

MOZAMBIQUE ECONOMIC UPDATE

Navigating Low Prices



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The World Bank’s biannual *Mozambique Economic Update* (MEU) series is designed to present timely, concise assessments of current economic trends in Mozambique in light of the country’s broader development challenges. Each edition includes a section on recent economic developments and a discussion of Mozambique’s economic outlook and constraints to growth, followed by a focus section analyzing an issue of particular importance. The focus section for this edition evaluates Mozambique’s evolving fiscal risks in a context of rising public investment. The MEU series seeks both to inform discussions within the Bank and to contribute to a robust debate among government officials, the country’s international development partners, and civil society regarding Mozambique’s economic performance and key macroeconomic policy challenges.

The cut-off date for this edition of the MEU was 28 March 2016.

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Abbreviations and Acronyms

BdM	Bank of Mozambique (<i>Banco de Moçambique</i>)
CAD	Current-Account Deficit
CFM	Mozambique Ports and Railways Company (<i>Caminhos de Ferro de Moçambique</i>)
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
EMATUM	Mozambican Tuna Company (<i>Empresa Moçambicana de Atum</i>)
FPC	Standing Lending Facility (<i>Facilidade Permanente de Cedência</i>)
FPD	Standing Deposit Facility (<i>Facilidade Permanente de Depósito</i>)
GEP	Global Economic Prospects
GDP	Gross Domestic Product
GNI	Gross National Income
INE	National Statistics Institute (<i>Instituto Nacional de Estatística</i>)
IMF	International Monetary Fund
MEF	Ministry of Economy and Finance (<i>Ministério da Economia e Finanças</i>)
MMBTU	Million British Thermal Units
Mt	Metric tons
MZN	New Mozambican Metical
PII	Integrated Investment Plan (<i>Programa Integrado de Investimento</i>)
PPP	Public-Private Partnership
SSA	Sub-Saharan Africa
VAT	Value Added Tax
WDI	World Development Indicators
WEO	World Economic Outlook
WB	World Bank

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Executive Summary

Recent Economic Developments

After several consecutive years of strong growth, Mozambique's economic performance has decelerated to its slowest pace since 2009. A continued decline in global commodity prices, weak growth amongst trading partners and the effects of a regional drought have contributed to a reduction in GDP growth from 7.4 to 6.3 percent in 2015. Export prices for aluminum and coal decreased by 18 percent and 12 percent respectively in 2015, reducing the value of production of these key industries. Lower levels of foreign direct investment (FDI) have further accentuated the declining trend in the extractive, manufacturing and services sectors. Agricultural production, which employs most of the country's labor force, remained robust in 2015, but the onset of El Niño related climatic conditions caused a regional drought in late 2015 and is increasing food insecurity amongst the most vulnerable households.

Fiscal consolidation has also contributed to the slowdown in growth, with cuts in investments and current expenditures through the course of the year. The low commodity prices and slowing investment placed pressures on the external position. The current account deficit widened from 38 to 41 percent of GDP in 2015. External account pressures also contributed to the depreciation of the metical by 30 percent

against the US dollar in 2015, accentuating inflation at a time when rising food costs as a result of drought already amplified prices. Inflation spiked to 11.1 percent in December.

In an effort to contain the metical's depreciation and manage inflation, the central bank intervened by selling off foreign reserves and tightening the monetary policy stance in the last quarter of 2015. International reserves fell by about US\$780 million in 2015, with the bulk of the decline (72 percent) occurring in the last four months of 2015. The exchange rate has since fluctuated between 45-52 MZN/US\$ as a result of the central bank's role in the market, but the underlying pressures remain. On top of these difficulties, Mozambique's debt levels have been rising and the country was downgraded by credit rating agencies in March 2016 in reaction to a government initiative to restructure the EMATUM "tuna bond". The restructuring deal represents considerable easing to the government's finances. Nevertheless, exposure to fiscal risk from public debt, guarantees, and the state owned enterprise sector remains heightened.

Outlook

GDP growth in 2016 is projected to decelerate further to 5.8 percent, before recovering to over 7 percent in 2017. The slowdown in 2016 reflects the continued decline in commodity

prices for key Mozambican exports, effects of the ongoing drought on agricultural production and further fiscal tightening. This outlook is subject to additional downward risk if gas megaproject investments are deferred to 2017, and if higher debt levels result in sharp macro policy adjustments. Given the weak external position, further currency depreciation is likely and will add to inflationary pressures in 2016 through its effect on the cost of imports. The central bank continues to respond to these developments by increasing rates, most recently in early 2016. However, additional monetary tightening could strain economic growth even further as higher interest rates have negative knock-on effects on the private sector and the banking sector's portfolio.

Taken together, economic conditions in 2016, including a potential investment shortfall, point to the importance of securing the final investment decisions for the development of the Rovuma basin gas fields. Notably, the prospects for Mozambique's gas sector remain sound even under current market conditions, and large associated foreign direct investment flows are expected between 2017 and 2020. These flows will support the widening of the current account deficit from 41 percent of GDP in 2015 to over 70 percent of GDP by 2018. Gas exports are expected to ramp up by 2022 and the current account deficit to shrink thereafter.

Fiscal Risks

Part two of the Mozambique Economic Update explores Mozambique's heightened exposure to fiscal risks from public debt, guarantees, state owned enterprises and public private partnerships. Substantial public investment is necessary to address the country's limited human capital stock and considerable infrastructure deficit, and discoveries of large natural resource reserves will significantly alter the country's fiscal situation. Anticipating these changes, the government has been substantially scaling-up public investment over the last few years. Financing has taken various forms and has contributed to increased debt financing, the provision of guarantees for public corporations, and increasing public-private partnership arrangements. However, these choices are not risk free. Liabilities have accumulated at a rapid pace while the due diligence mechanisms to govern them remained lagging. The EMATUM situation in particular has generated substantial fiscal risks for the government, as would be the case with other large guarantees. These developments highlight the need to improve monitoring, disclosure and management of debt and fiscal risks. These efforts should be complemented by measures to improve the government's capacity to manage public investments, including enhanced processes for evaluating projects that are likely to expose the country to fiscal risks.

Part One: Recent Economic Developments

International Developments

Global economic growth slowed in 2015.

The global GDP growth rate is estimated to have declined from 3.4 percent in 2014 to 3.1 percent in 2015. China's slowing growth rate has curbed its global imports, including commodity imports from Africa (China currently accounts for about 5 percent of Mozambique's exports). Meanwhile, Europe's recovery remains anemic, and global financial markets have begun to adjust in anticipation of tighter monetary policies in the United States.

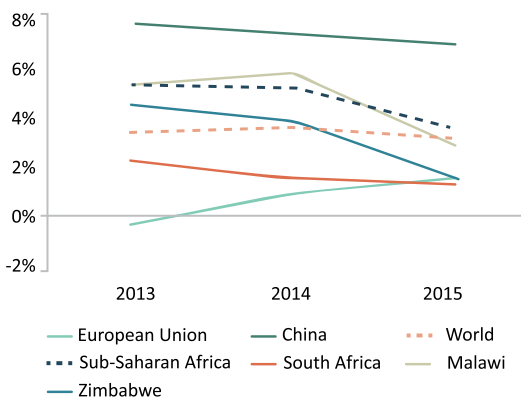
Lower commodity prices and uncertain global economic and financial conditions have weakened growth among commodity exporters

in SSA. In previous years high commodity prices played a central role in boosting growth among resource-rich countries such as Mozambique, South Africa, Zambia and Zimbabwe. However, falling commodity prices have put pressure on Mozambique's extractive industries sector, particularly the continued decline of global coal prices, which is undermining the development of the country's nascent coking-coal industry.

Aggregate economic growth in SSA slowed from 5 percent in 2014 to 3.4 percent in 2015, adversely affecting regional trade. Growth in South Africa, Mozambique's main trading partner, remains sluggish at about 1.3 percent in 2015. Growth has also decelerated in neighboring Malawi and Zimbabwe.

Figure 1: Growth is slowing among many of Mozambique's major trading partners...

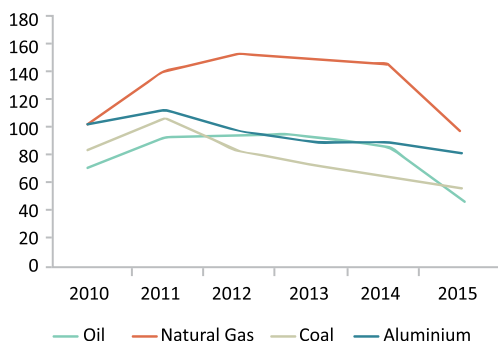
GDP Growth Rates in Selected Comparator Countries (%), 2013-15



Source: IMF and World Bank

Figure 2: ...and global commodity prices have fallen substantially.

Selected Commodity Price Trends, 2010-15 (2005 = 100)



Source: IMF and World Bank

Economic Growth and Inflation

Mozambique's economic performance slowed after several consecutive years of strong growth as it navigates lower commodity prices and reduced FDI.

Slowing extractive and service sectors contributed to a reduction in GDP growth from 7.4 percent in 2014 to 6.3 percent in 2015.

Growth in services, which accounts for over 50 percent of output, declined as financial services, real estate and tourism failed to attain growth levels similar to 2014. A substantial deceleration in the extractive industry's growth, from 44 percent in 2014 to 9 percent in 2015, also contributed further to the drop in GDP growth.

