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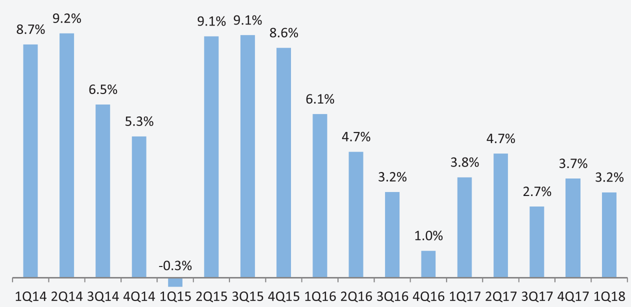
MOZAMBIQUE'S ECONOMIC OUTLOOK REMAINS SUBDUED IN THE FORESEEABLE

Recent Performance

Economic activity in Mozambique has slowed considerably since 2015 chiefly as a result of the sharp decline in commodity prices, namely aluminium and coal (the country's two main exports) and lower FDI. Investor sentiment also deteriorated after the revelation in April 2016 of previously undisclosed public borrowing amounting to nearly US$ 2 billion (about 17.5% of GDP) that lead to donor aid freezes. Real GDP growth decelerated to 3.8% in 2016 (from 6.6% in the previous year) and an estimated 3.7% last year. Despite this hard landing , the country's growth performance remained well above Sub-Saharan Africa's average of 1.4% in 2016 (the region's worst performance in more than two decades) and 2.8% in 2017.

The latest GDP data released by the National Statistics Institute (INE) showed that the Mozambican economy grew 3.2% in the first quarter of 2018 when compared with the same period of last year. This performance was essentially attributable to the robust growth recorded in agriculture and fishing (3.7% YoY), retail (4.7% YoY) and the extractive industry (9% YoY). Agriculture and fishing had the largest contribution to GDP (23.5% of the total) while retail and the extractive industry sector accounted for 11.5% and 5.8% of GDP, respectively.

Real GDP Growth (YoY; 1Q14-1Q18)

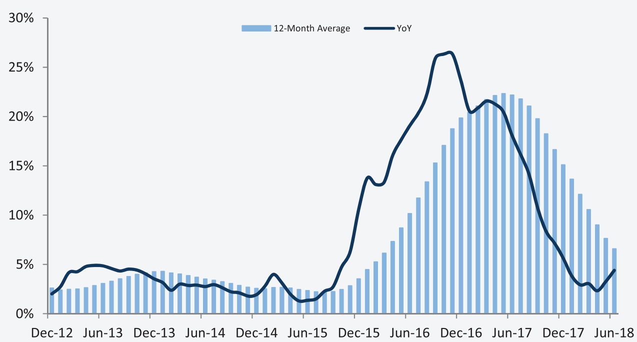


Source: INE.

In terms of the second quarter of 2018, the economic climate index released by the INE (considered a forward indicator of economic activity) showed some signs of stabilization in April and May when compared with the levels recorded in the first three months of the year. This evolution reflected better demand expectations and current employment conditions by the managers that take part in this monthly survey and helped to offset weaker employment and price expectations. By sector, the improvement in the economic climate index was witnessed in retail and other services.

Meanwhile, consumer price data collected throughout the first six months of 2018 for the cities of Maputo, Beira and Nampula showed that accumulated inflation stood at 2.59% in June (vs. 3.82% in the same period of last year). This was mostly due to higher transport prices, which had a contribution of 1.56% (out of the 2.59%), followed by restaurants and hotels (0.48%) and utilities (0.19%). Food and non-alcoholic drinks represent a significant part of the consumer basket and had a negative contribution of 0.15% in the first semester of the year. The annual inflation rate reached 4.40% in June (vs. 3.26% in the previous month) whereas the 12-month average inflation rate kept its downward trend intact, standing at 6.59% (vs. 15.11% in December 2017).

