

Mozambique

2012



Mozambique

- The year 2011 may well be remembered as a turning point in Mozambique's economy, with the first overseas export of coal marking the birth of Mozambique as a world exporter of minerals, and paving the way for the country to secure its future fiscal sustainability through yields from natural resources.
- The main short-term challenge for the government is the enlargement of its fiscal space while keeping its debt levels under control, in order to accommodate the ambitious infrastructure investment plan and the roll-out of social safety nets within the inclusive growth agenda, while resisting political pressures on expenditure prioritisation.
- The approval of the Action Plan for Reducing Poverty frames the government's political development agenda for the next four years, around the promotion of inclusive growth in order to reduce the incidence of poverty which has been stagnant since 2003.

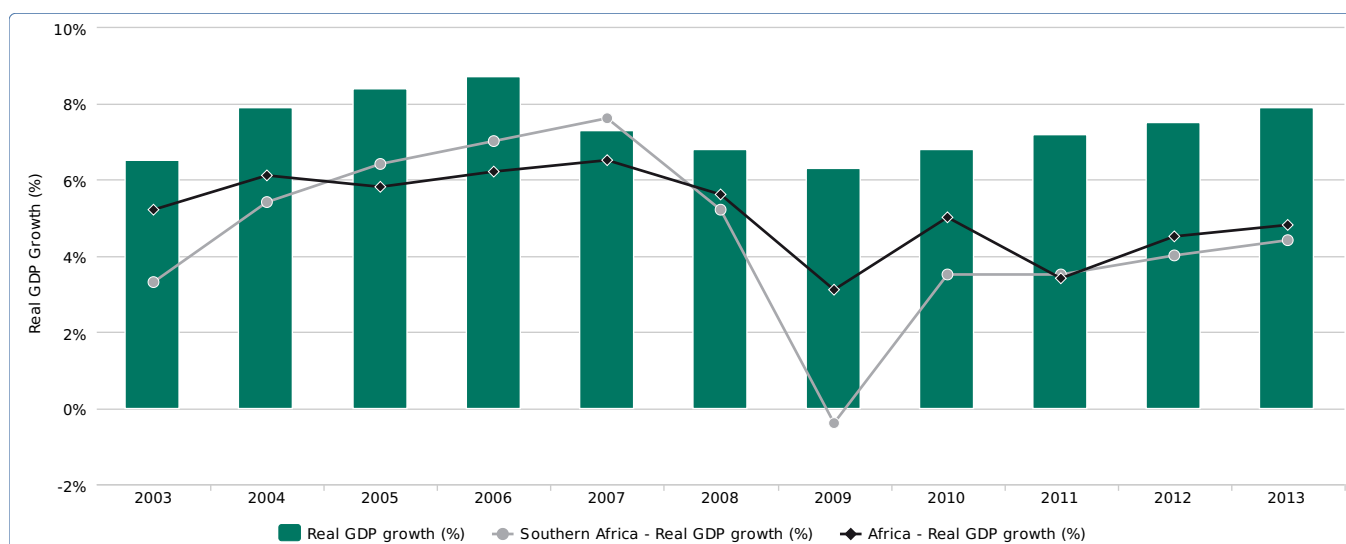
Overview

The boost in coal production from the first mega coal mining projects that came online this year, coupled with strong performance in the financial services sector, transport and communications, and construction, helped to push GDP real growth rate to 7.2% in 2011. The country has achieved an impressive average of 7.2% growth during the last decade. The continuation of high foreign direct investment (FDI) inflows, mostly in extractive industries, together with strong agricultural growth and infrastructure investment will drive growth to 7.5% and 7.9% in 2012 and 2013. Despite the strong growth, the Central Bank's consistent tight monetary policy, supported by a prudent fiscal policy, reduced the end of year inflation from 12.7% to 10.8% in 2011. Prospects of a further decrease in inflation to 7.2% in 2012 and stabilisation at 5.6% in 2013, will allow a monetary policy easing in 2012, targeting credit expansion. The roll-out of pro-poor measures prepared during 2011, coupled with an ambitious infrastructure investment programme should widen the fiscal deficit from -3.3% in 2011 to -6.8 and -7.4% in 2012 and 2013. Mozambique's main medium-term economic structural challenge is the broadening of its fiscal base. Aid flows are expected to decrease continually from 51.4% of budget in 2010 to 39.6% in 2012. The diversification of the revenue base, in particular through enhanced extractive sector taxation, is paramount to sustain and promote an inclusive growth agenda.

