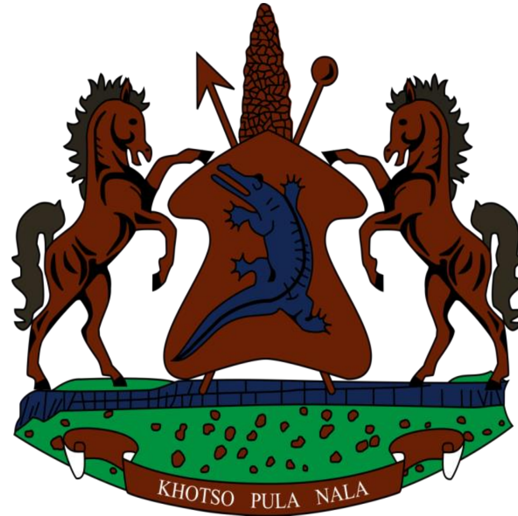

PUBLIC DEBT SUSTAINABILITY ANALYSIS REPORT FOR LESOTHO

DECEMBER 2016

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EXECUTIVE SUMMARY

This report presents results of the debt sustainability analysis (DSA) conducted in December 2016. The main objective of the analysis was to assess the sustainability of Lesotho's current debt stock and the Government's capacity to sustain the envisaged increased borrowing to finance infrastructural development. The results from this exercise will inform the government on the amount and terms of financing that are consistent with long-term debt sustainability and progress towards achieving the country's development objectives. The results of the current DSA will also provide a platform for developing a medium-term debt management strategy (MTDS) early 2017, to determine the optimal composition of public debt consistent with a sustainable debt level obtained in the DSA.

Based on the IMF/World Bank Debt Sustainability Framework (DSF) for Low Income Countries (LICs), the 2016 external DSA results show a temporary breach in the PV of debt to GDP threshold of 40 percent in the short to medium term. The PV of external debt to GDP is projected to remain above the indicative threshold of 40 percent in the baseline scenario up until 2018 after which it is projected to decline below the threshold through to 2037.. However, the risk of debt distress is significant as stress tests result in breaches of indicative thresholds. The debt burden ratios are projected to significantly breach the indicative threshold in the event of adverse shocks to exports or significant exchange rate depreciation. The results depicted the same pattern although with a slight improvement when remittances were taken into consideration.

Results of the public DSA indicate that Lesotho's public debt would broadly remain manageable over the projection period. The relevant debt ratio would remain below its threshold under the baseline scenario. However, higher fiscal deficits from 2017 onwards would rapidly increase the various public debt ratios.

Results of the DSA are based on macroeconomic framework that projects sustained real GDP growth rates stabilizing at 4% in the medium to long term in line with historical growth potential for Lesotho. It is assumed that financing terms will be less favorable to reflect the borrowing terms that are becoming more stringent and the expected transition to a middle income country, implying a gradual shift to the non-concessional financing window. FDI flows are assumed to average one percent of GDP during the projection period, reflecting the increased role that the

private sector is expected to play in spearheading infrastructure development. Over the medium term, the overall fiscal deficit is projected to move towards balanced budget due to fiscal consolidation. In the long term, the fiscal deficit is expected to remain within three percent of GDP in line with the Southern African Development Community (SADC) regional integration agenda.

Using the mechanical approach, the results suggest that Lesotho's external debt distress rating will deteriorate from moderate risk of debt distress to high risk of debt distress. The downgrade is mainly due to a temporary breach of the baseline scenario between 2016 and 2018. Moreover, all the debt burden ratios are projected to exceed the indicative thresholds under all shock scenarios. However, given that the breach in the baseline scenario is only temporary, Lesotho rating of debt distress remains moderate based on judgmental approach.

The findings, however, underscore the need for Government to continue with fiscal consolidation efforts and strong exchange rate management policies to mitigate the potential debt distress from exchange rate depreciation. There is a critical need to contain spending so that it is consistent with the expected long-run level of SACU revenue. The government also needs to move forward with structural reforms to boost productivity and competitiveness to raise the country potential growth.

SECTION 1: INTRODUCTION

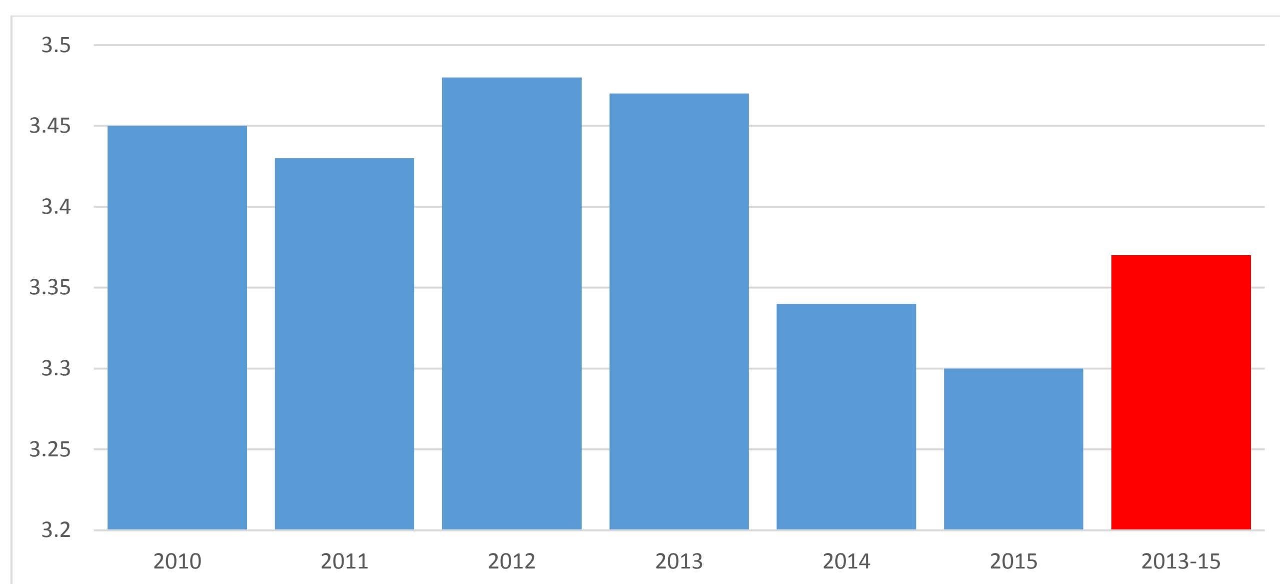
The Government of Lesotho conducted a debt sustainability analysis (DSA) from 21st November 2016 to 2nd December 2016, in collaboration with the Macroeconomic and Financial Management Institute (MEFMI) of East and Southern Africa. The DSA was conducted in line with the public debt management good practice, which emphasizes the need for regular DSA. The public debt is governed by Loans and Guarantees Act of 1967 and its subsequent amendments, Statutory Act 1975 and Local Loans Act 2001 which give authority to the Minister of Finance only to borrow on behalf of Government. The main objective is to meet the government financing requirements at the lowest possible long term borrowing cost, subject to a prudent degree of risk and to develop, deepen and broaden the domestic financial market for government securities. While it is essential to economies such as Lesotho to engage in developmental activities, this must be mostly be done with caution as excessive debt has negative impact. Hence, it is important for government to conduct debt sustainability analysis regularly in order assess the level of debt that simultaneously entrenches growth and sustainable debt position.

The objective of the DSA was to assess the sustainability of Lesotho's public debt in view of the envisaged huge borrowing to cover the fiscal deficit projected in the 2016/17 financial year of about 8.1% of GDP. In addition, the assessment involved identifying the historical drivers of public debt accumulation in Lesotho, including the size of the unexplained variations in the stock of public debt. The risks associated with different sources of financing, the structure of debt, such as currency structure, maturity structure of the existing and the potential new financing were also analyzed. The analysis also compared the results obtained in the 2014 DSA with the current DSA with a view to analyze the impact of new developments on debt indicators. The rest of the report is organized as follows: section two discusses the methodology used to undertake the DSA, Section three provides a review of the current debt portfolio, section four provides the baseline macroeconomic and financial assumptions underpinning the DSA, section five discusses the results of the DSA, and finally section six concludes and provides policy implications and recommendations.

SECTION TWO: METHODOLOGY AND SCOPE

The DSA was conducted using the standardized joint World Bank/IMF Debt Sustainability Framework for Low Income Countries (DSF-LICs) analytical tool. The DSF uses thresholds of debt burden indicators, which depend on the quality of a country's policies and institutions as measured by the World Bank under the CPIA. It comprises external and domestic debt, and is based on the framework for low-income countries approved by the respective Executive Boards. The framework takes into account indicative thresholds for debt burden indicators determined by the quality of the country's policies and institutions, and comprises baseline and alternative scenarios. Given the importance of remittances in enhancing Lesotho's capacity to repay debt, the DSA also uses the remittance-modified debt indicators, in addition to a standard baseline scenario, to assess the risk of debt distress. According to the 2015 CPIA rating, Lesotho is classified as medium policy performer with a three-year moving average CPIA score of 3.35 (see Figure 1 below).

Figure 1: Trends in CPIA Rating for Lesotho



Source: World Bank/IMF DSF Template

Accordingly, the relevant solvency thresholds of external debt for a country classified as a medium policy performer are PV of debt-to-GDP ratio less than 40 percent, PV of debt-to-exports ratio should be less than 150 percent, PV of debt-to-fiscal revenues ratio should be less than 250 percent, the debt service to exports ratio should be less than 20 percent, debt service to

revenue ratio should be less than 20 percent and PV of public debt should be less than 56%. **Table 1** shows indicative debt burden thresholds.

Table 1: Indicative debt burden thresholds

	Weak **CPIA <3.25**	**Medium** **3.25 < CPIA <3.75**	**Strong** **CPIA >3.75**
Solvency Ratios			
PV of Debt to GDP	30	40	50
PV of Debt to Exports	100	150	200
PV of Debt to Revenue	200	250	300
Liquidity Ratios			
Debt Service to Exports	15	20	25
Debt Service to Revenue	18	20	22
PV of Public debt to GDP	36	56	74

Source: World Bank

SECTION THREE: RECENT DEVELOPMENTS IN PUBLIC AND PUBLICLY GUARANTERED BEBT

Overview of Lesotho's debt

Public sector debt rose from 36.7 % of GDP in 2014/15 to 38 % at end-2015/16, largely owing to substantial depreciation of the loti against the dollar in the period under review.

Moreover, the steady increase in external debt between 2015/12 and 2014/15 can be attributed to the implementation of Metolong Dam Project.. The analysis takes into account only existing debt.

