

## International Credit Analysis

## Kingdom of Lesotho

### Ratings

#### Foreign Currency

Long-Term.....	BB-
Short-Term.....	B
Outlook.....	Stable

#### Local Currency

Long-Term.....	BB+
Outlook.....	Stable

Country Ceiling.....	BBB+
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### Peer Group

BB	Azerbaijan Colombia Costa Rica Peru Philippines
BB-	<b>Lesotho</b> Brazil Vietnam
B+	Cape Verde Indonesia Iran Turkey Ukraine Venezuela

### Ratings History

Date	LTFC	LTLC
02 September 2002	B+	BB
30 November 2004	BB-	BB+

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### ■ Summary

Lesotho's Long-term foreign currency rating has been upgraded to 'BB-' from 'B+' and its Long-term local currency rating to 'BB+' from 'BB'. The upgrade reflects progress on fiscal consolidation as a result of tax administration reforms implemented since January 2003, and a substantial decline in the external debt burden, owing to strong exchange rate appreciation over the last two years. Both of these factors have contributed to a marked decline in the public debt burden, which is projected to fall to below the 'BB' rating median this year. In addition, the extension of special textiles provisions under the Africa Growth and Opportunities Act (AGOA) from September 2004 to 2007 has improved the medium-term prospects for the textiles and clothing sector. The macroeconomic environment is also benefiting from South Africa's much sounder monetary policy approach, which has over the last year delivered the lowest inflation and interest rates in years. Lesotho's historical strengths – a modest net external debt burden, strong international liquidity and high fiscal revenue – all compare favourably with the 'BB' rating category.

The extension of AGOA means that the cessation of textiles quotas under the Multi-Fibre Agreement (MFA) at the end of 2004, which will intensify global competition, will have less of an immediate impact. The appreciation of the loti (LSL) (rand) is, however, putting downward pressure on the profitability of textiles and clothing manufacturers, and is at the very least likely to result in a slowdown of investment in the sector. Although Fitch Ratings considers Lesotho relatively well-placed to manage these threats, they do nevertheless highlight the importance of improving the cost competitiveness of the industry – and of diversifying the economy.

### ■ Credit Outlook

The Outlook is Stable. The ability of the textiles sector to adjust to tougher global competition as well as progress on diversification will be key factors influencing improvements in Lesotho's creditworthiness.

### ■ Strengths

- Relative political stability
- Major beneficiary of AGOA
- Close proximity to South Africa
- Improving fiscal consolidation
- Strong solvency and liquidity ratios

### ■ Weaknesses

- Narrow-based economy
- Weak, though improving public expenditure management
- Threats to the textiles and clothing sector
- Poverty and social challenges, including high unemployment and HIV/Aids

## Key Indicators for Lesotho

<b>Population (2003):</b> 2.25m	<b>Population growth rate (1998-2003):</b> 2.0% p.a.						
<b>GDP (2003):</b> USD1.1bn	<b>GDP per head at market exchange rates (2003):</b> USD507						
<b>GNI per head at purchasing power parity (2003):</b> USD3,120 (= 8% of USA level)							
<b>Modern sovereign rescheduling history:</b> None							
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004<sup>f</sup></b>	<b>2005<sup>f</sup></b>	<b>2006<sup>f</sup></b>
<b>Domestic Economy and Finance</b>							
Real GDP growth (%)	1.3	3.2	3.8	3.3	3.0	3.2	3.3
Unemployment (% of labour force)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Consumer prices (annual average % change)	6.1	5.9	11.7	7.3	4.5	5.2	5.0
Gross domestic savings (% of GDP)	-20.4	-15.9	-10.4	-9.3	-6.1	-4.6	-4.7
Gross domestic investment (% of GDP)	42.1	39.9	40.1	38.1	38.6	39.0	38.6
Short-term interest rate (%) <sup>(1)</sup>	9.3	11.0	12.2	9.8	8.0	8.5	8.5
Broad money (% change Dec to Dec)	1.4	17.2	8.8	6.0	6.0	5.0	5.0
LSL per USD (annual average)	6.94	8.61	10.54	7.56	6.40	6.50	7.00
REER (CPI, 2000=100)	100.0	86.7	75.9	105.5	109.7	106.4	100.0
REER: % change (+ = appreciation)	-4.0	-13.3	-12.4	38.9	4.0	-3.0	-6.0
<b>Public Finances</b>							
General government balance (% of GDP)	-2.9	-0.7	-4.3	0.7	2.7	2.0	-0.4
General government debt (% of GDP)	83.6	105.5	86.8	64.5	51.2	49.8	47.5
General government debt maturities (% of GDP) <sup>(2)</sup>	14.8	12.7	15.4	10.1	9.9	9.5	7.8
General government debt/revenue (%)	188.5	242.3	201.4	153.6	106.3	111.1	115.7
Interest payments/revenue (%)	9.9	6.8	6.6	6.0	4.8	3.6	3.4
<b>Balance of Payments</b>							
Current account balance (USDbn)	-151.4	-95.1	-118.8	-168.0	-152.5	-156.8	-183.6
Current account balance (% of GDP)	-17.6	-12.4	-16.1	-14.7	-10.3	-9.9	-11.7
Current account balance <i>plus</i> net FDI (USDbn)	-33.7	21.8	-37.9	-43.0	-32.5	-76.8	-103.6
Current account balance <i>plus</i> net FDI (% of GDP)	-3.9	2.8	-5.1	-3.8	-2.2	-4.8	-6.6
Gross financing requirement (% of official reserves) <sup>(3)</sup>	37.0	34.0	43.2	53.3	40.9	38.4	42.9
Current external receipts CXR (USDbn)	682	692	691	1003	1188	1236	1241
Current external receipts CXR (annual % change)	-1.2	1.4	-0.1	45.1	18.5	4.1	0.4
Current external payments CXP (USDbn)	834	787	810	1171	1340	1393	1424
Current external payments CXP (annual % change)	-8.5	-5.6	2.9	44.6	14.5	3.9	2.2
<b>External Assets and Liabilities</b>							
Gross external debt (USDbn)	629.4	563.7	648.5	710.5	733.3	757.3	777.3
Gross external debt (% of GDP)	73.0	73.4	87.9	62.4	49.6	47.8	49.4
Gross external debt (% of CXR)	92.2	81.5	93.9	70.9	61.7	61.3	62.7
Net external debt (USDbn)	131.0	112.1	165.8	124.1	113.3	127.3	137.3
Net external debt (% of GDP)	15.2	14.6	22.5	10.9	7.7	8.0	8.7
Net external debt (% of CXR)	19.2	16.2	24.0	12.4	9.5	10.3	11.1
Public external debt (USDbn)	567.0	507.8	584.2	646.2	651.9	678.0	682.2
Public external debt (% of GDP)	65.8	66.1	79.2	56.7	44.1	42.8	43.3
Net public external debt (% of CXR)	21.9	17.5	25.7	18.5	12.8	13.6	13.1
Public FC denominated & FC indexed debt (USDbn)	567.0	507.8	584.2	645.6	651.9	678.0	682.2
Short-term external debt (% of gross external debt)	3.9	3.5	3.1	2.8	2.7	2.6	2.6
External debt service (% of CXR)	7.6	8.7	8.9	6.2	4.1	3.8	3.7
External interest service (% of CXR)	2.7	2.0	1.9	1.4	1.1	0.9	0.8
Liquidity ratio (%) <sup>(4)</sup>	751.0	585.7	555.5	585.0	857.4	929.5	963.3
Official international reserves including gold (USDbn)	418	386	406	460	500	510	520
Official international reserves in months of CXP cover	6.0	5.9	6.0	4.7	4.5	4.4	4.4
Official international reserves (% of broad money)	185.9	235.2	161.9	133.0	127.3	135.6	139.4

