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QUARTERLY REVIEW

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Population Census in Lesotho

In April 2006, a population census was conducted in Lesotho. This exercise is carried out at regular intervals so that comparable information is obtained in a fixed sequence. For instance, in Lesotho, this frequency is every ten years. A population census is a process of collecting, compiling, analysing and disseminating demographic, social and economic data of all persons in country at a specified time. These data are crucial for any government particularly in the formulation of developmental policies.

This time oriented activity, which should cover the entire population, provides accurate and reliable data which are useful for socio-economic goals. The data characteristic specific that is, relates to features such as fertility, mortality, migration, age, gender, and employment status, and as such they can provide the basis for Government pro-poor policies. Importantly, they provide benchmarks on how many people need basics like health, education and clean water. Therefore, they can enable the authorities to project how many old people are supposed to get pension, and how many would need jobs in the near future. Furthermore, the data are useful for determining the changing patterns of urban or rural concentrations as well as the development of urban areas.

The Economic Impact of Temporary Price Controls on Bread

The Ministry of Trade and Industry, Cooperatives and Marketing (MTICM) set temporary price controls on the price of bread, from April 1, 2006 to 31, December 2006. The intervention by government was due to the outcry by small bakeries that they were loosing market share to big bakeries. This was driven by agreements undertaken by the biggest bakeries, which recently were reported to be selling a loaf of bread at a price lower than the cost of production. In an effort to maintain a more effective degree of competition, the MTICM set minimum and maximum price controls on the price of bread.

The intervention would maintain a more competitive environment in the bread industry. Subsequent to the expiry of price controls, the expectation is that prices would stabilise and as such both consumers and bakeries would benefit. On the other hand, market intervention in the form of price controls tends to restrict competition in the industry as it eliminates market determination of prices. The price of bread (in the absence of price controls) is determined by the quantity that bakeries are willing to supply at various prices and the amount consumers demand at various prices. Therefore, the price control could create or surpluses if the set price is above the market determined price.

Reconstruction and Maintenance of Damaged Roads Caused by Heavy Rains

The Ministry of Finance and Development Planning allocated funds amounting to about M16 million to the Ministry of Public Works and Transport for the maintenance and reconstruction of damaged roads and bridges caused by heavy rains during the first half of the year. The local contractors under the supervision of the Lesotho Emergency Infrastructure Consortium have been earmarked to execute the work. The roads to be maintained and reconstructed are across the country, with the emphasis on those in the lowlands.

A positive relationship exists between infrastructure development (capital investment) and economic growth. In addition, there are arguments for complementarities between government investment and private investment. In Lesotho, good road infrastructure would unlock economic growth especially since the majority of the areas are still not easily accessible.

Economic Impact of Tourism Development

The governments of Lesotho and South Africa (SA) have joined efforts to develop tourism through nature conservation and infrastructure provision around Drakensburg range. The Prime Minister and the Ministers of Tourism from both countries participated at the sod-turning ceremony for infrastructure development in the area. The project intends to construct lodges, chalets and environmental centres in the area. Those will be complemented with upgrading of Sani-pass road that will link Mokhotlong (Lesotho) with Pietermaritzburg (SA), through Thaba-Tseka to the Lowlands of Lesotho.

The initiative carries along with it benefits to both countries at different economic segments. Nature conservation will benefit from the project, particularly Sehlabathebe Nature Reserves and Uk'hahlampa Park. Endangered species of both animals and plants will be conserved for future generations. Furthermore, the infrastructure provision that is embedded will reduce travelling costs for locals. Additionally, the anticipated tourism will bring the necessary inflows of foreign currency. This also has potential to reduce unemployment with the establishment and functioning of the chalets and lodges.

Launching of Road Construction Leading to New Parliament Building

The Minister of Public Works and Transport launched the construction of access road to the site where the new Parliament of Lesotho will be constructed. The site is located at the top of Mpilo hill in Maseru. The project is funded by Government of Lesotho and Government of the People's Republic of China. The road is estimated to cost about M9.8 million. The road is expected to be completed in October 2006.

Access road to the new Parliament building will reduce traffic along Kingsway to the other areas of Maseru City. The road construction created some job opportunities for Basotho people. The new Parliament building could become a tourist attraction because of the scenic view it offers.

II. International Economic Developments and their Implications for the Lesotho Economy

United States (US)

The US economic growth, as measured by changes in Gross Domestic Products (GDP) decelerated on annual basis from 5.6 per cent in the first quarter to 2.5 per cent during the review quarter, as depicted by the preliminary estimates. The observed deceleration in GDP growth rate during the review quarter was driven largely by a decline in personal consumption, government spending and investments.

The US consumer inflation rate accelerated to 4.3 per cent in the review quarter, following 3.4 per cent registered in March. The persistent increase in the international oil prices continued to put upward pressure on the inflation rate. As a consequence, the US Federal Reserve Bank's Open Market Committee (FOMC) raised its benchmark lending rate to 5.25 per cent in June from 4.75 per cent March.

The US labour market continued to improve to some extent irrespective of the slowdown in economic growth during the quarter under review. Unemployment rate, seasonally adjusted, improved to 4.6 per cent in June, from 4.9 per cent registered in March 2006.

Lesotho has strong trade links with the US. As a result, the slowdown in the overall economic performance in the US does not bode well for Lesotho economy. Improvement in the labour market could be in favour of demand for Lesotho's exports in the US. However, inflationary pressures emanating from the persistent increase in the international oil prices could be detrimental to Lesotho's exports.

Euro-zone[1]

Economic growth in the Euro-zone accelerated to 0.9 per cent in the second quarter compared with 0.6 per cent realised in the previous quarter. The strong growth rates were registered in Germany, France and Spain. The high growth rate in the largest economy in the Euro area, Germany, was supported by the FIFA soccer world cup as well as by increased investment in the construction sub-sector.

Inflation in the Euro-Zone, as measured by the Harmonised Index of Consumer Prices (HICP) closed the quarter at a higher annual rate of 2.5 per cent, compared with 2.2 per cent in the previous quarter. The upward pressure of inflation emanated from an increase in the gas and electricity bill. The Producer Price Index (PPI) also increased by 0.2 per cent in June. As a consequence of accelerating inflation, the European Central Bank's (ECB's) Monetary Policy Committee (MPC) increased its key interest rate by 25 basis points to 2.75 per cent in June.

In the labour market, the unemployment rate remained high despite a slight decline. The unemployment rate declined from a seasonally adjusted average of 8.1 per cent in March to 7.9 per cent in May.

A large component of Lesotho's diamond exports is destined to European Union. As such, the slight decline in the unemployment rate and the improvement in economic growth could induce higher demand for Lesotho's exports.

South Africa

Real GDP growth accelerated from a seasonally adjusted and annualised rate of 4.0 per cent in the previous quarter to 4.9 per cent during the quarter under review. The acceleration in the growth rate emanated from the following sub-sectors; construction, financial and business services and real estate, wholesale and retail trade, and transport, storage and communications. Agriculture was the only sub-sector that remained in recession.

The CPI-X, which is the Consumer Price index (CPI) excluding interest rates on mortgage bonds, grew at a higher annual rate of 4.8 per cent in June compared with 3.8 per cent in March. Inflationary pressure on prices emanated from the transport and food categories as a result of a persistent increase in international oil prices. At this level the CPI-X is still within the target range of 3 per cent to 6 per cent.

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[1] Euro-zone: Austria, Belgium, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

Producer inflation, as measured by changes in the producer price index (PPI), rose by a higher annual rate of 7.5 per cent in June compared with 5.4 per cent in March. The increase mainly arose from higher international oil prices and the depreciation of the rand against major trading currencies.

As the result of the inflation developments, the South African Reserve Bank (SARB) Monetary Policy Committee (MPC) increased its key interest rate by 50 basis points from 7.0 per cent recorded in March to 7.5 per cent in June. Consequently the prime lending rate increased from 11.50 per cent recorded in March to 12.00 per cent in June.

Economic developments in SA have mixed implications for Lesotho. The acceleration in the real economic growth rate augurs well for Lesotho. However, upward pressure on prices, emanating from persistent increase in the international oil prices remained a threat on the Lesotho economy because of close trade linkages between Lesotho and SA. This almost invariably implies higher imported inflation from SA.

Commodity prices

Gold

The average price of gold increased by 13.3 per cent from $554.73 an ounce in the first quarter of 2006 to $628.2 an ounce during the review quarter. It reached a minimum and maximum of $559.75 and $714.80 an ounce, respectively. The dollar price of gold increased mainly due to the depreciation of the dollar against the other major currencies, such as the euro. In rand terms, the gold price increased by 28.6 per cent from R3,415.57 per ounce in the previous quarter to R4,391.68 in the quarter under review.

The increase in the rand price of gold could improve stability in the SA gold mining industry. If sustained, this could help to at least secure the existing employment status of Basotho migrant workers in SA mines. Consequently, this would benefit miners' remittances, which are a major source of financing for Lesotho's imports.

Oil

The average price of oil increased by 12.6 per cent from $57.52 per barrel in the first quarter of 2006 to $64.79 per barrel during the review quarter. In the latter period, the oil price fluctuated between $61.01 and $68.40 per barrel. The quarterly price of oil continued to remain considerably higher than the upper limit of the Organisation of the

Petroleum Exporting Countries (OPEC)[2] target band of $22 to $28 per barrel.

The international oil price increased in response to the persistent expansion in oil consumption in China and India. Furthermore, uncertainties in Iraq and elsewhere in the Middle East also continued to exert upward pressure on the international oil prices. In rand terms, the average price of oil increased by 27.9 per cent from R354.19 per barrel in the previous quarter to R452.97 per barrel in the review quarter.

The increase in the international oil prices could impact negatively on the Lesotho economy. It could result in an upward revision of fuel prices and therefore in an increase in the general price level within the country. This would be through increase in the cost of production which could adversely affect profit levels and encourage firms to cut employment levels. If increase is sustained it could negatively affect employment prospects.

III. Overview of Macroeconomic Developments in Lesotho

Economic Growth

During the second quarter of 2006, the various indicators reflected good performance of the economy. Water consumption by the industrial sector, a measure of activity in the manufacturing sub-sector, improved on both quarterly and year-on-year basis. In unit terms, it increased by a seasonally adjusted 10.1 per cent, on an annual basis.

In addition, the number of imported motor vehicles, a proxy for consumption and investment expenditure, increased by a seasonally adjusted 114.9 per cent compared with 39.6 per cent decline registered in the previous quarter. However, the number of building permit issued a measure of construction activity, declined by 33.1 per cent.

Inflation

Inflation during the quarter under review rose from 5.1 per cent in March to an estimated 6.6 per cent at the end of June 2006. This has been influenced mainly by the increase in the 'food and non-alcoholic beverages' category of the CPI. This category increased from 5.6 per cent in March to an estimated 10.0 per cent in June. This was largely on account of the shortfall in supply of cereals coupled with the rise in

[2] OPEC: Algeria, Indonesia, Islamic Republic of Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

international oil prices which continued to exert upward pressure on costs of production.

Employment

Manufacturing sector employment of Lesotho National Development Corporation (LNDC) assisted companies increased by an estimated 19.1 per cent on a quarterly basis. The sector continued to benefit from the depreciation of the loti against the US dollar, which led to a pick-up in orders for garments in the US.

Government employment, the second largest domestic employer, increased by 2.7 per cent from the last quarter, and is underpinned by increases in the number of teachers employed. Migrant mineworkers' employment continued to rise marginally in the review quarter. It increased by 4.5 per cent, from 50 640 in March to 52 926 in June.

Balance of Payments (BOP)

Lesotho balance of payments (BOP) position continued to register surpluses. The overall balance improved from a seasonally adjusted surplus of M172.6 million in the first quarter to M439.1 million in the review quarter. Transaction balance, which represents the overall balance excluding the effects of currency fluctuations, also recorded seasonally adjusted surplus of M165.4 million in the review quarter compared with M185.3 million registered in the previous quarter. The improvement in the BOP position was influenced mainly by the developments in the current account. The current account registered a surplus equivalent to 8.3 per cent of GDP. This was driven by the receipt of increased Southern African Customs Union (SACU) revenue during the quarter under review. SACU revenue rose by 28 per cent during the quarter, reflecting revised revenue for the new fiscal year. Furthermore, the strong growth in exports led to the narrowing of the trade deficit. The capital and financial account experienced a net outflow due to the increase in commercial banks outflows.