Table 2: External Debt (in Millions of Maloti)

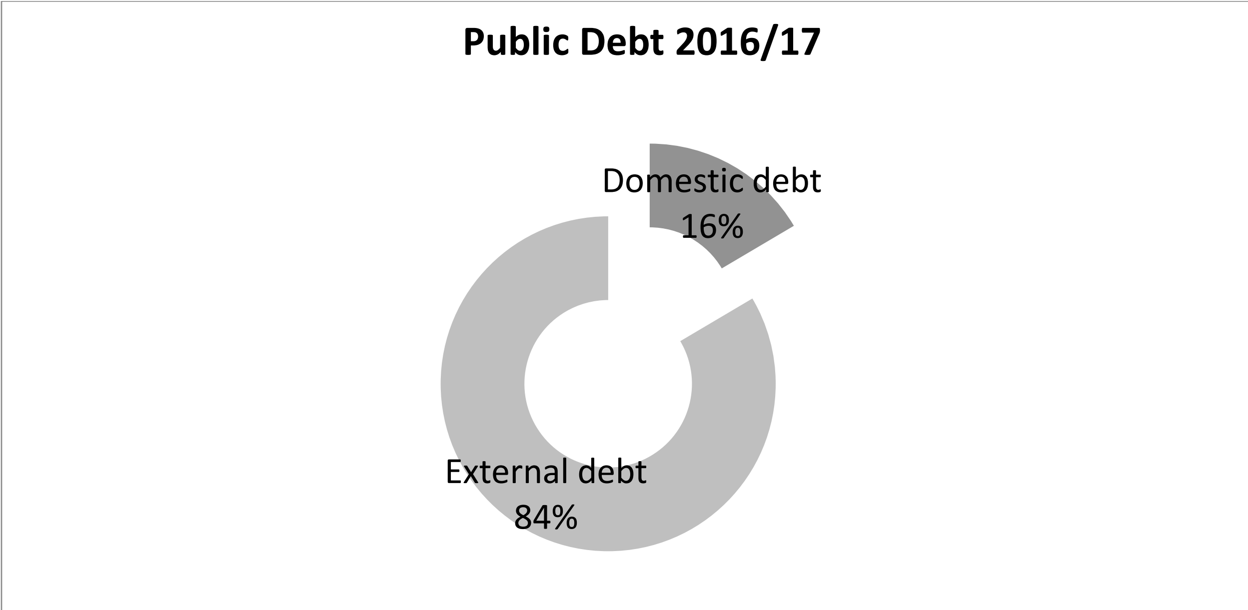
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Bilateral	275.0	376.3	565.1	840.4	1134.8	1003.8
Commercial Banks	68.9	63.3	59.6	54.3	0.6	0.6
Export credits	352.6	425.7	527.2	765.2	919.3	784.6
Multilateral	5,174.2	6,400.6	7,665.2	8,368.5	10,774.0	9,962.9
Total	5,870.7	7,265.9	8,817.1	10,028.4	12,828.7	11,751.9

Composition of Public Debt

External debt comprises 84% of total public debt while remaining 16% is domestic debt. The huge concentration of Public Debt is on External Debt and it exposes the country to exchange rate risk. As shown in Figure 2 below, Lesotho`s public domestic debt constitutes only a small proportion of total public debt. At end-2015/16, it comprised mainly of treasury bills and treasury bonds, which amounted to USD105 million, about 4.6 percent of GDP. In terms of domestic debt the government relies on treasury bonds mainly for financing the budget deficit.

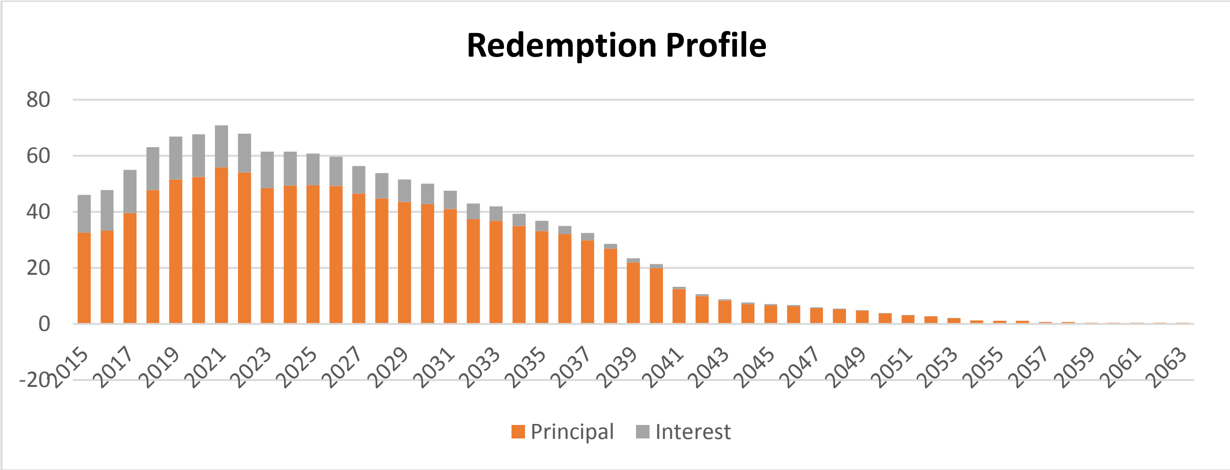
Domestic debt increased by 0.3 percent in the period under review, mainly as a result of the issuance of treasury bonds meant to facilitate capital market development and provide the government with an alternative source of financing. Short-term debt constituted 54 percent of total domestic debt while long-term debt amounted to 46 percent. The banking system is the main holder of domestic debt instruments, amounting to about 90 percent of currently outstanding debt.

Figure 2: Public Debt 2016/17



The debt service profile depicts a smooth redemption profile of the existing external debt in terms of both principal and interest payment. There is however, significant debt servicing pressure between 2019 and 2022 as depicted in the graph below.

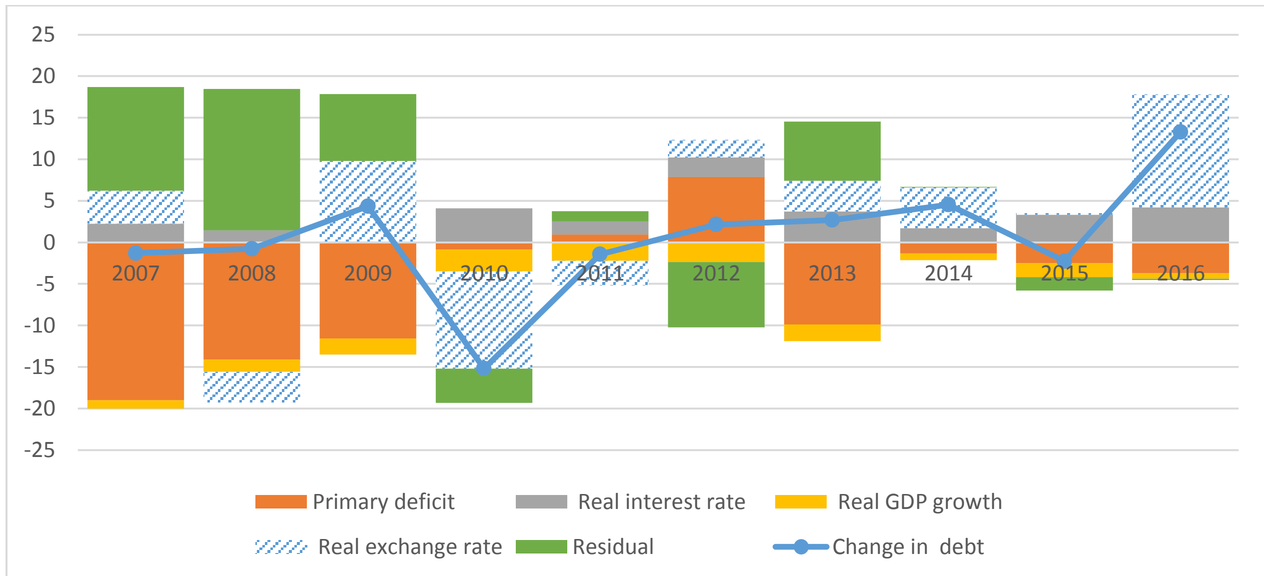
Figure 3 : Redemption Profile



Drivers of Debt Accumulation

An analysis of the drivers of debt accumulation suggests that exchange rate depreciation has been a significant driver of debt accumulation in Lesotho owing to the depreciation of the South African Rand witnessed in the recent past. The debt stock has also been subjected to significant stock flow adjustments mainly as a result of exchange rate revaluations. The Figure below shows the major drivers of public debt during the period 2007 to 2016.

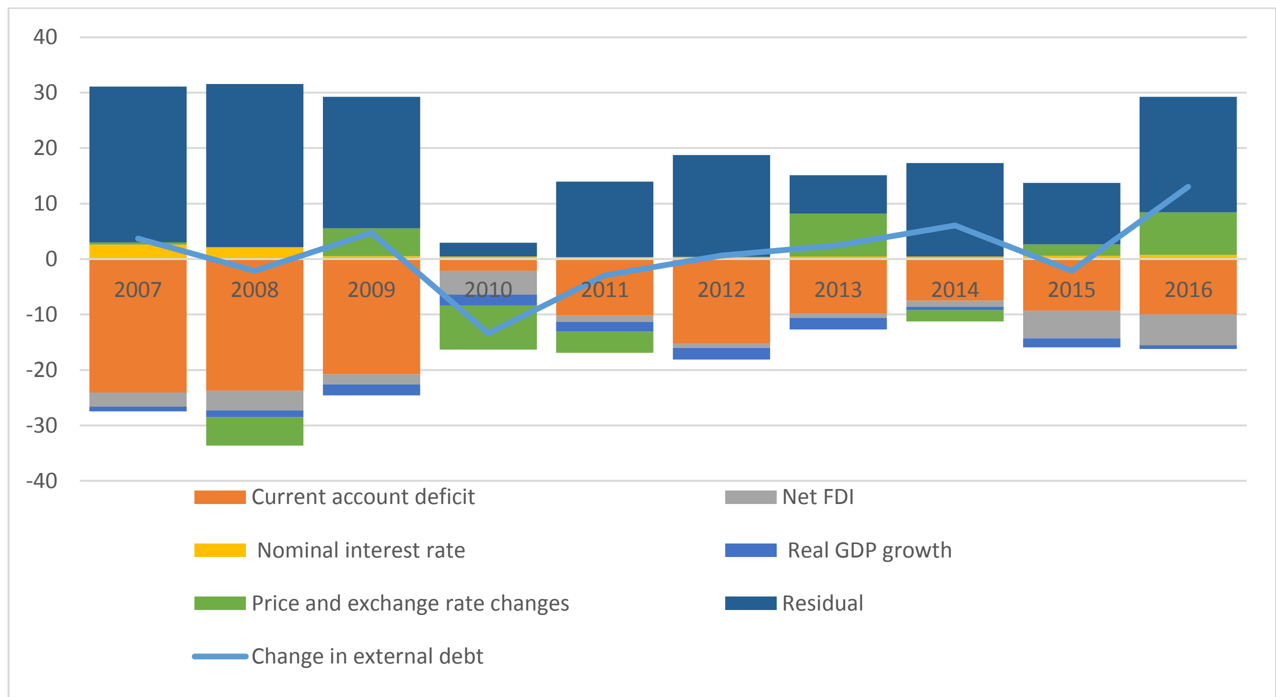
Figure 4: *Contributions to Changes in Public Debt*



As shown by the graph above, the primary balance contributed a small proportion of the changes in public debt as a result of the fiscal surplus that Lesotho has been recording in the past. The contribution from real interest rates has also been minimal given that the greater proportion of the country's debt portfolio has mainly been concessional in nature.

