CENTRAL BANK OF LESOTHO

LESOTHO MACROECONOMIC OUTLOOK: 2014 – 2017

Growth heading for a strong take-off

Highlights

- *Real GDP growth expected to moderate 3.2 per cent in 2016 before accelerating strongly to 5.7 per cent in 2017.*
    - *Resurgent diamond mining industry and strong growth in building and construction expected to give thrust to growth.*
    - *Services sector to remain the main pillar of growth*
    - *Manufacturing, textiles and clothing subsector to remain subdued in medium term*
- *Annual inflation to average 4.7 per cent in the medium term, with oil price-related dip.*
- *Money supply growth to decelerate in the medium term, with an average of 6.9 per cent per annum.*
- *Fiscal position deteriorates into a deficit equivalent to 1.8 per cent of GDP over the medium term.*
    - *SACU revenue to subside in 2015 – 2016.*
- *Overall balance of payments position to deteriorate to a deficit of 0.8 per cent of GDP*
    - *Gross reserves to fall from 6.2 months to 4.5 months of import cover.*

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1. *Executive Summary*

Global economic recovery is set to continue in the medium term largely supported by strong growth anticipated in the United States (US) and Emerging Markets Economies (EMEs). Despite the boost from lower oil prices, global financial markets volatility (particularly in EMEs), weaker activity in some major oil exporters due to sharp drop in oil prices as well as stagnation and low inflation in the Euro Area and Japan remains downside risks to global growth prospects.

In the domestic economy, strong economic growth ahead but manufacturing sector remains weak. Real GDP growth is expected to moderate in 2016 before accelerating strongly in 2017 driven mainly by the implementation of Second Phase of Lesotho Highlands Water Project (LHWP). Like its predecessor the multi-billion maloti project is expected to significantly influence economic growth performance in the country through construction activities associated with Polihali Dam. The strong performance is expected to be complemented by the coming into full operation of additional diamond mines – Liqhobong mining project. The tertiary sector is also expected to continue to remain strong. However, the textile and clothing industry which has been one of the main drivers of economic growth in Lesotho is projected to continue to shrink. Apart from uncertainty surrounding the renewal of African Growth and Opportunity Act (AGOA) beyond September 2015, the industry continues to lose its competitive edge in the US market.

Inflation rate remains subdue following significant oil price decline since September 2014. Consistent with strong increase in non-OPEC production (mainly from US shale oil deposits) and OPEC's intention to maintain production levels despite the perceived glut, the international price of crude oil is set to moderate in the medium term reducing pressure on domestic inflation. Nevertheless, a weak rand/US-dollar exchange rate and uncertainty surrounding global oil production threaten the inflation outlook.

Private sector credit to grow in line with domestic economic prospects, particularly the growth expected in building and construction industry in the medium term. Financial sector reforms including the establishment of national identification card system and launching of credit bureau are likely to give a thrust to the domestic credit. With a relatively weak external sector position and hence a slowdown in foreign assets accumulation, money supply is set to moderate.

Government budgetary operations expected to deteriorate due projected lower SACU revenue. Recurrent expenditures are set to remain elevated while capital spending remains subdue. With tax revenues increasing marginally while SACU revenue declines, the fiscal balance is set to deteriorate into a deficit in the medium term with a marginal impact on official reserves.

Current account deficit is set to widen in the wake of strong imports coupled with declining SACU revenue. With inadequate net capital and financial inflows, official international reserves are expected to decline, however, to the levels more than enough to preserve the exchange rate parity between the loti and SA rand.

2. *Global Economic Outlook*[1]

Global economic growth is anticipated to register 3.5 per cent in 2015 compared to the 3.3 per cent realized in 2014. In the subsequent year, global growth is projected to strengthen further, to 3.7 per cent. Although lower oil prices are likely to boost overall economic activity, troubles in other areas may outweigh these benefits. As reflected by the recent appreciation of the US dollar relative to the Yen and Euro, the outlook for the US economy is the most favourable among major developed economies. Outside the US, growth in major economies has been lower than expected, and future investment weakness due to reduced growth expectations is likely. The potential benefits from a lower oil price level rely on this level being sustained, which is uncertain. Furthermore, financial market volatility is affecting emerging market economies, with emerging market debt spreads widening and developed market bond yields contracting, reflecting a flight to quality. Stagnation and low inflation in the Euro area and Japan remain points of concern.

Table 1: The World Economic Outlook (Annual percentage changes in real GDP)

Regions	***Actuals***		***Projections***	
	2013	***2014***	***2015***	***2016***
World Output	***3.3***	***3.3***	***3.5***	***3.7***
Advanced Economies	***1.3***	***1.8***	***2.4***	***2.4***
United States	2.2	2.4	***3.6***	***3.3***
Euro Area	-0.5	0.8	***1.2***	***1.4***
Germany	0.2	1.5	***1.3***	***1.5***
Japan	1.6	0.1	***0.6***	***0.8***
United Kingdom	1.7	2.6	***2.7***	***2.4***
Emerging and Developing Economies	***4.7***	***4.4***	***4.3***	***4.7***
Russia	1.3	0.6	***-3.0***	***-1.0***
Emerging and Developing Asia	6.6	6.5	***6.4***	***6.2***
China	7.8	7.4	***6.8***	***6.3***
Sub-Saharan Africa	*5.2*	*4.8*	*4.9*	*5.2*
South Africa	1.9+	1.4+*	***2.2^***	***2.4^***

Source: IMF World Economic Outlook Update, July 2014.
+Sourced from South African Reserve Bank Monetary Policy Review, December 2014.
^Sourced from South African Reserve Bank Monetary Policy Committee Statement, January 2015.
****Projection***

In the ***United States (US)***, growth is projected to be 3.6 per cent in 2015, up from 2.4 per cent realized in 2014. In 2016, growth is set to consolidate to 3.3 per cent. Growth is expected to be

[1] The contents of this section draw upon the IMF World Economic Outlook Update, January 2015, the iMFdirect blog article “Seven Questions About The Recent Oil Price Slump” (22/12/2014), and the South African Reserve Bank Monetary Policy Committee Statement, January 2015.

supported by factors such as the low oil price and continued accommodative monetary policy, although the appreciation of the US dollar against major currencies may lead to lower net exports. Real growth in the ***Euro Area*** is projected to grow by 1.2 per cent in 2015, up from 0.8 per cent in 2014. Growth is projected to then rise to 1.4 per cent in 2016. Weak investment prospects are expected to weigh against the Euro Area's growth in the near term. Factors projected to contribute positively to growth include lower oil prices, favourable monetary and fiscal policy, and the recent Euro depreciation. In ***Japan,*** growth is projected to register 0.6 per cent in 2015, higher than the 0.1 per cent recorded in 2014. After falling into a technical recession in the third quarter of 2014, a gradual recovery is expected in Japan in 2015-16 due to supportive fiscal and monetary policy responses, the Yen depreciation and lower oil price.

Emerging and Developing Economies (EDEs) are projected to grow at 4.3 per cent in 2015 and 4.7 per cent in 2016. The economic growth of EDEs as a group can be expected to face a number of headwinds. In China, due to recent rapid credit and investment growth, authorities are not expected to respond strongly to the recent moderation. China's growth rate is thus projected to be 6.8 per cent and 6.3 per cent in 2015 and 2016 respectively, down from 7.4 per cent in 2014. This is also expected to affect the rest of the region, although the outlook for India is brightened by increased industrial and investment activity following policy reforms. Russia's economy is facing a weaker outlook due to geopolitical tensions and a lower oil price, with negative growth of -3.0 per cent and -1.0 per cent projected for 2015 and 2016 respectively. More generally, commodity exporting EDEs are facing pressure due to lower commodity prices, including many in Latin America and the Caribbean, and Sub-Saharan Africa, notably Nigeria and South Africa.

South Africa (SA), the second largest economy in the Sub-Saharan region, is facing a rather subdued outlook. GDP is projected to increase by 2.2 per cent and 2.4 per cent in 2015 and 2016 respectively. Commensurately with the loss of at least one percentage point of GDP growth in 2014 due to work stoppages, in 2015 and 2016 electricity supply disruptions are expected to more than offset the positive impact of cheaper oil. The manufacturing and mining sectors can look forward to making a greater contribution to economic growth following the resolution of recent strikes. Gross fixed capital formation and employment growth remain weak.

The sharp decline in the USD price of oil has significantly impacted the global economy. Although the overall effect on global growth is likely to be positive, the benefits are likely to be uneven. Oil exporting countries will take in less revenue, and their budgets and external balances will be under pressure. However, since the oil industry in many oil-exporting states is government owned, the nature and timing of the impact will depend on whether these governments are able smooth out any necessary fiscal adjustment. Oil importing countries on the other hand can expect higher real incomes for consumers, lower costs in the production of final goods, and improved external positions. However, benefits may be muted for countries whose local currencies have recently depreciated against the USD.

3. Lesotho's Economic Outlook

3.1 Overview of the previous forecast

Since September 2014, several economic developments had evolved triggering the need to review the Bank's forecasts. Global economic outlook (including SA economic outlook) was revised downwards while crude oil prices dipped. Domestic economic growth has been marked up by 30 basis points in 2015 and down by 40 basis points in 2016 relative to the September 2014 Bank's economic outlook (Table 2).

The revisions largely reflect a reassessment of prospects in mining industry, building and construction sub sector as well as inflation outlook in the wake of declining oil prices. The current growth forecasts for mining & quarrying include latest developments regarding Lemphane mining project; the project is set to commence stage 1 production during the first half of 2015. Furthermore, due to lack of information, the previous forecasts did not include the full effects the second phase of Lesotho Highlands Water Project; the timing of the project was uncertain.

Table 2: Overview of Economic Outlook

	2013	2014+	Projections			Diff. from September 2014 Outlook		
			2015	2016	2017	2014	2015	2016
Economic growth	**4.6**	**3.8**	**3.3**	**3.2**	**5.7**	**-0.3**	**0.3**	**-0.4**
Primary Sector	**6.3**	**2.9**	**0.3**	**8.8**	**10.4**	**-0.9**	**1.2**	**5.4**
Mining & Quarrying	-5.3	5.8	-1.6	17.5	19.2	-1.9	2.4	11.9
Secondary Sector	**1.6**	**0.8**	**0.8**	**-3.4**	**5.0**	**-2.2**	**-2.2**	**-7.4**
Manufacturing	-10.1	-7.0	-2.7	-2.2	-1.9	-5.9	-3.0	-2.6
Building & Construction	21.5	10.7	3.4	-8.8	13.2	2.1	-1.6	-16
Tertiary Sector	**5.4**	**5.3**	**5.0**	**4.6**	**4.8**	**1.4**	**1.1**	**1.2**
Inflation Outlook	**5.0**	**5.4**	**3.7**	**5.1**	**5.2**	**-1.2**	**-2.6**	**-0.8**

+ Estimates

Since September 2014 oil prices in U.S. dollars have declined by more than 50 per cent. This was consistent with strong increase in non-OPEC production, mainly from US shale oil deposits. Furthermore, Organization of the Petroleum Exporting Countries (OPEC) decided to maintain current production levels despite perceived glut to maintain their market share. For oil importing countries such as South Africa and Lesotho, the impact of a lower oil price on inflation is felt directly through the inclusion of oil-related products in consumption basket, as well as indirectly through a fall in the cost of production and hence the prices of final goods. SA Reserve Bank also revised its inflation forecast from 5.3 per cent to 3.8 per cent in 2015. Consequently, domestic inflation forecasts had been marked down by 2.6 and 0.9 percentage points in 2015 and 2016, respectively.

