CENTRAL BANK OF LESOTHO

QUARTERLY REVIEW

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MASERU
KINGDOM OF LESOTHO

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I. Introduction

The world economy continued to be robust during the second quarter of 2007. The International Monetary Fund (IMF) has revised the projections for the global gross domestic product (GDP). Global GDP is revised upward by 0.3 percentage points to 5.2 per cent in 2007. However, the concerns about the possible effects of the slow down in the US economy on the rest of the world still remain. The US economy measured by real GDP grew by 1.8 per cent during the review period driven by consumer spending. Strong growth performance is observed in most regions such as Euro zone, Asia and South Africa. However, the continued increase in the price of oil is likely to remain a threat to the price stability.

There are indications that during the second quarter of 2007, the Lesotho economy also reflected some improvement. Many of the indicators recorded positive growth but the agricultural sub-sector is expected to decline significantly. The primary sector is expected to reflect the effect of the worst drought in 30 years that the country is currently facing. Based on the WFP/FAO Assessment Mission Report total cereal production is expected to decline by 40 per cent in 2007. The situation is due to the above average temperature and low rainfall during the 2006/2007 cropping season. However, the negative performance of the primary sector was mitigated by the continued increase in diamond mining output.

The secondary sector remained strong during the second quarter. The textile and clothing sub-sector seems to have fully recovered. The textiles and clothing sub-sector accounts for 8.7 per cent of the gross domestic products (GDP). Water consumption by the manufacturing industries, which is used as an indicator of the performance of the sub-sector more than doubled during the quarter.

There are mixed indications about the performance of the tertiary sector. Wholesale and retail trade showed some improvements during the quarter. However, the telecommunications sub-sector, measured by the number of calls fell by 6.4 per cent on seasonally adjusted quarterly basis.

On the expenditure side, there are indications that private consumption remains strong. Consumption credit continued to increase; it rose by 18.3 per cent in the quarter under review. Furthermore, there are indications that total investment is improving. Investment credit rose by 18.3 per cent from 10.3 per cent in the previous period. In addition, other indicators of investment such as, imported commercial vehicles rose.

Employment conditions in the country reflected some improvements during the quarter. Employment in the Lesotho National Development Corporation (LNDC) assisted companies rose by 3.8 per cent. Migrant mine labour rose marginally by 0.1 per cent during the quarter.

Inflation developments continued to follow those of the region. Inflation rose by 8.0 per cent compared with 5.9 per cent of the previous quarter. In South Africa, inflation rate rose by 6.4 per cent compared with 5.5 per cent in March 2007. The continued food shortages due to drought conditions and the increased use of biofuels are exerting inflationary pressures on the economy. The rising oil prices are also contributing towards the increase in the prices.

Money supply grew modestly on quarterly basis and by 37.8 per cent on an annual basis. Domestic credit continued to increase during the quarter, driven mainly by credit extended to the private sector. Credit extended to the private sector rose by 11.1 per cent during the quarter. The bulk of the growth emanates largely from credit extended to the households and business enterprises. The net foreign assets declined by 2.7 per cent compared with 16.4 per cent in the previous quarter. The decline in CBL net foreign assets was due to government debt repayments during the quarter while those of the commercial banks were influenced by the reduction in earnings of the export sector.

The Lesotho 91 day treasury bills rate remained below that of South Africa. The rate rose to 7.56 per cent during the quarter. At that rate it is 1.12 percentage points below that of South Africa. Other interest rates in the economy remained in line with those of South Africa.

Government budgetary operations are estimated to have registered a surplus equivalent to 5.1 per cent of GDP. The surplus was due to the good performance of the non-customs revenue.

The overall balance of payments registered a deficit equivalent to M144.9 million following that of M1.02 billion in the previous quarter. The deficit was entirely due to the appreciation of the local currency against major currencies including the US dollar experienced during the second quarter.

II. International Economic Developments

United States (US)

Growth of the US economy strengthened during the quarter under review. On an annual basis, real GDP grew by 1.8 per cent against 0.6 per cent registered in the previous quarter due to faster growth in consumer expenditure. This growth rate was the strongest since the first quarter of 2006. Consumer spending, which accounts for two-thirds of economic activity, remained a driver of the expansion. It increased by 1.3 per cent during the review quarter. An increase of 6.4 per cent in exports also contributed to faster economic growth.

Unemployment rate in the US remained unchanged at 4.5 per cent during the quarter under review. The jobless rate has ranged from 4.4 per cent to 4.6 per cent since September 2006. The inflation rate decelerated to 2.7 per cent in June 2007 compared with 2.8 per cent observed in March largely due to a downturn in the index for gasoline prices. Gasoline prices fell by 1.9 percent from their peak level recorded in May. Although the inflation rate marginally decelerated during the quarter, at this rate, it is still considered to be on a high side. Therefore, in an effort to balance between the risks of slower growth and high inflation, the Federal Reserve Bank's Open Market Committee (FOMC) kept the benchmark lending rate unchanged at 5.25 per cent.

Acceleration in the US economic growth may have positive implications on the Lesotho economy. An increase in the US consumer spending may positively affect demand for Lesotho's exports, the bulk of which is destined to the US.

Table 1: World Economic Indicators

(Quarter I versus Quarter II: 2007)

	Real GDP Growth		Inflation		Key Interest Rates		Unemployment Rate	
	QI	QII	QI	QII	QI	QII	QI	QII
China	11.1	11.9	3.3	4.4	6.39	6.57	4.4	3.9
Euro Area	3.1	2.5	1.9	1.9	3.75	4	7.2	7
India	9.1	9.3	7.6	7.5	7.5	7.5	7.6*	7.6*
Japan	2.7	2.3	0.3	0.1	0.5	0.5	4	3.7
South Africa	4.7	4.5	5.5	6.4	9.0	9.5	25.5*	25.5*
Unites States	0.6	1.8	2.8	2.7	5.25	5.25	4.5	4.5

*as in 2006

Source: Bloomberg, The Economist, STATSSA and SARB

Euro-zone[1]

On an annual basis, real GDP grew by 2.5 per cent during the second quarter of the year compared with 3.1 per cent realised during the previous quarter. The moderate increase in GDP emanated largely from France and Germany.

Inflation in the Euro-zone as measured by changes in the Harmonised Index of Consumer Prices (HICP) remained unchanged at 1.9 per cent recorded in March. At this rate, inflation is still below the European Central Bank (ECB) targeted rate of 2.0 per cent. However, the inflation outlook led the ECB to raise its benchmark lending rate by 25 basis points to 4.00 per cent in June, the highest level in six years.

Economic developments in the Euro-zone have both direct and indirect impacts on Lesotho's economy. Firstly, a large portion of Lesotho's exports, in particular diamonds, is destined to the Euro-zone. Secondly, developments in the Euro-zone have direct implications for the South African economy because about 30 per cent of SA exports are destined to the Euro-zone. SA is Lesotho's main trading partner.

South Africa (SA)

Growth rate of GDP in real terms moderated during the quarter compared with the previous quarter. It increased by 4.5 per cent in the second quarter compared with a revised 4.7 per cent registered during the first quarter. The main contributors towards the increase in economic activity during the quarter were finance, real estate and business services industry (1.5 per cent), wholesale and retail trade, hotels and restaurants industry (0.6 per cent), transport, storage and communication industry (0.6 per cent), construction industry (0.5 per cent), and general government services (0.5 per cent).

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

The Consumer Price Index (CPI) excluding interest on mortgage bonds (CPIX) rose to 6.4 per cent in June compared with 5.5 per cent registered in March as a result of higher fuel and food prices. At this rate, the CPIX breached the South African Reserve Bank (SARB) target range of 3 to 6 per cent. Consequently, the SARB Monetary Policy Committee (MPC) raised the key interest rate by 50 basis points to 9.5 per cent in June.

Positive economic activity in SA augurs well for the Lesotho economy. However, upward pressure on prices and interest rates remains a threat because of trade and financial links between these two countries.

Asian Emerging Markets and Japan

The Asian region is regarded as one of the fastest growing regions in the world. Among other countries in the region, three largest and fastest-growing economies, namely, India, China and Japan continued to show positive economic signals during the second quarter.

China

Preliminary estimates indicated that GDP in China grew by 11.9 per cent in the second quarter compared with 11.7 per cent registered in the previous quarter. This growth rate was buoyed by investment in factories and real estate. This was due to the faster growth rates in the secondary and tertiary sectors. On the labour market, unemployment rate in seasonally adjusted terms remained unchanged at 4.4 per cent in June as in March.

Inflation rate rose to 4.4 per cent in the review period from 3.3 per cent registered in March. This high inflation rate was attributable to a rise in pork prices (by about 50 per cent) due to an outbreak of blue ear disease among China's pig population. Furthermore, food prices have also increased on the back of poor global harvests as well as drought in China's main crop-growing areas. At this rate, inflation was above the 3.0 per cent target of the People's Bank of China (PBC). Consequently, the PBC raised the one-year benchmark interest rate from 6.39 per cent in March to 6.57 per cent in May in order to curb inflation.

Developments in the Chinese economy have negative implications for the Lesotho economy. In particular, higher inflation in China, where a large proportion of Lesotho's manufacturing inputs are sourced, could negatively affect the competitiveness of Lesotho's exports.

Japan

Japanese real economic growth decelerated from 2.7 per cent realised during the first quarter to 2.3 per cent in the quarter under review. Although the growth rate has moderated, it is still considered to be strong. This is further supported by the trend realised in one of the leading indicator of economic growth, industrial production which grew by 1.2 per cent from the previous quarter. This was due to the significant expansion in industries for electronic parts and devices, transport equipment, and information and communication electronics equipment during the quarter. Electronics makers increased production to meet strong demand in the country and internationally. Japanese unemployment rate in seasonally adjusted terms fell from 4.0 per cent registered in the first quarter to 3.7 per cent during the second quarter. That was the lowest jobless rate since February 1998.

The core CPI which excludes fresh foods prices declined to 0.1 per cent in June from a fall of 0.3 per cent in March. The inflation outlook led the Bank of Japan to keep its key interest rate unchanged at 0.50 per cent during the second quarter.

India

Real GDP in India grew by 9.3 per cent during the quarter under review compared with 9.1 per cent registered in the previous quarter. The main contributors towards the faster growth rate were manufacturing (11.9 per cent), electricity, gas and water supply (8.3 per cent), construction (10.7 per cent), trade, hotels, transport and communication (12.0 per cent), finance, insurance, real estate and business services (11.0 per cent), and community, social and personal services (7.6 per cent).

Inflation rate fell to 7.5 per cent in June from 9.2 per cent recorded at the end of March. The observed decline was due to a fall in food prices. However, inflation expectations led the Reserve Bank of India (RBI) to keep the key interest rate unchanged at 7.5 per cent during the second quarter.

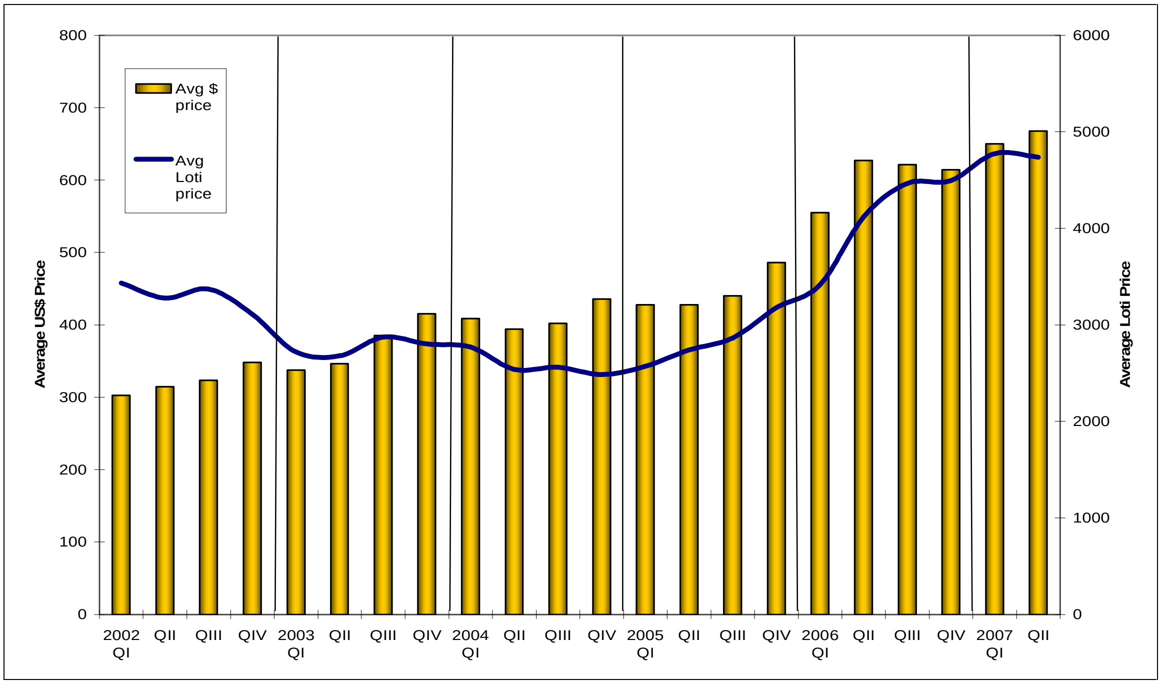
Commodity Prices

Gold

The average price of gold increased from US$650.1 per ounce in the previous quarter to US$667.6 per ounce in the second quarter. It ranged between a minimum and maximum of US$640.9 per ounce and US$691.9 per ounce, respectively. In Rand terms, the average price of gold declined by 0.75 per cent from R4 773.1 per ounce in the previous quarter to R4 737.2 per ounce during the quarter.

The increase in the international price of gold helped dampen the negative impact of the exchange rate in the rand price of gold. It could encourage mining companies to keep their current employment at a sustainable level.