On the external side, the stock flow adjustments mainly attributed to exchange rate revaluations have been the major contributor to changes in total external debt. The contributions to changes in total external debt are shown in the figure below.

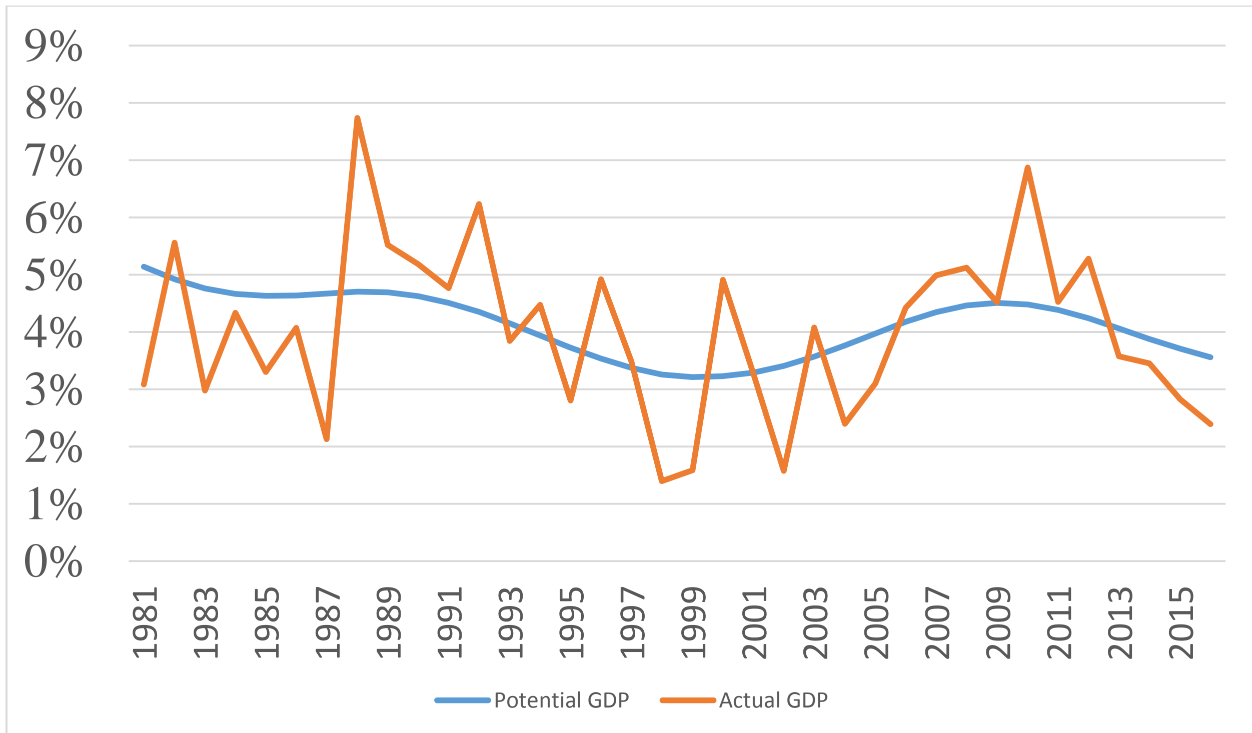
Figure 5: *Contributions to Changes in External Debt*



SECTION FOUR: BASELINE MACROECONOMIC ASSUMPTIONS

The debt sustainability analysis is based on the following assumptions: sustained economic growth over the medium term; continuous fiscal consolidation; and a relatively favorable external environment. Average potential GDP has been 4.1% since 1981 and the trend is projected to continue into the foreseeable future under the baseline scenario.

Figure 6: Potential and Actual GDP growth for Lesotho



Real GDP growth is assumed to be mainly driven by the recovery in agricultural production and continued expansion of mining. In the medium term, productivity improvements from ongoing structural reforms, including business climate reforms under the National Strategic Development Plan and the construction of the Lesotho Highlands Water Project, Phase II (LHWP II), which are likely to make Lesotho an exporter of water and electricity in the region are also expected to spur growth. The key macroeconomic assumptions are summarized in BOX 1 below.

BOX I: KEY ASSUMPTIONS:

BASELINE SCENARIO

Real Sector Assumptions

- **Real GDP growth rate** is projected to grow by 3.8 percent in the medium term and is expected to average 4.3 percent in the long term, supported primarily by increased activity in agriculture, mining, construction, and transport and communication. This growth assumption is consistent with historical potential GDP[1] growth rate for Lesotho of 4.1%.

Fiscal Assumptions

- **Total revenue** is expected to gradually decline and stabilize at 40 percent of GDP in the medium to long term. The revenue assumptions in the medium term are premised on planned improvements in administration efficiency. **SACU revenue** is projected at about 15-16 percent of GDP in the medium term.
- **Government expenditures** particularly recurrent are expected to shrink relative to capital outlay due to anticipated decline in compensation of employees arising from Public Sector Government Modernization project. Government is expected to consolidate aggressively in the medium term to rebuild foreign reserve buffer but expected to revert back to a policy of maintaining a deficit of at most 3 percent of GDP in the long run.
- **Fiscal balance** is assumed to remain within a deficit of the less than 3 percent band, over the medium term, on the basis of the implementation of the planned fiscal consolidation efforts to maintain sufficient international reserve buffer.

External Sector Assumptions

- **The current account balance** is expected to average 8 percent of GDP in the medium term and improve to an average of 5 percent of GDP in the long term. The external sector will be driven largely by a relatively higher growth in exports compared to imports. The projected high current deficit in the medium term is due to strong import demand associated with projects for energy and water developments.
- **Inflation** is expected to average 5 percent in the medium to long term. Specifically, inflation is assumed to move from an average of 6.2 percent in the last ten years to 5.1 percent in the

[1] Estimated using the Hodrick Prescott Filter (HPF) over the period 1981 to 2016

medium to long term, reflecting an expected recovery in prices of major export items.

- **International reserves are projected to remain at above 5 months of import cover or above that level over the long term.**

ALTERNATIVE SCENARIO

- **Real GDP** growth rate is projected to grow to a new potential higher growth rate of between 5 - 7 percent in the long term, supported primarily by full implementation NSDP

On new financing, the ratios of financing are assumed to be 80: 20 percent, external and domestic respectively.

External Financing

In 2015, Lesotho graduated from lower income to middle income country which has changed the lending terms to IDA blend. The Second major creditor to Lesotho which is ADF has indicated that it will also apply the blended terms to Lesotho going forward. The new terms are reflected in the table below.

Table 3: Terms of Major Multilateral Creditors

Terms of Major Multilateral Creditors		
	Old Terms (IDA only)	**IDA Blend Terms**
Maturity	40 years	25 years
Grace Period	10 years	5 years
Interest Rate	0.00 %	1,25 %
Service Charge	0.75 %	0.75%
Commitment Fee	0.50 %	0.50 %

Given the following pipeline projects expected to be signed in 2017, major multilateral creditors are expected to continue to be IDA and ADB while bilateral creditors will be led by China and The Kuwait Fund. Other creditors include Arab Funds, IFAD, etc.

Table 4: Pipeline Projects

Project	**Amount in (Million USD)**	**Creditor**	**Proportion of Total**
Mpiti-Sehlabathebe Road	135.24	China	11.50 %
Social Assistance Development	20.00	IDA	1.70 %
Solar Power	160.00	China	13.61 %
Rural Electrification	20.00	BADEA	1.70 %
Economic Diversification	7.00	ADF	0.60 %
Mesitsaneng-Maphutseng Road	30.00	BADEA	2.55 %
Beef Development	100.74	China	8.57 %
LHWP Phase II	550.00	IDA	46.77
Education Quality for Equality	35.00	IDA	2.98 %
Southern African TB Project	14.98	IDA	1.27 %
Public Sector Modernization	10.00	IDA	0.85 %
Transport Sector Development	30.00	IDA	2.50 %
Moshoeshoe I International Airport	63.00	KUWAIT	5.36 %

In terms of proportions, it is expected that IDA will provide the biggest portion of loan disbursements followed by China, through Exim Bank of China. Most of the IDA credits have already been negotiated and signed. The rest of the projects are expected to be negotiated and signed next year (2017) with the exception of LHWP Phase II.

The following creditors have been identified as key financiers for new projects during the projected periods. Their lending terms are also indicated in the same table.

Table 5: Terms of Major Bilateral and Multilateral Creditors

Terms of Major Bilateral and Multilateral Creditors					
Bilateral Creditors			**Multilateral Creditors**		
	Kuwait Fund	Exim China	IDA	ADB	BADEA
Maturity	15-20 years	15 years	23 years	25 years	20 years
Grace Period	5 years	5 years	5 years	5 years	7 years
Interest Rate	1.5-2.0 %	2 %	1.25 %	1.25 %	2 %
Service Charge	0.0 %	1 %	0.75 %	0.75 %	0.0 %
Commitment Fee	0.0 %	0.50 %	0.50 %	0.50 %	0.0 %

The expected interest rate on external debt in the medium to long term will average 4% and 8% on domestic debt. Concessional borrowing is expected to decline over the projection horizon. Currently, the grant element of external borrowing is just above 35 percent and it is expected to fall to 15 percent in the projected period.

