Executive Summary

Background

Lesotho made further progress toward macroeconomic stability in 2006. After sluggish economic activity in earlier years, real economic growth surged, reflecting accelerated mining production and the recovery of the textile sector. High Southern African Customs Union (SACU) revenue in 2006 contributed to a fiscal surplus, improved external accounts, and a significant increase in international reserves. Inflation has increased in the last year, driven by rising food and energy prices. The outlook is positive, but subject to risks arising mostly from the external environment.

Key Policy Issues

Maintaining a strong medium-term fiscal position will be key for macroeconomic stability and growth, given the fixed exchange rate and Lesotho's vulnerability to external shocks. Staff recommended prudent use of SACU revenues and urged the authorities to resist pressures for higher public expenditure across the board. The authorities concurred with the staff that the medium-term outlook is clouded by uncertainty about revenue sharing in SACU, global trade in textiles, and remittances from workers in South Africa. A slowdown in the U.S. poses short-term risks.

Sustained, rapid and broad-based growth is needed to reduce widespread poverty. Staff encouraged the authorities to implement vigorously their agenda to promote private sector development to unleash growth potential. Important measures include fostering financial intermediation, improving the legal and judicial environment, and improving infrastructure.

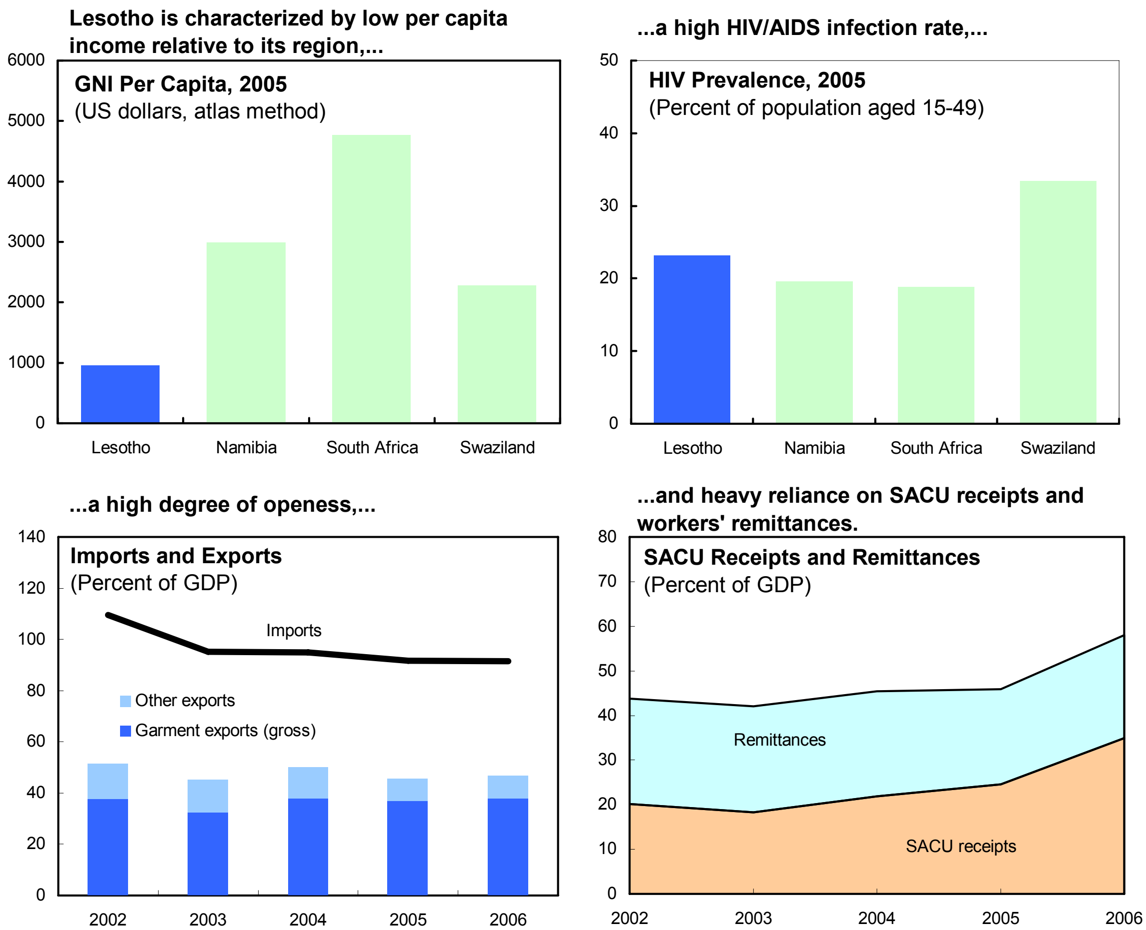
Macroeconomic policies are consistent with external and domestic stability, and there is no immediate threat to external stability.

Unlicensed deposit-taking entities pose risks to economic and social stability; the authorities expressed their intention to address this issue. The rapid growth of insufficiently regulated credit cooperatives gives cause for some concern; the authorities intend to strengthen the regulatory and supervisory framework of the financial sector.

I. Background

1. **Lesotho is a small, low-income country, with limited natural resources and a narrow production and export base, and with close economic linkages to South Africa.** A majority of the population lives on subsistence agriculture. The garment sector, which relies on imported inputs, plays a critical role in employment, output, and exports. With Namibia, Swaziland, and South Africa, Lesotho is a member of the Common Monetary Area (CMA). The Lesotho loti is pegged at par to the South African rand, which is also legal tender in Lesotho. CMA members and Botswana constitute the SACU. Economic growth has been inconsistent, poverty has declined from 67 percent of households in 1994/95 to a still high 57 percent in 2002/03, and HIV/AIDS prevalence is high.

Figure 1. Income, HIV/AIDS, and External Dependence



Sources: World Bank, *World Development Indicators*, for GNI per capita; UNAIDS, 2006, *2006 Report on the Global AIDS Epidemic* (Geneva: UNAIDS), for HIV/AIDS prevalence; national authorities, and IMF staff estimates.

II. Recent Economic Developments

2. **Macroeconomic performance in 2006 was strong.** After growing sluggishly in earlier years, real GDP rose 7.2 percent, driven by booming diamond production, a recovery of the garment industry, and good performance in the agriculture and services sectors. Reflecting high transfers from SACU and exports of textiles and diamonds, the current account balance registered a substantial surplus and gross international reserves increased to six months of imports.[2] The recovery of the garment industry was facilitated by the extension of the US African Growth and Opportunity Act (AGOA)[3], a cut in corporate tax rates, and a depreciation of the rand. Inflation has increased since the last quarter of 2006 owing to rising food and energy prices, but remains in the single digits, broadly mirroring trends in South Africa. In July 2007 Lesotho and the US Millennium Challenge Corporation (MCC) signed a compact for $363 million (23 percent of 2007 GDP) to be implemented over the next five years and covering the areas of water, health, and private sector development. Drought returned in 2007, prompting the government to activate its reserve for supplementary food imports and call for aid from development partners.[4]

Sources: National authorities and U.S. Department of Commerce.

