Mozambique

2011

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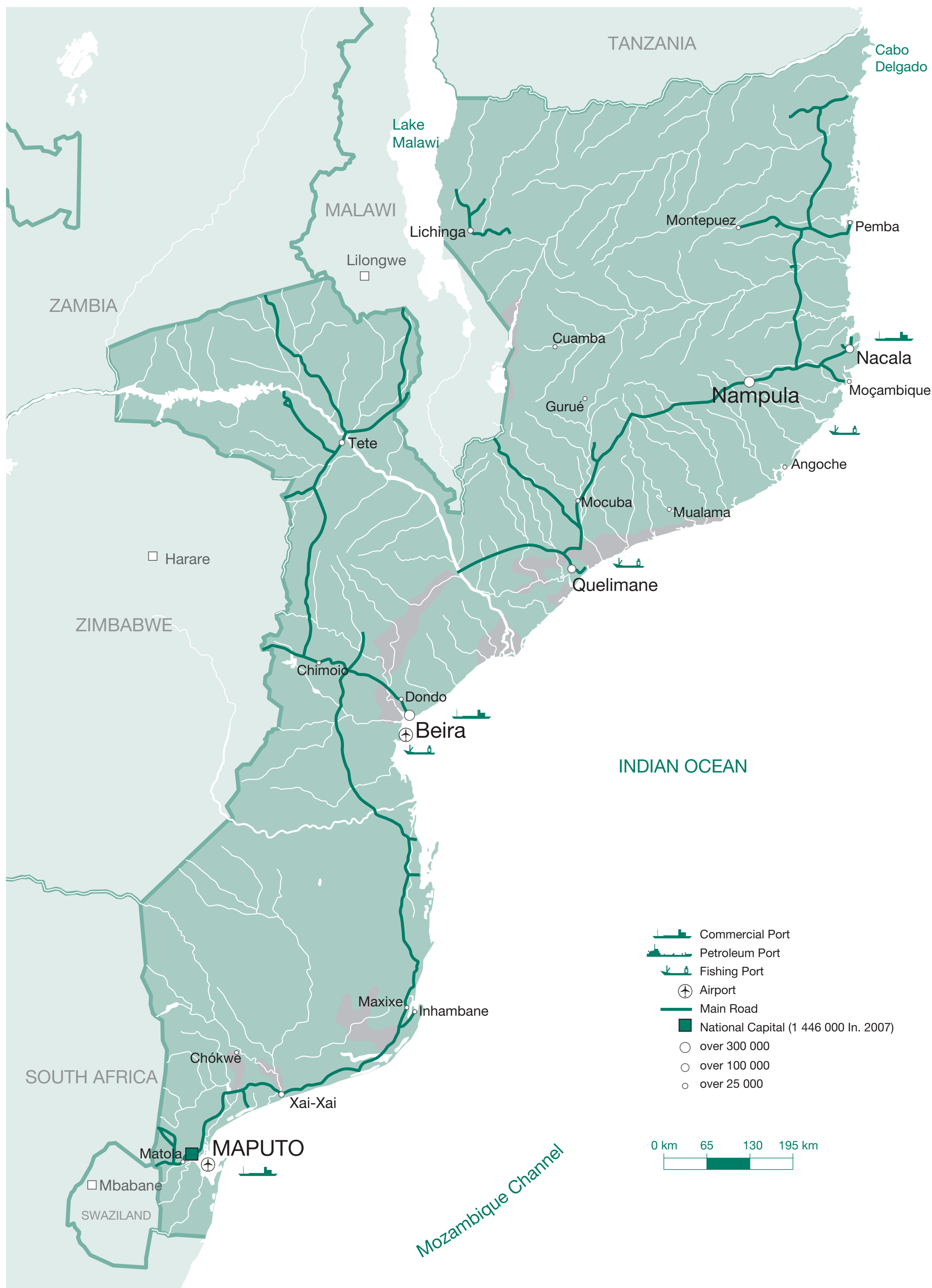


This map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.

Mozambique

Overview

Mozambique's economy continued to perform well in 2010, growing by an estimated 8.1%. Growth in 2009 had been achieved despite a drop in aluminium prices, offset by massive inflows of foreign direct investment (FDI) in coal projects, whereas in 2010 the economy benefited from both FDI and recovering aluminium prices. In addition, coal extracted from the "mega-projects" in Tete province will start adding to exports in 2011. Exports are therefore expected to increase, although the current account balance will remain structurally negative due to the country's dependence on imports of food, oil and manufactured products. Mozambique is expected to maintain high growth rates in the medium term, driven by mega-projects.

The inflation rate hit double digits in 2010, as a result of the scrapping of fuel subsidies in March-August 2010, the rise in international oil and food prices, the depreciation of the currency against the US dollar (USD) and the South African rand (ZAR), a poor agricultural year and loose monetary policies. Inflation should decline to single digits in 2011, contained by urban transport and wheat flour subsidies, a tighter monetary policy and reinforcement of the domestic food production strategy. The main risk in the growth forecast is that the recovery of international oil and food prices and poor weather will result in failure to control inflation.

However impressive the growth rate, riots in September 2010 and new data on poverty highlighted the weak linkages between macroeconomic performance and the bulk of the population. Social unrest forced the government, donors and international institutions to reconsider Mozambique's growth model. This model has been based on FDI mega-projects in the extractive industries, which are largely exempt from taxation, with human development supported by donor contributions. The government launched the 2010-14 Poverty Reduction Strategy Paper (PARPA) III, which apart from human development focuses on agricultural output and productivity and on the creation of jobs in small and medium-sized enterprises (SMEs).

The government's ambitious public works programme over the next few years is expected to result in a substantial widening of the deficit. Capital expenditure should rise by over 1.5 percentage points of GDP between 2008 and 2012. Public investment funded by non-concessional loans will focus on infrastructure based on public-private partnerships (PPPs) along the development corridors. Such projects will absorb all fiscal space over the 2011-13 period, favouring in a first stage large foreign investments linking extractive areas with the coast. Agriculture and SME jobs are expected to benefit through spill-over effects along the development corridors. Donors continue to support human development, although their budget contribution, which accounted for almost 50% of revenues in 2010, will start being phased out.

