CENTRAL BANK OF LESOTHO

QUARTERLY REVIEW

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QUARTERLY REVIEW

VOL. XXV **March , 2006**

CONTENTS **Page**

I. Key Economic Events in Lesotho during the First Quarter

January: Rebuilding the image of Cooperative Societies

In January, the Ministry of Trade and Industry, Cooperatives and Marketing held a three day forum on re-building the image of the two thousand cooperative societies in Lesotho. It was emphasised that the survival of these institutions depends on improved partnership between Government and other relevant stakeholders. However, government contribution would not compromise the autonomy of the societies. Members of these societies were encouraged to participate in the formulation of policies and legislation. Consequently, this involvement would ensure that their interests and activities are represented.

Cooperative societies are voluntary organizations open to every Mosotho who is willing to accept the responsibilities of membership and able to use the services provided by the unions. These organizations could give their members several advantages as long as the regulatory and legislative framework within which they operate exists. For example, to avoid the repercussions of their insolvency, the Cooperative Societies Act (2000) should be amended to prohibit them from soliciting deposits from non-members. In addition, the law should set a ceiling, equivalent to 100 per cent of paid up capital shares, should be imposed on their deposit taking from members. Their autonomy enables them to work for the sustainable development of their communities through policies approved by their members who are part of those communities. They also allow members to build task-specific skills and expertise. Furthermore, the cooperative societies facilitate savings accumulation and create jobs for the rural communities for whom they often function. However, there is a threat of discontinuity due to poor management practices and sometimes underinvestment.

February: Budget Speech

The Minister of Finance and Development Planning presented the 2006/2007 budget in the National Assembly in February. The budget speech emphasised importance of private sector development through improvement of investment climate. A number of policy reviews and revision of some outdated legislation are either ongoing, or pipelined for the next fiscal year. Producers, whose exports are destined beyond the Southern Africa Customs Union (SACU) region, will benefit from the zero per cent company tax on income, while the overall company tax has been revised downwards from 35 per cent to 25 per cent. The preferential tax rate for manufacturing and agriculture has also been revised from 15 per cent to 10 per cent. The initiative will be augmented with development of relevant infrastructure.

These initiatives have some implications on the budgetary operation. As a result of forgoing company tax, which forms the significant portion of government revenue, there will be inherent expenditure pressures. This would likely counteract government efforts targeted at improving domestic tax revenue. It further accentuates reliance on the customs revenue, which may not be sustainable in the long term, due to the free trade arrangements. This may result in the fiscal deficit being financed through domestic borrowing in the future, and hence crowd out private investment. Nevertheless, private sector growth, coupled with foreign direct investment, has potential to contribute to the reduction in poverty levels in the economy, and an accompanying recovery of revenue in the future.

February: Natural Disaster Affects Agriculture

It was noted that during the quarter under review the country experienced heavy rains that destroyed most crops at their formative stage. This was accompanied by occasional hailstorms which worsened the damage. The areas most hit by hailstorms, were reported in Mohale's Hoek. Farmers in the district have been seriously affected and they do not expect much harvest especially on vegetables; tomatoes, green pepper and green beans among others. These natural disasters consequently destroyed access roads in the rural roads.

It was noted that in the previous year agricultural output declined due to drought. On the contrary, the output for this year is expected to decline due to heavy rains. This was likely to adversely affect livelihood of people who depend on the agricultural sector, the majority of which are poor. And since agricultural output accounts for an estimated 17 per cent of national output, there might be a downward pressure on gross domestic product (GDP).

March: Establishment of New Factory at Maputsoe Industrial Area

A new factory has been established, with initial investment of about M37 million, at Maputsoe Industrial Area. It was officially opened by the Honourable Minister of Trade and Industry, Cooperatives and Marketing on 29 March 2006. According to the Lesotho National Development Corporation (LNDC), this firm, which is a joint venture of three Taiwanese companies, will manufacture t-shirts and jeans for export to the United States (US). Initially, this factory will employ about 500 Basotho, which are expected to increase to about 3000 after six months in operation.

This event is of significant economic importance to Lesotho. More so, against the backdrop of factory closures and associated job losses that followed in the wake of the expiry of the Agreement on Textiles and Clothing (ATC) of the World Trade Organisation (WTO) at the beginning of 2005. In this sense, first, employment generation and wage income by the newly established factory would, to some extent, reverse earlier losses in the sector. Second, the factory is expected to contribute positively to national output. Third, through increased exports, the country's external position would improve. However, the expected improvement in the balance of payments position is premised on full declaration and repatriation of exports' proceeds. At present, only about 10 per cent of Lesotho's export earnings are repatriated, which considerably minimises benefits that accrue to Lesotho from growth in the exports of textiles and clothing. Another critical policy challenge is to continuously seek ways to diversify Lesotho's economy. This would ensure that the country's economy could better cope with external shocks.

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

United States (US)

Preliminary estimates indicated that the US economy, as measured by changes in GDP, grew by 4.8 per cent on an annualised basis, during the review quarter. This is compared with 1.7 per cent growth observed in the fourth quarter of 2005. GDP growth was attributed to acceleration in consumer, government and investment spending. Consumer spending grew by 5.5 per cent in the review quarter, in contrast with 0.9 per cent increase in the fourth quarter of 2005. Business investment in equipment and software also rose significantly by 16.4 per cent during the first quarter, compared with 5.0 per cent in the previous quarter. Furthermore, government spending increased by 10.8 per cent during the review quarter, in contrast with a decline of 2.6 per cent in the previous quarter.

On the inflation front, the US consumer price index (CPI) grew by 3.4 per cent in March 2006, the same rate as in December 2005. However, due to concern about a build-up of inflationary pressures, the US Federal Reserve Bank's (Fed's) Open Market Committee (FOMC) continuously raised its benchmark lending rate by 25 basis points. As a result, Fed's overnight lending rate closed the quarter at 4.75 per cent.

The labour market continued to show a sign of improvement during the quarter under review. The unemployment rate declined from 4.9

per cent in the fourth quarter of 2005 to 4.7 per cent in the first quarter of 2006.

A sustainable strong consumption spending is expected to have positive spillover effects on the Lesotho economy. Coupled with other factors such as improvement in the labour market, this could boost demand for Lesotho exports in the US markets.

Euro-zone[1]

Preliminary estimates indicated that economic activity improved during the review quarter. On quarterly basis, GDP grew by 0.6 per cent in the first quarter of 2006, against 0.3 per cent in the previous quarter. On an annual basis, it rose by 2.0 per cent, compared with 1.7 per cent in December 2005.

The annual inflation rate in the Euro-zone, as measured by changes in the Harmonised Index of Consumer Prices (HICP) remained unchanged at 2.2 per cent during the quarter under review. The European Central Bank's (ECB's) Monetary Policy Committee (MPC) raised its refinancing rate from 2.25 per cent to 2.50 per cent. This interest rate hike was the second in five years.

The Euro-zone unemployment rate declined from 8.3 per cent to 8.1 per cent in December 2005. The reduction in employment bodes well for the Euro-zone domestic demand because it boosts consumer confidence.

The European Union is one of South Africa's (SA) main trading partners. As such, economic developments in the Euro-zone have a direct effect on SA's economy. A decline in unemployment rate augurs well for SA's exports, due to potential increase in consumer demand. This could also have positive spin-offs for the economy of Lesotho due to its close relationship with SA.

South Africa

Mining production which is one of the indicators of economic activities grew by 0.4 per cent during the review quarter. This resulted mainly from a decrease of gold production by 3.1 per cent. However, manufacturing production showed signs of recovery in the first quarter and it increased by 5.7 per cent in March.

The Consumer Price Index, excluding interest rates on mortgage bonds (CPIX) for the historical metropolitan and other urban areas,

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

grew at an annual rate of 3.8 per cent in March compared with 4.0 per cent in December 2005. This resulted mainly from the relatively strong Rand, which helped mitigate the impact of the persistent increase in the international oil prices. A slowdown in prices of clothing and footwear, vehicles and some food items also contributed to the deceleration in the CPIX.

In contrast, producer inflation, as measured by changes in the producer price index (PPI), accelerated during the review period. The PPI rose by an annual rate of 5.4 per cent in March 2006 compared with 5.1 per cent in December 2005. The key components, which exerted upward pressure on the producer prices, include agricultural products, mining and quarrying, food (at the manufacturing level) and basic metals. The rapid rise in the international oil price over the past few years continued to put upward pressure on mining and quarrying, and products of petroleum, even though the impact has been mitigated somewhat by a relatively strong Rand.

The South African Reserve Bank (SARB) Monetary Policy Committee (MPC) left its key interest rate, the Repo rate unchanged at 7.0 per cent during the review quarter. As such, the prime lending rate remained at the previous quarter's rate of 10.5 per cent. Although inflation remained within the target band of 3 to 6 per cent, the MPC continued to note with concern the deterioration in the inflation outlook amid persistent increases in the international oil prices.

As already indicated, economic developments that affect SA also have a bearing on Lesotho. Inflation in SA implies relatively muted imported inflation for Lesotho. However, a surge in producer inflation does not bode well for the Lesotho economy. This could raise the manufacturing sub-sector's costs of production on the back of imported rising fuel prices. Furthermore, the decrease in gold mining production could continue to exert downward pressure on the number of Basotho mineworkers in SA as well as on remittances.

Commodity prices

Gold

The average price of gold increased by 14.1 per cent from $486.01 an ounce in the fourth quarter of 2005 to $554.73 an ounce during the review quarter. It reached a minimum and maximum of $516.88 and $588.65 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. This induced higher demand for gold by European investors as it became less expensive. In Rand terms, the gold price increased by 7.5 per cent from R3,177.66 per ounce in the previous quarter to R3,415.57 in the quarter under review.

The increase in the Rand price of gold could boost the profitability of the SA gold mining industry. If sustained, this could at least help to 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 9.2 per cent from $52.70 per barrel in the fourth quarter of 2005 to $57.52 per barrel during the review quarter. In the latter period, the oil price fluctuated between $53.47 and $60.90 per barrel. The quarterly price of oil remained 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 tensions relating to the Iranian nuclear development programme. The insistent expansion in oil consumption in China and India continued to exert upward pressure on oil prices. 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 2.8 per cent from R344.57 per barrel in the previous quarter to R354.19 per barrel in the review quarter.

The increase in the international oil prices could impact negatively on the Lesotho economy. It could result in upward revision of fuel prices and therefore increase inflationary pressure.

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

III. Overview of Macroeconomic Developments in Lesotho

Economic Growth

The quarterly analysis of the overall economic performance uses various indicators because Lesotho does not produces quarterly national accounts data. A matrix of indicators on output for the quarter craft a mixed picture, though modest compared to the same quarter in the previous year. On the one hand, the number of purchases of motor vehicles seasonally adjusted, as an indicator of capital formation fell by 39.2 per cent on quarterly basis compared to an increase realised in the quarter ending December 2005. On the other hand, the number of building permits issued increased by 21.2 percent on quarterly basis compared to a 16 per cent decline in the previous quarter. Building permits issued is an indicator of activity in the construction sub sector. Finally, water consumption, which is an indicator of activity in the manufacturing sub-sector, in particular the textile and clothing industry, indicated a decline of 7.1 per cent on a quarterly basis relative to an increase in the period ending December 2005. This signalled a slowdown in the performance of the sub-sector.

Inflation

During the quarter ending March, the CPI was projected to have increased to 4.3 per cent compared with 3.5 percent registered in December 2005. This was considered a favourable inflation outlook, amidst pressure from administered prices (water and electricity consumption).