In response to the 2010 civil unrest the government restructured its development agenda around a new Action Plan for Reducing Poverty (PARP 2011-14), focused on increased agricultural production, promotion of employment linked to the development of small and medium-sized enterprises (SMEs) and investment in human and social development. Social safety nets were strengthened with the broadening of the direct cash transfer mechanisms to the most vulnerable groups coupled with the maintenance of subsidies to urban public transportation and productive public works programmes, in a bid to minimise the negative effects of the rising cost of food and fuel prices on the poor. Budgetary allocation to priority sectors increased in 2012 by 6.8%, to 66.7% of the budget.

Mozambique has a high population growth rate at 2.8% and an estimated 300 000 new entrants into the labour market every year. The country's high economic growth rates have largely been driven by capital-intensive projects, particularly in extractive industries. The overall unemployment rate stands at 27%. The formal economy is largely urban in nature and accounts for only 32% of all employment. As a result, many of the new entrants into the labour market are forced into marginal jobs in the informal economy, both in rural and urban areas, with little prospect of reliable employment.

Figure 1: Real GDP growth (Southern)



Figures for 2010 are estimates; for 2011 and later are projections.

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Table 1: Macroeconomic Indicators

	2010	2011	2012	2013
Real GDP growth	6.8	7.2	7.5	7.9
Real GDP per capita growth	4.5	5	5.2	5.6
CPI inflation	12.7	10.8	7.2	5.6
Budget balance % GDP	-4	-3.3	-6.8	-7.4
Current account % GDP	-12.1	-25.6	-25.5	-20

Figures for 2010 are estimates; for 2011 and later are projections.

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Recent Developments & Prospects

Table 2: GDP by Sector (percentage of GDP)

	2006	2010
Agriculture, forestry, fishing & hunting	27.9	30.9
Mining and quarrying	1.4	1.5
of which oil	-	-
Manufacturing	16	13.2
Electricity, gas and water	5.8	4.7
Construction	3.2	3.1
Wholesale and retail trade, hotels and restaurants	15.5	17.9
of which hotels and restaurants	1.5	1.6
Transport, storage and communication	10	10.1
Finance, real estate and business services	8.9	7
Financial intermediation, real estate services, business and other service activities	-	-
General government services	-	-
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	4	4
Public administration, education, health & other social & personal services	-	-
Other community, social & personal service activities	-	-
Other services	7.3	7.6
Gross domestic product at basic prices / factor cost	100	100

Figures for 2010 are estimates; for 2011 and later are projections.

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On 14 September 2011, for the first time in 20 years, an overseas shipment of 35 000 tonnes of coal was made from the Beira seaport by the Brazilian company Vale, placing Mozambique on the global coal market. The thermal coal came from the company's 1.7 billion US dollars (USD) Moatize open cast mining project in the Tete province, considered by investors to be one of the world's largest untapped mine fields. The reserves, made of approximately 30% thermal and 70% higher value metallurgical coal, are strategically well positioned to serve the expanding Indian, Brazilian and Chinese markets, amongst others. With the expansion of production in Tete, overall coal output in 2011 reached nearly 1 million tonnes, contributing to GDP real growth increase of 7.2%. Large investments in natural resources are quickly changing Mozambique's economy, and could potentially alter the country's prospects in the medium term.