Baseline Domestic Debt Assumptions

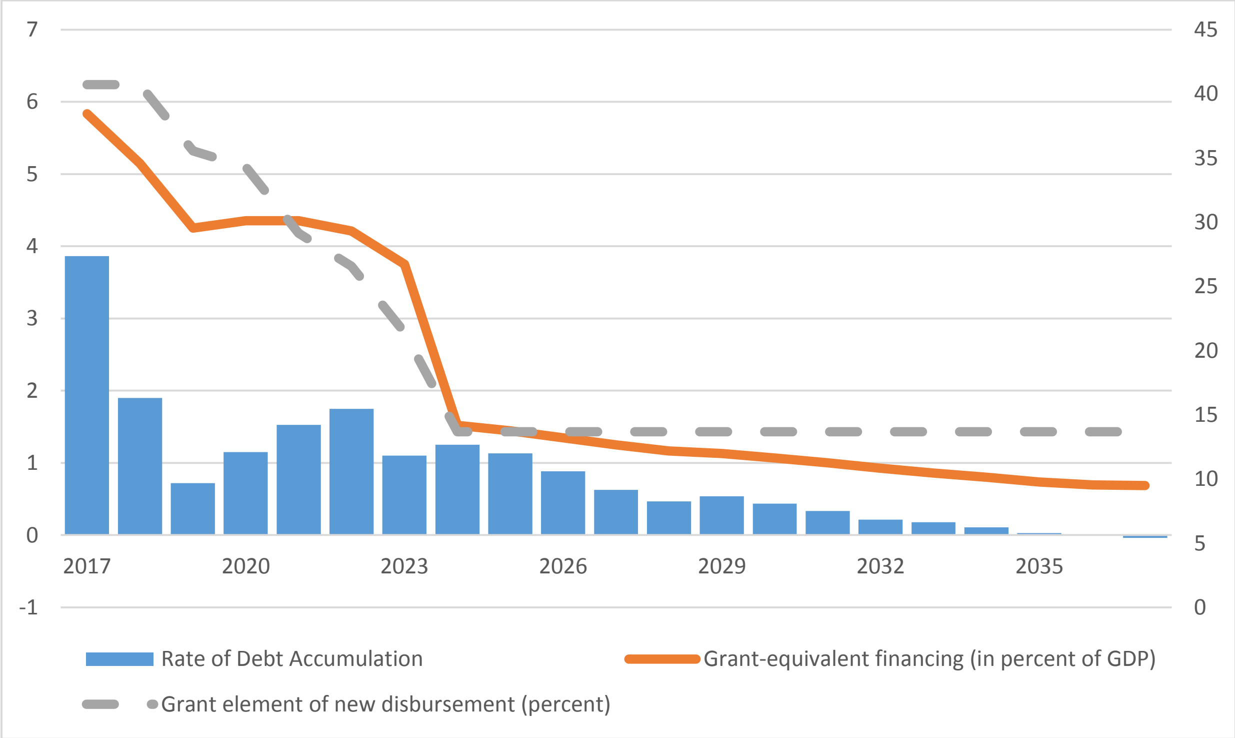
It is assumed that the projected fiscal deficit shall be financed by 20% domestic debt, the distribution of which shall be 55% Treasury Bonds and 45% Treasury Bills. Treasury bills are projected to decrease by a percentage point for the duration of the projection period to give additional room for Treasury Bonds used mainly for fiscal purposes.

It is also assumed that, Treasury bills for monetary policy purposes will be allowed to grow by 2% in line with projected growth in GDP but capped at M700m. It is expected that 3 and 5 year bonds will take effect as more appetite for medium term security is anticipated.

SECTION FIVE: DSA RESULTS AND ANALYSIS IN THE BASELINE SCENARIO

Based on the baseline assumptions discussed above, external debt accumulation will evolve as shown in the Figure below.

Figure 4: External Debt Accumulation under Baseline Scenario



Source:

The results show rapid debt accumulation in the short to medium term, resulting from the anticipated financing for infrastructure projects, particularly in energy, water and transport. In the long term, debt accumulation is however expected to subside, reflecting government fiscal consolidation efforts. Moreover, the grant element of new borrowing and grant equivalent financing are projected to decline significantly in the long run reflecting reduced access to concessional financing due to the blend status.

Evolution of External Debt Burden Indicators

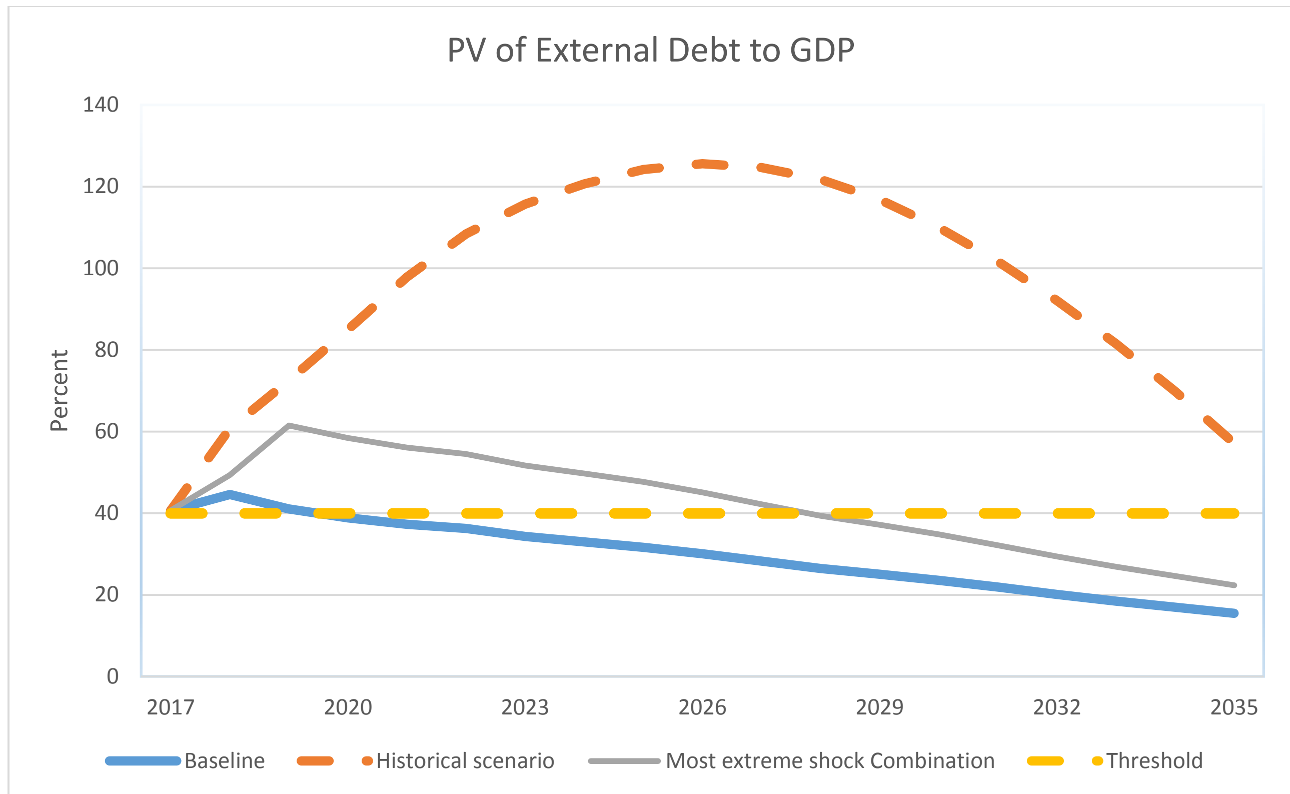
The results for external DSA under the baseline scenario suggest that all PPG external debt burden indicators remain below their indicative thresholds in the baseline scenario over the long term, despite a temporary breach in the PV of external debt to GDP ratio. However, debt service indicators are projected to rise gradually over time, reflecting the increasing recourse to non-concessional borrowing. Table 6 below shows the external DSA results under baseline scenario.

Table 6: External Debt Indicators

	2017	2018	2019	2020	2021	2022	2027	2037	Threshold
PV of PPG external debt	40.7	44.6	41.1	38.9	37.3	36.3	28.2	13.6	40
In percent of exports	113.6	125.8	117.7	112.9	107.0	100.2	75.4	35.0	150
In percent of government revenues	88.4	95.5	90.8	83.8	84.3	84.4	65.6	35.8	200
Debt service-to-exports ratio (in percent)	7.1	7.8	8.4	8.5	8.2	8.0	7.1	4.3	
PPG debt service-to-exports ratio (in percent)	7.1	7.8	8.4	8.5	8.2	8.0	7.1	4.3	
PPG debt service-to-revenue ratio (in percent)	5.5	5.9	6.5	6.3	6.4	6.7	6.2	4.4	

Using the **PV of debt to revenue and PV of debt to exports**, the results from the baseline scenario show that Lesotho's external debt is sustainable throughout the projection period. Specifically, the PV of Debt to revenue and the PV of Debt to exports are largely below their indicative thresholds of 200 percent and 150 percent, respectively. This indicates a solvent position, implying that Lesotho will be able to honour the current debt obligations using its future cash flows. The PV of debt to GDP however, shows a temporary breach as depicted in the graph below.

Figure 5. PV of external debt to GDP



As shown in figure 8 above, the PV of external debt to GDP temporarily breaches the indicative threshold before gradually falling below the policy pendent threshold of 40 percent in the medium to long term. The analysis shows that Lesotho would largely remain sustainable both in the medium to long term projection period under the baseline scenario.

