INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/268

KINGDOM OF LESOTHO

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

July 2023

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 2023 Article IV consultation with Kingdom of Lesotho, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on May 19, 2023, 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 June 30, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.

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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2023 Article IV Consultation with Kingdom of Lesotho

FOR IMMEDIATE RELEASE

Washington, DC – **July 20, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Kingdom of Lesotho.

Lesotho's economy continues to face a number of challenges in the wake of the pandemic. Climate shocks, delays to infrastructure projects, high food and fuel prices, declining diamond prices, layoffs in the textiles sector, and weak regional and external demand are weighing on activity. High public expenditure also continues to distort incentives and hinder private sector development.

Headline inflation remained elevated averaging 8.4 percent in FY22/23, two percentage points higher than the year before. Furthermore, food inflation rose to 10.4 percent during the same period. To anchor inflation expectations and support the exchange rate peg, the Central Bank of Lesotho has continued to track the policy rate changes of the South African Reserve Bank, raising rates by 425 basis points since November 2021.

The government is prioritizing fiscal consolidation on the back of windfall transfers from the Southern African Customs Union (SACU), which have helped alleviate near-term pressures on financing and reserves. However, the fiscal deficit deteriorated to 7.7 percent in FY22/23, due to lower revenue and rigid expenditure, with public debt increasing to almost 60 percent of GDP. Efforts to restrain expenditure have been hampered by persistent weaknesses in public financial management. The current account deficit is projected to widen to 7.9 percent of GDP in FY22/23, mirroring developments with the fiscus. As of end-March 2023, gross international reserves (excluding the second phase of the Lesotho Highlands Water Project) had declined to 3.8 months of imports.

Despite ample liquidity in the financial sector, credit growth only increased slightly to 8.7 percent year-on-year by the end of FY22/23 despite tighter financial conditions. Overall, credit to the private sector remains broadly flat at around 20 percent of GDP with banks primarily lending to households.

Looking ahead, the outlook is subdued with real GDP projected to grow at 2.1 percent in FY23/24 and average the same over the medium term. In the absence of stronger consolidation, the fiscal position is projected to deteriorate over the medium term due to lower SACU transfers, wage bill pressures, and recapitalization of the pension fund. The government is encouraged to push ahead with upfront growth-friendly fiscal adjustment to ensure debt sustainability and safeguard the exchange rate peg, alongside broad-ranging

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[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.

structural reforms to support the transition from government-centric to private sector-led growth.

Executive Board Assessment[2]

In concluding the Article IV consultation with Kingdom of Lesotho, Executive Directors endorsed the staff appraisal as follows:

Staff commends the new government on their bold reform agenda and encourages them to make the most of the economic, financial, and political window of opportunity. With the health crisis largely abated, staff welcomes the government's vision of a smaller and more efficient public sector with a high quality of service delivery that provides space for the private sector to grow. The SACU windfall, if well-managed, also provides the opportunity to build buffers and finance a durable, growth-friendly fiscal consolidation, through a well-paced sequence of reforms and CD.

The recommendations of the 2022 Article IV consultation still stand. The fixed exchange rate means adjustment must fall on fiscal policy and structural reforms. If unchanged, current policies could result in abrupt adjustment with a significant impact on growth and inequality. The gradual weakening in the external position, which is assessed in FY22/23 to be weaker than that implied by fundamentals and desired policies, underlines the fragility of the current economic model and the need to consolidate public finances.

Fiscal sustainability will require determined efforts to contain spending upfront and implement PFM reforms, without which Lesotho's boom-bust fiscal cycle will continue. Despite the recent SACU windfall, pressures are expected to resume over the medium term, risking reserves and debt sustainability once again. Critical for adjustment is reducing current spending (notably public sector wages) and rationalizing public investment, complemented by broad PFM reforms. Tax policy and revenue administration measures can also improve fiscal outcomes in the near term, while minimizing the impact on growth. In this way, the government would find itself better placed to finance key development priorities and stronger social safety nets.

Alongside, broad-ranging structural reforms will be vital for the economy to transition to durable, resilient, inclusive, job-rich, and sustainable private sector-led growth. Staff strongly encourages efforts to improve the business environment, strengthen financial stability, and enhance business lending. As the public sector recedes, enlarging financial access and improving the business environment will be critical. Therefore, the premium on undertaking reforms to address credit constraints, insolvency frameworks, consumer protection, and governance and corruption vulnerabilities as soon as possible to restore investor confidence and create a growth-friendly environment is higher than ever. A governance diagnostic can build on the commitments from the 2020 RCF/RFI.

Staff strongly encourages the authorities to continue their efforts to increase capacity, improve data quality, and coordinate closely on macroeconomic policies. High data quality and information sharing are critical for policymaking—from measuring economic performance to forecasting. Close coordination between fiscal and monetary authorities is also necessary to balance competing objectives for spending, debt, and reserves and ensure consistency of

[2] The Executive Board takes decisions under its laps-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

macroeconomic policies with the exchange rate regime. In the absence of coordination, credibility will suffer, and confidence will be lost.

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

Table 1. Lesotho: Selected Economic Indicators, 2019/20–2028/29[1]

Population (thousands; 2021 est.):	2,281									
GNI per capita (US$; 2021 est.):	1,210									
Poverty rate at national poverty line (percent; 2017 est.):	49.7									

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.	Projections					
	(12-month percent change, unless otherwise indicated)									
National Account and Prices										
GDP at constant prices (including LHWP-II)	-2.0	-3.9	1.8	2.1	2.1	2.3	2.5	2.1	1.8	1.6
GDP at constant prices (excluding LHWP-II)	-2.1	-2.2	1.5	1.6	1.7	1.5	1.5	1.5	1.5	1.5
GDP at market prices (Maloti billions)	35.1	34.9	37.8	41.8	45.5	49.1	52.7	56.5	60.4	64.4
GDP at market prices (US$ billions)	2.4	2.1	2.5	2.5	2.4	2.6	2.7	2.8	2.9	2.9
Consumer prices (average)	4.9	5.4	6.4	8.4	6.7	5.4	4.9	5.0	4.9	4.9
Consumer prices (eop)	4.0	6.5	7.2	7.9	5.9	5.0	4.9	4.9	4.9	4.9
GDP deflator	4.8	3.5	6.3	8.4	6.7	5.3	4.8	5.0	4.9	5.0
External Sector										
Terms of trade ("–" = deterioration)	2.0	4.0	-2.3	-3.0	2.3	1.2	1.4	1.1	0.7	0.5
Average exchange rate										
(Local currency per US$)	14.8	16.4	14.9	17.0	...	...	...	...	...	...
Nominal effective exchange rate change (– depreciation)[2]	-4.7	-8.7	6.3	-3.0	...	...	...	...	...	...
Real effective exchange rate (– depreciation)[2]	-2.1	-6.0	8.7	-1.9	...	...	...	...	...	...
Current account balance (percent of GDP)	-1.5	-1.0	-4.4	-7.9	-2.6	-4.1	-8.7	-7.1	-5.5	-4.2
(excluding LHWP-II imports, percent of GDP)	0.5	2.3	-2.0	-5.5	1.7	1.0	-4.0	-3.3	-2.6	-2.0
Gross international reserves										
(excluding imports for LHWP-II, months of imports)	4.7	4.2	4.3	3.8	4.1	4.1	3.8	3.6	3.3	3.0
Money and Credit										
Net international reserves										
(US$ millions)	670	718	846	663	756	813	784	753	722	693
(Percent of M1 Plus)	140	109	127	97	111	117	109	103	96	90
(US$ millions, CBL calculation)	605	777	756	855	845.3	842.8	N.A.	N.A.	N.A.	N.A.
(Percent of M1 Plus, CBL calculation)	126	118	114	125	124.4	121.2	N.A.	N.A.	N.A.	N.A.
Domestic credit to the private sector	12.9	-3.0	6.7	8.7	8.3	8.4	7.8	8.3	8.7	7.9
Reserve money	-3.8	17.2	1.0	24.5	8.3	-2.5	1.1	1.4	1.8	1.9
Broad money	11.8	12.2	0.0	19.6	3.9	4.9	5.9	5.6	6.1	5.8
Interest rate (percent)[3]	3.9	3.5	2.8	4.6	7.0	6.0	5.0	5.0	5.0	5.0
	(Percent of GDP, unless otherwise indicated)									
Public Debt	57.0	53.6	55.7	59.8	60.4	60.4	60.7	61.3	61.8	62.3
External public debt	45.4	42.1	40.4	43.9	44.8	44.3	44.1	44.3	44.4	44.9
Domestic public debt	11.6	11.5	15.3	15.9	15.5	16.1	16.5	17.0	17.4	17.5
Central Government Fiscal Operations										
Revenue and grants	46.8	53.4	44.9	41.5	51.4	49.7	46.1	45.7	45.8	45.8
(excluding SACU transfers and grants)	*25.5*	*24.6*	*26.0*	*25.4*	*26.5*	*25.0*	*26.0*	*26.1*	*26.3*	*26.3*
SACU transfers	*17.7*	*25.7*	*15.9*	*12.9*	*22.3*	*22.1*	*17.6*	*17.0*	*17.0*	*17.0*
Grants	*3.5*	*3.0*	*3.1*	*3.2*	*2.6*	*2.5*	*2.5*	*2.5*	*2.5*	*2.5*
Recurrent expenditure	39.2	42.2	36.8	37.1	37.8	37.8	37.7	37.5	37.2	36.9
Of which: wages, including social contributions	16.9	17.3	16.2	16.6	16.4	16.2	16.0	15.8	15.6	15.5
Capital expenditure	13.2	11.2	13.2	12.0	12.5	12.3	12.2	12.1	12.0	12.0
Overall balance	-5.6	0.0	-5.1	-7.7	1.1	-0.4	-3.8	-3.9	-3.3	-3.1
(excluding SACU transfers and grants)	*-26.8*	*-28.7*	*-24.1*	*-23.7*	*-23.8*	*-25.0*	*-23.9*	*-23.5*	*-22.9*	*-22.7*
Primary balance	-4.2	1.5	-3.8	-6.2	2.6	1.3	-2.0	-1.9	-1.3	-1.1
(excluding SACU transfers and grants)	*-25.4*	*-27.2*	*-22.8*	*-22.3*	*-22.3*	*-23.4*	*-22.1*	*-21.5*	*-20.9*	*-20.7*
Statistical discrepancy	0.0	-1.1	1.1	0.0	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 2023 ARTICLE IV CONSULTATION

June 30, 2023

KEY ISSUES

Context. The government-driven growth model remains a challenge for sustainable and inclusive growth in Lesotho, displacing resources from the private sector. Growth and inflation are subject to the impact of the war in Ukraine, sluggish regional performance, climate shocks, and longstanding structural issues including governance and corruption vulnerabilities, limited financial access, and fragile public financial management. The recently-elected government is prioritizing fiscal consolidation on the back of windfall transfers from the Southern African Customs Union (SACU) that have helped alleviate pressures on both financing and reserves.

Outlook and Risks. The outlook points to a muted growth path in the near term. Growth is estimated at 2.1 percent in FY23/24 and averaging the same thereafter. Under current policies, downward rigidities in spending are pushing public debt closer to the risk of high debt distress over the medium term and weighing on reserves. Key downside risks include delays in fiscal adjustment due to legal challenges and structural reforms that allow weaknesses in public financial management to persist, ongoing price disruptions and food insecurity from the war in Ukraine, and climate-related disasters, including droughts and floods. On the upside, stronger-than expected growth will help improve the medium-term fiscal outlook.

Focus of the Article IV Consultation. Staff urged the authorities to push ahead with upfront growth-friendly consolidation to maintain fiscal sustainability and support 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. Strengthening public sector governance and institutions would also help safeguard 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. The private sector would also benefit from an improved business climate, and enhanced financial intermediation, and greater financial inclusion.

Approved By
A. Richter Hume (AFR) and B. Barkbu (SPR)

Discussions were held in Maseru during May 8–19, 2023. The staff team comprised Aqib Aslam (head), Habtamu Fuje, Shushanik Hakobyan, and Zviad Zedginidze (all AFR), Mosito Ntema, and Mpati Mphatsoe (local office). Moeti Damane (OEDAE) participated in the discussions. The team met Minister of Finance and Development Planning Retšelisitsoe Matlanyane, Central Bank Governor Maluke Letete, and other officials. Qiuyan Yin (RES) provided research assistance. Cecilia Prado (AFR) managed document production. The team thanks the Basotho authorities for their collaboration and the candid and productive discussions.

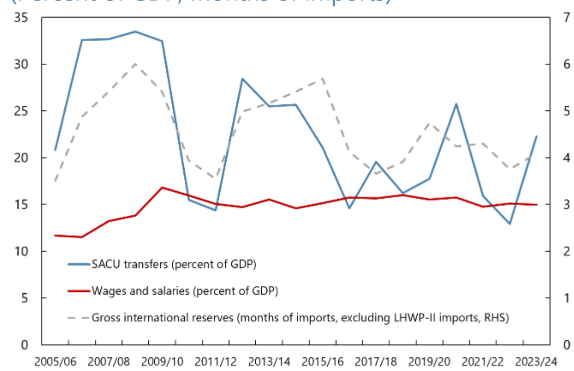
CONTENTS

ANNEXES

CONTEXT

1. **Large, volatile external transfers and persistent weaknesses in public financial management (PFM) have fostered high and rigid public expenditure (50 percent of GDP), distorting resource allocation and driving boom-bust cycles marked by arrears and periodic financing gaps.** Lesotho has one of the largest public sector wage bills in the region, averaging over 15 percent of GDP and 75 percent of tax revenue since FY11/12. When transfers from the Southern African Customs Union (SACU) increased from around 21 to 33 percent of GDP between FY05/06 and FY09/10, the wage bill also rose from 12 to 17 percent of GDP, skewing employment and lending in the public sector's favor. However, when transfers dipped, the wage bill remained broadly unchanged.[1] In FY10/11, the high wage bill came at the expense of reserve buffers and other parts of the budget, while in FY17/18 and FY21/22, the government was unable to draw down deposits without endangering reserves and the exchange rate peg, driving the government into arrears. Such rigidities drive procyclical fiscal policy and preclude adjustment, leaving little room to absorb shocks.

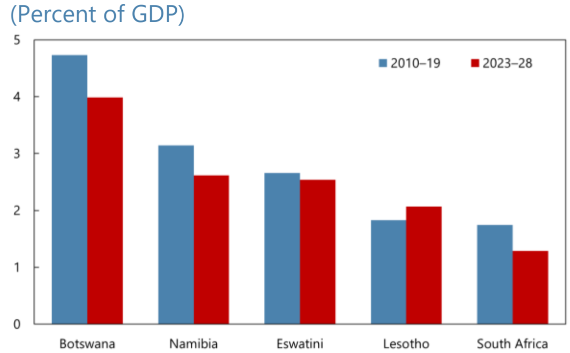
SACU Transfers, Public Sector Wages, and Gross International Reserves
(Percent of GDP; months of imports)



Sources: Lesotho authorities; World Economic Outlook, and IMF staff calculations.

2. **The economy has stagnated despite high public expenditure.** Since 2016, both real activity and per capita incomes have shrunk by 10 percent. Average growth in the decade preceding the pandemic was also among the weakest in the region: 1.8 percent between 2009 and 2019, close to South Africa (1.7 percent), but almost 3 percentage points slower than Botswana. Growth has remained well below the country's self-stated 5 percent target to meet national development goals.

Average Growth Performance Before and After Pandemic
(Percent of GDP)



Sources: Lesotho authorities; World Economic Outlook, and IMF staff calculations.

3. **Private-sector development has also been hampered by low financial access, corruption, and a weak business environment.** The largely foreign-owned banking sector is liquid and well-capitalized, but intermediates limited credit to micro-, small-, and medium-sized enterprises (MSMEs). High credit and setup costs, skill shortage, gaps in legal frameworks,

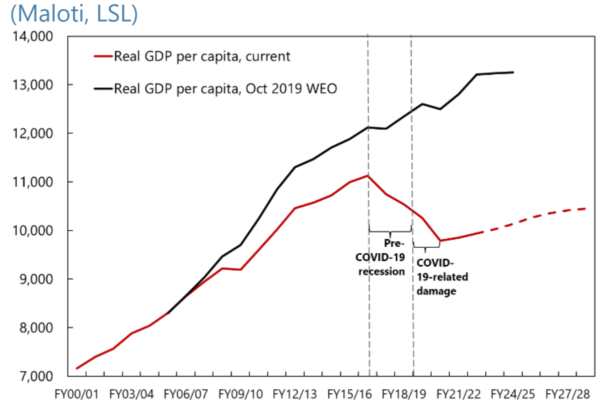
[1] Higher-than-budgeted spending and inadequate liquidity forecasting has driven cash shortages, forcing the government to rely on arrears, deposit drawdowns, and ad hoc debt issuance to finance expenditure.

dispute resolution, insolvency resolution, and property rights continue to inhibit business development and limit the country's capacity to attract foreign investment.

RECENT DEVELOPMENTS

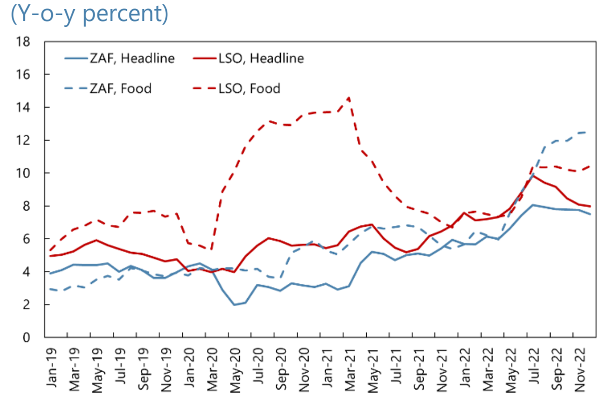
4. **Activity stalled and inflation remained elevated throughout 2022.** The textiles sector, which is estimated to benefit almost 15 percent of the population, cut jobs as external demand waned. Delays to Phase II of the Lesotho Highlands Water Project (LHWP-II) meant construction was only half what had been planned. Above average rainfall supported agriculture but also damaged infrastructure, and the decline in diamond prices since February 2022 is creating headwinds for mining. Food and fuel price increases worsened food insecurity and eroded living standards. Inflation averaged 6.4 percent in FY21/22—a percentage point higher than the year before—and 8.4 percent in FY22/23. Food inflation rose to 10.4 percent in FY22/23, 2.1 percentage points higher than the previous year.

Real GDP Per Capita
(Maloti, LSL)



Sources: Lesotho authorities; World Economic Outlook, and IMF staff calculations.

Headline and Food Inflation
(Y-o-y percent)



Sources: Haver Analytics LP; Lesotho authorities, and IMF staff calculations.

5. **The fiscal balance deteriorated in FY22/23 due to lower revenue and rigid expenditure and debt increased.** Revenue performance in FY22/23 (41.5 percent of GDP) was over 5 percentage points below the budget target and approximately 3.5 percentage points weaker than in FY21/22, because of lower income tax revenue and SACU transfers. While recurrent spending held steady (37.1 percent of GDP), capital expenditure dropped to 12 percent of GDP (over 4 percentage points lower than budgeted), as funds were reallocated for the election. The resulting fiscal deficit (7.7 percent of GDP) was approximately 2.5 percentage points larger than in FY21/22 but in line with the projections in the 2022 Article IV consultation. The stock of arrears was LSL650 million (1.7 percent of GDP) as of end-March 2022.[2] Public debt increased in FY22/23 by 4.1 percentage

[2] The LSL650 million of arrears are currently under review, of which LSL272 million have been deemed legitimate with full documentation, LSL255 million with partial documentation, and LSL123 million with no documentation. Additional arrears of about LSL300 million (0.7 percent of GDP) as of end-March 2022 have already been deemed illegitimate and will not be honored. Capacity constraints and weak PFM means that the Accountant General's Office must determine manually each year the legitimacy of arrears out of those outstanding unpaid claims received from MDAs. Only arrears that are under review are included in the DSA.

points to almost 60 percent of GDP—a 2.9 percentage point increase in present value terms to 47.1 percent of GDP.

6. The Central Bank of Lesotho (CBL) raised rates by 425bps since November 2021, in line with the South Africa Reserve Bank (SARB), to curb inflationary pressures. While credit to the private sector remains broadly flat at around 20 percent of GDP, credit growth recovered slightly to 8.7 percent y-o-y by end-FY22/23 despite tighter financial conditions. Nonperforming loans (NPLs) remain broadly stable at 4.2 percent as of end-FY22/23. Gross international reserves (GIR) were at 3.8 months of imports (excluding LHWP-II) as of end-March 2023, below 4.7 months suggested by a commonly used model for estimating reserve adequacy in credit-constrained economies (ARA-CC).[3]

7. The external position has continued to deteriorate. Despite a recovery in exports and remittances, higher commodity prices and the decline in SACU transfers (from 15.9 to 12.9 percent of GDP) widened the current account deficit in FY22/23. Foreign investment continued to decline given the weak external environment and limited domestic opportunities. Staff assesses the external position in FY22/23 to be weaker than implied by fundamentals and desired policies (Annex IV). Policy gaps, due to the fiscal stance, drive the current account gap.

8. A new party achieved a near-majority in October 2022 and has embarked on an ambitious reform agenda. Reforms in 2022 stalled due to elections (Annex I). However, the new coalition government has reinvigorated the medium-term National Strategic Development Plan (NSDP II) and demonstrated commitment to streamline the civil service and promote transparent recruitment. Parliamentary processes for legislation that had been delayed are being restarted, including the Public Financial Management and Accountability (PFMA) Bill and the "Omnibus Bill" of constitutional reforms sponsored by the Southern African Development Community (SADC).

OUTLOOK AND RISKS

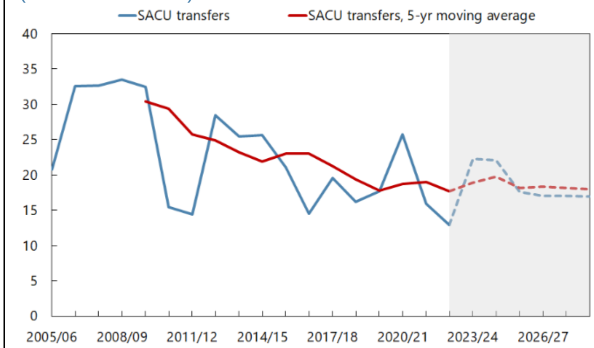
9. The growth outlook remains subdued. The global and regional slowdown increases headwinds: growth of 2.1 percent is expected for FY23/24 and averaging the same thereafter. Further delays to the LHWP-II will drag on medium-term growth, while the private sector needs time to get going. Inflation is estimated to have peaked in FY22/23 and expected to subside gradually as global food and energy prices ease. Diamond prices are expected to continue their downward trend.

10. The SACU windfall is expected to improve fiscal and external balances only temporarily before financing pressures reappear. While transfers are 9.4 percentage points of GDP higher in FY23/24 than FY22/23, the windfall over the next two years—around 5 percentage

[3] The FY23/24 budget also sets a minimum level for NIR (4.5 months of import cover), which compares favorably to the ARA-CC (¶11).

points of GDP relative to the past five-year average—is not expected to persist over the medium term.[4] The fiscal balance and current account excluding LHWP-II-related imports will move into surplus (1.1 and 1.7 percent of GDP, respectively) before deficits reemerge over the medium-term. The windfall is also expected to help bolster reserves in FY23/24, which, absent consolidation, are also expected to erode gradually as deficits return. Despite broadly adequate financial soundness indicators and ample liquidity in the financial sector, credit growth is expected to remain weak as banks remain focused on households (Section D).

SACU Transfers
(Percent of GDP)



Sources: Lesotho authorities and IMF staff calculations.

11. Risks to the outlook are tilted to the downside (Annex V). Reforms could stall or reverse due to legal challenges hindering fiscal consolidation and risking debt sustainability. Household indebtedness could result in higher NPLs. A sharper slowdown globally and in South Africa, additional inward-oriented policies in foreign markets, and uncertainty over the expiration of the African Growth and Opportunity Act could weaken external demand and exports. Greater-than-expected financial tightening and risk aversion could spill over through South Africa. Further shocks to food, fuel, and fertilizer prices could aggravate food security and worsen the external position. Climate and energy shocks are a major risk to infrastructure projects and livelihoods.

12. There are upside risks if opportunities are well-managed. Given Lesotho's elevation and freshwater endowment, commercialization of agriculture presents an avenue for export growth and food security (Annex VII). The Millennium Challenge Corporation's (MCC) second compact could also boost investment in high-value crop production.[5]

13. Debt vulnerabilities have increased given the sensitivity of the fiscus to reform delays and shocks. While Lesotho's risk of debt distress remains moderate, present value estimates of both external and total public debt are edging closer to the risk of high debt distress under the baseline, leaving limited space to absorb shocks. Competing forces weigh on the debt outlook: while the SACU transfers help ease borrowing needs in the near term, domestic arrears, contingent liabilities—related to contested commercial contracts, state-owned enterprises (SOEs), and the civil service pension fund—and potentially higher external debt service (should the Rand depreciate) elevate debt sustainability risks.

[4] The macro framework assumes SACU transfers remain at around 22 percent of GDP in FY23/24 and FY24/25, on the back of strong trade flows observed in 2021 and an expected positive adjustment following the shortfall in 2022. SACU transfers are assumed to moderate to an average of 17 percent of GDP over the medium term.

[5] Upon entry into force (expected March 2024), the MCC's Lesotho Health and Horticulture Compact will channel funds into agriculture (US$118 million), business development (US$62 million), and health systems (US$75 million).

Authorities' Views

14. The authorities concurred with staff's assessment of risks and were broadly aligned on growth projections. However, they also noted potential upsides from the MCC and LHWP-II construction. The authorities also acknowledged the pressures on reserves, debt sustainability, and the current account from persistent weak growth and the risks from failing to consolidate expenditure over the medium term.

POLICY PRIORITIES

15. Policy priorities are unchanged since the 2022 Article IV consultation. Staff discussed reforms to drive inclusive, job-rich, climate-resilient, sustainable private sector-led growth:

- *Aligning expenditure with resources to ensure debt sustainability and safeguard the exchange rate peg.*
- *Strengthening monetary policy frameworks, financial sector supervision, and policy coordination to support credibility, investor confidence, macroeconomic stabilization, and the peg.*
- *Strengthening public financial management to support fiscal consolidation.*
- *Rebalancing incentives within the economy by shifting from a government-centric focus to one with significantly more favorable conditions for private sector-led growth.*

A. Fiscal Policy: Align Expenditure with Resources

16. Given the sensitivity of the outlook to reform slippages, staff advised upfront consolidation averaging around 1 percent of GDP per year (¶19) to ensure debt sustainability. Despite strong non-SACU non-grants revenue averaging 25 percent of GDP between FY10/11 and FY19/20, recurrent spending has consistently exceeded these resources by almost 15 percentage points of GDP. Therefore, recurrent, and unproductive capital expenditure must bear the burden of adjustment in favor of growth-friendly investment, while efforts to mobilize revenues must continue. The pace and sequence of reforms must be rules-based and carefully managed to mitigate growth risks, given the economy's dependence on the public sector (Section D).

