DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/89/282

CONTAINS CONFIDENTIAL
INFORMATION

December 29, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Lesotho - Staff Report for the 1989 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1989 Article IV consultation with Lesotho, which will be brought to the agenda for discussion on a date to be announced.

Mr. Callender (ext. 8750) or Mr. Byrne (ext. 8391) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

LESOTHO

Staff Report for the 1989 Article IV Consultation

Prepared by the Staff Representatives for the 1989 Article IV Consultation with Lesotho

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by Mamoudou Touré and A. Basu

December 27, 1989

I. Introduction

The 1989 Article IV consultation discussions with Lesotho were held in Maseru during October 25-November 10, 1989. 1/ The last Article IV consultation with Lesotho was concluded on February 8, 1989 and the second annual arrangement under the structural adjustment facility (SAF) was approved by the Executive Board on June 6, 1989.

Lesotho continues to avail itself of the transitional arrangements of Article XIV. Lesotho's potential access under the SAF is SDR 10.57 million (70 percent of quota), of which the equivalent of SDR 3.02 million under the first arrangement was disbursed in July 1988, and an amount of SDR 4.53 million under the second arrangement, in June 1989. Lesotho has received loans from the Trust Fund. As of November 30, 1989, the IDA had approved 19 project-related credits amounting to US$158 million. Appendix I contains tables on structural and quantitative benchmarks under the SAF-supported program. Appendix II presents a detailed description of the medium-term projections. Summaries of Lesotho's relations with the Fund and World Bank Group are provided in Appendices III and IV, respectively. In addition, statistical issues are presented in Appendix V, and social and demographic indicators, in Appendix VI.

1/ The representatives for Lesotho included members of a subcommittee of Ministers (chaired by Dr. M. Sefali, Minister of Economic Planning and Development), concerned with monitoring the program under the SAF, the Principal Secretary, Ministry of Finance, Mr. L.A. Thoahlane, the Governor of the Central Bank, Dr. A.M. Maruping, and other senior officials of ministries and institutions concerned with economic and financial policies. The staff representatives were Messrs. C.V. Callender (head), A. Abdi, W.J. Byrne, J. Nnanna (all AFR), Ms. S.J. Fennell (TRE), and Ms. D. Heflin (secretary-AFR).

II. Background and Recent Economic Developments

Lesotho has very close economic ties with South Africa and is a member of the Southern African Customs Union (SACU), 1/ from which it derives more than one half of government revenues, and the Common Monetary Area (CMA). 2/ The economy is also heavily dependent on remittances from Basotho workers employed in South African mines. The recent agreement with South Africa to exploit Lesotho's surplus water for export to South Africa should provide an important additional source of income and employment for the Lesotho economy.

After several years of slow economic growth, rapidly rising fiscal deficits, and a substantial deterioration in the external current account and the overall balance of payments (Table 1 and Chart 1), 3/ the Government of Lesotho adopted an economic adjustment and restructuring program supported by an arrangement under the SAF covering the period 1988/89-1990/91.

Performance under the first annual arrangement (1988/89) was poor, with considerable slippages from the quantitative and structural benchmarks (Appendix I, Tables 1 and 2). Developments in the financial and external sectors were particularly disappointing. The budgetary deficit, reflecting both higher-than-programmed current and capital expenditure, was 9.7 percent of GNP, nearly 1 percentage point lower than the previous year but 3.8 percentage points higher than programmed; spending on salaries and wages and on other goods and services exceeded the program target by large amounts, while outlays on repair and rehabilitation of roads damaged by floods and the purchase of aircraft and embassy offices abroad were largely responsible for the higher-than-programmed capital expenditure. The benchmarks on net credit to Government and total domestic credit were exceeded by wide margins. The rate of inflation (as measured by the consumer price index), reflecting domestic financial policies and price developments in South Africa, remained at about 12 percent compared with a program target of 10 percent. In addition, the external current account deficit reached 6.4 percent of GNP compared with the program target of 3.8 percent; the

---

1/ The other members of the Customs Union are Botswana, South Africa, and Swaziland.

2/ The other members of the CMA are South Africa and Swaziland. The CMA allows free movement of capital between the member countries, and under this monetary arrangement, the currency of Lesotho, the loti, is pegged at parity to the South African rand. Certain amendments to the Trilateral and Bilateral Monetary Agreements between Lesotho and Swaziland and South Africa have been ratified to eliminate the exchange restrictions arising in the case of Lesotho from the limitations on South Africa's ability to obtain conversion of certain holdings of Lesotho's currency in the circumstances specified in the agreements.

3/ More detailed descriptions of recent economic developments in Lesotho are contained in SM/89/5 and EBS/89/92.

Table 1. Lesotho: Selected Economic and Financial Indicators, 1984/85-1989/90

Fiscal years (April/March)	1984/85	1985/86	1986/87	1987/88 Prel.	1988/89 Prog. 1/	1988/89 Est.	1989/90 Prog. 1/	1989/90 Prel. Est.
	(Annual percentage changes, unless otherwise indicated)							
National income and prices								
GDP at constant prices	3.6	2.6	2.3	8.4	3.5	9.4	6.3	5.5
GNP at constant prices	0.8	-3.6	1.5	5.3	3.3	5.6	2.6	4.5
GDP deflator	11.6	15.1	12.0	12.4	9.0	17.9	15.9	15.1
Consumer price index	11.1	15.2	15.5	12.1	10.0	12.3	16.0	14.7
External sector (on the basis of SDRs)								
Exports, f.o.b.	-14.6	-15.6	34.0	31.6	13.6	37.0	15.4	13.4
Imports, f.o.b.	-16.2	-21.0	-1.2	24.1	5.5	7.2	20.4	31.6
Workers' remittances	-20.0	-24.9	11.6	15.1	5.1	-1.2	0.7	9.1
Real effective exchange rate	-1.3	-1.5	-2.9	-2.5	...	-1.0	...	...
Nominal effective exchange rate	-1.1	-1.7	-0.9	--	...	-0.6	...	...
Government finances								
Revenue (excluding grants)	27.9	13.4	11.2	9.2	18.4	23.0	37.4	25.5
Of which: SACU	(37.9)	(6.3)	(-9.9)	(8.4)	(22.7)	(22.7)	(36.7)	(35.4)
Revenue (including grants)	30.9	9.3	17.5	3.2	22.8	30.0	33.9	26.4
Total expenditure 2/	23.5	27.7	20.2	21.1	5.2	24.1	6.0	2.2
	(Change as a percentage of opening broad money)							
Money and credit								
Money and quasi-money (M2)	18.2	21.4	11.1	17.8	16.4	21.9	22.0	13.2
Net foreign assets	32.3	6.6	-8.1	-3.4	5.4	-3.9	7.8	5.6
Domestic credit	-2.4	18.9	15.7	28.1	11.0	32.8	14.2	5.1
Government	-8.5	11.3	16.3	19.7	5.1	20.8	4.3	0.1
Private 3/	6.1	7.6	-0.6	8.4	5.8	12.0	9.9	4.7
Other items (net)	-11.7	-4.2	3.5	-6.8	--	7.3	--	--
Velocity (GNP relative to M2)	4.0	3.7	3.8	3.9	3.4	4.0	3.5	3.7
	(In percent of GNP, unless otherwise indicated)							
Central Government								
Revenue and grants	24.2	23.5	23.6	20.5	24.6	21.6	25.5	22.8
Expenditure and net lending	26.1	29.8	30.5	31.0	30.6	31.2	29.9	26.7
Overall surplus/deficit (-) 4/	-1.9	-6.2	-6.9	-10.6	-5.9	-9.7	-4.4	-3.9
Domestic bank financing	-2.0	2.8	4.1	4.7	1.4	4.9	1.1	0.6
Foreign financing	2.1	2.8	2.9	4.6	3.7	3.8	3.0	3.8
External current account surplus or deficit (-) 5/	-3.3	-2.6	-0.2	-7.1	-3.8	-6.4	-3.7	-4.4
External debt 6/	29.2	32.4	31.2	34.5	34.1	36.5	39.7	36.7
Debt service ratio (in percent of exports of goods and services)	6.5	6.2	3.7	3.5	3.5	5.0	5.3	5.0
Prime interest rate 7/	22.0	14.0	11.0	11.0	...	19.0	...	...
Minimum savings deposit rate 7/	12.0	7.0	6.0	6.0	...	13.5	...	...
	(In millions of SDRs)							
Overall balance of payments surplus or deficit (-) 8/	5.7	8.5	-9.9	-11.9	5.1	-10.7	3.6	10.7
Net official reserves (in weeks of imports, f.o.b.) 9/	7.6	10.2	8.2	5.6	6.6	4.1	5.4	5.4
Net foreign assets of banking system	105.5	90.5	73.4	60.4	70.6	49.3	56.8	63.7

Sources: Data provided by the Lesotho authorities; and staff estimates.

1/ The programmed indicators in percent of GNP reflect the national accounts data prior to the recent revisions.
2/ Including net lending.
3/ Including statutory bodies.
4/ Including grants.
5/ Including official unrequited transfers.
6/ Central Government only.
7/ End of period.
8/ Excluding SAF purchases in 1988/89 and 1989/90.
9/ Excluding LHWP imports.

overall balance of payments recorded a deficit of about SDR 11 million; and net foreign assets fell to the equivalent of 4.1 weeks of imports instead of increasing to the equivalent of 6.6 weeks as had been envisaged. Moreover, the benchmark on nonconcessional borrowing was not observed, and the debt service ratio rose from 3.5 percent of exports of goods and services in 1987/88 to 5.0 percent in 1988/89.

However, there were some positive aspects to Lesotho's performance. Real GDP growth of 9.4 percent (GNP growth of 5.6 percent) was considerably stronger than envisaged. Despite some delays, several of the structural benchmarks were observed; the export financing scheme was introduced, a number of revenue measures were successfully implemented, and the public investment program for the period 1988/89-1990/91 was completed. Moreover, late in fiscal year 1988/89 the Government began to put in place mechanisms for controlling expenditure.

III. Report on the Discussions

1. The 1989/90 program

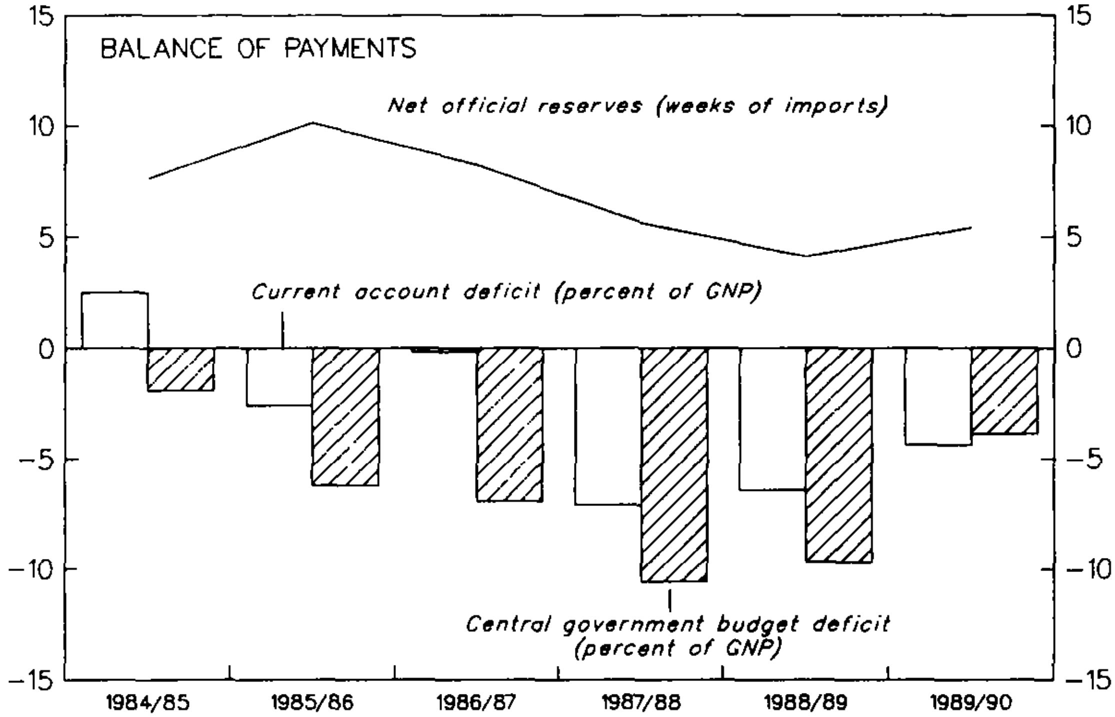
During the discussions on the 1988 Article IV consultation and the request for the second annual arrangement under the SAF, Executive Directors expressed deep disappointment with the slippages under the first-year program. They noted with regret that the authorities had not demonstrated sufficient control in the fiscal area and indicated that a fundamental reorientation of fiscal policy was required. In this context, they stressed the need for the establishment of effective monitoring and control mechanisms. Directors emphasized the importance of economic diversification and welcomed the planned land leasing reforms, the establishment of grazing associations, and the introduction of grazing fees to help ensure more efficient land use. Directors indicated that every effort should be made to accelerate adjustment and that performance under the program would have to be monitored very closely.

