CENTRAL BANK OF LESOTHO

LESOTHO MACROECONOMIC OUTLOOK - 2013-2015

Growth Expected to Remain Fairly Stable!!!

SUMMARY

- *Real GDP growth is expected to average 4.9 per cent over the medium term.*
    - *Construction is expected to be the main pillar of growth in Lesotho*
    - *Mining sub-sector also expected to remain subdued in the medium term.*
- *Annual average inflation and money supply to remain fairly stable at an average rate of 5.1 per cent and 9.5 per cent, respectively, in the medium term.*
- *Broad money supply expected to grow at an average growth rate of 10.0 per cent.*
- *Fiscal balance projected to register an average surplus equivalent to 0.6 per cent of GDP over the medium term.*
- *The external sector projected to register surpluses in the next two years; deficit anticipated in 2015.*

MASERU, OCTOBER 2013

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Table of Contents

List of Figures

List of Tables

1. THE GLOBAL ECONOMY: RECENT DEVELOPMENTS & OUTLOOK

The global economic growth remained weak, as its underlying dynamics are changing with advanced economies leading the world growth path and emerging markets economies (EMEs)'s growth is slowing. However, EMEs still remain main contributor to world output. The growth in global output is estimated at 3.2 per cent in 2012 following a 3.9 per cent rise in 2011; a decrease of 0.7 per cent owing to uncertainty about the ultimate resolution of the sovereign debt crisis.

Table 1: The World Economic Outlooks (Annual percentage changes – real terms)

Regions	***Actuals***	***Estimates***	***Projections***	
	2011	***2012***	***2013****	***2014****
World Output	***3.9***	***3.2***	***2.9***	***3.6***
Advanced Economies	***1.7***	***1.5***	***1.2***	***2.0***
United Stats	1.8	2.8	1.6	2.6
Euro Area	1.5	-0.6	-0.4	1.0
Germany	3.4	0.9	0.5	1.4
France	2.0	0.0	0.2	1.0
Japan	-0.6	2.0	2.0	1.2
United Kingdom	1.1	0.2	1.4	1.9
Emerging and Developing Economies	***6.2***	***4.9***	***4.5***	***5.1***
Developing Asia	*7.8*	6.4	6.3	6.5
China	*9.3*	7.7	7.6	7.3
Middle East and North Africa	*3.9*	4.6	2.1	3.8
Sub-Saharan Africa	*5.5*	4.9	5.0	6.0
South Africa+	*3.5*	2.5	2.0	2.9
Lesotho*	***5.0***	***4.0***	***4.9***	***4.9***

Source: IMF World Economic Outlook, October 2013; +South Africa National Treasury, economic policy and outlook; *Central Bank of Lesotho forecasts

In terms of the outlook, world output is expected to rise by 2.9 per cent in 2013 compared to 3.2 per cent achieved in 2012. In 2014, the global growth is projected to rise by 3.6 per cent. Although the world is projected to register positive growth in the short to medium term, sustainability of the recovery still remains subdued due to weak and fragmented financial system, high private debt, uncertainty, depressed confidence and slow fiscal adjustment in the Euro Area. In addition, high levels of unemployment and public debt in all major advanced economies, insufficient fiscal consolidation and structural reforms in Japan, slowing growth and tighter financial conditions in Emerging market economies (which is expected to worsen when the US unwind its quantitative easing programme) as well as the absence medium-term adjustment plans with concrete measures and strong entitlement reforms in major advanced economies, particularly the U.S and Japan, are expected to hamper economic recovery.

1.1 THE UNITED STATES (US)

In the ***United States (US),*** following 2.8 per cent acceleration in economic growth realized in 2012, about 1 percentage point more than in the previous year, 2011, output is projected to increase at a pace of 1.6 per cent in 2013, a projected decline of about 1.2 per cent of output realized from the previous year.

The growth in output in the US regained speed following the sharp fiscal consolidation estimated at 2.5 per cent of GDP during the first half of 2013, which was supported by a recovering real estate sector, higher household wealth, easier bank lending conditions and more borrowing. In 2014, the US economy is projected to grow by 2.6 per cent, which will be achieved via easing fiscal tightening from the previous 2.5 per cent of GDP in 2013 to 0.75 per cent of GDP in 2014. This level of growth will be sustained should the U.S congress authorize discretionary public spending and raise debt ceiling in a timely manner and develop and adopt strong plans, supported by concrete measures, for medium-term fiscal adjustment and entitlement reforms.

1.2 THE EURO AREA

In ***Euro area***, recent developments showed that economic growth has recovered moderately since July 2013, removing the region out of its worst recession in history. This was due to economic activity that led to stabilization in the southern periphery and already recovering in the core countries. However, the economic challenges that confront the region such as weak and fragmented financial system, high private debt, uncertainty, depressed confidence and slow fiscal adjustment still put the outlook of the region in a bleak stance. The rate of economic growth is projected to decrease by 0.4 per cent in 2013 after declining by 0.6 per cent in 2012. In 2014 the Euro Area's economy is projected to grow by 1.0 per cent owing to, among others, tight financial conditions which dampened reduction in fiscal tightening (from 1.0 per cent of GDP to less than 0.5 per cent of GDP). Sustainability of growth within this region hinges largely on the region's ability to wither the recent high private and public debt, repairing the financial system and adopting a banking union in the region.

1.3 EMERGING AND DEVELOPING MARKETS (EDMS)

Although ***Emerging and Developing Markets (EDMs)*** are confronted with tightening external financial conditions and supply-side constraints, among other challenges, there are indications that growth still remains positive. The EDMs are projected to grow at the pace of 4.5 per cent in 2013, a moderation of 0.4 per cent, from 4.9 per cent recorded in 2012. In 2014, output in EDMs is expected to accelarate by 5.1 per cent; 0.6 per cent above registered economic growth in 2013. This better growth performance is expected to be driven by increased exports due to better growth in developed countries and solid consumption encouraged by low levels of unemployment. In addition, neutral fiscal policies and low real interest rates are also expected to foster investment in many economies in these regions. The fastest growing emerging economy, China, grew at an average growth rate of 8.5 per cent in 2011 and 2012, although in relative terms growth declined by 1.6 per cent in 2012 from 9.3 per cent recorded in 2011. This economy is projected to grow by 7.6 per cent in 2013 compared to 7.3 per cent anticipated to be recorded in 2014; a projected decline of 0.3 per cent.

While in the past years emerging markets economies remained the drivers of global growth, recently the dynamics of growth have changed to be controlled by advanced economies. In order to turn around the growth dynamics, the emerging markets economies have to adjust lower potential output and undergo structural reforms to ease this adjusment, countries with large fiscal deficits should consolidate and more credible monetary policy frameworks should be put in place in countries with inflation rates outside the target range. In response to antcipated unwinding of US monetary easing, countries must put up their macro houses in order by clarifying their monetary policy framworks and maintain fiscal sustainability. In addition, countries must let their exchnage rates depreciate in respose to outflows.

1.4 SUB-SAHARAN AFRICA (SSA)

In ***Sub-Saharan Africa (SSA)*** many countries have managed to maintain strong growth during the time when the global economy was recovering at a low pace. The SSA region grew at the pace of 4.9 per cent in 2012 compared to a growth rate of 5.5 per cent recorded in 2011; a deceleration of 0.6 per cent. The main drivers of this strong growth incorporated structural policies which fostered favourable business and investment climate, and better macroeconomic policies. In terms of the outlook, SSA's output is projected to remain solid and grow at 5.0 per cent and 6 per cent in 2013 and 2014, respectively. Higher growth in the region is expected to be support by commodity-related projects and sharp adjustment in exchange rates. The strength of economic growth in SSA will depend on growth in the key exports markets and investments partners, particularly the US, Euro Area and China. In this regards, growth in SSA is likely to be vulnerable to strengthening of their currencies against the US dollar, Euro and Yuan. If sustained, it is likely to negatively affect the region's exports competitiveness in the global market.

1.5 SOUTH AFRICA (SA)

For ***South Africa (SA),*** the largest economy in Sub-Saharan region in terms of its contribution to the region's economic output, GDP grew by 2.5 per cent in 2012 following 3.5 per cent increase registered in 2011. This strong growth in 2011 was a result of multiplier effect of expenditure on infrastructure development and transport as well as tourism and tax revenues that were associated with the 2010 FIFA World cup. In addition, strong growth in SA was supported by positive investment growth resulting from accommodative US monetary stimulus, more stable inventories and slower, but still positive, growth in government consumption, increased exports due exchange rate depreciation. A 1.0 per cent decline in economic growth experienced in 2012 emanated from tensions in the labour market, which led to reduction in the production of gold and platinum as mines closed. This resulted in exchange rate depreciation consequent upon decline in investors' confidence. In addition, high unemployment, political instability, capacity constraints and structural bottlenecks also dampened economic growth in SA.

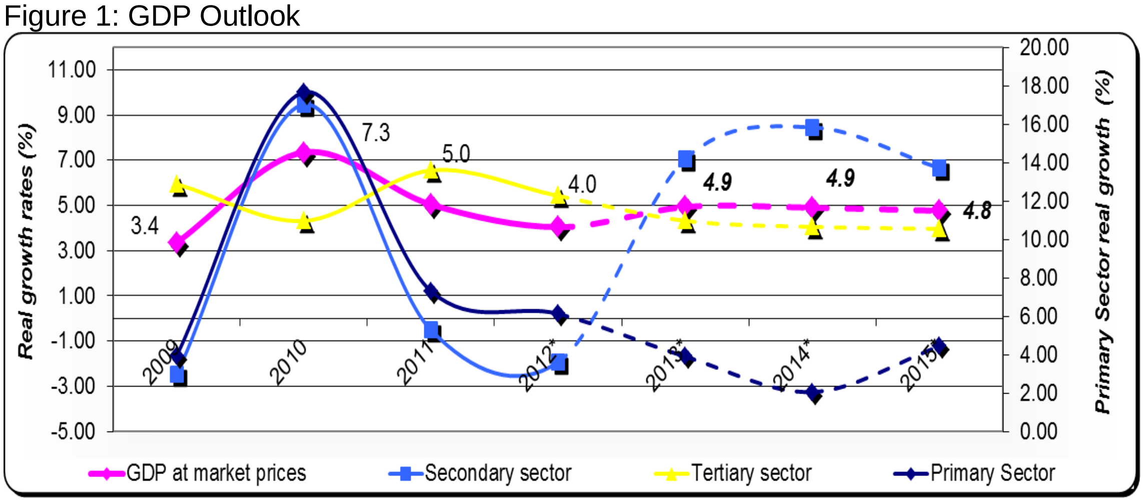
In terms of the outlook, the economy is projected to record 2.0 per cent GDP growth in 2013; a decline by 0.5 percentage points compared to 2.5 per cent realized in 2012. This projected decline is at the back of on-going capital flows reversal from emerging markets to advanced economies following Federal System's communication of its intention to unwind quantitative easing, although the actual tapering has not yet occurred. Furthermore, high unemployment, capacity constraints and structural bottlenecks still continue to hurt growth prospects in the economy. In 2014, GDP is projected to increase by 0.9 per cent from 2.0 per cent projected for 2013. SA's economic growth is projected to rebound in 2014 mainly on the back of recovery in private demand, exports and investments as advanced economies continue to grow.

2. LESOTHO'S ECONOMIC PERFORMANCE

2.1 DOMESTIC OUTPUT: RECENT DEVELOPMENTS AND FORECASTS

Following impressive growth of 7.4 per cent registered in 2010, economic activity in Lesotho decelerated gradually until it registered 4.0 per cent in 2012. The deceleration in economic growth was largely due to a fall in secondary sector, particularly manufacturing sub-sector. Primary sector also decelerated substantially over the period 2010 – 2012, due to several challenges which affected the sub-sector negatively.

Figure 1: GDP Outlook



+ Estimates & *Forecasts

In the medium term, economic growth is expected to accelerate marginally and register an average growth rate of 4.9 per cent over the period 2013 – 2014. In 2015, growth is expected to decelerate slightly to an average of 4.8 per cent. Growth is set to benefit largely from a relatively strong performance anticipated in the secondary sector. The growth in the sector is set to increase from 7.1 per cent in 2013 to 8.5 per cent in 2014 before subsiding to 6.7 per cent in 2015 as shown in figure 2.1.2 below. Building and construction sub-sector is expected to be the mainstay of the secondary sector.

The sub-sector is expected to register impressive growth performance owing to an on-going construction of Metolong dam and its related projects as well as on-going government construction activities as well as other major government building and construction projects. Private property development is also anticipated to give a thrust to the sub-sector. Favourable Rand/Dollar exchange rate is also anticipated to boost the confidence of the textiles and clothing industry. To this end, the manufacturing sub-sector is set recover in the medium term and boost economic growth.

The primary sector is set to remain subdued in the medium term owing to several agricultural challenges experienced since the beginning of 2013, including delayed onset of rains, occurrence of frost in the highlands, a mid-season dry spell, and pest infestation including army-worm infection. Mining and quarrying activities are projected to increase at a fairly lower growth rate compared to the previous year. This is mainly attributable to capacity constraints facing the domestic mining industry emanating from limited energy supply, particularly electricity supply. Any measure to increase mining productivity requires additional supply of energy, especially electricity.