Monetary Sector

At the end of the review quarter, the broad measure of money supply (M2) registered a quarterly increase of 5.3 per cent in contrast with slight 0.9 per cent fall registered at the end of the last quarter. The rise was mainly due to an increase in the overall banking system's net foreign assets adjusted for valuation changes which offset the decline observed in net domestic credit.

The prime lending rate rose from 11.5 per cent to 12.0 per cent in line with the increase in similar regional rates. The Lesotho 91-day Treasury bill rate remained unchanged at last quarter's 6.90 per cent. During the same period, the counterpart SA rate rose by 24 basis points from 6.59 per cent. As a result, the margin between the two rates narrowed from 31 to 7 basis points.

Fiscal position

Government budgetary operations were estimated to have realised a surplus equivalent to 9.2 per cent of GDP during the review period. This was facilitated by increased Government revenue which grew by 10.6 per cent. The growth mainly resulted from the 28.0 per cent hike in customs revenue. As a percentage of GDP, total revenue and grants grew by 190 basis points to 54.1 per cent.

Total public debt rose by 2.1 per cent during the period under review. This was mainly attributed to depreciation of the local currency against the major world currencies with which debt is contracted. As a percentage of GDP, the total debt stock was estimated to have decreased to 46.8 per cent compared with 48.9 in the previous quarter. The foreign debt comprises 85.9 per cent of total debt stock while domestic debt comprises 14.1 per cent.

IV. Economic Indicators

Household and Business Sector Housing Statistics

Due to the unavailability of actual building and construction statistics on a quarterly basis, the number and value of building permits is used as an indicator of activity in the construction sub-sector. The number of permits issued is reflective of the demand for building and construction materials and hence the performance of the construction sub-sector. The number of building permits adjusted for seasonality changes dropped by 26.9 per cent in the second quarter of 2006, in contrast to a 21.2 per cent rise realised in the previous quarter. On an annual basis, the number of building permits issued fell by 33.1 per cent. The slump on both quarterly and year-on-year basis reflects the return to normality following the strong increase observed last quarter due to building of schools by Government of Lesotho.

Table 1: Building Permits by Type of Building

(Value in Million Maloti)

Type	Permits	2005				2006	
		QI	QII	QIII	QIV	QI	QII
Residential	Value	8.49	8.27	11.93	9.05	18.05	23.53
	Number	37	49	61	40	54	45
Commercial	Value	6.50	1.14	0.00	14.59	0.88	1.13
	Number	3	5	0	7	3	2
Other	Value	3.44	22.87	1.38	1.12	70.31	0.33
	Number	4	18	3	2	5	1
Total	Value	18.43	32.28	13.31	24.76	89.24	24.99
	Number	44	72	64	49	62	48
	Number*	45	69	62	52	63	46

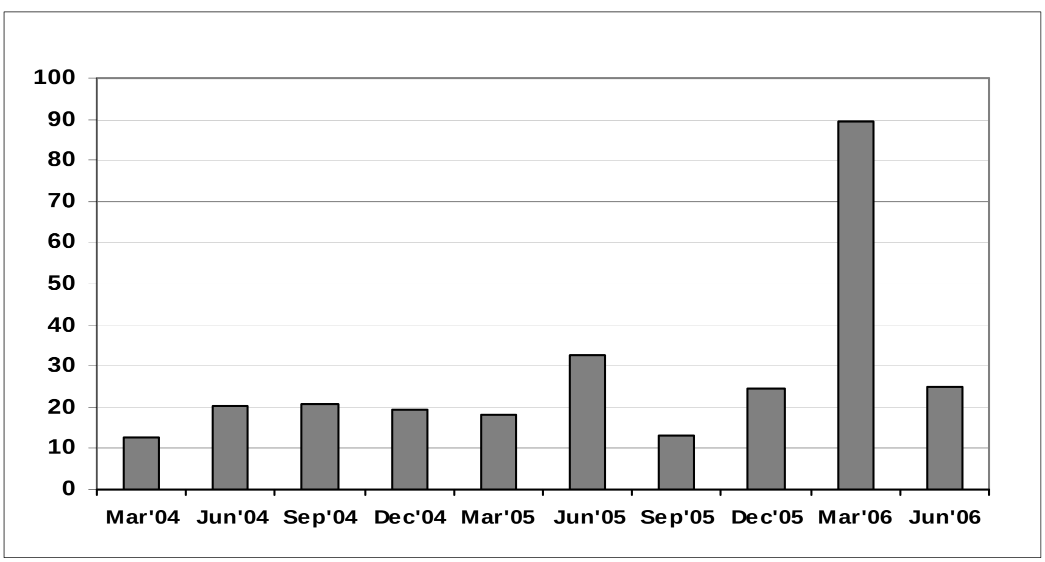
Source: Maseru City Council and Land Survey and Physical Planning

(1) Excludes data on buildings constructed without obtaining building permits. The table also excludes data on Mafeteng, Mokhotlong and Mohale's Hoek districts.

(2) Number denotes seasonally adjusted figures*

Figure 1: Value of Building Permits

(Million Maloti)



Imported Motor Vehicles

Statistics on imports of motor vehicles by both the private sector and Government is used as a useful indicator of economic activity (consumption and investment expenditure). Imports of motor vehicles continued on an upward trend in the second quarter of 2006. On a quarterly basis, the number of imported motor vehicles increased by a seasonally adjusted 114.9 per cent compared with 39.2 per cent drop observed in the previous quarter. The higher number of imported motor vehicles on a quarterly basis was driven by increased imports by Imperial Fleet Services as well as the private sector.

However, the number of imported motor vehicles decreased by 18.4 per cent on an annual basis. Although the overall number of imported motor vehicles slumped on an annual basis, the number of trucks (a proxy for investment) imported rose significantly, thus reflecting robust investment activity domestically. It can therefore be concluded that the higher number of imported trucks contributed positively to the performance of the economy.

The increase can partly, be attributed to amongst other factors, the continued extension of credit to the private sector on annual basis.

Table 2: Motor Vehicle Imports

(Value in Million Maloti)

		Cars	Vans	Trucks	Buses	Trac-tors	M/ Cycles	Trail-ers	Total
2004									
II	Value	8.49	8.69	0.53	0.85	0.09	0.00	0.38	19.03
	Number*								406
	Number	198	164	2	11	4	0	5	384
III	Value	17.40	16.34	2.62	4.02	0.21	0.00	0.56	41.15
	Number*								1011
	Number	323	244	6	45	7	0	15	640
IV	Value	19.57	19.23	0.21	5.01	0.52	0.00	0.81	47.23
	Number*								700
	Number	346	205	5	45	12	0	12	625
2005									
I	Value	15.79	25.19	1.57	2.77	0.70	0.01	0.48	46.51
	Number*								658
	Number	349	299	2	26	8	1	13	698
II	Value	23.18	31.41	2.12	4.12	0.49	0.33	0.52	62.17
	Number*								809
	Number	385	364	5	26	5	7	9	801
III	Value	10.26	21.51	0.02	0.22	0.63	0.12	0.56	33.32
	Number*								348
	Number	165	180	2	15	12	8	10	392
IV	Value	15.42	28.25	2.78	4.08	0.19	0.05	0.24	51.01
	Number*								505
	Number	210	208	5	13	6	1	8	451
2006									
I	Value	15.42	28.25	2.78	4.08	0.19	0.05	0.24	51.01
	Number*								307
	Number	152	135	0	22	9	0	8	326
II	Value	25.04	31.38	4.08	5.30	0.22	0.20	0.20	66.42
	Number*								659.9
	Number	336	223	13	31	5	7	9	624

Source: Imperial Fleet Services Lesotho and Customs Department

(1) Number* denotes seasonally adjusted figures

+ Includes imports of second hand cars

Water Consumption

Water consumption is a useful indicator of the level of activity in the water and sewerage sub-sector. However, water usage by the industrial sector serves as one of the most important indicators of activity within the Lesotho manufacturing sector. The Lesotho manufacturing sub-sector, dominated by the textile, food and beverages industries, and these industries rely heavily on water usage. In the second quarter of 2006, performance of the manufacturing sub-sector, as measured by the units of water consumed by the industrial sector reflected an improvement. Seasonally adjusted, total water consumption by the industrial sector rose by 4.4 per cent on a quarterly basis compared with 20.4 per cent rise realised in March 2006. On annual basis, it increased by 10.1 per cent.

The increase in water consumption on both quarterly and annual bases was reflective of robust economic activity in the manufacturing sub-sector. Therefore, it can be deduced that manufacturing sub-sector had a positive contribution to the performance of the economy during the quarter under review.

Table 3: Water Consumption

(Units in Million kilo-litres; value in Million Maloti)

Quarter		Domestic	Industrial	Other	Total
2004					
II	Units	0.84	1.40	0.58	2.82
	Value	3.16	5.79	2.38	11.33
	Units*		1.42		2.93
III	Units	0.76	1.49	0.52	2.77
	Value	2.73	6.14	2.11	10.98
	Units*		1.42		2.70
IV	Units	0.95	1.44	0.54	2.93
	Value	3.66	5.88	2.24	11.78
	Units*		1.30		2.96
2005					
I	Units	0.95	1.20	0.53	2.68
	Value	3.69	4.97	2.20	10.86
	Units*		1.40		2.64
II	Units	0.79	1.36	0.61	2.76
	Value	3.07	6.05	2.59	11.71
	Units*		1.29		2.69
III	Units	0.80	1.38	0.57	2.75
	Value	3.07	6.14	2.53	11.74
	Units*		1.25		2.77
IV	Units	0.95	1.25	0.58	2.78
	Value	3.82	5.55	2.60	11.97
	Units*		1.13		2.80
2006					
I	Units	0.92	1.16	0.58	2.65
	Value	3.72	5.19	2.60	11.97
	Units*		1.36		2.60
II	Units	0.78	1.40	0.65	2.83
	Value	3.20	6.52	3.05	12.77
	Units*		1.42		2.93

Source: Water and Sewerage Authority

(1) Units denotes seasonally adjusted figures*

Telecommunications

The statistics on the number of calls destined to SA and other countries is used as an indicator of economic activity in the export sub-sector. During the review quarter, the number of calls, seasonally adjusted, recovered by 20.7 per cent in contrast with 5.1 per cent fall registered in the previous quarter. On an annual basis, it rose by 0.4 per cent. The increase was on the back of more calls destined to SA as a result of the close trade linkages between the two economies. As depicted by the table below, the total number of calls destined to SA rose by 15.4 per cent, year-on-year. Thus, it can be inferred from the number of outgoing calls that there was robust activity in the export sub-sector, during the review quarter.

Table 4: Telephone Traffic Statistics

		SA Outgoing Calls	International Calls	Total Calls
2005				
I	No. of calls (millions)	2.68	0.09	2.77
	No. of calls*	*2.93*		*3.01*
	Total Duration (million	4.68	0.29	4.97
	Nominal Value (million	9.82	2.60	12.42
II	No. of calls (millions)	3.43	0.11	3.54
	No. of calls*	*3.73*		*3.83*
	Total Duration (million	4.68	0.36	5.04
	Nominal Value (million	8.88	2.98	11.86
III	No. of calls (millions)	*3.19*	0.12	*3.31*
	No. of calls*	*3.25*		*3.15*
	Total Duration (million	4.53	0.35	4.88
	Nominal Value (million	8.60	2.88	11.84
IV	No. of calls (millions)	*3.42*	0.13	*3.55*
	No. of calls*	*3.47*		*3.36*
	Total Duration (million	4.82	0.41	5.23
	Nominal Value (million	10.12	3.41	13.53
2006				
I	No. of calls (millions)	*3.41*	0.15	*3.56*
	No. of calls*	3.25	……	3.19
	Total Duration (million	4.86	0.56	5.42
	Nominal Value (million	10.21	5.11	15.32
II	No. of calls (millions)	3.21	0.08	3.29
	No. of calls*	3.75	……	3.85
	Total Duration (million	3.02	0.36	3.38
	Nominal Value (million	6.66	3.89	10.55

Source: Tele-Com Lesotho

(1) No. of calls refers to number of calls that have been adjusted for seasonality.*

V. Employment and Prices

Employment Developments

Employment developments in the domestic economy are usually estimated based on movements in the manufacturing sub-sector (LNDC assisted firms), the largest employer, and in government sub-sector, the second largest. Employment in manufacturing improved by an estimated 19.1 per cent on quarterly basis and 20.1 per cent annually.

