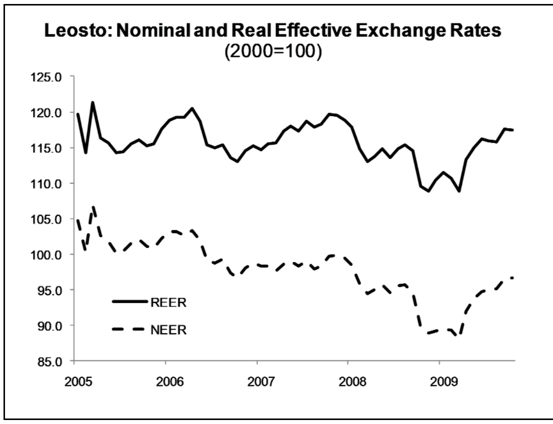
29. Lesotho's medium-term economic growth should accelerate with the construction of the Metolong Dam and the commencement of Phase II of the Lesotho Highlands Water Project (LHWP II). Both projects should boost economic growth during the construction phase and later when water is exported to South Africa.

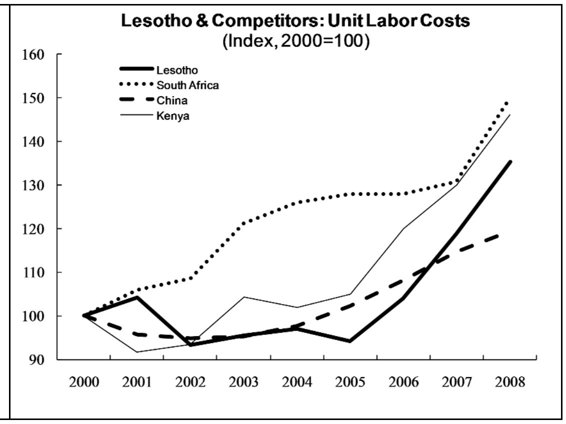
D. Strengthening Financial Sector Supervision and Enhancing Access to Financial Services Should Support Economic Development

30. The staff is encouraged by the authorities' actions to develop the money and capital markets in Lesotho. The development of a domestic bond market will help extend the yield curve and deepen the securities market, while providing government with an alternative source of budget financing. In the staff's view, there is a potential demand for longer-dated bonds, especially by institutional investors who are placing almost all of their assets abroad due to the lack of domestic investment opportunities.

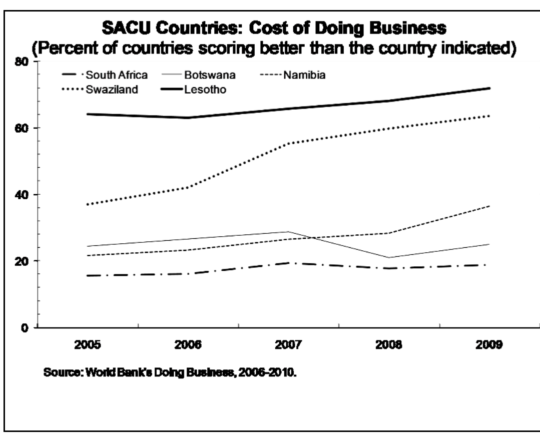
Box 1. The Real Exchange Rate and Competitiveness

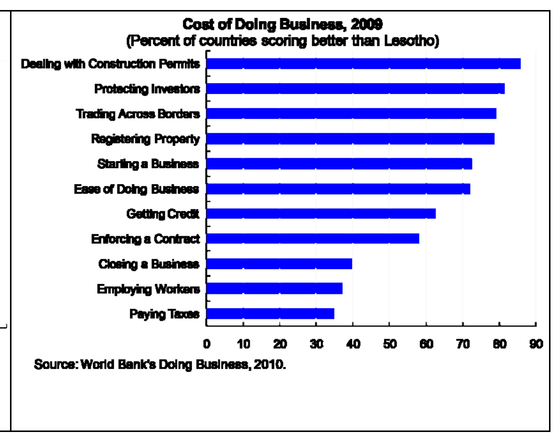
The exchange rate assessments based on the IMF's methodology suggest that the loti is moderately overvalued as of mid-November 2009.1/ The macroeconomic balance approach, 2/ which compares Lesotho's medium-term external current account stripped of temporary factors, to a norm derived from panel data of Sub-Saharan African countries indicates an overvaluation of 20 percent as of November 2009. The external sustainability approach, which assesses the level of the current account balance that would stabilize the country's net foreign asset position at end-2008, suggests that the loti is overvalued by about 13 percent as of November 2009.





Although Lesotho's garments exports to the US increased sharply between 2000 and 2004 (to some US$500 million), exports stagnated thereafter with Lesotho's market share in the US textile market declining in recent years.3/ The loss in competitiveness reflects, in part, the rapidly increasing unit labor costs and a poor investment climate, as measured by the World Bank's Doing Business Indicators (DBI). Although there are several reforms underway (e.g., the One Stop Business Facilitation Centre), Lesotho's competitiveness is slipping because other countries are reforming at a faster pace and/or many of its reforms (e.g., new businesses' registry and licensing) are taking longer to implement.





1/ The CGER methodology has been adapted to cover a sub-set of African countries, and removes Lesotho-specific temporary factors

2/ Assuming the agreed fiscal adjustment scenario.

3/Trends with Lesotho's exports have paralleled developments in other Sub Saharan exporters, with the region's share in total U.S. imports of apparel declining from 2.7 percent in 2004 to 1.5 percent by October 2009.

31. The staff welcomes the government's continued efforts to resolve the MKM Ponzi scheme and to prevent the re-emergence of new ones. In line with previous recommendations, the staff urges the authorities to avoid bailing out investors in the illegal Ponzi scheme given the risk of encouraging such behaviour in the future. Any limited government intervention related to the legitimate funeral services business will need to be addressed within the government's sharply reduced resource envelope.

32. The staff supports the Department of Cooperatives intention to develop a policy paper on savings and credit cooperatives (SACCs). In the staff's view, the policy paper, which is expected to be submitted to Cabinet in early 2010, should highlight existing weaknesses and develop an action plan to address gaps in prudential regulations and supervision of the SACCs, including for anti-money laundering requirements. It should also revisit the proposal for the establishment of bank cooperatives (i.e., SACCs that mobilize deposits from non-members). The staff recommends that regulations for SACCs be put in place quickly, and that bank cooperatives, which mobilize deposits from the general public, be supervised by the CBL and be subject to the same prudential and anti-money laundering requirements established for domestic banks.

