



Central Bank of Lesotho

# 2025

# FINANCIAL STABILITY REPORT

Safeguarding Stability.  
Building Resilience. Supporting Growth.







Central Bank of Lesotho

# FINANCIAL STABILITY REPORT

December 2025 | Issue No.10

The *Financial Stability Report* is available on the Central Bank of Lesotho website at [www.centralbank.org.ls](http://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. Through this Report, the CBL seeks to enhance awareness of the soundness of Lesotho's financial system 



## 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



|     |   |     |
|-----|---|-----|
|     |   |     |
|     | Preface   | iii |
|     | Foreword  | vi  |
|     | Financial Stability Assessment Overview           | vii |
|     |   |     |
| 1   | Macro-financial Environment                       | 1   |
| 1.1 | Key Developments                                  | 2   |
| 1.2 | Key Vulnerabilities                               | 5   |
|     |   |     |
| 2   | Resilience of the Non-Financial Sector            | 7   |
| 2.1 | Household   | 7   |
| 2.2 | Residential Real Estate                           | 9   |
| 2.3 | Businesses  | 10  |
| 2.4 | Sovereign   | 14  |
|     |   |     |
| 3   | Resilience of the Financial Sector                | 16  |
| 3.1 | Banking   | 16  |
| 3.2 | Insurance   | 24  |
| 3.3 | Microfinance Institutions                         | 27  |
| 3.4 | Financial Markets Infrastructure                  | 27  |
|     |   |     |
| 4   | Financial Sector Structure and Interconnectedness | 30  |
|     |   |     |
| 5   | Focus Topics                                      | 34  |
|     |   |     |



## FOREWORD

THE FINANCIAL STABILITY REPORT (FSR) is a core instrument through which the Central Bank of Lesotho (CBL) fulfils its mandate to promote and safeguard financial system stability. By systematically assessing vulnerabilities, resilience, and emerging risks across the financial system, the Report aims to enhance transparency, inform policy decisions, and strengthen public confidence in the soundness of Lesotho's financial sector. This tenth issue of the Financial Stability Report is published at a time of heightened global uncertainty and rising domestic macro-financial pressures, underscoring the importance of continued vigilance and proactive policy engagement.

Since the previous Report, the global financial environment has remained challenging. Persistent geopolitical tensions, fragmented global trade, volatile commodity markets, and elevated policy uncertainty have tested financial system resilience worldwide. While advanced and emerging market economies have generally demonstrated resilience, vulnerabilities related to high debt burdens, stretched asset valuations, and shifting monetary policy expectations have remained prominent. For small open economies such as Lesotho, these global developments continue to transmit through trade, commodity prices, financial flows, and confidence channels, amplifying domestic risks and constraining policy space.

Against this backdrop, financial stability risks in Lesotho increased during 2025. Pressures intensified across households, businesses, and the public sector as economic activity slowed and external support weakened. Household credit continued to expand despite fragile labour-market conditions, eroding financial buffers and contributing to rising non-performing loans, particularly in mortgage and unsecured personal lending. In the business sector, declining export demand, falling diamond prices, and heightened global trade

uncertainty strained cash flows and impaired debt-servicing capacity, leading to a broad-based increase in credit risk across key industries. At the sovereign level, fiscal outcomes remained favourable in headline terms; however, underlying vulnerabilities persisted due to continued reliance on volatile external revenues, notably Southern African Customs Union (SACU) receipts, and a rigid expenditure structure dominated by the public-sector wage bill.

The Report finds that structural developments within parts of the non-bank financial sector also contributed to elevated systemic risk. While the insurance and microfinance sectors recorded growth and improved profitability, underlying balance-sheet vulnerabilities remain. In the insurance sector, high operating costs, market concentration, and uneven reinsurance utilisation continue to heighten sensitivity to adverse shocks. The microfinance sector expanded rapidly, supporting financial inclusion, but remains exposed to credit and liquidity risks arising from loan-concentrated asset structures and reliance on borrowed funding. These developments underscore the need for strengthened risk management and supervisory oversight, particularly as financial intermediation deepens beyond the banking sector.

Encouragingly, Lesotho's core financial system remains broadly resilient. The banking sector continues to exhibit strong capitalisation, high liquidity buffers, and positive profitability, despite some moderation in earnings and a deterioration in asset quality during the year. Stress-testing results confirm that banks are well positioned to withstand macro-financial shocks, with capital remaining comfortably above regulatory minima across stress scenarios. Financial market infrastructures, including the Lesotho Wire and Automated Clearing House, operated reliably and continued to support the smooth functioning of payments and settlements. At the same time, the rapid growth in mobile-money services has advanced



financial inclusion, though it has also increased exposure to operational, liquidity, and cybersecurity risks that warrant close regulatory attention.

This Report places particular emphasis on two focus areas of growing importance for financial stability in Lesotho. The first examines the sustained decline in global diamond prices and its transmission to fiscal performance, banking-sector asset quality, and broader macro-financial conditions. The analysis highlights how prolonged weakness in the diamond sector has reduced export earnings, weighed on government revenues, and amplified credit risk through rising business distress and job losses. The second focus topic explores developments in the residential real estate market, which remains a key exposure for the banking system. While property prices have continued to rise, largely driven by domestic structural factors, increasing mortgage-loan stress and rising household indebtedness point to mounting vulnerabilities that require close monitoring.

Looking ahead, the risk outlook remains tilted to the downside. Global economic conditions are expected to remain uncertain, with subdued external demand, volatile commodity prices, and persistent geopolitical risks likely to continue weighing on growth prospects. Domestically, weak economic momentum, rising household and corporate leverage, and structural fiscal

constraints could further reinforce adverse feedback loops between the real economy and the financial system. In this environment, the Central Bank of Lesotho will continue to strengthen its macroprudential surveillance, refine its early-warning frameworks, and enhance cross-sectoral oversight to ensure that emerging risks are identified and addressed in a timely manner.

The Bank remains committed to maintaining a stable, resilient, and inclusive financial system that supports sustainable economic development. Achieving this objective will require continued policy coordination across monetary, fiscal, and macroprudential authorities, alongside sustained efforts to deepen financial markets, diversify the economy, and strengthen institutional capacity. The Bank will also continue engaging with financial institutions and other stakeholders to promote sound risk management, prudent lending practices, and adherence to regulatory standards.

As we celebrate this important milestone, the tenth issue of the Financial Stability Report, it is our hope that this publication will continue to serve as a valuable reference for policymakers, market participants, and the public, and will contribute to informed dialogue on safeguarding financial stability in Lesotho 



# FINANCIAL STABILITY ASSESSMENT OVERVIEW

SINCE THE LAST FINANCIAL STABILITY REPORT (FSR), the global financial system demonstrated notable resilience amid elevated risks due to persistent geopolitical tensions, fragmented trade, high asset valuations, and sovereign debt sustainability concerns.

Equity valuations, particularly for AI-focused firms, remained stretched, nearing levels seen during the late 1990s tech-bubble, increasing risks of a sharp market correction. Policy uncertainty also reached exceptionally high levels globally, driven by geopolitical rifts, trade tensions, and unpredictable policy shifts, with the World Uncertainty Index doubling since January 2025. While the global economy has shown resilience, this environment has suppressed investment, impacted trade, and slowed growth, particularly with rising tariffs.

Domestic financial stability risks also increased during the year as pressures intensified across households, businesses, and the public sector. Household borrowing rose despite weakening labour-market conditions, eroding financial buffers and driving a rise in mortgage-related non-performing loans (NPLs). Businesses faced mounting stress from declining external demand, tariff shocks, and insurmountable challenges in repaying their debt, evidenced by a rise in NPLs. At the sovereign level, vulnerabilities ranged from falling revenues, especially from SACU and trade taxes, combined with a rigid wage-dominated expenditure structure, to narrow fiscal space and heightened sovereign-bank linkages. Although public debt pressures eased marginally, the combination of weaker

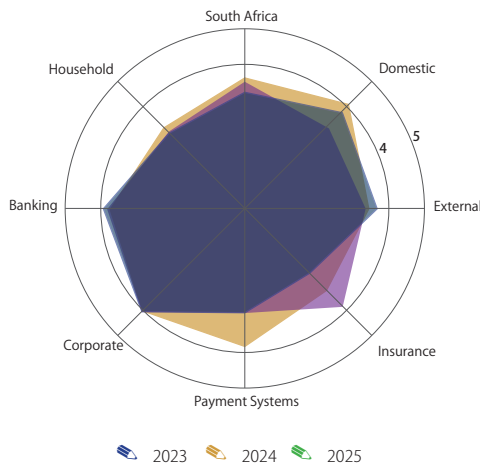
growth prospects and fiscal constraints continued to test the recent resilience.

Structural vulnerabilities within the insurance and microfinance sectors further contributed to systemic risk. While both sectors recorded growth and improved profitability, underlying balance-sheet weaknesses persisted. The insurance sector remained exposed to high operating costs, market concentration, and uneven use of reinsurance, all of which increased sensitivity to adverse shocks. The rapidly expanding microfinance sector faced challenges related to high loan concentration, dependence on borrowed funds, and weak liquidity buffers. These factors could amplify credit-quality deterioration and funding pressures.

Financial market infrastructures remained broadly stable, with the Lesotho Wire system operating reliably and supporting the smooth settlement of large-value transactions. However, risks related to operational disruptions, system downtime, and settlement delays persisted, with the potential to create liquidity pressures in the broader financial system. Mobile-money usage continued to expand rapidly, driven by a growing agent network and rising transaction volumes, thereby advancing financial inclusion. At the same time, this expansion increased exposure to operational, cybersecurity, and agent-network risks. These developments highlight the need for ongoing vigilance and robust regulatory oversight to maintain the resilience and integrity of Lesotho's payment and settlement systems.



**Figure 1 Financial Stability Risk Map**



Source: Central Bank of Lesotho

Financial stability risks outlook worsened in 2025, following temporary easing in 2024.

Financial stability risks outlook has deteriorated, driven by external environment vulnerabilities. Geopolitical tensions, including possible disruptions to the global trading system, volatility in commodity prices, inflationary pressures, all re-intensified, feeding into higher external-sector stress, and are casting a shadow over the global economic outlook. South African spillovers, persistent weak growth, elevated interest rates and ongoing fiscal strain, reinforce regional vulnerabilities.

Domestically, the macro-financial environment outlook deteriorated further as several downside risks materialise. The introduction of US tariffs, withdrawal of the MCC Compact II, and cuts in health sector aid have led to an unexpected downgrade in medium-term domestic growth. These developments are expected to negatively affect textile and clothing industry, slow growth in the services sector and weaken overall domestic demand.

# ONE MACRO-FINANCIAL ENVIRONMENT

## 1 MACRO-FINANCIAL ENVIRONMENT

THROUGHOUT 2025, THE GLOBAL MACRO-FINANCIAL ENVIRONMENT was shaped by heightened geopolitical tensions, shifting trade policies, and disruptions in global commodity markets, creating a challenging external environment for small open economies such as Lesotho's.

Changing U.S. tariff measures and retaliatory trade actions unsettled global trade flows, weakened investor sentiment, and contributed to sharp swings in global financial markets. Divergent monetary policy paths across major economies further complicated financial conditions, while declining natural-diamond prices placed additional strain on resource-dependent exporters. Together, these developments reinforced an external landscape characterized by elevated uncertainty and rising vulnerabilities.

Regionally, economic slowdown in South Africa persisted as structural bottlenecks, industrial contractions, logistical

inefficiencies, and energy-supply challenges continued to suppress growth. Moderating inflation, lower interest rates, and relatively resilient household consumption provided some support; however, weak demand in mining and manufacturing, higher U.S. tariffs, and low trade volumes eroded export competitiveness. These pressures curtailed tax revenues and weakened South Africa's fiscal position, transmitting adverse effects to Lesotho through financial and real-sector linkages.

Domestically, the macro-financial environment deteriorated in 2025. Economic activity slowed notably as external and domestic support weakened. The GDP gap remained negative, signaling continued weak economic momentum. Similarly, export performance weakened sharply as commodity prices fell and trade conditions tightened. Monetary conditions eased modestly as inflation remained moderate but volatile. Fiscal performance remained strong in headline terms, though underlying pressures persisted throughout 2025. Overall, domestic systemic vulnerabilities rose further in 2025 as global shocks, South African spillovers and domestic constraints converge.

| Table I Selected Economic Indicators |            |       |       |                               |       |      |                          |      |      |
|--------------------------------------|------------|-------|-------|-------------------------------|-------|------|--------------------------|------|------|
|                                      | GDP Growth |       |       | Interest Rates (12-month Avg) |       |      | Inflation (12-month Avg) |      |      |
|                                      | Δ pps      |       |       | Δ pps                         |       |      | Δ pps                    |      |      |
|                                      | 2024       | 2025  | y/y   | 2024                          | 2025  | y/y  | 2024                     | 2025 | y/y  |
| <b>Advanced Economies</b>            |            |       |       |                               |       |      |                          |      |      |
| US                                   | 2.40       | 2.00  | -0.4  | 5.27                          | 4.33  | -0.9 | 2.96                     | 2.47 | -0.5 |
| UK                                   | 2.00       | 1.00  | -1.0  | 5.10                          | 4.23  | -0.9 | 2.53                     | 3.38 | 0.9  |
| Euro Area                            | 1.30       | 1.20  | -0.1  | 4.07                          | 2.53  | -1.5 | 2.34                     | 2.13 | -0.2 |
| Japan                                | 0.50       | 0.30  | -0.2  | 0.14                          | 0.52  | 0.4  | 2.74                     | 3.20 | 0.5  |
| <b>Emerging Market Economies</b>     |            |       |       |                               |       |      |                          |      |      |
| Brazil                               | 3.60       | 1.80  | -1.8  | 10.92                         | 14.56 | 3.6  | 4.37                     | 4.26 | -0.1 |
| Russia                               | 3.30       | 17.83 | 18.92 | 1.1                           | 8.43  | 8.72 | 0.3                      | 8.43 | 0.5  |
| India                                | 7.40       | 7.80  | 0.4   | 6.50                          | 5.77  | -0.7 | 4.95                     | 2.23 | -2.7 |
| China                                | 5.40       | 4.50  | -0.9  | 3.34                          | 3.03  | -0.3 | 0.24                     | 0.05 | -0.2 |
| SA                                   | 0.80       | 0.80  | 0.0   | 8.13                          | 7.17  | -1.0 | 4.43                     | 3.23 | -1.2 |

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



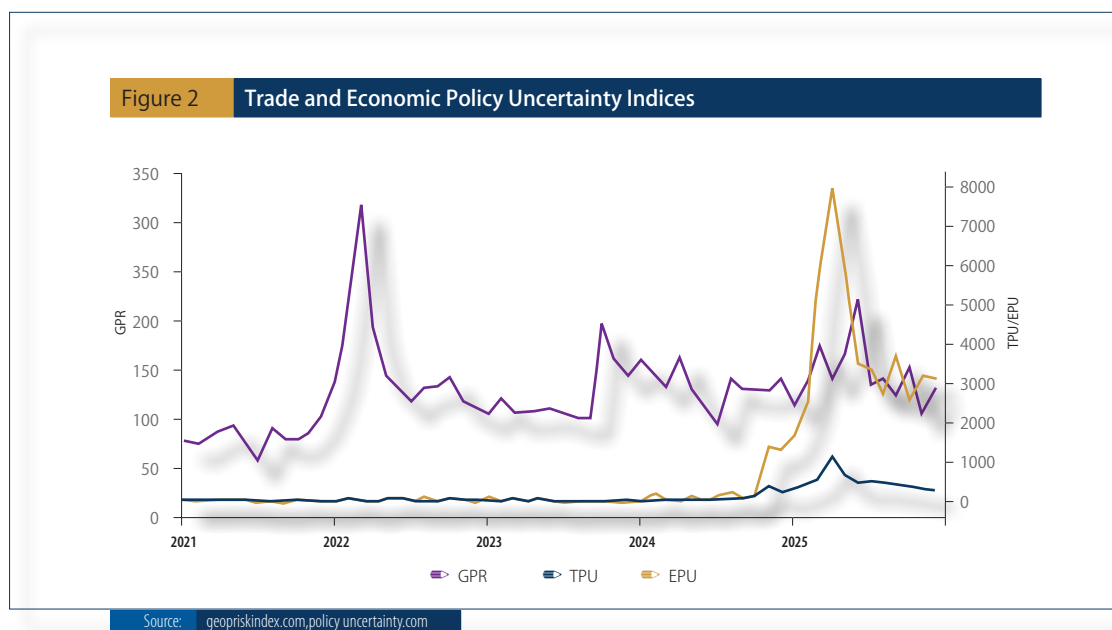
## 1.1 KEY DEVELOPMENTS

### Global Developments

Geopolitical conflicts and energy market disruptions dominated global developments in 2025. Geopolitical tensions drove the global economy towards a more fractured, multipolar world characterized by heightened protectionism, supply chain localization, and intense US-China competition. Key impacts include increased energy instability, trade disruptions due to cargo security issues, and a rise in cybersecurity risks. Economic growth is pressured by heightened uncertainty, protectionist tariffs, and high inflation.