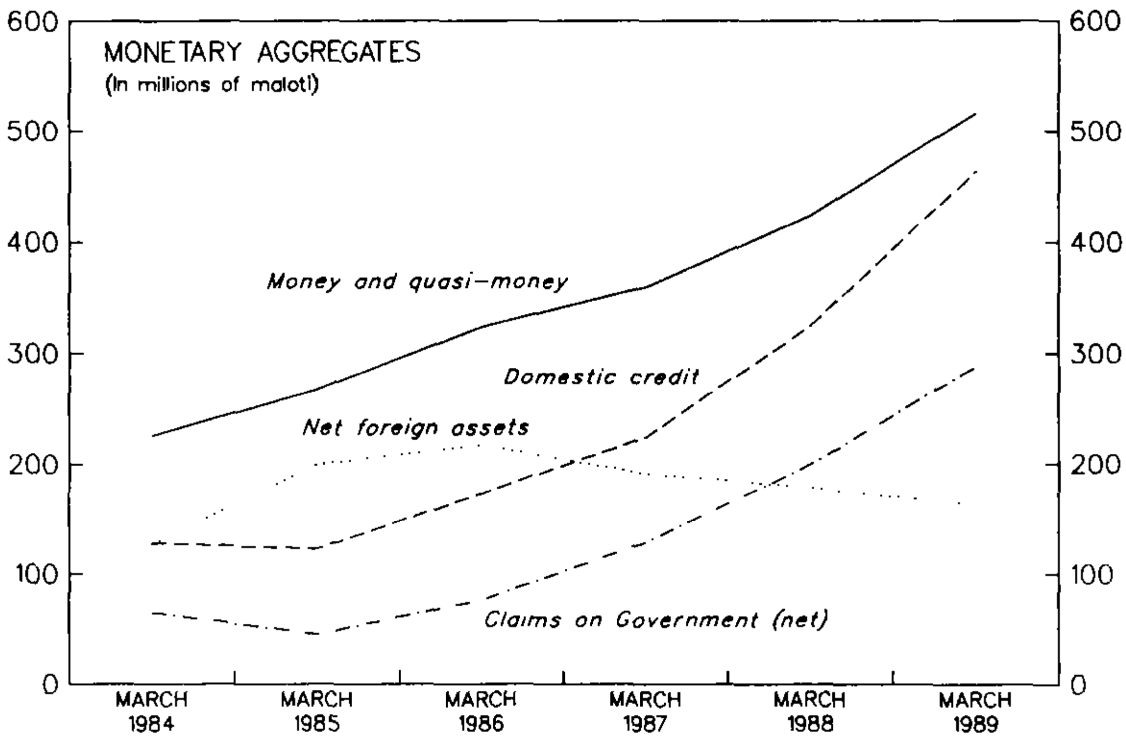
In light of these comments, and as a result of developments related to the Lesotho Highlands Water Project (LHWP), the adjustment path envisaged in the original program was reassessed and revised at the time of negotiations on the second annual arrangement. The objectives of the second annual program include real GDP growth of more than 6 percent; reduction in the overall fiscal deficit from 10.9 percent of GNP to 4.4 percent; containment of the annual rate of inflation to about 16 percent; and an increase in net official reserves to the equivalent of 5.4 weeks of imports. To achieve these goals the Government undertook to implement measures to increase agricultural and manufacturing productivity and output; introduce several revenue-raising measures

CHART 1

LESOTHO

EXTERNAL AND FINANCIAL DEVELOPMENTS, 1984–89





Sources: Data provided by the Lesotho authorities; and staff estimates.

while curtailing the growth of budgetary expenditure; 1/ and continue its policies to increase exports and promote import substitution. Appropriate limits were placed on credit expansion and nonconcessional borrowing and structural benchmarks were expanded to include budgetary management and parastatal monitoring.

To demonstrate their commitment to the program, the authorities took a number of actions prior to the Executive Board's consideration of the request for the second annual arrangement, namely, removal of the company tax exemption that had been extended to parastatals; retrenchment of 150 daily paid workers as part of the overall retrenchment program to be implemented in 1989/90; enactment of the annual budget appropriations for 1989/90; institution of an expenditure monitoring and control system; and appointment of a Board of Trustees for the Miners' Deferred Pay Fund (MDPF).

Against this background, the discussions focused on overall economic and financial developments and prospects for 1989/90 and the medium term in the context of the policies and targets of the policy framework paper (PFP) and the arrangement under the structural adjustment facility.

2. Policies and prospects for 1989/90

a. Financial policies

The Lesotho representatives regretted that they had not been able to reduce the lag in reporting of data on the execution of the budget to six weeks as had been envisaged in the program. This was due mainly to delays in recording expenditures, lack of coordination among the various data processing units, and shortage of trained staff. However, the data for the first half of the fiscal year, although incomplete, provided a good indication of fiscal developments, and it appeared that the fiscal situation would improve dramatically in 1989/90. The overall budgetary deficit (including grants) is estimated at M 87 million (3.9 percent of GNP), compared with a program target of M 91 million (4.4 percent of GNP) and an outcome of 9.7 percent of GNP in the previous year (Table 2). The improvement in the deficit was due mainly to lower-than-programmed expenditure. Revenue and grants are estimated at M 511 million, 26 percent higher than the previous year, but slightly lower than the program estimates. Although current expenditure is estimated to be 5 percent less than the programmed amount, total expenditure and net lending is expected to be only 2 percent lower than the target, owing to higher-than-programmed capital expenditure (Chart 2).

1/ Fiscal measures to be implemented during the course of the program included the extension of the sales tax to public utilities and the restraint of the growth of real expenditure on personnel.

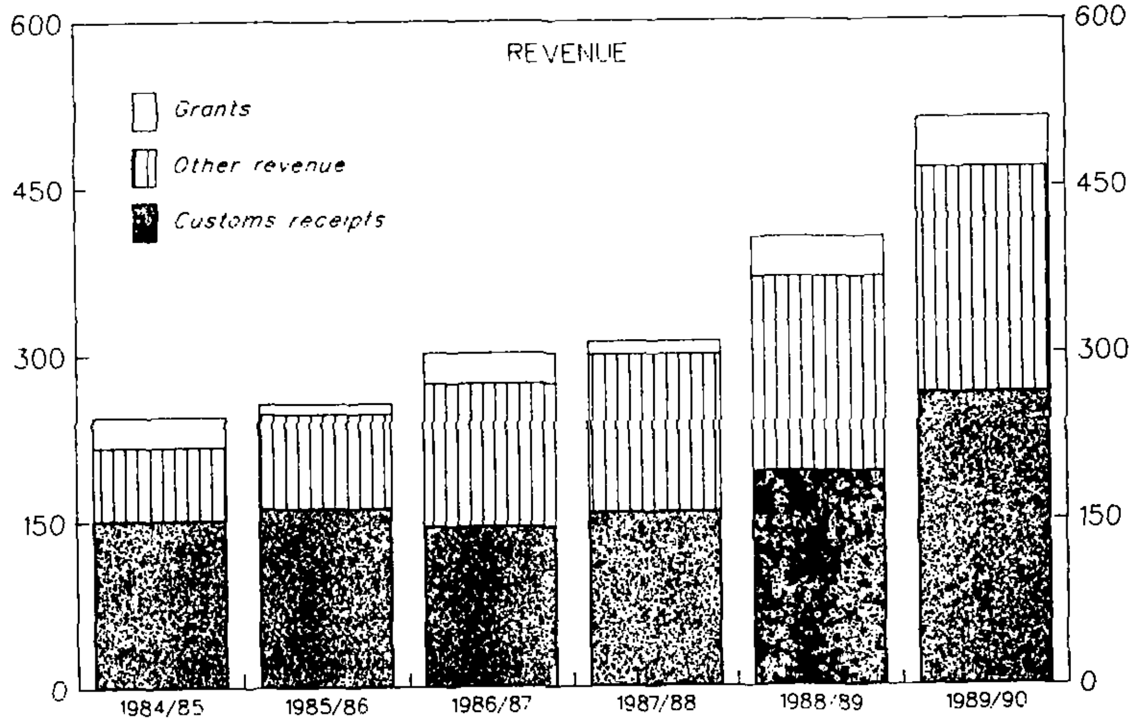
Table 2. Lesotho: Summary of Central Government Operations, 1984/85-1989/90

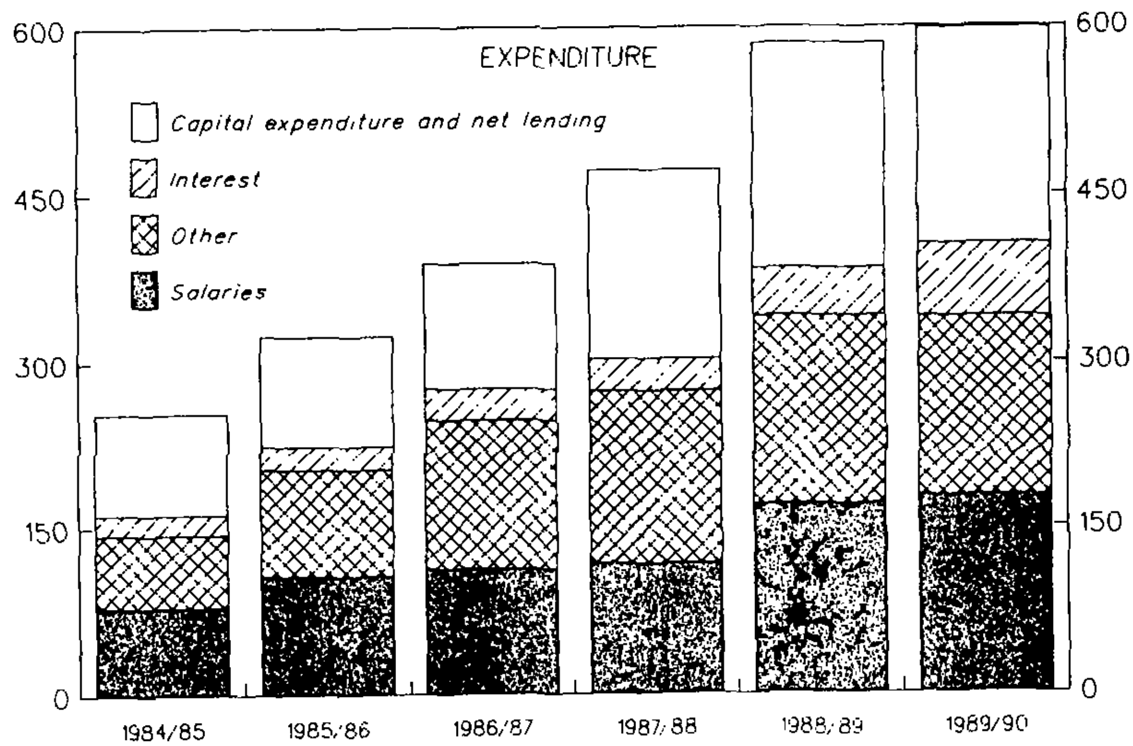
	1984/85	1985/86	1986/87	1987/88	1988/89		1989/90	
					Prog. 1/	Est.	Prog. 1/	Proj.
					(In millions of maloti)			
Revenue and grants	234.4	256.3	301.2	310.7	384.8	404.0	518.5	510.6
Revenue	217.3	246.5	274.1	299.4	356.8	368.5	477.6	466.0
Customs	(151.5)	(161.1)	(145.2)	(157.4)	(193.2)	(193.2)	(264.4)	(263.6)
Other revenue	(65.8)	(85.4)	(128.9)	(142.0)	(163.5)	(175.3)	(213.9)	(202.4)
Grants	17.1	9.8	27.1	11.3	28.0	35.4	40.9	44.6
Expenditure and net lending	253.4	323.6	389.0	471.2	477.6	584.9	609.0	597.9
Current expenditure	161.4	222.7	275.9	302.9	316.6	384.0	424.8	405.2
Salaries	(77.8)	(106.1)	(112.9)	(117.2)	(136.0)	(170.0)	(180.0)	(176.8)
Interest	*(17.5)*	*(20.7)*	*(28.4)*	*(29.9)*	*(36.6)*	*(43.4)*	*(69.4)*	*(65.4)*
Other	(66.1)	(95.9)	(134.6)	(155.8)	(144.0)	(170.6)	(175.5)	(163.0)
Capital expenditure and net lending	92.0	100.9	113.1	168.3	161.0	200.9	184.2	192.7
Surplus/Deficit (-)	-19.0	-67.3	-87.8	-160.5	-92.8	-180.9	-90.5	-87.3
Financing	19.0	67.3	87.8	160.5	92.8	180.9	90.5	87.3
Foreign	20.0	30.0	36.7	70.3	58.9	71.2	61.9	85.1
Borrowing	(37.4)	(59.2)	(56.5)	(92.7)	(78.2)	(106.2)	(98.1)	(121.2)
Amortization	(17.4)	(29.2)	(19.8)	(22.4)	(19.3)	(35.0)	(36.2)	(36.1)
Domestic	-1.0	37.3	51.1	90.2	33.9	109.7	28.6	2.2
Bank	(-19.1)	(30.1)	(52.7)	(70.8)	(21.7)	(91.9)	(22.6)	(14.5)
Other	(18.1)	(7.2)	(-1.6)	(19.4)	(12.2)	(17.8)	(6.0)	(-12.3)
					(In percent of GNP)			
Memorandum items:								
Revenue and grants	24.0	23.6	23.6	20.5	24.6	21.6	25.5	22.8
Expenditure and net lending	26.0	29.8	30.5	31.0	30.6	31.2	29.9	26.7
Surplus/Deficit (-)	-1.9	-6.2	-6.9	-10.6	-5.9	-9.7	-4.4	-3.9
					(Annual percentage change)			
Revenue and grants	30.9	9.3	17.5	3.2	23.8	30.0	28.3	26.4
Of which: SACU	(37.9)	(6.3)	(-9.9)	(8.4)	(22.7)	(22.7)	(36.9)	(36.4)
other	(9.7)	(29.8)	(50.9)	(10.2)	(15.1)	(23.5)	(22.0)	(15.5)
Expenditure and net lending	23.5	27.7	20.2	21.1	5.2	24.1	4.1	2.2
Current expenditure	14.1	38.0	23.9	9.8	6.0	26.8	10.6	5.5
Of which: salaries	(17.2)	(36.4)	(6.4)	(3.8)	(13.9)	(45.1)	(5.9)	(4.0)
Capital expenditure and net lending	44.7	9.7	12.1	48.8	3.7	19.4	-8.3	-4.1

