



KINGDOM OF LESOTHO

July 2020

REQUESTS FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY AND PURCHASE UNDER THE RAPID FINANCING INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE KINGDOM OF LESOTHO

In the context of the Requests for Disbursement Under the Rapid Credit Facility (RCF) and Purchase Under the Rapid Financing Instrument (RFI), the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 29, following discussions that ended on June 29, with the officials of Kingdom of Lesotho on economic developments and policies underpinning the IMF arrangement under the Rapid Credit Facility. Based on information available at the time of these discussions, the staff report was completed on July 17.
- A **Debt Sustainability Analysis** prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA).
- A **Statement by the Executive Director** for the Kingdom of Lesotho.

Letter of Intent sent to the IMF by the authorities of Kingdom of Lesotho*

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Washington, D.C.



IMF Executive Board Approves US\$49.1 million in Emergency Support to Lesotho to Address the Covid-19 Pandemic

FOR IMMEDIATE RELEASE

- The economic consequences of the COVID-19 pandemic in Lesotho have been severe, with a weak global and regional environment reducing exports and remittances.
- The IMF approved US\$49.1 million emergency support under the Rapid Credit Facility and the Rapid Financing Instrument to help Lesotho meet urgent balance of payments needs stemming from the COVID-19 pandemic.
- While the authorities' immediate priority is to respond to the pandemic through emergency health and economic mitigation measures, fiscal consolidation and structural reforms will be required to restore external balance, preserve debt sustainability, and stimulate inclusive growth over the medium-term.

Washington, DC – July 29, 2020. The Executive Board of the International Monetary Fund (IMF) today approved a disbursement under the Rapid Credit Facility (RCF) equivalent to SDR 11.7 million (about US\$16.5 million, or 16.7 percent of quota), and a purchase under the Rapid Financing Instrument (RFI) equivalent to SDR 23.2 million (about US\$32.6 million or 33.3 percent of quota), to a total amount of about US\$49.1 million, to help Lesotho meet the urgent balance of payment needs stemming from the outbreak of the COVID-19 pandemic.

The pandemic comes at a time when Lesotho's economy was already facing challenges. Growth has been subdued for several years, reflecting structural bottlenecks and a weak regional environment, while government finances have struggled to cope with the volatility of transfers from the Southern African Customs Union (SACU) that account for around half of total revenues. Even though the country's relatively well-developed social assistance framework partially mitigates the high levels of poverty, unemployment remains high, and the population suffers from one of the highest rates of HIV infection in the world.

The authorities responded to the COVID-19 crisis through a mix of tax relief and increased spending. To cushion the impact on the most vulnerable, the authorities expanded social assistance, supporting food production, and providing aid to small businesses through credit guarantees. The IMF support through RCF/RFI financing would help reduce balance of payments pressures and catalyze other concessional financing, while allowing the authorities to fully mobilize their COVID mitigation strategy. After the immediate crisis abates, the authorities intend to implement reforms to promote inclusive growth and ensure fiscal expenditures are brought into line with available resources.

Following the Executive Board's discussion on Lesotho, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, issued the following statement:

"The COVID-19 pandemic is having a severe social and economic impact on Lesotho. Disruptions to supply chains for major industries and a national shutdown to contain the virus have led to a sharp drop in production. The economy is being further hit by declining external

demand for textiles and diamonds, shrinking remittances, and delays to major construction projects.

“The authorities have been taking strong actions to mitigate the health and socio-economic impact of the pandemic. In collaboration with development partners, they are scaling up urgent health spending, and are introducing measures to mitigate the economic impact, including by boosting social safety nets and ensuring access to credit for affected businesses.

“The economic shock, as well as the additional required spending, has generated urgent balance-of-payments (BOP) financing needs. Emergency financing from the IMF under the Rapid Credit Facility and Rapid Financing Instrument will help meet these needs and create room for pandemic-related spending. The authorities’ commitment to transparently plan, use, monitor, and report all emergency funds is crucial to ensuring they reach their targeted objectives.

“Once COVID-19 subsides and in the context of a likely drop in SACU revenues, there is an urgent need to strengthen economic fundamentals and ensure debt sustainability by carrying out fiscal consolidation and implementing growth-enhancing structural reforms. The COVID-19 crisis heightens the importance of a steadfast implementation of pro-growth reforms to ensure sustainable and inclusive medium-term growth.”

More information

IMF Lending Tracker (emergency financing request approved by the IMF Executive Board)
<https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker>

IMF Executive Board calendar
<https://www.imf.org/external/NP/SEC/bc/eng/index.aspx>



KINGDOM OF LESOTHO

July 17, 2020

REQUESTS FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY AND PURCHASE UNDER THE RAPID FINANCING INSTRUMENT

EXECUTIVE SUMMARY

Context. The COVID-19 pandemic is having a severe impact on Lesotho's economy. Supply chains for major industries have been disrupted and a national shutdown to contain the virus curtailed economic activity with adverse social impacts. The economy is expected to be further hit by declining external demand for textiles and diamonds, shrinking remittances, and delays to major construction projects. The authorities are taking measures to contain the virus and are implementing plans to mitigate its health and economic consequences. The economic shock, as well as the additional required spending, have generated urgent balance-of-payments (BOP) needs. Lesotho does not have an arrangement with the Fund.

Request for Fund support. The authorities are seeking financial assistance under the Rapid Credit Facility under the exogenous shock window and Rapid Financing Instrument, for a total of SDR 34.9 million (50 percent of quota) to address the BOP financing gap arising from the economic impact and mitigation efforts to the COVID-19 pandemic, which are estimated at 6¾ percent of GDP. It is not feasible to implement a UCT-quality Fund-supported program due to the urgent nature of the BoP need which, if left unaddressed, would result in immediate and severe economic disruption to Lesotho. External partners are expected to finance the remaining needs. Public debt remains sustainable and there is adequate capacity to repay the Fund. Staff supports the request for disbursement under the RFI-RCF.

Economic policies. The authorities' immediate priority is to limit the impact of the pandemic while preserving macroeconomic stability. Health spending is being increased, and measures to protect the most vulnerable and support the private sector are being implemented. The Central Bank of Lesotho continues to maintain reserves at a level that safeguards the peg to the rand. Over the medium term, the authorities have announced plans for fiscal consolidation and structural reforms intended to restore external balance, preserve debt sustainability, and facilitate recovery in growth. The authorities have committed to measures to ensure transparency in the use of crisis-mitigation funds, including an ex-post audit of expenditures by the Auditor General.

Approved By
D. Robinson (AFR)
 and **Bjoern Rother**
(SPR)

Discussions were held remotely during the weeks of June 1 and June 29, 2020. The mission comprised Joseph Thornton (head), A. Habib, A. Massara, and Y. Mu (AFR, assisted by M. Ntema (local economist). Z. Wang (research assistant), H. Alsokhebr, Cecilia Prado de Guzman (HQ administrative assistants), M. Mphatsoe (local administrative assistant) also contributed to this report. Discussions were held via videoconference with Minister of Finance Hon. Sofonea, the Governor of the Central Bank Dr. Matlanyane, Principal Secretary Ms. Tsolo, and other senior government officials. Ms. Nainda (OED) participated in the policy discussions.

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CONTEXT

1. Lesotho was already facing a challenging economic outlook when the pandemic hit.

Growth has been subdued for several years, reflecting long-term structural bottlenecks and a weak regional environment. Private-sector growth has also been hampered by the difficult political context, as a series of unstable coalitions have struggled to deliver strong governance and quality public services. Inequality is high, half of the population is classified as poor, and a quarter live in extreme poverty, while the population suffers from one of the highest rates of HIV infection in the world. Over half the population continue to rely on rain-fed subsistence agriculture. However, the country does have a relatively well-developed social assistance framework, which helps to mitigate poverty.¹

2. Notwithstanding a temporary windfall this year, several years of low transfers from the Southern African Customs Union (SACU) have eroded Lesotho's buffers. Transfers from the SACU account for around half of the total tax take but tend to be volatile and on a generally declining path. Public spending, on the other hand, has averaged over 50 percent of GDP over the last five years, in large part the result of one of the highest wage bills to GDP in the world, and has resisted attempts at consolidation. Consequently, large deficits have persisted. Domestic payment arrears emerged after attempts to raise financing were hampered by the limited domestic market, and international reserves reached the CBL's floor.² This year's SACU transfers, however, are increasing by 8 percent of GDP, which in the absence of COVID-19, would have eased the government's recent financing difficulties.³

3. Lesotho has started feeling the impact of the pandemic. Although there were relatively few confirmed cases in Lesotho as of early July, the country is an enclave within South Africa, where community transmission is present. The authorities declared a state of emergency, and on March 29 imposed a lockdown of the country, including school closures and travel bans on public servants. Economic activity has also been hit by the spillovers from the economic lockdown in South Africa and, reflecting the peg to the Rand, the exchange rate depreciated sharply against the US dollar. Despite some delays due to the recent political transition, the authorities prepared policy responses to the health and economic implications of the pandemic, with assistance from development partners.⁴

¹ World Bank calculations suggest that the existing social programs have reduced the poverty rate by 3.4 percentage points at the upper bound line and by 6.5 percentage points at the extreme line and reduces the Gini coefficient by 4.1 percentage points.

² 120 percent of M1 + callable deposits.

³ Customs and excise duties collected by SACU members are pooled and distributed quarterly, based on a revenue-sharing formula negotiated by the member countries. The allocation formula includes an ex-post correction mechanism that can exacerbate trends.

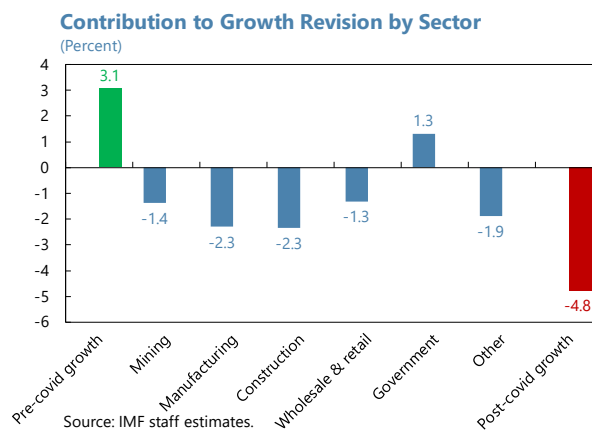
⁴ Following the collapse of the governing coalition and resignation of the previous Prime Minister, former Finance Minister Majoro was sworn in as Prime Minister on May 20 as head of a new coalition.

IMPACT OF THE PANDEMIC AND OUTLOOK

4. The pandemic is severely disrupting the economy. The textiles industry, which accounts for nearly a tenth of GDP – and is the largest private sector employer – had already reported supply disruptions from China when the national lockdown halted activities in most sectors.

Economic contractions in South Africa and the US will depress exports of diamonds and textiles, and the major mines have severely curtailed production for the next twelve months in anticipation. The Maloti depreciation against the US dollar is expected to have limited impact on inflation and growth, as disinflationary pressures from South Africa – the main source of imports – and low oil prices will dominate the impact on

inflation, while the drop in US demand and supply chain disruptions for the diamond and textile industries will negate any benefits to growth. Moreover, the shut-down in South Africa – by far the largest source of remittances on which many families depend, and which have been running at close to a fifth of GDP – resulted in around 60,000 workers returning to Lesotho before the border was closed.⁵ Activity on the second phase of the Lesotho Highland Water Project will likely be delayed due to the shutdown and disruptions to input supplies.



5. The health and economic crisis stemming from COVID will worsen the fiscal deficit and create pressure on the BOP. Domestic revenues are expected to fall by 7¼ percent of GDP compared to the pre-COVID scenario, while additional expenditures on healthcare and mitigation measures in response to the economic consequences of the virus are expected to exceed 5 percent of GDP (Text Table 1). The balance of payments will come under pressure as exports and remittances fall, though lower oil prices and compressed import volumes will mitigate the impact on the current account (Text Table 2).

6. The impact on the financial sector will depend on the duration and severity of the pandemic. The banking sector enters the COVID crisis with substantial capital buffers, ample liquidity (including deposits with parent banks in South Africa accounting for 17½ percent of total assets), and relatively low NPLs. However, lending to corporates is highly concentrated and focused on the construction, mining, and textiles sectors, all of which will be hit hard by the crisis and may find it difficult to raise funds overseas. At the same time, two-thirds of lending goes to households, mainly salaried workers, who are often highly-indebted, though their civil service employment and the use of deduction at source will mitigate credit risk. Non-bank lenders, though small, have gaps in their oversight, and any failures could be a potential vector of risk for banks.

⁵ With the border porous, there are many reports of Basotho returning from South Africa and evading formal controls.

Text Table 1. Fiscal Impact of COVID-19, FY 2020/21
(In millions of maloti)

	FY20/21		Change (percent GDP)
	Pre-COVID	Post-COVID	
Revenue	20,203	17,639	-7.3
o/w Tax revenue	8,199	6,110	-5.9
Non-tax revenue	1,950	1,447	-1.4
Expenditure	20,544	20,219	-0.9
Current	15,534	16,602	3.0
o/w COVID-19 related		1,800	5.1
Capital	5,009	3,617	-3.9
Overall Balance	-340	-2,580	-6.3

(in millions of US dollars)

Overall Balance			-121
Potential Financing			121
Government deposits			134.0
Domestic debt			-23.3
Net foreign disbursements			15.3
Other financing			-5.1
Memorandum			
Nominal GDP (billions maloti)	39.2	35.3	-3.9

Source: Staff Estimates.

Note: Other financing includes repayment of domestic arrears and amortization of the previous IMF ECF loan.

Text Table 2. Balance of Payments Financing Gap
(In millions of U.S. dollars)

	FY20/21		Change
	Pre-COVID	Post-COVID	
Current account	-121	-254	-132
Trade and service	-1344	-1054	290
Primary income	478	217	-261
Secondary income	745	583	-162
Capital account	230	86	-144
Financial account	-28	39	67
Foreign direct investment	40	10	-30
Portfolio investment	-2	-2	1
Other investment	-65	31	96
Overall Balance	81	-129	-209
Residual BOP financing needs	0	-129	-129
(In percent of GDP)	...	-6.7	...
Potential financing	...	129	...
IMF(RCF/RFI)	...	48	...
DSSI	...	6	...
World Bank COVID-19 EPRP	...	8	...
International reserves ("-" increase)	...	31	...
Unidentified support	...	37	...

Source: IMF staff estimates.

7. Beyond 2020, the recovery will likely be gradual with risks tilted towards the downside. Assuming the virus will be contained domestically by FY 2021/22, the pace of recovery in South Africa and the US, which is expected to be gradual, will be a key determinant of Lesotho's recovery. While major sectors will grow in FY 2021/22, with mining and textiles benefiting from recovering global demand and supply chains, and activity restarting on LHWP-II and delayed government capital projects, real GDP is not expected to exceed the FY 2019/20 level until FY2022/23. Furthermore, the current regional shock will transmit to future years through reductions in SACU transfers—the current sharp economic contraction in the SACU region is expected to substantially shrink the pool for the next two years, with downward corrections reflecting lower-than-anticipated regional imports. This will therefore add to the needed adjustment over the medium term, failing which there would be a renewal of reserve drawdowns, pressure to increase domestic debt, and a resumption of domestic payment arrears.

POLICY ISSUES

The authorities' immediate priority is to limit the impact of the pandemic and preserve macroeconomic stability. The authorities are cognizant that, given the lack of fiscal space and the need to preserve reserves, any response will require significant reallocation of spending within the existing budget as well as external financial support. Staff are assisting the authorities, alongside other development partners, to fine-tune and implement their response package.

A. Mobilize Resources and Reprioritize Spending to Protect Social and Economic Stability

8. The authorities have prepared a plan to respond to the health and economic consequences of the pandemic. An initial M700 million (about 2 percent of GDP) was allocated for the National Emergency Budget for COVID-19, to finance additional health care personnel, purchase of critical goods and services, logistics, security, and border management. In addition, the authorities are in the process of implementing a package of economic relief and social protection measures including the following:

- **Expanding social protection:** Existing cash transfers, such as the Child Grant Program will be topped-up. Public assistance will be expanded for 3 months, at a cost of M900 million, to add vulnerable groups such as children, elderly disabled, and those working in the informal sector. The authorities are providing a three-month stipend to industrial workers furloughed as a result of the COVID crisis.
- **Supporting food production:** M100 million in subsidies to support production and increase uptake of M100 million in matching grants.⁶

⁶ The grant will be administered by the Project Management Unit for an existing World Bank financed project for smallholder agricultural development, within the Ministry of Agriculture.

