Lesotho Economic Outlook: 2020—2023 March 2021—**An Update**

Uncertain Recovery and Unabated Risks

Overview

The domestic economy is estimated to have contracted by -6.1 per cent in 2020. This broad-based economic contraction, let by a sharp decline in the secondary sector, is due to a mix of negative domestic and external shocks. These include domestic supply disruptions consequent upon the national lockdown measures and travel restrictions and weak external demand, lower remittances and capital inflows. In the medium term, the economy is projected to recover gradually; growing by 4.3 per cent in 2021 and by an average growth of 5.2 per cent in 2022 – 2023. Meanwhile, domestic inflation is set to accelerate somewhat from 5.0 per cent in 2020 to an average of 5.5 per cent over the period 2022 – 2023.

In the public sector, the overall fiscal position is estimated to have improved from a deficit of 5.6 per cent of GDP in 2019/20 to 2.2 per cent of GDP in 2020/21. This reflects a substantial increase of 44.20 per cent in SACU revenue, against a moderate increase in government spending. Going forward, the fiscal position is projected to deteriorate and register a deficit of 13.2 per cent of GDP in 2022/23, mainly at back of the expected fall in government revenues (especially SACU revenue) against elevated expenditures. However, the fiscal deficit is projected to narrow to 4.8 per cent of GDP in 2023/24. The improvement in the fiscal position largely reflects an expected 26.0 per cent increase in government revenues, mainly a significant recovery in SACU revenue.

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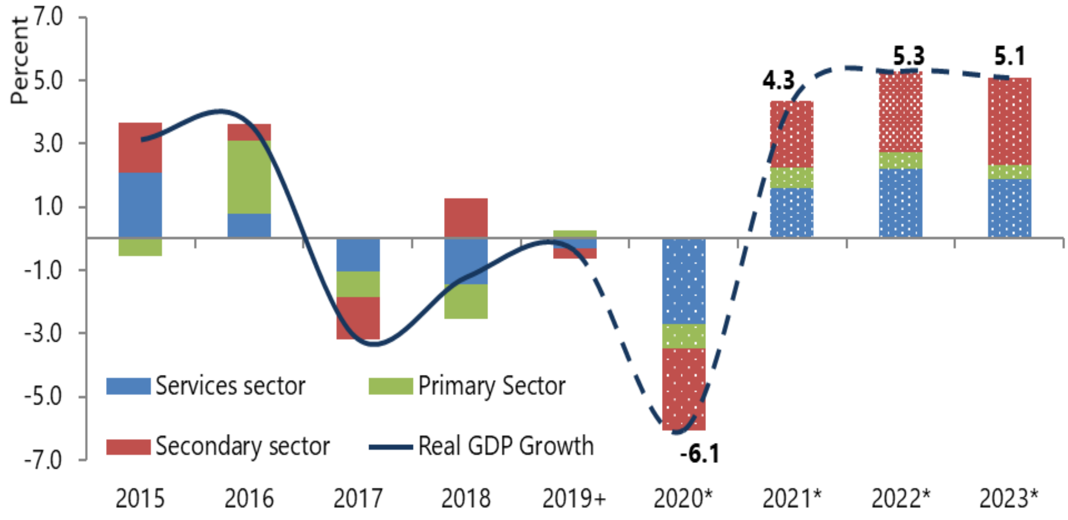
The external sector position is projected to deteriorate relative over the medium-term. It is expected to record a surplus of 1.4 per cent of GDP in 2021 relative 1.9 percent in the previous year. This is reflective of lower SACU revenue receipt and the widening trade account deficit. With the projected recovery in the global economic activity and widespread availability of the vaccine, trade flows are estimated to increase in 2021. Merchandise imports are projected to increase by 10.3 per cent while exports will increase by 8.8 pent in 2021. The income and transfers accounts are projected to remain in surplus in 2021. Both financial flows and foreign support for capital projects are set to increase in 2021. Money supply is expected to increase consistent with the expected recovery and this expected impact private sector credit positively. However, the huge of fiscal deficits in 2021/22 and 22/23 fiscal years and a possibility of financing through the banks will adversely impact resources available for lending to the private sector.

Notwithstanding, the recovery remains precarious given the uncertain acquisition and rollout of the vaccine, the possibility a stronger and prolonged COVID-19 third wave, elevated fiscal risks. This means that policymakers should remain vigilant and respond swiftly as economic conditions changes, and with more focus towards policies that mitigate health risks and facilitate economic recovery.

