# CENTRAL BANK OF LESOTHO

# QUARTERLY REVIEW

**June 2016**

**MASERU**

**KINGDOM OF LESOTHO**

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# 1. Executive Summary

The global economic performance was relatively lacklustre, underpinned by weak global trade; diminishing capital flows, low commodity prices and downward revisions to the Fed Reserve's tightening cycle. Moreover, towards the end of the second quarter of 2016 the United Kingdom (UK) citizens voted to leave European Union. This development is expected to have serious macroeconomic implications for the global economy through heightened economic and political uncertainty. Among advanced economies, the United States (US) and the experienced higher growth; while growth was also higher for South Africa among the emerging market economies. Growth in the US was supported by increased consumer spending and government spending amid low inventory investment. The UK's growth was boosted by good performance in services and production sectors. South Africa's positive growth was driven mainly by a sharp increase in manufacturing activity and a recovery in the mining sector. The central banks largely maintained accommodative monetary policies in a bid to support growth and attain price stability.

During the second quarter of 2016, the domestic economy experienced a slump after growing substantially in the first quarter of 2016. The bleak performance of the economy is attributable to the output decline in the service sector largely underpinned by the negative growth of the government sector and trade, and to a lesser extent the primary sector. The secondary sector, nonetheless, moderated the decline. The secondary sector was largely underpinned by both the manufacturing sector, at the back of buoyant performance of the textiles and clothing and the construction sector. In the labour market, employment by LNDC-assisted companies buoyed while the government and migrant mineworkers' employment deteriorated. During the review quarter, inflation rate remained unchanged, mainly underpinned by depreciating loti and accelerating food prices induced by drought related to El Niño.

The developments in the financial sector reflected a growth of 8.3 per cent in money supply for the quarter under review compared to a 3.0 per cent in the preceding quarter. This growth in money supply came at the back of an upsurge in Net Foreign Assets (NFA) as well as domestic claims. The upswing in NFA was driven primarily by the commercial banks' NFA that was moderated by a decline in Central Bank NFA. Furthermore, commercial banks were responsible for the rise in domestic claims that came as a result of a growth in commercial bank claims on the private sector.

The Government budgetary operations registered a fiscal deficit including grants of 13.5 per cent of GDP during the quarter ending June, 2016. This deficit was in line with more capital spending coupled with the underperforming revenue collection. The fall in revenue was mainly due to the declining receipts from Southern African Customs Union (SACU) Revenue Pool. The SACU receipts constituted 33.9 per cent of the total revenue during the review period.

The external sector of the economy continued to display a deficit, though at the lower rate during the second quarter of 2016 compared to the previous quarter. The narrowing of the deficit resulted from an improvement in the current account balance due to the deterioration in the trade account deficit and the growth in the primary income account. Moreover, the narrowing of deficit in the external sector was driven by an improvement in the financial account balance, whose deficit narrowed during the quarter. Despite a fall in the stock of official reserves due to the decline in SACU revenue, months of import cover rose to 5.9 month in the second quarter of 2016, from 5.2 month in the preceding quarter, resulting largely from decreased import bill during the quarter.

## 2. International Economic Developments

Global economic growth remained lacklustre in the second quarter of 2016. Both advanced and emerging market economies continued to face strong headwinds, including weak global trade; diminishing capital flows; low commodity prices and jitters about the Federal Reserve interest rate hike. Following the rate increase in December 2015, the US Federal Reserve signalled further hikes although gradually during the course of 2016 and expectations that have been mostly anchored around the second quarter. The review quarter also saw the UK vote to leave European Union (EU) in what has come to be known as the Brexit. This development destabilised global markets and eroded about 2 trillion US dollar in just two trading sessions. This has also sent the pound sterling to 31 years low. The Brexit is expected to have serious macroeconomic implications for the global economy through heightened uncertainty.

Inflation remained below target for advanced countries. It however increased for a number of emerging market economies, with exception of China and South Africa where it decelerated. Low energy prices, which prevailed since the beginning of this year, continued to drag on inflation in the advanced countries. However, in the emerging economies inflationary trends were driven mainly by upward pressure from food prices and weakened exchange rates. Drought conditions in major food producing countries adversely affected food production. Monetary policies remained accommodative in a bid to support growth in both advanced and emerging market economies.

Table 1 below summarises key global economic indicators for selected advanced and emerging economy countries.

**Table 1: Key World Economic Indicators**

| | Real GDP Growth | | Inflation Rate | | Key Interest Rate | | Unemployment Rate | |
|---|---|---|---|---|---|---|---|---|
| | **Mar 2016** | **Jun 2016** | **Mar 2016** | **Jun 2016** | **Mar 2016** | **Jun 2016** | **Mar 2016** | **Jun 2016** |
| **United States** | 0.8 | 1.1* | 0.9 | 1.0 | 0.50 | 0.50 | 5.0 | 4.9 |
| **Euro Area** | 1.7 | 1.6 | 0.0 | 0.1 | 0.00 | 0.00 | 10.2 | 10.1 |
| **Japan** | 1.9 | 0.7* | -0.1 | -0.4 | -0.10 | -0.10 | 3.2 | 3.1 |
| **United Kingdom** | 2.0 | 2.2 | 0.5 | 0.5 | 0.50 | 0.50 | 5.0 | 4.9 |
| **China** | 6.7 | 6.7 | 2.3 | 1.9 | 4.35 | 4.35 | 4.0 | 4.1 |
| **India** | 7.9 | 7.1 | 4.8 | 5.8 | 6.75 | 6.75 | **n/a** | **n/a** |
| **South Africa** | -1.2 | 3.3 | 6.3 | 6.3 | 7.00 | 7.00 | 26.7 | 26.6 |

Updated*

**Source:** Bloomberg, STATSSA and SARB, OECD National Accounts Statistics (database), US Bureau of Economic Analysis, National Bureau of Statistics China, Statistics Bureau of Japan, Government of India Department of Labour, United Kingdom Office for National Statistics

## ADVANCED ECONOMIES

### United States (US)

The US experienced weaker than expected growth in June 2016, as inventory investment fell for the first time in five years. Real GDP rose by 1.1 per cent against the expectations of 2.5 per cent growth in the second quarter of 2016. The growth rate represents a 0.3 percentage points increase from the first quarter. Acceleration in real GDP was due to increased consumer spending, rebounding exports and the Federal government spending. The offsetting effect came from decline in investment expenditure, inventory investment, non-residential and residential fixed investment, and also state and local government spending. Unemployment rate declined from 5.0 per cent in first quarter to 4.9 per cent in the second quarter. The decline in unemployment, however, reflected a decline in the participation rate.

Inflation rate continued to trend below inflation target of 2 per cent in the second quarter. The rate of inflation increased slightly to 1.0 per cent in the first quarter from 0.9 per cent in the first quarter. Inflation accelerated due to increased cost of medical care and housing. The Federal Open Market Committee (FOMC) has maintained an accommodative monetary policy stance in order to support sustained growth, job creation and that inflation rate returns to 2.0 per cent target. The key interest rate was left unchanged at the range of 0.25-0.50 per cent in the second quarter.

### Euro Area

In the second quarter, real GDP in the Euro Area increased by 1.6 per cent, decelerating slightly from the first quarter growth of 1.7 per cent. The growth was dragged by stagnation in French economic growth and slowdown in other countries due to weakening consumer demand, a decline in investment expenditure and exports. The countries that experienced expansion in the economic activity were Germany and Belgium. Labour market conditions improved in the region even though the unemployment rate was still high relative to other advanced countries. The unemployment rate declined from 10.2 per cent to 10.1 per cent in the second quarter.

The inflation rate accelerated to 0.1 per cent in the second quarter from 0.0 per cent in the first quarter. The acceleration reflected an increase in the prices of energy and services. The Governing Council of the of the European Central Bank left the key interest rate unchanged at 0.0 per cent in the second quarter. The Governing Council continued with the comprehensive package of monetary policy decisions, which included the corporate sector purchase program and the targeted long-term refinancing operations, so as to boost aggregate demand within the region, hence inflation and output.

### Japan

The Japanese economy showed the weak performance in the second quarter, owing to weakened consumer demand and slowdown in government spending. Exports and production declined due to slowdown in emerging markets. Furthermore, the Kumamoto earth quake destroyed the productive base affecting production, while strong yen hamstrung exports. The real GDP growth in the second quarter was 0.7 per cent and decelerated from 2.0 per cent in the first quarter. The unemployment rate was low at 3.1 per cent in the second quarter, from 3.2 per cent in the previous quarter. The decline in the unemployment rate came as a result of increased employment which rose by 0.9 per cent coupled with increased participation rate 60.5 per cent.

The annual inflation decelerated to -0.4 per cent in June, from -0.1 per cent the March 2016. While the food prices and medical care prices accelerated, the cost of housing and transport declined and this decline weighed down on the inflation rate. The Bank of Japan continued with expanding the monetary base through quantitative and qualitative monetary easing with a negative interest rate. This was done in an effort to achieve price stability target of 2 per cent and to support the growth recovery in the economy. The key interest rate was maintained at -0.1 per cent in the quarter under review.

## United Kingdom (UK)

The UK growth has recovered in the second quarter after slightly losing ground in the first quarter. The real GDP was recorded at 2.2 per cent in the second quarter accelerating from 2.0 realised in the first quarter. The increase was fuelled by 0.5 per cent increase in services and 2.1 per cent increase in production while agriculture and construction declined. The unemployment situation slightly improved in the second quarter as it declined from 5.0 per cent in the first quarter to 4.9 per cent in the second quarter. Employment rate has increased reaching the record high of 74.4 per cent, an increase of 0.2 percentage points from the first quarter.

The United Kingdom citizens voted to leave European Union in a referendum on the 23rd June 2016. Preliminary signs of this decision were a sharp fall in business and consumer sentiment and; delay in investment and recruitment decisions in the UK. The Brexit is likely to have negative macroeconomic consequences globally through economic, political and institutional uncertainty.

There was no change in the rate of inflation in the UK in the second quarter. The consumer price index (CPI) rose by 0.5 per cent, the same as in the first quarter. The Bank of England left the key interest rate unchanged and continued with asset purchases financed by issuance of Central Bank reserves of £375 billion.

## EMERGING MARKET ECONOMIES

### China

China's real GDP increased by 6.7 per cent in the second quarter, steady from the first quarter. Although exports declined, the growth in private consumption and industrial production counterbalanced the observed decline. Generally disposable incomes and retail sales increased reflecting strong domestic consumer demand. Furthermore, the strong government stimulus helped to keep the economy buoyed amid global economic downward pressure. The unemployment rate increased slightly from 4.0 in the quarter ending in March 2016 to 4.1 per cent in the quarter under review. The increase in unemployment reflected the on-going process of cutting over capacity in the coal and steel industries, rising labour costs and slowdown in the global economy.

Inflation decelerated from 2.3 per cent in the first quarter to 1.9 per cent in June 2016. The decline in inflation was driven by slowing food prices. The key interest rate was left unchanged in the second quarter to counteract the pressure of global economic slowdown. The policy stance remained accommodative to support the growth target of 6.5-7.0 per cent for 2016.

### India

Indian real GDP growth slowed to 7.1 per cent in the second quarter, following 7.9 per cent in the previous quarter, amid sluggish investment and farm output. Government's efforts to revive stalled projects; clean up banks and boost public investment continued to crowd out private investment. The low farm sector output reflected a change in monsoon trends. The slowdown in GDP was also on account of higher subsidy expenditure, with the main allocations to the food, petroleum and fertiliser side. Manufacturing production and services sector which rose by 9.1 per cent and 9.6 per cent, respectively, continued to support growth.

Consumer prices surged in June 2016 leading to annual inflation rate of 5.8 per cent accelerating from 4.8 per cent in the first quarter. The key drivers to accelerating inflation rate were increased cost of food and beverages. The Reserve Bank of India kept the key interest rate unchanged in the quarter ending in June 2016. The Bank maintained an accommodative policy environment to support growth amid inflationary pressures in the economy emanating from food prices and recovering energy prices.

### South Africa

South African economy registered positive growth in the second quarter, as it expanded by 3.3 per cent relative to -1.2 per cent in the first quarter. The growth in the real GDP was driven mainly by a sharp increase in manufacturing activity and a recovery in the mining sector. Furthermore, growth was supported by strong export activity and an increase in household and government final consumption. The continuing drought and water restrictions in some parts of the country were partly to blame for declines in output from agriculture, forestry and fishing as well as the electricity, gas and water sector which had an offsetting effect on growth. The unemployment rate eased by 0.1 percentage points to 26.6 per cent June 2016. However, the decline in unemployment rate did not reflect improvement in the labour market as employment rate declined while the inactivity rate rose. More job losses were in the informal sector followed by the agriculture, the formal sector and the private household, however, added jobs in the quarter under review.

Inflation rate for South Africa was steady in the second quarter at 6.3 per cent. Inflation increased mainly due to food and non-alcoholic prices, clothing and restaurants and hotel, while decline in communication costs and slow increase in transport costs had an offsetting effect on inflation hence no change in inflation rate from the first quarter. The SARB Monetary Policy Committee (MPC) kept the key interest rate on hold in the second quarter of 2016. The policy stance was to support ailing economy amid worsening inflation outlook. The MPC remained concerned about the high inflation expectations and the core inflation which is expected to breach the upper end of the 3-6 per cent target range, due to exchange rate and wage pressures.

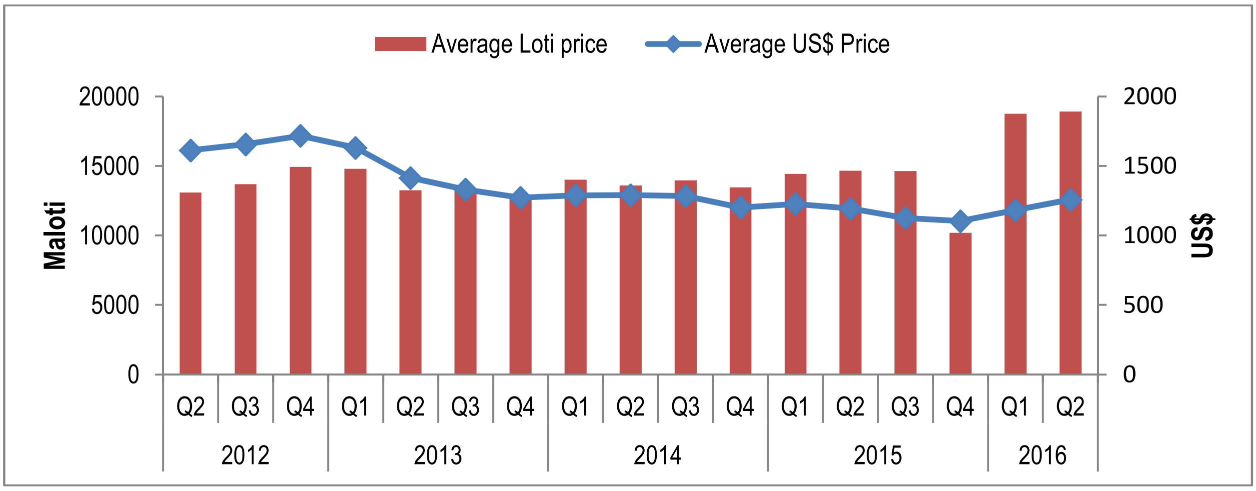
## COMMODITIES

### Minerals

#### *Gold*

The average price of gold increased during the quarter under review. In US Dollar terms, it increased by 6.4 per cent to US$1258.10 an ounce relative to a 7.1 per cent decline in the previous quarter. Factors that led to the increase included higher risk aversion, downward revisions to the Fed's tightening cycle and stronger speculative demand pertaining to growing political uncertainty in the US and Europe. In the US, investors face an election year after a two-term presidency, an event that has historically had a negative impact on equities amid higher uncertainty. Europe experienced the effects of the British referendum in June coupled with unsustainable trajectory of Greek debt. However, the observed gains were moderated by low gold demand in the Middle East, China and India, owing to the on-going political instability; poor consumer sentiment; and volatile prices. In Loti terms, the price of gold rose by 0.9 per cent against 8.4 per cent realised in the previous quarter.

