

Mozambique Country Brief



July 2021



Transforming Africa's Trade

African Export-Import Bank
Banque Africaine d'Import-Export

Introduction

The Republic of Mozambique is a country located in Southern Africa, bordered by the Indian Ocean to the east, Tanzania to the north, Malawi and Zambia to the northwest, Zimbabwe to the west, and Eswatini and South Africa to the southwest. The capital and largest city is Maputo.

16th largest African country by area

14th most populous African country

27th largest African economy by GDP

21st largest country by total African trade

41st largest country by intra-African trade



INTRODUCTION

Mozambique has an area of roughly 801,537 square kilometers, making it the 16th largest country in Africa by area. With a population of about 31.2 million inhabitants, the country is the 14th most populous nation in the continent. Portuguese is the official and most widely spoken language. Several indigenous languages also are widely spoken, including Makhuwa, Tsonga, Nyanja, and Sena.

The services sector, which accounts for about 57 percent of gross domestic product (GDP), is not the main source of employment. Instead, the agricultural sector (which accounts for 24 percent of GDP) employs more than 70 percent of the labor force, while industry accounts for 19 percent. The industrial sector comprises mainly petroleum, aluminum, clothing, and textiles. However, growth is also driven by other strategic sectors – such as tourism, financial services, and fishing – which are among the main sources of foreign exchange earnings. The recent discovery of huge gas reserves and the forthcoming launch of gas production projects will enable the country to further diversify its sources of growth.

POLITICAL ENVIRONMENT

The politics of Mozambique take place within the framework of a multiparty system underpinned by a presidential representative democratic republic, in which the President is both the head of state and head of government. Executive power is exercised by the government. Legislative power is vested in both the government and the Assembly. The judiciary is independent and applies a hybrid legal system based on Portuguese civil law and customary law.

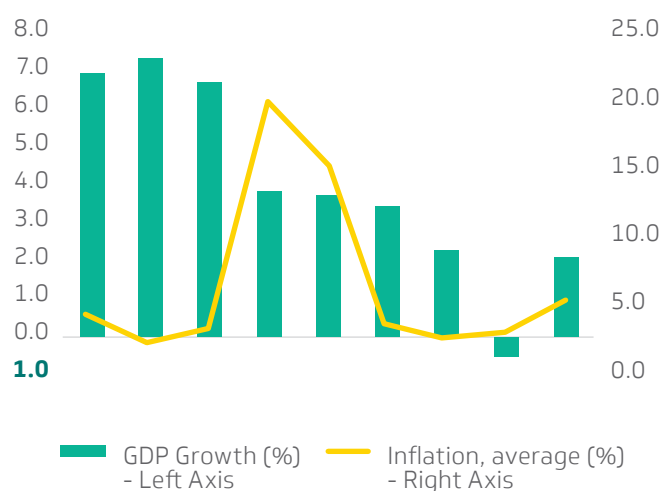
President Filipe Jacinto Nyusi is serving his second term after the Mozambique Liberation Front (FRELIMO) secured victory in 2019 elections.

ECONOMIC OVERVIEW

GDP

The lingering effects of cyclones Idai and Kenneth in 2019 meant that the COVID-19 pandemic caught Mozambique at a fragile moment in its economic history, as the country was attempting to recover from a sharp and deteriorating debt profile. The changing debt profile dented investor confidence in the country and contributed to increased borrowing. After the country's GDP growth hit peaks of 7.4 percent and 6.7 percent in 2014 and 2015 respectively (figure 1), it declined to 2.3 percent in 2019, after destruction of economic and physical infrastructure by the cyclone and rising borrowing costs.

Figure 1. Mozambique GDP Growth and Inflation



Source: IMF World Economic Outlook (2021).

The pandemic further exacerbated the growth and macroeconomic management challenges facing the country. The implementation of containment measures (lockdowns, social distancing, and travel restrictions) led to global demand and supply shocks and also widening fiscal and current account deficits, via deterioration of commodities terms of trade. Consistent with global trends of the pandemic triggering economic contraction, the country's GDP shrunk by 0.5 percent in 2020, significantly down from a pre-COVID forecast of 4.3 percent growth.

The forecast recovery of 2.1 percent growth in 2021 hinges on the country's ability to foster macroeconomic stability and improve governance to boost investor confidence. It also depends on recovery in commodity markets, in a country where the dynamics of the current account remains highly correlated with commodity price cycles.