33. The prospective expansion of Postbank operations into microfinance lending should help improve the provision of financial services to currently underserved rural areas. The staff supports the cautious approach that Postbank is taking to expand its activities, and would advise that it first strengthens its capacity to assess credit risk before any significant increase in lending. As its lending operations increase, close monitoring and supervision by the CBL will be critical. To further strengthen access to financial services countrywide, the staff encourages the government to rapidly implement the reforms spearheaded by the MCC including: (i) production of national identity cards; (ii) establishment of a credit reference bureau; and (iii) modernization of the commercial court.

E. Improving the Quality of Economic Statistics

34. The staff notes the progress being made to improve compilation of macroeconomic data, including national accounts, balance of payments, consumer price statistics, and preparation of fiscal data based on the IMF's 2001 Government Financial Statistics Manual. Looking forward, the challenge will be to sustain the improved compilation efforts through the development of robust basic data sources and further improvements in methodology, in line with international best practices. Efforts should also be made to publish data on a timely basis, and develop a cadre of government officials able to support a sustained production of high quality statistics. The latter is particularly important in view of current technical assistance from donors coming to an end during the next two years. The timely production of robust statistics should facilitate a productive dialogue on economic policymaking and more effective assessment of policy outcomes.

III. Issues for Discussion

- What are Directors' views on the proposed pace of fiscal adjustment and the recommended balance between financing measures—involving drawdown of accumulated deposits, domestic issuance of bonds—and containment of expenditure to address the emerging fiscal imbalances?

- What are Directors' views on policies to strengthen competitiveness through structural reforms to improve productivity and contain costs?

- What are Directors' views on the structural policies needed to achieve broad-based growth and poverty reduction?

Table 1. Lesotho: Selected Economic and Financial Indicators, 2005–2014 1/

				Est.	Projections					
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	(Annual percentage change, unless otherwise indicated)									
National income and prices										
Real GDP	1.1	6.5	2.4	4.5	1.4	3.0	2.8	5.8	2.7	4.8
Real GDP excl. LHWP	1.1	6.5	2.4	4.5	1.4	3.0	2.8	3.8	3.0	4.7
Consumer price index (period average)	3.4	6.1	8.0	10.7	7.7	5.9	5.7	5.6	4.7	4.7
Consumer price index (end of period)	3.5	6.4	10.5	10.6	5.1	5.8	5.6	5.5	4.6	4.6
GDP (millions of maloti)	8,364	9,587	11,025	13,085	13,573	14,932	16,310	18,443	19,882	22,015
GNP (millions of maloti)	10,297	12,162	14,025	17,226	17,210	18,737	20,366	22,769	24,614	27,175
External sector										
Exports, f.o.b. 2/	-7.3	7.5	14.9	8.2	-11.5	9.8	5.3	11.1	3.3	6.6
Imports, f.o.b. 2/	1.0	4.6	17.3	5.2	1.0	11.4	-3.5	4.5	0.8	5.5
Nominal effective exchange rate 3/	-1.4	-3.4	0.6	-10.3	...	...	...	...	...	...
Real effective exchange rate 3/	-0.6	-2.0	3.2	-7.1	...	...	...	...	...	...
Money and credit										
Net foreign assets 4/	12.4	71.7	66.0	67.6	7.9	-1.5	2.8	...	...	...
Net domestic assets 4/	-3.3	-36.4	-49.6	-47.9	12.9	15.5	11.6	...	...	...
Credit to the government	-8.3	-22.7	-52.0	-15.9	-0.1	31.7	12.0	...	...	...
Credit to the rest of the economy	10.3	4.3	9.4	6.2	6.4	4.0	4.0	...	...	...
Broad money	9.1	35.3	16.4	19.7	20.8	14.0	14.4	...	...	...
Velocity (GNP/average broad money)	4.1	4.0	3.7	3.8	3.2	3.0	2.8	...	...	...
Interest rate 5/	7.2	6.9	7.8	9.8	10.8	11.8	12.8	...	...	...
	(In percent of GDP; unless otherwise indicated)									
Investment	23.9	24.8	27.9	30.5	33.3	34.1	33.9	32.4	31.0	31.2
Public	8.1	7.6	10.4	13.1	15.8	16.6	16.4	14.6	11.9	11.1
Private 6/	15.7	17.2	17.4	17.4	17.5	17.5	17.5	17.8	19.1	20.1
Gross national savings (including remittances)	16.0	29.4	42.0	40.1	31.8	14.4	18.2	19.7	24.2	25.8
Public 7/	13.3	21.1	28.0	23.4	17.9	5.3	4.9	6.9	8.8	10.5
Private	2.7	8.3	14.0	16.7	13.9	9.1	13.3	12.8	15.4	15.3
Government budget 1/										
Revenue and grants	53.8	65.1	62.6	66.8	69.1	49.4	50.8	48.9	50.5	50.6
Grants	2.0	0.9	1.5	1.5	5.2	6.5	6.8	5.1	2.0	2.0
Total expenditure and net lending	49.5	48.9	51.7	51.4	70.2	65.9	60.6	56.0	52.3	50.8
Overall balance (excluding grants)	2.4	15.4	9.4	8.7	-6.2	-23.0	-16.5	-12.2	-3.7	-2.2
Overall balance (including grants)	4.3	16.3	10.9	10.2	-1.0	-16.5	-9.8	-7.1	-1.7	-0.2
Non-SACU overall balance (including grants)	-22.3	-23.4	-24.6	-25.0	-36.4	-30.7	-25.1	-22.2	-21.6	-20.0
Government debt 1/	52.4	54.2	54.6	52.0	39.4	46.1	49.4	53.0	55.3	54.5
Domestic debt	7.4	7.0	5.6	4.9	3.8	4.5	5.2	6.6	6.8	6.1
External debt	45.0	47.1	49.0	47.1	35.5	41.7	44.1	46.4	48.5	48.4
NPV of public debt	...	...	...	38.2	29.4	33.9	37.9	41.7	42.3	42.0
Total debt (in percent of GNP)	42.2	42.7	42.5	39.9	31.1	36.8	39.7	42.9	43.5	42.6
External debt-service ratio 8/	11.5	6.7	6.3	4.3	4.6	3.7	3.4	3.3	3.5	3.2
Balance of payments										
Current account balance (excl. official transfers)	-29.9	-21.6	-26.0	-22.5	-33.9	-37.3	-29.8	-26.6	-23.9	-23.6
Current account balance (incl. official transfers)	-7.9	4.7	14.1	9.6	-1.5	-19.7	-15.7	-12.7	-6.8	-5.4
Gross official reserves (end of period)										
Millions of U.S. dollars	526	664	946	923	1,123	831	735	700	681	687
Months of imports of goods and services	4.5	5.4	6.6	6.2	7.4	4.9	4.5	4.1	4.0	3.8
Months of imports of goods and services excl. LHWP	4.5	5.5	6.7	6.2	7.4	4.9	4.5	4.2	4.0	3.9
Ratio of reserves/M2	1.3	1.3	1.6	1.8	1.4	1.1	0.9	0.8	0.7	0.7
Ratio of reserves/M1	1.8	1.7	2.2	2.2	1.8	1.4	1.1	1.0	0.9	0.8

