CENTRAL BANK OF LESOTHO

QUARTERLY REVIEW

JUNE, 2008

VOLUME XXX, NO. 2

MASERU
KINGDOM OF LESOTHO

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I. Introduction

The second quarter of 2008 continued to be characterized by uncertainty about the world economy. Economic activity in the United States (US), measured as by Gross Domestic Product (GDP), accelerated to 1.9 per cent from 0.9 per cent in the previous quarter. The observed performance may indicate that the US economy has averted an eminent recession. Housing spending continued to decline while other consumer spending grew modestly. Mixed performances were observed in other parts of the world. In the Euro-Zone, there are indications that the economy may have decelerated during the quarter, and in South Africa (SA), improved performance may be expected, in line with increases in manufacturing and mining output. The emerging market economies continued to be dominated by the strong growth in India and China.

The economy of Lesotho showed mixed indications during the second quarter of 2008. Diamond production declined significantly during the quarter owing to lower demand in international markets as the global economy slows down. The good performance in the mining sub-sector is not expected to be sustained as increased production in Letseng and Kao mines is expected in the third quarter of the year. In the secondary sector, electricity and water consumption rose by 19.6 per cent and 3.0 per cent, respectively on a quarterly basis. Although employment in the Lesotho National Development Corporation (LNDC) assisted companies further declined by 4.1 per cent during the quarter, the observed increase in water consumption particularly of the industrial sector may be indicative of some resilience by the sector in the face of the current external shocks.

The retail and wholesale sub-sector seem to have been negatively impacted by the current economic conditions. Retail sales turnover declined by 9.1 per cent during the quarter under review. Moreover, a combination of employment losses in the manufacturing sector and soaring food and energy prices and the high interest rates may be negatively impacting on consumer spending in the country. However, the communications sector continued to show some indications of growth.

Employment developments in the country reflected weakening conditions in the manufacturing sector as some 1802 people lost their jobs in the second quarter. The government employment continued to increase as Government intensified efforts in areas of health, education and public service delivery. The number of migrant mineworkers remained relatively unchanged as the commodity boom continued.

Although continuing to pose a major challenge, inflation developments in Lesotho showed some improvements during the quarter under review. The rate of inflation as measured by the Consumer Price Index (CPI) declined from 10.7 per cent in March to 9.6 per cent in June, reflecting the slowdown in the food index observed in the period. Increases in the price of crude oil continue to exert much pressure on overall prices.

Developments in the financial sector show that money supply grew by 13.7 per cent during the quarter under review compared with 2.4 per cent recorded in the previous quarter. The strong growth in money supply was mainly driven by the increase in net foreign assets which more than offset the fall in total domestic credit by 6.5 per cent during the period.

Interest rates movements in the region continued to reflect the effects of the prevailing contractionary monetary policy environment in response to inflationary pressures. The key interest rate in Lesotho, the 91 days Treasury bill rate rose to 9.91 per cent from 9.21 per cent in March. The prime lending rate also increased to 16.25 per cent. Mixed directions were observed in the deposit rates, with the call rate declining while the savings deposit rate edged up.

Government budgetary operations are estimated to have registered a surplus equivalent to 8.1 per cent of GDP following a balanced budget in the previous quarter. The surplus position was mainly due to improvement in all categories of tax revenue and the decline in total expenditure. It is noteworthy that Government capital expenditure declined by a remarkable 22.1 per cent during the quarter. Total public debt stock fell by 2.7 per cent due to a fall in external debt. Measured as a ratio of GDP, total public debt was recorded at 45.0 per cent.

In line with the government budgetary operations, the external sector position further registered a surplus during the quarter under review. An overall surplus of M163.3 million was recorded compared to M769.3 million in the previous quarter. In months of import cover, the international reserves were at 7.4 months of imports. The healthy external sector position in Lesotho is driven by the continued current account surpluses that emanate from current transfers, in particular, SACU revenue.

II. International Economic Developments

United States (US)

Preliminary estimates indicate that the US economy showed some recovery during the review quarter. The real GDP grew by 1.9 per cent in the review period compared with the revised 0.9 per cent registered in the previous quarter. While the slump in the housing market continued and consumer spending remained sluggish, the 9.2 per cent surge in exports and the decline of 6.6 percent in imports boosted growth. Housing spending fell by 15.6 per cent while consumer spending rose by 0.6 per cent compared with 0.4 per cent in the first quarter.

The unemployment rate rose to 5.5 per cent during the review quarter from 5.1 per cent registered in the previous quarter. The consumer price index (CPI) increased at a higher annual rate of 5.0 per cent in June 2008 compared with 4.0 per cent in March, largely due to high food and oil prices. Nevertheless, the Federal Reserve Bank's Open Market Committee (FOMC) reduced the benchmark lending rate by a quarter of a percentage point during the review quarter in an effort to stimulate the economy. Thus the US policy rate closed the quarter at 2.0 per cent compared with 2.25 per cent at the end of the last quarter.

The recovery of the US economy is expected to have positive spill over effects on Lesotho's exports.

Table 1: Key World Economic Indicators

	Real GDP Growth		Inflation Rate		Key Interest Rate		Unemployment Rate	
	QI	QII	QI	QII	QI	QII	QI	QII
China	10.6	10.1	8.3	7.1	7.47	7.47	9.5	9.5
Euro Area	2.1	n/a	3.6	4.0	4.0	4.25	7.3	7.1
India	8.8	n/a	5.5	7.8	7.8	8.5	7.2	7.2
Japan	1.3	n/a	-0.3	2.0	0.5	0.5	3.8	4.1
South Africa	2.1	4.9	10.6	11.6	11.0	12.0	23.0	23.0
United States	0.9	1.9	4.0	5.0	2.0	2.25	5.1	5.5

Source: Bloomberg, The Economist, STATSSA and SARB

The figures shown are for the reference quarter. However, due to unavailability of up-to-date figures, the 2007 unemployment rates for China and India are shown. In the case of South Africa, the September 2007 unemployment rate is provided. The inflation rate for India is for the month of May.

Euro-zone[1]

Industrial production fell further by a monthly rate of 1.9 per cent in May following a decline of 0.6 per cent in March. This implies that the economic growth rate in the fifteen nations' region might have decelerated during the quarter under review.

The harmonised unemployment rate in the Euro-zone increased marginally during the quarter under review. It rose from 7.1 per cent in March to 7.3 per cent in June. Inflation as measured by changes in the Harmonised Index of Consumer Prices (HICP) accelerated from 3.6 per cent in March to 4.0 per cent in the last month of the second quarter largely due to high food and oil prices as well as high housing costs. At this rate, the inflation rate remained above the target rate of 2.0 per cent as determined by the European Central Bank (ECB). Thus the ECB increased its benchmark lending rate from 4.00 per cent in the last quarter to close the review quarter at 4.25 per cent.

South Africa (SA)

The economy of SA recovered significantly during the quarter under review. Real GDP growth increased to 4.9 per cent on an annual basis compared with 2.1 per cent in the

[1] Euro-zone: Austria, Belgium, Cyprus, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia and Spain. (Cyprus and Malta joined on the 1st January 2008).

previous quarter. This resulted mainly from stronger performance by the mining and manufacturing sectors. This is evidenced by the increase in the leading indicators of economic growth, mining and manufacturing production. In seasonally adjusted terms, mining production increased by 7.7 per cent in the second quarter of 2008 compared with a fall of 8.3 per cent observed in the previous quarter. This recovery emanated mainly from the recovery in the production of platinum group metals. The production of diamonds and gold went back to normal, as production disruptions due to power shortages stopped. Furthermore, manufacturing production is estimated to have increased by a seasonally adjusted 5.7 per cent during the quarter under review compared with a rise of 1.3 per cent observed in the first quarter. The main contributor was the rise in production of food and beverages as well as petroleum, chemical and plastic products.

Inflation as measured by the consumer price index excluding interest on mortgage bonds (CPIX), continued on an upward trend and remained above the targeted range of 3 to 6 per cent. The CPIX has exceeded the 6.0 per cent ceiling since April 2007. Prices increased at a higher rate of 11.6 per cent in June compared with 10.6 per cent in March 2008. Food prices and transportation costs were the main drivers of inflation at the respective rates of 17.6 and 18.8 per cent. In addition, credit extension is still high though it has started showing signs of moderation. In a continued effort to curb inflation, the South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) tightened monetary policy twice, by 50 basis points each time, during the quarter. Thus the repo rate closed the quarter at 12.00 per cent compared with 11.00 per cent at the end of the previous quarter.

Due to close trade links between Lesotho and SA, economic developments in SA impact directly on the Lesotho economy. The increase in production in the mining industry could positively affect the number of Basotho migrant mineworkers in the SA mines. A continued upward pressure on prices remained a threat on the Lesotho economy. Lesotho is likely to be negatively affected by higher interest rates as domestic interest rates follow developments in SA.

Asian Emerging Markets and Japan

China

Preliminary estimates indicated that GDP growth in the world's fourth-largest economy decelerated to 10.1 per cent in the second quarter of 2008 compared with 10.6 per cent in the first quarter. This growth moderation is a result of a slowdown in investment and exports. China is targeting a lower average growth rate of 8.0 per cent for 2008 on concerns of economic overheating.

The rate of inflation fell to 7.1 per cent in the review period from 8.3 per cent in March 2008 mainly due to lower food and oil prices. The Government of China has imposed price controls on food, fuel and other basic goods and is, in addition, giving subsidies to increase food supplies. Inflation rate was above the 3.0 per cent target of the People's Bank of China (PBC). The inflation expectations led PBC to keep the one-year benchmark interest rate unchanged at 7.47 per cent during the quarter.

Developments in the Chinese economy may have implications for Lesotho. The deceleration in China's inflation may have a positive impact for Lesotho's economy, since Lesotho imports most of manufacturing sector's inputs from China.

Japan

A leading indicator of economic growth in Japan, industrial production, declined by 2.0 per cent in June. Household spending also declined at an annual rate of 1.8 per cent. These developments may be viewed as an indication that economic growth could have decelerated during the quarter under review.

The Japanese unemployment rate worsened in June. It rose to 4.1 per cent compared with 3.8 per cent in March 2008. Inflation remained low during the review period. The core CPI, which excludes prices of fruits, vegetables and fish, increased by an annual rate of 2.0 per cent in June. The inflation outlook led the Bank of Japan (BOJ) to keep its key interest rate unchanged at 0.50 per cent during the first quarter.

India

Industrial production in India, increased by 3.8 per cent in May compared with a decline of 3.0 per cent in March 2008, due to good performance observed in mining, manufacturing and electricity sectors. Manufacturing production which accounted for 80.0 per cent share in the index of industrial production grew by 3.9 per cent year-on-year, compared with a rise of 2.9 per cent recorded in March. Mining and electricity production increased by 5.2 and 2.0 per cent respectively.

The rate of inflation in May was 7.8 per cent 5.5 per cent in March due to surging international food and oil prices. Consequently the Reserve Bank of India (RBI) increased its repurchase rate by 0.2 per cent in May and by 0.5 per cent in June. Thus it closed the quarter at 8.5 per cent.

Commodity Prices

Overview

Average prices of minerals and agricultural products depicted mixed signals even though an upward trend was observed overall both in Rand and US Dollar terms. On average, the price of gold decreased while that of platinum and oil increased.

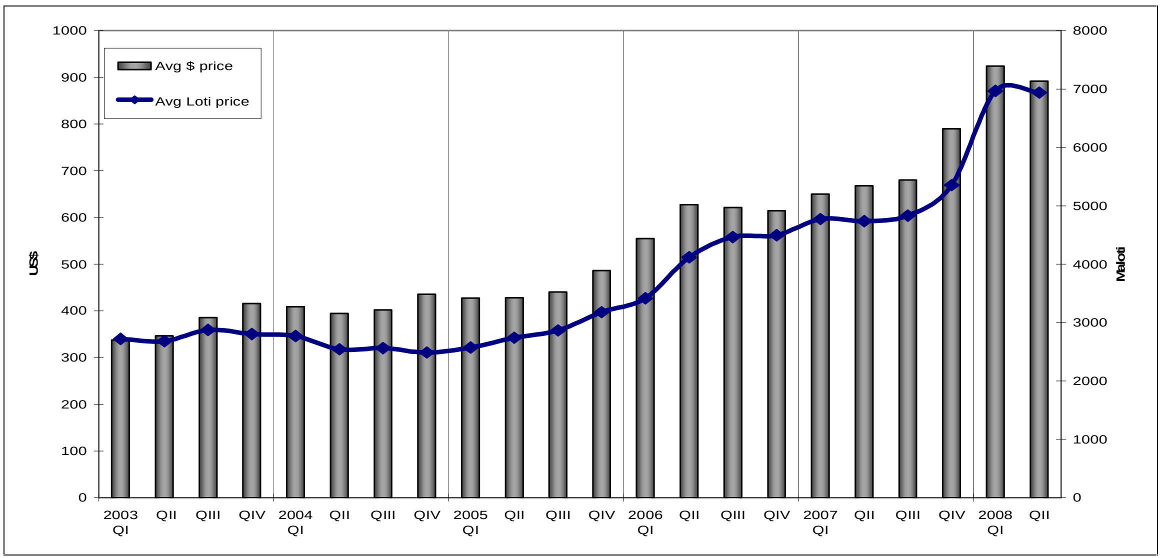
With respect to agricultural products, the average spot price of white maize increased. However, the average spot price of yellow maize declined in US Dollar terms and increased in Rand terms. Furthermore, the average spot price of wheat declined during the quarter under review.

Mineral Products

Gold

The average price of gold decreased from US$923.7 per ounce in the previous quarter to US$891.97 per ounce in the second quarter. It ranged between a minimum and maximum of US$556.45 per ounce and US$944.59 per ounce, respectively. In Rand terms, the average price of gold decreased by 0.4 per cent from M6 968.8 per ounce in the previous quarter to R6 938.2 per ounce during the quarter.

