The Mozambican Economy

Soft landing in 2015-16

Research
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Economics
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Existing headwinds hurt short-term growth

Mozambique's long-term prospects remain upbeat largely as a result of the natural gas projects expected to come on-stream later this decade. Local officials reportedly expect more than US$ 30 billion will be invested initially in the sector, with the first exports of LNG due to start no sooner than in 2020. This is huge for a country whose GDP stands at more than half of that amount. However, Mozambique is currently facing several headwinds that will likely prevent it from expanding at the rates witnessed in the last decade (7.4% average). These include (1) a sharp decline in commodity prices, namely aluminum and coal (Mozambique's main exports) and (2) lower foreign direct investment in the country. Overall, economic growth is expected to slow to 6-6.5% this year and next (from 7.2% in 2014). It is worth noting however that, despite the expected deceleration, this forecast remains well above the 4.1% average growth that the IMF foresees for Sub-Saharan Africa in 2015-16.

Inflation is picking up after a sharp depreciation of the metical

The latest consumer price data showed that inflation is gradually picking up after recording a constant downward trend in recent years. This has been mostly felt in the food and non-alcoholic beverages segment, with prices in other items going up very modestly in 2015. The inflation rate surged to 6.27% YoY in November while the 12-month average stood at 2.83%. It compares with 1.93% and 2.56%, respectively, at end-2014. Prices are expected to remain under pressure in the foreseeable future chiefly due to the sharp depreciation of the metical against other currencies like the US$ (58%) and the ZAR (20%) this year. On the other hand, foreign reserves have fallen markedly in recent months. In 2015, the local authorities have faced (1) higher external debt payments, (2) the absence of capital gains in the extractive industry, as no noteworthy transactions have existed so far this year, (3) lower disbursements from foreign donors and (4) deteriorating external accounts.

Higher budget deficit puts pressure on external debt position

The budget execution report for the 9M 2015 period showed a lower execution rate for revenues (68.7% of the yearly target vs. 75.8% in 2014) and much lower capital expenditures (-40% YoY, with execution rate of 37.2%), with the latter due to delays in implementing projects expected for 2015. Overall, the budget deficit (after grants) has fallen 32% YoY to MZM 10,823 million (or US$ 210 million), which represents an annualized deficit of 2.4% of GDP. This compares with the 2015 budget target of a deficit of 7.5%. Meanwhile, the budget proposal for 2016 was recently presented to Parliament. The government expects real GDP growth of 7% and average inflation of 5.6% next year, which we believe to be on the optimistic side. It also foresees a deficit (before grants) of 10.2% of GDP and 6.6% (after grants), lower than the figures projected for 2015. Although the government is still planning to finance the majority of its expenditures with fiscal receipts (58% of the total), it is worth noting that public debt levels are expected to increase significantly from the levels seen in recent years. In particular, external debt is projected at 65.7% of GDP this year and 58.3% in 2016 (much higher than the 41.6% in 2014). The increasing concerns about the sustainability of the country's external debt position have reportedly been behind the downgrades in Mozambique's rating by the main agencies throughout 2015.

ECONOMIC ACTIVITY

Economic activity in Mozambique is slowing this year. The latest data released by the National Statistics Bureau (INE) showed that real GDP expanded at a more modest 5.9% YoY in 2Q15. This is well below the growth rates seen in the previous four quarters, which averaged 7.4%. It is also significantly below the government's forecast of 7.5% for this year recently disclosed in its budget 2016 proposal.

Economic activity slowed to 5.9% YoY in 2Q15, below the average of 7.4% in the previous four quarters

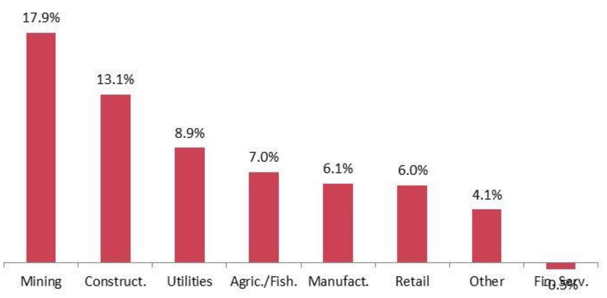
The mining and construction sectors remained the main growth drivers of the economy in the period April-June 2015, improving 17.9% and 13.1%, respectively, from the same period of 2014. Although mining still accounts for a small share of the country's GDP structure (3.7%), it has been responsible for a significant part of the foreign direct investment that has entered Mozambique in recent years. Large investments have initially been made in the coal sector, but more recently attentions have turned to the vast natural gas reserves in the Rovuma basin, in the north of the country. This has boosted other sectors such as construction, utilities and real estate. All in all, Mozambique is currently a more diversified economy, but it remains highly dependent on the agriculture sector, which still accounts for nearly a third of its GDP.

Mining and construction were the main growth drivers

REAL GDP GROWTH (1Q12-2Q15)

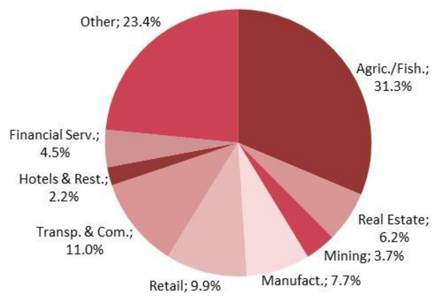
Source: National Statistics Bureau (INE).

REAL GDP GROWTH BY SECTOR (2Q15)



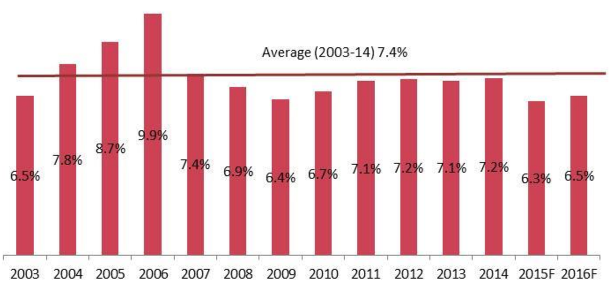
Source: National Statistics Bureau (INE).

GDP STRUCTURE (2Q15)



Source: National Statistics Bureau (INE).

REAL GDP GROWTH (2003-16F)

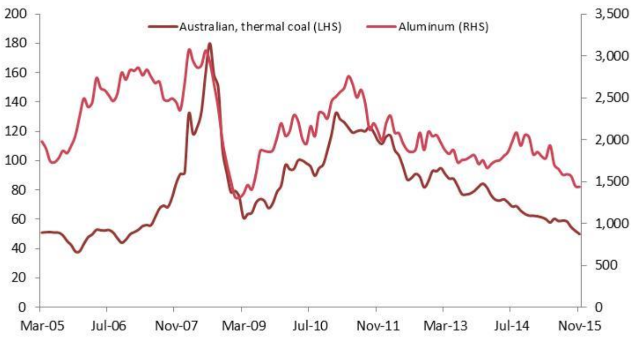


Source: National Statistics Bureau (INE), IMF and Eaglestone Securities.