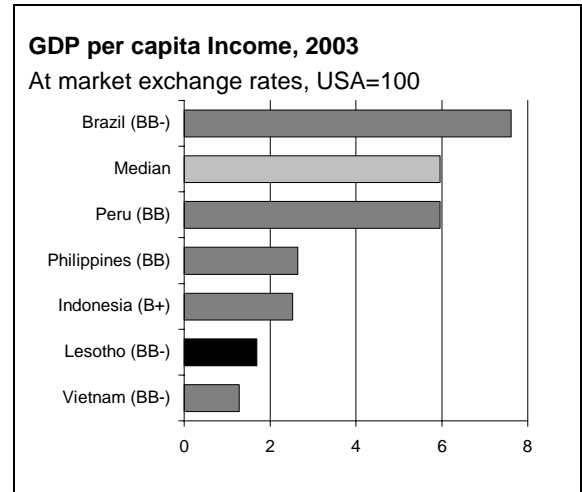
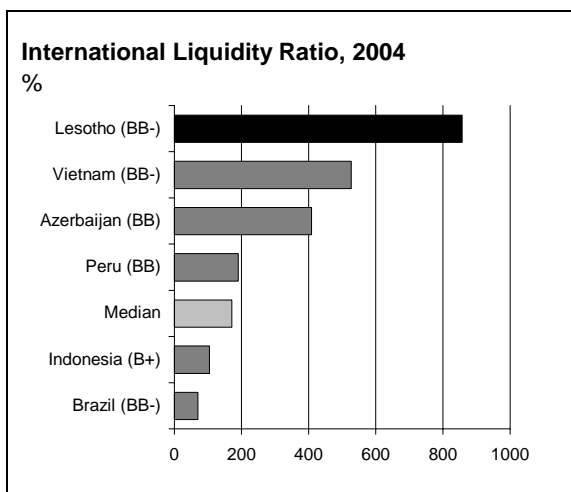
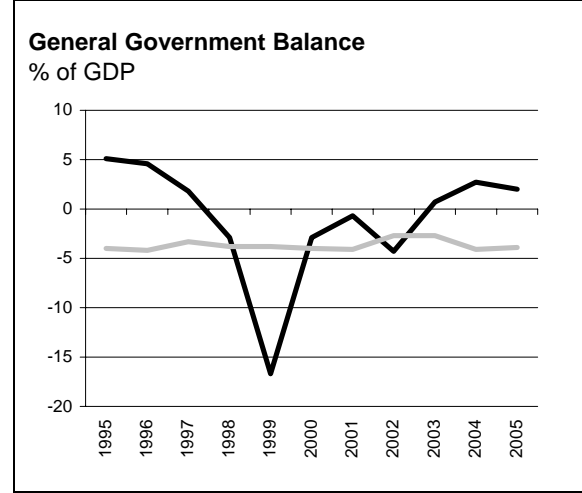
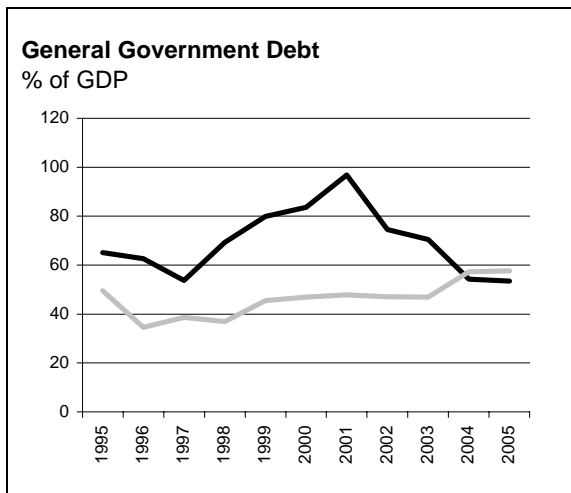
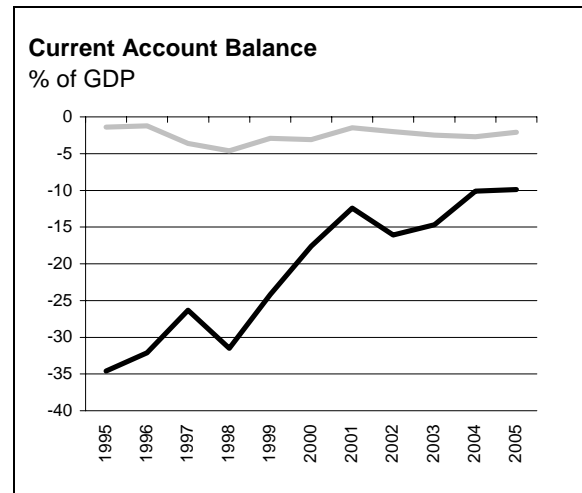
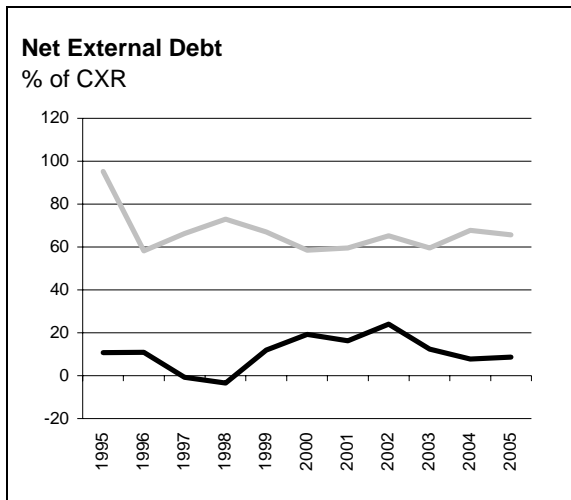
(1) Short-term treasury bill rate (end year).

(2) Maturities of medium and long-term debt during year *plus* short-term debt outstanding at the beginning of the year.

(3) Current account balance *plus* amortization of medium and long-term debt, over official international reserves.

(4) Official reserves incl. gold *plus* banks' foreign assets/ Debt service *plus* liquid external liabilities.

## Peer Comparison



— Lesotho

— BB Median

Source: Fitch Sovereign Comparator

## ■ Rationale

Lesotho's Long-term foreign currency rating has been upgraded to 'BB-' from 'B+' and its Long Term Local Currency (LTLC) rating to 'BB+' from 'BB'. The Outlook is Stable. The upgrade reflects progress on fiscal consolidation as a result of tax administration reforms implemented since January 2003, and a substantial decline in the external debt burden, owing to strong exchange rate appreciation over the last two years. Both of these factors have contributed to a marked decline in the public debt burden, which is projected to fall to below the 'BB' rating median this year. In addition, the extension of special textiles provisions under the Africa Growth and Opportunities Act (AGOA) from September 2004 to 2007 has improved the medium-term prospects for the textiles and clothing sector (T&C). The macroeconomic environment is also benefiting from South Africa's much sounder monetary policy approach, which has over the last year delivered the lowest inflation and interest rates in years. Lesotho's historical strengths – a modest net external debt burden, strong international liquidity and high fiscal revenue – all compare favourably with the 'BB' rating category.

The extension of AGOA means that the cessation of textiles quotas under the Multi-Fibre Agreement (MFA) at the end of 2004, which will intensify global competition, will have less of an immediate impact. The appreciation of the loti (LSL) (rand) is, however, putting downward pressure on the profitability of textiles and clothing manufacturers, possibly resulting in a slowdown of investment in the sector (at least in the short-term)<sup>1</sup>. Although Fitch considers Lesotho relatively well-placed to manage these short-term threats, they do nevertheless highlight the importance of improving the cost competitiveness of the industry – and of diversifying the economy.

Efforts continue to strengthen public expenditure management and control, but concerns about fiscal sustainability will continue until this area is more fully addressed in the medium term. Social factors such as the relatively low income *per capita*, the high level of unemployment and the high incidence of HIV/Aids (which is being more actively addressed) are medium to longer-term constraints. Food security is still a problem following three years of drought. With an income *per capita* of USD507 in 2003, compared with USD1,500 for the 'BB' rating median, Lesotho is much poorer than its rating peers.

