INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/161

KINGDOM OF LESOTHO

June 2022

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KINGDOM OF LESOTHO

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Kingdom of Lesotho, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 1, 2022, consideration of the staff report that concluded the Article IV consultation with Kingdom of Lesotho.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 1, 2022, following virtual discussions that ended on March 28, 2022, with the officials of Kingdom of Lesotho on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 16, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff[s] of the IMF and the World Bank.
- A **Statement by the Executive Director** for Kingdom of Lesotho.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR22/180

IMF Executive Board Concludes 2022 Article IV Consultation with Kingdom of Lesotho

FOR IMMEDIATE RELEASE

Washington, DC – June 3, 2022: On June 1st, 2022, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Kingdom of Lesotho.

Since early 2020, Lesotho has been hit simultaneously by the pandemic, declining transfers from the Southern African Customs Union (SACU), climate shocks, and the impact of the war in Ukraine. Despite a swift response by the authorities, the fallout from the pandemic—including delays to large infrastructure projects, supply chain disruptions, layoffs in the textiles sector, and weak external demand—has weighed on social and economic development, amplifying legacy structural challenges. Growth has been revised down to 2.1 percent in FY21/22 after contracting by 6 percent in FY20/21, and is forecast by staff at 2.7 percent in FY22/23 and 1.4 percent on average thereafter. The war in Ukraine has hindered food imports, exacerbating agricultural disruptions due to floods and the pandemic. Global price increases in food and fuel, which account for over half of the consumer basket, are hurting the vulnerable, with inflation expected to reach 6.8 percent in FY22/23.

Fiscal performance was better than expected in FY20/21. However, public expenditure has continued to increase, with the recent decline in SACU transfers weakening the external position. Recent cases have highlighted gaps in public financial management and efforts to restrain expenditure have been undermined by growing domestic arrears, as spending pressures mount ahead of the autumn 2022 elections.

The current account deficit is projected to reach 7.4 percent of GDP in FY21/22, due to lower SACU transfers, higher capital imports, and costlier food and fuel imports. Exports and remittances fell by 26 and 12 percent, respectively, and the goods and services trade deficit widened by 8 percentage points of GDP in FY20/21. Despite a recovery in exports and remittances, the drop in SACU transfers widened the current account further over the first nine months of FY21/22. Foreign investment, including FDI, declined given the weak external environment and limited opportunities domestically.

The banking sector is characterized by substantial capital buffers, ample liquidity, and low non-performing loans. However, its contribution to growth remains limited. Private sector credit contracted by 1.6 percent in 2020:Q3, only rebounding to 7.4 percent as of FY21/22:Q4. With gross international reserves stable at 4.5 months of imports—excluding those associated with the second phase of the Lesotho Highlands Water Project—in FY21/22, net international reserves have remained above the central bank's target for safeguarding the exchange rate peg, bolstered by the recent SDR allocation.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Directors welcomed the authorities' timely policy response to the pandemic and strong vaccination efforts. Directors noted, however, that the pandemic, declining transfers from the Southern African Customs Union (SACU), climate vulnerabilities, and spillovers from the war in Ukraine, have exacerbated longstanding structural weaknesses and undermined the recovery. Directors called for a steady fiscal adjustment supported by structural reforms to secure macroeconomic stability and promote stronger, inclusive, and sustainable private sector-led growth.

Directors emphasized the need for a growth-friendly fiscal consolidation to reduce imbalances, rein in public debt, and rebuild policy space. They called for measures to contain current spending, including the public sector wage bill, reprioritize social spending to focus on the most vulnerable, and rationalize capital spending.

Directors agreed that fiscal adjustment should be complemented by reforms to public financial management (PFM) and revenue and tax administration. They encouraged the authorities to finalize and submit the Public Financial Management and Accountability bill to Parliament and implement regulations to improve the budget process and minimize arrears. A debt management strategy focused on concessional sources is also important. Directors also underscored the importance of enhancing fiscal governance and transparency including implementing governance commitments made under emergency financing arrangements.

Directors concurred that monetary policy should focus on price stability and maintaining adequate reserves to safeguard the exchange rate peg. They encouraged the authorities to strengthen central bank independence and coordinate closely across institutions on fiscal and monetary policies for credible and effective macroeconomic management.

Directors welcomed the financial sector's resilience and encouraged the authorities to remain vigilant of risks, including in the nonbank financial sector. Broadening financial inclusion and strengthening financial sector development and supervision would also be important to support private sector growth.

Directors encouraged the authorities to implement ambitious and much-needed structural reforms. Continued efforts to improve the business climate and governance, diversify the economy, close gender gaps, and build climate resilience are also key to boost green, inclusive, job-rich, and sustainable growth.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1. Lesotho: Selected Economic Indicators, 2018/19–27/28[1]

Population (thousands; 2020 est.): 2,142
GNI per capita (US$; 2020 est.): 1,100
Poverty rate at national poverty line (percent; 2017 est.): 49.7

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.	Projections					
	(12-month percent change, unless otherwise indicated)									
National account and prices										
GDP at constant prices (incl. LHWP-II project)	-0.3	0.0	-6.0	2.1	2.7	1.6	2.1	2.3	0.7	0.1
GDP at constant prices (excl. LHWP-II project)	-0.3	0.0	-6.3	2.0	1.9	1.8	1.5	1.5	1.5	1.5
GDP at market prices (Maloti billions)	32.2	34.0	33.7	36.7	40.0	42.9	45.8	49.0	51.8	54.5
GDP at market prices (US$ billions)	2.3	2.3	2.1	2.5	2.6	2.7	2.9	3.1	3.3	3.5
Consumer prices (average)	4.7	4.9	5.4	6.4	6.8	5.5	4.9	4.9	4.9	4.9
Consumer prices (eop)	5.2	4.0	6.5	5.9	6.0	4.9	4.9	4.9	4.9	4.9
GDP deflator	5.5	5.5	5.5	6.5	6.4	5.4	4.7	4.6	4.9	5.0
External sector										
Terms of trade (– = deterioration)	-0.4	2.0	4.1	-2.3	-2.7	2.2	1.7	1.8	1.3	0.7
Average exchange rate										
(Local currency per US$)	13.8	14.8	16.4	…	…	…	…	…	…	…
Nominal effective exchange rate change (– = depreciation) [2]	-0.1	-5.6	-10.4	…	…	…	…	…	…	…
Real effective exchange rate (– = depreciation) [2]	2.1	-2.8	-7.4	…	…	…	…	…	…	…
Current account balance (CA) (percent of GDP)	-1.4	-2.1	-2.0	-7.4	-14.4	-9.6	-10.5	-10.0	-8.6	-5.4
CA excl. LHWP-II imports (percent of GDP)	-0.2	0.8	3.1	-4.8	-7.4	-4.5	-4.1	-4.0	-3.2	-2.8
Gross international reserves										
(Months of imports, excluding imports for LHWP-II)	4.0	4.5	4.5	4.5	4.0	3.6	3.3	3.2	3.2	3.1
Money and credit										
Net international reserves										
(US$ millions)	687	608	739	809	745	712	705	729	771	813
(Percent of M1 Plus)	116	135	112	127	115	104	97	93	92	92
(US$ millions, CBL calculation)	742	605	776	786	…	…	…	…	…	…
(Percent of M1 Plus, CBL calculation)	120	122	124	121	…	…	…	…	…	…
Domestic credit to the private sector	7.7	8.0	0.6	7.4	10.7	8.5	12.6	11.4	9.3	8.2
Reserve money	-11.5	14.2	-0.1	1.2	6.4	5.9	-5.2	-1.8	-1.9	-1.9
Broad money	5.5	7.2	17.2	0.0	5.0	5.1	7.0	7.9	6.0	5.5
Interest rate (percent) [3]	4.3	3.9	3.5	2.8	…	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)									
Public debt	50.9	58.8	57.4	59.2	60.7	62.4	63.7	64.2	64.4	64.1
External public debt	40.2	46.9	43.6	43.6	44.3	46.1	47.7	48.4	48.5	48.1
Domestic public debt	10.7	12.0	13.8	15.7	16.4	16.3	16.0	15.8	15.9	16.0
Central government fiscal operations										
Revenue and grants	50.0	48.4	55.3	46.2	47.0	47.0	47.8	46.6	46.5	46.3
Revenue excluding grants and SACU revenue	*28.6*	*26.3*	*25.5*	*25.7*	*27.9*	*27.9*	*27.8*	*27.7*	*27.9*	*27.8*
SACU revenue	*17.2*	*18.3*	*26.6*	*16.4*	*13.5*	*16.3*	*17.0*	*16.0*	*16.0*	*16.0*
Grants	*4.3*	*3.7*	*3.1*	*4.2*	*5.6*	*2.8*	*2.9*	*2.9*	*2.6*	*2.5*
Recurrent expenditure	40.8	39.9	43.4	39.5	40.1	40.7	40.0	38.3	38.2	38.2
Of which: wages, including social contributions	18.8	17.4	17.9	17.4	19.7	20.3	19.7	18.9	18.8	18.8
Capital expenditure	14.0	15.9	11.6	13.6	14.7	13.2	13.3	12.3	10.6	9.9
Overall balance	-4.8	-7.5	0.3	-6.9	-7.8	-6.8	-5.5	-4.0	-2.3	-1.7
(Excluding SACU transfers and grants)	*-26.2*	*-29.5*	*-29.5*	*-27.4*	*-26.9*	*-26.0*	*-25.5*	*-22.8*	*-20.8*	*-20.2*
Primary balance	-3.3	-6.0	1.9	-5.0	-6.2	-4.8	-3.1	-1.6	0.1	0.7
(Excluding SACU transfers and grants)	*-24.8*	*-28.0*	*-27.8*	*-25.6*	*-25.3*	*-24.0*	*-23.0*	*-20.4*	*-18.5*	*-17.8*
Statistical discrepancy	2.0	0.0	0.1	-2.8	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Lesotho authorities, World Bank, and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] IMF Information Notice System trade-weighted; end of period.

[3] 12-month time deposits rate.

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

May 16, 2022

KEY ISSUES

Context. Lesotho has been simultaneously hit by the pandemic, declining transfers from the Southern African Customs Union (SACU), and the impact of the war in Ukraine. The pandemic exacerbated the impact of sluggish regional performance, climate shocks, and longstanding structural issues such as regulation, governance, political stability, financial inclusion, and diversification. Public expenditure has continued to increase, such that the decline in external transfers precipitated significant financing pressures and growing domestic arrears. With limited inflows to the private sector, the resulting public sector-driven external imbalances have continued to put pressure on international reserves needed to maintain the exchange rate peg.

Outlook and Risks: The outlook points to a gradual recovery in the near term. Growth is estimated at 2.7 percent in FY22/23 and to average 1.4 percent thereafter. Under current policies, downward rigidities in spending are pushing public debt close to key tolerances and weighing on reserves. Fiscal adjustment efforts are hampered by political fragility and problems with public financial management. Key downside risks include further delays in fiscal adjustment and structural reforms, a more protracted pandemic at the global or regional level, ongoing price disruptions and food insecurity from the war in Ukraine, and the October 2022 elections. Climate-related disasters, particularly droughts and floods, remain a major risk. Stronger-than expected growth will help improve the fiscal outlook.

Focus of the Article IV Consultation. Staff urged the authorities to undertake upfront growth-friendly consolidation to maintain fiscal sustainability and the peg, alongside broad-ranging structural reforms to support the private sector. Fiscal adjustment should focus on addressing the high public sector wage bill and allowances, better targeting of social spending, and streamlining the capital budget—to create space to mitigate shocks and protect the vulnerable—complemented by resolving public financial management issues and strengthening domestic revenue mobilization. The private sector would also benefit from improving the business climate, enhancing financial intermediation, and promoting financial inclusion. Strengthening public sector governance and institutions would also help safeguard scarce resources, reduce vulnerabilities to corruption, and improve policy consistency and effectiveness. Monetary and exchange rate policy should continue to focus on price stability and maintaining adequate reserves to safeguard the peg. Amid growing spending pressures ahead of the general election, staff recommended that the government push ahead with reforms less constrained by the political economy.

Approved By
Vivek Arora (AFR) and Bjoern Rother (SPR)

Discussions were held from Washington, DC remotely during March 7–28, 2022. The staff team comprised Aqib Aslam (head), Habtamu Fuje, Shushanik Hakobyan, Romina Kazandjian, Yibin Mu, Haiyan Shi, Qiuyan Yin, and Zviad Zedginidze (all AFR), Mosito Ntema, and Mpati Mphatsoe (local office). Moeti Damane and Abigail Nainda (OEDAE) participated in the discussions. The team met Minister of Finance Thabo Sophonea, Principal Secretary Finance Nthoateng Lebona, Acting Central Bank Governor Lehlomela Mohapi, and other officials. Cecilia Prado (AFR) managed document production. The team thanks the Basotho authorities for their collaboration and for candid and productive discussions.

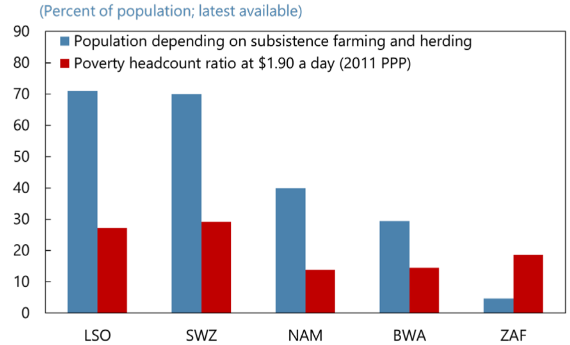
CONTENTS

ANNEXES

CONTEXT

1. **Lesotho has been facing significant structural challenges even before the COVID-19 pandemic.**[1]The economy has stagnated since 2016 and is estimated to have shrunk by almost 10 percent.[2] The country's export base—historically concentrated in textiles and mining—has been losing competitiveness.[3] Lesotho's geography makes it vulnerable to climate shocks, which have increased over the past decade. As one of the countries in the region most affected by natural disasters and with over two-thirds of the population dependent on rain-fed subsistence agriculture, poverty and food insecurity remain high.[4] Health indicators remain relatively weak, with 21.1 percent of adults infected by HIV and maternal mortality at over 1,000 for every 100,000 live births (Table 6).

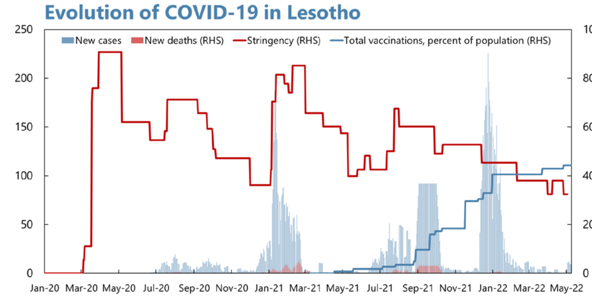
Poverty and Subsistence Farming
(Percent of population; latest available)



Sources: World Bank World Development Indicators (WDI) and IMF staff calculations.

2. **After three waves of the pandemic, reported cases remain low.** The authorities undertook measures to mitigate the health and economic consequences in FY20/21 (Annex II). Restrictions have been gradually lifted with the country moving to its lowest alert level in October 2021. With 53 percent of the target population fully vaccinated as of April 30, 2022, the government remains confident that the pandemic can be contained.[5]

Evolution of COVID-19 in Lesotho



Sources: Johns Hopkins University, University of Oxford, Our World in Data, WHO, and IMF staff calculations.
Notes: New case per million and new deaths per milion are 7-day moving averages; the Stringency Index measures government responses to COVID-19, specifically containment and closure policies including school closures and restrictions in movement, 100 = strongest; Vaccine doses administered may not equal population vaccinated, given the specific dose regime (e.g., single dose vs. multiple doses).

3. **The government-driven growth model remains a challenge for sustainable and inclusive growth, displacing resources from the private sector.** The fiscal landscape is

[1] An assessment of the implementation of the previous Article IV recommendations can be found in Annex I.

[2] Since July 2021 Lesotho has fallen back below the World Bank's IDA GNI per capita threshold, making it eligible for IDA funding again. Previously, Lesotho was upgraded to lower-middle-income country status by the World Bank in 2005 and had become ineligible for IDA funding since 2018.

[3] The textiles sector, which expanded rapidly in the late 1990s and early 2000s, thanks to preferential access to U.S. markets through the African Growth and Opportunity Act (AGOA), has been stagnating for some time. The outlook for the mining sector has improved recently as diamond prices have increased sharply and most mining companies have resumed full operations. See Selected Issues Paper (SIP): *Lesotho's Trade: Overview and Risks*.

[4] World Food Program, Lesotho Country Brief, September 2021.

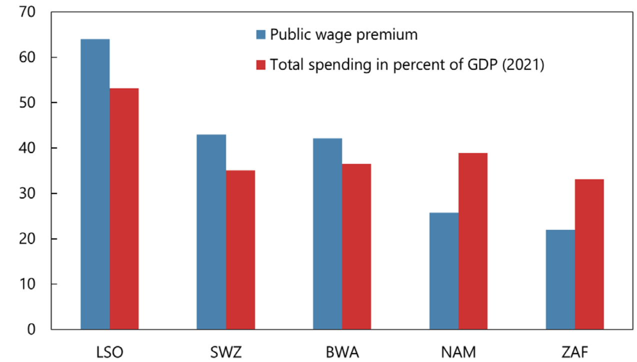
[5] Lesotho has made some important improvements in public health systems since the onset of the pandemic, though needs still exceed capacity. The government has established seven oxygen manufacturing plants and increased the number of ICU beds with ventilators from two to 36, as well as stockpiling additional ventilators. Treatment centers have also been set up in key urban locations.

characterized by gaps in PFM and a heavy reliance on large and volatile transfers from SACU—the latter contributing to high public expenditures that increase when transfers are buoyant but are not scaled back when transfers fall. The public sector is the major employer, with a high public wage premium crowding out private sector employment.[6]

4. Private-sector development and job creation have also been hampered by limitations in financial access, human capital, governance and corruption, and the overall business environment. The largely foreign-owned banking sector is well-capitalized and liquid but plays a limited role in intermediating credit, particularly to micro-, small- and medium-sized enterprises (MSMEs). Government arrears also create liquidity shortages. High credit and setup costs, skills mismatches, and gaps in legal frameworks, dispute resolution, insolvency resolution, and property rights continue to inhibit business development. With private sector growth concentrated in capital-intensive industries, new labor market entrants face fewer opportunities, often pushing them into informality.

Public Wage Premium and Total Spending

(Percent; Most recent year available for public wage premium estimates)

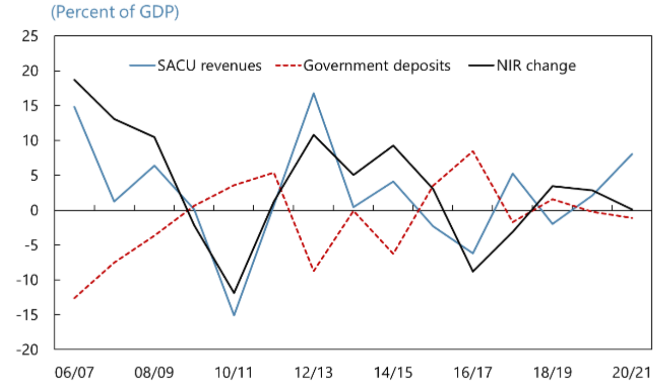


Source: IMF staff calculations.
Note: The public wage premium is estimated using Mincer equations. The log incomes of individuals/households are regressed on a public employment dummy, education, age, and disability status (as a proxy for experience and skills), gender, household size, marital status, and regional dummies. Propensity score matching is used to ensure robustness. Estimates for Botswana are based on 2020 Quarterly Multi-Topic Survey; for Namibia, based on 2018 Labor Force Survey, and for South Africa, FAD CD report. Estimates for Eswatini and Lesotho are from the SACU 2018 Spring Meeting workshop. Total spending in percent of GDP is calculated using 2021 data.

5. The exchange rate peg provides a nominal anchor and occasional constraint on government spending. Exchange rate and monetary policy cycles are driven by South Africa. In the absence of a formal fiscal anchor, enforcement of the net international reserves (NIR) target acts as a spending brake when SACU transfers dip. This has frequently led to tensions in fiscal-monetary policy coordination between the Ministry of Finance and the Central Bank of Lesotho (CBL).

Changes in SACU Revenues, Government Deposits, and NIR

(Percent of GDP)



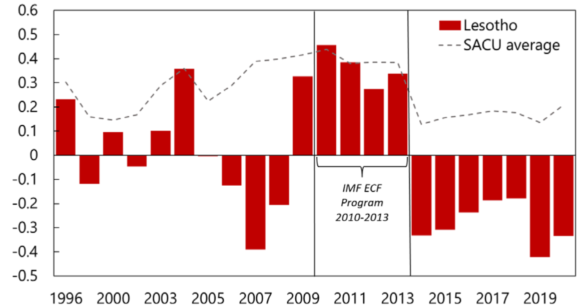
Source: IMF staff calculations.
Note: NIR = Net international reserves.

[6] The civil service internship program, by absorbing many young people into the public sector, further discourages new labor market entrants from actively seeking jobs in the private sector. This public works and internship program was initially envisaged as a temporary (two-year) arrangement and should be discontinued.

6. Political instability and governance issues have continued to hamper adjustment and the formulation of a coherent medium-term reform strategy (Annex III). Ongoing leadership challenges, the dispersion of key policy portfolios across Ministries, Departments, and Agencies (MDAs), and mounting expenditure pressures—also in the run-up to elections—have constrained the government's ability to reach consensus on reforms to bring the economy back onto a sustainable growth path.

Political Stability

(Ranges from approx. -2.5 (weak) to 2.5 (strong) governance performance)



Sources: Worldwide Governance Indicators (WGI) and IMF staff calculations.
Note: Political Stability and Absence of Violence/Terrorism measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.

7. The Fund provided financial support during the pandemic. The 2020 RCF/RFI disbursement (US$49.1 million, SDR34.9 million), the August 2021 Special Drawing Rights (SDR) allocation (US$95 million, SDR66.9 million), and debt relief granted through the Catastrophe Containment and Relief Trust (US$5.36 million, SDR3.84 million) helped meet financing needs and build reserve buffers in the short term.

RECENT ECONOMIC DEVELOPMENTS

8. The pandemic caused widespread social and economic disruption during 2020 and continued to drag on activity through 2021. The economy contracted by 6 percent in FY20/21. Weak external demand and supply chain disruptions also weighed on growth and the cost of living. The textiles industry saw closures and job losses and infrastructure "megaprojects"—notably, the Lesotho Highlands Water Project-II (LHWP-II, Annex IV)—were beset by delays. But while mining contracted sharply in 2020, increased quarrying helped the sector rebound in FY21/22:Q1. The recent war in Ukraine has raised commodity prices to the benefit of mining exports, while disrupting grain imports and food security in areas hit by recent flooding. Inflation averaged 6.4 percent in FY21/22—a percentage point higher than the year before—and is expected to remain elevated at 6.8 percent in FY22/23. Though the relatively low share of wheat in local diets could help moderate inflationary pressures, price increases in food and fuel, which account for over half of the consumer basket, are hurting the vulnerable (Annex V).

9. While fiscal performance in FY20/21 was better than expected, the hard-won savings were not capitalized on in FY21/22 (Annex VI). Revenue performance in FY20/21 was 5.3 percentage points of GDP higher than projected under the 2020 RCF/RFI, due to stronger direct taxes and royalties and lower nominal GDP. By limiting wage increases and spending on goods and services, current expenditure fell by 3.6 percentage points of GDP relative to 2020 RCF/RFI projections. The result was a small fiscal surplus in FY20/21. However, the FY21/22 budget did not build on these gains, setting out double-digit deficits over the medium term with no concrete adjustment measures. While the FY22/23 Budget has provisionally tempered the fiscal outlook, it remains sensitive to revenue collection and the ability to control spending.

10. Efforts to restrain expenditure have also been undermined by growing domestic payments arrears and gaps in PFM. Even though the FY21/22 Mid-Term Budget Review revised down spending, MDAs continued to spend according to previous budget allocations. As a result, the stock of arrears has increased to LSL1.25 billion (3.4 percent of GDP) as of end-November 2021 from LSL720 million (2.1 percent of GDP) at end-March 2021. Recent fraud cases have highlighted vulnerabilities in payment and procurement processes. In the absence of cuts and sufficient donor financing, the government is turning to domestic and external borrowing, deposits, and arrears.

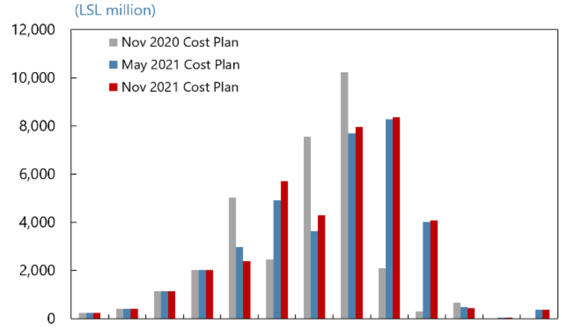
11. Reserves remain stable while credit to the private sector has recently started to recover. With gross international reserves (GIR) at 4.5 months of imports (excluding LHWP-II) in FY21/22, the CBL maintained NIR above a target floor of 120 percent of M1 plus callable deposits to safeguard the peg. Even with the recent SDR allocation, financing needs over the medium term risk reserves falling below adequate levels, estimated at around 4 months of imports. Despite substantial capital buffers, ample liquidity, and low non-performing loans (NPLs; 4.1 percent as of end-2021), banks' contribution to growth remains limited with lending focused in low-risk investments. Private sector credit growth fell to –1.6 percent in FY20/21:Q2, rebounding to 7.4 percent as of FY21/22:Q4.

12. The external position has continued to deteriorate. Exports and remittances fell by 26 and 12 percent, respectively, and the goods and services trade deficit widened by 8 percentage points of GDP in FY20/21. Despite a recovery in exports and remittances, the drop in SACU transfers widened the current account further over the first nine months of FY21/22. Foreign investment, including FDI, continued to decline given the weak external environment and limited opportunities domestically. Staff assesses the external position in FY21/22 to be substantially weaker than implied by fundamentals and desired policies (Annex VII). Policy gaps, driven by the fiscal stance, contribute significantly to the current account gap.

OUTLOOK AND RISKS

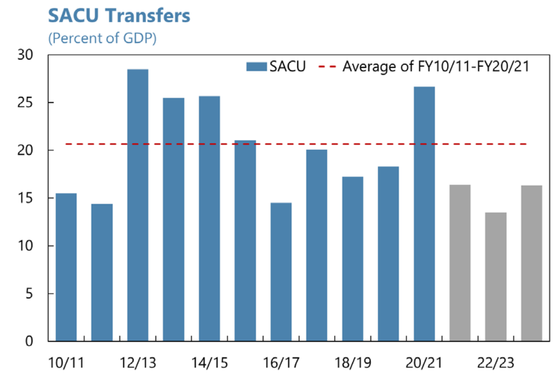
13. The growth outlook remains subdued and contingent on fiscal retrenchment, structural reforms, donor support, and external developments. Despite positive developments in mining, the decline of key sectors and limited access to finance weigh on the post-pandemic recovery. Growth for FY21/22 was revised down to 2.1 percent from 3.9 percent in the 2020 RCF/RFI and is forecast by staff at 2.7 percent in FY22/23 and 1.4 percent on average thereafter. Growth remains largely dependent on investments from local "megaprojects", developments in South Africa, and the path of the pandemic, declining after FY26/27 as LHWP-II construction winds down. Sustained growth over the medium and long term will hinge on the successful implementation of structural reforms to improve governance and boost private sector development.

LHWP-II Projected Cash Flow
(LSL million)



Sources: Lesotho Highlands Development Authority and IMF staff calculations.

14. The fiscal outlook remains challenging and upfront consolidation is needed to sustain the external position. Having shrunk by a third in FY21/22, SACU transfers are projected to remain subdued. The current account deficit is expected to reach 7.4 percent of GDP in FY21/22 and 14.4 percent of GDP in FY22/23, due to falling SACU transfers and capital goods imports for the LHWP-II. Spending trade-offs are likely to worsen if shocks persist and in the absence of consolidation the government would be forced to either (i) cut spending abruptly or (ii) accumulate sizeable new arrears, or both.



Source: IMF staff calculations.

15. Risks to the outlook are tilted to the downside (Annex VIII).

- **Domestic.** Fresh waves of the pandemic would further delay infrastructure projects and dent investor confidence. Ongoing disruptions to activity, growing unemployment, and income losses could drive social unrest. Governance reforms could stall or reverse, while capacity constraints and PFM issues hinder fiscal consolidation. Political tensions could also increase in the run-up to elections, worsening expenditure pressures. While banks are well-capitalized, growing domestic arrears represent a fiscal risk and could result in higher NPLs.

- **External.** A protracted war in Ukraine could weaken global demand and exports. A delayed recovery and additional inward-oriented policies in key foreign markets—notably the EU, South Africa, the U.S.—could further set back exports. Faster-than-expected U.S. monetary policy tightening could spill over through South Africa and balance sheet exposures to rand-denominated assets. Uncertainty about the expiration of the African Growth and Opportunity Act and food insecurity from rising fuel and food prices add to downside risks. Climate shocks remain a major risk to infrastructure, food security, and livelihoods.

16. There are upside risks for growth if opportunities are well-managed. Given Lesotho's elevation and freshwater endowment, commercialization of agriculture—supported by investment in infrastructure and irrigation, and meeting international standards for integration into global value chains—presents an avenue for export growth and food security. Development of subsectors—such as medical cannabis—are already underway. Other upside risks include a faster global recovery, faster vaccination, spillovers from the second Millennium Challenge Corporation compact, and a pick-up in revenues to buoy the fiscus.[7]

17. Debt sustainability risks have risen since 2020. While Lesotho's risk of debt distress remains moderate, the space to absorb shocks has narrowed with present value estimates of both

[7] The Board of the Millennium Challenge Corporation (MCC) approved a second grant program ("compact") of US$300 million on March 31, 2022. Once it has entered into force (expected late 2023), this will channel funding into agriculture, business development, and health. The MCC provides time-limited grants that pair investments in infrastructure with policy and institutional reforms to countries that meet rigorous standards for good governance, anticorruption, and respect for democratic rights.

external and total public debt very close to their thresholds under the baseline. The key risk to debt sustainability is delayed fiscal adjustment. Unaddressed contingent liabilities related to the civil service pension fund and other potential liabilities linked to governance issues add further risks.[8]

Authorities' Views

18. The authorities concurred with staff's assessment of risks. The authorities are more optimistic than staff on the medium-term growth outlook, noting the strong performance of the mining and construction sectors, supported by recent price developments and "megaprojects", and recent progress on the MCC. In the face of financing constraints, they noted the pressure to raise debt to finance growing expenditure needs while acknowledging the risks to debt sustainability over the medium term.

POLICY PRIORITIES

19. Discussions centered on policies to promote fiscal sustainability and a diversified, well-resourced private sector that can become the key engine of growth, while also paying due attention to the political context. Credible policies are needed in four critical areas:

- *Fiscal consolidation to align expenditures with resources.*
- *Strengthening governance, building strong institutions, streamlining government, and improving policy coordination to support credibility, investor confidence, and macroeconomic stabilization.*
- *Maintaining price stability, strengthening financial sector supervision, and reforms to unlock access to finance.*
- *Structural reforms to catalyze inclusive, green, job-rich, sustainable, private-sector-led growth.*

A. Aligning Expenditure with Available Resources to Ensure Sustainability and Preserve Stability

20. Fiscal consolidation is crucial to reduce imbalances and rebuild much-needed space to protect the vulnerable, finance the recovery, and mitigate external shocks.[9] Given the already high revenue ratio, expenditure must bear the brunt of adjustment. The authorities must find ways to contain current spending, scale back unproductive capital spending, and improve efficiency to

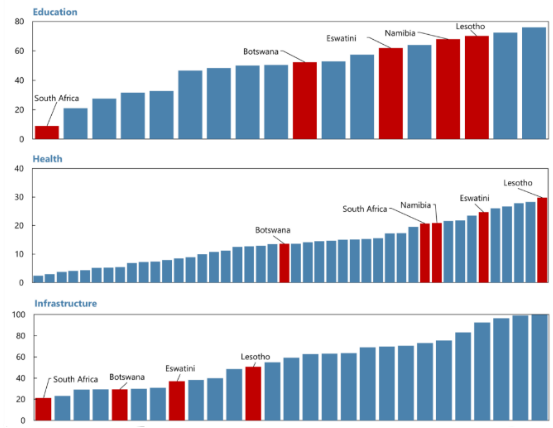
[8] The FY15/16 audit of the civil service pension fund flagged the fund's inability to meet future payments, based on actuarial valuation as of March 31, 2021, due to a shortfall of LSL3.5 billion (9.6 percent of GDP). Other potential liabilities include the claims by Frazer Solar GmbH, after they filed a global enforcement action to seize up to EUR50 million (2.5 percent of GDP) of Lesotho's assets in contractual damages. Following a counter suit against the seizure order filed by the authorities, the South African High Court has temporarily postponed the case.