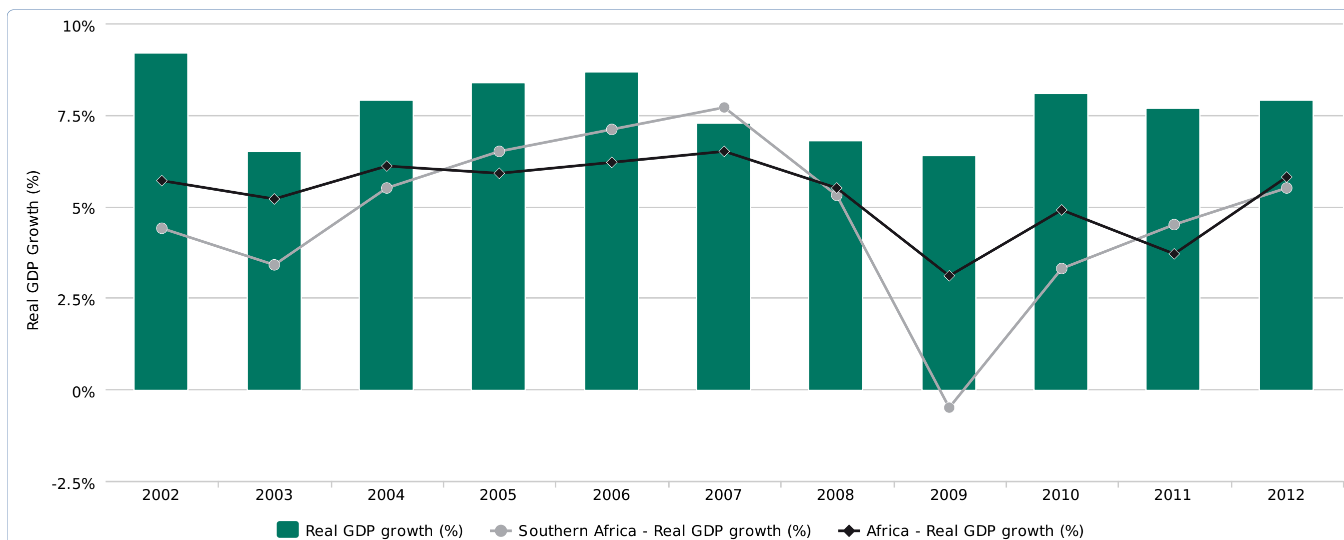
Mozambique's new growth model remains based on extractive industries. Two Industrial Free Zones (IFZs) will be created in Nacala in 2011, followed by five more IFZs and one Special Economic Zone (SEZ) before 2014. The extent to which this model will create spill-over effects that benefit the population is yet to be proven, after the government's failure to promote domestic manufacturing and services around existing mega-projects. The Moatize-Nacala corridor has nevertheless the potential to have a large impact on the economy. Nampula and Zambezia provinces have considerable agricultural potential and large populations, and exchanges with landlocked Malawi, Zambia and Zimbabwe could be exploited.

Mozambique benefits from the diversification of its development partners, notably China, Brazil and India. These emerging partners complement traditional donors' strong focus on social sectors with an interest in infrastructure and agriculture. During the global economic crisis, their rising demand for natural resources helped to sustain Mozambique's economy. Emerging partners also finance various research projects seeking to boost agricultural productivity. To date, however, large investments in infrastructure have mostly been geared towards enhancing the productivity of extractive industries, rather than benefiting the local economy. A more structured engagement with emerging and traditional partners alike is required to embed future projects in the national development plan.

Poverty remains widespread in Mozambique, notwithstanding sustained GDP growth over the past decade. The poverty rate declined from 69.4% of the population in 1997 to 55% in 2010, but poverty is now stagnating and regional disparities remain acute. Growing inequality could lead to further social tension if food prices remain high and the government out of touch with ordinary Mozambicans.

Development indicators have improved in recent years, but most of the Millennium Development Goals (MDGs) will not be attained unless the government and donors reinforce their commitment over the next five years. Basic challenges, such as improving the quality of education and health services and the fight against HIV/AIDS, remain daunting.

Figure 1: Real GDP growth (S)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	6.4	8.1	7.7	7.9
CPI inflation	3.5	12.7	9.2	7.3
Budget balance % GDP	-5.1	-5.4	-6	-5.4
Current account % GDP	-10.9	-11.2	-10.3	-11

Source: National authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	27	29.4
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	1.1	1.5
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	15.4	14.1
of which hydrocarbon	-	-
Electricity, gas and water	5.5	4.7
Electricity, water and sewerage	-	-
Construction	3.3	3.1
Wholesale and retail trade, hotels and restaurants	14.8	17.7
of which hotels and restaurants	1.5	1.6
Transport, storage and communication	10.6	10.2
Transport and storage, information and communication	-	-
Finance, real estate and business services	10.8	7.5
Financial intermediation, real estate services, business and other service activities	-	-
General government services	-	-
Public administration & defence; social security, education, health & social work	9.5	10.2
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	2	1.6
Other services	-	-
Gross domestic product at basic prices / factor cost	100	100

Source: AfDB Statistics Department, based on data from Statistics Mozambique.

Figures for 2010 are estimates; for 2011 and later are projections.

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Mozambique's growth rate surged to 8.1% in 2010, supported by the gradual recovery of aluminium prices,

public investment and FDI inflows. The economy had already proved strongly resilient to the global economic crisis in 2009, despite the sharp 35.7% decrease in aluminium prices, thanks to the USD 600 million investment in the Moatize coal mega-projects, which accounted for more than half of FDI. Growth rates will be slightly lower in 2011-12 than in 2010 but will remain healthy, driven by private consumption, public investment financed through non-concessional loans, private investment addressing huge infrastructure deficits in transport and energy, and the beginning of coal exports.

