



Economic Review

February 2010

LESOTHO'S BUDGET SPEECH FOR FISCAL YEAR 2010/2011: AN AGGRESSIVE DOMESTIC RESOURCE MOBILISATION AND EXPENDITURE PRIORITISATION IS AN IMPERATIVE

The Honourable Minister of Finance and Development Planning made a presentation of the national budget for the 2010/2011 Fiscal year to the Parliament of Lesotho on the 12th February 2010.....

INTRODUCTION

The budget speech has outlined how fiscal policy is going to be implemented in Lesotho during the 2010/2011 fiscal year. It has indicated the need for expenditure management and containment in response to the decline in fiscal financial resources caused by the global economic recession. While governments around the globe are implementing fiscal stimulus packages to offset the negative impact of the recession on their economies, Lesotho cannot do this to the required scale due to lack of resources.

THE ENVIRONMENT IN WHICH THE BUDGET WAS PREPARED

While the global financial crisis and economic recession have passed, their scars remain painfully visible on Lesotho's economy and have laid the basis for 2010/2011 budget. This budget is prepared in the aftermath of the global economic recession, which has had a number of negative consequences on the economy of Lesotho. It has caused a slower economic growth rate of 1.9 per cent in 2009 compared with 4.4 per cent in 2008 by directly reducing the performance of the mining and quarrying subsector and the manufacturing subsector. The mining and quarrying subsector declined by 15.0 per cent, attributable to low

prices of rough diamonds as a result of low global demand. The manufacturing subsector also fell by 1.3 per cent because local firms had to scale down production during 2009 in response to the decline in orders from enterprises in the United States (US). Other subsectors also felt the knock of the global recession and decelerated. These include electricity and water as well as transport and communication. The decline in economic activity as outlined necessitates increased expenditure by Government to boost aggregate demand and help the economy back on the growth path.

Another impact of the global recession has been the decline in imports by a number of the world economies including SACU member countries and hence fiscal revenues from import duties. SACU revenue, which has for a very long time been the largest source of Government revenue, accounting for more than 50.0 per cent of total revenue and grants in Lesotho, is expected to fall by 60.0 per cent in 2010/2011.

This setting necessitates a more expansionary fiscal policy to help the economy out of the difficult times caused by the global economic recession. Nevertheless, the scope to continue

in this direction is constrained by lack of financial resources.

THE BUDGET OUTTURN FOR 2009/2010

Government budgetary operations are expected to result in a lower deficit of 4.7 per cent of GDP in 2009/2010 fiscal year compared with 5.8 per cent that was budgeted. The lower deficit emanated from the lower than budgeted expenditure while revenue is also forecast to fall below the budget.

Total expenditure is projected to register 68.4 per cent of GDP and not 73.4 per cent that was

budgeted, mainly as a result of low capital expenditure while recurrent expenditure is projected to rise above the budget. On the one hand, capital expenditure is expected to record 17.2 per cent of GDP compared with the budgeted 23.5 per cent. On the other hand, recurrent expenditure is expected to increase to 51.2 per cent from the budgeted 49.9 per cent of GDP. Lesotho has a history of poor performance on utilization of the capital budget and this has implications on the future economic growth prospects. Nevertheless, utilization of the capital budget is expected to improve to 73.3 per cent in 2009/2010 from 70.0 per cent in the previous fiscal year.

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

Budget Items	Approved Budget for 2009/2010		Projected Outturn for 2009/2010		Proposed Budget for 2010/2011	
	Value	%	Value	%	Value	%
Revenue and Grants	9942.3	67.6	9376.9	63.7	8283.5	50.0
Revenue	8863.8	60.3	8749.7	59.4	6474.4	39.1
<i>Tax</i>	2699.3	18.4	3149.8	21.4	3448.8	20.8
<i>Other</i>	856.4	5.8	682.2	4.6	863.7	5.2
<i>SACU</i>	5308.1	36.1	4917.7	33.4	2161.9	13.1
Grants	1078.5	7.3	627.3	4.3	1809.1	10.9
Expenditure	10788.7	73.4	10064.8	68.4	10317.6	62.2
Recurrent Expenditure	7338.3	49.9	7535.7	51.2	6748.0	40.7
Capital Expenditure	3450.4	23.5	2529.1	17.2	3569.6	21.5
Surplus/Deficit after Grants	-846.4	-5.8	-687.8	-4.7	-2034.1	-12.3
Financing	846.4	5.8	687.8	4.7	2034.1	12.3

