INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/288

KINGDOM OF LESOTHO

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KINGDOM OF LESOTHO

September 2024

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 2024 Article IV consultation with Kingdom of Lesotho, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 6, 2024, consideration of the staff report that concluded the Article IV consultation with Kingdom of Lesotho.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 6, 2024, following discussions that ended on June 14, 2024, 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 August 22, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Kingdom of Lesotho.

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

Selected Issues

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2024 Article IV Consultation with Kingdom of Lesotho

FOR IMMEDIATE RELEASE

- *Lesotho's GDP growth has improved modestly, picking up to 2.2 percent in the fiscal year ending in March 2024. Inflation increased in the second half of 2023, peaking at 8.2 percent in January 2024. But upward pressures have eased, and inflation has since fallen to 6.5 percent in June.*
- *The outlook for Lesotho's fiscal and external balances has improved significantly owing to windfall transfers from the Southern African Customs Union (SACU) and renegotiated water royalties.*
- *In this context, and amid Lesotho's sizable development needs, a key challenge for the authorities will be to ensure that this revenue is saved wisely and spent strategically.*

Washington, DC – **September 11:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Kingdom of Lesotho.

GDP growth picked up modestly to 2.2 percent in 12-month period ending March 2024, compared with 1.6 percent a year earlier. This largely reflects accelerated construction from the Lesotho Highlands Water Project. Nonetheless, unemployment remains high, diamond and textile exports have been sluggish, and an exceptional dry season increased food-security concerns across the country.

Headline inflation reached 6.5 percent in June, up from 4.5 percent in July 2023, though down from a peak of 8.2 percent in January 2024. The increase in inflation was largely due to exogenous factors that will most likely fade going forward.

Lesotho registered a sizable fiscal surplus of 6.1 percent of GDP in during the fiscal year ending March 2024. In a change from past practice, transitory SACU transfers (10.4 percent of GDP higher than in FY22/23) were not accompanied by a parallel increase of the public wage bill. Instead, the authorities used the SACU proceeds to reduce arrears and rebuild deposits at the Central Bank.

In support of the Loti's peg to the Rand, the Central Bank of Lesotho has kept the policy rate steady at 7.75 percent since May 2023, in line with policy rates in South Africa.

Financial conditions remain stable—private sector credit growth picked up to 12.5 percent in FY23/24, mainly due to construction, while the nonperforming loans have eased to 3.8 percent of total loans as of 2023 Q4.

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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.

Growth is projected to peak in the fiscal year ending in March 2025 (at 2.7 percent), while inflation is expected to ease slowly. Another year of windfall SACU transfers (6 percentage points of GDP above the 10-year average) will again bolster fiscal and external balances in FY24/25. These transfers are projected to fall sharply starting in FY25/26, though higher water royalties will help fill the gap. As a result, the fiscal balance is projected at a surplus of around 1 percent of GDP over the medium term, with the current account deficit at a modest 2.6 percent.

The authorities are encouraged to continue their prudent fiscal approach, ensuring that additional revenues are saved wisely and spent strategically, while also pushing ahead with reforms to support private sector-led growth.

Executive Board Assessment[2]

Directors agreed with the thrust of the staff appraisal. They welcomed the recent pickup in growth but concurred that Lesotho's economy faces substantial challenges, including high unemployment, widespread poverty, and sluggish growth. They also noted the risks posed by global growth shocks, extreme weather events, uncertain transfers from the South African Customs Union (SACU), and commodity price volatility. Against this background, Directors welcomed the authorities' commitment to strengthening policy frameworks, supported by Fund capacity development as needed.

Directors emphasized the need for continued fiscal prudence to strengthen foreign exchange reserve coverage, safeguard the peg, and preserve medium-term debt sustainability. They agreed that containing the public wage bill, increasing spending efficiency, and prioritizing social spending on the most vulnerable remain critical. Given increased water royalties, Directors encouraged the authorities to establish a well-governed savings framework anchored by a credible fiscal rule to build buffers and support Lesotho's long-term development objectives.

Directors agreed that public financial management (PFM) should be strengthened. They encouraged passage of PFM-related legislation, and improved budget processes, strengthened internal controls, and enhanced financial reporting. Directors also underscored the importance of boosting public investment efficiency, through a prioritized capital project pipeline with enhanced project management capacity.

Directors concurred that monetary policy should focus on price stability and safeguarding the exchange rate peg. They noted the slowdown in inflation, but urged the authorities to monitor price dynamics closely and stand ready to adjust monetary policy if inflationary pressures reemerge. Directors encouraged the authorities to improve central bank governance and coordinate closely across institutions on fiscal and monetary policies.

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

Directors noted that the financial sector remains stable and encouraged continued monitoring of risks, including from the nonbank financial sector. They concurred that an updated national financial inclusion strategy would be key to improving financial intermediation and supporting private sector growth. They welcomed the progress made in strengthening legal and regulatory frameworks for financial stability and AML/CFT.

Directors strongly encouraged the authorities to implement much-needed structural reforms to catalyze job-rich inclusive growth, including by improving the business environment, strengthening governance, and reducing corruption risks. They lauded the authorities' commitment to improving data quality and timeliness to support policymaking.

Lesotho: Selected Economic Indicators, 2020/21–2029/30[1]

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
	(12-month percent change, unless otherwise indicated)									
National Account and Prices										
GDP at constant prices (including LHWP-II)	-5.3	1.7	1.6	2.2	2.7	2.4	1.9	2.1	2.1	2.1
GDP at constant prices (excluding LHWP-II)	-3.0	4.4	1.4	1.5	1.6	1.7	1.8	1.9	1.9	2.0
GDP at market prices (Maloti billions)	34.2	36.0	38.5	41.5	45.2	48.8	52.4	56.1	60.0	64.4
GDP at market prices (US$ billions)	2.1	2.4	2.3	2.2	2.3	2.4	2.5	2.7	2.8	2.9
Consumer prices (average)	5.4	6.5	8.2	6.5	6.7	5.8	5.6	5.3	5.1	5.1
Consumer prices (eop)	6.5	7.2	6.8	7.4	6.0	5.5	5.4	5.3	5.0	5.0
GDP deflator	5.2	3.5	5.3	5.4	6.0	5.4	5.3	4.9	4.9	5.1
External Sector										
Terms of trade ("–" = deterioration)	3.5	-1.6	-3.2	-5.9	-2.7	0.6	0.1	-0.6	0.1	0.1
Average exchange rate										
(Local currency per US$)	16.4	14.9	17.0	...	...	...	...	...	...	...
Nominal effective exchange rate change (– depreciation)[2]	-8.7	6.3	-3.0	...	...	...	...	...	...	...
Real effective exchange rate (– depreciation)[2]	-6.0	8.7	-1.9	...	...	...	...	...	...	...
Current account balance (percent of GDP)	-5.7	-9.0	-13.8	-0.2	-0.7	-2.3	-2.3	-3.2	-2.9	-2.5
(excluding LHWP-II imports, percent of GDP)	-2.3	-6.5	-9.6	6.4	3.6	1.7	0.1	-1.5	-1.9	-1.6
Gross international reserves										
(Months of imports)	4.1	4.3	4.0	4.3	4.9	5.7	6.2	6.3	6.4	6.5
(excluding imports for LHWP-II, months of imports)	4.2	4.5	4.3	4.5	5.0	5.9	6.3	6.4	6.4	6.5
Money and Credit										
Net international reserves										
(US$ millions)	718	846	671	755	916	1,121	1,258	1,343	1,417	1,513
(Percent of M1 Plus)	109	127	111	114	137	163	179	185	190	197
(US$ millions, CBL calculation)	777	843	698	755	843	...	...	...	...	...
(Percent of M1 Plus, CBL calculation)	118	127	116	114	126	...	...	...	...	...
Domestic credit to the private sector	-3.0	6.7	8.7	12.5	9.0	8.1	8.0	8.3	7.4	7.7
Reserve money	16.5	1.0	24.5	24.0	1.9	1.2	1.6	1.6	2.1	2.3
Broad money	12.2	0.0	8.7	15.2	3.9	5.0	5.1	5.4	5.1	5.4
Interest rate (percent)[3]	3.8	3.5	3.5	4.7	...	...	...	...	...	...
	(Percent of GDP, unless otherwise indicated)									
Public Debt	54.7	58.4	64.5	61.5	59.9	59.7	59.8	59.8	59.5	59.5
External public debt	42.9	42.3	47.2	47.8	46.6	46.4	46.2	46.2	46.0	46.0
Domestic public debt	11.7	16.1	17.3	13.7	13.3	13.3	13.5	13.5	13.5	13.5
Central Government Fiscal Operations										
Revenue	54.4	48.8	44.6	56.5	63.4	61.1	57.8	55.6	55.6	54.8
Domestic revenue (excluding SACU transfers and grants)	25.1	27.2	27.6	29.3	31.0	36.6	34.9	33.7	33.7	33.7
SACU transfers	26.2	16.7	14.0	24.5	25.6	19.3	18.5	17.5	17.5	17.5
Grants	3.1	4.9	3.0	2.8	6.9	5.2	4.3	4.3	4.3	3.6
Recurrent expenditure	43.0	38.6	40.5	40.8	42.0	40.9	40.9	40.8	40.8	40.8
Of which: wages, including social contributions	17.6	17.0	18.0	17.1	16.8	16.7	16.6	16.4	16.4	16.4
Capital expenditure	11.4	15.5	9.6	9.6	16.3	14.3	13.9	14.0	14.1	13.5
Additional fiscal measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.0	-5.4	-5.5	6.1	5.1	5.8	3.0	0.8	0.6	0.5
(excluding SACU transfers and grants)	-29.3	-27.0	-22.5	-21.1	-27.3	-18.6	-19.8	-21.1	-21.3	-20.6
Operating balance	0.0	-5.4	-5.5	6.1	5.1	5.8	3.0	0.8	0.6	0.5
Primary balance	1.6	-4.0	-3.6	8.1	6.7	7.5	4.8	2.7	2.6	2.6
(excluding SACU transfers and grants)	-27.7	-25.6	-20.6	-19.2	-25.7	-17.0	-18.0	-19.2	-19.3	-18.6
Statistical discrepancy	-0.6	0.6	2.2	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 2024 ARTICLE IV CONSULTATION

August 22, 2024

KEY ISSUES

Context: Lesotho's economy has been struggling with subdued growth, high unemployment, and widespread poverty. The government-led growth model has resulted in an economy heavily reliant on public spending, with a small and undiversified private sector. This has led to low private investment, declining competitiveness, and high informality. Additionally, the economy is highly dependent on rain-based agriculture, making it vulnerable to climate-related shocks.

Outlook and Risks: Lesotho's growth outlook is improving modestly, with GDP growth projected to peak at 2.7 percent in FY24/25. Inflation increased in the second half of 2023, but upward pressures have eased and the gap with South African inflation is narrowing. Importantly, the outlook for Lesotho's fiscal and external balances have improved significantly due to windfall transfers from the Southern African Customs Union (SACU) and renegotiated water royalties. Still, risks remain, including potential global economic slowdowns, climate-related shocks, and political instability.

Focus of the Article IV Consultation: In the context of higher external revenues from water royalties, the consultation emphasizes the continued need for fiscal prudence and reforms to support private sector-led growth. Key recommendations include swiftly establishing a well-governed savings framework (stabilization fund) to ensure that additional revenues are saved wisely and spent strategically, in line with the authorities' national development goals. To this end, the authorities are encouraged to prioritize high-quality public investment, strengthen internal controls to ensure transparency and accountability, and address governance and corruption vulnerabilities. Accompanying recommendations include: enhancing public financial management, improving the business environment, and increasing financial inclusion.

Approved By
Andrea Richter Hume (AFR) and Anna Ivanova (SPR)

Discussions were held in Maseru during June 3–14, 2024. The staff team comprised Andrew Tiffin (head), Adrian Alter, Shushanik Hakobyan, and Qianqian Zhang (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. Lixue Chen (AFR) provided research assistance. Erick Trejo Guevara and Mary Campestrin (AFR) managed document production. The team thanks the Lesotho authorities for their collaboration and the candid and productive discussions.

CONTENTS

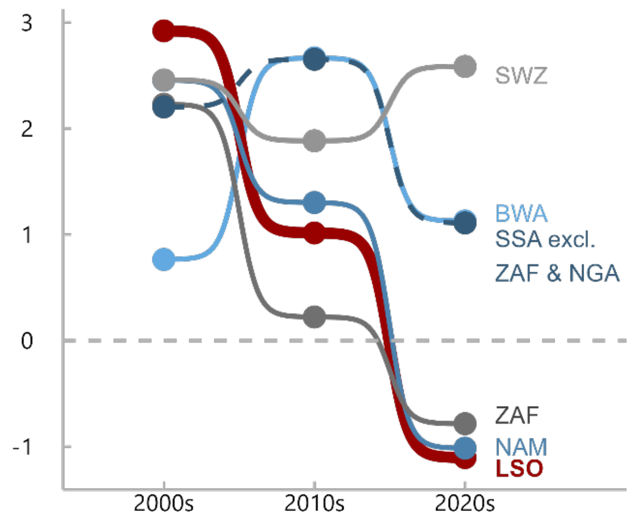
ANNEXES

CONTEXT

Sluggish Growth, Falling Living Standards, and a Large Government Footprint

1. Even with a pick-up in FY23/24, GDP growth in Lesotho remains anemic. Real per capita income has shrunk by 10 percent since 2016, unemployment remains high at 17 percent[1], and poverty is widespread.[2] Underlying this trend is the government-led growth model, which has struggled to deliver high-quality growth; resulting instead in an economy largely driven by public spending with a small and undiversified private sector (textiles, mining)—contributing to anemic private investment, declining competitiveness, and high informality. Moreover, the small, landlocked economy is highly reliant on rain-based agriculture and so is exposed to climate-related shocks.

Growth in Real GDP per Capita, 2000-23
(Percent)



Source: IMF, WEO database and IMF staff calculations.

2. Historically, resource allocation across the economy has been distorted by large and volatile public revenues, combined with weak public financial management (PFM). These have fostered high public spending, along with boom-bust cycles marked by arrears and periodic financing gaps—recurrent spending has tended to increase in the face of windfall transfers from the Southern African Customs Union (SACU) but has been downwardly inflexible when those transfers decline. Indeed, Lesotho now has one of the largest public wage bills in the region, reaching 17 percent of GDP in FY23 and 75 percent of tax revenue. Government spending accounts for about 50 percent of GDP, leaving less space for a private sector that has been hampered by low financial access, high public wages, corruption, and a weak business environment.

3. A new reform-minded government has been in place for 1½ years, but as leader of a fragile coalition the pace of change has remained slow, particularly on key legislation. Political instability and policy continuity remains a concern, owing to delayed implementation of fundamental political reforms.

[1] Latest available is 2019. https://www.ilo.org/lesotho.

[2] Projected at 35.3 percent in 2022, using the international poverty line of $2.15/day.

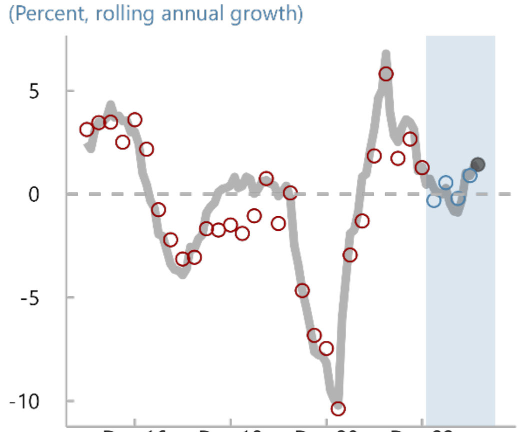
RECENT DEVELOPMENTS

A Modest Recovery, Fiscal Prudence, and a New Windfall

4. GDP growth picked up modestly to 2.2 percent in FY23/24, from 1.6 percent the year before.[3] This largely reflects accelerated construction from the Lesotho Highlands Water Project (LHWP-II). Nonetheless, unemployment remains high, with most of the adult population employed informally (mainly in agriculture). Moreover, activity has only just returned to pre-pandemic levels and Lesotho still has a negative output gap, muting pressures on inflation. Additionally, a decline in competitiveness in the apparel sector and lower diamond prices have depressed exports. High temperatures between January and March 2024 have led to an exceptionally dry season, and the number of food-insecure is projected at almost 700 thousand people over FY24/25, up 20 percent on the previous year. All regions are expected to be at crisis level by end FY24/25, and the authorities have declared a state of emergency.

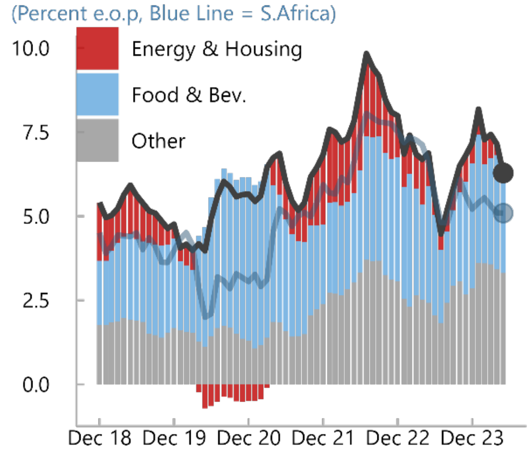
5. Inflation increased in the second half of 2023, but upward pressures have eased. Headline inflation was 6.5 percent in June, up from 4.5 in July 2023, but down from a peak of 8.2 in January 2024. The increase in inflation was largely due to exogenous factors such as higher regional food prices, elevated freight costs, and Rand depreciation. The impact of these factors will fade going forward. Core inflation has averaged 6.1 percent over the past six months, buoyed by higher services costs (transportation, education, restaurants, accommodation). The gap between inflation in Lesotho and South Africa mainly reflects the larger food share in Lesotho's CPI basket and is also expected to narrow (see Selected Issues Paper on Machine Learning and Inflation Forecasts). Still,

Monthly Nowcast of GDP Growth, 2015-24
(Percent, rolling annual growth)



Source: Haver Analytics, National Authorities, and IMF staff calculations.

CPI Inflation, 2018-24
(Percent e.o.p, Blue Line = S.Africa)



Source: Haver Analytics and IMF staff calculations.

[3] Revisions to national accounts data in 2023 revealed a contraction in the economy since 2020 exceeding initial estimates—nominal GDP in calendar year 2020 was revised downward by about 3 percent.

upside inflation risks remain, stemming from a larger-than-expected impact of El Niño on food and supply-chain disruptions.

6. **Lesotho registered a sizable fiscal surplus in FY23/24.** In a welcome change from past practice, windfall SACU transfers were not matched by a parallel ratcheting up of the public wage bill. Instead, the authorities used the SACU proceeds to reduce arrears and build up deposits at the Central Bank.

- Record-high SACU transfers (10.4 percent of GDP higher than in FY22/23) helped deliver a surplus of 6.1 percent of GDP, 11.6 percentage points larger than in FY22/23.

- Domestic revenue, at 29.3 percent of GDP, was 1.6 percentage points higher than in FY22/23, largely due to higher water royalties.

- Recurrent expenditure remained broadly unchanged at 40.8 percent of GDP, but compensation of employees and the use of goods and services both declined by 0.9 percent of GDP each, owing to a moratorium on public sector hiring and adoption of a new Public Procurement Act.

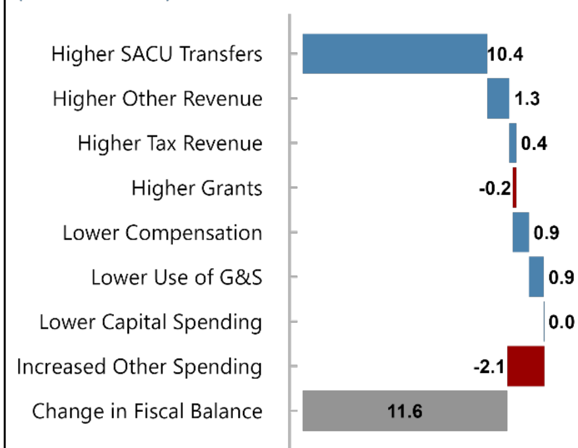
- Capital expenditure (9.6 percent of GDP) was about 40 percent lower than budgeted, due to weak implementation capacity.

- The stock of arrears was reduced by 0.9 percent of GDP to 1 percent by end-FY23/24. The authorities continue to grapple with contingent liabilities from contested commercial contracts (Frazer Solar GmbH, Netcare Hospital Group, Trencon) and from Lesotho's state-owned enterprises (SOEs) (11.1 percent of GDP combined).[4]

- Gross public debt decreased modestly to 61.5 percent of GDP, with about three-quarters of that amount owed to external creditors.

Change in Fiscal Balance, FY23/24 vs. FY22/23

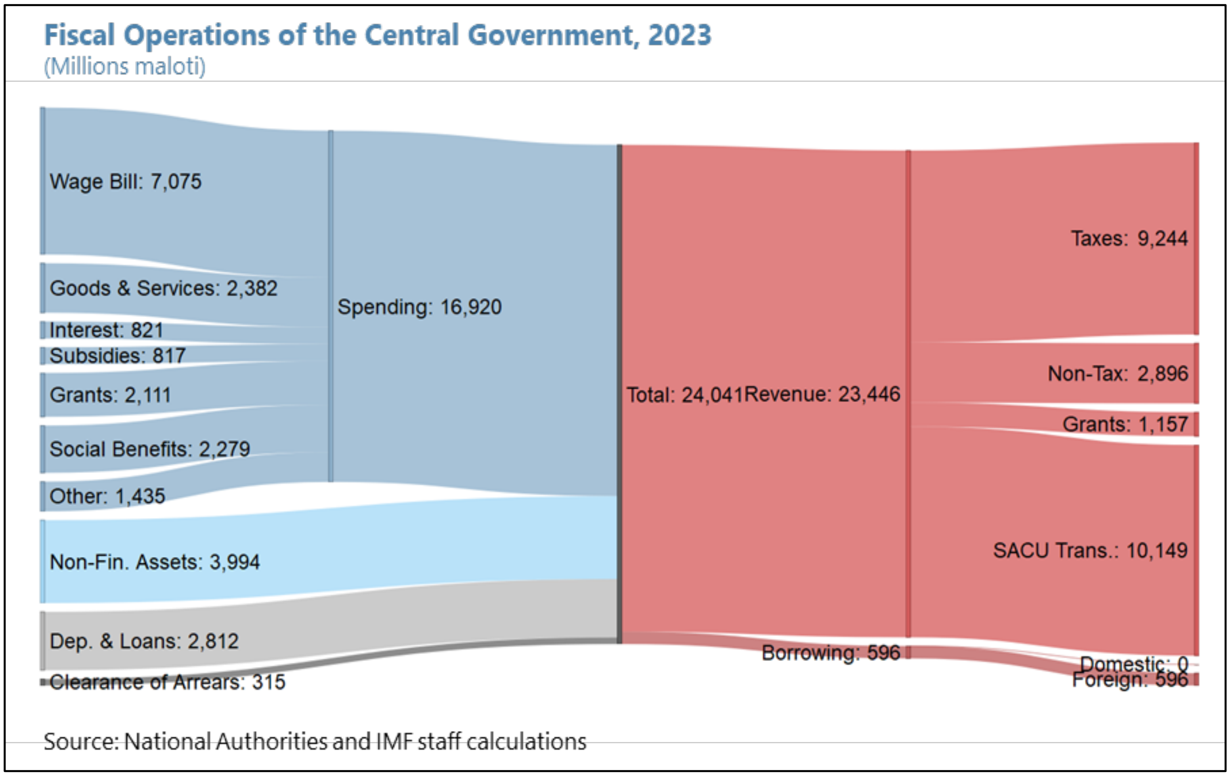
(Percent of GDP)



Source: National Authorities and IMF staff calculations

7. **Water royalties have recently been renegotiated under the LHWP-II Treaty with South Africa.** This represents additional revenue starting in 2024—royalties are projected at around 6½ percent of GDP in FY24/25 (compared to 3½ percent previously), and at around 9½ percent over the medium term.

[4] Arrears and contingent liabilities are included in the baseline and stress tests of the staff's debt sustainability analysis (DSA). Details of the contested contracts can be found in the DSA footnotes 7, 8, and 9.



8. In support of the peg, the Central Bank of Lesotho (CBL) has kept the policy rate steady at 7.75 percent since May 2023, in parallel with South Africa.[5] At 11.25 percent, the prime lending rate was about 4.2 percent in real terms in April 2024. Private sector credit growth picked up to 12.5 percent in FY23/24, mainly due to construction. Nonperforming loans (NPL) have eased to 3.8 percent of loans (as of 2023Q4).

9. Lesotho's external position was broadly consistent with fundamentals and desirable policies, primarily reflecting windfall transfers (Annex V). The current account deficit (0.2 percent of GDP) improved by 13.6 percent of GDP in FY23/24, as SACU transfers and increased water sales more than offset sluggish apparel and diamond exports.[6] Within the External Balance Assessment (EBA) framework, Lesotho's positive policy gap reflects its sizable fiscal surplus and strong reserves accumulation—over FY23/24, gross international reserves increased by 4 percentage points of GDP to $793 million, or 4½ months of imports. As SACU inflows ease, the fiscal surplus is also expected to ease, narrowing the policy gap in the future.

[5] Starting March 2023, the CBL allowed for a small gap with the South African Reserve Bank (SARB) policy rate. That gap has remained steady since May 2023 at 50 bps. In June 2024, the CBL again decided to maintain the policy rate at 7.75 percent vs a steady South African Rate of 8.25.

[6] Historical series for the current account were revised downward significantly over the past year, reflecting a better recording of social-security contributions by Basotho working in South Africa. As a result, secondary income balances have been revised downward starting 1986.

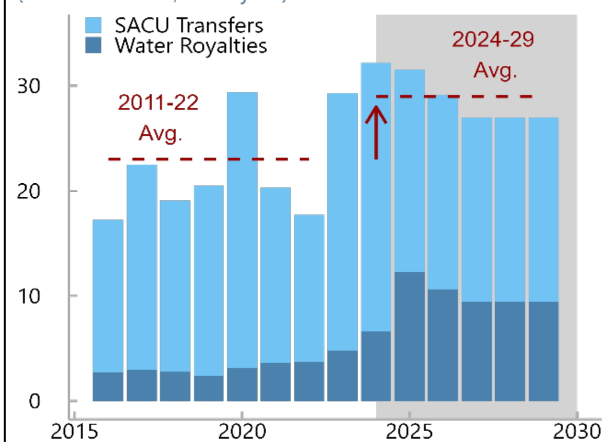
OUTLOOK AND RISKS

An Improved Outlook, But Risks Remain

10. Growth is projected to rise in FY24/25 (to 2.7 percent), while inflation is expected to ease slowly. The growth pickup will likely be short-lived, reflecting the peak phase of the construction of the Polihali dam and spillovers to transportation and other services. Still, medium-term potential growth is projected at 2.1 percent, about ½ percentage point higher than in the 2023 Article IV, due to higher electricity and water exports to South Africa and increased horticultural production under the Millennium Challenge Corporation (MCC) Compact II (Annex I). A modest improvement of the business environment and efforts to reduce the government's economic footprint will also help. The regional drought will continue to place upward pressure on inflation.

SACU Transfers and Water Royalties, 2016-29

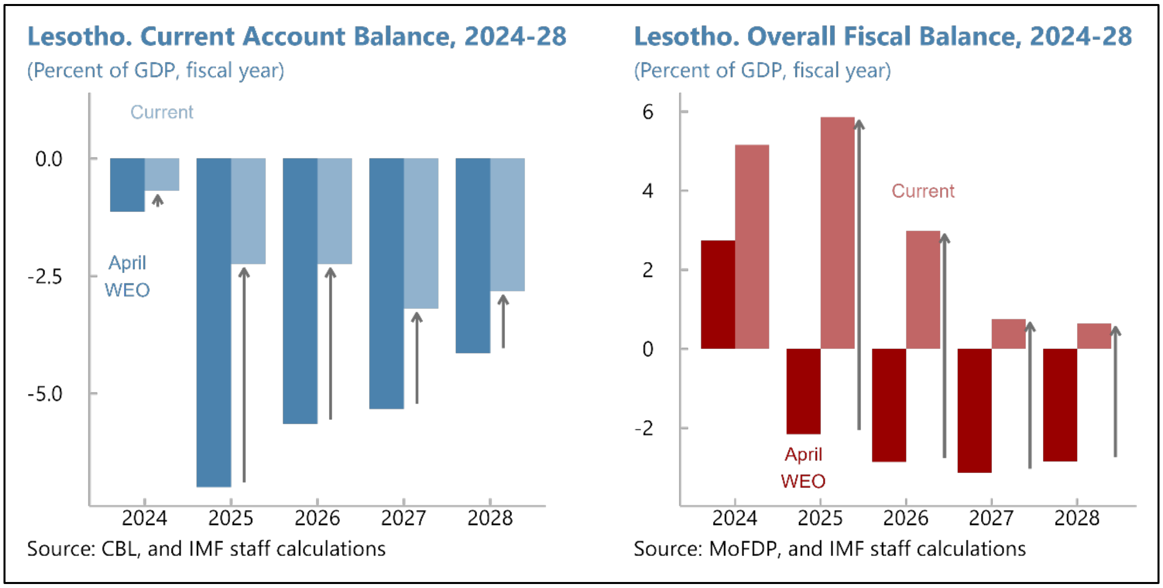
(Percent of GDP, fiscal year)



Source: National Authorities and IMF staff calculations

11. The outlook for Lesotho's fiscal and external balances has improved significantly. Another year of windfall SACU transfers (6 percentage points of GDP above the 10-year average) will again bolster fiscal and external balances in FY24/25. These transfers will fall sharply starting in FY25/26, but higher water royalties will help fill the gap. As a result, the fiscal balance is projected at a surplus of around 1 percent of GDP over the medium term, with the current account deficit at a modest 2.6 percent.