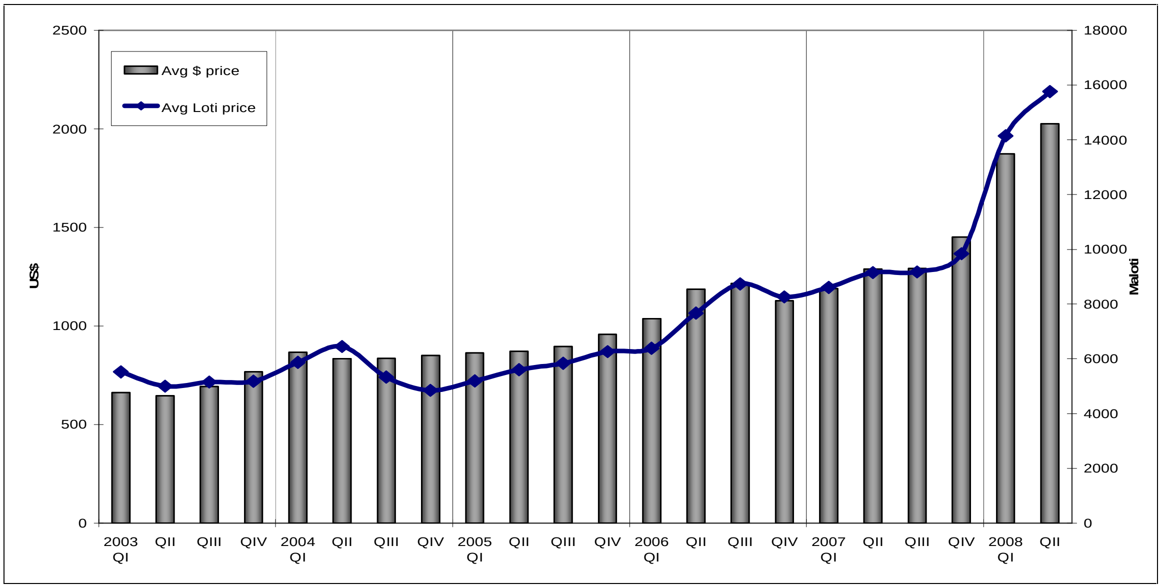
Figure 1: Average Price of Gold



Platinum

The average price of platinum increased from US$1 874.19 per ounce in the previous quarter to US$2 026.48 per ounce in the second quarter of 2008. It ranged between a minimum and maximum of US$1 866.0 per ounce and US$2 198.0 per ounce, respectively. In Rand terms, the average price of platinum increased by 11.4 per cent from R14 145.41 per ounce in the previous quarter to R15 762.92 per ounce during the quarter.

Figure 2: Average Price of Platinum



Although the price of gold has declined, it is still considered to be high. Higher prices of both gold and platinum augur well for Lesotho's economy in terms of employment generation and therefore higher migrants' remittances inflow to the country.

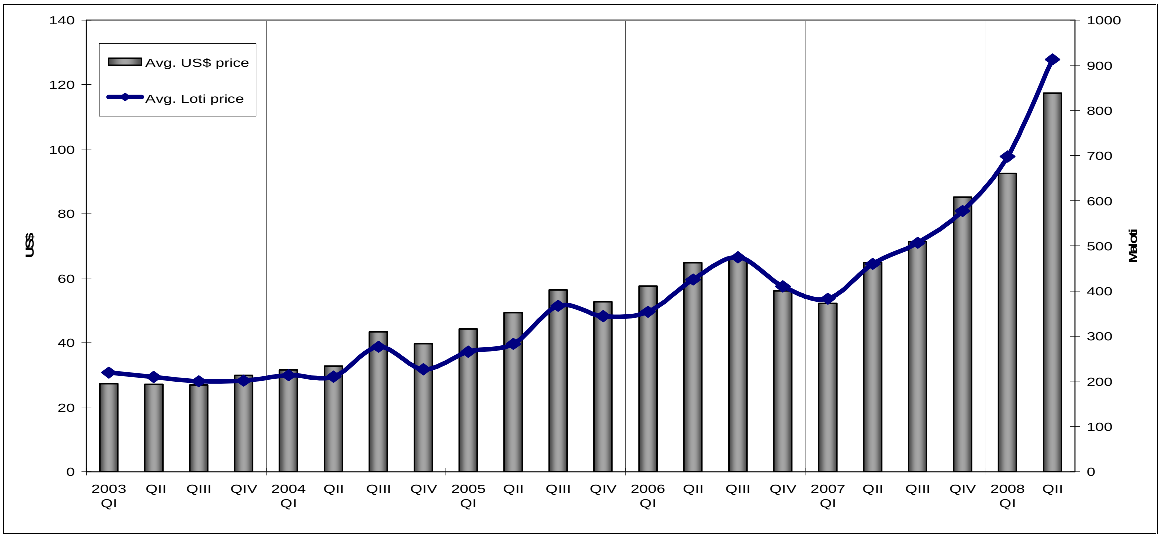
Oil

During the quarter under review, the average price of crude oil increased by 26.9 per cent, from US$92.51 per barrel in the previous quarter to US$117.36 per barrel. The increase in international oil prices resulted largely from geopolitical concerns, supply constraints and strong demand, especially from China, India and the Middle East.

The oil price ranged between a minimum and maximum of US$95.75 per barrel and US$136.03 per barrel, respectively during the quarter under review. In Maloti terms, it rose by 30.8 per cent, from M697.90 per barrel in the previous quarter to M912.88 per barrel in the second quarter. A rise in the price of crude oil in both US Dollar and Rand terms impacts negatively on Lesotho's economy in terms of inflationary pressures given that Lesotho imports all its petroleum products.

Due to the developments in the international oil prices, there were three upward revisions of fuel prices in the country during the review quarter. The pump price of petrol in Lesotho closed the review quarter higher at M9.55 per litre. The price of diesel and illuminating paraffin also closed the quarter higher at M11.70 per litre and M8.80 per litre, respectively. These compare with M8.05 per litre of petrol, M9.00 per litre of diesel and M6.45 per litre of illuminating paraffin at the end of the quarter ending March 2008.

Figure 3: Average Price of Oil

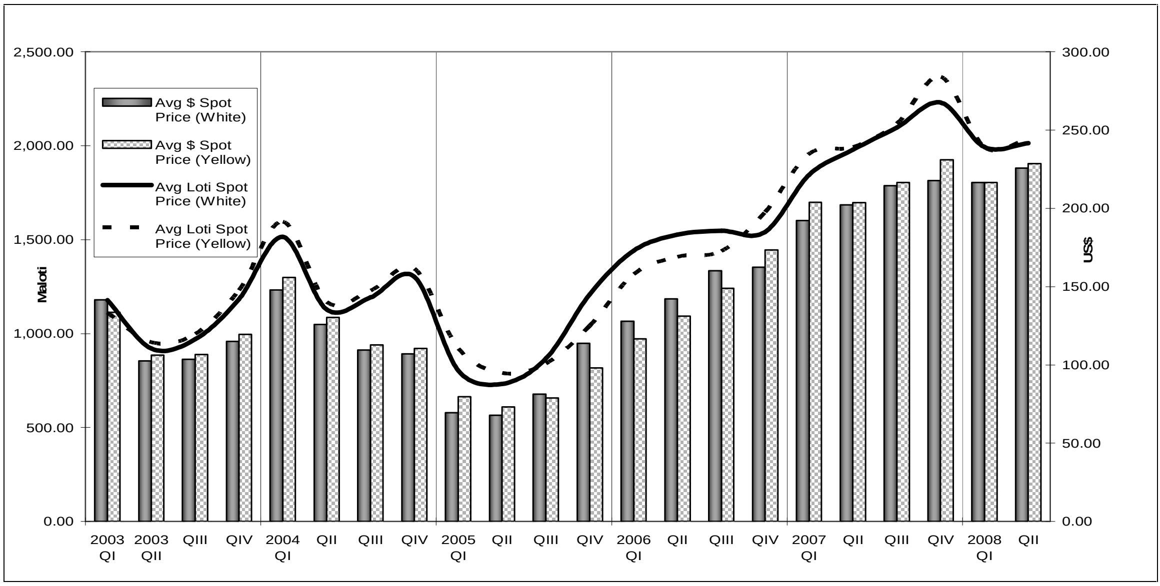


Agricultural Products

Maize

Average prices for white maize increased while that of yellow maize decreased during the quarter under review. The average spot price of white maize increased from US$239.11 per tonne in the previous quarter to US$241.55 per tonne in the review quarter, while that of yellow maize decreased from US$250.0 per tonne in the previous quarter to US$244.47 per tonne in the review quarter. However, in Maloti terms, the prices of both white and yellow maize increased. The average spot price of white maize increased from M1 804.69 per tonne in the previous quarter to M1 881.66 per tonne during the review quarter, and that of yellow maize increased from M1 886.85 per tonne in the previous quarter to M1 904.39 per tonne during the quarter under review.

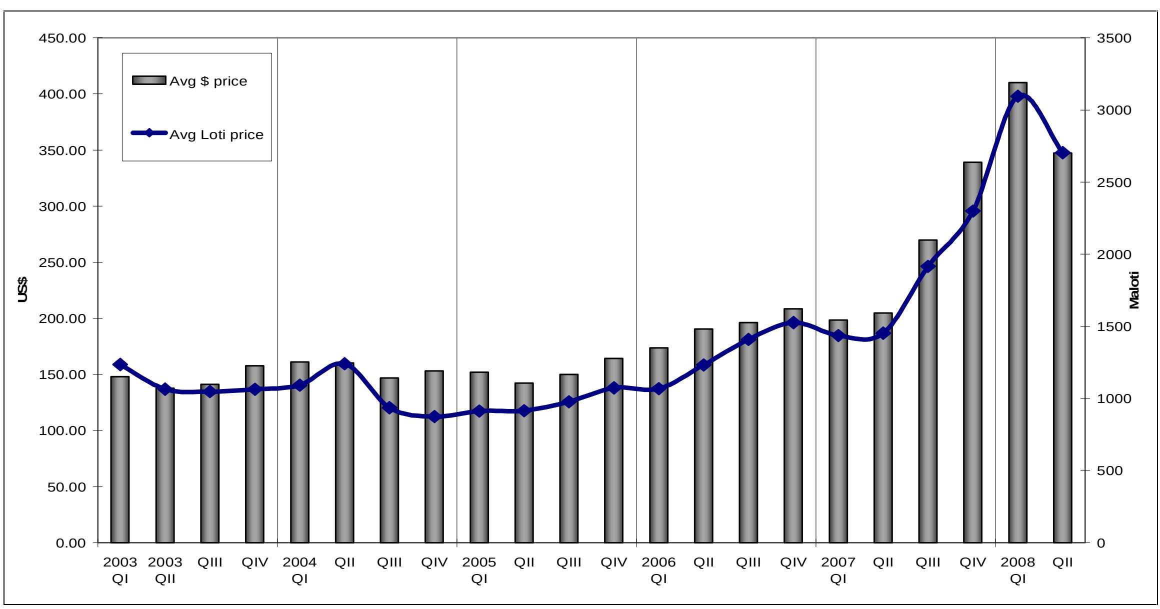
Figure 4: Average Prices of Maize



Wheat

The quarterly average spot price of wheat decreased by 15.3 per cent from US$410.05 per tonne registered in the first quarter to US$347.24 per tonne recorded during the quarter under review. In Maloti terms, the average spot price of wheat decreased from M3 094.84 per tonne realised in the previous quarter to M2 703.93 per tonne realised during the quarter under review.

Figure 5: Average Prices of Wheat



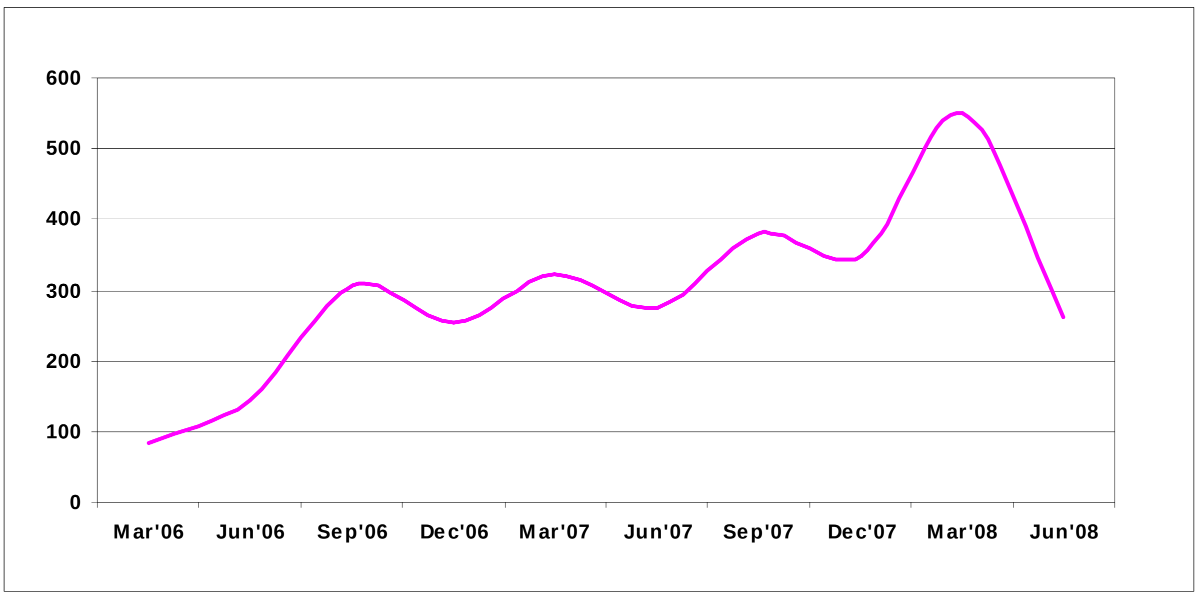
III. Real Sector, Employment and Price Developments

Diamond Production

The diamond production index declined from 549.4 points in the quarter ending March to 261.8 point at the end of the review quarter. The decline in the index reflects a fall in carats, while an increase in diamond exports as recorded under BOP reflects income accrual. The decrease may be an indicator of a lower demand in international markets as the global economy slows down after the recent disruptions in developed countries financial system's operations.

Figure 6: Diamond Production Index

(2005: QI=100)



Source: Department of Mines and Geology

Secondary Sector Developments

Electricity Consumption

Overall domestic electricity consumption increased by 19.6 per cent on a quarterly basis. The increase was recorded in all three categories; general purpose, domestic and commercial and industrial. The increase in consumption was due to more demand during the winter period when general consumption of electricity is high because of requirements for additional heating.

