# 2024 FINANCIAL STABILITY REPORT

CENTRAL BANK OF LESOTHO

BANKA E KHOLO EA LESOTHO

CENTRAL BANK OF LESOTHO

# FINANCIAL STABILITY REPORT

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The *Financial Stability Report* is available on the Central Bank of Lesotho website at **www.centralbank.org.ls.**

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# GOVERNANCE, MISSION & OBJECTIVES

## Ownership and Governance

The Central Bank of Lesotho is a statutory organisation
fully owned by the Government of Lesotho.

The Central Bank enjoys a fair amount of independence in formulating and implementing monetary policy. The Governor, who is also the chairman of the Board of Directors, together with the two Deputy Governors, are appointed by His Majesty The King on the advice of the Prime Minister.
The Minister of Finance appoints the other Board Members.

## Mission Statement

The Mission of the Central Bank of Lesotho is to achieve and maintain monetary and financial system stability to support balanced macroeconomic development of Lesotho.

## Objectives

The principal objective of the Central Bank of Lesotho, as stipulated in the Central Bank of Lesotho Act of 2000, is to achieve and maintain price stability.
Other related objectives which are supportive to this mission are:

- To foster the liquidity, solvency and proper functioning of a stable market-based financial systems;
- To formulate, adopt and execute the monetary policy of Lesotho;
- To issue, manage and redeem the currency of Lesotho;
- To formulate, adopt and execute the foreign exchange policy of Lesotho;
- To license, register and supervise institutions pursuant to the Financial Institutions;
- To own, hold and manage its official international reserves;
- To act as a banker and advisor to, and as fiscal agent of the Government of Lesotho;
- To promote the efficient operations of the payments system;
- To promote the safe and sound development of the financial system; and
- To monitor and regulate the capital market.

# PREFACE

FINANCIAL STABILITY refers to the resilience of the financial system to adverse shocks while continuing to function smoothly and supporting households and firms to use their financial assets with confidence. A stable financial system contributes towards broader economic growth and an improved standard of living for all people.

The Central Bank of Lesotho (CBL) has the mandate to promote the stability and soundness of the financial system of the country. It achieves this objective through delivering on its core functions, notably: fostering the liquidity, solvency, and proper functioning of a stable market-based financial system; promoting the safe and sound development of the financial system; conducting effective supervision and regulation of financial institutions; and providing efficient, reliable and safe payment and settlement systems.

This Financial Stability Report is a tool used by the CBL for financial stability surveillance. The report seeks to play a role in preventing crises by identifying risks and vulnerabilities in the financial system and assessing the resilience of the financial system to domestic and external shocks, as well as highlighting policies that may mitigate systemic risks, thereby contributing to global financial stability and sustained economic growth. The CBL publishes the Financial Stability Report once a year, in March. Through this Report, the CBL seeks to enhance awareness of the soundness of Lesotho's financial system ❑

# LIST OF ABBREVIATIONS

| | |
|---|---|
| AGOA | Africa Growth Opportunity Act |
| BIS | Bank for International Settlements |
| CAR | Capital Adequacy Ratio |
| CBL | Central Bank of Lesotho |
| CMA | Common Monetary Area |
| CPSS | Committee on Payment and Settlement Systems |
| CSD | Centralised Securities Depository |
| EU | European Union |
| EWI | Early Warning Indicator |
| GDP | Gross Domestic Product |
| IOSCO | International Organisation of Securities Commission |
| LACH | Lesotho Automated Clearing House |
| LHWP | Lesotho Highlands Water Project |
| LSW | Lesotho Wire |
| MNO | Mobile Network Operators |
| MFI | Micro-finance Institution |
| MTI | Money Transfer Institution |
| NPL | Non-performing Loans |
| NSDP | National Strategic Development Plan |
| OFC | Other Financial Corporations |
| PAL | Payments Association of Lesotho |
| PFMI | Principles for Financial Market Infrastructures |
| ROA | Return on Assets |
| ROE | Return on Equity |
| RTGS | Real Time Gross Settlement System |
| RWA | Risk-Weighted Assets |
| SA | South Africa |
| SACU | Southern African Customs Union |
| SIPS | Systemically Important Payment Systems |
| UK | United Kingdom |
| US | United States |
| MoF | Ministry of Finance |

# CONTENTS

# EXECUTIVE SUMMARY

1. Financial sector vulnerabilities have shown mixed trends since the last Financial Stability Report. Payment system vulnerabilities increased slightly due to the ending of the CMA EFT interim solution, which led to higher transaction costs and delays. Despite the measures introduced to enhance compliance and transaction security, the overall impact on financial stability remains uncertain. The Banking sector vulnerabilities remained unchanged, with key concerns centred around asset quality. Household sector vulnerabilities, on the other hand, declined due to moderating inflation, interest rate cuts, and improved economic conditions, though the debt burden continued to be a concern for some households, especially those affected by job cuts in the mining sector.

2. The global economy has demonstrated resilience amid recent challenges, maintaining growth, albeit at a slower rate. Geopolitical tensions and economic fragmentation continue to weigh on growth and remain the main threats the recovery. Inflation significantly decreased, showing signs of potential stabilisation, providing room for policy rate cuts. However, the decline in diamond prices, driven by weak demand and the rise of lab-grown diamonds, cut on exports revenue.

3. South Africa's economy grew modestly in 2024, although structural challenges persisted. Improvements in electricity supply, reduced inflation, and strengthened performance in network industries restored investor confidence. In addition, the two-pot retirement system boosted consumer spending. However, slow structural reforms, declining investments, and global uncertainties hindered productivity. The newly formed Government of National Unity remains fragile due to different ideologies, which could ultimately lead to policy gridlock. In addition, revenue shortfalls and rising expenditures, particularly for state-owned enterprises and social programs, undermined budget consolidation efforts.

4. Lesotho's economy grew in 2024, driven by infrastructure projects and increased revenues. However, it faced challenges that weighed on growth. The observed growth was mainly driven by the LHWP-II project and a surge in construction and real estate activities. However, global geopolitical conflicts, changing weather patterns, and a deterioration in manufacturing output negatively affected overall productivity. The Central Bank of Lesotho (CBL) also cut interest rates to support economic activity in line with easing inflation. Despite registering a surplus, high debt and dependence on volatile SACU revenues raised concerns about fiscal operations long-term sustainability.

5. The banking sector's performance declined slightly compared to the previous year but remained resilient. The sector's performance declined in the face of credit risk concentration, reliance on wholesale funding, weak global activity, high inflation and tighter monetary policy. However, the sector maintained strong capital and liquidity positions. Profitability also improved despite a slight deterioration in asset quality. The stress tests results further demonstrated the sector's resilience.

6. The performance of the insurance sector improved alongside the overall economic recovery. The sector remained resilient and financially stable. Long-term insurance saw an expansion of its asset base, while short-term insurance experienced a decline. Overall profitability in the sector increased during this review period. Similarly, the credit-only microfinance institutions (MFIs) maintained a strong credit portfolio, and their asset base continued to grow.

7. The financial market infrastructures operated effectively and efficiently and continued to anchor financial stability. The systemically important payment systems (SIPS) remained reliable and stable, effectively managing the increasing volume of transactions. The mobile money sector remains a key player in promoting financial inclusion. Vulnerabilities associated with mobile money operations have been minimal and pose negligible systemic threats ❑

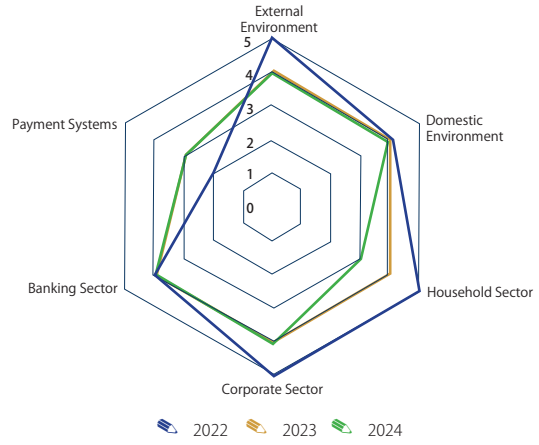
# FINANCIAL STABILITY RISKS

## 1. FINANCIAL STABILITY RISKS

Since the last Financial Stability Report (FSR), vulnerabilities across various sectors exhibited mixed trends, as shown in Figure 1. The payment system vulnerabilities increased slightly compared to 2023. Although the systems remained functional, the CMA Electronic Funds Transfers (EFT) interim solution for low-value payments and collections ended in Q3 of 2024, which led to inefficiencies. This change resulted in higher transaction costs and processing delays between CMA member states, affecting both individual and corporate payments. While efforts made to mitigate the risks and enhance cross-border transactions have improved the situation to some extent, the overall impact on financial stability remains uncertain.

The banking sector vulnerabilities remained unchanged despite the decline in interest rates and inflation rates. There are, however, concerns about asset quality and other inherent key risks, such as credit concentration and wholesale funding in the medium term. In contrast, the household sector saw reduced vulnerabilities and overall improvement. Easing inflation, interest rate cuts, and better economic conditions alleviated some financial pressures. However, the debt burden remained a concern for households affected by recent job cuts in the mining sector.

Figure 1 Financial Stability Risk Map




Source: Central Bank of Lesotho

Vulnerabilities across various sectors exhibited mixed trends.

# 2. MACRO-FINANCIAL ENVIRONMENT

## 2.1 International Developments

The global economy remained resilient, yet signs of sluggish growth persist. This resilience was demonstrated by slow but moderate growth rate compared to prior periods. The observed growth benefited from the moderating inflation, which moved towards most central banks targets, indicating potential stabilisation. Nevertheless, persistent geopolitical tensions and their repercussions for energy markets, trade dynamics, and investor sentiment generated uncertainty regarding the strength and trajectory of the anticipated recovery.

Monetary policy remained generally restrictive, although it varied across different economies. As inflation moderated towards pre-pandemic levels, major central banks, like the European Central Bank (ECB) and Federal Reserve Bank (Fed), commenced rate cuts earlier in 2024, subsequently followed by emerging markets towards year-end. Nevertheless, the renewed inflationary pressures pose a threat to the global economy. However, monetary policy remains responsive to balance concerns over inflation with the potential risk of economic slowdown.

Geopolitical risks remain elevated and pose a significant threat to the global economy. Ongoing conflicts, including the war in Ukraine and tensions surrounding the Middle East and between the US and China, created instability and intensified geoeconomic fragmentation[1]. These risks increased trade barriers, restricted capital and technology flows, and hindered cooperation, potentially leading to "black swan"[2] events that could severely impede investment, stifle innovation, disrupt commodity trade, and cause substantial economic losses as well as price volatility.

Diamond prices continue to plummet due to weakening demand, especially in key markets like China, and the increasing popularity of lab-grown diamonds. Natural diamond prices fell by 20 percent in 2024 and are projected to decline further by another 15-20 percent in 2025. This price drop reflects a shift in the diamond market from a near-monopoly to a more competitive landscape, driven by evolving demand patterns in major consumer countries like the US and China, prevailing economic conditions, and the rise of synthetic diamonds. Furthermore, the significant environmental impact of diamond mining, including deforestation, habitat destruction, and water contamination, has contributed to consumer preference for lab-grown alternatives.

Rising cyber-attacks continue to threaten economic and financial stability by eroding confidence in the financial system, disrupting critical services, or causing spillovers to other institutions. The cost of these attacks are huge and widespread, disruptive, and therefore compromised effectiveness and efficiency of the financial system. The potential losses of these attacks cause funding problems for companies and even jeopardize their solvency, while the indirect losses like reputational damage or security upgrades are substantially higher. Cyber incidents that disrupt critical services like payment networks also severely affect economic activity. For example, most attacks on the Central Banks disrupt the national payment system, preventing or causing delays in transactions.

## 2.2 South African Developments

In 2024, the South African economy showed modest improvements, even though it remains stifled by ongoing structural challenges. Improvements in the electricity supply, easing inflation, and better-functioning network industries helped boost stability and restore confidence in the latter half of the year. The introduction of the two-pot retirement system supported consumer spending, however, investment levels continued to decline, highlighting persistent structural weaknesses and global economic uncertainties. However, in line with easing inflation, the South African Reserve Bank (SARB) reduced interest rates in September and November in an attempt to lower borrowing costs and stimulate investment and consumption.

[1] Geoeconomic fragmentation is the division in global economic interactions and trade due to political tensions between countries.

[2] A black swan event is an unpredictable event that has a major impact and severe consequences.

# MACRO-FINANCIAL ENVIRONMENT

The newly formed Government of National Unity (GNU) remains fragile. While the new government was expected to pave way for more inclusive policies, the differences in coalition partners' ideologies raises the risk of policy gridlock. Furthermore, on the fiscal front, efforts to consolidate the budget were constrained by revenue shortfalls and rising expenditure commitments, particularly for state-owned enterprises and social programs.

## Vulnerabilities and risks associated with external environment developments

Weak global economic activity affects the domestic economy and financial system through macro-financial linkages. The economy is dependent on the global economy. If international growth remains weak, it may have major repercussions for Lesotho's export-dependent industries. These industries export goods and rely on banks for funding, so any revenue shock could compromise their ability to service their debt, ultimately affecting banks' profitability and asset quality.

Declining diamond export revenues pose significant economic risks, particularly for undiversified economies like Lesotho. These risks include strained government budgets and reduced public spending, followed by potential job losses, decreased investment, and rising loan defaults due to reduced profitability in the mining sector. Collectively, these negative consequences can impede economic growth and amplify systemic risks within the financial system.

Fluctuations in the rand also affect Lesotho's import costs and export competitiveness. When the rand depreciates, the cost of imports rises, while an appreciating rand makes exports less competitive. Weak global demand further compounds these currency risks, straining Lesotho's overall economic outlook.

A slowdown in the South African economic activity could result in reduced SACU revenue, constraining Lesotho's fiscal capacity. Moreover, the high public debt and ongoing grey-listing by the FATF further weakened investor sentiments, increasing uncertainty and the risk of capital outflows that could impact both economies. These macro-financial risks, combined with South Africa's fragile political environment and delayed reforms, heightened the vulnerability of Lesotho's financial system, especially with the extensive presence of South African banks operating in the country.

**Table 1 Selected Economic Indicators**

| | GDP Growth | | △ pps | Interest Rates (12-month Avg) | | △ pps | Inflation (12-month Avg) | | △ pps |
|---|---|---|---|---|---|---|---|---|---|
| | 2023 | 2024 | y/y | 2023 | 2024 | y/y | 2023 | 2024 | y/y |
| Advanced Economies | | | | | | | | | |
| US | 3.20 | 2.50 | **-0.7** | 5.23 | 5.27 | **0.0** | 4.14 | 2.96 | **-1.2** |
| UK | -0.30 | 1.40 | **1.7** | 4.73 | 5.10 | **0.4** | 7.38 | 2.53 | **-4.9** |
| Euro Area | 0.10 | 0.90 | **0.8** | 3.90 | 4.07 | **-0.8** | 5.5 | 2.40 | **-3.1** |
| Japan | 0.80 | 1.20 | **0.4** | -0.10 | 0.14 | **0.2** | 3.25 | 2.74 | **-0.5** |
| Emerging Market Economies | | | | | | | | | |
| Brazil | 2.40 | 3.60 | **1.2** | 13.25 | 10.02 | **-3.2** | 4.60 | 4.37 | **-0.2** |
| Russia | 4.90 | 4.5 | **-0.4** | 9.95 | 17.83 | **7.9** | 5.96 | 8.43 | **0.5** |
| India | 9.50 | 6.20 | **-3.3** | 6.48 | 6.50 | **0.0** | 5.66 | 4.95 | **-0.7** |
| China | 5.20 | 1.60 | **-3.6** | 3.55 | 3.34 | **-0.2** | 0.24 | 0.24 | **0.0** |
| SA | 1.40 | 0.90 | **-0.5** | 8.00 | 8.13 | **0.1** | 5.91 | 4.43 | **-1.5** |

*Source: Federal Reserve Bank, OECD data, Bank of Japan, ECB, SARB, STATS SA, Bank of Brazil, Reuters, Bank of India, Trading Economics.*

## 2.3 Domestic Developments

Economic recovery and resilience continued throughout 2024. Following subdued economic growth of about 0.9 percent in 2023, the economy rebounded strongly and expanded by 2.4 percent in 2024. Key drivers of this positive performance included the ongoing activities of the LHWP-II project, and increased activity in key sectors such as construction, real estate, and business services. On the other hand, growth was adversely affected by climate change-related shocks and a deterioration in manufacturing output stemming from the weak global demand. In addition, the delays in implementing national reforms remain a lingering concern to both the country's political and economic stability.