17. The FY23/24 budget envisages an improvement in the fiscal balance of over 10 percentage points of GDP on the back of the SACU windfall (Annex II).[6] The authorities project non-SACU non-grants revenue to increase by almost 5 percentage points of GDP—

[6] Data issues have rendered the medium-term fiscal framework (MTFF) unreliable beyond FY23/24.

supported by excises (0.5 percent of GDP) and income tax amendments (2.4 percent of GDP)[7]—while grants drop by over 3 percent of GDP. Wages are projected to decline from 15.1 to 13.7 percent of GDP, assuming successful consolidation of ministries, departments, and agencies (MDAs), offset by increases in other parts of budget. Recurrent spending also includes a payment of LSL200 million (0.4 percent of GDP) to partially cover the funding gap of the pension fund.[8] Domestically-financed capital expenditure in priority sectors and social spending will increase by over 2 and 0.5 percentage points of GDP, respectively.[9] A stabilization fund is planned to manage windfall SACU transfers and mining revenues.

18. In the absence of stronger consolidation, staff expects debt to accumulate and reserves to drain over the medium term. Staff's baseline assumes (i) lower tax revenue given delays to income tax amendments and less ambitious VAT revenue projections; (ii) slower consolidation in recurrent expenditure due to only a gradual reduction in the wage bill, and (iii) lower use of goods and services, implying a smaller fiscal surplus (1.1 percent of GDP). Overall, recurrent spending (excluding interest payments) is projected to fall by about 1.5 percentage points of GDP over the medium term. Reserves are expected to remain below the ARA-CC. Should reforms fail to materialize, contingency plans are needed—for example, reintroducing monthly spending limits, reducing transfers to the tertiary education bursary loan scheme, and retiring the youth apprenticeship program[10]—to stabilize debt and reserves.

19. A debt limit (in present value terms) of 45 percent of GDP can anchor the medium-term fiscal framework to preserve fiscal space and the peg and prevent a sudden deterioration of the debt distress rating.[11] The proposed limit would leave sufficient space for priority spending and provide a buffer against shocks and the realization of contingent liabilities. Staff recommends additional fiscal consolidation of 1 percent of GDP per year starting in FY24/25 to bring debt within the limit over the next five years—through expenditure cuts and/or revenue mobilization. For example, consolidation could be achieved entirely by spreading cuts evenly

[7] The 2023 Tobacco and Alcoholic Products Levy Act specifies that alcoholic beverages and tobacco are to be levied at ad valorem rates of 15 and 30 percent, respectively. However, the Act continues to face fierce opposition from businesses and some Parliamentarians. The income tax amendment bill has yet to be approved but estimates have been included in the government's revenue forecasts.

[8] As part of government's effort to support sustainability of the civil service pension fund and reduce contingent liabilities, the authorities plan to cover about two-thirds of the financing gap (LSL2 billion) with ten equal annual installments of LSL200 million from the budget starting in the current fiscal year. The other one-third of the gap is to be covered by the pension fund's operating income, which in turn will be supported by increased contributions. Close monitoring of the execution of the government's recapitalization plan and the evolution of the pension scheme's unfunded liabilities and associated fiscal risks is required.

[9] Priority sectors include (i) agriculture; (ii) extractives, (iii) energy, and (iv) transport infrastructure.

[10] The youth apprenticeship program provides 18–45-year-olds with opportunities in both the public and private sectors. It currently costs up to 1 percent of GDP and has a low uptake. While it is important to help youth gain work experience, costs should not be borne by the government and the program should be discontinued in favor of competitive processes in both sectors.

[11] This limit is in line with the government's public debt management policy framework.

between recurrent and capital spending, by front-loading wage bill consolidation of 2.5 percent of GDP (¶21) and back-loading equivalent cuts to the capital budget (¶25).[12]

Comparison of FY22/23 and FY23/24 Projections and Outturns: 2022 and 2023 Article IV Consultations and the Authorities' Budgets

(Percent of GDP)

	FY22/23			FY23/24		
	Budget	**2022 Art. IV**	**2023 Art. IV**	**Budget**	**2022 Art. IV**	**2023 Art. IV**
	Proj.	**Proj.**	**Est.**	**Proj.**	**Proj.**	**Proj.**
Revenue and grants	47.2	47.0	41.5	55.2	47.0	51.4
Revenue excluding SACU transfers and grants	*28.9*	*27.9*	*25.4*	*30.3*	*27.9*	*26.5*
SACU transfers	*12.9*	*13.5*	*12.9*	*22.3*	*16.3*	*22.3*
Grants	*5.4*	*5.6*	*3.2*	*2.6*	*2.8*	*2.6*
Recurrent expenditure	38.9	40.1	37.1	39.0	40.7	37.8
Of which: wages, including social contributions	18.9	19.7	16.6	15.9	20.3	16.4
Capital expenditure	16.2	14.7	12.0	13.9	13.2	12.5
Overall balance	-7.9	-7.8	-7.7	2.2	-6.8	1.1
(Excluding SACU transfers and grants)	*-26.2*	*-26.9*	*-23.7*	*-22.6*	*-26.0*	*-23.8*
Primary balance	-6.0	-6.2	-6.2	4.5	-4.8	2.6
(Excluding SACU transfers and grants)	*-24.3*	*-25.3*	*-22.3*	*-20.4*	*-24.0*	*-22.3*

Sources: Lesotho authorities and IMF staff calculations.

Note: All figures for the 2023 Article IV FY22/23 are outturns, except for grants.

20. Windfall revenue can be used to finance debt-stabilizing growth-friendly consolidation.[13] However, without consolidation, the current outlook precludes regular surpluses needed for savings to accumulate. Should the opportunity for savings—that leave primary surpluses that lower the debt burden—materialize, the proceeds can help (i) finance civil service reform to reduce the wage bill;[14] (ii) settle domestic arrears; (iii) finance climate-resilient infrastructure to support private sector development, or (iv) bolster reserves. Of these, wage bill reduction should be prioritized while an arrears clearance strategy is established (¶41) and the capital budget is reviewed.

21. Lowering the public sector wage bill remains critical for consolidation. Staff recommends establishing clear targets and cost estimates for employment reform and wage growth. The latter has been the main driver of public expenditure, due to generous pay scales and annual raises that produce strong upward drift. Hiring outside of the civil service "establishment list" has

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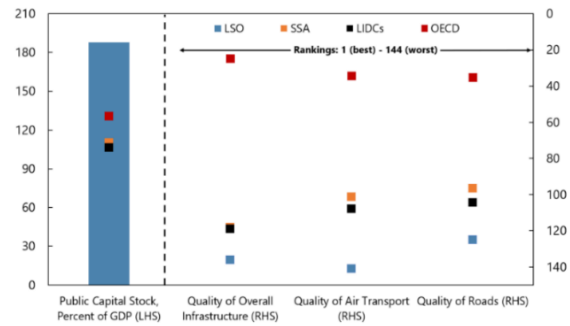
[12] This alternative scenario assumes the following: (i) elimination of duplicate functions at the consolidated MDAs, and (ii) reduction of automatic "notch" increase in wages to 2.5 percent. This would deliver around 2.5 percentage points of GDP adjustment in the wage bill by FY28/29. See SIP: *Decomposing the Public-Private Wage Differential in Lesotho*. See also IMF CD Report, "Managing the Government Wage Bill", December 2016. Capital budget savings increase over time as misclassified spending is eliminated and project selection and execution improve, delivering an additional 2.5 percentage points of GDP adjustment by FY28/29.

[13] The savings and management of windfalls should be clearly specified in legislation, including the accountability framework, capitalization rules, and where resources are saved. Any use of funds must be captured in the MTFF to avoid off-budget misappropriation. Fiscal rules should be developed in line with IMF CD to provide enforceable limits for spending and debt in the face of revenue volatility and embed discipline and credibility within the MTFF.

[14] Civil service reforms are yet to be costed by the government. The recent settlement reached with those Principal Secretaries whose contracts were terminated is estimated to cost LSL7 million or 0.015 percent of GDP.

also inflated the wage bill and should be terminated. The list itself should also be reassessed given the merger of MDAs. Containing the wage bill will improve administrative efficiency, professionalism, and labor market equity, given public sector employees earn more than private sector counterparts in comparable professions.

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



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

22. Social spending should be rationalized and reprioritized to better target the most vulnerable and disbursed in a timely manner. At around 7 percent of GDP, social spending is several times that of neighboring countries and dominated by schemes that are not poverty-reducing. 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. Costs (2.5 percent of GDP for FY22/23) can be reduced by introducing means-testing and improving loan recovery rates (currently only 2 percent) with savings redistributed to other schemes.

23. Given limited fiscal space, measures to alleviate hardship related to commodity price increases should be targeted and temporary. While temporary food and fuel subsidies introduced to counter high global commodity prices have been rolled back, existing untargeted fertilizer and seed subsidies have proven ineffective and should be phased out.[15]

24. Public investment should finance areas where it will maximize climate-resilient growth, crowd in private sector investment, and reduce poverty. Lesotho capital stock as a share of GDP is large but of a quality that lags peers. Staff emphasized completing the stocktaking of capital projects as soon as possible to identify space for growth-friendly investment. Correctly classifying recurrent spending within the capital budget will also provide a clearer picture of public investment. To achieve permanent efficiency gains, the government should implement a robust mechanism for project appraisal, selection, and monitoring through a public investment management information system with associated regulations.

25. Domestic revenue mobilization must support adjustment.

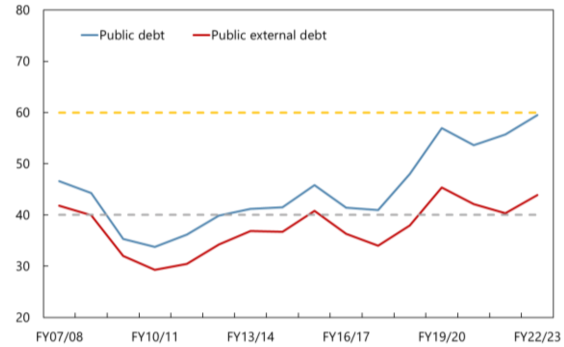
- **Tax policymaking functions are needed.** Plans for a tax policy unit (TPU) should be accelerated to improve tax system design and revenue forecasting. Past IMF

[15] Existing agricultural input subsidies (fertilizer and seed) are not well targeted and primarily benefit relatively well-off farmers. Furthermore, these subsidized inputs are delivered with large delays, typically arriving well after the planting season has ended. If the authorities wish to maintain the program, it must be overhauled with clear targeting criteria, fixed distribution times, and a predefined timeline for phasing out.

recommendations for the mining fiscal regime should also be implemented to strengthen taxation and anti-avoidance.[16]

- **Tax administration has clear opportunities for improvement.** The recent tax administration diagnostic (TADAT) highlighted weaknesses in core areas of Revenue Services Lesotho (RSL). RSL's current focus on promoting voluntary compliance through customer service needs to be balanced by taking actions to enforce adherence to tax laws. These include improving filing and payment compliance, and management of tax arrears and VAT refunds.[17]

Public Debt
(Percent of GDP)



Sources: Lesotho authorities and IMF staff calculations.

26. External financing should be primarily on concessional terms and grants to preserve debt sustainability. Given the increase in public debt over the last five years, staff recommends a conservative financing strategy avoiding nonconcessional foreign-currency borrowing alongside developing domestic bond markets (Section B).

Policy Recommendations

27. Staff recommends the following policies to help contain expenditure and boost domestic revenue mobilization:

- *Review the establishment list as soon as possible to determine the size of civil service needed to deliver public services efficiently under the new structure of MDAs.*

- *Introduce targets for civil service reductions and wage growth:*[18] (i) eliminate the automatic nonmerit ("notch") increases and replace over the medium term with performance-based increases and limits on the share of qualifying civil servants at each grade;[19] (ii) cap COLA for the next three years; (iii) eliminate positions created outside of the establishment list; and (iv) freeze hiring until MDAs have been integrated and duplicate functions eliminated. If vacancies need to be filled, redeploy existing staff.

[16] See IMF CD Report "Issues in Tax Policy and Mining Fiscal Regimes", November 2013.

[17] The VAT should also be applied on the excised price of goods and services.

[18] See also SIP: *Decomposing the Public-Private Sector Wage Differential in Lesotho*.

[19] Paragraph 89(2) of the 2008 Public Service Regulations states that: "Automatic annual increment shall cease to exist and shall be replaced by performance related pay upon coming into effect of these Regulations."

- *Streamline the capital budget* by (i) identifying and minimizing unproductive projects, and (ii) improving accountability, appraisal, contract design, efficiency, and execution, to target growth-friendly investment in line with development priorities.
- *On domestic revenue mobilization:* (i) operationalize the TPU in line with IMF CD recommendations;[20] and (iii) prioritize and follow up on revenue administration improvements identified in the 2023 TADAT.
- *Undertake a Climate-Public Investment Management Assessment (C-PIMA)* to evaluate governance practices at key stages in the investment cycle for climate-resilient infrastructure (¶52).
- *Over the medium term, calibrate, implement, and enforce fiscal rules* consistent with trend growth and debt sustainability, in line with IMF CD recommendations.

Authorities' Views

28. The authorities acknowledged the need to contain both recurrent and capital expenditures to safeguard debt sustainability and the peg, as well as provide space for growth-friendly investment. The authorities plan to establish a stabilization fund in FY23/24 and explore possible fiscal rules, as well as review the capital budget and the size of the civil service. The RSL plans to incorporate findings from the recent TADAT into its business plan and the MoFDP will continue to consider how to staff a tax policy unit. While poverty-reducing social spending is set to increase, the NMDS currently has no plans to streamline the size of the tertiary bursary education loan scheme but plans to expand the size of the directorate.

B. Monetary Policy, Financial Stability, and Policy Coordination

29. Tracking policy rate changes by the South African Reserve Bank and maintaining sufficient reserves have safeguarded the exchange rate peg and anchored inflation. The CBL raised rates in March and May by only 25bps compared to SARB rate increases of 50bps, opening a 50bps gap between them. Staff cautioned that persistent sizeable deviations could put pressure on the peg. The CBL also determines a floor for net international reserves (NIR) to support the peg with a lag. Given recent ZAR depreciation, staff advised that current methods could underestimate appropriate buffers and should be more forward-looking to account quickly for sharp and persistent valuation effects.

30. Bank balance sheets remain robust, but financial stability risks remain. Despite a moderate increase in nonperforming loans for mortgages, banks maintain sufficient buffers to absorb losses—the ratio of regulatory capital-to-risk-weighted assets is above 20 percent as of end-2022. While implementation of the Basel II Capital Adequacy Framework continues in line with past recommendations, nonbank financial sector supervision—notably of micro-finance institutions, and

[20] See IMF CD Report "Options for Establishing a Tax Policy Unit", May 2021.

savings and credit cooperatives (SACCOs)—is still in its early stages and must be strengthened to help address troubled institutions, for example, Boliba.

31. An independent central bank with robust governance structures in line with international best practice will ensure the credibility of both monetary and financial sector policies. Amendments to the CBL Act—based on recommendations from the 2021 Safeguards Assessment Update and IMF CD—are expected to be submitted to Cabinet. That said, some vulnerabilities remain relating to functional autonomy of the CBL, on which dialogue between parliament and the government should continue. Staff welcomes proposed amendments in the "Omnibus Bill" to anchor the central bank's independence in the Constitution[21] and cautions against further changes without consulting the CBL and that go against best practice.

32. Staff encourages reforms to the monetary policy implementation framework to improve monetary transmission and limit reserve volatility induced by banks' structural excess liquidity. Short-term liquidity management should be improved by increasing the range of instruments available in line with IMF CD recommendations. Amid tighter global financial conditions and exposure to rand-denominated assets, the CBL's credit risk framework should be further developed. Staff welcomes the development of Lesotho's local currency bond market (LCBM). Rising foreign-currency debt, large financing needs, and the expected decline in concessional borrowing underscore the importance of the LCBM to spur financial deepening and provide more diverse and stable sources of government funding—also to limit banks' sovereign exposure and not crowd out the private sector.

33. Following recent progress, and in light of the ongoing assessment, the authorities should continue to strengthen the AML/CFT framework. Recent progress includes a new asset recovery regime and systems to collate law enforcement statistics. The CBL must continue to strengthen its effectiveness' including by implementing a risk-based approach to financial sector AML/CFT supervision. Spillover risks from South Africa's recent "grey listing" by the Financial Action Task Force (FATF) should also be monitored. A report from the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) will be published in November 2023 with guidance on priority actions to address deficiencies in the country's AML/CFT regime.[22] In the meantime, staff encourages authorities to pay particular attention to the supervision of nonbank financial institutions and the non-financial sector, the management of risks associated with politically exposed persons, the collection and retention of beneficial ownership information, and nonprofit organizations identified as susceptible to terrorist financing abuse. Plans to establish a national

[21] Section 117D of the proposed Tenth Amendment to the Constitution 2022.

[22] Lesotho is currently undergoing its Mutual Evaluation, which will assess the country's compliance with the Financial Action Task Force (FATF) international standards on combating money laundering (ML), terrorist financing (TF), proliferation financing (PF), and the extent to which Lesotho is effective in mitigating its ML/TF risks.

registry of bank and mobile network operator accounts will provide information to support these efforts.[23]

34. The structure of the economy demands policy coordination and consistency between the MoFDP and CBL to credibly preserve debt sustainability and the peg. Fiscal and monetary policy must be coordinated to prevent upward drift in spending from depleting reserves needed to safeguard the peg. Through joint consultation, the medium-term debt ceiling can be determined by the MoFDP and the ceiling for net claims on government by the CBL. MoFDP can then optimize the level and composition of spending within the resource envelope informed by these ceilings. A well-calibrated analytical framework with commonly-agreed assumptions can help quantify the impact of different policy decisions and facilitate policy dialogue between institutions.[24]

35. At the operational level, policy coordination and data sharing should be promoted through regular high-level meetings and technical working groups.[25] The creation of a high-level platform for senior officials from the MoFDP, the CBL, and other relevant MDAs would allow for regular policy engagement and information exchange. Technical working groups should be tasked with addressing key policy areas, including harmonized growth forecasts.

Policy Recommendations

36. Staff recommends the following measures to improve monetary policy transmission, financial stability, and coordination:

- *On financial stability, step up efforts to plug data gaps on nonbank financial sector soundness and develop early intervention and resolution frameworks*.
- *Review the framework for determining the NIR floor*.
- *Augment the monetary policy operational framework and develop a LCBM in line with IMF CD recommendations.*[26] The CBL is advised to: (i) introduce a short-term instrument for Open Market Operations; (ii) introduce standing credit and deposit facilities; (iii) review reserve and liquidity requirement frameworks,[27] and (iv) improve the functioning of money markets.

[23] 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 AML/CFT supervision. 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.

[24] SIP: *Modelling the Impact of External Shocks on Lesotho*.

[25] Staff encourages the authorities also to learn from institutional arrangements in the region.

[26] See joint IMF/WB CD Report, "Domestic Bond Market Development", February 2023.

[27] See IMF CD Report, "Strengthening Liquidity Management and Enhancing Capacity for Financial Stability Analysis and Reporting", December 2012.

- *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.

- *Restart inter-Ministerial working groups, such as the Macroeconomic Working Group and ensure MoFDP attendance at the Liquidity Management Committee.*

- *Build common robust policy frameworks to improve monetary and fiscal policy coordination.* Fiscal and monetary policy should be guided by forward-looking model-based analysis. This would also help ensure the consistency of the NIR target with fiscal policy.

Authorities' Views

37. The authorities broadly agreed with staff's recommendations and reiterated their commitment to monetary policy and financial sector reforms. While acknowledging the importance of managing liquidity to improve monetary policy transmission, officials noted the potential costs to the central bank of absorbing excess liquidity. The CBL agreed on the need to closely monitor ZAR volatility for reserve adequacy. The CBL acknowledged the need to enhance bank and nonbank supervision and address AML/CFT shortcomings highlighted by the ESAAMLG mutual evaluation.

C. Strengthen Public Financial Management

38. Without urgent reform, PFM deficiencies will continue to complicate budget execution and undermine consolidation. IMF CD has helped improve core PFM functions, but many recommendations are yet to be fully implemented. Stronger PFM—grounded in legislation that supports a transparent and well-coordinated budget process with robust expenditure and procurement controls, treasury operations, and fiscal oversight of SOEs—will ensure an efficient use of public resources, improve governance, reduce corruption risks, and safeguard fiscal consolidation.

39. Budget preparation and execution must be strengthened to bolster budget credibility. The budget cycle is often heavily delayed, leaving little time to align the proposed budget with desired policies. Financing must be clearly identified to avoid gaps, liquidity rationing, and ad hoc debt issuances. Expenditure ceilings must be carefully monitored, and a supplementary budget submitted to accommodate spending above approved allocations—including unanticipated (one-off) appropriations, e.g., in response to disaster relief—as mandated by the Constitution. The functions of the Office of the Auditor General (OAG) should also be fully utilized, with inputs provided by MoFDP in a timely manner.[28]

[28] Additional resources and capacity can help the OAG improve and increase the frequency of risk-based audits to assess internal controls, forensic audits, IT audits, and performance audits (for example, for projects executed outside of the consolidated fund), which can help comprehensively improve expenditure controls.

40. Incomplete utilization of the integrated financial management system (IFMIS) means that macro-fiscal functions within MoFDP are short-circuiting. All budget commitments and disbursements should be recorded in IFMIS. MDAs continue to (i) commit to expenditure outside of IFMIS; (ii) use current budget allocations to pay for past procurement, and (iii) register purchase orders in IFMIS only when cash is available to pay for the (already-delivered) good or service. The MoFDP must, therefore, strengthen the link between budget releases and cash availability and enforce sanctions and penalties for non-compliance.

41. An arrears clearance strategy is required. Although the MoFDP's Treasury Department has developed surveys to capture arrears, response rates from MDAs are low, and the Accountant General's Office (AGO) must manually sort and compile purchase orders. Once the list of arrears is ready and verified—including only legitimate invoices from outside IFMIS—an arrears clearance strategy should be prepared.

42. Accounting practices and financial reporting have not provided a sound basis for government accountability and fiscal planning. Bank reconciliation continues to be a challenge and in-year reporting must be improved. Capacity in the AGO should also be increased for timely preparation of annual financial statements. Over the medium term, the authorities should migrate to a Treasury Single Account.

43. Fiscal policymaking must be improved by prioritizing greater coordination, information-sharing, and technical expertise within the MoFDP. Data discrepancies abound between the budget, macro forecasting, cash forecasting, and debt management, driving incorrect assessments of financing needs and unreliable medium-term fiscal frameworks. For example, ambitious revenue projections jeopardize budget implementation, debt sustainability, and reserves. Timely and reliable data would strengthen the MTFF, which should drive budget ceilings.

44. 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. For example, the recent Hackathon-sponsored by the IMF and Gates Trust-helped identify a digital signature prototype to help minimize fraud and theft of government funds.

Policy Recommendations

45. Staff recommends the following measures to improve PFM and restore credibility of the budget and liquidity management.

- *Undertake a comprehensive review of internal PFM controls as a priority, including the use and functionality of IFMIS.*
- *Enforce the use of IFMIS by all MDAs, with clear penalties and sanctions for individuals and businesses that bypass its use.*
- *Set clear, irrevocable milestones for the budget cycle.*

- *Reconcile and improve monitoring of government accounts—including in commercial banks—to reduce the risk of fraud and improve fiscal reporting*.
- *Take stock of arrears and produce a vintage analysis as input to a comprehensive arrears clearance strategy.*
- *Enact the PFMA bill and adopt regulations* to improve (i) budget analysis, execution, monitoring, and enforcement; (ii) fiscal reporting; (iii) arrears, cash, expenditure, and debt management, and (iv) public procurement.
- *Expand the coverage of government operations to decentralized entities and autonomous bodies and publish a fiscal risks statement as part of the annual budget process, in line with IMF CD recommendations.*

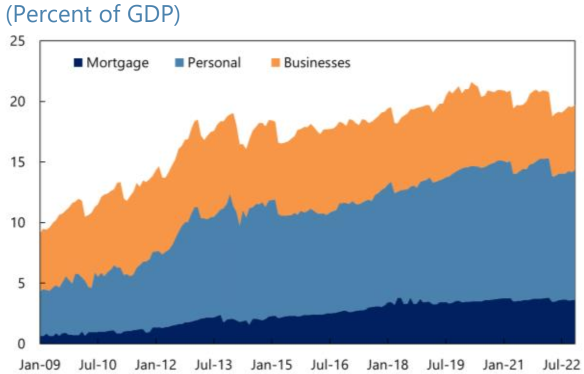
Authorities' Views

46. The authorities agreed on the necessity for strong internal PFM controls. They will continue to implement IMF CD recommendations on IFMIS, bank reconciliation, and fiscal data reporting. The criticality of better policy coordination and information sharing both within the MoFDP and with the CBL was also acknowledged.

D. Rebalance Incentives to Catalyze Inclusive, Sustainable, Private Sector-led Growth

47. Resource allocation has been distorted by the reach of the public sector, leaving the formal private sector small, undiversified, and in the government's tow. As in many low-income countries, state intervention has been used to tackle market failures, provide public goods, and drive investment. However, years of inefficient fiscal expansion and the prevalence of ineffective SOEs has fostered expectations that the government must be responsible for driving activity and bearing risk.[29] Having squeezed private sector participation, the economy is now characterized by low productivity, declining private investment, diminishing competitiveness, and high informality.

Composition of Commercial Banks Loans and Advances
(Percent of GDP)



Sources: Central Bank of Lesotho and IMF staff calculations.

48. Bank and nonbank lending is targeted towards private households linked to the public sector, with most MSMEs locked out. Lending is largely uncollateralized and skewed toward salaried professionals—notably civil servants, whose salaries the government are widely expected to

[29] SIP: *Handing the Reins of Growth to the Private Sector*.

prioritize, regardless of the fiscal situation—and away from lending to MSMEs. As a result, mortgage and personal loans amounted to 4 and 11 percent of GDP in 2022, respectively. Furthermore, a system that allows lenders to withdraw debt service directly from civil servants' payroll has served as collateral and fueled elevated levels of household indebtedness.

