Country Report

Mozambique

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The Economist Intelligence Unit

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Mozambique

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Highlights

Editor: **Sebastien Marlier**

Forecast Closing Date: **August 5, 2014**

Outlook for 2014-18

- The ruling party, the Frente de Libertação de Moçambique (Frelimo), will dominate the political landscape in 2014-18, winning national polls in 2014.
- Filipe Nyussi, Frelimo's presidential candidate, will succeed Armando Guebuza as president. Attempts by Mr Guebuza to retain influence from behind the scenes could trigger tensions, but a party split is unlikely.
- Tensions between security forces and Resistência Nacional Moçambicana (Renamo) militias threaten stability, but a widespread conflict is unlikely, given both parties' commitment to talks and Renamo's relative military weakness.
- Mozambique's fiscal deficit is set to narrow from 10% of GDP in 2014 to 7.3% of GDP in 2018 as brisk GDP growth and rising mining royalties boost fiscal revenue, more than offsetting declining aid and rising expenditure.
- Driven by a minerals and investment boom, real GDP growth will accelerate from 7.3% in 2014 to 7.8% in 2016, before moderating to 7.5% in 2018. Political tension and easing commodity demand will prevent faster growth.
- Average inflation will slow to 3.9% in 2014 from 4.2% in 2014 owing to falling international food and fuel prices. Inflation will remain below 5% in 2015–18, helped by further declines in global oil prices and currency appreciation.
- Imports for coal and gas investments will keep the current-account deficit wide in 2014–18. However, driven by rising coal exports and falling oil prices, the deficit will ease from 39.2% of GDP in 2014 to 32.9% of GDP in 2018.

Review

- Antonio Muchunga, a senior Renamo spokesman and member of the Council of State, has been arrested. The arrest may exacerbate the fear of the Renamo leader, Afonso Dhlakama, that he will also be detained if he leaves the bush.
- In a sign of their growing assertiveness toward businesses, the Mozambique authorities have fined some 50 companies for environmental violations.
- The Anglo-Australian mining company Rio Tinto has sold its Mozambican coal assets to a state-backed Indian entity, International Coal Ventures Private Limited (ICVL), for US$50m, a fraction of their purchase price three years ago.
- The Oil and Natural Gas Corporation, India's largest energy firm, has raised US$2.2bn in bond issues to finance the purchase of gas assets in Mozambique.
- Mozambique's economy grew by 7.5% year on year in the first quarter of 2014, driven by extractive industries, financial services, manufacturing and electricity and water production. Agriculture grew by a more modest 5.6%,
- Several energy firms have announced plans to study the potential to build Gas-to-liquids plants in Mozambique to use the country's gas resources.

Outlook for 2014-18

Political stability

The ruling party, the Frente de Libertação de Moçambique (Frelimo), will remain the dominant political force in 2014-18 and will win national elections in October 2014 comfortably. Filipe Nyussi, the former defence minister and Frelimo's presidential candidate, is set to succeed Armando Guebuza as state president after the 2014 election. Mr Nyussi's nomination in March, after fierce internal tensions, was a decisive victory for Mr Guebuza, who, despite serving his second and final term as the country's president, is keen to retain power behind the scenes. Mr Guebuza's re-election as Frelimo's president in 2012—under Frelimo statutes, the party and its president have authority over elected officials—and the appointment of Mr Nyussi, a relative lightweight who owes his ascent to Mr Guebuza, should enable him to do so. This risks further alienating Frelimo's anti-Guebuza factions, which decry his authoritarian and heavy-handed leadership and the lack of openness within the party. There is also a risk that Mr Nyussi will seek to distance himself from his mentor and assert his own authority, creating conflicting centres of power. However, Frelimo's 40-year tradition of unity means that party splits are unlikely.

Tensions between the government and the historical opposition party, the Resistência Nacional Moçambicana (Renamo), will continue to threaten political stability. In the two decades since the end of the civil war, Renamo has struggled to evolve into a well-organised and credible political party, while Frelimo has reinforced its control over political and economic institutions. Frustrated at having gained little benefit from peace, Renamo has since April 2013 been staging frequent guerrilla-type attacks, hoping to put pressure on the government in order to secure better representation in political and military institutions, as well as a larger share of the country's earnings. Frelimo's response thus far has included both heavy-handed military operations and the granting of concessions. The risk of widespread disruption or a return to civil war is low, not least given that both parties remain committed to reaching a negotiated settlement—there were rumours in July that a comprehensive peace deal could soon be agreed. However, the situation will remain volatile, as highlighted by the recent arrest of a senior Renamo member and with national polls coming up in October (in which Renamo and its leader, Afonso Dhlakama, intend to participate). Failure to implement a peace deal, which would necessarily involve the disarmament of Renamo and reintegration into the military, is likely to result in renewed violence.

Against a backdrop of heightened political tension, the government is likely to face increasing social unrest. Many Mozambicans have been disillusioned by Frelimo's sense of entitlement and its failure to ensure that the wider population benefits significantly from two decades of outstanding economic performance. This problem is likely to be exacerbated by the country's minerals boom, which has already raised expectations of widespread benefits, although new revenue streams will materialise only gradually and will not be widely spread. Despite eroding Frelimo's popularity, social discontent will remain manageable and will not destabilise the party's hold on power.

Election watch

Frelimo is set to retain its parliamentary majority and Mr Nyussi will secure the presidency at the next national elections, due on October 15th 2014, benefiting from a well-oiled party machine, large membership base, strong financial position and influence over state institutions and media. Frelimo's share of the vote is nonetheless likely to fall from 2009 (when it was around 75%), as its popularity is declining, especially in urban centres.

The Movimento Democrático de Moçambique (MDM), a Renamo breakaway established in 2009, which made a strong showing in municipal elections in November 2013 (boycotted by Renamo), could overtake Renamo as the leading opposition party. MDM performed well in Maputo, the capital and a Frelimo stronghold, and won in four (out of 53) cities: Beira, Quelimane, Nampula and Gurué. Renamo's demographic support base—rural populations in the centre and north of the country—has dwindled. Moreover, although Renamo's leader, Afonso Dhlakama, has filed an application to participate in the presidential election, his belligerence and the time he has spent in hiding—since October 2013—have undermined his credibility as a political leader. Against the backdrop of popular anger with the political elite and persistent Renamo-Frelimo clashes, the 2014 elections are likely to be tense, and may be accompanied by popular protests.

International relations

Bolstered by Mozambique's natural resources potential, the government is seeking a more prominent international position, diversifying its relations away from donors. Mozambique is set to reduce its aid dependency through rising mining royalties and in response to stagnating aid flows; the latter reflect economic austerity in donor economies, as well as growing donor concerns about standards of governance in Mozambique. Strong commercial, political and personal ties will ensure continued close relations with Portugal. Ties with South Africa, Mozambique's main trading partner, will remain strong, driven by foreign direct investment (FDI) inflows and long-standing commercial links. Investment from China, Brazil, India and Australia will strengthen ties with those countries. Sizeable gas reserves will attract more foreign investors and new trading partners, especially among Asia's major gas-importing countries.

Policy trends

The authorities will continue to implement an ambitious policy agenda to promote inclusive growth and address long-standing social ills. Attracting FDI in infrastructure, natural resources and services will also be key priorities. Challenges include reducing unemployment, improving infrastructure and enhancing the quality of education, all of which affect competitiveness and productivity. Despite resistance from vested interests, the government will make some efforts to improve the country's framework for private-sector participation.

Natural resources will also create major policy challenges. The authorities have successfully frontloaded the benefits from large offshore discoveries of natural gas in 2011–13, having earned around US$1.3bn in capital gains tax on gas-asset transactions thus far without alienating investors. However, awaiting royalties from gas extraction (not due until the end of the decade), the government will need to strike a balance between domestic expectations of higher spending and investor pressure for favourable treatment, and between much-needed public investment and fiscal sustainability. Progress on resources management will be patchy, a major risk being that the promise of large returns will lead to laxer management of public debt. The authorities will successfully consolidate macroeconomic stability under the IMF policy support instrument (PSI) for 2013–16, but progress on goals such as making growth more inclusive and strengthening governance will be slower.

Fiscal policy

The Economist Intelligence Unit expects Mozambique to post a record fiscal deficit of 10% of GDP in 2014. This reflects an increase in capital expenditure, despite a drop in aid-funded investment, and in current outlays (owing to the cost of organising elections and the purchase of fishing trawlers and patrol boats, for around US$300m). Public expenditure will increase further over the remainder of the outlook period amid pressure to raise public-sector wages and invest in infrastructure and social development. However, the deficit will narrow gradually, to 7.3% of GDP in 2018, as expenditure growth will be outstripped by rising fiscal revenue on the back of strong economic growth and increasing mining royalties. The deficit will be financed through borrowing abroad and to a lesser extent by domestic bond issues. Public debt will hover around 48% of GDP throughout the outlook period.

Monetary policy

The two key objectives of Banco de Moçambique (BDM, the central bank) will be to keep inflation, which poses a threat to social stability, under control and to expand credit to the economy. The BDM repeatedly cut its key lending rate in 2012–13, most recently in October 2013, to 8.25%, in a bid to bolster bank lending. As long as the BDM considers inflation to be under control, it is likely to persist with this expansionary policy. However, combined with high inflows of foreign investment and deepening financial markets, this policy will exert upward pressure on the money supply. Should this destabilise prices to a large extent, we expect the BDM to tighten its monetary stance again, even if this leads to currency appreciation and the erosion of export competitiveness.