Mozambique's long-term economic outlook remains upbeat largely as a result of the natural gas projects expected to come on-stream later this decade. Local officials reportedly expect more than US$30 billion will be invested initially in this sector to build capacity to produce 20 million tons per year of liquefied natural gas (LNG), with first exports due to start no sooner than in 2020. This is huge for a country whose GDP currently stands at more than half of that amount. However, Mozambique currently faces several headwinds that will most likely prevent it from expanding at the rates witnessed of the last decade. These include (1) a significant drop in commodity prices, namely aluminum and coal (its main exports) and (2) a deceleration in foreign direct investment in the country. We believe both the prices of these two commodities, which together represent about 40% of Mozambique's exports, and foreign direct investment are not expected to see a material recovery in the foreseeable future.

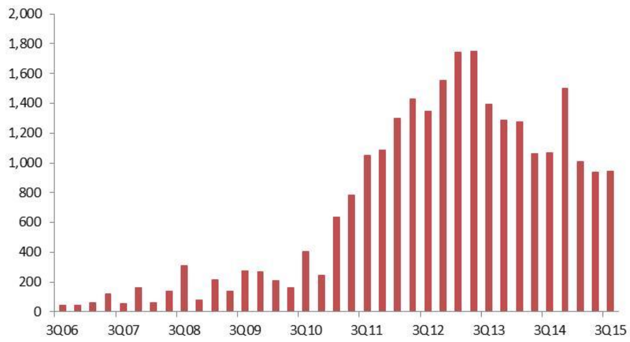
Mozambique's long-term economic outlook remains upbeat, but in the short-term growth prospects are likely to face some headwinds

ALUMINUM AND COAL PRICES (US$ / METRIC TON)



Source: World Bank.

FOREIGN DIRECT INVESTMENT (US$ MILLION)



Source: Central Bank of Mozambique (BM).

Overall, we estimate real GDP growth of around 6-6.5% this year and next (down from 7.2% in 2014) and for economic activity to accelerate thereafter. This means that growth could pick-up to nearly 8% in 2017-19 on the back of the anticipated investments in the natural gas projects in the Rovuma basin. Mozambique could benefit from international loans like the ones recently agreed with the IMF (US$ 286 million over an 18-month period) to help bring some stability to the economy following the sharp drop in commodity prices and the European Union (US$ 740 million over the next five years) to support several development projects. However, we believe that short-term risks remain skewed to the downside, as persistently low commodity prices and a weaker global economic outlook could put additional pressure on economic activity in the country.

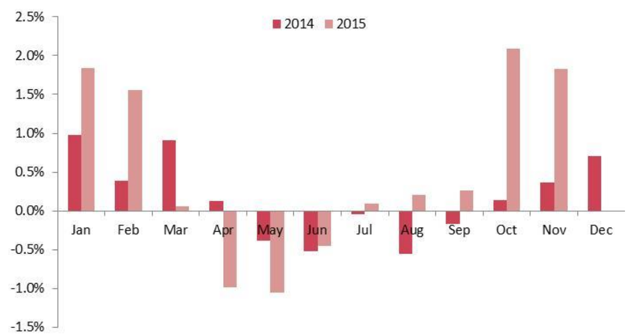
Real GDP growth is expected at 6-6.5% in 2015-16 and to accelerate to around 8% thereafter

INFLATION AND MONETARY POLICY

Data from the INE shows that the consumer price index (CPI) for the cities of Maputo, Beira and Nampula (used as a proxy for the inflation in the country) increased 1.83% in November relatively to the previous month. This figure compares with an already strong 2.1% MoM rise in October, which was the largest monthly increase registered since December 2010. The food and non-alcoholic beverages segment was the one mostly responsible for this increase in consumer prices, as it saw a 1.37% MoM rise in the period. The prices of tomato (14% MoM), electricity (7% MoM) and fresh fish (3% MoM) have all gone up strongly in November.

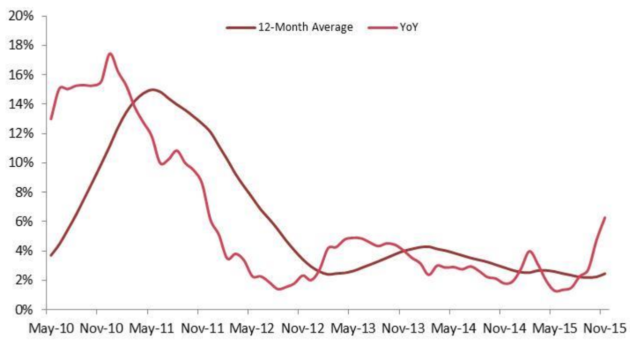
Consumer prices were up strongly once again on a monthly basis in November

CONSUMER PRICE INDEX (MONTHLY CHANGE)



Source: National Statistics Bureau (INE).

CONSUMER PRICE INDEX (12-MONTH AVERAGE AND YOY)

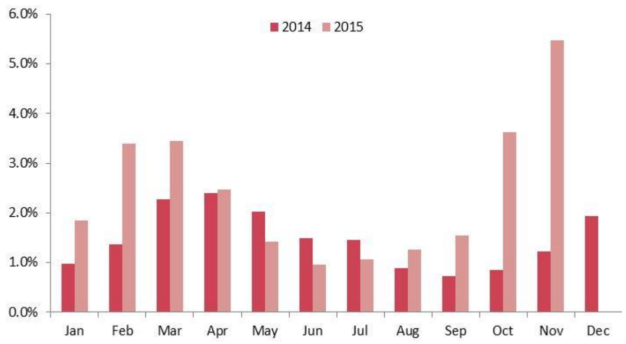


Source: National Statistics Bureau (INE).

Meanwhile, consumer prices rose 6.27% YoY in November while the 12-month average stood at 2.83%. These figures compare with 1.93% and 2.56%, respectively, in December 2014, which suggests that inflation is gradually picking up after recording a constant downward trend in recent years. As depicted in the graph below, the food and non-alcoholic beverages segment has clearly been the strongest contributor to inflation, as it has gone up 3.69% so far this year. On the other hand, the prices of other items have all gone up very modestly in 2015.