[9] SIP: *Assessing Fiscal Pressures in Lesotho*.

preserve fiscal sustainability and macroeconomic stability. The risk of ambitious revenue projections and high expenditure jeopardize not only fiscal sustainability, but also resources needed to sustain the peg (see ¶35). Staff advised upfront consolidation to improve the overall balance over the medium term and provide vital space should downside risks materialize.

Spending Inefficiency by Sector

(Efficiency gap (percent))



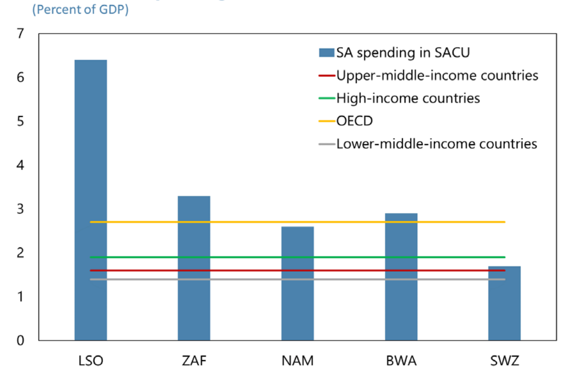
Sources: Baum, Mogues, and Verdier (2020); Garcia-Escribano, Juarros, and Mogues (2022); and IMF staff calculations.
Note: See Chapter 2, IMF April 2021 Fiscal Monitor; efficiency gaps provide a measure (in percent) of the distance between observed output levels and the maximum (the efficient frontier estimated using Data Envelopment Analysis) that could have been obtained given the inputs utilized; the larger the distance from the efficient frontier, the more inefficient the use of inputs; for health, output is life expectancy and input is total per capita health expenditure. For education, outputs are test scores and net enrollment rates and input is public education spending per student; for infrastructure, output is the volume and quality of infrastructure and input is public capital stock and GDP per capita.

21. The public sector wage bill can be contained through a combination of short-term measures and long-term structural reforms. Wage growth, the hiring of non-essential public servants, and perquisites should be restricted in the near term. Over the medium term, additional steps in job grades and merit-based remuneration can also help reduce pay increases. Additional cost-cutting measures should include rationalizing foreign embassies and missions. Compiling a registry of government assets can help identify and dispose of redundant public nonfinancial assets, for example, part of the large government vehicle fleet.

22. Social spending should be rationalized and reprioritized to better target the most vulnerable.[10] Social spending is several times that of neighboring countries and dominated by schemes that crowd out funding for other more effective poverty-reducing initiatives, such as the child grants programme. For example, the tertiary education loan bursary scheme provides merit- and quota-based loans to many who typically do not need support and fail to repay. Its costs (estimated at 2.7 percent of GDP for FY21/22) can be reduced by introducing means-testing and pursing loan recovery.[11] With the authorities passing recent fuel price increases on to consumers, temporary subsidies for agricultural inputs have been introduced and ways to supplement social assistance programs to target the most vulnerable are being explored as costs of living rise. Staff supports targeted and temporary measures given limited fiscal space.

SACU Social Spending

(Percent of GDP)



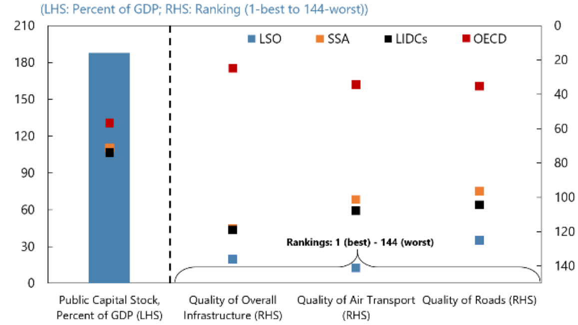
Sources: World Bank ASPIRE database and IMF staff calculations.
Notes: Spending data are from the latest available years in the ASPIRE database (based on administrative data): 2014-16 for Botswana, 2010-11 for Eswatini, 2014-17 for Lesotho, and 2015 for South Africa. Spending for Namibia are based on the SP note - for the year 2018. Regional averages come from the State of SSN, WB 2018. Data for OECD countries refer to 2013 and are based on the Social Expenditure Database. Economies are divided among income groups according to 2016 GNI per capita, calculated using the World Bank Atlas method. The groups are as follows: low-income, US$1,005 or less; lower-middle-income, US$1,006-3,955; upper-middle-income, $3,956-12,235; and high-income, $12,236 or more.

[10] SIP: *Progress Toward Poverty and Inequality Reduction: The Role of Social Programs.*

[11] Staff estimates suggest that total social spending can be reduced from 7.9 percent of GDP to around 5.5–6 percent of GDP, freeing up resources to extend the coverage of poverty-reducing programs (cash-for-assistance, child grants, orphans and vulnerable children, public assistance, and school feeding programs).

23. Public investment should finance areas where it will have the maximum growth impact, crowding in private sector investment, and reducing poverty. The capital budget has so far produced a capital stock that is relatively high as a share of GDP but of a quality that is lagging peers. Staff welcomes the reclassification of current spending previously misspecified under the capital budget. Further streamlining the budget by (i) identifying and minimizing stalled projects and (ii) improving accountability, contract design, investment appraisal, and execution, will help ensure that capital spending is more efficient and better targeted to achieve development priorities and maximize growth.

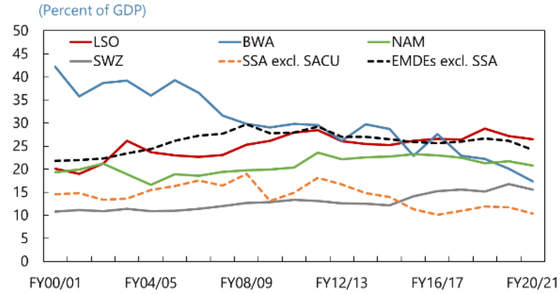
Capital Stock and Infrastructure Quality
(LHS: Percent of GDP; RHS: Ranking (1-best to 144-worst))



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, World Development Indicators, IMF Investment and Capital Stock Dataset, World Economic Forum, and IMF staff calculations.

24. Domestic revenue mobilization can still help support the adjustment. Despite strong (non-SACU non-grants) domestic revenues—driven by personal income taxes, VAT, and water royalties—all available opportunities to broaden the tax base, improve tax administration, and increase compliance must be exploited to maximize resources.[12] These include (i) introducing excises on alcohol and tobacco; (ii) improving administrative efficiency by introducing cashless collection systems, and (iii) improving compliance by enhancing transparency and audit. It is also vital to maintain the integrity of existing taxes, notably ensuring the structure of the VAT is aligned with best practice, and strengthen the tax system to guard against international tax avoidance. Staff recommends a diagnostic assessment of tax administration (TADAT) to help develop a reform plan.

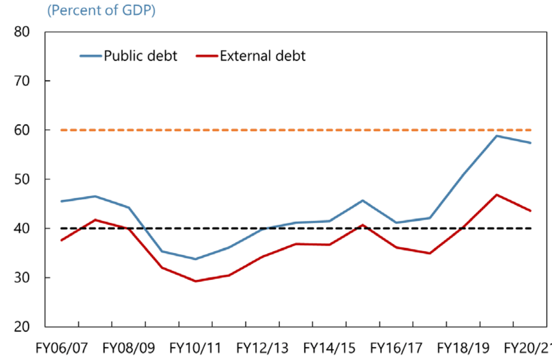
Non-SACU Non-Grant Domestic Revenues
(Percent of GDP)



Source: IMF staff calculations.
Notes: EMDE = emerging market and developing economies; SSA = Sub-Saharan Africa; Series for EMDEs and SSA are domestic revenues excluding grants and taxes on trade.

25. External financing should be primarily on concessional terms and grants to preserve debt sustainability. The government has continued to contract debt on both concessional and nonconcessional terms to finance capital projects. Given recent sharp increases in public debt, contingent liabilities from the civil service pension shortfall, and the growing risk of domestic payment arrears, staff recommends a conservative debt management strategy to maintain debt sustainability focused on concessional sources. Financing needs are

Public Debt
(Percent of GDP)

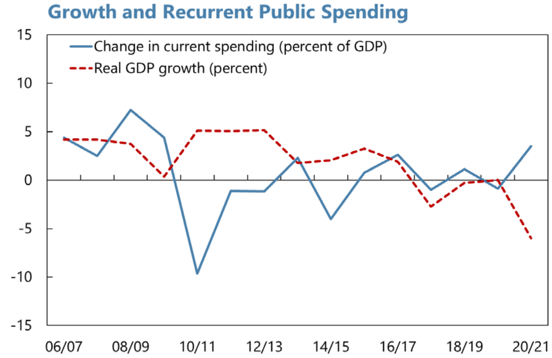


[12] SIP: *An Overview of Taxation in Lesotho.*

to be met by official flows—mostly on concessional terms—and domestic borrowing primarily from banks. The authorities should develop domestic public debt markets further while limiting banks' exposure and crowding out of the private sector.

26. Lesotho's experience would suggest that fiscal consolidation as outlined above would be growth friendly. Rising expenditure in recent years has not led to higher growth, likely owing to inefficiencies. Fiscal consolidation through scaling back less-productive expenditure while focusing on more efficient, well-targeted spending, growth-friendly investment, and robust tax policies and revenue administration could, therefore, mitigate risks to growth. Improving social safety nets will also help protect the vulnerable and secure livelihoods.

Growth and Recurrent Public Spending



Source: IMF staff calculations.

Authorities' Views

27. The authorities acknowledged the need to contain current and capital expenditures and the risks that unchecked expenditure growth poses for debt sustainability and the peg. However, they highlighted the difficulty of implementing consolidation ahead of elections and insufficient capacity to evaluate capital projects. On revenues, the authorities favored the enforcement of a sales tax and the elimination of VAT zero-rating on mining exports on the grounds that the mining sector does not pay its fair share of taxes.[13]

B. Enhancing Governance and Institutional Capacity

Building Strong Institutions to Support Macroeconomic Stabilization

Ministry of Finance

28. Fiscal reforms must be underpinned by robust PFM to ensure oversight and accountability and avoid corruption. Tight fiscal space makes sound budget and financial management essential but challenging. Capacity development has helped core PFM functions but these remain to be embedded. Robust expenditure control, a transparent and well-coordinated budget process, strong monitoring of SOEs, and centralized government accounts can help avoid instances of fraud, minimize fiscal risks, reduce corruption vulnerabilities, and limit spending overruns and arrears.[14]

[13] Amendments to the 2001 Value Added Tax Act were approved by Parliament shortly after the mission concluded.

[14] Other risks that may have a fiscal impact include those from legal claims, including the case brought by Frazer Solar GmbH and the payment dispute with the Tšepong Consortium over the construction and operation of the Queen Mamohato Memorial Hospital.

29. Improving budget processes, procurement, and treasury operations in the Ministry of Finance are critical to strengthening fiscal governance.

- **PFM gaps remain a strong risk for audit and expenditure controls and the Ministry of Finance's overall treasury functions.** Staff urged the finalization and submission of the Public Financial Management and Accountability (PFMA) Bill, implementation of which would improve (i) budget analysis, execution, and monitoring; (ii) fiscal reporting, and (iii) cash, expenditure, and (iv) debt management. All budget commitments should be recorded in IFMIS, while sanctions and penalties for officials committing expenditures outside IFMIS should be enforced.[15] Over the medium term, the authorities should migrate to accruals-based accounting and a Treasury Single Account.

- **Risks of additional unanticipated pressures on the budget must be mitigated.** One-off outlays must be considered carefully and allocated only when deemed critical.[16] Building on the 2020 RCF/RFI governance commitments (see below), checks and balances can be introduced by publishing cost-benefit analyses and procurement contracts online—including, where possible, the names of beneficial owners.[17]

- **Robust PFM controls are also critical to prevent accumulation of arrears.** While the Ministry of Finance's Treasury Department has developed surveys to capture arrears, response rates from MDAs are low. Staff advised both stocktaking and vintage analysis as inputs to a comprehensive arrears clearance strategy. Enacting the PFMA bill and adopting PFM regulations will help minimize arrears in the near term.

- **Digitalization can help improve PFM, revenue mobilization, and expenditure management over the medium term.** Digital infrastructures can help decrease leakages, increase efficiency, and provide systems to help protect the vulnerable. They also allow for robust checks and balances, for example, by connecting IFMIS to management information systems in other MDAs and the CBL's National Payments System. Staff recommended that the Ministry of Finance's Treasury department develop a road map for digitalizing government payments, in coordination with key MDAs.

30. Fiscal policymaking can be improved through organizational restructuring and boosting institutional capacity. Updating departmental functions within the Ministry of Finance to

[15] MDAs continue to enter into expenditure commitments outside of the IFMIS system. MDAs also use current budget allocations for payments related to past procurements, undermining the budget process. They also only register purchase orders in IFMIS later in the expenditure cycle, when cash is available to pay for the (already delivered) good or service.

[16] An example is the appropriation of additional funds for the rehabilitation of the Setsoto stadium for the hosting of the 2021 African Youth Games.

[17] At present, there is no legal definition of beneficial ownership in Lesotho, making it difficult to trace the ultimate beneficiary in procurement contracts. However, the authorities are interested to explore how best to introduce this concept into legislation.

reflect modern PFM processes can improve coordination and accountability.[18] A Tax Policy Unit should be established to support the work of the Tax Policy Committee in the Ministry of Finance.

31. The development, implementation, and commitment to a set of fiscal rules and a fiscal risk management framework will help embed much-needed discipline.[19] A fiscal rule framework—supported by appropriate institutions and legal frameworks—could be developed and calibrated over the medium term to provide limits to spending and debt, embed discipline and credibility within the country's macro-fiscal framework, and provide a bulwark against undue expenditure pressures. Staff also supports the publication of a fiscal risks statement as part of the annual budget process.[20]

Central Bank of Lesotho

32. The 2021 update safeguards assessment found that the CBL has made notable progress in strengthening its safeguards framework. The CBL has maintained robust external audit arrangements, while internal audit and controls have been strengthened in line with the 2012 safeguards recommendations. Enhancements to reporting have resulted in the Audit Committee receiving key information for effective oversight of the audit and control mechanisms.

33. An independent central bank with robust functions will lend credibility to both monetary and financial sector policies and limit political interference.

- The CBL Act should be strengthened in line with recommendations from the 2021 update safeguards assessment to align with leading practices in central bank governance, autonomy, and transparency.[21] The CBL is taking steps to implement recommendations and has requested CD on drafting amendments. The National Reforms Authority (NRA) has also submitted amendments to anchor the central bank's independence in the Constitution.[22]

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[18] Given PFM gaps at both the national and subnational levels, the planned devolution of expenditure powers from MDAs to subnational units should be deferred until such time that robust governance structures are in place.

[19] SIP: *Evaluating Fiscal Rules for Lesotho*.

[20] The Ministry of Finance is working to produce a first fiscal risks statement (FRS) as part of the FY22/23 budget .

[21] The amendments should, inter alia: (i) enhance functional and personal autonomy; (ii) safeguard financial autonomy; (iii) improve transparency and accountability provisions; and (iv) strengthen aspects of governance and oversight relating to the Board's oversight mandate, the establishment of committees, and the vesting of residual powers with the Board.

[22] A national reforms process supported by the Southern African Development Community (SADC) was initiated in 2019 to strengthen Lesotho's institutions and governance. The National Reforms Authority (NRA) committee was elected in February 2020 with the mandate to manage, lead, and coordinate the reform process as stipulated in 2019 National Reforms Authority Act. The reform process has identified constitutional reforms to streamline government, professionalize the civil service, buttress the role of independent institutions, and lay the groundwork for economic recovery. Since some of these reforms may undermine traditional patronage relationships, obtaining consensus may be challenging. Ongoing delays meant that the SADC summit also recommended an extension of the mandate of the NRA for a period of six months, from October 30, 2021, to April 30, 2022.

- Investment policy should be brought in line with leading practices and liquidity management improved by implementing past CD recommendations to protect against emerging credit and liquidity risks.[23] Current passive practices limit room to achieve other goals, including maximizing reserve management efficiency and developing money and secondary bond markets. Amid mounting risks of tighter global financial conditions, exposure to rand-denominated assets should also be monitored closely.

Policy Coordination to Promote Macroeconomic Stability

34. Given policy constraints imposed by the exchange rate peg, coordination between the Ministry of Finance and the CBL is paramount for macroeconomic stability.[24] As a small open economy with a large foreign-owned banking sector and pegged exchange rate, macroeconomic policy objectives should be well-articulated and aligned to ensure consistent fiscal and exchange rate policies. While the peg has helped anchor macroeconomic policy and keep inflation stable, the limited scope for nominal exchange rate adjustment calls for fiscal and structural policies to play a more robust role in external adjustment.[25]

35. The upward trend in expenditure puts pressure on the reserves needed to support the peg. In the absence of close coordination, the government's spending and cash management plans can be at odds with the minimum reserves needed, particularly when funds are scarce, as in 2017. More recently, disagreements over the use of the 2021 SDR allocation highlighted these competing objectives.[26] Under current assumptions for spending and borrowing, NIR—which includes the recent SDR allocation—is projected to drop below the CBL's target in FY23/24 and decline to below 100 percent in the medium term with GIR skirting the minimum three month import cover.

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[23] On investment policy, the CBL should (i) reassess the eligible asset classes and align these with the risk profile adopted for foreign reserve investments; and (ii) reassess the level of investment in term deposits, taking into account liquidity needs. On liquidity management, the CBL is advised to: (i) introduce a short-term instrument for Open Market Operations; (ii) introduce standing credit and deposit facilities; (iii) introduce 7-day reverse repurchase agreements; (iv) streamline the process of liquidity management; and (v) introduce an excess reserve requirement to address the structural excess liquidity situation in the banking system. The CBL has requested CD on foreign reserve management from the World Bank.

[24] SIP: *Policy Coordination in Lesotho*.

[25] Examples include (i) a revenue-neutral shift from taxes on labor to taxes on consumption to reduce the tax burden on exports and raising that on imports to restore competitiveness, and (ii) public-sector wage moderation, which can also exert downward pressure on wages in the private sector and reduce firms' production costs and lead to a real exchange rate depreciation restoring competitiveness.

[26] Options for SDR access include (i) on-lending (direct), subject to Article 42 of the CBL law, under which only 5 percent of domestic revenues can be lent and must be repaid within 6 months; and (ii) drawing down government deposits held at the CBL (indirect), which would lead to changes in money supply and outflows, with implications for reserves. The authorities did not indicate plans to access SDRs through on-lending. However, the SDR allocation indirectly helped to somewhat ease fiscal financing constraints as government deposits—otherwise used to support international reserves—could be partially drawn down to meet public spending needs. Staff encourages the use of SDRs to bolster reserves and (indirectly) support priority (emergency) spending.

36. The institutional independence of the central bank needs to be preserved within a cohesive, well-coordinated, and commonly agreed macroeconomic policy framework. Current practices can be augmented and formalized. For example, to safeguard the peg and preserve debt sustainability: (i) the debt ceiling can be determined by the Ministry of Finance; and (ii) the CBL can determine a ceiling for net claims on government, in consultation with one another. The government can then optimize the composition of spending within the resource envelope informed by these ceilings.

37. At the operational level, policy consultation and coordination can be embedded through regular cross-institutional high-level meetings and technical working groups.[27] The creation of a high-level platform involving top officials from the Ministry of Finance, the CBL and other relevant MDAs would allow for regular engagement, including information exchange and coordination of policy decisions. Technical working groups could have a special focus on key policy areas, including harmonized growth forecasts. In this way, coordination can boost credibility, macroeconomic stabilization, and help depoliticize policymaking.

Progress on Prior Governance Commitments

38. Progress is being made towards fulfilling governance commitments under the 2020 RCF/RFI (Text Table 1). The Procurement Bill has been submitted to Parliament. The internal audit on COVID-19 expenditures for FY20/21 has been published, with audits underway for FY21/22.[28] Quarterly budget implementation reports on COVID-19-related spending were published in 2020.[29] COVID-19-related procurement contracts from a subset of MDAs have been published online.[30] The Anti-Corruption and PFMA Bills are still being (re)drafted. Political and capacity constraints have caused delays and effort is needed to complete remaining measures.

39. The authorities have also proposed measures to streamline government. With over 50 MDAs, government functions have experienced problems with accountability, overlapping mandates, service delivery, and spending oversight. The NRA has submitted constitutional amendments that would limit the number of Ministers and Deputy Ministers to 12 percent of the members of both Houses of Parliament.

[27] Lessons can be learned from similar institutional setups in Ghana and Namibia. The Economic Policy and Coordinating Committee (EPCC) of Ghana, co-chaired by the Finance Minister and the Governor of the Bank of Ghana, is envisioned to provide strategic policy direction for the effective coordination of macroeconomic policy and the budget. The operationalization and legislation of the EPCC through the PFM regulations has been heralded as a critical institutional reform to ensure the continuity of hard-won macroeconomic stability. Similarly, the Committee on Policy Coordination (CPC) in Namibia, among other things, serves as a platform for exchanging information and coordinating monetary and fiscal policy.

[28] http://www.finance.gov.ls/documents/Internal%20Audit/Internal%20Audit%20Report%20on%20Covid%20-%2019%20Related%20Expenditure.pdf

[29] http://www.finance.gov.ls/official_documents.php?id=budget_documents&div=budget_implementation

[30] http://www.finance.gov.ls/official_documents.php?id=PPAD_documents

Text Table 1. Lesotho: Progress on 2020 RCF/RFI Governance Commitments

Progress on 2020 RCF/RFI Governance Commitments

2020 RCF/RFI Governance Commitments	Current Status	Additional Information
Publish quarterly reports on budget implementation, including specific budget lines accounting of expenditures for COVID-mitigation measures	Partially completed	Quarterly reports have been published online for FY20/21:Q1–Q2.
Have internal audit on a quarterly basis focusing on the COVID related expenditure	Partially completed	The internal audit for FY20/21 was completed and published. The internal audits for the four quarters of FY21/22 are still underway.
Have a full audit by the Auditor General of the revised FY2020/21 budget, including a targeted audit of COVID-19 related expenditure, with the results to be published disseminated within 8 months after the end of the fiscal year[1]	To be done	The audit report is ready. However, the Office of the Auditor General is awaiting funding to print the report for Parliament's approval for publication, which is expected end-May 2022.
Publish, on the government's website, signed procurement contracts for crisis-mitigation spending, the names of the companies awarded these contracts and their beneficial owners, and ex-post validation of delivery.	Partially completed	COVID-19 procurement details for a subset of MDAs and district administrations have been published online. Enforcing the submission of COVID-19-related procurement contracts for online publication requires enactment of the PFMA and Procurement Bills.
Submit the Anti-Corruption Bill to parliament	To be done	The authoring agency (DCEO) is being redesigned as the Lesotho Anti-Corruption and Ethics Commission as part of the recently-submitted Omnibus Bill. The Anti-Corruption Bill, will, therefore be revised.
Submit the PFMA Bill (at advanced stage) to parliament	To be done	The Ministry of Finance has decided to consult the main stakeholders about the Bill (those in the Ministry of Finance and a few line ministries), but there is no available timeline. After these consultations, the Bill will be ready to submit to the parliamentary counsel for drafting.
Submit the Procurement Bill to parliament	Completed	-
Maintain a sufficiently lean and efficient administration by reduction and merging of some portfolio ministries, a process that has commenced, while improving governance of the public service	To be done	The recently-submitted Omnibus Bill specifies that the number of Ministers and Deputy Ministers shall not exceed 12 percent of the members of both Houses of Parliament.

[1] Original wording referred to completion within 5 months, which deviates from standard practice within the Auditor General's office.
Notes: The Omnibus Bill sets out constitutional amendments proposed as part of the SADC-sponsored national reforms process and was tabled in Parliament on April 26, 2022. The authorities aim to have the Bill approved and enacted by end-July 2022. DCEO=Directorate on Corruption and Economic Offences; PFMA=public financial management and accountability; SADC=South African Development Community.

Authorities' Views

40. The authorities agreed on the necessity of completing outstanding PFM reforms. The authorities acknowledge PFM gaps are hampering fiscal policy and are committed to minimizing arrears. The importance of better policy coordination between the Ministry of Finance and CBL—through existing and new formal structures—was also mutually acknowledged. The authorities remain committed to implementing the remaining governance measures from the 2020 RCF/RFI. However, they noted that certain commitments are dependent on others. For example, enforcing the submission of COVID-19-related procurement contracts for online publication requires enactment of key legislation, such as the PFMA and Procurement Bills. The NRA is a strong proponent of central bank independence and depoliticizing key processes—such as public sector wage-setting, procurement, debt approval, and cash management.

C. Maintaining Price and Financial Stability and Enhancing Access to Financial Services

41. The exchange rate peg has helped anchor inflation and maintain monetary stability given Lesotho's very close economic linkages with South Africa. Under the peg, the inflation targeting framework is underpinned by the strong credibility of the South African Reserve Bank (SARB). The CBL has raised the policy rate by 75bp since November 2021 and will continue to track the SARB to import price stability and anchor expectations, while also standing ready to tighten in response to inflationary pressures.

42. Unlocking much-needed access to finance, notably for MSMEs, remains the key enabling factor for economic development and private sector growth. [31] The authorities must improve the credit infrastructure, enhance partial credit guarantee schemes, and support the development of capital markets. Staff advised the authorities to (i) complete the collateral property register; (ii) broaden the coverage and scope of the Credit Reporting Act,[32] and (iii) implement the Insolvency Act by developing regulations with detailed provisions for practitioners.[33]

43. While progress has been made with bank supervision, the nonbank financial sector requires extra attention.

- The authorities have implemented measures in line with past recommendations on the Basel II Capital Adequacy Framework, the Risk Based Approach to AML/CFT Supervision, and payments systems. However, due to the pandemic, Basel II.5 implementation was postponed. The resolution framework could be strengthened via amendments to the Financial Institutions Act, and implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions would help align with international best practice.

- Nonbank financial supervision is still in its early stages. The Financial Cooperatives Bill should be finalized and submitted to Parliament, to provide the Ministry of Small Business Development, Cooperatives, and Marketing with greater powers to address troubled financial cooperatives and capacity to improve supervisory effectiveness. Actions must also be taken to deal with large financial institutions that continue to operate without a license. A Financial Action Task Force evaluation will help identify priorities for nonbank institutions.

44. Following progress, AML/CFT framework must continue to be effectively implemented in line with international standards. The CBL recently revamped its AML/CFT framework and is currently building capacity at the Financial Intelligence Unit. The CBL must continue to strengthen its AML/CFT capacity, including the effective migration to a risk-based approach to financial sector supervision. Particular attention should be paid to the management of risks associated with Politically Exposed Persons and the collection and retention of beneficial ownership information. Plans to

[31] SIP: *Improving Financial Inclusion*.

[32] The current Act allows the Credit Bureau to access information across all types of providers. However, coverage remains limited—especially for women whose credit history is typically incomplete—and other data sources should be used, e.g., utilities. Credit scores and improved accessibility of credit information, e.g., via cell phones, are also needed.

[33] The implementation of the Act will modernize the framework for business rescue and restructuring, harmonize personal and business insolvency processes, and set out qualification and registration requirements for practitioners.

establish a national registry of bank and mobile network operator accounts will provide information to support these efforts.[34]

45. Fostering digital financial services will broaden financial inclusion and literacy. Staff advised authorities to (i) submit the National Payments Systems Bill to Parliament and implement associated regulations; (ii) implement the Government Payment Gateway; (iii) implement the National Switch—and the associated common data standards and protocols; (iv) implement the National Identification Act; (v) update the Data Protection Act in line with international good practices, and revise and resubmit the Computer Crime and Cybersecurity Bill; (vi) adopt simplified customer due diligence requirements; and (vii) adopt Financial Consumer Protection regulations.

Authorities' Views

46. The CBL agreed on the importance of closely monitoring inflation risks and monetary policy developments in South Africa given recent shocks. The CBL also agreed on the macro-criticality of increasing financial inclusion, noting progress in digitalizing financial services, the passage of the 2021 Insolvency Bill through Parliament, and recent pricing directives to alleviate financial transaction costs. However, the CBL highlighted that the rapidly growing nonbank financial sector is stretching its supervisory capacity and requires greater attention.

D. Catalyzing Inclusive, Sustainable, Private Sector-led Growth

47. Given the need for fiscal consolidation, broader structural reforms will be vital to help reenergize growth in the economy.

- **A stable and well-regulated business environment is an essential foundation for sustainable private sector-oriented growth.** Staff recommended reforms to improve the business environment, including establishing commercial standards, developing an investment law that provides for open and competitive foreign and domestic investment, implementing digital verification systems for businesses,[35] increasing private-sector participation in SOEs, and strengthening the rule of law.

- **As growth has been predominantly dependent on preferential trade schemes in a few sectors, the need to diversify and improve competitiveness is clear.** Robust policies focusing on governance, education, infrastructure, and removing barriers to trade can support competitiveness and diversification. These include (i) human capital development to

[34] The establishment of a national register of financial accounts serves several purposes. It will support the CBL's efforts to identify related parties, ultimate beneficial owners, and politically-exposed persons in the area of prudential supervision and AML/CFT. It will help the Financial Intelligence Unit to conduct investigations without compromising the process. In addition, it will help financial sector policy makers to trace the impact of financial inclusion policies by registering data on the type of account (bank, mobile), gender, and geographical location, alongside other key information. Furthermore, it will help improve tax administration. The register would have to be housed in a government institution with adequate infrastructure, including cybersecurity.

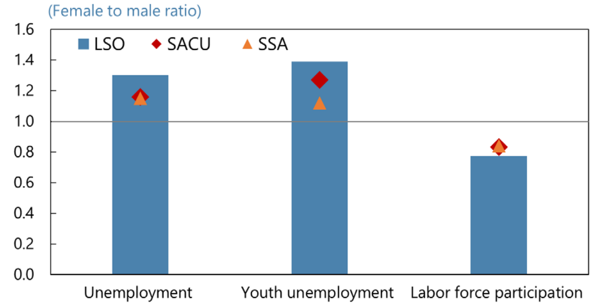
[35] Implementation of the Electronic Signature Act will ensure that digital signatures can be used as a means for verifying transactions and enhancing opportunities for digital financial services in the private sector, e.g., digital credit.

close skills gaps; (ii) moving businesses up the value chain; (iii) infrastructure investment to enhance connectivity, and (iv) easing nontariff barriers, especially on critical intermediate goods. The authorities are also looking to special economic zones to boost investment. Staff advised that careful attention must be paid to the design of incentives to avoid disrupting national tax policy, ceding tax base, and generating unjustified advantages, nonneutralities, and distortions. Consultation with stakeholders, including the private sector, will be critical.

48. **Vulnerability to climate shocks such as floods and droughts underscores the importance of building climate-resilient infrastructure.**[36] Specifically, measures to improve irrigation systems, halt soil degradation, and regulatory reforms to promote climate-smart agricultural practices could help strengthen resilience in agriculture.

49. **Building on positive strides in recent years, further efforts to address structural gender inequalities would help boost growth.**[37] Gender parity has been achieved at most levels of education. However, female labor remains concentrated in informal, low-skilled, contact-intensive sectors, which were among the hardest hit during the pandemic. Furthermore, local laws limit women's access to finance, land, and employment. To promote active female labor force participation, staff advised the authorities to improve paid parental leave policies, take measures to reduce girls' school drop-out rates, and improve female health outcomes, particularly in maternal health and HIV. The authorities have also begun work with development partners to introduce gender responsive budgeting.[38]

Labor Market
(Female to male ratio)



Sources: UNDP Human Development Index (HDI), World Bank World Development Indicators (WDI), and IMF staff calculations.
Notes: Unemployment rates are for 2018 and labor force participation rates are latest available for each country. SACU and SSA rates are median values.

50. **Work has begun on the successor to the government's current national development strategy (NSDP II), which is set to expire in 2023.** The NSDP-II aimed to shift Lesotho from a consumer- and government-driven economy to a producer-based economy led by the private sector. The list of reforms was ambitious and progress slow due to persistent structural challenges and disruptions caused by the pandemic. The new plan should set out an achievable development agenda with measurable outcomes over the planning horizon.

