Economic Review February 2009

Lesotho Budget Speech for Fiscal Year 2009/2010: Despite the Ravaging Financial Storms, Lesotho Must Remain Focused on High, Shared and Sustainable Growth and Protecting the Vulnerable

The Honourable Ministry of Finance and Development Planning presented a budget for the 2009/2010 Fiscal year on the 18th February 2009. His key message was that the government should focus on ensuring that the country strives to attain high and shared sustainable growth and protecting the vulnerable……….

Introduction

Budget speech is an annual government policy document that transmits the objectives that a government wants to achieve in almost every country. A budget speech serves the following purposes: firstly, it reviews the government's self performance appraisal on execution of the past year's budget, together with outstanding challenges, and the way forward. Secondly, it acquaints the public with the government's objectives and aspirations for the fiscal year. Lastly, it enables the public to make necessary adjustments so as to benefit from the impact of positive policy decisions or cushion the adverse effect.

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The Setting for the 2009/2010 Budget

The 2009/2010 budget proposals are made at the time when the global economy is entering into a recession, following the global financial crisis that has paralysed the financial systems in developed countries and some emerging market economies. The general belief is that African economies are likely to be affected negatively by the recessionary conditions prevailing in the developed world. Thus, there is a great expectation that fiscal policy will be used to assist economies to curb the negative effects of the recession.

The events in the second half of 2008 have indicated beyond doubt that the economy of Lesotho is likely to be affected negatively by the unfolding economic depression. The manufacturing sector which provides employment to about 45 000 Basotho females is under serious threat as credit from Asian Banks is drying up. In addition, orders from the US, the largest consumer of Lesotho's exports of textiles and clothing are falling, due to low aggregate demand in the US. This led some of manufacturing firms, particularly textiles and clothing, to scale-down their operations and thus retrench employees. Textiles and clothing firms reduced about 4000 workers during the second half of 2008. The manufacturing sub-sector is estimated to contribute around 15 per cent to Gross Domestic Product (GDP) in 2008 and accounts for 50 per cent of the total employment in Lesotho. The situation is worsening as it becomes clear that the US economy is not likely to turn around in 2009.

The mining sector which has grown in significance in recent years has seen two mines suspending their operations during the second half of 2008, due to credit unavailability and low prices of rough diamonds. The prices of rough diamonds are reported to have declined by 50 to 65 per cent. This is likely to have a two pronged effect on the economy of Lesotho. Firstly, it is likely to contribute to low economic growth. This sector was estimated to account for about 7 per cent of GDP in 2007. Secondly, the balance of payments position of Lesotho is also likely to weaken as exports of diamonds fall. The impact on employment is expected to be minimum because the sector is more capital intensive.

The global economic slowdown is affecting the South African (SA) mining industry negatively, particularly gold and platinum mines where a large number of Basotho men are employed. Due to a decline in commodity prices such as gold and platinum, SA mining sector suspended some of their operations, and thus reduced labour force. As a result, the number of Basotho migrant mineworkers has already started declining as was seen in the fourth quarter of 2008 where an annual fall of 1.4 per cent was recorded. Mineworkers' remittances have declined and expected to continue declining which could worsen poverty in Lesotho.

The South African economy which is highly integrated with Lesotho's economy, due to trade and finance links, is also showing signs of a recession. This has implications for customs receipts collected by SACU. While it is expected that the elimination of tariffs, due to a number of trade agreements being signed with other regions, will affect SACU revenue pool negatively in the long run, the contraction of trade in response to the economic slump has immediate negative impact. It is noteworthy that the SACU revenue finances about 60 per cent of Lesotho's budget, therefore reduction in SACU revenue will undermine the Government's efforts to accelerate economic growth and poverty reduction.