In 2010, agriculture continued to be the largest driver of GDP growth, followed by transport and communications, commerce and financial services. Manufacturing and tourism still lag behind.

Mozambique is seeking to diversify agricultural exports, currently limited to cashew nuts and cotton, and to promote the processing of raw materials. Agriculture production suffered from poor weather conditions in 2009 and 2010. High food prices in 2008 prompted the government to launch the 2008-11 Action Plan for Food Production, which seeks to ease reliance on imports. The plan has had only a moderate impact to date, however. Funding for the plan will amount to 1.3 billion Mozambican meticals (MZN) in 2011, and another MZN 2 billion will be allocated for food production at the local level. This programme builds on the 15-year Green Revolution Strategy approved in 2007, whose weak implementation has resulted in the phasing out of donor support.

Mineral prospects have sustained FDI inflows in spite of the global crisis, and Mozambique is expected to become the continent’s second-largest coal producer after South Africa. The USD 1 billion Benga coal project, a joint venture between Australia’s Riversdale (65%) and India’s Tata Steel Limited (35%), is expected to be completed in the second half of 2011; reserves are estimated at 4 billion tonnes. The USD 2 billion Zambezia Project, adjacent to the Benga mine, will exploit 9 billion tonnes of coal reserves. In June 2010, the Zambezia project became a joint venture between Riversdale (60%), Wuhan Iron and Steel Corporation, and China Communications Construction Company (the latter two have a joint holding of 40%). The government is seeking to acquire 5% of both the Benga and Zambezia projects. In addition, the USD 1.3 billion coal project in Tete developed by Brazil’s Vale will produce an annual 8.5 million tonnes of metallurgical coal and 2.5 million tonnes of thermal coal. In addition to these coal projects, the US firm Anadarko has discovered oil deposits offshore of northern Mozambique, although it is unclear whether the find will prove commercially viable.

Mining projects are generating investment in the transport and communications sectors, which will continue to be the second-largest source of economic growth after agriculture up to 2012. The Moatize-Beira railway between Tete province and the port of Beira will be operational in 2011. The 670 km line was rehabilitated by CCFB Consortium at a total cost of USD 260 million, of which USD 110 million was lent by the World Bank. CCFB is a joint venture between the state-owned Companhia de Ferros de Mocambique (49%), the state-owned Rail India Technical and Economic Services (26%) and Indian Railway Construction International (25%). The Moatize-Beira railway, with an annual capacity of 6 million tonnes, will be insufficient to transport the combined maximum production of 50 million tonnes from the Benga and Zambezia projects and Vale's operation in Moatize. The railway’s limited capacity, together with the high prices set by CCFB, are motivating mining companies to build alternative railway lines.

A tender was issued for a coal terminal with a capacity of 21 million tonnes for the Beira port, since the old terminal’s capacity of 1.2 million tonnes will meet only a fraction of the demand generated by the new coal projects in 2011. The port is also being rehabilitated with funds from Japan International Cooperation Agency.

Works in the USD 120 million Nacala airport started in 2011, supported by Brazil’s USD 80 million non-concessional line of credit. The airport will play a key role in the USD 1.5 billion Nacala SEZ. The corridors linking the ports of Beira and Maputo to Zimbabwe are being finalised with the rehabilitation of the roads between Beira and Inchope (120 km) and between Gaza and Maputo (170 km). The corridors will connect areas with tourism and agricultural potential.

As part of the country’s new growth strategy, the government is also promoting PPPs to develop transport in the development corridors. A railway link between Moatize and Nacala as well as the upgrade of the Nacala port are in the pipeline, at an estimated cost of USD 2 billion.

Energy and water will have contributed an annual 0.5% to GDP growth in 2009-12. The rural electrification programme continues to advance, supported by a USD 25 million line of credit from India. Construction of the USD 1.8 billion Mpanda Nkuwa dam has started, and the USD 413 million expansion of the Cahora Bassa hydroelectric dam is under way. Moreover, Portugal’s remaining 15% stake in the Cahora Bassa dam is to be sold to Mozambique in 2011 for USD 140 million. The transmission line between the Cahora Bassa dam and Maputo, now under construction, should reduce the country’s reliance on reimported electricity from South Africa.

Manufacturing remains largely linked to mega-projects such as the Mozal aluminium plant and the Moma heavy

sands mine. Most national firms are unable to deliver the required outputs, however, and the IFZs are dominated by foreign companies. The government is creating two new IFZs in Nacala's SEZ, the first of which will be operational in the first quarter of 2011. Five more IFZs and an additional SEZ are to be completed before 2014, in areas to be identified on the basis of foreign investors' interest.

Tourism continues to be dominated by South African, Portuguese and US investors. The Arco Norte project in Nampula, Cabo Delgado and Niasse provinces and the Âncora project in Nampula and Inhambane provinces will boost dynamism in a sector that is benefiting from both international and domestic demand.

Economic growth continued to be supported by private investment, which increased by 66.3% in 2010, following a 109% increase in 2009. FDI into mega-projects, notably the coal mines in Tete province, account for most of that expansion. In addition, the Public Investment Programme grew by 23.9%. Following a 14.9% contraction in 2009, exports also recovered with a 24.6% rise, driven by higher aluminium prices. Over the 2010-12 period, public consumption is expected to grow at a slower pace, due to the revision of salaries to match skills and performance. In 2011 and 2012, growth will be sustained mainly by private consumption, public investment in infrastructure financed through non-concessional loans, and coal exports. The annual growth of private investment will fall below 20% in 2011 and 2012. The main risk in the growth forecast is that the recovery of international oil and food prices and poor weather will result in failure to control inflation.

