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# KINGDOM OF LESOTHO

## JOINT WORLD BANK-IMF DEBT SUSTAINABILITY ANALYSIS

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Prepared by the staff of the International Development Association (IDA) and the International Monetary Fund (IMF).

| KINGDOM OF LESOTHO : JOINT BANK-FUND DEBT SUSTAINABILITY ANALYSIS | |
|---|---|
| **Risk of external debt distress** | Moderate |
| **Overall risk of debt distress** | Moderate |
| **Granularity in the risk rating** | Limited space |
| **Application of judgment** | No |

Lesotho's risk of external and overall debt distress remains moderate but risks to debt sustainability have risen since the last DSA.[1] While the exchange rate appreciation in FY20/21 somewhat lowered the debt burden, falling SACU transfers, growing public expenditure, new borrowing, and increasing contingent liabilities have elevated debt sustainability risks. Lesotho's debt indicators are expected to deteriorate in the near term before improving over the medium term, supported by recovering SACU transfers and slower growth in public expenditure relative to GDP. The moderate risk rating suggests limited space to absorb shocks. The DSA highlights the importance of fiscal consolidation to stabilize debt levels, build buffers for future shocks, and prevent the crowding out of credit to the private sector. Controlling current expenditures and improving the efficiency of capital spending, among other measures advised in the report, will be critical for fiscal consolidation. The results also show the need to address contingent liability risks, mainly stemming from the financing shortfall of the pension fund. Finally, the authorities should also prioritize developing domestic debt markets.

[1] This DSA updated the previous Joint DSA from July 2020 (IMF Country Report No 20/228). The DSA analysis reflects a debt carrying capacity of Medium considering Lesotho's Composite Indicator Index of 2.91, based on the IMF's April 2022 World Economic Outlook and the 2020 World Bank Country Policy and Institutional Assessment (CPIA).

# PUBLIC DEBT COVERAGE

1. **The DSA covers the central government debt, central bank debt taken on behalf of the government, and government-guaranteed debt** (Text Table 1).[2] Debt coverage includes both external and domestic obligations. Foreign currency-denominated debt is used as a proxy for external debt as data on creditor residency is unavailable and there is no nonresident participation in the domestic debt market. Debt also includes domestic arrears, estimated at 3.4 percent of GDP as of March 2022.[3] While total SOE debt is not yet available, government-guaranteed debt is available and included. Debt guarantees related to COVID-19 measures are also included.

2. **Debt coverage is similar to the previous DSA.** However, the authorities are making progress to expand the reporting and coverage of public debt by including non-guaranteed and on-lent debt of SOEs. They also plan to publish outstanding debt of SOEs, including guarantees, on the website of the Ministry of Finance from FY22/23 in agreement with the World Bank under the Sustainable Development Financing Policy (SDFP).

3. **The DSA includes a contingent liability stress test to capture extrabudgetary units, SOEs, Public Private Partnerships (PPPs), and financial market shocks in the assessment** (Text Table 2). The contingent liability stress test incorporates the following shocks:

- The pension fund—estimated at 9.6 percent of GDP.[4]
- Liabilities associated with potential asset seizures—estimated at 2.5 percent of GDP.[5]
- 5 percent of GDP for a financial market shock that exceeds the existing stock of banks' NPLs.
- 3.7 percent of GDP for non-guaranteed SOE debt, which is not captured in the government debt stock. Calibration includes LSL1 billion on-lent debt of SOEs and an estimate for non-guaranteed debt of the 10 SOEs.
- 1.1 percent of GDP to account for Lesotho's PPP capital stock, as specified in the World Bank's database on PPPs.

[2] The DSA does not include the central bank's net liability to the IMF SDR department in line with the Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations (July 28, 2021).
[3] Arrears have been accumulating as Ministries, Departments, and Agencies (MDAs) continue to undertake spending outside of IFMIS. The government is not in arrears on any debt repayments.
[4] The Public Officers Defined Contribution Pension Fund was established in 2008. According to the latest actuarial evaluation of pension liabilities obtained during the mission, the funding gap stands at LSL3.5 billion as of March 31, 2021. The authorities plan to increase contributions to gradually reduce unfunded liabilities.
[5] Frazer Solar GmbH filed a global enforcement action to seize up to EUR50 million of Lesotho's assets in contractual damages. Following a counter suit against the seizure order filed by the authorities, the South African High Court has temporarily postponed the case.

Text Table 1. Lesotho: Coverage of Public Sector Debt and Design of the Contingent Liability Stress Test

| | Subsectors of the public sector | Sub-sectors covered |
|---|---|---|
| 1 | Central government | X |
| 2 | State and local government | |
| 3 | Other elements in the general government | |
| 4 | o/w: Social security fund | |
| 5 | o/w: Extra budgetary funds (EBFs) | |
| 6 | Guarantees (to other entities in the public and private sector, including to SOEs) | X |
| 7 | Central bank (borrowed on behalf of the government) | X |
| 8 | Non-guaranteed SOE debt | |

Text Table 2. Lesotho: Summary of Shocks Used for the Contingent Liabilities Stress Test

| | | | | | |
|---|---|---|---|---|---|
| 1 | The country's coverage of public debt | The central government, central bank, government-guaranteed debt | | | |
| | | Default | | Used for the analysis | Reasons for deviations from the default settings |
| 2 | Other elements of the general government not captured in 1. | 0 | percent of GDP | 12.1 | Contingent liabilities representing the funding shortfall of the civil service pension fund and the asset seizure by Frazer Solar GmbH. |
| 3 | SoE's debt (guaranteed and not guaranteed by the government) 1/ | 2 | percent of GDP | 3.7 | Contingent liabilities relating with on-lent debt to SOEs considered to pose fiscal risk. |
| 4 | PPP | 35 | percent of PPP stock | 1.1 | Estimated value of PPP capital stock |
| 5 | Financial market (the default value of 5 percent of GDP is the minimum value) | 5 | percent of GDP | 5.0 | |
| | Total (2+3+4+5) (in percent of GDP) | | | 21.9 | |

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

# BACKGROUND ON DEBT

**4. In recent years, Lesotho's public debt has increased substantially** (Text Table 3).[6] The gross public debt-to-GDP ratio has increased from 42.2 percent of GDP in FY17/18 to 57.4 percent of GDP in FY20/21, mainly reflecting growing current spending and large capital projects. More recently, the increase in borrowing was compounded by the COVID-19 shock and falling SACU transfers. Given that external debt—denominated in foreign currency—accounts for 82 percent of total debt, exchange rate valuation effects on the debt-to-GDP ratio are also material. The rand strengthened by 17.3 percent during the fiscal year FY20/21, lowering the external debt-to-GDP ratio by 3.3 percentage points of GDP. However, the exchange rate effect reversed since then, contributing to the increase of debt-to-GDP ratio in FY21/22.

**5. Debt relief under the Catastrophe Containment and Relief Trust (CCRT) in 2021 and the Debt Service Suspension Initiative (DSSI) have provided some fiscal relief.** The authorities secured SDR3.8 million relief on debt service under the CCRT which helped to reduce the external financing gap. Lesotho also participated in the DSSI, which helped to suspend roughly debt service of around US$4.5 million in the last two years.[7] Both are reflected in the baseline scenario and the DSA.

[6] The fiscal year runs from April 1 to March 31.

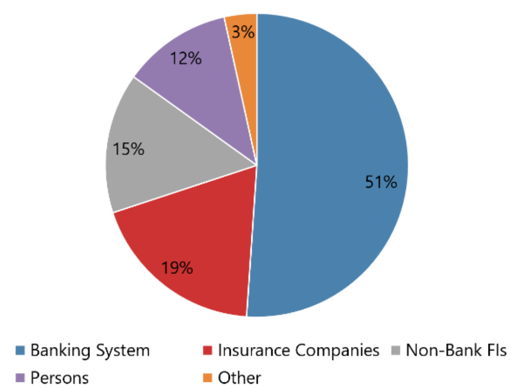
[7] Lesotho requested to benefit from the (final) extension of the DSSI. Potential savings have been estimated at US$13.5 million. The DSSI provides a time-bound suspension of official bilateral debt service payments to IDA-eligible and least developed countries.