The outturn for 2013 growth provided by Bureau of Statistics, which represent the basis for the forecasts, also played a role in reshaping the current forecast. Initially, growth was projected at 3.7 per cent against the outturn of 4.6 per cent. *Growth rate in services sector, particularly wholesale and retail trade as well as financial services, were underestimated.* Furthermore, recent developments throughout the fourth quarter of 2014, suggest that the 2014 growth was overestimated by 30 basis points in September 2014 Bank's economic outlook. Central to this was developments within the manufacturing sector, notably a more than anticipated decline in textiles and clothing industry.

3.2 Sectoral Outlook

Following average growth rate 4.8 per cent in 2012 and 2013, domestic economic growth is estimated to have decelerated to 3.8 per cent in 2014. This was mainly supported by the tertiary sector, particularly wholesale and retail trade services, transport and communications services, financial and insurance services. Marginal growth in public administration and real estate and business services also boosted growth.

In the secondary sector, growth remained subdued at 0.8 per cent in 2014 following a decline registered in manufacturing sub sector, particularly a fall in textiles and clothing industry. Strong growth in building and construction activities boosted the sub sector during the review period. The primary sector decelerated from 6.3 per cent in 2013 to 2.9 per cent in 2014 attributed to a subdue performance in agriculture production, especially the fall in crop production. Mining and quarrying activities increased by 5.8 per cent in 2014 following a decline observed in 2013.

In the medium term, growth is mainly shaped by resurgent diamond mining industry coupled with buoying building and construction industry with spill-over effects on services sector. Economic growth is expected to moderate to 3.2 per cent in 2016 and subsequently accelerated to 5.7 per cent in 2017. Growth performance in the primary sector is largely shaped by the prospects in the mining and quarrying industry over the medium term. Agriculture sub sector is expected to remain subdue in the medium term. Growth in the secondary sector is expected to benefit mainly from building & construction activities (except in 2016 when the sub sector is expected to fall) including the performance of water and electricity sub sector.

Building and construction industry is expected to receive a major boost from large infrastructure project – most notably, the second phase of Lesotho Highlands Water Project from 2017 onwards. Electricity and water sub sector is projected to register a moderate growth in the medium term, with a peak anticipated in 2016. Manufacturing sub sector is set to continue on downward trend in the medium term, driven by the expected decline in textiles & clothing industry.

Table 3: Domestic Economic Outlook

	Actuals			***Projections***		
	2012	***2013***	***2014+***	***2015***	***2016***	***2017***
Economic growth	***5.0***	***4.6***	***3.8***	***3.3***	***3.2***	***5.7***
Primary Sector	***0.5***	***6.3***	***2.9***	***0.6***	***8.8***	***10.4***
Agriculture & related	*-13.8*	*17.1*	*0.7*	*1.8*	*2.2*	*2.6*
Mining & Quarrying	*22.6*	*-5.3*	*5.8*	*-1.1*	*17.5*	*19.2*
Secondary Sector	***4.7***	***1.6***	***0.8***	***0.8***	***-3.4***	***5.0***
Textiles & Clothing	*-5.6*	*-13.9*	*-6.9*	*-6.4*	*-6.3*	*-6.2*
Building & Construction	*24.6*	*21.5*	*10.7*	*3.4*	*-8.8*	*13.2*
Tertiary/Services Sector	***5.9***	***5.4***	***5.3***	***5.0***	***4.6***	***4.8***
Wholesale & retail	*12.5*	*10.2*	*8.2*	*10.4*	*6.7*	*7.5*
Transport & Comm.	*5.5*	*5.6*	*6.3*	*8.4*	*8.6*	*8.7*
Financial Services	*7.1*	*16.1*	*6.3*	*9.0*	*7.6*	*7.5*
Real Estate & Bus.	*4.4*	*2.1*	*2.9*	*2.1*	*3.1*	*3.1*

+Estimate

The largest sector in the economy, tertiary sector, is expected to continue to grow at an average rate of 5.0 per cent. The increase in services sector is mainly support by robust growth anticipated in the wholesale & retail services, transport and communications services as well as financial and insurance services. Robust growth in building and construction sub sector as well as mining industry is expected to give a thrust to transport and communications as well as financial and insurance services in the medium term.

3.2.1 Primary Sector Outlook

From the impressive growth of 6.3 per cent in 2013, primary sector is estimated have decelerated to 2.9 per cent in 2014. Agriculture sub sector subsided from robust growth of 17.1 per cent in 2013 to approximately 0.7 per cent in 2014 following the fall in crop production in 2014.

Nevertheless, the increase in mining and quarrying activities, following recovery of three exceptional quality diamonds[2] in excess of 100 carat by Lets'eng during the first half of the year, boosted the sector 2014. In the medium term, the primary sector is projected to subside from 6.3 per cent in 2013 to approximately 0.3 per cent in 2015, before recovering strongly in the subsequent years – 2016 and 2017 – and grow at an average rate of 9.6 per cent. The performance of the sector over the medium term is largely shaped by the prospects in the mining & quarrying industry. Agriculture is set to experience moderate growth over the medium term.

Although the government of Lesotho continue to support agriculture sub sector, in the forms of subsidies for crop production and other programmes including training on conservation practices and procurement of agricultural machineries (the impact of which was felt strongly in 2013), there has not been a sustained resurgent upswing in the sub sector. Unfavourable weather conditions, limited access to finance and agricultural technology including inputs, soil infertility, HIV/AIDs pandemic remain the main obstacles to the prospects in agriculture sub sector. Continuous decline in arable land is also a constant threat to the sub sector, although this is mostly due to the use of arable land for non-agricultural purposes which are likely to be associated with development elsewhere in the economy. To this end, the sub sector is projected to grow moderately at an average growth of 2.2 per cent in the medium term.

In the mining and quarrying sub sector, growth is projected to decline in 2015 before recovering strongly in 2016 through 2017. This growth pattern reflects anticipated commencement and ramping up of production at Liqhobong and Lemphane in the medium term, particularly Liqhobong mining project. Liqhobong is set to start full production (processing 500 tonnes per hour – producing approximately 1.1 million carats per year) in the second half of 2016 following the establishment of the main treatment plant. Lemphane mining project, owned by Meso Diamonds, is expected to start stage 1 of production in 2015 with full production capacity anticipated at some point after the commencement of stage 2 production in 2017. The bad news is that Lucara Diamond Corp., owner of the Mothae diamond mine, had decided to divest in Mothae mining project following the difficulty in accessing electricity. This highlights that inadequate power supply is a severe infrastructure constraint on economic development.

Needless to say, there is need for the country to graduate from its current position within the diamond value chain; producing and exporting raw diamonds with minimal or no value addition.

[2] A 162.02 carat, a 161.31 carat and a 132.55 carat, sold for US$11.1 million, US$ 2.4 million and US$ 7.5 million, respectively.

At the center of this is mineral beneficiation. The argument is that the processes of cutting and polishing domestically-produced diamonds will maximise the value of diamond exports and therefore enhance the contribution of the mining industry on economic growth and developments in general.

3.2.2 Secondary Sector Outlook

In the secondary sector, growth is estimated to decelerate from 1.7 per cent registered in 2013 to 0.8 per cent in 2014. The deceleration is largely at the back of the fall in manufacturing sub sector. Textiles and clothing industry is set to have remained under pressure in 2014 owing to continuous loss of the sector's competiveness in the global market in the face of escalating inputs cots, particularly unit labour costs. Nevertheless, relatively strong growth performance in building and construction sub sector, due to the on-going construction of Metolong Dam and other major government construction activities, kept the sector growing.

In terms of the outlook, the sector is expected to remain under pressure until it declines by 3.4 per cent in 2016. Key to the fall is the decline anticipated in building and construction activities (-8.8 per cent) consequent upon the completion of construction activities associated with Metolong Dam and Water Supply project in 2016. Manufacturing sub sector is set to continue to remain under pressure in the medium term, with textiles and clothing industry continuing on a downward spiral thus dragging the sub sector down. Consequently the sub sector is set to decline at an average rate of 2.3 per cent over the period 2015 – 2017. Electricity and water sub sector is set to register a moderate growth in the medium term, with a peak anticipated in 2016. Following the completion of Metolong Dam and the associate Water Treatment Plant, water supply within the economy is expected to increase substantially in 2016 thus benefiting the sub sector. Adequate and reliable supply of water is crucial for the development of other sectors within the economy.

Since 2000, manufacturing sub sector has brought in much-needed foreign direct investment with the associate growth and employment effects. Despite these, the sub sector still remains narrow, concentrated in textiles and garments exported mainly to the US market. This has rendered it vulnerable to external shocks. Uncertainty surrounding the renewal of African Growth and Opportunities Act (AGOA) coupled with escalating utility costs including unit labour costs poses a serious challenge for the industry. In addition, the sub sector continues to face stiff competition in the global markets from other effective and efficient producers in Asian markets and other parts of the World.

Despite efforts to diversify manufacturing sub sector, the country still faces a number of challenges. Key to diversification policies is the development of a vibrant and competitive private sector with adequate human skills and technological know-how and, most crucially, access to credit for investment. Furthermore, adequate infrastructure and reliable supply of utilities include some of the essential ingredients of industrial development. All of these remain a challenge for the country.

In 2017, the secondary sector is set to rebound strongly and grow at 5.0 per cent supported mainly by building and construction sub sector. The commencement of advanced infrastructure development (particularly access road to Polihali Dam project, accommodation facilities, power supply and telecommunication infrastructure, etc.) to pave way for the construction of Polihali Dam and associated infrastructure (Phase II of the Lesotho Highlands Water Project), set to give a thrust to the sub sector. Furthermore, recent years have seen property development boom.

The second phase of LHWP (involving construction of the 165-m-high, 2.2-billion-cubic-metres reservoir Polihali Dam, in the Mokhotlong District) will ensure continuing water supply to the Gauteng province in SA. The project got off ground in 2014 and expected to be completed in 2013. Given the size of Lesotho's economy, construction project of a similar magnitude as phase II of the LHWP is bound to have a substantial impact on the economy. In 1990's, the construction sector emerged as the mainstay of domestic economy, driven mainly by the advent of Phase I of the multi-million Lesotho Highlands Water Project (LHWP). In mid-90's, at the peak of the project, the sub sector was in the lead contributing approximately 10.0 per cent of real GDP. In this period, Lesotho registered an impressive economic performance; the real growth rate made Lesotho one of the top performers in Africa at that time.

The implementation of the second phase of Lesotho Highlands Water Project come at the opportune time when one of the key industry (manufacturing, particularly textiles and garments industry) is facing a series of challenges. The project will also have spill-over effect on other industries in the economy, including transport and telecommunications, financial and insurance, wholesale and retail trade etc.

3.2.3 Tertiary Sector Outlook

In the tertiary sector, growth is set to have moderated marginally from 5.4 per cent registered in 2013 to 5.3 per cent in 2014. The growth in the sector is mainly supported by relatively strong growth in the following services; health and social work, wholesale and retail trade, transport and communications as well as financial and insurance services. Growths remain marginal in public administration and real estate and business services.

In terms of the outlook, the services sector is projected to subside to an average growth rate of 4.8 per cent in the medium term. Robust growth in transport and telecommunications, financial and insurance services as well as wholesale and retail trade underpinned the sector's good performance. Other services are expected to grow moderately over the medium term.

Financial and insurance sub sector is set expected to grow at an average growth of 8.0 per cent over the period 2015 – 2017. The sub sector is set to benefit from ongoing reforms including the establishment of national identification card system and credit bureau. Credit bureau will reduce the cost of accessing information, making it relatively easy for lenders to assess credit worthiness of borrowers, thus improving access to credit. Moreover, Land Act of 2010 provides security of tenure and hence enables the use of land as collateral to access credit.