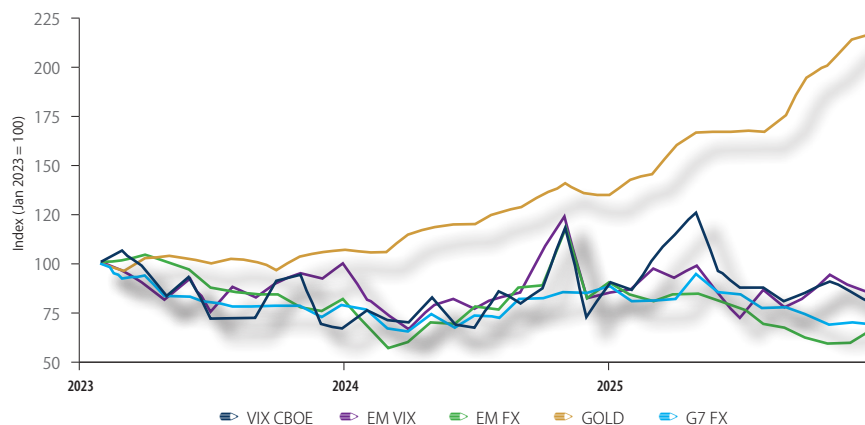
The US introduced new reciprocal, sector-specific and country-targeted tariffs affecting imports from China, Mexico, Canada, Brazil and India.

Trade policy uncertainty intensified as tariff actions oscillated from threat to suspension to implementation. In 2025, the global trade environment was shaped by successive tariff actions by major economies. The US introduced new reciprocal, sector-specific and country-targeted tariffs affecting imports from China, Mexico, Canada, Brazil and India. These were frequently announced with delayed effective dates, prompting significant front-loading of imports ahead of enforcement. Mid-year, the U.S. temporarily paused certain measures, offering brief relief before reinstating and implementing key tariffs later in the year, which reignited volatility. These shifts prompted several economies to adopt retaliatory trade and tariff measures, escalating policy frictions and intensifying global uncertainty around supply chains, production costs, and cross-border competitiveness. Together, these actions produced rapid shifts in trade flows, business inventories and global market sentiment.



# ONE MACRO-FINANCIAL ENVIRONMENT

**Figure 3** Volatility Indices and Gold Price



Source: Bloomberg

Financial markets experienced rapid shifts in risk appetite as policy actions and political developments evolved. Markets responded to tariff announcements with sharp risk-off selling across major equity indices, including weekly declines exceeding 3 percent, followed by a rebound driven by the temporary tariff pause and gains in large technology stocks. However, by late 2025, a credibility shock at the U.S. Federal Reserve spurred capital flight into safe-haven assets such as gold, while political risk events drove further turbulence. By year-end, market volatility increasingly reflected geopolitical uncertainty more than growth prospects, tightening liquidity conditions and raising global funding costs.

Diverging monetary policy paths across major economies added to global uncertainty. Central banks adopted mixed policy responses as growth slowed but inflation persisted. The U.S. Federal Reserve cut rates modestly, Japan increased rates, and Europe maintained a tighter stance around 5.25 percent. Emerging markets displayed a similarly uneven pattern: China eased to support domestic activity, while others held rates steady to protect currency stability. This divergence underscored the difficulty of coordinating policy in an environment marked by geopolitical tensions and disrupted supply chains.

Commodity market developments created additional headwinds for resource dependent economies. Natural diamond prices fell sharply through 2025, with smaller stones declining by nearly 26 percent as consumers shifted toward lab-grown alternatives. Consequently, producers responded by cutting output. By year end, lab grown diamonds accounted for more than 20 percent of the global market, weighing on traditional producers and adding to external balance risks for diamond-exporting economies.

## South African Developments

South Africa's economic activity weakened further in 2025 amid deepening industrial contractions and structural bottlenecks. Contractions in mining and manufacturing outweighed support from moderating inflation, interest rate reductions and the rollout of the two-pot pension withdrawal system. While household consumption remained resilient, weak external competitiveness, subdued investment and persistent logistical inefficiencies, including deteriorating rail networks and port congestion, continued to weigh on output. Higher U.S. tariffs on selected South African exports also contributed to softer industrial performance.

# ONE MACRO-FINANCIAL ENVIRONMENT



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Recurring port delays, rail freight inefficiencies and intermittent electricity shortages restricted production capacity and reduced export volumes.

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**Mining and manufacturing output remained weak due to persistent logistical and energy constraints.** Recurring port delays, rail freight inefficiencies and intermittent electricity shortages restricted production capacity and reduced export volumes. These operational challenges affected production schedules, narrowed margins and contributed to muted private sector investment, reinforcing the overall sluggishness in industrial activity.

**Subdued trade and industrial performance continued to weigh on fiscal outcomes and external conditions.** Lower-than-expected trade volumes affected tax revenue collections, and export competitiveness remained constrained by infrastructure bottlenecks and soft global demand. These developments contributed to a cautious external environment and modest investor sentiment, particularly in sectors sensitive to global trade dynamics.

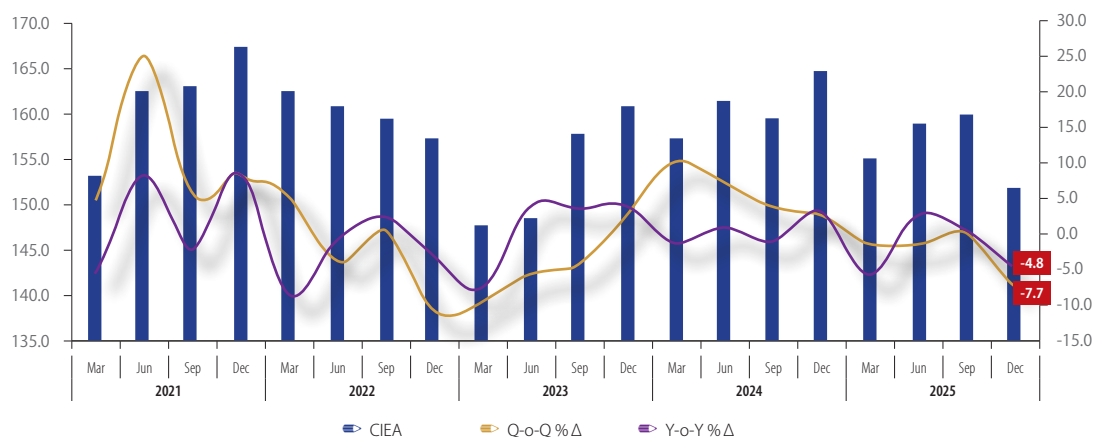
**Despite temporary improvements in electricity supply, longstanding structural weaknesses continued to limit growth potential.** Enhanced generation capacity provided some short-term relief, reducing the severity of load-shedding episodes. However, governance challenges in state-owned enterprises, infrastructure backlogs and slow progress on structural reforms continued to shape South Africa's medium-term growth trajectory.

**Monetary policy eased gradually as inflation moderated and near-term price pressures declined.** SARB reduced the repo rate from 7.5 percent to 6.75 percent by November as headline inflation eased, supported by declines in fuel and electricity prices. The easing aimed to support credit conditions and relieve debt-servicing pressures. However, underlying growth momentum remained subdued as structural constraints and weak external demand limited the broader impact of lower rates.

## Domestic Developments

**Economic activity slowed notably in 2025 as external and domestic support weakened.** Lesotho's GDP growth fell to 1.3 percent in 2025, down from 2.4 percent in 2024, reflecting softer external demand, falling commodity prices, and the withdrawal of foreign-aid support. The termination of MCC Compact II and the suspension of other donor-funded programmes led to the scaling-down or closure of several NGO-supported operations, contributing to job losses and weaker household incomes. At the same time, higher U.S. tariffs on apparel and selected manufactured goods reduced export orders, amplifying pressure on the textile industry. Weak global diamond demand also intensified the slowdown, with diamond export earnings declining by 48.9 percent as prices fell, prompting mine-level restructuring and retrenchments. The LHWP-II continued to support construction activity, but it was insufficient to offset the broader deceleration in domestic economic activity.

**Figure 4 High-Frequency Indicators of Economic Activity (CIEA), Indices**



Source: Central Bank of Lesotho

**Export performance weakened sharply as commodity prices fell and trade conditions tightened.** Merchandise exports contracted by 6.2 percent, driven largely by the steep fall in diamond revenues. Severe price declines and lower global demand resulted in operational downscaling and employment cuts in the mining sector. The textile industry also faced substantial pressure, with exports to the U.S. falling by 9.9 percent and more than 10,000 textile jobs lost during the year. While the renewal of AGOA preserved preferential access to the U.S. market, global shipping disruptions and tariff-related uncertainty constrained short-term recovery prospects.

**Monetary conditions eased modestly as inflation remained moderate but volatile.** Inflation rose to 4.4 percent early in 2025 before easing to 4.1 percent by year end, supported by lower fuel and food prices and a relatively stable exchange rate. With inflation moderating, the Central Bank of Lesotho reduced the policy rate by an average 100 basis points to 6.5 percent, providing temporary support to households and businesses. However, broader geopolitical tensions and uncertainty in global commodity markets kept upside inflation risks elevated throughout the year.

Fiscal performance remained strong in headline terms, though underlying pressures persisted throughout 2025. The fiscal position recorded a surplus of 9.9 percent of GDP, supported by elevated SACU receipts, higher water royalty inflows, and underspending on capital projects caused by implementation delays. Public debt stood at 52.9 percent of GDP and remained well below international and SADC prudential thresholds, which indicated a broadly sustainable fiscal position.

## 1.2 KEY VULNERABILITIES THAT COULD AFFECT FINANCIAL STABILITY IN LESOTHO

Lesotho faced several external vulnerabilities that were transmitted directly into domestic economic and financial conditions. Weaknesses in the global diamond market reduced export earnings and tightened liquidity for mining firms, which in turn weakened household incomes and reduced repayment capacity. Rising global protectionism also raised uncertainty for textile exporters and increased concentration risk, exposing firms and banks to sudden shifts in external demand. Geopolitical shocks elevated global energy and food prices, which raised input costs for businesses, eroded household purchasing power and limited the scope for monetary easing, thereby increasing credit risk.

# ONE MACRO-FINANCIAL ENVIRONMENT



Regional vulnerabilities stemmed largely from South Africa's prolonged economic stagnation. Weak industrial activity, logistical bottlenecks and unstable energy supply reduced demand for Lesotho's exports and affected cross-border labor earnings. Volatile SACU transfers complicated fiscal planning and indirectly influenced government spending, investment activity and domestic liquidity conditions. Exchange-rate movements tied to South African and broader emerging-market dynamics affected import costs and inflation patterns, with knock-on effects for firms' operating margins and banks' funding conditions.

*Weak industrial activity, logistical bottlenecks and unstable energy supply reduced demand for Lesotho's exports and affected cross-border labour earnings.*

Domestically, vulnerabilities emerged from slowing economic momentum, concentrated sectoral exposures and rising credit imbalances. Job losses across export-dependent and donor-funded sectors weakened household incomes and reduced borrowers' ability to service debt, which increased credit risk in both household and business loan portfolios. Elevated household indebtedness, combined with rising mortgage-market pressures, heightened sensitivity to income shocks and increased credit-risk transmission into banks' balance sheets. Corporate-sector strains also intensified as firms faced lower turnover and tighter liquidity, increasing the likelihood of payment delays and restructurings. Fiscal dependence on volatile external inflows and growing sovereign-bank linkages reinforced macro-financial vulnerabilities and elevated the system's exposure to external shocks.

**Figure 5** Macro-Financial Vulnerabilities Heat Map

| Sector               | Indicators   | 2021   | 2022   | 2023   | 2024   | 2025   |
|----------------------|--|--------|--------|--------|--------|--------|
| Global Economy       | Volatility (VIX)   | Red    | Red    | Red    | Yellow | Red    |
|                      | Commodity Prices (Bloomberg Index)                       | Red    | Red    | Red    | Yellow | Red    |
|                      | CPI Inflation advanced economies                         | Red    | Red    | Red    | Yellow | Red    |
|                      | Quarterly standard deviation NEER (Current Market Rates) | Yellow | Yellow | Yellow | Yellow | Yellow |
| South Africa         | S.A GDP Gap  | Red    | Red    | Red    | Red    | Red    |
|                      | SARB Policy Rate   | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | Unemployment Rate  | Red    | Red    | Red    | Red    | Red    |
| Domestic Environment | GDP Gap  | Red    | Red    | Red    | Red    | Red    |
|                      | Fiscal Balance (%GPD)                                    | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | Prime Rate   | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | CPI Inflation (Headline)                                 | Red    | Red    | Red    | Red    | Red    |
|                      | Import Cover   | Yellow | Yellow | Yellow | Yellow | Yellow |
| House-Hold Sector    | SACU revenue (YoY) % change                              | Red    | Red    | Red    | Red    | Red    |
|                      | H.H Debt to GDP  | Red    | Red    | Red    | Red    | Red    |
| Payment systems      | % Employment change                                      | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | Lesotho Wire (LSW) availability                          | Red    | Red    | Red    | Red    | Red    |
| Insurance            | Automated Clearing House (ACH) Availability              | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | Shareholder Equity to invested assets                    | Red    | Red    | Red    | Red    | Red    |
|                      | Return on equity (ROE)                                   | Yellow | Yellow | Yellow | Yellow | Yellow |
|                      | Combined ratio   | Red    | Red    | Red    | Red    | Red    |

Source: Central Bank of Lesotho

# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

## 2 RESILIENCE OF THE NON FINANCIAL SECTOR

FINANCIAL-STABILITY RISKS INCREASED as vulnerabilities build across households, businesses, and the public sector. Household borrowing rose despite weak income growth, eroding financial cushions and contributing to poorer repayment capacity. At the same time, businesses remained under pressure from subdued demand, global disruptions, and structural weaknesses, undermining their ability to manage debt. Although the fiscal position appears strong due to a temporary surplus, deep-rooted issues such as reliance on volatile SACU revenues, continue to pose significant risks to overall economic and financial stability.

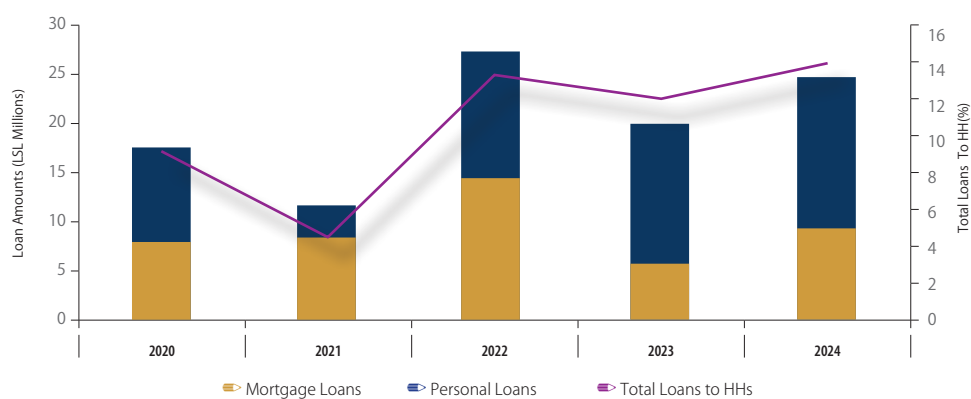
The upward trend in household borrowing over the review period was shaped mainly by movements in personal and mortgage lending.