Source: Lesotho Government Budget Speech 2010/2011

Total revenue and grants are projected at 63.7 per cent of GDP, which is lower than the budget by almost 4.0 per cent of GDP. The only component of this variable that is expected to outperform prior expectations is tax revenue, while SACU revenue and grants are projected to fall below the budget. Tax revenue is expected to be high mainly due to

higher income taxes. It is projected that just over half of the budgeted grants would be disbursed by the end of the fiscal year. This is in line with the expected poor performance of the capital budget as capital grants are disbursed on implementation of grant funded projects.

THE 2010/2011 BUDGET

Expenditure, Revenue and Financing

The 2010/2011 budget has proposed a budget deficit of 12.0 per cent of Gross Domestic Product (GDP) compared with the expected deficit of 4.7 per cent of GDP for 2009/2010. Total expenditure is expected to be below that of 2009/2010 with a reduction in recurrent expenditure and a marginal increase in capital expenditure. Total revenue is projected to fall by 16.7 per cent in 2010/2011 financial year compared to 2009/2010. Grants are expected to register a significant increase of 10.9 per cent from 4.3 per cent that is projected for 2009/2010 financial year.

The budget speech has highlighted the need for “belt tightening and expenditure rationalization”. In line with this call, a M1.3 billion reduction in total expenditure is proposed for 2010/2011. The proposed expenditure cut is expected to affect recurrent expenditure only. Capital expenditure is expected to increase by 3.5 per cent. Among other things, the proposed expenditure reduction will involve: cutting expenditure on international travel to 2007/08 levels; eliminating purchases of furniture completely; eliminating training and workshops as well as short term vehicle hire; and reducing expenditure on some

Budget Allocations

The proposed budget allocations are consistent with attainment of Government’s major priorities, namely, “pursuing high, shared and sustainable growth, reducing poverty, creating jobs and protecting the poor, orphans and vulnerable children and old citizens”. In particular, budget allocations have been made for improvement and development of infrastructure, which is necessary to promote private sector investment and facilitate speedy recovery and further growth of the economy.

goods and services. This expenditure rationalization is important taking into account the expected decline in Government revenue.

Government revenue is budgeted to decline to M6 474 million from the previous budget’s M8 883 million on account of the fall in SACU revenue and non tax revenue, while value added tax (VAT) and other tax revenue are expected to increase marginally. Government is expecting SACU revenue receipts to the tune of M2 161.9 million compared with the projected outturn of M4 917.7 million in 2009/2010, representing a fall of 56.0 per cent. Tax revenue plus non tax revenue and grants are projected to rise by 12.5 and 188.4 per cent respectively when comparing the budgeted amount with the projected outturn for 2009/10. Government is also intending to increase its external borrowing of soft loans from multilateral development institutions to finance the budget. But these will hardly be sufficient to finance the envisaged expenditure, therefore, a fiscal deficit of 12.0 per cent is expected. It is expected that the budget deficit will be financed out of domestic borrowing and careful use of Government deposits.

Infrastructure

Government continues to give priority to construction and maintenance of roads in the rural and urban areas and most importantly in industrial estate areas where big manufacturing firms are located. Allocations have also been made to increase the number of factory shells. Lack of factory space is one of the major constraints to the growth of the manufacturing subsector. The development of infrastructure related to water supply and waste water management

and energy supply also received its share of the budget.

Social Protection and Human Development

The Government continues to provide funds for social protection and human development. This has a more direct positive impact on improving and protecting the lives of the poor and vulnerable people of Lesotho.