**Figure 1: Average Price of Gold**

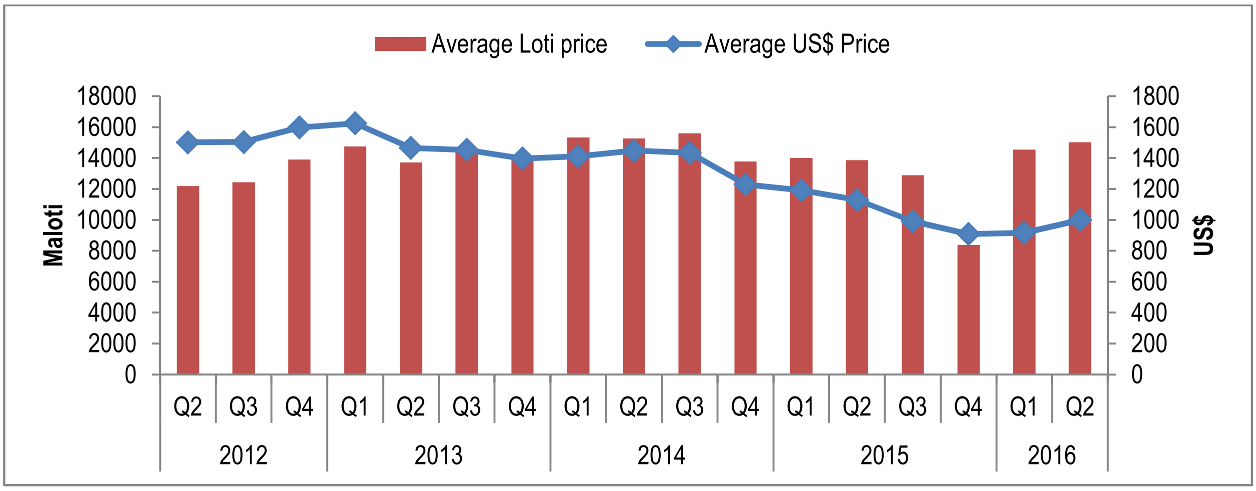



**Source:** Bloomberg

***Platinum***

The average US Dollar price of platinum rose by 9.1 per cent to US$1,000.48 per ounce during the quarter ending in June 2016, higher than 1.0 per cent increase in the previous quarter. The increase reflected a combination of lower supply and higher demand. Total mining supply was lower owing to the temporary shaft closure in some of the South African mines due to safety and stoppage instructions. South Africa remains one of the largest platinum producers globally, hosting about 80 per cent of the world's platinum resources. Global investment demand rose as bar-buying in Japan remained robust and industrial usage increased, amid lower automotive sales and jewelry consumption. The price of platinum, in Loti terms, increased slightly by 3.3 per cent to M15, 041.62 in the review period.

**Figure 2: Average Price of Platinum**




**Source:** Bloomberg

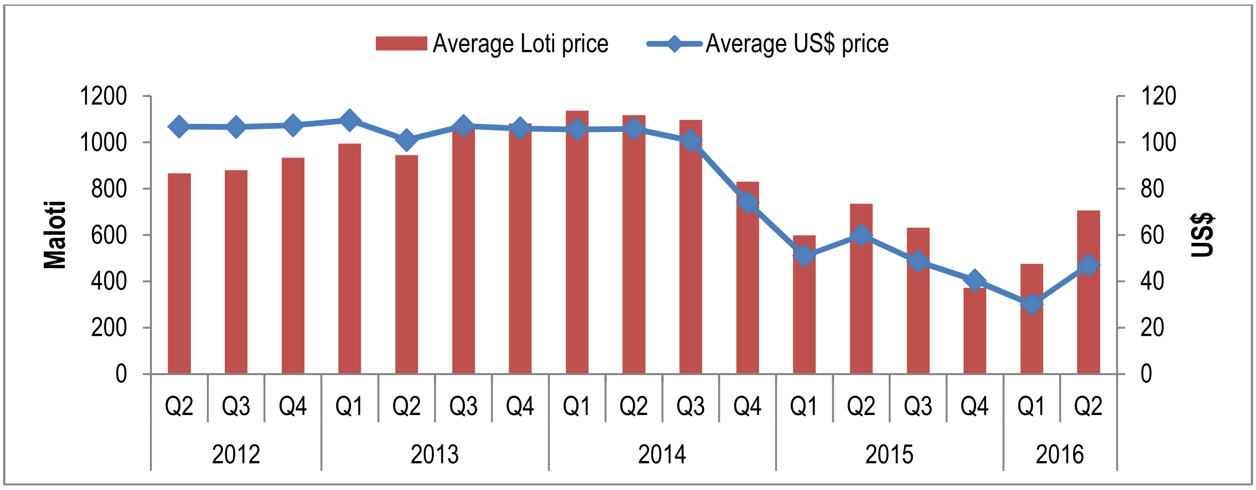
## Energy

***Oil***

The average US Dollar price of oil rose sharply by 56.8 per cent to US$47.03 per barrel, following a decrease of 25.4 per cent in the previous quarter. The initial decline was rapidly reversed due to new supply disruptions and a decrease in US oil production. In its projections for 2016, the US Energy Information Administration expects lower crude oil output in 2016 compared to 2015. The increase in oil prices also reflected a decrease in non-OPEC production and various supply outages; including the wildfires in Canada and labour disputes in Kuwait. However, OPEC production has been increasing and their last meeting, held on June 2, concluded without reaching an agreement on oil production. This decision was reached taking into consideration the fact that the market was rebalancing as shown by crude oil prices that have risen by more than 80 per cent since 2015; supply and demand were converging and oil product stock levels are showing relative moderation.

In Maloti terms, the average price of oil surged by 48.5 per cent to M706.82 per barrel relative to 27.9 per cent in the quarter ending in March 2016. In line with international prices, domestic oil prices also increased. The price of diesel rose from M8.60 in the previous quarter to M10.30 in the second quarter of 2016. The price of diesel increased from M8.65 to M10.45 in the review period. The price of paraffin also rose from M5.90 in the previous quarter to M7.05 in June 2016.

**Figure 3: Average Price of Oil**



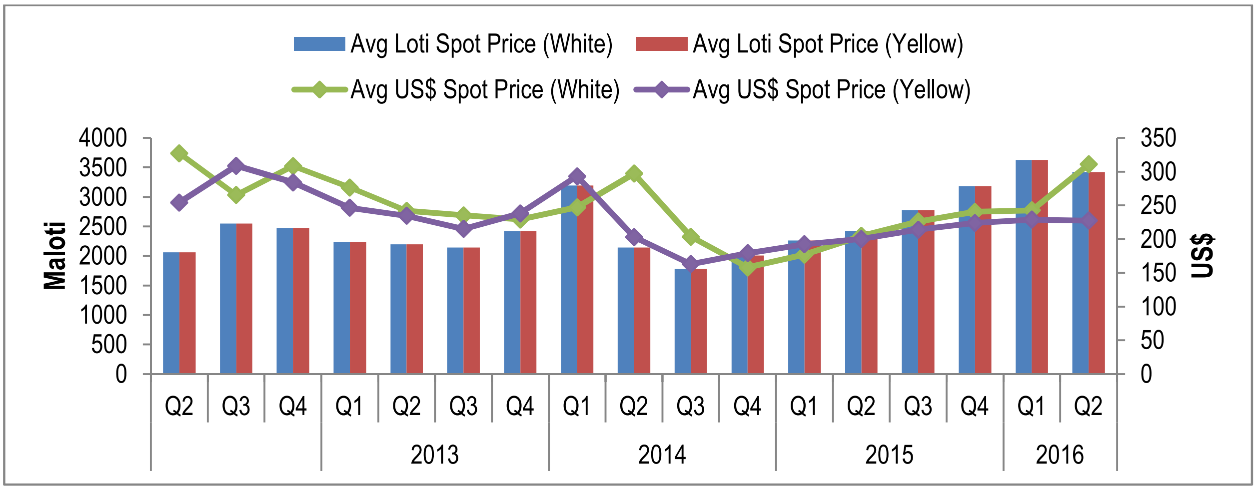

**Source:** Bloomberg

## Agricultural Products

### *Maize*

During the review period, the average US Dollar price of white maize rose by 1.1 per cent to US$314.23 per tonne after an increase of 28.1 per cent in the previous quarter. However, the average price of yellow maize dropped by 0.6 per cent to US$227.41 per tonne relative to a 2.2 per cent increase in the previous quarter. The increase was due to unfavourable weather conditions which affected harvests in South America, especially in Argentina and Brazil. This led to lower than anticipated production in South America amid improved global demand. In Maloti terms, the average prices of white and yellow maize declined by 4.1 per cent to M4722.81 per tonne and by 5.8 per cent to M3418.00, respectively.

**Figure 4: Average Price of Maize**

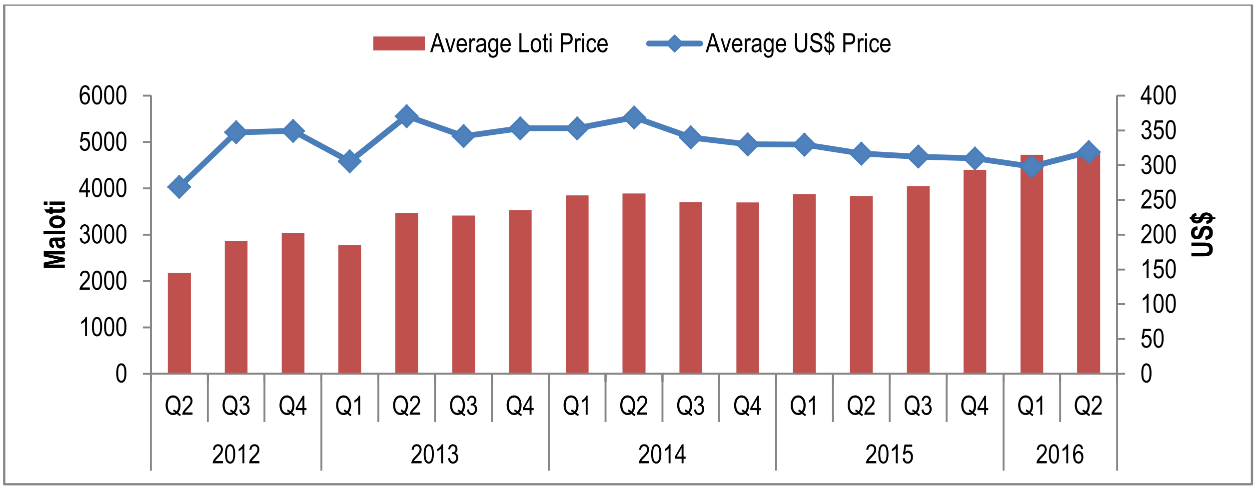



**Source:** Bloomberg

***Wheat***

In US Dollar terms, the average price of wheat increased by 7.1 per cent to US$318.94 during the quarter ending in June 2016, relative to a 3.9 per cent increase in the previous quarter. The wheat price rose despite ample supply, high inventories and good production prospects in Europe, US, Russia and the Black Sea region. In Maloti terms, it increased by a lower 1.5 per cent to M4,793.66 per tonne relative to a 7.3 per cent rise in the previous quarter.

**Figure 5: Average Price of Wheat**

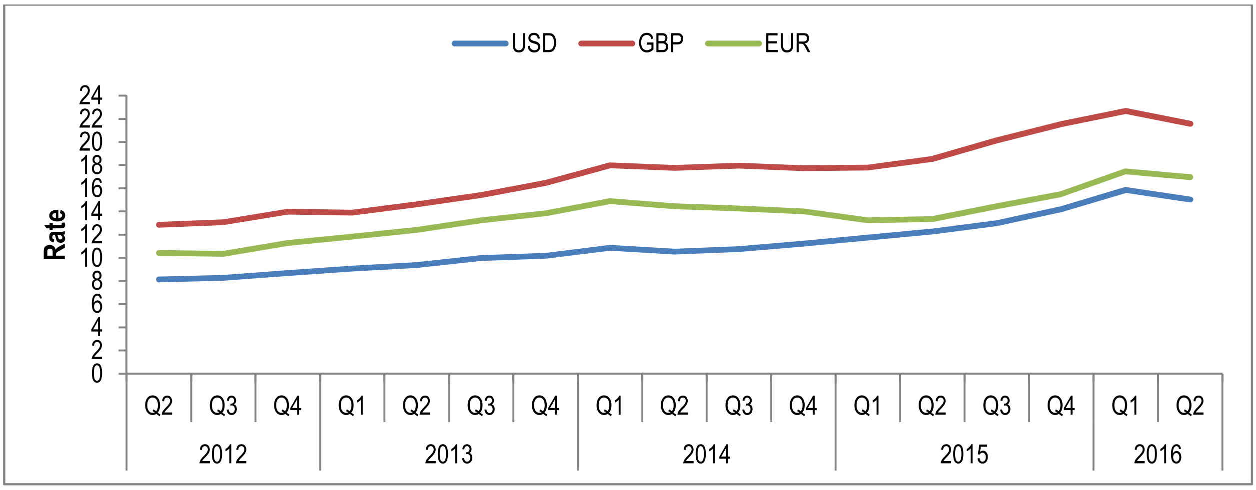



**Source:** Bloomberg

## EXCHANGE RATES

During the quarter ending in June 2016, the Rand and hence the Loti strengthened against the major world currencies. On average, the Loti appreciated by 5.2 per cent to M15.03, by 4.9 per cent to M21.57 and by 2.8 per cent to M16.97 against the US Dollar, the Pound Sterling and the Euro, respectively. The Rand was supported by improved commodity prices, the narrower trade balance, and expectations of a slower pace of US Fed monetary policy tightening. It also responded positively to the global search for higher yield, as manifested by a sharp increase in non-resident inflows to the SA bond and equity markets in June 2016. However, these gains were reversed as global growth concerns resurfaced, and other domestic factors, including the low growth outlook, concerns about a possible ratings downgrade and more recently heightened political uncertainty impacted adversely on the currency.

**Figure 6**: **Nominal Exchange Rate of Loti against Major Trading Currencies**




**Source:** Bloomberg

# 3. Real Sector Developments

## OVERVIEW

During the review period, Lesotho's economic activity deteriorated relative to the first quarter of 2016, as measured by EAI. This slump is recorded mainly at the back of massive declines in most of the services subsectors, namely the government and trade subsectors as well as the dip in output in the primary sector in both the mining and the quarrying subsectors. Nonetheless, the secondary sector, mostly manufacturing, utilities and construction subsectors moderated the decline during the period.

## OUTPUT DEVELOPMENTS

Notwithstanding the substantial growth of 15.9 per cent in the first quarter of 2016, output as proxied by EAI, recorded a negative growth of 6.7 per cent in the second quarter of 2016.