The moderation of inflation and economic recovery led to a cut in CBL's policy rate. In November, the CBL cut the policy rate by 25 basis points (bps) to 7.5 percent, for the first time in 2024 in an effort to improve economic conditions. However, inflationary pressures remain elevated, with demand-pull and cost-push factors persistent due to poor crop yields and the escalation of geopolitical and trade tensions. Although there is optimism for a decline in inflation and interest rates in the near term, they remained relatively high, posing ongoing constraints and risks to economic activity and financial stability.

In 2024, government budget operations recorded a surplus; however, long-term debt sustainability and dependence on unpredictable SACU revenues pose risks to financial stability. Fiscal operations resulted in an average surplus of approximately 15.0 percent of GDP. A significant increase in SACU revenues and an uptick in water royalties primarily supported this surplus. However, the fiscal balance remains unsustainable in the long run due to high government debt and continued reliance on volatile SACU revenue, which is highly susceptible to fluctuations in global economic conditions and South Africa's economic performance. In addition, low spending contributed to the observed surplus, which may weaken domestic demand, decrease productivity, result in job losses, and ultimately lead to an overall economic slowdown that threatens financial stability.

### Vulnerabilities and risks associated with domestic developments

The sluggish global economic activity and escalating geopolitical tensions pose a severe threat to the stability of Lesotho's financial sector. Weak global demand adversely affected the country's overall export performance, particularly in the mining and manufacturing sectors. The reduced export revenues may cause exporting industries to struggle with debt obligations, potentially increasing non-performing loans (NPLs) and unemployment and thus, leading to poor banking sector performance. Furthermore, ongoing global conflicts have created substantial uncertainty and strained supply chains, resulting in persistently elevated and volatile oil prices and dwindling global demand. In addition, the global economy is expected to endure greater uncertainty as the new Trump administration takes office and rolls out its new policies.

Lesotho's economic fortunes remain closely tied to South Africa's economic performance. The subdued South African economic growth is susceptible to various external risks, including commodity price fluctuations and geopolitical tensions. Due to the loti-rand peg and Lesotho's heavy dependence on SACU receipts, the country's financial sector faces ongoing exposure to the weak and volatile rand, as well as South Africa's broader economic performance. The depreciation of the rand/loti against major trading partners currencies drives up the cost of Lesotho's imports, weakening the purchasing power of companies that rely on foreign raw materials. In addition, SA's economic downturn spills over into Lesotho through various macroeconomic linkages, most notably SACU transfers, which are a critical source of funding for the country's fiscal operations. A decline in government revenue means some projects will be halted, directly impacting business profitability and, subsequently, the financial sector.

# 3. FINANCIAL STABILITY DEVELOPMENTS AND TRENDS

## 3.1 The Structure of the Financial System

The share of Lesotho's financial sector relative to GDP is significant. However, the financial markets are relatively small and concentrated, with limited investment options. The financial sector is dominated by the banking sector, which consists of three subsidiaries of South African banks and one local bank. The banking sector remains the main provider of financial services and products in the country. The three foreign-owned banks control about 90.0 percent of the banking industry's assets, revenue, and deposits. The pensions industry is the second largest sector in terms of asset base while the insurance sector is third.

The total financial sector[3] assets to GDP stood at 185.8 percent. The banking industry's total assets constituted 36.1 percent of the total financial sector assets[4] and about 67.0 percent of the gross domestic product (GDP) in 2024. Meanwhile, the pensions industry's assets represented 43.7 percent of GDP. The share of other non-bank financial institutions'[5] assets to total financial system assets was 75.1 percent as shown in Figure 2.

Financial markets in Lesotho comprise mainly money markets and securities markets, with the latter being the larger of the two markets. In both markets, government securities make up the entire portfolio of investments. This indicates that the market is relatively small and concentrated, with limited investment options. Furthermore, Lesotho's legal and regulatory framework allows for both deposit-taking MFIs and credit-only MFIs, but only deposit-taking MFIs operated during the review period. The eight largest MFIs hold a significant market share.

The four commercial banks collectively have 50 branches across the country. The banking sector is characterised by limited competitiveness and is highly concentrated with a Herfindal-Hirschman index[6] (HHI) of 3 725. The insurance sector also exhibited high concentration in both long-term and short-term categories, with HHI scores of 6 045 and 6 763, respectively.

[3] Banking, Pensions, Insurance and Micro-finance Institutions.
[4] Total financial system assets data is as at 30 September 2024 due to a one-quarter lag reporting for MFI's.
[5] The Insurance industry commanded 14.5 percent of the total financial system assets and 27.0 percent of the GDP.

[6] The Herfindal-Hirschman index (HHI) is a measure of market concentration which, unlike other methods, takes into account the relative size and number of institutions in the industry. It can assume values from zero (a situation close to perfect competition) to 10000 (a situation that reflects monopolistic behaviour). There are three HHI thresholds that determine the market structure of an industry: (1) less than 1000 suggests a competitive industry, (2) 1000 to 1800 indicates a moderately concentrated industry, and (3) a value greater than 1800 depicts a highly concentrated industry.

Figure 2 **Financial System Structure**

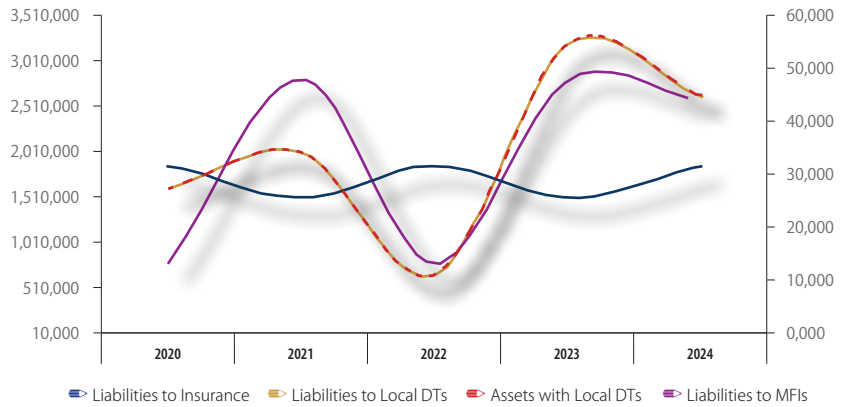

Source: Central Bank of Lesotho

## 3.2 Cross-Linkages in the Financial Sector

The linkages between domestic banks are predominantly in the form of placements for payments and settlements purposes rather than interbank loans, and investments and placements with parent banks between local banks and foreign banks. Banks and other non-bank financial institutions engage in credit, maturity and liquidity transformation and can underpin the accumulation of imbalances and pockets of stress in a downturn. Furthermore, risks associated with investments with banks from abroad expose domestic banks to exchange rate risks.

Domestic banks are also interconnected with other financial institutions in the country. They accept deposits from insurance companies and microfinance institutions. During the review period, deposits of short-term insurance declined by 17.6 percent while investments with the banking sector fell by 24.2 percent. Also, the long-term insurance deposits with banks declined by 2.2 percent, while their investments rose by 19.3 percent.

Figure 3 **Bank's interconnectedness with OFIs** (millions of maloti)




Source: Central Bank of Lesotho (Liabilities to MFI – right scale)

The linkages between domestic banks are predominantly in a form of placements for purposes of payments and settlements instead of interbank loans.

## 3.3 Linkages between the Financial Sector and Government

### The budget performance overview

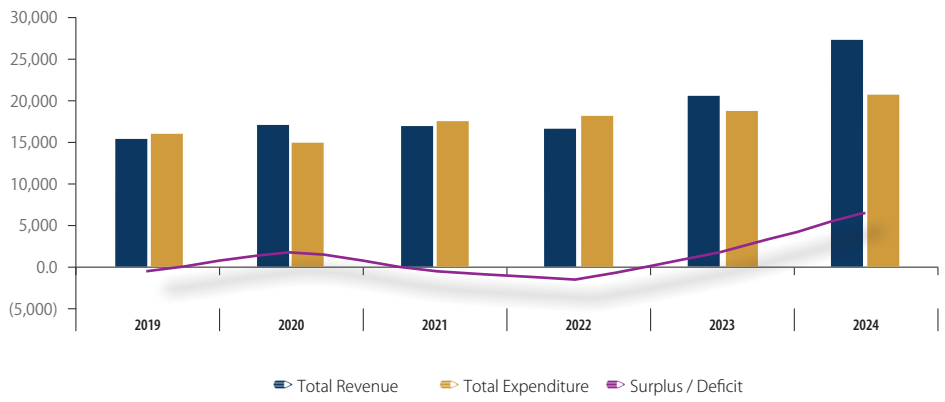
Government budgetary operations registered a surplus in 2024. However, long-term debt sustainability and reliance on volatile SACU revenues remain a threat to financial stability. The surplus was mainly driven by a windfall in SACU transfers and increased water royalties following the renegotiation under the LHWP-II Treaty with South Africa. Moreover, recurrent expenditure remained contained and the SACU proceeds were used mainly to reduce arrears and build up deposits at the Central Bank. Long-term debt sustainability risks remained moderate despite the rise in debt stock during the review period.

### Revenue and Expenditure

Government total revenue rose by 23.8 percent, driven primarily by higher tax collections. Value-added tax (VAT) revenue increased by 26.3 percent, boosted by declining inflation, which contributed to increased disposable income for some households compared to the previous year. Tax revenue from international trade and transactions increased due to the purchase of machinery for construction in the LHWP Phase II project. Income tax revenue also increased by 18.9 percent towards the end of the year compared to the same period in the previous year. Additionally, revenue from the Southern African Customs Union (SACU) surged by 13.8 percent to M11.5 billion, with key sectors like mining and quarrying, manufacturing, and financial and business services driving this growth.

On the other hand, overall government expenditure rose by 12.3 percent compared to the preceding year. This expenditure was largely accounted for by wage bill, which constituted approximately 36.0 percent of the total expenses. The GoL also significantly increased its investment in fixed assets by 118.0 percent compared to the previous year, mainly allocating funds to Economic Affairs and General Public Services. In contrast, it reduced interest payments and subsidies by 6.6 percent and 22.0 percent, respectively.

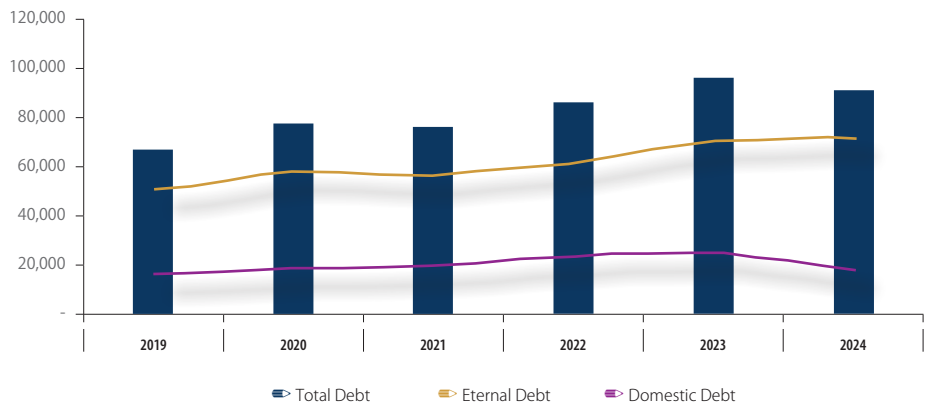
Figure 4 **Government Budget** (millions of maloti)




Source: Central Bank of Lesotho

The majority of Lesotho's public debt originated from external sources, mainly bilateral and multilateral loans, which accounted for roughly 65.0 percent of the total debt in FY2023/24. The remainder of the debt included Treasury bills and suppliers' credits. While the risk of external and overall debt distress remained moderate, the year-on-year increase of 15.2 percent in multilateral loans raised concerns about the country's long-term debt sustainability. However, the fact that 62.2 percent of external debt was concessional, with favourable loan terms, helped mitigate the risk of default.

Figure 5 **Total Debt** (million maloti)



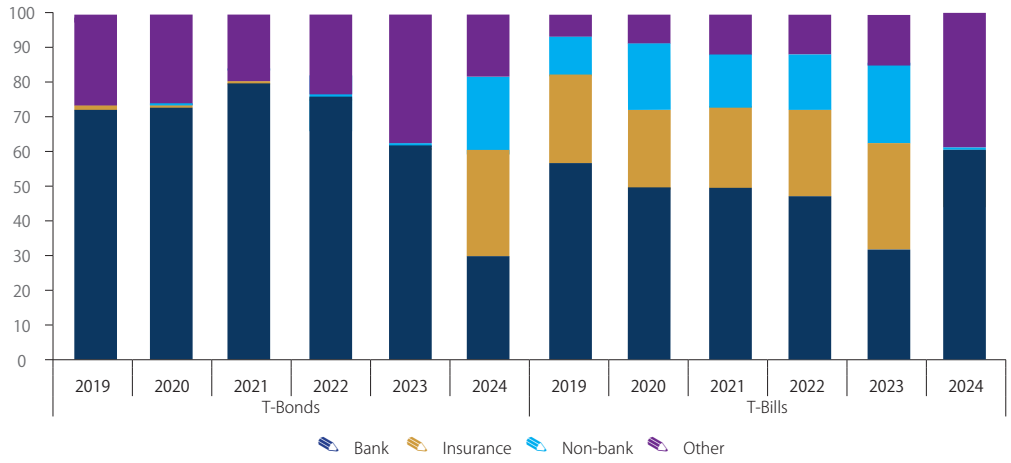

Source: Central Bank of Lesotho

## Bank Sovereign Nexus

The concept of the bank sovereign nexus highlights the interdependence between a government's financial health (often referred to as the "sovereign") and the banking sector. If one of these sectors encounters a problem, it can create a domino effect, exacerbating pre-existing vulnerabilities in the other.

The GoL's debt portfolio, as held by domestic banks, is predominantly comprised of Treasury securities, encompassing both bonds and bills. By the end of 2024, the banking sector emerged as the principal holder of Treasury bills within the broader financial landscape, surpassing the insurance sector and other non-bank financial institutions. Notably, commercial banks augmented their T-bill holdings by 29.2 percentage points (pps), reaching 61.1 percent. This strategic acquisition of Treasury bills strengthens the banks' liquidity reserves. In contrast, a significant volume of bank-held bonds reached maturity, resulting in a 32.0 pps reduction from the previous year. Overall, banks reduced their sovereign debt holdings by 2.8 pps compared to the previous year.

Figure 6 **T-Bills & Bonds Holdings** (%)




Source: Central Bank of Lesotho

## 4. BANKING SECTOR

The banking sector's performance slightly declined in 2024 amid existing risks such as credit concentration, reliance on corporate deposits, and tighter monetary policy. While banks maintained high-quality capital holdings, asset quality declined due to an increase in non-performing loans (NPLs), particularly in the personal loans category. Consequently, banks continued to strengthen their provisioning for NPLs, positioning themselves to absorb potential defaults and mitigate credit risk. The stress-test results also indicated that the existing levels of capitalisation, liquidity, and profitability ensured a high level of resilience in the sector.

**Table 2** Bank Health Index

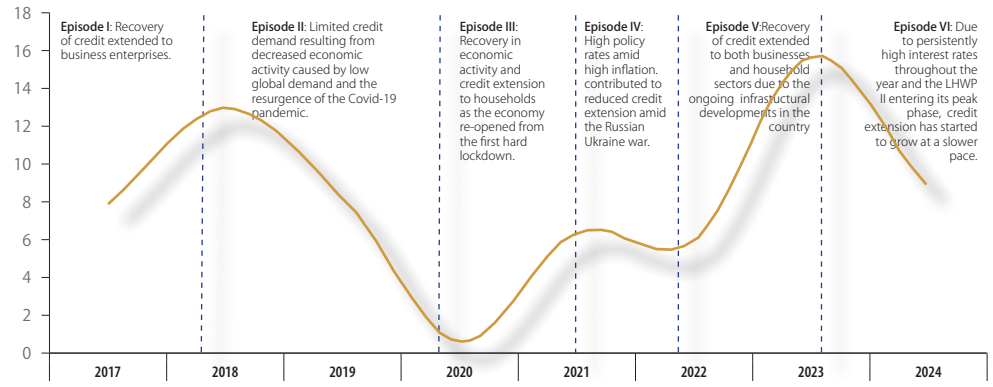
| Bank Health Index | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| Overall Industry Health | | | | | | | | | |
| Capital Adequacy | | | | | | | | | |
| Asset Quality | | | | | | | | | |
| Earnings | | | | | | | | | |
| Liquidity | | | | | | | | | |
| Leverage | | | | | | | | | |
| Sensitivity to Market Risk | | | | | | | | | |

*Source: Central Bank of Lesotho*

### 4.1 Credit Developments

Overall, credit extension improved in 2024 compared to 2023. However, as shown in Figure 7, the growth rate slowed, mainly due to the construction sub-sector. This decline was driven by the LHWP-II construction works reaching their peak, leading to lower overall credit demand compared to the initial phases. Moreover, persistently high interest rates, inflationary pressures, declining global demand, escalating geopolitical conflicts, and weak economic activity continued to pose significant downside risks to the credit market.