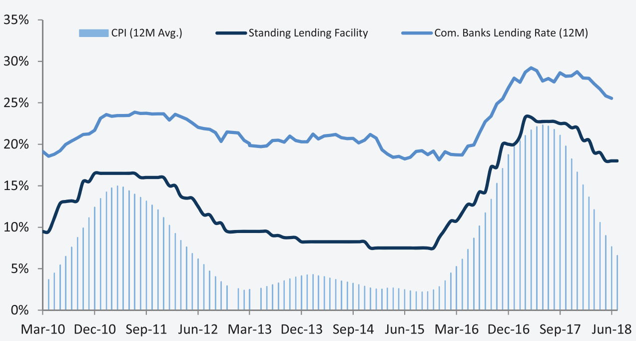
Annual Inflation



Source: INE and Eaglestone Securities.

The latest consumer price data suggest that the central bank's restrictive monetary policy implemented since 2016 proved to be adequate to stabilize the local currency and control inflation. The overnight lending rate was lifted to multi-year highs of 23.25% in early-2017, as inflation remained above 20%. Since then, and also helped by the significant influx of foreign currency from large coal exports, the Metical stabilized and inflationary pressures have receded. This allowed the benchmark interest rate to be gradually lowered to 18% currently. Further monetary policy easing could help support economic activity and partly offset the impact of the fiscal consolidation measures that will have to be implemented in the foreseeable future.

Inflation, Central bank Commercial Banks Rates



Source: INE and Banco de Moçambique.

Indeed, Mozambique has incurred significant fiscal deficits in recent years, averaging close to 5% of GDP during 2010-17 and undermining debt sustainability. According to the IMF, the overall public debt level stood at 102.2% of GDP in December 2017 after reaching 118.8% in 2016. Most of the debt is also external debt (c85% of the total in 2017), which means there is significant risk to currency fluctuations.

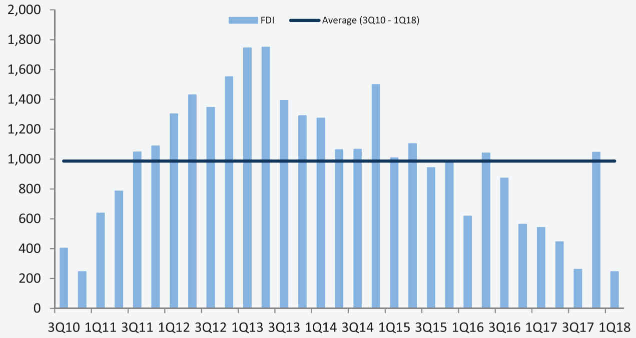
This requires a strong response from the local authorities in terms of implementing fiscal consolidation measures to lower deficits and return public debt to a more sustainable trajectory over the medium-term. In particular, the government stated at the time it released its 2018 budget proposal that it plans to (1) limit the admission of new employees to the public sector, (2) control staff costs and spending on goods and services, (3) postpone some projects like the rehabilitation and construction of public buildings and (4) manage public debt levels. On the latter, it is worth noting that the government met debt holders earlier this year, kicking off what promises to be quite challenging (and likely prolonged) restructuring negotiations judging from the response it received from the majority of the investors. That said, effective steps on this restructuring process remain crucial to restore macroeconomic stability in the country.

On the external front, preliminary trade data show that Mozambique's trade deficit reached US$ 261 million in the first quarter of 2018, down 30% YoY. Both exports and imports rose in the period by 19.7% YoY and 6.0% YoY, respectively. The country mainly exported coal (31.3% of the total) and aluminium (26.3%) whereas imports were more diversified. These included machinery, fuel and cereals (18.6%, 12.5% and 7.4% of the total, respectively). Mozambique's key exporting destinations included India (30.4% of total exports), South Africa (24%) and China (7.1%). On the other hand, the country's main suppliers included South Africa (23.1% of total imports), China (10%) and the Netherlands (9.7%).

