

Mozambique

February 2011

Mozambique better than its peers

- ⚡ The economic growth rate in 2010 is estimated to be around 8%, exceeding expectations once again. The official forecasts indicated a 6.2% expansion; in the Autumn, the International Monetary Fund forecasted 7.2% and, in the Spring, OECD forecasted 5.8%.
- ⚡ When compared to its peers, Mozambique is in a good position: the IMF forecasts GDP growth in the region of Sub-Saharan Africa of around 4.9%, while the group of countries in the coastal region, whose economies depend less on natural resources, should have grown by 3.5%.
- ⚡ Dynamism in economic activity was seen across the board in all sectors, with a special contribution from the agricultural sector. Favourable weather conditions, as well as an emphasis on sector investment and reorganization, justify this behaviour. Recovery of the global economy was also reflected in increased exports and the greater contribution of production from mega-projects, mainly aluminium, electrical power and also natural gas.
- ⚡ The inflation rate stood at 12.5% by the end of 2010, close to the official forecast but above the previous year's levels (2009: 3.3%). The depreciation of the Metical, which resulted in higher prices for imported goods, higher cost of energy and food products in the international markets and the end of subsidies for some essential goods and services, all justified this progression.
- ⚡ In 2011, inflation should decelerate due to the reintroduction of some of the price subsidies at the end of last year, the greater exchange rate stability and the forecast for a more moderate increase in energy and food prices in the international markets. The authorities forecast an annual average inflation rate of 8%, which may turn out to be too optimistic given the strong dynamics in domestic demand.
- ⚡ There should be no changes to the evolution pattern of the Mozambican economy over the next few years and activity expansion pace should continue to surprise, overtaking its regional peers. This positive scenario is based on the progressive start-up of several mega-projects, mainly in the energy and mining sectors. The IMF forecast an average real expansion rate of economic activity of around 8% between 2012 and 2015, while countries in the entire Sub-Saharan region should show an average growth of around 5.5%.
- ⚡ However, sustained progress in terms of economic development depends on the strengthening of the private sector, allowing for a growth pattern more equitably shared by the whole population. The maintenance of this dynamic will require the authorities to keep the following as vital goals: infrastructure and public services improvement; reinforcement of the financial system and maintenance of a business climate open to private enterprise. In this regard, the country's improved rating in the World Bank's Doing Business index in 2011 is noteworthy: Mozambique rose 4 places to 126th among 183 economies.

Paula Carvalho

Email: paula.goncalves.carvalho@bancobpi.pt

Telef.: 21 310 11 87

João Vitor Sousa

Email: joao.vitor.sousa@bancobpi.pt

Telef.: 21 310 10 28



Mozambique - Fortaleza São Sebastião

Research Department

Cristina Veiga Casalinho
Paula Gonçalves Carvalho
Susana de Jesus Santos
Teresa Gil Pinheiro
João Vitor Sousa

Chief Economist

TECHNICAL ANALYSIS
Agostinho Leal Alves

Tel.: 351 21 310 11 86 Fax: 351 21 353 56 94

Email: deef@bancobpl.pt

<http://www.bancobpl.pt>

<http://www.bplinvestimentos.pt/Research>

<http://www.bfa.ao>

INDEX

	Pag.
1. EVOLUTION OF ECONOMIC ACTIVITY	05
1.1 SUPPLY	05
1.2 DEMAND	06
2. INFLATION	07
3. MONETARY POLICY, CREDIT AND DEPOSITS	07
4. EXCHANGE RATE	08
5. GROWTH PROSPECTS IN SUB-SAHARAN AFRICA	09
6. DOING BUSINESS RANKING IMPROVES	10
7. SOCIO-ECONOMIC DEVELOPMENTS	11
7.1 Subsidy cuts cause disturbances in Maputo	11
7.2 Mining industry investment projects maintain development pace	11
7.3 Labour market shows scarcity of qualified labour	12
7.4 Third mobile communications license granted to Vietnamese-Mozambican consortium	12
7.5 Reinforcement of relationship with Malawi	12
8. EXTERNAL ACCOUNTS	13
8.1 Goods balance	13
8.2 Services balance	14
8.3 Current and capital transfer balance	14
8.4 Foreign direct investment	15
9. PUBLIC ACCOUNTS	15
9.1 2010 BUDGET EXECUTION	15
9.1.1 State revenue evolution	15
9.1.2 Expenditure evolution	16
9.2 2011 Budget	17
9.2.1 Macroeconomic framework	17
9.2.2 Budget balance	18
9.2.3 State revenue	19
9.2.4 State expenditure	20
9.2.4.1 Current Expenditure	20
9.2.4.2 Investment Expenses	21
9.2.5 Conclusion	21
DATABASE	23

1. EVOLUTION OF ECONOMIC ACTIVITY

1.1 Supply

In the first three quarters of 2010 there was an increase in GDP quarterly variation rates, compared to the previous year, which suggest an acceleration of annual growth. Up until the end of the third quarter, the annual GDP rate of change was around 8.5%, compared to the annual growth of 6.25% in the same period of the previous year. If the growth pattern in the final quarter was the same as in the last few years (a quarterly seasonal non-adjusted drop of around 10%), yearly GDP growth will be around 8.4%, above the IMF's 7.2% forecast. In order for the IMF's forecast to become reality the quarterly seasonal non-adjusted GDP drop has to be around 14%, there is, thus, a comfortable margin to exceed this forecast.

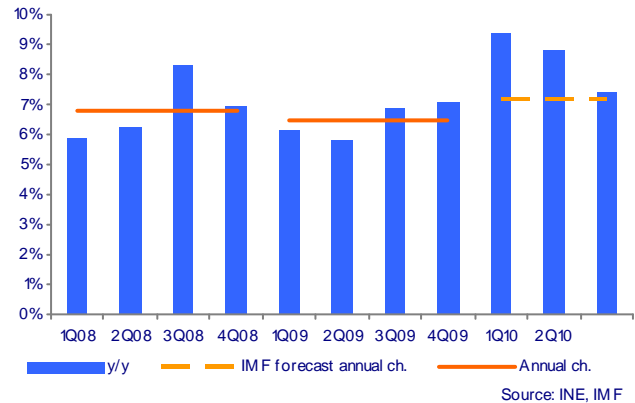
The main engine for growth has been the Agriculture sector (around 3 percentage points (pp) or 37.5% contribution in the first 9 months of 2010). This increase reflects the authorities' investment in the sector, as well as favourable climate conditions. Despite this growth, the agriculture sector still shows low productivity levels, due to large scale subsistence agriculture. The development of the agriculture sector should be a priority in government policies, since sector growth will be an important tool in the reduction of poverty levels. Actually, in rural areas, where the prevalence of absolute poverty is greater, the development of the agriculture sector should allow for the inclusion of a significant percentage of the population in the labour force, resulting in a rapid reduction of poverty levels. Another factor in the importance of agricultural development is the dependency on external food sources, which further causes imbalances in the external accounts. Considering the gradual predicted reduction of donations granted to the country in the long run, it is necessary to reduce external financing needs, which means achieving a balanced external account.

The sectors "Transportation and communications", "Commerce and repair services" and "Financial services" contributed 1.1pp, 1pp and 0.9pp, respectively, to product growth in the first 9 months of 2010. These sectors, related to tertiary activity, reflect the dynamism in internal demand, especially in the main urban centres, and they are not expected to decelerate in the next few months.

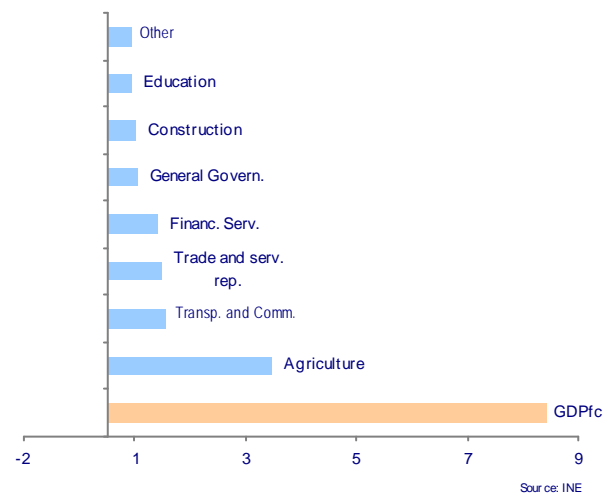
Other sectors which contributed significantly to growth in the first nine months of 2010 were "Public Administration", "Construction" and "Education" with a contribution of 0.6pp, 0.5pp and 0.5pp, respectively. As 2011 Budget forecasts a real growth of almost zero, the contribution of "Public Administration" to growth in 2011 should stagnate. "Construction" and "Education" sectors should keep growing, bearing in mind that there are several ongoing construction projects and that education remains a priority in government policy.

Regarding their weight on product, sectorial distribution remains practically unaltered when compared to the same period in the previous year. The largest positive variations were recorded in agricultural and financial services sectors, 0.6pp and 0.4pp, respectively, with a weight of 29.7% and 5.8%. Standing out with negative variation, however, was the manufacturing industry, with a drop of 0.8pp to 12.6% of product, and "Services to companies and real estate rental", with a drop of 0.5pp to 6.8% of product. Other sectors with a relevant GDP weight are: "Commerce and repair services" (12.9% of GDP), "Transportation and communications" (11.3% of GDP) and "Electricity and water" (4.9% of GDP).

Real GDP growth rate

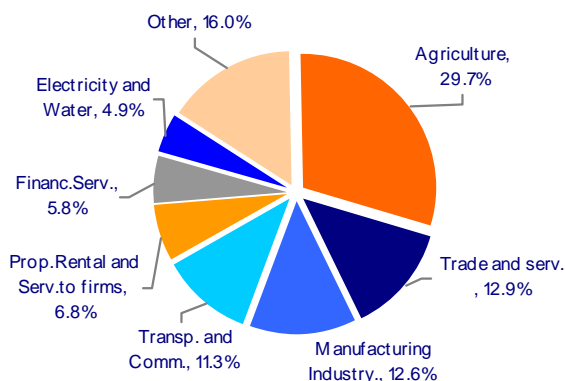


GDP - Contribution by sector Jan-Sept 2010 (p.p.)

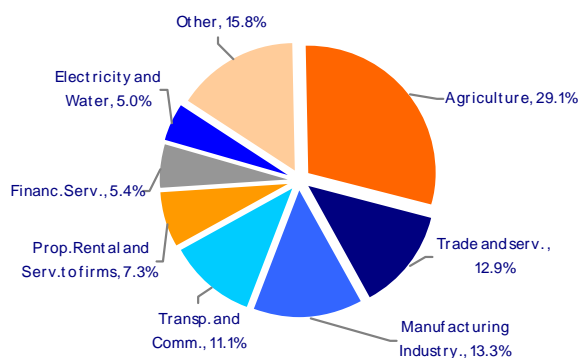


GDP by sector

I-III 2010



I-III 2009



Source: Bank of Moz., Min. Fin.