- **Supporting businesses:** The authorities intend to clear M800 millions of arrears to MSMEs (LOI ¶15), while negotiating payment schedules with large firms. They are expanding credit guarantee facilities by M450 million, while shifting risk exposure towards the government and loosening collateral requirements. They are also offering grants and rent subsidies to MSMEs and rent holidays to firms renting from the Lesotho National Development Corporation and local and municipal governments.
- **Tax relief measures:** The Lesotho Revenue Agency will defer CIT for the first two quarters for all businesses and provide tax deferrals for the Pay as You Earn (PAYE), VAT, and Simplified Business Taxes for non-essential service providers.
- **Administrative relief measures:** The LRA will remit fees incurred as a result of the crisis and expedite the clearance of essential and COVID-19 relief related imports.

9. The authorities are reprogramming domestic expenditures and seeking external support. With political uncertainties having delayed the passage of the budget for several months, the constitutional provisions allowing government expenditures were expiring. The new government therefore decided to move ahead quickly with the pre-COVID budget in June with only a few changes to take account of new circumstances, on the understanding that it would be reviewed later to ensure prioritization of COVID-related expenditures. To free resources to fight the pandemic and mitigate its consequences, the authorities are delaying spending through the issuance of warrants under the budgeted amounts for non-priority development projects and goods and services. This will save close to 5 percent of GDP compared to the budget.⁷ In addition, the government has obtained \$US7.5 million in rapid financing from the World Bank for urgent COVID-related expenditures and are discussing potential budgetary support for the Bank's next fiscal year.⁸ The authorities are requesting debt service suspension from official bilateral creditors in line with the term sheet in the April 15, 2020 Communiqué of the G20 Finance Ministers and Central Bank Governors (LOI, ¶19), and have committed to use the resulting space for COVID-related spending. Preliminary estimates suggest that the available support, together with reprioritization, should be enough to fill the fiscal financing gap this year, coming as it does in the context of temporarily elevated SACU revenues. However, in the event that financing, or revenues, fall short, the authorities are committed to releasing expenditure warrants on a monthly basis to ensure that spending aligns with available financing (LOI ¶11).

10. The authorities are committed to enhancing budget transparency and accountability. They have committed to consistent reporting on budget implementation through a quarterly budget outturn document, including a full accounting of all COVID-related expenditures. Internal

⁷ Staff have recommended passing a revised budget rather than attempting to use warrants and virements to reallocate resources. The authorities noted that this is an option if their current approach proves overly problematic. However, they highlighted that in recent months the use of warrants has proved effective in restraining expenditures, and that reopening budget discussions would require an extensive consultation process among the new coalition, impeding the government's ability to respond in a timely manner to the ongoing emergency.

⁸ Starting July 1.

audits will be conducted of the spending on a quarterly basis, with ex-post audit by the Auditor General which will be submitted to the Ministry of Finance and the Public Accounts Committee of Parliament. To ensure enhanced transparency and accountability of COVID-19 related spending, the government will also publish COVID-related procurement documentation (including tenders, bids, and names of awarded companies and their beneficial ownership) on their website.

11. Ensuring long-term fiscal sustainability remains fundamental, and is subject to downside risks. With SACU revenues set to decline significantly once again next year, medium-term adjustment will be needed to preserve fiscal and debt sustainability. On revenues, the authorities plan to introduce a levy on alcohol and tobacco, and the diamond tax regime can be updated to ensure it aligns with international best practice. However, with revenues already high and the private sector weak, the bulk of the adjustment will need to come from the expenditure side. Lesotho's government wage bill, already among the highest in the world, is set to increase by around 8 percent in real terms this fiscal year, reflecting previously-agreed wage increases, and will have to be addressed notwithstanding elections in 2022. The degree of adjustment needed will also depend on the severity of the COVID crisis, whose extent is not yet certain.

12. The authorities have begun setting out plan for post-pandemic adjustment, and announced their intention to seek Fund support in this regard. Staff and the authorities agree on the need to reduce the wage-to-GDP ratio over the medium term, which can be achieved through a combination of wage restraint, removing ghost workers, and reviewing the number of positions, without undermining service delivery.⁹ The authorities are also committed to implementing other expenditure measures, such as reducing travel and per diems, rationalizing foreign representation costs, and examining the returns from investment spending more cautiously, in order to provide additional savings while minimizing the impact on growth and the vulnerable. Strengthening PFM, in particular expenditure controls, would support adjustment measures, while more careful prioritization of investment spending could help support growth as the economy recovers. These measures will also help to strengthen governance and reduce the scope for misuse of public resources. The new government understands the need to build consensus for these reforms, including through demonstrating improved service delivery and such measures as a declaration of assets by Ministers and senior civil servants. The authorities have also announced their intention to seek Fund support for a program to achieve this adjustment (LOI ¶13).

13. Reflecting this envisaged adjustment, Lesotho's public debt is expected to remain sustainable in the medium term and the risk of debt distress remains moderate (see DSA). Public debt is projected to exceed 60 percent of GDP this year due to weaker GDP growth, the depreciation of the exchange rate, and the additional take up of debt in the near term as the deficit widens. Public debt is expected to rise slightly over the next two years, reflecting higher levels of domestic debt and concessional borrowing needed to partially offset the decline in SACU revenues, before falling gradually over the medium term as expenditure consolidation takes hold.

⁹ Limiting wage increases to 2.5 percent per year for the next four years, for example, would reduce the wage-to-GDP ratio by 2½ percent of GDP.

B. Safeguard the Peg and Maintain Macro-financial Stability

14. The CBL has acted to maintain macroeconomic stability while seeking to contain the effects of the shock. The CBL has noted that preserving adequate reserves to guarantee the peg is of paramount importance, given the fixed exchange rate's role as the key anchor of macroeconomic stability. Within those constraints, they are taking measures to support the economy, following the SARB to cut the policy rate from 6.25 to 3.75 percent. They have postponed the implementation of Basel II.5 and the associated rise in capital requirements to allow banks to increase their balance sheets and prevent deleveraging, and are temporarily allowing banks to apply for relaxed large exposure limits if the demand arises. Commercial banks have been encouraged to consider relief measures on a case by case basis, including payment holidays of up to three months, for previously performing borrowers affected by the COVID crisis, and have instructed they maintain the same classification and provisioning for the affected loans during the holiday period. Insurance companies have been directed to offer three-month premium holidays, continue claims processing, and allow three-month delay in policy renewals. The CBL has also encouraged the use of mobile money, including negotiating fee reductions with mobile network operators and raising prudential limits on transactions.

15. The CBL is faced with the challenge of balancing efforts to protect the real sector during the pandemic while maintaining the health of the financial system. Staff agreed with the authorities on the need to consider the tools at their disposal to ensure sufficient system-wide liquidity, including by adjusting reserve requirements and using other mechanisms to provide liquidity to banks as needed. The CBL is also continuing to monitor the impact of the pandemic on loan performance, encouraging banks to work on prudent extension of loan terms to struggling borrowers on a targeted and time-bound basis. Flexibility and pragmatism should be used in applying existing regulations in the current context. It was agreed that monetary policy conditions may be made more accommodative as the SARB continues to ease financial conditions in the region.

ACCESS AND CAPACITY TO REPAY THE FUND

16. The authorities are requesting a disbursement under the exogenous shock window of the RCF and a purchase under the standard window of the RFI equivalent to 50 percent of quota to be used for BOP support to help safeguard the peg. Staff believes the level of access is appropriate at this juncture, taking into account both the severity of the COVID crisis and the associated risks. The latter include political uncertainty and possible implementation risks: as evidenced, for example by previous difficulties in addressing the wage bill. This level of access would leave open the possibility of requesting additional support from the Fund in the coming months as the situation clarifies and the authorities' response is further elaborated. The financing also comes on top of a large one-off increase in SACU revenues this year that provides the fiscal space to accommodate the initial emergency spending needs. As Lesotho is a presumed blender, it draws on the RCF and RFI in a 1:2 ratio. The drawing would therefore be 16.7 percent of quota (SDR 11.66

million) under the RCF and 33.3 percent of quota (SDR 23.24 million) under the RFI. The authorities are also discussing significant financing arrangements from other development partners in the near term.

17. Lesotho meets the eligibility requirements for support under the RCF/RFI.

- As the result of the exogenous shock, Lesotho faces an urgent balance of payments need of around 6¾ percent of GDP, which, if not addressed, would result in immediate and severe economic disruption.
- It is not feasible to implement a UCT-quality Fund-supported program due to the urgent nature of the balance of payments need.
- The authorities have committed to implement policies aimed at addressing the balance of payments problems.

18. Lesotho continues to be assessed at moderate risk of debt distress and has sufficient capacity to repay the Fund (Table 8). The updated Debt Sustainability Analysis that incorporates the impact of the virus shows debt to be sustainable. Outstanding credit from the Fund, once the RCF disbursement and the RFI purchases have been made, will amount to 71.26 percent of quota, while obligations to the Fund would remain below 1.1 percent of government revenue and below 1.2 percent of exports of goods and services and 0.5 percent of GDP throughout the forecast horizon. While Lesotho faces substantial risks, its moderate risk of debt distress suggests that it would be able to repay the Fund even if some of these risks materialized.

19. The last safeguards assessment was carried out in 2012. The CBL has committed to provide Fund staff with the most recently completed external audit reports and to authorize the external auditors to hold discussions with staff. An update of the safeguards assessment will be conducted as soon as feasible, and before Executive Board approval of any subsequent arrangement.

STAFF APPRAISAL

20. The COVID-19 pandemic is having a severe impact on Lesotho, and the country faces urgent external and fiscal financing needs. The short-term economic outlook has deteriorated substantially as policies to contain the virus and a deteriorating external context takes its toll. Addressing the pandemic has created additional external financing needs of around 6¾ percent of GDP in 2020, while fiscal financing needs are expected to be met through a reprioritization of planned expenditures and additional financing from development partners.

21. Staff supports the authorities' immediate priorities to mitigate the impact of the pandemic and preserving macroeconomic stability.

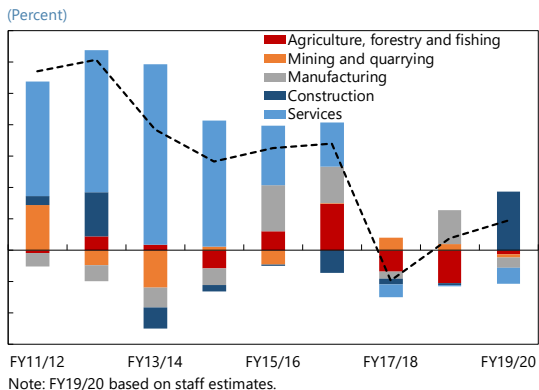
- **Fiscal policies.** The key priority is to meet all urgent health-related spending. Secondly, the authorities should ensure that fiscal policy cushions the most vulnerable from the effects the COVID-19 shock. A revised budget would be the preferred way to ensure these priorities are met, and staff encourage the authorities to pursue this option as the situation allows. Finally, the authorities will need to implement strong measures over the medium term to adjust to an environment of lower SACU revenues without falling back into domestic arrears. Careful prioritization of expenditures could deliver a growth-friendly consolidation while still protecting the vulnerable. In this regard, the medium-term measures set out in the LOI are a good foundation, and close engagement with the IMF through a Fund-supported program could help to further specify and implement the adjustment, as well as address any associated risks. However, steadfast implementation will also be key, and will require efforts to build a broad consensus on the necessity – and desirability - of reform.
- **Monetary and exchange rate policies, and financial sector supervision.** Monetary policy should remain focused on maintaining the peg to the Rand, the longtime anchor of macroeconomic stability. At the same time, the authorities should ensure sufficient liquidity to support economic activity. Regulators should also continue to monitor the impact of the pandemic on loan performance and work with banks to encourage extensions of loan maturities to struggling borrowers on a targeted and time-bound basis.

22. Staff supports the authorities' request for a disbursement under the RCF and RFI in the amount of SDR 34.9 million (50 percent of quota). A strong case for financing emerges from the expected severity of the impact of the pandemic, and the consequent urgent balance of payments needs. Staff support is also based on the authorities' policy commitments: the LOI has been approved by the Cabinet, evidencing high-level support for the short-term expenditure reprioritization, for the necessary medium term adjustment program, and for close engagement with the Fund to achieve these goals.

Figure 1. Lesotho: Recent Economic Developments

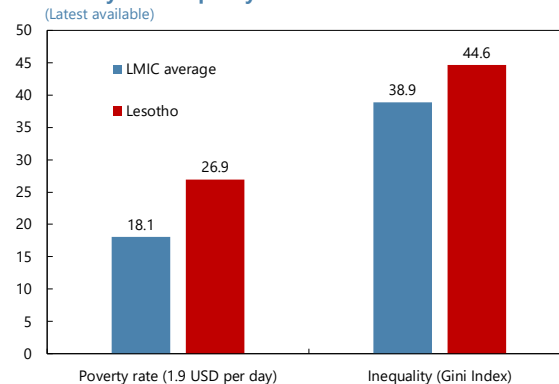
GDP growth had already slowed, with agriculture affected by drought and mining and manufacturing facing headwinds...

Sectoral Contributions to GDP Growth



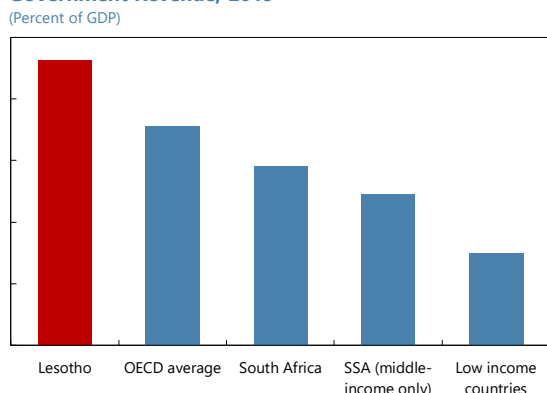
...so, despite some gains in the first decade of the century, poverty and inequality remain high.

Poverty and Inequality



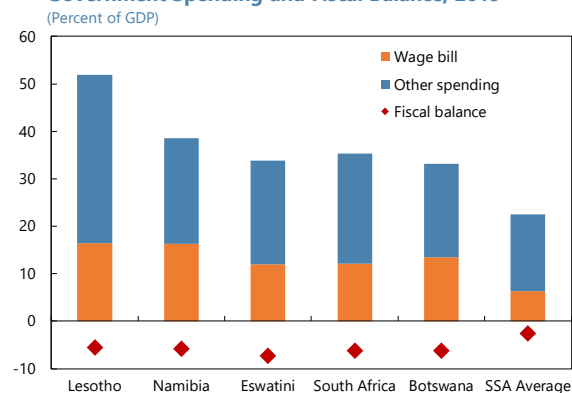
Despite substantial revenue...

Government Revenue, 2019



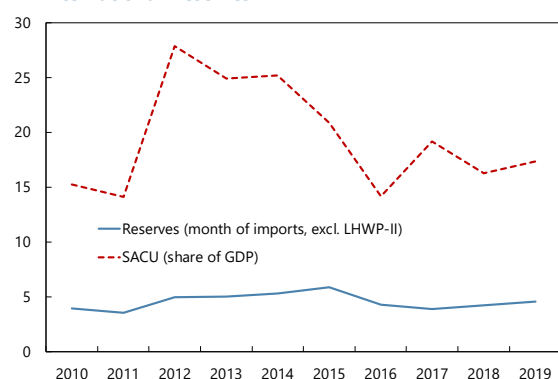
...higher expenditures have resulted in deficits and domestic payment arrears.