[36] SIP: *Addressing Lesotho's Climate and Environmental Challenges.*

[37] SIP: *The Impact of COVID-19 on Gender Inequality*.

[38] This includes: (i) the introduction of gender responsive budget documentation and gender impact analysis of new budget policy proposals in at least one pilot ministry in FY23/24; (ii) a review of COVID-19-related spending from a gender lens; and (iii) permanently embedding gender responsive budgeting in the annual budget cycle over the medium term.

Authorities' Views

51. The authorities acknowledge that structural reforms can help resuscitate and reenergize growth alongside fiscal consolidation. The authorities welcomed the discussion on climate issues and are already embarking on piloting gender-responsive budgeting in selected MDAs.

OTHER ISSUES

52. Capacity development will be critical in supporting the authorities' reform efforts (Annex IX). Priorities remain to strengthen PFM, financial sector oversight, liquidity and reserves management, tax policy and administration, and implement the anti-corruption legal framework.

53. Data are broadly adequate for surveillance. However, improvements are called for in the areas of debt, government finance statistics, national accounts, and trade:

- On **government finance statistics**, coverage should be improved to eliminate discrepancies between above- and below-the-line transactions, and to include the largest extrabudgetary units. The timeliness and consistency of fiscal data should also be improved.

- On **debt**, reliability and granularity of the public debt data should be improved to achieve greater accuracy of debt service projections. Contingent liabilities and guarantees should also be fully recorded and disclosed.

- On **national accounts**, quality should be improved through greater data sharing with the Bureau of Statistics and implementing the planned rebasing of the annual national accounts. Efforts to improve quarterly and expenditure-side GDP data should continue.

- On **trade**, granular data on values and volumes of products exported and imported could help assess sectoral performance. Such data should be supplemented with detailed publicly-available tariff schedules to help importers determine amounts owed upon importation.

Authorities' Views

54. The authorities acknowledged weaknesses in both data quality and timeliness. The Ministry of Finance aims to eliminate above- and below-the-line discrepancies, which will require improved coordination with the CBL and the Ministry of Development Planning. The Bureau of Statistics will continue their efforts to improve national accounts data.

STAFF APPRAISAL

55. Lesotho has been simultaneously buffeted by the pandemic and declining SACU transfers. The government responded swiftly to the pandemic—through containment, social, and economic mitigation measures, and vaccination. Nevertheless, the resulting fiscal pressures are weakening the external position, which is assessed in FY21/22 to be substantially weaker than implied by fundamentals and desired policies, underlining the fragility of the current economic model and the urgent need to consolidate public finances. Alongside, broad-ranging structural reforms will be vital to support a durable, resilient post-pandemic recovery built on green, inclusive, job-rich, and sustainable, private sector-led growth.

56. Fiscal sustainability will require determined efforts to contain spending upfront and implement PFM reforms. Fiscal and debt sustainability—and the ability to maintain sufficient reserves—are at risk under current policies. If unchanged, they could result in abrupt adjustment with a significant impact on macroeconomic stability, growth, and inequality. Critical for adjustment is containing current spending—notably high rigid public sector wages—and rationalizing capital spending. Fiscal consolidation complemented by both PFM and revenue reforms to minimize arrears, improve efficiency, control expenditure, and boost tax policy administration can improve fiscal outcomes in the near term, while minimizing the impact on growth. The government would then find itself better placed to finance key development priorities over the medium term.

57. The premium on undertaking structural reforms as soon as possible to create a growth-friendly environment is higher than ever. Staff strongly encourages efforts to improve the business environment, broaden financial inclusion, strengthen financial sector stability, and help the financial sector contribute more to growth by enhancing lending to businesses. To support these objectives, constraints related to credit reporting, collateral management, insolvency frameworks, liquidity management, and property rights need to be addressed. The nonbank financial sector needs to be developed. The authorities are encouraged to develop a financial sector development strategy based on the findings and recommendations of the IMF's Financial Sector Stability Review and the World Bank's Financial Sector Assessment Program Development Module.

58. Staff strongly encourages the authorities to continue their efforts to improve broader governance, build robust institutions, and coordinate closely across institutions on macroeconomic policies.

- **Policy coordination across institutions is essential for effective macroeconomic stabilization.** The fixed exchange rate leaves the weight of adjustment to fall on fiscal policy and structural reforms. Staff welcomes efforts to strengthen central bank independence and governance to ensure price and exchange rate stability. Close coordination between fiscal and monetary authorities is necessary to balance competing objectives for spending, debt, and reserves; boost credibility and investor confidence, and ensure consistency of macroeconomic policies with the exchange rate regime.

- **Staff urges the authorities to implement the full range of governance commitments made under the 2020 RCF/RFI in a timely manner and extend them to areas beyond COVID-19 public spending, where warranted.** Governance improvements will help macroeconomic stability, the business environment, and growth.

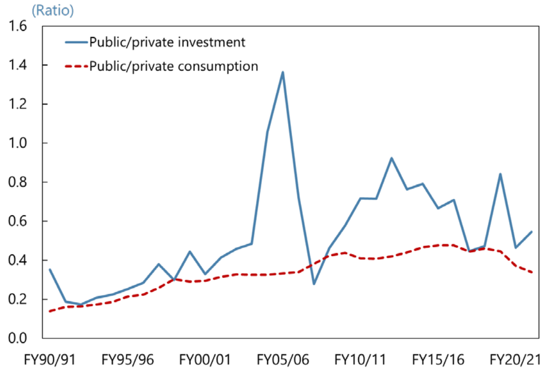
59. Notwithstanding the elections this year, a key set of macro-critical reforms that have broad support are important to pursue (Annex X). These include: overdue PFM reforms, which can help contain expenditure and arrears; auditing and prioritizing the capital budget; digitalizing government payment systems, and implementing the Insolvency Act.

60. Staff recommends that the next Article IV consultation for Lesotho be held on the standard 12-month cycle.

Figure 1. Lesotho: A Closer Look at Lesotho's Economic Model

The government-driven growth model is driving an increasing share of public expenditure…

Nominal Public-to-Private Investment and Consumption
(Ratio)

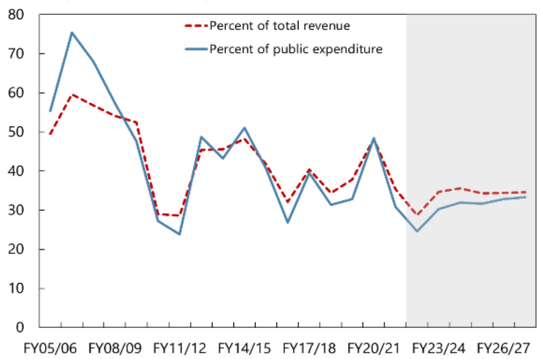


…while financial sector policies and regulatory development lag the region.

Economic Environment, 2018–19
(Index, 0~10 best)

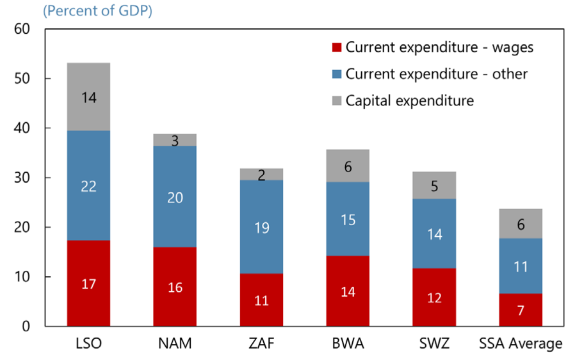
Lesotho has benefitted from large but volatile SACU transfers which are closely correlated expenditures…

Evolution of SACU Transfers



…and have, therefore, helped fund an outsized government.

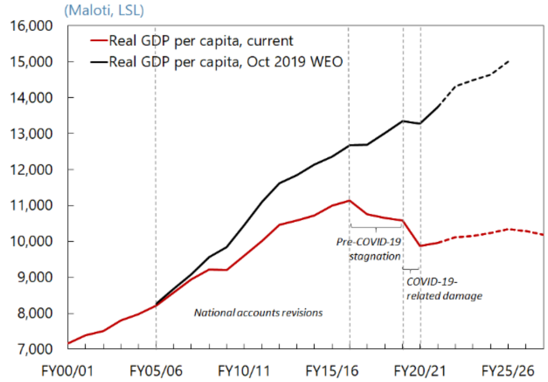
Government Spending, 2021
(Percent of GDP)



Note: SSA average excludes SACU countries.

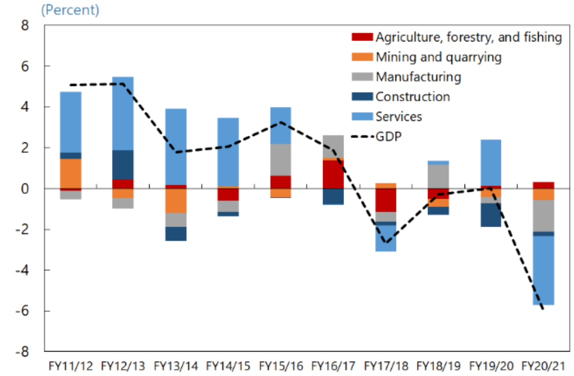
Following revisions to GDP, the economy has been stagnating since 2016…

Real GDP Per Capita
(Maloti, LSL)



…driven by strong fluctuations in construction, mining, and services.

Sectoral Contributions to GDP Growth
(Percent)

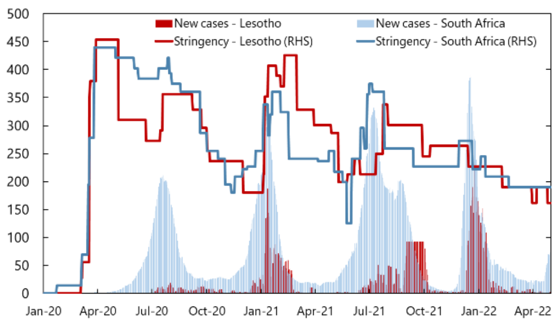


Sources: Bureau of Statistics, Ministry of Finance, World Economic Forum Global Competitiveness Index 2018, World Governance Indicators 2020, IMF World Economic Outlook, and IMF staff calculations.
Notes: SACU=Southern African Customs Union; WEO=World Economic Outlook; BWA=Botswana; LSO=Lesotho; NAM=Namibia; SSA=sub-Saharan Africa; SWZ=Eswatini; ZAF=South Africa.

Figure 2. Lesotho: The Impact of COVID-19

Official statistics show that Lesotho has been hit by at least three waves of the pandemic…

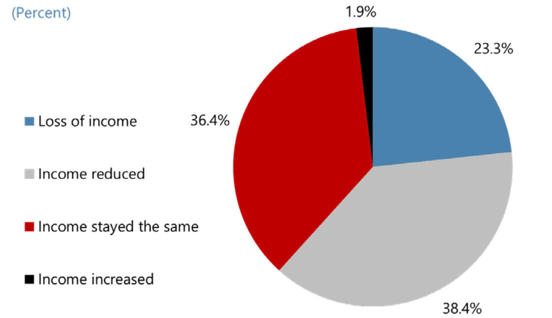
Lesotho and South Africa: New Cases per Million and Policy Stringency



Sources: Johns Hopkins University and University of Oxford.
Notes: New case per million is 7-day moving average; the Stringency Index measures government responses to COVID-19, specifically containment and closure policies including school closures and restrictions in movement, 100 = strongest.

…which have compounded income losses since 2020.

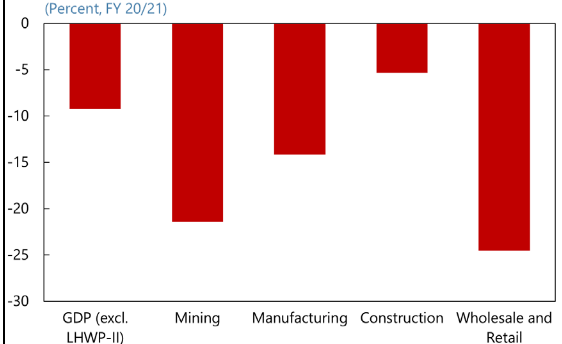
Distribution of Wage Income Respondents by Income Change, December 2020
(Percent)



Source: Lesotho COVID-19 Socio-Economic Impact on Households Survey Phase II

Mining, manufacturing, and construction were among the most heavily affected sectors in the economy…

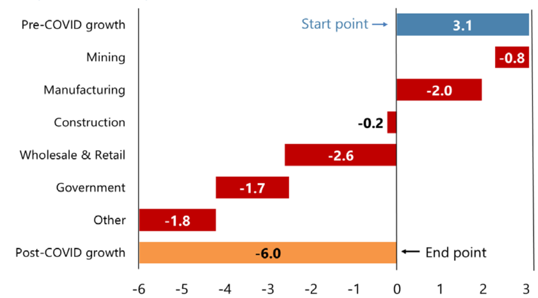
Growth Impact of Covid-19 by Sector
(Percent, FY 20/21)



Source: IMF staff calculations.

…while losses in manufacturing, contributed the most to the sizable downward revision in growth.

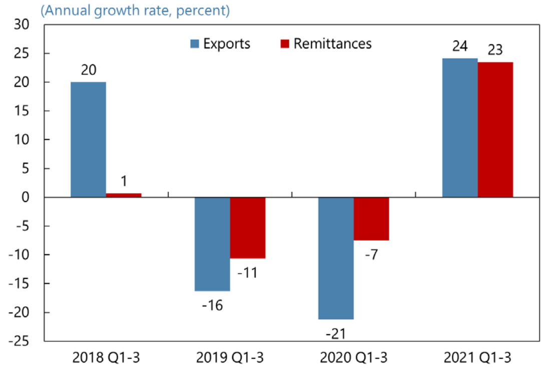
Sectoral Contributions to Revisions in Real GDP Growth
(Percent, FY20/21)



Source: IMF staff calculations.
Note: Red bars indicate negative contributions.

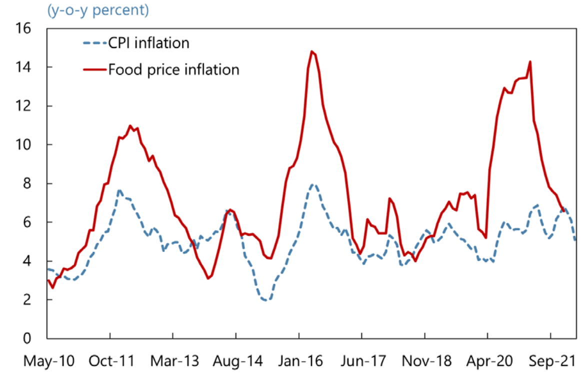
Exports and remittances collapsed during the pandemic…

Exports and Remittances
(Annual growth rate, percent)



…while food inflation increased risking food insecurity for those households with income losses.

CPI Inflation vs. Food Price Inflation
(y-o-y percent)

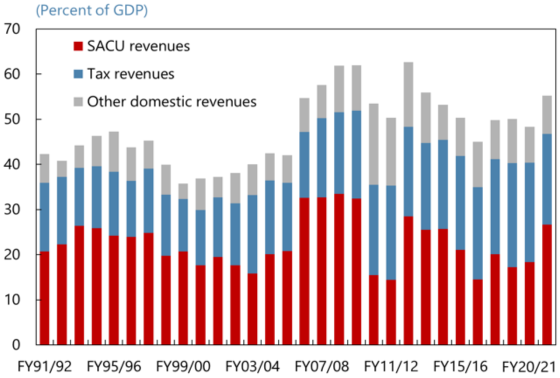


Sources: Central Bank of Lesotho, Lesotho COVID-19 Socio-Economic Impact on Households Survey, Johns Hopkins University, University of Oxford, and IMF staff calculations.

Figure 3. Lesotho: Fiscal Developments

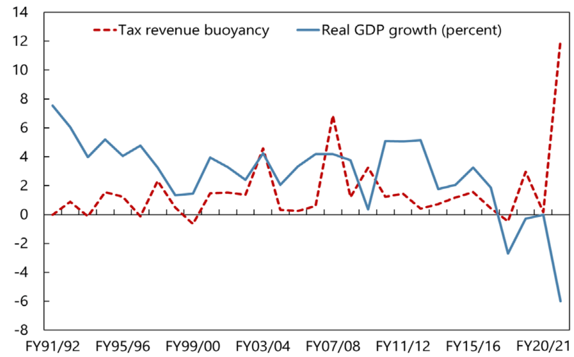
Volatile, SACU transfers typically dominate revenues…

Government Revenues
(Percent of GDP)



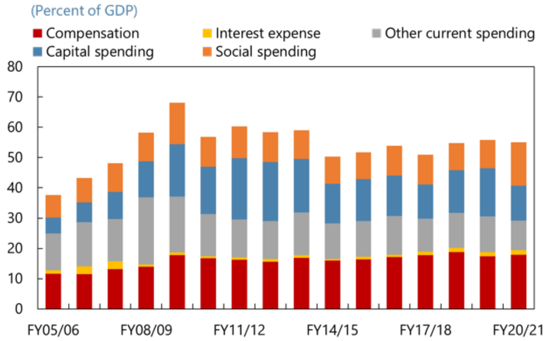
…but tax revenues have also been unstable as the economy has slowed.

Tax Revenue Buoyancy and Real GDP Growth



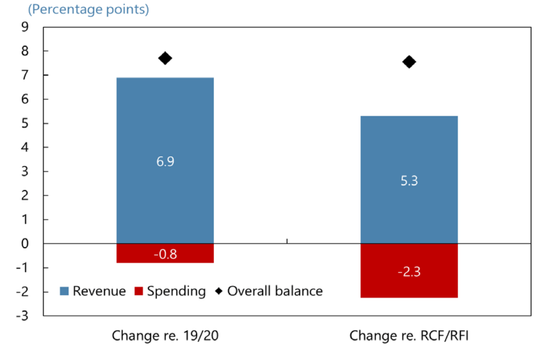
Wages and other items of current spending have remained stubbornly elevated over the past decade

Evolution of Public Expenditure
(Percent of GDP)



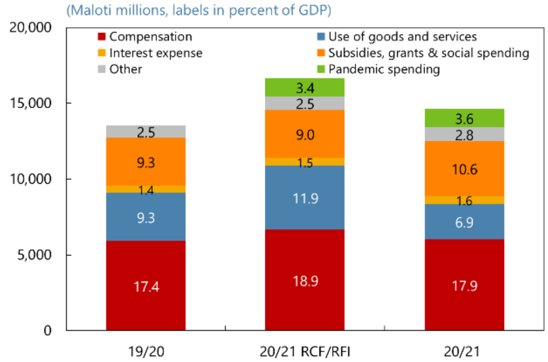
Strict budgeting meant that the FY20/21 fiscal outturn was much better than expected…

20/21 Outturn vs.19/20 and RCF/RFI Projections
(Percentage points)



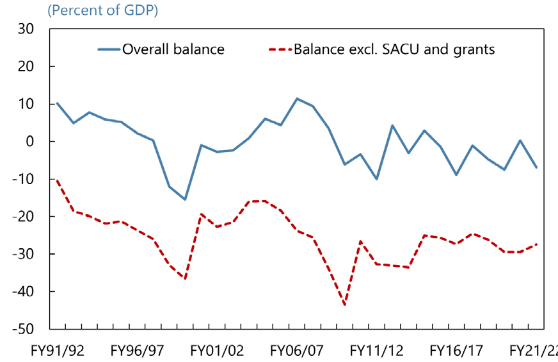
…providing space for vital COVID-19 expenditure.

Composition of Current Spending
(Maloti millions, labels in percent of GDP)



Fiscal rules that limit discretion can help minimize volatility in the overall fiscal balance.

Overall Balance
(Percent of GDP)

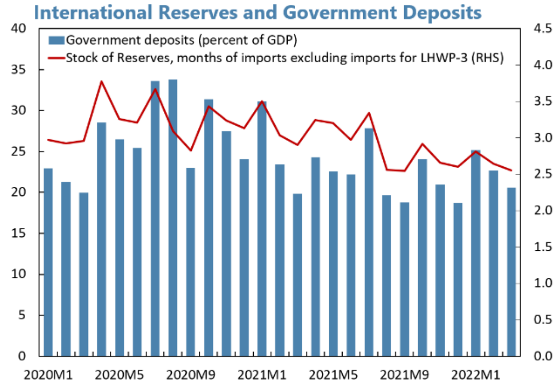


Sources: Ministry of Finance and IMF staff calculations.

Figure 4. Lesotho: Monetary Policy and the Financial Sector

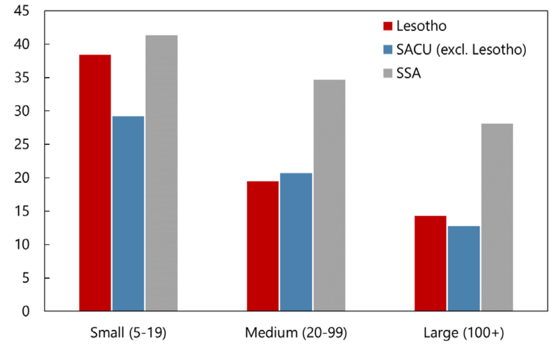
The peg remains protected by a stable high reserve target, helping to constrain government spending.

International Reserves and Government Deposits



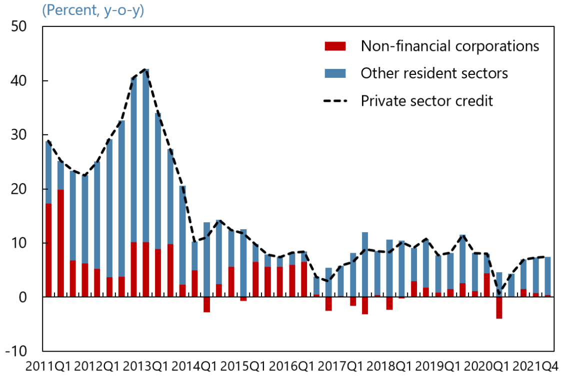
Business' access to credit is limited, especially for small businesses.

Businesses Reporting Access to Finance as Major Constraint
(Percent)



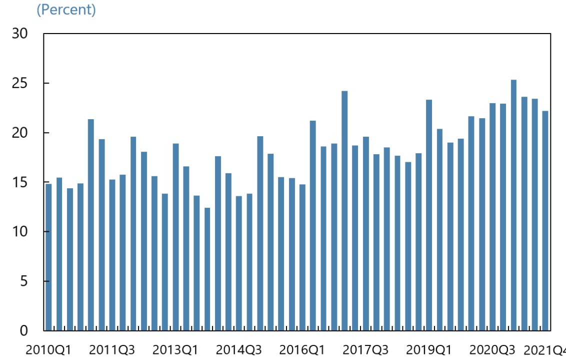
The financial sector's contribution to private sector credit is limited …

Private Sector Credit Growth
(Percent, y-o-y)



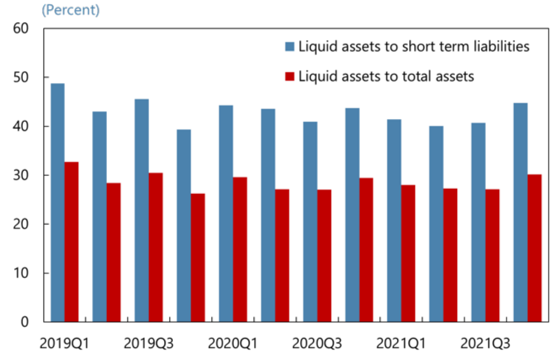
…while banks remain (increasingly) well-capitalized.

Bank Capital Adequacy Ratio
(Percent)



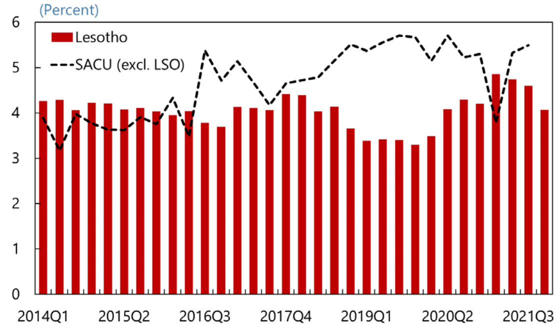
Banks are also awash with liquidity…

Liquid Assets Indicators
(Percent)



….and with limited lending to the economy, are seeing fewer NPLs on average than others in the region.

Non-Performing Loans to Gross Loans
(Percent)

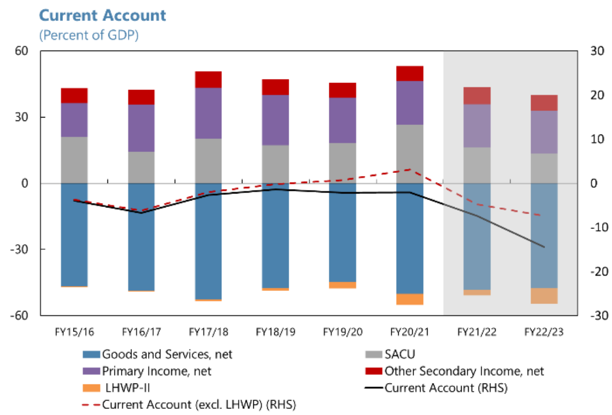


Note: SACU (excl. LSO) excludes Eswatini in 2020Q3-2021Q3 and South Africa in 2021Q2-Q3 due to data limitation.

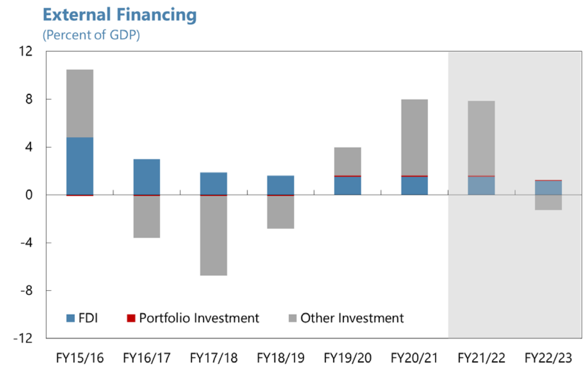
Sources: Central Bank of Lesotho, World Bank Enterprise Surveys, IMF Financial Soundness Indicators, and IMF staff calculations.

Figure 5. Lesotho: External Sector and Debt

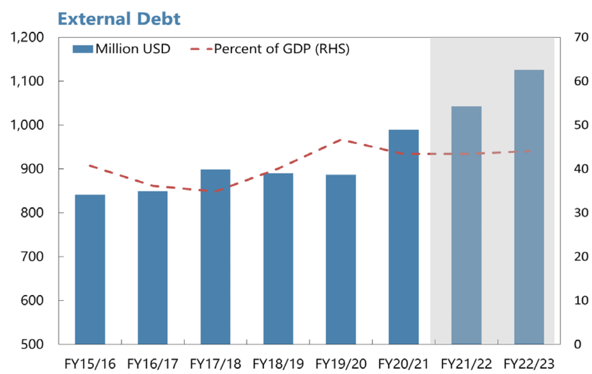
The current account deficit is expected to widen as SACU transfers drop…



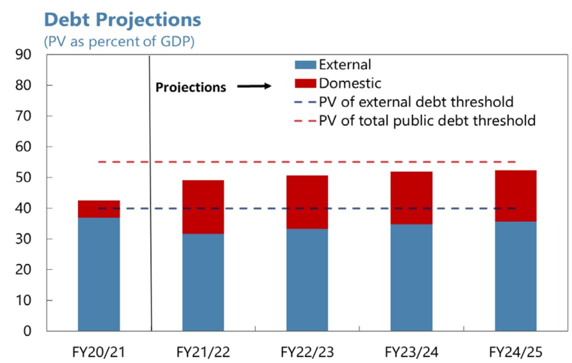
…and FDI flows remain subdued.



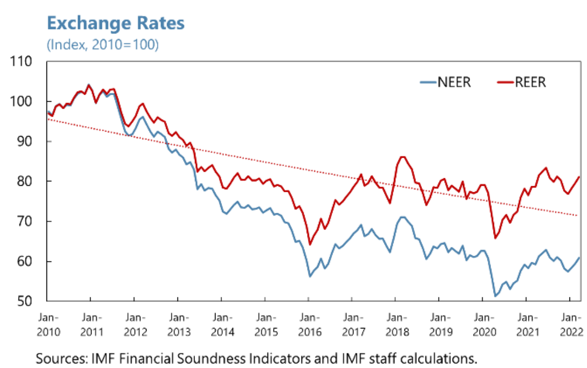
External debt continues to increase as the authorities continue to finance large capital projects…



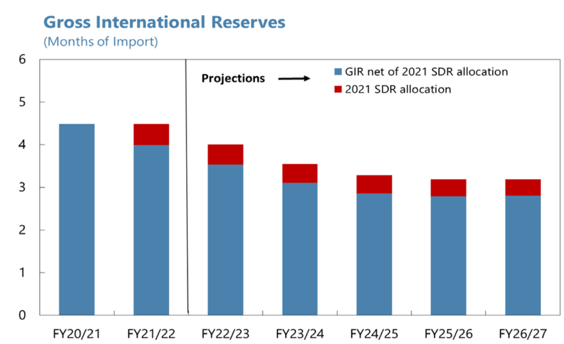
…nudging the country closer to a high risk of debt distress.



The exchange rate has been appreciating, implying overvaluation relative to long-term trend.



While the 2021 SDR allocation helped, external imbalances are putting pressure on international reserves.



Sources: Central Bank of Lesotho, Ministry of Finance, and IMF staff calculations.

Notes: SACU=Southern African Customs Union; FDI=foreign direct investment.

Table 1. Lesotho: Selected Economic Indicators, 2018/19–2027/28[1]

Population (thousands; 2020 est.):	2,142
GNI per capita (US$; 2020 est.):	1,100
Poverty rate at national poverty line (percent; 2017 est.):	49.7

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.			Projections			
					(12-month percent change, unless otherwise indicated)					
National account and prices										
GDP at constant prices (incl. LHWP-II project)	-0.3	0.0	-6.0	2.1	2.7	1.6	2.1	2.3	0.7	0.1
GDP at constant prices (excl. LHWP-II project)	-0.3	0.0	-6.3	2.0	1.9	1.8	1.5	1.5	1.5	1.5
GDP at market prices (Maloti billions)	32.2	34.0	33.7	36.7	40.0	42.9	45.8	49.0	51.8	54.5
GDP at market prices (US$ billions)	2.3	2.3	2.1	2.5	2.6	2.7	2.9	3.1	3.3	3.5
Consumer prices (average)	4.7	4.9	5.4	6.4	6.8	5.5	4.9	4.9	4.9	4.9
Consumer prices (eop)	5.2	4.0	6.5	5.9	6.0	4.9	4.9	4.9	4.9	4.9
GDP deflator	5.5	5.5	5.5	6.5	6.4	5.4	4.7	4.6	4.9	5.0
External sector										
Terms of trade (– = deterioration)	-0.4	2.0	4.1	-2.3	-2.7	2.2	1.7	1.8	1.3	0.7
Average exchange rate										
(Local currency per US$)	13.8	14.8	16.4	...	...	...	...	...	...	...
Nominal effective exchange rate change (– = depreciation)[2]	-0.1	-5.6	-10.4	...	...	...	...	...	...	...
Real effective exchange rate (– = depreciation)[2]	2.1	-2.8	-7.4	...	...	...	...	...	...	...
Current account balance (CA) (percent of GDP)	-1.4	-2.1	-2.0	-7.4	-14.4	-9.6	-10.5	-10.0	-8.6	-5.4
CA excl. LHWP-II imports (percent of GDP)	-0.2	0.8	3.1	-4.8	-7.4	-4.5	-4.1	-4.0	-3.2	-2.8
Gross international reserves										
(Months of imports, excluding imports for LHWP-II)	4.0	4.5	4.5	4.5	4.0	3.6	3.3	3.2	3.2	3.1
Money and credit										
Net international reserves										
(US$ millions)	687	608	739	809	745	712	705	729	771	813
(Percent of M1 Plus)	116	135	112	127	115	104	97	93	92	92
(US$ millions, CBL calculation)	742	605	776	786	...	...	...	...	...	...
(Percent of M1 Plus, CBL calculation)	120	122	124	121	...	...	...	...	...	...
Domestic credit to the private sector	7.7	8.0	0.6	7.4	10.7	8.5	12.6	11.4	9.3	8.2
Reserve money	-11.5	14.2	-0.1	1.2	6.4	5.9	-5.2	-1.8	-1.9	-1.9
Broad money	5.5	7.2	17.2	0.0	5.0	5.1	7.0	7.9	6.0	5.5
Interest rate (percent)[3]	4.3	3.9	3.5	2.8	...	...	...	...	...	...
					(Percent of GDP, unless otherwise indicated)					
Public debt	50.9	58.8	57.4	59.2	60.7	62.4	63.7	64.2	64.4	64.1
External public debt	40.2	46.9	43.6	43.6	44.3	46.1	47.7	48.4	48.5	48.1
Domestic public debt	10.7	12.0	13.8	15.7	16.4	16.3	16.0	15.8	15.9	16.0
Central government fiscal operations										
Revenue and grants	50.0	48.4	55.3	46.2	47.0	47.0	47.8	46.6	46.5	46.3
Revenue excluding grants and SACU revenue	*28.6*	*26.3*	*25.5*	*25.7*	*27.9*	*27.9*	*27.8*	*27.7*	*27.9*	*27.8*
SACU revenue	*17.2*	*18.3*	*26.6*	*16.4*	*13.5*	*16.3*	*17.0*	*16.0*	*16.0*	*16.0*
Grants	*4.3*	*3.7*	*3.1*	*4.2*	*5.6*	*2.8*	*2.9*	*2.9*	*2.6*	*2.5*
Recurrent expenditure	40.8	39.9	43.4	39.5	40.1	40.7	40.0	38.3	38.2	38.2
Of which: wages, including social contributions	18.8	17.4	17.9	17.4	19.7	20.3	19.7	18.9	18.8	18.8
Capital expenditure	14.0	15.9	11.6	13.6	14.7	13.2	13.3	12.3	10.6	9.9
Overall balance	-4.8	-7.5	0.3	-6.9	-7.8	-6.8	-5.5	-4.0	-2.3	-1.7
(Excluding SACU transfers and grants)	*-26.2*	*-29.5*	*-29.5*	*-27.4*	*-26.9*	*-26.0*	*-25.5*	*-22.8*	*-20.8*	*-20.2*
Primary balance	-3.3	-6.0	1.9	-5.0	-6.2	-4.8	-3.1	-1.6	0.1	0.7
(Excluding SACU transfers and grants)	*-24.8*	*-28.0*	*-27.8*	*-25.6*	*-25.3*	*-24.0*	*-23.0*	*-20.4*	*-18.5*	*-17.8*
Statistical discrepancy	2.0	0.0	0.1	-2.8	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Lesotho authorities, World Bank, and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] IMF Information Notice System trade-weighted; end of period.

