INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/127

KINGDOM OF LESOTHO

May 2013

Fifth Review Under the Three-Year Arrangement Under the Extended Credit Facility and Request for Extension of the Arrangement and Rephasing of Disburseement

In the context of the Fifth Review Under the Three-Year Arrangement Under the Extended Credit Facility and Request for Extension of the Arrangement and Rephasing of Disbursement, the following documents have been released and are included in this package:

- **Staff Report** for the fifth review under the three-year arrangement under the Extended Credit Facility and request for extension of the arrangement and rephasing of disbursement, prepared by a staff team of the IMF, following discussions that ended on March 29, 2013 with the officials of Lesotho on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 23, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Press Release** dated May 9, 2013.

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

Letter of Intent sent to the IMF by the authorities of Lesotho*
Memorandum of Economic and Financial Policies by the authorities of Lesotho*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

April 23, 2013

FIFTH REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND REQUEST FOR EXTENSION OF THE ARRANGEMENT AND REPHASING OF DISBURSEMENT

EXECUTIVE SUMMARY

Despite the drought, Lesotho has maintained positive growth, supported by mining and construction. Real GDP growth is estimated at 3⅔ percent in 2012/13. The growth outlook for 2013/14 and beyond stays above 4 percent, supported by the expected recovery in agricultural production and the continued expansion of mining activities. Growth prospects, however, are subject to downside risks, owing to the uncertain global and regional economic outlook which poses risks to future diamond prices and Southern African Customs Union (SACU) revenues, respectively. The prospects of the textile sector—the third largest employer in Lesotho—are also subject to downward risks, as the US African Growth and Opportunity Act (AGOA) is slated to expire in 2015.

Lesotho's international partners have responded strongly to the international appeal to address the drought. In response to the UN appeal launched in September 2012, Lesotho's international partners have pledged the total assistance of US$40 million, fully covering estimated immediate drought-related needs.

Continued fiscal consolidation has helped to rebuild some of the international reserve cushion. The non-SACU fiscal deficit (excluding externally financed capital projects) is estimated to have narrowed to about 20 percent of GDP in 2012/13, primarily owing to the delayed execution of some capital projects and lower recurrent spending. A recently formulated public financial management (PFM) reform action plan is expected to further improve efficiency of public spending, aiding the fiscal consolidation efforts. The ongoing fiscal consolidation and large financial inflows have improved external balances, notwithstanding weak diamond prices. International reserves reached about 4 months of imports at end-February 2013, up from 3½ months of imports at end-March 2012.

To sustain growth and increase employment, reform efforts to promote private sector development have continued. The efforts, consistent with the priorities of the National Strategic Development Plan (NSDP), have focused on improving the business climate, providing better access to finance, facilitating cross-border trade, and strengthening Lesotho's international competitiveness. The authorities intend to accelerate the land

titling program, fully implement the 2010 Land Administration Act, advance the national identification card project, and establish a credit rating system.

The ECF-supported program remains broadly on track. All end-September 2012 quantitative performance criteria (PCs) and end-December indicative targets were met (MEFP, Table 1). The indicative target for the floor on social spending for September 2012 was missed by a small margin, though the target for end-December 2012 was met. Three out of six structural benchmarks (SBs) through March 2013 were implemented, namely: the submission of the Industrial Licensing Bill and the Insurance Bill to parliament and a full-service Large Taxpayers Unit (LTU). The other three SBs—the reconciliation of all treasury accounts (revenue and expenditure), the establishment of the Cash Management Unit (CMU), and the submission of the amendments of the Loans and Guarantees Act to Parliament—have been delayed, partly owing to administrative setbacks. The authorities are committed to implementing the delayed SBs by end-May 2013.

Based on the performance under the program and policy commitments for 2013/14, staff supports the completion of the fifth review under the ECF arrangement and extension of the arrangement to September 30, 2013. Risks to the program can be mitigated by continued implementation of sound policy and reforms, in coordination with Lesotho's development partners.

Approved By
Anne-Marie Gulde-Wolf, AFR, and Chris Lane, SPR

The mission visited Maseru on January 10–23 and March 25–29, 2013. The mission met with the Finance Minister Ketso; Central Bank of Lesotho Governor Matlanyane; other senior government officials; and representatives of the donor community, and the private sector. The staff team comprising J. Honda (head), N. Koliadina, I. Masha, M. Yabara (all AFR) was assisted by M. Tharkur, resident representative.

CONTENTS

APPENDIX

ATTACHMENTS

INTRODUCTION

1. Extended Credit Facility Arrangement: The Executive Board approved a three-year Extended Credit Facility (ECF) in the amount of SDR 41.88 million (120 percent of quota) in June 2010, after a sharp fall in revenues from the Southern African Customs Union (SACU). To cushion the impact of the 2010–11 flood damage and high international commodity prices, the Board approved an augmentation of access in the amount of 25 percent of quota in April 2012, bringing total access to SDR 50.605 million (145 percent of quota). The fourth review under the (ECF) arrangement was concluded on November 27, 2012.

2. Review: The ECF-supported program remains broadly on track. All end-September 2012 quantitative performance criteria (PCs) and end-December 2012 indicative targets were met, except for the indicative target on social spending for September 2012, which was missed by a small margin. Three out of six structural benchmarks (SBs) through March 2013 were implemented with delay, namely: the submission of the Industrial Licensing Bill and the Insurance Bill to parliament, and the establishment of a full-service Large Tax Payers Unit. The other three SBs—the reconciliation of all treasury accounts, the establishment of the cash management unit, and the submission of the amendments of the Loans and Guarantees Act to Parliament—have been delayed. In the attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP), the authorities review program implementation and outline their policies for the remainder of 2012/13 and 2013/14. In view of the program performance, staff recommends the completion of the fifth review under the ECF arrangement and extension of the arrangement to September 30, 2013 (together with related rephasing of the last disbursement).

3. Publication: The authorities have consented to publication of the staff report and the program documents.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

4. Despite the recent drought, Lesotho has maintained positive growth (with real GDP growth projected at 3⅔ percent in 2012/13), supported by the expansion of mining and construction. Though agricultural production has been severely affected by the drought, the construction sector has grown significantly, driven by large infrastructure projects, while the mining sector has continued to expand. Private sector credit has grown fast, reflecting strong demand for personal and mortgage loans (Box 1). Inflation has continued to moderate, reaching 5.1 percent in February 2013, reflecting the weakening of international commodity prices.

5. Lesotho's international partners have strongly responded to the international appeal to address the drought. In response to the UN international appeal launched in September 2012, Lesotho's international partners have thus far pledged US$40 million, fully covering estimated immediate needs.[1]

6. In 2012/13, fiscal balances are estimated to have improved further, largely owing to lower recurrent spending but also low execution of some capital projects. Drought-related spending needs were met through the reallocation of funds within the approved budget and foreign assistance. The capital spending was lower than budgeted, owing to delayed execution of some domestically-financed capital projects during post-election transition. Domestic revenue collection continued to be strong, reflecting stepped-up administrative efforts for VAT collections.

7. Supported by ongoing fiscal consolidation efforts and large financial inflows, external balances are improving. Although diamond prices dropped significantly in 2012, its adverse impact has been more than offset by fiscal consolidation and significant financial inflows (drawdown of commercial bank assets held in South Africa). International reserves have thus been rebuilt, reaching 4 months of imports at end-February 2013, up from 3½ months of imports at end-March 2012.

[1] In the wake of the drought, a national food crisis was declared in August 2012. The UN estimated the immediate financing need of $38.5 million, or 1⅔ percent of GDP.

Box 1. Rising Private Sector Credit in Lesotho

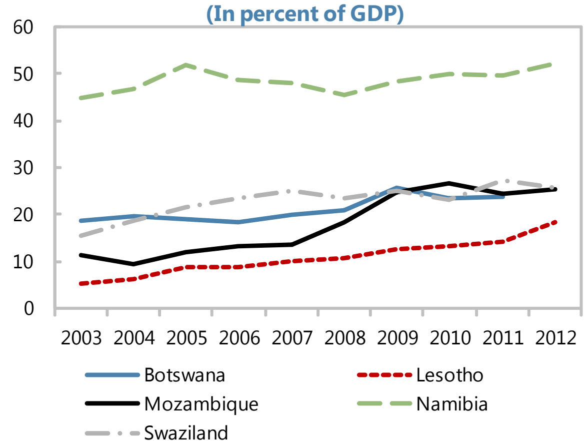
Commercial banks' lending activity has been expanding for the last few years. Albeit from a low base, private sector credit steadily increased to 18 percent of GDP in 2012 (up from 10 percent in 2007), catching up with Lesotho's neighboring countries. The banks in Lesotho have increasingly drawn their assets held at their parent banks in South Africa to meet the increasing local demand for private sector credit. The loan-to-deposit ratio has more than doubled for the last three years, reaching 66 percent in February 2013.

This hike in the credit is driven by factors on both demand and supply sides:

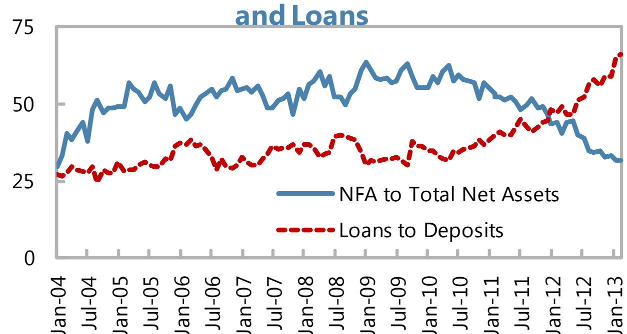
- The New Land Administration Act—introduced in 2010—has enabled the use of land as collateral, spurring mortgages and other collateral-based loans.
- The banks have recently explored markets for small, micro, and medium enterprises and mortgages, motivated by robust economic growth and lower interbank rates in South Africa (which reduce returns on their excess liquidity).

Banks' portfolio remains sound. The level of nonperforming loans stays low at about 3 percent of total loans, fully covered by provisions (Table 6), while commercial banks generally maintain adequate capital (at 15–16 percent for the whole banking system). The Central Bank of Lesotho (CBL)—fully aware of potential risk associated with a rapid increase in bank loans (40 percent per annum in early 2013)—has been monitoring banks' loan quality through risk-based supervision, while cautiously overseeing the developments of private sector credit. Given the dominance of South African banks in Lesotho's banking system, the CBL has been working with South Africa Reserve Bank on developing joint consolidated supervision and information sharing.

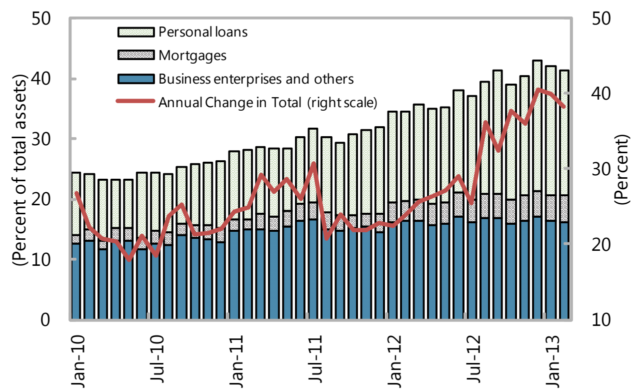
Credit to Private Sector
(In percent of GDP)



Commercial Banks' Net Foreign Assets and Loans



Commercial Banks' Loans by Borrowers

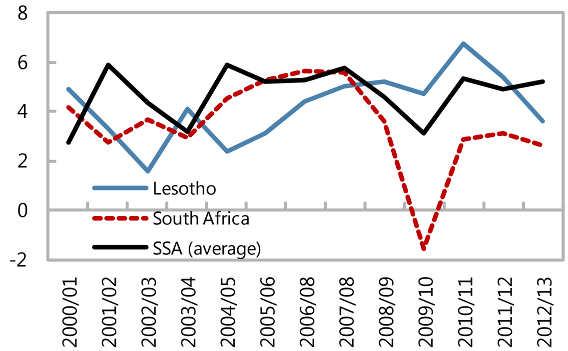


Source: Central Bank of Lesotho.

Figure 1. Recent Economic Developments

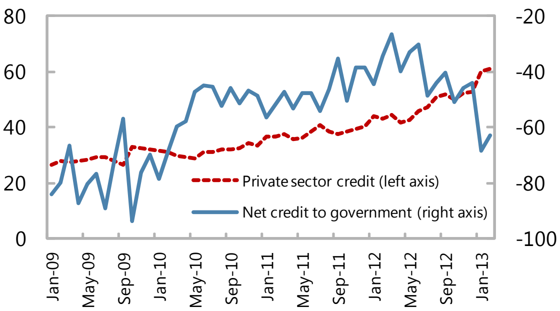
Despite the recent drought, Lesotho has maintained positive growth.

Lesotho and Regional GDP Growth
(in percent)



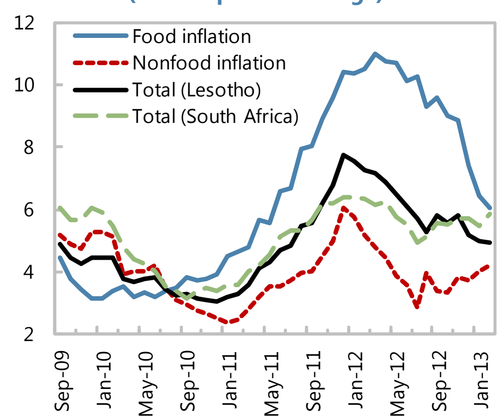
Private sector credit has been rising, while net credit to government has declined.