Table 3: Demand composition

	Percentage of GDP (current price)		**Percentage changes, volume**			**Contribution to real GDP growth**		
	2002	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	29.6	14.8	18.1	13.6	14.7	2.8	2.3	2.6
Public	12.1	9.3	20	14	14	1.9	1.5	1.6
Private	17.5	5.5	15	13	16	0.9	0.8	1
Consumption	100.5	93.9	4.8	4.3	7.4	4.2	3.6	6
Public	12.3	14	5.6	4.3	4.4	0.6	0.4	0.4
Private	88.2	80	4.7	4.3	7.8	3.6	3.2	5.6
External sector	-30.1	-8.8	-	-	-	1.1	1.8	-0.8
Exports	24.9	26	4.8	10.1	5.6	1.6	3.2	1.8
Imports	-55.1	-34.8	1.5	4.4	8	-0.5	-1.5	-2.6
Real GDP growth rate	-	-	-	-	-	8.1	7.7	7.9

Source: Data from IMF and National Institute of Statistics; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Fiscal Policy

Following a year of expansionary policy, Mozambique’s budget deficit increased slightly to 5.4% of GDP in 2010, albeit a reduction in the wage bill. The deficit is expected to widen over the next few years, owing to the government’s ambitious public works programme. Capital expenditure should rise by over 1.5 percentage points of GDP between 2008 and 2012.

Riots in September 2010 and the survey *Inquérito do Orçamento Familiar 2008/2009* highlighted the inability of the government and donors to improve living conditions, fuelling a debate that continued until the late release of the 2010-14 PARPA III in March 2011. As laid out in PARPA III, the government’s priorities, beyond the PARPA II objectives on human development, are to boost agricultural output and productivity and to create jobs in SMEs.

To achieve PARPA III’s objectives, the government is seeking to scale up infrastructure through PPPs around the development corridors. Public infrastructure investments in 2011-13 are to be financed by non-concessional loans equivalent to 2.5% of GDP each year. The government will seek domestic financing only as a last resort to avoid reducing access to credit in the economy.

In 2010, efficiency gains in tax revenues were mostly the result of the increase in customs collection. In 2011, the government will seek to maintain the same rate in efficiency gains with an electronic tax system and a one-stop shop. Although mineral and oil laws were revised in 2007 and new regulation was available in 2008, foreign investors continue to enjoy better tax benefits than domestic firms. Mega-project coal production, set to start in 2011, will therefore not contribute to government revenue in the short run.

The Mozal aluminium smelter, Sasol's gas operations, Vale's coal project and Kenmare Resources' heavy sands project in Moma enjoy broad tax exemptions, although companies providing services to Mozal in the contiguous IFZ will start paying taxes in 2011 after a ten-year exemption. The government is unwilling to renegotiate these tax conditions, since its growth strategy is based on attracting large flows of FDI in infrastructure and mega-projects.

Donors will continue to finance education and health under PARPA III, although the group of 19 donors (G19) has reached no consensus on the best growth model for Mozambique. Budget support was frozen in early 2010 following controversial elections in October 2009. To enhance government accountability, donors proposed to include a political matrix among the government’s objectives. The government eventually accepted the political matrix, though only after riots erupted in September 2010, and donor budget support resumed. According to the 2011 government budget, aid disbursements are expected to decrease at a rate of 3.6 percentage points of GDP per year over the 2011-13 period, down from 10.7% of GDP in 2010. Donors still funded 47.8% of the government budget in 2010.

Where transfers are concerned, fuel subsidies introduced in the wake of the 2009 elections were phased out after March 2010. Following the riots of September 2010, they were replaced by targeted price subsidies for urban transport and wheat flour, at a cost of MZN 488 million. To compensate for the cost of these subsidies, current government expenditures on salaries were reduced by 1.1%. These subsidies will be maintained in 2011 at a cost of MZN 1.2 billion. While the government’s short-term objective is to contain the deficit, the goal in the longer run is to finance infrastructure through non-concessional loans as from 2013, if preliminary disbursements over the 2011-13 period are adequately managed.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	22.1	25	25.3	27	26.6	26.8	26.5
Tax revenue	10.7	14.1	15.4	15.4	15.6	15.7	15.7
Oil revenue	0	0	0	0	0	0	0
Grants	10	9	9.4	9.4	8.8	8.9	8.7
Other revenues	1.4	1.8	0.5	2.2	2.2	2.1	2.1
Total expenditure and net lending (a)	29.1	27.3	28	32	32	32.7	31.9
Current expenditure	13.5	15.3	15.7	17.2	16.1	15.9	15
Excluding interest	12.3	14.7	15.1	16.7	15.6	15	14.4
Wages and salaries	6.2	7.7	8	8.8	7.7	7.1	6.8
Goods and services	2.8	3.2	3.3	3.4	3.4	3.4	3.2
Interest	1.3	0.6	0.5	0.5	0.5	0.9	0.7
Capital expenditure	12.1	11.2	11.5	13.2	14.6	15.5	15.8
Primary balance	-5.7	-1.8	-2.1	-4.5	-4.9	-5.1	-4.8
Overall balance	-7	-2.4	-2.7	-5.1	-5.4	-6	-5.4

a. Only major items are reported.
Source: Data from IMF and Ministry of Finance and Planning; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Monetary Policy

Inflation accelerated to double digits in 2010, due to rising international food and oil prices and the phasing out of fuel subsidies between March and August 2010. In addition, the metical depreciated by more than 30% in nominal terms against the currencies of major trading partners between January and July 2010, reflecting a recovering US dollar and a stronger South African rand. Donors' suspension of budget support until September 2010 also contributed to the depreciation of the metical during the first half of the year. The depreciation had only a minor impact on exports, owing to supply constraints, but the rising cost of imports penalised sectors that rely on foreign goods, with construction firms being particularly affected.

The supply of fruit and vegetables was also scarce following a poor agriculture year, and an unusual concentration of fuel imports in July-August 2010 further contributed to price increases. Water tariffs rose by 20% in the first five months of 2010, followed by another increase in September 2010, and electricity tariffs rose by 7.5% in September 2010. Lastly, loose monetary policies introduced to counteract the global crisis resulted in a 56% increase in credit and in the overheating of the economy by June 2010.

