Hard hit: BCI posted a 22% reduction in net profit in 2020

MOZAMBIQUE'S BANKS STAY CAUTIOUS AND RISK AVERSE

The challenging economic and security situation in the country means that financial institutions are focusing on remaining robust, resilient and well-capitalised, as Peter Wise reports.

Banks in Mozambique have been facing growing challenges since the coronavirus pandemic hit economic growth last year and an Islamist insurgency in the north led to the suspension of liquefied natural gas (LNG) projects, which hold the potential to transform one of the world's poorest economies.

Despite these setbacks, however, the banking sector has grown stronger and more resilient. "Over the past couple of years, banks have become more capitalised and more risk averse, with better liquidity levels and lower leverage ratios," says José Reino da Costa, chief executive of Millennium-Banco Internacional de Moçambique (Millennium bim), the country's second largest lender by deposits. "Banks have so far managed to absorb the slowdown in the economy and the impact of the pandemic on loans, even though net profits in 2020 decreased overall."

Gross domestic product (GDP) shrank by 1.3% last year — the first contraction in almost three decades — as the pandemic inflicted a heavy toll on an economy only just beginning to recover from a series of shocks in 2016, followed by devastating tropical cyclones in 2019.

The World Bank forecasts a modest return to growth in 2021, with the economy gradually picking up in the following years as global demand for commodities and domestic demand for services recovers. Bankers hope LNG investments will also regain momentum, but all projections for the Mozambican economy remain subject to considerable downside risks.

"We cannot expect significant banking growth in 2021 and 2022, especially on the loans side," says Mr Reino da Costa. "Banks are likely to remain very cautious and risk averse."

Chief among the uncertainties are the evolution of the coronavirus pandemic and the insurgency in the gas-rich northern province of Cabo Delgado. Mozambique, with a population of about 30 million, has reported comparatively low Covid-19 rates, with just over 70,000 Covid-19 infections and fewer than 850 deaths. Weak testing capacity, however, means that official figures may understate the true number of infections. As in most of Africa, vaccination rates remain extremely low.

TOUGH YEAR

In 2020, strict lockdown measures imposed to combat the virus combined with weak global demand and low commodity prices, triggering a sharp downturn, cutting income per capita and, according to the World Bank, increasing the number of people living below the poverty line by about 850,000; now 64% of the population exists on less than $2 a day.

The economic impact of the Islamic insurgency was brought sharply into focus in late April 2021 when Total, the French energy group, declared *force majeure* on its $20bn LNG project in Cabo Delgado — a contractual opt-out that has effectively and indefinitely suspended work on the largest private investment project in Africa.

"Because of their magnitude, the LNG projects will not only provide support for the fiscal consolidation of public accounts in the coming decades, but also help to leverage the development of local industry," says Mr Reino da Costa. "The suspension and delay caused by insurgent attacks will affect the pace of economic growth, as well as the return of foreign direct investment."

Total's decision came a month after more than 100 insurgents attacked the coastal town of Palma, killing dozens of people and forcing thousands to flee. The company withdrew all its staff from the project, located 15km away on the Afungi peninsula, and suspended payments to suppliers.

Mozambique has been struggling to control the insurgency in the north and centre of the country since 2017. Orchestrated by militants linked to Islamic State, it has claimed more than 2000 lives and displaced half a million people.

The risks this military instability poses for the economy are incalculable. In a country with a GDP of about $14.6bn, Standard Bank, Africa's largest lender, estimates total investment in Mozambique's planned LNG projects at $120bn. The government expects the first three projects to generate about $96bn in state revenue over 25 years. But of these, Total has suspended operations and for a third year Exxon Mobil has delayed final approval of an adjacent $30bn project. Only the smaller Coral South floating LNG project, led by Italy's Eni, is keeping to its original schedule of beginning export production by the end of 2022.

"Confidence that the recent gas discoveries in the Rovuma basin would result in a substantial increase in foreign investment and economic growth have generated a significant amount of borrowing and investment over the past decade," says Pedro Noronha, chief executive of Banco de Investimento Global (BIG). But following the decisions taken by Total and Exxon, he says: "Questions are being asked, not only regarding 'when', but also 'if' the projects will go ahead."

UNCERTAIN OUTLOOK

Tiago Dionísio, assistant director of Eaglestone Securities, a financial services company that specialises in sub-Saharan Africa, believes Total's decision to delay its project by at least a year will weaken the country's medium-term outlook. "Apart from addressing the security concerns and ensuring stability in that part of the country, the lower growth outlook for Mozambique will require urgent structural reforms to help improve growth outside the resources sector," he says. "Reforms to help strengthen local institutions, improve the business environment, attract investment and create jobs will also be crucial."

Mr Noronha fears the delays could also affect the country's recently restructured Eurobond, the debt service of which is linked to projected government income from LNG exports. "With so much at stake, the medium-term outlook for Mozambique is becoming increasingly fragile," he says. Yields on Mozambique's $900m of Eurobonds have increased amid fears that the LNG setbacks will make it more difficult for the state to fulfil its obligations when interest payments on the bonds increase to 9% in 2024. The debt, scheduled to be repaid from 2028, has already been restructured twice.