<sup>1</sup> The consensus is a moderate weakening of the exchange rate over the next two years.

Efficiency gains from improved tax administration – the launch of the Lesotho Revenue Authority (LRA) in January 2003 and the introduction of value added tax (VAT) in July 2003 – aimed more broadly at offsetting the expected decline in South African Customs Union (SACU)<sup>2</sup> revenue over the medium to longer term – contributed to strong fiscal consolidation last year, with the budget recording a small surplus (the first after five years). Expenditure cuts also aided fiscal consolidation last year. Fiscal consolidation is expected to continue over the next two years as a result of SACU windfall revenue (after which it will decline to more usual levels), resulting in a pay down of domestic debt. Projected revenue excluding grants, peaks at around 45% of GDP in 2004/05 (partly because of the SACU revenue windfall) before declining to 38% in 2006/07, at which time the debt to revenue ratio is projected to be 115% (compared with 260% for the 'BB' median). As a result, strong fiscal revenues will remain a rating strength for Lesotho. Over the medium term, implementation of a Medium Term Expenditure Framework (MTEF), which the government embarked on this year, should strengthen fiscal sustainability and effectiveness.

Lesotho's gross external debt (GXD) ratios have benefited from the loti's sharp appreciation against the US dollar. In 2003 the gross external debt to GDP ratio declined to 62% from 88% in 2002, and is projected to fall to around 50% in 2004, compared with the 'BB' median of 45%. In view of the high level of foreign currency-denominated public debt, the public debt ratio declines to 51% in 2004, which is below the 'BB' median of 54% of GDP. Fitch does not expect a sharp reversal of the loti's appreciation, ensuring that this one-off rise continues to benefit the public and external debt burdens.

## Peer Comparator – 2004

### Fiscal and External Debt Indicators

(%)	Lesotho	BB Median
GXD/GDP	49.6	45.0
NXD/CXR	9.5	67.7
Debt Service/CXR	4.1	12.8
Liquidity Ratio	850	150
General Gov't Balance/GDP	2.7	-3.8
General Gov't Debt/GDP	51.1	54.0
General Gov't Debt/Revenue	106	258

CXR – current account receipts

NXD – net external debt

Source: Fitch

The extended exemption of AGOA rules of origin for lesser developed countries to 2007 improves prospects for the textiles and clothing sector and

<sup>2</sup> Links South Africa, Botswana, Swaziland, Namibia and Lesotho in a customs union.

suggests that it will continue to drive growth over the medium term. In any case, Lesotho was better placed to meet the tighter rules of the origin criteria, owing to the completion of a denim mill operational since the second quarter of this year, which is expected to meet most of the denim sector's fabric requirements (denim accounts for 30% of output), and a knitted fabric mill, which is due for completion next year

There are, however, indications that growth in textiles exports under AGOA slowed this year. This was partly owing to the initial uncertainty over whether the special textiles provision will be extended, but also because of the impact of the currency's strengthening on the profitability of textiles and clothing manufacturers. The expiration of the MFA at end-December 2004 will see competition from China and other more efficient East Asian textile producers intensify. Nevertheless, the extension of AGOA, progress on vertical integration and export market diversification through trade agreements makes Lesotho relatively well-placed to manage these risks. Because of the trend towards lower tariffs globally, over the medium to longer term, Lesotho will need to diversify its products and markets as well as reduce costs in order to attract investment, create jobs and sustain growth.

Lesotho's already-modest net external debt ratios improved, as a result of the currency's appreciation, to 11% of GDP and 12% of current external receipts in 2003, from 22% and 24% respectively in the previous year. External liquidity remains strong, owing to the need to preserve the peg, with the net reserves target set at USD400m–USD450m since the first quarter of 2003, equivalent to almost 1½ times narrow money. These two indicators compare favourably with the 'BB' rating category.

#### ■ Political & Social Situation

Lesotho has remained politically stable following peaceful national elections in May 2002 and the introduction of an element of proportional representation in the electoral system, which has ensured broader representation in parliament.<sup>3</sup> Around 10 political parties are represented in parliament, with the ruling Lesotho Congress for Democracy (LCD) holding 77 seats and the main opposition party the Basotho National Party (BNP) having 21 seats out of a total of 118. The ruling party, which is well organised, has won all but one by-election. A dispute about the validity of the elections has made the BNP less effective in parliament, as it failed to receive support from other opposition

<sup>3</sup> Lesotho is a constitutional monarchy, and the king though head of state does not have any executive powers. In addition to the national assembly, it has the senate with 33 members, 22 of whom are traditional chiefs, and 11 appointed by the government.

parties, and its complaint was ultimately rejected by the high court this year. Local elections are expected this December (having been postponed from last December), helping to deepen the democratic process further.

Lesotho has implemented structural and macroeconomic reforms under the IMF since the late 1980s and has pursued an export-led growth strategy. This has resulted in a relatively sound economic framework, with the textiles and clothing sector the main source of economic, employment and export growth in recent years. Economic policy will continue to focus on poverty reduction through raising growth, creating employment and improving social conditions as well as improving the competitiveness of the economy, particularly in view of increased global competition in the textiles sector, so as to sustain investment and growth.

As one of the US government's 16 Millennium Challenge Account (MCA) countries, Lesotho's economy will receive a huge step-up in aid over the next three years. Aid will be based on the government's own proposals for sustaining growth and reducing poverty. The MCA countries are selected on the basis of their commitment to strong governance, human rights protection, rule of law and an open economic system. Total annual aid for MCA countries will reach USD5bn by 2006.

Lesotho's key social issues are food security and the HIV/Aids epidemic. Lesotho is in its third year of drought, which has reduced food security particularly in the highlands. This has necessitated continued government and international agency relief to the most vulnerable. More generally, however, agriculture productivity has declined by 40% over the last 20 years, owing to the overuse of land, soil erosion and degradation, and more recently the impact of HIV/Aids. However, this year the government is not providing subsidies to farmers for seeds and fertiliser, which it judged as not very effective and instead is encouraging more productive farming methods as a way of increasing sustainability.

Over the last year the government has made a much more concerted effort to tackle the HIV/Aids crisis. Around USD34m is available from the Global Aids Funds over five years for anti-retroviral drugs (ARVs), food supplements and looking after 90,000 Aids orphans. For 2004/05 2% of the government's expenditure is to be spent on implementing the National AIDS Strategic Plan, and many other bilateral donors are providing smaller amounts of funding, so the problem is less financial than organisational.

Lesotho moved down the Human Development Index (HDI) ranking to 145 in 2004 from 137 in 2003 mainly because of the effects of HIV/Aids on life expectancy. This compares with a ranking of 119 for South Africa ('BBB'), a 131 for Ghana ('B') and 105 for Cape Verde ('B+'). However, Lesotho's literacy rate is comparable to middle-income countries and it has made considerable progress on achieving the Millennium Development Goals such as universal primary education, reduction of child mortality and the promotion of gender equality.

Lesotho is completely surrounded by South Africa. In addition to a shared cultural and historical background, institutions such as a common customs union and a common currency area, as well as access to South Africa's sound transport infrastructure make Lesotho's close proximity to South Africa a rating strength. Relations with South Africa continue to be enhanced through a Joint Bilateral Commission on Cooperation, which is working on ways in which Lesotho can graduate from least developed status by 2006. Lesotho is also committed to participating in the NEPAD (the New Partnership for Africa's Development) peer review mechanism, which it hopes will improve transparency and investor confidence in the country.