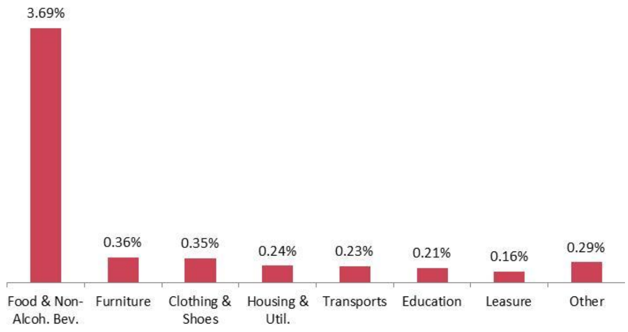
Annual inflation is gradually picking up after recording a constant downward trend in recent years

CONSUMER PRICE INDEX (ACCUMULATED YTD)



Source: National Statistics Bureau (INE).

STRONGEST CONTRIBUTION TO CPI (2015 YTD)

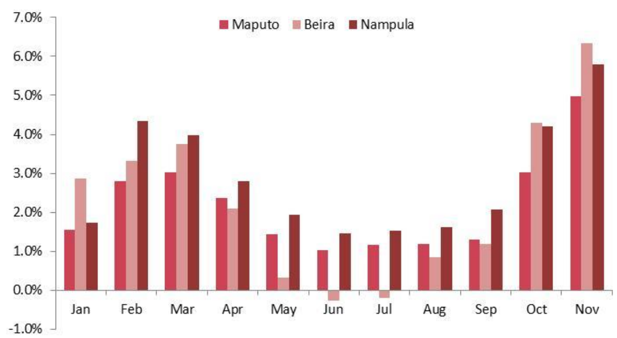


Source: National Statistics Bureau (INE).

Prices were up in the three largest cities of Mozambique, with Beira (2.03%) seeing the largest monthly increase followed by Maputo (1.95%) and Nampula (1.58%). However, out of the 1.83% monthly increase in the country, Maputo had the largest contribution (0.93%) while Nampula and Beira contributed with 0.53% and 0.34%, respectively. On an accumulated basis, Maputo posted an inflation rate of 5.04% so far in 2015 while Beira and Nampula saw 6.37% and 5.86% price increases, respectively. Finally, when compared with October 2014, prices were up 7.89% in Beira, 6.4% in Nampula and 5.71% in Maputo.

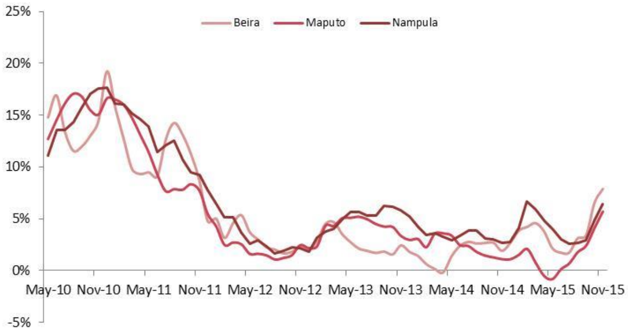
Maputo has recorded an accumulated inflation rate of 5.04% so far this year while Beira and Nampula saw 6.37% and 5.86% price increases, respectively

CPI FOR THREE LARGEST CITIES (ACCUMULATED YTD)



Source: National Statistics Bureau (INE).

CPI FOR THREE LARGEST CITIES (YOY)



Source: National Statistics Bureau (INE).

Consumer prices are expected to remain under pressure in the short-term and going into 2016. We currently expect average annual inflation to increase to 8% in 2016 from an expected 3% this year. Part of this has to do with the significant depreciation of the metical against other currencies such as the US dollar and the South African rand. Specifically, the metical has depreciated 58% against the US$ this year and 20% against the ZAR. A large part of this depreciation (20% and 10%, respectively) has taken place in the last two months alone.

Inflation is expected to increase in 2016 in large part due to the depreciation of the metical

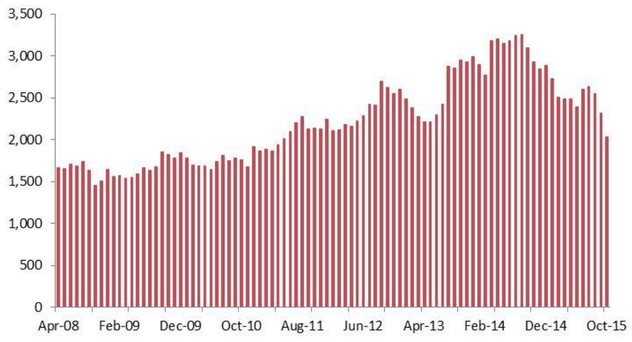
On the other hand, foreign reserves have fallen markedly in the last months, standing at about US$ 2 billion in October and representing about three months of imports. This is down from US$ 2.9 billion at the end of 2014. International reserves have been under pressure in 2015 due to (1) external public debt payments, (2) the absence of capital gains in transactions in the extractive industry (we note that Mozambique netted around US$1.3 billion in capital gains in the period 2012-14), (3) lower disbursements from foreign donors and (4) a deterioration in the country's external accounts (the current account deficit is expected to reach 41% of GDP this year vs. 33.9% in 2014).

International reserves have fallen significantly this year, standing at US$ 2 billion in October (vs. US$ 2.9 billion at the end of 2014)

EXCHANGE RATE (USD/MZN AND ZAR/MZN)

Source: Central Bank of Mozambique (BM).

INTERNATIONAL RESERVES



Source: Central Bank of Mozambique (BM).

The Central Bank has tightened monetary policy in its last two meetings, a move we expect to continue going forward

Meanwhile, the Central Bank has tightened monetary policy in its last two meetings (held in October and November) by raising interest rates and increasing reserve requirements. The Banco de Moçambique increased (1) the overnight lending interest rate by a combined 75bps to 8.25%, (2) the deposit standing facility interest rate by 150bps to 2.75% and (3) the reserve requirements by 250bps to 10.5%. This shift in monetary policy has been overdue and, in our view, should continue going forward bearing in mind the need to protect international reserves and limit the exchange rate depreciation.

It also announced several restrictions in the FX market to contain ensure this market functions in a smooth manner and, also, to contain the depreciation of the metical

The Central Bank also introduced several measures aimed at ensuring that the foreign exchange market functions in a smooth manner and, as the same time, to contain the depreciation of the metical. These measures state that:

- The conversion of import proceeds and offshore investment earnings by banks that were not involved as intermediary banks is strictly forbidden;
- Export proceeds of goods/services and offshore investment earnings shall only be transferred between local bank accounts for the sole purpose of amortizing foreign currency denominated loans within the local banking system;
- Entities authorized to import funds in the form of foreign direct investment or external loans are allowed to keep them in foreign currency in their accounts with intermediary banks;
- The foreign exchange funds mentioned above can only be transacted at the exchange rate of the respective bank;
- Entities authorized to import capital have to specify the commercial bank that will intermediate and assist in the application process for the approval of the Central Bank.