Employment

Employment generated by the Lesotho National Development Corporation (LNDC) assisted companies decreased by 6.2 percent in the review period. The decline was mainly due to a deceleration in retail activities, as the sector cooled off post festive season.

Government employment declined by 0.9 per cent, due to a 2.7 per cent decrease in the number of retired teachers.

The number of migrant mineworkers maintained a downward trend with an estimated decline of 1.4 per cent. The drop was from a realised employment figure of 50 835 in the last quarter of 2005 to 50 149 in the current period. It was observed that the margin of decline had narrowed as the mining sector benefited from a relatively favourable international environment.

Monetary Sector

At the end of the review quarter, the broad measure of money supply (M2) registered a slight quarterly decrease of 0.9 per cent compared with an increase of 1.8 per cent registered at the end of last quarter. The decrease resulted from a decline in bankers acceptances which offset the increase observed in both domestic credit and the overall banking sector's net foreign assets adjusted for valuation changes.

The major money market rates followed a downward trend observed in the movement of similar rates in the region. For example, the movements in the Lesotho 91-day treasury bill rate continued to be in line with the general trend of rates in the region. It fell by 5 basis points in March from its December level of 6.95 per cent to 6.90 per cent. As a result, the margin between the rate and its SA counterpart widened from 15 to 31 basis points.

Fiscal position

Preliminary estimates on the budget outturn indicated a surplus equivalent to 6.2 per cent of GDP. This resulted from 7.3 per cent increase in Government revenue coupled with a 5.3 per cent reduction in expenditure during the review period. As a percentage of GDP, total revenue and grants, on the one hand, grew to 52.2 per cent in contrast to 48.6 per cent realised in the previous quarter. Expenditure, on the other hand, fell by almost 260 basis points from 48.6 per cent in the previous quarter to a level equivalent to 46.0 per cent of GDP

Total public debt fell by 1.7 per cent during the period under review. The decrease was a result of a 2.0 per cent decline in external debt, following reduction in non-concessional debt. Domestic debt remained unchanged during the review period.

Balance of Payments (BOP)

Lesotho's external position, as measured by the overall balance, improved from a seasonally adjusted surplus of M95.0 million in the fourth quarter of 2005 to M172.6 million during the first quarter of 2006. The transactions balance, which represents the overall balance excluding the effects of currency fluctuations, also recorded a surplus of M147.9 million compared with that of M79.4 million in December 2005. As a result, gross external reserves increased from 6.5 to 7.4 months of import cover. The improvement in the BOP position was driven mainly by developments in the current account, which registered a surplus of M43.2 million, in contrast with a deficit of M164.2 million that was realised in the previous quarter. On the contrary, net capital and financial inflows declined from M254 million in December 2005 to M92.2 million in March 2006, influenced mainly by commercial banks' transactions between Lesotho and SA.

IV. Economic Indicators

Household and Business Sector Housing Statistics

Building permits issued is an indicator of building and construction activity in the economy as there are no actual building and construction activity statistics on a quarterly basis. In the first quarter of 2006, the number of building permits issued, seasonally adjusted, rose by 21.2 per cent in contrast with a 16.1 per cent decline registered for the period ending December 2005. On an annual basis, the number of permits increased by 40.0 per cent.

The increase on both quarterly and annual bases was on the back of rise in construction of residential, charity, and schools' building. The relatively good performance of the construction sub-sector, explained by the growth in the number of permits issued, contributed positively to the performance of economy. The rise also tracked the downward drift in interest rates in the economy which continued to fuel domestic demand.

BUILDING PERMITS BY TYPE OF BUILDING
(Value in Million Maloti)

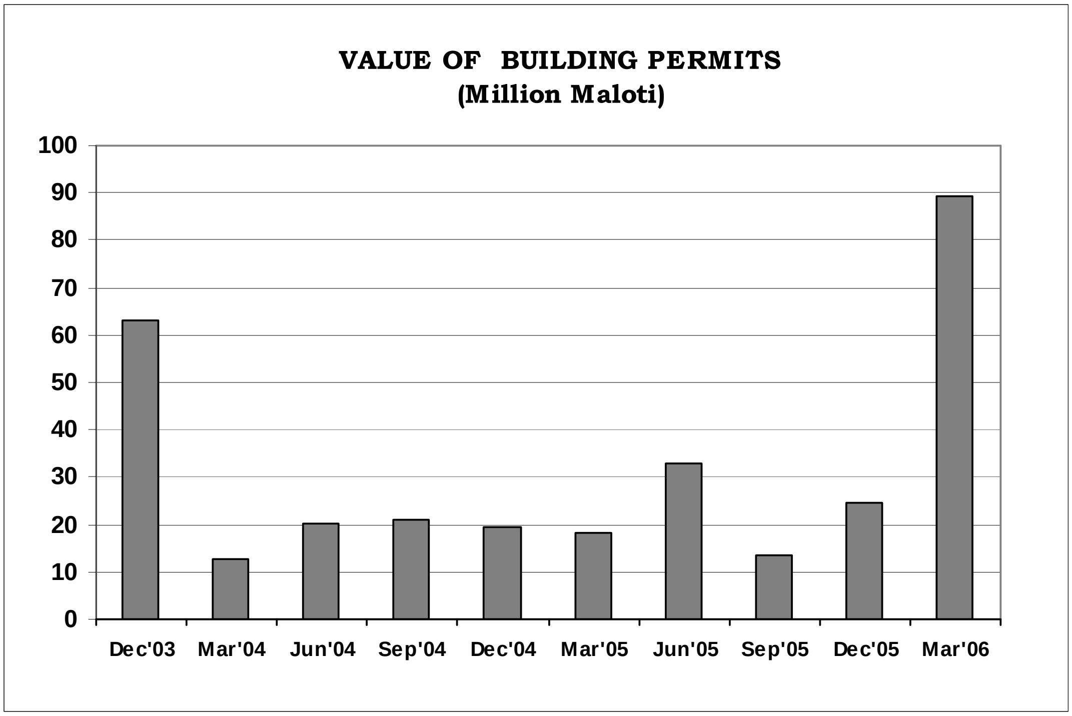
Type	Permits	2004	2005				2006
		QIV	QI	QII	QIII	QIV	QI
Residential	Value	17.28	8.49	8.27	11.93	9.05	18.05
	Number	58	37	49	61	40	54
Commercial	Value	0.65	6.50	1.14	0.00	14.59	0.88
	Number	4	3	5	0	7	3
Other	Value	1.49	3.44	22.87	1.38	1.12	70.31
	Number	5	4	18	3	2	5
Total	Value	19.42	18.43	32.28	13.31	24.76	89.24
	Number	67	44	72	64	49	62
	Number*	71	45	69	62	52	63

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



Imported Motor Vehicles

Data on imports of motor vehicles is an indicator of consumer demand and capital formation in the economy. Overall Imports of motor vehicles dropped in the first quarter of 2006. The number of imported motor vehicles seasonally adjusted fell by 39.2 per cent, on a quarterly basis in contrast with 45.1 per cent increase observed in the last quarter of 2005. On an annual basis, the number of imported motor vehicles fell by 53.3 per cent. It can be deduced that the deterioration in the number of imported motor vehicles reflects a drop in both investment and consumption expenditure and hence sluggish economic activity.

MOTOR VEHICLE IMPORTS

(Value in Million Maloti)

		Cars	Vans	Trucks	Buses	Trac-tors	M/ Cycles	Trail-ers	Total
2003									
IV	Value	18.89	13.46	9.27	2.60	0.07	0.00	0.52	44.81
	Number*								460
	Number	203	146	20	29	4	0	9	411
2004									
I	Value	15.91	10.37	1.31	3.73	0.22	0.00	0.55	32.09
	Number*								357
	Number	198	139	2	24	8	0	9	380
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

Source: Imperial Fleet Services Lesotho and Customs Department

(1) Number* denotes seasonally adjusted figures

Water Consumption

Water consumption is an indicator of the level of activity in the wet industries and in particular the manufacturing sub-sector. The latter is dominated by the textile and clothing, food and beverages industries, and these industries are heavily reliant on water. In March 2006, performance of the manufacturing sub-sector, as measured by the units of water consumed by the industrial sector dropped. Seasonally adjusted, total water consumption by the industrial sector fell by 7.1 per cent on a quarterly basis compared with 1.1 per cent increase realised at the end of December 2005. It further fell by 1.5 per cent on an annual basis compared with 5.4 per cent decline observed in the previous quarter. The drop in water consumption on both quarterly and annual bases continued to reflect subdued performance in the manufacturing sub-sector.

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

Quarter		Domestic	Industrial	Other	Total
2003					
IV	Units	0.88	1.16	0.53	2.57
	Value	3.09	4.42	2.04	9.55
	Units*	……	1.05	……	2.59
2004					
I	Units	0.92	1.13	0.55	2.60
	Value	3.21	4.39	2.04	9.64
	Units*	……	1.32	……	2.56
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

Source: Water and Sewerage Authority

(1) Units denotes seasonally adjusted figures*

Telecommunications

Statistics on the number of calls is an indicator of economic activity in the export sub-sector. Calls to SA are particularly important because of its proximity and trade facilitation. It is noted that overall phone traffic increased by 0.3 percent for the period ending March 2006. This is a smaller increase compared with 7.3 per cent realised in fourth quarter of 2005. Telephone statistics of calls destined to SA declined by 1.7 per cent in the review period, compared to an increase of 8.8 per cent in the previous quarter. Indication from calls to SA is consistent with a slowdown in the export sector, in particular the manufacturing sub-sector.

TELEPHONE TRAFFIC STATISTICS

		SA Outgoing Calls	International Calls	Total Calls
2004				
IV	No. of calls (millions)	3.06	0.12	3.18
	No. of calls*	2.91	……	3.03
	Total Duration (million	4.72	0.39	5.11
	Nominal Value (million	9.91	3.26	13.71
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*	3.34	……	3.33
	Total Duration (million	4.86	0.56	5.42
	Nominal Value (million	10.21	5.11	15.32

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

LNDC assisted companies employment declined during the quarter under review compared to the period ending December 2005. Employment registered 40 459 in the current period compared to a high of 43 131 for December 2005. This was an estimated decline of 6.2 per cent.

The fall in employment was due to the bottoming out of the festive season consumer expenditure. It was therefore attributed to a decrease in most of the temporary employees contracted during the December period. It was expected that the manufacturing component of LNDC companies will increase in the second quarter as a manufacturing firm, which is a conglomerate of three companies had opened for operation in the Maputsoe industrial area. The boost in employment was further expected from the construction of a knit fabric mill scheduled to start during the latter part of the year. It was estimated that the initial employment generated will be at least 3000 employees.

