INTERNATIONAL MONETARY FUND'S WORLD ECONOMIC OUTLOOK, APRIL 2010: REBALANCING GROWTH

The IMF shows that pace of global economic recovery is uneven across the globe. This presents some challenges to advanced, emerging as well as developing countries, calling for global policy coordination and response..........

Background

The International Monetary Fund's (IMF's) World Economic Outlook (WEO) publication released in April, 2010 highlights that the world economy is recovering though at varying degrees in different parts of the globe. In advanced economies, the recovery is slow, reflecting the substantial damage to their financial sectors, subdued household budgets and hefty lay-offs of workers. However, in emerging as well as developing economies, the output growth is strong owing to strong internal demand and recovery of global trade. There are also challenges faced by both advanced, emerging as well as developing countries resulting from policy interventions undertaken to avert the downturn. These challenges need global coordination of policies to keep the recovery intact.

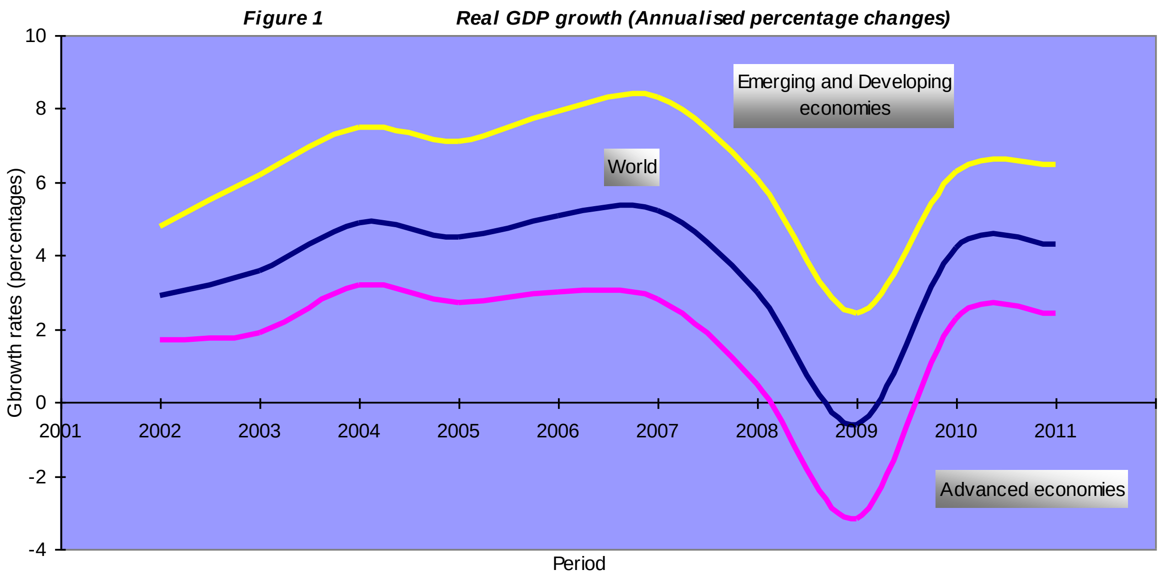
This article highlights the recent global economic developments, looking at the challenges that arose as a result of policy interventions against the global financial crisis across the globe. It will also highlight the implications of these developments for the economy of Lesotho.

INSIDE

Recent World Economic Developments

The global economy has averted one of the great recessions in the history of the world since the Second World War, and it is recovering at a rate higher than anticipated by the IMF, due to the massive stimulus packages injected in most countries in the 2008-2009 period. However, there remain challenges facing global economies as a result of policy actions taken during the crisis, and there is a need for a new set of solutions in order for the recovery to remain sustainable on the long term.

Following the 2001 financial crisis, which saw the growth rate of world real GDP declining from the annualised rate of 4.8 per cent in 2000 to 2.3 per cent annualised rate in 2001, the world real GDP increased by 4.4 per cent on average in the period 2002 to 2007. This was followed by the sub-prime mortgage crisis that started in the United States (U.S).



Source: *IMF estimates: WEO Database*

In 2008, when the crisis intensified into a global economic meltdown and the consequent global financial and economic crises, the global real growth rate decelerated to 3.0 per cent before moving into the negative trajectory in the following year.