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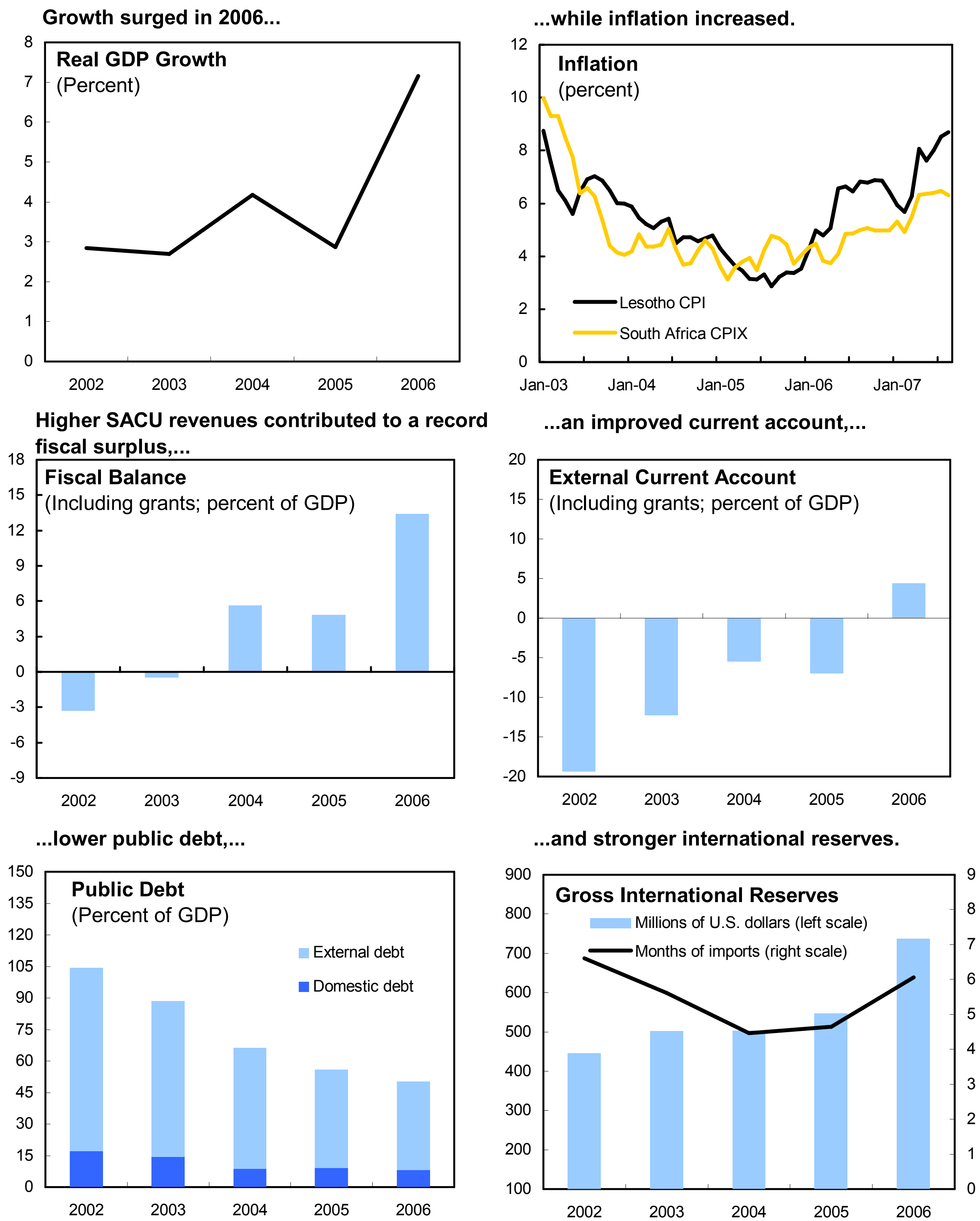
[2] Lesotho's SACU receipts have risen sharply since 2003/04, repeatedly exceeding budget forecasts and resulting in large "windfalls." The very large transfers in recent years reflect buoyant SACU revenue (mostly due to rapidly rising import duty and excise revenues collected by South Africa) and the transition from the old to a new revenue-sharing formula agreed in 2002 (IMF Country Report 05/437).

[3] At the time of the 2006 Article IV consultation, the prospects for the textile industry were unfavorable. The multi fiber agreement (MFA) ended in 2005, and AGOA's third-country provision was scheduled to lapse in 2007. However, this provision, allowing quota- and tariff-free entry to the U.S. of Lesotho's garments produced with third-country fabrics, has been extended through 2012.

[4] In July 2007, the UN called on the international community to help Lesotho cope with food shortages and drought. To date, $11.6 million has been provided by various donors, including the U.S., Canada, France, the European Commission, various UN agencies and the African Development Bank.

Figure 2. Recent Macroeconomic Performance



Sources: National authorities and IMF staff estimates.

3. **The fiscal position and public debt sustainability indicators have improved**. The overall balance registered a record surplus of 16 percent of GDP in 2006/07. This surplus (the third in a row and well above budget projections) is largely the result of an increase in SACU receipts and the limited execution of capital projects due to inadequate capacity in line ministries and complex procurement procedures, as well as one-off gains in domestic revenue that offset the decline in corporate tax rates. Most of the surplus was saved at the Central Bank of Lesotho (CBL)**.** The use of part of the SACU windfall to retire nonconcessional debt helped improve debt indicators, with ratios of external debt to GDP and debt service to exports of goods and nonfactor services falling, respectively, from 58 percent and 10 percent in 2003 to 43 percent and 6½ percent in 2006.

Lesotho: Key Fiscal Indicators

	2004/05	2005/06	2006/07	
		Est.	Budget	Outturn
	(Percent of GDP)			
Total revenue and grants	50.9	50.0	55.6	62.3
SACU revenue	23.2	24.7	30.4	37.9
Domestic revenue	24.9	23.5	22.3	23.5
Grants	2.8	1.8	2.8	0.9
Total expenditure	43.7	46.0	54.8	46.1
Current expenditure	36.4	38.6	42.1	39.2
Wages and salaries	13.6	13.7	14.2	13.8
Capital expenditure	7.2	7.5	12.8	7.0
Overall balance, incl. grants	7.2	4.0	0.8	16.1
Domestic balance	9.0	7.1	5.1	18.1
Memorandum items:				
Financing				
External	-0.4	-3.0	-1.3	-2.6
Domestic	-6.7	-1.1	0.6	-13.6

Sources: Ministry of Finance, and Fund staff calculations.

4. **Broad money grew by 35½ percent in 2006.** Coupled with a decline in net domestic assets reflecting the government surplus, among other factors, this resulted in a strong increase in net foreign assets (NFA) of the banking system. NFA and money growth also show the effect of rising workers' remittances.

III. Policy Discussions

5. The discussions focused on preserving fiscal sustainability to ensure macroeconomic stability given the fixed exchange rate; attaining sustainable and broad-based growth,

especially through private sector development; and strengthening external and internal economic stability.

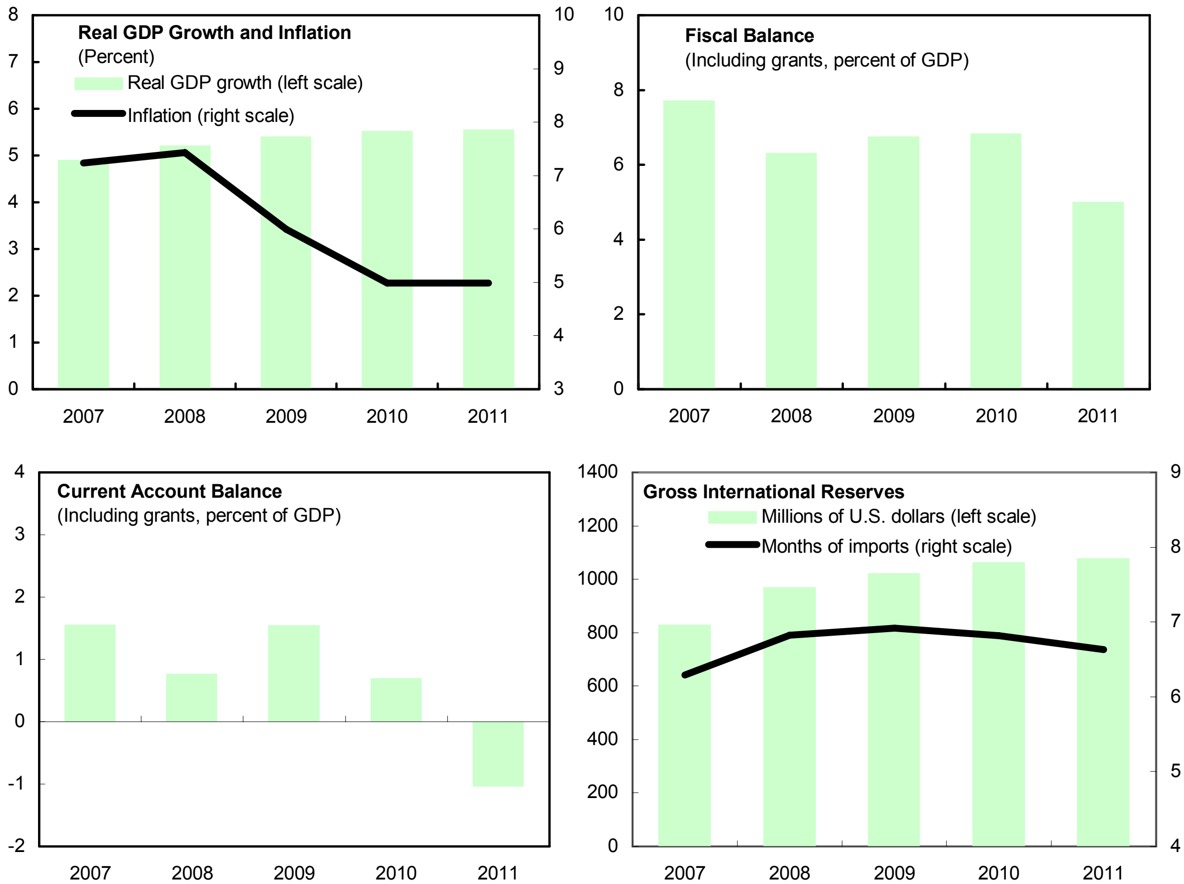
Box 1. Response to Previous Recommendations

