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MOZAMBIQUE – ACCELERATED GROWTH 2014 TO 2020

- *Accelerated growth above 7% from 2014 to 2020*
- *Possible political instability*
- *High levels of corruption*
- *Huge natural gas potential*
- *Small banking sector*

	2011	2012	2013(e)	2014(f)
GDP growth (%)	7.3	7.5	7.0	8.0
Inflation (yearly average) (%)	10.4	2.1	5.4	5.6
Budget balance* (% GDP)	-13.1	-9.6	-11.8	-12.0
Current account balance (% GDP)	-31.2	-41.8	-43.4	-44.8
Public debt (% GDP)	45.1	46.6	47.0	47.6

Strengths

- Considerable resources: energy (offshore gas, oil), mines (coal, titanium, gold, precious stones), agriculture (cotton, tea, coffee, sugar, cereals)
- Important hydroelectric potential
- Vast arable land
- Favourable geographic situation: long coastline, proximity to the South African market

Weaknesses

- Low agricultural sector productivity
- Heavy dependence on aluminum and international aid
- Poverty, malnutrition and low educational level
- Inadequate telecommunications and energy supply infrastructures
- Regional disparities: the north and the center disadvantaged compared with the south

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Economic growth

The Mozambican economy expanded by a estimated 7% in 2013, slower than the 7,5% rate of 2012 due to the impact that flooding had on agricultural output in the first quarter. However, growth is expected to accelerate again from 2014 and peak in 2020, when the production of natural gas begins on the reserves recently discovered off the northern coast.
The main risks to these growth prospects is the possibility of political instability. Recently tensions have been brewing between the government and civil war protagonist turned opposition party Renamo.

With a pro-reform government, Mozambique should achieve strong real GDP growth over a 10-year forecast period, averaging 10%. On a per capita basis, nominal GDP has grown by an average of 15,4% per annum between 2000 and 2009. However this is partly due to the low base, Mozambique remains one of the poorest countries in the world. While the economy has experienced rapid growth over the past decade and is likely to continue performing strongly, the business environment will remain challenging.

High levels of corruption, a weak transport system, and high levels of HIV/ AIDS reduce productivity and are likely to impose constraints on private sector investment in the years ahead. Although access to credit remains very limited, progress is being made on this front as the banking sector matures further.

Coal production and especially exports, were also impeded in 2013 by occasional interruptions of the Sena rail link, which further affected GDP growth. Reconstruction of the infrastructures damaged by the floods and the various projects, particularly in the transport sector, will favour the construction firms. Services, particularly financial services, will remain buoyant while wage increases will sustain household consumption in 2014.

Economy by sector

The outlook for private consumption is mixed. On one hand, the decline in agricultural output in the first quarter will impact the livelihood of the many Mozambicans who rely on farming for their income. On the other hand, the flood-related disruptions to food production have not led to a spike in headline inflation due to the strong performance of the Mozambican metical against the South African rand the currency of Mozambique's main import source.

The development of Mozambique's vast natural resources will provide a significant boost to growth in GDP and has the potential to transform the economy. Global blue chip firms like Rio Tinto and Vale are investing heavily in coal mines in the Tete province, while Indian and Chinese firms have also shown interest. Natural gas has the potential to play an even bigger role in driving Mozambican growth.

Based on recent discoveries of gas (150-trillion cubic feet) and coal (32-billion tons), Mozambique has the potential to become a leading exporter of both products. This potential attracted large amounts of foreign investments. FDI doubled from US$2,6-billion in 2011 to US$ 5,2-billion in 2012 (37% of GDP), making Mozambique the second largest destination for FDI in Africa, after Nigeria. Since these investments were mainly related to project development, huge imports of capital and know-how caused the current account deficit to soar to 36% of GDP in 2012, from 24% of GDP in 2011.

Consequently, the import cover deteriorated to 3,3 months, despite foreign exchange reserves having grown steadily in the past five years to US$2,8-billion in 2012. While the higher current account deficit increases reliance on external capital flows, the financing from FDI provides reasonable mitigation against a balance of payments or liquidity crisis. The resource bonanza is also set to benefit Mozambique in the medium to long term.

