



Economic Review

September 2011

**International Monetary Fund's September 2011 World Economic Outlook:
Slowing Growth, Rising Risks: Implications for Lesotho's Economy**

The global economic recovery has weakened due to large increases in fiscal and financial uncertainty in advanced economies.....

Introduction

The International Monetary Fund's September 2011 World Economic Outlook (WEO) indicates that the global economic recovery has weakened. Growth, which had strengthened in 2010, weakened in 2011 reflecting lacklustre recovery in advanced economies and a large increase in fiscal and financial uncertainty. In addition, a transition from fiscal stimulus to private demand has not taken place in advanced economies. The rebalancing act in emerging market economies, which have current account surpluses like China, has seen a shift from foreign demand to domestic demand while advanced economies, which have been characterised by current account deficits, have tried to compensate for low domestic demand through a rise in foreign demand but this does not seem to materialise.

Regarding medium term prospects, risks are to the downside, with two taking prominence. First, there is the euro area crisis, which needs to be addressed to preserve confidence in national policies. Second, the already weak US economy could weaken further as a result of lack of political consensus over fiscal consolidation, a weak housing market that is characterised by excess supply and declining prices and unprecedented increases in household saving rates or deteriorating financial conditions.

This article provides an overview of recent global economic developments and prospects for 2011 and 2012. It also provides highlights on the implications of these developments for the economy of Lesotho.

The Global Economic Performance and Projections

According to the September 2011 WEO, the global economy has weakened after showing signs of recovery in 2010 and up

to the first quarter of 2011. The world real economic growth rate is projected to decelerate to 4.0 per cent in 2011 from

5.1 per cent in 2010. The major contributor to this slowdown is the fragile economic recovery in the US. Growth is expected to remain sluggish in the euro area as a result of sovereign debt and banking sector problems that have proven to be more stubborn than anticipated. The Japanese earthquake and tsunami that disrupted global car manufacturing and oil supply also lowered global output.

In 2011-12 it is projected that activity in advanced economies would pick up modestly while emerging and developing economies would realise robust growth. Major supporters of growth in emerging and developing economies during this period include the recovery in activity in

Japan, the decline in oil and food prices and strong growth in demand in key emerging market economies.

Nonetheless, risks are mainly to the downside. Consumption in advanced economies is likely to remain sluggish because of high unemployment, sluggish wages and the depressed property market in the US. Lack of fiscal prudence and fragility in the banking system are hurting consumer and business confidence. Fiscal policy is also expected to tighten in the US and the euro area as a result of fiscal consolidation efforts geared towards addressing sovereign debt problems and restoring external sustainability. This may dampen short term economic growth, globally.

**Table 1: World Economic Outlook Projections
(Annual Percent Change)**

	2009	2010	2011	2012
World Output	-0.7	5.1	4.0	4.0
Advanced Economies	-3.7	3.1	1.6	1.9
United States	-3.5	3.0	1.5	1.8
Euro Area	-4.3	1.8	1.6	1.1
Emerging and Developing Economies	2.8	7.3	6.4	6.1
Sub-Sahara	2.8	5.4	5.2	5.8
Central and Eastern Europe	-3.6	4.5	4.3	2.7
Commonwealth of Independent States	-6.4	4.6	4.6	4.4
Developing Asia	7.2	9.5	8.2	8.0
Middle East and North Africa	2.6	4.4	4.0	3.6
Consumer Prices				
Advanced Economies	0.1	1.6	2.6	1.4
Emerging and Developing Economies	5.2	6.1	7.5	5.9
Imports				
Advanced Economies	-12.4	11.7	5.9	4.0
Emerging and Developing Economies	-8.0	14.9	11.1	8.1
Exports				
Advanced Economies	-11.9	12.3	6.2	5.2
Emerging Developing Economies	-7.7	13.6	9.4	7.8

SOURCE: International Monetary Fund (IMF) World Economic Outlook September 2011

The US

The US economy has weakened in 2011 after a major recovery in 2010. The US economy grew by 3.0 per cent in 2010, supported by private demand. Consumer confidence also recovered at the back of the improvement in financial conditions.

However, the US economy has failed to hold on to its 2010 gains. Growth deteriorated from an annual rate of 2.75 per cent in the second half of 2010 to 1.0 per cent in the first half of 2011. Factors that contributed to this slowdown include automotive supply disruptions due to the Japanese earthquake and tsunami and the deterioration in domestic demand as a result of the surge in the price of oil and the weak job growth. Both the household and business confidences have fallen markedly, and market volatility has risen quite significantly in response to concerns about the sluggish recovery and the downgrading of the US sovereign credit rating.