Transport and communications services is projected to grow at an average rate of 8.6 per cent per annum in the medium term, while wholesale and retail trade services is set to grow at an average rate of 8.2 per cent over the period 2015– 2017. Among others, the sub sectors are expected to benefit from the implementation of the second phase of LHWP. The second phase of LHWP is expected to spark developments in other sectors of the economy including transport and communications industry as well as financial and insurance industry. The project also has a potential to boost domestic employments with a spill-over effect on domestic consumption and hence wholesale and retail trade. Furthermore, low inflation environment anticipated in the medium term is set to provide a boost to domestic purchasing power encouraging domestic consumption benefiting wholesale and retail trade sub sector.

Public administration is set to register an average growth rate of 1.7 per cent over the medium term, as government entities endeavour to improve service delivery. Health and social work is expected to continue to benefit from the initiatives of the government and other international organisations aimed at addressing the effects of HIV/AIDS and tuberculosis (TB) and improving access to healthcare services in the country. Recent surge in property development will also benefit real estate and business services.

3.3 Inflation Outlook

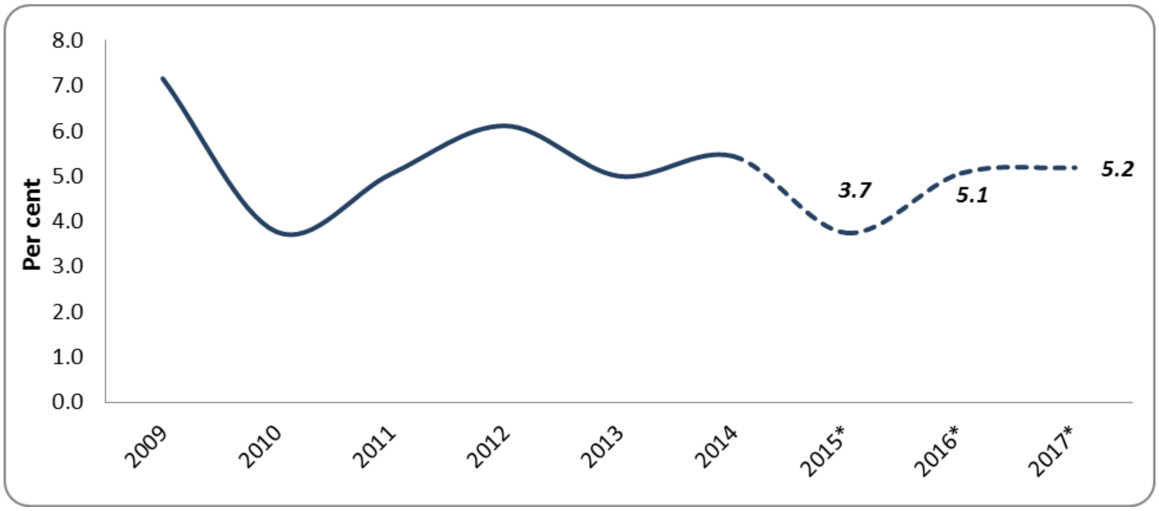
Following a down-surge in inflation since May 2014, Lesotho's annual inflation rate averaged 5.4 per cent for the year 2014. Key to this outcome is oil price developments during 2014. In the medium term, domestic inflation rate is projected to decelerate sharply in 2015 and averages 3.7 per cent before accelerating to 5.2 per cent in 2017. Domestic inflation is largely influenced by international price developments, particularly in SA given the trade and monetary relationships between the two countries. These are in turn influenced by the developments in the international prices of crude oil and food, as well as exchange rate considerations.

International price of crude oil is expected to continue on a downward trend during the first half of 2015 due to ample supply, but stabilize afterwards. This is consistent with strong increase in non-OPEC production, mainly from US shale oil deposits. Furthermore, other major oil producers within OPEC had highlighted their intentions not to curtail production despite perceived glut to maintain their market share. For oil importing countries such as South Africa and Lesotho, the dampening impact of a lower oil price on inflation is felt directly through the inclusion of oil-related products in consumption basket, as well as indirectly through a fall in cost of production and prices of final goods.

Needless to say, there are upside risks to the oil price outlook. Possible shift in OPEC's strategy and geopolitical tensions in a number of oil-producing regions (including turmoil in Libya, Middle East and international tensions surrounding the situation in Russia and Ukraine) cannot be underestimated. All these could disrupt oil production, causing a sharp rise in oil prices. Consequently, the futures markets expect only a gradual and partial recovery in oil prices in the medium term.

Aside from oil prices, food prices remain a major source of inflation pressure in Lesotho. International price of food is set to continue on its recent downward trend in the near term. The fall in food prices reflects an ample supply situation and stronger likelihood of inventories reaching their highest level in over a decade. The international production of grains is set to rebound in the short term increasing stock-to-use ratios to the highest level since 2002.

Figure 1: Inflation Outlook



Forecasts

In terms of exchange rate movements, the rand and hence loti depreciated by 10.0 per cent against the US dollar in 2014, therefore exerting upward pressure on domestic prices. The rand/loti is expected to remain relatively weak in 2015 throughout 2017, posing a major risk to the inflation outlook. There are also concerns that the degree of exchange rate pass-through from depreciation could increase, further threatening the inflation outlook. Concerns surrounding SA growth prospects are also set to exert downwards pressure on rand/loti.

Domestically-generated inflation comprises a small portion of overall Lesotho inflation. Of this, the major effect is expected to come from administered prices, particularly the expected hike in utility prices. Demand conditions in Lesotho are set to remain subdued in the near term and rebound in the medium term exerting marginal pressure on inflation.

3.4 External Sector Outlook

The external sector position is estimated to continue to register a surplus in 2014. The overall balance of payments surplus is set to widen to 7.1 per cent of GDP in 2014 compared to 6.6 per cent of GDP in 2013. The improvement in the external sector was mainly driven by net capital and financial inflows, which continued to benefit from government grants and loans for the financing of capital projects, as well as foreign direct investment, particularly in the mining industry.

The current account balance is estimated to have deteriorated marginally in 2014, and registered a deficit equivalent to 6.8 per cent of GDP compared to a deficit of 6.4 per cent of GDP in 2013. Multiple factors contributed to this development. Despite the increase in merchandise exports, particularly 60 per cent growth in diamond exports, the external sector continued to register a deficit in goods and services account. Net income declined modestly, corresponding to a fall in income from Lesotho's migrant mine workers following mining strikes in the first half of 2014. Current transfers increased supported mainly by SACU revenue.

In the terms of the outlook, the external sector is set to deteriorate from a surplus equivalent to 7.1 per cent of GDP in 2014 to an average deficit of 1.7 per cent in 2016 – 2017, with a marginal surplus of approximately 0.6 per cent of GDP in 2015. The deterioration of the external sector position is mainly on the back of an expected widening of current account deficit from 6.8 per cent of GDP in 2014 to approximately 16.5 per cent of GDP in 2017, with a partial offset coming from an increase in net capital and financial inflows from a surplus equivalent to 14.0 per cent of GDP in 2014 to approximately 15.7 per cent of GDP.

Merchandise exports are expected to remain subdued in 2015 due to a fall anticipated in diamond exports. Textile and clothing exports are set to remain fairly flat over the period 2014 – 2015, as the industry continue to remain under pressure in the medium term. In line with SA economic prospects, particularly manufacturing sector, SACU revenue is set decline in 2015 further exerting downwards pressure on the current account balance. In 2016 – 2017, merchandise exports are set to rebound, supported by robust growth in diamonds exports thanks to the resumption of mining production in Liqhobong in the second half of 2016 and the commencement of production from the Lemphane mining project. SACU revenue is also expected to recover in 2017.

Imports of goods and services are projected to continue to outpace exports, thereby exerting downwards pressure on the current account balance in the medium term. Specifically, imports of goods and services are expected to increase at an average growth rate of 9.6 per cent per annum in the medium term. The increase in imports of goods and services are generally driven by domestic consumption and investment (including construction activities) patterns. Domestic consumption is set to continue to increase in line with general economic growth. The on-going construction associated with Metolong Dam and major government construction activities are expected to exert pressure on imports. The establishment of Liqhobong's new mining plant (main treatment plant designed to have a capacity of 500 tonnes per hour) is also set to exert pressure on imports of machinery in 2015. Furthermore, advanced infrastructure development (particularly access road to Polihali Dam project, accommodation facilities, power supply and telecommunication infrastructure, etc) geared to pave the way for the construction of Polihali Dam and associated tunnels are set to exert upward pressure on imports in the medium term, particularly in 2016 and 2017.

The deficits in the current account balance are expected to be financed mainly by net capital and financial inflows equivalent to an average of 13.8 per cent of GDP over the period 2015 – 2017. Capital inflows are set to benefit mainly from government capital grants geared to finance developmental projects, as well as capital transfers towards the construction of Polihali Dam and the associated projects, particularly in 2016 onwards. Net financial inflows will be supported foreign direct investment anticipated in the mining industry, particularly investment in Liqhobong diamond mine, as well as government's net foreign borrowing associated with developmental projects.

Overall, the external sector is set to results in a marginal accumulation of foreign reserves in 2015. However, in the subsequent years, the financing gap between the current account and capital and financial account is set to be financed through the drawdown in official reserves. Consequently, gross official reserves (in months of import cover) are expected to decline from 6.2 months in 2014 to approximately 4.5 months in 2017. Despite this, the country will continue to have sufficient reserves to maintain the exchange rate parity between the loti and SA rand and go a long way in supporting macroeconomic stability in the country. Besides, with the implementation of Phase II of the Lesotho Highlands Water Project, the experience with phase I suggests that trend in official reserves is likely to reverse beyond 2017 with more capital inflows to finance the project.

3.5 Government Budgetary Operations Outlook

Government budgetary operations are estimated to have remained relatively healthy in 2014, registering an overall fiscal surplus equivalent to 1.3 per cent of GDP as compared to 0.8 per cent in 2013. The improvement in fiscal position reflects the increase in total government revenue relative to total government expenditure. Revenues increased by an estimated 9.3 per cent, following substantial increases in both SACU and tax revenues in 2014. Total government expenditure increased by approximately 8.2 per cent, mainly supported by an increase in recurrent expenditures. In fact, capital expenditures subsided reflecting poor project implementation during the review period. Relative to the size of the economy, both government revenue and expenditures declined marginally in 2014.

In the medium term, the fiscal position is set to deteriorate from a surplus registered in 2014 to deficit equivalent to 2.4 per cent of GDP in 2016 nevertheless improves in 2017. The deterioration in fiscal position is mainly attributed to the expected slowdown in the growth rate of total government revenue, (at approximately 4.2 per cent in 2015 – 2016) before regaining growth momentum and growing by 8.9 per cent in 2017. The main driver behind this progression is a fall in SACU revenue anticipated in 2015. SACU revenue is set to decline by 4.4 per cent in 2015 and stabilises in 2016. However, in 2017 SACU revenue is expected to recover marginally. Crucial to SACU revenue performance is the prospects in the SA economy, particularly manufacturing sector. SA economy is expected to remain subdue in the medium term. In line with general economic prospects, total revenue is set to moderate in 2015 through 2016. However, strong recovery is anticipated in 2017.

Government expenditure is set to increase by approximately 7.0 per cent over the medium term, let by recurrent component (at approximately 70.0 per cent of total government expenditure). Recurrent expenditures, particularly government wages and salaries (at approximately 50 per cent of recurrent expenditures) will remain elevated over the medium term. Capital expenditure is set to continue to grow moderately in the medium term. Relative to the size of the economy, recurrent expenditure is set to increase marginally and register an average of 42.0 per cent per of GDP per annum while capital expenditure will remain fairly steady at 17 per cent of GDP in the medium term.