International assumptions

	2013	2014	2015	2016	2017	2018
Economic growth (%)						
US GDP	1.9	1.7	3.2	2.5	2.4	2.6
OECD GDP	1.3	1.9	2.6	2.4	2.4	2.5
World GDP	2.0	2.5	3.0	2.9	2.9	3.0
World trade	2.7	4.4	5.0	5.3	5.4	5.5
Inflation indicators (% unless otherwise indicated)						
US CPI	1.5	1.8	2.2	2.3	2.3	2.5
OECD CPI	1.6	2.1	2.2	2.3	2.2	2.1
Manufactures (measured in US$)	-3.1	0.0	0.9	1.8	1.9	1.6
Oil (Brent; US$/b)	108.9	108.3	105.1	103.8	97.5	93.0
Non-oil commodities (measured in US$)	-6.8	-3.1	0.0	0.9	3.0	2.9
Food, feedstuffs & beverages (% change in US$ terms)	-7.4	-2.8	-4.6	-0.8	1.6	3.1
Aluminium (US$/tonne)	1,846.3	1,826.6	2,153.8	2,283.3	2,300.0	2,350.0
Coal (US$/tonne, Australia)	84.6	72.4	70.9	72.9	78.0	82.0
Financial variables						
US$ 3-month commercial paper rate (av; %)	0.11	0.13	0.39	1.43	2.43	2.90
US$:€ (av)	1.33	1.35	1.30	1.28	1.27	1.26
¥:US$	97.6	102.0	102.2	102.0	101.0	100.0

Economic growth

The economy will grow briskly throughout 2014–18, underpinned by rapid expansion in mining activity and investment in the natural gas sector. However, economic slowdown in China and softening demand for global commodities will hamper growth in the country's main exports. This, along with investor concerns about the outlook for Mozambique's political stability, is likely to lead to delays in or the cancellation of investments in natural resources and other sectors, meaning that the economy will not realise its full potential. The recent sale by Rio Tinto (UK/Australia) of its Mozambican coal assets for a fraction of their purchase price three years ago illustrates these issues, and we have slightly trimmed our economic growth forecasts for 2017–18 as a result.

We still expect real GDP growth, which reached 7.5% in the first quarter of this year —to accelerate from 7.3% in 2014 to 7.8% in 2016, driven by coal mining and investment in new transport infrastructure. Communications, industry and financial services will also grow strongly. In 2016 growth will also be bolstered by the launch of construction works on liquefied natural gas (LNG) facilities. However, we now forecast a marginally slower rate of economic expansion in 2017-18, as coal's contribution to output will stabilise. Furthermore, partly because of delays in infrastructure development, LNG production is more likely to start around 2020 than in 2018, as targeted by the government. Furthermore, energy companies are likely to proceed cautiously amid uncertainty over hydrocarbons legislation and concerns about a possible global gas supply glut (in part owing to surging output of shale gas).

Mozambique's buoyant headline growth figures will continue to mask stark differences between dynamic, capital-intensive mega-projects and relatively weak traditional sectors, and they are unlikely to have a significant impact on job creation and poverty reduction. Growth in the smallholder agricultural sector, which employs the majority of the population, is likely to remain subdued, hindered by farmers' limited access to funding, farming inputs, technology and markets. Performance in the labour-intensive manufacturing sector will continue to be held back by stiff international competition and an adverse domestic environment, which includes rigidity in the labour market, skills shortages, heavy regulation and corruption. Downside risks to our forecast stem from Mozambique's inadequate infrastructure and uncertain political outlook, which could dampen the mining boom, and from potential weakness in the global economy.

Economic growth

%	2013[a]	2014[b]	2015[b]	2016[b]	2017[b]	2018[b]
GDP	7.1	7.3	7.6	7.8	7.7	7.5
Private consumption	8.3	2.8	8.7	5.6	4.3	3.3
Government consumption	14.6	27.0	-3.0	7.7	7.8	11.3
Gross fixed investment	1.5	11.0	13.5	19.0	16.0	15.0
Exports of goods & services	16.1	7.4	17.0	13.3	10.9	10.3
Imports of goods & services	13.8	8.0	15.4	14.4	10.5	10.0
Domestic demand	7.3	7.6	8.3	9.3	8.0	7.8
Agriculture	3.1	6.0	5.0	4.0	3.5	4.0
Industry	10.0	9.0	10.0	14.5	12.0	11.5
Services	5.0	7.2	7.8	6.3	7.4	6.9

[a] Actual. [b] Economist Intelligence Unit forecasts.

Inflation

Inflation, as measured by the consumer price index in Maputo, is set to moderate in 2014, on the back of falling international food prices, a marginal drop in international oil prices and appreciation of the currency, the metical, against the South African rand—most non‑oil imports come from South Africa. Annual average inflation slowed to 2.5% in June and we now expect it to average 3.9% (down from 4.6% previously) over the full year. Despite further declines in global food and fuel prices, inflation will edge back up in 2015 driven by robust domestic demand, a strengthening of the rand and an anticipated increase in electricity tariffs. Inflation will edge down during the remainder of the outlook period, to 4.2% in 2018, helped by moderating oil prices, improved food availability and currency appreciation. Major disruptions to the local or regional food supply could lead to upward revisions to this forecast.

Exchange rates

After depreciating from MT30.1:US$1 in 2013 to MT31.1:US$1 in 2014, the currency will gain ground during the remainder of the forecast period, supported by rising coal exports and large investment inflows. The metical slipped in the first two months of 2014—owing to seasonal factors and the gradual reduction of US quantitative easing—but rebounded in March-April and we expect that it will continue to recover in the second half of the year. The exchange rate will continue to firm thereafter, averaging MT30:US$1 in 2018, notwithstanding some downward pressure stemming from large fiscal and current-account deficits. A drop in global demand for Mozambique's mineral exports, which could trigger a fall in export revenue or cause the investment boom to stall, represents the major risk to this outlook. However, exchange-rate intervention by the monetary authorities, owing to fears over the risk to social stability from imported inflation, is likely to prevent a sharp drop in the metical.

External sector

Mozambique's exports will be dominated by raw mining and agricultural commodities, as well as aluminium, currently the country's prime source of export revenue. Coal will be the major driver of export growth, overtaking aluminium as the country's main export by 2016. We expect coal export volumes to increase from 6.3m tonnes in 2014 to 21m tonnes in 2018. Nonetheless, this will remain far below the sector's potential and the government's ambitions, owing to depressed prices and infrastructure constraints. Gas is set to become a major export, but not until beyond the outlook period. Overall, we forecast that goods exports will rise from US$4.4bn in 2014 to US$6.9bn in 2018.

Goods imports, already elevated in 2012–13, will rise further throughout 2014–18, driven by the equipment needs of gas and mining companies, to about US$12.8bn in 2018. Meanwhile, the services deficit, which soared in 2012–13, reflecting imports from the offshore gas sector, will remain high as the minerals boom continues to draw in technical services from abroad.

The primary income deficit will widen from 0.5% of GDP in 2014 to 2.1% of GDP in 2018, as foreign firms start to repatriate growing profits from mining projects. Pushed up to 8.2% of GDP by large tax transfers on capital gains by foreign companies in 2014, the secondary income surplus will decline to 3.13% of GDP in 2018, as aid inflows drop. Overall, we forecast that the current-account deficit will narrow from 39.2% of GDP in 2014 to 32.9% of GDP in 2018, on the back of an expansion in mining exports. Mozambique's exceptionally high current-account deficits, reflecting the import requirements of investment in mining and LNG, will be financed mainly by FDI inflows and, in 2016–18, external borrowing from energy multinationals.

Forecast summary

Forecast summary
(% unless otherwise indicated)

	2013[a]	2014[b]	2015[b]	2016[b]	2017[b]	2018[b]
Real GDP growth	7.1	7.3	7.6	7.8	7.7	7.5
Consumer price inflation (av)	4.2	3.9	4.6	4.5	4.4	4.2
Lending interest rate (%)	15.3	15.3	15.5	15.4	15.1	14.8
Government balance (% of GDP)	-2.9[c]	-10.0	-8.2	-7.7	-7.5	-7.3
Exports of goods fob (US$ m)	4,123	4,376	5,313	6,022	6,540	6,868
Imports of goods fob (US$ m)	-8,480	-9,119	-9,883	-11,100	-12,068	-12,766
Current-account balance (US$ bn)	-5,892	-6,433	-6,982	-8,211	-9,554	-10,590
Current-account balance (% of GDP)	-38.5	-39.2	-36.0	-35.6	-34.7	-32.9
External debt (year-end; US$ bn)	6.4[c]	7.5	8.7	11.1	14.6	18.6
Exchange rate MT:US$ (av)	30.1	31.1	31.0	30.6	30.3	30.0
Exchange rate MT:¥100 (av)	30.9	30.5	30.3	30.0	30.0	30.0
Exchange rate MT:€ (av)	40.0	42.1	40.1	39.2	38.5	37.8
Exchange rate MT:SDR (av)	45.6	47.4	46.5	45.6	44.9	44.3

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.