Net Credit to Government and Private Sector Credit
(in percent of broad money)



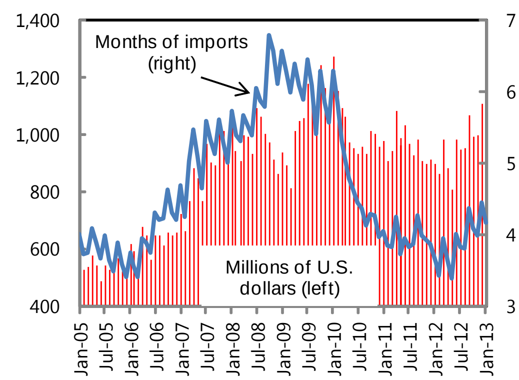
Inflation continues to subside.

Consumer Price
(Annual percent change)



International reserves have recently been rebuilt.

Gross International Reserves



Source: Country authorities; WEO; and staff estimates.

8. **In the coming years, robust economic growth is expected, though significant downside risks remain owing to the uncertain global economic outlook.** The growth prospects—somewhat weakened with downward adjustments in mining investment—are projected to stay robust in 2013/14 and beyond (above 4 percent), supported by recovery in agricultural production and continued expansion of mining activities. This growth prospect, however, is subject to significant downside risks. The recent decline in diamond prices, if prolonged, could undermine the prospects of the mining industry in Lesotho, slowing the pace of its expansion and adversely affecting economic growth and exports.[2] The uncertain global and regional economic outlook also poses risks to future Southern African Customs Union (SACU) revenues. The prospects of the textile sector—the third largest employer in Lesotho—are subject to downward risks, in light of prospective

[2] Some mining companies are reportedly considering postponing their investment plan.

expiration of the US African Growth and Opportunity Act (AGOA) in 2015. There is also upside risk to the growth prospect, depending on the success of the forthcoming implementation of the National Strategic Development Plan (NSDP) aiming at promoting private sector-led growth.[3]

PROGRAM PERFORMANCE

9. The ECF-supported program remains broadly on track. All end-September 2012 quantitative performance criteria (PCs) and end-December indicative targets were met (MEFP, Table 1). Net domestic financing of the government and net international reserves were well within the targets, reflecting the authorities' stepped-up adjustment efforts. The central government social expenditures—the indicative target under the ECF arrangement—fell below the end-September target by a small margin, though the end-December target was met.[4] The authorities have implemented measures to strengthen debt management and monitoring. The Debt Management Committee has been fully operational and now reviews all draft loans and guarantees; the authorities have also been working with the IMF experts on strengthening Lesotho's debt management legal framework, and plan to develop a debt management strategy, in collaboration with the World Bank.

10. The progress in structural benchmarks was mixed. Three out of six structural benchmarks (SBs) through March 2013 were implemented, namely: the submission of the Industrial Licensing Bill and the Insurance Bill to parliament, and the establishment of a full-service Large Taxpayers Unit (LTU). The other three SBs—the reconciliation of all treasury accounts (revenue and expenditure), the establishment of the Cash Management Unit (CMU) and the submission of the amendments of the Loans and Guarantees Act to Parliament—have not been implemented, partly owing to administrative setbacks. To facilitate the reconciliation of the government accounts, the minister of finance called for support from all ministers at a cabinet meeting in January 2013, and the accountant general issued a circular to the chief accounting officers. Nevertheless, still insufficient collaboration by line ministries would further delay the completion of the exercise to May 2013. For the CMU, the cabinet has approved the structure and function, and with hiring new staff, the unit is expected to be established by end-May 2013. The work on the amendments of the Loans and Guarantees Act is being finalized, in close collaboration with the IMF Legal Department.

POLICY DISCUSSIONS

11. Against this background, the discussions focused on policies required to put the economy on a firmer footing, while keeping up the growth momentum and addressing critical social needs. Given Lesotho's close economic and financial integration with South Africa, it is

[3] To facilitate the implementation of the NSDP, the government plans to finalize the Public Sector Investment Programme, the Implementation Plan, and the Monitoring and Evaluation Framework by end-May 2013, with a view to initiating a dialogue with international partners to mobilize resources to assist the implementation of the NSDP.

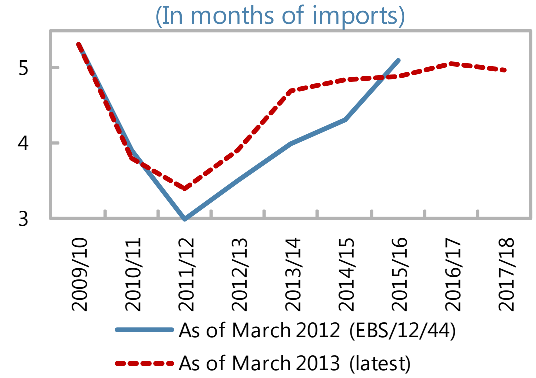
[4] For September 2012, the cost for a school feeding program was lower than estimated because of the school holidays.

considered desirable to maintain the current pegged exchange rate regime, which has helped to anchor price stability while facilitating capital and financial transactions with South Africa. In light of the high frequency of exogenous shocks in recent years (e.g., weather-related shocks, volatile SACU revenues), the key policy challenges remain achieving a comfortable international reserve cushion, ensuring fiscal and external sustainability, and facilitating the country's growth potential to ensure poverty reduction.

A. Steering the Economy to Macroeconomic Stability

12. In terms of a comfortable reserve cushion, the authorities remain committed to bringing the reserve coverage to five months of imports over the medium-term, through fiscal consolidation efforts. Over the last twelve months, Lesotho successfully accumulated international reserves, at the pace faster than previously envisaged. The authorities are currently targeting five months of imports by 2016/17.

Projected International Reserves
(In months of imports)



Source: Lesotho authorities and staff estimates.

13. In 2012/13, the authorities' progress in fiscal consolidation was critical for further reserve accumulation. The non-SACU deficit (excluding foreign financed capital projects) is estimated to have reached 20 percent of GDP, compared with 22¾ percent in 2011/12.[5] Delayed implementation of some investment projects during the transition period after the election facilitated savings on the expenditure side, while recurrent spending stayed within the budget. Revenue collection strengthened, supported by the ongoing reform of the Lesotho Revenue Authority (LRA) which was completed at end-March 2013.[6] Assisted by such consolidation efforts, international reserves reached 4 months of imports by end- February 2013, up from 3½ months projected a year ago (EBS/12/44).

[5] The non-SACU balance is defined as the fiscal balance excluding all SACU revenues and foreign-financed project loans.

[6] The restructuring of the LRA—partially implemented since early 2012—has created a function-based organization with taxpayer segmentation. The new administrative structure was approved by the Board in December 2012 and has been adopted from April 1, 2013. The new administrative units are organized to provide full service to large, medium and small taxpayers.

Fiscal Performance 2009/10–2017/2018[1,2]

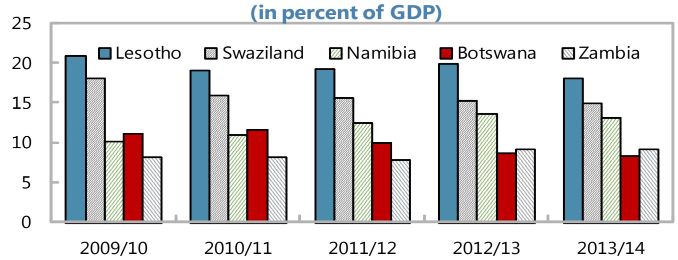
	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Prel.	Proj.	EBS/12/142 [3]	Proj.	EBS/12/142 [3]	Proj.	Proj.	Proj.	Proj.	Proj.
	(in percent of GDP)										
Revenue and Grants	62.4	51.3	50.9	66.0	65.5	57.9	61.2	54.1	50.7	49.9	49.7
Tax Revenue	21.3	21.0	22.7	23.8	23.5	23.6	24.5	24.7	24.6	24.7	24.6
Non-tax revenue	5.2	7.4	6.0	4.5	4.9	4.5	4.5	5.4	5.0	5.2	5.2
SACU	32.9	15.8	14.6	29.0	28.9	25.1	25.4	21.9	19.2	18.1	17.9
Core SACU	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Non-core SACU	17.9	0.8	-0.4	14.0	13.9	10.1	10.4	6.9	4.2	3.1	2.9
Grants	3.0	7.2	7.6	8.7	8.2	4.7	6.8	2.1	1.9	2.0	2.0
Budget support	0.0	2.2	1.5..	1.5	0.9	1.3	1.3	0.4	0.4	0.4	0.3
Project grants	3.0	5.0	6.1..	7.3	7.3	3.4	5.6	1.6	1.5	1.7	1.7
Total Expenditure	66.3	56.2	61.2	63.8	60.7	56.6	59.2	52.5	47.7	47.0	46.1
Recurrent	47.7	38.3	39.6	40.8	39.0	38.3	39.0	37.4	35.4	33.8	32.9
Capital expenditure	18.6	18.0	21.5	22.9	21.7	18.3	20.2	15.1	12.3	13.2	13.2
o/w Domestically funded	13.8	11.3	13.4	11.6	10.4	10.6	10.6	10.3	9.8	9.3	9.6
Overall Balance, incl. grants	-3.9	-4.9	-10.3	2.3	4.8	1.3	2.0	1.6	3.0	3.0	3.5
Overall Balance, excl. grants	-6.9	-12.1	-17.9	-6.5	-3.5	-3.4	-4.8	-0.5	1.1	0.9	1.5
Core-SACU Fiscal balance (excl. foreing-financed capital projects) [4]	-20.0	-4.9	-7.8	-8.2	-5.1	-4.0	-4.3	-2.2	-0.1	2.1	2.6
Non-SACU Balance (incl. foreign-financed capital projects)	-36.8	-20.7	-24.8	-26.8	-24.1	-23.8	-23.4	-20.3	-16.2	-15.1	-14.3
Non-SACU Balance (excl. foreign-financed capital projects)	-35.0	-19.9	-22.8	-23.2	-20.1	-19.0	-19.3	-17.2	-15.1	-12.9	-12.4
Financing	-1.2	2.0	7.2	-2.3	-4.8	-1.3	-2.0	-1.6	-3.0	-3.0	-3.5
Domestic (net)	-1.4	2.5	6.3	-4.7	-7.6	-4.9	-4.8	-3.8	-3.1	-4.4	-4.8
Foreign (net)	0.1	-0.4	0.9	2.4	2.8	3.6	2.8	2.2	0.1	1.5	1.3
Statistical Discrepancy [5]	5.1	2.9	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Ministry of Finance and Fund staff estimates.
1 The fiscal year runs from April 1- March 31.
2 Based on the GFSM 1986 format.
3 Values as in the fourth ECF review.
4 Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).
5 The fiscal discrepancy partly reflects the difficulty associated with IFMIS with some revenues under-recorded in the system.

14. **For the 2013/14 fiscal framework, the authorities have committed to maintaining the fiscal consolidation path, while creating space for critical social spending and growth-promoting infrastructure projects.** The authorities aim at further reducing a non-SACU fiscal deficit (excluding foreign financed capital projects) to 19⅓ percent of GDP. The authorities plan to create fiscal space for capital spending to facilitate the implementation of the NSDP, while keeping social spending at least at 3 percent of GDP in coming years. To achieve these objectives, the authorities are committed to the following efforts:

- **Containing recurrent spending**. The authorities intend to pursue further rationalization and efficiencies in recurrent spending, reducing non-priority outlays through stricter expenditure control. Specifically, despite the increases in wage bills to retain skilled workers and to fill posts in the newly-created ministries,[7] the authorities plan to restrict the overall wage bills at 16¾ percent of GDP in 2013/14 (unchanged from 2012/13), largely by (i) limiting the filling of the vacant posts; and (ii) containing the creation of new positions. Though there is a risk that the wage bills may stay above the target this fiscal year, from broader perspectives, the authorities are committed to reviewing the size of the civil service and undertaking a full civil service audit, which would determine the exact number of public servants and assist in the clean-up of the payroll.[8]

Compensation of Employees[1] of Lesotho and its Neighboring Countries
(in percent of GDP)



1 Compensation of employees comprises wages and salaries, and social contributions.

Source: Country authorities and staff estimates.

- **Enhancing revenue collection,** the LRA reform, including the full-service Large Taxpayer Unit (LTU), is expected to support fiscal consolidation. The LTU will be collecting 70–75 percent of tax revenues administered by the LRA. The government has been considering a comprehensive review of income taxes and the VAT, with a view of improving tax efficiency. To improve the efficiency and transparency of the mining sector taxation, the authorities, with the support from the IMF, plan to review the taxation regime. The ongoing automation of the systems—an integral part of the LRA reform—would strengthen revenue collection and administration.

15. The recently formulated public finance management (PFM) action plan is expected to improve the efficiency of public spending, aiding the fiscal consolidation. In December 2012, a comprehensive PFM action plan was formulated, assisted by the IMF's Fiscal Affairs Department (FAD) and AFRITAC South, in full coordination with all the key donors (Box 2).

