Economic Review April 2004

AN ASSESSMENT OF THE PRGF IN LESOTHO

The three-year PRGF programme agreed upon between the government of Lesotho and IMF was not strong enough to address poverty and related problems in Lesotho, though it did help the country to recover marginally from the political disturbances of 1998….

Background
During most of the 1990s, Lesotho enjoyed favourable macroeconomic environment, The Structural Adjustment Programme (SAP) implemented early in the decade, investment driven by Lesotho Highlands Water Project (LHWP), and improving manufacturing production resulted in an average real GDP growth of 6% for the decade ended 1997. Nonetheless, the situation changed towards the end of the decade. Following such developments, the Government launched a nine months programme monitored informally by the IMF and was a success. The Government then entered into a more formal programme for three years under the PRGF. The purpose of the paper is to assess the success or otherwise of the programme, highlight lessons learned and suggest possible solutions and improvements for the future.

Performance during Oct 2003 to March 2004
Net Domestic Financing (NDF)
The domestic financing criteria recorded a surplus of M32.14 million compared to the program target of a deficit of M272 million at the end of March 2004. In December 2003, the NDF was also met at M121.5 million compared with the program target of M269 million. The improved performance was largely on account of improved revenue collection by the Lesotho Revenue Authority (LRA).

Net International Reserves (NIR)
The NIR target was also met in December 2003 at $390.4 million and $373.0 million in March 2004. The Central Bank continued to sterilize the excess liquidity by issuing treasury bills to maintain an adequate level of reserves. The impact of capital account liberalisation embarked by the Bank in June 2003 has not yet been felt.
Structural Benchmarks

During the period, the country did not perform well in meeting the structural benchmarks. Out of the four performance criteria only one was met, and that relates to advertisement of positions of Deputy Accountant Generals. The other two were partially met with some work still remaining. The remaining performance criteria that relates to appointment of the vehicle lease contract representative is still on-going. The country also met only one of the non-performance criteria structural benchmarks out of four.

General Performance in the Medium-Term: 2000-2003
Export-Led Economic Growth
Economic growth was considered pivotal for poverty reduction. A target of 4.0 per cent real GDP growth was set for the medium-term. This was sufficient to increase real per capita GDP by at least 1.0 per cent. This would be achieved though export promotion with an emphasis on manufacturing. However, the target was not achieved as real GDP grew at an average rate of 3 per cent for the three years ended 2003/04.

Prudent Financial Management
The Government determined to limit the fiscal deficits to levels that will serve to contain aggregate demand, and that could be financed by external grants and concessional loans. Quantitative targets of Net Domestic Assets (NDA) and Net Domestic Financing (NDF) were set and reviewed every six months. The targets were set to guide the banking system. The NDF target controlled the size of the deficit and ensured that it would not be inflationary and impact negatively on the NIR. In addition, the Government planned to restrict the wage bill at 13.5 per cent of GDP over the medium-term through natural attrition and elimination of ghost workers. This would contain the size of recurrent expenditure and allow the Government more spending power on growth-friendly capital projects. Lastly, the Government aimed to strengthen its finances by undertaking reforms. In this regard, it planned to create a more autonomous revenue authority to enhance revenue collection, and replace General Sales Tax (GST) with a more efficient and fair Value Added Tax (VAT) system.

The NDF target was partially met as it was missed on two test dates during the programme period. The March 2002 target was missed mostly on the back of delays in receipts of foreign funds due to Government. On the other hand, the failure to meet the June 2003 target was ascribed to Government's off-budget expenditure on famine relief, specifically agricultural support. The NDA target was met on all test dates set as performance criteria for the disbursement of PRGF loan amounts.

Strong External Position

Minimum limits on NIR were set to ensure that the external position of the country remains strong. In addition, the government resolved to bring the contraction of more non-concessional debt to a halt. The objective is to maintain official reserves at levels equivalent of six months of import cover. A strong external position would attract foreign investment, maintain the loti/rand peg and facilitate cross border trade. The Central Bank planned to introduce open market operations and a competitive securities auction system in an effort to create a more effective liquidity management system. The minimum limits on NIR were met during the period under review.

Price Stability

Given the importance of price stability in poverty reduction efforts, authorities chose to monitor price developments during the programme period. Desired inflation levels would be pursued within the broader policy framework under the Common Monetary Area (CMA) region. An inflation rate of 5.0 per cent was projected for end of 2002/03. The projection was based on the outlook of inflation in South Africa, as Lesotho's inflation is largely imported due to the currency peg and close trading relationship between the two countries. The price stability objective was also achieved.

Institutional and Capacity Building

Structural benchmarks on various activities aimed at strengthening the foundation for poverty reduction efforts were set during the PRGF targets. In addition, other important targets included:

Establishment of a Credit Bureau, which would boost loan repayment culture and confidence of commercial banks to lend to the private sector. This target was is still on-going and applications for bidding companies are under consideration.

Establishment of Lesotho Telecommunications Authority (LTA), the telecommunications regulator. The establishment of LTA was successful.

Privatisation of Lesotho Electricity Corporation. This target is still on-going as the interim management of LEC was put in place to restructure the company being put for privatisation.

Issues For the Future

Table 2. Monetary and Financial Indicators+

	Dec	Jan	Feb
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.50	12.50	12.50
1.2 Prime Lending rate in RSA	12.00	11.5	11.5
1.3 Savings Deposit Rate	2.00	2.41	2.31
1.4 Interest rate Margin(1.1 – 1.3)	2.00	10.09	10.19
1.5 Treasury Bill Yield (91-day)	10.57	9.21	9.21
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2297.9	2217.9	2279.1
2.2 Net Claims on Government by the Banking System	-167.0	-386.4	-371.9
2.3 Net Foreign Assets – Banking System	3460.7	3699.4	3845.7
2.4 CBL Net Foreign Assets	2853.0	3188.1	3055.92
2.5 Domestic Credit	380.6	171.6	30.1
2.6 Reserve Money	364.9	333.6	325.50
3. Spot Loti/US$ Exchange Rate (monthly average)	6.500	6.963	6.6618
4. External Sector (Million Maloti)	**2003**		
	Q2	**Q3**	**Q4**
4.1 Current Account Balance	-304.8	-300.6	-299.8
4.2 Capital and Financial Account Balance	319.3	155.5	320.0
4.3 Reserves Assets	-0.8	391.7	-156.6

+These indicators refer to the end of period. 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

	2000	2001	2002*	2003+
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	1.3	3.2	3.8	3.3
1.2 Gross Domestic Product Excluding LHWP	0.0	3.5	3.3	3.2
1.3 Gross National Product – GNP	-3.2	0.6	2.5	2.7
1.4 Per capita –GNP	-5.0	-1.7	2.1	2.2
2. Sectoral Growth Rates				
2.1 Agriculture	2.9	0.6	-4.0	-0.4
2.2 Manufacturing	4.4	7.9	6.9	5.0
2.3 Construction	9.7	1.3	6.9	4.0
2.4 Services	-0.9	2.2	3.3	3.6
3. External Sector – Percent of GNP Excluding LHWP				
3.1 Imports of Goods	71.9	74.9	87.3	80.6
3.2 Current Account	-8.8	-2.9	-8.6	-7.8

3.3 Official Reserves (Months of Imports)	8.9	11.7	6.4	5.5
4. Government Budget Balance (Percent of GNP)	-4.9	-1.0	-2.7	-2.5

*Preliminary Estimates +Projections