## ■ Short-Term Prospects

Growth slowed last year to 3.3% owing to the effects of the sharp currency appreciation on manufactured exports. Growth in the construction sector also slowed because of lower government capital spending. This was partially offset by higher growth in the services sector, particularly primary education, and a smaller decline in agricultural output. Uncertainty over the extension of the US AGOA trade agreement and the strong currency will keep manufacturing activity (comprising mainly textile exports) relatively suppressed this year, with overall growth of around 3%. In July the extension of the existing textile exports arrangements under AGOA until 2007 was announced, indicating that growth will remain largely driven by textile exports, despite increased competition from the Asian economies following the expiration of the MFA at end-December 2004. Textile exports will also be supported by vertical integration by textile firms to ensure local sources of raw materials, reducing the cost and meeting the new rules of origin criteria, to be implemented in the medium term. Nonetheless, a weakening of the currency is required to maintain the export growth momentum.

Inflation fell to 4.7% in September and is expected to remain relatively low owing to lower imported inflation from South Africa, which accounts for around 80% of imports and where CPIX (consumer

prices excluding mortgage interest rates) is projected to remain within the target range of 3%-6% until 2006. South Africa's CPI (consumer prices, headline) is expected to average 1.5% in 2004, but to rise to around 4% in 2005. Similarly, interest rates in South Africa and Lesotho have fallen to their lowest level in several years. The loti (rand) has strengthened against the USD averaging around LSL6.3:USD this year, but Fitch expects a moderate weakening next year, owing to the narrowing interest rate differential between South Africa and the US and the possibility of lower commodities prices due to lower demand from China. However, owing to improved public sector external liquidity in South Africa, Fitch does not expect a sharp reversal of the loti (rand) appreciation and this should help to contain inflation. High oil prices are, however, a threat to inflation.

## Economic Performance and Outlook

	2003	2004f	2005f
Real GDP (%)	3.3	3.0	3.2
CPI Inflation (% Annual Avg.)	7.3	4.5	5.2
Budget Balance (% GDP)	0.7	2.7	2.0
Current Account (% GDP)	-14.7	-10.1	-9.9

Source: Central Bank of Lesotho, Ministry of Finance, Fitch estimates

## ■ Structural Issues

The economy continues to benefit hugely from the US AGOA trade initiative<sup>4</sup>. The manufacturing sector, which mainly comprises textiles and clothing, accounted for around 20% of GDP in 2003, has been growing by an average of 7% *per annum* over the last three years and is now the main source of economic and employment growth. Investment in textiles and clothing, which started in the late-1980s, is mainly by East Asian countries, notably Taiwan. It has taken advantage of export legislation and cheap labour as well as physical incentives – the provision of factory shells and utilities in industrial estates – and other domestic incentives. Nonetheless, the sector was given a big boost by the AGOA trade initiative.

Textile and clothing exports more than trebled in value to USD340m in 2003 from USD100m in 2000 (the year preceding the enactment of the AGOA trade initiative) (USD180m in 2001 and USD280m in 2002). In the first three quarters of 2004 textile export values were USD380m. Employment in the sector rose to over 50,000 from 41,000 in 2002 (20,000 in 2000). By September 2004 there were around 53,500 people employed in the textiles and

<sup>4</sup> The AGOA trade initiative, which was enacted in 2000, gives duty and quota-free access to textiles and a large number of other products to 37 eligible sub-Saharan African countries.

clothing sector. Vertical integration has started with a new denim mill operational since the second quarter of 2004<sup>5</sup> and a knitted-fabric mill due for completion next year. While growth in employment shows that the sector continued to expand this year (albeit more slowly), the higher US dollar value of exports in 2003 and 2004 reflects in large part the currency appreciation. Although data on textile exports volumes are unavailable, indications are that the textiles and clothing sector has been hit by the strengthening of the currency which has a negative impact on the profitability of the textiles and clothing manufacturers where the rise of domestic costs (estimated at around 50% of total) is squeezing margins. Uncertainty over whether there will be an extension of AGOA beyond September 2004 also contributed to a slow down in investment and in growth in 2004.

The extension of AGOA removes a major threat to Lesotho's economy (at least for the medium term). Under AGOA III, the entire programme is extended to 2015 (from 2008), at which point all tariff exemptions under AGOA are removed and the Special Apparel Provision – which allows lesser developed countries (LDCs) countries to import fabrics from anywhere in the world, enabling them to use the most competitively-priced fabrics – is extended to 2007 (from September 2004). This will allow more time for investment in fabric mills, so as to meet the new criteria, which only allows them to source fabrics from the US and other AGOA-eligible countries. The extension of AGOA (overall) will also help mitigate the effects of the cessation of all textiles and clothing quotas under the MFA at the end of the year, as eligible countries will continue to enjoy duty-free access to the US estimated to translate to a 15-20% margin. However, the advantage will diminish in the long term owing to the trend towards lower tariffs globally, and Lesotho will need to diversify its products and markets as well as increase its competitiveness.

Some progress is being made on diversifying export markets through preferential trade agreements. The US-SACU trade agreement currently being negotiated, is expected to extend and make more permanent the benefits of AGOA. Lesotho has agreements with Canada and Australia that are similar to AGOA and duty-free access to the EU, which has not been exploited at this stage owing to the more rigid rules of origin. However, Lesotho has not yet benefited from these agreements, as almost all of its textiles and clothing exports go to the US. Although there is an opportunity to diversify into

other AGOA approved products, there has been very minimal product diversification and this has been mainly as a result of South African investors taking advantage of lower labour costs. For example a circuit breaker factory was established this year and there are a few factories in the leather and footwear sectors. Currently the authorities and the stakeholders are focussing on ways on which to adapt to the much more competitive environment for the textiles and clothing sector which will require strengthening infrastructure including water resources and electricity supplies, easing bureaucracy and increasing productivity.

Agriculture, accounting for 15% of GDP in 2003 and providing a livelihood for over 50% of the population, has been in long decline as a result of soil erosion and reduced soil fertility. Efforts are now focused on improving the productivity of land, for example training on post-harvest techniques and small irrigation schemes. The government is looking into diversifying into high value-added exports to South Africa. The issue of land reform is now seen as essential to improving the productivity of agriculture. Currently all land is owned by the King and cannot be sold to anyone, and this provides little incentive to invest in the land.

Eco tourism, as a result of the opening up of the mountains because of the water project and mining, is another opportunity for diversification. Diamond mining has resumed in recent years, but both the mining and quarrying and tourism sectors will remain very small.

Miners' remittances are a major contributor to GNP. Following widespread redundancies of miners in the South African mining sector in the mid-1990s, the number of Basotho miners in South Africa has stabilised at around 60,000, which is less than half the number of a decade ago. Miners' employment fell slightly last year, reflecting weaker profitability in the South African mining sector, because of rand appreciation, but overall remittances rose slightly, owing to higher average earnings. With restructuring of South Africa's mining sector largely complete, the number of miners is expected to remain roughly stable and remittances are expected to rise gradually in line with earnings growth.

The bidding process for the privatisation of the remaining utilities, the Lesotho Electricity Company (LEC) has been extended until end-January 2005. This follows a relatively lengthy restructuring, which improved the efficiency of the company. As a final part of the restructuring process, electricity tariffs – which had not been increased since 1993 – were put up by 18% in January 2004, and similar increases are

<sup>5</sup> Two other companies have acquired a denim mill in South Africa for use under the AGOA preference system.

planned for January 2005 and 2007. The successful bidder will take over 70% of LEC on an operating concession basis for 20 years. Rural electrification will be financed through the budget and donors. The other major focus of structural reforms is to introduce a multi-sector regulatory framework.

## ■ Financial Sector

A banking licence was granted to First National Bank (FNB, South Africa), which started operations in October 2004. This brings the number of banks in Lesotho to four, of which Standard Bank, Nedbank and FNB are subsidiaries of three of the four major banks in South Africa, and Lesotho Bank is 70% owned by Standard Chartered Bank (UK). The ownership of Lesotho's banking sector by well-capitalised and well-supervised foreign banks minimises the risk to the sovereign in terms of contingent liabilities or systemic risk.