Inflation

Despite the growth and macroeconomic management challenges facing Mozambique, inflation has remained relatively low in recent years, reaching 2.8 percent in 2019. Although COVID-19 and cyclones have heightened inflationary pressures, price levels remain relatively low compared with averages across the region and more generally, across the developing world. The low inflationary pressure is a result of stable food prices, and monetary tightening. However, inflation has been trending upward and is forecast to hit 5.3 percent in 2021, after rising to 3.1 percent in 2020.

Exchange Rate

Several monetary policies have been in effect in Mozambique over the last few decades, oscillating between fixed exchange rate and fully flexible, and a market-determined exchange rate system. Since 1993, monetary policy has been anchored under flexible exchange rate systems, allowing adjustment to market

fundamentals. However, over the last few years, the country's currency, the metical (MT), has come under pressure, fueled by sustained deterioration of commodity terms of trade and widening fiscal and current account deficits. As a result, the country's currency traded at MT69 : US\$1 in 2020, a 29 percent depreciation from 2015. However, it is forecast to stabilize in 2021 at around MT76 : US\$1.

Fiscal Balance

Government expenditure rose significantly during fiscal year 2020 to cope with the fallout from the COVID-19 pandemic. These expenditures were on top of spending related to the gradual reconstruction of infrastructure, buildings, ports, and agriculture that were damaged by the cyclones in early 2019. At the same time, 2020 domestic resource mobilization, especially from tax collections, were lower than expected because of economic contraction, income losses, and tax deferrals, as the spread of COVID-19 and rising insecurity undermined overall economic activity. As a result, the fiscal deficit which stood at 6 percent of GDP in 2019 widened sharply to an estimated 13.3 percent of GDP in 2020. Nonetheless, government revenue is expected to rise in 2021, as export earnings and tax revenues rise on the back of improving external conditions and strengthening global demand, and increase further in 2022.

At the same time, as the pandemic crisis abates, the government will be able to strengthen public finances on the back of reduced government expenditures and increased revenues. These developments will strengthen Mozambique's fiscal position, with its fiscal deficit expected to narrow by 11.1 percent of GDP in 2021 and further by 8.1 percent and approximately 6 percent in 2022 and 2023, respectively. However, the high level of public debt and continued excessive dependency on primary commodities and natural resources for government revenues and foreign exchange earnings will remain major downside risks.

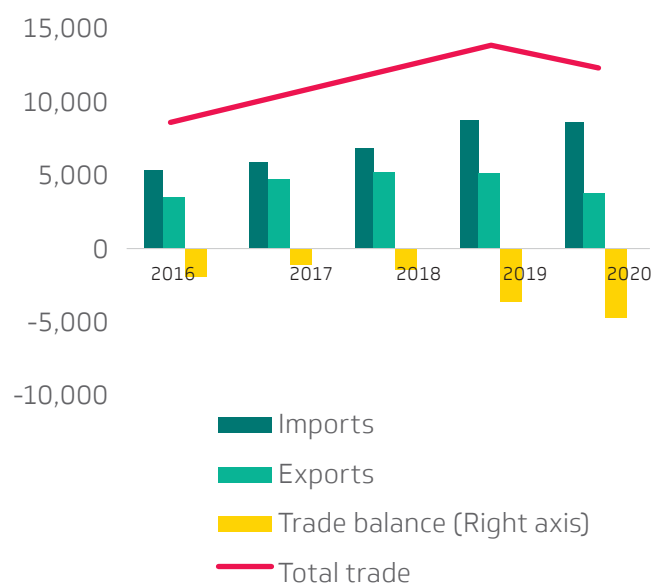
OVERVIEW OF TRADE, RESERVES, AND FINANCIAL SECTOR

Total Trade

Mozambique's exports are dominated by mineral fuels and aluminum. Other exports include ores, tobacco, pearls, and fruits. Its top export destinations are South Africa, India, China, Italy, and Germany, which together accounted for 54.4 percent of total exports in 2020. Mozambique's top imports include refined petroleum, chromium ore, iron ore, aluminum oxide, and electricity. The country's top import origins are South Africa, India, China, Zimbabwe, and Australia, which combined accounted for more than 72 percent of total imports in 2020.

In 2020, Mozambique's total exports were estimated at US\$3.8 billion and its imports were estimated at US\$8.5 billion, resulting in a trade deficit of about US\$4.7 billion, compared with US\$3.64 billion and US\$1.6 billion in 2019 and 2018, respectively. The widening of the trade deficit arose largely as the pandemic reduced global demand for commodities, while imports remained high, driven by refined petroleum and medical products that were purchased in response to the pandemic.

