



Easing access to credit

The Mozambican News Agency (Agencia de Informacao de Mocambique, AIM) released an article on 12 October reporting the Bank of Mozambique's desire to strengthen the credit rating system, so that lenders can assess the creditworthiness of individuals and firms seeking to borrow, which would improve the accessibility of credit.

Access to credit is a common constraint in sub-Sahara African countries, especially for individuals and proprietors of small and medium size businesses. In most cases only high net worth individuals and large corporates are able to access credit. One of the main reasons for this state of affairs is the asymmetry of information. According to the World Bank's Doing Business 2007 survey, Mozambique has a central credit registry, which is a public registry; however, it only covers a meagre 0.7% of adults. The registry compiles information on individuals and firms. Borrowers are permitted by law to inspect their credit rating. However, the registry only records information from financial institutions, so it gives an incomplete picture of a borrower's credit profile as it does not include their credit lines from retailers and utilities.

The little credit information that is available through the public registry is excellent and accessible unlike that offered in most of the southern Africa region. However, the laws designed to improve access to credit are not as progressive as those of Mozambique's regional neighbours. For instance, the law does not allow for general descriptions of debt so it precludes all types of assets from being used as collateral and it fails to provide general descriptions of debt, so not all types of obligations can be secured. Even in the limited instances where borrowers can provide security, a registry does not exist for all security rights in movable property and outside of bankruptcy procedures they are vulnerable as they do not have absolute priority to their security. In addition, during a company's reorganisation, management's control of company assets is not suspended.

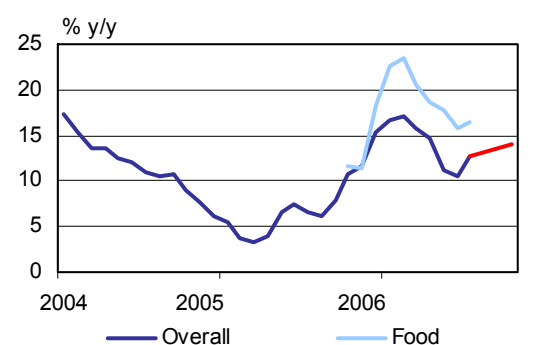
As the public registry is already in place, the central bank's challenge is to increase the credit information in the registry so that lenders are able to make more accurate credit assessments. Such measures will reduce the time and cost of processing a credit application and the bad debt ratio, which will improve the profitability of financial institutions and health of the financial sector. A healthy financial sector should manifest into cheaper credit lines and greater access to credit.

Inflation

After declining for four consecutive months to this year's low of 10.6% y/y in August, overall inflation accelerated in September to 12.7% y/y. The increase in overall inflation in September was largely due to rising food inflationary pressures. After falling for four months, food inflation increased in September by 0.85% m/m, indicating that food prices are picking up as we enter the lean season of October to March. This was also reflected in September's annualised food inflation rate, which accelerated to 16.48%.

Although the annualised energy inflation rate peaked at 22.25% in September, which is this year's high, monthly inflation slowed to 2.59% from a high of 6.32% in June. The high 12-month energy inflation rate reflects a low base, otherwise energy prices have eased as demonstrated by the waning monthly increase in prices.

FIGURE 1: INFLATION



Source: Instituto de Nacional Estatistica



We expect overall inflation to edge upwards in the short term as falling food supplies put pressure on prices and demand related to the festive season rises.

Money supply

Broad money (M3) comprises deposits, and notes and coins in circulation. Deposits constitute about 85% of M3. The tightening of monetary policy earlier this year had a more significant effect on deposits, which fed through into M3. Conversely, the rate of notes' and coins' expansion was steady at about 19% over the first eight months of this year.

After falling for four consecutive months from 33% y/y in February to 17% y/y in June, the growth rate of broad money picked up in July to 21% y/y and remained steady at this level in August.

In August, the central bank relaxed its policy stance. It is the moderate easing of monetary policy that prompted the brief spurt of monetary expansion before stabilising.