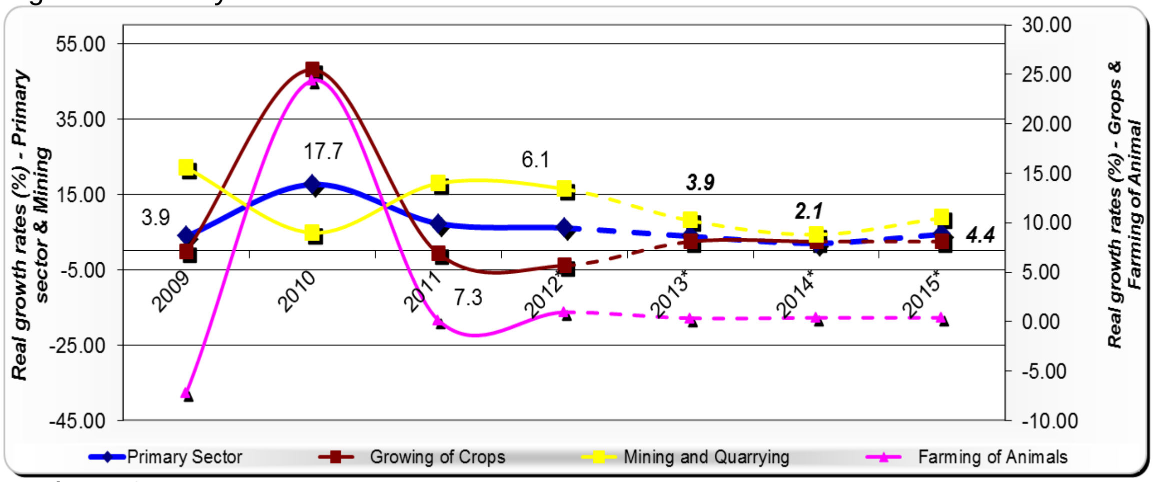
Services sector is estimated to continue to grow at a fairly stable rate over the period 2013 – 2015. The sector is estimated to benefit from the increase in health and social works, transport and telecommunication and public administration sub-sectors. Moderate performance of financial and real estate and business service sub-sectors are also set to boost the sector.

2.1.1 Primary Sector

The primary sector grew at an average growth rate of approximately 6.7 per cent over the period 2011 – 2012. The growth of the primary sector was mainly attributable to a relatively strong performance of the mining and quarrying sub-sector which recorded an average growth of 17.2 per cent. On the other hand, the agriculture, forestry and fishing sub-sector continue to suffer from major setbacks largely attributable to unfavourable weather conditions which started late 2010. The sub-sector was negatively affected by the drought that was experienced in some parts of the country at the beginning of the 2011/2012 agricultural year coupled with floods in other parts of the country. The heavy rains and floods that ravaged the country from December 2010 to February 2011 curtailed agricultural production for the 2010/2011.

In terms of the outlook, the sector is projected to register a lower growth rates over the medium-term (2013 – 2015), particularly in 2014, compared to the past three years. As depicted in figure 2.1.1 below, the primary sector is set to continue to register a relatively lower growth performance until 2014, after which the growth rate of the sector is expected to rebound. The growth rate of the sector is set to decline from 3.9 per cent in 2013 to 2.1 per cent in 2014 largely due to lower growth performance in the mining and quarrying sub-sector. However, the sector is expected to rebound in 2015 and register an average growth rate of 4.4 per cent as the mining and quarrying sub-sector begins to recover. The agriculture, forestry and fishing sub-sector is projected to remain on a fairly stable growth path as government intensifies its efforts to promote crop production and improves food security in the country.

Figure 2: Primary Sector Outlook



+ Estimates & *Forecasts

The *Mining sub-sector* is estimated to register an average growth rate of 7.1 per cent over the period 2013 – 2015 compared to 17.2 per cent observed over the period 2011 – 2012. Lower growth performance is largely due to capacity constraints facing the domestic mining industry emanating from limited energy supply particularly electricity supply. Any measure to increase mining productivity requires additional supply of energy, especially electricity. The current electricity infrastructure cannot not sustain further increase in electricity supply in northern part of the country where most of domestic mining operations are located. Nevertheless, the government and mining companies are working together to establish ways to put up necessary electricity infrastructure endeavoured to support the mining operations.

The positive outlook is largely at the back of expected growth in global diamond market in the medium term. The key to recovery in rough diamond markets is the return of confidence in major jewellery diamond-buying economies, particularly the US, China and the Gulf since these are the major players in the diamond jewellery market recently. The United States' diamond jewellery market, which represents approximately half of total international diamond jewellery sales, is expected to grow in line with consumer spending while markets in Japan and Europe are expected to grow less quickly compared with their general consumer spending. Markets in China, India and the rest of the world are generally projected to grow quicker than consumer spending.

The sub-sector is also expected to continue to benefit from favourable exchange rate. In dollar terms, diamond prices are expected to continue to increase in 2013 throughout 2014, with a slight decline expected in 2015. Due to the expected depreciation of the local currency against the US dollar, in Maloti terms, diamond prices are expected to increase substantially in 2013 and 2014. In 2015, the expected appreciation of the local currency is set to exert a downward pressure on Loti price of diamonds. Letšeng diamond mine is expected to continue to remain the main contributor to the sub-sector with the market share in excess of 80 per cent.

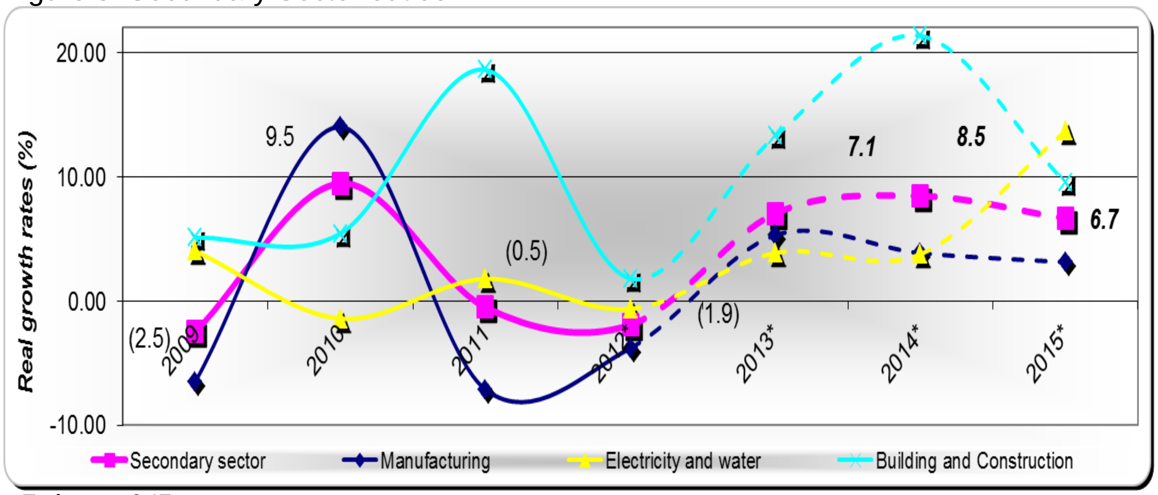
The *agriculture, forestry and fishing sub-sector* is set to experience a modest growth of approximately 0.7 per cent, on average, in the medium term. The sub-sector, particularly crops sub-sector is set to benefit from government initiatives in the form of subsidies and other measures endeavoured to promote crop production and improve food security in the country. On the negative side, the growth performance of the crops sub-sector is likely to be negatively affected by several agricultural challenges experienced since the beginning of the year 2013. These include delayed onset of rains, occurrence of frost in the highlands, a mid-season dry spell, and pest infestation including army-worm infection. Farming of animal sub-sector is likely to be affected by a decline in grazing land as well as stock theft.

2.1.2 Secondary Sector

The secondary sector, which comprises the manufacturing, electricity and water, and the building and construction sub-sectors, registered an average growth rate of -1.2 per cent over the period 2011 and 2012. Manufacturing, particularly textiles and clothing sub-sector, remained under strain in 2011 throughout 2012. Lesotho's textiles and clothing industry remained under pressure due to gradual loss of country's competitiveness in the US market at the expense of Asian producers. Electricity and water also remained under stress in 2012 compared to 2011 when it registered a positive growth performance. Building and construction grew sluggishly in 2012 compared to strong growth performance recorded in 2011.

The outlook for the sector remains positive owing to relatively strong growth performance anticipated in building and construction sub-sector. The sector is set to increase from 7.1 per cent in 2013 to 8.5 per cent in 2014 before subsiding to 6.7 per cent in 2015 as shown in figure 3 below. Both manufacturing, and water & electricity sub-sectors are expected to register positive growths in the medium term. Manufacturing, particularly textiles, clothing, footwear, and leather sub-sector, is expected to benefit form a favourable exchange rate over the period 2013 – 2014.

Figure 3: Secondary Sector outlook



+ Estimates & *Forecasts

Manufacturing sub-sector is expected to rebound in 2013 and register 5.3 per cent growth before slowing down in 2014 throughout 2015 from 3.9 per cent to 3.2 per cent projected for the year 2015. The growth performance of the sub-sector is mainly at the back of projected growth performance of textiles and clothing industry. Textiles and clothing industry is largely expected to benefit from favourable Rand-Dollar exchange rate which is expected to boost the confidence of the industry over the period 2013 – 2013. This has a potential to improve the country's international competitiveness in the international markets, particularly the US market where the bulk of textiles and clothing products are destined. Needless to say, fierce competition from low-cost producers from Asian countries such as China, India etc, (coupled with ever increasing utility costs such as water and electricity) as well as potential loss of preferential provisions (in particular, uncertainty surrounding the renewal of AGOA beyond 2015) in 2015 (as firms are expected to become risk averse) are expected to exert downward pressure on the industry. This would be a huge blow for the country; without this extension, exports to the US are likely to collapse.

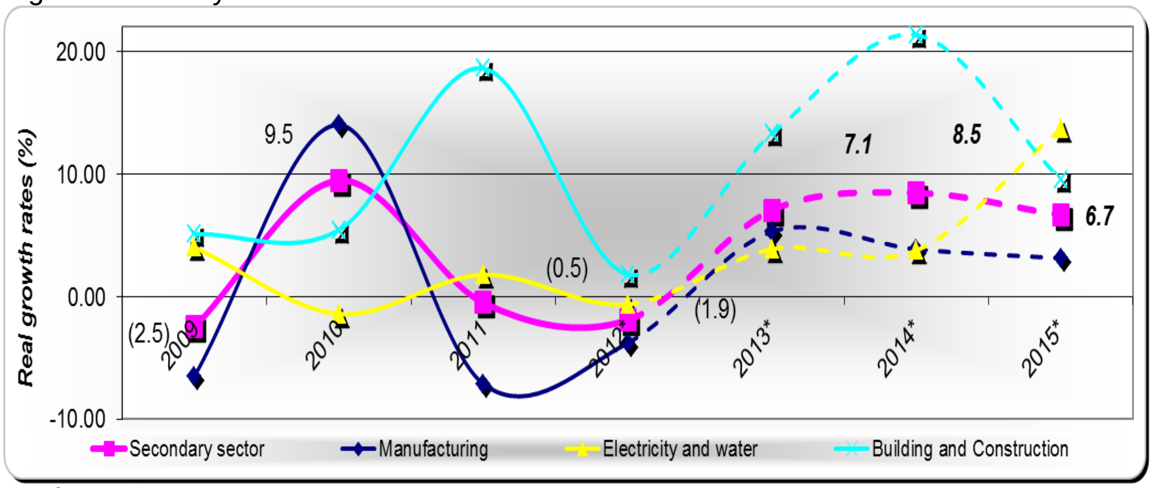
Food products and beverages and other manufacturing sub-sectors are set to remain fairly stable at 3.9 per cent and 3.6 per cent, respectively over the medium term. Other manufacturing sub-sector is expected to remain stable as Lesotho National Development Corporation (LNDC) intensifies efforts to diversify from both textiles and clothing products and market base. *Electricity and Water sub-sector* is projected to expand at an average rate of 3.8 per cent over the period 2013 – 2014 while growth is set to increase substantially to 13.7 per cent in 2015. In 2015, Metolong dam is expected to start to supply water in the country. This has a potential to boost the performance of the sub-sector substantially.

Building and Construction sub-sector is forecasted to increase from 13.3 per cent in 2013 to 21.4 per cent in 2014 before subsiding to 9.5 per cent in 2015. The sub-sector is expected to register impressive growth performance owing to an on-going construction of Metolong dam and its related projects as well as on-going government construction activities as well as other major government building and construction projects in the pipeline. Metolong project (which will supply water to Maseru and the neighbouring towns – Mazenod, Roma and Morija), is estimated at approximately M3 billion and its major construction component started in late 2013 and is expected to be completed in 2014. Major government construction projects include Roma-Ramabanta-Semonkong-Sekake, Mokhotlong-Sani Pass, Oxbow-Mokhotlong, Joel's Drift-Monont's'a, Mpiti-Sehlaba-Thebe roads and other urban roads networks. In addition, the recent years have seen an increase in property development, both residential and commercial, in urban areas, especially in the capital city Maseru. This is expected to continue in the medium term.