It increased from 40 459 in the first quarter to 48 187 at the end of June 2006. The rise was bolstered by the depreciation of the loti against the US dollar, which led to a pick up in orders for garments in the US during the review quarter.

According to a report released by LNDC, between March and April 2006, employment in the manufacturing sector rose by 8.0 per cent as a result of mobilisation of additional manpower to process the increased export orders by buyers. The report further highlights that Lesotho continues to be the largest exporter of garments to the US in Sub Saharan Africa (SSA) with exports from Lesotho accounting for 25.0 per cent of total SSA garments exports in the period January to February 2006.

Table 5: Employment Trend of LNDC Assisted Companies

Period	QI	QII	QIII	QIV
2006	40459	48187	-	-
2005	41985	40111	39597	43131
2004	52532	53525	52922	50607
2003	43525	46960	49862	51187
2002	36906	39255	42011	43773

In the second quarter of 2006, government employment stood at 38 089, compared with 37 097 in the previous quarter. This represented a 2.7 per cent quarterly growth rate. Most components of government employment contributed to the upward movement, particularly, teachers.

The high rate of unemployment in Lesotho has over the years been mitigated by migration to the South African mines, especially the gold mining industry. In the second quarter of 2006, employment of Basotho in the South African mines was estimated at 50 640, a slight improvement from 50 149 observed in the previous quarter. On annual basis, it increased from 50 640 to 52 926. This was on the back of the depreciation of the rand against the US dollar, which implied good performance of the mining industry. The SA mining production increased by 2.0 per cent in May 2006.

Figure 2: Annual Percentage Change in Government Employment

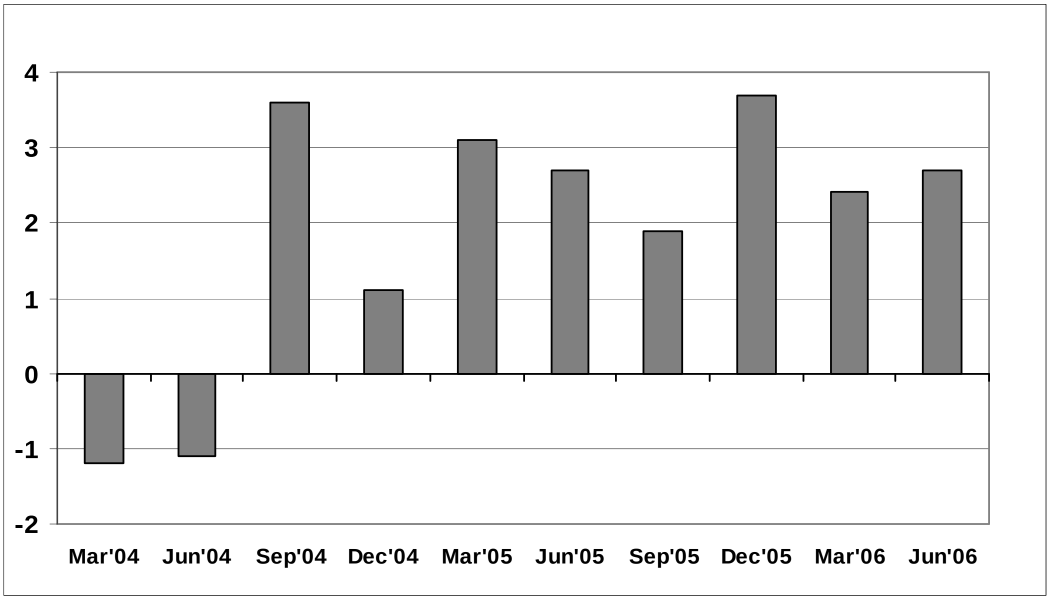
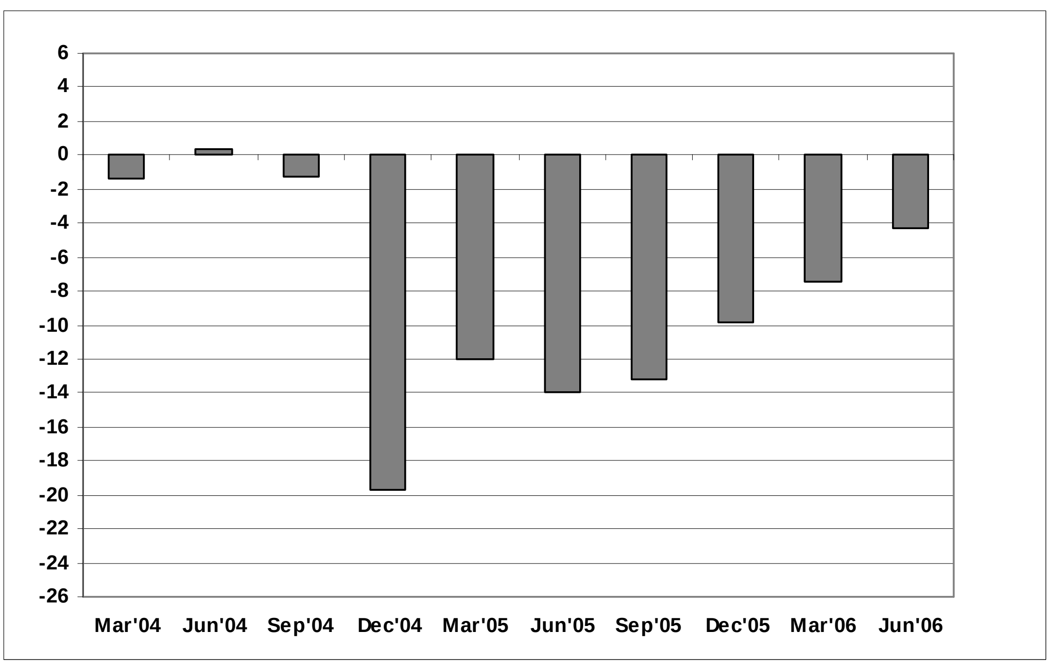


Figure 3: Annual Percentage Change in Migrant Mine Workers Employment



Price Developments

The year-on-year inflation rate, measured by the changes in CPI increased marginally from 5.1 per cent in March 2006, to an estimated 6.6 per cent at the end of June 2006. The rise reflected the impact of mounting inflationary pressures on some of the major items in the CPI. The major contributing factor to the acceleration in inflation during the period under review was the rise in 'food and non-alcoholic beverages' category. The index of 'food and non-alcoholic beverages' category increased from 5.6 per cent in March to 10.0 per cent at the end of June. The continued increase in food inflation component of the CPI is a serious threat on overall CPI as this category carries the largest weight in the CPI basket of goods, at 39.8 per cent. This was largely on account of the shortfall in supply of cereals coupled with the rise in international oil prices which continued to exert upward pressure on costs of production.

In addition to high food prices, the 'alcoholic beverages and tobacco' 'housing, electricity, gas and other fuels' categories contributed to the rise in the overall inflation rate. The persistent increase in international oil prices coupled with the depreciation of the rand vis-à-vis major international currencies is expected to continue pushing fuels prices upwards.

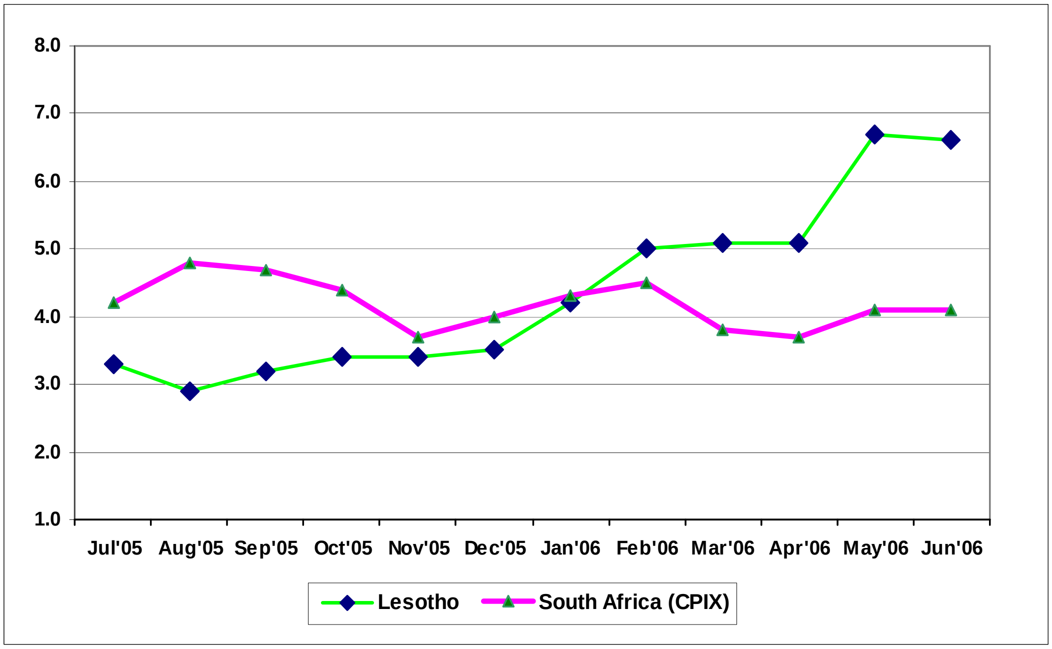
Table 6: Inflation Rate

(Annualised Percentage Change)
Base Period: 1997

	Weight	2006					
		Jan	Feb	Mar	Apr	May	Jun
All items	100.0	4.2	5.0	5.1	5.1	6.7	6.6
Food and non-alcoholic beverages	39.8	4.2	5.2	5.6	5.9	9.5	10.0
Alcoholic beverages & Tobacco	6.4	6.0	6.8	6.8	6.2	7.5	6.3
Clothing & footwear	15.6	4.1	4.6	3.9	3.7	3.4	2.9
Housing, electricity gas & other fuels	3.7	9.1	10.2	9.5	8.8	9.9	8.6
Furniture, households equipment & routine maintenance of house	17.0	3.9	4.7	4.7	4.5	4.8	4.7
Health	1.4	2.9	2.1	2.0	2.6	2.2	0.7
Transport	7.8	3.4	3.9	4.8	4.1	3.9	3.5
Communication	0.1	0.0	0.0	0.0	0.0	0.0	3.4
Leisure, entertainment & Culture	1.2	2.2	3.1	3.4	3.3	0.3	-0.4
Education	3.2	1.7	1.1	1.1	1.0	1.1	0.7
Restaurant & Hotels	0.4	5.0	4.7	5.2	5.5	8.3	7.8
Miscellaneous goods & services	3.2	2.0	2.4	2.1	1.9	2.1	2.8

Source: Bureau of Statistics, Lesotho

Figure 4: Annual Inflation Rate for Urban Households



VI. Balance of Payments (BOP)

Overview

Lesotho's external sector position remained strong during the second quarter of 2006. The overall balance of payments (BOP) recorded a seasonal adjusted surplus of M439.1 million compared with M172.6 million registered in the previous quarter. This is the third consecutive quarterly surplus. Transaction balance, which represents the overall balance excluding the effects of currency fluctuations, also recorded a seasonally adjusted surplus of M165.2 million compared with M185.3 million in the previous quarter. Thus currency depreciation observed during the quarter contributed about 65.4 per cent of the total BOP surplus. Gross reserves, measured by month of imports cover, improved from 5.5 months registered in the first quarter to 6.2 months recorded in the period under review.