[7] Under the 2013/14 budget, the total wage bills are set to increase to 18½ percent of GDP, reflecting (i) a 6 percent inflation indexation (amounting to 0.8 percent of GDP), (ii) creation of new positions, mainly at the newly created ministries (equivalent to 0.5 percent of GDP), and (iii) an increase in wages and salaries for retaining technically skilled workers (equivalent to 1.1 percent of GDP). The wage increase aims at regularizing and decompressing the wage structure, while bringing wages and salaries closer to the minimum income level for the lower grades.

[8] The World Bank is preparing a technical assistance to support the government in this area.

B. Supporting Private Sector Development and Sustainable Growth

16. The authorities remain committed to implementing reforms to facilitate private sector-led growth, including through improving business climate. The authorities intend to improve the business climate and access to finance, as planned under the NSDP. Specifically, the enactment of the Industrial Licensing Bill would simplify business licensing procedures. The authorities are accelerating the land titling program, and plan to fully implement the 2010 Land Administration Act, advance the national identification card project and work toward establishing the credit rating system (to foster bank lending to the private sector). In coordination with the World Bank, the authorities plan to embark on further reforms to improve access to land, facilitate cross-border trade with South Africa (by strengthening coordination of cross border agencies), and simplify the procedures for starting businesses and construction permits.

17. While promoting access to credit, adequate financial sector regulation and supervision are called for to ensure financial sector stability. While the banking system (made up mainly of subsidiaries of South African parents' banks) generally remains sound with adequate capital and sufficient liquidity (Table 6), effective implementation of the new Financial Institutions Act (FIA) will help to reduce financial sector risks. The Central Bank of Lesotho (CBL) has been preparing regulations for banks and nonbank financial institutions to implement the FIA, with support from the IMF. Furthermore, the CBL has been negotiating the revisions of the current memorandum of understanding for joint consolidated supervision and information sharing with the South Africa Reserve Bank. With technical assistance from the IMF and the World Bank, the authorities are working on a financial sector development strategy that would facilitate financial intermediation and promote private sector development.

18. The authorities are determined to explore ways to strengthen competitiveness of Lesotho's export industries, in view of prospective expiration of the AGOA in 2015. Lesotho's textile sector—the largest formal private-sector employer—had boosted its production in early 2000s, benefiting from trade preferences under the AGOA. The expansion of the sector, however, has recently been hampered by the erosion of preferential trade arrangements; relatively high production costs (e.g., transportation and labor costs); and the weak investment climate (Box 3). While the depreciation of the loti, pegged to the South African rand, has improved the competitiveness of labor costs in the past year, risks prevail owing to the impending 2015 expiration of AGOA and the related third country preference. The authorities have therefore been actively seeking to attract new fabric mills to Lesotho (to meet value-added trade requirements), while also seeking to expand new regional markets and to diversify into other export industries.

Box 2. Public Financial Management (PFM): The Reform Plans

PFM reforms have been gaining momentum and ownership. In late December 2012 the authorities, in consultation with the IMF, prepared a strategic PFM reform action plan, which takes forward the ongoing reforms and aims at putting in place the building blocks of a sound PFM system. The action plan has been endorsed by development partners, including the European Union and the World Bank. The plan has established reform priorities; identified strategic actions and key outputs; and defined responsibilities and performance indicators. The Ministry of Finance plans to establish a PFM Reform Secretariat to ensure comprehensive and timely implementation of the action plan. The plan provides a basis for developing the detailed work plan, setting annual budgets and procurement plans.

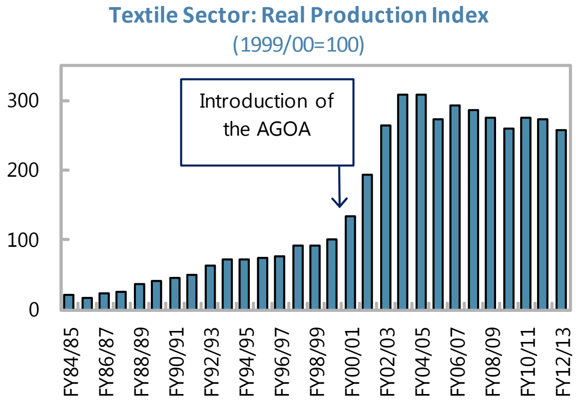
The key elements of the action plan are clearly identified and linked to the key performance indicators. The plan envisages (i) developing and implementing a modern regulatory framework; (ii) improving the transparency and effectiveness of policy orientation of the budget; (iii) strengthening cash management by developing cash flow forecasts; (iv) strengthening internal controls to ensure operational efficiency and effectiveness; (v) improving accounting and fiscal reporting to ensure compliance with the regulatory framework and accounting standards; (vi) ensuring the compliance of external audit and oversight with international standards; and (vii) strengthening governance and institutional management. Key performance indicators are result-oriented and consistent with the expected outputs.

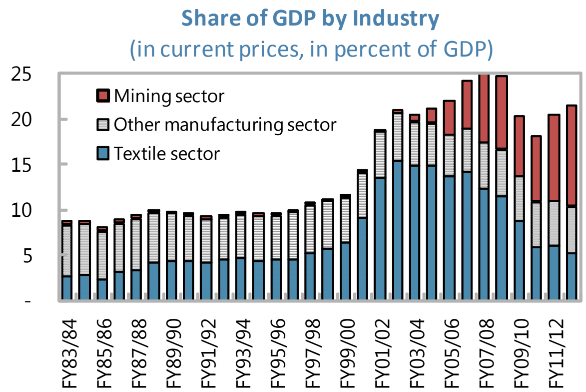
The action plan envisages the implementation of the following important measures:

Reform areas	Actions	Implementation date
Cash management	Selecting and training staff for the newly established Cash Management Unit and the Liquidity Committee and adopting a prescribed cash management manual	FY2012/13
Transparency and effectiveness of the budget process	Defining responsibilities for preparing budget documents, their purpose, content and dissemination in instructions/manuals	FY2012/13
Compliance with the regulatory framework	Eliminating the backlog of annual financial statements	FY2012/13
Compliance with the regulatory framework and accounting standards	Including accounts of subnational government and those of donor-funded projects in financial statements and in-year reports	FY 2013/14
PFM Regulatory framework	Amending the PFMAA, issuing Treasury regulations and synchronizing with other regulations	FY 2013/14
Transparency and effectiveness of policy	Setting up budget ceilings in line with the MTEF	FY2014/15
Cash management	Using IFMIS to monitor the accuracy of cash forecasts	FY2014/15

Box 3. Lesotho: Textile Sector Under the AGOA

Lesotho's textile sector expanded rapidly following the enactment of the U.S. African Growth and Opportunity Act (AGOA) in 2000.[1] Foreign direct investments into the sector grew, and by 2005, Lesotho had emerged as the largest exporter of textile and garments to the United States under the AGOA. More than 40,000 jobs were created, and the share of the textile sector in nominal GDP increased from around 5 percent before the AGOA to 15 percent by 2003/04.





Source: Country authorities and staff estimates

Notwithstanding the strong initial growth, the benefits of AGOA production did not last beyond the first five years, and the sector has since stagnated. The ratio of textile exports to GDP has declined, reverting to the level before the introduction of the AGOA. Though the sector is still a major employer, employment is also down by around 20 percent, compared to 2004/05.

Several factors account for the weakening of the sector's competitiveness.

- Erosion of some preferential arrangements and the transitory nature of the AGOA weakened Lesotho's comparative advantages and also discouraged investment. In 2005 following the phasing out of quotas under the Uruguay Round Agreement on Textile and Clothing, a number of firms closed and the sector shed 13,000 jobs. The end of China safeguards in 2008 also increased competition in global garment trade. In addition, the time-bound AGOA provisions discourage long term investment.
- Unfavorable exchange rate developments, especially in 2004–2006, contributed to loss of competitiveness.
- Lesotho's investment climate is weaker than that of its competitors in Asia. According to the World Bank's Doing Business indicators, Lesotho ranks very low, while facing relatively high production costs (e.g., transportation and labor costs).
- Trading arrangements and the global integration of the apparel business inhibits domestic linkages or diversification.

Given that all AGOA preferences will come to an end in 2015, and given its continued preferential access to US and EU markets under other trade agreements, Lesotho is actively seeking to attract new fabric mills and pursuing new markets, such as Europe and the Southern Africa, though these markets are relatively small and not as homogenous as the U.S. market.

---

[1] The Act granted time bound quota and tariff free access to the US market, and exempted the least developed economies like Lesotho from "rules of origin" requirements through the Third Country Fabric Provision (TCFP).

PROGRAM IMPLEMENTATION AND SAFEGUARDS ASSESSMENTS

A. Program Monitoring

19. Remaining structural benchmarks are proposed to be reset and scheduled to be implemented by May 2013. The completion of the sixth review under the ECF arrangement will be based on the observance of quantitative PCs through end-March 2013 (MEFP, Table 1). The remaining SBs—the reconciliation of all treasury accounts; the establishment of the CMU; and the submission of the amendments of the Loans and Guarantees Act—are set to be implemented by May 2013, given the observed delays in implementation and to allow sufficient time for consultation with stakeholders (MEFP, Table 3). The definitions of the variables monitored as quantitative PCs are provided in the Technical Memorandum of Understanding (TMU), Attachment II.

20. The authorities have requested an extension of the ECF arrangement to September 30, 2013 (together with related rephasing of the disbursement)**.** The extension will ensure sufficient time to complete the sixth review.

B. Safeguards Assessment

21. An update safeguards assessment was completed November 2012 in connection with the augmentation of access under the ECF arrangement approved in April 2012. The assessments confirmed that the CBL has taken steps to strengthen safeguards since the 2010 assessment, but also that risks remain. In 2010, Deloitte (South Africa) was appointed as the CBL's external auditor. The firm has since completed the audits of financial years 2010, 2011, and 2012 within the three-month statutory deadline and issued an unqualified audit opinion following each audit. Since the 2012 assessment, aspects of the monetary data reporting process have been strengthened with IMF technical assistance, and internal auditors worked with the January 2013 IMF mission to confirm test date data. Audit oversight and internal audit remain areas where improvements are needed to strengthen overall governance and accountability.

STAFF APPRAISAL

22. Despite the drought Lesotho maintained positive growth, while surrounded by significant downside risks for growth prospects. Although the recent drought severely affected agricultural production, its impacts on fiscal and external balances were absorbed through the authorities’ adjustment efforts and financial aid by Lesotho’s international partners. Looking forward, in light of high downside risks and the need to maintain fiscal consolidation efforts, it is important to promote private sector development in order to sustain the favorable growth trend over the long term, as rightly identified in the NSDP.

23. Staff welcomes the authorities’ fiscal consolidation efforts, which helped to strengthen international reserves, despite the drought and weak diamond prices. Stronger-than-projected fiscal balance, with spending cut and enhanced tax collection, has resulted in faster-than-programmed rebuilding of the international reserves cushion. Strong responses from Lesotho's international partners have also helped Lesotho to stay on a macroeconomic adjustment path, while sufficiently addressing the immediate drought-related needs.

24. For 2013/14, it is important to maintain fiscal consolidation efforts, while safeguarding priority social and growth-promoting capital spending. In light of Lesotho's vulnerability to exogenous shocks and their high frequency, staff supports the authorities' commitment to achieving the medium-term reserve target of five months of imports. In the mean time, the authorities and staff agreed on the need to create fiscal space for priority social and growth-promoting capital spending. To achieve this objective, as currently planned under the 2013/14 fiscal framework, the authorities should rationalize recurrent spending (specifically public sector wage bills and goods and services). Considering a dominant size of the public sector, it is important to review the size of the public sector and initiate civil service reform, assisted by the World Bank.

25. Staff encourages further progress in fiscal structural reforms to aid the consolidation efforts. Specifically it is important to step up PFM reforms in cash management (reconciliation of the government accounts and the establishment of the CMU). Enhanced coordination between the treasury and line ministries is required for the monthly reconciliation of government accounts. The recently prepared comprehensive PFM action plan forms an important road map to ensure sound public finance management, and it is essential to implement the actions in a timely fashion, with assistance from Lesotho's international partners. On the revenue side, staff welcomes the completion of the restructuring of the LRA, while also exploring other revenue administration measures. Staff also acknowledges the progress in strengthening public debt management, through reactivating the Debt Management Committee and reviewing the debt management legislation.

26. Staff welcomes the authorities' continued efforts to improve the business climate and promote private sector development. The effective enactment of the Industrial Licensing Bill will help to reduce the costs of doing business in Lesotho. Staff encourages the authorities to step up reforms, in collaboration with the World Bank, to further improve access to land; facilitate cross-border trade with South Africa by strengthening coordination of cross border agencies; complete the national identification card project; and establish a credit reporting agency. Supporting further development of a sound financial sector under strong financial sector supervision is important to improve access to finance, and staff encourages the CBL to formulate a FSDP, with technical assistances from the IMF and the World Bank.

27. Staff supports the authorities' request for the completion of the review and extension of the ECF arrangement to September 30, 2013 (together with related rephasing of the disbursement) to ensure sufficient time to complete the sixth and final review.