Figure 1: Commodity Prices (Gold)

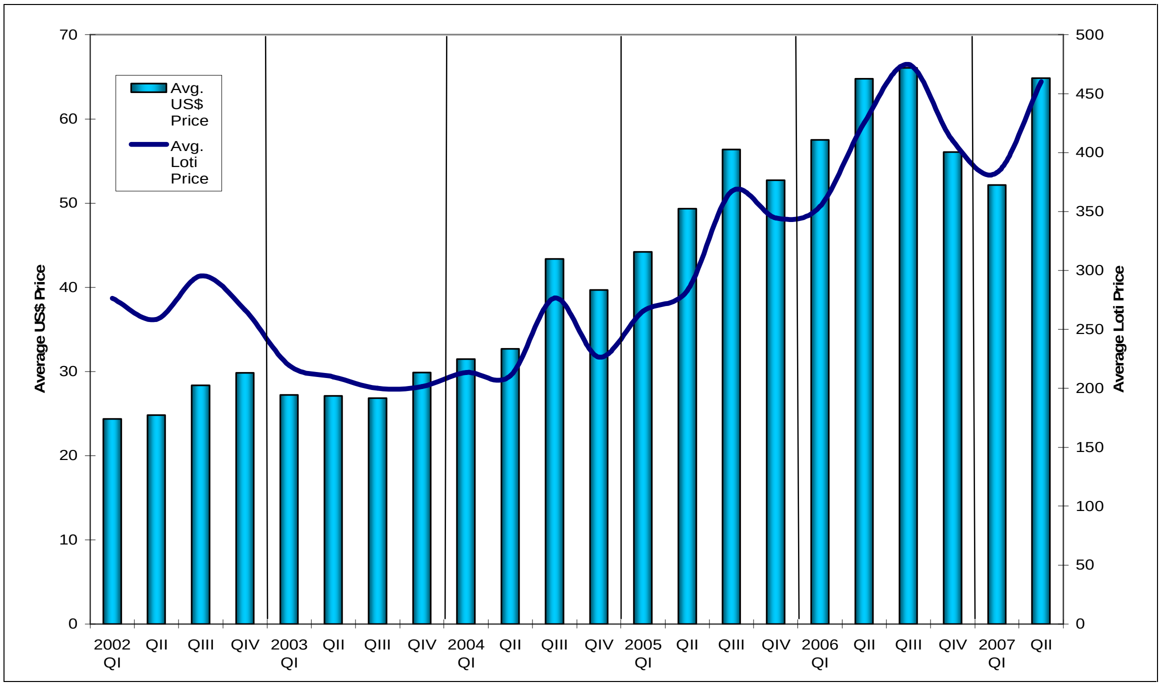


Oil

During the quarter under review, the average price of crude oil increased by 24.3 per cent, from US$52.2 per barrel in the previous quarter to US$64.9 per barrel. It ranged between a minimum and maximum of US$61.8 per barrel and US$68.2 per barrel, respectively. In Maloti terms, it rose by 20.2 per cent, from M383.0 per barrel in the previous quarter to M460.2 per barrel in the second quarter of 2007. A rise in the price of crude oil in both US Dollar and Loti terms could impact negatively on the Lesotho's economy.

In line with the global developments that transpired during the quarter, there were four upward revisions of fuel prices in the country. The pump prices of petroleum products in Lesotho closed the review quarter higher at M6.90 per litre of petrol, M6.80 per litre of diesel and M4.60 per litre of illuminating paraffin. These compare with M5.45 per litre of petrol, M6.10 per litre of diesel and M4.00 per litre of illuminating paraffin at the end of first quarter.

Figure 2: Commodity Prices (Oil)



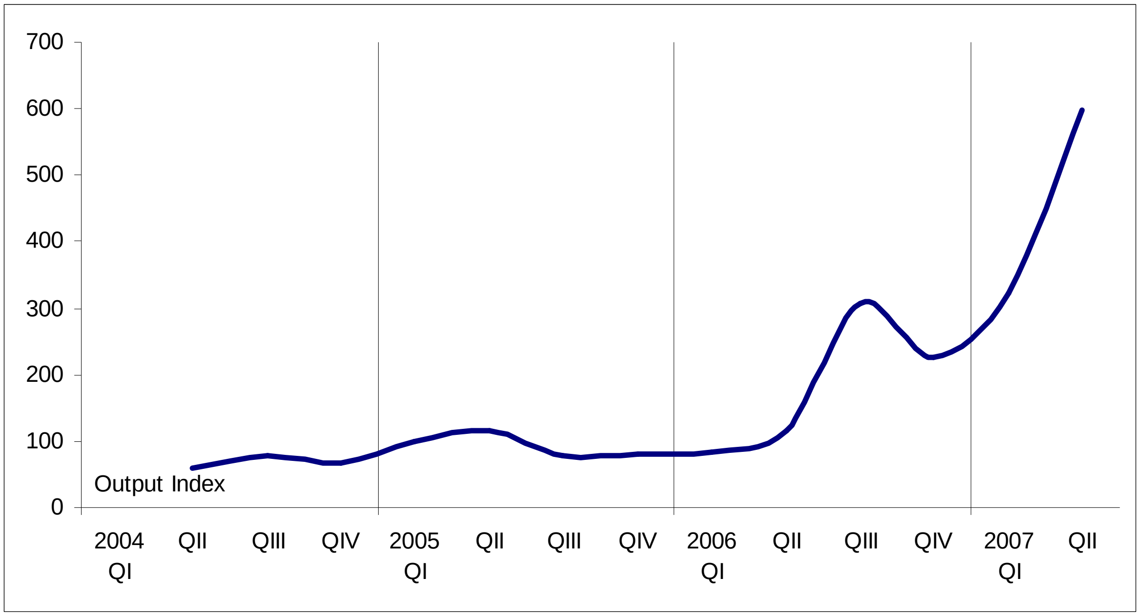
III. Real Sector, Employment and Price Developments

Primary Sector Developments

The diamond production index increased from 321.87 in the first quarter to 597.78 in the quarter ending June 2007. The output is expected to keep this upward trend given that at least four more mining companies are at a prospecting stage. These are the Kolo, Mothae, Kao and alluvial mining along Letseng and Mothae kimberlites and pipelines. The average life span of the mines ranges from 23 years to 34 years. There is an expected increase in the output given an estimated 21 hectare pipeline with probable reserves of 147m tonnes of ore at the grade of 6.9 carats per hundred tonnes.

Figure 3: Diamond Production Index

(2005: QI=100)



Source: Department of Mines and Geology

Agricultural Output

Estimates of the 2006/07 cropping season indicate that the country experienced the worst drought in 30 years. The average yield per hector of maize production is estimated to have declined by 42 .0 per cent while sorghum declined by 25.0 per cent compared to the last cropping season. The shortfall in cereal production is expected to be covered by imports to the tune of 256 000 tonnes during the marketing year 2007/08. The deficit is likely to affect more than a third of the population (401 200 people).

Secondary Sector Developments

Electricity Consumption

Consumption of electricity increased by 15.5 per cent on a quarterly basis, and by 0.3 per cent on an annual basis. The increase in both quarterly and annual terms was a reflection of a rise in economic activity in the country and an increase in household energy consumption due to the cold winter period. The major increase was recorded in the commercial and industrial category, though the domestic and general purpose categories also increased.

Table 2: Electricity Consumption

(Million Maloti)

	2006				2007			
	QIII		QIV		QI		QII	
	kwh	value	Kwh	value	Kwh	value	kwh	value
General Purpose	19.38	13.08	16.27	11.14	17.84	11.50	20.98	13.89
Domestic	34.59	17.82	28.22	14.51	28.55	13.99	35.43	17.36
Commercial & Industrial	79.54	33.87	64.79	28.27	62.87	25.74	69.74	31.42
Total	133.51	64.76	109.28	53.92	109.26	51.23	126.15	62.67

Source: Lesotho Electricity Authority

Water Consumption

Total water consumption increased by 69.9 per cent on a seasonally adjusted quarter to quarter basis. Water consumption by the industrial sector is used as a leading indicator of activity in the 'wet' industries (textile and clothing), which form a huge part of the industrial sector. The units of water consumed by the industrial category have more than doubled on a seasonally adjusted quarterly basis with an increase of 106.2 per cent. The increase in industrial water consumption is expected to keep an upward trend given the proposed LNDC pipeline projects. Domestic water consumption is also expected to maintain an upward trend as the Water and Sewage Authority starts the implementation of the second phase of water connections for the Maseru peripheral areas and expedite the implementation of phase I of the project.

Table 3: Water Consumption

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

Quarter		Domestic	Industrial	Other	Total
2006					
II	Units	0.78	1.40	0.65	2.83
	Value	3.20	6.52	3.05	12.77
	Units*		1.42		2.93
III	Units	0.78	1.51	0.65	2.94
	Value	3.11	7.05	2.87	13.03
	Units*		1.36		2.6*
IV	Units	0.94	1.44	0.59	2.97
	Value	3.96	6.39	2.70	13.05
	Units*		1.30		2.68
2007					
I	Units	1.01	1.38	062	3.01
	Value	4.34	6.42	2.88	13.64
	Units*		1.61		3.52
II	Units	1.47	3.27	1.15	5.89
	Value	3.85	7.38	3.00	14.22
	Units*		3.32		5.98

Source: Water and Sewerage Authority

*denotes seasonally adjusted figures

Building Permits

The number of building permits is an indicator of activities in the construction sector. It plummeted by 68.3 per cent on a seasonally adjusted quarterly basis and by 71.7 per cent on an annual basis. The decline was mainly in the residential and commercial property. However there was a jump in the value of the 'other' category. The rise was due to construction of the health centres with an estimated value of M22.0 million. It is however cautioned that the decline in the overall indicator may be due to the implementation lag of some of the buildings.

Table 4: Building Permits by Type of Building[1]

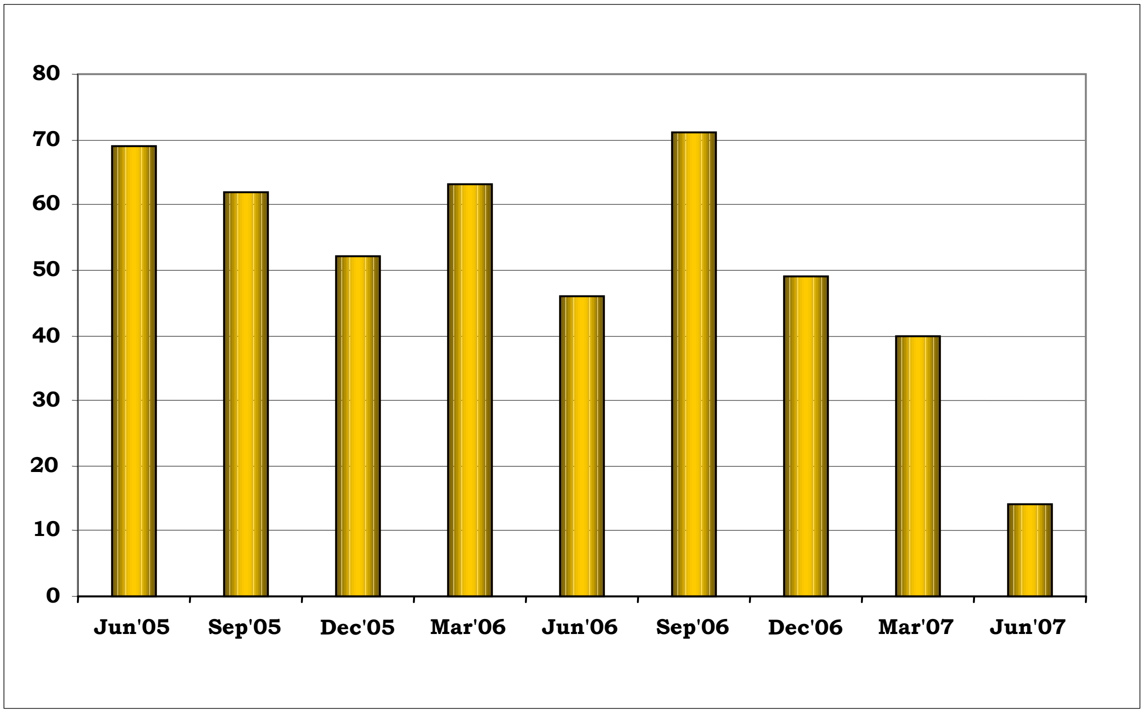
(Value in Million Maloti)

Type	Permits	2006			2007	
		QII	QIII	QIV	QI	QII
Residential	Value	23.53	28.40	16.69	12.21	7.69
	Units	45	71	46	36	11
Commercial	Value	1.13	0.00	0.50	0.34	0.00
	Units	2	0	2	1	0
Other	Value	0.33	1.32	11.76	1.53	24.25
	Units	1	2	1	3	3
Total	Value	24.99	29.72	28.95	14.08	31.94
	Units	48	73	49	40	14
	Units *	46	77	52	41	13

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.
*denotes seasonally adjusted figures

Figure 4: Number of Building Permits



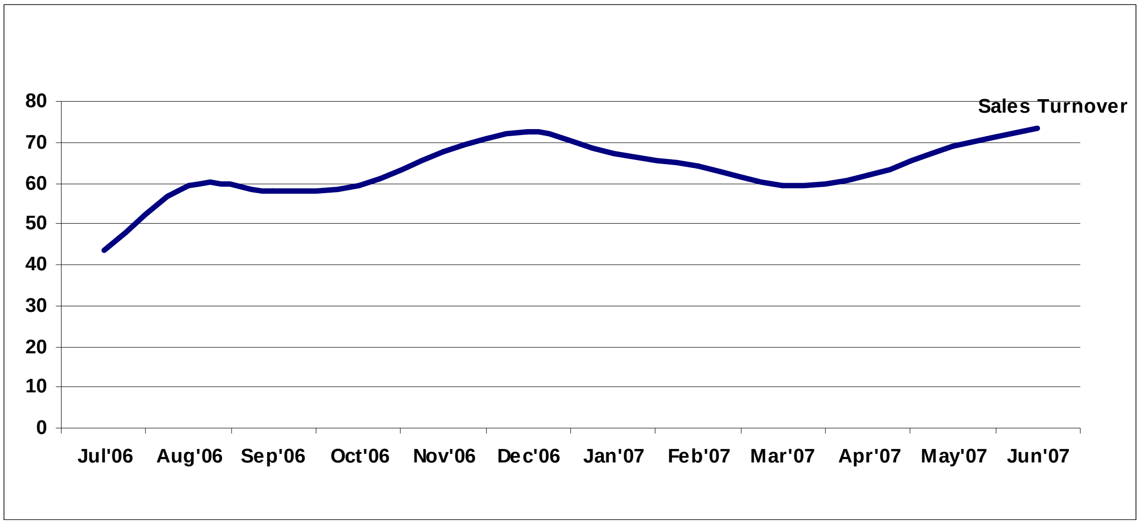
Tertiary Sector Developments

Retail Sales Turnover

The value of retail sales turnover as an indicator of performance of business activity in the economy, increased by 23.2 per cent on a quarterly basis, and by 20.4 per cent on an annual basis. The increase highlighted increased business activity implying a rise in consumer spending. This upward movement is in line with tax revenue collections on a quarterly basis. It is however noted that consumer spending may start to slow-down if high interest rates prevailing in the region are sustained.