**Figure 7** Annual Credit Growth (%)

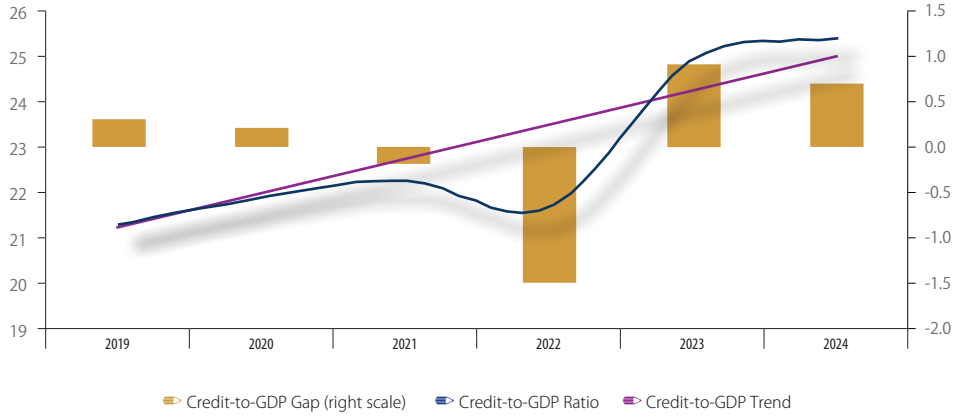



Source: Central Bank of Lesotho

# BANKING SECTOR

Figure 8 illustrates the evolution of credit-to-GDP gap, which serves as an early warning indicator (EWI) for potential credit bubbles or banking crises. The gap is calculated as the deviation of the credit-to-GDP ratio from its long-term trend. A positive gap indicates that the private sector may have borrowed beyond what the economy's output-producing capacity justifies, while a negative gap suggests room for additional safe borrowing for consumption or investment. Over time, the credit-to-GDP gap has generally remained positive and closely aligned with its long-term trend. In 2024, a positive credit-to-GDP was maintained. This suggests that credit growth levels were slightly above the long-term trend but not necessarily at an alarming level to signal financial imbalances in the system.

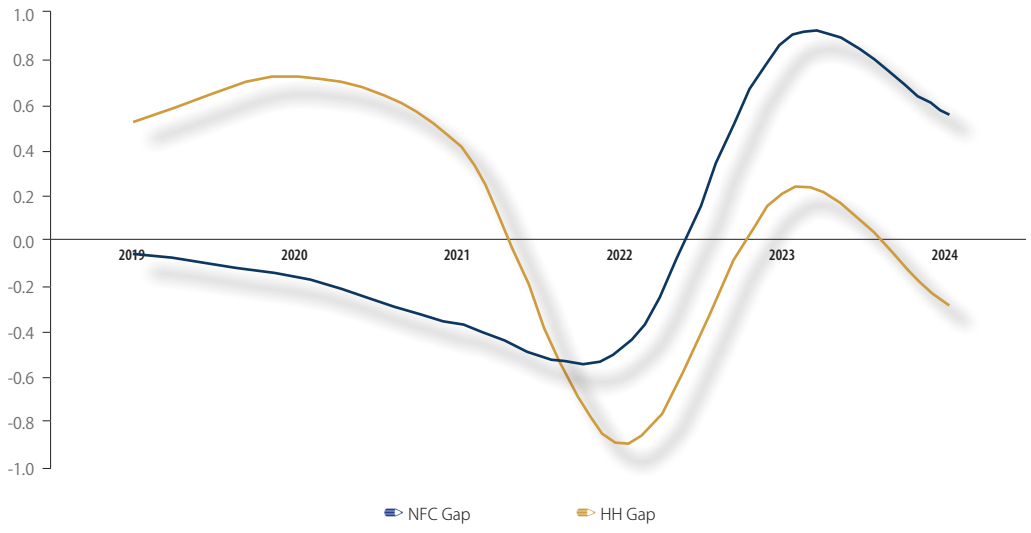
Figure 8 **Annual Credit-to-GDP Gap** (%)




Source: Central Bank of Lesotho

Furthermore, Figure 9 presents the credit-to-GDP gap for both households and non-financial corporations (NFC). Prior to 2021, household credit extension remained more sustainable compared to NFC. However, this trend reversed beyond 2021 as NFC credit expanded due to the emergence of the LHWP project, which created greater incentives for financial institutions to extend credit. Meanwhile, the decline in household credit was influenced by tight monetary policy conditions and persistent inflationary pressures, which constrained their borrowing capacity.

Figure 9 NFC and HH Credit-to-GDP Gap (%)

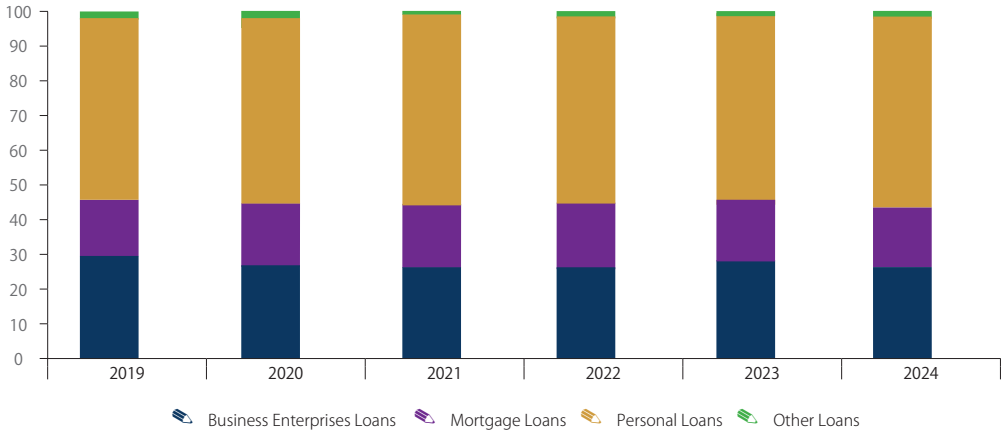



Source: Central Bank of Lesotho

Figure 10 illustrates the distribution of loans across various sectors as a percentage of total credit over time. In 2024, households and the business sector received 72.2 percent and 26.2 percent of the total credit, respectively, with the remaining 1.6 percent going to other sectors. Within the 72.2 percent, personal loans rose by 2.5 pps to 54.8 percent, while mortgage loans stayed relatively unchanged from 2023 levels. This trend highlights the banking sector's significant exposure to the household sub-sector.

Credit to the business sector grew by 2.5 percent, reaching M2.8 billion at the end of 2024. This growth indicated improving economic activity, especially in key sectors like real estate, business services, wholesale and retail trade, restaurants, and hotels. Although the LHWP-II project reached its peak, it remained the main driver of credit demand, fostering opportunities for business expansion and investment. However, high interest rates and persistent inflationary pressures limited the extent of credit expansion.

Figure 10 Distribution of Loans by Sector to Total Loans (%)



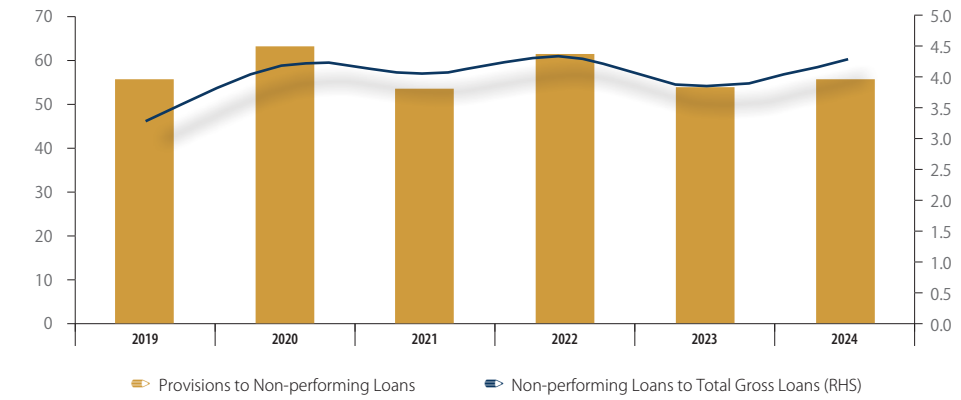

Source: Central Bank of Lesotho

## 4.2 Asset Quality

The banking sector's asset quality declined in 2024, due to elevated NPLs within the personal loan category. NPLs as a ratio of total gross loans increased to 4.3 percent. However, this uptick in credit risk was partially counterbalanced by a slight improvement in provisions for NPLs, which increased by 1.5 pps to 55.7 percent.

Furthermore, the assessment of loan concentration by economic activity revealed that the top three economic sectors—wholesale, retail trade, restaurants & hotels, real estate & business services, and construction—accounted for 66.1 percent of total business sector loans. This indicated that over half of the loans extended to the business sector were within these three sectors, thereby increasing concentration risk and exposing banks to risks associated with the performance of these sectors.

Figure 11 **Non-performing Loans and Provisions to Total Loans** (%)

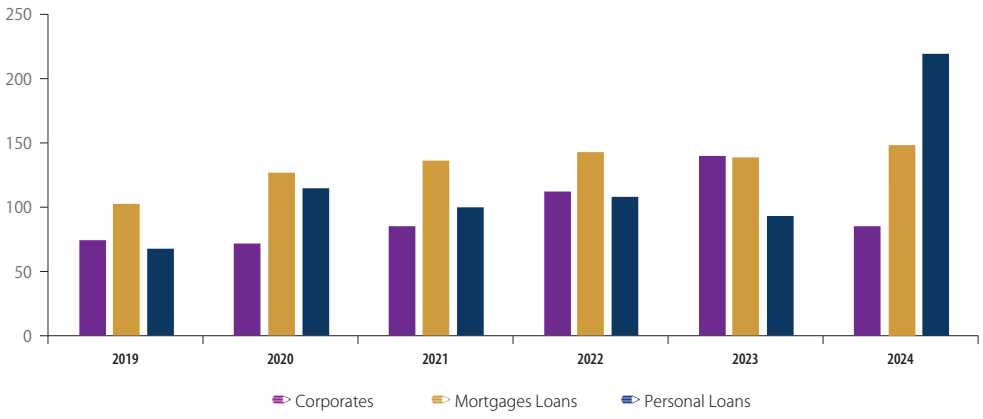



Source: Central Bank of Lesotho

The banking sector's asset quality declined in 2024, due to elevated NPLs within the personal loan category.

Figure 12 indicates that NPLs remained concentrated in the household and business sectors. This increased financial strain could ultimately impact banks' capital levels and profitability.

Figure 12 **Non-performing Loans** (million maloti)

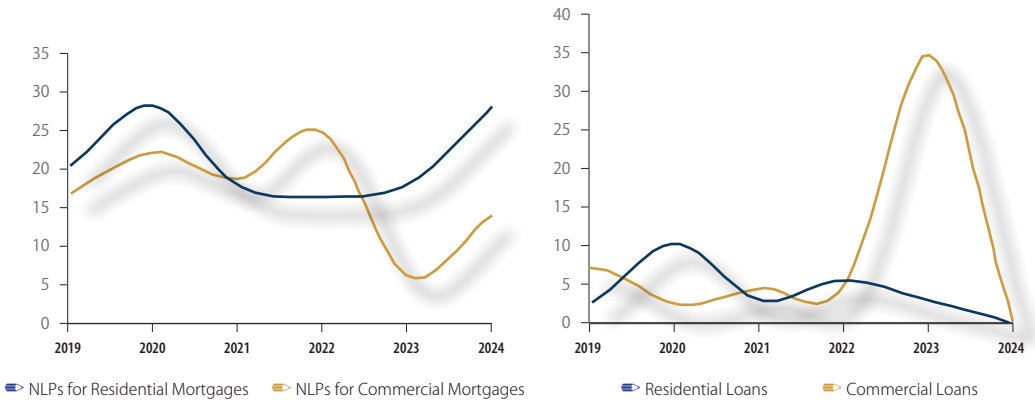



Source: Central Bank of Lesotho

# BANKING SECTOR

Figure 13 illustrates the NPLs along with restructured residential and commercial real estate loans. Following a sharp decline in 2023, commercial mortgage NPLs increased, while residential mortgage NPLs remained substantially high at M29 million in 2024. This indicated that households and businesses struggled to service their mortgage loans due to job losses and elevated interest rates. Further increases in NPLs could adversely impact banks' balance sheets and profitability. In response to these potential defaults, banks adjusted their provisions to cover the anticipated rise in credit losses adequately.

Figure 13 **NPLs and Restructured Mortgage Loans** (million maloti)




Source: Central Bank of Lesotho

## Box 1 - Residential Property Price Index (RPPI)

The Central Bank of Lesotho (CBL) is bestowed with the responsibility of supervising and regulating the financial system to ensure stability and safety. In an attempt to develop macro-prudential surveillance instruments, CBL is exploring an array of tools that can be used to monitor the build-up of vulnerabilities from the financial system. Among such tools, the CBL is exploring a residential property price index (RPPI).

A RPPI is a statistical measure that tracks changes in the prices of residential properties over time. It provides insights into housing market trends, helping policymakers to identify and mitigate potential risks to financial stability, and financial institutions and investors to assess property value fluctuations and risks. The RPPI is a valuable component in the assessment of financial stability since it enhances the understanding of how property prices affect financial institutions' stability. In addition, the RPPI serves as a crucial independent indicator of economic growth and performance within a country.

Lesotho's formal housing market is primarily composed of self-built properties with limited property sale transactions. The RPPI will, therefore, serve as an essential tool for tracking property price movements, offering a clearer understanding of market trends despite the scarcity of direct property sales. This is important for recognising early

signs of potential housing market volatility or rapid price increases that could affect financial and economic stability. Furthermore, given the growing demand for mortgage financing in Lesotho, especially for self-built homes, the RPPI will help financial institutions assess the risks associated with mortgage lending. For instance, it can provide insights into whether property prices are being overvalued, which could lead to increased risks of loan defaults, financial strain on borrowers and exposure for banks.

The RPPI is also vital for monitoring potential risks to the financial system. Fluctuations in property prices can influence the value of collateral backing loans, affecting the stability of financial institutions. By tracking these changes, the RPPI enables policymakers to proactively address emerging risks, particularly in a market where housing is a significant component of household wealth. The RPPI can help policymakers to make data-driven decisions regarding housing policy, fiscal measures and financial sector regulation. For example, if increasing property prices are causing affordability problems or adding to household debt, the RPPI can guide the development of regulatory measures to stabilise the housing market, thereby fostering sustainable economic growth. Moreover, real estate is an important investment asset class in Lesotho, especially in urban areas. In this regard, the RPPI can provide investors, developers and financial institutions with a reliable benchmark for assessing property value trends. This supports more informed decisions related to property development, purchasing or lending. Given the relatively limited availability of housing market data in Lesotho, the RPPI will also foster transparency by offering a consistent and reliable measure of property price changes. This will help various stakeholders, including financial institutions, policymakers and the general public, make more informed and sound decisions related to the housing market.

An appropriate methodology for calculating the RPPI is chosen on the basis of factors such as the characteristics of the available data set, the intended purpose and the expected use of the index. However, suitability depends on the purpose being addressed. Property Price index methodologies vary tremendously and range from the basic methods, which use simple median and arithmetic mean of each period's valuation prices, to more advanced methods such as hedonic and repeat sales methods. The basic methods are limited in that they don't control for any differences in quality or compositional changes. However, they are a useful first step in the development process and allow for an assessment of the data sources being used.

A variety of models have been explored for Lesotho's RPPI, and a preliminary index was developed using the hedonic time-dummy methodology, which is the most suitable approach to use when transaction numbers are limited. This approach ensures that the index remains simple to compute and controls for the effect of property characteristics on property price over different periods, with any residual price changes being attributed to inflation. This ensures that price changes reflect real market trends rather than variations in property composition and quality. Mortgage transaction data from four commercial banks have been used to develop the RPPI and these data provide market valuations during mortgage approvals, serving as the best proxy for tracking property price changes. The data includes key property characteristics such as size, number of bathrooms, number of stories, and location.