Table 1. Lesotho: Selected Economic Indicators, 2009/10–17/18 [1]

Population (in 1,000; 2011 est.)	2,194
GNI per capita (in U.S. dollars; 2011 est.):	1,220
Poverty rate (percent, 2005 est.):	56.6

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Est.	Est.	EBS/12/142 [2]	Proj.	EBS/12/142 [2]	Proj.	Projections			
				(Percentage changes; unless otherwise indicated)							
National account and prices											
GDP at constant prices	4.7	6.8	5.4	4.0	3.6	4.7	4.4	4.2	4.0	4.0	4.0
GDP deflator	3.9	4.6	7.5	7.5	5.5	7.1	10.7	7.5	8.7	7.4	7.8
GDP at market prices											
(Maloti millions)	14,945	16,684	18,896	20,559	20,653	23,063	23,871	26,728	30,204	33,745	37,845
Consumer prices (average)	5.9	3.4	6.2	5.7	5.6	5.2	6.2	5.9	5.8	5.7	5.7
External sector											
Terms of trade (deterioration -)	-4.6	4.0	9.0	-5.3	-7.6	0.5	7.1	3.1	1.1	-0.9	-1.0
Average exchange rate											
(local currency per U.S. dollar)	7.8	7.2	7.4	…	8.5	…	…	…	…	…	…
Nominal effective exchange rate change (– = depreciation) [3]	31.5	4.0	-7.1	…	…	…	…	…	…	…	…
Real effective exchange rate (– = depreciation) [3]	33.4	4.8	-3.1	…	…	…	…	…	…	…	…
Current account balance											
(including official transfers, in percent of GDP)	-3.1	-14.5	-24.2	-8.7	-10.6	-14.6	-14.1	-13.0	-5.3	-5.2	-4.3
(excluding official transfers, in percent of GDP)	-37.3	-36.1	-44.0	-42.2	-43.4	-42.7	-43.5	-36.9	-26.5	-25.2	-24.1
Gross international reserves											
(months of imports)	5.3	3.8	3.4	3.6	3.9	4.3	4.6	4.8	4.9	5.1	5.0
(percent of M1)	176.0	144.4	138.7	145.0	159.7	158.8	171.5	167.9	169.7	175.4	177.9
Money and credit											
Domestic credit to the private sector	20.7	26.9	25.1	…	36.2	…	43.8	…	…	…	…
Broad money	11.9	1.1	5.0	…	16.5	…	12.5	…	…	…	…
Interest rate (percent) [4]	4.5	3.2	2.8	…	n.a.	…	n.a.	n.a.	n.a.	n.a.	n.a.
				(Percent of GDP; unless otherwise indicated)							
Savings and investment											
Gross capital formation	29.0	28.6	34.4	42.7	38.7	45.7	39.0	34.3	30.7	30.3	26.3
Government	11.3	12.1	19.4	21.5	21.0	17.8	19.1	15.9	16.0	15.7	11.9
Private	16.6	14.9	14.7	21.1	17.4	27.8	19.5	18.0	14.4	14.3	14.1
National savings	25.8	14.1	10.2	34.0	28.2	31.2	24.9	21.2	25.4	25.0	22.1
Government	10.3	5.0	9.9	23.1	25.0	17.8	20.8	15.2	14.1	14.5	15.2
Private	15.5	9.1	0.4	10.9	3.2	13.4	4.1	6.0	11.3	10.6	6.9
Public debt	37.0	34.4	37.8	38.8	43.1	39.7	41.3	40.8	37.9	37.1	36.7
External public debt	33.5	29.7	32.2	33.3	37.7	34.9	36.6	36.6	34.3	33.8	33.7
Domestic debt	3.4	4.7	5.7	5.4	5.4	4.8	4.7	4.2	3.7	3.3	3.0
Central government fiscal operations											
Net lending/borrowing	-3.9	-4.9	-10.3	2.3	4.8	1.3	2.0	1.6	3.0	3.0	3.5
(excluding grants)	-6.9	-12.1	-17.9	-6.5	-3.5	-3.4	-4.8	-0.5	1.1	0.9	1.5
Non SACU fiscal balance [5]	-35.0	-19.9	-22.8	-23.2	-20.1	-19.0	-19.3	-17.2	-15.1	-12.9	-12.4
Revenue	62.4	51.3	50.9	66.0	65.5	57.9	61.2	54.1	50.7	49.9	49.7
Of which: grants	3.0	7.2	7.6	8.7	8.2	4.7	6.8	2.1	1.9	2.0	2.0
Expenses	55.5	44.7	45.9	47.8	45.0	43.2	44.1	40.9	38.7	37.7	36.8
Nonfinancial assets	10.8	11.5	15.2	16.0	15.7	13.5	15.1	11.5	9.0	9.3	9.3

Sources: Lesotho authorities and IMF staff estimates and projections.

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

[2] Values as in the fourth ECF review.

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

[4] 12-month time deposits rate.

[5] Excluding externally financed capital project.

Table 2. Lesotho: Fiscal Operations of the Central Government, 2009/10–17/18 [1]

(Maloti millions)

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Est.	EBS/12/142 [2]	Proj.	EBS/12/142 [2]	Proj.	Projections			
Revenue	9,328	8,559	9,616	13,581	13,534	13,364	14,605	14,449	15,325	16,852	18,797
Tax revenue	3,185	3,499	4,283	4,896	4,860	5,443	5,843	6,591	7,420	8,322	9,322
Taxes on income, profits, and capital gain	1,772	1,957	2,395	2,686	2,638	2,954	3,148	3,530	3,971	4,469	5,007
Taxes on property	96	106	125	148	150	178	191	213	252	286	321
Taxes on goods and services	1,290	1,414	1,590	1,861	1,870	1,974	2,161	2,435	2,754	3,080	3,456
Taxes on international trade	21	18	151	200	202	330	336	406	436	480	529
Grants	445	1,200	1,437	1,792	1,704	1,094	1,631	553	579	685	757
Budget support	0	372	290	300	196	300	300	120	121	121	128
Project grants	445	828	1,147	1,492	1,508	794	1,331	433	458	564	629
Of which: MCC	270	295	575	1,027	1,121	254	383	0	0	0	0
Non-tax revenue	780	1,232	1,143	926	1,004	1,036	1,076	1,439	1,518	1,747	1,955
Property Income	217	652	419	120	247	173	194	517	540	602	670
Sales of goods and services	502	530	692	757	749	818	840	886	946	1,108	1,242
Other non-tax revenue	61	50	32	49	8	45	42	36	32	36	42
SACU	4,918	2,628	2,753	5,966	5,966	5,791	6,055	5,866	5,808	6,098	6,763
Of which: volatile component	2,676	125	-82	2,881	2,868	2,331	2,474	1,857	1,277	1,037	1,087
Expense	8,293	7,459	8,680	9,830	9,298	9,953	10,516	10,940	11,692	12,718	13,942
Compensation of employees	3,144	3,199	3,638	4,084	3,979	4,336	4,625	5,008	5,404	5,861	6,408
Wages and salaries	2,677	2,881	3,136	3,594	3,477	3,807	4,013	4,377	4,744	5,159	5,611
Social contributions	465	319	503	490	501	586	612	631	661	702	797
Use of goods and services	2,549	1,918	2,177	2,946	2,650	2,813	2,976	2,941	3,087	3,338	3,569
Interest payments	118	96	137	172	166	197	229	231	237	310	350
Domestic	51	43	68	95	85	103	138	129	130	130	150
External	67	53	69	77	81	94	91	102	107	180	200
Subsidies	273	232	237	273	244	255	234	231	239	251	282
Grants	984	707	960	896	896	901	817	840	881	920	1,040
Social benefits	555	600	587	739	621	696	739	798	901	1,021	1,153
Other expenses	670	707	943	720	742	756	895	890	943	1,017	1,141
Gross operating balance	1,035	1,100	936	3,751	4,236	3,411	4,089	3,509	3,633	4,134	4,855
Nonfinancial assets	1,616	1,923	2,877	3,287	3,245	3,103	3,614	3,081	2,713	3,137	3,521
Net lending/borrowing	-581	-822	-1,941	464	990	308	476	427	920	997	1,334
Transactions in financial assets and liabilities	185	-337	-1,359	464	990	308	476	427	920	997	1,334
Financial assets	-178	-663	-870	1,010	1,619	1,129	1,156	1,012	952	1,493	1,831
Domestic	-179	-663	-870	1,008	1,619	1,128	1,156	1,012	950	1,492	1,830
Deposits	-179	-666	-870	1,011	1,619	1,129	1,156	1,012	950	1,492	1,830
Central bank	-163	-646	-870	1,011	1,619	1,129	1,156	1,012	950	1,492	1,830
Commercial banks	-16	-21	0	0	0	0	0	0	0	0	0
Loans	0	3	0	-3	0	-1	0	0	0	0	0
Financial liabilities	-363	-326	489	545	629	822	681	585	31	496	497
Domestic	-382	-253	323	45	45	0	0	0	0	0	0
Foreign	20	-73	166	500	584	822	681	585	31	496	497
Disbursements	274	128	388	733	822	1,106	963	850	312	740	740
Amortization	-254	-201	-222	-232	-238	-285	-282	-265	-281	-245	-244
Statistical discrepancy	-766	-485	-582	0	0	0	0	0	0	0	0
Memorandum items:											
Recurrent expenditure	7,136	6,385	7,492	8,396	8,063	8,839	9,302	9,993	10,682	11,398	12,461
Capital expenditure	2,774	2,996	4,065	4,720	4,481	4,217	4,828	4,029	3,723	4,457	5,002
Domestically financed	2,055	1,884	2,530	2,376	2,151	2,451	2,534	2,745	2,953	3,152	3,632
Externally financed	719	956	1,534	2,344	2,330	1,767	2,294	1,284	770	1,305	1,369
Non SACU fiscal balance, including foreign financed capital projects	-5,499	-3,450	-4,694	-5,502	-4,976	-5,483	-5,579	-5,438	-4,888	-5,101	-5,429
Non SACU fiscal balance, excluding foreign financed capital projects	-5,226	-3,323	-4,307	-4,769	-4,154	-4,377	-4,616	-4,588	-4,576	-4,361	-4,689
Core SACU fiscal balance (ex. volatile SACU and foreign project loans) [3]	-2,984	-820	-1,472	-1,684	-1,056	-917	-1,036	-579	-45	701	988

Sources: Lesotho authorities and IMF staff estimates and projections.

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

[2] Values as in the fourth ECF review.

[3] Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).

Table 3. Operations of the Central Government, 2009/10–17/18 [1]

(Percent of GDP)