Figure 2. Mozambique Total Merchandise Trade, US\$ Millions



Sources: IMF Direction of Trade Statistics (DOTS) dataset, Afreximbank research.

Intra-African Trade

Mozambique's total intra-African trade amounted to approximately US\$2.83 billion in 2020, accounting for around 23 percent of its total trade, well above the regional average of 14.5 percent. South Africa alone accounted for 76.4 percent of Mozambique's exports to Africa and 16.3 percent of Mozambique's exports to the world. Zimbabwe, Malawi, Zambia, and Botswana combined accounted for 14 percent of Mozambique's exports to Africa. The main exports products included mineral fuels, aluminum, fruits, nuts, and fertilizers.

South Africa is also Mozambique's largest import partner in the continent. Imports from South Africa to Mozambique reached 88.6 percent of total imports from Africa, followed by Namibia, Eswatini, and Mauritius, which collectively accounted for 8 percent in 2020. Mozambique's main intra-African imports are refined petroleum, machinery, vehicles, mechanical equipment, and plastics.

Reserves

Mozambique's foreign reserves, which increased to US\$3.89 billion in 2019 from US\$3.1 billion in 2018, declined to an estimated US\$3.6 billion in 2020, reflecting widening trade deficits as a consequence of falling commodity prices and global demand exacerbated by the COVID-19 downturn. At the same time, sharp fall in migrant remittances, as well as sudden stops in capital flows, further exacerbated pressure on the country's reserves.

However, Mozambique's stock of foreign reserves is expected to rise to US\$3.83 billion in 2021 and strengthen to US\$4.14 billion in 2022, as the pandemic recedes and an uptick in global demand and economic activity lift commodity prices and boost export earnings. At the same time, the expected boost in migrant remittances and inflows of foreign direct investment will further strengthen the country's reserve position.

Current Account Balance

Mozambique's current account deficit has deteriorated sharply over the last two years, widening to an estimated 27.3 percent of GDP in 2020, from 20.2 percent in 2019. The deterioration of the current account occurred as COVID-19 triggered a sharp fall in global demand and commodity prices, especially coal and aluminum, which weighed on export earnings, while heavy expenditures of capital goods to support development of the country's gas industry raised its import bill.

In addition, the high cost of importing medical kits and equipment in response to the pandemic and the negative impact of the cyclones on agricultural and coal production further exacerbated the trade deficit, heightening pressures on balance of payments. However, the current account deficit is projected to narrow to 24.8 percent of GDP in 2021, as COVID-19 abates. This will enable a gradual pickup in global demand and rising export receipts, underpinned by rebound in coal and aluminum production and complemented by rising prices. Mozambique's deficit is expected to narrow further to 23.5 percent in 2022, as exports increase, boosted by rising production and demand.

Financial Sector

The Mozambican financial sector comprises 19 commercial banks, 9 micro-banks, 24 exchange bureaus, 3 mobile money service providers, 21 insurance companies, several pension funds, 4 savings and credit cooperatives, and 69 specialized microcredit finance institutions. The banking sector dominates the financial landscape, with an embryonic capital market and limited capacity to effectively finance the private sector. Significant reforms have been implemented, with the aim of consolidating and stabilizing the sector. These include risk-based supervision by the Central Bank, in line with the Basel II Agreements, and strengthening the fight against money laundering and terrorist financing. Parliament approved amendments in May 2018 to Law No. 14/2013 for the full implementation of the United Nations' Security Council Resolutions on freezing terrorist assets (Resolutions 1267 and 1373).

The five largest banks dominate the banking sector and financial landscape, accounting for more than 80 percent of sector assets, more than 81 percent of loans, and more than 85 percent of deposits. Most banks operating in Mozambique are subsidiaries of foreign groups, mainly from Portugal and South Africa, and all but one of the banks are privately owned. Most (at least 9) of the banks are small, with capital of less than US\$27 million.

A restrictive monetary policy implemented by the Central Bank has contributed to a declining credit to the economy – for instance, from 36.8 percent of GDP in 2016 to 28.1 percent in 2017 and declined further to 14.6 percent in 2020. Moreover, the high cost of credit has deterred clients with good standing and increased the prospects of generating nonperforming loans. Rising interest rates also increased bank demand for short-term government securities. Customer deposits are the main sources

of funds mobilization for banking institutions, accounting over 80 percent of banking liabilities. Demand deposits remain the main component of customer deposits.