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

1/ Fiscal data are reported on a fiscal year basis; the fiscal year begins in April.
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.
6/ Includes changes in inventories and gross fixed capital formation by the Lesotho Highlands Development Authority (LHDA).
7/ For 2008-10, government current expenditure has been reduced by the actual and prospective transfer to the pension fund.
8/ Percent of exports of goods and nonfactor services.

Table 2. Lesotho: Central Government Operations, 2007/08-2015/16 1/

(In millions of maloti)

	Actual 2007/08	Actual 2008/09	Rev Auth 2009/10	Staff Est. 2009/10	No Adjustment 2010/11	With Adjustment 2010/11	No Adjustment 2011/12	With Adjustment 2011/12	No Adjustment 2012/13	With Adjustment 2012/13	With Adjustment 2013/14	With Adjustment 2014/15	With Adjustment 2015/16
Revenue and grants	7,225	8618.1	9,746	9,618	7,548	7,548	8,556	8,556	9,195	9,195	10,320	11,555	13,068
Revenue	7,047	8,597	9,022	8,895	6,554	6,554	7,418	7,418	8,241	8,241	9,911	11,098	12,550
Tax revenue	6,331	7,684	8,239	8,112	5,694	5,694	6,470	6,470	7,183	7,183	8,762	9,811	11,094
Customs revenue (SACU)	4,098	4,901	4,918	4,918	2,162	2,162	2,579	2,579	2,841	2,841	4,044	4,528	5,125
Noncustoms tax revenue	2,233	2,783	3,322	3,194	3,532	3,532	3,891	3,891	4,342	4,342	4,718	5,283	5,969
Income taxes	1,221	1,539	1,959	1,832	2,018	2,018	2,225	2,225	2,472	2,472	2,684	3,005	3,402
Sales tax / value-added tax (VAT)	848	988	1,120	1,120	1,215	1,215	1,325	1,325	1,453	1,453	1,567	1,748	2,006
Petrol levy	118	99	108	108	124	124	141	141	157	157	170	191	216
Other tax revenues	43	158	129	134	160	160	194	194	253	253	282	325	329
Nontax revenue	716	913	783	783	860	860	948	948	1,058	1,058	1,149	1,287	1,456
Water royalties	292	324	329	329	361	361	398	398	445	445	483	541	612
Interest received	7	10	8	8	8	8	9	9	10	10	11	12	14
Other nontax revenues	371	579	447	447	490	490	541	541	603	603	655	734	830
Grants	178	221	723	723	994	994	1,138	1,138	953	953	408	457	517
Of which: MCC	...	...	414	414	652	652	761	761	541	541	...	...	...
Total expenditure and net lending	5,965	8,240	9,726	9,765	10,897	10,072	11,497	10,202	12,414	10,531	10,675	11,603	13,067
Current expenditure	4,687	6,385	7,485	7,519	8,216	7,524	8,749	7,489	9,693	7,860	8,427	9,092	10,236
Wages and salaries	1,632	2,015	2,508	2,520	2,812	2,595	3,142	2,621	3,498	2,620	2,844	3,184	3,604
Interest payments	293	118	119	119	113	116	115	134	115	190	262	282	295
External	243	65	67	67	71	62	75	80	78	119	163	175	187
Domestic	50	53	52	52	42	54	39	55	38	71	99	107	107
Other expenditure	2,762	4,252	4,859	4,880	5,290	4,812	5,493	4,734	6,079	5,050	5,321	5,625	6,337
Goods and services	1,399	1,826	2,040	2,017	2,304	1,834	2,608	1,945	2,959	2,056	2,147	2,232	2,497
Transfer, subsidies and pensions	1,363	2,426	2,739	2,624	2,819	2,727	2,708	2,525	2,935	2,716	2,882	3,087	3,494
Pensions and gratuities	396	1,013	962	1,202	965	1,221	754	1,020	797	1,138	1,236	1,384	1,566
Subventions and transfers	967	1,413	1,776	1,422	1,854	1,505	1,954	1,505	2,139	1,578	1,646	1,703	1,928
Other Expenditure	...	...	80	240	168	252	176	264	185	278	291	306	346
Capital expenditure	1,278	1,855	2,240	2,246	2,687	2,554	2,754	2,718	2,727	2,676	2,253	2,516	2,837
Domestically funded	905.0	1,204	1,293	1,293	1.439	1.309	1,337	1,307	1,467	1.417	1.538	1,722	1.949
Externally funded	386	631	953	953	1,248	1,245	1,417	1,411	1,260	1,260	715	794	888
Net lending	-13	-1	-5	0	-6	-6	-6	-6	-5	-5	-5	-5	-6
Overall balance, before grants	1,082	358	-703	-870	-4,343	-3,518	-4,079	-2,783	-4,173	-2,290	-764	-505	-517
Overall balance, after grants	1,261	579	20	-147	-3,349	-2,524	-2,941	-1,646	-3,219	-1,336	-355	-48	0
Non-SACU balance 2/	-2,837	-4,322	-4,898	-5,064	-5,511	-4,686	-5,520	-4,225	-6,060	-4,177	-4,400	-4,576	-5,125
Domestic balance 3/	1,698	1,052	311	150	-3,030	-2,217	-2,592	-1,299	-2,840	-916	109	459	552
Total financing	-1,016	-191	-20	147	3,349	2,524	2,941	1,646	3,219	1,336	355	48	0
External financing, net	22	173	-41	-41	34	611	57	744	84	806	224	280	314
Loan drawings	208	410	230	230	254	251	280	273	307	306	306	337	371
New commitments (Budget support)	...	...	...	...	...	579	...	693	...	722	156	156	156
Amortization	-186	-237	-270	-270	-220	-220	-223	-223	-222	-222	-239	-213	-213
Domestic financing, net	-1,038	-364	21	187	...	1,913	...	902	...	531	132	-233	-314
Bank	-999	-364	...	...	...	1,913	...	902	...	531	132	-233	-314
Nonbank	-39	...	...	...	...	...	...	...	...	...	...	...	...
Statistical discrepancy/Residual gap	245	387	0	0	3,315	0	2,885	0	3,135	0	0	0	0