Over the years staff and authorities have generally agreed on the main economic challenges facing Lesotho. In 2006 staff recommended preserving fiscal sustainability, improving public expenditure management, and accelerating reforms aimed at fostering private-sector led growth. The government delivered a substantial fiscal surplus in 2006/07, and has emphasized public financial management issues and private sector development in its structural reform agenda. The pace of structural reform has been slow mainly due to implementation constraints.

A. Economic Outlook

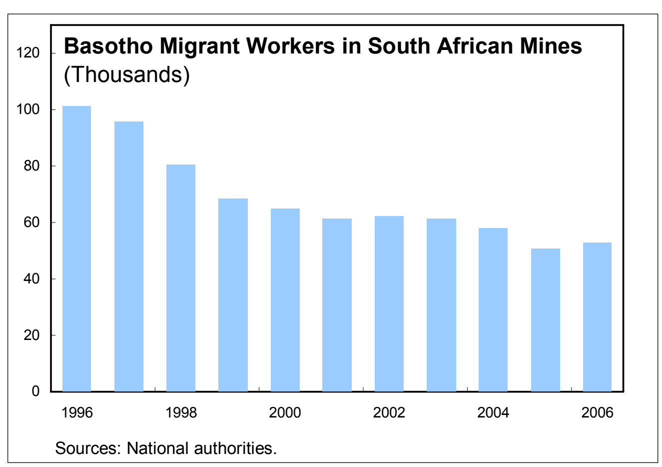
6. **Near-term economic prospects are favorable.** Real GDP growth is projected at about 5 percent in 2007 and could average nearly 5 ½ percent in the following years, propelled by continued expansion in mining, moderate growth of the garment industry (the recovery has taken place without new investments, and limited factory space is a bottleneck), and a pick-up in construction driven by high public investment. Agriculture is expected to make a negative contribution in 2007 due to the drought. The authorities project somewhat faster growth, especially in the garment sector. Growth will require diligent implementation of the investment projects included in the MCC compact. Staff agreed with the authorities that SACU revenues are likely to remain high at least through 2009/10 because of high economic activity in South Africa. Remittances are anticipated to rise in nominal terms—although diminishing as a ratio to GDP—as the increase in average pay should more than offset the decline in the number of workers resulting from structural changes in South African mines.

Figure 3. Medium Term Outlook



Source: IMF staff estimates and projections.

7. **The main risk to the real economy is the deterioration of the external environment**. The evolution of the global regime for trade in textiles will affect Lesotho's export sector. In particular, there is pressure to extend to non-African countries preferences similar to those established by AGOA, and Chinese exports to the U.S. and EU markets are expected to again be quota-free in 2008. The authorities are aware of these risks, and intend to strengthen infrastructure, notably electricity and water, to support productivity increases and vertical integration in the textile sector. Short run, the slowdown in the



U.S. economy could affect orders for garment producers. A steeper downward trend in remittances from abroad would affect consumption.

8. **A significant medium-term risk, especially for the budget, concerns the evolution of SACU revenues**. SACU revenues could be affected by a slowdown in South Africa and trade liberalization. More fundamentally, South Africa has called for a review of SACU's revenue-sharing arrangements, although it has not submitted a concrete proposal. In addition, the call for SADC to evolve into a customs union raises uncertainty about the durability of existing rules. The authorities believe that negotiations for a new revenue-sharing formula might be prolonged and it could take a long time to reach a consensus. Likewise, a SADC customs union would take time to materialize and the revenue implications for Lesotho would need to be taken into account.

9. **Authorities and staff agreed also that unlicensed deposit-taking entities pose significant risk to the financial system** (see paragraph 25 below). The growth of a weakly supervised credit cooperative sector is also worrisome.

B. Fiscal Policy and Reforms

10. **After the fiscal surpluses of recent years, the 2007/08 budget raises some concerns**. The high level of spending in the 2007/08 budget—an increase of 5 percentage points of GDP in current expenditure and a more than doubling of capital expenditure to 16 percent of GDP—could undermine fiscal sustainability and spending quality. Even if it is not expected that the budget will be fully executed, the amount of slack in the appropriations reduces the budget's usefulness as a programming instrument. The authorities confirmed that, taking into account actual spending capacity ("outturn basis"), they project a significantly better balance in 2007/08 than the approved budget suggests, and stated that current budgeting procedures tend to generate excessively high appropriations.

Lesotho: Fiscal Framework, 2006/07-2010/11

	2006/07	2007/08		2008/09	2009/10	2010/11
	Est.	Budget	Proj.	Projections		
	(Percent of GDP)					
Total revenue and grants	62.3	57.1	56.4	59.1	56.8	54.7
SACU revenue	37.9	31.8	33.0	31.7	29.7	27.9
Domestic revenue	23.5	21.2	21.9	21.9	21.9	21.9
Grants	0.9	4.1	1.5	5.5	5.2	4.9
Total expenditure	46.1	60.0	51.2	52.4	50.0	47.9
Current expenditure	39.2	44.1	41.6	40.0	38.5	37.1
Wages and salaries	13.8	14.5	14.5	14.2	13.8	13.6
Capital expenditure	7.0	15.9	9.7	12.4	11.5	10.8
Overall balance, incl. grants	16.1	-2.9	5.2	6.6	6.8	6.8

Sources: Ministry of Finance; and Fund staff projection

11. **Staff supported the medium-term fiscal stance represented in the authorities' projections on an outturn basis and under unchanged policies, while noting that implementing it will be challenging**.[5] Reflecting high SACU revenue, sustained non-SACU domestic revenue, and strict expenditure policies, the medium term fiscal framework (MTFF) projects fiscal surpluses (excluding grants) through 2010/11, even though government investment is substantially above its level of recent years. This projection implies a significant reduction in current expenditure as a ratio to GDP, which will be difficult to deliver; the projected revenue provides some margin of safety, but the risks to revenue itself advise against using up such margin.

12. **Avoiding a generalized expenditure increase is key to preserve fiscal sustainability, but spending pressures are significant**. Staff cautioned against using the SACU revenue windfall, temporary by definition, to raise recurrent spending. Specifically, staff recommended adopting a cautious approach to the introduction of the pension reform and the upcoming salary review, and limiting recruitment to priority areas. The authorities agreed in principle, but felt that pension reform will likely be costly and that Lesotho is losing qualified professionals such as nurses and teachers to South Africa and other countries, which suggests that increasing salaries for certain categories of civil servants may be justifiable.

13. **The envisaged increase in public investment poses challenges.** The under-spending of the capital budget in past years reveals weaknesses in the programming and execution of projects. The government intends to increase flexibility in its procedures to release resources to those projects moving fast. It is essential that the government redouble its efforts to improve project execution, especially in view of the fact that the MCC funds will be lost if they are not used within five years. To speed up the execution of some domestically-financed investments, the authorities have started using public-private partnerships (PPPs).[6] Staff agreed that PPPs could supplement government's implementation capacity, but recommended that PPPs only be used when they deliver higher value for money than traditional government investment. Moreover, managing PPPs requires careful contract drafting and close monitoring. The authorities are aware of these challenges, and indicated their intention to seek technical assistance from relevant agencies.

