

Mozambique

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MOZAMBIQUE - REPOSITIONING IN THE INTERNATIONAL ARENA (BRIEF ASSESSMENT OF OUR VISIT)

Paula Carvalho

Email: paula.goncalves.carvalho@bancobpi.pt

Telef.: 21 310 11 87

- ⚡ Mozambique registered a remarkable performance in the last decade, reaching an average GDP expansion close to 7.2%, outperforming their peers in the region. Since the period of domestic conflict ended, the country has also achieved considerable progresses in human development indicators - increased access to water and health care, reduction in child mortality and extreme poverty - as well as in business climate indicators. The success in the implementation of stabilization macroeconomic policies, the capacity to attract foreign direct investment boosting economic growth and the aid granted by international donors allowed the country to gradually improve its economic profile, laying the ground for the resurgence of a stronger private economic sector. However, despite comfortable economic growth pace in the last decade, the country maintains a significant dependence from external donations (although gradually diminishing) and the progress in reducing poverty and improving peoples' living standards has been slowing down and become more difficult to achieve.
- ⚡ 2011 marked a turning point for Mozambique, as some of the investment projects in the mineral resources sector initiated their production and the country started to export coal. In the near future, the economy will probably continue to expand close to 6%-7% as projects in the coal extraction area increase gradually their production (although constrained by transport infrastructure bottlenecks) and eventually other natural resources recently discovered begin to be explored. That is the case of natural gas, as vast reserves have been recently discovered in the north of the country. If present estimates are correct, Mozambique will be one of the major international players in the energy sector with the fourth largest reserves in the world, fact that will boost economic growth potential. The country is already attracting the attention of major international energy groups, and forecasts of foreign direct investment inflows in the next decade are being revised upwards, suggesting that the country's positioning in the international economic arena will change significantly in the near future.
- ⚡ Despite perceived low political risk, high growth potential and significant investment opportunities in almost every economic sector, the success is still not guaranteed as much will depend on how authorities will manage proceeds derived from the natural resources exploitation. Will Mozambique manage to escape the natural resources curse or Dutch disease and be able to implement a strategy that rescues development and inclusive growth? That is still uncertain but it is possible to recognize authorities' efforts in the several areas of public administration to avoid worst-case scenarios and take advantage of the present window of opportunity. Significant challenges can be identified, including the inexistence or poor infrastructures and resources in transports, energy, sanitation, health care and several other areas; the lack of skilled labor force, especially in mining, civil and mechanics engineering, but also in health and education areas; the need to broaden the fiscal base so that the megaprojects contribute more to internally generated revenues, allowing the decrease in the dependence from external donations and credit; the investment in human resources, with particular emphasis to the youngest, not only in urban but also in rural areas, granting that the domestic citizens become involved in the country's economic progress. This is critical to achieve sustainable economic development and growth, particularly when future economic growth will be based particularly on the exploitation of non-renewable natural resources.



Mozambique - Saint Sebastian Fortress in Mozambique Island

Research Department

Cristina Veiga Casalinho
Paula Gonçalves Carvalho
Carmen Mendes Camacho
Teresa Gil Pinheiro

Chief Economist

TECHNICAL ANALYSIS
Agostinho Leal Alves

Tel.: 351 21 310 11 86 Fax: 351 21 353 56 94

Email: deef@bancobpi.pt
<http://www.bpiinvestimentos.pt/Research>

<http://www.bancobpi.pt>
<http://www.bfa.ao>

1. GENERAL ASSESSMENT AND MAIN RISKS AHEAD

Within the regular monitoring of Mozambique's economy, a BPI team was back in Maputo three years after our previous visit. While in Maputo, we had the opportunity to share some views with local authorities, representatives of the private sector and faculty. This is our first account of what's going on in the country and will be followed by our regular report on the country that will include more detailed information.