Table 2: Electricity Consumption

(Million Maloti)

	2007				2008			
	QIII		QIV		QI		QII	
	Kwh	Value	Kwh	value	Kwh	Value	Kwh	value
General Purpose	20.95	13.84	18.64	12.32	21.63	14.30	25.75	14.84
Domestic	38.97	18.36	43.42	20.45	36.57	17.23	42.37	20.39
Commercial & Industrial	83.17	34.05	85.86	35.15	62.83	3.58*	76.67	29.16
Total	143.09	66.25	147.92	67.92	121.03	35.10	144.79	64.39

Source: Lesotho Electricity Authority

*Does not include maximum demand charge

Water Consumption

Water consumption is used as a leading indicator of activity in the wet industries. The units of water consumed during the review period increased by 3.0 per cent on a seasonally adjusted quarterly basis. Industrial water consumption increased by 5.7 per cent on a seasonally adjusted quarterly basis. Domestic use of water consumption is expected to increase as more households are accorded water connections, and industrial use of water is expected to moderate as the manufacturing sub-sector shows signs of resilience.

Table 3: Water Consumption

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

		Domestic	Industrial	Other	Total
2007					
II	Units	1.47	3.27	1.15	5.89
	Value	3.85	7.38	3.00	14.22
	Units*		3.32		5.98
III	Units	0.75	1.56	0.49	2.80
	Value	2.25	7.71	2.45	12.41
	Units*		1.48		2.66
IV	Units	0.91	1.29	0.78	2.98
	Value	3.65	6.34	2.77	12.76
	Units*		1.16		2.69
2008					
I	Units	0.87	1.18	0.52	2.56
	Value	3.65	5.83	2.58	12.06
	Units*		1.40		2.99
II	Units	0.95	1.46	0.62	3.03
	Value	4.38	8.15	3.77	16.30
	Units*		1.48		3.08

Source: Water and Sewerage Authority
*denotes seasonally adjusted figures

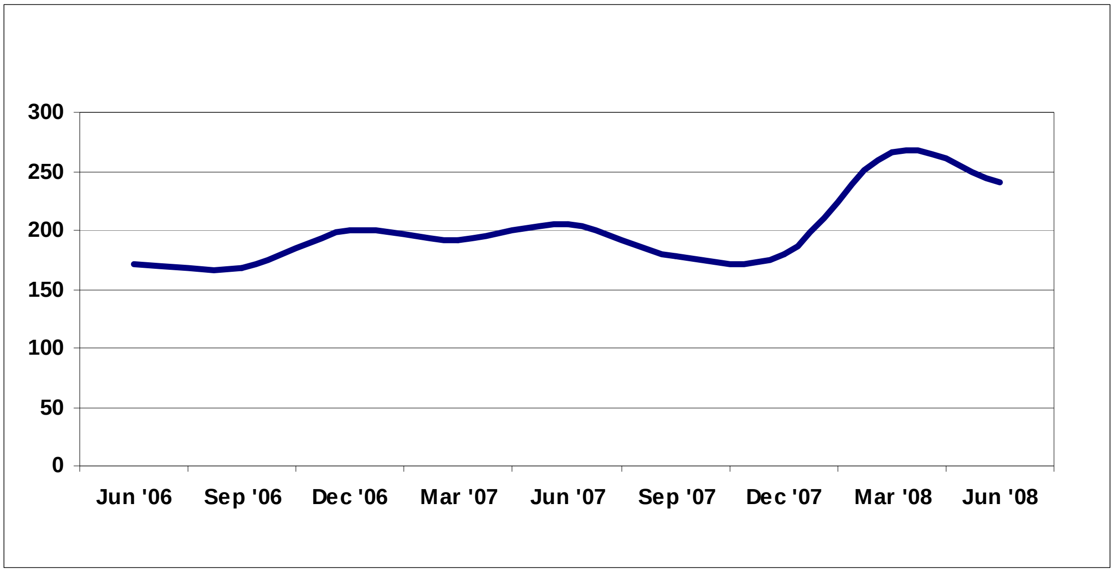
Tertiary Sector Developments

Sales Turnover

The value of retail sales turnover is an indicator of performance of business activity in the economy. The value of business turnover declined by 9.1 per cent on a quarterly basis, and increased by 13.6 per cent on an annual basis. The quarterly decline is consistent with relatively high interest rates that may have influenced people to cut their expenditure on consumables.

Figure 5: **Value of Sales Turnover**

(Million Maloti)



Source: Lesotho Revenue Authority

Telephone Statistics

The total number of telephone calls increased by a seasonally adjusted 1.6 per cent quarter to quarter, and 22.8 per cent on an annual basis. The increase in the telecommunication sub-sector is indicative of concerted effort to expand network coverage in the country. This has resulted in more people subscribing to phone usage. The expansion was also realised in the launch of wire-less Internet provision.

Table 4: Telephone Traffic Statistics

		SA Outgoing Calls	International Calls	Total Calls
2007				
I	No. of calls (millions)	*4.04*	0.19	*4.23*
	No. of calls*		……	4.50
	Total Duration (million minutes)	5.11	0.71	5.82
	Nominal Value (million maloti)	10.72	6.74	17.46
II	No. of calls (millions)	4.20	0.21	4.40
	No. of calls*			
	Total Duration (million minutes)	5.16	0.79	5.96
	Nominal Value (million maloti)	11.87	8.01	19.88
III	No. of calls (millions)	4.68	0.21	4.88
	No. of calls*			
	Total Duration (million minutes)	5.56	0.76	6.32
	Nominal Value (million maloti)	12.78	6.37	19.15
IV	No. of calls (millions)	5.07	0.22	5.29
	No. of calls*			
	Total Duration (million minutes)	5.65	0.80	6.45
	Nominal Value (million maloti)	12.99	6.17	19.16
2008				
I	No. of calls (millions)	4.97	0.21	5.18
	No. of calls*			
	Total Duration (million minutes)	5.73	0.75	6.48
	Nominal Value (million maloti)	13.19	6.09	19.28
II	No. of calls (millions)	5.19	0.22	5.41
	No. of calls*			5.60
	Total Duration (million minutes)	5.70	0.78	6.48
	Nominal Value (million maloti)	13.14	6.11	19.25

Source: Tele-Com Lesotho
* adjusted for seasonality

Investment Expenditure

Imported Motor Vehicles

The number of imported motor vehicles is a lead indicator of the direction of gross fixed capital formation in the economy. It increased by a seasonally adjusted 83.7 per cent on a quarterly basis and by 47.3 per cent on an annual basis. The increase was mainly in the categories; cars, vans, trucks and buses (Table 5). The surge in imports is consistent with the growth of private sector credit and private vehicles sales.

Table 5: Motor Vehicle Imports+

(Value in Million Maloti)

		Cars	Vans	Trucks	Buses	Trac-tors	M/Cycles	Trail-ers	Total
2007									
I	Value	23.48	30.21	2.92	1.81	0.33	0.08	0.33	59.16
	Units*								432
	Units	205	209	11	12	2	1	19	459
II	Value	21.79	37.93	3.74	6.58	0.42	0.10	0.10	70.66
	Units*								535
	Units	234	218	13	27	3	4	7	506
III	Value	22.82	43.05	5.04	4.74	1.13	0.32	1.00	78.10
	Units*								531
	Units	256	259	15	22	4	6	21	583
IV	Value	20.63	32.83	2.97	7.58	0.41	0.05	0.90	65.38
	Units*								576.95
	Units	230	224	13	24	9	2	13	515
2008									
I	Value	15.06	35.77	8.85	4.65	1.04	0.06	0.62	65.99
	Units*								428.95
	Units	210	204	16	16	3	1	6	456
II	Value	39.02	44.90	17.78	10.96	0.95	0.09	0.58	114.28
	Units*								787.90
	Units	367	287	46	29	6	2	8	745

Source: Imperial Fleet Services Lesotho and Customs Department

*denotes seasonally adjusted figures

+Includes imports of second hand cars

Employment Developments

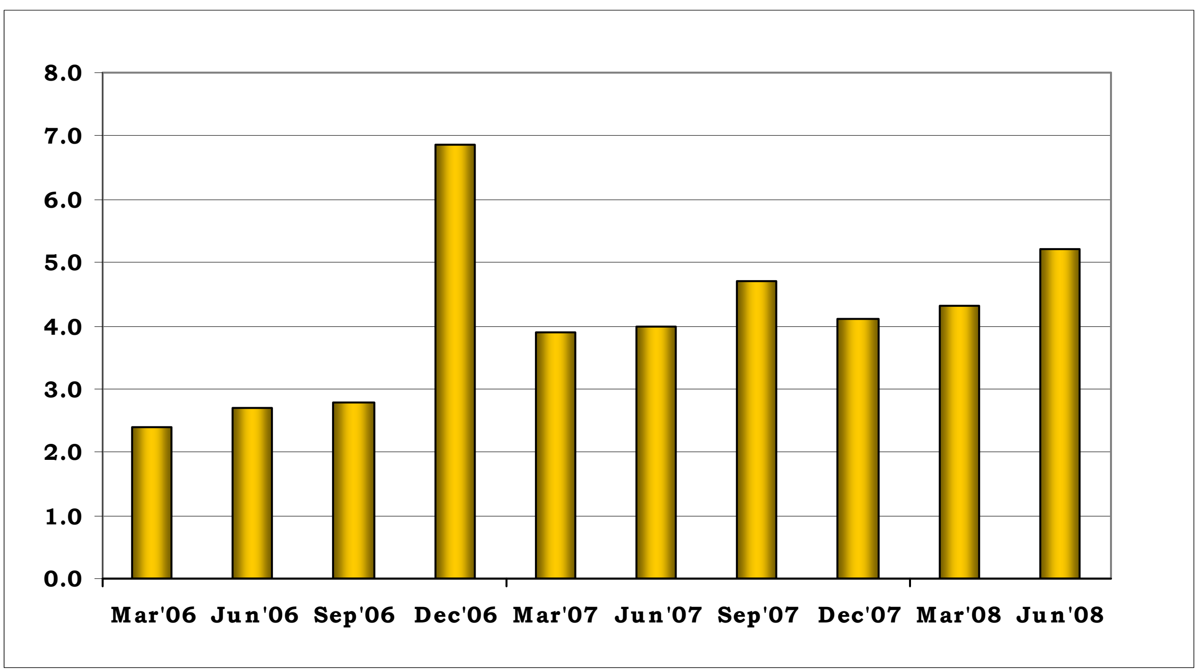
Employment of LNDC-assisted companies increased by 17.7 per cent on a quarterly basis to 53 663 employees, and on an annual basis employment increased by 9.8 per cent. The rise in employment was due to a slower rate of retrenchments than was experienced in the first quarter. The decline in quarter one was due to a slowdown in global economy, particularly the US.

Table 6: Employment Trend of LNDC Assisted Companies

Period	QI	QII	QIII	QIV
2008	45598	53663		
2007	47731	48892	46772	46921
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

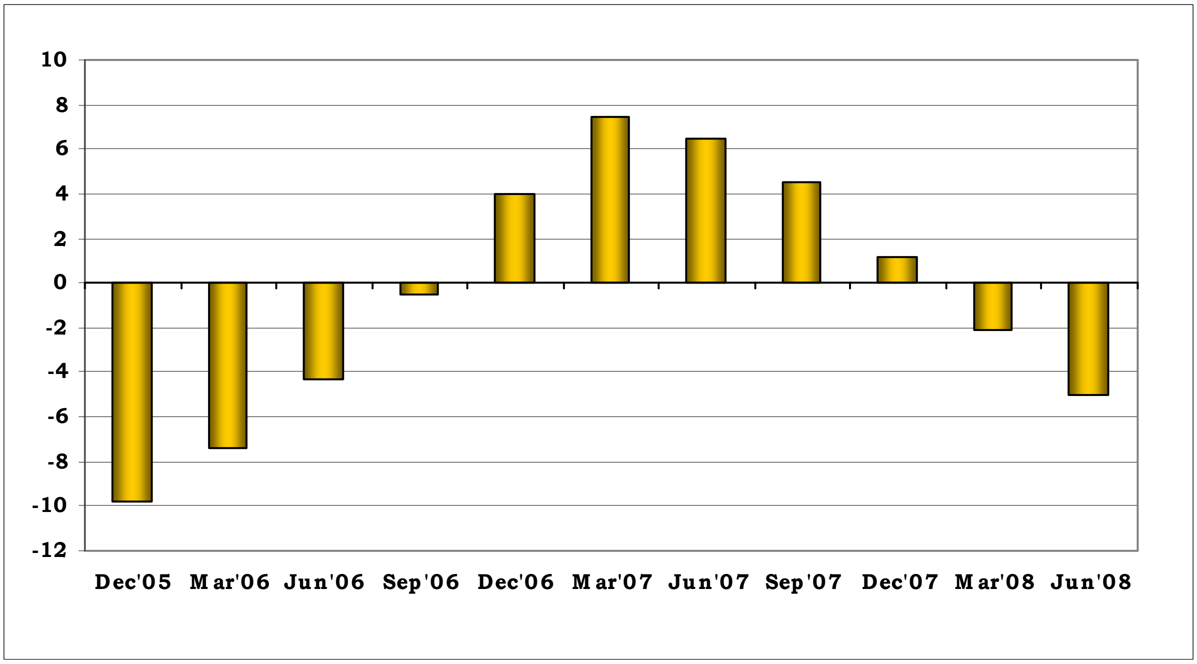
Source: Lesotho National Development Corporation

Figure 6: Government Employment
(Annual Percentage Change)



The number of government employees increased from 40 742 to 41 680 on a quarterly basis. And there was an increase from 39 617 to 41 680 employees on an annual basis. The quarterly increase is equivalent to 2.3 per cent, while the annual increase is equivalent to 5.2 per cent. The rise was underpinned by an increase in the 'teachers' and 'general civil servants' categories. The rise is indicative of the government efforts to intensify in the areas of education, health and public services delivery.

Figure 7: **Migrant Mineworkers Employment**
(Annual Percentage Change)



Migrant mineworkers remained barely unchanged on a quarterly level. On an annual basis it declined from 53 942 to 52 720, equivalent to 2.3 per cent. The observed movement at a quarterly level was mainly due to stability in the international gold market. The mining industry has reported a negative impact in their operations since the beginning of the year.

Price Developments

The rate of inflation declined from 10.7 per cent in the previous quarter to 9.6 per cent in June. This is despite continuous increases in the prices of fuel and food. The decline mainly reflected a slowdown in the growth of food as the second quarter of the year coincides with the harvesting season in the country. This tends to push down the prices of cereals in the market, hence a slower increase in the overall price of food.