14. **Strengthening expenditure management will help ensure a good level and quality of spending**. Staff welcomed progress made in this area in the context of the Public Sector Improvement and Reform Program (PSIRP), which includes the introduction of a medium-term expenditure framework, strengthening budget planning and execution, and

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[5] The text table reflects the authorities' initial expenditure plans and staff's revenue and GDP projections.

[6] The construction and operation of the ministry of Health Headquarters and of a new national referral hospital are taking place as PPPs.

public procurement reform. All line ministries are preparing budget framework papers for the 2008/09 budget that will cover a three year period. However, due to capacity limitations in line ministries, the full MTEF is being piloted in six ministries. Staff encouraged the authorities to extend the MTEF to all ministries as soon as feasible, following the recommendations of the PEMFAR assessment. Staff and authorities agreed that the use of the MTEF would help further align the budget with development priorities.

15. **Debt and financial management needs to be reinforced**. Staff welcomed the decision to use part of the surplus to pay off expensive nonconcessional debt. Nevertheless, the payment of substantial amounts (totaling nearly 5 percent of GDP in the last two years) to retire debts accumulated outside the conventional budgetary framework underscores the need for tight control of government's obligations.[7] The authorities expect their financial management reforms to help prevent similar problems in the future.

16. **An updated DSA shows Lesotho's external and public debts to be sustainable, although there is a moderate risk of debt distress (see supplement 2).** In the baseline scenario debt should continue to decline over the medium term. However, in some adverse scenarios some debt indicators might rise above levels that are considered sustainable for low-income countries. The authorities generally agreed with this assessment.

C. Achieving Broad-based and Sustainable Economic Growth

17. **The authorities underlined their intention to continue to focus on pro-growth policies to achieve poverty reduction.** While the output growth observed in 2006 was strong, it reflected in part the performance of sectors with limited linkages to the rest of the economy and a favorable external environment. Reducing poverty, improving living standards, and more generally making progress towards the MDGs depend on achieving sustainable and broadly based growth. In this context, staff recommended looking beyond the lapse of AGOA in 2015 and giving due priority to the challenges of the rural economy. Authorities and staff agreed that attaining sustainable growth will require a major effort to improve the quality of Lesotho's institutions.

18. **The mission provided feedback on the authorities' draft Growth Strategy Paper (GSP).** The GSP seeks to identify binding constraints on growth and to collate prior development programs to derive policy recommendations, emphasizing the improvement of the investment climate, especially in key sectors, and the enhancement of infrastructure and skills. To be most useful, the GSP should be congruent with the Poverty Reduction Strategy (PRS), provide a strategic approach to the challenges and opportunities arising from the proximity to South Africa, and outline a multi-year implementation agenda that may be

[7] The retired debt had been contracted on commercial terms by the Lesotho Highland Development Authority—a public enterprise—on behalf of the government.

reflected in the MTEF. The authorities indicated that these are elements they intend to incorporate in their growth strategy.

19. **Staff welcomed the inclusion of a Private Sector Development Component in the compact signed with the MCC**. Effective implementation of this program and of the ongoing Private Sector Competitiveness Program should relieve some constraints on growth, notably inadequate infrastructure and low access to credit. In this regard, to improve the business environment and reduce "red tape," the authorities have launched a one-stop trade facilitation center for foreign investors, which is part of their private sector development agenda (Box 2).

Box 2. Private Sector Development Agenda

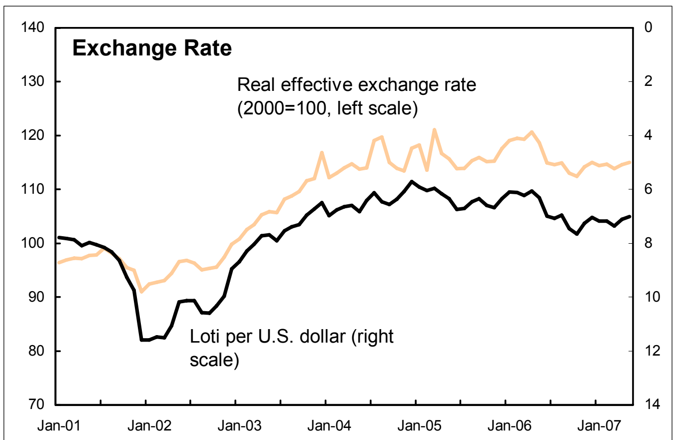
The current reform strategy aims at:

- mitigating structural constraints, such as high transport costs, availability of water and electricity;
- reducing the cost of doing business by improving the legal, judicial, and regulatory framework;
- raising labor productivity through improvements in education and health and demand-driven skills development programs; and
- increasing access to bank financing.

Many donors and international agencies are assisting the government in these reforms.

D. External Stability

20. **Economic policies have been consistent with external stability.** Staff shared the authorities' view that the current exchange rate system should be maintained. It promotes price stability in Lesotho and facilitates capital and current transactions with South Africa, Lesotho's most important economic partner. Prudent fiscal policies have underpinned the continued viability of this arrangement.



Sources: National authorities and IMF staff estimates.

21. **Standard assessments of the real exchange rate and the current account suggest no immediate threat to external stability (Box 3 and Selected Issues Paper).** While the appreciation of the rand between 2002 and 2005 reduced some measures of cost competitiveness in Lesotho, its depreciation in 2006 and so far in 2007 and recent adjustments in corporate tax rates seem to have stemmed that trend. The projections for the current account over the next few years are consistent with an improvement in Lesotho's NFA position. To the extent that it may be financed by capital transfers (such as some MCC grants) and FDI, a reduction in the current account balance would not raise significant concerns. Nevertheless, Lesotho's external stability is subject to uncertainty in the medium term (see paragraphs 7-8), which raises the margin of error of the methodologies used.

Box 3. Assessing the Real Exchange Rate

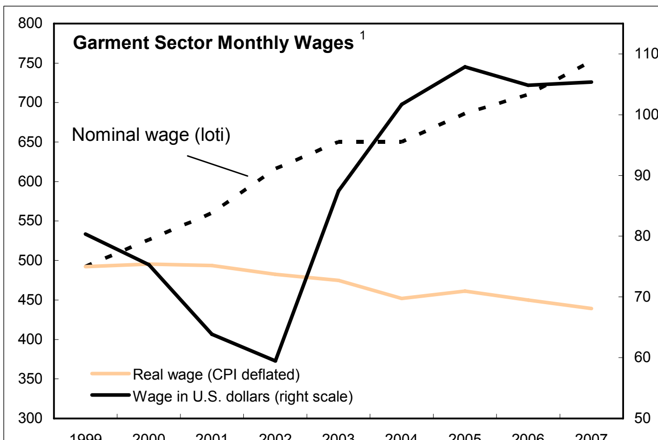
Lesotho pegs its currency to that of South Africa, from where most of its imports and inflation come, and sends most of its exports outside SACU. Thus, Lesotho's REER is essentially a smoothed version of South Africa's, and largely independent of its fundamentals. Conversely, Lesotho's current account and growth depend heavily on factors unrelated to its REER and outside the country's control, such as AGOA and SACU transfers. These factors are surrounded by a degree of uncertainty, especially in the outer years of the medium term projections. This suggests taking the estimates of current account norms shown below with caution. With these caveats, the various approaches used yielded no consistent evidence of misalignment.

When Lesotho's medium-term fundamentals are used, the *macroeconomic balance* approach, based on the regression estimates of CGER (http://www.imf.org/external/np/pp/eng/2006/110806.pdf, Table 1), produces a current account norm that is 1¾ points of GDP weaker than projected for 2007. The fundamentals used in this analysis are the medium term values of the fiscal balance (which incorporates a projected reduction in SACU transfers as a ratio to GDP), the old-age dependency ratio, population growth, oil balance and relative income.

The *external sustainability* approach indicates that the current account balance that would stabilize the ratio of net foreign assets to GDP at the 2006 level would be 1 percent of GDP weaker than projected for 2011 (also including the decline in SACU transfers mentioned above).

The *absolute version of the purchasing power parity* (PPP) approach estimates the deviation of the loti's REER from its "long-run level" based on an international comparison of price levels adjusted for productivity differentials. Under this approach, the loti was undervalued by 19 percent in 2006, but the margin of error (at a 90 percent confidence level) is larger than this.

On the other hand, Lesotho's dollar wage in the garment industry remains relatively high by the standard of the last decade, although below its 2005 peak.