49. Financial access for MSMEs and a stable and well-regulated business environment remain critical for the successful transition to sustainable private sector-led growth.[30] MSMEs flagged crime, high taxes, informality, limited infrastructure, and trade logistics as key constraints. The most pressing remains access to finance, without which MSMEs are unable to invest and scale. Structural reforms to improve regulation, encourage formalization, and incentivize private investment in infrastructure and logistics, would help reduce the costs of doing business and create a predictable environment attractive to domestic and foreign investors. Fostering digital financial services will also broaden financial literacy and inclusion.

50. As export growth has been largely dependent on mining and preferential trade schemes, 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 close skills gaps, (ii) moving businesses up the value chain, (iii) infrastructure investment to enhance connectivity, and (iv) easing nontariff barriers on intermediate goods. The authorities are also looking to special economic zones to boost investment. Staff cautioned over the use of incentives that cede tax base and generate unintended distortions and unfair advantages.[31]

51. Vulnerability to climate shocks such as floods and droughts underscores the importance of building climate-resilient infrastructure. Specifically, measures to improve irrigation systems, halt soil degradation, develop an early warning system, and strengthen regulations and institutional capacity to promote climate-smart agricultural practices will help strengthen resilience and risk management in agriculture.

52. Mitigating corruption risks and strengthening the rule of law is essential to restoring confidence and promoting a business environment conducive for investment and growth (Annex III). Recent fraud cases and growing arrears highlight vulnerabilities in payment and procurement processes. The courts are also overwhelmed, producing a backlog of unresolved cases that hold back business development. Stronger enforcement can send a strong signal that fraud and patronage will no longer be tolerated.

53. Partial progress has been made towards fulfilling governance commitments under the 2020 RCF/RFI (Text Table 1). Given delays caused by the election, the government transition, lags in legislative changes, and limited capacity have constrained completion, effort is needed to fulfil remaining commitments. The Public Procurement Bill was enacted in March 2023. The internal audit

[30] Results taken from the World Bank Lesotho Enterprise Survey (2016).

[31] See UNCTAD (2019), *World Investment Report 2019: Special Economic Zones*, United Nations, New York.

on COVID-19 expenditures for FY20/21 has been published.[32] Quarterly budget implementation reports on COVID-19-related spending were published in 2020.[33] COVID-19-related procurement contracts from a subset of MDAs have been published online.[34] The Anti-Corruption Bill is pending, while the PFMA Bill is in Parliament.

Text Table 1. Lesotho: 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:Q1–2. FY20/21: Q3–4 and FY21/22 still pending.
Have internal audit on a quarterly basis focusing on the COVID related expenditure	Partially completed	Internal audits for FY20/21 and the first two quarters of FY21/22 were completed and published.
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]	Completed	The audit report has been published. However, the targeted audit could not be completed as financial statements do not provide a full breakdown of expenditures by Covid-19 related items.
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 restarted	The authoring agency (DCEO) is being redesigned as the Lesotho Anti-Corruption and Ethics Commission as part of constitutional reforms specified in the "Omnibus Bill". The Anti-Corruption Bill, will, therefore be revised.
Submit the PFMA Bill (at advanced stage) to parliament	Completed	The Bill is currently with the Upper Chamber in Parliament (Senate) awaiting its third reading.
Submit the Procurement Bill to parliament	Completed	The Public Procurement Bill has been promulgated as of March 10, 2023.
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	Underway	The recently-elected government has consolidated the number of Ministries (from 27 to 15) and is undertaking a review to eliminate duplicate functions. In addition, a subset of senior civil servants and off-payroll public sector employees have been given notice. 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 Office of the Auditor General.
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.

Policy Recommendations

54. Staff recommends the following policies to support private sector development. As the public sector recedes, these reforms will be vital for a successful transition to private sector-led growth:

- *Financial access and inclusion.* (i) improve the credit infrastructure (including the collateral register, credit bureau, and the scope of the Credit Reporting Act);[35] (ii) implement

[32] http://www.finance.gov.ls/official_documents.php?id=Internal_Audit

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

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

[35] The current Act provides for the Credit Bureau to access credit information across all types of credit providers. However, coverage of businesses and individuals remains limited—especially for women, whose credit history is

(continued)

regulations for the Insolvency Act;[36] (iii) implement regulations for the Financial Consumer Protection Act.

- *Reforms to improve the business environment.* (i) reduce the stake of large and inefficient SOEs in businesses and utilities and (re)focus on policy implementation; (ii) support formalization and reduce rent-seeking behavior and burdensome regulation; (iii) address logistics and infrastructure constraints, and (iv) implement digital verification systems.[37]

- *Complete the outstanding 2020 RCF/RFI governance commitments and undertake an IMF governance diagnostic,* to provide a comprehensive analysis of key corruption and governance vulnerabilities and establish a strategic reform plan.

- *Establish an independent, well-resourced anti-corruption body with powers clearly specified in legislation and backed by specialized courts.*[38]

Authorities' Views

55. The authorities acknowledged how high government spending—both directly and through SOEs—had skewed incentives across the economy. They agreed that entrenched governance weaknesses had undermined development and opportunities for businesses to grow. While there was a clear understanding that deep structural reforms are needed to resuscitate the private sector and reenergize growth, the authorities noted the government's central role in incentivizing the private sector.

OTHER SURVEILLANCE ISSUES

56. CD is critical for supporting the authorities' reform efforts (Annex VI). Priorities remain to strengthen PFM, tax policy and administration, the monetary policy operations framework, financial sector supervision, and the anti-corruption legal framework.

57. While data are broadly adequate for surveillance, significant delays in data provision are undermining analysis and policymaking. The timeliness of data published under the Data Standards Initiatives (e-GDDS) needs to be improved substantially and does not compare favorably with regional peers. Improvements are required in the areas of debt, government finance, inflation, national accounts, and trade.

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typically incomplete. Data from other sources, such as from utilities, should be used. There is also the need to build credit scores and improve accessibility of credit information, e.g., via mobile phones.

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

[37] Implementation of the Electronic Signature Act will (i) ensure digital signatures can be used to verify transactions, and (ii) enhance opportunities for provision of digital financial services for the private sector, e.g., digital credit.

[38] Section 33 of the "Omnibus Bill".

58. Staff engaged with the authorities on the removal of the exchange restriction (see Informational Annex). The CBL is working to update the Currency and Exchanges Manual for Authorised Dealers in line with IMF recommendations.

Policy Recommendations

59. Staff emphasized the importance of CD prioritization and implementation over tackling multiple reforms simultaneously.[39]

60. Staff recommends improving data quality and reporting in line with IMF CD recommendations, as reliability and timeliness of data remain weak (including for any potential Fund arrangement).

Authorities' Views

61. The authorities acknowledged weaknesses in both data quality and timeliness. The BOS will continue its efforts to rebase national accounts data and improve the quality of the CPI with support from IMF CD and increased funding from the government. The MoFDP aims to improve both above- and below-the-line projections, which will require improved coordination between departments of the MoFDP, as well as with the BOS, CBL, and RSL.

STAFF APPRAISAL

62. Staff commends the new government on their bold reform agenda and encourages them to make the most of the economic, financial, and political window of opportunity. With the health crisis largely abated, staff welcomes the government's vision of a smaller and more efficient public sector with a high quality of service delivery that provides space for the private sector to grow. The SACU windfall, if well-managed, also provides the opportunity to build buffers and finance a durable, growth-friendly fiscal consolidation, through a well-paced sequence of reforms and CD.

63. The recommendations of the 2022 Article IV consultation still stand. The fixed exchange rate means adjustment must fall on fiscal policy and structural reforms. If unchanged, current policies could result in abrupt adjustment with a significant impact on growth and inequality. The gradual weakening in the external position, which is assessed in FY22/23 to be weaker than that implied by fundamentals and desired policies, underlines the fragility of the current economic model and the need to consolidate public finances.

64. Fiscal sustainability will require determined efforts to contain spending upfront and implement PFM reforms, without which Lesotho's boom-bust fiscal cycle will continue.

[39] The MoFDP should prioritize reforms and allocate resources appropriately with clear milestones and deadlines for implementation. Other reforms should only be taken up when top-priority reforms are near-completion, or their implementation is not jeopardized by reallocation of resources. The Minister can schedule regular updates to monitor performance.

Despite the recent SACU windfall, pressures are expected to resume over the medium term, risking reserves and debt sustainability once again. Critical for adjustment is reducing current spending (notably public sector wages) and rationalizing public investment, complemented by broad PFM reforms. Tax policy and revenue administration measures can also improve fiscal outcomes in the near term, while minimizing the impact on growth. In this way, the government would find itself better placed to finance key development priorities and stronger social safety nets.

65. Alongside, broad-ranging structural reforms will be vital for the economy to transition to durable, resilient, inclusive, job-rich, and sustainable private sector-led growth. Staff strongly encourages efforts to improve the business environment, strengthen financial stability, and enhance business lending. As the public sector recedes, enlarging financial access and improving the business environment will be critical. Therefore, the premium on undertaking reforms to address credit constraints, insolvency frameworks, consumer protection, and governance and corruption vulnerabilities as soon as possible to restore investor confidence and create a growth-friendly environment is higher than ever. A governance diagnostic can build on the commitments from the 2020 RCF/RFI.

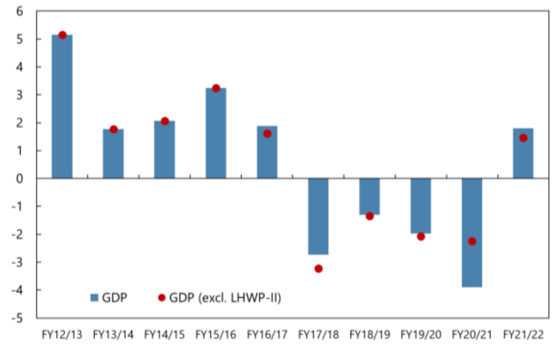
66. Staff strongly encourages the authorities to continue their efforts to increase capacity, improve data quality, and coordinate closely on macroeconomic policies. High data quality and information sharing are critical for policymaking—from measuring economic performance to forecasting. Close coordination between fiscal and monetary authorities is also necessary to balance competing objectives for spending, debt, and reserves and ensure consistency of macroeconomic policies with the exchange rate regime. In the absence of coordination, credibility will suffer, and confidence will be lost.

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

Figure 1. Real Sector Developments

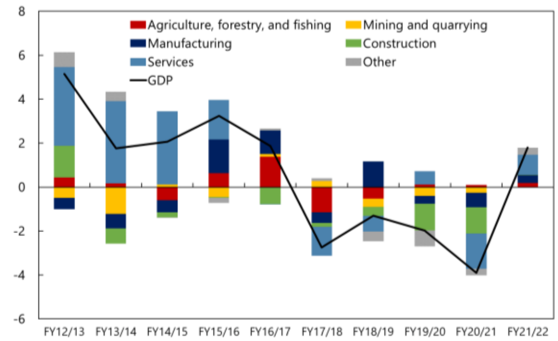
Growth turned positive after four years of decline…

Real GDP Growth
(Percent)



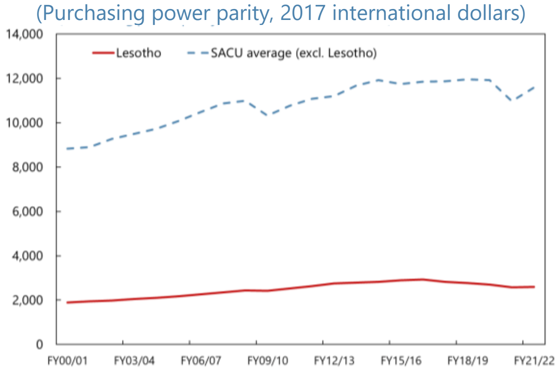
…supported by the rebound in services.

Sectoral Contributions to GDP Growth
(Percent)



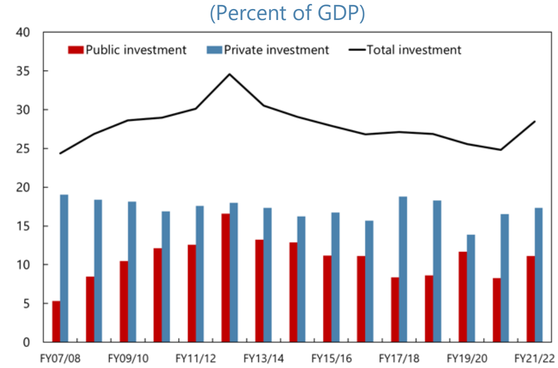
Cost of living-adjusted per capita GDP shows no sign of convergence to the SACU average…

Real GDP Per Capita
(Purchasing power parity, 2017 international dollars)



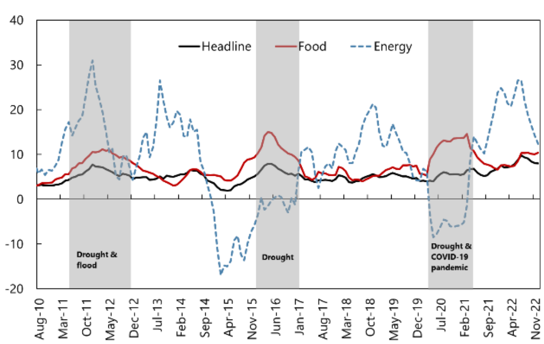
… and investment has been decelerating, signaling weaker prospects for future convergence.

Evolution of Investment
(Percent of GDP)



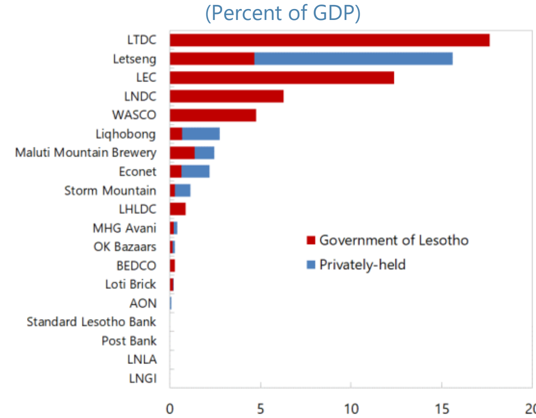
Inflation has abated recently as energy and food prices moderate.

Inflation
(Y-o-y percent)



The government's footprint extends beyond public expenditure through SOEs and shares in large enterprises.

Ownership of SOEs and Large Businesses, 2018
(Percent of GDP)

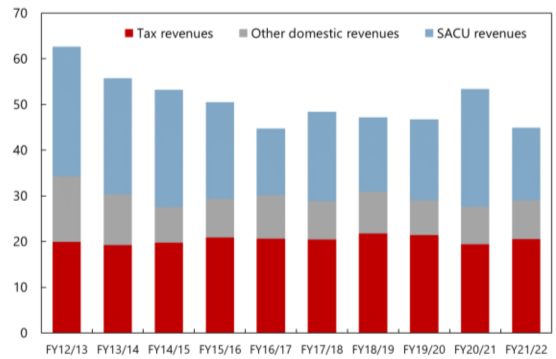


Sources: Bureau of Statistics; Worldwide Governance Indicators 2021; IMF, World Economic Outlook, and IMF staff calculations.
Notes: BEDCO=Basotho Enterprise Development Corporation; LEC=Lesotho Electricity Company; LHLDC=Lesotho Housing and Land Development Corporation; LNDC=Lesotho National Development Corporation; LNIG=Lesotho National General Insurance; LNLA=Lesotho National Life Assurance; LTDC=Lesotho Tourism Development Corporation; SACU=Southern African Customs Union; SOE=state-owned enterprise; WASCO=Water and Sewerage Company.

Figure 2. Fiscal Developments

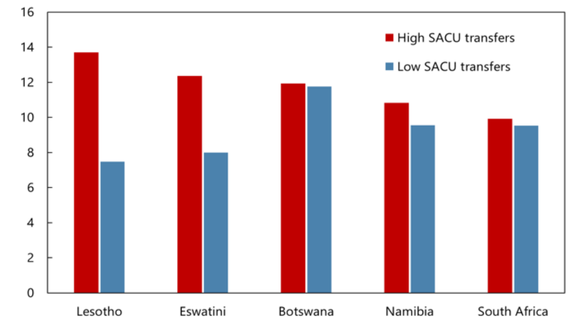
Volatile SACU transfers typically dominate revenue…

Government Revenues
(Percent of GDP)



…leading to upward drift and downward rigidities in public expenditure.

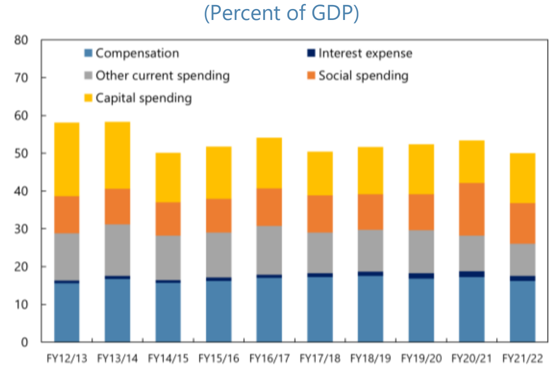
Wage Growth Conditional on SACU Transfers
(Percent, 2000–22 average)



Note: Periods of high SACU transfers are defined as the years when SACU transfers as a share of GDP exceed the historical average, which is 8.8% in Botswana, 13.2% in Eswatini, 22.3% in Lesotho, 10% in Namibia, and 0.9% in South Africa.

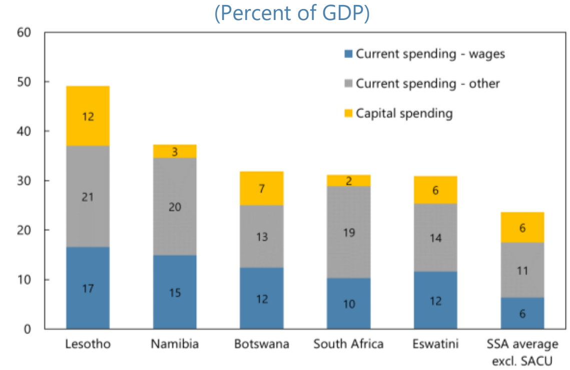
Wages and other items of current spending have remained stubbornly elevated over the past decade…

Evolution of Public Expenditure
(Percent of GDP)



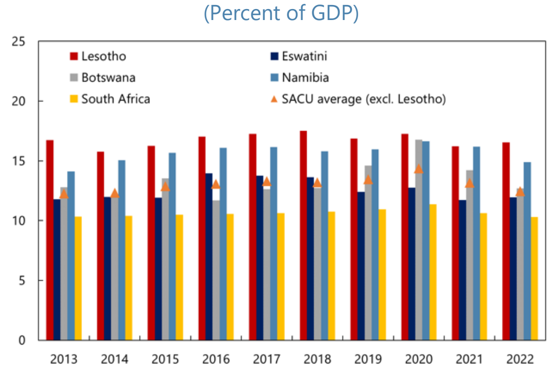
…leaving Lesotho with the largest public sector in the region.

Government Spending, 2022
(Percent of GDP)



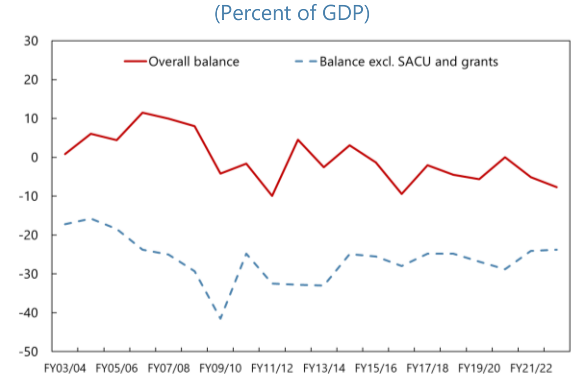
The public sector wage bill has consistently been the highest across SACU over the past decade.

Public Wage Bill
(Percent of GDP)



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

Overall Balance
(Percent of GDP)

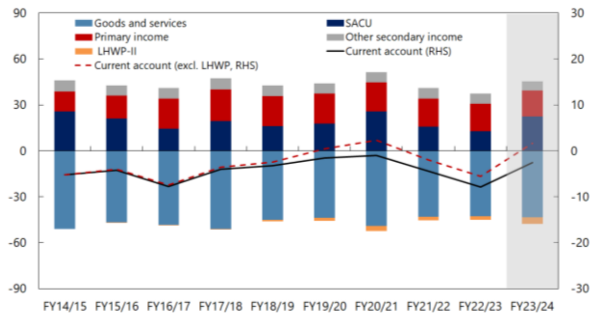


Sources: Ministry of Finance and Development Planning; IMF, World Economic Outlook, and IMF staff calculations.
Note: SACU=Southern African Customs Union.

Figure 3. External Sector and Debt

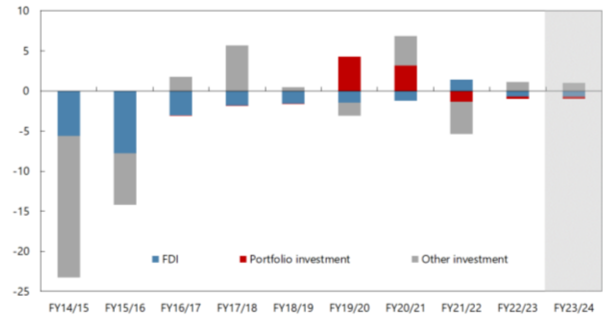
The current account balance is expected to improve on the back of windfall transfers…

Current Account
(Percent of GDP)



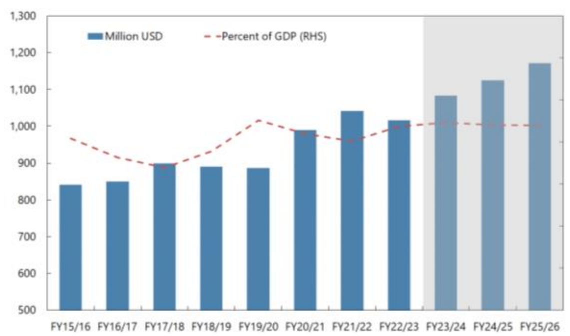
…and FDI flows remain subdued.

External Financing
(Percent of GDP)



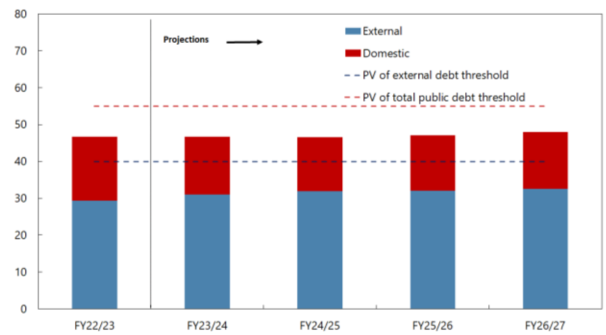
After a sharp increase on the back of FX valuation effects, external debt is expected to stabilize relative to GDP, due to greater domestic financing of capital expenditure.

External Debt



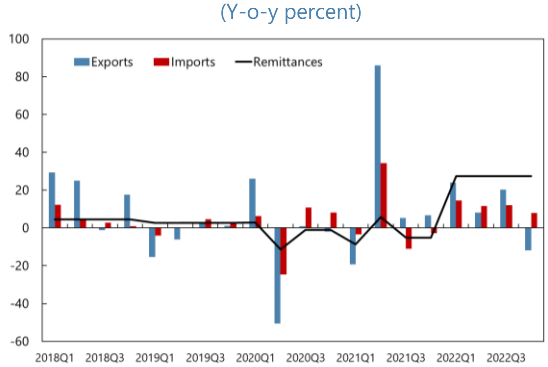
However, amid FX volatility and sizable contingent liability risks, projected debt levels (in PV terms) leave only a small buffer below the threshold at which Lesotho would be downgraded to a high risk of debt distress.

Debt Projections
(Present value as percent of GDP)



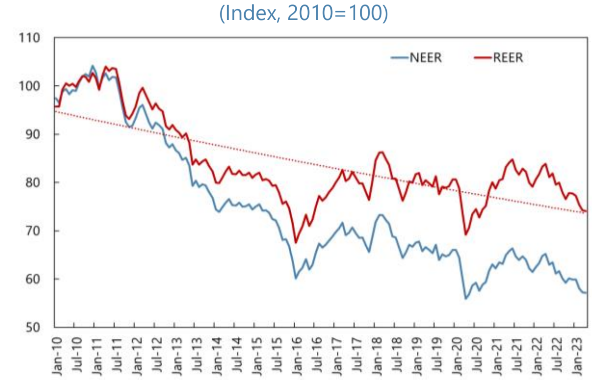
Exports and remittances have somewhat recovered from the pandemic-related slowdown.

Imports, Exports, and Remittances
(Y-o-y percent)



The REER is close to the trend, helped by recent South African rand depreciation.

Exchange Rates
(Index, 2010=100)

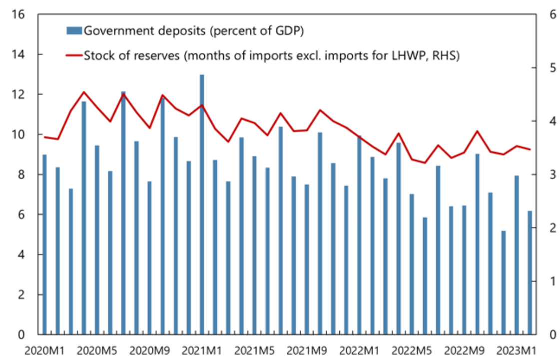


Sources: Central Bank of Lesotho; Ministry of Finance and Development Planning, and IMF staff calculations.
Notes: FDI=foreign direct investment; PV=present value; SACU=Southern African Customs Union.

Figure 4. Monetary Policy and the Financial Sector

Government spending stretches reserves.

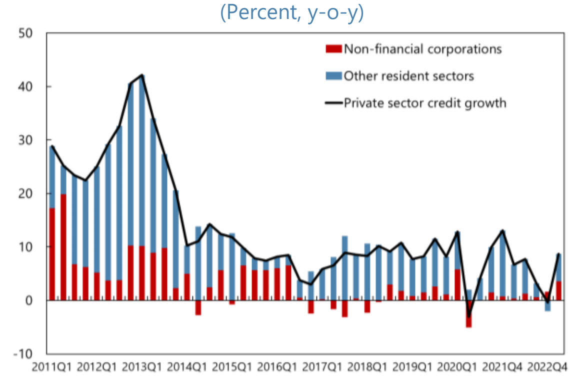
International Reserves and Government Deposits



Credit growth decelerated amid increasing interest rates.