The short-term prospects look gloomy. US growth is projected to deteriorate to 1.5 per cent in 2011 and remain sluggish in 2012, growing by 1.8 per cent. Downside risks to the outlook have increased significantly. The US needs to reach a political consensus regarding a strategy to reduce its debt. Failure to do so may result in fiscal deficits and also increase the US risk premium which could have negative effects on growth. In

addition, the housing market remains under pressure as supply continues to exceed demand and house prices remain low. Equity markets continue to suffer losses while consumer spending would be depressed further as risks on commodity prices appear to be on the upside.

The WEO September 2011 proposes a number of policy considerations for the US authorities. The first one is to commit to a credible fiscal consolidation strategy that puts public debt on a sustainable trajectory over the medium term, while also supporting the near term recovery. The strategy should include reform of social support benefits and revenue raising measures. Second, interest rates should be maintained at the current accommodative level and the Federal Reserve should, as needed, implement further unconventional support, especially when inflation expectations remain well anchored. Third, the accommodative monetary policy in the US could induce excessive risk taking thus necessitating rapid implementation of financial sector reforms and other measures to enhance financial stability, including strengthening regulation and supervision. Fourth, the US authorities need to implement policies to reduce the current account deficit and such policies should be centred on judicious fiscal consolidation.

Europe

Economic recovery in Europe has weakened, though there are divergences across the region. In advanced Europe, high public deficits and debt as well as lower potential output are weighing

heavily on growth. Sovereign debt risks are taking a toll on the euro area economies. Many central and eastern European (CEE) countries are rebounding strongly from recession.

The euro area economy grew by 1.8 per cent in 2010 after falling by 4.1 per cent in 2009. The euro area economy maintained the momentum, growing by 2.5 per cent in the first quarter of 2011. Nonetheless, growth fell sharply to 1.6 per cent in the second quarter of 2011. This deceleration resulted from the pressure of high commodity prices on disposable income, ongoing fiscal tightening and low consumer and business confidence because of the sovereign debt crisis.

According to the September 2011 WEO's projections, real GDP growth in the euro area is expected to slow from an annual rate of 2.0 per cent in the first half of 2011 to 0.25 per cent in the second half, averaging 1.6 per cent in 2011. It is expected to further slow down to 1.1 per cent in 2012. The ongoing financial turbulence in the euro area, whereby interbank markets are under strain and some banks are finding it difficult to obtain funding, is expected to weigh heavily on economic activity through lower financing and confidence. Its effect is expected to be so strong that growth

would weaken even if the negative effects of high commodity prices and supply disruptions from the Japanese natural disasters were to wane.

A number of policy considerations may assist in containing the crisis and putting the European economy back on a recovery path. The current plans to tighten the fiscal stance, if complemented with additional entitlement reform, could help create more fiscal policy room. Given the benign inflation outlook, the European Central Bank (ECB) has room to lower the policy rate and help bolster the economy. Efforts should be directed towards strengthening the financial system by capitalizing the banks. In addition, greater European integration would strengthen governance frameworks which are essential for aligning fiscal policies and limiting external imbalances. External rebalancing, which has largely been assisted by low domestic demand growth will need to continue in the euro area supported by domestic adjustment programs including fiscal adjustment.

Sub-Saharan Africa (SSA)

Most countries in the SSA region weathered the negative effects of the global economic crisis well as they were able to implement countercyclical fiscal and monetary policies, which helped to moderate the decline in domestic demand. These policy interventions were made possible by prudent fiscal and other macroeconomic policies pursued prior to the crisis.

The SSA region realised strong economic expansion in 2010 and appears to have maintained the good performance so far in 2011. A real

economic growth rate of 5.4 per cent was registered in 2010 and is projected to be 5.2 per cent in 2011. This strength was largely at the back of robust private and public consumption made possible by accommodative fiscal and monetary policies. The region is expected to continue expanding in the near term, growing by 5.8 per cent in 2012, provided the recent rise in financial and economic instability in the US and euro area is contained. However, prospects differ markedly across the region. SSA's oil exporting economies are at the fore front of the region's growth. They are forecast to grow by 6.0 per cent in 2011 and

further by 7.25 per cent in 2012. This growth is mainly attributable to domestic public spending related to infrastructure investment and resumption of production such as in Angola, following a disruption in 2011. Strong domestic demand and recovery in exports are expected to sustain growth in the region's low-income countries at 5.9 and 6.5 per cent in 2011 and 2012, respectively. The middle income countries in the region were hit harder by the crisis because of their greater integration with global markets hence slow recovery. Inflation has risen markedly across the region, fuelled by the surge in commodity prices.