Table 2a. Lesotho: Central Government Operations, 2007/08-2015/16 1/

(In percent of GDP; unless otherwise indicated)

	Actual	Actual	Rev Auth	Staff Est.	No Adjustment	With Adjustment	No Adjustment	With Adjustment	No Adjustment	With Adjustment	With Adjustment		
	2007/08	2008/09	2009/10	2009/10	2010/11	2010/11	2011/12	2011/12	2012/13	2012/13	2013/14	2014/15	2015/16
Revenue and grants	62.6	66.8	70.0	69.1	49.4	49.4	50.8	50.8	48.9	48.9	50.5	50.6	50.5
Revenue	61.1	65.1	64.9	63.9	42.9	42.9	44.0	44.0	43.8	43.8	48.5	48.6	48.5
Customs revenue (SACU)	35.5	37.1	35.3	35.3	14.2	14.2	15.3	15.3	15.1	15.1	19.8	19.8	19.8
Noncustoms tax revenue	19.4	21.1	23.9	23.0	23.1	23.1	23.1	23.1	23.1	23.1	23.1	23.1	23.1
Income taxes	10.6	11.6	14.1	13.2	13.2	13.2	13.2	13.2	13.1	13.1	13.1	13.1	13.1
Sales tax / value-added tax (VAT)	7.3	7.5	8.1	8.1	8.0	8.0	7.9	7.9	7.7	7.7	7.7	7.6	7.8
Petrol levy	1.0	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Other tax revenues	0.4	1.2	0.9	1.0	1.1	1.1	1.2	1.2	1.3	1.3	1.4	1.4	1.3
Nontax revenue	6.2	6.9	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Water royalties	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Interest received	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other nontax revenues	3.2	4.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Grants	1.5	1.7	5.2	5.2	6.5	6.5	6.8	6.8	5.1	5.1	2.0	2.0	2.0
Of which: MCC	...	...	3.0	3.0	4.3	4.3	4.5	4.5	2.9	2.9	...	...	...
Total expenditure and net lending	51.7	62.4	69.9	70.2	71.3	65.9	68.3	60.6	66.0	56.0	52.3	50.8	50.5
Current expenditure	40.6	48.3	53.8	54.0	53.8	49.3	51.9	44.5	51.5	41.8	41.3	39.8	39.6
Wages and salaries	14.1	15.3	18.0	18.1	18.4	17.0	18.7	15.6	18.6	13.9	13.9	13.9	13.9
Interest payments	2.5	0.9	0.9	0.9	0.7	0.8	0.7	0.8	0.6	1.0	1.3	1.2	1.1
External	2.1	0.5	0.5	0.5	0.5	0.4	0.4	0.5	0.4	0.6	0.8	0.8	0.7
Domestic	0.4	0.4	0.4	0.4	0.3	0.4	0.2	0.3	0.2	0.4	0.5	0.5	0.4
Other expenditure	23.9	32.2	34.9	35.1	34.6	31.5	32.6	28.1	32.3	26.9	26.1	24.6	24.5
Goods and services	12.1	13.8	14.7	14.5	15.1	12.0	15.5	11.5	15.7	10.9	10.5	9.8	9.7
Transfers and subsidies	11.8	18.4	19.7	18.9	18.4	17.8	16.1	15.0	15.6	14.4	14.1	13.5	13.5
Pensions and gratuities	3.4	7.7	6.9	8.6	6.3	8.0	4.5	6.1	4.2	6.1	6.1	6.1	6.1
Subventions and transfers	8.4	10.7	12.8	10.2	12.1	9.9	11.6	8.9	11.4	8.4	8.1	7.5	7.5
Other expenditure	...	...	0.6	1.7	1.1	1.6	1.0	1.6	1.0	1.5	1.4	1.3	1.3
Capital expenditure	11.1	14.0	16.1	16.1	17.6	16.7	16.4	16.1	14.5	14.2	11.0	11.0	11.0
Domestically funded	7.8	9.1	9.3	9.3	9.4	8.6	7.9	7.8	7.8	7.5	7.5	7.5	7.5
Externally funded	3.3	4.8	6.8	6.8	8.2	8.2	8.4	8.4	6.7	6.7	3.5	3.5	3.4
Net lending	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	9.4	2.7	-5.1	-6.3	-28.4	-23.0	-24.2	-16.5	-22.2	-12.2	-3.7	-2.2	-2.0
Overall balance, after grants	10.9	4.4	0.1	-1.1	-21.9	-16.5	-17.5	-9.8	-17.1	-7.1	-1.7	-0.2	0.0
Non-SACU balance 2/	-24.6	-32.7	-35.2	-36.4	-36.1	-30.7	-32.8	-25.1	-32.2	-22.2	-21.6	-20.0	-19.8
Domestic balance 3/	14.7	8.0	2.2	1.1	-19.8	-14.5	-15.4	-7.7	-15.1	-4.9	0.5	2.0	2.1
Total financing	-8.8	-1.4	-0.1	1.1	21.9	16.5	17.5	9.8	17.1	7.1	1.7	0.2	0.0
External financing	0.2	1.3	-0.3	-0.3	0.2	4.0	0.3	4.4	0.4	4.3	1.1	1.2	1.2
Loan drawings	1.8	3.1	1.7	1.7	1.7	1.6	1.7	1.6	1.6	1.6	1.5	1.5	1.4
New commitments (Budget support)	...	...	...	...	...	3.8	...	4.1	...	3.8	0.8	0.7	0.6
Amortization	-1.6	-1.8	-1.9	-1.9	-1.4	-1.4	-1.3	-1.3	-1.2	-1.2	-1.2	-0.9	-0.8
Domestic financing	-9.0	-2.8	0.1	1.3	0.0	12.5	0.0	5.4	0.0	2.8	0.6	-1.0	-1.2
Bank	-8.7	...	...	...	...	...	...	...	...	...	...	...	...
Nonbank	-0.3	...	...	...	...	...	...	...	...	...	...	...	...
Statistical discrepancy/Residual gap	2.1	2.9	0.0	0.0	21.7	0.0	17.1	0.0	16.7	0.0	0.0	0.0	0.0
Memorandum items:													
Non-SACU balance	-24.6	-32.7	-35.2	-36.4	-36.1	-30.7	-32.8	-25.1	-32.2	-22.2	-21.6	-20.0	-19.8
GNP at current prices (Millions of maloti) 4/	14,025	16,538	17,210	17,210	18,737	18,737	20,456	20,366	20,366	24,614	27,175	31,045	35,139
GDP at current prices (Millions of maloti) 4/	11,540	13,207	13,913	13,913	15,276	15,276	16,843	16,843	18,803	18,803	20,415	22,856	25,870

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

1/ The fiscal year runs from April 1- March 31.