The overall surplus in the BOP was mainly due to the developments in the current account. The current account registered a surplus equivalent to 8.3 per cent of GDP. The surplus was driven largely by the receipt of increased Southern African Customs Union (SACU) revenue at the beginning of the quarter. SACU non-duty receipts rose by 35.7 per cent during the quarter. In addition, trade deficit also narrowed due to an increase in exports. The capital and financial account registered a net outflow of M198.1 million during the quarter under review compared with a net inflow of M143.2 million in the previous quarter.

The net outflow resulted mainly from a rise in commercial banks foreign assets.

Table 7: Summary of Balance of Payments

(Million Maloti)

	2005			2006	
	QII	**QIII**	**QIV**	**QI***	**QII+**
I. CURRENT ACCOUNT	-167.31	10.71	-159.73	9.33	203.26
Goods, Services and Income	-585.70	-502.50	-660.75	-572.94	-472.80
(a) GOODS	-1018.76	-944.97	-1021.41	-1084.17	-978.36
Merchandise exports f.o.b.	1060.65	992.00	1165.09	876.07	1035.64
Merchandise imports f.o.b.	-2079.38	-1936.97	-2186.50	-1960.25	-2013.99
(b) SERVICES	-76.18	-77.42	-51.45	-42.80	-58.10
(c) INCOME	509.43	510.85	412.12	554.54	563.65
Labour	488.92	482.58	474.53	522.50	527.31
Other	20.5	28.27	-62.41	32.04	36.34
(d) CURRENT TRANSFERS	418.39	513.20	501.02	582.27	676.06
Government, net	398.38	496.66	474.17	552.42	646.21
SACU non-duty receipts	394.46	497.7	469.91	473.06	641.83
Other	3.92	-1.04	4.26	79.36	4.38
Other Sectors	20.01	16.54	26.85	29.85	29.85
II. CAPITAL AND FINANCIAL ACCOUNT	277.65	-116.00	303.02	143.23	-198.13
(e) CAPITAL ACCOUNT	36.00	34.50	8.20	4.90	7.00
(f) FINANCIAL ACCOUNT	241.65	-150.50	294.82	138.33	-205.13
Special Financing – LHWP	59.77	49.24	61.35	43.35	31.26
III. RESERVE ASSETS	-94.55	26.53	-86.90	-177.17	-441.12
IV. ERRORS AND OMISSIONS	-76.22	140.83	-45.13	43.27	146.77
V. VALUATION ADJUSTMENT	60.21	-62.06	-11.26	-18.66	289.22

* Revised estimates
+ Preliminary estimates

Merchandise Trade

Exports

During the second quarter, merchandise exports seasonally adjusted rose by 19.1 per cent compared with a decline of 19.9 per cent registered in the previous quarter. On annual basis, merchandise exports fell by 2.4 per cent. There are indications that domestic production is recovering. As already indicated water consumption and telephone statistics showed some strong growth during the quarter indicating strong recovery in the manufacturing sector. On the demand side, the US economy, the largest importer of Lesotho's textile products continued to display some growth although decelerating, which bodes well for Lesotho. The observed export performance during the quarter is important to the economy of Lesotho particularly the manufacturing sub-sector which experienced a downturn in 2005.

Imports

Merchandise imports, seasonally adjusted increased marginally by 0.1 per cent during the quarter under review, compared with 0.9 per cent in the previous quarter. On annual basis, imports fell by 3.1 per cent. The sluggish growth of imports to a large extend reflects the slow implementation of the Government capital projects. Capital expenditure fell by 3.5 per cent during the quarter. However, there are indications that private sector imports are recovering. Private motor vehicle imports rose by 123.1 per cent during the quarter.

Table 8: Value of Exports by Section of the S.I.T.C.
(Million Maloti)

COMMODITY	2005			2006	
	II	III	IV	I*	II+
0. Food & Live Animals	23.9	21.56	33.04	31.58	24.53
Cattle	2.22	1.83	1.79	1.28	0.13
Wheat Flour	9.72	6.64	8.33	10.62	13.18
Maize Meal	3.68	4.14	5.92	6.81	5.69
Other	8.29	8.95	17.00	12.87	5.53
1. Beverages & Tobacco	35.39	35.40	36.56	31.68	34.99
Beverages	35.36	35.36	36.39	31.68	34.99
2. Crude Materials	1.28	5.78	7.14	6.09	0.99
Wool	1.28	5.78	7.14	6.09	0.99
4. Chemicals	3.09	2.20	3.27	3.09	15.14
5. Manufactured Goods	236.21	105.36	194.63	103.84	161.63
6. Machinery & Transport Goods	58.23	92.21	113.91	84.39	65.26
7. Miscellaneous Manufactured Goods	697.99	723.73	772.50	612.74	730.25
8. Unclassified Goods	4.34	5.76	4.04	2.66	2.85
TOTAL EXPORTS	1060.65	992.00	1165.09	876.07	1035.64

Note: Totals may not tally due to rounding
* Revised estimates
+ Preliminary estimates

Direction of Trade

The US remained the largest recipient of Lesotho exports. During the review period, the share of exports to US registered 66.9 per cent compared with 68.7 per cent recorded in the previous quarter. The inception of African Growth and Opportunities Act (AGOA) shifted the direction of exports in favour of the US, but this trend could be reversed if AGOA agreement expires. The second largest share of Lesotho exports is destined to SACU market. Exports to SACU fell from 19.4 per cent as a share of total exports in the first quarter to 16.5 per cent in the review quarter. European market was a third largest recipient of Lesotho exports. Its share increased to 13.8 per cent during the quarter, following 9.2 per cent registered in the previous quarter. The proportion of exports to Asia declined from 1.1 per cent in the first quarter to 0.3 per cent during the quarter under review.

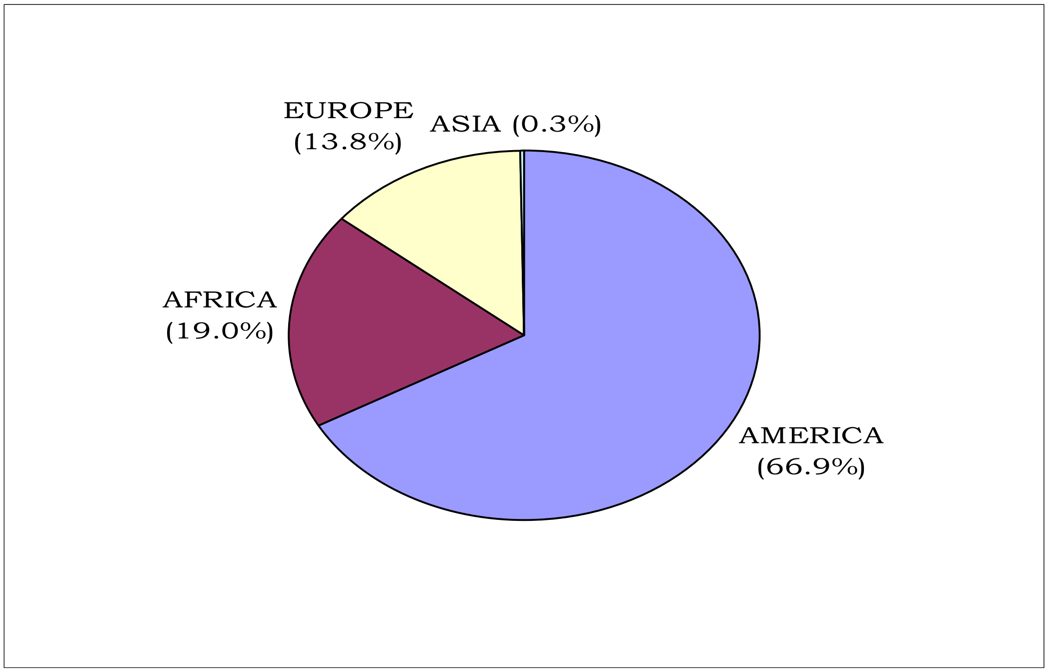
Table 9: Direction of Trade - Exports and Re-Exports, f.o.b.
(Million Maloti)

REGION	2005				2006			
	QIII AMOUNT	% SHARE	QIV AMOUNT	% SHARE	QI* AMOUNT	% SHARE	QII+ AMOUNT	% SHARE
World	992.00	100	1165.09	100	876.07	100	1035.64	100
Africa	168.11	16.95	314.68	27.09	183.65	20.97	196.38	18.96
SACU	136.85	13.80	303.89	26.16	169.77	19.38	170.34	16.45
SADC	0.46	0.05	0.43	0.04	4.28	0.49	1.74	0.17
Other	30.80	3.10	10.36	0.89	9.60	1.10	24.3	2.63
Europe	161.98	16.33	172.64	14.82	80.89	9.23	142.78	13.79
EC	161.98	16.33	172.64	14.82	80.89	9.23	142.78	13.79
America	655.26	66.05	675.22	58.12	601.70	68.68	693.19	66.93
Asia	6.65	0.67	2.55	0.22	9.83	1.12	3.29	0.32

Note: Total may not tally due to rounding
* Revised estimates
+ Preliminary estimates

Figure 5: Direction of Trade Exports

(Quarter II)



Labour Income

During the quarter under review, labour income, seasonally adjusted, continued to decline. It fell by 1.7 per cent during the review quarter compared with 2.8 per cent in the previous quarter. On annual basis, labour income rose by 7.9 per cent. The observed performance was consistent with the developments in SA mining industry where the depreciation of the rand and rise in the price of gold boosted profit margins. Miners' remittances rose by 0.8 per cent during the quarter compared with 10.9 per cent in the previous quarter. However, if increase is sustained, some mining shafts may resume operations. The outlook for Basotho employed in the mines remains bleak.

Investment Income

Inflows of investment income grew by 8.6 per cent in the second quarter compared with a fall of 12.8 per cent in the previous quarter. The observed growth was mainly due to increase in interest earnings by the CBL. Interest earnings by CBL continued to rise further during the quarter under review. A number of factors were responsible for this growth. Firstly, the foreign assets of CBL rose significantly during the quarter driven largely by the receipt of SACU revenue. Secondly, interest rates have been on the increase in the developed countries particularly the US. Lastly, the CBL has diversified the asset class structure into more profitable financial assets.

Investment income outflows rose by 5.2 per cent in the review period following a significant fall of 70.8 per cent recorded in the previous quarter. The observed increase was mainly due to a rise by18.9 per cent in interest on official loans.

Travel

Travel receipts rose by 4.2 per cent during the quarter under review compared with a decline of 1.1 per cent registered in the previous quarter. On an annual basis, the receipts rose by 4.6 per cent during the quarter. The growth in travel earnings was driven largely by increase in tourism spending.

On the other hand, travel payments rose by 0.5 per cent in the review quarter, following a decline of 19.9 per cent recorded in the previous quarter. This marginal increase resulted mainly from government international subsistence allowance which increased by 5.1 per cent.

Current Transfers

Net current transfers seasonally adjusted rose to M675.9 million at the end of the second quarter, from M567.0 million in the previous quarter. On an annual basis, net current transfers rose significantly by 61.6 per cent. The observed strong growth as already mentioned was mainly attributable to increase in SACU non-duty receipts. SACU non-duty receipts rose by 35.7 per cent during the quarter under review.

Capital and Financial Account

The capital and financial account deteriorated from a net inflow of M143.2 million in the first quarter to net outflow of 198.1 million in the second quarter. As already indicated, the net outflow in the capital and financial account resulted from the increase in commercial banks foreign assets. Commercial banks foreign assets increased to M251.4 million during the quarter compared with the modest M6.2 million in the previous quarter. CBL liabilities also increased to M20.9 million during the quarter, due to the depreciation of the local currency against major currencies, particularly the US dollar. Furthermore, official loans increased to M10.1 million during the quarter, from M9.6 million recorded in the previous quarter. Official repayment also increased from M32.4 million in the previous quarter to M82.6 million during the quarter.

VIII. Money and Banking

Money Supply

Determinants of Money Supply

At the end of the review quarter, M2 registered a quarterly increase of 5.3 per cent, in contrast with a small decrease of 0.9 per cent observed at the end of March. This increase was at the back of a jump of 16.0 per cent in the overall banking system's net foreign assets, which offset a decrease of 2.3 per cent in domestic credit. On an annual basis, money supply rose by 16.5 per cent following a 4.7 per cent rise reported at the end of March. The year on year rise in money supply was at the back of a significant growth in both domestic credit and the overall banking sector's net foreign assets adjusted for valuation changes.