The monetary authorities are targeting an annualised rate of monetary expansion of 15% for the end of this year, which they deem to be a comfortable level to stimulate credit extension without being inflationary. In June, this rate of expansion seemed achievable, however, monetary growth has since accelerated to 21% and appears to be holding steady.

Private sector credit

The acceleration of private sector credit growth between the second quarter of 2005 and the first quarter of 2006 was due to three factors: the inclusion of the operations of a leasing company purchased by Banco Internacional de Mocambique (Mozambique's biggest commercial bank) in the monetary survey since December 2005; borrowing by domestic petroleum distributors related to the syndication of oil import transactions; and the resumption of consumer credit lines as the health of the banking sector improves.

The rapid rate of monetary expansion and credit extension prompted a tightening of monetary policy in the first quarter of this year. Consequently, private sector credit growth slowed from 70% in February to 37% in June. The annualised rate of private credit extension remained steady in July, and then climbed to 39% y/y in August following the easing of monetary policy.

Due to the dollarised nature of the Mozambican economy, credit was extended foreign currency to the private sector. However, following macroeconomic stabilisation the authorities have elected to de-dollarise the economy. The rate of expansion of metical loans slowed to 94% y/y in August for the third consecutive month. Foreign currency loans extended to the private sector began to contract in June and continued to do so in July. In the 12 months to August, foreign currency loans extended to the private sector declined by 4%. The contraction of foreign currency loans reflects the effect of the 50% provisioning requirement on commercial banks that makes it more expensive for them to extend non-metical credit.

We expect the rate of private sector credit extension to stabilise at current levels over the short term.

FIGURE 2: MONEY SUPPLY GROWTH

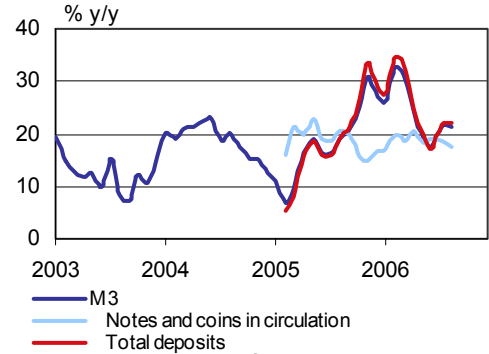
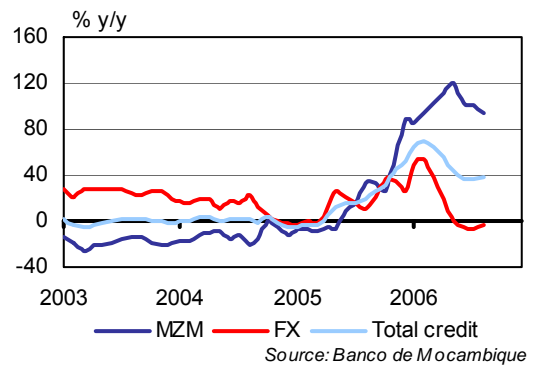


FIGURE 3: PRIVATE SECTOR CREDIT





Interest rates

The central bank eased monetary policy in August by cutting the policy interest rate (the standing lending facility interest rate) by two percentage points to 17% and remained at that level in September. The monetary authorities felt comfortable relaxing monetary policy following the slowdown of monetary expansion and the easing of overall inflation. According to the central bank, the policy rate was also shaved to lower the real interest rate which had risen too high on account of the falling inflation rate. The yield on the 91-day Treasury bill dropped to 15.5% in August, in line with the decline in the policy rate, and was at this level in September.

The prime lending rate, which is the most rigid of the three interest rates, fell to a record low of 17.89% in August from 18.29% in July. The gradual easing of the prime rate reflects the improvement in the health of the banking sector. The bad debt ratio has fallen, enabling banks to lend more; competition in the sector increased as new entrants came into the market and international banks invested in the sector; and fiscal dominance has receded, enabling banks to service domestic debt and reduce domestic borrowing, which eases short-term interest rates.