6. **Lesotho received about US$95 million equivalent of SDRs under the IMF's 2021 general allocation of SDRs.** At present, the allocation sits on the balance sheet of the Central Bank of Lesotho as part of international reserves. During the mission, the authorities did not indicate plans to access the SDRs through on-lending from the central bank to the government. However, given the positive balance of deposits at the central bank, there is leeway for the government to draw on them to tap the additional policy space created by the SDR allocation. The baseline scenario does not assume any further drawdown of SDR holdings. Instead, projections for net credit to government (NCG) are informed by the increased SDR holdings.

7. **Most of Lesotho's external debt is owed to multilateral creditors on a concessional basis** (Text Table 3). External debt accounts for 82 percent of total public debt and is predominantly owed to multilateral partners on concessional terms. The main creditor is the International Development Association (IDA), followed by the African Development Fund (AfDF), the European Investment Bank (EIB), and the IMF. As the primary bilateral (non-Paris Club) creditor, China accounts for 70 percent of bilateral debt.

8. **The share of domestic debt in total public debt has increased markedly over the recent years—albeit from a lower base.** Domestic public debt reached 15.3 percent of GDP in FY20/21, increased from 5 percent in FY16/17. Denominated in local currency, domestic debt has been issued through treasury bills and bonds at various maturities and is predominantly owned by banks, insurance companies, and individuals (see Text Figure 1). The average yield was 6 percent in FY20/21. While increasing domestic debt issuance has helped the authorities meet public financing needs and deepen local currency markets, the banking sector has limited appetite for absorption. In an environment of limited financial intermediation, the government is also at risk of crowding out private sector borrowing. The authorities have requested capacity development from the IMF on developing domestic debt markets.

Text Figure 1. Lesotho: Public Domestic Debt Holder Profile (As of Mar 31, 2021)



Text Table 3. Decomposition of Public Debt and Debt Service by Creditor, 2020/21–2022/23[1]

| | Debt Stock (end of period) | | | Debt Service | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020/21 | | | 2020/21 | 2021/22 | 2022/23 | 2020/21 | 2021/22 | 2022/23 |
| | *(US$ Millions)* | *Percent total debt)* | *(Percent GDP)* | *(In US$)* | | | *(Percent GDP)* | | |
| **Total** | 1,183.3 | 100.0 | 57.4 | 126.8 | 103.2 | 115.0 | 6.2% | 4.2% | 4.6% |
| **External** | 898.5 | 75.9 | 43.6 | 60.8 | 43.8 | 61.9 | 3.0% | 1.8% | 2.5% |
| Multilateral creditors[2] | 739.4 | 62.5 | 35.9 | 50.0 | 36.2 | 49.6 | 2.4% | 1.5% | 2.0% |
| IMF | 67.3 | 5.7 | 3.3 | | | | | | |
| World Bank | 358.6 | 30.3 | 17.4 | | | | | | |
| ADB/AfDB/IADB | 146.0 | 12.3 | 7.1 | | | | | | |
| Other Multilaterals | 167.5 | 14.2 | 8.1 | | | | | | |
| *o/w:* European Investment Bank | 87.4 | 7.4 | 4.2 | | | | | | |
| *o/w:* Arab Bank for Econ Dev in Africa | 34.8 | 2.9 | 1.7 | | | | | | |
| o/w: International Fund for Agr Dev | 32.4 | 2.7 | 1.6 | | | | | | |
| Bilateral Creditors | 155.2 | 13.1 | 7.5 | 10.8 | 7.6 | 12.3 | 0.5% | 0.3% | 0.5% |
| Paris Club | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Non-Paris Club | 155.2 | 13.1 | 7.5 | 10.8 | 7.6 | 12.3 | 0.5% | 0.3% | 0.5% |
| *o/w:* China | 102.3 | 8.6 | 5.0 | | | | | | |
| *o/w:* Kuwait | 19.5 | 1.7 | 0.9 | | | | | | |
| Bonds | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Commercial creditors | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Other international creditors | 3.8 | 0.3 | 0.2 | | | | | | |
| **Domestic** | 315.0 | 26.6 | 15.3 | 66.0 | 59.4 | 53.0 | 3.2% | 2.4% | 2.1% |
| T-Bills | 79.8 | 6.7 | 3.9 | | | | 0.0% | 0.0% | 0.0% |
| Bonds | 145.6 | 12.3 | 7.1 | | | | 0.0% | 0.0% | 0.0% |
| Loans | - | 0.0 | 0.0 | | | | 0.0% | 0.0% | 0.0% |
| **Memo items:** | | | | | | | | | |
| Collateralized debt[3] | - | 0.0 | 0.0 | | | | | | |
| *o/w:* Related | - | 0.0 | 0.0 | | | | | | |
| *o/w:* Unrelated | - | 0.0 | 0.0 | | | | | | |
| Contingent liabilities | 28.4 | 2.4 | 1.4 | | | | | | |
| Nominal GDP | 2,060.5 | | | | | | | | |

1/ As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA, except for.

2/ "Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears).

3/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

# BACKGROUND ON MACROECONOMIC PROJECTIONS

**9. The macroeconomic framework reflects the worsened outlook since the previous DSA** (Text Table 4). The baseline assumptions in the DSA are consistent with the macroeconomic framework outlined in the staff report.

- **Real GDP growth**: The economy contracted by 6 percent in FY20/21 as weak external demand and supply chain disruptions weighed on activity. However, restrictions have been gradually lifted as the country returned to its lowest alert level. Reported cases remain low and over 50 percent of the adult population are fully vaccinated as of April 16, 2022. Economic growth under the baseline is expected to rebound to 2.1 percent for FY21/22 and 2.7 for FY22/23. Over the medium term, GDP growth is expected to be buoyed by construction from the second phase of the Lesotho Highlands Water Project (LHWP-II).[8] However, sustaining growth over the long-term will require

[8] Following both pandemic- and climate shock-related delays, construction is planned to resume in FY22/23 and wrap up by FY29/30. As the project is financed by capital transfers from South Africa and donor grants, it has no implications for public finances and debt (Annex IV of the Staff Report).

addressing longstanding structural weaknesses as recent national accounts data revisions revealed a contraction in the economy prior to the pandemic. Assumption for medium-term growth has been moderated to 1.5 percent from the previous DSA's assumption of 3.7 percent.

- **Inflation:** Inflation is assumed to increase in the near term—reaching 6.8 percent on average in FY22/23—on account of recent increases in fuel and food prices. Over the medium-term, inflation is assumed to remain driven by the monetary policy developments in South Africa and anchored by the South African Reserve Bank's inflation target.

- **Fiscal balance**: The primary fiscal deficit is expected to reach 6.2 percent in FY22/23, reflecting lower SACU transfers and delayed fiscal adjustment. The fiscal balance is expected to improve due to the recovery in SACU transfers and slower growth of public expenditure relative to GDP.[9] The primary fiscal deficit is assumed to average 2.6 percent over 2022–27 and 0.8 in 2028–42. These assumptions represent upward revisions compared to previous DSAs.

- **External Sector**: Low SACU transfers, delays to the LHWP-II, and lingering weaknesses in export sectors are expected to leave the current account in deficit at 5.0 percent of GDP over the medium term. Export and import growth are also expected to dip, reflecting weak competitiveness and lower medium-term GDP growth.

Text Table 4. Lesotho: Macroeconomic Assumptions

| | 2019 DSA 2018–23 | 2020 DSA 2020–25 | 2022 DSA 2022–27 | 2019 DSA 2024–38 | 2020 DSA 2026–40 | 2022 DSA 2028–42 |
|---|---|---|---|---|---|---|
| Real GDP Growth (Percent) | 2.5 | 1.8 | 1.6 | 2.9 | 3.7 | 1.5 |
| Inflation (Percent) | 5.5 | 4.8 | 5.2 | 5.5 | 4.9 | 4.9 |
| Primary Deficit (Percent of GDP) | 0.8 | 1.9 | 2.8 | 0.4 | 0.5 | 0.8 |
| USD Export Growth (Percent) | 6.5 | 4.5 | 7.4 | 6.3 | 6.8 | 6.0 |
| USD Import Growth (Percent) | 5.3 | 3.9 | 5.4 | 5.2 | 5.7 | 5.8 |
| Non-interest Current Account Balance (Percent of GDP) | -9.6 | -12.8 | -8.9 | -2.7 | -1.6 | -2.2 |
| Net FDI (negative = outflow) | -1.6 | -0.9 | -1.2 | -1.7 | -0.9 | -1.1 |
| Grant element of new public sector borrowing (in percent) | 26.9 | 32.1 | 24.8 | 20.8 | 21.1 | 23.6 |
| External Debt (Percent of GDP) | 35.7 | 51.4 | 47.2 | 34.5 | 45.6 | 41.1 |
| Public Sector Debt (Percent of GDP) | 50.2 | 61.9 | 63.3 | 51.0 | 52.0 | 60.7 |

Sources: IMF Country Report No. 20/228 and IMF staff calculations.
Notes: Average of 2022–27 is the average of FY22/23–FY27/28.