Sources: Data provided by the Lesotho authorities; and staff estimates.

1/ The programmed indicators in percent of GNP reflect the national accounts prior to the recent revisions. The comparable ratios for 1988/89 and 1989/90, respectively, according to the revised national accounts are as follows: revenue and grants: 20.5, 23.1; expenditure and net lending: 25.5, 27.2; surplus/deficit (-): -5.0, -4.0.

CHART 2
LESOTHO
CENTRAL GOVERNMENT REVENUE AND
EXPENDITURE, 1984/85 – 1989/90
(In millions of maloti)





Sources: Data provided by the Lesotho authorities; and staff estimates.

Commenting on fiscal developments, the Lesotho representatives said that the improved revenue performance partly reflected higher customs revenues, but it also stemmed from significant increases in sales tax receipts owing to higher tax rates and in "other" revenues resulting from the new revenue measures introduced early in the fiscal year. They acknowledged that revenue performance would have been better if some of the measures, such as the extension of the company tax to parastatals, and the increase in tax rates on tobacco and alcohol, had been implemented earlier in the fiscal year. The Lesotho representatives informed the staff that further work was being undertaken on the reduction of the number of bands for individual incomes with a view to simplifying the personal income tax structure, but they regretted that negotiations regarding the extension of the income tax to Basotho miners in South Africa had stalled.

With regard to expenditure, the Lesotho authorities said that the expenditure control measures introduced late in 1988/89 and strengthened during the current fiscal year had begun to yield results (Table 3). In particular, the policy of granting only within-grade merit increases, the restraint in recruitment, the laying off of some daily paid workers, and the introduction of an early retirement scheme had slowed the growth in salaries and wages, while improved controls at the disbursement stage had helped to curtail the growth in expenditure on other goods and services. Consequently, recurrent expenditure was expected to fall below the budgetary target. Capital expenditure and net lending, on the other hand, was likely to exceed the target by nearly 5 percent, mainly on account of the purchase of two military cargo transport aircraft, which had not been budgeted for, but also on account of faster-than-envisaged implementation of hospital and irrigation projects.

The staff representatives welcomed both the improvements in the process and procedures of budgetary preparation and the measures the authorities had taken to increase revenues and restrain expenditure. They emphasized, however, that in order to achieve the revenue outcome, collection procedures must be strengthened, dividends from parastatals should be collected promptly, reimbursable expenditure on account of foreign-financed projects should be claimed on time, and advance payments of taxes had to be secured from the parastatals. Moreover, the lag in the provision of data on budgetary operations needed to be reduced and the mechanisms for monitoring and controlling expenditure, especially at the commitment stage, needed to be expanded and further strengthened. The staff representatives also stressed that expenditure on unbudgeted items, especially for less productive purposes, should be eliminated, since these expenditures tended to increase the budget deficit and generally made economic and financial management more difficult. They further pointed out the need to update the public sector investment program, establish priorities for investment projects, and accelerate the establishment of the parastatal monitoring unit.

With respect to the financing of the overall budgetary deficit, the staff representatives observed that, based on preliminary indications,

Table 3. Lesotho: Analysis of Fiscal Adjustment in 1989/90 1/

(In percent of GNP)

	Prog.	Proj.
1. Total increase in revenue and grants	1.6	1.3
Increase associated with revenue-raising measures	(0.1)	(-0.2)
Growth in SACU revenues	(1.5)	(1.5)
2. Total reduction in expenditure and net lending	4.0	4.5
Decrease attributable to expenditure-reducing measures	(1.5)	(4.3)
Decrease attributable to non-recurring expenditures	(2.5)	(0.2)
3. Reduction in overall budget deficit (1+2)	5.6	5.8

Sources: Table 2; and staff estimates.

1/ *Using actual outcome for 1988/89 and revised GNP figures.*

about 97 percent of the deficit would be financed by external borrowing, which exceeded the program amount by about M 23 million. Some of the additional external borrowing had financed the unbudgeted capital expenditure. They pointed out that, under the program, this unexpectedly high level of foreign borrowing would require both a reduction in government borrowing from the banking system and an increase in the foreign reserve target by the amount of foreign borrowing in excess of the programmed level. The Lesotho representatives replied that taking into account the amount falling due to nonbank domestic creditors, the Government felt that the amount of credit repayment to the banking system would be limited.

With regard to monetary and credit developments, the staff representatives commended the Lesotho authorities for shifting credit away from household consumption toward productive enterprises while remaining within the quarterly credit ceilings for June and September 1989. Total domestic credit and broad money had expanded on an annualized basis by about 6 and 13 percent, respectively, between March and September 1989 (Table 4). At the same time, they stressed the need to encourage the development of more creditworthy projects in order to channel some of the existing surplus liquidity in the commercial banks 1/ into productive investment. The staff representatives noted that, while the Government had recently changed interest rates in response to movements in South African rates (Chart 3), interest rates on deposits were still slightly negative in real terms, and should be made positive, 2/ particularly in view of the continuing loss of migrants' remittances to South Africa. They also urged the authorities to explore the possibility of developing new financial instruments and improving financial intermediation.

In response, the Lesotho representatives argued that because of institutional and other socio-economic factors higher interest rates were unlikely to have a significant effect on the mobilization of either foreign or domestic savings in Lesotho, particularly in the present environment of surplus liquidity in the banking system. With respect specifically to miners' remittances, the Lesotho representatives observed that, in addition to higher interest rates, the financial institution operated in South Africa by The Employment Bureau of Africa (TEBA) offered the Basotho miners more convenient deposit and withdrawal facilities than those provided by financial institutions in Lesotho. The staff representatives pointed out that this only strengthened the case for higher interest rates. Regarding the development of financial

---

1/ Liquidity ratio is defined as liquid assets as percentage of deposits. Comparable ratios for the past five years are as follows: September 1985: 85.2 percent; September 1986: 86.1 percent; September 1987: 91.9 percent; September 1988: 80.9 percent; September 1989: 79.3 percent.

2/ The Central Bank of Lesotho sets the minimum rate on savings deposits.

Table 4. Lesotho: Monetary Survey, 1984-89

	1984	1985	1986	1987	1988	1989		
	March					March	June	Sept.
	(In millions of maloti)							
Foreign assets (net)	126.3	199.1	216.9	190.6	178.2	163.2	171.4	219.5
Central Bank	65.1	94.7	140.7	126.6	108.7	96.2	95.5	123.5
Commercial banks	59.3	102.5	73.0	61.2	66.0	62.1	71.1	93.3
Rand with banks	1.9	1.9	3.2	2.8	3.5	4.9	4.8	2.7
Domestic credit	127.7	122.3	172.7	223.4	324.5	463.4	460.6	476.6
Claims on								
Government (net)	64.8	45.6	75.7	128.4	199.2	287.3	281.0	290.0
Central Bank	(6.4)	(1.7)	(7.7)	(31.7)	(134.9)	(157.9)	(139.2)	(140.4)
Commercial banks	(58.4)	(43.9)	(68.0)	(96.7)	(64.3)	(129.4)	(141.8)	(149.6)
Claims on rest								
of economy	62.9	76.7	97.0	95.0	125.3	176.1	179.6	186.6
Private sector	(49.1)	(64.7)	(85.6)	(85.0)	(113.0)	(147.1)	(152.0)	(160.6)
Statutory bodies	(13.8)	(11.9)	(11.4)	(10.0)	(12.0)	(29.0)	(27.6)	(26.0)
Money and quasi-money	225.4	266.5	323.5	359.4	423.4	516.2	534.3	550.3
Narrow money	88.5	106.5	135.8	162.4	174.4	233.6	243.7	254.8
Maloti with public	(23.2)	(24.9)	(28.9)	(33.0)	(34.3)	(43.1)	(45.5)	(51.9)
Demand and call								
deposits	(65.3)	(81.6)	(106.9)	(129.4)	(140.1)	(190.5)	(198.2)	(202.9)
Of which: MDPF 1/	[5.9]	[6.5]	[7.0]	[5.9]	[7.3]	[7.2]	[7.7]	[8.0]
Quasi-money	137.0	160.0	187.7	197.0	249.0	282.6	290.6	295.5
Time deposits	(70.0)	(78.8)	(88.2)	(77.8)	(106.9)	(108.2)	(112.8)	(134.4)
Of which: MDPF 1/	[53.1]	[58.4]	[63.4]	[53.1]	[65.8]	[64.6]	[69.3]	[71.7]
Savings								
Other items (net)	28.6	54.9	66.0	54.6	79.2	110.2	97.6	146.0
	(Annual percentage change)							
Memorandum items:								
Broad money	12.4	18.2	21.4	11.1	17.8	21.9	16.7 2/	13.6 3/
Total domestic credit	2.7	-4.2	41.2	29.4	45.3	42.8	26.9 2/	23.0 3/
Credit to Government (net)	-12.7	-29.6	66.0	69.6	55.1	44.2	31.8 2/	27.8 3/
Credit to private sector and statutory bodies	26.1	21.9	26.5	-2.1	31.9	40.5	20.0 2/	18.3 3/
	(Changes as a percentage of opening broad money)							
Net foreign assets	19.3	32.3	6.6	-8.1	-3.4	3.5	-4.5 2/	4.9 3/
Total domestic credit	1.7	-2.4	18.9	15.7	28.1	32.8	21.3 2/	19.0 3/
Credit to Government (net)	-4.8	-8.5	11.3	16.3	19.7	20.8	14.8 2	13.0 3/

Source: Data provided by the Central Bank of Lesotho.