Faced with accelerating inflation and a depreciating metical, Banco de Mocambique (BM) raised interest rates on the standing lending facility from 12.5% in April 2010 to 16.5% in February 2011 and on the standing deposit facility from 3% at end-2009 to 5% in February 2011. The central bank also increased the legal reserve requirements for banks from 8% at end-2009 to 9% in February 2011. BM's restrictive measures resulted in higher interest rates and shorter-maturity loans for commercial banks' customers: the average annual interest rate charged on bank loans was 21.26% in 2010.

BM's intervention in the interbank market – it sold USD 70.3 million in foreign exchange in November, up from USD 50.5 million in October – caused the metical to appreciate in late 2010. Meanwhile, treasury bills worth USD 52.8 million were issued on the interbank money market in November. These measures improved access

to foreign currency for purchases of imports, particularly fuel.

The government expects inflation to decelerate to single digits in 2011, thanks to improved domestic food production, the stabilisation in international commodity prices and the extension of the urban transport and wheat flour price subsidies. The exchange rate is also expected to stabilise in 2011-12, due to a restrictive monetary policy and a new regulation approved in 2010 that will come into force in 2012: exporters will have to convert at least 50% of sales proceeds into meticals within the 50 days following a transaction. On the other hand, the persistent expansion of the domestic money supply beyond the economy's productive capacity constitutes a major risk to the improving outlook for inflation and the exchange rate.

External Position

The current account deficit widened slightly to 11.2% of GDP in 2010, despite the improvement in the trade balance, due to a 5.7% rise in food and oil imports and a decrease in factor income. Average prices of key imports increased, particularly those of maize (up 41%), wheat (35.9%) and oil (14.2%), following a deflationary period in 2009.

Exports picked up by 27.2%, following a drop in 2009 due primarily to a decline in aluminium prices. This recovery was sustained by a gradual improvement in the aluminium sector, where prices rose by 14.8% in 2010. The recovery in non-mega-project exports was sluggish in aggregate terms, however, despite the price rises in cotton (89.5%) and sugar (16.1%). Mega-projects accounted for 75% of exports and 20% of imports in 2010.

Exports will increase further in 2011, boosted by the expected 10.4% rise in aluminium prices and the contribution of the coal mega-projects. Accelerating food and oil price indexes are expected to raise the import bill. The current account balance will remain structurally negative in 2012 and thereafter, however, due to the dependence on imports of food, oil and manufactured products.

After an increase in aid inflows to 16% of GDP in 2009, this contribution is expected to decline gradually over the 2010-15 period. While project support should remain stable at 7.8% of GDP, budget support will steadily decrease from 9% of GDP in 2010 with the gradual phasing out of some donors' contributions after the controversial 2009 elections.

Despite the global downturn, net FDI inflows rose from USD 587 million in 2008 to USD 878 million in 2009 and USD 917 million in 2010 (a figure roughly equivalent to the USD 895.2 million in foreign grants received in 2010), primarily as a result of coal mega-projects. The government will almost double net non-concessional foreign borrowing, though remaining under the USD 900 million annual ceiling, over the 2011-14 period compared to 2008-09, in order to fund massive infrastructure programmes under PPP arrangements. While the debt service to exports ratio remains well below the 20% threshold, the present value of debt to GDP could exceed the 40% limit set by the International Monetary Fund (IMF) in the event of an extreme shock within the 2011-20 horizon.

Following the 30th Southern African Development Community (SADC) summit in August 2010, the launch of the SADC customs union, originally planned for 2010, was postponed to 2012 to allow further study of the impact of such a reform on member states. The SADC member states nonetheless reaffirmed their commitment to set up a monetary union in 2016. In 2010, Mozambique continued to remove tariff and non-tariff barriers and to harmonise its trade policies with those of SADC's Free Trade Area, in force since August 2008.

The European Union (EU) and SADC discussed the benefits of an Economic Partnership Agreement (EPA) in March 2010. Mozambique, Botswana, Lesotho and Swaziland were invited to complete internal procedures to bring the June 2009 interim agreement into force. These four countries, however, vowed not to implement the interim EPA until the EU addresses grievances raised by Namibia, South Africa and Angola. Under the EPA, Mozambique would improve its access to EU markets with respect to the 2001 Cotonou agreement, but would also give legally binding commitments concerning imports from the EU.

Table 5: Current account (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Trade balance	-17.4	-8.4	-11.6	-13	-8.4	-6.8	-7
Exports of goods (f.o.b.)	19.3	29.8	26.7	21.9	28.3	30	28.5
Imports of goods (f.o.b.)	36.7	38.2	38.3	35	36.7	36.8	35.5
Services	-5.7	-4.9	-4.1	-4.7	-5.1	-4.5	-4.4
Factor income	-4.1	-9.2	-8.5	-1	-4.7	-6.5	-6
Current transfers	3.6	6.4	7.8	7.8	7.1	7.4	6.5
Current account balance	-23.6	-16.1	-16.4	-10.9	-11.2	-10.3	-11