In the year 2009, the world was reeling under substantial impact of the crisis since the Great Depression of the 1930s. The growth rate declined by an annualised 0.9 per cent, despite massive policy actions taken to forestall the ravaging speed and magnitude of the crisis. Nonetheless, in the second quarter of 2009, the world real GDP growth was about 3.3 per cent on annualised basis and rose to 4.5 per cent in the second half of the same year.

The United States (US)

The US economic resurgence was substantially supported by policy stimulus. According to the advance estimates of the US Bureau of Economic Analysis, in the first quarter of 2010, real GDP rose by an annualised rate of 3.2 per cent, a slowdown from 5.6 per cent observed in the fourth quarter 2009. The growth was mainly driven by the US consumer spending which contributed 2.6 percentage points during the first quarter of 2010. US consumption expenditure accounts for about 70.0 per cent of the US economic activity.

In addition, business expenditure on software and equipment contributed moderately to the economic activity. According to the WEO, substantial monetary and fiscal policies, inter alia, provided a broad-based fillip to the US growth. However, the report highlights the continued weakness of the US labour market, but, the rate at which jobs are being lost has come down substantially. The US financial market conditions have also began to stabilise. Equity markets have recovered from their lows in 2009 and corporate bond issuance is running above the pre-crisis levels.

Despite the positive outlook, there are still some downside risks for 2011. In the near term, residential real estate activity may undermine growth, though the stronger than expected inventory cycle may counterbalance the effect. Beyond the near-term, higher-than-anticipated rates of foreclosures in real estate's markets could pose downside risk to the US growth. In addition, fiscal imbalances in the US present a major macroeconomic challenge to the country.

The Euro Area

The global financial crises and the resultant economic recession left the Euro Area paralysed in 2009. The Euro Area saw six quarters of consecutive contraction of real GDP starting from the second quarter of 2008. However, moderate and uneven recovery is taking shape across the region, mainly supported by rebound in global trade and policy stimulus. The recovery is weaker than in the rest of the world; reflecting the depth of the effect of the crisis on this area.

The Euro Area growth rate slowed down from 2.8 per cent in 2007 to 0.6 per cent in 2008. Against the backdrop of the sub-prime mortgage crisis, the Euro Area declined by 4.1 per cent in 2009. In the first quarter of 2010, the region expanded by 0.2 per cent on annual basis from zero growth in the fourth quarter of 2009. The region's growth is expected to turn positive, rising by 1.0 per cent in 2010 before accelerating to 1.5 per cent in 2011. The recovery is expected to be moderate in Germany and France, where export growth is limited by external demand and investment is held back by credit constraints.

The downside risk to the recovery in the region may emerge from market concerns about sovereign liquidity and solvency in Greece and Portugal, which could turn into a full-blown sovereign debt crisis, leading to some contagion. The second risk lies in the fiscal and current account imbalances in the peripheral economies such as Ireland and Spain, although resolving these imbalances is expected to dampen growth.

Sub-Saharan Africa (SSA)

The SSA was not immune to the effects of the global financial crisis. The crisis affected the economies in the region in varying degrees. Following the average growth rate above 6.0 per cent, from 2003 to 2007, the SSA real GDP growth slowed to 5.6 per cent in 2008 and further decelerated to 2.1 per cent in 2009, mainly reflecting the impact of the economic showdown in the region.

Nonetheless, most countries in the region have weathered the crisis well and the recovery is expected to be stronger. The growth of output is expected to accelerate to 4.7 in 2010 and 5.9 per cent in 2011. The regions' quick recovery mainly reflects the limited integration of most low-income economies into the global financial system. Strong macroeconomic fundamentals in the pre-crisis period, the expansionary macroeconomic polices embarked upon by most countries in the years prior to the crisis, the rebound in world trade and an uptick in commodity prices added to the recovery.

The main risks to the region's economic prospects are higher-than-expected energy prices, which would benefit oil-exporters but dampen economic growth and raise inflation rates in the region's oil importers. Given large output declines in major donor economies, official aid flows may also decline. The major policy challenge for the region is attracting private capital flows. This will require appropriate and prudent macroeconomic policy measures.

Implications for the economy of Lesotho

The financial crisis that hit the global economy in 2008 and 2009 had negative effects on the economy of Lesotho. This resulted in a decline in government revenue, especially external trade related revenue. In addition, the demand for Lesotho's diamond and textile exports declined. Migrant workers' remittances also fell as more Basotho were retrenched in SA's mining industry.

Nonetheless, the ongoing global economic recovery is a welcome situation for Lesotho's economy for several reasons. First, given the sustained momentum of the U.S economic recovery, textile exports may be given a boost and the manufacturing sector employment may begin to grow. The U.S consumer demand climbed 3.6 per cent in the first quarter 2010 compared to 1.6 per cent in the last quarter of 2009, while retail sales surged by 17.9 per cent in the first three months of 2010. However, the U.S strain on the labour market remains the main risk to Lesotho's textile prospects.

Second, the Euro area grew at 0.2 per cent in the first quarter of 2010 mainly driven by exports. The recovery in the zone is likely to boost diamonds exports from Lesotho. The recent improvements in the diamond market and the uptick in their prices is a welcome development both for earnings and employment prospects for the economy of Lesotho. The major threat to sustainable economic recovery is Greece's debt situation. If not managed well and in time, it may be contagious and lead to yet another crisis.

For the global economy to fare well in the run up to the strong and sustainable recovery, policy makers need to formulate and implement appropriate strategies for exiting from crisis related intervention policies. The timing, pace and mode of exiting will, to a large extent, depend on the state of the economy and the health of the financial system.

Lesotho Electricity Authority (LEA) increase electricity tariffs that are lower than Lesotho Electricity Company's (LEC) proposals

Introduction

In early 2008, South Africa and other countries in the region, including Lesotho, experienced a tremendous electricity shortage. This shortage was due to inadequate investment in power generation, transmission and distribution, and also due to ageing power stations in South Africa. In a bit to overcome this power shortage, Eskom put up a R460 billion expansion program which was proposed to be financed partly through loans and higher prices. This led to an upward pressure on the price of electricity in the region, as neighbouring countries, such as Lesotho, import part of their electricity supply from SA.

The Lesotho Electricity Company (LEC) proposed an increase of 14 to 17 per cent in electricity tariffs for 2010/11. LEC cited the following as key drivers behind this proposal: 24 per cent Eskom tariff hike; 12 per cent Electricidade de Mozambique EDM adjustment; rising operational costs and general increase in prices; depreciation of infrastructure; and economic growth dynamics. However, the Lesotho Electricity Authority (LEA) in April 2010 granted LEC a 6 to 7.3 (excluding levies) per cent tariff increase for the financial year 2010/2011. This increase will exert pressure on the general price level, leading to higher cost of production for industries and higher cost of living for the poor.

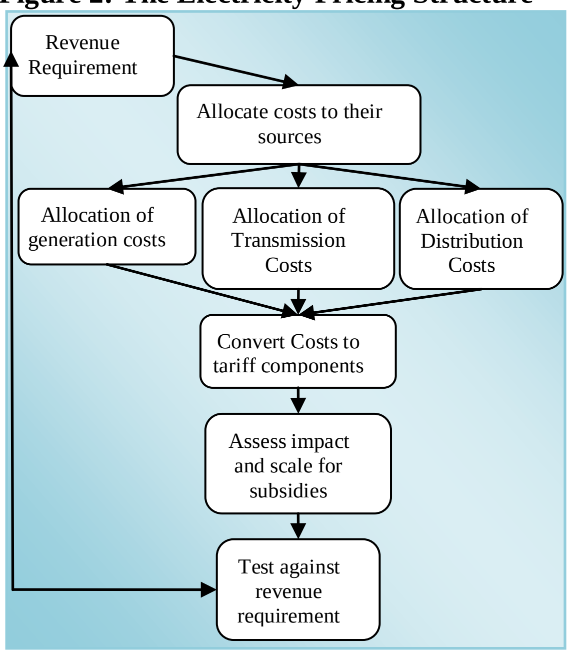
Electricity Supply in Lesotho

Electricity generation in Lesotho is done by 'Muela Hydroelectric plant while transmission and distribution are left to LEC. 'Muela produces 72 mega watts per hour at full capacity which is more than enough to meet the local demand during off-peak periods and in summer. The excess generated during off-peak periods is exported. However, shortfalls emerge during peak periods and in winter. Traditionally, Eskom has been able to fill the supply gap. In response to the power outages in 2008, LEC searched for another bulk supplier and secured a contract with EDM to fill the gap.

Determination of Electricity Tariffs

Electricity tariffs are determined based on the following principles: to promote economic efficiency and sustainability; to recover revenue enough to cover risks; and be non-discriminatory; and to serve customers in a fair and equitable manner. Figure 2 provides a summary of the major stages in determining electricity tariffs. The first stage is to set the revenue requirement which should reflect the total cost of business that should be recovered through tariffs based on projected volumes.

Figure 2: The Electricity Pricing Structure



Source: Tariff Design Methodology (Ekom)

The second step is the allocation of costs to their sources (generation, transmission and distribution). For LEC, prices charged by 'Muela, Eskom and EDM reflect generation costs since it is not involved in generation of electricity. Costs are then converted to tariff components. The third stage is assessment of impact and scale for subsidies. Finally, determination of revenue requirement is made. This is an iterative process and should be run until the new tariffs strike optimality.

Electricity tariff determination in Lesotho generally follows more or less the same structure as set above and is also in the spirit of the principles laid above. In addition, costs are adjusted to account for costs relating to non technical losses, such as theft, and the rural electrification and customer levies are added onto the approved tariffs. The rural electrification levy goes to a separate fund which is aimed at subsidising rural electrification. Finally, the regulatory body, LEA ensures that the licensee's regulated activities are fully funded from its tariff revenues.

Structure of Approved Tariffs

Table 1 below presents approved electricity tariffs and their percentage changes since the financial year 2008/09. The general purpose and domestic categories are charged the highest with M0.81 and M0.72 per kilowatt per hour whereas the industrial and commercial categories pay as little as M0.13 per kilowatt per hour. This is because the general purpose and domestic categories are on average the least consumers of electricity as compared to the industrial and commercial categories.

The tariffs for both industrial and commercial users registered the highest average increase of 10.3 per cent for 2010/11 and general purpose and domestic categories registered the lowest increases with 6.4 and 7.7 per cent, respectively. On average, the energy charges increased by 7.1 per cent excluding levies; and 8.9 per cent including customer and rural electrification levies. This increase is, on average, 1.1 percentage points lower compared to 2009/10 approved tariffs and it is attributable to a relatively lower inflation environment.

Table 1: Approved LEC Electricity Charges

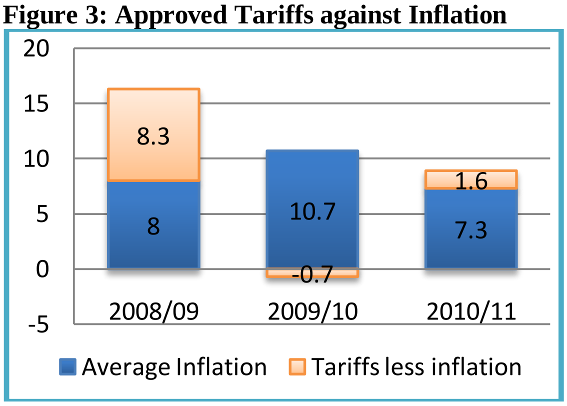
	Approved Tariffs 2008/09 (M/kWh)	Approved Tariffs 2009/10 (M/kWh)	Approved Tariffs 2010/11 (M/kWh)	% Changes 2008/09	% Changes 2009/10	% Changes 2010/11
Industrial HV	0.1048	0.1160	0.1280	23.6	10.7	10.3
Industrial LV	0.1134	0.1254	0.1380	21.4	10.6	10.0
Commercial HV	0.1048	0.1160	0.1280	23.6	10.7	10.3
Commercial LV	0.1134	0.1254	0.1380	21.4	10.6	10.0
General Purpose	0.6950	0.7580	0.8064	2.2	9.1	6.4
Domestic	0.6125	0.6680	0.7192	7.9	9.1	7.7
Street Lighting	0.3650	0.3983	0.4298	14.1	9.1	7.9
Average Price				**16.3**	**10.0**	**8.9**

Note*: The customer levy has been increased by M0.0056/kWh (40 per cent) to M0.0196/kWh and charges above are inclusive of such levies.*

Source*: LEA and LEC*

Figure 3 below presents the average inflation rates against the approved electricity tariffs. The comparison is very important since inflation is often used as a benchmark for increases in the prices of goods and services.

Figure 3: Approved Tariffs against Inflation



The financial year 2008/09 saw approved electricity tariffs higher than inflation by about 8.3 per cent. Approved increase in tariffs was lower than inflation by 0.7 per cent in 2009/10, while the 2010/11 approved electricity tariffs are 1.6 per cent higher than inflation.

Implications on the Economy and Policy Considerations

Tariff increases that are higher than inflation pose several challenges for the economy of Lesotho. They exert pressure on inflation and pose challenges to efforts directed at maintenance of price stability, particularly, from the supply side.

The manufacturing sector, as a whole, already faces a lot of challenges and this may hamper the economic recovery efforts and also contribute to erosion of price competiveness of the sector. This will also have a negative impact on final consumption which in turn, will result in slow economic recovery from the repercussions of the global economic downturn.

In addition, on the fiscal side, the actual deficit may exceed the budgeted one if inflation increases by more than anticipated. At the household's level, the impact of this increase will be directly felt since often higher prices are transferred to the consumers and this may exacerbate the already high poverty levels even further.

The following policy recommendations are worth some consideration in order to prevent and mitigate the possible impact. Relevant parties may consider price smoothing of price shocks by spreading them over a longer period.

The major force driving electricity tariffs is the Eskom expansion plan. Basotho are indirectly financing the South African investment through high imported tariffs. Another lesson that could be learned from the 2008 power shortages is that, Lesotho should not be overly dependent on South African power supply. In order to avoid this unfavourable reality, and also as a long-term solution to Lesotho's power problems, relevant parties should carry forward the plans of expanding 'Muela and augmenting a hydropower generation station on phase 2 of the Lesotho Highlands Water Project. Explorations of other green power generation alternatives like wind and solar may also be considered. These may be done in phases since the government is currently financially constrained.

3. Monetary Policy Operations Report for April, 2010

During the review period, monetary policy operations undertaken by the Central Bank of Lesotho (CBL) were successful in attaining the desired objectives. The primary objective of the CBL's monetary policy is to achieve and maintain price stability. To this end, the Bank employs Open Market Operations (OMO) to attain the stated objective. This initiative enables the Bank to maintain the parity between the local currency, Loti, and the South African Rand, which is important for price stability.

The report presents economic and operational issues surrounding the monetary policy operations conducted during the review period to assess the success of the operations. Table 1 below shows the amounts auctioned and discount rates that prevailed for each of the auctions during the review month.

It shows that the entire amounts of treasury bills (M10.0 million and M13.0 million) announced during the auctions conducted in April 14 and 27, 2010, respectively were ultimately issued.

The market for 91-day treasury bills continued to perform satisfactorily. Competitiveness of the 91-day treasury bills auction (measured by the number of bidders and bids received, over/under subscription of the auction, the spread of bidding prices as well as the movements of the discount rates) improved during the review period. The number of bidders increased from 2 to 7 in April 28, 2010. The number of bids increased from 2 to 20 from the first April auction to the second auction during the same period. Oversubscription increased from M10.2 million to M19.6 million.

Table 2: Treasury Bills Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (Million Maloti)	Amount Issued (Million Maloti)	Over/(under) Subscription (Million)	Discount Rate (%)	RSA Discount Rate (%)
91-day		14-Jul-10	M10.0	M10.0	M10.2	6.46%	6.59%
182-day		13-Oct-10	M10.0	M10.0	M17.9	6.65%	6.53%
273-day		12-Jan-10	M6.0	M6.0	M7.1	7.39%	6.61%
364-day	***14-Apr-10***	13-Apr-10	M6.0	M6.0	M6.4	7.50%	6.55%
91-day		28-Jul-10	M13.0	M13.0	M19.6	6.42%	6.60%
182-day		27-Oct-10	M13.0	M13.0	M19.9	6.65%	6.45%
273-day		26-Jan-10	M8.0	M8.0	M9.0	7.39%	6.46%
364-day	***28-Apr-10***	27-Apr-10	M8.0	M8.0	M8.1	7.50%	6.39%
Total for reporting period			M74.0	M74.0	M98.2		

During the review month, the intermediate target, Lesotho 91-day treasury bills rate (discount rate) declined by 4 basis points to 6.42 per cent. Nonetheless, the spread of the bidding prices widened to M0.13 in April 28, 2010 compared with M0.0 in April 14, 2010. On the other hand, the SA counterpart increased by a basis point to 6.60 per cent. As a result, the margin between the two rates widened by 5 basis points to 0.18 per cent. Lesotho's 91-day treasury bills' discount rate continued to remain below the SA counterpart.

Figure 4: Measuring the Success of Monetary Policy Objectives: Performance of Lesotho 91-Day T-Bills vs RSA T-Bills