**Table 2: Economic Performance by Industry** *(Quarter to Quarter Percentage Changes)*

| | | 2015 | | | 2016 | |
|---|---|---|---|---|---|---|
| | Weight | Q2 | Q3 | Q4 | Q1 | Q2 |
| **EAI** | **100** | **-11.3** | **10.7** | **-6.3** | **15.9** | **-6.7** |
| **Primary Sector** | | | | | | |
| Mining | **8.9** | 28.8 | -4.8 | 0.4 | -1.1 | -1.8 |
| **Secondary Sector** | | | | | | |
| Manufacturing | **18.5** | 17.2 | -14.5 | -24.2 | 61.1 | 13.1 |
| Electricity | **1.1** | 16.8 | 5.3 | -10.9 | 1.6 | 12.3 |
| Water | **4.9** | 38.2 | 3.3 | -12.7 | -24.5 | 46.1 |
| Construction | **7.6** | -79.2 | 328.1 | -24.5 | 7.9 | 39.9 |
| **Tertiary Sector** | | | | | | |
| Trade | **11.0** | -2.7 | -6.7 | 22.7 | -16.6 | -14.6 |
| Telecom | **5.1** | 12.9 | 2.9 | -29.5 | 46.4 | 3.3 |
| Financial Sector | **6.5** | -3.3 | 7.8 | 4.3 | -7.6 | 3.0 |
| Other services | **5.7** | 6.0 | 5.0 | 9.6 | -29.9 | -1.5 |
| Government | **30.6** | -30.4 | 22.4 | -3.3 | 41.8 | -34.9 |

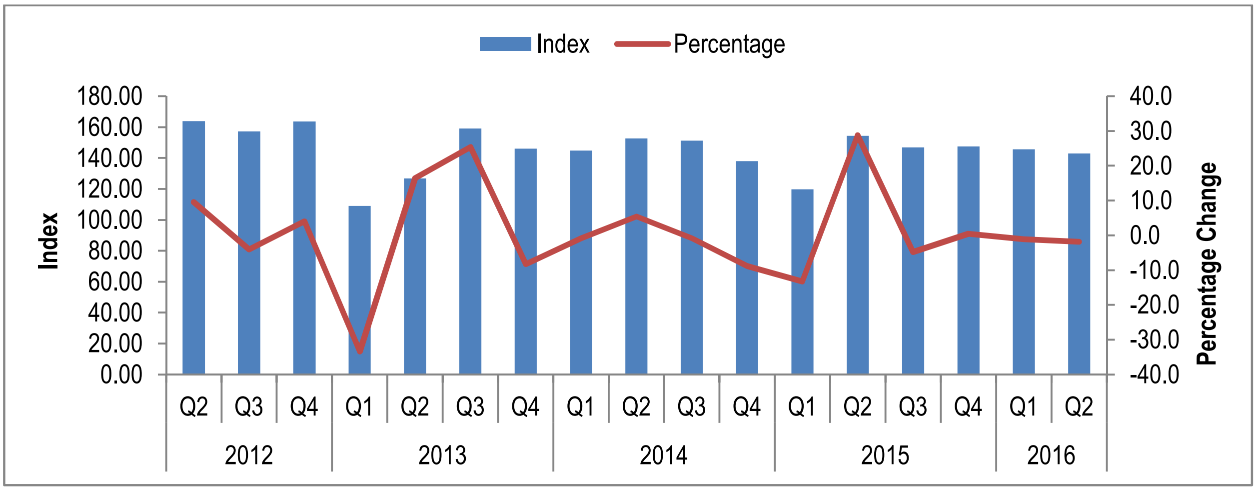
**Source:** Central Bank of Lesotho

## Primary Sector

### *Mining and Quarrying*

The mining and quarrying index continued to decline by 1.8 per cent in the second quarter of 2016 relative to 1.1 per cent recorded in the previous quarter. Both the mining and quarrying subsectors output contributed to the decline in the sector's index. In the mining subsector, the lower production was mainly due to Lets'eng Diamond Mine's operations, in which the mine operated through a lower value, but higher grade sections of the mine.

**Figure 7: Mining and Quarrying Index**



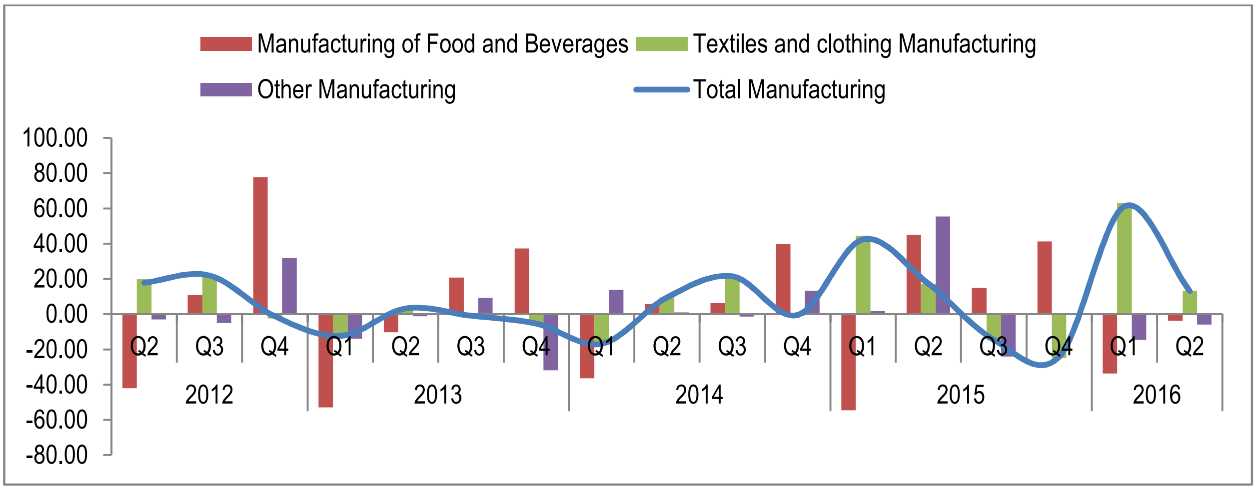

**Source:** Central Bank of Lesotho

## Secondary Sector

### *Manufacturing*

The manufacturing index increased but at a slower pace of 13.1 per cent in the second quarter of 2016 relative to 61.1 per cent recorded in the first quarter of 2016. The increase in the second quarter was mainly at the back of substantial contribution of the "textile and clothing" industry, which was moderated by the other two main categories, namely the "food and beverages" as well as "other manufacturing" industries. The main thrust to the increase in volume index of "the textile and clothing" subsector was mainly due to increased exports driven by an upsurge of orders from firms exporting to the U.S under the African Growth and Opportunities Act.

**Figure 8: Manufacturing Subsector** *(Quarter to Quarter Percentage Changes)*




**Source:** Central Bank of Lesotho

### *Electricity*

The index of electricity consumption substantially increased in the second quarter of 2016 relative to the preceding quarter. It recorded 12.3 per cent and 1.6 per cent for the second quarter and first quarter of 2016, respectively. The massive percentage increase in the electricity subsector is largely at the backdrop of both the commercial and industrial electricity consumption and hence output. During the review period, the wet industries performed commendably, thus putting this massive growth in electricity consumption.

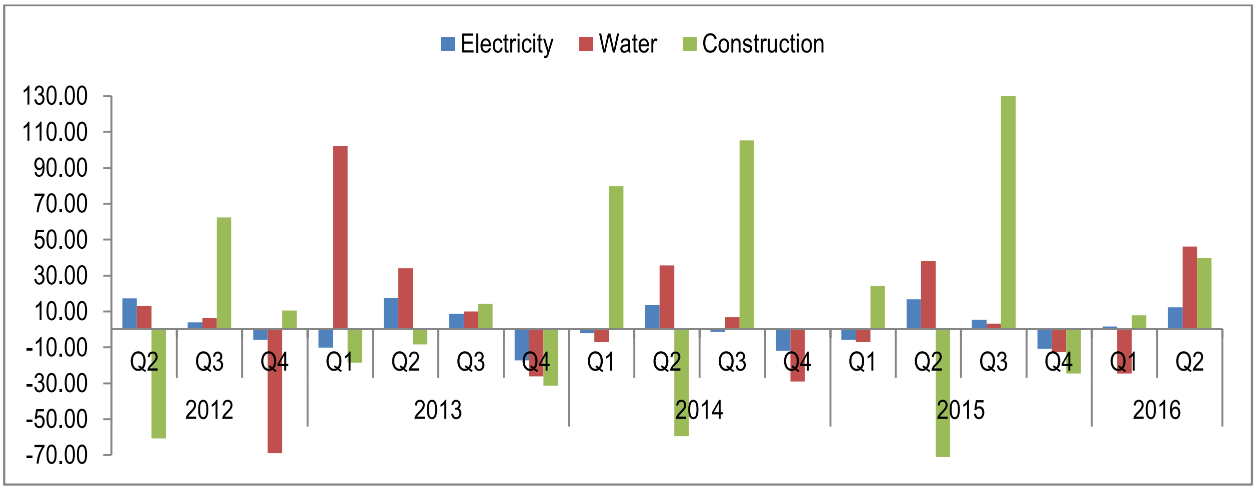
### *Water*

After declining by a massive 24.5 percent in the first quarter of 2016, the water consumption index substantially recovered and recorded an increase of 46.1 per cent in the second quarter of 2016. Both locally consumed and exported water to South Africa, increased during the review quarter. In particular, the water consumption index was largely driven by LHDA exports. On the domestic front, the water consumption by the "industrial" component substantially increased, while the "domestic" counterpart declined. The "other" component marginally increased during the review quarter. The industrial water consumption upsurge was attributed to the buoyant performance of the industrial as well as the commercial sectors in Lesotho during the review period.

### *Construction*

The construction subsector output index increased by 39.9 per cent in the second quarter of 2016 relative 7.9 per cent recorded in the first quarter of 2016. The acceleration of positive growth performance of this subsector was mainly at the back of increased number of capital projects mainly undertaken by the Government of Lesotho such as roads and bridges, among others in the review period. Under the ministry responsible for the constructions of above-mentioned infrastructure facilities, an allocation roughly M50.0 million was utilized.

**Figure 9: Utilities and Construction subsectors** *(Quarter to Quarter Percentage Changes)*




**Source**: Central Bank of Lesotho

## Tertiary Sector

### *Trade*

The trade index declined further, but at a slower pace of 14.6 per cent in the second quarter of 2016 from 16.6 per cent in the preceding quarter. The decline in the index was contributed to by the "retail", "wholesale" and "motor" components, while the "fuel" category moderated the decline in the overall index. The decline in the trade index is attributed to the subdued demand of goods and services as the domestic economy reeled under slow growth in the first half of 2016. Both wholesale and retail components became the main drivers of the trade subsector output slump during the review period. On the other hand, inflation acceleration from the first to the second quarter, on average, undermined the purchasing power of the consumers, hence their spending.

### *Telecommunications*

The telecommunications subsector index increased by a marginal 3.3 per cent in the quarter ending June 2016 relative to a massive 46.4 per cent increase in the first quarter of 2016. The slower pace is attributed to the slowdown in promotional services as no new products were introduced by the telecommunications subsector mobile services providers during the review period.

### *Finance*

The financial sector services index took a rebound in the quarter ending in June 2016, growing by 3.0 per cent relative to a decline of 7.6 per cent in the preceding quarter of the same year. The performance in this sector is attributed to the increased revenue or income earned from non-interest income since interest earned on loans may not have impacted massively on this sector due to the uptick in bank credit extended to the privative sector.

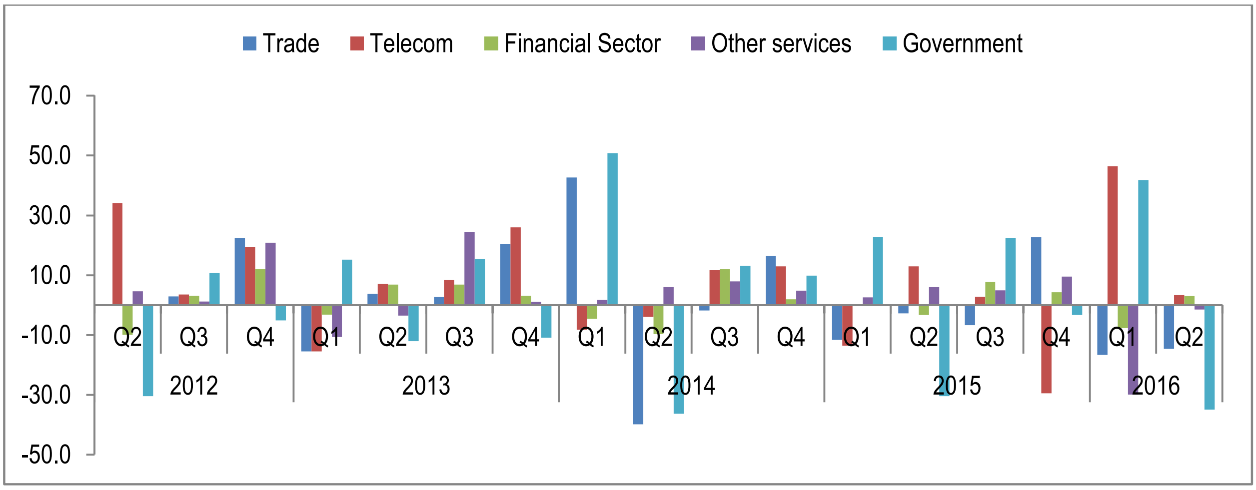
***Other Services***

The other services index has marginally declined by 1.5 per cent in the second quarter of 2016 relative to a massive 29.9 per cent decline in the preceding quarter. The slower pace of decline in the second quarter of 2016 is attributed to the rebound in output of services such as legal, bookkeeping and auditing, among others.

***Government***

Government output index substantially declined by 34.9 per cent in the quarter under review relative to an increase in the preceding quarter. The decline in this subsector's output was at the back of the decline in compensations of employees.

**Figure 10: Tertiary Sector** *(Quarter to Quarter Percentage Changes)*




**Source:** Central Bank of Lesotho

## EMPLOYMENT DEVELOPMENTS

During the review period, employment by LNDC-assisted companies rebounded and recorded a positive growth of 3.5 per cent relative to a decline of 4.9 per cent in the preceding quarter. In particular, the woven garments increased by 9.9 per cent during the review period relative to a decline of 6.0 per cent in the first quarter of 2016. The commendable growth in employment by LNDC-assisted companies was mainly at the back of increased orders from the textile and clothing subsector by the U.S under AGOA. The Loti-U.S dollar exchange rate has also played a significant role in making export goods from Lesotho relative to its competitors, cheaper and hence increased production and consequently employment. According to LNDC, the boost in employment is said to be largely, underpinned by the renewal of AGOA, which is set to expire in 2025.

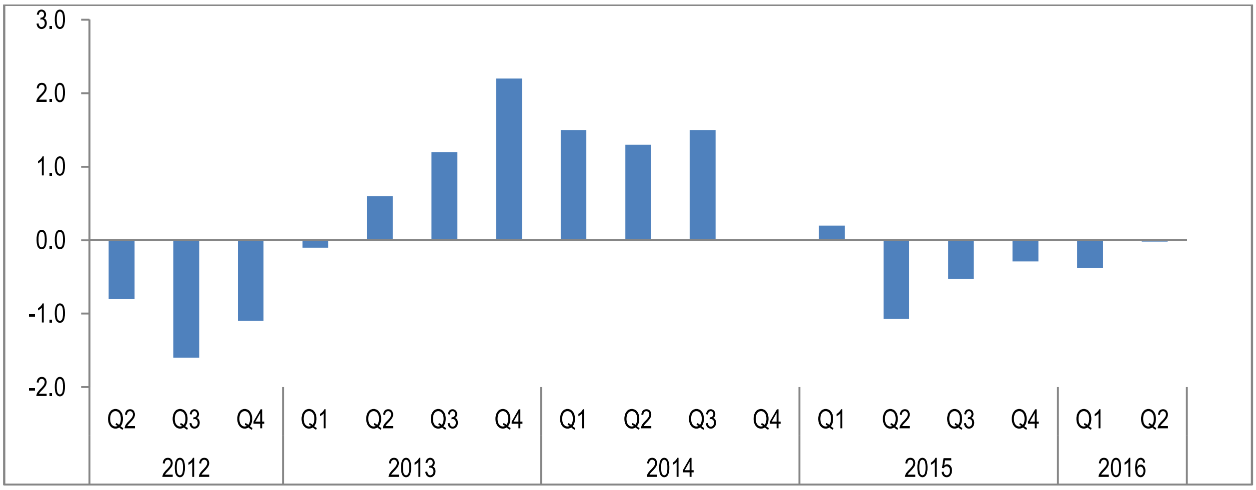
**Table 3: Employment by LNDC-Assisted Companies**

| Industry | 2015 | | | 2016 | | % Change | |
|---|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Q1 | Q2 | Q/Q | Y/Y |
| **Knit Garments.............** | 23427 | 24772 | 24601 | 23398 | 23829 | 1.8 | 1.7 |
| **Woven Garments.......** | 16027 | 16347 | 16241 | 15725 | 17274 | 9.9 | 7.8 |
| **Footwear.....................** | 1616 | 1839 | 1680 | 768 | 753 | -2.0 | -53.4 |
| **Fabrics, Yarn etc..........** | 1715 | 1801 | 1768 | 1721 | 1777 | 3.3 | 3.6 |
| **Construction................** | 317 | 317 | 301 | 322 | 327 | 1.6 | 3.2 |
| **Food & Beverages..........** | 904 | 901 | 826 | 662 | 682 | 3.0 | -24.6 |
| **Electronics.....................** | 926 | 908 | 872 | 923 | 141 | -84.9 | -84.8 |
| **Retail...........................** | 127 | 135 | 135 | 134 | 139 | 3.7 | 9.4 |
| **Hotel Accomm...........** | 385 | 519 | 580 | 365 | 565 | 54.8 | 46.8 |
| **Other.........................** | 1612 | 1720 | 1689 | 1818 | 1939 | 6.7 | 20.3 |
| **TOTAL.......................** | **47056** | **49259** | **48693** | **45836** | **47426** | **3.5** | **0.8** |

**Source:** Lesotho National Development Corporation

Government employment continued to decline but at a marginal pace of 0.4 per cent in the quarter ending in June 2016 relative to a decline of 0.3 per cent in the first quarter of 2016. The slump in the number of teachers and to a lesser extent, the civil servants contributed to the overall decline of government employment. On a quarterly basis, teachers' numbers contributed a decline of 0.33 per cent and civil servants 0.13 per cent, respectively during the review period. The decline in government employment is mainly attributed to the overhaul of the public service administration system, in which the retired and temporary employees are permanently removed from the payroll system.