Figure 6: Overview of Recent Monetary Developments

(Million Maloti: End of Period)

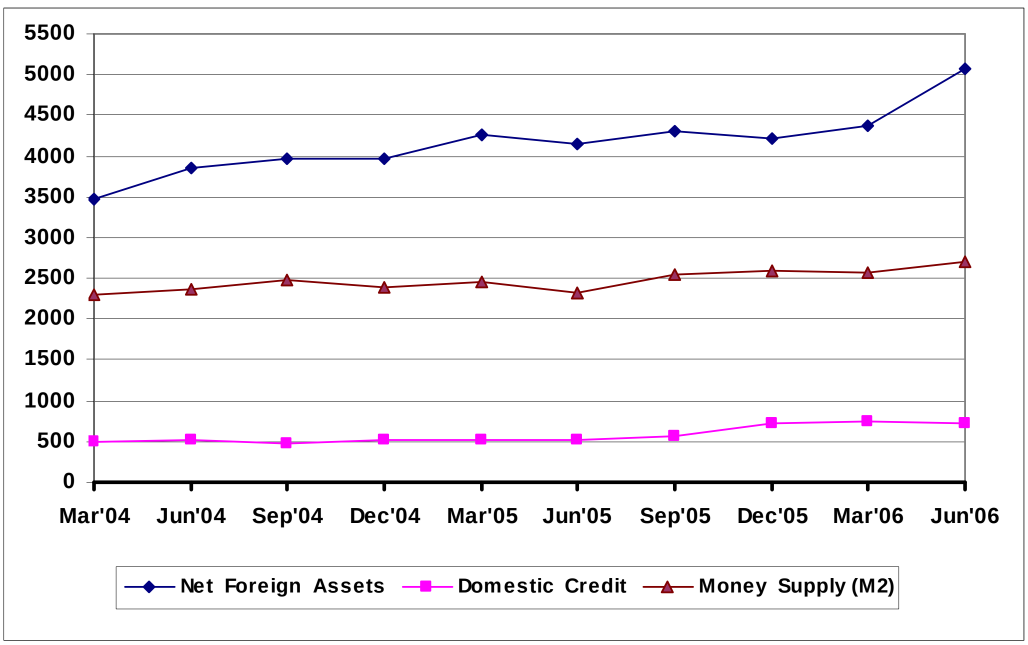


Table 10: Determinants of Money Supply

(Million Maloti: Changes)

Determinants	2005			2006		
	Mar	Jun	Sep	Dec	Mar	Jun
Net foreign assets	250.4	-81.2	154.2	-84.6	166.2	698.2
Domestic credit	7.0	9.7	32.1	159.7	26.6	-17.1
To statutory bodies	10.7	-8.3	-7.8	-13.3	-4.0	-11.4
To private sector	-3.6	18.0	39.9	173.0	30.6	-5.7
Other items, net	178.6	59.4	-37.2	29.5	215.9	543.8
Money Supply (M2)	78.8	-130.9	223.5	51.8	-23.1	137.0

Components of Money Supply

Money supply comprises narrow money (M1) and quasi money. At the end of the review quarter, an increase of 6.6 per cent was realised in narrow money compared with a rise of 1.9 per cent recorded at the end of the previous quarter. Furthermore, quasi money increased by 2.0 per cent in June in contrast with a 7.7 per cent fall which obtained at the end of the quarter ended March. The increase in narrow money, on the one hand was mainly due to an 8.9 per cent rise in demand and call deposits. On the other hand, quasi money rose as a result of a 4.8 per cent increase in time deposits and a marginal 0.4 per cent rise in savings deposits.

Table 11: Money Supply

(Million Maloti: End of Period)

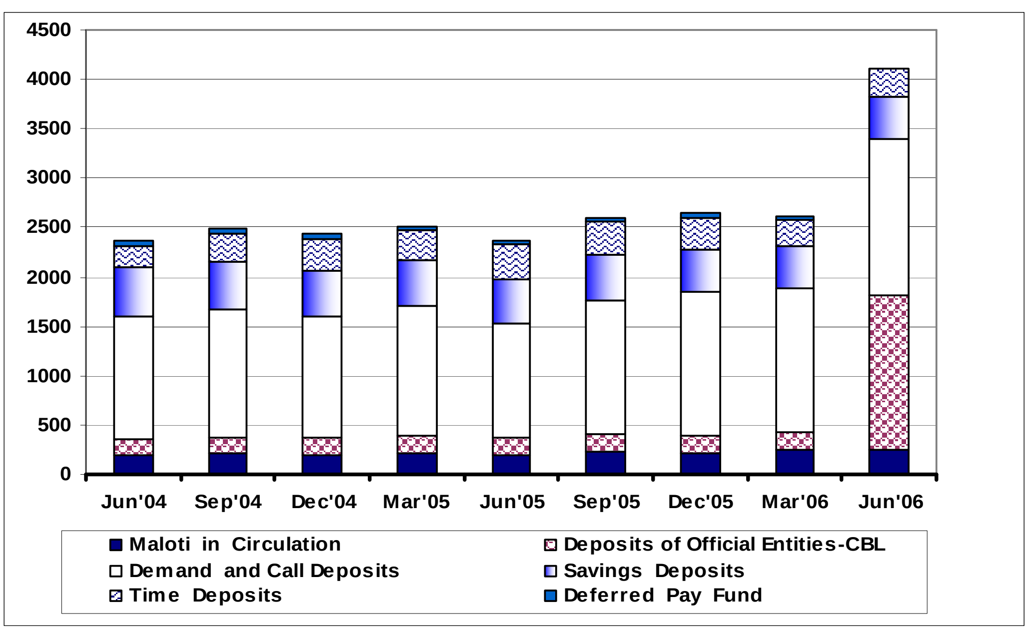
	2005				2006	
	Mar	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
Money Supply (M2)	2451.8	2320.9	2544.4	2590.0	2566.9	2704.0
Money (M1)	1698.4	1514.2	1790.1	1760.8	1864.8	1987.6
Maloti with public	212.6	202.5	232.0	212.8	247.4	242.6
Demand deposits[(1)]	1308.9	1135.3	1347.4	1440.0	1440.0	1568.3
Deposits of official Entities with CBL	176.9	176.4	176.7	176.7	177.4	176.7
Quasi-Money	753.4	806.7	788.3	760.5	702.2	716.4
Savings deposits	453.2	453.4	451.1	437.1	436.4	438.0
Time deposits	300.2	353.3	337.2	323.4	265.8	278.5

(1)– includes call deposits

NB: Totals may not tally due to rounding off

Figure 7: Components of Money Supply

(Million Maloti: End of Period)



Commercial Banks' Deposits by Holder

Commercial banks mobilise deposits from various surplus spending sectors of the economy. Total deposits increased by 6.6 per cent, at the end of June in contrast with a 2.7 per cent decline recorded at the end of the previous quarter. The table below shows that the rise was largely driven by a 3.9 per cent increase in private sector deposits as well as a 14.9 per cent increase in deposits held by statutory bodies.

Table 12: Commercial Banks Deposits by Holder

(Million Maloti: End of Period)

	2005				2006	
	Mar	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
TOTAL DEPOSITS	2050.3	1930.1	2123.7	2188.4	2130.2	2271.5
Private Sector	1672.1	1543.7	1667.1	1655.7	1598.7	1660.8
Demand deposits	1031.2	871.4	1014.8	1025.0	1001.3	1033.2
Savings deposits	453.2	453.4	451.1	437.1	436.4	437.9
Time deposits	187.6	219.0	201.2	193.7	161.0	189.6
Statutory Bodies	348.5	349.7	415.9	494.0	531.5	610.7
Deferred Pay Fund	29.8	36.7	40.8	38.7	0.0	0.0

NB: Totals may not tally due to rounding off

Liquidity of Commercial Banks

Proper and efficient management of liquidity enables commercial banks to meet the public's demand for cash. The liquidity of commercial Banks is measured by the ratio of their cash and near cash assets, including investment with maturities of less than twelve months at issue, to all their deposit liabilities. The ratio represents a chosen mix of cash and credit which enables the banks to meet customers' cash withdrawals as well as maintain a reasonable loan book to spur economic growth. At the end of June, the ratio increased from 70.0 per cent in March to 72.2 per cent.

Table 13: Components of Commercial Banks' Liquidity

(Million Maloti: End of Period)

COMPONENT	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
Maloti Notes and Coins	57.9	58.3	57.1	85.2	64.7	69.6
Rand Notes and Coins	10.5	9.4	9.1	20.3	10.0	12.5
Balances due from Lesotho Banks	824.6	606.3	793.6	741.4	633.6	713.6
Balances due from Foreign Banks	1127.1	974.5	1152.2	1051.9	938.1	1200.9
Clearing Balances with CBL	73.2	12.2	63.2	70.7	24.8	29.7
RSA Short-term Securities	0.0	0.0	0.0	0.0	0.0	0.0
CBL Bills	0.0	0.0	0.0	0.0	0.0	0.0
Lesotho Government Securities	196.6	374.8	386.2	359.9	420.7	334.5

The credit deposit ratio measures the extent to which banks use deposits liabilities to extent credit. The ratio declined from 34.1 per cent registered in March to 31.2 per cent in June. This fall implied a decrease in credit extended and an increase in deposits during the review quarter. However, it is desired that this ratio should continue to rise to enhance financial deepening which, in turn, would foster economic growth.

Table 14: Consolidated Balance Sheet of Commercial Banks
(Million Maloti: End of Period)

	2005				2006	
	Mar	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
Net foreign assets	1306.2	1150.1	1310.3	1135.0	1139.0	1375.2
Deposits with CBL	168.5	96.3	159.6	247.3	149.0	125.5
Credit:	773.8	963.2	995.5	1161.1	1217.4	1114.3
o/w: Statutory Bodies	62.8	54.5	46.7	33.4	29.4	17.9
Private Sector	437.7	455.5	493.7	666.1	696.9	691.9
Government:	273.2	453.2	455.2	461.6	491.1	404.5
o/w: Securities	272.3	452.5	454.5	461.6	490.6	404.3
Loans and Advances	1.0	0.6	0.7	0.5	0.5	0.2
ASSETS/LIABILITIES	2248.4	2209.7	2465.5	2543.4	2505.4	2614.9
Private sector deposits (2)	2050.3	1930.1	2123.7	2188.4	2130.2	2271.5
Government deposits	87.5	77.1	140.4	171.9	164.1	171.7
Capital, reserves & other, net	110.6	202.5	201.5	183.1	211.0	171.6

(2)– includes statutory bodies' deposits.

Demand for Money

Domestic Credit

Domestic credit decreased by 2.3 per cent at the end of March, converse to a rise of 3.7 per cent increase observed at the end of the previous quarter. The decrease was mainly due to a decline in credit extended to the private sector coupled with a fall in the portion granted to statutory bodies. This could reflect the response of the private sector and statutory bodies to the hike in interest rates which render borrowing costly, and the repayment of some loans. However, domestic credit was observed to have risen further by 38.2 per cent on an annual basis compared with an increase of 44.9 per cent registered at the end of March.