To protect and safeguard customer deposits in the event of a banking crisis, the Government established a Deposit Guarantee Fund. Its objective is to reimburse depositors if banks become insolvent or lose their license. While its objective is commendable, the fund provides a low-level guarantee per depositor, equivalent to US\$321.1, and also is limited in scope, covering only deposits in local currency and less than 1 percent of all deposits (well below the 3 percent target).

Banks' balance sheets and capacity to increase lending is hindered by monetary policy. The Central Bank increased the reserve requirement ratio for foreign currency liabilities from 14 percent to 27 percent at the end of 2018. Furthermore, the Central Bank adjusted interest rates upward, in a context of heightening monetary policy. This adjustment also reflects banks' preventive management of credit risk coverage, as well as structural problems such as high operating costs, lack of credit information, and insufficient collateral.

To ensure adequate levels of liquidity and solvency, the Central Bank increased bank solvency ratios from 8 percent to 12 percent. It also raised the minimum capital requirement for banks, from US\$1.1 million to US\$27.3 million. The average bank tier-one regulatory capital-to risk-weighted-asset ratio rose from 14.2 percent in December 2016 to 28.9 percent in December 2019, before falling to 23.2 percent in June 2020. These rates are above the regulatory minimum of 12 percent, and comfortably above global standards. Accordingly, the sector is well-positioned to cope with shocks. The frequency of overnight borrowing from the Central Bank was limited to two days per week, forcing banks to strengthen their liquidity management and leading to an increased liquidity ratio, which rose from about 58 percent in 2019 to 63.6 percent in 2020. These reforms in the regulatory environment strengthened the capitalization of banks, enabling them to remain profitable even as the challenging economic environment resulted in a deterioration of bank assets, with the non-performing loan ratio rising from 10.6 percent of total loans at the end of 2019 to 12.6 percent in June 2020.

This environment of high interest rates and the implementation of International Financial Reporting Standard (IFRS) 9 in January 2018, which helped maintain the provisioning rate for non-performing loans at a comfortable level, also were significant drivers of financial soundness and growth in Mozambique. The rate was 95.7 percent in 2018, compared with 87.4 percent in 2017. Funding in the financial sector is relatively stable, mostly from deposits that have continued to grow since the pandemic hit. Liquidity levels are higher than in peer countries, reflecting banks' conservative approach and high reserve requirements for foreign exchange deposits.

To further promote financial soundness and stability, efforts are being made to improve financial inclusion and digital finance, while ensuring that small and medium enterprises which constitute a significant proportion of the country's industrial base have access to finance to support their operations. The insurance industry has become increasingly attractive in the face of sustained growth and increasing profitability. In summary, Mozambique's financial services sector is vibrant and relatively stable.

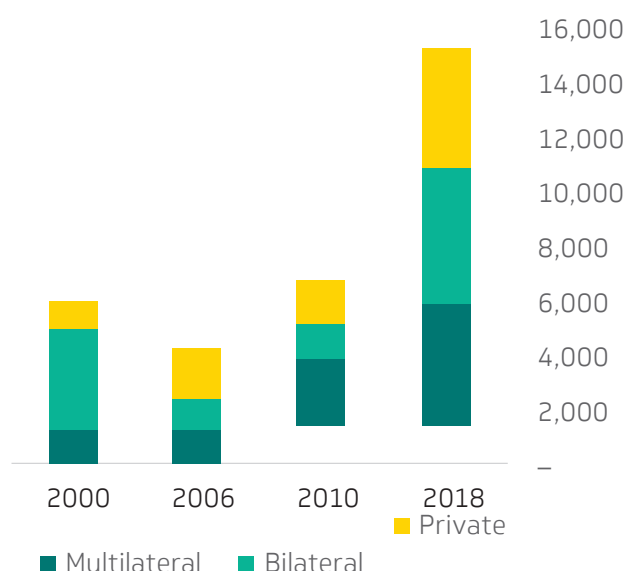
Debt Sustainability

The evolution of total public debt is driven mainly by the dynamics of external debt components, including those related to the share of the National Hydrocarbons Company (ENH) in LNG megaprojects and the management of state-owned enterprises.¹ The debt service (including rollover of treasury bills for cash flow management) absorbed nearly 37 percent of expected revenues and grants in 2020 and is expected to decline in following years.

Mozambique scored 3.1 out of 6 in the World Bank's Country and Policy Institutional Assessment (CPIA), down by 0.1 from the previous reading. Mozambique scores were weakest for economic management (2.8), within which debt policy scored 2.0. As such, the government is focusing on improving governance, transparency, and accountability across the board, including in financial and economic governance, as well as natural resource management.

