EAGLESTONE SECURITIES

The Mozambican Economy

Revised budget to face new economic backdrop

Research
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Economics
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Economic activity to expand at slowest pace since the year 2000
The Mozambican government cut its real GDP growth forecast for this year to 4.5% from a previous estimate of 7% and the 6.6% recorded in 2015. This is the slowest growth rate expected since the year 2000 when economic activity expanded at 1.7%. In its revised budget for 2016 (recently approved in the country's Parliament), the government also anticipates that average inflation will climb to 16.7% this year. This is significantly higher than the 5.6% estimated in the initial budget presented at the end of last year and the 3.6% seen in 2015. The local authorities highlighted that the amendments done to the 2016 budget resulted from several headwinds (both on the domestic and international fronts) that the Mozambican economy is facing this year.

Government includes "safety net" in the budget for possible surprises
The newly revised budget incorporates (1) lower expected government receipts and spending, (2) lower budget support following the suspension of disbursements from international donors, (3) higher debt service payments due to the depreciation of the metical and (4) significantly higher domestic financing. Overall, total revenues were revised downwards by 6.2% while expenditures were only reduced by a very modest (and surprising) 1.1% from the initial budget. This is due to a large increase in "other current expenditures", which according to the government are related to possible surprises that can occur in the months ahead, namely in terms of disbursements of donor partners and debt guarantees by the State. Meanwhile, grants are expected to stand 26.6% lower than previously expected and represent less than 10% of the total receipts.

Expenditures cut on all economic and social sectors except healthcare
Estimated capital expenditures saw a downward revision of 9.4% this year, as the government expects to cancel new projects that have not yet been initiated in 2016, namely the construction, repair and refurbishment of public buildings. The local authorities are also expected to cut public spending in several infrastructure projects such as roads and bridges. In terms of expenditures by economic and social sector, healthcare is apparently the only sector that is spared from the government's more restrictive spending plans. Overall, total expenditures by sector were lowered by 6.8% and are expected to represent 63% of total public spending excluding interests and net lending.

Deficit (ex-grants) to reach 11.3% of GDP (vs. prev. estimate of 10.2%)
Overall, the revised budget deficit forecast (before grants) is 11.7% higher than the previous estimate and represents 11.3% of GDP. After grants, it stands at 8.7% of GDP. This compares with previous forecasts of 10.2% and 6.6%, respectively. The government plans to finance the 2016 budget with higher domestic receipts, namely through a significant increase in domestic financing that is expected to nearly triple when compared with the initial budget proposal. Tax revenues will continue to cover the largest share of the government's financing needs while external receipts are expected to be impacted by the much lower grants received.

REVISED BUDGET (2016)

Mozambique's National Parliament approved the government's revised budget proposal for 2016 this week. The local authorities highlighted several reasons that led to this amendment. On the international front, these include (1) slower global economic growth than initially expected, (2) lower international trading volumes, (3) a fall in the prices of Mozambique's main exporting products and (4) lower capital flows into emerging and developing markets.

Mozambique's Parliament has approved a revised budget document for 2016

Domestically, the government stated that the changes to the 2016 budget resulted from a more adverse economic environment that includes (1) a lower economic growth projection for this year, (2) a deterioration in the current account, which is impacting the metical exchange rate, (3) higher average inflation and (4) lower international reserves. Specifically, the authorities cut their real GDP growth forecast for this year to 4.5% from a previous 7% while the average inflation rate was raised to 16.7% from 5.6%. International reserve estimates were lowered to US$ 1.2 billion, representing 3 months of imports.

The government mentioned several reason that led to this amendment, both on the domestic and international fronts

MACRO ASSUMPTIONS	2015		2016	
	Budget	Real	Initial Budget	Rev. Budget
Nominal GDP (MZM million)	594,645	589,294	680,487	686,718
Real GDP Growth	7.5%	6.6%	7.0%	4.5%
GDP per Capita (MZM)	23,152	23,641	25,753	25,989
Average Annual Inflation	5.1%	3.6%	5.6%	16.7%
Int. Reserves (US$ billion)	4.5	1.9	2.3	1.2
Int. Reserves (months of imports)	4.1	3.8	4.3	3.0
Exports (US$ million)	4,188	3,415	3,643	3,214
Population (million)	25,728	25,042	26,424	26,424

(1) September 2015; (2) November 2015. Source: Mozambican authorities.