12. Risks are still tilted to the downside (Annex IV). External risks include: slowing growth (worldwide and in South Africa); uncertainty over the African Growth and Opportunity Act (AGOA); shocks to commodity prices; extreme weather; and cyberattacks. A possible regional reassessment of the SACU arrangement (with lower transfers) is another risk. Domestically, reforms could stall due to legal challenges, hampering competitiveness. Upside risks include accelerated reforms to support private-sector growth, a swifter passage of income tax amendments, improved efficiency of public investment, and a further boost to water royalties either from retroactive application of renegotiated rates or from an earlier-than-expected completion of the Polihali Dam.



Authorities' Views

13. The authorities broadly concurred with staff's presentation of the outlook and risks. While near-term growth projections were very similar, the authorities' medium-term inflation expectations were slightly more benign, with a difference of about 0.5–0.7 ppts over 2025–26. The authorities agreed that the role of the public sector should be reduced, to increase job creation and boost potential growth over the medium term. Although they assessed that risks to outlook are more balanced, they also acknowledged downside risks from the external environment, particularly lower growth in main trading partners, political instability in South Africa, and AGOA renewal.

POLICY PRIORITIES

A. Fiscal Policy: Building Buffers Today

14. The FY24/25 budget sets out an extremely ambitious capital investment plan, implying a 2.3 percent of GDP deficit (Annex III). The SACU windfall and a pickup in donor grants are expected by the authorities to finance an increase in capital expenditure of almost 12 percentage points of GDP over a single year. Compensation of employees is budgeted to remain stable at around 17.4 percent of GDP, while spending on goods and services increases to 7.2 percent of GDP. But the budget does not incorporate the full impact of additional water royalties (which the authorities have so far assessed conservatively at about 3 percent of GDP). The authorities have discussed using these funds in the coming year, providing for greater agricultural subsidies to alleviate the impact of the drought (0.6 percent of GDP), and allowing for clearance of existing and possible new arrears (2.4 percent of GDP).

15. Staff instead project another surplus in FY24/25 (5.1 percent of GDP) stemming mainly from higher projected water royalties and lower capital expenditure (Table 2b). Water royalties are expected at around 6½ percent of GDP in FY24/25[7]—despite a 6-month outage due to LHWP tunnel maintenance. On capital expenditure, given past under-execution and the absence of a prioritized project pipeline, the budgeted expansion is likely infeasible. Even so, staff project an increase of 6.7 percentage points of GDP, primarily reflecting higher disbursements for externally financed capital projects less prone to execution delays, including the MCC compact grant, and the World Bank's Lowlands Water Development Project. Recurrent spending is flat, even with an extra 0.6 percent of GDP allocated to agricultural subsidies.

16. Under unchanged policies, staff's medium-term projections entail gradually declining fiscal surpluses, with public debt holding steady at around 60 percent of GDP. Surpluses reflect (i) the increase in water royalties; (ii) a gradual reduction in the wage bill, in line with a continued moratorium on hiring until FY27/28; and (iii) a more realistic level of capital expenditure, in line with past outcomes. Recurrent spending (excluding interest) is projected to fall by 1.6 percentage points of GDP over the medium term, as wage bill consolidation continues, and agricultural subsidies are withdrawn. SACU transfers will drop from FY25/26 onward, but additional water royalties will ensure that modest fiscal surpluses persist. Although options are under discussion, with no current plans for early debt repayment, public debt will stabilize at around 60 percent of GDP.

Comparison of FY23/24 and FY24/25 Projections and Outturns: Current, 2023 Article IV Consultation and the Authorities' Budgets
(Percent of GDP)

	FY23/24			FY24/25		
	Budget	2023 Art. IV	Current	Budget	2023 Art. IV	Current
	Proj.	Proj.	Est.	Proj.	Proj.	Proj.
Revenue	60.5	51.4	56.5	61.3	49.7	63.4
Revenue excluding SACU transfers, grants and water royalties	29.3	22.9	24.5	24.1	22.8	24.4
SACU transfers	24.5	22.3	24.5	25.6	22.1	25.6
Grants	2.9	2.6	2.8	8.1	2.5	6.9
Water royalties	3.9	3.6	4.8	3.6	2.2	6.6
Recurrent expenditure	42.8	37.8	40.8	42.2	37.8	42.0
Compensation of employees	17.4	16.4	17.1	17.4	16.2	16.8
Use of goods and services	8.3	6.0	5.7	7.2	6.0	7.1
Capital expenditure	15.2	12.5	9.6	21.5	12.3	16.3
Overall balance	2.4	1.1	6.1	-2.3	-0.4	5.1
(Excluding SACU transfers and grants)	-28.7	-27.4	-25.9	-39.5	-27.2	-33.9
Primary balance	4.9	2.6	8.1	-0.1	1.3	6.7
(Excluding SACU transfers and grants)	-22.4	-22.3	-19.2	-33.7	-23.4	-25.7

Sources: Lesotho authorities and IMF staff calculations.

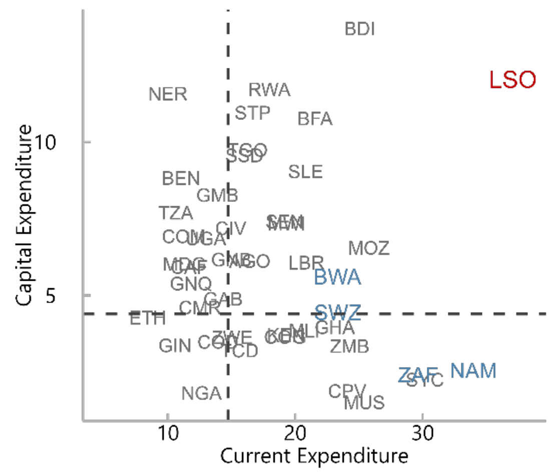
17. The fiscal stance for Lesotho is constrained by underlying weaknesses in expenditure control. From a stabilization perspective, the fiscal surplus in FY23/24 was potentially restrictive

[7] Based on estimates from the Lesotho Highlands Water Authority.

given that output was below potential and unemployment remained high.[8] Similarly, the baseline path of fiscal surpluses over the medium term represents a relatively tight stance, given Lesotho's modest growth prospects and clear development needs. But a hasty increase in public spending (especially recurrent spending) may be counterproductive, undermining efforts to improve service delivery and boost private-sector development. And any increase in capital investment should focus on projects closely aligned with the National Strategic Development Plan (NSDP) II, subject to implementation capacity.

18. In this context, new revenues present the authorities with a valuable opportunity, and a challenge. Despite high public spending over the past two decades, living standards have not increased. As a proportion of GDP, for example, government spending in Lesotho is well above international norms—with recurrent and capital spending at a 20-year average of 40 percent and 13 percent of GDP, respectively, more than double the SACU average. But this spending has not been matched by improved performance. So, when considering the use of additional revenues, the authorities should ensure that these funds are saved wisely and spent strategically.

Sub-Saharan Africa. Current and Capital Spending, 2023
(Percent of GDP)



Source: IMF WEO database and IMf staff calculations
Note: Dashed lines show the PPP-weighted average for sub-Saharan Africa, exluding SACU members.

19. The authorities should quickly take steps to establish a well-governed savings framework (stabilization fund). The main aim would be to build a buffer to ensure a stable source of funding going forward, which in turn would allow for steady and uninterrupted service delivery even in the face of volatile SACU transfers or other shocks. Eventually, savings in excess of this buffer might also help finance development spending, such as infrastructure investment. To be effective, however, a stabilization fund should be anchored by a clear and credible fiscal rule, which guides the pace of savings and the conditions under which funds are deposited and withdrawn.[9] The fund should also be set within a firm legal framework, with a clear governance structure that is independent from political influence, safeguarding Lesotho's savings until they can be used productively. To this end, the authorities are working closely with development partners to swiftly

[8] The (multiplier) impact of fiscal restraint on output and prices has been limited, in large part owing to the large share of imports in goods consumption. See International Monetary Fund (2023). "Modeling the Impact of External Shocks on Lesotho," Kingdom of Lesotho: Selected Issues. Country Report No. 2023/269. Washington, DC; and A. Alichi, I.Shibata, and K.Tanyeri (2019). "Fiscal Policy Multipliers in Small States," IMF Working Paper, International Monetary Fund .WP/19/072. Washington, DC.

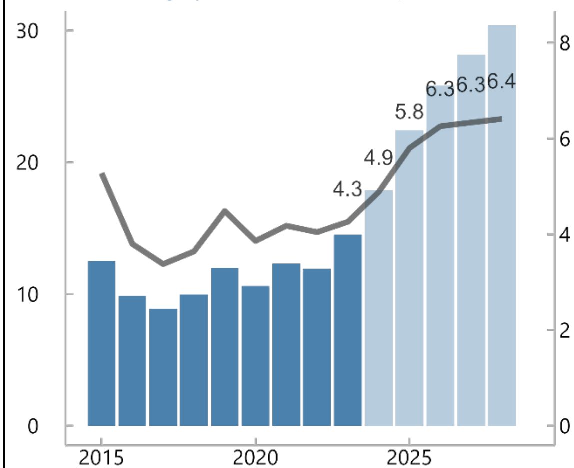
[9] For examples and guiding principles, See J.M.Davis, A.Fedelino, and R.Ossowski. (2003). Fiscal Policy Formulation and Implementation in Oil-Producing Countries. International Monetary Fund. Washington, DC; and U. Das, Y. Lu, C. Mulder, and A. Sy (2009), "Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations," IMF Working Paper. WP/09/179, International Monetary Fund. Washington, DC.

set up a stabilization fund and fiscal rule, with targets tailored to Lesotho's short-term funding needs and longer-term development goals.[10]

20. In the interim, the authorities should continue building international reserves and consider refining their reserve-management strategy. As a priority, the authorities should first clear any domestic arrears. Beyond that, as the economy recovers from a prolonged crisis, and in a global environment of larger and more frequent shocks, an increase in Lesotho's reserve buffer is warranted. Indeed, gross reserves are only now approaching 4½ months of imports—the minimum considered adequate for a credit-constrained economy like Lesotho. In assessing reserve adequacy and investment strategy, the authorities should consider Lesotho's volatile external drivers (SACU transfers, remittances, terms-of-trade, etc.), as well as the economy's limited access to capital markets. The investment strategy should continue to ensure the safety and liquidity of reserves, including a review of eligible assets for risk mitigation. But under unchanged policies, inflows from new water royalties will automatically flow into Lesotho's reserve pool, and as reserves increase, the marginal benefit of additional self-insurance will fall. The authorities should therefore consider refining their investment strategy to place a greater emphasis on returns—in coordination with the institutional arrangements of the authorities' eventual stabilization fund. Looking forward, gross reserves will likely exceed 6 months of imports sometime in FY26/27. *Staff analysis suggests that an appropriate level of reserves for a country like Lesotho is somewhere between 4.5 and 6 months of prospective imports.*

Net International Reserves, 2015-28

(Billions maloti, grey line = months of imports (RHS))



Source: National authorities and IMF staff calculations.

21. Once reserves are comfortable, the authorities should use fiscal savings to reduce the level of public debt. As reserves increase, the benefit of additional self insurance will need to be weighed against the possible savings of debt reduction. At 60 percent of GDP, public debt under the baseline is relatively high and is the maximum allowed under the authorities' announced medium-term fiscal strategy. Moreover, the risk of debt distress is rated as "moderate" under the DSA, with limited space to absorb shocks. Much of Lesotho's external debt is concessional, but a sizable portion (26 percent of external public debt) is on commercial terms. So *once reserves exceed comfortable levels (possibly, six months of imports), the authorities should use fiscal surpluses to attain a lower public debt path, including by avoiding Lesotho's most costly liabilities*. Staff analysis suggests that this approach would bring public debt down to 50 percent of GDP over the course of 5 years

[10] Past IMF recommendations on the nature of such a fiscal rule have focused on a two-pillar approach, with both a debt target and a structural balance rule (see International Monetary Fund (2022). "Evaluating Fiscal Rules for Lesotho," Kingdom of Lesotho: Selected Issues. Country Report No. 2022/162. Washington, DC.

(45 percent of GDP in present value terms), a level consistent with preserving the peg and preventing a sudden deterioration of Lesotho's debt distress rating.[11]

22. Even amid fiscal surpluses, containing the public wage bill remains essential. Lesotho's public wage bill (as a share of GDP) is the highest among SACU members and triple the sub-Saharan African average, impeding private-sector competitiveness and encouraging a dual labor market.[12] Measures undertaken over the past year have been a critical step in the right direction—even with automatic notch increases and a COLA adjustment, compensation of employees decreased by about 1 percent of GDP. This effort should continue. However, reducing the wage bill is not an end in itself. Ultimately, the objective is a fair and performance-based public employment system that rewards higher productivity and ensures better delivery of public services. To this end, *the authorities should maintain the moratorium on public hiring, streamline the establishment list, and institute regular reviews of the compensation system*.

23. There is scope to improve tax policy design and strengthen tax administration. The Tax Policy Unit (TPU) has been established and key staff are being hired. *The authorities should build the TPU's capacity to forecast revenue and improve tax-system design, with support of IMF capacity development. On tax administration, the authorities should develop a phased strategy to address identified weaknesses in core functions identified in the IMF's 2023 TADAT assessment. The authorities should also promptly approve the two pending tax-policy bills and tax administration bill, to help address key deficiencies.*

24. There are also opportunities to improve the efficiency of social spending to target the most needy. Social spending is already several times that of neighboring countries, but is dominated by poorly-targeted schemes. For example, the tertiary loan bursary fund education scheme (2.7 percent of GDP) provides loans to many who typically do not need support and fail to repay (loan recovery is only 2 percent). *The authorities should consider reforms to this scheme, including the introduction of means testing and increased recovery of education loans, to free resources for other more effective poverty-focused initiatives, such as the child grant program (CGP) or the public-assistance (PA) program, or the Orphans and Vulnerable Children's Bursary program (OVC-B).*

25. A better targeted safety net will also be critical to build climate resilience and address food insecurity. In this context, key elements of the social protection net include school-feeding programs, cash- or food-for-work on public projects, and subsidies for agricultural inputs. Although the latter may help encourage timely planting and the use of climate-resilient seeds, it is poorly targeted as a source of income support—access is dominated by large, well-connected enterprises, often at the expense of the most vulnerable smallholders. *The authorities should enhance the*

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[11] International Monetary Fund (2023). Kingdom of Lesotho: 2023 Article IV Consultation Staff Report. Country Report No. 2023/268. Washington, DC.

[12] International Monetary Fund (2023). "Decomposing the Public-Private Sector Wage Differential in Lesotho," Kingdom of Lesotho: Selected Issues. Country Report No. 2023/269. Washington, DC.

operation of cash transfer programs, streamline the identification and registration of beneficiaries under various assistance programs, and accelerate the deployment of mobile delivery tools.

Authorities' Views

26. The authorities acknowledged the tremendous opportunity presented by the renegotiated water royalties and the need to (i) rebuild reserves and (ii) pay down costly debt to safeguard the peg and lower the risk of debt distress, as well as (iii) establish a stabilization fund to save the additional revenue for growth-friendly investment. The authorities plan to establish a stabilization fund in FY24/25 to save the additional revenues received from the water royalties, as well as review the capital budget and develop a pipeline of capital projects. There are currently no plans to pay down debt in the short term, but options are being considered. The efforts to review and develop reform options for the size of civil service and wage bill will continue, with the support of the World Bank. Revenue Service Lesotho (RSL) plans to designate a coordinator to ensure the TADAT Action Plan is on track for implementation, and the MoFDP will complete the recruitment process for the new tax policy unit, ahead of IMF CD on revenue forecasting. The authorities acknowledged inefficiencies with existing safety nets and plan to revamp the transfer system, focusing more tightly on small farmers and vulnerable households.

B. Public Financial Management: Ensuring Prosperity Tomorrow

27. The authorities should redouble their efforts to enhance Public Financial Management. Without these measures in place, there is a danger that new revenues will be squandered.

28. Budget preparation and execution must be strengthened to improve governance and enhance credibility. This requires improved expenditure control through better collaboration between departments, monitoring and identifying misappropriated funds, and regular audits.[13] *The authorities should* reconcile *and improve monitoring of government accounts—including in commercial banks—to reduce the risk of fraud and improve fiscal reporting. More broadly*, *the authorities should implement the Medium-Term Expenditure Framework to better align policy objectives with budget allocations over a multi-year timeframe and enhance long-term planning*.

29. To build further trust in PFM, the authorities should strengthen internal controls within the integrated financial management system (IFMIS). Some procurement and contracting processes continue to be performed outside IFMIS, which is one of the leading causes of arrears. *Based on the IMF internal controls assessment, the authorities should improve the use and functionality of IFMIS, accelerating the deployment of digital signatures.*

30. The authorities should also continue to ensure a comprehensive analysis and management of fiscal risks. Several fiscal risks have materialized in recent years, including from collapsed public private partnerships; unquantified arrears; and contingent liabilities from loans and

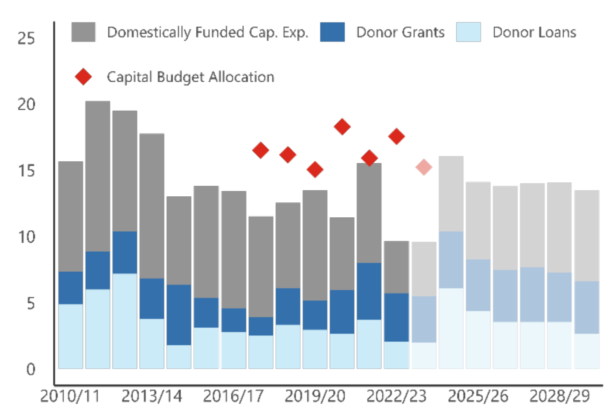
[13] The Office of the Auditor General (OAG) has been receiving inputs from MoFDP in a more timely manner, however, the backlog of audited reports pending parliamentary review and approval remains a significant obstacle to ensuring timely and effective financial oversight.

guarantees issued to state-owned enterprises (SOEs). *The authorities should further strengthen the effectiveness of SOE management, expand the coverage of government operations reporting to decentralized entities and autonomous bodies, and publish a fiscal risk statement as part of the annual budget process, in line with IMF CD recommendations.*

31. Public Financial Management (PFM) legislation should be passed swiftly. Currently, the most pressing items include i) the Public Financial Management and Accountability Bill; ii) the Public Debt Management Bill; and iii) secondary legislation to implement the 2023 Public Procurement Act. Together, this legislation will improve the efficiency and transparency of procurement, enhance fiscal responsibility, and strengthen reporting. The bills will also underpin other laws (such as procurement, digitalization, and SOE oversight) with strong controls, oversight, and financial-reporting and transparency requirements. In addition, they will ensure that the government's borrowing plan is well integrated with the budget process. *As a matter of priority, the authorities should pass these bills as soon as possible.*

32. The authorities should ensure that public investment projects have a maximum impact on growth. New revenues, if saved wisely, may allow for an expanded investment envelope. But progress in prioritizing and selecting capital projects, and in identifying unproductive projects, has been limited. Before Lesotho's savings are allocated for investment, sufficient controls should be put in place to ensure that this investment is closely aligned with national development objectives and represents value for money. In this context, past capital expenditures—more than double the SACU average—have not generated a capital stock of a comparable quality.[14] Moreover, owing to longstanding capacity constraints, the capital budget continues to be severely under executed. *To ensure that Lesotho's additional revenues are used appropriately, the authorities should take steps to boost the efficiency of public investment, including by creating a centralized asset registry, leveraging the newly created asset-management unit within the Treasury Department, establishing a prioritized project pipeline, and enhancing capacity for project appraisal, design, management, and monitoring, using the IMF's newly developed Public Investment Management Information System (PIMIS) tool.*

Under-Execution of the Capital Budget
(Billion Maloti)



33. Fiscal policymaking should be improved by strengthening coordination, information-sharing, and technical expertise within the MoFDP. Data discrepancies persist between the budget, macro forecasting, cash forecasting, debt management functions of the MofDP, and with

[14] International Monetary Fund (2023). Kingdom of Lesotho: 2023 Article IV Consultation Staff Report. Country Report No. 2023/268. Washington, DC.

Revenue Services Lesotho (RSL) and the Bureau of Statistics (BoS), resulting in misleading assessments of economic activity and financing needs, as well as unreliable medium-term fiscal frameworks (MTFF). Timely and reliable data would strengthen the MTFF, which should drive budget ceilings.

Authorities' Views

34. The authorities agreed on the necessity for strong internal PFM controls. They will continue work to implement IMF CD recommendations on IFMIS, bank reconciliation, and fiscal data reporting. The fiscal risk statement will become part of the annual budget process starting next cycle. The criticality of better policy coordination and information sharing both within the MoFDP and with the CBL was also acknowledged.

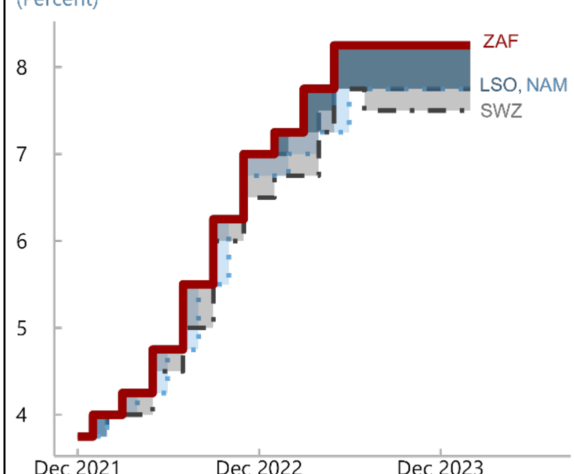
C. Monetary and Financial Policies: Supporting the Peg, Anchoring Inflation, and Ensuring Financial Stability

35. With a peg to the South African Rand, and with a banking system dominated by three large South African subsidiaries, Lesotho's ability to pursue an independent monetary policy is limited. But the peg has served Lesotho well, delivering low inflation—at 6½ percent in FY23/24, inflation was around one-third the sub-Saharan average of 16 percent. In addition, the peg has facilitated cross-border transactions with South Africa, Lesotho's predominant financial and trade partner.

36. Inflation remains well anchored and tied to the credibility of the SARB. Recent inflationary trends have been largely driven by external supply-side factors, which are subsiding. Indeed, inflation is falling and the gap with South Africa's inflation is narrowing.[15]

37. Given the fiscal stance and anchored inflationary expectations, the monetary stance is consistent with maintaining the peg. Amid a significant increase of policy rates in both Lesotho and South Africa, and output below potential, financial conditions are tight. In this context, the CBL opened a slight gap (50 bps) below the South African rate in May 2023. This has also occurred in other countries pegged to the Rand, but so far the gap has had little adverse impact on the credibility of the peg—Lesotho's reserves have increased significantly in line with SACU transfers, household and corporate deposit growth remains healthy (increasing over the course of FY23/24). All this suggests that Lesotho currently enjoys some small

Southern Africa. Policy Rates, 2021–24
(Percent)



Source: Haver Analytics.

[15] Inflation in South Africa has remained within the SARB's target band of 3-6 percent since mid-2023.

freedom of action on its policy rate. But the transmission of this narrow gap to economic activity is relatively limited: funding conditions for South African banks in Lesotho are determined largely by conditions in South Africa, while many non-financial corporates in Lesotho are similarly funded directly from their South African parents. *So in the near term, if the SARB loosens policy rates in line with easing global conditions, the CBL should broadly follow suit; but should also consider gradually closing the 50 bps gap to more clearly signal its commitment to the peg and better anchor local expectations. More broadly, inflation will need to be monitored carefully and a coordinated response with fiscal policy may be needed if divergence with South Africa reopens and becomes entrenched.*

38. An enhanced policy implementation framework will help improve monetary transmission, and develop local markets. Currently, with limited transmission and the lack of a monetary operations toolkit, the financial system is characterized by high margins—in which the prime lending rate mostly mirrors that in South Africa—and a narrow interbank market that is mainly focused on the banks' local prudential requirements. Structural excess liquidity makes the management of reserves complicated, as subsidiary banks can easily transfer liquidity to their parents in South Africa, who have access to the South African financial system. A more active liquidity management framework will help manage this excess and improve monetary transmission. *The authorities should build their capacity for liquidity analysis and forecasting and should follow up on IMF CD recommendations for developing a local-currency bond market, as part of a broader effort to improve the monetary operational framework and enhance transmission.*

39. Improved central bank governance and policy coordination with the MoFDP will further strengthen the peg. The authorities intend to submit amendments to the CBL Act to Parliament in the near future, aiming to safeguard the autonomy and governance of the central bank. But efforts to anchor the central bank's independence in the Constitution have stalled. Policy coordination between the MoFDP and CBL is critical, as fiscal policy remains the principal adjustment mechanism for the economy, and the ultimate backstop of the peg's credibility. *The authorities should revive regular high-level and technical working-group meetings for policy engagement and information exchange to ensure the consistency of forecasts and policy assessments.*

40. Bank balance sheets remain sound. NPLs remain well below the SACU average, and liquidity ratios are increasing. Regulatory capital has eased to below 20 percent—the lowest since the pandemic, but not a cause for concern. To improve risk-based supervision, the authorities have implemented measures in line with the Basel II Pillar II supervisory review process, and will continue to develop recovery planning and early warning frameworks in line with *Financial Sector Stability Review* (FSSR) recommendations. Supervision and regulation for nonbank financial institutions (NBFIs) are still in the early stages (Annex VIII). *The CBL should continue efforts to improve risk-based banking supervision (including by following up on key recommendations from IMF CD). They should also develop early warning and intervention frameworks, and enhance cross-border cooperation and review internal guidance for assessing banks' recovery planning. Underpinned by the amendments to the CBL Act, the CBL should also consider developing an Emergency Lending Assistance framework to ensure stability during periods of distress. In addition, the CBL should also step up efforts on NBFI supervision and regulation, incorporating NBFIs into the CBL's systemic risk analysis, continuing to* *strengthen data collection, accelerating progress on NBFI regulation reviews, and enhancing its ability to intervene early in the event of stress.*

41. Despite some improvements, gaps in compliance with the AML/CFT standards and in the effectiveness of the AML/CFT framework still need to be addressed. The authorities have started updating their AML/CFT legal framework to address technical compliance deficiencies identified in Lesotho's *2023 Mutual Evaluation Report (MER) prepared by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)*. Notably, the authorities have started gathering information for the risk assessment of NBFIs, and are amending guidelines relating to market entry requirements and beneficial ownership transparency of legal persons and legal arrangements. *Going forward, the authorities should ensure that all relevant stakeholders have a better understanding of ML/TF risks, enhance risk-based AML/CFT supervision of the financial and non-financial sectors, and improve the application of AML/CFT preventive measures. To address domestic and cross-border ML, the authorities should strengthen measures to prevent the misuse of legal persons and arrangements for ML purposes, prioritize ML investigation and prosecution, and strengthen the asset recovery regime. Spillover risks from South Africa's "grey-listing" by the Financial Action Task Force are limited but should continue to be monitored.*

Authorities' Views

42. The authorities broadly agreed with staff's recommendations and reiterated their commitment to maintain the peg and financial sector reforms. The CBL will continue monitor inflation dynamics and reserve levels. 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. With the expected higher reserves from the new water royalties, the CBL noted the need to coordinate with MoFDP on reserves management. The CBL acknowledged the need to continue enhancing bank and nonbank supervision and address AML/CFT shortcomings highlighted by the ESAAMLG mutual evaluation.

D. Structural Reform: Catalyzing Private Sector-Led Growth

43. Job-rich growth cannot be achieved without broad structural reforms. Translating higher water royalties into higher growth will require more than a simple increase in public investment. Better service delivery and higher-quality investment will help, but the government-led growth model has resulted in an economy with a small and undiversified private sector, owing in part to the government's dominant role as an employer and its stake in a broad range of commercial activities.[16] In parallel to its public saving and investment measures, therefore, the authorities should accelerate efforts to unlock the potential of the private sector.