Sources: National authorities and IMF staff estimates.

[1] Minimum wage for unskilled workers. For 2007, as of October with inflation assumed to be 8.6 percent.

22. **Staff supported further gradual accumulation of international reserves.** The CBL's net international reserves (NIR) target seeks to ensure the viability of the exchange rate peg of the loti to the rand, and should be considered a floor. Currently, reserves exceed the target, reflecting the saving of recent SACU revenue windfalls. The continuation of Lesotho's prudent fiscal stance should result in further accumulation of foreign assets in the near to medium term, provided that SACU transfers remain elevated. This is to be welcomed, in view of uncertainties that loom ahead. The authorities indicated that it might not be optimal to accumulate international reserves at the CBL indefinitely. Staff agreed that other options for managing the future accumulation of external assets should be considered as long as they held to high standards of governance and transparency.

E. Financial Sector Issues

23. **The banking system is solid, but access to banking services for households and SMEs remains limited**. The banking system, dominated by three South African banks, is profitable, well-capitalized, and liquid; nonperforming loans (NPLs) are moderate and well provisioned. Possible vulnerabilities might result from a relatively high and increasing concentration on the asset side of the banks' balance sheets. A challenge going forward is to increase the role, so far limited, of the banking system in financing domestic firms and households. The authorities indicated that the ongoing strengthening of Lesotho Postbank together with an ordered development of microfinance would increase population access to financial services. It is also expected that efforts to formalize land titling, build the credit bureau, and reform commercial courts will increase the availability and quality of bank credit to the economy.

Lesotho: Commercial Banks' Quarterly Performance Ratios, 2005-07

	2005	2006				2007
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Performance ratios			(Percent)			
Capital adequacy						
Basel capital ratio	22	25	23	19	19	20
Nonperforming loans to total capital	3	2	2	6	6	9
Top 20 exposures to total capital	100	84	63	98	117	116
Asset quality						
Loans to deposits ratio	29	30	17	30	26	26
Earning assets to total assets	93	94	95	94	95	95
Nonperforming loans to total loans	2	1	2	2	2	3
Reserve for losses to total loans	3	2	3	2	3	3
Reserve for losses to nonperforming loans	167	242	161	112	125	93
Liquidity Ratios						
Liquid assets to total deposits	120	112	132	88	100	98
Available reserves to total deposits	8	6	6	5	4	5
Liquid assets to total assets	77	75	83	75	78	78
Current assets to total current liabilities	86	85	95	83	85	84
Profitability ratios[1]						
Net income to average total assets (return on assets)	2	1	1	2	2	1
Net income to average total equity (return on equity)	15	7	8	20	27	8
Total expenses to total income	73	75	73	68	70	74
Solvency ratios						
Total debt ratio	10	12	12	10	7	8

Source: Central Bank of Lesotho.
[1] Since 2005, affected by the operations of two new banks.

24. **The rapid growth of the credit cooperative sector calls for better regulation and supervision**. Credit cooperatives have grown in response to the low access to bank credit. Taking advantage of loopholes in regulations, they often engage in financial intermediation with nonmembers without adequate supervision. The extent of the operations of these cooperatives is not well known, and the quality of supervision is limited at present. The authorities concurred with this assessment and stated that technical assistance is expected from the International Fund for Agriculture Development (IFAD). The measures currently contemplated include the revision of the regulation and supervision framework and a strengthening of the role of the CBL, which at present has no jurisdiction in this area.

25. **The operation in Lesotho of unlicensed deposit-taking entities poses significant risks to depositors and potentially to social stability**. These vehicles have attracted sizable deposits from the public by offering inordinately high rates of return (60 percent a year in one case), accumulating large and fast-growing liabilities that will be exceptionally difficult to meet. These vehicles face significant rollover risks, implying a high probability of failure with possible social and macroeconomic repercussions, as many thousands of savers could lose their investments. Their operation may create opportunities for money laundering and could undermine deposit-taking activities of the banks, although an eventual failure of those entities should not pose significant credit risk to banks. Staff noted that the liabilities of the largest vehicles had become quite large (about 8 percent of GDP) and that their unwinding might cause social tension. Staff encouraged the authorities to seek the support of regulatory agencies in partner countries with relevant expertise and take early action, and reiterated that the Fund is ready to help within the limits of its mandate and expertise. The authorities said they intend to address this issue and would approach some of their development partners for input should the need arise.

F. PRS Process

26. **The authorities are preparing a final report on the implementation of the PRS 2003/04–2006/07.** Staff noted that efforts made during that period were significant, but capacity limitations prevented the full implementation of the actions envisioned in the PRS. Staff observed that timely progress reports might have signaled implementation difficulties, and encouraged the authorities to improve the collection of economic and social statistics in support of monitoring the results of the PRS. The authorities intend to prepare a new PRS that will include some of the elements still pending and reflect the growth strategy under preparation and the results of the 2002 household budget survey. This PRS should be finalized by April, 2008; meanwhile, the PRS 2003/04–2006/07 remains operative.

27. **HIV/AIDS is highlighted as a cross-cutting challenge in the PRS.** Its impact on society and the economy is high, but difficult to quantify. Donor and budget resources are used to provide treatment and promote prevention, but implementation capacity is insufficient.

IV. Staff Appraisal

28. **Lesotho has continued to make progress in macroeconomic stabilization.** External developments have supported the acceleration of growth and the improvement in the balance of payments. Taking advantage of these trends, the maintenance of prudent macroeconomic policies has resulted in significant improvements in the fiscal and external balances and the buildup of international reserves, consolidating the exchange rate peg.

29. **Near-term economic prospects for Lesotho are positive, but there are a number of areas of uncertainty.** The major factors behind the surge in output in 2006 are likely to continue, and investment prospects have been boosted by the MCC compact. However, there are risks related to the worsening of the external environment, including a possible slowdown in export markets. The medium-term outlook is subject to uncertainty about SACU's revenue sharing regime, global trade in textiles and its regime, and remittances from workers in South Africa. These factors are largely beyond Lesotho's control, and the country should prepare for possible adverse developments. Consistent with this assessment, the DSA indicates that external debt would decline in the baseline scenario, although there is a moderate risk of debt distress.

30. **Large SACU revenue windfalls have been managed prudently so far, and pressures for generalized expenditure increases should be resisted**. The surge in spending envisaged in the 2007/08 budget is problematic, even if it is unlikely to be fully executed. As the DSA indicates, there seem to be limited immediate threats to fiscal sustainability and there is room to increase productive public investment in the next few years. Nevertheless, going forward it will be prudent to contain recurrent spending given the uncertainty about SACU revenues in the medium term. In particular, the upcoming salary review should be approached carefully, just as the pension reform. It is important to address weaknesses in the budget process and extend the MTEF to all ministries.

31. **The government should continue to use grants and own resources to boost public investment, especially in infrastructure**. Executing the desired public investment is a challenge that must be addressed to fully utilize MCC's resources. While PPPs have a role in public investment, the government needs to build up its capacity to manage them effectively.

32. **The authorities' effort to develop a growth strategy is welcome.** The government intention to draw up a strategy that may guide the formulation of medium term fiscal plans and institutional reform initiatives is appropriate. It will be necessary to ensure that such strategy is congruent with the PRS.

33. **Staff encourages the authorities to implement vigorously their structural reforms.** The Public Sector Improvement and Reform Program, the Private Sector Development Component of the MCC compact, and the World Bank-supported Private

Sector Competitiveness Program aim to relieve important constraints on growth. These programs target institution building, which is key to achieving sustainable growth.

34. **The monetary and exchange rate regime has been beneficial and should be preserved, along with the prudent policy mix that makes it viable.** Membership in the CMA and the peg of the loti to the rand have ensured stable and low inflation and facilitated capital and commercial exchanges with South Africa. Fiscal restraint in the face of strong SACU revenues has ensured external stability by helping keep NIR at levels consistent with the sustainability of the peg.

35. **The banking system appears solid, but access to banking services for households and SMEs is limited,** which has fostered the growth in weakly supervised credit cooperatives. Current efforts to improve their regulation and supervision and to increase access to banking services should be intensified.

36. **The operation of unlicensed deposit-taking entities gives cause for concern.** These vehicles have large and fast-growing liabilities, face constant rollover risks, and pose significant risks of failure. The longer they continue to operate, the larger their liabilities will grow and the higher the risk of social and financial repercussions. Staff urges the authorities to take prompt action to address this issue.