There are risks to SSA's economic prospects. The weakening US and European economic recovery could hamper the region's exports, remittances, official aid, and private capital flows. In addition, should oil prices increase sharply, oil importers would suffer serious challenges while exporters' growth would be boosted. The increasing inflation due to non-oil commodity prices would also present large social and fiscal costs for net commodity importers.

Implications for the Economy of Lesotho

The weakening of the US and euro zone economies does not augur well for the economies of the world, including Lesotho. This is mainly because of trade linkages between Lesotho and each one of these economies.

Since the inception of African Growth and Opportunity Act (AGOA) in 2000, the bulk of Lesotho's exports of textiles and clothing, have been destined for the US. This increased the manufacturing sub-sector's contribution to employment and economic growth. As aggregate demand in the US fell, on account of the recession, demand for Lesotho's exports of textiles and clothing to US retailers also fell. Consequently, Lesotho-based manufacturers started receiving very low orders from their customers in the US. As a result, the manufacturing sub-sector had to scale down operations and hence laid-off a considerable number of workers. The sub-sector has not as yet recovered and is instead weakening further. Two textiles manufacturing firms

closed operations in the third quarter of 2011, while some put workers on short time, resulting in more job losses.. Performance of the sector is expected to remain subdued until households in the US have resumed their expenditure, at least, to the pre-crisis levels.

The surge in commodity prices has benefited Lesotho's economy. The prices of diamonds rebounded along with the prices of other commodities leading to the recovery of the mining sector in Lesotho. Exports of diamonds are on the increase and the diamond mining production index has improved substantially.

The strong performance of the SSA economies opens up opportunities for Lesotho to diversify its exports markets. Though the SSA market may not be as large as the US one, such diversification would help minimise the effects of external shocks on Lesotho.

Making Water Infrastructure a Tool for Economic Development: Implications for Lesotho's Economy.

In September 2011, the Southern African Development Community (SADC) held a regional conference on strategic water infrastructure in Maseru, Lesotho to deliberate on water infrastructure, management and security.....

Introduction

Water plays a vital role in life. Water needs to be harnessed, secured and managed efficiently in order to expand its productive impact on the socioeconomic development of humanity. Developing adequate hydraulic infrastructure and related legal and institutional frameworks for water management are necessary steps towards making water a tool for economic development. Water infrastructure can be defined as the stock of facilities and installations necessary for the development and management of water resources. This includes supply, delivery, treatment and distribution, of water resources to its users and the sanitation purpose.

Water is one of the most important natural resources in Lesotho, often referred to as "white gold". Water has had a significant impact on the economy of Lesotho, particularly since the inception of the Lesotho Highlands Water Project (LHWP). The geological setup and impressive hydraulic landscape of Lesotho has enabled it to harness water and export it to South Africa and also

produce hydro-electric power for domestic consumption.

According to the new Water Act 2008, the ownership of all water resources is vested in the Basotho Nation and held in trust by the King for Basotho Nation. The efficient usage of water is governed by the principles set forth in the Act and in the case where there is a conflict in water usage; first preference shall be given to domestic use. The provisions include, but are not limited to; sustainable utilization of water resources, intergenerational equity, polluter pays principle.

The usage is regulated and controlled at the ministerial level where the incumbent minister is entrusted with giving directions to water management institutions. With the Ministry of Natural Resource, under Water department, there is a Commissioner of Water who is responsible for policy direction to departments within the ministry and water management institutions. The Commissioner is also responsible for implementation of Water and Sanitation Policy, inter alia.

Background to Water And Sanitation Policy

In order to facilitate national water infrastructure development programs, the Government of Lesotho has drafted a water and sanitation policy document. The main objective of this policy is to facilitate equitable and sustainable water resource availability. With this policy, the Government is committed to making sure

that effective and efficient water management and development maximizes the socioeconomic benefits that could be derived from efficient use of water. This is in line with national priorities. At the top of Lesotho's development agenda is poverty alleviation which, amongst other things,

includes ensuring reliable access to water supply and good sanitation

facilities.