1. Real Sector Outlook

The domestic economic activity is estimated to have declined by -6.1 per cent in 2020, representing an upward revision of 0.5 percentage compared to the December 2020 Lesotho Economic Outlook (LEO) as shown in table 1. This reflects higher than expected recovery in the second half of 2020, particularly in the textiles sub-sector. The broad-based economic contraction in 2020 is due to a mix of domestic and external shocks. These include domestic supply disruptions consequent upon the national lockdown measures and travel restrictions and a fall in global income implying weak external demand and lower remittances and capital inflows. The primary sector is estimated to have contracted by 6.1 per cent in 2020 driven by 24.6 per cent growth decline in the mining industry. The secondary sector is estimated to have contracted by 11.5 per cent in 2020, led by sharp declines in construction activity and textiles manufacturing. Meanwhile, the tertiary sector is projected to contract by 3.6 per cent in 2020 due to weak consumer demand and domestic supply chain disruptions consequent upon the national lockdown measures.

Figure 1: Domestic Economic Outlook



*Source: CBL, + Estimates, * Projections*

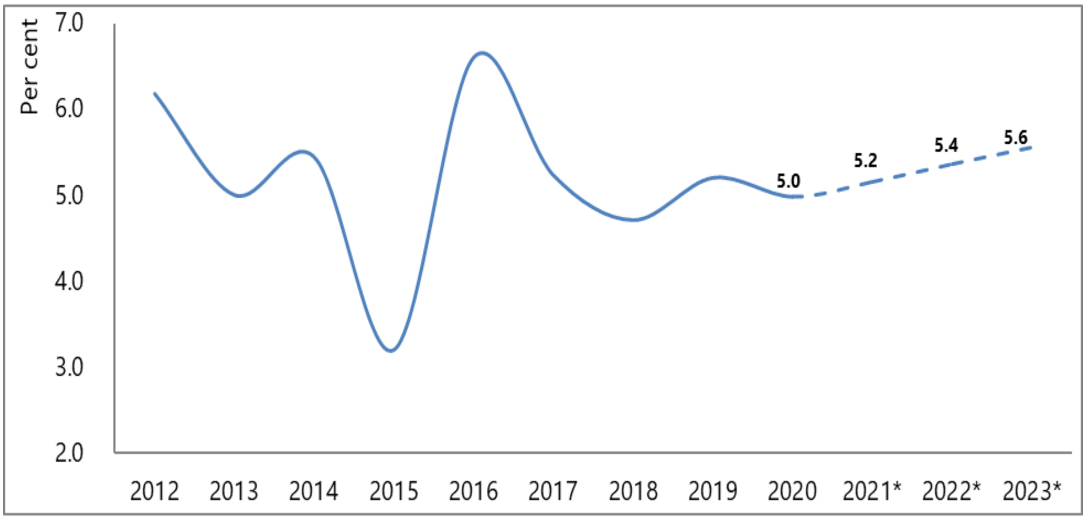
In terms of the outlook, the domestic economy is projected to recover gradually and grow by 4.3 per cent in 2021 and picking up further to an average growth of 5.2 per cent over the period 2022 – 2023, with the level of output barely reaching the pre-pandemic level in 2022. Key to the recovery is a strong rebound in the construction sector, a recovery in the mining sector and textiles and clothing sector as well as the anticipated improvement in business and consumer confidence. In the primary sector, the mining sector is set to recover and increase by 16 per cent in 2021 before registering an average growth of 9.7 over the period

2022 – 2023. Key to the recovery in the sector is the expected recovery in the global diamond market and the planned expansion works by some mining companies.

In the secondary sector, construction sector is projected to rebound strongly and register 28.0 per cent in 2021 (notwithstanding the potential drag caused by heavy rainfalls between January and February 2021) and 39.2 per cent over the period 2022 – 2023. The rebound in the construction activity will be supported by construction works related to the second phase of Lesotho Highlands Water Project (LHWP) and other major projects such as construction works related to the second phase of Lesotho Lowlands Water Development Project (LLWDP-II), construction of the Maseru district hospital, construction of Mafeteng Solar power plant and other government construction projects. Meanwhile, textiles and clothing industry is projected to recover partially in the medium term and grow by 7.7 per cent in 2021 and by 1.6 per cent over the period 2022 – 2023. The tertiary sector is projected to recover by 1.8 per cent in 2021 and 2.6 per cent in 2022-23. The projected growth path reflects an increase in aggregate demand, especially consumption spending, in line with general economic recovery. Further, we expect the COVID-19 vaccine rollout in 2021 to boost business and consumer confidence in the economy by facilitating a safe re-opening of the economy. This will facilitate a speedy recovery and promote more spending.

Following an average increase of 5.0 per cent in 2020, domestic inflation is set to accelerate somewhat to 5.2 per cent in 2021 and to an average of 5.5 per cent over the period 2022 – 2023. The marginal increase in the inflation rate is largely due to high food prices, which are expected to fall only marginally but remain elevated in the medium term. Additional pressures will come from imported inflation from South Africa that is expected to increase over the medium-term from the currently low level. At the same time, the expected increase in administered prices (especially prices of utilities) including the impact of recovering oil prices are expected to exert some pressure on inflation in the medium-term.