Our general assessment is positive as big improvements are quite apparent, even in every day life, starting with the new international airport where conditions for visitors are far better than in the recent past. Streets are cleaner and the city is bursting with traffic, the hotels are full and the international flights overbooked. Furthermore, it is possible to identify people from all over the world, from North Americans, Nordic, Japanese and other Asians (the last bank to enter the market has capital from Vietnam) to Brazilians and Portuguese.

From the viewpoint of international investment, Mozambique is a country thriving with numerous business opportunities, particularly considering the growth potential in almost every economic sector. It is not only the natural resources sector that attract interest but also agriculture and forestry, industry, construction and services (tourism, business related services such as accounting and consulting, etc). Despite perceived low political risk and the potential economic growth in the forthcoming future, there are still **very significant challenges facing authorities, and general society.**



- **Expected growth should benefit all the population and inter-generational partition should** also be considered - The wording "inclusive economic growth" is one of the most common expressions heard nowadays both in the media and also from authorities and market players. Newspapers run frequent articles on the subject, conferences and open debates are being held and the Government is in close talks with several experts trying to put in place a more global plan and set of measures intended to avoid the "Dutch disease" or "resources' curse". In this framework, demography is by itself a challenge: in 2010, 45% of the population was less than 15 years old; unemployment is high (OECD estimates 27%) and most of the population lives in the informal sector.

Demographic structure in 2010

Age Group	Population	%
0-14 anos	10,170	45%
15-24	4,347	19%
25-34	3,033	14%
35-44	2,071	9%
45-54	1,289	6%
55-64	816	4%
>65	691	3%
Total	22,417	-

Source: INE.

- **Inequalities and governance problems?** - A part of the society claims that there are increasing inequalities, that transparency and governance has been worsening, that poorest and rural population in general are not benefiting from the new investments in the minerals sector, social inclusion and employment is not being promoted, that education is not advancing with the desired pace and quality. Some of these issues should be related with the problem of lack education of human resources, even for unskilled jobs, including at the level of relationship skills and personal organization, the so-called "soft skills". The need for greater transparency, particularly with regard to the involvement of political leaders in business matters (eg, setting rules and boundaries similarly to examples already tested in other countries) should also be strengthened.

- **Lack of skilled labor force** - This is one of the major limitations mentioned by entrepreneurs and private sector representatives. The labor-specialized local labor is scarce - especially in the areas of mining engineering, mechanical, civil, among others - leading to some competition among the largest organizations / companies, which struggle for the most qualified local staff. This limitation reflects on the one hand, the existing supply in terms of areas of specialization, which until very recently favored areas of the humanities rather than technology; the preference of students; teaching quality, especially at primary and secondary levels of education. It should be noted that in 2010 only 6% of university students were enrolled in Engineering, and Construction Industry, by contrast, 30% and 45% were studying Education Social Sciences, Management and Law.
- **Poor or non-existing infrastructure** - roads are in poor conditions, railways have small capacity and there is not a proper North - South connection so that most of the times it is cheaper to import goods from South Africa than to bring them from northern provinces, where economic activity is more oriented towards agriculture; electricity only covers 36% of the country; and access to water and sanitation is still exclusive of a very small part of the population, namely the ones living at provincial capital cities. The availability of facilities and equipment in the health sector is still scarce: in 2006 existed 12 central hospitals throughout the country, that number shrank to 11 in 2010 (2 in Maputo city, and one in each of the other provinces); the number of health centers, external consultations and deliveries increased, as well as total staff in the NHS, but this increase was mainly registered at the level of staff with basic functions, elementary or general support. In fact, people with higher roles (doctors) went from 737 to 1426, one doctor for every ten thousand inhabitants, and even the personnel with medium functions, nurses, is still scarce, three per ten thousand inhabitants.

National Health Indicators

	2006	2010	Change	per 1000 inhabitant
Employees on NHS	16,983	33,402	97%	1.5
Superior	737	1426	93%	0.1
Medium	2643	6588	149%	0.3
Central Hospitals	12	11	-1	-
Rural Hospitals	37	43	6	-
Health Centres	777	1047	270	-
External medical consultations	20,676,201	26,185,269	27%	-
Deliveries/Births	435,222	623,702	43%	-

Source: INE.