A series of reforms following the collapse of two previously state-owned banks in 1998-99, have strengthened the banking sector. The capital adequacy ratio of 24% at end-2003 is far higher than the minimum required, and non-performing loans dropped to 3% of outstanding loans at end-2003 from 11% a year earlier. However, progress on increasing financial intermediation has been slower. The banking sector remains small, with a M2 to GDP ratio of just 27% and a loans to deposit ratio of 22.7% (up from 15% in 2001). After slowing to just 7.8% in 2003, credit to the private sector rose by 20.2% year-on-year in the first quarter of 2004 owing to the effects of substantially lower interest rates from the second half of 2003. Among the reforms aimed at facilitating credit to the private sector were the establishment of the Rural Savings and Credit Guarantee Fund worth LSL2.5m last year – which will help cover the exposure of banks dealing with rural credit groups – measures to enhance the performance of the commercial court and the licensing of the first credit bureau this year.

## Key Facts: Banking System

	Dec 2003
M2 (% GDP)	27
NPL Ratio	3
Capital Adequacy Ratio (%)	24.0
Public Ownership, % of Assets	5
Foreign Ownership, % of Assets	95

Source: Central Bank of Lesotho

## ■ Public Finance

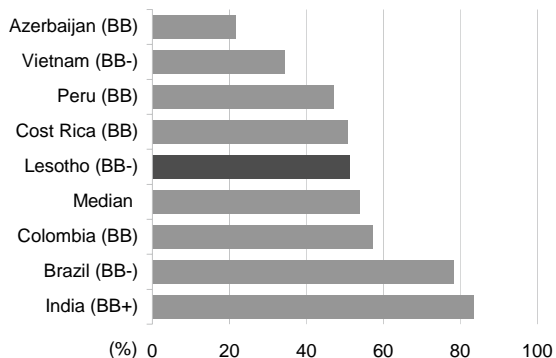
In 2003/04 Lesotho achieved strong fiscal consolidation as a result of efficiency gains from improved tax administration and expenditure restraints. Following higher than planned

expenditure by mid-fiscal year, the government cut expenditure proportionately across the operating ministries. It also made savings of LSL120m (1.4% of GDP), which was due to be spent on local elections that were postponed from December 2003 to this year. However, revenue from the newly-launched Lesotho Revenue Authority (LRA) in January 2003 and VAT, which was introduced in July last year, performed much more strongly than expected. Non-tax revenue was also considerably higher than planned because of two disbursements of rand monetary compensation<sup>6</sup>. This resulted in a small fiscal surplus of 0.7% of GDP in 2003/04.

In 2004/05 the local government elections, the start of old age pensions for people aged over 70 and a 5.5% salary adjustment for public servants will cause the expenditure to GDP ratio to rise, but continued efficiency gains from the LRA and a SACU<sup>7</sup> revenue windfall are expected to result in larger fiscal surpluses in 2004 and 2005. In the medium term, this surplus is projected to turn into a small deficit as SACU revenue is expected to revert to usual levels.

### Public Debt/GDP

2004



Source: Fitch estimates

In 2003/04 the budget surplus was deposited with the central bank. Domestic debt inched up slightly to 11% of GDP at end March 2004 from 10% a year earlier. The government's domestic debt position is even more comfortable when its large deposits with the banking system are taken into account; which were equivalent to 14% of GDP and have since risen. The government will use much of this year's SACU windfall to pay down gross domestic debt further, in

<sup>6</sup> This is money transferred from the South African Reserve Bank to compensate for loss of seigniorage for the estimated portion of rand circulating in the economy.

<sup>7</sup> An adjustment to SACU revenues is paid after 2 years in light of more accurate customs data becoming available. The windfall reflects a high increase in imports 2002 due to agriculture imports for famine relief and intermediate imports for the textiles sector.

particular it has designated the retirement of LSL273m, which was incurred to recapitalise Lesotho Bank. Continued moderate fiscal balances should help keep domestic debt relatively low in the medium term. Public external debt ratios have also benefited from the strength of the loti (rand) against the US dollar (USD). Hence Lesotho's general government debt to GDP ratio is forecast to decline to 51% in 2004/05 from 70% in 2003/04, with the public external debt to GDP ratio of 44% and the public domestic debt to GDP ratio of 7% projected in 2004/05. The general government debt to GDP ratio is below the 'BB' median of 54% of GDP.

comprising mainly water royalties as well as rand monetary compensation and dividend and interest income. Projected revenue excluding grants, peaks at around 45% of GDP in 2004/05 (partly because of the SACU revenue windfall) before declining to 38% in 2006/07. As a result, strong fiscal revenues currently at 42% of GDP (40% excluding grants) and a debt to revenue ratio of 167% (compared with 260% for the 'BB' median), will continue to be a rating strength for Lesotho. However expenditure prioritisation, management and control have to be strengthened in order to ensure fiscal effectiveness and sustainability.

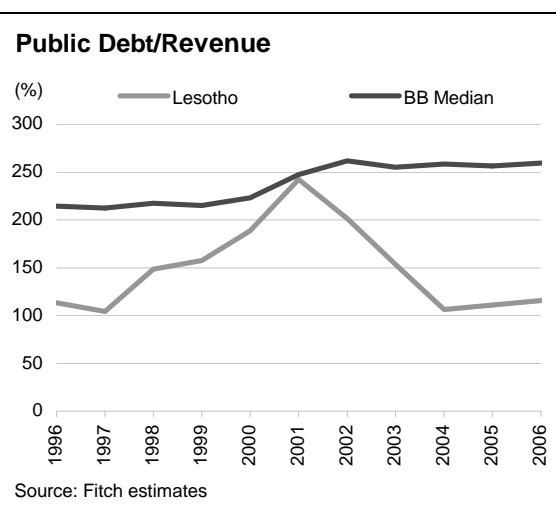
## Public Finances: Sources and Uses

(LSLm)	2003/04	2004/05f	2005/06f
Uses	333.8	276.0	70.4
Budget Balance	-62.2	-251.0	-205.4
Amortisation	396.0	527.0	275.7
Domestic	190.0	273.0	0.0
External	206.0	254.0	275.7
Sources	333.8	276.0	70.4
Gross Borrowing	333.8	276.0	70.4
Domestic	153.8	66.2	-204.6
External	180.0	210.1	275.0

Source: MoF, IMF, FitchRatings estimates and forecasts

The establishment of the LRA and the introduction of VAT have been successful at raising revenue collection. VAT, which was harmonised with South Africa at a higher rate of 14% (from 10%) and with almost the same zero-rated exemptions, rose by 33% from a year earlier, owing to a more streamlined procedure, improved compliance at the border because of better recording and the inclusion of VAT on government transactions (previously the government did not pay general sales tax). Because of these measures, proceeds from VAT rise from 4.4% of GDP in 2002/03 to around 7% in the medium term. Income tax rose by 28% to 10% of GDP, reflecting improved enforcement and compliance, but is expected to settle at around 8.5% of GDP in the medium term. Increased income tax revenue will help offset the expected decline in SACU revenue, which will be hit by tariff reductions under the free trade agreements with the EU, SADC, the US and various other bilateral trade agreements as well as a new formula for determining the share of the revenue pool for each country which will be fairer to South Africa.

In comparison with other countries however, customs revenue (at 16.6% of GDP in 2003/04 a non-windfall revenue year), which at full implementation of trade agreements in 10 years times is estimated to fall by 30%, will remain relatively high. Overall revenue will also be boosted by relatively large non-tax revenue projected at around 5%-6% of GDP in the medium term,



In 2003 the government proved adept at cutting expenditure when budgetary pressures emerged in the first quarter of the fiscal year. Expenditure targets are expected to be more or less met on aggregate, barring one-off crises. The process of strengthening expenditure management systems is continuing, but has proceeded more slowly. For example, steps have been taken to have audited accounts since 2001/02; the treasury function has been strengthened through the appointment of a new accountant-general and two deputies and the implementation of monthly reporting systems on expenditure and revenue; and there has been an aggressive campaign to root out corrupt practices at customs with the help of the South African Revenue Service. These have helped tighten expenditure controls, though much more needs to be done. The government has this year embarked on reforms to strengthen the fiscal framework with a view to budgeting within a medium-term expenditure framework guided by the Poverty Reduction Strategy Paper (PRSP), which is due to be completed by year-end. This will target expenditure more precisely to national development objectives, improving the effectiveness and transparency of spending and predictability of the budget.