2.1.3 Tertiary Sector

After recording an average growth rate of 6.0 per cent over the past two years, the sector is estimated to grow at an average growth rate of 4.1 per cent in the medium term; it is set to grow by 4.3 per cent, 4.1 per cent and 4.0 per cent in 2013, 2014 and 2015, respectively. The sector is estimated to benefit from the increase in health and social works, transport and telecommunication and public administration sub-sectors. Moderate performance of financial and real estate and business service sub-sectors are also set to boost the sector.

Figure 4: Tertiary Sector outlook



+ Estimates & *Forecasts

Wholesale and retail trade repair sub-sector is projected to continue to benefit from expansion of shopping centers in the country, particularly the establishment of new shopping malls in capital city of Lesotho in 2012. The sub-sector is also set to benefit from low inflation environment expected over the next three years. The expected deterioration in the labour market conditions in the domestic industries as well as stagnant growth in the public sector employment continues to remain the downside risk to the growth prospects of the sub sector.

Transport and telecommunication sub-sector is projected to grow at an average rate of 5.7 per cent while *financial intermediation* is set to increase at a constant rate of 4.9 per cent over the medium term. *Transport and telecommunication* is set to benefit from technological advancement largely in the form of introduction of the new products. The establishment of credit bureau, commercial court and other institutional arrangements geared toward reducing impediments to credit extension in the domestic sector are expected to have positive impact on *financial intermediation.*

The growing demand for new residential buildings as seen by increasing property developments in the urban areas is set to benefit *Real Estate and business services. The sub-sector* is estimated to grow at an average rate of 4.2 per cent in the medium term.

The real value added by the *Public Administration* is estimated to record an impressive growth rate of 6.5 per cent in 2013 as the government intensifies efforts to improve services delivery. This was seen by introduction of new line ministries following the establishment of the new co-alition government in 2012.

Education sub-sector is expected to have reached a saturation point following the implementation of free primary education over the past years. The sub-sector is projected to increase by an average growth rate of 1.9 per cent in the period 2013 – 2015. *Health* is estimated to continue to benefits from the government efforts to fight the HIV/AIDS pandemic and other health related projects supported by international partners. Millennium Challenge Corporation's (MCC's) health sector projects (which were aimed at strengthening the health care infrastructure in Lesotho) implemented over the past five years of the compact are expected to continue to boost health outcomes.

2.2 Production Account

2.2.1 Private Consumption Expenditure

Private consumption expenditure grew at an average rate of 9.0 per cent from 2010 to 2011. The increase was mainly attributed to the resilient domestic macroeconomic environment. In terms of the outlook, it is projected to increase by 4.0 per cent and 10.0 per cent, in 2012 and 2013, respectively. In 2014, it is expected to record a relatively higher growth rate of 10.0 per cent, before declining to 7.0 per cent in 2015.

During the forecasting horizon, private consumption is expected to be driven largely by building and construction sub-sector, mining and quarrying sub-sector as well as manufacturing sub-sector. Each of these sub-sectors is expected to boost domestic employment and hence spending power of the private sector. In addition, lower inflation developments are set to benefit private consumption. Inflation is expected to remain in line with South African (SA) inflation as Lesotho imports a sizeable part of goods from SA. The lower inflationary pressure in the economy will help support consumption growth in 2013 throughout 2015. The outlook is favorable in the medium term as most economic fundamentals are expected to improve.

2.2.2 Government Consumption Expenditure

Public consumption expenditure grew at an average growth rate of 2.9 per cent in 2010 and 2011. This lower growth was largely driven by reduced Southern African Customs Union (SACU) revenue receipts, which forced the Government of Lesotho (GoL) to intensify efforts to implement fiscal consolidation by prioritising its expenditures. The decline in SACU revenues was attributed to global economic downturn and globalization.

Following the recovery of weak SACU revenues and improved revenue collection by Lesotho Revenue Authority (LRA) in 2012, which coincidently occurred during the national election year, the projected outturn for government consumption expenditure is expected to increase sharply by about 26.0 per cent; compared to 0.2 per cent decline realized in 2011.The outlook for public consumption remains positive in 2013 through 2015 though it is expected to decrease by 7.9 per cent and 9.1 per cent, respectively, in 2014 and 2015 from 10.0 per cent projected for 2013.

2.2.3 Gross Fixed Capital Formation

Gross fixed capital formation (GFCF)is estimated to have grown by approximately 9.3 per cent in 2011 compared to 9.2 per cent in the previous year; a decline of 1.0 percentage points. This relatively better growth was boosted by private sector investment which remained relatively strong owing to increase in property developments in Lesotho and several other building and construction activities. In addition, public sector investment also contributed to the increase in GFCF.

In the medium term, GFCF is forecasted to grow relatively strong due to ongoing construction of Tikoe factory shells, Metolong Water Project as well as private property development. GFCF is also expected to be boosted by government initiatives towards capital projects. It is expected to increase by 10.3 per cent, 8.2 per cent and 6.8 per cent in 2013, 2014 and 2015, respectively. The decline noticed in 2014 and 2015 is expected to occur following completion of Metolong Water Project and Tikoe factory shells in 2014.

2.2.4 Exports and Imports of goods and services

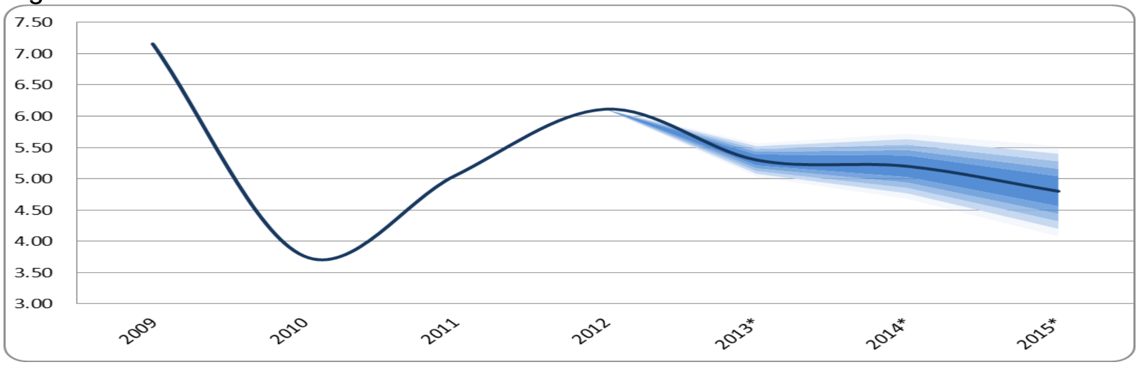
Export of goods and services grew at a marginal growth rate of 1.7 per cent in 2010 on the back of the global economic downturn, particularly in US and Euro Area where the bulk of domestic exports are destined. However, in 2011 the export sector registered a 30.9 per cent increase due to recovery in the diamond market and manufacturing sub-sector following government's effort to diversify from textiles and clothing exports. The export of goods and services is expected to have declined by 3.0 per cent in 2012. In terms of the outlook the exports are expected to increase by 18.8 per cent, 15.5 per cent and 9.0 per cent in 2013, 2014 and 2015, respectively.

Imports of goods and services increased at an average rate of 7.8 per cent in 2010 and 2011 and estimated to have grown by 14.9 per cent in 2012. In terms of the outlook, imports are forecasted to increase by 11.1 per cent and 7.9 per cent in 2013 and 2014, respectively, before registering a lower growth of 5.7 per cent in 2015. The increase is mainly associated with construction of Metolong dam which is at its peak until 2014, then imports will start to decline until 2015.

2.3 PRICES DEVELOPMENTS

From a record high of 10.8 per cent realized in 2008, annual domestic inflation rate (measured by the annual change in the Consumer Price Index – CPI) declined gradually until it registered 3.8 per cent in 2010. Declining food and fuel prices, since the second half of 2008, have been the major driving force behind the downward trend in inflation. In the subsequent years, domestic inflation rate accelerated until it recorded an average rate of 6.1 per cent in 2012. The increase in aggregate prices largely attributed to exogenous factors, particularly the surge in international food and fuel prices. Unfavourable weather conditions were the main reason behind the increase in international food prices.

Figure 5: Inflation Outlook



***Forecasts**

In terms of the outlook, the annual inflation rate is projected to average **5.3 per cent** in 2013, 5.2 per cent in 2014 and 4.8 per cent in 2015. Owing to the trade relations between Lesotho and SA, domestic prices are expected to remain in line with price developments in SA in the medium term. The imported inflation component of Lesotho's inflation is expected to be influenced by the developments in the price of crude oil and the depreciation of the Rand against major currencies. Furthermore, the recent upsurge in international crude oil prices has implications for fuel prices in the region and hence this is expected to lead to higher inflation rates in the region and also in Lesotho. This has been the major force behind inflation pressures in the country in recent years.

On the one hand, domestically generated inflation is mainly due to administered prices and the demand conditions on food items. With bleak outlook on the crops production due to several agricultural challenges experienced during the agriculture year 2012/13, domestically generated inflation may worsen.

2.4 Income and Outlay Account

National disposable income is estimated to have increased by 15.3 per cent in 2011 compared to 0.3 per cent in 2010. The decline in growth in 2010 was largely on account of a decline in growth in net factor income from abroad.

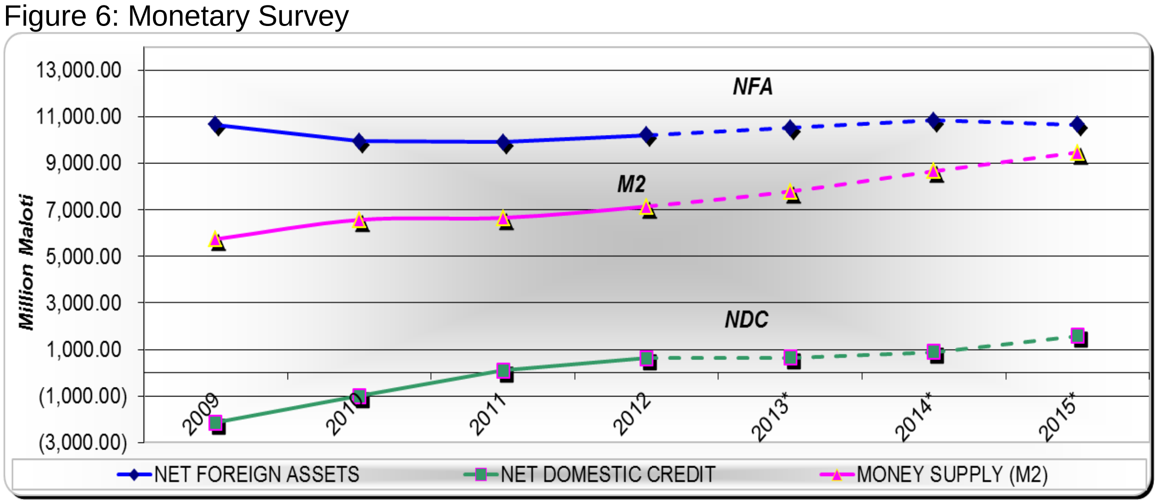
In terms of the outlook, national disposable income is set to have increased by 11.4 per cent in 2012, 13.3 per cent in 2013, 8.6 per cent in 2014 before declining to 7.1 per cent in 2015. The decline in 2014 and 2015 is largely on the back of the projected modest decline in Net factor income from abroad.

2.5 MONETARY DEVELOPMENTS

Broad measure of money supply (M2) grew by 7.3 per cent in 2012, in nominal terms, compared to 1.3 per cent observed in the previous year. The increase in money supply was largely due to an increase in credit to private sector as well as net foreign assets (NFA).

In terms of the outlook, money supply is projected to continue to increase in 2013 throughout 2014 before subsiding slightly in 2015. It is set to increase by 9.1 per cent and 11.1 per cent in 2013 and 2014, respectively. The increase in money supply over the period 2013 – 2014 is mainly on account of the increase in net foreign assets (as the central bank accumulates foreign assets) and domestic credit (as financial institutions particularly commercial banks became aggressive in financing domestic activities). Over the period 2013 – 2014, NFA and domestic credit are projected to contribute an average of 4.2 per cent and 11.1 per cent of the total increase in money supply, respectively.

Figure 6: Monetary Survey



***Forecasts**

In the subsequent year, money supply is projected to register a growth rate of 9.3 per cent largely on account of an increase in net domestic assets, particularly domestic credit. NFA are expected to fall in 2015 as the financing needs of balance of payments exert downward pressure on official reserves. The increase in net domestic assets is expected to contribute 11.2 per cent of the total increase in money supply with domestic credit accounting 12.6 per cent of the total growth of money supply.