Figure 2: Inflation Outlook

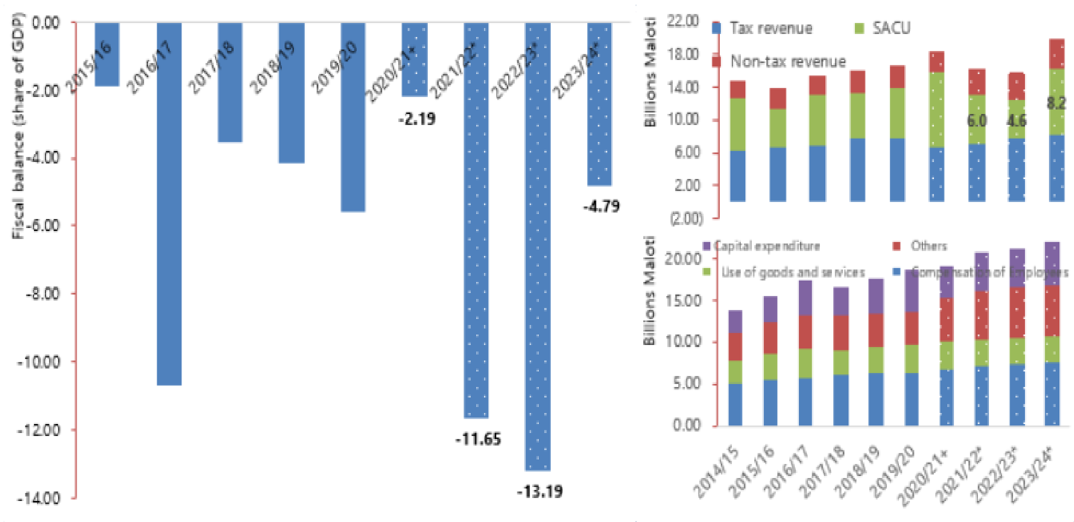


*Source: CBL, + Estimates, * Projections*

2. Public Sector

The overall fiscal position is estimated to improve from a deficit of 5.6 per cent of GDP in 2019/20 to 2.2 per cent of GDP in 2020/21. The improvement in the fiscal position is largely driven by an increase in government revenue, especially a substantial increase of 44.20 per cent in SACU revenue. At the same time tax and non-tax revenues are estimated to decline by an average of 10.4 per cent due to the fall in domestic economic activity consequent upon the impact of the COVID-19 pandemic and the associate containment measures. Meanwhile government spending is estimated to increase moderately by 2.9 per cent largely driven by recurrent spending. In particular, recurrent spending is estimated to increase by 12.5 per cent due an increase in government spending on health care system to aid the fight against the pandemic and on relief measures to mitigate the economic impact of the pandemic. This increase is against the backdrop of a fall in capital spending due to a delay in implementing major government projects and a deliberate policy to reallocate funds towards health care system and COVID-19 economic relief measures.