### 2.1. HOUSEHOLDS

#### Household borrowing rose despite weak income growth

Household borrowing from the banking sector continued to grow despite the weak labour market, indicating rising vulnerability in repayment capacity. The upward trend in household borrowing was shaped mainly by movements in personal and mortgage lending. Despite a fall in 2021–2022 amid weak conditions, household borrowing rebounded strongly in 2023. It then slowed in 2024 due to weaker mortgage lending, but picked up again in 2025, driven mainly by continued growth in personal loans while mortgage recovery remained modest. Therefore, the growing reliance on personal loans signals rising household indebtedness and heightened vulnerability, as unsecured borrowing is more sensitive to income shocks, highlighting increased financial-stability risks.

Figure 6 Households Borrowing (year-on-year growth)



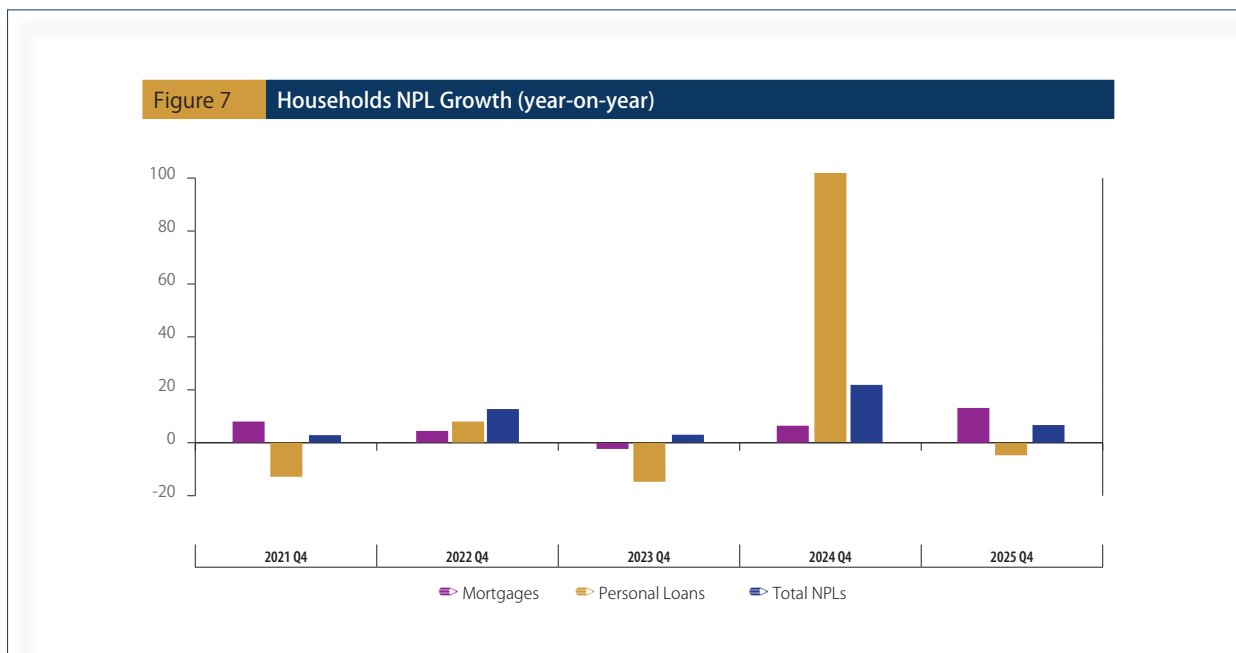
Source: Central Bank of Lesotho

# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR



The dynamics in Household borrowing unfolded against a backdrop of deteriorating household-sector fundamentals. Labour-market conditions remained fragile in 2025 amid subdued economic activity, particularly in key sectors such as mining, manufacturing, and health. Job losses driven by declining global diamond prices, reduced export activity, and the suspension of some USAID-funded projects placed downward pressure on household incomes. Against this backdrop, the continued expansion of household borrowing raises concerns about growing financial strain and weakening repayment capacity. These pressures are reflected in a 2.5 percent increase in household non-performing loans in 2025, largely driven by mortgage loans defaults, pointing to intensifying credit risks within the household sectors.

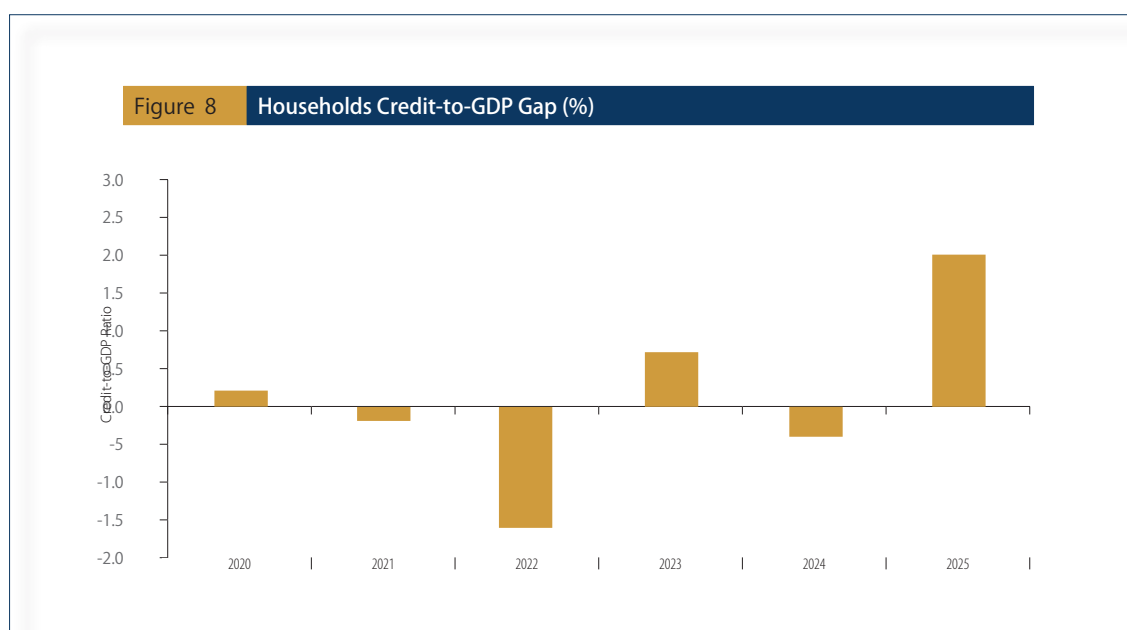
Figure 7 further shows increasing volatility and general deterioration in household asset quality. Mortgage NPLs remained relatively moderate but trended upward over time, rising notably in 2024 and further in 2025, signaling growing stress in the housing segment. Personal-loan NPLs were more volatile, but consistently trending upwards between 2022 and 2024, suggesting a widespread deterioration in unsecured credit quality. This surge reflected delayed stress transmission from weakened household incomes and rising debt-servicing pressures. In 2025, personal-loan NPLs declined but remained elevated relative to earlier years, indicating persistent credit-risk pressures in the household sector. Overall, the trend highlights increasing vulnerabilities driven by unsecured lending, heightening risks if income conditions remain weak.



## TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

Household credit growth points to a shift toward faster-than-sustainable credit expansion, signalling emerging risks that require closer monitoring. The household credit-to-GDP gap increased from –0.5 percent in 2024 to 2.0 percent in 2025 (Figure 8), marking a move from below-trend to above-trend credit growth. Over the same period, the household credit-to-GDP ratio grew from 17.5 percent

to 19.9 percent, reflecting deeper financial intermediation and a greater reliance on credit to support household consumption and overall economic activity. Although this increase in credit growth may bolster short-term economic performance, the persistent upward trend could heighten future financial-stability risks.



Source: Central Bank of Lesotho

The household credit-to-GDP gap increased from –0.5 percent in 2024 to 2.0 percent in 2025 (Figure 8), marking a move from below-trend to above-trend credit growth.

### 2.2. RESIDENTIAL REAL ESTATE

Repayment pressures are mounting amid weak economic activity

Developments in residential lending point to mounting repayment pressures and growing vulnerabilities in the housing credit segment. Figure 9 highlights growing stress in the residential real-estate credit segment, reflected in the widening gap between loan growth, asset-quality deterioration, and interest-rate dynamics. Residential loan growth was very strong in 2019 and 2020, peaking sharply in 2020, before contracting in 2021 as economic conditions weakened. Although lending recovered somewhat in 2022

# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR



and 2023, growth slowed again in 2024 and remained subdued in 2025, indicating cooling demand and tighter credit conditions. In contrast, residential NPL growth surged dramatically in 2024, marking a clear deterioration in asset quality, before easing in 2025 but remaining elevated. At the same time, restructured residential loans showed extreme volatility, with strong growth in 2020, a contraction in 2021, and a sharp negative swing again in 2024, suggesting that

lenders increasingly relied on restructurings to manage borrower distress as repayment pressures intensified. These developments occurred alongside relatively stable, but elevated maximum lending and prime rates, which remained high throughout the period and only moderated slightly toward 2025. Therefore, these developments highlight financial-stability risks in the residential mortgage market and thereby underscoring the need for close monitoring of loan performance and restructuring practices.



Lesotho’s private sector, heavily concentrated in the textile industry, faced significant headwinds, particularly in the first half of 2025, following the imposition of tariffs by the U.S. administration on its trading partners.

## 2.3. BUSINESSES

Businesses remain under pressure at the back of weak economic activity

The business sector remained fragile, largely due to heightened external policy uncertainty and persistently weak global demand. Lesotho’s private sector, heavily concentrated in the textile industry, faced significant headwinds, particularly in the first half of 2025, following the imposition of tariffs by the U.S. administration on its trading partners. These measures dampened external demand, resulting in a decline in export revenues and the loss of more than 40 percent of jobs in the

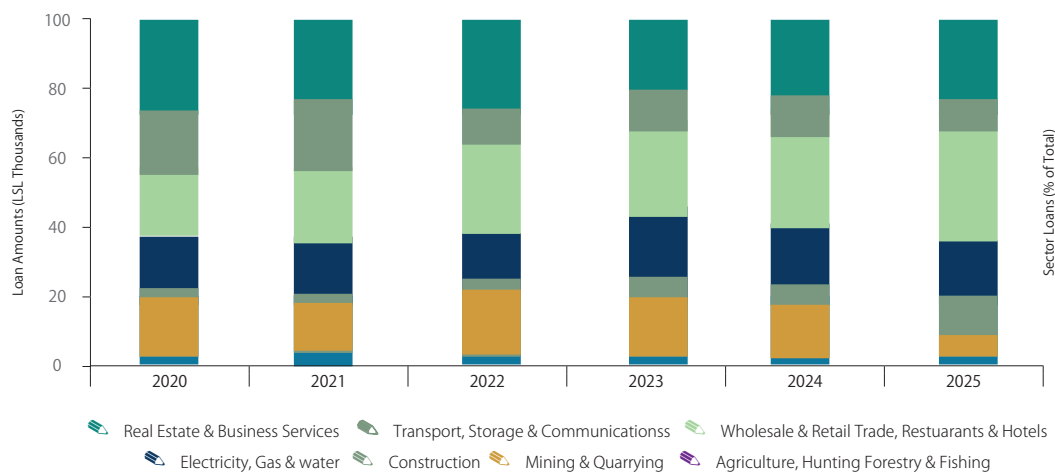
# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

sector. This highlights the lack of market diversification, which continues to expose the sector to external shocks, particularly those originating from the U.S. market. The contraction in economic activity not only weakened business performance but also had indirect implications for the banking sector, as reduced revenues among textile firms constrained their debt-servicing capacity and heightened credit risk.

**Business loan concentration largely reflects subdued and skewed demand for credit across economic sectors.** Demand for business loans, as shown in Figure 10, remained highly concentrated in a few key sectors over the period from 2020 to 2025, reflecting uneven borrowing appetite across the business sector. Demand for bank credit continued to be strongest in wholesale and retail trade, alongside construction

and real estate and business services. In contrast, sectors such as agriculture, mining, and manufacturing recorded smaller, but relatively stable demand for credit, constrained by weak profitability, high operating costs, and heightened uncertainty surrounding export markets and input prices. Business borrowing as a share of total loans peaked at around 28 percent in 2023, before moderating to approximately 26 percent during 2024–2025, signalling a softening in corporate borrowing appetite amid slower economic growth and tighter financial conditions. Therefore, the persistent concentration of credit demand in a narrow set of sectors underscores the need for continued monitoring of sectoral exposures to safeguard financial stability and mitigate vulnerabilities arising from concentrated lending patterns.

**Figure 10** Banks' business loan portfolio



Source: Central Bank of Lesotho

# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

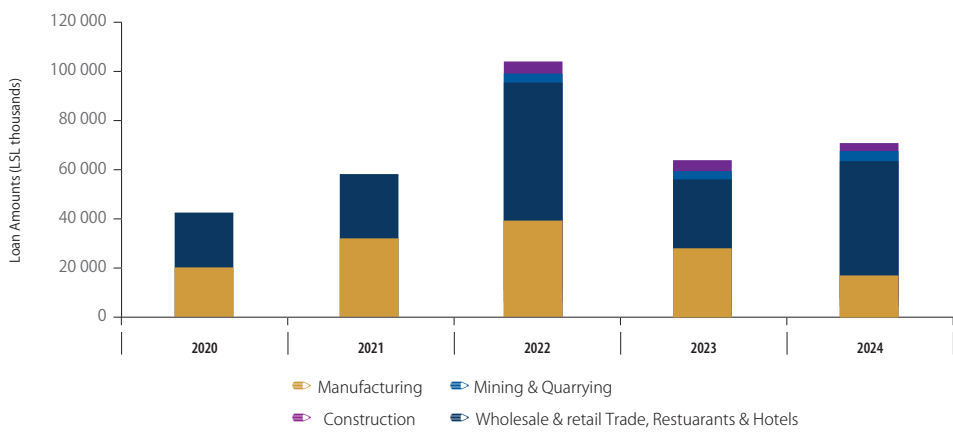


The business sector remained under significant strain in 2025, as renewed credit risks across major industries highlighted rising vulnerabilities. The reemergence of credit risk across key business sectors, signal rising vulnerabilities in the corporate segment as depicted in Figure 11. Specifically, after a period of relative moderation between 2022 and 2024, NPL ratios increase markedly in 2025, driven by a broad-based deterioration across wholesale and retail trade, construction, manufacturing, and mining and quarrying. The sharp increase in wholesale and retail trade NPLs reflects subdued domestic consumption, which weakened business revenues and strained repayment capacity. At the same time, the mining sector continues to face pressure from declining diamond prices,

while manufacturing remains constrained by challenges in the textile industry amid heightened global policy uncertainty, all of which have contributed to rising loan distress.

This broad-based deterioration across sectors suggests that vulnerabilities are becoming more widespread within the business environment. From a financial stability perspective, rising sectoral NPL ratios elevate credit risk exposures for banks, potentially eroding profitability and capital buffers if losses materialize, and may also constrain future lending, thereby resulting in adverse feedback loops between the real economy and the financial sector.

**Figure 11 Business-Sector Non-Performing Loan (NPL) Ratios by Industry**



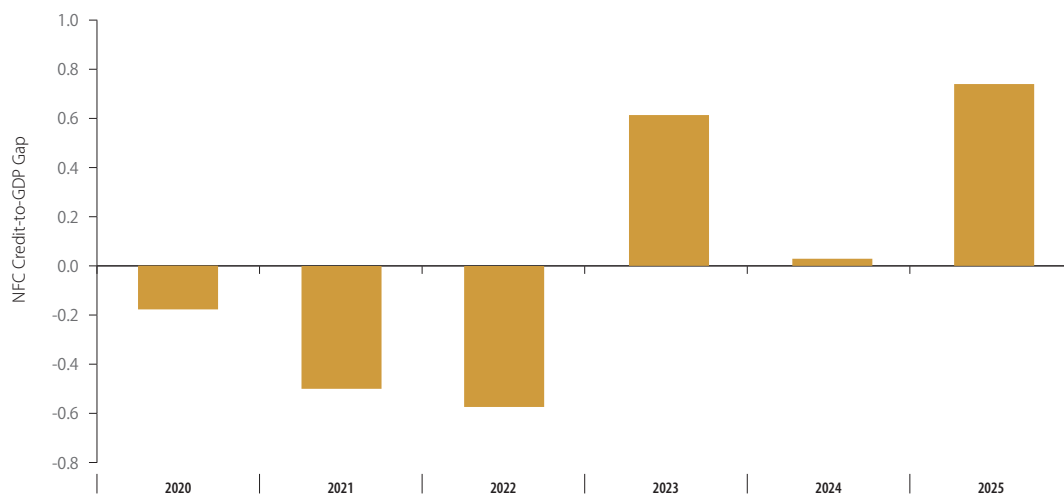
Source: Central Bank of Lesotho

## TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

Recent movements in corporate credit suggest rising cyclical pressures that may heighten financial stability risks. The credit-to-GDP gap was negative from 2016 to 2022, indicating below-trend credit growth, whereas positive gaps in 2023 and 2025 reflect above-trend expansion. The recent increase, partly driven by financing needs for infrastructure projects such as the Lesotho Highlands Water Project Phase II (LHWP-II), highlights

stronger corporate borrowing relative to economic activity. The widening credit gap underscores emerging financial stability risks, including potential loan impairments if project cash flows are delayed or economic conditions weaken, thereby heightening the risk of future loan impairments and broader banking sector vulnerabilities.