44. Developing a national strategy for financial inclusion is imperative. Evidence suggests that access to finance remains a key challenge for private sector development, particularly for small

[16] International Monetary Fund (2023). "Handing the Reins of Growth to the Private Sector," Kingdom of Lesotho: Selected Issues. Country Report No. 2023/269. Washington, DC.

and informal firms. The authorities have tried to address this through various interventions, including partial credit guarantees, establishment of a moveable asset registry (LERIMA), and supervision and support of a credit bureau. A broad financial inclusion strategy, including a renewed focus on digital financial services, should be a priority. *The authorities should improve intermediation, underpinned by a national strategy of financial inclusion that provides a level playing field and coordinates financial inclusion efforts. They should also: ensure the smooth operation and security of the National Payment Switch—including the interoperability of mobile money platforms—to enhance the payment system's efficiency and inclusiveness; leverage and consolidate the two partial guarantee schemes; facilitate international transactions; and develop the capacity for smaller MFIs to utilize credit assessments.*

45. Providing a stable, predictable, and well-regulated business environment is also essential. Needed reforms include: measures to reduce the cost of doing business (including through supporting formalization, reducing rent-seeking behavior; and implementing digital verification systems); a reduction in the stake of large state-owned enterprises in key sectors; and efforts to boost broader private investor confidence (including through more predictable business licensing, streamlined procedures for work visas, and easier construction permits). *To this end, the authorities should focus on the provision of transparent and consistent regulatory frameworks, greater policy consistency, and a clear long-term strategy for infrastructure development. To reverse the long-term decline of some industries (e.g., textiles) and take full advantage of new opportunities (e.g., agriculture, tourism, digital economy, mining), the authorities should focus on coordinating the efforts of the Lesotho National Development Corporation (LNDC) and the Basotho Enterprise Development Corporation (BEDCO), avoiding duplication and focusing on the facilitation and promotion of private investment (including FDI), and the creation of employment opportunities. The authorities should also enhance the regulatory framework for the establishment, operation, and oversight of SOEs, while developing a strategy for the gradual privatization of non-performing SOEs to enhance efficiency and attract investment.*

46. Mitigating corruption and strengthening the rule of law is essential to restoring confidence, investment, and growth. Recent fraud cases and growing arrears point to underlying vulnerabilities in government payment and procurement processes, underscoring the need for the transparency and accountability that would result from successful PFM reform. This is a clear priority given the large government footprint in the economy. Given their macro-critical nature, lack of progress in anti-corruption reform, including the passage of the Omnibus Bill (an outstanding 2020 RCF/RFI governance commitment) or its derivative is concerning. More broadly, strengthening key bodies such as the Office of the Auditor General and the Directorate on Corruption and Economic Offences (DCEO) would also send a strong signal of the government's resolve, and help incentivize private sector development. In this regard, the increased funding and expansion of the DCEO has been most welcome. *The establishment of independent, well-resourced anti-corruption institutions, including a dedicated court system with powers clearly specified in legislation, should be prioritized.*

Authorities' Views

47. The authorities acknowledged how high government spending—both directly and through SOEs—had skewed incentives across the economy. They also agreed that entrenched governance weaknesses and lack of coordination 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 stressed the government's traditional role in aiding the development of the private sector, particularly in the area of access to finance. They also acknowledged the importance of increasing financial intermediation and inclusion, for which the Financial Sector Development Strategy II and National Payment Switch will contribute to enhancing financial inclusion.

OTHER SURVEILLANCE ISSUES

48. Capacity Development is critical for supporting the authorities' reform efforts (Annex VI). Priorities include: strengthening PFM and fiscal-risk assessment, tax policy and administration, improving national-accounts and government-financial statistics, and financial-sector supervision. Given the depth of Lesotho's CD needs, careful sequencing and prioritization is required, not least to ensure that recipients are capable of absorbing and implementing recommendations.

49. The data provided to the Fund has some shortcomings that somewhat hamper surveillance, owing to capacity constraints. A more granular assessment is provided in Annex VII, but priority improvements include a rebasing of national accounts, and expanded coverage of government statistics, which should include the general government.

50. Staff engaged with the authorities on the removal of the existing exchange restriction (see Informational Annex). The CBL is working with staff to clarify the operation of the latest version of the Currency and Exchanges Manual for Authorized Dealers to explore ways for removing the existing exchange restrictions. There has been no change in the foreign exchange system since the last Article IV, and staff has not identified any new exchange restrictions or multiple currency practices (MCPs).

Authorities' Views

51. The authorities agreed that more efforts are needed to improve data quality and timeliness. The BOS will continue its efforts to rebase national accounts data with support from IMF CD and increased funding from the government. The MoFDP aims to improve both above- and below-the-line projections, and classification of capital expenditure, and to expand the coverage of extrabudgetary units, which will require improved coordination between departments of the MoFDP, as well as with the BOS, CBL, RSL, and other MDAs. The MoFDP also agrees to publish the quarterly Debt Transparency Report in a more timely manner.

STAFF APPRAISAL

52. Staff commend the authorities for their efforts to ensure fiscal sustainability, including through a welcome departure from the boom-bust fiscal cycle of the past. Amid sizable SACU transfers, the government has held to its vision of a more effective public sector that provides room for the private sector to grow—the net result has been a surplus in FY23/24 that has restored reserves, strengthened the peg, and halted the upward march of public debt.

53. But many reform items are still pending. In particular, key legislation is either still being revised, or has stalled. This includes laws on: public financial management; tax reform; tax administration; and amendments to the constitution that would boost central-bank independence and strengthen Lesotho's anti-corruption efforts. Passage of these items should be accelerated, as a matter of priority.

54. Lesotho's external position is broadly consistent with the level implied by fundamentals and desirable policies (Annex V). The current account balance has improved in FY23/24: robust SACU transfers, higher water royalties, and lower-than-expected imports have more than offset downbeat textile and diamond exports. However, given the temporary nature of SACU windfalls, long-standing competitiveness issues within the textile industry, and Lesotho's limited capacity to channel domestic savings into productive investment, the medium-term external position continues to hinge on fiscal prudence and structural reforms.

55. Higher water royalties present Lesotho with a valuable opportunity to expand development spending. Still, caution is warranted. As a proportion of GDP, government spending is already above international norms. But this has not been matched by improved economic performance. The authorities' main goal should be to ensure that additional revenues are saved wisely and spent strategically.

- Immediate options include strengthening short-term resilience by building reserve buffers and repaying debt, starting with domestic arrears.
- The authorities should also take steps to establish a savings framework (stabilization fund). To be effective, the fund should be anchored by a clear and credible fiscal rule, and set within a transparent governance and accountability structure.

56. The authorities' prudent approach to fiscal policy should be maintained. On recurrent spending in particular, measures to contain the public wage bill represent a critical step towards better service delivery. On revenues, tax policy and revenue-administration measures can also ensure a fairer and more efficient tax system.

57. The recommended fiscal stance for Lesotho is constrained by weaknesses in expenditure control. The baseline path of fiscal surpluses is potentially restrictive, but a hasty increase in public spending may undermine efforts to boost private-sector development. Instead, extra spending should be focused on capital investment, and should be contingent on the authorities' capacity to ensure that this investment is well targeted.

58. As a priority, therefore, stronger public financial management is needed urgently. Without additional measures in place, there is a danger that new revenues will be wasted.

59. Improved public investment management is essential. Before Lesotho's savings are allocated for investment or infrastructure projects, sufficient controls should be put in place to ensure that this investment is aligned with NSDP II priorities and represents value for money.

60. The monetary stance is consistent with maintaining the peg. In line with policy rates in South Africa, financial conditions in Lesotho are tight. If the South African authorities loosen their stance, the CBL should broadly follow suit, but should consider closing the small gap between the two countries' rates to more clearly signal Lesotho's commitment to the peg. On financial stability, the authorities should continue efforts to improve risk-based supervision of the banking sector, while enhancing supervision and regulation in the NBFI sector.

61. Job-rich growth will require broad structural reforms. Staff strongly encourages efforts to strengthen governance and reduce corruption risks, improve the business environment, strengthen financial inclusion, and enhance business lending. In in this context, PFM reforms will also be key in securing a more even playing field.

62. Staff strongly encourages the authorities to continue their efforts to increase capacity, improve data quality, and coordinate on macroeconomic policies. High data quality and information sharing are critical for policymaking, while close coordination between fiscal and monetary authorities is key to ensuring the consistency of macroeconomic policies with the exchange rate regime.

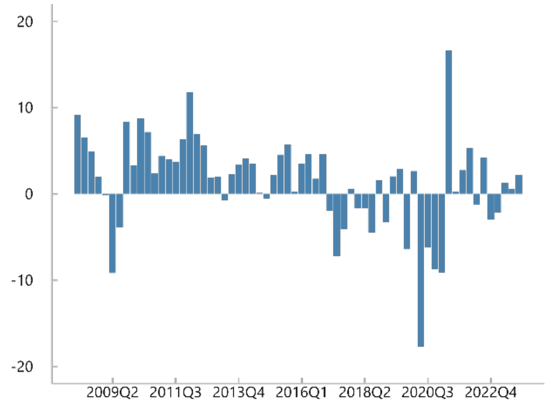
63. Staff recommends that the next Article IV consultation for Lesotho be held on the standard 12-month cycle.

Figure 1. Lesotho: High-Frequency Indicators

Real GDP growth picked up in the past two years…

Quarterly Real GDP Growth

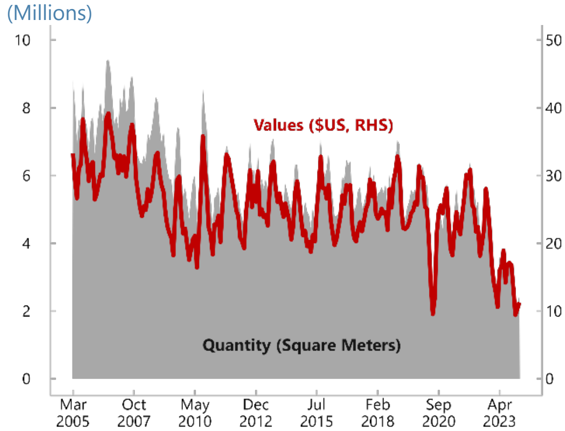
(Percent, year-on-year)



…despite declining apparel exports to the US.

Apparel Exports to the US

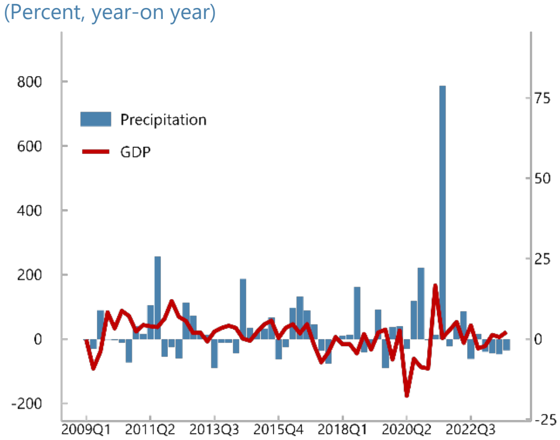
(Millions)



El Niño-induced drought in Southern Africa weighs negatively on Lesotho's rain-fed agriculture…

Precipitation and Growth in Agriculture

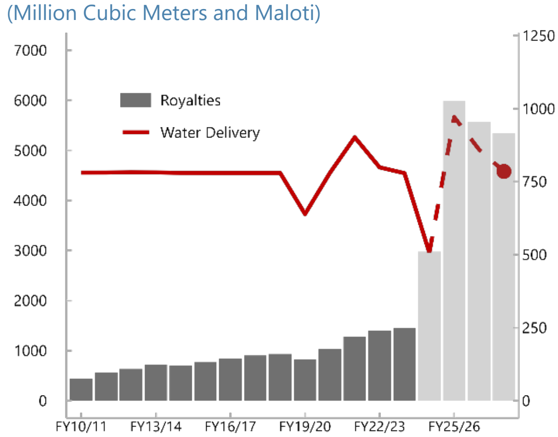
(Percent, year-on year)



…while renegotiated rates for water exports to South Africa are set to yield higher water royalties.

Water Exports to South Africa

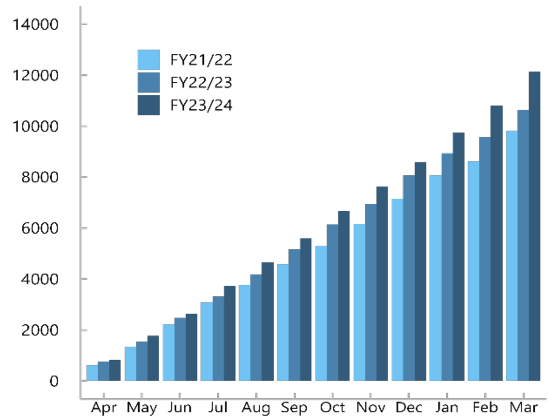
(Million Cubic Meters and Maloti)



Increase in domestic revenue was driven by the new alcohol and tobacco levy.

Cumulative Domestic Revenue

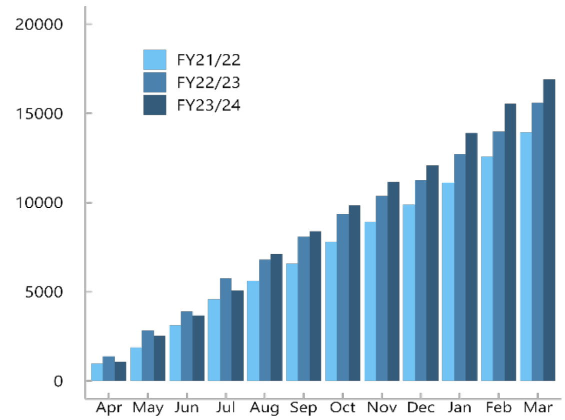
(Million Maloti)



Recurrent expenditure accelerated toward the end of the fiscal year, as the new procurement processes took hold.

Cumulative Recurrent Expenditure

(Million Maloti)

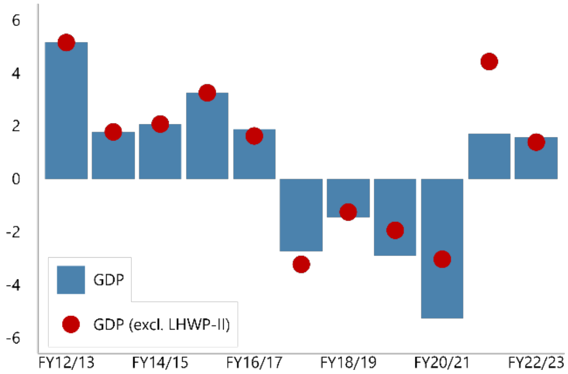


Sources: Bureau of Statistics; US International Trade Administration; Lesotho Highlands Development Authority; Food and Agriculture Organization; Ministry of Finance and Development Planning; and IMF staff calculations.

Figure 2. Lesotho: Real Sector Developments

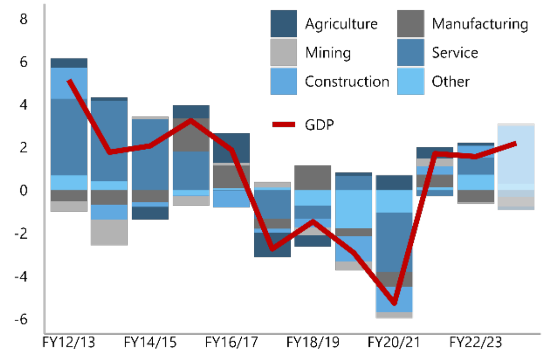
Growth turned positive in FY21/22 after four years of decline…

Real GDP Growth
(Percent)



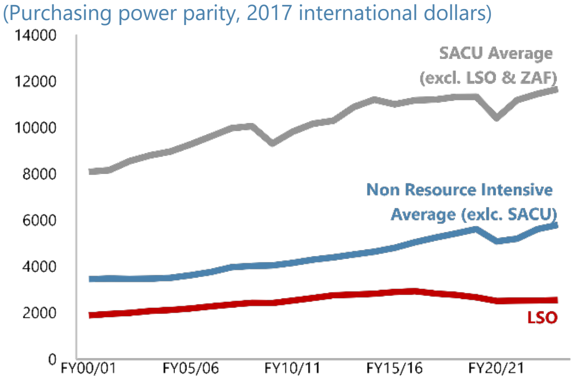
…supported by the rebound in services.

Sectoral Contributions to GDP Growth
(Percent)



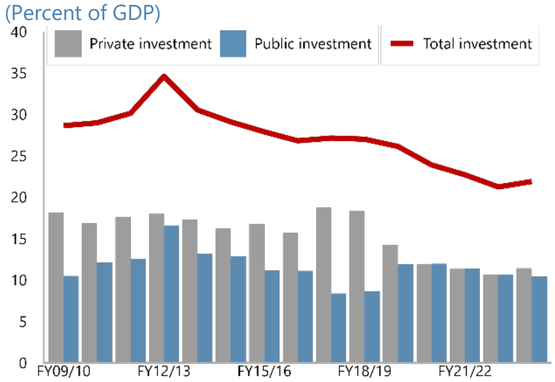
Cost of living adjusted per capita GDP shows no sign of convergence to SACU and SSA average…

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



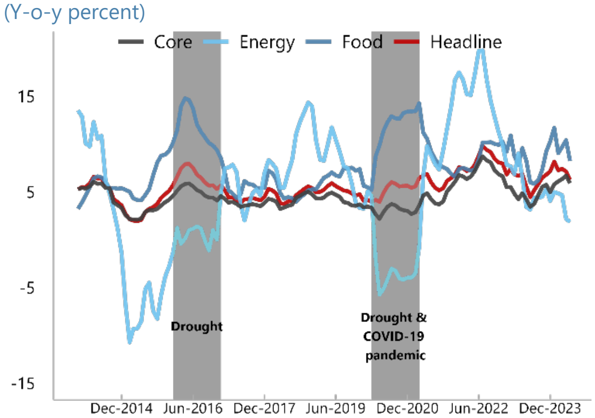
…and yet investment not yet taken off, signaling a delay for future convergence.

Evolution of Investment
(Percent of GDP)



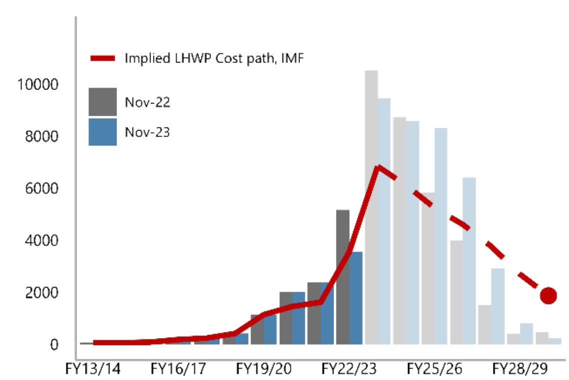
Inflation has abated over the past year as energy and food prices moderate.

Inflation
(Y-o-y percent)



The cash flows from the LHWP-II mega project are projected to surge in FY23/24 and FY24/25.

LHWP Projected Cash Flow and Cost Path
(Percent of GDP)



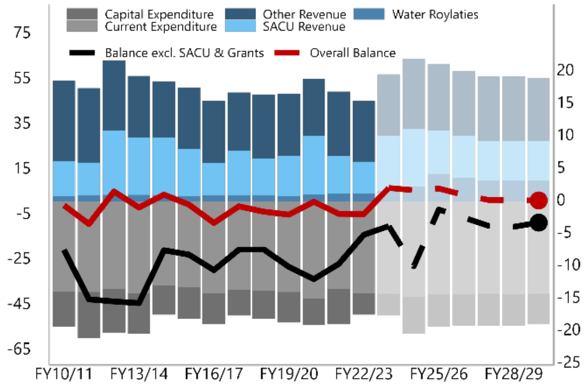
Sources: Bureau of Statistics; IMF, World Economic Outlook; Lesotho Highlands Development Authority; and IMF staff calculations.

Figure 3. Lesotho: Fiscal Developments

The historical pattern of high SACU transfers mirrored by a high wage bill did not materialize in FY23/24…

Fiscal Balance

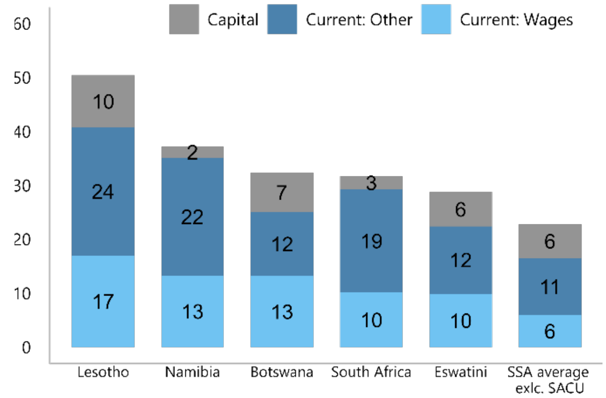
(Percent of GDP)



…though Lesotho's public wage bill remains the highest in the region.

Government Spending, 2023

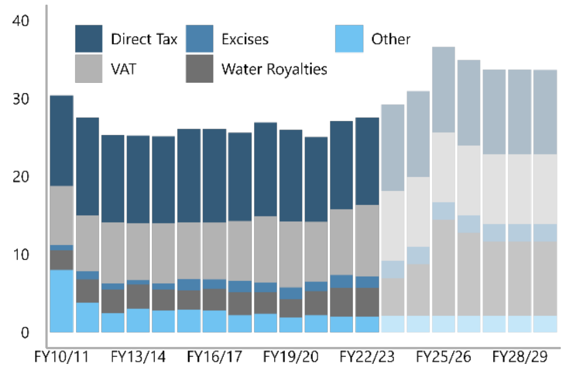
(Percent of GDP)



Domestic revenue mobilization efforts are bearing fruit…

Domestic Revenue

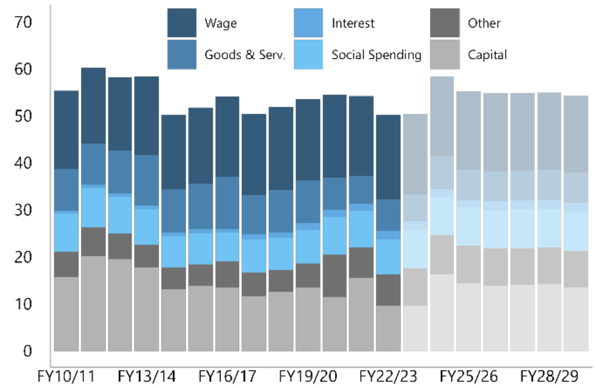
(Percent of GDP)



…so are the efforts to contain the recurrent expenditure.

Government Expenditure

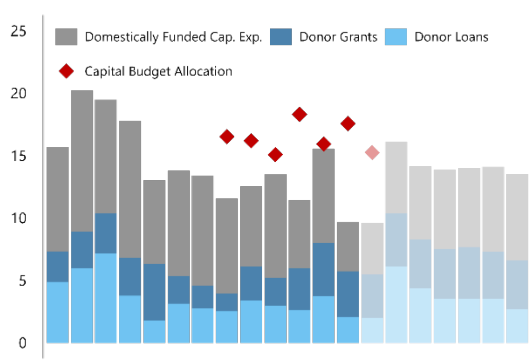
(Percent of GDP)



Capital expenditure has consistently been under-executed over the past decade.

Capital Expenditure

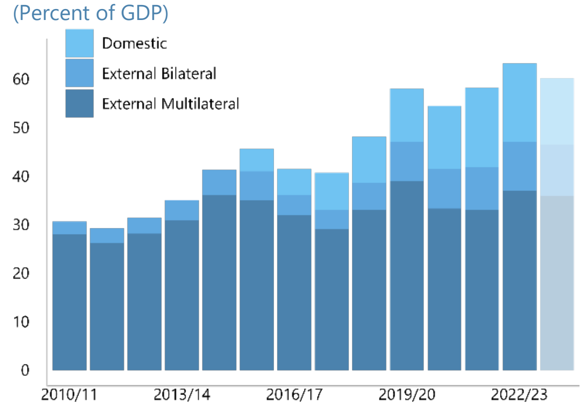
(Percent of GDP)



Public debt, largely consisting of external borrowing, appears to have stabilized at around 60 percent of GDP.

Total Public Debt

(Percent of GDP)

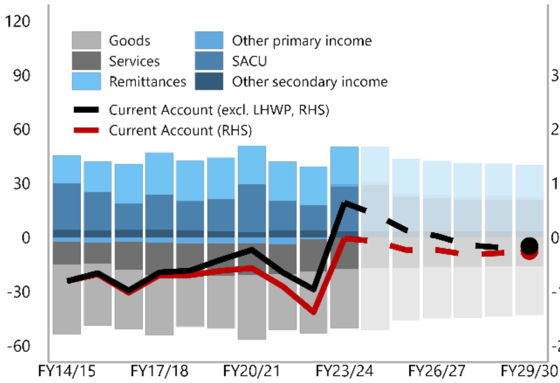


Sources: Ministry of Finance and Development Planning; IMF, World Economic Outlook, and IMF staff calculations.
Note: SACU=Southern African Customs Union.

Figure 4. Lesotho: External Sector Developments

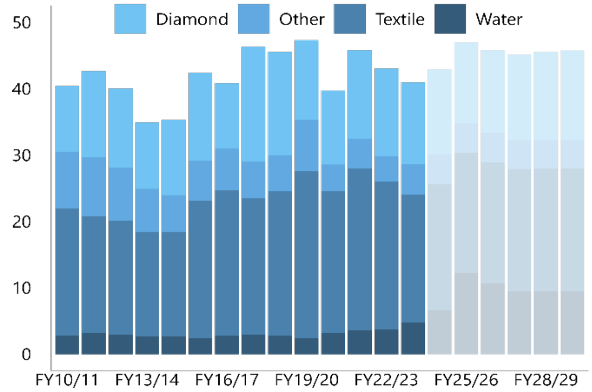
The current account will improve with windfall transfers…

Current Account
(Percent of GDP)



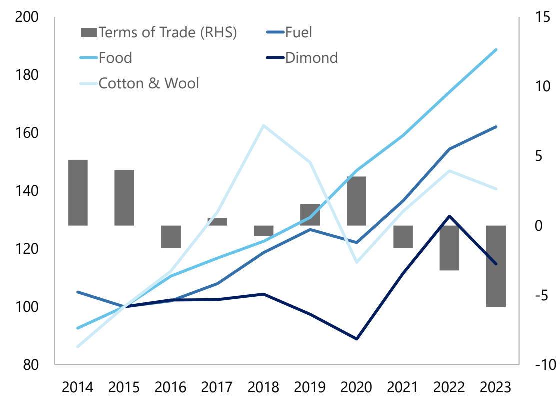
…despite sluggish exports from key sectors…

Composition of Exports
(Percent of GDP)



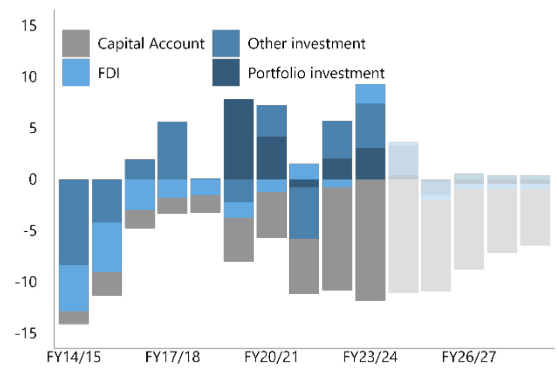
…with deteriorating terms of trade.

Terms of Trade and Prices of Key Commodities
(LHS: Index, 2015=100; RHS: percent change)



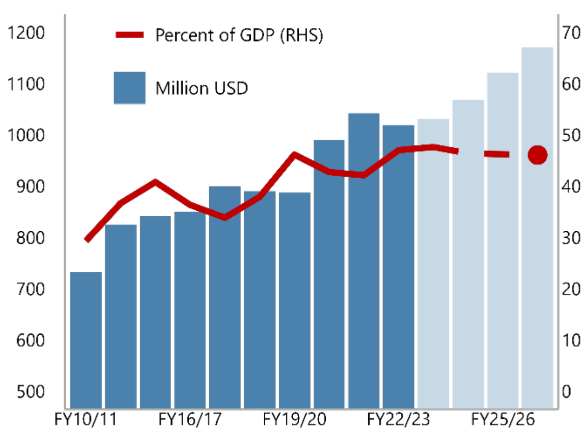
FDI remains subdued, and financing relies on capital transfers and loans…

External Financing
(Percent of GDP)



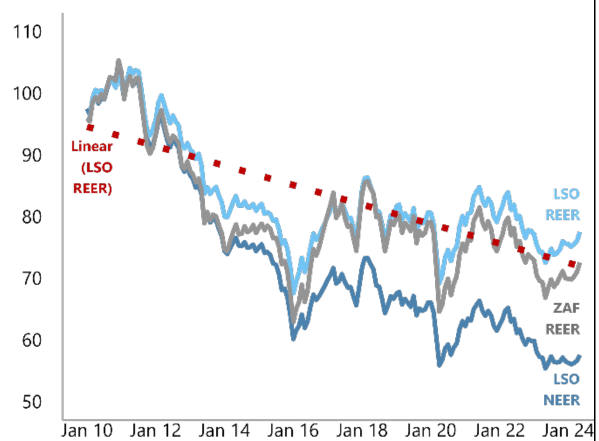
…and future debt levels still hinge on the fiscal stance.

External Debt



The REER is close to the trend but diverges from South Africa due to inflation differentials.

Exchange Rates
(Index, 2010=100)

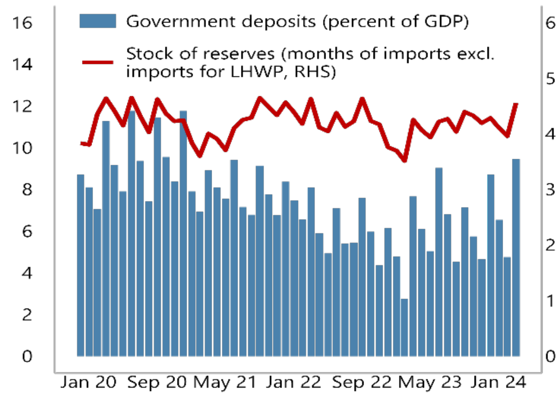


Sources: Central Bank of Lesotho; Ministry of Finance and Development Planning, and IMF staff calculations.
Notes: FDI=foreign direct investment; PV=present value; SACU=Southern African Customs Union.