Private Sector Credit Growth

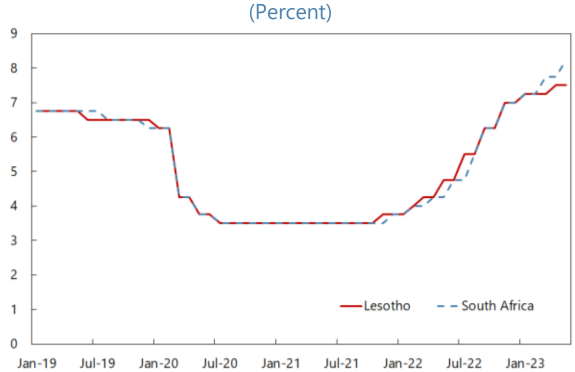
(Percent, y-o-y)



The Central Bank of Lesotho's policy rate closely tracks the South African Reserve Bank's policy rate.

Policy Rate

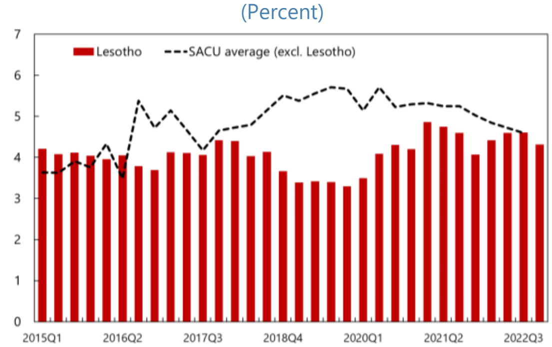
(Percent)



Nonperforming loans have been broadly stable and low.

Nonperforming Loans to Gross Loans

(Percent)

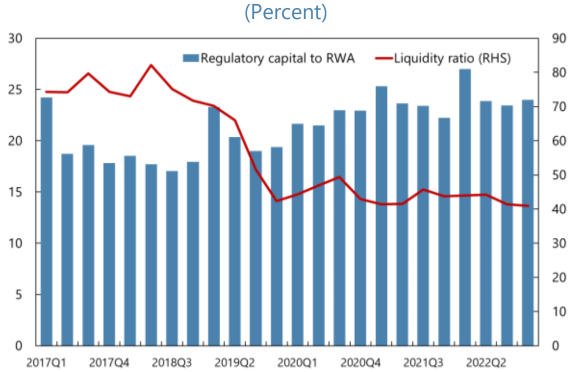


Note: SACU average (excl. Lesotho) excludes Eswatini in 2020Q3-2022Q3 due to data limitation.

Banks remain liquid and well capitalized …

Bank Capital Adequacy and Liquidity Ratio

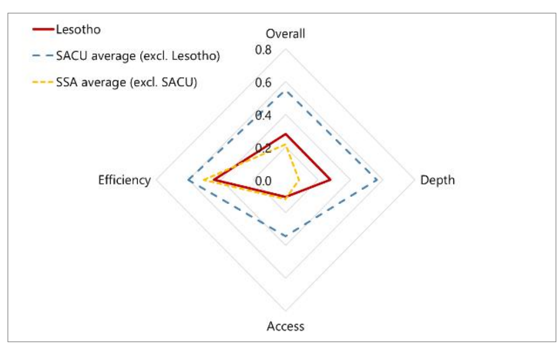
(Percent)



…with limited financial development.

Financial Institution Development, 2020

(Index, higher = better)



Sources: Central Bank of Lesotho; IMF, Financial Development Index Database, and IMF staff calculations.

Table 1. Lesotho: Selected Economic Indicators, 2019/20–2028/29[1]

Population (thousands; 2021 est.):	2,281
GNI per capita (US$; 2021 est.):	1,210
Poverty rate at national poverty line (percent; 2017 est.):	49.7

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.			Projections			
	(12-month percent change, unless otherwise indicated)									
National account and prices										
GDP at constant prices (including LHWP-II)	-2.0	-3.9	1.8	2.1	2.1	2.3	2.5	2.1	1.8	1.6
GDP at constant prices (excluding LHWP-II)	-2.1	-2.2	1.5	1.6	1.7	1.5	1.5	1.5	1.5	1.5
GDP at market prices (Maloti billions)	35.1	34.9	37.8	41.8	45.5	49.1	52.7	56.5	60.4	64.4
GDP at market prices (US$ billions)	2.4	2.1	2.5	2.5	2.4	2.6	2.7	2.8	2.9	2.9
Consumer prices (average)	4.9	5.4	6.4	8.4	6.7	5.4	4.9	5.0	4.9	4.9
Consumer prices (eop)	4.0	6.5	7.2	7.9	5.9	5.0	4.9	4.9	4.9	4.9
GDP deflator	4.8	3.5	6.3	8.4	6.7	5.3	4.8	5.0	4.9	5.0
External sector										
Terms of trade ("–" = deterioration)	2.0	4.0	-2.3	-3.0	2.3	1.2	1.4	1.1	0.7	0.5
Average exchange rate										
(Local currency per US$)	14.8	16.4	14.9	17.0	...	...	...	...	...	...
Nominal effective exchange rate change (– depreciation) [2]	-4.7	-8.7	6.3	-3.0	...	...	...	...	...	...
Real effective exchange rate (– depreciation) [2]	-2.1	-6.0	8.7	-1.9	...	...	...	...	...	...
Current account balance (percent of GDP)	-1.5	-1.0	-4.4	-7.9	-2.6	-4.1	-8.7	-7.1	-5.5	-4.2
(excluding LHWP-II imports, percent of GDP)	0.5	2.3	-2.0	-5.5	1.7	1.0	-4.0	-3.3	-2.6	-2.0
Gross international reserves										
(excluding imports for LHWP-II, months of imports)	4.7	4.2	4.3	3.8	4.1	4.1	3.8	3.6	3.3	3.0
Money and credit										
Net international reserves										
(US$ millions)	670	718	846	663	756	813	784	753	722	693
(Percent of M1 Plus)	140	109	127	97	111	117	109	103	96	90
(US$ millions, CBL calculation)	605	777	756	855	845.3	842.8	N.A.	N.A.	N.A.	N.A.
(Percent of M1 Plus, CBL calculation)	126	118	114	125	124.4	121.2	N.A.	N.A.	N.A.	N.A.
Domestic credit to the private sector	12.9	-3.0	6.7	8.7	8.3	8.4	7.8	8.3	8.7	7.9
Reserve money	-3.8	17.2	1.0	24.5	8.3	-2.5	1.1	1.4	1.8	1.9
Broad money	11.8	12.2	0.0	19.6	3.9	4.9	5.9	5.6	6.1	5.8
Interest rate (percent) [3]	3.9	3.5	2.8	4.6	7.0	6.0	5.0	5.0	5.0	5.0
	(Percent of GDP, unless otherwise indicated)									
Public debt	57.0	53.6	55.7	59.8	60.4	60.4	60.7	61.3	61.8	62.3
External public debt	45.4	42.1	40.4	43.9	44.8	44.3	44.1	44.3	44.4	44.9
Domestic public debt	11.6	11.5	15.3	15.9	15.5	16.1	16.5	17.0	17.4	17.5
Central government fiscal operations										
Revenue and grants	46.8	53.4	44.9	41.5	51.4	49.7	46.1	45.7	45.8	45.8
(excluding SACU transfers and grants)	*25.5*	*24.6*	*26.0*	*25.4*	*26.5*	*25.0*	*26.0*	*26.1*	*26.3*	*26.3*
SACU transfers	*17.7*	*25.7*	*15.9*	*12.9*	*22.3*	*22.1*	*17.6*	*17.0*	*17.0*	*17.0*
Grants	*3.5*	*3.0*	*3.1*	*3.2*	*2.6*	*2.5*	*2.5*	*2.5*	*2.5*	*2.5*
Recurrent expenditure	39.2	42.2	36.8	37.1	37.8	37.8	37.7	37.5	37.2	36.9
Of which: wages, including social contributions	16.9	17.3	16.2	16.6	16.4	16.2	16.0	15.8	15.6	15.5
Capital expenditure	13.2	11.2	13.2	12.0	12.5	12.3	12.2	12.1	12.0	12.0
Overall balance	-5.6	0.0	-5.1	-7.7	1.1	-0.4	-3.8	-3.9	-3.3	-3.1
(excluding SACU transfers and grants)	*-26.8*	*-28.7*	*-24.1*	*-23.7*	*-23.8*	*-25.0*	*-23.9*	*-23.5*	*-22.9*	*-22.7*
Primary balance	-4.2	1.5	-3.8	-6.2	2.6	1.3	-2.0	-1.9	-1.3	-1.1
(excluding SACU transfers and grants)	*-25.4*	*-27.2*	*-22.8*	*-22.3*	*-22.3*	*-23.4*	*-22.1*	*-21.5*	*-20.9*	*-20.7*
Statistical discrepancy	0.0	-1.1	1.1	0.0	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, 2019/20 – 2028/29[1]

(LSL millions)

	2019/20	2020/21		2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	RCF/RFI	Act.	Act.	Est.	Projections					
Revenue	**16,417**	**17,639**	**18,635**	**16,968**	**17,333**	**23,391**	**24,381**	**24,290**	**25,836**	**27,674**	**29,510**
Tax revenue [2]	7,505	6,110	6,779	7,756	8,486	9,590	10,295	11,018	11,776	12,536	13,389
Taxes on income, profits, and capital gain	4,052	3,344	3,722	4,088	4,306	4,736	5,064	5,400	5,751	6,102	6,528
Taxes on property	0	0	0	0	0	0	0	0	0	0	0
Taxes on goods and services	3,453	2,766	3,056	3,669	4,180	4,853	5,230	5,618	6,025	6,434	6,861
Taxes on international trade	0	0	0	0	0	0	0	0	0	0	0
Other taxes	0	0	0	0	0	0	0	0	0	0	0
Grants	1,229	1,100	1,051	1,155	1,327	1,183	1,242	1,298	1,441	1,527	1,622
Budget support	213	242	149	429	363	157	165	173	165	168	169
Project grants	1,015	858	902	726	964	1,026	1,077	1,124	1,276	1,359	1,453
Non-tax revenue	1,457	1,447	1,825	2,048	2,120	2,470	1,992	2,680	2,995	3,329	3,528
Property Income	532	349	625	659	707	770	829	891	955	1,020	1,088
Sales of goods and services	924	1,098	1,199	1,389	1,413	1,701	1,162	1,789	2,040	2,308	2,440
Other non-tax revenue	1	1	1	0	0	2	2	3	3	3	4
SACU transfers	6,226	8,981	8,981	6,008	5,400	10,148	10,852	9,295	9,625	10,282	10,971
Expense	**13,753**	**16,602**	**14,725**	**13,922**	**15,498**	**17,227**	**18,538**	**19,856**	**21,214**	**22,463**	**23,751**
Compensation of employees	5,922	6,675	6,028	6,130	6,921	7,482	7,949	8,429	8,930	9,428	9,975
Wages and salaries	5,457	6,222	5,500	5,584	6,306	6,819	7,248	7,686	8,142	8,595	9,091
Social contributions	465	453	528	546	615	663	701	743	788	833	884
Use of goods and services	3,132	4,207	2,331	2,153	2,529	2,755	2,968	3,138	3,315	3,491	3,673
Interest payments	502	523	544	505	619	702	812	982	1,141	1,230	1,282
Domestic	266	224	282	267	302	373	424	515	605	648	671
External	237	299	262	238	317	329	387	467	536	582	611
Subsidies	341	541	1,041	548	555	601	644	688	736	783	832
Grants	1,304	1,114	2,001	1,650	1,732	1,928	2,112	2,297	2,486	2,620	2,756
Social benefits	1,687	2,660	1,847	1,877	1,875	2,180	2,366	2,523	2,693	2,881	3,083
Of which: Poverty-reducing social spending	0.0	...	0.0	0.0	569	778	838.4	900.6	965.8	1,031	1,100
Other expenses	864	883	934	1,060	1,267	1,580	1,687	1,797	1,913	2,029	2,151
Of which: Tertiary education loan bursary scheme	762	...	891	950	1,030	1,122	1,209	1,299	1,393	1,488	1,586
Nonfinancial Assets	**4,632**	**3,617**	**3,914**	**4,986**	**5,036**	**5,670**	**6,026**	**6,451**	**6,845**	**7,230**	**7,754**
Domestically financed	2,853	1,330	1,862	2,717	2,677	2,719	3,256	3,516	3,531	3,972	4,112
Externally financed	1,780	2,287	2,052	2,269	2,359	2,952	2,770	2,935	3,314	3,258	3,641
Net Lending(+)/Borrowing (–) (Overall Fiscal Balance)	**-1,968**	**-2,580**	**-4**	**-1,941**	**-3,201**	**493**	**-184**	**-2,017**	**-2,222**	**-2,019**	**-1,996**
Transactions in Financial Assets and Liabilities	**34**	**-2,580**	**377**	**-2,355**	**-3,201**	**493**	**-184**	**-2,017**	**-2,222**	**-2,019**	**-1,996**
Financial assets	280	-1,449	209	247	-1,843	2,078	1,341	-319	-344	-344	-282
Domestic	261	-1,449	184	247	-1,843	2,078	1,341	-319	-344	-344	-282
Deposits	243	-1,449	160	225	-1,843	2,078	1,341	-319	-344	-344	-282
Central bank	580	-1,449	152	45	-1,466	1,904	1,042	-504	-408	-411	-351
Commercial banks	-337	0	8	180	96	0	0	0	0	0	0
Repayments to the IMF (net of CCRT)	19	...	25	22	11	174	298	185	64	66	69
Loans	19	0	25	22	0	0	0	0	0	0	0
Financial liabilities	356	1,131	586	2,602	1,358	1,585	1,525	1,698	1,878	1,674	1,713
Domestic	246	-550	-56	1,611	800	400	650	750	750	700	500
of which: banks (securities)	77	...	-211	707	168	400	733	-248	112	112	113
of which: banks (loans)	36	...	-2	-2	0	0	0	0	0	0	0
of which: Change in domestic arrears	0	-800	-279	0	100	-50	-50	-50	-50	-50	-50
Foreign	110	1,691	642	991	558	1,185	875	948	1,128	974	1,213
Disbursements	764	2,383	1,150	1,543	1,395	1,926	1,693	1,811	2,038	1,899	2,188
of which: G20 DSSI	0	113	88	0	0	0	0	0	0	0	0
of which: World Bank COVID-19 EPRP	0	148	148	0	0	0	0	0	0	0	0
Amortization	-655	-691	-507	-552	-837	-741	-819	-863	-910	-925	-975
CCRT	0	...	0	78	0	0	0	0	0	0	0
Statistical discrepancy	-1,892	...	-381	71	0	0	0	0	0	0	0
Memorandum Items:											
Social spending	2,449	2,660	2,738	2,827	2,905	3,302	3,575	3,822	4,086	4,369	4,669
Stock of arrears [3]	1,000	...	721	650	750	700	650	600	550	500	450

Sources: Lesotho authorities and IMF staff calculations.

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

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

[3] Estimates for 2022/23 assume the write-off of arrears of up to LSL275 million.

Table 3. Lesotho: Fiscal Operations of the Central Government, 2019/20 – 2028/29[1]

(Percent of GDP)

	2019/20	2020/21		2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	RCF/RFI	Act.	Act.	Est.	Projections					
Revenue	**46.8**	**50.0**	**53.4**	**44.9**	**41.5**	**51.4**	**49.7**	**46.1**	**45.7**	**45.8**	**45.8**
Tax revenue [2]	21.4	17.3	19.4	20.5	20.3	21.1	21.0	20.9	20.8	20.8	20.8
Taxes on income, profits, and capital gain	11.5	9.5	10.7	10.8	10.3	10.4	10.3	10.2	10.2	10.1	10.1
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	9.8	7.8	8.8	9.7	10.0	10.7	10.7	10.7	10.7	10.7	10.7
Taxes on international trade	0.0	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	3.5	3.1	3.0	3.1	3.2	2.6	2.5	2.5	2.5	2.5	2.5
Budget Support	0.6	0.7	0.4	1.1	0.9	0.3	0.3	0.3	0.3	0.3	0.3
Project grants	2.9	2.4	2.6	1.9	2.3	2.3	2.2	2.1	2.3	2.3	2.3
Non-tax revenue	4.1	4.1	5.2	5.4	5.1	5.4	4.1	5.1	5.3	5.5	5.5
Property Income	1.5	1.0	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Sales of goods and services	2.6	3.1	3.4	3.7	3.4	3.7	2.4	3.4	3.6	3.8	3.8
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 transfers	17.7	25.4	25.7	15.9	12.9	22.3	22.1	17.6	17.0	17.0	17.0
Expense	**39.2**	**47.0**	**42.2**	**36.8**	**37.1**	**37.8**	**37.8**	**37.7**	**37.5**	**37.2**	**36.9**
Compensation of employees	16.9	18.9	17.3	16.2	16.6	16.4	16.2	16.0	15.8	15.6	15.5
Wages and salaries	15.5	17.6	15.8	14.8	15.1	15.0	14.8	14.6	14.4	14.2	14.1
Social contributions	1.3	1.3	1.5	1.4	1.5	1.5	1.4	1.4	1.4	1.4	1.4
Use of goods and services	8.9	11.9	6.7	5.7	6.0	6.0	6.0	6.0	5.9	5.8	5.7
Interest payments	1.4	1.5	1.6	1.3	1.5	1.5	1.7	1.9	2.0	2.0	2.0
Domestic	0.8	0.6	0.8	0.7	0.7	0.8	0.9	1.0	1.1	1.1	1.0
External	0.7	0.8	0.8	0.6	0.8	0.7	0.8	0.9	0.9	1.0	0.9
Subsidies	1.0	1.5	3.0	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Grants	3.7	3.2	5.7	4.4	4.1	4.2	4.3	4.4	4.4	4.3	4.3
Social benefits	4.8	7.5	5.3	5.0	4.5	4.8	4.8	4.8	4.8	4.8	4.8
Of which, Poverty-reducing social spending	0.0	...	0.0	0.0	*1.4*	*1.7*	1.7	1.7	1.7	1.7	1.7
Other expenses	2.5	2.5	2.7	2.8	3.0	3.5	3.4	3.4	3.4	3.4	3.3
Of which: Tertiary education loan bursary scheme	2.2	...	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Non-Financial Assets	**13.2**	**10.2**	**11.2**	**13.2**	**12.0**	**12.5**	**12.3**	**12.2**	**12.1**	**12.0**	**12.0**
Domestically financed	8.1	3.8	5.3	7.2	6.4	6.0	6.6	6.7	6.2	6.6	6.4
Externally financed	5.1	6.5	5.9	6.0	5.6	6.5	5.6	5.6	5.9	5.4	5.7
Net Lending(+)/Borrowing (-) (Overall Fiscal Balance)	**-5.6**	**-7.3**	**0.0**	**-5.1**	**-7.7**	**1.1**	**-0.4**	**-3.8**	**-3.9**	**-3.3**	**-3.1**
Transactions in Financial Assets and Liabilities	**-0.2**	**-7.3**	**1.1**	**-6.2**	**-7.7**	**1.1**	**-0.4**	**-3.8**	**-3.9**	**-3.3**	**-3.1**
Financial assets	0.8	-4.1	0.6	0.7	-4.4	4.6	2.7	-0.6	-0.6	-0.6	-0.4
Domestic	0.7	-4.1	0.5	0.7	-4.4	4.6	2.7	-0.6	-0.6	-0.6	-0.4
Deposits	0.7	-4.1	0.5	0.6	-4.4	4.6	2.7	-0.6	-0.6	-0.6	-0.4
Central bank	1.7	-4.1	0.4	0.1	-3.5	4.2	2.1	-1.0	-0.7	-0.7	-0.5
Repayment to IMF (net of CCRT)	0.1	...	0.1	0.1	0.0	0.4	0.6	0.4	0.1	0.1	0.1
Commercial banks	-1.0	0.0	0.0	0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	1.0	3.2	1.7	6.9	3.2	3.5	3.1	3.2	3.3	2.8	2.7
Domestic	0.7	-1.6	-0.2	4.3	1.9	0.9	1.3	1.4	1.3	1.2	0.8
of which: banks (securities)	0.2	...	-0.6	1.9	0.4	0.9	1.5	-0.5	0.2	0.2	0.2
of which: banks (loans)	0.1	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: Change in domestic arrears	0.0	-2.3	-0.8	0.0	0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Foreign	0.3	4.8	1.8	2.6	1.3	2.6	1.8	1.8	2.0	1.6	1.9
Disbursements	2.2	...	3.3	4.1	3.3	4.2	3.5	3.4	3.6	3.1	3.4
of which: G20 DSSI	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.9	4.8	-1.5	-1.5	-2.0	-1.6	-1.7	-1.6	-1.6	-1.5	-1.5
CCRT	...	...	...	0.2	...	...	...	...	...	...	...
Statistical discrepancy	-5.4	0.0	-1.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:											
Social spending	7.0	7.5	7.8	7.5	6.9	7.2	7.3	7.3	7.2	7.2	7.3
Stock of arrears	2.8	...	2.1	1.7	1.8	1.5	1.3	1.1	1.0	0.8	0.7

Sources: Lesotho authorities and IMF staff calculations.

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

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

Table 4a. Lesotho: Monetary Accounts, 2019/20 – 2028/29[1]

(LSL millions, unless otherwise indicated)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.	Projections					
					I. Monetary Survey					
Net foreign assets	16,319	17,146	16,582	17,773	19,277	19,685	19,474	18,893	18,325	17,821
Central bank	11,181	9,936	10,319	10,000	12,154	13,545	13,336	13,116	12,911	12,769
Commercial banks	5,139	7,210	6,263	7,773	7,123	6,140	6,138	5,776	5,414	5,051
Net domestic assets	-3,778	-3,072	-2,505	-939	-1,784	-1,333	-36	1,641	3,461	5,227
Claims on central government (net)	-2,628	-3,180	-2,853	-1,414	-3,098	-3,710	-3,640	-3,184	-2,727	-2,333
Central bank	-3,069	-3,402	-3,602	-2,236	-4,320	-5,665	-5,346	-5,002	-4,658	-4,376
Commercial banks	441	222	749	822	1,222	1,955	1,706	1,818	1,930	2,043
Claims on private sector	7,696	7,464	7,961	8,656	9,375	10,164	10,962	11,869	12,902	13,918
Other items (net)	-9,040	-7,530	-7,827	-8,533	-8,444	-8,520	-8,561	-8,609	-8,662	-8,713
Broad money (M2)	12,541	14,075	14,077	16,834	17,493	18,352	19,438	20,534	21,785	23,047
Currency outside banks	1,095	1,380	1,207	1,480	1,538	1,613	1,709	1,805	1,915	2,026
Deposits	11,446	12,695	12,870	15,354	15,955	16,739	17,729	18,729	19,870	21,021
					II. Central Bank					
Net foreign assets	11,181	9,936	10,319	10,000	12,154	13,545	13,336	13,116	12,911	12,769
Gross reserves	12,646	11,665	13,166	12,565	14,685	15,875	15,543	15,329	15,135	15,007
Net domestic assets	-9,470	-7,931	-8,294	-7,479	-9,423	-10,882	-10,643	-10,386	-10,132	-9,938
Claims on central government (net)	-3,069	-3,402	-3,602	-2,236	-4,320	-5,665	-5,346	-5,002	-4,658	-4,376
Claims on private sector	107	160	113	164	179	193	207	222	237	253
Other items (net)[2]	-6,508	-4,689	-4,805	-5,407	-5,281	-5,410	-5,505	-5,606	-5,711	-5,816
Reserve money	1,711	2,005	2,025	2,522	2,731	2,664	2,692	2,731	2,779	2,831
Currency in circulation	1,451	1,765	1,575	1,940	2,016	2,115	2,240	2,366	2,511	2,656
Commercial bank deposits	258	238	449	580	715	549	452	364	268	175
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	-3.8	17.2	1.0	24.5	8.3	-2.5	1.1	1.4	1.8	1.9
Broad money	11.8	12.2	0.0	19.6	3.9	4.9	5.9	5.6	6.1	5.8
Narrow money (M1, percentage change)	16.6	18.8	-3.2	19.1	3.9	4.9	5.9	5.6	6.1	5.8
Narrow money (M1)	5,774	6,862	6,640	7,907	8,217	8,621	9,131	9,646	10,234	10,827
Credit to the private sector (percentage change)	12.9	-3.0	6.7	8.7	8.3	8.4	7.8	8.3	8.7	7.9
Credit to the private sector (percent of GDP)	21.9	21.4	21.1	20.7	20.6	20.7	20.8	21.0	21.4	21.6
Velocity (GDP/broad money)	2.8	2.5	2.7	2.5	2.6	2.7	2.7	2.8	2.8	2.8
Net international reserves	11,983.5	10,626	12,330	11,933	14,197	15,652	15,506	15,356	15,228	15,169
(percent of domestic currency deposits)	60.0	37.8	50.7	30.3	...	...	...	...	...	...