The budget for old age pension has been increased by M12 million compared with the 2009/2010 budget, to cater for the increase in the number of senior citizens, while the monthly pension received by each pensioner remains unchanged at M200.00. This shows strong determination on the side of Government to continue to care for the old despite the fiscal difficulties being experienced.

Concerning human development and education, in particular, the Ministry of Education and Training continued to be the largest recipient of the total budget at 23.9 per cent, with M1,487 million and M161 million for recurrent and capital expenditures, respectively. Government is continuing to invest in free primary education (FPE). In addition, with the first group of FPE having completed the junior school certificate in 2009, budget allocations have been made to provide facilities, including new secondary and high schools and additional class rooms to cater for the increased intake. It is through these initiatives that Lesotho stands a good chance of achieving the millennium development goal (MDG) of “education for all”.

CONCLUSION

The global economic slowdown that was experienced in 2009 has contributed to the decline in Government revenue in Lesotho. Consequently, Lesotho is projected to record its first fiscal deficit in five years in 2009/2010 and it is expected that deficits

The second largest share of the total budget (18.7 per cent) goes to the Ministry of Health and Social Welfare. The need for health services has increased significantly as a result of the high prevalence rate of HIV/AIDS at 24.0 per cent in Lesotho. Proper health care infrastructure has become an imperative in the fight against the pandemic. Its impact on financial resources allocation has become a reality to reckon with. Proposals in this regard include completion of the referral hospital, which will replace Queen Elizabeth II hospital and reduce the costs of referring patients to South Africa. In addition, a number of clinics and laboratories around will be constructed and refurbished.

Public Service Delivery

Improvement of public service delivery to attain operational efficiency and effectiveness remains imperative and has become more paramount as a result of the decline in Government revenue. Improvement of public financial management, decentralization of public services and reforming the management of the public service are the key focus areas envisaged to be achieved through implementation of the Public Sector Improvement and Reform Programme (PSIRP). In addition, Government is envisaging implementing a performance management system to monitor performance of public servants and enable consideration of appropriate action in case of under performance.

will continue for several years to come. This calls for caution on the side of Government as theory and experience have shown that fiscal deficits could become unsustainable, thus resulting in interest rate increases and slowdown in economic growth. In addition,

cognizance should be exercised in financing the deficit to avoid inflation brewing money creation, government borrowing crowding

out private investment and/or external borrowing resulting in balance of payments crisis.

2. The South Africa's Government Budget for 2010/2011: Implications for the Economy of Lesotho

The South African Minister of Finance presented the national budget for the 2010/2011 fiscal year before parliament in February 17, 2010. Developments in SA have significant implications for Lesotho because of trade, financial and other relationships between these two countries.

The budget is forecasting a lower fiscal deficit of 6.2 per cent of GDP for 2010/2011 compared with 7.3 per cent of GDP for 2009/2010. Government expenditure is expected to start moderating while revenue will recover as a result of higher levels of economic activity, as the economy recovers from recession.

The SA economy is expected to recover in 2010/2011 in response to global recovery, higher commodity prices and increased government spending. Real GDP is projected to increase by 2.9 per cent compared with a contraction of 1.5 per cent in 2009/2010. The main engine of growth, household spending fell by 3.5 per cent in 2009 and is expected to recover and grow by 0.9 per cent this year. Investment spending, another growth engine is expected to accelerate by 5.8 per cent in 2010 compared with 4.0 per cent in 2009.

The recovery in SA economy augurs well for the economy of Lesotho. SA is the largest recipient of Lesotho's exports and the recovery in consumer demand in SA could relieve the manufacturing subsector in Lesotho from its current difficult situation.

In addition, SA is the largest source of foreign direct investment to Lesotho hence the growth in SA's economy may trigger more investment inflows to Lesotho. This is important for diversification of manufacturing products away from textiles and clothing.

The Government of SA intends to take measures to address the problem of unemployment, which has been exacerbated by the recession. R52 billion is going to be allocated for expanded public work programmes over the next three years and a wage subsidy scheme will be launched to encourage employment of youth. The resultant increase in employment will boost consumer spending and could boost demand for Lesotho's exports.

