

Mozambique

January 2009

2009 - Moderated optimism

- ⚡ In the first half of 2008, the economy grew by 4.3% (yoy), below the 7% posted in 2007, which has been mainly due to combined power supply shortages and a drop in industrial production. The agricultural sector performed positively and its growth contribution exceeded 50%, as the sector expanded by more than 8% yoy despite flooding, increasing its share in GDP from 24% to 30%. Meanwhile, inflation accelerated in the first months of the year, reaching a peak of 15.85% in September, a trend explained by the rising price of food.
- ⚡ The macroeconomic scenario of the 2009 State budget is relatively optimistic: GDP growth of 6.5% in 2008 and 6.7% in 2009, inflation of 8% in 2009. Indeed, given the strongly negative international environment, inflows of foreign direct investment may be weaker than expected and some of the planned megaprojects (Mependa Uncua dam in the Zambezi River, the Corridor Sands project and several others) may be delayed because of funding difficulties. However, the flow of international aid is not at stake as some donors have already guaranteed significant amounts for the current year. The fall in food and international fuel prices should decelerate inflation although this effect should be partially offset by the re-introduction of customs taxes and elimination of subsidies on fuel and public transport, reversing the steps taken in 2008 following strong public protests in the light of price escalations.
- ⚡ HIV / AIDS continue to affect the Mozambican society. According to the authorities about 16% of the population between 15 to 49 years is HIV positive. This represents a serious obstacle to the country's development since it impairs productivity, resulting not only in higher mortality but also in greater work absenteeism.
- ⚡ After an improvement in the ranking in 2008, Mozambique posted a weak performance in the Doing Business 2009 ranking of the World Bank. The country ranked 141 from a list of 181 countries, 8 positions under its 2008 mark. This ranking is an international reference in assessing business conditions in Mozambique and the country's poor performance could reduce its attractiveness in international terms. Compared with other countries in sub-Saharan Africa, Mozambique continues to position itself better than Angola but is still well below the top countries, such as Namibia.

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

Research Department

Rui Martins dos Santos

Cristina Veiga Casalinho
Paula Gonçalves Carvalho
Susana de Jesus Santos
Teresa Gil Pinheiro
João Teixeira de Sousa
Lara Cordovil Wemans

Chief Economist

TECHNICAL ANALYSIS
Agostinho Leal Alves

Tel.: 351 21 310 11 86

Fax: 351 21 353 56 94

Email: deef@bancobpi.pt

<http://www.bancobpi.pt>

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

<http://www.bfa.ao>

INDEX

| | Pág. |
|---|------|
| RECENT SOCIAL AND POLITICAL DEVELOPMENTSS | 04 |
| ECONOMIC GROWTH | 07 |
| INFLATION | 08 |
| EXTERNAL SECTOR | 09 |
| Current Account | 09 |
| Foreign Exchange | 09 |
| MONETARY POLICY AND THE FINANCIAL SYSTEM | 10 |
| COMPETITIVENESS INDICATORS | 12 |
| 2009 BUDGET - A BRIEF VIEW | 14 |
| 1. 2008 ACCOUNTS | 14 |
| ...PUBLIC REVENUES | 14 |
| ...PUBLIC SPENDING | 15 |
| ...CAPITAL EXPENDITURE | 16 |
| ...THE INCREASE OF THE DEFICIT | 16 |
| ...GLOBAL EXPENDITURE BY PRIORITY AREAS | 16 |
| 2. 2009 FORECAST | 17 |
| ... CAPITAL EXPENDITURE | 19 |
| 3. CONCLUSIONS | 19 |

RECENT SOCIAL AND POLITICAL DEVELOPMENTS

UNEVENTFUL ELECTIONS

On 19th November 2008, Mozambique held the third municipal elections after independence in 43 municipalities. Frelimo, the governing party, consolidated its position to win 41 municipalities. In the city of Nacala Port a second round will be held to determine the winner while in the city of Beira an independent candidate emerged victorious. The electoral process went off relatively smoothly apart from some irregularities and was considered the best organized in the country so far by international observers.

The Technical Secretariat for Electoral Administration (STAE) has already started to prepare for the 2009 presidential and legislative elections. Before the elections, this organisation is expected to update the electoral roll as well as implement measures to avoid the technical errors of previous elections. In these coming elections, it is expected that the Frelimo will strengthen its majority and that Armando Guebuza, President of the Republic, will remain in office for his second four-year term.

In a situation common to young African democracies, the main opposition party, Renamo, has found it difficult to cope with the hegemony of the party in power. Recently, in South Africa a group of African National Congress dissidents formed a new party, whose success could spark a new trend in the region; i.e., opposition to the dominant party could emerge from within the rank and file of the party itself.

HIV / AIDS GRIM OUTLOOK

HIV / AIDS continue to spread, impairing the Mozambican society. According to the authorities, about 16% of the population between 15 to 49 years is HIV positive which is a serious obstacle to the country's development since it hinders productivity, resulting not only from higher mortality but also of greater work absenteeism caused by the disease.

Civil servants are particularly affected by this disease: over 31 000 infected public workers from a total of 165 000. Furthermore, it is estimated that by 2010, 17% of teachers in the country will die due to the disease, causing a fall in the teacher / student ratio to 1 / 82 with adverse consequences on the quality of education. Also by 2010, about 20% of children will be orphans and the average life expectancy of the country should be reduced even more, from the already low 41 years.

The authorities also estimate that during this decade about a million people will die due to HIV/AIDS in a country of 21 million inhabitants. The challenges faced by authorities in combating this epidemic encompass preventing its spread to a greater proportion of the population and the support of the infected population. Thus, the authorities should strive to: inform the public on ways through which the disease is transmitted; create a health system to support those infected by administering them drugs that can extend life expectancy; create a child support system so that they can receive a formal education, thus avoiding the path of falling into the traps of marginality.

The high prevalence rate has also increased the degree of discrimination against infected people. With a view to fighting this, legislation was approved, whose special purpose was to reduce discrimination in accessing health care and in society since the law already protected infected people in the labour market.

ANTI-CORRUPTION FIGHT CONTINUES UNABATED

Corruption continues to foster local institutions, discrediting the authorities' best efforts. It is particularly important for Mozambique to assert itself as a rule of law country in the eyes of the international community as international donors are responsible for about half the country's budget. Therefore, the Central Office for Combating Corruption (GCCC) whose operation depends directly on the Attorney General's Office, has carried out several investigations and assertions that resulted in the arrest of the former Minister of the Interior and eight officials from the ministry suspected of misusing funds amounting to USD 8.8 million. Moreover, the former president of the National Social Security Institute (INSS) and president of the Airports of Mozambique (WMD) were also held under custody on allegations of corruption.

GOVERNMENT ANNOUNCES NEW ENERGY SECTOR INVESTMENT

The government announced that a consortium composed of the electricity companies of Mozambique (EDM), Camargo Correia (Brazil) and Energy Capital (Mozambique) will be building a new hydroelectric dam on the Zambezi River Mependa Uncua. The dam will have a production capacity of 1,500 MWh, which compares with a capacity of 2,075 MWh of Cahora Bassa and an estimated cost of USD1.65 billion. The government expects the construction work to begin in 2009 but the project still lacks fund guarantees which may prove difficult to secure against the backdrop of the current global credit crisis.