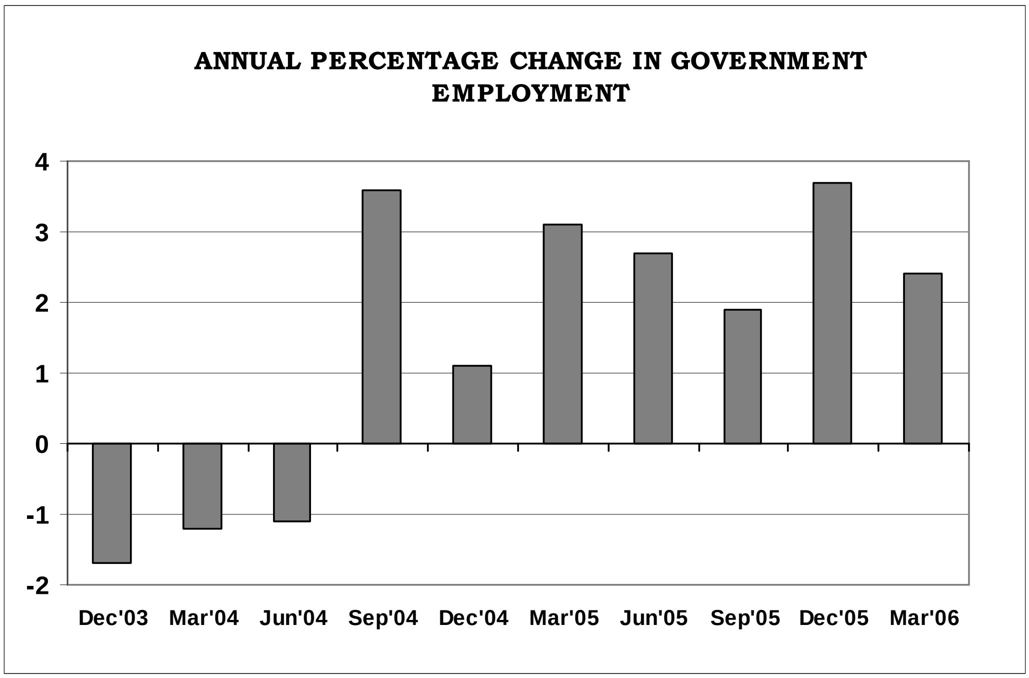
EMPLOYMENT TREND OF LNDC ASSISTED COMPANIES

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

Employment in the government sector has marginally declined by an estimated 0.9 per cent on an annualised basis. This was a change of direction on the upward trend observed in the quarter ending December 2005. The total number of employees decreased from 37 908 in quarter four 2005 to 37 580 during the quarter under review.

The major influence was an estimated decline of 2.7 per cent in the teacher's category. And a slight increase in the general civil service category. This was consistent with the increase of 0.4 per cent of general government realised for the quarter ending March 2005. The decline in number of teachers was attributed to the retirement in the teaching service.

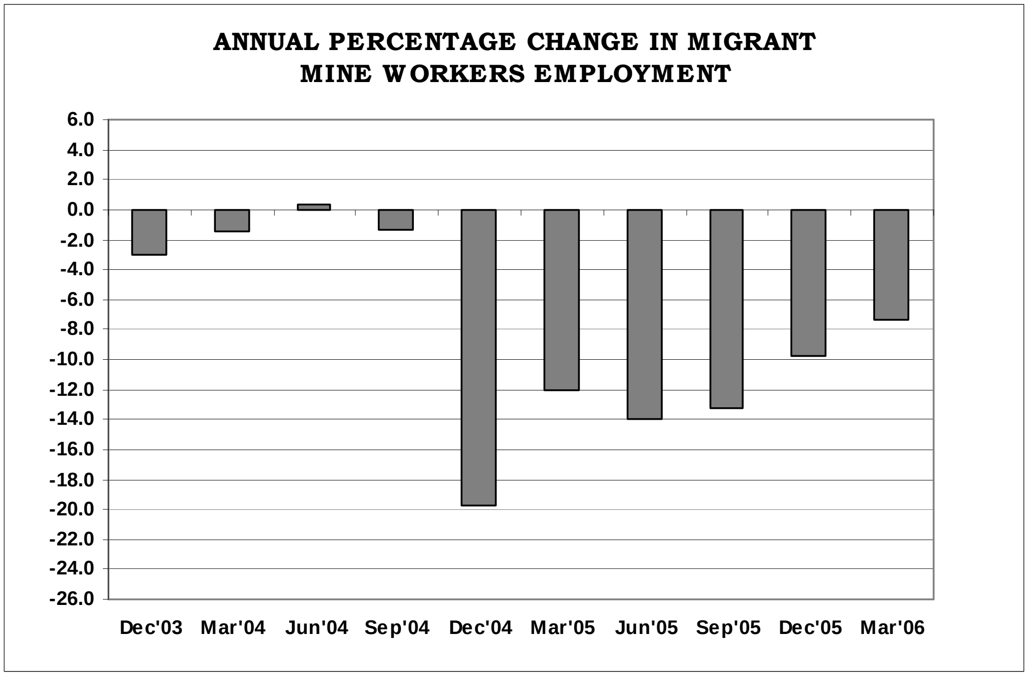
Figure 2



The number of mineworkers for the quarter ending March 2006 was estimated at 50 149, this was a decline of 1.4 per cent from 50 835 registered in December 2005. This was compared to a higher figure of 54 171 registered in the first quarter of 2005. There were indications of recovery in gold mining, as the price of gold in the international market had sky-rocketed. This has helped to cushion company loses. The smaller decline in employment was attributed to benefits that accrued from gold price increase that averaged an estimated R109 000 a kilogram for the quarter ending March. This was 7.6 per cent higher than the quarter ending December 2005.

Employment in the mining sector continued a downward drift, and there was a concern of retrenchment to the general economy. There was however, optimism with the possibility of the sector gaining from the favourable international environment. The improvement would help in decelerating retrenchments.

Figure 3

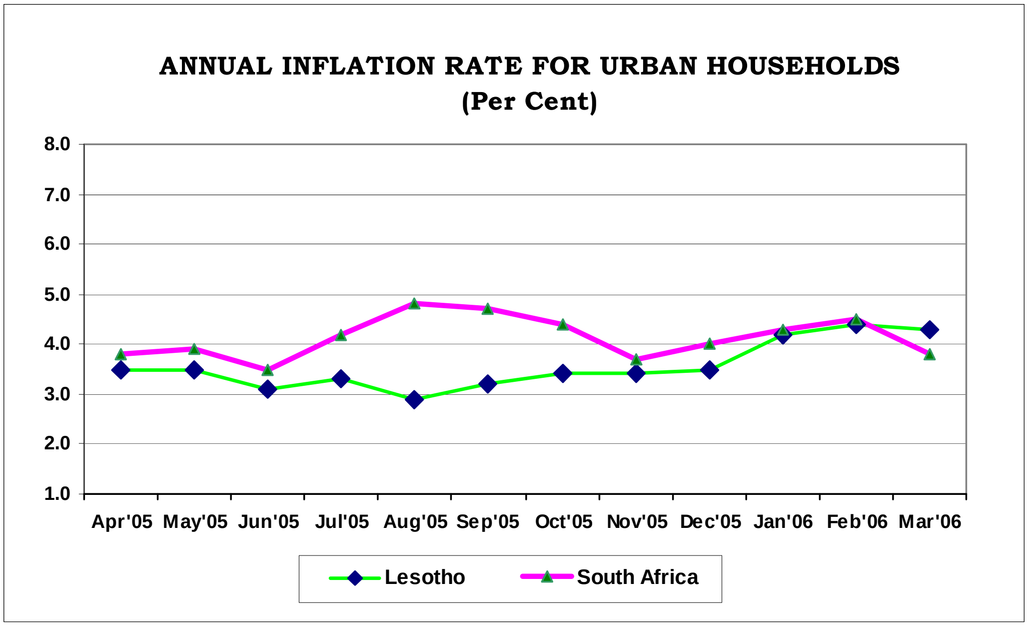


Price Developments

The overall price movement as measured by CPI was based on the projection for the quarter under review. Projections indicated that inflation will increase in the current quarter compared to the period ending December 2005. The movement in Lesotho price changes map changes in the South African consumer price index excluding mortgage costs. The major influence on the South African prices was on the back of increases in Brent crude oil prices and exchange rate movements.

The major movers in the Lesotho CPI concentrate mainly in administered prices; there had been a 14.0 percent increase in electricity prices. The movement in the food component was expected to slightly increase due to increases in maize prices. Increased water consumption prices were expected to feed into inflation in the subsequent period.

Figure 4



VI. Balance of Payments (BOP)

Overview

Lesotho's external sector position improved during the first quarter of 2006. The overall balance registered a seasonally adjusted surplus of M172.62 million, compared to a surplus of M95.0 million in the fourth quarter of 2005. The transactions balance, which represents the overall balance excluding the effects of currency fluctuations, also recorded a surplus of M147.97 million compared with that of M79.4 million in December 2005. However, the level of reserves measured in months of imports declined from 5.8 per cent to 5.5 per cent in the first quarter of 2006.

During the review period, the transactions balance was influenced mainly by developments in the current account. The latter registered a surplus of M43.2 million, in contrast with a deficit of M164.2 million that was realised in the previous quarter. This was mainly due to current transfers, which increased by 16.2 per cent in the first quarter compared with a decrease of 2.4 per cent in the previous quarter. The other three components of the current account, namely, goods, services and income balances, also performed better in the review period than the preceding quarter. On the contrary, net capital and financial inflows declined from M254 million in December 2005 to M92.2 million in March 2006. Large movements in the financial account mainly reflected commercial banks' transactions between Lesotho and SA.

SUMMARY OF BALANCE OF PAYMENTS
(Million Maloti)

	2005				2006
	QI	QII	QIII	QIV*	QI+
I. CURRENT ACCOUNT	31.33	-167.31	10.71	-164.17	43.18
Goods, Services and Income	-446.06	-585.70	-502.50	-665.20	-539.09
(a) GOODS	-902.37	-1018.76	-944.97	-1024.82	-997.72
Merchandise exports f.o.b.	920.31	1060.65	992.00	1161.68	956.66
Merchandise imports f.o.b.	-1822.69	-2079.38	-1936.97	-2186.50	-1954.39
(b) SERVICES	-43.52	-76.40	-68.38	-52.49	-47.87
(c) INCOME	499.83	509.43	510.85	412.12	506.51
Labour	475.76	488.92	482.58	474.53	474.48
Other	24.07	20.5	28.27	-62.41	32.04
(d) CURRENT TRANSFERS	477.39	418.39	513.20	501.02	582.27
Government, net	473.19	398.38	496.66	474.17	552.42
SACU non-duty receipts	383.14	394.46	497.7	469.91	473.06
Other	90.05	3.92	-1.04	4.26	79.36
Other Sectors	4.20	20.01	16.54	26.85	29.85
II. CAPITAL AND FINANCIAL ACCOUNT	-15.24	277.65	-24.30	254.82	92.22
(e) CAPITAL ACCOUNT	54.60	36.00	34.50	8.20	4.90
(f) FINANCIAL ACCOUNT	-69.84	241.65	-58.80	246.62	87.32
Special Financing – LHWP	53.81	59.77	49.24	61.35	43.35
III. RESERVE ASSETS	-119.83	-94.55	-86.90	-86.90	-177.17
IV. ERRORS AND OMISSIONS	-2.27	-16.00	-15.00	-15.00	23.10
V. VALUATION ADJUSTMENT	106.01	0.21	2.06	11.26	18.66

* Revised estimates
\+ Preliminary estimates

Merchandise Trade

Exports

Merchandise exports declined by 12.8 per cent, in seasonally adjusted terms, during the first quarter of 2006, compared with an increase of 17.5 per cent in the previous quarter. Sluggish export performance continued to mirror strong competition faced by Lesotho's textile and clothing exports in the international markets. Since the expiry of the ATC at the end of 2004, Lesotho's manufactured exports remained relatively weak. However, diamond exports grew by 22.2 per cent in the review quarter.

Imports

Merchandise imports were estimated to fall by 10.6 per cent during the review quarter, compared to an increase of 12.9 per cent in the previous quarter. A reduction in imports was attributable to decreased demand for imported inputs, in line with the relatively weak performance by the export manufacturers. Government capital expenditure was also estimated to fall short of the budget for the 2005/06. This also tends to slow down or reduce the demand for imports of intermediate goods.