Source: Data from IMF and Bank of Mozambique; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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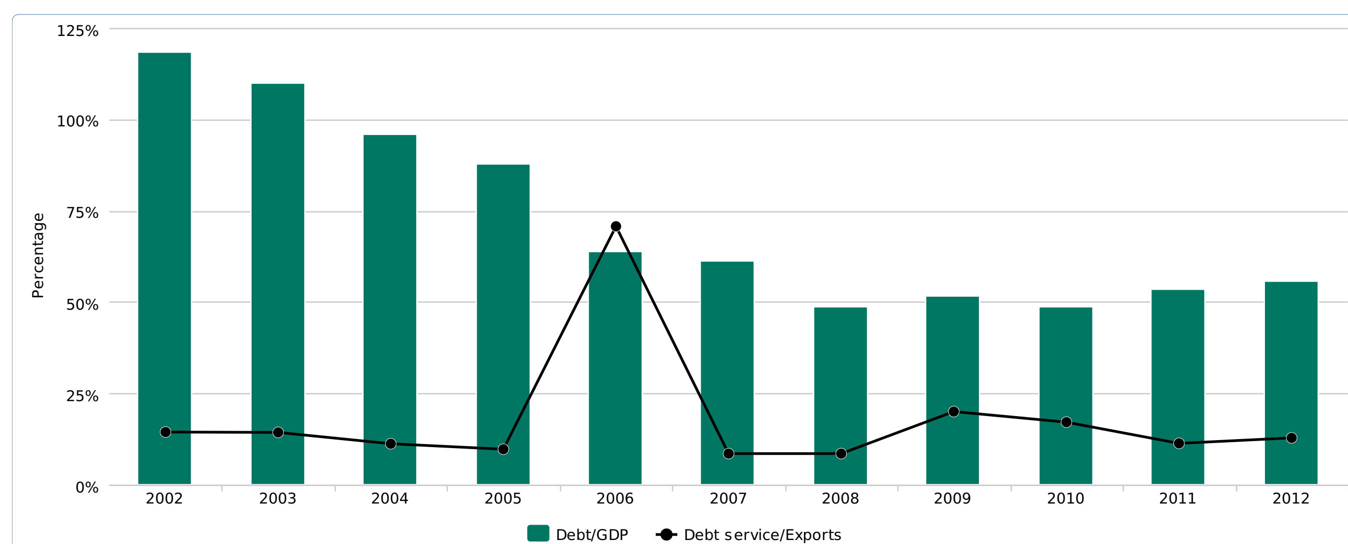
Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

The business environment continued to improve, as reflected in the World Bank's 2011 *Doing Business* report, which ranked Mozambique four places higher than the previous year, at 126th out of 183 countries reviewed. In 2010, Mozambique introduced reforms that facilitated starting a business, registering property and closing a business. A simplified licensing process lowered the total number of days required to register a business to 13 days, compared to an average of 45.2 days in sub-Saharan Africa. The high cost of capital, with higher nominal and real interest rates than in neighbouring countries, remains a challenge, however. Further reforms are needed to reduce transaction costs and speed up the ongoing land reform, as land titles still cannot be used as collateral to obtain credit.

Structural hurdles are hampering the industrialisation of the economy. The competitiveness of local SMEs is low compared to those in Mozambique's regional peers, due to the high cost of weak public services such as energy and transport, unskilled human capital and inadequate financing.

The government is committed to continuing its efforts to strengthen the domestic financial sector by implementing the recommendations of the IMF's Financial Sector Assessment Program. Measures include improved risk management, deposit insurance and enhanced supervision of commercial bank activities. These measures aim to improve the quality of loan portfolios, which will be undergoing regular stress tests. The current financial system is unable to finance big items with a long maturity, particularly in infrastructure.

The banking sector is highly concentrated, with over 90% of total financial assets in 11 private, foreign-owned commercial banks. The microfinance segment is relatively small and highly concentrated as well. Commercial banks are pushing to expand their services in rural areas, but poor rural infrastructure is slowing the shift towards a banked economy. Indeed, the ratio of private credit to GDP remains low, and below the sub-Saharan average. Over half of Mozambique's 128 districts remain without a bank branch, as most branches are being set up to service new rural investment projects. People living in rural and peri-urban areas own only slightly over 20% of savings accounts, although they account for the large majority of the population.

Mozambique's stock market, operating since the late 1990s, has failed to develop into a modern, transparent financial institution that enables Mozambicans to finance large national investment projects. Political elites have a vested interest in keeping efficiency low and information asymmetric, with the result that prices fail to reflect market information immediately.

The non-bank financial sector remains small and relatively disconnected from the banking system. The pension sector relies mainly on the state-run pay-as-you-go system.

Other Recent Developments

The second phase of the public sector reform will be finalised in 2011. It aims to improve the image of the public administration, based upon merit, integrity and quality. The decentralisation process will be strengthened through a new government plan covering the 2010-15 period that enables districts to manage and allocate their budgets through the overall financial management information system. Only 13.6% of civil servants work in central agencies.

The government is pushing for the creation of SEZs and IFZs to diversify FDI and develop local nodes of economic growth. To date, however, the SEZs have not lived up to their potential, as the local economy lacks the skills and capacity required to take advantage of the new business opportunities being created.

In 2010, the energy sector absorbed the biggest share of total public investment, concentrated in the new USD 1.9 billion hydroelectric plant in Tete. Other sectors attracting substantial public investment include services and agriculture. The latter, although it attracts a smaller share of total private investment, accounts for the majority of new employment created. Most private investment in 2010 came from South Africa, the EU and China. The main projects in agriculture are production of vegetable oils and bio-fuel processing plants.

To ensure that large investment projects generate wealth and employment through linkages with the local economy, Mozambique has promulgated a new procurement law requiring that at least 20% of each project be spent on national goods and services and that projects with over 100 employees have no more than 5% of foreign employees. Projects financed by official development assistance (ODA) are not subject to these requirements.

As long as Mozambique Telecom maintains its monopoly over fixed-line telephony and broadband infrastructure, telecommunications costs are not expected to decrease. The market for mobile telephony is more liberalised,

with two mobile operators, mCel and Vodacom Mozambique. In 2010, a Vietnam-based consortium obtained a licence to become the country's third mobile operator. The consortium plans to invest USD 465 million over the next five years.

The SEACOM fibre-optic submarine cable and the alternative East African Submarine System (EASSy) link, accessible through a landing station in Maputo, should gradually make services cheaper in the capital, but connecting remote rural areas remains a challenge. To that end, the government will launch a public tender in 2011 to install a new fibre-optic network to connect hospitals, schools and government buildings across the country. In order to promote the use of information and communication technology, the government is seeking to increase the coverage of public facilities providing free Internet access and information technology services from 50 districts to all 128 districts.