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, 2019/20 – 2028/29[1]

(Percent of GDP; unless otherwise indicated)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.	Projections					
				I. Monetary Survey						
Net foreign assets	46.5	49.1	43.9	42.5	42.3	40.1	36.9	33.4	30.4	27.7
Central bank	31.8	28.5	27.3	23.9	26.7	27.6	25.3	23.2	21.4	19.8
Commercial banks	14.6	20.7	16.6	18.6	15.6	12.5	11.6	10.2	9.0	7.8
Net domestic assets	-10.8	-8.8	-6.6	-2.2	-3.9	-2.7	-0.1	2.9	5.7	8.1
Claims on central government (net)	-7.5	-9.1	-7.6	-3.4	-6.8	-7.6	-6.9	-5.6	-4.5	-3.6
Central bank	-8.7	-9.7	-9.5	-5.3	-9.5	-11.5	-10.1	-8.8	-7.7	-6.8
Commercial banks	1.3	0.6	2.0	2.0	2.7	4.0	3.2	3.2	3.2	3.2
Claims on private sector	21.9	21.4	21.1	20.7	20.6	20.7	20.8	21.0	21.4	21.6
Other items (net)	-25.7	-21.6	-20.7	-20.4	-18.5	-17.4	-16.2	-15.2	-14.3	-13.5
Broad money (M2)	35.7	40.3	37.3	40.3	38.4	37.4	36.9	36.3	36.1	35.8
Currency outside banks	3.1	4.0	3.2	3.5	3.4	3.3	3.2	3.2	3.2	3.1
Deposits	32.6	36.4	34.1	36.7	35.0	34.1	33.6	33.1	33	33
				II. Central Bank						
Net foreign assets	31.8	28.5	27.3	23.9	26.7	27.6	25.3	23.2	21.4	19.8
Gross reserves	36.0	33.4	34.8	30.1	32.2	32.3	29.5	27.1	25.1	23.3
Net domestic assets	-27.0	-22.7	-22.0	-17.9	-20.7	-22.2	-20.2	-18.4	-16.8	-15.4
Claims on central government (net)	-8.7	-9.7	-9.5	-5.3	-9.5	-11.5	-10.1	-8.8	-7.7	-6.8
Claims on private sector	0.3	0.5	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other items (net) [2]	-18.5	-13.4	-12.7	-12.9	-11.6	-11.0	-10.4	-9.9	-9.5	-9.0
Reserve money	4.9	5.7	5.4	6.0	6.0	5.4	5.1	4.8	4.6	4.4
Currency in circulation	4.1	5.1	4.2	4.6	4.4	4.3	4.2	4.2	4.2	4.1
Commercial bank deposits	0.7	0.7	1.2	1.4	1.6	1.1	0.9	0.6	0.4	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	-3.8	17.2	1.0	24.5	8.3	-2.5	1.1	1.4	1.8	1.9
Broad money	11.8	12.2	0.0	19.6	3.9	4.9	5.9	5.6	6.1	5.8
Narrow money (M1, percentage change)	16.6	18.8	-3.2	19.1	3.9	4.9	5.9	5.6	6.1	5.8
Narrow money (M1)	16.4	19.7	17.6	18.9	18.0	17.6	17.3	17.1	17.0	16.8
Credit to the private sector (percentage change)	12.9	-3.0	6.7	8.7	8.3	8.4	7.8	8.3	8.7	7.9
Credit to the private sector	21.9	21.4	21.1	20.7	20.6	20.7	20.8	21.0	21.4	21.6
Velocity (GDP/broad money)	2.8	2.5	2.7	2.5	2.6	2.7	2.7	2.8	2.8	2.8
Net international reserves	34.1	30.4	32.6	28.5	31.2	31.9	29.4	27.2	25.2	23.6
(percent of domestic currency deposits)	60.0	37.8	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, 2019/20 – 2028/29[1]

(US$ millions, unless otherwise indicated)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.	Projections					
Current Account	**-37**	**-21**	**-112**	**-195**	**-62**	**-105**	**-231**	**-197**	**-156**	**-123**
Current account (excluding LHWP-II)	**11**	**49**	**-50**	**-136**	**41**	**26**	**-106**	**-92**	**-75**	**-59**
Trade balance	-677	-753	-750	-722	-759	-806	-834	-812	-795	-784
Exports, f.o.b.	1,099	831	1,111	1,089	1,058	1,112	1,152	1,204	1,234	1,265
Imports, f.o.b	1,776	1,584	1,861	1,811	1,818	1,918	1,986	2,015	2,029	2,049
Services (net)	-406	-361	-405	-392	-400	-428	-444	-455	-462	-469
Primary income (net)	470	403	461	441	415	421	430	449	464	478
Secondary income (net)	576	690	581	479	682	709	617	621	638	652
Official transfers	447	568	441	347	556	580	487	489	504	518
Of which: SACU transfers	421	549	405	318	541	564	470	472	487	501
Other transfers	130	121	140	132	126	128	130	132	134	134
Capital Account	**100**	**93**	**131**	**88**	**165**	**205**	**200**	**185**	**162**	**146**
Financial Account [2]	**28**	**119**	**-101**	**3**	**1**	**45**	**-6**	**8**	**25**	**39**
Foreign direct investment	-34	-26	36	-18	-17	-18	-19	-20	-21	-21
Portfolio investment	102	68	-34	-6	-6	-6	-7	-7	-7	-7
Other investment	-39	78	-103	27	25	70	20	35	53	67
Of which:										
Public sector	-7	-39	-67	-33	-63	-45	-48	-55	-46	-55
Disbursements	52	70	104	82	103	88	92	100	90	100
Central government	52	17	99	82	103	88	92	100	90	100
Amortization	44	31	37	49	39	43	44	45	44	45
Errors and Omissions	**-62**	**144**	**-152**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall Balance	**-27**	**97**	**-33**	**-110**	**101**	**54**	**-26**	**-20**	**-19**	**-16**
Financing	**27**	**-97**	**33**	**110**	**-101**	**-54**	**26**	**20**	**19**	**16**
Net official reserve movements (+ increase)	-27	36	-38	-110	101	54	-26	-20	-19	-16
SDR allocation	0	0	94	0	0	0	0	0	0	0
Other reserves	-27	36	-132	-110	...	...	...	...	...	...
Exceptional financing	0	60	5	0	0	0	0	0	0	0
IMF RCF/RFI	0	48	0	0	0	0	0	0	0	0
G20 DSSI	0	5	0	0	0	0	0	0	0	0
IMF CCRT	0	0	5	0	0	0	0	0	0	0
World Bank COVID-19 EPRP	0	8	0	0	0	0	0	0	0	0
Memorandum Items:										
Nominal GDP	2,375	2,133	2,544	2,464	...	...	...	...	...	...
Gross international reserves										
(US$ millions)	707	788	903	697	781	823	785	751	716	684
(excluding LHWP-II, months of imports)	4.7	4.2	4.3	3.8	4.1	4.1	3.8	3.6	3.3	3.0
Net international reserves										
(US$ millions)	670	718	846	663	756	813	784	753	722	693
(excluding LHWP-II, months of imports)	4.5	3.9	4.0	3.6	4.0	4.1	3.8	3.6	3.4	3.1
Remittances	529	452	524	501	475	483	495	517	534	551
Exports of goods and services (percentage change)	-2.5	-25.4	34.4	-2.1	-2.8	5.0	3.6	4.4	2.5	2.5
Imports of goods and services (excluding LHWP-II, percentage change)	-3.7	-11.6	13.7	-2.7	-1.4	4.7	4.0	2.6	1.9	1.9

Sources: Lesotho authorities and IMF staff calculations.

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

[2] Negative sign indicates net inflows.

Table 5b. Lesotho: Balance of Payments, 2019/20 – 2028/29[1]

(Percent of GDP; unless otherwise indicated)

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
	Act.	Act.	Act.	Est.	Projections					
Current Account	-1.5	-1.0	-4.4	-7.9	-2.6	-4.1	-8.7	-7.1	-5.5	-4.2
Current account (excluding LHWP-II)	0.5	2.3	-2.0	-5.5	1.7	1.0	-4.0	-3.3	-2.6	-2.0
Trade balance	-28.5	-35.3	-29.5	-29.3	-31.3	-31.6	-31.3	-29.3	-27.8	-26.7
Exports, f.o.b.	46.3	39.0	43.7	44.2	43.6	43.6	43.2	43.4	43.1	43.0
Imports, f.o.b	74.8	74.3	73.2	73.5	74.9	75.2	74.5	72.7	70.9	69.7
Services (net)	-17.1	-16.9	-15.9	-15.9	-16.5	-16.8	-16.7	-16.4	-16.1	-15.9
Primary income (net)	19.8	18.9	18.1	17.9	17.1	16.5	16.1	16.2	16.2	16.2
Secondary income (net)	24.3	32.3	22.9	19.4	28.1	27.8	23.1	22.4	22.3	22.2
Official transfers	18.8	26.6	17.3	14.1	22.9	22.8	18.3	17.6	17.6	17.6
Of which: SACU transfers	17.7	25.7	15.9	12.9	22.3	22.1	17.6	17.0	17.0	17.0
Other transfers	5.5	5.7	5.5	5.3	5.2	5.0	4.9	4.8	4.7	4.6
Capital Account	**4.2**	**4.4**	**5.1**	**3.6**	**6.8**	**8.0**	**7.5**	**6.7**	**5.7**	**5.0**
Financial Account [2]	**1.2**	**5.6**	**-4.0**	**0.1**	**0.1**	**1.8**	**-0.2**	**0.3**	**0.9**	**1.3**
Foreign direct investment	-1.4	-1.2	1.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Portfolio investment	4.3	3.2	-1.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other investment	-1.7	3.6	-4.1	1.1	1.0	2.7	0.7	1.2	1.8	2.3
Of which:										
Public sector	-0.4	-2.2	-2.8	-2.3	-4.5	-4.9	-3.7	-2.1	-1.6	-2.6
Disbursements	2.2	3.7	4.2	4.3	6.1	6.6	5.3	3.8	3.2	4.2
Central government	2.2	3.7	4.2	4.3	6.1	6.6	5.3	3.8	3.2	4.2
Amortization	1.9	1.5	1.5	2.0	1.6	1.7	1.6	1.6	1.5	1.5
Errors and Omissions	**-2.6**	**6.8**	**-6.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall Balance	**-1.1**	**4.5**	**-1.3**	**-4.5**	**4.2**	**2.1**	**-1.0**	**-0.7**	**-0.7**	**-0.5**
Financing	**1.1**	**-4.5**	**1.3**	**4.5**	**-4.2**	**-2.1**	**1.0**	**0.7**	**0.7**	**0.5**
Net official reserve movements (– increase)	-1.1	1.7	-1.5	-4.5	4.2	2.1	-1.0	-0.7	-0.7	-0.5
SDR allocation	0.0	0.0	3.7	0.0	...	...	...	...	...	...
Other reserves	-1.1	1.7	-5.2	-4.5	...	...	...	...	...	...
Exceptional financing	0.0	2.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF RCF/RFI	0.0	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
G20 DSSI	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF CCRT	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank COVID-19 EPRP	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Nominal GDP (US$ millions)	2,375	2,133	2,544	2,464	...	...	...	...	...	...
Gross international reserves	29.8	37.0	35.5	28.3	32.2	32.3	29.4	27.1	25.0	23.3
Net international reserves	28.2	33.7	33.3	26.9	31.2	31.9	29.4	27.2	25.2	23.6
Remittances	22.3	21.2	20.6	20.4	19.6	19.0	18.6	18.7	18.7	18.7

Sources: Lesotho authorities and IMF staff calculations.

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

[2] Negative sign indicates net inflows.

Annex I. Status of Key Recommendations from the 2022 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 FY23/24 budget includes measures to reduce the size of the civil service and low cost-of-living adjustment (COLA) helped to contain the wage bill. Revenue measures have also been changed in line with recommendations, including enactment of the Tobacco and Alcoholic Products Levy Act. The sales tax on exports (outside of the VAT) is pending.
Address PFM deficiencies.	The Public Procurement Bill was enacted on March 10, 2023. The IFMIS system remains poorly implemented, leading to vulnerabilities in procurement and cash management. 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 has been submitted to Parliament.
Improve debt management	A medium-term debt management strategy was completed in FY19/20. However, better quality debt statistics are needed to monitor debt flows. Capacity development for local currency bond markets has begun.
Strengthen the business climate.	Government intervention continues to be problematic, with high expenditure and policy uncertainty distorting incentives and undermining activity. 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.
Enhance the financial sector's contribution to growth	The Financial Consumer Protection Bill was enacted on June 3, 2022, with regulations still pending. The Insolvency Bill was enacted on July 8, 2022, with regulations are still pending. The CBL has issued a license to one of the largest troubled savings cooperatives but has yet to take full responsibility of its supervision and oversight.

Annex II. Summary of the FY23/24 Budget

1. This Annex provides key excerpts from the FY23/24 Budget Speech and other key documents.

2. The government's aim is not so much to reduce expenditures given the prevailing global and domestic economic conditions. Rather, the aim is to direct resources to productive ventures that stimulate investment by the private sector and away from recurrent spending save [sic] for recurrent spending that strictly supports productive spending directly. It is this manner of expenditure control that will secure us growth.

3. The public sector wage bill is declining by 1.7 percentage points of GDP and travel and per diem costs cut by 0.9 percent of GDP.[1]

4. Increases in salaries and social benefits:

- Salaries and wages will increase by 2.5 percent across-the-board to preserve the take home pay. Given the already high wage bill, the Government can only afford a modest adjustment to restrain further growth of the wage bill.
- To ensure that low-income earners remain outside the tax bracket, I propose that, the tax credit be adjusted upwards from LSL880 to LSL902 per month. This will translate into an adjustment of the minimum taxable income from LSL5,620 to LSL5,760 per month.
- Old Age Pension will be increased from LSL850 to LSL900 per month, effective April 1, 2023.

5. Domestically-financed capital expenditure will be increased by almost 2 percentage points in FY23/24 for priority sectors, while the overall capital budget declines.[2] The government aims to improve the quality of existing capital projects and eliminate stalled, unproductive investments.

6. Social spending will be increased by 0.7 percentage points of GDP, including child grants, disability grants, orphans, and vulnerable children (OVC) bursaries and old age pension.

7. Domestic revenue will be supported by the passage of the alcohol and tobacco excise bill,[3] while proposals to remove VAT zero-rating of mining exports are to be replaced by an export sales tax. Staff assesses that the new excises would generate additional revenues of 0.7 percent of GDP.

[1] The government is attempting to lead by example, with Ministers giving up certain perquisites.

[2] Priority sectors include (i) agriculture; (ii) extractives, (iii) energy, and (iv) transport infrastructure.

[3] Alcoholic beverages and tobacco are to be levied at ad valorem rates of 15 and 30 percent, respectively.

8. The medium-term fiscal strategy aims at reinforcing long term fiscal sustainability and providing sufficient buffers to guard against domestic and external shocks and imbalances. Prudent fiscal management is crucial to sustain confidence of investors and development partners. It also helps to make it easier for the private sector to secure financing for large investment projects from multilateral institutions as it improves the credit rating of a sovereign.

9. Key measures that will be implemented to achieve this outcome include:

- Maintaining reserves of not less than 4.5 months of import cover as a buffer against both external and fiscal shocks.
- Reducing high and unsustainable level of recurrent spending. Active monitoring and implementation of tighter controls over recurrent expenditure budgets to ensure that existing resources are utilized more effectively and efficiently as well as targeting no real increases in recurrent spending over the next three years (excluding maintenance of assets).
- Reduction in the wage bill through restructuring of the public service and consolidation of ministries to remain with sufficient numbers of staff.
- Improved collection of domestic nontax revenues.
- Mobilizing additional resources, especially grants to finance public investments and crowding- in private investment.
- Institute measures to improve tax efficiency.
- Outsourcing some of the services that government currently provides to the private sector for efficiency.
- Review some of the fees and charges for services to reflect the cost of such services.
- Use of subsidies programs that are target to relevant groups.

10. In pursuit of macro-fiscal stability, the government shall work hard over the medium term to reduce Lesotho's dependence on volatile SACU receipts by working towards a state where recurrent expenditures can be covered by tax and nontax revenues. The development component of SACU revenue and donor funding will be used to finance infrastructure and capital spending, as well as to create a development and stabilization fund. This fund shall also be complemented by a part of earnings from natural resources.

11. The government's budget strategy paper sets out the following principles to control and curb expenditure: (i) over the medium term, bring the overall fiscal deficit to below 3 percent of GDP consistent with long-term GDP growth; (ii) the government's expenditure on the wage bill should not grow as a share of GDP, and must be reduced over the medium term alongside measures to streamline the civil service, and (iii) consistently constrain the government's recurrent expenditure not to grow more than development expenditure.

Annex III. Recent Developments in Governance and Anti-Corruption

1. **Corruption is generally associated with weak economic growth, lower investment and fiscal revenue, higher inequality, and worse inclusive growth performance.** Strengthening governance and reducing corruption vulnerabilities in Lesotho are expected to have a significant impact on macroeconomic performance in the medium- and long-term and on the ability of the government to pursue policies to achieve external viability and sustainable growth. Effectiveness of anti-corruption strategies are largely determined by their responsiveness to political, social, and economic context in which these weaknesses and vulnerabilities emerge.

2. **The investment climate stands to improve if the country can root out and deter corruption by strengthening governance and enforcing existing laws.** Lesotho's macroeconomically critical governance vulnerabilities are rooted in decade-long practices that have eroded institutions, transparency, and accountability. Over time, an overlap of public positions and private business interests slowly became a common feature in Lesotho with the dominance of informal political processes, patronage, corruption, and concentration of power and resources in the hands of politico-economic entrepreneurs. The impunity for officials who engaged in corrupt practices created an expectation and perception of tolerance towards extensive corruption. The previous Parliament's inability to conclude the national constitutional reforms process—by passing the "Omnibus Bill"—also highlighted the political difficulties facing even the most pressing legislative reforms.

3. **Agreements have been entered into on behalf of the government by officials who have been deemed to have acted without the authority to do so.** These include:

- **Government of Lesotho vs. Frazer Solar GmbH.** In 2021, Frazer Solar GmbH filed a global enforcement action in South Africa to seize up to EUR50 million (2.5 percent of GDP) of Lesotho's assets in contractual damages following claims that the government reneged on an agreement to supply solar energy equipment and services. The government filed a countersuit, disputing the legitimacy and legality of the contract as it was entered into by the Minister in the Prime Minister's Office who does not have the authority to do so. The case is still pending, but Frazer Solar has continued to file claims in other jurisdictions to seize government assets as compensation.

- **Government of Lesotho vs. Lincoln University College, Malaysia.** A former minister is under investigation for signing a multi-million maloti deal with Lincoln University College in Malaysia to establish a medical school in Lesotho without not only following due process, but ignoring the legal opinions provided to her by both the legal officer in her then ministry as well as the government's Attorney General. The current government successfully canceled the agreement.

- **Other fraudulent procurement cases within the government.** Back in October 2021, several government officials in the Ministry of Finance misappropriated to LSL50 millions of government funds, by taking advantage of outdated PFM process in local offices. Another example is the purchase in February 2023 of agricultural inputs worth LSL41.8m without following the prescribed procurement procedures. Since 2022, the DCEO has also been investigating the awarding of LSL42m and LSL40m worth of fertilizers respectively where procurement procedures have allegedly been flouted, highlighting the need to apply more effort to curb nonstandard procurement processes. The auditor general's FY19/20 and FY20/21 reports on COVID-19-related expenditures also provide many examples of misappropriated funds during the pandemic.

4. **Convictions in fraud cases are limited as the courts of law fail to conclude and deliver judgement.** Of the 12 cases that have been initiated since 2015, judgement has been delivered on only one. The other eleven, it is either the investigations are still on-going, or they are still pending in the courts of law.[1] These compromise the transparency of the work done, and the accountability and integrity of the institutions involved. Expediting trials would not only help clear the backlog of cases in the judicial system but send a clear signal that defrauding the government and the taxpayer is unacceptable and carries a severe penalty.

5. **Existing parts of the anti-corruption infrastructure must be fully utilized and improved**:

- **The Office of the Auditor General (OAG) provides vital financial oversight and should be leveraged fully to monitor and identify misappropriation of funds**. While the OAG enjoys some autonomy, inadequate resources impair the quality, frequency, and timeliness of the reports. Staffing requirements are not easily resolved, as a lack of powers means that the OAG is unable to guarantee timely submission of financial statements from spending units.

- **The passage of the "Omnibus Bill" is critical to the establishment of a well-resourced and independent anti-corruption agency with powers clearly specified in legislation.** This will help elevate the current DCEO and improve its effectiveness. Nevertheless, even recent changes at the DCEO—for example, internal staff review and an improved resource envelope—can help improve reputation and investigative outcomes. However, the granting of prosecuting powers and the introduction of courts that specialize in anti-corruption will also be instrumental in overcoming the backlog of cases and preventing premature dismissals. Increasing the DCEO's presence at the district level can also facilitate whistleblowing and the reporting of illegal activities.

6. **The government has acknowledged the problem of unauthorized spending and spending beyond amounts allocated under the budget by Finance Officers.** The law is clear on

[1] See Audit Report on the Consolidated Financial Statements of the Government of Lesotho for the Year Ended 31st March 2021.

the limits to spending by officials.[2] Nevertheless, public expenditure continues to be undertaken illegally without penalties or sanctions, and in many cases, they are authorized retroactively, in breach of procurement laws and regulations, and standard PFM practices. The resulting payment delays and arrears have a knock-on effect to overpricing of supplies by government vendors.

7. Lesotho has in the past demonstrated the ability to tackle corruption and improve perceptions. Between 2013 and 2014, the government—with support from South Africa—investigated and successfully prosecuted members of the Lesotho highlands Water Commission (LHWC), the CEO of the Lesotho Highlands Development Authority (LHDA), and foreign entities involved in bribery and corruption in construction. Since then, the country has struggled to build on such progress.

[2] Section 18(1)(b) of the Financial Regulations of 2014 clearly states that warrants distributed shall not exceed the amount of the warrant received. Section 18(3)(b) says that when there is no budget, an authorizing officer should apply to the Budget Controller for a budget virement.

Table AIII.1. Lesotho: Summary of Key Sections in the Tenth Amendment to the Constitution 2022 ("Omnibus Bill")

Reforms Issues	Plenary Decision & Constitutional Amendment
	Political Stabilization
Floor crossing	Allow floor crossing after three (3) years of life of Parliament, otherwise, by-elections are needed.
Dissolution and Prorogation of parliament	Remove prorogation powers from Prime Minister (PM) and shorten period. Parliament dissolved by advice of Council of State. Prorogation not to exceed 60 days.
Vote of no confidence	Prohibit the PM from advising the King on dissolution after a successful vote of no confidence. The PM does not ordinarily have powers to advise on dissolution unless it is supported by two-thirds majority of the National Assembly. Remove the PM by two-thirds majority.
	PFM, Public Expenditure, and Civil Service Reform
Maximum number of ministers	The number of Ministers and Deputy Ministers not to exceed 12% of the membership of both Houses of Parliament
PM and DPM Pension Qualification	To serve for at least 3 cumulative years. Surviving spouse only to get 50% after the demise of the PM/DPM. Former PM or DPM shall not receive pension while still MPs (Does not have retrospective effect).
Public Procurement	Establishes Lesotho Public Procurement Authority answerable to parliament through the Minister of Finance.
Career Diplomatic Service	Establish a Career Diplomatic Service; ensure that the Foreign Service is occupied by qualified career diplomats, appointed in a fair, and transparent manner and on permanent and pensionable terms like the rest of the Public Service.
Permanent Secretaries	Appointed by Public Service Commission through merit-based, open, and competitive processes, rather than political nomination.
Salaries of Public Servants	Establish Salaries & Remuneration Commission to set Salaries for Cabinet, Members of Parliament, and other Statutory Bodies
Office of the Accountant General	Provides for the independence of the Office of the Accountant General under the Minister responsible for Finance. Appointed by the King on the advice of the PM through a transparent process and upon recommendation by the Public Service Commission for term of five years which may be renewable once.
	Depoliticizing Macroeconomic Policymaking
Central Bank of Lesotho	Governor appointed by the King on the advice of the Council of State following recommendation by Parliament.
	Anti-Corruption and Governance
Establish the Lesotho Anti-Corruption and Ethics Commission	Independent body accountable to Parliament, headed by Commissioner General appointed by the King on the advice of JSC through a fair, merit based and competitive process.

Annex IV. External Sector Assessment

Overall Assessment: *The external position of Lesotho in FY22/23 is assessed to be weaker than the level implied by fundamentals and desirable polices. Further decline in SACU transfers and higher food and fuel prices resulting from Russia's war in Ukraine contributed to a widening of the current account deficit, which was in part compensated for by the recovery in exports and remittances.*

Potential Policy Responses: Fiscal consolidation coupled with structural reforms to increase productivity and enhance competitiveness remain key to address structural imbalances. Reducing the public expenditure and improving public spending efficiency would reverse the crowding out of the private sector and promote competitiveness. Likewise, continued efforts to address corruption vulnerabilities, strengthen governance in public institutions, support human capital development, and reduce red-tape are critical to achieve private sector-led growth and correct longstanding structural weaknesses in the external position.

Foreign Assets and Liabilities: Position and Trajectory

Background. Lesotho is a net debtor country with reliance on mostly donor project-loans. The net international investment position (NIIP) deteriorated slightly to -27.8 percent of GDP in 2022, owing to foreign currency valuation effects. More generally, over recent years, the NIIP has in absolute terms declined reflecting slower foreign direct investment and growth. The NIIP is expected to continue declining over the medium term as gross assets build up, driven by the recovery in SACU transfers

Assessment. A significant share of gross assets is held in Rand while gross liabilities are largely held in U.S. dollars or U.S. dollar-linked currencies, Lesotho's external sustainability is vulnerable to increase in South Africa's risk premia in international markets. However, risks from currency mismatches are in part mitigated by the external buffers. Risks from the gross external liabilities are also mitigated by the favorable debt composition (over 80 percent of external debt is owed to multilateral creditors on concessional terms).

2022 Q3 (% of GDP)	NIIP: -27.8	Gross Assets: 51.3	Debt Assets: 17.4	Gross Liab: 84.3	Debt Liab: 61.4

Current Account

Background. The current account deficit is projected to widen to 7.9 percent of GDP in FY22/23. Further decline in SACU transfers and higher food and fuel prices resulting from war in Ukraine contributed to widening of current account deficit. However, the negative impact on the current account was in part compensated by the lower-than-expected LHWP-II related imports and the gathering momentum of recovery in exports and remittances after the COVID pandemic related slowdown. The current account deficit excluding LHWP-II related imports widened to 5.5 percent of GDP in FY22/23 from 1.9 percent of GDP in FY21/22. Over the medium term, surge in SACU transfers is expected to improve current account deficit if the authorities contain expenditure. However, large volatility of SACU transfers weigh on the risks of external balance and financing needs over the medium term.

Lesotho: EBA-lite Model Results, FY22/23
(In percent of GDP)

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual 3/	**-5.5**	
Cyclical contributions (from model) (-)	-0.5	
COVID-19 adjustors (-) 2/	-0.1	
Additional temporary/statistical factors (-)	0.0	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-4.8**	
CA Norm (from model) 3/	**-1.3**	
Adjusted CA Norm	**-1.3**	
CA Gap	**-3.6**	**-1.7**
o/w Relative policy gap	-3.4	
Elasticity	-0.4	
REER Gap (in percent)	**8.2**	**4.0**

1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the temporary impact of the pandemic
3/ Current account excluding LHWP-II related imports

Current Account

Assessment. The external position is assessed to be weaker than the level implied by fundamentals and desirable polices. The qualitative assessment is informed by the CA and REER models, indicated CA gap in the range of -3.6 to -1.7. The EBA-lite cyclically-adjusted current account deficit of 5.5[1]—incorporating cross-country consistent adjustors—is higher than the CA norm of 2.5 percent of GDP for FY22/23. The EBA-lite REER model overvaluation implies -1.3 percent of GDP for CA gap in FY22/23. The misalignment is attributed to policy gaps, driven largely by the fiscal stance. LHWP-II-related imports also contribute to the gap. Fiscal consolidation, reducing size of the public sector relative to economy and structural reforms aimed at improving spending efficiency are key to correcting longstanding structural weaknesses in external position.

[1]Projections of current account deficit are impacted by the pace of LHWP-II implementation, as the project-related imports account for a significant share of total imports. As the project is fully financed with capital grants from South Africa, this is excluded from the headline figure for external sector assessment purposes.