Figure 3: Overall Fiscal Balance

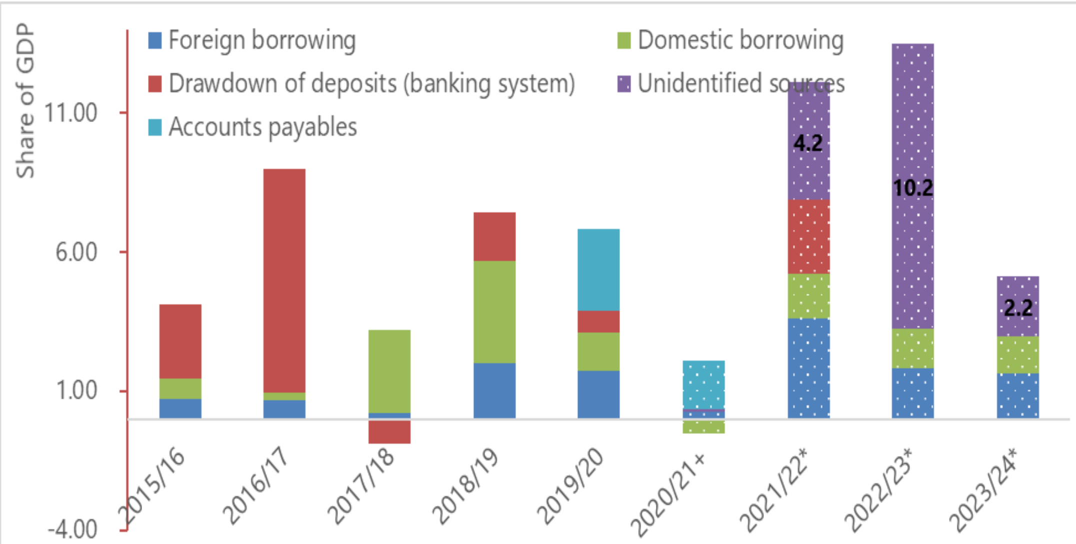


*Source: CBL, + Estimates, * Projections*

In terms of the outlook, the fiscal position is projected to deteriorate and register a deficit of 13.2 per cent of GDP in 2022/23 before narrowing to 4.8 per cent of GDP in 2023/24. The deterioration in the fiscal position over the period 2021/22 – 2022/23 is mainly at back of the expected fall in government revenues against elevated expenditures. In particular, government revenues are expected to decline by 14.0 per cent, largely driven by a sizeable 48.4 per cent decline in SACU revenue. Meanwhile domestic tax and non-tax revenues are projected to increase by 19.2 per cent over the period 2021/22 – 2022/23 (and partially offset the fall in SACU revenue) as economic activity recovers. At the same time, government spending is set to increase by 11.1 per cent mainly driven by the recovery in capital spending. In 2023/24, the overall fiscal position is projected to improve with a fiscal deficit narrowing to 4.8 per cent of GDP. The improvement in the fiscal position is at the back of a 26.0 per cent increase in government revenues, especially a significant increase of 76.6 per cent in SACU revenue. The substantial increase in government revenue is against a moderate increase of 4.0 per cent in total government expenditures.

The projected fiscal deficits are set to be financed by a mix of a drawdown in government savings, domestic and planned foreign borrowings, especially in 2021/22. However, the government will need to identify additional financing to meet the residual financial gap that remains after exhausting its savings, domestic borrowings as well as planned foreign borrowings. In particular, the government will have to identify add additional financial equivalent to 4.2 per cent of GDP in 2021/22. The residual financial gap is projected to widen further to 10.2 per cent of GDP in 2022/23 before narrowing to 2.7 per cent of GDP in 2023/24 as the overall fiscal operations improves. The policy implication of this is clear. The government should undertake growth-friendly fiscal consolidation to curb widening fiscal deficit that has a potential to threaten fiscal sustainability and macroeconomic stability in general.

Figure 4: Fiscal Financing



*Source: CBL, + Estimates, * Projections*

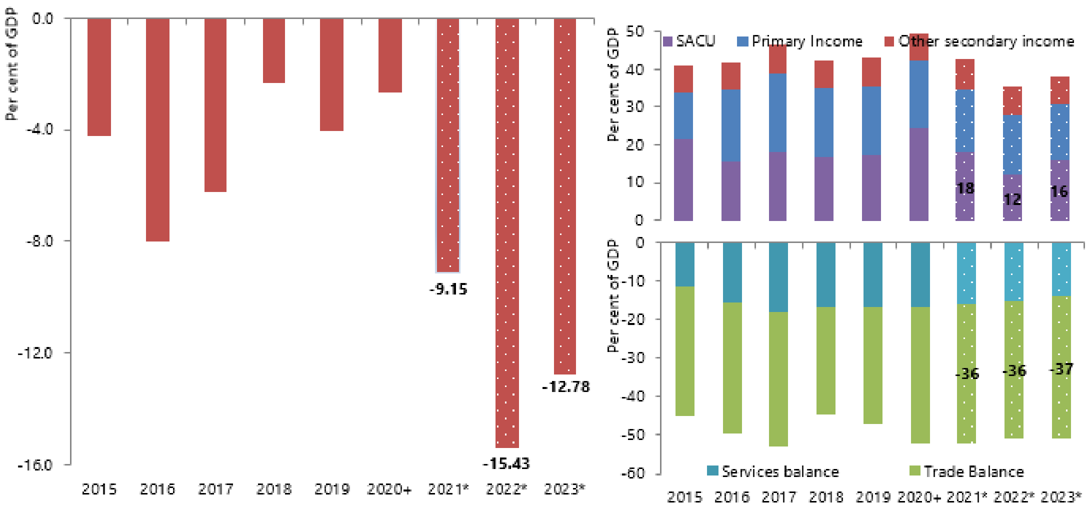
3. External Sector

The external sector position registered a surplus of 1.9 per cent of GDP in 2020, lower than 3.9 per cent of GDP realised in 2019. The surplus reflected the narrower current account deficit and more inflows in the capital and financial accounts. The lockdown measures imposed due to COVID-19 and weak consumer demand led to low trade flows as well as lower inflows of incomes and transfers. Despite the delays experienced during the lockdown period, the economy received more inflows of capital transfers associated with LHWP II. In the financial account, commercial banks increased their foreign assets abroad for investment purposes, while reserve assets were boosted by the financial assistance from the IMF under the Rapid Credit Facility and the Rapid Financing Instrument for balance of payments support. Reserve assets, measured in months of imports, rose to 4.8 months.

In the near-term, the external sector position is projected to deteriorate relative to 2020, recording a surplus of 1.4 per cent of GDP. This is reflective of lower SACU revenue receipt and the widening trade account deficit. With the projected recovery in the global economic activity and widespread availability of the vaccine, trade flows are estimated to increase in 2021. Merchandise imports are projected to increase by 10.3 per cent while exports will increase by 8.8 pent in 2021. The income and transfers accounts are projected to remain in surplus in 2021. Both financial flows and foreign support for capital projects are set to increase in 2021.