The Banco de Moçambique also limited the use of international cards

Moreover, the Banco de Moçambique announced that it was limiting the use of international cards (that can be used both domestically and internationally) for overseas payments to MZM 700,000 (or about US$ 13,500 at the current exchange rate). This limit is assigned to each card holder regardless of the number of contracts signed with one or more issuers. Exceptions to this limit can occur, but they will need to be evaluated by the card issuers and are subject to the approval from the Central Bank. This measure will come into force on January 1st, 2016.

BUDGET EXECUTION (JANUARY-SEPTEMBER 2015)

According to the budget execution report for 9M 2015, total revenues stood at 68.7% of the targeted figure for the whole of 2015 (vs. 75.8% in 9M 2014)

The Mozambican government recently disclosed its budget execution report for the period January-September 2015. Total revenues amounted to MZM 110,440 million (about US$ 2,140 million at current exchange rates), representing a fall of 4.9% YoY. Revenues stood at 68.7% of the government’s target for the year, which is 7.1% less than the execution rate recorded in the homologous period. Income tax and non-tax revenues saw the highest execution rates in the period while capital and other revenues stood well below expectations. If we annualize the figure for total revenues it would represent 24.5% of the expected GDP for the year (vs. 29% in 2014).

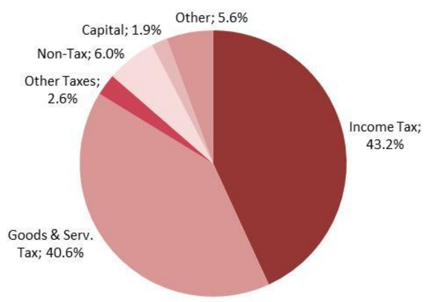
REVENUES	Executed Amount		Execution Rate		2015 vs. 2014		% of GDP (1)	
Million MZM	9M 2014	9M 2015	9M 2014	9M 2015	Executed Amount	Execution Rate	Executed (9M2014)	Executed (9M2015)
Tax Revenues	100,315	93,551	75.8%	70.3%	-6.7%	-5.5%	25.0%	20.7%
Income Tax	50,101	41,685	84.4%	81.1%	-16.8%	-3.4%	12.5%	9.2%
Goods & Services Tax	47,151	47,646	69.8%	63.4%	1.1%	-6.4%	11.8%	10.5%
Other Taxes	3,063	4,220	57.1%	65.7%	37.8%	8.6%	0.8%	0.9%
Non-Tax Revenues	6,999	8,547	74.4%	75.2%	22.1%	0.8%	1.7%	1.9%
Capital Revenues	2,231	1,505	70.0%	47.2%	-32.6%	-22.8%	0.6%	0.3%
Other Revenues	6,558	6,838	79.8%	52.0%	4.3%	-27.8%	1.6%	1.5%
Total Revenues	**116,103**	**110,440**	**75.8%**	**68.7%**	**-4.9%**	**-7.1%**	**29.0%**	**24.5%**

(1) Annualized. Sources: Ministry of Finance and Eaglestone Securities.

A closer look at the revenue breakdown shows that most of the government receipts continued to come from tax related items, namely income tax (37.7% of the total) and goods & services taxes (43.1%). Income tax fell nearly 17% YoY due to a non-recurrent effect related to capital gains in 2014 while taxes on goods & services stood broadly unchanged from the homologous period. Capital revenues fell sharply in the period as a result of a much lower contribution from dividends (-65% YoY), which for the most part reflects the fact that the government received no dividends from Banco de Moçambique (the central bank) and lower proceeds from the state-owned railway company (Caminhos de Ferro de Moçambique).

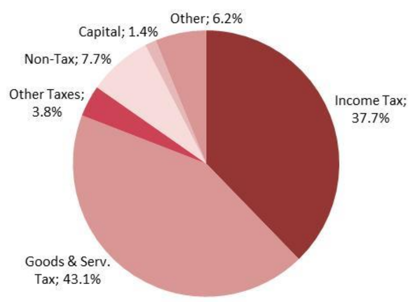
Fiscal revenues (income and goods & services taxes) accounted for most of the government receipts

TOTAL REVENUE BREAKDOWN (9M 2014)



Source: Ministry of Finance.

TOTAL REVENUE BREAKDOWN (9M 2015)



Source: Ministry of Finance.

Meanwhile, the contribution from megaprojects reached MZM 7,611 million in the first nine months of the year (+6.3% YoY) and accounted for 6.9% of total revenues (6.2% in 2014). The largest contribution came from oil exploration related megaprojects, which improved by almost 12% YoY. The energy production sector also performed quite favorably, representing nearly a quarter of the total contribution from megaprojects.

The contribution of megaprojects to total revenues improved during 9M 2015

MEGAPROJECTS	Contribution			% of Total		% Total Revenues	
Million MZM	9M 2014	9M 2015	Change	9M 2014	9M 2015	9M 2014	9M 2015
Energy Production	1,731	1,912	10.5%	24.2%	25.1%	1.5%	1.7%
Oil Exploration	3,319	3,702	11.6%	46.3%	48.6%	2.9%	3.4%
Mineral Resources Exploration	1,696	1,467	-13.5%	23.7%	19.3%	1.5%	1.3%
Other	418	530	26.6%	5.8%	7.0%	0.4%	0.5%
Total	**7,163**	**7,611**	**6.3%**	**100.0%**	**100.0%**	**6.2%**	**6.9%**

Sources: Ministry of Finance and Eaglestone Securities.

On the other hand, the amount of total spending, including net lending, reached MZM 135,152 million (US$ 2,489 million), falling 9.1% YoY. This is just 59.7% of the targeted figure for the year (the same as in 2014), which means that the government will most likely increase its spending levels in the last three months of 2015. Overall, total (annualized) expenditures accounted for 29.9% of GDP (vs. 37.1% in the homologous period).

Total spending executed this year represented 59.7% of the projection for the whole year (the same level as in 9M 2014)

Current expenditures stood at 67.7% of total spending (vs. 57.1% in 2014) and were up 7.8% YoY. It is worth highlighting the strong increases in (1) staff costs, which is explained by the recruitment of new public sector employees this year, namely in the education and health sectors, (2) debt payments from much higher interest owed on external debt and (3) transfer payments, namely to underprivileged families. Moreover, we note the sharp drop of 40% in the

Current expenditures stood at more than 2/3 of total spending executed amount of capital expenditures, as these stood at just 37.2% of the projection for the whole year. The Mozambican government stated that this was due to the fact that in the first four months of this year it had only executed projects included in the 2014 budget.