Figure 5: **Value of Sales Turnover**

(Million Maloti)



Source: Lesotho Revenue Authority

Telephone Statistics

The total number of calls declined by a seasonally adjusted 6.4 per cent on a quarterly basis and increased by a higher 9.4 per cent on an annual basis. The drop on a quarterly basis may be a reflection of lower demand during the quarter under review. However the upward trend on an annual basis reflected the on-going expansion of the coverage and introduction of new products.

Table 5: Telephone Traffic Statistics

(In minutes)

		SA Outgoing Calls	International Calls	All Calls
2006				
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
III	No. of calls (millions)	3.81	0.28	4.09
	No. of calls*		……	3.71
	Total Duration (million)	5.37	1.64	7.01
	Nominal Value (million)	12.36	12.02	24.38
IV	No. of calls (millions)	3.98	0.20	4.18
	No. of calls*		……	4.22
	Total Duration (million)	5.02	0.81	5.83
	Nominal Value (million)	11.55	6.53	18.08
2007				
I	No. of calls (millions)	4.04	0.19	4.23
	No. of calls*			4.50
	Total Duration (million)	5.11	0.71	5.82
	Nominal Value (million)	10.72	6.74	17.46
II	No. of calls (millions)	3.90	0.16	4.06
	No. of calls*			4.21
	Total Duration (million)	4.71	0.57	5.28
	Nominal Value (million)	11.36	5.74	17.10

Source: Tele-Com Lesotho

* Seasonality adjusted figures.

Investment Expenditure

Imported Motor Vehicles

The number of imported motor vehicles increased by a seasonally adjusted 16.6 per cent on a quarterly basis, but declined by 18.8 per cent on an annual basis. The rise on quarterly basis was mainly underpinned by the increase in all categories except trailers as depicted in Table 6. The major increase was recorded in the cars and vans categories. The decline on an annual basis indicates subdued long term capital formation, while on the shorter term the economy is expected to have accumulated more fixed capital formation.

Table 6: **Motor Vehicle Imports**+

(Value in Million Maloti)

		Cars	Vans	Trucks	Buses	Trac-tors	M/Cycles	Trail-ers	Total
2006									
II	Value	25.0	31.38	4.08	5.30	0.22	0.20	0.20	66.42
	Units*	4							659
	Units	336	223	13	31	5	7	9	624
III	Value	38.2	27.59	6.00	6.16	0.11	0.04	1.10	79.29
	Units*	9							644
	Units	296	212	25	23	3	3	13	575
IV	Value	13.5	19.83	4.15	5.22	0.33	0.04	0.31	43.43
	Units*	5							388
	Units	148	133	10	37	8	5	6	347
2007									
I	Value	23.4	30.21	2.92	1.81	0.33	0.08	0.33	59.16
	Units*	8							432
	Units	205	209	11	12	2	1	19	459
II	Value	21.7	37.93	3.74	6.58	0.42	0.10	0.10	70.66
	Units*	9							535
	Units	234	218	13	27	3	4	7	506

Source: Imperial Fleet Services Lesotho and Customs Department
*denotes seasonally adjusted figures
+Includes imports of second hand cars

Employment Developments

Employment in LNDC assisted companies increased by 3.8 per cent on a quarterly basis and 8.7 per cent on an annual basis. The quarterly increase was a result of increased investment in the textile and clothing sub-category. The annual increase is an indicator of stability in the manufacturing industry. This was consistent with the increase in the textile and clothing component of the total exports. The sector is expected to keep an upward trend given further commitments on investments, with an estimated 15 (high probability) projects for the second half of the year.

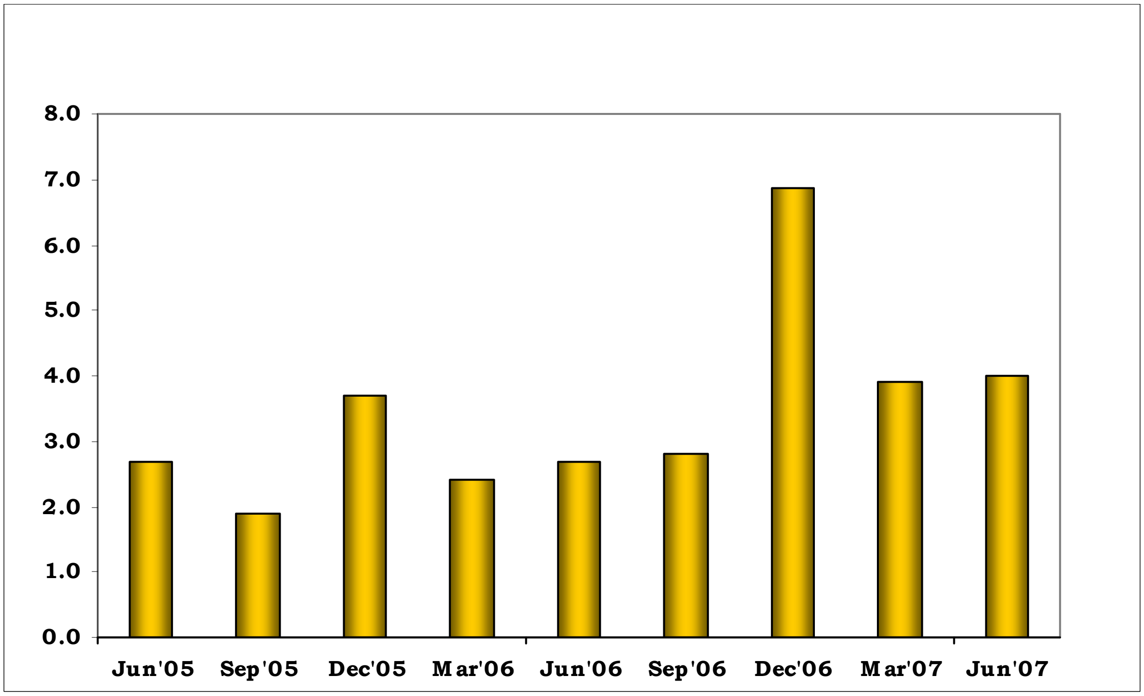
Table 7: Employment Trend of LNDC Assisted Companies

Period	QI	QII	QIII	QIV
2007	47609	49416		
2006	40459	45140	46189	47462
2005	41985	40111	39597	43131
2004	52532	53525	52922	50607
2003	43525	46960	49862	51187
2002	36906	39255	42011	43773

Source: Lesotho National Development Corporation

Figure 6: Government Employment

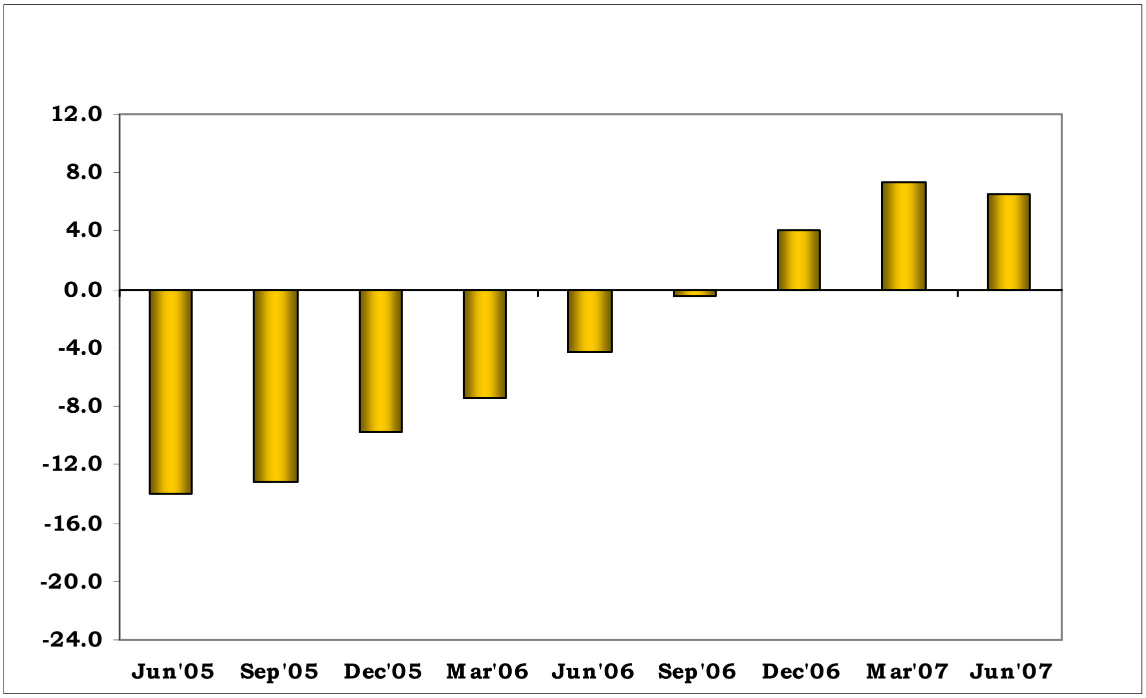
(Annual Percentage Change)



The number of government employees increased by 1.5 per cent to 39 617 on a quarterly basis. The turn-around on a quarterly basis came from the correction of under coverage of teachers in the quarter ending March 2007. On an annual basis the increase was 4.0 per cent. The annual increase reflected the continued increase in the teaching service personnel and general public servants.

Figure 7: Migrant Mineworkers Employment

(Annual Percentage Change)



Migrant mine workers increased by 0.1 per cent to 53 942 employees on a quarterly basis. On an annual basis, the increase was higher at 6.5 per cent. The annual change was slower than the 7.4 per cent in the first quarter.

The slower growth in the numbers employed, both quarterly and annually, is a reflection of the decline in the price of gold in rand terms. It declined by 0.8 per cent from R4 773.1 per ounce in the first quarter to R4 737.2 per ounce during the quarter under review. However, platinum showed some resilience during the same period. Projections indicate that total world platinum will increase by 5.6 per cent with much of production coming from South Africa which is expected to increase its platinum output from 71.3 per cent to 72.4 per cent in 2007 alone.

Price Developments

Inflation rate accelerated from 5.9 per cent in the first quarter to 8.0 per cent in the quarter ending June. The following were the main determinants of the direction due to the magnitude of their change; 'food and non-alcoholic beverages', 'Alcoholic beverages and tobacco', 'Housing, electricity, gas and other fuels', 'transport' and 'Restaurant and Hotels'.

The major changes were observed in food and fuel pump prices. The former is expected to keep the upward trend because of the continued shortage in overall cereal production and decline in yields. The Food and Agricultural Organisation/World Food Program (FAO/WFP) estimated that the 2006/07 harvest will be smaller than the 2005/06 harvest period. The 2007 cereal production is estimated to represent 42.0 percent drop from 2006 and 40.0 per cent decline for the last 5 years. This gives rise to the overall uncovered deficit of 30 000 tonnes that will need to be covered by additional government and international assistance.

The pump price of petrol increased by 27.0 per cent from the first quarter, while diesel increased by 11.0 per cent and illuminated paraffin which is for household use increased by 15.0 per cent. These prices are expected to keep an upward movement in the medium term due to the supply concerns in the international oil market and the Brent crude price exceeding the US$70 per barrel.

Table 8: Inflation Rate

(Annualised Percentage Change: April 1997=100)

	Weight	2007				
		Feb	Mar	Apr	May	June
All items	100.0	5.6	5.9	8.1	7.6	8.0
Food and non-alcoholic beverages	39.8	9.9	10.8	15.2	13.3	14.1
Alcoholic beverages & Tobacco	6.4	5.1	4.8	5.4	4.9	6.1
Clothing & footwear	15.6	0.8	1.2	1.5	2.3	2.1
Housing, electricity gas & other fuels	3.7	6.7	6.0	7.9	8.2	9.4
Furniture, households equipment & routine maintenance of house	17.0	1.3	1.1	1.3	1.4	1.5
Health	1.4	-0.1	-0.5	-2.1	-1.8	-1.7
Transport	7.8	4.0	2.9	3.6	4.5	4.3
Communication	0.1	3.4	3.4	3.4	3.4	0.0
Leisure, entertainment & Culture	1.2	-1.8	-2.6	-2.5	-0.6	0.1
Education	3.2	1.9	2.0	2.3	2.4	2.6
Restaurant & Hotels	0.4	13.2	12.9	17.4	24.9	21.7
Miscellaneous goods & services	3.2	2.2	2.5	4.1	4.1	3.2

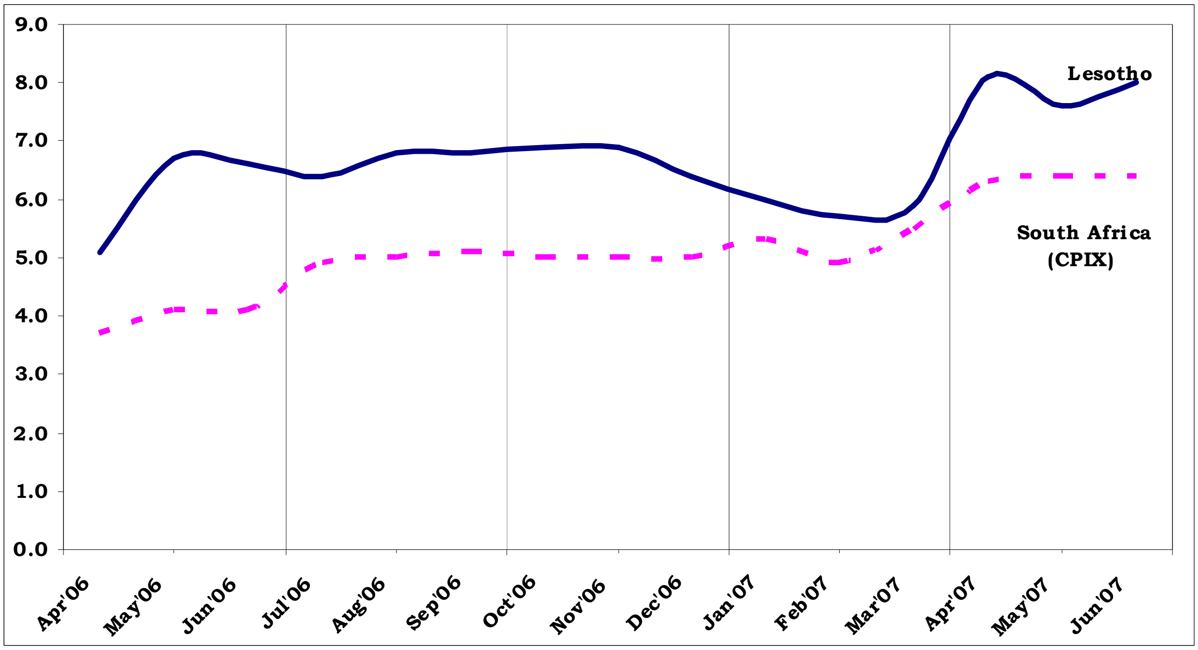
Source: Bureau of Statistics, Lesotho

Figure 5 shows that while Lesotho and SA inflation rates generally move together, there are incidences of divergence. Lesotho inflation rate temporarily appeared to increase while that of SA decline around April the previous year. A similar divergence was observed again in

March this year, where Lesotho's rate increased at a much faster rate. Despite an easing in May, the June figures implied renewed divergence.