Medium term indications are that the external sector position will deteriorate further in 2022, reflecting the decline in SACU revenue, but improve from 2023. The trade account will remain in deficit as the value of merchandise imports continues to outpace the value of exports. Imports will be boosted mainly by the construction activity related to, among others, the LHWP II and LLWP II and the renewable energy project. The fragile recovery expected in South Africa bodes well for migrant workers' incomes and current transfers. However, forecast estimates of SACU revenue show a 26.8 per cent decline in 2022, reflecting modest regional economic growth as well as the expected downward adjustment, due to lower than anticipated imports into the SACU region. A turnaround is expected in 2023 as the growth outlook in SA improves, and hence better performance in the collection of duties. The economy is expected to continue to attract more capital and financial flows in the medium-term. Reserve assets, measured in months of imports, are set drop to 3.0 months in 2023.

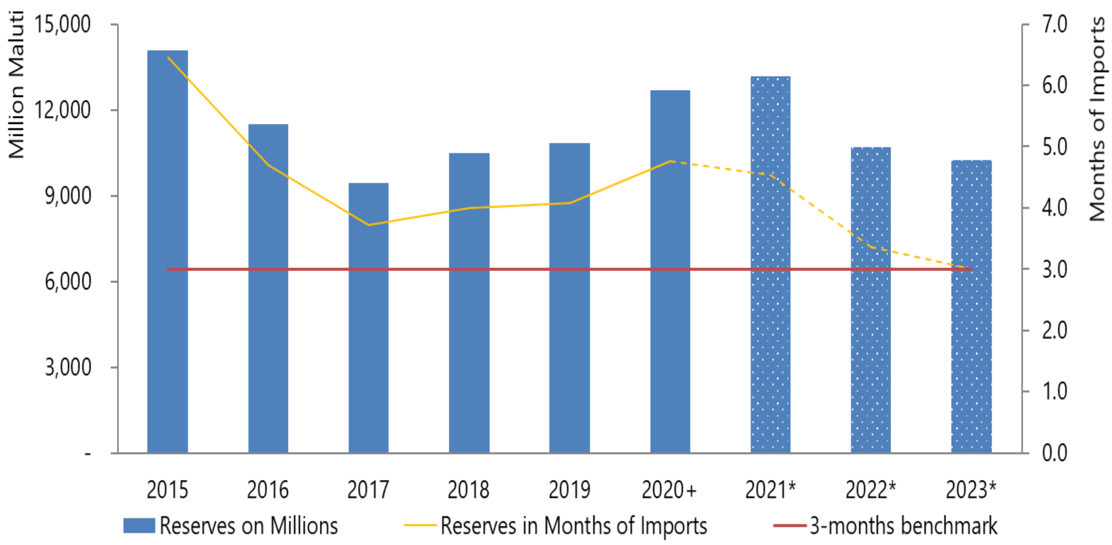
Figure 3: The External Sector



*Source: CBL, + Estimates, * Projections*

In terms of the outlook, the external position is expected to deteriorate in the medium-term, with the overall deficit registering 0.8 per cent and 6.1 per cent of GDP in 2021 and 2022. Current account deficit is set to widen in the medium term as imports associated with major capital projects (LHWP II, Mafeteng Solar Plant, LLHWP II) gain momentum. This is despite the recovery in exports underpinned by improvement in external demand as global growth recovers. At the same time, SACU receipts are projected to drop substantially by 49.1 per cent over the period 2020 – 2022, contributing to a widening of current account deficit. The steep fall mainly reflects the modest regional economic growth as well as the expected downward adjustment due to lower than anticipated imports into the SACU region. A substantial share of the current account deficit is projected to be financed by capital inflows, associated with the LHWP II projects and somewhat by government capital projects, and government foreign loans to finance major government investments, notably Mafeteng Power Plant, LLWDP Phase II.

Figure 4: Gross Reserves



*Source: CBL, + Estimates, * Projections*

4. Money & Credit

Money supply rose by 17.1 per cent in 2020, relative to a 9.0 per cent decline in the previous year. The growth in money supply was underpinned by an increase in the banking sector foreign assets, moderated slightly by the fall in domestic assets. The central bank foreign assets were boosted by higher receipt of SACU revenue and the IMF emergency financing to address the balance of payments needs. Commercial banks foreign assets rose on account of more placements for investment purposes. On domestic assets, the increase in government deposits was moderated by a modest rise in credit extended to the private sector due to low economic induced by COVID-19.

Projections suggest an increase in money supply in line with the expected rebound in economic activity. Money supply is estimated to rise by 9.4 per cent in 2021, reflecting an increase in both domestic and foreign assets. It is anticipated that credit extended to the private sector will recover from the low levels of 2020 and grow by 8.5 per cent in 2021. Over the period 2022-23, money supply is set to continue to increase by an average of 9.9 per cent in line with growth in nominal GDP. The increase largely reflects a 10.3 per cent growth in credit extended to business enterprises and households. Credit extended to business enterprises will benefit mostly from the expected growth momentum in mining, manufacturing and construction industries.