Development Indicators

	2007	2011	Change
Life expectancy at birth (years)	50.9	52.4	1.5
Infant mortality (per thous.live births)	93.6	86.2	-7.4
Illiteracy Rate	-	50.4	-

Source: INE.

So, despite considerable opportunities, Mozambique authorities, the society and people in general are also facing particularly heightened challenges in order to achieve sustainable and inclusive growth in the long run. The confirmation of existing oil reserves in the North of the country, though very favorable from a purely economic perspective, would increase these challenges and pressures will definitely intensify.

2. RECENT DEVELOPMENTS

In the last couple of years Mozambique's position in investors' radar has changed considerably. Not many years ago it was seen especially as one of the best examples of the positive results of macroeconomic stabilization policies in post-conflict countries. During the last two decades, since the civil war ended, the country has benefited from the aid of developed economies, either via direct grants, through debt relief or via credit lines conceded by international organizations with favored conditions (EIB, IMF, etc). Meanwhile, with the advice of international organizations, particularly the World Bank and the International Monetary Fund, the Government has put in practice a set of policy measures in order to gradually reduce the dependence on external donations, including policies to reduce poverty, promote development and revive the private sector, increase transparency and accountability. **These policies included the adoption of a set of measures designed to attract foreign direct investment, together with a favorable fiscal framework and other attractive conditions, which at that time had been set in order to compensate external investors of significant political and economic risk, in the years after the conflict ended.** The biggest of the so called megaprojects, and one of the first to initiate activities in the country was Mozal, the aluminum smelter, that is still responsible for a significant part of Mozambique's exports - close to 50% of goods exports in the last two years. Overseas exports with origin in megaprojects accounted for 73% of total in 2011 while imports due to megaprojects activity represented roughly 37% of total Mozambique's imports.

In the last five years the situation changed significantly as new reserves of natural resources have been discovered or confirmed, attracting

the attentions of international investors coming particularly from the new emerging market biggest economies', specifically China, Brazil and India. Indeed, **apart from water, precious metals' including gold, and forestry, Mozambique has significant reserves of coal (considered to be one of the largest in the world), natural gas off-shore in the Northern province of Cabo Delgado (if present estimates are correct, Mozambique will have the fourth largest reserves in the world) and probably oil in the Rovuma basin.** Last year marked a turning point for the country, as the first big megaprojects in the mineral resources sector initiated their activities and the country started to export coal. Considering the vast natural resources of Mozambique, the country is strategically well positioned **to supply the highly expanding emerging markets of Brazil, India and China, countries that have been increasing their relationship with Mozambique. The way local authorities manage yield revenues expected from the world scale natural resources should be fundamental to dictate the future of the country and its probabilities to achieve sustainable and inclusive growth and development.**

3. THE COAL AND NATURAL GAS SECTORS - A WINDOW OF OPPORTUNITY TO RESHAPE MOZAMBIQUE ECONOMIC AND SOCIAL STRUCTURE

The sector of mining and quarrying represents only circa 1.5% of GDP while the energy weight is close to 5%. However, these sectors are expected to keep expanding more than 10% per year, according to OECD. **The new reserves found in the minerals and extractive sectors as well as the natural gas exploration might change the position of the country in the world economic arena in a decisive way in the next decade.** In short, the present and expected future situation in the coal and natural gas areas are the following:

Coal - The Government has granted 112 licenses to national and non-resident companies during the last two years. In 2011, coal output reached 1 million tones (mt); in 2012 coal production is projected to increase to 5.93 mt, reaching in the long run 110 mt per year according to OECD estimates, as long as the necessary infrastructure is provided.

The main players in the sector are:

- o Vale, a Brazilian company that invested circa 1.7 bln USD in the Moatize mine; announced investment of USD 6 bln in order to expand capacity from 11 mt/y to 26 mt/y in 2014.
- o Rio Tinto, an Australian company; took control of 22 exploring licenses, including 65% of the Benga mining project. Combined production estimates amount to 25 mt/y by 2016.
- o Beacon Hill, a British company, that exported the first coal last December (circa 11 mt), using trucks to the port of Beira due to the Sena railway saturation.
- o Jindal Power and Steel of India should start operations before year end.