Figure 8: Annual Inflation Rate for Urban Households

(Percent)



IV. Monetary and Financial Developments

Determinants of Money Supply

The broad measure of money supply (M2) remained intact at its March level during the quarter ending June. This was a result of an increase in domestic credit which was offset by the fall in the overall banking system's net foreign assets. On an annual basis, money supply retained an upward trend recording a 37.8 per cent increase in June compared to 45.0 per cent at the end of March.

Figure 9: **Overview of Recent Monetary Developments**

(Million Maloti: End of Period)

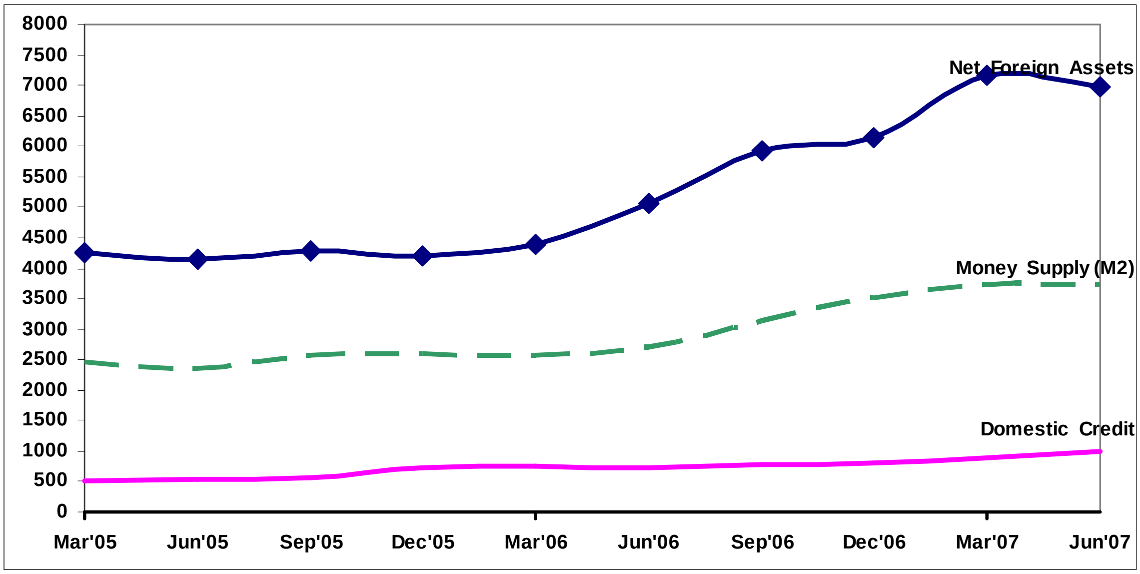


Table 9: **Determinants of Money Supply**

(Million Maloti: Changes)

Determinants	2006			2007	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Net foreign assets	698.2	858.8	215.2	1009.6	-194.1
Domestic credit	-270.4	-58.6	-56.3	-715.5	-31.8
Net Claims on Govt	-256.8	-112.2	-102.6	-776.5	-145.2
Statutory bodies	-11.4	-2.5	2.0	0.2	16.7
Private sector	-2.3	56.2	37.0	58.1	95.5
Other items, net	290.7	382.7	-225.4	75.3	-227.3
Money Supply (M2)	137.0	417.5	384.3	219.0	1.5

Components of Money Supply

Broad money is equivalent to the sum of narrow money (M1) and quasi money. Narrow money (M1) saw a decline of 2.0 per cent in the quarter ended June, in contrast with a rise of 5.6 per cent registered at the end of March. The fall was mainly attributable to a decrease of 3.6 per cent in demand and call deposits which overshadowed a rise of 9.7 per cent in currency in circulation. Nevertheless, quasi money increased by 6.5 per cent during the same period following an increase of 8.5 per cent observed at the end of the previous quarter largely as a result of 12.2 and 0.1 per cent growth in time and savings deposits, respectively. During the review quarter the inverse changes in narrow and quasi-money netted out each other leaving M2 unchanged.

Table 10: Money Supply

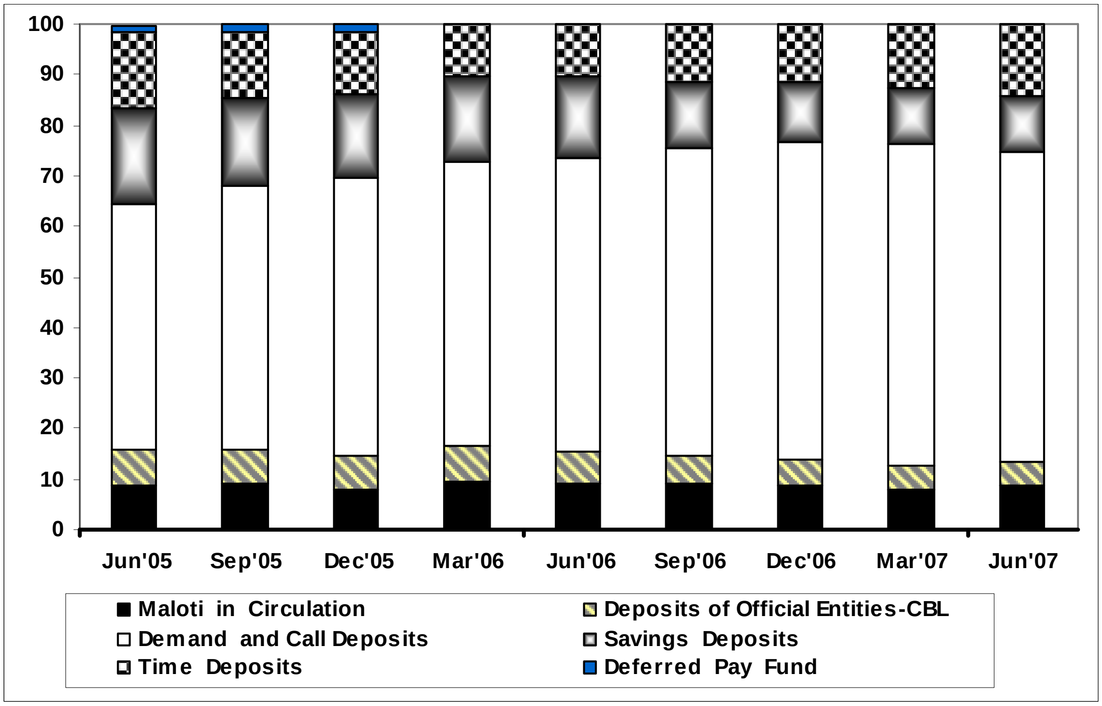
(Million Maloti; End of Period)

	2006			2007	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Money Supply (M2)	2704.0	3121.5	3505.8	3724.7	3726.2
Money (M1)	1987.6	2348.6	2686.7	2836.2	2779.7
Maloti with public	242.6	283.1	309.4	293.1	321.5
Demand deposits[1]	1568.3	1888.1	2199.0	2365.8	2281.2
Deposits of official Entities with CBL	176.7	177.4	178.3	177.4	176.9
Quasi-Money	716.4	772.8	819.1	888.5	946.6
Savings deposits	438.0	409.5	415.2	415.5	415.9
Time deposits	278.5	363.4	403.9	473.0	530.7

[1] includes call deposits
NB: Totals may not tally due to rounding off

Figure 10: Components of Money Supply

(Percentage shares)



Commercial Banks' Deposits by Holder

The deposits of the private sector constituted the largest share of commercial banks' total deposits holding. The total amount of deposits declined by a small 0.8 per cent, at the end of June, contrasted with 7.8 per cent registered at the end of March. The decrease was at the back of a 1.9 per cent decline in private sector deposits which offset an increase of 4.4 per cent in deposits held by statutory bodies (see Table 14).

Table 11: Commercial Banks' Deposits by Holder

(Million Maloti: End of Period)

	2006			2007	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Total Deposits	2271.5	2649.4	3006.3	3242.1	3216.7
Private Sector	1660.8	2140.6	2426.9	2679.4	2629.3
Demand deposits	1033.2	1469.5	1712.3	1901.5	1812.3
Savings deposits	437.9	409.5	415.2	415.5	415.8
Time deposits	189.6	261.7	299.6	362.5	401.3
Statutory Bodies	610.7	508.8	579.4	562.6	587.4

NB: Totals may not tally due to rounding off

Liquidity of Commercial Banks

The liquidity of commercial banks is measured by the ratio of their cash and near cash assets, including investments with maturities of less than twelve months, to deposit liabilities. The liquidity level remained high as the ratio rose further to 74.1 per cent in June from 73.1 per cent during the quarter ending March in response to increased holdings of SA short-term instruments by commercial banks (see Table 12).

Table 12: Components of Commercial Banks' Liquidity

(Million Maloti: End of Period)

COMPONENT	2006			2007	
	Jun	Sep	Dec	Mar	Jun
Maloti Notes and Coins	69.6	43.3	68.3	36.2	29.1
Rand Notes and Coins	12.5	34.2	59.3	23.0	19.3
Balances due from Lesotho Banks	713.6	15.7	420.3	467.0	418.3
Balances due from Foreign Banks	1200.9	1382.5	1542.3	1728.2	1769.3
Clearing Balances with CBL	29.7	15.9	2.8	10.5	112.6
RSA Short-term Securities	0.0	0.0	0.0	0.0	0.0
CBL Bills	0.0	0.0	0.0	0.0	0.0
Lesotho Government Securities	328.6	409.6	520.5	511.5	520.8

The credit to deposit ratio increased from 26.3 per cent observed in March to 30.0 per cent in the quarter ended June. The increase reflected a steady growth in credit extended during the review period coupled with a decline in commercial banks' deposits. Although the steady increase in credit extension is a positive development, the decline in deposits, should it persist, may be an indicator of financial disintermediation in the country.

Table 13: Consolidated Balance Sheet of Commercial Banks

(Million Maloti: End of Period)

	2006			2007	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Net foreign assets	1375.2	1614.6	1772.4	1832.4	1731.5
Deposits with CBL	125.5	101.5	112.9	131.8	235.0
Credit:	1115.4	1242.8	1393.2	1442.1	1563.7
o/w*: Statutory Bodies	17.9	15.4	17.4	17.6	34.3
Private Sector	693.0	740.1	777.6	835.3	930.8
Government:	404.5	487.4	598.3	589.3	598.6
o/w: Securities	404.3	487.4	598.3	589.3	598.6
Loans and Advances	0.2	0.0	0.0	0.0	0.0
Assets/Liabilities	2616.0	2958.9	3278.8	3406.4	3530.1
Private sector deposits[2]	2271.5	2649.4	3006.3	3242.1	3216.7
Government deposits	171.7	110.6	123.1	113.5	111.2
Capital, reserves & other, net	172.8	199.0	149.5	50.8	202.2

* of which

[2] includes statutory bodies' deposits.

Demand for Money

Domestic Credit

Domestic credit sustained a steady upward trend on a quarterly basis, registering an increase of 12.8 per cent at the end of June, compared with 7.1 per cent recorded at the end of the March quarter. The increase was largely attributable to the growth in credit extended to both the private sector and statutory bodies. Furthermore, domestic credit increased by 35.1 per cent on an annual basis during the review quarter compared with 17.1 per cent registered at the end of March.

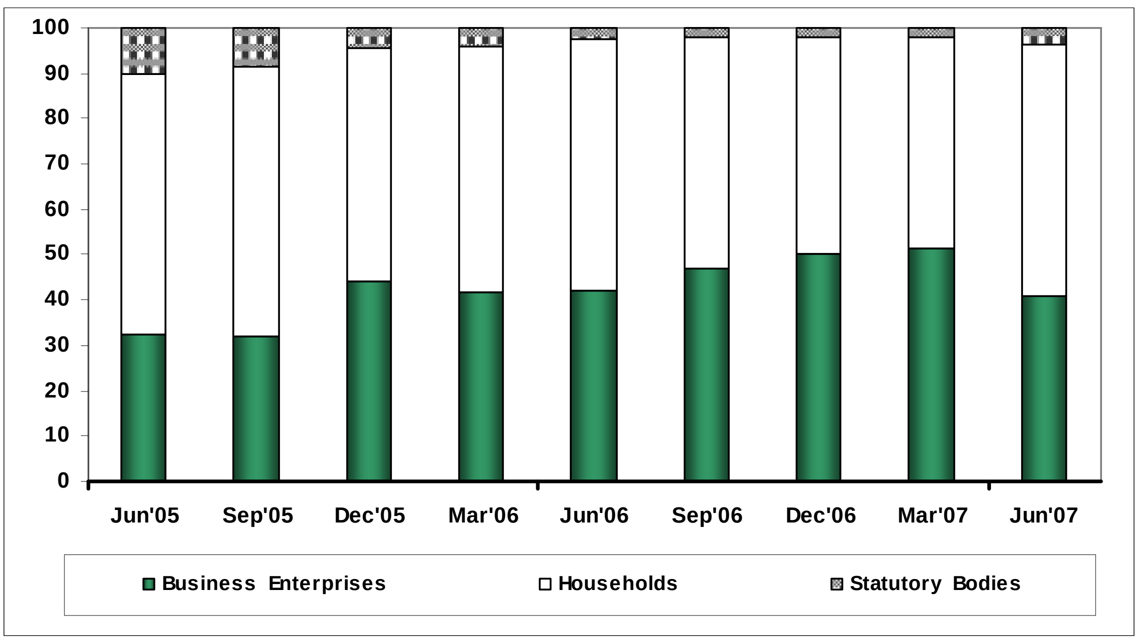
Table 14: Domestic Credit Excluding Net Claims on Government

(Million Maloti: End of Period)

	2006			2007	
	Jun	Sep	Dec	Mar	Jun
Domestic Credit	731.1	777.1	817.9	875.9	988.3
Credit to private sector	713.2	761.7	800.5	858.3	954.0
Business enterprises	307.8	365.8	409.9	452.0	473.2
Households	405.4	395.9	390.6	406.3	480.9
Credit to statutory bodies	17.9	15.4	17.4	17.6	34.3

Figure 11: Distribution of Credit by Holder

(Percentage shares)



Credit to Private Sector

Finance is an important ingredient in the private sector-led growth strategy. Credit to the private sector continued to have a dominant share of total credit extended in the economy. It increased by 11.1 per cent during the quarter under review due to a rise in both credit granted to households and business enterprises which increased by 18.3 per cent and 4.6 per cent, respectively. This indicated that the private sector continued to drive economic activity during the quarter ending June.