Budget Outturn for 2008/2009

The projected outturn for the fiscal year 2008/2009 indicated the overall surplus, after grants, equivalent to 5.4 per cent of Gross Domestic Products (GDP), compared with a budgeted overall deficit of 2.8 per cent of GDP. The surplus was driven mainly by tax revenue, which was higher than expected, and low expenditure and net lending. Total expenditure including net lending is projected to be at 54.8 per cent of GDP, compared to the approved budget of 64.7 per cent of GDP for 2008/2009. The expected low performance is a result of poor performance in both recurrent and capital expenditures. Recurrent expenditure is projected to record 44.1 per cent of GDP compared with the budgeted 49.5 per cent of GDP, and capital expenditure was projected at 10.8 per cent of GDP compared with the budgeted 15.3 per cent of GDP. The under spending of budget particularly capital expenditure has implications on the future economic growth prospects. It is in this regard that the Honourable Minister of Finance and Development Planning pointed out that there was progress in expediting the capital budget implementation. During the fiscal year 2008/2009 implementation rate is estimated at 70 per cent.

Total revenue and grants is projected at 60.1 per cent of GDP compared with the budgeted 61.9 per cent of GDP mainly due to lower than expected grants. It is projected that less than half of the budgeted grants would be disbursed during the fiscal year. Tax revenue is projected to be high due mainly to higher than expected income taxes. The projected revenue resulted from income tax component which was higher than budgeted by 41.9 per cent. Furthermore, oil levy collection is estimated to improve more than budgeted for by 30.0 per cent.

The projected overall surplus is expected to build government deposits with the banking system and to reduce the foreign borrowings. Cognisant of the eminent decline in the customs revenue and the recurring drought conditions in the country, it is crucial that the government keeps more reserves to be used during difficult times.

Table 1: Government Budgetary Operations (Million Maloti; Per cent of GDP)

Budget Items	Approved 2008/2009 Budget		Projected Outturn for 2008/2009		Proposed 2009/2010 Budget	
	Amt	%	Amt	%	Amt	%
Revenue and Grants	**8696.5**	**61.9**	**8453.0**	**60.1**	**9942.3**	**62.3**
Revenue	8006.0	57.0	8147.0	58.0	8863.8	55.6
Grants	690.5	4.9	306.0	2.2	1078.5	6.8
Expenditure & Net lending	**9095.9**	**64.7**	**7697.1**	**54.8**	**11632.3**	**72.9**
Recurrent Expenditure	6956.7	49.5	6193.0	44.1	8236.6	51.6
Capital Expenditure	2157.1	15.3	1514.1	10.8	3414.5	21.4
Net lending	-17.9	-0.1	-10.0	-0.1	-18.7	-0.1
Surplus/Deficit after Grants	**-399.4**	**-2.8**	**755.9**	**5.4**	**-1690.0**	**-10.6**
Financing	**399.4**	**2.8**	**-755.9**	**-5.4**	**1690.0**	**10.6**

Source: Lesotho Government Budget Speech 2009/2010

2009/2010 Budget

Revenue, Expenditure and Financing

The 2009/2010 budget proposes a budget deficit equivalent to 10.6 per cent of GDP compared with projected surplus of 5.4 per cent of GDP in 2008/2009. Total revenue and grants is expected to increase by 14.3 per cent to M9.9 billion during 2009/2010, which is 62.3 per cent of GDP. The high total revenue growth is attributed to the envisaged increase in customs, VAT and other tax revenue. Non-tax revenue is also expected to boost total revenue by 16.9 per cent. The projects' grants are expected to increase by 56.2 per cent to M1.1 billion. The grants include the cost of the implementation of the United States (US)'s Millennium Challenge Account.

Total expenditure and net lending is budgeted to increase by 27.9 per cent to M11.6 billion. Recurrent and capital expenditure are expected to grow by 18.4 per cent and 58.3 per cent, respectively. The budget deficit is expected to narrow down in the next three years to the benchmark of 3.0 per cent. The deficit is expected to be financed by running down government deposits with the banking sector or through issuance of government securities which support development of money and capital market in the economy.

Allocation of Government Spending in the 2009/2010

The priorities of the government towards the attainment of high, shared and sustainable growth with protection of the vulnerable during the unfolding global depression can best be deduced from the analysis of the ministerial allocations. The Ministry of Education and Training continued to claim the largest share of the budget at 18.8 per cent of total budget. The government continues to spend on Free Primary Education (FPE). The emerging challenge is accommodation of increased FPE graduates into secondary education. An allocation is proposed for the construction of secondary schools including building of hostels in remote areas to enable children who live away from school to attend school without taking long journeys. The government also continued to provide free school meals for primary school children. However, teachers' training is a major challenge to improve the quality and relevance of education at all levels in the country. The Information and Communications Technology education would also be expanded.