However, evidence points to constraints in the sector caused by railway and ports capacity that is already weighing on present production (EIU estimates that installed capacity stands at proximately 40 mt/y). The more viable way of transport coal from Tete, where the major coal reserves are located, is through the Sena railway and the Beira port with a capacity to handle close to 6 mt/y. A new rail line is already being constructed through Malawi and should link Tete to the Nacala port with capacity to larger vessels.

Electricity - The country's coverage is still small; only around 35% of the territory has electricity so far, which is still a significant constraint for the development of any economic activity. Indeed, even for telecommunications companies this is a constraint as there are already parts of the territory that are covered by mobile communications but do not have electricity. Last November the Government launched the CESUL project, a consortium formed by several companies, including the Portuguese REN, EDM - the electricity company of Mozambique, ESKOM from South Africa, Eletrobrás from Brazil and EDF, whose main purpose is to construct a regional transmission line, to assure the distribution of electricity from the hydro dams located in the North (Cahora Bassa and Mpanda Nkuwa) to the southern part of the country. It will involve an investment of around USD 2 bln.

Gas - The discovery of extensive off-shore reserves of natural gas has been one of the main economic developments in Mozambique in 2011. Indeed, according to OECD, **if present estimates prove to be correct, Mozambique will have the fourth largest reserves of natural gas in the world**, behind Russia, Iran and Qatar. Last September Anadarko Petroleum announced findings in Area 1 block of 623 trillion cubic metres of gas; ENI, the Italian oil company, found an estimated 424 trillion cubic metres of reserves. According to observers, the extension of the reserves found justify the construction of a large liquefied natural gas (LNG) plant in Mozambique. **This particular finding, that until now has had low impact on economic activity, might completely change the whole economic and human development of Mozambique in the middle to long run.**

4. THE MACROECONOMIC SCENARIO AND THE MAIN CHALLENGES AHEAD

Having in mind this global picture, some of the conclusions we have taken after our visit are the following:

□ **One of the biggest challenges that authorities face in the next couple of years is to enlarge the country's fiscal base,** with the aim to generate more revenue internally and reduce dependence from abroad: grants and credit provided by international organizations still account for round 40% of the fiscal budget. An enhanced capacity of the State to collect revenues is essential for several reasons. First, it is fundamental to tackle the infrastructural deficit, that is constraining the development of other sectors and whose investment needs involve very large amounts of funds; it is also needed to promote inclusive growth, reduce poverty and generally fulfill the goals set in the Government's Action Plan to Reduce Poverty (PARP 2011-14) whose focus last year has been set at: increased agricultural production; promotion of employment linked to small and medium sized companies development; investment in human and social development. **It should be recognized that the initial circumstances that were behind the favorable conditions obtained by international investors in the so-called megaprojects - on account of high economic and political risk - are no longer in place, as Mozambique has already a tracking record of economic stability and success in policy implementation.** So, it is justifiable that contract conditions are revisited, rethought, so that the yields coming from natural resources exploration, most of them non-renewable, can contribute to meet social, economic and human development needs of the country. This can be done via increased taxation - megaprojects historically contributed with less than 1 p.p. of GDP to fiscal revenue (in 2011, according to Budget execution, megaprojects accounted for 3.5% of total State revenue) - particularly increased royalties on the mining sector and future natural gas exploration investments. There are not definite conclusions from the part of authorities on the subject. **Government officials just declare they are studying all possibilities and assessing the several options. International donors are also paying a lot of attention to any evolution on this regard, specifically helping the authorities to consider forms of making growth more inclusive** - the Norwegian advice with their one case and experience is an example; the Danish authorities are also involved and pushing for a more inclusive growth, supporting some civil movements that take several initiatives on this area and helping to bring the discussion to the ordinary citizen.