The IMF estimates that economic growth from coal and gas could add an average of 2 percentage points per year to GDP in the next decade and that revenues from the sector could make up for 40% of government receipts by 2030.

With the date set for National election for October 2014, attention will now turn to the campaign, during which there is likely to be strong government spending both on social initiatives and on getting the country prepared for that election. On the former point, the incentive to spend will be increased by signs that average Mozambicans have become frustrated with the lack of improvement in lifestyle proportionate to the rate of headline economic growth.

Most of infrastructure spending will come from foreign firms ploughing money into the country's natural resources and associated infrastructure. However government will also play its part with investment into infrastructure and development of key sectors such as agriculture.

Political landscape

There have been mixed signals over recent months emanating from attempts to address friction between the ruling Frente de Libertaçao de Moçambique (Frelimo) and its former civil war opponent and the current opposition party Resist ê ncia Nacional Moçambicana (Renamo).

On one hand, negotiations between the two sides have continued despite several attacks and local media reported that the parties have agreed minor changes to electoral laws, concerns over which are one of Renamo's major grievances. On the other hand however, Frelimo continues to refuse Renamo's key demand for equal representation on the national electoral body.

Meanwhile, although the leaders of the two parties, President Armando Guebuza of Frelimo and Alfonso Dhlakama of Renamo, have both said they are open to meeting each other, neither man is willing to travel to the other's stronghold for such a meeting to take place. Indeed, a meeting of the Council of State, a presidential advisory body that counts Dhlakama as one of its members, began on July 31 without the opposition leader being present.

Tensions between Renamo and Frelimo are unlikely to escalate into sustained conflict. Although Renamo's threat to close major transport arteries in central Mozambique materialised into attacks on vehicles which led to several deaths the scale of the attacks and the resulting disruption has so far been less than many had feared. Frelimo responded to Renamo's attacks by raiding a Renamo base near Muxungue in central Mozambique.

However, there were no casualties as the inhabitants of the base had been tipped off and had vacated it. Renamo's actions have been more about strengthening its negotiating position than provoking Frelimo back into war. As long as there continues to be signs of progress further isolated incidents will diminish.

Balance of trade

The public deficit is not expected to fall in 2014, because of spending forecasts related to infrastructure projects, as well as the expected rise in public sector wages. The strikes which broke out in 2013 in the medical sector led to a 15% rise in salaries for this category of public sector workers and further public sector wage demands cannot be excluded.

The prospect of the October 2014 national elections (legislative and presidential) are expected to make it difficult to control social spending. Moreover, the current account balance is also expected to worsen. After a slowdown in coal exports in 2013, due mainly to the floods, which hit transport despite the rise in production, sales of mining products should again accelerate in 2014.

This rise will still not be enough, however, to cover the sharp increase in imports. There is still a great need for capital goods both for mining operations and for the exploration of the immense gas reserves discovered off the Mozambican coast in 2010. Moreover, rising real wages will increase demand for consumer goods.

The current account deficit will exert strong downward pressure on the metical exchange rate, but the depreciation of the Mozambican currency against the dollar is expected to be limited due to the influx of capital into a country whose growth prospects and whose gas potential remain very attractive for foreign investors.

Legal system

The 1990 constitution that came out of peace negotiations provided for a multi-party system, has widened the recognition of citizens' rights, and recognised the independence of the courts from the executive and party control. Individual rights and judicial independence were further strengthened by the 2004 revised constitution. The country's court structure is still governed by the 1992 Organic Law of the Judicial Courts which establishes three main layers of judicial courts (tribunais judiciais): district courts, provincial courts and a Supreme Court in Maputo.

There also exists a system of community courts which, while the most widespread officially recognised judicial fora in Mozambique, with more than 1 500 reportedly in existence, have no formal links with the judicial courts.