Government Spending and Fiscal Balance, 2019



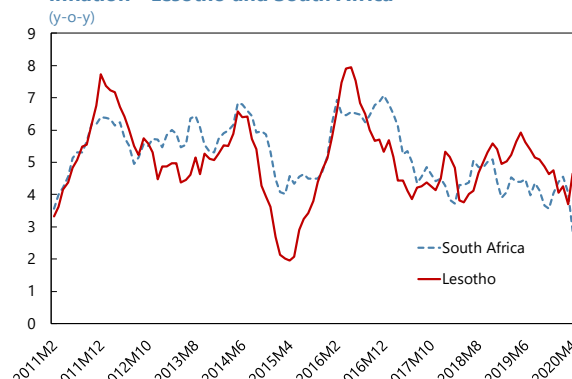
Adequate international reserves have been maintained, albeit at the expense of a build-up of domestic payment arrears in the context of declining SACU receipts...

International Reserves



... but the peg to the Rand has buttressed macroeconomic stability by ensuring low inflation.

Inflation - Lesotho and South Africa

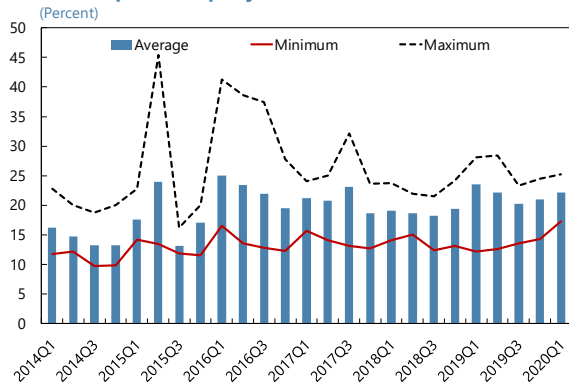


Sources: Lesotho authorities, World Economic Outlook, World Development Indicators, Stats SA, and staff estimates.

Figure 2. Lesotho: A Stable Banking Sector Facing Rising Vulnerabilities

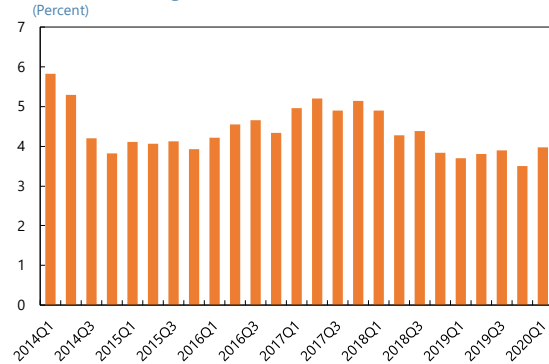
Lesotho's banks enter the COVID crisis with high capital, ...

Bank Capital Adequacy Ratio



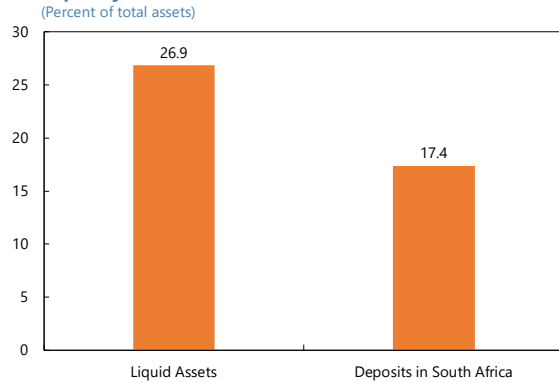
... low and stable NPLs...

Non-Performing Loans to Gross Loans



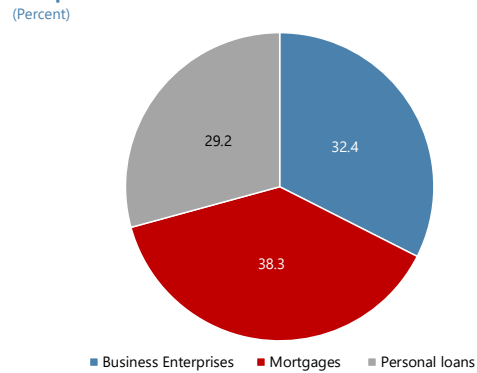
... and substantial local currency and Rand liquidity.

Liquidity



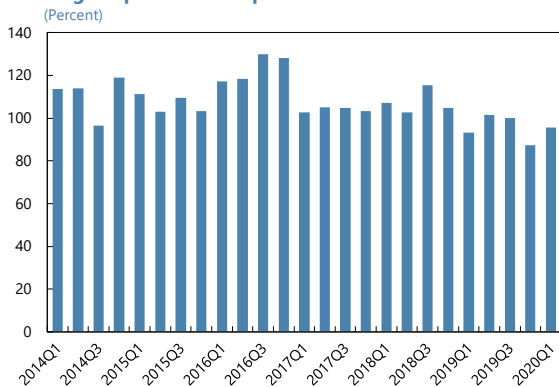
The impact of the crisis on NPLs will likely be mitigated by the high share of loans going to households, mainly to civil servants who will receive a raise.

Composition of NPLs



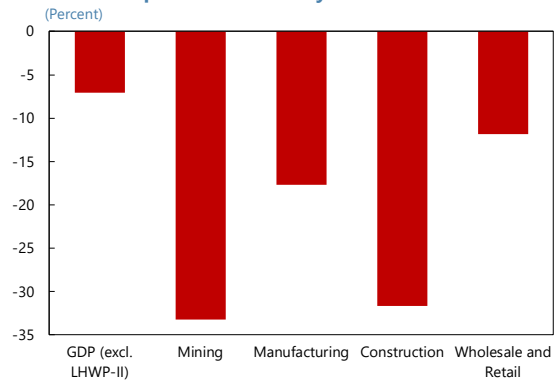
However, corporate lending is highly concentrated...

Large Exposures to Capital



... and major sectors will likely get hit hard by the pandemic.

Growth Impact of Covid-19 by Sector



Sources: Lesotho authorities and staff estimates.

Table 1. Lesotho: Selected Economic Indicators, 2018/19–2025/26¹

Population (1,000; 2016 est.)	2,204							
GNI per capita (U.S. dollars; 2016 est.):	1,270							
Poverty rate (percent, 2017 est.):	50							
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Act.	Est.	Projections					
	(12-month percent change, unless otherwise indicated)							
National account and prices								
GDP at constant prices	0.4	1.0	-4.8	3.9	4.3	3.7	1.7	2.1
GDP at constant prices (exc. LHWP-2 project)	0.2	-0.4	-4.1	3.1	2.7	2.7	3.8	3.7
GDP at market prices (billions Maloti)	34.0	35.9	35.3	38.4	42.1	45.9	49.1	52.7
GDP at market prices (billions US\$)	2.5	2.4	...	...	...	...	...	...
Consumer prices (average)	4.7	4.9	4.2	4.8	4.9	5.0	4.9	4.9
Consumer prices (eop)	5.2	4.0	4.5	5.0	4.9	4.9	4.9	4.9
GDP deflator	5.4	4.6	3.3	4.8	5.0	5.2	5.1	5.1
External sector								
Terms of trade (deterioration -)	-0.6	2.0	4.8	0.8	0.5	0.6	0.8	-3.3
Average exchange rate								
(Local currency per U.S. dollar)	13.8	14.8	...	...	...	...	...	...
Nominal effective exchange rate change (- = depreciation) ²	-0.1	-5.6	...	...	...	...	...	...
Real effective exchange rate (- = depreciation) ²	2.1	-2.9	...	...	...	...	...	...
Current account balance								
(Including official transfers, percent of GDP)	-1.3	-8.4	-13.3	-11.9	-21.0	-20.2	-10.8	-4.7
Current account (exc. LHWP-2 project, percent of GDP)	-0.1	-1.6	-9.2	-4.7	-6.9	-2.5	-1.8	-2.6
Gross international reserves								
(Months of imports, excluding imports for LHWP-2)	4.2	4.6	4.2	3.9	3.4	3.4	3.6	3.9
Domestic credit to the private sector								
Reserve money	-11.5	14.2	0.4	9.9	7.2	7.2	8.2	9.9
Broad money	5.5	7.2	0.5	8.9	6.5	7.5	8.4	9.1
Interest rate (percent) ³	6.8	...	...	...	...	...	...	...
	(in percent of GDP)							
Public debt								
External public debt	38.1	44.4	53.0	53.4	52.3	50.6	49.8	49.4
Domestic public debt	10.2	10.0	8.5	9.8	10.7	11.2	11.4	11.6
Central government fiscal operations								
Revenue and grants	47.4	46.3	50.0	44.4	42.1	46.3	47.4	48.4
<i>Of which: SACU revenue</i>	16.3	17.3	25.4	17.1	13.7	17.2	17.5	18.2
<i>Of which: grants</i>	4.0	3.5	3.1	3.1	3.0	3.0	2.9	2.9
Recurrent expenditure	39.1	37.7	47.0	40.5	39.0	37.5	37.5	37.3
<i>of which: wages, including social contributions</i>	17.6	16.4	18.9	18.3	17.3	16.1	15.8	15.5
Capital expenditure	12.5	14.2	10.2	11.8	10.5	9.2	9.8	10.6
Overall balance	-4.2	-5.6	-7.3	-7.9	-7.3	-0.4	0.1	0.5
(Excluding grants)	-8.2	-9.1	-10.4	-10.9	-10.4	-3.4	-2.9	-2.4
Non SACU primary balance	-19.2	-21.6	-31.3	-23.3	-19.2	-15.6	-15.4	-15.7
Statistical discrepancy/Arrears	2.8	0.7	-2.3	0.0	0.0	0.0	0.0	0.0

Sources: Lesotho authorities, World Bank, and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.² IMF Information Notice System trade-weighted; end of period.³ 12-month time deposits rate.

Table 2. Lesotho: Fiscal Operations of the Central Government, 2018/19–2025/26^{1,2}
(In millions of maloti)

	2018/19	2019/20	2020/21	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Act.	Est.	Budget						
				Projections					
Revenue	16,117	16,637	17,863	17,639	17,066	17,735	21,275	23,266	25,475
Tax revenue ³	7,438	7,505	5,959	6,110	7,521	8,640	9,789	10,862	11,784
Taxes on income, profits, and capital gain	4,100	4,052	3,275	3,344	4,009	4,594	5,177	5,731	6,278
Taxes on property	0	0	0	0	0	0	0	0	0
Taxes on goods and services	3,300	3,453	2,683	2,766	3,511	4,046	4,612	5,131	5,506
Taxes on international trade	38	0	0	0	0	0	0	0	0
Grants	1,373	1,256	1,108	1,100	1,177	1,267	1,361	1,439	1,527
Budget support	232	241	250	242	243	244	245	246	247
Project grants	1,141	1,015	858	858	934	1,023	1,116	1,193	1,280
Non-tax revenue	1,764	1,650	1,815	1,447	1,776	2,045	2,230	2,384	2,559
Property Income	682	532	477	349	580	635	692	740	794
Sales of goods and services	1,081	1,116	1,333	1,098	1,195	1,409	1,536	1,642	1,763
Other non-tax revenue	0	1	5	1	1	2	2	2	2
SACU	5,542	6,226	8,981	8,981	6,592	5,783	7,895	8,580	9,605
Expense	13,282	13,535	16,416	16,602	15,566	16,407	17,237	18,426	19,628
Compensation of employees	5,995	5,891	7,180	6,675	7,018	7,275	7,389	7,764	8,160
Wages and salaries	5,469	5,425	6,644	6,222	6,530	6,745	6,817	7,158	7,517
Social contributions	526	465	537	453	488	530	572	605	643
Use of goods and services	3,112	3,161	3,391	4,207	3,591	3,627	3,852	4,134	4,364
Interest payments	449	480	505	523	660	799	915	996	1,066
Domestic	219	252	222	224	324	437	520	568	613
External	230	227	283	299	336	362	395	428	453
Subsidies	340	346	1,068	541	489	535	534	570	612
Grants	1,022	1,133	1,119	1,114	1,213	1,329	1,449	1,549	1,662
Social benefits	1,734	1,687	2,201	2,660	1,895	2,076	2,264	2,520	2,805
Other expenses	630	837	952	883	699	766	835	893	958
Gross operating balance	2,835	3,101	1,447	1,036	1,500	1,328	4,038	4,839	5,847
Nonfinancial assets	4,254	5,111	5,605	3,617	4,528	4,421	4,216	4,803	5,583
Domestically financed	2,343	3,331	3,350	1,330	1,348	1,426	1,605	1,866	2,253
Externally financed	1,911	1,780	3,221	2,287	3,180	2,995	2,611	2,937	3,331
Financing gap	0	0	0	0	0	0	0	0	0
Net lending(+)/borrowing (-) (Overall fiscal balance)	-1,419	-2,009	-4,158	-2,580	-3,027	-3,093	-178	36	264
Transactions in financial assets and liabilities	-2,185	-2,251	-4,158	-2,580	-3,027	-3,093	-178	36	264
Financial assets	-560	-1,892	-3,219	-1,449	342	-19	1,098	1,468	1,988
Domestic	-560	-1,892	-3,219	-1,449	342	-19	1,098	1,468	1,988
Deposits	-586	-1,907	-3,219	-1,449	342	-19	1,098	1,468	1,988
Central bank	-586	-45	-3,197	-1,449	342	-19	1,098	1,468	1,988
Commercial banks	1	-1,862	-22	0	0	0	0	0	0
Loans	26	15	0	0	0	0	0	0	0
Financial liabilities	1,626	358	939	1,131	3,369	3,074	1,276	1,432	1,723
Domestic	1,310	139	-633	-550	600	600	600	500	500
of which: Change in domestic arrears	200	0	-800	-800	0	0	0	0	0
Foreign	316	220	1,572	1,681	2,769	2,474	676	932	1,223
Disbursements	770	764	2,057	2,363	3,472	3,191	1,495	1,744	2,050
of which: G20 DSSI	0	0	0	113	0	0	0	0	0
of which: World Bank COVID-19 EPRP	0	0	0	148	0	0	0	0	0
of which: unidentified financing	0	0	0	821	1,226	1,219	0	0	0
Amortization	-454	-545	-811	-681	-703	-718	-819	-812	-827
Statistical discrepancy	766	241	0	0	0	0	0	0	0

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.

² Data for 17/18 and 18/19 are presented on a modified cash basis to correctly reflect current year expenses.

³ Other taxes are not shown in the table.

Table 3. Lesotho: Fiscal Operations of the Central Government, 2018/19–2025/26^{1,2}
(Percent of GDP)

	2018/19	2019/20	2020/21	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Act	Est.	Budget	Projections					
Revenue	47.4	46.3	50.6	50.0	44.4	42.1	46.3	47.4	48.4
Tax revenue ³	21.9	20.9	16.9	17.3	19.6	20.5	21.3	22.1	22.4
Taxes on income, profits, and capital gain	12.1	11.3	9.3	9.5	10.4	10.9	11.3	11.7	11.9
Taxes on property	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on goods and services	9.7	9.6	7.6	7.8	9.1	9.6	10.0	10.5	10.5
Taxes on international trade	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	4.0	3.5	3.1	3.1	3.1	3.0	3.0	2.9	2.9
Budget Support	0.7	0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5
Project grants	3.4	2.8	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Non-tax revenue	5.2	4.6	5.1	4.1	4.6	4.9	4.9	4.9	4.9
Property income	2.0	1.5	1.4	1.0	1.5	1.5	1.5	1.5	1.5
Sales of goods and services	3.2	3.1	3.8	3.1	3.1	3.3	3.3	3.3	3.3
Other non-tax revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SACU	16.3	17.3	25.4	25.4	17.1	13.7	17.2	17.5	18.2
Expense	39.1	37.7	46.5	47.0	40.5	39.0	37.5	37.5	37.3
Compensation of employees	17.6	16.4	20.3	18.9	18.3	17.3	16.1	15.8	15.5
Wages and salaries	16.1	15.1	18.8	17.6	17.0	16.0	14.8	14.6	14.3
Social contributions	1.5	1.3	1.5	1.3	1.3	1.3	1.2	1.2	1.2
Use of goods and services	9.2	8.8	9.6	11.9	9.3	8.6	8.4	8.4	8.3
Interest payments	1.3	1.3	1.4	1.5	1.7	1.9	2.0	2.0	2.0
Domestic	0.6	0.7	0.6	0.6	0.8	1.0	1.1	1.2	1.2
External	0.7	0.6	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Subsidies	1.0	1.0	3.0	1.5	1.3	1.3	1.2	1.2	1.2
Grants	3.0	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Social benefits	5.1	4.7	6.2	7.5	4.9	4.9	4.9	5.1	5.3
Other expenses	1.9	2.3	2.7	2.5	1.8	1.8	1.8	1.8	1.8
Gross operating balance	8.3	8.6	4.1	2.9	3.9	3.2	8.8	9.9	11.1
Non-financial assets	12.5	14.2	15.9	10.2	11.8	10.5	9.2	9.8	10.6
Domestically financed	6.9	9.3	9.5	3.8	3.5	3.4	3.5	3.8	4.3
Externally financed	5.6	5.0	9.1	6.5	8.3	7.1	5.7	6.0	6.3
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending(+)/borrowing (-) (Overall fiscal balance)	-4.2	-5.6	-11.8	-7.3	-7.9	-7.3	-0.4	0.1	0.5
Transactions in financial assets and liabilities	-6.4	-6.3	-11.8	-7.3	-7.9	-7.3	-0.4	0.1	0.5
Financial assets	-1.6	-5.3	-9.1	-4.1	0.9	0.0	2.4	3.0	3.8
Domestic	-1.6	-5.3	-9.1	-4.1	0.9	0.0	2.4	3.0	3.8
Deposits	-1.7	-5.3	-9.1	-4.1	0.9	0.0	2.4	3.0	3.8
Central bank	-1.7	-0.1	-9.1	-4.1	0.9	0.0	2.4	3.0	3.8
Commercial banks	0.0	-5.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	4.8	1.0	2.7	3.2	8.8	7.3	2.8	2.9	3.3
Domestic	3.9	0.4	-1.8	-1.6	1.6	1.4	1.3	1.0	0.9
of which: Change in domestic arrears	0.6	0.0	-2.3	-2.3	0.0	0.0	0.0	0.0	0.0
Foreign	0.9	0.6	4.5	4.8	7.2	5.9	1.5	1.9	2.3
Disbursements	2.3	2.1	5.8	6.7	9.0	7.6	3.3	3.6	3.9
of which: G20 DSSI	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
of which: World Bank COVID-19 EPRP	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0
of which: unidentified financing	0.0	0.0	0.0	2.3	3.2	2.9	0.0	0.0	0.0
Amortization	2.3	2.1	-2.3	6.7	9.0	7.6	3.3	3.6	3.9
Statistical discrepancy	2.3	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Lesotho authorities and IMF staff estimates and

¹ The fiscal year runs from April 1 to March 31.