Although inflationary pressures will rise in the last quarter of 2006 and the first quarter of 2007, we expect interest rates to remain stable in the short-term, especially as the cause of inflation is exogenous.

Exchange rates

In September, the new metical weakened against the US dollar, compared to August, by 1% to MZN26.04 per US dollar. The new metical's loss of value against the dollar reflects a recovery of the US dollar that stemmed from positive data out of the US, which calmed fears of the US economy experiencing a hard landing. The US economic slowdown is projected to be gradual.

Although the new metical remained steady against the euro in September at MZN33.08 per euro, it strengthened by a significant 5.5% against the rand to MZN3.50 for one rand on account of rand weakness. Structural imbalances in the form of a large current account deficit explain the sharp loss in value of the South African currency.

The oil price, which has fallen by at least 20%, may provide some relief to the trade account and the metical. However, the approaching festive season typically leads to an increase in consumer demand for goods and services, including imports, which puts pressure on the metical to weaken. We expect the metical to weaken moderately over the short-term, particularly due to emerging inflationary pressures.

FIGURE 4: INTEREST RATES

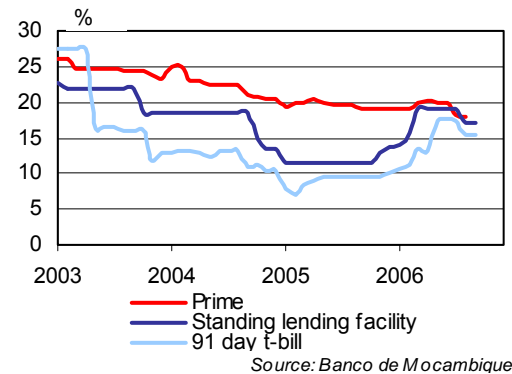
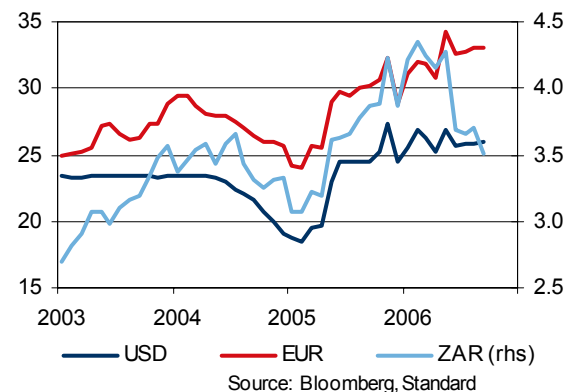


FIGURE 5: EXCHANGE RATES





Government finances

Government revenue rose by 30% q/q in the second quarter of 2006 to MZN6.70 million from MZN5.17 million in the first quarter. Mozambique's tax revenue to GDP ratio, 13.2% in 2005, is significantly lower than that of its neighbours and the sub-Saharan Africa average of 24.1%. This is attributed to a high level of non-compliance, especially for VAT collections, and generous tax concessions. However, revenue mobilisation is gradually improving due to measures implemented by the fiscal authorities.

Also in the second quarter grant receipts increased by 8% q/q to MZN3.76 million. The government has secured US\$583 million in direct budget support for 2007 under the "Programme Aid Partners" initiative that comprises the World Bank, the African Development Bank, the European Union and other individual EU countries. At today's exchange rate, that works out to approximately MZN5.5 million per quarter. Mozambique's good relations with foreign donors give assurance that the authorities' large projects will be facilitated by donor funding.

In the second quarter, government spending increased by 24% q/q to MZN11.11 million. The government's huge infrastructure drive explains its increase in expenditure. In the third quarter the government announced two new projects in the pipeline that are focused on road rehabilitation and urban renewal. Government spending is hence expected to continue rising.