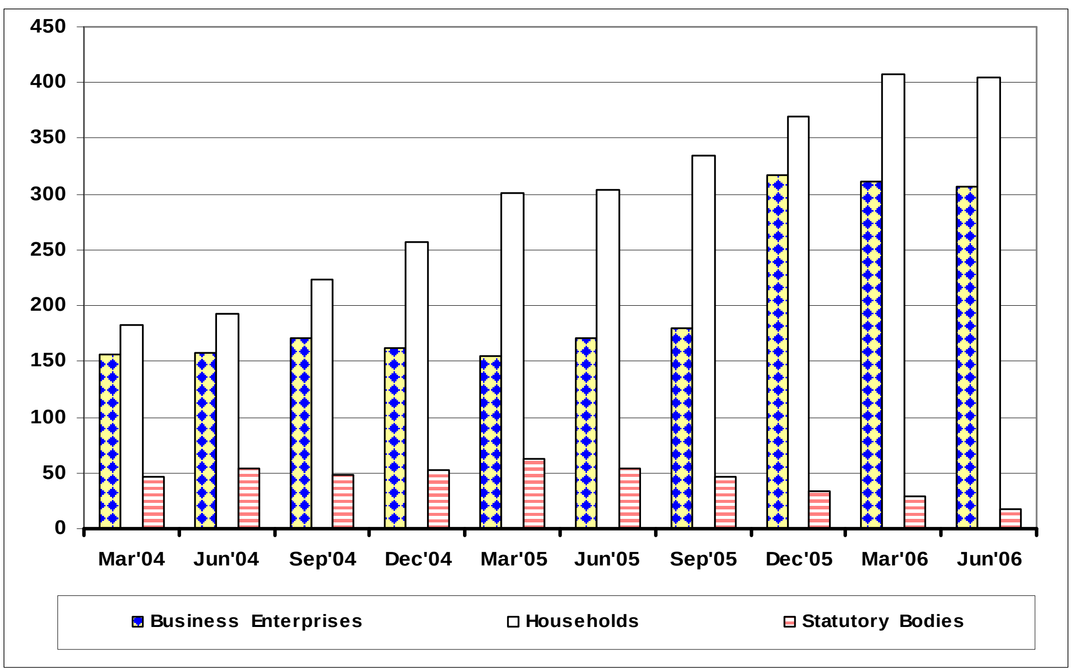
Table 15: Domestic Credit

(Million Maloti: End of Period)

	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
DOMESTIC CREDIT	519.1	528.8	560.9	719.3	747.1	728.5
Credit to private sector	456.3	474.3	514.3	685.9	717.7	710.6
Business enterprises	155.5	171.1	179.1	316.6	310.5	307.1
Households	300.8	303.2	335.1	369.3	407.3	405.0
Credit to statutory bodies	62.8	54.5	46.7	33.4	29.4	17.9

Figure 8: Distribution of Credit by Holder

(Million Maloti: End of Period)



Credit to Private Sector

Credit to the private sector fell by 1.0 per cent during the quarter ending June, compared with an improvement of 4.6 per cent recorded in March. The fall was at the back of a 0.6 and 1.1 per cent decrease in credit extended to households and business enterprises, respectively. The slowdown in performance of credit extension to the private sector reflected increasing borrowing costs for this sector as lending rates started to rise during the review period.

Nonetheless, the year on year increase in credit to the private sector remained strong during the period under review. It soared by 38.2 per cent on an annual basis following a 44.1 per cent increase reported at the end of the quarter ended March. The share of credit to households in total private sector credit remained large at 57.0 per cent in June compared to a 53.8 per cent reported in March. The share of credit to business enterprises was almost unchanged at 43.2 per cent in March. Hence, the bias in credit extension in favour of households indicated that much of the deposits that were mobilised by the banking system were channelled to towards consumption expenditure relative to productive investment.

Credit to Statutory Bodies

The amount of funds lent to statutory bodies was expected to decline due to the on-going privatisation process in the medium to long-term. In line with this expectation, the size of credit extended to these institutions plunged by 39.0 per cent in June, compared with a decrease of 12.0 per cent recorded in March. Furthermore, credit to this sub sector declined by 67.1 per cent on an annual basis following a 53.3 per cent shrinkage registered at the end of March.

Sectoral Distribution of Credit to Business Enterprises and Statutory Bodies

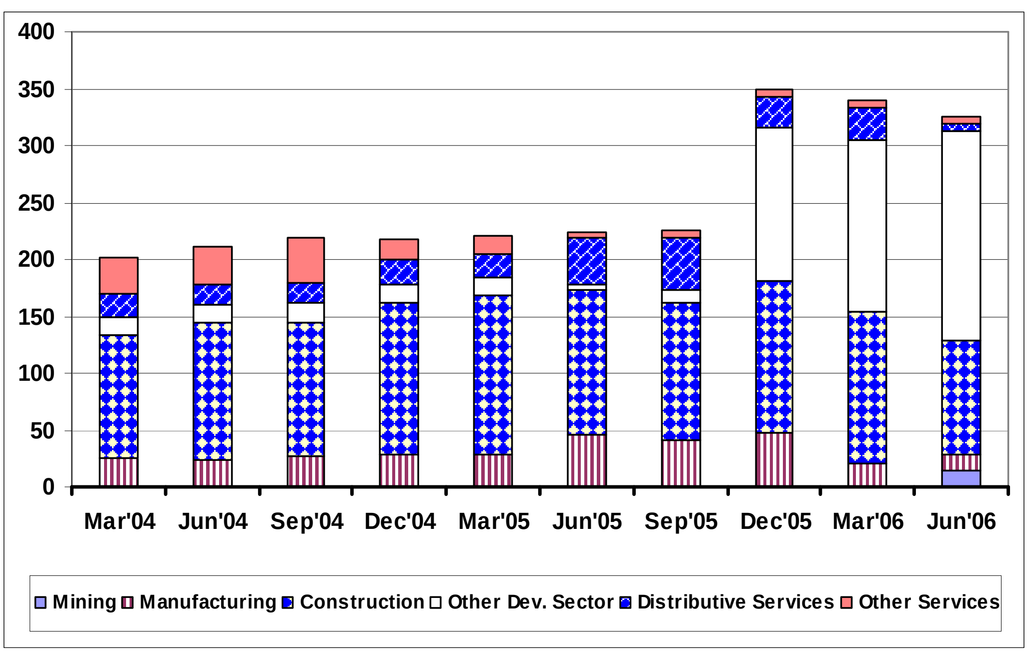
The sectoral distribution of credit reflects the degree to which the funds permeated the economy to finance various economic activities. The analysis of sectoral distribution of credit gauged the extent of financial deepening in the economy by establishing the degree to which banks allocated deposits between competing sectors throughout the economy. Total credit distributed to all business-oriented sectors of the economy, including official entities, but excluding non-performing loans, decreased further by 4.1 per cent in June following a decrease of 3.0 per cent reported in March. The fall in total credit during the quarter under review was mainly due to a general fall in credit extended to most sectors with the exception of mining and other developmental sectors.

Credit allocated to other development sectors (made up of wholesale agriculture, hunting, storage, electricity, transport and communication) increased by 38.2 per cent in June in contrast with a small decline of 1.4 per cent in March. Moreover, the mining sub sector also received an allocation of credit which represented 4.2 per cent of total credit to the business sector during the June quarter.

Table 16: Sectoral Distribution of Credit to Enterprises
(Million Maloti: End of period)

SECTOR	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
Mining	0.0	0.0	0.0	0.0	0.0	13.5
Manufacturing	28.2	46.0	41.3	47.8	20.4	15.6
Construction	140.0	126.8	121.0	132.6	133.3	99.1
Other development sectors	14.3	4.9	10.7	135.2	151.5	184.2
Distributive services	20.7	42.2	46.5	27.5	16.1	6.7
Other services	15.1	6.0	6.1	6.9	18.4	6.6
All sectors	218.3	225.9	225.7	350.0	339.6	325.8

Figure 9: Sectoral Distribution of Credit to Business Enterprises
(Million Maloti: End of Period)



Net Claims on Government

The net creditor position of Government improved further by 25.0 per cent during the quarter ended June, following a 12.9 per cent improvement observed at the end of March. The decrease was mainly driven by a build-up in government deposits with the Central Bank during the review quarter. Consequently, as the table below shows the net claims on Government by the Central bank fell by 12.0 per cent. Furthermore, commercial banks' net claims on Government also decreased by 28.8 per cent.

Table 17: Banking System's Net Claims on Government
(Million Maloti: End of Period)

Holder	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
Commercial banks	185.7	376.1	314.9	289.8	327.0	232.7
Claims on Government	273.2	453.2	455.2	461.6	491.1	404.5
o/w MP T Bills (3)	*196.6*	*374.8*	*386.2,*	*359.9*	*420.7*	*334.5*
Less Government deposits	87.5	77.1	140.4	171.9	164.1	171.7
Central Bank of Lesotho	-1143.8	-1193.3	-1179.8	-1199.9	-1354.2	-1516.7
Claims on Government(4)	197.8	237.6	226.3	222.2	237.7	257.0
Less Government deposits	1341.6	1430.9	1406.2	1422.0	1591.9	1773.7
o/w those in blocked acct.	*292.3*	*478.72*	*484.2*	*519.6*	*487.7*	*490.7*
TOTAL NET CLAIMS	-958.1	-817.2	-865.0	-910.1	-1027.2	-1284.0

(3) – 'o/w' means of which and 'MP T Bills' means monetary policy treasury bills
(4) – IMF loans on-lent to the GOL

Net Foreign Assets

The Net Foreign Assets (NFA) of the overall banking system rose by a significant 16.0 per cent in June compared with a 3.9 per cent increase recorded in March. The increase mainly reflected a rise in both the NFA of the Central Bank and commercial banks. The commercial banks foreign assets increased by 20.7 per cent reflecting their transfers abroad, while Central Bank's net foreign assets grew as a result of SACU revenue receipts during the review period.

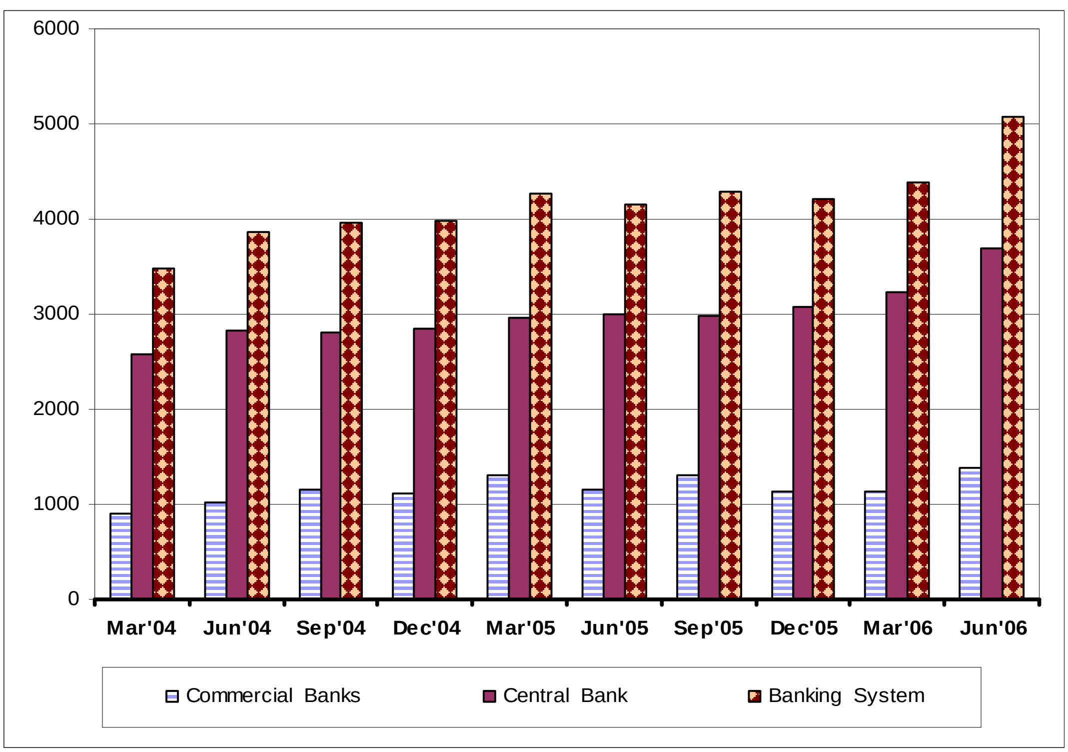
Table 18: Banking System's Foreign Assets and Liabilities

(Million Maloti: End of Period)

Holder	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
A. Commercial Banks	1306.2	1150.2	1310.3	1135.0	1139.0	1375.2
Foreign Assets	1409.7	1274.3	1388.6	1241.8	1248.1	1500.5
Foreign Liabilities	-103.5	-124.1	-78.3	-106.9	-109.1	-125.4
B. Central Bank of Lesotho	2960.1	3000.9	2985.5	3076.2	3238.4	3700.5
Foreign Assets	3471.4	3566.0	3539.3	3625.6	3803.3	4244.4
Foreign Liabilities	-511.3	-565.1	-553.8	-549.3	-564.9	-543.9
NET TOTAL	4266.3	4151.0	4295.8	4211.2	4377.4	5075.7

Figure 10: Net Foreign Assets

(Million Maloti: End of Period)



VIII. Money and Capital Markets

Money Market Developments

A total of four treasury bill auctions, comprising three 91-day and one 182-day treasury bill auctions, were conducted during the quarter under review. 91-day treasury bills were offered for monetary policy purposes while the 182-day treasury bills were targeted at encouraging investment by the general public. The total stock of securities for the quarter under review amounted to M545.8m. This value marked an increase from M530.2 million which was offered during the last quarter. The composition of the holding of treasury bills shifted in favour of the non-bank sector.