Figure 12 Non-financial Corporations' Credit-to-GDP Gap



Source: Central Bank of Lesotho

# TWO

## RESILIENCE OF THE NON – FINANCIAL SECTOR



### 2.4. SOVEREIGN

Fiscal performance remained strong and expenditure contained, while debt moderated

The government entered the 2025/26 fiscal year with a solid fiscal position underpinned by resilient domestic tax performance, although the need for greater revenue diversification remained. Fiscal adjustments were shaped by global economic headwinds, including new export tariffs and significant challenges in the textile and mining sectors. By mid-year, domestic taxes had performed well, reaching 46.4 percent of their annual target, yet overall revenue collection stood at only 42 percent due to substantial shortfalls in grants and non-tax revenues. A sharp contraction in capital spending, following the suspension of major US-funded projects under the Millennium Challenge Corporation and USAID, unexpectedly shifted the initially projected deficit into a surplus of M1.65 billion. Despite these pressures, the government maintained strong execution in priority sectors, such as health and education, underscoring its continued commitment to human capital development. The medium-term budget review also reiterated the urgent need to diversify revenue sources and advance the transition toward a more private-sector-led economy.

However, the total revenue collected declined by 5.5 percent to M25.9 billion, primarily due to weaker tax performance. Value-added tax (VAT) on goods and services fell slightly by 3.0 percent, while revenue from international trade and transactions dropped by 12.2 percent from M8.3 billion, largely reflecting reduced demand for machinery as LHWP-II reached

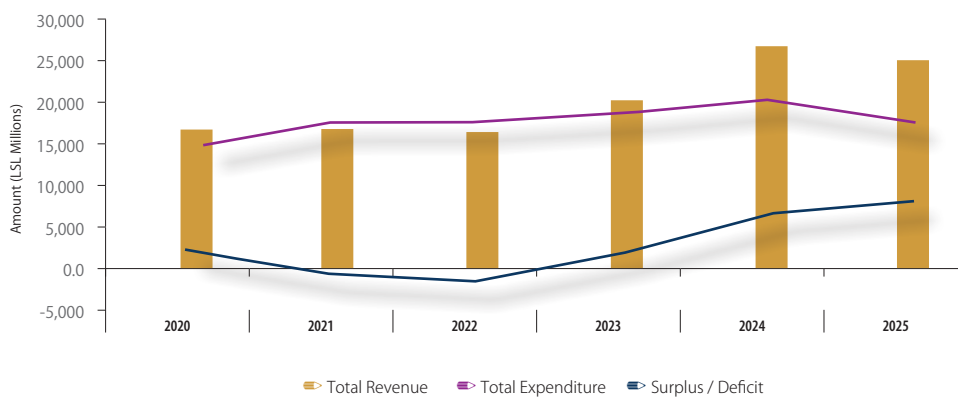
its plateau. Additionally, SACU receipts fell by 12.7 percent to M9.8 billion, further weighing on total revenue.

Conversely, government expenditure increased by 3.6 percent compared to the previous fiscal year. The wage bill continued to dominate the spending structure, accounting for approximately 41.9 percent of total expenditure. Investment in fixed assets, particularly machinery and equipment, rose by 114.6 percent to M307.4 million, while spending on buildings and structures declined by 14.2 percent from M1.7 billion, reflecting adjustments in capital project implementation.

Fiscal developments revealed emerging vulnerabilities that heightened the risk of spillovers from sovereign pressures into the wider financial sector. Declining revenues, especially from SACU and trade taxes, combined with rising expenditures reduce fiscal space and increase the likelihood of higher government borrowing, which could strengthen the sovereign-bank nexus and expose banks to greater sovereign-risk pressures. The sharp contraction in capital spending, driven by the suspension of major external projects weakened medium-term growth prospects, indirectly affect household and corporate repayment capacity and raised non-performing loans. At the same time, a rigid expenditure structure dominated by the wage bill limits the government's ability to respond to shocks, increasing vulnerability to further revenue shortfalls. Together, these dynamics raise fiscal pressures and could spill over into the financial sector through weaker economic activity, rising credit risks, and greater exposure to sovereign stress, underscoring the need for careful monitoring and sustained fiscal reforms.

# TWO RESILIENCE OF THE NON – FINANCIAL SECTOR

**Figure 13** Government Budget (millions of maloti)

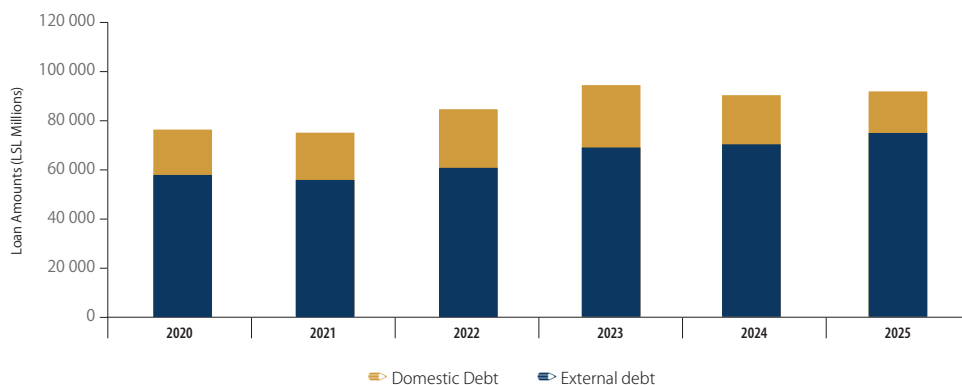


Source: Central Bank of Lesotho

Despite a debt structure dominated by external obligations, Lesotho experienced a marginal easing in public debt pressures during FY2025/26. Lesotho’s public debt stood at M22.4 billion, reflecting a marginal decline of 3.2 percent over the period. The debt structure remained heavily dominated by external obligations, primarily bilateral and multilateral loans, which accounted for about 79.5 percent of total debt in

FY2025/26. The remaining share consisted of domestic Treasury bills and bonds. Despite the elevated debt levels, the country’s risk of external and overall debt distress remained moderate, supported by a 5.8 percent year-on-year reduction in both bilateral and multilateral loans. This improvement contributed to a more favourable debt profile, signalling strengthened sustainability and reduced near-term vulnerability..

**Figure 14** Total Debt (millions of maloti)



Source: Central Bank of Lesotho

# THREE RESILIENCE OF THE FINANCIAL SECTOR



## 3 RESILIENCE OF THE FINANCIAL SECTOR

Lesotho’s financial system has weathered significant shocks over recent years and maintained a sound and resilient position, with core sectors exhibiting strong buffers and capacity to absorb potential shocks. However, geopolitical tensions, including possible disruptions to the global trading system, are casting a shadow over the domestic economic outlook.

The banking sector continues to demonstrate resilience, supported by strong capital buffers, high liquidity levels, and solid profitability. Furthermore, the stress-testing results reaffirm that the sector is well positioned to withstand severe macroeconomic shocks, with industry-wide capital remaining comfortably above regulatory thresholds. The microfinance sector also retains a stable risk profile while expanding financial access for underserved households and small enterprises, supporting financial inclusion. Similarly, the insurance industry continues to exhibit robust solvency margins alongside steady premium growth, enhancing its capacity to meet policyholder obligations. In addition, national payment and settlement systems maintain uninterrupted operations and strong cyber-resilience, ensuring secure, efficient, and reliable financial transactions across the economy.

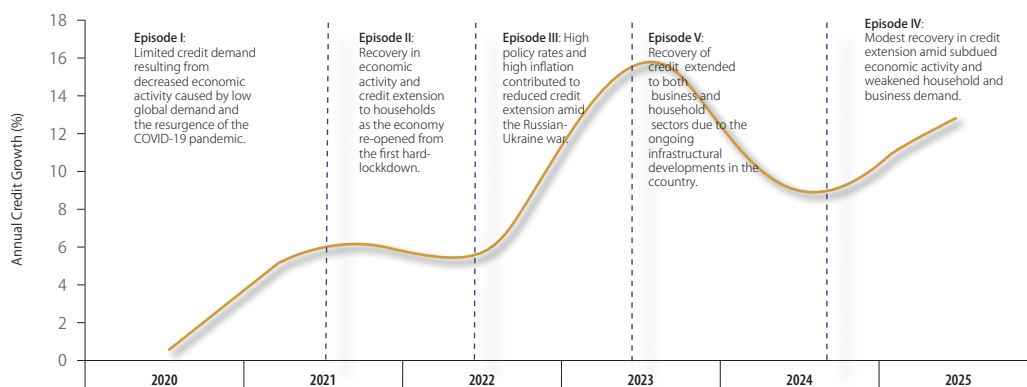
The banking sector continues to demonstrate resilience, supported by strong capital buffers, high liquidity levels, and solid profitability.

### 3.1. BANKING

The banking sector remained sound and well-positioned to withstand shocks.

Credit growth continued to improve, primarily supported by ongoing infrastructure development, particularly the (LHWP II), moderating inflation and easing financial conditions as well as increased household consumption. Between 2019 and 2025, credit extension followed a trajectory shaped by global shocks and domestic monetary conditions. Weakness during the pandemic was followed by a short-lived recovery, but high inflation and policy rate hikes amid the Russia–Ukraine war constrained lending. Infrastructure projects later supported renewed growth, though persistently high interest rates continued to weigh on demand. By 2025, credit showed a modest recovery, leaving demand subdued despite the positive credit-to-GDP gap. This divergence between rising credit and sluggish economic activity highlights potential systemic vulnerabilities, as increasing leverage without robust growth could undermine financial stability.

Figure 15 Annual Credit Growth (%)



Source: Central Bank of Lesotho

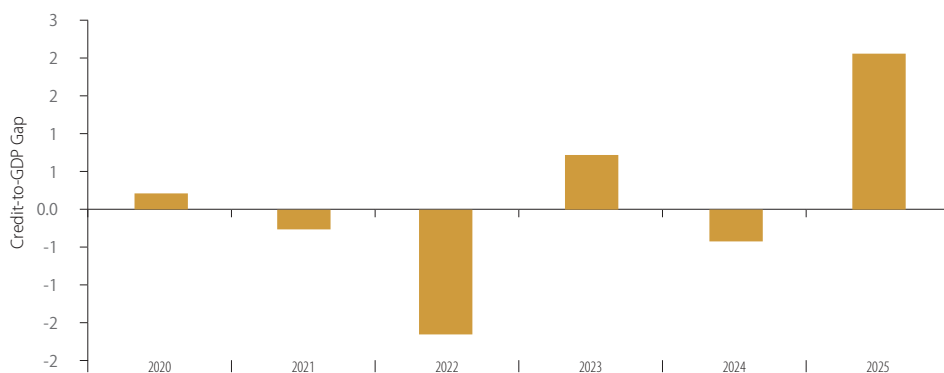
# THREE RESILIENCE OF THE FINANCIAL SECTOR

The evolution of the credit-to-GDP gap points to a **deterioration in credit extension sustainability**. The annual credit-to-GDP gap (Figure 16), shows a clear shift from mild credit expansion before 2021 to a sharp downturn in 2022, followed by a strong rebound that accelerates through 2023 to 2025. While the credit-to-GDP ratio and its long-run trend rose steadily, the credit-to-GDP gap swings from slightly positive levels in 2019–2021 to a negative trough in 2022, indicating a brief period of deleveraging before turning strongly positive again. The increasingly large positive gaps in 2023–2025 signal that credit is growing faster than GDP, suggesting build-up of cyclical financial stability risks. Overall, the pattern indicates that vulnerabilities are rising, pointing to the need for closer monitoring.

**Signs of weakening asset quality became more pronounced in 2025, driven by persistent credit-risk vulnerabilities.** The banking sector’s asset quality weakened, as the non-performing loan (NPL) ratio exceeded the industry benchmark

of 4 percent and remained higher than in 2024, reflecting ongoing credit risk pressures. The deterioration was primarily driven by both household NPLs, particularly personal loans and mortgage-related NPLs and business enterprises NPLs. Household NPLS grew by 2.5 percent while businesses’ NPLs grew by 24.0 percent as compared to 2024. Weak domestic economic conditions, including subdued economic activity, job losses in the textile and mining sectors, and the suspension of certain USAID programs, strained household incomes and firms’ cash flows, thereby limiting repayment capacity. Loan concentration also remained elevated, with lending to construction, wholesale & retail trade, restaurants & hotels, and real estate & business services accounting for about 68.6 percent of business loans, which heightened exposure to sector-specific shocks and potential financial stability risks. While provisioning against losses (Figure 17) remained adequate, persistent NPLs could threaten banks’ loan books if economic conditions and external pressures persist.

Figure 16 Annual Credit-to-GDP Gap (%)

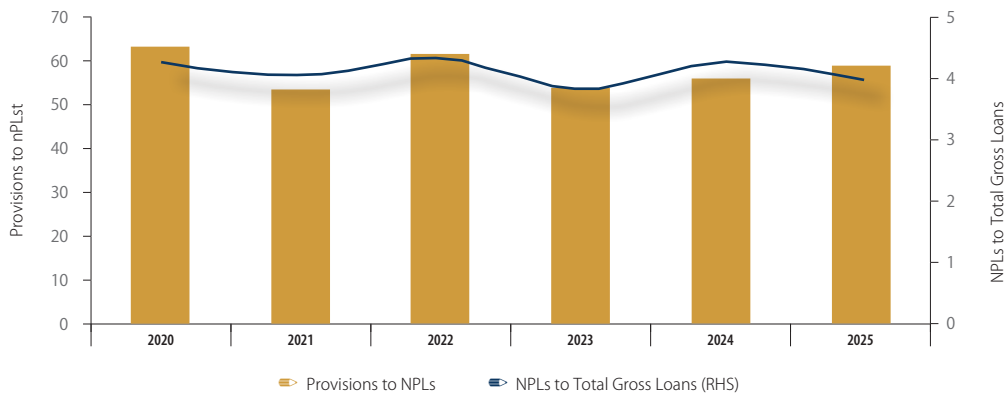


Source: Central Bank of Lesotho

# THREE RESILIENCE OF THE FINANCIAL SECTOR



**Figure 17 Non-Performing Loans and Provisions to Total Loans (%)**



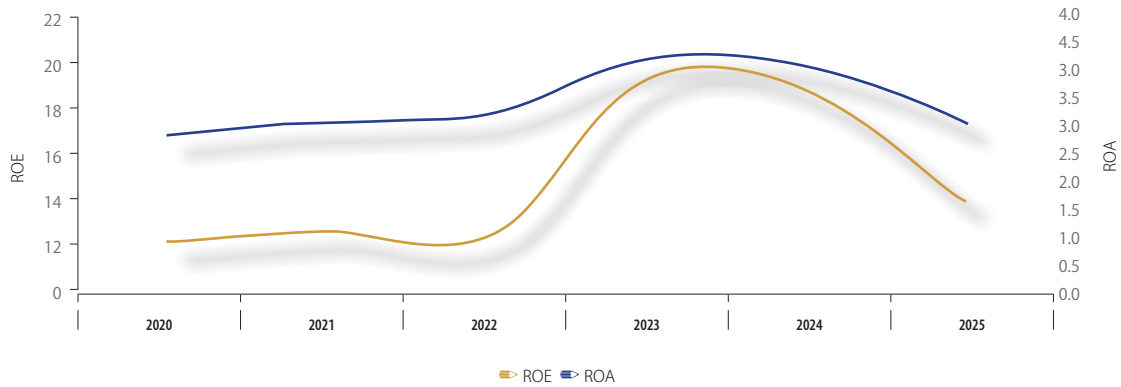
Source: Central Bank of Lesotho

The banking sector earnings and profitability moderated, even though overall performance remained positive. In comparison to 2024, the return on assets (ROA) fell from 3.2 percent to 2.3 percent, reflecting lower net income relative to total assets, and return on equity (ROE) declined from 19.3 percent to 12.8 percent, signaling reduced returns on shareholders’ capital. Although interest income from loans and securities continued to grow, overall earnings were constrained by lower income from placements and narrowing interest margins. This was reflected in the decline of the interest margin-to-gross income ratio, which fell from 56.6 percent in 2024 to 52.3 percent in 2025, reducing the share of income generated from traditional intermediation activities.