The budget deficit doubled in the second quarter to MZN646 000 compared to the first quarter on account of the higher spending. In the medium term the budget deficit, excluding grants, is expected to deteriorate, despite the gradual improvement in revenue mobilisation, because of the large development projects that the government has in the pipeline. However, a sizeable portion of the deficit will be comfortably financed by donors.

Aluminium

Mozambique is one of Africa's six main aluminium producers. According to the IMF, aluminium generated 60% of total export earnings in 2004. However, as all the aluminium ore is imported and not mined in Mozambique, the metal's net contribution to the trade account is moderate.

Africa's monthly aluminium output breached the 150 000 metric tonnes level for the first time in October 2005. For most of 2006, monthly output has been in excess of 150 000 tonnes. In August, 159 000 tonnes of aluminium was produced in Africa.

The aluminium price surged from US\$1 731.30 a metric tonne in June 2006 to a record high of US\$2 873.43 in May 2006. The narrowing emerging market spread, on account of a rising US Fed rate, prompted a sharp sell off of emerging market assets, including commodity-linked securities in May. This explains the drop in the aluminium price to US\$2 532.41 in June 2006. The aluminium price was stable throughout the third quarter and averaged US\$2 528.05 in September. On 17 October the price of a metric tonne of aluminium was US\$2 674, implying that the price may be climbing again.

FIGURE 5: GOVERNMENT FINANCES

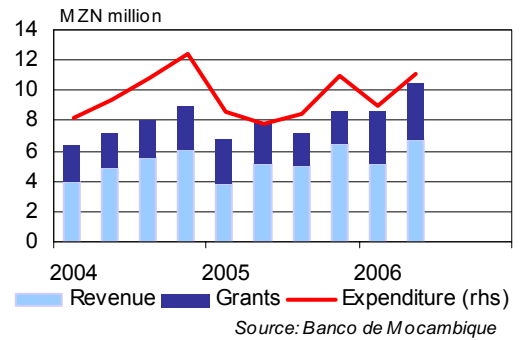
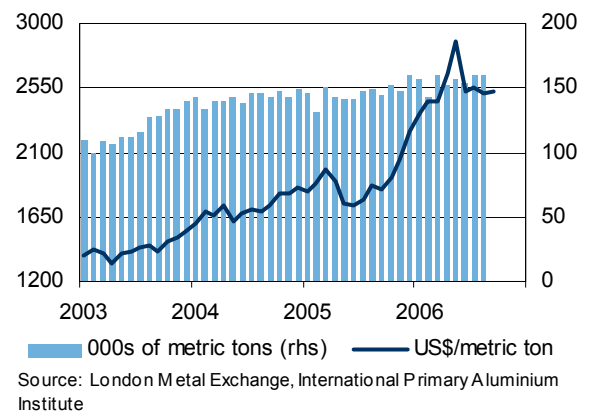


FIGURE 6: ALUMINIUM: WORLD PRICES AND AFRICA'S OUTPUT





Tobacco

Mozambique's burley leaf production has increased consistently from the beginning of this millennium. Burley production surged from 6.1 million kilograms in 2000 to 44.1 million in 2005, which is a seven-fold increase. This year's burley production is estimated at 48 million kilograms and is projected to increase by 0.5 million kilograms in 2007. Favourable agricultural policies have contributed to the significant expansion of the tobacco industry.

Low grower prices and the attractiveness of the high-quality African filler burley that only grows in two African countries, of which Mozambique is one, have also contributed to the expansion of burley production. African filler burley is expected to sustain the continent's tobacco industry. Burley production will continue to increase as long as grower prices remain low and attractive to manufacturers.

Sugar

Sugar, which contributed 3% to export earnings in 2004, generates an equivalent amount of foreign currency earnings as tobacco. EU sugar reforms that will gradually increase access for Mozambican sugar from 2006 to 2009 have stimulated investment in the industry.