The government also plans to expand the national electricity grid by around 1400 km in order to connect the new dam to the Cahora Bassa dam, the Moatize coal thermoelectric power station and Maputo, a project that will cost around USD 2.5 billion. This infrastructure is vital for economic development since electricity distribution doesn't connect the north to the south of the country. Hence the energy produced at Cahora Bassa is initially exported to South Africa for subsequent re-importation, leaving Mozambique dependent on South Africa for the energy supply. Currently only 13% of the population has access to electricity, an improvement of 6 percentage points over 2003. Furthermore, as the country is growing, energy needs increase not only due to the swell of domestic consumption but also due to the enlargement of the productive structure. Thus, given the increasing reluctance of South Africa to pass-through energy due to local energy shortages, an improvement in infrastructure for electricity production and distribution justifies the priority given by the government to the sector.

LOCAL FUNDS ARE GOVERNMENT MANAGED

Municipality development funds are being directly managed by the government, firstly due to the inefficient use of the funds and secondly, on suspicions that they were being used as a form of political influence. These funds are a presidential initiative that seeks to directly finance the 138 districts and ought to be applied to projects that encourage the creation of jobs and increase local agricultural production. Each district is allocated a sum that can vary between USD 250 000 and USD 350 000. These funds are paid annually so that the funding would be reused each year but to date, no district has repaid the loans. Despite this setback, the Minister of Finance continues to defend the program as necessary to create employment and management capacity at local level as well as to support the emergence of an entrepreneurial class in the most remote districts of Mozambique.

CREDIT RESTRAINTS DELAY SOME LESS DEVELOPED MEGA PROJECTS

Economic growth will remain strong in Mozambique in 2009-2010 on the back of scaling up donor support and continuing FDI flows. Some mega projects will start up in 2009-2010 since they are well advanced; namely the Moatize coal mega project, expansion of the Sasol pipeline and building of a new pipeline that connects Maputo to South Africa. However, some mega projects that have been announced but remain in blueprint may be delayed due to financial constraints imposed by the present financial crises. The projects at risk include:

- In addition to building the Mependa Uncua hydroelectric dam, which should start early in 2009 and the extension of the electricity national grid by 1400 km, the government intends to expand the productive capacity of Cahora Bassa at an estimated cost of USD 1,000 million;
- The Corridor Sands titanium project led by BHP Billiton (estimated at USD 500 million) was deferred due to doubts about its viability and risks being cancelled;
- In mid November, the Arcelor Mittal temporarily suspended its investment including the construction of a steel mill in Maputo. A proposal for the construction of another steel mill unit in Maputo costing USD 2 billion is on the table, but risks being deferred.
- Various projects led by the smaller mining companies are in doubt because of their more vulnerable situation.

Projects at an advanced stage or secured funding will not be at risk.

BIANNUAL REVIEW CONDUCTED WITH PROGRAM AID PARTNERSHIP (PAPs)

The Government and the PAPs held the biannual review of Mozambique support program. The meeting aimed to establish the targets for 2009 and indicative goals for 2010 under the support program. The 19 donor countries that provide budget support and account for about

half of budget revenues, have pledged a USD 774 mln aid for 2009 and made increases for 2010 dependent on progress in second generation reforms. These are aimed at bringing more flexibility into the Mozambican economy, improving its business environment, and facilitating the expansion of FDI inflows. The 2008 goals that have not been achieved were also analysed at the meeting. Some of these include the following:

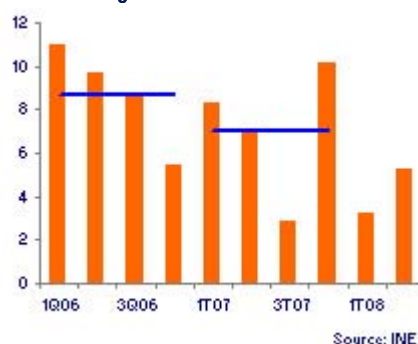
- Mozambique should create 11 Provincial Development Observatories (ODPs) - with the aim of analysing and studying poverty. So far only 4 have been created and 3 more are being implemented. However none of the ODP's created has published any report so it is impossible to certify their quality or relevance;
- Under the Search Location of Public Expenditure (PETS) initiative, an education study should be produced although probably not available until the end of the year;
- The number of cases judged by courts grew by 2% in the first half of 2008 when the target was 15%;
- The number of children benefiting from pediatric TARV (HIV / AIDS treatment) was much less than expected (7,551 to 20,826) due to a overestimation of the patients number given available resources;
- Scholarships for girls under 6 years old came out 1 percentage point below that expected (73%) and the pupil to teacher ratio in the first stage Primary degree decreased from 73/1, in 2007 to 71/1 when the target was 69/1. The hiring of 8.4 thousand teachers contributed to the fall; however, the delay in the teacher replacement process did not allow the target to be met;
- Pre-shipment inspections in the import/export process were not eliminated; this could mean that the 20 day target in the time required to perform an export or import should not be met;
- The area of newly irrigated land reached 640 ha in the first semester of 2008, 19% of the annual target. This low level of implementation was due to the floods that devastated the country and the authorities are working towards recovering the delay in putting these projects into practice;
- Only 31 agricultural community areas have been registered while the target was 242. However, this target is considered unrealistic because between 1998 and 2007 only 246 communities were created;
- 20 District Development Strategic Plans (PEDDs) specifying the territory used should have been approved but to date none have, while 27 are pending approval.

NATIONAL ACCOUNTS

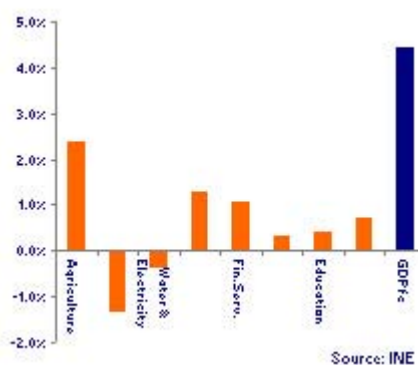
GDP growth accelerated in the 2008 to 5.3% yoy, 2.1 percentage points above that registered in the previous quarter. On a quarterly basis, the change in the seasonally adjusted GDP stood at 1.2%, which compares to a 3.6% fall in the first quarter that was mainly due to very strong growth recorded in the last quarter of 2007.

In the first half of 2008, the economy grew by 4.3% yoy. The contribution of the agricultural sector exceeded by 50%, since the sector managed to grow more than 8% yoy despite the floods, leading to an increase in its weight in GDP from 24% to 30%. Transport and Communications together with the Financial Services sectors also posted good performances with contributions of 28% and 23.5% respectively. The improvement in infrastructure and strength of domestic demand explains the favourable development of the Transport and Communications sector, while the increase in loans justifies the dynamism seen in the financial area. The weight of these sectors in GDP has remained stable at 10% and 6% respectively. On the negative side, the Manufacturing and Electricity and Water sectors whose contribution was -30% and -8.4% respectively should be highlighted. The decline in manufacturing output has been due to the falls seen in the Mozal aluminium ingots production plant as a result of electricity shortages while the fall in Electricity and Water output was due to the failure of an electrical substation which caused a delay in exports from Cahora Bassa to South Africa. The most dynamic sectors in 1H08 had been Financial Services, Mining, Transport and Communications, as well as Education, growing by respectively 19.5%, 15.2%, 13.3% and 10.8% yoy.