The development of the RPPI marks a significant improvement in macroprudential surveillance, providing a much-needed benchmark for analysing housing market trends. The index's implementation will improve risk assessment within the real estate sector strengthen financial stability monitoring and support evidence-based policymaking for sustainable economic growth in Lesotho. A technical note on Lesotho's RPPI will be included in the tenth edition of the FSR.

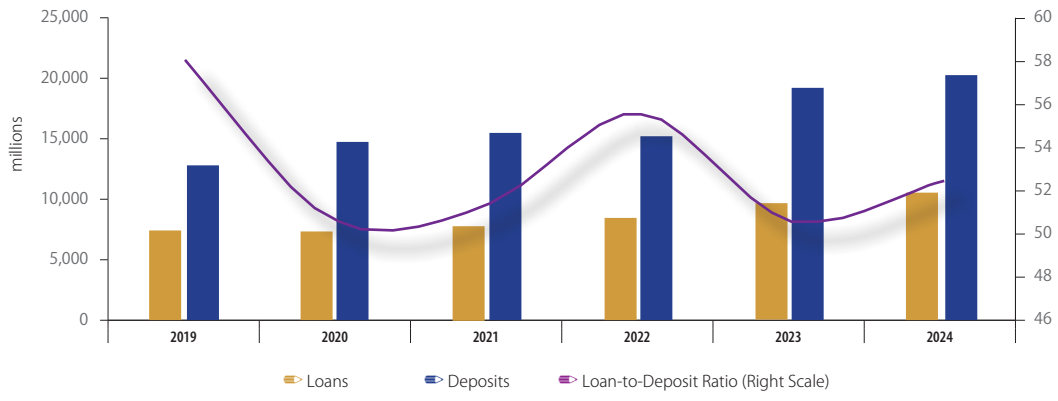
## 4.3 Liquidity Developments and Funding Structure

Liquidity reflects the available resources to meet both expected and unexpected cash outflows. It also highlights the liquidity mismatch between assets and liabilities, offering insight into the extent to which banks can manage short-term withdrawals without encountering liquidity problems. The most common cause of bank failures arises from liquidity shortages, which can trigger classic bank runs or modern equivalents, such as restricted access to debt markets for refinancing. Even a solvent bank[7] can face an insolvency crisis if its assets are illiquid while its liabilities have short-term maturities, leading to an inability to meet immediate cash withdrawals.

The loan-to-deposit ratio increased, indicating a moderate expansion in lending relative to deposit growth as illustrated in Figure 14. The ratio increased by 1.8 pps to 52.4 percent, reflecting the banking sector ability to balance lending with available deposits while maintaining liquidity. Also, this ratio serves as a key measure of a financial institution's short-term viability. While a rising ratio suggests improved credit intermediation, it also underscores the need for prudent liquidity management to mitigate funding risks.

However, the liquid assets-to-short-term liabilities ratio declined by 8.4 pps to 33.1 percent, as depicted in Figure 15. Despite an increase in currency and other cash items, the overall decline in liquid assets stemmed from reduced transferable deposits held with both domestic and non-resident banks. This reduction in liquidity buffers suggested potential vulnerabilities in meeting short-term obligations, especially during financial stress. However, the simultaneous drop in short-term liabilities, primarily driven by a reduction in deposits from other depository corporations, helped offset some of the pressure.

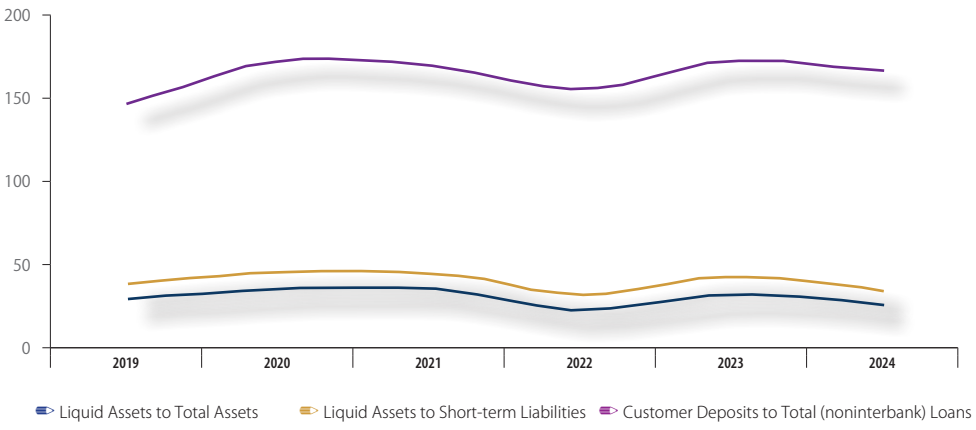
Figure 14 Loan to Deposit Ratio




Source: Central Bank of Lesotho

[7] The economic value of its assets exceeds its liabilities.

Figure 15 **Liquidity Ratios** (%)




Source: Central Bank of Lesotho

The ratio of liquid assets to total assets declined by 6.7 pps to 23.1 percent, suggesting lower levels of liquidity buffers within the banking sector. While this decline indicated increased asset allocation toward lending or investment activities, it also highlighted the importance of maintaining sufficient liquidity to cushion against potential financial shocks.

Another crucial liquidity measure, the ratio of customer deposits to total (non-interbank) loans, reflects the extent to which banks finance their loan portfolios with relatively stable customer deposits rather than more volatile wholesale funding. In 2024, this ratio declined by 5.7 pps to 164.6 percent from previous year. The decrease was primarily driven by an overall rise in customer deposits from nonfinancial corporations, coupled with an increase in total loans, largely attributed to the continued expansion of the construction sector. The funding structure remains relatively stable by industry standards, as customer deposits accounted for nearly twice the total loans issued

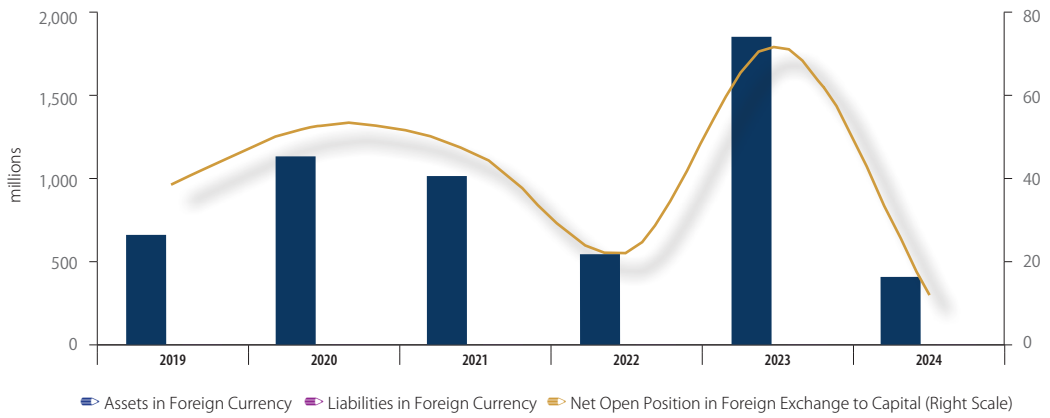
.

## 4.4 Market Risk

Market risk refers to the potential financial loss arising from fluctuations in market prices, including interest rates and exchange rates. In this report, market risk is evaluated using the net open position in foreign exchange relative to capital. Banks with a short open position in a foreign currency are vulnerable to exchange rate risk when the foreign currency appreciates, as it increases the cost of settling foreign-denominated liabilities. Conversely, banks holding a long open position in a foreign currency face exposure when the foreign currency depreciates, potentially eroding the value of their foreign-denominated assets.

The banking sector experienced a decline the net open position in foreign exchange to capital ratio from by 59.6 pps to 11.9 percent in 2024, as illustrated in Figure 16. This decline was due to placements maturing from abroad thus reducing foreign assets. Additionally, capital increased relative to the net open position, further reinforcing the sector's ability to absorb potential market shocks.

Figure 16 Sensitivity to Market Risk

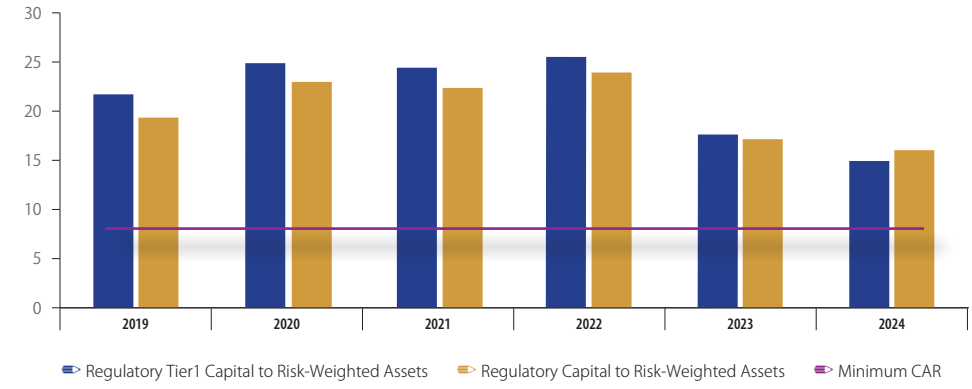



Source: Central Bank of Lesotho

## 4.5 Capital Adequacy

Capital adequacy ratios (CAR)[8] measure banks' health and soundness relative to insolvency risk. Minimum CAR serves to protect depositors and promote the stability and efficiency of the banking system[9] by ensuring that banks can absorb a reasonable amount of losses before becoming insolvent and depositors' funds are lost. The higher the capital adequacy ratio a bank has, the greater the level of unexpected losses it can absorb.

Figure 17 Capital Adequacy Ratios (%)



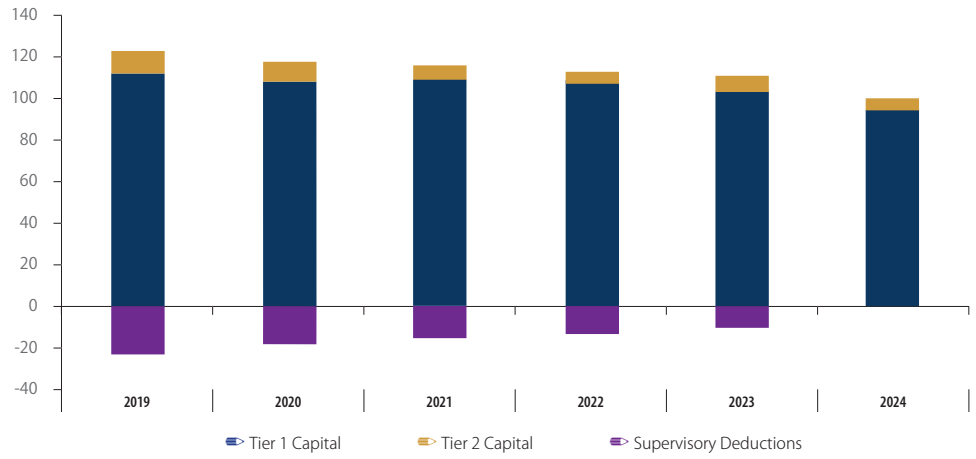

Source: Central Bank of Lesotho

[8] Currently, the minimum requirement for CAR is eight percent (8%).
[9] http://www.rbnz.govt.nz/finstab/banking/regulation/0091769.html.

# BANKING SECTOR

In 2024, the banking sector continued to maintain a CAR above the minimum prudential requirement of 8 percent, as shown in Figure 17. The total regulatory capital to risk-weighted assets ratio stood at 16.0 percent, reflecting a 1.2 pps decline from 2023. Similarly, the Tier-1 capital to risk-weighted assets ratio fell by 2.6 pps to 15.0 percent. Despite this downward trend, the banking industry sustained core capital buffers well above the regulatory threshold, underscoring the sector's resilience and capacity to absorb potential financial shocks. Figure 18 provides a detailed breakdown of total regulatory capital.

Figure 18 **Composition of Total Regulatory Capital[10] (%)**




Source: Central Bank of Lesotho

[10] Migration to Basel II.5 ensured that banks report capital on net basis, thereby eliminating the capital deductions in the reporting templates).

## Box 2 - Migration from Basel I to Basel II.5

The Basel Accords, a series of international banking regulations issued by the Basel Committee on Banking Supervision, were initiated in 1988 with Basel I. This initial accord focused primarily on credit risk, establishing a framework for minimum capital requirements based on risk-weighted assets. In 2004, Basel II was introduced, shifting the focus towards a more comprehensive approach to risk management, encompassing operational and market risks alongside credit risk, and introducing the 'three pillars' framework: minimum capital requirements, supervisory review, and market discipline. The global financial crisis of 2007-2008 exposed significant vulnerabilities in the financial system, leading to the development of Basel III. This latest iteration, finalized in 2010 and progressively implemented, significantly strengthens capital requirements and introduces liquidity standards like the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), addressing systemic risk.

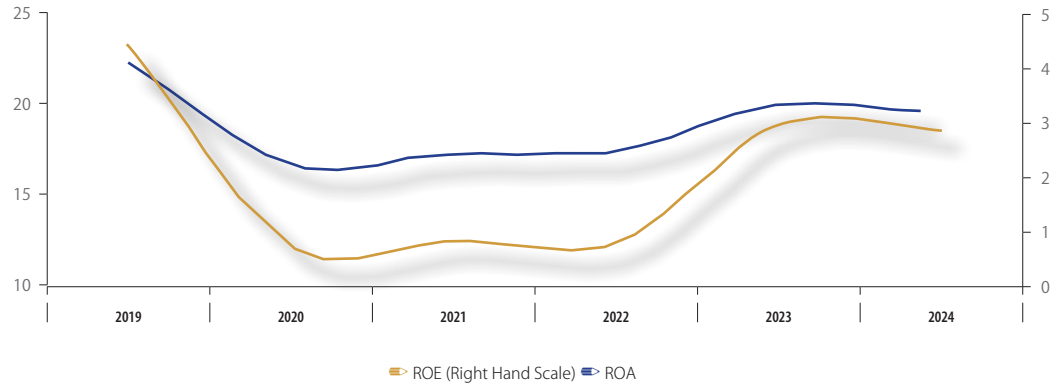
Lesotho's regulatory trajectory, marked by its transition from Basel I to the interim adoption of Basel II.5, and, subsequently, its ongoing implementation of Basel III, exemplifies this adaptive evolution and the corresponding adjustments in regulatory focus. This progression highlights Lesotho's dedication to reinforcing risk mitigation, enhancing capital sufficiency, and aligning with international best practices to protect its financial system from emerging vulnerabilities. Specifically, Basel II.5 was introduced as a transitional phase, designed to facilitate the shift towards the comprehensive Basel III framework. In the context of Lesotho, the adoption of Basel II.5 introduced high quality capital requirements to absorb potential losses and capital conservation buffers.

Common Equity Tier 1 (CET1) capital pillar is important for the financial strength of banks, as it enhances loss absorbency and enables commercial banks to meet immediate obligations and maintain depositor confidence during periods of stress. This highly liquid form of capital comprises of assets such as cash, government bonds, and other premium securities. CET1 serves as a critical buffer against unforeseen outflows, effectively mitigating the risk of liquidity crises. Ultimately, the adoption of the Basel II.5 framework's primary objective is to construct a more resilient financial ecosystem. Robust CET1 capital will ensure that banks are better equipped to navigate market turbulence, ensuring the uninterrupted flow of credit. This strategic approach not only reduces banks' vulnerability to liquidity crises but also ensures access to essential financial services. Thus, Lesotho's journey from Basel I to the ongoing implementation of Basel III represents a substantial and sustained endeavour, demanding continuous adaptation and seamless integration to effectively promote financial stability.

## 4.6 Earnings and Profitability

Profitability ratios assess the ability of a bank to generate earnings, profits, and cash flows relative to the amount of money invested. The industry profitability remained relatively unchanged from 2023, mostly due to increases in net interest income from loans and securities as well as non-interest income, which increased overall net income before tax. ROA and ROE remained relatively unchanged at 3.2 percent and 18.8 percent, respectively, as illustrated in Figure 19.

Figure 19 **Profitability Ratios** (%)




Source: Central Bank of Lesotho, ROE (rhs)

The interest margin to gross income ratio measures the difference between the interest income generated by banks and the interest paid out, relative to their gross income. This ratio remained relatively unchanged from 2023, at 56.6 percent in 2024, indicating that more than half of the banks' income was derived from their core business, which is intermediation.