Despite the moderation in earnings, the banking sector continues to generate a stable income base. Interest income remains the dominant source of revenue, accounting for more than half of total income, while moderate growth in gross income has been supported by fee-based activities that helped stabilise overall earnings. Collectively, these developments point to a moderation in profitability but also highlight the sector’s resilience and its continued ability to generate sufficient income to support capital adequacy and sustain operations amid heightened economic pressures.

# THREE RESILIENCE OF THE FINANCIAL SECTOR

**Figure 18 Profitability Ratios (%)**

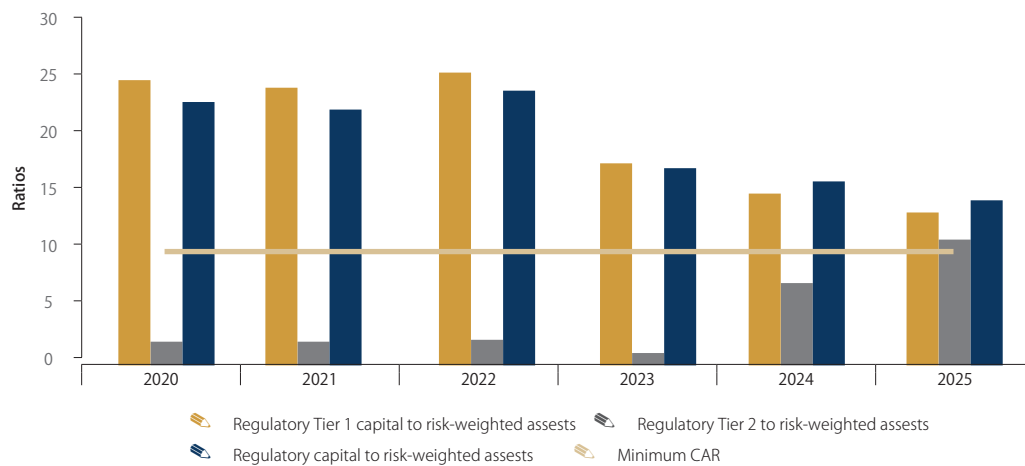


Source: Central Bank of Lesotho, ROE (rhs)

The banking sector’s capital position remained strong in 2025, with adequacy ratios comfortably above regulatory requirements despite a modest decline from the previous year. The total regulatory capital to risk-weighted assets averaged 15.1 percent, reflecting a moderate decline from 15.7 percent in 2024. Similarly, the Tier 1 capital ratio eased to 13.9 percent from 14.6 percent in the previous year. Despite these

marginal reductions, capital buffers remained comfortably above regulatory thresholds, underscoring the sector’s strong capacity to absorb potential shocks and safeguard financial stability. Figure 19 illustrates these developments, while Figure 20 provides a detailed composition of total regulatory capital, highlighting the continued robustness of the banking system’s capital position.

**Figure 19 Capital Adequacy Ratio (%)**



Source: Central Bank of Lesotho

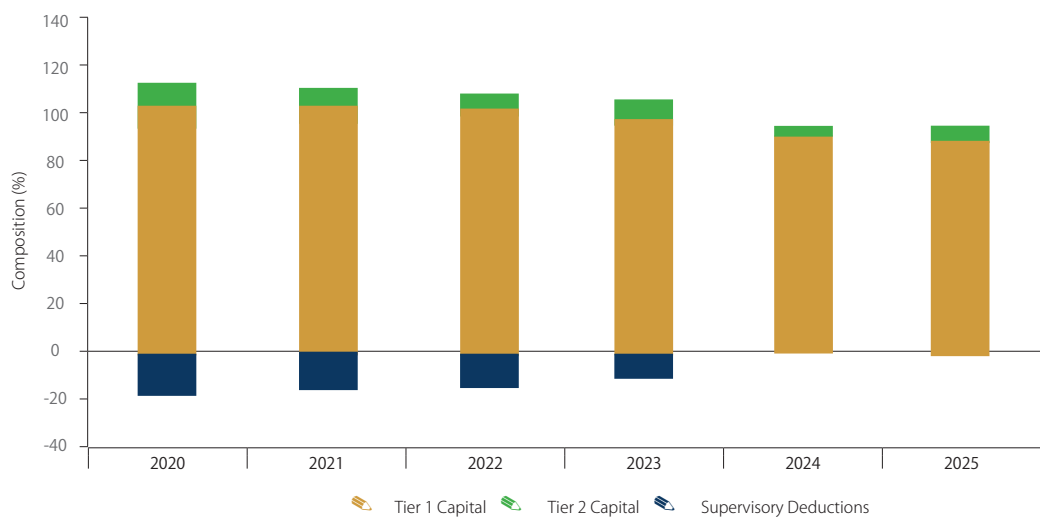
# THREE RESILIENCE OF THE FINANCIAL SECTOR



The evolution of regulatory capital between 2019 and 2025 indicates that while the banking sector remained well-capitalised, emerging signs of weakening have begun to surface. Tier 1 capital, which constitutes the core of regulatory capital, consistently remained the largest component of banks' capital buffers over the period, although it trended downward, reflecting slower capital accumulation amid rising credit-risk pressures and moderating profitability. The decline in Tier 1 capital was further driven by dividend payouts, which reduced retained earnings and, consequently, the banking sector's

capital base. In contrast, Tier 2 capital remained relatively small and stable, indicating limited reliance on supplementary capital instruments. Overall, while capital ratios remain above the prudential requirements, the downward drift in Tier 1 capital highlights emerging pressure on the sector's loss-absorbing capacity, particularly in an environment of rising non-performing loans and weaker earnings. These developments underscore the need for continued monitoring to safeguard financial stability.

Figure 20 Composition of Total Regulatory Capital<sup>1</sup>



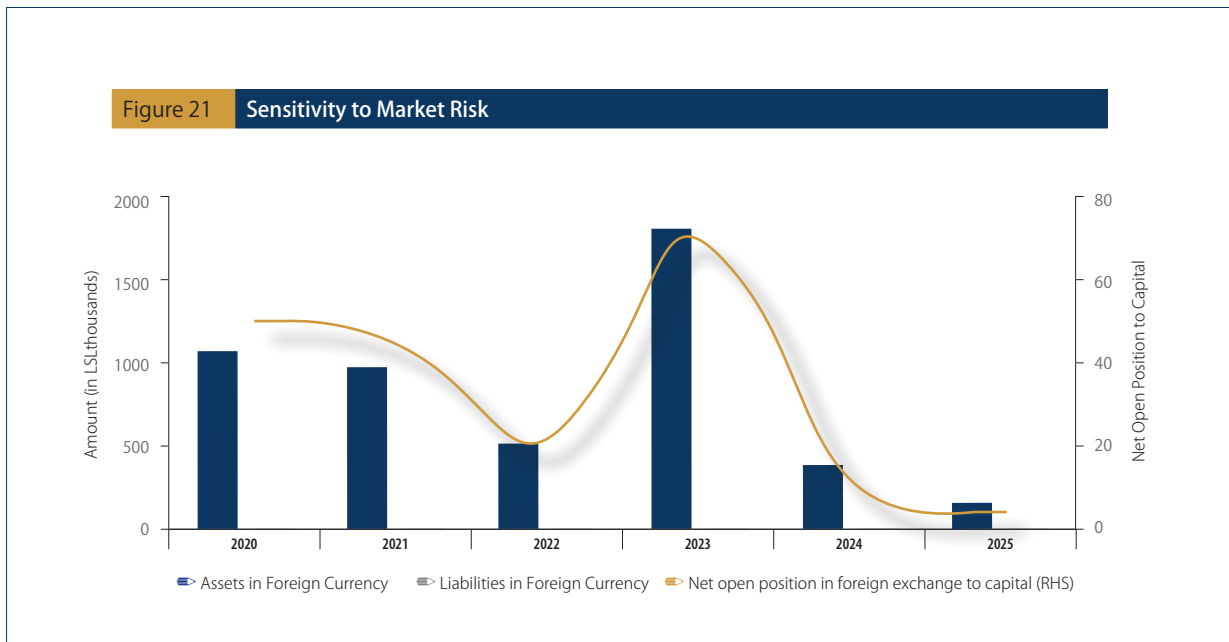
Source: Central Bank of Lesotho

<sup>1</sup> Migration to Basel II.5 ensured that banks report capital on net basis, thereby eliminating the capital deductions in the reporting templates.

# THREE RESILIENCE OF THE FINANCIAL SECTOR

The evolution of the banking sector’s foreign-currency assets and liabilities reveals a marked decline in overall foreign-exchange exposure. The banking sector’s net open position in foreign exchange to capital fell sharply to 4.03 percent, following a 7.9 percentage-point (pps) decline, reflecting a substantial reduction in foreign-currency exposure. This adjustment was driven by a steep contraction in foreign-currency-denominated assets, stemming from lower valuations of foreign equity investments, higher expected

credit losses, and reduced holdings with non-resident counterparties, while foreign-currency liabilities remained small and stable. After peaking in 2023, foreign-currency assets declined markedly in 2024 and 2025, causing the net open position to drop rapidly to near-zero levels. Although this development has reduced vulnerability to exchange-rate risk, the change was primarily valuation-driven rather than the result of active risk-mitigation measures..



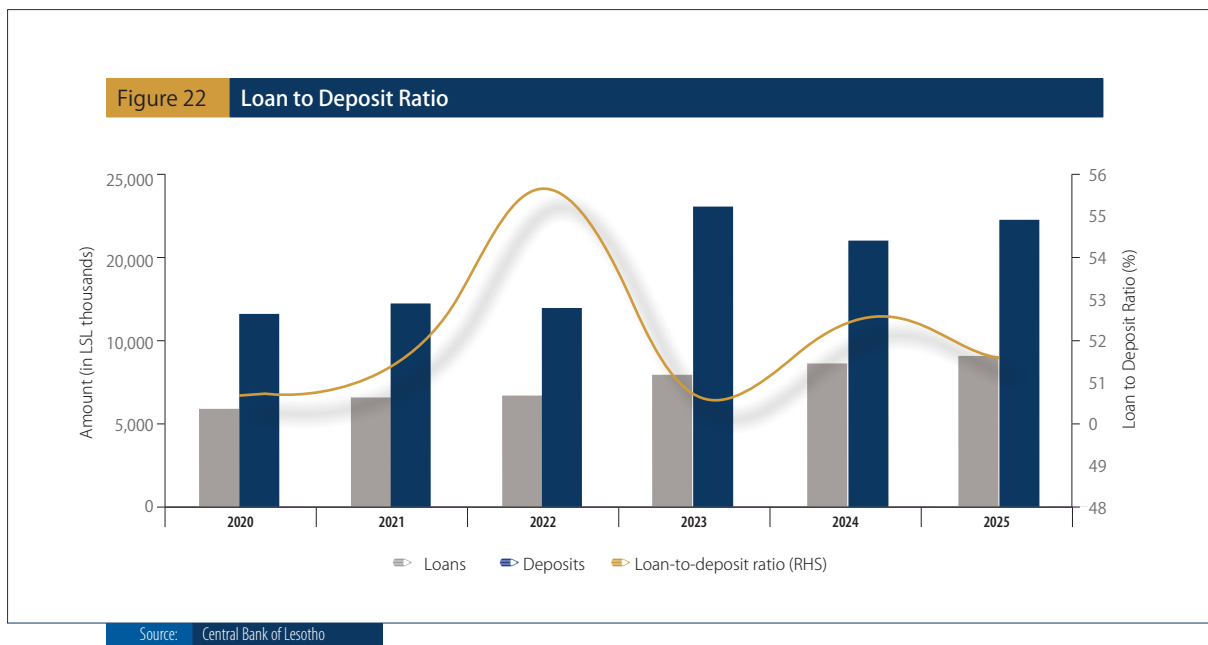
Source: Central Bank of Lesotho

# THREE RESILIENCE OF THE FINANCIAL SECTOR

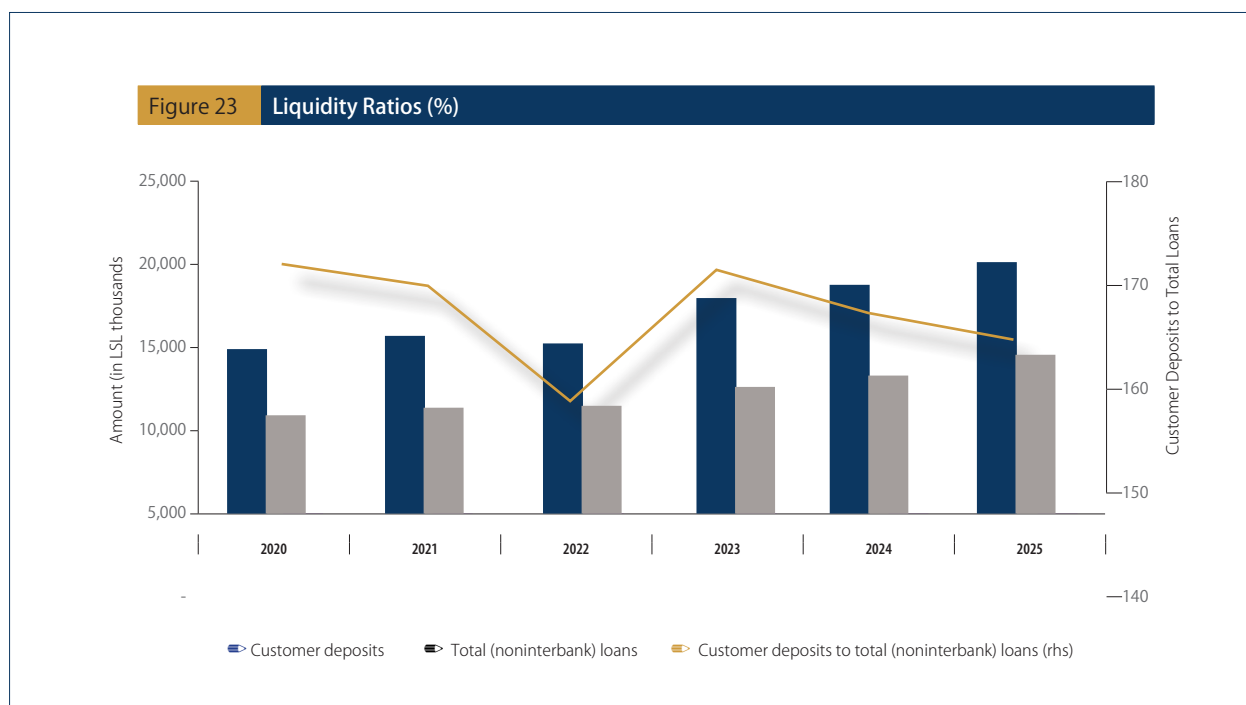


The evolution of liquidity and funding highlights both stable intermediation and emerging liquidity pressures. The loans-to-deposits ratio remained moderate and stable over the period, reflecting a consistently liquid banking sector in which deposit growth outpaced lending. Deposits increased steadily, especially after 2022, while loan growth remained gradual, resulting in a loan-to-deposit ratio that declined in 2020, rose temporarily in 2021–2022, and then stabilised around 51–52 percent by 2025. This trend indicates conservative lending behaviour and strong reliance on stable customer deposits, which supports liquidity resilience and limits funding risk. However, the persistently low ratio also points to subdued credit intermediation, suggesting weak loan demand or cautious lending amid rising credit risk. The liquidity ratios (Figure 23) indicate that while the banking sector remained well funded over the period, liquidity buffers gradually

weakened toward 2025. The customer-deposits-to-total-loans ratio stayed consistently high, peaking around 2020 – 2021 and remaining elevated through 2025, showing that banks continued to rely largely on stable customer deposits to finance lending. However, both the liquid-assets-to-total-assets ratio and the liquid-assets-to-short-term-liabilities ratio declined noticeably after 2023, reaching their lowest levels in 2025. This downward trend suggests a reduction in readily available liquidity buffers, reflecting increased asset reallocation and lower holding of liquid instruments. While overall liquidity remains adequate, the erosion of these buffers signals rising sensitivity to short-term liquidity shocks and underscores the importance of continued monitoring to ensure that banks can withstand funding stress in a more challenging economic and financial environment.