The overall fiscal balance is expected to fall into deficit (of more than 1 per cent of GDP) in the medium term, after recording a surplus the previous year. Key to this outcome is the prospects in SACU revenue. With net external borrowing projected to remain fairly steady at 1.9 per cent of GDP in 2015, the government will eventually draw down on its deposits with the CBL. In the subsequent years, the government will start accumulating deposits following an increase in net external borrowing, well above 2 per cent of GDP, to finance developmental projects.

In general, fiscal operations will continue to remain vulnerable to SACU revenue in the medium term. Recurrent expenditures, particularly government wages and salaries will remain elevated while capital spending will remain subdue. Tax revenues are projected to increase marginally while SACU revenue set to decline in the medium term, particularly in 2015 through 2016. Consequently, the fiscal balance is set to dip into a deficit well above 1 per cent of GDP. Needless to say, for the economy to achieve sustainable and inclusive growth, there is a need to reconsider fiscal policy. Reforms aimed at creating adequate fiscal space for capital spending and development projects will go a long way in supporting sustainable and inclusive growth. This could be achieved by curbing recurrent expenditures, particularly compensation of employees, to allow greater investment spending.

3.6 Monetary Sector Outlook

Following a strong growth in 2013, money supply increased marginally by 4.0 per cent in 2014. The deceleration in money supply growth mainly reflects the slowdown in net foreign assets and private sector credit. The increase in net foreign assets subsided from 25.7 per cent in 2013 to an estimated 8.8 per cent in 2014, mainly due to a fall in commercial bank's net foreign assets. Private sector credit also decelerated from 20.6 per cent growth in 2013 to 12.4 per cent in 2014.

In terms of the outlook, money supply is projected to grow at an average rate of 6.9 per cent in the medium term; increasing by 9.2 per cent in 2015 before decelerating to 8.3 per cent in 2017. Private sector credit is set to remain the main driving force behind the increase in money supply. It is set to continue to register robust growth; registering an average growth rate of 15.4 per cent in medium term. This reflects general economic growth anticipated in the medium term, particularly growth expected in building and construction industry as well as transport and telecommunication services. Furthermore, financial sector reforms including the establishment of national identification card system and launching of credit bureau will have positive effects on credit extension. Credit bureau will reduce the cost of accessing information, making it relatively easy for lenders to assess credit worthiness of borrowers. Land Act of 2010 provides security of tenure and hence enables the use of land as collateral to access credit.

Net foreign assets are expected to grow marginally by 3.1 per cent in 2015, before dipping by 6.0 per cent in 2016. This largely reflects a deteriorating external sector position, particularly the anticipated decline in SACU in 2015 through 2016. In the subsequent year, net foreign assets will rebound.

4. Conclusion

Global economic recovery is set to continue in the medium term, growing at 3.5 per cent and 3.7 per cent in 2015 and 2016, respectively, largely supported by strong growth anticipated in the US and EMEs. Despite the boost from lower oil prices (though uncertain about its sustainability), global financial markets volatility (particularly in EMEs), weaker activity in some major oil exporters due to sharp drop in oil prices as well as stagnation and low inflation in the Euro Area and Japan remains downside risks to global growth prospects.

Following an average growth of 4.5 per cent over the past three years, Lesotho's economic growth is set to moderate to an average of 3.3 per cent in 2015 through 2016 before a strong take-off of approximately 5.7 per cent in 2017. In the medium term, growth is mainly shaped by resurgent diamond mining industry coupled with buoying building and construction industry with spill-over effects on services sector. In particular, construction is expected to receive a major boost from large infrastructure project – most notably, the second phase of Lesotho Highlands Water Project. Commencement and ramping up of production at Liqhobong mining project are set to give a thrust to mining industry. Manufacturing sub sector, particularly textiles and clothing industry, continue to remain under pressure. In line with the prospects in international commodity markets and exchange rate considerations, inflation is projected to remain moderate in the medium term.

Fiscal position will continue to remain vulnerable to SACU revenue. Recurrent expenditures, particularly compensation of employees will remain elevated while capital spending will remain subdue. With tax revenues projected to increase marginally while SACU revenue set to decline, the fiscal balance is set to dip into a deficit well above 1 per cent of GDP in the medium term. Money supply is projected to decelerate from 21.2 per cent in 2013 to 8.3 per cent in 2017, reflecting slowdown in accumulation of foreign reserves balanced with increasing domestic credit. The external sector position is set to deteriorate, in the medium term, mainly at the back of a widening current account deficit in the wake of strong imports coupled with declining SACU revenue. With inadequate net capital and financial inflows, official international reserves are projected to decline to approximately 4.5 months in 2017. Despite this, the country will continue to have sufficient reserves to maintain the exchange rate parity between the loti and SA rand.

APPENDIX I: STATISTICAL TABLES

Table 1. Selected Macroeconomic Indicators						
	2012	2013	2014+	2015*	2016*	2017*
Output - Constant prices						
Gross Domestic Product (% p.a.)	4.99	4.60	3.79	3.33	3.21	5.68
Per capita GDP (% p.a.)	4.67	4.24	8.19	2.94	2.79	5.21
Gross National Income (% p.a.)	2.54	3.98	7.33	0.99	3.87	4.43
Per capita GNI (% p.a.)	2.23	3.62	6.96	0.61	3.45	3.98
Gross Domestic Product (M Million)	11 522	12 053	12 509	12 925	13 340	14 098
Per Capita GDP	6 056	6 313	6 552	6 744	6 932	7 294
Gross National Income (M Million)	13 620	14 162	14 618	14 763	15 334	16 014
Per Capita GNI	7 158	7 417	7 656	7 703	7 968	8 285
Output - Current prices						
Nominal GDP (% p.a.)	6.82	5.94	13.34	6.72	8.06	11.35
Nominal GNI (% p.a.)	4.33	5.31	10.62	7.41	7.07	9.97
Nominal GDP (M Million)	19 573	20 736	23 501	25 081	27 102	30 177
Nominal GNI (M Million)	23 136	24 365	26 953	28 949	30 996	34 087
Sectoral Growth rates (% p.a.)						
Primary Sector	0.54	6.30	2.91	0.55	8.82	10.41
Crops	-23.89	13.93	-1.81	1.22	1.69	2.48
Mining and Quarrying	22.58	-5.30	5.83	-1.10	17.48	19.26
Secondary Sector	4.70	1.65	0.83	0.80	-3.39	5.03
Manufacturing	-3.43	-10.07	-6.96	-2.72	-2.23	-1.92
Construction	24.55	21.52	10.72	3.44	-8.76	13.21
Tertiary Sector	5.87	5.36	5.30	5.03	4.64	4.81
Wholesale and retail trade,repairs	12.46	10.18	8.22	10.36	6.66	7.47
Financial intermediation	7.10	16.05	6.26	8.98	7.61	7.48
Savings and Investment - Per cent of GNI						
National Savings	15.78	18.94	17.60	14.56	12.56	15.17
Of which Government Savings	10.26	11.47	10.55	7.96	7.16	7.89
Of which Private Sector Savings	5.52	7.47	7.05	6.60	5.40	7.28
Investment	28.09	24.39	23.57	24.64	26.67	29.80
Of which Government Investment	14.97	13.62	10.81	10.75	10.61	10.31
Of which Private Sector Investment	13.13	10.78	12.77	13.89	16.06	19.50
Resource Balance	-12.31	-5.45	-5.97	-10.08	-14.10	-14.64
Savings and Investment - Per cent of GDP						
National Savings	18.65	22.26	20.19	16.80	14.37	17.13
Of which Government Savings	12.13	13.48	12.11	9.18	8.19	8.91
Of which Private Sector Savings	6.52	8.78	8.08	7.62	6.18	8.22
Investment	33.20	28.66	27.03	28.44	30.50	33.67
Of which Government Investment	17.69	16.00	12.39	12.40	12.13	11.64
Of which Private Sector Investment	15.52	12.66	14.64	16.04	18.37	22.02
Resource Balance	-14.55	-6.40	-6.85	-11.64	-16.13	-16.53

+Estimates; * Projections

Table 1. Selected Macroeconomic Indicators, continued						
Inflation rate % (CPI)	0.06	0.05	0.05	0.04	0.05	0.05
Loti/US Dollar exchange rate (Annual averages)						
External Sector - Per cent of GNI						
Current Account	-12.31	-5.45	-5.97	-10.08	-14.10	-14.64
Imports of Goods	-79.77	-74.37	-74.94	-74.73	-76.56	-77.94
Exports of Goods						
Capital Flows (+ means an inflow)	6.12	3.39	1.80	2.72	3.48	4.53
Of which Government	7.11	4.05	2.46	3.36	4.12	5.14
Of which Private Sector	-1.00	-0.66	-0.67	-0.64	-0.63	-0.61
Official Reserves (Months of Imports)	4.7	6.1	6.2	5.9	5.1	4.5
External Sector - Per cent of GDP						
Current Account	-14.55	-6.40	-6.85	-11.64	-16.13	-16.53
Imports of Goods	-94.30	-87.39	-85.95	-86.26	-87.56	-88.03
Exports of Goods	40.87	39.45	40.67	37.95	38.18	40.23
Capital Flows (+ means an inflow)	7.23	3.99	2.06	3.14	3.98	5.12
Of which Government	8.41	4.76	2.82	3.88	4.71	5.80
Of which Private Sector	-1.18	-0.77	-0.76	-0.74	-0.73	-0.69
Exports of goods f.o.b (M Million)	7 999	8 181	9 557	9 518	10 348	12 142
Imports of goods f.o.b (M Million)	(18 456)	(18 121)	(20 199)	(21 635)	(23 731)	(26 566)
Government Finance - Per cent of GDP						
Revenue (excluding grants)	55.81	56.58	57.73	55.53	54.40	53.33
Tax Revenue						
Recurrent Expenditure	40.61	40.84	41.76	42.90	41.88	40.27
Of which compensation of employees	19.18	20.04	21.42	21.16	21.39	20.99
Transaction in non-financial assets						
Budget Balance (+ means a surplus)	0.42	0.85	1.34	-1.60	-2.40	-1.29
Monetary Aggregates - Nominal growth						
Money supply (M2)	7.34	21.16	3.95	9.22	3.17	8.33
Private Sector Credit	40.61	20.59	12.41	13.79	16.12	16.36