[3] 12-month time deposits rate.

Table 2. Lesotho: Fiscal Operations of the Central Government, 2018/19–2027/28[1,2]

(LSL millions)

	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	RCF/RFI	Act.	Est.	Projections					
Revenue	**16,117**	**16,437**	**17,639**	**18,633**	**16,957**	**18,815**	**20,153**	**21,912**	**22,856**	**24,084**	**25,208**
Tax revenue [3]	7,438	7,505	6,110	6,779	7,673	9,050	9,708	10,334	11,030	11,720	12,253
Taxes on income, profits, and capital gain	4,100	4,052	3,344	3,722	3,906	4,763	5,067	5,373	5,718	6,109	6,355
Taxes on property	0	0	0	0	0	0	0	0	0	0	0
Taxes on goods and services	3,300	3,453	2,766	3,056	3,767	4,287	4,641	4,961	5,307	5,605	5,893
Taxes on international trade	38	0	0	0	0	0	0	0	0	0	0
Other taxes	0	0	0	0	0	0	0	0	5	6	6
Grants	1,373	1,256	1,100	1,049	1,541	2,261	1,210	1,350	1,407	1,322	1,360
Budget support	232	241	242	147	178	147	147	147	147	147	147
Project grants	1,141	1,015	858	902	1,363	2,114	1,063	1,203	1,260	1,175	1,213
Non-tax revenue	1,764	1,450	1,447	1,825	1,735	2,104	2,237	2,423	2,572	2,754	2,883
Property Income	682	532	349	625	484	708	758	810	867	916	963
Sales of goods and services	1,081	916	1,098	1,199	1,249	1,394	1,476	1,609	1,701	1,834	1,915
Other non-tax revenue	0	1	1	1	2	2	3	3	4	4	5
SACU	5,542	6,226	8,981	8,981	6,008	5,400	6,998	7,806	7,847	8,288	8,713
Expense	**13,128**	**13,561**	**16,602**	**14,635**	**14,475**	**16,062**	**17,450**	**18,323**	**18,786**	**19,787**	**20,789**
Compensation of employees	6,049	5,924	6,675	6,030	6,365	7,887	8,698	9,031	9,280	9,735	10,228
Wages and salaries	5,524	5,459	6,222	5,502	5,744	7,550	7,850	8,150	8,553	8,972	9,427
Social contributions	526	465	453	528	621	337	848	881	727	763	801
Use of goods and services	3,112	3,161	4,207	2,331	2,129	2,734	2,870	3,014	3,221	3,443	3,681
Interest payments	449	480	523	544	608	529	717	857	1,028	1,172	1,270
Domestic	219	252	224	282	316	259	390	468	569	652	712
External	230	227	299	262	291	270	327	389	459	520	557
Subsidies	279	338	541	1,041	945	504	529	556	587	615	642
Grants	874	1,133	1,114	1,915	1,397	1,436	1,511	1,587	1,298	1,371	1,441
Social benefits	1,734	1,687	2,660	1,847	1,902	1,786	1,876	1,969	2,061	2,141	2,217
Of which: Poverty-reducing social spending	0.0	0.0	…	446	502	569	648	692.6	741.0	782.6	823
Other expenses	630	838	883	928	1,128	1,186	1,248	1,310	1,310	1,310	1,310
Of which: Tertiary education loan bursary scheme	577	762	…	891	998	1,030	974	920	828	745	671
Nonfinancial Assets	**4,522**	**5,409**	**3,617**	**3,914**	**4,997**	**5,883**	**5,641**	**6,112**	**6,022**	**5,482**	**5,366**
Domestically financed	2,610	3,630	1,330	1,862	2,401	1,764	1,853	1,944	2,080	2,196	2,348
Externally financed	1,911	1,780	2,287	2,052	2,596	4,119	3,788	4,168	3,942	3,286	3,018
Net Lending(+)/Borrowing (-) (Overall Fiscal Balance)	**-1,532**	**-2,533**	**-2,580**	**84**	**-2,516**	**-3,130**	**-2,938**	**-2,523**	**-1,952**	**-1,185**	**-947**
Transactions in Financial Assets and Liabilities	**-1,843**	**-2,016**	**-2,580**	**62**	**-1,474**	**-3,130**	**-2,938**	**-2,523**	**-1,952**	**-1,185**	**-947**
Financial assets	-533	-1,878	-1,449	147	572	-1,011	-493	-84	367	672	650
Domestic	-560	-1,892	-1,449	147	572	-1,011	-493	-84	367	672	650
Deposits	-586	-1,907	-1,449	129	572	-1,011	-493	-84	367	672	650
Central bank	-586	-45	-1,449	429	392	-1,129	-648	-344	209	619	597
Commercial banks	1	-1,862	0	-301	180	0	0	0	0	0	0
Repayments to the IMF (net of CCRT)	26	15	…	19	86	118	154	260	158	53	53
Loans	26	15	0	0	0	0	0	0	0	0	0
Financial liabilities	1,636	408	1,131	209	1,964	2,119	2,444	2,439	2,319	1,857	1,597
Domestic	1,310	139	-550	-451	1,090	700	272	73	313	439	471
of which: banks (securities)	841	178	…	-311	426	300	400	733	-248	112	112
of which: banks (loans)	0	40	…	-6	-2	0	0	0	0	0	0
of which: Change in domestic arrears	200	0	-800	-279	529	-300	-300	-300	-300	-50	0
Foreign	326	269	1,691	660	874	1,419	2,172	2,366	2,006	1,418	1,126
Disbursements	770	764	2,383	1,238	1,233	2,005	2,785	3,025	2,682	2,110	1,805
of which: G20 DSSI	0	0	113	88	0	0	0	0	0	0	0
of which: World Bank COVID-19 EPRP	0	0	148	148	0	0	0	0	0	0	0
Amortization	-444	-495	-691	-577	-359	-586	-613	-658	-676	-692	-680
CCRT	0	0	…	0	82	0	0	0	0	0	0
Statistical discrepancy	638	-248	…	22	0	0	0	0	0	0	0
Memorandum Items:											
Social spending	2,311	2,449	2,660	2,738	2,900	2,816	2,849	2,889	2,889	2,886	2,887
Stock of arrears	…	1,000	…	721	1,250	950	650	350	50	0	0

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] Data for 2017/18 and 2018/19 are presented on a modified cash basis to correctly reflect current year expenses.

[3] Other taxes are not shown in the table.

Table 3. Lesotho: Fiscal Operations of the Central Government, 2018/19–2027/28[1,2]

(Percent of GDP)

	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	RCF/RFI	Act.	Est.	Projections					
Revenue	**50.0**	**48.4**	**50.0**	**55.3**	**46.2**	**47.0**	**47.0**	**47.8**	**46.6**	**46.5**	**46.3**
Tax revenue [3]	23.1	22.1	17.3	20.1	20.9	22.6	22.6	22.5	22.5	22.6	22.5
Taxes on income, profits, and capital gain	12.7	11.9	9.5	11.0	10.7	11.9	11.8	11.7	11.7	11.8	11.7
Taxes on property	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on goods and services	10.2	10.2	7.8	9.1	10.3	10.7	10.8	10.8	10.8	10.8	10.8
Taxes on international trade	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	4.3	3.7	3.1	3.1	4.2	5.6	2.8	2.9	2.9	2.6	2.5
Budget Support	0.7	0.7	0.7	0.4	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Project grants	3.5	3.0	2.4	2.7	3.7	5.3	2.5	2.6	2.6	2.3	2.2
Non-tax revenue	5.5	4.3	4.1	5.4	4.7	5.3	5.2	5.3	5.2	5.3	5.3
Property Income	2.1	1.6	1.0	1.9	1.3	1.8	1.8	1.8	1.8	1.8	1.8
Sales of goods and services	3.4	2.7	3.1	3.6	3.4	3.5	3.4	3.5	3.5	3.5	3.5
Other non-tax revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SACU	17.2	18.3	25.4	26.6	16.4	13.5	16.3	17.0	16.0	16.0	16.0
Expense	**40.8**	**39.9**	**47.0**	**43.4**	**39.5**	**40.1**	**40.7**	**40.0**	**38.3**	**38.2**	**38.2**
Compensation of employees	18.8	17.4	18.9	17.9	17.4	19.7	20.3	19.7	18.9	18.8	18.8
Wages and salaries	17.2	16.1	17.6	16.3	15.7	18.9	18.3	17.8	17.4	17.3	17.3
Social contributions	1.6	1.4	1.3	1.6	1.7	0.8	2.0	1.9	1.5	1.5	1.5
Use of goods and services	9.7	9.3	11.9	6.9	5.8	6.8	6.7	6.6	6.6	6.6	6.8
Interest payments	1.4	1.4	1.5	1.6	1.7	1.3	1.7	1.9	2.1	2.3	2.3
Domestic	0.7	0.7	0.6	0.8	0.9	0.6	0.9	1.0	1.2	1.3	1.3
External	0.7	0.7	0.8	0.8	0.8	0.7	0.8	0.8	0.9	1.0	1.0
Subsidies	0.9	1.0	1.5	3.1	2.6	1.3	1.2	1.2	1.2	1.2	1.2
Grants	2.7	3.3	3.2	5.7	3.8	3.6	3.5	3.5	2.6	2.6	2.6
Social benefits	5.4	5.0	7.5	5.5	5.2	4.5	4.4	4.3	4.2	4.1	4.1
Of which, Poverty-reducing social spending	0.0	0.0	...	*1.3*	*1.4*	*1.4*	*1.5*	1.5	1.5	1.5	1.5
Other expenses	2.0	2.5	2.5	2.8	3.1	3.0	2.9	2.9	2.7	2.5	2.4
Of which: Tertiary education loan bursary scheme	1.8	2.2	...	2.6	2.7	2.6	2.3	2.0	1.7	1.4	1.2
Non-financial Assets	**14.0**	**15.9**	**10.2**	**11.6**	**13.6**	**14.7**	**13.2**	**13.3**	**12.3**	**10.6**	**9.9**
Domestically financed	8.1	10.7	3.8	5.5	6.5	4.4	4.3	4.2	4.2	4.2	4.3
Externally financed	5.9	5.2	6.5	6.1	7.1	10.3	8.8	9.1	8.0	6.3	5.5
Net Lending(+)/Borrowing (-) (Overall Fiscal Balance)	**-4.8**	**-7.5**	**-7.3**	**0.3**	**-6.9**	**-7.8**	**-6.8**	**-5.5**	**-4.0**	**-2.3**	**-1.7**
Transactions in Financial Assets and Liabilities	**-6.7**	**-6.7**	**-7.3**	**0.2**	**-4.0**	**-7.8**	**-6.8**	**-5.5**	**-4.0**	**-2.3**	**-1.7**
Financial assets	-1.7	-5.5	-4.1	0.4	1.6	-2.5	-1.2	-0.2	0.7	1.3	1.2
Domestic	-1.7	-5.6	-4.1	0.4	1.6	-2.5	-1.2	-0.2	0.7	1.3	1.2
Deposits	-1.8	-5.6	-4.1	0.4	1.6	-2.5	-1.2	-0.2	0.7	1.3	1.2
Central bank	-1.8	-0.1	-4.1	1.3	1.1	-2.8	-1.5	-0.8	0.4	1.2	1.1
Repayment to IMF (net of CCRT)	0.1	0.0	...	0.1	0.2	0.3	0.4	0.6	0.3	0.1	0.1
Commercial banks	0.0	-5.5	0.0	-0.9	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	5.1	1.2	3.2	0.6	5.4	5.3	5.7	5.3	4.7	3.6	2.9
Domestic	4.1	0.4	-1.6	-1.3	3.0	1.7	0.6	0.2	0.6	0.8	0.9
of which: banks (securities)	2.6	0.5	...	-0.9	1.2	0.7	0.9	1.6	-0.5	0.2	0.2
of which: banks (loans)	0.0	0.1	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: Change in domestic arrears	0.6	0.0	-2.3	-0.8	1.4	-0.7	-0.7	-0.7	-0.6	-0.1	0.0
Foreign	1.0	0.8	4.8	2.0	2.4	3.5	5.1	5.2	4.1	2.7	2.1
Disbursements	2.4	2.2	...	3.7	3.4	5.0	6.5	6.6	5.5	4.1	3.3
of which: G20 DSSI	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: World Bank COVID-19 EPRP	0.0	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.4	-1.5	4.8	-1.7	-1.0	-1.5	-1.4	-1.4	-1.4	-1.3	-1.2
CCRT	...	...	...	...	0.2	...	...	...	...	...	...
Statistical discrepancy	2.0	-0.7	0.0	0.1	-2.8	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:											
Social spending	7.2	7.2	7.5	8.1	7.9	7.0	6.6	6.3	5.9	5.6	5.3
Stock of arrears	...	2.9	...	2.1	3.4	2.4	1.5	0.8	0.1	0.0	0.0

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] Data for 2017/18 and 2018/19 are presented on a modified cash basis to correctly reflect current year expenses.

[3] Other taxes are not shown in the table.

Table 4a. Lesotho: Monetary Accounts, 2018/19–2027/28[1]
(LSL millions, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.			Projections			
					I. Monetary Survey					
Net foreign assets	14,019	14,677	17,448	16,598	15,231	13,957	12,758	13,016	13,215	13,392
Central bank	9,295	10,078	10,237	10,336	9,588	9,080	8,979	9,355	10,035	10,693
Commercial banks	4,724	4,599	7,210	6,263	5,643	4,878	3,779	3,660	3,180	2,699
Net domestic assets	-2,801	-2,651	-3,349	-2,493	-422	1,607	3,902	4,957	5,838	6,715
Claims on central government (net)	-2,233	-2,095	-2,479	-2,625	-1,322	-436	373	-244	-805	-1,344
Central bank	-2,259	-2,327	-2,701	-3,375	-2,372	-1,886	-1,808	-2,178	-2,850	-3,501
Commercial banks	26	233	222	749	1,049	1,449	2,182	1,933	2,045	2,157
Claims on private sector	6,817	7,363	7,408	7,960	8,815	9,567	10,776	12,002	13,121	14,201
Other items (net)	-7,589	-8,172	-8,452	-8,041	-8,148	-7,973	-8,048	-8,073	-8,097	-8,120
Broad money (M2)	11,217	12,026	14,099	14,105	14,809	15,564	16,660	17,972	19,053	20,107
Currency outside banks	1,014	1,170	1,380	1,208	1,271	1,336	1,430	1,542	1,635	1,726
Deposits	10,203	10,856	12,719	12,898	13,538	14,229	15,230	16,430	17,418	18,381
					II. Central Bank					
Net foreign assets	9,295	10,078	10,237	10,336	9,588	9,080	8,979	9,355	10,035	10,693
Gross reserves	10,640	11,478	11,964	13,182	12,417	11,779	11,443	11,661	12,289	12,895
Net domestic assets	-7,516	-8,046	-8,207	-8,282	-7,404	-6,766	-6,787	-7,203	-7,923	-8,621
Claims on central government (net)	-2,259	-2,327	-2,701	-3,375	-2,372	-1,886	-1,808	-2,178	-2,850	-3,501
Claims on private sector	100	107	104	112	122	131	140	150	158	166
Other items (net) [2]	-5,357	-5,825	-5,610	-5,019	-5,154	-5,012	-5,118	-5,175	-5,231	-5,287
Reserve money	1,779	2,032	2,030	2,054	2,185	2,313	2,193	2,152	2,112	2,072
Currency in circulation	1,272	1,451	1,765	1,575	1,657	1,742	1,865	2,011	2,132	2,250
Commercial bank deposits	453	537	239	449	527	571	328	141	-21	-179
Liabilities to other sectors	0	0	0	0	0	0	0	0	0	0
Memorandum Items:				(12-month percent change, unless otherwise indicated)						
Reserve money	-11.5	14.2	-0.1	1.2	6.4	5.9	-5.2	-1.8	-1.9	-1.9
Broad money	5.5	7.2	17.2	0.0	5.0	5.1	7.0	7.9	6.0	5.5
Narrow money (M1, percentage change)	-6.9	3.5	33.8	-3.2	5.2	5.1	7.0	7.9	6.0	5.5
Narrow money (M1)	4,954	5,128	6,862	6,640	6,986	7,343	7,860	8,479	8,989	9,486
Credit to the private sector (percentage change)	7.7	8.0	0.6	7.4	10.7	8.5	12.6	11.4	9.3	8.2
Credit to the private sector (percent of GDP)	21.2	21.7	22.0	21.7	22.0	22.3	23.5	24.5	25.3	26.1
Velocity (GDP/broad money)	2.9	2.8	2.4	2.6	2.7	2.8	2.8	2.7	2.7	2.7
Net international reserves	9,956.4	10,880.6	10,927	12,347	11,678	11,171	11,073	11,451	12,132	12,792
(in percent of domestic currency deposits)	55.7	58.5	40.1	50.7	...	...	...	...	...	...

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] Including valuation changes.

Table 4b. Lesotho: Monetary Accounts, 2018/19–2027/28[1]

(Percent of GDP; unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.	Projections					
I. Monetary Survey										
Net foreign assets	43.5	43.2	51.7	45.3	38.0	32.5	27.8	26.5	25.5	24.6
Central bank	28.9	29.6	30.4	28.2	23.9	21.2	19.6	19.1	19.4	19.6
Commercial banks	14.7	13.5	21.4	17.1	14.1	11.4	8.2	7.5	6.1	5.0
Net domestic assets	-8.7	-7.8	-9.9	-6.8	-1.1	3.7	8.5	10.1	11.3	12.3
Claims on central government (net)	-6.9	-6.2	-7.4	-7.2	-3.3	-1.0	0.8	-0.5	-1.6	-2.5
Central bank	-7.0	-6.8	-8.0	-9.2	-5.9	-4.4	-3.9	-4.4	-5.5	-6.4
Commercial banks	0.1	0.7	0.7	2.0	2.6	3.4	4.8	3.9	3.9	4.0
Claims on private sector	21.2	21.7	22.0	21.7	22.0	22.3	23.5	24.5	25.3	26.1
Other items (net)	-23.6	-24.0	-25.1	-21.9	-20.3	-18.6	-17.6	-16.5	-15.6	-14.9
Broad money (M2)	34.8	35.4	41.8	38.5	37.0	36.3	36.3	36.6	36.8	36.9
Currency outside banks	3.1	3.4	4.1	3.3	3.2	3.1	3.1	3.1	3.2	3.2
Deposits	31.7	31.9	37.7	35.2	33.8	33.2	33.2	33.5	33.6	34
II. Central Bank										
Net foreign assets	28.9	29.6	30.4	28.2	23.9	21.2	19.6	19.1	19.4	19.6
Gross reserves	33.0	33.8	35.5	36.0	31.0	27.5	25.0	23.8	23.7	23.7
Net domestic assets	-23.3	-23.7	-24.3	-22.6	-18.5	-15.8	-14.8	-14.7	-15.3	-15.8
Claims on central government (net)	-7.0	-6.8	-8.0	-9.2	-5.9	-4.4	-3.9	-4.4	-5.5	-6.4
Claims on private sector	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other items (net) [2]	-16.6	-17.1	-16.6	-13.7	-12.9	-11.7	-11.2	-10.6	-10.1	-9.7
Reserve money	5.5	6.0	6.0	5.6	5.5	5.4	4.8	4.4	4.1	3.8
Currency in circulation	3.9	4.3	5.2	4.3	4.1	4.1	4.1	4.1	4.1	4.1
Commercial bank deposits	1.4	1.6	0.7	1.2	1.3	1.3	0.7	0.3	0.0	-0.3
Liabilities to other sectors	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:	(12-month percent change, unless otherwise indicated)									
Reserve money	-11.5	14.2	-0.1	1.2	6.4	5.9	-5.2	-1.8	-1.9	-1.9
Broad money	5.5	7.2	17.2	0.0	5.0	5.1	7.0	7.9	6.0	5.5
Narrow money (M1, percentage change)	-6.9	3.5	33.8	-3.2	5.2	5.1	7.0	7.9	6.0	5.5
Narrow money (M1)	15.4	15.1	20.4	18.1	17.4	17.1	17.1	17.3	17.4	17.4
Credit to the private sector (percentage change)	7.7	8.0	0.6	7.4	10.7	8.5	12.6	11.4	9.3	8.2
Credit to the private sector	21.2	21.7	22.0	21.7	22.0	22.3	23.5	24.5	25.3	26.1
Velocity (GDP/broad money)	2.9	2.8	2.4	2.6	2.7	2.8	2.8	2.7	2.7	2.7
Net international reserves	30.9	32.0	32.4	33.7	29.2	26.0	24.2	23.3	23.4	23.5
(in percent of domestic currency deposits)	55.7	58.5	40.1	50.7	...	...	...	...	...	...

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

[2] Including valuation changes.

Table 5a. Lesotho: Balance of Payments, 2018/19–2027/28[1]

(US$ millions, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.	Projections					
Current Account	**-33**	**-49**	**-42**	**-181**	**-371**	**-262**	**-306**	**-311**	**-282**	**-187**
Current account (excl. LHWP-II)	**-5**	**17**	**65**	**-117**	**-189**	**-122**	**-120**	**-125**	**-105**	**-95**
Trade balance	-701	-677	-753	-832	-947	-927	-1,026	-1,017	-1,015	-1,028
Exports, f.o.b.	1,126	1,099	831	957	1,040	1,113	1,194	1,279	1,372	1,473
Imports, f.o.b	1,827	1,776	1,584	1,788	1,987	2,040	2,220	2,295	2,387	2,501
Services (net)	-435	-418	-384	-422	-458	-465	-493	-541	-570	-522
Primary income (net)	534	470	407	481	499	517	540	564	588	614
Secondary income (net)	570	576	689	591	534	613	672	682	715	749
Official transfers	434	447	568	437	392	466	519	523	548	575
Of which: SACU revenue	403	421	549	404	347	446	497	499	527	554
Other transfers	136	130	121	154	142	147	153	160	167	174
Capital Account	**41**	**100**	**93**	**108**	**299**	**166**	**254**	**259**	**209**	**93**
Financial Account	**-29**	**91**	**164**	**194**	**-1**	**55**	**30**	**66**	**112**	**132**
Foreign direct investment	37	35	32	38	30	32	34	36	38	40
Portfolio investment	-2	2	2	2	2	2	2	3	3	3
Other investment	-64	55	131	154	-33	21	-6	27	72	89
Of which:										
Public sector (net)	24	18	-13	40	84	129	134	118	87	66
Disbursements	56	52	23	83	129	178	193	171	134	115
Central government	56	52	23	78	129	178	193	171	134	115
Other public sector	0	0	0	5	0	0	0	0	0	0
Amortization	-32	-33	-35	-43	-45	-49	-59	-53	-47	-49
Errors and Omissions	**85**	**-169**	**-119**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall Balance	**65**	**-27**	**97**	**120**	**-73**	**-41**	**-22**	**13**	**39**	**38**
Financing	**-65**	**27**	**-97**	**-120**	**73**	**41**	**22**	**-13**	**-39**	**-38**
Net official reserve movements (- increase)	-65	27	-157	-125	73	41	22	-13	-39	-38
SDR allocation	0	0	0	-91	0	0	0	0	0	0
Other reserves	-65	27	-157	-34	73	41	22	-13	-39	-38
Exceptional financing	0	0	60	5	0	0	0	0	0	0
IMF RCF/RFI	0	0	48	0	0	0	0	0	0	0
G20 DSSI	0	0	5	0	0	0	0	0	0	0
IMF CCRT	0	0	0	5	0	0	0	0	0	0
World Bank COVID-19 EPRP	0	0	8	0	0	0	0	0	0	0
Memorandum Items:										
Nominal GDP	2,342	2,299	2,061	...	...	...	...	...	...	...
Gross international reserves										
(US$ millions)	735	642	809	864	792	751	729	742	781	819
(Months of imports, excl. LHWP-II)	4.0	4.5	4.5	4.5	4.0	3.6	3.3	3.2	3.2	3.1
Net international reserves										
(US$ millions)	687	608	739	809	745	712	705	729	771	813
(Months of imports, excl. LHWP-II)	3.7	4.3	4.1	4.2	3.8	3.4	3.2	3.1	3.1	3.1
Remittances	602	530	468	558	578	599	626	653	682	712
Exports of goods and services (percentage change)	-0.1	-2.5	-25.7	15.1	8.6	7.0	7.2	7.1	7.3	7.3
Imports of goods and services (percentage change)	-5.0	-3.0	-11.1	12.3	10.5	2.5	8.3	4.6	4.3	2.2

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

Table 5b. Lesotho: Balance of Payments, 2018/19–2027/28[1]

(Percent of GDP; unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Act.	Act.	Act.	Est.	Projections					
Current Account	-1.4	-2.1	-2.0	-7.4	-14.4	-9.6	-10.5	-10.0	-8.6	-5.4
Current account (excl. LHWP-II)	-0.2	0.8	3.1	-4.8	-7.4	-4.5	-4.1	-4.0	-3.2	-2.8
Trade balance	-29.9	-29.4	-36.6	-33.7	-36.7	-33.9	-35.1	-32.6	-30.8	-29.7
Exports, f.o.b.	48.1	47.8	40.3	38.8	40.4	40.7	40.9	41.0	41.7	42.6
Imports, f.o.b	78.0	77.3	76.9	72.5	77.1	74.6	76.0	73.5	72.5	72.3
Services (net)	-18.6	-18.2	-18.7	-17.1	-17.8	-17.0	-16.9	-17.3	-17.3	-15.1
Primary income (net)	22.8	20.4	19.8	19.5	19.4	18.9	18.5	18.1	17.9	17.7
Secondary income (net)	24.3	25.1	33.4	24.0	20.7	22.4	23.0	21.9	21.7	21.6
Official transfers	18.5	19.4	27.6	17.7	15.2	17.0	17.8	16.8	16.6	16.6
Of which: SACU revenue	17.2	18.3	26.6	16.4	13.5	16.3	17.0	16.0	16.0	16.0
Other transfers	5.8	5.6	5.9	6.2	5.5	5.4	5.3	5.1	5.1	5.0
Capital Account	**1.8**	**4.3**	**4.5**	**4.4**	**11.6**	**6.1**	**8.7**	**8.3**	**6.3**	**2.7**
Financial Account	**-1.2**	**4.0**	**8.0**	**7.9**	**0.0**	**2.0**	**1.0**	**2.1**	**3.4**	**3.8**
Foreign direct investment	1.6	1.5	1.5	1.5	1.2	1.2	1.2	1.2	1.2	1.2
Portfolio investment	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other investment	-2.7	2.4	6.4	6.2	-1.3	0.8	-0.2	0.9	2.2	2.6
Of which:										
Public sector (net)	1.0	0.8	2.0	1.6	3.2	4.7	4.6	3.8	2.6	1.9
Disbursements	2.4	2.2	3.7	3.4	5.0	6.5	6.6	5.5	4.1	3.3
Central government	2.4	2.2	3.7	3.4	5.0	6.5	6.6	5.5	4.1	3.3
Other public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.4	-1.5	-1.7	-1.8	-1.8	-1.8	-2.0	-1.7	-1.4	-1.4
Errors and Omissions	**3.6**	**-7.4**	**-5.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall Balance	**2.8**	**-1.2**	**4.7**	**4.9**	**-2.8**	**-1.5**	**-0.8**	**0.4**	**1.2**	**1.1**
Financing	**-2.8**	**1.2**	**-4.7**	**-4.9**	**2.8**	**1.5**	**0.8**	**-0.4**	**-1.2**	**-1.1**
Net official reserve movements (- increase)	-2.8	1.2	-7.6	-5.1	2.8	1.5	0.8	-0.4	-1.2	-1.1
SDR allocation	0.0	0.0	0.0	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Other reserves	-2.8	1.2	-7.6	-1.4	2.8	1.5	0.8	-0.4	-1.2	-1.1
Exceptional financing	0.0	0.0	2.9	0.2	0.0	0.0	0.0	0.0	0.0	0.0
IMF RCF/RFI	0.0	0.0	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
G20 DSSI	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF CCRT	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
World Bank COVID-19 EPRP	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Nominal GDP (US$ millions)	2,342	2,299	…	…	…	…	…	…	…	
Gross international reserves	31.4	27.9	39.2	35.0	30.7	27.5	25.0	23.8	23.7	23.7
Net international reserves	29.4	26.5	35.8	32.8	28.9	26.0	24.1	23.3	23.4	23.5
Remittances	25.7	23.1	22.7	22.7	22.4	21.9	21.4	20.9	20.7	20.6

Sources: Lesotho authorities and IMF staff calculations.

[1] The fiscal year runs from April 1 to March 31.

Table 6. Lesotho: Sustainable Development Goals (SDGs)

Goal	Indicator	Year	Data
SDG 1	*No poverty*		
	Poverty headcount ratio at $1.90 a day (in percent)	2021	29.1
	Poverty headcount ratio at $3.20 a day (in percent)	2021	49.8
SDG 2	*Zero hunger*		
	Prevalence of undernourishment (in percent of population)	2019	23.5
SDG 3	*Good health and wellbeing*		
	Maternal mortality rate (per 100,000 live births)	2017	544.0
	Life expectancy at birth (years)	2019	50.7
SDG 4	*Quality education*		
	Primary completion rate, total (percent of relevant age group)	2020	77.1
	Literacy rate, adult total (percent of people ages 15 and above)	2014	76.7
SDG 5	*Gender equality*		
	Proportion of seats held by women in national parliaments (in percent)	2020	23.3
SDG 6	*Clean water and sanitation*		
	Population using at least basic drinking water services (in percent)	2020	72.2
	Population using at least basic sanitation services (in percent)	2020	50.3
SDG 7	*Affordable and clean energy*		
	Population with access to eletricity (in percent)	2019	44.6
SDG 8	*Decent work and economic growth*		
	GDP per capita growth (annual in percent)	2020	-10.3
	Adults with an account at a bank or other financial institution or with a mobile-money-service provider (% of population aged 15 or over)	2017	45.6
SDG 9	*Industry, innovation, and infrastructure*		
	Manufacturing, value added (in percent of GDP)	2020	16.0
	Population using the internet (in percent)	2019	29.0
	Mobile broadband subscriptions (per 100 people)	2019	64.1
SDG 10	*Reduced inequalities*		
	Gini coefficient adjusted for top income	2010	63.0
SDG 11	*Sustainable cities and communities*		
	Urban population (in percent of total)	2020	29.0
	Satisfaction with public transport	2019	52.0
SDG 12	*Responsible comsumption and production*		
	CO2 emissions from liquid fuel consumption (kt)	2016	803.1
	Total natural resources rents (% of GDP)	2019	3.0
SDG 13	*Climate action*		
	CO_2 emissions from fossil fuel combustion and cement production (tCO_2/capita)	2019	1.1
	Disaster risk reduction progress score (1-5 scale; 5=best)	2011	2.5
SDG 14	*Life below water*		
	Total fisheries production (metric tons)	2018	2552.5
SDG 15	*Life on land*		
	Permanent deforestation (% of forest area, 5-year average)	2018	0.0
	Red List Index of species survival (worst 0 - 1 best)	2020	1.0
SDG 16	*Peace, justice, and strong institutions*		
	Corruption Perception Index (worst 0 - 100 best)	2020	41.0
	Press Freedom Index (best 0 - 100 worst)	2020	30.5
	Children involved in child labor (% of population aged 5 to 14)	2018	8.2
SDG 17	*Partnerships for the goals*		
	Government spending on health and education (% of GDP)	2019	12.7

Sources: World Bank World Development Indicators Database, The Sustainable Development Index and Dashboards (https://dashboards.sdgindex.org/), and UNESCO Institute for Statistics SDG 4 Database.