The budget speech also highlighted that the transfers by SA to the other members of the Southern African Customs Union (SACU) had declined to R14.9 billion for the 2010/2011 fiscal year from 27.9 billion in the previous year. This means that SACU revenue receipts by member countries will fall by around the same margin. This has resulted in serious financial constraints in member countries like Lesotho that rely heavily on this source of revenue. Lesotho is expected to realize a high fiscal deficit because of the financing gap created by the fall in SACU revenue and expenditure containment and rationalisation is in order.

3. Monetary Policy Operations Report for February 2010

One of the main objectives of the Central Bank of Lesotho (CBL) is to maintain price stability, which is achieved through maintenance of adequate level of Net

International Reserves (NIR). The adequate level of NIR ensures that the parity between local currency, the Loti and the South African Rand is maintained. The CBL's

Monetary Policy Committee (MPC) set the NIR target range of US\$650-US\$700 million during the period under review. The CBL employs the Open Market Operations (OMO) as a monetary policy tool in order to achieve the stated objective. The open sale and purchase of treasury bills goes a long way to protect the currency peg.

The report presents economic and operational issues surrounding the monetary policy operations conducted during the month of February to assess the success of the operations.

Table 1 below shows that the entire amounts of treasury bills announced during the auctions, to the tune of M34 million and M26 million for February 10 and 24 respectively, were issued. The market continued to perform satisfactorily during the review period and both auctions were over-subscribed. Nevertheless, there were some indications the competitiveness of the

91 day treasury bills deteriorated as the number of bids received during each of the two auctions were lower than during each one of the two preceding auctions. In addition, the number of successful bids also declined significantly.

Lesotho's 91-day Treasury bills rate (discount rate) remained below its South African counterpart by 0.44 per cent, on February 10, 2010. The margin of interest rate differential between Lesotho's 91-day Treasury bills rate and SA counterpart widened marginally by 0.46 per cent on February 24, 2010. This implies that there was a minimal incentive for undesirable cross border transfers of funds between the two countries. Therefore, the Monetary Policy operations undertaken during the review month were successful in attaining their desired objectives of price stability by maintaining the target NIR level.

Table 2: Treasury Bills Auctions

Type Security	Auction Date	Maturity Date	Auction Amount (Million Maloti)	Amount Issued (Million Maloti)	Discount Rate (%)	RSA Discount Rate (%)
91-day	10-Feb-2010	12-May-10	M10.0	M10.0	6.64%	7.08%
182-day		11-Aug-10	M10.0	M10.0	6.88%	7.15%
273-day		10-Nov-10	M7.0	M7.0	7.63%	7.10%
364-day		09-Feb-11	M7.0	M7.0	7.69%	7.03%
91-day	24-Feb-2010	26-May-10	M8.0	M8.0	6.62%	7.08%
182-day		25-Aug-10	M8.0	M8.0	6.84%	7.18%
273-day		24-Nov-10	M5.0	M5.0	7.60%	7.16%
364-day		23-Feb-11	M5.0	M5.0	7.65%	7.09%
Total for reporting			M60.0	M60.0		

Figure 1: Measuring the Success of Monetary Policy Objectives: Performances of Lesotho 91-day T-bills vs RSA 91-day T-bills