+Estimates; * Projections

Table 2. Real GDP growth rates						
	2012	2013	2014+	2015*	2016*	2017*
Primary Sector	**0.54**	**6.30**	**2.91**	**0.55**	**8.82**	**10.41**
Agriculture,forestry and fishing	**-13.84**	**17.07**	**0.71**	**1.85**	**2.18**	**2.62**
Growing of Crops	-23.89	13.93	-1.81	1.22	1.69	2.48
Farming of Animals	1.92	-0.76	0.77	0.96	0.95	0.94
Services	-6.54	25.07	0.10	1.67	2.03	3.02
Forestry	-46.86	125.47	3.90	4.87	5.75	6.54
Mining and Quarrying	22.58	-5.30	5.83	-1.10	17.48	19.26
Secondary sector	**4.70**	**1.65**	**0.83**	**0.80**	**-3.39**	**5.03**
Manufacturing	-3.43	-10.07	-6.96	-2.72	-2.23	-1.92
Food products and beverages	0.74	-5.14	-4.91	3.52	3.52	3.52
Textiles, clothing, footwear and leather	-5.59	-13.86	-6.88	-6.37	-6.27	-6.18
Other manufacturing	1.34	0.80	-10.40	3.35	4.66	4.66
Electricity and water	2.05	2.23	0.91	3.50	6.64	3.67
Electricity	7.51	4.27	4.68	4.08	3.96	4.50
Water	-0.57	1.18	-1.11	3.17	8.17	3.22
Building and Construction	24.55	21.52	10.72	3.44	-8.76	13.21
Tertiary sector	**5.87**	**5.36**	**5.30**	**5.03**	**4.64**	**4.81**
Wholesale and retail trade, repairs	12.46	10.18	8.22	10.36	6.66	7.47
Restaurants and hotels	3.46	4.82	0.70	2.76	2.76	2.76
Transport and Communication	5.52	5.56	6.31	8.45	8.58	8.67
Transport and storage	4.04	6.92	4.75	4.57	4.75	4.82
Post and Telecommunications	6.31	4.87	7.13	10.44	10.44	10.44
Financial intermediation	7.10	16.05	6.26	8.98	7.61	7.48
Real Estate and business services	4.39	2.13	2.89	2.14	3.11	3.12
Real estate	2.93	-1.06	1.65	1.45	1.44	1.28
Business services;renting	8.07	9.77	5.55	3.56	6.51	6.69
Public Administration	2.24	-3.12	1.82	1.74	1.82	1.52
Education	-0.88	1.02	3.28	0.41	0.44	0.47
Health and Social Work	28.18	18.35	17.52	2.92	2.95	2.98
Community, social and personal services	2.27	4.08	2.23	2.45	2.82	2.77
GDP at factor cost (Unadjusted)	4.82	4.51	3.83	3.37	3.24	5.64
Financial services indirectly measured	2.71	2.86	6.26	8.98	7.61	7.48
GDP at factor cost	4.86	4.54	3.77	3.25	3.14	5.59
Taxes on products	5.50	3.42	3.77	3.25	3.14	5.59
Subsidies on products	-0.26	-15.66	2.19	-6.46	-6.90	-7.41
GDP at market prices	**4.99**	**4.60**	**3.79**	**3.33**	**3.21**	**5.68**
GDP at market prices(Excl. Mng & QRyng)	**4.07**	**5.22**	**3.67**	**3.58**	**2.44**	**4.83**

+Estimates; * Projections

Table 3. GDP by sector 2004 prices (In Million Maloti)						
	2012.00	2013.00	2014.00	2015.00	2016.00	2017.00
Primary Sector	**1395.69**	**1483.61**	**1526.75**	**1535.11**	**1670.47**	**1844.42**
Agriculture,forestry and fishing	723.67	847.19	853.22	868.96	887.88	911.13
Growing of Crops	182.03	207.37	203.63	206.12	209.61	214.80
Farming of Animals	430.01	426.73	430.02	434.13	438.23	442.34
Services	38.45	48.09	48.14	48.95	49.94	51.44
Forestry	73.18	165.00	171.43	179.77	190.10	202.54
Mining and Quarrying	672.01	636.42	673.53	666.15	782.59	933.29
Secondary sector	**2753.52**	**2798.84**	**2822.00**	**2844.54**	**2748.19**	**2886.56**
Manufacturing	1451.64	1305.44	1214.60	1181.60	1155.29	1133.17
Food products and beverages	308.68	292.80	278.41	288.21	298.35	308.84
Textiles, clothing, footwear and leather	950.98	819.12	762.79	714.19	669.40	628.04
Other manufacturing	191.99	193.52	173.39	179.20	187.55	196.29
Electricity and water	459.85	470.12	474.38	490.96	523.55	542.77
Electricity	156.94	163.64	171.29	178.28	185.33	193.67
Water	302.91	306.48	303.08	312.68	338.22	349.10
Building and Construction	842.04	1023.28	1133.03	1171.98	1069.34	1210.62
Tertiary sector	**6286.69**	**6623.66**	**6974.58**	**7325.46**	**7665.64**	**8034.41**
Wholesale and retail trade, repairs	861.29	948.96	1026.97	1133.40	1208.84	1299.14
Restaurants and hotels	128.70	134.90	135.84	139.59	143.43	147.39
Transport and Communication	935.17	987.21	1049.53	1138.21	1235.87	1342.99
Transport and storage	317.81	339.79	355.94	372.21	389.91	408.71
Post and Telecommunications	617.36	647.42	693.59	766.00	845.97	934.28
Financial intermediation	755.72	877.04	931.91	1015.61	1092.90	1174.68
Real Estate and business services	1381.96	1411.39	1452.13	1483.17	1529.29	1577.04
Real estate	974.83	964.47	980.42	994.64	1008.96	1021.89
Business services;renting	407.13	446.93	471.71	488.53	520.33	555.15
Public Administration	1040.73	1008.23	1026.53	1044.35	1063.39	1079.58
Education	741.72	749.27	773.80	776.96	780.36	784.05
Health and Social Work	331.12	391.89	460.54	473.98	487.96	502.52
Community, social and personal services	110.27	114.77	117.33	120.21	123.60	127.02
GDP at factor cost (Unadjusted)	**10435.90**	**10906.11**	**11323.34**	**11705.12**	**12084.30**	**12765.39**
Financial services indirectly measured	-219.40	-225.68	-239.80	-261.34	-281.23	-302.27
GDP at factor cost	**10216.50**	**10680.43**	**11083.54**	**11443.78**	**11803.07**	**12463.12**
Taxes on products	1420.28	1468.88	1524.32	1573.86	1623.27	1714.05
Subsidies on products	-114.61	-96.66	-98.78	-92.40	-86.02	-79.65
GDP at market prices	**11522.17**	**12052.65**	**12509.07**	**12925.24**	**13340.32**	**14097.52**

Contribution to growth						
	2012	2013	2014+	2015*	2016*	2017*
GDP at market prices	**4.99**	**4.60**	**3.79**	**3.33**	**3.21**	**5.68**
Primary Sector	**0.07**	**0.76**	**0.36**	**0.07**	**1.05**	**1.30**
Secondary sector	**1.13**	**0.39**	**0.19**	**0.18**	**-0.75**	**1.04**
Tertiary sector	**3.17**	**2.92**	**2.91**	**2.81**	**2.63**	**2.76**

+Estimates; * Projections

Table 4: GDP AT CURRENT PRICES (In Million Maloti)						
	2012	2013	2014	2015	2016	2017
Primary Sector	**2 591.56**	**2 464.88**	**3 023.93**	**2 989.11**	**3 330.50**	**3 893.14**
Agriculture,forestry and fishing	1 300.49	1 571.47	1 640.08	1 731.94	1 866.97	2 000.27
Growing of Crops	390.23	466.81	505.32	531.96	590.74	639.12
Farming of Animals	717.37	766.90	768.00	803.85	839.70	875.55
Services	72.44	81.90	86.44	91.17	97.73	105.90
Forestry	120.45	255.87	280.31	304.95	338.81	379.70
Mining and Quarrying	1 291.07	893.41	1 383.86	1 257.17	1 463.53	1 892.87
Secondary sector	**4 174.19**	**4 557.15**	**4 915.11**	**5 254.01**	**5 338.10**	**5 948.78**
Manufacturing	1 980.93	1 982.91	1 988.15	2 081.75	2 106.16	2 189.66
Food products and beverages	517.14	512.66	529.58	581.38	638.25	700.67
Textiles, clothing, footwear and leather	1 158.73	1 146.46	1 200.40	1 213.50	1 149.14	1 134.76
Other manufacturing	305.05	323.80	258.16	286.87	318.77	354.22
Electricity and water	841.14	824.03	883.59	979.55	1 129.95	1 255.96
Electricity	116.11	113.59	125.37	135.37	147.85	162.52
Water	725.03	710.44	758.21	844.18	982.09	1 093.44
Building and Construction	1 352.12	1 750.21	2 043.38	2 192.71	2 102.00	2 503.16
Tertiary sector	**10 794.65**	**11 601.67**	**13 148.20**	**14 282.68**	**15 692.01**	**17 290.08**
Wholesale and retail trade, repairs	1 614.01	1 838.36	2 167.08	2 481.17	2 780.33	3 143.02
Restaurants and hotels	216.22	215.00	219.88	240.38	262.80	287.30
Transport and Communication	1 193.93	1 284.96	1 458.52	1 643.56	1 865.49	2 120.50
Transport and storage	534.27	598.52	661.09	717.17	789.31	870.30
Post and Telecommunications	659.65	686.44	797.43	926.38	1 076.18	1 250.20
Financial intermediation	1 120.31	1 319.42	1 411.86	1 596.23	1 804.69	2 040.37
Real Estate and business services	2 190.07	2 341.90	2 540.28	2 691.47	2 915.21	3 161.62
Real estate	1 569.03	1 608.19	1 723.75	1 814.19	1 933.50	2 059.87
Business services;renting	621.04	733.70	816.53	877.28	981.70	1 101.75
Public Administration	1 999.46	1 968.17	2 383.57	2 513.19	2 745.63	2 999.60
Education	1 713.94	1 768.38	1 925.68	2 005.87	2 116.69	2 237.01
Health and Social Work	569.07	672.56	833.38	889.79	962.42	1 042.55
Community, social and personal services	177.65	192.92	207.94	221.02	238.76	258.10
GDP at factor cost (Unadjusted)	**17 560.40**	**18 623.71**	**21 087.24**	**22 525.80**	**24 360.61**	**27 131.99**
Financial services indirectly measured	- 293.12	- 314.96	- 337.02	- 381.03	- 430.79	- 487.05
GDP at factor cost	**17 267.28**	**18 308.75**	**20 750.22**	**22 144.77**	**23 929.81**	**26 644.94**
Taxes on products	2 305.55	2 427.32	2 751.00	2 935.89	3 172.54	3 532.51
Subsidies on products	-	-	-	-	-	-
GDP at market prices	**19 572.83**	**20 736.07**	**23 501.23**	**25 080.66**	**27 102.36**	**30 177.44**

+Estimates; * Projections

Table 5. Expenditure on Gross Domestic Product (GDP) (In Million Maloti)									
	2009	2010	2011	2012	2013	2014+	2015*	2016*	2017*
Final Government Consumption Expenditure	***5 740.20***	***6 069.84***	***6 420.26***	***7 361.37***	***7 525.56***	***8 931.44***	***10 022.21***	***10 919.10***	***11 482.41***
Final Private Consumption Expenditure	***14 884.12***	***16 409.30***	***18 173.64***	***19 389.73***	***20 287.72***	***21 922.96***	***23 123.39***	***24 598.61***	***26 376.02***
Gross Fixed Capital Formation	***3 697.36***	***4 413.24***	***4 630.37***	***5 936.67***	***7 537.66***	***6 353.54***	***7 395.71***	***8 716.01***	***10 710.31***
Changes in inventories	*-0.84*	*243.45*	*-526.42*	*-609.51*	*-445.54*	*0.00*	*0.00*	*0.00*	*0.00*
Gross Domestic Expenditure	***24 320.83***	***27 135.83***	***28 697.86***	***32 078.26***	***34 905.41***	***37 207.95***	***40 541.31***	***44 233.71***	***48 568.73***
Exports of goods and Services	***6 535.97***	***7 106.59***	***8 864.00***	***8 482.89***	***8 656.88***	***10 078.27***	***10 073.56***	***10 922.69***	***12 744.99***
Diamonds	*1 120.65*	*1 328.77*	*2 621.66*	*2 488.96*	*2 295.88*	*3 681.06*	*3 327.87*	*4 126.19*	*5 713.48*
Textiles, clothing, footwear	*3 286.53*	*3 146.54*	*3 517.56*	*3 410.19*	*3 629.43*	*3 765.76*	*3 806.85*	*3 604.95*	*3 559.86*
Less Imports of Goods and services	***16 347.76***	***17 837.99***	***18 959.85***	***20 192.50***	***21 677.61***	***23 784.99***	***25 534.22***	***28 054.05***	***31 136.28***
Expenditure on GDP	***14 509.04***	***16 404.43***	***18 602.01***	***20 368.65***	***21 884.68***	***23 501.23***	***25 080.66***	***27 102.36***	***30 177.44***
GDP at market prices	***14 502.49***	***16 014.52***	***18 322.34***	***19 572.83***	***20 736.07***	***23 501.23***	***25 080.66***	***27 102.36***	***30 177.44***
In percent of GDP (unless indicated otherwise)									
Final Government Consumption Expenditure	39.58	37.90	35.04	37.61	36.29	38.00	39.96	40.29	38.05
Final Private Consumption Expenditure	102.63	102.47	99.19	99.06	97.84	93.28	92.20	90.76	87.40
Gross Fixed Capital Formation	25.49	27.56	25.27	30.33	36.35	27.03	29.49	32.16	35.49
Exports of goods and Services	45.07	44.38	48.38	43.34	41.75	42.88	40.16	40.30	42.23
Imports of Goods and services	112.72	111.39	103.48	103.17	104.54	101.21	101.81	103.51	103.18

