

Recent macroeconomic and financial developments

The Lesotho economy was estimated to contract by 5.2% in 2020 from modest growth of 0.6% in 2019. This reflects measures to mitigate the COVID-19 pandemic and low external demand, which adversely impacted the mining and manufacturing industries. Estimates of growth in the mining industry (textiles and clothing, construction) and services were revised downwards by 34.5, 29.3 and 9.9, and 4.2 percentage points in 2020, respectively.

Lesotho's economy is closely linked to South Africa's with imports from South Africa, mainly foodstuffs, constituting about 80% of its total imports. The decline in imports from South Africa contributed to food shortages in Lesotho, fueling inflationary pressures. Hence, inflation was estimated to decline only marginally, to 5.0 % in 2020 from 5.2 % in 2019. The fiscal deficit was estimated to widen to 10.2% of GDP in 2020 from 5.6% in 2019, largely driven by a 25 % increase in government expenditures mainly on the wage bill and government spending on health care to fight the pandemic. Much of the financing gap is expected to be met through foreign borrowing unless the government undertakes substantial fiscal adjustments to curb the widening fiscal deficit and the associated accumulation of foreign debt, which could threaten debt sustainability. External debt stood at 36.1% of GDP in 2020, well below the convergence criterion of 60% of GDP set by the South African Development Community (SADC). The decline in exports to both South Africa and the United States and reduced investments from China and South Africa, coupled with dwindling incomes and transfers, led to a deterioration in the current account, deficit from 6.0% of GDP in 2019 to 7.2% in 2020. The widening current account deficit also reflected a 26.6% decline in diamond exports and a 21.2 % decline in textile exports. It will be financed by a drawdown in foreign reserves. The banking sector remains stable with non-performing loans declining marginally from 3.2%

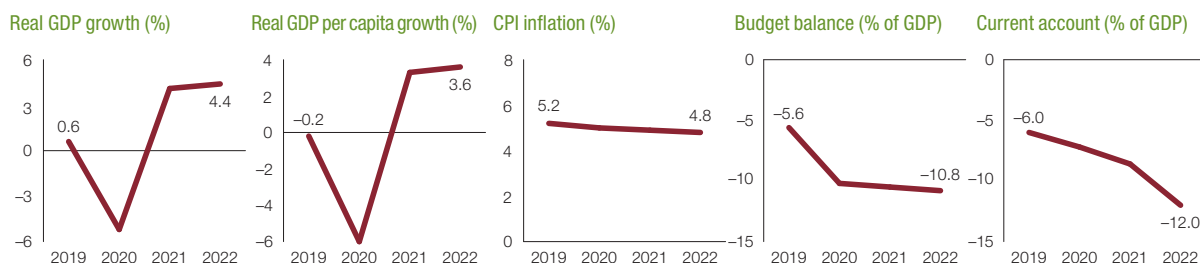
in 2019 before increasing to 4% in the second quarter of 2020.

Outlook and risks

Lesotho's growth trajectory and recovery are highly dependent on the path of the pandemic in South Africa given the close economic ties between the two countries. The economy is projected to grow by 4.1% in 2021 and 4.4% in 2022, owing to mining and construction associated with the second phase of Lesotho Highlands Water Project. Inflation is projected to decline further to 4.9% in 2021 and 4.8% in 2022, owing to subdued demand arising from the second wave of the pandemic in neighboring South Africa, the main trading partner. The fiscal deficit is projected to remain elevated at more than 10.0% of GDP in the medium term, owing to massive health-related spending if the crisis continues in 2021 and the revenue allocation from the Southern African Customs Union declines due to weak economic activity in the region. The current account deficit is projected to deteriorate further to 8.6% in 2021 and 12% in 2022, reflecting low external demand and dwindling incomes and transfers from migrants in South Africa.

Financing issues and options

Total public debt is projected to increase to 62.8% of GDP in 2021 due to the pandemic, breaching the SADC convergence criterion of 60% of GDP. Lesotho's risk of external debt distress has, therefore, been revised from low in 2019 to moderate. Going forward, Lesotho needs capacity strengthening for domestic resource mobilization, drawing down reserves, renegotiating debt, attracting concessionary financing, deploying remittances for infrastructural development, and fiscal consolidation to reduce the wage bill from its current level of 24% of GDP (three times the average for sub-Saharan Africa). The textile industry needs to source inputs from alternative countries to alleviate overdependence on China.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Lesotho's fiscal year, which runs from April 1 to March 31.