In terms of the budget itself, the new economic backdrop led the Mozambican authorities to (1) lower the level of expected government proceeds and spending, (2) lower the level of budget support due to the suspension of disbursements, (3) increase the level of debt service payments due to the depreciation of the metical and shorter debt maturities and (4) significantly increase the level of domestic financing to cover the budget deficit.

The revised budget includes lower revenues and expenditures, lower donor support, higher debt service payments and higher domestic financing

This means that (1) total revenues were revised downwards by 6.2% to MZM 165,541 million (24.1% of GDP), (2) grants are 26.6% lower than previously expected (MZM 18,193 million, or 2.6% of GDP) and (3) expenditures were cut by a modest 1.1% to MZM 243,358 million (35.4% of GDP). Overall, the revised budget deficit forecast (before grants) rose 11.7% to MZM 77,817 million, representing 11.3% of GDP. The budget deficit after grants increased to 8.7% of GDP. This compares with previous forecasts of 10.2% and 6.6% of GDP, respectively, as shown below.

The revised budget deficit (before grants) stands at 11.3% of GDP and at 8.7% of GDP after grants

STATE BUDGET				Change			% of GDP		
Million MZM	2015	Initial Budget (2016) (1)	Revised Budget (2016) (2)	(1) / 2015	(2) / 2015	(2) / (1)	2015	Initial Budget (2016)	Revised Budget (2016)
Revenues	155,893	176,409	165,541	13.2%	6.2%	-6.2%	26.5%	25.9%	24.1%
Grants	18,677	24,800	18,193	32.8%	-2.6%	-26.6%	3.2%	3.6%	2.6%
Expenditures	200,491	246,070	243,358	22.7%	21.4%	-1.1%	34.0%	36.2%	35.4%
Deficit (before Grants)	**-44,598**	**-69,661**	**-77,817**	**56.2%**	**74.5%**	**11.7%**	**-7.6%**	**-10.2%**	**-11.3%**
Deficit (after Grants)	**-25,920**	**-44,861**	**-59,625**	**73.1%**	**130.0%**	**32.9%**	**-4.4%**	**-6.6%**	**-8.7%**

Sources: Ministry of Finance and Eaglestone Securities.

The revised revenue forecast figures show that the government now expects lower tax proceeds namely from taxes on goods and services. These are now expected to come 9.2% below the initial projected figure, although they are still forecasted to improve 11.1% from 2015. This is anticipated to more than offset a more favorable contribution from income tax revenues, which in the revised budget are projected to be 3.7% higher than previously expected and increase 11.5% YoY. All in all, income tax and tax on goods and services are expected to account for 9.4% and 10.8% of GDP, respectively. Meanwhile, other assigned revenues were cut by nearly a third from the initial estimate and are expected to fall by 28% from the previous year. As mentioned above, the projection for total revenues was cut by 6.2% from the initial budget and is now expected to represent 24.1% of GDP (vs. 25.9% previously).

The government now expects lower tax revenues, namely from taxes on goods and services

REVENUES Million MZM	2015	Initial Budget (2016) (1)	Revised Budget (2016) (2)	Change (1) / 2015	Change (2) / 2015	Change (2) / (1)	% of GDP 2015	% of GDP Initial Budget (2016)	% of GDP Revised Budget (2016)
Tax Revenues	129,657	151,433	144,450	16.8%	11.4%	-4.6%	22.0%	22.3%	21.0%
Income Tax	57,919	62,262	64,596	7.5%	11.5%	3.7%	9.8%	9.1%	9.4%
Tax on Goods & Services	67,036	82,056	74,467	22.4%	11.1%	-9.2%	11.4%	12.1%	10.8%
Other Tax Revenues	4,702	7,116	5,388	51.3%	14.6%	-24.3%	0.8%	1.0%	0.8%
Non-Tax Revenues	11,981	10,240	9,869	-14.5%	-17.6%	-3.6%	2.0%	1.5%	1.4%
Capital Revenues	3,097	3,187	3,187	2.9%	2.9%	0.0%	0.5%	0.5%	0.5%
Other Revenues	11,158	11,549	8,034	3.5%	-28.0%	-30.4%	1.9%	1.7%	1.2%
Total Revenues	**155,893**	**176,409**	**165,541**	**13.2%**	**6.2%**	**-6.2%**	**26.5%**	**25.9%**	**24.1%**

Sources: Ministry of Finance and Eaglestone Securities.