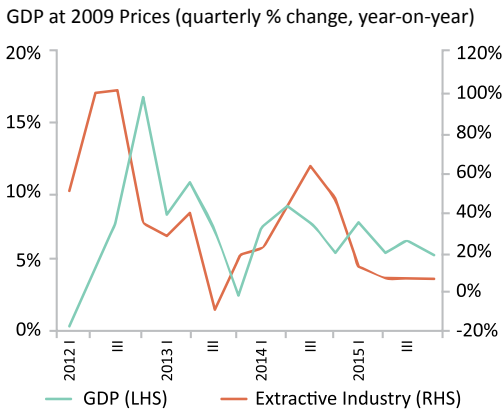
The continued decline in global commodity prices and worsening external and domestic demand conditions contributed to a slowdown in growth. Lower levels of FDI accentuated the declining trend in extractives and services as final

investment decisions for the development of the Rovuma basin remain pending. A decline in growth rates amongst Mozambique's key trading partners also limited demand in export sectors at a time when low commodity prices are already causing a strain. In addition, fiscal consolidation in 2015 contributed to lower growth levels, with cuts in recurrent and investment expenditures through the course of the year.

In contrast, agriculture and manufacturing increased their contribution to growth.

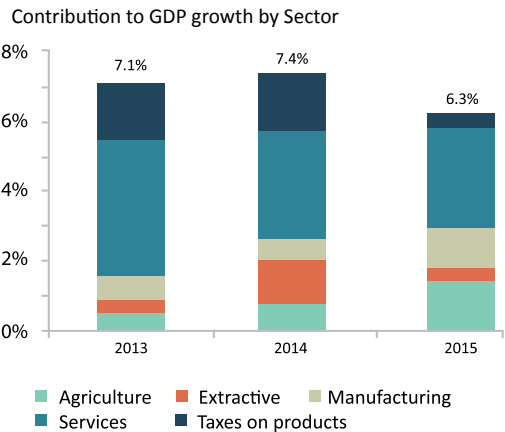
Manufacturing grew by 9 percent in 2015, reflecting high growth in the power generation and water sectors, along with core manufacturing activities. Agriculture, which employs most of the country's labor force and represents almost a quarter of total output, grew at 6 percent and increased its contribution to overall output. Yet, although agriculture remained robust, the onset of El Niño caused a regional drought in late 2015 and is increasing food insecurity amongst the most vulnerable households.

Figure 3: Slower growth in the resource sector is contributing to a broader deceleration...



Source: INE

Figure 4: ...while agriculture and manufacturing's contributions to growth increase.



Source: INE

Inflation accelerated in the second half of 2015.

Consumer price inflation continued to accelerate in 2015, driven by rising food prices and the depreciation of the metical.

The 12-month CPI inflation rate reached 11.11 percent in December 2015, up from 1.1 percent a year earlier. Most of the increase occurred in the last quarter of the year, as the 12-month inflation rate in September was only 1.3 percent.

¹ Inflation refers to Maputo area.

By end 2015, food prices were 20 percent above their level in December 2014.² In December 2014 12-month food-price inflation was just 1.6 percent. However, local flooding and a regional drought put upward pressure on food prices in late 2015, while the metical's depreciation,

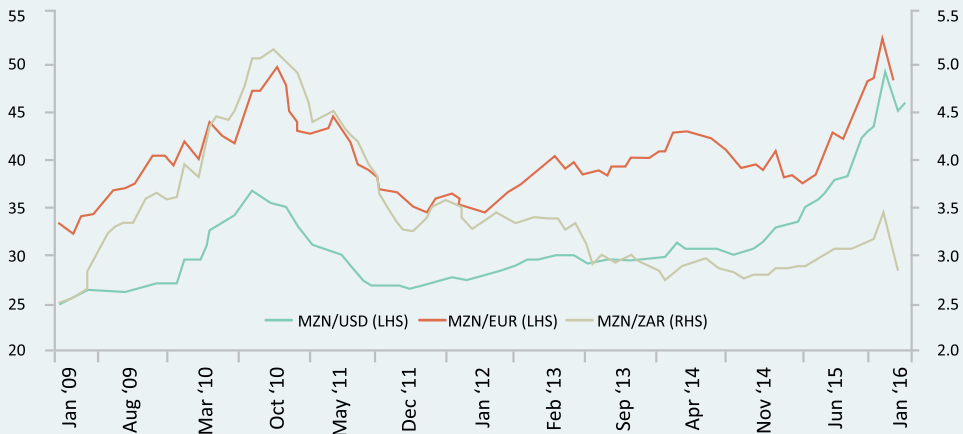
especially against the South African rand, in the last part of the year increased the cost of food imports. Inflation has continued on an upward trend in 2016, with consumer prices reaching 11.6 percent year-on-year in February 2016.

Box 1: Recent Exchange-Rate Trends

Since October 2014 the increasingly robust recovery of the US economy has caused most global currencies to depreciate against the US dollar. The expected tightening of US monetary policy and the decline of international commodity prices have contributed to this trend. As a result, by the end of 2015 the metical had depreciated by 32 percent against the dollar since mid-2014, falling by 14 percent in the last 6 months alone.

Greater exchange-rate flexibility accelerated the metical's depreciation in 2015, after central bank interventions reduced international reserves. The recent deceleration in capital inflows further increased pressure on the exchange rate. Depreciation is expected to spur inflation via higher import prices, with a notable effect on food. Mozambique is not heavily dependent on the US market given that its main trading partners are South Africa and the euro zone, which has mitigated the impact of the depreciation.

Figure 5: The metical has depreciated against the dollar and the euro while remaining broadly stable against the rand.



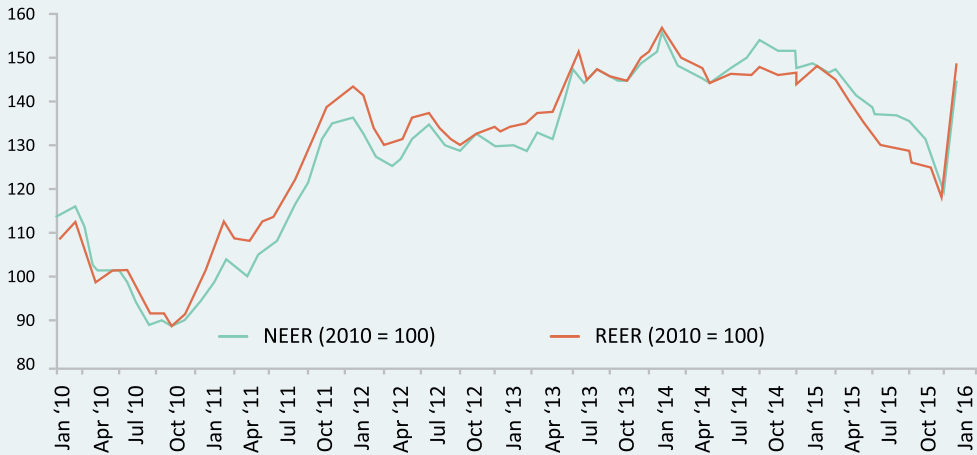
Source: BdM

The metical has depreciated less sharply against other major currencies. Although in the third quarter of 2015 it depreciated faster against the South African rand and the euro, it has now recovered slightly and the nominal depreciation against the rand has been reversed. An analysis of Mozambique's multilateral nominal exchange rate, a weighted-average of the currencies of its

main trading partners, indicates that the metical depreciated by 8 percent overall during 2015, compared to a year earlier, but monetary policy interventions caused it to stabilize in the final months of the year. The recent depreciation should have a modest impact on the trade balance due to the relative importance of large-scale investments in the natural resource sector.

² Food prices carry a 40 percent weight in the CPI.

Figure 6: Both the nominal and real effective exchange rates have depreciated since 2010.



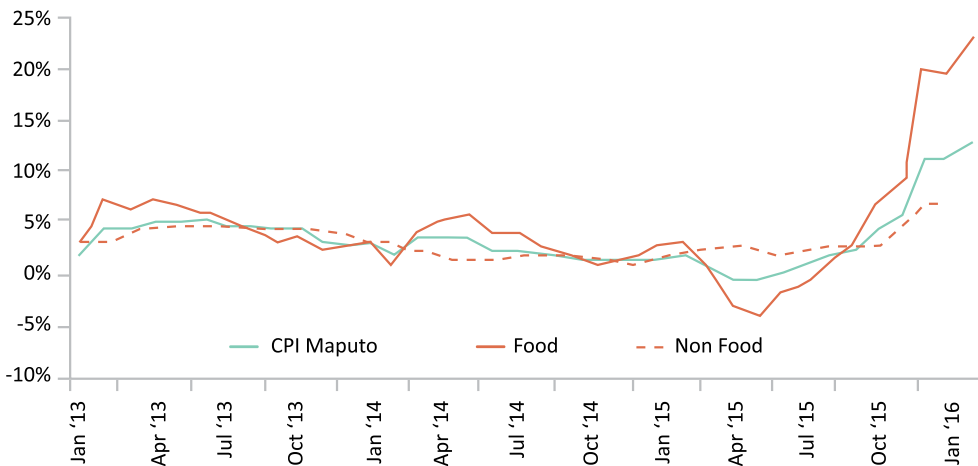
Source: BdM

A variable auto-regression model based on quarterly data indicates that an annual increase of 1 percent in the nominal exchange rate boosts inflation by just 0.2 percent.³ A modest pass-through effect contributed to inflation remaining above the government’s target, prompting the central bank to tighten its monetary policy by raising both interest

rates and the mandatory reserve ratio due to concerns about rising inflation in a context of slowing growth. However, the recent rise in inflation primarily reflects adjustments in administratively determined prices for certain staple foods and utilities in addition to the depreciation of the metical.