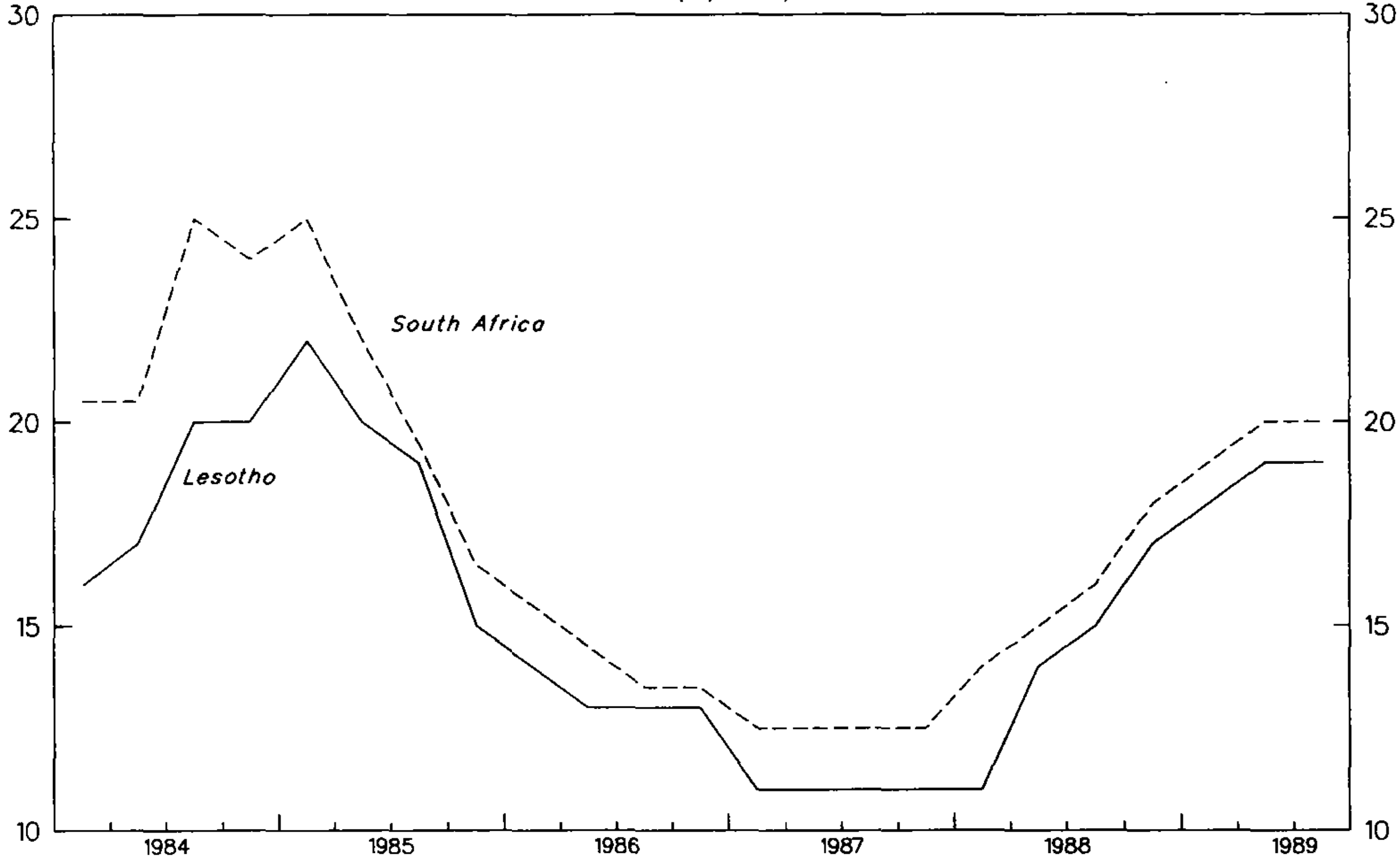
1/ Miners' Deferred Pay Fund.
2/ June 1988-June 1989.
3/ Sept. 1988-Sept. 1989

CHART 3

LESOTHO

COMPARATIVE PRIME LENDING RATES, Q1 1984–Q3 1989

(In percent)



Sources: Central Bank of Lesotho, *Quarterly Review*, and South African Reserve Bank, *Quarterly Bulletin*.

instruments, the Lesotho representatives remarked that the limit on Government borrowing constrained the development of government financial instruments but there was scope for the development of bonds issued by some of the parastatal enterprises. However, they were awaiting the World Bank's Financial Sector Report on Lesotho before proceeding further.

b. The external sector

Based on preliminary data for the first half of the fiscal year 1989/90, the external current account deficit is estimated to narrow to 4.4 percent of GNP during 1989/90 (Table 1). Exports are estimated to rise by 13 percent in SDR terms, of which 7.5 percent would constitute an increase in volume (Table 5). Imports (exclusive of LHWP) are estimated to increase by 22 percent, owing mainly to higher imports of raw materials and food. LHWP imports are estimated to increase more than fourfold. Workers' remittances are estimated to rise by 18 percent, reflecting an increase of a similar magnitude in the average wage, while official unrequited transfers are estimated to rise sharply in line with higher levels of budgetary and other grants. Even with a significant increase in net capital inflows, the overall balance of payments surplus would only be SDR 10.7 million, and after the SAF disbursement is taken into account, additional financing of some SDR 8 million would still be required to attain the reserve target equivalent to 5.4 weeks of imports.

The Lesotho representatives said that the Government's policies to diversify exports and increase import substitution were already having a positive effect; manufactured exports, particularly of textiles, had increased substantially, and foreign investment had continued to expand (this is partly reflected in the increase in investment through the financial rand). They explained that the export financing scheme, which had been in operation for a year, had contributed to this growth in investment and exports, and would be expanded. Moreover, agricultural production and exports were expected to increase as a result of the recent introduction of a revolving fund, financed by the United Nations Capital Development Fund (UNCDF), to provide short- and long-term credit to farmers through the Lesotho Agricultural Development Bank (LADB) and the commercial banks. Nonetheless, it was unlikely that the significant rise in foreign reserves that had occurred in the first half of 1989/90 (M 27 million) would continue in the second half. In addition to higher seasonal imports associated with the holiday season, additional foreign exchange would be needed for imports of food grains to supplement domestic production. 1/ The Lesotho representatives indicated, however, that they were seeking food aid from donors, which would alleviate the need to use additional foreign exchange for imports of food grains. The staff representatives urged the authorities to monitor foreign reserve

---

1/ See Section 2c below. Production of maize and wheat was adversely affected by unfavorable weather.

Table 5. Lesotho: Balance of Payments, 1984/85-1989/90

	1984/85	1985/86	1986/87	1987/88	1988/89 Prel.	1989/90 Prog. 1/	1989/90 Est.
			(In millions of SDRs)				
Current account	6.3	-12.1	-0.8	-40.5	-37.8	-21.0	-28.5
Goods and services balance	-93.2	-79.9	-54.4	-90.6	-107.4	-203.2	-205.8
Exports, f.o.b.	25.4	21.4	28.7	37.8	51.8	48.6	58.7
Imports, f.o.b.	-398.2	-308.1	-304.5	-377.8	-405.2	-486.7	-533.3
Of which: LHWP	(--)	(--)	(--)	(--)	(-26.9)	(-101.3)	(-107.2)
Workers' remittances	288.4	216.6	241.6	178.0	274.6	250.2	299.7
Other services (net)	-17.2	-16.1	-18.5	-24.1	-23.0	-17.7	-23.7
Investment income (net)	8.4	6.3	-1.7	-4.5	-5.6	-4.5	-7.2
Unrequited transfers (net)	99.5	67.8	53.6	50.1	69.6	182.2	177.3
Official	96.5	65.7	52.6	49.0	34.7	60.9	45.6
Private	3.0	2.1	1.0	1.0	2.4	0.7	2.6
LHWP	—	—	—	—	32.4	120.6	129.1
Long-term capital (net)	19.4	22.2	23.9	35.8	28.2	28.2	35.0
Official (net)	15.8	17.1	16.6	26.4	18.8	12.8	24.9
Private foreign investment	3.7	5.2	7.4	9.5	9.4	10.6	10.1
Other official 2/	-0.1	-0.1	-0.1	-0.1	—	-0.2	—
LHWP	—	—	—	—	—	4.9	--
Short-term capital (net)	-26.0	12.0	4.7	-2.1	0.8	—	-2.7
SDR allocations	—	—	—	—	—	—	—
Errors and omissions 3/	6.0	-13.6	-37.7	-5.1	-1.9	-3.6	6.9
Overall surplus/deficit	5.7	8.5	-9.9	-11.9	-10.7	3.6	10.7
SAF purchases	—	—	—	—	3.0	4.5	4.5
Financing required	—	—	—	—	—	—	8.1
Change in reserves (increase -)	-5.7	-8.5	9.9	11.9	7.7	-8.1	-23.3
			(In percent of GNP, unless otherwise indicated)				
Memorandum items:							
Current account	2.5	-2.6	-0.2	-7.1	-6.4	-3.7	-4.4
Net official reserves (weeks of imports)	7.6	10.1	8.2	5.6	4.1	5.4	5.4
Conversion factor (SDR/loti)	0.6020	0.4262	0.3806	0.3738	0.3132	0.2810	0.2897
Import volume (percent change)	-0.1	-6.4	-3.3	11.4	2.9	-1.6	6.6
Export volume (percent change)	-0.1	-0.1	27.8	18.9	40.0	12.5	7.5
Debt service ratio (percent of goods and services)	6.5	6.2	3.7	3.5	5.0	5.3	5.0

Sources: Central Bank of Lesotho; and staff estimates.

1/ From EBS/89/92.
2/ Subscriptions to international institutions by the Lesotho Government.
3/ Including valuation adjustments.

developments closely in the coming months and, if necessary, to tighten credit and raise interest rates with a view to curbing aggregate demand while also attracting a larger amount of migrants' remittances and short-term capital.

The Lesotho authorities raised the issue of the appropriateness of the existing exchange regime. They said that although the recent depreciation of the loti-rand 1/ had generated a higher rate of inflation in Lesotho and had contributed to an increase in debt service payments, the positive aspects of the arrangement outweighted its disadvantages. Given Lesotho's geographic location inside South Africa, and its participation in the customs union (SACU) and the common monetary arrangements, the real effective depreciation of the loti-rand had improved the competitiveness of Lesotho's exports, which had become necessary as a result of the recent increases in minimum wages in Lesotho. Moreover, Lesotho had continued to benefit from sizable inflows of direct foreign investment and migrants' remittances. The staff representatives said that, in the circumstances, the issue deserved careful study before any changes were contemplated in the current arrangements.

The staff representatives also stressed that although the ratio of debt service payments to exports of goods and services was estimated to remain stable at about 5 percent in 1989/90, there was no room for complacency, since the debt service ratio had to be considered in the context of the weakness and vulnerability of Lesotho's balance of payments. They therefore urged the authorities to improve the compilation of data and management of external debt and to continue to rely on concessional loans and eschew commercial loans.

The Lesotho authorities said that the amendments to the Trilateral and Bilateral Monetary Agreements between Lesotho, Swaziland, and South Africa to remove the exchange restrictions had been ratified, and that Lesotho's exchange system was free of exchange restrictions.

c. Production, prices, and employment

Preliminary indications based on data for the first half of the fiscal year are that real GDP growth would amount to 5.5 percent in 1989/90, compared with 6.3 percent envisaged in the program and 9.4 percent in 1988/89. Significant increases are expected in the construction and manufacturing sectors, but output in the agricultural sector is expected to fall as a result of unfavorable weather. Gross investment, mainly paralleling an increase in activity associated with the LHWP, is estimated to rise sharply from 30 percent of GNP in 1988/89 to 44 percent in 1989/90. The rate of inflation (as measured by the consumer

1/ Over the eighteen months through end-September 1989 the loti depreciated by 19 percent against the SDR, and 25 percent against the U.S. dollar (Chart 4).

price index), largely reflecting price developments in South Africa, is estimated to accelerate from 12.3 percent in 1988/89 to 14.2 percent in 1989/90.

The authorities are continuing their efforts to increase and diversify agricultural and livestock production. They indicated that extensive use of irrigation had boosted production and that with the help of the UNCDF-financed project they intended to expand the area under irrigation by about 70,000 acres over the next five years. Moreover, the establishment of a freeze-drying plant had improved the commercialization of vegetables, and they expected to export vegetables to Europe. Regarding range land management and the introduction of grazing fees, the Lesotho representatives said that four grazing associations (representing about 30 percent of livestock holders) had already been established, and that within these established associations a system of grazing fees was being implemented. However, the process of extending the system on a nationwide basis was taking longer than anticipated because of resistance from some groups of livestock owners. In the meantime, the Government was continuing to explore other avenues to improve range management, including the establishment of capacity guidelines and the issuance of permits for use of the grazing range, and the culling of herds with a view to improving the quality of livestock. The Lesotho representatives explained that land reform was progressing slowly; the commission's report on changes in the Land Act of 1979 had been translated into Sesotho and was being distributed to Principal Chiefs and Development Councils in order to obtain wide approval and support for its implementation. The current system of contract farming involving lease arrangements for three years to five between the trustee of the land and the farmer was being expanded, but the authorities acknowledged that the leasing arrangements did not address the problem of providing farmers with collateral that could be used to raise loans from commercial sources, and indicated that they were still trying to resolve the problem.

Commenting on investment, the Lesotho representatives said that foreign investment in the manufacturing sector, particularly for textile production, had continued to increase. Most of this investment had come from South African and Asian firms, and production was destined mainly for the European and North American markets. However, there was a great need for venture capital to enable domestic entrepreneurs to participate in new enterprises. The Lesotho authorities were currently reviewing the entire package of investment incentives, including tax holidays, the differential company tax rate for manufacturing enterprises, and the establishment of an investment promotion unit, but were awaiting the World Bank's recommendations before making final decisions.