- **Concessional borrowing**: External loan disbursements incorporate the authorities' most recent projections and reflect commitments from donors. Concessional external borrowing is assumed to remain critical for financing large investment projects. To reflect renewed IDA eligibility, a grant element of around 24 percent has been assumed over the medium term—slightly higher than in the previous DSA. However, concessionality is expected to decline gradually over the long term as Lesotho grows and is expected to graduate from IDA eligibility. On balance, should income growth

[9] SACU transfers are determined two-years ahead based on regional trade and growth projections. The partial recovery of SACU transfers over the medium term is expected as regional activity picks up (see also Table 3.8 in the National Treasury of South Africa's 2022 Budget Review). However, compare to historical levels, SACU transfers relative to GDP are still expected to remain muted. The improvement in primary balance is also expected to be driven by slower growth in wages and social spending relative to GDP.

in Lesotho be higher than assumed, this will also improve Lesotho's debt carrying capacity and help mitigate the debt sustainability risks.

- **Domestic borrowing**: In line with the authorities' medium-term goals, the development of the domestic debt market is assumed to continue. The baseline scenario assumes that the share of domestic debt in total debt will be around 16 percent of GDP in the medium term.

**10. The realism of the macroeconomic framework is confirmed by standard measures.** However, the unprecedented nature of the current crisis and ongoing revisions to national accounts data calls for caution for interpretating these results (Figures 3 and 4).

- **Public debt:** While the contribution of real GDP growth is lower than in the past, the baseline assumptions can be considered conservative. GDP growth is expected to be boosted by LHWP-II-related construction. Further, as mentioned earlier in the report, the assumed long-term real GDP growth rate has halved compared to the previous DSA and is lower than the projections in the authorities' National Strategic Development Plan II. The residuals over 2022–24 are largely driven by the government's use of deposits at the central bank to finance the deficit, while residuals in the long term are driven by the appreciation of the real effective exchange rate. Large unexplained changes in public debt relative to the median for LICs are mostly explained by the 2021 national accounts data revision according to which the GDP has shrunk by around 10 percent since 2016.

- **External debt**: The contribution of the current account deficit to the accumulation of external debt over the 5-year projection period is substantially larger than in the past, due to the sizeable LHWP-II investments over the next 8 years (approximately equivalent to Lesotho's 2020 nominal GDP). However, this "mega project" is fully financed by capital transfers from South Africa, captured in the DSA through residuals. Thus, the contribution of the current account deficit is expected to be largely offset by a residual attributable to LHWP-II related capital transfers. Additional capital transfers are also anticipated on the back of green energy and other infrastructure projects. The unexpected changes in external debt over the past 5 years were mainly due to the methodological change in the compilation of remittances.[10]

## COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

**11. Lesotho has a medium debt carrying capacity** (Text Table 5). Debt carrying capacity is determined by a composite indicator (CI) that includes the World Bank's Country Policy and Institutional Assessment score, global economic growth, Lesotho's real growth rate, import coverage of reserves, and remittances. The composite indicator for the April 2022 WEO data and the World Bank's CPIA 2020 CPIA score yields a medium CI rating (2.91), as in the previous vintage.

[10] The authorities recently updated compensation of employee inflows in the primary income account. The revision increased inflows by roughly LSL 2.5 billion per year (about 8 percent of GDP).

**12. Lesotho does not trigger other tailored stress tests.** Apart from the contingent liability tailored shock described above, Lesotho's economic characteristics do not trigger any of the tailored stress tests on natural disasters, commodity prices, and/or market financing risk module.

### Text Table 5. Lesotho: Debt Carrying Capacity

**Debt Carrying Capacity and Thresholds**

| | |
|---|---|
| Country | Lesotho |
| Country Code | 666 |

| | |
|---|---|
| Debt Carrying Capacity | Medium |

| Final | Classification based on current vintage | Classification based on the previous vintage | Classification based on the two previous vintages |
|---|---|---|---|
| Medium | Medium<br>2.91 | Medium<br>2.92 | Medium<br>2.94 |

**Applicable thresholds**

| APPLICABLE<br>EXTERNAL debt burden thresholds | |
|---|---|
| PV of debt in % of | |
| Exports | 180 |
| GDP | 40 |
| Debt service in % of | |
| Exports | 15 |
| Revenue | 18 |

| APPLICABLE<br>TOTAL public debt benchmark | |
|---|---|
| PV of total public debt in percent of GDP | |

**Calculation of the CI Index**

| Components | Coefficients (A) | 10-year average values (B) | CI Score components (A*B) = (C) | Contribution of components |
|---|---|---|---|---|
| CPIA | 0.385 | 3.308 | 1.27 | 44% |
| Real growth rate (in percent) | 2.719 | 0.404 | 0.01 | 0% |
| Import coverage of reserves (in percent) | 4.052 | 33.122 | 1.34 | 46% |
| Import coverage of reserves^2 (in percent) | -3.990 | 10.971 | -0.44 | -15% |
| Remittances (in percent) | 2.022 | 15.494 | 0.31 | 11% |
| World economic growth (in percent) | 13.520 | 3.044 | 0.41 | 14% |
| CI Score | | | 2.914 | 100% |
| CI rating | | | Medium | |

| New framework | Cut-off values | | | |
|---|---|---|---|---|
| Weak | CI < | 2.69 | | |
| Medium | 2.69 | ≤ CI ≤ | | 3.05 |
| Strong | CI > | 3.05 | | |

# EXTERNAL DEBT SUSTAINABILITY ANALYSIS

**13. Under the baseline scenario, the PV of external debt-to-GDP ratio remains below but very close to its corresponding thresholds** (Tables 1 and 2, and Figure 1). The present value (PV) of PPG external debt-to-GDP is expected to increase and stabilize around 36 percent level. The near-term increase in the external borrowing is mainly driven by the emerging financing needs due to the falling SACU transfers and the COVID-19 crisis. Afterwards, a combination of somewhat recovering SACU transfers, fiscal adjustment and expansion of domestic borrowing is expected to ease external financing needs. All the other indicators of external debt sustainability remain below their thresholds.

**14. Stress tests show that Lesotho's external debt is most vulnerable to current transfers-to-GDP[11], export and combined contingent liabilities shocks** (Tables 3 and 4, and Figure 1). For these shocks, the PV of PPG external debt-to-GDP would breach the 40 percent threshold and remain above the threshold during the entire forecast horizon. The rest of the debt indicators remain below their respective thresholds under the stress tests.

# PUBLIC DEBT SUSTAINABILITY ANALYSIS

**15. Under the baseline scenario, the PV of total public debt-to-GDP remains below but close to its corresponding threshold** (Table 2 and Figure 2). The PV of public debt-to-GDP is expected to stabilize below the 55 percent threshold, in the medium term. PV of Debt-to-Revenue ratio is expected to increase

[11] Under the standardized stress tests this is captured in other flows shock.

in the near term before falling to the current levels in the medium term. The increase is mainly driven by sluggish near-term revenue projections related with lingering effect of the COVID-19 pandemic. Yet another indicator, Debt Service-to-Revenue ratio, shows increasing trend reflecting Lesotho's gradual transition to domestic financing away from external borrowing on concessional terms.

**16. Stress tests show that Lesotho's public debt is vulnerable to a number of shocks in the standardized tests** (Table 4 and Figure 2). Public debt is most vulnerable to a combined contingent liability shock, under which PV of public debt-to-GDP ratio would breach 55 percent over the entire projection period. Public debt is also vulnerable to shocks to current transfers-to-GDP, exports, real GDP growth, and the primary balance. For these shocks, the PV of public debt-to-GDP would also breach the 55 percent threshold.