The holding of securities in June comprised commercial banks, Non-Bank Financial Institutions (NBFIs), and other institutions. The banking sector continued to dominate the market by holding more securities than the NBFIs. However, the share of the banking sector fell to 61.3 per cent of the total in June following last quarter's 79.3 per cent. At the same time NBFIs succeeded to increase their share from 9.4 per cent in March to 28.5 per cent in June. The general public controlled a 9.3 per cent share in June compared with 10.3 per cent observed in March.

Table 19: Holdings of Treasury Bills
(Million Maloti)

Holders Type	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
Total	**300.0**	**489.5**	**534.7**	**530.2**	**530.2**	**545.8**
Banking System	196.6	374.8	386.2	359.9	425.8	339.6
Central Bank	0.0	0.0	0.0	0.0	5.1	5.1
Commercial Banks	196.6	374.8	386.2	359.9	420.7	334.5
Non-Bank Sector	103.4	114.7	148.6	170.3	104.4	206.2
NBFIs	45.7	77.3	89.8	108.3	49.6	155.3
Others	57.7	37.4	58.8	62.0	54.8	50.9
Memorandum Item						
Average Yield per cent	8.11	7.25	7.21	7.27	7.10	7.04

(5) – Figures at face value

Money Market and Short-term Interest Rates

The movements in the Lesotho 91-day treasury bill rate continued to be in line with the general trend of rates in the region. The 91-day treasury bill rate remained intact at its March level of 6.90 per cent in June. Its SA counterpart rose by 24 basis points from 6.59 per cent during the previous quarter. The margin between the two rates narrowed from 31 to 7 basis points. As expected, the local rate continued to hover above the South African rate.

The prime lending rate in the country increased from 11.5 per cent to 12.0 per cent in June, in line with regional trends. The average deposit rates remained constant and as a result the spread between lending and deposit rates widened. The table below shows that the deposits rates did not respond with the adjustment in the prime lending rate. Moreover, at the end of June, real interest rate on a one-year deposit (adjusted for inflation) turned negative at 1.95 per cent. This simply meant that the return on deposits could not cushion the public against the erosion in purchasing power.

Table 20: Major Money Market Interest Rates

(Per cent: End of Period)

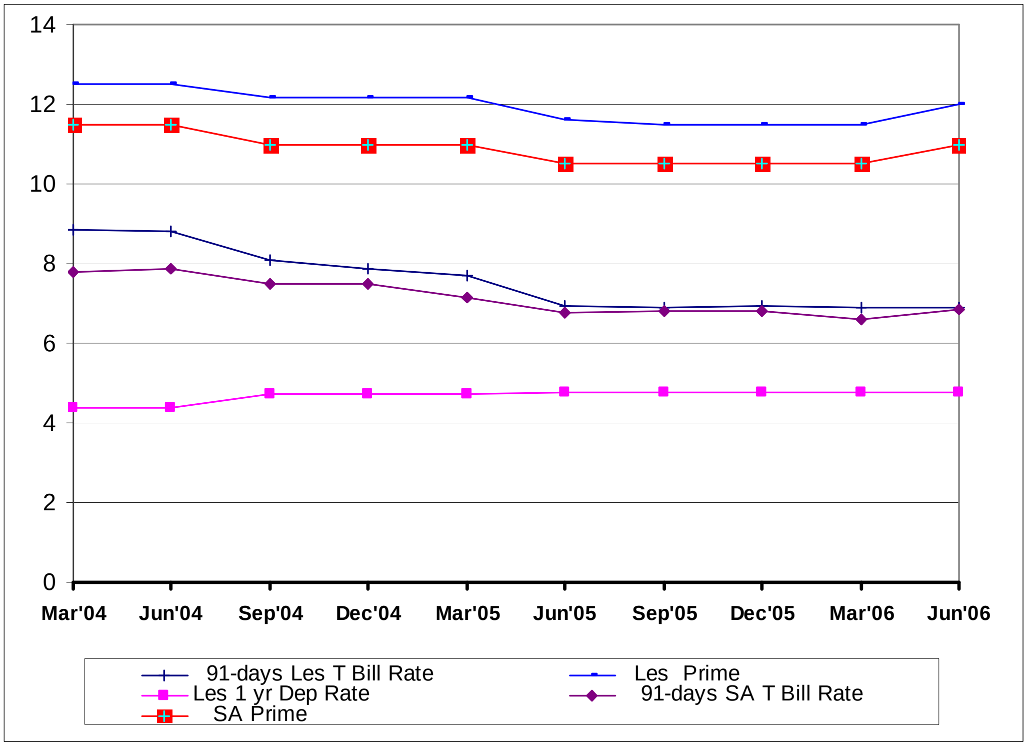
Interest Rates by Type	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
Central Bank						
T Bill Rate – 91 Days	7.72	6.93	6.89	6.95	6.90	6.90
Lombard Rate	13.00	13.00	13.00	13.00	13.00	13.00
Commercial Banks(6)						
Call	3.25	2.83	2.83	2.83	2.83	3.50
Time:						
31 days	3.50	3.50	3.50	3.50	3.50	3.50
88 days	4.25	4.25	4.25	4.25	4.25	4.25
6 months	4.50	4.50	4.50	4.50	4.50	4.50
1 year	4.75	4.75	4.75	4.75	4.75	4.75
Savings	2.00	2.00	2.00	2.00	2.00	2.00
Prime	12.17	11.50	11.50	11.50	11.50	12.00
South Africa*						
Repo	7.50	7.00	7.00	7.00	7.00	7.50
T Bill Rate – 91 Days	7.17	6.76	6.79	6.80	6.59	6.83
Marginal Lending Rate	12.50	12.00	12.00	12.00	12.00	12.50
Prime	11.00	10.50	10.50	10.50	10.50	11.00

* Figures for South Africa were obtained from the SARB

(6) - Average rates by commercial banks

Figure 11: Short-Term Interest Rates

(Per Cent Per Annum)



Foreign Exchange Rates

The rand and therefore the Loti weakened during the second quarter. On average, the local currency unit depreciated by 7.5, 9.8, 4.9 and 9.5 per cent against the SDR, the euro, the US dollar and the pound sterling, respectively.

Several reasons supported the weakening of the rand during the review quarter. Investments in the US became more attractive as a result of an increase in interest rates during the quarter. As a result, investors revised their investment portfolios.

Depreciation of the rand against major currencies has direct implications for Lesotho economy. It improves the price competitiveness of the country's exports in the international markets, particularly in the US, where the bulk of Lesotho's exports are destined. This in turn, impacts positively on exports earnings and therefore manufacturing production. However, the depreciation could lead to a build up in inflationary pressures.

Table 21: Selected Exchange Rates

(Loti per Foreign Currency units: Quarterly Averages)

Currency	2005				2006	
	Mar	Jun	Sep	Dec	Mar	Jun
SDR	9.154	9.584	9.512	9.398	8.871	9.537
EURO	7.874	8.077	7.937	7.772	7.403	8.127
USD	6.009	6.425	6.510	6.538	6.157	6.473
POUND STERLING	11.358	11.909	11.611	11.427	10.789	11.814

IX. Government Finance

Summary of Budget Outturn

Government budgetary operations were estimated to have resulted in a surplus equivalent to 9.2 per cent of GDP. This was facilitated by increased Government revenue during the review period. The growth in revenue benefited from augmented SACU inflows.

Overall Government expenditure and net lending rose by 4.2 per cent. As a percentage of total expenditure, capital expenditure stood at 11.9 per cent, while recurrent expenditure constituted 88.1 per cent. This continued to reflect the slow implementation of development projects during the first quarter of fiscal year. However, this is expected to improve in the subsequent quarters as implementation gains momentum.

Revenue

During the period under review, Government revenue including grants grew by 10.6 per cent. This was mainly attributed to a rise in customs revenue, which swelled by 28.0 per cent. As a percentage of GDP, total revenue and grants grew by 190 basis points to 54.1 per cent compared with 52.5 per cent realised in the previous quarter.

Tax revenue augmented by 15.4 per cent from the previous period. This was largely amplified by the increase in customs revenue as earlier mentioned. Conversely, revenue from income and value added tax (VAT) weakened by 2.5 and 3.5 per cent, respectively during the review period. The descent in VAT collections, on the one hand, mainly resulted from the artificial development in the previous quarter following delayed transmittal from South Africa Revenue Services (SARS) during the festive season. The decline in income tax collections for the review period, on the other hand, was largely attributed to a fall in withholding tax.

SACU receipts take into account the intra SACU trade, excise duties, and domestic economic developments. SACU receipts constituted 64.9 per cent of total tax receipts during the review period. Income tax and VAT constituted 19.7 per cent and 14.7 per cent, respectively of tax revenue.

Subsequent to receipts of Rand Monetary compensation in the previous quarter, non tax revenue decreased by 20.4 per cent during the period under review. In addition, water royalties also declined by 6.3 per cent during the period under review. Grants, which are normally used to finance development projects rose by 45.1 per cent in contrast to 40.8 per cent decline realised in the previous quarter. However, due to the slow implementation of development projects, grants-funded components had only utilised about 1.6 per cent of the budgeted amount.

Table 22: Government Budgetary Operations

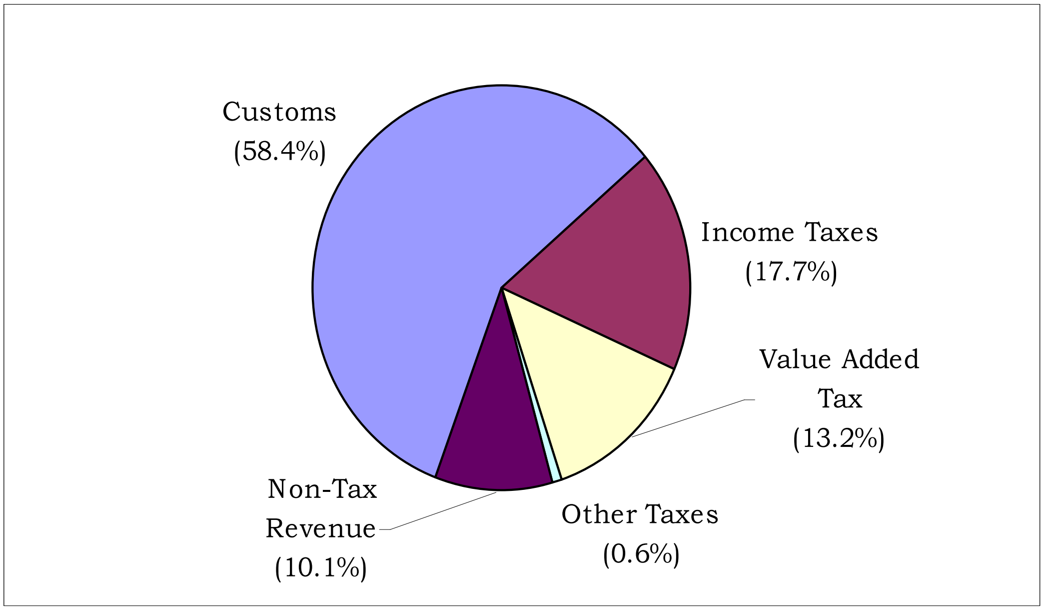
(Million Maloti)