The weight of the mining industry is expected to increase significantly in the next few years (1.2% of GDP) as a result of the sector's growth prospects. The country's development stage suggests that the growth potential of other sectors is also high, but those with the greatest potential in the next few years, together with mining, are: the agriculture sector, since the current low productivity leaves enough room for a sharp production increase; the construction sector, as the development of basic infrastructure should continue to represent a government priority; and the energy sector, due to the increase in production capacity of Cahora Bassa and the construction of a new dam in Mphanda Nkuwa.

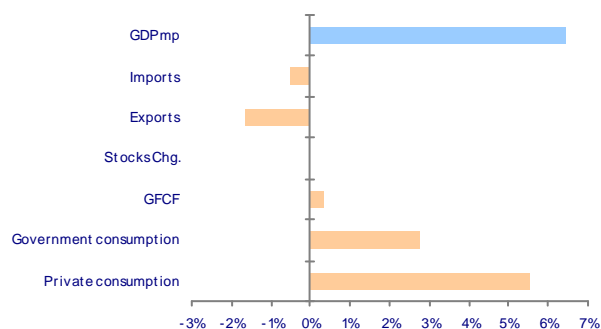
1.2 Demand

In regard to demand, the only data available is from 2009. The growth of 6.4% was only achieved because of domestic demand contribution (8.6pp) while external demand weighed negatively on growth (-2.1pp).

Domestic demand contribution was mainly a result of consumption, both private and public. Private consumption contributed with 5.5pp, up from 4.9pp in the previous year, while public consumption contributed with 2.8pp to product growth, an annual increase of 2pp. Gross investment contributed with 0.3pp, a decrease of 0.9pp compared to 2009, while stock variation had a null contribution to growth following a contribution of 0.7pp in the previous year.

Net external demand showed a negative contribution due to a decrease in exports of around 5% and a marginal increase in imports (around 1%) resulting in a negative contribution of 1.6pp from exports and 0.5pp from imports.

GDP growth contribution in 2009



Source: INE

The detailed GDP shows that public consumption allowed economic development to exceed initial growth expectations in 2009, with the maintenance of high private demand. Investment growth, however, was weak (1.5%). Expenditure growth and, on a smaller scale, investment growth led to increased imports, which presented a negative contribution of 0.5pp to product growth. The decrease in exports, mainly due to a drop in aluminium exports, had a negative growth contribution of 1.6pp.

These data show that it is necessary to create policies which will allow a more balanced growth model. High investment rates are highly desirable in the current development stage, which will allow productive structures growth. As mentioned before, the agriculture sector is crucial due to its growth potential and capacity to decrease poverty levels, but it is also necessary to develop industry to decrease external dependency. The diversification of the export base and the climbing in the value added scale would also make the tradable sector less exposed to variations of external demand and, this way, provide more sustainable growth.

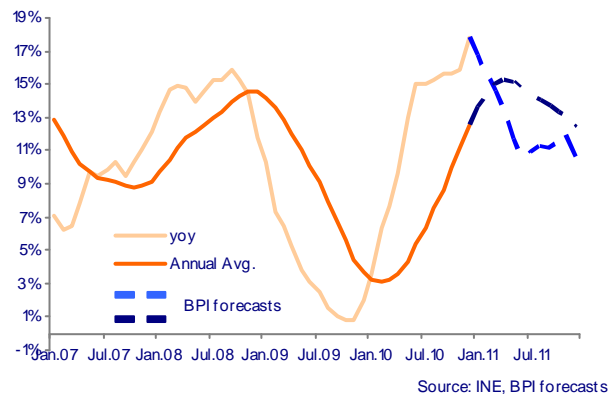
2. INFLATION

Following the historic low reached at the end of 2009 (0.78% y/y in October), the inflation rate has been accelerating throughout 2010. Therefore, following its accelerated pace between November 2009 and June 2010, from 0.8% to 15.1% annually, inflation rate stabilized around 15% until December, when it reached 17.8%. The annual average inflation rate followed the same trend; at the end of the year it reached 12.5%, slightly below the authorities' Budget estimate (12.7%). This is due to the more moderate behaviour of consumer prices in the final months of the year.

The main reasons for the acceleration of inflation were: the depreciation of the Metical against the American Dollar, the South African Rand and the Euro, increasing the cost of imported goods, which have a significant weight in the basket of goods; energy and food price increases in the international markets, which boosted the effect of the Metical's depreciation; and the removal of subsidies for bread and fuel, among other essential goods and services.

The reintroduction of some subsidies, the Metical's greater exchange rate stability and the forecast of a more stable evolution for energy and food prices in the international markets indicate a deceleration of the inflation rate. The authorities forecast an annual average inflation rate of 8% in 2011, which may prove to be overly optimistic, given the domestic demand's strong dynamic.

Inflation Rate (year-on-year)



3. MONETARY POLICY, CREDIT AND DEPOSITS

Key Interest Rates

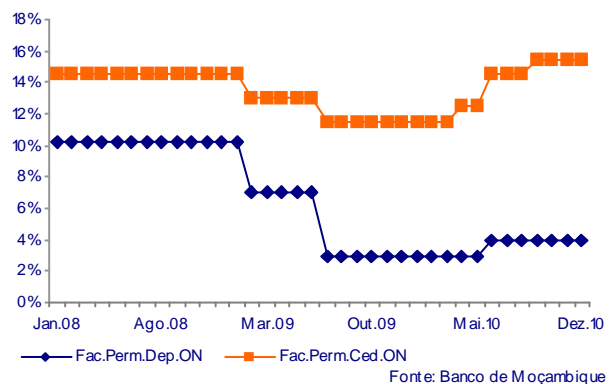
	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10
Treasury Bills												
91 Days	9.5%	9.5%	9.5%	9.5%	11.1%	12.5%	13.1%	13.2%	13.2%	13.8%	14.5%	14.7%
182 Days	10.4%	10.4%	10.4%	10.7%	-	12.3%	13.6%	13.2%	-	13.7%	15.0%	15.0%
364 Days	11.0%	11.0%	11.0%	11.0%	11.2%	13.7%	14.2%	14.3%	-	15.3%	15.3%	15.4%
Permanent Deposit Facility	3.0%	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Permanent Liquidity Providing Facility	11.5%	11.5%	11.5%	12.5%	12.5%	14.5%	14.5%	14.5%	15.5%	15.5%	15.5%	15.5%

Source: Bank of Mozambique.

The mandate of the Bank of Mozambique (BdM) is to ensure price stability. In 2010, the BdM had, as an objective, an average annual inflation of 12.7%, revised upwards from the previous objective of 9.5%, and international reserves equivalent to around 5 months cover of imports of goods and services. The instrumental variable of monetary policy is the reserve money. In order to control the evolution of this aggregate, the BdM intervenes in the Interbank Monetary Market (MMI) through the sale and acquisition of Treasury Bonds; and in the Interbank Exchange Market (MCI) through the acquisition and sale of currency.

In this way, the central bank has been acting in order to contain existing inflationary pressure and the appreciation of the Metical against the main reference currencies in trade transactions.

Bank of Mozambique key interest rates



Between March and September 2010, the BdM increased the marginal lending facility rate by 4pp to 15.5%, to restrain monetary based growth, which showed an accumulated growth of 22.7% until October. The deposit facility rate rose only 1pp to 4%.

The increase in the marginal lending facility rate was followed by an increase in the Treasury Bond rates, a financial instrument used by the BdM to absorb liquidity in the system. In tenures issued more regularly - 91 days - the average rate increased around 5pp to 14.67%. Considering the inflation rate increase, the real rate of return of this financial product turned negative, mitigating the restrictive effects of monetary policy. However, the scarce supply of alternative financial products maintains the Treasury Bonds' attractive on a risk/return basis.

Another measure used by the BdM to restrict liquidity was the increase of the coefficient of minimum required reserves to 8.5% forcing the banks to retain a greater proportion of their reserves, limiting credit.

As a result of more restrictive monetary policy measures, credit to the economy shows a more moderate growth rate. In the second quarter of 2010 there was still acceleration, from 50.8% in March to 57.6% in July, but by October it had fallen to 43.7%.

Although credit granted to the economy continues to have a crucial role in its development, considering internal demand dynamics and its effects on inflation, it is important to moderate credit granted, thus avoiding speculative movements or granting credit to high risk projects.

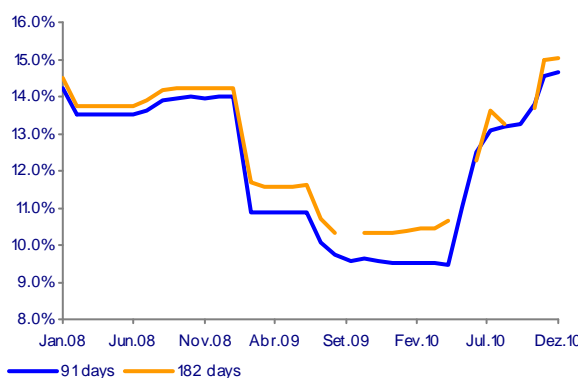
As previously mentioned, maintaining credit flow to the economy is fundamental for its development. The traditional banking sector and micro credit financial institutions which have a foothold in Mozambique should continue to have an important role.

Deposits have also shown a decelerating tendency in the last few months, although not as pronounced. Between July and October 2010, the annual change rate fell from 37% to 29%. Deposits, both in local and foreign currency displayed a smaller growth rate. In the case of national currency deposits the annual change rate decreased from 29% to 21%, while the annual change rate of foreign currency deposits dropped from 48% to 42%, which can be explained by the slight appreciation of the Metical against the main currencies in the last few months. However, this appreciation wasn't enough to prevent the decreasing trend of the weight of national currency deposits in total (57% in October against 63% at the end of 2009), which demonstrates the need pointed out by the BdM to increase usage of local currency in internal transaction instead of the American Dollar.