Real Exchange Rate

Background. Lesotho's nominal effective exchange rate is mainly driven by the peg to the South African Rand (ZAR). Amid global financial conditions tightening and worsening sentiment towards emerging markets, ZAR depreciated against major hard currencies, contributing to the depreciation of Lesotho's nominal effective exchange rate throughout FY22/23. However, the impact of nominal depreciation on the real effective exchange rate was in part offset by the higher inflation owing to large share of food and energy prices in the CPI basket. Lesotho's nominal and real effective exchange rates depreciated by 3.2 and 2.3 percent y-o-y in FY22/23.

Assessment. Lesotho's real effective exchange rate is assessed to be overvalued largely owing to wage inflation in excess of productivity growth. The assessment is informed by the EBA-lite REER model which suggest overvaluation of 5.2 percent, mainly attributed to policy gaps.

Capital and Financial Accounts: Flows and Policy Measures

Background. Lesotho relies on large capital transfers from South African Customs Union and public external borrowing in the form of donor project-loans to finance its current account deficit. During the LHWP-II implementation, capital grants from South Africa aimed at financing the mega project is also a significant source of financing the current account deficit. Financial account flows such as foreign direct investment and portfolio flows continue to be subdued.

Assessment. The declining trend in investment flows reflect longstanding challenges to the business environment. Reforms remain 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 fixed exchange rate regime with South Africa and interventions in the foreign exchange market is automatic. After an increase supported by 2021 SDR allocation, the international reserves fell in FY22/23 on the back of decline in SACU transfers and valuation effects. Given that a large share of international reserves is denominated in ZAR, it is sensitive to ZAR exchange rate with US dollar. As of March 2023, gross international reserves stood at 3.8 months of imports.

FX Interventions and Reserves Level
Assessment. The adequate level of gross international reserves in Lesotho is assessed to be 4.7 months of prospective imports. The assessment takes into account the exchange rate regime, frequency of external shocks, development of financial markets and other country specific factors.[1] The surge in FY23/24 SACU transfers provide an opportunity to build much needed external buffer in the form of international reserves. To mitigate adverse spillover risks from global financial conditions tightening through its effects on South Africa, share of ZAR holdings in the international reserves warrant close monitoring.
[1] See "Assessing Reserve Adequacy (ARA)" Board Papers (IMF 2011, 2013, 2014) and "Guidance Note: Assessing Reserve Adequacy in Credit-Constrained Economies" (IMF 2016).

Annex V. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Impact if Realized	Policy Response
Conjunctural Risks			
Intensification of Regional Conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	**High**	**Medium.** Spillover through supply chains or commodity price could negatively affect growth, inflation, and balance of payment and financial system vulnerability. Deteriorating terms of trade could add to inflationary pressure, worsen the external position, and further undermine the recovery. Supply disruptions and sharper-than-anticipated increases in international energy prices raise the costs of energy imports and other imported goods.	Limit the damage by cushioning income losses for individuals and firms, including by increasing spending on health and social protection.
Social Discontent. Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies with possible spillovers to other EMDEs. This exacerbates imbalances, slows growth, and triggers market repricing.	**High**	**High.** Social unrest could weaken political impetus for economic adjustment and reform and dent investor confidence, causing capital flight, growth slowdown, and inflation. 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.
Abrupt Global Slowdown or Recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation.	**Medium**	**High.** A global slowdown would negatively impact manufacturing and exports (via impact on Europe, South Africa, and United States).	Advance fiscal consolidation to cut back nonessential public expenditure and maintain support for the most vulnerable and preserve debt sustainability. Advance structural reforms to improve the business environment and foster private sector-led growth and economic diversification. Strengthen, expand, and better target the social safety net.
Commodity Price Volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	**Medium**	**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.

[1] Aligned with the Global Risk Assessment Matrix (G-RAM) as of February 13, 2023.

Source of Risks	Likelihood	Impact if Realized	Policy Response
Conjunctural Risks			
Monetary Policy Miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**Medium**	**Medium.** Worsening supply-demand imbalances, higher commodity prices, and higher nominal wage growth lead to persistently higher inflation (expectations), prompting the SARB to tighten rates faster than anticipated. Alternatively, premature loosening by the SARB could cause the real exchange rate to depreciate and add to domestic inflation via import prices.	In the absence of independent monetary policy, maintain reserves and optimize currency decomposition against rand currency risk; moderate fiscal spending; continue implementing structural reforms to strengthen the financial system, improve competitiveness, and diversification to increase the resilience.
Systemic Financial Instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or nonbank financial institutions, causing markets dislocations and adverse cross-border spillovers.	**Medium**	**Medium.** Potential risk to private sector credit and availability of credit for government finance through branches and subsidiaries of foreign (ZAF) banks in Lesotho.	Advance fiscal consolidation to alleviate gross financing needs and correct distortions to resource allocation within the economy; maintain and bolster financial sector supervision, particularly on nonbank financial institutions.
Structural Risks			
Deepening Geo-economic Fragmentation. Broader and deeper conflict(s) and weakened international cooperation lead to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**High**	**Medium.** Further, geo-economic fragmentation would negatively impact external demand and growth (via its impact on South Africa and other key markets).	Advance structural reforms to improve the business environment and foster a private sector-led growth; diversify economic activity, exports, and external links to increase resilience.
Cyberthreats. Cyberattacks on critical domestic and/or international physical or digital infrastructure (including digital currency and crypto ecosystems) trigger financial and economic instability.	**Medium**	**Medium**. With the rapid increase in digitalization, cyber-attacks could have significant effects on economic activity—notably the provision of e-government and financial services.	Strengthen cyber resilience while supporting digital financial inclusion; incorporate cyber risks into financial stability analysis; work toward building capacity in cyber security.
Extreme Climate Events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	**Medium**	**High.** Higher frequency of natural disasters causes 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.

Annex VI. Capacity Development Strategy

A. Context

1. **Lesotho has received extensive capacity development (CD) in recent years from the IMF and other donors, and priorities remain unchanged.** The authorities maintain a long wish-list of CD projects, but progress in implementation remains limited. Given the depth of needs, careful sequencing and prioritization of reforms is required, also to ensure that recipient MDAs are capable of absorbing and implementing recommendations (Table AV.1). CD must be aligned with the four key policy challenges and surveillance priorities outlined in the 2023 Article IV consultation: (i) aligning expenditures with resources to ensure fiscal sustainability; (ii) strengthening public financial management (PFM); (iii) strengthening monetary policy frameworks, financial sector supervision, and policy coordination to support credibility, investor confidence, macroeconomic stabilization, and the peg, and (iii) Rebalancing incentives within the economy by shifting from a government-centric focus to one with significantly more favorable conditions for private sector-led growth.

2. **Lesotho's 2023 medium-term CD strategy will continue to support implementation of the authorities' revised National Strategic Development Plan (NSDP II) through intensified engagement.** In discussions with the authorities, priorities will center on a large program of fiscal, monetary, financial sector, and statistical CD to (i) support fiscal consolidation through broad PFM reforms and the introduction of fiscal rules; (ii) strengthen liquidity management and monetary policy frameworks; (iii) develop local bond markets; (iv) bolster transparency and governance, and (v) improve the quality of macroeconomic data to facilitate timely policymaking.

3. **Capacity constraints are relatively more acute in the MoFDP than in the CBL.** The authorities actively participate in various training modules, both online and in person, which aim to supplement and reinforce CD recommendations. The MPMD within MoFDP has received significant CD but absorption has been limited due to high turnover. Capacity is generally stronger at the CBL, but gaps persist.

4. **The recent merger of MDAs across government has heightened the appetite and need for CD.** The merger of the Ministry of Finance with the Ministry of Development Planning has consolidated the capital budget under the new MoFDP. The government is also looking to temporarily centralize all procurement processes within MoFDP. As a result, the combination of a larger remit and longstanding PFM weaknesses risk further undermining budget processes, cash management, debt management, and procurement. Greater CD and coordination will be critical between the key departments within MoFDP—specifically, the Office of the Budget Controller, the Department of Macroeconomic Policy & Management, the Treasury, and the Debt Department.

5. **Coordination of CD across a broad spectrum of developmental partners is essential for its effectiveness.** Numerous partners, including the AfDB, the EU, U.S. government agencies, and the WB, are currently actively engaged in related policy areas in support of 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.

B. Fiscal Sector

6. PFM is a key priority for CD in Lesotho. Weaknesses in IFMIS, budget processes, debt management, cash management, expenditure controls, and financial reporting hinder the efficient allocation of resources and hamper surveillance. The MoFDP should draft annual borrowing plans and a medium-term debt strategy, as part of developing domestic bond markets to provide for stable government financing. 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, which had been provided previously with IMF/EU support. The WB has very active programs in the field of PFM, and close coordination is essential. Following a promising start, the MoFDP is assisting MDAs in mainstreaming gender equality into their spending plans and programs through gender audit studies and gender-responsive budgeting. However, implementation will require significant CD support.

7. Domestic revenue mobilization is essential for Lesotho to delink recurrent expenditure from the volatility of SACU external transfers. The authorities should build on previous CD to support tax policy analysis and forecasting capabilities within the MoFDP and reforms focused on enforcement and core functions of Revenue Services Lesotho (RSL). The RSL should follow up on the areas of weakness identified by the TADAT assessment. Additional CD can cover: (i) estimating the size of the tax gap through an RA-GAP assessment (data permitting); (ii) e-services suites to enable e-registration, e-filing, and e-payment; (iii) a risk-based taxpayer compliance program focused on the large and medium-sized taxpayers; (iv) international taxation, with a focus on audit capabilities and exchange of information.

C. Monetary Policy and Financial Sector

8. The first FSSR concluded in May 2021 and implementation of the accepted CD roadmap will start in May 2023. The Central Bank of Lesotho (CBL) agreed to the recommendations on financial stability and macroprudential policy, as well as early intervention, crisis management and resolution. The IMF FSSR mission and the World Bank FSAP Development Module teams collaborated closely on their respective topics and the delivery of key messages.

9. Monetary policy implementation and debt management and the development local currency bond markets (LCBMs) are a priority for Lesotho. A joint IMF/WB mission developed a roadmap for reforms to develop a LCBM and identified necessary capacity building in this area. Progress on improving public debt collection and deepening the government securities market is also critical to support the authorities' medium-term debt objectives. The CBL should follow up on recommendation to develop repo, money, and primary markets, while the MoFDP should develop strong investor relations and communication channels.

10. Financial stability and supervision remain critical areas for CD at the CBL. The CBL should complete implementation of the new financial stability report. Systemic risk monitoring should be enhanced alongside bank stress testing frameworks. On bank supervision, CD can help complete the risk-based supervision framework (on-site and off-site examinations, early warning, and recovery planning). While progress has been made with bank supervision, the nonbank financial sector requires extra attention. The authorities have expressed interest in IMF CD to implement recommendations from the forthcoming ESAAMLG mutual evaluation report. CD can also be sought to develop implementing regulations for the 2022 Financial Consumer Protection Act.

D. National Statistics

11. National accounts and inflation indices remain another critical area for CD. The Bureau of Statistics (BOS) remains underfunded and in need of capacity to improve GDP and CPI indicators. Incorrectly measured national accounts and inflation can undermine macroeconomic forecasting and policymaking. To avoid a sudden correction, resources must be directed to ensuring adequate data inputs from MDAs, support to undertake business surveys, and correctly compile CPI indices. The IMF continues to support the BOS with an active program of CD, but capacity must be built and retained within the BOS.

Table AVI.1. Lesotho: Capacity Development Priorities

Priorities	Objectives
Public Financial Management	Pass the PFMA Bill; strengthen budget processes; improve expenditure and procurement controls; enforce the use of IFMIS; financial reporting and accountability (including reconciliation of bank accounts); carry out fiscal risks assessments with regular reports; strengthen cash and liquidity management; gender responsive budgeting (medium term).
Macroeconomic Policy & Management	Develop tax policy unit with revenue forecasting capabilities; financial programming and macro-fiscal capabilities to support (i) production of medium-term fiscal framework, and (ii) design and implementation of fiscal rules; produce regular economic and fiscal bulletins.
Domestic Revenue Mobilization	Improve tax administration in line with TADAT (notably taxpayer registration, filing and payment compliance, management of tax arrears and VAT refund management; Review mining tax regime to minimize opportunities for international tax avoidance.
Monetary Policy Framework and Debt Management	Monetary operations; liquidity forecasting and management; develop domestic debt and money markets; improve payment systems supervision
Macroprudential Toolkit, Financial Regulation, and Financial Sector Supervision	On bank supervision: improve monitoring and stress testing; improve risk-based supervision (including on-site examinations, early intervention, and recovery planning). On nonbank supervision, improve data collection on and oversight of SACCOs, MFIs, and other nonbank payment service providers.

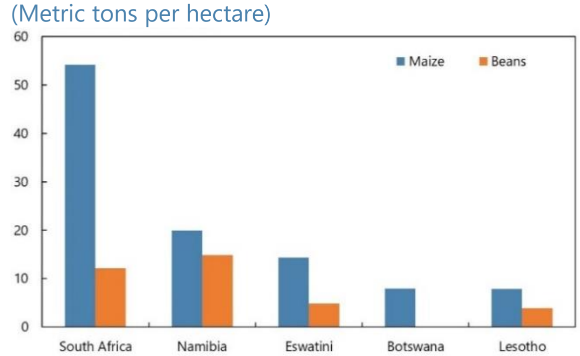
Table AVI.1. Lesotho: Capacity Development Priorities (conclude)

Priorities	Objectives
National Accounts	Develop and finalize expenditure-based annual national accounts; finalize quarterly national accounts.
Price Indices	Ensure integrity of aggregation and methodology for consumer price indices (CPI); develop producer price indices (medium term).
Government Finance Statistics	Harmonize above- and below-the-line data; expand coverage to include extrabudgetary units (SOEs and parastatals).
Monetary and Financial Statistics (MFS)	Expand coverage of MFS to include the largest nonbank financial institutions.

Annex VII. Agriculture in Lesotho

1. An underdeveloped agriculture sector and the high dependency on food imports has increased risks to food security. 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. Almost half of Basotho farmers work on plots of land less than a hectare and rely heavily on rainfed agriculture. According to the World Bank (2019), a lack of growth in agriculture income contributed to an increase in rural poverty by 4 percentage points during 2002–2016/17. The sector has been affected by repeated droughts and floods that reduced production and increased reliance on imports. The underdeveloped agriculture sector and the high dependency on food imports has also increased risks to food security. In addition to small farm size and repeated weather shocks, the sector faces several challenges including lack of irrigation, advisory services, market information, rural infrastructure, and access to credit that need to be addressed (World Bank 2022). Therefore, the modernization of agriculture—supported by investment in infrastructure, irrigation, and international standards—can help unlock inclusive growth, improve the livelihoods of rural households, and improve food security.

Maize and Beans Yield, 2021
(Metric tons per hectare)

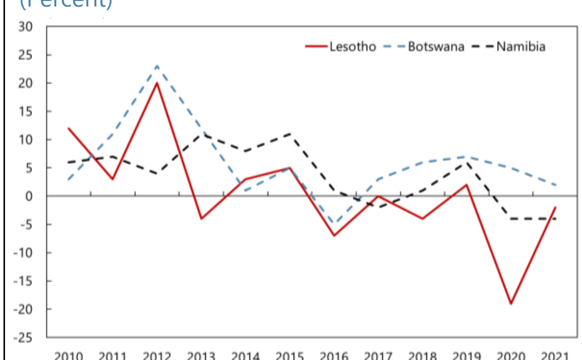


Sources: FAO and IMF staff calculations.

2. With limited arable land and low crop yields, the scope for raising agricultural productivity and the sector's resilience is large. According to World Bank (2018), the intensity of fertilizer application is much lower than neighboring countries. Fertilizer and seed subsidies, which are already poorly targeted, are also being delivered with delays, compromising their effectiveness. As a result, yields of key staples such as maize and beans have been much lower than that of other SACU members (chart). In addition, topography limits arable land, underlining the need for improving smallholders' productivity and reducing vulnerabilities.

3. Both public and private investment in agriculture is low. Agriculture has accounted for around 5 percent of total public spending, half of the 10 percent target set by the African Union members. In addition, it has been very volatile, increasing from 3.8 percent in 2016 to 15 percent in 2019 before declining to 2.4 percent in 2021. Credit growth to the sector has also been on a downward trend (chart). Weak enforcement of land laws, burdensome regulations, and limited

Real Growth of Credit to Agriculture
(Percent)



Sources: FAO and IMF staff calculations.

access to finance present strong barriers to entry and have left opportunities for commercial horticulture under-exploited and under-developed, for example, in fruit and vegetable farming, medical cannabis, poultry, dairy, and fisheries (on reservoirs developed by the Lesotho Highlands Water Project). Companies that were able to prove the value proposition to foreign investors have been able to: (i) secure long-term investment, (ii) overcome considerable fixed costs and regulatory hurdles, (iii) meet international standards, and (iv) secure access to external markets—such as in the medical cannabis sector. As outlined in the FY23/24 budget, the government also plans to increase productivity and invest aggressively in the sector.

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

June 30, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

African Department
(In consultation with other departments)

CONTENTS

RELATIONS WITH THE IMF

(As of May 31, 2023)

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)	80.27	115.01
Reserve Tranche Position	12.81	18.35

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	99.78	100.00
Holdings	75.77	75.94

Outstanding Purchases and Loans	**SDR Million**	**% Quota**
RCF loans	11.66	16.70
Emergency Assistance[1]	23.24	33.30
ECF[2] arrangements	0.57	0.81

Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	06/02/2010	09/17/2013	50.61	50.61
ECF[1]	03/09/2001	10/31/2004	24.50	24.50
Stand-By	09/23/1996	09/22/1997	7.17	0.0

Outright Loans:

Type	**Date of Commitment**	**Date Drawn/Expired**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
RCF	07/29/2020	07/31/2020	11.66	11.66
RFI	07/29/2020	07/31/2020	23.24	23.24

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

[2] Formerly PRGF.

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

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	3.47	11.62	8.72	2.33	2.33
Charges/interest	1.02	1.69	1.13	0.92	0.92
Total	**4.50**	**13.31**	**9.84**	**3.25**	**3.25**

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 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 Fund has provided technical assistance on drafting amendments to the CBL Act, are expected to be submitted to the Cabinet and discussions are underway to include other improvements to the draft law. 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 June 30, 2023, the maloti rate per U.S. dollar was LSL18.78.

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

Article IV Consultation

The 2022 Article IV consultation was concluded by the Executive Board on June 1, 2022. 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	**Date of Delivery**	**Beneficiary Agency**
IFMIS Diagnostic	Jun-23	MoFDP
Revenue Administration	May-23	MoFDP
Fiscal Rules	Apr-23	MoFDP
TADAT Assessment	Apr-23	RSL
Fiscal Reporting (AFS)	Apr-23	MoFDP
PFM Hackathon	Jan-23	MoFDP
Medium-Term Fiscal Framework (AFS)	Jan-23	MoFDP
Tax Debt Management (AFS)	Dec-22	RSL
Customs Administration (AFS)	Sep-22	RSL
Authorized Economic Operator (AEO) and Customs Border Management (CBM) (AFS)	Aug-22	RSL
Excise (AFS)	Aug-22	RSL
Gender Responsive Budgeting (AFS)	Jul-22	MoF
GovTech: Improving Digital Payments, Bank Reconciliation and Cash Consolidation	Jul-22	MoF
Macro Fiscal Forecasting (AFS)	Apr-22	MoF
Tax Debt Management (AFS)	Apr-22	RSL
Fiscal Risks Statement	Nov-21	MoF
Tax Policy Unit	May-21	MoF
Fiscal Risks Management	Apr-21	MoF
Fiscal Rules	Feb-21	MoF
Authorized Economic Operator Program	Dec-20	LRA
Excise Legislation	Nov-20	LRA
PFMA Bill Review and Quality Assurance	Sep-20	MoF
Data Analysis	May-20	MoF
AEO and CBM	Apr-20	LRA
Medium-Term Fiscal Framework	Dec-19	MoF
Fiscal Decentralization	Nov-19	MoF
Legal Department		
Public Debt and Aid Management Bill Review	Feb-23	MoFDP

Central Bank Act Amendments	Sep-21	CBL
Monetary and Capital Markets Department		
Risk-based Supervision Framework Enhancement	May-23	CBL
National Payment Systems Development	Apr-23	CBL
Financial Market Infrastructures Training	Apr-23	CBL
Risk-based Supervision Framework Enhancement -Risk Rating and SAP - Final	Jul-22	CBL
Risk-based Supervision Framework Enhancement -Risk Rating and SAP - Follow up	Feb-22	CBL
Basel II/III Reform Implementation - ICAAP assessment	Jul-21	CBL
Risk-based Supervision Framework Enhancement	Jun-21	CBL
FSSR Main Mission FY21-FY22	May-21	CBL
Basel II/III; DSIB Framework	Feb-21	CBL
Risk-Based Supervision	Nov-20	CBL
Basel II implementation	Mar-19	CBL
IFMIS and GFS	Jan-19	CBL
Statistics Department		
Financial Soundness Indicators	May-23	CBL
Real Sector: Review CPI Methods	Apr-23	BOS
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA (AFS)	Feb-23	BOS
Real Sector: Updating CPI	Jan-23	BOS
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA (AFS)	Sep-22	BOS
Real Sector: National Accounts (NA) - Accrued Budget	May-22	BOS
Monetary Financial Statistics	Jun-22	CBL
Government Finance Statistics	Apr 22	MOF
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA (AFS)	Mar-22	BOS
Real Sector: National Accounts - GDP, Business Register	Feb-22	BOS
External Sector: Balance of Payments	May-21	BOS
Government Finance: SOEs Fiscal Statistics	May-21	MOF
Real Sector: Updating CPI	Aug-21	BOS
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA	Nov-21	BOS
Real Sector: National Accounts (NA) - GDP/Source Data	Dec-21	BOS
Real Sector: National Accounts (NA) - GDP/Source Data	Dec-21	BoS

Notes: BOS = Bureau of Statistics; CBL = Central Bank of Lesotho; LRA = Lesotho Revenue Authority; MoF = Ministry of Finance; MoFDP = Ministry of Finance and Development Planning (formerly MoF); RSL = Revenue Services Lesotho (formerly LRA).

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 (AFRITAC South—AFS): http://www.southafritac.org/

STATISTICAL ISSUES

As of June 2023
I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance but with key data shortcomings in fiscal, national accounts, and price 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 production and expenditure (experimental). 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 experimental status, with slow progress in improving quarterly indicators for agriculture (livestock) and construction. Quarterly GDP estimates and annual GDP estimated using the expenditure approach should be finalized. Lack of funding to conduct the necessary surveys preclude accurate rebasing of the annual national accounts creating bias. Development of a plan for the next annual GDP rebase is ongoing with funding for key surveys a binding constraint in finalizing the plan and choosing the base year. Accuracy and timeliness can also be improved through greater data sharing by MDAs with the Bureau of Statistics, as incomplete business capture in the Revenue Services Lesotho VAT database means GDP estimation is delayed. Funding for the household budget survey and the upcoming 2026 Population Census has also yet to be secured.
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 updated the CPI weights using the 2017 Household Budget Survey (as opposed to the current weights based on 2010 expenditure data) and released a new CPI starting January 2023 with some errors that are being addressed with help of IMF CD. These errors must be resolved immediately to ensure the integrity of inputs for monetary policy to manage inflation. The work on developing producer price indices is still at an early stage and acknowledged as challenging given lack of inputs. 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 and Development Planning 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 persist and classification issues remain for some revenue and expenditure items. Broadening coverage and improving data accuracy remain critical for sound fiscal policy. Better use of IFMIS can improve the consistency of fiscal data and, therefore, improve forecasting, budgeting, and cash management. With coverage limited to the budgetary central government, other government operations at the local level and in autonomous entities (state-owned enterprises or extrabudgetary units) are, therefore, largely unfactored in fiscal policy. The authorities have started compiling GFS for local governments with help from IMF CD and are expected to start disseminating annually. 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. Comprehensive balance sheet data is currently not 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. 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.	
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 sectoral classification in the accounts. Following the June 2022 IMF CD mission, the central bank, and other depository corporations (ODCs) surveys now fully comply with the methodology of the MFSMCG. Efforts are underway to expand coverage to other financial corporations (OFC) to enable full consolidation of the financial corporations survey. The CBL in collaboration with IMF CD continues work on expanding coverage to all insurance companies (ICs) and pension funds (PFs). This includes the CBL's efforts to register pension funds since the Pension Fund Bill was enacted in November 2019. The collection of data is complicated by the fact that many of the PFs are umbrella funds, and that a significant number of PFs are part of the RSA Group, a multinational insurance group. The Monetary and Financial Statistics Section (MFSS) is advised to coordinate with the Pensions and Securities Supervision Division to introduce a call report form for PFs with the level of disaggregation needed for MFS. If data from all PFs are difficult to obtain, the MFSS should concentrate on the largest funds, in particular the Government Pension Fund. The CBL also reports several indicators in the Financial Access Survey, including 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 is making progress on the publication of financial soundness indicators (FSIs) in line with the latest 2019 FSI Compilation Guide, having previously reported based on the 2006 FSI Guide. Recently, the CBL also complied 11 core and eight additional FSIs for deposit-taking institutions. Efforts are also underway to extend the institutional coverage of FSI indicators for insurance companies and real estate markets While the regulatory and accounting data for banks are broadly consistent with Basel I and IFRS9 frameworks, more effort is needed to fill data gaps for the nonbank financial sector.	
Balance of Payments: Lesotho has improved the timeliness of submitting BPM6-based balance of payments (BOP) and (partial) IIP data to STA. The CBL has made progress in implementing the 2021 IMF CD recommendations on External Sector Statistics and incorporating the results of the private capital flow survey to collect financial account transactions and stock position data. Continued effort is needed to further enhance data quality and improve coverage, methodological soundness, and consistency between the BOP and IIP. 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.	
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 31, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	Mar-2023	Apr-2023	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Mar-2023	Apr-2023	D	D	Q
Reserve/Base Money	Mar-2023	Apr-2023	D	D	Q
Broad Money	Mar-2023	Apr-2023	M	M	Q
Central Bank Balance Sheet	Mar-2023	Apr-2023	D	D	Q
Consolidated Balance Sheet of the Banking System	Mar-2023	Apr-2023	D	D	Q
Interest Rates[3]	Mar-2023	Apr-2023	M	M	Q
Consumer Price Index	April-2023	May-2023	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	Mar-2023	May-2023	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Feb-2023	Apr-2023	Q	I	A
External Current Account Balance	Q4-2022	Apr-2023	Q	Q	Q
Exports and Imports of Goods and Services	Q4-2022	Apr-2023	Q	Q	Q
GDP/GNP	2021	Jan-2023	A	A	A
Gross External Debt	Q1-2023	May-2023	Q	Q	Q
International Investment Position[7]	Q4-2022	Apr-2023	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 general government 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 the general government.