² Data for 17/18 and 18/19 are presented on a modified cash basis to correctly reflect current year expenses.

³ Other taxes are not shown in the table.

Table 4. Lesotho: Monetary Accounts, 2018/19–2023/24^{1,2}
(Maloti millions, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Act.	Act.		Projections		
I. Monetary Survey						
Net foreign assets	15,116	16,174	15,020	14,820	14,067	15,076
Central bank	10,393	11,575	10,671	10,750	10,318	11,691
Commercial banks	4,724	4,599	4,349	4,069	3,749	3,384
Net domestic assets	-3,899	-4,148	-2,935	-1,663	-51	-2
Claims on central government (net)	-2,233	-2,095	-848	-1,321	-1,302	-2,399
Central bank	-2,259	-2,327	-1,080	-1,553	-1,534	-2,632
Commercial banks	26	233	233	232	232	232
Claims on private sector	6,817	7,363	7,296	8,380	9,327	10,302
Other items (net)	-8,687	-9,669	-9,981	-9,374	-8,790	-8,882
Broad money (M2)	11,217	12,026	12,085	13,157	14,016	15,074
Currency outside banks	1,014	1,170	1,180	1,285	1,369	1,472
Deposits	10,203	10,856	10,905	11,872	12,647	13,602
II. Central Bank						
Net foreign assets	10,393	11,575	10,671	10,750	10,318	11,691
Gross reserves	11,362	12,601	12,399	12,285	11,794	13,205
Net domestic assets	-8,614	-9,543	-8,630	-8,507	-7,914	-9,113
Claims on central government (net)	-2,259	-2,327	-1,080	-1,553	-1,534	-2,632
Claims on private sector	100	107	105	114	125	136
Other items (net) ²	-6,455	-7,323	-7,655	-7,068	-6,505	-6,618
Reserve money	1,779	2,032	2,040	2,243	2,404	2,578
Currency in circulation	1,272	1,451	1,464	1,593	1,697	1,826
Commercial bank deposits	453	537	577	649	706	752
Liabilities to other sectors	0	0	0	0	0	0
<i>Memorandum items:</i>	(12-month percent change, unless otherwise indicated)					
Reserve money	-11.5	14.2	0.4	9.9	7.2	7.2
Broad money	5.5	7.2	0.5	8.9	6.5	7.5
Narrow money (M1)	-6.9	3.5	0.9	8.9	6.5	7.5
Narrow money (M1) (Maloti millions)	4,954	5,128	5,171	5,630	5,998	6,450
Credit to the private sector	7.7	8.0	-0.9	14.9	11.3	10.5
Credit to the private sector (percent of GDP)	20.0	20.5	20.7	21.8	22.2	22.4
Velocity (GDP/broad money)	3.0	3.0	2.9	2.9	3.0	3.0

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.

² Including valuation changes.

Table 5. Lesotho: Balance of Payments, 2018/19–2025/26¹
(US\$ millions, unless otherwise indicated)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Act.	Projections						
Current account	-33	-203	-254	-252	-514	-537	-300	-136
Trade balance	-701	-768	-743	-720	-929	-1,048	-982	-926
Exports, f.o.b.	1,126	1,128	800	987	1,117	1,170	1,262	1,331
Imports, f.o.b.	1,827	1,896	1,543	1,707	2,046	2,218	2,244	2,257
Services (net)	-435	-433	-311	-379	-488	-630	-584	-515
Primary income (net)	534	455	217	386	437	523	599	607
Secondary income (net)	570	543	583	461	467	617	667	698
Official transfers	434	447	502	383	356	478	516	540
<i>Of which:</i> SACU revenue	403	421	485	364	336	457	484	528
Other transfers	136	96	81	78	110	139	151	158
Capital account	41	227	86	159	400	564	330	173
Financial account	-39	64	39	44	42	37	52	73
Foreign direct investment	37	37	10	21	22	24	25	27
Portfolio investment	-2	-2	-2	-2	-2	-2	-2	-2
Other investment	-75	29	31	26	22	14	29	48
<i>Of which:</i>								
Public sector (net)	21	4	41	74	62	36	53	66
Disbursements	56	52	91	124	115	87	98	113
Amortization	-35	-48	-50	-50	-52	-50	-46	-47
Errors and omissions	122	0	0	0	0	0	0	0
Overall balance	92	88	-129	-49	-72	64	83	109
Financing	-92	-88	129	49	72	-64	-83	-109
Change in reserve assets (- increase)	-92	-88	31	-19	1	-64	-83	-109
RCF/RFI	0	0	48	0	0	0	0	0
DSSI	0	0	6	0	0	0	0	0
World Bank COVID-19 EPRP	0	0	8	...	...	...	...	...
Unidentified financing sources	0	0	37	68	71	0	0	0
Memorandum items:								
Nominal GDP (millions of Maloti)	34,003	35,900	35,309	38,440	42,104	45,914	49,087	52,675
Nominal GDP (millions of USD)	2,472	2,428	...	...	...	...	...	...
Gross international reserves								
(US\$ millions)	784	705	674	693	692	755	838	947
(Months of imports)	3.91	4.40	3.89	3.34	2.84	3.12	3.53	3.84
(Months of imports, excluding imports for LHWP-2)	4.20	4.59	4.19	3.86	3.40	3.42	3.61	3.86
National currency per US\$	13.8	14.8	...	...	...	...	...	...
	(In percent of GDP)							
Current account	-1.3	-8.4	-13.3	-11.9	-21.0	-20.2	-10.8	-4.7
Current account (exc. LHWP-2 project)	-0.1	-1.6	-9.2	-4.7	-6.9	-2.5	-1.8	-2.6
Trade Balance	-28.4	-31.6	-39.0	-33.9	-38.0	-39.4	-35.5	-32.0
Current and capital account	0.4	1.0	-8.8	-4.4	-4.7	1.0	1.1	1.3
Official transfers	17.6	18.4	26.3	18.0	14.6	18.0	18.6	18.6
	(12-month percent change)							
Exports of goods and services								
Percent change (Maloti terms)	5.8	7.7	-13.2	23.3	7.7	5.3	10.5	8.2
Percent change (\$US terms)	-0.4	0.2	-30.7	26.3	13.2	4.9	7.7	5.5
Imports of goods and services								
Percent change (Maloti terms)	0.5	10.6	-1.4	11.1	15.6	12.8	1.9	0.6
Percent change (\$US terms)	-5.2	2.9	-21.3	13.8	21.4	12.3	-0.7	-1.9
Imports of goods and services (excl. LHWP)								
Percent change (Maloti terms)	-0.1	4.3	1.6	7.7	7.7	8.9	11.2	7.8
Percent change (\$US terms)	-5.7	-3.4	-18.8	10.3	13.2	8.5	8.4	5.1

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.

Table 6. Lesotho: Financial Soundness Indicators, 2014–19
(End of period, percent)

	2014	2015	2016	2017	2018	2019
	(In percent)					
Core FSIs						
Regulatory capital to risk weighted assets	13.1	16.1	18.9	17.8	17.9	19.4
Regulatory Tier 1 capital to risk-weighted assets	12.2	14.4	17.2	20.9	20.2	21.7
Non-performing loans net of provisions to capital	5.5	6.5	5.8	6.4	5.8	4.7
Non-performing loans to total gross loans	3.8	3.9	3.7	4.4	3.7	3.3
Return on assets	3.1	3.4	3.3	2.4	3.4	3.1
Return on equity	31.4	33.6	28.4	18.0	28.6	24.8
Interest margin to gross income	58.3	58.3	58.0	59.6	60.4	58.5
Non-interest expenses to gross income	52.3	52.8	54.7	62.2	60.7	58.0
Liquid assets to total assets	41.9	40.4	31.9	36.3	36.1	22.6
Liquid assets to short-term liabilities	59.8	62.9	47.3	52.8	52.9	34.0
Net open position in FX to capital	5.5	14.4	31.9	24.6	23.6	28.3
Sectoral distribution of loans						
Domestic residents	100.0	100.0	100.0	100.0	100.0	100.0
Deposit takers	0.2	0.0	0.0	0.0	0.0	0.0
Central bank	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	0.0	0.5	0.5	0.4	1.9	1.0
General government	0.0	0.0	0.0	0.0	0.0	0.5
Nonfinancial corporations	40.0	39.1	35.0	36.3	30.8	29.8
Households	59.7	60.4	64.4	63.4	67.3	68.7
Nonresidents	0.0	0.0	0.0	0.0	0.0	0.0
Additional FSIs						
Capital to assets (leverage ratio)	12.6	10.9	11.9	11.1	11.5	12.6
Large exposures to capital	182.8	124.4	107.1	80.7	82.1	83.0
Gross assets position in derivatives to capital	0.3	0.8	1.6	4.6	0.2	9.5
Gross liabilities position in derivatives to capital	3.7	6.7	0.1	0.3	3.4	0.1
Trading income to total income	4.8	4.6	3.6	3.1	3.8	3.9
Personnel expenses to total income	52.1	49.5	48.9	46.1	46.1	49.6
Customer deposits to total non-interbank loans	172.9	163.6	154.6	184.6	179.8	170.7
FX loans to total loans	0.0	0.0	0.0	0.0	0.0	0.0
FX liabilities to total liabilities	0.0	0.1	0.1	0.3	0.0	0.0

Source: IMF Financial Soundness Indicators.

Table 7. Lesotho: External Financing Requirements and Sources, 2020/21–2022/23¹
(US\$ millions unless otherwise indicated)

	2020/21	2021/22	2022/23
1. Gross Financing Requirements	315	352	609
Current account deficit (excl. budget support)	267	265	528
Debt amortization	50	50	52
Other flows ²	-1	37	29
2. Available Financing	186	303	537
Capital account inflows (incl. LHWP2 project)	86	159	400
Foreign direct investment	10	21	22
Debt disbursements	91	124	115
3. Financing gap	129	49	72
Changes of gross reserves("-" increase)	31	-19	1
IMF RCF/RFI	48	0	0
DSSI	6	0	0
World Bank COVID-19 EPRP	8		
Remaining financing gap ³	37	68	71

Sources: Lesotho authorities and IMF staff estimates and projections.

1/ The fiscal year runs from April 1 to March 31.

2/ Including repayment to the Fund.

3/ Expected to be covered with budget support from multilateral creditors.

Table 8. Lesotho: Indicators of Capacity to Repay the Fund

Fiscal year 1/	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Fund obligations based on existing credit											
Principal	4.3	8.0	5.4	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.01	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02
Fund obligations based on existing and prospective credit											
Principal	4.3	8.0	5.4	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.20	0.27	0.27	0.27	0.19	0.06	0.02	0.02	0.02	0.02	0.02
Total obligations based on existing and prospective credit											
Millions of SDRs	5.8	8.3	5.7	7.8	11.8	7.0	2.3	2.3	2.3	2.3	1.2
Millions of Maloti	130.8	189.9	124.7	171.9	268.1	164.5	56.4	58.1	59.8	61.5	31.9
Percent of exports of goods and services	0.9	1.1	0.6	0.8	1.2	0.6	0.2	0.2	0.2	0.2	0.1
Percent of debt service	6.7	9.2	6.7	7.6	11.8	7.2	1.3	1.9	1.6	1.7	0.8
Percent of GDP	0.4	0.5	0.3	0.4	0.5	0.3	0.1	0.1	0.1	0.1	0.0
Percent of government revenue	0.7	1.0	0.7	0.8	1.1	0.7	0.2	0.2	0.2	0.2	0.1
Percent of quota	8.4	11.8	8.1	11.1	16.9	10.1	3.4	3.4	3.4	3.4	1.7
Outstanding IMF credit based on existing and prospective drawings											
Millions of SDRs	50.0	42.0	36.6	32.0	20.4	11.7	9.3	7.0	4.7	2.3	0.0
Millions of Maloti	1,119.8	967.2	804.8	708.1	463.9	273.1	224.9	173.7	119.0	61.2	0.0
Percent of exports of goods and services	7.5	5.4	4.2	3.3	2.0	1.1	0.8	0.5	0.3	0.2	0.0
Percent of debt service	57.5	46.7	42.9	31.4	20.4	12.0	5.3	5.6	3.1	1.7	0.0
Percent of GDP	3.1	2.5	1.9	1.5	0.9	0.5	0.4	0.3	0.2	0.1	0.0
Percent of government revenue	6.0	5.1	4.2	3.2	2.0	1.1	0.9	0.7	0.4	0.2	0.0
Percent of quota	71.6	60.2	52.4	45.8	29.2	16.7	13.4	10.0	6.7	3.3	0.0
Net use of IMF credit (millions of SDRs)											
Disbursements	34.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	4.3	8.0	5.4	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Exports of goods and services	14,909	17,889	19,392	21,433	23,028	25,442	28,504	31,865	35,653	39,834	44,450
Debt service	1,949	2,073	1,875	2,257	2,275	2,282	4,261	3,124	3,836	3,672	4,091
Nominal GDP (at market prices)	36,231	39,318	42,672	46,844	49,689	52,785	56,851	61,231	65,948	71,029	76,501
Government revenue	18,602	18,901	19,112	22,240	23,498	25,139	24,673	26,574	28,622	30,827	33,201
Quota (millions of SDRs)	69.8	69.8	69.8	69.8	69.8	69.8	69.8	69.8	69.8	69.8	69.8
1/ The fiscal year runs from April 1 to March 31.											
Source: IMF staff estimates and projections.											