The commodity boom was also reflected in the industry by the surge in the price of a pound of sugar in the 12 months to April 2006, from 8.61 US cents to 17.13 US cents. However, the change in emerging market sentiment, prompted by indications at the time that the US Fed would continue to hike the Fed rate, led to declines in the prices of emerging market assets, including commodities. From the middle of 2006, the sugar price has been falling and in September had dropped to 10.85 US cents a pound.

The current sugar price is at the level it was a year ago. We expect continued access to preferential markets such as the EU to sustain the industry.

FIGURE 7: TOBACCO: BURLEY LEAF PRODUCTION

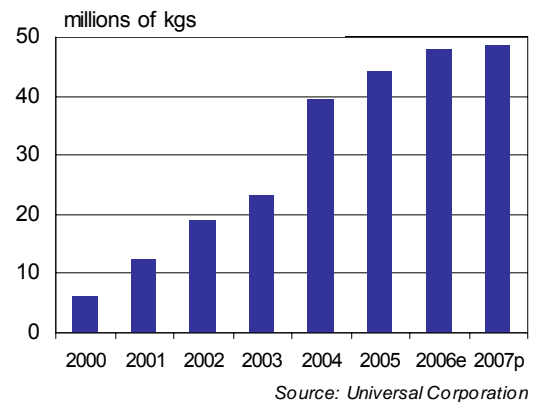
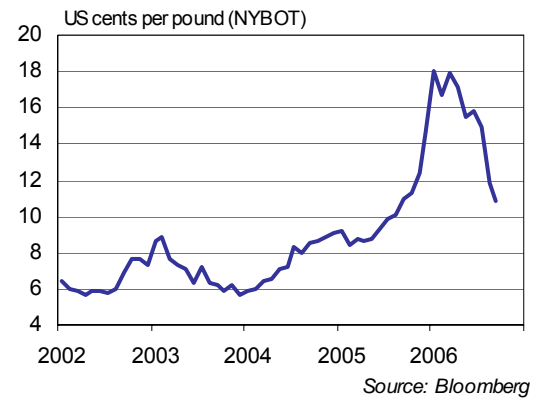


FIGURE 8: SUGAR





Summary forecasts

	2000	2001	2002	2003	2004	2005e
Balance of payments (US\$ million)						
Exports	364	704	810	1,044	1,504	1,726
Imports	-1,163	-1,063	-1,543	-1,741	-2,035	-2,387
Trade balance	-799	-360	-733	-697	-531	-661
Services and Income (net)	-243	-605	-210	-257	-312	-483
Current account (before grants)	-1,042	-965	-943	-953	-843	-1,144
Current account (after grants)	-482	-462	-543	-440	-352	-594
Trade credit (net)	-	-	-129	-94	43	0
Foreign borrowing	544	167	802	395	463	561
Public	222	115	259	236	315	356
Private	322	52	543	160	148	205
Amortisation	-373	-403	-182	-210	-303	-279
Direct investment (net)	139	255	380	342	241	135
Other investment of the government*	-	-	-	-	-123	24
Capital account	310	19	871	433	320	441
Errors and omissions	-180	99	-230	129	244	69
Overall balance	-351	-343	98	122	212	-83
BoM gross reserve assets (increase -)	-98	-82	-98	-122	-212	83
Net change in arrears (increase: +)	0	0	0	0	0	-
Debt relief	449	425	0	0	0	-
Financing (change in reserves)	351	343	-98	-122	-212	0
Government finances* (meticaís billion)						
Tax revenue	6,862	8,400	10,629	13,629	15,598	18,923
Non-tax revenue	474	672	1,070	1,428	1,085	2,167
Total revenue	7,535	9,469	12,057	14,714	16,838	21,089
Grants	4,576	10,520	10,020	10,841	10,053	11,791
Current expenditure	7,686	10,345	13,468	16,341	19,006	22,099
Capital expenditure	6,060	11,808	12,149	13,362	12,543	17,942
Total expenditure and net lending	15,558	24,579	29,031	30,184	32,607	41,408
Overall balance (including grants)	-7,980	-15,211	-16,765	-15,928	-16,078	-20,319
Overall balance (excluding grants)	-3,404	-4,691	-6,745	-5,087	-6,025	-8,162
Domestic (net)	2,438	3,309	5,939	4,994	4,271	231
External (net)	966	1,382	806	93	1,754	7,931
Total financing	3,404	4,691	6,745	5,087	6,025	8,162
Supplemental indicators						
Real GDP growth (%)	1.9	13.1	8.2	7.9	7.5	7.7
Nominal GDP (shilling bn)	58,355	76,545	96,883	113,811	137,425	152,894
Annual average inflation (%)	12.74	9.05	17.15	13.45	12.71	7.15
3 month t-bill rate (year end)	21.55	31.65	27.50	13.00	10.49	9.99
Exchange rate (annual average)	15,569	20,589	23,271	23,373	22,149	22,835
Exchange rate (year end)	15,739	20,778	23,295	23,308	21,939	23,091
Gross official reserves (US\$ mn)	746	727	823	858	1,159	1,076
Months of import cover	6.1	5.8	4.4	6.0	5.8	4.6
Current account to GDP excl. grants (%)	28.2	26.8	28.1	39.0	14.1	17.0
Tax revenue to GDP (%)	12.9	12.4	12.4	12.9	12.6	13.8
Government expenditure to GDP (%)	26.7	32.1	27.9	26.5	24.4	27.1