# THREE RESILIENCE OF THE FINANCIAL SECTOR



Overall, stress test results indicate that the sector maintains adequate capital buffers and, in most cases, sufficient liquidity to withstand severe adverse conditions, reflecting prudent risk management and effective regulatory oversight, despite elevated concentration risk and isolated liquidity pressures. Credit risk tests incorporated increases in NPLs, defaults of top borrowers, sector-specific shocks for concentration risk, and reverse stress testing. Results indicate that all banks would have been sufficiently capitalised to absorb losses from increased NPLs; thus, general credit risk remains moderate. However, credit concentration risk stays high due to increased exposure to the business sector, especially the construction industry. Asset quality has slightly improved since the June 2025 reverse stress test results. Liquidity risk shows moderate vulnerability. Under a five-day bank-run scenario (Scenario II), one bank faces liquidity shortfalls, indicating a decline in liquid

assets compared to the previous stress test. Conversely, large depositor withdrawals would minimally impact liquidity and capital positions.

Interest rate risk stays low, with simulated yield curve movements causing minimal changes to net interest income, asset valuations, and capital adequacy ratios, showing banks' balance sheets are highly inelastic to interest rate fluctuations. Foreign exchange risk is assessed as moderate. While institutions with foreign exchange exposures could face notable losses under currency shocks, the sector's robust solvency ensures that post-shock capital levels and regulatory ratios remain largely unaffected. Lastly, under a combined multi-factor scenario, with simultaneous credit, interest rate, and foreign exchange shocks, the banking sector remains broadly resilient.

# THREE RESILIENCE OF THE FINANCIAL SECTOR



## 3.2. INSURANCE

The insurance sector recorded stronger profitability and improved operational efficiency, supported by enhanced underwriting performance and positive investment income.

Underwriting performance and profitability strengthened across the insurance sector, although persistent cost pressures and structural vulnerabilities continued to limit overall resilience. The long-term insurance sector recorded stronger financial performance in 2025, with gross written premiums rising to M1.7 billion and profitability rebounding sharply due to improved claims experience and solid investment income. Claims incurred declined to 53.1 percent of gross written premiums (GWP), returning to within prudential tolerance, while underwriting results shifted from a loss in 2024 to a profit of M266.0 million in 2025. However, the market remains highly concentrated, with the top three insurers writing 87.1 percent of premiums, and the life insurance category continues to underperform with a sizeable technical loss.

Elevated operating costs, high market concentration, and imbalances in reinsurance reliance continue to present key vulnerabilities, underscoring the need for strengthened risk-management practices to sustain stability. Operating expenses remain elevated, with a total expense ratio of 43.3 percent, exceeding supervisory benchmarks, and reinsurance utilization remains low at 8.2 percent of GWP, leaving insurers exposed to volatility in high-risk product lines. The sector's

stability is also dependent on investment earnings, which delivered a 3.5 percent yield and significantly supported overall profitability, lifting profit after tax to M1.23 billion. To strengthen resilience, insurers will need to address high costs, improve life insurance category performance.

The short-term insurance industry posted a modest increase in gross written premiums, rising by 3.3 percent to M189.9 million in 2025. Reinsurance usage remained structurally high, with over half of premiums ceded, around 56 percent, limiting domestic risk retention and keeping net written premiums at M84.0 million. Profitability strengthened, with the underwriting performance reaching M9.8 million, supported by higher underwriting revenue and reduced gross claims. Investment and other income contributed a further M6.8 million, enabling the industry to reverse the prior year's loss and post a profit after tax of M1.3 million at the end of the year.

Despite this recovery, the sector remains exposed to significant systemic risks. Heavy reinsurance dependence increases vulnerability to counterparty shocks, pricing shifts, or capacity withdrawals, with high market concentration, where few insurers write more than 95 percent of premiums. Cost pressures also persist where net claims incurred rose to M38.8 million, and underwriting expenses climbed to M66.9 million, constraining technical margins. Overall, while profitability has improved, the industry's low retention, concentrated structure, and rising cost base continue to pose financial stability concerns.

# THREE RESILIENCE OF THE FINANCIAL SECTOR

| Table 2                                     | Insurance Industry Selected Ratios |        |       |       |       |           |
|---|------------------------------------|--------|-------|-------|-------|-----------|
|   | 2021                               | 2022   | 2023  | 2024  | 2025  | %y/y(pps) |
| <b>Short-term insurance</b>                 |                                    |        |       |       |       |           |
| Claims                                      | 77.9                               | 39.8   | 41.7  | 52.7  | 44.7  | (8.1)     |
| Expense                                     | 77.8                               | 76.5   | 65.1  | 72.0  | 69.5  | (2.5)     |
| Combined                                    | 155.7                              | 116.3  | 106.8 | 124.7 | 49.4  | (75.3)    |
| Investment Returns                          | 3.1                                | 2.2    | 2.7   | 6.3   | 9.7   | 3.5       |
| Net Investment Income                       | 18.6                               | 14.6   | 16.1  | 8.7   | 5.6   | 5.6       |
| Underwriting Expense                        | 96.5                               | 62.6   | 48.9  | 69.1  | 111.7 | 42.6      |
| Shareholder equity to total invested assets | 37.6                               | 32.7   | 38.9  | 33.9  | 40.9  | 7.0       |
| Return on Equity                            | 10.1                               | (10.3) | 0.3   | 10.9  | 131.6 | 120.7     |
| <b>Long-term insurance</b>                  |                                    |        |       |       |       |           |
| Claims                                      | 71.5                               | 60.1   | 0.3   | 82.3  | 59.3  | (23.0)    |
| Expense                                     | 60.1                               | 34.4   | 46.2  | 43.4  | 43.   | (0.1)     |
| Investment Returns                          | 61.8                               | 2.0    | 2.9   | 3.2   | 4.1   | 0.9       |
| Net Investment Income                       | 82.3                               | 33.1   | 31.2  | 17.9  | 24.2  | 6.3       |
| Underwriting Expense                        | 59.3                               | 72.7   | 64.7  | 92.9  | 68.5  | (24.4)    |
| Shareholder equity to total invested assets | (23.0)                             | 13.8   | 13.6  | 13.4  | 23.5  | 10.1      |
| Return on assets                            | 5.3                                | 4.7    | 1.6   | 4.1   | 11.0  | 6.9       |
| Return on equity                            | 35.3                               | 32.9   | 11.0  | 28.6  | 56.2  | 27.6      |

Source: Central Bank of Lesotho

The long-term insurance sector exhibits a concentrated and risk-sensitive asset structure that heightens its exposure to financial-market and macroeconomic shocks. The long-term insurance sector's asset base remains highly concentrated in investment instruments, particularly government securities, investment funds, listed equities, and sizeable deposits with domestic banks, which together account for the majority of total assets. While these support income generation, they heighten exposure to market, interest-rate, and liquidity risks. Additional vulnerabilities arise from significant related-party lending, elevated premium receivables, and growing offshore exposures, all of which reinforce credit, governance, and exchange-rate risks. This concentration, combined with close interconnectedness with the domestic banking system, leaves long-term insurers sensitive to broader financial-sector and macroeconomic shocks.

The short-term insurance sector's asset profile reveals significant structural weaknesses that heighten its vulnerability to liquidity and counterparty risks. The short-term insurance

sector, though smaller, exhibits pronounced vulnerabilities stemming from a narrow and undiversified asset structure. Reinsurance recoverables represent an unusually large share of total assets, creating considerable counterparty and settlement-timing risks, especially during high-claim periods. Liquidity buffers are minimal, with cash holdings near zero, leaving insurers dependent on the timely liquidation of investment-fund holdings, primarily money-market instruments, to meet claims. Limited asset diversification further amplifies sensitivity to financial-market fluctuations. As a result, both sectors require ongoing supervisory attention, particularly around liquidity risk, concentration exposures, and the quality of reinsurance counterparties.

The higher 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, non-governmental securities and investment funds, as illustrated in Figures 24 and 25. These investments generated positive net investment income

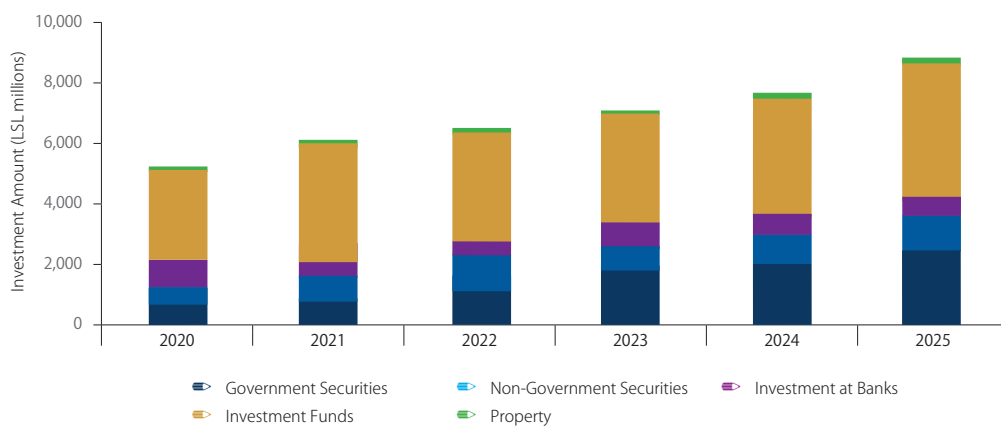
# THREE RESILIENCE OF THE FINANCIAL SECTOR



for both sectors in 2025. An increase in investment income enhances insurers' overall financial resilience by strengthening profitability and supporting the accumulation of capital.

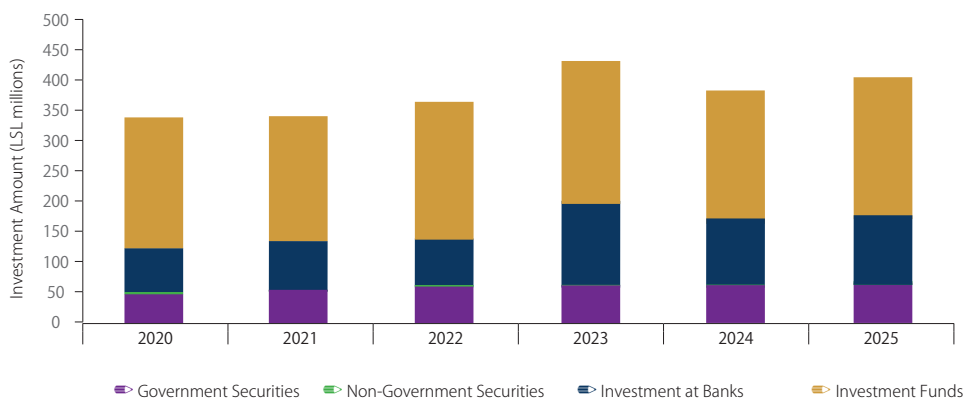
The broad diversification of their investment portfolios also reduced risks, contributing to the sector's overall soundness and financial stability.

**Figure 24** Investments by LT Insurance (million maloti)



Source: Central Bank of Lesotho

**Figure 25** Investments by ST Insurance (million maloti)



Source: Central Bank of Lesotho

# THREE

## RESILIENCE OF THE FINANCIAL SECTOR

### 3.3. MICROFINANCE INSTITUTIONS

The microfinance sector expanded rapidly but remains vulnerable due to its loan-concentrated asset base, reliance on borrowed funding, and limited liquidity buffers.

The microfinance sector registered growth in 2025, but its rapid expansion, combined with a highly concentrated loan portfolio and reliance on borrowed funding, continues to elevate key credit and liquidity risks. The sector continued to expand at a strong pace, with the asset base of MFIs growing by 21.4 percent to reach M2.2 billion. The structure of assets remained broadly unchanged, dominated by loans, which comprised 89.1 percent of total assets. Cash and deposits with financial institutions accounted for 6.7 percent, other financial assets for 5.3 percent, and non-financial assets for 0.4 percent. This composition reflects the sector's strong orientation toward credit intermediation and highlights the limited diversification of its asset base.

Although the sector's size and limited interconnectedness constrain its systemic footprint, several vulnerabilities within the balance sheet structure warrant close attention. The high concentration of loans exposes MFIs to elevated credit-risk sensitivities, particularly if repayment capacity among households or micro-enterprises were to weaken. The rapid expansion of assets may also outpace enhancements in risk-management practices, increasing the potential for deteriorating credit underwriting standards. In addition, reliance on borrowed funding heightens susceptibility to liquidity pressures should counterparties reduce or withdraw funding under stressed conditions.

While these vulnerabilities do not currently pose a material threat to financial stability, they underscore the need for continued supervisory vigilance and the strengthening of prudent risk-management practices to support the sector's resilience.

### 3.4. FINANCIAL MARKETS INFRASTRUCTURE

Lesotho's payment systems remained largely stable and continue to support financial stability and inclusion mandates, but ongoing operational and cybersecurity risks require continued regulatory vigilance to safeguard financial system resilience.

Systemically important payment systems (SIPS) remained stable, reliable, and with sufficient capacity to handle the increasing volumes of transactions that were cleared through them during the review period. The SIPS<sup>2</sup> are critical for maintaining financial stability, supporting effective monetary policy implementation, and promoting financial inclusion. These systems underpin the smooth functioning of financial markets by facilitating the safe and efficient settlement of payments while reducing settlement risks. However, risks in large-value payment systems, such as the Lesotho Wire (LSW) may arise from (i) system unavailability or downtime, (ii) the degree of system utilisation, and (iii) the inability of participants to settle their obligations on time. Disruptions to critical financial infrastructure can delay payments and settlements, potentially creating a chain of payment delays that may lead to liquidity pressures or defaults if not promptly addressed. Consequently, close monitoring of these key risk indicators remains essential to safeguard the resilience of LSW.

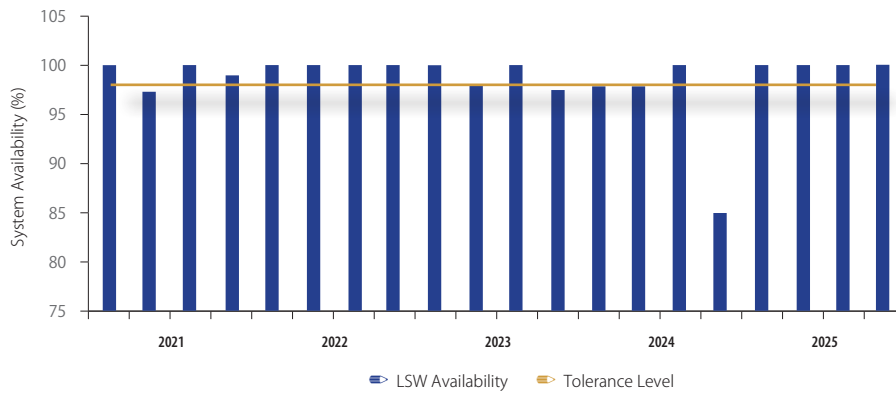
The Lesotho Wire (LSW) is a core component of the national financial infrastructure, enabling real-time gross settlement (RTGS) of large-value transactions. As a SIPS, its reliable operation is essential for maintaining confidence in the payment system. During the review period, system availability remained strong at 99.9 percent, meeting the revised tolerance threshold of 99.9 percent.

<sup>2</sup> Lesotho Wire (LSW), the Centralised Securities Depository (CSD), and the Lesotho Automated Clearing House (LACH), all operated by the Central Bank of Lesotho (CBL).