Status of Water Infrastructure in Lesotho

Lesotho's geological setting (mountains and rivers) provides opportunities in water catchment. However, the pace of infrastructure development is slow. The current infrastructure includes larger water storage like major dams (Katse and Mohale), small scale dams such as maqalika dam, inter alia. There are also some other dams like the one used for mini-hydropower station in Mant'sonyane.

Concerning infrastructure, the biggest water reservoir is the Katse dam, which was constructed under phase 1A of the Lesotho Highlands Water Project (LHWP) led by the Lesotho Highlands Water Authority (LHDA) and the Lesotho Highlands Water Commission (LHWC).

The Mohale dam water catchment, which was constructed under Phase 1B of the LHWP, transfers water to the Katse dam. From Katse dam, water is transferred to the Gauteng province in South Africa. The Government is in the process of developing more water infrastructure to increase access to water for social and economic growth and development. The Metolong dam, which is envisaged to supply water to the urban areas, was launched in October, 2011. In the meantime, the Governments of Lesotho and South Africa are engaged in the startup of Phase 2 of LHWP. This project involves construction of the Polihali Multipurpose Dam from which water will be transferred to Katse Dam.

Water Infrastructure and Economic Development

Water is an intermediate input in the production processes of a significant number of economic sectors, including agriculture, industrial manufacturing, energy, transport and health. As such it is one of the key drivers of sustainable growth and poverty alleviation.

One of the most important sectors of the economy, especially in developing countries is the agricultural sector. In this sector, water is mainly used for irrigation purposes. The agricultural sector is the key sector in achieving sustainable food production; hence food security that would meet nutritional needs and improve health, especially in the rural areas. This permeates throughout the poverty alleviation process.

Second, water infrastructure that is harnessed and managed for industrial

growth and development becomes a cornerstone for sustainable growth and development as evidenced by efficient water infrastructure in advanced countries. Efficient and reliable water supply could increase production, boost volumes of exports and also increase employment.

Third, the importance of water supply as the driver of the energy sector cannot be underestimated. Water is used in many countries to generate hydro-electric power. The importance of hydro-electric power, in this era where climate change and issues of switching to the green economy have taken prominence cannot be overemphasized. Water is used to produce crops such as corn that is used in the production of bio-fuel, contributing to the clean environment.

Water transport has proved to be a cornerstone of economic growth and development of countries which have lakes, dams, and are near the coasts. This has brought a lot of economic benefits. The investment in water infrastructure enables aquatic transport to run efficiently and affect the performance of the economy. For example, along the shores of Indian Ocean, especially in Tanzania, a lot of business enterprises have emerged that serve the transport industry. This ranges from food, hotels and accommodation and tourism sites. This has also brought

a lot of revenue to the Republic of Tanzania.

Water infrastructure (such as dams, lakes, and springs) acts as a catalyst for the development of the recreation and tourism industry. For example, most of Zambia's national parks, national forests and wetlands are situated along rivers and lakes with impressive ecosystems. The expansion of the tourism sector which is due to increased water infrastructure may drive economic growth and enhance economic development

Implications for the Economy of Lesotho

The development of water infrastructure holds some benefits for Lesotho's socioeconomic development. Completed projects have demonstrated this and projects that are on the pipeline are expected to make a significant positive contribution.

In order to implement water infrastructure projects, labour input is very crucial and thousands of Basotho will be recruited during the construction period, thus making a positive contribution to employment generation. According to the Directorate of Infrastructure and Services under SADC Regional Water Programme, the unskilled labour input requirement will be reserved for the locals, especially villagers around the project area. For the semi-skilled and skilled work, labour will be sourced locally first before it goes regional or international.

Second, with an expansion in water infrastructure and consequent security and management, Lesotho's hydroelectric power production will

increase. Lesotho has an electricity deficit during peak periods, especially in winter. The current projects are expected to increase the number of power stations. As more stations are erected and a planned 1200MW hydropower plant is in place, more electricity will be generated for domestic consumption and the surplus will be exported regionally.

Third, the amount of water royalties that Lesotho gets from sale of water to South Africa is expected to increase. The increase in water royalties will increase the non-tax revenue of the Lesotho government. Such an increase will, in turn, provide more fiscal space to carry out additional projects that may impact positively on economic growth.

Fourth, improved water supply may increase the country's exports by facilitating manufacturing production, particularly in the wet industries. This may help improve the current account balance and in building foreign exchange reserves.