VALUE OF EXPORTS BY SECTION OF THE S.I.T.C.
(Million Maloti)

COMMODITY	2005				2006
	I	II	III	IV*	I+
0. Food & Live Animals	22.50	23.9	21.56	33.04	34.58
Cattle	2.13	2.22	1.83	1.79	1.28
Wheat Flour	8.97	9.72	6.64	8.33	13.62
Maize Meal	4.00	3.68	4.14	5.92	6.81
Other	7.40	8.29	8.95	17.00	12.87
1. Beverages & Tobacco	27.19	35.39	35.40	36.56	31.68
Beverages	27.19	35.36	35.36	36.39	31.68
2. Crude Materials	14.20	1.28	5.78	7.14	6.09
Wool	14.20	1.28	5.78	7.14	6.09
4. Chemicals	3.50	3.09	2.20	3.27	3.72
5. Manufactured Goods	153.23	236.21	105.36	194.63	112.21
6. Machinery & Transport Goods	64.80	58.23	92.21	113.91	112.39
7. Miscellaneous Manufactured Goods	632.38	697.99	723.73	769.09	652.74
8. Unclassified Goods	2.36	4.34	5.76	4.04	3.25
TOTAL EXPORTS	920.31	1060.65	992.00	1161.68	956.66

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

Direction of Trade

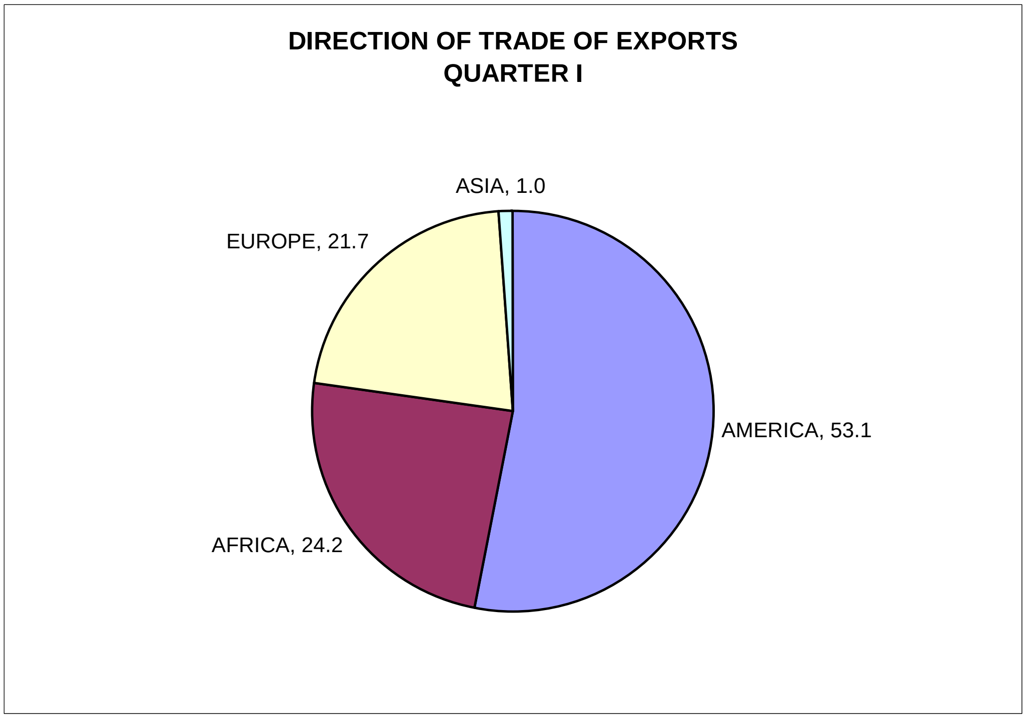
The US remained the largest recipient of Lesotho's exports. However, the share of exports to the US declined from 58.1 per cent in the previous quarter to 53.1 per cent during the review period. SACU, also maintained its position as the second largest market of Lesotho's exports during the review quarter. Its share of Lesotho's exports declined to 22.7 per cent, from 26.2 per cent in the fourth quarter of 2005. The third largest portion of Lesotho exports was destined to the European market. At the same time, the share of Lesotho's exports destined to Europe rose to 21.7 per cent, from 14.6 per cent in December 2005. This was attributed to increased diamond exports to Belgium, the largest market of Lesotho's diamonds. The proportion of exports to Asia remained negligible but increased from 0.2 per cent in the previous quarter to 1.0 per cent in the review quarter.

DIRECTION OF TRADE - EXPORTS AND RE-EXPORTS, f.o.b.
(Million Maloti)

REGION	2005						2006	
	QII* AMOUNT	% SHARE	QIII AMOUNT	% SHARE	QIV* AMOUNT	% SHARE	QI+ AMOUNT	% SHARE
World	1060.65	100	992.00	100	1161.68	100	956.68	100
Africa	183.09	17.26	168.11	16.95	314.68	27.09	231.26	24.17
SACU	155.10	14.62	136.85	13.80	303.89	26.16	217.38	22.72
SADC	1.76	0.17	0.46	0.05	0.43	0.04	4.28	0.45
Other	26.23	2.47	30.80	3.10	10.36	0.89	9.60	1.00
Europe	231.46	21.82	161.98	16.33	169.23	14.57	207.81	21.72
EC	231.46	21.82	161.98	16.33	169.23	14.57	207.81	21.72
America	644.46	60.76	655.26	66.05	675.22	58.12	507.78	53..08
Asia	1.64	0.10	6.65	0.67	2.55	0.22	9.83	1.03

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

Figure 5



Labour Income

During the review period, labour income remained almost the same as in the previous quarter at M474.5 million. This was in contrast with a decline of 1.7 per cent that was registered in the previous quarter. Miners' remittances, which account for the largest portion of labour income, declined by 1.3 per cent in the first quarter of 2006, compared to a decrease of 2.2 per cent in the previous quarter. This was in line with a decline of 1.4 per cent in the number of Basotho workers employed in the SA mining industry, which is the main source of labour income for the economy of Lesotho.

In spite of the resilience in gold price, most of the SA mining houses continued to complain about depressed profit margins and thus the need to reduce operational costs. This situation and the implied layoffs of miners do not augur well for Lesotho's BOP position and economy in general.

Investment Income

Inflows of investment income declined by 12.8 per cent during the review quarter. This was attributed mainly to interest paid to commercial banks, which declined by 39.3 per cent from M32.6

million during the last quarter of 2005 to M19.8 million. In contrast, interest paid to the Central Bank of Lesotho, which contributed the bulk of these inflows, increased by 3.1 per cent from M54.1 million to M55.8 million.

Outflows of investment income fell by 70.8 per cent to M43.6 million, from M149.2 million in the previous quarter. The decline arose mainly from interest on official loans, which fell by 82.5 per cent. The reduction in interest payments partly reflected a one-off settlement of a commercial loan by the Government that was effected in the previous quarter. But, it was also due to the appreciation of the loti against major currencies during the review quarter.

Travel

The country's travel earnings fell by 0.9 per cent in the review quarter, compared to a decline of 2.5 per cent in the previous quarter. Tourism spending, which forms the largest component of travel earnings, increased by 1.0 per cent during the quarter, as a result of growth in expenditure on food and accommodation.

In the meantime, payments on travel grew by 5.6 per cent, following a decline of 15.8 per cent in the previous quarter. This resulted mainly from an increase on international subsistence allowances by the Government, from M1.2 million in the previous quarter to M3.4 million.

Current Transfers

Current transfers, seasonally adjusted, increased from M509.5 million in the previous quarter to M567.0 million in the quarter under review. On annual basis, they rose by 16.2 per cent. The observed increase was due to the rand compensation and SACU non-duty receipts. In line with the provisions of the CMA Agreement, the Government of Lesotho receives compensation for rand that circulates in the country. This compensatory payment, for the 2005/06 fiscal year, amounted to M78.2 million. Furthermore, SACU non duty receipts remained strong at M473.1 million, from M469.9 million in the previous quarter.

Capital and Financial Account

The surplus on the capital and financial account declined from M254.8 million in the previous quarter to M92.2 million in the review quarter. As already indicated, developments in the capital and financial account continued to reflect significant influence by commercial banks' transactions. The latter contributed a net outflow of M8.5 million in the review quarter, as against a net inflow of M118.2 million that was registered during the quarter to December 2005. Thus, the decrease in net financial inflows in the review period was mainly due to the fact that, during the last quarter of 2005, commercial banks' transfer of funds was relatively abnormal in size. In contrast, the movement of funds by the banks during the period under review was a reflection of a normal situation.

In addition, capital grants to the Government, as well as official loan disbursements, remained relatively low and thus continued to put downward pressure on net inflows. Government grants declined by 40.2 per cent, while official loan disbursements also fell from M27.9 million in the previous quarter to M6.5 million during the review quarter.

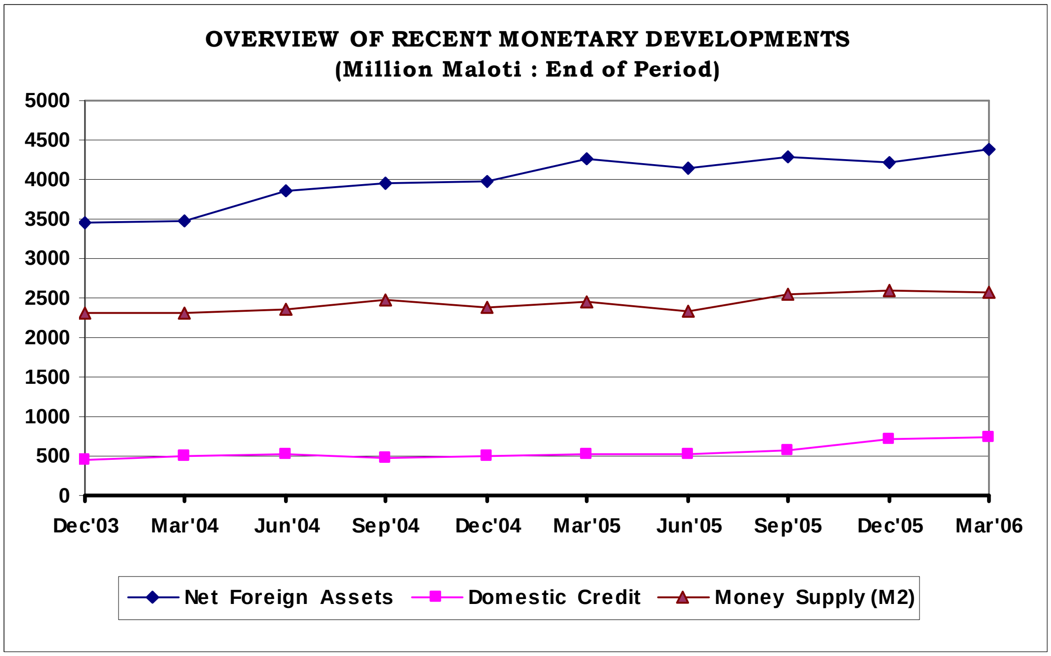
VII. Money and Banking

Money Supply

Determinants of Money Supply

Changes in Money supply (M2) are measured by changes in the overall banking system's net foreign assets, domestic credit and other items net. At the end of the review quarter, M2 registered a small quarterly decline of 0.9 per cent contrasted with an increase of 1.8 per cent observed at the end of the last quarter of 2005. On an annual basis, money supply rose by 4.7 per cent following a faster 9.1 per cent reported at the end of December last year. The annualised quarter to quarter increase in broad money was expected to exert inflationary pressures in the economy during the quarter under review. 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



DETERMINANTS OF MONEY SUPPLY
(Million Maloti; Changes)

Determinants	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Net foreign assets	-67.0	250.4	-81.2	154.2	-84.6	166.2
Domestic credit	32.3	7.0	9.7	32.1	159.7	26.6
To statutory bodies	4.5	10.7	-8.3	-7.8	-13.3	-4.0
To private sector	27.8	-3.6	18.0	39.9	173.0	30.6
Other items, net	66.5	178.6	59.4	-37.2	29.5	215.9
Money Supply (M2)	-101.2	78.8	-130.9	223.5	51.8	-23.1

Components of Money Supply

Money supply in Lesotho is defined as the sum of narrow money (M1) and quasi money. An increase of 1.9 per cent was realized in narrow money at the end of the review quarter compared with a rise of 4.2 per cent recorded at the end of December 2005. On the contrary, quasi money fell by 7.7 per cent in March following a 6.6 per cent fall which obtained at the end of the previous quarter. The increase in narrow money was mainly due to a 16.3 per cent rise in currency in circulation. However, quasi money declined as a result of a 17.8 per cent fall in time deposits and a marginal 0.2 per cent decrease in savings deposits. The observed shifts in components of money indicate that costs incurred to hold money for transactional purposes are lower than those resulting from maintaining either savings or time deposits accounts in view of the low real return and operational charges. Thus the public preferred to hold cash during the review quarter.