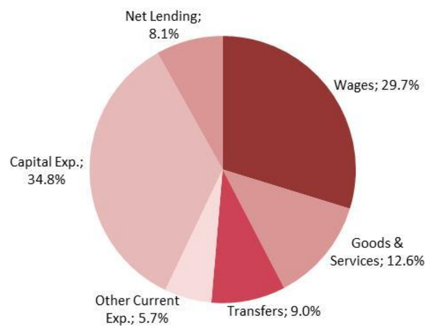
EXPENDITURES	Executed Amount		Execution Rate		2015 vs. 2014		% of GDP (1)	
Million MZM	9M 2014	9M 2015	9M 2014	9M 2015	Executed Amount	Execution Rate	Executed (9M2014)	Executed (9M2015)
Current Expenditures	84,913	91,504	70.1%	76.0%	7.8%	6.0%	21.2%	20.3%
Staff Costs	44,224	50,710	73.3%	79.0%	14.7%	5.6%	11.0%	11.2%
Goods and Services	18,764	17,152	69.6%	69.5%	-8.6%	-0.1%	4.7%	3.8%
Debt Payments	3,689	5,549	60.8%	80.2%	50.4%	19.4%	0.9%	1.2%
Current Transfers	13,380	15,809	72.0%	81.5%	18.2%	9.5%	3.3%	3.5%
Subsidies	1,572	1,579	58.8%	50.0%	0.4%	-8.8%	0.4%	0.3%
Other Current Expenditures	3,283	706	49.4%	35.7%	-78.5%	-13.6%	0.8%	0.2%
Capital Expenditures	51,730	30,972	49.5%	37.2%	-40.1%	-12.2%	12.9%	6.9%
Domstically Financed	27,024	21,364	58.4%	47.6%	-20.9%	-10.8%	6.7%	4.7%
Externally Financed	24,707	9,608	42.4%	25.1%	-61.1%	-17.3%	6.2%	2.1%
Net Lending	12,070	12,676	51.7%	55.4%	5.0%	3.7%	3.0%	2.8%
Total Expenditures	**148,712**	**135,152**	**59.7%**	**59.7%**	**-9.1%**	**0.0%**	**37.1%**	**29.9%**

(1) Annualized. Sources: Ministry of Finance and Eaglestone Securities.

The breakdown of total expenditures is detailed in the graphs below. We highlight the strong increase in the weight that wages represent in total government spending (37.5% vs. 29.7% in 2014) and, at the same time, the sharp drop of capital expenditures (22.9% vs. 34.8% in 2014).

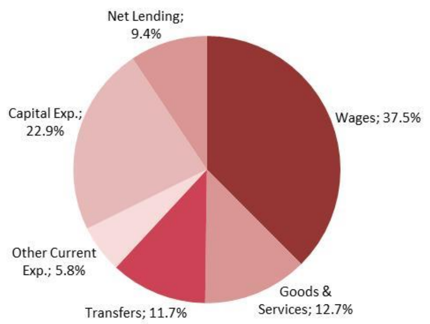
Wages represent a very significant part of total government expenditures

TOTAL EXPENDITURES BREAKDOWN (9M 2014)



Source: Ministry of Finance.

TOTAL EXPENDITURES BREAKDOWN (9M 2015)



Source: Ministry of Finance.

In sum, the budget deficit (before grants) for the first three quarters of the year stood at MZM 24,712 million (US$ 480 million), which is 24.2% lower than in the previous year. If including grants, the deficit would stand at MZM 10,823 million (US$ 210 million), meaning a drop of 32.1% YoY. If we annualize these figures, they would represent a deficit of 5.5% and 2.4% of GDP, respectively. This is comparatively better than in the homologous period.

The budget deficit until September has fallen from the same period of 2014

STATE BUDGET	Executed Amount		Execution Rate		2015 vs. 2014		% of GDP (1)	
Million MZM	9M 2014	9M 2015	9M 2014	9M 2015	Executed Amount	Execution Rate	Executed (9M2014)	Executed (9M2015)
Total Revenues and Grants	**132,767**	**124,329**	**72.4%**	**68.6%**	**-6.4%**	**-3.7%**	**33.1%**	**27.5%**
Total Revenues	116,103	110,440	75.8%	68.7%	-4.9%	-7.1%	29.0%	24.5%
Grants	16,665	13,889	54.8%	67.9%	-16.7%	13.1%	4.2%	3.1%
Total Expenditures	**148,712**	**135,152**	**59.7%**	**59.7%**	**-9.1%**	**0.0%**	**37.1%**	**29.9%**
Current Expenditures	84,913	91,504	70.1%	76.0%	7.8%	6.0%	21.2%	20.3%
Capital Expenditures	51,730	30,972	49.5%	37.2%	-40.1%	-12.2%	12.9%	6.9%
Net Lending	12,070	12,676	51.7%	55.4%	5.0%	3.7%	3.0%	2.8%
Deficit (before Grants)	**-32,610**	**-24,712**	**34.0%**	**37.6%**	**-24.2%**	**3.6%**	**-8.1%**	**-5.5%**
Deficit (after Grants)	**-15,945**	**-10,823**	**24.3%**	**23.9%**	**-32.1%**	**-0.4%**	**-4.0%**	**-2.4%**

(1) Annualized. Sources: Ministry of Finance and Eaglestone Securities.

All in all, total receipts and expenditures reached 65.3% of the targeted figure for 2015. With lower revenues and grants so far this year, the Mozambican government financed its spending by significantly increasing the amount of domestic borrowing (although it still stands at 50% of the annual target). Moreover, the local authorities have also taken advantage of lower spending

The significant fall in capital expenditures so far this year has allowed the government to save more than double the amount of levels, particularly capital expenditures (37.2% of the yearly target), and were able to save MZM 12,609 million in the first nine months of 2015 (more than double the figure of 2014).