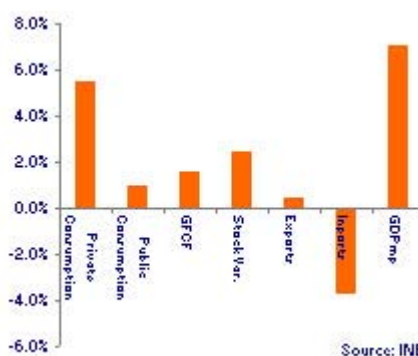
Real GDP growth



Contributes to growth (1S08)



Contributes to growth (1S07)

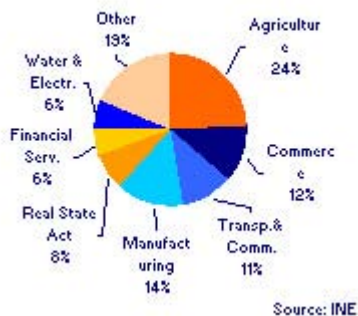


GDP composition (current prices)

| | 2007 (MTZ Millions) | % |
|---------------------|---------------------|---------|
| Private consumption | 164,213 | 79.20% |
| Public consumption | 24,739 | 11.90% |
| GFCF | 37,283 | 18.00% |
| Stock changes | -1,945 | -0.90% |
| Exports | 58,283 | 28.10% |
| Imports | 75,319 | -36.30% |
| GDPcp | 207,254 | 100.00% |

Source: INE Moçambique

GDP by sector (1S07)



GDP by sector (1S08)



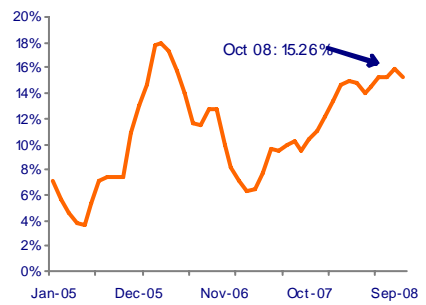
The annual accounts for 2006 and 2007 were reviewed. Estimated real GDP growth in 2007 remained at 7% while 2006 growth was revised upwards from 8.5% to 8.7%. Private consumption accounts for 79% of GDP and added 5.4 percentage points to growth in 2007. Capital expenditure benefits from FDI inflows and increasing public investment, vital for the construction of basic infrastructure and social support to the development of the economy; investment represented 18% of GDP and accounted for 22% of output growth in 2007. Net external demand contributed negatively to GDP by 3.4 percentage points. Exports registered a scant increase of 1.4% while imports accelerated by 8.8%. The 22.5% increase in services exports (taking advantage of the tourism sector development) deserves special mention and this should play an increasingly important role in the economy. Among the countries of tourist origin, there is South Africa which accounted for approximately 50% of the total in 2004, followed by Malawi and Zimbabwe. Outside the African continent, the main countries of origin are respectively, Portugal, the UK and USA, which still represent a small proportion of the total.

INFLATION

Between April and October 2008, inflation accelerated from 14.74% to 15.26% yoy before peaking at 15.85% in September. This accelerated trend in consumer prices has mostly been due to the increase in food prices. Annual cumulative inflation by October 2008 was 9.63% and the component of food and beverages contributed 7.08 percentage points to this total. Nevertheless, the change in international scenario since the last months of 2008 should reverse this trend. Indeed, by July 2008 there was an increase in food and energy prices in international markets that resulted in an increase in inflation globally. This increase was felt more in developing countries where the weight of those goods in household consumption is higher. The present scenario of global recession, especially in developed countries which will probably see their GDP contract in 2009, prompted a sharp drop in energy and food prices on international markets exerting a downward pressure on inflation globally.

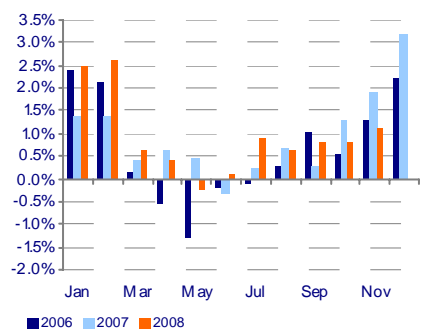
Factors specific to Mozambique will somewhat buffer this generalised slowdown and avoid it being excessively pronounced. Maintaining a high growth rate implies a dynamic domestic demand, which face restrictions on the supply side, causing pressure on prices. Furthermore, the existence of legislative and presidential elections should ensure that the authorities increase public spending and put additional pressure on domestic demand.

Inflation (y/y)



Source: INE Moçambique

Inflation (q/q)



Source: INEMoçambique

EXTERNAL SECTOR

BALANCE OF PAYMENTS

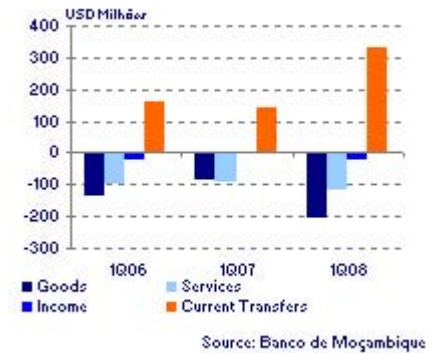
In the 1Q08, the Mozambican current account improved over the same period in 2007. This improvement was due to an increase in current transfers of USD 140 million to approximately USD 330 million while the balance of goods and services suffered a worsening of USD 177 million to USD 320 million. On the back of the increase in current transfers were transfers made to central government which increased from USD 130 million to USD 324 million. The worsening of the balance of goods and services was related to the deterioration of both components. The balance of goods recorded a negative figure of USD 205 million which compares to a negative balance of USD 87 million in the same period of 2007. Exports showed a slight decline (-3.8%) due to a decrease in production at the Mozal aluminium plant owing to power shortages, causing a 8.5% drop in exports related to mega projects. In the second half of the year, the effect of the fall in aluminium prices on the international markets should be felt in the value of exports since aluminium ingots exceed 50% of total exports. In turn, imports have increased as a result of more buoyant domestic demand. Conversely, there has been a reduction in imports related to mega projects since some of them are already at an advanced stage. It is possible that the imports of capital-intensive products related to mega-projects will slow in the coming years due to the smaller scale of the latter. The services balance has deteriorated due to the sectors of transport, construction and financial services. In addition, the low development of the economy leads to the use of services abroad, a trend that should be maintained in the coming years. However, the expected expansion in the tourism sector should offset this effect, at least partially, avoiding a significant worsening in the services balance.

Foreign direct investment (FDI) flows to Mozambique are expected to remain high. The global credit crisis has made investors more risk averse and access to credit has become more restricted. Mozambique is not immune to this juncture but the country is in a good position to continue to attract FDI. As a successful example of political and social stabilization post war, Mozambique will continue to enjoy external aid and monitoring by international organizations through donations and other supporting actions, which give a guarantee of stability to international investors. The dynamics of domestic demand, guaranteeing an accelerated growth to the economy, is another factor which will ensure that investors continue to favour Mozambique as a destination for investment.

EXCHANGE RATE

The Bank of Mozambique (BdM) primarily aims to preserve the currency value through price stability. The exchange rate policy seeks to maintain the stability of the Metical against the dollar to contain imported inflation. Continuous accumulation of reserves implies that the BdM will be able to pursue with this policy in the near future. The appreciation of the euro against the dollar in the 1S08 has increased the price of imports from the European continent and exerted pressure on inflation. Reversal of this trend constitutes a relief in the price of imported goods.

Current Account



Aluminium prices in international markets (USD per ton)



FDI Inflows (USD Millions)



Metical FX Evolution



MONETARY POLICY AND FINANCIAL SYSTEM

Money supply and exchange rate control are the main instruments used by the BdM to achieve price stability. With the economy showing signs of lively growth and with a view to eliminating the excessive liquidity, the BdM acts through issuing treasury bills and by acquiring the domestic currency.

The central bank has a marginal lending facility and a liquidity facility to absorb liquidity. Since January 2008, the central bank has not made any change in their key rates. The rate of the absorbing facility remained at 10.25% while the rate of the marginal lending facility liquidity stands at 14.5%.