Figure 5. Lesotho: Monetary and Financial Sector Developments

Reserves are bolstered by strong SACU transfers.

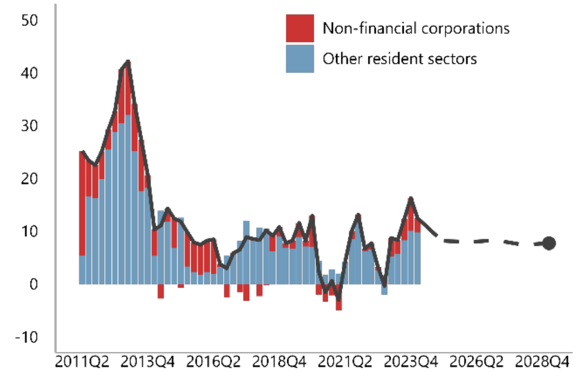
International Reserves and Government Deposits



Credit growth gained momentum due to the ramp-up of LHWP-II construction activities.

Private Sector Credit Growth

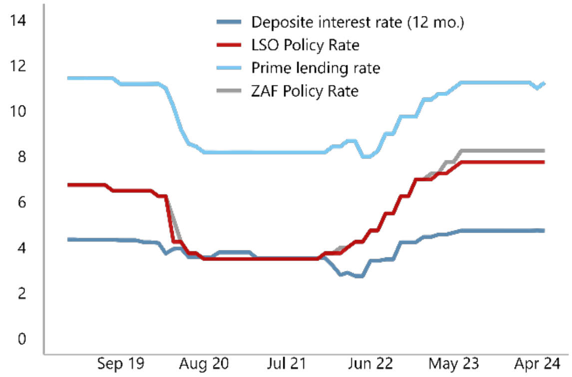
(Percent, y-o-y)



Policy rate has broadly followed the South African rate.

Policy Rate

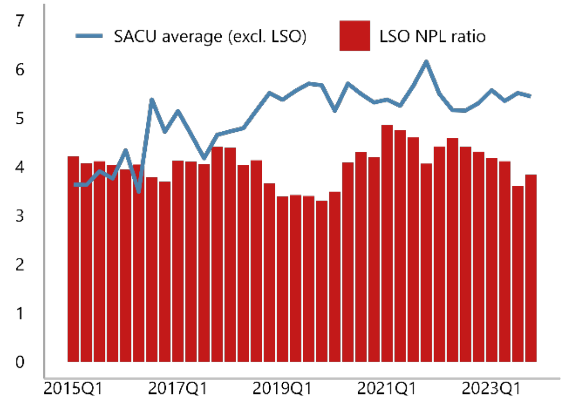
(Percent)



Nonperforming loans have declined and remained well below the SACU average.

Nonperforming Loans to Gross Loans

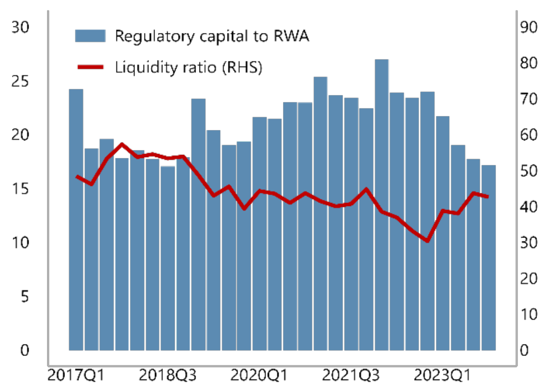
(Percent)



Banks remain liquid while capital coverage has declined.

Bank Capital Adequacy and Liquidity Ratio

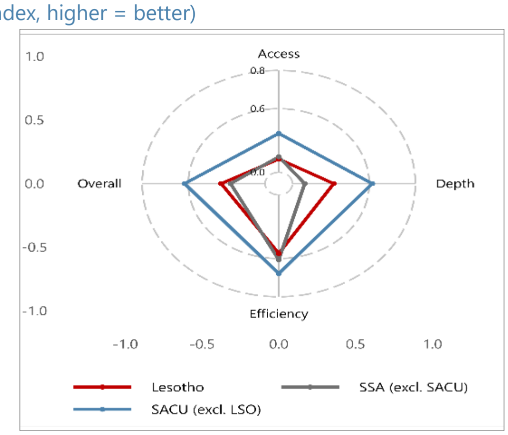
(Percent)



Financial development remains limited.

Financial Institution Development, 2021

(Index, higher = better)



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

Table 1. Lesotho: Selected Economic Indicators, 2020/21–2029/30[1]

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
	(12-month percent change, unless otherwise indicated)									
National Account and Prices										
GDP at constant prices (including LHWP-II)	-5.3	1.7	1.6	2.2	2.7	2.4	1.9	2.1	2.1	2.1
GDP at constant prices (excluding LHWP-II)	-3.0	4.4	1.4	1.5	1.6	1.7	1.8	1.9	1.9	2.0
GDP at market prices (Maloti billions)	34.2	36.0	38.5	41.5	45.2	48.8	52.4	56.1	60.0	64.4
GDP at market prices (US$ billions)	2.1	2.4	2.3	2.2	2.3	2.4	2.5	2.7	2.8	2.9
Consumer prices (average)	5.4	6.5	8.2	6.5	6.7	5.8	5.6	5.3	5.1	5.1
Consumer prices (eop)	6.5	7.2	6.8	7.4	6.0	5.5	5.4	5.3	5.0	5.0
GDP deflator	5.2	3.5	5.3	5.4	6.0	5.4	5.3	4.9	4.9	5.1
External Sector										
Terms of trade ("–" = deterioration)	3.5	-1.6	-3.2	-5.9	-2.7	0.6	0.1	-0.6	0.1	0.1
Average exchange rate										
(Local currency per US$)	16.4	14.9	17.0	...	...	...	...	...	...	...
Nominal effective exchange rate change (– depreciation) 2/	-8.7	6.3	-3.0	...	...	...	...	...	...	...
Real effective exchange rate (– depreciation) 2/	-6.0	8.7	-1.9	...	...	...	...	...	...	...
Current account balance (percent of GDP)	-5.7	-9.0	-13.8	-0.2	-0.7	-2.3	-2.3	-3.2	-2.9	-2.5
(excluding LHWP-II imports, percent of GDP)	-2.3	-6.5	-9.6	6.4	3.6	1.7	0.1	-1.5	-1.9	-1.6
Gross international reserves										
(Months of imports)	4.1	4.3	4.0	4.3	4.9	5.7	6.2	6.3	6.4	6.5
(excluding imports for LHWP-II, months of imports)	4.2	4.5	4.3	4.5	5.0	5.9	6.3	6.4	6.4	6.5
Money and Credit										
Net international reserves										
(US$ millions)	718	846	671	755	916	1,121	1,258	1,343	1,417	1,513
(Percent of M1 Plus)	109	127	111	114	137	163	179	185	190	197
(US$ millions, CBL calculation)	777	843	698	755	843	...	...	...	...	...
(Percent of M1 Plus, CBL calculation)	118	127	116	114	126	...	...	...	...	...
Domestic credit to the private sector	-3.0	6.7	8.7	12.5	9.0	8.1	8.0	8.3	7.4	7.7
Reserve money	16.5	1.0	24.5	24.0	1.9	1.2	1.6	1.6	2.1	2.3
Broad money	12.2	0.0	8.7	15.2	3.9	5.0	5.1	5.4	5.1	5.4
Interest rate (percent) 3/	3.8	3.5	3.5	4.7	...	...	...	...	...	...
	(Percent of GDP, unless otherwise indicated)									
Public Debt	54.7	58.4	64.5	61.5	59.9	59.7	59.8	59.8	59.5	59.5
External public debt	42.9	42.3	47.2	47.8	46.6	46.4	46.2	46.2	46.0	46.0
Domestic public debt	11.7	16.1	17.3	13.7	13.3	13.3	13.5	13.5	13.5	13.5
Central Government Fiscal Operations										
Revenue	54.4	48.8	44.6	56.5	63.4	61.1	57.8	55.6	55.6	54.8
Domestic revenue (excluding SACU transfers and grants)	*25.1*	*27.2*	*27.6*	*29.3*	*31.0*	*36.6*	*34.9*	*33.7*	*33.7*	*33.7*
SACU transfers	*26.2*	*16.7*	*14.0*	*24.5*	*25.6*	*19.3*	*18.5*	*17.5*	*17.5*	*17.5*
Grants	*3.1*	*4.9*	*3.0*	*2.8*	*6.9*	*5.2*	*4.3*	*4.3*	*4.3*	*3.6*
Recurrent expenditure	43.0	38.6	40.5	40.8	42.0	40.9	40.9	40.8	40.8	40.8
Of which: wages, including social contributions	17.6	17.0	18.0	17.1	16.8	16.7	16.6	16.4	16.4	16.4
Capital expenditure	11.4	15.5	9.6	9.6	16.3	14.3	13.9	14.0	14.1	13.5
Additional fiscal measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.0	-5.4	-5.5	6.1	5.1	5.8	3.0	0.8	0.6	0.5
(excluding SACU transfers and grants)	*-29.3*	*-27.0*	*-22.5*	*-21.1*	*-27.3*	*-18.6*	*-19.8*	*-21.1*	*-21.3*	*-20.6*
Operating balance	0.0	-5.4	-5.5	6.1	5.1	5.8	3.0	0.8	0.6	0.5
Primary balance	1.6	-4.0	-3.6	8.1	6.7	7.5	4.8	2.7	2.6	2.6
(excluding SACU transfers and grants)	*-27.7*	*-25.6*	*-20.6*	*-19.2*	*-25.7*	*-17.0*	*-18.0*	*-19.2*	*-19.3*	*-18.6*
Statistical discrepancy	-0.6	0.6	2.2	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 2a. Lesotho: Fiscal Operations of the Central Government, 2020/21–2029/30[1]
(LSL millions)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
Revenue	**18,635**	**17,584**	**17,193**	**23,312**	**28,622**	**29,774**	**30,258**	**31,141**	**33,323**	**35,304**
Tax revenue 2/	6,779	7,756	8,434	9,244	10,004	10,801	11,582	12,357	13,221	14,182
Taxes on income, profits, and capital gain	3,722	4,088	4,306	4,600	4,962	5,344	5,723	6,086	6,512	6,983
Taxes on goods and services	3,056	3,669	4,128	4,644	5,043	5,457	5,859	6,271	6,710	7,200
Of which: VAT	2,608	3,051	3,551	3,715	4,035	4,366	4,688	5,017	5,368	5,760
Grants	1,051	1,771	1,155	1,024	3,105	2,512	2,269	2,428	2,598	2,332
Budget support	149	429	363	332	344	382	410	439	470	504
Project grants	902	1,342	792	692	2,761	2,130	1,859	1,989	2,128	1,828
Of which: MCC	0	0	0	0	433	457	468	483	499	0
Non-tax revenue	1,825	2,048	2,205	2,896	3,963	7,054	6,713	6,526	6,982	7,490
Property Income	625	659	712	673	731	791	849	909	972	1,043
Sales of goods and services	1,199	1,389	1,493	2,192	3,199	6,226	5,825	5,575	5,965	6,398
Of which: Water royalties	1,074	1,303	1,423	1,988	2,977	5,987	5,567	5,300	5,670	6,082
Other non-tax revenue	1	0	0	31	34	37	39	42	45	48
SACU transfers	8,981	6,008	5,400	10,149	11,549	9,407	9,693	9,831	10,521	11,300
Recurrent Expenditure	**14,725**	**13,922**	**15,588**	**16,910**	**18,928**	**19,938**	**21,437**	**22,871**	**24,473**	**26,215**
Compensation of employees	6,028	6,130	6,921	7,075	7,583	8,142	8,705	9,207	9,861	10,569
Wages and salaries	5,500	5,584	6,306	6,443	6,914	7,421	7,932	8,394	8,981	9,627
Social contributions	528	546	615	632	669	721	774	813	880	942
Use of goods and services	2,331	2,153	2,541	2,381	3,222	3,120	3,351	3,586	3,837	4,107
Interest payments	544	505	710	821	739	802	968	1,083	1,182	1,275
Domestic	282	267	392	464	421	491	574	641	688	731
External	262	238	317	357	318	310	394	442	494	544
Subsidies	1,041	548	555	810	1,117	1,196	1,275	1,365	1,460	1,566
Grants	2,001	1,650	1,732	2,111	2,233	2,334	2,471	2,646	2,815	3,009
Social benefits	1,847	1,877	1,875	2,277	2,484	2,684	2,899	3,106	3,321	3,562
Of which: Poverty-reducing social spending	0.0	0.0	569	648	704	761	818	875	936	1,005
Other expenses	934	1,060	1,255	1,435	1,550	1,660	1,768	1,878	1,996	2,127
Of which: Tertiary education loan bursary scheme	891	950	1,030	1,109	1,205	1,303	1,400	1,498	1,603	1,720
Capital Expenditure	**3,914**	**5,603**	**3,714**	**2,571**	**7,367**	**6,976**	**7,255**	**7,848**	**8,460**	**8,691**
Domestically financed	1,862	2,717	1,506	433	2,684	2,934	3,336	3,545	4,071	4,429
Externally financed	2,052	2,885	2,208	2,138	4,683	4,041	3,919	4,304	4,389	4,262
Net Lending (+)/Borrowing (–) (Overall Fiscal Balance)	**-4**	**-1,941**	**-2,109**	**3,832**	**2,327**	**2,860**	**1,565**	**422**	**390**	**398**
Transactions in Financial Assets and Liabilities	**186**	**-2,152**	**-2,974**	**3,832**	**2,327**	**2,860**	**1,565**	**422**	**390**	**398**
Financial assets	209	227	-1,371	4,108	3,406	4,400	3,159	2,114	2,005	2,487
Domestic	184	227	-1,371	4,108	3,406	4,400	3,159	2,114	2,005	2,487
Deposits	160	225	-1,371	4,108	3,406	4,400	3,159	2,114	2,005	2,487
Central bank	152	45	-1,466	852	3,104	4,213	3,095	2,048	1,938	2,418
Commercial banks	8	180	96	784	0	0	0	0	0	0
Repayments to the IMF (net of CCRT)	25	2	-19	-28	302	187	64	66	67	69
Loans	25	2	0	0	0	0	0	0	0	0
Financial liabilities	394	2,379	1,603	276	1,080	1,540	1,594	1,692	1,615	2,088
Domestic	-248	1,388	1,037	-319	265	600	500	630	650	900
of which: banks (securities)	-211	707	168	-832	-300	-300	-200	-150	-100	-100
of which: banks (loans)	-7	-4	-4	-4	0	0	0	0	0	0
of which: Change in domestic arrears	-279	-71	100	-315	-235	-200	0	0	0	0
Foreign	642	991	566	596	815	940	1,094	1,062	965	1,188
Disbursements	1,150	1,543	1,415	1,446	1,922	1,911	2,061	2,314	2,261	2,534
of which: G20 DSSI	88	0	0	0	0	0	0	0	0	0
of which: World Bank COVID-19 EPRP	148	0	0	0	0	0	0	0	0	0
Amortization	-507	-552	-850	-850	-1,107	-971	-967	-1,253	-1,296	-1,346
CCRT	0.0	78	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	-189	0	865	0	0	0	0	0	0	0
Memorandum Items:										
Domestic revenue (tax and nontax revenue)	8,603	9,805	10,639	12,140	13,968	17,854	18,295	18,883	20,203	21,672
Recurrent expenditure (excluding interest payments)	14,181	13,417	14,879	16,089	18,188	19,136	20,469	21,788	23,291	24,939
Social spending	2,738	2,827	2,905	3,386	3,689	3,988	4,299	4,604	4,924	5,281
Stock of arrears	721	650	750	435	200	0	0	0	0	0

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 2b. Lesotho: Fiscal Operations of the Central Government, 2020/21–2029/30[1]

(Percent of GDP)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
Revenue	**54.4**	**48.8**	**44.6**	**56.5**	**63.4**	**61.1**	**57.8**	**55.6**	**55.6**	**54.8**
Tax revenue 2/	19.8	21.5	21.9	22.3	22.2	22.2	22.1	22.0	22.0	22.0
Taxes on income, profits, and capital gain	10.9	11.3	11.2	11.1	11.0	11.0	10.9	10.9	10.9	10.9
Taxes on goods and services	8.9	10.2	10.7	11.2	11.2	11.2	11.2	11.2	11.2	11.2
Of which: VAT	7.6	8.5	9.2	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Grants	3.1	4.9	3.0	2.8	6.9	5.2	4.3	4.3	4.3	3.6
Budget Support	0.4	1.2	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Project grants	2.6	3.7	2.1	2.0	6.1	4.4	3.5	3.5	3.5	2.8
Of which: MCC	0.0	0.0	0.0	1.0	1.0	1.0	0.9	0.9	0.0	0.0
Non-tax revenue	5.3	5.7	5.7	7.0	8.8	14.5	12.8	11.6	11.6	11.6
Property Income	1.8	1.8	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Sales of goods and services	3.5	3.9	3.9	5.3	7.1	12.8	11.1	9.9	9.9	9.9
Of which: Water royalties	3.1	3.6	3.7	4.8	6.6	12.3	10.6	9.5	9.5	9.5
Other non-tax revenue	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
SACU transfers	26.2	16.7	14.0	24.5	25.6	19.3	18.5	17.5	17.5	17.5
Recurrent Expenditure	**43.0**	**38.6**	**40.5**	**40.8**	**42.0**	**40.9**	**40.9**	**40.8**	**40.8**	**40.8**
Compensation of employees	17.6	17.0	18.0	17.1	16.8	16.7	16.6	16.4	16.4	16.4
Wages and salaries	16.1	15.5	16.4	15.5	15.3	15.2	15.2	15.0	15.0	15.0
Social contributions	1.5	1.5	1.6	1.5	1.5	1.5	1.5	1.4	1.5	1.4
Use of goods and services	6.8	6.0	6.6	5.7	7.1	6.4	6.4	6.4	6.4	6.4
Interest payments	1.6	1.4	1.8	2.0	1.6	1.6	1.8	1.9	2.0	2.0
Domestic	0.8	0.7	1.0	1.1	0.9	1.0	1.1	1.1	1.2	1.2
External	0.8	0.7	0.8	0.9	0.7	0.6	0.8	0.8	0.8	0.8
Subsidies	3.0	1.5	1.4	2.0	2.5	2.5	2.5	2.5	2.5	2.4
Grants	5.8	4.6	4.5	5.1	5.0	4.8	4.7	4.7	4.7	4.7
Social benefits	5.4	5.2	4.9	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Of which, Poverty-reducing social spending	0.0	0.0	*1.5*	*1.6*	1.6	1.6	1.6	1.6	1.6	1.6
Other expenses	2.7	2.9	3.3	3.5	3.4	3.4	3.4	3.4	3.3	3.3
Of which: Tertiary education loan bursary scheme	2.6	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Capital Expenditure	**11.4**	**15.5**	**9.6**	**9.6**	**16.3**	**14.3**	**13.9**	**14.0**	**14.1**	**13.5**
Domestically financed	5.4	7.5	3.9	4.2	5.9	6.0	6.4	6.3	6.8	6.9
Externally financed	6.0	8.0	5.7	5.5	10.4	8.3	7.5	7.7	7.3	6.6
Net Lending (+)/Borrowing (-) (Overall Fiscal Balance)	**0.0**	**-5.4**	**-5.5**	**6.1**	**5.1**	**5.8**	**3.0**	**0.8**	**0.6**	**0.5**
Transactions in Financial Assets and Liabilities	**0.5**	**-6.0**	**-7.7**	**6.1**	**5.1**	**5.8**	**3.0**	**0.8**	**0.6**	**0.5**
Financial assets	0.6	0.6	-3.6	6.8	7.5	9.0	6.1	3.8	3.3	3.8
Domestic	0.5	0.6	-3.6	6.8	7.5	9.0	6.1	3.8	3.3	3.8
Deposits	0.5	0.6	-3.6	6.8	7.5	9.0	6.1	3.8	3.3	3.8
Central bank	0.4	0.1	-3.8	2.1	6.8	8.6	5.9	3.7	3.2	3.7
Repayment to IMF (net of CCRT)	0.1	0.0	-0.1	-0.1	0.7	0.4	0.1	0.1	0.1	0.1
Commercial banks	0.0	0.5	0.2	1.9	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	1.2	6.6	4.2	0.7	2.4	3.2	3.0	3.0	2.7	3.2
Domestic	-0.7	3.9	2.7	-0.8	0.6	1.2	1.0	1.1	1.1	1.4
of which: banks (securities)	-0.6	2.0	0.4	-2.0	-0.7	-0.6	-0.4	-0.3	-0.2	-0.2
of which: banks (loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: Change in domestic arrears	-0.8	-0.2	0.3	-0.8	-0.5	-0.4	0.0	0.0	0.0	0.0
Foreign	1.9	2.8	1.5	1.4	1.8	1.9	2.1	1.9	1.6	1.8
Disbursements	3.4	4.3	3.7	3.5	4.3	3.9	3.9	4.1	3.8	3.9
of which: G20 DSSI	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.5	-1.5	-2.2	-2.0	-2.5	-2.0	-1.8	-2.2	-2.2	-2.1
CCRT	...	0.2	...	...	...	...	...	...	...	...
Statistical discrepancy	-0.6	0.6	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Domestic revenue (tax and nontax revenue)	25.1	27.2	27.6	29.3	31.0	36.6	34.9	33.7	33.7	33.7
Recurrent expenditure (excluding interest payments)	41.4	37.2	38.6	38.8	40.4	39.3	39.1	38.9	38.9	38.8
Social spending	8.0	7.8	7.5	8.2	8.2	8.2	8.2	8.2	8.2	8.2
Stock of arrears	2.1	1.8	1.9	1.0	0.4	0.0	0.0	0.0	0.0	0.0

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 3a. Lesotho: Monetary Accounts, 2020/21–2029/30[1]

(LSL millions, unless otherwise indicated)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
I. Monetary Survey										
Net foreign assets	17,146	16,582	17,773	21,613	25,150	29,875	33,321	35,666	37,867	40,500
Central bank	9,936	10,319	10,000	11,970	15,282	19,782	23,103	25,373	27,549	30,157
Commercial banks	7,210	6,263	7,773	9,643	9,868	10,093	10,218	10,293	10,318	10,343
Net domestic assets	-3,072	-2,505	-939	-3,242	-6,833	-10,647	-13,120	-14,378	-15,504	-16,938
Claims on central government (net)	-3,180	-2,853	-1,414	-3,919	-7,605	-12,295	-15,664	-17,927	-20,006	-22,547
Central bank	-3,402	-3,602	-2,236	-3,126	-6,512	-10,902	-14,071	-16,183	-18,162	-20,603
Commercial banks	222	749	822	-793	-1,093	-1,393	-1,593	-1,743	-1,844	-1,944
Claims on private sector	7,464	7,961	8,656	9,737	10,615	11,480	12,394	13,420	14,415	15,526
Other items (net)	-7,530	-7,827	-8,533	-9,413	-10,186	-10,204	-10,248	-10,298	-10,370	-10,407
Broad money (M2)	14,075	14,077	15,307	17,636	18,317	19,228	20,201	21,287	22,363	23,562
Currency outside banks	1,380	1,207	1,480	1,607	1,669	1,752	1,841	1,940	2,038	2,148
Deposits	12,695	12,870	13,827	16,029	16,648	17,475	18,360	19,347	20,325	21,414
II. Central Bank										
Net foreign assets	9,936	10,319	10,000	11,970	15,282	19,782	23,103	25,373	27,549	30,157
Gross reserves	11,665	13,166	12,565	15,209	18,425	22,816	26,144	28,410	30,588	33,346
Net domestic assets	-7,931	-8,294	-7,479	-8,843	-12,097	-16,560	-19,829	-22,048	-24,153	-26,684
Claims on central government (net)	-3,402	-3,602	-2,236	-3,126	-6,512	-10,902	-14,071	-16,183	-18,162	-20,603
Claims on private sector	160	113	164	190	207	224	240	257	276	296
Other items (net) 2/	-6,596	-6,510	-7,704	-7,563	-5,792	-5,882	-5,999	-6,122	-6,267	-6,377
Reserve money	2,005	2,025	2,522	3,127	3,185	3,222	3,273	3,325	3,396	3,473
Currency in circulation	1,765	1,575	1,940	2,120	2,202	2,312	2,429	2,560	2,689	2,833
Commercial bank deposits	238	449	580	1,004	982	910	844	765	707	640
Liabilities to other sectors	2	2	2	2	0	0	0	0	0	0
Memorandum Items:	(12-month percent change, unless otherwise indicated)									
Reserve money	16.5	1.0	24.5	24.0	1.9	1.2	1.6	1.6	2.1	2.3
Broad money	12.2	0.0	8.7	15.2	3.9	5.0	5.1	5.4	5.1	5.4
Narrow money (M1, percentage change)	18.8	-3.2	-3.9	33.7	3.8	5.0	5.1	5.4	5.1	5.4
Narrow money (M1)	6,864	6,642	6,382	8,531	8,859	9,299	9,770	10,295	10,816	11,396
Credit to the private sector (percentage change)	-3.0	6.7	8.7	12.5	9.0	8.1	8.0	8.3	7.4	7.7
Credit to the private sector (percent of GDP)	21.8	22.1	22.5	23.5	23.5	23.5	23.7	23.9	24.0	24.1
Velocity (GDP/broad money)	2.4	2.6	2.5	2.4	2.5	2.5	2.6	2.6	2.7	2.7
Net international reserves	10,626	12,330	11,933	14,478	17,962	22,540	25,932	28,264	30,509	33,336
(percent of domestic currency deposits)	37.8	50.7	44.7	41.7	...	...	...	...	...	...

Sources: Lesotho authorities and IMF staff calculations.

1/ The fiscal year runs from April 1 to March 31.

2/ Including valuation changes.

Table 3b. Lesotho: Monetary Accounts, 2020/21–2029/30[1]

(Percent of GDP, unless otherwise indicated)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
					I. Monetary Survey					
Net foreign assets	50.1	46.0	46.1	52.1	55.7	61.3	63.6	63.6	63.1	62.8
Central bank	29.0	28.6	26.0	28.8	33.8	40.6	44.1	45.3	45.9	46.8
Commercial banks	21.1	17.4	20.2	23.2	21.8	20.7	19.5	18.4	17.2	16.0
Net domestic assets	-9.0	-7.0	-2.4	-7.8	-15.1	-21.8	-25.1	-25.6	-25.8	-26.3
Claims on central government (net)	-9.3	-7.9	-3.7	-9.4	-16.8	-25.2	-29.9	-32.0	-33.3	-35.0
Central bank	-9.9	-10.0	-5.8	-7.5	-14.4	-22.4	-26.9	-28.9	-30.3	-32.0
Commercial banks	0.6	2.1	2.1	-1.9	-2.4	-2.9	-3.0	-3.1	-3.1	-3.0
Claims on private sector	21.8	22.1	22.5	23.5	23.5	23.5	23.7	23.9	24.0	24.1
Other items (net)	-22.0	-21.7	-22.1	-22.7	-22.6	-20.9	-19.6	-18.4	-17.3	-16.1
Broad money (M2)	41.1	39.1	39.7	42.5	40.6	39.4	38.6	38.0	37.3	36.6
Currency outside banks	4.0	3.4	3.8	3.9	3.7	3.6	3.5	3.5	3.4	3.3
Deposits	37.1	35.7	35.9	38.6	36.9	35.8	35.1	35	34	33
					II. Central Bank					
Net foreign assets	29.0	28.6	26.0	28.8	33.8	40.6	44.1	45.3	45.9	46.8
Gross reserves	34.1	36.5	32.6	36.7	40.8	46.8	49.9	50.7	51.0	51.7
Net domestic assets	-23.2	-23.0	-19.4	-21.3	-26.8	-34.0	-37.9	-39.3	-40.2	-41.4
Claims on central government (net)	-9.9	-10.0	-5.8	-7.5	-14.4	-22.4	-26.9	-28.9	-30.3	-32.0
Claims on private sector	0.5	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other items (net) 2/	-19.3	-18.1	-20.0	-18.2	-12.8	-12.1	-11.5	-10.9	-10.4	-9.9
Reserve money	5.9	5.6	6.5	7.5	7.1	6.6	6.3	5.9	5.7	5.4
Currency in circulation	5.2	4.4	5.0	5.1	4.9	4.7	4.6	4.6	4.5	4.4
Commercial bank deposits	0.7	1.2	1.5	2.4	2.2	1.9	1.6	1.4	1.2	1.0
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	16.5	1.0	24.5	24.0	1.9	1.2	1.6	1.6	2.1	2.3
Broad money	12.2	0.0	8.7	15.2	3.9	5.0	5.1	5.4	5.1	5.4
Narrow money (M1, percentage change)	18.8	-3.2	-3.9	33.7	3.8	5.0	5.1	5.4	5.1	5.4
Narrow money (M1)	20.0	18.4	16.6	20.6	19.6	19.1	18.7	18.4	18.0	17.7
Credit to the private sector (percentage change)	-3.0	6.7	8.7	12.5	9.0	8.1	8.0	8.3	7.4	7.7
Credit to the private sector	21.8	22.1	22.5	23.5	23.5	23.5	23.7	23.9	24.0	24.1
Velocity (GDP/broad money)	2.4	2.6	2.5	2.4	2.5	2.5	2.6	2.6	2.7	2.7
Net international reserves	31.0	34.2	31.0	34.9	39.8	46.2	49.5	50.4	50.8	51.7
(percent of domestic currency deposits)	37.8	50.7	44.7	...	...	...	...	...	...	...

