



2026/2027 BUDGET STRATEGY PAPER

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Executive Summary

This Budget Strategy Paper is anchored on the theme: "Building Strategies for Inclusive Growth in a Digital Era: Empowering Youth for a Resilient Future." It outlines the Government's strategic approach to translating policy priorities into actionable programmes and capital investments over the medium term, with a strong emphasis on inclusive growth and youth empowerment. The strategy aims to align fiscal resources with national development goals, ensuring that budgeting processes are transparent, efficient, and results oriented.

Lesotho's economy grew by 2.4 percent in FY2024/25, driven by a 20 percent expansion in the construction sector, largely attributed to the Lesotho Highlands Water Project Phase II. The services sector showed resilience with a 3.7 percent growth, while crop production declined by 10.1 percent and manufacturing contracted by 8.4 percent, highlighting structural vulnerabilities. Public debt stood at M23.2 billion, representing 55.8 percent of GDP, and inflation is projected to average 4.5% in 2025, rising to 5.1 percent in 2027. The current account deficit is expected to widen to 4.3 percent of GDP in 2026.

Youth unemployment remains a critical challenge, with over 35 percent of youth aged 15–35 not in employment, education, or training (NEET). This underscores the urgency of targeted interventions to empower young people through skills development, entrepreneurship, and job creation. The strategy emphasizes the importance of investing in youth as a cornerstone for building a resilient and prosperous future.

To address these challenges, the Government recommends prioritizing use of digital public goods and service to unlock new economic opportunities, youth employment through public-private partnerships, expanding VAT coverage to strengthen domestic revenue mobilization, and enhancing resilience in agriculture and mining through climate-smart practices. Maintaining fiscal discipline, improving capital project execution, and institutionalizing performance-based budgeting are also key to ensuring accountability and sustainable development outcomes.

Through the Medium-Term Expenditure Framework (MTEF), the Government commits to a multi-year planning horizon that promotes predictability and strategic resource allocation. Robust monitoring and evaluation mechanisms will be used to track progress, ensure accountability, and inform policy adjustments. This strategy serves as a guiding document for stakeholders involved in budget formulation, execution, and oversight, reinforcing the Government's commitment to prudent fiscal management and inclusive development that empowers youth and builds resilience for the future.

Introduction

Guided by the theme "Building Strategies for Inclusive Growth in a Digital Era: Empowering Youth for a Resilient Future," this Budget Strategy Paper serves as a critical instrument in the national budgeting process, bridging policy formulation and resource allocation. It articulates the Government's fiscal and policy priorities for the medium term and provides a coherent framework for translating these priorities into budgetary decisions that promote inclusive growth and youth empowerment.

Lesotho's economy is recovering from multiple shocks, including the COVID-19 pandemic, global trade disruptions, and the impact of international sanctions. In FY2024/25, the economy grew by 2.4 percent, driven by a 20 percent expansion in the construction sector. However, youth unemployment remains a pressing concern, with over 35 percent of youth aged 15–35 not in employment, education, or training (NEET).

The Government recognizes that external pressures—such as sanctions—have contributed to rising unemployment and constrained service delivery. These factors are expected to continue influencing the pace of economic recovery and the quality of public services available to citizens.

This document reflects the Government's commitment to fiscal discipline, efficient public spending, and improved service delivery. It emphasizes strategic investments in education, digital public infrastructure, entrepreneurship, and employment to empower youth and build resilience. The paper is structured around five key areas:

- Macroeconomic Context and Outlook
- Translating policies into resource allocations through programmes and capital projects
- Key policy initiatives and reforms
- Risks and mitigation measures
- The Medium-Term Expenditure Framework (MTEF) and Monitoring and Evaluation mechanisms

Each section provides detailed analysis and guidance to inform the upcoming budget cycle and ensure alignment with strategic objectives that empower youth and foster inclusive development.

Macroeconomic Context and Outlook

Global and Regional Economic Developments

The global economy is confronted with major policy shifts due to the current era of high tariff rates imposed by the United States of America (USA) as well as continued geopolitical tensions. These disruptions are anticipated to lead to a slower growth in the global economy with intermittent risks and high uncertainty. According to the April 2025 WEO Update, Global growth is forecast to be sluggish in 2025, registering 2.8 percent from 3.3 percent in 2024, before rebounding slightly to 3.0 percent in 2026. The downturn anticipated

in growth, is primarily attributed to rapidly intensifying trade tensions and policy uncertainty, which are expected to significantly disrupt global economic activity.

Meanwhile, global headline inflation is projected to fall more gradually than previously anticipated, reaching 4.3 percent in 2025 and 3.6 percent in 2026.

Advanced economies are set to experience a growth slowdown, falling from 1.8 percent in 2024 to 1.4 percent in 2025, before slightly recovering to 1.5 percent in 2026. Specifically, USA faces a more significant deceleration, with its growth forecast revised down by 0.9 percentage points from the January 2025 WEO Update to 1.8 percent. This weaker outlook for the USA stems from heightened policy uncertainty, escalating trade disputes, and a general softening in demand.

On the other hand, regarding the Emerging Markets and Developing Economies, growth is expected to slow down from 4.3 percent in 2024 to 3.7 percent and 3.9 percent in 2025 and 2026 respectively, with significant downgrades for countries affected most by recent trade measures, such as Russia and China.

	2024	2025	2026
	Projections		
World Output	3.3	2.8	3.0
Advanced Economies	1.8	1.4	1.5
United States	2.8	1.8	1.7
Euro Area	0.9	0.8	1.2
Emerging Market and Developing Economies	4.3	3.7	3.9
China	5.0	4.0	4.0
Russia	4.1	1.5	0.9

Source: WEO April 2025

Domestic Economic Performance and Outlook

Lesotho's macro-fiscal stability has been precarious, largely due to pre-existing risks that were amplified by the COVID-19 outbreak in 2020/21. The economy faced a tough period, experiencing negative growth rates since 2017/18 due to prolonged dry spells, unfavourable global diamond prices, and the rise in demand of synthetic diamonds. Adding to these woes, wage disputes in the textile industry in 2018 spilled over into 2019, causing a temporary shutdown of some textile firms. However, the tide began to turn in the second half of 2020/21 through 2021/22 as the pace of COVID-19 vaccination roll-out increased, lockdown measures lifted, favourable weather conditions experienced and the economy starting to regain its momentum.