Figure 6. PV of Debt to Exports

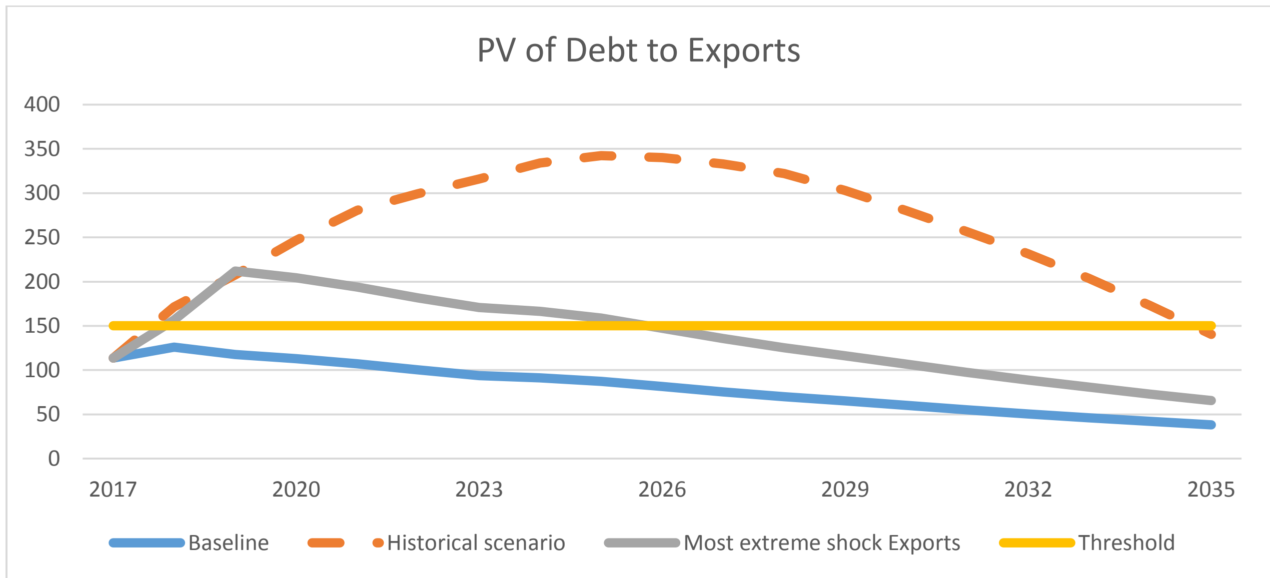
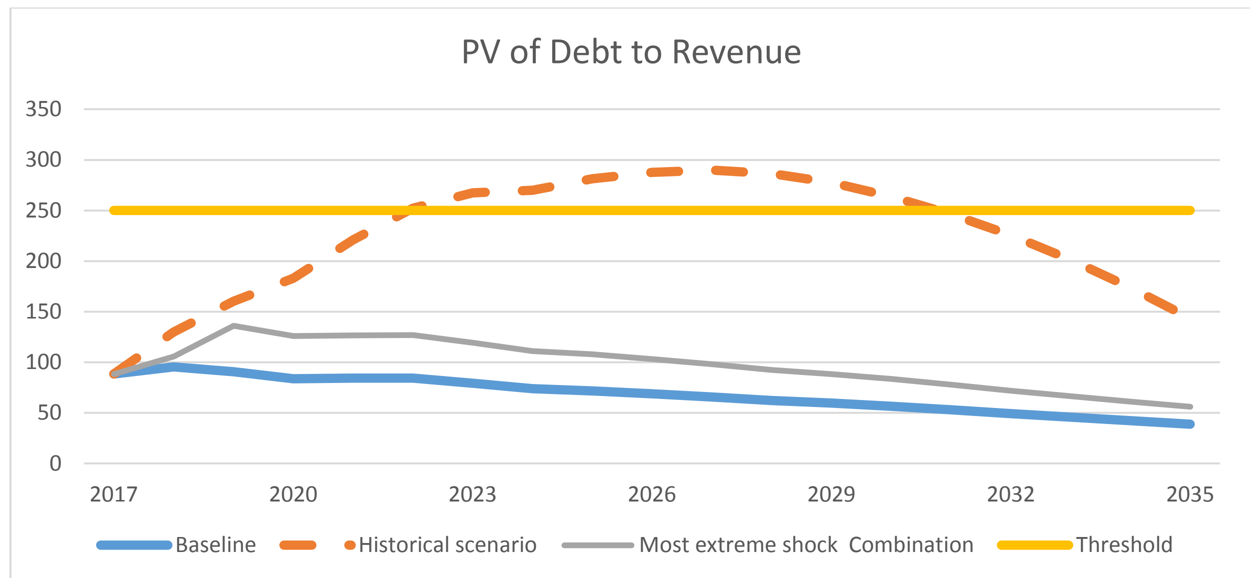


Figure 7. PV of external debt to Revenue



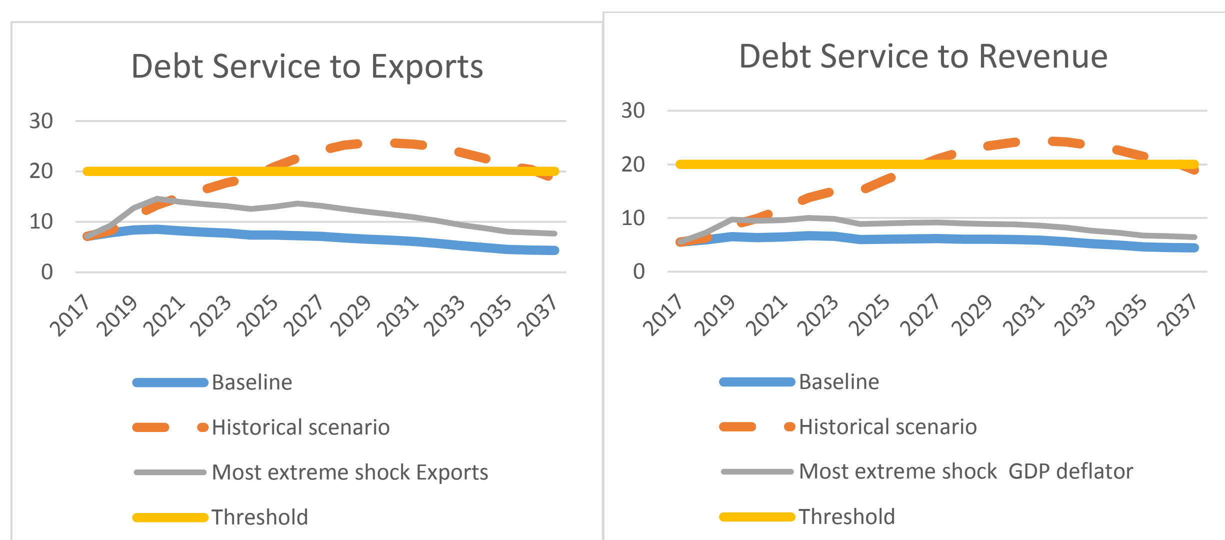
The figure 10 above implies that the country will be able to honour its obligations under the baseline. The difference in the results (PV of Debt to GDP and PV of Debt to Revenues) may be attributed to the possible understatement of nominal GDP. Both ratios would remain well below the thresholds because of the highly concessional nature of existing debt and limited non-

concessional debt borrowing. The gradual increase in the ratios of debt service is due to the assumed changes in international interest rates and the short maturity profile of non-concessional debt assumed in the baseline. The rates are projected to average 2.3 percent in the medium term and increasing to an average of around 3.7 percent in the longer term, while the portfolio's maturity profile is projected to reduce to an average of 22 years with a grace period of just 5 years. Taking into account remittances, the PV of external debt (in percent of GDP and remittances) would be slightly lower than the ratio without remittances.

Evolution of liquidity indicators

Both the liquidity ratios of debt-service-to-exports and debt-service-to-revenue are projected to remain below their respective thresholds. This is due to the size of concessional debt that accounts for a large part of Lesotho debt portfolio, characterized by long maturity profiles and relatively small principal repayments. Nonetheless, the External debt-service-to-exports and External debt-service-to-revenue ratios are projected to reach nine and seven percent respectively, almost doubling their respective current debt service figures. The increase in the debt service cost over the projection period is largely on the account of the reduction of grace periods on some loans, more non-concessional debt is contracted while interest rates as earlier observed are projected to be higher.

Figure 8: External Debt Service Ratios



Sensitivity Analysis of External Debt

Sensitivity analysis results show that Lesotho's external debt burden would deteriorate if the nominal exchange rate depreciates or if export growth turned out lower than the historical average or in the event of less favorable public sector borrowing terms. In a scenario in which the key variables are set at their average of the past 10 years, Lesotho's external debt ratios significantly increased relative to the baseline, reflecting low inflows of non-debt-creating FDI, and the high level of average fiscal deficits over this period. This result is evidenced by a significant breach shown by the historical scenario in figures 8 up to 13. The table below shows the historical and projected averages of key macroeconomic variables.

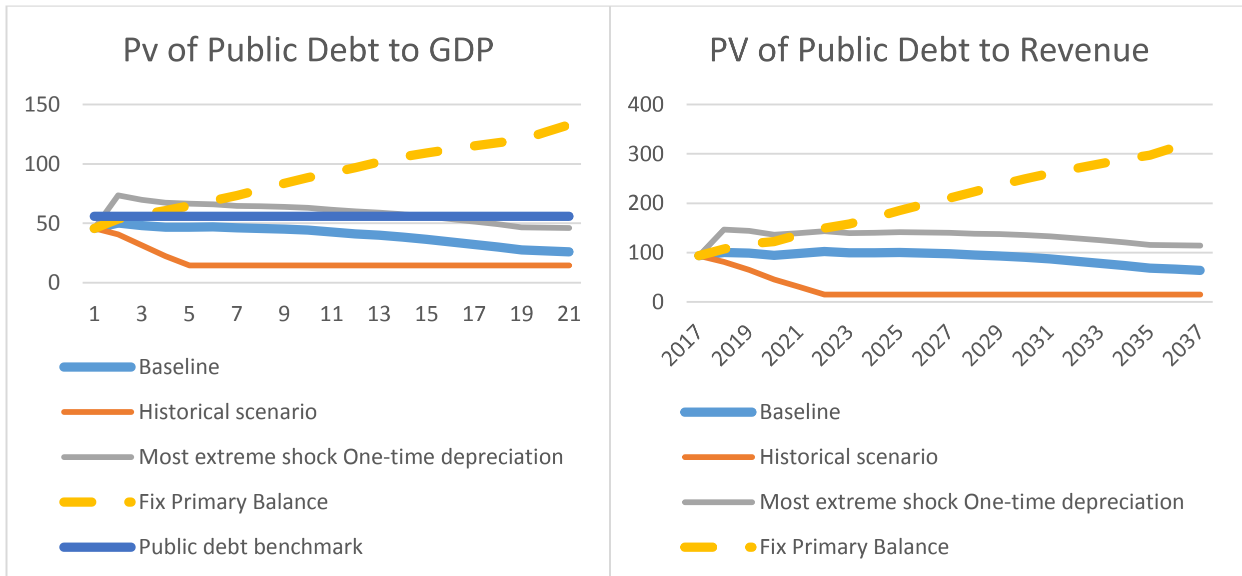
Table 7: Historical and projected Averages of key macroeconomic variables

	Historical Average	**Standard Deviation**	**Average (2017-2022)**	**Average (2023-2037)**
Non-interest current account in percent of GDP	13.26	7.39	21.83	9.86
Real GDP growth (in percent)	4.08	1.88	4.10	4.22
US GDP Deflator (percent change)	-0.10	13.11	3.62	4.15
Growth of exports of G&S (US dollar terms, in percent)	3.84	11.82	3.73	9.05
Current official transfers in percent of GDP	36.57	6.28	23.92	24.86
Net non-debt creating flows (FDI) to GDP ratio	2.67	1.81	4.91	3.17