Data and charts

Annual data and forecast

	2009[a]	2010[a]	2011[a]	2012[a]	2013[a]	2014[b]	2015[b]
GDP							
Nominal GDP (US$ bn)	9.7	9.3	12.5	14.4	15.3	16.4	19.4
Nominal GDP (MT m)	266,210	314,960	364,740	407,900	461,100	510,951	601,228
Real GDP growth (%)	6.3	7.1	7.3	7.2	7.1	7.3	7.6
Expenditure on GDP (% real change)							
Private consumption	4.9	5.4	11.9	0.3	8.3	2.8	8.7
Government consumption	8.6	12.9	7.8	20.0	14.6	27.0	-3.0
Gross fixed investment	5.4	6.9	9.9	49.6	1.5	11.0	13.5
Exports of goods & services	2.3	7.4	18.2	21.0	16.1	7.4	17.0
Imports of goods & services	1.0	6.5	20.2	25.4	13.8	8.0	15.4
Origin of GDP (% real change)							
Agriculture	6.0	6.7	7.7	6.9	3.1	6.0	5.0
Industry	5.1	5.3	6.5	8.3	10.0	9.0	10.0
Services	7.1	7.5	7.0	7.2	5.0	7.2	7.8
Population and income							
Population (m)	23.4	24.0	24.6	25.2	25.8[c]	26.5	27.1
GDP per head (US$ at PPP)	868	918[c]	979[c]	1,042[c]	1,105[c]	1,175	1,258
Fiscal indicators (% of GDP)							
Central government budget revenue	27.1	28.7	28.6	28.6	32.9[c]	32.5	28.5
Central government budget expenditure	32.6	32.9	33.9	32.7	35.7[c]	42.5	36.7
Central government budget balance	-5.5	-4.2	-5.3	-4.1	-2.9[c]	-10.0	-8.2
Public debt	42.2	39.7[c]	36.4[c]	39.5[c]	41.4[c]	47.4	48.1
Prices and financial indicators							
Exchange rate MT:US$ (end-period)	29.20	32.60	27.30	29.80	30.10	31.05	30.85
Exchange rate MT:€ (end-period)	42.07	43.56	35.32	39.00	41.11	40.83	39.49
Consumer prices (end-period; %)	2.2	19.0	5.4	2.2	3.0	5.8	4.9
Stock of money M1 (% change)	37.2	20.7	9.4	36.0	10.0	9.4	17.0
Stock of money M2 (% change)	32.6	24.6	7.8	29.2	16.4	10.5	20.8
Lending interest rate (av; %)	15.7	16.3	19.1	16.8	15.3	15.3	15.5
Current account (US$ m)							
Trade balance	-1,275	-1,179	-2,249	-4,048	-4,357	-4,743	-4,570
Goods: exports fob	2,147	2,333	3,118	3,856	4,123	4,376	5,313
Goods: imports fob	-3,422	-3,512	-5,368	-7,903	-8,480	-9,119	-9,883
Services balance	-433	-628	-1,436	-3,136	-2,717	-2,952	-3,413
Primary income balance	-277	-336	-204	-16	-52	-80	-178
Secondary income balance	763	692	891	829	1,234	1,342	1,179
Current-account balance	-1,221	-1,450	-2,997	-6,371	-5,892	-6,433	-6,982
External debt (US$ m)							
Debt stock	4,138	3,736	4,106	4,788	6,417[c]	7,522	8,683
Debt service paid	41	87	57	83	128[c]	179	326
Principal repayments	15	38	29	42	64[c]	70	183
Interest	26	48	28	41	64[c]	109	143
International reserves (US$ m)							
Total international reserves	2,099	2,159	2,469	2,770	3,142	3,379	3,578

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.
Source: IMF, International Financial Statistics.

Quarterly data

	2012 2 Qtr	3 Qtr	4 Qtr	2013 1 Qtr	2 Qtr	3 Qtr	4 Qtr	2014 1 Qtr
Prices[a]								
Consumer prices (2000=100)	112.4	111.7	113.5	117.2	118.2	116.8	117.5	120.7
Consumer prices (% change, year on year)	1.9	1.2	2.0	3.7	5.2	4.6	3.5	3.0
Financial indicators								
Exchange rate MT:US$ (av)	28.00	28.60	29.53	30.37	30.17	29.97	30.00	31.17
Exchange rate MT:US$ (end-period)	28.10	28.80	29.80	30.50	30.00	29.90	30.10	31.50
M1 (end-period; MT m)	113,163	119,617	132,715	128,669	138,010	145,604	146,021	143,480
M1 (% change, year on year)	26.7	32.7	36.0	34.7	22.0	21.7	10.0	11.5
M2 (end-period; MT m)	155,909	166,787	185,855	183,580	189,799	200,707	216,425	216,346
M2 (% change, year on year)	19.3	24.5	29.2	28.2	21.7	20.3	16.4	17.8
Foreign reserves (US$ m)								
Reserves excl gold (end-period)	2,473	2,867	2,770	2,429	2,492	3,038	3,142	3,354

[a] Maputo.

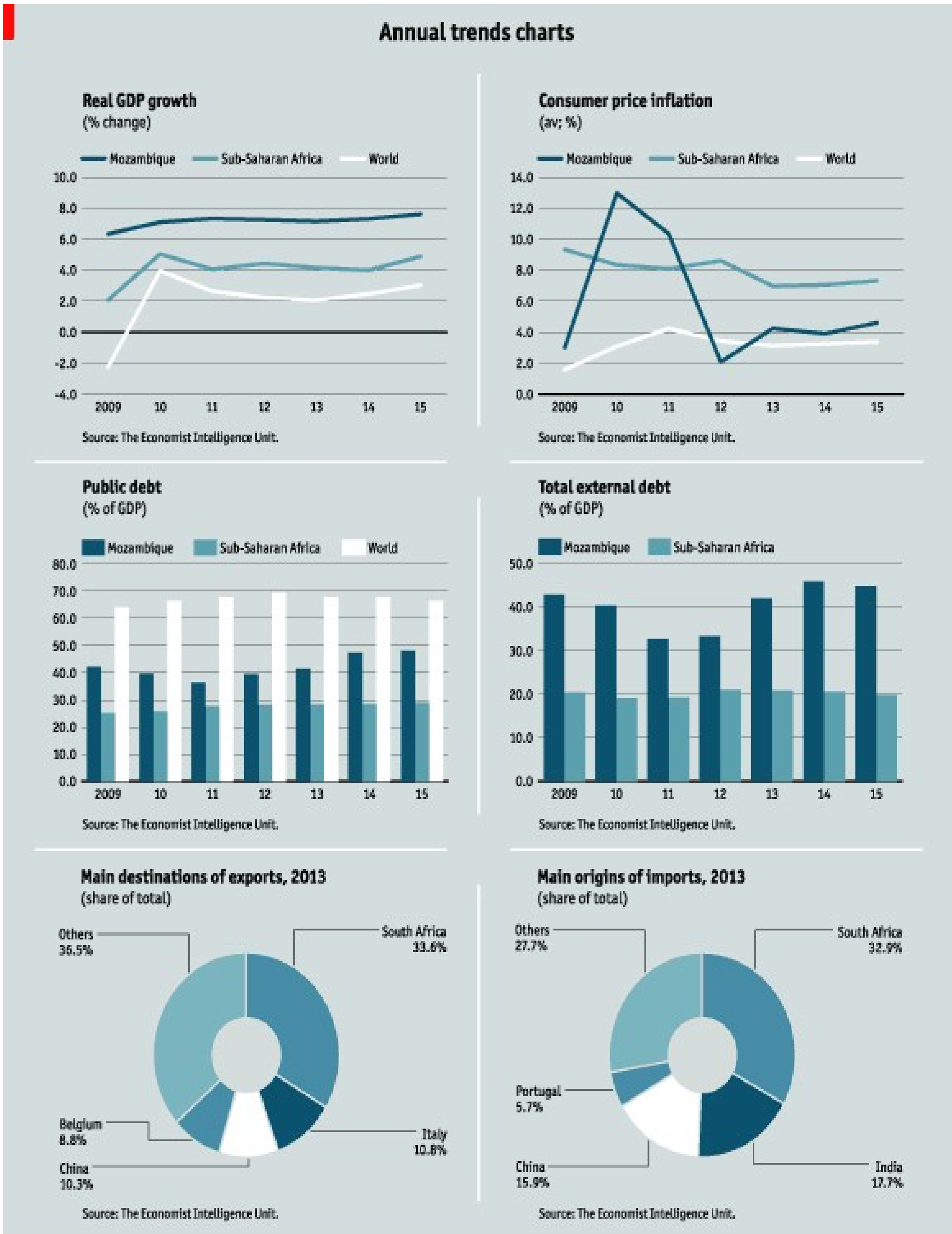
Sources: IMF, International Financial Statistics; UN Food and Agriculture Organisation.

