Lesotho: Selected Economic Indicators, 2002/03-2006/07 [1]

	2002/03	2003/04	2004/05	2005/06 Est.	2006/07 Proj.
	(Annual percent change, unless otherwise indicated)				
Real Economy					
Real GDP growth (percent)	3.6	3.2	2.6	1.3	2.5
Nominal GDP (millions of maloti)	7,541	8,249	8,930	9,405	10,141
Inflation (percent)	12.2	6.4	4.7	3.6	4.5
	(Percent of GDP)				
National Accounts					
Gross domestic investment	43.0	43.9	34.4	28.1	30.0
Gross national savings	25.0	33.1	31.3	26.2	25.3
Central Government					
Revenue and grants	44.2	43.9	51.0	48.8	55.6
Revenue	40.2	41.7	48.4	47.7	52.8
Total grants	3.9	2.2	2.5	1.0	2.8
Total expenditure and net lending	48.5	43.1	42.1	44.8	54.8
Overall balance (excluding grants)	-8.3	-1.4	6.3	2.9	-2.1
Overall balance (including grants)	-4.4	0.8	8.8	3.9	0.8
	(Annual percent change, unless otherwise indicated)				
Money and Credit					
Net domestic assets [2]	73.4	16.5	-27.9	-0.2	-8.4
Money and quasi-money (M2)	2.7	5.3	6.2	4.7	6.7
	(Percent of GDP)				
External Sector					
Current account balance (excluding grants)	-34.6	-25.7	-21.9	-22.3	-28.4
Current account balance (including grants)	-18.0	-10.8	-3.0	-1.8	-4.7
External debt [3]	81.8	61.4	49.8	47.2	47.1
External debt-service ratio [4]	11.8	9.2	7.3	10.9	1.9
Gross official reserves (millions of US dollars)	408.4	436.9	507.7	564.0	626.2
Gross official reserves (months of imports)	4.3	3.7	4.4	4.9	4.8

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

[1] Fiscal year beginning in April.
[2] Change in percent of M2 at the beginning of the period.
[3] Government only. The appreciation of the loti significantly affected the debt-to-GDP ratio in 2003/04.
[4] In percent of exports of goods and services.

Statement by Peter Gakunu, Executive Director for Kingdom of Lesotho
Leonia 'Moi Lephoto, Advisor to Executive Director
October 6, 2006

1. Introduction

On behalf of our Lesotho authorities we would like to thank staff for the constructive dialogue during the last Article IV consultations and the board and management for their continued support. The authorities appreciate the advice proffered by the fund and are in general agreement with the thrust of the staff report. As indicated in the staff report, the authorities' commitment to prudent macroeconomic management has contributed to maintaining macroeconomic stability. However, high and sustained economic growth necessary for meaningful poverty reduction has remained elusive. Lesotho has been experiencing several exogenous shocks in the last few years which have made macroeconomic management more challenging: the lapsing last year of the Multifibre Agreement resulted in closures of textile factories and increased unemployment; there is concern about the prospects of erosion of preferences under AGOA, which may also worsen the performance of the textile industries; ongoing massive retrenchments of mine workers by South African mines has cut-off the main source of remittances from abroad; and, there are uncertainties surrounding the future of the government's main source of revenue, SACU receipts. These developments have impacted adversely on the prospects for growth and have compounded poverty. In addition, Lesotho's debt, especially multilateral, remains high, yet the country does not qualify for debt relief, thus depriving the country of the necessary fiscal space for achieving the MDGs. Going forward the authorities are dedicated to implementing the policies and reforms aimed at preserving stability and promoting sustainable growth and poverty reduction.

2. Recent Economic Developments

Lesotho's economic performance continued to show sustained improvements towards macroeconomic stability. The fiscal balance registered a surplus for the third consecutive year. At 3.9 percent of GDP during 2005/06, the fiscal surplus reflected a significant growth in total revenue and grants as a result of higher than expected Southern African Customs Union (SACU) revenues, as well as the lower than budgeted expenditure. The surplus enabled Government to repay more of its non-concessional debt, thus further improving the country's external debt position to 53.1 percent of GDP. This further demonstrates the government's commitment to prudent and sustainable fiscal policies.

The external position remained favorable in 2005, with a build-up in gross official reserves to about 5.8 months of import coverage. The growth in reserves was facilitated by a significant improvement in the current account balance from a deficit of 2.9 per cent of GDP in 2004 to a surplus of 1.2 per cent in 2005 as a result of higher SACU receipts.