Business climate

In Transparency International's 2012 corruption perception index, Mozambique's score was 31, indicating that corruption is perceived to be rampant. Out of 176 countries surveyed, Mozambique ranked 123rd, an improvement from 2009. Despite comprehensive public-sector reforms aimed at fighting corruption and improving governance in general, control of corruption in Mozambique has improved only slightly since the end of the civil war. Running on an anti-corruption ticket, President Guebuza's government has upgraded its Anticorruption Unit to a Central Office for Combating Corruption and provided extra funds.

Effective legislative safeguards remain weak, however. The country's regulatory system is very slow and bureaucratic, creating opportunities for corruption and bribery. Regulations in the areas of labour, health and safety and the environment are routinely unenforced, or are enforced randomly to generate revenue from fines.

In addition, civil servants have at times threatened to enforce antiquated regulations that remain on the books to obtain favours or bribes. Many businesses depend on patronage. Mozambique has historically struggled with the process of issuing construction permits. The slow issuing process was identified by the private sector as a major obstacle impeding businesses.

However, things are starting to change for the better. The latest World Bank Doing Business 2014 report shows a substantial improvement in the country's construction permit indicator, jumping 46 places to 77th from 123rd in the most recent rankings. The country overall improved in rank by 7 places, from 142th last year to 139th this year, out of the 189 economies in the overall Doing Business country ranking.

The World Bank Doing Business report is comprised of 11 indicators that measure a country's business regulations, property rights, tax burdens, access to credit, and the cost of exporting and importing. While the country scored well on two parameters protecting investors (52th) and starting a business (95th) its ranking on other factors such as getting electricity (171th) and registering property (152th) was relatively poor.

Employment

Out of a total population of 21-million, the labour force is estimated to be in the region of 8,5 to 9-million, of whom only 16,4% are in salaried employment. The labour movement in Mozambique is weak, as are the employers' associations: Mozambique's 14 unions have a membership of less than 200 000. The judicial system that supports labour regulation in Mozambique is also a constraint. The literacy rate is around 50%, with education and technical skill levels extremely low assessed at 7% of the employee's wages, of which a maximum of 3% is deductible from the employee's salary, and the remaining 4% is met by the employer.

Foreign trade

Mozambique is party to a number of trade agreements. With the US, its exports are eligible for duty-free access under the Africa Growth and Opportunity Act (AGOA). Alongside Botswana, Lesotho, Namibia and Swaziland, Mozambique agreed a reciprocal 'interim' (goods only) Economic Partnership Agreement (EPA) with the European Union that took effect on January 1 2008. Replacing the non-reciprocal trade portion of the 2000 Cotonou Agreement, the new treaty covers 80,5% of trade with the EU.

Imports from the EU of 100 sensitive products are to be liberalised by 2018. Additionally, as a least developed country (LDC), Mozambique also retains duty-free market access under the EU's 'Everything But Arms' initiative. Despite duty-free access for the country's exports, the World Bank has found that Mozambique's utilisation rate of EU and US preferences was modest (57,5%), as was their value, equivalent to 4% of its bilateral exports.

In addition, its exports are eligible for preferential access to India under the Global System of Trade Preferences (GSTP). The Southern African Development Community (SADC), of which Mozambique is a member, has been a free trade area since the start of 2008. Duties on 85% of trade have been abolished, with the remaining tariffs to go by 2012 when a customs union is expected to be established.

Financial sector

Mozambique has one of the smallest banking sectors for a country of its size on the African continent. Yet the growing number of banks operating in the country, steady increases in the size of retail networks and the focus on grassroots banking all suggest that the market is set for substantial growth over the next few years. It may be a long time before Mozambican financial institution feature in the upper echelons of African Business's survey of the Top 250 banks in

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Africa but they will surely play an important role in ensuring that the benefits of the country's burgeoning export industries help to drive wider economic development.

Tax

The government has made significant progress in improving the efficiency and transparency of its tax administration. The authorities are also committed to implementing new mining and petroleum fiscal regime laws.

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