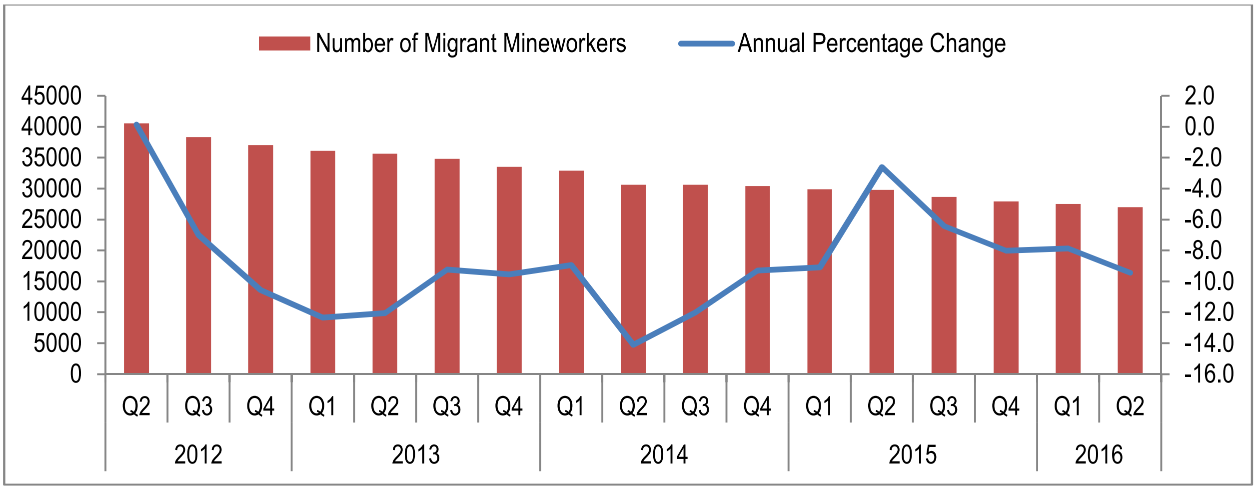
**Figure 11: Government Employment** *(Year-on-Year Percentage Change)*




**Source:** Ministry of Finance

Employment of Basotho migrant mineworkers in South African mines continued to decline by 9.4 per cent in the quarter ending in June 2016 relative to a decline of 7.9 percent recorded in the preceding quarter. The acceleration in the decline of the number of Basotho migrant mineworkers comes at a time when the mining industry in SA is reeling under pressure. In the second quarter of 2016, mining output in SA from various metals and gold plummeted, thus prompting the cut back in the number of employees.

**Figure 12: Migrant Mineworkers** *(Year-on-Year Percentage Changes on Secondary Axis)*




**Source:** The Employment Bureau of Africa (TEBA)

## PRICE DEVELOPEMNTS

Inflation rate in Lesotho, as measured by the percentage change in the overall consumer price index (CPI) remained unchanged at 7.5 per cent in the quarter ending in June, 2016 from the quarter ending in March, 2016. The main contributors to the constant rate between the two quarter are "food and non-alcoholic beverages", whose contribution stood at 5.26 per cent. Nonetheless, "Clothing & footwear", and "Housing, electricity gas & other fuels" moderated the acceleration. Their contributions declined, but marginally under the review period. The overall higher inflation rate in both quarters, which is outside the SA target band, was largely underpinned by the continued exchange rate depreciation against the U.S dollar and the adverse weather conditions experienced since the last quarter of 2015. It severely affected the crop production and food prices increased as a result. This impacted on the acceleration in food prices during the review period.

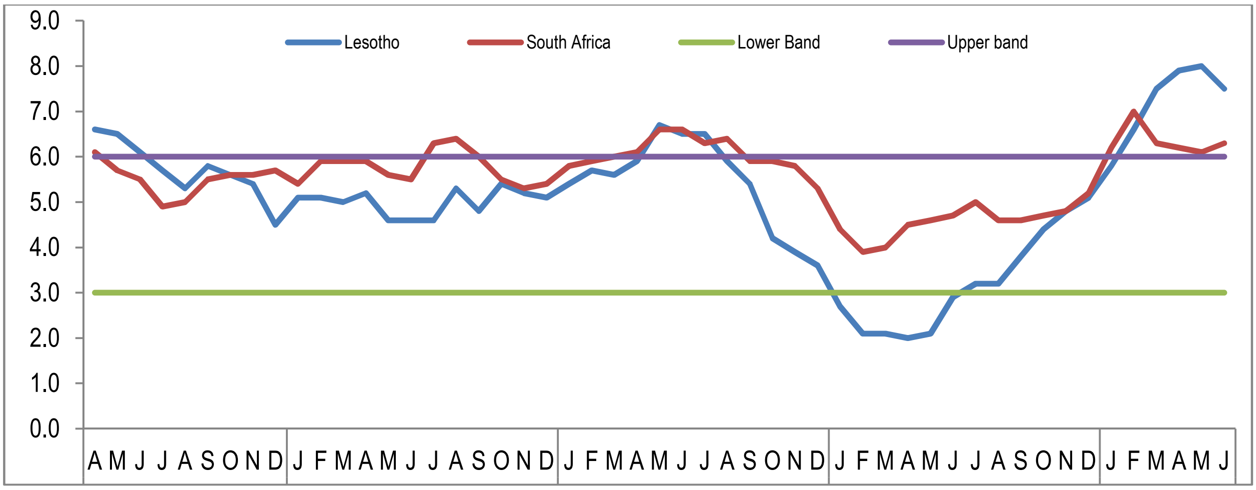
**Table 4: Inflation Rate** *(Year-on-Year Percentage Changes)*

| | | 2015 | | | | |
|---|---|---|---|---|---|---|
| | Weight | Feb | Mar | Apr | May | Jun |
| **All items** | **100** | **6.6** | **7.5** | **7.9** | **8.0** | **7.5** |
| Food and non-alcoholic beverages | 38.1 | 11.5 | 13.8 | 14.8 | 14.7 | 13.8 |
| Alcoholic beverages & Tobacco | 1.2 | 3.9 | 3.9 | 4.2 | 4.5 | 4.8 |
| Clothing & footwear | 17.4 | 4.7 | 4.9 | 4.9 | 4.8 | 5.0 |
| Housing, electricity gas & other fuels | 10.6 | 1.3 | -0.4 | 0.1 | 1.0 | 1.2 |
| Furniture, households equipment & routine maintenance | 9.4 | 4.4 | 3.6 | 4.5 | 4.4 | 3.9 |
| Health | 1.9 | 1.4 | 1.8 | 1.9 | 2.0 | 1.8 |
| Transport | 8.5 | 1.2 | 1.1 | 1.2 | 1.3 | 1.0 |
| Communication | 1.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Leisure, entertainment & Culture | 2.4 | 2.2 | 2.2 | 2.1 | 2.1 | 1.3 |
| Education | 2.7 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 |
| Restaurant & Hotels | 0.7 | 2.3 | 2.4 | 2.4 | 2.3 | 2.3 |
| Miscellaneous goods & services | 5.8 | 5.0 | 5.0 | 4.7 | 4.8 | 4.2 |

**Source:** Bureau of Statistics

During the period under review, the Lesotho inflation rate hovered that of South Africa reflecting both the domestically-generated inflation as a result of severe weather conditions and the imported inflation from SA during the review period. The main drivers of the high inflation rates in the two countries were due to exchange rate depreciation against major currencies and El Niño effect on food prices.

**Figure 13: Lesotho and South Africa's Inflation**



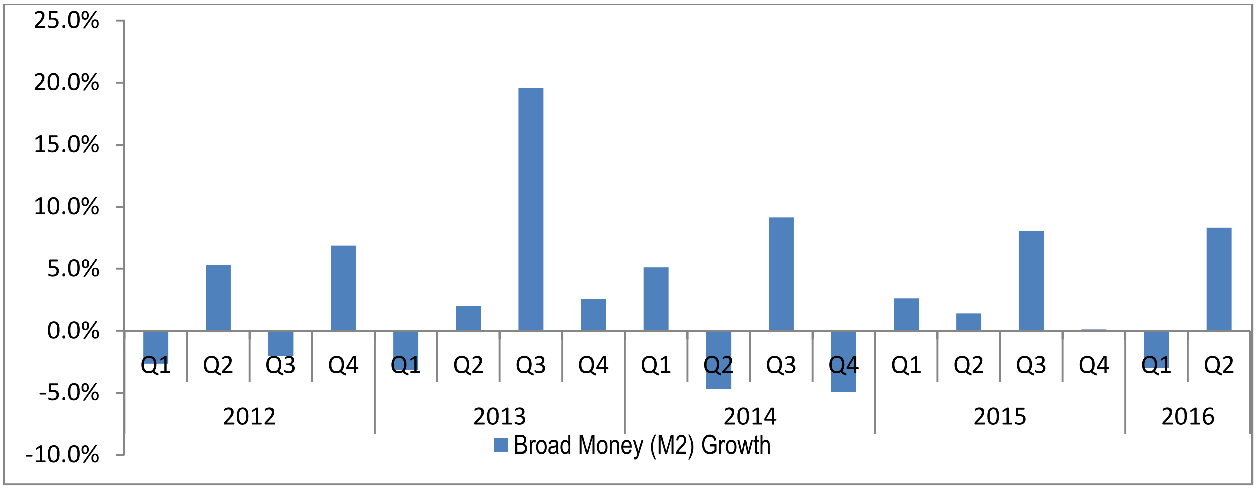

**Source:** Bureau of Statistics, Statistics South Africa

# 3. Monetary and Financial Developments

**BROAD MONEY (M2)**

Money supply increased during the review quarter contrary to a deceleration recorded during the previous quarter. On a quarterly basis, money supply grew by 8.3 per cent compared to the 3.0 per cent recorded during the previous quarter. The growth in money supply came at the back of an upsurge in both the Net Foreign Assets (Net Foreign Assets) as well as domestic claims. The upswing in NFA was primarily driven by the commercial banks' NFA while central Bank NFA registered a decline. Furthermore, commercial banks were responsible for the rise in domestic claims and this was due to a growth in commercial bank claims on the private sector

**Figure 14: Broad Money (M2)**




**Source:** Central Bank of Lesotho

## Determinants of M2

### *Domestic Credit*

Domestic claims, including net claims on government, increased at a decreasing rate of 32.7 per cent relative to the 119 per cent increase reported during the quarter ending March 2016. This was at the back of a 9.7 per cent increase in net claims on government following increased spending by the government coupled with slight expansion of 1.0 per cent in claims on other sectors. The sluggish growth in claims on other sectors is attributed to a muted increase in private sector credit. .

**Table 5: Domestic Claims** *(Million Maloti: End Period)*

| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | Jun | Sept | Dec | Mar | Jun | Annual | Quarterly |
| **Domestic Claims** | **-467.56** | **533.13** | **742.94** | **1626.84** | **2158.58** | **561.7** | **32.7** |
| **Net Claims on Government** | **-5620.40** | **-4919.72** | **-4790.12** | **-3972.47** | **-3497.51** | **37.8** | **12.0** |
| **Commercial Banks Net Claims** | **565.50** | **663.29** | **717.61** | **799.51** | **810.94** | **43.4** | **1.4** |
| Claims on Central Government | 576.10 | 674.66 | 825.42 | 850.15 | 843.52 | **46.4** | **-0.8** |
| Liabilities to Central Government | 10.60 | 11.36 | 107.81 | 50.64 | 32.58 | **207.4** | **-35.7** |
| **Central Bank Net Claims** | **-6185.90** | **-5583.01** | **-5507.73** | **-4771.97** | **-4308.45** | **30.4** | **9.7** |
| Claims on Central Government | 868.00 | 986.20 | 1073.81 | 1034.41 | 1046.02 | **20.5** | **1.1** |
| Liabilities to Central Government | 7053.90 | 6569.21 | 6581.53 | 5806.38 | 5354.46 | **-24.1** | **-7.8** |
| **Claims on Other Sectors** | **5152.84** | **5452.85** | **5533.06** | **5599.30** | **5656.09** | **9.8** | **1.0** |
| Claims on OFCs | 14.40 | 0.00 | 31.39 | 79.81 | 84.10 | **484.0** | **5.4** |
| Claims on St &Local Government | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | | |
| **Claims on Private Sector** | **5138.44** | **5452.85** | **5501.67** | **5519.49** | **5571.99** | **8.4** | **1.0** |
| Claims on Business Enterprises | 1859.11 | 2121.70 | 2103.45 | 2097.13 | 2196.70 | **18.2** | **4.7** |
| Claims on Households | 3279.33 | 3331.15 | 3398.22 | 3422.36 | 3375.29 | **2.9** | **-1.4** |

**Source:** Central Bank of Lesotho

### *Net Foreign Assets*

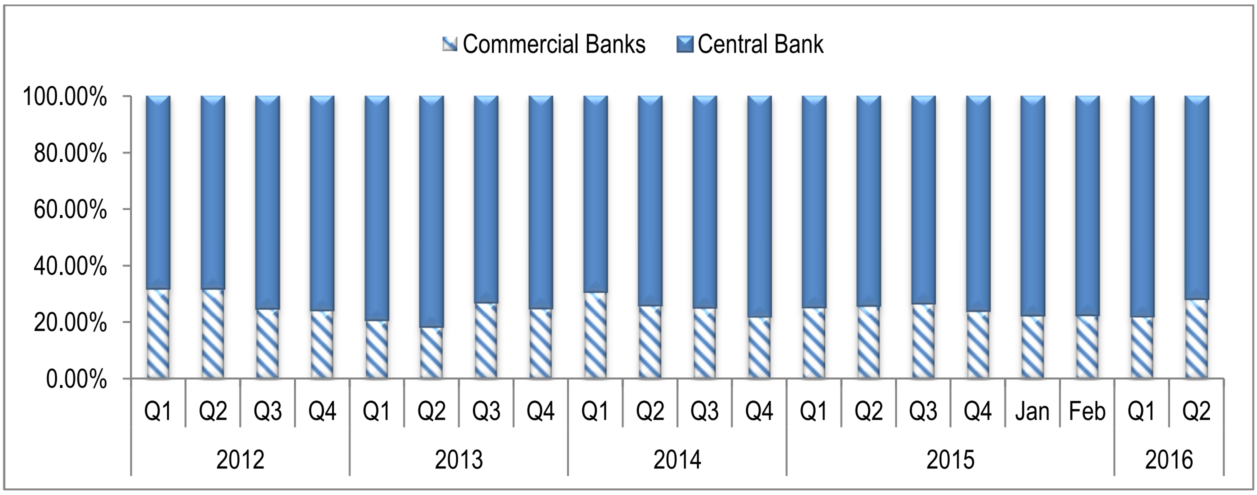
Overall banking system NFA grew by 1.95 per cent during the review period as compared to the 1.22 per cent growth recorded in Quarter 2 2016. The increase was propelled by commercial banks' NFA which rose by 30.2 per cent in June 2016 when compared with an 8.6 per cent decline in March 2016. The increase in commercial banks' NFA was however weakened by a 6.19 per cent decline in Central Bank NFA. The major driver behind the increase in commercial banks' NFA was a 35.99 per cent upsurge in commercial bank other deposits with banks in South Africa from a 13.56 per cent decline in Quarter 1 2016 and was funded by increased government spending over the review period. The decline in Central Bank NFA on the other hand was accounted for by an 8.10 per cent decline in Central Bank securities included in official reserves. This weak Central Bank position followed a previous 4.67 per cent decline in Central Bank securities recorded in the quarter ending March 2016.