2/ Overall balance excluding customs revenue (SACU)

3/ Domestic balance excludes grants, foreign-financed capital spending, foreign interest payments, and exceptional factors.

4/ On a fiscal year basis.

Table 3. Lesotho: Balance of Payments, 2005–2014

				Est.	Projections					
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
				(In millions of U.S. dollars)						
Trade balance	**-656.6**	**-667.4**	**-799.0**	**-817.5**	**-934.4**	**-1,053.5**	**-942.6**	**-926.7**	**-909.8**	**-948.8**
Exports, f.o.b.	650.7	699.5	804.0	869.6	769.5	845.2	890.2	988.5	1,020.8	1088.0
Of which: garments	445.9	499.4	503.3	457.1	399.9	403.5	407.6	411.9	416.3	420.8
Imports f.o.b 1/	-1,307.3	-1,366.9	-1,603.0	-1,687.1	-1,703.9	-1,898.7	-1,832.8	-1,915.3	-1,930.6	-2,036.8
Of which: garment inputs	-215.0	-240.8	-242.7	-220.4	-192.8	-194.6	-196.6	-198.6	-200.8	-202.9
Services (net)	**-51.2**	**-36.0**	**-33.9**	**-42.6**	**-40.2**	**-43.4**	**-42.5**	**-46.2**	**-45.7**	**-45.8**
Receipts	52.2	59.2	76.2	66.3	68.9	76.9	77.3	80.1	82.3	83.7
Of which: water royalties	18.1	18.4	20.4	19.3	19.5	20.8	21.6	22.9	23.5	23.9
Payments	-103.4	-95.2	-110.1	-108.8	-109.0	-120.3	-119.8	-126.4	-127.9	-129.5
Income (net)	**304.0**	**380.2**	**425.8**	**501.3**	**429.3**	**444.5**	**447.7**	**455.3**	**475.6**	**495.2**
Labor income (net)	302.2	345.2	416.4	413.1	366.2	393.4	407.7	421.0	442.5	465.1
Receipts	319.1	356.6	437.4	426.0	379.2	407.6	420.2	433.1	454.7	477.3
Of which: miners' wages	253.8	292.8	373.6	369.4	323.5	351.8	366.9	381.8	403.2	425.7
Payments	-16.9	-11.4	-21.0	-12.9	-13.1	-14.2	-12.5	-12.1	-12.2	-12.2
Investment income (net)	1.8	35.0	9.5	88.2	63.1	51.2	40.0	34.3	33.1	30.0
Receipts	50.3	56.1	86.5	104.6	86.0	75.2	66.0	65.2	68.5	68.1
Payments	-48.6	-21.2	-77.0	-16.4	-22.9	-24.0	-26.0	-30.8	-35.4	-38.1
Of which: interest on debt	-37.9	-9.6	-64.0	-8.0	-7.8	-7.4	-8.3	-11.5	-15.3	-16.5
Unrequited transfers	**300.3**	**389.0**	**628.0**	**510.6**	**521.1**	**308.4**	**255.2**	**271.8**	**344.7**	**384.9**
Official	289.7	371.5	627.0	509.0	519.5	306.7	253.4	270.0	342.9	383.1
SACU nonduty receipts	274.4	358.0	605.0	494.1	503.6	289.3	237.2	253.7	326.8	367.4
Rand compensation	11.5	11.5	12.6	12.0	12.6	13.2	13.2	13.3	13.3	13.3
Other	3.8	2.0	9.4	2.8	3.2	4.1	2.9	2.9	2.8	2.4
Private	10.6	17.5	1.0	1.6	1.6	1.7	1.8	1.8	1.8	1.8
Current account (including official transfers)	-103.5	65.9	220.8	151.9	-24.2	-344.0	-282.3	-245.9	-135.1	-114.6
Current account (excluding official transfers)	-393.3	-305.7	-406.2	-357.1	-543.7	-650.7	-535.7	-515.8	-478.0	-497.6
Of which: LHWP 2/	-12.2	-7.3	-9.0	-6.9	3.3	3.2	2.8	-27.3	-26.1	-52.9
Capital and financial account	**152.0**	**12.6**	**118.9**	**55.9**	**93.1**	**138.0**	**204.8**	**227.9**	**131.9**	**136.9**
Capital account (transfers received)	21.0	11.1	32.1	13.9	70.5	108.2	121.6	123.6	72.3	76.3
Financial account	131.0	1.5	86.7	42.0	22.5	29.8	83.2	104.3	59.6	60.6
Direct investment (excl. LHDA) 3/	57.3	92.0	105.7	92.4	81.5	81.5	83.6	84.8	87.3	92.3
Financing LHWP (net)	35.2	20.3	24.4	16.3	0.0	0.0	0.0	13.2	12.6	24.0
Other investment	38.5	-110.8	-43.5	-66.7	-59.0	-51.7	-0.4	6.3	-40.3	-55.7
Assets	1.9	-89.1	-60.8	-91.3	-105.2	-103.4	-78.1	-76.1	-76.5	-80.2
Liabilities 4/	36.6	-21.7	17.3	24.6	46.3	51.7	77.7	82.4	36.2	24.5
Change in reserve assets	-28.6	-137.6	-282.5	-153.8	-68.9	206.0	77.5	17.9	3.2	-22.3
Errors and omissions	-19.9	59.2	-57.2	-53.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:				(Percent of GDP, unless otherwise indicated)						
Trade balance	-49.9	-47.1	-51.1	-51.6	-58.3	-60.4	-52.4	-47.7	-45.5	-44.9
Net remittances	23.0	24.4	26.6	26.1	22.9	22.5	22.6	21.7	22.1	22.0
Current account (including official transfers)	-7.9	4.7	14.1	9.6	-1.5	-19.7	-15.7	-12.7	-6.8	-5.4
Current account (excluding official transfers)	-29.9	-21.6	-26.0	-22.5	-33.9	-37.3	-29.8	-26.6	-23.9	-23.6
Excluding LHWP	-30.3	-22.4	-26.7	-23.3	-35.4	-38.7	-31.1	-26.3	-23.8	-22.2
Total SACU receipts (Millions of U.S dollars)	346.8	431.2	676.3	568.9	579.8	333.0	273.1	292.1	376.2	423.0
Gross official reserves (Millions of U.S. dollars) 4/	526.1	663.7	946.2	923.1	1,122.6	831.4	734.7	700.3	681.4	687.2
Gross official reserves 4/										
(Months of imports of goods and services)	4.5	5.4	6.6	6.2	7.4	4.9	4.5	4.1	4.0	3.8
(Months of imports of goods and services exc	4.5	5.5	6.7	6.2	7.4	4.9	4.5	4.2	4.0	3.9
Nominal GDP (USD millions)	1,315	1,416	1,565	1,584	1,602	1744	1,800	1,941	1,998	2,113

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.