# THREE RESILIENCE OF THE FINANCIAL SECTOR



**Figure 26 LSW System Uptime (%)**

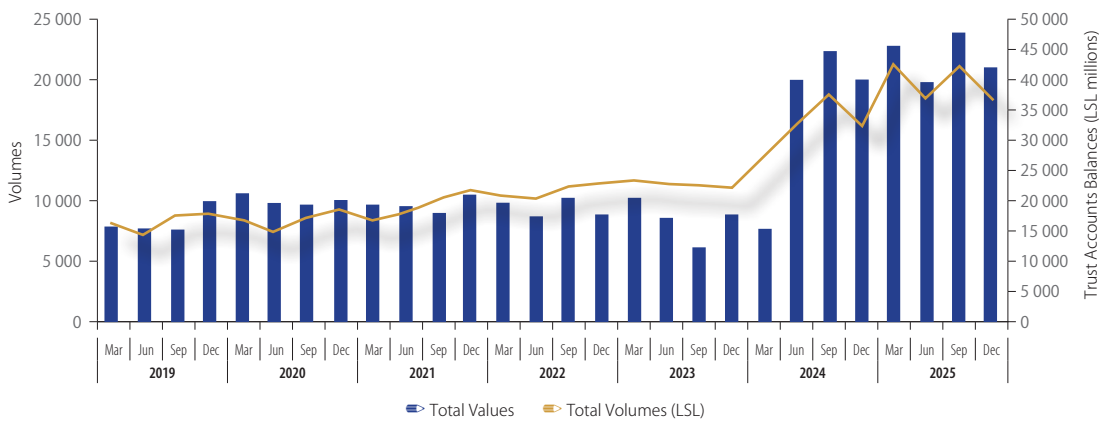


Source: Central Bank of Lesotho

Mobile-money usage continued to expand rapidly, driven by a growing agent network and rising transaction volumes, thereby advancing financial inclusion. Mobile money in circulation, as reflected by the trust account balance<sup>3</sup>, rose by 26.4 percent year-on-year to M1.16 billion in December 2025. The increase reflects the continued expansion in the utilisation of mobile money services across the country. In addition,

the mobile money agent network expanded significantly nationwide, with the total number of agents increasing from 31,776 in March 2024 to 48,493 in December 2025. The expansion of the agent network has improved accessibility to mobile money services and supported the broader adoption of digital financial services across the country.

**Figure 27 Trust Account Balance (millions maloti)**

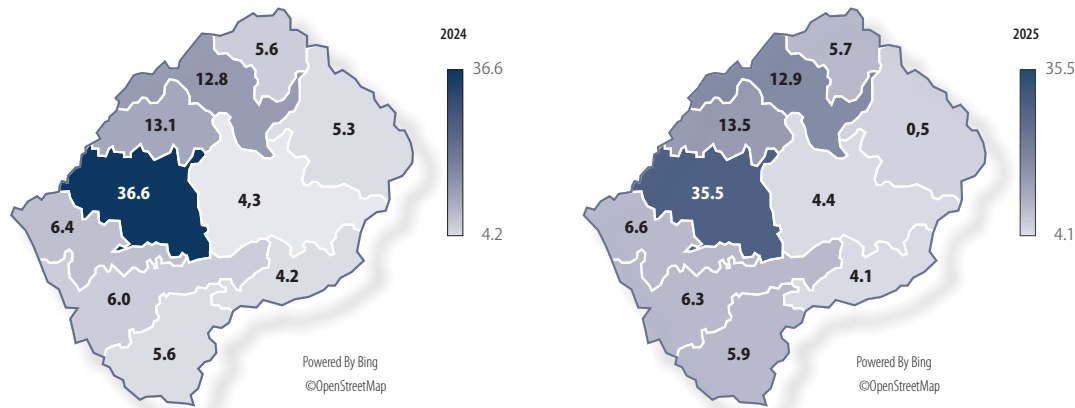


Source: Central Bank of Lesotho

<sup>3</sup> The total funds held by the mobile money providers, which is equivalent to the funds held per unit of mobile money in circulation.

# THREE RESILIENCE OF THE FINANCIAL SECTOR

Figure 28 Mobile Money Agents Distribution (% per district)



Source: Central Bank of Lesotho

Despite the positive developments and benefits realised, full adoption of mobile money is hindered by structural and operational constraints that limit its effectiveness. Key constraints include frequent liquidity shortages at agent outlets (especially in rural areas), high transaction and cash-out fees, weak network infrastructure in mountainous regions, and low levels of digital literacy that result in user errors and

mistrust. These issues are compounded by inconsistent agent conduct, difficulties meeting KYC requirements in the informal economy, and an ecosystem that still relies heavily on cash-in/cash-out rather than widespread digital payments, preventing mobile money from reaching its full potential as a catalyst for financial inclusion and a cash-light economy.

# FOUR

## FINANCIAL SECTOR STRUCTURE AND INTERCONNECTEDNESS



### 4 FINANCIAL SECTOR STRUCTURE & INTERCONNECTEDNESS

The financial sector structure remained relatively unchanged but highly concentrated and bank-centric with emerging growth in non-bank financial institutions and persistent structural constraints within the country's financial markets.

The banking industry comprised of three subsidiaries of South African banks and one locally owned bank, predominantly leads the sector and continues to serve as the principal provider of financial products and services in the country. The three foreign-owned banks collectively account for approximately 90 percent of total banking assets, revenues, and customer deposits, underscoring their significant influence on the structure and performance of the domestic banking landscape. Following the banks, the pensions industry represents the second-largest segment of the financial system in terms of asset holdings, reflecting its growing role in long-term savings and investment. The insurance sector ranks third, supported by a diversified portfolio of life and non-life offerings, while the microfinance sector, though much smaller in scale, occupies the fourth position and contributes to financial inclusion efforts.

The four commercial banks collectively operated 56 branches nationwide by end of 2025. The banking sector remains highly concentrated, exhibiting limited competitiveness, with a Herfindahl-Hirschman Index<sup>4</sup> (HHI) of 3,643, representing a 2.2 percent decline compared with December 2024. Concentration is also pronounced in the insurance sector, where both the long-term and short-term segments recorded exceptionally high HHI values of 6,194 and 6,192, respectively.

These indicators point to a market structure dominated by a small number of institutions, with potential implications for competition, pricing, and consumer choice.

In 2025, the financial system maintained a substantial presence in the economy, reinforced by the dominant roles of the banking and pensions industries. The total financial sector assets to GDP stood at 80.0 percent in 2025, reflecting the continued significance of financial institutions in supporting economic activity. The banking industry remained the dominant component of the financial system, with its total assets accounting for 46.3 percent of overall financial sector assets and 69.1 percent of GDP at the end of 2025. The pensions industry followed, with assets equivalent to 52.0 percent of GDP, underscoring its growing importance as a source of long-term savings and investment. Meanwhile, other non-bank financial institutions<sup>5</sup> collectively represented 42.7 percent of total financial system assets, as illustrated in Figure 29.

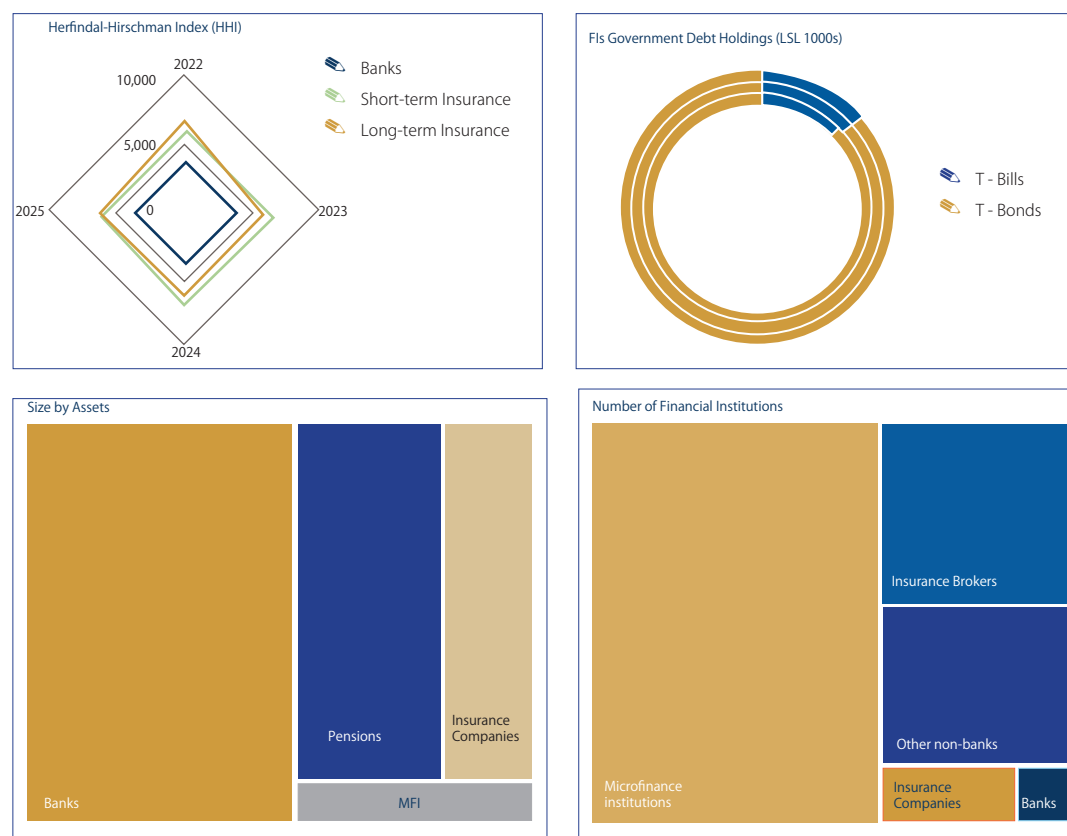
**Financial markets in Lesotho consist primarily of the money market and the securities market, with the latter being the larger of the two.** In both markets, government securities constitute the entire investment portfolio, indicating that the market remains relatively small, shallow, and highly concentrated, with limited diversification opportunities. This highlights the narrow scope of financial market instruments and the need to broaden market participation to enhance financial sector development.

<sup>4</sup>The Herfindahl-Hirschman index (HHI) is a measure of market concentration which, unlike other methods, considers 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.

<sup>5</sup>The Insurance industry commanded 39.3 percent of the total financial system assets and while microfinance was 3.4 percent.

# FOUR FINANCIAL SECTOR STRUCTURE AND INTERCONNECTEDNESS

Figure 29 Financial System Structure



Source: Central Bank of Lesotho

## Cross-Linkages within the Financial Sector

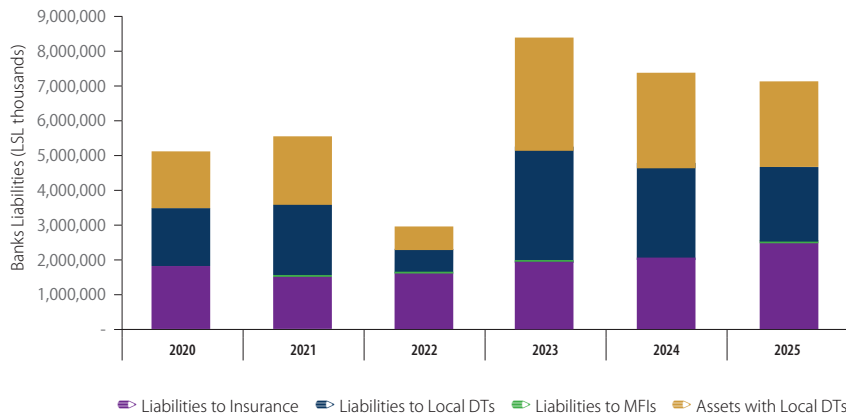
The linkages between domestic banks are predominantly in the form of placements for payments and settlements purposes rather than interbank loans, and investments and placements with parent banks between local banks and foreign banks. Banks and other non-bank financial institutions engage in credit, 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 in the banking sector fell by 24.2 percent. Conversely, the long-term insurance deposits with banks declined by 2.2 percent, while their investments in the banking sector rose by 19.3 percent.

# FOUR FINANCIAL SECTOR STRUCTURE AND INTERCONNECTEDNESS



**Figure 30 Bank's Interconnectedness with OFIs (millions of maloti)**



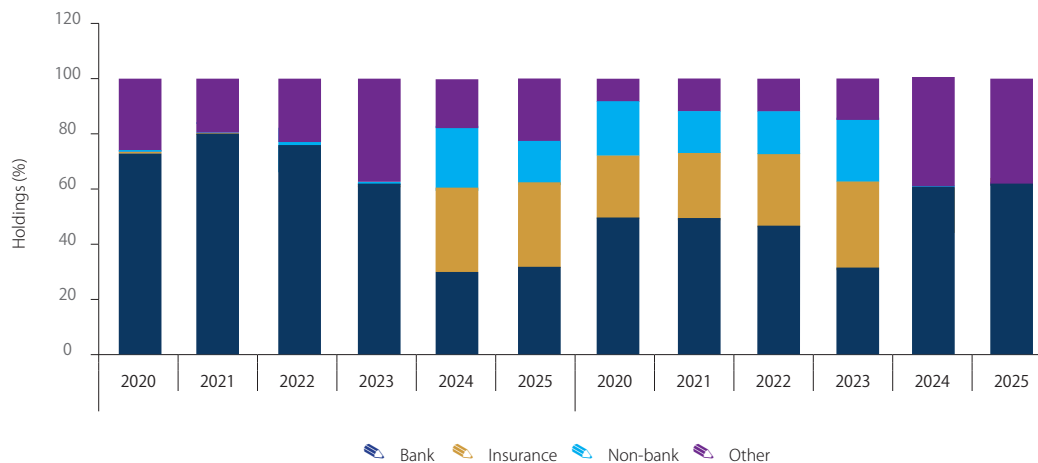
Source: Central Bank of Lesotho

Financial institutions' holdings of the sovereign debt were marked by shifting portfolio positions across banks and non-bank institutions, driven largely by changes in Treasury bill and bond holdings. 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 2025, 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 increased their holdings of T-bonds by 19.0 percent to M 1.3 billion, while non-banks had a decline of 6 percent from M 2.7 billion due to the maturity of the bonds. To strengthen their liquidity reserves, non-banks increased their T-bill holdings by 6.4 percent to M 294.6 million, while the banking industry reduced its holdings by a marginal 1.8 percent to M 462.3 million.

# FOUR FINANCIAL SECTOR STRUCTURE AND INTERCONNECTEDNESS

Figure 31 T-Bills & Bonds Holdings (%)



Source: Central Bank of Lesotho

## FINANCIAL INSTITUTIONS' HOLDINGS OF SOVEREIGN DEBT

AS AT END-2025

TREASURY SECURITIES  
—  
BONDS & BILLS

By the end of 2025, 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.

### T-BONDS HOLDINGS

#### COMMERCIAL BANKS

↑ 19.0%

M 1.1 billion



2024

Change driven by maturity of bonds

#### NON-BANK FINANCIAL INSTITUTIONS

↓ 6.0%

M 2.7 billion



2024

M 2.5 billion



2025

### T-BILL HOLDINGS

#### COMMERCIAL BANKS

↓ 1.8%

M 470.7 million



2024

M 462.3 million



2025

Increase to strengthen liquidity reserves

#### NON-BANK FINANCIAL INSTITUTIONS

↑ 6.4%

M 276.9 million



2024

M 294.6 million



2025



Shifting portfolio positions across institutions, driven by changes in Treasury bill and bond holdings, reflect strategic liquidity management and evolving investment preferences.



## 5 FOCUS TOPICS

### 5.1. Focus Topic: Falling Diamond Prices and Financial Stability Risks in Lesotho

#### 1. Introduction

Post the COVID-19 pandemic, the global diamond market experienced significant slowdowns reflecting a combination of weakening demand and changing industry dynamics. Subsequently, this led to a sustained drop in diamond prices, posing challenges for diamond-producing economies like Lesotho. Diamonds play an important role in Lesotho's economy, contributing significantly to export earnings, fiscal revenues, and employment. The mining sector, dominated by diamond production, is, therefore, one of the key sectors that shape the broader macroeconomic and financial sector developments.

#### 2. Global Diamond Market Development

Global diamond prices significantly declined between 2023 and 2025, reflecting weakening demand and structural changes in the global diamond industry. Demand for diamonds softened across key consumer markets, particularly in the United States, China and India, which together account for a large share of global jewellery consumption. Slower economic growth, persistent inflation, and tighter financial conditions reduced discretionary spending for luxury goods, including diamond jewellery (World Bank, 2025; De Beers, 2024).

Simultaneously, structural shifts within the industry have further amplified the downward pressure on prices. The rapid expansion of laboratory-grown diamonds (LGDs) has intensified competition in the diamond market, as these stones are typically sold at significantly lower prices due to their lower production costs. Their cost which is about 73 percent less than natural diamonds and the increasing acceptance have boosted their popularity and sales, particularly in the bridal

jewellery segment, placing additional pressure on demand for natural diamonds (Bain & Company, 2024). The sale of LGD jewellery increased from 5.2 percent in 2019 to 41.1 percent in 2025 (Lemick, 2026). In addition, excess inventories across the global diamond supply chain also weighed on prices. During the post-pandemic recovery period, producers increased supply in anticipation of stronger demand in the wake of the health crisis. However, the global demand slowed post the crisis, consequently, producers and traders were forced to discount prices in order to clear existing inventories (Rapaport, 2025).