Major movements in prices were found in the categories; Maize Meal 3.0 points; Wheat Meal 2.2 points; Bread Flour 1.0 points; Cooking Oil 0.8 points; Sugar 0.6 points; Motor Vehicles 0.6 points; Petrol 0.6 points; Cabbage 0.5 points; Paraffin 0.4 points; Washing Soaps 0.4 points; Chicken 0.4 points; Women's Footwear 0.4 points; Mutton 0.3 points; Beans 0.3 points; Cigarettes 0.3 points; Blankets 0.3 points as well as Gas 0.3 points.

During the quarter under review, the Lesotho inflation rate was lower than the targeted inflation rate in SA, CPIX, which was quoted at 11.6 per cent. The continuous increase in the general price level may signal more rate increase before the end of the year. The increase in interest rates may further help to dampen private consumption, thus slowing inflation.

Table 7: Inflation Rate

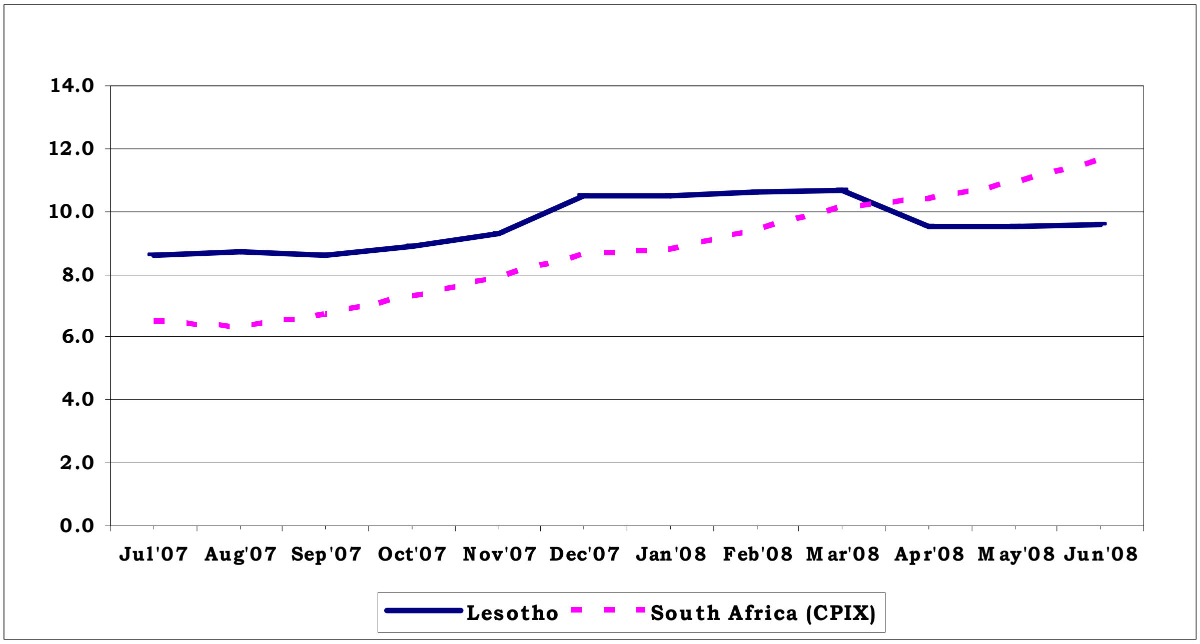
(Annualised Percentage Change: April 1997=100)

	Weight	2008				
		Feb	Mar	Apr	May	Jun
All items	100.0	10.6	10.7	9.5	9.5	9.6
Food and non-alcoholic beverages	39.8	18.3	17.8	14.3	13.8	13.6
Alcoholic beverages & Tobacco	6.4	5.4	5.5	5.8	5.0	5.0
Clothing & footwear	15.6	5.7	5.7	5.9	6.1	6.3
Housing, electricity gas & other fuels	3.7	8.7	9.5	11.0	13.6	13.8
Furniture, households equipment & routine maintenance of house	17.0	2.1	2.5	2.9	3.0	3.5
Health	1.4	0.5	0.4	1.8	1.8	1.9
Transport	7.8	4.4	6.6	8.6	10.1	10.7
Communication	0.1	0.0	0.0	0.0	0.0	0.0
Leisure, entertainment & Culture	1.2	-0.6	0.0	-0.3	0.3	0.2
Education	3.2	2.6	2.6	2.3	2.2	2.2
Restaurant & Hotels	0.4	19.1	21.3	19.1	11.8	12.1
Miscellaneous goods & services	3.2	4.6	4.7	3.9	4.2	5.4

Source: Bureau of Statistics, Lesotho

Figure 8: Annual Inflation Rate for Urban Households

(Percent)



IV. Monetary and Financial Developments

Determinants of Money Supply

Growth in money supply accelerated in the second quarter of 2008, registering 13.7 per cent on a quarterly basis from 2.4 per cent the preceding quarter. As Figure 11 below demonstrates, the increase in M2 was driven by growth in net foreign assets. Net foreign assets have been on a sustained increase in the recent quarters due to SACU receipts and narrowing trade deficits.

The effect of a strong increase in private sector credit on broad money was dampened by a rise in the net creditor position of government (see Table 8 below). Thus total domestic credit fell by 6.5 per cent during the quarter.

Figure 7: Overview of Recent Monetary Developments

(Million Maloti: End of Period)

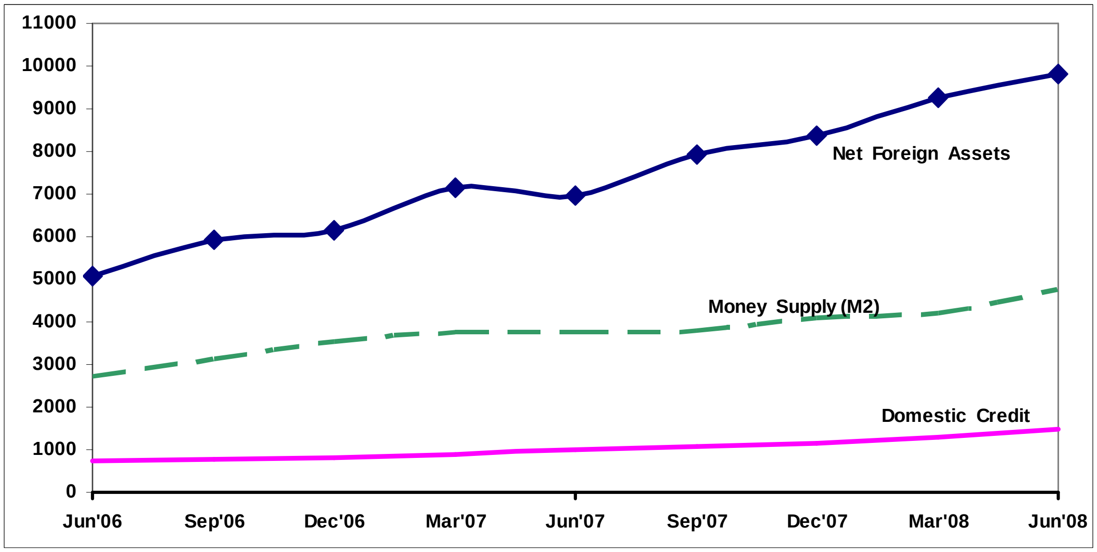


Table 8: Determinants of Money Supply

(Million Maloti: Changes)

Determinants	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Net foreign assets	-194.1	974.3	438.1	895.5	526.2
Domestic credit	-31.8	-597.2	-161.7	137.3	-126.3
Net Claims on Govt	-145.2	-679.7	-224.2	50.6	-257.4
Statutory bodies	16.7	14.0	3.2	-1.3	-2.4
Private sector	95.5	66.1	55.5	79.6	159.6
Other items, net	-227.3	337.3	-38.5	935.2	-171.4
Money Supply (M2)	1.5	39.9	313.0	97.5	571.3

Components of Money Supply

The increase in broad money continued to be reflected in narrow money which grew by 20.8 per cent on quarterly basis in June, from a 4.2 per cent rise in March. All sub-components of M1 realised an increase, with demand deposits recording the largest growth at 23.0 per cent.

Quasi money declined for the second consecutive quarter in June 2008. It registered a 7.2 per cent decline in the review period from a 2.5 per cent fall in the previous quarter. The fall in quasi money was driven by a 14.2 per cent decline in time deposits, which overshadowed a slight increase in savings deposits.

The share of narrow money in M2 increased from 74.6 per cent in June 2007 to 79.2 per cent in the review period. Figure 9 indicates that demand deposits account for the largest portion of broad money. The shares of demand deposits and time deposits in broad money increased during the period, while the shares of saving deposits and deposits of official entities with the Central Bank fell. The share of currency with public remained steady at around 8.0 per cent.

Table 9: Money Supply

(Million Maloti; End of Period)

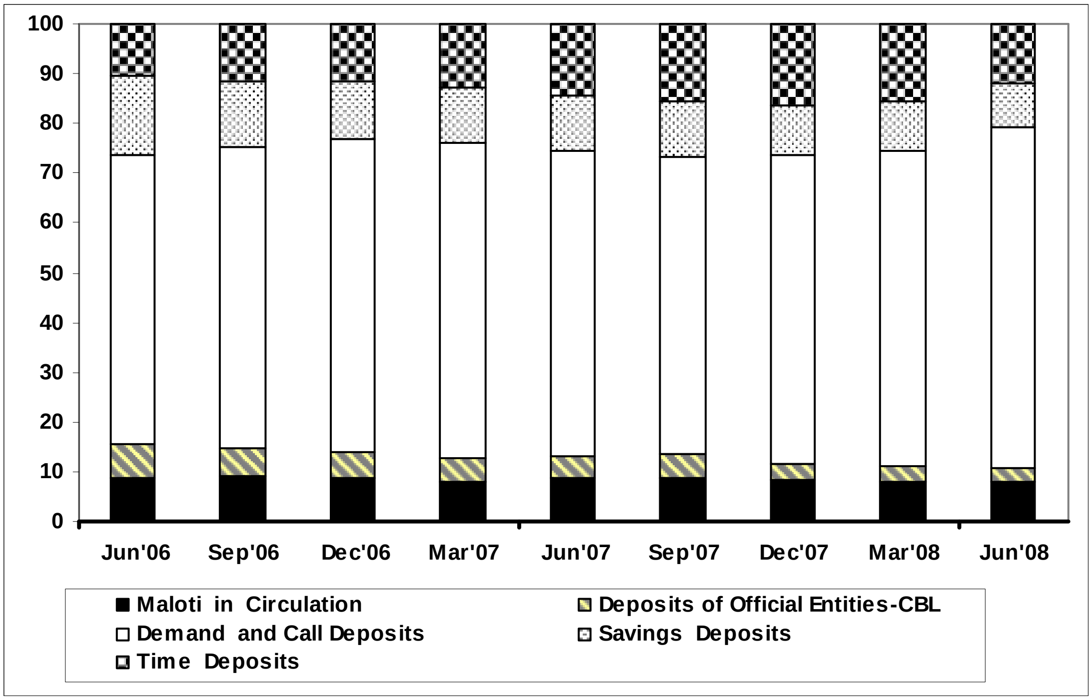
	2007			2008	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Money Supply (M2)	3726.2	3766.1	4079.1	4176.5	4747.9
Money (M1)	2779.7	2755.4	2988.3	3112.6	3760.4
Maloti with public	321.5	335.5	399.3	331.0	368.9
Demand deposits[1]	2281.2	2242.4	2508.6	2640.5	3248.6
Deposits of official Entities with CBL	176.9	177.5	140.4	141.1	142.9
Quasi-Money	946.6	1010.8	1090.8	1063.9	987.5
Savings deposits	415.9	421.4	404.0	411.4	427.9
Time deposits	530.7	589.3	686.8	652.5	559.7

[1] includes call deposits

NB: Totals may not tally due to rounding off

Figure 8: Components of Money Supply

(Percentage shares)



Commercial Banks' Deposits by Holder

Deposits mobilised by commercial banks continued to increase in the quarter under review, jumping by 14.4 per cent in the second quarter of 2008 following an increase of 0.8 per cent in March. Both deposits of the private sector and statutory bodies increased, with the former rising by 11.0 per cent as the sector increase holdings of demand deposits and savings deposits. However, time deposits held by the private sector declined by 16.9 per cent in the same period. It has been on the decline since reaching a peak of M576.0 million in December 2007. This implied an increase in liquidity preference by the private sector.

Official entities increased their deposits by 32.56 per cent in the quarter ended June 2008, following a reduction of 21.3 per cent in the first quarter of the year.

Table 10: **Commercial Banks' Deposits by Holder**

(Million Maloti: End of Period)

	2007			2008	
	Jun	**Sep**	**Dec**	**Mar**	**Jun**
Total Deposits	3216.7	3242.3	3662.7	3693.7	4225.2
Private Sector	2629.3	2582.7	2930.6	3117.7	3462.0
Demand deposits	1812.3	1704.3	1968.8	2186.3	2602.6
Savings deposits	415.8	421.4	403.9	411.1	427.7
Time deposits	401.3	457.1	557.9	519.8	431.7
Statutory Bodies	587.4	659.6	732.1	576.2	763.2

NB: Totals may not tally due to rounding off

Liquidity of Commercial Banks

Liquidity is important to commercial banks because it allows them to readily provide cash to customers making deposit withdrawals. This in turn maintains strong public and business confidence in the banking system, and help curb panic and bank runs when problems arise. Liquidity is measured by the ratio of liquid assets such as cash, balances with domestic and foreign banks and short-term securities to the sum of total deposit liabilities, balances due to banks abroad and other borrowings.

Liquidity remained almost unchanged at 67.1 per cent in June. A rise in liquid assets was matched by an increase in liabilities. At the current level, liquidity is unnecessarily high since a minimum ratio of 25 per cent is considered adequate for Lesotho. It implies that customers are more than adequately covered for withdrawals and a small portion of assets are held as loans. Thus excessively high levels of liquidity could restrain economic activity through low levels of finance and threatening prospects for price stability.