At the last meeting of the Monetary Policy Committee, held in December, the BdM decided to "step up action in the interbank markets to ensure a level of liquidity in the economy consistent with the objectives of controlling inflation, the monetary base and net international reserves". The monetary authorities' stance considered the behaviour of the monetary base, the forecast for the evolution of inflation and monetary aggregates and the possible negative impacts arising from the financial crisis, the volatility of commodity prices as well as the instability in some countries of the region.

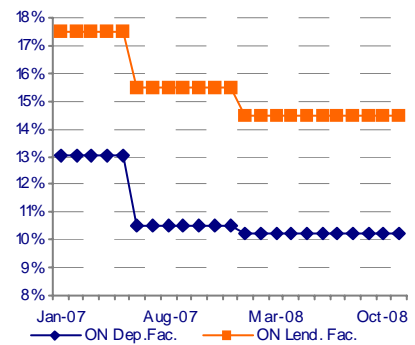
Treasury Bills (TBill's) placement rates with maturities of 91 and 182 days, those more frequently issued, went down in the first half of 2008 and have since risen slightly. TBill rates with 91 days maturity are close to 14% while the 182 days security has a higher return of about 0.25 pp, a difference that has remained stable. In a low diversified economy with a poorly developed financial system, this instrument constitutes a safe alternative investment, justifying the continued demand for such products.

In the interbank market, credit and deposit interest rates remained stable thus maintaining a significant spread between them. The high level of interest rates remains an active obstacle to granting credit. Authorities' efforts to reduce the level of interest rates still have no effect because the main obstacle to the reduction in spreads charge remains (the lack of a broad set of real guarantees against a still too informal economic structure). Other factors intrinsic to the condition of developing countries pressurising the risk premium on the upside are: little economic diversification, low purchasing power of the majority of the population and a poorly developed financial system.

The existence of a solid financial system is essential to the progress of a country. Its existence allows credit access to a wider proportion of the population allowing the development of small projects that enable the economy to become more diversified and more inclusive in individual terms, fostering a virtuous cycle of poverty reduction. In Mozambique, credit growth remains at low levels considering the country development, though the pace of expansion has been accelerating. In the first ten months of 2008, credit concession accelerated from 22% y/y in January to 42% y/y last October.

In sector terms, internal trade continued to stand out in terms of credit concession, representing 26% of the total, followed by the industrial sector whose weight has decreased from 19% in 2006 to 15% in September 2008. The transport and communications sector

Bank of Mozambique reference rates



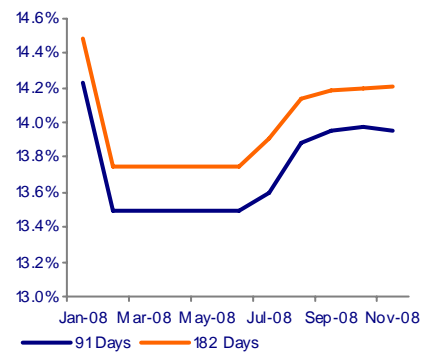
Source: Banco de Moçambique

Active and Passive taxes of Interest

| | 2005 | 2006 | 2007 | Mar-08 | Out-08 |
|----------------|-------|-------|-------|--------|--------|
| Active | | | | | |
| 90 | 20.36 | 24.15 | 21.55 | 21.55 | 21.3 |
| 180 | 21.48 | 24.53 | 22.06 | 22.06 | 22.15 |
| 1 Year | 19.2 | 23.22 | 21.87 | 21.87 | 21.51 |
| Passive | | | | | |
| 90 | 6.57 | 9.58 | 10.43 | 10.45 | 10.68 |
| 180 | 7.61 | 11.23 | 11.55 | 10.86 | 11.07 |
| 1 Year | 8.52 | 12.37 | 11.96 | 11.54 | 11.36 |

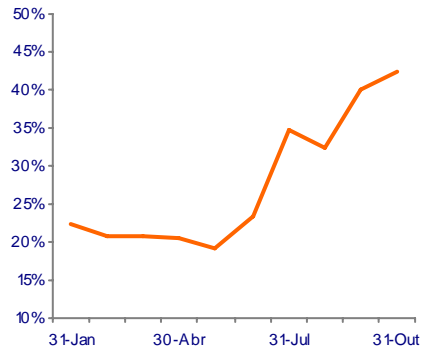
Source: Banco de Moçambique.

Treasury Bills interest rates



Source: Banco de Moçambique

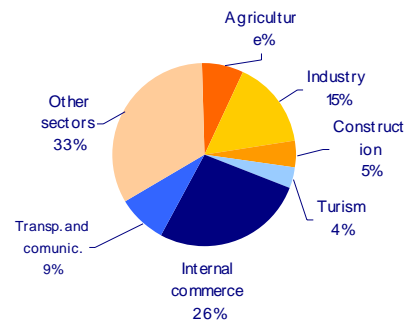
Credit to residents (y/y)



Source: Banco de Moçambique

accounts for 9% of the total which implies an increase of 3 percentage points (pp) compared to 2006 but a decrease of 3 pp when compared to the end of 2007 while the agricultural sector accounts for about 8% of the total, keeping its weight stable.

Credit by sector (Set 08)



Source: Banco de Moçambique

COMPETITIVENESS INDICATORS

After an improvement in the 2008 ranking, Mozambique posted a weak performance in the Doing Business 2009 ranking of the World Bank. Mozambique ranks 141 in a list of 181 countries, 8 positions under previous year's mark. When looking at the different components of the index, it is significant that the only improvement was in contracts' fulfilment - due to a decrease in the number of days required to fulfil a contract from 1010 to 730 - which had already registered a slight improvement on the previous year. On the negative side, there is: the worsening in the ease of starting a business - due to an increase in the cost and minimum capital required to start a business; the drop in the component relating to property registration due to its increased cost; the greater difficulty of obtaining credit; and, the drop in the component relative to paying taxes - due to an improved performance in other countries since the Mozambican situation remained unchanged.

This ranking is an international reference in assessing the conditions for doing business in Mozambique and its performance could reduce the attractiveness of the country in international terms. For other countries in sub-Saharan Africa, Mozambique continues to be better positioned than Angola but is still well below the leading countries, such as Namibia. It is worth mentioning that not only has the performance of Mozambique deteriorated but also the region's performance as a whole. Extra revenue provided by high oil and other commodity prices on international markets have led many countries to relax the pace of reforms, justifying the poor performance of the region.

The Index of Corruption Perception from Transparency International measures the perceived level corruption in the public sector through the private sector surveys and consultants. This index scale ranges from 0 (very corrupt) to 10 (free of corruption) and it is estimated that the 1 point improvement in the index leads to a 4% increase in average income. Public sector corruption is seen as a major constraint to the development of a country. The lack of ethics and the eventual selection of projects or investors through bribes or influence networks inhibit the impartial choice of projects that would eventually optimize potential growth. Furthermore, an environment in which corruption prevails does not encourage the development of private initiative in particular for small businesses, preventing a more diversified and inclusive growth, which would reduce poverty levels.

In the Corruption Perception Index for 2008, Mozambique received a poor performance. The country has seen its position deteriorate globally, losing ground within the sub-Saharan Africa and in absolute terms. Mozambique scored 2.6, two tenths less than in the previous year. A score below 3 indicates that corruption is perceived as rampant while between 3 and 5 means that corruption is seen as a serious challenge for investors and analysts. Given this framework, Mozambique's position means that the country still has a long way to go with regard to improving the functioning of public institutions.