Appendix I. Letter of Intent

Maseru, Lesotho

July 16, 2020

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Managing Director,

1. The COVID-19 pandemic is already having a significant impact on the economy of the Kingdom of Lesotho. Real GDP is expected to fall by several percentage points this year due to lower external demand, a sharp fall in remittances, and a decline in textile manufacturing production and diamond mining.
2. The government has established a COVID-19 Command Center to oversee a comprehensive set of responses and interventions, including buttressing the preparedness of the health sector and economic mitigation measures. Lesotho declared a state of emergency and adopted a range of containment measures, including social distancing, travel restrictions, closure of borders to all but essential goods, closure of schools, five-week lockdown of the country and suspension of some retail activities (e.g. gymnasiums, hair/beauty parlors, arcades, liquor stores, etc.).
3. The Central Bank of Lesotho (CBL) has also taken measures to alleviate the impact of the COVID-19 pandemic on the economy and the financial system. The CBL has lowered its policy rate by 250 basis points from 6.25 to 3.75 percent, while ensuring the Net International Reserves (NIR) are sufficient to buttress reserve coverage and maintain the peg between the Loti and the Rand under the Common Monetary Area (CMA) Agreement. Additional financial sector measures were also unveiled. For affected clients and for a three-month period, the CBL has directed banks to consider loan restructuring and payment holidays where appropriate, while insurance companies have been directed to accommodate those who cannot make premium payments. The implementation of Basel II.5 was postponed to avoid an increase in capital requirements affecting lending. Meanwhile, the CBL is continuing to assess the macroeconomic impact and formulating policy responses.
4. Our fiscal policy response will focus on reprogramming domestic expenditures and mobilizing additional external resources to help contain the pandemic, while mitigating its adverse economic and social consequences. We have set aside M700 million, about 2 percent of GDP, for the National COVID-19 Response Integrated Plan 2020, which will cover health care personnel, purchase of critical goods and services, logistics, security, and border management.

5. The government will also provide broader measures to support the livelihood of the population and economy via general private sector support, support to agriculture, social protection, monetary policy and support to financial sector. The total related costs, including the scaling up of transfers to the most vulnerable groups and the need for additional financing, are estimated to be M1.8 billion, including (i) M1.2 billion for food security and social protection, (ii) Revenue foregone due to tax exemptions and deferment, M75 million and (iii) additional support for SMEs totaling M500 million. We have made provision to repay M800 million in domestic arrears from previous years, which will provide much-needed liquidity for the private sector. We expect a large overall tax loss of around M2.2 billion as a result of the economic impact of the crisis compared to the previously budgeted amount.

6. While there is much uncertainty in the short term, Lesotho will undoubtedly suffer a severe contraction in economic activity this year. Based on these developments, we expect a widening BOP gap and escalating external financing needs at around 6¾ percent of GDP.

7. The FY20/21 deficit is expected to increase to exceed 7 percent of GDP from 5½ percent the previous fiscal year. Revenue excluding SACU receipts is expected to fall by M2.4 billion while additional expenditure is needed to address critical spending on health and social assistance to mitigate the impact on the most vulnerable sections of the population. Given this difficult situation, we intend to reprioritize spending within the existing budget to ensure that the essential COVID-related health and mitigation expenditures can be met.

8. To buttress our reserves in the face of the economic volatility, we request emergency financing from the IMF under the Rapid Credit Facility and the Rapid Financing Instrument (RCF/RFI) in the amount of SDR 34.9 million, equivalent to 50 percent of quota. We are confident that IMF assistance to Lesotho in coping with this global pandemic will be a catalyst in securing additional support from other IFIs and bilateral donors. We are also seeking other external support. We are discussing budgetary support from the World Bank, the European Union is providing 5.5 million Euro to support social transfers to vulnerable households affected by the crisis, and we are actively engaging with other partners for support (e.g., DFID, UN, US, PEPFAR, SADC, SACU, AU). We intend to use the RCF/RFI disbursement to help fill the projected BOP financing gap and strengthen the reserve position.

9. We intend to request debt service suspension from official bilateral creditors in line with the term sheet in the April 15, 2020 Communiqué of the G20 Finance Ministers and Central Bank Governors. We commit to spend the fiscal space released by that debt service suspension on COVID-19 related health or economic relief and to monitor and report on this. We commit to disclose the debt of public sector borrowing entities (as defined in 2014 Government Finance Statistics Manual) to the IMF and the World Bank within 3 months.

10. The government is committed to strengthen macroeconomic stability and lay the ground for sustainable and inclusive growth. We intend to continue implementing our National Strategic Development Plan, which envisages the private sector as the main driver of the economy, through further efforts to improve the business environment and tackling key bottlenecks to growth and job

creation. To further reduce poverty, we intend to enhance social programs that are having the greatest impact.

11. In the short-term, we are carefully managing cash by releasing warrants on a monthly basis to ensure that expenditure aligns with available financing and to avoid incurring new expenditure arrears. We will ensure that international reserves are maintained at a level judged by the CBL to be sufficient to maintain macroeconomic stability and safeguard the peg of the Loti to the Rand.

12. We understand that a significant fiscal adjustment will be required over the medium term, and that current expenditures will have to be brought into line with the available resources as SACU revenues decline. To that end, we intend to reduce recurrent expenditure by 9½ percent of GDP (including temporary COVID-related expenditures) over the medium term, which should be sufficient to place our debt on a sustainable trajectory and ensure the stability of our external position. The Government of the Kingdom of Lesotho is committed to undertake the following complementary measures to ensure a sustainable macroeconomic outlook:

- Institute COVID-related mitigation measures to protect the poor, vulnerable and affected sections of society while we allow economic activity to continue with caution and within safe margins with clear protocols and guidelines for safety.
- Review and adopt a new Public Service Employment Policy that aims to maintain a sufficiently lean, largely professional and highly efficient civil service while addressing the high wage-to-GDP ratio.
- The maintenance of a sufficiently lean and efficient administration by way of reduction and merging of some portfolio ministries, a process that has commenced, while improving governance of the public service.
- Review and rationalize the Foreign Mission Policy with the intention to reduce foreign representation costs.
- Enhance collection of student loans and review the model for granting educational loans to ensure efficiency and sustainability.
- Legislation of fiscal rules that will ensure sustainability of the fiscus.

13. We are wishing to reiterate our interest in exploring and pursuing a medium-term program with the IMF after the immediate crisis is resolved, with the intention to anchor the necessary adjustments and ensure sustainability.

14. The government is committed to enhance governance and transparency in the use of public resources. In this regard, we are committed to (i) publish quarterly reports on budget implementation, including specific budget lines accounting of expenditures for COVID-mitigation measures, (ii) having internal audit on a quarterly basis focusing on the COVID related expenditure, (iii) a full audit by the Auditor General of the revised FY2020/21 budget, including a targeted audit of COVID-19 related expenditure, with the results to be published and disseminated within 5 months after the end of the fiscal year, and (iv) publish, on the government's website, signed procurement contracts for crisis-mitigation spending, the names of the companies awarded these contracts and their beneficial owners, and ex-post validation of delivery. More broadly, we are

committed to submit the following bills to the parliament: (i) Anti-corruption Bill (the draft bill is complete), (ii) PFM Bill (at advanced stage), and (iii) and Procurement Bill.

15. The last safeguards assessment was carried out in 2012. The CBL has committed to provide Fund staff with the most recently completed external audit reports and to authorize the external auditors to hold discussions with staff. An update of the safe-guards assessment will be conducted before Executive Board approval of any subsequent arrangement. We do not intend to take measures that would compound our balance of payments difficulties, including introducing or intensifying restrictions on the making of payments and transfers for international transactions, trade restrictions, or multiple currency practices, or to enter into bilateral payments agreements which are inconsistent with Article VIII of the IMF's Articles of Agreement.

16. We authorize the IMF to publish this Letter of Intent and its Staff Report upon receipt of the request for disbursement under the RCF/RFI.

/s/

Thabo Sophonea
Minister
Ministry of Finance

/s/

Retselisitsoe Matlanyane
Governor
Central Bank of Lesotho



KINGDOM OF LESOTHO

July 17, 2020

REQUESTS FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY AND PURCHASE UNDER THE RAPID FINANCING INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By
D. Robinson (AFR), Bjoern Rother (SPR), and Marcello Estevão (IDA)

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	<i>Moderate</i>
Overall risk of debt distress	<i>Moderate</i>
Granularity in the risk rating	<i>Limited space</i>
Application of judgment	<i>No</i>

This DSA¹ assesses Lesotho's risk of external and overall debt distress at moderate despite the impact of the COVID shock, but risks to debt sustainability have risen since the last DSA.² The overall risk of debt distress is also assessed to be moderate. The moderate risk tool suggests limited space to absorb shocks. The results of the DSA highlight the rapid increase in debt levels over the past 3 years, particularly on the domestic side, as well as the impact of the large depreciation of the exchange rate against the US dollar in early 2020 and additional financing needed for COVID mitigation measures. The results also point to the importance of addressing financing shortfalls of the pension fund, building buffers to mitigate external shocks, and maintaining a conservative approach to debt contraction. Recent undersubscription of domestic debt auctions underscores the limited absorption capacity of domestic markets. Controlling current expenditure will be essential to reduce pressure to expand domestic issuance, restore external balances, and mitigate vulnerabilities. Finally, the authorities are encouraged to carefully vet new investment projects to ensure that new borrowing is productive.

¹ This DSA updates the previous Joint DSA from April 2019 (IMF Country Report No. 19/113). This DSA follows the Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-Income Countries (December 26, 2017).

² Lesotho's debt carrying capacity is assessed to be medium based on the composite indicator of 3.02 as described in this DSA.

PUBLIC DEBT COVERAGE

1. Lesotho's public debt data covers the central government, the central bank, and government-guaranteed debts. Debt coverage is similar to the previous DSA (Text Table 1). While coverage does not include extrabudgetary units such as the Road Fund, the contingent liability of the pension fund, estimated between 10 and 20 percent of GDP, is included in the contingent liability stress test. Increasing participant contributions would gradually reduce the unfunded liabilities. Guaranteed SOE debt is covered by debt data and preliminary estimates on non-guaranteed SOE debt are also included in the analysis. Guaranteed debt related to COVID stimulus measures are also included. Since those estimates are not comprehensive, another 2 percent of GDP is added to the contingent liability stress test. The contingent liability stress test also includes 5 percent of GDP for a financial market shock and 35 percent of the PPP capital stock, which is estimated to be 3.2 percent of GDP (Text Table 2). External debt is defined based on currency-criterion as there is no foreign holdings of local-currency debt. The authorities will begin publishing outstanding debt, including guarantees, of SOEs on the website of the Ministry of Finance in agreement with the World Bank under the Sustainable Development Financing Policy (SDFP).

Text Table 1. Lesotho: Coverage of Public Sector Debt and Design of the Contingent Liability Stress Test

Subsectors of the public sector		Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

Text Table 2. Lesotho: Summary of Shocks Used for the Contingent Liabilities Stress Test

	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	20.7	Contingent liabilities representing the funding shortfall of the civil service pension fund.
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2.0	
4 PPP	35 percent of PPP stock	1.1	Estimated value of PPP capital stock
5 Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5.0	
Total (2+3+4+5) (in percent of GDP)		28.8	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1). If it is already included in the government debt (1) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

Background

2. Lesotho's total public debt exceeded 50 percent of GDP in FY 2019/20 from 48 percent the previous year (Text Table 3).³ The increase was driven by new external and domestic borrowing, a sharp weakening of the rand to which the maloti is pegged, and revisions to national accounts data. Higher levels of domestic borrowing also reflect efforts by the authorities to finance larger deficits in recent years.

³ The fiscal year runs from April 1 to March 31.

External debt accounts for more than three-quarters of total debt and is largely owned to multilateral creditors on a concessional basis. The main creditor is the International Development Association (IDA) followed by the African Development Fund (ADF), the European Investment Bank (EIB), and the IMF. On the bilateral front, the main creditors are China and Kuwait.

Text Table 3. Lesotho: Stock of Outstanding Debt, 2014/15–2019/20

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	(in million USD)					
Domestic Debt	104	99	115	181	239	201
External Debt	825	841	849	899	894	891
Multilateral	692	709	727	780	758	757
IDA	273	292	295	331	344	364
ADF	167	167	159	165	166	166
EIB	102	95	127	135	108	101
IMF	68	70	65	61	49	34
Other	83	85	82	91	94	96
Bilateral	129	132	123	124	137	134
China EXIM Bank	57	54	50	49	63	62
Kuwait Fund	29	29	27	26	24	22
Saudi Fund	23	23	23	22	15	20
Abu Dhabi Fund	10	16	15	17	15	13
India EXIM Bank	7	6	6	5	5	4
Other	4	3	3	6	15	14
Commercial	5	0	0	0	0	0
Total	930	941	965	1,080	1,133	1,092
	(in percent of GDP)					
Domestic Debt	4.5	4.8	4.8	6.7	10.2	10.0
External Debt	36.0	40.4	35.3	33.2	38.1	44.4
Multilateral	30.2	34.1	30.2	28.8	32.3	37.7
IDA	11.9	14.0	12.3	12.2	14.7	18.1
ADF	7.3	8.0	6.6	6.1	7.1	8.3
EIB	4.4	4.6	5.3	5.0	4.6	5.0
IMF	3.0	3.4	2.7	2.3	2.1	1.7
Other	3.6	4.1	3.4	3.4	4.0	4.8
Bilateral	5.6	6.3	5.1	4.6	5.8	6.7
China EXIM Bank	2.5	2.6	2.1	1.8	2.7	3.1
Kuwait Fund	1.3	1.4	1.1	0.9	1.0	1.1
Saudi Fund	1.0	1.1	0.9	0.8	0.6	1.0
Abu Dhabi Fund	0.4	0.7	0.6	0.6	0.6	0.7
India EXIM Bank	0.3	0.3	0.2	0.2	0.2	0.2
Other	0.2	0.2	0.1	0.2	0.6	0.7
Commercial	0.2	0.0	0.0	0.0	0.0	0.0
Total	40.6	45.2	40.1	39.9	48.3	54.4

Source: Country authorities and staff estimates.

Note: Domestic Debt includes arrears and guarantees.

Assumptions

3. The macroeconomic framework reflects the worsened outlook since the previous DSA (Text Table 4). The framework underlying this DSA is the same as that included in the staff report of the 2020 RCF and RFI request which reflects recent global developments. The current macroeconomic framework reflects currently available information. However, updates with respect to economic impact and policy response to the COVID-19 crisis are rapidly evolving and risks are tilted to the downside. Despite the continued expansionary fiscal stance, real GDP growth for the medium term and long has fallen with respect to the

previous DSA, due to the COVID-19 crisis and weakened prospects for the main industrial sectors (mining and textile). Inflation projections are slightly lower in line with monetary policy developments in South Africa. A primary fiscal deficit of about 2 percent on average is expected for the medium term as lower SACU revenues and wage pressures prevent additional consolidation, contributing to the increase in public debt. Over the long run, the primary fiscal deficit is unchanged from the previous DSA. On the external sector, the LHWP-II project and lingering weakness in the export sectors from the COVID crisis lead to a current account deficit of around 13 percent of GDP in the medium term. The increase in debt levels with respect to the previous DSA reflects significant financing needs related to the COVID crisis, the higher levels of domestic issuances, and weaker exchange rate dynamics.

Text Table 4. Lesotho: Macroeconomic Assumptions

	2019 DSA 2018-23	2020 DSA 2019-24	2019 DSA 2024-38	2020 DSA 2025-39
Real GDP Growth (Percent)	2.5	1.8	2.9	3.7
Inflation (Percent)	5.5	4.8	5.5	4.9
Primary Deficit (Percent of GDP)	0.8	1.9	0.4	0.5
USD Export Growth (Percent)	6.5	4.5	6.3	6.8
USD Import Growth (Percent)	5.3	3.9	5.2	5.7
Non-interest Current Account Balance (Percent of GDP)	-9.6	-12.8	-2.7	-1.6
Net FDI (negative = outflow)	-1.6	-0.9	-1.7	-0.9
Grant element of new public sector borrowing (in percent)	26.9	32.1	20.8	21.1
External Debt (Percent of GDP)	35.7	51.4	34.5	45.6
Public Sector Debt (Percent of GDP)	50.2	61.9	51.0	52.0

Sources: IMF Country Report No. 19/113 and staffs estimates and projections.

4. External borrowing at concessional terms is expected to decline moderately, while remaining significant. As Lesotho grows and graduates from some concessional borrowing sources and the domestic market develops, concessional borrowing is expected to decline gradually over the long term. However, concessional external borrowing will remain critical for financing large investment projects. In line with the authorities' medium-term goals, the development of the domestic debt market is assumed to continue.