Monthly data

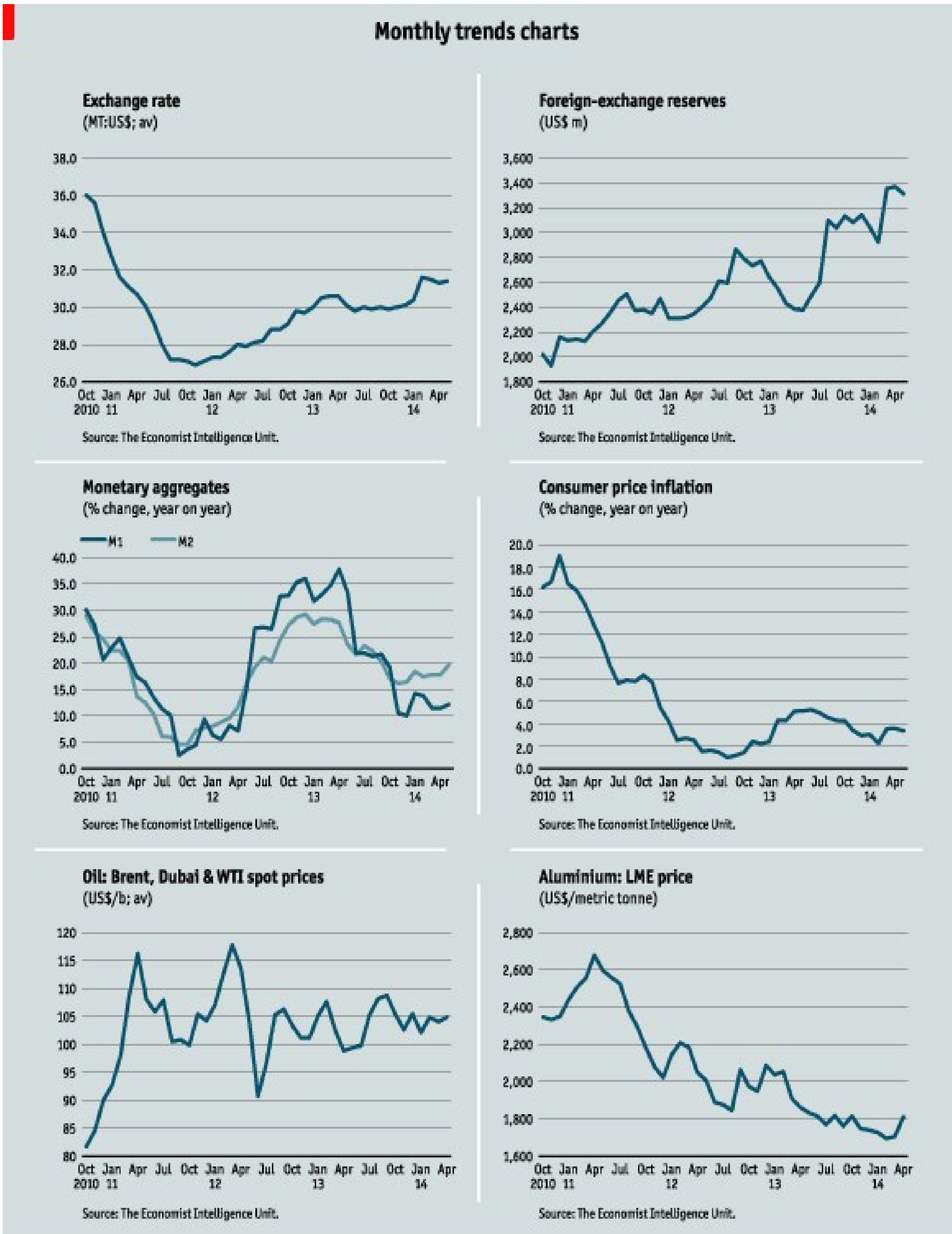
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate MT:US$ (av)												
2012	27.30	27.30	27.60	28.00	27.90	28.10	28.20	28.80	28.80	29.10	29.80	29.70
2013	30.00	30.50	30.60	30.60	30.10	29.80	30.00	29.90	30.00	29.90	30.00	30.10
2014	30.40	31.60	31.50	31.30	31.40	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate MT:US$ (end-period)												
2012	27.20	27.40	28.10	27.70	28.20	28.10	28.40	29.10	28.80	29.80	30.00	29.80
2013	30.20	30.70	30.50	30.30	29.80	30.00	30.00	30.00	29.90	29.90	30.10	30.10
2014	31.20	31.80	31.50	31.40	31.50	n/a	n/a	n/a	n/a	n/a	n/a	n/a
M1 (% change, year on year)												
2012	6.3	5.6	8.1	7.2	15.0	26.7	26.8	26.5	32.7	32.8	35.4	36.0
2013	31.7	33.1	34.7	37.8	33.4	22.0	21.9	21.4	21.7	19.2	10.6	10.0
2014	14.3	13.8	11.5	11.5	12.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a
M2 (% change, year on year)												
2012	8.0	8.8	9.6	11.7	16.1	19.3	21.1	20.4	24.5	27.3	28.7	29.2
2013	27.5	28.4	28.2	27.7	23.6	21.7	23.3	22.3	20.3	17.1	16.2	16.4
2014	18.4	17.5	17.8	17.8	19.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2012	13.0	13.1	12.6	12.4	11.8	11.6	10.8	10.8	10.5	10.2	10.2	10.2
2013	9.2	8.9	8.9	8.8	9.0	8.7	8.9	9.2	8.5	8.6	8.5	8.6
2014	n/a	8.6	8.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2012	18.3	18.3	18.0	17.6	17.3	17.0	16.6	16.1	15.9	15.7	15.5	15.5
2013	15.6	15.5	15.5	15.5	15.4	15.4	15.4	15.3	15.3	15.0	15.0	15.0
2014	n/a	14.9	14.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2012	4.2	2.5	2.7	2.5	1.5	1.6	1.5	1.0	1.2	1.4	2.4	2.2
2013	2.4	4.3	4.3	5.1	5.2	5.3	5.0	4.6	4.3	4.3	3.4	3.0
2014	3.0	2.3	3.6	3.6	3.4	2.5	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US$ m)												
2012	2,312	2,311	2,315	2,345	2,404	2,473	2,609	2,595	2,867	2,788	2,734	2,770
2013	2,641	2,551	2,429	2,385	2,376	2,492	2,596	3,098	3,038	3,133	3,082	3,142
2014	3,043	2,923	3,354	3,369	3,313	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

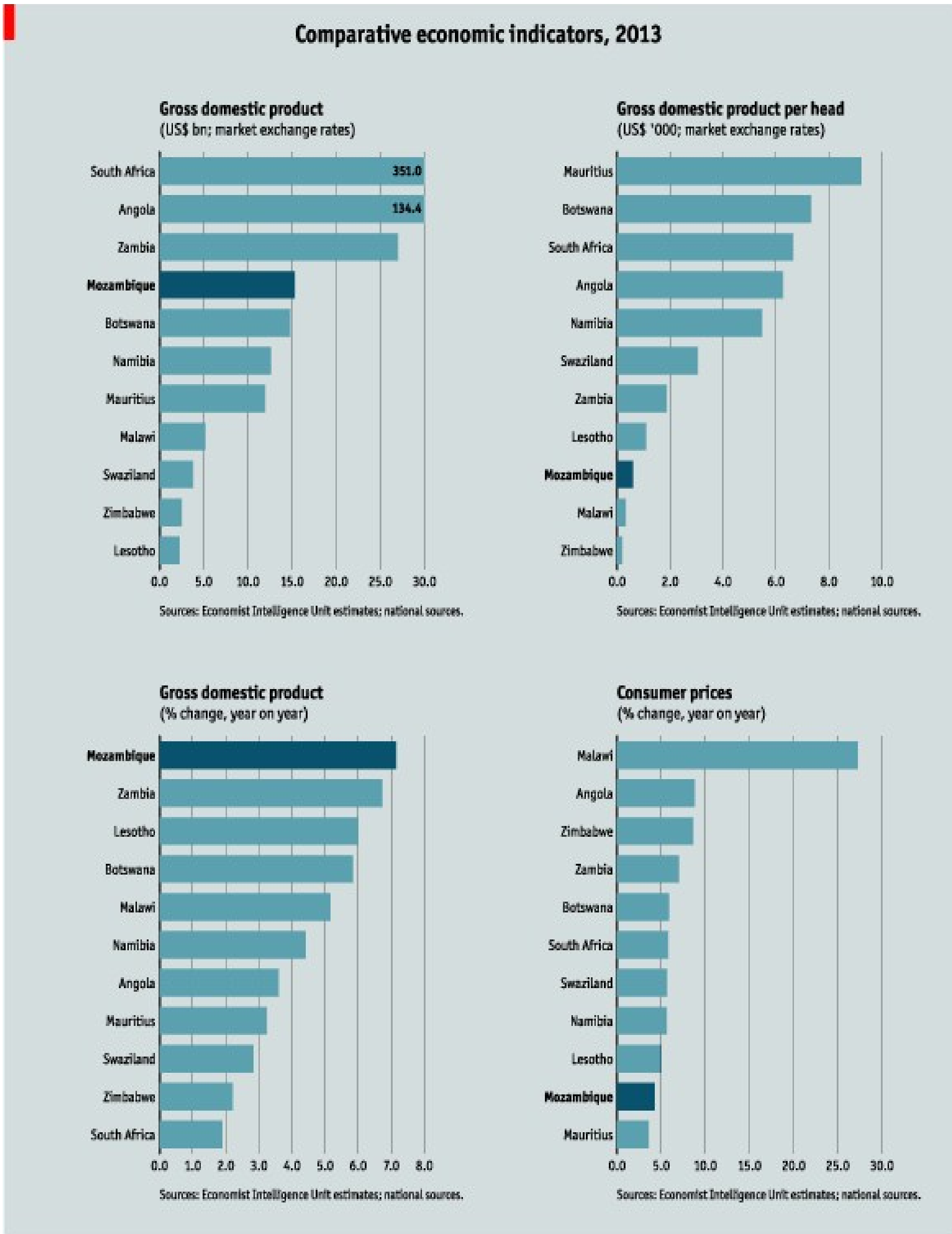
Annual trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