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

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

June 30, 2023

Approved By
Andrea Richter Hume (AFR), Bergljot Barkbu (SPR), Asad Alam, and Manuela Francisco (WB)

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, with risks to debt sustainability broadly unchanged since the last DSA.[1] The surge in SACU transfers is expected to improve the fiscal balance in FY22/23 and help stabilize the public debt burden in the medium term. However, growing risks to debt from unaddressed contingent liabilities, exchange rate depreciation, and persistent domestic arrears, elevate debt sustainability risks. While debt indicators remain below their thresholds under the baseline scenario, stress tests indicate that both the PV of public debt-to-GDP and PV of PPG external debt-to-GDP are vulnerable to contingent liability, current transfers-to-GDP, exchange rate, and export shocks, breaching their thresholds in the near term. The moderate risk rating suggests limited space to absorb shocks. The use of windfall external transfers to amortize public debt over the medium term is critical to create a buffer against future volatility and setbacks in reform implementation. Improved efficiency on critical public infrastructure investment is needed to raise productivity and lift the growth outlook. Finally, addressing contingent liability risks, strengthening public financial management, and introducing robust and enforceable fiscal rules will be critical for maintaining debt sustainability.

[1] This DSA updated the previous Joint DSA from May 2022 (IMF Country Report No. 22/161). The DSA analysis reflects a debt carrying capacity of Medium considering Lesotho's Composite Indicator Index of 2.86, based on the IMF's April 2023 World Economic Outlook and the 2022 World Bank Country Policy and Institutional Assessment (CPIA).

PUBLIC DEBT COVERAGE

1. The coverage of the DSA remains broadly same since the last DSA in 2022 (Text Table 1). Debt coverage includes both external and domestic obligations.[2] The perimeter of the public debt includes the central government, central bank debt taken on behalf of the government, and government-guaranteed debt of SOEs.[3] Debt also includes domestic arrears, estimated at 1.8 percent of GDP as of March-2023.[4] The authorities have started publishing the Debt Transparency Report on the website of the Ministry of Finance Development and Planning in FY22/23 in agreement with the World Bank under the Sustainable Development Financing Policy (SDFP). The report also includes government-guaranteed debt of SOEs but total SOE debt is not available.

2. The DSA includes a contingent liability stress test to capture extrabudgetary units, SOEs, and financial market shocks in the assessment (Text Table 2).[5] The contingent liability stress test incorporates the following shocks:

- The pension fund financing gap—estimated at 7.4 percent of GDP.[6]
- Liabilities associated with potential asset seizures—estimated at 2.5 percent of GDP.[7]
- 5 percent of GDP for a financial market shock that exceeds the existing stock of banks' NPLs.

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[2] Definition of external/domestic debt is based on currency principle as the data on residency basis is not available and there are neither locally-issued FX-denominated debt nor significant foreign holdings of local currency debt.

[3] 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).

[4] Arrears to providers of goods and services to the government 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.

[5] The contingent liability stress test includes involves a one-off increase in the debt-to-GDP ratio in the second year of the projection. The shock has two components: (i) a minimum starting value of 5 percent of GDP (representing the average cost to the government of a financial crisis in a LIC since 1980; see Laeven and Valencia (2013); and (ii) a tailored value, reflecting additional potential shocks for portions of the public sector that are not included in the definition of public debt used in the DSA.

[6] 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 LSL3.1 billion as of March 31, 2021. As part of government's effort to support sustainability of the pension fund and reduce contingent liabilities, the authorities plan to cover about two-thirds of this financing gap (LSL2 billion) with ten equal annual installments of LSL200 million from the budget starting in the current fiscal year. The other one-third of the gap is to be covered by the pension fund's operating income, which in turn will be supported by increased contributions. Close monitoring of the execution of the government's recapitalization plan and the evolution of the pension scheme's unfunded liabilities and associated fiscal risks is required.

[7] Frazer Solar GmbH is seeking to enforce damages of EUR50 million related to a contract to supply solar power equipment to Lesotho. While the High Court of South Africa had decided in favor of the company in April 2021, the Commercial (High) Court of Lesotho ruled in November 2022 that the original contract was unconstitutional and invalid as the Loans and Guarantees Act (1967) provides that only the Minister of Finance has the authority to contract projects and loans on behalf of the government of Lesotho. However, Frazer Solar has dismissed the ruling and continues to pursue global enforcement proceedings.

- 3.7 percent of GDP for SOE debt, which is not captured in the country's definition of public debt. Calibration includes LSL1.5 billion as an estimate for non-guaranteed and on-lent debt of the six fully-owned and four majority-owned SOEs.[8]

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	10.0	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	0.0	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)			18.7	

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

3. **Lesotho's public debt has increased since the last DSA** (Text Table 3).[9] The gross public debt-to-GDP ratio has increased by 4.1 percentage points to 59.8 percent of GDP in FY22/23, reflecting both exchange rate valuation effects on external debt and growing domestic debt issuance. Given that foreign currency-denominated external debt—of which approximately 90 percent is US$-denominated—accounts for 75 percent of total debt, valuation effects from the strengthening U.S. dollar against the South African Rand (ZAR) and Maloti (LSL) have a material effect on the debt-to-GDP ratio. The ZAR depreciated against the US$ by 17 percent during FY22/23, contributing the lion's share of the increase. Higher domestic borrowing was mainly driven by the larger public spending due to the lower external transfers from the Southern African Customs Union (SACU).

4. **Debt relief under the Catastrophe Containment and Relief Trust (CCRT) and the Debt Service Suspension Initiative (DSSI), combined with new resources from the general SDR allocation, provided some fiscal space.** The authorities received SDR3.8 million relief on debt service under the CCRT

[8] The calibration includes an estimate of the portion of on-lent debt that is not accounted for in the government debt stock.

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

in 2021 and suspended roughly US$5 million under the DSSI supported by the G-20 and Paris Club.[10] The 2021 general SDR allocation (SDR66.9 million, US$95 million) remains on the balance sheet of the Central Bank of Lesotho (CBL) as part of international reserves. The authorities have not directly accessed SDRs through on-lending. However, the SDR allocation indirectly helped to ease fiscal financing constraints as government deposits—otherwise used to support international reserves—have been partially drawn down to meet public spending needs. Staff encourages the use of SDRs to bolster reserves and (indirectly) support priority (emergency) spending. The baseline scenario in the macroeconomic framework assumes no drawdown of SDR holdings. Instead, projections for net credit to government (NCG) and government deposits at the CBL available to meet public spending needs are informed by SDR holdings.

5. Most of Lesotho's external debt is owed to multilateral creditors on a concessional basis (Text Table 3). External debt accounts for 74 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. Debt owed to bilateral creditors accounts for less than 15 percent of total external public debt. Of this, China accounts for 70 percent.

6. The share of domestic public debt ([26.2] percent in FY22/23) has increased in recent years. Denominated in local currency, domestic debt has been issued through treasury bills and bonds at various maturities and is predominantly held by banks, insurance companies, and individuals (see Text Figure 1). The average yield was 8.5 percent in FY22/23. 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 absorption beyond regulatory compliance requirements. In an environment of limited financial intermediation, the government is also at risk of crowding out private sector borrowing.

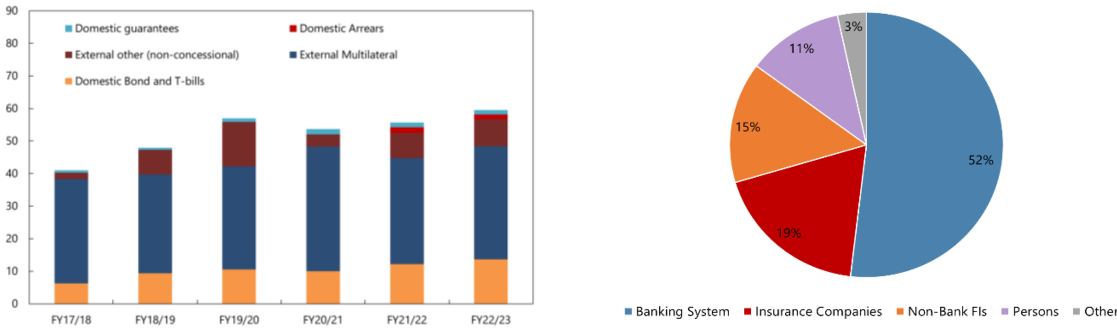
7. The authorities have received joint IMF-World Bank technical assistance on developing the local currency bond markets (LCBM). Key recommendations include to: (i) introducing short-term liquidity management instruments by the CBL to set the stage for primary market and money market development; (ii) improving integration of government cash and debt management and associated forecasting; (iii) recording and publishing trades on an aggregate basis; and (iv) fostering the development of the domestic investor base. Together with a prudent debt management strategy, the LCBM can play an important role in reducing high exposure to foreign-currency debt, provide a stable source of funding for public financing needs, and support financial development.

[10] The initiative provides a time-bound suspension of official bilateral debt service payments to IDA-eligible and least developed countries.

Figure 1. Domestic Public Debt and Holder Profile

Public and Publicly-Guaranteed Debt
(FY17/18 – FY22/23)

Domestic Debt Holder Profile
(As of Dec 31, 2022)



Text Table 3. Lesotho: Decomposition of Public Debt and Debt Service by Creditor, 2022/23–2024/25[1]

	Debt Stock (end of period)			Debt Service					
	2022/23			2022/23	2023/24	2024/25	2022/23	2023/24	2024/25
	(US$ Millions)	*Percent total debt)*	*(Percent GDP)*	*(In US$)*			*(Percent of GDP)*		
Total	1,474.0	100.0	59.8	184.2	134.0	136.9	7.5%	5.4%	5.6%
External	1,081.9	73.4	43.9	72.4	65.2	73.5	2.9%	2.6%	3.0%
Multilateral creditors[2]	828.5	56.2	33.6	53.2	52.5	60.7	2.2%	2.1%	2.5%
IMF	50.8	3.4	2.1						
World Bank	448.9	30.5	18.2						
ADB/AfDB/IADB	161.0	10.9	6.5						
Other Multilaterals	167.9	11.4	6.8						
o/w: European Investment Bank	75.0	5.1	3.0						
o/w: Arab Bank for Econ Dev in Africa	37.2	2.5	1.5						
o/w: International Fund for Agr Dev	36.5	2.5	1.5						
Bilateral Creditors	239.8	16.3	9.7	13.3	12.2	12.2	0.5%	0.5%	0.5%
Paris Club	-	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%
Non-Paris Club	239.8	16.3	9.7	13.3	12.2	12.2	0.5%	0.5%	0.5%
o/w: China	185.5	12.6	7.5						
o/w: Kuwait	20.9	1.4	0.8						
Bonds	-	0.0	0.0						
Commercial creditors	9.1	0.6	0.4						
Other international creditors	4.5	0.3	0.2						
Domestic	392.0	26.6	15.9	111.8	68.8	63.5	4.5%	2.8%	2.6%
T-Bills	91.3	6.2	3.7						
Bonds	195.8	13.3	7.9						
Loans	-	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	33.3	2.3	1.4						
Nominal GDP	2,463.8								

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.

ASSUMPTIONS

8. **The growth outlook remains subdued.** The baseline assumptions in the DSA are consistent with the macroeconomic framework outlined in the staff report for the 2023 Article IV Consultation for the Kingdom of Lesotho (Text Table 4). Headwinds from the global and regional slowdown are expected to drag on growth over the medium term, alongside delays to the second phase of the Lesotho Highlands

Water Project (LHWP-II), while the private sector needs time to gain momentum following years of resource misallocation from high and rigid public expenditure. In the absence of stronger consolidation, the fiscal deficit is assumed to widen, debt to accumulate and reserves to drain over the medium term. While SACU transfers are 9.4 percentage points of GDP higher in FY23/24 than FY22/23, the windfall over the next two years—around 5 percentage points of GDP relative to the past five-year average—is not expected to persist over the medium term. The fiscal balance and current account excluding LHWP-II-related imports will move into surplus before deficits reemerge over the medium-term. The windfall is also expected to help bolster reserves in FY23/24, which, absent consolidation, are also expected to erode gradually as deficits return. The government is expected to increase reliance on domestic financing as local currency bond markets develop, which will proportionally increase outstanding debt across both short-term and long-term maturities.

- **Real GDP growth**: The assumption for medium- and long-term growth remains at 1.5 percent as in the previous DSA but lower than the assumed 3.7 percent in 2020 DSA. Since 2020, the national accounts data revisions revealed a contraction in the economy over the last four years. The sluggish regional environment amid global financial tightening and the energy crises in South Africa coupled with Lesotho's longstanding structural weaknesses, weigh on growth.

- **Inflation:** Inflation is estimated to have peaked in FY22/23 and expected to subside gradually as global food and energy prices ease. As a result, the forecast for average inflation has been revised upward since last DSA to 5.4 percent over the medium term, reflecting higher commodity and energy prices. Over the long-term, inflation is assumed to remain driven by the monetary policy developments in South Africa and anchored within its inflation target range of 3–6 percent.

- **Fiscal deficit**: The assumed reduction in public expenditure over the medium term is smaller than the previous DSA. This reflects more limited consolidation given the alleviation of financing constraints from the surge in SACU transfers. While this would increase the primary deficit, it is also assumed to improve relative to the last DSA on the back of the SACU windfall. Under current projections, these transfers will average 18.8 percent of GDP over FY23/24–FY28/29. As a result, the primary fiscal balance is assumed to be in deficit on average by 0.4 percent of GDP over FY23/24–FY28/29, 2.4 percentage points smaller than the previous DSA.

- **External Sector**: While uncertainty over the LHWP-II and weaknesses in export sectors are expected to persist, higher-than-expected external SACU transfers—and the resulting improved fiscal balance—are expected to help improve the non-interest current account balance over the medium term, compared to the previous DSA. With limited consolidation efforts, the average current account deficit is assumed to widen to almost 4 percent of GDP over the long term. Average export and import growth (in US$ terms) over the medium term is expected to be weaker compared to the last DSA due to the valuation effects from the stronger US$.

Text Table 4. Lesotho: Macroeconomic Assumptions

	2020 DSA 2020–25	2022 DSA 2022–27	2023 DSA 2023–28	2020 DSA 2026–40	2022 DSA 2028–42	2023 DSA 2029–43
Real GDP Growth (Percent)	1.8	1.6	2.1	3.7	1.5	1.5
Inflation (Percent)	4.8	5.2	5.3	4.9	4.9	4.9
Primary Deficit (Percent of GDP)	1.9	2.8	0.4	0.5	0.8	0.4
USD Export Growth (Percent)	4.5	7.4	2.5	6.8	6.0	6.6
USD Import Growth (Percent)	3.9	5.4	2.3	5.7	5.8	6.5
Non-interest Current Account Balance (Percent of GDP)	-12.8	-8.9	-4.6	-1.6	-2.2	-3.6
Net FDI (negative = inflow)	-0.9	-1.2	-0.7	-0.9	-1.1	-0.8
Grant element of new public sector borrowing (in percent)	32.1	24.8	24.9	21.1	23.6	23.8
External Debt (Percent of GDP)	51.4	47.2	44.5	45.6	41.1	40.5
Public Sector Debt (Percent of GDP)	61.9	63.3	61.1	52.0	60.7	61.5

Sources: IMF Country Report No. 22/161 and IMF staff calculations.
Note: Average of 2023–28 is the average of FY23/24–FY28/29.

- **Concessional borrowing**: External loan disbursements in the DSA incorporate the authorities' most recent projections and reflect commitments with donors. The profile for external borrowing is assumed to remain broadly unchanged and will continue to be channeled by donors for investment (over 60 percent of total public financing). Concessional external borrowing is assumed to remain critical for financing large investment projects. The grant element for concessionality is assumed to remain broadly similar to the last DSA, both in the medium and long term.

- **Domestic borrowing**: In line with the authorities' medium-term goals, the development of the domestic debt market—which is being supported by joint IMF-WB capacity development—is assumed to continue. The baseline assumes that the share of domestic debt in total debt will be in line with financial sector growth. The profile for domestic borrowing and the mix of instruments to be used are assumed to remain broadly unchanged.

9. **The realism of the macroeconomic framework is confirmed by standard measures.** However, high uncertainly over the outlook and ongoing revisions to national accounts data call for caution for interpretating these results (Figures 3 and 4).

- **Public debt:** While baseline macroeconomic assumptions remain conservative, the projected increase in public debt is lower than in the past. Realism tools flag that (i) the projected three-year adjustment in the primary balance is in the top quartile and (ii) the estimated impact of consolidation on growth is lower than that implied by the default fiscal multipliers. These are largely due to the projected improvement in the primary fiscal balance driven by the rebound in SACU transfers in FY23/24 and FY24/25, which has raised cumulative inflows by 15 percentage points of GDP over the next five years compared to the previous DSA. In addition, GDP growth is also expected to be moderately boosted by LHWP-II-related construction and higher transfers. The more favorable contribution of GDP growth in the future debt dynamics compared to the past is also explained by (i) the rebound in activity as the economy reopened after the COVID-19 pandemic; and (ii) the 2021 national accounts data revision resulted in a reduction in nominal GDP for 2018–21, shrinking the

GDP denominator. The residuals, which contribute to the increase of the projected public debt ratio, are driven by the accumulation of government deposits at the central bank to beef up the international reserves. The unexplained change in public debt relative to the LIC median remains broadly the same compared to the previous DSA and is largely explained by the above-mentioned data revisions in national accounts.

- **External debt**: External debt is also lower than in the past for similar reasons as most external debt is public debt. Mirroring the fiscal balance, the current account balance excluding the LHWP-II project-related imports is projected to improve in the near-term. The large residuals to external debt accumulation are attributable entirely to capital transfers from South Africa, not captured in the DSA, used to finance the LHWP-II.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

10. 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 remittances. The composite indicator for the April 2023 WEO data and the World Bank's 2021 CPIA score yields a medium CI rating (2.86), similar to the previous vintage.

11. 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.

Text Table 5. Lesotho: Debt Carrying Capacity and Thresholds

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 2.86	Medium 2.90	Medium 2.97

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	3.303	1.27	44%
Real growth rate (in percent)	2.719	0.205	0.01	0%
Import coverage of reserves (in percent)	4.052	31.528	1.28	45%
Import coverage of reserves^2 (in percent)	-3.990	9.940	-0.40	-14%
Remittances (in percent)	2.022	15.494	0.31	11%
World economic growth (in percent)	13.520	2.898	0.39	14%
CI Score			2.863	100%
CI rating			Medium	

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

Reference: Thresholds by Classiciation

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23

TOTAL public debt benchmark	Weak	Medium	Strong
PV of total public debt in percent of GDP	35	55	70

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

12. **Under the baseline scenario, the PV of external debt-to-GDP ratio remains below but close to its corresponding thresholds** (Tables 1 and 2, and Figure 1). The present value (PV) of public and publicly guaranteed (PPG) external debt-to-GDP is expected to remain at broadly the same level in the coming years before gradually increasing again. Relatively lower external borrowing in the near-term term is the result of attenuated financing needs due to the recent windfall in SACU transfers. Over the medium term, the reprieve for the fiscal position fades as lower SACU transfers and the relative expansion of private sector investment raises the external financing needs once again. All indicators of external debt sustainability remain below their thresholds.

13. **Stress tests show that Lesotho's external debt is most vulnerable to current transfers-to-GDP,**[11] **exchange rate, 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 in the near term 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

14. **Under the baseline, the PV of total public debt-to-GDP remains below but close to its corresponding threshold** (Table 4 and Figure 2). The present value (PV) of total public debt-to-GDP is expected to moderately decline—primarily due to higher SACU transfers—before increasing again in the medium-term. The PV of public debt-to-GDP is expected to remain below the 55 percent threshold, in the medium term. The PV of the debt-to-revenue ratio is expected to increase due to sluggish revenue projections in the medium term. The debt service-to-revenue ratio is mainly driven by the changing mix of domestic and external financing. In the near term, domestic debt issuance falls amid improving fiscal balances and, over the medium term, Lesotho transitions toward domestic financing away from external borrowing on concessional terms.

15. **Stress tests show that Lesotho's public debt is vulnerable to a number of shocks in the standardized tests** (Table 4 and Figure 2). Along with current transfers-to-GDP and export shocks, the PV of public debt-to-GDP is most vulnerable to contingent liability, exchange rate, and real GDP growth shocks, all of which lead to a breach of the 55 percent threshold in the near term.

RISK RATING AND VULNERABILITIES

16. **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

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

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. The granularity of risk rating—assessing available space the country has to absorb shocks without being downgraded to a high-risk category—remains limited.

17. Risks to debt sustainability are tilted to the downside. The key risks are the realization of contingent liabilities, delayed fiscal adjustment, and further accumulating arrears. While external and total PV of debt-to-GDP ratios have improved, domestic and external risks remain high. Weak public financial management (PFM) and poor liquidity management—resulting in growing domestic arrears and the rapid increase in domestic debt—can quickly dry up fiscal space to absorb further shocks. Larger contingent liabilities also put debt sustainability at significant risk, for example, the civil service pension funding gap, weak SOE balance sheets, and asset seizures (from the dispute with Frazer Solar GmbH). On the external side, the slowdown in external demand will weigh on the debt outlook, for example, sluggish growth in South Africa will impact remittances and a broader regional slowdown in domestic demand across SACU could lead to lower-than-expected imports and, therefore, SACU transfers. Exchange rate valuation effects amid global financial tightening are also a material risk for external debt. However, grant-financed infrastructure megaprojects, such as the LHWP-II, remain supportive to the growth and debt outlook.

18. Fiscal consolidation coupled with reforms to improve governance and spending efficiency remain critical for debt sustainability. The DSA highlights the need for fiscal consolidation—via controlling recurrent expenditure, improving the efficiency of capital spending, and addressing PFM weaknesses to reduce arrears and contingent liability risks—supported by structural reforms to promote higher and sustainable private sector-led growth. The DSA also calls for a conservative debt management strategy focused on concessional sources wherever possible and pursuing objectives to develop local currency debt. Finally, efforts are needed to further increase coverage, quality, and relatability of debt statistics.

Authorities' Views

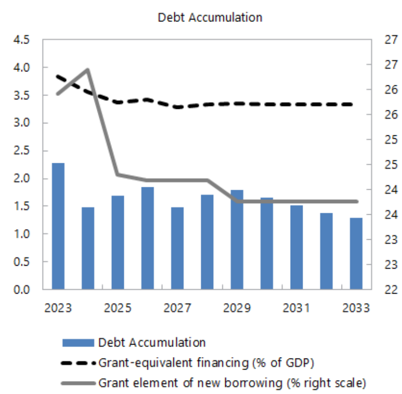
19. The authorities concurred with staff's assessment and the need for fiscal consolidation and prudent debt management to reduce debt vulnerabilities over the medium term. They acknowledged the opportunity that the SACU windfall provides to limit net increases in debt and support macroeconomic stability over the medium-term, while also maintaining a conservative debt management strategy that does not crowd out the private sector. They underscored the need for the Ministry of Finance and Development Planning and the Central Bank of Lesotho to push ahead with the development of local currency bonds markets. The authorities also noted progress in addressing the funding gap of the pension fund and reiterated their commitment to improve monitoring of contingent liabilities to ensure a comprehensive overview of debt.