4. EXCHANGE RATE

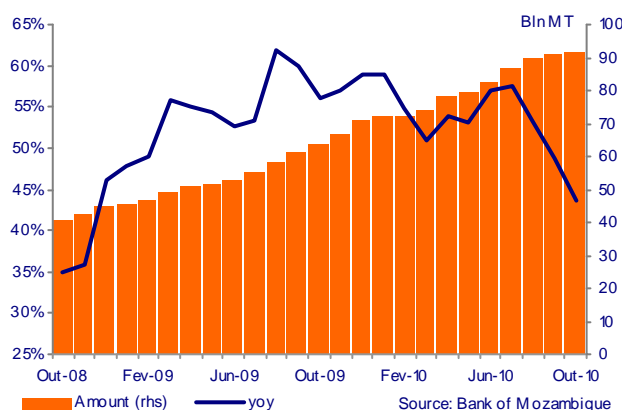
The Metical suffered a strong depreciation against the main currencies between mid-2009 and mid-2010. The Metical

Treasury Bill Interest rates



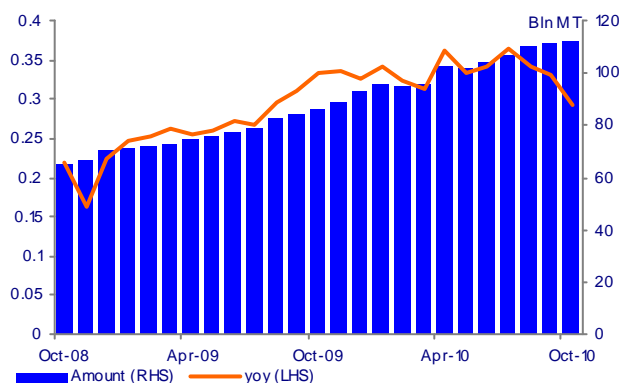
Source: Bank of Mozambique

Domestic Credit



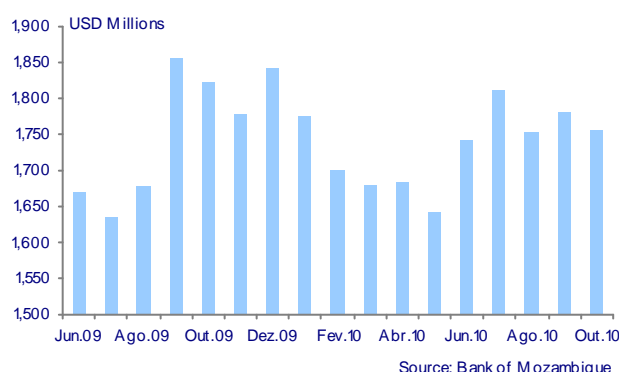
Source: Bank of Mozambique

Deposits in Credit Institutions



Source: Bank of Mozambique, BPI

Net International Reserves



Source: Bank of Mozambique

depreciated 44% against the American Dollar until mid-August, peaking at 38 USD/MZN. Since then, it has shown a trajectory of slight appreciation. This appreciation results from the intervention of the BdM in the Interbank Exchange Market and an improvement in the external trade balance due to the step-up in exports and incoming donations.

Other important currencies are the Euro and South African Rand. The Euro appreciated around 36% against the Metical between July and November this year. Considering the greater priority given by the BdM to stability against the Dollar, the Metical's fluctuation against the Euro mirrors the evolution of this currency against the Dollar, especially since mid-August, when the USD/MZN exchange rate stabilised. From the three currencies analysed, the South African Rand appreciated the most against the Metical (around 56% between July 2009 and August 2010). This is due to the favourable evolution of the Rand during this period, resulting in the return of capital flows and improved exports following the strong devaluation which it suffered in the final quarter of 2008.

As previously mentioned, an objective of the BdM has been the maintenance of international reserves equivalent to around 5 months cover of imports of goods and services. In 2009 this amount corresponded to around USD 1765 million and, it is hoped, this will be greater in 2010, since GDP growth results in increased imports and the devalued Metical made these more expensive. Considering the 2009 limit, international reserves have hovered around this figure since June. Currency inflow from donations and exports were the main factors pushing reserve values up, growth rate was not greater due to the intervention of the BdM in the Interbank Exchange Market, to stabilise the Metical's value against the main reference currencies.

5. GROWTH PROSPECTS IN SUB-SAHARAN AFRICA

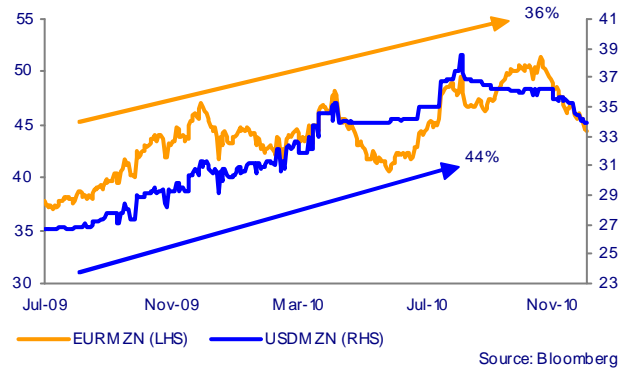
According to the Regional Economic Outlook, published by the IMF in October, growth in the Sub-Saharan region should be 5% in 2010, and 5.5%, in 2011. This growth level reflects the recovery of several economies in the region to the vigorous growth levels recorded in the second half of the last decade.

Despite the region's history of heightened sensitivity to external adverse shocks, this was not the case in the last world financial crisis. Actually, countries in Sub-Saharan Africa are, this once, better prepared to face adversity, since the implementation of macroeconomic stability policies in recent years, such as balancing public accounts, accumulation of foreign reserves, a decrease in public debt and inflation control, provided the authorities with room to manoeuvre in using fiscal and monetary policy in counter cycle.

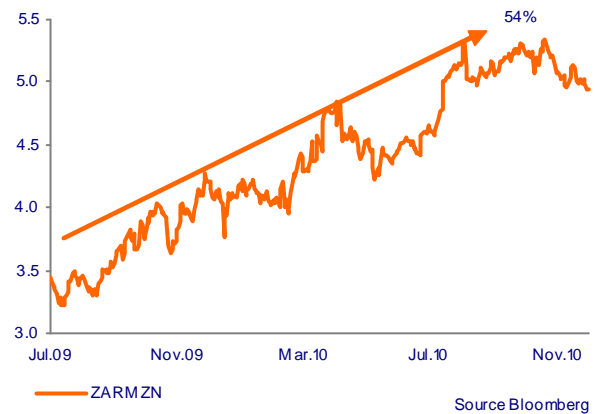
Furthermore, expected growth in 2010 and 2011 will have a broader base. Internal demand remains robust, both due to consumption and public and private investment, and exports have benefited from the recovery of the global economy and the region's increasingly stronger connection with Asian economies.

However, some effects from the crisis persist, such as increased unemployment in countries with greater manufacturing industry weight, budgetary imbalance and exports still have not reached pre-crisis levels. The main risks for activity in the region are related to the possibility of decreased capital flow from advanced economies, as well as, with a full electoral calendar (around 17 elections in the region throughout next year), which may lead to a postponement of structural reforms.

Metical exchange rate - evolution against USD and EUR....



...and south-african rand



The main political recommendation for the region given by the IMF is related to the need to focus concerns on financial sustainability and medium and long term debt, opposed to a greater emphasis on short term growth. Such recommendations stem from the fact that the great majority of economies in the region are nearing their potential for growth and, for this reason, it is now necessary to adjust the revenue and public expenditure trajectories to a level which will ensure medium term public accounts sustainability.

To maintain this growth dynamic in the long term will require the authorities to keep the following as vital objectives: infrastructure and public services improvement; reinforcement of the financial system and maintenance of a business climate open to private enterprise.

According to the IMF, Mozambique's economic performance should perform better than the region's throughout the next few years. Effectively, GDP growth in Mozambique should hover around 8% between 2012 and 2015, whereas the region should have an average growth of around 5.5%. In relation to price evolution, in 2010 inflation behaved more benignly overall in the region than in Mozambique, reflecting the greater deceleration recorded the previous year in Mozambique. By removing some price subsidies, inflation in Mozambique should evolve more in tune with the other countries in the region. It is expected to stabilise at around 5.6%.

The budget balance of the group of countries deteriorated significantly in 2009; a gradual rebalancing is expected throughout the next few years benefiting mostly from the improved budget balance of commodity exporting countries, which show a gradual price increase in international markets. Mozambique's budget balance has also deteriorated. It should show a slower correction to this imbalance, due to the ongoing public investment plan. In relation to the external deficit, the region's economies show a slight deficit, reflecting the inclusion of net commodities exporting countries like Nigeria, Angola, South Africa and Botswana in this group. Low income countries like Mozambique show high external deficit, reflecting the need to import most consumer goods and the import of goods associated with investment projects. In this way, Mozambique's external deficit is expected to remain above 12% of GDP.

6. DOING BUSINESS RANKING IMPROVES

Mozambique improved its position in the World Bank Doing Business ranking in 2011, to 126th among 183 economies, which represents an increase of 4 positions compared to the previous year. The main improvement was observed in the "Start a business" sub-dimension, which showed an increase of 31 positions to 65th, as a result of the decrease from 26 to 13 in the average number of days necessary to start a business. Other sub-dimensions with a noteworthy increase were "Registering Property" (9 positions) and "Close a business" (6 positions), where Mozambique ranks 144th and 129th, respectively.

Despite the recorded improvements, the countries' positioning is still low and shows the difficulties in starting entrepreneurial

Key macroeconomic Indicators

GDP (annual rate of change, %)	2008	2009	2010	2011	2012	2013	2014	2015
Sub-Saharan Africa	5.5	2.6	5.0	5.5	5.7	5.7	5.5	5.4
Mozambique	6.8	6.4	7.2	7.5	7.8	7.9	7.8	7.8
Angola	13.3	0.7	5.9	7.1	6.3	6.1	5.5	4.2
Botswana	3.1	-3.7	8.4	4.8	7.2	7.4	5.1	5.3
South Africa	3.7	-1.8	3.0	3.5	3.9	4.2	4.4	4.5
Inflation (annual average - %)								
Sub-Saharan Africa	11.7	10.4	7.5	7.0	6.3	5.9	5.7	5.5
Mozambique	10.3	3.3	12.7	8.0	5.6	5.6	5.6	5.6
Angola	12.5	13.7	13.3	11.3	10.9	8.3	6.5	6.0
Botswana	12.6	8.1	6.7	6.3	5.6	5.4	5.3	5.2
South Africa	11.5	7.1	5.6	5.8	5.6	5.2	5.0	4.5
Budget Balance (% GDP)								
Sub-Saharan Africa	0.7	-5.6	-4.4	-3.3	-2.0	-1.2	-0.7	-0.4
Mozambique	-2.2	-5.4	-4.9	-7.0	-6.9	-6.1	-5.1	-5.1
Angola	8.9	-8.6	2.7	3.3	3.5	5.0	4.8	3.3
Botswana	-3.1	-11.5	-7.9	-5.0	-0.9	1.6	2.9	4.2
South Africa	-0.5	-5.2	-5.8	-4.5	-3.1	-1.5	-0.4	0.7
Current Account Balance (% GDP)								
Sub-Saharan Africa	-0.2	-1.7	-1.1	-1.9	-1.5	-1.6	-1.3	-1.7
Mozambique	-11.9	-10.5	-13.4	-12.0	-12.0	-12.2	-12.4	-13.1
Angola	7.6	-5.0	1.6	1.3	3.0	0.1	1.0	-1.8
Botswana	3.5	-2.1	-0.5	0.4	2.0	3.1	3.8	4.6
South Africa	-7.1	-4.0	-4.3	-5.8	-5.9	-5.9	-6.3	-6.5

Source: IMF.