Amid these uncertainties, the climate for banks has grown increasingly difficult. GDP growth had already slowed to 2.3% in 2019, compared with an annual average of 5% in the previous five years. "Subdued GDP growth in 2021 and 2022 will make it more challenging for banks to generate revenues and increase the need to implement cost-containment measures to secure adequate profitability levels," says Mr Dionísio.

"The banking sector is likely to experience a deterioration in the credit quality following the contraction of GDP in 2020 and the sluggish growth expected in 2021," adds Mr Noronha. "In general, we expect banks to maintain the tendency for increased balance sheet exposure to treasury securities, and less appetite for credit."

RESILIENT AND STRONG

The central bank, Banco de Moçambique, responded to the coronavirus pandemic by reducing mandatory reserves in local and foreign currencies, lowering reference interest rates and exempting banks from having to build provisions on loans that have been restructured because of the pandemic. "Despite these efforts, bank results were clearly impacted as the need to significantly build loan impairments and provisions affected the bottom line," says Mr Dionísio.

Mozambique's six largest banks — Banco Comercial e de Investimentos (BCI), Millennium bim, Standard Bank Mozambique, Barclays Bank Mozambique, Moza Banco and Banco Único — account for 80-90% of total assets, loans and deposits. Most of the country's 18 lenders are either subsidiaries of foreign banks or controlled by international investors. Of the top six, only Moza Banco's majority shareholders are from Mozambique.

BCI, Mozambique's largest bank by assets, deposits and lending, posted a 22% reduction in net profit in 2020, mainly owing to a 42% increase in impairments and provisions. The bank, controlled by Portugal's state-owned Caixa Geral de Depósitos, increased net assets by 17%, largely due to »

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an increase in bank and treasury security investments. It also maintained a Tier 1 capital ratio of more than 25% and a solvency ratio above 24%, at the same time increasing its customer base and branch network.

Millennium bim saw net profit fall 23% to $90.4m, as impairments and provisions rose by almost 69%. Deposits increased 16%, while the bank, controlled by Millennium bcp, Portugal's largest listed banking group, kept both its Tier 1 capital and solvency ratios well above 40%.

Rui Carvalho Fonseca, president of Millennium bim's board of directors, told shareholders this year that "despite the risks and vulnerabilities resulting from the pandemic, the instability in the centre and north, adverse weather events, falling export prices, the depreciation of [the Mozambican currency] the metical and its impact on rising inflation, the national banking system has remained solid, resilient and well-capitalised."

DIGITAL DRIVE

Mozambique's financial system is becoming increasingly well developed. Financial inclusion levels have risen, with more customers having access to a bank account and a wider range of banking products. According to the central bank, the number of bank accounts held in the country increased from just over two million in 2011 to close to five million in 2019, and is continuing to grow. In a predominantly rural country, branch networks are also expanding, increasing from 457 in 2011 to 694 in 2019, although almost three-quarters of them remained concentrated in urban areas. The number of ATMs in the country more than doubled from 853 to 1766 over the same period.

Pressure to accelerate digitalisation is increasing. "The economic and social impact of Covid-19, including changes in consumer behaviour and demand for banking services will increase the challenges facing the banking sector in 2021 and 2022," says Mr Dionísio. "This is likely to accelerate the need to implement digital transformation programmes. In particular, it will be important to adapt the services provided to customers through mobile phone applications and internet banking to an increasingly more competitive business environment."

In 2020, the central bank introduced several measures to ease cash flow constraints and promote digital transactions. These included a reduction in fees and commissions for digital payments made through commercial banks and mobile money platforms. Combined with social distancing requirements, the measures contributed to a significant increase in the volume and number of electronic transactions, particularly on mobile platforms.

DEBT PRESSURES

Public accounts are facing increasing strain, however. "Over the medium-to-long term, the delay in starting the LNG projects will put significant pressure on public finances," says Mr Noronha, particularly in terms of "the sustainability of public debt and the increasingly high debt service costs associated with domestic financing, which have been increasing since the hidden debt scandal froze budget support from donors."

The "hidden debt crisis" of 2016, when almost $2bn in concealed sovereign debt was disclosed, followed close on the heels of the "tuna bonds" case in which the bulk of $850m in state-backed loans intended to finance a fishing fleet were diverted to buy naval patrol boats. The revelations caused the International Monetary Fund to cut off support, resulting in debt defaults and a currency collapse that plunged the economy into crisis.

Mr Dionísio believes average real GDP growth will be lower than previously projected over the next few years, following the attacks by insurgents. "This could have significant implications for the fiscal and external balance accounts," he says. "In particular, the government's fiscal consolidation efforts will be more difficult to implement as a result of the impact of increased security challenges on public expenditures. The increased balance of payments pressures are likely to impact the metical and, as a result, make it increasingly more difficult to lower the public debt ratio to more sustainable levels." Public debt stood at almost 103% of GDP in 2019 and was projected by the World Bank to move considerably higher in 2020.

The insurgency comes as a further deterrent to foreign investors already unsettled by the tuna bonds and hidden debt cases. But, says Mr Noronha, the country's long-term prospects remain promising. "Mozambique is still an underdeveloped country with a young population that is greatly underserved in terms of basic infrastructure, and it is abundant in natural resources, including natural gas, coal and gemstones." Its 2500km coastline also give it a "vast potential" for tourism, he adds.

Mr Reino da Costa says: "Looking ahead, Mozambique's potential is still there. International investors are likely to continue to look closely at the country and will eventually decide the right moment to come back." TB