5. Risks to the Outlook

There continue to be significant risks to the domestic outlook. The lingering adverse effects of the COVID-19 shock could result to a weaker-than anticipated recovery. While there has been a significant progress in the development of COVID-19 vaccine, production could take long to meet global demand and high production cost could deter access by poor countries like Lesotho to implement largescale vaccination. Coupled with risk of localized outbreaks or a new wave of infections, the potential delay in national vaccination means the country could see a recurring widespread lockdowns to contain the spread of the virus in 2021. This will trigger a further delay in economic recovery. New waves of infections could slow growth pick-up in Lesotho' major trading partners (esp. SA), dampening domestic growth prospects through lower exports demand, remittances, current transfers in the form of SACU revenue as well as capital inflows. In addition, heavy rainfalls (and local floods) experienced in the first quarter of 2021 could also result to a delay in some of the major construction activity in economy, resulting in lower-than anticipated rebound in the construction sector.

6. Conclusion

There is a tremendous uncertainty surrounding the speed of the economic recovery across the world including in Lesotho: much depends on the ability to contain the virus and defend people's health. Specifically, the ability to contain the virus and defend people's health will facilitate a safe re-opening of the economy, which is a necessary condition for economy recovery. There can be no recovery until the spread of the virus and future health risks are contained. From the fiscal policy perspective, there is a clear evidence of a build-up of fiscal vulnerability in the medium-term, requiring urgent policy intervention. In this regard, growth-friendly fiscal adjustment in favour of high priority areas such as health sector and other measures aimed at facilitating economic recovery will go a long way. The expected deterioration in the external sector position suggests that the country is facing protracted balance of payment challenges, which would be addressed through a medium-term engagement with the IMF. In the nutshell, the medium term forecasts suggest that policymakers should remain vigilant and respond promptly as economic conditions changes, and with more focus towards policies that mitigate health risks and facilitate economic recovery.

Appendix A: Overview of Domestic Economic Outlook

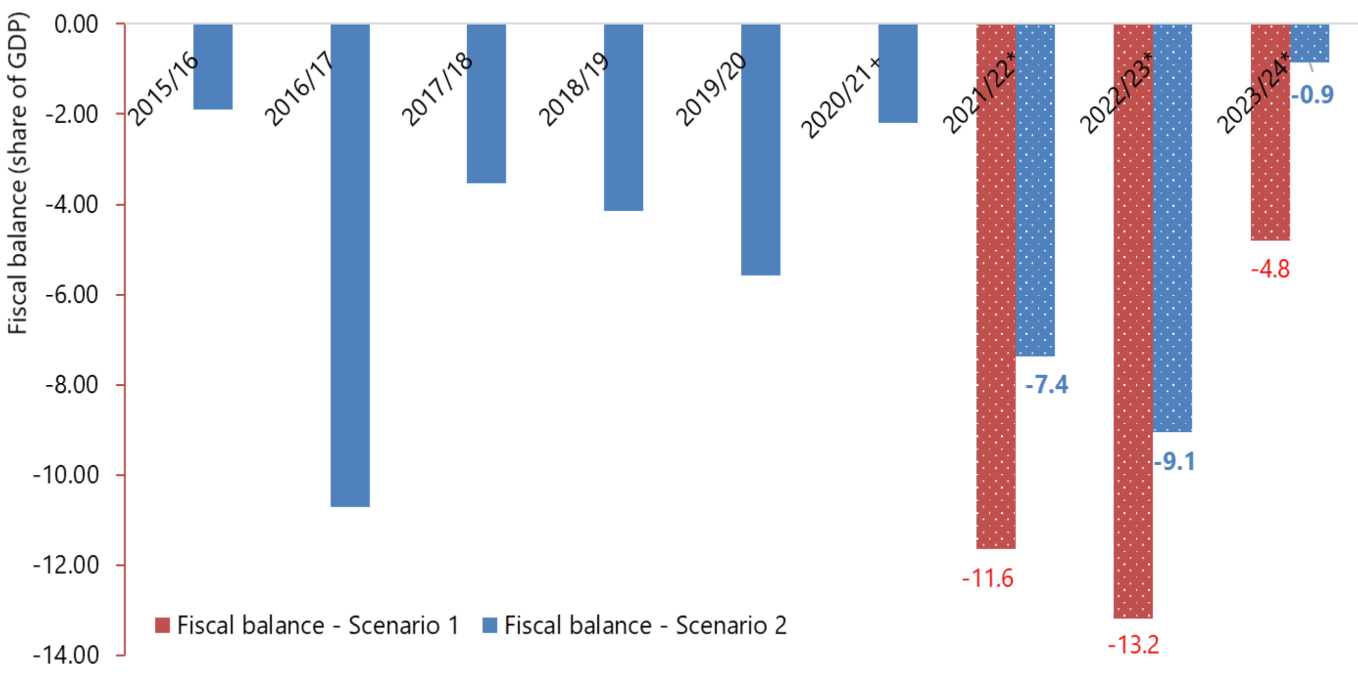
	Actual	Estimate	March 2020 projections			Differences from Dec 2020 projections		
	2019	2020+	2021*	2022*	2023*	2020*	2021*	2022*
Economic growth	**-0.4**	**-6.1**	**4.3**	**5.3**	**5.1**	**0.5**	**-0.3**	**-0.2**
Primary Sector	**3.1**	**-9.2**	**8.0**	**6.5**	**5.2**	**0.0**	**-1.3**	**0.7**
Agriculture	6.1	2.3	3.6	3.2	3.2	0.0	0.0	0.0
Mining & Quarrying	-0.7	-24.6	16.0	11.7	8.3	0.0	-3.5	1.8
Secondary Sector	**-1.4**	**-11.5**	**9.9**	**11.3**	**11.5**	**2.8**	**-1.5**	**-1.2**
Manufacturing	0.7	-9.0	6.3	1.9	1.7	4.5	-1.0	-0.3
Textiles & Clothing	-3.0	-12.3	7.7	1.7	1.5	13.0	-1.4	-0.4
Building & Construction	-3.7	-24.9	27.9	42.9	35.6	0.4	-4.4	-2.3
Services Sector	**0.6**	**-3.6**	**1.8**	**2.8**	**2.3**	**-0.2**	**0.2**	**0.0**
Inflation rate (%)	**5.2**	**5.0**	**5.2**	**5.4**	**5.6**	**0.0**	**0.0**	**0.0**