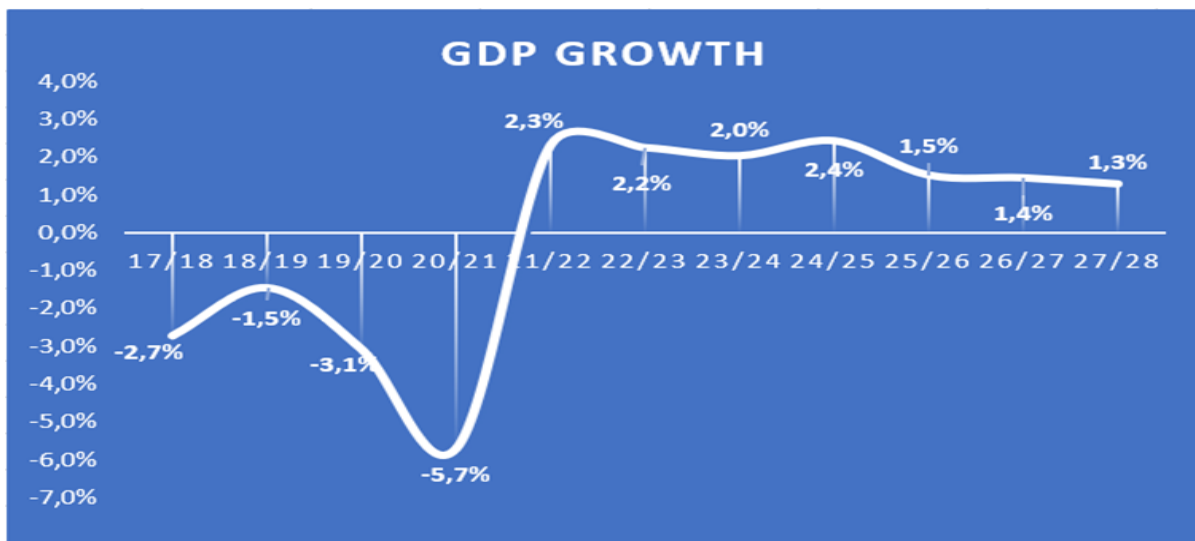
In the fiscal year 2024/25, Lesotho's economy is estimated to have grown by 2.4 percent, primarily fuelled by a remarkable 20 percent expansion in the construction sector. This growth is mainly attributable to the Lesotho Highland Water Project Phase II mega project, along with substantial investments in infrastructure and building activities aimed at fostering long-term economic growth through physical capital improvements. The services industries have also demonstrated resilience with a 3.7 percent growth, benefiting mostly from expected spill-over effects of the Polihali dam construction activities. The services industries continue to contribute a lion's share in economic activity.

However, not all industries in the Lesotho economy are thriving; the primary industries continue to portray prolonged bottlenecks. Crop production fell by 10.1 percent in 2024/25, due to adverse weather, supply chain disruptions, and other agricultural challenges. Despite these setbacks, animal farming maintained a steady growth of 3.5 percent, suggesting a degree of resilience within the broader agricultural sector. The mining industry has also been experiencing great hurdles over the years and is estimated to have registered a decline of 7.4 percent in 2024/25, reflecting a dwindle in global demand for rough diamonds and persistent structural issues.

Similarly, manufacturing industries with Textiles sector being the main contributor, have contracted by 8.4 percent, owing to weaknesses experienced in global supply chains, rising production costs and uncertainty surrounding the renewal of the USA African Growth and Opportunities Act (AGOA), after its anticipated expiry in 2025.

In 2025/26 throughout the medium horizon, Lesotho's Real GDP growth is expected to slow down significantly. Projections indicate a drop to 1.5 percent in 2025/26, followed by further decreases to 1.4 percent and 1.3 percent in 2026/27 and 2027/28 respectively. This slowdown is primarily due to the economy's heavy reliance on the fragile US market for Textiles as well as the anticipated slowdown in construction activities as the Lesotho Highlands Water Project Phase II (LHWP II) approaches completion in the medium term. While LHWP II has boosted the economy from its commencement, especially construction and the services industries, its completion, as well as winding down of mega projects in the country always have a negative effect on Lesotho's economy mainly due to the fragility in the structure of the economy.

Moreover, the recent US Administration executive orders including the proposed imposition of tariffs on exports destined to the US, as well as Aid suspension and cancellation of Millennium Challenge Compact (MCC) funding, will contribute negatively to economic growth in the medium term.



Source: Ministry of Finance and Development Planning.

On the upside, the agriculture industry is projected to perform well in the medium term with crop production benefiting from expected favourable climate conditions while livestock is also anticipated to thrive due to improved breeding practices. Equally, a slight

recovery is anticipated in the mining industry primarily driven by the Letšeng mine's implementation of an updated long-term mine plan which aims to reduce waste volume. The recovery in the mining industry is also anticipated due to a modest increase in diamond prices observed since January 2025 and is anticipated to continue to improve in the medium term.

Enterprise Risk Management

The Government of Lesotho is institutionalising Enterprise Risk Management (ERM) across all Ministries, Departments and Agencies. The ERM Policy and Framework have been established and are currently being implemented in five pilot ministries, laying the foundation for full-scale rollout across the public sector.

This initiative is embedded within the performance contracts of Chief Accounting Officers, thereby reinforcing accountability at the highest administrative level. Institutionalising ERM entails embedding risk assessment and mitigation into government structures, processes, and culture—ensuring that risk management becomes an integral part of budgeting and service delivery. The integration of ERM into budget formulation and execution is expected to safeguard fiscal sustainability, enhance resilience to economic and environmental shocks, and ensure that public resources are directed towards inclusive growth and youth empowerment.