Evolution of Public Debt Burden Indicators

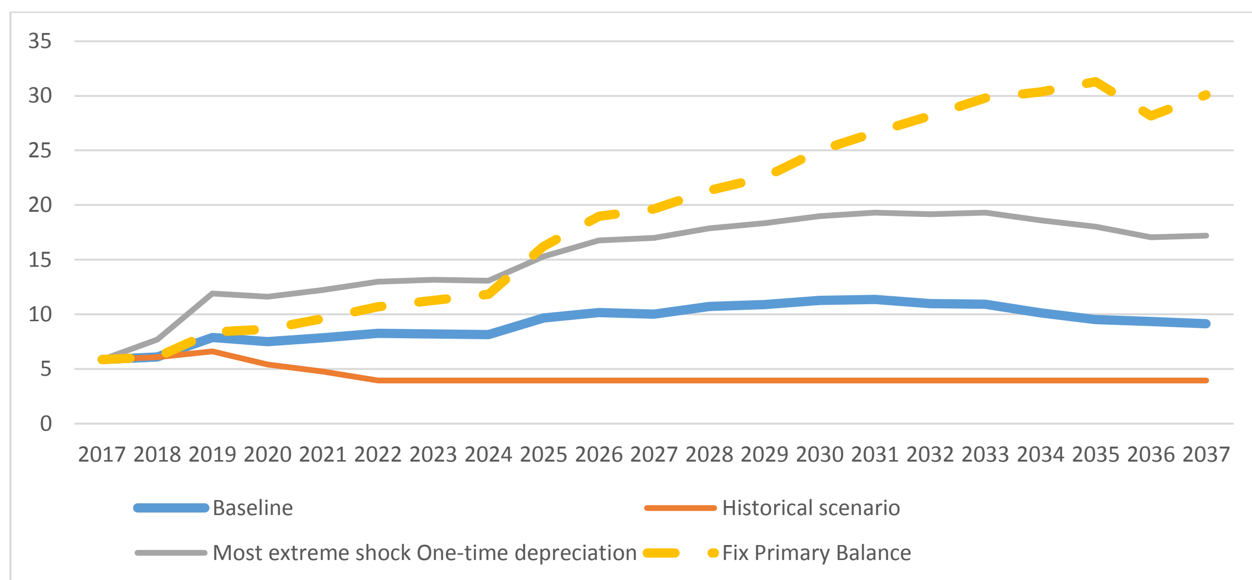
The DSA results for public debt indicators largely mirror those of external debt, because domestic debt remains relatively low (4.6 percent of GDP at the end of 2015/16). Debt is projected to remain below the threshold of 56% of GDP throughout the projection period indicating a sustainable public debt position.

Figure 9. Public Debt to GDP and Revenue Ratios



The liquidity indicator for public debt depicts an increasing trend in the medium term signifying debt service pressure from projected new borrowing going forward. This is depicted in the graph below.

Figure 10: Public Debt Service to Revenue Ratios



Sensitivity Analysis of Public Debt

For public debt, the standard sensitivity test, including the scenarios with an unchanged primary balance from 2016/17 and lower long-run GDP growth, reveals substantial deviation of the baseline scenario, with the debt indicators exceeding their indicative threshold. This indicates that the current fiscal stance cannot be maintained in the medium to long term without jeopardizing debt sustainability.

Specifically, in a scenario assuming that the primary deficit (as a percent of GDP) remains at the projected 2016/2017 level over the entire projection period, the PV of public debt would keep on growing towards breaching the indicative threshold. However, in a scenario assuming that the country follows its historical path, the debt burden indicators would decline, which underscores the need for continued prudent fiscal policy.

LESOTHO'S OVERALL RISK RATING

Table 8: Mechanical Approach for Risk Rating

	Number of Debt Burden Indicators exceeding threshold under Baseline scenario	**Number of Debt Burden Indicators exceeding threshold under Stress test scenario**
Low risk	0	0
Moderate Risk	0	1+
High Risk	1+	1+
In debt distress	Country is already having problems in servicing its debt (Arrears)	

Source: IMF

Using the mechanical approach, Lesotho's risk rating will deteriorate from a moderate risk rating to a high risk of debt distress. However, since there is only one temporary breach of the threshold, Lesotho's public debt would be judged to remain in the moderate risk category. Moreover, the pace of debt accumulation is not rapid to the extent of justifying a downgrade. All baseline scenarios are projected to fall under the relevant indicative thresholds in the long term. Only shock scenarios exceed the indicative debt burden thresholds.

The country risk rating would significantly improve with a related improvement in the country's CPIA to a strong rating. The country's debt portfolio, however, remained prone to increased vulnerabilities from growth, exchange rate and revenue shocks.

DSA RESULTS UNDER THE ALTERNATIVE SCENARIO

The alternative scenario assumes that the intended projects to be financed from new borrowing will raise the potential growth rate of Lesotho from the current 4.1 percent to around 6-7 percent in the medium to long term. Assuming such a growth scenario, Lesotho's external debt ratios would comfortably fall within sustainable thresholds and guaranteeing sustainable debt position.

The debt-to-GDP ration would temporarily breach the threshold in 2018 although the size of the breach is much lower than under the baseline macroeconomic scenario (See fig 14).

Figure 114: PV of debt to GDP

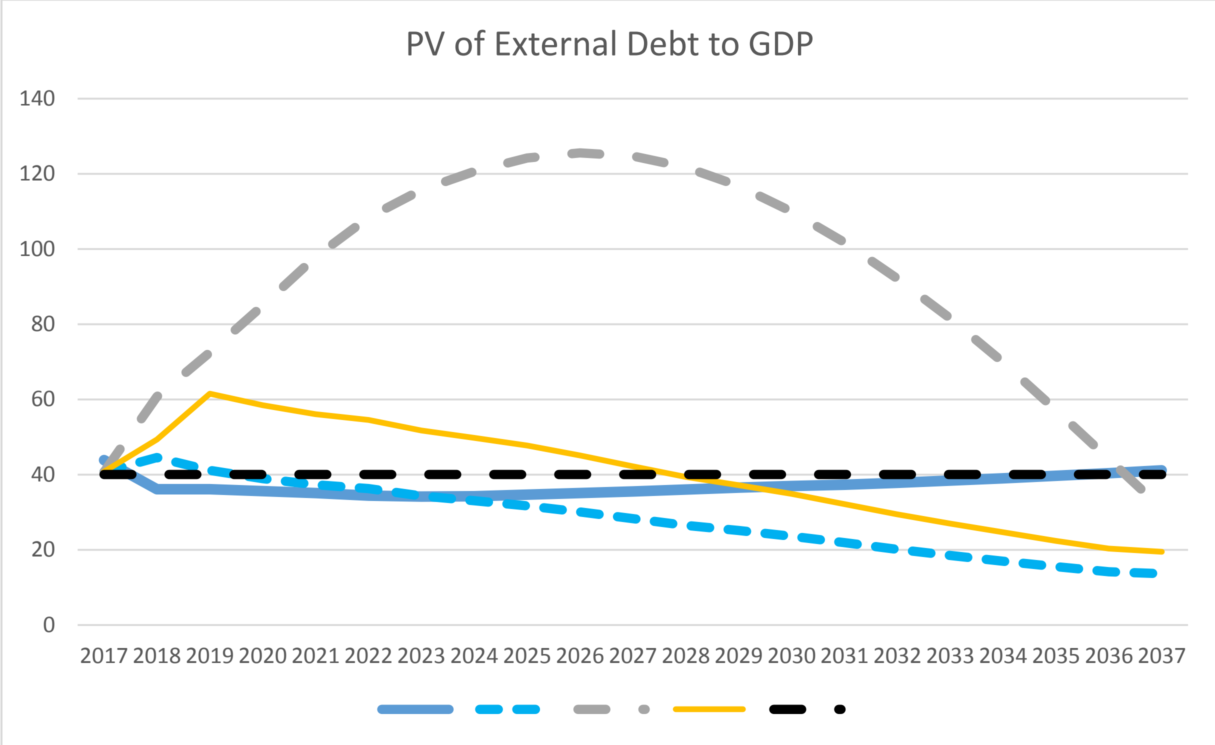
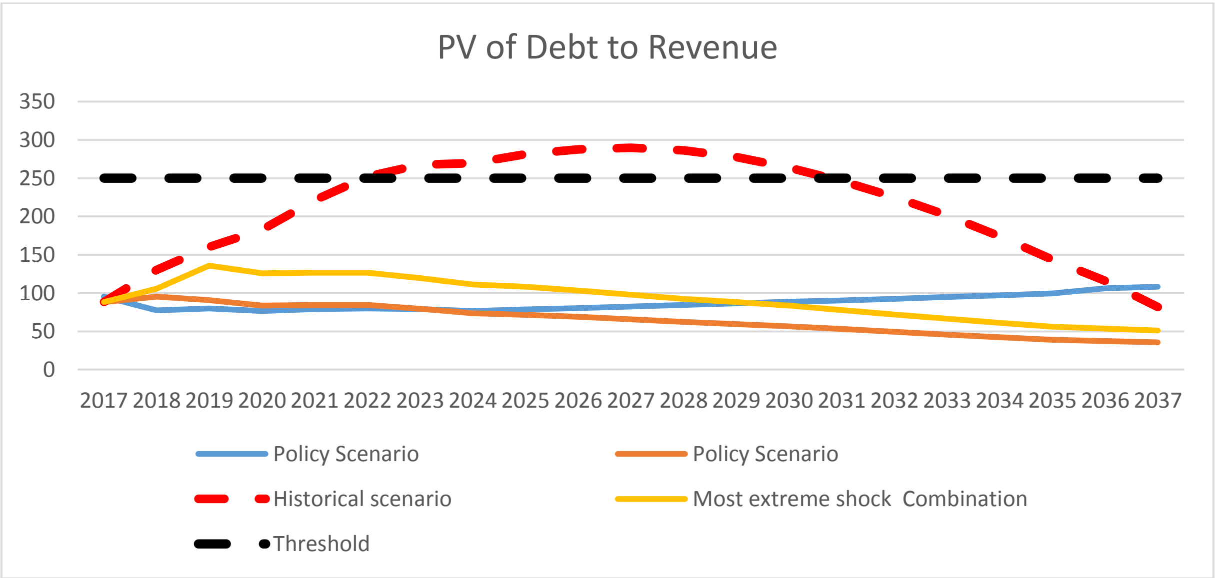


Figure 125: PV of debt to Revenue



SECTION SIX: CONCLUSION AND POLICY RECOMMENDATIONS

The debt sustainability analysis results suggest that the external risk rating for Lesotho would remain moderate under both the baseline and alternative scenarios while public debt is projected to ramain sustainable. The recent GDP rebasing has significantly improved the country's debt carrying capacity with all indicators remaining below indicative thresholds under the baseline scenario.