In 2009, the government approved a long-term strategy to develop an integrated transport system that would facilitate investment, raise competitiveness and stimulate regional integration. The strategy takes into account the World Bank's three development corridors in Maputo, Nacala and Tete. It aims to reduce transaction costs, facilitate intermodal freight transport and promote tourism. Coastal maritime transport should benefit from an upgrade of all port infrastructure. A new international airport will be built in Pemba to stimulate tourism, while the other four airports will be upgraded to regional hubs.

Most improvements in the rail sector are financed by private partners interested in coal extraction. The national railway company CFM refurbished rolling stock to transport coal from South Africa to the international market through the port of Matola. The completed Sena railroad should increase transport capacity by 6 million tonnes of cargo per year. Further upgrades of existing transport channels will be necessary to meet the increased demand, which is expected to reach 100 million tonnes by 2025.

Access to electricity improved (17% of the overall population in 2009, up from 14% in 2005), but remains low. The Mozal aluminium smelter alone consumes 900 megawatts (MW), over 70% of the total power output of the Cahora Bassa hydroelectric plant. International donors will provide USD 530 million to fund short- and medium-term projects for electricity generation in Mozambique. From 2013 onwards, the Benga power plant is expected to produce 500 to 600 MW, with future expansion increasing capacity to 2 000 MW. These investments remain far below what is needed to meet current energy needs.

The government's plan is to improve agricultural productivity to stimulate economic growth and reduce poverty. Over the last decade, however, GDP per capita has increased while agricultural output per capita declined. Agriculture absorbs only 10% of private investment, of which 90% is geared to export-oriented crops. The government plan, which since 2007 has allocated USD 400 million to maize, rice, wheat, soya, sweet potato and manioc farming, has not as yet brought a solution to the problems of low productivity, food insecurity and volatile prices. Storage facilities and transport infrastructure are insufficient to distribute food efficiently across the country.

Following the Cancun summit in August 2010, Mozambique strengthened its strategy to adapt to climate change and mitigate its impact on the agricultural production cycle. Coastal erosion, cyclones and floods strongly affect most of the big cities, which are all located on the coastline. Approximately 1.6% of the budget is dedicated to climate change, below the United Nations (UN) recommendation of 2.5%.

Emerging Economic Partnerships

Mozambique is highly dependent on external partners to provide basic public services and infrastructure. Whereas traditional donors emphasise social sectors, including education and health, emerging partners tend to focus on agriculture and infrastructure projects. Data on such emerging bilateral co-operation and investments are not captured through traditional information channels; they remain scarce and highly inaccurate, in particular with respect to Chinese activities.

Mozambique's three main non-traditional partners are China, Brazil and India, although other countries are increasingly active as well. Vietnam acquired the third mobile telephony licence and promotes agricultural research. Saudi Arabia plans to invest USD 100 million in an upscale tourism resort. Sectors of interest to the private sector do not differ strongly between traditional and emerging partners: all aim to acquire a stake in the extractive industries and the construction sector. China has a strong interest in tropical hardwood and fisheries, whereas Brazilian and Indian conglomerates are extracting coal. The aluminium sector's output is already captured by the EU, mainly the Benelux countries and Italy.

China's presence dates back to Mozambique's struggle for independence. Over the last decade, China's bilateral co-operation increased its activities in major public works, including transport, water and sanitation. China also supports the government's efforts to boost agricultural productivity through experimental research centres, focusing on increasing yields for rice production. The Mozambican government is now trying to encourage the Chinese private sector, already heavily involved in the logging industry, to further invest in the country, notably in the energy sector. In 2011, Chinese companies will construct a car assembly line and a cement factory. China trade flows to Mozambique increased eight-fold during the last decade, while Mozambican exports to China nearly doubled in the same period. In 2010, bilateral trade (mainly agricultural, fisheries products and manufactured goods) was estimated at USD 270 million.

Brazil focuses on capacity building and exchange of best practices in order to help Mozambique improve its social indicators and food security. The Brazilian private sector is very active in the coal industry and related infrastructure works, but trade remains limited so far. Diplomatic ties have been intensifying, culminating in President Lula's November 2010 visit to attend the inauguration of a factory that produces antiretroviral drugs. Brazil tends to engage in triangular co-operation for research projects to boost agricultural productivity, notably with Japan or South Africa. It is also active in education, including technical and vocational skills, capacity building in public administration, and scholarships. At the request of the government, it plans to provide technical assistance to strengthen the manufacturing sector. Similarities between Brazil and Mozambique in soil structure as well as in development challenges offer scope for strong collaboration in the future.

India's priority for the coming years is to secure access to sufficient coal from southern Africa, including Mozambique, where it has already acquired two coal mines. Its private-sector activities also include the construction of training centres for local staff and a thermal power plant to provide electricity to the Benga coal project and the Tete region. Together with Brazilian companies, Indian firms will undertake construction works related to coal transport, including the railway from Tete to Beira. Additionally, India maintains a concessional credit line of USD 140 million, mainly for rural electrification and water management.

Traditional donors and emerging partners differ in the way they engage with the Mozambican government. Western partners emphasise governance, security and social indicators and try to harmonise their engagement through the G19, with each donor providing general budget support. Emerging partners, in contrast, focus on infrastructure and business. Emerging partners' co-operation and investment are, with the exception of Brazil, often tied to their national enterprises. Brazil and India tend to work with local partners, hire local staff and provide technology transfers.

Mozambique's engagement with emerging partners is serving as a political tool to reduce the country's dependence on, and accountability to, western donors, who currently finance 47.8% of the government's budget. ODA flows from traditional donors have become more uncertain, due to budgetary pressures on the donors' side and increasingly stringent conditions with regard to governance. Following Angola's example, Mozambique aims to become more assertive in its relations with donors as earnings from the extractive industries increase.