Figure 7: Inflation began rising rapidly in late-2015, driven by food prices.

The CPI Inflation Rate (Maputo, 12-month % change)



Source: INE

³ The model considers external inflation as an external supply shock approximated by aluminum prices. GDP represents domestic economic activity and exchange-rate shocks are identified by nominal depreciation dynamics, which are computed as the variation in the metical’s exchange rate against the dollar after controlling for supply and demand shocks. Finally, domestic inflation is calculated using the Maputo CPI.

Fiscal Policy

Fiscal policy is pursuing consolidation to reverse previous slippages and respond to imbalances in the external sector, but the burden of adjustment is heaviest on the capital budget.

Lower capital spending and reduced lending to state entities helped reduce the overall fiscal deficit to 6.5 percent of GDP in 2015. Recurrent spending remained largely steady. Although recurrent spending estimates for 2015 show a reduction compared to the previous year, the decline was driven by a one-off adjustment made in 2014 to account for previously un-budgeted maritime security outlays. In contrast, the domestically financed capital budget narrowed. Net lending, dominated by externally financed loans to public enterprises, also shrank from 3 percent of GDP in 2014 to 0.4 percent in 2015. Revenues remained robust in 2015 with a nominal increase of around 3 percent compared to the previous year, when capital gains receipts had been a boon.⁴

The budget for 2016 foresees further consolidation as part of a policy package to rebalance the budget and mitigate pressures on the external position. The budget anticipates increased revenue collections with improvements in tax administration. A further revenue boost would arise if capital gains taxes are realized in 2016 from the sale of assets in extractives sector megaprojects. Expenditures are projected to decline, with adjustments to

the capital budget being sharper than those for recurrent spending. The budget also maintains a steady upwards trend in the nominal public sector wage bill and debt service. Overall, the fiscal deficit is set to narrow further from an estimated 6.5 percent of GDP in 2015 to 4.0 percent of GDP in 2016.

Public debt ratios have been increasing but success in restructuring EMATUM will bring some relief.

The depreciation of the metical contributed to the increase in the public debt ratio from 56 percent of GDP in 2014 to 73 percent in 2015. Similarly, the debt service to revenue ratio increased from 3.6 percent in 2014 to 9.1 percent in 2015 and is projected to increase further in 2016. These trends reveal the vulnerability of the debt position, particularly to the depreciation of the Metical given that most of Mozambique's debt is held in foreign currency.

The authorities are seeking to reduce the debt service burden by restructuring the EMATUM bond. The proposal, which is intended as a friendly restructuring, will bring much needed relief to the government's position in the short term as it would convert the bond from an amortizing to a bullet bond with an extension in maturity from 2020 to 2023. Nevertheless, the restructuring proposal quickly prompted credit rating downgrades by Moody's and Standard & Poor's when it was announced (Fitch maintained its rating) which may affect investor sentiment.

⁴ Italy's Eni Group paid the government about US\$400 million in capital gains taxes following the sale of its stakes in Mozambican oil and gas fields to the China National Petroleum Corporation in the first half of 2014. Excluding capital gains taxes, tax receipts grew by about 15 percent in 2015 as tax enforcement was strengthened for both personal and corporate taxes through the course of the year. Despite this, total revenues decreased as a share of GDP, from 27.3 in 2014 to 25.6 in 2015).

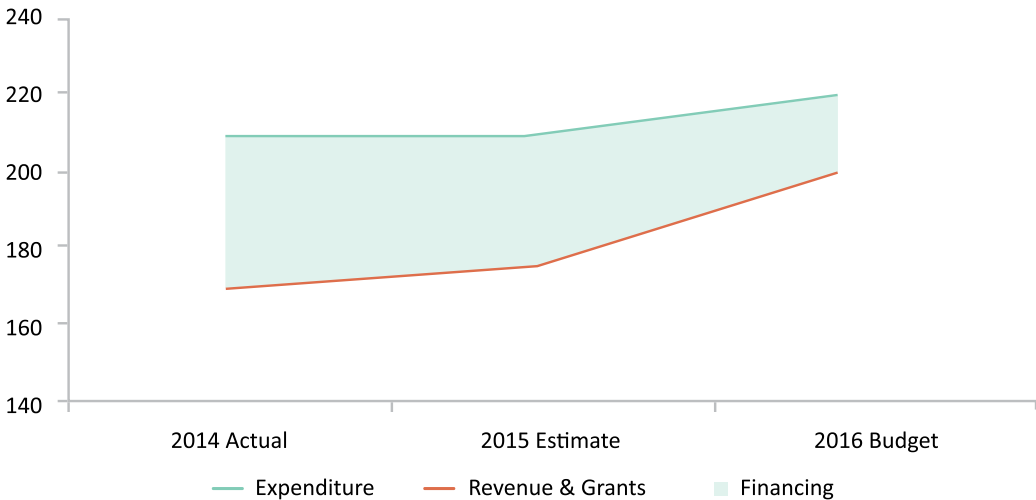
Table 1: Government Finances

(percent of GDP)	2014 Actual	2015 Estimate ⁵	2016 Budget
Total Revenue	27.3	25.4	26.1
Tax Revenues	23.4	20.9	22.4
Non Tax Revenue	4.0	4.5	3.7
Grants	4.2	4.3	3.7
Total Expenditure	39.1	36.3	32.5
Recurrent Expenditure	24.1	21.5	20.1
<i>Of which:</i>			
Compensation to employees	11.2	11.0	10.5
Interest on public debt	1.0	1.5	1.8
Maritime security	2.8	--	--
Capital Expenditure	15.0	14.6	12.5
Domestically financed	8.2	7.3	6.2
Externally financed	6.8	7.2	6.3
Net Lending	3.0	0.4	1.2
Overall Balance	-10.6	-6.5	-4.0
GDP (nominal, MZN million)	536	587	676

Source: MEF, IMF and WB

Figure 8: Fiscal deficit narrowed in 2015 and is expected to continue on this trend in 2016.

Government Finances (in MZN millions)



Source: MEF, IMF and WB

⁵ Preliminary estimates. The official 2015 budget execution figures were not available by March 2016.

The External Sector

The deterioration of the current account and lower FDI have worsened the balance of payments.

The current account deficit widened from 38 to 41 percent of GDP in 2015, driven by a worsening trade balance for merchandise

and declining transfers. Falling prices for Mozambique's major commodity exports and slowing growth rates among its main trading partners curbed export growth. Official grants also registered a decrease. These movements were partly counteracted by an improvement in the service balance, which registered a notable reduction in construction and professional services, a side effect of lower investment in 2015.



Table 2: The Balance of Payments

(millions US\$)	2014 Actual	2015 Estimate	% Δ 14/15
Current Account	-5797	-6185	7%
Trade Balance	-6968	-6815	-2%
Exports g&s	4641	4095	-12%
Exports g&s	11609	10910	-6%
Income and transfers, net	1170	630	-46%
Capital & Financial Account	5691	5601	-2%
FDI, net	4902	3711	-24%
Other, net ⁶	789	1890	139%
Overall Balance	-106	-584	451%

Source: BdM

The decline of commodity prices since mid-2013 in the context of a sluggish global economic recovery contributed to a 14 percent reduction in merchandise exports. Mozambique's exports are dominated by aluminum, coal, and natural gas which have suffered significant declines in prices. As such, the fall in commodity exports was largely driven by lower prices rather than output volumes.⁷ Agricultural commodities tended to depart from this trend and have shown robust export performance. Sugar, tobacco and cashew, which together represented 12 percent of merchandise exports, grew by 16 percent in 2015 due to higher outputs and a slight recovery in tobacco prices in the second half of 2015.

Merchandise imports dropped by 5 percent in 2015 as a result of cheaper oil and lower FDI. Petroleum product and megaproject imports shrunk by almost 50 and 40 percent respectively, and were the main drivers of the decline in imports. However, slowing growth and the depreciation of the metical also affected consumption related imports such as motor vehicles, which recorded a 22 percent reduction.

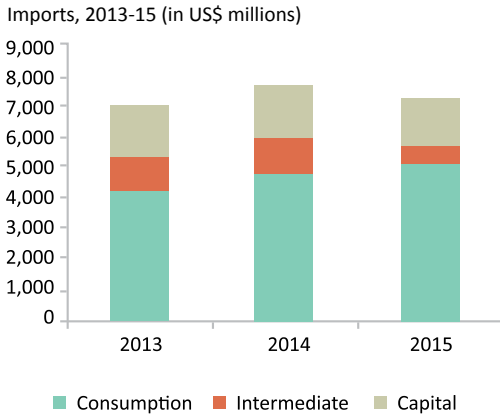
Foreign direct investment inflows contracted by 25 percent in 2015. With a larger current account deficit and reduced FDI, the BdM reported a cumulative deficit of nearly US\$584 million in the overall balance of payments in 2015, up from 106 the previous year.

⁶ Other includes errors and omissions.

⁷ Export earnings from aluminum fell by 14 percent, coal by 24 percent, and gas by 20 percent.

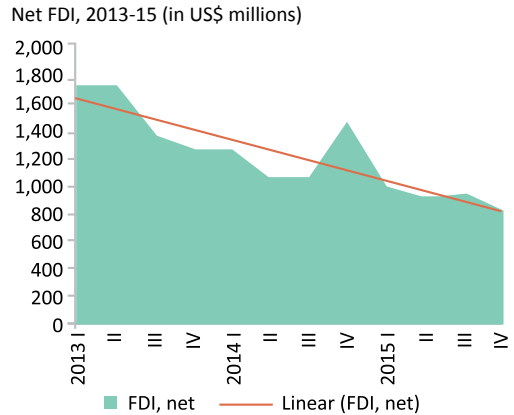


Figure 9: Capital and petroleum goods contribute to lower import growth...