4/ Include Lesotho's SDR allocation of SDR 29.1mn, received August 28, 2009.

Table 4. Lesotho: Monetary Survey, 2005–14

	December									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	(In millions of maloti; unless otherwise indicated)									
Net foreign assets	4,306.9	6,205.3	8,520.6	11,237.7	11,621.1	11,530.5	11,715.7	12,415.1	13,288.6	14,509.8
Central bank	3,151.7	4,373.6	6,289.9	8,260.3	7,711.4	6,736.6	6,215.3	6,193.2	6,307.1	6,694.1
Commercial banks	1,155.2	1,831.7	2,230.7	2,977.4	3,909.7	4,793.9	5,500.4	6,221.9	6,981.6	7,815.7
Net domestic assets	-1,714.3	-2,697.4	-4,439.1	-6,354.1	-5,723.9	-4,809.1	-4,028.0	-3,680.7	-3,404.8	-3,286.5
Domestic credit	-100.5	-576.8	-2,071.1	-2,465.7	-2,157.0	-52.9	1,024.1	1,577.5	2,166.4	2,408.7
Claims on central government (net)	-910.1	-1,498.8	-3,324.3	-3,972.7	-3,978.8	-2,109.7	-1,301.5	-1,074.7	-871.5	-1,072.4
Central bank	-1,199.9	-1,973.9	-3,728.8	-4,232.6	-4,343.6	-2,574.4	-1,866.2	-1,689.4	-1,651.2	-1,877.2
Commercial banks	289.8	475.2	404.5	259.9	364.7	464.7	564.7	614.7	779.7	804.7
Claims on the rest of the economy	809.6	921.9	1,253.3	1,507.0	1,821.8	2,056.8	2,325.7	2,652.2	3,037.8	3,481.1
Other items (net)	-1,613.9	-2,120.6	-2,368.1	-3,888.4	-3,566.9	-4,756.2	-5,052.1	-5,258.2	-5,571.2	-5,695.2
Money and quasi-money (M2)	2,592.6	3,507.9	4,081.5	4,883.6	5,897.2	6,721.4	7,687.7	8,734.4	9,883.8	11,223.3
Money	1,832.0	2,688.8	2,990.7	3,877.4	4,682.2	5,336.6	6,103.8	6,934.9	7,847.4	8,911.0
Of which:										
Currency outside dep. mon. banks	212.8	309.4	339.3	402.1	461.9	508.1	555.0	627.6	676.6	749.2
Demand deposits	1,619.3	2,379.4	2,651.4	3,475.3	4,220.3	4,828.5	5,548.8	6,307.3	7,170.8	8,161.8
Quasi-money	760.5	819.1	1,090.8	1,006.2	1,215.0	1,384.8	1,583.9	1,799.6	2,036.4	2,312.4
Of which:										
Time and savings deposits	760.5	819.1	1,090.8	1,006.2	1,215.0	1,384.8	1,583.9	1,799.6	2,036.4	2,312.4
	(Annual change in percent of beginning of period M2)									
Net foreign assets	12.4	73.2	66.0	66.6	7.9	-1.5	2.8	9.1	10.0	12.4
Central bank	11.1	47.1	54.6	48.3	-11.2	-16.5	-7.8	-0.3	1.3	3.9
Commercial banks	1.2	26.1	11.4	18.3	19.1	15.0	10.5	9.4	8.7	8.4
Net domestic assets	-3.3	-37.9	-49.7	-46.9	12.9	15.5	11.6	4.5	3.2	1.2
Claims on central government (net)	-8.3	-22.7	-52.0	-15.9	-0.1	31.7	12.0	3.0	2.3	-2.0
Claims on the rest of the economy	10.3	4.3	9.4	6.2	6.4	4.0	4.0	4.2	4.4	4.5
Claims on the rest of the econ. (yearly change)	43.2	13.9	35.9	20.2	20.9	12.9	13.1	14.0	14.5	14.6
Other items (net)	-5.2	-19.5	-7.1	-37.3	6.6	-20.2	-4.4	-2.7	-3.6	-1.3
Money and quasi-money (M2)	9.1	35.3	16.4	19.7	20.8	14.0	14.4	13.6	13.2	13.6

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

Table 5. Lesotho: Commercial Banks' Performance Ratios, 2005-09

(As of end-December; in percent)

	2005	2006	2007	2008	Sept. 2009
I. Capital adequacy					
a) Basel capital ratio	22	19	14	12	15
b) Nonperforming loans net of provisions to capital	0.3	-0.1	0.2	3	2.6
c) Top 20 exposures to statutory capital and reserves	220	406	520	315	372
II. Asset quality					
a) Loans to deposit ratio	29	26	29	30	29
b) Earning assets to total assets	93	95	96	94	96
c) Nonperforming loans to total assets	2	2	2	4	0.7
d) Reserve for losses to total loans	3	3	3	4	4
e) Reserve for losses to nonperforming loans	167	125	115	118	113
III. Liquidity					
a) Liquidity assets to total deposits	120	100	94	101	109
b) Available reserves to total deposits	8	4	3	4	1.1
c) Liquid assets to total assets	77	78	76	77	79
d) Current assets to current liabilities	86	85	82	83	102
IV. Profitability					
a) Net income after tax to total income	18	22	21	22	23
b) Retained income to total income	16	22	16	32	23
c) Total expenses to total income	81	70	71	69	68
d) Return on assets (ROA)	2	2	3	3	4
e) Return on equity	15	27	32	37	50
V. Solvency					
a) Total debt ratio	11	9	8	8	7

Source: Central Bank of Lesotho.