## RISK RATING AND VULNERABILITIES

**17. The risk ratings of both Lesotho's external and overall public debt are moderate with limited space to absorb shocks.** The moderate risk rating of external debt distress comes from the PV of PPG external debt-to-GDP breaching its threshold under the stress tests, while the moderate overall risk rating of public debt distress comes from the moderate risk of external debt distress and from the PV of public debt-to-GDP breaching its benchmark under the stress tests. All the external and public debt indicators remain below their thresholds under the baseline scenario. The granularity of risk rating—assessing available space the country has to absorb shocks without being downgraded to a high-risk category—remains limited.

**18. Risks to the debt sustainability are tilted to the downside. The key risk to the debt sustainability is delaying fiscal adjustment and accumulating arrears.** Both the external and total PV of debt-to-GDP ratios are close to high-risk thresholds, leaving limited space to absorb further shocks. In addition, larger gross financing needs and heightened liquidity constraints stemming from the recently accumulated domestic debt and nonconcessional external borrowing to support pandemic related spending add to the risks. Contingent liabilities related with pension fund and potential new contingent liabilities that may result from poor governance– such as, for example, asset seizure from Frazer Solar agreement—are also putting debt sustainability at significant risk. From the external side, the risks of delaying recovery in major trading partners and further lowering of SACU transfers are critical. In addition, while exchange rate appreciation in FY20/21 helped to somewhat ease external debt burden, this can reverse in the future. On the positive side, however, debt sustainability is supported by the large and stable worker's remittances from South Africa and mega infrastructure projected financed by the grants.

**19. Fiscal consolidation and improving governance are critical to ensure debt sustainability.** The DSA highlights the need to control recurrent expenditure—particularly the wage bill—and improve efficiency of capital spending. The government will also need to address the pension fund's financing gap and improve fiscal governance to ensure the sustainability of public sector. The DSA also calls for a conservative debt management strategy focused on concessional sources wherever possible and a well thought strategy to develop local currency debt markets while limiting risks of crowding out private sector and excessive increase of bank's exposure to government. Finally, efforts are needed to further increase coverage, quality, and reliability of debt statistics. The authorities' efforts on these fronts are also supported by a Policy and Performance Action under the IDA SDFP.

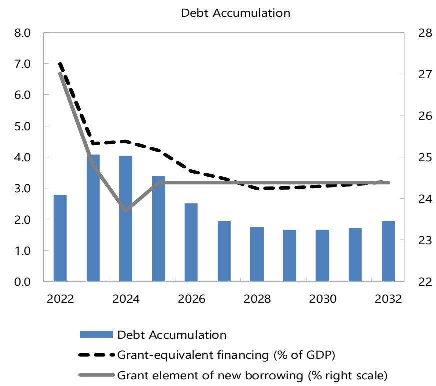
## AUTHORITIES' VIEWS

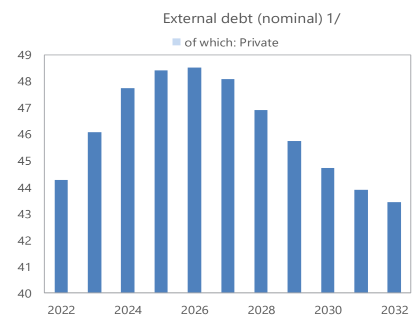
**20. The authorities concurred with staff's assessment, emphasizing that reducing debt vulnerabilities is key for medium-term macroeconomic stability.** They also acknowledged the trade-off between near-term public spending needs and medium-term debt sustainability. Noting the pressure to raise debt to finance growing expenditure needs, they highlighted the recent success in extending maturity and deepening of domestic debt markets. However, they agreed on the need to exercise conservative public debt management strategies that focus on concessional sources and do not crowd out the private sector. The authorities reiterated their commitment to address the funding gap of the pension fund and to improve monitoring of contingent liabilities to ensure a comprehensive overview of debt.

## Table 1. Lesotho: External Debt Sustainability Framework, Baseline Scenario, 2021–42
(In percent of GDP, unless otherwise indicated)

| | Actual | Projections | | | | | | | | Average 8/ | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2032 | 2042 | Historical | Projections |
| **External debt (nominal) 1/** | 43.6 | 44.3 | 46.1 | 47.7 | 48.4 | 48.5 | 48.1 | 43.4 | 35.4 | 39.4 | 45.9 |
| *of which: public and publicly guaranteed (PPG)* | 43.6 | 44.3 | 46.1 | 47.7 | 48.4 | 48.5 | 48.1 | 43.4 | 35.4 | 39.4 | 45.9 |
| Change in external debt | 0.0 | 0.7 | 1.8 | 1.7 | 0.7 | 0.1 | -0.4 | -0.5 | -0.8 | | |
| **Identified net debt-creating flows** | -1.3 | 12.1 | 7.7 | 8.4 | 7.8 | 7.1 | 4.2 | 1.3 | 1.7 | 2.4 | 5.3 |
| **Non-interest current account deficit** | 6.8 | 13.7 | 8.8 | 9.7 | 9.1 | 7.6 | 4.4 | 2.1 | 2.5 | 4.0 | 6.3 |
| Deficit in balance of goods and services | 50.9 | 54.5 | 50.9 | 52.0 | 49.9 | 48.1 | 44.8 | 42.0 | 39.3 | 52.2 | 47.1 |
| Exports | 39.1 | 40.7 | 41.0 | 41.2 | 41.3 | 42.0 | 42.9 | 42.9 | 40.5 | | |
| Imports | 90.0 | 95.2 | 91.9 | 93.2 | 91.2 | 90.1 | 87.6 | 85.0 | 79.9 | | |
| Net current transfers (negative = inflow) | -24.0 | -20.7 | -22.4 | -23.0 | -21.9 | -21.7 | -21.6 | -21.6 | -20.3 | -28.9 | -21.8 |
| *of which: official* | -17.7 | -15.2 | -17.0 | -17.8 | -16.8 | -16.6 | -16.6 | -16.6 | -15.6 | | |
| Other current account flows (negative = net inflow) | -20.1 | -20.1 | -19.7 | -19.3 | -19.0 | -18.8 | -18.7 | -18.3 | -16.5 | -19.4 | -18.9 |
| **Net FDI (negative = inflow)** | -1.5 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.1 | -2.5 | -1.2 |
| **Endogenous debt dynamics 2/** | -6.6 | -0.4 | 0.1 | -0.1 | -0.1 | 0.6 | 0.9 | 0.3 | 0.4 | | |
| Contribution from nominal interest rate | 0.6 | 0.7 | 0.7 | 0.8 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | | |
| Contribution from real GDP growth | -0.8 | -1.1 | -0.7 | -0.9 | -1.0 | -0.3 | -0.1 | -0.6 | -0.5 | | |
| Contribution from price and exchange rate changes | -6.4 | ... | ... | ... | ... | ... | ... | ... | ... | | |
| **Residual 3/** | 1.3 | -11.4 | -5.9 | -6.8 | -7.1 | -7.0 | -4.6 | -1.8 | -2.6 | -1.0 | -5.2 |
| *of which: exceptional financing* | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| **Sustainability indicators** | | | | | | | | | | | |
| **PV of PPG external debt-to-GDP ratio** | 30.3 | 31.6 | 33.7 | 35.3 | 36.2 | 36.7 | 36.8 | 34.3 | 28.5 | | |
| **PV of PPG external debt-to-exports ratio** | 77.4 | 77.8 | 82.1 | 85.7 | 87.8 | 87.5 | 85.8 | 79.8 | 70.3 | | |
| **PPG debt service-to-exports ratio** | 4.5 | 6.0 | 6.1 | 6.8 | 6.3 | 5.7 | 5.6 | 6.9 | 6.9 | | |
| **PPG debt service-to-revenue ratio** | 4.2 | 5.9 | 5.7 | 6.3 | 6.0 | 5.5 | 5.5 | 6.9 | 6.5 | | |
| Gross external financing need (Million of U.S. dollars) | 173.7 | 387.1 | 279.2 | 331.1 | 328.5 | 291.5 | 195.7 | 184.4 | 366.3 | | |
| **Key macroeconomic assumptions** | | | | | | | | | | | |
| Real GDP growth (in percent) | 2.1 | 2.7 | 1.6 | 2.1 | 2.3 | 0.7 | 0.1 | 1.5 | 1.5 | 0.7 | 1.7 |
| GDP deflator in US dollar terms (change in percent) | 17.2 | 1.8 | 4.4 | 4.6 | 4.5 | 4.8 | 4.9 | 4.8 | 4.8 | -0.7 | 4.4 |
| Effective interest rate (percent) 4/ | 1.5 | 1.6 | 1.8 | 1.9 | 2.0 | 2.1 | 2.2 | 2.3 | 2.5 | 1.6 | 2.1 |
| Growth of exports of G&S (US dollar terms, in percent) | 15.1 | 8.6 | 7.0 | 7.2 | 7.1 | 7.3 | 7.3 | 6.4 | 6.5 | -0.7 | 7.0 |
| Growth of imports of G&S (US dollar terms, in percent) | 12.3 | 10.5 | 2.5 | 8.3 | 4.6 | 4.3 | 2.2 | 6.4 | 6.4 | -1.4 | 6.2 |
| Grant element of new public sector borrowing (in percent) | ... | 27.0 | 24.8 | 24.4 | 24.4 | 24.4 | 24.4 | 24.4 | 23.1 | ... | 24.7 |
| Government revenues (excluding grants, in percent of GDP) | 42.0 | 41.3 | 44.2 | 44.9 | 43.7 | 43.9 | 43.8 | 43.0 | 43.0 | 47.5 | 43.3 |
| Aid flows (in Million of US dollars) 5/ | 832.1 | 215.5 | 152.1 | 156.0 | 157.8 | 137.8 | 132.3 | 182.6 | 279.2 | | |
| Grant-equivalent financing (in percent of GDP) 6/ | ... | 7.0 | 4.4 | 4.5 | 4.2 | 3.5 | 3.3 | 3.2 | 3.0 | ... | 4.0 |
| Grant-equivalent financing (in percent of external financing) 6/ | ... | 65.7 | 47.6 | 47.2 | 50.4 | 53.5 | 56.9 | 50.5 | 54.0 | ... | 52.7 |
| Nominal GDP (Million of US dollars) | 2,465 | 2,577 | 2,734 | 2,920 | 3,121 | 3,294 | 3,461 | 4,718 | 8,768 | | |
| Nominal dollar GDP growth | 19.6 | 4.5 | 6.1 | 6.8 | 6.9 | 5.5 | 5.1 | 6.4 | 6.4 | -0.1 | 6.2 |
| **Memorandum items:** | | | | | | | | | | | |
| PV of external debt 7/ | 30.3 | 31.6 | 33.7 | 35.3 | 36.2 | 36.7 | 36.8 | 34.3 | 28.5 | | |
| In percent of exports | 77.4 | 77.8 | 82.1 | 85.7 | 87.8 | 87.5 | 85.8 | 79.8 | 70.3 | | |
| Total external debt service-to-exports ratio | 4.5 | 6.0 | 6.1 | 6.8 | 6.3 | 5.7 | 5.6 | 6.9 | 6.9 | | |
| PV of PPG external debt (in Million of US dollars) | 746.5 | 815.1 | 920.4 | 1031.0 | 1130.4 | 1209.1 | 1273.1 | 1617.8 | 2500.1 | | |
| (PVt-PVt-1)/GDPt-1 (in percent) | | 2.8 | 4.1 | 4.0 | 3.4 | 2.5 | 1.9 | 1.9 | 1.2 | | |
| Non-interest current account deficit that stabilizes debt ratio | 6.8 | 13.0 | 7.0 | 8.0 | 8.4 | 7.5 | 4.8 | 2.6 | 3.3 | | |