Listing In the World Bank's Doing Business

	Mozambique		Angola		Namibia	
	2010	2011	2010	2011	2010	2011
Global Index	130 ^o	126 ^o	164 ^o	163 ^o	68 ^o	69 ^o
Starting a Business	96 ^o	65 ^o	164 ^o	164 ^o	125 ^o	124 ^o
Dealing with Construction Permits	159 ^o	155 ^o	119 ^o	128 ^o	37 ^o	36 ^o
Registering Property	153 ^o	144 ^o	173 ^o	174 ^o	137 ^o	136 ^o
Getting Credit	125 ^o	128 ^o	109 ^o	116 ^o	14 ^o	15 ^o
Protecting Investors	41 ^o	44 ^o	57 ^o	59 ^o	73 ^o	74 ^o
Paying Taxes	98 ^o	101 ^o	135 ^o	142 ^o	97 ^o	99 ^o
Trading Across Borders	136 ^o	133 ^o	167 ^o	166 ^o	151 ^o	153 ^o
Enforcing Contracts	129 ^o	132 ^o	181 ^o	181 ^o	42 ^o	41 ^o
Closing a Business	135 ^o	129 ^o	144 ^o	147 ^o	55 ^o	53 ^o

Source: World Bank.

activities in the country. The World Bank ranking is used as a reference to foreign investors regarding the ease in doing business in a country and thus is an important factor in attracting Foreign Direct Investment. For this reason the authorities will have to persevere in their efforts to decrease bureaucratic and legislative barriers, among others, which hinder foreign and domestic private initiative.

Position in Corruption Perception Index

	2010			2009		
	World	Sub-Saharan Africa	Index	World	Sub-Saharan Africa	Index
Botswana	33 ^o	1 ^o	5.8	37 ^o	1 ^o	5.6
Namibia	56 ^o	6 ^o	4.4	56 ^o	6 ^o	4.5
Mozambique	116 ^o	20 ^o	2.7	130 ^o	27 ^o	2.5
Angola	168 ^o	42 ^o	1.9	162 ^o	38 ^o	1.9

Source: Transparency International.

Another important factor towards liberating entrepreneurial activity is the absence of corruption at several levels in society. Transparency International issues the annual Corruption Perceptions Index (CPI) report which measures corruption levels in a society. Mozambique is in 116th place among 178 countries, an improvement of 14 positions in comparison to 2009, whilst, in a regional context, there was an improvement of 7 positions to 20th. Despite the currently unsatisfactory result, this improvement is positive when considering some recent political developments.

7. SOCIO-ECONOMIC DEVELOPMENTS

7.1 Subsidy cuts cause disturbances in Maputo

In the final semester of 2010 there was some tension related to bread and fuel subsidy cuts. The subsidy cuts, together with the depreciation of the Metical and the price increase of these products in international markets resulted in an increased cost of living which hit the poorest segments of the population hardest.

Following several incidents and increased social tension, the authorities decided to reintroduce bread price subsidies. The subsidy will be granted directly to producers in the Mozambique Bread Makers Association, consisting of a 200 Meticals subsidy for every 50 kg of bread produced. Authorities introduced expenditure cuts in other areas in order to compensate this measure from the budget point of view.

Despite the reintroduction of subsidies which allow for the lessening of the effects of the increased cost of living in the short term, it is necessary to make them more effective. According to the World Bank separate subsidies granted to products such as fuel, bread or electricity show a regressive distribution, benefiting the population segment with higher income more significantly. This results from the subsidies being granted to producers, which reflect the subsidy on the final price of the product. However, the final price is not low enough for the purchasing power of the lower income population segment to be able to afford it, which leads to a greater benefit to the population segment with higher income.

Thus, the subsidies have to be distributed in a way which makes positive discrimination possible in its distribution. Furthermore, there needs to be a reduction in the high levels of poverty in the population for greater satisfaction of its basic needs. The current growth model has been based on the development of basic infrastructure and in attracting the so-called mega projects. Although this model has produced robust growth levels, there is the need for a more inclusive growth model, which should include development in the labour intensive sectors, more specifically in agriculture.

7.2 Mining industry investment projects maintain development pace

The so-called mega projects related to the mining industry, especially coal extraction, maintain an accelerated development pace, as five coal mines are expected to enter the extraction phase in the next 2 years. In May 2010, a new mining license for the area of Moatize was granted to the Australian company Beacon Hill Resources, who have already declared the discovery of additional reserves. This company has the only active coal mine at the moment, which produces around 100.000 tons/year, with a forecasted 20% production increase in 2011. It also has plans for the development of an open pit coal mine with a production capacity of 2 million tons/year.

Currently coal exports are shipped by river and via the renewed Sena railway line, and new coal mines are expected to use this same line,

although no agreements have been reached to that effect. Additionally, the Vale company plans to build its own railway line for coal transportation, which should be operational in 2015. This line will also be available for other companies, thus obtaining cost synergies. Other projects related to coal mining which have evolved are: Nippon Steel - surveyed potential reserves of 2.1 billion tons of coal in its exploration area in Tete; Riversdale (Australia) and Tata Steel (India) - should start production at the end of 2011, at a rate of 20 million tons/year.

Projects under development related to coal mining will make Mozambique one of the largest coal producers in the world, which should lead to increased exports. The increasing demand for this commodity is predicted to be robust, considering the growth rate of emerging economies, countries which frequently still use coal as an energy source. The increased exports should result in a reduction of the trade balance deficit, even though this reduction will be limited given the increased need for capital goods in the mid/long term for the implementation of projects and current high demand for imported goods due to the incipient industrial sector and agricultural production.

7.3 Labour market shows scarcity of qualified labour

The Labour Consulting Committee (CCT), an organisation which includes employee, employer and government representatives, points out scarcity of qualified labour as one of the greatest challenges facing the development of the Mozambican economy, since it can result in decreased external competitiveness. Current legislation allows for little flexibility and is too restrictive in terms of hiring foreign workers, making it difficult to hire qualified labour given the low qualification levels of national labour. Currently, there is a maximum limit of 5% and 10% of foreign workers for companies with more than 100 workers or less than 100 workers respectively. Added to that, the bureaucratic process is slow and requires authorisation from the Labour Minister. These restrictions have resulted in increased qualified labour costs, comparing negatively with the countries in the region. The implementation of greater flexibility is, therefore, desirable, since the increase in qualified national labour is a process with only long term results.

7.4 Third mobile communications license granted to Vietnamese-Mozambican consortium

In the telecommunications sector the third mobile communications license was granted to Vietnamese operator (Viettel), who are partnered with the Mozambican Sociedade Gestora de Investimentos (SGI). Viettel's offer was USD 29 million and, despite not being the highest bidder, the National Institute of Telecommunications of Mozambique (INCM) granted the license due to better technical conditions put forward and an investment plan of USD 400 million over the next 5 years.

The mobile telecommunications market had two operators up until now, Vodacom and Mcel. The introduction of a new provider is expected to increase competition in the sector resulting in a reduction in consumer prices. The increased competition is also likely to keep increasing the penetration rate. Currently, there are around 6.8 millions subscribers, corresponding to a 30% penetration rate. Despite the sharp increase in recent years (it was 3.5% in 2004) there is still high growth potential in the penetration rate, making it an attractive business.

7.5 Reinforcement of relationship with Malawi

The Mozambican authorities reached an agreement with the Malawian authorities for the use of the Zambezi River by Malawi as a way to ship their goods. Despite initial reluctance due to the environmental impact that increased river traffic may cause, an agreement was reached. The use of this channel will have a positive impact in decreasing goods transportation costs to Malawi by USD 175 million and will reinforce the bilateral relationship between the two countries. Despite the SADC's (Southern African Development Community) stated objective to create a free trade zone among its members, including Mozambique and Angola, there are still bureaucratic obstacles which prevent greater regional integration. The weak development of transport infrastructure in the region is another important inhibiting factor of increased commercial trade between countries, since it increases transportation costs.

8. EXTERNAL ACCOUNTS

Mozambique's liquid external financing needs measured by the joint balance of current and capital account, decreased in the first 9 months of 2010, compared to the same period in the previous year. Annually, the joint deficit of both accounts fell from 6.9% to 4.4% of GDP. The 2.2 pp improvement in the trade balance (particularly goods) was the main reason for this reduction. Net financing needs were relatively minor, but this is due to current and capital transfers, which include donations. Considering the gradual reduction of granted donations there should be mid-term increased pressure in external liquid financing needs. In order for this to happen, a structural decline in the trade imbalance will be crucial which should occur either through increased exports or through the decrease in import needs.

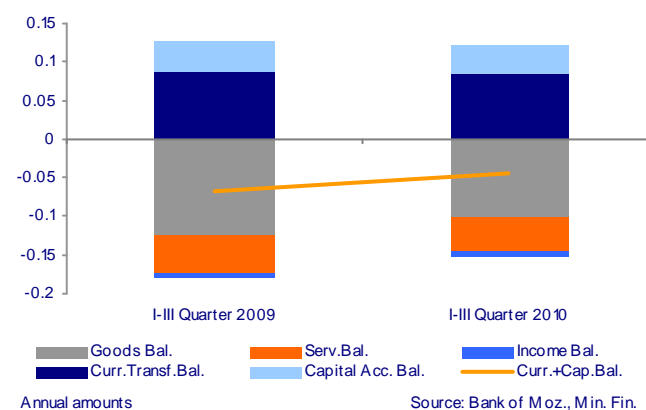
8.1 Goods balance

As previously mentioned the goods balance deficit is the largest contributor to the country's external deficit. Annually, goods balance deficit was 10.2% of GDP, in the first 3 quarters of 2010, a step down from 12.6%, in the same period of the previous year. The improvement in the balance of goods was a joint result of increased exports (6.3% annually) and decreased imports (-4.2% annually).

A more detailed analysis reveals that export growth was supported by exports coming from large investment projects. In the period under review, this component grew 33%, which resulted in a weight increase of 15pp, to 75% of total exports. The exports component not related to large projects shrunk by 34% during the first 9 months of 2010 which led to the weight reduction in total exports to 25%. Evolution analysis by product reflects the evolution of these two large categories. Thus, aluminium exports increased 38%, benefiting from its price increase in the international markets and from Mozal's greater production volume, which increased its weight in total exports to 52%. Other relevant products, and also related to large projects, are gas and electrical power which grew by 12% and 11%, respectively. Tobacco, with a weight of around 6% in total exports, decreased 25%, a similar evolution to some traditional export products, which led to a reduction in the export component not related to large projects. In the next few years products related to the mining industry, mainly coal, should have an increasing weight in exports, as well as electrical power exports, considering the production expansion plans and the neighbouring countries' expected increase in energy needs.