Additionally, the ratio of non-interest expenses to gross income decreased slightly by 1.8 pps, reaching 62.9 percent in 2024. This decrease suggested that, while administrative expenses consumed a significant portion of the income, the allocation towards income-earning assets was relatively lower

# NON-BANK FINANCIAL INSTITUTIONS

## 5. OTHER FINANCIAL CORPORATIONS

### 5.1 The Insurance Sector

The insurance sector remained resilient and financially sound. The long-term insurance expanded its asset base, while the short-term insurance saw a decline. The overall insurance sector's profitability also improved in line with the observed economic recovery.

#### 5.1.1 Underwriting and Profitability

The insurance sector underwriting performance improved despite the observed concentration risk. The long-term (LT) insurance industry derived most of its net written premiums from its life cover segment (52.2 percent), followed by the assistance (funeral insurance) (33.7 percent) and credit life (11.4 percent). The net earned premiums declined by 20.0 percent to M314.2 million due to increased reinsurance costs compared to the previous year. On the other hand, the short-term (ST) insurance categories consisted mostly of motor and property insurance products, with a combined share of 66.1 percent of total ST insurance net written premiums. The ST insurance sector experienced a significant 40.5 percent decline in gross written premiums, reaching M610.2 million. This drop resulted from reduced underwriting in the engineering category, a consequence of a reduction in insurable business relative to the beginning of the LHWP-II project. This trend shows concentration risk in certain insurance categories by both LT and ST insurance sectors. Any shock to these key business lines will affect the sectors underwriting performance negatively.

The underwriting process in the life insurance industry resulted in losses, as expenses exceeded income during the review period, mirroring the situation from the previous year. In contrast, the short-term insurance industry benefited from the underwriting process, generating more revenue than it spent on expenses.

**Table 3** Insurance Industry Selected Ratios

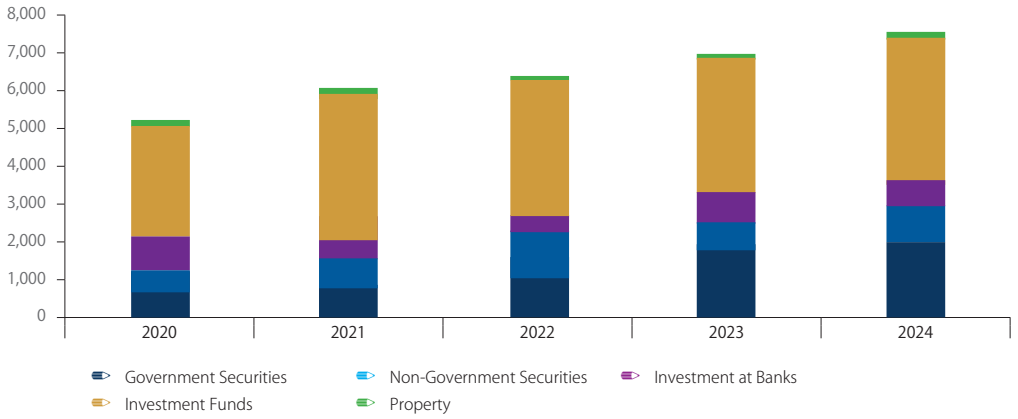
| | 2020 | 2021 | 2022 | 2023 | 2024 | %y/y(pps) |
|---|---|---|---|---|---|---|
| ***Short-term insurance*** | | | | | | |
| *Claims* | 31.2 | 77.9 | 39.8 | 41.7 | 52.7 | **11.0** |
| *Expense* | 73.9 | 77.8 | 76.5 | 65.1 | 72.0 | **5.9** |
| *Combined* | 105.1 | 155.7 | 116.3 | 106.8 | 124.7 | **17.9** |
| *Investment Returns* | 2.0 | 3.1 | 2.2 | 2.7 | 6.3 | **3.6** |
| *Net Investment Income* | 12.0 | 18.6 | 14.6 | 16.1 | 8.7 | **(7.4)** |
| *Underwriting Expense* | 58.3 | 96.5 | 62.6 | 48.9 | 69.1 | **20.2** |
| *Shareholder equity to total invested assets* | 36.6 | 37.6 | 32.7 | 38.9 | 33.9 | **(5.0)** |
| *Return on Equity* | | 10.1 | (10.3) | 0.3 | 10.9 | **10.6** |
| ***Long-term insurance*** | | | | | | |
| *Claims* | 56.4 | 71.5 | 60.1 | 61.8 | 82.3 | **20.5** |
| *Expense* | 24.2 | 22.1 | 34.4 | 46.2 | 43.4 | **(2.8)** |
| *Investment Returns* | 1.4 | 1.7 | 2.0 | 2.9 | 3.2 | **0.3** |
| *Net Investment Income* | 16.9 | 26.0 | 33.1 | 31.2 | 17.9 | **(13.3)** |
| *Underwriting Expense* | 71.4 | 87.3 | 72.7 | 64.7 | 92.9 | **28.2** |
| *Shareholder equity to total invested assets* | 14.8 | 12.8 | 13.8 | 13.6 | 13.4 | **(0.2)** |
| *Return on assets* | | 5.3 | 4.7 | 1.6 | 4.1 | **2.5** |
| *Return on equity* | | 35.3 | 32.9 | 11.0 | 28.6 | **17.6** |

***Source:*** *Central Bank of Lesotho*

## 5.1.2 Investment Mix

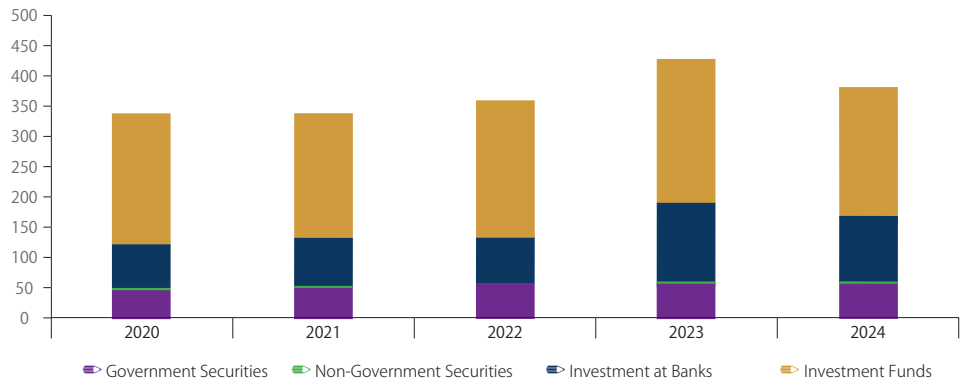
The high interest rate environment prompted the sector to increase its investments for improved returns. Both the LT and ST insurance industries invested in a variety of asset classes, including government securities and real estate, as illustrated in Figures 20 and 21. These investments generated positive net investment income for both sectors in 2024. The returns from these investments improved both industries' financial performance, helping offset underwriting losses for the LT industry while further strengthening the positive results for the ST industry. The broad diversification of their investment portfolios also reduced risks, contributing to the sector's overall soundness and financial stability.

Figure 20 **Investments by LT Insurance** (million maloti)




Source: Central Bank of Lesotho

Figure 21 **Investments by ST Insurance** (million maloti)




Source: Central Bank of Lesotho

## 5.2 Microfinance Institutions (MFIs)

The MFI industry remained relatively small compared to the banking, pensions and insurance industries. The industry's assets made up 4.3 percent of total financial sector assets, a 0.7 pp decrease from the previous year. In addition, the MFIs' asset base grew by 30.1 percent to M1.8 billion. Loans repayable within one year increased by 14.1 percent, and loans repayable beyond one year rose by 8.7 percent. Overall, loans increased by 8.5 percent to M1.3 billion.

The asset mix remained largely unchanged, with loans comprising 63.3 percent of total assets. Cash and deposits with financial institutions represented 5.1 percent, other financial assets constituted 0.5 percent, and non-financial assets accounted for 0.4 percent, while other asset categories included debt securities. Despite a 22.7 percent decrease in net income, the MFIs industry remained profitable. The sector's limited exposure to other financial institutions, combined with its small share of total financial assets and its profitability, make the sector less systemic and poses no threats to financial stability.

Table 4 MFIs Performance Indicators (Summary)

| Indicators | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| *Assets* | 949 153 | 1 046 612 | 1 288 067 | 1 199 032 | 1 409 206 | 1 765 601 |
| *Total Loans* | 875 288 | 1 012 840 | 1 140 254 | 1 159 032 | 1 266 506 | 1 117 845 |
| *Net profit/loss* | 88 926 | 131 501 | 65 585 | 75 397 | 56 376 | 43 583 |
| *ROA* | 7.5 | 10.0 | 8.0 | 6.4 | 5.8 | 3.5 |
| *ROE* | 22.8 | 28.1 | 22.1 | 18.0 | 15.9 | 11.9 |

*Source: Central Bank of Lesotho*

## 6. FINANCIAL MARKETS INFRASTRUCTURE

Financial market infrastructures (FMIs)[11] deliver services that are vital to the smooth functioning of the financial system and the domestic economy. The services enable payments for goods and services to be made, allow securities to be held and sold, and facilitate risk management. The CBL is mandated to provide efficient, reliable, and safe payment and settlement systems. In line with this mandate, the Payment Systems Act 2014, Section 2(a) empowers the CBL to oversee, inspect, and monitor the national payment systems in Lesotho. This mandate is not only achieved by ensuring that the payment system in Lesotho complies with the domestic legal and regulatory framework but also with other international standards and best practices in the payment system sphere[12].

### 6.1 Systemically Important Payment Systems

Systemically Important Payment Systems (SIPS)[13] are vital for a stable financial environment, effective monetary policy implementation, and broad financial inclusion. These SIPS underpin the smooth functioning of financial markets and economic activity by reducing settlement uncertainties and facilitating efficient payments. However, there are many ways through which risks may manifest in large-value payment systems such as LSW. These include (a) protracted system unavailability (downtimes), (b) the degree of utilisation, and (c) the inability of system participants to settle their obligations on time. Critical financial system disruptions can make it more difficult for people and institutions to meet their financial obligations on time. As such, if these interruptions are not immediately resolved, they may lead to a series of late payments that could eventually result in defaults. Therefore, close monitoring of these key aspects in LSW is crucial as they represent the main operational and financial risks that could adversely affect LSW and might lead to a systemic crisis.

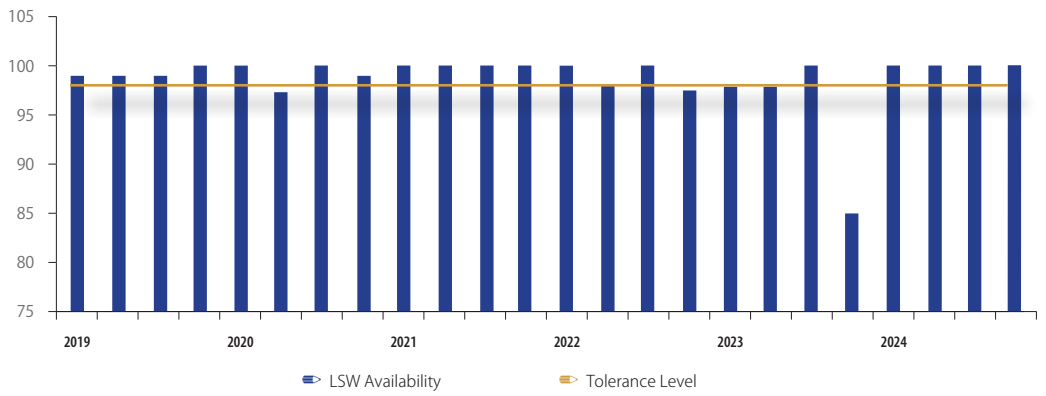
The Lesotho Wire (LSW) is an essential system to the national financial infrastructure, enabling real-time gross settlement (RTGS) transactions. As a SIPS, its uninterrupted operation is critical for financial stability. Prolonged and frequent LSW downtimes present significant economic risks, impacting various sectors and stakeholders. During the review period, the system achieved 99.9 percent availability, surpassing the 98.0 percent tolerance threshold.

[11] Payment Systems, Settlement Systems, Central Counterparties, Central Securities Depositories, and Trade Repositories.

[12] These include the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI's) and the CPSS-BIS Central Bank Oversight of Payment and Settlement Systems.

[13] Lesotho Wire (LSW), the Centralised Securities Depository (CSD), and the Lesotho Automated Clearing House (LACH), all operated by the Central Bank of Lesotho (CBL).

Figure 22 **LSW System Uptime** (%)



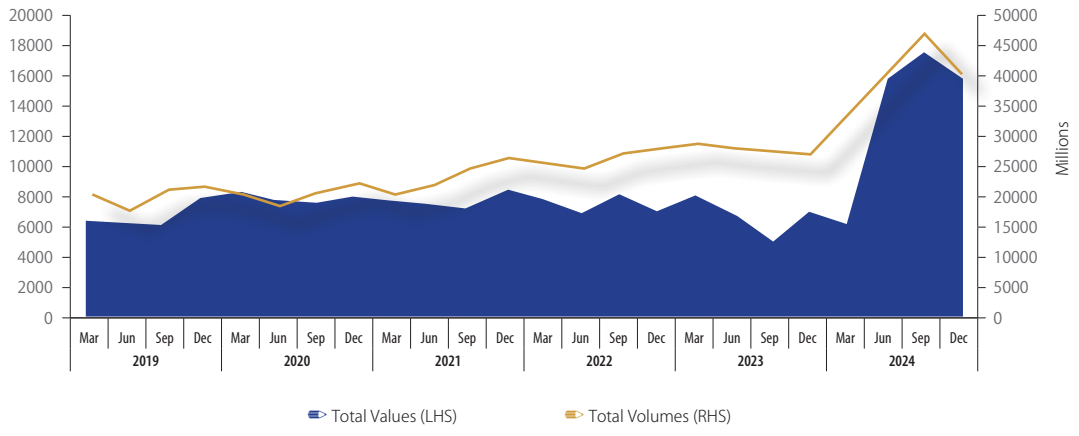

Source: Central Bank of Lesotho

## 6.2 Mobile Money

Mobile money in circulation, as mirrored by the trust account balance stood at M 918.7 million, marking a 28.6 percent increase year on year. The rise in circulation was attributed to improved utilisation of mobile money payment systems. Also, the number of mobile money agents rose by 55.3 percent to 48 069 agents, showing the expansion of mobile money services.

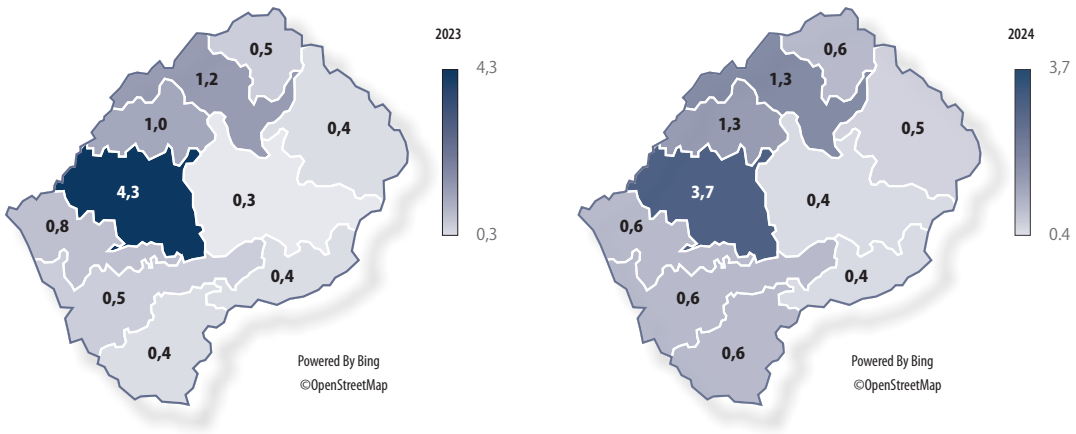
[13] The total funds held by the mobile money providers, which is equivalent to the funds held per unit of mobile money in circulation.

Figure 23 **Trust Account Balance** (millions maloti)




Source: Central Bank of Lesotho

Figure 24 **Mobile Money Agents Distribution (% per district)**




Source: Central Bank of Lesotho

# 7. FINANCIAL SYSTEM RESILIENCE

The Central Bank Act of 2000 tasks the CBL to promote and safeguard the stability and soundness of the financial system in Lesotho. The Bank uses stress-testing[15], among other tools, to achieve its objective of promoting the resilience of the domestic financial system and mitigating vulnerabilities arising from financial and economic shocks. In 2024, the CBL ran two stress-tests to determine the resilience of the banking system in Lesotho to adverse and plausible credit, interest rate, and liquidity shocks[16]. The tests covered all four commercial banks. The results covered in this report highlight June and December 2024 stress-test results and their implications for the banking industry and Lesotho's economy. The stress-test results demonstrate that the banking sector is highly resilient and could withstand shocks of similar nature and magnitude as the ones assumed in the stress-test.