Digital Transformation

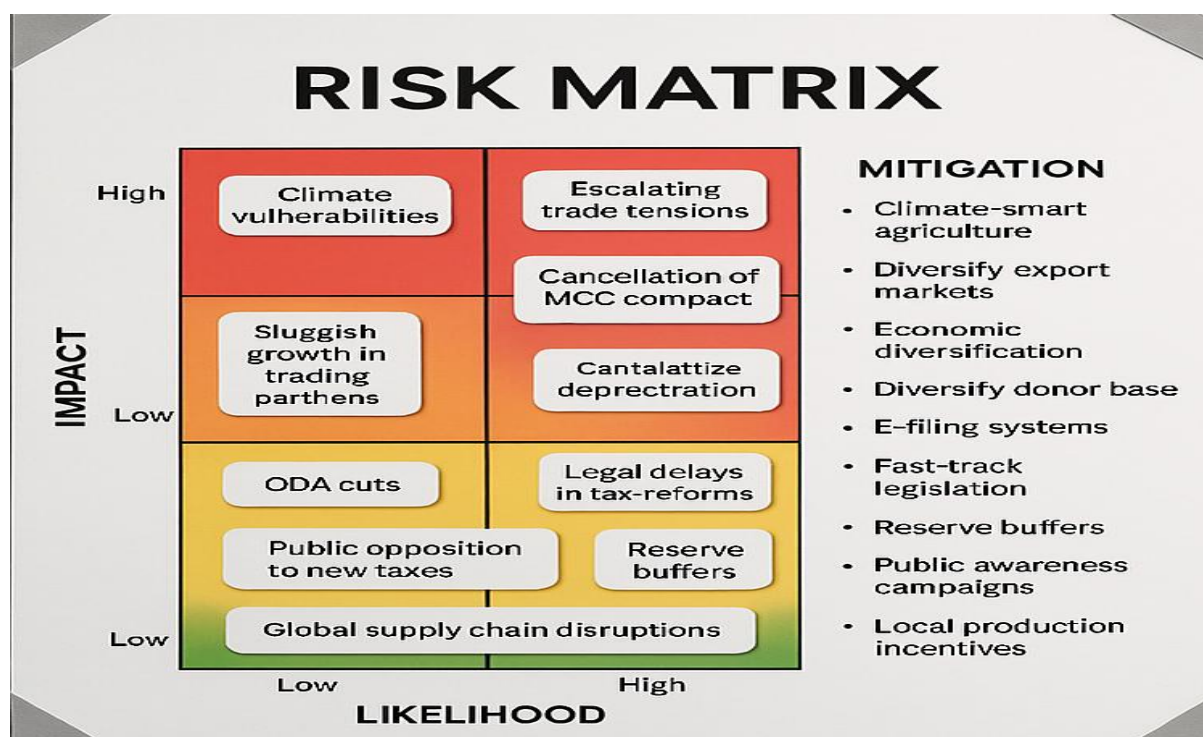
As Lesotho advances its National Digital Transformation Strategy 2024–2030, the upcoming budget must not only fund digital infrastructure and services but also embed Enterprise Risk Management (ERM) to ensure secure, resilient, and sustainable implementation. ERM provides a structured approach to identifying and mitigating risks such as cybersecurity threats, data privacy issues, infrastructure failures, and digital exclusion—that could undermine the success of digital initiatives. By aligning digital investments with risk management practices, the government can safeguard public trust, optimize resource use, and enhance the long-term impact of its digital transformation agenda.

Risks to the Outlook

- ***Climate Vulnerabilities:*** Lesotho is highly susceptible to the adverse effects of climate change with increased frequency of extreme weather events like droughts, floods, and storms. This directly impacts key sectors such as agriculture (which is predominantly rain-fed), water resources, energy, and health. The country's mountainous topography (limiting arable land) and erratic rainfall patterns exacerbate these vulnerabilities.
- ***Sluggish growth in key trading partners:*** The economy is highly reliant on export competitiveness, which is significantly impacted by the economic performance of its trading partners, particularly South Africa, USA, Japan and Belgium. Slowdown in these economies translates to reduced demand for Lesotho's exports thus impacting industries like textiles, mining and overall economic growth.
- ***Escalating trade tensions:*** The imposition of USA tariffs especially the 50 percent tariff suspended since April 2025 has already negatively impacted the garment industry particularly AGOA destined exports. This uncertainty and the potential for higher tariffs

have led to job losses and factory closures, given the industry's heavy reliance on the USA market.

- **Official Development Assistance (ODA) Cuts:** A decline in ODA including announced cuts from major providers and particularly a projected significant drop in bilateral ODA to Least Developed Countries and sub-Saharan Africa, poses a substantial challenge. ODA is a crucial source of funding for development projects and budgetary support in Lesotho.
- **Aftermath of the cancellation of MCC (\$300 million grant for health and horticulture projects):** This compact was expected to create 90,000 direct and indirect jobs impacting 2.5 million lives, focusing on improving healthcare, strengthening business environment, and irrigation development. Its termination with only a small portion of the funds disbursed, leaves a substantial funding gap and impacts critical development initiatives.



Monetary Policy and Inflation

Inflation is projected to average 4.5 percent in 2025, before rising to 5.0 percent in 2026 and 5.1 percent in 2027. The moderation in 2025 is attributed to lower oil prices, improved agricultural output, and the withdrawal of proposed VAT increases in both Lesotho and South Africa. However, risks to the inflation outlook remain, including potential exchange rate depreciation and disruptions in global supply chains.

The money supply is expected to grow modestly by 2.9 percent in 2025, in line with nominal GDP growth, primarily driven by net foreign assets. Private sector credit is forecast to increase by 3.3 percent, supported by household borrowing and ongoing construction activities. Over the 2026–2027 period, money supply growth is anticipated to average 4.2 percent, while private sector credit is projected to grow at an average rate of 4.1 percent.