799,380 sq km

Population

23.5m (2013, World Gazetteer calculation)

Main towns

Population, 2013 (World Gazetteer calculations)

Maputo (capital): 2,006,494a

Nampula: 596,679

Beira: 441,865

Chimoio: 279,677

Nacala: 234,553

Quelimane: 216,339

Tete: 187,807

Lichinga: 183,923

aIncluding Matola

Climate

Tropical and subtropical

Weather in Maputo (altitude 59 metres)

Hottest month, February, 22-31°C (average daily minimum and maximum); coldest month, July, 13-24°C; driest months, July, August, 13 mm average rainfall; wettest month, January, 130 mm average rainfall

Languages

Portuguese (official) and three main African language groups: Makua-Lomwe, Tsonga and Sena-Nyanja

Measures

Metric system

Currency

Metical (MT)

Time

2 hours ahead of GMT

Public holidays

January 1st (New Year's Day), February 3rd (Heroes' Day), April 7th (Women's Day), May 1st (Labour Day), June 25th (Independence Day), September 7th (Victory Day), September 25th (Armed Forces Day), November 10th (Maputo City Day—Maputo only), December 25th (Family Day)

Political structure

Official name

República de Moçambique

Form of state

Unitary republic

Legal system

Based on Portuguese-Roman law and the 1990 constitution, updated in 2004

National legislature

250-member Assembleia da República (parliament) elected by direct, universal suffrage every five years

National elections

October 28th 2009 (legislative and presidential); next legislative and presidential elections are due on October 15th 2014

Head of state

President, chosen by direct universal suffrage

National government

The president and his appointed prime minister and Council of Ministers; new cabinet appointed in 2009; last reshuffle in September 2013

Main political parties

Frente de Libertação de Moçambique (Frelimo) is the ruling party and holds 191 parliamentary seats; the main opposition party is Resistência Nacional Moçambicana (Renamo; 51 seats); the Movimento Democrático de Moçambique (MDM; 8 seats) was formed in March 2009 with the mayor of Beira, Daviz Simango, as its leader; it is drawing strong support from disaffected Renamo members and is bidding to replace Renamo as the main opposition party; another opposition party, Partido Humanitário de Moçambique (Pahumo), was launched by former Renamo members in April 2010

President: Armando Guebuza

Prime minister: Alberto Vaquina

Ministers in the presidency

Parliamentary affairs: Adeleaide Amurane

Social affairs: Feliciano Gundana

Key ministers

Agriculture: José Pacheco

Defence: Agostinho Mondlane

Education: Augusto Jone

Energy: Salvador Namburete

Environmental co-ordination: Alcinda Abreu

Finance: Manuel Chang

Fisheries: Victor Manuel Borges

Foreign affairs & co-operation: Oldemiro Baloi

Health: Alexandre Manguele

Industry & trade: Armando Inroga

Interior: Alberto Mondlane

Justice: Maria Benvinda Levi

Labour: Helena Taipo

Mineral resources: Esperança Bias

Planning & development: Aiuba Cuereneia

Public works & housing: Cadmiel Muthemba

Science & technology: Louis Pelembe

State administration: Carmelita Namashulua

Tourism: Carvalho Muária

Transport & communications: Gabriel Muthisse

Women's affairs & social welfare: Iolanda Cintura

Youth & sport: Fernando Sumbana

Central bank governor

Ernesto Gouveia Gove

Recent analysis

Generated on August 18th 2014

The following articles were published on our website in the period between our previous forecast and this one, and ser a review of the developments that shaped our outlook.

Politics

Forecast updates

July 15, 2014: Election watch

Police arrest opposition spokesman

Event

A senior member of the opposition Resistência Nacional de Moçambique (Renamo) party has been arrested.

Analysis

The arrest of a spokesman, Antonio Muchunga, on July 7th marks an escalation in tensions between the Frente de Libertação de Moçambique (Frelimo) government and Renamo. Mr Muchanga was detained by police after a meeting of the Council of State, of which he is a member. The 18member council is a highlevel advisory body on issues of state sovereignty and security. It has three Renamo members, including Mr Muchunga and the Renamo leader, Afonso Dhlakama, who does not participate in meetings as he is currently in hiding. Mr Muchunga is to be charged with inciting violence in his capacity as spokesperson for Mr Dhlakama. This is the second senior Renamo member to be arrested after the party's director of information, Jerónimo Malagueta, was detained for nine months, also for inciting violence. He was released in March.

The move marks another setback to ongoing efforts to find a negotiated solution to the stalemate between Renamo and Frelimo. Discussions have dragged on for months, failing to make significant breakthrough beyond an agreement on electoral legislation, in part owing to strong distrust between the two sides. The arrest of Mr Dhlakama's spokesman is now likely to exacerbate his fear that he will also be arrested if he leaves the bush, as he has declared he wishes to do, and begin campaigning for the next presidential election, due in October.

Our core forecast remains that Mr Dhlakama and Renamo will participate in the presidential and legislative polls of October. Boycotting another election would be political suicide for Renamo, which is at risk of being overtaken as Mozambique's major opposition party by the rising Movimento Democrático de Moçambique (MDM), a Renamo breakaway established in 2009. Frelimo, for its part, will want to avoid a backlash—both in terms of its domestic popularity and relations with donors—of Renamo's absence at the election. However, given that Frelimo's strategy also seems to include delaying Mr Dhlakama's return to the political stage —to dent his prospects at the polls—the possibility of an election without Renamo cannot be ruled out entirely.

Impact on the forecast

We maintain our forecast that the October elections will proceed in a tense climate as a comprehensive peace deal between Renamo and the government is unlikely to be concluded before the polls. We also continue to expect Frelimo to win, whether Renamo participates or not.

Economy

Forecast updates

July 3, 2014: Fiscal policy outlook

Donors pledge less aid in 2015

Event

Foreign donors' aid pledges for the 2015 budget have fallen substantially.

Analysis

Aid commitments for next year have dropped sharply, perpetuating the declining trend in foreign aid's contribution to the Mozambique state budget. Donor commitments, announced in June, point toward a sharp drop in support for 2015, to US$564m—US$274.6m in direct budget support and US$289.8m in sector-specific programmes—down by 18% from the US$666m promised for this year. Although some donors, including Germany, have yet to provide a final pledge, others, including most notably the UK and the African Development Bank, have already announced a reduction in their support to the country.

Mozambique's falling aid levels are in part a reflection of tighter aid budgets in donor countries, as part of broader fiscal austerity measures. Spain, for instance, last year abandoned budget support to Mozambique as a result of its own fiscal troubles. However, the lower commitments also stem from a deterioration in government-donor relations. Italy's ambassador to Mozambique, Roberto Vellano, reportedly told the press that "concerns over fiscal transparency, fighting corruption and other outstanding issues" had led "some partners to think they could no longer confirm their participation". In particular, the issue last year of a US$850m international bond, without advance warning or consultation, severely undermined confidence in the government. The bond is ostensibly meant to fund a new state fishing company, Ematum, but there is a lack of clarity about the government's intentions regarding the use of part of the funds.

We do not expect the loss in aid income to pose significant financing problems in 2015. This is largely because the authorities will be able to draw on the sizeable funds accumulated over the past two years—some US$1.3bn in total—from capital-gains tax payments by international energy firms on transactions in the natural gas sector, which were kept aside to cover exceptional budget needs. However, Mozambique's declining reliance on aid underlines that until royalties from natural gas become a prominent share of income, which is unlikely until the middle of the next decade, the government will need to find alternative funding methods—including domestic revenue or external borrowing—for its ambitious investment programmes.

Impact on the forecast

Our fiscal policy forecast for 2014–18 will not be revised as it already assume a decline in foreign aid. As we highlight in our international relations outlook, donors' falling contribution to the state budget goes in tandem with a shrinking influence over the country's policies.

July 8, 2014: Economic growth

Financial sector keeps expanding

Event

Mozambique's fast-growing financial sector has continued to expand in June–July with new entrants to the market and the addition of new services.

Analysis

In June Ecobank, a pan-African bank, announced the purchase of a 96% stake in Banco ProCredit, a local subsidiary of Germany's ProCredit Holding, itself an international group of small lenders founded by European development finance companies. With a loan portfolio of MT695m (US$22m) and deposits of MT930m, Banco ProCredit is one of the smallest of Mozambique's 18 commercial banks and is positioned to serve small and medium-sized enterprises. Ecobank has confirmed that it will continue to serve Banco ProCredit's traditional small business market but will otherwise use the bank as a platform to expand into wider consumer and corporate banking services, stating that it intends to become a significant player in the domestic financial market.