On an annual basis, credit to the private sector remained robust growing by 35.2 per cent at the end of June compared with 17.3 per cent registered at the end of March. This strong growth was largely due to credit granted to business enterprises which realised a 53.7 per cent growth at the end of June compared with 45.7 per cent observed at the end of the previous quarter.

Total private sector credit comprised credit extended to business enterprises and households. The share of the former diminished from 51.2 per cent of total private sector credit to 47.9 per cent registered at the end of June. However, the share of credit extended to households increased from 46.4 per cent at the end of March to 48.7 per cent recorded at the end of June. The steady growth in credit to the private sector is in line with the Government's private sector-led growth strategy. Nonetheless, an ideal situation would be that a greater share of total private credit should be extended to business enterprises because of their role in investment.

Credit to Statutory Bodies

Credit extended to statutory bodies increased by 94.7 per cent in June, compared with 1.3 per cent recorded in March. In addition, credit to this sub-sector increased by 91.4 per cent on an annual basis at the end of the quarter ending June, *vis-à-vis* a decline of 40.0 per cent observed at the end of March. As Figure 8 shows, the share of credit to this sub-sector to total credit, recovered slightly in June.

Sectoral Distribution of Credit to Business Enterprises and Statutory Bodies

Total credit distributed to all business sub-sectors of the economy, including official entities, but excluding non-performing loans, increased by 7.0 per cent in June compared with 10.0 per cent recorded in March. Credit granted to mining, other development sectors, and construction sub sectors mainly accounted for the increase in total credit during the quarter ending June.

As an indication of increased economic activity in construction and mining sub sectors, the amount of credit extended to them rose further by 7.9 and 14.0 per cent at the end of the review quarter, respectively. Furthermore, credit allocated to other development sectors which comprise wholesale, agriculture, storage, electricity, transport and communication increased by 5.4 per cent during the same period compared with 6.5 per cent recorded during the previous quarter.

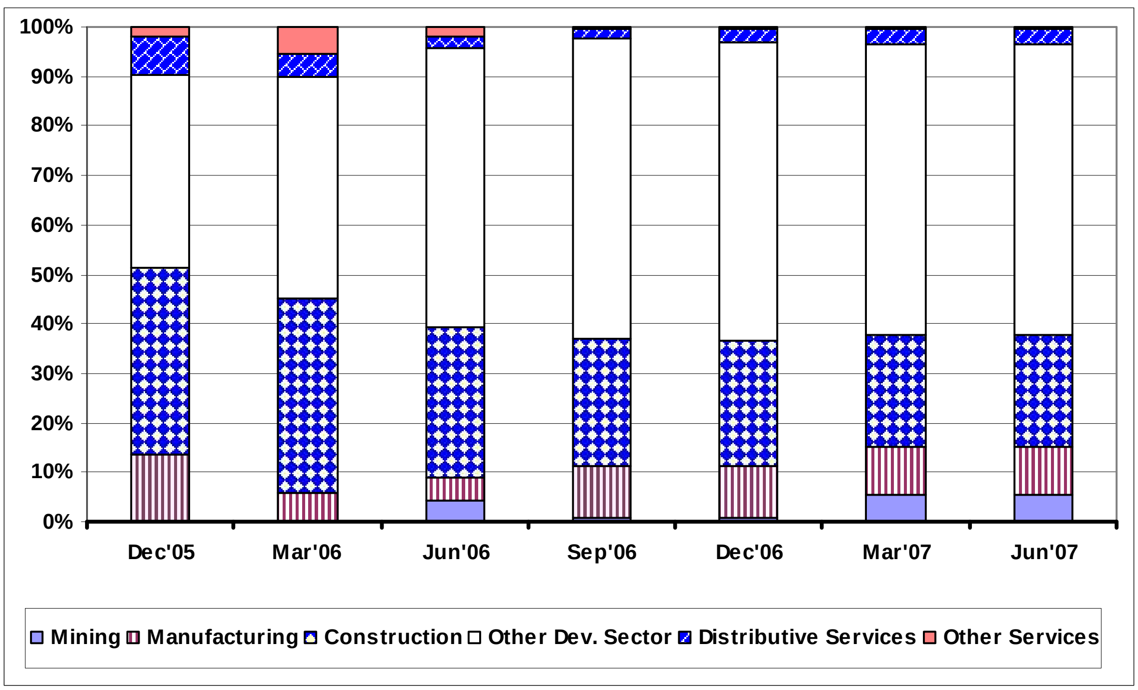
Table 15: Sectoral Distribution of Credit to Enterprises

(Million Maloti: End of period)

SECTOR	2006			2007	
	Jun	Sep	Dec	Mar	Jun
Mining	13.5	3.0	2.8	26.5	28.6
Manufacturing	15.6	44.0	45.7	44.3	44.0
Construction	99.1	97.8	107.9	112.5	128.3
Other development sectors	184.2	241.5	257.1	273.7	288.6
Distributive services	6.7	12.0	12.3	11.3	11.9
Other services	6.6	0.9	1.1	1.5	1.4
All sectors	325.8	399.3	426.9	469.8	502.9

Figure 12: Commercial Banks' Credit to Business Enterprises

(Percentage shares)



Net Claims on Government

Net claims on Government by the banking system declined further by 6.4 per cent in June compared with 51.8 per cent observed at the end of the previous quarter. This reflected a good fiscal position facilitated by a build-up in government deposits.

Table 16: Banking System's Net Claims on Government

(Million Maloti: End of Period)

Holder	2006			2007	
	Jun	Sep	Dec	Mar	Jun
Commercial banks	232.7	376.8	475.2	475.7	487.4
Claims on Government	404.5	487.4	598.3	589.3	598.6
o/w MP T Bills[3]	334.5	417.6	529.3	586.2	508.6
Less Government deposits	171.7	110.6	123.1	113.5	111.2
CBL	-1516.7	-1773.0	-1973.9	-2751.0	-2907.8
Claims on Government[4]	257.0	282.1	257.6	268.8	261.5
Less Government deposits	1773.7	2055.0	2231.5	3019.8	3169.3
o/w blocked account	529.2	529.1	565.1	573.9	587.9
Total Net Claims	-1284.0	-1396.2	-1498.8	-2275.3	-2420.4

[3] 'MP T Bills' means monetary policy treasury bills
[4] IMF loans on-lent to the GOL

Net Foreign Assets

At the end of June, the net foreign assets of the banking system plummeted by 2.7 per cent contrasted with 16.4 per cent recorded in March. The decline to a large extent reflected a fall in the net foreign assets of both CBL and commercial banks. Commercial banks' net foreign assets decreased by 5.5 per cent reflecting smaller foreign currency earnings by the private sector during the quarter. Moreover, the Central Bank's net foreign assets decreased as a result of repayments of government foreign debt made during the quarter under review.

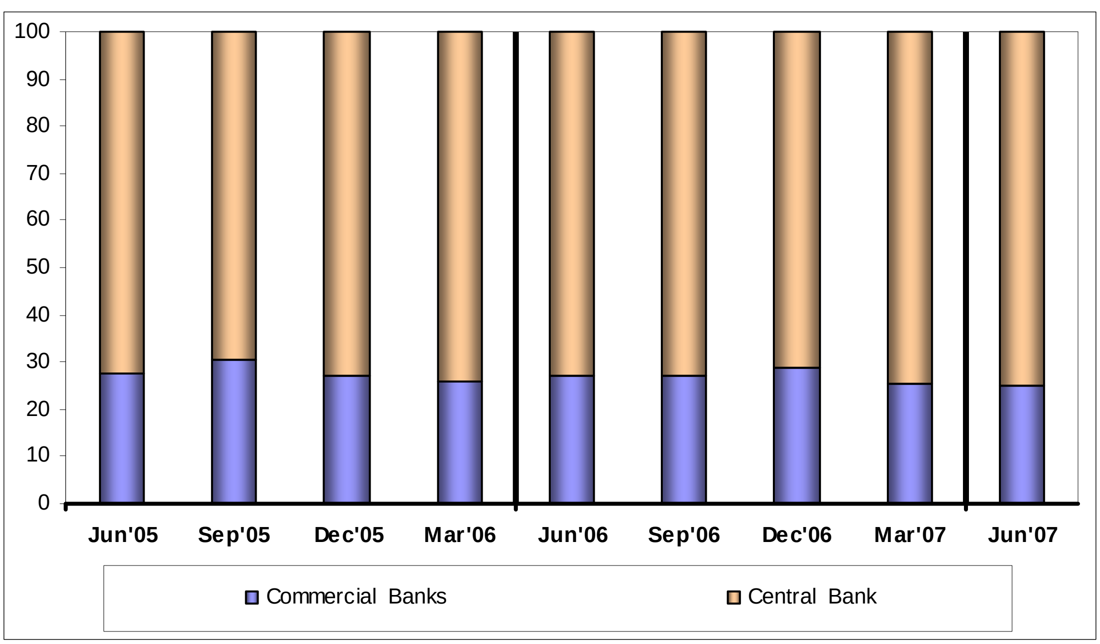
Table 17: Banking System's Foreign Assets and Liabilities

(Million Maloti: End of Period)

Holder	2006			2007	
	Jun	Sep	Dec	Mar	Jun
A. Commercial Banks	1375.2	1614.6	1772.4	1832.4	1731.5
Foreign Assets	1500.5	1683.1	1845.4	1969.7	1858.2
Foreign Liabilities	-125.4	-68.6	-72.9	-137.2	-126.7
B. Central Bank of Lesotho	3700.5	4319.9	4377.2	5326.8	5233.7
Foreign Assets	4244.4	4885.9	4918.7	5942.6	5799.2
Foreign Liabilities	-543.9	-566.0	-541.5	-615.8	-565.5
Net Total	5075.7	5934.4	6149.7	7159.3	6965.2

Figure 13: Net Foreign Assets

(Percentage shares)



Money Market Developments

Overview

In line with its dual objective of monetary policy implementation and financial deepening in Lesotho, the CBL conducted four treasury bill auctions. They composed of three 91-day and one 182-day treasury bill auctions. The total stock of securities for the quarter was valued at M601.0 million which represented an increase from a total holding of M586.9 million reported for the quarter ending March.

Participants during the various auctions were made up of commercial banks, Non-Bank Financial Institutions (NBFI's), and other institutions. The holding of securities by the NBFIs remained insignificant during the review quarter. However, the banking sector continued to play a dominant role in the market boasting a holding of 84.6 per cent of the total holding. This marked a slight increase from 84.3 per cent recorded in the previous quarter. Further, the share of the general public in total securities holding declined from 15.4 per cent in March to 15.3 per cent in June.

Table 18: Holding of Bills

(Face Value; Million Maloti)

Type of Holder	2006			2007	
	Jun	Sep	Dec	Mar	Jun
Total	545.8	544.7	576.4	586.9	601.0
Banking System	339.6	423.2	498.0	495.0	508.9
Central Bank	5.1	4.9	0.0	0.4	0.3
Commercial Banks	334.5	418.3	498.0	494.6	508.6
Non-Bank Sector	206.2	121.5	78.4	90.9	92.2
NBFIs	155.3	66.0	0.5	0.4	0.5
Others	50.9	55.5	77.9	90.5	91.7
Memorandum Item					
Average Yield (percent)	7.04	7.16	7.05	7.82	7.79

Money Market and Short-term Interest Rates

Although the Lesotho 91-day treasury bill rate remained below the SA counterpart rate at the end of June, it exceeded its March value by 10 basis points registering 7.56 per cent. The SA counterpart rate rose by 27 basis points in June to 8.68 per cent. As a result, the margin between the two rates widened from 88 basis points observed in March to 112 basis points at the end of June.

The deposit rates also followed the upward trend in line with similar rates in the region. The one year deposit rate rose by 100 basis points at the end of June from 5.00 per cent recorded at the end of the quarter. However, real interest rates on a one year deposit were 160 basis points below the inflation rate reported during the review quarter. This implied that the return on deposits was not adequate to cushion depositors from loss of purchasing power. In addition, the prime lending rate increased from 13.58 per cent reported in March to 14.08 per cent in June. Hence, the spread between the domestic lending rates and the deposits rates widened from 7.58 percentage points in March to 8.08 percentage points at the end of June.

Table 19: Major Money Market Interest Rates

(Percent: End of Period)

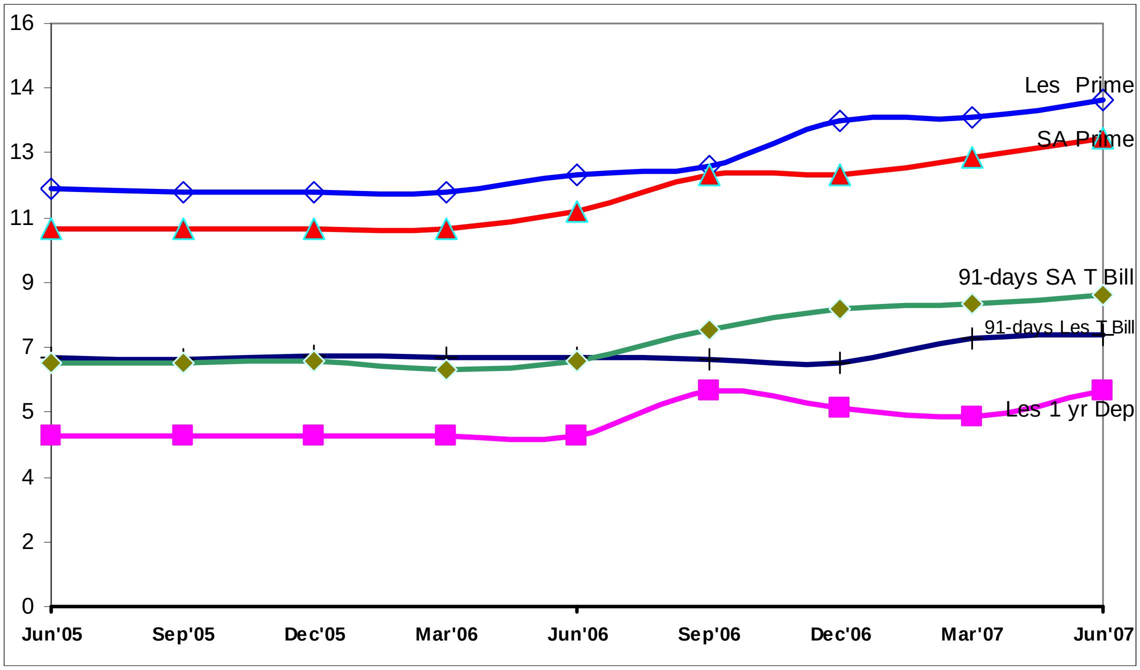
Interest Rates by Type	**2006**			**2007**	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Central Bank					
T Bill Rate – 91 Days	6.90	6.86	6.76	7.46	7.56
Lombard Rate	10.40	10.36	10.26	11.46	11.56
Commercial Banks[5]					
Call	3.50	3.13	3.83	3.83	3.95
Time:					
31 days	3.50	3.50	3.50	3.50	3.90
88 days	4.25	5.50	5.00	4.50	4.52
6 months	4.50	5.80	6.25	4.58	4.77
1 year	4.75	6.00	5.50	5.00	6.00
Savings	2.00	2.96	5.00	2.68	3.21
Prime	12.00	12.33	13.50	13.58	14.08
South Africa*					
Repo	7.00	8.00	9.00	9.00	9.50
T Bill Rate – 91 Days	6.83	8.00	8.26	8.41	8.68
Marginal Lending Rate	12.50	13.00	12.00	14.00	14.50
Prime	11.00	11.50	12.50	12.50	13.00