the 9M 2014

RECEIPTS/EXPENDIT.	Executed Amount		Execution Rate		% of Total		YoY Chg
Million MZM	**9M 2014**	**9M 2015**	**9M 2014**	**9M 2015**	**9M 2014**	**9M 2015**	**9M**
Receipts:							
Domestic Receipts	**118,625**	**115,040**	**73.5%**	**67.7%**	**77.2%**	**77.9%**	**-3.0%**
Revenues	116,103	110,440	75.8%	68.7%	75.6%	74.7%	-4.9%
Domestic Financing	2,522	4,600	44.1%	50.1%	1.6%	3.1%	82.4%
External Receipts	**35,041**	**32,721**	**39.9%**	**57.9%**	**22.8%**	**22.1%**	**-6.6%**
Grants	16,665	13,889	54.8%	67.9%	10.8%	9.4%	-16.7%
External Financing	18,376	18,832	32.0%	52.2%	12.0%	12.7%	2.5%
Total Receipts	**153,665**	**147,761**	**61.7%**	**65.3%**	**100.0%**	**100.0%**	**-3.8%**
Expenditures:							
Current Expenditures	**84,913**	**91,504**	**70.1%**	**76.0%**	**57.1%**	**67.7%**	**7.8%**
Capital Expenditures	**51,730**	**30,972**	**49.5%**	**37.2%**	**34.8%**	**22.9%**	**-40.1%**
Domestic	27,024	21,364	58.4%	47.6%	18.2%	15.8%	-20.9%
External	24,707	9,608	42.4%	25.1%	16.6%	7.1%	-61.1%
Net Lending	**12,070**	**12,676**	**51.7%**	**55.4%**	**8.1%**	**9.4%**	**5.0%**
Total Expenditures	**148,713**	**135,152**	**59.7%**	**59.7%**	**100.0%**	**100.0%**	**-9.1%**
Change in the Balance	4,953	12,609					154.6%
Receipts & Expenditures	**153,665**	**147,761**	**61.7%**	**65.3%**			**-3.8%**

Sources: Ministry of Finance and Eaglestone Securities.

BUDGET PROPOSAL (2016)

The Mozambican government recently presented its budget proposal for 2016 to the country's Parliament. In the proposal, the authorities plan to center their fiscal policy for next year on (1) increasing and diversifying revenue sources, (2) controlling public spending levels (including wages by only hiring new workers in the education, health and police sectors), (3) concluding ongoing public works, (4) continuing to provide basic social services, (5) prioritizing debt service payments, (6) improving human capital development and (7) promoting a business environment that will foster the development of local enterprises and attract investment.

The government recently outlined its fiscal policy plans for 2016

The document also includes the following macro assumptions for 2016: (1) a real GDP growth rate of 7% and (2) an average annual inflation of 5.6%. These forecasts are the same as the ones expected this year. The government expects economic activity to be boosted by several sectors namely agriculture, extractive industry, manufacturing, electricity, retail and transports and communication.

It expects economic growth of 7% and an average annual inflation of 5.6% next year

MACRO ASSUMPTIONS	2014	2015E	2016E
Nominal GDP (MZM Million)	534,533	602,244	680,487
Real GDP Growth	7.2%	7.0%	7.0%
GDP per Capita (MZM)	21,346	23,408	25,753
Average Annual Inflation	2.3%	5.6%	5.6%
Int. Reserves (Monts of Imports)	4.1	4.0	4.3
Exports (US$ Million)	3,916	3,557	3,643
Population (Million)	25,042	25,728	26,424

Source: Mozambican authorities.

Looking at the figures in the 2016 budget proposal, the government foresees total revenues (ex-grants) will reach MZM 176,409 million and total expenditures MZM 246,070 million. This is roughly US$ 3,615 million and US$ 5,040 million, respectively, at the current exchange rate. It also leads to a projected budget deficit (excluding grants) of MZM 69,661 million, or 10.2% of GDP. If we include the projected grants of MZM 24,800 million for 2016, the budget deficit is forecasted at 6.6% of GDP.

The government forecasts a budget deficit of 6.6% of GDP (including grants) in 2016

STATE BUDGET						Change			
Million MZM	2012	2013	2014	Budget (2015)	Budget (2016)	2013/2012	2014/2013	2015/2014	2016/2015
Total Revenues and Grants	**125,809**	**156,552**	**180,443**	**181,172**	**201,209**	**24.4%**	**15.3%**	**0.4%**	**11.1%**
% of GDP	*29.0%*	*32.5%*	*33.8%*	*30.1%*	*29.6%*				
Total Revenues	98,477	126,319	156,336	160,708	176,409	28.3%	23.8%	2.8%	9.8%
% of GDP	*22.7%*	*26.2%*	*29.2%*	*26.7%*	*25.9%*				
Tax Revenues	84,455	107,543	135,085	133,009	151,433	27.3%	25.6%	-1.5%	13.9%
Non-Tax Revenues	6,036	7,487	9,666	11,360	10,240	24.0%	29.1%	17.5%	-9.9%
Capital Revenues	1,780	3,624	2,887	3,187	3,187	103.6%	-20.3%	10.4%	0.0%
Other Revenues	6,205	7,664	8,698	13,151	11,549	23.5%	13.5%	51.2%	-12.2%
Grants	27,332	30,233	24,106	20,464	24,800	10.6%	-20.3%	-15.1%	21.2%
Total Expenditures	**145,246**	**182,191**	**227,049**	**226,425**	**246,070**	**25.4%**	**24.6%**	**-0.3%**	**8.7%**
% of GDP	*33.5%*	*37.8%*	*42.5%*	*37.6%*	*36.2%*				
Current Expenditures	83,805	95,655	118,470	120,352	136,159	14.1%	23.9%	1.6%	13.1%
Staff Costs	41,592	49,521	59,831	64,441	71,308	19.1%	20.8%	7.7%	10.7%
Goods and Services	14,322	18,859	26,038	24,495	28,966	31.7%	38.1%	-5.9%	18.3%
Debt Payments	4,125	3,970	5,193	6,923	12,500	-3.8%	30.8%	33.3%	80.6%
Current Transfers	13,527	15,398	18,333	19,280	19,297	13.8%	19.1%	5.2%	0.1%
Subsidies	5,240	3,371	2,671	3,157	2,121	-35.7%	-20.8%	18.2%	-32.8%
Other	4,999	4,536	6,404	2,056	1,967	-9.3%	41.2%	-67.9%	-4.3%
Capital Expenditures	53,457	72,301	87,036	83,180	83,866	35.2%	20.4%	-4.4%	0.8%
Domstically Financed	24,927	34,013	45,375	44,881	41,339	36.4%	33.4%	-1.1%	-7.9%
Externally Financed	28,530	38,288	41,662	38,298	42,527	34.2%	8.8%	-8.1%	11.0%
Net Lending	7,983	14,235	21,543	22,894	26,046	78.3%	51.3%	6.3%	13.8%
Deficit (before Grants)	**-46,769**	**-55,872**	**-70,713**	**-65,717**	**-69,661**	**19.5%**	**26.6%**	**-7.1%**	**6.0%**
% of GDP	*-10.8%*	*-11.6%*	*-13.2%*	*-10.9%*	*-10.2%*				
Deficit (after Grants)	**-19,437**	**-25,638**	**-46,607**	**-45,253**	**-44,861**	**31.9%**	**81.8%**	**-2.9%**	**-0.9%**
% of GDP	*-4.5%*	*-5.3%*	*-8.7%*	*-7.5%*	*-6.6%*				

Sources: Ministry of Finance and Eaglestone Securities.