The fall of imports has been due both to reduced imports related to large projects (-2.9%) and also imports excluding large projects (-4.5%). The weight of each of these components remained unchanged at 21% and 79%, respectively. Analysis by product shows some heterogeneity among their evolution. On the positive side, the increase in fuel import (80%) and electric power (18%) stand out, the former pushed by price increases in the international markets.

Gross External Financing Needs (% of GDP)



Annual amounts

Source: Bank of Moz., Min. Fin.

Exports of Goods

	2009: I-III Quarter		2010: I-III Quarter		Annual rate of change
	USD Millions	% total	USD Millions	% total	
Total	1,535	100%	1,632	100%	6%
Tobacco	132	9%	98	6%	-25%
Electricity	198	13%	219	13%	11%
Gaz	87	6%	98	6%	12%
Aluminum	610	40%	841	52%	38%
Total excl. Mega Projects	610	40%	406	25%	-34%
Mega Projects	924	60%	1,226	75%	33%

Source: Bank of Mozambique.

Imports of goods

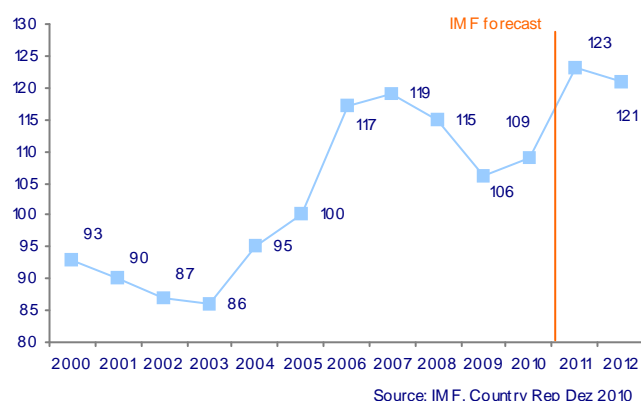
	2009: I-III Quarter		2010: I-III Quarter		Var. Hom.
	USD M	% total	USD M	% total	
Total	2,481	100%	2,378	100%	-4%
Consumer goods	443	18%	326	14%	-26%
Cereals	180	7%	96	4%	-47%
Autos	234	9%	201	8%	-14%
Raw materials and interm. goods	300	12%	484	20%	61%
Fuels	212	9%	381	16%	80%
Electricity	87	3.5%	103	4.3%	18%
Capital goods	403	16%	318	13%	-21%
Total excl. Mega Projects	1,964	79%	1,876	79%	-4.5%
Mega Projects	518	21%	502	21%	-2.9%

Source: Bank of Mozambique.

The weight of fuel component increased 7pp, to 16%, while electric power weight increased from 3.5% to 4.3%. The products which showed a stronger negative tendency were cereal (-47%), capital goods (-21%) and passenger vehicles (-14%). The decrease in cereal imports should be related to increased internal agricultural production, which grew considerably in 2010, while the decrease in imports of capital goods may indicate a decline in investment not related to large projects. The fall of imports related to large projects is explained by the final phase of conclusion of important investment projects which resulted in decreased import needs.

The terms of trade suffered a remarkable depreciation between 2008 and 2009, as a result of price decreases in international markets, mainly in aluminium, the main Mozambican export product. In 2010, the terms of trade recovered slightly, benefiting from the commodities' price recovery in international markets, but this effect was mitigated by the depreciation of the Metical against the main currencies. The terms of trade improvement also had a positive effect on the balance of goods. In 2011, this trend should be accentuated, since the Metical is expected to show greater stability, although the depreciation tendency should be maintained, and commodities' prices should continue to increase in international markets. In this respect the price of aluminium in international markets ended in 2010 at around 20% below the mid-2008 peak. There is, therefore margin for appreciation.

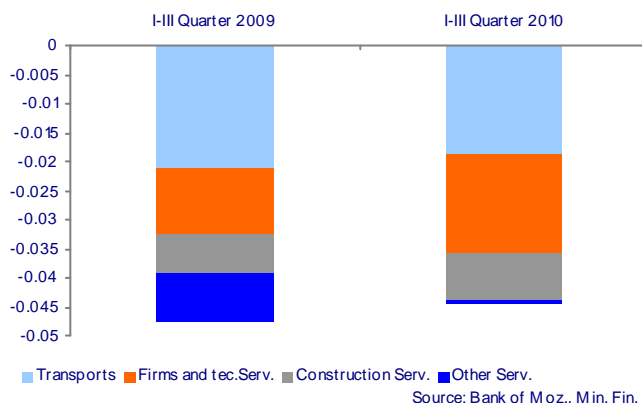
Terms of Trade - Index (2005=100)



8.2 Services balance

The services balance deficit decreased annually by 0.3pp, to 4.4% of GDP, in the first 3 quarters of 2010 compared to the same period in the previous year. This improvement reflects a 0.7pp decrease in the transportation component and of 0.6pp in various services. In opposition to this, the negative balance of company and technical services and construction services, increased by 0.6pp and 0.1pp, respectively. Strong foreign direct investment in the Mozambican economy tends to stimulate an exchange of services with foreign countries, so this deficit is expected to remain unaltered in the next few years.

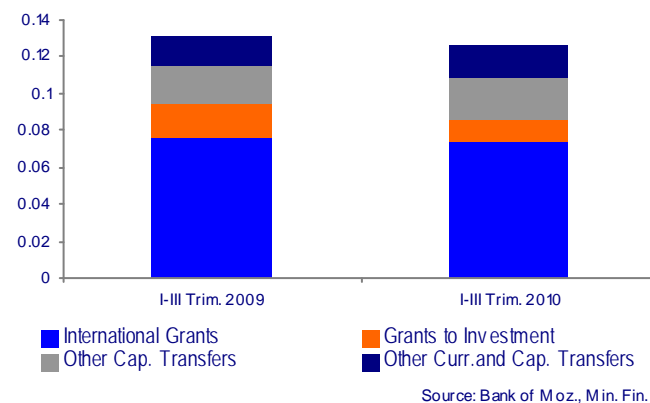
Services Account (% of GDP)



8.3 Current and capital transfer balance

The current transfer and capital balance are the main reasons for low external net financing needs, considering the country's stage of development. The current transfer balance was 8.6% of GDP annualised between January and September de 2010, 0.2pp below the surplus from the same period in the previous year. Donations to Public Administration are the main component of this surplus, with a weight of 7.4% of GDP, compared to 7.6%, in the previous period. Excluding Public Administration the balance was 1.2% of GDP. In relation to capital balance there was a 3.5% surplus of GDP in the first 9 months of 2010, a 0.4pp drop compared to the same period last year. This drop was a result of a 0.6pp decrease in donations to investment, which in the period remained around 1.3% of GDP, while private capital transfers increased by 0.3pp, to 2.3% of GDP.

Current Transfers and Capital Account (% GDP)

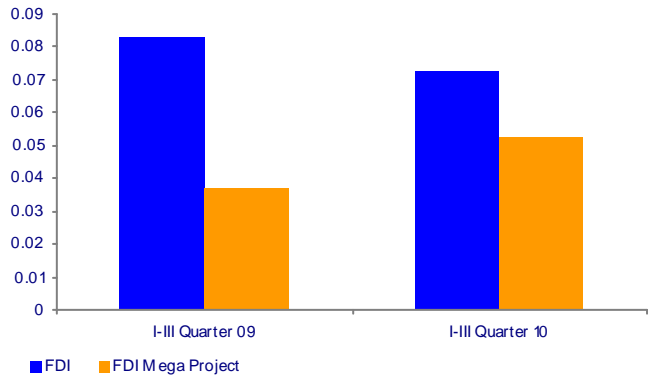


8.4 Foreign direct investment

Mozambique has shown the capacity to attract high volumes of foreign direct investment in the last years, for projects essentially related to the mining industry. This sector is known for its intensive capital needs and thus the positive impact on GDP does not reflect a significant employment increase. Annualised, foreign direct investment in Mozambique was 7.3% of GDP, a yearly decrease of 0.9pp but still a high level.

Foreign direct investment related to large projects increased 1.6pp, to 5.3% of GDP, in the first 9 months of 2010, which means that investment in other sectors went from 4.5% to 2% of GDP. Investment in the mining industry is expected to remain high in the next few years, which should be reflected in foreign direct investment flows.

Foreign Direct Investment (GDP %)



Source: Bank of Moz., Min.Fin.

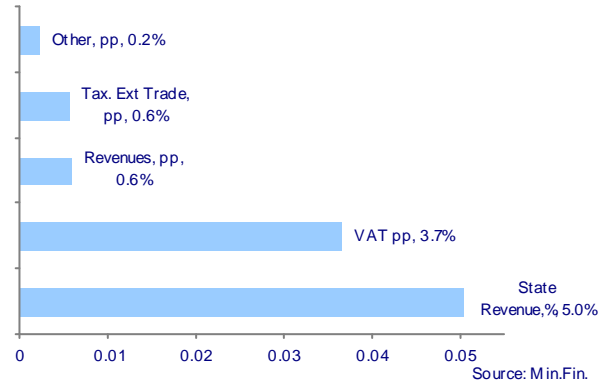
9. PUBLIC ACCOUNTS

9.1 2010 Budget execution

9.1.1 State revenue evolution

Considering the economy's elevated dynamic activity, State revenue for 2010 was revised upwards to MT 59.940 million, a 5% increase compared to the budget. This deviation is a result of the increase in fiscal revenue, namely tax revenue on goods and services, since income tax estimates have remained almost unchanged compared to the 2010 Budget (OE10). This reflects the high level of informality in the economy, which makes that consumption taxes have a greater correlation to the evolution of economic activity. Among taxes on goods and services the Value Added Tax (VAT) stands out, for it shows a 72% contribution to this revenue deviation. Still, regarding revenue on tax on goods and services, external trade tax shows an 11% contribution to the positive revenue deviation. In the same way as VAT, this tax benefits from greater dynamics in internal demand, since this leads to increased imports. Also worth mentioning is the 12% contribution of own revenues.

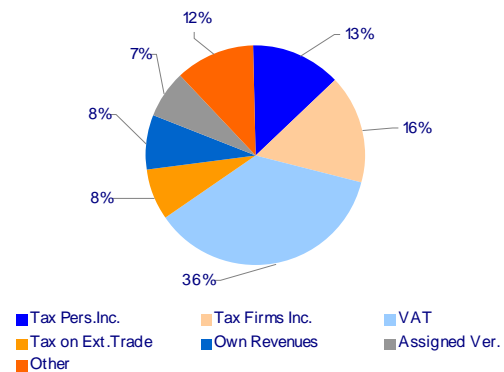
State Revenue - Deviation from the Budget



Source: Min.Fin.