Sources: Lesotho authorities and IMF staff calculations.

1/ The fiscal year runs from April 1 to March 31.

2/ Including valuation changes.

Table 4a. Lesotho: Balance of Payments, 2020/21–2029/30[1]
(US$ millions, unless otherwise indicated)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
Current Account	**-118**	**-219**	**-313**	**-4**	**-16**	**-56**	**-59**	**-85**	**-80**	**-73**
Current account (excluding LHWP-II)	**-48**	**-157**	**-217**	**142**	**83**	**41**	**3**	**-41**	**-53**	**-48**
Trade balance	-753	-750	-774	-723	-781	-704	-718	-750	-775	-786
Exports, f.o.b.	831	1,111	975	906	988	1,140	1,164	1,202	1,269	1,338
Imports, f.o.b	1,584	1,861	1,749	1,630	1,769	1,844	1,882	1,952	2,044	2,124
Services (net)	-365	-403	-414	-388	-394	-405	-417	-431	-446	-467
Primary income (net)	386	435	471	487	489	501	519	539	558	571
Secondary income (net)	614	499	404	621	670	552	557	558	582	609
Official transfers	573	447	357	578	627	508	513	512	535	561
Of which: SACU transfers	549	405	318	541	589	468	470	467	489	513
Other transfers	41	52	46	43	43	44	45	46	47	48
Capital Account	**93**	**131**	**229**	**263**	**256**	**216**	**199**	**167**	**154**	**141**
Financial Account 2/	**124**	**-105**	**110**	**204**	**83**	**-49**	**-10**	**-16**	**-15**	**-39**
Foreign direct investment	-26	36	-17	41	7	-12	-13	-13	-14	-24
Portfolio investment	87	-19	46	67	9	-6	-11	-12	-12	-17
Other investment	64	-121	82	96	67	-31	14	9	11	2
Of which:										
Public sector	-39	-67	-33	-32	-42	-47	-53	-50	-45	-54
Disbursements	70	104	83	77	98	95	100	110	105	115
Central government	17	99	83	77	98	95	100	110	105	115
Amortization	31	37	50	45	56	48	47	60	60	61
Errors and Omissions	**246**	**-49**	**165**	**-1**	**0**	**0**	**0**	**0**	**0**	**0**
Overall Balance	**97**	**-33**	**-29**	**54**	**157**	**209**	**151**	**97**	**89**	**108**
Financing	**-97**	**33**	**29**	**-54**	**-157**	**-209**	**-151**	**-97**	**-89**	**-108**
Net official reserve movements (+ increase)	36	-38	-29	54	157	209	151	97	89	108
SDR allocation	0	94	0	0	0	0	0	0	0	0
Other reserves	36	-132	-29	54	...	...	...	...	...	...
Exceptional financing	60	5	0	0	0	0	0	0	0	0
IMF RCF/RFI	48	0	0	0	0	0	0	0	0	0
G20 DSSI	5	0	0	0	0	0	0	0	0	0
IMF CCRT	0	5	0	0	0	0	0	0	0	0
World Bank COVID-19 EPRP	8	0	0	0	0	0	0	0	0	0
Memorandum Items:										
Nominal GDP	2,092	2,427	2,267	2,211	...	...	...	...	...	...
Gross international reserves										
(US$ millions)	788	903	707	793	939	1,134	1,269	1,350	1,421	1,509
(excluding LHWP-II, months of imports)	4.2	4.5	4.3	4.5	5.0	5.9	6.3	6.4	6.4	6.5
Net international reserves										
(US$ millions)	718	846	671	755	916	1,121	1,258	1,343	1,417	1,513
(excluding LHWP-II, months of imports)	3.9	4.2	4.0	4.3	4.9	5.8	6.3	6.4	6.4	6.4
Remittances	429	490	505	470	471	483	499	518	537	548
Exports of goods and services (percentage change)	-25.4	34.8	-12.4	-7.2	8.9	15.2	2.1	3.3	5.5	5.5
Imports of goods and services (excluding LHWP-II, percentage change)	-11.7	13.5	-6.3	-9.5	10.2	4.9	3.3	4.5	5.2	4.3

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 4b. Lesotho: Balance of Payments, 2020/21–2029/30[1]

(Percent of GDP, unless otherwise indicated)

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Act.	Act.	Act.	Est.	Projections					
Current Account	-5.7	-9.0	-13.8	-0.2	-0.7	-2.3	-2.3	-3.2	-2.9	-2.5
Current account (excluding LHWP-II)	-2.3	-6.5	-9.6	6.4	3.6	1.7	0.1	-1.5	-1.9	-1.6
Trade balance	-36.0	-30.9	-34.1	-32.7	-33.9	-29.0	-28.3	-28.2	-27.8	-26.9
Exports, f.o.b.	39.7	45.8	43.0	41.0	42.9	47.0	45.8	45.1	45.5	45.8
Imports, f.o.b	75.7	76.7	77.1	73.7	76.8	76.0	74.1	73.3	73.3	72.6
Services (net)	-17.5	-16.6	-18.2	-17.5	-17.1	-16.7	-16.4	-16.2	-16.0	-16.0
Primary income (net)	18.5	17.9	20.8	22.0	21.2	20.7	20.4	20.2	20.0	19.5
Secondary income (net)	29.3	20.6	17.8	28.1	29.1	22.8	21.9	20.9	20.9	20.8
Official transfers	27.4	18.4	15.8	26.1	27.2	21.0	20.2	19.2	19.2	19.2
Of which: SACU transfers	26.2	16.7	14.0	24.5	25.6	19.3	18.5	17.5	17.5	17.5
Other transfers	2.0	2.1	2.0	1.9	1.9	1.8	1.8	1.7	1.7	1.6
Capital Account	**4.4**	**5.4**	**10.1**	**11.9**	**11.1**	**8.9**	**7.8**	**6.3**	**5.5**	**4.8**
Financial Account 2/	**5.9**	**-4.3**	**4.9**	**9.2**	**3.6**	**-2.0**	**-0.4**	**-0.6**	**-0.6**	**-1.3**
Foreign direct investment	-1.3	1.5	-0.8	1.9	0.3	-0.5	-0.5	-0.5	-0.5	-0.8
Portfolio investment	4.1	-0.8	2.0	3.0	0.4	-0.2	-0.4	-0.4	-0.4	-0.6
Other investment	3.0	-5.0	3.6	4.3	2.9	-1.3	0.5	0.4	0.4	0.1
Of which:										
Public sector	-2.2	-2.7	-2.1	-4.1	-4.1	-3.3	-1.9	-0.9	-2.0	-3.1
Disbursements	3.7	4.2	4.3	6.1	6.6	5.3	3.8	3.2	4.2	5.2
Central government	3.7	4.2	4.3	6.1	6.6	5.3	3.8	3.2	4.2	5.2
Amortization	1.5	1.5	2.2	2.0	2.5	2.0	1.8	2.2	2.2	2.1
Errors and Omissions	**11.8**	**-2.0**	**7.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall Balance	**4.6**	**-1.4**	**-1.3**	**2.4**	**6.8**	**8.6**	**5.9**	**3.7**	**3.2**	**3.7**
Financing	**-4.6**	**1.4**	**1.3**	**-2.4**	**-6.8**	**-8.6**	**-5.9**	**-3.7**	**-3.2**	**-3.7**
Net official reserve movements (+ increase)	1.7	-1.6	-1.3	2.4	6.8	8.6	5.9	3.7	3.2	3.7
SDR allocation	0.0	3.9	0.0	0.0	...	...	...	...	...	...
Other reserves	1.7	-5.4	-1.3	2.4	...	...	...	...	...	...
Exceptional financing	2.9	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF RCF/RFI	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
G20 DSSI	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF CCRT	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank COVID-19 EPRP	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:										
Nominal GDP (US$ millions)	2,092	2,427	2,267	2,211	...	...	...	...	...	...
Gross international reserves	37.7	37.2	31.2	35.9	40.8	46.8	49.9	50.7	51.0	51.6
Net international reserves	34.3	34.9	29.6	34.1	39.8	46.2	49.5	50.4	50.8	51.7
Remittances	20.5	20.2	22.3	21.2	20.5	19.9	19.7	19.4	19.2	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.

Table 5. Lesotho: Financial Soundness Indicators, 2016/17–2023/24[1]

(Percent, unless otherwise indicated)

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Banking Indicators								
Capital Adequacy								
Capital to assets	11.2	10.3	12.8	11.6	12.8	13.5	12.1	11.0
Regulatory capital to risk-weighted assets	24.2	18.5	23.3	21.6	25.3	27.0	21.7	15.6
Regulatory tier I capital to risk-weighted assets	22.4	21.2	25.6	23.6	27.1	29.0	22.7	14.6
Nonperforming loans net of provisions to capital	7.4	6.8	5.0	5.3	5.7	6.9	4.3	5.2
Asset Quality								
Large exposure to capital	109.3	85.5	74.4	91.3	61.9	56.2	61.3	58.3
Nonperforming loans to total gross loans	4.1	4.4	3.4	3.5	4.9	4.4	4.2	3.8
Bank provisions to nonperforming loans	45.9	62.7	56.6	59.6	61.2	49.9	67.6	53.3
Earnings and Profitability								
Trading income to total income	2.8	2.9	4.3	5.0	4.4	4.6	4.3	2.8
Return on assets	4.1	3.8	4.1	3.5	2.0	2.5	0.8	0.9
Return on equity	22.8	23.5	23.9	19.4	10.0	12.8	4.4	5.5
Interest margin to gross income	60.5	59.7	62.9	58.1	55.0	55.4	58.5	56.7
Noninterest expenses to gross income	57.7	59.8	57.7	59.7	68.5	70.2	64.1	61.6
Personnel expenses to noninterest expenses	43.1	40.1	44.3	43.2	42.1	40.1	40.8	42.0
Liquidity								
Liquid assets to total assets	35.8	38.0	33.3	30.1	28.5	26.4	27.7	32.6
Liquid assets to short-term liabilities	48.4	53.7	48.7	44.3	41.4	38.5	38.7	46.4
Customer deposits to total (non-interbank) loans	156.2	170.3	156.1	144.9	168.8	161.4	177.2	171.7
Exposure to Foreign Exchange Risk								
Net open position in foreign exchange to capital	178.2	354.0	265.9	261.4	303.1	251.6	293.4	280.4
Foreign currency-denominated loans to total loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency-denominated liabilities to total liabili	74.8	95.8	30.7	36.7	262.9	25.2	82.2	24.0

Sources: Lesotho authoritie and IMF staff calculations.

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

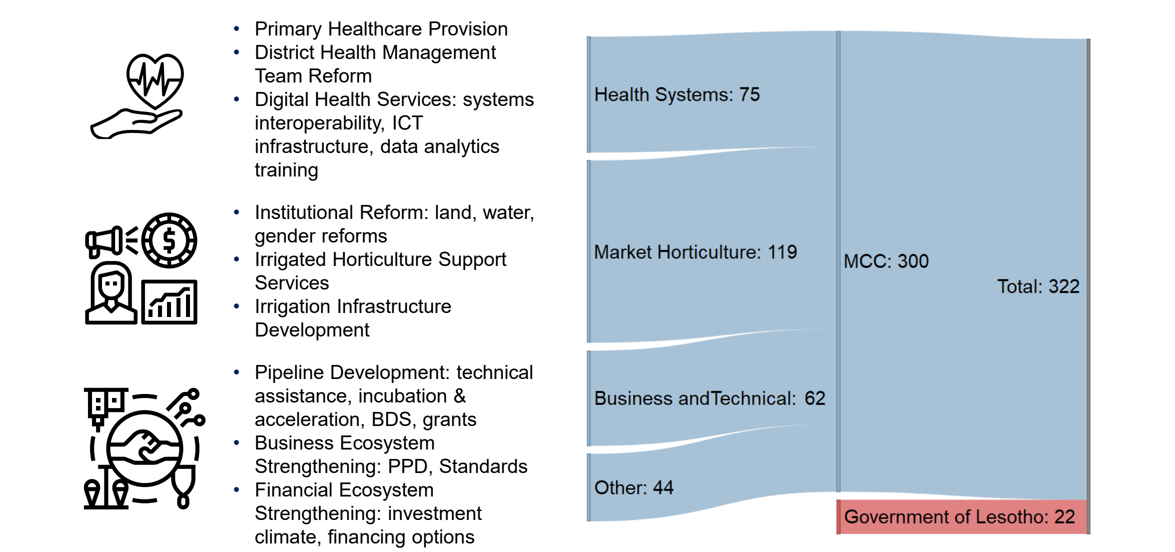
Annex I. Lesotho's Compacts with the Millennium Challenge Corporation

1. The first MCC Compact between the US Government and Lesotho extended over 2008–13. This aimed to i) improve Lesotho's water supply, sanitation services, and healthcare system, and ii) to stimulate private sector activity by improving access to credit, reducing financial transaction costs, and promoting women's participation in the economy. The five-year grant was for $362.5 million.

2. The MCC Compact II aims to invest in high-value crop production, ensure greater access to quality healthcare, and further support private sector development. The MCC Health and Horticulture Compact, a 5-year project with a total funding of $322 million ($300 million from the U.S. government and $22 million by the Lesotho government), came into effect in March 2024, after several preconditions were met, including enacting the *Counter Domestic Violence Act,* the *Harmonization of the Rights of Customary Widows with Legal Capacity of Married Person Act,* and the *Occupational Health and Safety Act*. The compact aims to:

- Increase rural incomes and combat food insecurity by investing in climate-smart irrigation infrastructure and fostering partnerships between commercial farmers and local small-holders to produce high-value crops and build value chains;
- Improve primary healthcare services (especially maternal and child health), improve healthcare financial and management systems, and modernize health data systems; and
- Support existing and new firms in priority sectors (agriculture, creative industries, manufacturing, tourism), particularly those led by women and youth, through technical assistance, business development services and access to financing.

MCC Compact II (Million $US)



Source: MCA Lesotho.

Annex II. Implementation of 2023 Article IV Recommendations

Recommendation	Status of Implementation
Align expenditure with resources	The moratorium on public sector hiring has remained in effect since February 2023. Transition to performance-based pay which will eliminate the automatic nonmerit ("notch") increases is underway with the support of the World Bank. Positions created outside of the establishment list have been eliminated. However, the capital budget continues to include unproductive projects which lack prioritization and effective implementation, and a C-PIMA has not been carried out. An upcoming TA mission will build the revenue forecasting capacity of the newly established Tax Policy Unit. A post-TADAT mission in May will help RSL develop a coherent reform agenda to address administrative weaknesses identified in TADAT in March 2023. An agreed fiscal rule is yet to be identified and submitted to the cabinet for approval.
Strengthen PFM	The new procurement act was enacted in March 2023, but the procurement authority has yet to be set up and regulations are yet to be adopted. Monthly reconciliation is still not being carried out, and the backlog of unreconciled transactions is increasing. Expenditure controls continue to be weak, a quarterly arrears survey has yet to be finalized, and a clearance strategy has not yet been developed. The new PMFA bill was returned to the MoFDP for revision. Draft fiscal risk statement has been prepared but not published.
Improve monetary policy transmission, financial stability and coordination	The CBL continues to enhance its risk-based supervision framework for banks, including reviewing and assessing bank recovery plans, and developing an early intervention framework. While supervision framework for NBFIs is still in its early stages, insurance sector data are now submitted to the Fund on a quarterly basis. The CBL has reviewed the eligible asset classes for its foreign reserve investment, and maintained a highly liquid working capital that is in line with the liquidity needs of the Bank. The CBL intends to maintain the current liquidity management framework and continue developing domestic bond market without overburdening the government with interest payments. The CBL is open for discussions on liquidity analysis and forecasting to build analytical understanding of liquidity in the system, including an overview of the operational toolkit and instruments for liquidity absorption and injection. Progress has yet to be made in restarting the inter-Ministerial working groups and building common policy frameworks for monetary and fiscal policy coordination.
Strengthen the business climate	Parliament passed the Insolvency Bill 2021 on March 17, 2022, but implementation of regulations is pending. Government footprint on the economy remains large, with a public stake in 20 SOEs, some of which are in competitive sectors such as manufacturing and accommodation services. A follow up mission on digital signatures developed a prototype; the authorities are working on identifying a vendor and expect to pass the Law on Digital Signatures by December. Government diagnostic hasn't been undertaken. Update on anti-corruption body is pending passage of the Omnibus Bill.

Annex III. Summary of the FY24/25 Budget

1. This Annex provides key excerpts from the FY24/25 Budget Speech and other key documents.

2. The government's aim is not so much to reduce expenditures but improve expenditure efficiency and effectiveness. The government will focus on building the enabling infrastructure to support growth sectors[1] and creating viable public private partnerships to accelerate infrastructure development, directing resources to productive ventures that stimulate investment by the private sector and away from recurrent spending.

3. The medium-term fiscal strategy aims at reinforcing long term fiscal sustainability which would help achieve sustainable, job-rich and resilient economic growth. Further fiscal consolidation and counter-cyclical fiscal policy will help use fiscal resources more prudently by building buffers for use in times of economic downturn. The fiscal strategy emphasizes diversifying revenue sources and improving the efficiency in revenue collection, while containing recurrent expenditure, to keep the deficit below 3 percent of GDP, and maintaining an acceptable debt level not exceeding 60 percent of GDP threshold. Macroeconomic stability and prudent fiscal management are crucial to sustain confidence of investors and development partners.

4. The capital budget is to grow from 13 percent to 20 percent of GDP in the medium term [sic]. The government aims to wind down unproductive spending and accommodate key pipeline projects that contribute to economic and private sector growth.

5. Cost saving and leakage-reducing measures on the recurrent expenditure side include:

- *Reducing the wage bill from 18.5 percent to around 14 percent of GDP* will be achieved by a combination of hiring freeze, except for critical positions, eliminating redundant positions, implementing a new Performance Management Policy, developing policy for voluntary separation and providing negotiated exit packages for selected staff.
- Improving the targeting of subsidies or grants through adoption of means-testing mechanisms.
- Establishing e-payment gateway for cashless payments.
- Improving asset management.
- Establishing Public Procurement Authority to oversee procurement issues.

[1] Key growth sectors include (i) agriculture; (ii) manufacturing, (iii) tourism and creative industries, and (iv) innovation and technology, and (v) mining.

6. Despite these measures, the FY24/25 budget envisages increases in salaries and social benefits:

- Salaries and wages will increase by the automatic notch of 2.5 percent plus 2 percent across-the-board to preserve the take home pay. The tax credit and tax brackets will be adjusted accordingly.

- Old Age Pension will be increased by LSL50 (from LSL900 to LSL950 per month), effective April 1, 2024.

7. Domestic revenue will be supported by the following measures:

- Developing a medium-term revenue strategy and more efficient forecasting model,

- Passage of outstanding tax bills by Parliament (the passage of tax bills is not assumed in the baseline projections of staff or the authorities),

- Fiscalization of VAT and other taxes,

- Developing a uniform policy for fees and charges,

- Revising oil levy, and

- Exploring options for budget support grants, concessional financing and other innovative financing instruments. MCA Lesotho will invest $300 million over a 5-year period in agriculture, health and enhancing business environment.

8. The budget FY24/25 recognizes the importance of credible and reliable statistics for effective policymaking. To this end, the authorities will finalize the Statistics Act, restructure relevant institutions, and conduct the labor force survey to inform targeted interventions to address underemployment and unemployment.

9. The government's budget strategy paper sets out the following principles to improve resource allocation in the economy: (i) capital budget should be reviewed to wind down unproductive spending and accommodate key projects aimed at improving business environment and catalyzing private sector investment, especially in selected growth sectors; (ii) recurrent expenditure, especially the wage bill, should grow slower than capital budget, and (iii) the government footprint on the economy should be reduced in favor of private-sector-led economy, including by reducing dependence of public institutions on fiscal transfers.

Annex IV. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Impact if Realized	Policy Response
Conjunctural Risks			
Intensification of regional conflict(s). Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	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.
Commodity price volatility. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	High	**Medium.** Commodity prices are volatile and trend up amid supply constraints, war in Ukraine, export restrictions, and currency depreciations. This leads to short-run disruptions in the green transition, bouts of price and real sector volatility, food insecurity, social unrest, and acute food and energy crises (especially in EMDEs with lack of fiscal space).	Limit the damage by cushioning higher consumption expenditure for individuals and firms, including by increasing spending on social protection.
Global growth surprises: • **Slowdown.** Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction (e.g., in China), with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs. • **Acceleration.** Positive supply-side surprises, monetary easing, productivity gains from AI, and/or stronger EMDE performance raise global demand and trade, and ease global financing conditions.	Medium Low	**High.** A global slowdown would negatively impact manufacturing and exports (via impact on Europe and U.S.). At the same time, weaker demand from China would drive commodity prices lower, negatively impacting South Africa.	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.
Social discontent. High inflation, real income loss, spillovers from conflicts (including migration), and worsening inequality stir social unrest, drive populist policies, and increase resistance to reforms, especially in the context of polarized and disputed elections. This exacerbates imbalances and weakens growth prospects, leadings to policy uncertainty and market repricing.	High	**Medium.** 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).	Engage with key stakeholders (including civil society) to build support for fiscal consolidation and the SADC-supported national reforms process.

1/ Aligned with the Global Risk Assessment Matrix (G-RAM) as of July 26, 2024.

Source of Risks	Likelihood	Impact if Realized	Policy Response
Conjunctural Risks			
Sovereign debt distress. Domino effects from high global interest rates, deteriorating debt sustainability in some AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, loss of market access, and contraction of growth and social spending.	**Medium**	**Medium.** The cost of borrowing—both domestic and external—has increased and continues to be elevated for many. Therefore, the funding squeeze is likely to continue, with region's governments still grappling with financing shortages, high borrowing costs, and rollover risks amid persistently low domestic resource mobilization.	Use additional royalties to repay debt more quickly. Diversifying funding sources and the economy are also essential mitigating measures. Improving the business climate to attract more FDI and develop the private sector.
Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdowns and elevated uncertainty (e.g., including from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**Medium**	**Medium.** Potential risk to private sector credit and availability of credit for government finance through branches and subsidiaries of foreign (South Africa) 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 NBFIs.
Structural Risks			
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower 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 physical or digital infrastructure (including digital currency and crypto assets), technical failures, or misuse of AI technologies trigger financial and economic instability.	**High**	**High.** With the rapid increase in digitalization, cyberattacks 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.
Climate change. Extreme climate events driven by rising temperatures cause loss of life, demage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability. A disorderly transition to net-zero emissions and regulatory uncertainty lead to stranded assets and low investment.	**Medium**	**High.** More frequent natural disasters cause severe economic damage to smaller vulnerable economies and accelerate emigration. Severe events in large economies reduce global GDP, cause further supply chain disruptions and inflationary pressures, and prompt a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	Reallocate fiscal spending to finance recovery work and appeal to donors for post-disaster financing. Transition to a greener economy and provide adaptation opportunities, particularly in agriculture (e.g., irrigation for rain-fed produce).

Annex V. External Sector Assessment

Overall Assessment: *The external position of Lesotho in FY23/24 is assessed to be broadly consistent with fundamentals and desirable polices. Against a backdrop of fiscal restraint, the strong rebound in SACU transfers, higher water royalties, and lower imports have more than offset the decline in textile and diamond exports, contributing to an almost balanced current account. However, given the temporary nature of SACU windfalls, the gradually declining LHWP-II imports, the long-standing competitiveness issue with the textile industry, and the country's limited capacity to channel domestic savings into productive investment due to its structural constraint including low financial intermediation and a challenging business environment, the assessment highlights the importance of addressing these underlying issues.*

Potential Policy Responses: *Continued fiscal prudence coupled with structural reforms to increase productivity and enhance competitiveness remain key to a sustainable external balance going forward. With the exchange rate determined exogenously, containing public expenditures, improving public spending efficiency, embarking on first-generation structural reforms, and revisiting productivity and factor costs in the export sector can promote competitiveness. Likewise, continued efforts to address corruption, strengthen governance, and ease trade and non-trade barriers are critical.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Lesotho is a net debtor country. However, as of 2023Q4, the net international investment position (NIIP) has improved significantly to -14.3 percent of GDP, compared to -25.8 percent of GDP as of end-FY22/23, owing to the SACU windfall and higher water royalties, and a consequently stronger asset position (reflected in higher official reserves, and an accumulation of bank and portfolio assets abroad). The NIIP is expected to decline slightly over the medium term, as the current account deficit is projected to increase in line with declining SACU transfers but will be generally supported by the new water royalties. The government also plans to continue contracting external debt to finance its capital budget, relying mostly on donor project loans.

Assessment. Given the potential impact of real shocks from South Africa, a significant share of Lesotho's gross assets is held in Rand. Gross liabilities, on the other hand, are largely in U.S. dollars or U.S. dollar-linked currencies. Given the NIIP improvement in FY23/24, risks from such currency mismatches have been partly mitigated. And risks from Lesotho's gross external liabilities are also mitigated by the country's favorable debt composition (over 75 percent of external debt is owed to multilateral creditors on concessional terms). However, Lesotho's external sustainability continues to be susceptible to changes in South Africa's risk premia and exchange rate valuation effects.

2024 Q1 (% of GDP)	NIIP: -14.3	Gross Assets: 78.1	Debt Assets: 41.5	Gross Liab: 92.6	Debt Liab: 58.6

Current Account

Background. The current account balance registered a small deficit of 0.2 percent of GDP in FY23/24, marking a significant improvement from -13.8 percent of GDP in FY22/23 (based on revised data). Robust SACU transfers, higher water exports, and lower-than-expected imports have more than offset the downbeat textile and diamond exports, which have deteriorated due to weaker demand from the US and a drop in diamond prices. Over the medium term, SACU transfers are projected to fall, while the structurally higher water exports will continue to support external balances if fiscal restraint is sustained. Export-oriented horticulture is also assumed to gain momentum from the MCC starting from the end of the medium term.

Lesotho: EBA-lite Results, FY23/24
(In percent of GDP)

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**-0.2**	
Cyclical contributions (from model) (-)	0.1	
Additional temporary/statistical factors (-) 2/	4.8	
Natural disasters and conflicts (-)	-0.1	
Adjustment for the LHWP-II project (-)	-3.8	
Adjusted CA	**-1.2**	
CA Norm (from model) 3/	**-1.9**	
Adjusted CA Norm	**-1.9**	
CA Gap	**0.7**	**0.5**
o/w Relative policy gap	2.8	
Elasticity	-0.4	
REER Gap (in percent)	**-1.6**	**-1.1**

1/ Based on the EBA-lite 3.0 methodology
2/ Additional temporary adjustment for the one-time correction to SACU receipts.
3/ Cyclically adjusted, including multilateral consistency adjustments.

Assessment. The external position is assessed to be broadly consistent with fundamentals and medium-term desirable policies, where the qualitative assessment by the CA and REER models indicates a positive CA gap of 0.7 and 0.5 respectively. Adjustments have been applied to the cyclically adjusted CA balance to account for: (i) a one-off correction to the SACU transfers (4.8 percentage point of GDP higher than the 10-year historical average); (ii) the impact of the LHWP-II project on the CA balance (the project is financed with capital grants from South Africa and accounting for other spillover effects, the project's import content comprises a significant share of total imports. Project-related imports will peak in FY24/25 and FY25/26 before gradually declining). The CA gap has been lifted by a positive policy gap, driven largely by the fiscal surplus in FY23/24. A strong accumulation of reserves also contributes to the gap. However, given the structural weakness of the economy and loss of competitiveness in the textile industry, which are factors not included in the CA model, the medium-term external position continues to hinge on fiscal prudence and structural reforms aiming at improving spending efficiency and business environment.

Real Exchange Rate

Background. Lesotho's nominal and real effective exchange rates depreciated by 7 and 5.1 percent y-o-y in FY23/24, respectively. Lesotho's nominal effective exchange rate is mainly driven by the peg to the South African Rand, which has depreciated by 10.3 percent in the same period against the US dollar. The impact of nominal depreciation on Lesotho's real effective exchange rate has been partly offset by high inflation, which in turn reflects the large share of food and energy prices in Lesotho's CPI basket.

Assessment. Lesotho's real effective exchange rate is assessed to be broadly consistent with fundamentals in FY23/24, as informed by the EBA-lite CA model and REER model which suggest a slight undervaluation of 1.6 and 1.1 percent respectively. This change from the previous assessment of overvaluation is largely attributed to a lower rate of wage inflation, now moving closer to productivity growth, and nominal depreciation that has helped improve competitiveness.

Capital and Financial Accounts: Flows and Policy Measures

Background. Lesotho continues to rely on capital transfers 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. Capital transfers have recorded a historical high as of end-FY23/24 at 11.9 percent of GDP. Financial account flows such as foreign direct investment and portfolio inflows continue to be subdued.

Assessment. The subdued investment flows reflect longstanding challenges to the business environment. Reforms remain critical to create an environment more conducive to private sector development, and to mitigate risks from reliance on non-FDI flows for external financing, which tend tom be more volatile.