In line with regional developments and despite the higher oil import prices inflationary pressures remained subdued in 2005. The CPI based inflation rate declined from an average of 5.1 per cent registered in 2004 to 3.5 per cent.

Economic growth, however, declined further from 3.1 per cent in 2004 to 1.2 per cent in 2005, largely as a result of a contraction in manufacturing output. Performance of the manufacturing sector has been adversely affected by removal of textile quotas and the resultant increase in competition, for the US market, from low-cost producers such as China, and the relative strength of the loti against the US dollar. The unemployment situation worsened in 2005 with manufacturing sector employment declining significantly due to the closure of some textile and clothing firms and the continued fall in Basotho mineworker employment by the South African mines.

3. Macroeconomic outlook and policies

Macroeconomic prospects for Lesotho are clouded by the current deterioration in output as a result of external shocks as well as the uncertainty surrounding future SACU revenues. The deterioration in economic growth has worsened the unemployment problem and threatens to worsen the already wide spread poverty levels. The high levels of HIV prevalence in the country could also affect labor productivity negatively thus exacerbating the growth problem and making it even more difficult for the country to reach the MDGs. The uncertainty of SACU revenue poses a challenge to fiscal management as these receipts continue to account for the bulk of government revenue.

The continued retrenchment of the Basotho workers from the South African mines also has negative effects, reducing remittances and affecting the balance of payments, as well as increasing unemployment and exacerbating poverty.

Fiscal policy

Lesotho's membership of the CMA shifts the burden of macroeconomic management to fiscal policy. Therefore, the importance of prudent fiscal policy cannot be overstated. The core objective of Lesotho's fiscal strategy is to maintain fiscal sustainability. Throughout most of the 1990s and early 2000s the authorities have been successful in achieving this objective with fiscal surpluses being consistently realized. The authorities continued to exercise prudence in managing these surpluses and used them to retire some of the country's commercial and domestic debt, thereby improving debt sustainability and reducing the fiscal burden of future interest payments. The surpluses are expected to continue up to 2007/08 due to higher SACU revenue but fiscal prospects may deteriorate thereafter, as these receipts begin to taper off. The authorities are conscious not to use the additional resources from SACU in a manner that will create future expenditures. They will continue to use them to settle some of the public debt and for critical once off expenditures. These will include the expenditure on the repair of the physical infrastructure that was destroyed by the heavier than normal rains that were experienced earlier this year.

The authorities are aware of the challenges that the potential fall in future SACU revenue poses to maintaining the current policy stance and are committed to undertake expenditure reforms to dampen its impact. They plan to improve the quality of public expenditure by targeting high priority activities as identified in the poverty reduction strategy. The authorities appreciate the potential fiscal impact of the pension and medical reform for civil servants. They are currently studying the options available for their execution and undertake to limit their costs to the minimum possible. These reforms are necessary as the pension reform aims to replace the current unfunded defined benefit scheme with a funded defined benefit or defined contribution scheme. The medical benefit scheme is also necessary to keep up with regional labor market developments and alleviate the problem of brain drain. Measures to improve the public financial management are also being undertaken that include, widening the use of the medium term fiscal framework, improving service delivery at local levels and introduction of the integrated financial management information system.

On the revenue front, the authorities continue to be committed to undertake domestic revenues enhancing measures through continuous improvements in revenue administration by the Lesotho Revenue Authority (LRA).

Monetary policy and Financial sector issues

The conduct of monetary policy in Lesotho is limited by the country's membership in the CMA, which provides for the loti to be pegged at par to the South African rand and for free movement of capital within the CMA. In this regard, monetary policy in Lesotho aims at maintaining a strong external reserve position that is adequate to support the exchange rate peg as well as to meet the country's external obligations. The central bank currently holds a level of reserves that is more than adequate to cover these objectives.

The banking sector in Lesotho continues to be sound and well capitalized. The authorities continue to implement measures geared towards improving prudential supervision and to facilitate the development of the banking sector as well as the non-bank financial sector. However, the banking sectors' reluctance to extend credit to the private sector remains a major concern for the authorities. To address this issue the Central Bank has embarked on a number of reforms to improve financial intermediation and make conditions more conducive for credit extension. These include the review of the laws that affect the financial sector, which was initiated in 2005 and is expected to be completed in 2006. The review is expected to harmonize and improve the legal and regulatory framework for the financial sector. The Financial Institutions Act (FIA) is also being revised to accommodate the implementation of the tiered banking system. The authorities have also developed an Anti Money Laundering bill which is expected to be enacted into law before the end of 2006.