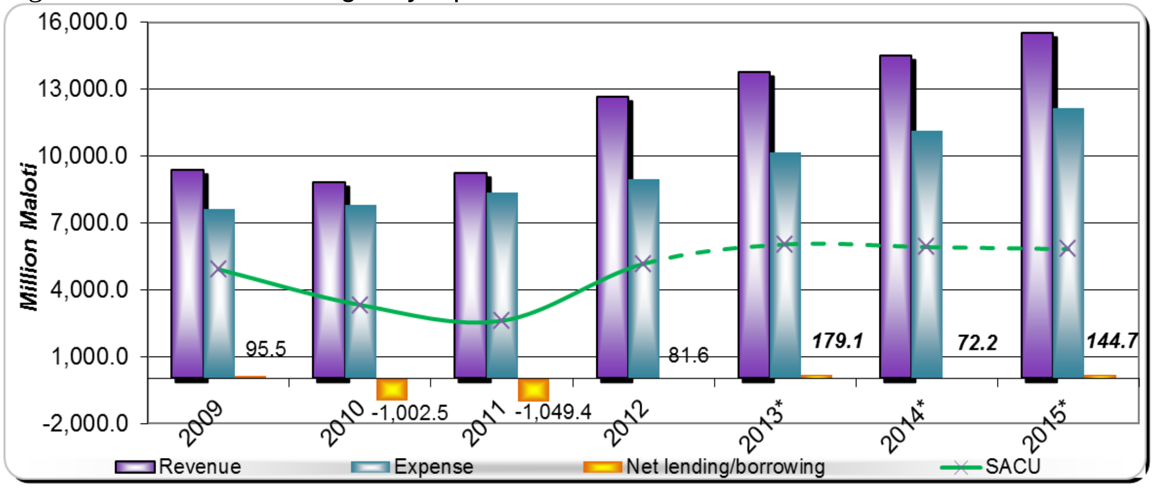
Velocity of money is projected to hover around 2.8 over the medium term while the ratio of narrow money (M1) to GDP is estimated at 0.18.

2.6 GOVERNMENT BUDGETARY OPERATIONS

Following the aftermath of the recent financial and economic crisis, government budgetary operations improved gradually and registered a surplus equivalent to 0.4 per cent of GDP in 2012. The surplus largely reflected an increase in total revenue, particularly SACU revenue, relative to total expenditures. As a share of GDP, total revenue increased from 50.0 per cent recorded in 2011 to 65.6 per cent registered in 2012. SACU revenue increased from 14.1 per cent to 26.8 per cent in 2012. On the other hand, total expenditures increased from 56.0 per cent of GDP in 2011 to 65.2 per cent in 2012.

In relation to the outlook, fiscal operations are projected to remain relatively healthy over the medium term. Government budgetary operations are set to register an average surplus equivalent to 0.6 per cent of GDP over the next three years. On the financing side, government budgetary operations are expected to results in accumulation of government deposits to the tune of M717.5 million in 2013. In the subsequent years, accumulation of government deposit is expected to slow down to M406.1 million in 2015.

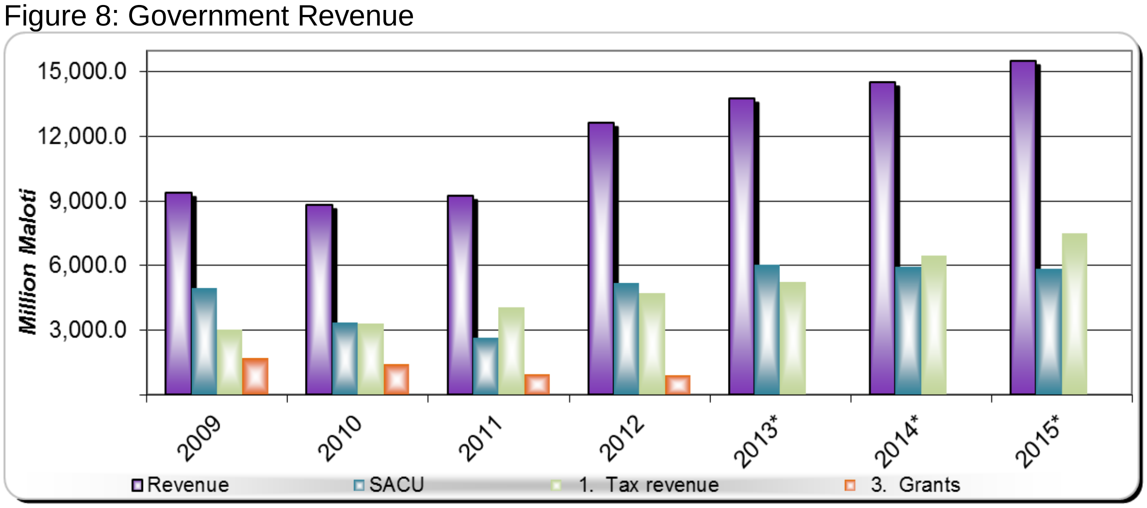
Figure 7: Government Budgetary Operations



***Forecasts**

The increase in total government revenue is projected to slow down from 36.9 per cent registered in 2012 to 8.8 per cent in 2013. The increase is expected to slow down further in 2014 throughout 2015 and register 6.8 per cent in 2015. Total tax revenue is set to increase by 23.0 per cent in 2014 before subsiding to 15.8 per cent in 2015. On the other hand SACU revenue is set to decline over the medium term. As a share of GDP, total government revenue is set to remain relatively stable at approximately 60.0 per cent while SACU revenue is set to fall from 27.5 per cent to 21.6 per cent over the medium term.

Figure 8: Government Revenue



***Forecasts**

On the expenditure side of the fiscus, total government expenditures are expected to slow down to 8.1 per cent in 2013 and thereafter remain relatively flat at an average of 6.4 per cent. Compensation of employees is expected to increase substantial in 2013 following revision of government salary structure and efforts to improve service delivery during the financial year 2012/13. In the subsequent year, compensation of government employees is set to remain relatively flat at an average of 8.3 per cent. Following a substantial increase observed in 2012, non-financial assets is expected to decline over the medium term. In percentage of GDP, total government expenditures are set to remain relatively stable at an average of 60.0 per cent of GDP over the medium term compared to 65.2 per cent observed in 2012. Compensation of employees are also expected to remain flat at an average of 20.5 per cent of GDP.

Figure 9: Government Expenditures

***Forecasts**

2.7 External sector developments

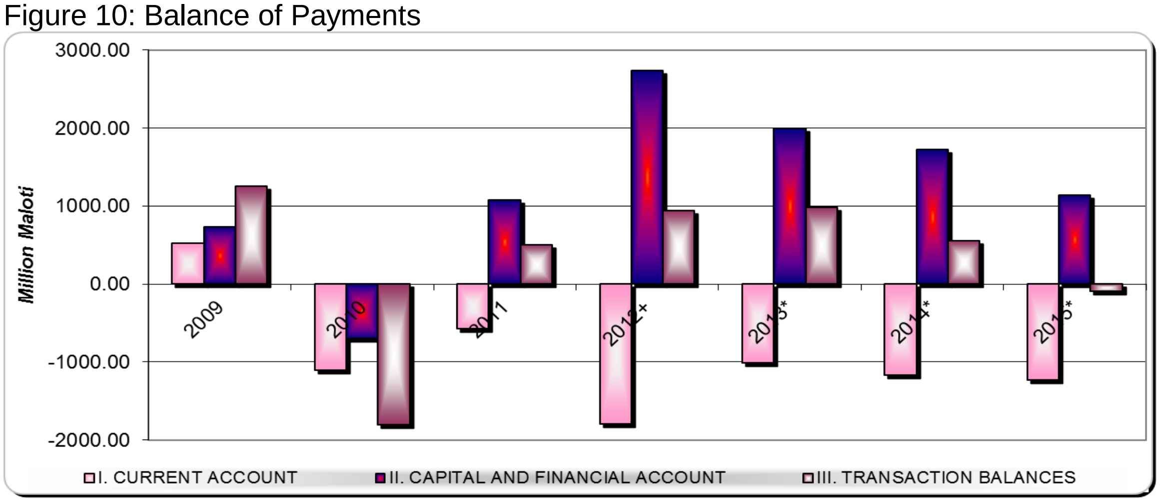
The external sector position recorded a surplus equivalent to M940.7 million (5.0 per cent of GDP) in 2012; an improvement from M502 million observed in the previous year. The improvement in the overall balance was mainly driven by an increase in capital and financial inflows, particularly government grants and loans endeavoured to finance among others Metolong projects, MCA-related projects and other government development projects. Capital and financial account registered net inflow equivalent to 14.2 per cent of GDP. The surplus was also supported by the gains derived from the depreciation of the local currency against the currencies of Lesotho's major trading partners. On the other hand, current account balance deteriorated further in 2012 from

3.1 per cent of GDP to 9.3 per cent in 2013. In months of import cover, gross official reserves increased marginally from 4.6 to 4.7 months of imports in 2012.

Looking forward, the external sector is projected to continue to register surpluses in the next two years. The surplus is set to narrow from 4.9 per cent of GDP to 4.5 per cent in 2013 until it reaches 2.3 per cent in 2014. This is mainly on account of a fall in Capital and Financial inflows from 14.2 per cent of GDP in 2012 to approximately 7.0 per cent of GDP in 2014. Capital and financial inflows are set to decline largely on account of the anticipated winding down of government capital projects such as Metolong and other developments projects which were largely financed through government capital grants and loans. Commercial banks are also expected to continue to drawdown their foreign assets, though at a relatively lower pace compared to 2012, to finance thriving investment opportunity in the domestic market, particularly property development.

Current account deficit is also projected to narrow substantially from 9.3 per cent of GDP to 4.7 per cent in 2014. The narrowing of current account reflects the increase in net income from abroad and current transfers relative to net imports of goods and services over the period 2013 – 2014. Current transfers continue to be supported by the receipts of SACU revenue receipts.

Figure 10: Balance of Payments

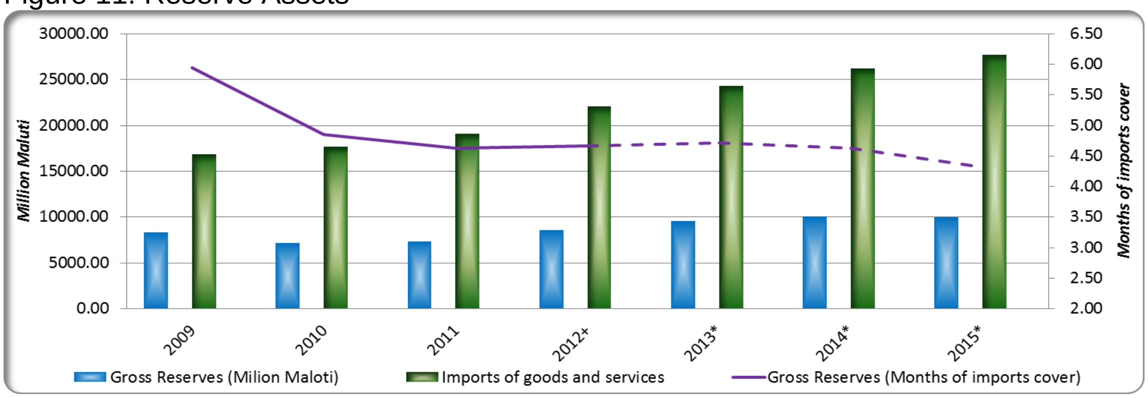


***Forecasts**

Further into the future, the overall balance is projected to register a deficit. In 2015, the overall balance is projected to register a deficit equivalent to 0.3 per cent of GDP largely at the back of continuous fall in capital and financial inflows. Capital and Financial inflows are projected to decline from 7.0 per cent of GDP in 2014 to 4.2 per cent in 2015; the decline largely due to anticipated decline in government capital grants and loans. The anticipated completion of Metolong projects is set to reduce government foreign loans substantially in 2015. Current account deficit is set to remain relatively flat at an average of 4.7 per cent of GDP in 2015.

Following an increase of 17.0 per cent in 2012, the gross international reserves are to increase at a relatively lower pace of 11.0 per cent and 6.0 per cent in 2013 and 2014, respectively. The increase in official reserves reflects anticipated accumulation of foreign assets by the Central Bank supported by the expected increase in government deposit with the Bank consequent upon government surplus. In 2015, however, the gross international reserves are set to decline by 1.0 per cent as capital and financial inflows become inadequate to finance current account deficit. In months of imports of goods and services, the gross official reserves are set to remain relatively flat at 4.7 months from 2012 to 2013 as shown in figure 11 below. However, in the subsequent years, the gross official reserves are projected to decline marginally to 4.6 months and 4.3 months in 2014 and 2015, respectively.

Figure 11: Reserve Assets



***Forecasts**

2.8 CONCLUSION

The world economic growth is projected to continue on its recovery path which started during the third quarter of 2009. Moving forward, the global economy is set to recover gradually in the medium term.

Following impressive growth of 7.4 per cent registered in 2010, economic activity in Lesotho decelerates gradually until it registered 4.0 per cent in 2012 largely due to deterioration in the secondary sector, particularly manufacturing sub-sector, as well as deceleration in the primary sector. In the medium term, economic growth is expected to accelerate marginally and register an average growth rate of 4.9 per cent over the period 2013 – 2014. In 2015, growth decelerated slightly to an average of 4.8 per cent. Growth is set to benefit largely from a relatively strong performance anticipated in the secondary sector. The sector is set to increase from 7.1 per cent in 2013 to 8.5 per cent in 2014 before subsiding to 6.7 per cent in 2015. Building and construction sub-sector is expected to be the mainstay of the secondary sector.