Ecobank's move was announced as South Africa's Nedbank completed its acquisition of a 36.4% stake in Mozambique's Banco Único for US$24.4m. In other developments in the financial sector, South Africa's First National Bank (FNB) in late June unveiled crossborder money transfer services to Mozambique, which will enable its South Africa-based customers to easily send money to Mozambique through the bank's online or mobile banking services. On June 30th a new insurance company, Diamond Seguros, of joint Zimbabwean and Mozambican ownership, was officially launched in the capital, Maputo. On the same day, Nairobi-based Diamond Trust Bank (DTB) kicked off a share issue with the aim of expanding into new markets outside its core East African region, including Mozambique.

Although very diverse, all these developments point toward buoyant activity in and further internationalisation of Mozambique's financial sector. The sector, which over the past three years grew by an average rate of 11% in real terms, remains on track to be one of Mozambique's strongest performers this year. Nonetheless, despite continued growth in the number of service providers, a large majority of the country's poor will continue to struggle to gain access to formal financial services, mainly owing to structural issues, including low income levels, financial illiteracy, geographical constraints and the low perceived creditworthiness of borrowers.

Impact on the forecast

As we stress in our economic growth forecast, the financial sector will remain one of the fastest-growing economic sectors in the country, contributing to average real GDP growth of 7.7% a year in 2014–18. It will also continue to attract foreign investment.

July 10, 2014: Economic growth

Firms to assess the potential for GTL plants

Event

Several international energy companies have announced plans to study development of industrial plants to process Mozambique's natural gas resources.

Analysis

Gas-to-liquids (GTL) plants would enable Mozambique to add significant value to its recently discovered gas resources in the offshore Rovuma basin. On July 3rd a consortium involving Eni of Italy, which has a significant stake in these resources, and Sasol of South Africa signed agreements with the Mozambique authorities and the state hydrocarbons firm, Empresa Nacional de Hidrocarbonetos (ENH), outlining plans to study development of GTL plants. The Anglo-Dutch energy giant, Royal Dutch Shell, in late June signed a separate Memorandum of Understanding with ENH to carry out pre-feasibility studies for a GTL plant.

If they materialise, these projects would complement other anticipated developments of Mozambique's natural gas. Thus far, international energy companies operating in the country have predominantly focused on the construction of liquefied natural gas (LNG) processing and export facilities, which could turn Mozambique into a significant global LNG exporter. The GTL plants, however, would supply local and regional markets with diesel, synthetic fuels and other refined petroleum products, thereby carrying greater benefits for the domestic economy in terms of job creation, industrial activity and savings on costly energy imports. The proposed GTL plants are consistent with the national Gas Master Plan (GMP), which aims to accelerate industrial development through the local use and processing of energy resources. The GMP, which was developed with technical assistance from the World Bank and was approved by cabinet in late June, also envisages the construction of a 2,000 km pipeline from the northern Cabo Delgado province (where gas finds have been made) to the capital, Maputo, in the south.

Sasol and Shell have yet to release an estimate of the value of their potential investments or a timeline for development, but the feasibility studies alone are likely to take 1-2 years or more. Nonetheless, these agreements are a positive sign that Mozambique is looking to diversify the potential use of its natural gas resources. Furthermore, Shell and Sasol are world leaders in GTL technology and the latter is a major player in regional energy markets—where it is both a prominent supplier and retail and wholesale distributor—providing additional credibility to these projects.

Impact on the forecast

GTL plants could, if fully developed, have major industrial, commercial and fiscal impacts on Mozambique, but these would probably occur beyond our 2014-18 outook period. We will not alter our current economic forecasts.

July 18, 2014: Economic growth

Indian firm borrows US$2.2bn to fund gas assets purchase

Event

The Oil and Natural Gas Corporation (ONGC), India's largest energy company, has raised US$2.2bn through bond issues to finance the acquisition of gas assets in Mozambique.

Analysis

The announcement that ONGC has successfully issued international bonds to finance the purchase of gas assets in Mozambique has underlined the availability of finance for investment in the country's nascent liquefied natural gas (LNG) sector. ONGC confirmed on July 9th that it had raised US$1.5bn in US dollar-denominated bonds and another €525m (US$714m) in euro-denominated bonds. The bonds, with maturities of five to ten years and yields of between 2.81% and 4.69%, received strong uptake from investors. The funds will finance the company's acquisition, in June 2013, of a 10% stake in Mozambique's Rovuma-1 gasfield from Anadarko Petroleum (US) for US$2.64bn. In 2013 ONGC, together with another state-owned company, Oil India, also purchased the Mozambican gas assets—another 10% stake in the Rovuma-1 field—of Videocon (also of India) for US$2.64bn.

ONGC's successful bond issue supports our view that energy companies involved in Mozambique will manage to raise finance for their LNG investments, enabling the industry to take off. Some observers have raised concerns about companies' ability to raise funds—up to US$40bn—for gas investments in Mozambique because of the country's poor credit rating and the fact that it faces strong competition, including from Australia and the US, in the race to supply gas-starved Asian countries with LNG. However, although Mozambique's LNG prospects will remain vulnerable to volatile global financing conditions, they are supported by the involvement of state-owned companies from LNG-importing countries such as India, Thailand and China. Asian state-owned firms have been behind all the acquisitions of Mozambican gas assets over the past two years and are strongly committed to seeing these resources come on stream. Mozambique's LNG also benefits from relatively good project economics, thanks to a favourable location (compared with the US) and comparatively low costs (building costs in some of Australia's LNG projects have shot up considerably).

Yet, the official 2018 target date for first output of LNG in Mozambique is unachievable. For one thing, firms are waiting for the publication of new oil and gas legislation, currently under review in parliament. Mozambique's infrastructure and skilled labour gaps also mean that the construction of LNG production and export facilities is likely to face delays.

Impact on the forecast

We continue to expect that Mozambique's LNG will come on stream beyond our 2014-18 forecast period (probably in 2020).

July 23, 2014: Policy trends

Environmental regulation shows its teeth

Event

Mozambique has fined a significant number of private companies for environmental violations.

Analysis

The announcement that 50 companies were fined in the first half of 2014 for various environmental protection infractions is an indication of the authorities' growing seriousness about environmental regulation. Fines of MT18m (US$582,000) have been levied, or around US$12,000 per company, according to officials of the Ministry of Environmental Co-ordination, on July 16th. The infractions include operating without proper licences and permits and failing to dispose of or manage waste materials appropriately. The ministry did not disclose information on the names, nationalities or sizes of the companies concerned, meaning that the economic impact of the measure is unclear.

The fines are also a reflection of the authorities' more assertive approach towards business in general, bolstered by the discovery in recent years of significant natural resources (mainly natural gas, but also coal and graphite); other areas where the government has become more assertive include tax and labour regulations. With regard to environmental protection, the environmental co-ordination ministry assesses the environmental impact of major public infrastructure investment projects, as well as large foreign direct investments in the energy and mining sectors. It does so by granting licences, based on the environmental impact assessments (EIAs) provided by companies. It also manages the relocation of local communities from affected areas.

Owing to institutional weaknesses, however, enforcement of environmental protection regulations remains patchy. For instance, there have been reports of failed population resettlement programmes, with evidence of poor handling of relocation, compensation and benefits. There are also a number of large-scale environmental challenges to which Mozambique has thus far struggled to respond, such as wildlife protection. Local and international non-governmental organisations have blamed the country for its lack of action on rhino and elephant poaching, which has surged in recent years, as well as on alleged smuggling of timber to China. Amid pressure to move ahead on the development of large-scale natural resources projects, there is a strong risk that environmental protection will remain haphazard in the medium term.

Impact on the forecast

As we already stress in our economic policy forecast for 2014-18, Mozambique faces immense policy challenges, especially in the context of natural resources development, but progress towards addressing these issues is likely to remain patchy.

August 4, 2014: External sector

Rio Tinto's exit underscores risks for the coal sector

Event

The Anglo-Australian mining company Rio Tinto has sold its Mozambican coal assets to a state-backed Indian entity, International Coal Ventures Private Limited (ICVL), for US$50m, a fraction of their purchase price three years ago.

Analysis

The deal ends a disastrous experience for Rio. The company entered Mozambique's coal sector in 2011, by acquiring Australia's Riversdale—whose assets included the now-operational Benga mine, the Zambeze project (as yet undeveloped), the Zululand Anthracite Colliery mine in South Africa and some exploration licences in Mozambique—for US$3.7bn. The acquisition was made at the height of a commodities boom, when the price of coking coal (used in steel manufacturing) was above US$330/tonne and that of thermal coal (burned to generate electricity) topped US$100/tonne—prices are currently US$120/tonne and US$70/tonne respectively. In addition, Rio has faced myriad setbacks in Mozambique, starting with lower than expected quality of its coal reserves. Infrastructure turned out to be the major hurdle, however, as the government rejected on environmental grounds Rio's plans to barge coal down the Zambezi River. Existing rail and port infrastructure proved insufficient for the company's needs. Flooding in early 2013 and multiple technical problems with rail transport also triggered several temporary suspensions in coal shipments. Security concerns added to Rio's worries: political instability in central Mozambique disrupted coal transports, and a surge in kidnappings in the capital, Maputo, led the company to evacuate families of expatriate staff. Tax problems compounded these issues, with the government reportedly seeking payment of capital gains taxes on Rio's acquisition of Riversdale.