Annex I. Status of Key Recommendations from 2019 Article IV Consultation

Recommendation	Status of Implementation
Adjust fiscal policy in line with lower revenues, with a focus on bringing down current expenditures and the wage bill.	The FY20/21 budget included a substantial forced consolidation via warrants. Implementation has been mixed: while a zero cost-of-living adjustment (COLA) helped to contain wages, this is hard to implement without strong political will. While some revenue measures were implemented, those requiring new legislation (the new alcohol and tobacco levies) have not passed parliament. An upward adjustment of the income tax threshold also reduced revenues.
Address PFM deficiencies.	The authorities have appointed a new Accountant General after a long hiatus, and a new IFMIS system has been implemented. However, monthly reconciliation is still not being carried out, and the backlog of unreconciled transactions is increasing. Expenditure controls continue to be weak, and a quarterly survey of arrears has yet to be finalized. The new PMFA bill still has been submitted to Parliament.
Improve debt management	A medium-term debt management strategy has been completed in FY19/20; however further capacity development is needed to help develop the government debt market.
Strengthen the business climate.	Government intervention in the wool and mohair industry continues to be problematic, with policy uncertainty undermining the sector. Other related challenges include the high cost of setting up a business, burdensome insolvency resolution, limited information exchange between private and public sector entities, and skills mismatches. The authorities have established a standards bureau and are working to further develop its functions and are also matching entrepreneurs with external investors.
Enhance the financial sector's contribution to growth	The Pension Bill was enacted on November 15, 2019, and regulations were adopted on September 11, 2020. The Financial Institutions Act has been sent to cabinet for approval. Parliament passed the Insolvency Bill 2021 on March 17, 2022. The Security Interest in Movable Property Bill was enacted on August 14, 2020, with regulations adopted on August 28, 2020. The CBL has not taken on greater responsibility for regulation of the financial cooperatives, although the largest ones should now fall under the CBL's purview.

Annex II. Vaccination Progress and Key Policy Responses to COVID-19 in FY20/21

The Ministry of Finance spent a total of LSL1.2 billion (3.5 percent of GDP) on COVID-19-related measures in FY20/21, which were not extended in FY21/22. For FY21/22, LSL500 million (1.4 percent of GDP) was also budgeted for vaccination and other COVID-19-related contingencies.

A. COVID-19 Vaccination Progress

1. Like many countries in sub-Saharan Africa, Lesotho has had to approach multiple agencies and governments to secure vaccines:

- AstraZeneca vaccines were received under the COVAX facility in two phases: (1) a first batch of 36,000 doses was received on March 3, 2021, with roll-out to health professionals; and (2) a second batch of 36,000 doses—donated by France—was delivered on May 31, 2021, to vaccinate the vulnerable and exposed groups like factory workers and teachers.

- On July 23, 2021, 302,400 doses of the Johnson & Johnson vaccine were received, donated by the US through COVAX in coordination with the African Union (AU). The Government paid a deposit of LSL25 million to the AU to procure 1.3 million Johnson & Johnson vaccine doses and the first batch of 108,000 doses was delivered on August 8, 2021, through the African Union Vaccines Acquisition Trust (AVAT). The cost of the first batch is covered by a donation of US$1 million by Vodacom Group to the Government of Lesotho made in March.

- Contributions from private sector organizations and development partners including World Bank were also used to fund these vaccines. A donation by China of 203,340 doses of the Sinopharm vaccine was received on August 20, 2021 and 60,000 more doses of this vaccine were purchased by the Lesotho private sector and received by end-August. Another private sector-led initiative has raised over LSL40 billion for vaccine procurement of Russian Sputnik V vaccine. However, the Ministry of Health has so far refused to authorize this on the grounds that the vaccine has not been approved by the WHO.

2. Lesotho's vaccination strategy has targeted urban areas to maximize access and coverage of the population. Recently, the government has begun vaccinating minors between the ages of 12 and 17 years using the newly-arrived Pfizer doses. As of April 30, 2022, 820,001 Basotho have been fully vaccinated, approximately 53 percent of the target population (12+ years).

B. Key Policy Responses to COVID-19 in FY20/21

Fiscal Measures

3. ***Public Financial Management.*** Introduced quarterly warrants to contain non-pandemic spending to create space for pandemic spending.

4. ***Tax Policy Administration.*** Company Income Tax filing season extended to the end of September 2020.

Social Mitigation Measures

5. The authorities spent LSL213.5 million on pandemic-related social assistance (around 0.7 percent of GDP) for up to three months in FY20/21. Measures included:

- **Increasing existing benefits** (LSL50.1 million, 0.2 percent of GDP). The government topped up cash transfers to existing beneficiaries (50,000 existing households under the Child Grants Program and 12,741 existing destitute families under the Public Assistance Program) by LSL831 per month (Jul–Sep 2020).

- **Payments to new beneficiaries** (LSL112.1 million, 0.3 percent of GDP). Under the Public Assistance Program, cash transfers (LSL831 per month) were provided to 10,000 newly destitute families (Jul–Sep 2020) and 45,000 persons aged 60–69 (May–Jul 2020).

- **Food security** (LSL46.0 million, 0.1 percent of GDP).

    - Cash support to beneficiaries in privately-owned care facilities (housing 1,335 children, 23 elderly persons, and 651 persons with disabilities) (May–Jul 2020).

    - Food parcels for vulnerable households (up to 100) across community councils (Jul–Sep 2020).

    - Food stamps to vulnerable Basotho living in South Africa (9,000–12,000) (Jun 2020).

    - Food and/or cash transfers (LSL831 per month) to acutely vulnerable households (72,626) with livelihoods affected by poor planting and COVID-19 mitigation measures.

    - Under the School Feeding Program, take-home rations for early childhood care and development and primary school-going vulnerable children (72,200) (May–Jul 2020).

- **Gender and sports** (LSL5.2 million, <0.1 percent of GDP).

    - Support to gender-based violence survivors.

    - Stipends for 14 premier league clubs.

    - Cash grants for athletes in other sporting codes.

Economic Mitigation Measures

6. Measures included:

- LSL698 billion for National COVID-19 Secretariat (NACOSEC).

- Assist informal sector vendors (LSL500 per vendor).
- Cover business rent for May 2020.
- Provide 75 percent partial credit guarantee for firms.
- LSL130 million agricultural subsidy, up to 60 percent subsidy on agriculture inputs for summer cropping.
- LSL170 million salary subsidy for textile industry workers, the only gender-sensitive measure, according to the UNDP COVID-19 Global Gender Response Tracker.
- LSL50 million grant scheme to MSMEs, especially in tourism (LSL20,000 matching grant to companies with less than 50 employees).
- LSL1.5 million for other measures (including PPE).

Monetary and Financial Sector Measures

7. Since March 2020, the CBL undertook measures to support the financial sector, while ensuring the safety of the exchange rate peg. Measures included:

- Since March 2020, the policy rate was reduced four times from 6.25 to 3.50 percent (275bp); increased three times to 4.25 percent by March 29, 2022.
- The NIR target was lowered by 20 percent in May 2020, followed by several increases to safeguard the peg. Net increase of US$190 million in the NIR target floor by March 29, 2022, to US$820 million.
- Bank loan repayments suspended for 6 months until September 2020.
- Insurance companies' premium payments suspended for 3 months.
- Basel II.5 implementation postponed, to maintain banks' lending capacity.
- Banks and insurance companies instructed not to pay dividends to shore up capital and liquidity.
- CBL used moral suasion to encourage banks to reduce fees on digital platforms.

Annex III. Timeline of Key Political Developments, 2019–22

2019	
Feb 1–2	Mr. Nqosa Mahao (outgoing Vice Chancellor of the National University of Lesotho) is elected Deputy Leader of All Basotho Convention (ABC), alongside a new national executive committee (NEC). This election precipitates a number of disputes over ABC party leadership in the coming years.
Jul 2	ZAF President Mr. Cyril Ramaphosa, as SADC facilitator, oversees agreement between political parties to coordinate a national reforms process in Lesotho.
Aug 28	Lesotho's Upper House, the Senate, passes the National Reforms Authority Bill. The Act provides for the establishment of the National Reforms Authority (NRA) to manage, coordinate, and lead the SADC-sponsored reforms process.
2020	
Feb 6	First Lady Ms. Maesiah Thabane is arrested for murdering Prime Minister Mr. Thabane's ex-wife, Ms. Lipolelo Thabane, in 2017.
Mar 20	Mr. Thabane prorogates parliament until Jun 19.
Apr 4	The ABC and Democratic Congress (DC) NECs agree on a new coalition deal, removing Alliance of Democrats (AD) as a coalition partner.
Apr 17	High Court finds prorogation of parliament unlawful and irrational.
Apr 18	Mr. Thabane deploys the army to restore order.
May 8	Mr. Thabane will step down in July as the country's leader but is pushed out in the 3rd week of May.
May 20	Mr. Moeketsi Majoro replaces Mr. Thabane as Prime Minister.
2021	
Apr 22	Mr. Mahao leaves the ABC with 9 MPs to set up a new party, the Basotho Action Party (BAP).
Apr 26	ABC NEC appoints Mr. Majoro as Deputy Leader of the ABC following Mr. Mahao's departure.
May 11	Mr. Tefo Mapesela leaves ABC to form his own Basotho Patriotic Party (BPP).
Jun 2	Mr. Mooki Sello (AD) tables no confidence motion against Mr. Majoro.
Aug 25	Mr. Tefo Mapesela (BPP) tables a no confidence motion against Prime Minister Moeketsi Majoro.
Sep 21	Tenth MP joins the BAP from the ABC.
Nov 30	Mr. Thabane charged with the murder of his ex-wife.
Dec 2	The ABC NEC votes to recall Mr. Majoro as Deputy Leader of ABC.
Dec 5–11	A constitutional court application filed to stop Mr. Majoro ouster
Dec 31	Mr. Thabane announces he will step down as ABC leader on 28 January when elective conference is held by party
2022	
Jan 21–28	Mr. Thabane formally resigns as ABC leader. Leadership election for ABC commences with four candidates, including Mr. Majoro.
Jan 28–29	Mr. Majoro concedes ABC leadership to Mr. Nkaku Kabi.
Mar 21	Mr. Majoro wins the no confidence motion.
Oct	General Elections (expected)

Annex IV. The Lesotho Highlands Water Project

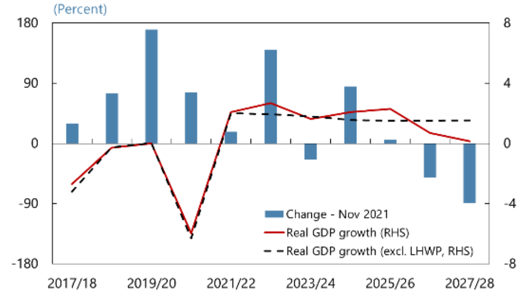
1. Lesotho's medium-term growth is expected to be buoyed by construction from the second phase of the LHWP. Phase I was completed in 1998 with the Katse and Mohale dams, the Muela hydropower station, and tunnels to export water to South Africa. At its peak employed over 3,000 workers, generating skill transfers. Phase II will add the Polihali dam and tunnel with investments roughly equivalent to Lesotho's 2020 nominal GDP over the next 8 years, fully financed through capital grants from South Africa.

2. Lesotho and South Africa jointly coordinate the construction. The LHWP-II is administered by the Lesotho Highlands Development Authority (LHDA), which is overseen by the Lesotho Highlands Water Commission with joint Basotho and South African management. On the South African side, the Trans-Caledon Tunnel Authority sources funding for the phase II construction from international partners, e.g., the African Development Bank and the New Development Bank.

3. Construction of the dam and diverting tunnel will begin in FY22/23 and is planned to be completed in FY29/30. Construction of advanced infrastructure experienced COVID-related delays. After the project is completed, water will be delivered to South Africa in exchange for royalties. A hydropower component is planned and would be financed by Lesotho with possible grants from Sweden and Japan. Prospective plans for tourism around the dam are being developed, in partnership with the Ministry of Tourism. Environmental mitigation plans are in place, including wetlands rehabilitation, and compensation for the resettlement of 329 households from the Polihali Reservoir.

4. The size of the project implies a substantial growth and employment impact. The timing and uneven magnitudes of the planned LHWP-II investment are major drivers of the country's growth outlook, adding a significant volatility to growth forecasts. Project cash flows are expected to have two peaks in FY22/23 and FY24/25. The largest drops in spending are expected in FY26/27 and FY27/28, causing projected real GDP growth excluding LHWP-II to be higher than total real GDP growth for these years, due to base effects.

LHWP-II Projected Changes in Cash Flow and Real GDP Growth
(Percent)



Sources: Lesotho Highlands Development Authority and IMF staff calculations.

5. While LHWP-II-related spending is not accounted for as government capital expenditure, it shows up in the balance of payments. LHWP-II-related spending increases the current account deficit due to large imports of goods and services. These are financed by corresponding project-related inflows in the capital account. Furthermore, as the project is financed by capital transfers from South Africa and donor grants, there are no implications for government finances and public debt.

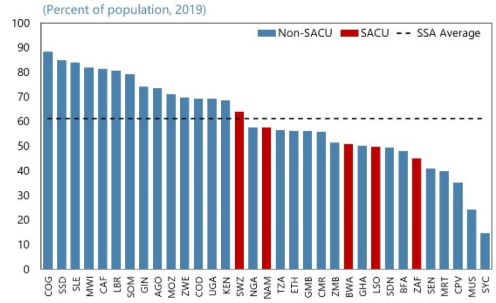
6. **Delays in the project over time have also led to significant adjustments in the paths of spending and, therefore, growth and the current account.** Spending revisions to the LHDA's cost plan have sizeable implications for the construction, and the wholesale and retail sub-sectors as well as the current account deficit. The recent pandemic and other climate shocks in 2021 have led to delays in the project timeline, pushing spending plans out by a year.

Annex V. Impact of the War in Ukraine on Food Security in Lesotho

A. Background

1. **Food security has been a longstanding issue for Lesotho given low agricultural productivity and vulnerability to climate shocks.** As a result of inconsistent rains and frequent droughts, agricultural productivity has been deteriorating since the early 1990s (WFP 2021).[1] In 2015/16, an El Niño-induced drought triggered massive food shortages with food price increases disproportionately affecting the poor (FAO 2016).[2] As of 2019, half of the population faced moderate or severe food insecurity.

Prevalence of Moderate or Severe Food Insecurity
(Percent of population, 2019)

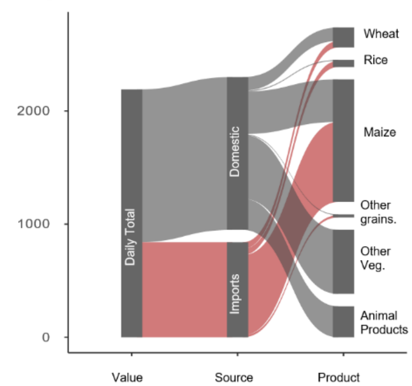


Sources: World Bank World Development Indicators (WDI) and IMF staff calculations.

2. **Despite the low contribution to GDP, agriculture provides livelihoods for a large share of the population.**[3] Agriculture in Lesotho is predominantly characterized by small-scale, rainfed, subsistence cereal production and animal grazing.[4] The sector's share of GDP has shrunk to around five percent from 15 percent in the 1980s. While agriculture accounts for less than 45 percent of employment, it provides livelihoods—either directly or indirectly—for about 80 percent of the population.

3. **Maize is Lesotho's primary food staple constituting an estimated 50 percent of calories consumed.**[5] Less than half of the domestic demand for maize is satisfied by the country's own production, while the rest is imported from South Africa. Maize production is costly—due to agroecological challenges—and has been in decline in recent years, favoring cheaper imports from South Africa, which become vital to food security in the wake of droughts.

Food Balance and Imports, 2019
(Daily calories consumed)



Sources: Food and Agriculture Organization of the United Nations, and IMF staff calculations.

4. **Food expenditure accounts for a large share of household budgets.** Over a third of the consumer basket comprises food, whereas fuel and transportation, together with

[1] World Food Program. 2021. Lesotho Country Brief (June).

[2] FAO. 2016. Impact of food prices increase among Lesotho's poorest. Rome, Italy

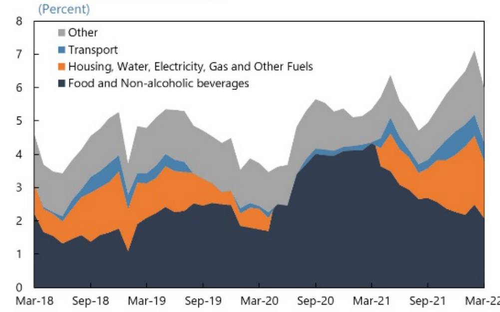
[3] The agricultural sector remains constrained by several factors including high climate variability (see SIP: *Addressing Lesotho's Climate and Environmental Challenges*). Adoption of modern agricultural practices and improved technology by the farmers is relatively low. Unsustainable agricultural practices such as mono-cropping, overgrazing, and unregulated firewood extraction result in land degradation.

[4] The climate conditions and terrain in the country favor livestock production. However, several challenges, including poor value chains and poor-quality breeds hinder productivity.

[5] Sorghum and wheat are also consumed but in smaller quantities.

housing, water, electricity, and gas, contribute 17.2 percent—the third largest component after clothing and footwear. During the pandemic, food prices were the largest sources of overall domestic inflation. In recent months, however, fuel price increases were also driving inflation.

Inflation Contributions
(Percent)

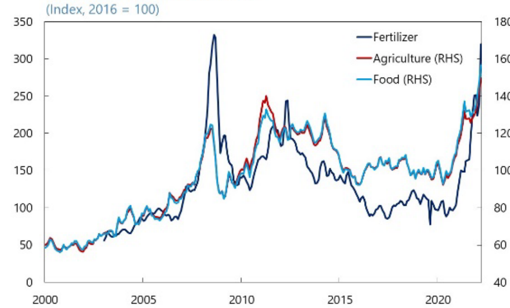


Sources: Lesotho Bureau of Statistics and IMF staff calculations.

B. The Impact of the War in Ukraine

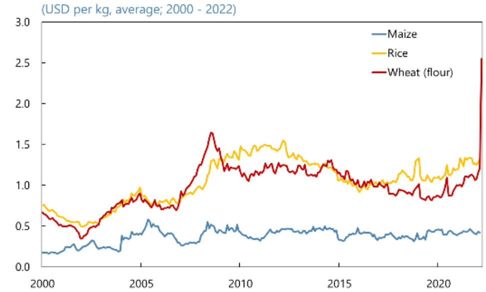
5. The global surge in food and fuel prices due to the war in Ukraine is disrupting supply chains and threatening food security. Given export disruptions, global prices of wheat and energy have risen in recent months to new highs. Even before the conflict, global food prices during the pandemic had already surged above the average for the past five years, prompting double-digit food price inflation across the region with a disproportionate impact on food security for the urban poor and market-dependent households in rural areas.

Global Commodity Prices
(Index, 2016 = 100)



Source: IMF Primary Commodity Price System.

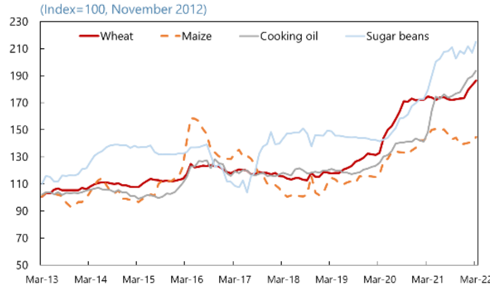
Sub-Saharan Africa: Monthly Food Prices
(USD per kg, average; 2000 - 2022)



Sources: Food and Agriculture Organization of the United Nations and IMF staff calculations.

6. Import disruptions are compounding existing poor agricultural outcomes to drive domestic food price inflation. While the price of wheat has increased sharply in Lesotho, as in other sub-Saharan African countries, the prices of other cereals (maize and rice) have remained relatively stable as of end-March 2022. To the extent that local and regional production can help keep maize prices steady, the relatively lower share of wheat in local diets could help moderate domestic inflationary pressures. However, heavy rainfall early in 2022 led to waterlogging and the destruction of crops in several parts of the country. As a result, import disruptions mean the loss of a key hedge for households against local harvest shortfalls. Prices of some food items (cooking oil and sugar beans) have also increased in recent months, adding to inflationary pressures.

Food prices, Maseru
(Index=100, November 2012)



Sources: Lesotho Bureau of Statistics and IMF staff calculations.
Note: Wheat and maize refer to prices of easy bake and chai per 12.5 kilograms.

7. Higher global fuel prices are also passing through to domestic food price inflation. As a landlocked country, costlier fuels directly impact ground transportation of goods (Barrett and Dillion 2016).[6] Indeed, the government is already allowing

[6] Barrett, C., and B. Dillion. 2016. "Global Oil Prices and Local Food Prices: Evidence from East Africa." American Journal of Agricultural Economics 98(1), pp.154–71.

recent fuel price increases to fully pass through to the pump: as of April 8, 2022, the Petroleum Fund parastatal increased prices at the pump by 12.1 percent (LSL2.25 per liter) for petrol, 21.8 percent (LSL4.10 per liter) for diesel, and 21.5 percent (LSL3.00 per liter) for paraffin.[7]

8. The risk of prolonged hardship is high if food price increases are compounded by fertilizer shortages and fresh climate shocks. A protracted war in Ukraine would continue to limit agricultural exports in the coming months and further strain global supply, prolonging higher global prices and shortages. Increases in fertilizer prices also risk compounding the recent shock by compromising local agricultural production and limiting domestic supply. Future climate shocks risk exacerbating food insecurity further should subsistence agriculture be impacted.

9. Even with limited fiscal space, Lesotho is undertaking measures to ease the economic and social impact. Where space exists, Fund advice is for countries with existing social programs to expand them through targeted and temporary transfers to the vulnerable. In countries where this is not feasible due to inadequate social safety nets, digital tools present an option for the delivery of income support. Where none of these are feasible but fiscal space is available, countries may introduce targeted tax reductions or targeted price subsidies, with clear end dates. Despite limited fiscal space, the government plans to subsidize 60 percent of seed and fertilizer costs for both winter and summer cropping, as during the 2015/16 drought. The authorities are also exploring ways to supplement the child grants programme to target and insulate the most vulnerable from the rising costs of living. The Disaster Management Authority will distribute emergency food relief (beans and maize) following a mapping exercise by the Lesotho Vulnerability Assessment Committee that identified 328,000 households facing food insecurity in recent years.

[7] See: https://www.gov.ls/wp-content/uploads/2022/04/FUEL-PRICE-INCREASE.jpeg

Annex VI. Recent Fiscal Performance and the Authorities' Medium-Term Fiscal Framework

A. Recent Fiscal Performance

1. The net fiscal outturns in the first nine months of FY21/22 are considerably weaker than for the same period in FY20/21 and FY19/20 (Table A4.1). Compared to FY19/20, FY21/22 has seen (i) higher revenue collection (just under 1.0 percent of GDP), with higher grants and non-tax revenue, offset by lower tax revenue and a drop in SACU transfers, and (ii) much higher spending (4.02 percent of GDP), with significant higher capital spending and slightly higher wages, offset by lower budget transfers to the tertiary education loan bursary scheme. Compared to FY20/21, FY21/22 has seen (i) revenue collection has been weaker (3.1 percent of GDP) despite higher tax and nontax revenues and grants helping to offset the lower SACU transfers, and (ii) spending has increased significantly (5.4 percent of GDP) with much higher capital spending and higher public wage spending, offset by lower budget transfers to the tertiary education loan bursary fund.

B. The Authorities' Medium-Term Fiscal Framework, FY22/23–FY24/25

2. This section compares the authorities' medium-term fiscal outlook —as presented in the FY22/23 Budget[1]—with staff's baseline projections (Table A4.2).

Revenues

3. Stronger revenue performance in the FY22/23 Budget relative to staff's baseline is driven by the following:

- **New tax measures for the mining sector.** As of April 2022, the authorities have eliminated VAT zero rating for mining exports and are enforcing a sales tax on mining exports. They estimate that these measures could bring in around LSL750 million and LSL920 million, respectively, in revenues once implemented. They incorporated 50 percent of the effect in FY22/23, 75 percent of the effect in FY23/24, and full effect in FY24/25. Staff have not incorporated these measures in the baseline given significant uncertainties over their implementation and how much revenue could be generated given the potential adverse impact these measures will have on the competitiveness of the mining sector.

- **Small Business Taxation.** The authorities are looking to introduce a small business turnover tax, which is expected to provide LSL135 million in revenues. While staff supports this initiative, the baseline incorporates a smaller additional revenues given uncertainties over the Parliamentary approval of this measure and potential administration difficulties.

[1] The latest Budget was released on March 2, 2022, and laid out estimates of revenues and expenditures for FY22/23 and projections of revenue and expenditure for FY23/24 and FY24/25.

- **Excises.** The authorities' assume levies of 15–20 percent and 30 percent on alcohol and tobacco, respectively. While staff supports this initiative, this initiative has proven politically difficult to approve and introduce.

- **Grants.** The authorities project grants will jump to 4.2 percent of GDP in FY21/22, and further to 5.6 percent in FY22/23—mainly driven by new grants from China (around LSL 500 million) and Road Fund (around LSL 200 million)—from 3.1 percent in FY20/21 and then decline to below 3 percent afterwards.

- **Optimism bias** in Lesotho's nominal GDP forecasts is potentially leading to upward bias in revenue forecasts. Forecasts for nominal GDP in the fiscal framework are on average 2.9 percent higher than the actual outturn over the past years.

Expenditure

- Public sector compensation in FY22/23 is projected to jump by 24 percent, due to the following factors: (i) full structural ("notch") increases; (ii) full cost-of-living adjustment (COLA); (iii) reclassification of misclassified current spending under the capital budget; (iv) reclassification of postal service wages misclassified under "transfers"; and (v) new hiring of health and security workers. In addition, it assumes a flat LSL300 million (0.9 percent of GDP) allocation for the civil service apprenticeship program.

- Social spending remains relatively high over the medium term, which continues to be driven by large spending on the tertiary education loan bursary scheme, with only limited scaling back (5 percent cuts per year).

Overall Fiscal Balance

- The authorities projected path for the fiscal balance is stronger than staff's baseline over the next three years. This is largely driven by the stronger projection for revenues (particularly non-tax revenues, taxes on goods and services) and lower interest spending.

Arrears

- The latest estimates for arrears in FY21/22 suggest that LSL1.25 billion (3.4 percent of GDP) is unpaid due to cash constraints and with the likelihood of additional amounts as yet unreported, i.e., invoices not yet entered in IFMIS. This indicates that the deficit would be larger on a cash basis than that the estimated headline deficit in the FY22/23 Budget.

Table AVI.1. Lesotho: FY21/22:Q1–Q3 Budget Execution Report

	FY19/20	FY20/21	FY21/22	Compared to FY19/20		Compared to FY20/21	
	LSL Million	LSL Million	LSL Million	LSL Million	Percent of GDP	LSL Million	Percent of GDP
Total Revenue	**12,190**	**13,657**	**12,540**	**350**	**0.95**	**(1,117)**	**(3.05)**
Tax revenue	5,616	4,862	5,416	-200	(0.55)	555	1.51
Non tax revenue	1,127	1,323	1,448	321	0.87	125	0.34
Grants	776	737	1,169	393	1.07	432	1.18
SACU	4,670	6,735	4,506	-164	(0.45)	(2,230)	(6.08)
Total Spending	**(13,586)**	**(13,097)**	**(15,059)**	**1,473**	**4.02**	**1,961**	**5.35**
Current spending	(9,878)	(10,210)	(9,945)	67	0.18	(266)	(0.72)
o/w: Wages	(4,194)	(4,077)	(4,188)	-6	(0.02)	111	0.30
o/w: Tertiary bursary	(582)	(528)	(433)	-149	(0.41)	(94)	(0.26)
Capital spending	(3,708)	(2,887)	(5,114)	1,406	3.83	2,227	6.07
Overall Balance	**(1,396)**	**560**	**(2,519)**	**1,123**	**3.06**	**3,079**	**8.40**

Source: Ministry of Finance and IMF staff calculations.

Note: Positive sign means more revenue or spending for the last four columns while negative sign means less revenue or spending.

Table AVI.2. Lesotho: Comparison between Staff's Baseline and FY22/23 Budget Fiscal Frameworks

(Maloti millions)

	2021/22			2022/23		2022/23		2024/25	
	FY21/22 Budget	Est.	Budget	Proj.	Budget	Proj.	Budget	Proj.	Budget
Revenue	**17,254**	**16,957**	**17,232**	**18,815**	**19,732**	**20,153**	**22,817**	**21,912**	**24,979**
Tax revenue	7,060	7,673	7,948	9,050	9,512	9,708	12,224	10,334	13,259
Taxes on income, profits, and capital gain	3,595	3,906	4,181	4,763	4,856	5,067	6,117	5,373	6,570
Taxes on goods and services	3,465	3,767	3,767	4,287	4,655	4,641	6,106	4,961	6,686
Grants	1,590	1,541	1,541	2,261	2,261	1,210	1,150	1,350	1,290
Non-tax revenue	2,136	1,735	1,735	2,104	2,560	2,237	2,445	2,423	2,625
SACU	6,008	6,008	6,008	5,400	5,400	6,998	6,998	7,806	7,806
Expense	**16,301**	**14,475**	**14,219**	**16,062**	**16,251**	**17,450**	**17,462**	**18,323**	**18,214**
Compensation of employees	7,115	6,365	6,365	7,887	7,887	8,698	8,698	9,031	9,031
Wages and salaries	6,431	5,744	5,745	7,550	7,550	7,850	7,850	8,150	8,150
Social contributions	...	621		337		848		881	
Use of goods and services	3,122	2,129	2,129	2,734	2,734	2,870	2,870	3,014	3,014
Interest payments	811	608	384	529	767	717	787	857	807
Subsidies	847	945	945	504	504	529	529	556	556
Grants	894	1,397	1,445	1,436	1,433	1,511	1,505	1,587	1,580
Social benefits	2,461	1,902	1,902	1,786	1,786	1,876	1,876	1,969	1,969
Of which: Poverty-reducing social spending	...								
Other expenses	1,048	1,128	1,049	1,186	1,140	1,248	1,197	1,310	1,257
Of which: Tertiary education loan bursary scheme	...	998.1	998.1	1,030.2	1,030.2	973.5	973.5	920	920
Rest of other expenses		130	51	155	110	274	43	390	45
Nonfinancial Assets	**5,738**	**4,997**	**5,621**	**5,883**	**6,764**	**5,641**	**6,357**	**6,112**	**6,674**
Domestically financed	...	2,401	2,012	1,764	1,764	1,853	1,852	1,944	1,945
Externally financed	...	2,596	3,609	4,119	5,000	3,788	4,504	4,168	4,730
Net Lending(+)/Borrowing (-) (Overall Fiscal Balance)	**-4,785**	**-2,516**	**-2,609**	**-3,130**	**-3,283**	**-2,938**	**-1,001**	**-2,523**	**91**
(Percent of GDP)									
Revenue	**47.1**	**46.2**	**47.0**	**47.0**	**49.3**	**47.0**	**53.2**	**47.8**	**54.5**
Tax revenue	19.3	20.9	21.7	22.6	23.8	22.6	28.5	22.5	28.9
Taxes on income, profits, and capital gain	9.8	10.7	11.4	11.9	12.1	11.8	14.3	11.7	14.3
Taxes on goods and services	9.4	10.3	10.3	10.7	11.6	10.8	14.2	10.8	14.6
Grants	4.3	4.2	4.2	5.6	5.6	2.8	2.7	2.9	2.8
Non-tax revenue	5.8	4.7	4.7	5.3	6.4	5.2	5.7	5.3	5.7
SACU	16.4	16.4	16.4	13.5	13.5	16.3	16.3	17.0	17.0
Expense	**44.5**	**39.5**	**38.8**	**40.1**	**40.6**	**40.7**	**40.7**	**40.0**	**39.7**
Compensation of employees	19.4	17.4	17.4	19.7	19.7	20.3	20.3	19.7	19.7
Wages and salaries	17.5	15.7	15.7	18.9	18.9	18.3	18.3	17.8	17.8
Social contributions	...	1.7	0.0	0.8	0.0	2.0	0.0	1.9	0.0
Use of goods and services	8.5	5.8	5.8	6.8	6.8	6.7	6.7	6.6	6.6
Interest payments	2.2	1.7	1.0	1.3	1.9	1.7	1.8	1.9	1.8
Subsidies	2.3	2.6	2.6	1.3	1.3	1.2	1.2	1.2	1.2
Grants	2.4	3.8	3.9	3.6	3.6	3.5	3.5	3.5	3.4
Social benefits	6.7	5.2	5.2	4.5	4.5	4.4	4.4	4.3	4.3
Other expenses	2.9	3.1	2.9	3.0	2.8	2.9	2.8	2.9	2.7
Of which: Tertiary education loan bursary scheme	...	2.7	2.7	2.6	2.6	2.3	2.3	2.0	2.0
Nonfinancial Assets	**15.6**	**13.6**	**15.3**	**14.7**	**16.9**	**13.2**	**14.8**	**13.3**	**14.6**
Domestically financed	...	6.5	5.5	4.4	4.4	4.3	4.3	4.2	4.2
Externally financed	...	7.1	9.8	10.3	12.5	8.8	10.5	9.1	10.3
Net Lending(+)/Borrowing (-) (Overall Fiscal Balance)	**-13.0**	**-6.9**	**-7.1**	**-7.8**	**-8.2**	**-6.8**	**-2.3**	**-5.5**	**0.2**

Note: "Budget" refers to FY22/23 Budget.