Doing Business for 2009 (World Bank)

| | Mozambique | | | Angola | | Namibia | |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 |
| General rate | 140 ^o | 134 ^o | 141 ^o | 167 ^o | 168 ^o | 43 ^o | 51 ^o |
| Starting a business | 157 ^o | 125 ^o | 144 ^o | 173 ^o | 156 ^o | 101 ^o | 112 ^o |
| Dealing with construction permits | 147 ^o | 147 ^o | 153 ^o | 136 ^o | 125 ^o | 31 ^o | 38 ^o |
| Employing workers | 162 ^o | 162 ^o | 161 ^o | 172 ^o | 174 ^o | 33 ^o | 34 ^o |
| Registering property | 124 ^o | 126 ^o | 149 ^o | 166 ^o | 173 ^o | 128 ^o | 129 ^o |
| Getting credit | 94 ^o | 97 ^o | 123 ^o | 84 ^o | 84 ^o | 36 ^o | 12 ^o |
| Protecting Investors | 96 ^o | 33 ^o | 38 ^o | 51 ^o | 53 ^o | 64 ^o | 70 ^o |
| Paying Taxes | 66 ^o | 72 ^o | 88 ^o | 120 ^o | 130 ^o | 48 ^o | 96 ^o |
| Trading Across Borders | 137 ^o | 140 ^o | 140 ^o | 164 ^o | 172 ^o | 144 ^o | 150 ^o |
| Enforcing Contracts | 141 ^o | 138 ^o | 124 ^o | 176 ^o | 179 ^o | 33 ^o | 36 ^o |
| Closing business | 130 ^o | 134 ^o | 133 ^o | 138 ^o | 142 ^o | 47 ^o | 52 ^o |

Source: Doing Business 2009.

Corruption Perception Index

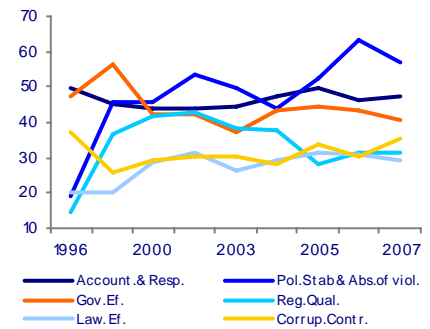
| | 2008 | | | 2007 | | |
|------------|------------------|-----------------|------|------------------|-----------------|------|
| | World | Sub-Saharan | Rate | World | Sub-Saharan | Rate |
| Botswana | 36 ^o | 1 ^o | 5.8 | 38 ^o | 1 ^o | 5.4 |
| Namibia | 61 ^o | 6 ^o | 4.5 | 57 ^o | 5 ^o | 4.5 |
| Mozambique | 126 ^o | 25 ^o | 2.6 | 111 ^o | 20 ^o | 2.8 |
| Angola | 158 ^o | 35 ^o | 1.9 | 147 ^o | 37 ^o | 2.2 |

Source: Transparency International

The Sub-Saharan Africa region registered a mixed performance within this index, as some countries improved significantly such as Nigeria while others saw their performance worsen, such as Somalia. Within this latter group, Mozambique fell 5 positions from 20 to 25, obtaining a rating higher than Angola but much lower than neighbouring countries such as Namibia or Botswana.

Apart from issues relating to the environment for doing business and corruption among public institutions, good governance is also a key element for the sustainable development of a country. A working group from the World Bank has been compiling the Worldwide Governance Indicators (WGI) for the past decade which intends to capture six key dimensions of good practice undertaken by countries to ensure a better quality in governance. These dimensions include: voice and accountability which measures the extent to which citizens enjoy freedom in choosing their leaders, freedom of expression, of association and a free press; political stability and absence of violence / terrorism which measures the likelihood of a government being destabilized by violence or terrorism; government effectiveness which measures the quality of public services, involvement of civil society and independence from political power and the quality of the policies formulated; regulatory quality which measures the capacity of government to create a stable and effective regulatory environment, allowing healthy development of the private sector; law effectiveness which measures how far society has confidence in law enforcement and in the proper functioning of the judiciary system; corruption control which measures the extent to which public power is exercised for private benefit, including corruption on a small and large scale as well as the state institutional dominance by the political elites.

Worldwide Governance Indicators



Source: World Bank

These indicators provide a comprehensive framework for the quality of the institutions and are recognized by the international community as a good gauge of the success and effectiveness in development programs, which is particularly important for Mozambique, as the country benefits and depends largely on international donations. These indicators also allow some usual beliefs to be demystified, as it is possible to find several cases of good governance practices in emerging and developing countries, such as Botswana, as well as significant improvements in this field within the last decade, such as Ghana, Angola or Ethiopia.

In the last ten years, Mozambique has improved in three of the above dimensions and obtained a worse classification in the remaining two components. In the voice and accountability sub-index it kept its position, reaching an evaluation better than 47% of the countries; political stability and absence of violence was the segment which improved the most, as the country now ranks better than 57% of the considered group of countries, compared to 19% back in 1996; this has been a normal performance due to the end of the civil war in 1994. Law effectiveness and regulatory quality gauges have also improved although their performance has not been so impressive; in fact, they continue to register the worst performance among the dimensions studied. Government effectiveness and corruption control have registered a negative evolution, meaning that the quality of public institutions and free participation of the population in the political arena are still far away from what is desirable, though an improvement in this field is expected in the future, as democracy becomes more deep-rooted and stabilizes.

As in the previous indices, when compared to other countries in the region, Mozambique obtains an average classification, still far away from the top countries, such as Namibia or Botswana but in a better position than Angola, a country that needs to step up its efforts to stabilise its democratic institutions.

Relative position in the World Governance Indicators

| | Voice and accountability | Political Stability and Absence of Violence | Government Effectiveness | Quality of Regulation | Law Effectiveness | Corruption Control |
|------------|--------------------------|---|--------------------------|-----------------------|-------------------|--------------------|
| Mozambique | 47% | 57% | 40% | 32% | 29% | 35% |
| Angola | 16% | 28% | 11% | 17% | 7% | 6% |
| Namibia | 64% | 79% | 62% | 54% | 57% | 63% |

Fonte: Banco Mundial

STATE BUDGET ANALYSIS FOR 2009

The underlying macroeconomic scenario in the 2009 State Budget (SB) is relatively balanced although it could be considered optimistic in terms of growth and conservative in terms of inflation. Indeed, given the currently strongly negative international environment, foreseeable foreign direct investment inflows could be weaker than expected and eventually some mega projects may be delayed (the Mependa Uncua dam in the river Zambeze, Sands Corridor from the titanium mines project and several others - see related chapter) due to financing difficulties although international aid influxes are not at stake (the 19 countries that give donations under the PAP -Parceiros do Acordo Programático- have ensured that they will send USD 774 million in 2009). Regarding inflation, the fall in food and energy prices will induce a deceleration in inflation in 2009. Nevertheless, this should be partially compensated for the re-introduction of customs taxes and elimination of fuel and public transport subsidies, reversing the measures adopted during 2008 in the light of strong public protests following price escalations.

| Macroeconomic forecasts | | | | |
|--------------------------------|-------------|-------------|-------------|-------------|
| | 2008 | 2009 | 2010 | 2011 |
| Nominal GDP (mln USD) | 9,728 | 10,468 | 11,149 | 12,999 |
| Nominal GDP (MM MTZ) | 234,764 | 266,572 | 300,118 | 337,886 |
| Real GDP growth | 6.50% | 6.70% | 7.00% | 7.00% |
| Annual average inflation | 9.80% | 8.00% | 9.90% | 6.20% |

Source: State Budget 2009

As a reference, the IMF scenario is relatively similar. The biggest differences are the more moderated pace of growth, lower long-term inflation (2010-11) and higher inflation in 2008 and 2009.

| Macroeconomic forecasts - International Monetary Fund Out 2008 | | | | |
|---|-------------|-------------|-------------|-------------|
| | 2008 | 2009 | 2010 | 2011 |
| Real GDP annual growth | 6.50% | 6.70% | 6.60% | 6.50% |
| Average annual inflation | 10.10% | 8.40% | 5.60% | 5.20% |

Source: State Budget 2009

1. 2008 EXECUTION

...Revenues

Regarding the execution of public revenue, it appears that the first half of 2008 was slightly below the target but still better than in 2007 (execution rate was 47.2% in 1S08 vs. 46.8% in the same period last year). State revenues derive mostly from taxes (donations are not considered as income, they are autonomous), especially those taxes levied on goods and services, which account for half the revenue. Regarding VAT, we emphasise that this contributes a significant weight corresponding to 34% of the total.