Although ICVL's strategic commitment to increase India's supply of coal bodes well for Mozambique's long-term coal outlook, Rio's departure is a setback for the sector, as it highlights the challenging operating environment for mining companies. The debacle suggests that, at current coal prices, it may not be commercially viable to expand Mozambique's coal-carrying rail capacity beyond that of the Sena line with a capacity of 6.5m tonnes/year (t/y) and the under-construction Nacala line with a planned capacity of 11m t/y—Brazil's Vale, which is building the line, hopes to complete it by end-2014. Bangkok-based Italian‑Thai Development, which the Mozambican government has chosen to build another coal export outlet—a US$4.5bn rail line and port at Macuse—said it would be "tough" to meet its 2018 deadline, given elevated costs and depressed coal prices.

Impact on the forecast

We may slightly revise down our forecast that coal exports will expand from about 6m tonnes in 2014 to 22m tonnes in 2018.

Analysis

July 7, 2014

Poor policies

African countries are making variable progress on strengthening the quality of the policies and institutions that underpin development, with conflict and political instability eroding the policy and institutional environment in some states, and other countries making solid progress with reform. However, converting growth into poverty reduction is proving problematic across the region, while attempts to

monitor progress are regularly undermined by event risk.

Research from leading organisations such as the World Bank confirms that African economies are being held back by the toxic combination of poor policies and poor institutions. A new report by the World Bank—*Assessing Africa's Policies and Institutions*—seeks to assess the policy and institutional environment in 39 sub-Saharan states that are eligible to borrow from the Bank's concessional lending arm, the International Development Agency (IDA). To do so, it grades countries on four broad "clusters"—economic management, structural policies, polices for social inclusion and equity, and public-sector institutions and management. Within these, 16 different dimensions are measured on a scale of one to six (lowest to highest), to arrive at a Country Policy and Institutional Assessment (CPIA) score for each country. These scores are then used by World Bank officials to determine how much is lent to the region's poorest states.

In the latest rankings, covering 2013, Cape Verde, Kenya, and Rwanda are deemed to have the most positive environment of the states assessed, with scores of 3.9. Burkina Faso, Senegal, and Tanzania are only slightly behind, on 3.8. The remaining top-ten places are filled by Ghana and Uganda (on 3.7), and Mozambique and Nigeria (3.6). At the other end of the scale, the poorest performers are deemed to be Eritrea, South Sudan, Zimbabwe, Sudan, Guinea-Bissau and the Central African Republic (CAR), all with scores of 2-2.5 (well below the 3.2 average for the 39 countries). Eight countries—Chad, Côte d'Ivoire, the Democratic Republic of Congo, Mauritania, Nigeria, Rwanda, Sudan and Zimbabwe—improved their scores in the 2013 rankings, but scores fell in the CAR, Eritrea, The Gambia, Ghana, Guinea-Bissau, Malawi, Mozambique and Zambia.

Corruption a persistent problem

Inevitably, performance varies substantially between individual states. For example, Zimbabwe scores particularly poorly in terms of debt policy—unsurprisingly, given that sections of the ruling party do not believe that Zimbabwe has a debt problem. This does, however, call into question the IMF's attempts to persist with a staff-monitored programme. In contrast, Madagascar scores 4 for its debt-management policy—well above the regional average of 3.3—but falls down on public-sector management and institutions (that is, governance, corruption, and the quality of budgetary and financial management). Angola also scores poorly on quality of public administration, and also on the business regulatory environment, which will come as little surprise to would-be investors given its poor ranking in other reports such as the World Bank's *Doing Business* (where it is ranked 179th out of 189 economies in the 2014 edition).

Among the states ranking above the regional average, both Kenya and Tanzania score strongly in terms of economic management, notably as regards their monetary and exchange-rate policy, while falling down slightly in terms of property rights and rule-based governance, and corruption. (In the 2013 Corruption Perceptions Index, published by Transparency International, Kenya and Tanzania ranked a respective 136th and 111th out of 177 states.) Ethiopia, meanwhile, scores strongly on social inclusion and equity policies (along with states including Burundi, Malawi, South Sudan and Zimbabwe), but poorly on structural policies governing trade, the financial sector and business regulatory environment. This largely reflects its state-driven model of development, and restrictions on foreign participation in key sectors.

Growth does not equal poverty reduction

Overall, scores were lowest in the public management and institutions cluster, in part reflecting conflict and political instability in a number of countries. However, it is striking that the link between a country's CPIA score and poverty reduction is very weak. The Bank says that its analysis shows "a low conversion rate of Africa's growth into poverty reduction". For the developing world as a whole excluding China, it says, conversion rates are three times greater than in Sub-Saharan Africa.

One reason for this is that growth has not been strong in areas where the poorest people live.

Because institutional quality and performance is central to sustained economic growth, the World Bank's CPIA indicators are a useful addition to the policy toolbox used by governments, lenders and investors. But because they don't take account of such mundane but crucial characteristics as market size and resource endowment, and because they can rapidly be overtaken by events, they have severe limitations.

The risks of ignoring risk

Obvious examples of this are the high and (mostly) improving rankings of countries as diverse as Nigeria, Kenya, Rwanda and Mozambique. In all four, worrying political developments, especially terrorism and civil unrest, pose a threat to future economic performance. The report notes the impact of unrest in the CAR, but there is no mention of attacks by Boko Haram in Nigeria or al-Shabab in Kenya, or of the government's stand-off with the opposition group, Renamo, in Mozambique.

In other words, no investor or lender can afford to make judgments purely on CPIA, or indeed other league-table type analyses such as the Corruption Perceptions Index. Events in recent years, especially in the Middle East and North Africa, but also in a growing number of sub-Saharan states, underline the folly of underestimating risk.

July 24, 2014

El Niño: the return of the kid

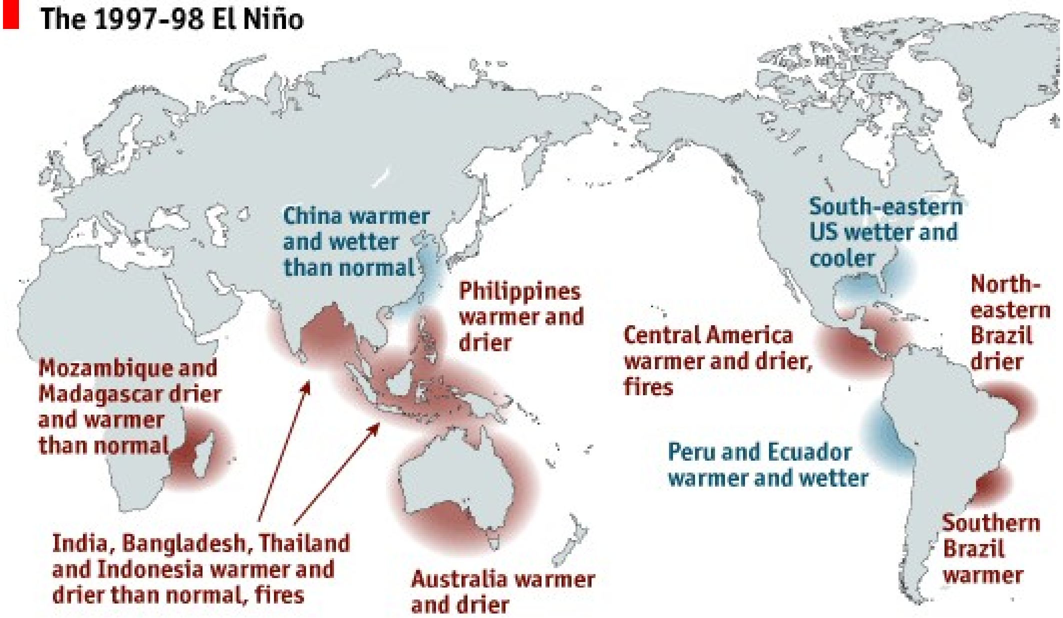
For several months climatologists have reported the probability of an El Niño weather event occurring in late 2014. Although the causes of El Niño are not widely understood, its potential to disrupt agricultural markets, supply chains and incomes is clear. The Economist Intelligence Unit expects 2014 to see the first El Niño event since 2009–10, but a combination of supply factors in commodity markets and greater government preparedness means that the effect on global economic growth in 2014–15 will be minimal.

El Niño is a weather phenomenon associated with warming sea surface temperatures in the Pacific Ocean. Warmer waters lead to greater evaporation from the sea and more moisture in the atmosphere. As trade winds drive these warmer waters and wetter air westwards across the Pacific, East Africa, Indonesia and Australia experience drier than usual conditions, while the west coast of South America is deluged with rain. The trigger for the initial rise in sea temperatures varies with each event, but an El Niño episode—defined as a period where the temperature at the centre of the Pacific Ocean is 0.5°C above its long-term average for five consecutive months—typically occurs every five years or so. Based on historical patterns, a severe episode is in prospect.

Too much or too little

The Australian Bureau of Meteorology (BoM) uses eight different models to monitor the likelihood of an El Niño episode occurring. Currently, five suggest that El Niño conditions will occur by October 2014. Nevertheless, the BoM has also reported that it now expects a weaker episode compared with its forecast from several months ago, and believes a strong El Niño to be unlikely. Previous severe events have been catastrophic. The 1982–83 episode killed 2,000 people on both sides of the Pacific, through flooding in Peru (where a huge lake, measuring 90 miles by 20 miles, was formed in the Sechura desert) and bushfires in Australia. The 1997–98 event killed 450 people in Peru and Ecuador and resulted in 1998 becoming the then hottest year on record.