The coal sector continues to expand and attract large investments. Vale has already announced its intention to expand Moatize's capacity from the 11 million tonnes per year it expects to reach by the end of 2014, to 26 million tonnes per year with an investment of USD 6 billion, which will include expansion of railway linkages. By acquiring Riversdale's operations in Mozambique, Anglo-Australian Rio Tinto took control of 22 exploration licenses in Tete, including 65% of the Benga mining project (Tata Steel from India holds the other 35%) and the Zambezia project where it will invest USD 4 billion. Rio Tinto now estimates it can reach a combined production of 25 million tonnes per year with both projects by 2016, an amount that could more than double when the projects mature. Overall the government has granted 112 licenses to 45 national and foreign companies during the last two years. The country's production is projected to increase to 5.93 million tonnes in 2012, reaching in

the long run 110 million tonnes per year, if provided with the necessary infrastructure. In December the British company, Beacon Hill, undertook its first coal overseas export of 10 650 tonnes, trucked from Tete to Beira seaport owing to the Sena rail line saturation.

The strong economic expansion has promoted investment in the country's weak infrastructures, developed around the three main logistic corridors (Maputo, Beira and Nacala) that serve coal exports, and link the hinterland countries. Transport and communications is the second largest contributing sector to GDP. The CCFB (Companhia Dos Caminhos De Ferro da Beira [Beira Railway company]) consortium, led by the Indian group, RITES (Rail India Technical and Economic Services) and Ircon International, failed to achieve the complete overhaul of the Sena rail line's 670 km to a capacity of 3 million tonnes per year within the contractual terms, prompting the take-over of the line by the government in December. The line is to have its capacity doubled to 6 million tonnes per year by 2013, although this will still be insufficient to meet demand. Additional rail lines from Tete are now planned, such as Vale's sponsored proposal to build a 500 km connection, through Malawi, from Moatize to the northern line that serves the Nacala port, where the implementation of a new USD 1.5 billion coal terminal is planned. The construction of Sena's parallel rail line, linked to the Quelimane sea port which is being rehabilitated, has also been approved. In parallel, Beira's seaport coal terminal upgrade from 1.8 million to 6 million tonnes per year will be finished during 2012, with possible further expansion to 20 million in 2014. The expansion of Maputo's seaport capacity from 100 million to 700 million tonnes per year is underway, as also is the rehabilitation of Nacala's seaport container terminal. At Nacala's airport, a USD 120 million project 66% financed by a non-concessional loan from Brazil, is expected to be finished in 2013. Also the USD 300 million Vilanculos airport project was concluded in 2011. Additional airport hubs are programmed for Pemba and Tete totalling a USD 420 million investment. The construction of a network of main corridors is currently underway, with the Milange-Mocuba and the Nampula-Cuamba road projects, respectively costing USD 100 million and USD 250 million, now beginning.

Representing around 5% of GDP, the energy sector is expected to continue its expansion of nearly 10% a year. In November 2011 the government officially launched the CESUL ("Center-South") project, a USD 1.8 billion Regional Transmission line project, often referred to as the country's "electric back-bone". This project will enable the large northern hydropower stations to connect directly to the Southern African Power Pool, while another line will cross the rural country side to Maputo, providing electric power to the rural population. The CESUL, supported by the ongoing expansion of the Cahora Bassa-North hydro dam and construction of the Mpanda Nkuwa hydro dam project on the Zambezi, will enable hydroelectric projects and ensure the delivery of electricity for consumers locally and potentially abroad.

In April 2012, Mozambique President Guebuza and Portuguese Prime Minister Passos Coelho signed an agreement transferring ownership of Portugal's 15% share in Hidroelectrica de Cahora Bassa (HCB), the company operating the Cahora Bassa dam, over two stages - 7.5% of the shares will be sold to Mozambique this year for USD 42 million, and the remaining over the next two. By 2014, Mozambique will have full ownership of the company.