## 7.1 Stress-test Key Assumptions and Shocks

### 7.1.1 Credit Risk Shocks

Credit risk is defined as the potential that a bank borrower, or counterparty, will fail to meet its payment debt obligations with the bank. The level of non-performing loans (NPLs) is normally used as an indicator of credit risk inherent in a bank's loan portfolio. A non-performing loan is the sum of borrowed money for which the debtor has not made his or her scheduled payments for at least 90 days[17]. Banks normally set aside funds to cover potential losses on loans in the form of loan-loss provisions. Consequently, since loan-loss provisions are an expense to a bank, they erode the institution's capital levels by decreasing retained earnings and reducing the value of the risk-weighted assets (RWA). The credit risk shock transmission channel is summarised in Figure 25.

The level of non-performing loans (NPLs) is normally used as an indicator of credit risk inherent in a bank's loan portfolio.

Figure 25 Credit Risk Shock Transmission


Source: Central Bank of Lesotho

### 7.1.2 Liquidity Risk

Liquidity risk is the risk that a bank will not be able to meet its current and future cash flow and collateral needs, both expected and unexpected, without materially affecting its daily operations or overall financial condition. Liquidity stress-tests are used to assess banks' resilience against maturity mismatches between short-term assets and liabilities. They also assess how banks would cope with unexpected adverse events, such as a bank run. The bank-run type shock can be transmitted within the banking sector as indicated in Figure 26.

[15] The Bank uses a simple sensitivity test model which is static and does not perform any form of forecasting. A static model assesses the impact of a particular shock or a group of shocks at a certain point in time. The stress-testing approach applied is a top-down one. This implies that CBL collected necessary data and conducted stress-testing based on the information received.

[16] Shocks refer to exceptional but plausible adverse economic events that can occur either at an individual or system-wide level. These shocks are classified based on their severity, ranging from low to severe, and are used to determine the resilience of various risk factors. To calibrate shocks, both historical and hypothetical approaches are used. The historical approach involves using past crises information to formulate shocks and scenarios. On the other hand, the hypothetical approach is used when such information is not available.

[17] Financial Institutions (Loan portfolio classification) Regulations 2016.

Figure 26 Liquidity Risk Shock Transmission


Source: Central Bank of Lesotho

Liquidity risk is the risk that a bank will not be able to meet its current and future cash flow and collateral needs, both expected and unexpected, without materially affecting its daily operations or overall financial condition.

### 7.1.3 Interest Rate Risk Shocks

Interest rate risk can have both a direct and indirect impact on the bank's balance sheets. Direct interest rate risk is the risk incurred by a bank when its interest-rate-sensitive assets and liabilities maturities are not matched. In contrast, a bank is exposed to indirect interest rate risk through the impact of interest rate changes on the borrower's creditworthiness and ability to repay. Direct interest rate calculates the changes in interest income and interest expenses resulting from the gap between the flow of interest on the holdings of assets and liabilities in each bucket. The gap in each time bucket provides a relative magnitude of the impact of the shock on the net interest income (NII) given a change in interest rate. Interest income is the most important source of revenue for banks and an indicator of profitability. The test run by CBL assumed shocks in the form of an equal change in all rates (parallel yield curve shift). The shocks are calibrated using historical changes in policy rates. Figure 27 shows the transmission of interest rate shocks.

### 7.1.4 Foreign Exchange Rate Risk

Foreign exchange risk is the risk that a bank's balance sheet may fluctuate because of changes in the value of a local currency relative to the currency with which the bank's assets are denominated, as shown in Figure 28. For instance, if a bank has foreign currency (FX) denominated assets and liabilities, its balance sheet will be prone to fluctuations in currency markets. The bank's balance sheet is more sensitive to currency market swings when it has a larger exposure to foreign exchange assets and liabilities. Foreign exchange stress-test scenarios assumed shocks of 20, 25, and 30 percent depreciation of local currency for low, moderate, and severe scenarios, respectively.

Figure 27 Interest Rate Risk Shock Transmission Channel


Source: Central Bank of Lesotho

Interest rate risk is the risk the risk to income and capital of a bank brought about by movements market interest rates.

Figure 28 **Foreign Exchange Risk Shock Transmission Channel**


Source: Central Bank of Lesotho

Foreign exchange risk is the risk that a bank's balance sheet may fluctuate because of changes in the value of a local currency relative to the currency with which the bank's assets are denominated.

## 7.2 Stress-test Results

### 7.2.1 Credit Risk

All banks passed the credit risk stress-test entailing a sector-wide increase in NPLs shock in both June and December 2024. As depicted in Table 5, in the case of Group I shocks, all banks would have maintained CAR above the minimum regulatory requirement of eight percent and remained solvent. Therefore, given the assumptions and types of shocks, the overall credit risk can be deemed low, as all banks would have been sufficiently capitalised to absorb losses arising from elevated NPL levels.

Table 5 **Credit Risk Stress Test Results**

| Risks | Number of banks below 8.0% CAR | Assets share of banks< 8.0% CAR | Number of Insolvent Banks | Capital Deficiency Relative to CAR | Capital Deficiency Relative to Minimum Capital |
|---|---|---|---|---|---|
| June 2024 | | | | | |
| Group I: System level credit risk | | | | | |
| Shock I: NPLs increase by 60% | 0 | 0 | 0 | 0 | 0 |
| Shock II: NPLs increase by 120% | 0 | 0 | 0 | 0 | 0 |
| Shock III: NPLs increase by 180% | 0 | 0 | 0 | 0 | 0 |
| Group II: Concentration Risk | | | | | |
| Shock I: Largest 1 Borrower Defaults | 1 | 14.2 | 0 | 20 497 | 0 |
| Shock II: Top 3 Borrowers Default | 1 | 14.2 | 1 | 162 938 | 72 556 |
| Shock III: Top 5 Borrowers Default | 1 | 14.2 | 1 | 238 596 | 148 214 |
| December 2024 | | | | | |
| Group I: System level credit risk | | | | | |
| Shock I: NPLs increase by 60% | 0 | 0 | 0 | 0 | 0 |
| Shock II: NPLs increase by 120% | 0 | 0 | 0 | 0 | 0 |
| Shock III: NPLs increase by 180% | 0 | 0 | 0 | 0 | 0 |
| Group II: Concentration Risk | | | | | |
| Shock I: Largest 1 Borrower Defaults | 1 | 15.9 | 0 | 22 333 | 0 |
| Shock II: Top 3 Borrowers Default | 1 | 15.9 | 1 | 176 839 | 77 563 |
| Shock III: Top 5 Borrowers Default | 1 | 15.9 | 1 | 261 973 | 162 698 |

***Source**: Central Bank of Lesotho*

Stress test for concentration risk in banks' loan portfolios was conducted to evaluate their resilience to large exposures. One bank failed the test in the scenarios where its largest, top three, and top five borrowers defaulted in both June and December

2024. This indicates that the bank's capital would have not been sufficient to absorb the incurred losses, falling below the eight percent CAR threshold and the minimum unimpaired capital. Additionally, this bank would have gone insolvent under Shock II and III scenarios. This shows that concentration risk in the loan book is high. However, this can be mitigated by ensuring that banks hold sufficient and high-quality collateral against their top five borrowers.

Table 6 presents the test results regarding the banking industry's exposure to two economic sectors: households and business sector (corporates). The stress test focused on mortgage and personal loan portfolios within the household sector, based on the assumptions outlined in Section 7.1. For mortgages and personal loans, the impact was minimal, all banks would have maintained post-shock capital adequacy ratios (CAR) above the minimum requirement, thus obviating the need for recapitalization in both June and December 2024.

Secondly, stress tests were conducted on business lines, which represent more than half of the total loans to the business sector. For the first period, June 2024, if the shock assumed for the construction industry occurred, three banks, holding a combined assets market share of 91.3 percent, would have fallen below the regulatory capital. Furthermore, one of these banks would have faced insolvency. This would have necessitated a collective recapitalisation of approximately M447.3 million relative to capital adequacy ratio (CAR) and an additional M150.7 million relative to unimpaired capital. For December 2024 period, two banks, with a combined assets market share of 36.7 percent, would have breached regulatory capital requirements, requiring a combined recapitalization of about M233.9 million. In addition, one of these banks would have faced insolvency and required an additional recapitalisation of M37.5 million relative to its unimpaired capital. Lastly, in the scenario involving a surge in NPLs in the mining, quarrying, and manufacturing sectors, all banks passed the test and would have maintained adequate post-shock capital levels above the prudential CAR requirements in both review periods.

**Table 6** Sectoral Credit Risk Stress-Test Results

| Risks | Number of banks below 8.0% CAR | Assets share of banks< 8.0% CAR | Number of Insolvent Banks | Capital Deficiency Relative to CAR | Capital Deficiency Relative to Minimum Capital |
|---|---|---|---|---|---|
| June 2024 | | | | | |
| Group III: Sectoral level credit risk (20 percent increase in NPLs) | | | | | |
| HOUSEHOLD SECTOR | | | | | |
| Mortgages | 0 | 0 | 0 | 0 | 0 |
| Personal loans | 0 | 0 | 0 | 0 | 0 |
| BUSINESS SECTOR | | | | | |
| Manufacturing | 0 | 0 | 0 | 0 | 0 |
| Construction | 3 | 91.3 | 1 | 447 327 | 150 751 |
| Mining & quarrying | 0 | 0 | 0 | 82 335 | 0 |
| December 2024 | | | | | |
| Group III: Sectoral level credit risk (20 percent increase in NPLs) | | | | | |
| HOUSEHOLD SECTOR | | | | | |
| Mortgages | 0 | 0 | 0 | 0 | 0 |
| Personal loans | 0 | 55.4 | 0 | 355 160 | 0 |
| BUSINESS SECTOR | | | | | |
| Manufacturing | 0 | 0 | 0 | 0 | 0 |
| Construction | 2 | 36.7 | 1 | 233 854 | 37 530 |
| Mining & quarrying | 0 | 0 | 0 | 0 | 0 |

***Source**: Central Bank of Lesotho*

### 7.2.2 Liquidity Risk

The liquidity stress-tests results for both June and December 2024 revealed that all banks would have maintained adequate liquidity levels even after five days of continuous deposit withdrawals. Initially, in scenario I, each bank would have needed to conduct one round of liquidation on the first day of the run, generating sufficient cash to cover customer withdrawals for the remaining five days. This underscores the adequacy and quality of liquidity assets held by the banks. Similarly, in Scenario II, all banks would have endured the five-day bank run, although multiple rounds of liquidation would have been necessary until the fifth day. Nonetheless, all banks would have remained liquid throughout the assumed duration of the run in this test.

In the June stress test, scenario I would have resulted in about M8.6 billion worth of deposits withdrawn from banks, causing the banking industry balance sheet to shrink by 33.8 percent. Moreover, M8.4 billion worth of deposits would have been withdrawn in December 2024, causing the balance sheet to shrink by 33.4 percent. On the other hand, in scenario II, the June 2024 stress-test results show that shocks assumed would have led to multiple rounds of liquidation to avoid insolvency. In addition, total cumulative withdrawals would have totalled to M13.9 billion, leading to a 52.2 percent reduction in the banking industry's balance sheet. Similarly, M13.6 billion worth of deposits would have been withdrawn as at December 2024 causing the banking industry balance sheet to shrink by 51.8 percent. The results from both test periods are largely similar, implying that the banking system's resilience has not significantly changed throughout 2024.

Therefore, liquidity risk could also be regarded as minimal since banks would have sustained a bank-run type event for a period of five days under both scenarios, allowing the banks and the CBL a window of five days to one week to work on a solution that would restore confidence in the industry. It is, however, worth noting that the size of the banking industry, measured by total assets, would have emerged considerably smaller from such bank-run scenarios, especially for scenario II.

**Table 7 Daily Withdrawals**

| | June 2024 | | | | December 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Scenario I | | Scenario II | | Scenario I | | Scenario II | |
| | Daily Withdrawals (%) | No. of illiquid Banks (out of 4) | Daily Withdrawals (%) | No. of illiquid Banks (out of 4) | Daily Withdrawals (%) | No. of illiquid Banks (out of 4) | Daily Withdrawals (%) | No. of illiquid Banks (out of 4) |
| 1st day | 5 | 0 | 5 | 0 | 5 | 0 | 5 | 0 |
| 2nd day | 5 | 0 | 10 | 0 | 5 | 0 | 10 | 0 |
| 3rd day | 5 | 0 | 15 | 0 | 5 | 0 | 15 | 0 |
| 4th day | 10 | 0 | 20 | 0 | 10 | 0 | 20 | 0 |
| 5th day | 10 | 0 | 25 | 0 | 10 | 0 | 25 | 0 |

*Source: Central Bank of Lesotho*

The large depositors' bank runs stress-test results in Table 8 revealed that if the largest depositor(s) of each bank had simultaneously withdrawn their deposits, none of the banks would have exhausted their liquidity. However, one bank would have breached the 25.0 percent minimum liquid assets requirement[18] in the moderate and severe scenarios where (top three depositors simultaneously withdraw their deposits)

[18] Still meet the 25 percent minimum liquid assets requirements (prudential hurdle rate). Financial Institutions (Liquidity Requirements) Regulations 2000.

in June 2024. On the other hand, in December 2024, one bank would have breached the minimum liquid assets requirements in the severe scenario. As the results show, the liquidity position appears to have remained more or less the same in June and December 2024. Therefore, the results demonstrated a high level of resilience, as none of the banks would have exhausted their liquidity even in the severe scenario of a top-five depositors' run. This indicates that the sector is well-cushioned to handle a large depositor bank run and liquidity risk poses minimal threats to financial stability.

### 7.2.3 Interest Rate Risk

In both the June and December 2024 stress test outcomes, assumed movements in the yield curve in all scenarios would have resulted in a minimal impact on banks' balance sheets. The post-shock net-interest income as well as capital adequacy ratios, displayed a slight change following the assumed shocks. Therefore, bank balance sheets are considered highly inelastic to interest rate movements. The fluctuations in the yield curve would have had an insignificant impact on capital levels.

**Table 8 Large Depositor Run**

| | | 2024 | |
|---|---|---|---|
| | | June | December |
| **Baseline** | Liquid Assets/Short-term Liabilities | 70.0 | 69.7 |
| | Liquid Asset Ratio/Deposit | 82.0 | 79.4 |
| | *Liquid Asset Ratio* | 59.0 | 57.2 |
| **Shocks** | | | |
| **Largest Depositor withdrawals** | | | |
| **Shock I** | Liquid Assets/Short-term Liabilities | 67.5 | 66.7 |
| | Liquid Asset Ratio | 56.2 | 53.8 |
| | Liquid Asset Ratio less Hurdle Rate | 31.2 | 28.8 |
| | *Banks with exhausted liquidity* | 0 | 0 |
| **Top 3 Depositors' withdrawals** | | | |
| **Shock II** | Liquid Assets/Short-term Liabilities | 62.9 | 63.1 |
| | Liquid Asset Ratio | 51.2 | 49.8 |
| | Liquid Asset Ratio less Hurdle Rate | 26.2 | 24.8 |
| | *Banks with exhausted liquidity* | 1 | 0 |
| **Top 5 Depositors withdrawals** | | | |
| **Shock III** | Liquid Assets/Short-term Liabilities | 60.1 | 60.2 |
| | Liquid Asset Ratio | 48.2 | 46.8 |
| | Liquid Asset Ratio less Hurdle Rate | 23.2 | 21.8 |
| | *Banks with exhausted liquidity* | 1 | 1 |

***Source**: Central Bank of Lesotho*

**Table 9 Upward yield curve shift**

| Period | Baseline | 2024 | | | | | |
|---|---|---|---|---|---|---|---|
| | | June | | | December | | |
| | | Upward Yield Curve Shift | | | | | |
| | | Repricing Gap, thousand maloti | | | | | |
| | | +150 bps | +200 bps | +250 bps | +150 bps | +200 bps | +250 bps |
| 0 – 3 months | (10 466 949) | (157 004) | (209 339) | (261 674) | (164 831) | (219 775) | (274 719) |
| 3 – 6 months | 883 569 | 13 254 | 17 671 | 22 089 | 15 361 | 20 482 | 25 602 |
| 6 – 9 months | - | - | - | - | - | - | - |
| 9 – 12 months | 3 972 532 | 59 588 | 79 451 | 99 313 | 80 021 | 106 695 | 133 369 |
| > 12 months | 8 335 190 | 125 028 | 166 704 | 208 380 | 145 991 | 194 655 | 243 319 |
| Total Repricing Gap | 2 742 343 | 40 865 | 54 487 | 68 109 | 76 543 | 102 057 | 127 571 |
| Impact on Prudential Requirements | | | | | | | |
| Tier I Capital / RWA | 19.6 | 19.8 | 19.9 | 20.0 | 23.9 | 24.1 | 24.2 |
| Regulatory Capital / RWA | 21.3 | 21.6 | 21.6 | 21.7 | 25.5 | 25.6 | 25.7 |
| Banks below 8% ratio | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Assets of banks below 8% ratio | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Insolvent Banks | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Recapitalization relative to CAR | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Recapitalization relative to MUC | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

***Source**: Central Bank of Lesotho*

### 7.2.4 Foreign Exchange Rate Risk

The results indicate that the depreciation of the loti would have had an insignificant impact on the prudential ratios. Even when subjected to severe scenarios, the banking sector's capital adequacy ratios would not have fallen below the minimum 8 percent threshold. In June 2024, stress test results showed that the banking sector would have maintained a negative net open position under all scenarios. However, by December 2024, the banking sector would have experienced a positive net open position across all scenarios

[17] See Appendix III for detailed assumptions for this shock.