Annex VII. External Sector Assessment

Overall Assessment: *Lesotho's external position in FY21/22 is assessed to be substantially weaker than implied by fundamentals and desired polices. The decline in SACU transfers and the COVID-19 pandemic have contributed to the deterioration of the external sector.*

Potential Policy Responses: Fiscal consolidation and structural reforms to enhance competitiveness are needed to address structural imbalances. Reducing public sector wages' share of the economy, would reverse the crowding out of private sector employment and help promote competitiveness. Alongside, competitiveness can be improved by addressing corruption vulnerabilities, supporting human capital development, easing trade barriers, and strengthening connectivity to the region. Such reforms would not only help create business environment conducive to private sector development but also correct longstanding structural weaknesses in the external position over the medium term.

Foreign Assets and Liabilities: Position and Trajectory

Background. As a net debtor country, Lesotho's gross external liabilities exceed its assets. In recent years, Lesotho's net international investment position (NIIP) has steadily increased as foreign investments have declined. In 2021:Q4, Lesotho's NIIP was –25.5 percent of GDP, 12 percentage points higher than in 2018. However, NIIP is expected to decline over the medium term as the current account deficit is projected to increase, reflecting a lower SACU transfers. Over the last three years, gross external debt increased by 3.4 percentage points to 43.6 percent of GDP in FY21/22, as the government continued to contract external debt on both concessional and nonconcessional terms to finance public investment.

Assessment. Risks from large gross external liabilities are in part mitigated by the external asset position and debt composition (over 80 percent of external debt is owed to multilateral creditors on concessional terms).

2021 Q4 (% GDP)	NIIP: -25.5	Gross Assets: 86.4	Debt Assets: 41.8	Gross Liab.: 111.9	Debt Liab.: 50.4

Current Account

Background. The current account deficit is projected to widen from 2 percent of GDP in FY20/21 to 7.4 percent of GDP in FY21/22 on the back of declining SACU transfers and LHWP-II-related imports. Amid continued COVID-19 restrictions, exports and remittances were muted, compounding the negative effect of lower inflows. Imports grew rapidly as construction of the LHWP-II resumed, contributed to the widening of the FY21/22 current account deficit. Over the medium term, LHWP-II imports will weigh on the current account deficit. However, the project will be fully financed with capital grants from South Africa and is expected to produce inflows close to 1 percent of GDP from water royalties beginning in FY27/28. As domestic demand adjusts to lower SACU transfers and exports improve after the pandemic, the current account deficit (adjusted for LHWP-II imports) is projected to narrow from FY22/23.

Lesotho: Model Estimates for 2021/22
(In percent of GDP)

	CA model	REER
CA-Actual	**-7.4**	
Cyclical contributions (from model) (-)	0.4	
COVID-19 adjustor (+)	0.2	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-7.5**	
CA Norm (from model) 1/	**-2.0**	
Adjusted CA Norm	**-2.0**	
CA Gap	**-5.5**	**-1.4**
o/w Relative policy gap	-4.9	
Elasticity	-0.49	
REER Gap (in percent)	**11.2**	**2.8**

1/ Cyclically adjusted, including multilateral consistency adjustments.

Assessment. The qualitative assessment of the external position is based primarily on the CA model, which captures fiscal imbalances most accurately. The EBA-lite cyclically-adjusted current account deficit norm of 2.0 percent of GDP is significantly lower than the projected 7.4 percent for FY21/22. The difference is attributable to a large policy gap, driven largely by the fiscal stance. LHWP-II-related imports also contribute to the gap. Moderating public wage growth and implementing structural reforms—strengthening governance and improving the business environment—are key to correcting longstanding structural weaknesses in the external position.

Real Exchange Rate

Background. Real and nominal effective exchange rate movements continue to be driven by the peg to the South African Rand (ZAR). After depreciating at the start of the pandemic, the nominal effective exchange rate (NEER) recouped most of its loss in value. At the same time, the real effective exchange rate (REER) strengthened further due to the inflation dynamics. Since March 2020, the REER has risen by around 14 percent as of March 2022. The stagnation of the textiles and other manufacturing industries and the sharply negative trade balance have also exposed an underlying lack of export competitiveness.[1]

Assessment. A mix of wage inflation in excess of productivity growth and the fixed nominal exchange rate resulted in the loss of external competitiveness. The EBA-lite assessment also suggests an overvaluation of real effective exchange rate. The impact of grant-financed investment projects, distortions induced by the build-up of domestic payments arrears, and data quality concerns results into higher uncertainty regarding the model estimate. Thus, the overall assessment puts greater weight on the fiscal stance, reserve adequacy, and competitiveness to conclude that the REER is overvalued.

Capital and Financial Accounts: Flows and Policy Measures

Background. Public external borrowing is the main source for financing the current account deficit. FDI continued to decline in FY21/22, falling below 2 percent of GDP. Portfolio investments continue to be negligible for Lesotho.

Assessment. The declining trend in FDI in recent years partly reflects the weakness of Lesotho's business environment. Reforms are critical to create a business environment conducive to private sector development and mitigate risks from a reliance on non-FDI flows for external financing.

FX Interventions and Reserves Level

Background. Lesotho has a pegged exchange rate regime with South Africa and interventions in the foreign exchange market is automatic. As of January 2022, the Central Bank of Lesotho has maintained net international reserves above its internal target of 120 percent of M1 plus callable deposits. Gross international reserves—boosted by the August 2021 SDR allocation—stood at around 4.5 months of prospective imports and compared favorably to the adequate level of 4.0 months suggested by a commonly used model for estimating reserve adequacy in credit constrained economies.[2]

Assessment. Without significant fiscal consolidation efforts, the twin current account deficit and fiscal deficits will put pressure on reserves over the coming years. Also, given that a large share of international reserves is denominated in ZAR, reserve adequacy is vulnerable to any increase in South Africa's risk premia and U.S. monetary policy tightening through its effects on South Africa. To mitigate these risks, maintaining adequate reserve buffers and optimizing currency decomposition is warranted.

[1] World Economic Forum, Global Competitiveness Report, 2019.

[2] See "Assessing Reserve Adequacy (ARA)" Board Papers (IMF 2011, 2013, 2014) and "Guidance Note: Assessing Reserve Adequacy in Credit-Constrained Economies" (IMF 2016).

Annex VIII. Risk Assessment Matrix[1]

	Risks	Likelihood	Impact	Policy Response
	Conjunctural Shocks and Scenario			
Global	**Outbreaks of lethal and highly contagious Covid-19 variants.**	Medium	**Medium.** Rapidly increasing hospitalizations and deaths due to low vaccine protection or vaccine-resistant variants force more social distancing and/or new lockdowns. This results in extended supply chain disruptions and a reassessment of growth prospects, triggering capital outflows, financial tightening, currency depreciations, and debt distress in some EMDEs.	Limit the damage by cushioning income losses for individuals and firms, including by increasing spending on health and social protection. Speed up vaccine procurement and rollout.
Global	**De-anchoring of inflation expectations in the U.S. and/or advanced European economies.**	Medium	**Medium.** Worsening supply-demand imbalances, higher commodity prices (in part due to war in Ukraine), and higher nominal wage growth lead to persistently higher inflation and/or inflation expectations, prompting central banks to tighten policies faster than anticipated. The resulting sharp tightening of global financial conditions and spiking risk premia lead to lower global demand, currency depreciations, asset market selloffs, bankruptcies, sovereign defaults, and contagion across EMDEs.	In the absence of independent monetary policy, maintain reserves and optimize currency decomposition against the rand—currency risk; moderate fiscal spending to soften inflation pressures; reduce fiscal risks; continue implementing structural reforms to strengthen the financial system, improve competitiveness, and diversification to increase the country's resilience to shocks.
Global	**Rising and volatile food and energy prices.**	High	**Medium.** Commodity prices are volatile and trend up amid supply constraints, war in Ukraine, export restrictions, and currency depreciations. This leads to short-run disruptions in the green transition, bouts of price and real sector volatility, food insecurity, social unrest, and acute food and energy crises (especially in EMDEs with lack of fiscal space).	Limit the damage by cushioning higher consumption expenditure for individuals and firms, including by increasing spending on social protection.
Domestic	**Widespread social discontent and continued political instability.**	High	**High.** Political instability and expenditure pressures in the run-up to the October 2022 elections would delay reform implementation, particularly for urgently needed fiscal consolidation efforts. Failure to continue SADC-supported national reforms may also jeopardize access to the African Growth and Opportunity Act (AGOA) and derail the recently approved MCC second compact.	Engage with key stakeholders (including civil society) to build support for fiscal consolidation and the SADC-supported national reforms process.
	Structural Risks			
Global	**Natural disasters related to climate change.**	Medium	**High.** Higher frequency of natural disasters cause severe economic damage to smaller vulnerable economies and accelerate emigration. Severe events in large economies reduce global GDP, cause further supply chain disruptions and inflationary pressures, and prompt a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	Reallocate fiscal spending to finance recovery work and appeal to donors for post-disaster financing.

[1] Aligned with the Global Risk Assessment Matrix (G-RAM) as of April 26, 2022.

	Risks	Likelihood	Impact	Policy Response
Domestic	**Elevated ongoing political uncertainty; stalled or reversals in anti-corruption and governance reforms.**	**High**	**High.** A lack of transparency and evenhandedness may increase fiscal spending pressures and damage credibility, compromising donor support and hindering private investment.	Undertake reforms, clear backlog of legislation, and renew commitment to strengthening governance and transparency. Step-up anti-corruption and AML/CFT efforts.
Domestic	**Capacity constraints and PFM weakness prevent successful fiscal consolidation.**	**High**	**High.** Lesotho's efforts to implement fiscal consolidation are hindered by capacity and PFM weaknesses, leading to further increases in domestic arrears.	Strengthen PFM systems using ongoing CD; fill vacant positions at the Ministry of Finance and provide adequate training.
Domestic	**Accelerating de-globalization, expiration of AGOA, delay in large energy, water, and extractive projects.**	**Medium**	**Medium.** Accelerating de-globalization drives protectionist policies globally and in South Africa, causing a decline in trade, loss of preferential access to global and regional markets, and delays to donor-funded projects. Reduced exports and greater fragmentation reduce potential growth.	Re-prioritize fiscal spending to priority crisis spending and support the most vulnerable. Mobilize donor support by emphasizing the merits of the NSDP II. Building external buffers and stepping-up efforts to support export diversification.

Annex IX. Capacity Development Strategy

1. **Lesotho has received extensive capacity development (CD) in recent years from the IMF and other donors.** The authorities also actively participate in a range of training modules, both online and in person, which help supplement and reinforce CD recommendations.

2. **The authorities maintain a long wish-list of CD projects and it will be necessary to ensure that capacity is available for absorption and implementation** (Table 1). Capacity constraints are most acute in the Ministry of Finance, particularly in the Macro Unit. The latter has received significant TA but absorption has been weak. Recent staffing changes in the Accountant General's office and Budget have enhanced capacity there. Capacity is generally stronger at the Central Bank of Lesotho. Political economy considerations are most acute in the field of expenditure controls.

3. **The Fund continues to support implementation of the authorities' National Strategic Development Plan (NSDP II) through intensified CD provision.** Short-term priorities are being adjusted aptly to respond to challenges emerging from the COVID-19 pandemic. Business continuity plans are being upgraded in the Lesotho Revenue Administration. The Fund is also helping the authorities develop a framework to track COVID-19 expenditures and report them transparently. In line with the NSDP II, post-COVID-19 priorities will center on further enhancements in domestic revenue mobilization (tax policy and revenue administration), public financial management, banking supervision, financial integrity (AML/CFT), and the introduction gender responsive budgeting.

4. **Domestic revenue mobilization is essential for Lesotho to break free of its dependence on SACU revenues.** To this end, the authorities should build on CD that has already begun to support tax policy analysis and forecasting capabilities within the Ministry of Finance and ongoing reforms at the Lesotho Revenue Authority. Additional CD can cover: (i) estimating the size of the tax gap through an RA-GAP assessment (data permitting); (ii) a TADAT assessment of the tax administration system to provide a baseline and identify areas of weakness; (iii) e-services suites to enable e-registration, e-filing, and e-payment; (iv) a risk-based taxpayer compliance program focused on the large and medium-sized taxpayers; (v) international taxation, with a focus on audit capabilities and exchange of information.

5. **Public financial management is the key priority area for CD in Lesotho.** Weak expenditure controls, financial reporting, and budgeting processes hinder the efficient allocation of resources and hamper surveillance. Support for capital budgeting—notably, investment planning and execution—is particularly urgent to provide mechanisms for oversight, accountability, and enforcement, improve efficiency, and prevent waste. The authorities have stressed the need for longer-term support on PFM issues and noted the importance of a resident advisor as they had previously had with IMF/EU support. The World Bank (WB), and to a lesser extent the African Development Bank (AfDB), have very active programs in the field of PFM, and close coordination is essential. The EU has been active in the past but has reduced support in recent years due to the limited results.

6. Other key weaknesses are in nonbank supervision[1], debt management and the enforcement of AML/CFT provisions, ahead of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) assessment in 2022. Further progress on improving public debt collection and deepening the government securities market is also critical to support the authorities' medium-term debt objectives. National accounts are another important area for CD. On the financial side, the WB has been particularly engaged on issues of financial inclusion.

7. Coordination of capacity development across a rich landscape of developmental partners is essential to ensure its effectiveness. Numerous partners, including the AfDB, the EU, U.S. government agencies, and the WB, among others, are currently actively engaged in policy areas covered by IMF CD. Close cooperation with partners and coordination of TA delivery across agencies will be of utmost importance to avoid overlaps, explore synergies, and deliver consistent advice without overburdening authorities' absorptive capacity.

[1] The CBL would be the main recipient of TA on non-bank supervision.

Table AIX.1. Lesotho: Capacity Development Priorities

Priorities	Objectives	Challenges
Public financial management	Revise and update the PFMA Act, strengthen budget preparation, improve expenditure control, financial reporting and accountability, introduce gender responsive budgeting.	Capacity constraints. Weak control over spending units. Lack of implementation of existing sanctions.
Macroeconomic Policy & Management	Develop tax policy and administration and revenue forecasting, fiscal risk assessment and analysis, expenditure policy and analysis, and financial programming capacity.	Capacity constraints in Ministry of Finance's Macro Unit.
Revenue mobilization (tax policy, revenue administration)	Property tax reform, in particular valuation and registration of properties, taxation of SMEs, VAT and taxation of utilities; improve tax administration.	
Debt markets	Develop government securities market.	
Financial regulation	Implementation of Basel II, development of bank crisis management/resolution framework, conduct Financial Sector Stability Review (FSSR).	
National accounts statistics	Strengthen expenditure-based annual national accounts; implement strategy to improve quarterly data.	Poor coordination across government hampering collation of data; lack of resources for data gathering.
Government finance statistics	Harmonize above and below the line data; expand the coverage to include the largest extrabudgetary units.	
Monetary and financial statistics	Expand coverage of MFS to include the largest non-bank financial institutions; improve classification of data to include a separation of loti and rand-denominated instruments.	

Annex X. Key Policies to Implement in the Current Political Context

1. Following discussion with officials, below are a list of key policies that can be implemented to help build and maintain reform momentum in the current political context:

- Rationalize the capital budget by (i) by performing an audit of existing capital projects on the budget with a view to eliminating unproductive projects and temporarily halting stalled yet productive projects, and (ii) improving accountability, contract design, investment appraisal, and execution.

- Establish a centralized database of the investment projects to strengthen public investment management processes.

- Continue to use monthly warrants to ensure well-contained Budget execution. While already implemented in FY21/22, warrants need to be used in subsequent years.

- Issue new regulations to ensure all budget commitments (including multi-year commitments) are recorded in IFMIS and make procurement without commitment registration illegal.

- Complete a stocktaking and vintage analysis of domestic payment arrears to domestic suppliers to determine a comprehensive arrears figure.

- Finalize and publish an arrears clearance strategy and refrain from incurring new arrears until the strategy is finalized and published.

- Develop action plans to (i) migrate to accruals-based accounting system from current cash-based system, and (ii) to migrate to an operational Treasury Single Account arrangement.

- Improve assets and liability management by creating a government-wide consolidated assets registry and incorporate financial assets and liabilities onto the government's balance sheet.

- Establish a road map on the digitalization of government payments, in close coordination with the Ministry of Communications, Science, and Technology, that includes: (i) a definition of the issues; (ii) a determination of the scope of payment processes to be reengineered; (iii) a list of MDAs that need to be involved; (iv) potential infrastructure gaps; (iv) potential policy reforms; (v) milestones and timelines of planned activities; (vi) a risk analysis, and (vii) a funding plan.

- Establish a Tax Policy Unit that directly supports the work of the Tax Policy Committee in the Ministry of Finance.

- Calibrate and finalize numerical fiscal rule targets consistent with trend growth and debt sustainability.
- Initiate gender responsive budgeting by incorporating gender responsive budget proposal documentation in the Budget Strategy Paper and gender impact analysis of budget policy proposals according to guidance in the Budget Call Circular, in at least one pilot ministry, in coordination with development partners.
- Close established positions that have been vacant for 12 months or more and fill existing posts by re-deploying the current workforce as needed. The closure of long-vacant positions can be recorded in the Civil Service Establishment Policy and published online.
- Submit a revised National Manpower Development Council Bill to Parliament, with provisions for the introduction of a means-testing mechanism to better target tertiary education loan bursaries and full loan recovery. Employ a debt collection agency to ensure recovery of existing loans.
- Broaden the coverage and scope of the Credit Reporting Act.
- Implement the Insolvency Act by developing appropriate regulations with detailed provisions for insolvency practitioners.
- Submit the Financial Cooperatives Bill to Parliament for approval.
- Submit the National Payments Systems Bill to Parliament and adopt the Oversight Regulations mandated by the National Payments Systems Bill.
- Implement the Government Payment Gateway (P2G, G2P).
- Implement the National Switch—and the associated common data standards and protocols.
- Implement the updated National Identification Act.
- Establish a commission to update the Data Protection Act in line with international good practices.
- Revise and resubmit the draft Computer Crime and Cybersecurity Act to Parliament.
- Adopt simplified customer due diligence requirements.
- Harmonize Financial Agency requirements, e.g., for banks and MNO harmonization.

Adopt Financial Consumer Protection Regulations

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 16, 2022

Prepared By

African Department
(In consultation with other departments)

CONTENTS

RELATIONS WITH THE IMF

(As of April 30, 2022)

Membership Status

Joined July 25, 1968; accepted the obligations of Article VIII, Sections 2, 3, and 4: March 5, 1997.

General Resources Account:	**SDR Million**	**% Quota**
Quota	69.80	100.00
IMF Holdings of Currency (Exchange Rate)	80.31	115.06
Reserve Tranche Position	12.74	18.25

SDR Department:	**SDR Million**	**% Allocation**
Net Cumulative Allocation	99.78	100.00
Holdings	66.05	66.19

Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
RCF Loans	11.66	16.70
Emergency Assistance[1]	23.24	33.30
ECF[2] Arrangements	4.54	6.51

Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	6/02/2010	9/17/2013	50.61	50.61
ECF[1]	3/09/2001	10/31/2004	24.50	24.50
Stand-By	9/23/1996	9/22/1997	7.17	0.00

Outright Loans:

Type	**Date of Commitment**	**Date Drawn/Expired**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
RCF	7/29/2020	7/31/2020	11.66	11.66
RFI	7/29/2020	7/31/2020	23.24	23.24

[1] Emergency Assistance may include ENDA, EPCA, and RFI.

[2] Formerly Poverty Reduction and Growth Facility (PRGF).

Projected Payments to the IMF:
(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2022	2023	2024	2025	2026
Principal	2.84	4.61	11.62	8.72	2.33
Charges/Interest	0.35	0.51	0.41	0.23	0.17
Total	**3.19**	**5.12**	**12.03**	**8.95**	**2.50**

Implementation of Catastrophe Containment and Relief (CCR)[3]:

Date of Catastrophe	Board Decision Date	Amount Committed (SDR million)	Amount Disbursed (SDR million)
N/A	Oct 06, 2021	3.21	3.21
N/A	Dec 15, 2021	0.63	0.63

Safeguards Assessment:

An update safeguards assessment, completed in May 2021, found that the Central Bank of Lesotho (CBL) has made notable progress in strengthening its safeguards framework. All recommendations from the 2012 assessment have been implemented, including improvements in the Audit Committee oversight, internal audit mechanism and internal control systems. Notwithstanding these important developments, staff recommended amending the CBL Act to align it with leading practices in areas of central bank governance, autonomy, and transparency. Following the assessment, the CBL has requested the Fund to provide technical assistance on drafting amendments to the CBL Act. In addition, the CBL's investment policy and guidelines should be revised to mitigate emerging credit and liquidity risks.

Exchange Rate Arrangement:

Lesotho is a member of the Common Monetary Area (CMA). The de facto and de jure exchange rate arrangement are classified as a conventional peg at par to the South African Rand, which is also legal tender in the country. Lesotho has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. Lesotho maintains one exchange restriction arising from single discretionary allowances of LSL1 million per individual per calendar year, for residents over 18, and of LSL200,000 on the same basis for residents under 18. Foreign exchange transactions beyond these limits need CBL approval. As of May 16, 2022, the maloti rate per U.S. dollar was LSL16.21.

[3] As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed into the Catastrophe Containment and Relief Trust (CCRT).

Article IV Consultation:

The 2019 Article IV Consultation was concluded by the Executive Board on April 26, 2019. Lesotho is on the standard 12-month Article IV Consultation cycle.

Capacity Development:

The Fund has been providing Lesotho with technical assistance and training to help authorities strengthen their capacity to design and implement effective policies. Capacity Development covers wide range of areas in macroeconomic, fiscal, and monetary. Specific capacity development projects since 2019 include the following:

Fiscal Affairs Department	
Fiscal Risk Management	Apr-21
Authorized Economic Operator Program	Dec-20
Excise Legislation	Nov-20
PFMA Bill Review and Quality Assurance	Sep-20
Data Analysis	May-20
AEO and CBM	Apr-20
MTFF	Dec-19
Fiscal Decentralization	Nov-19
Legal Department	
Central Bank Act Amendments	Sep-21
Monetary and Capital Markets Department	
Risk-based Supervision Framework Enhancement -Risk	Feb-22
Basel II/III Reform Implementation - ICAAP assessment	Jul-21
Risk-based Supervision Framework Enhancement	Jun-21
FSSR Main Mission FY21-FY22	May-21
Basel II/III; DSIB Framework	Feb-21
Risk-Based Supervision	Nov-20
Basel II implementation	Mar-19
IFMIS and GFS	Jan-19
Statistics Department	
External Sector - Balance of Payments	May-21
Government Finance - SOEs Fiscal Statistics	May-21
Real Sector - Prices- Updating CPI	Aug-21
Real Sector - National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA	Nov-21
Real Sector - National Accounts - GDP/Source Data	Dec-21
Real Sector - National Accounts - GDP/Source Data	Dec-21

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: https://www.worldbank.org/en/country/lesotho
- African Development Bank: https://www.afdb.org/en/countries/southern-africa/lesotho/
- Regional Technical Assistance Center for Southern Africa: http://www.southafritac.org/

STATISTICAL ISSUES

(As of May 16, 2022)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance with some key data shortcomings in fiscal and national accounts statistics.
National Accounts: The Bureau of Statistics (BOS) compiles and reports national accounts statistics on an annual and quarterly basis—in current prices and volume terms by the Production and expenditure. Statistical methods used to derive GDP have improved and new sources of data have been developed, although serious challenges remain. The quarterly accounts still have an experimental status, with meaningful progress on quarterly indicators for agriculture and mining and ongoing progress on quarterly estimates for construction which are expected to be finalized in June 2022, after which the quarterly accounts will no longer be considered experimental. Development of a plan for the next annual GDP rebase is ongoing with funding for key surveys being a binding constraint in finalizing the plan and choosing the base year. Also funding for the upcoming 2026 Population Census, including a household budget survey, has not been secured yet.
Price Statistics: The official monthly consumer price index (CPI), a composite of urban and rural price data, is available on a timely basis. The BOS is updating the CPI weights using the 2017 Household Budget Survey (to update the current weights based on 2010 expenditure data) and expects to release the new CPI later in 2022. The work on developing producer price indices is ongoing. In the meantime, the national accounts rely on South Africa's producer price index and import price indices.
Government Finance Statistics (GFS): The Ministry of Finance compiles and disseminates GFS consistent with the *GFSM 2001* for the budgetary central government. Monthly GFS for the budgetary central government are reported on a regular basis on the national summary data page (NSDP); and annual GFS have consistently been reported to the GFS yearbook. Longstanding data quality issues pertaining to discrepancies between transactions above and below the lines have improved, but classification issues remain for some revenue items. The authorities have started compiling GFS for local governments, with help from STA technical assistance, and are expected to start disseminating those data annually going forward. Compilation of consolidated general government GFS remains challenging, for lack of comprehensive data on extrabudgetary units. Work is ongoing, with support from STA technical assistance to expand the institutional coverage of GFS to include the largest extrabudgetary units, and initiate GFS compilation for public corporations. No comprehensive balance sheet data is currently compiled but public-sector debt statistics covering the budgetary central government and public financial corporations (currently only including the central bank) have been compiled and disseminated in the joint IMF/World Bank quarterly public sector debt statistics database.
Monetary and Financial Statistics (MFS): The Central Bank of Lesotho (CBL) reports monetary data on a regular basis using the Standardized Report Forms (SRFs), with monthly data disseminated through the International Financial Statistics. Improved data sources helped enhance the classification and sectorization in the accounts. The institutional coverage of MFS,

however, needs to be expanded to include other financial corporations. The CBL is working on expanding coverage and, to that effect, insurance companies have been trained on MFS template and beginning January 2018 started to report through the Banking Supervision Application (BSA). The next phase of coverage improvement is pension funds. The CBL reports several indicators of the Financial Access Survey, including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
Financial Sector Surveillance: The CBL has begun the process of compiling consistent financial sector indicators (FSIs) from 2006 onwards. FSIs on depository corporations are reported on a quarterly basis, but FSIs on non-financial corporations, households, and real estate markets are not available. Efforts are underway to compile FSIs for the insurance sector and real estate markets.	
Balance of Payments: Lesotho has improved the timeliness of submitting BPM6-based balance of payments and (partial) IIP data to STA. The CBL has made progress in incorporating the results of the private capital flow survey to collect financial account transactions and stock position data. The 2021 IMF Technical Assistance on External Sector Statistics assisted the CBL in further enhancing data quality, improve the coverage, methodological soundness, and consistency between the balance of payments and IIP.	
II. Data Standards and Quality	
Lesotho became, in 2003, a participant of a GDDS, which was superseded by the enhanced GDDS (e-GDDS) in 2015. Lesotho has implemented the recommendations of e-GDDS in 2016. It disseminates 12 of the 14 data categories needed for surveillance on its National Summary Data Page (NSDP). We encourage the authorities to disseminate the remaining data categories, general government operations and external debt, and further improve periodicity and timeliness of data.	No Data ROSC mission has been conducted in Lesotho.

Lesotho: Table of Common Indicators Required for Surveillance

(As of May 16, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	Mar-2022	May-2022	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Mar-2022	May-2022	D	D	Q
Reserve/Base Money	Mar-2022	May-2022	D	D	Q
Broad Money	Mar-2022	May-2022	M	M	Q
Central Bank Balance Sheet	Mar-2022	May-2022	D	D	Q
Consolidated Balance Sheet of the Banking System	Mar-2022	May-2022	D	D	Q
Interest Rates[3]	Mar-2022	May-2022	M	M	Q
Consumer Price Index	Mar-2022	Apr-2022	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]— General Government (GG)[5]	N.A.	N.A.	N.A.	N.A.	N.A.
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Dec-21	Mar-2021	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Sep-21	Sep-2021	Q	I	A
External Current Account Balance	Q4-2021	Apr-2021	Q	Q	Q
Exports and Imports of Goods and Services	Q4-2021	Apr-2021	Q	Q	Q
GDP/GNP	2020	March-2022	A	A	A
Gross External Debt	Q1-2022	Apr-2021	Q	Q	Q
International Investment Position[7]	Q4-2021	Apr-2021	Q	Q	Q

[1] Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

[2] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[4] Foreign, domestic bank, and domestic nonbank financing.

[5] The GG consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[6] Including currency and maturity composition. Due to capacity constraints, the authorities do not report revenue, expenditure, balance and financing composition for general government.

[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

May 16, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
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Prepared by the staff of the International Monetary Fund (IMF) and the International Development Association (IDA).

Joint Bank-Fund Debt Sustainability Analysis	
Risk of External Debt Distress	***Moderate***
Overall Risk of Debt Distress	***Moderate***
Granularity in the Risk Rating	***Limited space***
Application of Judgment	***No***

Lesotho's risk of external and overall debt distress remains moderate but risks to debt sustainability have risen since the last DSA.[1] While the exchange rate appreciation in FY20/21 somewhat lowered the debt burden, falling SACU transfers, growing public expenditure, new borrowing, and increasing contingent liabilities have elevated debt sustainability risks. Lesotho's debt indicators are expected to deteriorate in the near term before improving over the medium term, supported by recovering SACU transfers and slower growth in public expenditure relative to GDP. The moderate risk rating suggests limited space to absorb shocks. The DSA highlights the importance of fiscal consolidation to stabilize debt levels, build buffers for future shocks, and prevent the crowding out of credit to the private sector. Controlling current expenditures and improving the efficiency of capital spending, among other measures advised in the report, will be critical for fiscal consolidation. The results also show the need to address contingent liability risks, mainly stemming from the financing shortfall of the pension fund. Finally, the authorities should also prioritize developing domestic debt markets.

[1] This DSA updated the previous Joint DSA from July 2020 (IMF Country Report No 20/228). The DSA analysis reflects a debt carrying capacity of Medium considering Lesotho's Composite Indicator Index of 2.91, based on the IMF's April 2022 World Economic Outlook and the 2020 World Bank Country Policy and Institutional Assessment (CPIA).

PUBLIC DEBT COVERAGE

1. The DSA covers the central government debt, central bank debt taken on behalf of the government, and government-guaranteed debt (Text Table 1).[2] Debt coverage includes both external and domestic obligations. Foreign currency-denominated debt is used as a proxy for external debt as data on creditor residency is unavailable and there is no nonresident participation in the domestic debt market. Debt also includes domestic arrears, estimated at 3.4 percent of GDP as of March 2022.[3] While total SOE debt is not yet available, government-guaranteed debt is available and included. Debt guarantees related to COVID-19 measures are also included.