| Definition of external/domestic debt | Currency-based |
|---|---|
| Is there a material difference between the two criteria? | No |




Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

## Table 2. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2022–32 (In percent of GDP)

| | Projections 1/ | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
| | **PV of debt-to GDP ratio** | | | | | | | | | | |
| **Baseline** | 32 | 34 | 35 | 36 | 37 | 37 | 36 | 36 | 35 | 35 | 34 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 32 | 31 | 30 | 28 | 26 | 26 | 28 | 30 | 32 | 35 | 39 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 32 | 34 | 38 | 39 | 39 | 40 | 39 | 38 | 38 | 37 | 37 |
| B2. Primary balance | 32 | 34 | 38 | 39 | 39 | 40 | 39 | 39 | 38 | 37 | 37 |
| B3. Exports | 32 | 34 | **47** | **48** | **49** | **49** | **48** | **47** | **46** | **45** | **44** |
| B4. Other flows 3/ | 32 | 34 | **46** | **46** | **47** | **47** | **46** | **45** | **43** | **42** | **41** |
| B5. Depreciation | 32 | 34 | 35 | 36 | 37 | 37 | 36 | 36 | 35 | 35 | 34 |
| B6. Combination of B1-B5 | 32 | 34 | 36 | 37 | 37 | 38 | 37 | 37 | 36 | 36 | 36 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 32 | 34 | **49** | **50** | **51** | **52** | **51** | **51** | **50** | **49** | **49** |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Threshold** | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 |
| | **PV of debt-to-exports ratio** | | | | | | | | | | |
| **Baseline** | 78 | 82 | 86 | 88 | 87 | 86 | 84 | 83 | 82 | 80 | 80 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 78 | 76 | 72 | 67 | 62 | 60 | 65 | 69 | 75 | 82 | 90 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 78 | 82 | 86 | 88 | 87 | 86 | 84 | 83 | 82 | 80 | 80 |
| B2. Primary balance | 78 | 82 | 92 | 94 | 94 | 93 | 91 | 90 | 88 | 87 | 86 |
| B3. Exports | 78 | 82 | 138 | 140 | 139 | 136 | 134 | 132 | 128 | 125 | 123 |
| B4. Other flows 3/ | 78 | 82 | 111 | 112 | 111 | 109 | 107 | 104 | 101 | 99 | 96 |
| B5. Depreciation | 78 | 82 | 86 | 88 | 88 | 86 | 85 | 83 | 82 | 81 | 80 |
| B6. Combination of B1-B5 | 78 | 82 | 76 | 106 | 106 | 104 | 103 | 101 | 100 | 100 | 99 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 78 | 82 | 119 | 122 | 122 | 121 | 120 | 118 | 116 | 115 | 114 |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Threshold** | 180 | 180 | 180 | 180 | 180 | 180 | 180 | 180 | 180 | 180 | 180 |
| | **Debt service-to-exports ratio** | | | | | | | | | | |
| **Baseline** | 6 | 6 | 7 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 6 | 7 | 8 | 7 | 6 | 6 | 7 | 7 | 7 | 7 | 7 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 6 | 6 | 7 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| B2. Primary balance | 6 | 6 | 7 | 7 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| B3. Exports | 6 | 6 | 9 | 9 | 8 | 8 | 9 | 9 | 11 | 11 | 11 |
| B4. Other flows 3/ | 6 | 6 | 7 | 7 | 6 | 6 | 7 | 8 | 8 | 9 | 9 |
| B5. Depreciation | 6 | 6 | 7 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| B6. Combination of B1-B5 | 6 | 6 | 9 | 8 | 7 | 7 | 8 | 8 | 8 | 8 | 8 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 6 | 6 | 8 | 7 | 7 | 7 | 7 | 7 | 8 | 8 | 8 |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Threshold** | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 |
| | **Debt service-to-revenue ratio** | | | | | | | | | | |
| **Baseline** | 6 | 6 | 6 | 6 | 5 | 5 | 6 | 6 | 7 | 7 | 7 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 6 | 6 | 7 | 7 | 6 | 6 | 7 | 7 | 7 | 7 | 7 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 6 | 6 | 7 | 6 | 6 | 6 | 6 | 7 | 7 | 7 | 7 |
| B2. Primary balance | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| B3. Exports | 6 | 6 | 7 | 7 | 7 | 7 | 7 | 7 | 9 | 9 | 9 |
| B4. Other flows 3/ | 6 | 6 | 7 | 7 | 6 | 6 | 7 | 7 | 8 | 9 | 9 |
| B5. Depreciation | 6 | 6 | 6 | 6 | 5 | 6 | 6 | 6 | 7 | 7 | 7 |
| B6. Combination of B1-B5 | 6 | 6 | 7 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 7 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 6 | 6 | 7 | 7 | 6 | 7 | 7 | 7 | 8 | 8 | 8 |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Threshold** | 18 | 18 | 18 | 18 | 18 | 18 | 18 | 18 | 18 | 18 | 18 |