+Estimates; * Projections

Table 6. Income and Outlay Account (In Million Maloti)										
	2008	2009	2010	2011	2012	2013	2014*	2015*	2016*	2017*
GDP at market prices	**13 471.31**	**14 502.49**	**16 014.52**	**18 322.34**	**19 572.83**	**20 736.07**	**23 501.23**	**25 080.66**	**27 102.36**	**30 177.44**
Factor income from abroad, net	5 303.87	4 805.67	4 827.73	3 853.09	3 563.17	3 628.77	3 452.20	3 868.77	3 893.34	3 909.71
Receivable from the rest of the world	6 114.80	5 849.89	5 440.62	5 265.61	5 064.81	5 203.65	5 089.75	5 649.88	5 783.91	5 908.75
Payable to rest of the world	-810.93	-1044.22	-612.89	-1412.52	-1501.64	-1574.88	-1637.55	-1781.11	-1890.57	-1999.04
GNI	**18 775.18**	**19 308.16**	**20 842.25**	**22 175.43**	**23 136.00**	**24 364.84**	**26 953.43**	**28 949.43**	**30 995.69**	**34 087.16**
Transfers from abroad,net	5 661.61	6 042.01	4 945.52	4 966.39	7 265.65	8 064.27	8 645.61	8 410.44	8 416.27	8 941.88
Receivable from the rest of the world	5 767.13	6 148.54	5 004.47	5 018.84	7 343.43	8 156.34	8 760.83	8 530.04	8 542.32	9 074.74
Payable to rest of the world	-105.52	-106.53	-58.95	-52.46	-77.78	-92.07	-115.22	-119.60	-126.05	-132.86
National Disposable Income	**24 436.80**	**25 350.17**	**25 787.77**	**27 141.82**	**30 401.65**	**32 429.11**	**35 599.04**	**37 359.87**	**39 411.96**	**43 029.04**
Consumption	18 767.24	20 624.32	22 479.14	24 593.90	26 751.10	27 813.29	30 854.40	33 145.60	35 517.71	37 858.43
Savings	5 669.55	4 725.85	3 308.62	2 547.91	3 650.55	4 615.82	4 744.64	4 214.27	3 894.25	5 170.61
Of which Government Savings	1 823.76	1 393.76	605.49	7.45	2 374.40	2 795.40	2 844.86	2 303.15	2 220.37	2 688.67
Of which Private Savings	3 845.80	3 332.09	2 703.13	2 540.46	1 276.15	1 820.42	1 899.78	1 911.12	1 673.89	2 481.93
National Disposable Income	**24 436.80**	**25 350.17**	**25 787.77**	**27 141.82**	**30 401.65**	**32 429.11**	**35 599.04**	**37 359.87**	**39 411.96**	**43 029.04**
National Savings(% of GNI)	30.20	24.48	15.87	11.49	15.78	18.94	17.60	14.56	12.56	15.17
of which government savings	9.71	7.22	2.91	0.03	10.26	11.47	10.55	7.96	7.16	7.89
of which private savings	20.48	17.26	12.97	11.46	5.52	7.47	7.05	6.60	5.40	7.28
Consumption (% of GNI)	99.96	106.82	107.85	110.91	115.63	114.15	114.47	114.49	114.59	111.06

+Estimates; * Projections

Table 7: Government Financial Statistics (In Million Maloti)										
	2008	2009	2010	2011	2012	2013	2014*	2015*	2016*	2017*
Revenue	**8 377.5**	**9 377.0**	**8 804.9**	**9 221.2**	**12 624.4**	**13 017.9**	**14 232.0**	**14 778.8**	**15 454.4**	**16 833.7**
Tax revenue	**2 653.92**	**2 999.80**	**3 292.15**	**4 015.03**	**4 681.57**	**4 731.25**	**5 571.60**	**6 138.41**	**6 950.29**	**7 795.37**
Taxes on income, profits, and capital gains	1 409.83	1 765.22	1 867.73	2 133.01	2 566.59	2 516.59	2 830.66	3 162.70	3 534.62	3 952.31
Taxes on goods and services	1 042.42	1 142.64	1 341.43	1 459.67	1 842.82	1 887.18	2 269.65	2 528.16	2 820.40	3 198.62
O/W Value-added tax	945.74	1 008.55	1 203.95	1 287.25	1 624.02	1 741.79	2 053.25	2 350.83	2 634.28	2 977.92
Grants	**461.82**	**590.45**	**881.88**	**1 605.61**	**1 700.62**	**1 284.79**	**663.90**	**851.82**	**709.62**	**740.27**
Capital	393.62	590.45	783.91	1 041.60	1 504.22	988.11	663.90	589.32	559.62	589.52
Other revenue	**627.22**	**873.07**	**1 313.82**	**995.67**	**1 079.31**	**969.33**	**1 207.34**	**1 298.87**	**1 303.37**	**1 327.22**
SACU	**4 634.53**	**4 913.69**	**3 317.01**	**2 604.89**	**5 162.91**	**6 032.49**	**6 789.19**	**6 489.69**	**6 491.16**	**6 970.80**
Expense	**-6 339.1**	**-7 617.6**	**-7 776.2**	**-8 354.0**	**-8 926.9**	**-9 378.5**	**-10 877.2**	**-11 931.0**	**-12 674.5**	**-13 555.5**
Compensation of Employees	**-2 208.43**	**-3 015.77**	**-2 987.02**	**-3 591.77**	**-3 753.27**	**-4 155.75**	**-5 032.85**	**-5 306.52**	**-5 797.32**	**-6 333.57**
Use of goods and services	**-2 226.52**	**-2 307.95**	**-2 321.63**	**-1 908.67**	**-2 493.21**	**-2 413.85**	**-3 009.63**	**-3 427.86**	**-3 680.62**	**-3 901.28**
Interest Payments	**-136.21**	**-119.26**	**-108.26**	**-134.63**	**-156.69**	**-189.21**	**-263.41**	**-308.08**	**-337.08**	**-354.82**
Nonresidents	-66.73	-58.50	-57.90	-63.26	-74.55	-87.74	-139.47	-183.89	-207.10	-224.66
Grants	**-868.84**	**-888.92**	**-863.01**	**-960.18**	**-859.16**	**-885.13**	**-807.10**	**-819.07**	**-813.27**	**-861.41**
Social benfits	**-230.56**	**-531.70**	**-519.90**	**-596.26**	**-593.50**	**-736.13**	**-764.43**	**-889.73**	**-874.76**	**-922.33**
Transactions in Nonfinancial Assets	**-1 179.4**	**-1 663.9**	**-2 031.1**	**-1 916.6**	**-3 614.4**	**-3 463.5**	**-3 040.3**	**-3 247.8**	**-3 431.5**	**-3 668.4**
Net lending/borrowing	**859.0**	**95.5**	**-1 002.5**	**-1 049.4**	**83.1**	**175.8**	**314.6**	**-400.0**	**-651.6**	**-390.2**
Transactions in Fin. assets & Liabilities (Financing)	**-528.0**	**-730.7**	**-739.1**	**-1 203.5**	**68.3**	**906.2**	**331.9**	**-400.0**	**-651.6**	**-390.2**
Financial assets	**-805.6**	**264.5**	**-774.4**	**-808.8**	**910.1**	**1 209.5**	**745.8**	**-135.3**	**196.8**	**201.5**
Domestic	**-804.29**	**268.09**	**-774.44**	**-808.81**	**910.08**	**1 209.51**	**745.78**	**-135.25**	**196.82**	**201.52**
Deposits	-809.44	268.07	-774.44	-808.81	910.08	1 209.51	745.78	-135.25	196.82	201.52
Central Bank	-770.16	100.78	-771.93	-806.56	930.11	1 198.69	745.13	-135.25	196.82	201.52
Liabilities	**278**	**-995**	**35**	**395**	**842**	**303**	**414**	**265**	**848**	**592**
Domestic	**130.29**	**-1 066.89**	**-139.23**	**331.01**	**321.04**	**31.53**	**11.73**	**-220.61**	**189.60**	**-76.03**
Foreign	**147.32**	**71.70**	**174.60**	**63.68**	**520.77**	**271.80**	**402.18**	**485.40**	**658.78**	**667.75**
Memoranda Items										
In percent of GDP (unless indicated otherwise)										
Revenue	62.19%	64.66%	54.98%	50.33%	64.5%	62.8%	60.6%	58.9%	57.0%	55.8%
Tax revenue	19.70%	20.68%	20.56%	21.91%	23.92%	22.82%	23.71%	24.47%	25.64%	25.83%
SACU (RHS)	34%	34%	21%	14%	26%	29%	29%	26%	24%	23%
Expense	47.06%	52.53%	48.56%	45.59%	45.61%	45.23%	46.28%	47.56%	46.76%	44.91%
Compensation of Employees	16.39%	20.79%	18.65%	19.60%	19.18%	20.04%	21.42%	21.15%	21.39%	20.98%
Nonfinancial Assets	8.76%	11.47%	12.68%	10.46%	18.47%	16.70%	12.94%	12.95%	12.66%	12.15%
Overall fiscal balance	**6.4%**	**0.7%**	**-6.3%**	**-5.7%**	**0.4%**	**0.8%**	**1.3%**	**-1.6%**	**-2.4%**	**-1.3%**
Overall primary balance	7.56%	1.39%	-5.63%	-5.03%	1.2%	1.8%	2.4%	-0.4%	-1.2%	-0.1%