Table 10 Currency depreciation

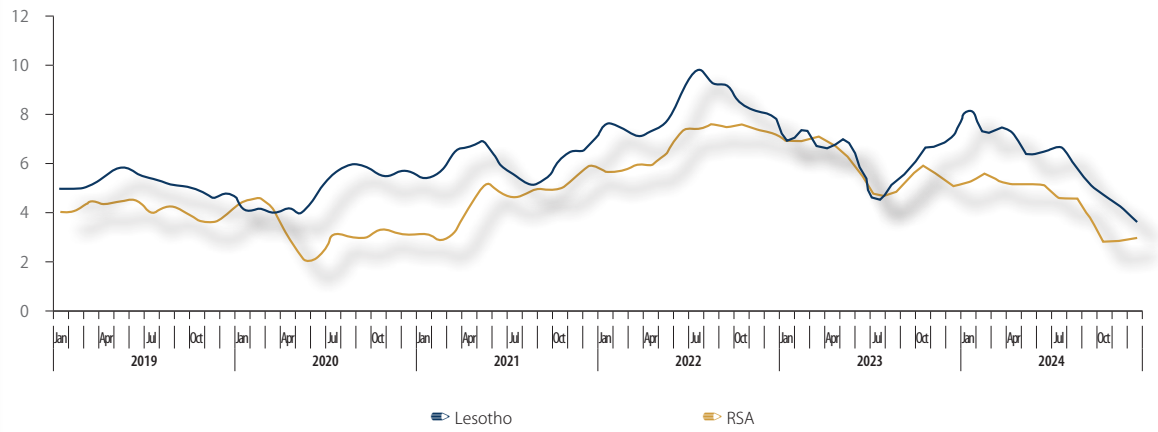
| | 2024 | | | | | |
|---|---|---|---|---|---|---|
| | June | | | December | | |
| FX Rate Risk Analysis Baseline | All Banks | Large Banks | Small Banks | All Banks | Large Banks | Small Banks |
| Relative Bank Size (%) | **100.0** | **55.1** | **44.9** | **100.0** | **54.3** | **45.6** |
| Tier I Capital / RWA | 19.6 | 16.3 | 25.5 | 23.5 | 21.8 | 25.9 |
| Regulatory Capital / RWA | 21.3 | 17.9 | 27.5 | 25.0 | 23.1 | 27.8 |
| Net open position | (3 948) | (2 997) | (951) | 6 086 | 3 147 | 2 939 |
| Shock I - Currency Depreciation of 20 percent | | | | | | |
| **Total Valuation Gains/Losses** | **(790)** | **(599)** | **(190)** | **1 217** | **629** | **588** |
| Post Shock Tier I / RWA | 19.6 | 16.3 | 25.5 | 23.5 | 21.8 | 25.9 |
| Post Shock Regulatory Capital / RWA | 21.3 | 17.9 | 27.5 | 25.0 | 23.1 | 27.8 |
| Net open position | (4 738) | (3 596) | (1 141) | 7 303 | 3 776 | 3 527 |
| *Banks below 8% ratio* | 0 | 0 | 0 | 0 | 0 | 0 |
| Shock II - Currency Depreciation of 25 percent | | | | | | |
| **Total Valuation Gains/Losses** | **(987)** | **(749)** | **(238)** | **1 522** | **787** | **735** |
| Post Shock Tier I / RWA | 19.6 | 16.3 | 25.5 | 23.5 | 21.8 | 25.9 |
| Post Shock Regulatory Capital / RWA | 31.3 | 17.9 | 27.5 | 25.0 | 23.1 | 27.8 |
| Net open position | (4 935) | (3 746) | (1 189) | 7 608 | 3 934 | 3 674 |
| *Banks below 8% ratio* | 0 | 0 | 0 | 0 | 0 | 0 |
| Shock III - Currency Depreciation of 30 percent | | | | | | |
| **Total Valuation Gains/Losses** | **(1 184)** | **(899)** | **(285)** | **1 826** | **944** | **882** |
| Post Shock Tier I / RWA | 19.6 | 16.3 | 25.5 | 23.5 | 21.8 | 25.9 |
| Post Shock Regulatory Capital / RWA | 21.3 | 17.9 | 27.5 | 25.0 | 23.1 | 27.8 |
| Net open position | (5 132) | (3 896) | (1 236) | 7 912 | 4 091 | 3 821 |
| *Banks below 8% ratio* | 0 | 0 | 0 | 0 | 0 | 0 |

*Source: Central Bank of Lesotho*

# APPENDICES

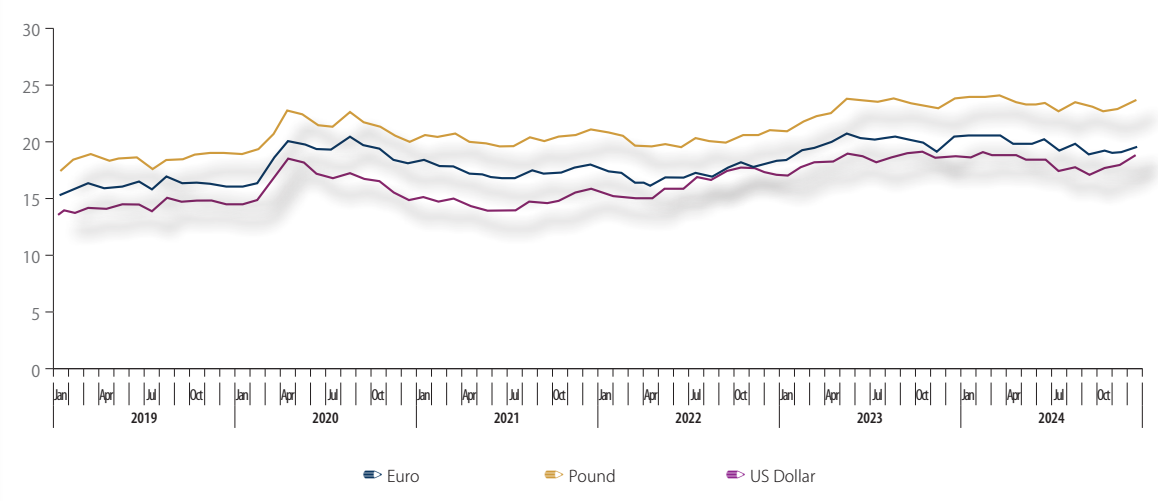
## Appendix I: Graphs

Appendix A Lesotho and RSA Inflation (%)



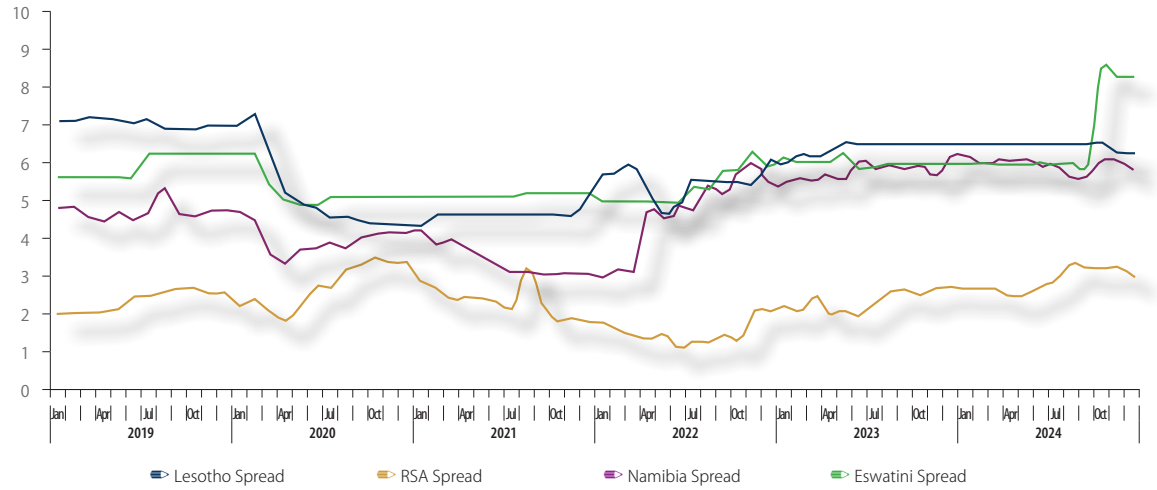

Source: Central Bank of Lesotho

Appendix B Loti Exchange Rate to the Euro, Pound & US Dollar



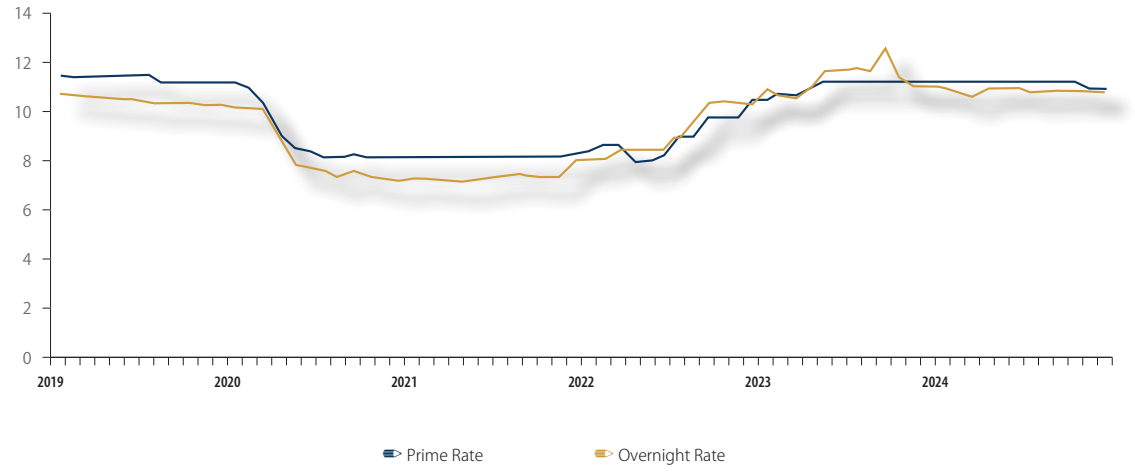

Source: Central Bank of Lesotho

Appendix C **Intermediation Spread (%)**




Source: CBL, BON, CBS

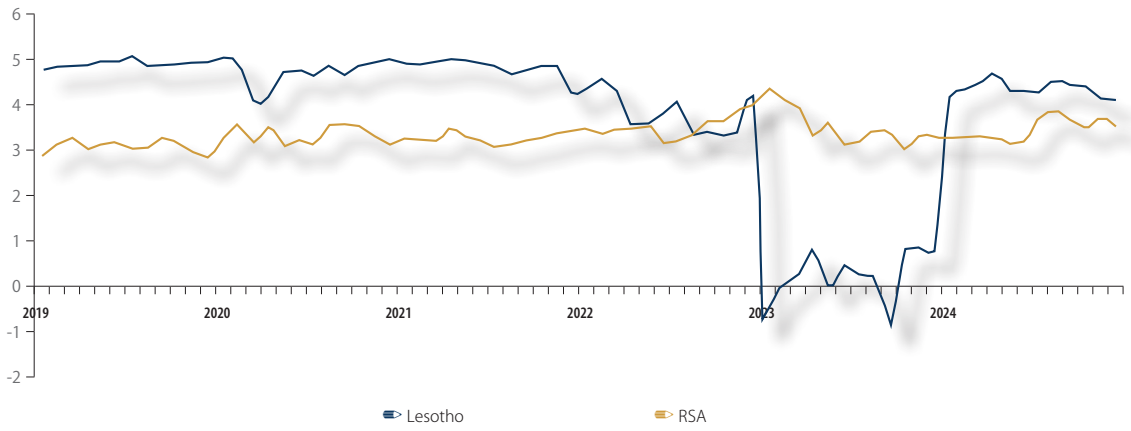
Appendix D **Money Market Spread (%)**




Source: Central Bank of Lesotho

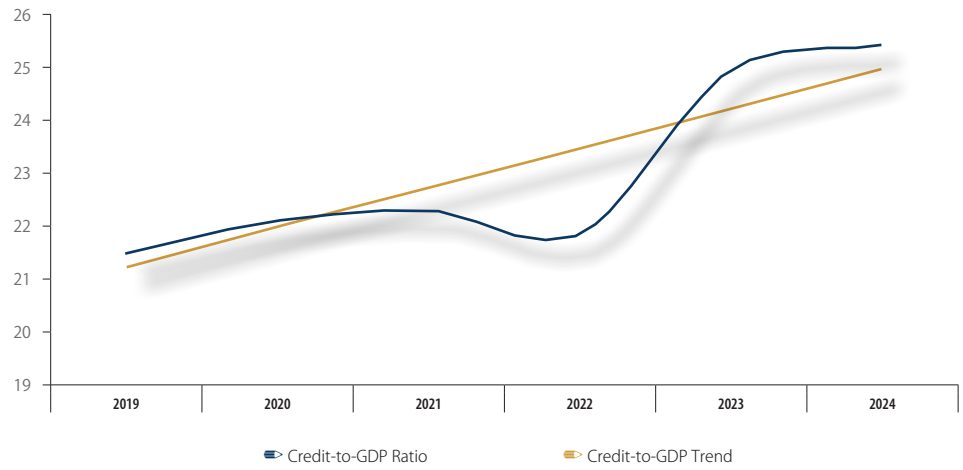
# APPENDICES

Appendix E **Lesotho and RSA Risk Premium (%)**



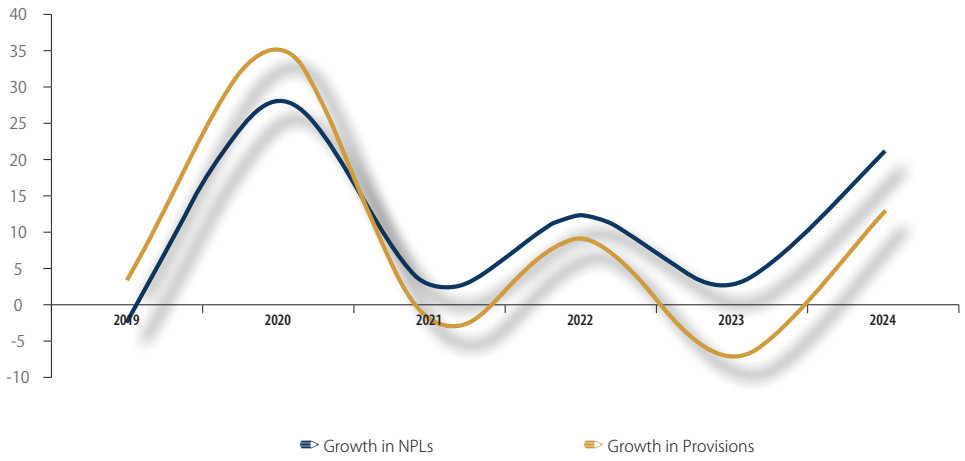

Source: Central Bank of Lesotho

Appendix F **Credit-to-GDP ratio and its trend (%)**



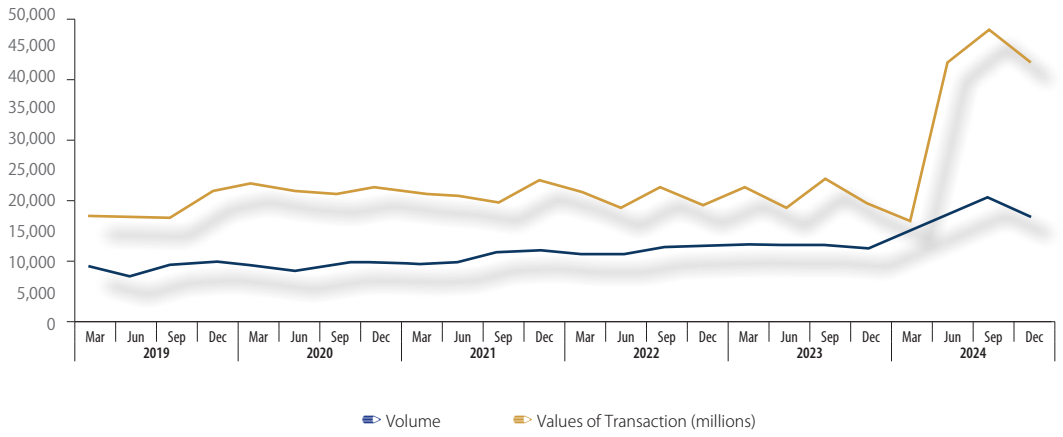

Source: Central Bank of Lesotho

## Appendix G Growth in NPLs and Provisions




Source: Central Bank of Lesotho

## Appendix H LSW Transactions and Values




Source: Central Bank of Lesotho CBL (The primary axis is in millions, while the secondary axis is in thousands.)