This revenue collecting structure constitutes a direct reflex from the features and deficiencies in the tax base. The high degree of informality in every dimension of economic activity, from work relationships to goods and services transactions etc., make it difficult to collect taxes. Nonetheless, the legal and fiscal framework is usually recognised as being one of the most adequate to the region's reality. In this context, the government has made efforts towards enlarging the tax base and facilitating compliance with fiscal duties, for example through the creation of a Simplified Tax for Small Taxpayers in rural and urban areas and advancing the process of allocating a taxpayer number (Número Único de Identificação Tributária), among others. There is also the need to urgently advance this process given the weight of collected taxes in customs transactions (about 20% of total revenue) and considering the intention to end the barriers to international transactions due to Mozambique's participation in the Southern Africa Development Community (SADC). Worth reminding also is that one of the organization's purposes is to create a free market zone and single currency among participants. Also worth mentioning is the fact that mega projects contributed 204 million meticaís through personal and corporate income taxes, only 3.4% of tax revenue.

Public Revenue - 2008 execution

Unity: Million Meticals

| | State Budget | | | | Half-yearly execution | | Execution rates | | Real growth rate |
|-----------------------------|----------------------|---------------|------------|---------------|-----------------------|-------------------|--------------------------|--------------------------|------------------|
| | 2007 | % | 2008 | % | 2007 Exec. 1º sem | 2008 Exec. 1º sem | 2007 % de accomplishment | 2008 % de accomplishment | |
| | State Revenue | 33,261 | 100 | 38,816 | 100 | 15,557 | 18,312 | 46.8 | |
| Current revenue | 31,401 | 94 | 37,117 | 96 | 14,615 | 17,431 | 46.5 | 47 | 12.8 |
| Fiscal receipts | 26,532 | 80 | 30,801 | 79 | 12,650 | 15,979 | 47.7 | 51.9 | 19.5 |
| Income Taxes | 7,555 | 23 | 10,004 | 26 | 4,317 | 5,557 | 57.1 | 55.6 | 21.8 |
| Special tax on gambling | 47 | 0 | 69 | 0 | 25 | 23 | 52.7 | 32.5 | -13 |
| Taxes on corporate income | 3,259 | 10 | 4,622 | 12 | 1,961 | 2,675 | 60.2 | 57.9 | 29 |
| Taxes on personal income | 4,250 | 13 | 5,312 | 14 | 2,331 | 2,860 | 54.9 | 53.8 | 16.1 |
| Indirect Taxes | 17,222 | 52 | 18,861 | 49 | 7,688 | 8,871 | 44.6 | 47 | 9.2 |
| of which: Value Added Tax | 11,073 | 33 | 13,168 | 34 | 15,072 | 5,977 | 45.8 | 45.4 | 11.5 |
| ...on imports | 6,614 | 20 | 7,702 | 20 | 2,950 | 3,405 | 44.6 | 44.2 | 9.2 |
| ...on domestic transactions | 4,459 | 13 | 5,466 | 14 | 2,122 | 2,572 | 47.6 | 47.1 | 14.7 |
| Other Fiscal Revenues | 1,755 | 5 | 1,936 | 5 | 646 | 1,551 | 36.8 | 80.1 | 127.3 |
| Non Fiscal Revenues | 2,540 | 8 | 2,718 | 7 | 1,005 | 1,041 | 39.6 | 38.3 | -2 |
| Dedicated Revenue | 2,329 | 7 | 3,599 | 9 | 960 | 410 | 41.2 | 11.4 | -59.6 |
| Capital Revenues | 1,860 | 6 | 1,699 | 4 | 3,943 | 881 | 50.7 | 51.8 | -11.6 |

Source: State Budget 2009

This small contribution clearly illustrates one of the usual critics to the excessive fiscal benefits conceded to these mega projects since they end up generating little internal wealth particularly through tax collection.

Fiscal receipts coming from the megaprojects (10³ meticals)

| | |
|-------------------|----------------|
| Energy production | 12,077 |
| Mineral resources | 54,820 |
| Other Projects | 137,333 |
| Total | 204,230 |

Source: State Budget 2009

...Expenditure

Public Expenditure - 2008 execution

Unity: Million Meticals

| | State Budget | | | | Half-yearly execution | | Execution rates | | Real growth rate |
|---|----------------------------|---------------|---------------|---------------|-----------------------|-------------------|--------------------------|--------------------------|------------------|
| | 2007 | % | 2008 | % | 2007 Exec. 1º sem | 2008 Exec. 1º sem | 2007 % de accomplishment | 2008 % de accomplishment | |
| | Current Expenditure | 31,970 | 100 | 37,695 | 100 | 15,399 | 18,754 | 48.2 | |
| Current Expenditure (excluding debt burden) | 30,644 | 96 | 36,044 | 96 | 14,750 | 18,100 | 48.1 | 50.2 | 16.1 |
| Personel Expenditure | 15,874 | 50 | 18,815 | 50 | 37,672 | 9,343 | 48.3 | 49.7 | 15.2 |
| Wages and Salaries | 14,426 | 45 | 17,570 | 47 | 6,958 | 8,627 | 48.2 | 49.1 | 17.3 |
| Other personel expenditure | 1,448 | 5 | 1,246 | 3 | 714 | 716 | 49.3 | 57.5 | -5.1 |
| Consumption of Goods and Services | 6,607 | 21 | 8,131 | 22 | 13,492 | 4,076 | 52.9 | 50.1 | 10.4 |
| Debt Burden | 1,326 | 4 | 1,651 | 4 | 649 | 654 | 48.9 | 39.6 | -4.7 |
| ...Domestic | 889 | 3 | 1,122 | 3 | 456 | 439 | 51.3 | 39.1 | -8.9 |
| ...External | 437 | 1 | 529 | 1 | 193 | 215 | 44.1 | 40.6 | 5.3 |
| Current Transfers | 5,983 | 19 | 6,920 | 18 | 2,907 | 3,638 | 48.6 | 52.6 | 18.4 |
| Subsidies to Corporations | 378 | 1 | 423 | 1 | 168 | 175 | 44.5 | 41.4 | -1.3 |
| Other Current Expenditure | 1,791 | 6 | 1,743 | 5 | 507 | 867 | 28.3 | 49.7 | 61.7 |
| From previous years | 12 | 0 | 12 | 0 | 4 | 1 | 34.5 | 5.3 | -84.7 |
| Capital Expenditure | 203 | 1 | 386 | 1 | 87 | 93 | 42.8 | 24.1 | 1 |
| Total of functioning | 32,174 | 101 | 38,081 | 101 | 15,486 | 18,846 | 48.1 | 49.5 | 14.9 |

Source: State Budget 2009

In looking at the fine print in expenditure execution we realize that the fiscal policy continues to be markedly expansionary as public revenue increased by 11.4% in real terms in the 1S08 versus a 14.9% expansion on the expenditure side. Moreover the execution degree is satisfying, close to 50% of that planned, a fact that reflects e-SISTAFE's full functioning (e-Government version of State Financial Management Integrated System). This programme, created in 2002, combines five subsystems, namely the State Budget, Public Accounting, Public Treasury, State Property and Internal Control. Principles such as financial regularity, legality, efficiency and effectiveness rule SISTAFE which is under the direction and coordination of the Finance Ministry.