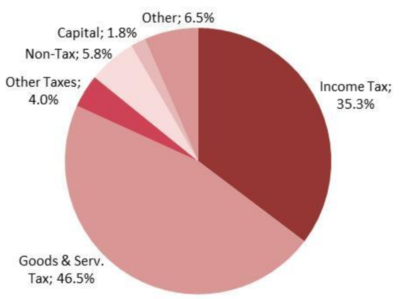
The budgeted figures show that total revenues are projected to see a 10% improvement from the 2015 budget proposal and account for 25.9% of GDP, a slight drop when compared with the 26.7% in 2015. Tax revenues, including income and goods & services taxes, are forecasted to increase 14% and represent 86% of total receipts. Most of this expected improvement is likely to come from higher goods & services taxes, namely VAT (32.4% of total revenues). The government also foresees the amount of grants to improve 21% YoY and account for 3.6% of the projected GDP (roughly the same as in 2015).

Revenues are expected to improve next year, namely tax related revenues like income and goods & services taxes

Regarding expenditures, the government is anticipating to spend 8.7% more than expected in 2015. Still, total spending is forecasted to represent 36.2% of GDP, which is lower than the 37.6% projected in 2015 budget. Current expenditures should see a strong increase, as the local authorities expect to (1) hire new public sector employees in strategic sectors (like education, health and defense) and (2) significantly increase debt payments (namely interest on domestic debt instruments and interest on external debt related to infrastructure investments). They are expected to account for nearly 55% of the government's total expenditures.

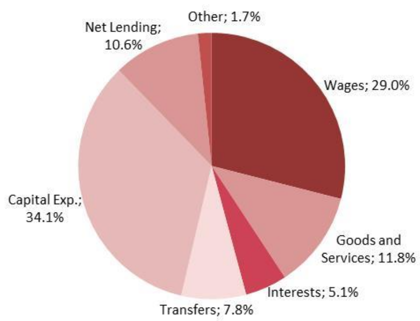
Expenditures are also forecasted to increase, with current expenditures expected to represent nearly 55% of the total spending

BREAKDOWN OF TOTAL REVENUES (2016)



Source: Ministry of Finance.

BREAKDOWN OF TOTAL EXPENDITURES (2016)



Source: Ministry of Finance.

Capital expenditures are projected to remain at the same levels as in 2015, as the drop in domestically financed expenses is offset by a double-digit rebound in externally financed capital expenses. However, when analyzing public investment levels as a percentage of GDP, they are expected to fall from the levels witnessed in recent years.

Capital expenditures are expected to remain flat and represent a lower share of GDP than in recent years

STATE BUDGET	% of GDP				
	2012	2013	2014	Budget (2015)	Budget (2016)
Total Revenues and Grants	**29.0%**	**32.5%**	**33.8%**	**30.1%**	**29.6%**
Total Revenues	22.7%	26.2%	29.2%	26.7%	25.9%
Tax Revenues	19.5%	22.3%	25.3%	22.1%	22.3%
Non-Tax Revenues	1.4%	1.6%	1.8%	1.9%	1.5%
Capital Revenues	0.4%	0.8%	0.5%	0.5%	0.5%
Other Revenues	1.4%	1.6%	1.6%	2.2%	1.7%
Grants	6.3%	6.3%	4.5%	3.4%	3.6%
Total Expenditures	**33.5%**	**37.8%**	**42.5%**	**37.6%**	**36.2%**
Current Expenditures	19.3%	19.8%	22.2%	20.0%	20.0%
Staff Costs	9.6%	10.3%	11.2%	10.7%	10.5%
Goods and Services	3.3%	3.9%	4.9%	4.1%	4.3%
Debt Payments	1.0%	0.8%	1.0%	1.1%	1.8%
Current Transfers	3.1%	3.2%	3.4%	3.2%	2.8%
Subsidies	1.2%	0.7%	0.5%	0.5%	0.3%
Other	1.2%	0.9%	1.2%	0.3%	0.3%
Capital Expenditures	12.3%	15.0%	16.3%	13.8%	12.3%
Domstically Financed	5.8%	7.1%	8.5%	7.5%	6.1%
Externally Financed	6.6%	7.9%	7.8%	6.4%	6.2%
Net Lending	1.8%	3.0%	4.0%	3.8%	3.8%

Sources: Ministry of Finance and Eaglestone Securities.

The education and infrastructure sectors get nearly two-thirds of the total spending

Meanwhile, the government stated that it was allocating MZM 138,116 million to the economic and social sectors next year. This figure is 12.4% higher than the one allocated in 2015. It also represents 66.6% of total expenditures (excluding interests and net lending) planned for next year (vs. 62.5% this year). Education gets a third of the total spending by sector while the infrastructure sector gets nearly 30% of this allocated amount, with most of this going to spending on roads, as described in the table below.

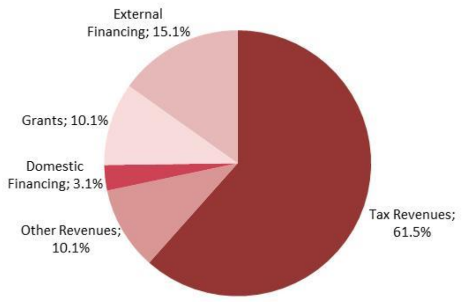
EXPEND. BY SECTOR	Budget			% of Total Expend. by Sector		% of Total Expenditures (1)	
Million MZM	2015	2016	2016/2015	2015	2016	2015	2016
Education	44,745	45,801	2.4%	36.4%	33.2%	22.8%	22.1%
Healthcare	20,132	21,608	7.3%	16.4%	15.6%	10.2%	10.4%
Infrastructures	31,055	40,895	31.7%	25.3%	29.6%	15.8%	19.7%
Roads	17,965	28,725	59.9%	14.6%	20.8%	9.1%	13.8%
Water and Public Works	10,133	9,138	-9.8%	8.2%	6.6%	5.2%	4.4%
Mineral Resources & Energy	2,956	3,033	2.6%	2.4%	2.2%	1.5%	1.5%
Agriculture	15,845	19,892	25.5%	12.9%	14.4%	8.1%	9.6%
Judicial System	4,002	4,272	6.7%	3.3%	3.1%	2.0%	2.1%
Social Work & Employment	7,088	5,648	-20.3%	5.8%	4.1%	3.6%	2.7%
Total Expenditures by Sector	**122,866**	**138,116**	**12.4%**	**100.0%**	**100.0%**	**62.5%**	**66.6%**

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

Public debt (external and domestic) is expected to remain above the levels seen in recent years