## ■ Monetary & Exchange Rate Policy

Lesotho together with Namibia, Swaziland and South Africa is a member of the Common Monetary Area (CMA). Under this arrangement the three separate currencies are pegged at par with the rand (ZAR), which is also in circulation alongside their currencies. Monetary policy is effectively that of South Africa's, which since 2000 is an inflation-targeting monetary framework and is transmitted to the smaller member states through interest rate changes.

The Central Bank of Lesotho held its first Monetary Policy Committee (MPC) in July. Its main monetary policy objective is to preserve the peg, and the MPC is aiming to increase the transparency of that process. At the MPC on 1 September 2004, the net international reserves (NIR) target range was set at USD400m–USD450m, or nearly equivalent to 1 ½ times narrow money, and is the level that has been maintained since the first quarter of 2003.

Inflation was down to 4.7% in September, after averaging 7.3% in 2003 and 11.7% in 2002, which is in line with trends in South Africa, where the rand's strong recovery and a 400 basis points increase in interest rates in 2002 has seen its CPIX fall within the target range of 3%-6% since September 2003. Increases in administered prices of electricity, water and telephones in Lesotho in the second quarter of 2004 are expected to add to inflationary pressures. However, food price increases are low, wage settlements of the private and public sector are relatively modest at 5.5% and the currency's strong recovery has helped offset the inflationary impact of high oil prices so far, though it still presents the biggest risk to the inflation outlook next year. The consensus is that South Africa's CPIX will remain within the target range through to 2006, indicating a continued relatively low inflation environment for Lesotho.

Interest rate developments also follow those of South Africa. The South African Reserve Bank made an unexpected interest rate cut of 50 basis points on 12 August to 7.5%, having kept them on hold since December 2003. This follows on from a 550 basis point cut during the second half of 2003. Treasury bill rates in Lesotho have followed suit, with rates falling to 8% (South Africa's 91-day treasury bill rate is 7.51%). The prime rate in Lesotho has declined to 12.2% from 13% in January. Given strong growth momentum in South Africa's economy and as demand pressures build, we expect South Africa's monetary policy to be tightened possibly in the latter part of next year to keep CPIX within the 3%-6% target in 2006.

The loti (rand) appreciated by 40% in 2002, 30% in 2003 and 12% as of end-November 2004 against the US dollar. Nonetheless, Fitch expects the loti (rand) to weaken moderately next year, reflecting a narrowing of the interest rate differential (owing to interest rate rises in the US and the EU) and assuming a decline in global commodity prices, because of lower demand from China. Although Lesotho's monetary policy benefits from lower inflation and enhanced credibility from South Africa, the strength of the currency is hitting Lesotho's much less diversified export base disproportionately.

## ■ External Finance

Merchandise exports struggled last year, owing to the strength of the loti (rand). In loti terms exports declined by 5% (textiles exports declined by 1%). Import growth also declined because of lower capital spending and lower agricultural support by the government and in line with the lower value of intermediate inputs for manufactured exports. However in US dollar terms exports rose by 36% (AGOA exports rose by 24%) and imports by 39%, reflecting the strong recovery in the currency. The other major sources of foreign exchange earnings are miners' remittances and SACU receipts. An increase in miners' remittances resulted in a slight narrowing of the current account deficit, estimated at 15% of GDP in 2003.

In 2004 we expect textile export growth to remain relatively sluggish owing to the continued strength of the currency and uncertainty over whether the AGOA will be extended. The textiles sector will require a lower level of imports owing to the completion of the denim mill earlier this year and also because of reduced government spending. Windfall SACU receipts will help narrow the current account deficit this year and next. The current account deficit will continue to be covered by foreign direct investment (FDI), FDI-related debt and concessional borrowing.

### External Finances: Sources and Uses

(USDm)	2003	2004f	2005f
<b>Uses</b>	216	182	192
Current Account Balance	168	146	157
MLT Amortisation	48	36	35
<b>Sources</b>	216	182	192
Gross MLT Borrowing	110	59	59
Net FDI	125	120	120
Net Resident Lending Abroad	-28	-20	-20
Other Capital Net	20	20	20
Change in FX Reserves (- = Increase)	-11	4	13

Source: Central Bank of Lesotho, Fitch estimates

The government's external debt management strategy involves paying back the more expensive

commercial loans that it took out for the Lesotho Highlands Water Project (LHWP)<sup>8</sup> which is nearing completion, and it only borrows on concessional terms because of IMF restrictions on PRGF (Poverty Reduction and Growth Facility) country's borrowing. Altogether around 70% of Lesotho's debt is on concessional terms. The official statistics do not include private sector debt. Based on World Bank data and exposures by BIS banks Fitch estimates Lesotho's private sector debt at around 10% of the total and assume that it will increase gradually in line with investment prospects because of AGOA. Much of the borrowing will be inter-company debt and going towards export-oriented companies, mitigating concerns about rising private sector debt.

Lesotho's gross external debt ratios have benefited from the loti (rand) appreciating against the US dollar which increased the USD value of GDP (USD-denominated debt accounts for over 50% of external debt). Although, gross external debt (GXD) rose to USD710m in 2003 from almost USD650m in

2002, reflecting mainly a rise in public sector borrowing, the gross external debt to GDP ratio declined to 62% in 2003 from 88% in 2002, and is projected to fall to 50% in 2004 compared with the BB median of 45%.

Lesotho's net external debt ratios benefit from high official reserves and deposit money banks' foreign assets, and at 11% of GDP and 12% of current external receipts are comparable with countries much higher up the rating scale and represent a major rating strength. Similarly, Lesotho has one of the highest liquidity ratios – measured as foreign exchange reserves plus banks' liquid foreign assets/short-term debt obligations – of all countries rated by Fitch, reflecting high official reserves, owing to the need to preserve the exchange rate peg with the rand and low debt servicing and other short-term obligations. Because of the high level of concessional debt, debt servicing is forecast at just 4% of current external receipts in 2004.

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<sup>8</sup> The Lesotho Highlands Water project (LHWP) is implemented under a Treaty between the governments of South Africa and the Kingdom of Lesotho signed in 1986 to supply water from Lesotho to Gauteng province. The LHWP involved a USD2.5bn investment for Phase 1A completed in 1999 and an estimated USD1.5bn for Phase IB completed in 2003. Explicit guarantees are given for full debt repayment of the water transfer scheme (95% of cost) by the South African government and the Muela Hydropower dam and ancillary developments (5%) by the Lesotho government. The Lesotho government took over all loans guaranteed to the LHWP. Lesotho receives annual water royalties and electricity rates from the South African government.