FX Interventions and Reserves Level

Background. Lesotho has a fixed exchange rate regime with South Africa and interventions in the foreign exchange market are automatic. As of end-FY23/24, the Central Bank of Lesotho has maintained net international reserves above its internal target of 120 percent of M1 plus callable deposits. Strong SACU windfalls and higher water exports have boosted gross reserve coverage from 3.9 to 4.5 months of prospective imports.

Assessment. The reserves level reaches the adequate threshold for Lesotho, assessed to be 4.5 months of prospective imports according to the ARA-CC model used for credit-constrained economies. The assessment takes into account the exchange rate regime, frequency of external shocks, development of financial markets, and other country specific factors.[1] Reserves will continue to be bolstered by the higher water royalties, assuming fiscal discipline, reaching almost 6 months of prospective imports in two years' time. The adequate level of reserves for Lesotho should then consider the opportunity costs where the marginal benefit by holding more reserves is exceeded by the marginal cost to maintain that level of reserves. Also, a large share of Lesotho's international reserves is denominated in Rand (ZAR), making these buffers sensitive to the ZAR exchange rate with US dollar. To mitigate adverse spillover risks from South Africa, given its political volatility, the share of ZAR holdings in the international reserves warrant close monitoring. A significant share of foreign-exchange reserves reflects commercial banks' transfer deposits and other deposits needed to meet CBL reserve requirements: reserves linked to these provisions may also need to be closely monitored, especially if they were to decline and are not available for other balance of payment purposes.

[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 VI. Capacity Development Strategy

1. **Lesotho has received extensive capacity development (CD) from the IMF and other donors, and priorities remain unchanged.** The authorities maintain a long list of CD requests, but progress in implementation remains limited. Given the depth of Lesotho's CD needs, careful sequencing and prioritization of reforms is required, also to ensure that recipient MDAs are capable of absorbing and implementing recommendations (Table 1). CD must be aligned with the main policy and surveillance priorities outlined above: (i) ensuring continued fiscal discipline and increasing public investment efficiency; (ii) strengthening PFM processes, financial sector supervision, and policy coordination to support credibility, investor confidence, and macroeconomic stabilization, and (iii) enhancing governance and advancing structural reforms to foster private sector development and financial inclusion.

2. **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.

3. **Close coordination of CD across a broad spectrum of development partners is essential.** Numerous development partners are currently actively engaged in related policy areas in support of IMF CD and past Article IV recommendations, including:

- Support from the United States Treasury Department's Office of Technical Assistance on the consolidation of the Treasury Single Account;
- AfDB Institutional Support Project for Debt and Expenditure Management providing financing for technical assistance on sustainable public debt management, the establishment of a Public Sector Investment Database, support for the extension of the IFMIS, and TA on the causes of arrears; and E-Government Infrastructure Phase II financing the expansion of broadband coverage, the upgrading of post offices to serve as eService centers, and the development of an ePayment gateway and policy for eServices;
- United Nations Development Programme's support for strengthening governance, including support to the national reforms process arising from proposed constitutional amendments, assistance to the national anti-corruption agency, the development of a gap assessment arising from the merger of ministries, and the preparation of a capacity development strategy for the public service;
- UNICEF support on a pilot program for the digitization of select civil registration processes;
- World Bank's Public Sector Foundations for Service Delivery Project to strengthen expenditure controls, including in the areas of asset and procurement management, and improve delivery of select digital public services; and Competitiveness and Financial Inclusion Project to increase access to business support services and financial products targeted at MSMEs and

entrepreneurs, especially women and youth. The Bank is also working closely with the authorities to help establish a stabilization fund to save the additional revenue from water royalties.

A. Fiscal Sector

4. PFM is a key priority for CD in Lesotho. Weaknesses in budget processes, debt management, cash management, expenditure controls, and financial reporting hinder the efficient allocation of resources and hamper surveillance. Support for capital budgeting—notably, investment planning and execution—and asset management 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 currently have four advisors in priority CD areas (PFM, treasury, macroeconomic policy, project cycle management), supported by the World Bank, UNDP and European Union. Continued support is needed to monitor SOE fiscal risks, and to produce a fiscal risk statement as part of the budget process. Over the longer term, the introduction of fiscal rules can provide a much-needed framework for fiscal credibility and discipline.

5. Domestic revenue mobilization is essential to help delink recurrent expenditure from volatile SACU transfers. The establishment of a new tax policy unit is in its final stages, and the authorities should build its capacity to support tax policy design, analysis, and forecasting. The RSL should strengthen its core functions and enforcement, identified as areas of weakness by the 2023 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 large and medium-sized taxpayers; (iv) international taxation, with a focus on audit capabilities and exchange of information.

6. Efforts to improve government financial statistics (GFS) are much needed. Newly hired GFS expert based in AFRITAC South will help the authorities harmonize above- and below-the-line data and expand the coverage to include extrabudgetary units (SOEs and parastatals).

B. Monetary Policy and Financial Sector

7. Workplans for financial supervision and systemic risk monitoring, as a follow-up of the findings in the 2021 FSSR, have gained positive momentum. On financial supervision, the CD roadmap continues to focus on advancing the risk-based supervision framework, reviewing and implementing the recovery planning schemes, and building an early intervention framework for banks. On financial stability, the work agenda includes developing and expanding the risk dashboard, strengthening the stress test framework by building improved macro-financial models, and building capacity in risk assessments, including for insurance companies.

8. Monetary policy implementation and debt management have gained less traction but remain a priority in the medium term. A joint IMF/WB mission developed a roadmap for reforms to develop local currency bond market and identified necessary capacity building in this area. Progress on deepening the government securities market and developing a framework for monitoring and managing publicly guaranteed debt is also critical to support the authorities' medium-term debt objectives. CBL welcomes the idea of receiving assistance in liquidity analysis and forecasting, and an overview of operational toolkits and instruments for managing the liquidity.

9. The authorities have expressed new interest in cyber security and IFRS S2 implementation. CBL acknowledges the rising frequency of cyberattacks and emphasizes the need to enhance government digital system security. Capacity building is needed for the whole financial sector, and CBL welcomes the Fund's assistance on cyber regulation and supervision. CBL also requested guidance on the relevance and applicability of the newly issued IFRS S1 (General Requirements of Sustainability Related Information) and IFRS S2 (Climate-related Disclosures) to central banking, and how the standards will affect the financial sector.

C. National Statistics

10. National accounts and inflation indices remain critical area for CD. Mismeasurement of national accounts and inflation can undermine macroeconomic forecasting and policymaking. The Bureau of Statistics (BOS) received funding to rebase the GDP in FY24/25. Continued assistance will be needed to improve both annual and quarterly GDP estimates and CPI compilation methods. The IMF continues to support the BOS with an active program of CD, but capacity must be built and retained within the BOS. Improved coordination between the RSL and BOS, as well as a more timely and tailored usage of the value added tax data, should remain a priority.

Table 1. Lesotho: Capacity Development Priorities

Priorities	Objectives
Public Financial Management	Pass the PFMA Bill; strengthen budget processes; improve expenditure and procurement controls; enforcing the use of IFMIS; financial reporting and accountability (including reconciliation of bank accounts); develop an arrears clearance strategy; carry out regular fiscal risks assessments; strengthen cash and liquidity management, enhance digitalization.
Macroeconomic Policy & Management	Improve financial programming and macro-fiscal capabilities to support (i) production of a medium-term fiscal framework, (ii) design and implementation of fiscal rules, and (iii) production of regular economic and fiscal bulletins.
Domestic Revenue Mobilization	Enhance tax policy capacity (e.g., revenue forecasting, assessing tax policy changes) by strengthening the newly established tax policy unit; improve tax administration in line with TADAT recommendations (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	Amend the CBL Act; monetary operations; liquidity forecasting and management; develop domestic debt and money markets; improve coverage and reliability of public debt statistics; update MTDS and develop in-house DSA capacity; enhance payment systems supervision.
Macroprudential Toolkit, Financial Regulation, and Financial Sector Supervision	Enhance bank monitoring and stress testing; strengthen risk-based supervision (including on-site examinations, early intervention, and recovery planning); improve nonbank supervision and oversight of nonbank payment service providers; improve enforcement of AML/CFT standards for NBFIs.
National Accounts and Prices	Develop expenditure-based annual national accounts; develop quarterly national accounts, develop producer price index (PPI).
Government Finance Statistics	Harmonize above- and below-the-line data; expand coverage to include extrabudgetary units (SOEs and parastatals); improve classification of data.
Monetary and Financial Statistics	Expand coverage of MFS to include the largest nonbank financial institutions; improve classification of data to include a separation of loti and rand-denominated instruments.

Annex VII. Data Issues

Table 1. Lesotho: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
C							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	A	C	B	B	C	C
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	C	A	C	B	B		
Granularity 3/	C		B	B	C		
			B		B		
Consistency			C	C		C	
Frequency and Timeliness	B	A	C	B	B		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.

1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. The national accounts have been last rebased in 2012, introducing bias in all ratios. Once the ongoing rebasing is finalized, the NA rating could be upgraded. Delays in GDP estimation and substantial revisions stem from delayed, inaccurate, and incomplete data sharing between various agencies and the BOS. Longstanding fiscal 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. 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. Compilation of consolidated general government GFS remains challenging, for lack of comprehensive data on extrabudgetary units. Lack of accurate and timely data on arrears hampers the analysis of fiscal risks. Reliability and granularity of the public debt data, including contingent liabilities and guarantees, could be improved to achieve greater accuracy of debt service projections. Coverage of other financial corporations (OFC), including insurance companies (ICs) and pension funds (PFs), could enable full consolidation of the financial corporations survey. While the regulatory and accounting data for banks are broadly consistent with Basel I and IFRS9 frameworks, there exist data gaps for non-banking sector. Institutional coverage of financial soundness indicators (FSI) has now extended to insurance companies. Continued effort is needed to further enhance data quality and to improve coverage, methodological soundness, and consistency between the balance of payments 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.

Changes since the last Article IV consultation. The BOS has secured funding for national accounts rebasing in FY24/25. The errors in the new CPI using the 2017 Household Budget Survey for the CPI weights have been addressed with the help of IMF CD. Misclassifiations of some revenue and expenditure items have been addressed with the help of STA technical assistance. The historical BOP data (dating back to 1986) have been updated to incorporate new sources of data (obtained from South Africa and from the private capital flow survey) and address classification issues. The refresher training was offered to the authorities in March 2024 on how to update the data on Lesotho's NSDP through the Open Data Platform, to improve the periodicity and timeliness of data provision.

Corrective actions and capacity development priorities. An upcoming IMF CD will assist the BOS with the development of the GDP rebasing plan and other requested documents in terms of the rebasing project. AFRITAC South recruited a long-term GFS expert who will work with the authorities on fiscal statistics, particularly resolving discrepancies between transactions above and below the lines, expanding the institutional coverage of GFS to include the largest extrabudgetary units, as well as identifying and correctly recording capital expenditure.

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff does not use any data and/or estimates in the staff report in lieu of official statistics.

Other data gaps. N/A

Table 2. Lesotho: Data Standards Initiatives

Lesotho participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since April 2016.

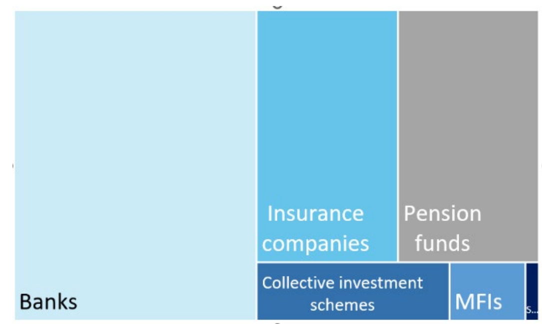
Table 3. Lesotho: Table of Common Indicators Required for Surveillance

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Lesotho[8]	Expected Timeliness[6,7]	Lesotho[8]
Exchange Rates	Jun-24	Jul-24	M	M	D	M	...	1M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun-24	Jul-24	D	M	M	M	1M	1M
Reserve/Base Money	Apr-24	Jul-24	D	M	M	M	2M	6W
Broad Money	Apr-24	Jul-24	M	M	M	M	1Q	6W
Central Bank Balance Sheet	Apr-24	Jul-24	D	M	M	M	2M	6W
Consolidated Balance Sheet of the Banking System	Apr-24	Jul-24	D	M	M	M	1Q	6W
Interest Rates[2]	Apr-24	Jul-24	M	M	M	M	...	1M
Consumer Price Index	May-24	Jun-24	M	M	M	M	2M	1M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	NA	NA	NA	NA	A	A	3Q	12M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Mar-24	May-24	M	Q	Q	M	1Q	2W
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar-24	Jun-24	M	I	Q	A	2Q	2M
External Current Account Balance	Q1-2024	Jun-24	Q	Q	Q	Q	1Q	2M
Exports and Imports of Goods and Services	Q1-2024	Jun-24	Q	Q	M	Q	12W	12M
GDP/GNP	Q4-2023	Apr-24	Q	Q	Q	A	1Q	10M
Gross External Debt	Q1-2024	Jun-24	Q	Q	Q	M	2Q	1M
International Investment Position	Q1-2024	Jun-24	Q	Q	A	Q	3Q	2Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VIII. Nonbank Financial Institutions in Lesotho

Share of Total Financial System Assets
(Percent)



Source: Central Bank of Lesotho and IMF staff calculations

1. **NBFIs account for 54 percent of total assets of the financial system.** By end-2023, the NBFI sector consisted of 10 insurance companies, 7 pension funds, 4 collective investment schemes (1 money market and 3 non-money market funds), 68 savings and credit cooperatives (SACCOs), and 132 microfinance institutions (MFIs)[1]. The NBFI sector is dominated by insurance firms and pension funds, which together account for more than 80 percent of the sector's total financial assets. In the remaining portion, MFIs are mostly non-deposit takers accounting for a further 5 percent of total NBFI assets. SACCOs are all domestically controlled or incorporated deposit-takers but represent only 1 percent of NBFI assets.

2. **NBFI credit providers and banks largely compete for the same market, and financial intermediation in Lesotho is low.** Banks mainly lend to large corporations and salaried government workers, with repayments deducted directly at source from their payrolls. Meanwhile, MFIs mainly compete head-to-head with banks for the same customer segment; rather than catering for the low-income or underbanked households that would usually be served under the traditional microfinance model. So far, both banks and MFIs have been reluctant to lend to micro, small, and medium-sized enterprises—some small MFIs and SACCOs cater to riskier households, including those in the informal sector, but they tend to be loosely regulated with little available performance data. Given this limited role, NBFIs have to date played little role in advancing the process of financial inclusion.

3. **The supervisory framework for NBFIs is still in its early stages.** The CBL currently supervises all NBFIs except for some SACCOs. Large SACCOs with over LSL500 million in assets fall under CBL supervision, with the rest overseen by the Department of Small Business Development, Cooperatives and Marketing (MoSBC), which lacks resources for effective regulation. Small SACCOs and insurance brokers and agents are not supervised for AML/CFT purposes. A sound mechanism for regular information exchange and coordination between CBL and MoSBC for SACCO supervision and crisis management is also lacking. The CBL plans to develop an overarching macroprudential policy framework that includes all NBFIs into its oversight system, and to establish an early intervention framework to detect and respond to emerging risks. While systemic risks from NBFI credit providers are limited, sustained pressure on SACCOs could expose depositors, who are predominantly from the poorer sections of society. The CBL is receiving IMF CD for a more comprehensive systemic risk dashboard covering banks, MFIs, and SACCOs so that the central bank can have a consolidated view of private sector credit developments.

[1] IMF, Lesotho Technical Assistance Mission Report on the Financial Soundness Indicators, November 2023; and IMF, Lesotho Financial Sector Stability Review, September 2021.

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 22, 2024

Prepared By

African Department
(In consultation with other departments)

CONTENTS

RELATIONS WITH THE IMF

(As of June 30, 2024)

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)	57.01	81.67
Reserve Tranche Position	12.81	18.35

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	99.78	100.00
Holdings	82.21	82.40

Outstanding Purchases and Loans	**SDR Million**	**% Quota**
RCF loans	11.66	16.70

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

1/ Formerly Poverty Reduction and Growth Facility (PRGF).

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

Projected Payments to the IMF:

(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2024	2025	2026	2027	2028
Principal			2.33	2.33	2.33
Charges/interest	0.36	0.71	0.71	0.71	0.71
Total	**0.36**	**0.71**	**3.04**	**3.04**	**3.04**

Implementation of Catastrophe Containment and Relief (CCR)[1]:

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 a single discretionary allowance of LSL1 million per individual per calendar year for residents above 18, and travel allowance limit of LSL200,000 per individual per calendar year for residents under 18. Foreign exchange transactions beyond these limits need CBL approval. As of July 15, 2024, the maloti rate per U.S. dollar was LSL18.71.

[1] 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 2023 Article IV consultation was concluded by the Executive Board on July 20, 2023. 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**
Fiscal Risks Statement	Jan-24	MoFDP
Medium-Term Fiscal Framework (AFS)	Nov-23	MoF
Fiscal Risk Assessment	Aug-23	MoFDP
Integrated Financial Management Information System (IFMIS)	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	Date of Delivery	Beneficiary Agency
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	Nov-23	CBL
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		
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA (AFS)	Jun-24	BOS
Residential Property Price Index (RPPI)	Jun-24	CBL
Government Finance: SOEs Fiscal Statistics	Oct-23	MOF
Residential Property Price Index (RPPI)	Sep-23	CBL
Real Sector: Improving CPI	Sep-23	BOS
Real Sector: National Accounts (NA) - Rebasing Annual NA and Improving Quarterly NA (AFS)	Sep-23	BOS
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

Statistics Department	**Date of Delivery**	**Beneficiary Agency**
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/

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

August 22, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Andrea Richter Hume (AFR), Anna Ivanova (SPR), Manuela Francisco and Hassan Zaman (IDA)

Prepared by the staffs 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 broadly unchanged risks to debt sustainability since the last DSA.[1] *The fiscal surplus in FY23/24, backed by strong Southern African Customs Union (SACU) transfers and higher water royalties, has lowered public debt. However, risks from rising contingent liabilities, persistent domestic arrears, and difficulty sustaining the current degree of fiscal restraint may put upward pressure on future debt levels. The moderate risk rating suggests limited space to absorb shocks. Debt-to-GDP thresholds are breached under the most extreme shock of GDP growth and of currency depreciation, respectively for public debt and external debt, remaining above the threshold during the entire forecast horizon in both cases. The DSA highlights the importance of continued fiscal prudence to stabilize debt levels, building buffers against future volatility, and the benefits of using the current SACU windfall and increased revenues from the renegotiated water royalties to clear arrears and amortize public debt, to rebuild trust in governance and safeguard against future shocks. Improved efficiency in critical public infrastructure investment is needed to raise productivity and lift Lesotho's growth outlook. Finally, addressing contingent liability risks, strengthening public financial management, and maintaining a conservative debt management strategy focused on concessional borrowing will be critical for continued debt sustainability.*

[1] This DSA updates the previous Joint DSA from July 2023 (IMF Country Report No. 23/268). The DSA analysis reflects a debt carrying capacity of Medium considering Lesotho's Composite Indicator Index of 2.98, based on the IMF's April 2024 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 2023 (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 state-owned enterprises (SOEs).[3] Debt also includes domestic arrears, estimated at 1 percent of GDP as of March-2024.[4] Starting from FY22/23, the authorities have been publishing the quarterly Debt Transparency Report in agreement with the World Bank under the Sustainable Development Financing Policy (SDFP). While total SOE debt is not yet available, publicly guaranteed debt on SOEs and private enterprises are available in the report.

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

- The pension fund financing gap—estimated at 7 percent of GDP.[6]
- Liabilities associated with potential asset seizures—estimated at 3.1 percent of GDP.[7]

[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 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 actuarial evaluation of pension liabilities, 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 have committed to cover about two-thirds of this financing gap (LSL2 billion) with ten equal annual installments of LSL200 million. The other one-third of the gap is to be covered by the pension fund's operating income, which will be supported by increased contributions. The first installment was made in August 2023, and the authorities had a draft memorandum to be signed to formalize the ten-year commitment. For the contingent liability stress test, LSL2.9 billion (LSL3.1 billion less the LSL200 million paid) is being included given that the pension fund's liabilities and associated fiscal risks still require close monitoring.

[7] In January 2024, the South African High Court ruled in favor of Frazer Solar GmbH, who was seeking to enforce damages related to a contract to supply solar power equipment to Lesotho. The ruling not only dismissed the case but also mandated the Government of Lesotho (GoL) to cover the legal costs incurred by Frazer Solar and the South African Ministry of Justice. The total value of the claim, including interest and costs, is estimated to be LSL1.3 billion. The GoL has appealed this decision, and a hearing by the South African High Court is scheduled for early 2025.

- Liabilities associated with potential payments for the termination of a PPP contract—estimated at 4.3 percent of GDP.[8]

- Liabilities associated with potential dispute for the termination of the contract—estimated at 1 percent of GDP.[9]

- 5 percent of GDP for a financial market shock that exceeds the existing stock of banks' NPLs.

- 2.7 percent of GDP for SOE debt, which is not captured in the country's definition of public debt. Calibration includes LSL1.1 billion as an estimate for non-guaranteed and on-lent debt of the SOEs.

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

	Subsectors of the public sector	Check box
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	15.4	Contingent liabilities representing the funding shortfall of the civil service pension fund, the lost case and ongoing appeal to the asset seizure by Frazer Solar GmbH, and the disputes with Netcare Hospital Group and Trencon of the termination of contracts.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2.7	
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 val	5 percent of GDP	5	
	Total (2+3+4+5) (in percent of GDP)		23.1	

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%.

[8] The High Court of Lesotho in March 2024 agreed to allow Netcare Hospital Group's suit against the government for a LSL1.6 billion PPP agreement that was unlawfully terminated. Netcare was part of the Tšepong Consortium, which entered the 18-year PPP arrangement with the GoL signed in 2008. This was for the design, building, and operation of the Queen 'Mamohato Memorial Hospital and a network of refurbished filter clinics. The government cancelled the agreement in August 2021. Against this backdrop, Netcare filed an application in the High Court, seeking permission to bring proceedings on behalf of Tšepong to pursue claims against the government. Estimated liabilities, including other costs, amount to LSL1.8 billion.

[9] The Lesotho Millennium Development Agency (LMDA) in May 2023 terminated its LSL519 million contract with Trencon, a construction company, to build 80 health centers around the country. The government assumed the liability in line with the Millennium Challenge Account - Lesotho Authority (Winding Up and Repeal) Act 2022, which provided that any obligations and liabilities incurred by LMDA shall be transferred to the government. Both parties (LMDA and Trencon) have sued each other in arbitration court, where the LMDA claimed LSL400 million plus costs for breach of contract because Trencon had become insolvent, while Trenco claimed LSL258 million from LMDA for loss of business. The cross suits have not yet been adjudicated.

BACKGROUND

3. **Lesotho's public debt has declined since the last DSA** (Text Table 3).[10] The gross public debt-to-GDP ratio has decreased by 3 percentage points from 64.5 to 61.5 percent of GDP in FY23/24, mainly driven by a decline in net domestic debt issuance. This has more than offset the valuation effects of ZAR depreciation against the US dollar during FY23/24 for foreign currency-denominated external debt, which accounts for 78 percent of total debt. Lower-than-expected domestic borrowing in FY23/24 was mainly on account of a large fiscal surplus at 6.1 percent of GDP, as a result of strong Southern African Customs Union (SACU) transfers and increased water royalties from South Africa.

4. **In the immediate aftermath of the COVID-19 pandemic, 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 (about US$5.3 million) relief on debt service under the CCRT during 2021–22, and suspended roughly US$5 million under the DSSI supported by the G-20 and Paris Club during 2020-21.[11] 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. 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. SDR holdings are reflected in the projections for net credit to government (NCG) and government deposits at the CBL available to meet public spending needs.

5. **Most of Lesotho's external debt is owed to multilateral creditors on a concessional basis** (Text Table 3). In FY23/24, external debt is still predominantly owed to multilateral partners on concessional terms, accounting for 74 percent of total external public debt. 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 has increased significantly since the pandemic, from 15 percent in FY19/20 to 22.5 percent of total external public debt in FY23/24. China accounts for more than 80 percent of this bilateral debt, with Export-Import Bank of China (EXIM Bank of China) taking 17.5 percent of Lesotho's total external public debt.

6. **The share of domestic public debt to total public debt has declined in FY23/24 to 22 percent from 27 percent in FY22/23.** 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, other nonbank financial institutions, and individuals (see Text Figure 1). The average yield has continued to climb and was almost 10 percent in FY23/24. With strong SACU windfalls and buoyant reserves, net domestic debt issuance has been smaller than in the previous two years. Despite another year of strong SACU transfers and a new source of revenues from water royalties expected in FY24/25, the authorities plan to continue issuing domestic debt at a similar scale to develop the domestic bond market.

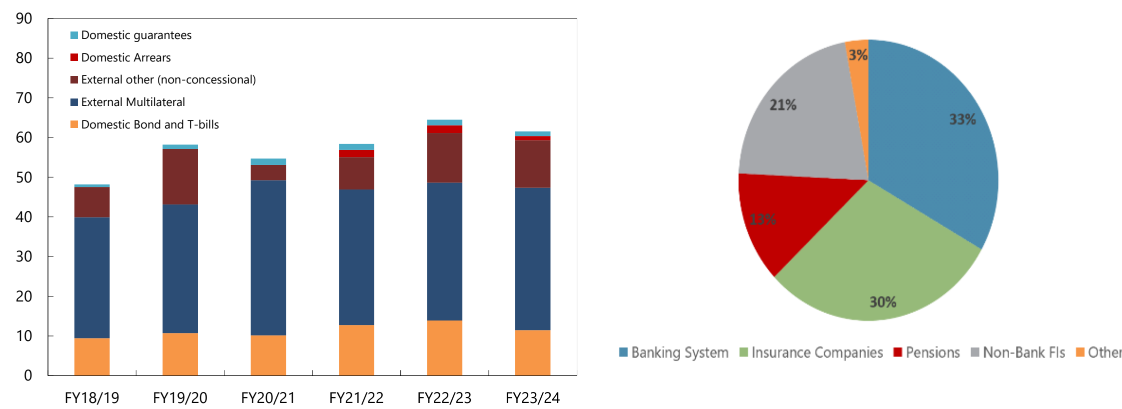
[10] The fiscal year runs from April 1 to March 31.

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

While increasing domestic debt issuance has helped the authorities meet public financing needs and deepen local currency markets, the government should monitor risks from sovereign-bank nexus given banking sector's large share in holding the domestic debt.

Text Figure 1. Domestic Public Debt and Holder Profile

Public and Publicly Guaranteed Debt (FY18/19 – FY23/24) | **Domestic Debt Holder Profile** (As of end-FY23/24)



Text Table 3. Lesotho: Decomposition of Public Debt and Debt Service by Creditor, 2023/24–2025/26[1]

	Debt Stock (end of period)			Debt Service					
	2023/24			2023/24	2024/25	2025/26	2023/24	2024/25	2025/26
	(US$ Millions)	*(Percent total debt)*	*(Percent GDP)*	*(In US$)*			*(Percent GDP)*		
Total	1,330.6	100.0	61.5	162.3	159.7	135.0	7.3%	7.2%	6.1%
External	1,034.6	77.8	47.8	70.8	87.5	69.8	3.2%	4.0%	3.2%
Multilateral creditors[2]	793.1	59.6	36.7	53.4	71.2	56.4	2.4%	3.2%	2.6%
IMF	47.3	3.6	2.2						
World Bank	449.4	33.8	20.8						
ADB/AfDB/IADB	151.0	11.3	7.0						
Other Multilaterals	145.4	10.9	6.7						
o/w: European Investment Bank	57.5	4.3	2.7						
o/w: Arab Bank for Econ Dev in Africa	37.3	2.8	1.7						
o/w: International Fund for Agr Dev	30.8	2.3	1.4						
Bilateral Creditors	232.3	17.5	10.7	13.2	13.3	13.3	0.6%	0.6%	0.6%
Paris Club	-	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%
Non-Paris Club	232.3	17.5	10.7	13.2	13.3	13.3	0.6%	0.6%	0.6%
o/w: China	190.0	14.3	8.8						
o/w: Kuwait	16.8	1.3	0.8						
Bonds	-	0.0	0.0						
Commercial creditors	4.9	0.4	0.2						
Other international creditors	4.2	0.3	0.2						
Domestic[3]	296.0	22.2	13.7	91.4	72.2	65.2	4.1%	3.3%	2.9%
T-Bills	39.0	2.9	1.8						
Bonds	208.9	15.7	9.7						
Loans	-	0.0	0.0						
Memo items:									
Collateralized debt[4]	-	0.0	0.0						
o/w: Related	-	0.0	0.0						
o/w: Unrelated	-	0.0	0.0						
Contingent liabilities	31.4	2.4	1.5						
Nominal GDP	2,163.6								

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.

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/ The sub-components do not add up to the total because domestic debt also includes arrears and public guarantees such as for the SOEs.

4/ 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

7. The macroeconomic framework entails an outlook that is slightly better than the 2023 DSA (Text Table 4). The baseline assumptions in the DSA are consistent with the macroeconomic framework outlined in the staff report.