After three years of acceleration, domestic inflation rate is projected to remain fairly stable at an average rate of 5.1 per cent in the medium term. Money supply is projected to continue to increase in 2013 throughout 2014 before subsiding slightly in 2015. The increase in money supply over the period 2013 – 2014 is mainly on account of the increase in NFA (as the central bank accumulates foreign assets) and domestic credit (as financial institutions particularly commercial become aggressive in financing domestic activities).

Government budgetary operations are set to register an average surplus equivalent to 0.6 per cent of GDP over the medium term. The external sector is projected to continue to register surpluses in the next two years. The surplus is set to narrow from 4.9 per cent of GDP in 2012 to 4.5 per cent in 2013 until it reaches 2.3 per cent in 2014. This is mainly on account of a fall in capital and financial inflows from 14.2 per cent of GDP in 2012 to approximately 7.0 per cent of GDP in 2014. Capital and financial inflows are set to decline largely on account of the anticipated winding down of government capital projects such as Metolong and other developments projects which were largely financed through government capital grants and loans. In 2015, the overall balance is projected to register a deficit equivalent to 0.3 per cent of GDP largely at the back of continuous fall in capital and financial inflows.

Following an increase of 17.0 per cent in 2012, the gross international reserves are expected to increase at a relatively lower pace of 11.0 per cent and 6.0 per cent in 2013 and 2014, respectively. In 2015, however, the gross international reserves are set to decline by 1.0 per cent as capital and financial inflows become inadequate to finance current account deficit. In months of imports of goods and services, the gross official reserves are set to remain relatively flat at 4.7 months from 2012 to 2013. However, in the subsequent years, the gross official reserves are projected to decline marginally to 4.6 months and 4.4 months in 2014 and 2015, respectively.

APPENDIX I: STATISTICAL TABLES

Table 1. Real GDP growth rates	2010	2011	2012+	2013*	2014*	2015*
Primary Sector	**17.7**	**7.3**	**6.1**	**3.9**	**2.1**	**4.4**
Agriculture,forestry and fishing	**25.8**	**1.7**	**(0.3)**	**0.9**	**0.3**	**0.9**
Growing of Crops	48.1	(0.7)	(3.9)	2.5	2.5	2.5
Farming of Animals	24.4	0.2	1.0	0.3	0.4	0.4
Services	(8.7)	4.3	3.2	0.2	0.2	0.2
Forestry	4.5	18.1	0.8	0.4	0.4	0.4
Mining and Quarrying	4.8	17.9	16.5	8.1	4.3	8.8
Secondary sector	**9.5**	**(0.5)**	**(1.9)**	**7.1**	**8.5**	**6.7**
Manufacturing	14.0	(7.1)	(3.8)	5.3	3.9	3.1
Food products and beverages	8.6	8.3	0.5	3.9	3.9	3.9
Textiles, clothing, footwear & leather	15.7	(10.4)	(5.8)	6.2	3.9	2.8
Other manufacturing	13.1	(9.4)	(1.4)	3.6	3.6	3.6
Electricity and water	(1.4)	1.8	(0.7)	3.9	3.8	13.7
Electricity	2.1	5.5	0.1	5.4	5.1	5.4
Water	(3.0)	0.0	(1.0)	3.1	3.1	18.1
Building and Construction	5.4	18.6	1.8	13.3	21.4	9.5
Tertiary sector	**4.3**	**6.5**	**5.4**	**4.3**	**4.1**	**4.0**
Wholesale and retail trade, repairs	7.2	6.6	12.3	2.3	4.5	3.6
Restaurants and hotels	2.6	4.2	(1.9)	1.1	1.1	1.1
Transport and Communication	9.1	8.0	11.1	5.7	5.8	5.7
Transport and storage	4.3	3.5	4.6	4.0	4.1	4.1
Post and Telecommunications	12.0	10.5	14.5	6.5	6.5	6.5
Financial intermediation	14.3	10.0	5.5	4.9	4.9	4.9
Real Estate and business services	(1.3)	6.0	7.1	4.0	4.3	4.3
Owner-occupied dwellings	2.8	4.4	5.0	4.1	4.5	4.5
Business services;renting	(10.7)	10.0	12.1	3.8	3.8	3.8
Public Administration	0.5	0.2	(6.4)	6.5	2.0	2.0
Education	5.7	2.6	1.5	1.9	1.9	1.9
Health and Social Work	2.6	47.1	17.1	7.0	7.0	7.0
Community, social and personal services	0.6	3.1	3.2	3.1	3.2	3.2
GDP at factor cost (Unadjusted)	7.4	4.7	3.6	4.9	4.9	4.7
Financial services indirectly measured	18.7	10.7	10.1	4.9	4.9	4.9
GDP at factor cost	7.2	4.6	3.4	4.9	4.9	4.7
Taxes on products	7.8	7.7	8.1	4.9	4.9	4.7
Subsidies on products	2.7	(5.0)	(0.3)	6.2	3.9	2.8
GDP at market prices	**7.3**	**5.0**	**4.0**	**4.9**	**4.9**	**4.8**
GDP at market prices(Excl. Mng & QRyng)	**7.5**	**4.4**	**3.4**	**4.7**	**4.9**	**4.5**

Table 2. GDP by sector 2004 prices	2010	2011	2012+	2013*	2014*	2015*
Primary Sector	**1,344.05**	**1,442.17**	**1,530.50**	**1,590.18**	**1,622.81**	**1,694.82**
Agriculture,forestry and fishing	**877.98**	**892.50**	**890.24**	**898.27**	**900.83**	**909.30**
Growing of Crops	240.91	239.26	229.97	235.72	235.72	241.61
Farming of Animals	522.10	522.89	527.86	529.69	531.81	533.94
Services	39.45	41.14	42.47	42.56	42.64	42.73
Forestry	75.52	89.22	89.94	90.30	90.66	91.02
Mining and Quarrying	466.07	549.67	640.25	691.91	721.98	785.52
Secondary sector	**2,671.08**	**2,657.30**	**2,605.88**	**2,789.64**	**3,025.44**	**3,226.65**
Manufacturing	1,703.66	**1,582.11**	**1,522.01**	**1,602.66**	**1,664.38**	**1,716.37**
Food products and beverages	283.10	306.60	308.25	320.25	332.72	345.68
Textiles, clothing, footwear and leather	1,124.37	1,007.29	949.18	1,008.35	1,047.79	1,076.67
Other manufacturing	296.18	268.22	264.59	274.05	283.86	294.02
Electircity and water	429.72	437.36	434.50	451.32	468.30	532.38
Electricity	138.66	146.24	146.34	154.32	162.18	170.95
Water	291.06	291.12	288.16	297.01	306.12	361.44
WASA	54.57	52.17		-	-	-
LHDA	236.49	238.96		-	-	-
Construction	537.69	637.83	649.37	735.66	892.76	977.90
Tertiary sector	**5,554.72**	**5,918.53**	**6,239.61**	**6,509.14**	**6,772.99**	**7,041.70**
Wholesale and retail trade, repairs	715.24	762.49	856.11	876.01	915.07	948.31
Restaurants and hotels	120.00	125.01	122.58	123.95	125.34	126.74
Transport and Communication	823.55	889.71	988.63	1,044.95	1,105.05	1,168.58
Transport and storage	293.85	304.21	318.33	331.00	344.62	358.63
Post and Telecommunications	529.70	585.51	670.30	713.94	760.43	809.95
Financial intermediation	618.36	680.28	717.57	752.56	789.25	827.74
Real Estate and business services	1,295.90	1,373.20	1,470.14	1,529.06	1,594.88	1,663.87
Owner-occupied dwellings	938.46	980.10	1,029.38	1,071.54	1,119.97	1,170.90
Other real estate	357.43	393.10	440.76	457.52	474.91	492.97
Public Administration	967.07	969.07	907.37	966.61	986.35	1,006.11
Education	735.80	754.75	766.04	780.43	795.35	810.77
Health and Social Work	174.19	256.18	299.89	320.80	343.28	367.44
Community, social and personal services	104.62	107.83	111.28	114.77	118.41	122.14
GDP at factor cost (Unadjusted)	**9,569.84**	**10,017.99**	**10,375.99**	**10,888.96**	**11,421.24**	**11,963.18**
Financial services indirectly measured	(193.03)	(213.60)	(235.08)	(246.54)	(258.56)	(271.17)
GDP at factor cost	**9,376.80**	**9,804.39**	**10,140.91**	**10,642.42**	**11,162.67**	**11,692.01**
Indirect taxes on products	1,237.83	1,333.01	1,441.43	1,512.72	1,586.67	1,661.91
Subsidies on products	(120.98)	(114.91)	(114.61)	(121.76)	(126.52)	(130.01)
GDP at market prices	**10,493.65**	**11,022.49**	**11,467.73**	**12,033.38**	**12,622.82**	**13,223.91**

+Estimates; * Projection

Table 3: GDP AT CURRENT PRICES						
Table 3. GDP current prices	**2010**	**2011+**	**2012***	**2013***	**2014***	**2015***
Primary Sector	**2324.95**	**3204.63**	**2,896.04**	**3,385.62**	**3,938**	**4,124**
Agriculture,forestry and fishing	**1,386.69**	**1,522.24**	**1,659.07**	**1,782.57**	**1,914.20**	**2,048.01**
Growing of Crops	378.81	443.90	489.45	533.80	581.61	631.33
Farming of Animals	830.13	873.70	956.46	1,021.21	1,089.89	1,158.81
Services	67.47	70.10	72.43	77.22	82.25	87.28
Forestry	110.29	134.54	140.73	150.33	160.44	170.59
Mining and Quarrying	938.26	1,682.39	1,236.96	1,603.05	2,023.57	2,075.80
Secondary sector	**3,362.48**	**3,759.52**	**4,038.15**	**4,602.72**	**5,288.55**	**5,897.43**
Manufacturing	1,929.61	2,032.44	2,104.52	2,434.81	2,667.37	2,786.27
Food products and beverages	407.46	472.73	516.37	570.81	630.40	693.60
Textiles, clothing, footwear and leather	1,132.83	1,161.28	1,161.78	1,394.11	1,519.60	1,525.18
Other manufacturing	389.32	398.43	426.37	469.89	517.36	567.49
Electricity and water	655.71	759.09	825.76	907.52	995.28	1,225.13
Electricity	117.12	126.59	121.67	135.37	149.29	167.34
Water	538.59	632.50	704.10	772.15	845.99	1,057.79
Building and Construction	777.16	967.99	1,107.87	1,260.38	1,625.89	1,886.04
Metolong Dam	1.00	206.59		151.50	321.83	235.06
Tertiary sector	**8,798.69**	**9,749.34**	**10,949.33**	**12,459.33**	**13,703.66**	**15,048.24**
Wholesale and retail trade, repairs	1,143.50	1,327.04	1,611.37	1,754.35	1,948.02	2,137.89
Restaurants and hotels	182.27	202.41	179.31	190.78	202.80	214.77
Transport and Communication	982.51	1,085.27	1,225.20	1,374.20	1,540.92	1,721.25
Transport and storage	441.24	468.04	531.08	587.56	650.28	716.64
Post and Telecommunications	541.27	617.23	694.13	786.64	890.64	1,004.61
Financial intermediation	944.05	995.42	1,388.52	1,549.42	1,727.34	1,918.45
Real Estate and business services	1,858.55	2,067.26	2,330.29	2,578.87	2,859.57	3,159.53
Real estate	1,356.49	1,487.40	1,657.61	1,835.92	2,039.80	2,258.39
Business services;renting	502.06	579.86	672.68	742.94	819.77	901.14
Public Administration	1,767.29	1,789.99	1,804.42	2,368.57	2,527.06	2,728.92
Education	1,473.13	1,695.28	1,714.11	1,858.08	2,012.89	2,172.99
Health and Social Work	291.92	422.08	518.67	590.35	671.51	761.16
Community, social and personal services	155.45	164.59	177.44	194.71	213.54	233.27
GDP at factor cost (Unadjusted)	**14,486.12**	**16,713.50**	**17,883.52**	**20,447.66**	**22,929.97**	**25,069.47**
Financial services indirectly measured	(297.18)	(304.45)	(660.71)	(737.28)	(821.94)	(912.88)
GDP at factor cost	**14,188.95**	**16,409.05**	**17,222.80**	**19,710.39**	**22,108.03**	**24,156.59**
Taxes on products	1,771.66	2,015.95	2,023.17	2,259.11	2,518.83	2,793.93
Subsidies on products	-	-	-	-	-	-
GDP at market prices	**15,960.60**	**18,425.00**	**19,245.97**	**21,969.49**	**24,626.86**	**26,950.52**

