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SOUTH AFRICAN RAND: WHAT IS THE POSSIBLE NEW NORMAL?

HOW INTEREST RATE CAPS SHAPED KENYA'S DOMESTIC DEBT MARKET

MACROECONOMIC PROSPECTS: MOZAMBIQUE, UGANDA

EQUITY MARKETS: KENYA, MAURI-TIUS, NIGERIA, TUNISIA

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MOZAMBIQUE: MACROECONOMIC PERFORMANCE AND PROSPECTS

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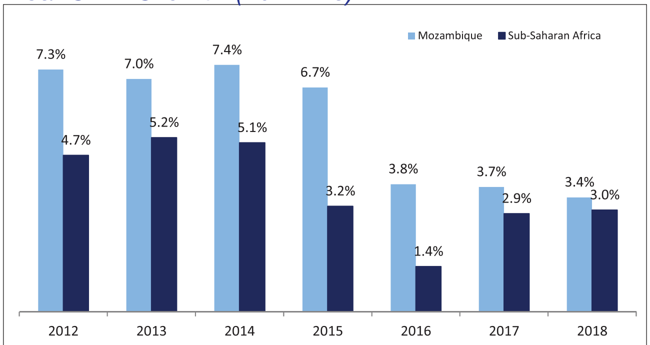
Review of 2018

The Mozambican economy slowed to 3.4% in 2018 from a real GDP growth rate of 3.75% in the previous two years and an annual average of about 6% in the previous decade. This was mainly due to a weaker expansion in the mining industry (10.7% from 32.1% in the previous year), which nevertheless remained the fastest growing sector. Data from the National Statistics Institute (INE) also showed that agriculture (by far the largest sector of the economy representing just over a fifth of the country's GDP) advanced by 3.1% in the period (from 4.0% in 2017). Despite the deceleration in economic activity, the country continued to outperform the average of 3.0% for Sub-Saharan Africa, as the region struggled to recoup from a prolonged deceleration in recent years.

Real GDP Growth (2012-18)



Sources: INE and IMF.

Data from INE also showed that average consumer price inflation declined to 3.91%. This is the lowest figure since end-2015 and compares with 15.1% in the previous year. Prices for the majority of product classes saw very modest increases while the cost of food items and non-alcoholic drinks, which is the largest product class of the consumer price index, remained unchanged from 2017. Lower inflation allowed the Banco de Moçambique, the central bank, to continue easing monetary policy. The reference lending rate (FPC) was cut three times during the year for a total of 325 basis points (bps) (to 17.25%) while the interbank reference lending rate (MIMO) dropped 525bps (to 14.25%) in four rate cuts.

Meanwhile, the country's current account deficit widened significantly to 30.2% of GDP from 20.5% in the previous year. This deterioration was mainly due to a higher deficit in the services and trade balances, with the latter nearly doubling in the period. More positively, foreign direct investment (FDI) in the country saw a sharp recovery when compared with recent years. This was particularly felt in the last three months of 2018 after a recovery in FDI levels in the extractive industry (coal, oil, gas and minerals).

Other central bank data showed that net international reserves stabilized after seeing some downward pressure and volatility for most of 2016-17. Although net reserves were down 7% YoY at US$ 2,844 million in December, they recovered nearly 65% from the levels recorded in end-2016. Gross reserves stood at US$ 3,041 million, enough to cover almost six months of imports of goods and services (excluding those of large projects).

On the fiscal front, the budget execution showed that the government reached a deficit of 6.5% of GDP after grants. This is better than the deficit expected in the budget proposal (7.3%), but materially higher than the 2.2% recorded in 2017.

Recent Performance and Prospects

Economic activity remained relatively subdued in the first three months of 2019. Real GDP growth stood at 2.5% YoY after the mining sector continued to see a sharp slowdown from its recent impressive performance. This mainly reflected the dual impact from a drop in coal prices in international markets and the heavy rains in the centre region of the country (before cyclone Idai) that hurt coal production. Adverse weather conditions also impacted the performance of the electricity and water sector as well as transport and communications while agriculture recorded a modest deceleration. On the other hand, manufacturing and construction showed some signs of recovery, namely the latter, as it had witnessed a contraction in the previous three quarters. All in all, real GDP growth for the 12-months ending in March 2019 stood at 3.1% (down from 3.4% in 2018).