- **Real GDP growth:**[12] The assumption for growth in the medium term continues to hinge on the Lesotho Highland Water Project (LHWP-II). Towards the end of the medium term, growth is projected to be around 2.1 percent, higher than in the previous DSA of 1.5 percent. This moderate upgrade mainly takes into account a modest improvement in private sector development supported by macroeconomic stability and a more conducive policy environment to advance reforms. Spillover effects from the LHWP-II investment that is expected to deliver higher electricity and water output, and the Millennium Challenge Corporation (MCC) Compact II, which has been successfully unlocked in March 2024 and aims to increase agricultural productivity, among other investments, will also boost growth.

- **Inflation:** Projected CPI inflation has been revised upward to 6.7 percent for FY24/25, before gradually easing to 5.1 percent over the medium term. Over the short term, this reflects inflation driven by food price spikes related to the drought in Southern Africa, which will subside. Other reasons for higher prices in Lesotho are transportation and intermediation costs. Projected dissipation of inflation points to a slower process than in the past, assuming that the gap to South African inflation will steadily shrink but will not completely disappear in the medium term. Over the long-term, inflation is assumed to remain anchored by the peg to the Rand, which is driven by the monetary policy developments in South Africa and is in turn anchored by that country's inflation target range of 3-6 percent.

- **Fiscal deficit:** The primary fiscal balance profile is assumed to improve relative to the last DSA, due to an increase in projected grants, a contained wage bill owing to the public hiring moratorium, and a significant increase in water royalties (which are expected to increase to 9.6 percent of GDP on average over the next five years, about 6 percentage points above the historical average). Under current projections, SACU transfers will be similar to the previous DSA, averaging 19.3 percent of GDP over FY24/25–FY29/30 with another year of windfall for FY24/25 before declining to below historical average. Capital expenditures will increase proportionally in line with the increased capital project grants, and recurrent expenditures are assumed to grow broadly in line with nominal GDP. As a result, the primary fiscal balance is assumed to be in surplus, on average, of 4.5 percent of GDP over the next five years. The long-term primary balance will also be lifted compared to the last DSA.

- **External Sector:** Due to data revisions, Lesotho's current account history has been adjusted downward, mainly on account of improved data on expatriates' contributions to South Africa's social security schemes (recorded on the debit side), which has resulted in a smaller recorded

[12] The historical national accounts data have been revised again back to 2018, after the 2023 DSA publication.

amount for net secondary income. The medium-term current account balance will be largely bolstered by higher water exports, and continue to be affected by the volatility in SACU transfers, changes in fiscal balance, remittances (shaped by growth prospects in South Africa), and LHWP-II imports which are assumed to peak in FY24/25 and FY25/26. The medium-to-long-term current account balance is also assumed to be improved by the impact of the MCC Compact II on agricultural exports.

Text Table 4. Lesotho: Macroeconomic Assumptions

	2022 DSA 2022–27	2023 DSA 2023–28	2024 DSA 2024-29	2022 DSA 2028–42	2023 DSA 2029–43	2024 DSA 2030-44
Real GDP Growth (Percent)	1.6	2.1	2.2	1.5	1.5	2.1
Inflation (Percent)	5.2	5.3	5.3	4.9	4.9	5.0
Primary Deficit (Percent of GDP) 1/	2.8	0.4	-4.5	0.8	0.4	0.2
USD Export Growth (Percent)	7.4	2.5	6.7	6.0	6.6	7.2
USD Import Growth (Percent)	5.4	2.3	4.3	5.8	6.5	7.1
Non-interest Current Account Balance (Percent of GDP) 2/	-8.9	-4.6	-1.6	-2.2	-3.6	-2.0
Net FDI (negative = inflow)	-1.2	-0.7	-0.4	-1.1	-0.8	-0.9
Grant element of new public sector borrowing (in percent)	24.8	24.9	24.8	23.6	23.8	23.8
External Debt (Percent of GDP)	47.2	44.5	46.3	41.1	40.5	42.2
Public Sector Debt (Percent of GDP)	63.3	61.1	59.7	60.7	61.5	56.1

Sources: IMF Country Report and IMF staff calculations.
Note: Average of 2023–28 is the average of FY23/24–FY28/29.
1/ Positive indicates a deficit, negative indicates a surplus.
2/ Estimates for 2022 and 2023 DSA were based on pre-revised BOP data so projections have a structural break.

- **Concessional borrowing:** External loan disbursements incorporate the authorities' most recent projections and reflect commitments from donors. Concessional external borrowing is assumed to remain central for financing large investment projects. The World Bank's Development Policy Operation (DPO) (US$30 million), which is currently under negotiation, is assumed to be disbursed during FY24/25-FY25/26 as budget support. In the absence of any further changes in IDA eligibility criteria, the grant element and profile for concessionality are assumed to remain broadly similar to the latest financing composition, where multilateral concessional borrowing accounts for the bulk of new borrowing followed by official bilateral loans.

- **Domestic borrowing:** In line with the authorities' medium-term goals, the development of the domestic debt market 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 medium-term domestic borrowing and the mix of instruments are assumed to stay broadly in line with the authorities' current borrowing terms, and to gradually move to a moderately developed domestic debt market in the long term that relies more on longer-term maturities, following the LIC-DSF guidelines.

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

- **Public debt:** The projected increase in public debt over the medium term is lower than in the past DSA. According to the realism tool, based on a comparison of debt-creating flows over the past five years' with the future five-year projected change, this is mainly driven by (i) a projected improvement in the primary fiscal balance on account of stronger inflows of grants and contained recurrent expenditures; (ii) smaller currency depreciation of Rand; and (iii) more favorable GDP growth in light of the LHWP-II project and private sector growth. The residuals, which contribute to the increase of the public debt ratio, are driven by the accumulation of government deposits at the central bank to strengthen international reserves. Also, looking at the contribution of unexpected changes from past projections, the unexplained change in public debt is close to the LIC median, which has been largely explained by a greater pace of Rand depreciation, weaker-than-expected growth during the COVID-19 pandemic, and a revision to national accounts data that also turns up in the residual. The realism tool also shows that the projected three-year adjustment in the primary balance is towards the bottom quartiles, as the strong SACU transfers will only last for the current fiscal year FY24/25, and primary balance is projected to somewhat decline but will be bolstered by the higher water royalties in the next three years. The estimated impact of fiscal relaxation for projected FY24/25 and FY25/26 on growth are almost in line with those implied by the default fiscal multipliers.

- **External debt:** External debt is also lower than in the past for similar reasons as public debt, in line with the projected changes in exchange rate and real GDP growth. The current account deficit has been the main contributor to debt, but given a better projected external position from higher water exports it will no longer stand as the single biggest contributor to future debt creating flows. The previous large residuals to external debt accumulation are attributable to capital transfers from South Africa used to finance the LHWP-II, which will gradually subside as imports from LHWP-II wind down. The unexpected changes in external debt, similar to the public debt and at the level of LIC medium, are explained by exchange rate, growth, and stronger-than-expected SACU transfers.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

9. 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 2024 WEO data and the World Bank's 2022 CPIA score yields a medium CI rating 2.98, higher than the previous vintage of 2.86.

10. 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

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	Medium	Medium
	2.98	2.86	2.90

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	43%
Real growth rate (in percent)	2.719	0.687	0.02	1%
Import coverage of reserves (in percent)	4.052	40.633	1.65	55%
Import coverage of reserves^2 (in percent)	-3.990	16.510	-0.66	-22%
Remittances (in percent)	2.022	15.494	0.31	11%
World economic growth (in percent)	13.520	2.856	0.39	13%
CI Score			2.978	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 Clasciciation

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

11. 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 PPG external debt-to-GDP is expected to remain at broadly the same level in the coming years. In light of the recent development of higher renegotiated water royalties, the authorities have not yet made substantial changes to their medium-term borrowing strategy, which continues to be supported by new loans for capital projects and disbursements from old loans. However, given that the fiscal position is projected to be better than in the previous DSA, mainly on account of higher projected grants to finance public capital investment and higher water revenues, smaller medium-term financing needs are assumed to result in lower projected external borrowing. All indicators of external debt sustainability remain below their thresholds.

12. Stress tests show that Lesotho's external debt is most vulnerable to the exchange rate, combined contingent liabilities shocks, exports, and current transfers-to-GDP[13] (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 FY26/27 under the most extreme shock of depreciation, 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. The breach of PV of debt-to-GDP ratio and PV of debt-to-exports ratio in the historical scenario are due to the historical revision of national account and current account data, as well as a the largely improved medium-term external position caused by higher water exports. Given the large revisions to historical data and new medium-term outlook for external balance, the historical scenario should be interpreted with

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

caution, as it fully discounts the impact of the recent water-royalty agreement and assumes instead that key macroeconomic variables in the baseline projection will be permanent replaced by their (revised down) 10-year historical averages.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

13. Under the baseline, the PV of total public debt-to-GDP remains below, but close to, its corresponding threshold (Table 3 and 4, and Figure 2). The present value (PV) of total public debt-to-GDP is expected to increase slightly in the medium term, but remain below the 55 percent threshold. The PVs of the debt-to-revenue ratio and debt service-to-revenue ratio are expected to increase but have improved compared to the last DSA, again due to higher grant and water revenue projections. The path of PV of debt service-to-revenue ratio is also driven by the projected changes in the mix of domestic and external financing. In the near term, domestic debt issuance falls amid improving fiscal balance, though not in a great scale because the authorities still intend to develop the domestic debt market. Over the medium term, Lesotho plans to gradually transition towards domestic financing away from external borrowing on concessional terms.

14. Stress tests show that Lesotho's public debt is vulnerable to a number of shocks in the standardized tests (Table 4 and Figure 2). The PV of public debt-to-GDP is most vulnerable to real GDP growth, contingent liabilities, current transfers-to-GDP, and export shocks. The PV of PPG debt-to-GDP ratio would breach the 55 percent threshold in FY27/28 under the most extreme shock of GDP growth, and remain above the threshold during the entire forecast horizon. Like the external debt, historical scenarios for public debt are also affected by data revisions and a new outlook for the medium-term external position.

RISK RATING AND VULNERABILITIES

15. The risk ratings of both Lesotho's external and overall public debt are "moderate" with limited space to absorb shocks. The moderate risk rating of external debt distress comes from the PV of PPG external debt-to-GDP breaching its threshold under the stress tests, while the moderate overall risk rating of public debt distress comes from the moderate risk of external debt distress and from the PV of public debt-to-GDP breaching its benchmark under the stress tests. All the external and public debt indicators remain below their thresholds under the baseline. The granularity of risk rating—assessing available space the country has to absorb shocks without being downgraded to a high-risk category—remains limited (Figure 5).

16. Risks to debt sustainability are tilted to the downside. The key risks are the realization of contingent liabilities, stalled fiscal adjustment, and further arrears. While external and total PV of debt-to-GDP ratios have improved, they are close to the thresholds for high-risk, leaving limited space to absorb further shocks. Weak public financial management (PFM), inefficient capital investment, and poor liquidity management—resulting in growing domestic arrears—can quickly reduce the fiscal space available 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 disputes with Frazer Solar GmbH, Netcare Hospital Group, and Trencon). The current authorities have successfully reined in the wage bill and contained spending in FY23/24, and continued fiscal prudence is strongly recommended. On the external side, despite the positive impact of additional water royalties on the external balance, declining SACU transfers remain a concern. A potential slowdown in South Africa and uncertainty over changes in the terms of African Growth and Opportunity Act (AGOA) will weigh on external demand, further affecting the debt outlook. Exchange rate valuation effects amid volatile global financial conditions are also a material risk for external debt. However, the grant-financed megaprojects, such as the LHWP-II, remain supportive to the growth and debt outlook.

17. Fiscal prudence coupled with reforms to improve governance and spending efficiency remain critical for debt sustainability. The DSA highlights the need for continued fiscal discipline—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 while developing the local debt market. Finally, efforts are needed to further increase debt transparency including the coverage, quality, and relatability of debt statistics, in line with the World Bank SDFP Performance and Policy Actions.

18. The authorities should also consider boosting economic resilience by reducing Lesotho's public liabilities. Additional revenues from the water royalties present a unique and valuable opportunity to rebuild Lesotho's external buffers and prepare the country for a more shock-prone world. Beyond accumulating reserve buffers to maintain the exchange rate peg, Lesotho's improved fiscal situation could allow the authorities to scale back new borrowing, and build increased resilience against future shocks such as retiring existing debt more rapidly. As a priority, the authorities should document and clear domestic arrears as soon as possible as first steps of a medium-term strategy for debt sustainability.

Authorities' Views

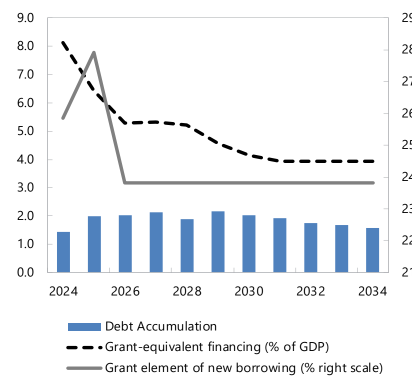
19. The authorities concurred with staff's assessment and the need for continued fiscal discipline, managing contingent liability risks, and prudent debt management to reduce debt vulnerabilities over the medium term. They acknowledged the opportunity that the SACU windfall and new water royalties provide to limit net increases in debt and support macroeconomic stability over the medium term, while also agreeing that a plan for debt management is needed to strengthen resilience in a shock-prone environment, underpinned by the Public Debt Management Bill. In the medium term, they underscored the need to continue developing the local currency bond markets. The authorities also reiterated their commitment to pay down arrears and improve monitoring of contingent liabilities to ensure a comprehensive overview of debt. They noted the potential of paying down costly debt using the new source of revenues could help bring extra room for the country to absorb shocks that will weigh on its debt outlook.

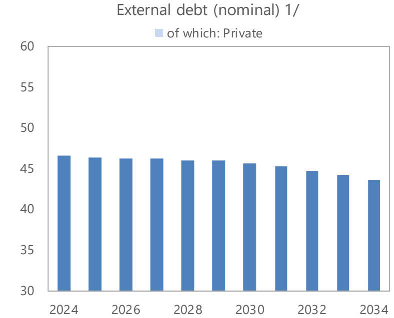
Table 1. Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2021–44

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2044	Historical	Projections
External debt (nominal) 1/	42.3	47.2	47.8	46.6	46.4	46.2	46.2	46.0	46.0	43.6	39.3	41.3	45.5
of which: public and publicly guaranteed (PPG)	42.3	47.2	47.8	46.6	46.4	46.2	46.2	46.0	46.0	43.6	39.3	41.3	45.5
Change in external debt	-0.6	4.9	0.6	-1.3	-0.2	-0.2	0.0	-0.2	0.0	-0.6	-0.2		
Identified net debt-creating flows	4.6	16.0	3.2	-0.2	0.7	0.9	1.8	1.5	0.7	0.9	1.6	6.2	0.9
Non-interest current account deficit	8.4	13.0	-0.6	0.0	1.7	1.5	2.4	2.1	1.6	1.8	2.4	6.7	1.6
Deficit in balance of goods and services	47.5	52.4	50.3	51.0	45.7	44.7	44.3	43.8	42.8	45.8	54.3	49.3	45.4
Exports	46.7	43.8	41.7	43.5	47.6	46.4	45.7	46.1	46.4	50.2	59.4		
Imports	94.2	96.1	91.9	94.6	93.4	91.1	90.0	89.9	89.2	96.0	113.8		
Net current transfers (negative = inflow)	-20.6	-17.8	-28.1	-29.1	-22.8	-21.9	-20.9	-20.9	-20.8	-22.5	-27.1	-23.5	-22.6
of which: official	-18.4	-15.8	-26.1	-27.2	-21.0	-20.2	-19.2	-19.2	-19.2	-20.7	-25.0		
Other current account flows (negative = net inflow)	-18.6	-21.6	-22.8	-21.9	-21.3	-21.2	-21.0	-20.8	-20.4	-21.6	-24.8	-19.1	-21.2
Net FDI (negative = inflow)	1.5	-0.8	1.9	0.3	-0.5	-0.5	-0.5	-0.5	-0.8	-0.9	-1.1	-1.6	-0.6
Endogenous debt dynamics 2/	-5.2	3.8	2.0	-0.5	-0.4	-0.1	-0.1	-0.1	-0.1	0.0	0.2		
Contribution from nominal interest rate	0.7	0.8	0.8	0.7	0.6	0.8	0.8	0.8	0.8	0.9	1.0		
Contribution from real GDP growth	-0.6	-0.7	-1.1	-1.2	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8		
Contribution from price and exchange rate changes	-5.3	3.7	2.3	...	...	...	...	...	...	...	...		
Residual 3/	-5.2	-11.1	-2.6	-1.0	-0.9	-1.1	-1.8	-1.7	-0.8	-1.5	-1.8	-5.1	-1.4
of which: exceptional financing	-0.2	0.0	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	...	...	34.5	34.4	34.6	35.0	35.4	35.6	36.0	35.3	31.9		
PV of PPG external debt-to-exports ratio	...	...	82.7	79.1	72.7	75.3	77.4	77.3	77.6	70.2	53.7		
PPG debt service-to-exports ratio	5.3	7.4	7.8	8.8	6.3	5.9	6.1	6.0	5.7	6.3	5.2		
PPG debt service-to-revenue ratio	5.6	7.7	6.0	6.8	5.4	5.1	5.4	5.4	5.1	6.9	6.5		
Gross external financing need (Million of U.S. dollars)	299.2	349.5	99.2	95.2	101.3	95.8	124.7	120.4	101.4	154.9	288.6		
Key macroeconomic assumptions													
Real GDP growth (in percent)	1.7	1.6	2.2	2.7	2.4	1.9	2.1	2.1	2.1	2.1	2.1	0.0	2.2
GDP deflator in US dollar terms (change in percent)	14.0	-8.0	-4.6	1.4	2.8	2.8	2.7	2.5	2.7	3.2	3.2	-0.2	2.8
Effective interest rate (percent) 4/	1.8	1.8	1.6	1.5	1.4	1.7	1.8	1.9	1.9	2.2	2.6	1.7	1.9
Growth of exports of G&S (US dollar terms, in percent)	34.8	-12.4	-7.2	8.9	15.2	2.1	3.3	5.5	5.5	7.5	7.3	2.0	7.1
Growth of imports of G&S (US dollar terms, in percent)	16.7	-4.7	-6.8	7.1	4.0	2.2	3.7	4.4	4.1	7.1	7.3	-0.1	5.6
Grant element of new public sector borrowing (in percent)	...	...	...	25.9	27.9	23.8	23.8	23.8	23.8	23.8	23.8	...	24.5
Government revenues (excluding grants, in percent of GDP)	43.9	41.6	53.7	56.5	55.9	53.5	51.2	51.2	51.2	46.3	47.5	46.2	50.3
Aid flows (in Million of US dollars) 5/	864.7	793.9	806.9	208.3	187.4	145.1	154.0	157.5	146.1	166.2	249.9		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	8.1	6.4	5.3	5.3	5.2	4.6	3.9	3.4	...	5.1
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	69.6	66.2	63.7	62.8	64.6	60.3	56.9	53.3	...	61.6
Nominal GDP (Million of US dollars)	2,427	2,267	2,211	2,303	2,425	2,541	2,665	2,788	2,925	3,804	6,437		
Nominal dollar GDP growth	16.0	-6.6	-2.5	4.2	5.3	4.8	4.9	4.6	4.9	5.4	5.4	-0.2	5.0
Memorandum items:													
PV of external debt 7/	...	...	34.5	34.4	34.6	35.0	35.4	35.6	36.0	35.3	31.9		
In percent of exports	...	...	82.7	79.1	72.7	75.3	77.4	77.3	77.6	70.2	53.7		
Total external debt service-to-exports ratio	5.3	7.4	7.8	8.8	6.3	5.9	6.1	6.0	5.7	6.3	5.2		
PV of PPG external debt (in Million of US dollars)			761.9	793.4	839.4	888.4	942.6	992.9	1053.1	1342.2	2054.0		
(PVt-PVt-1)/GDPt-1 (in percent)				1.4	2.0	2.0	2.1	1.9	2.2	1.6	1.5		
Non-interest current account deficit that stabilizes debt ratio	9.0	8.1	-1.2	1.3	1.8	1.7	2.4	2.3	1.7	2.4	2.6		

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, 2024–34

(In percent of GDP)

	Projections 1/										
	2024	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**	**2033**	**2034**
						PV of debt-to GDP ratio					
Baseline	34	35	35	35	36	36	36	36	36	36	35
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	34	**40**	**46**	**51**	**56**	**62**	**69**	**75**	**81**	**87**	**93**
B. Bound Tests											
B1. Real GDP growth	34	35	38	38	38	39	39	39	39	38	38
B2. Primary balance	34	35	38	38	39	39	39	40	39	39	38
B3. Exports	34	35	**47**	**48**	**48**	**48**	**48**	**48**	**47**	**47**	**46**
B4. Other flows 3/	34	35	**45**	**45**	**46**	**46**	**46**	**46**	**45**	**44**	**43**
B5. Depreciation	34	35	**47**	**48**	**49**	**51**	**53**	**54**	**54**	**55**	**55**
B6. Combination of B1-B5	34	35	36	36	36	37	37	37	37	37	37
C. Tailored Tests											
C1. Combined contingent liabilities	34	35	**50**	**51**	**52**	**52**	**53**	**53**	**53**	**52**	**52**
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	79	73	75	77	77	78	77	76	74	72	70
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	79	85	99	111	122	134	147	159	168	177	**185**
B. Bound Tests											
B1. Real GDP growth	79	73	75	77	77	78	77	76	74	72	70
B2. Primary balance	79	73	82	84	84	85	84	83	81	79	77
B3. Exports	79	73	115	118	118	118	117	115	111	107	103
B4. Other flows 3/	79	73	97	99	99	99	98	96	92	89	85
B5. Depreciation	79	73	100	105	107	110	112	114	113	112	110
B6. Combination of B1-B5	79	73	66	91	91	92	91	91	89	88	86
C. Tailored Tests											
C1. Combined contingent liabilities	79	73	107	111	112	113	113	111	109	106	103
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	9	6	6	6	6	6	6	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	9	7	7	8	8	8	9	11	12	13	15
B. Bound Tests											
B1. Real GDP growth	9	6	6	6	6	6	6	6	6	6	6
B2. Primary balance	9	6	6	6	6	6	6	6	7	7	7
B3. Exports	9	7	7	8	8	8	8	8	10	9	9
B4. Other flows 3/	9	6	6	7	7	6	7	7	8	8	8
B5. Depreciation	9	6	6	7	7	7	7	7	9	9	9
B6. Combination of B1-B5	9	6	8	8	8	7	7	7	7	7	8
C. Tailored Tests											
C1. Combined contingent liabilities	9	6	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	7	5	5	5	5	5	6	6	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	7	6	6	7	7	8	9	11	13	14	16
B. Bound Tests											
B1. Real GDP growth	7	5	5	6	6	6	6	7	7	7	7
B2. Primary balance	7	5	5	6	6	5	6	6	7	7	7
B3. Exports	7	5	6	7	7	6	7	7	9	9	9
B4. Other flows 3/	7	5	5	6	6	6	7	7	8	8	8
B5. Depreciation	7	5	5	6	6	6	7	7	9	9	10
B6. Combination of B1-B5	7	5	6	6	6	6	7	6	7	7	7
C. Tailored Tests											
C1. Combined contingent liabilities	7	5	6	6	6	6	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.

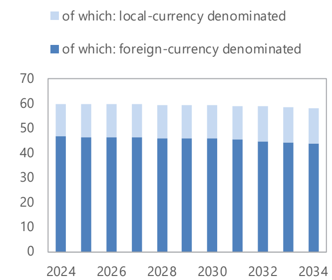
Table 3. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021–44

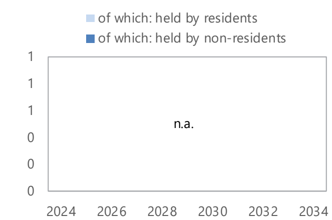
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2044	Historical	Projections
Public sector debt 1/	58.4	64.5	61.5	59.9	59.7	59.8	59.8	59.5	59.5	58.1	52.2	51.5	59.3
of which: external debt	42.3	47.2	47.8	46.6	46.4	46.2	46.2	46.0	46.0	43.6	39.3	41.3	45.5
Change in public sector debt	3.7	6.1	-3.0	-1.6	-0.2	0.0	0.0	-0.3	0.0	-0.5	-0.8		
Identified debt-creating flows	2.1	10.5	-7.2	-8.6	-8.7	-5.6	-3.4	-3.3	-3.3	0.0	-0.3	2.3	-2.9
Primary deficit	4.0	3.6	-8.1	-6.7	-7.5	-4.8	-2.7	-2.6	-2.6	0.5	0.0	1.2	-2.1
Revenue and grants	48.8	44.6	56.5	63.4	61.1	57.8	55.6	55.6	54.8	54.0	54.0	49.6	54.5
of which: grants	4.9	3.0	2.8	6.9	5.2	4.3	4.3	4.3	3.6	3.0	2.5		
Primary (noninterest) expenditure	52.8	48.3	48.4	56.7	53.6	53.0	52.9	53.0	52.3	54.5	54.0	50.8	52.4
Automatic debt dynamics	-1.9	6.8	0.8	-1.8	-1.2	-0.8	-0.7	-0.7	-0.7	-0.5	-0.3		
Contribution from interest rate/growth differential	-1.7	-2.7	-2.0	-1.8	-1.2	-0.8	-0.7	-0.7	-0.7	-0.5	-0.3		
of which: contribution from average real interest rate	-0.8	-1.8	-0.6	-0.2	0.2	0.4	0.5	0.5	0.5	0.7	0.7		
of which: contribution from real GDP growth	-0.9	-0.9	-1.4	-1.6	-1.4	-1.1	-1.2	-1.2	-1.2	-1.2	-1.0		
Contribution from real exchange rate depreciation	-0.2	9.5	2.8	...	...	...	...	...	...	...	...		
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	1.6	-4.4	4.3	6.9	8.5	5.6	3.4	3.0	3.3	-0.6	-0.5	-0.2	2.5
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	48.9	47.8	47.9	48.5	48.9	49.1	49.5	49.8	44.8		
PV of public debt-to-revenue and grants ratio	...	...	86.6	75.3	78.5	83.9	88.0	88.4	90.2	92.3	89.2		
Debt service-to-revenue and grants ratio 3/	10.7	18.1	13.2	11.0	9.8	9.4	9.8	10.5	11.1	11.9	11.2		
Gross financing need 4/	9.2	11.7	-0.6	0.2	-1.5	0.6	2.8	3.3	3.5	6.9	6.0		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	1.7	1.6	2.2	2.7	2.4	1.9	2.1	2.1	2.1	2.1	2.1	0.0	2.2
Average nominal interest rate on external debt (in percent)	1.6	1.8	1.7	1.6	1.4	1.7	1.8	1.9	1.9	2.2	2.6	1.7	1.9
Average real interest rate on domestic debt (in percent)	3.4	1.7	1.7	1.3	2.6	3.3	4.0	4.0	3.7	4.2	4.5	0.7	3.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.4	24.0	6.2	...	...	...	...	...	...	...	...	3.9	...
Inflation rate (GDP deflator, in percent)	3.5	5.3	5.4	6.0	5.4	5.3	4.9	4.9	5.1	5.0	5.0	5.8	5.1
Growth of real primary spending (deflated by GDP deflator, in percent)	1.6	-7.1	2.6	20.2	-3.2	0.8	1.9	2.2	0.8	3.5	3.5	-1.5	2.8
Primary deficit that stabilizes the debt-to-GDP ratio 5/	0.3	-2.5	-5.1	-5.1	-7.3	-4.9	-2.7	-2.3	-2.6	1.0	0.8	-2.4	-1.8
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

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

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

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

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

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

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

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

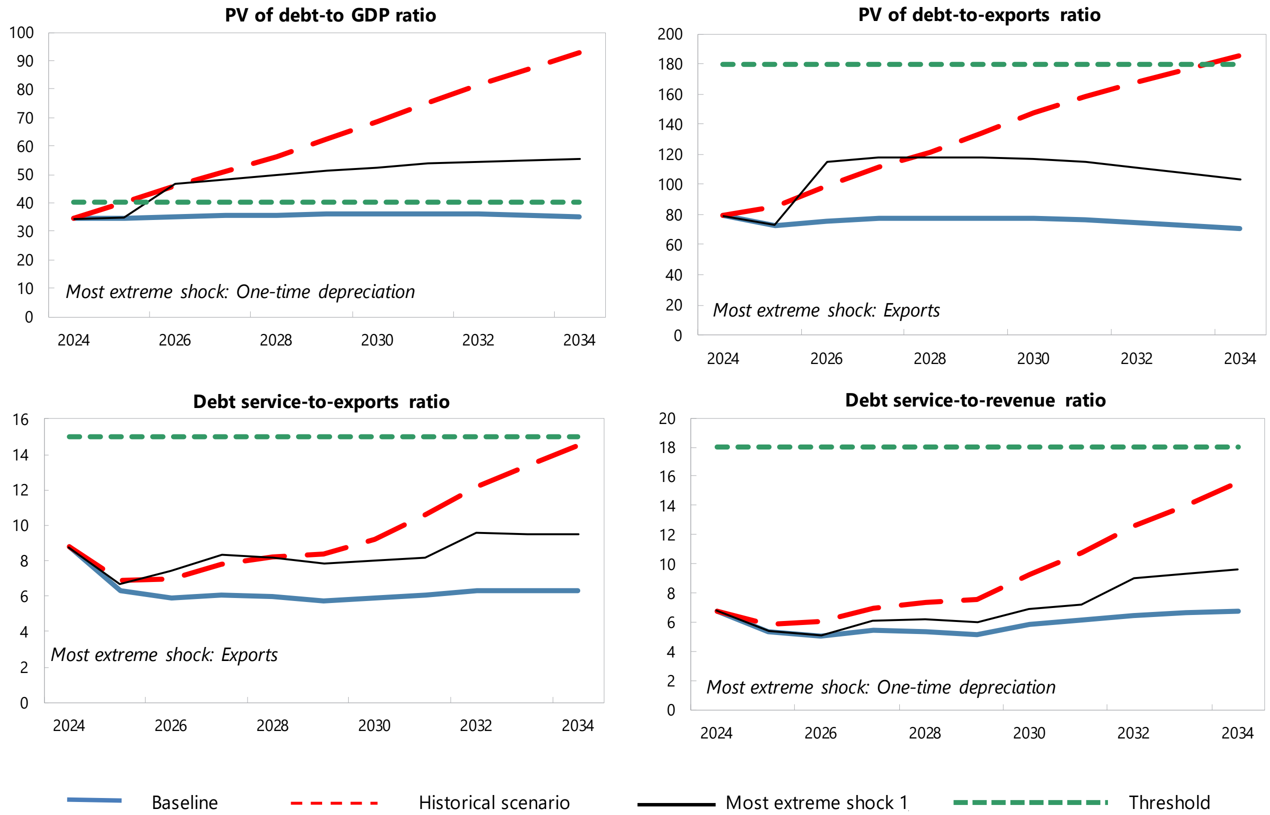
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 4. Lesotho: Sensitivity Analysis for Key Indicators of Public Debt, 2024–34
(In percent of GDP)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
					PV of Debt-to-GDP Ratio						
Baseline	48	48	48	49	49	49	50	50	50	50	50
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	48	48	54	**58**	**62**	**67**	**67**	**68**	**69**	**70**	**71**
B. Bound Tests											
B1. Real GDP growth	48	48	53	**55**	**57**	**59**	**61**	**63**	**65**	**66**	**68**
B2. Primary balance	48	48	52	53	53	53	53	54	54	54	53
B3. Exports	48	48	**56**	**56**	**56**	**57**	**57**	**57**	**57**	**56**	**55**
B4. Other flows 3/	48	48	**59**	**59**	**59**	**59**	**60**	**59**	**59**	**58**	**57**
B5. Depreciation	48	48	**61**	**59**	**58**	**57**	**56**	55	54	53	52
B6. Combination of B1-B5	48	48	52	51	51	52	52	52	52	52	52
C. Tailored Tests											
C1. Combined contingent liabilities	48	48	**61**	**62**	**63**	**64**	**64**	**64**	**65**	**64**	**64**
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	75	79	84	88	88	90	101	102	102	101	92
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	75	79	94	105	112	121	137	139	141	140	130
B. Bound Tests											
B1. Real GDP growth	75	79	91	99	103	108	125	128	132	133	125
B2. Primary balance	75	79	91	95	95	97	109	109	110	108	99
B3. Exports	75	79	97	101	101	103	116	116	116	113	103
B4. Other flows 3/	75	79	101	106	106	108	122	121	120	117	106
B5. Depreciation	75	79	105	107	104	103	113	111	110	106	96
B6. Combination of B1-B5	75	79	89	91	92	94	105	106	106	104	96
C. Tailored Tests											
C1. Combined contingent liabilities	75	79	79	85	87	91	103	105	107	107	99
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	10	9	10	11	11	12	12	13	13	12
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2025-2035 2/	11	10	10	11	12	14	15	16	16	16	15
B. Bound Tests											
B1. Real GDP growth	11	10	10	11	12	13	14	14	15	16	15
B2. Primary balance	11	10	9	10	11	12	13	13	13	13	12
B3. Exports	11	10	9	10	11	12	12	13	14	14	13
B4. Other flows 3/	11	10	10	10	11	12	12	13	14	14	13
B5. Depreciation	11	10	9	10	10	11	12	12	13	13	12
B6. Combination of B1-B5	11	10	10	10	11	12	12	13	13	13	12
C. Tailored Tests											
C1. Combined contingent liabilities	11	10	12	12	13	14	15	14	14	14	13
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 1. Lesotho: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2024–34



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.

