



## **The Impact of the Global Economic Recession on Lesotho: 2010 Economic Developments, Policies and Challenges**

*The global economic recession has affected different sectors of Lesotho's economy, posing serious policy challenges.....*

### **Introduction**

The global financial and economic crisis, which originated in the United States of America (US) sub-prime mortgage market more than two years ago, has left most countries around the globe grappling with economic uncertainty and imbalances. Output, in general, has contracted at unprecedented rates while household budgets have been curtailed in some regions. The roots of poverty that has rocked most poor African countries have been entrenched. Lesotho could not have been left unscathed because of its growing integration into the global economy. Lesotho directly exports clothing and textile manufactured goods to the US and the Southern African Development Corporation (SADC) member countries. It also exports diamonds to the Euro area and water to South Africa so that any economic developments in these economies will undeniably have an impact on its economy.

At the back of lacklustre economic developments in the aforementioned regions, Lesotho's main economic sectors have been affected. These include, *inter alia*, the manufacturing sub-sector, the fiscal position of the country, the balance of payments, and the household sectors. In aggregate, the impact in these sectors has posed

formidable challenges to the future economic developments and policy formulation.

This article, therefore, intends to highlight the economic developments of Lesotho, in particular, the impact of the crisis on some macroeconomic variables in 2010. Challenges arising as a result of addressing the effect of the crisis and policy options necessary to deal with the aftermath of the crisis are also looked into.

### ***The Impact on Manufacturing Sector***

The manufacturing sector in Lesotho, especially the textile and clothing industry, has been the mainstay of Lesotho's economic growth, thanks to the *African Growth and Opportunity Act (AGOA)*. Nonetheless, accession of low-cost producers like China to the US markets has eroded the gains Lesotho got under AGOA. The strengthening of Loti, the local currency, especially in 2004 and the expiration of the Multi-Fibre Agreement by the end of 2005 also posed very serious challenges to the textile and clothing industry. However, the sector recovered somewhat in 2006 through 2007. But the global financial crisis and recession that ensued in the second half of 2007

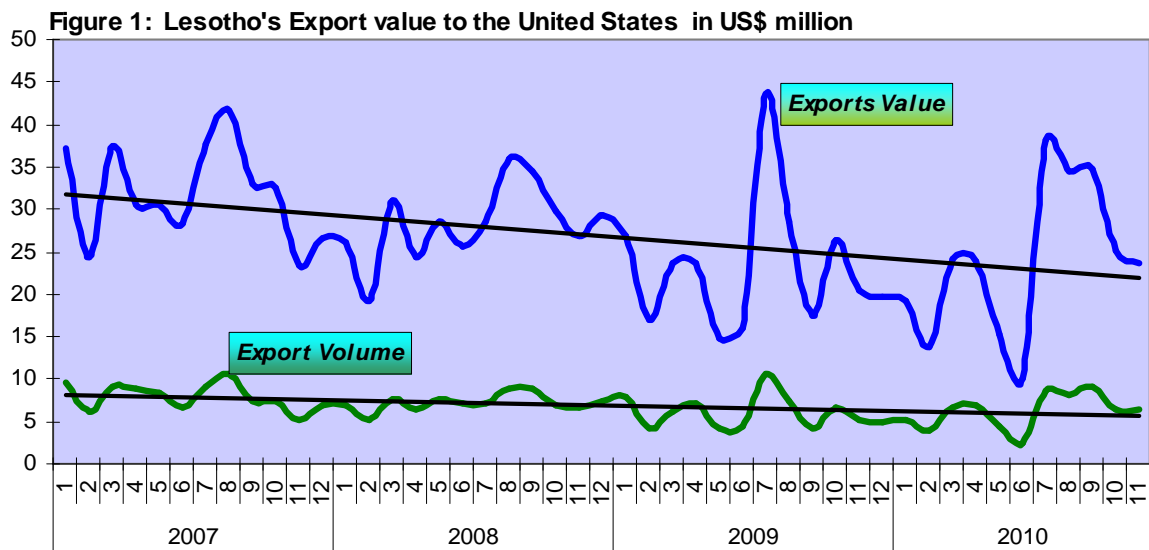
weighed heavily on this sub-sector up until the present times.