Moreover, Banco de Moçambique figures show that FDI inflows have declined sharply since mid-2016, with the exception being the strong recovery in 4Q 2017 that lifted the FDI figure for the last three months of last year closer to the quarterly average of near US$ 985 million recorded since 2010. Specifically, FDI stood at US$ 1,045 million in 4Q 2017 after standing at US$ 541 million, US$ 446 million and US$ 261 million in the three previous quarters, respectively. The most recent figures relate to 1Q18 and show that FDI stood at US$ 245 million in the period, again far below the quarterly average registered in recent years. This sharp fall in FDI levels seen since 3Q 2016 largely reflects the impact that the revelation of the hidden debts in April 2016 had on investor sentiment.

Central bank data also show that nearly 60% of the FDI inflows recorded in recent years have gone to the mining sector followed by transport and communication (10-15%), real estate (5-10%), retail (5-6%) and construction (2-5%).

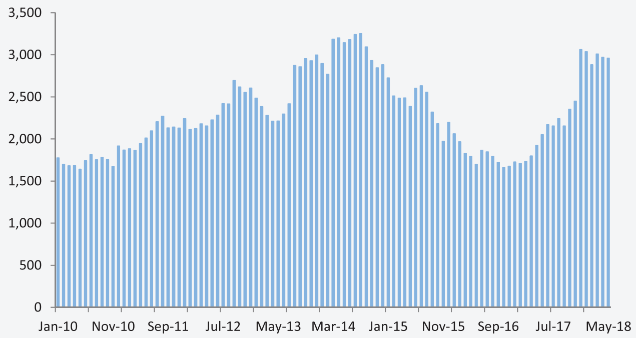
Foreign Direct Investment (US$ Million)



Source: Banco de Moçambique and Eaglestone Securities.

Other data disclosed by the central bank show a strong recovery in net international reserves at the end of 2017 and some stabilization in the first five months of this year. Net reserves stood at US$ 3,062 million in December, up 25% from the previous month and 77% from December 2016, while gross reserves rose to US$ 3,299 million in the same period, enough to cover seven months of imports of goods and services (excluding those of large projects). This compares with three months of coverage at the end of 2016. The sharp increase in the amount of foreign reserves relates to the continued improvement in the country's external position. However, it also reflects the impact of the capital gains tax (estimated at US$ 354.4 million) from the sale of half of Eni's stake in Area 4 of the Rovuma basin to ExxonMobil that was concluded in 2017.

Net International Reserves (US$ Million)



Source: Banco de Moçambique.

Outlook

Mozambique's economic outlook remains subdued in the foreseeable future, with real GDP growth projected to slow down further to around 3% in 2018-19. The agriculture sector and the extractive industry are expected to continue to drive economic activity during this period, benefitting from improved weather conditions and a further expansion in mining and coal exports. The latter should also be supported by a continued recovery in commodity prices.

The country's long-term prospects remain upbeat, however, as a result of the anticipated investments in the natural gas sector in the coming years. The local authorities expect that more than US$ 35 billion will be invested initially in the sector, with the first exports of LNG due to start by the end of 2022. This is huge for a country where GDP currently stands at less than half of that amount.

Mozambique is currently at a crossroad though, as its economic growth perspectives in the next few years remain very much dependent on the outcome of negotiations with debt holders and the normalization of relations with the IMF and other international donors.

The steps taken by the local authorities towards a sustainable peace process in the country and the ongoing developments in the LNG sector are clearly positive for economic activity and investment. Still, they could remain insufficient to reverse the current trend of lower growth that Mozambique has fallen into in recent years.

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Contributor's Profile

Tiago Dionisio is Chief Economist at Eaglestone since 2013 where he covers Portuguese- speaking countries in Africa such as Angola and Mozambique both as a macro and banking sector research analyst. He has over 17 years' experience in investment banking, namely at Portugal's Banco Português de Investimento (BPI) and later at Espírito Santo Investment Bank (ESIB). Before joining Eaglestone, Tiago was part of ESIB's Project Finance team for two years. Prior to that, Tiago was a sell-side analyst covering the main listed Iberian banks for eight years both at BPI and ESIB. Before that, he was a macro research analyst at BPI for three years responsible for covering Portugal, Spain and several Latin America countries, including Brazil and Argentina.