+Estimates; * Projections

Table 8. Depository Corporation Survey (In Million Maloti)										
	2008	2009	2010	2011	2012	2013	2014+	2015*	2016*	2017*
Net Foregn Assets	**11 285.62**	**10 651.58**	**9 942.80**	**9 905.65**	**10 210.57**	**12 835.38**	**13 962.93**	**14 400.28**	**13 812.11**	**13 998.72**
Commercial Banks (CBs)	3 034.05	2 986.69	3 799.95	3 209.50	2 486.70	3 236.64	3 039.45	3 325.58	3 425.41	3 775.34
Central Bank (CBL)	8 251.57	7 664.89	6 142.86	6 696.15	7 723.87	9 598.74	10 923.48	11 074.71	10 386.69	10 223.38
Net Domestic Assets	**-6 263.59**	**-4 907.56**	**-3 367.99**	**-3 246.01**	**-3 061.89**	**-4 173.76**	**-4 956.46**	**-4 566.59**	**-3 666.24**	**-3 008.07**
Net Domestic Credit	**-2 443.75**	**-2 136.21**	**-1 000.82**	**106.99**	**639.67**	**389.96**	**171.28**	**856.44**	**1 721.62**	**2 551.17**
Net Claims on Central Government (CG)	-3 950.73	-3 996.00	-3 197.63	-2 592.65	-3 148.94	-4 177.85	-4 962.56	-4 983.52	-5 057.94	-5 335.48
Claims on other Sectors	1 506.98	1 859.79	2 196.81	2 699.64	3 788.61	4 567.81	5 133.84	5 839.97	6 779.56	7 886.65
Claims on private sector	1 463.15	1 859.79	2 193.83	2 687.00	3 778.16	4 556.11	5 121.30	5 827.43	6 767.03	7 874.12
Other Items Net	**3 819.83**	**2 771.34**	**2 367.17**	**3 352.99**	**3 701.55**	**4 563.72**	**5 127.74**	**5 423.04**	**5 387.86**	**5 559.24**
Money Supply (M2)	**5 022.04**	**5 744.03**	**6 574.81**	**6 659.64**	**7 148.68**	**8 661.61**	**9 003.84**	**9 833.69**	**10 145.87**	**10 990.65**
Narrow Money (M1)	3 879.37	4 176.40	4 985.99	2 801.07	3 476.25	3 988.21	4 096.62	4 371.94	4 724.35	5 260.38
Other Deposits	1 142.67	1 567.63	1 588.82	3 858.58	3 672.43	4 673.40	4 907.22	5 461.76	5 421.52	5 730.27
Memorandum Items;	Annual percentage change; unless otherwise indicated									
Velocity of Money	2.7	2.52	2.44	2.75	2.74	2.39	2.61	2.55	2.67	2.75
Private Sector Credit (percentage of GDP)	10.9	12.8	13.7	14.67	19.30	21.97	21.79	23.23	24.97	26.09
M1/GDP	0.29	0.29	0.31	0.15	0.18	0.19	0.17	0.17	0.17	0.17
Money Supply	23.1	14.4	14.5	1.29	7.34	21.16	3.95	9.22	3.17	8.33

+Estimates; * Projections

Table 9: EXTERNAL SECTOR ACCOUNTS (In Million Maloti)							
	2011	2012	2013	2014+	2015*	2016*	2017*
I. CURRENT ACCOUNT	**-1 377.75**	**-2 848.56**	**-1 327.68**	**-1 608.91**	**-2 918.95**	**-4 371.75**	**-4 988.95**
Trade Balance, net	**-7 124.29**	**-10 457.20**	**-9 939.87**	**-10 641.61**	**-12 117.12**	**-13 383.50**	**-14 424.83**
Merchandise, exports	8 457.40	7 999.13	8 181.30	9 557.38	9 517.59	10 347.91	12 141.56
Diamonds	2 621.66	2 488.96	2 295.88	3 681.06	3 327.87	4 126.19	5 713.48
Textiles	3 517.56	3 410.19	3 629.43	3 765.76	3 806.85	3 604.95	3 559.86
Merchandise, imports	-15 581.69	-18 456.33	-18 121.17	-20 198.99	-21 634.71	-23 731.42	-26 566.38
Services, net	**-3 072.94**	**-3 220.18**	**-3 080.86**	**-3 065.11**	**-3 343.54**	**-3 447.85**	**-3 566.46**
Income, net	**3 853.09**	**3 563.17**	**3 628.77**	**3 452.20**	**3 868.77**	**3 893.34**	**3 909.71**
Current Transfers	**4 966.39**	**7 265.65**	**8 064.27**	**8 645.61**	**8 672.94**	**8 566.27**	**9 092.63**
Government, net	3 660.10	5 910.65	6 642.68	7 179.16	7 193.35	7 049.71	7 538.13
SACU, net	2 455.40	5 005.21	5 827.50	6 596.56	6 320.96	6 322.39	6 789.56
Other sectors, net	1 306.29	1 355.00	1 421.59	1 466.45	1 479.59	1 516.56	1 554.50
II. CAPITAL AND FINANCIAL ACCOUNT	**1 600.13**	**4 131.40**	**2 690.31**	**3 276.90**	**3 057.57**	**3 649.35**	**4 749.61**
CAPITAL ACCOUNT	**815.35**	**1 415.09**	**826.72**	**484.16**	**787.42**	**1 079.28**	**1 544.22**
Government: Grants in budget, credit	1 012.40	1 645.30	987.20	663.90	973.99	1 275.93	1 751.49
FINANCIAL ACCOUNT	**784.78**	**2 716.32**	**1 863.59**	**2 792.74**	**2 270.15**	**2 570.07**	**3 205.39**
Direct investment in Lesotho, net	488.48	512.90	534.45	558.40	673.78	533.78	533.78
Loans, government, net	26.83	405.00	271.80	402.18	485.40	658.78	667.75
Borrowing, credit	303.19	638.70	547.90	724.51	886.21	1 085.85	1 149.33
Repayments, debit	-276.36	-233.70	-276.10	-322.33	-400.81	-427.08	-481.58
III. OVERALL BALANCES	**222.38**	**1 282.84**	**1 362.63**	**1 667.99**	**138.62**	**-722.41**	**-239.34**
IV. ERRORS AND OMISSIONS	**-350.53**	**-481.88**	**412.85**	**-290.43**	**0.00**	**0.00**	**0.00**
V. RESERVE ASSETS	**-588.75**	**-1 221.23**	**-2 400.82**	**-1 377.56**	**-138.62**	**722.41**	**239.34**
VI. VALUATION ADJUSTMENT	**716.90**	**420.27**	**625.34**	**0.00**	**0.00**	**0.00**	**0.00**
MEMO ITEMS							
In percent of GDP (unless indicated otherwise)							
CURRENT ACCOUNT	-7.52	-14.55	-6.40	-6.85	-11.64	-16.13	-16.53
Trade Account	-0.39	-0.53	-0.48	-0.45	-0.48	-0.49	-0.48
CAPITAL AND FINANCIAL ACCOUNT	8.73	21.11	12.97	13.9	12.2	13.5	15.7
OVERALL BALANCES	1.21	6.55	6.57	7.10	0.55	-2.67	-0.79
Gross Reserves (Million Maloti)	**7 350.63**	**8 633.20**	**10 964.45**	**12 342**	**12 481**	**11 758**	**11 519**
Gross Reserves (Months of import cover)	**4.6**	**4.7**	**6.1**	**6.2**	**5.9**	**5.1**	**4.5**

+Estimates; * Projections

APPENDIX II: Forecasting Assumptions

The domestic GDP projections for the period 2015 – 2017 are based on the following assumptions about the various sectors.

1. GDP by activities:

Primary Sector

- The forecast crops sub-sector is based on the moving average of the past years. The series reveal no apparent trend. Other agriculture (farming of animals, services and forestry) are assumed to follow their observed trends over recent years. *These projection methodologies are used for the time being, with anticipation of the development of more sophisticated methodologies for future use.*
- The mining and quarrying sub-sector projections are based on the capacity of each individual mine's main treatment plant, grade, available reserves as well as corporate plans. Three mines will be in operation in 2015; the Lets'eng diamond mine, which is expected to remain the main contributor, Kao (Storm Mountain Diamonds), and Lemphane (owned by Meso Diamonds, a subsidiary of London-based Paragon Diamonds Limited) which is expected to begin production in 2015. In 2016, Liqhobong is expected to start operations. The Törnqvist methodology for price index calculation is used to estimate inflation in the mining and quarrying sector.

Secondary Sector

- The overall *Textiles and clothing* sector is assumed to follow the observed trend over the past years, in real terms. The series is divided into AGOA (approximately 85% market share) and Non-AGOA. For AGOA exports, nominal growth is based on expected exchange rate depreciation and projected US CPI while that of Non-AGOA is assumed to increase in line with projected SA inflation.
- *Food products and beverages* and *Other manufacturing* are assumed to follow their observed trend over recent years.
- *Electricity and water productions* are assumed to follow their observed trend over recent years, with consideration of the impact of major projects such as the Metolong dam, which is expected to positively impact water consumption in 2016 and 2017.
- The *Building and Construction* sub-sector is based on consideration of projected government capital expenditure on construction projects.

Tertiary Sector

- The *Wholesale and retail trade and repairs* sub-sector is assumed to increase in line with value added tax in the government financial statistics. A simple trend analysis suggests that, on average, the two have increased at a similar rate over the last decade. Besides, as economic activities in this subsector increase, the tax base and hence VAT revenue also increase.
- The *Restaurants and hotels* sub-sector forecast is based on the observed trend over recent years.

- The *Transport and storage* forecast is based on a moving average of the past five years' growth rates. This is in line with the observed trend.
- The *Post and telecommunications* forecast is based on observed trends in previous data for this sub-sector.
- *Financial intermediation* is also based on the observed trend in recent years.
- *Real estate and business services* are based on moving average of the past five years in line with the observed trend.
- *Public administration* in nominal terms is based on the expected increase in government employee compensation from the Ministry of Finance. In real terms, the series is forecast based on a more simplistic moving average approach.
- *Education and health* sub-sector nominal forecasts are based primarily on consideration of wage increases and population growth. Real growth is derived by deflating the nominal series by the projected inflation rate.
- *Financial services indirectly measured (FISIM)* is assumed to remain the same size relative to the financial intermediation sector as in 2013.
- To forecast *Indirect taxes,* these are assumed to remain constant as a portion of GDP at factor cost from 2013 onwards.

2. Production Account – GDP by expenditure

Private Consumption

- Private consumption is based on the estimated structural equation. See appendix III below.

Government Consumption

- Government consumption is based on the growth rates of ***recurrent expenditures*** – compensation of employees and use of goods and services.

Gross Fixed Capital Formation

- Gross fixed capital formation by government is assumed to grow in line with capital expenditure.
- Private sector gross fixed capital formation is based on logarithmic trend equation in line with the observed trend over the past decade. This is complemented by major private sector construction activities anticipated in the medium term. Notably, Liqhobong diamond mine is expected to spend approximately M1.7 billion over the period July 2014 – June 2015 to establish a new plant while CBL expected to inject approximately M350 million in the construction of Bank extension. Note that efforts are at advanced stage to find ways to forecast the series through the use of structural equation – private investment function.

Imports of goods and services

- *Imports of goods and services* are based on the estimated structural equation. See appendix III below.

Exports of goods and services are linked with the performance of textiles and clothing industry and diamond mining sector in secondary and tertiary sector, respectively.

3. Government Financial Statistics

The basis for government financial statistics is MTFF provided by the Ministry of Finance, however adjusted by the budget execution rate based on the past trend. On average, compensation of employees is projected fairly accurate by the Ministry of Finance. Other expenditure components, particularly use of goods and services and expenditures on non-financial assets are adjusted for the budget execution rate; on average the execution rate of capital expenditures is in the neighbourhoods of 85 per cent.

Total Revenue

SACU

- ***SACU*** revenue is based on SACU council meeting for the financial year 2014/15; for the remaining years, it is based on forecasts of customs and excise duties provided by the RSA mid-term budget review and annual budget statements. Lesotho's revenue share is determined in with SACU revenue sharing formula[3] with;

(i). Lesotho's share of intra-SACU imports (Customs component) is determined as a 5-year moving average of past trend.

(ii). Lesotho's share of excise component (85% of excise pool) determined as 5-year moving average of the past trend.

(iii). Lesotho's share of development component (15% of excise pool) is determined as a 5-year moving average of the past trends.

These ratios remained fairly constant over the past decade.

Taxes (income & VAT)

- Taxes are assumed to increase in line with overall economic growth – DGP.

Total Expenditures

- Use of goods and services and expenditures on non-financial assets are adjusted for the budget execution rate of the government over the past five years; approximately 80 – 90 per cent depending on expenditure component.