In spite of economic growth generated by mega-projects and added competitiveness provided by infrastructure development, the impact on poverty reduction has been minimal. The new PARP 2011-14 focuses particularly on increasing agricultural production. The sector, which represented 30.9% of GDP in 2011, is expected to grow by 9.9% in 2012. However, cashew nut production, Mozambique's traditional cash crop, is forecasted to flatten at 112 800 tonnes, up from 105 000 tonnes in 2010. An ambitious Cashew Master Plan, targeting an 80% increase in the next decade, was approved by the Ministry of Agriculture. The Ministry also anticipates an increase of 23.4% in sugar cane production. Expected production increases of 12.5% and 13.8% for wheat and rice respectively, will not be sufficient to meet domestic demand. Despite the decrease of 5.1% in fisheries production in 2011, the sector should expand by 18.4% in 2012. However, the government has capped commercial prawn fishing at 5 650 tonnes per year due to evidence of overfishing.

Private sector investment was over USD 1.9 billion in 2011 as a result of large FDI in coal mega-projects. A total of 30 000 new jobs were created by the 285 new projects, of which 13 were in the Nacala Exclusive Economic Zone, representing a USD 400 million investment from export companies. The services and manufacturing sectors took the lead. A strong investment in the cement sector will triple production by 2013. Four Chinese companies (Africa Great Wall Cement Manufacturer, China International Fund, GS Cimento, and Bill Wood) and the South African Pretoria Portland Cement are entering the market with an overall investment of USD 450 million. A new mobile operator, Movitel, started operations in 2012. Movitel is a USD 400 million joint venture between Viettel, a telecommunications company owned by the Vietnamese Defence Ministry, and SPI (Gestão e Investimentos) the holding company of Mozambique's ruling Frelimo Party.

Notwithstanding the strong economic dynamics, the most relevant economic development of 2011 was the discovery of extensive off-shore natural gas reserves. In September, Anadarko Petroleum announced findings at the Area 1 block of 623 trillion cubic metres of gas. Later, in October a consortium led by ENI (Ente Nazionale Idrocarburi S.p.A. [Italian Oil Company]) found, at approximately 40 km off the Cabo Delgado coast, nearly 424

trillion cubic metres of natural gas reserves. If proven correct, the cumulative natural gas reserves will rank Mozambique 4th in the world for natural gas reserves, behind the three giants, Russia, Iran and Qatar. The scale of reserves justifies the construction of a large liquefied natural gas (LNG) plant in Mozambique. The potential windfall revenues could reshape Mozambique's economic and human development in the medium term.

Macroeconomic Policy

Fiscal Policy

The main pillars of Mozambique's fiscal policy continue to be the strengthening of revenue collection, reducing transfers, and supporting disinflation. The 2011 budget projected a 6.5% fiscal deficit to accommodate the government's medium-term growth and poverty reduction objectives, based on overcoming the country's infrastructure and skills' deficiencies, while providing enhanced social safety nets. The excessive burden of fuel and other emergency subsidies introduced in 2010 to calm social unrest, led to a budgetary revision with a partial phasing out of these subsidies. The budget also introduced a 7% increase in expenditure, re-allocating resources from capital to current expenditures designed to create new social protection schemes.

Despite these extra-budgetary expenses, lower than expected resort to non-concessional borrowings and slow disbursements of donor-financed capital spending, coupled with strong revenue collection, produced a fiscal deficit of just -3.3%. The 2012 budget is a structured response to address the social challenges and support the PARP 2011-14 approved in May, which is focused on an inclusive growth model. Education and Health will have a budgetary real increase of 6.32% and 4.42% respectively, while capital expenditure will suffer a real decrease of 7.2%. There are, however, fiscal challenges on the horizon. In the short term, financing both the investment plan and the social protection schemes to sustain social peace will strain fiscal resources. In the medium term foreign aid support, which represents 40% of budget, is expected to diminish.