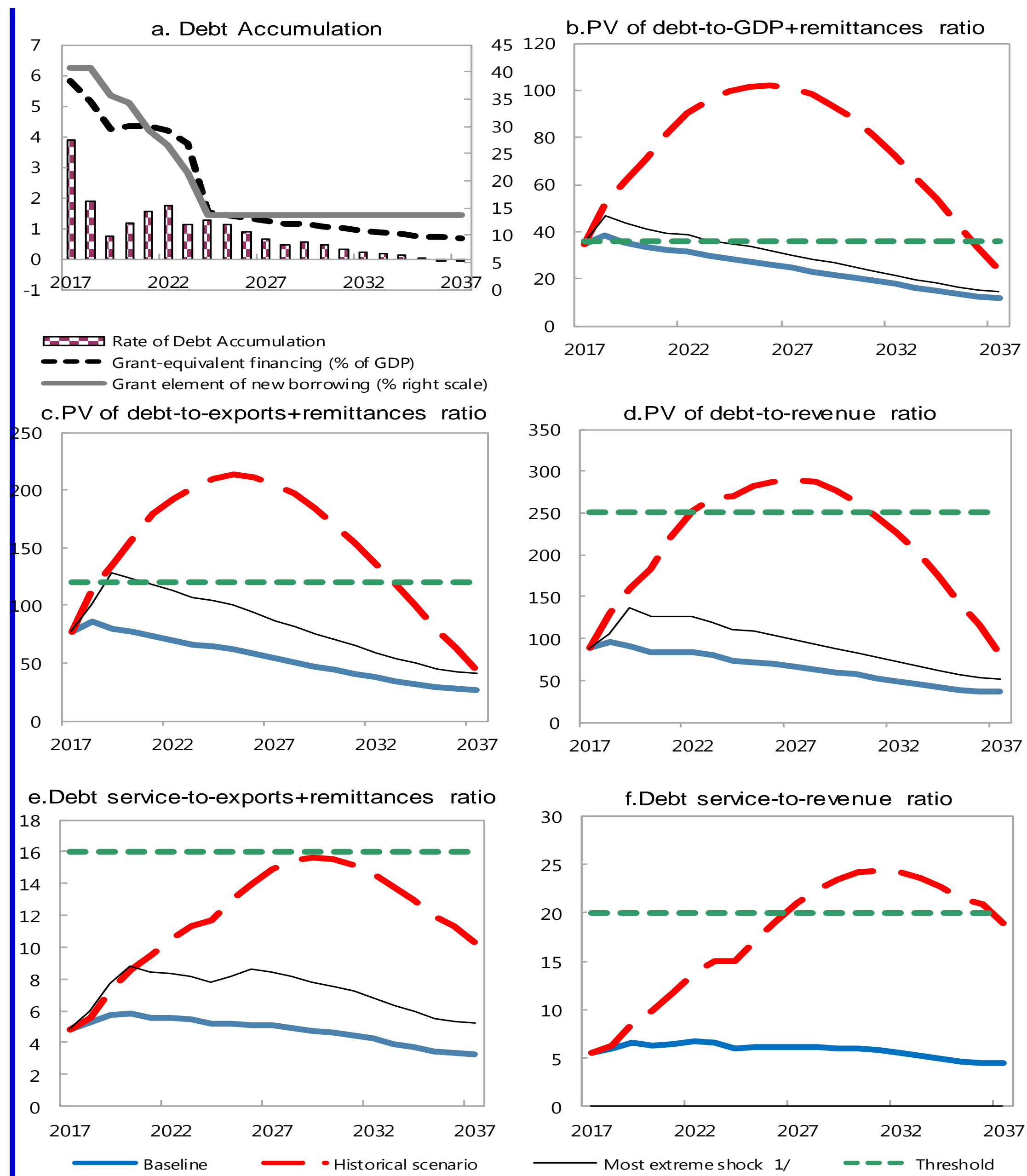
Sensitivity analysis results indicate that the country is highly susceptible to shocks. The main vulnerabilities include lower real GDP, exports and revenue growth and sustained exchange rate depreciation. This suggests that to maintain sustainability, the country should attain relatively high growth rates, compared to historical averages.

To preserve debt sustainability, it is important for the Government to continue formulating and implementating prudent fiscal and growth oriented policies and enhancing debt management capacity and public investment management (efficient implementation of infrastructure projects). As reflected in figure 1 above, there is a consistent downward trend in Lesotho's CPIA rating and therefore a high risk for downgrade to a weak performer country category due to weak institutional framework which subsequently lowers debt burden thresholds. There is, therefore, need to improve the country's policies and institutional framework to curb leakages and promote efficient use of resources. The successful implementation of these policy initiatives would also provide strong impetus to efforts geared at accelerating accumulation of capital, productivity and economic growth and enhance the country's ability to meet future external debt obligations when they fall due. An improvement in the CPIA rating will enable the country to migrate from the current moderate policy performer rating to a strong policy performer.

There is also need for effective monitoring of projects implementation to ensure a positive spinoffs from borrowing to economic growth. A number of empirical studies generally find a positive impact of public investment on growth both through a direct impact on economic activity and through spillover effects on private investment.

ANNEX 1

Evolution of public and publicly gurantered external debt under baseline scenario with remittances



ANNEX 2

Evolution of public and publicly gurantered external debt under baseline scenario with remittances