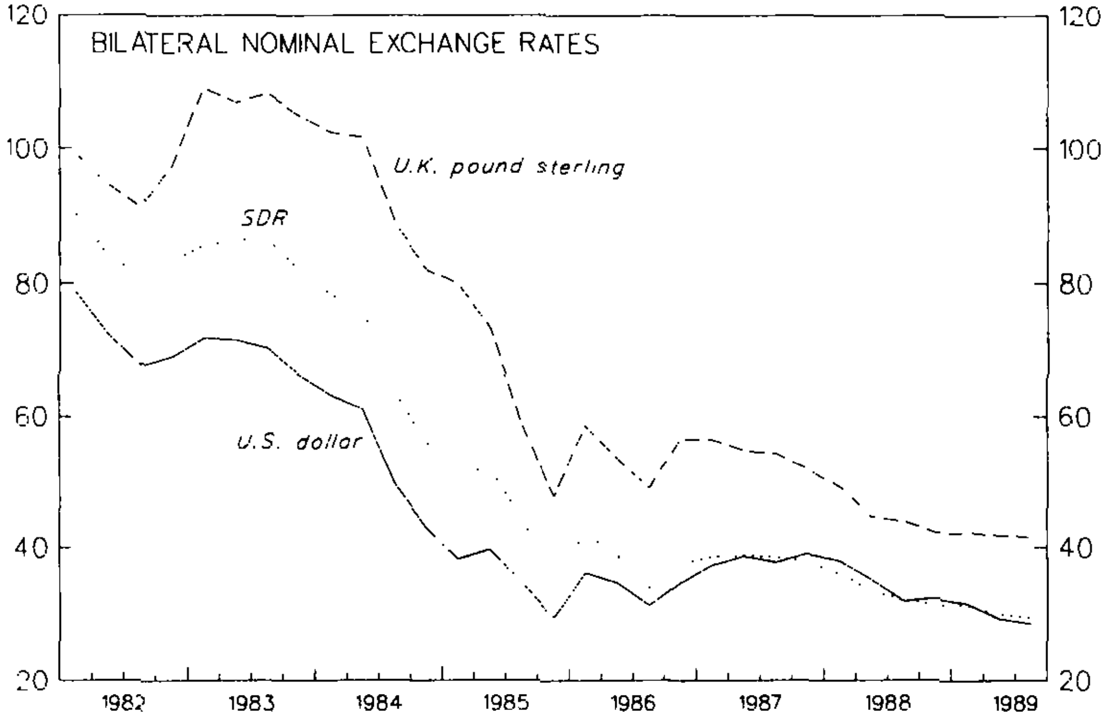
Prices for most products in Lesotho continued to be market determined. Producer prices for the five main agricultural crops were currently based on producer prices for South Africa, plus the cost of transport between the South African border and Maseru, and a margin for Co-op Lesotho's handling and marketing costs. The consumer price index

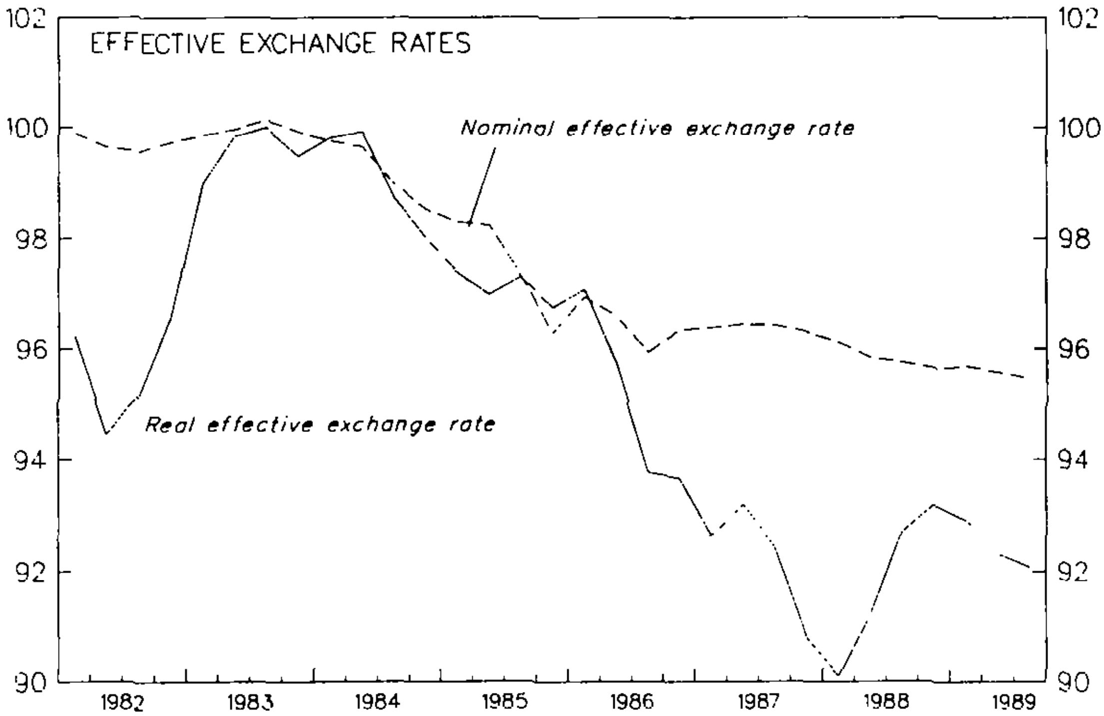
CHART 4

LESOTHO

EXCHANGE RATE DEVELOPMENTS, Q1 1982 – Q3 1989

(Period average, 1980=100; foreign currency per loti) [1]





Sources: IMF, *International Financial Statistics*, and staff estimates.

[1] The loti is pegged to the South African rand at par.

increased by 3.3 percent in the first three months of 1989/90, and, for the year as a whole, was expected to be 2 percentage points higher than the previous year (Table 1).

The Lesotho representatives acknowledged that the employment situation in Lesotho gave cause for concern. A large number of Basotho were currently working in South African mines, and there were few employment opportunities in Lesotho for the large number of new entrants to the labor market. The number of Basotho employed in the gold mines had declined slightly during the past year owing to the closure of older mines that ceased to be profitable, but the number of such workers was expected to remain stable in the medium term. Therefore, the Government, with the assistance of several donor agencies, was trying to expand employment opportunities in Lesotho, particularly in the rural sector, through the provision of more credit to the rural sector, expansion of training programs to improve skills, and strengthening of the marketing and transportation systems. Moreover, the Lesotho authorities expected that the implementation of the LHWP would generate employment in the construction sector as well as in ancillary industries providing goods and services for the project.

d. Social dimensions of adjustment

The Lesotho authorities recognized the need to protect the vulnerable groups within the economy and had already begun taking measures in that regard. To this end, the sales tax exempted basic food and other items (including cereals, fruits, vegetables, eggs, milk, schoolbooks, locally manufactured medicines, and agricultural implements) that weigh heavily in the budgets of the poor. Moreover, in order to protect the poor from higher charges, the recent extension of the sales tax to public utilities did not include water. In addition, the individual income tax was levied largely on the urban wage and salaried sector and had little impact on the rural areas, where a large proportion of the population is considered to fall below the poverty line.

The Lesotho representatives noted that the adverse transitional impact of the structural adjustment program had been felt mainly by a relatively small number of civil servants who had been laid off and had not yet found alternative employment. In addition, the budgetary restraint on salaries had prompted nurses and physicians to leave Lesotho for higher paying jobs in the Republic of South Africa, while the reduction in the number of vehicles had limited the availability of health services, particularly in rural areas. The Lesotho representatives emphasized, however, that the structural adjustment measures were being complemented by reforms in the social sectors. The Government, with assistance from donors, was placing emphasis on the improvement of health and education services; projects in the education and health sectors focused on improving basic education and technical skills by providing more resources for primary education, teacher training and technical schools; expanding maternal and child health care; upgrading clinics; and introducing family planning to the health delivery system. The Government, with technical assistance from the World Bank, was also trying to alleviate malnutrition, which is prevalent among the rural dwellers.

e. Environmental protection

The Lesotho representatives explained that in order to mitigate any potential adverse socioeconomic and environmental impact of the LHWP, the Government, with donor support, was preparing a comprehensive program, involving compensation for households that would be deprived of grazing or arable land as a result of the project, provision of training and employment opportunities for those affected, and protection of the environment. More broadly, the Government had recently adopted an Environmental Action Plan, aimed at improving agricultural production through the conservation of the country's environment.

2. Medium-term prospects

Lesotho's economic prospects are likely to improve over the medium term. This would depend, however, on the Government's adherence to the policies indicated in the PFP and the SAF-supported adjustment program, the implementation of the LHWP as scheduled, and no adverse geopolitical developments in southern Africa.

The medium-term scenario, including the key assumptions, is described in Appendix II. This scenario assumes the effective and timely implementation of the policies described above. Under these assumptions, real GDP is projected to grow at an average rate of 5.6 percent (real GNP, 3.4 percent) over the five-year period 1990/91 to 1994/95. Both savings and investment as a percentage of GNP are projected to rise, with Government savings registering a marked increase; the fiscal situation is projected to improve significantly, changing from a budgetary deficit of 3.9 percent of GNP in 1989/90 to a small surplus in 1991/92 and then to a small deficit by 1994/95, reflecting mainly fluctuations in SACU receipts; the external current account, which is dominated by the evolution of LHWP operations, including receipts of advance royalties, is projected to register a smaller deficit earlier in the period, moving from 6.4 percent of GNP in 1988/89 to 2.4 percent in 1991/92, but the deficit would then increase to 8.1 percent in 1994/1995 as payments for imports associated with the hydroelectric rise sharply; the overall balance of payments will register cumulative surpluses and thereby permit the foreign reserve position to improve, but not enough to attain the targeted 12 weeks of import cover. 1/ To achieve this, additional external financing will be required. Lesotho's external debt service ratio is projected not to exceed 5.2 percent of exports of goods and services throughout the program period.

1/ Import cover calculations are exclusive of LHWP imports.

Given the dependence of the Lesotho economy on mine workers' remittances, a sensitivity analysis was undertaken to assess the direct impact ot a decline in the number of Basotho workers employed in the South African mining industry and the associated fall in remittances. Because of lower imports, SACU receipts are projected to be less than in the baseline scenario, while lower receipts from sales taxes and income taxes will reduce other revenue below the level of the baseline scenario. Under these assumptions, real GDP would grow more slowly, the budget deficit would continue at a high level, the external current account deficit would widen, larger financing gaps would emerge, and stronger adjustment measures would be required.

In discussing the medium-term prospects with the authorities, the staff representatives stressed that the revised projections were tentative and that they assumed timely and effective implementation of policies indicated in the PFP/SAF, implementation of the LHWP as scheduled, and except where explicitly stated in the sensitivity analysis, no exogenous shocks. They pointed out that even with favorable conditions, the next few years will be difficult because of the budgetary constraints and balance of payments pressures. The authorities agreed with the broad thrust of the staff's assessment of Lesotho's medium-term prospects and assured the staff that they would continue the policies indicated in the PFP and would be prepared to take additional adjustment measures should the need arise. In this context, the authorities said that they intended to continue with a Fund-supported program but would inform the staff later whether they would request a third-year arrangement under the SAF or arrangements under the enhanced structural adjustment facility (ESAF).

IV. Staff Appraisal

After several years of slow economic growth, rapidly increasing fiscal deficits, and a substantial deterioration in the external current account and the overall balance of payments, the Government embarked upon a financial program in 1988 that was supported by arrangements under the structural adjustment facility, and was designed to accelerate economic growth and reduce internal and external imbalances. In the context of a PFP and SAF arrangements covering the period 1988/89-1990/91, the Lesotho Government began implementing measures to boost agricultural and manufacturing productivity and output, and increase revenues while curtailing the growth in expenditure, expanding exports, and promoting import substitution. Performance under the first annual program was unsatisfactory and several of the benchmarks were breached. Consequently, and in order to reflect the impact of the LHWP in the program, during the second annual program the adjustment path of the program was revised and policies were modified to enable the Government to attain its economic and financial goals.

On the basis of preliminary data for the first half of the fiscal year 1989/90, it appears that in the second annual program there has been significant improvement in most areas over Lesotho's performance in the first year. Output in the manufacturing and construction sectors is expected to increase significantly but agricultural output is estimated to fall as a result of unfavorable weather. As a result, real GDP growth would amount to 5.5 percent in 1989/90 compared with 9.4 percent in 1988/89 and a program target of 6.3 percent. Improvements in marketing, crop diversification, and greater commercialization have benefited the agricultural sector while increased foreign investment, particularly in textiles, has been mainly responsible for the increase in manufacturing output. However, progress on land reform has been slow and the issue of providing leasehold titles and more appropriate collateral for commercial banks will need to be resolved. Moreover, further gains in livestock development will depend on how assiduously the authorities pursue more efficient range management practices and improvements in the quality of livestock.