The second largest recipient is the Ministry of Health and Social Welfare accounting for 13.4 per cent of total budget. Lesotho is one of the countries that are worst affected by HIV/AIDS, with a prevalence rate of 24 per cent. The allocation presents evidence that the scourge is beginning to affect resource allocation. In an endeavour to fight the pandemic, proper health infrastructure is a prerequisite. The proposals include the construction of the new hospital through Public Private Partnership to replace the Queen Elizabeth II hospital and the three filter clinics at Likotsi, Mabote and Qoaling. The projects are expected to be completed by 2010. The MCC is also assisting with the rehabilitation of 150 health centres across the country.

Public Service Delivery

It is paramount that efforts are made towards improvement of public service delivery in order to attain effectiveness and efficiency. This is important at this time since government expenditures are likely to decline in line with the expected fall in revenues. The Government intends to direct resources towards capacity building and implementation of the new Integrated Financial Management Information System. This is in line with ongoing Public Sector Improvement and Reform Programme (PSIRP).

Public Service Pension Reform

The Government proposes to further strengthen pension fund for public servants. In the 2009/2010 budget, the pension scheme has been extended to include employees aged below 45.

Old Age Pensions

The Government reviewed a need for protecting vulnerable people such as elderly people, orphans and vulnerable children. In this regard, the old age pensions will be increased by M100.00 to M300.00 per month. Moreover, the Government, in collaboration with European Commission and UNICEF, established a Child Support Grants which supports vulnerable families with M300.00 per family every quarter.

Income Tax Adjustments

One of the policies of the government is to keep level of taxation on income constant as to avoid tax burden on individuals. As a result, the government proposes to increase tax income threshold by 8.0 per cent to M40, 368. Tax rebate is also proposed to increase to M5000.

Conclusion

The current global slowdown poses a significant challenge to the economic policymaking. A significant number of Basotho employed in the textile and clothing sector and in the South African mining industry are on the brink of losing their jobs. Thus it is important that all efforts are directed towards high, shared and sustainable economic growth.

2. South African Budget for 2009/2010: Implications for the economy of Lesotho.

The South African (SA) Minister of Finance presented the 2009/2010 budget before Parliament in February 11, 2009. The developments in South Africa are important to the economy of Lesotho, particularly in this time when global economies are edging towards recession.

The budget proposes a deficit of 3.8 per cent of GDP following the projected deficit of 1.0 per cent of GDP in the 2008/09 budget outturn. The proposed overall deficit is mainly due to slower growth in tax revenue as global economic conditions continue to worsen. Real GDP in SA is projected to slowdown to 1.2 per cent in 2009 compared with the estimated 3.8 per cent in 2008. The slowdown can be attributed to the deceleration of final household consumption in the face of high interest rates and inflation. In addition, low external demand is putting pressure on exports demand. However, economic growth is expected to recover in the medium term due to buoyant household consumption that benefits from falling inflation rates and lower interest rates, a continuing expansion of public-sector fixed investment and benefits from 2010 FIFA world Cup.

The slowing economic activity in South Africa poses a number of challenges to the economy of Lesotho. First, SA remains the second largest recipient of Lesotho's exports and a reduction in demand from SA may worsen the already vulnerable situation in the manufacturing sector due to the collapse of the US market. Second, according to the Private Capital Flows Survey 2006 conducted by the Central Bank of Lesotho, SA is the largest source of foreign direct investment to Lesotho hence an economic downturn in

SA may trigger a disinvestment from Lesotho. Third, a large number of Basotho is employed in the SA mining sector, particularly gold mining. With the current economic crisis, manifesting itself in the fall of prices of commodity prices, it is reported that about 35 000 people employed in the mines may lose their jobs. The retrenchment may pose a huge social problem in Lesotho. Last, the slow down is reducing the amount of imports into the region and hence reducing the expected SACU revenue pool. The pool is projected to decline from R27.9 billion in 2009/2010 to 26.2 billion in 2010/11 before picking up to R27.9 billion in 2011/12. This shock will have serious implications for Lesotho Government's budget.