**Table 6: Net Foreign Assets** *(Million Maloti: End Period)*

| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | June | Sept | Dec | March | June | Annual | Quarterly |
| **Commercial Banks** | **3869.42** | **4169.14** | **3859.15** | **3527.63** | **4594.25** | **18.7** | **30.2** |
| Claims on Non-residents | 4233.30 | 4578.92 | 4244.11 | 3873.12 | 4895.02 | **15.6** | **26.4** |
| Liabilities to Non-residents | 363.88 | 409.79 | 384.96 | 345.49 | 300.76 | **-17.3** | **-12.9** |
| **Central Bank** | **10910.96** | **11323.81** | **11957.92** | **12267.04** | **11507.86** | **5.5** | **-6.2** |
| Claims on Non-residents | 12342.84 | 12950.71 | 13739.59 | 13983.68 | 13233.44 | **7.2** | **-5.4** |
| Liabilities to Non-residents | 1431.89 | 1626.90 | 1781.67 | 1716.64 | 1725.58 | **20.5** | **0.5** |
| **Net Foreign Assets Total** | **14780.38** | **15492.95** | **15817.07** | **15794.67** | **16102.11** | **8.9** | **1.9** |

**Source:** Central Bank of Lesotho

**Figure 15: Net Foreign Assets** *(percentage shares)*




**Source:** Central Bank of Lesotho

## Components of M2

The major components of broad money (M2) are narrow money (M1) and quasi money. During the review period, M2 increased by 8.31 per cent from a 3.0 per cent decline in Quarter 2 2016. The increase came at the back of a rise in both M1 as well as quasi money. M1 rose by 5.7 per cent following a 7 per cent decline in the previous quarter. The increase in M1 was attributed to a 6.95 per cent rise in transferrable deposits which was a rebound from the 6.1 per cent decline recorded in the previous quarter. On the other hand, the increase in quasi money due to an 11 per cent increase in other deposits of commercial banks that followed a 1 per cent increase in Quarter 1 2016.

**Table 7: Components of Money Supply** *(Million Maloti: End Period)*

| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | Jun | Sep | Dec | Mar | Jun | Annual | Quarterly |
| **Broad Money (M2)** | **9368.6** | **10124.0** | **10134.6** | **9829.4** | **10646.6** | **13.64** | **8.31** |
| **Narrow Money (M1)** | **4368.9** | **4860.6** | **5295.3** | **4927.0** | **5206.0** | **19.16** | **5.66** |
| Currency Outside DCs | 842.1 | 912.7 | 1014.5 | 907.2 | 907.1 | **7.72** | **-0.01** |
| Transferable Deposits | 3526.9 | 3947.9 | 4280.8 | 4019.8 | 4299.0 | **21.89** | **6.95** |
| **Quasi Money** | **4999.6** | **5263.4** | **4839.2** | **4902.4** | **5440.5** | **8.82** | **10.98** |
| Other Deposits Commercial Banks | 4953.5 | 5223.1 | 4801.3 | 4850.3 | 5385.4 | **8.72** | **11.03** |
| Other Deposits Central Bank | 46.2 | 40.4 | 38.0 | 52.1 | 55.1 | **19.30** | **5.75** |

**Source:** Central Bank of Lesotho

## CREDIT EXTENSION

### Trends of credit extended to Business Enterprises

During the review period, total credit to business enterprises rose by 4.7 per cent relative to a 0.3 per cent decline in the quarter ending March 2016. The mining, construction, real estate and business services sectors experienced an increase in credit extension while credit extended to manufacturing, wholesale, retail, hotel and restaurant, transport, storage and communication as well as electricity, gas and water declined. The increase in credit to business has been in light of new loan issuances to existing customers and the utilization of bank overdraft facilities while run offs were responsible for the observed declines in identified business sectors.

**Table 8: Credit Extension by Economic Activity** *(Million Maloti)*

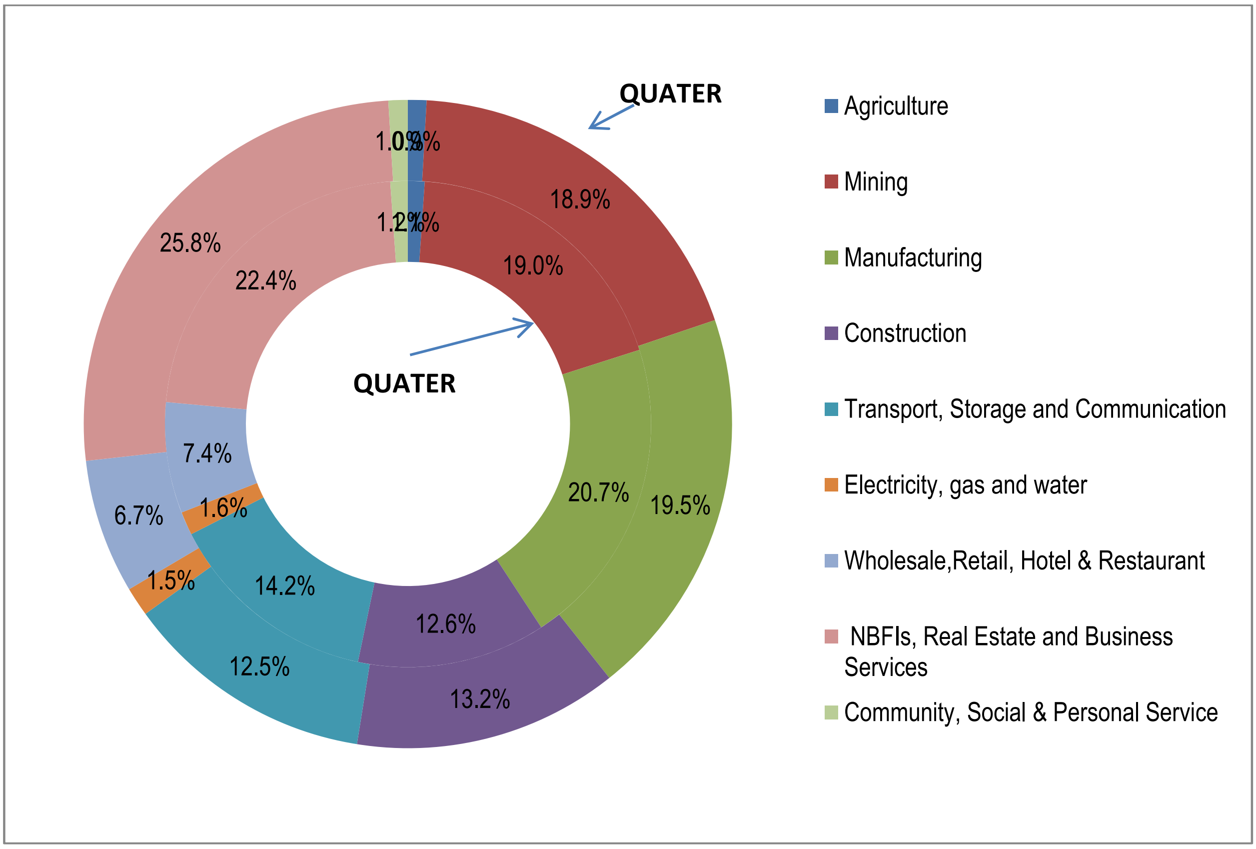
| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| **SECTOR** | **Jun** | **Sep** | **Dec** | **Mar** | **Jun** | **Annual** | **Quarterly** |
| Agriculture | 12.81 | 17.20 | 18.10 | 23.21 | 20.34 | **58.8** | **-12.3** |
| Mining | 340.18 | 475.40 | 406.92 | 397.53 | 414.73 | **21.9** | **4.3** |
| Manufacturing | 401.31 | 465.80 | 481.74 | 433.99 | 428.66 | **6.8** | **-1.2** |
| Construction | 229.36 | 234.50 | 228.17 | 263.28 | 289.91 | **26.4** | **10.1** |
| Transport, Storage and Communication | 158.79 | 236.90 | 235.34 | 297.74 | 274.97 | **73.2** | **-7.6** |
| Electricity, gas and water | 62.66 | 34.90 | 32.89 | 32.80 | 31.97 | **-49.0** | **-2.5** |
| Wholesale, Retail, Hotel & Restaurant | 173.10 | 195.80 | 235.85 | 154.60 | 146.92 | **-15.1** | **-5.0** |
| NBFIs, Real Estate and Business Services | 464.19 | 444.10 | 444.62 | 469.48 | 567.82 | **22.3** | **20.9** |
| Community, Social & Personal Service | 16.71 | 17.00 | 19.82 | 24.51 | 21.36 | **27.8** | **-12.8** |
| **All Sectors** | **1859.11** | **2121.60** | **2103.45** | **2097.12** | **2196.70** | **18.2** | **4.7** |

**Source:** Central Bank of Lesotho

### Distribution of credit Extended to Business Enterprises

When attention is given to the allocation of credit extended to business enterprises by type of sector, real estate and business services received the biggest share at 25.8 per cent followed by manufacturing, then mining and construction at 19.5 per cent, 18.9 per cent and 13.2 per cent respectively. Historically, the manufacturing sector received the lion's share of credit to business enterprises but the recent developments in the real estate and business services; particularly the use of overdraft facilities by commercial banks' top borrowers could suggest a shift. The agriculture sector continues to have the lowest share of credit at 0.9 per cent.

**Figure 16: Distribution of Credit** *(Percentage Shares)*

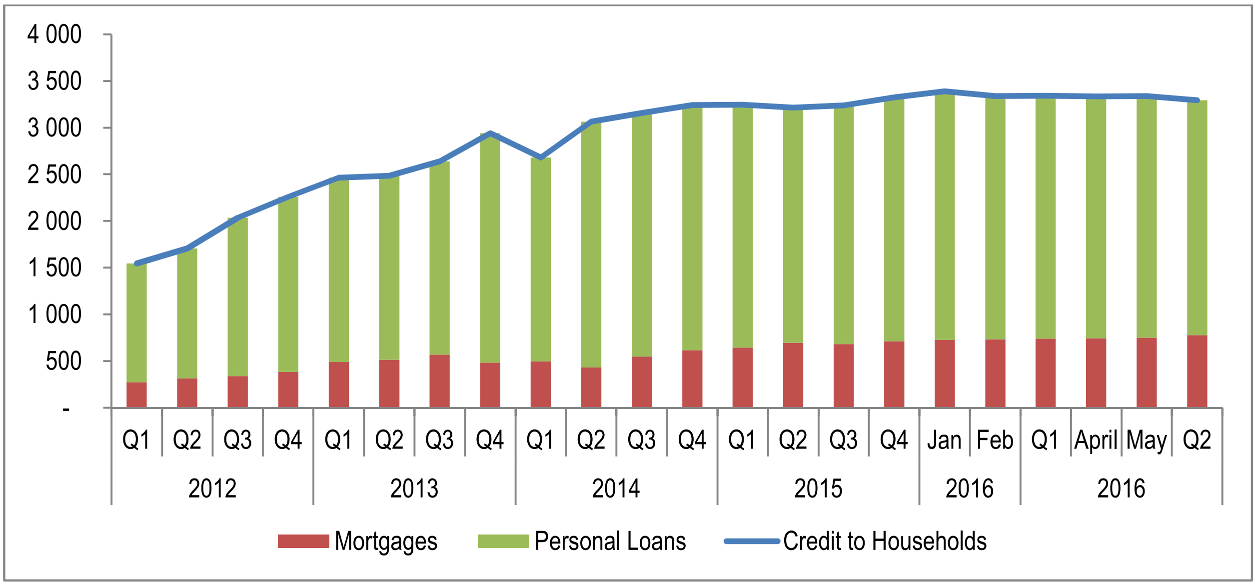



**Source:** Central Bank of Lesotho

## Credit extended to Households

Credit extended to households declined by 1.5 per cent in the quarter under review when compared to a 0.6 per cent increase in the previous quarter. The decline was on account of a 3.4 per cent decline in personal loans moderated by a 5.3 per cent increase in mortgage loans. Even though personal loans continue to account for the highest proportion in total loans to households, their decline reflect the tightening of commercial bank lending parameters as well as bank run offs. In addition, the observed increase in mortgage loans reflects commercial banks' continued strategy to favour more asset based loans.

**Figure 17: Credit Extension to Household** *(Million Maloti)*




**Source:** Central Bank of Lesotho

## LIQUIDITY OF COMMERCIAL BANKS

### Components of liquidity

Commercial banks' liquidity ratio declined from 89.4 per cent as recorded in Quarter 1 2016 to 86 per cent in the quarter under review. The decline was the result of an increase in total deposits that outstripped the increase in liquidity components. Similarly, the credit to deposit ratio fell to 56.7 per cent compared to a 61.4 per cent increase in the previous period. The growth in commercial bank total deposits was mainly the result of increased government expenditure through the domestic banking system. Financial sector intermediation grew, albeit at a sluggish pace in the quarter under review as evidenced by a 1 per cent rise in credit to the private sector.

**Table 9: Components of Liquidity** *(Million Maloti)*

| | 2015 | | | 2016 | |
|---|---|---|---|---|---|
| | **Jun** | **Sep** | **Dec** | **Mar** | **Jun** |
| **Credit to Deposit Ratio** | **59.9%** | **58.8%** | **59.8%** | **61.4%** | **56.7%** |
| Private Sector Credit | 5076.70 | 5389.12 | 5432.19 | 5442.59 | 5495.21 |
| Total Deposits | 8480.33 | 9170.98 | 9082.06 | 8870.10 | 9684.43 |
| **Liquidity Ratio** | **81.7%** | **78.6%** | **82.6%** | **89.4%** | **86.0%** |
| Notes and Coins | 304.97 | 293.04 | 476.34 | 375.41 | 349.94 |
| Balance due from banks in Lesotho | 2411.64 | 2395.28 | 2343.95 | 3139.31 | 2577.87 |
| Balance due from banks in SA | 3669.12 | 3723.89 | 3760.57 | 3284.10 | 4501.12 |
| Surplus funds | -65.61 | 122.88 | 96.42 | 284.96 | 55.32 |
| Government Securities | 610.16 | 674.66 | 825.42 | 850.15 | 843.52 |
| **Total** | **6930.27** | **7209.75** | **7502.69** | **7933.93** | **8327.78** |

**Source:** Central Bank of Lesotho

## Commercial Banks Sources of Funds

The main sources of funds for commercial banks are deposits which comprise of transferable deposits and other deposits. Total deposits increased by 8.4 per cent compared to a 1.61 per cent decline in Quarter 1 2016. The increase came on account of a rise in deposits from the household, mining and other financial corporation sectors as well as an increase in government spending through the domestic banking system. In addition, other deposits of other financial corporations increased from 1.96 million to 120.78 million during the review period. This was driven by insurance sector placements with commercial banks.