The fiscal situation has improved considerably over the previous year. The Central Government's budgetary deficit is likely to be contained within the program target of 4.4 percent of GNP. Revenue and grants, though somewhat lower than the program estimates, are considerably higher than the previous year, and total expenditure and net lending is estimated to be only slightly higher than the previous year and 2 percent below the program target. Much of this enhanced performance is due to the revenue-raising and expenditure control measures implemented by the Government in 1989/90. Nonetheless, there is scope for further improvement. Revenue collection procedures need to be strengthened, and the streamlining of the personal income tax and the prompt recovery of reimbursable expenditure on account of foreign-financed projects should be pursued more vigorously. On the expenditure side, unbudgeted expenditures remain a serious problem; they complicate the task of efficient economic and financial management, and the Government should intensify its efforts to eliminate them. In addition, the monitoring and expenditure control mechanisms need to be expanded and reinforced, and any potential acceleration of expenditure in the final quarter of the fiscal year should be checked. Moreover, the Government should accelerate its work in updating the public investment program, including the establishment of appropriate priorities among investment projects, and further integration of the current and capital budgets.

The authorities are to be commended for shifting credit away from consumption and toward the productive sector and for raising interest rates in response to developments in South Africa. Nonetheless, in view of the need to attract a larger amount of migrant remittances, the authorities should consider raising interest rates further. Moreover, should the foreign reserve position deteriorate, the Government would need to act quickly to tighten credit. These policies should be considered in the broader context of channeling some of the commercial banks' surplus liquidity into productive investment, and the need to create financial instruments and improve financial intermediation. In this connection, the financial sector study being prepared by the World Bank is particularly welcome.

Developments in the external sector are encouraging. Both the external current account and the overall balance of payments are expected to show significant improvements over the previous year. The external current account deficit is estimated to narrow from 6.4 percent of GNP in 1988/89 to 4.4 percent in 1989/90 while the overall balance of payments is expected to register a surplus of SDR 10.7 million compared with a deficit of similar magnitude in 1988/89. In addition, the ratio of external debt to exports of goods and services is estimated to remain at the previous year's level. The Government's ongoing policies to increase exports and promote import substitution, and to increase direct foreign investment in the country, as well as the limit placed on nonconcessional borrowing, should help over time to improve Lesotho's external current account and the overall balance of payments, and strengthen external reserves. Nevertheless, the foreign exchange situation remains precarious in the short run, and policies should be directed toward raising foreign exchange reserves to a more comfortable level. To this end, the Government should continue its efforts to attract foreign investment but eschew nonconcessional external borrowing or other arrangements that would weaken the country's debt servicing capacity and adversely affect the balance of payments. In this context, the authorities should strengthen their efforts to improve the compilation and management of external debt.

The Lesotho authorities are taking steps to protect the vulnerable groups in the society from the transitional adverse impact of the structural adjustment program. In this undertaking, they will continue to need external assistance to finance projects which will alleviate the situation until Lesotho's fiscal situation improves sufficiently to enable the Government to assume the burden.

Lesotho's economic prospects are likely to improve in the medium term. This will depend, however, on economic and financial developments in the region (especially in South Africa), the implementation of the LHWP on schedule, and the Government's adherence to the policies in the PFP and the SAF-supported adjustment program.

The staff notes that the amendments to remove the exchange restrictions in the Trilateral Monetary Agreement have been ratified by the respective parties thus removing the exchange restrictions on the making of payments and transfers for current international transactions on the part of Lesotho that arose thereunder.

In view of the fragility of the balance of payments and the need to review developments under the SAF-supported program, it is proposed that the next Article IV consultation with Lesotho be held on the standard 12-month cycle.

Table 1. Lesotho: Benchmarks of Implementation of Structural Policy for the 1989/90 Program Under the Structural Adjustment Facility

	Measure	Program Time Frame	Present Status
1.	Implementation of grazing fees	By end-March 1990	Partially implemented
2.	Amendment of 1979 Land Act to legalize informal leasing arrangements	By end-March 1990	Delayed
3.	Reduction in lag in reporting of government revenue, expenditure, and financing to six weeks.	By end-September 1989	Delayed
4.	Establishment of parastatal monitoring system.	By end-March 1990	Delayed
5.	Completion of the compilation of an inventory of government employees	By end-December 1989	In progress; expected to be completed on time
6.	Form a Board of Trustees to oversee the investment of deposits in the Miners' Deferred Pay Fund	By end-March 1989	Legislation passed by March 1989; Board appointed subsequently

Table 2. Lesotho: Quantitative Benchmarks, 1989/90

	1989								March 1990	
	March		June		Sept.		Dec.			
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual
	(In millions of maloti)									
Credit ceilings										
Domestic credit	448.2	463.4	466.0	460.6	484.3	476.6	503.4	...	523.2	...
Net credit to Government	283.7	287.3	289.2	281.0	294.8	290.0	300.5	...	306.3	...
	(In millions of SDRs)									
External sector										
Contracting or guaranteeing of new short-, medium- or long-term nonconcessional external debt by the Government (in millions of SDRs) 1/	46.0	--	--	--	--	--	--	--	46.0	...
Net external reserves (in weeks of imports)	4.3	4.1	...	...	...	...	...	...	5.4	...
Central Government										
Overall budget deficit (in perent of GNP)	10.9	9.7	...	...	...	...	...	...	4.4	...

Source: Government of Lesotho.

1/ Excludes short-term trade financing.

Lesotho: Medium-Term Outlook

The medium-term outlook for the Lesotho economy depends principally on the implementation of appropriate economic policies and structural reforms, the execution as scheduled of the Lesotho Highlands Water Project (LHWP), and economic and political developments in the southern African subregion. In view of the adoption of an economic adjustment and restructuring program under the SAF arrangement and the authorities' intention to continue with a Fund-supported adjustment program (possibly under an ESAF), the baseline scenario, described in Section I below, is based on vigorous implementation of appropriate demand management and structural reforms in the medium term. The key assumptions underlying the baseline scenario are detailed in Section II. While the medium-term outlook is favorable, on the assumption of no adverse external shocks and timely execution of the LHWP, the Lesotho economy is highly susceptible to fluctuations in earnings of Basotho workers in the Republic of South Africa. Accordingly, Section III describes the impact of lower migrant workers' remittances on Lesotho's medium-term outlook.

I. The Baseline Scenario

1. Real sector

Real GDP growth is projected to decline to 5.5 percent in 1989/90 from 9.4 percent in 1988/89, owing in part to the poor agricultural harvest as a result of adverse weather conditions (Table I). Thereafter, real GDP is expected to grow at an average rate of about 5.6 percent per annum. This pattern of growth partly reflects the implementation pattern of investment associated with the LHWP. Subsectors such as manufacturing, construction, and wholesale and retail trade are all expected to perform well during the medium term. Real GNP is projected to grow somewhat more slowly than real GDP, reflecting an expected slower growth for workers' remittances. Gross national savings are expected to increase substantially relative to the historical rates, primarily because of LHWP transfers, 1/ but also because of an increase in public savings (including grants) by more than 8 percentage points of GNP during the period. Gross domestic investment as a share of GNP shows a somewhat uneven pattern during the period, again reflecting the implementation pattern of the LHWP. Exclusive of the LHWP, gross domestic investment is targeted to rise steadily as a share of GNP during the medium term. Through 1991/92, gross national savings rise more quickly than gross domestic investment, and the resource balance, which remains in deficit, is nevertheless projected to decline gradually (in absolute terms). The resource gap widens after 1991/92 partly on

---

1/ Financing of the water transfer component and the associated infrastructure is reflected as unrequited transfers, since the servicing of the relevant loans is not Lesotho's responsibility. This does not apply, however, to the hydroelectric component.

account of an increase in LHWP investment, which is associated with the hydroelectric component and hence financed by loans rather than transfers.

2. External sector

The medium-term projections for the balance of payments, shown in Table II, indicate that the current account deficit would be reduced through 1991/92 and then widen thereafter as a result of the imports associated with the hydroelectric component of the LHWP. Excluding the imports associated with the LHWP, the volume of imports is projected to increase at an annual average of 3.5 percent, owing to import substitution for consumer and intermediate goods. Export volume is projected to increase substantially, but at a lower pace than during the last three years. Workers' remittances are expected to be maintained in real terms with nominal wages increasing in line with the rate of inflation in the Republic of South Africa. 1/

As a result of an expected steady increase in unrequited transfers and long-term capital inflows, associated with the LHWP, overall balance of payments surpluses would be generated, but they would not be sufficient to build up net official reserves to the targeted 12.2 weeks' import cover at the end of the period. Under the assumption that the required additional financing would be met at concessional terms, the debt service obligations would remain below 5.3 percent of exports of goods and services.

3. Central Government

Customs revenue will remain the largest single source of government revenue, increasing to a peak of 16.9 percent of GNP in 1991/92 (Table III). The sharp rise projected for 1991/92 results from the expected rapid expansion of imports in maloti terms in 1989/90 as SACU revenues reflect the value of imports two years earlier. The major reason for the growth in imports in the projection period is the implementation of the LHWP. Customs receipts are projected to grow by a modest 2 percent in 1993/94, reflecting a slowdown in import growth in 1991/92, when LHWP imports are projected to fall (see Table II). These developments in SACU receipts determine the course of the overall deficit. Total revenue is projected to grow from 20.8 percent of GNP in 1989/90 to 26.0 percent in 1991/92 and 1992/93. Consequently, the overall deficit of 3.9 percent of GNP in 1989/90 is expected to become

---

1/ World inflation rate is projected to average about 3 percent annually. The loti-rand exchange rate is projected to depreciate to offset Lesotho's higher inflation rate vis-à-vis the rest of the world. Therefore, workers' remittances are projected to increase by approximately 3 percent in SDR terms.

an overall surplus of 0.8 percent by 1992/93. The slow growth of customs revenue results in an overall deficit of 1.8 percent of GNP in 1993/94, which narrows to 0.8 percent in 1994/95.

Other items of public finance are expected to behave fairly steadily. Other revenues will grow gradually in relation to GNP. Measures to restrain current expenditure to about the rate of inflation will reduce its share in GNP from 18.1 percent in 1989/90 to 16.6 percent in 1994/95. However, capital expenditure is projected to increase gradually from 8.6 percent of GNP in 1989/90 to 10.6 percent in 1994/95.

The substantial improvement in the overall budget deficit in combination with a steady level of net foreign financing will enable the Government to repay the banking system beginning in 1990/91.

4. Monetary sector

On the basis of an estimated income elasticity of money demand greater than unity, and the projected increase in real income during the medium term, income velocity of money is expected to decline gradually from approximately 4.0 to 3.6 throughout the medium term. Thus, money supply is projected to increase at an average annual rate of approximately 20.0 percent. In view of the projected steady increase in foreign assets throughout the period, part of the excess liquidity is assumed to be sterilized in order to restrain net domestic credit expansion. Aggregate net domestic credit is projected to increase at an average annual rate of 5.4 percent in relation to broad money at the beginning of each period. Whereas the Central Government will begin to make substantial repayments to the banking system, domestic credit to the private sector is projected to expand by an average of approximately 26.0 percent per annum during the period 1989/90-1994/95.

II. Medium-Term Projections - Main Assumptions by Sector

The main assumptions for each sector are outlined below.

1. Real sector

a. Aggregate real GDP projections are derived from sectoral projections. The direct contribution of the LHWP to value added in the construction sector has been taken into account, and attempts have been made to incorporate its indirect impact on value added in other sectors, such as the manufacturing and tertiary sectors, through its effect on overall aggregate demand. Relatively favorable weather conditions are assumed to prevail throughout the projection period.

b. Investment, exclusive of the LHWP, is targeted to rise from 24.8 percent of GNP in 1989/90 (about the same as in 1988/89) to 29.3 percent of GNP in 1994/95. Within this total, it is assumed that the share of private investment will increase somewhat between 1989/90 and 1994/95; including investment associated with the LHWP, total investment is expected to vary between 43.6 percent and 49.5 percent of GNP.

c. Government consumption is derived from the projections of recurrent expenditure in the fiscal sector. Private consumption is consistent with private sector savings of 14-15 percent of GNP.

d. In view of the openness of the economy of Lesotho, the retail price index is assumed to move in line with price developments in South Africa. The GDP deflator follows essentially the same pattern.