External Sector Performance

The overall balance of payments is projected to remain in surplus over the period 2025–2027, supported by strong capital and financial inflows associated with the Lesotho Highlands Water Project Phase II (LHWP II). However, the current account is expected to record a deficit of 1.6 percent of GDP in 2025, widening to 4.3 percent in 2026, before returning to balance in 2027. These deficits are largely driven by a weak trade balance, reflecting subdued performance in key export sectors-particularly textiles and diamonds-amid global demand challenges and competitiveness issues. Imports, meanwhile, remain elevated due to infrastructure-related capital goods and consumer demand. The negative trade balance is partially offset by inflows from water royalties and Southern African Customs Union (SACU) revenues.

Official reserves are expected to remain above adequacy thresholds throughout the forecast period, averaging over **5.9 months of import cover**, thereby providing a strong buffer against external shocks and supporting macroeconomic stability.

Public Debt Trends and Sustainability

As at the end of 2024/25 financial year, the Government of Lesotho’s total debt stock amounted to **M23,181.9 million, representing 55.8 percent of GDP**. This reflects a year-on-year reduction of M738.4 million from FY2023/24, driven by prudent fiscal management. During the year, new borrowing and disbursements totalled M2,587.6 million, while repayments amounted to M1,901.9 million, complemented by parity gains of M 625.2 million. As of the quarter ending June 2025, total debt increased by M432 million to M23,614.1 million, though it is projected to decline by year-end in line with the government’s debt reduction policy. The consistent decline in the debt-to-GDP ratio over the past three years underscores the effectiveness of measures aimed at maintaining fiscal sustainability.

Of the **M2,265.6 million borrowed during the year, M513.6 million was sourced domestically and M2,073.9 million from external loan disbursements**. This was against a budgeted financing requirement of M4,540.4 million, comprising a fiscal surplus of M1,044.3 million and donor loans of M3,496.1 million. Domestic debt currently accounts for 16.3 percent of the total debt stock and is primarily used to finance fiscal deficits and support the development of the domestic bond market. External debt, which constitutes 83.7 percent, is mainly directed towards capital expenditure. In the first quarter of FY2025/26, M251.7 million in domestic debt was contracted through two auctions for market development purposes, in line with the Medium-Term Debt Strategy (MTDS).

	2024/25		2025/26 June	
TOTAL DEBT	23,181.9	55.8%	23,614.1	54.2%
EXTERNAL DEBT	19,587.3	47.2%	19,769.5	45.4%
Multilateral Creditors	15,631.2	37.6%	15,927.8	36.6%
International Monetary Fund	676.3	1.6%	645.6	1.5%
World Bank	8,929.4	21.5%	9,030.7	20.7%
African Development Fund	2,597.8	6.3%	2,648.6	6.1%
Other Multilaterals	3,427.8	8.3%	3,602.9	8.3%
o/w European Investment Bank	1,075.1	2.6%	1,162.1	2.7%

	2024/25		2025/26 June	
o/w Arab Bank For Econ Dev in Africa	723.1	1.7%	692.1	1.6%
o/w International Fund for Agr Dev	586.6	1.4%	588.0	1.4%
Bilateral	809.8	1.9%	752.82	1.7%
Non-Paris Club	809.8	1.9%	752.82	1.7%
o/w China	141.2	0.3%	138.8	0.3%
o/w Kuwait	281.3	0.7%	265.4	0.6%
Commercial Creditors	0.0	0.0%	37.8	0.1%
EXPORT CREDITS	3,146.3	7.6%	3,088.9	7.1%
o/w EXIM Bank China	3,125.6	7.5%	3,125.6	7.2%
DOMESTIC DEBT	3,594.6	8.7%	3,844.6	8.8%
T-Bills	0.0	0.0%	0.0	0.0%
Bonds	3,594.6	8.7%	3,844.6	8.8%
Loans	0.0	0.0%	0.0	0.0%

Fiscal Performance and Outlook

The medium-term economic outlook for Lesotho remains subdued, with average GDP growth expected to remain below potential. Recovery from recent external shocks is anticipated to be gradual, supported by a rebound in mining activity, modest improvements in textile exports, and continued resilience in the services sector. However, the outlook is subject to several risks, including prolonged weakness in global diamond prices, persistent trade tensions, volatility in Southern African Customs Union (SACU) revenues, and delays in the execution of public investment projects. Inflation is projected to stabilise around 5.0 percent over the medium term, aided by lower oil prices, improved harvests, and the withdrawal of proposed VAT increases in both Lesotho and South Africa. Nonetheless, risks such as exchange rate depreciation and global supply chain disruptions could affect price stability.

The Government entered the FY2025/26 budget cycle from a position of relative fiscal strength, having recorded surpluses of 7.1 percent and 9.6 percent of GDP in FY2023/24 and FY2024/25, respectively. These favourable outcomes were largely driven by a SACU windfall in FY2023/24, which increased by M4,749.0 million from the previous year, and an additional LSL 910 million increase in water royalties in FY2024/25. These inflows provided critical fiscal space and enabled the accumulation of government deposits. Despite this strong performance, structural challenges persist. The fiscal position remains vulnerable to SACU revenue volatility, while expenditure pressures, particularly a high public sector wage bill, accumulation of arrears, and elevated debt levels, pose risks to long-term sustainability. Total government expenditure rose by 10 percentage points to 57 percent of GDP between FY2022/23 and FY2024/25 and is projected to reach 61.3 percent of GDP in FY2025/26. The wage bill has remained relatively stable, averaging 17.9 percent of GDP, and is expected to slightly decline to 18.1 percent in FY2025/26, supported by ongoing wage bill reform measures.

The overall balance of payments is projected to remain in surplus over the period 2025–2027, supported by strong capital and financial inflows associated with the Lesotho Highlands Water Project Phase II. However, the current account is expected to record a deficit of 1.6 percent of GDP in 2025, widening to 4.3 percent in 2026, before returning to balance in 2027. These deficits are largely driven by a weak trade balance, reflecting subdued

performance in textile and diamond exports amid global demand challenges. Imports remain elevated due to infrastructure-related capital goods and consumer demand. Water royalties and SACU revenues continue to provide partial offset to the trade imbalance. Official reserves are expected to remain above adequacy thresholds throughout the forecast period, averaging over 5.9 months of import cover, thereby providing a strong buffer against external shocks and supporting macroeconomic stability.