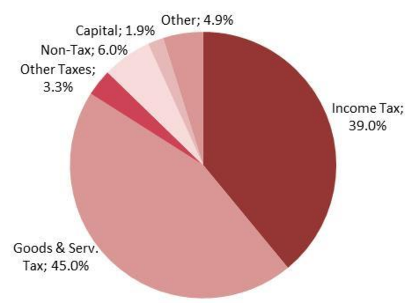
Income tax and taxes on goods and services account for most of the government proceeds

The revenue breakdown shows that receipts from income tax and taxes on goods and services account for most of the total proceeds. In particular, income tax is expected to stand at 39% of the total revenues and taxes on goods and services to account for 45% of the total this year. This is slightly higher than the figures recorded in 2015, namely 37.2% and 43%, respectively.

Grants are expected to account for just 9.9% of the total government proceeds this year (vs. 34.9% of the proceeds in 2009)

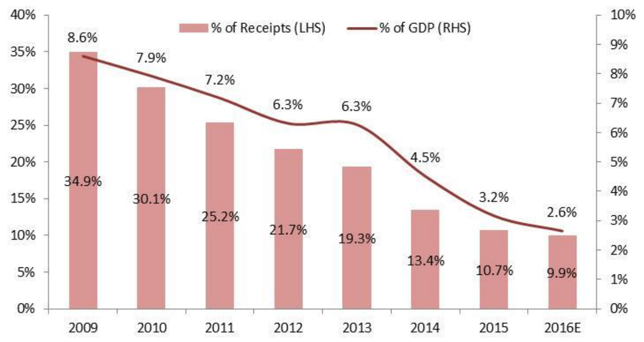
Revenues are also anticipated to represent 90.1% of total government receipts (if excluding domestic and external financing) and grants to account for just 9.9%. This compares with a breakdown of 89.3% and 10.7%, respectively, last year. However, looking further back to 2009, for instance, one can see that the weight of grants as a percentage of receipts (excluding financing) has gradually decreased from 34.9% of the total to the current 9.9% expected. This is also clearly evident when looking at this indicator as a percentage of GDP (grants are seen falling from 8.6% of GDP in 2009 to 2.6% this year).

TOTAL REVENUE BREAKDOWN (2016E)



Sources: Ministry of Finance and Eaglestone Securities.

EVOLUTION OF GRANTS (2009-16E)



Sources: Ministry of Finance and Eaglestone Securities.

The government is only expected to cut public spending by 1.1% from its previous estimate

Meanwhile, the revised budget document also suggests that the government is only expected to cut its total spending by 1.1% from its previous estimate for this year. Total expenditures are now expected to increase 21.4% from 2015 and account for 35.4% of GDP this year. This very modest downward revision in total spending, which in large part comes as a surprise, is due to higher expected current expenditures namely "other current expenditures" which are forecasted to increase more than fivefold from its prior estimate. According to the government, this strong increase was due to the fact that there are figures that have not yet been incorporated and may surprise in the months ahead. These include the disbursement of donor partners, which we recall were suspended in the first half of 2016, as well as debt guarantees by the State.

The revised budget also includes higher spending on debt payments and current transfers

The revised budget also includes higher than initially estimated expenditures on debt payments (possibly related to Ematum's debt, which was restructured earlier this year into sovereign debt) and current transfers. On the other hand, the local authorities have lowered their estimates for staff costs and spending on goods and services, as detailed below.