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

Table 1. Lesotho: Selected Economic and Financial Indicators, 2003-2011

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.	Projections				
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Real GDP	2.7	4.2	2.9	7.2	4.9	5.2	5.4	5.5	5.6
Real GNP	3.3	3.3	1.1	10.8	2.3	2.7	4.4	3.7	3.6
Consumer price index (period average)	7.3	5.0	3.4	6.1	7.2	7.4	6.0	5.0	5.0
Consumer price index (end of period)	5.9	4.8	3.5	6.4	8.0	7.0	6.0	5.0	5.0
GDP (millions of maloti)	7,862	8,522	9,065	10,120	11,273	12,723	14,341	15,891	17,585
GNP (millions of maloti)	9,793	10,523	10,997	12,690	13,789	15,184	16,958	18,459	20,056
External sector									
Exports, f.o.b.[1]	32.5	40.3	-1.4	7.5	6.1	10.0	6.7	6.7	6.7
Imports, f.o.b.[1]	31.2	26.8	4.4	4.6	7.9	8.4	4.6	6.5	5.3
Nominal effective exchange rate[2]	11.7	0.5	-1.8	-3.6	...	...	...	...	...
Real effective exchange rate[2]	17.1	0.7	-0.1	-2.2	...	...	...	...	...
Money and credit									
Net foreign assets[3]	-19.5	22.3	10.9	76.2	23.8	...	...	...	...
Net domestic assets[3]	25.5	-19.0	-1.8	-40.8	-12.4	...	...	...	...
Credit to the government[3]	7.1	-25.1	-7.1	-22.7	-15.4	...	...	...	...
Credit to the rest of the economy	-21.5	2.7	8.5	4.3	3.0	...	...	...	...
Broad money	6.0	3.3	9.1	35.4	11.4	...	...	...	...
Velocity (GNP/average broad money)	4.4	4.5	4.4	4.2	3.7	...	...	...	...
Interest rate[4]	12.0	8.5	7.2	6.9	...	...	...	...	...
	(Percent of GDP, unless otherwise indicated)								
Investment and saving									
Investment	33.2	31.4	28.0	24.3	26.2	28.9	28.9	28.4	27.7
Public	8.7	7.4	7.5	7.2	9.2	11.9	11.7	11.0	10.3
Private	18.3	18.1	19.1	17.1	17.0	17.0	17.2	17.4	17.4
Lesotho Highlands Water Project	6.2	5.9	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Gross national savings (including remittances)	20.9	25.9	21.1	28.7	27.7	29.7	30.5	29.1	26.7
Public	8.1	13.1	12.3	20.4	16.8	18.1	18.4	17.8	14.8
Private	12.8	12.8	8.8	8.2	10.9	11.5	12.1	11.3	11.9
Government budget									
Revenue	42.2	46.7	48.7	58.4	56.6	54.0	52.0	50.3	47.6
Total grants	2.6	2.6	2.1	1.1	1.4	4.6	5.3	5.0	4.3
Total expenditure and net lending	45.3	43.7	45.9	46.2	50.3	52.3	50.5	48.4	47.4
Overall balance (excluding grants)	-3.1	3.0	2.7	12.3	6.3	1.7	1.5	1.9	0.3
Overall balance (including grants)	-0.4	5.6	4.8	13.4	7.7	6.3	6.8	6.8	4.5
Government debt[5]	72.6	55.8	54.5	51.4	49.4	45.6	43.0	42.1	41.5
Domestic debt	14.5	8.9	9.0	8.2	7.0	5.9	5.0	4.6	4.4
External debt[5]	58.1	46.9	45.5	43.1	42.4	39.7	38.0	37.4	37.1
External debt-service ratio[6]	9.8	7.6	10.9	6.4	5.2	3.7	3.2	3.0	2.8
Current account balance									
Excluding official transfers	-27.8	-23.5	-27.3	-20.5	-25.6	-25.7	-23.0	-23.1	-22.5
Including official transfers	-12.3	-5.5	-7.0	4.4	1.6	0.8	1.5	0.7	-1.0
Gross official reserves (end of period)									
Millions of U.S. dollars	501.6	503.3	546.5	737.6	829.2	970.1	1,021.9	1,063.5	1,079.1
Months of imports of goods and services	5.6	4.5	4.6	6.1	6.3	6.8	6.9	6.8	6.6

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

[1] U.S. dollars.
[2] End of period; a minus sign indicates a depreciation.
[3] Change in percent of broad money at the beginning of the period.
[4] The average effective rate on three-month treasury bills.
[5] The appreciation of the loti had a significant effect on the debt-to-GDP ratio in 2003.
[6] Percent of exports of goods and nonfactor services.

Table 2. Lesotho: Central Government Operations, 2003/04-2011/12 [1]

	2003/04	2004/05	2005/06	2006/07	2007/08		2008/09	2009/10	2010/11	2011/12
				Est.	Budget	Proj.	Projections			
					(Millions of Maloti)					
Revenue	3,416.7	4,169.9	4,495.8	6,386.8	6,393.0	6,384.0	7,032.1	7,593.9	8,125.3	8,455.4
Tax revenue	2,887.5	3,693.0	4,005.9	5,787.1	5,817.1	5,808.1	6,382.4	6,864.9	7,317.8	7,563.0
SACU revenue [2]	1,421.6	2,012.4	2,306.0	3,945.0	3,836.3	3,836.3	4,157.7	4,369.0	4,553.1	4,507.6
Of which: Non-duty receipts	1,160.4	1,483.5	1,915.0	2,571.7	…	3,055.2	3,226.9	3,403.8	3,517.9	3,516.0
Noncustoms tax revenue	1,465.9	1,680.6	1,699.9	1,842.1	1,980.8	1,971.8	2,224.6	2,496.0	2,764.7	3,055.4
Income taxes	852.5	901.8	924.6	973.1	1,042.5	1,033.5	1,166.0	1,308.2	1,449.1	1,601.5
Sales tax / value-added tax (VAT)	519.3	659.8	655.7	714.6	804.5	804.5	907.6	1,018.3	1,128.0	1,246.6
Petrol levy	80.6	88.3	82.5	65.6	83.9	83.9	94.7	106.2	117.6	130.0
Other tax revenues	13.5	30.7	37.1	88.8	49.9	49.9	56.3	63.2	70.0	77.3
Nontax revenue	529.2	476.9	489.9	599.7	575.9	575.9	649.7	729.0	807.5	892.4
Grants	177.8	238.4	171.4	92.4	490.0	180.0	720.2	770.5	797.9	734.0
Total expenditure and net lending	3,532.2	3,787.1	4,291.4	4,799.4	7,229.7	5,963.1	6,881.6	7,363.2	7,807.9	8,501.0
Current expenditure	2,906.8	3,147.8	3,604.0	4,075.5	5,315.5	4,836.6	5,253.3	5,673.0	6,048.1	6,683.1
Wages and salaries	1,123.2	1,178.6	1,282.1	1,433.2	1,745.8	1,689.6	1,858.2	2,033.4	2,217.9	2,451.1
Interest payments	216.4	157.0	225.1	96.7	366.6	116.6	105.3	98.4	93.0	88.6
External	90.5	91.9	179.3	55.3	304.3	54.3	52.3	53.4	54.7	56.1
Domestic	125.9	65.1	45.8	41.4	62.3	62.3	53.0	45.0	38.3	32.5
Other expenditure	1,567.2	1,812.2	2,096.8	2,545.6	3,203.1	3,030.4	3,289.8	3,541.3	3,737.3	4,143.4
Goods and services	935.9	991.0	1,119.2	1,436.3	1,733.6	1,558.3	1,735.9	1,890.3	2,047.5	2,262.9
Transfer and subsidies	631.3	821.2	977.6	1,109.3	1,469.5	1,472.1	1,553.9	1,651.0	1,689.8	1,880.5
Capital expenditure	634.9	625.2	697.3	733.3	1,924.2	1,136.5	1,638.3	1,700.2	1,769.8	1,827.8
Domestically funded	314.3	331.0	411.7	484.1	1,103.5	735.9	729.9	747.4	769.0	807.6
of which: Capital transfers	96.3	167.8	127.1	152.8	250.0	250.0	363.6	351.8	341.7	358.8
Externally funded	320.6	294.2	285.6	249.2	820.7	400.6	908.4	952.8	1,000.8	1,020.2
Grant funded	140.2	182.6	171.4	92.4	490.0	180.0	670.2	695.5	722.9	734.0
Loan funded	180.4	111.6	114.2	156.8	330.7	220.6	238.2	257.3	277.9	286.2
Net lending	-9.5	14.1	-9.9	-9.4	-10.0	-10.0	-10.0	-10.0	-10.0	-10.0
Overall balance, before grants	-115.5	382.8	204.4	1,587.4	-836.7	420.9	150.5	230.7	317.4	-45.5
Overall balance, after grants	62.3	621.2	375.8	1,679.8	-346.7	600.9	870.7	1,001.2	1,115.3	688.5
Domestic balance [3]	309.6	783.0	659.4	1,882.5	7.6	865.8	1,101.2	1,226.9	1,362.9	1,020.8
Total financing	-62.3	-621.2	-375.8	-1,679.8	346.7	-600.9	-870.7	-1,001.2	-1,115.3	-688.5
External financing	-25.7	-38.3	-276.6	-266.1	61.8	-298.3	53.9	58.6	72.8	69.8
Loan drawings	180.4	207.1	114.2	156.8	330.7	220.6	238.2	257.3	277.9	286.2
of which: Budget support loans	…	…	…	…	…	…	0.0	…	…	…
Amortization	-206.1	-245.4	-390.8	-213.1	-268.9	-268.9	-184.4	-198.7	-205.1	-216.4
Payment of arrears	--	--	--	-209.8	0.0	-250.0	--	--	--	--
Domestic financing	-36.7	-582.9	-99.2	-1,413.7	284.9	-302.6	-924.5	-1,059.8	-1,188.1	-758.3
Bank	-129.6	-605.2	-102.1	-1,248.0	284.9	-302.6	-924.5	-1,059.8	-1,188.1	-758.3
Nonbank	92.9	22.3	2.9	-165.7	0.0	0.0	0.0	0.0	0.0	0.0

