

Letter of Intent

Government of Lesotho
Maseru, Lesotho
July 16, 2020

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Managing Director,

1. The COVID-19 pandemic is already having a significant impact on the economy of the Kingdom of Lesotho. Real GDP is expected to fall by several percentage points this year due to lower external demand, a sharp fall in remittances, and a decline in textile manufacturing production and diamond mining.
2. The government has established a COVID-19 Command Center to oversee a comprehensive set of responses and interventions, including buttressing the preparedness of the health sector and economic mitigation measures. Lesotho declared a state of emergency and adopted a range of containment measures, including social distancing, travel restrictions, closure of borders to all but essential goods, closure of schools, five-week lockdown of the country and suspension of some retail activities (e.g. gymnasiums, hair/beauty parlors, arcades, liquor stores, etc.).
3. The Central Bank of Lesotho (CBL) has also taken measures to alleviate the impact of the COVID-19 pandemic on the economy and the financial system. The CBL has lowered its policy rate by 250 basis points from 6.25 to 3.75 percent, while ensuring the Net International Reserves (NIR) are sufficient to buttress reserve coverage and maintain the peg between the Loti and the Rand under the Common Monetary Area (CMA) Agreement. Additional financial sector measures were also unveiled. For affected clients and for a three month period, the CBL has directed banks to consider loan restructuring and payment holidays where appropriate, while insurance companies have been directed to accommodate those who cannot make premium payments. The implementation of Basel II.5 was postponed to avoid an increase in capital requirements affecting lending. Meanwhile, the CBL is continuing to assess the macroeconomic impact and formulating policy responses.
4. Our fiscal policy response will focus on reprogramming domestic expenditures and mobilizing additional external resources to help contain the pandemic, while mitigating its adverse economic and social consequences. We have set aside M700 million, about 2 percent of GDP, for the National COVID-19 Response Integrated Plan 2020, which will cover health care personnel, purchase of critical goods and services, logistics, security, and border management.

5. The government will also provide broader measures to support the livelihood of the population and economy via general private sector support, support to agriculture, social protection, monetary policy and support to financial sector. The total related costs, including the scaling up of transfers to the most vulnerable groups and the need for additional financing, are estimated to be M1.8 billion, including (i) M1.2 billion for food security and social protection, (ii) Revenue foregone due to tax exemptions and deferment, M75 million and (iii) additional support for SMEs totaling M500 million. We have made provision to repay M800 million in domestic arrears from previous years, which will provide much-needed liquidity for the private sector. We expect a large overall tax loss of around M2.2 billion as a result of the economic impact of the crisis compared to the previously budgeted amount.

6. While there is much uncertainty in the short term, Lesotho will undoubtedly suffer a severe contraction in economic activity this year. Based on these developments, we expect a widening BOP gap and escalating external financing needs at around 6¾ percent of GDP.

7. The FY20/21 deficit is expected to increase to exceed 7 percent of GDP from 5½ percent the previous fiscal year. Revenue excluding SACU receipts is expected to fall by M2.4 billion while additional expenditure is needed to address critical spending on health and social assistance to mitigate the impact on the most vulnerable sections of the population. Given this difficult situation, we intend to reprioritize spending within the existing budget to ensure that the essential COVID-related health and mitigation expenditures can be met.

8. To buttress our reserves in the face of the economic volatility, we request emergency financing from the IMF under the Rapid Credit Facility and the Rapid Financing Instrument (RCF/RFI) in the amount of SDR 34.9 million, equivalent to 50 percent of quota. We are confident that IMF assistance to Lesotho in coping with this global pandemic will be a catalyst in securing additional support from other IFIs and bilateral donors. We are also seeking other external support. We are discussing budgetary support from the World Bank, the European Union is providing 5.5 million Euro to support social transfers to vulnerable households affected by the crisis, and we are actively engaging with other partners for support (e.g., DFID, UN, US, PEPFAR, SADC, SACU, AU). We intend to use the RCF/RFI disbursement to help fill the projected BOP financing gap and strengthen the reserve position.

9. We intend to request debt service suspension from official bilateral creditors in line with the term sheet in the April 15, 2020 Communiqué of the G20 Finance Ministers and Central Bank Governors. We commit to spend the fiscal space released by that debt service suspension on COVID-19 related health or economic relief and to monitor and report on this. We commit to disclose the debt of public sector borrowing entities (as defined in 2014 Government Finance Statistics Manual) to the IMF and the World Bank within 3 months.