**Table 10: Sources of funds for ODCs** *(Million Maloti)*

| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | Jun | Sep | Dec | Mar | Jun | Annual | Quarterly |
| **Transferable Deposits Incl. in BM** | **3526.86** | **3947.90** | **4280.81** | **4085.31** | **4298.99** | **21.9** | **5.2** |
| Other Financial Corporations | 0.00 | 0.00 | 0.00 | 38.28 | 65.19 | **-** | **70.3** |
| Public Nonfinancial Corporations | 56.34 | 92.81 | 83.51 | 44.82 | 33.92 | **-39.8** | **-24.3** |
| Private Sector | 3452.56 | 3837.14 | 4179.35 | 3918.75 | 4181.92 | **21.1** | **6.7** |
| Other NFCs | 2582.90 | 2780.31 | 2813.91 | 2577.72 | 2734.49 | **5.9** | **6.1** |
| Other Sectors (Households) | 869.66 | 1056.83 | 1365.44 | 1341.03 | 1447.44 | **66.4** | **7.9** |
| **Other Deposits Incl. in BM** | **4953.47** | **5223.07** | **4801.25** | **4850.30** | **5385.45** | **8.7** | **11.0** |
| Other Financial Corporations | 26.11 | 22.15 | 87.46 | 1.96 | 120.78 | **362.6** | **6060.2** |
| Public Nonfinancial Corporations | 94.09 | 187.43 | 115.83 | 205.51 | 231.33 | **145.9** | **12.6** |
| Private Sector | 4833.27 | 5013.50 | 4597.96 | 4642.83 | 5033.33 | **4.1** | **8.4** |
| Other NFCs | 3610.37 | 3748.38 | 3053.65 | 2974.01 | 3571.34 | **-1.1** | **20.1** |
| Other Sectors (Households) | 1222.90 | 1265.12 | 1544.31 | 1668.82 | 1462.00 | **19.6** | **-12.4** |
| **Total Deposits** | **8480.33** | **9170.98** | **9082.06** | **8935.61** | **9684.43** | **14.2** | **8.4** |

**Source:** Central Bank of Lesotho

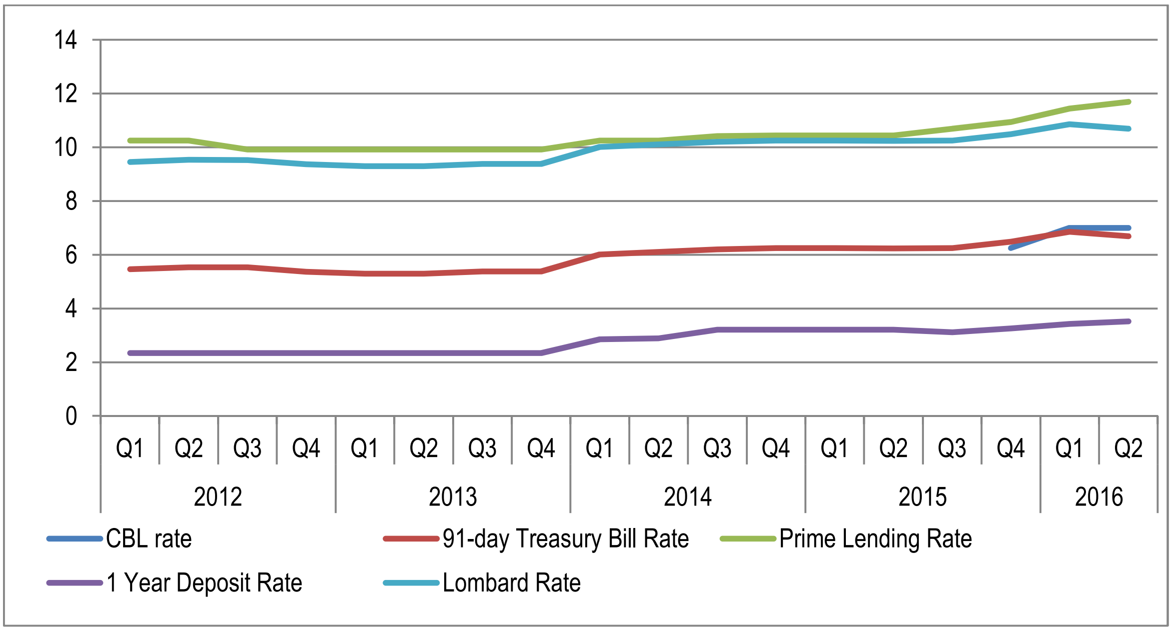
## MONEY AND CAPITAL MARKET DEVELOPMENTS

## Money Market

### *Interest Rates*

The Central Bank of Lesotho introduced the CBL rate in the last quarter of 2015 at 6.25 per cent. Since then, the bank's Monetary Policy Committee hiked the rate by a total of 75 baiss points to 7 per cent owing to upward risks to inflation and a gloomy economic outlook. In response, money market rates have also been on a steady increase with the prime lending rate recording 11.69 per cent in the quarter udner review up from 11.44 per cent. This was accompanied by a 3 per cent increase in the 1 year deposit rate from a 5 per cent incrase in the previous period.

**Figure 18: Short Term Interest Rates** *(Per Cent per Annum)*




**Source:** Central Bank of Lesotho

**Table 11: Interest rates**

| | 2015 | | | 2016 | |
|---|---|---|---|---|---|
| | Jun | Sept | Dec | Mar | Jun |
| **Central Bank** | | | | | |
| CBL rate | - | - | 6.25 | 7 | 7 |
| T-Bill Rate - 91 days | 6.24 | 6.25 | 6.49 | 6.86 | 6.69 |
| Lombard Rate | 10.24 | 10.24 | 10.49 | 10.86 | 10.69 |
| **Commercial Banks** | | | | | |
| Call | 0.99 | 0.85 | 1.03 | 1.74 | 1.82 |
| Time: | | | | | |
| 31 days | 1.23 | 0.83 | 0.48 | 0.41 | 0.44 |
| 88 days | 1.72 | 2.13 | 1.04 | 1.09 | 1.12 |
| 6 months | 2.31 | 2.18 | 2.26 | 2.44 | 2.53 |
| 1 year | 3.21 | 3.11 | 3.26 | 3.43 | 3.52 |
| Savings | 0.86 | 0.61 | 0.51 | 0.55 | 0.56 |
| Prime | 10.44 | 10.69 | 10.94 | 11.44 | 11.69 |
| **South Africa** | | | | | |
| Repo | 5.75 | 6.00 | 6.25 | 7.00 | 7.00 |
| T-Bill Rate - 91 days | 5.72 | 6.21 | 6.98 | 7.10 | 7.19 |
| Marginal Lending Rate | | | | | |
| Prime | 9.25 | 9.50 | 9.75 | 10.5 | 10.5 |

**Source:** Central Bank of Lesotho

### *Holding of Treasury Bills and T-Bill Rates*

The holding of Treasury Bills increased by 1 per cent in the quarter under review relative to a 1 per cent decline in the previous quarter. The Treasury bill average yiled rate declined from 7 per cent to 6.8 per cent over the same period.

**Table 12: Holding of Bills and Yields** *(Million Maloti)*

| | 2015 | | | 2016 | |
|---|---|---|---|---|---|
| | Jun | Sep | Dec | Mar | Jun |
| **Treasury Bills** | **592.26** | **542.12** | **595.85** | **592.48** | **598.39** |
| Banking System | 396.53 | 331.9 | 395.61 | 394.7 | 393.49 |
| Non-Bank Sector | 195.73 | 210.22 | 200.24 | 197.78 | 204.9 |
| **Memorandum Item** | | | | | |
| Yield Bills (91-days) | 6.34 | 6.35 | 6.6 | 7 | 6.8 |

**Source:** Central Bank of Lesotho

### *Holding of Treasury Bonds and T-Bonds Rates*

There was a 0.01 per cent increase in holding of Treasury bonds in Quarter 2 2016 compared to a 9 per cent increase in the previous quarter. The increase in the quarter under review emanated from a 0.1 per cent increase in banking system's holdings relative to a 0.2 per cent decline in holdings by the non-bank sector.

### *Holding of Treasury Bonds and T-Bonds Rates*

**Table 13: Holding of Bonds and Yields** *(Million Maloti)*

| | 2015 | | | 2016 | |
|---|---|---|---|---|---|
| | Jun | Sept | Dec | Mar | Jun |
| **Holding of Treasury Bonds** | **573.17** | **573.17** | **622.87** | **681.79** | **681.85** |
| Banking System | 338.97 | 339.39 | 468.03 | 471.7 | 472.19 |
| Non-Bank Sector | 234.2 | 233.78 | 154.84 | 210.09 | 209.65 |

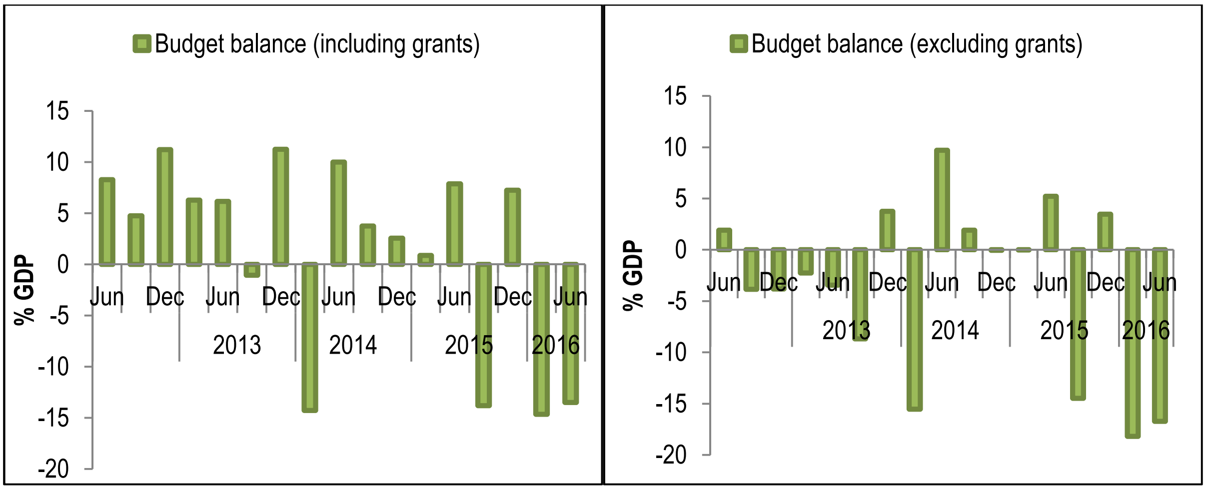
**Source:** Central Bank of Lesotho

# 4. Government Finance

## OVERVIEW

The fiscal balance including grants during the quarter ending June, 2016 registered a deficit of 13.5 per cent of GDP while the deficit that excludes grants recorded 16.7 per cent. A deficit in the first quarter of the fiscal year was last experienced in the same quarter in 2011/2012, when total **revenue** declined significantly by 19.8 per cent. The main reason for the current decline is 16.1 per cent fall in total revenue during the quarter under review compared to a rise of 1.2 per cent in the previous quarter. Though the recurrent expenditure (expense) has declined substantially (37.3 per cent), the capital expenditure (non-financial assets), has increased significantly by 88.0 per cent during the quarter under review. The stock of public debt recorded 50.9 per cent of GDP in the quarter ending June, 2016 compared with the revised 51.4 per cent in the previous quarter. The changing debt-to-GDP ratio is mainly due to a fall in the external debt stock.

**Figure 19: Fiscal Balance** *(Per cent of GDP)*

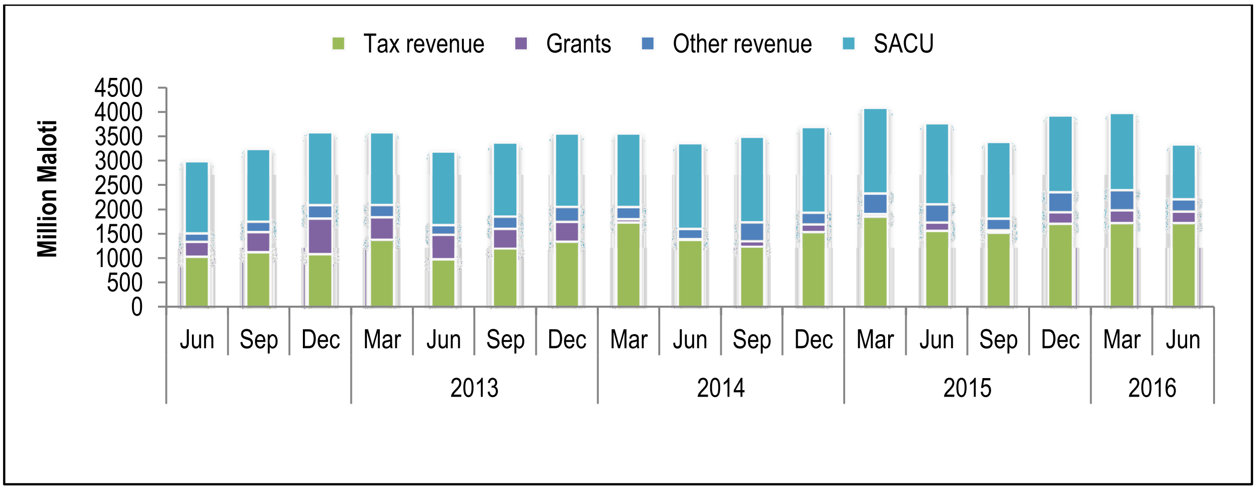



**Source:** Central Bank of Lesotho (CBL) and Ministry of Finance (MOF)

## REVENUE

The total revenue as a ratio of GDP was 46.9 per cent of GDP during the quarter ending June, 2016 compared with 55.9 per cent in the quarter ending March, 2016. This change was explained by a marginal fall in tax revenue amounting to 0.3 per cent during the quarter under review compared to a rise of 1.2 per cent in the previous quarter. The main contributors were SACU receipts which fell by 28.4 per cent, company tax by 16.0 per cent, value added tax by 14.6 per cent, and also withholding tax which declined by 11.3 per cent value added tax. The grants decreased by 8.8 per cent during the quarter under review compared to the revised rise of 5.4 per cent in the previous quarter, mainly due to a fall of 10.3 per cent in capital grants from foreign governments. Other revenue fell by 39.7 per cent during the quarter ending June, 2016 compared to 2.5 per cent rise that was registered in the previous quarter. This fall was attributable to declining dividends, mining royalties, electricity sales from 'Muela, and water royalties from LHDA.

**Figure 20: Total Revenue** *(Million Maloti)*



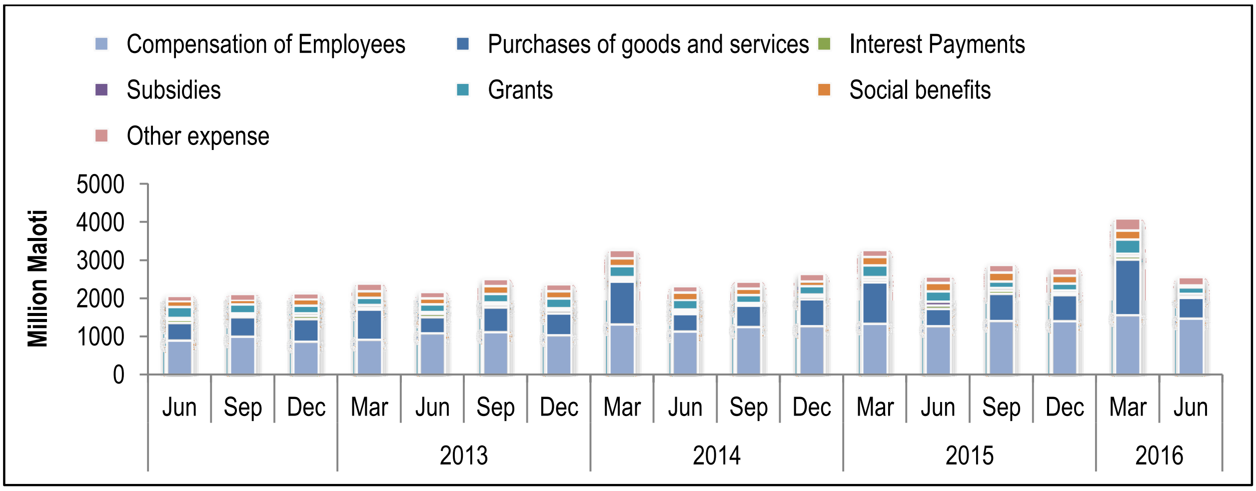

**Source:** CBL and MOF

## TOTAL EXPENDITURE

The total expenditure recorded 60.4 per cent of GDP during the quarter ending June, 2016 compared with 70.5 per cent in the quarter ending March, 2016. This movement is explained by a fall in expenses of 37.3 per cent during the quarter ending June, 2016 relative to a rise of 45.6 per cent in the previous quarter. Thus, the proportional share of expense to total expenditure declined from 81.7 per cent in the previous quarter to 59.9 during the quarter ending June, 2016. This decline in expense was explained by a list of items, including interest payments to non-residents (77.6 per cent), grants to both extra-budgetary units and local governments (63.1 per cent), purchases of goods and services (61.9 per cent), social assistance benefits in kind (40.1) and wages and salaries in cash (8.4 per cent). The late release of Appropriation Bill in June, 2016 also contributed to the under performance of the recurrent budget spending.