The Netherlands has announced the end of its budget support in 2013, and overall official development assistance (ODA) is believed to have peaked and will decrease in the future due to political shifts in the developed world. Fiscal programming could be further negatively affected by lower relative value of donor support due to the metical appreciation. Therefore the expansion of the revenue base is crucial. Revenue collection has seen significant increases, profiting from comprehensive reforms. Initiatives such as the Strategic Plan for Tax Payments through Banks, the strengthening of the Large Tax Payers' division in the Ministry of Finance, and additional planned reforms on streamlining tax payment, will contribute to further enhance tax collection. Fiscal revenue collection increased from 19.6% of GDP in 2010 to 20.2% in 2011 and is expected to reach 20.6% in 2012. Nevertheless, a revision on natural resource extraction and mega-project taxation is crucial. Currently, revenues from these activities represent roughly 5% of company profits due to fiscal exemptions and benefits. If the fiscal regime were fully applied the figure would rise to 30%.

Table 3: Public Finances (percentage of GDP)

	2003	2006	2007	2008	2009	2010	2011	2012	2013
Total revenue and grants	24.7	25.6	25	26.5	27.1	29.7	29.4	27.3	26.1
Tax revenue	14.3	12.9	14.1	15	15.6	18.1	19.1	18.3	17.3
Oil revenue	-	-	-	-	-	-	-	-	-
Grants	9.5	10.6	9	9.4	9.5	9.1	7.7	6.5	6.3
Total expenditure and net lending (a)	30.2	27.2	27.3	33	32.6	33.6	32.7	34.2	33.5
Current expenditure	14.2	14.4	15.3	14.8	18	19	18	17.5	16.4
Excluding interest	13	13.7	14.7	14.2	17.5	18.2	17.1	16.4	15.8
Wages and salaries	6.7	7.2	7.7	7.9	8.9	9.3	8.5	8	7.6
Interest	1.2	0.8	0.6	0.5	0.5	0.9	0.9	1.1	0.6
Primary balance	11.4	-0.9	-1.8	18.3	12.9	14	13.4	13.7	14.3
Overall balance	-4.3	-1.6	-2.4	-6	-5	-3.1	-2.4	-5.8	-6.8

Figures for 2010 are estimates; for 2011 and later are projections.

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Monetary Policy

In 2011, the Central Bank of Mozambique continued to tighten monetary policy, implemented throughout 2010 to absorb excess liquidity and control core inflation to within a single digit. The lending rate to commercial banks was progressively increased from 14.5% up to 16.5% and their minimum reserve requirements increased from 8.5% to 9% of total deposits. As a result, monetary supply M3 grew by 20% in 2011, down from 22.8% in 2010. The favourable external environment of lower food and fuel prices supported the tight monetary policy. The appreciation of the metical against the South African rand also contributed to curb inflation. Yearly inflation has continually decreased since December 2010, reaching 5.5% and the 12-month average, which peaked at 15.37% in April, was 10.8% at the end of the year. Both results are below initial targets and the future prospects are for further a decrease in inflationary pressures due to monetary contraction policy and stabilisation of the metical. However, the domestic credit market was negatively impacted. Growth of domestic credit to the economy decreased from 27.5% in 2010 to 19.5% in 2011, with one year market borrowing interest rates peaking in July 2011 at 23%. The present monetary policy challenge is the trade-off between credit growth to private sector, fundamental to the much needed expansion of job-generating private sector growth, and the control of inflationary pressures. With inflation secured around 5% to 6%, and relying on the continuation of an effective budget execution, it will be possible to accommodate a mild level of monetary easing in 2012 allowing for a modest credit expansion.

Economic Cooperation, Regional Integration & Trade

Mozambique is responsible for 70% of SADC goods transit, with logistic corridors linking the deep water coastal ports with the four neighbouring landlocked countries. The country absorbs one of the highest Aid/GDP ratios in Africa, averaging USD 89.2 per capita, although FDI is now the main driver for economic development and regional integration. Transport and Communications led FDI projects in 2011 with USD 511.8 million. Emerging partners have assumed an increasing role. China became the second largest investor since 2010 and is expected to invest over USD 13 billion in the next ten years, mainly in infrastructure (ports, roads, energy). Furthermore, Brazilian companies plan to invest USD 4 billion over the next four years, focusing on agriculture, mineral resources, infrastructure and health.