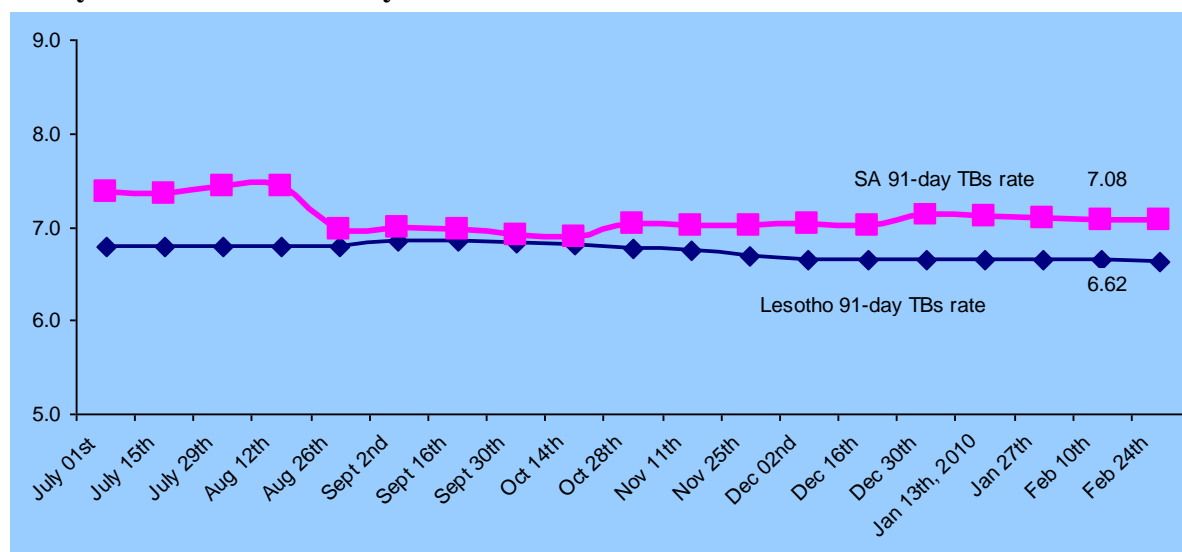


Table 2: Selected Monetary and Financial Indicators

	2009		2010
	November	December	January
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	11.83	11.67	12.00
1.2 Prime Lending rate in RSA	10.50	10.50	10.50
1.3 Savings Deposit Rate	2.11	2.05	2.05
1.4 Interest rate Margin(1.1 – 1.3)	9.72	9.62	9.95
1.5 Treasury Bill Yield (91-day)	6.99	6.94	6.94
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	5697.69	5744.69	5939.34
2.2 Net Claims on Government by the Banking System	-4348.79	-3996.00	-4663.78
2.3 Net Foreign Assets – Banking System	11152.62	10702.08	12162.27
2.4 CBL Net Foreign Assets	8166.44	7785.54	8664.40
2.5 Domestic Credit	-2496.74	-2136.21	-2767.70
2.6 Reserve Money	820.94	819.61	886.95
3. Spot Loti/US\$ Exchange Rate (Monthly Average)	7.5164	7.4632	7.4576
4. Inflation Rate (Annual Percentage Changes)	4.3	4.2	4.1
5. External Sector (Million Maloti)	2009		
	QII	QIII	QIV+
5.1 Current Account Balance	339.97	-132.30	-366.04
5.2 Capital and Financial Account Balance	507.34	-501.16	1303.29
5.3 Reserves Assets	70.01	875.49	-368.78

+Preliminary Estimates.

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

Table 3: Selected Economic Indicators

	2006	2007	2008	2009+
1. Output Growth(Percent)				
<i>1.1 Gross Domestic Product – GDP</i>	6.6	2.3	4.4	1.9
<i>1.2 Gross National Product – GNI</i>	2.4	1.7	11.4	0.7
<i>1.3 Per capita –GNI</i>	2.3	1.6	11.3	0.7
2. Sectoral Growth Rates				
<i>2.1 Agriculture</i>	18.4	-14.0	6.3	1.1
<i>2.2 Manufacturing</i>	9.1	1.2	3.2	-1.3
<i>2.3 Construction</i>	-1.3	5.1	7.7	7.9
<i>2.4 Services</i>	5.7	2.5	4.0	2.7
3. External Sector – Percent of GNI				
<i>3.1 Imports of Goods</i>	80.5	87.8	82.8	78.7
<i>3.2 Current Account</i>	3.5	11.0	11.1	3.2
<i>3.3 Capital and Financial Account</i>	0.8	5.9	7.6	8.7
<i>3.4 Official Reserves (Months of Imports)</i>	1.2	5.0	8.9	10.4
4. Government Budget Balance (Percent of GDP)	42.8	43.1	43.3	48.1

+Preliminary Estimates