Over the last two years, inflation measured by changes in consumer price index has been fuelled by rapid increases in food and oil prices, domestic capacity constraints and a weaker rand.

The headline inflation averaged 11.6 per cent in 2008, and it is projected to slow down to 5.3 per cent and 5.0 per cent in 2009 and 2010, respectively. Lower oil and food prices and weak domestic demand are expected to bring inflation within the targeted range of 3 per cent to 6 per cent. Lesotho is expected to benefit from this scenario since inflationary developments in South Africa are always transmitted into Lesotho's economy as Lesotho imports large portion of its consumables from South Africa.

The budget also proposes some measures aimed at reducing poverty such as increased public spending on public roads and transport in response to the current deterioration in employment and economic activity.

3. Monetary Policy Operations Report for February 2009

One of the main objectives of the Central Bank of Lesotho (CBL) is to maintain price stability, which is achieved through maintenance of adequate level of Net International Reserves (NIR). The adequate level of NIR ensures that the parity between the Loti and the Rand is maintained. The NIR target set by CBL's Monetary Policy Committee (MPC) remained unchanged at US$500.0 million during the period under review.

CBL uses Open Market Operations (OMO) to achieve stated objectives made by MPC. Table 2 below shows the amount auctioned and discount rates that prevailed for each of the auction during the review month. The level of competitiveness in the treasury bills' market is estimated by the number of participants in an auction. Therefore, during the review month, the 91-day treasury bills auction saw a participation of 5 bidders who submitted 10 bids on the 11th February and 7 bidders who submitted 10 bids on the 25th February. All bidders were partially successful. However, the successful bidders were below that of the previous month.

Table 2: Treasury Bills Auctions

Type of Security	Auction Date	Maturity Date	Action Amount (Million Maloti)	Amount Issued (Million Maloti)	Discount Rate (%)	RSA Discount Rate (%)
91-day	11-Feb-09	13- May-09	M10.5	M10.5	9.83%	9.35%
182-day		12-Aug-09	M9.0	M9.0	10.31%	8.51%
273-day		11-Nov-09	M6.0	M0.45	9.65%	7.85%
364-day		10-Feb-10	M4.5	M0.033	9.85%	7.22%
91-day	25-Feb-09	27-May-09	M10.5	M10.5	9.71%	8.92%
182-day		26-Aug-09	M9.0	M0.11	9.86%	7.86%
273-day		25-Nov-09	M6.0	M6.0	9.33%	7.34%
364-day		24-Feb-10	M4.5	M0.03	9.27%	7.32%
Total for reporting period			**M60.0**	**M36.623**	**-**	**-**

During the review month, the Lesotho 91-day treasury bills rate became above that of SA counterpart for the first time in a year. The SA counterpart treasury bills rate declined on account of the decision made by SA Reserve Bank Monetary Policy Committee that reduced repo rate by 100 basis points during the period. Consequently, the discount rate margin between Lesotho and SA recorded 48 basis points and 79 basis points on the 11th and 25th February 2009. However, as a result of the global economic meltdown, both rates fell by a larger margin as depicted in figure 1 below. The Monetary Policy Operations undertaken in the review period were successful in attaining their desired objectives of financial stability and the target NIR level.

Figure 1: Measuring the Success of Monetary Policy Objectives: Performance of Lesotho 91-Day T-Bills vs RSA T-Bills