* Tracks movement in the government account set up abroad with the proceeds of the coal mine concession (Moatize coal mine).

Source: IMF



Picture Gallery

FIGURE 1: MAJOR CPI COMPONENTS

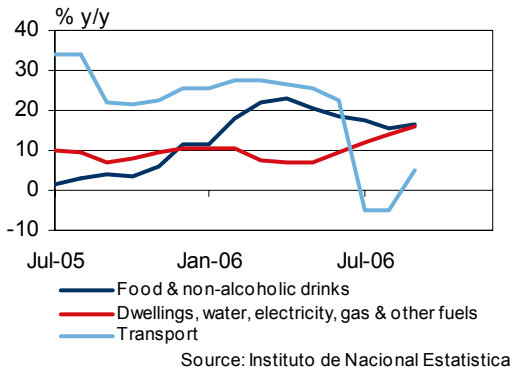


FIGURE 2: CPI WEIGHTS

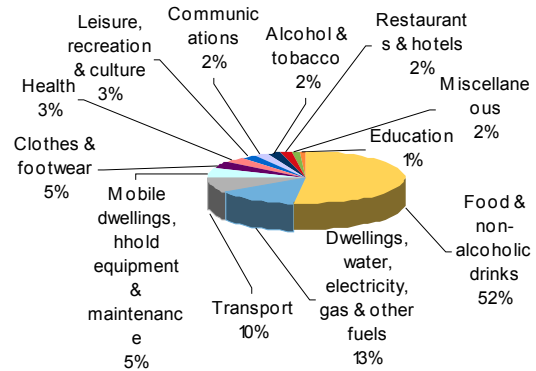


FIGURE 3: CONTRIBUTION OF MEGAPROJECTS TO EXPORTS

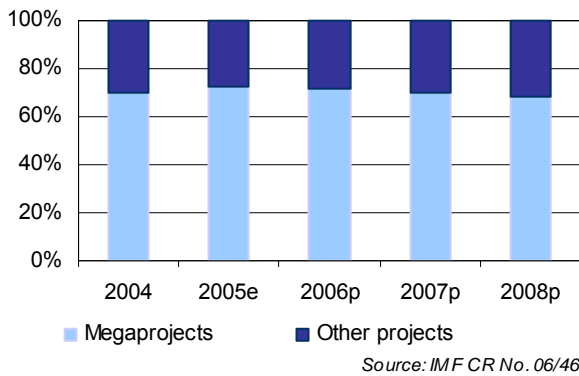


FIGURE 4: CONTRIBUTION OF MEGAPROJECTS TO IMPORTS