Among the expenditure components, we highlight the debt burden which evolved better than expected, reaching only about 40% of that intended until mid-year. International initiatives under the debt forgiveness (MDRI) and a more effective treasury management, allowing costs reduction in Treasury bills issuing, are the reasons behind the more favourable evolution of this component.

In structural terms, about 50% of total expenditure is related to salaries and remunerations.

...Investment Expenditure

Unlike the other components, investment expenses registered a low execution at only 22.8% of the total planned. In fact, 4 3901.5 million meticals (Mtz) were planned in investment expenditure but until 1H08 only 1 0013.1 million meticals had in fact been executed. According to the authorities, the execution rate could improve a little until the end of the year because some projects are being implemented whose public tenders were launched in first semester. Still, compared to the 2007 execution, there has been an increase of 7.5% in real terms.

...Deficit increased in homologous terms

In light of the revenue and expenditure execution, the semester deficit (before donations) hit 1 2063.2 million meticals which corresponds to about 5.4% of GDP, 0.5 p.p. more than in the previous year's homologous period.

...Global expenditure in priority areas

Global expenditure execution at the end of the first semester in 2008 was only 34.2% which was naturally influenced by the difficulties encountered in executing the investment expenditures. Execution rate of the state's financial operations, internal debt amortization or loan to corporate, were below that intended, at only 22%. Among expense in priority sectors, HIV/AIDS combat expenses were positively felt, with an increase in real terms of 72% over that registered a year ago. On the negative side, we note the low growth in the Rural Development and Agricultural sector: the total expenses goal dropped in absolute value in SB 2008 and execution increased by only 4% in real terms, the lowest increase rate observed. Despite the difficulties, a large number of projects were affected by floods, mainly in the country's central territory and because many irrigation rehabilitation projects had a late start, there seems to be little determination from the authorities to invest in a sector whose development is considered fundamental to the improvement in quality of life and combating poverty of the population. In September last, due to the crises in international food markets, it was decided to accelerate the so called Green Revolution which involves rice, corn, wheat, cassava, potato, oilseeds (sunflower and soybean), poultry and fishery. According to SB 2009, it was intended to execute 30% of total amount planned for that year by the end of 2008. The results of those efforts as yet remain unavailable.

Execution of Expenditure in the Priority Areas of the Parpa (*)

Unity: Million Meticals

| | State Budget | | Half-yearly execution | | Execution rates | | Real growth rate |
|---|------------------|----------------------|-----------------------|------------------|--------------------------|--------------------------|------------------|
| | 2007 | % | 2008 | % | 2007 % de accomplishment | 2008 % de accomplishment | |
| | 2007 | % | 2008 | % | 1º sem | 1º sem | |
| Total expenditure | 72,915.20 | -89,002.60 | -25,520.30 | 30,406.40 | 35 | 34.2 | 12.5 |
| Debt Burden | 1,326.30 | - 1,651.00 | - 649 | 687.7 | 48.9 | 41.5 | -0.2 |
| Financial operations | 5,769.90 | - 7,020.50 | - 1,222.30 | 1,515.40 | 21.2 | 21.6 | 17.1 |
| Total expenditure excluding interest on debt and financial operations | 65,819.00 | -80,331.20 | - 23,649.00 | 28,205.30 | 35.9 | 35.1 | 12.6 |
| Total Expenditure in Priority Sectors | 42,611.90 | 100052,645.50 | 10014,054.00 | 17,011.40 | 33 | 32.3 | 14.3 |
| (% of total expenditure) | 58.4 | - 59.2 | - 55.1 | 55.9 | | | |
| (% of total expenditure excluding interest on debt) | 64.7 | - 65.5 | - 59.4 | 60.3 | | | |
| Education | 12,840.80 | 3014,826.70 | 28 5,190.00 | 6,373.10 | 40.4 | 43 | 16 |
| General Education | 11,398.60 | 2712,588.00 | 24 4,550.00 | 5,518.10 | 39.9 | 43.8 | 14.5 |
| High Grade Education | 1,442.10 | 3 2,238.60 | 4 640 | 855 | 44.4 | 38.2 | 26.1 |
| Health | 8,220.30 | 19 9,568.70 | 18 2,722.00 | 2,812.20 | 33.1 | 29.4 | -2.4 |
| HIV/AIDS | 345.6 | 1 637.7 | 1.2 126 | 229.3 | 36.5 | 36 | 71.8 |
| Infrastructure | 10,243.20 | 2417,052.60 | 32 2,933.00 | 3,802.20 | 28.6 | 22.3 | 22.4 |
| Roads | 6,420.60 | 15 9,195.30 | 18 1,828.00 | 2,198.20 | 28.5 | 23.9 | 13.6 |
| Water Systems | 2,537.60 | 6 4,497.70 | 9 553 | 970.9 | 21.8 | 21.6 | 65.8 |
| Public works | 272.1 | 1 664.8 | 1 151 | 172.9 | 55.5 | 26 | 8.1 |
| Mineral resources and Energy | 1,012.90 | 2 2,694.80 | 5 8,401.00 | 460.1 | 39.6 | 17.1 | 8.4 |
| Agriculture and Rural Development | 4,310.90 | 10 3,146.80 | 6 838 | 922.9 | 19.4 | 29.3 | 4 |
| Government, Security and Judicial System | 6,079.30 | 14 6,488.00 | 12 2,007.00 | 2,522.40 | 33 | 38.9 | 18.7 |
| Security and Public Order | 2,817.20 | 7 2,384.50 | 5 1,009.00 | 1,242.20 | 35.8 | 52.1 | 16.3 |
| Governance | 1,800.10 | 4 2,207.50 | 4 454 | 593.3 | 25.2 | 26.9 | 23.4 |
| Judicial system | 1,462.00 | 3 1,896.00 | 4 544 | 686.9 | 37.2 | 36.2 | 19.2 |
| Other Priority Sectors | 571.9 | 1 925 | 2 238 | 349.4 | 41.6 | 37.8 | 38.6 |
| Social action | 373.1 | 1 633.2 | 1 162 | 265.8 | 43.4 | 42 | 55 |
| Labour and Employment | 198.9 | 1 291.8 | 1 76 | 83.5 | 38.2 | 28.6 | 3.8 |

Source: State Budget 2009

Note: *PARPA - Plan to Reduce Absolute Poverty

2. 2009 OUTLOOK

Budgetary policy for 2009 incorporates the following goals, to:

- Stimulate the pace of internal accumulation and sustainable economic growth patterns;
- Support stability in the General Price Index;
- Promote tradable goods competitiveness and diversification;
- Contribute to the gradual correction of structural imbalances in the Balance of Payments;
- Promote employment and self employment in rural areas and urban centres.

Concerning fiscal policy, it is intended to increase the level of fiscal administration efficiency and diversify the sources of State revenue. For 2009 it is expected that the revenues amount will reach 46 216.3 millions Mtz, equal to 17.3% of GDP, representing a 1.4 p.p. increase against the 2008 target.

Among the main areas to develop in fiscal area, we highlight the following:

- Expansion and consolidation of the Computerised Tax System;
- Continuation of the process of allocating taxpayer numbers at all levels;
- Reinforcement of mechanisms towards tax payments through commercial banks;
- Adequacy, improvement and dissemination of fiscal and customs legislation;
- Proceeding with the divulgation and information campaigns about taxes aiming at the taxable population.