These developments and other factors including concerns about natural diamonds impact on the environmental, social, and governance (ESG) are the main contributors to sustained downward pressure on global diamond prices. This has posed challenges for diamond-producing countries whose export revenues depend significantly on the performance of the global diamond market.

#### 3. Developments in Lesotho's Diamond Sector

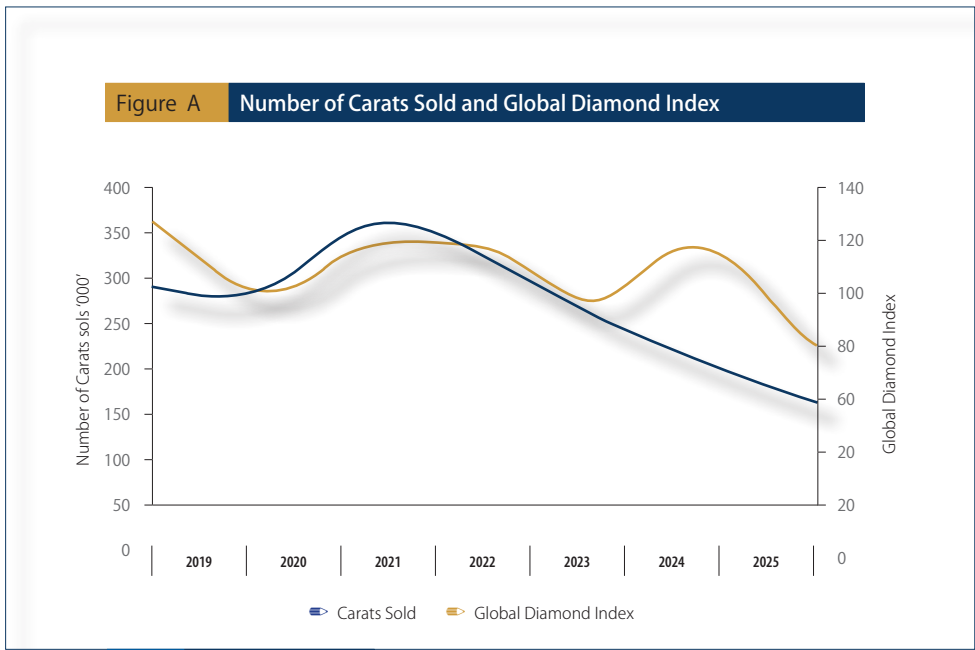
Diamonds account for around 8 percent of the country's GDP. Therefore, deteriorating global prices have significantly weakened the country's fiscal balance. However, mining companies have been the most affected, placing pressure on profitability and operational decisions. Liqhobong and Mothae mines have halted operations and are at risk of permanent closures, while Lets'eng and Kao mines are at risk of scaling back production and revised expenditure plans in response to weaker global market conditions. These pressures have been evidenced in the sharp drop in diamond export revenues that fell by 55.8 percent to 2.3 billion between 2022 and 2025. Secondly, for the financial year 2024/25, the mining sector contracted by 5 percent due to declining global diamond demand.

As shown in Figure A, After peaking around 2021–2022, both the global diamond prices and carats sold began to trend downward, signalling weakening market conditions. From

# FIVE FOCUS TOPICS

2022 onwards, the persistent decline in prices reflects soft global demand and excess supply, which has constrained production and sales. Although there is a brief recovery in carats sold around 2024, this did not translate into improved financial performance, as prices remained relatively low.

As a result, most mining companies experienced a plunge in revenues, highlighting that higher volumes alone were insufficient to offset the impact of depressed prices. By 2025, the continued drop in both prices and volumes underscores the deepening strain on the diamond sector.



Diamonds account for around 8% of the country's GDP. Therefore, deteriorating global prices has significantly weakened the country's fiscal balance.



Letšeng is the world's highest dollar per carat diamond mine (© Gem Diamonds' presentation)



## 4. Transmission Channels to Financial Stability

The sustained decline in diamond prices continues to pose significant risks to Lesotho's financial stability through several transmission channels, notably the fiscal and banking channels.

### 4.2 Banking Sector Channel

During the 2021–2022 period, the global diamond market experienced a strong rebound in luxury spending, which drove diamond prices high. As a result, the country earned an average of about M4.8 billion in diamond export revenue, equivalent to approximately 13.0 percent of GDP. However, by 2025, diamond export earnings had declined significantly to M2.3 billion, representing only 5.5 percent of GDP. This substantial loss in revenue also implies reduced government earnings from the mining sector royalties that fell sharply by 170 percent to M99 million between 2019 and 2025. This weakened fiscal position could delay government repayments to suppliers and contractors, creating liquidity strains in other sectors of the economy. In turn, this constrains business operations, weakens cash flows, and heightens credit risk, posing a downside risk to financial stability through broader spillover effects.

### 4.2 Banking Sector Channel

The financial strain within the mining sector is increasingly evident in credit performance. Since 2019, credit extension to the sector reduced by approximately 52 percent to only M200 million, reflecting subdued business activity. Over the same period, Lesotho's largest mine, Letšeng Diamond Mine, has experienced a marked deterioration in debt-servicing capacity, with its debt-to-EBITDA ratio rising from below 1x to around 5x, largely driven by a sharp decline in earnings rather than an increase in debt. This weak performance of the mine has also resulted in over 200 job losses, amplifying economic stress beyond the mining sector. These layoffs have reduced

household incomes, leading to lower consumption and generating spillover effects in linked sectors such as retail. However, the banking sector remains the most affected. As displaced workers and struggling businesses face reduced cash flows, their ability to service loans weakens, placing pressure on banks' asset quality and profitability.

In general, these pressures continue to elevate credit risk, constrain credit extension and dampen overall economic activity, reinforcing adverse feedback loops between the real economy and the financial system. Therefore, the downturn in the mining sector is not only affecting production and employment but is also amplifying risks to overall financial stability.

## 5. Outlook and Policy Considerations

The outlook for global diamond prices remains uncertain and growth in the market will largely depend on how players strategically position themselves to adapt to this evolving industry. Demand for luxury goods, including diamonds, is expected to remain subdued over the medium term, as rising oil prices add to inflationary pressures amid escalating geopolitical tensions. This environment is likely to erode disposable incomes and weaken consumer purchasing power. Supply and production cuts by major mining companies, aimed at reducing market saturation, are likely to support a recovery in diamond prices by creating scarcity.

To remain competitive, it is important for natural diamond producers to emphasize product differentiation through rarity, strengthen ESG standards, and build trust through traceability and responsible sourcing. The need for diversification into LGDs or recycled diamonds to capture shifting consumer demand has become increasingly urgent. Additionally, exploring alternative applications of diamonds in high-tech industries offers an opportunity to diversify revenue streams and reduce reliance on traditional jewellery markets.

## 5.2. Focus Topic: Lesotho Real Estate Market Dynamics

### 1. Global Real Estate Market Trends

The real estate market plays a pivotal role in promoting socio-economic development and supporting financial stability within an economy. The sector contributes significantly to economic growth by stimulating construction activity, job creation, and increasing household wealth. Furthermore, financial stability is deeply intertwined with the performance of the real estate markets since financial institutions are extensively exposed to the property markets through mortgages. Specifically, the rise in the value of properties increases the value of banks' mortgage-backed assets and real estate investments and thus, strengthening their capital positions and profitability. However, a downturn in these markets can severely undermine financial stability, this has been demonstrated by historic crises such as the collapse of the Japanese asset prices in the 1990s and the United States (U.S.) subprime mortgage collapse that triggered the 2008 Global Financial Crisis (GFC).

Historically, global property prices have experienced significant cycles driven mainly by macroeconomic conditions and financial sector developments. During and in the aftermath of the COVID-19 pandemic, most advanced and emerging markets economies experienced a housing boom, underpinned by historically low interest rates and high demand. However, this was followed by a significant increase in inflation. In response, most central banks implemented aggressive monetary tightening measures to combat increasing inflation, which in turn weighed on property markets globally, resulting in declining valuations, reduced transaction volumes, and rising financial stress.

Overall, these global experiences underscore that real estate markets are highly sensitive to shifts in macroeconomic conditions and financial cycles, with important implications for financial stability. In 2025, global property markets were in a

moderation phase, with real house prices declining slightly by around 0.7 percent year- on-year basis. While some advanced economies experienced stable or mildly rising prices, many emerging markets continued to face subdued real price growth, alongside persistent affordability challenges due to weakened purchasing power and income constraints.

### 2. South Africa Real Estate Trends

As Africa's largest real estate market, South Africa property market continues to face persistent headwinds. Recent economic uncertainty and elevated interest rates which peaked to 11.75 percent between 2023–2024 placed a significant strain on the real estate market by increasing borrowing costs and reducing housing affordability. While these high rates slowed activity and pressured property developers' and homeowners' cash flows, interest rate cuts in 2025 have begun to support a gradual recovery, boosting buyer appetite, and prompting banks to extend additional home loans. This recovery has become evident in residential property price indices, most of which show that house price growth in 2025 accelerated to around 4–6 percent, signalling a modest rebound in demand and improved market sentiment.

The South African residential property market is highly sensitive to movements in interest rates, as these directly influence household borrowing capacity and affordability. During the high-interest-rate period of 2023, home loan application volumes declined significantly, falling by around 8–11 percent on a year-on-year basis. This decline was largely driven by reduced affordability and weaker demand for housing, as elevated interest rates increased borrowing costs. For instance, when the prime lending rate reached 11.25 percent in May 2023, the monthly repayment on a M1 million home loan increased by approximately M2,740 per month, placing additional financial pressure on prospective homeowners.

These developments in borrowing costs, housing demand and mortgage lending are ultimately reflected in movements in residential property prices. In South Africa and most



economies, changes in house prices are commonly monitored through the Residential Property Price Index (RPPI), which tracks changes in the value of residential properties over time. The South African national RPPI increased to 118.8 in 2025 (December 2020 set as the base year = 100), signalling a steady recovery in property prices. Annual residential property inflation also accelerated, increasing from 2.5 percent in 2024 to 5.2 percent in 2025.

Beyond macroeconomic factors, several structural and market-specific factors also influence house prices in South Africa. Population growth, increasing urbanisation and concentration of demand in prime locations continue to exert upward pressure on housing prices. In recent years, migration towards economic centres offering greater employment opportunities, improved services and enhanced lifestyle amenities, such as Cape Town, Johannesburg and Pretoria has contributed to stronger demand for housing and, consequently, rising residential property prices in these regions and countrywide.

### 3. Lesotho Residential Real Price Index

The real estate market in Lesotho remains relatively underdeveloped and largely informal compared with the South African market. Property transactions are mainly conducted through private negotiations, as there is no formal centralized platform or exchange through which properties are systematically traded. The market is also heavily dominated by residential properties, reflecting strong demand for housing and the limited development of commercial real estate segments.

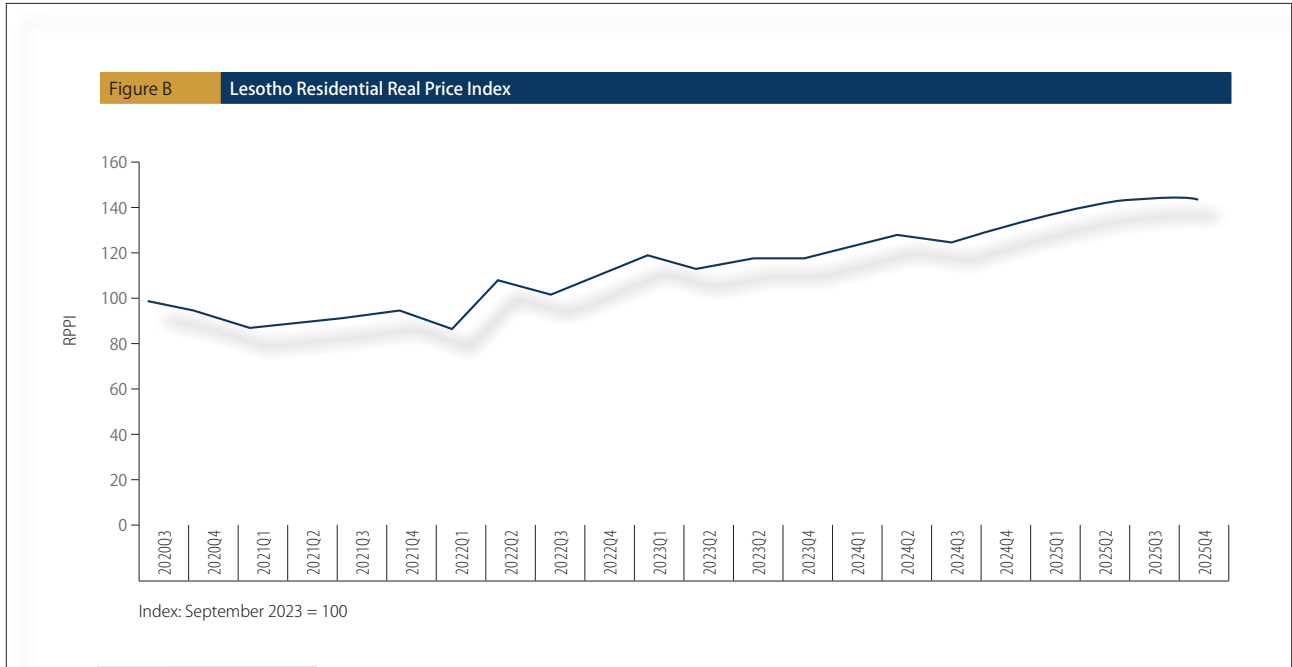
In addition, the market is characterised by a relatively small house resale segment. Most homeowners build houses primarily for owner-occupation and long-term family use, often intending to pass the property on to future generations

rather than reselling it in the market. This cultural norm limits the frequency of property transactions and contributes to the relatively thin and less liquid housing market.

Despite stringent credit regulations and limited housing finance options in Lesotho, the banking sector remains highly exposed to the real estate market. Mortgage loans constitute a notable share of banks' loan portfolios, amounting to approximately M2 billion and accounting for about 16.8 percent of the total banks' lending in 2025. This highlights the continued importance of the housing market on the banking sector and underscores the need to closely monitor developments in prices of properties and mortgage lending.

The Central Bank of Lesotho used the methodology discussed in FSR Issue 9 to estimate Lesotho's RPPI is displayed in the Figure below. Generally, since the aftermath of the COVID-19 pandemic, residential property prices in Lesotho have gradually trended upward over the period. Moreover, unlike many residential property price indices that recorded notable declines during the 2023–2024 period of rising interest rates, Lesotho's residential property market appears relatively less responsive to interest rate changes, as property prices continued to rise over the period.

On an annual basis, Lesotho's residential property prices increased by approximately 43 percent. This strong growth reflects a combination of structural and cost-related factors. Proximity to the capital town Maseru, where economic activity is concentrated attracts sustained demand for housing. Construction costs, largely driven by inflation have increased the cost of new developments and subsequently property prices. Lastly, Lesotho's property prices are also driven by housing supply constraints linked to the country's low-income dynamics.



Lesotho’s property price inflation is highly volatile compared to global market trends, suggesting that the market is not firmly anchored by strong real estate fundamentals. This volatility is largely driven by low transaction volumes, where a small number of high-value sales, particularly in prime areas can significantly distort overall price movements. In addition, weak market transparency and underdeveloped price discovery mechanisms further amplify these fluctuations. As a result, property price dynamics in Lesotho tend to diverge from global housing cycles, indicating that the market is primarily driven by domestic factors rather than external trends.

The continued mortgage lending in domestic banks’ portfolios suggests that financing conditions have remained supportive to the real estate sector despite tight credit conditions.

Specifically, in 2025, new mortgage lending continued to grow, with residential property loans rising by 1.7 percent, even as non-performing residential loans increased by 2.9 percent. This signals that households continue to face financial strain, largely driven by income losses associated with rising unemployment. Despite these pressures, loan growth can coexist with rising NPLs when credit supply remains accommodative, even when economic conditions are not favourable. Overall, this combination implies that financial stability is increasingly exposed to downside risks, while accommodative credit conditions are sustaining lending and cushioning the real estate sector, they are also masking underlying household vulnerabilities, potentially leading to higher credit risks if economic conditions do not improve.