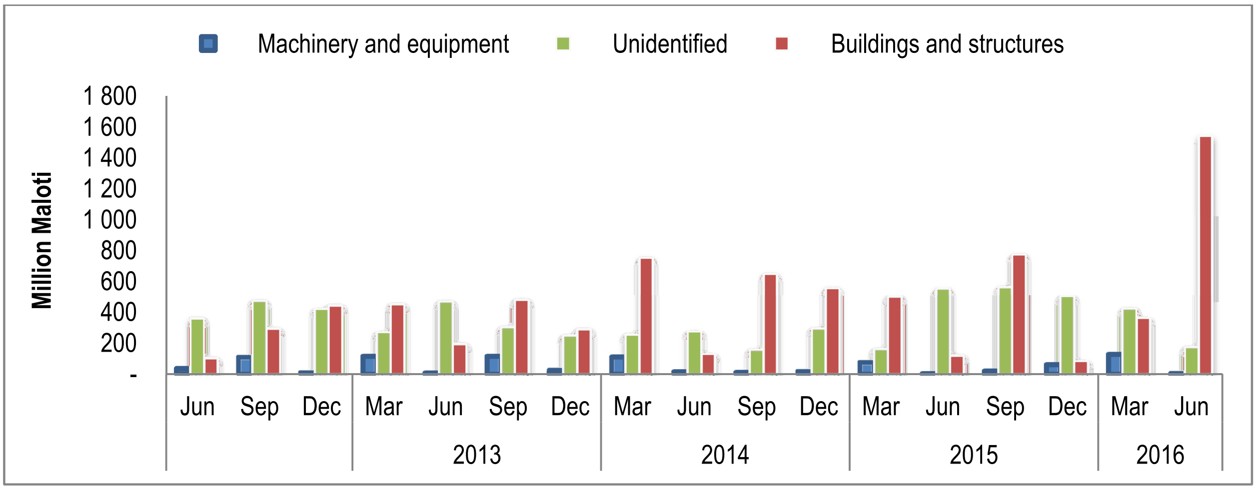
Moreover, the non-financial assets increased by 88.0 per cent during the quarter under review compared with 40.6 per cent in the quarter ending March, 2016. Thus, buildings and structures increased by 324.0 per cent as a result of M440.50 million paid for compensation on Roma-Ramabanta-Semonkong-Sekake road, Mokhotlong-Sani road, Bethele bridge, Leshele-Mathokoane road, and Oxbow-Mokhotlong road, among other big payments. About M153.40 million was also transferred to the District Councils.

**Figure 21: Total Expense** *(Million Maloti)*




**Source:** CBL and MOF

**Figure 22: Total Non-financial assets or Capital expenditure** *(Million Maloti)*




**Source:** CBL and MOF

**Table 14: Statement of Sources and Uses of Cash** *(Million Maloti)*

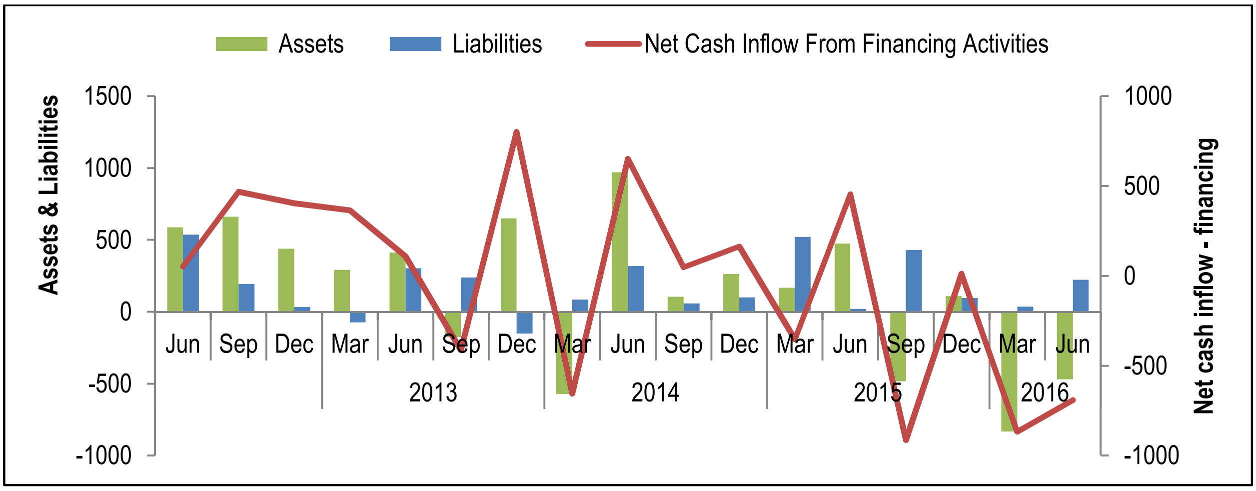
| | | | 2015 | | 2016 | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | Jun | Sep | Dec | Mar | Jun | Q-to-Q | Y-on-Y |
| **Total Revenue** | **3768.87** | **3384.96** | **3924.40** | **3970.16** | **3330.49** | **-16.1** | **-11.6** |
| Tax revenue | 1559.33 | 1527.46 | 1700.59 | 1723.43 | 1718.94 | -0.3 | 10.2 |
| Grants | 168.57 | 41.71 | 239.61 | 252.55 | 230.43 | -8.8 | 36.7 |
| Other revenue | 373.52 | 238.74 | 407.14 | 417.12 | 251.38 | -39.7 | -32.7 |
| SACU receipts | 1667.45 | 1577.06 | 1577.06 | 1577.06 | 1129.74 | -28.4 | -32.2 |
| **Total Expense** | **2586.75** | **2899.18** | **2811.88** | **4093.90** | **2566.71** | **-37.3** | **-0.8** |
| Compensation of Employees | 1270.35 | 1406.24 | 1395.95 | 1556.82 | 1468.38 | -5.7 | 15.6 |
| Purchases of goods and services | 451.22 | 737.05 | 706.22 | 1474.67 | 561.96 | -61.9 | 24.5 |
| Interest Payments | 88.96 | 72.87 | 52.72 | 80.49 | 30.21 | -62.5 | -66.0 |
| Subsidies | 99.82 | 72.28 | 70.04 | 67.04 | 81.03 | 20.9 | -18.8 |
| Grants | 287.24 | 170.74 | 170.94 | 367.53 | 162.86 | -55.7 | -43.3 |
| Social benefits | 216.14 | 229.49 | 217.65 | 234.63 | 51.76 | -77.9 | -76.1 |
| Other expense | 173.02 | 210.51 | 198.36 | 312.72 | 210.51 | -32.7 | 21.7 |
| **Net Cash Inflow From Operating Activities** | **1182.13** | **485.78** | **1112.52** | **-123.74** | **763.78** | **-717.2** | **-35.4** |
| **Total Nonfinancial Assets** | **681.51** | **1363.97** | **651.46** | **915.65** | **1721.04** | **88.0** | **152.5** |
| Fixed Assets | 681.51 | 1363.97 | 651.46 | 915.65 | 1721.04 | 88.0 | 152.5 |
| Non-Produced Assets | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.0 | 0.0 |
| **Cash deficit(-)/surplus(+)** | **500.62** | **-878.19** | **461.06** | **-1039.39** | **-957.26** | **-** | **-** |
| **Net Cash Inflow From Financing Activities** | **-438.60** | **905.15** | **-12.42** | **866.94** | **757.02** | **-** | **-** |
| Net Acquisition of Financial assets | -457.90 | 475.97 | -108.77 | 831.34 | 535.44 | - | - |
| Net Incurrence of Liabilities | 19.29 | 429.18 | 96.34 | 35.60 | 221.58 | - | - |
| Statistical Discrepancy | 62.01 | 26.97 | 448.64 | -172.45 | -200.24 | - | - |

**Source:** CBL and MOF

## FINANCIAL ASSETS AND LIABILITIES

The net cash inflow from financing activities registered a fall of M757.02 million during the quarter under review compared to the revised decline of M866.94 million in the quarter ending March, 2016. The reason for this fall is in conjunction with the decline in the Government deposits to a record of M469.98 million, coupled with an increase in the foreign loans (net) amounting to M210.07, among others factors. Foreign loan disbursements from European Investment Bank to Metolong Dam Project amounted to M245.24 milllion. The extended credit facility (on-lent) from the IMF through the Central Bank increased by M11.61 million due to revaluation gains as Loti depreciated against Special Drawings Rights.

**Figure 23: Net Cash Inflow from Financing Activities** *(Million Maloti)*

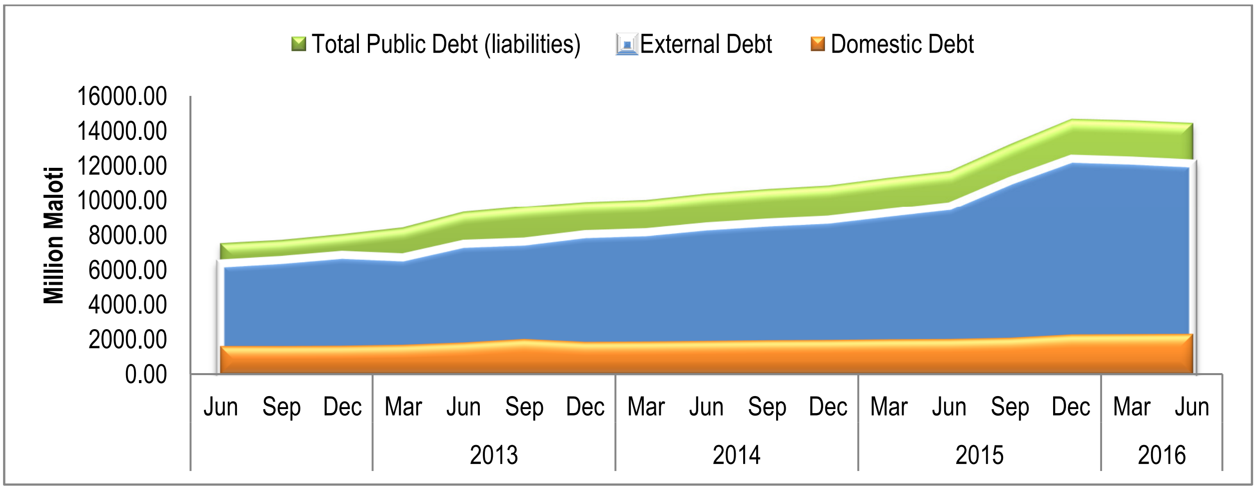



**Source:** CBL and MOF

## TOTAL PUBLIC DEBT

The stock of public and publicly guaranteed debt recorded a decline of 1.0 per cent during the quarter under review compared with 0.6 per cent in the previous quarter. The new debt during the quarter under review constituted an increase of M210.07 compared to the revised fall of M2.34 million in the previous. However, the decline in the stock of debt was mainly due to the positive gains as a result of Loti appreciation to major currencies in terms of foreign currency-denominated debt. That is, the stock of debt declined from the revised M14,456.29 million in the quarter ending June, 2016 which was down from M14,609.18 recorded in the quarter ending March, 2016 due to a fall in the stock of external debt mainly concessional bilateral and multilateral loans (declined by 4.2 per cent and 3.1 per cent, respectively). The suppliers' credit also fell by 4.8 per cent as a result of a decline in loans from Export Import Bank of China (M42.20 million). Furthermore, the domestic debt increased by 0.8 per cent during the quarter ending June, 2016 compared with 0.7 per cent in the quarter ending March, 2016. The reason for this marginal increase included a rise in the long-term treasury bonds that were held by the banks (0.1 per cent), and short term non-bank treasury bills (3.6 per cent).

**Figure 24: Outstanding Public Debt** *(Million Maloti)*




**Source:** CBL and MOF

**Table 15: External Debt Stock** *(Million Maloti)*

| | | | 2015 | | 2016 | Debt / GDP (%) | |
|---|---|---|---|---|---|---|---|
| | Jun | Sep | Dec | Mar | Jun | Mar-16 | Jun-16 |
| **TOTAL PUBLIC DEBT** | **11720.70** | **13265.70** | **14699.42** | **14609.18** | **14456.29** | **57.79** | **51.41** |
| **EXTERNAL DEBT** | **9687.20** | **11164.20** | **12406.90** | **12300.00** | **12129.70** | **43.29** | **42.69** |
| Bilateral Loans | 876.90 | 996.60 | 1147.10 | 1134.80 | 1087.30 | 3.99 | 3.83 |
| Concessional | 876.90 | 996.60 | 1147.10 | 1134.80 | 1087.30 | 3.99 | 3.83 |
| Non-concessional | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Multilateral Loans | 8010.10 | 9298.80 | 10299.90 | 10245.60 | 10167.40 | 36.06 | 35.78 |
| Concessional | 6632.10 | 7506.40 | 8344.30 | 8284.10 | 8024.70 | 29.15 | 28.24 |
| Non-concessional | 1378.00 | 1792.40 | 1955.60 | 1961.50 | 2142.70 | 6.90 | 7.54 |
| Financial Institutions | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Concessional | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Non-concessional | 55.10 | 54.40 | 1.50 | 1.40 | 1.40 | 0.00 | 0.00 |
| Suppliers' Credit | 800.20 | 868.80 | 959.90 | 919.60 | 875.00 | 3.24 | 3.08 |
| **DOMESTIC DEBT** | **2033.50** | **2101.50** | **2292.52** | **2309.18** | **2326.59** | **8.13** | **8.19** |
| Banks | 1603.57 | 1657.49 | 1937.44 | 1901.25 | 1912.04 | 6.69 | 6.73 |
| Long-term (t-bonds) | 1206.99 | 1325.59 | 1541.83 | 1506.45 | 1518.55 | 5.30 | 5.34 |
| Treasury bonds | 338.97 | 339.39 | 468.03 | 472.04 | 472.53 | 1.66 | 1.66 |
| Central Bank (IMF-ECF) | 868.02 | 986.20 | 1073.81 | 1034.41 | 1046.02 | 3.64 | 3.68 |
| Short-term (t-bills) | 396.58 | 331.91 | 395.61 | 394.80 | 393.49 | 1.39 | 1.38 |
| Non-bank | 429.93 | 444.01 | 355.08 | 407.93 | 414.55 | 1.44 | 1.46 |
| Short-term (t-bills) | 195.73 | 210.22 | 200.24 | 197.78 | 204.90 | 0.70 | 0.72 |
| Long-term (t-bonds) | 234.20 | 233.78 | 154.84 | 210.15 | 209.65 | 0.74 | 0.74 |

**Source:** CBL and MOF

# 5. Foreign Trade and Payments

### OVERVIEW

The external sector flows continued to show a deficit equivalent to 11.7 per cent of GDP in the quarter ending in June 2016, following a revised deficit of 13.4 per cent in the quarter ending in March 2016. The narrowing of the deficit was mainly driven by improvement in the current account due to the fall in trade account deficit together with an increase in the primary income account.

### CURRENT ACCOUNT

The current account balance registered a deficit of M599.82 million in the second quarter of 2016, lower than a revised deficit of M993.10 million in the previous quarter. This was driven largely by a 29.1 per cent reduction of the merchandise trade deficit in the review quarter, in contrast with 6.8 per cent growth in the deficit during the previous quarter. The decline in the deficit of trade in goods reflected lower merchandise imports while merchandise exports grew during the period. The narrowing of the current account deficit was also supported by a reduction in payments for services acquired abroad together with an increase in the primary income account which was supported by the growth in returns on foreign portfolio investments. However, improvement in the current account balance was dampened by shrinking of the secondary income balance due to the fall in SACU revenue which takes the largest share in the account.