Money supply is projected to grow modestly by 2.9 percent in 2025, in line with nominal GDP growth, primarily driven by net foreign assets. Private sector credit is expected to increase by 3.3 percent, supported by household borrowing and ongoing construction activities. Over the 2026–2027 period, money supply growth is anticipated to average 4.2 percent, while private sector credit is projected to grow at an average rate of 4.1 percent.

In FY2024/25, capital expenditure execution reached 82 percent of the budget, reflecting the government’s commitment to infrastructure development, particularly road rehabilitation. However, execution rates for externally financed projects, both loans and grants, remained below 50 percent on average, highlighting implementation challenges that need to be addressed to fully realise development objectives.

BUDGET AND PERFORMANCE OF CAPITAL EXPENSE

	BUDGET			PERFORMANCE			PERFORMANCE RELATIVE TO BUDGET		
	22/23	23/24	24/25	22/23	23/24	24/25	22/23	23/24	24/25
Capital Expense	6763.8	6323.4	9695.2	3206.5	3615.9	5481.3	47.4%	57.2%	56.5%
GOL	1764.0	2690.5	2934.3	1277.7	1807.3	2418.5	72.4%	67.2%	82.4%
Grants	2114.2	1025.7	3264.7	792.2	692.4	1160.0	37.5%	67.5%	35.5%
Loans	2885.7	2607.2	3496.1	1136.6	1116.2	1902.8	39.4%	42.8%	54.4%

However, Estimates for the current fiscal year 2025/26 suggest a tightening of the fiscal balance to 3.3 percent of GDP, as SACU revenues begin to normalize from their peak as depicted by the chart below. This performance sets the stage for the medium-term outlook, which demands a decisive policy shift from managing temporary windfalls to building lasting fiscal resilience, **denoting fiscal rules and revenue stabilisation policy are inevitable.**

HEAT-MAP

Revenue Source	2026/27	2027/28	2028/29
SACU Receipts	Normalizing (Indicates revenue is reducing or falling from a peak)	Stable (No change, but still at a lower level)	Stable (No change, but still at a lower level)
Water Royalties	Increasing (Small but positive growth)	Stable High (No change, but already high)	Stable High (No change, but already high)
Domestic Tax Revenue	Gradual Increase (Steady, meaningful growth)	Increasing (Small but positive growth)	Increasing (Small but positive growth)
Non-Tax Revenue	Modest Increase	Gradual Increase (Steady, meaningful growth)	Gradual Increase (Steady, meaningful growth)

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Development Priorities and Strategic Objectives

The National Strategic Development Plan II (NSDP II) serves as Lesotho's blueprint for inclusive and sustainable development, aiming to transform the country into a prosperous and resilient nation. Anchored on six key priority areas, the plan emphasizes strategic interventions that drive economic diversification, enhance human capital, expand infrastructure, empower youth, address climate change, and strengthen governance. This document outlines targeted strategic actions under each priority area, accompanied by measurable indicators to track progress and ensure accountability. These actions are designed to catalyze growth, improve livelihoods, and align national efforts with regional and global development agendas.

Key Strategic Pillars for FY2026/27

- 1. Economic Diversification and Private Sector Development - Strategic Objective:** Broaden the economic base by promoting non-textile manufacturing, expanding agricultural exports, enhancing SME competitiveness, and leveraging tourism as a driver of growth through investment in infrastructure, cultural heritage, and eco-tourism.
- 2. Human Capital Development (Health, Education, Social Protection) - Strategic Objective:** Improve education outcomes, reduce child mortality, and address malnutrition through integrated health and social protection systems.
- 3. Infrastructure for Inclusive Growth - Strategic Objective:** Expand and modernize physical and digital infrastructure and digital public goods to support economic activity and improve access to essential services, particularly in rural areas.
- 4. Youth Empowerment and Job Creation - Strategic Objective:** Increase youth employment through skills development, entrepreneurship support, and targeted job creation programs.
- 5. Climate Change, Environment, and Disaster Risk Management - Strategic Objective:** Enhance resilience to climate change by promoting sustainable land use, renewable energy, and disaster preparedness.
- 6. Governance, Public Sector Efficiency, and Accountability - Strategic Objective:** To strengthen institutions, improve public financial management, and promote transparency and citizen engagement, the Government is restructuring LIPAM, promoting research in public administration, and rolling out a Culture Change Program to enhance service delivery and accountability.

Cross-Cutting Priorities

- **Gender Equality and Social Inclusion (GESI):** Ensure equitable access to opportunities and services for women, youth, and vulnerable groups.
- **Digital Transformation:** Leverage secure digital and transformative/emerging technologies to improve service delivery, enhance transparency, and support innovation.
- **Decentralization:** Empower local governments to deliver services effectively and respond to community needs.
- **Regional Integration:** Align national development with SADC and AU frameworks to enhance trade, mobility, and cooperation.
- **Environmental Sustainability and Waste Management:** Promote green growth, climate resilience, and sustainable resource use. Prioritise effective waste management,

including e-waste, to address the growing challenge of unmanaged waste and ensure a clean, healthy environment.

- **Stakeholder Engagement and Communications:** Strengthen inclusive participation, transparency, and trust by establishing clear communication channels, responsive feedback mechanisms, and culturally sensitive engagement strategies that ensure all stakeholders are informed, involved, and empowered.

Role of Stakeholders in Achieving Priorities

- **Government Ministries and Agencies:** Lead policy formulation, implementation, and monitoring of strategic actions.
- **Private Sector:** Drive investment, innovation, and job creation, particularly in priority sectors.
- **Development Partners:** Provide technical and financial support aligned with national priorities.
- **Civil Society and Communities:** Advocate for inclusive development and hold institutions accountable.
- **Youth and Women’s Groups:** Actively participate in decision-making and program implementation.
- **Academia and Research Institutions:** Generate evidence to inform policy and evaluate impact.