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Est.	EBS/12/142 [2]	Proj.	EBS/12/142 [2]	Proj.	Projections			
Revenue	62.4	51.3	50.9	66.0	65.5	57.9	61.2	54.1	50.7	49.9	49.7
Tax revenue	21.3	21.0	22.7	23.8	23.5	23.6	24.5	24.7	24.6	24.7	24.6
Taxes on income, profits, and capital gain	11.9	11.7	12.7	13.1	12.8	12.8	13.2	13.2	13.1	13.2	13.2
Taxes on property	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8
Taxes on goods and services	8.6	8.5	8.4	9.0	9.1	8.6	9.1	9.1	9.1	9.1	9.1
Taxes on international trade	0.1	0.1	0.8	1.0	1.0	1.4	1.4	1.5	1.4	1.4	1.4
Grants	3.0	7.2	7.6	8.7	8.2	4.7	6.8	2.1	1.9	2.0	2.0
Budget Support	0.0	2.2	1.5	1.5	0.9	1.3	1.3	0.4	0.4	0.4	0.3
Project grants	3.0	5.0	6.1	7.3	7.3	3.4	5.6	1.6	1.5	1.7	1.7
Of which: MCC	3.4	1.8	3.0	5.0	5.4	1.1	1.6	0.0	0.0	0.0	0.0
Non-tax revenue	5.2	7.4	6.0	4.5	4.9	4.5	4.5	5.4	5.0	5.2	5.2
Property income	1.5	3.9	2.2	0.6	1.2	0.7	0.8	1.9	1.8	1.8	1.8
Sales of goods and services	3.4	3.2	3.7	3.7	3.6	3.5	3.5	3.3	3.1	3.3	3.3
Other non-tax revenue	0.4	0.3	0.2	0.2	0.0	0.2	0.2	0.1	0.1	0.1	0.1
SACU	32.9	15.8	14.6	29.0	28.9	25.1	25.4	21.9	19.2	18.1	17.9
Of which: volatile component	17.9	0.8	-0.4	14.0	13.9	10.1	10.4	6.9	4.2	3.1	2.9
Expense	55.5	44.7	45.9	47.8	45.0	43.2	44.1	40.9	38.7	37.7	36.8
Compensation of employees	21.0	19.2	19.3	19.9	19.3	18.8	19.4	18.7	17.9	17.4	16.9
Wages and salaries	17.9	17.3	16.6	17.5	16.8	16.5	16.8	16.4	15.7	15.3	14.8
Social contributions	3.1	1.9	2.7	2.4	2.4	2.5	2.6	2.4	2.2	2.1	2.1
Use of goods and services	17.1	11.5	11.5	14.3	12.8	12.2	12.5	11.0	10.2	9.9	9.4
Health care	1.9	1.7	2.7	3.8	3.8	3.6	3.5	3.3	3.3	3.3	3.3
Interest payments	0.8	0.6	0.7	0.8	0.8	0.9	1.0	0.9	0.8	0.9	0.9
Domestic	0.3	0.3	0.4	0.5	0.4	0.4	0.6	0.5	0.4	0.4	0.4
External	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5
Subsidies	1.8	1.4	1.3	1.3	1.2	1.1	1.0	0.9	0.8	0.7	0.7
Grants	6.6	4.2	5.1	4.4	4.3	3.9	3.4	3.1	2.9	2.7	2.7
Social benefits	3.7	3.6	3.1	3.6	3.0	3.0	3.1	3.0	3.0	3.0	3.0
Other expenses	4.5	4.2	5.0	3.5	3.6	3.3	3.8	3.3	3.1	3.0	3.0
Gross operating balance	6.9	6.6	5.0	18.2	20.5	14.8	17.1	13.1	12.0	12.3	12.8
Non-financial assets	10.8	11.5	15.2	16.0	15.7	13.5	15.1	11.5	9.0	9.3	9.3
Net lending(+)/borrowing (-)	-3.9	-4.9	-10.3	2.3	4.8	1.3	2.0	1.6	3.0	3.0	3.5
Transactions in financial assets and liabilities	1.2	-2.0	-7.2	2.3	4.8	1.3	2.0	1.6	3.0	3.0	3.5
Financial assets	-1.2	-4.0	-4.6	4.9	7.8	4.9	4.8	3.8	3.2	4.4	4.8
Domestic	-1.2	-4.0	-4.6	4.9	7.8	4.9	4.8	3.8	3.1	4.4	4.8
Deposits	-1.2	-4.0	-4.6	4.9	7.8	4.9	4.8	3.8	3.1	4.4	4.8
Central bank	-0.1	-0.1	0.0	4.9	0.0	4.9	0.0	0.0	0.0	0.0	0.0
Commercial banks	-1.1	-3.9	-4.6	0.0	7.8	0.0	4.8	3.8	3.1	4.4	4.8
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	-2.4	-2.0	2.6	2.7	3.0	3.6	2.9	2.2	0.1	1.5	1.3
Domestic	-2.6	-1.5	1.7	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.1	-0.4	0.9	2.4	2.8	3.6	2.9	2.2	0.1	1.5	1.3
Disbursements	1.8	0.8	2.1	3.6	4.0	4.8	4.0	3.2	1.0	2.2	2.0
Amortization	-1.7	-1.2	-1.2	-1.1	-1.2	-1.2	-1.2	-1.0	-0.9	-0.7	-0.6
Statistical discrepancy	-5.1	-2.9	-3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:											
Recurrent expenditure	47.7	38.3	39.6	40.8	39.0	38.3	39.0	37.4	35.4	33.8	32.9
Capital expenditure	18.6	18.0	21.5	22.9	21.7	18.3	20.2	15.1	12.3	13.2	13.2
Domestically financed	13.8	11.3	13.4	11.6	10.4	10.6	10.6	10.3	9.8	9.3	9.6
Externally financed	4.8	6.7	8.1	10.8	11.3	8.2	9.6	4.8	2.6	3.9	3.6
Non SACU fiscal balance, including foreign financed capital projects	-36.8	-20.7	-24.8	-26.8	-24.1	-23.8	-23.4	-20.3	-16.2	-15.1	-14.3
Non SACU fiscal balance, excluding foreign financed capital projects	-35.0	-19.9	-22.8	-23.2	-20.1	-19.0	-19.3	-17.2	-15.1	-12.9	-12.4
Core SACU fiscal balance (ex. volatile SACU and foreign project loans) [3]	-20.0	-4.9	-7.8	-8.2	-5.1	-4.0	-4.3	-2.2	-0.1	2.1	2.6

Sources: Lesotho authorities and IMF staff estimates and projections.

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

[2] Values as in the fourth ECF review.

[3] Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).

Table 4. Lesotho: Monetary Accounts, 2011–14 [1,2]

(Maloti millions; unless otherwise indicated)

	2011	2012						2013		2014
	Mar.	Mar.	Jun.	Sept.		Dec.		Mar.		Mar.
	Act.	Act.	Act.	EBS/12/142[3]	Act.	EBS/12/142[3]	Act.	EBS/12/142[3]	Proj.	Proj.
				Depository Corporations Survey						
Net foreign assets	9,304	8,801	8,706	8,871	9,374	9,037	10,141	9,586	10,400	11,146
Central bank	5,801	5,975	5,903	6,068	7,016	6,234	7,654	6,712	7,782	9,436
Commercial banks	3,503	2,827	2,803	2,803	2,358	2,803	2,487	2,874	2,619	1,709
Net domestic assets	-3,091	-2,277	-1,858	-1,821	-2,685	-2,242	-2,992	-2,229	-2,796	-2,589
Claims on central government (net)	-2,922	-1,729	-2,067	-2,503	-2,680	-2,731	-3,149	-2,695	-3,273	-4,429
Central bank	-3,477	-2,568	-2,908	-3,366	-3,555	-3,593	-3,986	-3,579	-4,187	-5,342
Commercial banks	555	839	841	863	875	863	837	884	914	914
Claims on private sector	2,326	2,909	3,143	3,375	3,473	3,513	3,778	3,454	3,963	5,699
Other items (net)	-2,501	-3,458	-2,937	-2,712	-3,478	-3,038	-3,621	-2,990	-3,486	-3,859
Broad money	6,213	6,525	6,848	7,050	6,689	6,796	7,149	7,357	7,604	8,557
Currency outside banks	529	643	722	699	734	577	769	655	879	994
Deposits	5,683	5,881	6,127	6,351	5,955	6,218	6,380	6,702	6,725	7,563
Memorandum items:				(12–month percentage change; unless otherwise indicated)						
Broad money	1.1	5.0	8.6	0.5	-4.6	1.4	6.7	12.8	16.5	12.5
Credit to the private sector	26.9	25.1	29.2	28.9	32.7	30.8	40.6	18.7	36.2	43.8
Credit to the private sector (in percent of GDP)	12.3	14.1	15.2	16.4	16.8	17.1	18.3	15.0	16.6	21.3
Velocity (GDP/broad money)	3.0	3.2	3.0	2.9	3.1	3.0	2.9	3.1	3.1	3.1

Sources: Lesotho authorities and IMF staff estimates and projections.

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

[2] Including valuation changes.

[3] Values as in the fourth ECF review.

Table 5. Lesotho: Balance of Payments, 2009/10–17/18 [1]

(US$ millions; unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Est.	Est.	EBS/12/142 [2]	Proj.	EBS/12/142 [2]	Proj.	Projections			
Current account	-60	-336	-613	-227	-258	-407	-362	-355	-156	-163	-141
Trade balance	-951	-1,062	-1,086	-1,284	-1,170	-1,329	-1,174	-1,043	-760	-747	-748
Exports, f.o.b.	779	951	1,097	1,122	1,062	1,284	1,223	1,340	1,480	1,560	1,625
Imports, f.o.b	-1,730	-2,013	-2,183	-2,406	-2,232	-2,614	-2,398	-2,383	-2,240	-2,306	-2,373
Services (net)	-417	-495	-524	-476	-466	-471	-452	-440	-438	-441	-447
Income (net)	512	551	316	406	411	356	350	307	248	221	204
Of which: interest on public debt	-8	-7	-7	-10	-10	-11	-10	-10	-10	-17	-17
Transfers	796	671	680	1,127	966	1,037	915	821	795	805	849
Official transfers	652	501	504	874	802	786	752	651	618	620	656
Other transfers	144	169	176	253	164	251	163	170	177	185	194
Capital and financial account	25	15	308	333	410	547	527	388	222	261	235
Capital account	84	55	142	166	156	84	125	39	42	47	49
Financial account	-58	-40	165	167	254	463	402	350	180	214	186
Foreign direct	109	120	137	299	201	517	273	258	185	197	206
Portfolio investment	0	0	0	0	0	0	0	0	0	0	0
Other investment	-167	-159	28	-132	53	-54	129	91	-5	18	-20
Medium and long-term	-167	-159	28	-132	53	-54	129	91	-5	18	-20
Of which:											
Public sector (net)	2	-10	22	63	69	100	73	60	3	46	32
Disbursements	35	18	52	93	97	134	103	87	30	68	78
Amortization	-32	-28	-30	-29	-28	-35	-30	-27	-27	-22	-46
Short-term	0	0	0		0	0	0	0	0	0	0
Errors and omissions	-6	70	333	0	0	0	0	0	0	0	0
Overall balance	-40	-250	28	106	152	140	165	33	66	98	94
Financing	40	250	-28	-106	-152	-140	-165	-33	-66	-98	-94
Memorandum items:					(Percent of GDP)						
Current account	-3.1	-14.5	-24.2	-8.7	-10.6	-14.6	-14.1	-13.0	-5.3	-5.2	-4.3
Trade balance	-49.8	-45.8	-42.8	-50.6	-47.9	-54.4	-45.8	-38.3	-26.0	-24.1	-22.7
Capital and financial account	1.3	0.7	12.1	13.1	16.8	22.4	20.6	14.2	7.6	8.4	7.1
Overall balance	-2.1	-10.8	1.1	4.2	6.2	5.7	6.5	1.2	2.2	3.2	2.8
Gross international reserves											
(US$ millions) [3]	1,105	961	858	962	970	1,091	1,145	1,151	1,192	1,262	1,314
(months of imports)	5.3	3.8	3.4	3.6	3.9	4.3	4.6	4.8	4.9	5.1	5.0

Sources: Lesotho authorities and IMF staff estimates and projections.

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

[2] Values as in the fourth ECF review.

[3] Including the SDR allocation in 2009.

Table 6. Lesotho: Commercial Bank Performance Ratios, 2005–12

(As of end-December; percent)

	2005	2006	2007	2008	2009	2010	2011	2012 [1]
I. Capital adequacy								
a) Basel capital ratio	22.0	19.0	14.2	13.6	13.6	15.0	16.2	15.7
b) Nonperforming loans net of provisions to capital	0.3	-5.4	-13.4	-13.5	-9.3	0.5	-6.3	-1.2
c) Top 20 exposures to statutory capital and reserves	220	386	465	308	364	523	536	489
II. Asset quality								
a) Loans to deposit ratio	29.0	24.9	28.6	29.1	32.4	35.4	43.6	56.4
b) Earning assets to total assets	93.0	90.3	89.7	90.1	88.8	93.2	91.2	94.1
c) Nonperforming loans to total assets	2.0	2.0	1.4	2.1	3.2	3.1	2.2	2.7
d) Reserve for losses to total loans	3.0	2.8	2.6	4.0	4.3	3.1	2.7	2.8
e) Reserve for losses to nonperforming loans	167.0	131.8	193.0	195.7	136.2	98.3	124.0	103.2
III. Liquidity								
a) Liquidity assets to total deposits	120	101	92	97	99	102	94	85
b) Available reserves to total deposits	8.0	3.5	3.4	1.9	3.5	3.6	2.3	2.3
c) Liquid assets to total assets	77	78	73	74	72	74	67	61
d) Current assets to current liabilities	86	105	107	106	107	108	109	110
IV. Profitability								
a) Net interest margin	…	4.5	5.6	6.6	6.0	5.1	5.4	4.2
b) Cost to income	…	65	63	57	56	56	58	58
c) Return on assets (ROA)	2.0	0.3	1.7	2.7	2.8	2.7	2.8	2.4
d) Return on equity	15.0	4.5	21.0	36.2	33.3	30.9	29.0	22.7

Source: Central Bank of Lesotho.

[1] Data as of September 2012.

Table 7. Lesotho: Indicators of Capacity to Repay the IMF[1]

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual			Projections									
IMF obligations based on existing credit													
(Millions of SDRs)													
Principal	4.6	4.9	3.9	2.5	1.4	0.7	0.8	2.1	4.7	7.9	7.9	7.1	5.7
Charges and interest	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0
IMF obligations based on existing and prospective credit[2]													
(Millions of SDRs)													
Principal	4.6	4.9	3.9	2.5	1.4	0.7	0.8	2.1	5.9	10.1	10.1	9.4	8.0
Charges and interest	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Total obligations based on existing and prospective credit													
Millions of SDRs	4.6	4.9	3.9	2.5	1.4	0.7	0.9	2.3	6.0	10.1	10.1	9.4	8.0
Millions of US$	7.3	7.6	6.2	3.9	2.2	1.1	1.4	3.6	9.4	16.0	16.0	14.8	12.6
Percent of exports of goods and services	0.9	0.8	0.6	0.4	0.2	0.1	0.1	0.2	0.6	0.8	0.7	0.6	0.5
Percent of debt service	15.4	18.3	12.9	8.2	4.0	2.2	2.8	7.0	18.2	32.4	28.8	30.4	24.1
Percent of GDP	0.4	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.2	0.4	0.4	0.3	0.2
Percent of gross international reserves	0.7	0.8	0.7	0.4	0.2	0.1	0.1	0.3	0.7	1.1	1.2	1.4	1.6
Percent of quota	13.3	14.1	11.2	7.0	4.0	2.0	2.6	6.4	17.1	29.1	29.1	26.8	23.0
Outstanding IMF credit													
Millions of SDRs	13.3	16.2	18.0	41.4	51.3	50.6	49.8	47.7	43.0	34.6	24.5	15.1	7.1
Millions of US$	20.7	25.4	28.8	65.7	81.4	80.1	78.7	75.3	67.8	54.6	38.6	23.8	11.2
Percent of exports of goods and services	2.5	2.6	2.5	6.0	6.5	5.8	5.2	4.7	4.1	2.7	1.7	1.0	0.4
Percent of debt service[3]	43.6	61.6	59.7	137.5	148.2	158.1	157.1	147.8	131.1	110.7	69.4	49.0	21.4
Percent of GDP	1.1	1.1	1.1	2.7	3.2	2.9	2.7	2.4	1.7	1.3	0.9	0.5	0.2
Percent of Gross International Reserves	1.9	2.6	3.4	6.8	7.1	7.0	6.6	6.0	5.2	3.6	2.8	2.3	1.4
Percent of quota	38.1	46.4	51.7	118.5	147.0	145.0	142.8	136.7	123.2	99.1	70.1	43.3	20.4
Net use of IMF credit (millions of SDRs)	-4.6	2.9	1.8	23.3	10.0	-0.7	-0.8	-2.1	-5.9	-10.1	-10.1	-9.4	-8.0
Disbursements	0.0	7.8	5.7	25.8	11.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments	4.6	4.9	3.9	2.5	1.4	0.7	0.8	2.1	5.9	10.1	10.1	9.4	8.0
Memorandum items:													
Exports of goods and services (millions of US$)	813	984	1,130	1,094	1,253	1,369	1,508	1,587	1,651	2,057	2,237	2,433	2,647
Debt service (millions of US$)[3]	47.5	41.2	48.2	47.8	54.9	50.7	50.1	50.9	51.8	49.3	55.6	48.6	52.4
Nominal GDP (millions of US$)	1,911	2,319	2,536	2,442	2,562	2,726	2,922	3,099	3,900	4,176	4,473	4,791	5,131
Gross international reserves (millions of US$)	1,105	961	858	970	1,145	1,151	1,192	1,262	1,314	1,511	1,368	1,046	783
Quota (millions of SDRs)	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9

Sources: IMF staff estimates and projections.