Source: BdM

Figure 10: ...given that FDI inflows have weakened substantially.



Source: BdM

Box 2: The Current-Account Deficit

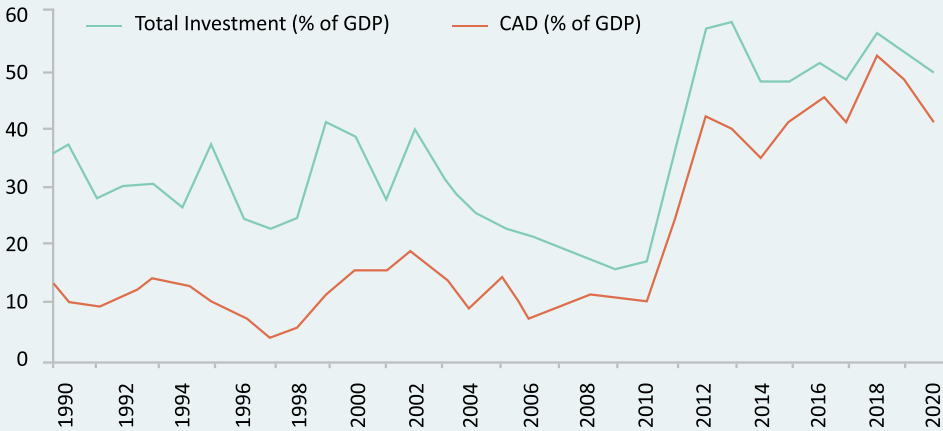
Mozambique’s traditionally small current-account deficits (CADs) have widened in recent years as the value of imports has significantly exceeded the value of exports. Large-scale megaproject-related imports have driven this trend, beginning with investments in aluminum production, and followed by the expansion of the mining and gas sectors financed by FDI. Unlike other developing countries, Mozambique’s CAD is not primarily financed by grants and loans, and FDI covers the CAD without adding to the external debt burden.

The country’s first major FDI-financed megaproject was the US\$2 billion Mozal aluminum smelter, which opened in 2000. The Sasol gas plant came online in 2004, and a gas pipeline expansion is currently planned. These megaprojects have since

been joined by major investments by Kenmare in heavy sands extraction and by Rio Tinto and Vale in coal mining.

Large megaproject-related FDI inflows have caused the CAD to widen from an average of around 11 percent of GDP from 2004 to 2010 to around 40 percent of GDP from 2012 to 2015. This reflected a huge increase in total investment, which shot to over 50 percent of GDP in 2012. In recent years slowing growth among Mozambique’s main trading partners, especially China, and low international commodity prices have caused exports to stagnate. Meanwhile, imports have continued growing, even as capital inflows have declined. The CAD is currently estimated at 41 percent of GDP in 2015 and is projected to exceed 70 percent of GDP by 2018 as the gas fields in the Rovuma basin are developed.

Figure 11: A dramatic rise in the CAD between 2010 and 2012 was accompanied by a similar spike in total investment.

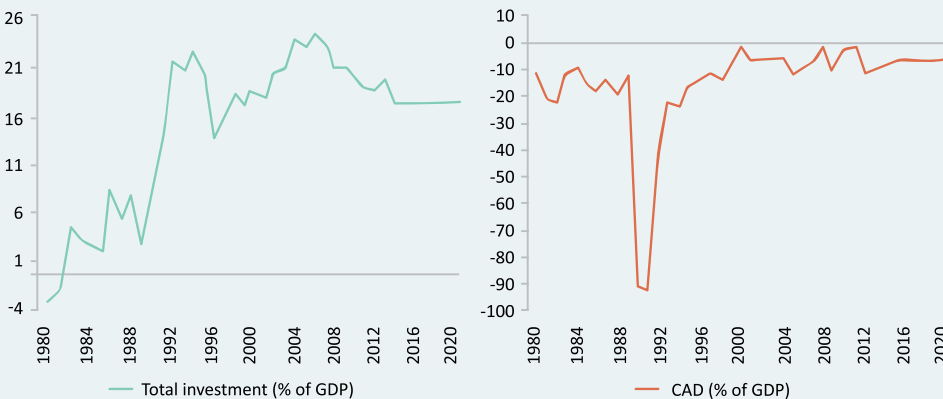


Source: IMF, International Financial Statistics

A large and persistent CAD could potentially threaten external stability, but the current widening of the CAD is expected to be temporary as it is primarily financed by megaproject-related FDI. Assuming that FDI inflows successfully contribute to long-term increases in economic output, rising exports should help narrow the CAD over time. Technological spillovers can accelerate this process, and the international experience suggests that large CADs are associated with faster rates of economic growth.

The lag between FDI inflows and rising export volumes differs by country, and longer lead times tend to imply larger increases in production. For example, Sudan began exporting oil nearly 20 years after the start of oil exploration and after almost a decade of investment and infrastructure development. Following years of large deficits, the start of oil production narrowed the CAD dramatically.

Figure 12: The start of Sudanese oil production in the early 1990s rapidly narrowed the CAD.



Source: IMF, International Financial Statistics

In Mozambique, a further decline in global commodity prices and/or a deteriorating economic outlook among its main trading partners could delay resource exports. Domestic political or economic instability could also undermine investor confidence.

Large CADs are common among resource-rich developing countries, and Mozambique's current account is expected to remain in

deficit over the medium term, as several megaprojects are still in their early stages. At present, Mozambique's CAD is not cause for serious concern, as current large-scale investments in extractive industries are likely to yield future surpluses. However, the authorities must continue to closely monitor the CAD, as it could become unsustainable in a context of diminishing FDI.

Monetary Policy

International reserves have fallen due to the worsening balance of payments (BoP) and the BdM's interventions in the foreign-exchange market.

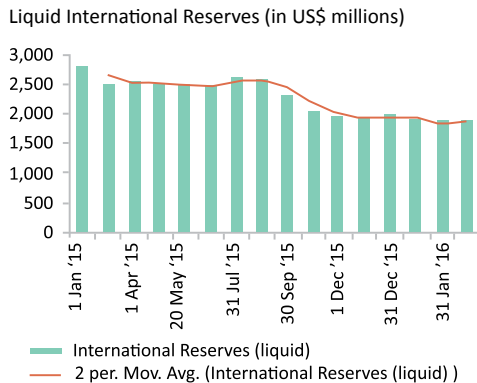
The BoP deficit coincided with the central bank's interventions in the foreign-exchange market to control the depreciation of the metical and limit its pass-through effect on inflation. Reserves fell from US\$2.8 billion, or nearly 3 months of imports, at the beginning of 2015 to roughly US\$1.9 billion, or about 2 months of imports, by end-December with the largest share of the decline (US\$561 million) occurring in the last four months of the year. International reserves fell a further US\$167 million in the first two months of 2016.

The BdM intervened in foreign exchange markets in an effort to stabilize the exchange rate while also injecting liquidity to mitigate the associated contraction of both the monetary base and the supply of credit to the economy. The growth of BdM's net domestic assets and domestic financial credit mirrors the decline in its international reserves, reflecting its reliance on sterilization to minimize the negative impact on the monetary base, ease exchange-rate pressures and attenuate the pass-through effect on inflation.

The government's increased borrowing from the financial system may have a crowding out effect on private sector investment. Despite the authorities' approval of a conservative 2015 budget, financial sector credit to the



Figure 13: Interventionist monetary policies have lowered international reserves.



Source: BdM

government was growing at an average 12-month rate of 15 percent by end-year, up from an average of about 3 percent in April. The metical's depreciation has prompted a shift from external to domestic borrowing.

The central bank began tightening its monetary stance in the last quarter of 2015, as foreign-exchange and inflationary pressures intensified.

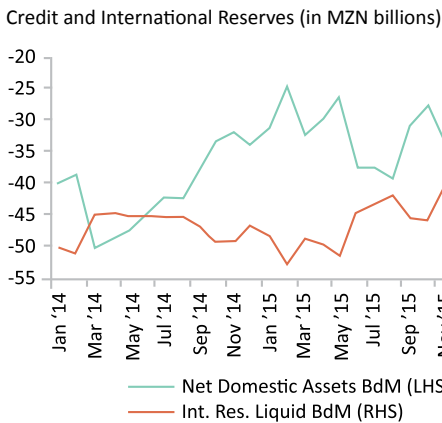
The central bank has continued tightening monetary policy since the last quarter of 2015.

After having maintained its standing lending facility (*facilidade permanente de cedência*, FPC) rate fixed at 7.5 percent for a year, the BdM implemented four rate increases between October 2015 and February 2016, bringing the

rate to 10.75 percent by end-February 2016. The central bank also raised the standing deposit facility rate (*facilidade permanente de depósito*, FPD) in similar stages from 1.5 percent in September to 4.25 percent by February 2016. In parallel, the reserve ratio was increased from 8 to 10.5 percent. Additional measures were also adopted in late 2015 to help contain foreign-exchange outflows, including a limit on international payments with credit cards.