First, the slump in economic activity in the US, especially the personal consumption expenditure in 2008 and 2009, as well as deterioration in the US labour market, resulted in a decline in orders for Lesotho's exports. Figure 1 below shows Lesotho's exports to the US from January 2007 to November 2010. As the figure depicts, exports value has been declining since then but the most notable movement starts from August 2007 to March 2008. After marginally increasing in July 2008,

exports value fell from around US\$37.0m to just below US\$10.0m in June 2010.

The fall in the value of exports to the US has meant that the exporting firms are not gaining profits and this has led to massive layoffs and closure of some firms at the beginning of 2010. One knit garment in Mafeteng shut down its operations around February 2010 leaving around 2400 people jobless.

Figure 2 below shows employment statistics in manufacturing sector as well as the textile and clothing industry.



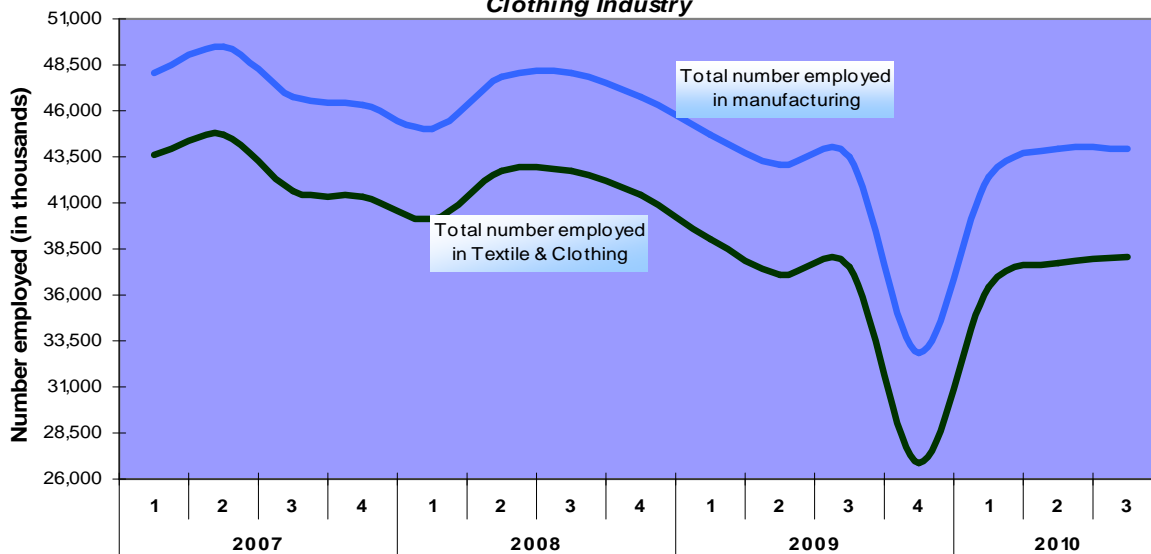
Source: [www.otexa.ita.doc.gov](http://www.otexa.ita.doc.gov)

During the second quarter of 2008, the number of people employed in the textile and clothing industry was around 43000 but at the end of 2008 it had fallen to 41000 which means that around 2000 had been laid off. This number fell further to less than 28000 during the fourth quarter 2009. Nonetheless, the path towards global economic recovery at the beginning of 2010 saw the employment increasing to around 35000 people during the first quarter of 2010 and then remaining relatively constant. The deterioration meant that the dependents of the textile workers were negatively affected. The

purchasing power, despite the low inflation, for these workers has also declined, and the consumption pattern has been reversed.

Despite modest recovery in textile and clothing subsector recently, challenges still remain. The continued appreciation of the local currency may derail the recovery of the manufacturing sector. Moreover, the current proposal to extend AGOA benefits to more countries may threaten Lesotho's textile and clothing industry.

**Figure 2: Total Employment in Manufacturing Sector and the Textile & Clothing Industry**



Source: Bureau of Statistics, Lesotho

### **The Impact on Budgetary Operations**

Lesotho is a member of the Southern African Customs Union (SACU), along with South Africa, Namibia, Botswana and Swaziland. Lesotho obtains 60.0 per cent of the total government revenue from SACU. This makes it highly vulnerable to the economic shocks that reduce SACU revenue pool, inter alia. It is important to note that the revenue pool from which members of SACU get their shares also highly hinges on the performance of South Africa's economy, the largest SACU member in terms of its contribution to the pool. As a result of the global recession, the SA economy slumped, and consumption expenditure plummeted while SA labour market also deteriorated. These conditions did not augur well for imports into the economy, thereby reducing the SACU revenue pool.