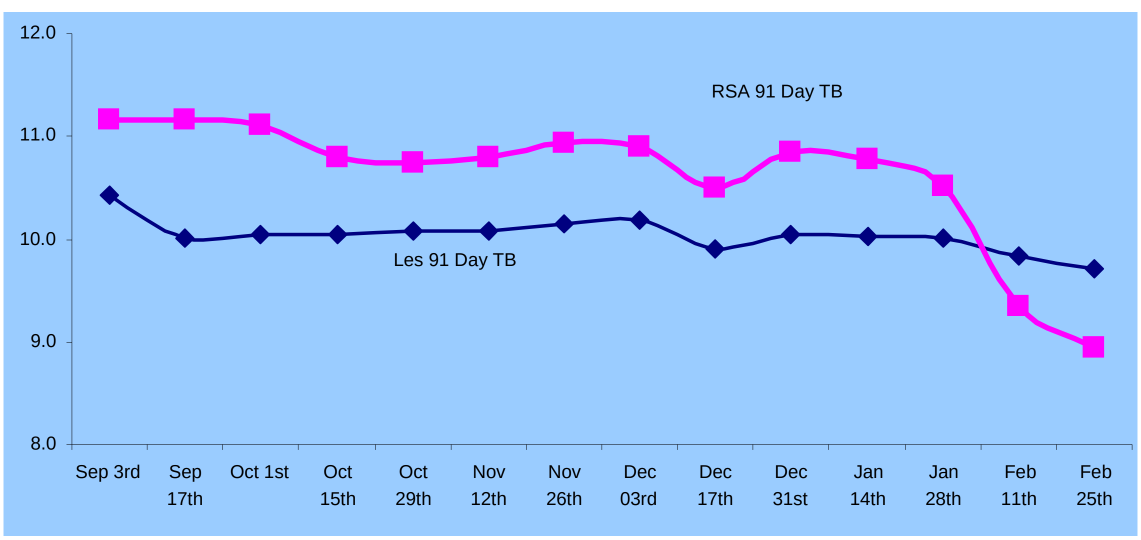

Table 2: Selected Monetary and Financial Indicators

	2008		2009
	Dec	January	February
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	*16.58*	*16.58*	*15.17*
1.2 Prime Lending rate in RSA	*15.00*	*15.00*	*14.00*
1.3 Savings Deposit Rate	*5.28*	*4.61*	*3.98*
1.4 Interest rate Margin(1.1 – 1.3)	*11.30*	*11.39*	*11.19*
1.5 Treasury Bill Yield (91-day)	*10.05*	*10.67*	*9.35*
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	*4880.99*	*5494.34*	*5412.82*
2.2 Net Claims on Government by the Banking System	*-3972.70*	*-4606.27*	*-4319.72*
2.3 Net Foreign Assets – Banking System	*11172.63*	*12408.45*	*11907.63*
2.4 CBL Net Foreign Assets	*8,251.57*	*8949.13*	*8577.37*
2.5 Domestic Credit	*-2465.73*	*-3090.42*	*-2748.22*
2.6 Reserve Money	*580.32*	*613.76*	*643.05*
3. Spot Loti/US$ Exchange Rate (Monthly Average)	***10.0203***	***9.9250***	***9.8640***
4. Inflation Rate (Annual Percentage Changes)	***10.6***	***10.7***	***10.2***
5. External Sector (Million Maloti)	***2008***		
	QII	***QIII***	***QIV+***
5.1 Current Account Balance	*824.12*	*346.40*	*412.57*
5.2 Capital and Financial Account Balance	*117.74*	*1083.26*	*-184.20*
5.3 Reserves Assets	*-165.33*	*-704.65*	*-558.82*

+Preliminary Estimates.

**Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities*

Table 3: Selected Economic Indicators

	2005	2006	2007	2008+
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	*0.7*	*8.1*	*5.1*	*3.4*
1.2 Gross National Product – GNI	*-1.9*	*12.0*	*3.0*	*5.0*
1.3 Per capita –GNI	*-1.9*	*12.0*	*2.2*	*4.2*
2. Sectoral Growth Rates				
2.1 Agriculture	*-12.4*	*14.9*	*-8.6*	*1.8*
2.2 Manufacturing	*-10.2*	*6.0*	*9.9*	*-4.5*
2.3 Construction	*5.4*	*3.5*	*6.9*	*7.7*
2.4 Services	*2.8*	*6.5*	*3.1*	*2.4*
3. External Sector – Percent of GNI				
3.1 Imports of Goods	*83.5*	*77.6*	*82.0*	*86.8*
3.2 Current Account	*-5.8*	*3.4*	*9.8*	*9.5*
3.3 Capital and Financial Account	*3.7*	*0.7*	*5.5*	*5.1*
3.4 Official Reserves (Months of Imports)	*5.5*	*6.7*	*7.6*	*7.4*
4. Government Budget Balance (Percent of GDP)	*5.0*	*11.6*	*7.5*	*-1.0*

+Preliminary Estimates