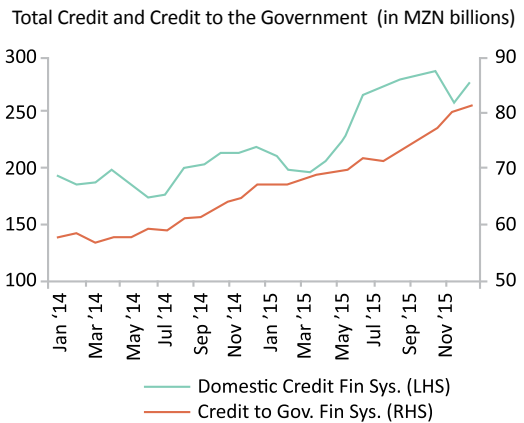
Continued pressure on the foreign-exchange market and the metical's depreciation prompted the BdM to tighten its monetary stance later in the year. Liquidity constraints are expected to slow the growth of credit to the economy and relieve pressure on both the exchange rate and international reserves. Credit policy remained loose through September 2015, as financial system credit grew at a 12-month average of over 25 percent.

Figure 14: In 2014 the BdM drew on its international reserves to inject liquidity...



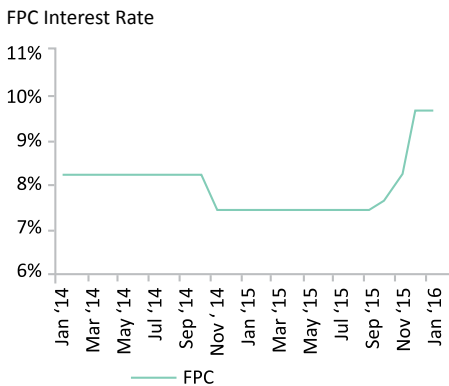
Source: BdM

Figure 15: ...and both total domestic credit and credit to the government increased rapidly.



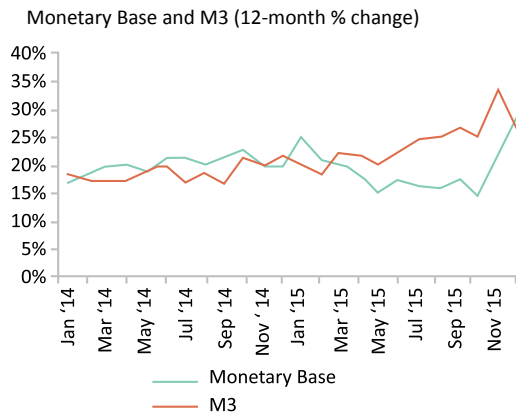
Source: BdM

Figure 16: In late 2015 the BdM began raising interest rates...



Source: BdM

Figure 17: ...as the monetary base contracted, while M3 continued to expand.



Source: BdM

Outlook

The adverse external environment is expected through 2016 with sluggish global growth and low commodity prices.

Weak external demand conditions are expected to continue through 2016 and into 2017.

The aggregate growth rate among advanced economies is projected to remain unchanged in 2016 and rise slightly to 2.0 percent 2017.

European Union growth is expected to decelerate to 1.5 percent in 2016, followed by a marginal rise to 1.6 percent in 2017. Growth in China is projected to further decelerate from 6.9 percent in 2015 to 6.5 percent in 2016 and 6.2 percent in 2017. Sub-Saharan Africa growth is expected to fall to 3.0 percent in 2016, before rebounding to 4.0 percent in 2017. A sharp decrease is forecasted for South Africa, from 1.3 percent in 2015 to 0.6 percent in 2016, and a recovery to about 1.2 percent in 2017.

Table 3: Outlook

	2015e	2016p	2017p
External Scenario			
Real GDP (% change)			
Advanced	1.9	1.9	2.0
European Union	1.6	1.5	1.6
China	6.9	6.5	6.2
Sub-Saharan Africa	3.4	3.0	4.0
South Africa	1.3	0.6	1.2
Commodity Nominal Price (% change)			
Aluminum \$/mt	-10.8	-6.9	4.0
Coal, Australia \$/mt	-18.0	-13.0	3.8
Natural gas, Europe \$/mmbtu	-27.8	-17.4	3.2
Tobacco \$/mt	-1.0	1.2	-1.2
Domestic Scenario			
Real GDP and Inflation (% change)			
Real GDP % change	6.3	5.8	7.7
Inflation CPI average	3.6	6.5	5.6

e: Estimate; p: Projection

Source: IMF (WEO) and World Bank

Commodity prices are expected to continue their decline in 2016, with a gradual recovery anticipated by mid-2017. A stronger US dollar and tighter US monetary policies will maintain downward pressure on commodity prices. Prices for Mozambique's main exports are expected to drop further in 2016, with aluminum prices projected to fall by 7 percent, coal prices by 13 percent and gas prices by 17 percent. Meanwhile, tobacco prices are expected to increase slightly in 2016 before contracting in 2017.

GDP growth is expected to continue decelerating in 2016 before recovering in 2017.

GDP growth in 2016 is projected to decelerate further to 5.8 percent, before recovering to

over 7 percent by 2017. The slowdown in 2016 reflects the continued decline in commodity prices for key exports and the effects of the ongoing regional drought on agricultural and food prices, which may remain elevated. This outlook is subject to additional downward risk if gas megaproject investments are deferred to 2017, and if higher debt levels result in sharp macro policy adjustments. The weaker metical adds further inflationary pressures in 2016 through its effect on the cost of imports. The central bank continues to respond to these developments through additional monetary tightening. However, these interventions could strain economic growth even further as higher interest rates have negative knock-on effects on the private sector and the banking sector's

portfolio.

medium term prospects remain sound.

The continued depreciation of the exchange rate could gradually help stimulate exports, as long as inflation remains contained. However, the development of non-commodity exports will require adequate investment in complementary infrastructure. The continued depreciation of the metical should also contain the growth of intermediate and capital imports.

Taken together, short-term pressures in 2016 point to the importance of securing the final investment decisions for the development of the Rovuma basin gas fields. In this regard, the prospects for Mozambique’s gas sector remain sound and large associated FDI flows are expected between 2017 and 2020.⁸ These flows will support the widening of the current account deficit and boost growth. Gas exports are expected to ramp up by 2022 and the current account deficit to shrink thereafter.

Short-term pressures on the external position are pronounced in 2016, but



Part Two: Risks vs. Returns: The Implications of Scaling-Up Investments in an Emerging Resource-rich Economy

Introduction

This section explores Mozambique’s heightened exposure to fiscal risks arising from its efforts to increase public investment.

Substantial public investment is necessary to address the country’s limited human capital stock and considerable infrastructure deficit, and discoveries of large natural resource reserves will significantly alter the country’s fiscal situation. Anticipating these changes, the government has been substantially scaling-up public investment over the last few years. In today’s resource constrained environment, the government is financing these ambitions through different means, such as an upward trend of resources allocated through the budget,⁹ raising debt, providing guarantees for public corporations, and increasing public-private partnership (PPP) arrangements. However, these choices are not risk free, as Mozambique’s fiscal vulnerabilities

have led the three major international credit rating agencies to downgrade the country’s sovereign credit rating. The objective of this section is to describe the evolution of fiscal risks in the context of the government’s recent drive to increase public investment and to provide recommendations for addressing those risks.

What Are Fiscal Risks?

Fiscal risks can be broadly defined as the risk that fiscal outcomes will deviate from what was expected when a budget or other forecast was prepared. Fiscal risks can arise from unforeseen changes in the economy that cause key variables such as the growth rate, the exchange rate, or public revenues to differ from projections. As substantial resource revenues are expected to come on stream over the medium term, the volatility of commodity prices particularly for coal and liquefied natural gas will become an

⁸ Progress towards final investment decisions has been steady and was boosted by the approval of ENI’s area 4 development plan in February 2016.

⁹ With the exception of 2015 resource allocation to public investment has been rising each year.

increasingly important source of fiscal risk, which the government will have to carefully manage.

Fiscal risks can also arise from specific events or policy arrangements. Natural disasters, pension liabilities and unsustainable borrowing by subnational governments are examples of specific fiscal risks that can increase the government's expenditure obligations. Contingent liabilities are an especially critical concern. For example, if the state explicitly guarantees a loan undertaken by a public corporation and it cannot be repaid according to the agreed-upon terms, the state will be obligated to service the loan. In the case of an implicit contingent liability, there may be an expectation that the state will intervene even without an explicit guarantee. Contingent liabilities are often unquantifiable and uncertain, making fiscal risks challenging to manage.

Changing economic conditions may exacerbate certain fiscal risks related to public investment. An unanticipated slowdown in growth could cause investment projects to fail to realize their anticipated revenue potential. For example, a project that generates revenue through user fees might suffer from weakening demand. A deteriorating exchange rate could raise debt-service costs, diminishing fiscal revenues and/or increasing real expenditure obligations. This could heighten the fiscal risks of the public investment program at a time when the public finances are most vulnerable.

The issue of fiscal risks is not new in Mozambique. The collapse of two state-owned banks in the 1990s increased government liabilities related to nonperforming loans. Financial sector reforms were subsequently introduced, including the privatization of the two banks. Rising debt levels have also been a serious issue, with external debt peaking at 366 percent of gross national income (GNI) in 1994. The government qualified for debt relief under

the Heavily Indebted Poor Countries Initiative in 1999, which greatly improved its debt profile. However, as far back as 2001 a review of public spending identified fiscal risks stemming from the financial sector, the pension scheme and potential natural disasters. Fifteen years later the country's exposure to fiscal risks is increasing, and a growing debt burden, substantial investor uncertainty and rising macroeconomic instability have had adverse implications for growth.

The Public Investment Program

The government has been rapidly scaling up public investment. Mozambique's Council of Ministers approved an Integrated Investment Plan (*Programa Integrado de Investimento*, PII) in 2013. The PII outlines a number of priority areas for investment, including agriculture and irrigation, ports and railways, airports, roads and bridges, energy, fishing, human capital development, water supply, and youth housing. Well-targeted investments could increase human and physical capital and generate higher growth rates.