Appendix B: Selected Macroeconomic Indicators

	2018	2019	2020+	2021*	2022*	2023*
Output - Constant prices						
Gross Domestic Product (% p.a.)	-1.22	-0.38	-6.06	4.35	5.28	5.07
Per capita GDP (% p.a.)	-1.69	-0.85	-6.50	3.86	4.78	5.07
Gross National Income (% p.a.)	-0.93	-0.60	-2.43	3.55	4.45	4.00
Per capita GNI (% p.a.)	-1.39	-1.07	-2.89	3.06	3.96	4.00
Gross Domestic Product (M Million)	21531	21448	20148	21024	22134	23256
Per Capita GDP	10618	10527	9843	10222	10711	11254
Gross National Income (M Million)	24534	24387	23794	24638	25735	26764
Per Capita GNI	12099	11970	11624	11979	12454	12952
Output - Current prices						
Nominal GDP (% p.a.)	8.28	2.33	-1.71	9.40	10.00	9.84
Nominal GNI (% p.a.)	8.47	2.14	1.83	8.39	9.10	8.72
Nominal GDP (M Million)	33272	34046	33465	36611	40272	44235
Nominal GNI (M Million)	37918	38730	39440	42750	46642	50707
Sectoral Growth rates (% p.a.)						
Primary Sector	-11.58	3.09	-9.21	8.02	6.46	5.24
Crops	-46.94	-21.45	-2.84	5.50	2.50	2.38
Mining and Quarrying	-9.40	-0.69	-24.65	16.02	11.74	8.26
Secondary Sector	6.12	-1.40	-11.48	9.88	11.31	11.52
Manufacturing	14.23	0.73	-9.03	6.34	1.89	1.67
Construction	-3.68	-3.72	-24.88	27.89	42.87	35.63
Tertiary Sector	-2.15	0.63	-3.61	1.85	2.76	2.34
Wholesale and retail trade,repairs	-9.23	-3.75	-9.96	3.66	3.93	3.74
Financial and insurance activities	-1.93	7.95	-4.52	3.66	6.09	3.64
Real estate activities	-0.13	0.59	-0.22	0.74	0.75	0.79
Public Admin, Education & Health	0.80	0.59	4.29	-1.11	-0.27	0.25
Savings and Investment - Per cent of GDP						
National Savings	15.66	16.55	28.26	23.71	20.99	27.27
Of which Government Savings	4.68	6.57	6.29	-1.51	-4.45	1.94
Of which Private Sector Savings	10.98	9.98	21.97	25.22	25.44	25.32
Investment	17.99	20.62	30.93	32.86	36.42	40.05
Of which Government Investment	11.67	13.86	11.53	11.82	11.14	11.22
Of which Private Sector Investment	6.32	6.76	19.40	21.04	25.27	28.82
Resource Balance	-2.33	-4.07	-2.67	-9.15	-15.43	-12.78
Inflation rate % (CPI)	4.71	5.20	4.98	5.15	5.36	5.55
External Sector - Per cent of GDP						
Current Account	-2.33	-4.07	-2.67	-9.15	-15.43	-12.78
Imports of Goods	76.41	75.68	78.00	78.62	79.10	77.92
Exports of Goods	48.34	45.20	42.94	42.70	43.15	41.01
Capital Flows (+ means an inflow)	1.48	3.68	4.53	8.60	8.65	11.34
Of which Government	1.48	3.68	4.53	8.60	8.65	11.34
Of which Private Sector	0.00	0.00	0.00	0.00	0.00	0.00
Financial Account	5.59	-0.82	5.75	-0.55	-6.78	-1.44
Official Reserves (Months of Imports)	4.00	4.09	4.76	4.54	3.36	3.00
Government Finance - Per cent of GDP						
Revenue (excluding grants)	44.62	45.78	50.80	41.77	36.40	39.83
Tax Revenue	22.01	23.24	21.11	18.62	18.93	18.24
Recurrent Expenditure	-39.43	-39.17	-44.41	-43.20	-40.76	-37.72
Of which compensation of employees	-18.21	-18.57	-19.46	-19.31	-17.98	-16.74
Transaction in non-financial assets	-12.02	-14.28	-11.88	-12.18	-11.48	-11.56
Budget Balance (+ means a surplus)	-3.76	-4.32	-2.75	-10.08	-12.80	-6.80
Monetary Aggregates - Nominal growth						
Money supply (M2)	10.69	-8.99	17.12	9.40	10.00	9.84
Private Sector Credit	10.77	8.15	0.67	8.49	10.40	10.21