## Rating Peer Comparisons, 2004

Foreign/Local Long-Term Currency Ratings	Les'tho BB-/BB+	Vietnam BB-/BB	Brazil BB-/BB+	Azer- bajjan BB/BB	Ukraine B+/B+	Indon'ia B+/B+	Turkey B+/B+
<b>Domestic Economy and Finance</b>							
Per Capital GDP on PPP Basis (2003) (USDbn)	3.1	2.5	7.5	3.4	5.4	3.2	6.7
Real GDP Growth (%)	3.0	7.2	4.7	11.0	12.0	4.5	9.0
Unemployment (% Labour Force, Ann. Avg.)	n.a.	6.0	10.8	n.a.	9.0	9.5	9.5
Consumer Prices (Annual Avg. % Change)	4.5	7.5	8.4	4.0	10.0	6.6	14.0
Gross Domestic Savings (% of GDP)	-6.1	28.3	24.2	33.7	22.2	20.5	19.3
Gross Domestic Investment (% of GDP)	38.6	35.1	20.3	58.2	20.7	15.9	22.5
Short-Term Interest Rate (%)	8.0	7.8	16.2	7.0	8.0	6.5	21.0
Broad Money (% Change Dec to Dec)	6.0	28.0	10.0	23.5	45.0	7.0	20.0
<b>Public Finances</b>							
General Government Balance (% of GDP)	2.7	-4.3	-4.8	1.3	-3.7	-1.4	-7.7
General Government Debt (% of GDP)	51.1	34.4	78.4	21.7	24.7	68.3	73.4
General Government Debt Maturities (% of GDP)	9.9	3.1	24.3	n.a.	2.8	3.3	48.2
General Government Debt (% of Revenue)	106.2	167.8	206.2	93.6	70.0	349.5	294.0
Interest Payments (% of Revenue)	4.8	5.9	22.1	1.4	3.5	18.1	52.9
Public External Debt (USDbn)	0.7	11.4	115.5	1.7	12.4	85.3	102.5
Public External Debt (% of GDP)	44.1	27.0	20.0	19.6	20.4	39.2	35.1
Net Public External Debt (% of CXR)	12.8	14.7	60.8	-7.9	2.3	60.2	77.6
Public FC Denominated & FC Indexed Debt (USDbn)	0.7	11.4	149.9	1.7	13.5	83.8	133.6
<b>Balance of Payments</b>							
Current Account Balance (USDbn)	-0.2	-2.1	7.5	-2.5	6.3	5.7	-13.3
Current Account Balance (% of GDP)	-10.3	-5.0	1.3	-28.8	10.4	2.6	-4.6
Current Account Balance Plus Net FDI (USDbn)	-0.0	-0.5	17.4	.1	7.7	6.7	-12.3
Current Account Balance Plus Net FDI (% of GDP)	-2.2	-1.2	3.0	0.9	12.7	3.1	-4.2
Gross Financing Requirement (% of Official Reserves)	40.9	53.1	64.2	315.3	-53.3	24.6	114.7
Current External Receipts CXR (USDbn)	1.2	28.9	107.1	4.0	41.4	82.0	84.8
CXR (Annual % Change)	18.5	12.8	18.9	19.6	31.6	10.3	15.2
Current External Payments CXP (USDbn)	1.3	31.1	99.6	6.4	35.1	76.2	98.1
CXP (Annual % Change)	14.5	12.8	15.8	20.6	22.8	13.9	20.4
<b>External Assets and Liabilities</b>							
Gross External Debt (USDbn)	0.7	14.1	219.4	2.0	26.8	131.4	160.4
Gross External Debt (% of GDP)	49.6	33.3	37.9	23.4	43.8	60.3	54.9
Gross External Debt (% of CXR)	61.7	48.6	204.9	50.6	64.6	160.3	189.2
Net External Debt (USDbn)	0.1	4.6	148.6	-2	13.7	85.4	109.7
Net External Debt (% of GDP)	7.7	10.8	25.7	-2.7	22.5	39.2	37.5
Net External Debt (% of CXR)	9.5	15.8	138.8	-5.9	33.1	104.2	129.4
Short-Term Debt (% of GXD)	2.7	1.3	9.6	5.7	35.0	18.6	21.3
External Debt Service (% of CXR)	4.1	5.7	50.9	3.7	8.1	25.2	40.9
External Interest Service (% of CXR)	1.1	1.4	14.4	0.7	1.8	7.3	8.5
Liquidity Ratio (%)	857.4	527.0	70.9	408	66.3	104.9	76.4
Official Intl. Reserves incl. Gold (USDbn)	0.5	7.1	50.3	1.0	11.5	36.0	36.7
Official Intl. Reserves (in Months of CXP Cover)	4.5	2.8	6.1	1.8	3.9	5.7	4.5
Official Intl. Reserves (% of Broad Money)	127.3	23.8	31.9	151.4	44.7	31.7	30.5
<b>Payment History</b>							
Rescheduled at any Time	No	Yes	Yes	Yes	Yes	Yes	Yes
Rescheduled in Past Five Years	No	No	Yes	No	Yes	Yes	No

Source: Fitch Ratings

## Fiscal Accounts Summary\*

% of GDP	2000	2001	2002	2003	2004f	2005f	2006f
<b>Revenue &amp; Grants (Excl. Priv'n)</b>	<b>44.4</b>	<b>43.5</b>	<b>43.1</b>	<b>42.0</b>	<b>48.1</b>	<b>44.8</b>	<b>41.1</b>
o/w SACU	18.3	21.0	19.0	16.6	21.4	19.5	16.7
o/w Non SACU	13.3	13.7	14.3	17.1	17.8	16.9	16.4
o/w Non Tax Revenue	11.2	6.0	5.9	6.2	5.7	5.4	5.3
o/w Grants	1.6	2.8	3.8	2.1	3.2	3.0	2.7
<b>Expenditure &amp; Net Lending</b>	<b>47.2</b>	<b>44.2</b>	<b>47.3</b>	<b>41.3</b>	<b>45.5</b>	<b>42.8</b>	<b>41.5</b>
o/w Expenditure on Goods & Services	14.9	10.5	13.5	11.1	12.8	11.1	10.7
o/w Wages & Salaries	15.0	14.5	14.0	13.1	12.9	12.7	12.6
o/w Current Transfers & Subsidies	5.4	5.8	6.6	7.2	9.0	8.7	8.4
o/w Interest Payments	4.4	3.0	2.8	2.5	2.3	1.6	1.4
<b>Capital Expenditure (incl. Nationalisation Expenses)</b>	<b>7.7</b>	<b>10.9</b>	<b>10.8</b>	<b>7.4</b>	<b>8.6</b>	<b>8.7</b>	<b>8.4</b>
<b>Primary Balance (excl. Interest)</b>	<b>-0.2</b>	<b>0.3</b>	<b>-2.1</b>	<b>2.9</b>	<b>4.6</b>	<b>3.5</b>	<b>0.8</b>
<b>Overall Balance</b>	<b>-2.9</b>	<b>-0.7</b>	<b>-4.3</b>	<b>0.7</b>	<b>2.7</b>	<b>2.0</b>	<b>-0.4</b>
Overall Balance Excluding Grants	-4.4	-3.4	-8.1	-1.4	-0.6	-1.0	-3.2
<b>Financing</b>	<b>2.9</b>	<b>0.7</b>	<b>4.3</b>	<b>-0.7</b>	<b>-2.7</b>	<b>-2.0</b>	<b>0.4</b>
<b>Domestic</b>	<b>6.8</b>	<b>0.2</b>	<b>3.5</b>	<b>-0.4</b>	<b>-2.2</b>	<b>-2.0</b>	<b>0.4</b>
<b>External</b>	<b>-3.9</b>	<b>0.5</b>	<b>0.7</b>	<b>-0.3</b>	<b>-0.5</b>	<b>0.0</b>	<b>0.1</b>
<b>Public Debt*</b>	<b>83.6</b>	<b>105.5</b>	<b>86.8</b>	<b>64.5</b>	<b>51.2</b>	<b>49.8</b>	<b>47.5</b>
Domestic	13.3	14.1	9.8	10.8	6.9	5.3	4.8
External	70.3	91.3	77.0	53.8	44.3	44.5	42.7
Public Debt (% of Revenue)	188.5	242.3	201.4	153.6	106.3	111.1	115.7
<b>Memo</b>							
Interest Service (% of Revenue)	9.9	6.8	6.6	6.0	4.8	3.6	3.4

\* All figures refer to the consolidated general government  
Source: IMF, Ministry of Finance, FitchRatings estimates and forecasts