* Figures for South Africa were obtained from the SARB

[5] Average rates by commercial banks

Figure 14: Short-Term Interest Rates

(Percent Per Annum)



V. Government Finance

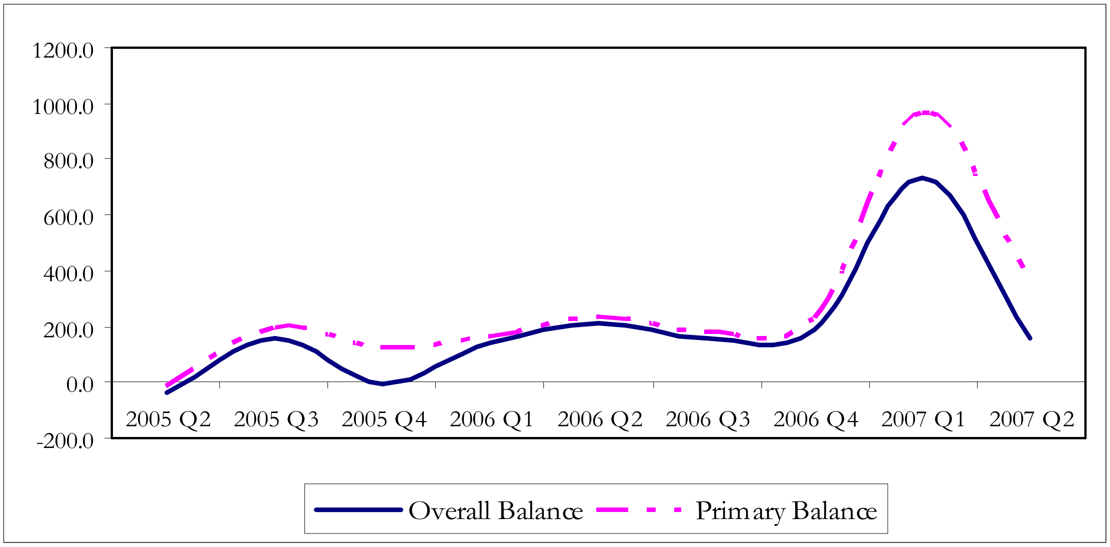
Summary of Budget Outturn

It is estimated that government budgetary operations resulted in a surplus equivalent to 5.1 per cent of GDP during the period under review. This was mainly influenced by, among others, improvement in collection of non-customs revenue. The primary balance accounted for 12.1 per cent of GDP[2].

Government expenditure and net lending increased by 8.0 per cent during the period under review. This was mainly attributed to the overall increase in Government employment, a 10.0 per cent salary adjustment effected in April, and an increase in transfers and subsidies. As a share of total expenditure, recurrent expenditure stood at 87.2 per cent against 86.9 per cent in the previous quarter.

[2] Primary balance is a good indicator of budgetary operation since it excludes interest costs on public debt.

Figure 15: Primary balance versus overall balance



Revenue

Government revenue including grants dropped by 20.1 per cent at the end of the period under review. This was mainly attributed to normalisation of SACU revenue following the backward adjustment made in the previous quarter. As a percentage of GDP, total revenue and grants stood at 60.1 per cent down from 84.8 per cent observed in the previous quarter.

Table 20: Government Revenue

(Million Maloti)

	2006/07				2007/08
	Apr-Jun	**Jul-Sept**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun** * Preliminary
Total Revenue and Grants	1371.4	1401.3	1391.2	2269.5	1813.2
Total Revenue	1344.3	1373.2	1360.5	2261.6	1793.8
Tax Revenue	1209.9	1230.8	1244.0	2099.4	1598.3
Customs	772.3	772.3	772.3	1626.3	959.1
Non-customs	437.6	458.5	471.7	473.2	639.2
Income Taxes	234.0	251.6	254.4	233.1	407.3
Taxes on goods & services	194.6	188.2	188.8	178.2	197.5
Other Taxes	9.0	18.8	20.5	40.7	5.1
Non-Tax Revenue	134.3	142.4	116.5	162.2	195.5
Of which: Water royalties	58.1	70.9	69.7	63.6	63.6
Grants	27.1	28.1	30.8	7.9	19.4

Source: Ministry of Finance and Development Planning (MoFDP)

*Preliminary estimates

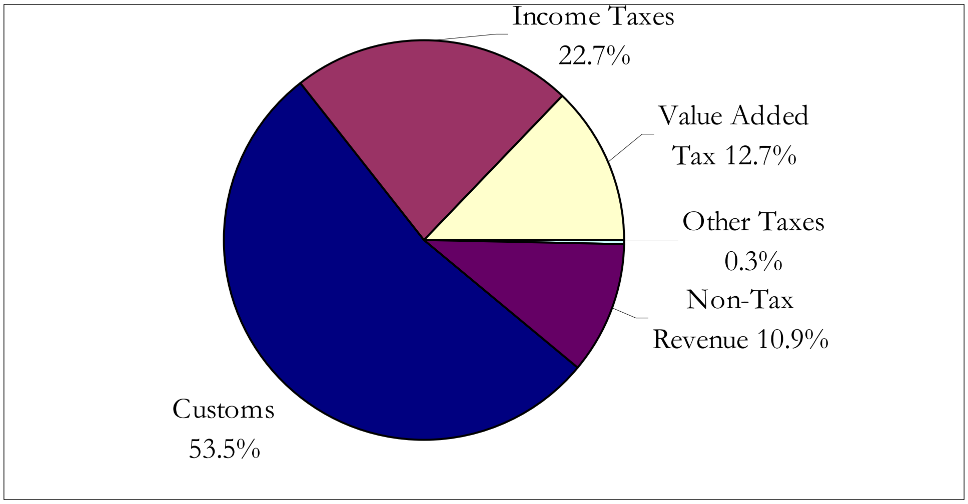
Value Added Tax (VAT) grew by 13.9 per cent against a decrease of 5.7 per cent observed at the end of the first quarter, reflecting increased economic activity Income tax rose by 74.7 per cent, largely driven by a 77.5 per cent increase in personal income tax, and a more than two fold growth in company tax. The rise in personal income tax was mainly on account of the overall increase in compensation of employees following salary adjustments effected at the beginning of the quarter. As for company tax, the reporting period coincided with end of financial year reporting and submission of tax returns by the sole traders. The other income tax components grew by a sluggish 1.6 per cent. [4]

As a result of the above discussion, SACU receipts fell by 41.0 per cent during the period under review. However, it continued to dominate tax revenue, constituting 60.0 per cent of total tax receipts during the review period, while income tax and VAT accounted for 25.5 per cent and 14.2 per cent, respectively.

Non-tax revenue increased by 20.6 per cent during the period under review, largely attributed to receipt of dividends. In contrast to the sluggish performance in the previous quarter, grants increased by more than two fold.

[4] Other Income tax component comprises withholding and fringe benefits taxes.

Figure 16: Sources of Government Revenue



Expenditure

Total expenditure and net lending was estimated to have increased by 8.0 per cent during the review period, largely driven by 9.4 per cent rise in recurrent expenditure. As a percentage of GDP, total expenditure dropped to 55.0 per cent, against 57.4 per cent in the previous quarter.

The rise in recurrent expenditure was mainly attributed to, among others, a 16.1 per cent increase in personal emoluments following the 10.0 per cent salary adjustment effected in April, plus the overall increase in civil service employment. Furthermore, expenditure on goods and services increased by 6.5 per cent as a result of the rise in size of the civil service.

In contrast to the previous period, the level of subsidies and transfers extended during the review period rose by 20.8 per cent, mainly due to transfers made to extra-budgetary institutions. This expenditure category is directed to, among others, educational entities, health establishments and finances of pensions and gratuities. Expenditure on pensions and gratuities grew by 5.0 per cent.

Table 21: Government Expenditure

(Million Maloti)

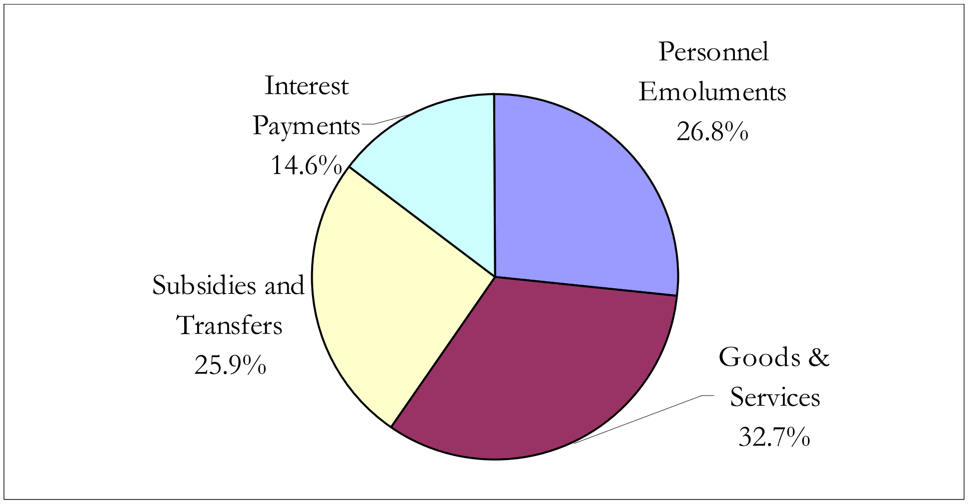
	2006/07				2007/08
	Apr-Jun	**Jul-Sept**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun** Preliminary
Total Expenditure & Net Lending	1159.4	1242.8	1200.7	1536.4	1659.3
Recurrent Expenditure	1000.1	1006.5	1034.5	1324.8	1447.6
Personnel Emoluments	340.6	341.9	342.9	334.1	387.7
Interest Payments	26.6	25.7	36.1	234.4	211.9
Foreign	16.3	13.0	24.2	221.1	199.1
Domestic	10.3	12.7	11.9	13.3	12.8
Other Expenditure	632.9	638.9	655.5	756.4	848.0
Capital Expenditure	159.3	238.8	166.2	205.4	212.9
Net Lending	0.0	-2.5	0.0	-2.0	-1.1

Source: MoFDP

*Preliminary estimates

The pace of implementation of development projects slightly deteriorated by 1.5 per cent during the period under review, after showing some improvement in the preceding quarter. This was largely on account of ongoing construction of health sector related infrastructure that is nearing completion. Government continued to be a dominant financier of development projects, with about 65.2 per cent, while loans and grants accounted for 24.8 per cent and 10.0 per cent, respectively.

Figure 17: Recurrent Expenditure by Type



Financing

Government budgetary operations resulted in a surplus equivalent to 5.1 per cent of GDP during the review period relative to the preceding period. This enabled Government to continue to accumulate deposits with the banking sector and be a net repayer of external debt. The healthy Government position with the banking system could mitigate the negative impact of the anticipated decline in SACU revenue.

Table 22: Government Financing

(Million Maloti)

	2006/07				**2007/08**
	Apr-Jun	**Jul-Sept**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun** * Preliminary
Financing	-212.0	-158.5	-190.5	-733.1	-153.9
Foreign	-55.1	38.0	-44.4	32.7	-9.7
Loan drawings	27.8	79.5	20.8	78.3	48.2
Amortization	-82.9	-41.5	-65.2	-45.6	-57.8
Domestic	-156.9	-196.5	-146.1	-765.8	-144.3
Bank Financing	-256.8	-112.2	-102.6	-776.5	-145.2
Non – Bank	99.8	-84.3	-43.5	10.7	0.9

Source: MoFDP

*Preliminary Estimates

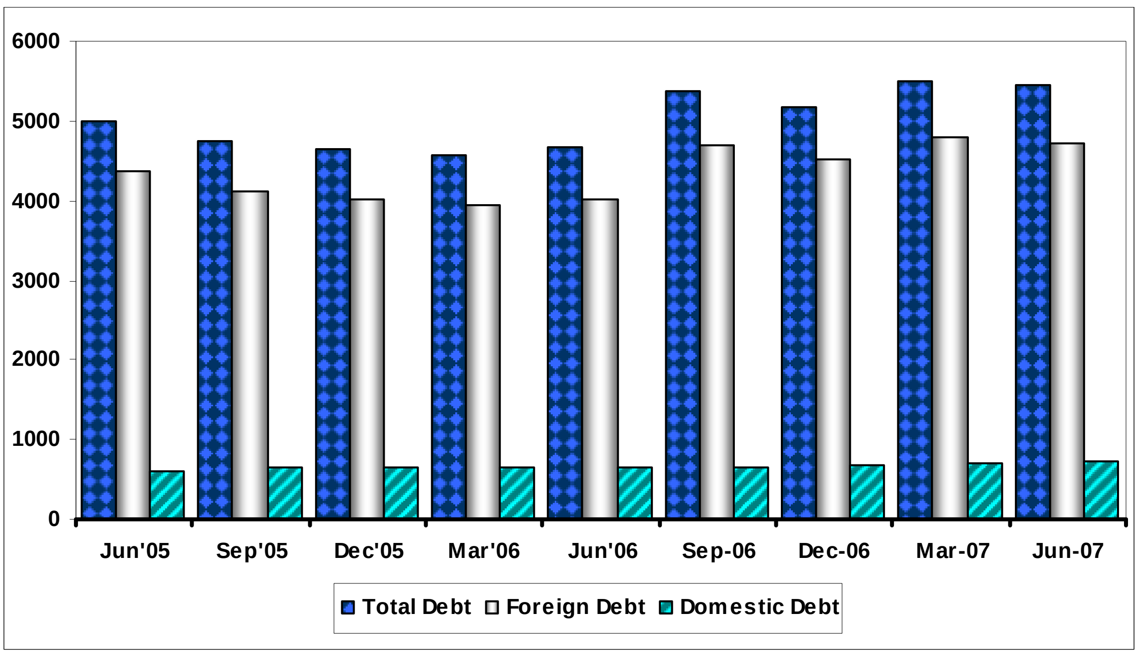
Public Debt

Overview

Public debt fell by 1.0 per cent during the period under review, mainly on account of the appreciation of Loti against the currencies (US Dollar and SDR) with which debt is denominated. As a ratio of GDP, the total debt stock was estimated to have declined to 45.6 per cent in contrast to 51.6 per cent observed in the previous quarter. External debt accounts for the larger share of total debt stock.