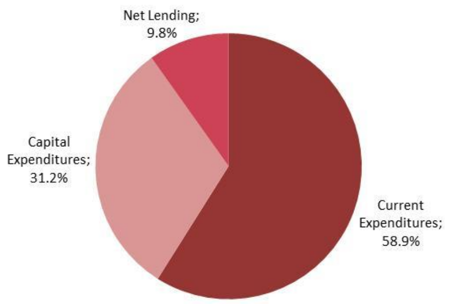
EXPENDITURES				Change			% of GDP		
Million MZM	2015	Initial Budget (2016) (1)	Revised Budget (2016) (2)	(1) / 2015	(2) / 2015	(2) / (1)	2015	Initial Budget (2016)	Revised Budget (2016)
Current Expenditures	117,836	136,159	143,412	15.5%	21.7%	5.3%	20.0%	20.0%	20.9%
Staff Costs	64,299	71,308	70,089	10.9%	9.0%	-1.7%	10.9%	10.5%	10.2%
Goods and Services	22,512	28,966	24,804	28.7%	10.2%	-14.4%	3.8%	4.3%	3.6%
Debt Payments	7,622	12,500	15,122	64.0%	98.4%	21.0%	1.3%	1.8%	2.2%
Current Transfers	19,860	19,297	21,346	-2.8%	7.5%	10.6%	3.4%	2.8%	3.1%
Subsidies	2,213	2,121	942	-4.2%	-57.4%	-55.6%	0.4%	0.3%	0.1%
Other	1,329	1,967	11,107	48.0%	735.6%	464.7%	0.2%	0.3%	1.6%
Capital Expenditures	64,078	83,866	76,015	30.9%	18.6%	-9.4%	10.9%	12.3%	11.1%
Domstically Financed	42,677	41,339	28,870	-3.1%	-32.4%	-30.2%	7.2%	6.1%	4.2%
Externally Financed	21,400	42,527	47,145	98.7%	120.3%	10.9%	3.6%	6.2%	6.9%
Net Lending	18,577	26,046	23,932	40.2%	28.8%	-8.1%	3.2%	3.8%	3.5%
Total Expenditures	**200,491**	**246,070**	**243,358**	**22.7%**	**21.4%**	**-1.1%**	**34.0%**	**36.2%**	**35.4%**

Sources: Ministry of Finance and Eaglestone Securities.

All in all, current expenditures are now expected to account for 58.9% of total government spending, capital expenditures 31.2% and net lending 9.8%. In terms of the breakdown of current expenditures, we note that staff costs are still expected to account for nearly half of this type of spending, despite the lower estimated figure this year.

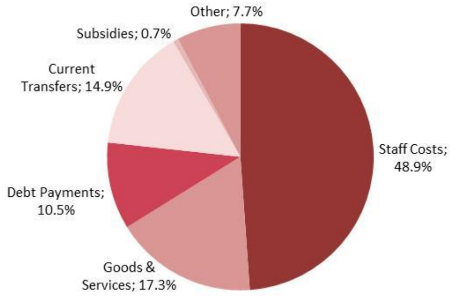
Current expenditures are expected to account for 58.9% of total government spending

TOTAL EXPENDITURES BREAKDOWN (2016E)



Source: Ministry of Finance.

CURRENT EXPENDITURES BREAKDOWN (2016E)



Source: Ministry of Finance.

Also worth highlighting is the 9.4% downward revision in capital expenditures this year, as the government expects to cancel new projects that have not yet been initiated in 2016, namely the construction, repair and refurbishment of public buildings. The authorities are also expected to cut public spending in several infrastructure projects such as roads and bridges.

Capital expenditures have been revised downwards as new projects are expected to be canceled

The table below shows the newly estimated expenditure levels by economic and social sector. Healthcare is apparently the only sector that is spared from the government's austerity plans, with its spending revised upwards by 10.6%. However, total expenditures by sector are expected to be cut by 6.8% from their initial projection, but still advance 26% from 2015. The government still expects to allocate the most funds to education (34.5% of the total) followed by infrastructures (27.1%). All in all, total spending by sector is expected to represent 63% of total expenditures if excluding debt payments and net lending.

Education remains the largest beneficiary in terms of spending by economic and social sectors

EXPEND. BY SECTOR					% of Total Expend. by Sector		
Million MZM	2015	Initial Budget (2016) (1)	Revised Budget (2016) (2)	(2) / (1)	2015	Initial Budget (2016)	Revised Budget (2016)
Education	41,815	45,801	44,400	-3.1%	40.8%	33.2%	34.5%
Healthcare	18,399	21,608	23,896	10.6%	18.0%	15.6%	18.6%
Infrastructures	21,592	40,895	34,951	-14.5%	21.1%	29.6%	27.1%
Roads	15,044	28,725	23,986	-16.5%	14.7%	20.8%	18.6%
Water and Public Works	4,582	9,138	8,303	-9.1%	4.5%	6.6%	6.4%
Mineral Resources & Energy	1,967	3,033	2,661	-12.2%	1.9%	2.2%	2.1%
Agriculture	11,366	19,892	16,218	-18.5%	11.1%	14.4%	12.6%
Judicial System	4,238	4,272	3,943	-7.7%	4.1%	3.1%	3.1%
Social Work & Employment	5,035	5,648	5,337	-5.5%	4.9%	4.1%	4.1%
Total Expenditures by Sector	**102,445**	**138,116**	**128,744**	**-6.8%**	**100.0%**	**100.0%**	**100.0%**
% of Total Expenditures (*)	*53.1%*	*66.6%*	*63.0%*				
Total Expenditures (*)	**192,914**	**207,525**	**204,304**	**-1.6%**			