# APPENDICES

## Appendix II: Tables

| Appendix A A. Financial Soundness Indicators (%) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Description (Percentage Ratio)** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| **1. Banking Sector** | | | | | | | | | | | |
| **Capital Adequacy** | | | | | | | | | | | |
| Total Regulatory Capital to RWA | 14.56 | 15.42 | 18.89 | 17.81 | 17.92 | 19.38 | 22.95 | 22.44 | 23.99 | 17.16 | 15.98 |
| Regulatory Tier 1 to RWA | 13.67 | 13.79 | 17.19 | 20.87 | 20.18 | 21.72 | 24.89 | 24.38 | 25.60 | 17.64 | 15.00 |
| Tier 1 Capital to Assets | 6.66 | 7.08 | 9.06 | 9.69 | 10.28 | 10.40 | 11.35 | 10.91 | 12.47 | 9.54 | 11.16 |
| NPLs Net of provisions to Capital | 9.19 | 7.73 | 7.01 | 8.79 | 7.48 | 6.41 | 5.44 | 6.81 | 5.98 | 6.61 | 5.95 |
| **Earnings & Profitability** | | | | | | | | | | | |
| Return on Equity | 29.54 | 30.36 | 27.67 | 18.17 | 23.58 | 23.35 | 12.34 | 12.70 | 12.51 | 19.00 | 18.78 |
| Return on Assets | 4.28 | 4.50 | 4.44 | 3.24 | 3.76 | 4.17 | 2.29 | 2.49 | 2.54 | 3.36 | 3.22 |
| Net Interest Margin to Gross Income | 58.33 | 57.62 | 58.03 | 59.60 | 60.42 | 58.48 | 56.05 | 54.15 | 56.29 | 56.28 | 56.56 |
| Noninterest Expenses to Gross Income | 52.30 | 52.23 | 54.66 | 62.20 | 60.69 | 57.98 | 65.57 | 66.81 | 69.16 | 64.12 | 62.85 |
| **Asset Quality** | | | | | | | | | | | |
| NPLs to Total Gross Loans | 4.23 | 4.04 | 3.69 | 4.42 | 3.66 | 3.30 | 4.20 | 4.07 | 4.31 | 3.84 | 4.27 |
| Provisions to NPLs | 61.05 | 61.36 | 55.38 | 55.07 | 51.91 | 55.63 | 63.14 | 53.48 | 61.21 | 54.24 | 55.71 |
| Loan Concentration by Economic Activity | 60.98 | 62.46 | 60.64 | 52.65 | 61.34 | 61.08 | 60.44 | 61.31 | 66.17 | 59.18 | 62.66 |
| **Liquidity** | | | | | | | | | | | |
| Liquid Assets to Total Assets | 43.07 | 41.60 | 33.21 | 40.16 | 37.41 | 26.65 | 29.99 | 30.82 | 20.60 | 30.49 | 23.14 |
| Liquid Assets to Short-Term Liabilities | 57.46 | 58.25 | 48.49 | 57.27 | 53.90 | 39.35 | 43.68 | 44.78 | 30.31 | 42.60 | 33.08 |
| **Market Sensitivity** | | | | | | | | | | | |
| Net Open Position in FX to Capital | 7.56 | 17.22 | 38.88 | 33.68 | 30.27 | 38.91 | 52.81 | 46.15 | 22.69 | 71.49 | 11.93 |
| **2. Other Financial Corporations (OFCs)** | | | | | | | | | | | |
| OFCs' Assets to GDP: Insurance | - | - | - | - | - | - | 22.84 | 25.42 | 25.11 | 28.07 | 27.10 |
| Insurance Combined Ratio (Nonlife) | - | - | - | - | - | - | 63.66 | 75.29 | 78.08 | 116.94 | 91.91 |
| Insurance Return on Assets (Life) | - | - | - | - | - | - | - | 5.27 | 4.67 | 1.61 | 4.12 |
| Insurance Return on Equity (Life & Nonlife) | - | - | - | - | - | - | - | 32.35 | 28.10 | 9.78 | 10.86 |
| Insurance Shareholder Equity to total invested assets (Life & Nonlife) | - | - | - | - | - | - | 15.88 | 13.90 | 14.71 | 14.88 | 14.34 |
| **3. Household** | | | | | | | | | | | |
| Household Debt to GDP | **12.2** | **11.0** | **11.6** | **13.2** | **13.6** | **14.7** | **15.7** | **16.2** | **16.1** | **17.8** | **18.3** |

***Source**: Central Bank of Lesotho*

| Appendix B | Macro-Financial Indicators | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| GDP Growth rate (%) | 0.0 | -2.0 | 2.4 | -1.0 | 2.8 | 2.4 |
| Inflation rate (%) | 4.8 | 5.7 | 6.8 | 8.0 | 7.2 | 6.1 |
| Current account deficit (million maloti) | -405.4 | -412.3 | -712.9 | -1 582.2 | -661.9 | 296.9 |
| Total debt (million maloti) | 49.4 | 55.1 | 56.8 | 59.6 | 59.8 | 57.9 |
| External debt-to-total debt | 76.3 | 73.2 | 73.6 | 72.4 | 77.2 | 77.8 |
| Concessional debt-to-external debt | 80.7 | 77.7 | 77.9 | 74.6 | 75.2 | 74.0 |
| External debt service-to-revenue | 7.0 | 10.7 | 6.3 | 5.4 | 6.2 | 5.2 |
| External debt service-to-exports | 7.3 | 12.7 | 8.1 | 7.2 | 8.0 | 8.9 |
| Government deficit (million maloti) | -429.5 | 1 660 | -694.6 | -842.1 | 258.3 | 439.4 |
| Employment (# of persons) | 114 093 | 113 315 | 101 985 | 122 284 | 94 747 | 139 767 |
| Prime lending rate (%) | 11.2 | 8.2 | 8.4 | 10.5 | 11.3 | 11.0 |

***Source**: Central Bank of Lesotho*

# APPENDICES

## Appendix III: Tables

| Appendix C | Stress Test Assumptions and Shocks | | |
|---|---|---|---|
| Index | Description | Shock | Description |
| 1. General Credit Risk | | | |
| Shock 1.1 | Uniform NPL increase | 60% | Indicates an increase in NPLs of 60 percent across the credit spectrum. |
| Shock 1.2 | Uniform NPL increase | 120% | Indicates an increase in NPLs of 120 percent across the credit spectrum. |
| Shock 1.3 | Uniform NPL increase | 180% | Indicates an increase in NPLs of 180 percent across the credit spectrum. |
| 2. Sectoral Credit Risk | | | |
| Shock 2.1 | Mortgages | 20% | Indicates the percentage increase in NPLs across the Mortgages sector. |
| Shock 2.2 | Resident household (personal loans) | 20% | Indicates percentage increase in NPLs across the Resident household (personal loans) sector. |
| Shock 2.3 | Non-bank (Non-depository) financial institutions | 20% | Indicates the percentage increase in NPLs across the Non-bank (Non-depository) financial institutions sector. |
| 3. Credit risk Exposure by Lines of Business | | | |
| Shock 2.4 | Manufacturing | 20% | Indicates the percentage increase in NPLs across the Manufacturing sector. |
| Shock 2.5 | Construction | 20% | Indicates the percentage increase in NPLs across the construction sector. |
| Shock 2.6 | Mining and Quarrying | 20% | Indicates the percentage increase in NPLs across the Mining and Quarrying sector. |
| Shock 2.7 | Community, Social, and Personal services | 20% | Indicates the percentage increase in NPLs across the Community, Social, and Personal services sector. |
| Shock 2.8 | Real Estate and Business Services | 20% | Indicates the percentage increase in NPLs across the Real Estate and Business Services sector. |
| 4. Concentration Risk | | | |
| Shock 3.1 | Largest Borrower Defaults | 1 | Indicates a default of the largest borrower. |
| Shock 3.2 | Top Three Borrowers Default | 3 | Indicates a default of the largest three borrowers. |
| Shock 3.3 | Top Five Borrowers Default | 5 | Indicates a default of the largest five borrowers. |
| Detail 1 | Assumed provisioning rate | 20% | To calculate provisioning expenses for large borrower default. |
| 5. Reverse Stress Testing | | | |
| Shock 4.1 | Reverse Testing - Deterioration of performing loans | 7.9% | Deterioration of performing loans which causes capital to go below 8 percent. |
| 6. Interest Rate Risk | | | |
| Shock 5.1 | Interest shock | 150 bps | Indicates an increase in market-wide interest rates of 150 basis points. |
| Shock 5.2 | Interest shock | 200 bps | Indicates an increase in market-wide interest rates of 200 basis points. |
| Shock 5.3 | Interest shock | 250 bps | Indicates an increase in market-wide interest rates of 250 basis points. |
| Shock 5.4 | Interest shock | -150 bps | Indicates a decrease in market-wide interest rates of -150 basis points. |
| Shock 5.5 | Interest shock | -200 bps | Indicates a decrease in market-wide interest rates of -200 basis points. |
| Shock 5.6 | Interest shock | -250 bps | Indicates a decrease in market-wide interest rates of -250 basis points. |
| 7. Foreign-Exchange Risk | | | |
| Shock 6.1 | Depreciation of LSL | 20% | Indicates a depreciation of the LSL of 20 percent. |
| Shock 6.2 | Depreciation of LSL | 25% | Indicates a depreciation of the LSL of 25 percent. |
| Shock 6.3 | Depreciation of LSL | 30% | Indicates a depreciation of the LSL of 30 percent. |
| Shock 7.1 | Standard FX Loans Default | 20% | Indicates the percentage increase in NPS of 20 percent due to FX changes. |
| Detail 1 | Assumed provision rate | 50% | Indicates the percentage increase in NPS of 50 percent due to FX changes. |

***Source**: Central Bank of Lesotho*

| Appendix C | Stress Test Assumptions and Shocks (continued) | | |
|---|---|---|---|
| Index | Description | Shock | Description |
| **8. Multi-Factor Risk Scenarios** | | | |
| Shock 8.1 | Aggregate NPLs Increase | 60% | Indicates a simultaneous increase in NPLs of 60 percent, a depreciation of the LSL by 20 percent, and an increase in market-wide interest rates of 150 basis points. |
| | Depreciation of LSL | 20% | |
| | Interest rate shock | 150 bps | |
| Shock 8.2 | Aggregate NPLs Increase | 120% | Indicates a simultaneous increase in NPLs of 120 percent, a depreciation of the LSL by 25 percent, and an increase in market-wide interest rates of 200 basis points. |
| | Depreciation of LSL | 25% | |
| | Interest rate shock | 200 bps | |
| Shock 8.3 | Aggregate NPLs Increase | 180% | Indicates a simultaneous increase in NPLs of 180 percent, a depreciation of the LSL by 30 percent, and an increase in market-wide interest rates of 250 basis points. |
| | Depreciation of LSL | 30% | |
| | Interest rate shock | 250 bps | |
| **9. General Liquidity Risk** | | | |
| Shock 9.1 | Withdrawal of deposits: 1st day by | 5% | An outflow of deposits is assumed. Liquidity is generated through the fire sale of assets. Haircuts are assumed for all assets. Liquid assets generate the most liquidity, while non-liquid assets are assumed to generate not more than 1 percent liquidity after a fire sale. It is also assumed that after 5 days, there is a cooling-off period to allow banks and the central bank to restore confidence. |
| | Withdrawal of deposits: 2nd day by | 10% | |
| | Withdrawal of deposits: 3rd day by | 15% | |
| | Withdrawal of deposits: 4th day by | 20% | |
| | Withdrawal of deposits: 5th day by | 25% | |
| Detail 1 | Fire sale volume assumption: liquid assets | 80% | The assumption is that 80 percent liquidity can be generated through a fire sale. |
| Detail 2 | Fire sale pricing haircut: liquid assets | 75% | The assumption is that 75 percent liquidity can be generated through a fire sale. |
| Detail 3 | Fire sale volume assumption: non-liquid assets | 1% | The assumption is that 1 percent liquidity can be generated through a fire sale. |
| Detail 4 | Fire sale pricing haircut: non-liquid assets | 100% | |
| **10. Liquidity Concentration Risk – large-depositor bank run** | | | |
| Shock 9.2 | Withdrawal of deposits by large depositor | 1 | This affects liquidity ratios. Withdrawals are deducted from liquid assets, short term assets and total assets before the new ratio is calculated. |
| | Withdrawal of deposits by large depositors | 3 | |
| | Withdrawal of deposits by large depositors | 5 | |
| Detail 5 | Assumed liquidity ratio hurdle rate | 25% | The minimum liquidity ratio rate. |

***Source**: Central Bank of Lesotho*

# APPENDICES

## Appendix III: Technical Notes

### The Bank Health Index

The Bank Health Index (BHI) is a straightforward indicator of the stability of the banking system that makes it easier to conduct initial comparisons between different financial institutions. If proper mitigation measures are implemented, the BHI is a valuable instrument for the first-pass assessment of bank soundness conditions and facilitates the early identification of vulnerabilities in the banking system, which may assist in preventing extensive spillovers from any realization of tail risks.

To develop the BHI, banks' financial data are used and simple CAMELS-type ratings for each institution in the defined sample are calculated to get a rough and ready measure of individual banks' health. A BHI is subsequently derived from the ratings and a heat map is generated to provide an effective visual snapshot of a particular bank or banking system using a series of steps. ***First***, the following five categories of financial ratios are calculated: (i) Capital Adequacy, (ii) Asset Quality, (iii) Earnings, (iv) Liquidity, (v) Leverage, and Sensitivity to market risk. ***Second***, each financial ratio is then normalized to facilitate comparability using z-scores,

$$Z_{i,t} = \frac{x_{i,t} - \mu}{\sigma}$$

Where $Z_{i,t}$ is the normalized (or z-score for the) financial ratio of bank $i$ at time $t$; $x_{i,t}$ is the (raw) financial ratio of bank $i$ at time $t$; $\mu$ is the system mean of a particular financial ratio over nine periods to time $t$; $\sigma$ is the system standard deviation of a particular financial ratio over nine periods to time $t$.

The z-score indicates a bank's performance in particular areas relative to its peers and relative to historical patterns. In essence, the z-score communicates the number of standard deviations of a financial ratio from its nine-period average. A negative z-score is the number of standard deviations below the average while a positive z-score quantifies the number of standard deviations above the average. It is important to realise that some financial ratios and their z-scores are inversely related to financial stability like the asset quality measure (NPL ratio) and sensitivity to market risk (net open position in FX to capital ratio) wherein, a large positive z-score implies that the financial ratio of a particular bank is worse than the corresponding average across its peer group over a certain time. ***Last***, an overall relative health score for each bank at a particular point in time is estimated by summing up the z-scores for each of the five categories of financial ratios.

Table 2 (in text, section 4) shows the heat map calculated using the average of nine quarters and z-scores of CAMELS indicators calculated using biannual (or nine-quarter) averages. Percentiles of the distribution of z-scores are used to assign colours between green and red to specific z-scores wherein, anything below the 10th percentile is red, anything above the 90th percentile is green and lighter shades of amber (combinations of the RGB[19] colours) for z-scores in between[20].

[19] Red Green Blue (RGB) colours.

[20] $z_i = \frac{x_i - \mu_x}{\sigma_x}$, is the z-score for each time point, where the mean and standard deviations are calculated over nine quarters.

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