## Balance of Payments

(USDm)	2000	2001	2002	2003	2004f	2005f	2006f
<b>Current Account Balance</b>	<b>-151.4</b>	<b>-95.1</b>	<b>-118.8</b>	<b>-168.0</b>	<b>-152.5</b>	<b>-156.8</b>	<b>-183.6</b>
% of GDP	-17.6	-12.4	-16.1	-14.7	-10.3	-9.9	-11.7
<b>Trade Balance</b>	<b>-516.5</b>	<b>-400.0</b>	<b>-381.2</b>	<b>-541.0</b>	<b>-632.4</b>	<b>-620.1</b>	<b>-594.1</b>
Exports, Fob	211.1	278.6	354.8	482.0	550.0	609.0	655.9
(Annual % Change)	22.4	32.0	27.4	35.9	14.1	10.7	7.7
Imports, Fob	727.6	678.6	736.0	1023.0	1182.4	1229.1	1250.0
(Annual % Change)	-6.6	-6.7	8.5	39.0	15.6	3.9	1.7
<b>Services, Net</b>	<b>0.1</b>	<b>-8.5</b>	<b>-20.2</b>	<b>-36.4</b>	<b>-38.2</b>	<b>-46.3</b>	<b>-51.0</b>
Services, Credit	42.7	40.5	35.4	48.5	62.6	65.2	72.4
Services, Debit	42.5	49.0	55.5	84.9	100.8	111.5	123.4
<b>Income, Net</b>	<b>226.1</b>	<b>178.6</b>	<b>161.4</b>	<b>241.4</b>	<b>240.1</b>	<b>261.6</b>	<b>273.2</b>
Income, Credit	288.8	235.3	177.8	302.0	295.1	312.0	322.1
Income, Debit	62.6	56.7	16.4	60.6	55.0	50.4	48.9
o/w: Interest Payments	18.4	13.5	12.9	14.1	12.5	11.3	10.2
<b>Current Transfers, Net</b>	<b>138.8</b>	<b>134.7</b>	<b>121.2</b>	<b>168.0</b>	<b>278.0</b>	<b>248.0</b>	<b>188.3</b>
<b>Non-Debt Creating Flows, Net</b>	<b>117.8</b>	<b>117.0</b>	<b>80.8</b>	<b>125.0</b>	<b>120.0</b>	<b>80.0</b>	<b>80.0</b>
Equity Direct Investment, Net	117.8	117.0	80.8	125.0	120.0	80.0	80.0
o/w Special Financing - LHWP	86.3	88.5	56.5	73.0	60.0	20.0	20.0
Portfolio Equity Investment, Net	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>External Borrowing, Net</b>	<b>-18.7</b>	<b>-3.7</b>	<b>12.1</b>	<b>62.0</b>	<b>22.8</b>	<b>24.0</b>	<b>20.0</b>
<b>Net Lending Abroad</b>	<b>-19.1</b>	<b>-20.2</b>	<b>0.7</b>	<b>-28.0</b>	<b>-20.0</b>	<b>-20.0</b>	<b>-20.0</b>
<b>Capital Nes, Net</b>	<b>22.0</b>	<b>16.8</b>	<b>23.4</b>	<b>20.0</b>	<b>20.0</b>	<b>20.0</b>	<b>20.0</b>
<b>Net Errors and Omissions</b>	<b>62.1</b>	<b>155.4</b>	<b>-115.7</b>	<b>18.7</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Overall Balance = Chg in Reserves -ve = Increase</b>	<b>12.6</b>	<b>170.2</b>	<b>-117.3</b>	<b>29.7</b>	<b>-9.7</b>	<b>-52.8</b>	<b>-83.6</b>
Memo							
Gross Borrowing (incl. Short-Term)	40.2	67.9	80.5	130.4	78.7	79.4	75.2
Gross External Financing Requirement	185.0	142.1	167.2	216.4	188.4	192.2	218.8
Stock of International Reserves, excl. Gold	417.9	386.5	406.4	460.3	500.0	510.0	520.0

Source: IMF IFS, FitchRatings estimates and forecasts

## External Debt & Liquidity

(USDm)	2000	2001	2002	2003	2004f	2005f	2006f
<b>Gross External Debt</b>	<b>629.4</b>	<b>563.7</b>	<b>648.5</b>	<b>710.5</b>	<b>733.3</b>	<b>757.3</b>	<b>777.3</b>
% of GDP	73.0	73.4	87.9	62.4	49.6	47.8	49.4
% of CXR	92.2	81.5	93.9	70.9	61.7	61.3	62.7
<b>By Maturity</b>	<b>629.4</b>	<b>563.7</b>	<b>648.5</b>	<b>710.5</b>	<b>733.3</b>	<b>757.3</b>	<b>777.3</b>
Medium and Long-Term	604.8	543.7	628.5	690.5	713.3	737.3	757.3
Short-Term	24.6	20.0	20.0	20.0	20.0	20.0	20.0
% of Total Debt	3.9	3.5	3.1	2.8	2.7	2.6	2.6
<b>By Debtor</b>	<b>629.4</b>	<b>563.7</b>	<b>648.5</b>	<b>710.5</b>	<b>733.3</b>	<b>757.3</b>	<b>777.2</b>
Public Sector	567.0	507.8	584.2	646.2	651.9	678.0	682.2
Private Sector	62.4	55.9	64.3	64.3	81.4	79.3	95.0
<b>By Creditor: (Public Sector)</b>	<b>567.0</b>	<b>507.8</b>	<b>584.2</b>	<b>645.6</b>	<b>651.9</b>	<b>678.0</b>	<b>682.2</b>
Multilateral	417.5	414.7	471.3	522.8	535.4	572.3	585.5
Bilateral	95.3	51.7	60.7	68.5	67.8	61.1	55.8
Commercial Banks	44.2	31.4	34.7	38.2	37.6	37.1	33.9
Other	72.4	65.9	81.8	81.0	92.5	86.8	102.1
<b>Gross External Assets*</b>	<b>498.4</b>	<b>451.6</b>	<b>482.7</b>	<b>586.4</b>	<b>640.0</b>	<b>650.0</b>	<b>660.0</b>
International Reserves, Incl. Gold	417.9	386.5	406.4	460.3	500.0	510.0	520.0
Deposit Money Banks' Foreign Assets	80.5	65.1	76.3	126.1	140.0	140.0	140.0
<b>Net External Debt</b>	<b>131.0</b>	<b>112.1</b>	<b>165.8</b>	<b>124.1</b>	<b>93.3</b>	<b>107.3</b>	<b>117.3</b>
% of GDP	15.2	14.6	22.5	10.9	6.3	6.8	7.4
% of CXR	19.2	16.2	24.0	12.4	7.9	8.7	9.5
<b>Debt Service (Principal &amp; Interest)</b>	<b>52.0</b>	<b>60.5</b>	<b>61.3</b>	<b>62.5</b>	<b>48.4</b>	<b>46.7</b>	<b>45.4</b>
Debt Service (% of CXR)	7.6	8.7	8.9	6.2	4.1	3.8	3.7
<b>Liquidity Ratio (%)</b>	<b>751.0</b>	<b>585.7</b>	<b>555.5</b>	<b>585.0</b>	<b>857.4</b>	<b>959.5</b>	<b>993.9</b>
Excl. Banks' Foreign Assets	646.9	491.1	475.4	492.6	673.0	749.6	779.8

\* Non-bank private sector external assets are not taken into account

Source: Ministry of Finance, World Bank Global Development Finance, FitchRatings estimates and forecasts

## Amortisation Schedule on Medium- and Long-Term Debt

(USDm)	2004	2005	2006	2007	2008
<b>Public Sector</b>	<b>30.9</b>	<b>49.2</b>	<b>47.5</b>	<b>40.5</b>	<b>43.1</b>
IMF	0.1	0.2	0.2	2.2	6.4
Other Multilateral Creditors	11.0	21.4	20.6	20.9	21.5
Bilateral Creditors	9.1	12.5	12.2	6.7	6.4
Other	10.8	15.2	14.5	10.7	8.8
<b>Private Sector</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>
<b>Total</b>	<b>30.9</b>	<b>49.2</b>	<b>47.5</b>	<b>40.5</b>	<b>43.1</b>

Source: Ministry of Finance

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