Table 4. Expenditure on Gross Domestic Product (GDP)									
Current Prices - Million Maloti	**2007**	**2008**	**2009**	**2010**	**2011+**	**2012+**	**2013***	**2014***	**2015***
Final Government Consumption Expenditure	***4,017.10***	***4,958.98***	***5,746.57***	***6,085.07***	***6,075.50***	***7,659.10***	***8,888.44***	***9,620.43***	***10,291.52***
Central government	3,510.59	4,363.33	5,129.67	5,355.24	5,311.73	6,789.91	7,876.88	8,499.54	9,055.49
Final Private Consumption Expenditure	***11,895.28***	***13,808.41***	***14,915.28***	***16,282.45***	***17,787.89***	***18,470.82***	***20,381.53***	***22,095.69***	***23,587.29***
Gross Fixed Capital Formation	***2,471.42***	***3,756.05***	***3,920.47***	***4,388.83***	***4,863.80***	***6,391.05***	***6,807.65***	***7,377.77***	***8,008.55***
Private	***1,979.16***	***2,576.61***	***2,257.56***	***2,358.76***	***2,895.26***	***4,211.35***	***4,759.55***	***5,362.78***	***6,047.62***
Government excl. LHDA	492.25	1,179.43	1,662.90	2,030.08	1,968.54	2,179.69	2,048.09	2,014.98	1,960.93
Changes in inventories	*253.44*	*(35.60)*	*18.78*	*379.31*	*(81.73)*	-	-	-	-
Gross Domestic Expenditure	***18,637.24***	***22,487.83***	***24,601.11***	***27,135.66***	***28,645.47***	***32,520.96***	***36,077.61***	***39,093.88***	***41,887.35***
Exports of goods and Services	***5,863.67***	***7,546.79***	***6,632.22***	***6,741.43***	***8,824.61***	***8,559.08***	***10,150.36***	***11,707.77***	***12,737.95***
Diamonds	1,124.71	1,544.60	1,378.20	1,328.77	2,621.66	2,488.96	3,056.13	3,820.96	3,925.93
Textiles, clothing, footwear	3,275.47	3,780.18	3,125.23	3,146.54	3,517.56	3,410.19	4,281.14	4,666.50	4,683.63
Water	295.80	326.82	333.37	463.57	568.43	631.10	657.02	773.32	861.82
Other	1,167.69	1,895.19	1,795.42	1,802.55	2,116.96	2,028.83	2,156.06	2,446.98	3,266.57
Less Imports of Goods and services	***13,280.98***	***16,237.01***	***16,347.76***	***17,627.09***	***19,002.50***	***21,834.07***	***24,258.47***	***26,174.79***	***27,674.78***
Expenditure on GDP	***11,219.93***	***13,797.62***	***14,885.57***	***16,249.99***	***18,467.58***	***19,245.97***	***21,969.49***	***24,626.86***	***26,950.52***
Discrepancy	*34.94*	*(326.31)*	*(406.08)*	*(289.39)*	*(42.58)*	*0.00*	*0.00*	*0.00*	*0.00*
GDP at market prices	***11,254.86***	***13,471.31***	***14,479.49***	***15,960.60***	***18,425.00***	***19,245.97***	***21,969.49***	***24,626.86***	***26,950.52***

+Estimates; * Projections

Table 5. Income and Outlay Account									
	2007	2008	2009	2010	2011+	2012+	2013*	2014*	2015*
GDP at market prices	**11,254.86**	**13,471.31**	**14,479.49**	**15,960.60**	**18,425.00**	**19,245.97**	**21,969.49**	**24,626.86**	**26,950.52**
Factor income from abroad, net	2,980.21	3,301.20	3,383.93	3,062.85	4,624.03	4,378.44	4,725.17	5,023.55	5,329.47
Receivable from the rest of the world	5,559.65	6,114.81	5,849.89	5,440.62	5,263.64	5,064.71	5,400.23	5,698.61	6,004.53
Payable to rest of the world	(2,579.43)	(2,813.60)	(2,465.96)	(2,377.77)	(639.60)	(686.26)	(675.06)	(675.06)	(675.06)
GNI	**14,235.08**	**16,772.51**	**17,863.43**	**19,023.45**	**23,049.04**	**23,624.41**	**26,694.66**	**29,650.40**	**32,279.99**
Transfers from abroad,net	5,100.75	5,743.93	6,150.73	4,916.73	4,554.37	7,133.32	8,139.49	8,168.40	8,215.22
Receivable from the rest of the world	5,212.83	5,861.95	6,274.35	5,044.50	4,683.75	7,211.10	8,216.71	8,239.96	8,291.51
Payable to rest of the world	(112.08)	(118.03)	(123.62)	(127.77)	(129.38)	(77.78)	(77.22)	(71.56)	(76.29)
National Disposable Income	**19,335.83**	**22,516.44**	**24,014.16**	**23,940.18**	**27,603.41**	**30,757.73**	**34,834.15**	**37,818.80**	**40,495.21**
Consumption	15,912.38	18,767.39	20,661.86	22,367.51	23,863.39	26,129.91	29,269.96	31,716.11	33,878.81
Savings	3,423.45	3,749.05	3,352.30	1,572.67	3,740.02	4,627.82	5,564.19	6,102.69	6,616.40
Of which Government Savings	2,444.86	1,823.76	1,393.76	605.49	7.45	2,371.18	2,433.54	2,588.14	2,630.85
Of which Private Savings	978.59	1,925.29	1,958.54	967.17	3,732.57	2,256.64	3,130.65	3,514.55	3,985.56
National Disposable Income	**19,335.83**	**22,516.44**	**24,014.16**	**23,940.18**	**27,603.41**	**30,757.73**	**34,834.15**	**37,818.80**	**40,495.21**
National Savings(% of GNI)	24.05	22.35	18.77	8.27	16.23	19.59	20.84	20.58	20.50
of which government savings	17.17	10.87	7.80	3.18	0.03	10.04	9.12	8.73	8.15
of which private savings	6.87	11.48	10.96	5.08	16.19	9.55	11.73	11.85	12.35
Consumption (% of GNI)	111.78	111.89	115.67	117.58	103.53	110.61	109.65	106.97	104.95

+Estimates; * Projections

Table 6: Government Financial Statistics (In Million Maloti)									
	2007	2008	2009	2010	2011	2012+	2013*	2014*	2015*
Revenue	***7,901.7***	***8,377.5***	***9,377.0***	***8,804.9***	***9,221.2***	***12,624.4***	***13,735.4***	***14,512.0***	***15,503.9***
1. Tax revenue	***2,260.67***	***2,653.92***	***2,999.80***	***3,292.15***	***4,015.03***	***4,681.57***	***5,235.23***	***6,451.86***	***7,473.25***
1.1. Taxes on income, profits, and capital gains	*1,147.68*	*1,409.83*	*1,765.22*	*1,867.73*	*2,133.01*	*2,566.59*	*2,767.96*	*3,590.67*	*4,265.06*
1.4. Taxes on goods and services	*941.92*	*1,042.42*	*1,142.64*	*1,341.43*	*1,459.67*	*1,842.82*	*1,997.82*	*2,358.18*	*2,586.01*
O/W Value-added tax	*821.12*	*945.74*	*1,008.55*	*1,203.95*	*1,287.25*	*1,624.02*	*1,788.28*	*2,087.63*	*2,291.11*
2. Social Contributions	***.0***	***.0***	***.0***	***.0***	***.0***	***.0***	***.0***	***.0***	***.0***
3. Grants	***285.61***	***461.82***	***590.45***	***881.88***	***1,605.61***	***1,700.62***	***1,394.90***	***904.71***	***872.56***
3.1.2. Capital	*285.61*	*393.62*	*590.45*	*783.91*	*1,041.60*	*1,504.22*	*1,178.99*	*823.71*	*763.88*
4. Other revenue	***590.59***	***627.22***	***873.07***	***1,313.82***	***995.67***	***1,079.31***	***1,072.79***	***1,242.53***	***1,335.77***
SACU	***4,764.87***	***4,634.53***	***4,913.69***	***3,317.01***	***2,604.89***	***5,162.91***	***6,032.49***	***5,912.91***	***5,822.30***
Expense	***-5,321.4***	***-6,339.1***	***-7,617.6***	***-7,776.2***	***-8,354.0***	***-8,930.2***	***-10,161.8***	***-11,100.2***	***-12,109.1***
1. Compensation of Employees	***-1,798.56***	***-2,208.43***	***-3,015.77***	***-2,987.02***	***-3,591.77***	***-3,753.27***	***-4,615.89***	***-5,005.53***	***-5,418.37***
2. Use of goods and services	***-1,684.23***	***-2,226.52***	***-2,307.95***	***-2,321.63***	***-1,908.67***	***-2,493.21***	***-2,757.43***	***-3,189.47***	***-3,562.07***
4. Interest Payments	***-522.25***	***-136.21***	***-119.26***	***-108.26***	***-134.63***	***-156.69***	***-218.02***	***-228.23***	***-221.50***
4.1. Nonresidents	*-455.40*	*-66.73*	*-58.50*	*-57.90*	*-63.26*	*-74.55*	*-93.52*	*-97.27*	*-91.64*
5. Subsidies	***.0***	***-148.53***	***-247.36***	***-247.66***	***-233.22***	***-249.84***	***-239.07***	***-238.93***	***-245.81***
6. Grants	***-742.74***	***-868.84***	***-888.92***	***-863.01***	***-960.18***	***-859.16***	***-779.47***	***-845.90***	***-924.69***
7. Social benfits	***-204.50***	***-230.56***	***-531.70***	***-519.90***	***-596.26***	***-593.50***	***-755.28***	***-730.71***	***-754.94***
8. Other expense	***-369.14***	***-520.02***	***-506.62***	***-728.75***	***-929.27***	***-824.51***	***-796.64***	***-861.39***	***-981.75***
Transactions in Nonfinancial Assets	***-492.3***	***-1,179.4***	***-1,663.9***	***-2,031.1***	***-1,916.6***	***-3,612.7***	***-3,394.5***	***-3,339.7***	***-3,250.1***
Net lending/borrowing	***2,088.0***	***859.0***	***95.5***	***-1,002.5***	***-1,049.4***	***81.6***	***179.1***	***72.2***	***144.7***
Transactions in Fin. assets & Liabilities (Financing)	***-1,724.7***	***-528.0***	***-730.7***	***-739.1***	***-1,203.5***	***69.6***	***355.2***	***72.2***	***144.7***
3.2. Financial assets	***-1,783.1***	***-805.6***	***264.5***	***-774.4***	***-808.8***	***910.1***	***717.5***	***665.3***	***406.1***
3.2.1. Domestic	***-1,781.80***	***-804.29***	***268.09***	***-774.44***	***-808.81***	***910.08***	***717.47***	***665.34***	***406.06***
3.2.1.2. Deposits	*-1,792.50*	*-809.44*	*268.07*	*-774.44*	*-808.81*	*910.08*	*717.47*	*665.34*	*406.06*
3.2.1.2.1 Central Bank	*-1,760.81*	*-770.16*	*100.78*	*-771.93*	*-806.56*	*930.11*	*718.13*	*665.34*	*406.06*
3.3. Liabilities	***58***	***278***	***-995***	***35***	***395***	***841***	***362***	***593***	***261***
3.3.2. Foreign	***96.54***	***147.32***	***71.70***	***174.60***	***63.68***	***520.77***	***381.40***	***593.17***	***261.40***
3.3.2.4. Loans	*96.54*	*147.32*	*71.70*	*174.60*	*63.68*	*520.77*	*381.40*	*593.17*	*261.40*
Statistical Discrepancy	***363.3***	***330.9***	***-635.2***	***-263.4***	***154.1***	***11.9***	***-176.1***	***-0.0***	***-0.0***