	2005/06				2006/07
	Apr-Jun	**Jul-Sep**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun** * Preliminary
Total Revenue and Grants	**1019.4**	**1174.6**	**1139.2**	**1222.5**	**1351.7**
Total Revenue	983.5	1140.1	1130.9	1217.7	1344.6
Tax Revenue	898.7	1024.8	1025.5	1049.9	1211.2
Customs	496.0	603.3	603.3	603.3	772.3
Non-customs	402.7	421.4	422.1	446.6	438.9
Income Taxes	227.3	227.6	229.6	240.1	234.0
Taxes on goods & services	163.4	172.7	188.0	194.7	196.3
Other Taxes	11.9	21.1	4.6	11.8	8.6
Non-Tax Revenue	84.8	115.3	105.5	167.7	133.4
Of which: Water royalties	43.7	66.5	63.6	62.0	58.1
Grants	**36.0**	**34.5**	**8.2**	**4.9**	**7.0**
Total Expenditure & Net Lending	**1058.8**	**1015.4**	**1137.5**	**1077.3**	**1122.3**
Recurrent Expenditure	884.4	835.9	951.8	941.7	988.2
Personnel Emoluments	309.7	313.1	318.7	321.4	332.1
Interest Payments	28.9	40.2	131.5	23.3	27.1
Foreign	21.5	22.5	120.4	10.7	16.8
Domestic	7.4	17.7	11.1	12.6	10.3
Other Expenditure	545.8	482.6	501.7	596.9	629.0
Capital Expenditure	175.6	179.6	189.0	138.9	134.1
Net Lending	-1.2	0.0	-3.4	-3.3	0.0
Surplus/deficit before grants	-75.4	124.6	-6.5	140.4	222.4
Surplus/deficit after grants	-39.4	159.2	1.7	145.2	229.4
Financing	39.4	-159.2	-1.7	-145.2	-229.4
Foreign	-83.0	-143.0	-33.9	-22.8	-72.5
Loan drawings	32.1	38.6	28.1	9.6	10.1
Amortization	-115.1	-181.6	-62.0	-32.4	-82.6
Domestic	122.4	-16.2	32.2	-122.4	-156.9
Bank Financing	107.9	-47.8	-45.1	-117.1	-256.8
Non – Bank	14.5	31.6	77.3	-5.3	99.8

Source: Ministry of Finance and Development Planning (MoFDP)

*CBL Preliminary Estimates

Figure 12: Sources of Government Revenue



Expenditure

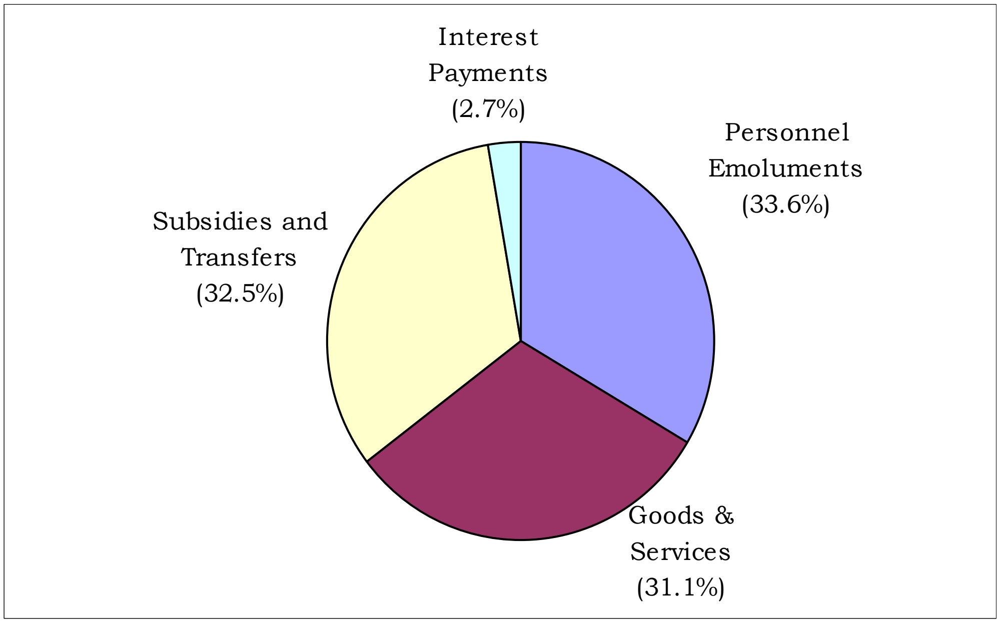
Total expenditure and net lending, was estimated to have increased by 4.2 per cent during the review period. The increase was largely on account of the rise in personnel emoluments following an inflation adjustment effected in April, plus the hike in expenditure on goods and services. As a percentage of GDP, total expenditure fell to 44.9 per cent compared with 46.0 per cent of GDP realised in the previous quarter.

The upsurge in recurrent expenditure was mainly attributed to the increase in expenditure on goods and services, which responded to price developments as earlier mentioned under the section on price developments. This item rose by 10.2 per cent during the period under review. Likewise personnel emoluments increased by 3.3 per cent.

The level of subsidies and transfers extended during the review period increased marginally by 1.2 per cent. This was mainly driven by expenditure on pensions and gratuities which grew by 14.4 per cent.

Capital expenditure was estimated to have declined by 3.5 per cent on a quarterly basis. The fall in capital expenditure was mainly on account of the slow implementation of development projects in the first quarter. The Government continued to finance development projects mainly from domestic resources. Government funded 79.8 per cent of capital expenditure; while those financed from loans and grants accounted for 11.9 per cent and 8.3 per cent, respectively.

Figure 13: Recurrent Expenditure by Type & Percentage Share



Financing

The fiscal operations during the review period were estimated to have resulted in a surplus equivalent to 9.2 per cent of GDP. The surplus enabled Government to accumulate deposits with the banking sector in anticipation of consecutive deficits in the subsequent fiscal years, and be the net re-payer of foreign debt.

Public Debt

Overview

Total public debt rose by 2.1 per cent during the period under review. The growth was a result of the increase in both domestic and external debt. The increase in domestic debt was attributed to a rise in holding of treasury bills by the non-banking sector, which more than offset the decrease in holdings by the banking sector. The increase in foreign debt was due to the depreciation of the local currency against the major world currencies with which debt is contracted. As a ratio of GDP, the total debt stock was estimated to have decreased to 46.8 per cent compared with 48.9 per cent registered in the previous quarter. The foreign debt component continued to dominate the composition of the total debt stock at 85.9 per cent. Domestic debt comprised 14.1 per cent of the total debt stock.

External debt

The level of external debt soared by 2.1 per cent during the second quarter. This was in contrast to the fall that was experienced since second quarter of 2005. The increase in foreign indebtedness was due to the surge in non-concessional debt which rose by 5.9 per cent, following the depreciation of the local currency against major currencies with which debt is contracted. External debt maintained 85.9 per cent of the total public debt stock. About 84.1 per cent of external debt was concessional. This was in line with Government policy to borrow on concessional terms in order to moderate the country's future debt burden.

The concessional nature of public debt stock enables the country to retain a favourable position during the review period. Contrasted with the expansion in stock, the ratio of foreign debt to GDP continued to shrink from 42.0 per cent to 40.2 per cent. At this level, the debt to GDP ratio was well below the 60 per cent sustainability threshold for Highly Indebted Poor Countries (HIPC). This position mainly benefited from long maturity structure and concessionality of the overall external debt stock. As a ratio of exports of goods and services, debt service stood at 4.5 per cent, compared with the 15.0 per cent threshold.

Table 23: Outstanding Government Debt
(Million Maloti)

	2005				2006	
	QI	QII	QIII	QIV	QI	QII
A. EXTERNAL DEBT	**4352.9**	**4379.4**	**4105.6**	**4011.6**	**3932.6**	**4012.9**
Bilateral Loans	467.3	422.0	408.6	396.9	408.5	383.2
Concessional	370.8	381.6	375.9	369.9	386.2	381.5
Non-concessional	96.5	40.4	32.7	27.1	22.3	1.7
Multilateral Loans	3490.6	3581.6	3484.6	3399.1	3334.4	3443.8
Concessional	3030.8	3125.0	3037.4	2985.9	2939.3	2992.4
Non-concessional	459.9	456.6	447.2	413.2	395.1	451.4
Financial Institutions	316.5	306.7	147.9	141.5	117.2	113.1
Concessional	58.0	2.7	2.6	2.6	2.4	2.4
Non-concessional	258.4	304.0	145.4	138.9	114.8	110.7
Suppliers' Credit	78.5	69.1	64.4	74.1	72.5	73.8
B. DOMESTIC DEBT	**415.7**	**604.2**	**649.3**	**644.9**	**644.9**	**661.0**
Banks	312.3	489.5	500.9	474.6	540.4	454.3
Long-term	114.7	114.7	114.7	114.7	114.7	114.7
Short-term	197.6	374.8	386.2	359.9	425.7	340.0
Of which: treasury bills	196.6	374.8	386.2	359.9	425.7	339.6
Non-bank	103.4	114.7	148.5	170.3	104.4	206.3
Short-term (TBs)	103.4	114.7	148.5	170.3	104.4	206.3
TOTAL (A + B)	**4768.6**	**4983.6**	**4754.9**	**4656.5**	**4577.5**	**4674.9**

N.B: External debt figures are from MoFDP

Domestic Debt

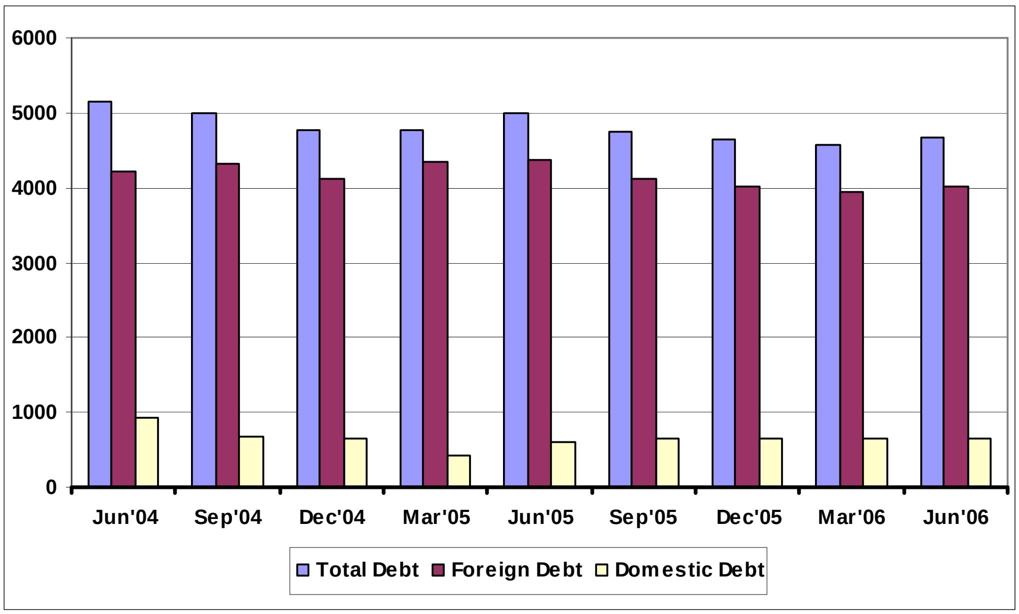
Domestic debt increased marginally by 2.5 per cent during the period under review. The increase in domestic debt was largely due to the rise in holding of short term debt by the non-banking sector. As a result, short term debt increased by 2.9 per cent, while long term debt maintained the level recorded in the previous quarter. The long term component constitutes entirely of the ten year bond[3] that matures in 2009. As a percentage of GDP, domestic debt slightly dropped to 6.6

[3]This bond had been issued to finance the restructuring of the old Lesotho Bank in 1999.

per cent during the period under review and it constituted 14.1 per cent of total public debt. Short-term debt continued to consist entirely of treasury bills, which were issued in the monetary policy operations.

Figure 14: Outstanding Public Debt

(Million Maloti: End of Period)



X. Statistical Tables