Table 6. Lesotho: Indicators of External Vulnerability, 2005–09

(In percent of GDP; unless otherwise indicated)

	2005	2006	2007	2008	2009
Financial indicators					
Public sector debt [1]	52.4	54.2	54.6	52.0	39.4
Broad money (M2; annual percent change)	9.1	35.3	16.4	19.7	20.8
Private sector credit (annual percent change)	10.3	4.3	9.4	6.2	6.4
Domestic credit	-1.2	-6.0	-18.8	-18.8	-15.9
Treasury-bill yield (percent) [2]	7.0	6.8	8.8	10.1	0.0
Treasury-bill yield (real, percent) [3]	3.5	0.7	0.8	-0.7	-7.7
External indicators					
Exports of goods and services (U.S. dollars, annual percent change)	-9.2	7.9	16.0	6.3	-10.4
Imports of goods and services (U.S. dollars, annual percent change)	1.5	3.6	17.2	4.8	0.9
Current account balance	-7.9	4.7	14.1	9.6	-1.5
Capital and financial account balance	11.6	0.9	7.6	3.5	5.8
Of which: inward foreign direct investment	4.4	6.5	6.8	5.8	5.1
Net foreign assests of the banking sector (millions of U.S. dollars)	182.6	262.8	327.6	320.0	529.8
Foreign assets of the banking sector (millions of U.S. dollars)	199.5	273.3	338.3	329.9	536.8
Foreign liabilities of the banking sector (millions of U.S. dollars)	16.9	10.5	10.8	10.0	7.0
Gross official reserves (millions of U.S. dollars)	526.1	663.7	946.2	923.1	1122.6
Gross official reserves (months of imports of goods and services)	4.5	5.4	6.6	6.2	7.4
Ratio of reserve money to reserves (percent)	22.1	14.7	10.7	8.4	9.8
Ratio of broad money to reserves (percent)	77.9	75.8	63.3	56.9	71.2
Total external debt [4]	45.0	47.1	49.0	47.1	35.5
Ratio of total external debt to exports of goods and services (percent)	102.2	101.9	105.2	78.9	89.0
Nominal exchange rate (maloti per U.S. dollar, period average)	6.4	6.8	7.0	8.3	8.5
REER depreciation (-) (end of period, CPI-based)	-0.6	-2.0	3.2	-7.1	...
Memorandum items:					
GDP (millions of U.S. dollars)	1,315.3	1,415.8	1,564.9	1,583.9	1,601.8
Nominal exchange rate (maloti per U.S. dollar, end-of-period)	6.3	7.0	6.8	9.3	7.4

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

[1] National government debt on a fiscal year basis; the fiscal year begins in April.

[2] End of period.

[3] Backward-looking with actual CPI.

[4] Excludes private debt within the Common Monetary Area.

Table 7. Lesotho: Millennium Development Goals

	1990	1995	2000	2005	2008
Goal 1: Eradicate extreme poverty and hunger					
Employment to population ratio, 15+, total (%)	51.0	50.0	56.0	55.0	56.0
Employment to population ratio, ages 15-24, total (%)	43.0	40.0	45.0	43.0	43.0
Income share held by lowest 20%	..	1.5	..	3.0	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	15.0	16.6	..
Poverty headcount ratio at national poverty line (% of population)	..	48	..	43	..
Prevalence of undernourishment (% of population)	15	13	..	15	..
Vulnerable employment, total (% of total employment)	..	..	..	..	..
Goal 2: Achieve universal primary education					
Literacy rate, youth female (% of females ages 15-24)	..	..	..	..	..
Literacy rate, youth male (% of males ages 15-24)	..	..	..	..	..
Persistence to last grade of primary, total (% of cohort)	..	..	54	62	..
Primary completion rate, total (% of relevant age group)	58	..	60	62	78
Total enrollment, primary (% net)	..	..	78	75	73
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliament (%)	..	5.0	4.0	12.0	25.0
Ratio of female to male enrollments in tertiary education	130.0	..	153.0	127.0	119.0
Ratio of female to male primary enrollment	122.0	112.0	104.0	100.0	100.0
Ratio of female to male secondary enrollment	142.0	..	131.0	126.0	127.0
Share of women employed in the nonagricultural sector	..	51.6	51.0	..	..
(% of total nonagricultural employment)			..	..	..
Goal 4: Reduce child mortality					
Immunization, measles (% of children ages 12-23 months)	80.0	83.0	74.0	85.0	85.0
Mortality rate, infant (per 1,000 live births)	81.0	81.0	84.0	77.0	68.0
Mortality rate, under-5 (per 1,000)	102.0	102.0	107.0	96.0	84.0
Goal 5: Improve maternal health					
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	94.0	91.0	80.0	73.0
Births attended by skilled health staff (% of total)	..	50.0	60.0	55.0	..
Contraceptive prevalence (% of women ages 15-49)	23.0	..	30.0	37.0	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	960.0	..
Pregnant women receiving prenatal care (%)	..	88.0	85.0	90.0	..
Unmet need for contraception (% of married women ages 15-49)	..	..	..	31.0	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Children with fever receiving antimalarial drugs (% of children under age 5 with fever	..	..	..	..	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	..	26.0	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	..	44.0	..
Incidence of tuberculosis (per 100,000 people)	184.0	323.0	553.0	639.0	637.0
Prevalence of HIV, female (% ages 15-24)	..	..	..	14.9	14.9
Prevalence of HIV, male (% ages 15-24)	..	..	..	6.0	6.0
Prevalence of HIV, total (% of population ages 15-49)	0.8	14.2	23.9	23.4	23.2
Tuberculosis cases detected under DOTS (%)	..	63.0	78.0	90.0	16.0
Goal 7: Ensure environmental sustainability					
CO2 emissions (kg per PPP $ of GDP)	..	..	..	..	..
CO2 emissions (metric tons per capita)	..	..	..	..	..
Forest area (% of land area)	0.0	0.0	0.0	0.0	..
Improved sanitation facilities (% of population with access)	..	33.0	34.0	36.0	36.0
Improved water source (% of population with access)	..	77.0	77.0	78.0	78.0
Marine protected areas, (% of surface area)	..	..	..	..	..
Nationally protected areas (% of total land area)	..	..	..	0.2	0.2
Goal 8: Develop a global partnership for development					
Aid per capita (current US$)	87.0	65.0	19.0	35.0	65.0
Debt service (PPG and IMF only, % of exports of G&S, excl. workers' remittances)	4.0	6.0	11.0	7.0	7.0
Internet users (per 100 people)	0.0	0.0	0.2	2.6	3.6
Mobile phone subscribers (per 100 people)	0.0	0.0	1.0	13.0	29.0
Telephone mainlines (per 100 people)	1.0	1.0	1.0	2.0	3.0
Other					
Fertility rate, total (births per woman)	4.9	4.5	4.0	3.5	3.4
GNI per capita, Atlas method (current US$)	540	710	570	810	1080
GNI, Atlas method (current US$) (billions)	0.9	1.2	1.1	1.6	2.2
Gross capital formation (% of GDP)	56.2	63.4	50.5	29.1	28.8
Life expectancy at birth, total (years)	59	57	49	43	43
Literacy rate, adult total (% of people ages 15 and above)	..	..	82	..	..
Population, total (millions)	1.6	1.7	1.9	2.0	2
Trade (% of GDP)	132.6	138.7	131.1	153.6	158.1

Source: World Development Indicators database.