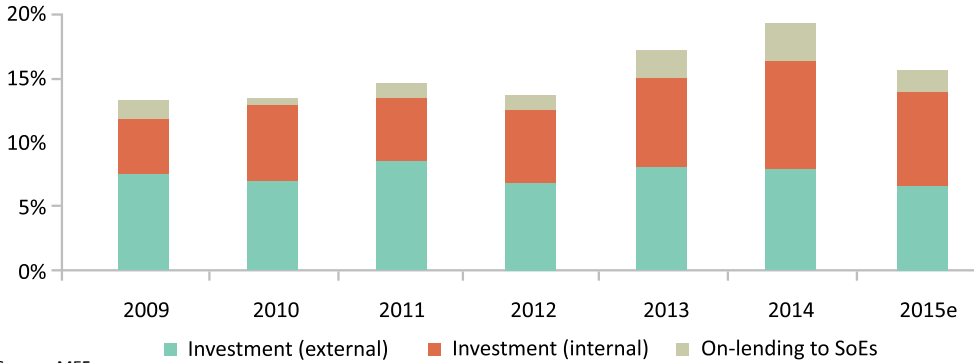
Nominal public investment levels increased each year between 2009 and 2014 to reach 19.1 percent of GDP. However, spending levels were projected to decline to 15.5 percent of GDP in 2015 as the government scaled back expenditures in response to short-term financial challenges (Figure 18). Externally financed investments through concessional loans and grants fluctuated at 7 to 8 percent of GDP between 2009 and 2014. Domestically financed investment through fiscal revenues or commercial loans has steadily increased each year, from MZN 13.43 billion in 2009 to an estimated 41.03 billion in 2015.¹⁰ Excluding projections for 2015, loans to public corporations via the budget have also been increasing.

¹⁰ Values are expressed in real terms with 2009 as the base year.



Figure 18: Public investment increased through 2014.

(Public investment, % of GDP)



Source: MEF

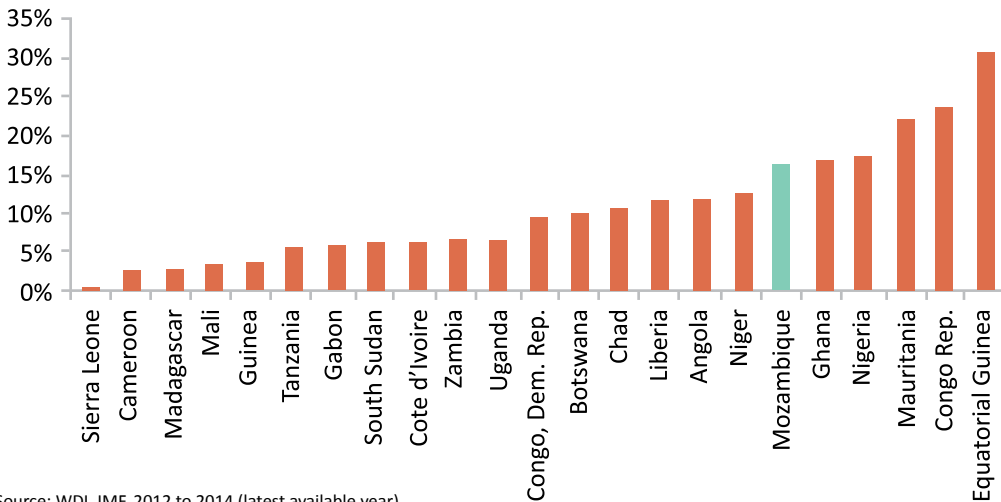
Mozambique’s public investment budget is relatively large compared to peer countries (Figure 19). A number of countries across SSA have made efforts to scale up public investment. Resource-rich countries, as well as those anticipating significant resource revenues,

can use this revenue stream to expand public investment. Public investment in Mozambique is high compared to both emerging resource-rich countries such as Uganda and Tanzania, and countries with established resource revenue streams such as Angola and Botswana.



Figure 19: Public investment spending is relatively high compared to peer countries.

Gross fixed capital formation, public sector (% of GDP)



Source: WDI, IMF, 2012 to 2014 (latest available year)

In addition to increasing the investment budget the government is using other mechanisms to expand public investment, which are heightening the country’s vulnerability to

fiscal risks. First, public investment is increasingly financed through borrowing, adding to the government’s direct liabilities. Second, public corporations are becoming increasingly

engaged in public investment,¹¹ which could generate contingent liabilities if the government has provided financial guarantees to these companies. Third, PPP arrangements involving public corporations are also becoming more prevalent. If a project does not realize its anticipated returns the government may be expected to intervene, even if this is not explicitly provided for in the contract. These alternative financing mechanisms are particularly attractive when budgetary resources are constrained. The following subsections describe each of these sources of fiscal risks in greater detail, with reference to relevant examples given the lack of published data.

Major Sources of Fiscal Risk

Fiscal risks associated with rising debt levels.

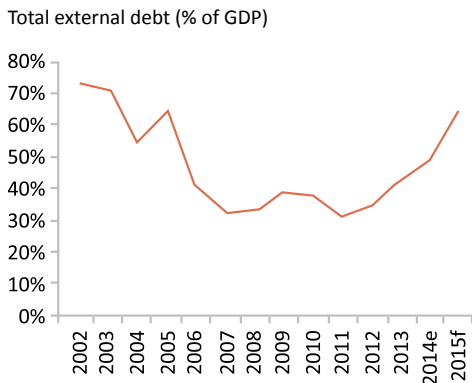
The government is increasingly borrowing to finance large-scale infrastructure projects. Borrowing for current investments can lead to higher growth and promote positive socioeconomic returns, but only if the right

investments are undertaken. The authorities are implementing a number of large infrastructure projects through public corporations using bilateral loans contracted on non-concessional terms. For example, the South Maputo Development Company (*Empresa de Desenvolvimento Maputo Sul*), a public corporation, is managing the implementation of the Maputo ring road, Katembe bridge and Ponta d'Ouro road projects using a US\$725.8 million loan provided by the China Export-Import Bank. The expansion of Nacala and Maputo airports were also financed through non-concessional borrowing.

Public and publicly guaranteed debt levels are rapidly increasing. Total external debt levels rose from 38 percent of GDP in 2010 to an estimated 63 percent of GDP in 2015 (Figure 20), as the overall fiscal balance declined (Figure 21). Notably, in 2014 the overall fiscal balance fell due to increased spending on the wage bill and public investment.¹² The increase in loans compared to grants is notable (Figure 22), especially as these loans are increasingly non-concessional in nature, which is raising overall public liabilities (Figure 23).

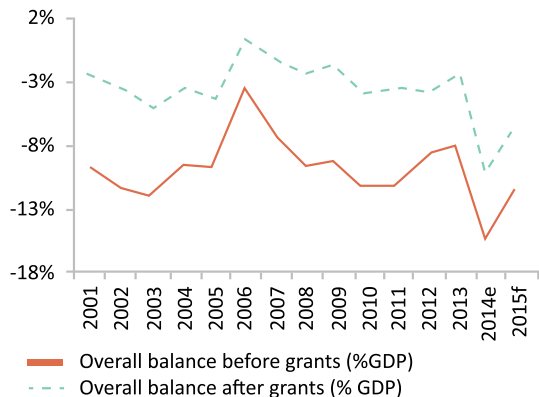


Figure 20: Total external debt levels are rising...



Source: Debt Sustainability Analysis, 2015

Figure 21: ...as the overall fiscal balance has been deteriorating.



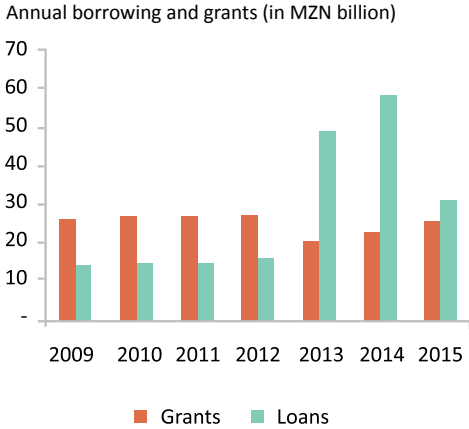
Source: MEF and IMF

¹¹ The term “public corporation” encompasses (i) non-financial public corporations, including 14 public corporations that are fully owned by the government, (ii) financial public corporations such as the Bank of Mozambique and the National Investment Bank, and (iii) private companies in which the government has shareholdings. The state has both direct and indirect shareholdings in private companies, which are not fully disclosed.

¹² This trend was accentuated by the expenditure demands of the election cycle, and windfall revenues from one-off capital gains taxes related to the consolidation of gas ownership structures in the Rovuma Basin in the previous year.

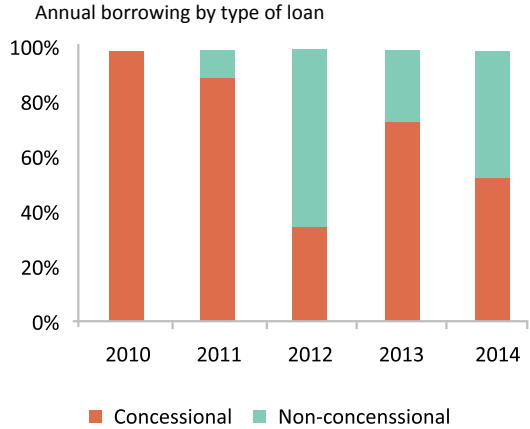


Figure 22: Loans are rising rapidly in relation to grants...