10. The government is committed to strengthen macroeconomic stability and lay the ground for sustainable and inclusive growth. We intend to continue implementing our National Strategic Development Plan, which envisages the private sector as the main driver of the economy, through

further efforts to improve the business environment and tackling key bottlenecks to growth and job creation. To further reduce poverty, we intend to enhance social programs that are having the greatest impact.

11. In the short-term, we are carefully managing cash by releasing warrants on a monthly basis to ensure that expenditure aligns with available financing and to avoid incurring new expenditure arrears. We will ensure that international reserves are maintained at a level judged by the CBL to be sufficient to maintain macroeconomic stability and safeguard the peg of the Loti to the Rand.

12. We understand that a significant fiscal adjustment will be required over the medium term, and that current expenditures will have to be brought into line with the available resources as SACU revenues decline. To that end, we intend to reduce recurrent expenditure by 9½ percent of GDP (including temporary COVID-related expenditures) over the medium term, which should be sufficient to place our debt on a sustainable trajectory and ensure the stability of our external position. The Government of the Kingdom of Lesotho is committed to undertake the following complementary measures to ensure a sustainable macroeconomic outlook:

- Institute COVID-related mitigation measures to protect the poor, vulnerable and affected sections of society while we allow economic activity to continue with caution and within safe margins with clear protocols and guidelines for safety.
- Review and adopt a new Public Service Employment Policy that aims to maintain a sufficiently lean, largely professional and highly efficient civil service while addressing the high wage-to-GDP ratio.
- The maintenance of a sufficiently lean and efficient administration by way of reduction and merging of some portfolio ministries, a process that has commenced, while improving governance of the public service.
- Review and rationalize the Foreign Mission Policy with the intention to reduce foreign representation costs.
- Enhance collection of student loans and review the model for granting educational loans to ensure efficiency and sustainability.
- Legislation of fiscal rules that will ensure sustainability of the fiscus.

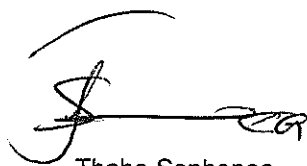
13. We are wishing to reiterate our interest in exploring and pursuing a medium-term program with the IMF after the immediate crisis is resolved, with the intention to anchor the necessary adjustments and ensure sustainability.

14. The government is committed to enhance governance and transparency in the use of public resources. In this regard, we are committed to (i) publish quarterly reports on budget implementation, including specific budget lines accounting of expenditures for COVID-mitigation measures, (ii) having internal audit on a quarterly basis focusing on the COVID related expenditure, (iii) 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 and disseminated within 5 months after the end of the fiscal year, and (iv) publish, on the government's website, signed procurement contracts for crisis-mitigation spending, the names of the companies awarded these contracts and

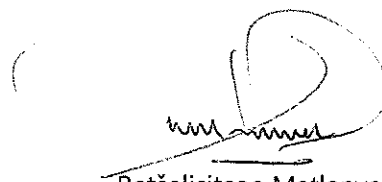
their beneficial owners, and ex-post validation of delivery. More broadly, we are committed to submit the following bills to the parliament: (i) Anti-corruption Bill (the draft bill is complete), (ii) PFM Bill (at advanced stage), and (iii) Procurement Bill.

15. The last safeguards assessment was carried out in 2012. The CBL has committed to provide Fund staff with the most recently completed external audit reports and to authorize the external auditors to hold discussions with staff. An update of the safe-guards assessment will be conducted before Executive Board approval of any subsequent arrangement. We do not intend to take measures that would compound our balance of payments difficulties, including introducing or intensifying restrictions on the making of payments and transfers for international transactions, trade restrictions, or multiple currency practices, or to enter into bilateral payments agreements which are inconsistent with Article VIII of the IMF's Articles of Agreement.

16. We authorize the IMF to publish this Letter of Intent and its Staff Report upon receipt of the request for disbursement under the RCF/RFI.



Thabo Sophonea
Minister
Ministry of Finance



Retšelisitsoe Matlanyane
Governor
Central Bank of Lesotho