5. The realism of the macroeconomic framework is supported by several checks, although the unprecedented nature of the current crisis calls for caution in interpretation of these results (Figures 3 and 4). The path for external debt accumulation is steeper with respect to the previous DSA. The current account deficits and a methodological change to the compilation of remittances have been the main driver of unexpected changes in external debt over the past 5 years.⁴ Over the medium term, the current account deficit is expected to be financed with the support of South African capital transfers, in particular those financing the LHWP-II. More inflows are also anticipated on the back of green energy and other infrastructure projects. Unexpected changes in debt have not been significant over the past five years. GDP growth is expected to be boosted by LHWP-II-related construction. As LHWP-II is not accounted as

⁴ The authorities recently updated compensation of employee inflows in the primary income account. The revision increased inflows by roughly M2.5 billion per year (about 8 percent of GDP).

government capital spending, however, the contribution of government capital to real GDP growth is expected to remain low.⁵

Country Classification and Determination of Scenario Stress Tests

6. Lesotho has a medium debt carrying capacity (Text Table 5). Debt carrying capacity is determined by a composite indicator (CI) that includes the World Bank's Country Policy and Institutional Assessment score, global economic growth, Lesotho's real growth rate, import coverage of reserves, and remittances. The composite indicator for the October 2019 WEO and the World Bank's CPIA 2018 CPIA score yields a medium CI rating (3.02), as in the previous vintage.

7. Lesotho does not trigger other tailored stress tests. Apart from the contingent liability tailored shock described above, Lesotho's economic characteristics do not trigger any of the tailored stress tests on natural disasters, commodity prices, and/or market financing risk module.

Text Table 5. Lesotho: Debt Carrying Capacity

Debt Carrying Capacity and Thresholds				
Country	Lesotho			
Country Code	866			
Debt Carrying Capacity	Medium			
	Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
	Medium	Medium 3.02	Medium 2.99	Medium 2.94

Note: Until the April 2019 WEO vintage is released, the two previous vintages ago classification and corresponding score are based solely on the CPIA per the previous framework.

Applicable thresholds	
APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of Exports	180
GDP	40
Debt service in % of Exports	15
Revenue	18

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	55

Calculation of the CI Index				
Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.327	1.28	42%
Real growth rate (in percent)	2.719	2.296	0.06	2%
Import coverage of reserves (in percent)	4.052	33.406	1.35	45%
Import coverage of reserves*2 (in percent)	-3.990	11.159	-0.45	-19%
Remittances (in percent)	2.022	14.489	0.29	10%
World economic growth (in percent)	13.520	3.499	0.47	16%
CI Score			3.018	100%
CI rating				Medium

New framework		
	Cut-off values	
Weak	CI <	2.69
Medium	2.69 ≤ CI ≤	3.05
Strong	CI >	3.05

Reference: Thresholds by Classification				
EXTERNAL debt burden thresholds	Weak	Medium	Strong	
PV of debt in % of Exports	140	180	240	
GDP	30	40	55	
Debt service in % of Exports	10	15	21	
Revenue	14	18	23	

TOTAL public debt benchmark	Weak	Medium	Strong
PV of total public debt in percent of GDP	35	55	70

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

8. All external debt sustainability indicators remain below their corresponding thresholds in the baseline scenario (Tables 1 and 2, and Figure 1). The present value (PV) of PPG external debt-to-GDP is expected to reach close to the 40 percent threshold in FY 2020/21, about 10 percentage points higher than the 2019 DSA. Afterwards, it is expected to slowly decline as domestic borrowing expands and financing needs decline. The higher levels of external borrowing mainly reflect additional financing needs to address the COVID crisis, as well as the recent exchange rate depreciation. For example, the World Bank

⁵ The LHWP-II-related capital transfers also account for much of the large residuals in the external debt table (Table 2) in the medium term.

is discussing a Development Policy Operation in addition to a COVID health project. Lesotho is also participating in the debt services suspension initiative (DSSI) supported by the G-20 and Paris Club, which will save roughly \$6 million in debt service this year.⁶ This debt suspension is reflected in the macro framework and the DSA. All other indicators of external debt sustainability remain well below the thresholds.

9. Stress tests show that Lesotho's external debt vulnerabilities could emerge in the event of a realization of an export or contingent liabilities shock (Tables 3 and 4, and Figure 1). The PV threshold of PPG external debt-to-GDP would be breached if an export shock was realized and financed with external debt. In this scenario, servicing the current account deficit would increase the PV of debt-to-GDP by close to 20 percentage points with respect to the baseline by 2030. The threshold would also be breached in the event of growth shock, primary balance shock, and contingent liabilities shock. The PV of debt-to-exports and debt service to exports breach the indicative threshold under the export shock scenario as well. All other stress scenarios remain under the thresholds for these indicators.

Overall Risk of Public Debt Distress

10. All public debt sustainability indicators remain below their corresponding thresholds in the baseline scenario (Table 2 and Figure 2). The PV of public debt-to-GDP is expected to reach close to 50 percent in FY 2021/22, below the 55 percent threshold, before falling below 40 percent in the long run.

11. Lesotho's public debt is vulnerable to a potential growth shock. (Table 4 and Figure 2). The PV threshold of public debt-to-GDP will breach in the event of a shock to growth, whereby real GDP growth is set to its historical average minus one standard deviation for the second and third year after the projections begin. Under this stress test, the PV of debt-to-GDP would rise to around 80 percent by 2030. The historical scenario, whereby real GDP growth, primary balance-to-GDP ratio, GDP deflator, non-interest current account, and net FDI flows are set to their historical averages, would also breach the indicative threshold. The 55 percent threshold would also be breached under the contingent liability and export shock scenarios.

12. The mechanical signal for the overall risk of public debt distress is moderate. The moderate signal comes from three of the external debt indicators and the public debt indicator breaching the threshold under the stress scenario.

Risk Rating and Vulnerabilities

13. Lesotho's risk of external and public debt distress remains moderate, with limited space to absorb shocks (Figure 5). Notwithstanding the crisis, external and public debt and debt service indicators for the baseline remain below their respective thresholds, but shocks to contingent liabilities, growth, and exports lead to breaches. Moreover, given that the debt burden has risen significantly in recent years, the DSA results highlight the importance of a conservative debt management strategy focused on concessional sources wherever possible. Domestic debt issuance should be expanded cautiously and in line with the

⁶ The initiative provides a time-bound suspension of official bilateral debt service payments to IDA-eligible and least developed countries.

market's absorption capacity. The government will also need to address the pension fund's financing gap to ensure the sustainability of public sector financing. Ensuring sustainability in the post-COVID world will require strong efforts to control recurrent expenditure, particularly on the wage bill.

Authorities' Views

The authorities concurred with the DSA and the "moderate" risk rating, with limited space to borrow. In the context of additional financing needs amidst the COVID crisis, they acknowledged the need for additional external borrowing in the short term. However, they also noted that prudent debt management must continue in the medium term, in particular by pursuing financing with a significant grant element and that stronger capacity in the Cash Management Unit would support the forecasting of financing needs. Steps to curb the wage bill and other recurrent expenditures will also be needed to ensure debt sustainability. Finally, the authorities highlighted upcoming improvements to debt transparency in accordance with their participation in the World Bank's SDFP.

Table 1. Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2019–2040

(In percent of GDP, unless otherwise indicated)

	Actual										Projections										Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2040	Historical	Projections							
External debt (nominal) 1/	44.4	53.0	53.4	52.3	50.6	49.8	49.4	49.0	48.5	48.0	47.4	46.8	43.1	35.6	49.8							
of which: public and publicly guaranteed (PPG)	44.4	53.0	53.4	52.3	50.6	49.8	49.4	49.0	48.5	48.0	47.4	46.8	43.1	35.6	49.8							
Change in external debt	6.3	8.6	0.5	-1.1	-1.7	-0.7	-0.5	-0.4	-0.5	-0.5	-0.5	-0.6	-0.3									
Identified net debt-creating flows	7.5	15.5	9.0	18.1	17.5	9.1	2.8	0.6	-0.3	-0.4	-0.1	-0.1	1.2	3.6	6.5							
Non-interest current account deficit	7.7	12.5	11.0	20.1	19.4	9.9	3.8	2.4	1.5	1.4	1.6	1.6	2.5	6.0	7.7							
Deficit in balance of goods and services	49.5	55.3	51.7	58.0	63.2	56.5	49.7	45.0	44.0	43.5	42.5	41.8	39.6	52.9	50.1							
Exports	47.7	42.1	47.7	46.9	45.3	46.8	47.2	49.9	48.9	49.4	50.0	50.6	52.0									
Imports	97.2	97.4	99.5	104.9	108.5	103.4	96.9	94.9	92.9	92.9	92.5	92.4	91.6									
Net current transfers (negative = inflow)	-22.4	-30.6	-21.7	-19.1	-23.2	-24.1	-24.1	-22.7	-24.1	-24.1	-24.1	-24.1	-23.5	-27.6	-23.8							
of which: official	-18.4	-26.3	-18.0	-14.6	-18.0	-18.6	-18.6	-18.6	-18.6	-18.7	-18.7	-18.7	-18.3									
Other current account flows (negative = net inflow)	-19.4	-12.2	-19.1	-18.7	-20.6	-22.5	-21.8	-19.9	-18.5	-18.0	-16.8	-16.1	-13.6	-19.4	-18.6							
Net FDI (negative = inflow)	-1.5	-0.5	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-2.4	-0.9							
Endogenous debt dynamics 2/	1.3	3.6	-1.0	-1.1	-0.9	0.1	-0.1	-0.9	-0.9	-0.8	-0.8	-0.8	-0.4									
Contribution from nominal interest rate	0.7	0.8	0.9	0.9	0.9	0.9	0.9	0.8	0.9	0.9	0.9	0.9	1.1									
Contribution from real GDP growth	-0.4	2.7	-1.8	-2.0	-1.8	-0.8	-1.0	-1.7	-1.7	-1.7	-1.7	-1.7	-1.5									
Contribution from price and exchange rate changes	1.1	...	...	...	...	...	...	...	...	...	...	...	...
Residual 3/	-1.3	-6.9	-8.6	-19.2	-19.3	-9.8	-3.2	-1.0	-0.2	-0.1	-0.4	-0.5	-1.4	-2.3	-6.3							
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0									
Sustainability indicators																						
PV of PPG external debt-to-GDP ratio	27.3	39.3	39.5	37.8	36.1	35.8	35.7	35.8	35.7	35.6	35.5	35.3	35.1									
PV of PPG external debt-to-exports ratio	57.3	93.4	82.8	80.6	79.6	76.4	75.7	71.7	73.1	72.1	71.0	69.8	67.5									
PPG debt service-to-exports ratio	5.8	8.2	6.8	6.4	6.1	6.6	6.4	5.4	5.8	5.9	5.9	5.9	6.5									
PPG debt service-to-revenue ratio	6.5	7.4	7.8	7.7	6.4	7.0	6.7	6.5	6.8	7.1	7.1	7.2	8.1									
Gross external financing need (Million of U.S. dollars)	217.6	293.2	281.2	543.4	563.2	335.7	172.4	127.9	111.0	116.8	133.6	142.5	348.4									
Key macroeconomic assumptions																						
Real GDP growth (in percent)	1.0	-4.8	3.9	4.3	3.7	1.7	2.1	3.7	3.7	3.7	3.7	3.7	3.7	3.2	2.7							
GDP deflator in US dollar terms (change in percent)	-2.7	-17.6	7.4	10.3	4.8	2.5	2.5	2.3	2.3	2.3	2.3	2.3	2.3	-0.6	1.9							
Effective interest rate (percent) 4/	1.7	1.5	1.9	1.9	1.8	1.8	1.8	1.8	1.9	1.9	2.0	2.0	2.7	1.5	1.8							
Growth of exports of G&S (US dollar terms, in percent)	0.2	-30.7	26.3	13.2	4.9	7.7	5.5	12.2	4.0	7.3	7.3	7.4	6.3	4.3	5.9							
Growth of imports of G&S (US dollar terms, in percent)	2.9	-21.3	13.8	21.4	12.3	-0.7	-1.9	3.9	3.9	6.1	5.6	5.9	5.9	1.3	4.5							
Grant element of new public sector borrowing (in percent)	...	32.3	36.7	36.9	29.4	29.1	28.0	27.0	26.2	25.5	24.8	24.2	13.5	...	29.1							
Government revenues (excluding grants, in percent of GDP)	42.8	46.8	41.3	39.1	43.4	44.5	45.5	41.5	41.5	41.5	41.5	41.5	41.5	45.6	42.6							
Aid flows (in Million of US dollars) 5/	746.3	161.2	163.3	166.4	120.7	128.2	131.0	105.4	109.0	112.8	116.8	121.1	134.0									
Grant-equivalent financing (in percent of GDP) 6/	...	6.1	6.4	5.8	3.9	4.0	4.0	3.0	3.0	3.0	3.0	2.9	2.5	...	4.1							
Grant-equivalent financing (in percent of external financing) 6/	...	49.5	52.7	54.9	63.1	61.1	58.8	49.5	48.8	48.4	48.1	47.9	39.4	...	53.0							
Nominal GDP (Million of US dollars)	2,428	1,906	2,125	2,445	2,656	2,769	2,898	3,075	3,263	3,462	3,673	3,898	7,051									
Nominal dollar GDP growth	-1.8	-21.5	11.5	15.0	8.7	4.3	4.6	6.1	6.1	6.1	6.1	6.1	6.1	2.5	4.8							
Memorandum items:																						
PV of external debt 7/	27.3	39.3	39.5	37.8	36.1	35.8	35.7	35.8	35.7	35.6	35.5	35.3	35.1									
In percent of exports	57.3	93.4	82.8	80.6	79.6	76.4	75.7	71.7	73.1	72.1	71.0	69.8	67.5									
Total external debt service-to-exports ratio	5.8	8.2	6.8	6.4	6.1	6.6	6.4	5.4	5.8	5.9	5.9	5.9	6.5									
PV of PPG external debt (in Million of US dollars)	663.6	749.5	839.8	925.3	959.2	991.1	1035.5	1100.0	1166.2	1233.7	1304.4	1376.3	2478.0									
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	3.5	4.7	4.0	1.4	1.2	1.6	2.2	2.2	2.1	2.0	2.0	2.3									
Non-interest current account deficit that stabilizes debt ratio	1.4	3.9	10.5	21.3	21.1	10.7	4.3	2.8	1.9	1.9	2.2	2.2	2.8									

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)] / (1+g+p+g)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

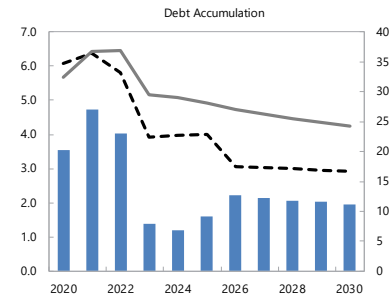
5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No



■ Debt Accumulation
 - - - Grant-equivalent financing (% of GDP)
 — Grant element of new borrowing (% right scale)

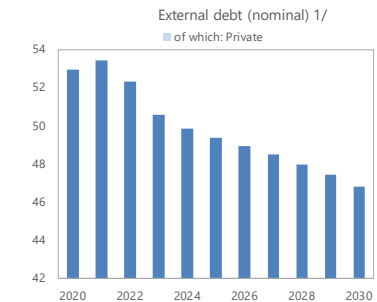


Table 2. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2020–2030
(In percent)