Figure 18: Outstanding Public Debt

(Million Maloti: End of Period)



External debt

As a result of the appreciation of the Loti against the currencies with which debt is contracted, external debt decreased by 1.5 per cent. Correspondingly, a 9.8 per cent rise in concessional debt (due to disbursement) was curbed by a 68.1 per cent reduction in non-concessional debt. As a share of total debt stock, external debt slightly fell to 86.8 per cent in contrast to 87.2 per cent in the previous quarter. The degree of concessionality of external debt stock rose to a higher 94.1 per cent of total debt stock. This reflected Government's commitment to limit borrowing to concessional terms in order to moderate the country's future debt burden.

As a ratio of GDP, external debt eased to 39.6 per cent, against 45.0 per cent in the previous period. At this level, the debt to GDP ratio was below the 60 per cent sustainability threshold and the SADC convergence indicator. Debt service increased to 2.7 per cent, in contrast to 2.1 per cent observed in the previous period.

Table 23: External Debt

(Million Maloti)

	2006			2007	
	QII	QIII	QIV	QI	QII
External Debt	4013.9	4699.9	4514.3	4794.3	4725.0
Bilateral Loans	383.2	385.4	386.9	349.5	346.6
Concessional	381.5	322.3	327.1	292.3	299.7
Non-concessional	1.7	63.0	59.9	57.2	46.9
Multilateral Loans	3443.8	4129.2	3968.4	4282.7	4230.8
Concessional	2992.4	3612.8	3480.7	3756.8	4119.2
Non-concessional	451.4	516.3	487.7	525.9	111.6
Financial Institutions	113.1	113.6	101.1	98.7	87.6
Concessional	2.4	2.4	2.3	2.1	29.4
Non-concessional	110.7	111.1	98.8	96.6	58.2
Suppliers' Credit	73.8	71.8	57.8	63.4	60.0

Domestic Debt

Domestic debt increased by 2.1 per cent during the period under review, following an increase of a 5.3 per cent recorded in the previous quarter. This was a result of 2.3 per cent and 1.2 per cent rise in the holdings of domestic debt by both the banking and non-banking sector, respectively. Short-term debt represents treasury bills issued for monetary policy purposes. Long-term debt, which is made up of the ten year bond, maintained the level of the previous quarter[5]. As a percentage of GDP, domestic debt stood at 6.0 per cent during the period under review. It grew from 12.8 per cent of debt stock observed in the previous period, to 13.2 per cent.

VI. Foreign Trade and Payments

Overview

The external sector position depicted a downward trend during the quarter under review. In seasonally adjusted terms, the overall balance registered a deficit of M144.9 million in the

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

review period in contrast with a surplus of M1.0 billion recorded in the previous quarter. The deterioration was largely due to the appreciation of the Loti against the US Dollar where some portion of Lesotho's foreign reserves is held. The transactions balance, which represents the overall balance excluding the effects of currency fluctuations, in seasonally adjusted terms, registered a surplus equivalent to M17.6 million compared to M956.4 million observed in the previous quarter. This was driven largely by the decline in the current account on the back of the SACU revenue.

Current account

The current account declined from a revised surplus of M697.2 million recorded in the previous quarter to a surplus of M1.7 million in the review period. Deterioration in the current account position was mainly on account of a decline in current transfers due to SACU non-duty receipts. SACU revenue declined as a result of normalisation after the windfall registered in the previous quarter.

Table 24: Current Account Balance

(Million Maloti)

	2006			2007	
	QII	**QIII**	**QIV**	**QI***	**QII+**
I. Current Account	256.41	151.78	18.50	697.20	1.68
(a) Goods	-976.11	-1139.80	-1309.84	-1397.28	-1360.30
Merchandise exports f.o.b.	1049.43	1517.91	1293.24	1305.93	1244.83
Of which diamonds	141.18	263.90	136.49	277.62	178.54
Of which textiles & clothing	721.50	968.59	983.66	826.05	797.02
Other exports#	186.75	285.42	173.09	202.26	269.27
Merchandise imports f.o.b.	-2025.54	-2657.71	-2603.08	-2703.21	-2605.13
(b) Services	-56.56	-55.10	-75.41	-91.34	-77.96
(c) Income	613.01	666.94	706.56	550.43	586.15
(d) Current Transfers	676.06	679.74	697.19	1635.39	853.79

* Revised estimates
+ Preliminary estimates
# All other merchandise exports excluding 'textiles and clothing' and 'diamonds'

Merchandise exports

Merchandise exports, in seasonally adjusted terms fell by 3.8 per cent in the second quarter in contrast with a rise of 5.9 per cent registered in the first quarter. On an annual basis, merchandise exports increased by 18.6 per cent. A decline on quarterly basis was attributable to among others, a fall in diamond and manufactured exports. Appreciation of the local currency against US Dollar negatively affected performance of manufactured exports.

Merchandise imports

Preliminary estimates showed that merchandise imports in seasonally adjusted terms, fell by 0.2 per cent compared with a fall of 0.4 per cent observed in the previous quarter. This was consistent with a slowdown in manufacturing production during the same period. Merchandise imports, on an annual basis however increased by 28.6 per cent reflecting the general upward trend in manufacturing.

Table 25: Value of Exports by Section of the S.I.T.C#

(Million Maloti)

COMMODITY	2006			2007	
	QII	QIII	QIV	QI*	QII+
0. Food & Live Animals	24.53	31.82	29.31	57.54	60.69
Cattle	0.13	0.25	0.55	0.27	0.45
Wheat Flour	13.18	15.57	13.12	15.92	23.60
Maize Meal	5.69	7.07	6.52	15.09	6.52
Other	5.53	8.93	9.12	26.26	30.57
1. Beverages & Tobacco	34.99	39.62	31.97	30.29	40.98
Beverages	34.99	39.62	31.97	30.29	40.98
2. Crude Materials	0.99	2.55	5.87	7.17	1.98
Textiles fibres	0.99	2.55	5.87	7.17	1.98
Of which Wool	0.45	0.75	5.17	7.07	1.19
Of which Mohair	0.54	1.79	0.70	0.09	0.80
3. Mineral Fuels & Related Products	0.88	3.01	0.95	0.32	0.84
4. Chemicals	14.26	2.68	3.66	0.67	0.60
5. Manufactured Goods	161.63	321.45	245.75	297.81	209.03
Of which diamond	141.18	263.90	136.49	277.62	178.54
Of which textiles yarn and fabric	13.79	48.49	30.38	13.57	22.09
Other manufacture goods	6.66	9.06	78.88	6.62	8.4
6. Machinery & Transport Goods	79.05	143.80	152.52	82.70	112.69
7. Miscellaneous Manufactured Goods	730.25	969.78	990.78	826.82	815.55
Of which clothing accessories	706.72	917.55	947.40	805.31	772.94
Other	23.53	52.23	43.38	21.51	42.61
8. Unclassified Goods	2.85	1.41	2.20	2.93	2.47
TOTAL EXPORTS	1049.43	1517.91	1293.24	1305.93	1244.83

Note: Totals may not tally due to rounding
* Revised estimates
+ Preliminary estimates
# Standard International Trade Classification

Direction of Trade

During the quarter under review, the US remained the largest recipient of Lesotho's exports. Its share however declined to 51.6 per cent compared with 55.5 per cent recorded in the previous quarter. Africa, particularly the SACU region continued to be the second largest destination of Lesotho's exports at a share of 22.8 per cent in the review quarter compared with 33.2 per cent observed in the previous quarter. Lesotho's exports to the European market remained the third largest with 14.7 percentage share during the review period compared with 21.5 per cent registered in the previous quarter, as a result of a fall in the diamond exports. The proportion of exports to Asia increased to 0.6 per cent during the same period compared with 0.2 per cent observed in the previous quarter.

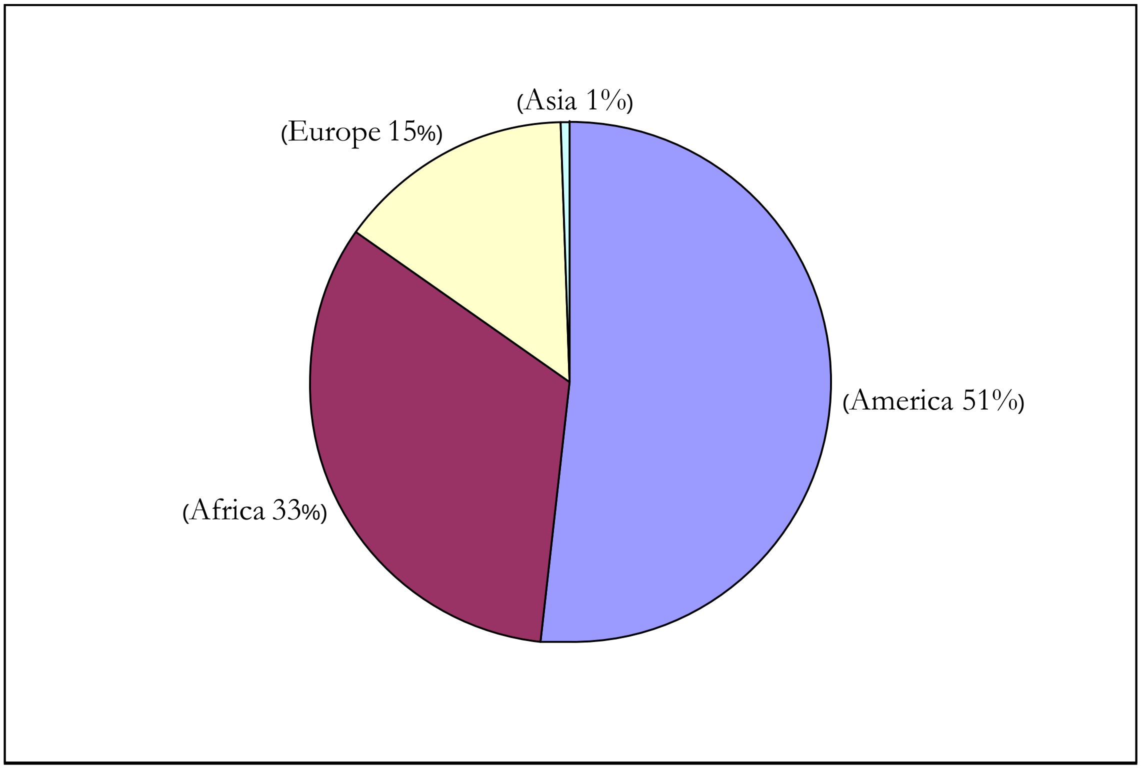
Table 26: Direction of Trade - Exports and Re-Exports, f.o.b.

(Million Maloti)

REGION	2006			2007	
	QII	QIII	QIV	QI*	QII+
World	1049.43	1517.91	1293.24	1305.93	1244.83
Africa	210.17	410.64	384.74	297.30	413.22
SACU	184.13	375.55	359.87	272.33	363.02
SADC	1.74	0.60	3.39	2.50	1.99
Other	24.3	34.49	21.48	22.47	48.21
Europe	142.78	266.73	141.01	280.68	182.34
EC	142.78	266.73	141.01	280.68	182.34
America	693.19	839.50	766.19	725.14	642.38
Asia	3.29	1.04	4.30	2.81	6.89

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

Figure 19: Direction of Merchandise Exports



Services Account

Net services registered an outflow of M77.9 million during the review quarter compared with an outflow of M91.3 million registered in the previous quarter. The improvement in the services account was mainly attributed to lower payments in the transportation and travel categories.

Travel

Net travel grew by 70.3 per cent compared with a revised 15.9 per cent fall registered in the previous quarter. On an annual basis net services grew by 33.3 per cent. Travel receipts increased by 7.0 per cent compared with a decline of 1.2 per cent recorded in the previous quarter, as a result of a rise in tourism-related inflows. Travel payments fell by 14.3 per cent during the quarter under review compared with a revised 4.9 per cent in the previous quarter, mainly due to a decline in government international subsistence allowance.

Income

Net income increased to M586.2 million during the review period from M550.4 million recorded in the previous quarter. A rise was largely attributable to investment income.

Labour Income

In seasonally adjusted terms, labour income fell by 1.3 per cent in the review period compared with a fall of 1.7 per cent registered in the previous quarter. On an annual basis, labour income grew by 19.9 per cent. In nominal terms, labour income improved on account of miners' remittances which rose by 1.6 per cent during the period. The rise in miners' remittances was due to an increase in the average number of Basotho migrant mineworkers in SA.

Investment Income

Net investment income registered an inflow equivalent to M92.5 million during the quarter compared with an outflow of M123.4 million recorded in the previous quarter. The improvement resulted from a rise in returns on CBL investments coupled with a decline on interest paid on official loans.

Investment income inflows fell by 3.7 per cent compared with a rise of 12.4 per cent observed in the previous quarter, due to a decline in the interest received by the commercial banks. Investment income outflows also decreased to M215.7 million from M251.3 million registered in the previous quarter, as a result of a fall in the interest payments on government loans.

Current Transfers

Current transfers, in seasonally adjusted terms, declined to M853.7 million during the quarter from M1.6 billion registered in the previous quarter, resulting from a decline in SACU non-duty revenue. On an annual basis, current transfers rose by 25.5 per cent.

Capital and Financial Account

The capital and financial account continued to register inflows during the quarter. It registered a higher inflow of M202.6 million compared with a revised M182.4 million recorded in the previous quarter, as a result of an increase in government grants coupled with a rise in 'other investment' category. Furthermore, commercial banks' foreign assets registered an inflow of M110.1 million in contrast with an outflow of M124.3 million recorded in the previous period.