Expenditure distribution in the 2009 Budget has a fundamental objective, in line with the targets fixed in the plan against poverty 2006-2009 (Portuguese acronym: PARPA II), **namely the reduction in absolute poverty incidence index from 54% in 2003 to 45% in 2009**. According to the 2009-11 Medium Term Fiscal Scenario, ensuring an economic growth of 7%, the prosecution of price and exchange rate stability are also generic targets in this budget.

The milestones that will mark the public expenditure execution in 2009 according to the State Budget are as follows:

- Staging the General and Provincial elections in 2009;
- Inaugurating the Public Sector Wage Policy (which aims to maintain qualified staff in the Public Sector, reinforcing wages at a senior level);
- Implementing the Food Production Action Plan, costing USD 333 million, to be completed by 2011;
- Proceeding with the promotion of projects that generate income, employment and food production at a local level;
- Rehabilitating and constructing high schools and professional schools;
- Proceeding with implementing the rural electrification project and projects aimed at extending telecommunications to district capitals;
- Drilling boreholes and rehabilitating the water supply in rural areas.

SB 2009 anticipates that State revenues will increase by 19% in 2009, increasing by about 1.2 p.p. in relation to GDP. Behind this objective there is a significantly increased prediction in fiscal revenues (about 20%) and capital revenues (which apart from privatizations include concession revenues and dividends). In relation to tax revenues, given the lower food and energy prices on international markets, it seems plausible that the Government will reintroduce customs taxes and VAT on some products as well as fuel tax.

2009 Public Revenues and Expenditures

| | 2007 Executed | 2008 Estimate | Rate of Growth | 2009 State Budget | Rate of Growth |
|---|-------------------|-------------------|-------------------|----------------------|-------------------|
| Public Revenues | 34,473.30 | 38,815.70 | 13% | 46,216.30 | 19% |
| GDP % | 17.10% | 16.50% | - | 17.30% | - |
| Current Revenues | 32,623.60 | 37,116.60 | 14% | 43,989.20 | 19% |
| Fiscal Receipts | 29,509.90 | 30,800.60 | 4% | 37,197.80 | 21% |
| Non-fiscal receipts | 2,457.30 | 2,717.60 | 11% | 2,613.80 | -4% |
| Dedicated Revenues | 656.4 | 3,598.50 | 448% | 4,177.50 | 16% |
| Capital Revenues | 1,849.70 | 1,699.10 | -8% | 2,227.20 | 31% |
| Total Expenditure (including financial operations) | 60,663 | 89,003 | 47% | 104,327 | 17% |
| GDP % | 30.10% | 37.90% | - | 39.10% | - |
| Current Expenditure | 31,983 | 38,081 | 19% | 43,995 | 16% |
| Investment Expenditure | 24,661 | 43,902 | 78% | 53,637 | 22% |
| Financial Operations | 4,019 | 7,021 | 75% | 6,695 | -5% |
| Public Deficit (before grants and loans) | -26,189.80 | -50,186.90 | - | -58,110.30 | - |
| GDP % | -13% | -21% | - | -22% | - |

Source: State Budget 2009

In relation to public expenditure, from the 2009 total planned amount of Mtz 104 326.6 million, 42.2% will be allocated to operational expenses, 51.4% to investment expenses and 6.4% to financial operations expenses. Current expenditure in 2009 will increase 0.3 p.p. of GDP versus 2008. Priority action areas will be pedagogical supervision activities (admission of 16 000 new public workers, 12 000 in Education and 1 200 in Health); increasing the supply of anti-retroviral treatment services; reinforcement in administrative inspection and State supervision as well as the increase and improvement in the supply of public services mostly in Education, Health, Justice, Safety and Public Order and Financial Administration of the State. Operational expenses include expenses related to staging the Provincial and General Elections together with social assistance to the more vulnerable groups of the population (food subsidies, direct social support, income generator program) in addition to the promotion of 15 000 public workers. According to the economic classification, staff expenditure will see its weight in GDP increase from 7.7% in 2007 to 8.1% in 2009, when it will account for about 49% of total expenditure. On a positive note, debt burden will decrease from 0.6% to 0.5% of GDP in same period.

... Investment expenditures

2009 investment expenditure will absorb 51.4% of the budget, representing an increase of 2 p.p. against 2008. Priorities will go to the following sectors as stated in the State Budget text:

- Education Sector - favouring the expansion of education and its quality improvement. This policy will be achieved through school maintenance, rehabilitation and construction; under the expansion of distance learning; universal primary education, adult literacy and education and teacher training; reinforcement of pedagogical supervision measures at district level; consolidation of the Rural Development College in Vilanculos and opening an Entrepreneurship and Business School in Chibuto; reinforcement of investigation and education quality improvement under curricular reform.
- Health Sector - continuation of measures to prevent and combat HIV/AIDS and malaria; health unit expansion; appropriated medicinal supply and channelling funds to ensure the operation start of the General Hospital of Nacala Porto.
- Agriculture and Rural Development Sector - the public investment program relies on the promotion of household income through increasing their productivity. Sector strategy includes the improvement in the commercialization chain for production surpluses and providing financial services to rural families. For 2009, the weight of the agriculture sector in total expenditure will reach 7% due to the Mtz 5.810 million increase in finance to the Food Production Action Plan.
- In Tourism, the focus will be on development of the Gorongosa National Park with the implementation of the Brand Mozambique project.
- Sports and Youth sectors - the highlight will go to construction of the National Stadium. Construction of a sports complex in Pemba as well as other sports infrastructures will continue.
- In Public Works and Housing the emphasis will go to the opening of water sources (boreholes), small systems of water supply construction, construction of 4 900 improved latrines in Sofala and Niassa; rehabilitation of 60 sources of water supply in four districts in the Niassa province; rehabilitation of the N7 road that connects Vandúzi-Changara through a 154 km extension and N1 road which connects Namacurra-Rio Ligonha; R4 122008/09/03 road improvement between Magude and Motaze; the road connecting Mopeia and Chinde, between Namaús and Nangade as well as the N361 road which connects Metangula and Cóbue.
- Labour Sector - job creation, reinforcement of professional training infrastructure and extension of social security countrywide will continue to deserve special attention under the government's combat poverty program.

3. CONCLUSIONS

2009 Public Revenues and Expenditures

| | 2007 Executed | 2008 Estimate | Rate of Growth | 2009 State Budget | Rate of Growth |
|---------------------------|-------------------|-------------------|-------------------|----------------------|-------------------|
| Government Balance | -26,189.80 | -50,186.90 | 92% | -58,110.30 | 16% |
| Financing | | | | | |
| Domestic Credit | 0 | 350 | - | 290 | -17% |
| Grants | 20,291 | 33,828 | 67% | 42,856 | 27% |
| External Credit | 8,748 | 16,009 | 83% | 14,964 | -7% |

Fonte: Orçamento de Estado 2009

The 2009 Budget does not introduce any significant measures. Emphasis goes to the planned strong increase in public expenditure although this mainly arises from execution difficulties in the investment budget which in 2008, will also be below that projected as can be seen from first semester execution data. On the other hand, the high amount of public expenditure planned and respective deficit have to be seen in the context of the external countries' willingness to support them. It appears that despite the prevailing international crises, this willingness remains.

Nonetheless, given the nature of Mozambique's public accounts framework, it is worth noting the main criticisms, namely the:

- Low execution rate of investment expenditure;
- Regional nature of resource distribution which penalizes (or does not discriminate positively) the poorer provinces;
- Large dependence on International Donations;
- Reduced expenditure weight of development priority areas such as agriculture;
- Disproportionate fiscal benefits of Mega Projects.

Paula Carvalho

"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