2. External sector

a. It is assumed that the loti will remain pegged at par to the South African rand, and that the rand/SDR exchange rate will remain constant in real terms at the level prevailing at end-August 1989.

b. Exports are assumed to grow in real terms by 11 percent in 1990/91, 10 percent in 1991/92, and 9 percent per annum thereafter over the projection period.

c. Imports are projected to grow in real terms at an annual average of 5.5 percent; imports of consumer/intermediate goods, capital goods (exclusive of LHWP investment), and LHWP imports are projected separately.

d. Workers' remittances are projected to increase in line with projected trends in wages and numbers of Basotho miners employed in South Africa. Wages are linked directly to expected inflation in South Africa (i.e., to remain constant in real terms) and the numbers of Basotho miners employed in South Africa are assumed to remain unchanged.

e. Official transfers comprise official grants; the Southern African Customs Union (SACU) nonduty receipts, which are calculated as total SACU receipts less duty receipts, imputed as the "all-duty rate" multiplied by the dutiable base; and LHWP transfers. 1/

f. Projections of long-term official capital disbursements are linked to government capital expenditure. Long-term capital inflows to parastatals are assumed to rise slowly over the medium term. Amortization payments are calculated on commitments entered into prior to March 1989 and commitments entered into after this date are assumed to carry grace periods of at least five years and therefore do not lead to any repayment obligations over the projection period.

1/ Financing of the water transfer component and the associated infrastructure of the LHWP is shown as unrequited transfers since the servicing of the relevant loans is not Lesotho's responsibility. This does not apply, however, to the hydroelectric power component.

3. Central Government

a. Customs revenue is based on the formula in the SACU agreement, which essentially links any year's receipts to Lesotho's imports two years earlier.

b. Income tax revenue is assumed to rise in line with GDP.

c. Sales tax, trade licenses, petrol tax, stamp duties, and property income are assumed to rise in line with GNP.

d. Revenue for 1989/90 includes the effect of the measures to be implemented in that fiscal year. These are (i) the imposition of sales tax on public utility services (electricity and telephone); (ii) the increases in the general sales tax rate from 12 to 13 percent and in the rates on luxury cars from 15 percent to 25 percent, on wines and spirits from 20 percent to 25 percent, and on beer from 30 percent to 35 percent.

e. Grants are estimated on a project-by-project basis for 1989/90 and thereafter are assumed to decline slowly as a proportion of capital expenditure.

f. The growth of wages and salaries exceeds that of nominal GNP by 4.0 percent in 1991/92 to allow for salary increases and recruitment of specialized personnel. The growth rate slows thereafter, and from 1993/94 onward equals the growth rate of nominal GNP. Expenditure on other goods and services is expected to grow slowly in real terms. Interest payments on domestic debt are projected to decline in line with the decrease in domestic bank borrowing, while interest payments on foreign debt are derived from the balance of payments debt service obligations.

g. The ratio of capital expenditure to GNP is projected to grow steadily over the period.

h. Domestic nonbank financing is based on the availability of savings in the civil service compulsory savings scheme. Bank financing is a residual.

4. Monetary sector

a. Projections of broad money are based on an estimated demand for money function, with an income elasticity of 1.14 in 1989/90.

b. The change in net foreign assets of the banking system is obtained from the balance of payments, net foreign assets of commercial banks being assumed to remain constant.

c. The change in net credit to Government is derived from the fiscal accounts, and it is envisaged that government repayments to the banking system shall commence by 1990/91.

d. Other items (net) are assumed to fluctuate to reflect changes in monetary policy to sterilize excess liquidity.

e. The change in domestic credit to the nongovernment sector is projected in line with expected growth in private expenditures.

III. Sensitivity Analysis

A sensitivity analysis was undertaken in which it is assumed that migrant workers' remittances remain constant in nominal terms throughout the projection period, rather than increasing at approximately the South African inflation rate. If this shock were to take place by means of a reduction in the number of mine workers, there would 40 percent fewer Basotho mine workers in South Africa at the end of the projection period under the alternative scenario than under the baseline scenario. On account of the reduction in aggregate demand, the average level of real GDP growth falls from 5.6 percent to 3 percent under the alternative scenario. The financing gap is calculated on the assumption that the same ratio of reserves to imports is maintained as in the baseline scenario. The level of imports is lower because of reduced income. Nevertheless, a large and growing financing gap results.

Only the direct impact of this shock is analyzed and no adjustment effort is taken into account. Thus, the analysis is meant to demonstrate the vulnerability of Lesotho's external position. If such a shock were to occur, it is clear that strong adjustment measures would be required. The results of the sensitivity analysis are shown in Table V.

Table 1. Lesotho: Medium-Term Projections
Baseline Scenario--Real Sector Projections, 1988/89-1994/95

Fiscal Year, April/March	1988/89 Est.	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
		Projections					
			(In millions of maloti)				
Gross national product	1,872.9	2,241.5	2,642.6	3,115.5	3,691.1	4,308.1	[illegible]
Net factor income from abroad	858.7	1,009.5	1,160.8	1,341.4	1,532.5	[illegible]	1,945.8
Gross Domestic product	1,014.2	1,232.0	1,481.8	[illegible]	2,158.5	2,581.4	[illegible]
Consumption	1,646.3	1,960.0	2,333.9	2,769.2	[illegible]	[illegible]	[illegible]
Government consumption	228.9	228.3	266.6	322.8	389.1	[illegible]	[illegible]
Private consumption	1,417.4	1,731.7	2,067.2	2,446.4	2,952.0	[illegible]	[illegible]
Investment	569.7	996.3	1,151.0	1,268.2	[illegible]	[illegible]	[illegible]
Gross fixed capital formation	567.3	993.6	1,147.9	1,264.7	1,687.3	[illegible]	2,441.1
Government	134.3	128.8	146.6	200.5	245.7	[illegible]	[illegible]
Private	329.6	425.1	530.3	625.7	766.6	[illegible]	[illegible]
LHWP	103.5	439.7	471.0	438.5	675.1	[illegible]	[illegible]
Change in stocks	2.4	2.7	3.3	3.5	4.0	5.5	[illegible]
Net exports	-1,201.7	-1,724.4	-2,003.0	-2,263.3	-2,773.8	[illegible]	[illegible]
Exports of merchandise	165.4	202.7	256.6	323.3	400.5	[illegible]	[illegible]
Imports of merchandise and of nonfactor services, net	1,367.1	1,927.1	2,259.1	2,586.7	3,174.4	[illegible]	[illegible]
			(In percent of GNP, unless otherwise indicated)				
Memorandum items:							
Gross national savings 1/	24.0	39.9	[illegible]	[illegible]	41.7	[illegible]	[illegible]
Private savings	17.7	16.0	14.2	[illegible]	15.2	14.5	14.2
Public savings 2/	1.1	4.7	6.8	[illegible]	10.6	8.5	[illegible]
LHWP transfers	5.2	19.1	17.7	14.0	16.9	[illegible]	17.1
Gross domestic investment	30.4	44.4	43.6	40.7	45.8	49.5	[illegible]
Private gross fixed capital formation	17.6	19.0	20.1	20.1	[illegible]	21.5	[illegible]
Public investment	7.2	5.7	5.5	6.4	[illegible]	[illegible]	7.1
LHWP investment	5.5	19.6	17.8	13.1	18.3	21.1	[illegible]
Change in stocks	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Resource balance = foreign savings	-6.3	4.6	-4.8	[illegible]	-4.1	[illegible]	[illegible]
Real GNP percent change	9.4	5.5	5.2	[illegible]	[illegible]	[illegible]	5.1
Real GDP percent change	5.6	4.5	3.1	2.8	[illegible]	[illegible]	3.1
GDP deflator percent change	17.9	15.1	14.3	14.7	13.6	[illegible]	[illegible]
Retail price index percent change	12.3	14.2	14.4	14.8	13.6	[illegible]	[illegible]

Source: Staff estimates.

1/ Including unrequited transfers.
2/ Including grants.

Table 11. Lesotho: Medium-term Projections
Baseline Scenario -- External Sector Projections 1988/89-1994/95

Fiscal Year, April/March	1988/89 Prel.	1989/90 Est.	1990/91	1991/92	1992/93 Projections	1993/94	1994/95
			(In millions of SDRs)				
Current account	-37.8	-28.5	-34.7	-18.9	-34.3	-80.4	-77.2
Goods and services balance	-107.4	-205.8	-232.7	-231.2	-283.5	-332.6	-352.6
Exports	51.8	58.7	70.9	81.1	91.5	103.3	117.0
Imports, f.o.b.	-405.2	-533.3	-595.7	-618.3	-692.9	-764.4	-807.9
Of which: LHWP	(-26.9)	(-107.2)	(-108.1)	(-91.3)	(-128.0)	(-158.6)	(-159.6)
Workers' remittances	274.6	299.7	325.4	339.0	350.7	362.7	377.2
Other services (net)	-23.0	-23.7	-28.7	-30.6	-32.5	-34.5	-40.6
Investment income (net)	-5.6	-7.2	-4.5	-2.4	-0.5	0.4	1.4
Unrequited transfers	69.6	177.3	198.0	212.3	249.3	252.2	275.4
Official	34.7	45.6	65.5	99.8	103.4	99.2	106.3
Private	2.4	2.6	2.8	3.0	3.1	3.2	3.3
LHWP	32.4	129.1	129.6	109.6	142.8	159.9	165.8
Long-term capital (net)	28.2	35.0	31.3	33.8	53.2	78.5	77.0
Official (net)	18.8	24.9	16.9	15.1	19.6	20.3	18.7
Private foreign investment	9.4	10.1	13.9	18.2	22.1	27.0	33.1
Other official 1/	--	--	--	--	--	--	--
LHWP	--	--	0.6	0.5	11.5	31.2	25.2
Short-term capital (net) 2/	-0.9	4.2	11.9	5.8	7.7	29.1	0.2
Overall surplus/deficit	-10.7	10.7	8.5	20.8	26.7	27.2	--
SAF purchases	3.0	4.5	3.0	--	--	--	--
Change in reserves (increase -)	7.7	-23.3	-28.2	-33.2	-42.4	-65.4	-27.5
Financing need	--	8.1	16.7	12.4	15.7	38.2	27.5
Memorandum items:		(In percent of GNP, unless otherwise indicated)					
Current account	-6.4	-4.4	-4.8	-2.4	-4.1	-8.9	-7.9
Net official reserves (weeks of imports)	4.1	5.4	6.2	7.9	9.9	11.6	12.2
Conversion factor (SDR/loti)	0.3132	0.2897	0.2764	0.2509	0.2285	0.2103	0.1946
Import volume (percent change)	2.9	6.6	4.2	3.7	3.6	3.7	3.0
Export volume	40.0	7.5	11.0	10.0	9.0	9.0	9.0
Debt service ratio (% of goods and services)	5.0	5.0	4.0	4.2	4.1	4.4	5.2

Sources: Central Bank of Lesotho; and staff estimates.

1/ Subscriptions to international institutions by the Lesotho Government.
2/ Including valuation adjustments, and errors and omissions.

Table III. Lesotho: Medium-Term Projections
Baseline Scenario--Central Government Projections, 1988/89-1994/95

Fiscal Year, April/March	1988/89 Est.	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
		Projections					
			(In millions of maloti)				
Revenue and grants	404.0	510.6	633.4	857.2	1012.3	1091.3	1315.0
Revenue	368.5	466.0	596.0	809.7	958.7	1031.9	1249.7
Customs revenue	193.2	263.6	264.4	354.7	525.2	619.5	633.4
Other revenue	175.3	202.4	241.3	284.5	339.3	398.5	464.0
Grants	35.4	44.6	37.4	47.5	53.5	59.4	65.3
Expenditure and net lending	584.9	597.9	673.4	832.4	989.3	1167.1	1,357.0
Current expenditure	384.0	372.3	405.2	454.0	532.4	621.8	724.1
Wages and salaries	170.0	65.4	57.1	52.0	42.7	35.5	32.1
Interest	43.4	38.1	48.6	52.9	49.0	34.0	12.6
Other	170.6	163.0	190.7	223.8	260.6	307.6	345.6
Capital expenditure and net lending	200.9	192.7	219.4	300.0	367.5	443.0	529.7
Overall deficit (-)	-181.1	-87.3	-39.9	24.7	22.9	-75.8	-42.0
Financing	181.1	87.3	39.9	-24.7	-22.9	75.8	42.0
Foreign net	71.2	85.1	70.2	57.5	82.0	91.9	91.1
Domestic	109.9	2.2	-30.3	-82.2	-104.9	-16.1	-49.1
Bank	91.9	14.5	-42.3	-94.2	-80.9	-28.1	-61.1
Nonbank	17.8	-12.3	12.0	12.0	-24.0	12.0	12.0
			(In percent of GNP)				
Memorandum items:							
Overall deficit	-9.7	-3.9	-1.5	0.8	0.6	-1.9	-0.8
(excluding customs revenue)	-22.0	-19.7	-18.3	-16.0	-15.5	-15.6	-16.6
Revenue and grants	21.6	22.8	24.0	27.5	27.4	25.3	26.3
Revenue	19.7	20.8	22.6	26.0	26.0	24.0	25.0
Customs revenue	10.3	11.8	13.4	16.9	16.8	14.7	15.7
Other revenue	9.4	9.0	9.1	9.1	9.2	9.3	9.3
Expenditure and net lending	31.2	26.7	25.5	26.7	26.8	27.1	27.2
Current expenditure	20.5	18.1	17.2	17.1	16.8	16.8	16.6
Other goods and services	9.1	7.3	7.2	7.2	7.1	7.1	6.9
Capital expenditure and net lending	10.7	8.6	8.3	9.6	10.0	10.3	10.6
Own savings 1/	-0.8	2.7	5.4	8.9	9.1	7.1	8.5

Source: Staff estimates.