continued

Table 2. Lesotho: Central Government Operations, 2003/04-2011/12 (concluded)

	2003/04	2004/05	2005/06	2006/07	2007/08		2008/09	2009/10	2010/11	2011/12
				Est.	Budget	Proj.	Projections			
	(Percent of GDP, unless otherwise indicated)									
Revenue	42.6	48.2	48.2	61.4	53.0	54.9	53.6	51.6	49.8	46.9
Customs revenue (SACU)[2]	17.7	23.2	24.7	37.9	31.8	33.0	31.7	29.7	27.9	25.0
Noncustoms tax revenue	18.3	19.4	18.2	17.7	16.4	16.9	16.9	16.9	16.9	16.9
Nontax revenue	6.6	5.5	5.3	5.8	4.8	4.9	4.9	4.9	4.9	4.9
Grants	2.2	2.8	1.8	0.9	4.1	1.5	5.5	5.2	4.9	4.1
Total expenditure and net lending	44.0	43.7	46.0	46.1	60.0	51.2	52.4	50.0	47.9	47.1
Current expenditure	36.2	36.4	38.6	39.2	44.1	41.6	40.0	38.5	37.1	37.1
Wages and salaries	14.0	13.6	13.7	13.8	14.5	14.5	14.2	13.8	13.6	13.6
Interest payments	2.7	1.8	2.4	0.9	3.0	1.0	0.8	0.7	0.6	0.5
External	1.1	1.1	1.9	0.5	2.5	0.5	0.4	0.4	0.3	0.3
Domestic	1.6	0.8	0.5	0.4	0.5	0.5	0.4	0.3	0.2	0.2
Other expenditure	19.5	20.9	22.5	24.5	26.6	26.0	25.1	24.0	22.9	23.0
Goods and services	11.7	11.4	12.0	13.8	14.4	13.4	13.2	12.8	12.6	12.6
Transfers and subsidies	7.9	9.5	10.5	10.7	12.2	12.7	11.8	11.2	10.4	10.4
Capital expenditure	7.9	7.2	7.5	7.0	16.0	9.8	12.5	11.5	10.8	10.1
Of which: domestically funded	3.9	3.8	4.4	4.7	9.2	6.3	5.6	5.1	4.7	4.5
Net lending	-0.1	0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall balance, before grants	-1.4	4.4	2.2	15.3	-6.9	3.6	1.1	1.6	1.9	-0.3
Overall balance, after grants	0.8	7.2	4.0	16.1	-2.9	5.2	6.6	6.8	6.8	3.8
Domestic balance[3]	3.9	9.0	7.1	18.1	0.1	7.4	8.4	8.3	8.4	5.7
Total financing	-0.8	-7.2	-4.0	-16.1	2.9	-5.2	-6.6	-6.8	-6.8	-3.8
External financing	-0.3	-0.4	-3.0	-2.6	0.5	-2.6	0.4	0.4	0.4	0.4
Domestic financing	-0.5	-6.7	-1.1	-13.6	2.4	-2.6	-7.0	-7.2	-7.3	-4.2
Memorandum items:										
GNP at current prices (Millions of maloti)	9,975	10,642	11,420	12,965	14,516	14,138	15,628	17,334	18,858	20,255
GDP at current prices (Millions of maloti)	8,027	8,658	9,329	10,408	12,052	11,636	13,128	14,729	16,314	18,030

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

[1] On fiscal year basis (April - March)

[2] Adjustment receipts of M 330 million in 2005/06 included.