Expected Outcomes and Results Framework

Strategic Pillar	Expected Outcomes	Key Performance Indicators (KPIs)
Economic Diversification	Increased contribution of non-textile sectors to GDP	Annual percentage increase in international tourist arrivals and tourism-related revenue; Growth in export value of agricultural products; digital trade and services; Number of new non-textile manufacturing enterprises established; Increase in SME registration and their share in national employment and GDP.
Human Capital Development	Improved health and education outcomes	Priority skills developing tertiary education programmes focus and enrolment rate, Primary school completion rate, under-five mortality, stunting prevalence; TVETs and providing pathways for youth that fail to complete primary or secondary education and Technical Academies for early technical specialisation.
Infrastructure Development	Enhanced access to basic services	Road network coverage, universal and meaningful access to broadband and government services, rural electrification, access to water and sanitation
Youth Empowerment	Increased youth employment and entrepreneurship	Youth employment rate, youth-led enterprises supported
Climate & Environment	Strengthened climate resilience	Area under sustainable land management, households using renewable energy; and increase in the amount of sustainably managed waste.
Governance & Accountability	Improved public sector performance	Budget execution rate, Broadcasting services coverage, digital procurement

Strategic Pillar	Expected Outcomes	Key Performance Indicators (KPIs)
		usage, citizen satisfaction index, percent of public servants trained annually in NSDP-aligned programmes, Number of research studies informing policy decisions, percent of MDAs implementing the program and percent of staff completing it.

Resource Envelope and Expenditure Framework

The Government of Lesotho remains committed to building a stable, broad-based revenue system to support sustainable development, while reducing fiscal risks. Heavy reliance on Value Added Tax (VAT) and Southern African Customs Union (SACU) transfers leaves the budget vulnerable to regional trade fluctuations. VAT contributes nearly half of domestic tax revenue, while SACU transfers account for a significant share of overall income.

The 2026/27 Budget prioritizes strategic measures aimed at enhancing domestic revenue mobilization, broadening and diversifying the tax base, and progressively reducing the country’s reliance on SACU transfers. These efforts are critical to strengthening fiscal sustainability, improving the resilience of public finances, and supporting the delivery of national development priorities.

Expected Revenue Performance in FY2025/26 and Medium-Term Targets for FY2026/27

In FY2025/26, total tax revenue is expected to rise to M10.89 billion, marking a modest increase from M10.42 billion in FY2024/25. As a share of GDP, tax revenue is estimated at 25.3 percent, slightly up from the previous year’s 25.2 percent. This growth is driven mainly by taxes on goods and services, particularly Value Added Tax (VAT), which is projected to increase from M4.31 billion to M4.82 billion. Taxes on income, profits, and capital gains are projected to remain relatively flat in nominal terms at M5.09 billion, declining marginally as a share of GDP from 12.5 percent to 11.8 percent.

Looking ahead, tax revenue is projected to reach M11.75 billion in FY2026/27 and M12.55 billion in FY2027/28. As a percentage of GDP, revenue performance is expected to improve to 26.1 percent and 26.7 percent, respectively. This upward trajectory is underpinned by continued growth in VAT collections, which are forecast to increase to M5.34 billion in FY2026/27 and M5.84 billion in FY2027/28, as well as steady gains in income taxes. These projections suggest a strengthening domestic revenue base and reflect ongoing efforts to enhance tax administration and compliance.

Tax Revenue projections 2026/27 in million Maloti

STATEMENT OF GOVERNMENT OPERATION	24/25	25/26	26/27	27/28
	Act.	Est.	Proj.	Proj.
Taxes	10 417.0	10 893.3	11 745.0	12 551.3
Taxes on income, profits and capital gains	5 188.6	5 088.6	5 370.4	5 641.6
Payable by individuals	3 178.8	3 092.1	3 263.3	3 428.1
Payable by corporations and other enterprises	1 121.9	1 084.4	1 144.4	1 202.2
Other taxes on income, profits and capital gains	887.8	912.1	962.6	1 011.3
Taxes on goods and services	5 227.6	5 803.9	6 373.9	6 909.3
Value added taxes	4 309.4	4 822.8	5 344.2	5 836.3
Excise taxes	903.6	946.3	990.2	1 032.8
Alcohol and tobacco	160.8	160.5	164.5	168.7

Tax Revenue projections 2026/27 in % of GDP

STATEMENT OF GOVERNMENT OPERATIONS	24/25	25/26	26/27	27/28
	Act.	Est.	Proj.	Proj.
Taxes	25.2	25.3	26.1	26.7
Taxes on income, profits and capital gains	12.5	11.8	11.9	12.0
Payable by individuals	7.7	7.2	7.2	7.3
Payable by corporations and other enterprises	2.7	2.5	2.5	2.6
Other taxes on income, profits and capital gains	2.1	2.1	2.1	2.2
Taxes on goods and services	12.6	13.5	14.2	14.7
Value added taxes	10.4	11.2	11.9	12.4
Excise taxes	2.2	2.2	2.2	2.2
Alcohol and tobacco	0.4	0.4	0.4	0.4

Key Revenue Measures for 2026/27

Reaching Lesotho’s revenue and compliance targets will require a coordinated set of actions that promote fairness, efficiency, and broad-based participation. Strengthening both personal and corporate income tax collection will be central to these efforts, with enhanced audits and better taxpayer support services helping ensure that obligations are met. Expanding VAT coverage, particularly in the fast-growing digital sector, and refining the VAT system to balance equity with revenue growth will further bolster fiscal capacity.

Improving the tax administration framework is equally essential. By rolling out e-filing and online payment platforms, the government can simplify tax processes and make compliance more accessible. Enhancing taxpayer education will help individuals and businesses better understand their responsibilities, reducing errors and boosting voluntary compliance. Accelerating the passage of key tax policy and administration bills will also play a vital role in addressing persistent gaps in collection and enforcement.

In parallel, greater attention must be given to small and informal businesses. Simplifying tax regimes and offering clear pathways to formalization will encourage these enterprises to come into the fold, broadening the tax base while supporting inclusive economic growth.