Regarding structure, VAT is the main source of revenue, representing around 36% of State revenue forecast for 2010. This is followed by corporate tax and personal income tax, which represent 16% and 13% of State revenue, respectively. Other important sections are taxes on foreign trade (8%), own revenue (8%) and consigned revenue (7%). In comparison to 2009, State revenue should have grown by 30% while VAT, pushed by internal demand, should have increased by 36%. Similarly, foreign trade tax should increase by 30% y/y. Income and corporate taxes should increase by 41%, as a result of the 28% increase in personal income tax and of the 54% increase

Public Revenue Structure



Source: Min.Fin.

in corporate tax. Non-fiscal revenue, including own revenue, should increase by 88%, as a result of a process of revenue inclusion and reclassification in the Budget from several national and provincial bodies.

As for State revenue execution, in the first semester of 2010, the execution rate reached 48.7%, compared to 45.6% in the same period last year. This increase is a result of accelerating economic activity and of efforts on the part of the authorities to increase tax efficiency. Thus, fiscal revenue showed an execution of 52.8%, compared to 47.2% in the same period of the previous year. Noteworthy, and included in this revenue were revenue on goods and services (50.5% in the first semester of 2010, compared to 44.6% in the first semester of 2009) due to an VAT execution of 52.1% and foreign trade tax (52.2%).

On the other hand, non-fiscal revenue, including own revenue, and consigned revenue had an execution rate of 34.9% and 21.4%, respectively, due to delays in the process of revenue inclusion and reclassification in the Budget and of withholding revenue by public bodies.

9.1.2 Expenditure evolution

The forecast for total expenditure in 2010 was reduced by 2.6%, in comparison to the budget of MT 115479.7 million. The decreased expenditure is a result of: reduction of other expenses with personnel (-9% below budget) and expenses with goods and services (-14.1% below budget), which is a result of the authorities' efforts to reduce these expenses due to the additional costs with subsidies; the internal component of investment expenses has also decreased compared to the budgeted value by 18.7%, which was due to the low execution rate until mid-year.

The main positive corrections were in the salaries and remuneration component (+6%), in debt costs (+25.7%) and subsidies (26.4%). The correction to the first component is a result of the implementation of salary policy and corrections to the payroll to eliminate the habitual under-budgeting of this component. The forecast increase with debt costs is due to the effect of increased internal debt interest rates and the devaluation of the Metical in external debt. Lastly, increased expenses with subsidies reflect the increase expenditure with fuel subsidies in the first semester and the continuance of bread and public transportation subsidies in the second semester.

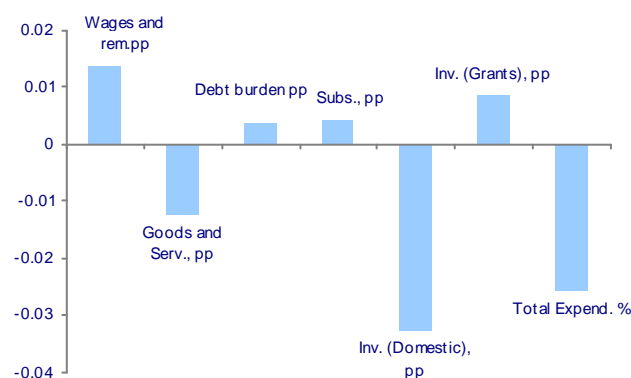
The expenditure structure is mostly split between current expenditure (50.1%) and investment expenses (45.3%). In current expenditure, personnel expenses stand out, corresponding to 26.8% of total expenses, followed by current transfers (9.1% of total), which have an important role in reduction situations of extreme poverty. These

Public Revenue

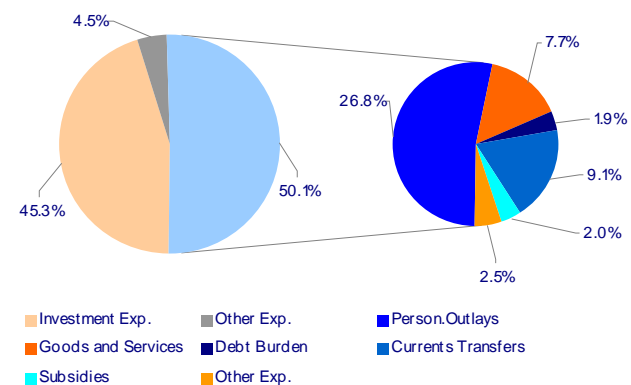
	IH09	IH10
State Revenue	45.6%	48.7%
Current Revenues	46.5%	49.0%
Tax Revenues	47.2%	52.8%
Income taxes Revenue	53.4%	48.9%
IRPS - individuals	50.3%	48.4%
IRPC - firms	56.5%	49.4%
Revenue on goods and services' taxes	44.6%	50.5%
Value Added Tax (VAT)	45.2%	52.1%
Taxes on Foreign Trade	50.7%	52.2%
Non Fiscal Revenues (incl. own revenue)	52.5%	34.9%
Revenue Allocations	35.8%	21.4%
Capital Revenues	55.5%	49.3%

Source: Ministry of Finance, Direcção Nacional do Orçamento.

State Expenditure - Deviation from the Budget



Public Spending Structure



are followed by expenses with the goods and services (7.7% of total) component where the authorities intend to reduce costs through efficiency gains in public administration. Despite increased expenses with subsidies and debt cost, these components represent only 2% and 1.9% of total expenses, respectively.

Regarding investment expenses, these are split between those that are internally financed (14.6% of total expenses) and those that are financed externally (30.7% of total expenses). Around 2/3 of externally financed expenses are supported by donations, the remainder being achieved through resourcing to credit.

Public Expenditure		
	IH09	IH10
Current Spending	50.0%	48.6%
Personnel expenses	50.8%	47.2%
Goods and Services	47.9%	43.7%
Debt Burden	46.4%	79.7%
Grants	64.4%	77.4%
Current transfers	49.4%	47.6%
Investment expenditure	26.2%	24.8%
Internal component	39.0%	27.9%
External component	21.1%	23.4%
Financial Operations	22.3%	47.5%
Total expenditure	36.4%	37.4%

Fonte: DNO..

Expense execution in the first semester was around 37.4%, 1pp above the same period last year, although execution of current expenditure and investment expenses decreased by 1.4pp, to 48.6% and 24.8%, respectively. The increased expenditure execution rate was a result of financial operations execution to 47.5%, compared to 22.3% in the same period last year.

In current expenditure, there were some regressions in expenditure execution with personnel, expenses with goods and services and current transfers of 2.6pp, 4.2pp and 1.8pp, respectively. The decrease in execution of personnel expenses to 47.2% is due to the corrections made to the initial budget, since, in absolute terms, there was an increase in this component. Regarding expenses with goods and services, the execution rate remained around 43.7%, due to withheld funds, a measure implemented to force ministerial services to use their resources more efficiently, while current transfers have an execution rate of 47.6%.

Investment expenses showed an execution rate of 24.8%, reflecting a 27.9% execution in the internal investment component and 23.4% in the external component. The low execution rate of investment expenses resourcing to internal financing can be explained by the late approval of the 2010 Budget, the external component by the late availability of funds agreed to with donors.

The increased execution rate of financial operations is mainly a result of external loan amortization and internal bank loans.

9.2 2011 Budget

9.2.1 Macroeconomic framework

Growth prospects for the Mozambican economy continue to exceed expectations. The government's growth forecasts included in the 2011 Budget (OE11) were revised upwards by the IMF in the first evaluation report of the Agreement under the Economic Policy Instrument, carried out around one month after the OE11. Thus, in 2010, according to the IMF, the economy should expand 7.2%, compared to 6.4% in 2009. In the next year and until 2015, growth should accelerate up to 8%, resulting in the expectation of sustained high investment levels and increased exports. Regarding price evolution, both the government and the IMF expect a deceleration of inflation to 8%, followed by its stabilization at 5.6% by 2015. This inflation level is consistent with the country's development level and with the expected growth rate, which causes permanent pressure on the demand side, preventing a decrease in inflation to lower levels. The exchange rate should continue to depreciate, since the country should continue to have external deficits.

Macroeconomic Indicators - Forecasts

	2010		2011		2012		2013		2014	2015
	2011 Budget	IMF	2011 Budget	IMF	2011 Budget	IMF	2011 Budget	IMF	IMF	IMF
Nominal GDP (USD million)	9,759	9,761	10,218	10,483	-	12,100	-	13,557	14,976	16,260
Nominal GDP (million MT)	324,000	326,000	375,000	378,000	-	430,000	-	490,000	558,000	635,000
GDP annual real rate of change (%)	6.7	7.2	7.2	7.5	7.4	7.8	7.7	7.9	7.8	7.8
Annual Inflation Rate (%)	12.7	12.7	8	8	-	5.6	-	5.6	5.6	5.6
MTZ/USD exchange rate (average)	-	33.3	-	36.8	-	36.9	-	37	38.7	40.6

Fonte: DNO, FMI.

The expected economic growth will have as main contributors the agriculture sector, mining, electricity and water, construction and transportation and communications. In the 2011-2013 period these sectors show average growth rates oscillating between 9.5%, in the case of transportation and communications, and 11.3% for construction. This strong growth reflects the main tendencies of the Mozambican economy:

- The mining industry has benefitted from the strong influx in foreign direct investment and several projects will start production in the next two years. A significant production increase is expected;

- Important investments in infrastructure are also expected in the electricity sector, such as increased production capacity in Cahora Bassa, the construction of a new dam on the Zambezi and the improvement of the country's power grid, which will support growth in the sector;

- The country's agricultural potential is high. In the great majority of situations it is still subsistence agriculture. For this reason, there are important productivity gains to be achieved. It is noteworthy that the country is a net food importer, and increased production would result in decreased foreign deficit. In this way, the development of the agriculture sector is recognised as an important factor in the reduction of extreme poverty;

- Construction and transportation and communications also show a strong dynamic, which is associated with the strong dynamic of internal demand;

- Also noteworthy is the growth of sectors related to State expenditure. The authorities need to provide basic services (schools, hospitals, water supply, etc.) to the population and to improve and increase the public services cover. A real significant growth is therefore expected to be maintained by these components in the next few years.

GDP Annual Rate of Change (constant prices)

	2011	2012	2013
Agriculture	9.4%	9.6%	9.8%
Mining	9.5%	10.0%	11.3%
Electricity and Water	10.7%	10.7%	10.9%
Construction	11.5%	11.5%	10.8%
Transport and Communications	9.4%	9.5%	9.7%
Public Administration and Defence	7.3%	7.6%	7.9%
Education	6.8%	7.5%	7.7%
Health	6.9%	7.5%	8.1%
GDP	7.2%	7.4%	7.7%

Source: Ministry of Finance (DNO).