The inflows from SACU revenue pool to Lesotho is estimated to decline from M5,204.7 million recorded in 2008 to

M4,917.7 million, M2,162.9 million and M1694.7 million in 2009/10, 2010/11 and 2011/12 respectively, according to South Africa's forecasts. This decline is mainly on account of repayments to the SACU revenue pool and the impact of the recession. This reduction means that the revenue component of budgetary operations will be severely curtailed.

The recession has also posed a very serious challenge on the expenditure component of the fiscal operations. SACU shares have been an anchor for expenditure planning in Lesotho. An expected decline in SACU receipts has prompted the government to curtail some areas of expenditure. To this effect, the government has planned to reduce the wage bill because the largest share of government expenditure has been on compensation of employees. New positions will therefore be frozen. This will worsen the already high rate of unemployment in the country.

Government has also announced that it will not sponsor new students to tertiary institutions in SA in 2011 but will only continue with those that it is already sponsoring. Overall, the country's deficit as share of GDP is projected at 11.0 per cent in 2010/11 and 12.8 per cent in 2011/12.

**The Impact on Migrant Mineworkers Remittances and Employment**

Migrant labour is an important source of income for many households and countries around the world. Lesotho like other countries benefits greatly from positive developments in this category. For many decades, Lesotho has supplied unskilled and semi-skilled labour to SA.

The remittances generated by these miners have been very important for expenditure behaviour of many Basotho. First, they bring in foreign exchange, which the country needs for imports and other foreign payments. Second, miners and their dependents use the proceeds to finance consumption, especially in the

rural areas and some make investments out of it. They spent this money on foreign and capital goods thereby facilitating trade between Lesotho and SA.

Remittances from migrant mineworkers have been volatile depending on factors affecting the mining industry in SA. Migrant mineworker's remittances transferred to Lesotho increased from M87441 million in 2000 to M167387 million in 2005. However, the value of remittances declined since then, owing much to structural problems and lower prices of metals, especially diamonds and gold. Moreover, the fall in commodity and diamond prices that befell the world in 2008, as a result of the global recession and the recent strength of the rand, has added stress to the SA's mining industry. In the first quarter of 2009, SA mining industry contracted by 32.8 per cent on a quarter-to-quarter basis, while on annual basis, the sector contracted by 9.4 per cent, on average.



Source: TEBA

Figure 3 above shows that the number of Basotho employed in SA mines increased from 2005 to 2007. It stood at around 55000 employees in 2007. However, the number of employees declined to 50686 in 2008 and 45276 in 2009. Nonetheless, the recovery in

commodity prices due to use of commodities as a safe haven at the end of 2009 and throughout the course of 2010 has meant that the decline in employment remained relatively stable.

The decline in the number of Basotho migrant mineworkers and hence remittances, has posed a serious challenge for the economic development of Lesotho. First, the decline in remittances contributed to the deterioration in current account balance. Second, there are more people now who have experienced dire economic situations where the roots of poverty have laid hold. Third, the VAT collections that would arise from these remittances will be curtailed.

### ***The Impact on the External Position***

The external position has been registering surpluses for the past ten years. This was mainly on account of SACU receipts, which grew strongly in 2006 as a result of over performance in actual collections of the SACU revenue pool. Exports of textile and clothing as well as diamonds also made a significant contribution in this regard. This has enabled the country to accumulate foreign reserves. However, at the back of the decline in exports and SACU revenue, gross reserves have fallen from M8989.2 million in 2008 to M6749.5 million at the end of 2010, indicating that the government is drawing down its foreign reserves to finance its budget deficit.

The advent of the global economic recession has led to deterioration in current account. The current account balance declined to a deficit of M309.1 million in 2009 and it is expected to widen further in 2010. The deterioration in current account balance mainly reflected a decline in merchandise exports, lower current transfers reflecting dwindling SACU receipts and lower migrant mineworkers' remittances as more Basotho are retrenched.