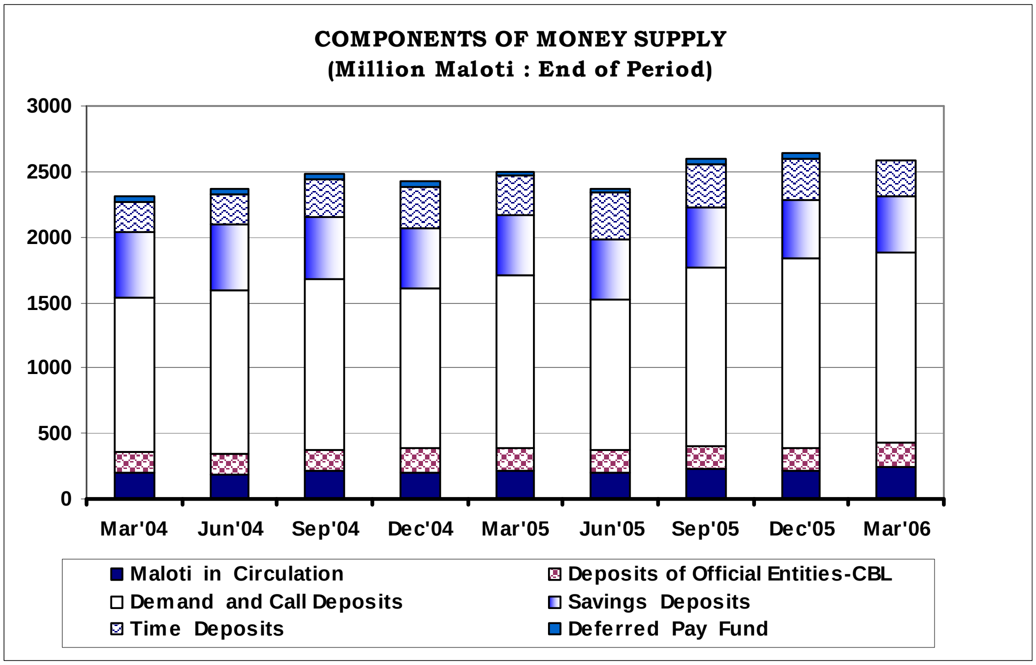
MONEY SUPPLY
(Million Maloti; End of Period)

	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Money Supply (M2)	2373.0	2451.8	2320.9	2544.4	2590.0	2566.9
Money (M1)	1589.4	1698.4	1514.2	1790.1	1760.8	1864.8
Maloti with public	204.5	212.6	202.5	232.0	212.8	247.4
Demand deposits(1)	1209.0	1308.9	1135.3	1347.4	1440.0	1440.0
Deposits of official Entities with CBL	175.9	176.9	176.4	176.7	176.7	177.4
Quasi-Money	783.6	753.4	806.7	788.3	760.5	702.2
Savings deposits	463.4	453.2	453.4	451.1	437.1	436.4
Time deposits	320.3	300.2	353.3	337.2	323.4	265.8

(1)– includes call deposits

NB: Totals may not tally due to rounding off

Figure 7



Commercial Banks' Deposits by Holder

A vibrant financial sector performs a paramount function of mobilising savings from the surplus spending sectors of the economy. In Lesotho, total deposits were mobilised from the private sector and statutory bodies during the review quarter. At the end of March, total deposits declined by 2.7 per cent in contrast with a 3.0 per cent increase observed at the end of the previous quarter. From the table below, it can be observed that the fall was largely driven by a 3.4 per cent decrease in private sector deposits which offset a 7.6 per cent increase in deposits held by statutory bodies. Deferred pay fund was liquidated during the review quarter.

COMMERCIAL BANKS DEPOSITS BY HOLDER
(Million Maloti; End of Period)

	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
TOTAL DEPOSITS	1981.1	2050.3	1930.1	2123.7	2188.4	2130.2
Private Sector	1628.9	1672.1	1543.7	1667.1	1655.7	1598.7
Demand deposits	968.4	1031.2	871.4	1014.8	1025.0	1001.3
Savings deposits	463.3	453.2	453.4	451.1	437.1	436.4
Time deposits	197.2	187.6	219.0	201.2	193.7	161.0
Statutory Bodies	313.3	348.5	349.7	415.9	494.0	531.5
Deferred Pay Fund	38.9	29.8	36.7	40.8	38.7	0.0

NB: Totals may not tally due to rounding off

Liquidity of Commercial Banks

Financial intermediaries among other things manage the liquidity and credit risks in the economy. As such, they seek to strike an optimal balance between long term investment that is vital for economic growth and at the same time maintain sufficient liquidity to be able 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 bank to meet customer's cash withdrawals as well as maintain a reasonable loan book to spur economic growth. At the end of March, the ratio declined from 73.7 per cent in December to 70.0 per cent. Although this still reflected high levels of liquidity, it represented a decline in liquidity in the banking system.

COMPONENTS OF COMMERCIAL BANKS' LIQUIDITY
(Million Maloti; End of Period)

COMPONENT	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Maloti Notes and Coins	52.4	57.9	58.3	57.1	85.2	64.7
Rand Notes and Coins	7.7	10.5	9.4	9.1	20.3	10.0
Balances due from Lesotho Banks	616.4	824.6	606.3	793.6	741.4	633.6
Balances due from Foreign Banks	818.4	1127.1	974.5	1152.2	1051.9	938.1
Clearing Balances with CBL	32.6	73.2	12.2	63.2	70.7	24.8
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	427.7	196.6	376.9	378.9	383.3	415.0

The depth of financial intermediation in the economy is measured by the credit-deposit ratio. This ratio establishes the degree to which banks attempt to allocate deposits between competing sectors throughout the economy. The ratio rose further from 32.0 per cent in December to 34.1 per cent in March implying an increase in credit extended in the latter quarter coupled with a slight fall in deposits. It is desired that this ratio continue to rise due to an increase in credit and not a fall in deposits. Continued declines in total deposits levels may indicate financial disintermediation which is not desirable for economic growth.

CONSOLIDATED BALANCE SHEET OF COMMERCIAL BANKS
(Million Maloti; End of Period)

	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Net foreign assets	1117.9	1306.2	1150.1	1310.3	1135.0	1139.0
Deposits with CBL	114.8	168.5	96.3	159.6	247.3	149.0
Credit:	1037.6	773.8	963.2	995.5	1161.1	1217.4
o/w: Statutory Bodies	52.2	62.8	54.5	46.7	33.4	29.4
Private Sector	442.0	437.7	455.5	493.7	666.1	696.9
Government:	543.4	273.2	453.2	455.2	461.6	491.1
o/w: Securities	542.4	272.3	452.5	454.5	461.6	490.6
Loans and Advances	1.1	1.0	0.6	0.7	0.5	0.5
ASSETS/LIABILITIES	2270.2	2248.4	2209.7	2465.5	2543.4	2505.4
Private sector deposits (2)	1981.1	2050.3	1930.1	2123.7	2188.4	2130.2
Government deposits	57.8	87.5	77.1	140.4	171.9	164.1
Capital, reserves & other, net	231.3	110.6	202.5	201.5	183.1	211.0

(2)– includes statutory bodies' deposits.

Demand for Money

Domestic Credit

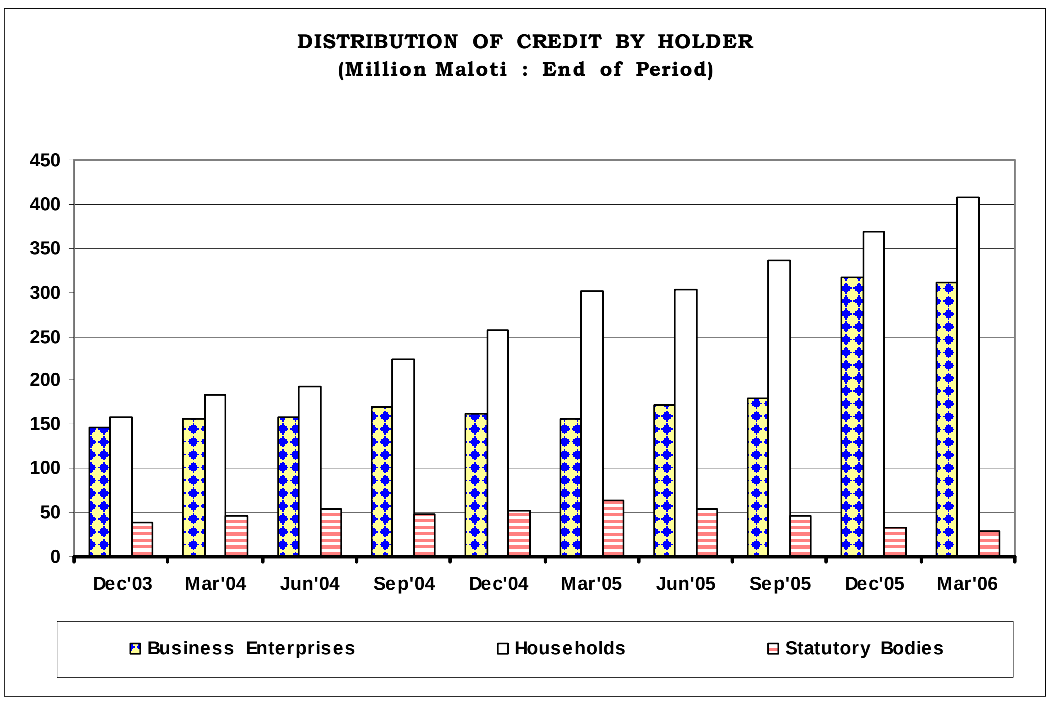
At the end of March, domestic credit increased further by 3.7 per cent following a significant 28.6 per cent increase observed at the end of the previous quarter. The increase was mainly attributable to a rise in credit extended to the private sector which overtook the decrease in credit extended to statutory bodies. Evidently, the private sector continued to benefit from the low cost of borrowing in the economy as a result of the low interest rates. Moreover, domestic credit was observed to have risen further by 44.1 per cent on an annual basis compared with an increase of 40.9 per cent registered at the end of December.