The overall CPIA score of 3.1 is indicative of the following thresholds for debt sustainability: Present value (PV) of external debt to GDP of 30 percent; PV of total debt to GDP of 35 percent; PV of external debt/exports of 140 percent; and PV of external debt service/exports of 15 percent. Mozambique's debt sustainability is assessed against the aforementioned benchmarks.

Figure 3. Evolution of Mozambique External Debt Composition, US\$ Billions



Sources: IMF, Afreximbank research.

¹ Although Mozambique has approved a law to control the ability of state-owned enterprises to issue debt and mitigate the risk of debt distress, a strong financial oversight is still needed over the entire state-owned enterprises sector.

i. PV of external debt/GDP

The PV of external public debt in terms of GDP is estimated at 68 percent as of the end of 2020 and is projected to remain above the prudent threshold of 30 percent until 2027. This is partially driven by ENH's borrowing to finance its equity participation in the LNG megaprojects, and the issuance of a sovereign guarantee to ENH to cover its share in the borrowing package for the Golfinho project. The ratios would drop below the prudent threshold by 2028, as the sovereign guarantee contractually lapses in 2026 (after the start of LNG production).

ii. PV of total debt /GDP

Total public and publicly guaranteed debt amounted to about 110 percent of GDP as of the end of 2019, above the 35 percent threshold, suggesting that the country could be on the verge of debt distress.

iii. PV of external debt/exports

After worsening in 2020, the PV of external public debt in terms of exports is expected to gradually decline, albeit above the 140 percent prudent threshold, until 2023. It would improve rapidly thereafter, as LNG exports pick up over the long term.

iv. External debt service/exports

The estimate for debt service to exports is 25.5 in 2020, above the maximum threshold of 15 percent, and is forecast to stay in breach until 2024, when the ratio should decline to 14.8 percent.

An assessment of Mozambique's debt based on the above-mentioned debt sustainability indicators suggests that the country is debt distress. The risks of a further deterioration of the country's debt sustainability profile are tilted to the downside, especially considering the deterioration of fiscal outlook associated with both the COVID-19 pandemic downturn and rising insecurity.

OPPORTUNITIES FOR BANK SUPPORT

Mozambique's development aspirations outlined in its National Development Strategy (2015 -2035) seek to improve living conditions and alleviate poverty through structural transformation and increased diversification of sources of growth and trade. The country's long-term development strategy is fully aligned with the Bank's current strategy, which is underpinned by a number of key pillars, including intra-African trade and industrialization. This offers opportunities to the Bank to further enhance its relevance by supporting implementation of the country's development strategy through various programs and facilities.

Opportunities for development financing and investment in Mozambique are broad-based, including in the financial industry and the manufacturing and agro-processing industries and their related infrastructure. According to the African Development

Bank, the country's annual infrastructure financing gap is estimated at US\$1.7 billion over the coming decade. In the manufacturing sector, to boost value-addition and local content, the Afreximbank's financing could scale up the capacity of Mozambique's light manufacturing and agro-processing industries and deepen agricultural and natural gas value chains to accelerate local enterprises' integration into regional and global value chains.

Achieving these goals will require improvement in infrastructure – particularly transport infrastructure such as logistics, port, railways, and roads – to enhance mobility and connectivity, which will facilitate access to local and regional markets. It will also require development of the electrical power system. In addition to supporting the expansion of hard physical infrastructure, the Bank could fund the development of industrial parks (IPs) and special economic zones (SEZs), to accelerate the process of industrialization.

Table 1. Mozambique Selected Macroeconomic and Financial Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021(f)
Real GDP, %	7.0	7.4	6.7	3.8	3.7	3.4	2.3	-0.5	2.1
Inflation, annual average, %	4.3	2.6	3.6	19.9	15.1	3.9	2.8	3.1	5.3
Exports of goods and services, % y/y	1.63	-0.73	-2.94	-2.81	2.02	3.31	3.50	-9.1	10.0
Current account, % of GDP	-40	-38.8	-35.3	-25.9	-16.2	-22.8	-20.2	-27.3	-24.8
Total reserves, US \$ millions	3,142	3,222	2,582	2,081	3,361	3,104	3,888	3,598	3,830
Gross reserves, months of imports	4.4	4.86	4.09	5.28	4.59	4.58	5.12	5.1	–

Sources: World Bank, IMF, Afreximbank research.

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