+Estimates; * Projections

Table 7. Depository Corporation Survey (In Million Maloti)									
	2007	2008	2009	2010	2011	2012	2013*	2014*	2015*
NET FOREIGN ASSETS	***8,363.07***	***11,285.62***	***10,651.58***	***9,942.80***	***9,905.65***	***10,210.57***	***10,506.43***	***10,789.14***	***10,573.61***
COMMERCIAL BANKS (CBs)	***2,185.76***	***3,034.05***	***2,986.69***	***3,799.95***	***3,209.50***	***2,486.70***	***2,062.94***	***1,765.35***	***1,639.18***
CENTRAL BANKS (CBL)	***6,177.31***	***8,251.57***	***7,664.89***	***6,142.86***	***6,696.15***	***7,723.87***	***8,443.49***	***9,023.79***	***8,934.43***
NET DOMESTIC ASSETS	***(4,283.96)***	***(6,263.59)***	***(4,907.56)***	***(3,367.99)***	***(3,246.01)***	***(3,061.89)***	***(2,724.58)***	***(2,170.23)***	***(1,198.76)***
NET DOMESTIC CREDIT	***(2,065.51)***	***(2,443.75)***	***(2,136.21)***	***(1,000.82)***	***106.99***	***639.67***	***657.74***	***899.16***	***1,581.21***
NET CLAIMS ON CENTRAL GOVERNMENT (CG)	*(3,324.33)*	*(3,950.73)*	*(3,996.00)*	*(3,197.63)*	*(2,592.65)*	*(3,148.94)*	*(3,875.90)*	*(4,541.24)*	*(4,947.30)*
by Central Bank	*(3,728.82)*	*(4,232.60)*	*(4,353.35)*	*(3,639.68)*	*(3,292.81)*	*(3,986.06)*	*(4,539.33)*	*(5,204.67)*	*(5,610.73)*
CLAIMS ON OTHER SECTORS	***1,258.82***	***1,506.98***	***1,859.79***	***2,196.81***	***2,699.64***	***3,788.61***	***4,533.64***	***5,440.40***	***6,528.51***
Claims on private sector	*1,207.35*	*1,463.15*	*1,859.79*	*2,193.83*	*2,687.00*	*3,778.16*	*4,533.79*	*5,440.55*	*6,528.66*
by Commercial Banks	1185.16	1437.04	1832.758	2,166.75	2654.37	3,735.90	4,556.26	5,556.77	6,776.97
Claims on public nonfinancial corporations	*51.47*	*43.83*	*0.00*	*2.98*	*1.37*	*-0.15*	*-0.15*	*-0.15*	*-0.15*
Claims on other financial corporations	*-*	*-*	*-*	*-*	*11.27*	*10.60*	*-*	*-*	*-*
Claims on state and local governments	*-*	*-*	*-*	*-*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
OTHER ITEMS NET & CAPITAL ACCOUNTS	***2,218.45***	***3,819.83***	***2,771.34***	***2,367.17***	***3,352.99***	***3,701.55***	***3,382.32***	***3,069.39***	***2,779.97***
CAPITAL ACCOUNTS	2,375.50	3,628.66	2,383.88	2,120.72	3,032.96	3,610.03	3,290.80	2,977.86	2,688.45
Capital accounts - CBL	*1,962.43*	*3,149.37*	*1,752.19*	*1,407.13*	*2,217.68*	*2,655.04*	*2,335.81*	*2,022.87*	*1,733.46*
Capital accounts - CBs	*413.07*	*479.28*	*631.69*	*713.59*	*815.27*	*954.99*	*954.99*	*954.99*	*954.99*
OTHER ITEMS NET	*(157.06)*	*191.18*	*387.46*	*246.45*	*320.04*	*91.52*	*91.52*	*91.52*	*91.52*
MONEY SUPPLY (M2)	***4079.11***	***5,022.04***	***5,744.03***	***6,574.81***	***6,659.65***	***7,148.68***	***7,781.85***	***8,618.91***	***9,374.85***
NARROW MONEY (M1)	*2,988.33*	*3,879.37*	*4,176.40*	*4,985.99*	*2,801.07*	*3,476.25*	*3,968.18*	*4,448.16*	*4,867.86*
OTHER DEPOSITS	*1,090.79*	*1,142.67*	*1,567.63*	*1,588.82*	*3,858.58*	*3,672.43*	*3,813.68*	*4,170.75*	*4,506.99*
Nominal GDP	***11,254.86***	***13,471.31***	***14,479.49***	***15,960.60***	***18,425.00***	***19,245.97***	***21,969.49***	***24,626.86***	***26,950.52***
Velocity of Money	***2.76***	***2.68***	***2.52***	***2.43***	***2.77***	***2.69***	***2.82***	***2.86***	***2.87***
M1/GDP	***0.27***	***0.29***	***0.29***	***0.31***	***0.15***	***0.18***	***0.18***	***0.18***	***0.18***

+Estimates; * Projections

Table 8	EXTERNAL SECTOR ACCOUNTS					
	2010	2011	2012+	2013*	2014*	2015*
I. CURRENT ACCOUNT	**(1,102.01)**	**(575.13)**	**(1,798.39)**	**(1,027.55)**	**(1,194.07)**	**(1,283.47)**
Goods and services, net	**(10,921.26)**	**(10,215.40)**	**(13,506.54)**	**(14,108.12)**	**(14,467.02)**	**(14,936.83)**
a) GOODS, net	**(8,003.00)**	**(7,124.29)**	**(10,331.65)**	**(10,829.70)**	**(11,094.82)**	**(11,743.15)**
Merchandise, exports	6,392.68	8,457.40	7,999.13	9,573.80	11,098.46	11,891.89
Agriculture	50.04	35.06	30.79	32.05	33.37	74.00
Diamonds	1,328.77	2,621.66	2,488.96	3,056.13	3,820.96	3,925.93
Textiles	3,146.54	3,517.56	3,410.19	4,281.14	4,666.50	4,683.63
Water distribution	463.57	568.43	631.10	657.02	773.32	861.82
Merchandise, imports	(14,395.68)	(15,581.69)	(18,330.78)	(20,403.50)	(22,193.28)	(23,635.05)
b) SERVICES, net	**(2,918.26)**	**(3,091.12)**	**(3,174.90)**	**(3,278.42)**	**(3,372.20)**	**(3,193.68)**
Transportation, net	(473.17)	(515.88)	(700.24)	(744.73)	(791.30)	(837.62)
Travel, net	(1,795.87)	(1,892.68)	(1,654.86)	(1,655.80)	(1,644.72)	(1,474.31)
Business services, net	(243.38)	(361.57)	(411.15)	(437.47)	(465.03)	(461.97)
Government services, net	(240.58)	(157.86)	(216.02)	(229.85)	(244.33)	(241.95)
Other services, net	0.93	0.98	1.04	1.11	1.17	51.24
c) INCOME, net	**4,826.95**	**4,624.03**	**4,378.44**	**4,725.17**	**5,023.55**	**5,329.47**
Compensation of employees, credit	4,417.26	4,647.76	4,496.18	4,761.45	5,037.62	5,309.65
Investment income, net	(108.41)	(170.36)	(283.47)	(202.02)	(179.81)	(145.92)
d) CURRENT TRANSFERS	**4,992.31**	**5,016.24**	**7,329.72**	**8,355.40**	**8,249.40**	**8,323.89**
Government, net	3,810.64	3,723.09	5,981.72	6,921.36	6,725.25	6,710.07
Rand compensation, credit	127.66	124.14	125.07	133.07	141.46	149.80
SACU, net	3,230.75	2,518.39	5,076.27	5,945.49	5,825.91	5,735.30
Budget Suport	97.97	564.00	196.40	215.92	81.00	108.68
Other sectors, net	1,181.67	1,293.15	1,348.00	1,434.04	1,524.15	1,613.82
II. CAPITAL AND FINANCIAL ACCOUNT	**(701.69)**	**1,076.66**	**2,739.11**	**1,997.17**	**1,724.37**	**1,144.11**
e) CAPITAL ACCOUNT	**642.36**	**844.56**	**1,274.01**	**934.04**	**563.33**	**488.14**
Government: Grants in budget, credit	783.91	1,041.60	1,504.22	1,178.99	823.71	763.88
f) FINANCIAL ACCOUNT	**(1,344.05)**	**232.10**	**1,465.10**	**1,063.13**	**1,161.04**	**655.96**
Direct investment in Lesotho, net	69.53	69.54	71.46	152.54	152.54	152.54
Other assets	(1,155.46)	140.75	884.88	420.99	309.06	138.54
Other liabilities	(243.07)	37.42	525.03	506.04	715.28	380.93
III. TRANSACTION BALANCES	**(1,803.70)**	**501.53**	**940.73**	**969.62**	**530.30**	**(139.36)**
IV. ERRORS AND OMISSIONS	**855.60**	**(629.68)**	**(139.77)**	**-**	**-**	**-**
V. RESERVE ASSETS	**1,211.38**	**(588.75)**	**(1,221.23)**	**(969.62)**	**(530.30)**	**139.36**
VI. VALUATION ADJUSTMENT	**(263.28)**	**716.90**	**420.27**	**-**	**-**	**-**
MEMO ITEMS						
Gross Reserves (Milion Maloti)	**7133.92**	**7350.63**	**8571.86**	**9,541**	**10,072**	**9,932**
Imports of goods and services	**17,662.69**	**19,040.01**	**22,065.63**	**24,258.47**	**26,174.79**	**27,674.78**
Gross Reserves (Months of imports cover)	**4.85**	**4.63**	**4.66**	**4.72**	**4.63**	**4.31**

+Estimates; * Projections

APPENDIX II: FORECASTING ASSUMPTIONS

The domestic GDP projections for the period 2013 – 2015 are based on the following assumptions about the various sectors.

1. GDP by activities:

Primary Sector

- The crops sub-sector is set to experience a fairly stable growth over the medium term. The basis for the growth forecasts includes the projected intercensal population growth over the medium term. We also assume that government initiatives in the form of subsidies and others are set to boost domestic agriculture. Nevertheless, the expected fall in available arable land and difficulties in farmers' access to credit from financial institutions are expected to exert a downward pressure on the performance of the crops sub-sector.
- The farming of animals and forestry sub-sectors are based on inter-census growth rate of 0.4 percent with the CPI used as a proxy for deflator. These series reveal no apparent trend. Besides, they are not statistically significant. *In addition, although this may not be the best method to project time series data, better methodologies are yet to be proposed in this regard.*
- Projections for agriculture services are based on the moving average over the past five years.
- The mining sub-sector is projected on the basis of the respective corporate plans of individual mines. The sub-sector is set to realise a positive growth, though at a lower pace compared to the pick periods (2006 – 2009). In dollar terms, diamond prices are expected to continue to increase in 2013 throughout 2014, with a slight decline expected in 2015. Due to the expected increase in the Loti price of US dollar (expected depreciation of the local currency against the US dollar), in Maloti terms, diamond prices are expected to increase substantially in 2013 and 2014. In 2015, the expected appreciation of the local currency is set to exert a downward pressure on Loti price of diamonds. Letseng diamond mine is expected to remain the main contributor to the sector.

Secondary Sector

- *Textiles and clothing* is based on information acquired during discussion meetings with Lesotho Textiles and Clothing Association as well as information provided by LNDC. Favourable exchange rate is expected to boost the confidence of the industry over the next two years. Nevertheless, potential loss of preferential provisions (esp. uncertainty surrounding the renewal of AGOA beyond 2015) in 2015, increasing cost of operating inputs such as electricity and water are expected to exert downward pressure on the sector. In real terms, exports to the US are assumed to remain constant over the next two years with potential fall expected in the year 2015. Other textiles and clothing markets (particularly

SACU market) are assumed to increase in line with the average growth rates observed over the past five years.

- The basis for other manufacturing forecasts is logarithmic trend line while food products and beverages is based on log linear trend over the past ten years in line with the observed trend over the past ten years. Other manufacturing sub-sector is expected to continue to grow as LNDC intensify efforts to diversify from textiles and clothing products.
- *Electricity and water productions* are projected on the basis of the respective corporate plans as informed by continued implementation of projects geared towards extending service provision by both the Lesotho Electricity Company and the Water and Sewage Corporation.
- *Building and Construction sub-sector* is based on the forecast of capital projects expenditures provided Ministry of Public Works and Transport. The sub-sector is also expected to benefit from the on-going construction of Metolong dam and its related project; the information of which is provided by the Authority.

Tertiary Sector

- Wholesale and retail trade repair sub-sector is assumed to increase in line with Value Added Tax in the Government Financial Statistics. A simple trend analysis suggests that, on average, the two increases at the same rate over the last decade.
- Restaurants and hotels sub-sector is based on logarithmic trend line in line with the observed trend over the past decade.
- Transport and storage is based on moving average of the past five years in line with the observed trend while post and telecommunications is based on logarithmic trend line in line with the observed trend over the past decade.
- Financial intermediation is also based on logarithmic trend line in line with the observed trend over the past decade.
- Real estate and business services are based on moving average of the past five years in line with the observed trend.
- Public administration is based on the growth rate of compensation of employees in the fiscal account. To derive the constant growth, the current estimates are deflated by the increase in wage indexation (including inflation adjustment) and notch increase (from the ministry of Finance).
- Education and health sub-sectors are based on expected wage indexation (including inflation adjustment), notch increase (the information of which comes from the ministry of Finance) as well as the projected population.
- The basis for indirect taxes is the moving average of the proportions of indirect taxes in GDP at factor cost (implicit indirect tax rate) over the previous year. Subsidies are based on the growth rate of textiles and clothing sector.

2. Production Account – GDP by expenditure

Private Consumption

- Private consumption is based on the estimated structural equation. See appendix III below.

Government Consumption

- Government consumption is based on the growth rates of ***recurrent expenditures*** – compensation of employees and goods and services.

Gross Fixed Capital Formation

- Gross Fixed Capital Formation by government is assumed to grow in line with capital expenditure.
- Private sector gross fixed capital formation is based on logarithmic trend equation in line with the observed trend over the past decade. Please note that efforts are in the process to find ways to estimate this item though the use of structural equation.
- Changes in stock are assumed to be zero.

Imports of goods and services

- *Imports of goods and services* are based on the estimated structural equation. See appendix III below.

Exports are derived from BOP forecasts as informed by individual forecasts.

3. Government Financial Statistics

The basis for government financial statistics is MTFF provided by the Ministry of Finance, however adjusted by the budget execution rate based on the past information. On average, the revenue side and compensation of employees are projected fairly accurate by the Ministry of Finance. Nevertheless, other expenditures components, particularly use of goods and services and expenditures on non-financial assets are adjusted for the budget execution rate based on the assumption that government have limitations in terms of absorptive capacity.

Total Revenue

SACU

- ***SACU*** revenue is based on SACU council meeting for the financial year 2013/14; for the remaining years, it is based on projections from Ministry of Finance.

Taxes (income & VAT)

- The basis is LRA's income and VAT targets over the short to medium term discounted for non-achievement of targets. Non-performance ratios are based on actual performance compared with the plan over the past 5 financial years.