□ **In the next couple of years, Mozambique's economy will probably continue to expand above 6% to 7%. However, the growth potential seems to be much larger** (some of our contacts suggest even double digit figures, 14%-15%) **and present projections might be conservative and still cautious, waiting for definite official positions in some aspects regarding natural resources exploration.** It should be recalled that the country registered an average expansion of 7.2% in the last decade, outperforming their peers in the region. Government projections point to 7.5% GDP expansion in 2012; the IMF is more prudent expecting 6.7% growth mostly due to possible credit restraint reflecting commercial bank's policies giving some restrictions mother institutions are facing at home; the Economist Intelligence Unit, which is typically cautious or even pessimistic on their assumptions, expects that the economy expands on average 8% in the next couple of years reflecting the boom in the mining sector. Finally, the OECD, that recently published its African Economic Outlook, expects 7.5% growth for 2012 and 7.9% in 2013. This is the more recent and updated projection.

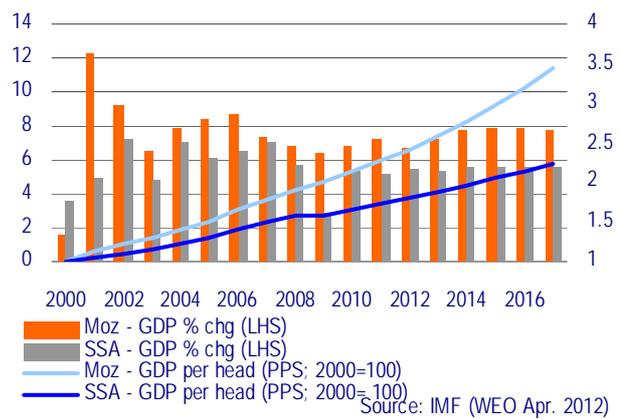
Macroeconomic Forecasts

	2010	2011(e)	2012(p)	2013(p)
OECD - May 2012				
Real GDP growth	6.8	7.2	7.5	7.9
Real GDP per capita growth	4.5	5.0	5.2	5.6
CPI inflation	12.7	10.8	7.2	5.6
Budget balance % GDP	-4.0	-3.3	-6.8	-7.4
Current account % GDP	-12.1	-25.6	-25.5	-20.0
IMF - April 2012				
Real GDP growth	6.8	7.1	6.7	7.2
Real GDP per capita growth	4.7	5.0	4.7	5.1
CPI inflation	12.7	10.4	7.2	5.6
Budget balance % GDP	-4.0	-4.9	-6.3	-6.0
Current account % GDP	-11.7	-13.0	-12.7	-12.4
Economist Intelligence Unit - May 2012				
Real GDP growth		7.2	8.0	8.5
Real GDP per capita growth		n.a.	n.a.	n.a.
CPI inflation		10.4	8.0	7.0
Budget balance % GDP		-3.8	-3.5	-3.3
Current account % GDP		-11.9	-16.5	-16.1
Government - Ministry of Finance - May 2012				
Real GDP growth	6.5	7.2	7.5	n.a.
Real GDP per capita growth	4.6	3.1	n.a.	n.a.
CPI inflation	12.7	10.4	7.2	n.a.
Budget balance % GDP	-6.1	-5.7	-7.4	-5.3
Current account % GDP	-8.9	-14.2	n.a.	n.a.

Source: OECD, IMF, EIU, Ministry of Finance (2011 Budget Execution Report and 2012 Budget)
Note: Budget and Current Account Balances include grants from international donors.

