Mozambique's economy awaits a gas-powered revival

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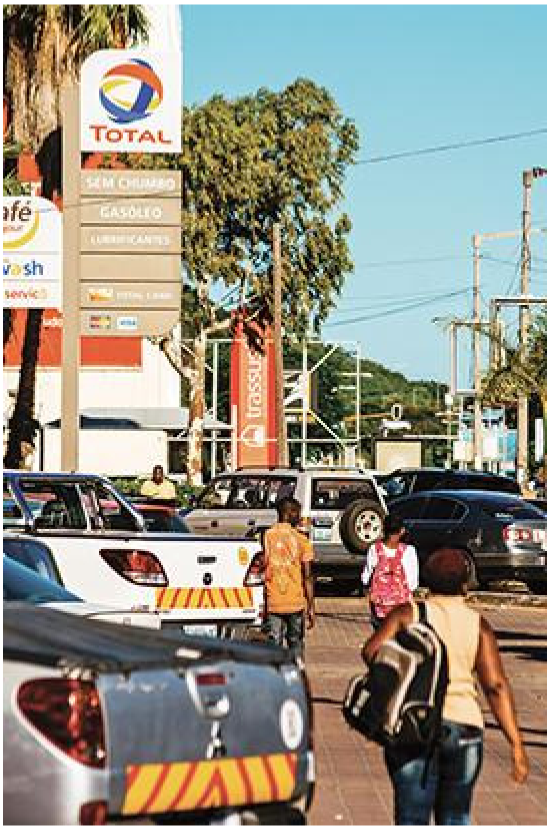
While waiting for its liquid natural gas projects to start paying off, Mozambique continues to fight a budget deficit and political instability. Peter Wise reports.



At a small ceremony at a shipyard on the South Korean island of Geoje in September, the first steel plate was cut for a 210,000-ton floating platform due to begin pumping liquid natural gas (LNG) off the north coast of Mozambique in 2022. The attendance of a Mozambican delegation headed by energy minister Ernesto Max Tonela highlighted the importance of the project to the economy of one of the world's poorest countries.

The floating LNG unit will operate in the Coral natural gas field, part of the Area 4 offshore concession granted to a consortium led by Italy's ENI to tap the 5000 billion cubic metres of reserves in the Rovuma basin. According to government estimates, Mozambique may discover twice that amount in total gas reserves by 2030, making it a global LNG powerhouse.

High hopes

Mozambique has placed its hopes in these recently discovered energy riches to lift the economy out of a protracted slowdown. Hit by a drop in commodity prices, adverse weather conditions and the continuing fallout from the country's hidden debt crisis of 2016, growth has decelerated and is not expected to recover significantly until large-scale LNG exports begin in about five years.

"Initial investments in the LNG sector are expected to reach more than $30bn," says Pedro Ferreira Neto, chief executive of Eaglestone Securities, a financial services company that specialises in sub-Saharan Africa. "This is huge for a country whose gross domestic product [GDP] is currently less than half that amount." As LNG exports come on stream in the mid-2020s, GDP growth, currently between 3% and 4%, is forecast to jump back towards pre-2016 levels when Mozambique was one of the world's fastest growing economies.

LNG mega-projects are among the certainties that Mozambique is holding onto in an otherwise less stable environment. ENI, whose partners in Mozambique include ExxonMobil and the China National Petroleum Corporation, gave the final go-ahead for its £8bn ($10.43bn) floating LNG project at Coral in 2017, which will have an annual production capacity of about 3.4 million tonnes.

A consortium led by Anadarko Petroleum of the US has said it will give investment approval in the first half of 2019 to a £7.7bn LNG export project, part of its Area 1 concession, also off the north coast of Mozambique. The plant, due to be completed by 2023 or 2024, will have an export capacity of almost 13 million tonnes a year.

"There's no going back on these mega-projects," says Tiago Dionísio, chief researcher at Eaglestone. "They will trigger new investments in service providers, real estate and other sectors and boost the economy. Investors have for some time seen the long-term potential of Mozambique, and the fact that these LNG investments are going ahead is a positive sign.

"People want to see the economy as a whole moving forward on a stable footing. It's difficult to persuade a credit committee to put money in a country that is still in default with its creditors."

Surviving scandal

Mozambique's 'selective default' credit rating, meaning it has defaulted on some but not all of its sovereign debt, is a consequence of the country's hidden debt crisis. In 2016, it was revealed that £1.4bn in state-owned company debts, equivalent to 11% of GDP at the time, had not been disclosed to donors or creditors. The news came shortly after the revelation that the bulk of £850m in state-backed loans intended to finance a fishing fleet had instead been diverted to buy naval patrol boats. The scandal hit the economy hard and damaged the reputation of a country that had previously been seen as one of Africa's star performers.