Table 11: Components of Commercial Banks' Liquidity

(Million Maloti: End of Period)

COMPONENT	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Maloti Notes and Coins	29.1	41.9	62.9	55.8	43.8
Rand Notes and Coins	19.3	28.6	45.0	36.4	27.3
Balances due from Lesotho Banks	418.3	474.7	511.4	690.1	843.5
Balances due from Foreign Banks	1769.3	1884.9	2261.5	1719.1	2205.0
Clearing Balances with CBL	112.6	-6.5	-3.0	2.3	-11.2
CBL Bills	0.0	0.0	0.0	0.0	0.0
Lesotho Government Securities	520.8	492.5	483.6	452.0	476.84

The credit to deposit ratio rose slightly between the first and second quarters of 2008. It rose by 1.2 percentage points to 33.2 per cent in June 2008. Growth in credit of 12.3 per cent was stronger that the 6.6 per cent increase in deposits. However, the ratio is still low given the 75 per cent upper limit imposed by prudential liquidity limits. Stronger credit extension would improve the credit to deposits ratio, and increase the economy's potential to grow.

Table 12: Consolidated Balance Sheet of Commercial Banks

(Million Maloti: End of Period)

	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Net foreign assets	1731.5	1876.1	2185.8	2371.4	2792.5
Deposits with CBL	235.0	131.6	132.8	32.0	103.1
Credit:	1563.7	1629.3	1797.8	1825.5	2001.3
Statutory Bodies	34.3	48.3	51.5	50.1	47.7
Private Sector	930.8	1010.8	1213.5	1268.6	1401.0
Government securities	598.6	570.2	559.3	532.8	552.5
Assets/Liabilities	3530.1	3637.0	4116.4	4228.9	4896.9
Private sector deposits[2]	3216.7	3242.3	3662.7	3963.7	4225.2
Government deposits	111.2	131.5	154.8	146.6	169.7
Capital, reserves & other, net	202.2	263.3	298.8	118.6	502.0

[2] includes statutory bodies' deposits.

Demand for Money

Domestic Credit

Credit to the private sector and statutory bodies has been on a sustained upward trend in the recent quarters. It grew by 9.9 per cent in the second quarter, compared with 6.6 per cent in the quarter to March. The increase was driven by a rise in private sector credit, especially credit extended to business enterprises. The latter rose by 19.2 per cent in the review period, following an increase of 6.7 per cent the preceding quarter. The growth in business credit is an indicator of robust business confidence given increasing lending rates during the review period. Loans contracted by households declined by 8.4 per cent in June, against a growth of 7.2 per cent in the first quarter.

Credit to official entities fell by 4.8 per cent in the second quarter of the year.

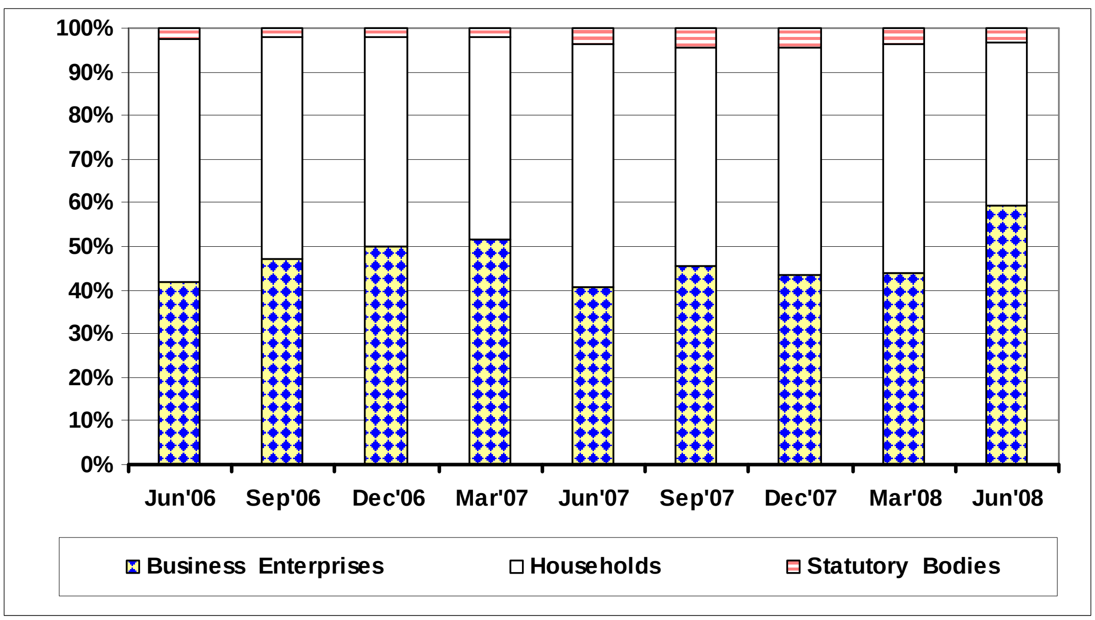
Table 13: Domestic Credit Excluding Net Claims on Government

(Million Maloti: End of Period)

	2007	2008	
	Dec	Mar	Jun
Domestic Credit	1236.6	1318.8	1448.8
Credit to private sector	1185.2	1268.6	1401.0
Business enterprises	683.6	731.0	871.5
Households	501.6	537.6	529.2
Credit to statutory bodies	51.5	50.1	47.7

Figure 9: Distribution of Credit by Holder

(Percentage shares)



Credit to Private Sector

Figure 9 shows that credit to businesses overtook credit to household as the largest contributor to total credit to the private sector and statutory bodies. Businesses account for 59.2 per cent of the total while households took 37.5 per cent. The share of business credit rose by 34.2 per cent from 44.1 per cent in March this year.

Credit to Statutory Bodies

Statutory bodies continued to account for a small share of credit extended to the non-government sectors. At 3.3 per cent in June, the share showed a slight change from the March level. The size of statutory bodies sector declined significantly following the privatisation process undertaken in the country in the past years.

Sectoral Distribution of Credit[2]

The transport, storage and communications category accounts for the largest share of credit extended to business and statutory bodies. The category saw an increase in credit of 42.4 per cent between March and June this year. Construction received the second largest share of credit at 22.9 per cent of the total, though its credit fell by 5.0 per cent in the quarter under review. Community, social and personal services increased by 2.6 per cent, and took up 12.3 per cent of total credit.

[2] Data on sectoral distribution has been revised following data correction efforts of one the commercial banks where some credit to business enterprises were wrongly classified as being granted to households. The revision corrects the overestimate of credit extended to households.

Table 14: Sectoral Distribution of Credit

(Million Maloti: End of period)

SECTOR	2007	2008	
	Dec	Mar	Jun
Agriculture+	14.0	52.7	67.2
Mining	3.2	3.8	3.8
Manufacturing	74.1	80.5	84.5
Construction	220.4	221.8	210.7
Transport, storage and communication	218.7	197.3	281.0
Electricity, gas and water	3.1	3.8	6.3
Wholesale, retail, hotel and restaurant	63.6	70.3	81.8
Non-bank financial institutions and real estate	41.5	40.5	71.1
Community, social and personal services.	96.5	110.3	113.2
All sectors	735.1	781.2	919.7

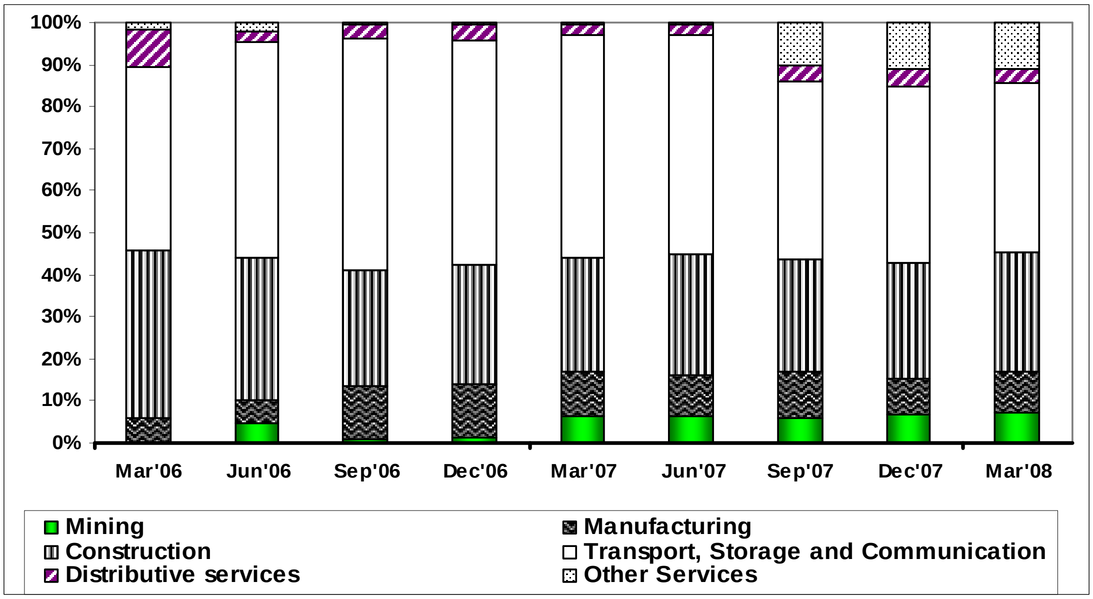
+ Incl. hunting, forestry and fishing.

Manufacturing is the largest contributor to gross domestic product, with an estimated contribution of 15.0 per cent for the year 2007. However, its share of credit is relatively low at 9.2 per cent in June 2008. In addition, the sector grew modestly during the quarter under review implying that the sector continues to be largely financed through other options.

Wholesale, retail and leisure enterprises' credit rose by 9.0 per cent, and improved its share of credit to 8.9 per cent. The non-bank financial institutions and real estate category also saw a strong increase in credit. The mining industry, which has shown strong growth and increasing contribution to aggregate economic activity, accounts for a small share of credit extended by domestic commercial banks.

Figure 10: Commercial Banks' Credit to Business Enterprises

(Percentage shares)



Net Claims on Government

Total net claims of government fell significantly during the period under review after an increase of 1.5 per cent in the previous quarter. The fall mainly reflected a buildup in government deposits with both the Central Bank and commercial banks. Deposits held with the Central Bank increased by 3.2 per cent during the review quarter. In addition, claims on the government by the Bank fell by 4.7 per cent in the same period. Thus, net claims on government by the Bank declined by over M200.0 million.

Net claims by commercial banks changed modestly between the two periods due to similar increases in claims and deposits (see Table 8).

Table 15: Banking System's Net Claims on Government

(Million Maloti: End of Period)

Holder	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Commercial banks	487.4	438.7	404.5	386.2	382.8
Claims on Government	598.6	570.2	559.3	532.8	552.5
o/w MP T Bills[3]	508.6	480.2	470.3	443.8	476.8
Less Government deposits	111.2	131.5	154.8	146.6	169.7
CBL	-2907.8	-3538.8	-3728.8	-3660.0	-3914.0
Claims on Government[4]	261.5	261.2	263.3	327.7	311.7
Less Government deposits	3169.3	3800.0	3992.3	3987.7	4115.7
o/w blocked account	587.9	590.9	537.8	510.3	509.5
Total Net Claims	-2420.4	-3100.1	-3324.3	-3273.8	-3531.7

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

Net Foreign Assets

Net foreign assets of the banking system maintained an upward trend during the reporting period increasing by 6.1 per cent in June from a rise of 10.5 per cent in March. Net foreign assets held by the Central Bank rose by 2.1 per cent in the quarter ending June compared to 11.5 per cent at the end of March. Commercial banks also experienced a net growth in foreign asset holdings, recording a 17.8 per cent change in the second quarter from 7.8 per cent growth in the preceding quarter.

The growth in external reserves was driven by a strong increase in the current account surplus, which overshadowed a slowdown in the capital and financial account. A combination of a rise in net exports and receipt of higher SACU non-duty revenue accounted for an increase in the current account surplus.

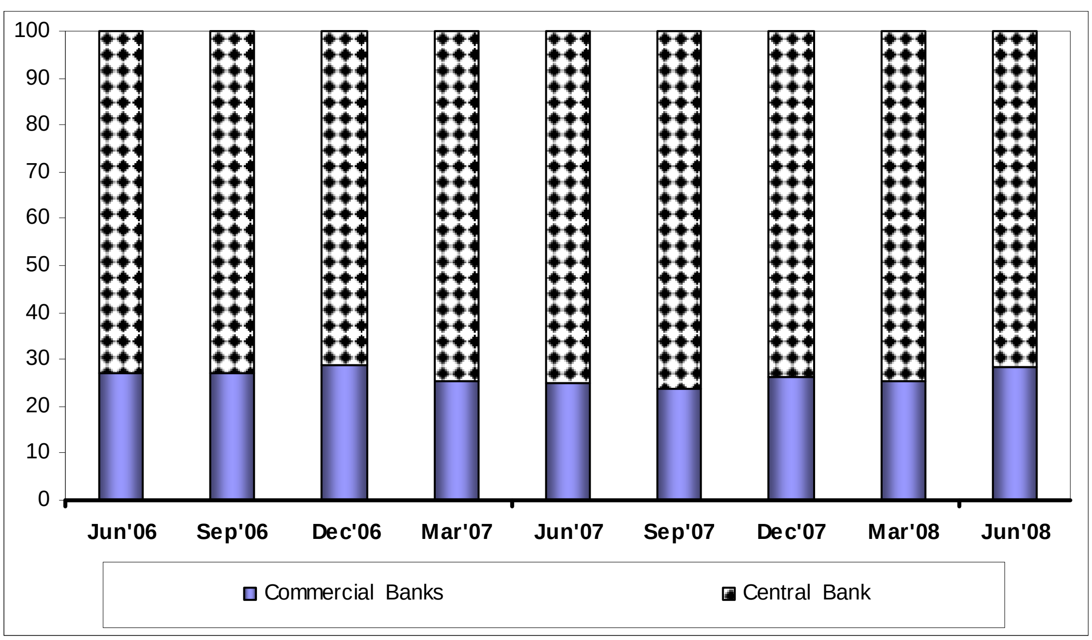
Table 16: Banking System's Foreign Assets and Liabilities

(Million Maloti: End of Period)

Holder	2007			2008	
	Jun	Sep	Dec	Mar	Jun
A. Commercial Banks	1731.5	1876.1	2200.3	2371.4	2792.5
Foreign Assets	1858.2	1971.3	2273.7	2448.4	2858.4
Foreign Liabilities	-126.7	-95.1	-73.4	-77.0	-65.9
B. Central Bank of Lesotho	5233.7	6063.4	6177.3	6887.2	7028.8
Foreign Assets	5799.2	6670.1	6786.3	7560.4	7725.8
Foreign Liabilities	-565.5	-606.7	-609.0	-673.2	-697.0
Net Total	6965.2	7939.5	8377.6	9258.6	9821.2

Figure 11: Net Foreign Assets

(Percentage shares)



Money Market Developments

Overview

The total stock of treasury bills auctioned in the second quarter was virtually unchanged from the level recorded in the first quarter at M533.0 million. Currently, treasury bills are auctioned by the Central Bank solely for monetary policy purposes. The unchanged stock implies that the Bank did not experience abnormal liquidity changes during the period. However, the holding of treasury bills between major groups of investors changed during the period. Securities held by commercial banks declined slightly whereas the non-financial sector gained in the share of securities held.