(*) Excluding Interests and Net Lending. Sources: Ministry of Finance and Eaglestone Securities.

The Mozambican government plans to finance this year's budget with higher domestic receipts (77% of the total), namely through a significant increase in domestic financing that is expected to nearly triple when compared with the initial budget proposal. This is expected to represent 8.9% of the total, significantly higher than the 3.1% initially projected and the 4.3% reported last year. Tax revenues will continue to represent the bulk of the government's financing needs, accounting for 59.4% of the total receipts. External receipts (23% of the total) are expected to be impacted by much lower grants received, with external financing forecasted to remain relatively unchanged at 15.6% of the total receipts.

The government plans to finance its budget through a significant increase in domestic financing

RECEIPTS & EXPEND.				% of Total			% of GDP		
Million MZM	2015	Initial Budget (2016)	Revised Budget (2016)	2015	Initial Budget (2016)	Revised Budget (2016)	2015	Initial Budget (2016)	Revised Budget (2016)
Receipts:									
Domestic Receipts	**165,025**	**184,029**	**187,309**	**76.9%**	**74.8%**	**77.0%**	**28.0%**	**27.0%**	**27.3%**
Tax Revenues	129,657	151,433	144,450	60.4%	61.5%	59.4%	22.0%	22.3%	21.0%
Other Revenues	26,236	24,976	21,091	12.2%	10.1%	8.7%	4.5%	3.7%	3.1%
Domestic Financing	9,132	7,620	21,768	4.3%	3.1%	8.9%	1.5%	1.1%	3.2%
External Receipts	**49,677**	**62,042**	**56,043**	**23.1%**	**25.2%**	**23.0%**	**8.4%**	**9.1%**	**8.2%**
Grants	18,677	24,800	18,193	8.7%	10.1%	7.5%	3.2%	3.6%	2.6%
External Financing	31,000	37,242	37,850	14.4%	15.1%	15.6%	5.3%	5.5%	5.5%
Total Receipts	**214,702**	**246,071**	**243,352**	**100.0%**	**100.0%**	**100.0%**	**36.4%**	**36.2%**	**35.4%**
Expenditures:									
Current Expenditures	**117,836**	**136,159**	**143,411**	**58.8%**	**55.3%**	**58.9%**	**20.0%**	**20.0%**	**20.9%**
Capital Expenditures	**64,078**	**83,866**	**76,015**	**32.0%**	**34.1%**	**31.2%**	**10.9%**	**12.3%**	**11.1%**
Domestic	42,677	41,339	28,870	21.3%	16.8%	11.9%	7.2%	6.1%	4.2%
External	21,400	42,527	47,145	10.7%	17.3%	19.4%	3.6%	6.2%	6.9%
Net Lending	**18,577**	**26,046**	**23,932**	**9.3%**	**10.6%**	**9.8%**	**3.2%**	**3.8%**	**3.5%**
Total Expenditures	**200,491**	**246,070**	**243,358**	**100.0%**	**100.0%**	**100.0%**	**34.0%**	**36.2%**	**35.4%**

Sources: Ministry of Finance and Eaglestone Securities.

Disclaimer

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Disclosures

Eaglestone was founded in December 2011 with the aim to be a committed partner for the development of businesses located primarily in Sub-Saharan Africa and to support the development of renewable energy projects on a global basis.

The company has three business activities - financial advisory services, asset management and brokerage - and currently has offices in Amsterdam, Cape Town London, Lisbon, Luanda and Maputo

Eaglestone is committed to operating and behaving according to the highest standards of corporate governance. Its subsidiary in the United Kingdom is authorized and regulated by the Financial Conduct Authority.

Eaglestone operates with a clear vision and mission to act on behalf of and in the best interests of all its stakeholders, whether they are investors, employees or users of its services.

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