Economic Review April 2013

Contents:

1. International Monetary Fund's April 2013 World Economic Outlook (Risks, Hopes, Realities): Implications for Lesotho's Economy

Though global economic activity is expected to improve, the road to recovery in advanced economies will remain bumpy……….

Introduction

The World Economic Outlook (WEO) released in April, 2013 indicates that the global economic prospects have improved though economic activity in advanced economies, particularly the Euro Area, still remains fragile. Contrary to the observed slowdown in output of emerging markets and developing economies during 2012, economic growth in 2013 is expected to improve at the back of resilient consumer demand, improved macroeconomic policy stance and reviving exports. Notable improvement has been on Asia and Sub-Saharan Africa and many economies in the Latin America as well as the commonwealth of independent states. Middle East and North Africa economies, however, continue to struggle with difficult internal transitions while some economies in South America are facing high inflation and increasing exchange market pressures. Economic growth in advanced economies is expected to accelerate steadily starting in the second half of

2013 supported by improved growth prospects in the United States (US) as private demand picks up. Following successful defusing of the two biggest short-term threats (the threats posed by the Euro Area break-up and US fiscal cliff) to the global recovery, financial stability has also improved.

This article highlights the recent developments and prospects pertaining to the global economic outlook. It also provides the implications of these developments for the economy of Lesotho.

The Global Economic Performance and Projections

The April 2013 WEO indicates that the global activity is expected to stabilize in advanced economies, while picking up in emerging economies at the back of policies and renewed confidence. World output is projected at 3.3 per cent in 2013 and 4.0 per cent in 2014. In advanced economies, economic activity is expected to gradually improve, with US in the lead. With regards to emerging market and developing economies, economic activity has already picked up and is expected to improve further in 2013 and 2014.

However, new risks have now surfaced while old threats still remain. In the short-term, risks mainly relate to developments in the Euro Area, specifically the uncertainty regarding the outcome of events in Cyprus and politics in Italy as well as vulnerabilities in the European Union (EU) peripheral economies[1].

In the medium-term risks will revolve around adjustment fatigue, insufficient Institutional reform and prolonged stagnation in the EU (regarding the strengthening of the Economic and Monetary Union). Moreover, high fiscal deficit and debt in the US and Japan also pose a threat to the medium-term outlook.

[1] The peripheral economies are taken to be small economies such as Greece, Portugal, Italy e.t.c, where the crisis began and their financial problems spilling over to the core, which are bigger economies such as Germany and France.

Table 1: SELECTED ECONOMIC INDICATORS, 2011 – 2014* (Percentage changes)

Indicators	2011	2012	2013	2014*
World Output	4.0	3.2	3.3	4.0
Advanced Economies	1.6	1.2	1.2	2.2
United States	1.8	2.2	1.9	3.0
Euro Area	1.4	-0.6	-0.3	1.1
Germany	3.1	0.9	0.6	1.5
Italy	0.4	-2.4	-1.5	0.5
Spain	0.4	-1.4	-1.6	0.7
Emerging and Developing Economies	6.4	5.1	5.3	5.7
Sub Saharan Africa	5.3	4.8	5.6	6.1
South Africa	3.5	2.5	2.8	3.3
Central and Eastern Europe	5.2	1.6	2.2	2.8
Commonwealth of Independent States	4.8	3.4	3.4	4.0
Developing Asia	8.1	6.6	7.1	7.3
Middle East and North Africa	4.0	4.8	3.1	3.7
Consumer Prices				
Advanced Economies	2.7	2.0	1.7	2.0
Emerging and Developing Economies	7.2	5.9	5.9	5.6
Imports				
Advanced Economies	4.7	1.0	2.2	4.1
Emerging and Developing Countries	8.6	4.9	6.2	7.3
Exports				
Advanced Economies	5.6	1.9	2.8	4.6
Emerging and Developing Economies	6.4	3.7	4.8	6.5

Source: International Monetary Fund (IMF) World Economic Outlook, April 2013
*Indicates projections

The United States

Growth in the US is expected to slow down to 1.9 per cent in 2013 from 2.2 per cent in 2012 due to the lasting effects of the financial crisis, fiscal consolidation, a weak external environment and temporary shocks, which include severe drought and disruptions in the northeast following super-storm Sandy.

Economic growth is expected to pick up towards the end of 2013 and projected to accelerate to 3.0 per cent in 2014 as a result of a pick-up in credit growth and improving bank lending conditions.