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of debt-to GDP ratio											
Baseline	39	40	38	36	36	36	36	36	36	36	35
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	39	38	29	18	13	14	16	20	25	30	35
B. Bound Tests											
B1. Real GDP growth	39	41	42	40	40	40	40	40	40	39	39
B2. Primary balance	39	42	43	41	41	41	40	42	42	41	41
B3. Exports	39	51	64	62	61	61	60	58	57	55	54
B4. Other flows 3/	39	44	47	45	45	44	44	44	43	42	42
B5. Depreciation	39	49	35	33	33	33	33	34	34	35	36
B6. Combination of B1-B5	39	55	52	50	50	49	49	48	47	47	46
C. Tailored Tests											
C1. Combined contingent liabilities	39	55	52	50	50	50	52	53	53	52	52
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	93	83	81	80	76	76	72	73	72	71	70
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	93	79	61	39	28	29	33	42	51	60	68
B. Bound Tests											
B1. Real GDP growth	93	83	81	80	76	76	72	73	72	71	70
B2. Primary balance	93	88	91	91	87	87	83	85	84	83	81
B3. Exports	93	143	223	220	212	210	196	194	187	179	172
B4. Other flows 3/	93	93	101	99	96	95	89	89	87	85	82
B5. Depreciation	93	83	60	59	56	56	53	56	56	56	56
B6. Combination of B1-B5	93	138	99	147	141	139	130	131	127	124	121
C. Tailored Tests											
C1. Combined contingent liabilities	93	114	111	110	107	106	103	108	107	105	103
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	8	7	6	6	7	6	5	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	8	7	7	7	7	6	5	4	4	4	4
B. Bound Tests											
B1. Real GDP growth	8	7	6	6	7	6	5	6	6	6	6
B2. Primary balance	8	7	7	6	7	7	6	7	7	7	7
B3. Exports	8	9	12	13	14	13	13	16	16	15	15
B4. Other flows 3/	8	7	7	7	7	6	7	7	7	7	7
B5. Depreciation	8	7	6	5	6	6	5	4	4	5	5
B6. Combination of B1-B5	8	9	11	10	11	10	10	11	11	11	10
C. Tailored Tests											
C1. Combined contingent liabilities	8	7	7	7	7	7	6	7	7	7	7
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	7	8	8	6	7	7	6	7	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	7	9	9	7	7	7	6	5	4	4	5
B. Bound Tests											
B1. Real GDP growth	7	8	9	7	8	7	7	8	8	8	8
B2. Primary balance	7	8	8	7	7	7	7	8	8	8	8
B3. Exports	7	8	9	8	9	9	10	12	12	11	11
B4. Other flows 3/	7	8	8	7	8	7	8	9	9	9	9
B5. Depreciation	7	10	10	7	8	8	7	6	7	7	7
B6. Combination of B1-B5	7	8	10	8	8	8	9	9	10	10	10
C. Tailored Tests											
C1. Combined contingent liabilities	7	8	9	7	8	8	7	8	8	8	8
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

Table 3. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–2040
(In percent of GDP, unless otherwise indicated)

	Actual													Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2040	Historical	Projections
Public sector debt 1/	54.4	61.4	63.2	63.0	61.7	61.2	61.0	59.7	58.5	57.3	56.1	54.9	45.4	41.7	59.8
of which: external debt	44.4	53.0	53.4	52.3	50.6	49.8	49.4	49.0	48.5	48.0	47.4	46.8	43.1	35.6	49.8
Change in public sector debt	6.1	7.0	1.8	-0.2	-1.3	-0.5	-0.3	-1.2	-1.2	-1.2	-1.2	-1.2	-0.8		
Identified debt-creating flows	11.7	9.4	4.5	3.4	-3.3	-2.5	-3.2	-1.1	-1.1	-1.1	-1.0	-1.0	-0.7	4.5	0.3
Primary deficit	4.3	5.8	6.2	5.4	-1.6	-2.1	-2.5	0.5	0.5	0.5	0.5	0.5	0.5	3.7	1.2
Revenue and grants	46.3	50.0	44.4	42.1	46.3	47.4	48.4	43.4	43.4	43.4	43.4	43.4	43.4	48.7	45.1
of which: grants	3.5	3.1	3.1	3.0	3.0	2.9	2.9	1.9	1.9	1.9	1.9	1.9	1.9		
Primary (noninterest) expenditure	50.6	55.8	50.6	47.6	44.7	45.3	45.8	43.9	43.9	43.9	43.9	43.9	43.9	52.4	46.3
Automatic debt dynamics	7.4	3.6	-1.6	-2.0	-1.7	-0.4	-0.7	-1.6	-1.6	-1.6	-1.5	-1.5	-1.2		
Contribution from interest rate/growth differential	-0.2	3.6	-1.6	-2.0	-1.7	-0.4	-0.7	-1.6	-1.6	-1.6	-1.5	-1.5	-1.2		
of which: contribution from average real interest rate	0.3	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5		
of which: contribution from real GDP growth	-0.5	2.7	-2.3	-2.6	-2.2	-1.0	-1.3	-2.2	-2.2	-2.1	-2.1	-2.0	-1.7		
Contribution from real exchange rate depreciation	7.6	...	...	...	...	...	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-5.5	-2.4	-2.7	-3.6	2.0	2.1	2.9	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-2.6	-0.2
Sustainability indicators															
PV of public debt-to-GDP ratio 2/	43.1	47.5	48.5	48.2	47.7	47.6	47.7	46.9	46.2	45.4	44.6	43.8	37.9		
PV of public debt-to-revenue and grants ratio	92.9	95.1	109.3	114.4	102.9	100.4	98.7	108.2	106.4	104.5	102.7	101.0	87.3		
Debt service-to-revenue and grants ratio 3/	7.5	17.1	13.8	11.6	9.4	11.3	11.4	10.8	13.5	13.6	12.5	11.3	9.4		
Gross financing need 4/	7.7	14.4	12.3	10.4	2.7	3.2	3.0	5.2	6.4	6.4	5.9	5.4	4.6		
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	1.0	-4.8	3.9	4.3	3.7	1.7	2.1	3.7	3.7	3.7	3.7	3.7	3.7	3.2	2.7
Average nominal interest rate on external debt (in percent)	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.9	1.9	2.0	2.0	2.7	1.5	1.9
Average real interest rate on domestic debt (in percent)	2.6	2.8	5.8	6.3	6.0	5.7	5.6	5.8	5.9	5.4	5.3	5.3	5.5	1.4	5.4
Real exchange rate depreciation (in percent, + indicates depreciation)	20.1	...	...	...	...	...	...	...	...	...	...	...	...	6.0	...
Inflation rate (GDP deflator, in percent)	4.6	3.3	4.8	5.0	5.2	5.1	5.1	4.9	4.9	4.9	4.9	4.9	4.9	5.6	4.8
Growth of real primary spending (deflated by GDP deflator, in percent)	1.7	4.9	-5.9	-1.8	-2.5	3.0	3.3	-0.6	3.7	3.7	3.7	3.7	3.7	1.3	1.4
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.9	-1.2	4.4	5.7	-0.3	-1.6	-2.2	1.7	1.7	1.7	1.7	1.7	1.3	-2.1	1.2
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt. Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (-): a primary surplus, which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No

Public sector debt 1/

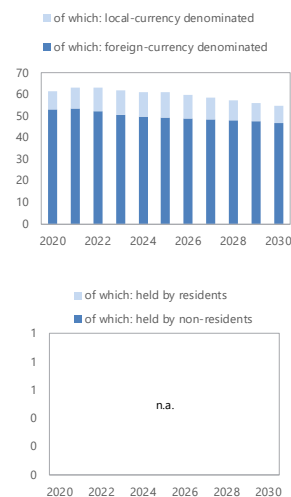


Table 4. Lesotho: Sensitivity Analysis for Key Indicators of Public Debt, 2020–2030

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of Debt-to-GDP Ratio											
Baseline	48	49	48	48	48	48	47	46	45	45	44
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	48	46	45	49	53	57	59	61	62	63	65
B. Bound Tests											
B1. Real GDP growth	48	53	59	62	66	70	73	75	78	80	82
B2. Primary balance	48	53	56	56	56	56	55	54	53	52	51
B3. Exports	48	58	71	70	70	70	69	66	64	62	60
B4. Other flows 3/	48	53	57	57	57	57	56	54	53	51	50
B5. Depreciation	48	57	52	49	46	44	40	37	34	31	29
B6. Combination of B1-B5	48	50	51	48	48	48	48	47	46	45	44
C. Tailored Tests											
C1. Combined contingent liabilities	48	72	70	70	70	70	68	67	66	64	63
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	95	109	114	103	100	99	108	106	104	103	101
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	95	105	107	106	111	118	136	140	143	146	149
B. Bound Tests											
B1. Real GDP growth	95	118	138	133	138	145	167	173	178	184	189
B2. Primary balance	95	118	133	120	117	115	126	124	121	119	117
B3. Exports	95	131	169	152	148	145	158	153	147	142	137
B4. Other flows 3/	95	120	136	123	120	117	128	125	122	118	115
B5. Depreciation	95	130	125	106	98	91	93	86	79	73	66
B6. Combination of B1-B5	95	113	120	105	102	100	110	108	105	103	101
C. Tailored Tests											
C1. Combined contingent liabilities	95	163	167	150	147	144	157	154	151	149	146
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	17	14	12	9	11	11	11	14	14	13	11
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	17	14	11	9	11	12	11	14	16	17	17
B. Bound Tests											
B1. Real GDP growth	17	14	13	11	14	14	15	19	21	20	20
B2. Primary balance	17	14	12	10	12	12	13	17	16	14	13
B3. Exports	17	14	12	11	13	13	13	18	17	16	15
B4. Other flows 3/	17	14	12	10	12	12	12	15	15	14	13
B5. Depreciation	17	14	14	11	13	13	12	14	13	12	11
B6. Combination of B1-B5	17	13	12	10	11	11	11	14	14	13	11
C. Tailored Tests											
C1. Combined contingent liabilities	17	14	15	12	14	14	20	22	16	15	13
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

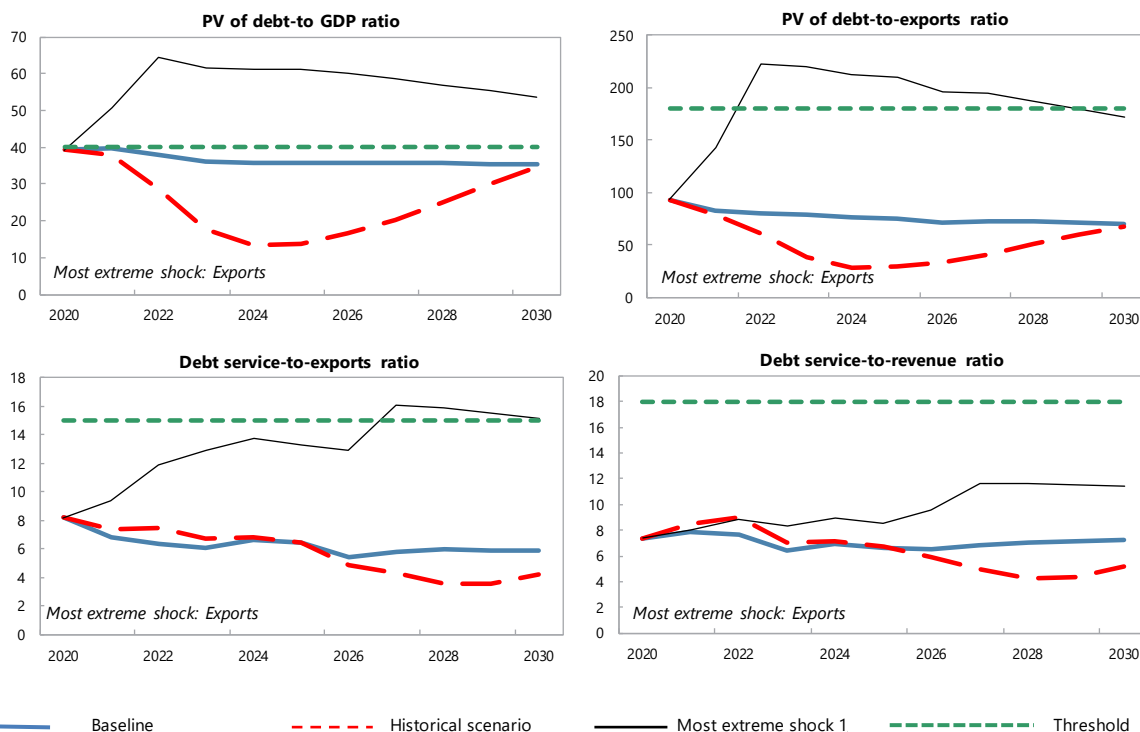
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 1. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2020–2030^{1, 2}



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price	n.a.	n.a.
Market financing	n.a.	n.a.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.3%	2.3%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	24	24
Avg. grace period	4	4

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

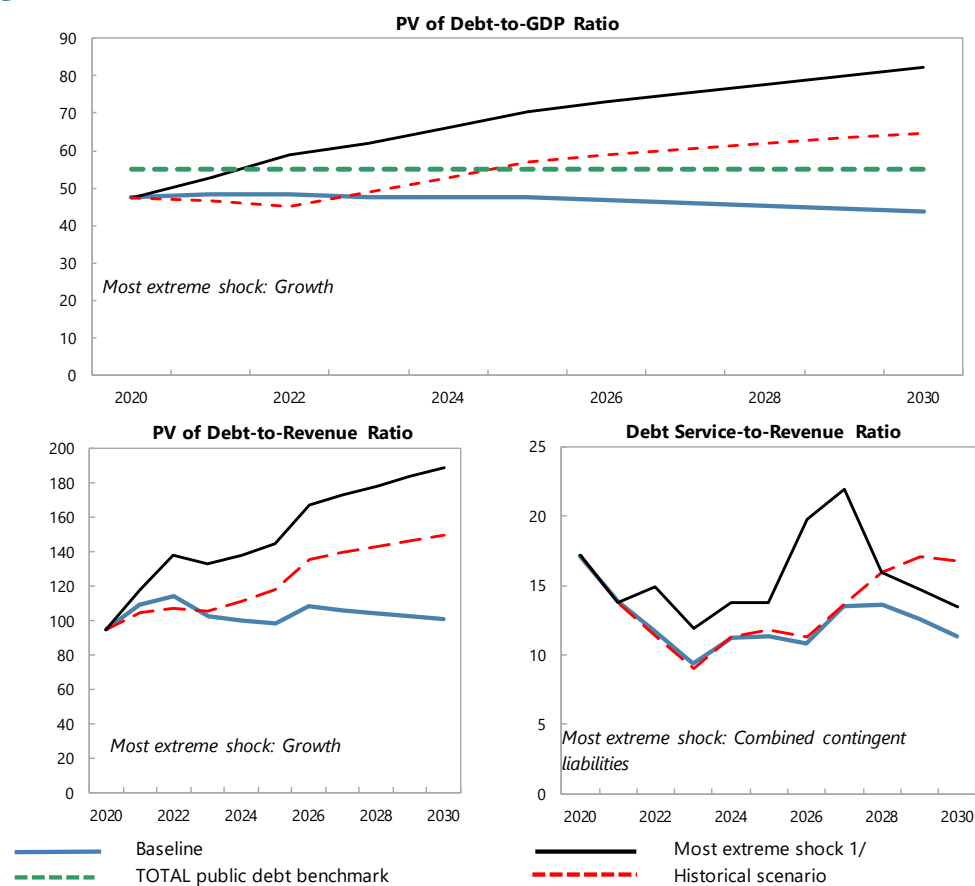
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Lesotho: Indicators of Public Debt under Alternative Scenarios, 2020–2030