DOMESTIC CREDIT
(Million Maloti; End of Period)

	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
DOMESTIC CREDIT	510.4	519.1	528.8	560.9	719.3	747.1
Credit to private sector	458.3	456.3	474.3	514.3	685.9	717.7
Business enterprises*	162.7	155.5	171.1	179.1	316.6	310.5
Households	256.8	300.8	303.2	335.1	369.3	407.3
Credit to statutory bodies	52.2	62.8	54.5	46.7	33.4	29.4

* This amount excludes credit to business enterprises extended by old Lesotho Bank

Figure 8



Credit to Private Sector

The attainment of private sector led growth depends on the availability of the much needed funds to finance business projects which are important to foster economic growth. During the quarter ending March, credit to the private sector improved further by 4.6 per cent compared with a massive 33.4 per cent recorded in December. The rise was caused by a 10.3 per cent increase in credit extended to households which offset the fall of 1.9 per cent in credit granted to businesses. The continued strong performance in credit extended to the private sector reflected lower borrowing costs for this sector as lending rates remained low during the review period. In addition, it could imply that the banking sector's confidence in the private sector is recovering. Moreover, it indicated the impact of the diversification in products as commercial banks introduced micro-loan schemes.

During the period under review, private sector credit rose further by a 57.3 per cent on an annual basis following a 49.7 per cent reported at the end of the December quarter. It could be highlighted that although credit granted to the private sector increased, the increase resulted from the portion that was granted to households. The share of credit to households in total private sector credit rose from 53.8 per cent in December to 56.8 per cent in March. However, the share of credit to business enterprises decreased from 46.2 per cent in December to 43.3 per cent during the review period. Hence, the bias in credit extension in favour of households indicated that deposits that were mobilised by the banking system were channelled to finance more of consumption expenditure than productive investment.

Credit to Statutory Bodies

The volume of funds lent to official entities is expected to decline due to the on-going privatisation process in the medium to long-term. The size of credit extended to these institutions diminished further by 12.0 per cent in March, compared with a decrease of 28.5 per cent recorded in December. Furthermore, credit to this sub sector declined by 53.3 per cent on an annual basis following a 36.0 per cent shrinkage recorded at the end of December.

Sectoral Distribution of Credit to Business Enterprises and Statutory Bodies

The sectoral distribution of credit reflects the degree to which the funds spread throughout the economy to finance various economic activities. Therefore, depending on the contribution of each sector to GDP growth, the extent of financial deepening in the economy could be revealed. Total credit distributed to all business-oriented sectors of the economy, including official entities, but excluding non-performing loans, decreased by 3.0 per cent in March in contrast to an increase of 55.1 per cent reported in December. The fall in total credit during the quarter under review was largely attributable to a huge decrease in credit extended to distributive services and manufacturing sub sectors. However, an increase of 14.3 per cent in credit granted to the construction sub sector moderated the fall. This rise largely reflected the increased activity in this sub sector.

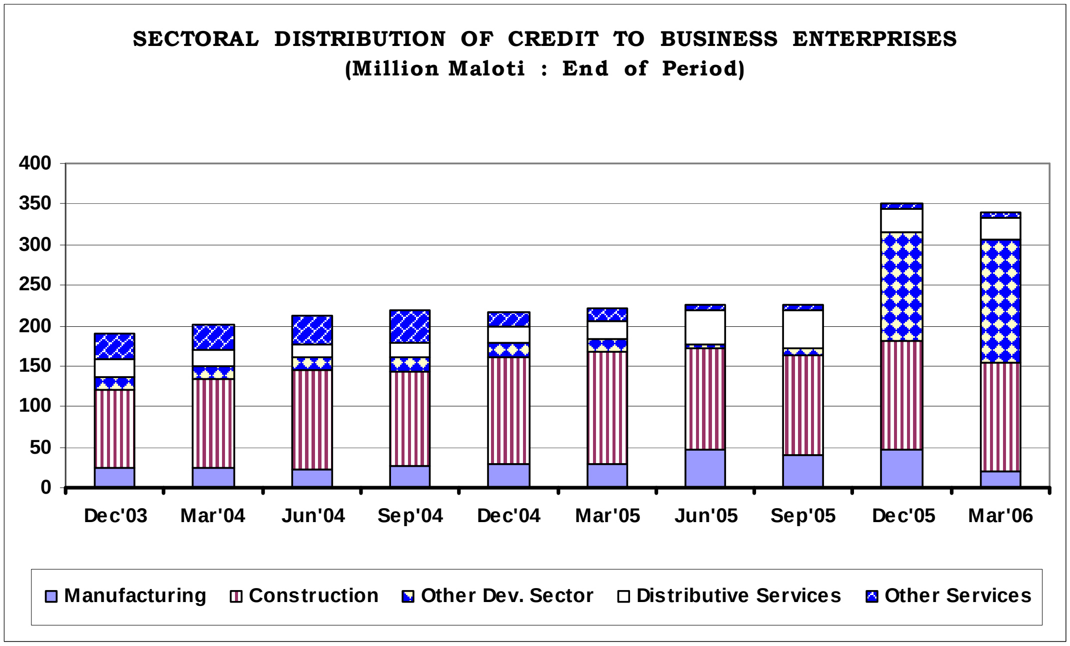
Credit allocated to other development sectors (made up of wholesale agriculture, hunting, storage, electricity, transport and communication) increased its share of total credit to businesses from 37.1 per cent in December to 43.0 per cent in March 2006. This development shifted dominance in credit allocation from the manufacturing sub sector whose share was registered at 6.0 per cent at the end of March.

SECTORAL DISTRIBUTION OF CREDIT TO ENTERPRISES
(Million Maloti; End of period)

SECTOR	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Manufacturing	29.3	28.2	46.0	41.3	47.8	20.4
Construction	132.5	140.0	126.8	121.0	132.6	133.3
Other development sectors	16.7	14.3	4.9	10.7	135.2	151.5
Distributive services	20.9	20.7	42.2	46.5	27.5	16.1
Other services	18.1	15.1	6.0	6.1	6.9	18.4
All sectors*	217.4	218.3	225.9	225.7	350.0	339.6

*This amount excludes loans granted to business enterprises by old Lesotho Bank

Figure 9



Net Claims on Government

The banking system's net claims on Government plummeted further by 12.9 per cent during the quarter under review following a decrease of 5.2 per cent noted at the end of December 2005. The decrease was mainly driven by an accumulation in government deposits with the Central Bank during the quarter ended March. As a result, as demonstrated by the table below, net claims by the Central bank fell by 12.9 per cent and overshadowed the increase in commercial banks' net claims on Government.

BANKING SYSTEM'S NET CLAIMS ON GOVERNMENT
(Million Maloti; End of Period)

Holder	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Commercial banks	485.7	185.7	376.1	314.9	289.8	327.0
Claims on Government	543.4	273.2	453.2	455.2	461.6	491.1
o/w MP T Bills (3)	*427.7*	*196.6*	*374.8*	*386.2,*	*359.9*	*420.7*
Less Government deposits	57.8	87.5	77.1	140.4	171.9	164.1
Central Bank of Lesotho	-1228.3	-1143.8	-1193.3	-1179.8	-1199.9	-1354.2
Claims on Government(4)	183.5	197.8	237.6	226.3	222.2	237.7
Less Government deposits	1411.8	1341.6	1430.9	1406.2	1422.0	1591.9
o/w those in blocked acct.	*536.3*	*292.3*	*478.72*	*484.2*	*519.6*	*519.8*
TOTAL NET CLAIMS	-742.7	-958.1	-817.2	-865.0	-910.1	-1027.2

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

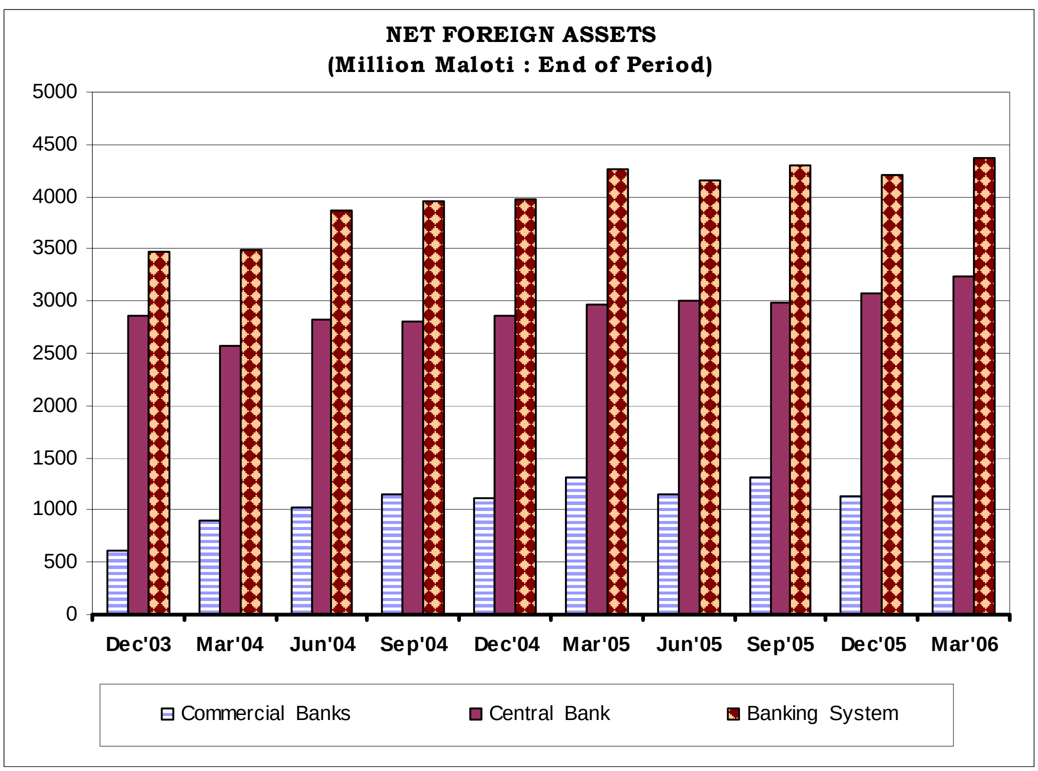
Net Foreign Assets

The Net Foreign Assets (NFA) of the overall banking system rose by 3.9 per cent in March as opposed to a 2.0 per cent decline recorded in December. The increase mainly reflected a rise in both the NFA of the Central Bank and commercial banks. The commercial banks foreign assets increased by a slight 0.5 per cent reflecting their transfers abroad.

BANKING SYSTEM'S FOREIGN ASSETS AND LIABILITIES
(Million Maloti; End of Period)

Holder	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
A. Commercial Banks	1117.9	1306.2	1150.2	1310.3	1135.0	1139.0
Foreign Assets	1253.8	1409.7	1274.3	1388.6	1241.8	1248.1
Foreign Liabilities	-135.9	-103.5	-124.1	-78.3	-106.9	-109.1
B. Central Bank of Lesotho	2854.5	2960.1	3000.9	2985.5	3076.2	3238.4
Foreign Assets	3351.5	3471.4	3566.0	3539.3	3625.6	3803.3
Foreign Liabilities	-497.0	-511.3	-565.1	-553.8	-549.3	-564.9
NET TOTAL	3972.4	4266.3	4151.0	4295.8	4211.2	4377.4

Figure 10



VIII. Money and Capital Markets

Money Market Developments

The CBL employs Open Market Operations (OMOs) in order to attain monetary policy goals. The total amount of securities issued for the three 91-day treasury bill auctions, which were conducted during the review quarter was M530.2 million. Although the composition of the holding of treasury bills shifted in favour of commercial banks, the total was equal to that offered during the last quarter. In addition, M70.0 million worth of 182-day treasury bills were offered with the aim of invigorating investment by all members of the public.

The holding of securities in March comprised commercial banks, Non-Bank Financial Institutions (NBFI's), and others institutions. The banking sector continued to dominate the market by holding more securities than the NBFI's. The share of NBFI's fell to 9.4 per cent of the total in March following last quarter's 20.4 per cent share. The commercial banks' share rose from 73.2 per cent in December to 79.3 per cent during the review period. The general public controlled a 10.3 per cent share in March compared with 11.0 per cent in December 2005.