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

[2] ECF disbursements of SDR 7.78 million (22.3 percent of quota) June 9, 2010; six sucessive disbursements of SDR 5.68 million (16.3 percent of quota) upon completion of each of the six reviews, through May 2013; and an additional SDR 8.73 million (25 percent of quota) to the third disbursement from augmentation of access; in total SDR 50.61 million (145 percent of quota) during 2010-13.

[3] Total debt service includes IMF repayments.

Table 8. Lesotho: Schedule of ECF Disbursements and Reviews[1]

Date	Conditions	Original ECF disbursement		ECF augmentation		Total disbursement	
		Millions of SDRs	Percent of quota [2]	Millions of SDRs	Percent of quota [2]	Millions of SDRs	Percent of quota [2]
9-Jun-10	Executive Board approval	7.800	22.3	-	-	7.800	22.3
4-Apr-11	Completion of the first review on a lapse-of time basis, based on observance of performance criteria through September 30, 2010	5.680	16.3	-	-	5.680	16.3
9-Apr-12	Completion of combined second and third reviews, based on observance of performance criteria through end-March 31, 2011, and end-September 30, 2011	11.360	32.6	8.725	25.0	20.085	57.6
27-Nov-12	Completion of fourth review, based on observance of performance criteria through March 31, 2012	5.680	16.3	-	-	5.680	16.3
8-May-13	Completion of fifth review, based on observance of performance criteria through September 30, 2012	5.680	16.3	-	-	5.680	16.3
30-Aug-13	Completion of sixth review, based on observance of performance criteria through March 31, 2013	5.680	16.3	-	-	5.680	16.3
Total		41.880	120.0	8.725	25.0	50.605	145.0

Source: IMF staff estimates.

[1] Disbursements are expected to take place shortly after Board meeting.

[2] Lesotho's quota is SDR 34.9 million.

APPENDIX I. LETTER OF INTENT

April 20, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States of America

Dear Ms. Lagarde:

This letter and the attached Memorandum of Economic and Financial Policies (MEFP) update and supplement my communication of November 12, 2012, describe performance under the government's economic program, and outline our economic policies for 2012/13 and 2013/14.

Last year Lesotho experienced severe drought. Agricultural production declined significantly, and our government declared an Emergency Food Crisis in August 2012 and subsequently launched an appeal for international assistance. Thus far, the pledges from our development partners have been strong, amounting to US$40 million, and have fully covered estimated immediate needs. Thanks to this support, we are able to sustain our fiscal adjustment program and gradually rebuild our international reserve buffer, without undermining Lesotho's medium term economic growth prospects. We are firmly committed to the reform program aimed at achieving macroeconomic stability consistent with sustained growth and poverty reduction.

Our performance under the program supported under the ECF arrangement has remained strong. We met all the performance criteria through end-September 2012 and the indicative targets for end-December 2012, except for the indicative target on social spending for September 2012, which was missed by a small margin (Table 1, MEFP). Although we are fully committed to our structural reforms under the program, administrative setbacks resulted in a delay in the completion of some structural benchmarks (SBs), with only three SBs out of six completed (Table 2, MEFP). These include (i) the submission of the Industrial Licensing Bill to Parliament; (ii) the submission of the Insurance Bill to Parliament, and (iii) the establishment of a full-service large taxpayer unit (LTU). For the remaining three SBs, we are committed to implementing them by end-May 2013, as set forth in Table 3. The reconciliation of all treasury accounts (revenue and expenditure) is set to start by end-May 2013, owing to the inability of line ministries and agencies to provide necessary information for completing the reconciliation. Although the administrative structure of the CMU was approved, there has been some delay in the recruitment of all staff for that unit. We are aiming to complete this by end-May 2013. To allow more time for stakeholder consultations on the public debt legislation, a draft of which is being prepared with IMF TA, we plan to submit the amendments of the Loans and Guarantees Act to Parliament by end-May 2013.

We therefore request completion of the fifth review of the ECF-supported program and associated disbursement, based on overall performance under the program and the government's policy intentions going forward. Performance criteria and structural benchmarks for 2012–13 are included in Tables 1 and 3, MEFP.

We believe that the policies set forth herein are adequate to achieve the objectives of our program, notwithstanding the drought-related food crisis. The government is committed to ensuring that the program remains on track and will continue to monitor implementation. We will continue to consult with the IMF on any new measures and/or revisions to the policies described in this letter. We will also continue to provide the IMF with timely information required to monitor progress in program implementation. We consent to the publication, including on the IMF website, of this Letter of Intent, the attached MEFP, and the accompanying staff report.

In light of our successes under the current ECF arrangement and remaining challenges we are facing, particularly in respect of public financial management and a civil service reform, we are interested in continuing program relations with the Fund through a successor three-year arrangement. We believe that a successor Fund arrangement would support continued macroeconomic stability and sustainable growth. Structural reforms would also be facilitated, in collaboration with the World Bank and other international partners. Thus we welcome discussions on a possible follow-up program in coming months.

To ensure that there is sufficient time to complete the sixth review under the three-year arrangement, which will be based on performance at end-March 2013, we request that the arrangement be extended until September 30, 2013 with rephasing of the remaining disbursement.

Yours sincerely,

/s/

Hon. Dr. Leketekete Victor Ketso,
Minister of Finance

/s/

Dr. Rets'elisitsoe Matlanyane
Governor of the Central Bank of Lesotho

Attachments

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Recent Economic Developments and Outlook

Despite the recent drought, Lesotho has maintained robust growth, largely driven by its expanding mining sector. Annual inflation has subsided to 5.1 percent in February 2013 in response to the continued easing of international commodity prices. Supported by the progress in fiscal consolidation, the external balances are steadily recovering, with gross international reserves reaching US$1 billion, equivalent to about 4 months of imports, by end-February 2013, up from 3½ months of imports in March 2012.

Although Lesotho is expected to maintain robust growth, its macroeconomic prospects remain challenging, owing to the recent drought, susceptibility to natural disasters, and the uncertain global economic outlook. The uncertain global economic outlook poses risks to the regional economy and future Southern African Customs Union (SACU) revenues, as well as external demand for Lesotho's key exports—diamonds and textiles. Exports of textiles are likely to be affected by the expectation of the African Growth and Opportunity Act (AGOA) trade preferences being phased out in 2015/16

Owing to cumulative adverse weather in recent years exacerbated by the drought in 2012, Lesotho's food security situation has worsened and could affect the pace of our medium term fiscal consolidation efforts. According to the latest estimates by the Lesotho Vulnerability Assessment Committee, domestic agricultural production is expected to decline by 70 percent in 2012/13. Our international appeal launched in September 2012 has so far generated $40 million, covering most of our immediate needs.

Performance Under the Program

Overall performance under the ECF-supported program has been strong. We have continued to meet all quantitative performance criteria through end-September 2012 and indicative targets through end-December 2012 (Table 1), except for the indicative target on social spending for September 2012, which was missed by a small margin. This is associated with lower-than-estimated cost for a school feeding program, owing to the school holidays. Structural reforms are also progressing, albeit with delays in some areas. Three out of six structural benchmarks (SBs) through March 2013 were implemented (Table 2), namely: the submission of the Industrial Licensing Bill to the Parliament; the submission of the Insurance Bill to Parliament; and (iii) the establishment of a full service LTU. The reconciliation of all treasury accounts (revenue and expenditure) was further delayed, owing to the failure of chief accounting officers of line ministries and agencies to furnish necessary information. To facilitate the reconciliation, the Minister of Finance called for support from all ministers at a cabinet meeting in January 2013, and the Accountant General issued a circular to the chief accounting officers to complete the exercise by March 2013. The administrative structure of the cash management unit was approved by the cabinet, there has been some delay in the recruitment of staff for that unit, and the unit is expected to be fully established by end-May 2013, with all staff deployed and an operational manual prepared. The large tax payers unit was established at the end of March as a part of the broader restructuring program in the Lesotho Revenue Authority (LRA). To allow more time for stakeholder consultations on the public debt legislation, a draft of which is being prepared with IMF TA, we plan to submit the amendments of the Loans and Guarantees Act to Parliament by end-May 2013.

Macroeconomic Policies Under the Program

We remain committed to achieving fiscal and external sustainability over the medium term, while addressing our development and social needs. As a small open economy, Lesotho is prone to exogenous shocks. We are therefore committed to rebuilding an adequate level of international reserves cushion for such future shocks (equivalent to above five months of imports), through fiscal consolidation over the medium term. The current account imbalance is expected to narrow over the medium term, in line with fiscal consolidation, supported by strong performance in the mining sector.

We are conscious of the need for, and are committed to promote private sector development as the most effective route to achieving sustainable growth and poverty reduction. Accordingly, we will continue to streamline government activities and size, while enhancing private sector access to credit and the business climate. The recently formulated National Strategic Development Plan (NSDP) lays out a set of comprehensive reforms. To facilitate the implementation of the NSDP the government plans to finalize the *Public Sector Investment Programme* (PSIP), the Implementation Plan, and the Monitoring and Evaluation Framework by end-May 2013. Subsequently, the government aims to initiate a dialogue with international partners to mobilize resources to assist the implementation of the NSDP.

A. Macroeconomic Policies for 2012/13

We were able to achieve an estimated fiscal surplus of 4¾ percent of GDP, compared with a budgeted surplus of 0.2 percent of GDP, partly due to delayed execution of some capital projects, while pursuing external grant financing for immediate drought-related costs and spending for vulnerable groups and some priority infrastructure. A core SACU fiscal deficit (excluding externally financed capital projects) is estimated to have further improved to 5 percent of GDP,[1] helping to restore macroeconomic stability and further improve international reserves. We achieved these objectives by reducing non-priority outlays through stricter expenditure control and enhancing revenue collection.

To secure financing for the drought-related costs, the government managed to mobilize donor supports and accommodate spending needs within the current budget envelope. The international appeal (launched in September 2012) has so far generated $40 million, apparently covering most immediate needs. We have also accommodated other immediate spending needs, including the cost

[1] The core SACU fiscal balance—defined as the fiscal balance excluding the volatile component of SACU revenue and foreign-financed project loans—is the key policy anchor for fiscal consolidation efforts. The volatile component of SACU revenue is defined as the total SACU revenue minus the core component equivalent to 15 percent of GDP, which is close to the lowest annual SACU receipt in the last two decades.

of addressing emergency response needs for the drought (providing M117 million for agricultural inputs, in addition to the already budgeted subsidy of M18 million), by reallocating spending within the 2012/13 budget envelope.

B. Macroeconomic Policies for 2013/14 and Beyond

To achieve our medium-term objective of rebuilding international reserves in support of our exchange rate peg to the South African Rand, we will maintain our fiscal consolidation efforts, while supporting economic growth and employment, protecting vulnerable groups and proceeding with priority infrastructure projects under the NSDP. Though SACU revenue is projected to increase further in 2013/14, we will refrain from expanding government spending by saving the increase and targeting a deficit limit in the core SACU fiscal of 4⅓ percent of GDP for 2013/14. This target would facilitate adequate capital spending for growth, while we pursue further rationalization and efficiencies in recurrent spending (particularly on goods and services), and strengthen revenue administration. Specifically, we intend to (i) limit the filling of vacant posts and contain creation of new positions to a few posts, intended to create capacity for newly created ministries),[2] (ii) conduct a review of the civil service with the assistance of the World Bank to determine the optimal size of the civil service and restructuring needs, with a view to improving efficiency and helping to achieve the goals of the NSDP, (iii) reduce non-priority outlays through stricter expenditure control, (iv) limit contingency spending to emergencies, and (iv) implement revenue administration measures following the completion of the LRA restructuring. While we continue to contain the overall wage bill, we intend to restrict the filling of vacancies to priority posts. We provided a modest increase in wages and salaries to retain technically skilled workers, regularized the wage structure and brought wages and salaries closer to the minimum income level for the lower grades. With the assistance of the World Bank the government intends to undertake a full civil service audit, which would determine the exact number of public servants and assist in the clean-up of the payroll. With these consolidation efforts, our economic growth is expected to remain robust, the external balances are expected to further improve, and gross international reserves would reach US$1.1 billion, equal to 4⅔ months of imports by March 2014.