The 1997-98 El Niño



Within the global economy, El Niño is most consequential to farmers, not only in terms of their output but also their planting decisions. And not all of El Niño's effects are destructive; above-average rains can also lead to bumper harvests of some crops. (Indeed, our expectation of extra rain and lower temperatures on the east side of the Americas is incorporated into our forecasts for soybeans and maize.) The commodities whose markets are typically most disrupted are those that are grown predominately in East Africa, the western Pacific and on the west coast of Latin America: palm oil, sugar, cocoa and coffee.

The major palm oil producers are all in South-east Asia. We forecast that around 90% of the 2013/14 (October-September) crop will be grown in Thailand, Malaysia and Indonesia. In the last severe El Niño event, in 1997‑98, this region experienced extremely high temperatures and very low rainfall, which poses a sharp upside risk to prices. The global palm oil market is currently in surplus, however, with stocks equivalent to around three months of consumption, and yields from mature fields are rising. These factors should more than offset the El Niño effect, and we forecast a drop in prices for palm oil, from US$886/tonne in the second quarter of 2014 to US$831/tonne a year later.

The cocoa and sugar markets are more vulnerable to disruption, as they are closer to balance and with smaller stocks. The biggest cocoa producers are in two distinct areas: the West African states of Côte d'Ivoire, Ghana, Nigeria and Cameroon, and a band across central Latin America, encompassing Ecuador, Peru and Brazil. West Africa, like South‑east Asia, sees higher temperatures and lower rainfall during El Niños, while the west coast of Latin America is at risk from flooding. Sugar production is more diverse, it is grown in substantial quantities in China, India and Europe, as well as Latin America, which offers some insurance should a single region be badly hit. However, the rate of sugar production growth is already slowing at a time when demand is rising quickly, and growing regions of Brazil, the world's largest producer, suffered a severe drought in early 2014, which damaged crops. The market is therefore entering a period of disruption in a vulnerable state. We expect prices to rise steadily throughout 2014‑15.

Building barricades

Based on the BoM's estimates, we believe that a minor El Niño event will take place, and this has manifested itself in small reductions to our commodity production forecasts and slightly higher prices. However, our baseline forecast for global economic growth of 2.5% in 2014 and 3% in 2015 is unaffected for two reasons. First, several years of reasonable weather and subdued demand has created substantial surpluses in many agricultural commodities. This will be a major factor that will keep a lid on prices and ensure that supplies continue to reach final markets. Second, several of the countries most vulnerable to El Niño are now less exposed than during the most recent severe episodes, in 1982–83 and 1997–98. The Peruvian government has budgeted US$1bn of public money to protect the country's infrastructure, while the Ecuadorian administration is setting up credit lines. This planning demonstrates governments' greater resources.

Last, a word of caution. Given the small sample size of previous El Niño events, the inherent unpredictability of weather systems and the large number of variables that determine commodity prices (and therefore farmers' incomes), the possibility of a more (or less) severe episode than we currently expect is considerable. We are confident that the countries most likely to be affected are more resilient than previously, and the BoM's forecasts of a small rise in sea temperatures have been relatively consistent. But forecasting much more precisely would be blowing in the wind.

July 24, 2014

Enabling agriculture to reach its potential

Long a provider of jobs and subsistence incomes, agriculture has become more important as an economic growth-driver in several African economies in recent years. Much of this is down to the developing role of smallholder farmers, many of whom are successfully scaling up their agricultural output. Challenges still exist in the sector, however, as struggles over land ownership and restrictions on access to dependable infrastructure have stunted the capacity for even greater growth in many parts of the region.

Land ownership and poor infrastructure are key obstacles to smallholder farmers, who are otherwise performing well; the value of agricultural output is rising with the aid of public-private partnerships and effective national agricultural policies. Nevertheless, existing levels of agricultural productivity across Africa have varied substantially in recent years, from an increase of 325% in Nigeria to a decline of around 40% in Zimbabwe (although Zimbabwe has had its own specific challenges).

This has prompted the Economic Commission for Africa to ask member states to reflect on the adequacy of their current agricultural policies and to look ahead to valuable agribusiness opportunities that could facilitate a link between African farmers and regional economic value chains.

Varying trends

Contrasting economic, social and political environments make it difficult to measure regional trends in agricultural growth. The Maputo Declaration of 2003 advocated the commitment of African governments to pledge at least 10% of national budgetary resources to agriculture and rural development by 2008. To date, Burkina Faso, Ethiopia, Ghana, Guinea, Malawi, Mali, Niger and Senegal have surpassed this target and have secured improved output from farms. The implementation of similar policies has the capacity to increase the employment potential of young Africans, of whom there are an estimated 200m aged between 15 and 24, in agribusinesses and agro-industries.

The issue of food security is a critical challenge for an increasing number of countries. As of March 2014, the number of African countries requiring external assistance for food totalled 26, of which the Central African Republic (CAR) and Zimbabwe have experienced exceptional shortfalls. The 83% increase in food prices between 2005 and mid-2008 served as a major signal to African economies to look at their food security situations in order to relieve existing and potential pressures on food supplies. The need for external support has encouraged the empowerment of national smallholder farms.

Ghana and Malawi have experienced important gains since the introduction of government subsidies. Ghana is regarded as the first African country to have halved the number of people living in extreme poverty, in part through increased fertiliser use by small farmers. A 49% government subsidy and the creation of 4,000 fertiliser retail outlets have had a significant impact on national productivity. In Malawi, the input of a large fertiliser and seed subsidy programme, concentrated solely on small-scale farmers, played a part in strong food production growth.

However, subsidy schemes are not without their challenges. Corruption and mismanagement can prevent the assistance reaching those who need it most, while the vast cost of the schemes has necessitated compromises elsewhere. In particular, it is arguable that production could have been boosted more effectively by investing in local infrastructure or rolling out more modern farming techniques and equipment.

Infrastructure upgrades

Reliable infrastructure is a fundamental element in developing food security, as it boosts both output per capita and output per unit of land. It is a strategic component in the reduction of transaction costs in input and output markets, while also improving markets within subregions. High transportation costs originating from poor road networks can curtail market integration between countries and subregions, leaving little choice for smallholder farmers but generally to trade at local levels.

The Nacala Road Corridor Development Project is one of the most ambitious infrastructure projects in Sub-Saharan Africa to date. The aim of the project is to develop sustainable road transportation and trade facilitation links along the Nacala Road Corridor, which stretches from Lusaka in Zambia, through Malawi to the port of Nacala in Mozambique. An estimated 2m people inhabit the area, and Malawi and Zambia's dependency on the agricultural sector means that a reduction in the cost of transporting goods from these countries, with the aid of an improved road network, should have an overall positive outcome on farm revenue.

In Ethiopia, the accessibility of state-run irrigation schemes has been extended to small farmers, in order to help boost horticultural crop production—a significant priority for the Ethiopian government. In Kenya, the Galana-Kulalu Food Security Project comprises one of the largest irrigation schemes in Central and East Africa. The government has allocated an estimated US$42m to finance the project, which aims to use the 400,000 ha site for the production of crops, livestock and fish for both domestic consumption and export purposes.

Land issues

Sub-Saharan Africa possesses almost 202m ha of uncultivated land, yet inequality in land ownership is a significant hurdle for small farmers to overcome. The issue of land grabs by large-scale investors still proves a challenge in many countries. According to the World Bank, an estimated 1m ha of land were claimed in each of Ethiopia, Liberia, Mozambique and Sudan during the 2004–09 period. The issue of land ownership is growing in importance in Côte d'Ivoire, Kenya, Liberia and Southern Africa. However, policymakers are eager to avoid any social unrest, such as the aggressive fallout in Zimbabwe over the struggle for land ownership.

Communal land rights and gender equality—the majority of women, who are the main subsistence producers, are barred from land ownership by customary laws—are two basic areas of land administration that need to be improved upon. Certain countries are nonetheless making progress in the development of land rights. Rwanda carried out a nationwide programme of issuing land titles in June 2012, with a photomap, at an estimated US$10 per parcel of land. The positive impact on investment and gender equity in that country has prompted Madagascar, Namibia and Tanzania to adopt similar means of land entitlement. In recent years Malawi has witnessed the success of its community-based "willing seller, willing buyer" method in land reform. The programme has helped more than 15,000 smallholders by increasing agricultural incomes by 40% per year, and has achieved an economic internal rate of return of 20%.

No magic formula

Despite the advances being made in African agriculture, a number of challenges still need to be overcome if the sector is to realise fully its enormous potential. Productivity has remained subdued, and African farm yields are amongst the lowest in the world.

Overall, it is clear that national governments are beginning to recognise the growing relevance of small-scale agriculture as a significant driver of growth, social cohesion and stable inflation in the region, but differing national schemes to address agricultural issues have not allowed for a comprehensive model of success to materialise. However, strategies will probably need to focus on an amalgamation of clear land entitlement policy, targeted support schemes (rather than universal subsidies), infrastructure development and the improved access to financing for smallholders.

It will also be necessary for the governments within the region to provide an enabling environment, including tackling corruption and mismanagement in agricultural policy, in order to increase yields and to allow agriculture to develop beyond subsistence levels.