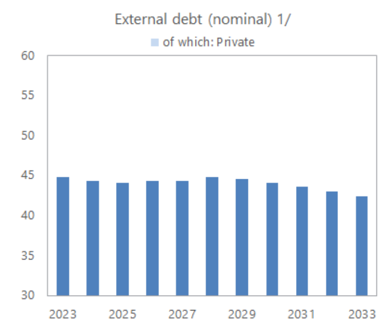
Table 1. Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2023–43

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2033	2043	Historical	Projections
External debt (nominal) 1/	42.1	40.4	43.9	44.8	44.3	44.1	44.3	44.4	44.9	42.4	36.7	39.4	43.9
of which: public and publicly guaranteed (PPG)	42.1	40.4	43.9	44.8	44.3	44.1	44.3	44.4	44.9	42.4	36.7	39.4	43.9
Change in external debt	-3.3	-1.8	3.6	0.9	-0.5	-0.2	0.2	0.1	0.5	-0.6	-0.4		
Identified net debt-creating flows	4.9	-1.0	8.5	0.9	2.4	6.9	5.5	3.9	2.8	3.0	3.3	2.3	3.5
Non-interest current account deficit	0.2	3.8	7.2	1.8	3.4	7.9	6.3	4.6	3.3	3.5	3.8	3.8	4.2
Deficit in balance of goods and services	52.2	45.4	45.2	47.8	48.4	47.9	45.7	43.9	42.6	45.8	52.9	48.8	45.9
Exports	39.4	44.4	44.9	44.3	44.3	43.9	44.1	43.8	43.6	47.3	55.8		
Imports	91.7	89.8	90.1	92.1	92.7	91.8	89.7	87.7	86.2	93.1	108.7		
Net current transfers (negative = inflow)	-32.3	-22.9	-19.4	-28.1	-27.8	-23.1	-22.4	-22.3	-22.2	-24.0	-27.9	-26.5	-24.1
of which: official	-26.6	-17.3	-14.1	-22.9	-22.8	-18.3	-17.6	-17.6	-17.6	-19.0	-22.2		
Other current account flows (negative = net inflow)	-19.7	-18.8	-18.6	-17.8	-17.2	-16.9	-17.0	-17.0	-17.1	-18.4	-21.1	-18.4	-17.5
Net FDI (negative = inflow)	-1.2	1.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8	-0.9	-2.4	-0.7
Endogenous debt dynamics 2/	5.9	-6.2	2.1	-0.2	-0.2	-0.3	-0.1	0.0	0.2	0.3	0.4		
Contribution from nominal interest rate	0.8	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.9	0.9		
Contribution from real GDP growth	2.0	-0.6	-0.9	-0.9	-1.0	-1.1	-0.9	-0.8	-0.7	-0.6	-0.5		
Contribution from price and exchange rate changes	3.2	-6.2	2.2	...	...	...	...	...	...	...	...		
Residual 3/	-8.2	-0.8	-5.0	0.0	-3.0	-7.1	-5.3	-3.9	-2.3	-3.7	-3.7	-1.3	-3.7
of which: exceptional financing	-2.8	-0.2	0.0	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	...	...	29.4	32.1	32.0	32.2	32.7	33.2	33.9	33.3	29.1		
PV of PPG external debt-to-exports ratio	...	...	65.4	72.5	72.2	73.4	74.3	75.8	77.7	70.3	52.3		
PPG debt service-to-exports ratio	7.2	5.3	6.5	6.1	6.8	6.3	5.7	5.8	5.8	6.4	5.3		
PPG debt service-to-revenue ratio	5.7	5.6	7.6	5.6	6.4	6.3	5.8	5.9	5.8	7.0	6.8		
Gross external financing need (Million of U.S. dollars)	39.5	192.0	230.9	93.2	144.8	265.1	225.2	184.6	151.8	215.9	356.7		
Key macroeconomic assumptions													
Real GDP growth (in percent)	-3.9	1.8	2.1	2.1	2.3	2.5	2.1	1.8	1.6	1.5	1.5	0.3	1.9
GDP deflator in US dollar terms (change in percent)	-6.5	17.1	-5.2	-3.6	2.7	2.0	1.8	1.3	1.2	3.3	3.3	0.1	2.0
Effective interest rate (percent) 4/	1.5	1.8	1.8	1.6	1.7	1.8	1.9	1.9	2.0	2.2	2.5	1.7	1.9
Growth of exports of G&S (US dollar terms, in percent)	-25.4	34.4	-2.1	-2.8	5.0	3.6	4.4	2.5	2.5	6.6	6.7	2.0	4.3
Growth of imports of G&S (US dollar terms, in percent)	-11.6	16.9	-2.8	0.6	5.8	3.6	1.7	0.8	1.1	6.5	6.5	-1.0	4.3
Grant element of new public sector borrowing (in percent)	...	...	...	25.9	26.4	24.2	24.2	24.2	23.8	23.8	23.8	...	24.4
Government revenues (excluding grants, in percent of GDP)	50.4	41.9	38.3	48.8	47.1	43.6	43.2	43.3	43.3	43.4	43.7	45.2	44.4
Aid flows (in Million of US dollars) 5/	796.0	823.3	799.0	118.0	114.5	100.7	105.7	103.8	109.1	139.3	222.0		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	3.8	3.6	3.4	3.4	3.3	3.3	3.3	3.3	...	3.4
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	52.0	55.3	54.3	55.6	58.0	56.5	55.5	56.2	...	55.2
Nominal GDP (Million of US dollars)	2,133	2,544	2,464	2,426	2,550	2,667	2,773	2,861	2,942	3,737	6,029		
Nominal dollar GDP growth	-10.2	19.2	-3.2	-1.5	5.1	4.6	4.0	3.1	2.8	4.9	4.9	0.4	3.9
Memorandum items:													
PV of external debt 7/	...	...	29.4	32.1	32.0	32.2	32.7	33.2	33.9	33.3	29.1		
In percent of exports	...	...	65.4	72.5	72.2	73.4	74.3	75.8	77.7	70.3	52.3		
Total external debt service-to-exports ratio	7.2	5.3	6.5	6.1	6.8	6.3	5.7	5.8	5.8	6.4	5.3		
PV of PPG external debt (in Million of US dollars)			723.6	779.8	815.6	858.8	907.8	948.8	997.5	1242.6	1757.1		
(PVt-PVt-1)/GDPt-1 (in percent)				2.3	1.5	1.7	1.8	1.5	1.7	1.3	1.1		
Non-interest current account deficit that stabilizes debt ratio	3.5	5.5	3.6	0.9	3.9	8.1	6.1	4.6	2.9	4.1	4.3		

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, 2023–33

(In percent of GDP)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
PV of debt-to GDP ratio											
Baseline	32	32	32	33	33	34	34	34	34	34	33
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	32	33	30	29	28	28	29	29	29	30	30
B. Bound Tests											
B1. Real GDP growth	32	32	35	35	36	37	37	37	37	36	36
B2. Primary balance	32	32	34	35	36	37	37	37	37	36	36
B3. Exports	32	32	**44**	**45**	**45**	**46**	**46**	**46**	**46**	**45**	**44**
B4. Other flows 3/	32	32	**42**	**43**	**44**	**44**	**45**	**44**	**43**	**42**	**41**
B5. Depreciation	32	32	**43**	**44**	**45**	**47**	**49**	**50**	**51**	**51**	**52**
B6. Combination of B1-B5	32	32	33	34	34	35	35	35	35	35	35
C. Tailored Tests											
C1. Combined contingent liabilities	32	32	**44**	**45**	**46**	**48**	**48**	**48**	**48**	**48**	**47**
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	72	72	73	74	76	78	77	75	74	72	70
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	72	75	69	65	64	65	65	64	64	64	64
B. Bound Tests											
B1. Real GDP growth	72	72	73	74	76	78	77	75	74	72	70
B2. Primary balance	72	72	78	80	81	84	83	82	80	78	76
B3. Exports	72	72	116	118	120	123	121	119	115	111	107
B4. Other flows 3/	72	72	97	98	100	102	100	98	94	91	87
B5. Depreciation	72	72	98	101	104	108	109	111	111	110	109
B6. Combination of B1-B5	72	72	65	82	84	86	85	84	83	82	80
C. Tailored Tests											
C1. Combined contingent liabilities	72	72	101	103	106	109	109	107	105	103	100
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	7	6	6	6	6	6	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	6	7	7	6	6	6	7	7	7	7	7
B. Bound Tests											
B1. Real GDP growth	6	7	6	6	6	6	6	6	6	6	6
B2. Primary balance	6	7	6	6	6	6	6	6	7	7	7
B3. Exports	6	7	8	8	8	8	8	9	10	10	10
B4. Other flows 3/	6	7	7	6	7	7	7	8	8	8	8
B5. Depreciation	6	7	6	6	7	7	7	7	9	9	9
B6. Combination of B1-B5	6	7	8	7	7	7	7	7	7	7	7
C. Tailored Tests											
C1. Combined contingent liabilities	6	7	7	7	7	7	7	7	7	7	7
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	6	6	6	6	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	6	7	7	6	6	6	7	7	7	7	7
B. Bound Tests											
B1. Real GDP growth	6	6	7	6	6	6	7	7	7	7	8
B2. Primary balance	6	6	6	6	6	6	6	7	7	7	8
B3. Exports	6	6	7	7	7	7	7	8	9	9	9
B4. Other flows 3/	6	6	7	7	7	7	7	8	9	9	9
B5. Depreciation	6	6	6	7	7	7	7	7	9	10	10
B6. Combination of B1-B5	6	6	7	6	6	6	7	7	7	7	7
C. Tailored Tests											
C1. Combined contingent liabilities	6	6	7	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	18	18	18	18	18	18	18	18	18	18	18

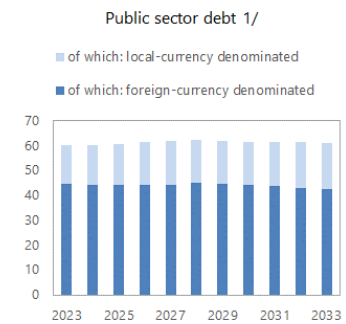
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private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

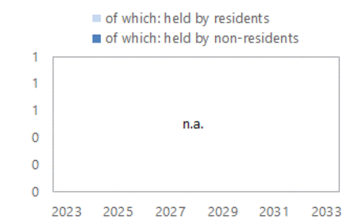
Table 3. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2023–43

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2033	2043	Historical	Projections
Public sector debt 1/	53.6	55.7	59.8	60.4	60.4	60.7	61.3	61.8	62.3	61.2	61.7	48.5	61.3
of which: external debt	42.1	40.4	43.9	44.8	44.3	44.1	44.3	44.4	44.9	42.4	36.7	39.4	44.0
Change in public sector debt	-3.3	2.1	4.1	0.5	0.0	0.3	0.6	0.5	0.5	-0.1	0.1		
Identified debt-creating flows	-8.4	0.6	11.5	-4.7	-2.5	1.0	1.2	0.9	0.8	0.5	0.6	3.0	-0.1
Primary deficit	-1.5	3.8	6.2	-2.6	-1.3	2.0	1.9	1.3	1.1	0.5	0.2	2.4	0.4
Revenue and grants	53.4	44.9	41.5	51.4	49.7	46.1	45.7	45.8	45.8	45.9	46.2	48.6	46.7
of which: grants	3.0	3.1	3.2	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5		
Primary (noninterest) expenditure	51.8	48.7	47.6	48.7	48.4	48.0	47.6	47.1	46.9	46.4	46.4	51.0	47.2
Automatic debt dynamics	-6.8	-3.2	5.3	-2.1	-1.2	-1.0	-0.7	-0.4	-0.3	0.0	0.4		
Contribution from interest rate/growth differential	2.2	-1.9	-2.9	-2.1	-1.2	-1.0	-0.7	-0.4	-0.3	0.0	0.4		
of which: contribution from average real interest rate	-0.1	-1.0	-1.8	-0.8	0.1	0.5	0.5	0.7	0.7	1.0	1.3		
of which: contribution from real GDP growth	2.3	-0.9	-1.2	-1.2	-1.4	-1.5	-1.3	-1.1	-1.0	-0.9	-0.9		
Contribution from real exchange rate depreciation	-9.0	-1.3	8.2	...	...	...	...	...	...	...	...		
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	5.0	1.4	-7.3	5.2	2.5	-0.7	-0.6	-0.3	-0.3	-0.6	-0.5	-1.0	0.2
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	47.1	47.7	48.1	48.7	49.7	50.6	51.4	52.1	54.1		
PV of public debt-to-revenue and grants ratio	...	...	113.5	92.8	96.7	105.8	108.7	110.4	112.1	113.6	117.0		
Debt service-to-revenue and grants ratio 3/	5.4	10.9	18.7	10.8	11.6	12.4	12.0	12.8	13.5	15.3	18.2		
Gross financing need 4/	1.4	8.7	13.9	2.9	4.5	7.7	7.4	7.2	7.3	7.5	8.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	-3.9	1.8	2.1	2.1	2.3	2.5	2.1	1.8	1.6	1.5	1.5	0.3	1.8
Average nominal interest rate on external debt (in percent)	1.8	1.6	1.8	1.7	1.7	1.8	1.9	1.9	2.0	2.2	2.5	1.7	2.0
Average real interest rate on domestic debt (in percent)	-3.0	1.5	1.1	0.5	2.2	3.3	3.4	3.8	3.7	4.4	4.5	-0.8	3.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-19.0	-3.2	21.9	...	...	...	...	...	...	...	...	3.4	...
Inflation rate (GDP deflator, in percent)	3.5	6.3	8.4	6.7	5.3	4.8	5.0	4.9	5.0	4.9	4.9	6.9	5.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.2	-4.3	-0.1	4.5	1.6	1.7	1.2	0.8	1.2	1.5	1.5	-1.4	1.6
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.8	1.7	2.0	-3.2	-1.3	1.7	1.3	0.8	0.6	0.6	0.1	1.9	0.3
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**





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, 2023–33

(In percent of GDP)

	Projections 1/										
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
PV of Debt-to-GDP Ratio											
Baseline	48	48	49	50	51	51	51	52	52	52	52
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	48	48	49	51	52	54	55	**56**	**57**	**59**	**60**
B. Bound Tests											
B1. Real GDP growth	48	48	52	55	**57**	**59**	**60**	**62**	**63**	**65**	**66**
B2. Primary balance	48	48	52	53	54	54	54	54	55	55	55
B3. Exports	48	48	**56**	**57**	**58**	**59**	**59**	**59**	**59**	**59**	**58**
B4. Other flows 3/	48	48	**59**	**60**	**61**	**62**	**62**	**62**	**61**	**61**	**60**
B5. Depreciation	48	48	**60**	**59**	**58**	**57**	**56**	55	54	54	53
B6. Combination of B1-B5	48	48	51	51	52	53	53	53	53	53	54
C. Tailored Tests											
C1. Combined contingent liabilities	48	48	**61**	**62**	**64**	**65**	**66**	**66**	**66**	**66**	**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	93	97	106	109	110	112	112	112	113	113	114
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	93	97	107	111	114	117	119	122	125	128	131
B. Bound Tests											
B1. Real GDP growth	93	97	113	119	124	129	131	135	138	141	144
B2. Primary balance	93	97	112	115	117	119	118	119	119	119	120
B3. Exports	93	97	122	125	127	129	129	129	128	127	127
B4. Other flows 3/	93	97	128	131	133	135	135	134	133	132	131
B5. Depreciation	93	97	131	129	126	124	121	120	118	117	116
B6. Combination of B1-B5	93	97	111	112	114	116	115	116	116	116	117
C. Tailored Tests											
C1. Combined contingent liabilities	93	97	100	105	109	113	115	117	119	120	122
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	12	12	12	13	14	14	15	15	15	15
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	11	12	12	12	13	14	14	16	15	16	16
B. Bound Tests											
B1. Real GDP growth	11	12	13	13	14	15	15	17	17	18	18
B2. Primary balance	11	12	12	13	13	14	14	16	15	16	16
B3. Exports	11	12	12	13	13	14	14	16	16	17	17
B4. Other flows 3/	11	12	13	13	13	14	14	17	17	17	17
B5. Depreciation	11	12	12	12	13	13	14	15	15	15	15
B6. Combination of B1-B5	11	12	13	12	13	14	14	16	15	16	16
C. Tailored Tests											
C1. Combined contingent liabilities	11	12	15	15	16	16	17	17	16	17	17
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.

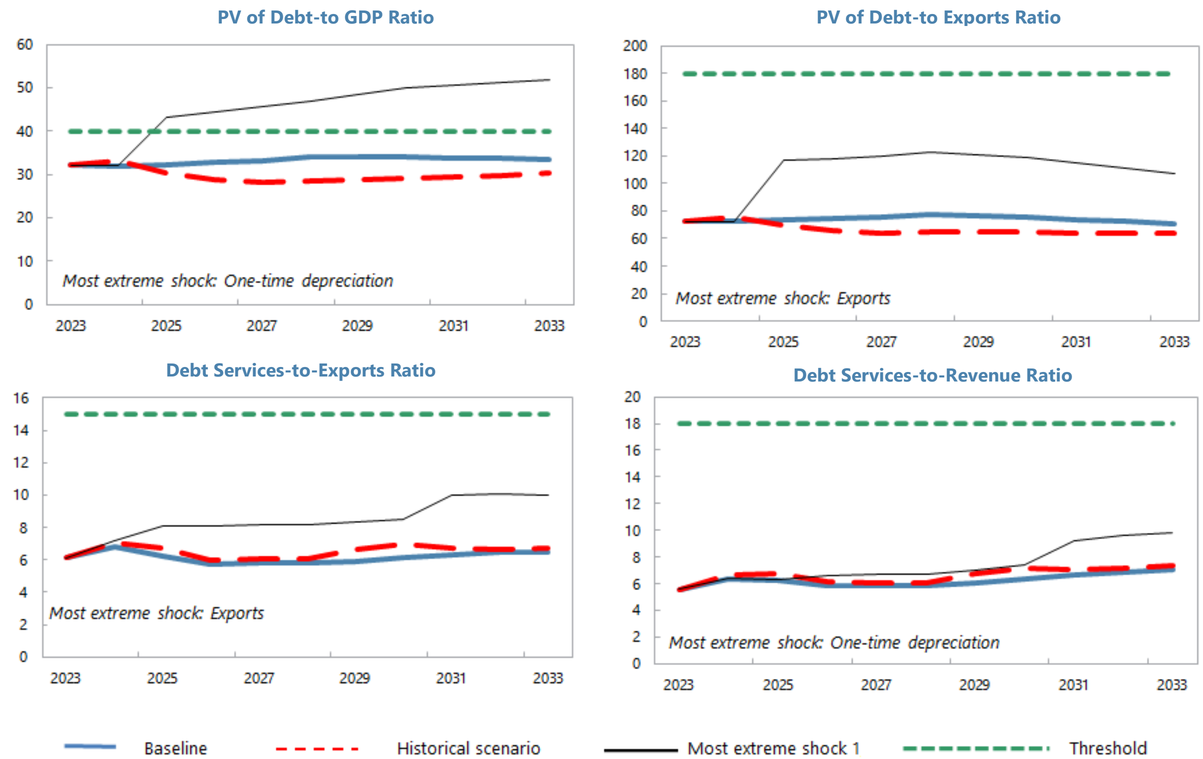
Sources: Country authorities; and staff estimates and projections.

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 Alternative Scenarios, 2023–33



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.

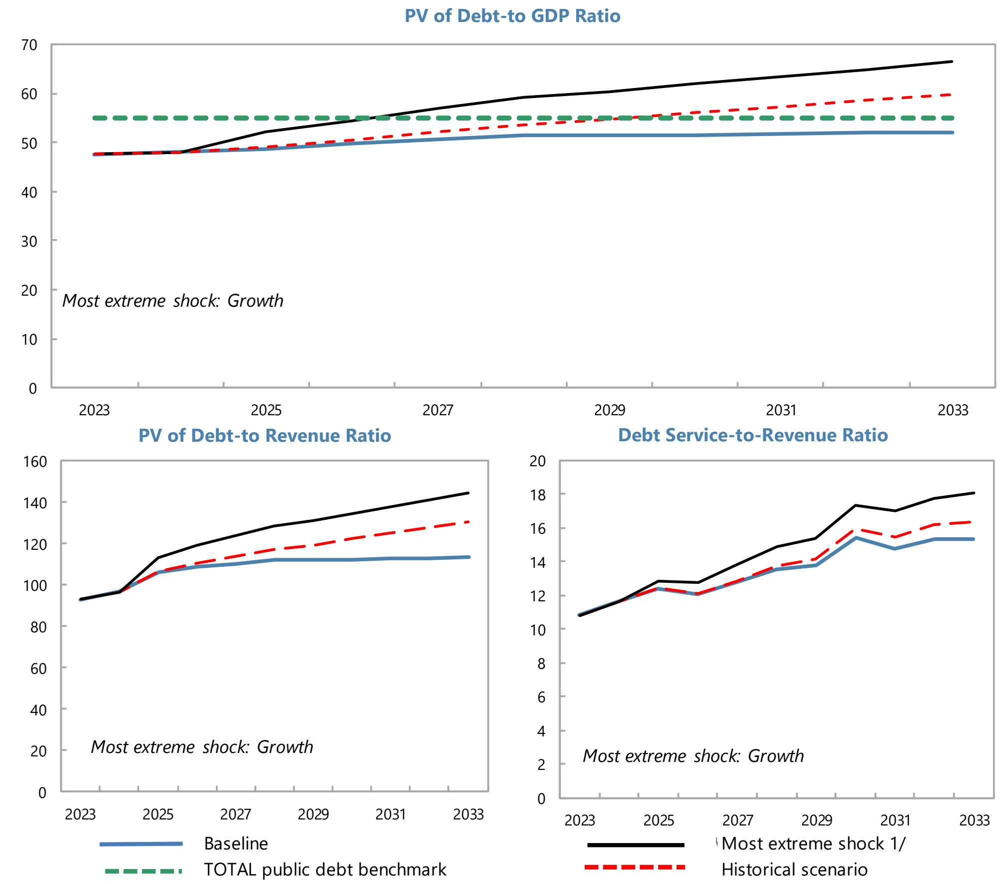
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.6%	2.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	22	22
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 2033. 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 2. Lesotho: Indicators of Public Debt Under Alternative Scenarios, 2023–33



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	51%	80%
Domestic medium and long-term	49%	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)	22	22
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.7%	4.7%
Avg. maturity (incl. grace period)	5	5
Avg. grace period	4	0
Domestic short-term debt		
Avg. real interest rate	2.1%	2.1%

* 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.

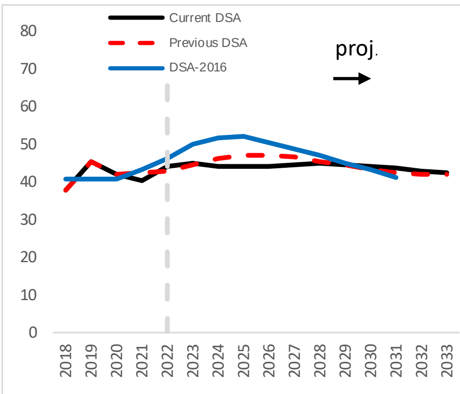
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. 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.

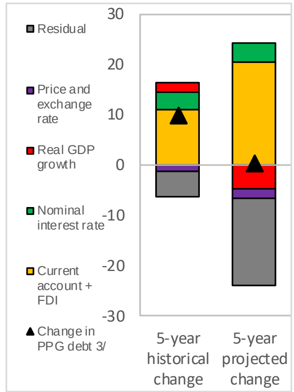
Figure 3. Lesotho: Drivers of Debt Dynamics – Baseline Scenario

External Debt

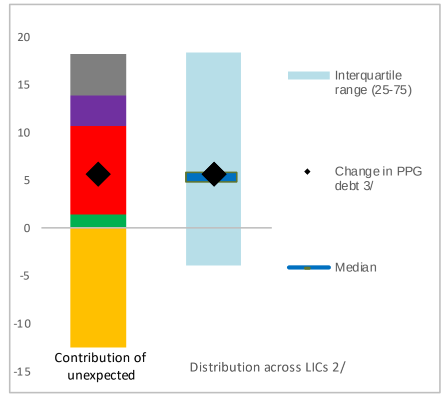
Gross Nominal PPG External Debt
(In percent of GDP; DSA vintages)



Debt-Creating Flows
(Percent of GDP)

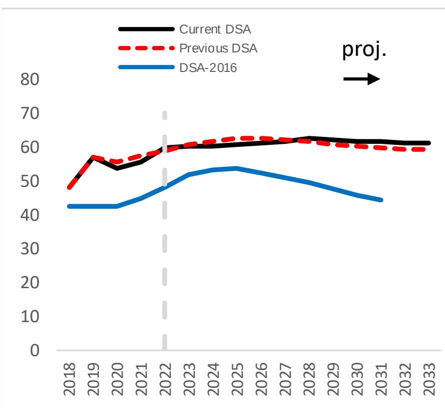


Unexpected Changes in Debt 1/
(Past 5 years, percent of GDP)

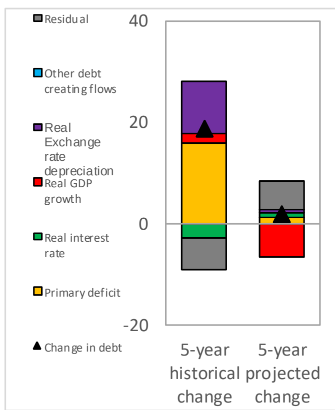


Public Debt

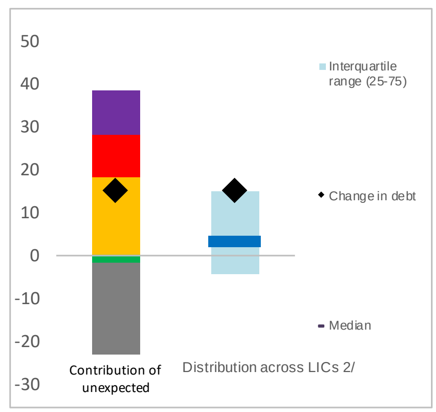
Gross Nominal Public Debt
(In percent of GDP; DSA vintages)



Debt-Creating Flows
(Percent of GDP)



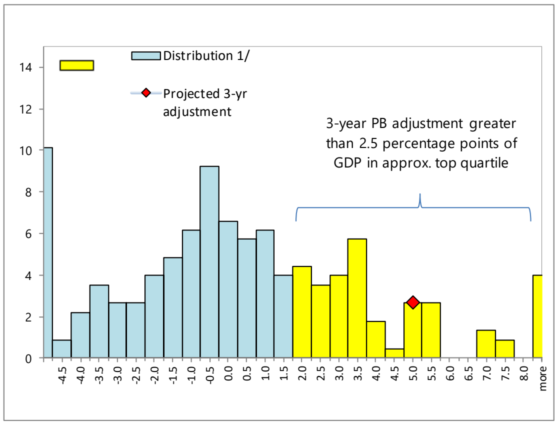
Unexpected Changes in Debt 1/
(Past 5 years, percent of GDP)



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.

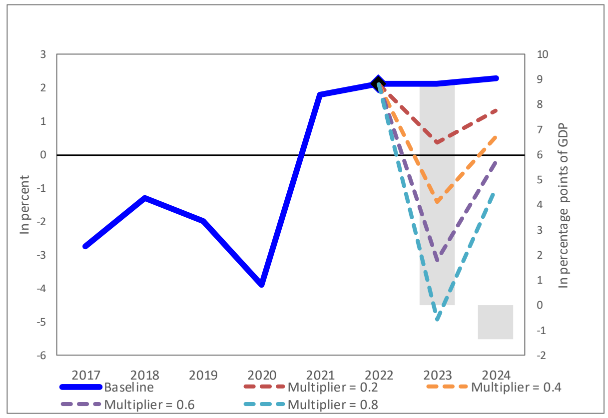
Figure 4. Lesotho: Realism Tools

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



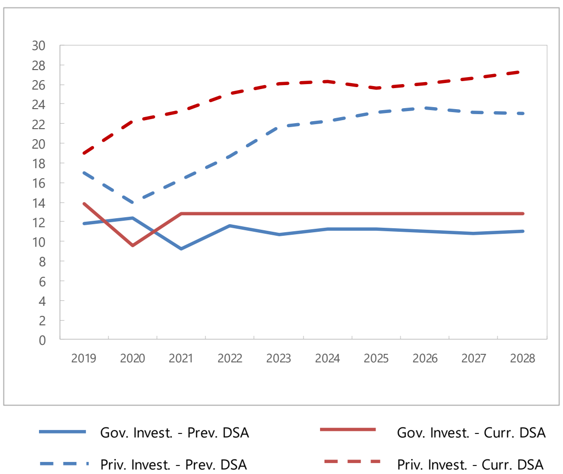
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

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)

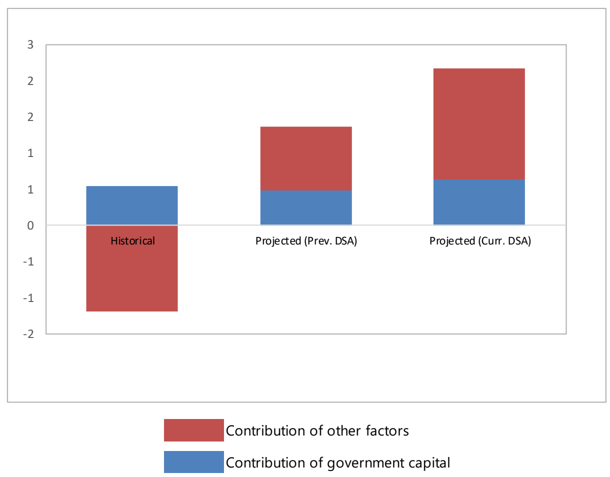


Figure 5. Lesotho: Qualification of the Moderate Category, 2023–2033[1/]

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 Services/Exports and Debt Service/Revenue thresholds, x is 12 percent and y is 35 percent.