Residential investment has also recovered towards normal trend levels while household balance sheets have also improved due to stronger house prices. Private demand is also expected to recover, thus will more than offset the drag on growth from fiscal consolidation. Though the US recovery seems to be progressing well, the following downside risks still remain. Regarding the external environment, the main risk lies with the worsening Euro Area debt crisis, the higher risk aversion and a stronger US currency.

For the internal environment, the budget sequesters (i.e. the US automatic spending cuts), which came to effect on 1st March 2013, is projected to subtract about 0.3 percentage points from GDP growth in 2013 if sustained until end of the fiscal year (30th September 2013). It is also projected that if the sequester continues into 2014, it could lower GDP growth by another 0.2 percentage points. Moreover, the difficulties over rising debt ceiling and lack of progress on the medium-term consolidation plan could lead to higher sovereign risk premium.

Despite progress made so far through discretionary spending caps and moderate tax increases, developing a comprehensive medium-term deficit-reduction framework remains the top policy priority for the US government.

Europe

Economic activity in Europe remains weak, though confidence regarding the viability of Economic and Monetary Union have increased. Economic growth is projected to stay in the negative territory due to the weaknesses that have been observed from the peripheral countries and have also spilled over to the core. Though financial conditions for sovereigns and banks have improved, these have not translated to increased private sector borrowing conditions or improved economic activity. This could be attributable to financial conditions in the EU that remain highly vulnerable to shifts in market sentiments as evidenced by the renewed volatility in the wake of the inconclusive outcome of Italy's elections and recent events in Cyprus.

The need to sort out public and private balance sheets and the continued policy uncertainty, have weighed against robust recovery in investment and consumption in both the periphery and the core. This has led to a steady rise in unemployment rates in many EU countries.

Economic activity is forecasted to contract by 0.3 per cent instead of expanding by the same amount, as projected in the October 2012 WEO. Inflation pressure has recently been close to EU Central Bank's target, which is set below but close to 2 per cent and is expected to moderate further amid negative growth revisions, diminishing effects of crisis-related fiscal measures and lower oil prices. The short-term risks include incomplete policy implementation at both the national and European level, while events in Cyprus could lead to more sustained financial market fragmentation. The medium-term risks lie with prolonged stagnation in the Euro Area.

The policy prescription will therefore have to focus on improving demand conditions and making further progress on the banking union and fiscal integration.

Sub-Saharan Africa (SSA)

The Sub-Saharan Africa region is projected to grow at 5.6 per cent in 2013 compared to 4.8 per cent in 2012. The strong growth will be supported by on-going investment in infrastructure and productive capacity continuing robust consumption and the activation of new capacity in extractive sector.

Growth is expected to continue to strengthen further in 2014, hence projected to be about 6.0 per cent. Growth in 2014 will mainly be driven by stronger economic activity in South Africa and other middle income come countries, centered on improvements in the external environment. However, in the short-term, some deterioration in the current account balances of a number of countries is expected. The worsening current account will be largely driven by the expected decline in the terms of trade, especially among oil exporters. On the inflation front, the SAA inflation rate is projected to continue to fall to 7.0 per cent in 2012, in the absence of fuel and food price shocks.

The main risk to the outlook emanate from the external environment. Specifically, the Euro Area downside risk of prolonged stagnation is expected to hamper the region's exports, remittances, official flows as well as private capital flows. Secondly the risk of a reduction in investment in emerging market economies (including South Africa) would weaken key commodity prices thus hurting mineral exporters.

Implications for the Economy of Lesotho

Through the trade links, Lesotho is highly susceptible to any adverse economic shock in advanced and emerging markets, particularly the US and the Euro Area. Subdued economic developments in the EU does not bode well for Lesotho as exports of one of the fast growing industries (mining) are traded in Europe. Moreover, the slowdown growth in the EU has a negative impact on demand by the EU consumers. This implies low imports in the car manufacturing industry for South African Manufactures, which has a negative impact on SA import duties.

A decline in import duties would result in a significant decline in the Southern African Customs Union's (SACU's) revenue pool as SA contributes the largest share of this pool. This would imply lower transfers to the SACU member states, hence devastating impact on Lesotho's fiscal position, which has been improving since the recent recovery of the pool.

However, the US is expected to be the pillar of economic recovery in advanced economies. This is an encouraging development for the economy of Lesotho. About 80 per cent of Lesotho's textile exports are destined for the US, hence any improvement on the US economy is a welcome development for Lesotho. Expected improvement in private demand in the US in 2013, implies an increase in demand for Lesotho's exports.