Outlook and Next Steps

The Government aims to steadily increase domestic revenue as a share of GDP while reducing SACU dependency. In order to establish a more self-sustaining and stable revenue system that aids Lesotho's development, investment, and environmental aims, the government will execute focused actions in the realms of digital economy taxation and carbon pricing. This includes the introduction of a tax on international digital platforms that profit from Lesotho users, starting the collection of VAT on cross-border digital services, and offering clear directives on the taxation of cryptocurrencies and digital assets. Moreover, by implementing a carbon tax, initially on fuel, the country can create revenue while also lowering carbon emissions, thus aligning fiscal policy with larger environmental objectives.

Key Risks to Revenue Projections

The introduction of new tax measures, including the Digital Services Tax and Carbon Tax, presents significant opportunities for enhancing Lesotho's revenue system. However, various practical challenges must be overcome to achieve success. Timely legal reforms are crucial; without prompt approval of the required laws and regulations, revenue collection could face considerable delays.

Public opposition to new taxes, especially those impacting fuel and digital services, also represents a potential threat. If these reforms are not communicated clearly and introduced gradually, both businesses and citizens may resist, resulting in lower compliance rates. Furthermore, external economic influences such as a slowdown in growth, regional trade interruptions, or geopolitical tensions could hinder taxable activities and reduce revenue collection. Lastly, the dependence on external tax sources, such as income from digital platforms and cross-border transactions, underscores the importance of international collaboration and enforcement. Without this, essential revenue streams may be lost.

Risk Mitigation Measures

In order to effectively manage the risks that come with the introduction of new tax instruments, the Government must embrace a proactive and people-oriented approach. This involves prioritizing legal reforms and speeding up the legislative process for critical tax policies to prevent implementation delays.

It is equally important to strengthen the capacity of the Revenue Service Lesotho (RSL), by investing in staff development, enhancing digital infrastructure, and improving taxpayer services, a more responsive and efficient tax system can be created. Engaging the public through focused awareness campaigns will foster understanding and trust in new tax measures, which will help reduce resistance and improve compliance.

Offering simplified tax options for small and informal businesses will be essential to ensure inclusivity and support economic activity across all sectors. Lastly, ongoing monitoring of the economic environment will facilitate agile adjustments to tax administration targets, enabling Lesotho to remain resilient in the face of external shocks and fluctuating market conditions.

Translating Policies into Resource Allocations through Programmes and Capital Projects

The FY 2025/26 Budget adopts the NSDP II Key Priority Areas (KPAs) as the core programme classification for budgeting, ensuring full integration of planning, policy, and resource allocation. All capital projects and recurrent expenditures are aligned with the following five NSDP II KPAs:

Programme Structure Based on NSDP II Key Priority Areas (KPAs)

NSDP II KPA	Definition & Coverage
KPA 1: Enhancing Inclusive and Sustainable Economic Growth and Private Sector-Led Job Creation	Encompasses agriculture, manufacturing, tourism, mining, MSMEs, trade, and job creation initiatives.
KPA 2: Strengthening Human Capital	Covers education, health, social protection, youth empowerment, and digital and specialized skills development.
KPA 3: Building Enabling Infrastructure	Includes roads, energy, digital infrastructure, transport, urban development, and water infrastructure.
KPA 4: Strengthening National Governance and Accountability Systems	Supports justice, anti-corruption, broadcasting services, decentralization, public sector reform, and PFM strengthening.
KPA 5: Strengthening Climate Risk Management and Environmental Sustainability	Focuses on sustainable land use, water resource management, disaster risk reduction, renewable energy, and climate adaptation and mitigation.

Budget Resource Allocation by KPA (FY 2025/26 Baseline)

Programme Area (KPA)	2025/26 Budget	2026/27 Projection	2027/28 Projection
KPA 1: Economic Growth & Job Creation	16.5%	17.2%	17.8%
KPA 2: Human Capital Development	39.0%	39.5%	40.0%
KPA 3: Enabling Infrastructure	24.5%	25.0%	25.3%
KPA 4: Governance & Accountability	9.0%	8.8%	8.5%
KPA 5: Climate & Environmental Sustainability	3.0%	3.5%	4.0%
Debt Service & Statutory Obligations	8.0%	6.0%	4.4%

Alignment of Key Programmes and Capital Projects per KPA

KPA	Examples of Key FY 2025/26 Initiatives
KPA 1	MSME Credit Facility, Agriculture Subsidy Reform, Tourism Development Strategy rollout
KPA 2	Free Primary Education Expansion, National Health Insurance Pilot, Skills Training Grants
KPA 3	Rural Road Rehabilitation (500km), Metolong Dam Phase II, ICT Backbone Extension
KPA 4	Public Finance Management Reform, Integrated Case Management System for Judiciary
KPA 5	Lesotho Climate Change Adaptation Fund, Tree Planting & Watershed Protection Initiatives

Capital Projects Prioritization and Management

To improve public investment outcomes, the Government of Lesotho will establish a centralized body to manage all government projects, ensuring better coordination and delivery. In FY 2025/26, capital proposals will be screened against NSDP II objectives using the PIM Framework, which mandates feasibility, environmental, and cost-benefit assessments.

A Project Prioritisation Tool is being developed to guide resource allocation based on strategic, economic, environmental, and institutional criteria. Capacity will be strengthened through the Capital Project Management Information System (CPMIS), enabling real-time tracking and financial integration.

In FY 2026/27, a Public Investment Policy and Law will be introduced to define financing modalities and enforce compliance. Under Mission 300, the government aims for universal access to clean, reliable energy by 2030, supported by the Energy Compact through infrastructure upgrades, regional links, and private sector-led investment and reform.

Key Policy Initiatives and Reforms

Informed by 2025/26 performance, 2026/27 pre-budget consultations, and current socioeconomic realities, the Government's 2026/27 Budget Strategy emphasizes inclusive economic growth, efficient public service delivery, and resilience. Key initiatives include:

1. Fiscal Governance and Accountability

- Strengthening fiscal discipline through digitized procurement, expenditure control, and audit reform.
- Scaling up RSL efficiency, expanding the tax base, and piloting new tax instruments such as environmental levies to reduce dependence on SACU revenues.
- Finalizing functional reviews and implementing phased civil service restructuring based on 2025/26 audits.