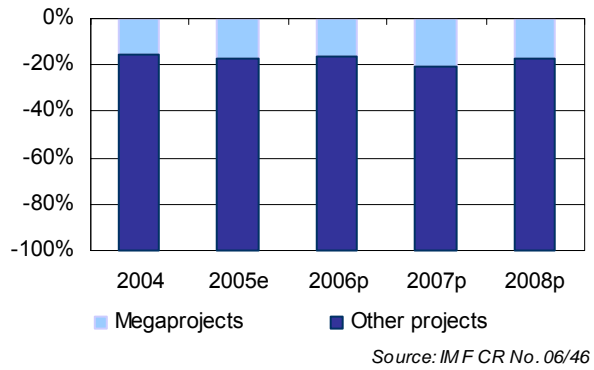


FIGURE 5: GROSS FOREIGN RESERVES & IMPORT COVER

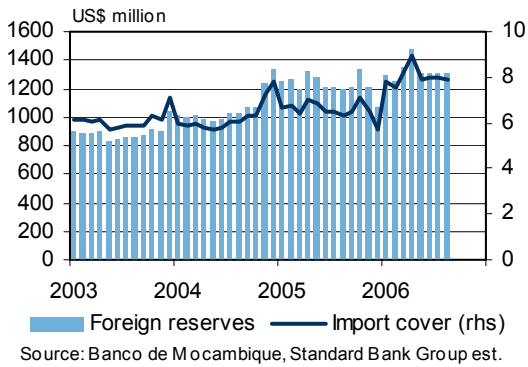


FIGURE 6: EXTERNAL DEBT

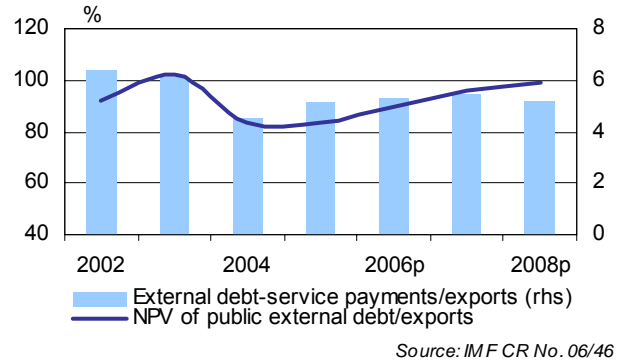


FIGURE 7: SECTORAL DISTRIBUTION OF LOANS

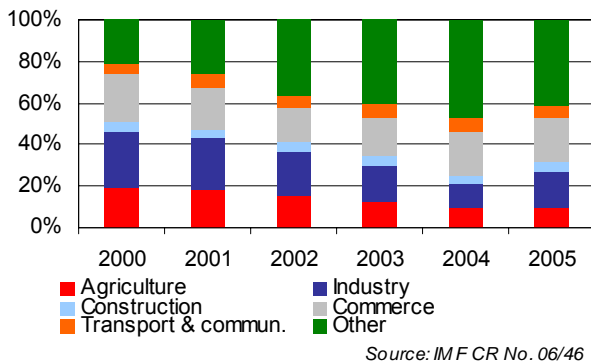
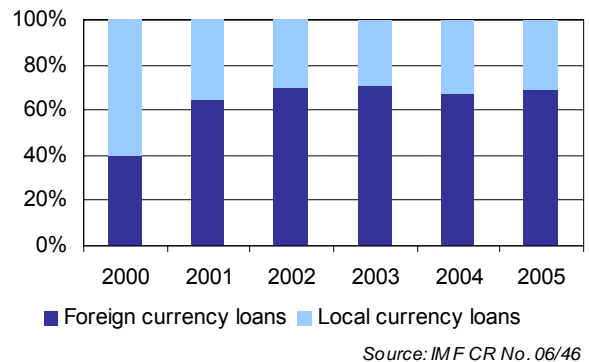


FIGURE 8: FOREIGN & LOCAL LOANS





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