"The debt crisis continues to have a negative impact on the economy and the banking sector," says José Reino da Costa, chief executive of Millennium BIM, Mozambique's second largest bank by assets. "Donors suspended aid leading to a significant decrease in the government's financing capacity, both for investment and general expenditure. It also resulted in a sharp currency devaluation and high interest rates, along with a reduction in domestic consumption and credit demand."

Mozambique agreed to an independent audit of the undisclosed loans, carried out by Kroll, a risk management company, and published a summary of the findings in June 2017. The International Monetary Fund (IMF) has welcomed these measures as "important steps towards transparency". The fund, however, continues to call for clarity on "critical information gaps" relating to the use of the loans.

In response, the government has recommended waiting for the outcome of an investigation by the public prosecutor's office. Meanwhile, talks continue with Mozambique's donors and sovereign creditors. The government is also holding discussions with private creditors on a plan to restructure the private external debt, seen as a vital step towards restoring debt sustainability. The overall stock of external arrears on public and publically guaranteed external debt servicing had reached almost $710m at the end of 2017.

The good news

Amid these difficulties, however, positive signs are emerging. “Foreign investors have been slowly coming back to the country and the donor community, while not directly supporting the budget, has been backing specific projects and advising through technical assistance programmes,” says Sérgio Magalhães, chief financial officer of Barclays Bank Moçambique. “The economy will nevertheless remain under pressure while the ‘selective default’ credit rating stands, and investors will demand a higher premium for placing their funds in Mozambique.”

Bankers are cautiously confident that the government’s damage limitation measures are producing results. “The economy is growing modestly, and the treasury has managed to finance itself through local currency-denominated bond issues,” says Joel Rodrigues, chief executive officer of Banco BIG Mozambique, a subsidiary of Portugal’s Banco de Investimento Global. “The government and the central bank have taken positive steps, particularly in terms of monetary policy, which have already produced tangible results, including a steady decline in inflation, currency stability and a healthy cushion of international reserves.”

Tight monetary policy and currency appreciation have resulted in a sharp fall in inflation from a peak of 23% year on year in November 2017 to 4.7% in July 2018. GDP growth, which fell from 6.6% in 2015 to about 3.8% in 2016 and 2017, is forecast by the IMF to slow to 3% in 2016. There is also concern about the budget deficit, which is estimated to have increased from 7.6% of GDP in 2016 to 8.2% in 2017, including external and domestic arrears.

“Work still needs to be done to improve fiscal imbalances,” says Mr Reino da Costa of Millennium BIM. “It is important to finalise the debt restructuring process and regain access to international markets. Focusing on inflation stability over the medium term would also lead to a less restrictive monetary policy through a cycle of lower interest rates.”

Political progress

Talks aimed at reaching a durable peace agreement between the ruling Front for the Liberation of Mozambique (Frelimo) party and the Mozambique National Resistance (Renamo), the former rebel group that became the main opposition party, have continued following the death in May of Renamo leader Afonso Dhlakama. Fighting between the two parties between 2013 and 2016 had raised fears of a return to the 16-year civil war that followed Mozambique’s independence from Portugal in 1975, in which up to 1 million people died.

After a truce was called in 2017, president Filipe Nyusi and Mr Dhlakama held face-to-face talks, and were thought to have been close to a lasting agreement when the latter died. Negotiations between Frelimo and the new Renamo leadership are continuing with the presidential, parliamentary and regional elections scheduled to be held in October 2019 seen as an additional spur for reaching a definitive peace accord.

In the poor, isolated north, attacks blamed on shadowy insurgents have claimed at least 39 lives since May. The raids are attributed to a little-known group seeking to impose a militant form of Islam in Cabo Delgado province, not far from offshore gasfields now being developed. The insurgents have so far evaded capture, despite a crackdown by the Mozambican armed forces. Energy groups say there have been no specific threats to their installations and are working closely with the authorities to safeguard their employees and operations.

Rich in hydrocarbon, agricultural and mineral resources, Mozambique remains “one of the most promising countries in sub-Saharan Africa”, according to Mr Ferreira Neto of Eaglestone, who adds that it also benefits from “a successful track record for implementing large-scale projects and a friendly legal framework". The current outlook remains challenging, but, as Mr Rodrigues of Banco BIG puts it: "The worst seems to be over and this could be an attractive time for investors to seize opportunities in an economy expected to grow significantly in the coming years."

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