C. Structural Reforms

Enhancing Revenue Administration

To improve domestic revenue collection, we will continue to strengthen tax administration and broaden the tax base. As a part of restructuring of LRA, a full-service Large Tax Payer Unit has been established. Furthermore, the LRA has been undertaking further efforts to improve recovery of unpaid taxes, expand the taxpayer's registration, and strengthen compliance and service delivery. The government has been considering a comprehensive review of the income taxes and the VAT, with a view of improving tax efficiency. With IMF technical assistance, we aim to review the mining taxation regime by mid-2013 with a view to ensuring that the regime is consistent with international best practices.

[2] These include the ministries of Development Planning, Mining, and Social Development.

Improving Public Financial Management (PFM)

We have recently prepared a comprehensive PFM action plan, assisted by the IMF's Fiscal Affairs Department (FAD) and AFRITAC South, in full coordination with all the key donors. This plan details the reform deliverables for the next three years. The reforms aim at achieving the following objectives: (i) developing and implementing a modern PFM regulatory framework; (ii) improving transparency and effectiveness of fiscal policy by enhancing macro-fiscal projections and strengthening the links between fiscal strategy and budget appropriations; (iii) strengthening internal controls, accounting and fiscal reporting to achieve full compliance with the regulatory framework; and (iv) improving governance and institutional management of PFM reforms. Our reform efforts in 2013/14 will focus on developing capacity to implement the PFM regulatory framework; improving the budget process by strengthening the links between development plans and budgetary appropriations and greater engagement of policy makers in the budget process; and improving cash management and strengthening internal controls. In coming months, we plan to coordinate areas of technical assistance to support the implementation of our PFM action plan, with Lesotho's international partners (e.g., IMF, EU, World Bank, AfDB).

Following a comprehensive inventory of all government accounts, the monthly reconciliation of government's main bank accounts and monthly monitoring reports are expected to start in May 2013, and the Cash Management Unit is to be established in the Accountant General's Office by end-May 2013. To successfully implement these reforms, enhanced coordination between the treasury and line ministries is being actively undertaken.

Strengthening Debt Management

We have made progress in strengthening debt management. With technical assistance from the IMF, legislative reforms are being formulated to safeguard debt sustainability and modernize the debt management framework. Based on the forthcoming Debt Management Performance Assessment (DEMPA), we will develop a broader reform plan and a medium-term debt management strategy, with the assistance from the World Bank. In view of our moderate risk of debt distress, we will continue to seek external financing through grants and concessional loans to support the implementation of the NSDP. Looking forward, we also are assessing options for the medium-term financing of the second phase of the Lesotho Highlands Water Project, which may not be available on concessional terms.

Supporting Financial Sector Development

We will continue our efforts to strengthen the legal and regulatory frameworks necessary for financial deepening. The new Financial Institutions Act (FIA) has empowered the CBL to regulate and supervise nonbank financial institutions (money lenders, foreign exchange bureaus, microfinance, cooperative banks). To effectively implement the FIA, regulations for nonbank financial institutions are being prepared, and a new Insurance Bill, in line with international standards, has been submitted to Parliament. Based on further technical assistance from the IMF, other financial institutions regulations (e.g., asset classification, lending limits) are being developed, and we will also improve supervision and regulation of the insurance sector. In accordance with the NSDP, we aim to review and improve other related legal frameworks, including pension legislation; bankruptcy; and leasing laws. These measures will help improve confidence in the financial system, and further spur financial sector development. To also facilitate financial intermediation and promote private sector development and inclusive growth, the CBL, with assistance from the IMF and World Bank, is also undertaking a comprehensive diagnostic assessment of the financial sector to formulate the Financial Sector Strategic Development Plan (FSSDP) by end-2013.

Improving Investment Climate

We have embarked on private sector development, in the context of a comprehensive plan to improve the business climate in the NSDP. In collaboration with the World Bank, we will seek to improve the business climate and promote private sector development, including through improving access to finance through better collateralization of loans. We will intensify our efforts to complete the national identification card project given its importance to establishing a credit rating agency, and to foster bank lending to the private sector. We will also accelerate our ongoing land titling program, fully implement the 2010 Land Administrations Act, and advance the national identification card project to facilitate the establishment of a credit rating system. In view of prospective expiration of the AGOA in 2015, we will review the sector's development under the AGOA and explore ways to strengthen competitiveness of Lesotho's export industries.

Program Issues

Safeguard assessment. We remain committed to implementing all safeguards recommendations from the 2010 and 2012 assessments. Specifically, the CBL will continue the practice of appointing international audit firms with experience in auditing central banks for the duration of this and any successor arrangements, and thereafter for as long as IMF's credit remains outstanding. We will also publish the CBL's audited annual financial statements within one month after audit completion. To introduce the recommended internal audits of the monetary program data as an additional safeguard, internal auditors worked with the IMF mission to confirm test date data. Finally, we intend to provide resources in the 2013 budget of the CBL to strengthen internal audit capacity in the near term.

Program monitoring. Completion of the sixth review under the arrangement, by August 30, 2013 will be based on the observance of quantitative performance criteria through end-March 2013, respectively (Table 1). The definitions of the variables monitored as quantitative performance criteria are provided in the Technical Memorandum of Understanding (TMU).

Table 1. Lesotho: Quantitative Performance Criteria, Benchmarks, and Indicative Targets, March 2011–March 2013

	2011						2012											2013
	March		Status	Sep.		Status	March		Status	Jun.		Sep.		Status	Dec.		Status	Mar.
	PC	Act.		PC	Act.		PC	Act.		IT	Act.	PC	Act.		IT	Est.		PC
(Maloti millions)																		
Ceiling on the domestic financing requirement of the central government [1, 2]	1,453			1,435			1,629			148		227			-1,002			-966
Adjusted benchmark	1,670	1,231	Met	1,385	482	Met	1,564	1,284	Met	139	-320	346	-950	Met	-1,017	-1,414	Met	
Ceiling on the net domestic assets of the Central Bank of Lesotho [1, 2]	1,335			1,314			1,275			-43		118			-264			-499
Adjusted benchmark	1,551	1,397	Met	1,264	9	Met	1,210	515	Met	-52	-315	237	-1,065	Met	-279	-1,460	Met	
(US$ millions)																		
Floor on the stock of net international reserves of the Central Bank of Lesotho [2]	805			634			736			722		723			917			987
Adjusted benchmark	776	897	Met	641	892	Met	745	851	Met	723	876	707	973	Met	919	1,050	Met	
Ceiling on the stock of external payments arrears [3]	0	0	Met	0	0	Met	0	0	Met	0	0	0	0	Met	0	0	Met	0
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-March 2010) [2, 3]																		
Maturity of less than one year	0	0	Met	0	0	Met	0	0	Met	0	0	0	0	Met	0	0	Met	0
Maturity of one year or more	182	242	Not Met [5]	182	242	Not Met [5]	182	274	Not Met [5]	182	274 [5]	182	274	Not Met	274	274	Met	274
(Maloti millions)																		
Indicative targets:																		
Floor on the central government social expenditures[4]	170	205	Met	170	170	Met	170	170	Met	183	184	183	175	Not Met	183	183	Met	183
***Memorandum items*:**																		
Net disbursements [1,2]	304	272	…	-18	32	…	-122	-57	…	-88	-79	-65	-184	…	-104	-90	…	-104
General budget support	552	530	…	154	162	…	207	302	…	0	0	120	0	…	180	196	…	300
Debt service payments	249	258	…	172	131	…	329	359	…	88	79	185	184	…	284	286	…	404
SACU receipts [1]	2,628	2,628	…	1,376	1,376	…	2,752	2,752	…	1,492	1,492	2,983	2983	…	4,475	4,475		5,966

Sources: Ministry of Finance; Central Bank of Lesotho; and Fund staff estimates.

[1] Values are cumulative from April 1st (beginning of the fiscal year).

[2] Definitions and program adjusters are specified in the TMU.

[3] Continuous performance criteria.

[4] Includes spending on school feeding program, old age pension, war veterans, and HIV/AIDS.

[5] At the time of the 4th review under the ECF arrangement for Lesotho on November 27, 2012 the Board granted a waiver of nonobservance of the continuous PC on contracting/guaranteeing of new nonconcessional debt up to 274 million cumulative from March-2010.

Table 2. Structural Benchmarks for September 2012–March 2013

Benchmarks	Test date	Status
I. Other structural reforms		
Submit to Parliament the Industrial Licensing Bill, which will improve the process of licensing industrial enterprises	End-September 2012	Met with delay
Submit to Parliament the Insurance Bill	End-December 2012	Met with delay
II. Public Financial Management		
Reconcile all Treasury (Revenue and Expenditure) Accounts on a monthly basis and produce a monthly monitoring report.	End-November 2012	Not met
Establish a Cash Management Unit in the Treasury	End-December 2012	Not met
II. Debt Management		
Submit to Parliament the amendments of the Loans and Guarantees Act	End-March 2013	Not met
III. Revenue collection		
Establish a full-service Large Tax Payers Unit, which provides the full range of tax administration functions.	End-December 2012	Met with delay

Table 3. Structural Benchmarks through May 2013

Benchmarks	Test date	Macroeconomic rationale
I. Public Financial Management		
Establish a Cash Management Unit in the Treasury.	End-May 2013	Support expenditure efficiency and medium-term fiscal consolidation
Reconcile all Treasury (Revenue and Expenditure) Accounts on a monthly basis and produce a monthly monitoring report.	End-May 2013	Support expenditure efficiency and medium-term fiscal consolidation
II. Debt Management		
Submit to Parliament the amendments of the Loans and Guarantees Act	End-May 2013	Strengthen debt management

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets forth the understandings between the government of Lesotho and the IMF staff regarding the definitions of the quantitative performance criteria and benchmarks for the fifth and sixth reviews of its arrangement under the ECF-supported program, as well as the respective reporting requirements. These performance criteria and benchmarks are reported in Table 1 of the government's Memorandum of Economic and Financial Policies (MEFP).

A. Ceiling on the Domestic Financing Requirement (DFR) of the Central Government

2. Definition. The central government includes the central administration and all district administrations. The domestic financing requirement of the central government is defined as net credit to the government from the banking system (that is, the Central Bank of Lesotho and the commercial banks) plus holdings of treasury bills and other government securities by the nonbank sector. For program monitoring purposes, the domestic financing requirement will be calculated as the change from the end of the previous fiscal year (which runs from April 1 to March 31) of net credit to the government by the banking system and of holdings of treasury bills and other government securities by the nonbank sector. In particular, the calculation of the domestic financing requirement shall include changes in (i) balances held in the privatization account or balances of other accounts into which proceeds from the sale of public enterprises are deposited; (ii) the amount of outstanding treasury bills issued by the Central Bank of Lesotho for monetary policy purposes and held in the balance of the blocked government deposit account used by the Central Bank of Lesotho to sterilize reserve money absorbed by monetary policy operations. The calculation of the domestic financing requirement shall exclude changes in balances held in any account into which revenues collected by the customs department are held pending their transfer to the SACU revenues pool. External debt service, amortization, disbursements and external grants will be calculated at current exchange rates.

3. Supporting material. The Central Bank of Lesotho will provide the monetary survey and other monthly monetary statistics, as well as a table showing the details of all government financing operations from the nonbank public, on a monthly basis and within 30 days of the end of the month. The following information will be presented as memorandum items in the monetary survey: (i) the outstanding balances in the privatization account or accounts; and (ii) details of any monetary operations with treasury bills, including changes in government deposits as a result of such operations. The Central Bank of Lesotho will also provide a table showing the details of government debt by type and holder. The Ministry of Finance will provide detailed monthly budget operation reports and tax arrears reports.

B. Ceiling on the Stock of Net Domestic Assets of the Central Bank of Lesotho

4. Definition. The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency in circulation plus total bank deposits at the central bank) and NFA (as defined in paragraph 5). For program monitoring purposes, the NDA will be calculated as the change from the end of the previous fiscal year (which runs from April 1 to March 31). The NDA thus includes net claims by the Central Bank of Lesotho on the government (loans and treasury bills purchased less government deposits), claims on banks, and "other items net" (other assets, other liabilities, and the capital account).

5. Definition. The net foreign assets (NFA) of the Central Bank of Lesotho are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank. The values of all foreign assets and liabilities will be calculated in U.S. dollars at the end of each quarter using the program exchange rates.

6. Supporting material. The Central Bank of Lesotho will provide detailed data on its balance sheet on a monthly basis within 21 days of the end of the month. The central bank will also provide a table of selected monetary indicators covering the major elements of its balance sheet on a weekly basis.