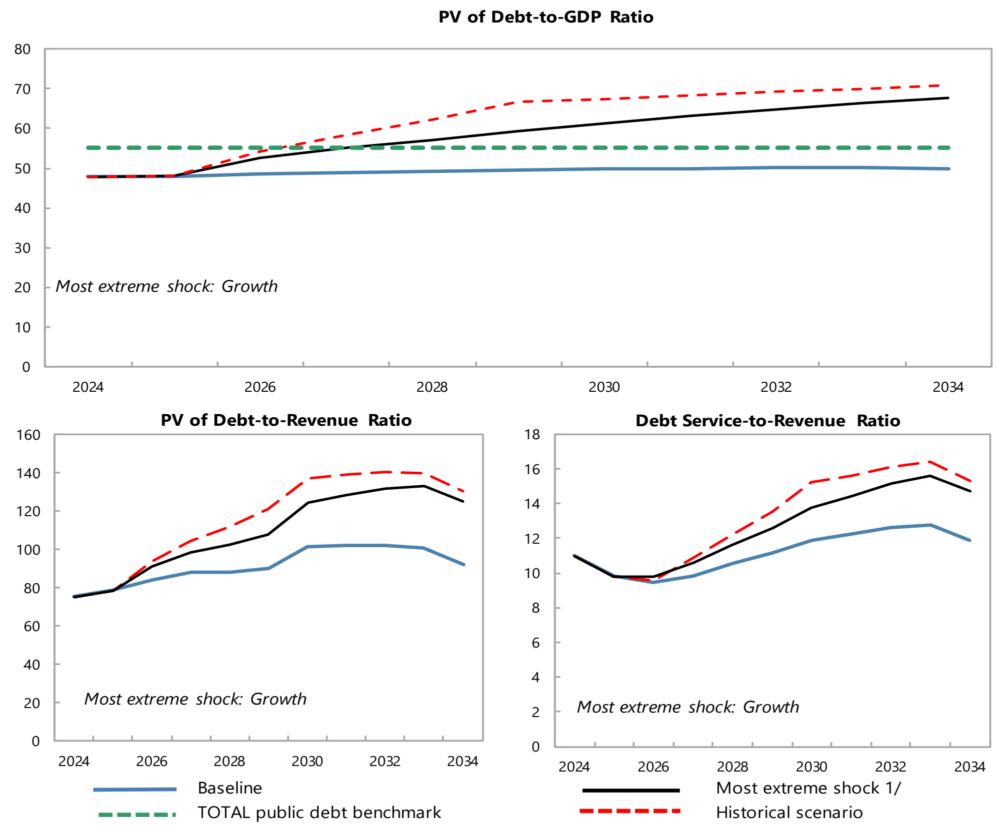
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.6%	2.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace 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 2034. 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, 2024–34



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	58%	80%
Domestic medium and long-term	42%	20%
Domestic short-term	0%	0%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.6%	2.6%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.5%	4.5%
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.

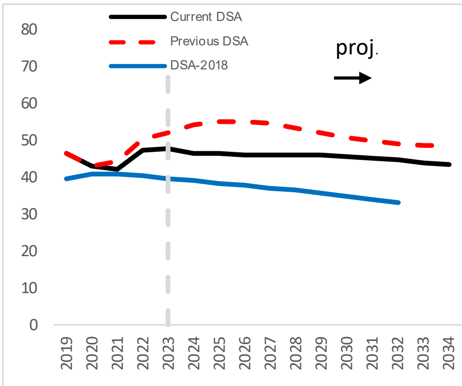
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. 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.

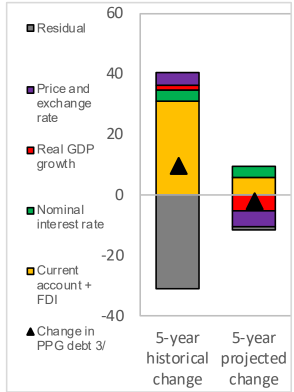
Figure 3. Lesotho: Drivers of Debt Dynamics – Baseline Scenario

External Debt

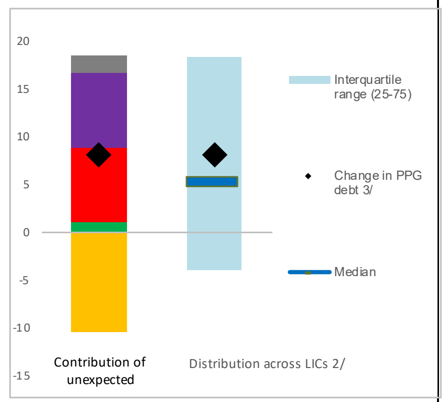
Gross Nominal PPG External Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)

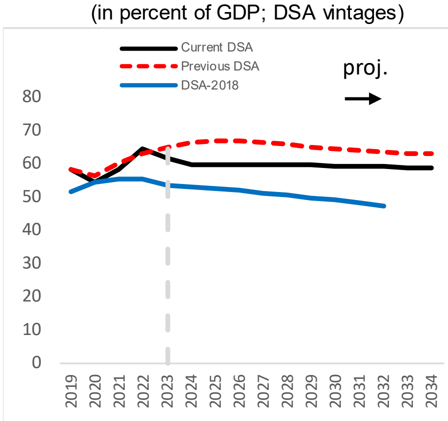


Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

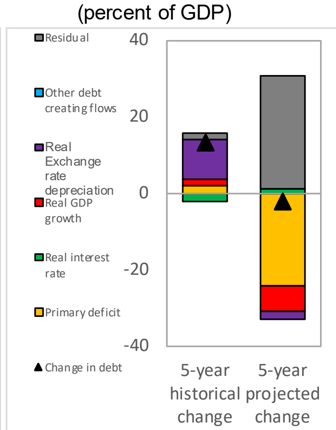


Public Debt

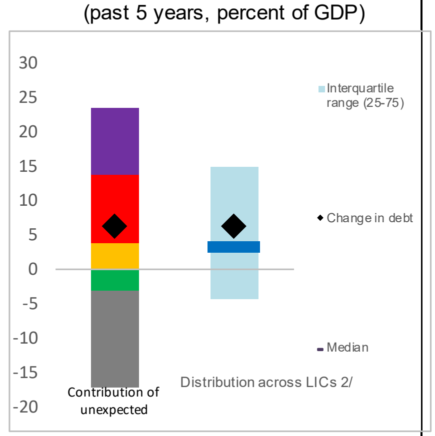
Gross Nominal Public Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)



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



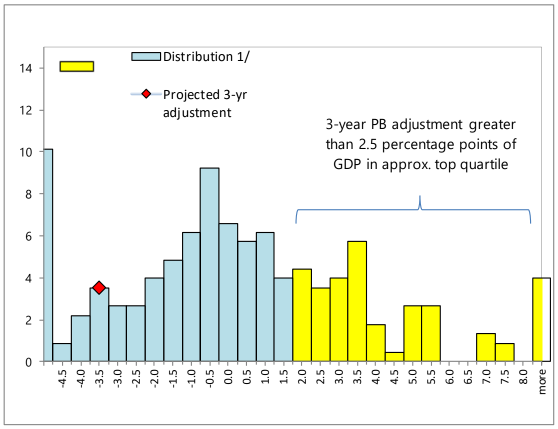
1/ Difference between anticipated and actual contributions on debt ratios.

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.

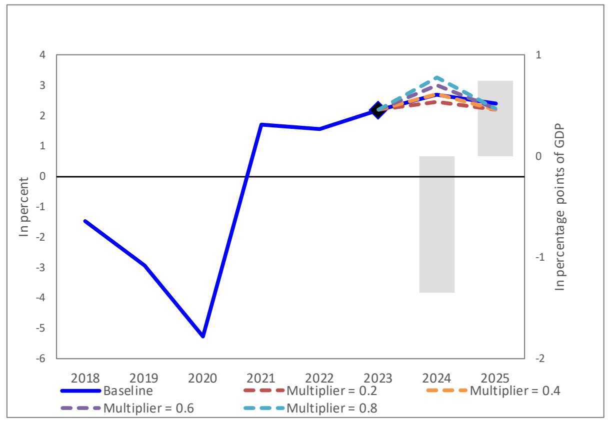
Figure 4. Lesotho: Realism Tools

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



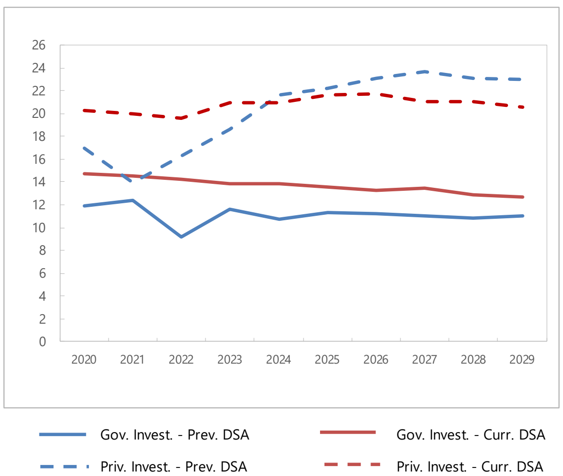
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

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)

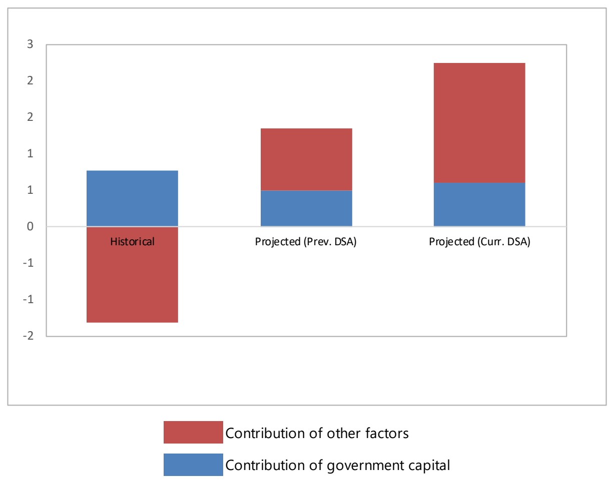
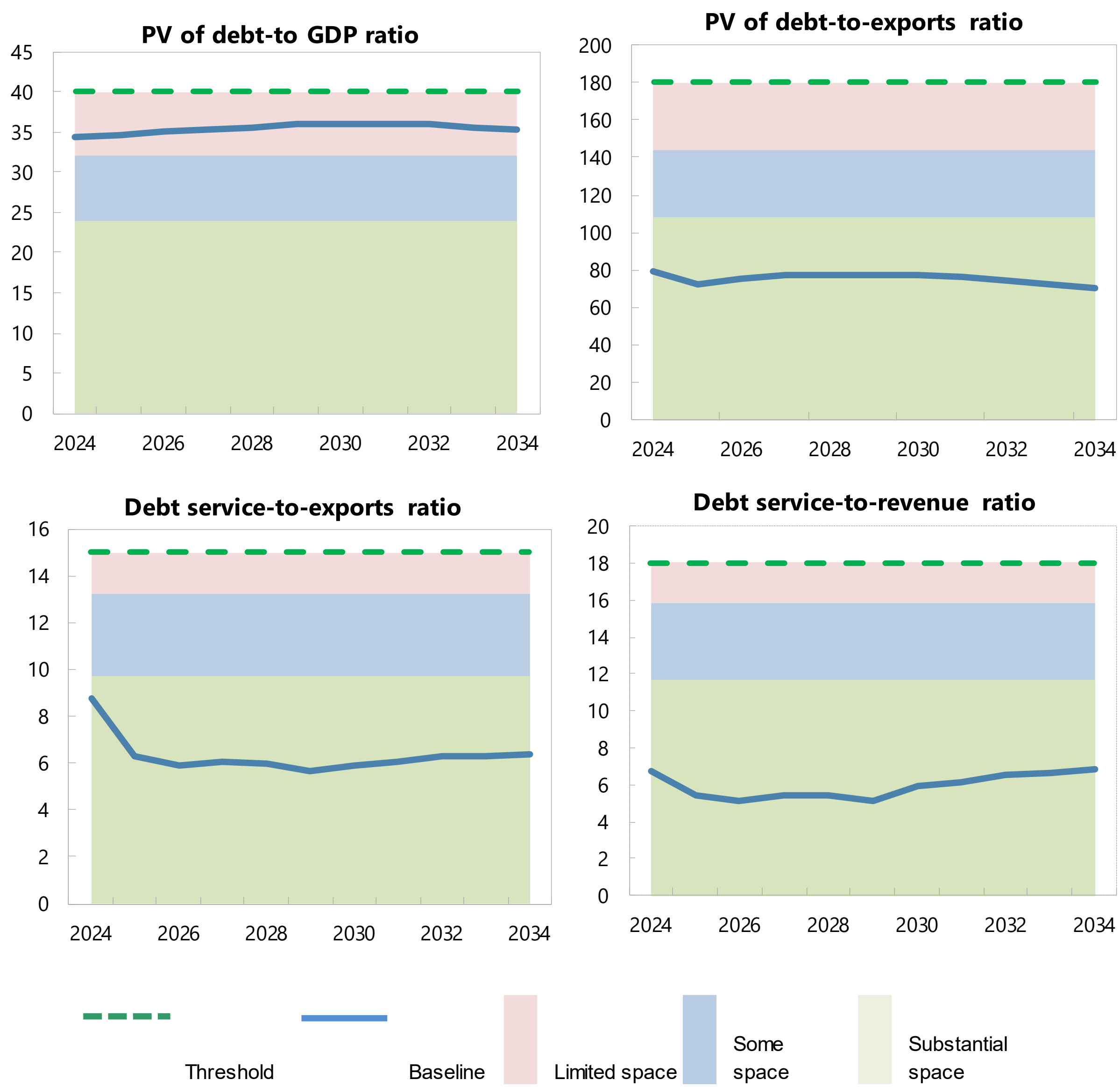


Figure 5. Lesotho: Qualification of the Moderate Category, 2024–2034[1/]



Sources: Country authorities; and staff estimates and projections.

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

Statement by Mr. Willie Nakunyada Executive Director for Kingdom of Lesotho and Mr. Moeti Godfrey Damane Senior Advisor to the Executive Director for Kingdom of Lesotho
September 6, 2024

Introduction

1. Our authorities appreciate the constructive discussions with staff during the 2024 Article IV consultation and broadly agree with the thrust of the staff appraisal and policy priorities.

2. The economy of Lesotho is experiencing a modest growth recovery, while the near-term outlook has improved on the back of stronger fiscal and external balances. Nevertheless, the country's growth has remained subdued against the background of recurrent climate shocks, lower growth in key trading partners, and limitations of a public sector driven growth model. Despite the challenging circumstances, the new administration has taken decisive measures to restore macroeconomic stability, build reserve buffers, and preserve the exchange rate peg. While the broader implementation of reforms has been slower than anticipated, the authorities are determined to ensure prudent fiscal management. At the same time, they are committed to implementing comprehensive structural reforms aimed to improve governance and the business environment, to promote sustainable, inclusive, and private sector-led growth, and fortify the foundations for a prosperous future for the nation.

Recent Economic Developments and Outlook

3. Real GDP grew modestly from 1.6 percent in FY22/23 to 2.2 percent in FY23/24, driven in part by accelerated construction activities at the Lesotho Highlands Water Project (LHWP-II). Looking ahead, growth is projected to further firm up to 2.7 percent in FY24/25, supported by robust construction activity and easing inflation. While the authorities assess risks to the outlook as broadly balanced, they remain attentive to the evolution of risks from climate-related shocks, growth headwinds in key trading partners, and uncertainty over the renewal of the African Growth and Opportunity Act (AGOA). At the same time, the outlook remains challenged by declining competitiveness in the apparel sector, and the impact of lower diamond prices on export earnings. Meanwhile, inflation declined from 8.2% in January 2024 to 6.5% in June 2024, notwithstanding the rising regional food prices, transport costs, and the weakening of the Rand. Going forward, inflation is expected to ease slowly.

4. Fiscal and external balances improved markedly in FY23/24, reflecting the higher windfall transfers from the Southern African Customs Union (SACU). Furthermore, the recently renegotiated water royalty rates under the Treaty with South Africa on the LHWP-II are expected to further shore up fiscal and export revenues. Against this background, as of end-FY23/24, the gross reserve coverage was boosted from 3.9 to 4.5 months of prospective imports, and the Central Bank of Lesotho has maintained net international reserves above its internal target.

Fiscal Policy and Debt

5. Our authorities acknowledge that continued fiscal prudence and public debt sustainability remain essential in efforts aimed to rebuild buffers, enhance resilience to shocks and supporting development spending. Additionally, they are committed to maintaining and reinforcing their efforts to control spending and boost domestic revenues. Considering that the country's wage bill surpasses that of other SACU members and as well as the sub-Saharan African average, the authorities plan to continue implementing measures to contain the wage bill with support from development partners such as the World Bank. These measures include maintaining the hiring moratorium (implemented over the past year), streamlining the establishment list, and conducting regular reviews of the compensation system.

6. To enhance tax policy design and strengthen tax administration, the authorities have established a Tax Policy Unit and are currently hiring key staff. Moving forward, they plan to bolster the unit's capacity for accurate revenue forecasting and improve tax system design with technical assistance from the IMF. Regarding tax administration, the Revenue Services Lesotho (RSL) will implement a phased reform strategy to address identified weaknesses in core functions, aligning it with the IMF's 2023 TADAT assessment. Additionally, a designated coordinator will ensure that the TADAT Action Plan progresses as planned. To further address deficiencies in the tax system, the authorities will expedite approval of the two outstanding tax policy bills and the tax administration bill.

7. While the SACU transfers are expected to enhance fiscal and external balances in FY24/25, the authorities are making efforts to prudently manage these windfall resources to smoothen the volatility in fiscal resources. However, these transfers are expected to decline sharply from FY25/26. The recently renegotiated water royalty rates under the LHWP-II Treaty with South Africa provide an additional revenue source, projected to be around 6½ percent of GDP in FY24/25 (up from 3½ percent previously). These royalties are anticipated to rise to over 12½ percent of GDP in FY25/26 and stabilize at approximately 9½ percent of GDP annually over the medium term. To effectively manage the windfall transfers, authorities plan to establish a stabilization fund in FY24/25. They are currently receiving technical assistance from the World Bank to support this initiative. They will also review the capital budget (to identify high quality investment projects in line with the nation's development agenda) while formulating proposals for optimizing utilization of water royalties. These initiatives are expected to help provide well-targeted support to the most vulnerable, particularly given the high levels of food insecurity in the country.

8. The authorities acknowledge the significance of enhancing the efficiency of social spending to help better support the most vulnerable. Despite social spending being several times higher than that of neighboring countries in terms of GDP share, it is largely dominated by schemes that need to be well-targeted. In light of this, the authorities are intensifying efforts to establish a more targeted safety net, which is also crucial for building resilience against climate-related shocks and food insecurity. They appreciate the staff's recommendations to improve the functioning of existing cash transfer programs, streamline the process of identifying and registering beneficiaries under various social assistance programs, and expedite the implementation of new benefit delivery mechanisms.

9. In their efforts to control spending and enhance transparency, the authorities are intensifying efforts to strengthen Public Financial Management (PFM). Relatedly, the authorities are committed to passing essential PFM legislation, recognizing its critical role in enhancing overall PFM efficiency, transparency, and reporting. They view this exercise as a top priority, understanding that robust PFM practices are fundamental to achieving sustainable economic growth and maintaining public trust. To strengthen trust in PFM, the authorities will prioritize implementation of recommendations from the IMF internal controls assessment, including accelerating the deployment of digital signatures to prevent arrears accumulation. In addition, they consistently engage in pre-budget consultations with citizens, interest groups, and experts to identify priorities and investment areas. Additionally, they plan to implement the Medium-Term Expenditure Framework (MTEF) for better policy alignment and long-term planning. Furthermore, given fiscal risks from public-private partnerships, unquantified arrears, and state-owned enterprise liabilities, the authorities will incorporate a fiscal risk statement into the annual budget process.

10. To further enhance expenditure control, the authorities will improve collaboration between ministries and agencies (including the Central Bank of Lesotho - CBL), monitor and identify misappropriated funds, and conduct regular audits. They will also continue implementing IMF recommendations related to IFMIS, bank reconciliation, and fiscal data reporting. At the same time, the authorities view the new IMF Public Investment Management Information System as an important tool to enhance public investment planning and allocation.

11. The authorities acknowledge the recent steady increase in public debt, attributed to pandemic-related borrowings and attach great prominence on effective debt management. Although the country's risk of debt distress remains 'moderate,' there is limited capacity to absorb additional shocks. Therefore, the authorities view the improved fiscal situation as an opportunity to reduce new borrowing, enhance resilience against future shocks, and expedite the repayment of existing debt and domestic arrears. Additionally, the authorities are actively engaging with Fund staff, seeking guidance and feedback on the most effective and efficient ways to achieve these goals. They also plan to develop a debt management strategy to strengthen resilience in a shock-prone environment, supported by the Public Debt Management Bill.

Monetary and Financial Sector Policies

12. The monetary authorities are committed to price stability, keeping inflation expectations anchored, and maintaining an adequate level of international reserves to safeguard the exchange rate peg. They acknowledge that Lesotho's macroeconomic stability is inextricably bound to preservation of the exchange rate peg of the Loti against the South African Rand. This peg has served Lesotho well by ensuring that inflation expectations remain stable while also acting as the last backstop against fiscal slippages. Naturally, the peg's credibility relies on the country's international reserves position. As the economy is recovering from an overlapping global crisis, gross reserves are nearing 4½ months of imports. In a global economy marked by larger and more frequent shocks, the authorities observe that there is considerable scope to further bolster reserve buffers. As such, the Central Bank of Lesotho (CBL) will continue monitoring reserve levels and inflation

trends, as well as the volatility of the South African Rand and its effect on the net international reserve floor. To manage liquidity and enhance monetary policy transmission, the CBL will intensify coordination with the Ministry of Finance and Development Planning (MoFDP) on reserves management, particularly considering the potential costs to the central bank of absorbing surplus liquidity in view of the anticipated higher reserves from the new water royalties.

13. The CBL will continue to enhance the supervision of banks and nonbanks while addressing the AML/CFT shortcomings identified in the ESAAMLG mutual evaluation report. At the same time, priority will be accorded to improving financial intermediation and inclusion, especially for Micro, Small, and Medium Enterprises (MSMEs). Despite the implementation of partial credit guarantees, the creation of a movable asset registry (Lesotho Registry of Interests in Movable Assets - LERIMA), and the supervision and support of a credit bureau, along with the significant advancements made by the Financial Sector Development Strategy II and National Payment Switch towards improving financial inclusion, the authorities acknowledge that further work remains. As such, they will focus on leveraging digitization by refocusing on digital financial services and strengthening ongoing efforts to build capacity for MSMEs. Additionally, the authorities plan to enhance collateral ownership and loan enforcement, improve the utilization of the credit bureau, and reduce regulatory barriers for financial innovation, as these efforts are crucial for the continued development and inclusivity of the financial sector.

Structural Reforms

14. The authorities will intensify structural reform efforts geared to rejuvenate growth by promoting private sector development, while tackling corruption and governance vulnerabilities. Accordingly, they will tackle longstanding governance challenges and bridge policy coordination gaps that have hindered development and private sector opportunities. Further, the authorities aim to intensify their efforts to curb corruption and reinforce the rule of law, to restore confidence, while promoting investment, and growth. In addition to the recent funding increase and expansion of the Directorate on Corruption and Economic Offences (DCEO), the authorities will further strengthen the DCEO's role in investigating corruption complaints and preventing economic offences by supporting the recently revised District Anti-Corruption Committee (DACC) and enhancing support for other key entities, such as the Office of the Auditor General. This is expected to send a strong signal on the government's determination to uphold good governance practices and stimulate private sector development.

15. The authorities are currently working on providing a stable, predictable, and well- regulated and conducive business environment, to support private sector development and rebalance the growth model. To this end, they are implementing reforms to reduce the cost of doing business, including reducing the stake of large state-owned enterprises in businesses and utility companies. Concurrent efforts are underway to boost broader private investor confidence through transparent, consistent, and clear regulatory frameworks, greater policy consistency, and a long-term strategy for infrastructure development. To reverse the long-term decline of some industries (e.g., textiles) and take full advantage of new opportunities for growth and employment, the authorities are focusing on coordinating and streamlining the efforts of the Lesotho National Development Corporation (LNDC) and the Basotho Enterprise Development Corporation (BEDCO). In addition, they are enhancing the

regulatory framework for the establishment, operation, and oversight of State-Owned Enterprises (SOEs). The authorities are also developing a strategy for the gradual privatization of non-performing SOEs to enhance efficiency and attract investment. These initiatives are currently in progress to foster a more conducive business environment.

Conclusion

16. To accelerate economic recovery, maintain stability, and promote structural reform, the authorities are focusing on strengthening policy coherence and coordination. They are taking decisive steps to improve reform implementation by enhancing coordination across government departments, to achieve a robust, sustainable, balanced, and inclusive growth. The authorities will continue to vigilantly monitor global and domestic developments, assessing their impact on the country's macroeconomic and financial stability, and will implement necessary policy measures. In this context, they value the continued policy and technical support from the Fund. Importantly, they look forward to Executive Directors' support in conclusion of the 2024 Article IV Consultation.