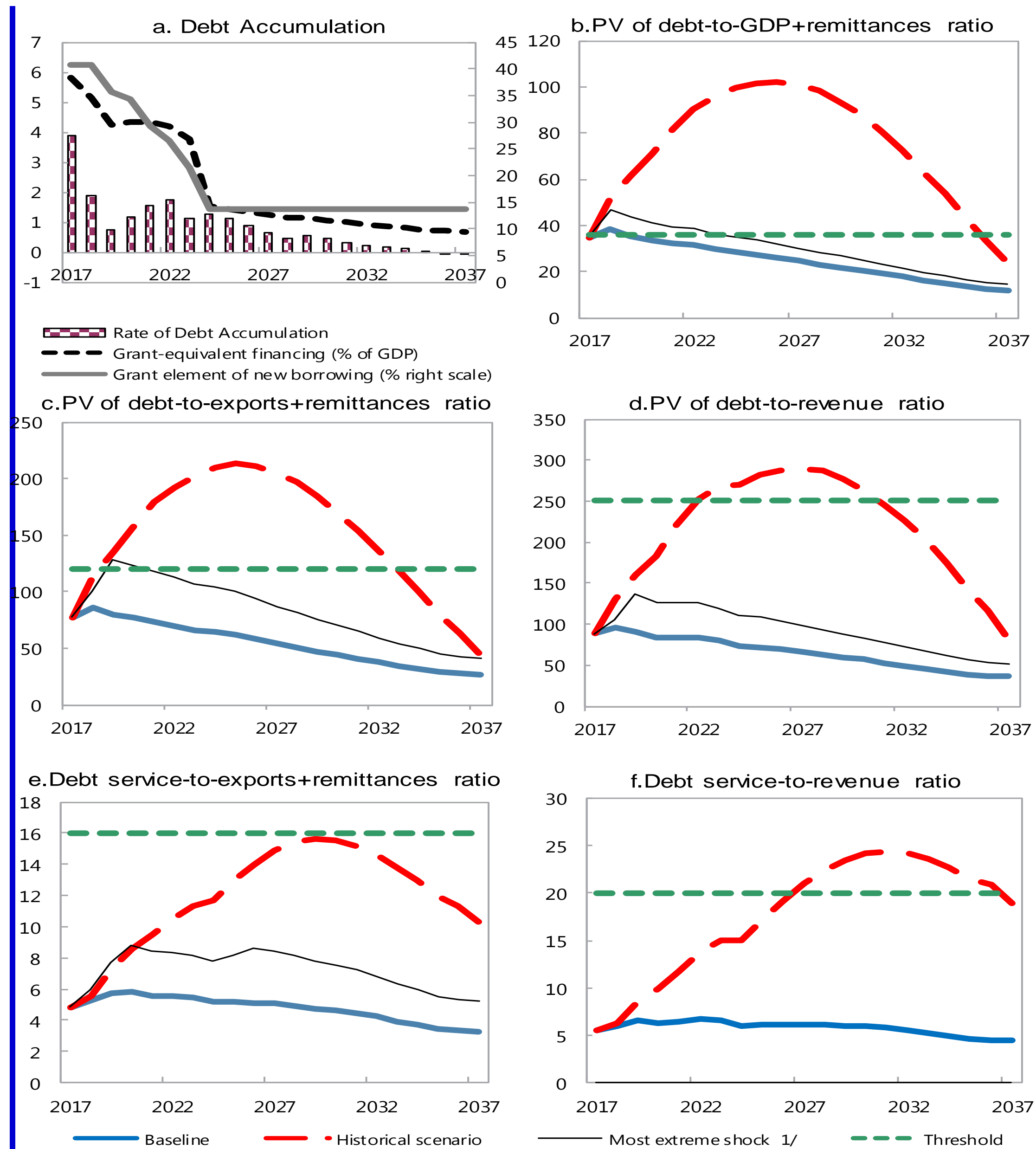


Table xx .Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2014-2037 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-2022 Average	2027	2037	2023-203 Average
External debt (nominal) 1/	**40.6**	**38.4**	**51.5**			**45.5**	**50.4**	**46.3**	**44.1**	**42.5**	**41.5**		**31.8**	**16.3**	
of which: public and publicly guaranteed (PPG)	40.6	38.4	51.5			45.5	50.4	46.3	44.1	42.5	41.5		31.8	16.3	
Change in external debt	6.0	-2.2	13.0			-5.9	4.8	-4.0	-2.3	-1.6	-1.0		-2.1	-0.5	
Identified net debt-creating flows	-10.8	-13.2	-7.8			-21.0	-30.0	-29.1	-29.1	-29.3	-26.6		-16.8	-6.6	
Non-interest current account deficit	**-7.5**	**-9.3**	**-10.0**	**-13.3**	**7.4**	**-14.7**	**-24.1**	**-23.2**	**-23.7**	**-23.8**	**-21.4**		**-13.0**	**-4.3**	-9.9
Deficit in balance of goods and services	30.1	28.9	28.4			39.8	40.6	42.1	43.0	42.5	40.3		37.0	30.6	
Exports	37.5	38.7	48.1			35.8	35.4	34.9	34.5	34.9	36.2		37.5	38.8	
Imports	67.6	67.6	76.5			75.7	76.0	77.0	77.4	77.3	76.5		74.4	69.4	
Net current transfers (negative = inflow)	-36.5	-34.7	-31.9	-36.6	6.3	-33.1	-23.5	-22.7	-21.9	-21.1	-21.3		-24.7	-24.7	-24.9
of which: official	-30.1	-28.7	-25.9			-27.6	-17.8	-16.8	-15.7	-14.7	-14.7		-16.9	-14.9	
Other current account flows (negative = net inflow)	-1.1	-3.5	-6.5			-21.4	-41.2	-42.7	-44.8	-45.2	-40.5		-25.3	-10.2	
Net FDI (negative = inflow)	**-1.1**	**-5.0**	**-5.6**	**-2.7**	**1.8**	**-5.6**	**-5.3**	**-5.0**	**-4.7**	**-4.6**	**-4.4**		**-3.6**	**-2.3**	-3.2
Endogenous debt dynamics 2/	**-2.3**	**1.1**	**7.7**			**-0.7**	**-0.7**	**-0.9**	**-0.7**	**-0.9**	**-0.8**		**-0.2**	**0.0**	
Contribution from nominal interest rate	0.4	0.6	0.8			1.0	0.9	1.0	1.0	1.0	1.1		1.1	0.7	
Contribution from real GDP growth	-0.7	-1.6	-0.7			-1.7	-1.6	-1.9	-1.7	-1.9	-1.9		-1.4	-0.6	
Contribution from price and exchange rate changes	-2.0	2.1	7.7			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**16.9**	**11.1**	**20.8**			**15.0**	**34.9**	**25.0**	**26.9**	**27.7**	**25.6**		**14.7**	**6.0**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	47.3			40.7	44.6	41.1	38.9	37.3	36.3		28.2	13.6	
In percent of exports	...	...	98.3			113.6	125.8	117.7	112.9	107.0	100.2		75.4	35.0	
PV of PPG external debt	**...**	**...**	**47.3**			**40.7**	**44.6**	**41.1**	**38.9**	**37.3**	**36.3**		**28.2**	**13.6**	
In percent of exports	**...**	**...**	**98.3**			**113.6**	**125.8**	**117.7**	**112.9**	**107.0**	**100.2**		**75.4**	**35.0**	
In percent of government revenues	**...**	**...**	**86.0**			**88.4**	**95.5**	**90.8**	**83.8**	**84.3**	**84.4**		**65.6**	**35.8**	
Debt service-to-exports ratio (in percent)	**4.8**	**4.5**	**5.1**			**7.1**	**7.8**	**8.4**	**8.5**	**8.2**	**8.0**		**7.1**	**4.3**	
PPG debt service-to-exports ratio (in percent)	**4.8**	**4.5**	**5.1**			**7.1**	**7.8**	**8.4**	**8.5**	**8.2**	**8.0**		**7.1**	**4.3**	
PPG debt service-to-revenue ratio (in percent)	**3.3**	**3.1**	**4.4**			**5.5**	**5.9**	**6.5**	**6.3**	**6.4**	**6.7**		**6.2**	**4.4**	
Total gross financing need (Millions of U.S. dollars)	-154.3	-282.7	-249.4			-343.8	-568.1	-595.5	-653.9	-709.7	-688.1		-622.1	-501.8	
Non-interest current account deficit that stabilizes debt rati	-13.5	-7.1	-23.0			-8.7	-28.9	-19.2	-21.5	-22.2	-20.5		-10.9	-3.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.1	3.9	1.6	4.1	1.9	3.3	3.8	4.1	4.0	4.8	4.7	4.1	4.4	4.0	4.2
GDP deflator in US dollar terms (change in percent)	6.3	-4.9	-16.7	-0.1	13.1	-1.6	6.2	6.0	4.5	3.5	3.0	3.6	4.2	0.0	4.1
Effective interest rate (percent) 5/	1.4	1.4	1.7	2.2	1.9	1.9	2.1	2.2	2.3	2.6	2.8	2.3	3.6	4.0	3.7
Growth of exports of G&S (US dollar terms, in percent)	-7.7	2.0	5.2	3.8	11.8	-24.3	8.9	8.8	7.2	9.8	11.9	3.7	10.3	4.0	9.1
Growth of imports of G&S (US dollar terms, in percent)	-33.0	-1.2	-4.2	-0.2	15.8	0.5	10.7	11.8	9.2	8.4	6.7	7.9	8.0	4.0	7.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	40.7	40.7	35.6	34.3	29.1	26.6	34.5	13.7	13.7	14.2
Government revenues (excluding grants, in percent of GDP	54.7	56.5	55.0			46.0	46.7	45.2	46.4	44.3	43.0		43.0	38.0	41.6
Aid flows (in Millions of US dollars) 7/	496.5	846.6	693.1			151.9	134.9	117.7	132.6	145.7	147.1		82.0	100.9	
of which: Grants	106.8	44.8	56.3			56.3	73.2	78.0	81.7	91.5	94.9		42.4	54.2	
of which: Concessional loans	389.7	801.8	636.8			95.6	61.7	39.7	50.9	54.2	52.2		39.6	46.7	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.8	5.1	4.3	4.4	4.4	4.2		1.3	0.7	1.2
Grant-equivalent financing (in percent of external financing)	...	...	...			57.8	67.2	71.3	66.0	62.7	59.3		39.2	40.6	40.2

Memorandum items:

Table xx .Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2014-2037 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical [6/]	Standard [6/]	Projections									
				Average	Deviation							2017-2022			2023-203
	2014	2015	2016			2017	2018	2019	2020	2021	2022	Average	2027	2037	Average
External debt (nominal) 1/	**40.6**	**38.4**	**51.5**			**45.5**	**50.4**	**46.3**	**44.1**	**42.5**	**41.5**		**31.8**	**16.3**	
of which: public and publicly guaranteed (PPG)	40.6	38.4	51.5			45.5	50.4	46.3	44.1	42.5	41.5		31.8	16.3	
Change in external debt	6.0	-2.2	13.0			-5.9	4.8	-4.0	-2.3	-1.6	-1.0		-2.1	-0.5	
Identified net debt-creating flows	-10.8	-13.2	-7.8			-21.0	-30.0	-29.1	-29.1	-29.3	-26.6		-16.8	-6.6	
Non-interest current account deficit	**-7.5**	**-9.3**	**-10.0**	**-13.3**	**7.4**	**-14.7**	**-24.1**	**-23.2**	**-23.7**	**-23.8**	**-21.4**		**-13.0**	**-4.3**	-9.9
Deficit in balance of goods and services	30.1	28.9	28.4			39.8	40.6	42.1	43.0	42.5	40.3		37.0	30.6	
Exports	37.5	38.7	48.1			35.8	35.4	34.9	34.5	34.9	36.2		37.5	38.8	
Imports	67.6	67.6	76.5			75.7	76.0	77.0	77.4	77.3	76.5		74.4	69.4	
Net current transfers (negative = inflow)	-36.5	-34.7	-31.9	-36.6	6.3	-33.1	-23.5	-22.7	-21.9	-21.1	-21.3		-24.7	-24.7	-24.9
of which: official	-30.1	-28.7	-25.9			-27.6	-17.8	-16.8	-15.7	-14.7	-14.7		-16.9	-14.9	
Other current account flows (negative = net inflow)	-1.1	-3.5	-6.5			-21.4	-41.2	-42.7	-44.8	-45.2	-40.5		-25.3	-10.2	
Net FDI (negative = inflow)	**-1.1**	**-5.0**	**-5.6**	**-2.7**	**1.8**	**-5.6**	**-5.3**	**-5.0**	**-4.7**	**-4.6**	**-4.4**		**-3.6**	**-2.3**	-3.2
Endogenous debt dynamics 2/	**-2.3**	**1.1**	**7.7**			**-0.7**	**-0.7**	**-0.9**	**-0.7**	**-0.9**	**-0.8**		**-0.2**	**0.0**	
Contribution from nominal interest rate	0.4	0.6	0.8			1.0	0.9	1.0	1.0	1.0	1.1		1.1	0.7	
Contribution from real GDP growth	-0.7	-1.6	-0.7			-1.7	-1.6	-1.9	-1.7	-1.9	-1.9		-1.4	-0.6	
Contribution from price and exchange rate changes	-2.0	2.1	7.7			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**16.9**	**11.1**	**20.8**			**15.0**	**34.9**	**25.0**	**26.9**	**27.7**	**25.6**		**14.7**	**6.0**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	47.3			40.7	44.6	41.1	38.9	37.3	36.3		28.2	13.6	
In percent of exports	...	...	98.3			113.6	125.8	117.7	112.9	107.0	100.2		75.4	35.0	
PV of PPG external debt	**...**	**...**	**47.3**			**40.7**	**44.6**	**41.1**	**38.9**	**37.3**	**36.3**		**28.2**	**13.6**	
In percent of exports	**...**	**...**	**98.3**			**113.6**	**125.8**	**117.7**	**112.9**	**107.0**	**100.2**		**75.4**	**35.0**	
In percent of government revenues	**...**	**...**	**86.0**			**88.4**	**95.5**	**90.8**	**83.8**	**84.3**	**84.4**		**65.6**	**35.8**	
Debt service-to-exports ratio (in percent)	**4.8**	**4.5**	**5.1**			**7.1**	**7.8**	**8.4**	**8.5**	**8.2**	**8.0**		**7.1**	**4.3**	
PPG debt service-to-exports ratio (in percent)	**4.8**	**4.5**	**5.1**			**7.1**	**7.8**	**8.4**	**8.5**	**8.2**	**8.0**		**7.1**	**4.3**	
PPG debt service-to-revenue ratio (in percent)	**3.3**	**3.1**	**4.4**			**5.5**	**5.9**	**6.5**	**6.3**	**6.4**	**6.7**		**6.2**	**4.4**	
Total gross financing need (Millions of U.S. dollars)	-154.3	-282.7	-249.4			-343.8	-568.1	-595.5	-653.9	-709.7	-688.1		-622.1	-501.8	
Non-interest current account deficit that stabilizes debt rati	-13.5	-7.1	-23.0			-8.7	-28.9	-19.2	-21.5	-22.2	-20.5		-10.9	-3.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.1	3.9	1.6	4.1	1.9	3.3	3.8	4.1	4.0	4.8	4.7	4.1	4.4	4.0	4.2
GDP deflator in US dollar terms (change in percent)	6.3	-4.9	-16.7	-0.1	13.1	-1.6	6.2	6.0	4.5	3.5	3.0	3.6	4.2	0.0	4.1
Effective interest rate (percent) 5/	1.4	1.4	1.7	2.2	1.9	1.9	2.1	2.2	2.3	2.6	2.8	2.3	3.6	4.0	3.7
Growth of exports of G&S (US dollar terms, in percent)	-7.7	2.0	5.2	3.8	11.8	-24.3	8.9	8.8	7.2	9.8	11.9	3.7	10.3	4.0	9.1
Growth of imports of G&S (US dollar terms, in percent)	-33.0	-1.2	-4.2	-0.2	15.8	0.5	10.7	11.8	9.2	8.4	6.7	7.9	8.0	4.0	7.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	40.7	40.7	35.6	34.3	29.1	26.6	34.5	13.7	13.7	14.2
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of which: Grants	106.8	44.8	56.3			56.3	73.2	78.0	81.7	91.5	94.9		42.4	54.2	
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Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.8	5.1	4.3	4.4	4.4	4.2		1.3	0.7	1.2
Grant-equivalent financing (in percent of external financing)	...	...	...			57.8	67.2	71.3	66.0	62.7	59.3		39.2	40.6	40.2