Source: MEF

Figure 23: ...and are increasingly being undertaken on non-concessional terms.



Source: GoM Fiscal Risk Statement, 2015

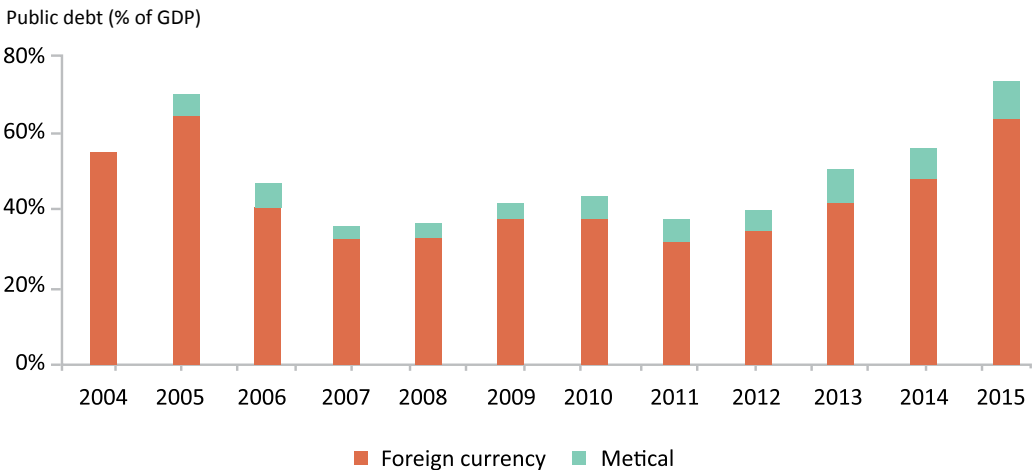
Mozambique’s risk of external debt distress is still moderate, although risks have heightened.

A Debt Sustainability Analysis (DSA) conducted in November 2015 found that while the risk of external debt distress remains moderate, the depreciation of the metical against the US dollar has increased debt ratios and debt-service requirements. Given that the public debt is largely denominated in foreign currency (Figure 24), exchange-rate dynamics have important implications for debt sustainability

levels (Figure 25). Under baseline assumptions of the exchange rate the present value of debt-to-GDP ratio is within the threshold.¹³ However, if the metical depreciates against the dollar by 15 percent, which would be closer to the market exchange rate in March 2016 the present value of debt-to-GDP threshold would be breached. If the metical was to depreciate by a further 30 percent the ratio would be even higher at a projected 56.5 percent of GDP in 2016.



Figure 24: Public debt is largely denominated in foreign currency.

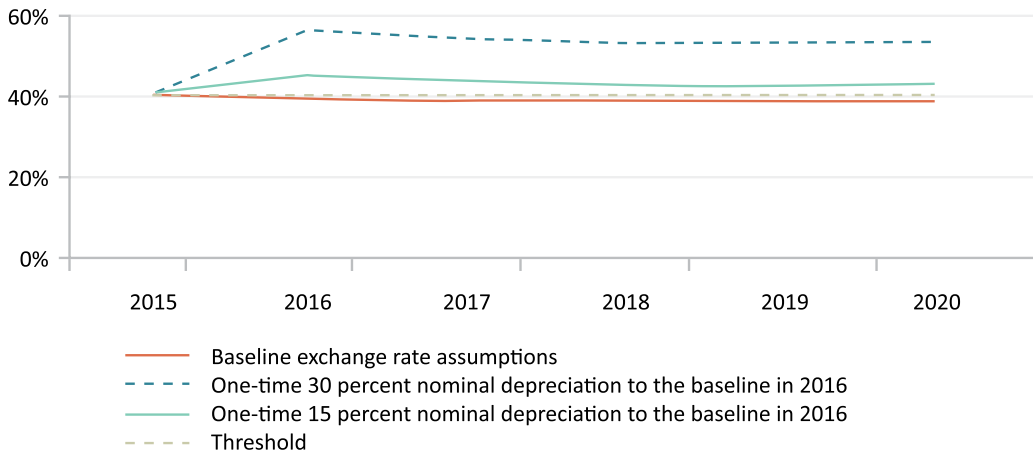


Source: Debt Sustainability Analysis, World Bank staff estimates

¹³ Under the baseline scenario the exchange rate was projected as follows US\$ 1 = MZN: 2015 (45.0), 2016 (45.9), 2017 (46.9), 2018 (47.8), 2019 (48.8) and 2020 (49.8): The threshold value of debt sustainability for the present value of debt to GDP ratio is 40 percent of GDP.



Figure 25: The depreciation of the Metical has raised the present value of debt-to-GDP ratio.



Source: Debt Sustainability Analysis, World Bank staff estimates

If the government is unable to meet its obligations, the shrinking fiscal envelope and rising risk of debt distress could have negative implications for the economy. The threat of a debt default can erode private sector confidence and discourage investment. Moreover, an unsustainable debt trajectory can increase the cost of commercial borrowing. Elevated risks of debt distress in Ghana and Zambia, two other resource-rich SSA countries, have led to downgrades in their sovereign credit ratings.

Fiscal risks arising from explicit contingent liabilities: the case of EMATUM.

Certain public corporations have benefited from government guarantees as part of the recent drive to increase public investment. Each year the government issues a ceiling for guarantees, which is approved by parliament in the budget law. The total stock of government guarantees is not published. In 2013 the Mozambican Tuna Company (*Empresa Moçambicana de Atum*, EMATUM) was founded as a private entity with the government serving as the majority shareholder.¹⁴ EMATUM received a loan of US\$850 million from

international creditors, backed by a government guarantee.¹⁵ US\$350 million was dedicated to tuna fishing activities and US\$500 million to maritime security. The value of the guarantee vastly exceeded the ceiling specified in the 2013 budget law. In 2014 government-issued guarantees amounted to US\$392.6 million,¹⁶ significantly higher than in previous years, with the bulk of the guarantees assigned to EMATUM.

EMATUM's government-issued guarantee represents a substantial fiscal risk. EMATUM was established through a large state-backed loan guarantee, even though the project was not included in the PII and the procurement was completed without tender. EMATUM is experiencing financial distress, with expectations that the government will assume the entire debt, exceeding the value of the guarantee approved in the Budget Law. In 2014 EMATUM recorded losses of US\$25.3 million. Following an intervention by the government and the central bank, a first tranche of repayments was made in September 2015 in the amount of US\$105 million, of which US\$77 million went toward debt repayment and US\$27 million toward interest payments.

¹⁴ The Mozambican government's Institute for the Management of State Holdings (*Instituto de Gestão das Participações do Estado*) owns 34 percent of the shares, the Mozambican Fishing Company (*Empresa Moçambicana de Pesca*) owns 33 percent and the final 33 percent is owned by the Management of Investments, Holdings and Services company (*Gestão de Investimentos, Participações e Serviços*), which is majority owned by the government's social services agency.

¹⁵ Credit Suisse raised US\$500 million, while a Russian bank, VTB, raised a further US\$350 million.

¹⁶ US\$392,640,127.39 is equivalent to MZN 12,328,900,000 based on the 2014 exchange rate: US\$1 = MZN 31.4.

The EMATUM situation has generated a number of adverse economic consequences. The financial infeasibility of EMATUM's operations was one of the key factors behind the downgrading of Mozambique's sovereign credit rating in 2015, as it became increasingly apparent that EMATUM would continue to add to the government's debt obligations. In order to attract foreign investors the EMATUM bond is primarily denominated in foreign currency,¹⁷ placing further stress on the debt burden as the metical depreciates. The government has successfully negotiated the restructuring of the EMATUM bond, with 81.7 percent of investors approving the "early swap" offer. The move prompted Moody's and Standard and Poor's credit ratings agencies to further downgrade Mozambique's sovereign credit rating, which may affect broader investor sentiment.¹⁸

The EMATUM situation also raises concerns regarding the quality of Mozambique's public financial management institutions. International bond markets can be an attractive option, as they allow governments to access large amounts of financing quickly and without increasing the tax burden. However, for a loan to be undertaken on non-concessional terms the project incurring the debt must be financially viable and have the capacity to generate the expected returns. This can be assessed through project appraisals and feasibility studies, neither of which was used to assess EMATUM. The international experience highlights the importance of strong public institutions in enabling resource-rich countries to reap the benefits of their natural resource endowments.

There are signs that the government is making efforts to improve fiscal transparency. Mozambique is the first country in Africa to make its public finances available for the IMF's fiscal transparency evaluation, which is publicly accessible. The authorities are also taking steps to improve reporting on fiscal operations, such as reporting on public corporations and the

issuance of new guarantees. The maritime security element of EMATUM's operations was regularized by incorporating that element of the loan into national budget documents. In addition, public guarantees were published for the first time in the country's 2014 audited state accounts. In November 2015 the country also published its first fiscal risk statement. While the document does not fully disclose information about the government's liabilities, it represents a positive step in improving transparency.

Fiscal risks arising from implicit contingent liabilities: public corporations and PPPs.

The State Equity Holdings Management Institute¹⁹ has determined that a number of Mozambique's public corporations are commercially non-viable and represent a potential fiscal risk to the government. The government recently signaled its intention to privatize more than half of the country's public corporations, which are either not contributing to key policy objectives or are operating at a loss. Demonstrating the poor financial health of Mozambican public corporations, the government did not expect to receive any dividends from its shareholdings from 2012 to 2014.²⁰ Contrary to these projections, however, nine public corporations generated dividends in 2014, with nearly half derived from the BdM and a quarter from the Mozambique Ports and Railways Company (*Caminhos de Ferro de Moçambique*, CFM). This indicates that the government must improve its capacity to forecast revenue inflows from public corporations, and that the majority of public corporations do not generate dividends for the state.