These developments threatened the sustainability of the external sector position to the extent that the government had requested financial assistance from the IMF under the Extended Credit

Facility (ECF). The ECF arrangement is meant to restore fiscal and external sustainability, achieve broad-based growth for poverty reduction and to strengthen the financial sector while enhancing access to financial services.

### ***The Impact on the Monetary Sector***

The recession that followed the credit crunch led to a decline in global demand, which resulted in lower inflation rates and also led policy makers, around the globe, to implement accommodative monetary policy by reducing interest rates to stimulate their ailing economies.

The inflation phenomenon in South Africa and Lesotho could not be left behind. After creeping to as high as above 12.0 per cent in the first half and the third quarter of 2008, inflation rates in Lesotho and South Africa began trending downwards. The escalation was mainly due to high international food and fuel prices as well as some commodity prices like gold and platinum. It is important to note that inflation dynamics in SA affect Lesotho's inflation developments because a large proportion of Lesotho's imports comes from SA.

As the global recession intensified, the fall in demand eased inflationary pressures. From a high of 12.1 per cent in October 2008, inflation in Lesotho decelerated until July 2009. Thereafter, the inflation rate has been hovering within 3-6 per cent target band set by SA. In Lesotho, it was recorded at 3.1 per cent from October to December 2010.

In line with the global economic policy, the SA authorities adopted the accommodative monetary policy by slashing the repo rate to 5.5 per cent. Other rates like prime lending rates and treasury bill rates also declined. As a result of the currency peg between Lesotho and SA, interest rates movements in Lesotho track those of SA rates closely. Lower interest rates have reduced the cost of consumer borrowing.

## **Conclusion**

The recession has negatively impacted the manufacturing sector, household income, the fiscal operations and the external position of Lesotho. However, lower demand conditions have resulted in low inflation. The government is already embarking on measures to ensure that

the fiscal and external imbalances are addressed. The government is implementing structural reforms and pursuing some quantitative benchmarks under the ECF program. Some benchmarks have been met with success while others are yet to be achieved.

## **Lesotho's Performance under Extended Credit Facility (ECF)**

*Lesotho is in a three year ECF arrangement with the IMF.....*

The Government of Lesotho entered into a three-year arrangement with the International Monetary Fund (IMF) under the Extended Credit Facility (ECF) in May 2010. The ECF is one of the facilities through which the IMF extends financial support to low income countries to tackle balance of payments problems and put economies back to sustainable growth paths.

The global economic crisis had debilitating effects on the economy of Lesotho, including curtailing exports and migrant mineworkers' remittances and causing a sharp drop in SACU revenue receipts, all of which led to the significant deterioration of both the current account and fiscal balances. Consequently, the authorities approached the IMF for financial assistance under the ECF to support the implementation of the medium-term macroeconomic program intended to help Lesotho address the above mentioned challenges. The program defines key structural reform measures to be pursued as well as quantitative benchmarks to be achieved in an endeavour to restore fiscal and external sustainability, attain sustainable and broad-based growth for poverty reduction, and strengthen the financial sector.

Measures to be undertaken are specifically targeted at containing public expenditure while protecting the poor and

vulnerable groups; strengthening non-SACU revenues; strengthening public financial management to improve spending efficiency and public service delivery; improving the business climate to facilitate private sector expansion; and strengthen the regulatory framework for the financial sector while also enhancing access to financial services.

Implementation of the program is monitored through a set of semi-annual quantitative performance criteria and structural benchmarks. For the first year of the program, performance criteria are set for end-September 2010 and end March 2011. Thus the objective of this paper is to undertake an assessment of Lesotho's performance on structural and quantitative benchmarks that were to be achieved by end-September 2010. Following this introduction is an outline of structural and quantitative benchmarks for the end-September performance period. Then an overview of performance on the set targets is provided, after which the paper is concluded.

### ***An overview of Performance Criteria for End-September 2010***

By entering into a program with the IMF, the Government has committed itself to undertake policies to address its economic and structural problems. It is in this undertaking that Government, in consultation with the IMF, has set itself

some specific quantitative targets and structural policies as milestones towards the achievement of the broad objectives of the program. The following structural benchmarks were to be attained by end-September 2010; preparation of monthly audit reports assessing the impact of modification of the Integrated Financial Management Information System (IFMIS) to prevent over-commitment of government funds; submission of a review of all on-going capital projects to Cabinet; an assessment of the desirability or otherwise of capital projects and recommendations on their continuation or elimination; Submission of the Companies Bill to Parliament; and

Submission of the amended Financial Institutions Act to Parliament.