2. Debt coverage is similar to the previous DSA. However, the authorities are making progress to expand the reporting and coverage of public debt by including non-guaranteed and on-lent debt of SOEs. They also plan to publish outstanding debt of SOEs, including guarantees, on the website of the Ministry of Finance from FY22/23 in agreement with the World Bank under the Sustainable Development Financing Policy (SDFP).

3. The DSA includes a contingent liability stress test to capture extrabudgetary units, SOEs, Public Private Partnerships (PPPs), and financial market shocks in the assessment (Text Table 2). The contingent liability stress test incorporates the following shocks:

- The pension fund—estimated at 9.6 percent of GDP.[4]
- Liabilities associated with potential asset seizures—estimated at 2.5 percent of GDP.[5]
- 5 percent of GDP for a financial market shock that exceeds the existing stock of banks' NPLs.
- 3.7 percent of GDP for non-guaranteed SOE debt, which is not captured in the government debt stock. Calibration includes LSL1 billion on-lent debt of SOEs and an estimate for non-guaranteed debt of the 10 SOEs.
- 1.1 percent of GDP to account for Lesotho's PPP capital stock, as specified in the World Bank's database on PPPs.

[2] The DSA does not include the central bank's net liability to the IMF SDR department in line with the Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations (July 28, 2021).

[3] Arrears have been accumulating as Ministries, Departments, and Agencies (MDAs) continue to undertake spending outside of IFMIS. The government is not in arrears on any debt repayments.

[4] The Public Officers Defined Contribution Pension Fund was established in 2008. According to the latest actuarial evaluation of pension liabilities obtained during the mission, the funding gap stands at LSL3.5 billion as of March 31, 2021. The authorities plan to increase contributions to gradually reduce unfunded liabilities.

[5] Frazer Solar GmbH filed a global enforcement action to seize up to EUR50 million of Lesotho's assets in contractual damages. Following a counter suit against the seizure order filed by the authorities, the South African High Court has temporarily postponed the case.

Text Table 1. Lesotho: Coverage of Public Sector Debt and Design of the Contingent Liability Stress Test

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

Text Table 2. Lesotho: Summary of Shocks Used for the Contingent Liabilities Stress Test

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt			
		Default		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0	percent of GDP	12.1	Contingent liabilities representing the funding shortfall of the civil service pension fund and the asset seizure by Frazer Solar GmbH.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	3.7	Contingent liabilities relating with on-lent debt to SOEs considered to pose fiscal risk.
4	PPP	35	percent of PPP stock	1.1	Estimated value of PPP capital stock
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			21.9	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

BACKGROUND ON DEBT

4. **In recent years, Lesotho's public debt has increased substantially** (Text Table 3).[6] The gross public debt-to-GDP ratio has increased from 42.2 percent of GDP in FY17/18 to 57.4 percent of GDP in FY20/21, mainly reflecting growing current spending and large capital projects. More recently, the increase in borrowing was compounded by the COVID-19 shock and falling SACU transfers. Given that external debt—denominated in foreign currency—accounts for 82 percent of total debt, exchange rate valuation effects on the debt-to-GDP ratio are also material. The rand strengthened by 17.3 percent during the fiscal year FY20/21, lowering the external debt-to-GDP ratio by 3.3 percentage points of GDP. However, the exchange rate effect reversed since then, contributing to the increase of debt-to-GDP ratio in FY21/22.

5. **Debt relief under the Catastrophe Containment and Relief Trust (CCRT) in 2021 and the Debt Service Suspension Initiative (DSSI) have provided some fiscal relief.** The authorities secured SDR3.8 million relief on debt service under the CCRT which helped to reduce the external financing gap. Lesotho also participated in the DSSI, which helped to suspend debt service of around US$4.5 million in the last two years.[7] Both are reflected in the baseline scenario and the DSA.

[6] The fiscal year runs from April 1 to March 31.

[7] Lesotho requested to benefit from the (final) extension of the DSSI. Potential savings have been estimated at US$13.5 million. The DSSI provides a time-bound suspension of official bilateral debt service payments to IDA-eligible and least developed countries.

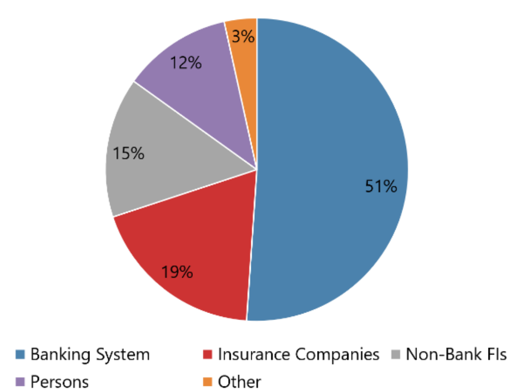
6. Lesotho received about US$95 million equivalent of SDRs under the IMF's 2021 general allocation of SDRs. At present, the allocation sits on the balance sheet of the Central Bank of Lesotho as part of international reserves. During the mission, the authorities did not indicate plans to access the SDRs through on-lending from the central bank to the government. However, given the positive balance of deposits at the central bank, there is leeway for the government to draw on them to tap the additional policy space created by the SDR allocation. The baseline scenario does not assume any further drawdown of SDR holdings. Instead, projections for net credit to government (NCG) are informed by the increased SDR holdings.

7. Most of Lesotho's external debt is owed to multilateral creditors on a concessional basis (Text Table 3). External debt accounts for 82 percent of total public debt and is predominantly owed to multilateral partners on concessional terms. The main creditor is the International Development Association (IDA), followed by the African Development Fund (AfDF), the European Investment Bank (EIB), and the IMF. As the primary bilateral (non-Paris Club) creditor, China accounts for 70 percent of bilateral debt.

8. The share of domestic debt in total public debt has increased markedly over the recent years—albeit from a lower base. Domestic public debt reached 15.3 percent of GDP in FY20/21, increased from 5 percent in FY16/17. Denominated in local currency, domestic debt has been issued through treasury bills and bonds at various maturities and is predominantly owned by banks, insurance companies, and non-bank financial institutions (see Text Figure 1). The average yield was 6 percent in FY20/21. While increasing domestic debt issuance has helped the authorities meet public financing needs and deepen local currency markets, the banking sector has limited appetite for greater absorption. In an environment of limited financial intermediation, the government is also at risk of crowding out private sector borrowing. The authorities have requested capacity development from the IMF on developing domestic debt markets.

Text Figure 1. Lesotho: Public Domestic Debt Holder Profile

(As of Mar 31, 2021)



Text Table 3. Lesotho: Decomposition of Public Debt and Debt Service by Creditor, 2020/21–2022/23[1]

	Debt Stock (end of period)			Debt Service					
	2020/21			2020/21	2021/22	2022/23	2020/21	2021/22	2022/23
	(US$ Millions)	*(Percent total debt)*	*(Percent GDP)*	*(In US$)*			*(Percent GDP)*		
Total	1,183.3	100.0	57.4	126.8	103.2	115.0	6.2%	4.2%	4.6%
External	898.5	75.9	43.6	60.8	43.8	61.9	3.0%	1.8%	2.5%
Multilateral creditors[2]	739.4	62.5	35.9	50.0	36.2	49.6	2.4%	1.5%	2.0%
IMF	67.3	5.7	3.3						
World Bank	358.6	30.3	17.4						
ADB/AfDB/IADB	146.0	12.3	7.1						
Other Multilaterals	167.5	14.2	8.1						
o/w: European Investment Bank	87.4	7.4	4.2						
o/w: Arab Bank for Econ Dev in Africa	34.8	2.9	1.7						
o/w: International Fund for Agr Dev	32.4	2.7	1.6						
Bilateral Creditors	155.2	13.1	7.5	10.8	7.6	12.3	0.5%	0.3%	0.5%
Paris Club	-	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%
Non-Paris Club	155.2	13.1	7.5	10.8	7.6	12.3	0.5%	0.3%	0.5%
o/w: China	102.3	8.6	5.0						
o/w: Kuwait	19.5	1.7	0.9						
Bonds	-	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%
Commercial creditors	-	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%
Other international creditors	3.8	0.3	0.2						
Domestic	315.0	26.6	15.3	66.0	59.4	53.0	3.2%	2.4%	2.1%
T-Bills	79.8	6.7	3.9				0.0%	0.0%	0.0%
Bonds	145.6	12.3	7.1				0.0%	0.0%	0.0%
Loans	-	0.0	0.0				0.0%	0.0%	0.0%
Memo items:									
Collateralized debt[3]	-	0.0	0.0						
o/w: Related	-	0.0	0.0						
o/w: Unrelated	-	0.0	0.0						
Contingent liabilities	28.4	2.4	1.4						
Nominal GDP	2,060.5								

1/ As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA, except for.

2/ "Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears).

3/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

BACKGROUND ON MACROECONOMIC PROJECTIONS

9. The macroeconomic framework reflects the worsened outlook since the previous DSA (Text Table 4). The baseline assumptions in the DSA are consistent with the macroeconomic framework outlined in the staff report.

- **Real GDP growth**: The economy contracted by 6 percent in FY20/21 as weak external demand and supply chain disruptions weighed on activity. However, restrictions have been gradually lifted as the country returned to its lowest alert level. Reported cases remain low and 53 percent of the target population are fully vaccinated as of April 30, 2022. Economic growth under the baseline is expected to rebound to 2.1 percent for FY21/22 and 2.7 for FY22/23. Over the medium term, GDP growth is expected to be buoyed by construction from the second phase of the Lesotho Highlands Water Project (LHWP-II).[8] However, sustaining growth over the long-term will require addressing longstanding structural

[8] Following both pandemic- and climate shock-related delays, construction is planned to resume in FY22/23 and wrap up by FY29/30. As the project is financed by capital transfers from South Africa and donor grants, it has no implications for public finances and debt (Annex IV of the Staff Report).

weaknesses as recent national accounts data revisions revealed a contraction in the economy prior to the pandemic. Assumption for medium-term growth has been moderated to 1.5 percent from the previous DSA's assumption of 3.7 percent.

- **Inflation:** Inflation is assumed to increase in the near term—reaching 6.8 percent on average in FY22/23—on account of recent increases in fuel and food prices. Over the medium-term, inflation is assumed to remain driven by monetary policy developments in South Africa and anchored by the South African Reserve Bank's inflation target.

- **Fiscal balance**: The primary fiscal deficit is expected to reach 6.2 percent in FY22/23, reflecting lower SACU transfers and delayed fiscal adjustment. The fiscal balance is expected to improve due to the recovery in SACU transfers and slower growth of public expenditure relative to GDP.[9] The primary fiscal deficit is assumed to average 2.8 percent over 2022–27 and 0.8 in 2028–42. These assumptions represent upward revisions compared to previous DSAs.

- **External Sector**: Low SACU transfers, delays to the LHWP-II, and lingering weaknesses in export sectors are expected to leave the current account in deficit at 5.0 percent of GDP over the medium term. Export and import growth are also expected to dip, reflecting weak competitiveness and lower medium-term GDP growth.

Text Table 4. Lesotho: Macroeconomic Assumptions

	2019 DSA 2018–23	2020 DSA 2020–25	2022 DSA 2022–27	2019 DSA 2024–38	2020 DSA 2026–40	2022 DSA 2028–42
Real GDP Growth (Percent)	2.5	1.8	1.6	2.9	3.7	1.5
Inflation (Percent)	5.5	4.8	5.2	5.5	4.9	4.9
Primary Deficit (Percent of GDP)	0.8	1.9	2.8	0.4	0.5	0.8
USD Export Growth (Percent)	6.5	4.5	7.4	6.3	6.8	6.0
USD Import Growth (Percent)	5.3	3.9	5.4	5.2	5.7	5.8
Non-interest Current Account Balance (Percent of GDP)	-9.6	-12.8	-8.9	-2.7	-1.6	-2.2
Net FDI (negative = outflow)	-1.6	-0.9	-1.2	-1.7	-0.9	-1.1
Grant element of new public sector borrowing (in percent)	26.9	32.1	24.8	20.8	21.1	23.6
External Debt (Percent of GDP)	35.7	51.4	47.2	34.5	45.6	41.1
Public Sector Debt (Percent of GDP)	50.2	61.9	63.3	51.0	52.0	60.7

Sources: IMF Country Report No. 20/228 and IMF staff calculations.
Notes: Average of 2022–27 is the average of FY22/23–FY27/28.

- **Concessional borrowing**: External loan disbursements incorporate the authorities' most recent projections and reflect commitments from donors. Concessional external borrowing is assumed to remain critical for financing large investment projects. To reflect renewed IDA eligibility, a grant element of around 24 percent has been assumed over the medium term—slightly higher than in the previous DSA. However, concessionality is expected to decline gradually over the long term as Lesotho grows and is expected to graduate from IDA

[9] SACU transfers are determined two-years ahead based on regional trade and growth projections. The partial recovery of SACU transfers over the medium term is expected as regional activity picks up (see also Table 3.8 in the National Treasury of South Africa's 2022 Budget Review). However, compare to historical levels, SACU transfers relative to GDP are still expected to remain muted. The improvement in primary balance is also expected to be driven by slower growth in wages and social spending relative to GDP.

eligibility. On balance, should income growth in Lesotho be higher than assumed, this will also improve Lesotho's debt carrying capacity and help mitigate the debt sustainability risks.

- **Domestic borrowing**: In line with the authorities' medium-term goals, the development of the domestic debt market is assumed to continue. The baseline scenario assumes that the share of domestic debt in total debt will be around 16 percent of GDP in the medium term.

10. The realism of the macroeconomic framework is confirmed by standard measures. However, the unprecedented nature of the current crisis and ongoing revisions to national accounts data calls for caution for interpretating these results (Figures 3 and 4).

- **Public debt:** While the contribution of real GDP growth is lower than in the past, the baseline assumptions can be considered conservative. GDP growth is expected to be boosted by LHWP-II-related construction. Further, as mentioned earlier in the report, the assumed long-term real GDP growth rate has halved compared to the previous DSA and is lower than the projections in the authorities' National Strategic Development Plan II. The residuals over 2022–24 are largely driven by the government's use of deposits at the central bank to finance the deficit, while residuals in the long term are driven by the appreciation of the real effective exchange rate. Large unexplained changes in public debt relative to the median for LICs are mostly explained by the 2021 national accounts data revision according to which the GDP has shrunk by around 10 percent since 2016.

- **External debt**: The contribution of the current account deficit to the accumulation of external debt over the 5-year projection period is substantially larger than in the past, due to the sizeable LHWP-II investments over the next 8 years (approximately equivalent to Lesotho's 2020 nominal GDP). However, this "mega project" is fully financed by capital transfers from South Africa, captured in the DSA through residuals. Thus, the contribution of the current account deficit is expected to be largely offset by a residual attributable to LHWP-II related capital transfers. Additional capital transfers are also anticipated on the back of green energy and other infrastructure projects. The unexpected changes in external debt over the past 5 years were mainly due to the methodological change in the compilation of remittances.[10]

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

11. Lesotho has a medium debt carrying capacity (Text Table 5). Debt carrying capacity is determined by a composite indicator (CI) that includes the World Bank's Country Policy and Institutional Assessment score, global economic growth, Lesotho's real growth rate, import coverage of reserves, and

[10] The authorities recently updated compensation of employee inflows in the primary income account. The revision increased inflows by roughly LSL 2.5 billion per year (about 8 percent of GDP).

remittances. The composite indicator for the April 2022 WEO data and the World Bank's CPIA 2020 CPIA score yields a medium CI rating (2.91), as in the previous vintage.

12. Lesotho does not trigger other tailored stress tests. Apart from the contingent liability tailored shock described above, Lesotho's economic characteristics do not trigger any of the tailored stress tests on natural disasters, commodity prices, and/or market financing risk module.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

13. Under the baseline scenario, the PV of external debt-to-GDP ratio remains below but very close to its corresponding thresholds (Tables 1 and 2, and Figure 1). The present value (PV) of PPG external debt-to-GDP is expected to increase and stabilize around 36 percent level. The near-term increase in the external borrowing is mainly driven by the emerging financing needs due to the falling SACU transfers and the COVID-19 crisis. Afterwards, a combination of somewhat recovering SACU transfers, fiscal adjustment and expansion of domestic borrowing is expected to ease external financing needs. All the other indicators of external debt sustainability remain below their thresholds.

14. Stress tests show that Lesotho's external debt is most vulnerable to current transfers-to-GDP[11], export and combined contingent liabilities shocks (Tables 3 and 4, and Figure 1). For these shocks, the PV of PPG external debt-to-GDP would breach the 40 percent threshold and remain above the threshold during the entire forecast horizon. The rest of the debt indicators remain below their respective thresholds under the stress tests.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

15. Under the baseline scenario, the PV of total public debt-to-GDP remains below but close to its corresponding threshold (Table 2 and Figure 2). The PV of public debt-to-GDP is expected to stabilize below the 55 percent threshold, in the medium term. PV of Debt-to-Revenue ratio is expected to increase in the near term before falling to the current levels in the medium term. The increase is mainly driven by sluggish near-term revenue projections related with lingering effect of the COVID-19 pandemic. Yet another indicator, Debt Service-to-Revenue ratio, shows increasing trend reflecting Lesotho's gradual transition to domestic financing away from external borrowing on concessional terms.

16. Stress tests show that Lesotho's public debt is vulnerable to a number of shocks in the standardized tests (Table 4 and Figure 2). Public debt is most vulnerable to a combined contingent liability shock, under which PV of public debt-to-GDP ratio would breach 55 percent over the entire projection period. Public debt is also vulnerable to shocks to current transfers-to-GDP, exports, real GDP growth, and the primary balance. For these shocks, the PV of public debt-to-GDP would also breach the 55 percent threshold.

[11] Under the standardized stress tests this is captured in other flows shock.

Text Table 5. Lesotho: Debt Carrying Capacity

Debt Carrying Capacity and Thresholds

Country	Lesotho
Country Code	**666**

Debt Carrying Capacity	**Medium**

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Medium	Medium 2.91	Medium 2.92	Medium 2.94

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	180
GDP	40
Debt service in % of	
Exports	15
Revenue	18

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	55

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.308	1.27	44%
Real growth rate (in percent)	2.719	0.404	0.01	0%
Import coverage of reserves (in percent)	4.052	33.122	1.34	46%
Import coverage of reserves^2 (in percent)	-3.990	10.971	-0.44	-15%
Remittances (in percent)	2.022	15.494	0.31	11%
World economic growth (in percent)	13.520	3.044	0.41	14%
CI Score			2.914	100%
CI rating			**Medium**	

New framework			
	Cut-off values		
Weak	CI <	2.69	
Medium	2.69	≤ CI ≤	3.05
Strong	CI >	3.05	

RISK RATING AND VULNERABILITIES

17. The risk ratings of both Lesotho's external and overall public debt are moderate with limited space to absorb shocks. The moderate risk rating of external debt distress comes from the PV of PPG external debt-to-GDP breaching its threshold under the stress tests, while the moderate overall risk rating of public debt distress comes from the moderate risk of external debt distress and from the PV of public debt-to-GDP breaching its benchmark under the stress tests. All the external and public debt indicators remain below their thresholds under the baseline scenario. The granularity of risk rating—assessing available space to absorb shocks without being downgraded to a high-risk category—remains limited.

18. Risks to the debt sustainability are tilted to the downside. The key risk to the debt sustainability is delaying fiscal adjustment and accumulating arrears. Both the external and total PV of debt-to-GDP ratios are close to high-risk thresholds, leaving limited space to absorb further shocks. In addition, larger gross financing needs and heightened liquidity constraints stemming from the recently accumulated domestic debt and nonconcessional external borrowing to support pandemic related spending add to the risks. Contingent liabilities related with pension fund and potential new contingent liabilities that may result from poor governance– such as, for example, asset seizure from Frazer Solar agreement—are also putting debt sustainability at significant risk. From the external side, the risks of delaying recovery in major trading partners and further lowering of SACU transfers are critical. In addition, while exchange rate appreciation in FY20/21 helped to somewhat ease external debt burden, this can reverse in the future. On the positive side, however, debt sustainability is supported by the large and stable worker's remittances from South Africa and grant-financed "megaprojects".

19. Fiscal consolidation and improving governance are critical to ensure debt sustainability. The DSA highlights the need to control recurrent expenditure—particularly the wage bill—and improve efficiency of capital spending. The government will also need to address the pension fund's financing gap and improve fiscal governance to ensure the sustainability of public sector. The DSA also calls for a conservative debt management strategy focused on concessional sources wherever possible and a well thought strategy to develop local currency debt markets while limiting risks of crowding out private sector and excessive increase of bank's exposure to government. Finally, efforts are needed to further increase coverage, quality, and reliability of debt statistics. The authorities' efforts on these fronts are also supported by a Policy and Performance Action under the IDA SDFP.

Authorities' Views

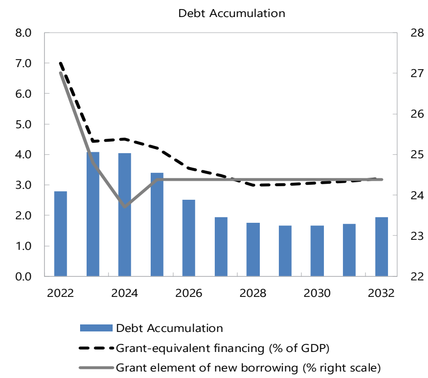
20. The authorities concurred with staff's assessment, emphasizing that reducing debt vulnerabilities is key for medium-term macroeconomic stability. They also acknowledged the trade-off between near-term public spending needs and medium-term debt sustainability. Noting the pressure to raise debt to finance growing expenditure needs, they highlighted the recent success in extending maturity and deepening of domestic debt markets. However, they agreed on the need to exercise conservative public debt management strategies that focus on concessional sources and do not crowd out the private sector. The authorities reiterated their commitment to address the funding gap of the pension fund and to improve monitoring of contingent liabilities to ensure a comprehensive overview of debt.

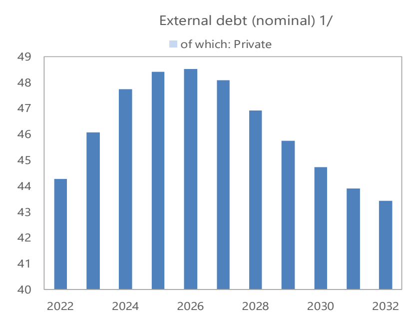
Table 1. Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2021–42

(In percent of GDP, unless otherwise indicated)

	Actual	Projections								Average 8/	
	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
External debt (nominal) 1/	43.6	44.3	46.1	47.7	48.4	48.5	48.1	43.4	35.4	39.4	45.9
of which: public and publicly guaranteed (PPG)	43.6	44.3	46.1	47.7	48.4	48.5	48.1	43.4	35.4	39.4	45.9
Change in external debt	0.0	0.7	1.8	1.7	0.7	0.1	-0.4	-0.5	-0.8		
Identified net debt-creating flows	-1.3	12.1	7.7	8.4	7.8	7.1	4.2	1.3	1.7	2.4	5.3
Non-interest current account deficit	6.8	13.7	8.8	9.7	9.1	7.6	4.4	2.1	2.5	4.0	6.3
Deficit in balance of goods and services	50.9	54.5	50.9	52.0	49.9	48.1	44.8	42.0	39.3	52.2	47.1
Exports	39.1	40.7	41.0	41.2	41.3	42.0	42.9	42.9	40.5		
Imports	90.0	95.2	91.9	93.2	91.2	90.1	87.6	85.0	79.9		
Net current transfers (negative = inflow)	-24.0	-20.7	-22.4	-23.0	-21.9	-21.7	-21.6	-21.6	-20.3	-28.9	-21.8
of which: official	-17.7	-15.2	-17.0	-17.8	-16.8	-16.6	-16.6	-16.6	-15.6		
Other current account flows (negative = net inflow)	-20.1	-20.1	-19.7	-19.3	-19.0	-18.8	-18.7	-18.3	-16.5	-19.4	-18.9
Net FDI (negative = inflow)	-1.5	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.1	-2.5	-1.2
Endogenous debt dynamics 2/	-6.6	-0.4	0.1	-0.1	-0.1	0.6	0.9	0.3	0.4		
Contribution from nominal interest rate	0.6	0.7	0.7	0.8	0.9	1.0	1.0	1.0	0.9		
Contribution from real GDP growth	-0.8	-1.1	-0.7	-0.9	-1.0	-0.3	-0.1	-0.6	-0.5		
Contribution from price and exchange rate changes	-6.4	...	...	...	...	...	...	...	...		
Residual 3/	1.3	-11.4	-5.9	-6.8	-7.1	-7.0	-4.6	-1.8	-2.6	-1.0	-5.2
of which: exceptional financing	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators											
PV of PPG external debt-to-GDP ratio	30.3	31.6	33.7	35.3	36.2	36.7	36.8	34.3	28.5		
PV of PPG external debt-to-exports ratio	77.4	77.8	82.1	85.7	87.8	87.5	85.8	79.8	70.3		
PPG debt service-to-exports ratio	4.5	6.0	6.1	6.8	6.3	5.7	5.6	6.9	6.9		
PPG debt service-to-revenue ratio	4.2	5.9	5.7	6.3	6.0	5.5	5.5	6.9	6.5		
Gross external financing need (Million of U.S. dollars)	173.7	387.1	279.2	331.1	328.5	291.5	195.7	184.4	366.3		
Key macroeconomic assumptions											
Real GDP growth (in percent)	2.1	2.7	1.6	2.1	2.3	0.7	0.1	1.5	1.5	0.7	1.7
GDP deflator in US dollar terms (change in percent)	17.2	1.8	4.4	4.6	4.5	4.8	4.9	4.8	4.8	-0.7	4.4
Effective interest rate (percent) 4/	1.5	1.6	1.8	1.9	2.0	2.1	2.2	2.3	2.5	1.6	2.1
Growth of exports of G&S (US dollar terms, in percent)	15.1	8.6	7.0	7.2	7.1	7.3	7.3	6.4	6.5	-0.7	7.0
Growth of imports of G&S (US dollar terms, in percent)	12.3	10.5	2.5	8.3	4.6	4.3	2.2	6.4	6.4	-1.4	6.2
Grant element of new public sector borrowing (in percent)	...	27.0	24.8	24.4	24.4	24.4	24.4	24.4	23.1	...	24.7
Government revenues (excluding grants, in percent of GDP)	42.0	41.3	44.2	44.9	43.7	43.9	43.8	43.0	43.0	47.5	43.3
Aid flows (in Million of US dollars) 5/	832.1	215.5	152.1	156.0	157.8	137.8	132.3	182.6	279.2		
Grant-equivalent financing (in percent of GDP) 6/	...	7.0	4.4	4.5	4.2	3.5	3.3	3.2	3.0	...	4.0
Grant-equivalent financing (in percent of external financing) 6/	...	65.7	47.6	47.2	50.4	53.5	56.9	50.5	54.0	...	52.7
Nominal GDP (Million of US dollars)	2,465	2,577	2,734	2,920	3,121	3,294	3,461	4,718	8,768		
Nominal dollar GDP growth	19.6	4.5	6.1	6.8	6.9	5.5	5.1	6.4	6.4	-0.1	6.2
Memorandum items:											
PV of external debt 7/	30.3	31.6	33.7	35.3	36.2	36.7	36.8	34.3	28.5		
In percent of exports	77.4	77.8	82.1	85.7	87.8	87.5	85.8	79.8	70.3		
Total external debt service-to-exports ratio	4.5	6.0	6.1	6.8	6.3	5.7	5.6	6.9	6.9		
PV of PPG external debt (in Million of US dollars)	746.5	815.1	920.4	1031.0	1130.4	1209.1	1273.1	1617.8	2500.1		
(PVt-PVt-1)/GDPt-1 (in percent)		2.8	4.1	4.0	3.4	2.5	1.9	1.9	1.2		
Non-interest current account deficit that stabilizes debt ratio	6.8	13.0	7.0	8.0	8.4	7.5	4.8	2.6	3.3		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 2. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2022–32

(In percent of GDP)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
	PV of debt-to GDP ratio										
Baseline	32	34	35	36	37	37	36	36	35	35	34
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	32	31	30	28	26	26	28	30	32	35	39
B. Bound Tests											
B1. Real GDP growth	32	34	38	39	39	40	39	38	38	37	37
B2. Primary balance	32	34	38	39	39	40	39	39	38	37	37
B3. Exports	32	34	**47**	**48**	**49**	**49**	**48**	**47**	**46**	**45**	**44**
B4. Other flows 3/	32	34	**46**	**46**	**47**	**47**	**46**	**45**	**43**	**42**	**41**
B5. Depreciation	32	34	35	36	37	37	36	36	35	35	34
B6. Combination of B1-B5	32	34	36	37	37	38	37	37	36	36	36
C. Tailored Tests											
C1. Combined contingent liabilities	32	34	**49**	**50**	**51**	**52**	**51**	**51**	**50**	**49**	**49**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
	PV of debt-to-exports ratio										
Baseline	78	82	86	88	87	86	84	83	82	80	80
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	78	76	72	67	62	60	65	69	75	82	90
B. Bound Tests											
B1. Real GDP growth	78	82	86	88	87	86	84	83	82	80	80
B2. Primary balance	78	82	92	94	94	93	91	90	88	87	86
B3. Exports	78	82	138	140	139	136	134	132	128	125	123
B4. Other flows 3/	78	82	111	112	111	109	107	104	101	99	96
B5. Depreciation	78	82	86	88	88	86	85	83	82	81	80
B6. Combination of B1-B5	78	82	76	106	106	104	103	101	100	100	99
C. Tailored Tests											
C1. Combined contingent liabilities	78	82	119	122	122	121	120	118	116	115	114
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
	Debt service-to-exports ratio										
Baseline	6	6	7	6	6	6	6	6	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	6	7	8	7	6	6	7	7	7	7	7
B. Bound Tests											
B1. Real GDP growth	6	6	7	6	6	6	6	6	7	7	7
B2. Primary balance	6	6	7	7	6	6	6	6	7	7	7
B3. Exports	6	6	9	9	8	8	9	9	11	11	11
B4. Other flows 3/	6	6	7	7	6	6	7	8	8	9	9
B5. Depreciation	6	6	7	6	6	6	6	6	7	7	7
B6. Combination of B1-B5	6	6	9	8	7	7	8	8	8	8	8
C. Tailored Tests											
C1. Combined contingent liabilities	6	6	8	7	7	7	7	7	8	8	8
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
	Debt service-to-revenue ratio										
Baseline	6	6	6	6	5	5	6	6	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	6	6	7	7	6	6	7	7	7	7	7
B. Bound Tests											
B1. Real GDP growth	6	6	7	6	6	6	6	7	7	7	7
B2. Primary balance	6	6	6	6	6	6	6	6	7	7	7
B3. Exports	6	6	7	7	7	7	7	7	9	9	9
B4. Other flows 3/	6	6	7	7	6	6	7	7	8	9	9
B5. Depreciation	6	6	6	6	5	6	6	6	7	7	7
B6. Combination of B1-B5	6	6	7	6	6	6	6	6	7	7	7
C. Tailored Tests											
C1. Combined contingent liabilities	6	6	7	7	6	7	7	7	8	8	8
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

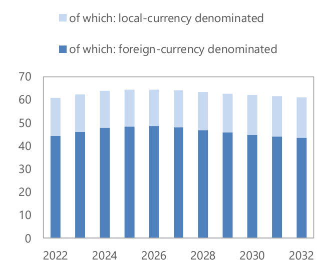
Table 3. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–42

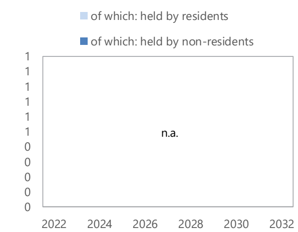
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
Public sector debt 1/	**58.8**	**57.4**	**59.2**	**60.7**	**62.4**	**63.7**	**64.2**	**64.4**	**64.1**	**61.0**	**60.3**	**47.8**	**62.7**
of which: external debt	**46.9**	**43.6**	**43.6**	**44.3**	**46.1**	**47.7**	**48.4**	**48.5**	**48.1**	**43.4**	**35.4**	**39.4**	**46.2**
Change in public sector debt	8.0	-1.4	1.8	1.4	1.7	1.3	0.6	0.2	-0.3	-0.4	0.3		
Identified debt-creating flows	**13.9**	**-8.2**	**3.3**	**2.8**	**3.8**	**2.4**	**0.9**	**0.2**	**0.0**	**0.8**	**1.2**	**2.3**	**1.2**
Primary deficit	**6.0**	**-1.9**	**5.2**	**6.5**	**5.2**	**3.6**	**1.9**	**0.0**	**-0.6**	**0.8**	**0.8**	**1.5**	**1.9**
Revenue and grants	48.4	55.3	46.2	47.0	47.0	47.8	46.6	46.5	46.3	45.2	45.2	**51.7**	**46.1**
of which: grants	3.7	3.1	4.2	5.6	2.8	2.9	2.9	2.6	2.5	2.2	2.2		
Primary (noninterest) expenditure	54.4	53.4	51.4	53.5	52.2	51.4	48.5	46.5	45.7	46.0	46.0	**53.2**	**48.0**
Automatic debt dynamics	**7.9**	**-6.3**	**-1.9**	**-3.7**	**-1.4**	**-1.2**	**-1.0**	**0.2**	**0.6**	**0.0**	**0.4**		
Contribution from interest rate/growth differential	0.2	4.1	-2.3	-3.7	-1.4	-1.2	-1.0	0.2	0.6	0.0	0.4		
of which: contribution from average real interest rate	0.2	0.3	-1.1	-2.2	-0.4	0.1	0.5	0.6	0.6	0.9	1.3		
of which: contribution from real GDP growth	0.0	3.7	-1.2	-1.5	-1.0	-1.3	-1.4	-0.4	-0.1	-0.9	-0.9		
Contribution from real exchange rate depreciation	7.7	-10.4	0.4	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**-5.9**	**6.8**	**-1.5**	**-1.3**	**-2.1**	**-1.1**	**-0.4**	**0.0**	**-0.3**	**-1.2**	**-1.0**	**0.0**	**-1.0**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**46.7**	**48.3**	**50.0**	**51.3**	**52.1**	**52.6**	**52.8**	**51.9**	**53.4**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**101.1**	**102.9**	**106.4**	**107.3**	**111.7**	**113.2**	**114.1**	**114.9**	**118.1**		
Debt service-to-revenue and grants ratio 3/	**7.6**	**15.0**	**6.4**	**11.4**	**10.8**	**13.7**	**12.5**	**9.8**	**12.7**	**14.5**	**17.2**		
Gross financing need 4/	9.7	6.4	8.2	11.8	10.2	10.2	7.7	4.6	5.3	7.3	8.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	0.0	-6.0	2.1	2.7	1.6	2.1	2.3	0.7	0.1	1.5	1.5	**0.7**	**1.5**
Average nominal interest rate on external debt (in percent)	1.8	1.8	1.4	1.7	1.8	1.9	2.0	2.1	2.2	2.3	2.5	**1.6**	**2.1**
Average real interest rate on domestic debt (in percent)	1.7	0.0	0.2	-1.7	0.7	1.9	3.0	3.4	3.5	4.1	4.8	**0.4**	**2.8**
Real exchange rate depreciation (in percent, + indicates depreciation)	19.1	-20.7	0.8	...	...	...	...	...	...	...	...	**3.8**	**...**
Inflation rate (GDP deflator, in percent)	5.5	5.5	6.5	6.4	5.4	4.7	4.6	4.9	5.0	4.9	4.9	**6.1**	**5.0**
Growth of real primary spending (deflated by GDP deflator, in percent)	1.9	-7.7	-1.7	6.7	-0.9	0.7	-3.6	-3.4	-1.6	1.5	1.5	**-0.6**	**0.6**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.9	-0.4	3.4	5.1	3.5	2.3	1.3	-0.1	-0.3	1.2	0.5	**0.3**	**1.7**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 4. Lesotho: Sensitivity Analysis for Key Indicators of Public Debt, 2022–32
(In percent of GDP)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
	PV of Debt-to-GDP Ratio										
Baseline	50	51	52	53	53	53	52	52	52	52	52
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	50	52	**56**	**60**	**63**	**66**	**69**	**72**	**74**	**76**	**79**
B. Bound Tests											
B1. Real GDP growth	50	**56**	**58**	**61**	**63**	**64**	**66**	**67**	**68**	**69**	**71**
B2. Primary balance	50	55	**55**	**56**	**56**	**56**	**56**	**55**	**55**	55	55
B3. Exports	50	**59**	**59**	**60**	**60**	**60**	**59**	**59**	**58**	**57**	**57**
B4. Other flows 3/	50	**62**	**62**	**62**	**63**	**62**	**62**	**61**	**60**	**59**	**58**
B5. Depreciation	50	51	52	53	53	53	52	52	52	52	52
B6. Combination of B1-B5	50	54	54	55	55	55	54	54	54	54	54
C. Tailored Tests											
C1. Combined contingent liabilities	50	48	**66**	**67**	**67**	**68**	**68**	**67**	**67**	**67**	**66**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
	PV of Debt-to-Revenue Ratio										
Baseline	103	106	107	112	113	114	116	116	116	115	115
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	103	106	110	120	129	137	147	153	159	164	170
B. Bound Tests											
B1. Real GDP growth	103	106	116	125	130	135	142	145	148	151	153
B2. Primary balance	103	106	115	119	120	121	124	123	122	122	121
B3. Exports	103	106	123	128	129	130	132	131	130	129	127
B4. Other flows 3/	103	106	129	133	134	135	138	136	134	133	131
B5. Depreciation	103	106	107	112	113	114	116	116	116	115	115
B6. Combination of B1-B5	103	106	113	116	117	118	121	120	120	120	119
C. Tailored Tests											
C1. Combined contingent liabilities	103	106	101	107	110	113	116	117	118	119	120
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	Debt Service-to-Revenue Ratio										
Baseline	11	11	14	13	10	13	11	15	13	15	14
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2023-2033 2/	11	11	14	13	10	14	13	18	16	18	19
B. Bound Tests											
B1. Real GDP growth	11	11	14	14	11	14	13	18	16	18	18
B2. Primary balance	11	11	14	13	10	13	11	16	14	15	15
B3. Exports	11	11	14	13	10	13	11	16	15	16	16
B4. Other flows 3/	11	11	14	13	10	13	11	16	15	16	16
B5. Depreciation	11	11	14	13	10	13	11	15	13	15	14
B6. Combination of B1-B5	11	11	14	13	10	13	11	16	14	15	15
C. Tailored Tests											
C1. Combined contingent liabilities	11	11	17	16	13	16	14	17	15	16	16
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

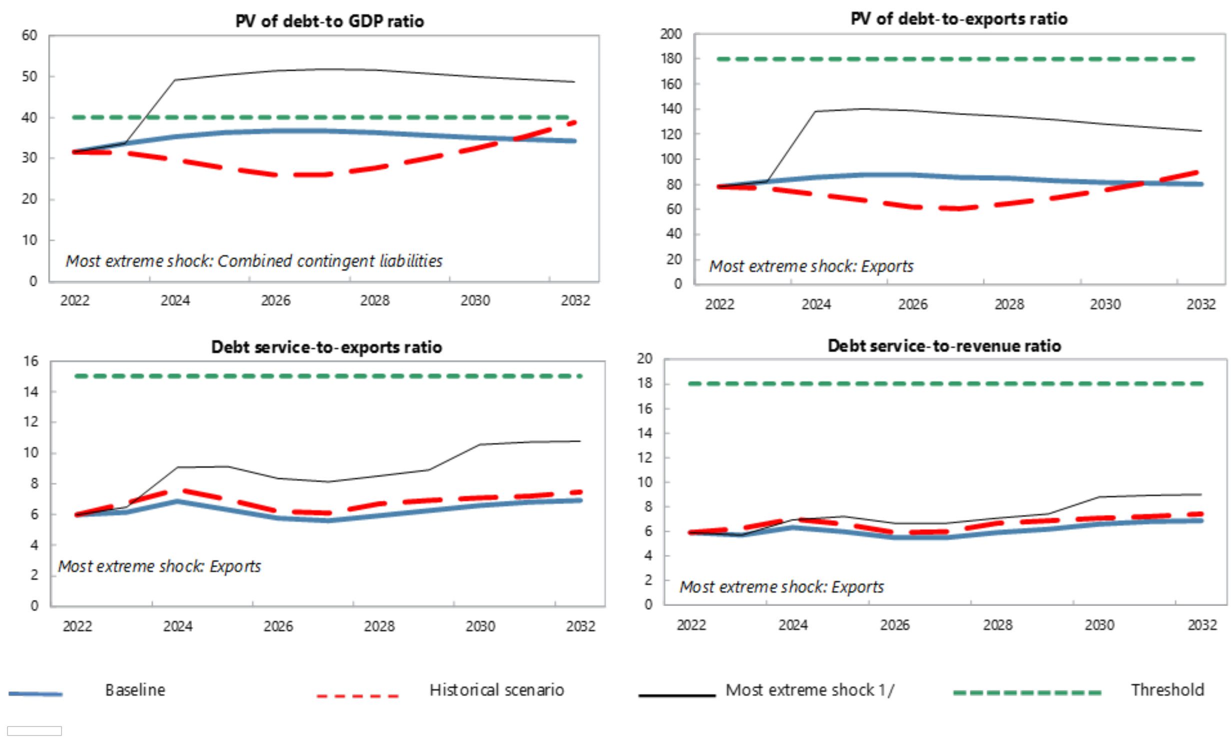
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 1. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2022–32[1, 2]



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price	n.a.	n.a.
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.6%	2.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	23	23
Avg. grace period	5	5

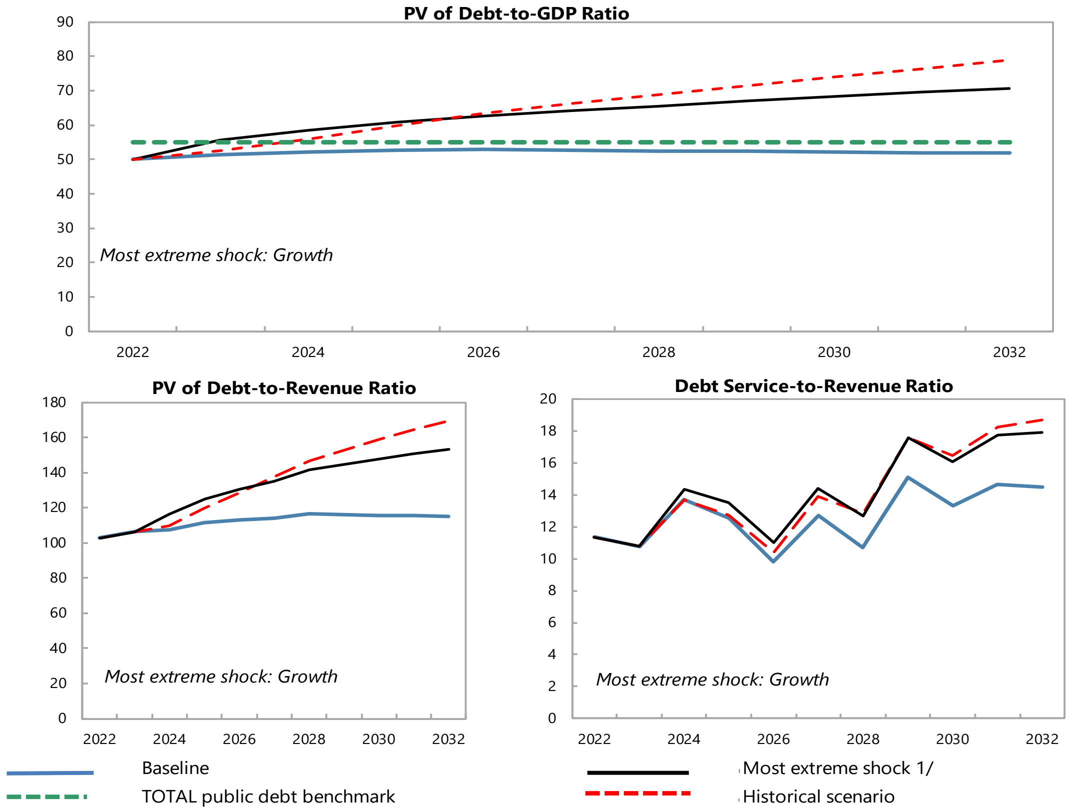
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Lesotho: Indicators of Public Debt Under Alternative Scenarios, 2022–32



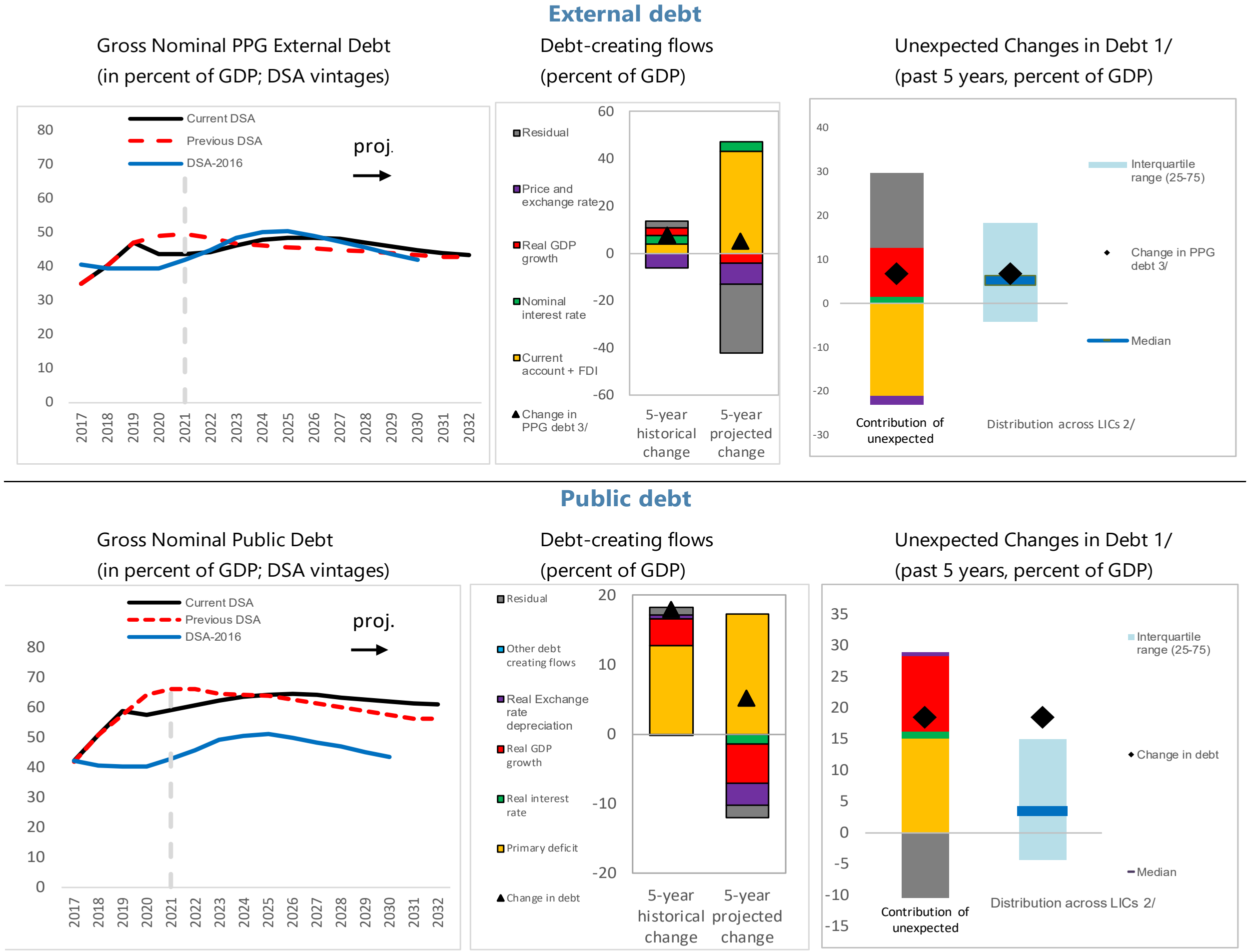
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	58%	80%
Domestic medium and long-term	42%	20%
Domestic short-term	0%	0%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.6%	2.6%
Avg. maturity (incl. grace period)	23	23
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	5.1%	5.1%
Avg. maturity (incl. grace period)	5	5
Avg. grace period	4	0
Domestic short-term debt		
Avg. real interest rate	3.0%	3.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Drivers of Debt Dynamics – Baseline Scenario



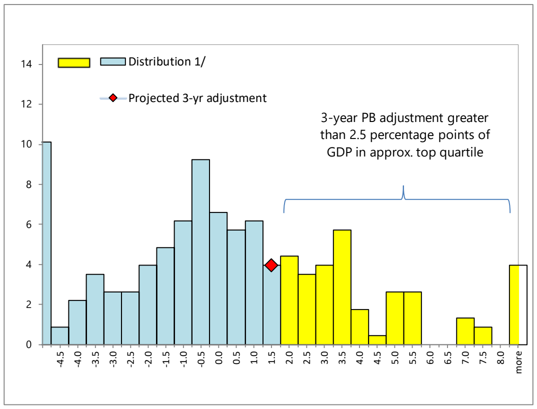
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

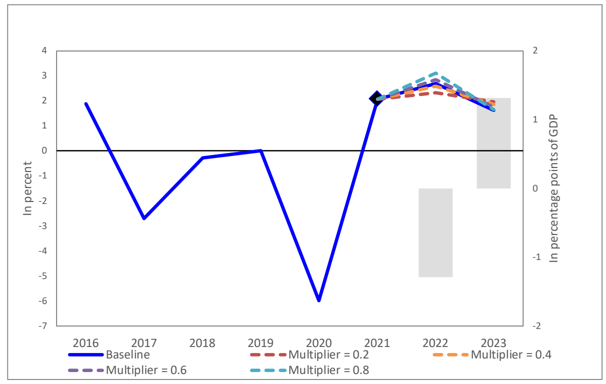
Figure 4. Lesotho: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



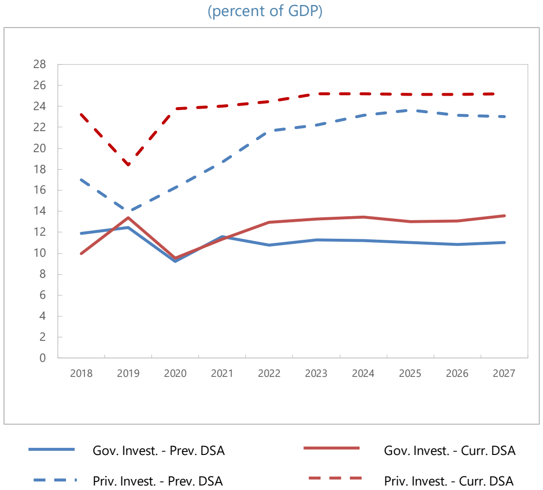
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

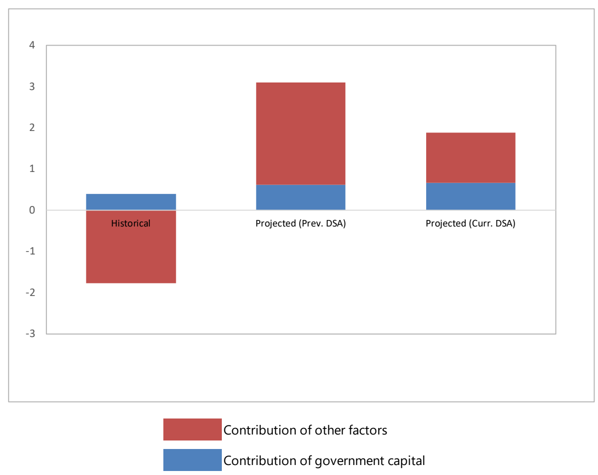


Figure 5. Lesotho: Qualification of the Moderate Category, 2022–2032 [1/]

Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

Statement by Ms. Ita Mannathoko Executive Director for Kingdom of Lesotho and Mr. Moeti Godfrey Damane and Ms. Abigail Nainda, Advisors to the Executive Director for Kingdom of Lesotho
June 1, 2022

The Lesotho economy is exposed to a wide array of external shocks. Over the past two years, the authorities had to contend simultaneously with the pandemic, declining SACU transfers, climate events and impacts from the war in Ukraine, all generating significant fiscal and balance of payments stress. While the authorities undertook effective measures in response to the pandemic, containing its spread, rolling out vaccinations, shielding vulnerable households, and reducing social and economic effects, subsequent shocks are undermining the recovery. Current fiscal and external pressures highlight the importance of measures to resuscitate growth and revenues by developing the private sector and boosting production in pursuit of positive per capita income growth and a sustainable and inclusive post-pandemic recovery. While the spillovers from the war in Ukraine on commodity prices, fertilizer supplies, agricultural production, and food security present renewed risks to the outlook, the authorities are hopeful that efforts to stabilize the economy in the short-to-medium term will combine with stronger performance in the mining and construction sectors, continuing "megaprojects" and recent progress on Millennium Challenge Corporation support for agriculture and business development, to boost medium term growth above the 2 percent projected by staff.

Introduction

1. Our authorities appreciate the constructive discussions with staff during the recent Article IV consultation. They valued the Fund's emergency financing support under the RCF, debt relief under the CCRT and the SDR allocation. They look forward to continued policy guidance and technical support, and given their extended negotiations with staff, hope that agreement can be reached with the Fund on a UCT quality program, sooner rather than later. The authorities broadly agree with the thrust of the staff appraisal.

2. While the Lesotho economy is coming out of a COVID-19 induced recession in 2021/22, it will take some years to recover to pre-pandemic levels. Multiple shocks amidst severely limited fiscal space have exerted a heavy toll on the economy**,** with extensive social and economic disruption from the shocks affecting key sectors and vulnerable groups. Apart from the pandemic and declining receipts (revenue) from the Southern African Customs Union (SACU), successive climate shocks over the past decade including recurrent droughts and flooding in some regions have negatively impacted agriculture, livelihoods and food security. Recent floodwaters and heavy rain have also destroyed critical road networks, forcing the redirection of spending away from development priorities. The war in Ukraine now presents additional downside risks, as food and energy price shocks add to imported inflationary pressures that had been building due to supply chain disruption. Despite swift and decisive measures adopted under the COVID-19 Socio Economic Response Plan that helped to contain COVID-19 and its impact, including a countercyclical stance and accommodative policy to support the economic recovery, scarring is evident.

3. Given the adverse impact on revenues and the fiscal balance from recent shocks, the authorities aim to undertake growth-friendly fiscal consolidation that is needed to ensure sustained debt sustainability. Consistent monetary policies will seek to sustain the exchange rate peg and

anchor inflation expectations. The authorities also intend to restore economic development and counter the disruption to education and the exacerbation of pre-existing inequalities, with a focus on vulnerable groups including women. Reforms under the National Strategic Development Plan (NSDP II) which ends in 2023, sought to transform Lesotho from a consumer- and government-driven economy to a producer-based economy led by the private sector. The successor plan, which is currently being framed, will build on progress so far and seek to reverse scarring and bolster the recovery.

Recent Economic Developments and Outlook

4. Following two years of stagnation and a 6 percent contraction in GDP in FY2020/21 induced by the pandemic, economic growth resumed in FY2021/22, with an 8-percentage point improvement bringing growth to an estimated 2.1 percent. This was underpinned by increased activity in the primary sector. Real GDP growth is projected at 2.7 percent in FY22/23, buttressed by investments in local "megaprojects" and reopening of the economy following vaccination. Staff expect GDP growth to moderate to an average 1.5 percent in the medium term; the authorities, however, are more optimistic expecting a further boost from renewed consumer confidence owing to significant gains in vaccination and strong performance in mining, construction (especially the second phase of the Lesotho Highlands Water Project, LHWP), and wholesale and retail trade activities, as well as recent progress with agriculture and SME programs funded by the Millennium Challenge Corporation (MCC).

5. The monetary outlook in Lesotho remains closely linked to policy and price developments in South Africa, which serve as an anchor. Inflation averaged 6.4 percent in FY21/22, a percentage point higher than the average figure in FY20/21 and two percentage points higher than South African inflation, possibly reflecting in part, domestic pressures from broad money expansion in 2020/21. Annual inflation for FY22/23 is expected to remain elevated, with significant risks emanating from prevailing high international food and energy prices due to the war in Ukraine disrupting supply and threatening food security amidst negative impacts of climate change on agricultural production in Lesotho.

6. Despite recent improvements in exports and remittances, the current account deficit is projected to widen from 2 percent of GDP in FY20/21 to 7.4 percent and 14.4 percent of GDP in FY21/22 and FY22/23 respectively, due to declining SACU transfers and LHWP-II-related imports. As a result, international reserves are expected to drop from 4.5 months of import cover in FY21/22 to 4 months in FY22/23, including a slight moderation on account of favorable prices of mineral exports.

Fiscal Policy and Debt

7. Given significant financing pressures and risks to debt and fiscal sustainability, growth friendly fiscal consolidation has become more urgent. Our authorities are actively engaging line ministries, government agencies, and the private sector, to galvanize buy-in and build consensus on important expenditure management and revenue measures required to place public finances on a sustainable footing. They are exploring ways to rationalize expenditure and prioritize targeting, even as they plan to strengthen revenue administration and increase compliance. At the same time, they wish to pursue more impactful expenditure decisions that better accommodate marginalized shares of the labor force, and to this end have begun work with development partners to introduce gender responsive budgeting. They also plan to

intensify domestic revenue mobilization efforts. The FY22/23 national budget announced the enforcement of a sales tax and the elimination of VAT zero-rating on mining exports. As part of efforts to improve administrative efficiency, there are plans to introduce cashless collection systems in addition to improving compliance through greater transparency and auditing.

8. The authorities also aim to implement a clear and transparently communicated medium-term expenditure framework (MTEF). Noting the need to contain expenditure, the authorities intend to curb unproductive capital spending, identifying and minimizing stalled projects while improving investment appraisal and execution. They are also exploring hiring and public wage freezes to contain public wage bill growth in the medium term and reduce it below 60 per cent of domestic revenues. In addition they intend to reduce the level of arrears back down to levels below the 2.1 percent of GDP recorded at the end of March 2021 and will explore the adoption of a fiscal rule that uses arrears as an adjustor in calculating the budget balance. Targeting under the tertiary education loan bursary scheme is also being improved with steps underway to introduce means testing and pursue loan recovery.

9. The authorities intend to complete outstanding public financial management (PFM) reforms needed to strengthen expenditure controls, promote a transparent and well-coordinated budget process, strengthen monitoring of SOEs, and centralize government accounts to promote oversight and accountability. They have developed a draft Public Financial Management and Accountability (PFMA) Bill with the assistance of the IMF, which has been submitted for official drafting. They are also exploring migration to an accruals-based accounting system and digitalization to improve PFM. They have submitted the 2022 PFMA Bill to Parliament, which should improve budget processes, limit the accumulation of domestic arrears, and close attendant PFM gaps. Legacy arrears were catalogued in 2021 and are being gradually reduced. Passage of the PFMA and procurement bills will enable enforcement of some governance measures including those such as online publication of COVID-19-related procurement contracts.

10. Our authorities have been monitoring the increase in debt vulnerabilities and associated risks. The crisis response spending occasioned by the pandemic and other shocks added almost 2 percentage points to the debt to GDP ratio, bringing it to 59.2 percent of GDP in FY21/22 amidst constrained fiscal space. Against this background, the authorities are exploring fiscal rules and a fiscal risk management framework to support fiscal and debt sustainability, together with efforts to improve the granularity and reliability of public debt data and debt service cost projections, leveraging Fund CD/TA.

Monetary and Financial Sector Policies

11. The monetary authorities are committed to price stability, keeping inflation expectations anchored, and maintaining an adequate level of international reserves to safeguard the exchange rate peg. Given the importance of central bank autonomy they would welcome Fund support to strengthen the CBL Act in line with best practice, and to foster greater coordination between fiscal and monetary policy. Following staff's recommendations, they plan to enhance policy coordination between the Central Bank and the Ministry of Finance through the re-establishment of the macroeconomic working group (MWG). The MWG is also expected to help improve data collection and consistency, leveraging existing formal structures and other relevant forums that facilitate platforms for comprehensive policy engagement.

12. The authorities have made notable progress strengthening the supervisory framework and safeguarding financial stability. The banking sector has remained resilient to multiple shocks with ample capital and liquidity buffers, and low NPLs, compared to peers in the SACU region. Our authorities have advanced the implementation of the Basel II capital adequacy framework, a risk-based approach to anti-money laundering/combating the financing of terrorism (AML/CFT) and credit infrastructure and support for capital market development. They plan to implement Basel II.5 in the post-COVID era and focus on strengthening supervision of the non-bank financial sector with support from external partners, including evaluation feedback from the Financial Action Task Force (FATF). The central bank notes that the rapidly growing nonbank financial sector is stretching its supervisory capacity and requires greater attention. The authorities may seek technical support in this regard.

13. Increasing financial inclusion is critical for the authorities, and they continue to make progress in digitalizing financial services, and with the passage of the 2021 Insolvency Bill through Parliament, and recent pricing directives to alleviate financial transaction costs. Given the role of micro, small and medium- sized enterprises (MSMEs) as potential engines for growth, the authorities prioritize improving their access to financial services. They recently established a LSL50 million grant scheme for MSMEs, especially in the tourism sector, to help cushion them against the adverse effects of the pandemic. They are dedicated to promoting safe and efficient adoption of digital financial services and increasing financial literacy. They have taken significant steps to implement the national payment switch and associated common data standards and protocols. The Central Bank of Lesotho acquired the infrastructure in the first quarter of the year, including hardware components and specialized equipment, to run the national payment switch. The "go-live" date for mobile money providers is in June 2022 while that of banks is tentatively earmarked for September 2022.

14. The CBL continues with efforts to promote the development of financial markets. Lesotho's capital markets are relatively underdeveloped, with no secondary market for capital market transactions. The Maseru Securities Market listed the first company on its stock exchange on December 6, 2021, a significant milestone. Meanwhile, the appetite for government debt has been growing, and in the recent February 23, 2022 auction, the authorities issued a 7-year instrument, which was oversubscribed, supported by important changes to transparency and investor sensitization.

Structural reforms

15. The authorities plan to intensify the structural reform agenda as this will resuscitate and reenergize growth by promoting private sector development, while tackling corruption and improving governance. Efforts are underway to enhance competitiveness and unlock bottlenecks to private sector development, through measures that improve business regulation, simplify business registration, effect land administration reforms and enhance human capital formation. On transparency, they are making progress on RCF/RFI governance commitments, including through maintaining transparency of COVID-19 spending and public procurement. Signed procurement contracts for crisis-mitigation spending, the names and beneficial owners of companies awarded these contracts, and ex-post validation of delivery, are published on the Ministry of Finance website, albeit with some delays. A procurement Bill has been submitted to Parliament and is currently with the upper house, which will help to address delays in the supply of relevant information.

16. The authorities are also exploring avenues for market and product diversification to enhance resilience to shocks. In the last quarter of 2020, they launched: (i) the National Trade and Export Strategy – aimed at supporting the export industry, and in particular horticulture, textile and clothing, and light industries; (ii) an updated AGOA Response Strategy –to support the export industry and incorporate additional sectors, including leather and leather products and water; and (iii) a New Product – New Market strategy - to support the country's export industry, with an initial focus on 21 products and 21 nontraditional export markets.

17. Building climate resilience is also a priority, given increased vulnerability to large and frequent climate shocks that now threaten food security and livelihoods. Policy and institutional frameworks have been established to address climate change impacts, including the National Strategic Resilience Framework 2015-2025, the National Climate Change Policy (NCCP), 2017-2027 and the Energy Policy 2015-2025. Continued support including from international partnerships, will be essential to develop effective community and household resilience. This includes support with early warning systems, relevant technologies, and proposals for bankable projects for climate change adaptation. Support is also needed to improve irrigation systems, stave off soil degradation and promote climate-smart agricultural practices to insulate the agricultural sector from the adverse effects of climate change.

18. On data quality concerns, the Ministry of Finance aims to eliminate above- and below-the-line discrepancies through improved coordination with the Central Bank and the Ministry of Development Planning. The Central Bank has committed to undertake measures to improve nonbank financial sector coverage, drawing from IMF CD/TA to develop an Other Financial Corporations (OFCs) survey. The Bureau of Statistics will also continue efforts to improve national accounts data.

Conclusion

19. To expedite economic recovery, preserve stability, and advance structural reform, the authorities will work to strengthen policy coherence and coordination. Steps are being taken to enhance implementation underpinned by coordination across government departments in pursuit of more robust, sustainable, balanced, and inclusive post-pandemic economic growth. Cognizant of the need for fiscal consolidation and the gaps in the country's fiscal and monetary architecture, the authorities look forward to continued policy and technical support and hope to reach agreement on program support.