Commodity prices (with the exception of metals) are in general expected to decline in 2013, amid improved supply prospects for all main commodity groups, including oil. Metal prices are projected to increase in line with global economic recovery and higher demand, especially in China. This would benefit the South African (SA) economy through its mining sector, which would have positive spill-overs to Lesotho. However, this could be dampened by the slower demand in EU, which would impact negatively on employment prospects in the SA mining industry and hence lower remittances for Lesotho.

The declining commodity prices especially food prices bode well for inflation in Lesotho as 40 per cent of Lesotho's basket consists of food. Declining oil prices also has important implications for the economy of Lesotho as the economy relies exclusively on imported oil for its consumption and production activities.

The strong performance of the SSA economies also augurs well for Lesotho, given its on-going efforts to attract diversified markets for its exports.

2. Featured Definition

Foreign Reserves

Foreign reserves are a 'kitty' of foreign currencies that the country has at its disposal. This kitty is usually kept and managed by the country's central bank. In the case of Lesotho this 'kitty' consists mainly of US dollars, euros, rands, pound sterling and few other currencies. The size of the 'kitty' is an important indicator of the health of the economy. For instance, it measures the country's ability to pay for imports and to withstand external shocks by serving as a buffer against exchange rate fluctuations.

It is generally felt that a country, at any given time, should have sufficient amount of reserves to pay for at least three months of imports (also known as months of imports cover). Investors are general weary of investing in a country whose foreign reserves are below this threshold.

This featured definition benefitted from:
Roux, A. (2008) *Everyone's Guide to the South African Economy*, 9th ed, Zebra Publishing

3. Featured Economic Event

Technical Extension of ECF for Lesotho

During the 2013 World Bank and IMF Spring meetings held in Washington D.C. from the 18th- 21st April 2013, the Lesotho delegation held a bilateral meeting with the IMF's African Department to discuss amongst other things, the coming to an end of the ECF program. It was during this meeting that the Minister of Finance and the Governor of the Central Bank of Lesotho expressed an interest to continue to have the program relations with the IMF through a successor three-year arrangement. The Minister of Finance and the Governor also requested that the arrangement be extended until September 30th, 2013 with rephrasing of the remaining disbursement. It is envisaged that this arrangement would support continued macroeconomic stability and sustainable growth. Furthermore, the extension will allow for more time to discuss different program options the Government may be interested in for the successor program.

The Three-Year Extended Credit Facility (ECF) Program with the International Monetary Fund (IMF) signed in June 2010 provides a platform for the Government to consolidate and sharpen its macroeconomic and development direction. Lesotho recently completed the fifth review of the ECF program and its performance has remained strong.

4. Featured Descriptor

Base Period

The period may be a month, a quarter or a year. The base period is the period that is used as a yardstick against which new data is compared. Base periods are usually assigned a value of hundred (100) when used as an index such that all subsequent changes can be expressed as percentages. For instance it may be reported that Consumer price index is 127 points. This simply means that the cost of living has gone up by 27 per cent since the base period.

5. Selected Economic Indicators

	Feb 2013	Mar 2013	April 2013
1. Interest rates (% Per Annum)			
1.1 Prime Lending Rate (Lesotho)	9.92	9.92	9.92
1.2 Prime Lending Rate (South Africa)	8.50	8.50	8.50
1.3 Treasury Bill Discount Rates			
- *91-day*			
Lesotho	5.30	5.30	5.12
South Africa	5.38	5.37	5.35
- *182-day*			
Lesotho	5.27	5.26	5.15
South Africa	5.41	5.10	5.15
- *273-day*			
Lesotho	5.40	5.36	5.13
South Africa	5.63	5.61	5.61
- *364-day*			
Lesotho	5.35	5.37	5.11
South Africa	5.66	5.67	5.61
2. Monetary Base – In Million Maloti	1099.41	1202.31	1190.60
2.1 Maloti in Circulation	827.13	945.30	932.60
2.2 Liabilities To Other Depository Corporations	253.96	238.55	240.89
2.3 Liabilities To Other Sectors	18.32	18.46	17.13
2.4 Reserve Money Target	900.00	900.00	900.00
3. Net International Reserves (NIR) – In US$			
4.1 Actual NIR	1126.1	1092.5	1230.2
4.3 NIR Target – Monetary Policy Committee	1083.0	987.0	987.0
4. Inflation Rate (Y-o-Y Percentage Changes)	5.1	5.0	5.2
5. Exchange Rates (Monthly Averages)			
6.1 Loti/United States Dollar (US$)	9.21	9.20	8.68
6.2 Loti/Pound Sterling (£)	13.77	19.89	13.94
6.3 Loti/Euro (€)	11.89	11.93	11.86