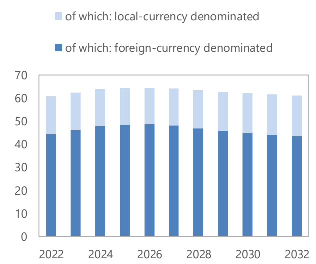
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

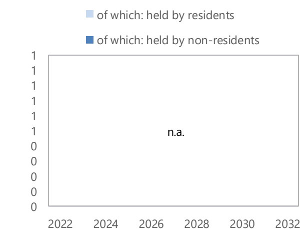
## Table 3. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–42
## (In percent of GDP, unless otherwise indicated)

| | Actual | | | Projections | | | | | | | | Average 6/ | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2032 | 2042 | Historical | Projections |
| **Public sector debt 1/** | **58.8** | **57.4** | **59.2** | **60.7** | **62.4** | **63.7** | **64.2** | **64.4** | **64.1** | **61.0** | **60.3** | **47.8** | **62.7** |
| **of which: external debt** | **46.9** | **43.6** | **43.6** | **44.3** | **46.1** | **47.7** | **48.4** | **48.5** | **48.1** | **43.4** | **35.4** | **39.4** | **46.2** |
| Change in public sector debt | 8.0 | -1.4 | 1.8 | 1.4 | 1.7 | 1.3 | 0.6 | 0.2 | -0.3 | -0.4 | 0.3 | | |
| **Identified debt-creating flows** | **13.9** | **-8.2** | **3.3** | **2.8** | **3.8** | **2.4** | **0.9** | **0.2** | **0.0** | **0.8** | **1.2** | **2.3** | **1.2** |
| **Primary deficit** | **6.0** | **-1.9** | **5.2** | **6.5** | **5.2** | **3.6** | **1.9** | **0.0** | **-0.6** | **0.8** | **0.8** | **1.5** | **1.9** |
| Revenue and grants | 48.4 | 55.3 | 46.2 | 47.0 | 47.0 | 47.8 | 46.6 | 46.5 | 46.3 | 45.2 | 45.2 | **51.7** | **46.1** |
| *of which: grants* | 3.7 | 3.1 | 4.2 | 5.6 | 2.8 | 2.9 | 2.9 | 2.6 | 2.5 | 2.2 | 2.2 | | |
| Primary (noninterest) expenditure | 54.4 | 53.4 | 51.4 | 53.5 | 52.2 | 51.4 | 48.5 | 46.5 | 45.7 | 46.0 | 46.0 | **53.2** | **48.0** |
| **Automatic debt dynamics** | **7.9** | **-6.3** | **-1.9** | **-3.7** | **-1.4** | **-1.2** | **-1.0** | **0.2** | **0.6** | **0.0** | **0.4** | | |
| Contribution from interest rate/growth differential | 0.2 | 4.1 | -2.3 | -3.7 | -1.4 | -1.2 | -1.0 | 0.2 | 0.6 | 0.0 | 0.4 | | |
| *of which: contribution from average real interest rate* | 0.2 | 0.3 | -1.1 | -2.2 | -0.4 | 0.1 | 0.5 | 0.6 | 0.6 | 0.9 | 1.3 | | |
| *of which: contribution from real GDP growth* | 0.0 | 3.7 | -1.2 | -1.5 | -1.0 | -1.3 | -1.4 | -0.4 | -0.1 | -0.9 | -0.9 | | |
| Contribution from real exchange rate depreciation | 7.7 | -10.4 | 0.4 | ... | ... | ... | ... | ... | ... | ... | ... | | |
| **Other identified debt-creating flows** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| Privatization receipts (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Recognition of contingent liabilities (e.g., bank recapitalization) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Debt relief (HIPC and other) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Other debt creating or reducing flow (please specify) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| **Residual** | **-5.9** | **6.8** | **-1.5** | **-1.3** | **-2.1** | **-1.1** | **-0.4** | **0.0** | **-0.3** | **-1.2** | **-1.0** | **0.0** | **-1.0** |
| **Sustainability indicators** | | | | | | | | | | | | | |
| **PV of public debt-to-GDP ratio 2/** | **...** | **...** | **46.7** | **48.3** | **50.0** | **51.3** | **52.1** | **52.6** | **52.8** | **51.9** | **53.4** | | |
| **PV of public debt-to-revenue and grants ratio** | **...** | **...** | **101.1** | **102.9** | **106.4** | **107.3** | **111.7** | **113.2** | **114.1** | **114.9** | **118.1** | | |
| **Debt service-to-revenue and grants ratio 3/** | **7.6** | **15.0** | **6.4** | **11.4** | **10.8** | **13.7** | **12.5** | **9.8** | **12.7** | **14.5** | **17.2** | | |
| Gross financing need 4/ | 9.7 | 6.4 | 8.2 | 11.8 | 10.2 | 10.2 | 7.7 | 4.6 | 5.3 | 7.3 | 8.6 | | |
| **Key macroeconomic and fiscal assumptions** | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 0.0 | -6.0 | 2.1 | 2.7 | 1.6 | 2.1 | 2.3 | 0.7 | 0.1 | 1.5 | 1.5 | **0.7** | **1.5** |
| Average nominal interest rate on external debt (in percent) | 1.8 | 1.8 | 1.4 | 1.7 | 1.8 | 1.9 | 2.0 | 2.1 | 2.2 | 2.3 | 2.5 | **1.6** | **2.1** |
| Average real interest rate on domestic debt (in percent) | 1.7 | 0.0 | 0.2 | -1.7 | 0.7 | 1.9 | 3.0 | 3.4 | 3.5 | 4.1 | 4.8 | **0.4** | **2.8** |
| Real exchange rate depreciation (in percent, + indicates depreciation) | 19.1 | -20.7 | 0.8 | ... | ... | ... | ... | ... | ... | ... | ... | **3.8** | **...** |
| Inflation rate (GDP deflator, in percent) | 5.5 | 5.5 | 6.5 | 6.4 | 5.4 | 4.7 | 4.6 | 4.9 | 5.0 | 4.9 | 4.9 | **6.1** | **5.0** |
| Growth of real primary spending (deflated by GDP deflator, in percent) | 1.9 | -7.7 | -1.7 | 6.7 | -0.9 | 0.7 | -3.6 | -3.4 | -1.6 | 1.5 | 1.5 | **-0.6** | **0.6** |
| Primary deficit that stabilizes the debt-to-GDP ratio 5/ | -1.9 | -0.4 | 3.4 | 5.1 | 3.5 | 2.3 | 1.3 | -0.1 | -0.3 | 1.2 | 0.5 | **0.3** | **1.7** |
| PV of contingent liabilities (not included in public sector debt) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |

| | |
|---|---|
| **Definition of external/domestic debt** | **Currency-based** |
| **Is there a material difference between the two criteria?** | **No** |