C. Floor on the Stock of Net International Reserves of the Central Bank of Lesotho

7. Definition. The net international reserves (NIR) are defined as the Central Bank of Lesotho's liquid, convertible foreign assets minus its short-term foreign liabilities. Pledged or otherwise encumbered assets, including, but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from reserve assets. Reserve assets include cash and balances held with banks, bankers' acceptances, investments, foreign notes and coins held by the Central Bank of Lesotho, Lesotho's reserve position in the Fund, and SDR holdings. Reserve liabilities include nonresident deposits at the Central Bank of Lesotho, use of IMF credit, and any other short term liabilities of the central bank to nonresidents. The stock of NIR at the end of each quarter is defined in U.S. dollars and will be calculated using the program exchange rates.[1]

8. Supporting material. The Central Bank of Lesotho will provide data on its NIR on a monthly basis within three weeks of the end of the month. The NIR data will be provided in a table showing the currency breakdown of the reserve assets and reserve liabilities of the Central Bank of Lesotho converted into U.S. dollars and maloti at the program exchange rates.

[1] Program cross exchange rates are: South African rand per U.S. dollar: 7.3; U.S. dollars per pound sterling: 1.5; U.S. dollars per euro: 1.3; Swiss francs per U.S. dollar: 1.1; Swedish kronor per U.S. dollar: 7.3; and Botswana pula per U.S. dollar: 6.8. SDR per U.S. dollar: 0.648; Program maloti per U.S. dollar exchange rate: 7.3.

D. Ceiling on the Amount of New Nonconcessional External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of One Year or More

9. Definition. For purposes of the ECF arrangement, concessionality requirements will be applied to foreign-currency denominated debt regardless of the residency of the creditor. The public sector comprises the central government, the Central Bank of Lesotho, and all public enterprises and other official sector entities with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, adopted by Decision No. 6230-(79/140), as revised on August 24, 2000, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-March 2010 onward.

10. Definition. A loan is concessional if its grant element is at least 35 percent of the value of the loan, calculated using a discount rate based on commercial interest reference rates (CIRRs) reported by the OECD. For loans of maturity of at least 15 years, the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity of less than 15 years, the grant element will be based on the six-month average of OECD CIRRs. Margins for differing repayment periods would be added to the CIRRs: 0.75 percent for repayment periods of less than 15 years, 1 percent for repayment periods of 15 to 19 years, 1.15 percent for repayment periods of 20 to 29 years, and 1.25 percent for repayment periods of 30 years or more.

11. Supporting material. Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within 30 days of the end of the month.

E. Ceiling on the Amount of New External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of Less than One Year

12. Definition. The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, adopted by Decision No. 6230-(79/140), as revised on August 24, 2000, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets

(including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. Excluded from this performance criterion are normal short-term import credits. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from the end of the previous fiscal year (March 31).

13. Supporting material. Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within 30 days of the end of the month.

F. Ceiling on the Stock of External Payments Arrears

14. Definition. During the period of the arrangement, the stock of external payments arrears of the public sector (central government, Central Bank of Lesotho, and all enterprises with majority state ownership) will continually remain zero. Arrears on external debt-service obligations include any nonpayment of interest and/or principal in full and on time falling due to all creditors, including the IMF and the World Bank.

15. Supporting material. Details of arrears accumulated on interest and principal payments to creditors will be reported within one week from the date of the missed payment.

G. Floor on the Central Government Social Expenditures

16. Definition: There will be a floor on the central government social expenditures from domestic resources. The observance of this floor is an indicative target. Social expenditures comprise spending on the following: school feeding program, old age pension, war veterans, HIV/AIDS, and cash grants to orphaned and vulnerable children.

17. Supporting material: Data on social spending will be compiled by the Ministry of Finance and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

H. Adjusters

18. The quantitative performance criteria specified under the program are subject to the following adjusters:

A. Southern African Customs Union Revenues

- The program targets for the NDA in any quarter will be adjusted downward (upward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

- The program targets for the DFR in any quarter will be adjusted downward (upward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

- The program targets for the NIR in any quarter will be adjusted upward (downward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

19. Supporting material: The Central Bank of Lesotho will provide data on SACU receipts on a quarterly basis within the first month of the quarter.

B. Budgetary Support net of Debt Service[2]

- The ceiling on the NDA will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

- The ceiling on the DFR will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

- The floor on the NIR of the Central Bank of Lesotho will be adjusted upward (downward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

20. Supporting material: Data on budget support and debt service will be compiled by the Ministry of Finance and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

C. Unused Metolong loan balance

- The ceiling on the NDA will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

- The ceiling on the DFR will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

[2] General budget support consists of grants and loans received by the Central Government for financing its overall policy and budget priorities.

- The floor on the NIR of the Central Bank of Lesotho will be adjusted upward (downward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

21. Supporting material: Data on the Metolong project loan balance under the government's accounts will be compiled by the Central Bank of Lesotho and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

22. The above supporting data and reports required for program monitoring by IMF staff will be transmitted by the authorities to the IMF Resident Representative to Lesotho.

INTERNATIONAL MONETARY FUND

KINGDOM OF LESOTHO

FIFTH REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND REQUEST FOR EXTENSION OF THE ARRANGEMENT AND REPHASING OF DISBURSEMENT—INFORMATIONAL ANNEX

April 23, 2013

Prepared By African Department

CONTENTS

RELATIONS WITH THE FUND

(As of February 28, 2013)

Membership status: Joined 07/25/1968; accepted the obligations of Article VIII, Sections 2, 3, and 4: 03/05/1997.

General resources account:	SDR Million	Percent Quota
Quota	34.90	100.00
Fund holdings of currency	31. 20	89.40
Reserve position in Fund	3.71	10.64

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	32.88	100.00
Holdings	37.55	114.22

Outstanding purchases and loans:	SDR Million	Percent Quota
ECF[1] arrangements	41.70	119.47

Financial arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	06/02/2010	06/01/2013	50.61	39.25
ECF[1]	03/09/2001	10/31/2004	24.50	24.50
Stand-By	09/23/1996	9/22/1997	7.17	0.0

Projected obligations to fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	2014	2015	2016	2017
Principal	1.40	1.05	0.78	2.13	4.70
Charges/Interest	0.00	0.00	0.10	0.09	0.09
Total	**1.40**	**1.05**	**0.88**	**2.22**	**4.79**

[1] Formerly PRGF.

Safeguards Assessment

An update safeguards assessment was completed November 2012 in connection with the augmentation of the ECF arrangement that occurred earlier in the year. The assessments confirmed that the CBL has taken steps to strengthen safeguards since the 2010 assessment, but also that risks remain. In 2010, Deloitte (South Africa) was appointed as the CBL's external auditor. The firm has since completed the audits of financial years 2010, 2011, and 2012 within the three-month statutory deadline and issued an unqualified audit opinion following each audit. Since the 2012 assessment, aspects of the monetary data reporting process have been strengthened with IMF technical assistance, and internal auditors worked with the January 2013 IMF mission to confirm test date data. Audit oversight and internal audit remain areas where improvements are needed to strengthen overall governance and accountability.

Exchange arrangement:

Lesotho is a member of the Common Monetary Area (CMA) and the Lesotho loti is both *de facto and de jure* pegged 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 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. As of March 31, 2013, the Maloti rate per U.S. dollar was M9.24.

Article IV consultation:

The 2012 Article IV consultation was concluded by the Executive Board on April 9, 2012. Lesotho is on the standard 24-month Article IV consultation cycle.

Technical assistance missions:

Public Financial Management	STA	short-term	2010
Financial sector regulations	FAD	short-term	2010
Payment systems	LEG	short-term	2010
Monetary and Financial Statistics	MCM	short-term	2010
Public Financial Management	MCM	short-term	2011
Financial sector supervision	FAD	short-term	2011
Revenue administration	MCM	short-term	2011
SRF data development	FAD	short-term	2011
Develop risk management function	STA	short-term	2011
Develop the post control audit function in customs	FAD	short-term	2012
Insurance Supervision	FAD	short-term	2012
Risk management	MCM	short-term	2012
Enhanced Insurance Supervision	MCM	short-term	2012
Risk Management	MCM	short-term	2012
Balance of payments	MCM	short-term	2012
Capacity to manage MTEF	STA	short-term	2012
Limit accumulation of arrears	FAD	short-term	2012
Training functions in customs	FAD	short-term	2012
Missions planned for 2013			
Fiscal Law: Public Debt (AFRITAC South)	LEG	short-term	2013
Balance of Payments Statistics - IIP	STA	short-term	2013
Training: Balance of Payments Statistics Course (MEFMI)	BOP	short-term	2013
Compliance with Basel I and move to Basel II	MCM	short-term	2013
Risk Management follow up TA assignment.	FAD	short-term	2013
Review of tax administration law	FAD	short-term	2013
Payment Systems Modernizations	MCM	short-term	2013
Customs Administration	FAD	short-term	2013
Consumer Price Index	STA	short-term	2013
Compliance with Basel Core Principles	MCM	short-term	2013
Develop Regulations to Implement the New Financial Institutions Act	MCM	short-term	2013
National Accounts Statistics	STA	short-term	2013
PFM Reform	FAD	short-term	2013
TA in Fiscal Law: Public Debt	LEG	short-term	2013

Resident Representatives:

The new IMF resident representative office in Maseru headed by Mr. Michael Tharkur was opened in May 2012.

THE JMAP BANK-FUND MATRIX

(As of March 31, 2013)

Title	Products	Provisional Timing of missions	Expected Delivery date
A. Mutual information on relevant work programs			
Bank work program in next 12 months	• First Growth and Competitiveness DPC	• Ongoing regular missions	• May 2013
	• Private Sector competitiveness and Economic Diversification project	Ongoing regular missions	• Implementation ongoing
	• Water Sector Improvement Project Phase 2	• Ongoing regular missions	• June 2014
	• Social safety net review	• May 2013	• Jun. 2013
	• Maternal and Newborn Health PBF		• Jun. 2017
	• Public Financial Management Reform Project	• Apr. 2013	• Oct. 2013
	• Medium Term Debt Management Strategy	• Apr. 2013	• Aug. 2013
IMF work program in next 12 months	**Macroeconomic policy analysis and advice and IMF program**		
	• Fifth review of the ECF	• Jan. and Mar. 2013	• May 2013
	• Sixth Review of the ECF	• May 2013	• Jun. 2013
	• Article IV Consultation	• Dec. 2013	• Feb. 2014
	Technical assistance		
	• Payments system modernization	• Apr. 2013	• Ongoing
	• Financial Sector Development Strategy	• Aug. 2013	• Ongoing
	• PFM reform plan	• Ongoing regular missions in 2013	• Ongoing
	• Review of debt legislation	• Mid-2013	• Ongoing
	• Review of mining taxation code	• Mid-2013	• Ongoing
B. Requests for work program inputs			
Fund request to Bank	• Updates on policy reform work: the business climate, economic diversification, private sector development, and civil service audit and reforms.	Ongoing	
	• Updates on budget support programs	• Ongoing	
Bank request to Fund	• Updates on the ECF program	• Ongoing	
C. Agreements on joint products and missions			
Joint products in next 12 months	• Debt sustainability analysis	• Dec. 2013	• Feb. 2014

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 13/164
FOR IMMEDIATE RELEASE
May 9, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under ECF Arrangement for Lesotho, and Approves US$8.6 Million Disbursement and Extension of Arrangement

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review of the Kingdom of Lesotho's economic performance under a program supported by the Extended Credit Facility (ECF) arrangement. The Executive Board's decision was taken on a lapse of time basis.[1] In completing the review, the Board also approved the extension of the ECF arrangement to September 30, 2013 to ensure sufficient time to complete the sixth and final review. The Board's decision will enable an immediate disbursement of an amount equivalent to SDR 5.68 million (US$8.6 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 44.925 million (US$67.9 million).

In the fiscal year 2012/13 (April to March), the Lesotho economy grew by 3½ percent, with growth negatively affected by a drought. The drought severely affected agricultural production, but the authorities' adjustment efforts and financial aid by Lesotho's international partners helped mitigate the impact on fiscal and external balances. Looking forward, it will be important to promote deeper and broader private sector development in order to sustain the favorable growth trend over the long term, as rightly identified in the National Strategic Development Plan (NSDP).

The authorities' fiscal consolidation efforts are welcome, helping to strengthen international reserves, despite the drought and weak diamond prices. A stronger-than-projected fiscal balance, thanks to spending cuts and enhanced tax collection, has resulted in faster-than-programmed rebuilding of the international reserves cushion. Strong responses from international partners have also helped Lesotho stay on a macroeconomic adjustment path, while sufficiently addressing immediate drought-related needs. For 2013/14, as currently planned under the current fiscal framework, it is important to maintain fiscal consolidation efforts, while safeguarding priority social and growth-promoting capital spending.

[1] The Executive Board takes decisions under its lapse of time procedures when it is agreed by the Board that a proposal can be considered without convening formal discussions.

The ECF-supported program remains broadly on track. All end-September 2012 quantitative performance criteria were met. Three out of six structural benchmarks through March 2013 were implemented, namely: the submission of the Industrial Licensing Bill and the Insurance Bill to Parliament and the creation of a full-service Large Taxpayers Unit, while the other structural benchmarks have been delayed, partly owing to administrative setbacks.

The three-year ECF arrangement for the Kingdom of Lesotho in an amount of SDR 41.88 million (120 percent of Lesotho's quota in the IMF) was approved by the IMF's Executive Board on June 2, 2010 (see Press Release No. 10/224). On April 9, 2012, the Executive Board approved an augmentation of access equal to 25 percent of quota, which has led to a total access of SDR 50.605 million (145 percent of quota) in order to cushion the impact of the 2010–11 flood damage and high international commodity prices (see Press Release No. 12/126).