The export base remains narrow, with more than half of exports being aluminium. Only 15 products registered annual exports higher than USD 1 million, traditionally including cashew, shrimp, copra, sugar and cotton. Coal exports, which started in 2011, are expected to overtake aluminium as the main export. The prospect for a liquefied natural gas (LNG) plant to be ready in 2018 could make natural gas Mozambique's main export product. Mozambique still imports a considerable volume of machinery, vehicles, fuel and consumer durables, mainly from South Africa (35%), Asia (26%) and Europe (24%). The country's exports are mostly directed to Europe (54%). The volume of intraregional trade remains low at 19% of GDP, awaiting the consolidation of SADC free trade tariffs, which were initiated in 2008. Bilateral agreements were signed with Malawi and Zimbabwe to enforce the rules of origin based on a product's value. The country enjoys preferential access to European markets under the European Union/SADC Economic Partnership Agreement signed in 2009.

Customs performance and trade facilitation have the potential to improve significantly with the introduction of the single electronic window "Janela Única Electrónica", the electronic taxing system "e-tributação" and other internal electronic applications (such as M/H20).

Table 4: Current Account (percentage of GDP)

	2008	2009	2010	2011	2012	2013
Trade balance	-11.6	-13.2	-12.8	-25.3	-24	-16.7
Exports of goods (f.o.b.)	26.7	22.2	25.3	14.6	14.2	18.5
Imports of goods (f.o.b.)	38.3	35.4	38.1	39.9	38.2	35.2
Services	-4.1	-4.7	-5.5	-6.7	-5.9	-6.8
Factor income	-8.5	-2.6	-0.9	-0.2	-1	-1.2
Current transfers	7.8	7.9	7.1	6.6	5.4	4.7
Current account balance	-16.4	-12.6	-12.1	-25.6	-25.5	-20

Figures for 2010 are estimates; for 2011 and later are projections.

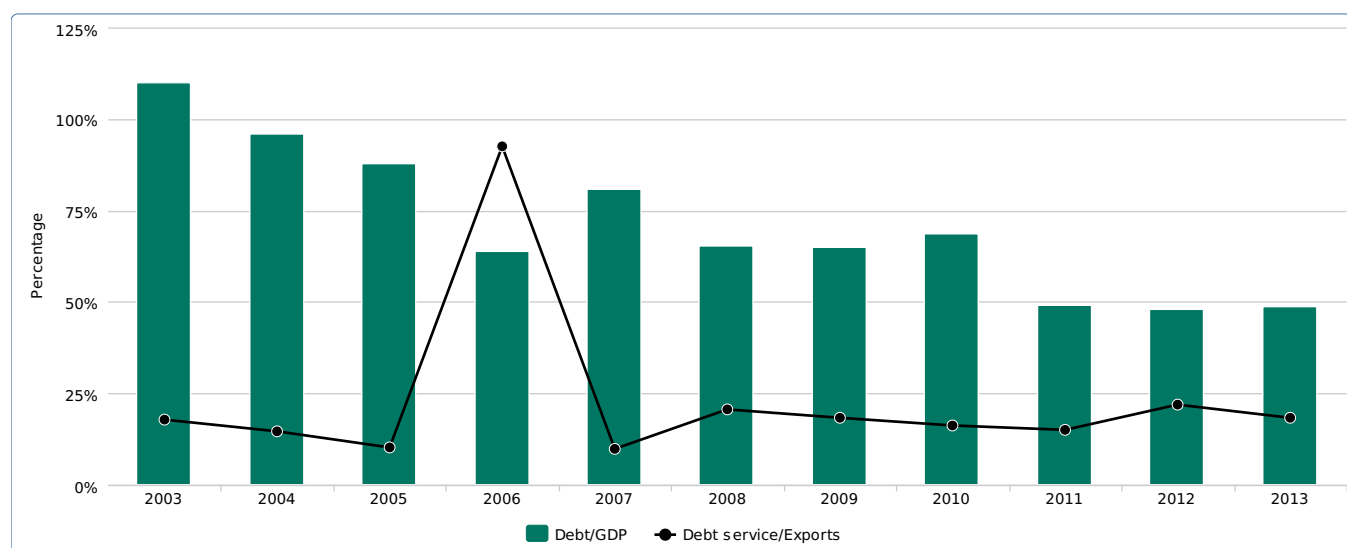
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Debt Policy