Public sector debt 1/




Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

## Table 4. Lesotho: Sensitivity Analysis for Key Indicators of Public Debt, 2022–32
## (In percent of GDP)

| | Projections 1/ | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
| **PV of Debt-to-GDP Ratio** | | | | | | | | | | | |
| **Baseline** | 50 | 51 | 52 | 53 | 53 | 53 | 52 | 52 | 52 | 52 | 52 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 50 | 52 | **56** | **60** | **63** | **66** | **69** | **72** | **74** | **76** | **79** |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 50 | **56** | **58** | **61** | **63** | **64** | **66** | **67** | **68** | **69** | **71** |
| B2. Primary balance | 50 | 55 | **55** | **56** | **56** | **56** | **56** | **55** | **55** | 55 | 55 |
| B3. Exports | 50 | **59** | **59** | **60** | **60** | **60** | **59** | **59** | **58** | **57** | **57** |
| B4. Other flows 3/ | 50 | **62** | **62** | **62** | **63** | **62** | **62** | **61** | **60** | **59** | **58** |
| B5. Depreciation | 50 | 51 | 52 | 53 | 53 | 53 | 52 | 52 | 52 | 52 | 52 |
| B6. Combination of B1-B5 | 50 | 54 | 54 | 55 | 55 | 55 | 54 | 54 | 54 | 54 | 54 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 50 | 48 | **66** | **67** | **67** | **68** | **68** | **67** | **67** | **67** | **66** |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **TOTAL public debt benchmark** | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 |
| **PV of Debt-to-Revenue Ratio** | | | | | | | | | | | |
| **Baseline** | 103 | 106 | 107 | 112 | 113 | 114 | 116 | 116 | 116 | 115 | 115 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 103 | 106 | 110 | 120 | 129 | 137 | 147 | 153 | 159 | 164 | 170 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 103 | 106 | 116 | 125 | 130 | 135 | 142 | 145 | 148 | 151 | 153 |
| B2. Primary balance | 103 | 106 | 115 | 119 | 120 | 121 | 124 | 123 | 122 | 122 | 121 |
| B3. Exports | 103 | 106 | 123 | 128 | 129 | 130 | 132 | 131 | 130 | 129 | 127 |
| B4. Other flows 3/ | 103 | 106 | 129 | 133 | 134 | 135 | 138 | 136 | 134 | 133 | 131 |
| B5. Depreciation | 103 | 106 | 107 | 112 | 113 | 114 | 116 | 116 | 116 | 115 | 115 |
| B6. Combination of B1-B5 | 103 | 106 | 113 | 116 | 117 | 118 | 121 | 120 | 120 | 120 | 119 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 103 | 106 | 101 | 107 | 110 | 113 | 116 | 117 | 118 | 119 | 120 |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Debt Service-to-Revenue Ratio** | | | | | | | | | | | |
| **Baseline** | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 15 | 13 | 15 | 14 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2023-2033 2/ | 11 | 11 | 14 | 13 | 10 | 14 | 13 | 18 | 16 | 18 | 19 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 11 | 11 | 14 | 14 | 11 | 14 | 13 | 18 | 16 | 18 | 18 |
| B2. Primary balance | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 16 | 14 | 15 | 15 |
| B3. Exports | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 16 | 15 | 16 | 16 |
| B4. Other flows 3/ | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 16 | 15 | 16 | 16 |
| B5. Depreciation | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 15 | 13 | 15 | 14 |
| B6. Combination of B1-B5 | 11 | 11 | 14 | 13 | 10 | 13 | 11 | 16 | 14 | 15 | 15 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 11 | 11 | 17 | 16 | 13 | 16 | 14 | 17 | 15 | 16 | 16 |
| C2. Natural disaster | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

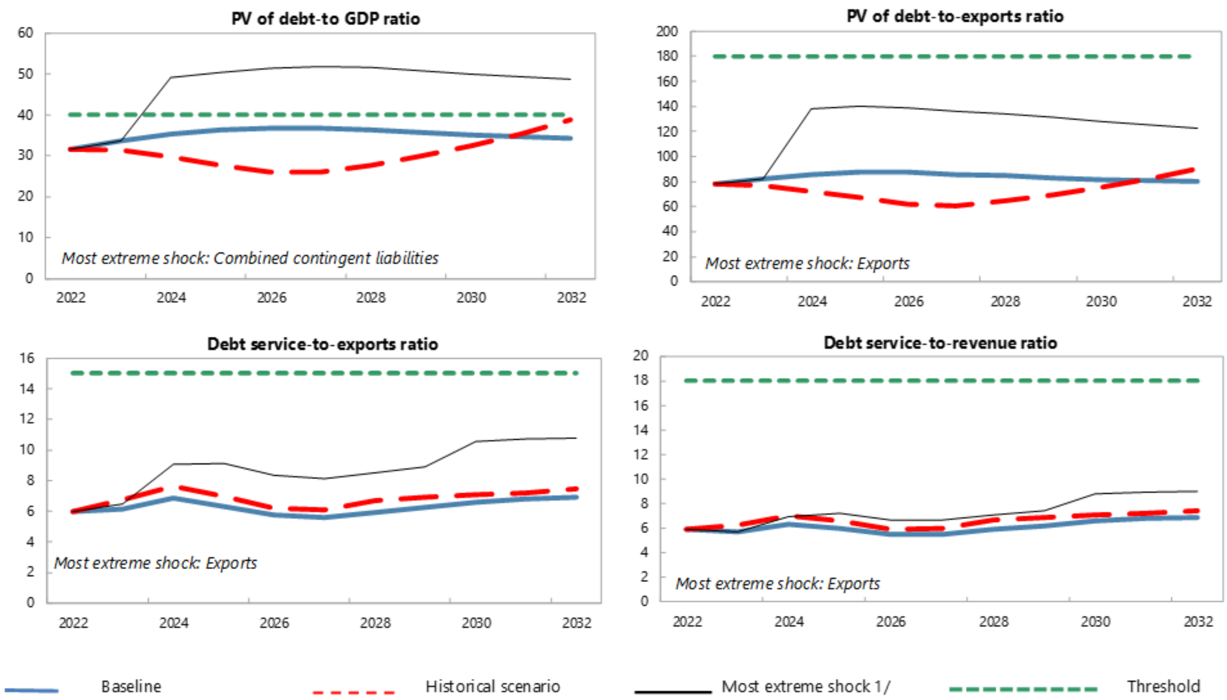
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

## Figure 1. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2022–32




| Customization of Default Settings | Size | Interactions |
|---|---|---|
| **Tailored Stress** | | |
| Combined CL | Yes | |
| Natural disaster | n.a. | n.a. |
| Commodity price | n.a. | n.a. |
| Market financing | n.a. | n.a. |

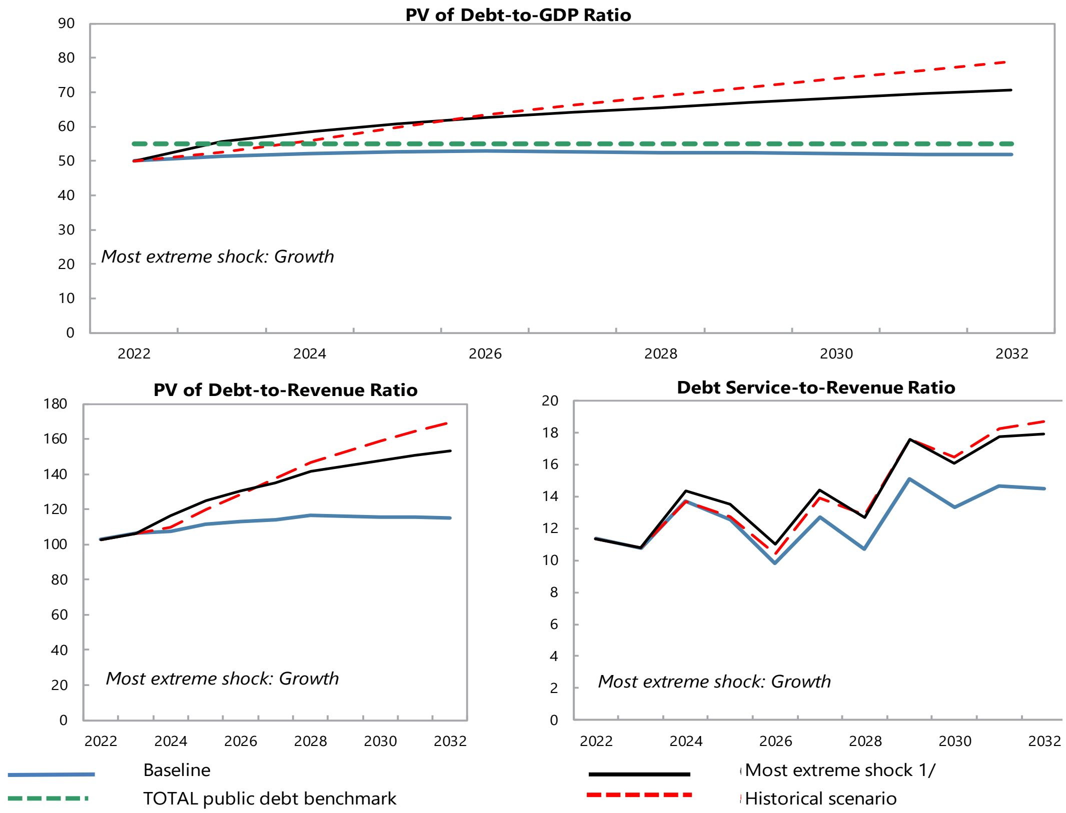
Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

| Borrowing assumptions on additional financing needs resulting from the stress tests* | Default | User defined |
|---|---|---|
| **Shares of marginal debt** | | |
| External PPG MLT debt | 100% | |
| **Terms of marginal debt** | | |
| Avg. nominal interest rate on new borrowing in USD | 2.6% | 2.6% |
| USD Discount rate | 5.0% | 5.0% |
| Avg. maturity (incl. grace period) | 23 | 23 |
| Avg. grace period | 5 | 5 |