HOLDINGS OF TREASURY BILLS (5))
(Million Maloti)

Holders Type	2004	2005				2006
	Dec	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**
Total	**532.2**	**300.0**	**489.5**	**534.7**	**530.2**	**530.2**
Banking System	427.9	196.6	374.8	386.2	359.9	420.7
Central Bank	0.0	0.0	0.0	0.0	0.0	5.1
Commercial Banks	427.9	196.6	374.8	386.2	359.9	420.7
Non-Bank Sector	104.4	103.4	114.7	148.6	170.3	104.4
NBFIs	33.9	45.7	77.3	89.8	108.3	49.6
Others	70.5	57.7	37.4	58.8	62.0	54.8
Memorandum Item						
Average Yield per cent	8.26	8.11	7.25	7.21	7.27	7.10

(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 fell by 5 basis points in March from its December level of 6.90 per cent. Its SA counterpart declined by 21 basis points from 6.80 per cent during the previous quarter. The margin between the two rates widened from 15 to 31 basis points. As usual, the local rate continued to hover above the South African rate.

The prime lending rate in the country remained intact at 11.5 per cent in line with the overall tide of the money market prices in the region. The average deposit rates remained constant and the spread between lending and deposit rates continued to be large. The magnitude of the spread normally reflects the efficiency of financial intermediaries in the economy. As such, a high spread could be linked to relative inefficiency. However, at the end of March, real interest rate on a 1 year deposit (adjusted for inflation) turned positive at 0.55 per cent. This simply meant that the return on deposits could, to some extent, cushion the public against purchasing power erosion.

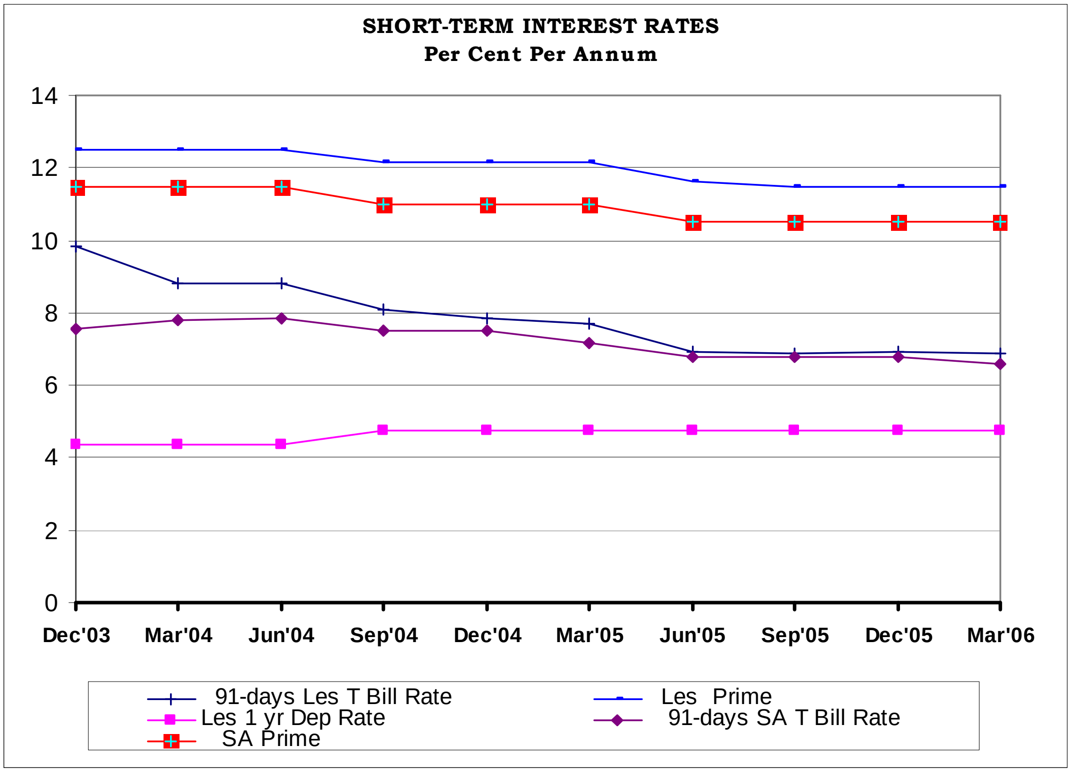
MAJOR MONEY MARKET INTEREST RATES
(Per cent; End of Period)

Interest Rates by Type	2004	2005				2006
	Dec	Mar	Jun	Sep	Dec	Mar
Central Bank						
T Bill Rate – 91 Days	7.86	7.72	6.93	6.89	6.95	6.90
Lombard Rate	13.00	13.00	13.00	13.00	13.00	13.00
Commercial Banks(6)						
Call	3.25	3.25	2.83	2.83	2.83	2.83
Time:						
31 days	3.10	3.50	3.50	3.50	3.50	3.50
88 days	4.15	4.25	4.25	4.25	4.25	4.25
6 months	3.65	4.50	4.50	4.50	4.50	4.50
1 year	4.74	4.75	4.75	4.75	4.75	4.75
Savings	1.35	2.00	2.00	2.00	2.00	2.00
Prime	12.17	12.17	11.50	11.50	11.50	11.50
South Africa*						
Repo	7.50	7.50	7.00	7.00	7.00	7.00
T Bill Rate – 91 Days	7.49	7.17	6.76	6.79	6.80	6.59
Marginal Lending Rate	12.50	12.50	12.00	12.00	12.00	12.00
Prime	11.00	11.00	10.50	10.50	10.50	10.50

* Figures for South Africa were obtained from the SARB

(6) - Average rates by commercial banks

Figure 11



Foreign Exchange Rates

The loti was rather strong during the first quarter of 2006. On average, the local currency unit appreciated by 5.6, 4.7, 5.8 and 5.6 per cent against the SDR, the euro, the US dollar and the pound sterling, respectively.

A number of factors supported the strengthening of the Rand and thus the Loti, against other major currencies such as the SDR, euro, US dollar and UK pound sterling. Firstly, interest rates in SA remained relatively high compared to the world's major economies. This continued to enhance the attractiveness of rand denominated assets and therefore attracted portfolio investment flows into the SA market. Secondly, price of precious metals such as gold and platinum remained relatively high throughout the review period. As SA is one of the major commodity exporters, the Rand continued to benefit from strong commodity prices. In addition, economic growth prospects in SA also remained bullish, which boosted the currency.

Currency appreciation have varying economic inflations. On the one hand, it tends to reduce the price competitiveness of the country's exports in the international markets. This could impact negatively on Lesotho's export earnings. On the other hand, the appreciation of the loti reduces the cost of foreign currency denominated imports, and thus eases inflationary pressures.

SELECTED EXCHANGE RATES
(Loti per Currency units; Quarterly Averages)

Currency	**2004**	**2005**				**2006**
	Dec	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**
SDR	8.778	9.154	9.584	9.512	9.398	8.871
EURO	7.665	7.874	8.077	7.937	7.772	7.403
USD	5.707	6.009	6.425	6.510	6.538	6.157
POUND STERLING	10.999	11.358	11.909	11.611	11.427	10.789

IX. Government Finance

Summary of Budget Outturn

Preliminary estimates on the budget outturn indicated a surplus equivalent to 6.2 per cent of GDP. This resulted from increased Government revenue coupled with a reduction in expenditure during the review period. This was in contrast to a deficit realised in the previous quarter. Total revenue and grants were estimated to have surged by 7.3 per cent.

Overall Government expenditure and net lending dropped by 5.3 per cent. As a percentage of total expenditure, capital expenditure stood at 12.9 per cent, while recurrent expenditure constituted 87.1 per cent. This continued to reflect the need for a more balanced resource allocation, because economic development benefits more from capital than recurrent expenditure.

Revenue

During the first quarter of 2006, Government revenue including grants grew by 7.3 per cent. This was mainly attributed to a rise in non-customs revenue, which increased by 5.8 per cent. As a percentage of GDP, total revenue and grants grew to 52.2 per cent from 48.6 per cent realised in the previous quarter.

Tax revenue soared by 2.4 per cent from the previous period. This was primarily strengthened by the increase in non-customs revenue as earlier mentioned. Revenue from value added tax (VAT) also improved by 8.1 per cent during the review period. The increase in VAT collections reflected delayed transmittal from SARS[3] during the festive season coupled with the LRA's continued efforts to enhance revenue collections through tax payer education. Income tax collections for the review period grew by 4.6 per cent. This was largely attributed to an improvement in withholding tax.

SACU receipts remained unchanged and continued to dominate tax revenue during the period under review. This took into account the intra SACU trade, excise duties, and domestic economic developments. SACU receipts constituted 58.3 per cent of total tax receipts during the review period. Income tax and VAT contributed 23.2 per cent and 17.4 per cent, respectively to tax revenue. The extensive reliance on SACU continued to expose Lesotho to the fiscal risk posed by the possible reductions in receipts from this source of revenue.

Non tax revenue was estimated to have increased by 59.0 per cent during the period under review. This was largely attributed to an inflow of rand monetary compensation. Grants, which are normally used to finance development projects, maintained a downward trend. They fell by 40.8 per cent compared with a 76.2 per cent realised in the previous quarter. This, to a great extend, reflected lack of absorptive capacity by some Government agents.

[3] SARS is South Africa Revenue Services

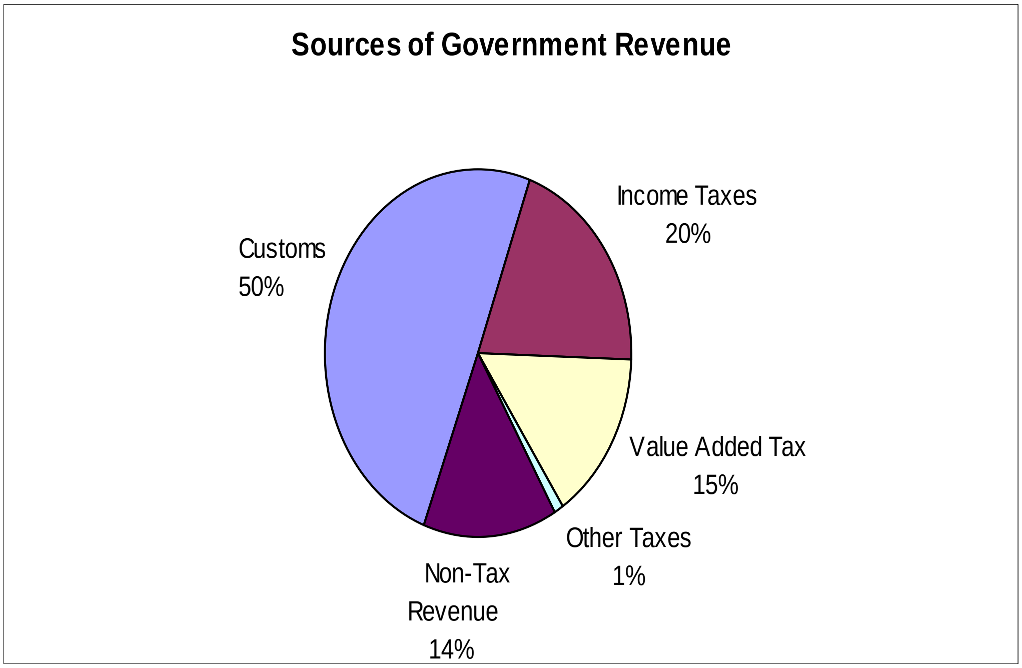
GOVERNMENT BUDGETARY OPERATIONS
(Million Maloti)