**Table 16: Current Account Balance** *(Million Maloti)*

| | 2015 | | | 2016 | | Changes (%) | |
|---|---|---|---|---|---|---|---|
| | Q2 | Q3 | Q4 | Q1 | Q2 | Q-to-Q | Y-on-Y |
| **Current Account** | **-447.00** | **-262.34** | **-724.10** | **-993.09** | **-599.82** | **39.6** | **34.2** |
| **a) Goods** | -2652.48 | -2346.22 | -3070.38 | -3279.69 | -2324.11 | -29.1 | -12.4 |
| Merchandise exports, f.o.b | 2396.50 | 3282.98 | 3191.09 | 3223.37 | 3379.45 | 4.8 | 41.0 |
| O/W diamonds | 917.20 | 1134.78 | 990.11 | 981.30 | 974.21 | -0.7 | 6.2 |
| O/W textiles and clothing | 949.24 | 1561.95 | 1486.58 | 1491.38 | 1675.13 | 12.3 | 76.5 |
| O/W re-reports | 0.74 | 18.35 | 69.02 | 52.66 | 58.13 | 10.4 | 7755.4 |
| O/W Other Exports | 529.32 | 567.9 | 645.38 | 698.03 | 671.98 | -3.7 | 27.0 |
| Merchandise Imports, f.o.b | -5048.98 | -5629.20 | -6261.47 | -6503.06 | -5703.56 | -12.3 | 13.0 |
| **b) Services** | **-879.96** | **-914.29** | **-719.26** | **-973.23** | **-965.27** | **-0.8** | **9.7** |
| **c) Primary Income** | **981.54** | **969.03** | **1044.26** | **1025.60** | **1106.65** | **7.9** | **12.7** |
| **d) Secondary Income** | **2103.90** | **2029.14** | **2021.27** | **2234.22** | **1582.91** | **-29.2** | **-24.8** |

**Source:** Central Bank of Lesotho

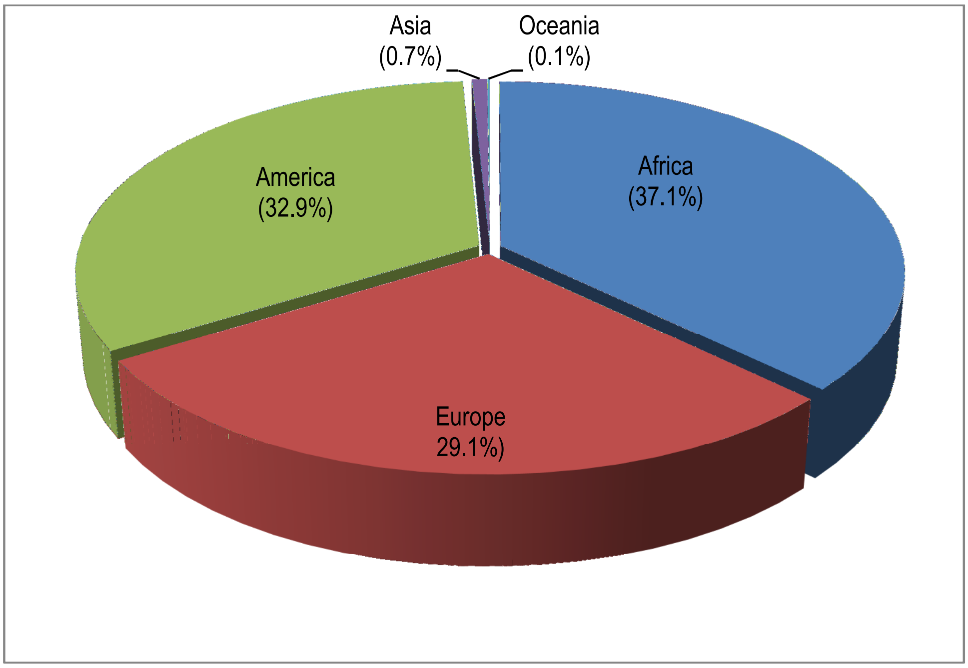
## Merchandise Exports

Merchandise exports' performance improved during the quarter under review as result of increasing demand from the major trading partner. They rose by 4.8 per cent reaching 47.5 per cent of GDP in the second quarter of 2016 compared with an increase of 1.0 per cent in the first quarter of 2016, equivalent to 45.3 per cent of GDP. While diamond exports underperformed during the quarter, textiles exports were supported by an increase in orders from US under the African Growth and Opportunity Act (AGOA). Textiles and clothing exports grew by 12.3 per cent in the review quarter, following a marginal increase of 0.3 per cent in the previous quarter. Non-AGOA exports also increased on account of a surge in re-exports to SA which rose by 10.4 per cent in the review quarter, in contrast with a decline of 23.7 per cent in the previous quarter. These are goods which were previous imported to support domestic economic activity and subsequently returned to SA for various reasons. The 32.7 per cent increase in water exports generated by LHDA to SA offset the observed decline of merchandise exports to SA. Diamond exports declined by 0.7 per cent, reflecting lower production in the diamond mines and the weak diamond prices in the international markets during the period. On an annual basis, merchandise export rose by 41.0 per cent in the review quarter, following a rise of 62.7 per cent in the previous quarter.

## Direction of Trade - Exports

Africa, particularly the SACU region, continued to be the major recipient for Lesotho's exports with a share of 36.7 per cent of total exports during the review quarter, lower than 39.5 per cent registered in the previous quarter. Exports to the region include textiles and clothing, water generated by LHDA, re-exports and other goods. The American market became the second largest destination of Lesotho's manufactured goods, 'textiles and clothing', with a share of 32.9 per cent in the review quarter, compared with 28.7 per cent in the previous quarter. The European market stood at the third position with a share of 29.1 per cent in the review period, lower than 30.8 per cent in the quarter ending in March 2016. This is where a largest portion of Lesotho's rough diamonds is destined. Asia and Oceania markets remained insignificant with a share of 0.7 per cent and 0.1 per cent in the quarter under review, compared with 0.4 per cent and 0.2 per cent in the previous quarter

**Figure 25: Direction of Merchandise Exports** *(Percentage Share)*




**Source:** Central Bank of Lesotho

### Merchandise Imports

During the quarter under review, the value of merchandise imports fell by 12.3 per cent compared with a revised increase of 3.8 per cent in the previous quarter. The observed performance of imports reflected lower declarations at border posts, where a large portion of imports from SA are channelled. This reflected weak domestic demand in the review period. Imports from other countries except SA grew marginally during the quarter. Year-on-year basis, merchandise imports grew by 13.0 per cent in the review quarter compared with a rise of 26.2 per cent in the previous quarter. As percentage of GDP, merchandise imports registered 80.2 per cent in the quarter ending in June 2016, following 91.5 per cent in the quarter ending in March 2016.

### Services

Lesotho continued to be a net importer of services though at the lower rate during the quarter under review. The deficit in net services dropped by 0.8 per cent in the second quarter of 2016, in contrast with an increase in deficit of 35.3 per cent in the first quarter of 2016. The fall in payments for foreign services was driven by a decline in payments for freight services on imported goods and lower government payments for foreign official travel during the review quarter. On an annual basis, net services increased by 9.7 per cent in the second quarter 2016, following 4.7 per cent in the previous quarter.

## Primary Income

The primary income balance account improved in the second quarter of 2016, after deteriorating in the previous quarter. It grew by 7.9 per cent in the review quarter, compared with a decline of 1.7 per cent in the previous quarter. This was driven largely by the growth in interest earnings on foreign portfolio investments of commercial banks and an increase of income from SA government for maintenance and operational cost of Katse and Mohale dams. In addition, a decline in payment of interest on government external loans contributed to the improvement in the primary income account. Year-on-year basis, the primary income account rose by 12.7 per cent in the quarter under review, following a rise of 7.3 per cent in the preceding quarter.

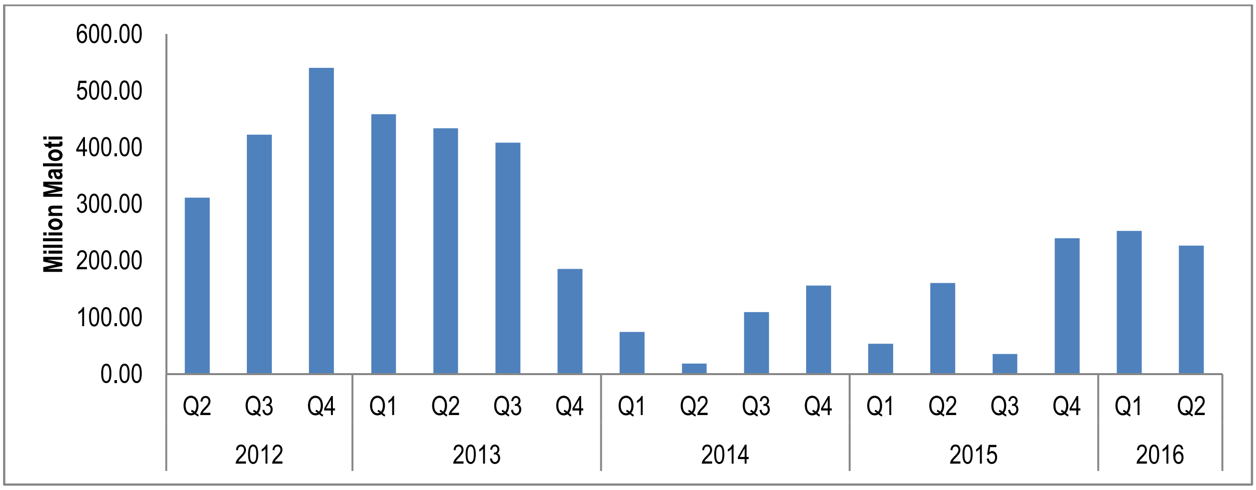
## Secondary Income

In the review quarter, the secondary income account weakened due to largely a reduction in SACU receipts which takes the largest share in the account. The secondary income account fell by 29.2 per cent in the second quarter of 2016, in contrast with an increase of 10.5 per cent in the previous quarter which was boosted by the rand compensation receipts which are normally registered in the first quarter of each year. The observed performance of the secondary income reflects weak economic activity in the SACU region, particularly in the SA, since it remains the major source of SACU revenue for the region. The account registered a drop of 24.8 per cent on an annual basis in the second quarter of 2016, higher than a decline of 6.4 per cent in the previous quarter. However, a significant decline in payments for subscriptions on international organisations moderated the decrease in the secondary income account.

## CAPITAL ACCOUNT

The capital account continued to register a surplus albeit a lower one compared to the quarter ending in March 2016. Traditionally, Lesotho's capital account has been in surplus due to the huge inflows of funds received from development partners. A net inflow of M226.65 million was received in the second quarter of 2016 following a revised capital account balance of M252.55 million in previous quarter. This reflects continuing support for domestic economic activity by international development partners.

**Figure 26: Capital Account** *(Million Maloti)*

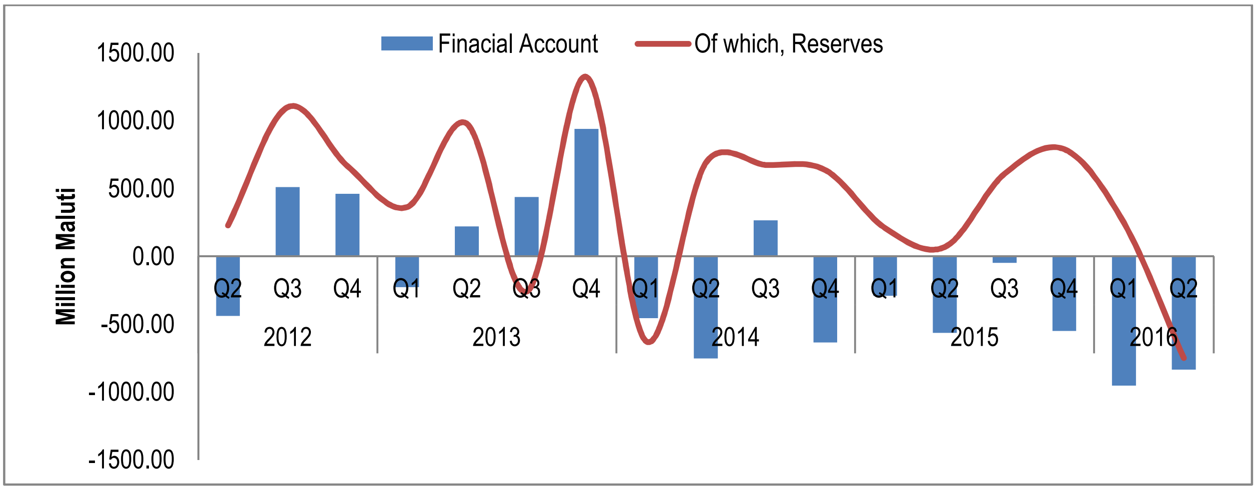



**Source:** Central Bank of Lesotho

## FINANCIAL ACCOUNT

During the quarter under review, Lesotho continued to be a net borrower from the rest of the world. The financial account recorded a deficit of M834.48 million during the review quarter following a revised deficit of M952.28 in the previous quarter. The deficit reflected a much higher net incurrence of liabilities compared to the net acquisition of assets in direct investment. Moreover, a rise in government's net borrowing from abroad contributed to the deficit in the financial account. In addition, a negative impact on the financial account resulted from a decline in net foreign assets of the Central Bank. The expansion in the deficit was however, partially offset by a significant increase in commercial banks' foreign assets which recorded M1.02 billion in the quarter ending in June in contrast to a reduction in their foreign assets amounting to M370.98 million in the previous quarter.

**Figure 27: Financial Account** *(Million Maloti)*

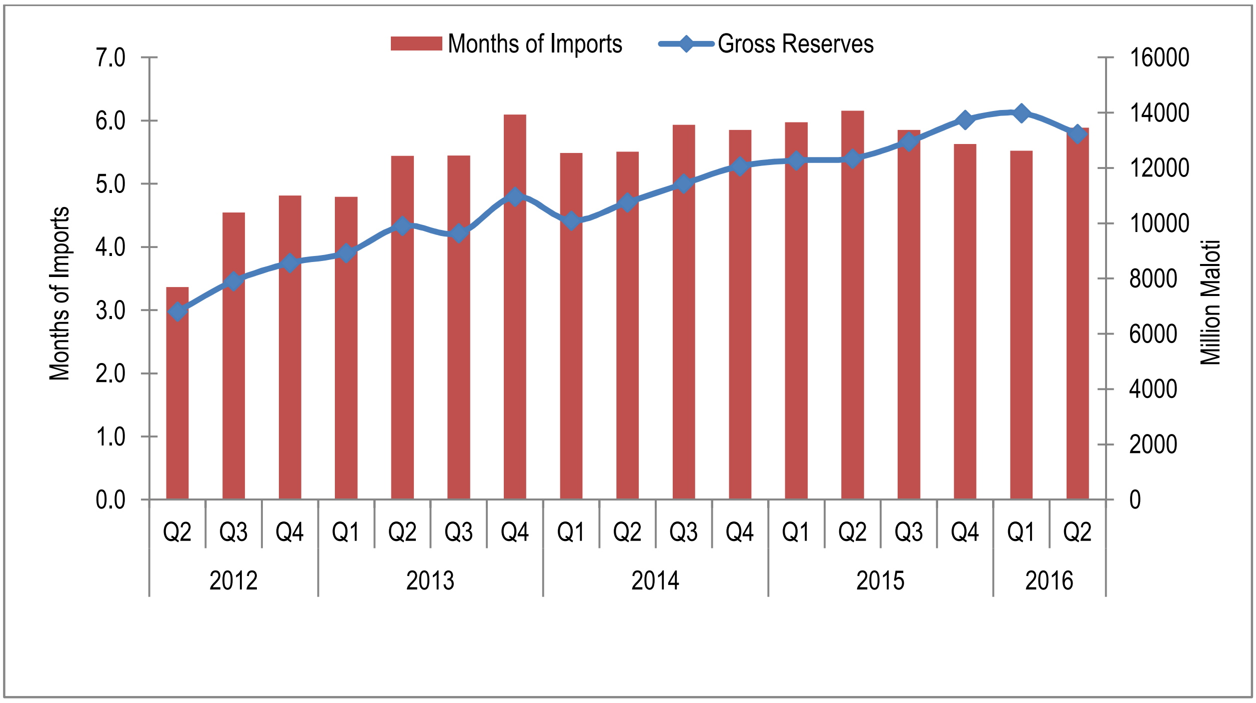



**Source:** Central Bank of Lesotho

## Reserve Assets

The official stock of reserves fell substantially to M12.33 billion in the review quarter in contrast to a build-up of M14.00 billion of reserves observed in the previous quarter. The reduction in reserves largely reflected a fall in SACU inflows during the quarter under review. Despite a sluggish performance, official reserves recorded 5.9 months of import cover in the quarter ending in June from 5.2 months in the previous quarter as a result of a fall in imports.

**Figure 28: Reserves Assets**




**Source:** Central Bank of Lesotho