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

Table 3. Lesotho: Balance of Payments, 2003- 2011
(Millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Est.	Projections				
Trade balance	-517.8	-592.5	-656.6	-667.4	-732.3	-782.0	-800.9	-851.9	-883.6
Exports, f.o.b.	470.3	660.0	650.7	699.5	742.4	816.3	871.0	929.0	990.8
Of which: garments	337.8	501.3	527.7	567.2	589.9	644.0	682.9	725.1	769.7
Imports f.o.b [1]	-988.1	-1,252.4	-1,307.3	-1,366.9	-1,474.7	-1,598.3	-1,671.8	-1,780.9	-1,874.4
Of which: garment inputs	-145.4	-215.8	-227.1	-244.2	-253.9	-277.2	-293.9	-312.1	-331.3
Services (net)	-34.7	-36.9	-46.7	-35.4	-47.1	-31.1	-11.8	21.4	53.2
Receipts	49.6	61.1	56.6	59.8	60.6	77.0	90.0	111.9	132.5
Of which: water royalties	14.7	17.0	18.1	18.4	23.3	35.5	47.0	57.6	58.6
Payments	-84.3	-98.1	-103.4	-95.2	-107.7	-108.1	-101.8	-90.6	-79.2
Income (net)	255.3	309.8	303.8	379.5	354.4	340.9	351.3	334.3	311.8
Labor income (net)	254.4	304.2	302.2	345.2	317.7	310.4	302.4	275.9	256.6
Receipts	281.3	333.8	319.1	356.6	334.2	339.9	337.6	313.1	292.9
Of which: miners' wages	229.7	271.0	253.8	292.8	242.9	249.6	250.9	242.8	239.9
Payments	-26.9	-29.5	-16.9	-11.4	-16.6	-29.5	-35.2	-37.2	-36.4
Investment income (net)	0.8	5.5	1.6	34.3	36.7	30.4	48.9	58.4	55.3
Receipts	27.9	38.3	50.2	55.5	54.3	47.5	67.6	76.9	73.2
Payments	-27.0	-32.8	-48.6	-21.2	-17.6	-17.0	-18.7	-18.6	-17.9
Of which: interest on debt	-12.8	-11.9	-37.9	-13.8	-13.5	-12.5	-13.7	-13.3	-12.2
Unrequited transfers	169.7	247.2	300.4	389.2	449.7	485.8	491.0	510.8	495.6
Official	161.5	238.1	289.7	371.6	431.6	467.2	472.1	491.5	476.0
SACU nonduty receipts	143.0	216.1	274.4	358.0	424.5	440.5	451.9	457.6	444.8
Rand compensation	8.7	9.9	11.5	11.5	0.0	0.0	0.0	0.0	0.0
Other	9.7	12.0	3.8	2.0	7.1	26.7	20.2	34.0	31.2
Private	8.2	9.1	10.6	17.6	18.1	18.7	18.9	19.2	19.6
Current account (including official transfers)	-127.6	-72.4	-99.1	65.9	24.7	13.6	29.7	14.5	-23.0
Current account (excluding official transfers)	-289.0	-310.5	-388.9	-305.6	-406.9	-453.6	-442.4	-477.1	-499.0
Of which: LHWP [2]	-62.3	-53.0	-26.3	-15.4	-2.8	-0.2	0.0	0.0	0.0
Capital and financial account	176.1	56.0	19.9	-213.5	-24.6	-13.6	-29.7	-14.5	23.0
Capital account (transfers received)	18.3	22.4	21.0	11.1	22.3	81.0	101.7	103.0	94.6
Financial account	157.7	33.6	-1.1	-224.7	-46.9	-94.6	-131.4	-117.4	-71.6
Direct investment (excl. LHDA) [3]	41.9	53.2	57.3	57.0	57.0	58.5	59.0	59.5	60.0
Financing LHWP (net)	73.0	70.8	35.3	20.3	5.3	0.0	0.0	0.0	0.0
Other investment	-25.5	-88.7	-50.4	-110.8	-17.6	-12.3	-138.6	-135.2	-116.1
Assets	-37.1	-95.0	1.9	-89.1	-54.0	-37.5	-114.4	-123.3	45.3
Liabilities	11.6	6.3	-52.3	-21.7	36.4	25.2	-24.2	-12.0	-161.4
Change in reserve assets	68.3	-1.6	-43.2	-191.1	-91.6	-140.8	-51.8	-41.6	-15.5
Valuation adjustment	49.9	33.4	14.6	53.5	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-98.4	-17.0	64.7	94.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:			(Percent of GDP, unless otherwise indicated)						
Trade balance	-49.8	-44.9	-46.1	-44.7	-46.1	-44.4	-41.6	-41.2	-39.8
Net remittances	24.5	23.1	21.2	23.1	20.0	17.6	15.7	13.3	11.6
Current account (including official transfers)	-12.3	-5.5	-7.0	4.4	1.6	0.8	1.5	0.7	-1.0
Current account (excluding official transfers)	-27.8	-23.5	-27.3	-20.5	-25.6	-25.7	-23.0	-23.1	-22.5
Excluding LHWP	-24.0	-20.3	-26.7	-20.7	-26.9	-27.7	-25.4	-25.9	-25.1
Total SACU receipts	189.5	288.7	351.1	522.1	544.2	564.7	579.4	586.6	570.2
Gross official reserves (Millions of U.S. dollars)	501.6	503.3	546.5	737.6	829.2	970.1	1,021.9	1,063.5	1,079.1
Gross official reserves (Months of imports of goods and services)	5.6	4.5	4.6	6.1	6.3	6.8	6.9	6.8	6.6

Sources: Central Bank of Lesotho (CBL), and IMF staff estimates and projections.

[1] Adjusted for SACU duty receipts

[2] Lesotho Highlands Water Project.

[3] Lesotho Highlands Development Authority.

Table 4. Lesotho: Monetary Survey, 2003-07

	2003	2004	2005	2006	2007
	Dec.	Dec	Dec	Dec	Dec
				Est.	Proj.
	(Millions of maloti, unless otherwise indicated)				
Net foreign assets	3,460.7	3,972.4	4,231.4	6,205.3	7,039.0
Central bank	2,837.5	2,846.8	3,076.2	4,373.6	5,024.2
Commercial banks	623.2	1,125.6	1,155.2	1,831.7	2,014.9
Net domestic assets	-1,162.8	-1,599.4	-1,641.4	-2,697.4	-3,131.3
Domestic credit	380.6	-133.9	-100.5	-576.8	-1,010.7
Claims on central government (net)	-167.0	-742.7	-910.1	-1,498.8	-2,037.7
Central bank	-1,090.1	-1,228.3	-1,199.9	-1,973.9	-2,512.9
Commercial banks	923.1	485.7	289.8	475.2	475.2
Claims on the rest of the economy	547.7	608.7	809.6	921.9	1,027.0
Other items (net)	-1,543.4	-1,465.4	-1,540.9	-2,120.6	-2,120.6
Money and quasi-money (M2)	2,297.8	2,373.0	2,590.0	3,507.9	3,907.8
Money	1,537.7	1,589.4	1,829.5	2,688.8	3,080.7
Of which: currency outside dep. mon. banks	183.5	204.5	212.8	309.4	354.5
demand deposits	1,185.2	1,197.5	1,427.9	2,379.4	2,726.2
Quasimoney	760.1	783.6	760.5	819.1	827.1
Of which: time and savings deposits	760.1	783.6	760.5	819.1	827.1
Net foreign assets [1]	-19.5	22.3	10.9	76.2	23.8
Central bank	-16.8	0.4	9.7	50.1	18.5
Commercial banks	-2.8	21.9	1.2	26.1	5.2
Net domestic assets [1]	25.5	-19.0	-1.8	-40.8	-12.4
Claims on central government (net)	7.1	-25.1	-7.1	-22.7	-15.4
Claims on the rest of the economy	-21.5	2.7	8.5	4.3	3.0
Claims on the rest of the econ. (yearly change)	-46.0	11.1	33.0	13.9	11.4
Other items (net)	39.9	3.4	-3.2	-22.4	0.0
Money and quasimoney (M2) [1]	6.0	3.3	9.1	35.4	11.4

Sources: Central Bank of Lesotho, and Fund staff estimates and projections.

[1] Annual change in percent of beginning-of-year M2, unless otherwise indicated

Table 5. Lesotho: Indicators of External Vulnerability, 2002-06
(Percent of GDP, unless otherwise indicated)

	2002	2003	2004	2005	2006
Financial indicators					
Public sector debt [1]	104.5	72.6	55.8	54.5	51.4
Broad money (M2; annual percent change)	8.8	6.0	3.3	9.1	35.4
Private sector credit (annual percent change)	1.3	-21.5	2.7	8.5	4.3
Domestic credit	9.6	4.8	-1.6	-1.1	-5.7
Treasury-bill yield (percent) [2]	11.3	12.0	8.5	7.2	6.9
Treasury-bill yield (real, percent) [3]	-1.1	4.7	3.5	3.8	0.8
External indicators					
Exports of goods and services (U.S. dollars, annual percent change)	6.4	34.0	38.7	-1.9	7.4
Imports of goods and services (U.S. dollars, annual percent change)	2.0	33.3	25.9	4.5	3.6
Current account balance	-19.4	-12.3	-5.5	-7.0	4.4
Capital and financial account balance	10.7	14.9	3.7	1.4	-14.7
Of which: inward foreign direct investment	3.3	3.5	3.5	4.0	3.9
Net foreign assests of the banking sector (millions of U.S. dollars)	79.1	93.8	199.9	182.6	262.8
Foreign assets of the banking sector (millions of U.S. dollars)	114.0	155.9	262.2	234.6	309.6
Foreign liabilities of the banking sector (millions of U.S. dollars)	34.9	62.0	62.3	51.9	46.8
Gross official reserves (millions of U.S. dollars)	406.4	501.6	503.3	546.5	737.6
Gross official reserves (months of imports of goods and services)	4.5	5.6	4.5	4.6	6.1
Ratio of reserve money to reserves (percent)	9.4	10.5	13.1	15.8	13.2
Ratio of broad money to reserves (percent)	61.8	69.0	83.8	74.9	68.2
Total external debt [4]	73.0	58.1	46.9	45.5	43.1
Ratio of total external debt to exports of goods and services (percent)	157.0	132.3	98.5	92.2	82.5
Nominal exchange rate (maloti per U.S. dollar, period average)	8.6	6.6	5.6	6.3	7.0
REER depreciation (-) (end of period, CPI-based)	9.7	17.1	0.7	-0.1	-2.2
Memorandum items:					
GDP (millions of U.S. dollars)	838.4	1,184.0	1,513.7	1,433.2	1,451.9
Nominal exchange rate (maloti per U.S. dollar, end-of-period)	8.6	6.6	5.6	6.3	7.0

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

[1] National government debt.

[2] End of period.

[3] Backward-looking with actual CPI.

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