Certain public corporations implementing major public investment projects are not generating a profit, but are still receiving non-concessional loans. For example, the government has invested heavily in financing airport expansion through

¹⁷ The loan is comprised of different currency denominations: US\$516 million, €291 million and MZN 1.1 billion.

¹⁸ Under the original terms of the EMATUM deal a yield of 8.5 percent was agreed to for a seven-year bond with a two-year grace period. The bond has an amortizing structure giving it a weighted average life of 4.5 years. The government's revised offer to investors swaps the debt for new US dollar denominated 2023 bonds maturing in January 2023, priced at 80 percent holding a coupon of 10.5 percent. The "early swap" offers holders a 105 percent ratio, bringing the coupon above 11 percent. The debt swap will enable the government to smooth its debt maturity profile.

¹⁹ The State Equity Holdings Management Institute is a public entity under the oversight of MEF.

²⁰ From 2013 dividends from companies have been reported in audited state accounts.

borrowing,²¹ but the state-controlled public corporation Mozambique Airports does not yield any dividends to the state. A related public corporation, LAM Mozambique Airlines (*Linhas Aéreas de Moçambique*), which has a monopoly over the country's airspace, has been running deficits for the past two years. Mozambique Telecommunications (*Telecomunicações de Moçambique*) is another public corporation facing a financial deficit. Mozambique Cellular (MCell) is a publicly owned mobile phones operator, which is similarly facing considerable financial challenges, leading to speculation that the government may sell its shares. Since the government owns these companies either in full or in part, their poor financial health could add to the state's fiscal obligations.

A number of PPP agreements²² are being implemented to develop Mozambique's natural resource-related infrastructure. There has been a significant increase in the use of PPP arrangements since 2011, with many supporting the development of infrastructure for coal mining. Projects are also underway to develop ports in key areas such as Pemba and Palma to facilitate the transportation of natural resources, and projects designed to increase energy generation and export are ongoing. CFM

is involved in a number of PPPs, including a large-scale initiative to construct the railway link between Moatize and Nacala and expand the Nacala port. This project has an estimated cost of more than US\$5 billion, with financial support provided by the Brazilian mining company Vale, and will be implemented from 2013 to 2017. The National Oil Company (*Empresa Nacional de Hidrocarbonetos*) may also become involved in PPPs going forward.

While PPPs can be used to scale-up public infrastructure, there are substantial fiscal risks involved. PPPs are essentially risk-sharing arrangements. Risks are assigned according to the comparative advantage of the parties involved, with the private sector typically addressing construction-related risks and the government managing political risks. Moreover, PPPs are sometimes used to defer the costs of a major investment until additional budgetary resources are available. However, in some countries poorly planned and managed PPPs have resulted in large and unexpected fiscal costs due to poor contract design, excessively optimistic assumptions about revenue potential from user fees and government-provided minimum income guarantees (Box 3).

Box 3: Flawed PPP Arrangements in Colombia and Portugal

Colombia's 1991 Constitution and a series of economic reforms promoted private sector involvement in areas traditionally managed by the state. As a result, PPP schemes emerged in areas such as electricity generation and distribution, transportation and telecommunications, largely backed by state guarantees. When demand dropped below the contractual targets established in the PPPs, the government was forced to make large payouts to its private partners. At the time,

contingent liabilities were not systematically assessed or included in the budget.

In Portugal the government pursued PPPs largely to overcome budgetary constraints in a broad range of sectors including ports, energy, transportation, health and water services. Between 1995 and 2010 the government entered into 22 PPP arrangements in the road sector, accumulating nearly €13.7 billion in debt,

²¹ A new terminal was built at Maputo International Airport through a US\$70 million contract to a Chinese construction firm. Further modernization work is underway on the runways with an estimated cost of US\$65 million. Similarly, the Brazilian national development bank provided a non-concessional loan to finance the refurbishment of Nacala airport.

²² PPPs are typically long-term contracts. Investment and service provision are usually carried out by the private sector, with support from the public sector, and user fees which contribute to cost recovery.

more than two-thirds of which was owed to commercial banks. In most cases PPPs were privately financed with a concession awarded to the private sector. Costs were to be recuperated through tolls, user fees or shadow tolls. Following the 2008 financial crisis, demand projections failed to materialize as growth slowed. Access to credit

was also affected, as domestic banks were no longer financially leveraged. As a result, private investors called on state guarantees, contributing to a rapid deterioration in Portugal's fiscal position and forcing the government to seek financial assistance and renegotiate the terms of the contracts.

Source: Salazar (2013), Sarmiento and Renneboog (2014) and WDI

Mozambique's experience with PPPs has been mixed, and they could become a source of significant fiscal risk in the future.

In the case of the Nacala railroad, investment by the operator and rail traffic have failed to meet expectations. Moreover, it is unclear whether comprehensive feasibility studies were conducted to determine the railroad's commercial viability in addition to its prospects for service provision. While the government does not provide explicit guarantees for PPPs, since public corporations are often party to the agreement there may be an implicit assumption that the state will intervene if the project does not realize its expected returns. Should economic conditions weaken, the growing use of PPPs could entail significant fiscal risks by creating unexpected financial obligations on the part of the government.

How Can Fiscal Risks Be Managed?

The first step in better managing fiscal risks is to more thoroughly assess and quantify them.

Fiscal risks by nature are difficult to quantify because they are predicated on an uncertain event in the future. However, steps can be taken to improve risk assessment, such as establishing upper and lower limits on the potential costs of identified risks. In other countries contingent liabilities related to guarantees for public corporations or PPPs are calculated annually by examining contractual conditions and changes in key economic variables. Methods have also been devised for estimating other types of fiscal risk that may affect the economy such as economic

growth rates and commodity-price volatility.²³

The second step is to disclose fiscal risks.

Improving disclosure processes can help ensure that fiscal risks are subject to appropriate scrutiny, which can promote more effective policy responses. In some countries the government is legally obligated to disclose fiscal risks. For example, Uganda's 2015 Public Finance Management Act requires that the government publish a fiscal risk statement, which must include the distinct sources of fiscal risk along with a cost estimate and an alternative fiscal framework based on more realistic macroeconomic assumptions. In Colombia, publishing the estimated cost of guarantees has reduced incentives to hide potential state obligations by making them more closely comparable to conventional expenditures.

While Mozambique has made progress by publishing its first fiscal risk statement, there is significant scope for further improvement.

Moving forward, risks related to contingent liabilities from guarantees to public corporations and PPPs should also be assessed. Establishing a fiscal risk unit will help coordinate information from different departments. Such a unit will also be able to address the capacity and information gaps involved in estimating contingent liabilities and other sources of fiscal risks. Ensuring that the unit has a properly qualified and experienced staff, including experts with strong quantitative and legal backgrounds, will be important, but may take time to develop.


²³ For example, in Chile two panels of experts forecast potential GDP and long-run copper prices over a five-year period. The two extreme calculations on either end are discarded, an average of the estimates is taken and the results are published.



Conclusion

The government's ambitions to scale-up public investment in Mozambique have resulted in the country's heightened exposure to fiscal risks, which will need to be carefully managed. Financing for public investment has expanded rapidly through an increase in budgetary resources and in other ways that defer government obligations. Short-term budget constraints increase the attractiveness of alternative financing mechanisms, particularly as future earnings are expected to significantly expand once resource revenues come on stream. Rising debt levels and the growing

prominence of public corporations and PPPs all suggest that fiscal risks are becoming more pronounced. The EMATUM situation in particular has generated substantial fiscal risks for the government. These developments highlight the need to improve monitoring, disclosure and management of fiscal risks. These efforts should be complemented by measures to improve the government's capacity to manage public investments, including enhanced processes for evaluating projects that are likely to expose the country to fiscal risks.



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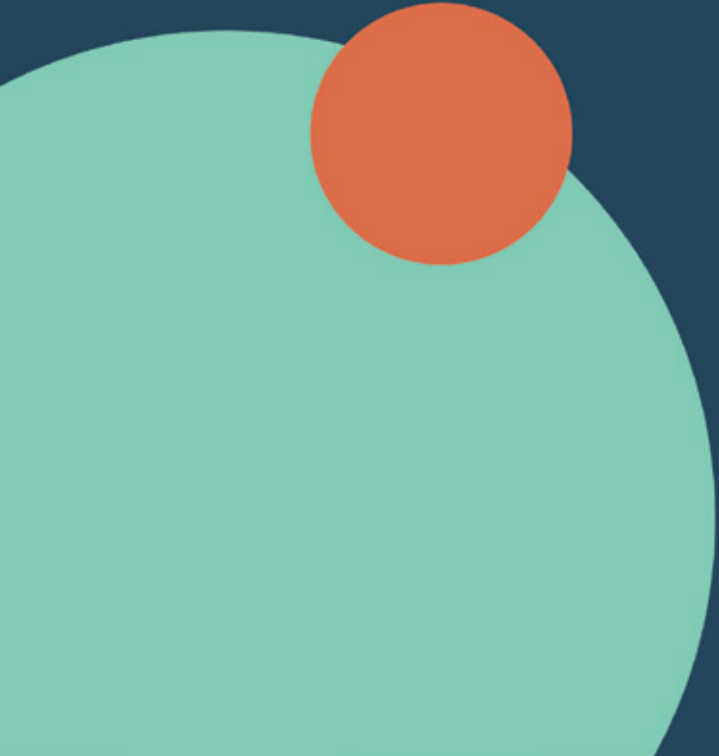
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