Annex 1

Southern African Customs Union (SACU) Revenue-Sharing Formula

The Southern African Customs Union (SACU), comprising of Botswana, Lesotho, Namibia, Swaziland (the BLNS) and South Africa, was established in 1910 and administered by the 1969 and 2002 Agreements. All customs duties and excise taxes collected by the members of the union are paid into a Common Revenue Pool (CRP) administered by South Africa and distributed quarterly based on country shares. For 2009/10, SACU revenue accounts for a significant share of government revenue for the BLNS, ranging from 27 percent in Botswana to 55 percent in Lesotho and 63 percent in Swaziland.

The CRP is allocated among the member countries as follows: (i) customs revenues are shared according to each country's share of intra-SACU trade (ii) a share (85 percent) of the excise pool is allocated on the basis of the country's share of SACU GDP; and (iii) the remainder of the excise pool, designated as the development component, is distributed inversely to each member's per capita GDP, such that the smaller the country's GDP per capita, the larger its share of the development component. Under the current formula, the BLNS benefit in particular from the treatment of customs revenues, given that their share of intra-SACU trade is much higher than their share of total customs collections.

The size of the CRP, and the resulting payments to the BLNS, increased significantly since 2004/05, reflecting sharp increases in South Africa's imports of capital and consumer durables – in particular motor vehicles, which have high tariffs - in the context of robust growth in investment and rising household incomes. In addition, the revenue sharing formula was changed in 2005 to treat customs and excise revenues separately as two distinct components, and provided for the establishment of the development component, which enhanced the receipts of the smaller economies.

The size of the pool has started to decline as a result of the recent global economic downturn and ensuing contraction in most SACU countries, particularly South Africa. Reflecting a sharp drop in imports by South Africa in 2009 and a projected slow recovery, the size of the pool will remain lower than in the recent past, resulting in lower SACU payments to the BLNS. The current projection is for a 31 percent reduction in collection of customs duties in 2010/11, from R24.6 billion to R17 billion, and a 7 percent reduction in excise duties, from R22.6 billion to R21 billion.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Appendix 1

Draft Public Information Notice (PIN) No. 10/xx
FOR IMMEDIATE RELEASE
[February [ ], 2010]

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

IMF Executive Board Concludes 2009 Article IV Consultation with the Kingdom of Lesotho

On February 22, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of Lesotho.[1]

Background

After several years of improved economic management, Lesotho's fiscal and external balances deteriorated in 2009 owing to the global economic crisis and a sharp increase in expenditure. Real GDP growth is projected to slowdown in 2009 due to reduced demand for Lesotho's main exports of textiles and diamonds and lower remittances from South Africa. Reflecting a sharp increase in government spending, the fiscal position is projected to record a small deficit in 2009/10, after five consecutive years of surpluses, while the external current account position is expected to shift from a surplus in 2008 to a deficit in 2009.

A steep decline in SACU revenues over the next few years is expected to result in large, albeit declining, fiscal and external current account deficits. Containing growth of expenditures, particularly the wage bill, and strengthening non-SACU revenues will be key to achieving fiscal and external sustainability in the medium-term.

The financial sector appears to have weathered the impact of the global financial crisis, and banks remain well capitalized, liquid and profitable. Financial sector vulnerabilities stemming from weakly supervised nonbank financial institutions are being addressed

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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.

through the strengthening of regulations and supervision, including on illegal financial schemes.

Lesotho’s medium-term growth prospects will depend significantly on the construction of two water projects. The outlook is subjected to significant downside risks arising from a more protracted global recovery, delays in undertaking fiscal adjustment, and potentially lower SACU revenues.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Lesotho: Selected Economic and Financial Indicators, 2005–2009 1/

	2005	2006	2007	Est. 2008	Proj. 2009
	(Annual percentage change, unless otherwise indicated)				
Real Economy					
Real GDP	1.1	6.5	2.4	4.5	1.4
GDP at current market prices (millions of maloti)	8,364	9,587	11,025	13,085	13,573
Consumer price index (period average)	3.4	6.1	8.0	10.7	7.7
	(Percent of GDP)				
National Accounts					
Gross Domestic Investment	23.9	24.8	27.9	30.5	33.3
Gross national savings	16.0	29.4	42.0	40.1	31.8
Central Government					
Revenue and grants	53.8	65.1	62.6	66.8	69.1
Revenue					
Total Grants	2.0	0.9	1.5	1.5	5.2
Total expenditure and net lending	49.5	48.9	51.7	51.4	70.2
Overall balance (excluding grants)	2.4	15.4	9.4	8.7	-6.2
Overall balance	4.3	16.3	10.9	10.2	-1.0
	(Annual percentage change, unless otherwise indicated)				
Money and Credit					
Net Domestic assets of the banking system 2/	-3.3	-37.9	-49.7	-46.9	12.9
Money and quasi-money	9.1	35.3	16.4	19.7	20.8
External Sector					
Current account balance					
Excluding official transfers	-29.9	-21.6	-26.0	-22.5	-33.9
Including official transfers)	-7.9	4.7	14.1	9.6	-1.5
External public debt	45.0	47.1	49.0	47.1	35.5
External debt-servcie ratio 3/	11.5	6.7	6.3	4.3	4.6
Gross official reserves (end of period)					
In millions of U.S. dollars	526	664	946	923	1,123
In months of imports of goods and services	4.5	5.4	6.6	6.2	7.4

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

1/ Fiscal data are reported on a fiscal year basis; the fiscal year begins in April.
2/ Change in percent of M2 at the beginning of the period
3/ In percent of exports of goods and service