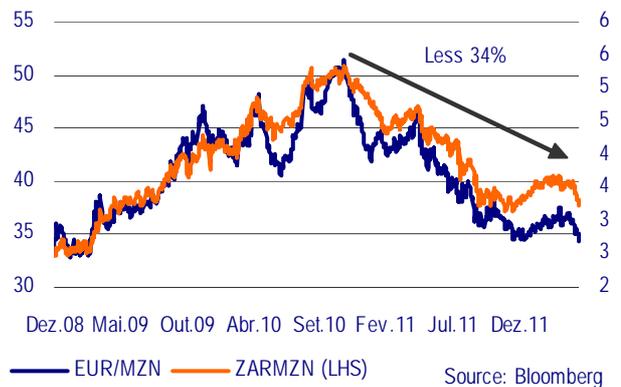
Concerning growth prospects on a longer horizon (IMF projects 7.8% from 2014 to 2014) it should be said: first, that **growth in the next couple of years should be downward impacted by significant import needs related to megaprojects' investments**, even before they came afloat and start to add to growth; this is already incorporated in the several scenarios available; secondly, **according to IMF simulations, the new investment projects in the mineral and also energy sectors should propel the economy's potential growth rate in about 2 p.p to 4 p.p.** The extent of the full impact will also depend on the authorities' success in developing a strong private sector outside the megaprojects area; on the Government resolve on providing a proper infrastructural and social network (namely, transport, sanitation, health and social transfers for the most vulnerable); results will also be dependant on authorities determination on guarantying a fair distribution of the natural resources revenues amongst several generations, particularly for resources that are non-renewable.

Gross Domestic Product - history and prospects



Government intends to keep inflation at single digit levels, purpose that is also important considering the unrests that took place in September 2010, whose main cause was the increase in prices of basic consumption items, such as bread and transports. For 2012, the IMF projects average inflation to stand at 7.2% while EIU anticipates that it could even fall to lower levels due to the forecasted decline in international food prices. Indeed, Mozambique imports almost all consumer goods from South Africa and the European Union, meaning that domestic prices are particularly subject to volatility in international food and energy prices as well as to the exchange rate. Concerning the domestic currency, the metical (MZN) has been on an appreciating trend since end 2010 - it appreciated round 34% against the euro. **Interest rate increases to fight domestic inflation and strong FDI inflows are the main factors behind the metical's trend:**

Foreign Exchange Evolution



according to the Bank of Mozambique, historically annual FDI inflows stood at around USD 800 million, while last year it reached USD 2 bln. Although the monetary policy stance has changed since August 2011, when the central bank first cut key interest rates, the metical has persisted strong against the more relevant currencies, the euro, the dollar and the rand, although the trend has been gradually abating. Expectations for continued pressure coming from strong FDI inflows - EIU expects inflows of around EUR 90 bln in the next decade, level that is being revised upwards every month - and the effort to control inflation should keep the currency at strong levels although the Central Bank should try to moderate this trend in order to stimulate domestic production, that has been losing competitive advantage for international suppliers, particularly South Africa.

Political risk in Mozambique is perceived to be low although there is some discomfort given the presence of Frelimo, the dominant party, in almost every sector of economic activity and some claims that corruption has been rising. In last general elections held in 2009, the President Armando Guebuza won 75% of the votes, while Renamo's leader, Mr. Dhlakama had 16% of the ballot. In National Parliament elections, Frelimo won by an overwhelming majority and obtained 191 seats while Renamo gained 49 seats and the new political force, Movimento Democrático de Moçambique, of Mr. Davis Simango, that was authorized to concur only in four circles, reached only 8 places. **Mr Guebuza has already declared that he does not intend to stand for re-election in 2014**, (which would only be possible with a change in Constitution rules, as the President has a maximum of two four-year terms). However it is possible that more news are known in this subject next October, when Frelimo will held its congress. Prime Minister, Mr Aires Ali, is one of the natural candidates but every possibility is still open. Anyway, the presence of big multinationals, international players, huge investment projects essential for the country's economic growth, also play an important role in guarantying that political environment will be kept stable.

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BANCO BPI. S.A.

Rua Tenente Valadim, 284
Telef.: (351) 22 207 50 00

4100 - 476 PORTO
Telefax: (351) 22 207 58 88

Largo Jean Monnet, 1 - 9º
Telef.: (351) 21 724 17 00

1269-067 LISBOA
Telefax: (351) 21 353 56 94