DETAILS	2004/05	2005/06			
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec Revised	Jan-Mar * Preliminary
Total Revenue and Grants	**1081.8**	**1019.4**	**1174.6**	**1139.2**	**1222.5**
Total Revenue	1027.2	983.5	1140.1	1130.9	1217.7
Tax Revenue	920.1	898.7	1024.8	1025.5	1049.9
Customs	503.1	496.0	603.3	603.3	603.3
Non-customs	417.0	402.7	421.4	422.1	446.6
Income Taxes	226.5	227.3	227.6	229.6	240.1
Taxes on goods & services	185.8	163.4	172.7	188.0	194.7
Other Taxes	4.7	11.9	21.1	4.6	11.8
Non-Tax Revenue	107.1	84.8	115.3	105.5	167.7
Of which: Water royalties	41.3	43.7	66.5	63.6	62.0
Grants	**54.6**	**36.0**	**34.5**	**8.2**	**4.9**
Total Expenditure & Net Lending	**822.0**	**1058.8**	**1015.4**	**1137.5**	**1077.3**
Recurrent Expenditure	698.7	884.4	835.9	951.8	941.7
Personnel Emoluments	298.6	309.7	313.1	318.7	321.4
Interest Payments	40.8	28.9	40.2	131.5	23.3
Foreign	24.9	21.5	22.5	120.4	10.7
Domestic	15.9	7.4	17.7	11.1	12.6
Other Expenditure	359.3	545.8	482.6	501.7	596.9
Capital Expenditure	123.3	175.6	179.6	189.0	138.9
Net Lending	0.0	-1.2	0.0	-3.4	-3.3
Surplus/deficit before grants	205.2	-75.4	124.6	-6.5	140.4
Surplus/deficit after grants	259.8	-39.4	159.2	1.7	145.2
Financing	-259.8	39.4	-159.2	-1.7	-145.2
Foreign	-39.8	-83.0	-143.0	-33.9	-22.8
Loan drawings	28.5	32.1	38.6	28.1	9.6
Amortization	-68.3	-115.1	-181.6	-62.0	-32.4
Domestic	-220.1	122.4	-16.2	32.2	-122.4
Bank Financing	-213.1	107.9	-47.8	-45.1	-117.1
Non – Bank	-7.0	14.5	31.6	77.3	-5.3

Source: Ministry of Finance and Development Planning

*CBL Preliminary Estimates

Figure 12



Expenditure

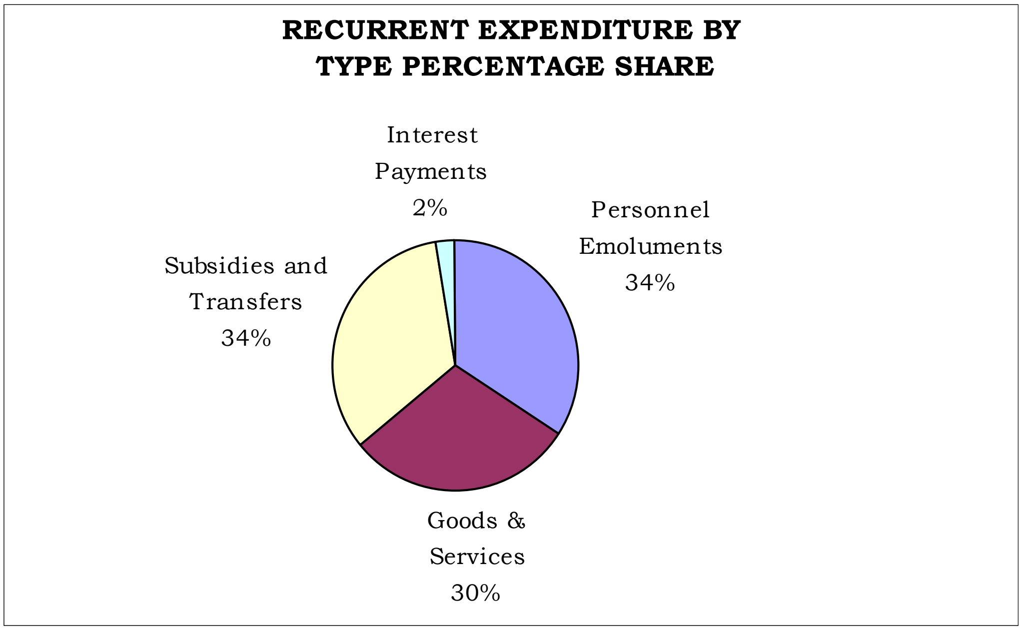
Total expenditure and net lending, was estimated to have declined by 5.3 per cent during the review period. As a percentage of GDP, they fell by almost 260 basis points from 48.6 per cent in the previous quarter to a level equivalent to 46.0 per cent of GDP. The drop was attributed to the decrease in both recurrent and capital expenditures, which fell by 1.1 and 26.5 per cent, respectively.

The fall in recurrent expenditure was largely driven by the stabilisation of interest payments after servicing the penalty in the previous period. The overall interest expenditure dropped by 82.3 per cent during the review period, following 91.1 per cent reduction in foreign interest expenditure. However, the 13.8 per cent increase in domestic interest moderated the decrease.

The level of subsidies and transfers extended during the review period increased by 41.8 per cent, mainly driven by scholarships for students studying abroad. The component of scholarships for students grew by 144.3 per cent. Expenditure on pensions and gratuities also grew by 30.8 per cent.

Capital expenditure was estimated to have declined by 26.5 per cent on a quarterly basis. The fall in capital expenditure was mainly on account of slow implementation of both loan and grant funded projects. GoL funded 86.9 per cent of capital expenditure; while those financed from external loans and grants accounted for 8.7 per cent and 4.4 per cent, respectively.

Figure 13



Financing

The fiscal operations during the review period were estimated to have realised a surplus equivalent to 6.2 per cent of GDP. The surplus enabled Government to accumulate deposits with the banking sector and be the net re-payer of foreign debt. Government reduced part of non-concessional foreign debt owed to financial institutions by 17.2 per cent.

Public Debt

Overview

The total public debt fell by 1.7 per cent during the period under review. The decrease was a result of the 2.0 per cent decline in external debt, following reduction in non-concessional debt. Domestic debt remained unchanged during the review period. This was attributed to a fall in holding of treasury bills by the non-banking sector, which was offset by the increase in holdings by the banking sector. As a ratio of GDP, the total debt stock was estimated to have decreased to 48.9 per cent compared with 49.7 in the previous quarter. The foreign debt component continued to dominate the composition of the total debt stock at 85.9 per cent, while domestic debt comprised 14.1 per cent.

External debt

The level of foreign debt further dropped by 2.0 per cent during the period under review. The decrease in foreign indebtedness was due to the fall in non-concessional debt which fell by 8.1 per cent. External debt constituted 85.9 per cent of the total public debt stock and about 84.6 per cent of it was concessional. This was in line with Government's policy to borrow on concessional terms in order to moderate the country's future debt burden.

The concessional nature of the public debt stock enables the country to retain the favourable position during the review period. As a percentage of GDP, the level of foreign debt continued to shrink from 42.8 per cent to 42.0 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 was also strengthened by the long maturity structure and concessionality of the overall external debt stock. As a percentage of exports of goods and services, debt service stood at 2.3 per cent compared with 15.0 per cent threshold.

OUTSTANDING GOVERNMENT DEBT

(Million Maloti)

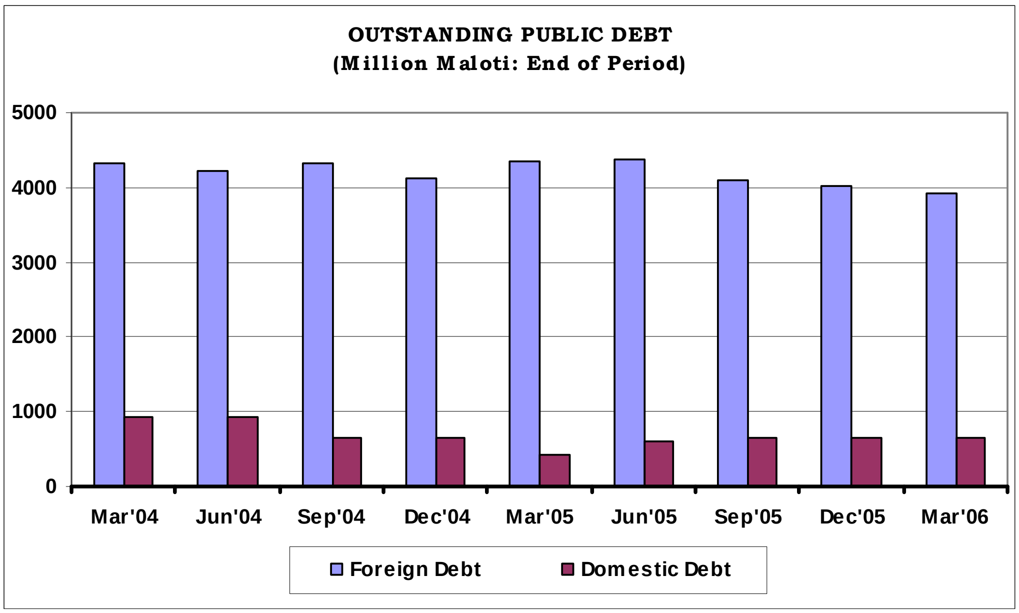
	2004	2005				2006
	QIV	QI	QII	QIII	QIV	QI
A. EXTERNAL DEBT	**4112.8**	**4352.9**	**4379.4**	**4105.6**	**4011.6**	**3932.6**
Bilateral Loans	531.4	467.3	422.0	408.6	396.9	408.5
Concessional	432.0	370.8	381.6	375.9	369.9	386.2
Non-concessional	99.4	96.5	40.4	32.7	27.1	22.3
Multilateral Loans	3183.7	3490.6	3581.6	3484.6	3399.1	3334.4
Concessional	2737.4	3030.8	3125.0	3037.4	2985.9	2939.3
Non-concessional	446.3	459.9	456.6	447.2	413.2	395.1
Financial Institutions	315.8	316.5	306.7	147.9	141.5	117.2
Concessional	60.1	58.0	2.7	2.6	2.6	2.4
Non-concessional	255.7	258.4	304.0	145.4	138.9	114.8
Suppliers' Credit	81.9	78.5	69.1	64.4	74.1	72.5
B. DOMESTIC DEBT	**647.1**	**415.7**	**604.2**	**649.3**	**644.9**	**644.9**
Banks	542.6	312.3	489.5	500.9	474.6	540.4
Long-term	114.7	114.7	114.7	114.7	114.7	114.7
Short-term	427.9	197.6	374.8	386.2	359.9	425.7
Of which: treasury bills	427.9	196.6	374.8	386.2	359.9	425.7
Non-bank	104.5	103.4	114.7	148.5	170.3	104.4
Short-term (TBs)	104.5	103.4	114.7	148.5	170.3	104.4
TOTAL (A + B)	**4759.9**	**4768.6**	**4983.6**	**4754.9**	**4656.5**	**4577.5**

N.B: External debt figures are from the Ministry of Finance and Development Planning

Domestic Debt

Domestic debt remained unchanged during the review period. The fall in holding of short term debt by the non-banking sector was offset by the increase in holding by the banking sector. As a result, short term and long term debt maintained the previous quarter's level of M530.2m and M114.7m respectively. The long term component constitutes entirely of the ten year bond[4] that retires in 2009. As a percentage of GDP domestic debt remained unchanged at 6.9 per cent recorded in the last quarter 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



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