9.2.2 Budget balance

The budget deficit should decrease to 15.8% of GDP in 2011, 1.3pp below the 2010 forecast. This forecast differs from the IMF's, which forecasts a 14.1% deficit in 2010, followed by an increase to 16.4%, in 2011. Until 2015, the IMF predicts a gradual reduction down to 13.4% of GDP. This decline, a stated Government objective, reflects an increase in State revenue of around 1pp, to 19.5% of GDP, and a decline in expenditure of 0.3pp, to 35.3% of GDP. Economic activity growth should affect revenue while the weight decrease of expenses in GDP is explained mostly by the decline in active financial operations, namely loans granted to public companies.

Financing this imbalance will continue to be achieved mainly through grant donations

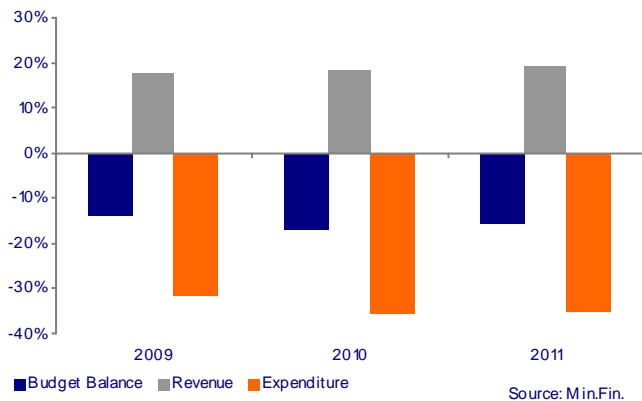
Major revenue and expenditure items

	2009		2010		2011		(Million MT and % of GDP)	
	CGE	Forecast	Forecast	Budget	CGE	Forecast	Budget	
Total Resources	84,876	115,480	132,403	132,403	31.6%	35.6%	35.3%	
Internal Resources	45,294	62,244	74,338	74,338	16.8%	19.2%	19.8%	
State Revenue	47,565	59,940	73,275	73,275	17.7%	18.5%	19.5%	
Current Revenues	45,850	59,001	71,962	71,962	17.0%	18.2%	19.2%	
Tax Revenues	39,394	49,819	60,796	60,796	14.6%	15.4%	16.2%	
Income Taxes	13,727	17,475	23,365	23,365	5.1%	5.4%	6.2%	
Goods and Services Taxes	23,880	30,084	34,416	34,416	8.9%	9.3%	9.2%	
Non Fiscal Revenues	2,811	4,923	6,314	6,314	1.0%	1.5%	1.7%	
Revenue Allocations	3,645	4,259	4,852	4,852	1.4%	1.3%	1.3%	
External Resources	39,583	53,236	58,065	58,065	14.7%	16.4%	15.5%	
Grants	25,771	34,661	35,769	35,769	9.6%	10.7%	9.5%	
Credits	13,812	18,575	22,296	22,296	5.1%	5.7%	5.9%	
Total Expenditure	84,876	115,480	132,403	132,403	31.6%	35.6%	35.3%	
Current expenditure	43,793	58,445	68,785	68,785	16.3%	18.0%	18.3%	
Personnel Outlays	22,544	30,938	36,250	36,250	8.4%	9.5%	9.7%	
Goods and Services	9,081	8,936	9,764	9,764	3.4%	2.8%	2.6%	
Current Transfers	7,913	10,551	11,504	11,504	2.9%	3.3%	3.1%	
Capital Expenditures	35,336	52,323	60,044	60,044	13.1%	16.1%	16.0%	
Internal Component	13,432	16,905	18,840	18,840	5.0%	5.2%	5.0%	
External Component	21,905	35,419	41,204	41,204	8.1%	10.9%	11.0%	
Financial Operations	5,747	4,711	3,574	3,574	2.1%	1.5%	1.0%	

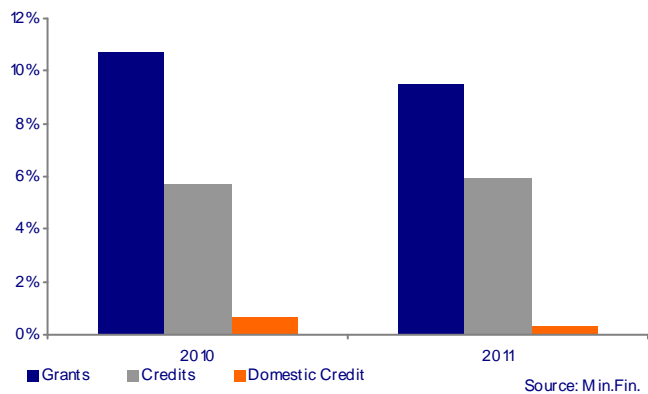
Source: Bank of Mozambique.

(approximately 2/3 of financing). In 2011, the value of donations should be 9.5% of GDP (versus 10.7% of GDP in 2010), and the donations are split between donations to the budget (3.1pp), donations to investment projects (4.1pp) and donations to special programmes (2.3pp). This distribution shows that donors only directly handover less than 1/3 of donations to the government, directing the remaining funds to specific programmes, thus increasing transparency in fund distribution. According to the IMF's forecast, donations should decrease gradually until 2015, to 8.3% of GDP. The decline in donations is expected and desirable, since the increasing development of Mozambique results in a declining need for foreign aid. GDP growth will also cause the relative weight of donations to fall.

Budget Balance (% of GDP)



Deficit Financing (% of GDP)



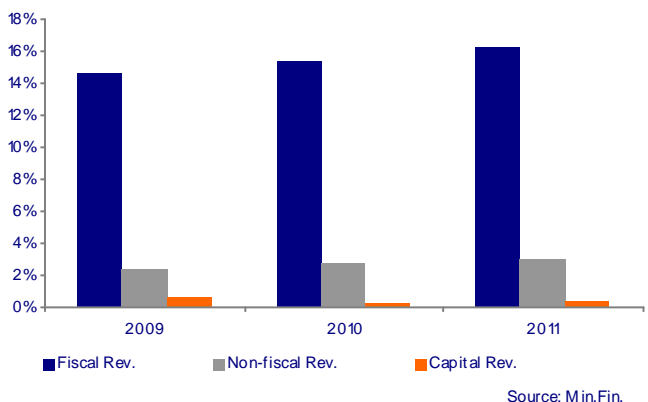
The second main source of financing is external credit which should reach 6% of GDP in 2011. From this around 1.4pp will be directed to the Budget, the remaining to investment projects, which is a guarantee to both creditors and donors. Domestic credit will be residual (0.3% of GDP).

9.2.3 State revenue

State revenue should reach 18.5% of GDP in 2011, 1pp above the previous year, which will result in an annual increase of 22%. This value represents an expenditure cover ratio of 55%, above 52% forecast for 2011. Considering the expected gradual decline in donations the increase of this ratio is important to ensure that the imbalance of public accounts does not become unsustainable. According to the IMF's forecast, revenue should continue to increase gradually, reaching 20.5% of GDP in 2015. Important factors which will contribute to increased revenue will be improvement in the operation of the State's fiscal services and a decrease in the degree of informality in the economy.

State revenue is mainly fiscal revenue (more than 4/5 of total) and expected to increase to 16.2% of GDP in 2011, compared to 15.4% in 2010. As previously mentioned, fiscal revenue will benefit from the evolution of economic activity in maintaining this tendency towards expansion. State revenue is also composed of non-fiscal revenue or own revenue and capital revenue. The former are transfers from public bodies. The current process for Budget inclusion of allocations that had, until now, remained off the Budget and the increased pressure on public institutions and local governments to transfer allocations to the central administration should push this revenue to 3% of GDP in 2011, 0.2pp above 2010. Capital revenue makes a minor contribution (0.4% of GDP in 2011), and there should be no changes in the following years.

State Revenue Composition (% of GDP)



Within fiscal revenue the main components will remain tax on goods and services and income tax, all other taxes making a minor contribution. The most significant increase will be in income tax, which should increase by 0.8pp, to 6.2% of GDP in 2011. This considerable tax increase from direct taxation is related to corporate tax, since production in several mines is expected to begin this year. The forecast for tax on goods and services shows a small weight reduction of 0.1pp, to 9.2% of GDP, however, it will be the most important source of revenue (57% of fiscal revenue) and its nominal growth will be robust (14.4%). Other taxes should stay around 0.8% of GDP in 2011, slightly above 0.7% in 2010.

9.2.4 State expenditure

Expenditure should decrease its GDP weight slightly in 2011, to 35.3%, compared to 35.6% in the previous year. Annually, this will translate to 14.7%, an increase below that of revenue. In 2011, expenditure is split between current expenditure (18.3% of GDP or 52% of total expenses), investment expenses (16% of GDP or 45% of total expenses) and financial operations (1% of GDP or 3% of total expenses). The high expenditure allocation to investment expenses is desirable considering the country's stage of development. In actual terms there is a huge shortage of basic infrastructure, from hospitals and schools, to means of transportation, making extreme poverty situations even more pressing. Thus, the authorities are expected to maintain investment efforts in the medium to long term (according to IMF forecasts, investment expenses should fall slightly until 2015, to 15% of GDP).

9.2.4.1 Current Expenditure

Current expenditure should increase by 17.7% in 2011, boosting its GDP weight by 0.3pp to 18.3%. The main component corresponds to personnel expenses, which should have a GDP weight of 9.7% in 2011, an increase of 0.2pp. Beyond the forecast salary updates and career progressions, this component includes an allocation for new admissions. These should come to 13.000, mostly for the education (8500) and health (1500) sectors.

The second component with greater weight will be current transfers (3.1% of GDP, a drop of 0.2pp compared to 2010). This component includes expenses with civilian and military pensions, food subsidies, among others related to the Social State so that, in the long term, there will be rising pressure on this component.

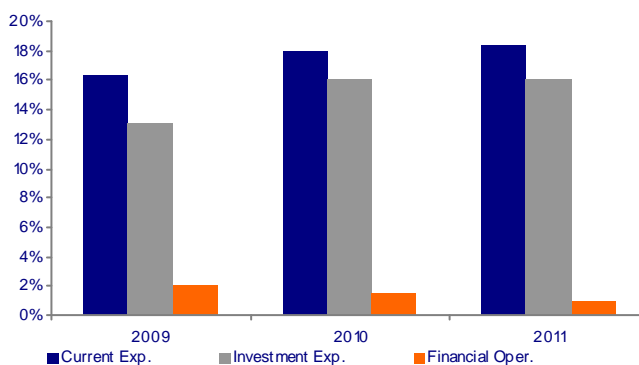
Expenses with goods and services represent 2.6% of GDP. The weight of this component fell 0.8pp in the last 2 years. The States' expenses rationalisation efforts have been increasing, there is greater control of expenses with air travel, fuel and lubricants and communications, among others, which provide significant savings.