4. Monetary Survey

Net Foreign Assets

Commercial Banks

- Commercial banks are assumed to continue to increase their holdings of foreign assets and liabilities at the average pace observed in recent years.

Central Bank of Lesotho

- Changes in central bank foreign assets are set equal to the projected overall balance of payments, and are thus determined by the analysis of the external sector.

[3] *Kirk & Stern (2003) The New Southern African Customs Union Agreement*

- Changes in Foreign liabilities are assumed to be in line with the projected IMF net loan disbursement (disbursement less repayment) to Lesotho.

Net Domestic Credit

- Private sector credit is projected based on extrapolation of recent growth rates.
- Net claims on government are assumed to be in line with government deficit financing needs from fiscal operations (IMF's net loan disbursement as well as the issuance of debt instruments).

Other items and capital accounts

- Most other items and capital accounts are assumed to be constant over the projected period.

Narrow money (M1)

- M1 is forecast by assuming that the ratio of M1 to GDP remains equal to the 2014 estimate going forward.

5. EXTERNAL SECTOR

CURRENT ACCOUNT

Marchandise exports

- *Diamonds and textiles/clothing exports* are forecast on the same basis as in section 1 – GDP by activities, earlier in this Appendix.
- *Other exports* are projected by assuming the continuation of historical growth rates.

Marchandise imports

- *Imports of goods and services* are based on the estimated structural equation set out in Appendix III below.

Income

- *Compensation of miners in SA* is forecast by considering the number of Basotho residents employed in SA, as well as an SA inflation measure.
- *Dividends on direct investment in Lesotho* are inflated using projected SA CPI.

Current Transfers

- *SACU revenue* forecasts are compiled based on information on customs and excise revenue provided by the SA National Treasury.
- *Other remittances* mainly comprise social benefits to former SA mineworkers. Since workers no longer normally accrue the rights to such benefits, it is inflated by SA CPI, and incorporates an assumed mortality rate of beneficiaries.

CAPITAL & FINANCIAL ACCOUNT

- Government grants and disbursement/repayment of government loans are derived from projected fiscal operations.
- Government grants are derived from projected fiscal operations.
- Commercial banks are assumed to continue to increase foreign assets holdings, particularly in Rands, at the average pace observed prior to 2011 – 2012

The rest of items are based on developments in other sectors of the economy while others are assumed to increase in line with inflation developments and the average growth over the previous period. Many items in the external sector are forecast by assuming trend growth, inflating using projected SA CPI, or assuming a moving average. Where items are linked to other sectors of the economy, the forecasts of these items are made consistent with the other sectors. Errors & omissions, and the valuation adjustment are assumed to be zero for forecasting purposes.

APPENDIX III: Estimation results of import demand, private consumption and inflation functions – reduced form versions.

The estimation procedure is based on Autoregressive Distributed Lag (ARDL) bounds testing approach to cointegration proposed by Pesaran, *et.al*. (2001). The results of reduced-form versions of the estimated equations are presented below.

1. Import Demand Function

1.1 Literature Review

Trade theory indicates that import demand in an economy depends on income (which can be proxied by aggregate domestic expenditure) and relative prices of imports – ratio of prices of imported goods and services relative to the prices of locally produced goods and services. The exchange rate variable can also be considered, although it enters the model implicitly through exerting its influence on prices of imported goods. This is in line with Khan (1974), Constant and Yue (2010) and Arize and Afifi (1987). While it is anticipated *a priori* that an increase in domestic income would lead to an increase in total amount of imports demanded by a country, an increase in the relative prices should lead to a decrease in imports.

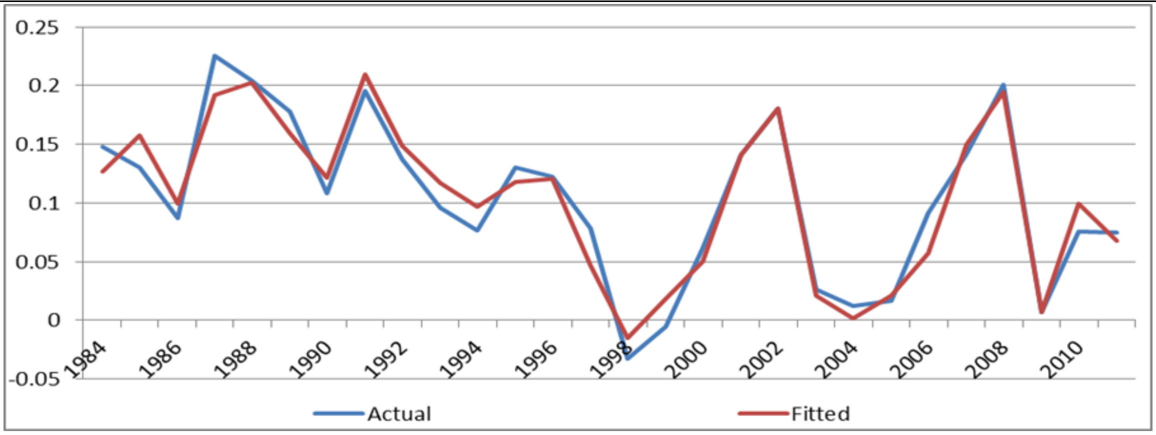
Table 1; Estimation Results

Dependent Variable: DLIM					
Dependent Variable: DLIM					
Method: Least Squares					
Date: 10/29/13 Time: 11:49					
Sample (adjusted): 1983 2011					
Included observations: 29 after adjustments					
Variable		Coefficient	Std. Error	t-Statistic	Prob.
DLGDE		1.13492	0.08682	13.07206	0.0000
LIM(-1)		-0.24666	0.09444	-2.61190	0.0159
LGDE(-1)		0.24341	0.09261	2.62825	0.0154
C		-0.07640	0.05461	-1.39907	0.1757
DUM01		0.12100	0.02323	5.20820	0.0000
DUM02		0.08272	0.02222	3.72306	0.0012
DUM09		-0.06655	0.02238	-2.97431	0.0070

Where *LIM* is the logarithm of import demand while LGDPE is the logarithm of gross domestic expenditure. Dum01, Dum02, Dum09 are impulse dummies capturing outliers for the years, 2001, 2002 and 2009, respectively.

The figure 2 below shows the plot of both the fitted and actual residuals of the model. It shows that the estimated model approximates/mimics the actual dynamics of the data. This confirms that the model fit the data well.

Figure 2



2. Private consumption function

2.1 Review of the Literature

Keynes' Absolute Income Hypothesis (AIH) posits that household's consumption expenditure depends on disposable income[4] in that as household's disposable income increases consumption also increases (Keynes, 1939). Following Keynes' conjecture, Life-Cycle Hypothesis (LCH) and Permanent-Income Hypothesis (PIH) introduced opportunity cost variables such as interest rate or inflation rate as additional long-run determinants of consumption (Modigliani and Brumberg, 1954 and Friedman, 1957). In addition to disposable income as a wealth variable, other empirical studies in the literature include household wealth derived as consisting of financial wealth (difference between financial assets and financial liabilities) and housing wealth in the consumption model.

Table 2: Estimation Results

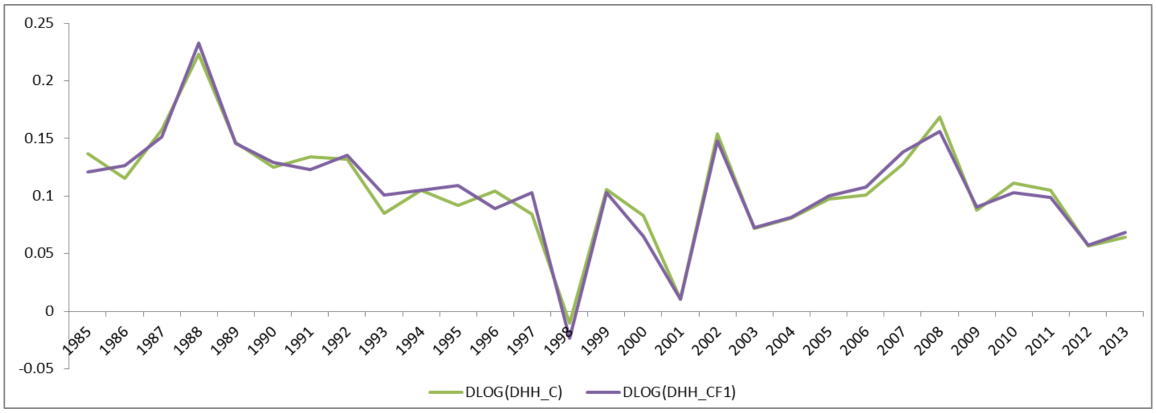
Dependent Variable: DLDHH_C				
Dependent Variable: D(LOG(DHH_C))				
Method: Least Squares				
Date: 08/20/14 Time: 16:14				
Sample (adjusted): 1985 2013				
Included observations: 29 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LOG(DHH_C(-2)))	0.27491	0.06037	4.55340	0.00020
D(LOG(GDP))	0.67959	0.05755	11.80819	-
LOG(DHH_C(-1))	(0.29284)	0.04080	(7.17792)	-
LOG(GDP(-1))	0.24749	0.03338	7.41369	-
C	0.40001	0.06680	5.98832	-
D01	(0.11816)	0.01030	(11.47097)	-
D98	(0.10952)	0.00999	(10.96070)	-
D04	(0.03969)	0.01151	(3.44782)	0.00270

Where DHH_C is the private consumption expenditure is, GDP is the gross domestic product, and D01, D98, D04 are impulse dummies for the period 2001, 1998 and 2004, respectively.

[4] This may consist of compensation of employees, household's property income as well as transfer payments and receipts.

The figure 2 below shows the plot of both the fitted and actual residuals of the model. It shows that the fitted equation approximates the actual series of the model, implying that the change in private consumption expenditure has been captured well and therefore the model can be used for forecasting.

Figure 2



3. Consumer Price Index (Inflation) function

3.1 Review of the Literature

The two major theories of inflation are the monetarists and structuralists (Adu and Marbuah, 2011).

The monetarists relate inflation to demand-side factors emanating from expansionary fiscal and monetary policies (which can be proxied by output). Structuralists' theory is based on the view that major causes of inflation are structural imbalances in economies; food scarcity, resource imbalance, foreign exchange developments and social and political constraints. Bernanke (2005) argues that structuralism places emphasis on the supply-side factors emanating from increase in costs of production. This can be thought of SA inflation dynamics given trade links between the two countries.

Table 3: Estimation Results

Dependent Variable: DLI					
Dependent Variable: D(LOG(CPI))					
Method: Least Squares					
Date: 08/27/14 Time: 10:25					
Sample (adjusted): 1982 2013					
Included observations: 32 after adjustments					
Variable		Coefficient	Std. Error	t-Statistic	Prob.
LOG(CPI(-1))		-0.209908	0.033165	-6.329283	0.000000
LOG(SACPI(-1))		0.222913	0.035472	6.284101	0.000000
C		-0.05339	0.023203	-2.300979	0.031200
D(LOG(SACPI))		0.818963	0.075631	10.828350	0.000000
D(LOG(RGDP(-1)))		0.082757	0.018336	4.513274	0.000200
D90		-0.039892	0.009862	-4.044954	0.000500
D8788		-0.02785	0.007253	-3.839751	0.000900
D94		-0.030848	0.009591	-3.216233	0.004000

Where CPI and SACPI are domestic and SA consumer price indices, respectively. RGDP is real GDP. Others are impulse dummies. The figure 2 below shows the plot of both the fitted and actual residuals of the model. It shows that the estimated model approximates/mimics the actual dynamics of the data. This confirms that the model fit the data well.

Figure 3