Table 27: Capital and Financial Account

(Million Maloti)

	2006			2007	
	QII	QIII	QIV	QI*	QII+
I. Capital and Financial Account	-154.91	-23.94	-81.15	190.60	202.63
Capital Account	27.10	27.20	16.30	7.90	19.40
Financial Account	-182.01	-51.14	-97.45	182.70	183.23
Special Financing – LHWP	31.26	31.26	31.49	37.79	45.56
II. Reserve Assets	-442.82	-641.50	-32.81	-1023.89	143.38

* Revised estimates
+ Preliminary estimates

Reserve Assets

Gross reserves declined to M5.8 billion during the review period, following M5.9 million registered in the previous quarter. Expressed in months of import cover, official reserves fell to 6.5 months from 6.6 months observed in the previous quarter. The Net International Reserves (NIR) also declined by 10.0 per cent to US$701.8 in June 2007, mainly due to a decline in SACU revenue.

Figure 20: Reserve Assets

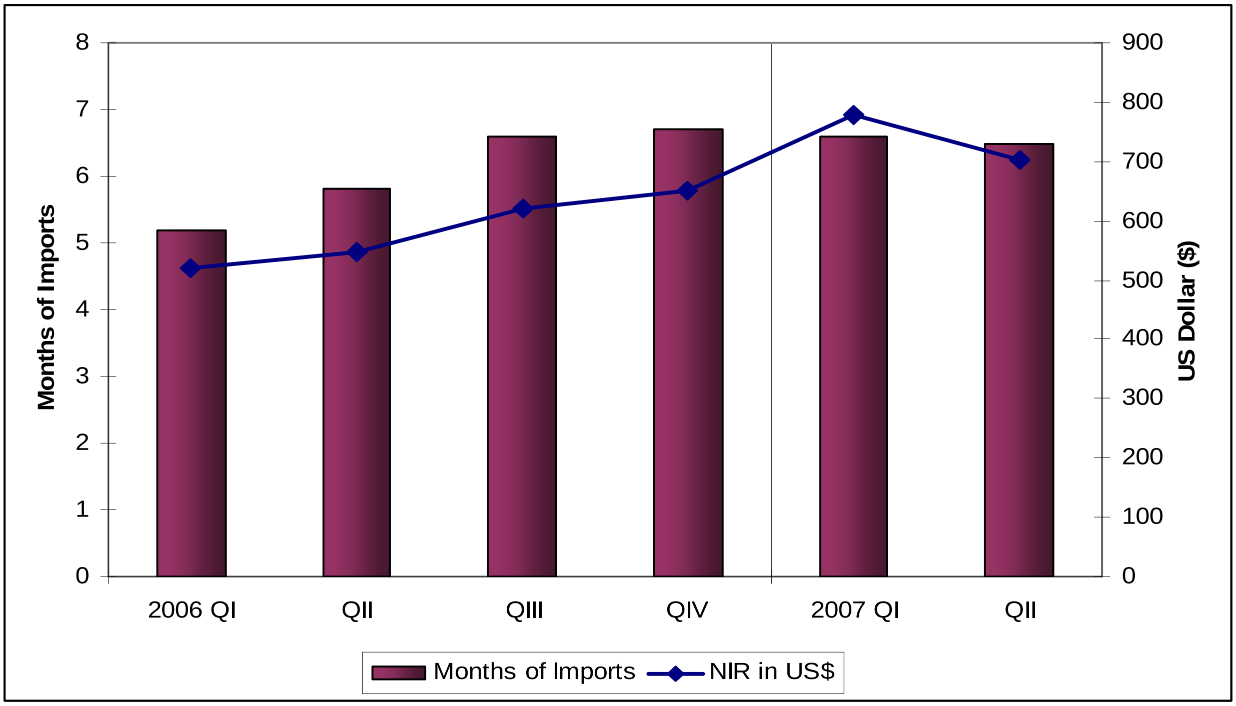
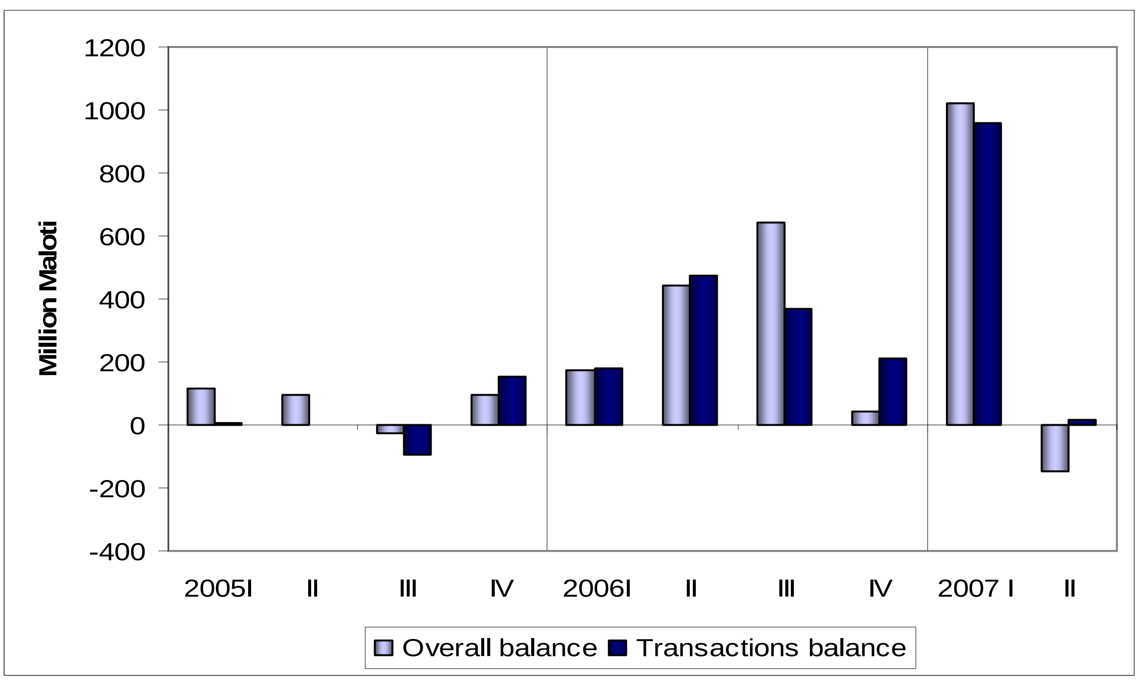


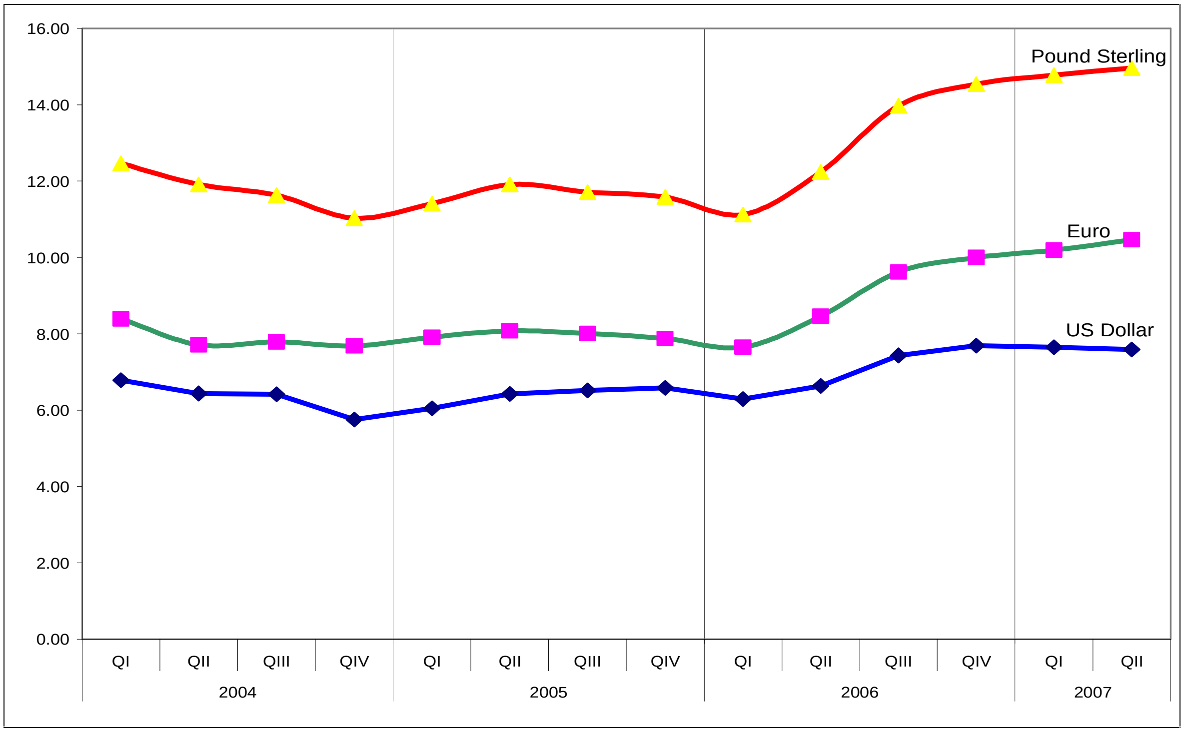
Figure 21: Balance of Payments



Exchange Rates

The Loti strengthened against the US Dollar, while against other major currencies it weakened during the quarter under review. In real terms, the Loti appreciated by 0.8 per cent against the US Dollar. Measured against the Euro and the Pound Sterling, the Loti depreciated by 2.7 per cent and 1.2 per cent, respectively in real terms.

Figure 22: Real exchange rate of the Loti against major currencies



A Note on the Inclusion of Communications Services in the Balance of Payments Statement

Introduction

Lesotho, being among the countries submitting data to the International Monetary Fund (IMF), the Central bank of Lesotho (CBL), follows the IMF Balance of Payments Manual 5th edition (BPM5) and subscribes to the General Data Dissemination Standards (GDDS). However, it is evident that Lesotho is lagging behind in terms of fully adopting the BPM5. This is attributable to number of factors which are beyond the scope of this report. The generic balance of payments (BOP) statement comprises current account, capital account and reserve assets. Within the current account, there are transactions relating to merchandise goods, services, income and current transfers. Within the services account, the transactions relating to communications services between Lesotho residents and the rest of the world (non-residents) were not captured by the CBL, hence during the end of 2006, efforts were made to capture this transactions.

Methodology

According to the BPM5, communications services cover two main categories of international communications transactions between residents and non-residents, namely; telecommunications and, postal and courier services. On the one hand, telecommunications encompass the transmission of sound, images, or other information by telephone, telex, telegram, cable, broadcasting, satellite, electronic mail, etc and include business network services, teleconferencing and support services. In Lesotho, information relating to this item is required from the following institutions; Telecom Lesotho (pty) Ltd, Vodacom Lesotho (pty) Ltd and Econet Ezi-Cell Lesotho (pty Ltd). On the other hand, postal and courier services encompass the pick-up, transport, and delivery of letters, newspapers, periodicals, brochures, other printed matter, parcels, and packages by national postal administrations and other operators. Also included are post office counter and mailbox rental services. Information relating to this item is required from the following institutions; Federal Express (FedEx), DHL Lesotho (pty) Ltd, Lesotho Post Office and SkyNet Worldwide Courier Express. Questionnaires are delivered and collected from all the above-mentioned enterprises on quarterly basis. Among the information required, enterprises are asked about the value of payments they make abroad and about the value of the receipts they get from abroad. Hence, covering both debit entries (outflows to the country) and credit entries (inflows from the country).

Conclusion

Among the services categories, communications services item is also regarded as one of the most important sources of inflows to the country. This item is also important as it is also used as the leading indicator for the performance of the economy. For instance, if a high value of payments to non-residents was realised during a particular quarter, then this indicates that probably more orders were placed by manufacturing firms outside the country. With the addition of this item in the BOP statement, accuracy, efficiency and timeliness of the external sector data captured by the CBL is improved.

VII. Appendix

Statement of the Monetary Policy Committee
22 May 2007

Issued by Dr. M. P. Senaoana, Governor of the Central Bank of Lesotho, at a meeting of the Monetary Policy Committee in Maseru

1. Introduction

At its 10th meeting of the 22nd May 2007, the Monetary Policy Committee (MPC) of the Central Bank of Lesotho (CBL) discussed inflation-related developments and made policy decisions to maintain price stability.

The Committee sets the Net International Reserves (NIR) targets range that it deems sufficient to underwrite the rand loti-peg while meeting the country's foreign currency obligations. This serves the price stability objective by allowing Lesotho to benefit from the low inflation environment imported from South Africa.

2. Inflation Developments during the Fourth Quarter of 2006

Lesotho inflation rate stood at 5.9 per cent in March, compared with 6.4 per cent in December 2006. The Lesotho inflation trend is in line with that of the neighbouring country, South Africa. The key interest rate in South Africa, the repo rate, was left unchanged in April on expectations of subdued inflation rates in the near future. The South African inflation rate slowed down to 4.9 per cent relative to the 6.8 per cent that closed the year 2006. The decline was mainly driven by a deceleration in food inflation. Modest producer price inflation and a relatively steady exchange rate boosted hopes subdued inflationary pressures. However, the continued growth in consumption and high international oil prices implied that the inflation rate could increase. Modest inflation in South Africa could spill-over into Lesotho, but high oil prices and the spending could threaten the inflation outlook.

On the domestic monetary front, money supply grew by 6.2 per cent in the first quarter of 2007, and might not be inflationary.

3. Prospects of the Maintenance of Price Stability

a. Balance of Payments

The balance of payments point to an accumulation of foreign reserves. Cross border transactions registered a surplus of M1.0 billion in the first quarter of 2007, mainly on the back of an increase in exports and current transfers. The rise in exports was influenced by strong diamond production, whereas current transfers rose due to SACU non-duty receipts.

An analysis of the growth in imports implied that the present NIR minimum target of US$400 million is equivalent to 3.3 month of import cover. This corresponded to 105 per cent back up of narrow money. The Committee considered this level to be low as it considered an NIR level 120 per cent of narrow money a comfortable minimum amount of reserves to underwrite the fixed exchange rate system.

b. Fiscal Balance Outlook

Government operations continue to impact favourably on the domestic inflation environment. Strong receipts from the SACU revenue pool (resulting from a backward adjustment of Lesotho's share) and restrained expenditure levels (as share of GDP) are resulting in budget surpluses which are used to build up government reserves held with the banking system. The government achieved an overall surplus estimated at 2.7 per cent of GDP for the quarter ended March 2007.

4. Monetary Policy Stance

The Committee expressed satisfaction that domestic inflationary pressures are contained, and imported inflation remained modest under the fixed exchange rate system. It observed that narrow money and import levels have been increasing over time, compromising the US$400.0 million NIR minimum target level's strength in guarding against breakage of the rand-loti peg. It therefore revised the NIR target range to US$450 to US$500.0 million. The minimum limit of this range is equivalent to 120 per cent of narrow money and provides 4 months of import cover.