Fiscal Revenue Composition (% of GDP)



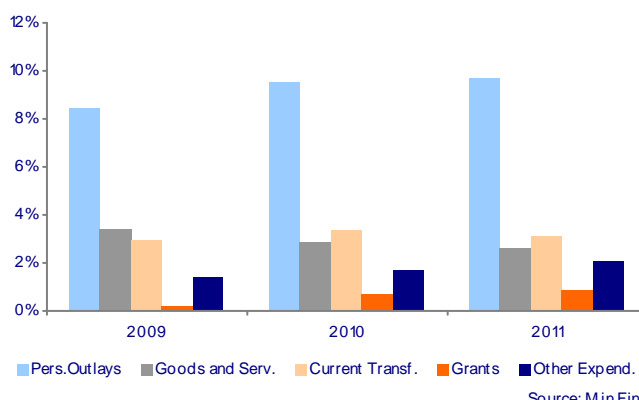
Source: Min.Fin.

State Expenditure Composition (% of GDP)



Source: Min.Fin.

Current Expenditure Structure (% of GDP)



Source: Min.Fin.

Also noteworthy is the subsidies component, whose weight will quadruple between 2009 and 2011, to 0.8% of GDP. In 2011 it will be subsidies granted to bread producers and urban passenger transportation businesses which will have greater impact. In 2011 debt costs should increase by 0.3pp to 1% of GDP. Internally, this is a result of increased costs with Treasury Bonds and compensation to fuel companies and externally, to the effect of the currency's depreciation on the interest due.

9.2.4.2 Investment Expenses

Investment expenses should increase by around 14.8% of GDP in 2011 which will not prevent a drop of 0.1pp in its GDP weight to 16%. The domestic financing component will be around 1/3 of total investment expenses and corresponds to 5% of GDP. In turn, the component which resorts to external financing will have a GDP weight of 11%. The greater use of external financing stems from the possibility of using donations to reduce the cost of the project and also the authorities' concern not to use excessive domestic credit which would decrease credit availability to private individuals.

The sectorial distribution of investment expenses shows that infrastructure and governance will be the two main areas of intervention in 2011. The weight of each of these components will be slightly above 30% of total investment expenses, corresponding to around 5% of GDP. Around half of the allocation to the infrastructure component will be used in the rehabilitation and maintenance of bridges and roads, one of the country's main needs, which hinders development of economic activity. Other relevant infrastructure projects are related to water supply and sanitation (4% of investment expenses) and the rehabilitation of the coal terminal (2% of investment expenses), one important investment to allow the flow of coal production.

In the governance sector, funds are allocated mainly by district (90% of governance expenses), which is representative of the continued effort on the part of the authorities to decentralise the decision process. The authorities' increased closeness to local realities allows for a better perception of the population's most pressing needs and, thus, better prioritised of investment.

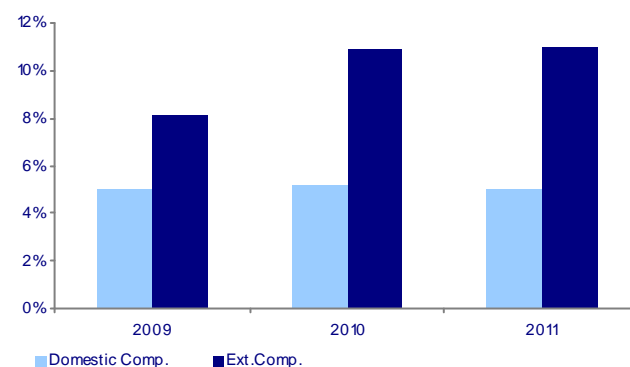
Other relevant sectors are education and health, with a 6% and 4% weight in investment expenses, respectively. The main projects in these areas are construction and rehabilitation of secondary and technical schools and the acquisition and distribution of medicines. The projects reflect some of the country's main needs, namely the population's low qualification level and low average life expectancy.

Also worth mentioning are investment in the agriculture sector (3% of total investment expenses) and youth, tourism and sports (2% of total expenses). While, in the former, the Action Plan for Food Production stands out, in the latter the funds will be used in the organization of the African Games in 2011.

9.2.5 Conclusion

The high deficit before donations mirrors the need to gradually increase domestic revenue since donations are expected to shrink as the

Investment composition (% of GDP)



Source: Min.Fin.

Investimento por sector

	Valor (MT M)	% Inv. Total	% PIB
Infra-estruturas	19,163	32%	5%
Constr., Reab. e Manut. de Estradas e Pontes	9,491	16%	3%
Água e Saneamento	2,698	4%	1%
Reab. do Terminal de Carvão	1,468	2%	0%
Governança	18,396	31%	5%
Alocação aos Distritos	16,714	28%	4%
Educação	3,595	6%	1%
Constr. e Reab. de Esc. Secund. e Técnicas	1,108	2%	0%
Saúde	2,281	4%	1%
Aquisicao e Distribuicao de Medicamentos	1,425	2%	0%
Agricultura	1,607	3%	0%
Plano de Acção para Produção de Alimentos	1,265	2%	0%
Juventude, Turismo e Desportos	1,425	2%	0%
Jogos Africanos de 2011	1,182	2%	0%

Fonte: DNO.

country's development level increases. The authorities express this concern by stating that the objective of budget policy is to ensure public accounts sustainability in the medium to long term and decrease the budget deficit and foreign dependency.

The fact that this deficit is in line with the amount earmarked for investment expenses is considered positive since these expenses enhance economic growth and, consequently, lead to an increase in State revenue. The sectorial distribution of investment expenses shows that the main priority is the development of infrastructure which should allow for a decrease in barriers to entrepreneurial activity. It will also be necessary to invest significantly in education and health sectors, since the country's population has a low level of qualifications and the average life expectancy at birth is low, mostly because of HIV/AIDS. Agriculture is another priority sector, given its poverty reduction possibilities.

In order to increase own revenues fiscal collection services will have to become more effective and mainly there will have to be a reduction in the degree of informality in the economy. The high levels of poverty and unemployment result in the majority of the population using minor activities or occasional business opportunities to subsist without any form of legal record. On this subject, the creation of a simplified taxation system for small taxpayers, the 'Imposto Simplificado para Pequenos Contribuintes' was created as an important tool in the fight against informality.

Also noteworthy is the need to change the economic growth model. Currently, the high level of foreign direct investment is focused on the mining industry, a capital intensive sector. Therefore, the accelerated growth of the economy does not translate into a significant reduction in the unemployment levels. Thus, it is necessary to develop labour intensive sectors, such as agriculture or the manufacturing industry in order to make economic growth inclusive to a greater percentage of the population. An additional benefit would be the decrease in imported consumption and food goods, reducing the need for external financing in the economy. The creation of incentives by the authorities should have a pivotal role in the development of these activities, similar to the current situation in the mining sector. As a conclusion, beyond the efficiency increase of the tax machine and widening of the taxpayer base, it is also important to promote the sustained development of a robust private sector which creates wealth and employment.

Main Economic Indicators

	2007	2008	2009	2010P
Population	20.3	20.7	21.2	21.6
GDP per capita PPP	828	886	933	982

Source: World Bank, IMF.

Gross Domestic Product

	2007	2008	2009	2010P
GDP (millions MZN)	207,644	239,775	269,000	324,000
GDP (billions USD)	8.12	9.92	10.04	9.76

Composition of GDP (by sectors)

Agriculture	25.20%	28.00%	27.70%	n.d.
Manufacturing	15.00%	13.70%	14.20%	n.d.
Commerce	14.80%	14.80%	16.10%	n.d.
Transportation and communication	9.70%	9.80%	10.20%	n.d.
Real Estate	6.20%	5.90%	5.80%	n.d.
Elect. and water supply	5.60%	5.00%	4.70%	n.d.
Fin. Activ.	4.60%	4.20%	4.30%	n.d.
Others	18.80%	18.60%	17.00%	n.d.

Source: INE, IMF.

Forecasts for growth in Mozambique (GDP rate of change, %)

	2010	2011	2012
State Budget 2011	6.7	7.2	7.4
IMF (CR Dez 10)	7.2	7.5	7.8
Economist Intelligence Unit (Dez 10)	8.5	7.3	7.5

Source: Mozambique Ministry of Finance (DNO), Economist Intelligence Unit, IMF.

Consumer Price Index

	2007	2008	2009	2010
Inflation rate (CPI, %)	9.20%	14.50%	3.70%	12.50%

Source: INE.

External Sector

	2007	2008	2009	2010
Exports (USD millions)	2,381.10	2,412.10	2,653.30	1,852.60
Imports (USD millions)	2,648.80	2,811.10	3,457.80	3,243.10
Commercial Account Balance(%GDP)	-3.70%	-4.90%	-8.10%	-14.20%
Current Account Balance (%GDP)	-8.80%	-9.80%	-9.90%	-12.00%
Net external reserves (USD millions)	1,206.10	1,503.50	1,643.20	1,840.80

Source: Banco de Moçambique..

Public Accounts

	2007	2008	2009	2010
Total Revenues (%GDP)	26	25.3	26.8	27.6
Total Expenditures (%GDP)	29	27.8	32.2	32.5
Budget balance(%GDP)	-3	-2.2	-5.4	-4.9

Source: EIU.

Main Financial Variables

	2007	2008	2009	2010
Exchange rate				
'31 Dec				
USD/Mtz	23.75	25.25	30.2	34
EUR/Mtz	35.36	35.28	43.3	45.56
Average				
USD/Mtz	25.81	24.22	27.67	35
EUR/Mtz	34.65	35.63	38.65	46.4
Nominal Interest Rates (Mtz)				
Until 180 dias	22.89	22.89	20.02	20.73
More than 1year	21.18	21.18	19.87	19.46

Source: Bloomberg, Banco de Moçambique and BPI.

"This document is only for private circulation and only partial reproduction is allowed, subject to mentioning the source. This research is based on information obtained from sources which we believe to be reliable, but is not guaranteed as to accuracy or completeness. At any time BPI or any affiliated companies (or employees) may have a position, subject to change, in these securities. Unless otherwise stated all views (including estimates or forecasts) herein contained are solely expression of BPI's Estudos Económicos e Financeiros department and subject to change without notice."

BANCO BPI. S.A.

Rua Tenente Valadim, 284
Telef.: (351) 22 207 50 00

4100 - 476 PORTO
Telefax: (351) 22 207 58 88

Largo Jean Monnet, 1 - 9º
Telef.: (351) 21 724 17 00

1269-067 LISBOA
Telefax: (351) 21 353 56 94