Despite the constant total stock of securities auctioned, the average yield improved by 40 basis points to 10.16 per cent. This was in line with the general trend of interest rates in the region.

Table 17: Holding of Treasury Bills

(Face Value; Million Maloti)

Type of Holder	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Total	601.0	590.3	560.2	533.0	533.2
Banking System	508.9	480.4	470.6	458.2	455.5
Central Bank	0.3	0.3	0.3	0.3	0.3
Commercial Banks	508.6	480.1	470.3	457.9	455.2
Non-Bank Sector	92.2	109.9	89.6	74.8	77.7
NBFIs	0.5	0.0	0.3	0.3	0.3
Others	91.7	109.9	89.3	74.5	77.4
Memorandum Item					
Average Yield (percent)	7.79	9.32	9.33	9.76	10.16

Money Market and Short-term Interest Rates

Interest rates in the region continued to increase in line with signals sent by monetary authorities in their bid to contain inflationary pressures. The SARB increased its repo rate by 100 basis points during the second quarter, after a 50 basis points raise in the first quarter. This influenced South African commercial banks to increase their prime lending rates by the same margin. Commercial banks in Lesotho responded by raising the average prime rate by 58 basis points. This further reduced the margin between the South African and Lesotho average prime rates from 117 basis points in March to 75 basis points in June (see Figure 12).

Treasury bill rates in both countries continued on an increasing trend, but Lesotho's rate stayed below that of South Africa due to strong competition for securities in the domestic market. The direction of deposit rates was mixed during the review period. Average savings rate recovered by 45 basis points to 5.04 per cent at the end of June, following a decline of 8 basis points in the preceding quarter. The 88-days, 6 months and 1 year deposit rates also increased in the second quarter. However, the 31-day average deposit fell by 18 basis points.

Table 18: Major Money Market Interest Rates

(Percent: End of Period)

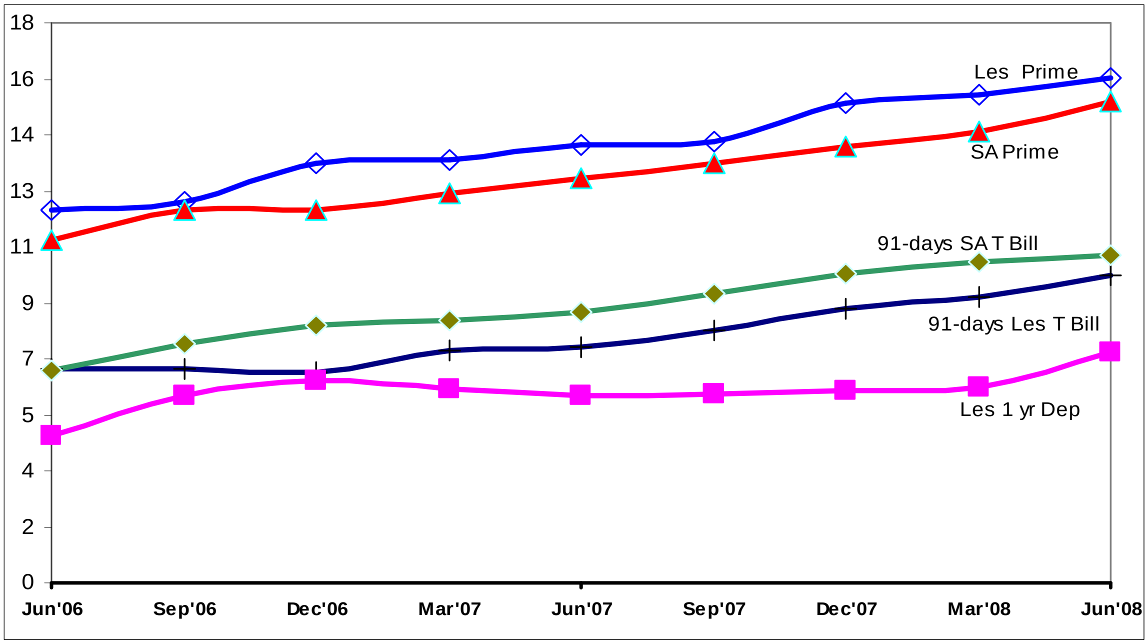
Interest Rates by Type	2007			2008	
	Jun	Sep	Dec	Mar	Jun
Central Bank					
T Bill Rate – 91 Days	7.56	8.12	8.82	9.21	9.91
Lombard Rate	11.56	12.12	12.82	13.21	13.81
Commercial Banks[5]					
Call	3.95	4.27	4.37	5.20	5.02
Time:					
31 days	3.90	4.88	4.88	6.25	5.41
88 days	4.52	5.47	5.38	5.55	6.09
6 months	4.77	5.87	5.63	5.75	6.52
1 year	6.00	6.07	6.17	6.28	7.42
Savings	3.21	4.05	4.67	4.59	5.04
Prime	14.08	14.17	15.42	15.67	16.25
South Africa*					
Repo	9.50	10.00	10.50	11.00	12.00
T Bill Rate – 91 Days	8.68	9.30	9.96	10.29	10.55
Marginal Lending Rate	14.50	15.00	15.50	16.00	17.00
Prime	13.00	13.50	14.00	14.50	15.50

* Figures for South Africa were obtained from the SARB

[5] Average rates at commercial banks

Figure 12: Short-Term Interest Rates

(Percent Per Annum)



V. Government Finance

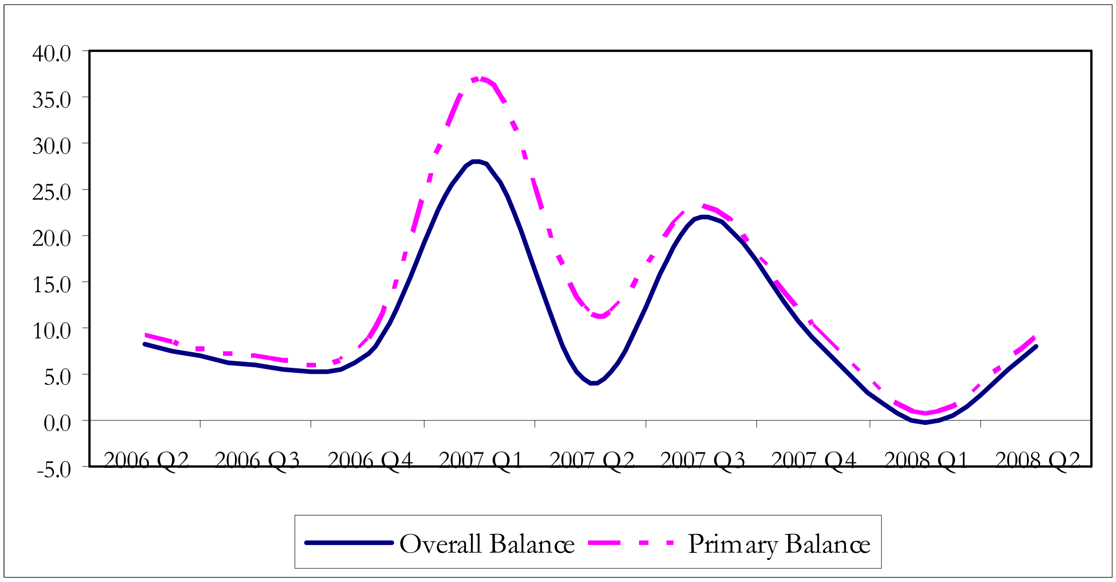
Summary of Budget Outturn

During the period under review government budgetary operations resulted in an estimated surplus equivalent to 8.1 per cent of GDP. The primary balance was slightly higher at 9.0 per cent of GDP[3], largely reflecting a smaller interest payment. The surplus was realised mainly on account of improvement in revenue collections during the period under review.

Government expenditure and net lending fell by 3.5 per cent during the same period. This item accounted for 50.9 per cent of GDP, in contrast to 60.7 per cent recorded in the previous period, while revenue occupied 59.0 per cent of GDP. As a share of total, recurrent expenditure stood at 73.7 per cent, compared with 26.3 per cent of expenditure on capital formation.

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

Figure 13: Primary Balance versus Overall Balance



Revenue

Customs revenue continued to dominate tax revenue during the period under review. This sub-item occupied 65.7 per cent of tax revenue, compared with 20.9 per cent and 13.3 per cent from income tax and Value Added Tax (VAT) respectively. Total revenue including grants rose by 12.5 per cent, mainly attributable to 18.8 per cent and 27.8 per cent increases in customs and non-customs revenue.

Table 19: Government Revenue

(Million Maloti)

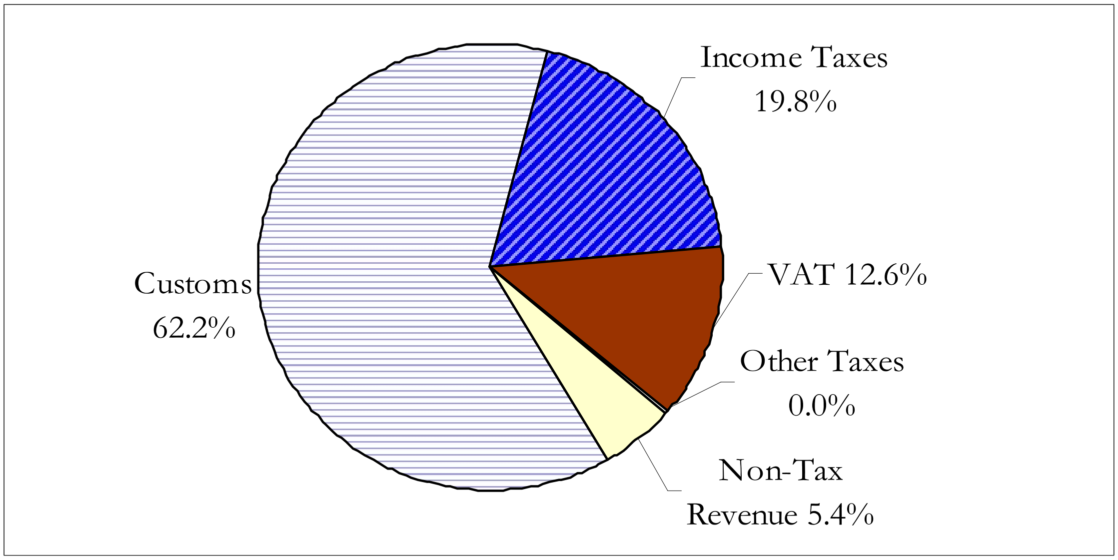
	2007/08				2008/09
	Apr-Jun	**Jul-Sep**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun*** Preliminary
Total Revenue and Grants	1885.0	2058.0	1790.7	1758.5	2001.2
Total Revenue	1800.0	1949.0	1766.2	1748.8	1971.4
Tax Revenue	1598.6	1782.3	1562.5	1497.4	1864.7
Customs	959.1	1220.5	959.1	959.1	1225.2
Non-customs	639.6	561.8	603.4	538.3	639.5
Income Taxes	407.3	289.4	293.4	301.8	390.1
Taxes on goods & services	227.2	261.3	287.6	230.5	248.5
Other Taxes	5.2	11.1	22.4	6.0	0.9
Non-Tax Revenue	201.3	166.8	203.8	251.4	106.7
Of which: Water royalties	63.6	80.7	81.0	67.0	77.9
Grants	85.0	109.0	24.5	29.8	29.8

Source: Ministry of Finance and Development Planning (MoFDP)
*Preliminary estimates

In contrast to a 15.0 per cent decline in the previous period, VAT grew by 11.4 per cent. This mainly reflected an improvement in buying power, following a 15.0 per cent salary adjustment effected in April. Income tax collections rose by 29.2 per cent compared with a 2.9 per cent recorded in March, largely on account of a two fold increase in company and withholding taxes. However, a 10.5 per cent decrease in personal income tax component moderated the increase.

Non-tax revenue fell by 57.6 per cent during the period under review, compared with a 23.4 per cent surge in the previous quarter which was attributed to receipts of Rand Monetary Compensation which is remitted once during the first quarter. This item also comprises administrative fees, royalties, dividends, interest on loans on-lent to public enterprises and other property income. Development grants remained relatively small during the review period. However, this item is expected to improve in the future with implementation of donor supported development projects.

Figure 14: Sources of Government Revenue



Expenditure

Government expenditure and net lending dropped by 3.5 per cent during the review period, mainly reflecting a 22.1 per cent decrease in capital expenditure, which more than offset a 5.3 per cent increase in recurrent expenditure. The growth in recurrent expenditure was driven by transfers and subsidies along with payments of wages and salaries.

The level of subsidies and transfers extended during the period under review rose by 9.8 per cent. This expenditure category is directed to, among others, educational entities, health establishments and finances of pensions and gratuities. Subventions and transfers surged by 15.1 per cent during the review period, while pensions and gratuities declined by 6.2 per cent. The wage bill increased by 14.3 per cent in response to, among others, the 15.0 per cent salary adjustment effected at the beginning of the fiscal year, and the increase in employment of professional personnel in civil service.

However, the increase in recurrent expenditure was moderated by the decline in expenditure on goods and services, which measured 10.0 per cent during the period under review.