2. Youth Employment and Job Creation

- Launching a National Youth Employment Strategy (NYES) focused on skills matching, entrepreneurship, and access to finance
- Expanding public-private youth employment partnerships in high-potential sectors such as agriculture, manufacturing, and digital services.
- Empower UNIPOD and implement Innovation Fund to support startups and regional innovation hubs.
- Implementing the Youth Skills for Jobs Program through vocational training centers, with performance-based incentives for private-sector absorption.
- Including youth-specific quotas in public works and infrastructure projects.
- Developing targeted job creation strategies that address economic diversification, education and skills mismatch, and private sector growth.

3. Private Sector Development and Investment

- Improving access to finance, streamlining licensing processes, and operationalizing industrial zones to attract investment and create jobs.
- Supporting entrepreneur development and creating a conducive environment for private sector growth.

4. Infrastructure Development

- Prioritizing high-impact, job-creating infrastructure, roads, water systems, digital public infrastructure (Digital ID, Digital Payments and Data Exchange Systems)-supported by domestic and blended financing.
- Developing comprehensive infrastructure plans with strategic financing mechanisms, especially for rural and highland communities.
- Building capacity in local government structures for planning, implementation, and monitoring.

5. Agriculture and Rural Development

- Investing in climate-smart agriculture, irrigation, and rural agro-processing to stimulate value chains and employment.
- Enhancing rural connectivity and access through infrastructure development.
- **Decentralization and Local Governance**-Enacting the Decentralisation Bill to promote equitable development, improve service delivery, and enhance resource allocation.

6. Security and Community Safety-Addressing rising stock-theft and insecurity in hard-to-reach areas by:

- Enhancing law enforcement practices
- Empowering community policing structures
- Promoting sustainable safety and justice at the community level

7. Environmental Sustainability and Waste Management

- Piloting environmental levies and promoting green growth.
- Developing a national waste management policy and investing in infrastructure for efficient waste collection and disposal.

8. Social Protection and Equity

- Consolidating fragmented social protection programs through single payment gateway, increasing coverage through digital ID systems, and ensuring targeting of vulnerable youth and households.
- Improving and balancing resource allocation for Development Funds, factoring in district-specific characteristics and ensuring equitable budgeting between recurrent and capital expenditures.

9. Education and Skills Development-Aligning education outcomes with labor market needs by reforming curricula, focus on developing and offering priority skills providing tertiary education programmes and increasing the capacity of technical and vocational education institutions.

Medium-Term Expenditure Framework (MTEF)

The 2026/27–2028/29 MTEF is guided by fiscal realism and strategic resource allocation based on the macroeconomic outlook established in 2025/26. Key elements of the MTEF include:

- Baseline revenue for 2025/26 has improved marginally due to stronger tax collection and SACU transfers. The MTEF targets further growth in domestic revenue, aiming to reach 28% of GDP by 2028/29.
- Spending Prioritization:
 - Social sectors (health and education) will continue to receive at least 40% of the recurrent budget.
 - Capital expenditure will be maintained above 7 percent of GDP annually, with greater domestic financing.
 - Budget reallocations will emphasize results and impact, especially in underperforming programs.
- Ministries will receive indicative three-year ceilings linked to strategic outcomes, promoting multi-year planning and fiscal discipline.
- Strengthening the performance budgeting framework to improve accountability and ensure alignment between resources and results.
- Targeting a gradual reduction in the fiscal deficit to below 3 percent of GDP by 2028/29, in line with SADC and IMF benchmarks.
- Strengthen project management capabilities to enhance implementation efficiency and accountability.
- Improve procurement skills by revising job specifications and providing targeted training to ensure value-for-money and compliance.
- All grants must be comprehensively included in the budget estimates to ensure transparency, alignment with national priorities, and effective resource allocation.

Monitoring and Evaluation

The Monitoring and Evaluation (M&E) Framework for the 2026/27 Budget Strategy Paper is a critical instrument for ensuring that national priorities are effectively implemented and aligned with the NSDP II and future development objectives. Building on systems strengthened in 2025/26, the framework emphasizes performance-based budgeting, where ministries are required to submit sector-specific indicators and annual targets aligned with the national results framework. The Ministry of Finance and Development Planning will lead coordination efforts, supported by line ministries, the Bureau of Statistics, and development partners. Real-time tracking through expanded digital platforms and dashboards will enhance transparency and service delivery monitoring, while 2025/26 performance data will inform budget allocations and trigger expenditure reviews for underperforming sectors.

To strengthen accountability and citizen engagement, the government will integrate social accountability tools such as community scorecards and citizen report cards. Continued investment in M&E capacity, particularly for planning units and district-level officials will improve data quality and reporting. This approach ensures that lessons learned are fed back

into planning cycles, enabling adaptive management and continuous improvement. Ultimately, the M&E strategy will serve as a cornerstone for evidence-based decision-making, ensuring that public investments deliver measurable results and improve the lives of Basotho.

Conclusion

Aligned with the theme "Building Strategies for Inclusive Growth in a Digital Era: Empowering Youth for a Resilient Future," this Budget Strategy Paper reaffirms the Government's commitment to sound fiscal management, digital transformation, policy coherence, and inclusive development. By linking policy priorities to budget allocations, the strategy ensures that public resources are used effectively to deliver tangible results for all citizens, especially the youth.

Key reforms and initiatives are designed to strengthen institutions, enhance transparency, and build resilience in the face of economic and environmental challenges. The integration of risk management and performance monitoring supports the achievement of sustainable development outcomes.

Policymakers are encouraged to:

- Prioritize youth employment through targeted skills development and entrepreneurship support.
- Maintain fiscal discipline by managing the wage bill and improving capital project execution.
- Enhance resilience in agriculture and mining through climate-smart practices.
- Institutionalize performance-based budgeting and monitoring to ensure accountability.
- Increase local production and reduce reliance on imports and the outsourcing of education and health to SA and other neighbouring countries.

As the Government moves forward with the budget preparation process, this strategy will serve as a foundational reference for decision-makers, development partners, and the public. It underscores the importance of collaboration, accountability, and innovation in building a more prosperous and equitable future that empowers youth and promotes inclusive growth.