Other revenue

- The basis is the forecasts from Ministry of Finance; multiplied by average of the proportions of the actual as a percentage of the budget over the past 5 years.

Total Expenditures

- The basis is the forecasts from Ministry of Finance; multiplied by average of the proportion of the actual as a percentage of the budget – execution rate over the past 5 years.
- It is assumed that compensation of employees is projected fairly accurate by the Ministry of Finance.
- Use of goods and services and expenditures on non-financial assets are adjusted for the budget execution rate of the government over the past five years – approximately 80 – 90 per cent depending on expenditure component.

4. Monetary Survey

Net Foreign Assets

Commercial Banks

- Commercial banks are assumed to continue to reduce their foreign assets in an endeavour to boost domestic credit however at a relatively lower pace compared to the previous years.
- Foreign liabilities are assumed to be constant throughout the projected period.

Central Bank of Lesotho

- Central bank foreign assets are in line with overall balance of payment.
- Foreign liabilities are assumed to be in line with IMF's net loan disbursement (disbursement less repayment) to Lesotho.

Net Domestic Credit

- Private sector credit is based on logarithmic trend equation in line with the observed trend over the past decade. On average, the observed trend over the past ten years suggests that private sector credit increases at an average rate of approximately 22 per cent.
- Net claims on government are assumed to be in line with government deficit financing needs, IMF's net loan disbursement as well as the issuance of debt instruments.

Other items and Capital accounts

- Other items and Capital accounts are assumed to be relatively constant over the projected period.

5. EXTERNAL SECTOR

CURRENT ACCOUNT

Marchandise exports

- Diamonds exports are based on information provided by the respective corporate plans of individual mines.
- Textiles and clothing exports is based on information acquired during discussion meetings with Lesotho Textiles and Clothing Association as well as information provided by LNDC. Favourable exchange rate is expected to boost the confidence of the industry over the next

two years. Nevertheless, potential loss of preferential provisions (esp. uncertainty surrounding the renewal of AGOA beyond 2015) in 2015, increasing cost of operating inputs such as electricity and water are expected to exert downward pressure on the sector.

Marchandise imports

- *Imports of goods and services* are based on the estimated structural equation. See appendix III below.

Current Transfers

- ***SACU*** revenue is in line with development in the fiscal sector.

CAPITAL ACCOUNT

- Government grants are based on IMF projections

The rest of items are based on developments in other sectors of the economy while others are assumed to increase at the rate of inflation while others are based on the average growth over the previous period.

APPENDIX III: ESTIMATING IMPORT DEMAND & PRIVATE CONSUMTION FUNCTIONS IN LESOTHO

1. IMPORT DEMAND FUNCTION

1.1 Literature Review

Trade theory indicates that import demand in an economy depends on income (economic activity) (which can be proxied by aggregate domestic demand) and relative prices of imports – ratio of prices of imported goods and services relative to the prices of locally produced goods and services. The exchange rate variable can also be considered, although it enters the model implicitly through exerting its influence on prices of imported goods. This is in line with Khan (1974), Constant and Yue (2010) and Arize and Afifi (1987). While it is anticipated *a priori* that an increase in domestic income would lead to an increase in total amount of imports demanded by a country, an increase in the relative prices should lead to a decrease in imports.

1.2. Model Specification and Data Description

This brief used quantity of imports and gross domestic expenditure data for the period 1982 to 2011[1], and employed Autoregressive Distributed Lag (ARDL) approach to estimate the change in import demand in Lesotho. ARDL bounds testing procedure proposed by Pesaran, *et.al*. (2001) are used to test for long-run relationship between these variables. After using general specific approach, in which different specifications of the model are estimated, the following optimal ARDL was chosen and the results are presented in the table 1 below:

Table 1

Dependent Variable: DLIM					
Dependent Variable: DLIM					
Method: Least Squares					
Date: 10/29/13 Time: 11:49					
Sample (adjusted): 1983 2011					
Included observations: 29 after adjustments					
Variable		Coefficient	Std. Error	t-Statistic	Prob.
DLGDE		1.13492	0.08682	13.07206	0.0000
LIM(-1)		-0.24666	0.09444	-2.61190	0.0159
LGDE(-1)		0.24341	0.09261	2.62825	0.0154
C		-0.07640	0.05461	-1.39907	0.1757
DUM01		0.12100	0.02323	5.20820	0.0000
DUM02		0.08272	0.02222	3.72306	0.0012
DUM09		-0.06655	0.02238	-2.97431	0.0070

Where LIM is the logarithm of import demand while $LGDE$ is the logarithm of gross domestic expenditure (GDE). The dummy variables; $DUM01$, $DUM02$ and $DUM09$ capture outliers

[1] Note that relative prices variable was not incorporated in the model due to unavailability of such data.

for the years, 2001, 2002 and 2009, respectively and each dummy assumes a values of one during a year in question and zero, otherwise.

As can be observed from table 1 above, all the estimated coefficients in the ECM are statistically significant at all levels of significance and maintained correct signs as anticipated *a priori*. In addition, the model diagnostics for goodness of fit, serial correction, heteroskedasticity, normality and functional form all indicate no misspecification. The figure 2 below shows the plot of both the fitted and actual residuals of the model.

Figure 1

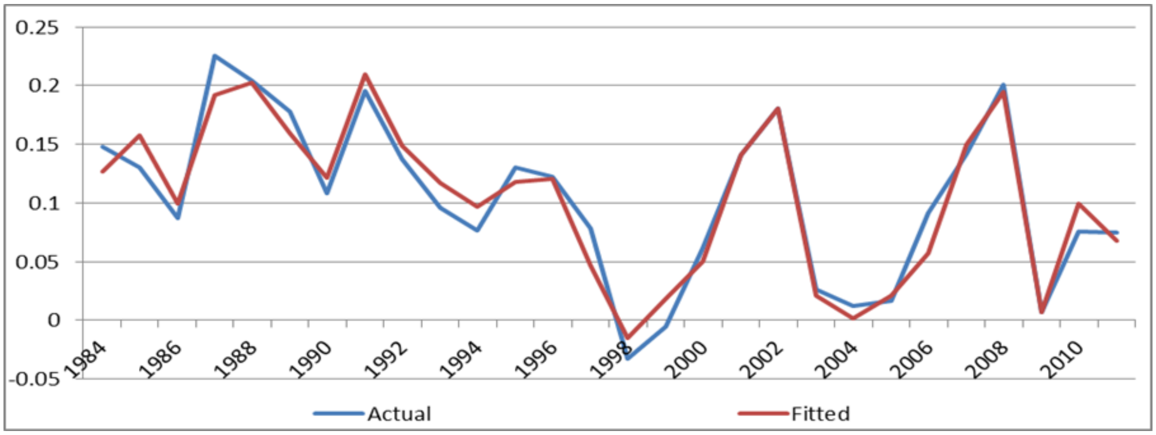


Figure 1 above shows that the estimated model approximates/mimics the actual dynamics of the data. This confirms that the model fit the data well. Since ARDL bounds testing procedure does not require pretesting of the variables for unit root before cointegration can be tested, the paper further used that technique to confirm cointegration between the variables in the model. This involved testing the null hypothesis of no cointegration, $H_0 : \alpha_2 = \alpha_3 = 0$ against the alternative of cointegration, $H_0 : \alpha_2 \neq \alpha_3 \neq 0$. The results of the test confirm cointegration between the variables since the calculated $F_{cal} = 5.013$ was greater than the upper bound[2] at 5 per cent level of significance.

[2] Note the critical bounds were obtained from Nayaran (2005) who revised Perasan,at.al. (2001) bounds statistic to suit small sample properties of the data.

2. PRIVATE CONSUMPTION FUNCTION

2.1 Review of the Literature

Keynes' Absolute Income Hypothesis (AIH) posits that household's consumption expenditure depends on disposable income[3] in that as household's disposable income increases consumption also increases (Keynes, 1939). Following Keynes' conjecture, Life-Cycle Hypothesis (LCH) and Permanent-Income Hypothesis (PIH) introduced opportunity cost variables such as interest rate or inflation rate as additional long-run determinants of consumption (Modigliani and Brumberg, 1954 and Friedman, 1957). In addition to disposable income as a wealth variable, other empirical studies in the literature include household wealth derived as consisting of financial wealth (difference between financial assets and financial liabilities) and housing wealth in the consumption model. The effect of interest rates on consumption can be divided into substitution and income effects. While higher interest rates encourage saving and probably lead to lower demand for loans and hence lead to decrease in final consumption, higher interest rates, on the other hand, generate an increase in the financial wealth of the households, and affect consumption positively. Hence the effect of real interest rate on consumption cannot be determined *a priori*, and therefore will be determined be through estimation. It should be noted that interest rates and inflation rate should not be incorporated simultaneously in the model (Singh, 2004).

2.2. Model Specification and Data Description

This paper estimated the change in private consumption based GDP as proxy for income, average prime based on the following ARDL ECM. After testing different model specifications, the following optimal estimation results presented in table 2 were obtained:

Table 2:

Dependent Variable: DLPCEX				
Method: Least Squares				
Date: 10/17/13 Time: 11:45				
Sample (adjusted): 1983 2011				
Included observations: 29 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DLGDP	0.647368	0.081778	7.818966	0.000000
LPCEX(-1)	-0.368345	0.06201	-6.086664	0.000000
LGDP(-1)	0.268911	0.048086	5.739519	0.000000
PLR_AV(-1)	-0.002734	0.001029	-2.655947	0.014800
DUM8586	-0.038715	0.011474	-3.374283	0.002900
DUM9801	-0.099712	0.010182	-9.793281	0.000000
DUMFCRS	0.046050	0.010423	4.417958	0.000200
C	0.944769	0.123629	7.641942	0.000000

[3] This may consist of compensation of employees, household's property income as well as transfer payments and receipts.

Where $LPCEX$ is the logarithm of private consumption expenditure is, $LGDP$ is the logarithm of gross domestic product (GDP), and PLR_AV denotes the average prime lending rate $DUM8586$, $DUM9801$ are defined as outliers dummy variables for the periods, 1985-1986, 1998 -2001, respectively, and they each take a value one during the period in question and zero, otherwise. In addition, $DUMFCRS$ is the outlier dummy for the financial crisis and assumes a value of one during that period and zero otherwise.

The coefficients of the model are statistically significant and maintained theoretically consistent signs. In addition, the diagnostics for goodness of fit, serial correction, heteroskedasticity and normality and functional form associated with the model indicate no misspecification. The null hypothesis of no cointegration, $H_0 : \alpha_2 = \alpha_3 = 0$ against the alternative of cointegration, $H_0 : \alpha_2 \neq \alpha_3 \neq 0$ was rejected since the calculated $F_{cal} = 28.12$ was by far greater than the upper bound[4] at all levels of significance, confirming the long-run relationship among the variables in the model. The figure 2 below shows the plot of both the fitted and actual residuals of the model.

Figure 1

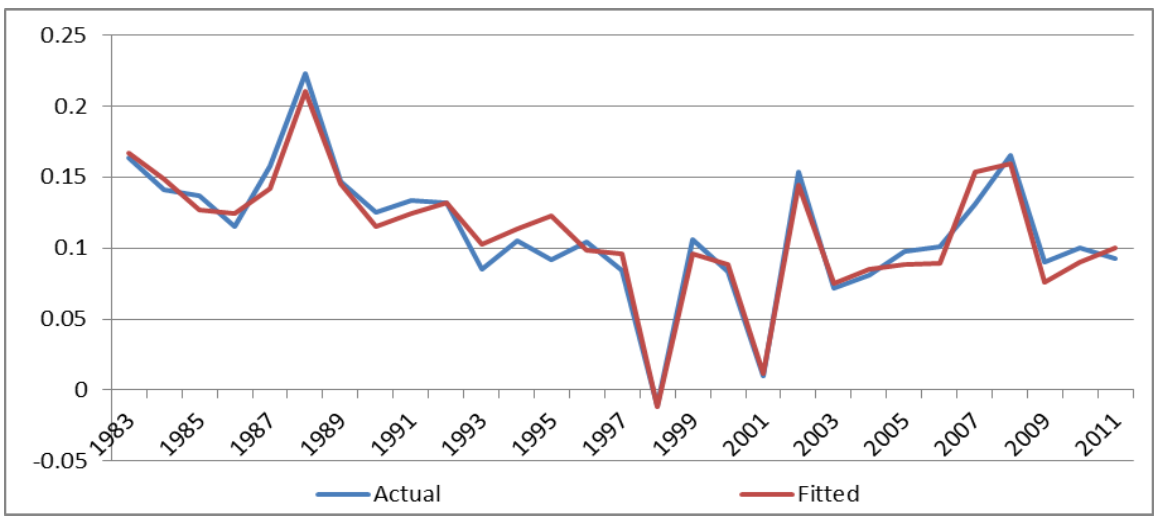


Figure 2 shows that the fitted residuals of the ECM approximate the actual series of the model, implying that the change in private consumption expenditure has been captured well and therefore the model can be used for forecasting.

[4] Note the bounds were obtained from Nayaran(2005) who revised Perasan,at.al(2001) bounds statistic to suit small sample properties of the data.

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