Table 20: Government Expenditure

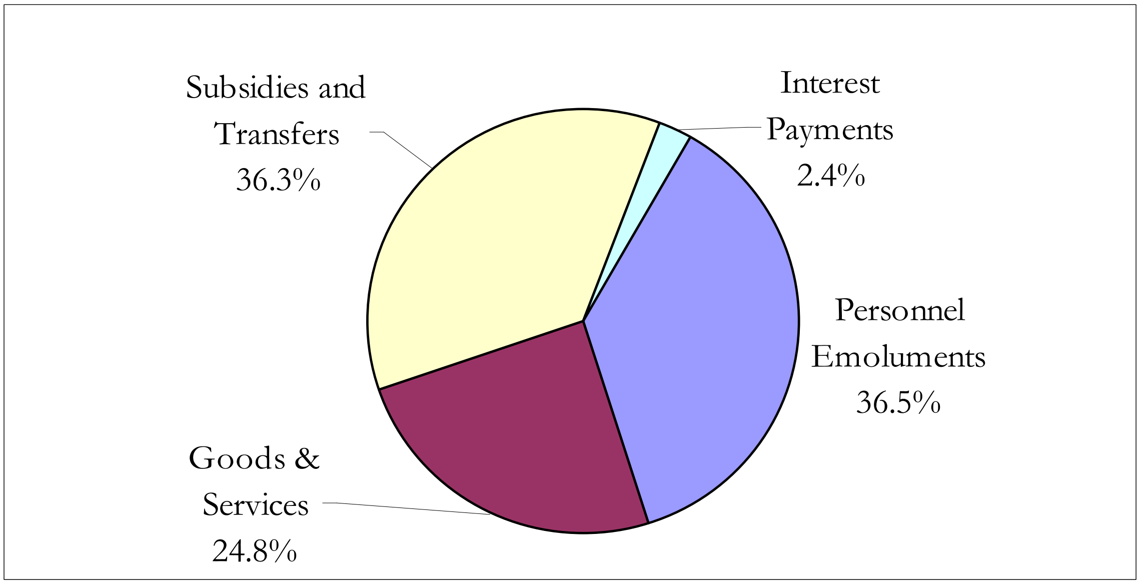
(Million Maloti)

	2006/07	2007/08			
	Apr-Jun	**Jul-Sep**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun*** Preliminary
Total Expenditure & Net Lending	1766.3	1406.2	1523.1	1788.4	1726.0
Recurrent Expenditure	1437.5	1120.1	1207.7	1208.5	1272.4
Personnel Emoluments	387.7	402.3	407.1	406.9	465.0
Interest Payments	219.7	36.9	34.8	30.9	30.2
Foreign	204.0	11.5	14.2	12.5	13.1
Domestic	15.7	25.4	20.6	18.4	17.1
Other Expenditure	830.1	680.9	765.7	770.8	777.2
Capital Expenditure	329.9	287.9	315.5	582.8	454.3
Net Lending	-1.1	-1.8	0.0	-2.9	-0.6

Source: MoFDP
*Preliminary estimates

Government continued to show commitment to provision of infrastructure. This is reflected by a larger contribution in capital expenditure at 86.5 per cent, compared with 7.0 per cent and 6.6 per cent funding from loans and grants, respectively. Overall, capital expenditure fell by 22.1 per cent from the level observed in the previous quarter. However, this is expected to increase in the near future with construction of road and water related infrastructure.

Figure 15: Recurrent Expenditure by Type



Financing

Government budgetary operations resulted in a surplus equivalent to 8.1 per cent of GDP during the period under review. This was largely on account of improvement in revenue collections, coupled with the increased SACU remittances. However, Government needs to diversify revenue sources to reduce reliance on SACU revenue as it may decline significantly with implementation of SADC Free Trade Area (FTA).

Table 21: Government Financing

(Million Maloti)

	2006/07	2007/08			
	Apr-Jun	**Jul-Sep**	**Oct-Dec**	**Jan-Mar** Revised	**Apr-Jun*** Preliminary
Financing	-118.7	-651.8	-267.6	9.8	-275.2
Foreign	25.6	18.9	-23.0	-26.0	-20.7
Loan drawings	81.5	62.0	30.7	36.7	10.9
Amortization	-55.9	-43.1	-53.7	-62.7	-31.6
Domestic	-144.3	-670.7	-244.6	35.8	-254.5
Bank Financing	-145.2	-679.7	-224.2	50.6	-257.4
Non – Bank	0.9	9.0	-20.3	-14.8	2.9

Source: MoFDP

Public Debt

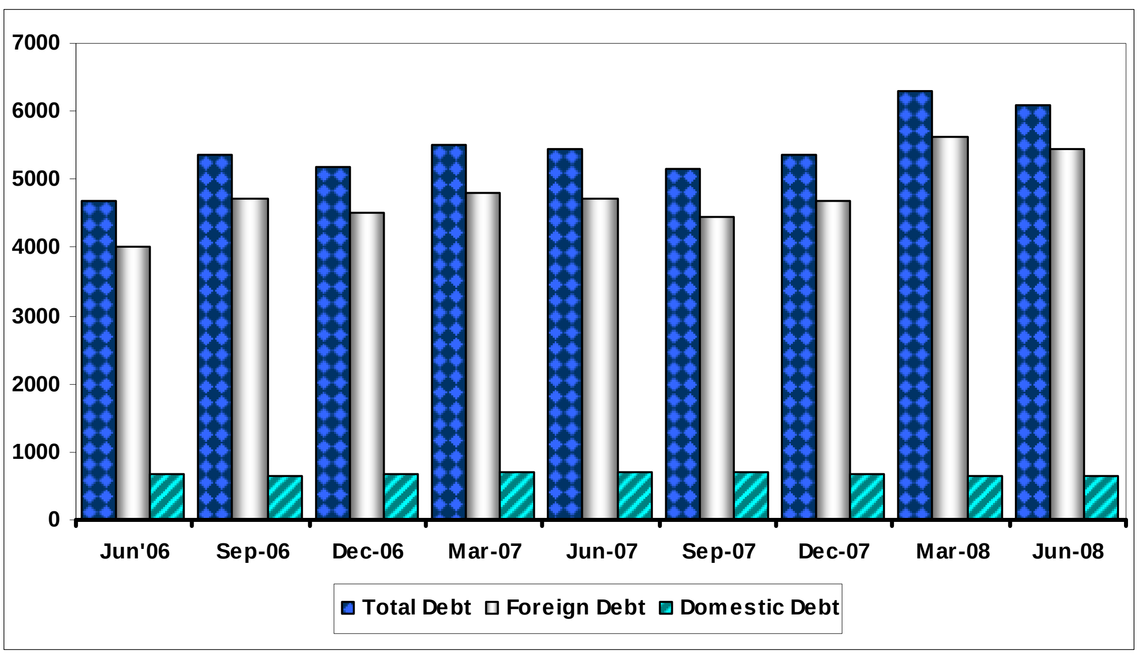
Overview

Public debt comprises external and domestic debt all of which are a liability of Government. The total stock fell by 2.7 per cent at the end of the second quarter of 2008, largely driven by the external component. As a percentage of GDP, public debt was estimated at 45.0 per cent, compared with 53.2 per cent recorded in the previous period. Foreign debt service ratio declined from 2.8 per cent to 1.5 per cent, largely on account of improved performance by the exports sector. It was recorded at 2.2 per cent when factor income is excluded. This is calculated as the ratio of debt service to exports of goods and services; it may include factor income depending on how significant it is to the overall value.

External debt continued to occupy the lion's share of the total public debt, accounting for 89.3 per cent compared with a meagre 10.7 per cent of domestic debt. As a result, public debt is vulnerable to foreign exchange volatility.

Figure 16: Outstanding Public Debt

(Million Maloti: End of Period)



External debt

External debt (or foreign debt) is defined as the liability of Government to creditors outside the country, or debt denominated in foreign currency. External debt is broken down into concessional and non-concessional. During the period under review, external debt decreased by 3.0 per cent, against a 20.2 per cent growth observed in the previous quarter. The fall was mainly attributed to 2.9 per cent drop in debt from multilateral agencies which was, to some extent, driven by currency appreciation against the major currencies with which debt is contracted. As a result, multilateral debt remained almost unchanged from 92.6 per cent of external debt recorded in the last quarter while that from bilateral sources and financial institutions dropped further to 4.8 per cent and 1.5 per cent respectively. Consequently, concessional debt as a percentage of external debt declined marginally to 94.3 per cent. This bodes well for Lesotho as it plays a critical role to ease debt service burden, and also to meet debt sustainability indicators.

Various rules of thumb have been developed by different institutions in an effort to assist countries to test for debt sustainability. These rules of thumb are used as early warning signals for fiscal sustainability, depending on the nature and composition of public debt stock.

Table 22: External Debt

(Million Maloti)

	2007			2008	
	QII	QIII	QIV	QI	QII
External Debt	4725.0	4464.6	4680.6	5626.5	5455.2
Bilateral Loans	346.6	224.9	296.3	275.1	261.2
Concessional	299.7	188.1	250.6	234.0	221.5
Non-concessional	46.9	36.8	45.7	41.1	39.7
Multilateral Loans	4230.8	4109.1	4220.8	5210.7	5058.5
Concessional	4119.2	3990.0	4099.3	5051.1	4900.4
Non-concessional	111.6	119.1	121.5	159.6	158.1
Financial Institutions	87.6	81.4	98.8	81.3	79.8
Concessional	29.4	24.4	29.4	24.0	24.0
Non-concessional	58.2	57.0	69.4	57.3	55.8
Suppliers' Credit	60.0	49.2	64.7	59.4	55.7

Source: MoFDP

Domestic Debt

Domestic debt is the component of public debt which is denominated in local currency. In contrast to the trend established last year, it rose marginally by 0.4 per cent. This was a result of an increase in the holding of Government securities by the non-banking sectors, which grew by 7.5 per cent during the review period.

Short-term debt comprised Treasury bills issued for monetary policy purposes, while long-term debt represented a ten year bond issued to finance the restructuring of the financial sector in 1999. Long-term debt remained unchanged from the level recorded in the previous quarter. As a percentage of GDP, domestic debt dropped to 4.8 per cent.

VI. Foreign Trade and Payments

Overview

The external sector position continued to show surpluses during the quarter under review. The overall balance registered a lower seasonally adjusted surplus of M163.3 million compared with M769.6 million recorded in the previous quarter. The transaction balance, which represents the overall balance excluding the effects of currency fluctuations, in seasonally adjusted widened to a surplus of M303.0 million in the review quarter from M173.5 million, largely due to improvements in the current account.

Current Account

The current account balance remained strong in the review quarter. It registered a surplus equivalent to M829.3 million during the review quarter compared with revised surplus of M506.3 million recorded in the previous quarter, mainly as a result of development in the export sub-sector and an increase in current transfers. Relative to GDP, current account surplus widened to 26.1 per cent in the second quarter from 15.9 per cent registered in the first quarter 2008.

Table 23: Current Account Balance

(Million Maloti)

	2007			2008	
	QII	QIII	QVI	QI*	QII+
I. Current Account	36.83	440.15	328.39	506.26	829.25
(a) Goods	-1360.30	-1489.23	-1382.65	-1399.37	-1223.39
Merchandise exports f.o.b.	1244.83	1656.58	1456.93	1445.27	1846.99
Of which diamonds	178.54	341.21	357.30	291.69	391.69
Of which textiles & clothing	797.02	991.10	842.01	877.11	942.73
Other exports#	269.27	324.27	257.62	276.37	512.57
Merchandise imports f.o.b.	-2605.13	-3145.81	-2839.58	-2844.64	-3070.38
(b) Services	-42.19	-61.27	-66.48	-63.03	-82.10
(c) Income	591.72	849.22	950.00	1020.96	1032.83
(d) Current Transfers	875.65	1169.60	827.52	947.70	1101.91

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

Merchandise exports

Merchandise exports, in seasonally adjusted terms, grew by 28.7 per cent in the review quarter compared with a rise of 4.1 per cent registered in the previous quarter. The improvement resulted from an increase in exports of diamonds which was supported by high production at the Liqhobong Diamond mine coupled with inclusion of Kao Diamond mine production which started exporting in the second quarter 2008. On an annual basis, merchandise exports rose by 48.0 per cent. As a share of GDP, merchandise exports rose to 58.1 per cent in the review period following 45.4 per cent recorded in the previous quarter.

Merchandise imports

In seasonally adjusted terms, merchandise imports fell by 0.4 per cent in the quarter under review as compared to a fall of 0.02 per cent in the previous quarter. This reflected improvements in declarations at Border Post coupled with an increase in private vehicles. In unadjusted terms, imports grew by 7.9 per cent in the second quarter compared with a rise of 0.2 per cent recorded in the first quarter 2008. On an annual basis, merchandise imports rose by 17.9 per cent reflecting among others, a general upward trend in raw materials of manufacturing industries.

Table 24: Value of Exports by Section of the S.I.T.C. #

(Million Maloti)

COMMODITY	2007			2008	
	QII	QIII	QIV	QI*	QII+
0. Food & Live Animals	60.69	38.45	49.00	56.52	88.24
Cattle	0.45	0.02	0.00	0.08	0.00
Wheat Flour	23.60	19.81	21.53	26.84	48.43
Maize Meal	6.52	6.66	7.86	3.08	3.24
Other	30.57	11.96	19.61	26.52	36.57
1. Beverages & Tobacco	40.98	46.73	34.67	31.97	48.39
Beverages	40.98	46.69	34.67	31.97	48.39
2. Crude Materials	1.98	2.85	3.09	4.30	3.47
Textiles fibres	1.98	2.85	3.09	4.30	3.47
Of which Wool	1.19	0.97	3.09	3.94	3.17
Of which Mohair	0.80	1.88	0.00	0.36	0.30
3. Mineral Fuels & Related Products	0.84	0.35	0.05	0.98	0.39
4. Chemicals	0.60	1.59	0.28	0.82	0.95
5. Manufactured Goods	209.03	367.23	368.54	326.35	459.70
Of which diamonds	178.54	341.21	357.30	291.69	391.69
Of which textiles yarn and fabric	22.09	15.98	8.06	19.42	47.71
Other manufactured goods	8.4	10.04	3.18	15.24	20.39
6. Machinery & Transport Goods	112.69	178.23	210.62	133.47	259.41
7. Miscellaneous Manufactured Goods	815.55	1017.69	790.60	886.96	984.77
Of which clothing accessories	772.94	972.27	778.43	859.65	942.73
Other	42.61	45.42	12.19	27.31	32.04
8. Unclassified Goods	2.47	3.46	0.08	3.92	1.67

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

Direction of Trade

During the quarter under review, Africa, particularly SACU region became the largest recipient of Lesotho's exports with a share of 44.4 per cent compared with 39.2 per cent recorded in the previous quarter. The second largest portion of Lesotho's exports was destined to the US market at a share of 31.6 per cent compared with 39.6 per cent observed in the previous quarter. The European market remained the third largest recipient of Lesotho's export, in particular diamond exports. Its share rose to 21.2 per cent in the review quarter from 20.5 per cent recorded in the previous quarter. The proportion of exports to the Asian market remained negligible at a share of 0.6 per cent.