Table 1 below also outlines the quantitative targets that were to be achieved by end-September 2010. These are mainly aimed at addressing and ensuring sustainability of the fiscal position. These are ceilings on the domestic financing requirement of government, on the net domestic assets of the Central Bank of Lesotho (CBL) as well as on the amount of new non-concessional external debt contracted or guaranteed by the public sector; and a floor on the stock of net international reserves of the CBL.

**Table 1: Quantitative Performance Criteria and Benchmarks for March - September 2010**

	June Benchmarks	September Perf. Criteria	Level as at end-September
	<b>(In millions of Maloti)</b>		
Ceiling on domestic financing requirements	-217.50	311.50	620.00
Ceiling on the net domestic assets	1170.00	1884.00	1408.30
	<b>(In millions of US Dollars)</b>		
Floor on the stock of NIR	992.00	956.00	933.00
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector			
Maturity of less than one year	0.00	0.00	0.00
Maturity of one year or more	182.00	182.00	182.00
Floor on the central government social expenditures	170.00	170.00	253.00
Ceiling on gross cumulative payments of domestic arrears	200.00	200.00	199.00

### **An Overview of Lesotho's Performance as at End-September 2010**

By and large, Lesotho performed well on the quantitative performance criteria. As indicated in Table 1 above, all performance criteria through end-September 2010 were met, except for the NIR, which was missed by a small margin of US\$5.0 million. The ceilings on the domestic financing requirement of government and the net domestic assets of the CBL were over performed by high margins. On the structural reforms, some progress was made though there were

some delays relative to the benchmarks for end-September 2010.

Some of these benchmarks were not met, including the submission of the review of capital projects, for which the new date was changed to end January, 2011; and submission of the amended Financial Institutions Act to Parliament, which is now expected to be done by end March, 2011.

### **Conclusion**

Lesotho could benefit in a number of ways from being in a program with the IMF. The financial assistance that Lesotho receives under the ECF arrangement could help the economy to

avoid a disruptive adjustment to the shock resulting from the plummeting of SACU revenue. The successful implementation of the program's policy objectives, quantitative and structural

reforms could reinforce policy credibility and increase confidence on the economy as it could indicate implementation of

sound policies. This could in turn act as a catalyst for more financing from other sources, including donor funding.

**Table 2: Selected Monetary and Financial Indicators**

	<b>2010</b>		
	<b>October</b>	<b>November</b>	<b>December</b>
<b>1. Interest rates (Percent Per Annum)</b>			
1.1 Prime Lending rate	10.83	10.50	10.50
1.2 Prime Lending rate in RSA	9.00	9.00	9.00
1.3 Savings Deposit Rate	1.21	1.21	1.21
1.4 Interest rate Margin( 1.1 – 1.3)	9.62	9.49	9.49
1.5 Treasury Bill Yield (91-day)	5.9855	5.7500	5.950
<b>2. Monetary Indicators (Million Maloti)</b>			
2.1 Broad Money (M2)	6514.77	6347.64	6574.81
2.2 Net Claims on Government by the Banking System	515.49	522.56	466.31
2.3 Net Foreign Assets – Banking System	11051.29	10780.81	10667.01
2.4 CBL Net Foreign Assets	7185.69	7206.98	6749.51
2.5 Domestic Credit	-1220.716	-790.89	-1000.82
2.6 Reserve Money	701.19	723.78	696.23
<b>3. Spot Loti/US\$ Exchange Rate (Monthly Average)</b>	<b>6.9166</b>	<b>6.9864</b>	<b>6.8271</b>
<b>4. Inflation Rate (Annual Percentage Changes)</b>	<b>3.1</b>	<b>3.1</b>	<b>3.1</b>
<b>5. External Sector (Million Maloti)</b>	<b>2010</b>		
	<b>QII</b>	<b>QIII</b>	<b>QIV+</b>
5.1 Current Account Balance	-891.37	-680.49	-547.75
5.2 Capital and Financial Account Balance	332.15	328.46	253.29
5.3 Reserves Assets	928.04	342.90	109.75

+Preliminary Estimates.

\*Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho.