Economic Review October 2007

Government Provides M10 million worth of Subsidies on Selected Food Items

The Government has released a portion of the M220 million amount allocated for famine relief to subsidise consumers on basic food items. This initiative has potential to protect the poor from escalating food prices…

Background

Southern Africa has experienced the worst drought in 30 years. This has resulted in shortages of basic food items in most parts of the region. The combination of high temperatures and low rainfall during January to March 2007 created one of the worst drought situations ever experienced in Lesotho. There was a decline in area planted for cereals over the past years, with some potential farmland left uncultivated mainly due to the uncertainty of agro-climate conditions, shortage of labour and lack of capital for inputs and investment. The decrease in area planted was estimated to range between 15 per cent and 20 per cent compared to the 5-year average.

As a result, excess demand pushed prices to a level that an increasing number of the poor could not afford. Inflation rates in both Lesotho and South Africa have been on the increase, with the South Africa's targeted measure exceeding the upper limit of 6 per cent. In response to these developments, the Government of Lesotho released a M10 million subsidy on selected food items to cover the period October 2007 to March 2008. The subsidy is part of the M220 million allocated for the famine relief programme.

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In addition, a task team made up of stakeholders was established to engage on food prices subsidy campaigns to sensitise the public about the recommended prices. The initiative is spearheaded by the Department of Trade and Marketing.

The food items selected in the initiative include sugar beans, peas, as well as, selected locally produced maize meal and dairy products. These items and respective subsidies are indicated in table 1 below.

Table 1: Food Items Subsidised.

Food Items	**Subsidies**
Maize (Mealie) Meal	20 per cent of price
Peas	20 per cent of price
Sugar Beans	20 per cent of price
Fresh and Sour Milk	55 Lisente per Litre

Source: MTICM

Economic Implications of the Subsidy

The increase in food inflation has been the main driver of overall inflation rates recently. The food and non-beverages items account for 39.8 per cent of total household expenditure, of which food represents 38.4 per cent. Owing to the importance of food prices in the consumer price index (CPI) basket, the behaviour of the overall inflation rate moved in tandem with the former. Food inflation continued on a strong upward trend, reaching a peak of 15.2 per cent in April and October, and averaging 12.9 per cent during the past twelve months to October 2007. The overall inflation rate recorded an average of 7.4 per cent during the same period.

The subsidy has potential to curb inflationary pressures in the coming months. It would also improve access by all to the basic food stuffs. Thus school attendance could improve and the potential rise in crime curbed. This may also influence increase in production and distribution of those items in reaction to high demand.

Prices of Wool surge to all time high in October 2007

Introduction

The South African wool industry is booming following Australia's poor production due to drought. This resulted in farmers realising the best prices at the October 2007 auction held in Port Elizabeth. The average price was 50 per cent higher than last season. The highest price ever paid for a bale was also achieved at the same auction. This has benefited Southern African farmers, with prices soaring by more than 40 per cent from the first to the last sale. Clean wool was selling at M62.35 per kilogram (kg), with the highest price offered at M150.00 per kg for a bale of wool.

The demand for wool had been decreasing due to increased use of synthetic fibres. As a result, wool production is much lower than past production levels. The collapse in the price of wool began in late 1966 with a 40 per cent drop due to, among others, occasional interruptions in the market. The result has been sharply reduced production and movement of resources into production of other commodities such as meat.

Global wool production is approximately 1.3 million tonnes per annum of which 60 per cent go into apparel. Australia, China and New Zealand are leading commercial producers of wool. Most Australian wool comes from the merino breed.

Sheep Husbandry in Lesotho

Sheep are kept primarily for production of wool. However, due to the subsistence nature of livestock husbandry in Lesotho, farmers periodically slaughter castrates (hammels) and old sheep for family consumption. This practice is more common in winter. They are also used for such cultural obligations as payment of bride price, payment to traditional healers and burial ceremonies.

Vaccinations and dosing are not mandatory, but farmers are advised to vaccinate their small stock against common diseases such as blue tongue, pulpy kidney and black quarter at least once a year. It is reported that only insignificant number of sheep and goat farmers vaccinated their animals against these diseases.

Production of wool is not spread evenly throughout the country. The highlands region remains the largest producer of wool. However, Leribe, Berea and Mohale's Hoek showed signs of improvement relative to the previous period. Wool from these districts also attracted higher prices with better yields per sheep.

The table that follows gives the performance of wool price and production in the past two agricultural years. Although production of wool is declining, the price was increasing. This calls for farmers to engage more on high value producing stock to get more returns. Production of wool fell by 1.3 per cent, while the quality (cleanness) improved by 5.9 per cent. The drop was attributed to the overall decrease in yield per kilogram due to climatic conditions experienced last season.

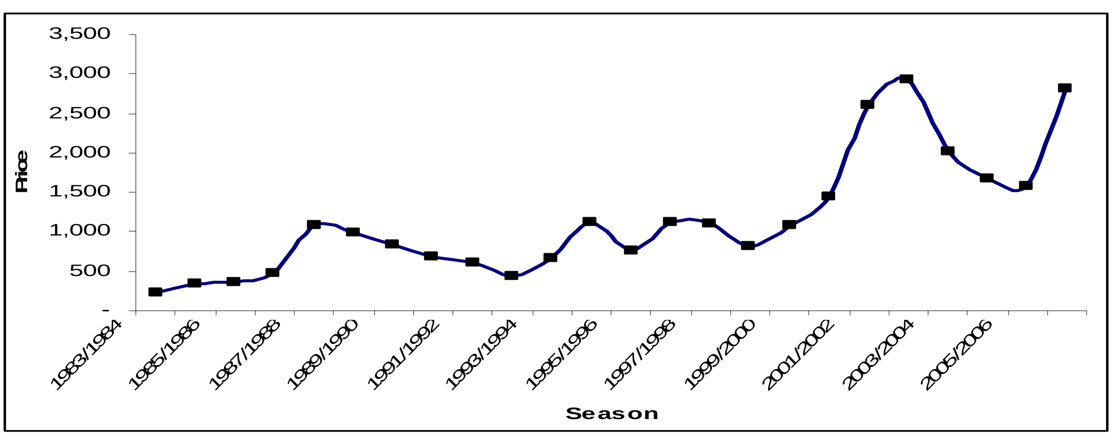
Table 2: Comparison of Wool Production

Output	2006/07	2005/06
Net Mass (Million KG)	2.194 m	2.224m
Clean Yield (%)	59.20	55.92
Total Sheep	820,694	777,425
Production – KG Per Sheep (Average)	2.67	2.86
Average Greasy Price – Maloti Per KG	M28.12	M15.70

Source: Livestock Production and Marketing Services (LPMS)

Price per kilogram has been volatile in the past 23 years, with minimum realised in 1983/84 season, and peak reached in 2002/03 (see Figure 1). Prices showed signs of improvement in 2006/07, after plummeting from the peak realised in 2002/03. The prevailing price is an incentive enough for local farmers to increase production.

Figure 1: Average Price of Wool per kilogram since 1983/84



Source: LPMS

Government Policy

It is government policy to encourage small stock farmers to keep only Merino and Angora breeds of sheep and goats, respectively. This has been the policy since 1927 when the importation of crossbred rams and bucks was legally prohibited. By 1935, livestock officers were legally authorised to castrate crossbreeds on sight.

Market outlets

There are presently two officially recognised wool and mohair marketing channels in Lesotho. Farmers can either sell their wool and mohair at private trading stations authorised to deal in wool and mohair or at government shearing sheds placed at 96 locations across the country. Normally farmers using government sheds are members of Wool and Mohair Growers Associations (WMGAs) and their marketing groups (MGs), while those using trading stations are individuals not affiliated to any group.

It is not uncommon, however, to find members of WMGA and MGs using private trading stations for fast payment. The WMGAs sell their wool through the South African outlets, hence the significance of the October auction prices in Port Elizabeth to Lesotho.

Conclusions and Recommendations

The surging prices and declining global output are an incentive for growing the livestock sub-sector in the economy. While the sub-sector 's contribution to total output would remain low, it has positive spin-offs on poverty reduction, rural wealth, insurance against income shocks, health, affordability of education and as a deterrence of urban migration.

Government has to put in place structures to support potential farmers to restore wool and mohair as one of the main foreign exchange earners of the country. There should also be an initiative to establish processing zones domestically so that prices will not fluctuate with international developments. Security also needs to be tightened to protect livestock in general. Most farmers have withdrawn from the industry because of prevailing high stock theft. In addition, efforts to increase vaccinations and encourage efficient management of grazing land would maximise benefits from this sub-sector.

Monetary Policy Operations for October 2007

Central Bank of Lesotho employs monetary policy as a vital instrument to achieve price stability using open market operations (OMO). This enables the Bank to maintain money market rates that are in line with the South African counterpart rates, and realise the ideal level of Net International Reserves (NIR) to defend the parity between the local currency, Loti, and the South African Rand.

During the auction in October, an amount of M160.0 million worth of securities was announced for auction in 91-day treasury bills. The amounts auctioned and discount rates that prevailed for each of the auctions are presented in table 3 below. The level of competitiveness in the market is estimated by the number of participants in an auction. The auction saw a participation level of 7 bidders who submitted 19 bids for the auction and the number of bidders was equal to the September figure of 13. All bidders became partially successful and 15 bids were successful against 12 bids that were successful in the previous auction. At present, there is no limit on the number of bids per bidder in one auction.

Table 3: Treasury Bill Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (million)	Amount Issued (million)	Discount Rate	RSA Disc. Rate
91-day TBs	03 Apr 07	06 Jul 07	M160.0	M160.0	7.49%	8.27%
91-day TBs	02 May 07	03 Aug 07	M170.0	M170.0	7.50%	8.32%
182-day TBs	08 May 07	09 Nov 07	M50.0	M30.2	7.45%	8.38%
91-day TBs	30 May 07	31 Aug 07	M170.0	M171.0	7.56%	8.68%
91-day TBs	04 Jul 07	05 Oct 07	M170.0	M170.0	7.62%	9.10%
182-day TBs	11 Jul 07	11 Jan 08	M50.0	M32.0	8.20%	9.42%
91-day TBs	01 Aug 07	02 Nov 07	M170.0	M170.0	7.76%	8.86%
91-day TBs	29 Aug 07	30 Nov 07	M160.0	M160.0	8.12%	9.30%
182-day TBs	05 Sep 07	07 Mar 08	M20.0	M20.0	8.90%	9.67%
91-day TBs	03 Oct 07	04 Jan 08	M160.0	M160.0	8.32%	9.43%
Total for reporting period			M160.0	M160.0		

The success of monetary policy operations is judged amongst other things, by the margin of interest rates between Lesotho and South Africa (a neighbour and largest CMA member). A large treasury bill rate differential, say greater than 2 percentage points, would lead to undesirable transfers of funds which would bring unnecessary interest costs to Government if in favour of

Lesotho, or a run-down of external reserves if against.

The Lesotho 91-day treasury bill rate still remained below its SA counterpart rate despite the fact that it continued to increase in October. The Lesotho 91-day treasury bill rate rose by 20 basis points to 8.32 per cent. The counterpart SA rate also increased from its previous level of 9.30 per cent in September to 9.43 per cent in October. Consequently, the gap between the two rates narrowed from 118 basis points to 111 basis points at the end of the review period, as depicted in figure 2 below. At this level, the margin is considered adequate and monetary policy operations successful. Indeed, the level of net international reserves as the ultimate policy target performed well at USD 410.5 million above the targeted minimum level.

Figure 2. Measuring the Success of Monetary Policy Objectives: Lesotho 91-Day T-Bills vs. RSA T-Bills

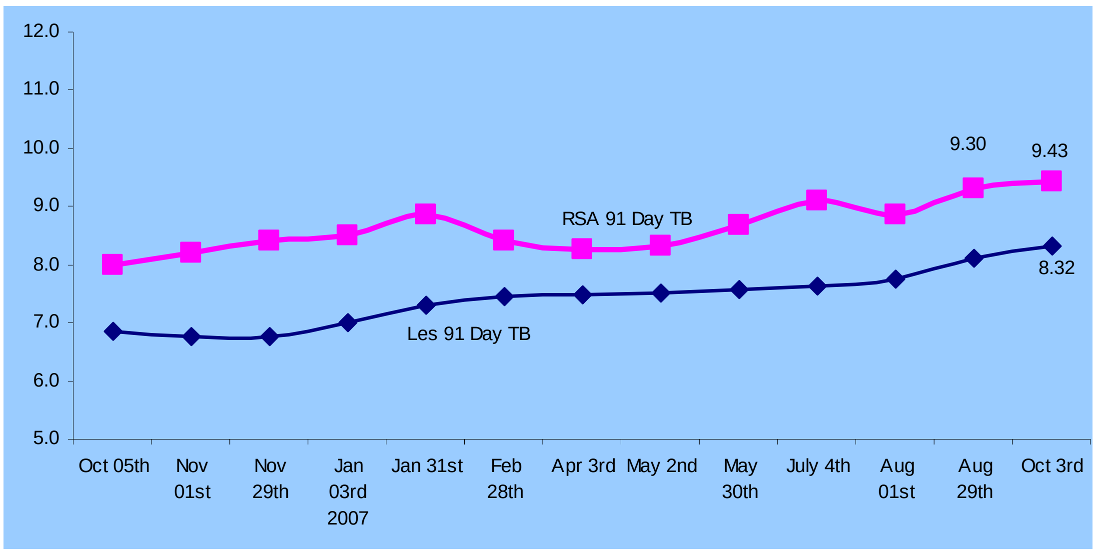


Table 4: Selected Monetary and Financial Indicators

	2007		
	August	**September**	**October**
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	*14.75*	*14.17*	*14.50*
1.2 Prime Lending rate in RSA	*13.50*	*13.50*	*14.00*
1.3 Savings Deposit Rate	*4.05*	*4.05*	*4.08*
1.4 Interest rate Margin(1.1 – 1.3)	*10.7*	*10.12*	*10.42*
1.5 Treasury Bill Yield (91-day)	*7.76*	*8.12*	*8.32*
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	*3779.71*	*3766.12*	*3869.05*
2.2 Net Claims on Government by the Banking System	*-3301.17*	*-3100.09*	*-3873.83*
2.3 Net Foreign Assets – Banking System	*8136.10*	*7939.53*	*8702.39*
2.4 CBL Net Foreign Assets	*6276.99*	*6063.39*	*6725.60*
2.5 Domestic Credit	*-2135.25*	*-1909.39*	*-2676.81*
2.6 Reserve Money	*500.890*	*508.999*	*496.755*
3. Spot Loti/US$ Exchange Rate (Monthly Average)	***7.2232***	***7.1083***	***6.7831***
4. Inflation Rate (Annual Percentage Changes)	***8.7***	***8.6***	***8.7***
5. External Sector (Million Maloti)	***2006***		***2007***
	QIV	***QI***	***QII***
5.1 Current Account Balance	*18.50*	*697.20*	*1.68*
5.2 Capital and Financial Account Balance	*-81.15*	*190.60*	*202.63*
5.3 Reserves Assets	*-32.81*	*-1023.89*	*143.38*

+These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities

Table 5: Selected Economic Indicators

	2004	***2005***	***2006***	***2007+***
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	*4.2*	*2.9*	*7.2*	*4.9*
1.2 Gross National Product – GNI	*7.9*	*5.5*	*3.1*	*3.6*
1.3 Per capita –GNI	*7.9*	*5.5*	*3.1*	*3.6*
2. Sectoral Growth Rates				
2.1 Agriculture	*-1.9*	*-1.7*	*1.7*	*-22.5*
2.2 Manufacturing	*2.1*	*-8.6*	*10.5*	*11.0*
2.3 Construction	*-4.4*	*-3.4*	*0.6*	*2.5*
2.4 Services	*2.1*	*4.1*	*6.6*	*6.3*
3. External Sector – Percent of GNI				
3.1 Imports of Goods	*86.3*	*83.1*	*80.1*	*86.5*
3.2 Current Account	*-4.7*	*-5.7*	*3.5*	*8.6*
3.3 Capital and Financial Account	*5.8*	*3.6*	*-1.2*	*5.9*
3.4 Official Reserves (Months of Imports)	*5.2*	*5.5*	*6.7*	*7.2*
4. Government Budget Balance (Percent of GDP)	*5.7*	*4.8*	*12.6*	*4.8*

** Preliminary estimates*
+CBL Projections