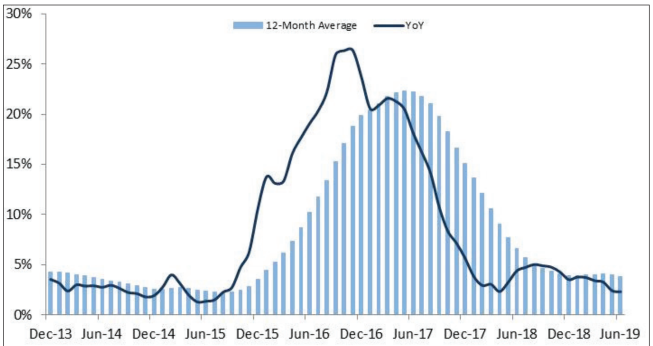
REAL GDP GROWTH (YoY)			
SECTORS	1Q 2018	4Q 2018	1Q 2019
Agriculture, Livestock	3.3%	2.7%	2.6%
Fishery	6.4%	1.0%	3.8%
Mining Industry	7.7%	15.2%	2.0%
Manufacturing Industry	2.1%	0.0%	2.9%
Electricity and Water	-2.4%	0.6%	-7.1%
Construction	2.8%	-1.1%	1.2%
Retail and Services	0.2%	1.4%	2.6%
Hotels and Restaurants	4.4%	7.0%	1.1%
Transports and Communications	5.0%	7.2%	3.3%
Financial Services	2.2%	5.6%	2.7%
Public Admin. Education and Health	5.2%	3.3%	1.5%
Others	4.5%	4.7%	4.9%
Total	**3.7%**	**3.0%**	**2.5%**

Source: INE.

More recently, the economic climate index saw a slight recovery in April and May after a sharp fall in the previous month due to cyclone Idai. This was particularly reflected in the industrial production and construction sectors, which came in line with the performance recorded earlier in the year. It is worth noting, nevertheless, that confidence levels remained below the levels witnessed in the months prior to the latest climatic shocks that took place in Mozambique. As a result, it is highly likely that economic growth continued to slow in the second quarter.

Average inflation remained at close to 4% in the first half of 2019, with inflation standing at just 2.3% YoY in June. The recent inflation performance reflects (1) a relatively stable metical exchange rate against the currencies of the country's main trading partners, (2) a downward revision in administered fuel prices in April and (3) an increase in the supply of domestic agricultural products. This allowed the central bank to cut interest rates further in June, lowering the FPC and the MIMO by 100bps to 16.25% and 13.25%, respectively.

Consumer Price Inflation



Source: INE.

All in all, the Mozambican economy is expected to lose momentum this year due to the devastating impact of Cyclones Idai and Kenneth which struck in March and April. Real GDP growth is forecasted to remain at 1-2% (at best) this year and recover to a level above 5% in 2020. As a result, and with inflation risks likely to remain contained (and in single-digits this year and next), there is likely to be room for further monetary policy easing going forward. Meanwhile, the country's fiscal and current account deficits are likely to widen further due to the reconstruction costs from the storms. The government estimates these costs could amount to US$ 1.5 billion (roughly 10% of GDP), putting further pressure on the already elevated public debt burden.

The country's medium to long-term prospects will largely depend on three key topics. First, the latest developments on the LNG sector saw U.S. energy giant Anadarko Petroleum recently approving its LNG project worth about US$ 23 billion in Area 1 of the Rovuma basin in the northern part of the country. A similar sized venture has also been approved by the local authorities for another consortium led by Italy's Eni operating in Area 4 of the same Rovuma basin, whose final announcement is expected to happen by the end of the year. These natural gas projects are the largest in Africa and are expected to go into production in about five years' time. They are forecasted to boost the country's economic growth to more than 10% by 2024. Some studies also show that Mozambique could become the world's second largest LNG producer while revenues from this sector could amount to US$ 3 billion annually from 2030 onwards.

Second, the government reached an agreement with private creditors to restructure Mozambique's Eurobond and previously hidden debts. An agreement in principle with a group of Eurobond holders was reached last November, but revisions to this accord were recently made. The most significant change is that income from the LNG projects will no longer be used to pay off part of the hidden debt that was considered illegal. This agreement is particularly relevant since it could help the local authorities put public debt levels on a downward trajectory and assist in normalising relations with the IMF and other development partners.

And third, encouraging steps have been taken by the government and the main opposition party, Renamo, toward durable peace in the country. Indeed, both parties recently signed an agreement aimed at disarming and reintegrating the Renamo party fighters. This is especially important as it comes ahead of the parliamentary and presidential elections in October.