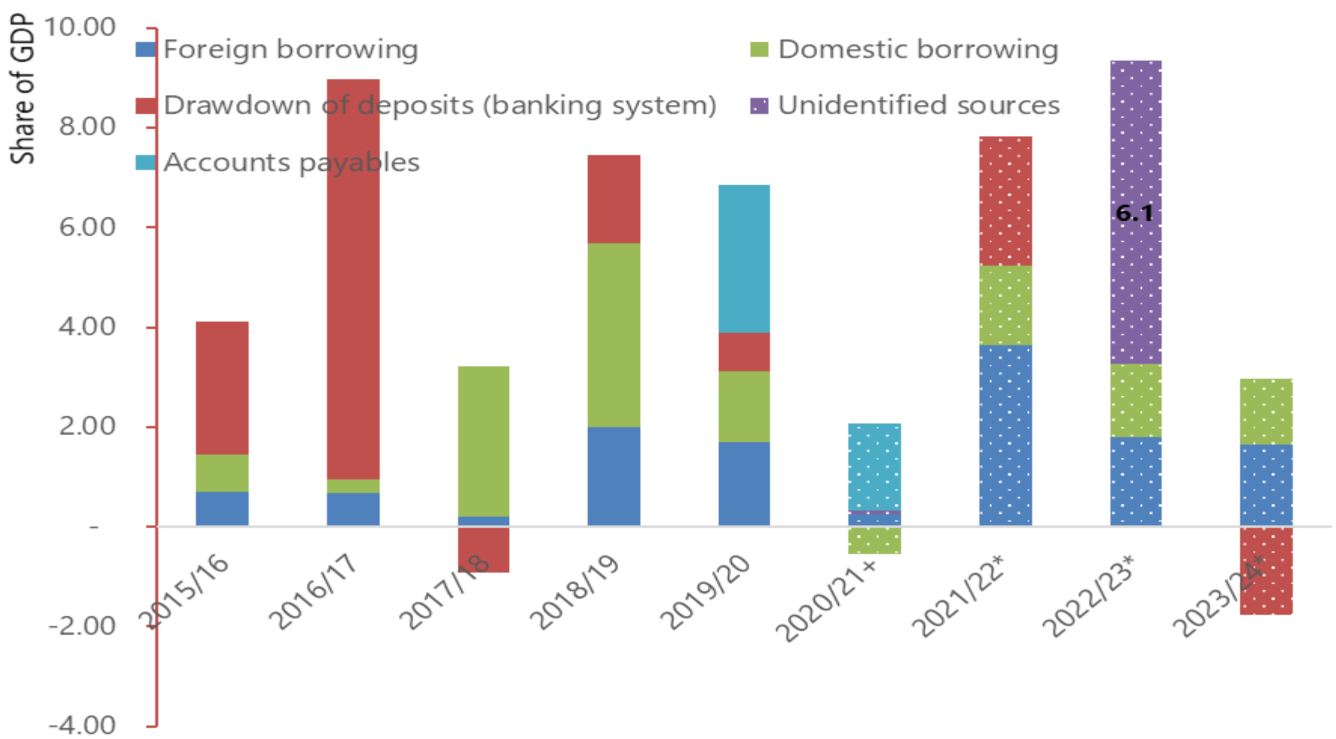
Appendix C: Alternative Fiscal Outlook Scenario—assume fiscal adjustment

Figure C1: Overall Fiscal Balance assuming adjustment



Source: CBL, + Estimates, * Projections

Figure C2: Fiscal Financing assuming adjustment



Source: CBL, + Estimates, * Projections

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