Thus far, the government has taken a very positive view of the projects undertaken with emerging partners and is seeking to increase emerging countries' involvement through projects financed by non-concessional loans. The emergence of new players has strengthened the country's bargaining power, as evidenced by improved terms in the coal extraction contracts. The agricultural sector, neglected by Mozambique's traditional partners in favour of education and health, is also receiving more attention. The impact of the new partners' growing involvement is not entirely positive, however. In 2010, a clash between Chinese management and local workers over working conditions resulted in the death of two African employees. Illegal practices by Chinese private companies, involving local officials, have also been reported in the logging and fishing industries.

Political Context

The ruling party, Frente de Libertação de Moçambique (Frelimo), has increasingly been centralising political power, relegating the largest opposition party, Resistência Nacional de Moçambique (Renamo), to a marginal role. Under 24 years of Frelimo rule, the democratic process has gradually been eroded, straining government relations with the donor community. This concentration of power is the result of closely intertwined political and economic interests, estranging the government from its constituency. The ostentatious behaviour of the present government and president stand in sharp contrast to the high levels of poverty in rural Mozambique.

With Renamo in disarray, a new contender, the Movimiento Democratico de Moçambique (MDM), is gaining prominence, but does not offer a genuine political alternative in the short term. The government promulgated a new electoral law requiring that a party must obtain a given threshold proportion of the national vote to obtain any seats in the parliament. Municipal elections are to be held in 2013, with the next national and presidential elections scheduled for late 2014.

The three days of serious civil disturbances in September 2010, sparked by rising food and utilities prices, were rooted in a deeper problem of eroding purchasing power. Although the riots involved a minority of the population, they reflected a general sentiment of discontent. They were repressed brutally by the police, resulting in 18 casualties. Although the government subsequently introduced wheat flour subsidies, further unrest is possible if food prices continue to increase.

Social Context and Human Resource Development

Notwithstanding steady progress on social indicators, Mozambique's population remains highly vulnerable. The urban population, which accounts for about 30% of the total population, is exposed to international macroeconomic shocks, while the rural population suffers from the effects of the climate change, which can damage harvests and undermine food security. According to UN data, the country is not on track to meet most of the MDGs. The government's commitment to improve food security is unlikely to halve the proportion of those suffering from hunger by 2015 because of irregular harvests and structural constraints, which hamper the distribution of excess food production from the north to the southern and central regions. The 2010 Human Development Index ranked Mozambique 165th out of 169 countries.

The latest survey, published in September 2010, showed that poverty remained high despite sustained GDP growth over the past decade. Consumption poverty levels remained the same as in early 2003, at around 55% of the population. Fluctuations in agricultural output strongly affect consumption poverty levels and food security, making progress in poverty reduction fragile and reversible. The level of inequality in Maputo is significantly higher than in the rest of the country, as evidenced by a Gini coefficient of 0.51. A specific government fund is being considered to tackle strong regional disparities in poverty.

The government's poverty reduction strategy focuses on creating jobs, increasing agricultural output and expanding human capital. Unfortunately, the Ministry of Planning lacks the administrative capacity needed to co-ordinate the various initiatives from line ministries with the government's macroeconomic policy in order to implement this strategy successfully.

Substantial past investments in primary education have borne fruit as net enrolment rates reached 92% in 2010, compared to 76.1% in 2005. The current budget allocates 18% to the common fund that finances the implementation of Mozambique's 2010-13 strategic plan for the education sector. The gender parity index improved in both primary and secondary education, to 0.94 and 0.90 respectively. Access to secondary education nonetheless remains a fundamental structural bottleneck to growth: current levels of infrastructure and staff are incapable of absorbing the large number of pupils finishing primary education. The government actively supports technical and vocational education and training (TVET) as a means of both absorbing pupils who are unable to enter secondary education and providing a technically skilled workforce for nascent manufacturing industries. The results are disappointing, however, due to insufficient and obsolete teaching materials, as well as negative popular perceptions about the value of TVET.

The results of the yearly national examination indicate that the quality of the education system has worsened. The ambition to raise enrolment rates has not been backed by substantial investment in staff, infrastructure and study materials. The pupil-teacher ratio improved from 66 in 2005 to 58 in 2010 for primary education, but worsened from 32 in 2005 to 34 in 2010 for secondary education. Both government and donors are aware of the urgency of the situation, but it will not be easy to mobilise additional funding. Donors mention the lack of inclusive dialogue and transparency as one of the main reasons for their gradual phasing out of education projects. They also point out that a significant portion of the budget is being wasted due to embezzlement and a lack of absorptive capacity.

The number of health centres, rural hospitals and general hospitals has grown steadily since 2003, but Mozambique continues to have one of the most under-staffed health sectors in the world, with only one doctor per 30 000 inhabitants and one nurse per 3 000. Malaria is the leading cause of death in Mozambique (29%), followed closely by HIV/AIDS (27%). Child mortality in the first month and maternal health remain a challenge. The maternal mortality ratio, although improving, remained high at 550 for 100 000 births in 2009, compared to 640 in 2005.

According to the World Bank, the national HIV prevalence rate was 13% in 2008, up from 10% in 2000. A study undertaken in 2010 revealed that prevalence remains particularly high among 15- to 24-year-olds. It is also high in the southern part of the country, including Maputo, due to the proximity of neighbouring countries with high HIV rates, whereas the north has seen prevalence rates drop as a result of its relative economic isolation. The National Strategic Plan (NSP) to fight HIV will increase prevention efforts and better target groups at risk by focusing on social behaviour and religious habits.

Donor co-ordination and alignment of aid directed at HIV/AIDS are improving as a result of strong pressure from the government. Around 45% of people who need antiretroviral drugs are covered by the NSP, receiving free treatment in national health centres. The objective for 2011 is to raise coverage to 95% by improving access in remote rural areas. Future challenges include applying the NSP at district level, as well as co-ordinating, monitoring and communicating the national response.