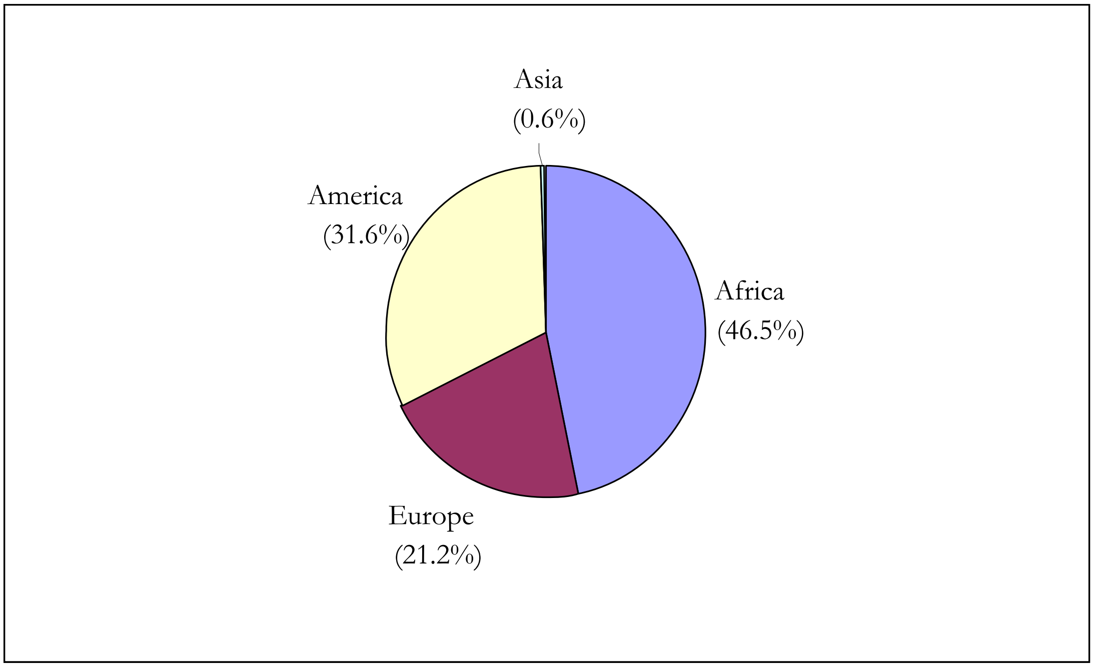
Table 25: Direction of Trade - Exports and Re-Exports, f.o.b.

(Million Maloti)

Region	2007			2008	
	QIII	QIII	QIV	QI*	QII+
World	1244.83	1656.58	1456.93	1445.27	1842.70
Africa	413.22	535.26	557.15	566.54	857.69
SACU	363.02	513.45	512.51	513.07	818.55
SADC	1.99	1.21	16.13	14.45	3.98
Other	48.21	20.60	28.55	39.02	35.16
Europe	182.34	346.23	360.34	295.85	391.29
EC	182.34	346.23	360.34	295.85	391.29
America	642.38	770.76	537.16	572.92	582.76
Asia	6.89	4.33	2.29	9.96	10.96

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

Figure 17: Direction of Merchandise Exports



Services Account

Net services recorded an outflow of M82.1 million during the review quarter, compared with outflow of M63.0 million registered in the previous quarter, largely due to an increase in outflows of transportation and government services.

Travel

The value of net travel grew by 12.2 per cent during the second quarter in contrast with a fall of 6.7 per cent observed in the previous quarter. Travel receipts increased by 4.7 per cent following a decline of 2.1 per cent registered in the previous quarter. Travel payments fell by 5.4 per cent from a rise of 4.9 per cent recorded in the previous quarter, due to a decline in government international subsistence allowance which fell by 45.1 per cent.

Income

Net income increased by 1.2 per cent in the second quarter compared with a rise of 7.5 per cent registered in the first quarter 2008. The observed performance was largely attributable to a rise in interest earned by CBL and commercial banks which rose by 4.6 per cent and 21.6 per cent, respectively. On an annual basis, net income rose by 78.9 per cent.

Labour income

During the review quarter, Labour income fell by 0.2 per cent compared with a rise of 8.1 per cent registered in the previous quarter. This was on account of a fall in number of Basotho migrant mineworkers as a result of temporary closure of certain mining shafts due to introduction of load-shedding measures. A number of mines in South Africa have reported an effect of load-shedding on their operations. As a result, miners' remittances fell marginally by 0.03 per cent. On an annual basis, labour income grew by 25.1 per cent.

Investment Income

Net investment income recorded a net inflow equivalent to M174.9 million in the review quarter, following a net inflow of M161.8 million registered in the previous quarter, due to a rise in returns on CBL and commercial banks' investments.

Investment income inflows increased by 8.9 per cent in the period under review compared with a fall of 0.3 per cent observed in the previous quarter. The growth was on account of attractive regional interest rates which boosted the earnings on investments. Investment income outflows rose by 13.4 per cent during the quarter in contrast to a fall of 20.4 per cent recorded in the previous quarter, largely as a result of an increase in interest payments on government loans.

Current Transfers

In seasonally adjusted terms, current transfers rose to M1.1 billion during the quarter under review compared with M928.4 million registered in the previous quarter. The observed performance resulted from a rise in SACU non-duty receipts which increased by 31.3 per cent. On an annual basis, current transfers increased by 30.0 per cent.

Capital and Financial Account

The capital and financial account narrowed to net inflows of M72.4 million in the review period from a revised inflow of M330.9 million observed in the previous quarter, due to a rise in commercial banks' foreign assets. Commercial banks foreign assets rose to M410.0 million compared with M189.3 million recorded in the previous quarter, as a result of higher interest rate in SA.

Table 26: Capital and Financial Account

(Million Maloti)

	2007			2008	
	QII	QIII	QIV	QI*	QII+
I. Capital and Financial Account	393.09	248.60	-83.21	330.96	72.44
Capital Account	85.00	109.00	24.50	29.80	29.80
Financial Account	305.49	136.40	-107.71	301.16	42.64
Special Financing – LHWP	45.56	37.91	50.97	37.79	49.93
II. Reserve Assets	143.38	-870.86	-116.19	-774.19	-165.33

* Revised estimates
\+ Preliminary estimates

Reserve Assets

Gross reserves rose by 2.2 per cent to M7.7 billion during the quarter under review compared with 11.4 per cent increase recorded in the previous quarter. As a result, official reserves measured in months of imports cover increased to 7.4 months from 7.2 months observed in the previous quarter. The Net International Reserves (NIR) grew by 4.7 per cent to US$876.4 million in the review period.

Figure 18: Reserve Assets

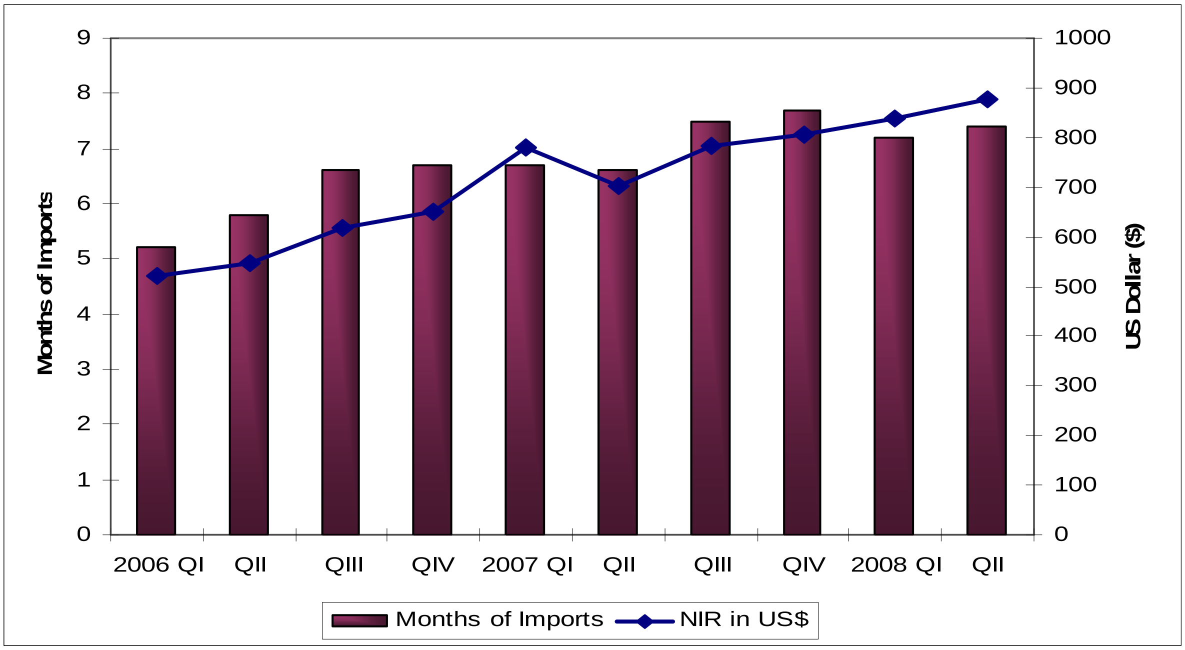
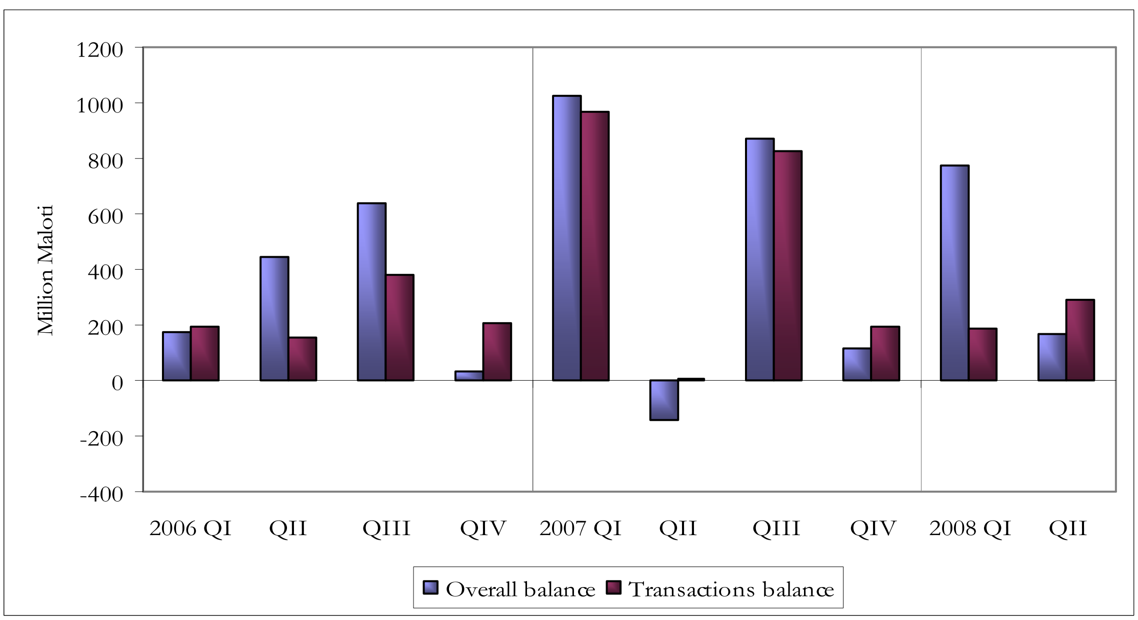


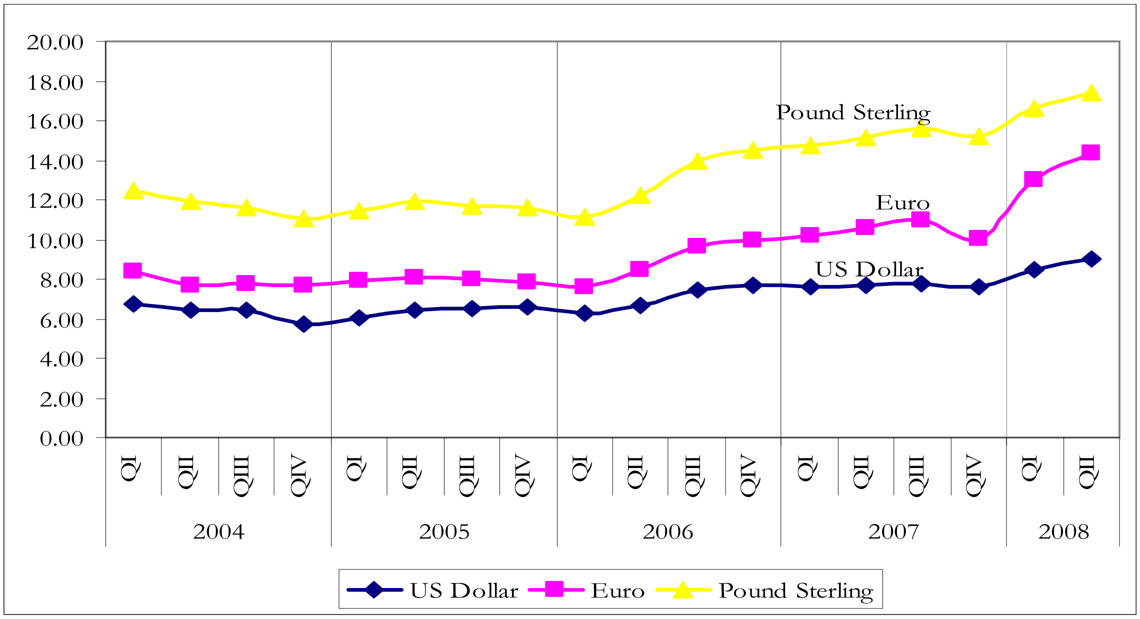
Figure 19: Balance of Payments



Exchange Rates

The local currency continued to show some weakness against major currencies during the quarter under review. In real terms, the Loti depreciated by 6.4 per cent against the US dollar, due to among other factors, negative investor perceptions with regard to SA growth prospects following electricity supply shortages. Against the Euro and the Pound Sterling, the Loti depreciated by 10.5 per cent and 4.8 per cent, respectively.

Figure 20: Real Exchange Rate of the Loti against Major Currencies



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