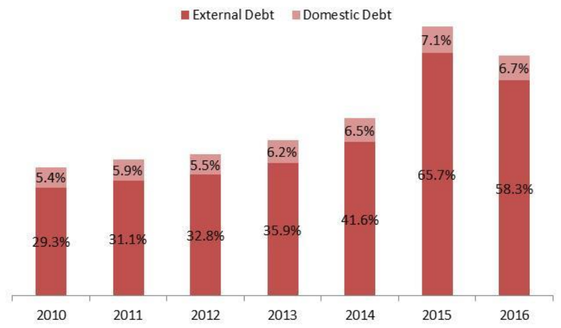
The government is still planning to finance the majority of its expenditures with fiscal receipts (61% of the total). It also expects to continue to borrow (both domestically and internationally). Domestic financing is expected to represent 3.1% of total government receipts while borrowing in overseas market should account for 15.1% of the total in 2016. This is not much different than the levels expected in the 2015 budget. However, it is worth noting that public debt levels are expected to remain significantly above the levels seen in recent years. In particular, external debt is projected to increase from US$ 7 billion at the end of 2014 to an estimated US$ 7.4 billion this year and US$ 7.75 billion in 2016. This means that, after taking into account the exchange rate effect, Mozambique's external debt as a percentage of GDP is expected to surge from 41.6% in 2014 to 65.7% this year and 58.3% in 2016, as depicted in the graph below.

BREAKDOWN OF FINANCING (2016)



Source: Ministry of Finance.

EXTERNAL AND DOMESTIC PUBLIC DEBT (% OF GDP)



Sources: Ministry of Finance and Eaglestone Securities.

S&P's downgraded the rating of the country from "B" to "B-" in July, also placing it on "credit watch"

The increasing concerns about the sustainability of the country's external debt position have been behind the downgrades in the country's rating by the main agencies during 2015. In July, Standard & Poor's downgraded Mozambique's credit rating from "B" to "B-", questioning the governance model in the country and the government's management of public sector debt. This followed the announcement that the government was planning to restructure the state-backed US$ 850 million loan issued back in 2013 to Ematum, a domestic tuna company. The local authorities ended up confirming that the state was responsible for US$ 500 million out of the total issued amount, with the remaining staying with Ematum. S&P's also placed Mozambique on "credit watch", suggesting that it could downgrade its rating further.

Moody's cut the rating to "B2" from "B1" and changed its outlook to "negative"

The following month, it was Moody's turn to lower the country's rating to "B2" from "B1" and change its outlook to negative. The rating agency stated that the key driver behind this decision was the underperformance of the country's fiscal and debt metrics relatively to its peers, which is something that is expected to continue in the medium-term. The negative outlook reflected uncertainties over the local authorities' strategy for covering its increasing external debt payments in foreign currency.

Fitch lowered its rating to "B" from "B+", with a stable outlook

More recently, in October, Fitch lowered Mozambique's rating to "B" from "B+", with a stable outlook. It stated that the country's fiscal profile deteriorated significantly over the past year, reflecting (1) high budget deficits, (2) a rapid rise in public debt, (3) volatile government revenue and (4) a widening wage bill. The rating agency added that the new government is making efforts to control capital expenditures, but fiscal consolidation is expected to be gradual, evidencing in part difficulties in increasing the tax base.

CREDIT RATINGS	Moody's		Standard & Poors		Fitch	
	Old	New	Old	New	Old	New
Rating	B1	B2	B	B-	B+	B
Outlook	Stable	Negative	Negative	Credit Watch	Stable	Stable
Date of change	September 2013	August 2015	February 2015	July 2015	May 2015	October 2015

Sources: Rating agencies.

ANNEX – ECONOMIC FORECAST SUMMARY

ECONOMIC FORECAST SUMMARY	2010	2011	2012	2013	2014	2015F	2016F
Gross Domestic Product							
Real GDP growth	6.7%	7.1%	7.2%	7.1%	7.2%	6.3%	6.5%
Gross Domestic Product (current prices, MZM bn)	345	382	433	482	535	602	680
Gross Domestic Product (current prices, US$ bn)	10.2	13.1	15.3	16.0	17.0	15.1	13.2
Population (million)	22.4	23.0	23.7	24.4	25.0	25.7	26.4
Gross Domestic Product per capita (US$)	453	570	644	657	681	585	500
External Sector							
Exports of Goods (US$ mn)	2,333	3,118	3,470	4,123	3,916	4,188	4,501
Imports of Goods and Services (US$ mn)	3,512	5,368	6,168	8,480	7,952	7,661	8,046
Trade Balance of Goods (% of GDP)	-11.6%	-17.1%	-17.7%	-27.2%	-23.7%	-23.1%	-26.8%
Current Account Balance (% of GDP)	-15.0%	-22.8%	-33.9%	-39.0%	-34.0%	-41.0%	-45.3%
Consumer Price Inflation							
Consumer Prices (period average)	12.7%	10.4%	2.1%	4.2%	2.3%	3.0%	8.0%
Consumer Prices (end of period)	16.6%	5.5%	2.2%	3.0%	1.1%	5.4%	8.0%
Government Accounts (% of GDP)							
Total Revenues	18.4%	21.2%	22.7%	26.2%	29.2%	26.7%	25.9%
Grants	7.9%	7.2%	6.3%	6.3%	4.5%	3.4%	3.6%
Total Expenditures	31.1%	33.5%	33.5%	37.8%	42.5%	37.6%	36.2%
Current Expenditures	17.2%	18.6%	19.3%	19.8%	22.2%	20.0%	20.0%
Capital Expenditures	12.7%	13.4%	12.3%	15.0%	16.3%	13.8%	12.3%
Budget Balance (before Grants)	-12.6%	-12.3%	-10.8%	-11.6%	-13.2%	-10.9%	-10.2%
Budget Balance (after Grants)	-4.7%	-5.1%	-4.5%	-5.3%	-8.7%	-7.5%	-9.3%
External Public Debt	29.3%	31.1%	32.8%	35.9%	41.6%	65.7%	58.3%
Domestic Public Debt	5.4%	5.9%	5.5%	6.2%	6.5%	7.1%	6.7%
Foreign Investment and Reserves							
Net Foreign Direct Investment (US$ mn)	1,018	3,559	5,629	6,175	6,173	4,847	4,706
Net International Reserves (US$ mn)	1,917	2,240	2,605	2,996	2,882	2,125	2,550
Net International Reserves (in months of imports)	5.9	4.5	3.9	3.6	3.4	2.6	3.0
Exchange Rate							
Exchange Rate (period average, US$/MZM)	34.0	29.1	28.4	30.1	31.4	40.0	51.5
Exchange Rate (end of period, US$/MZM)	32.8	27.1	29.5	30.0	31.6	53.5	51.5

Sources: Mozambican authorities, World Bank, IMF and Eaglestone Securities.

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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

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