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.
2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

## Figure 2. Lesotho: Indicators of Public Debt Under Alternative Scenarios, 2022–32




| Borrowing assumptions on additional financing needs resulting from the stress tests* | Default | User defined |
|---|---|---|
| **Shares of marginal debt** | | |
| **External PPG medium and long-term** | 58% | 80% |
| **Domestic medium and long-term** | 42% | 20% |
| **Domestic short-term** | 0% | 0% |
| **Terms of marginal debt** | | |
| **External MLT debt** | | |
| **Avg. nominal interest rate on new borrowing in USD** | 2.6% | 2.6% |
| **Avg. maturity (incl. grace period)** | 23 | 23 |
| **Avg. grace period** | 5 | 5 |
| **Domestic MLT debt** | | |
| **Avg. real interest rate on new borrowing** | 5.1% | 5.1% |
| **Avg. maturity (incl. grace period)** | 5 | 5 |
| **Avg. grace period** | 4 | 0 |
| **Domestic short-term debt** | | |
| **Avg. real interest rate** | 3.0% | 3.0% |

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

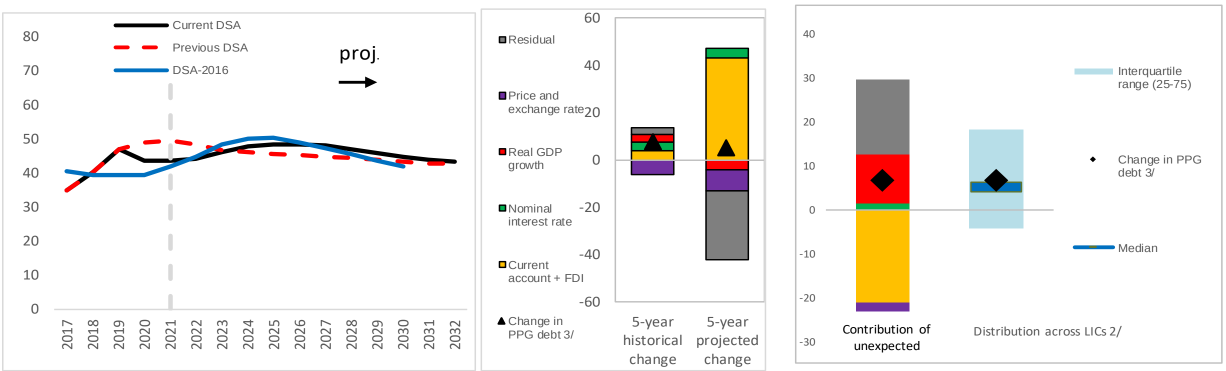
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

### Figure 3. Drivers of Debt Dynamics – Baseline Scenario

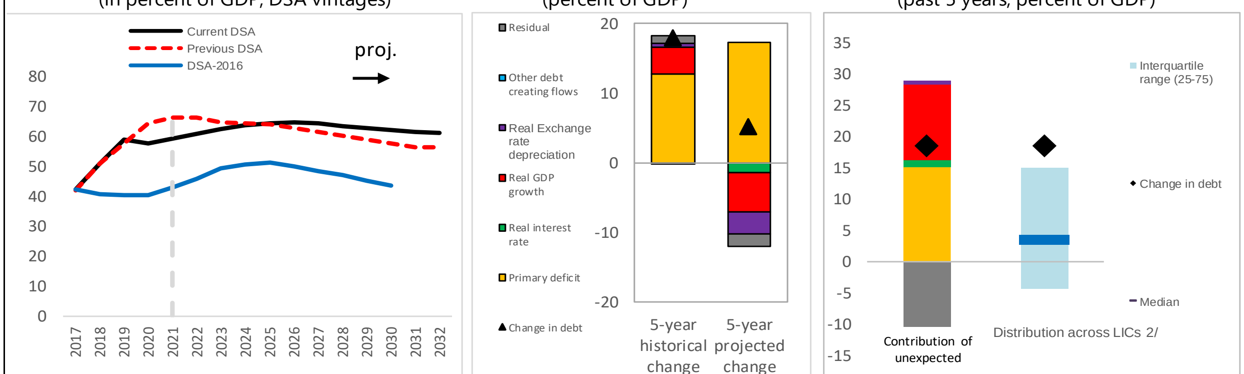
**External debt**

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)




**Public debt**

Gross Nominal Public Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



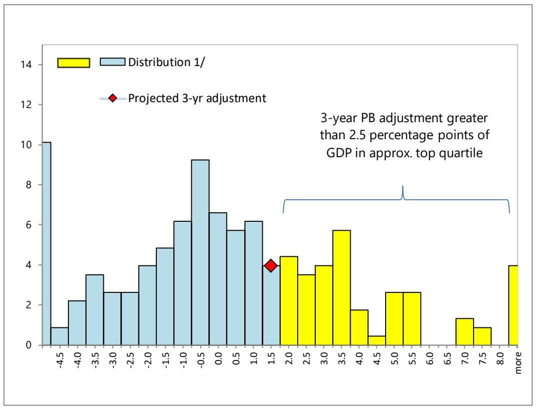

1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

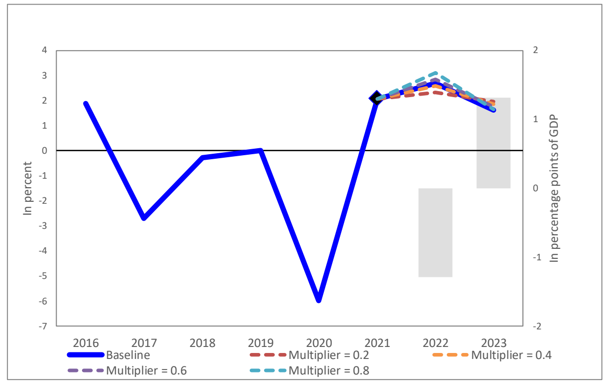
## Figure 4. Lesotho: Realism Tools

**3-Year Adjustment in Primary Balance**
**(Percentage points of GDP)**



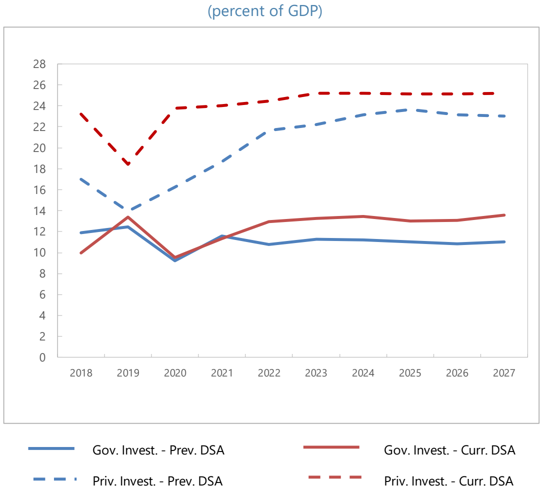

1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

**Fiscal Adjustment and Possible Growth Paths 1/**




1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

**Public and Private Investment Rates**
(percent of GDP)




**Contribution to Real GDP growth**
(percent, 5-year average)

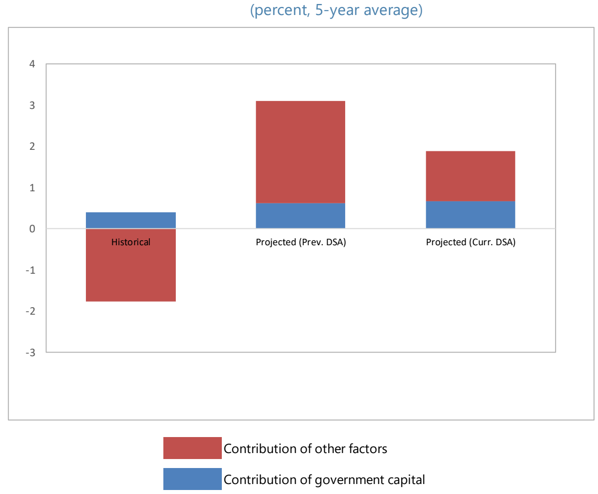


Figure 5. Lesotho: Qualification of the Moderate Category, 2022–2032 [1/]


Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.