1/ Revenue less current expenditure.

Table IV. Lesotho: Medium-Term Projections
Financial Sector Projections, 1988/89-1994/95

Fiscal Year April/March	1988/89 Est.	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
		Projections					
	(In millions of maloti)						
Changes in							
Net foreign assets	-16.4	56.6	58.9	109.0	151.7	172.6	140.3
Net official assets	-12.5	56.6	58.9	109.0	151.7	172.6	140.3
Commercial bank assets (net)	-3.9	(--)	(--)	(--)	(--)	(--)	(--)
Domestic credit	139.0	60.3	26.5	-4.1	35.9	91.9	91.3
Government (net)	88.1	14.5	-42.3	-94.2	-80.9	-28.1	-61.1
Rest of economy (net)	50.8	45.8	68.8	90.1	116.8	120.0	152.3
Money and quasi-money	92.8	116.9	113.5	163.9	187.6	204.3	231.5
Other items (net)	110.3	--	-28.1	-59.0	--	60.2	--
	(Change as a percentage of opening broad money)						
Memorandum items:							
Changes in:							
Money and quasi-money	21.9	22.6	17.9	22.0	20.6	18.6	17.8
Net foreign assets	-3.8	11.0	9.3	14.6	16.7	15.7	10.8
Domestic credit	32.8	11.7	4.2	-0.5	3.9	8.4	7.0
Government	20.8	2.8	-6.7	-12.6	-8.9	-2.6	-4.7
Rest of economy	12.0	8.9	10.7	12.1	12.8	10.9	11.7
Other items (net)	26.1	--	-4.4	-7.9	--	5.5	--

Source: Staff estimates.

Table Va. Lesotho: Medium-Term Projections
Baseline Scenario--Summary, 1988/89-1994/95

Fiscal year, April/March	1988/89 Est.	1989/90 Projections	1990/91	1991/92	1992/93	1993/94	1994/95
	(In millions of SDRs, unless otherwise indicated)						
Current account	-37.8	-28.5	-34.7	-18.9	-34.3	-80.4	-77.2
Overall balance	-10.7	-10.7	8.5	20.8	26.7	26.7	27.2
Net official reserves (in weeks of imports)	4.1	5.4	6.2	7.9	9.9	11.6	12.2
Financing gap	--	8.1	16.7	12.4	15.7	38.2	27.5
	(In percent of GNP, unless otherwise indicated)						
Overall budget deficit	-9.7	-3.9	-1.5	0.8	0.6	-1.8	-0.8
Total revenues and grants	21.6	22.8	24.0	27.5	27.4	25.3	26.3
Of which: customs revenue	(10.3)	(11.8)	(13.4)	(16.9)	(16.8)	(14.7)	(15.7)
Total expenditure and net lending	31.2	26.7	25.5	26.7	26.8	27.1	27.2
	(Annual percentage change)						
Real GNP	5.6	4.5	3.1	2.8	4.3	3.8	3.1

Source: Staff estimates.

Table Vb. Lesotho: Medium-Term Projections
Sensitivity Analysis, 1988/89-1994/95 1/

Fiscal year, April/March	1988/89 Est.	1989/90 Projections	1990/91	1991/92	1992/93	1993/94	1994/95
	(In millions of SDRs, unless otherwise indicated)						
Current account	-37.8	-28.5	-34.7	-51.0	-72.8	-125.8	-143.5
Overall balance	-10.7	10.7	8.5	-17.2	-28.0	-64.8	-94.4
Net official reserves (in weeks of imports)	4.1	5.4	6.2	7.9	9.9	11.6	12.2
Financing gap	--	8.1	16.7	43.0	56.6	93.0	115.0
	(In percent of GNP, unless otherwise indicated)						
Overall budget deficit	-9.7	-3.9	-1.5	0.5	0.7	-2.3	-2.5
Total revenue and grants	21.6	22.8	24.0	28.9	30.3	28.5	29.5
Of which: customs revenue	(10.3)	(11.8)	(13.4)	(18.0)	(19.3)	(17.4)	(18.3)
Total expenditure and net lending	31.2	26.7	25.5	28.4	29.5	30.9	32.0
	(Annual percentage change)						
Real GNP	5.6	4.5	3.1	-3.8	-1.9	-2.2	-1.7

Source: Staff estimates.

1/ No growth in workers' remittances is assumed.

Lesotho--Relations with the Fund
(As of November 30, 1989)

I. Membership Status

a.	Date of membership	July 25, 1968
b.	Status:	Article XIV

A. Financial Relations

II. *General Department*

a.	Quota:	SDR 15.1 million
b.	Fund holdings of Lesotho maloti:	SDR 13.81 million (91.51 percent of quota)
c.	Use of Fund credit	--
	structural adjustment facility	SDR 7.55 million (50.00 percent of quota)
d.	Reserve tranche position:	SDR 1.3 million
e.	Current operational budget:	--
f.	Lending to the Fund:	None

III. Current and Previous Arrangements and Special Facilities

a.	Current arrangement under the structural adjustment facility:	SDR 10.57 million (70 percent of quota)
b.	Stand-by and extended arrangements during last ten years:	None

IV. SDR Department

a.	Net cumulative allocation:	SDR 3.74 million
b.	Holdings:	SDR 0.74 million (19.79 percent of net cumulative allocation)
c.	Current designation plan:	--

V. Administered Accounts

a.	*Trust fund loans:*	
	1. Disbursed	SDR 4.89 million
	2. Outstanding	SDR 0.17 million
b.	SFF Subsidy Account:	--

Lesotho--Relations with the Fund (concluded)
(As of November 30, 1989)

VI. Financial Obligations to the Fund (in SDRs) (provisional)

	November 30, 1989 Total principal outstanding	November 30, 1989 Overdue financial obligations	Principal and interest due 1/ 1989	1990	1991	1992
Repurchases		None	--	--	--	--
Trust Fund loans	170,879		--	152,000	18,879	--
SAF loans	7,550,000		--	--	--	--
Total principal	7,720,879		--	152,000	18,879	--
Total charges	--		19,682	303,614	303,154	303,253
Net total	7,720,879		19,682	455,614	322,033	303,253

Source: Treasurer's Department.

1/ Amounts are not accrued amounts, but are estimated amounts due to be paid.

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

The currency of Lesotho, the loti (plural maloti), is pegged at par to the South African rand at a rate of M 1 = R 1.

VIII. Article IV Consultation

The 1988 Article IV consultation discussions with Lesotho were held in Maseru during the period October 30-November 15, 1988; and the consultation was concluded on February 17, 1989. On June 29, 1989 the policy framework paper (PFP) was discussed by the Executive Board and the request for arrangements under the Fund's structural adjustment facility (SAF) was approved.

Lesotho is on the standard 12-month cycle for Article IV consultations.

IX. Technical Assistance

(a) CBD: CBD is currently providing the Central Bank of Lesotho with an Advisor to the Governor and a General Manager, and a banking supervisor.

(b) FAD: A fiscal advisor to the Ministry of Finance is expected to assume duty in December.

X. Resident Representative/Advisor: None

Lesotho - Relations with the World Bank Group

As of October 31, 1989, IDA had approved 19 credits amounting to US$158.00 million (original principal), of which US$94.1 million had been disbursed, US$59.0 million remained undisbursed, and US$94.0 million in borrower's obligations 1/ were outstanding. These credits were for education, road, agricultural, and rural development; land management and conservation, urban development, rural water supply, and health and population projects; and supporting the Lesotho National Development Corporation and the Lesotho Highlands Water Engineering Project.

The following table summarizes the World Bank's lending operations as of October 31, 1989:

Sector	Fully disbursed 2/	Disbursing Credits Disbursed	Disbursing Credits Undisbursed	Sub-total	Total
		(In millions of U.S. dollars)			
Education	21.4	2.5	9.8	12.3	33.7
Transportation	17.3	13.2	3.8	17.0	34.3
Agricultural/Land management and conservation	9.5	0.5	14.5	15.0	24.5
Industry	5.8	--	--	--	5.8
Water supply	5.0	--	--	--	5.0
Urban development	5.5	2.4	16.8	19.2	24.7
Health and population	--	2.5	12.1	14.6	14.6
Highlands Water	--	8.5	2.0	10.5	10.5
Total disbursed and undisbursed	64.5	29.6	59.0	88.6	153.1 3/
Total borrower's obligation 2/	63.0	31.0	--	31.0	94.0

Source: IBRD.

1/ Total disbursements less repayments adjusted for exchange rate changes.
2/ Original principal less cancellations.
3/ Reflects adjustment for exchange rate movements.

Lesotho - Statistical Issues

1. Outstanding Statistical Issues

a. Real sector

The recently revised version of the CPI (April 1989=100) has been used to update the Bureau's data base for publication in IFS.

b. Government Finance

Annual data published in IFS correspond to the data provided for the 1988 GFS Yearbook (GFSY). No monthly or quarterly data are published in IFS. The 1988 GFSY includes data for consolidated central government through 1985. Revised figures for 1983-85 and data for 1986 were received for publication in the 1989 GFS Yearbook.

c. Balance of payments

In July 1988, the Bureau made a proposal for revising the recording in the balance of payments of transactions arising from the Southern African Customs Union Agreement (SACU). The authorities have indicated that they would inform the Bureau shortly of their reactions to the Bureau's proposal for revising the recording of SACU transactions in the balance of payments. However, before formulating their views, they wished to meet with counterparts in the central banks of Botswana, Swaziland, and the Republic of South Africa.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Lesotho in the December 1989 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Lesotho, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in December 1989 IFS
Real sector	- National Accounts	AA 1988
	Prices: CPI	April 1989
	Production	n.a.
	Employment	n.a.
	Earnings	n.a.
Government Finance	- Deficit/Surplus	1985 1/
	- Financing	1985 1/
	- Debt	1984
Monetary Accounts	- Monetary Authorities	Sept. 1989
	- Deposit Money Banks	Sept. 1989
	- Other Banking Institutions	Sept. 1989
Interest Rates	- Discount Rate	Sept. 1989
	- Bank Deposit/Lending Rates	Sept. 1989
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Value	Q4 1988
	Prices	n.a.
	- Balance of Payments:	Q4 88
	- International Reserves	Oct. 1989
	- Exchange Rates	Oct. 1989

3. Technical Assistance Missions in Statistics (1986-Present)

Subject	Staff member	Date
Government Finance Statistics	Mr. E. Matayoshi	05/25-6/09/87

1/ Preliminary data.

Lesotho - Social and Demographic Indicators

Area	Population (1987)	Density (1986)
30,444 sq. km.	1.629 million Rate of growth: 2.6 percent per annum	69 per sq. km. of agricultural land

Population characteristics (1988)

Life expectancy at birth	51.0
Infant mortality (per thousand)	110.0
Child death rate (per thousand)	14.0
Crude death rate (per thousand)	13.8

Health

Population per physician (1984)	18,600
Population per nurse (1975)	3,900

GDP per capita (1987)

SDR 286

Income distribution (1986)

Percentage of population with low incomes 1/	
Urban Maseru	33.8
Other urban	48.6
Rural	71.0

Distribution of land (1985)

Percentage of total land area used for agricultural purposes	75.6

Access to safe water (1980)

Percentage of population:	
Urban	37.0
Rural	14.0

Nutrition (1985)

Daily calorie supply per capita (1988)	2.2 kcal
Daily protein intake per capita	66.0 grams

Education (percent)

Adult literacy rate (1982)	53
Primary school enrollment (1985)	120
Secondary school enrollment (1988)	26
Higher education (1988)	2

Labor force (1987)

Total (millions)	0.7
Female (percent)	44.0

Sources: World Bank, Social Indicators of Development, 1988; World Development Report, 1989; and Household Budget Survey, 1986/87.

1/ At or below M 86 per month per present consumption unit. A one-person household is composed of one consumption unit. Each additional adult is counted as 0.7 consumption unit and each child is counted as 0.5 consumption unit.