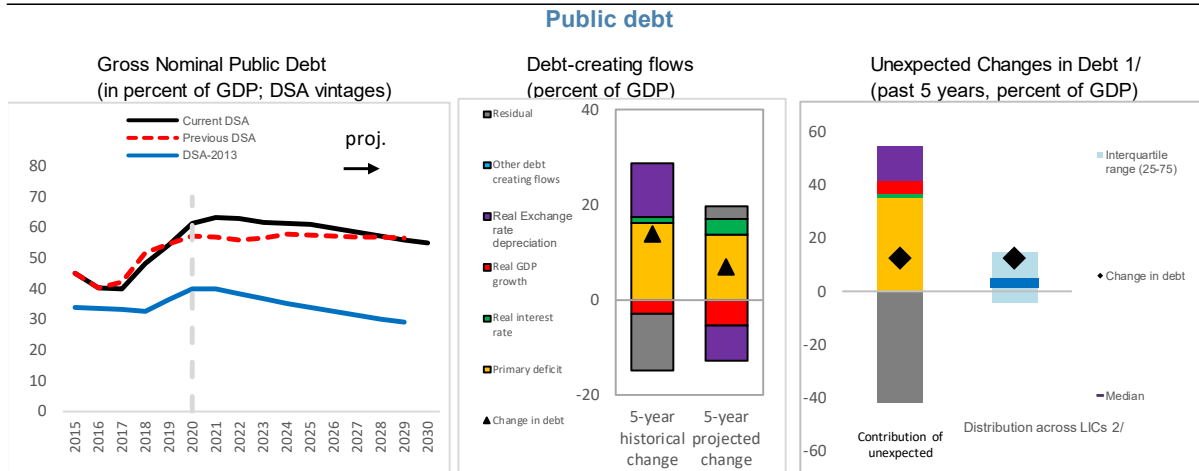
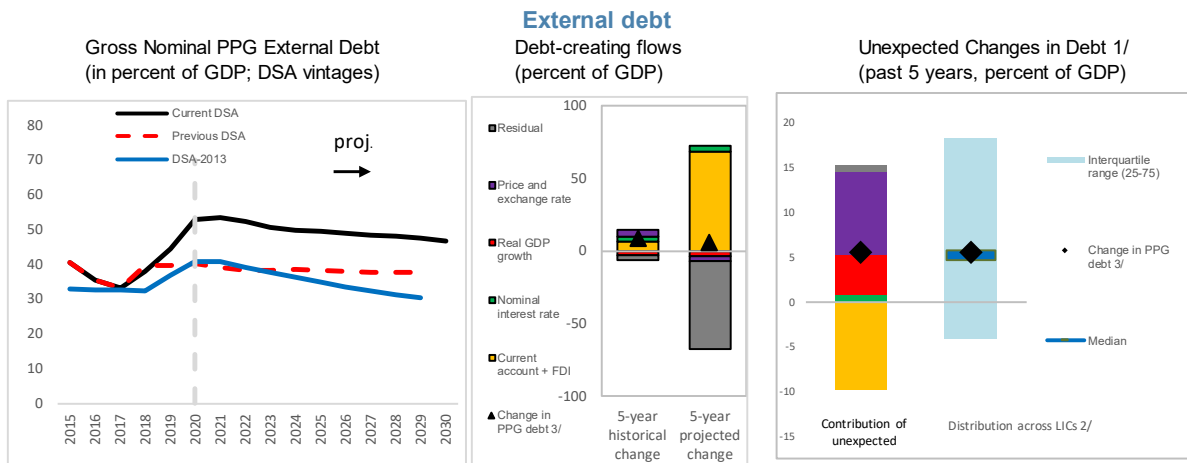
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	71%	71%
Domestic medium and long-term	29%	29%
Domestic short-term	1%	1%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.3%	2.3%
Avg. maturity (incl. grace period)	24	24
Avg. grace period	4	4
Domestic MLT debt		
Avg. real interest rate on new borrowing	5.5%	5.5%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	4	4
Domestic short-term debt		
Avg. real interest rate	3.2%	3.2%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Lesotho: Drivers of Debt Dynamics – Baseline Scenario



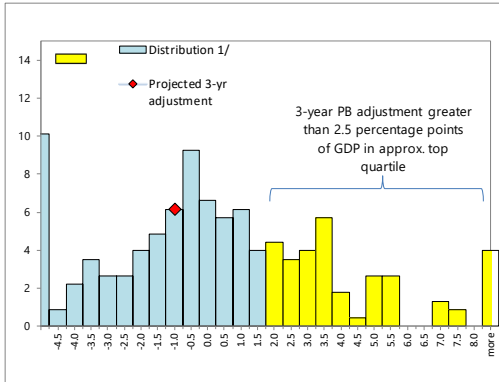
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

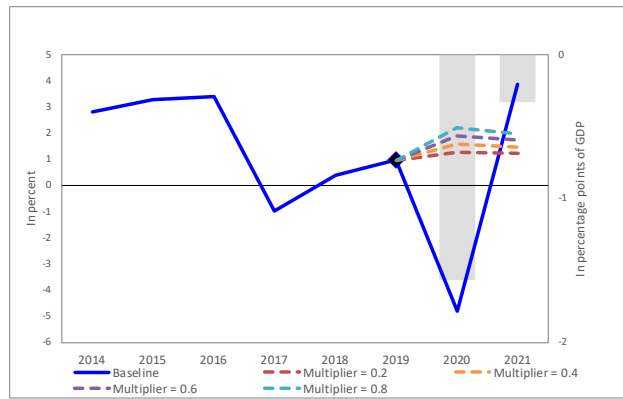
Figure 4. Lesotho: Realism Tools

**3-Year Adjustment in Primary Balance
(Percentage points of GDP)**



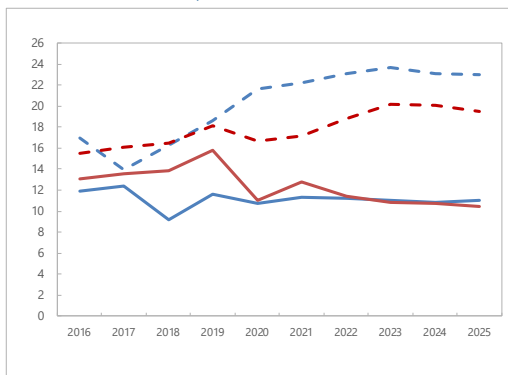
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



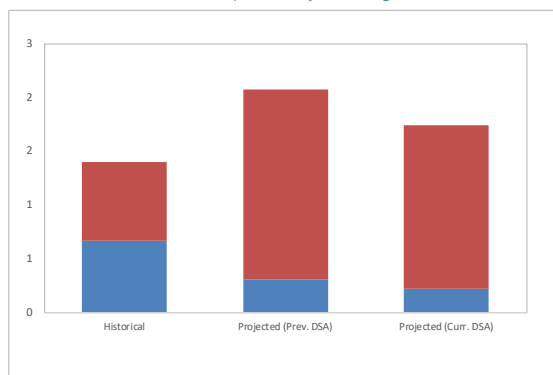
1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

**Public and Private Investment Rates
(percent of GDP)**



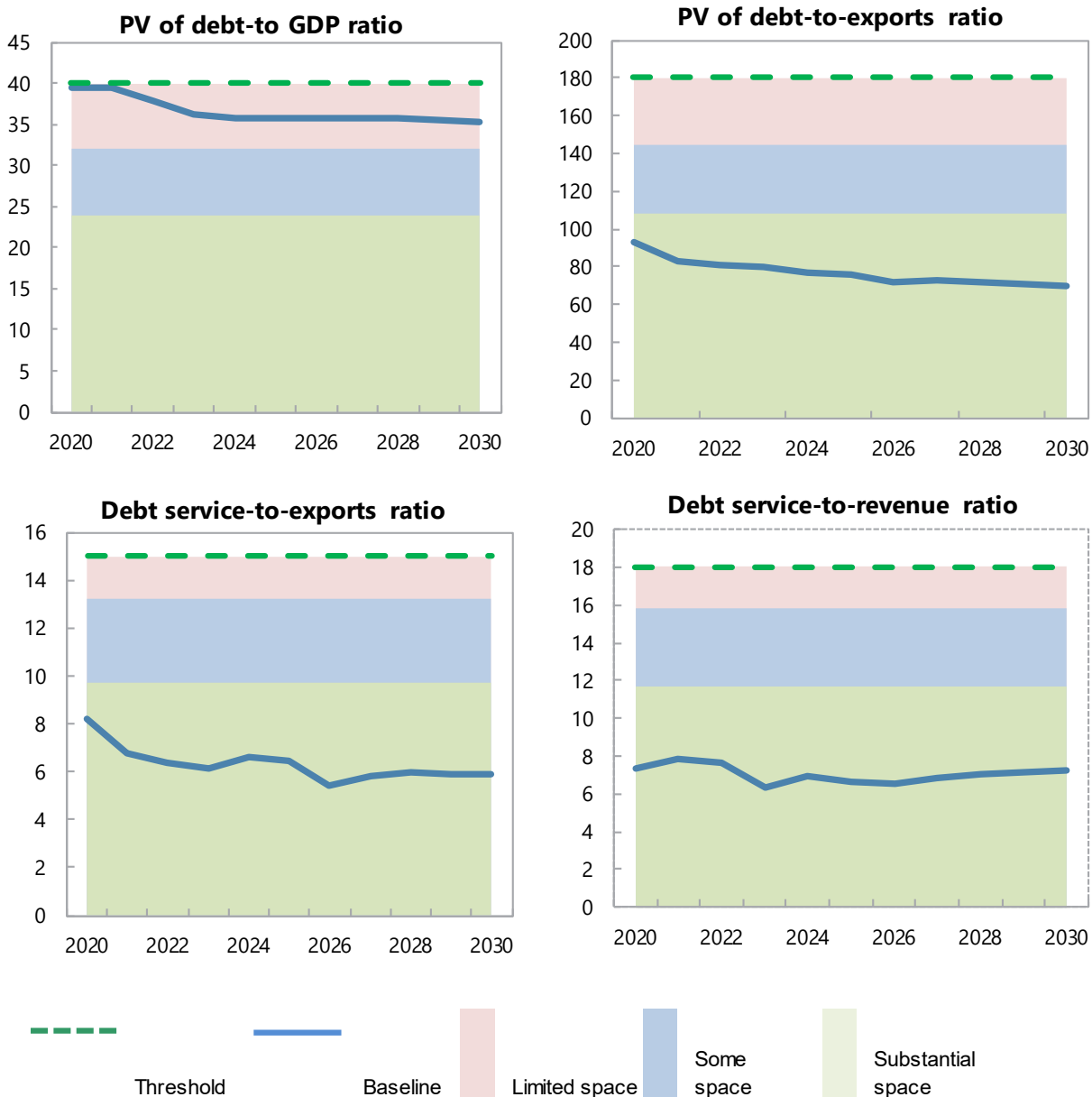
— Gov. Invest. - Prev. DSA — Gov. Invest. - Curr. DSA
 - - - Priv. Invest. - Prev. DSA - - - Priv. Invest. - Curr. DSA

**Contribution to Real GDP growth
(percent, 5-year average)**



■ Contribution of other factors
 ■ Contribution of government capital

Figure 5. Lesotho: Qualification of the Moderate Category, 2020–2030 1/



Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

**Statement by Mr. Dumisani Hebert Mahlinza and Ms. Abigail Nainda
on Kingdom of Lesotho
July 29, 2020**

Our Lesotho authorities appreciate the Fund's prompt response to their request for emergency financing assistance under the Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI). They consider the Fund's emergency assistance as instrumental in catalyzing additional support from other development partners.

The COVID-19 shock hit the country at a time when the economy was faced with a challenging environment, characterized by constrained fiscal space, subdued growth, volatile SACU revenues and political uncertainty. As a result, the pandemic has created a sizeable fiscal gap and increased pressure on international reserves. To deal with the repercussion of the COVID crisis, the authorities request emergency financing under the RCF/RFI in the amount of SDR 34.9 million, equivalent to 50 percent of quota. In addition, the authorities are engaging the World Bank, the African Development Bank and other development partners to fill the residual financing gap. They also plan to seek debt service relief under the G20 Debt Service Suspension Initiative (DSSI), which would help free up budgetary resources to address immediate needs.

The authorities are committed to an effective and transparent use of COVID-19-related resources. They will publish quarterly reports on budget implementation, including specific pandemic related budget lines on the government's website. Moreover, they have committed to a full audit and ex-post validation of COVID-19 delivery by the Auditor General. The results of the audit will be published and disseminated within 5 months after the end of the fiscal year. The central bank has also committed to undergo an update of the safeguards assessment before the Executive Board approval of any subsequent arrangement.

Impact of the COVID-19 Pandemic

Lesotho recorded its first confirmed case of COVID-19 on May 13, 2020, becoming the last country on the continent to detect the virus. Since then, the number of confirmed cases have continued to increase, reaching 505 as of July 26, 2020 with 12 fatalities. The number of cases are expected to increase further given the country's geographic position vis a vis South Africa, where community transmission has surged significantly. Moreover, the return of immigrant workers from South Africa, estimated at about 60 000, has direct implications on remittances, with negative social impacts.

Domestic containment measures to curtail the spread of the pandemic have weighed heavily on economic activity, disrupting production and supply chains. Real GDP growth is now expected to contract by 4.8 percent in 2020, compared to a pre-COVID estimate of 3.1 percent. At the same time, the loss of foreign exchange receipts from tourism and remittances, combined with the halt in textile manufacturing and diamond mining is

exerting substantial pressure on the BoP and the level of reserves. Further, the FY2020/21 fiscal deficit is expected to exceed 7.0 percent of GDP, while revenues, excluding SACU receipts, are estimated to fall by 7.3 percent of GDP.

Policy Responses to the Pandemic

To contain the spread of the virus and mitigate the economic fallout, the government moved promptly to declare a national emergency, closing its border with South Africa in mid- March, well before any confirmed cases were recorded. Further, the authorities established a COVID-19 Command Center to oversee the response to the pandemic, including buttressing the preparedness of the health sector and economic mitigation measures. They also instituted a range of containment measures, including social distancing, travel restrictions, closure of schools, and suspension of some retail activities.

In view of the immediate healthcare spending needs, the authorities have reprioritized domestic expenditure towards COVID-related health and mitigation expenditures. Accordingly, an initial M700 million (or about 2 percent of GDP), has been set aside for the National COVID-19 Response Integrated Plan 2020, which covers health care personnel, purchase of critical goods and services, logistics, security, and border management. The authorities also plan to provide broader support including expanding social grants targeted to vulnerable households as well as agriculture subsidies to support food production. To support businesses, the Lesotho Revenue Agency will provide tax deferrals in the first two quarters of 2020 and Simplified Business Taxes for non-essential service providers. In addition, the authorities have made provision to repay longstanding domestic arrears, which will provide much-needed liquidity for the private sector. They are also expanding credit guarantee facilities by M450 million, while shifting risk exposure towards the government and loosening collateral requirements.

The Central Bank of Lesotho (CBL) has adopted an accommodative monetary policy stance to alleviate the impact of the COVID-19 pandemic on the economy. In this respect, the CBL has lowered the policy rate by 250 basis points from 6.25 to 3.75 percent, while maintaining adequate reserves to preserve the peg under the Common Monetary Area (CMA) Agreement. Further, the CBL has directed banks to consider loan restructuring and payment holidays where appropriate, and insurance companies to accommodate those businesses and households that are unable to make premium payments. The authorities have also postponed the implementation of Basel II.5 to avoid an increase in capital requirements at this time.

Post-crisis Measures to Support Macroeconomic Stability

The new administration intends to strengthen macroeconomic stability to lay the ground for sustainable and inclusive growth once the crisis subsides. In this regard, they plan to reinstitute reforms under the second National Strategic Development Plan (NSDPII). They also plan to further deepen engagement with the Fund by pursuing a follow-up program to more effectively tackle the medium to long-term challenges.

Over the medium term, the authorities plan to pursue significant fiscal adjustment to align spending to available resources and maintain public debt on a sustainable trajectory. To this end, they intend to reduce recurrent expenditure by 9.5 percent of GDP, including the temporary COVID-related expenditure. They particularly recognize the challenges that the wage bill presents and reiterate their intention to bring down the wage-to-GDP ratio over the medium term. As such, they have committed to adopting a new Public Service Employment Policy that aims to maintain a sufficiently lean and highly efficient civil service as well as rationalizing the Foreign Mission Policy to reduce associated costs. To create additional fiscal space, the authorities will enhance the collection of student loans, and reform the government's bursary scheme to ensure efficiency. They are also considering adopting legislation to introduce fiscal rules to enhance fiscal sustainability.

The new administration has made the eradication of corruption and the promotion of good governance one of its key priorities. To this end, all government Ministers have been asked to declare their assets, and Parliamentarians and senior government officials are expected to follow suit. Going forward, the authorities plan to undertake further legal and financial management reforms under the Public Sector Improvement Reform Program (PSRIP). Meanwhile, the full implementation of the new IFMIS is underway, including its expansion to cover donor-financed expenditures and parastatals. In the short-term, they intend to carefully manage cash by releasing warrants on a monthly basis to align expenditure with available financing and to avoid incurring new domestic arrears.

Once the crisis abates, the CBL will finalize implementation of the Basel framework, including the adoption of international best practices for the resolution of banks. They will continue to strengthen their capacity to carry out the AML/CFT supervision functions and count on Fund support as well as other partners, on this front.

Conclusion

The authorities reaffirm their commitment to sustained implementation of prudent macroeconomic policies to lay a solid foundation for accelerated, durable, and inclusive growth, once the pandemic abates. They look forward to Executive Directors' support for emergency financing under the RCF/RFI to address urgent BoP needs. Going forward, they plan to sustain close engagement with the Fund by pursuing a medium-term program with the intention to anchor the necessary adjustments and ensure sustainability.