The government plans to boost public infrastructure investment to address the country's infrastructure gaps and development needs, despite encouraging increases in revenue collection and prudent fiscal programming. Going forward the investment expansion will push the fiscal deficit to 6% of GDP from 2013 onward. The government considers that the impact on domestic demand will be contained by the returns from these investments, while deficit financing measures will focus more on domestic and external borrowing, including on non-concessional loans. A USD 100 million worth of 5-year treasury bonds were issued in 2011 to finance the budget deficit. However, to prevent crowding out of the private sector, the government intends to limit the use of domestic financing to just 0.5% of GDP. The Government has negotiated with the IMF a non-concessional borrowing limit of USD 900 million for the next three years, focused on productive investments' financing. Notwithstanding, the government has been prudent in negotiating any non-concessional borrowing, which should help to support the public investment programme, compared to initial projections, without scaling back the overall multi-year investment envelope. Under the new non-concessional borrowing window, the government has contracted two operations representing only 16% of the borrowing limit: a USD 66 million operation to modernise the Maputo airport, financed with a Chinese loan signed in December 2010; and a contract for the construction of the Nacala airport, financed by a USD 80 million non-concessional line of credit from the Brazilian Development Bank which was signed in April 2011.

According to the IMF Debt Sustainability Analysis, and already reflecting the revised public investment and borrowing plans, the country's debt indicators remain below the benchmark thresholds, indicating a low risk of debt distress, including in the longer term. External debt is expected to double over three years, from the USD 2 billion in 2010, to USD 4.2 billion in 2013, although the present value will still be below 30% of GDP in 2013, while debt service will represent roughly 5% of exports. The increase in non-concessional borrowings will pose new challenges and will require the strengthening of debt management capacities, particularly regarding borrowing by state-owned enterprises and other sovereign guarantees. A Debt Management Committee was created to inform the first annual borrowing plan for 2012 and support the finalisation of the second Government Debt Sustainability Analysis. The medium-term debt strategy preparation was concluded and regular debt sustainability assessment created.

Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



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Economic & Political Governance

Private Sector

In June 2011, the Government completed the process of drafting of the new law on insolvency which completely overhauled the existing framework and now conforms to international standards. Mozambique dropped 7 positions in the World Bank's 2012 Ease of Doing Business report, ranking 139th out of 183 economies. However, procedures for obtaining construction permits have been marginally eased, as illustrated by an improvement of 3 positions in the 2012 Doing Business index "Dealing with Construction Permits" (from 129 in 2011 to 126 in 2012). Getting credit has comparatively worsened the most, dropping 20 positions (from 130 in 2011 to 150 in 2012). Procedures for starting a business, paying taxes and clearing customs remain moderately burdensome in some sectors. The Government interventions to control food and fuel prices were phased out in March 2011. Nevertheless, there remain some subsidies to urban transportation. Mozambique's labour regulations are restrictive. The non-salary cost of employing a worker is low, but the cost of laying-off an employee is high. A recently passed labour law was intended to make the labour market more flexible, but it also increased overtime restrictions.

Financial Sector

The banking system lacks competition since 85% of the total financial sector's assets are concentrated in the three largest banks which are closely linked to the Portuguese banking industry. The sector may become vulnerable to shocks in the medium term due to the deterioration of the crisis in Portugal. The share of non-performing loans (NPL) remains stable at 2%, and the Central Bank started the transition to risk-based Basel II standards. Supervision ability has improved with the completion of the banking crisis resolution framework but there remains some work to be done on the modules of the rules for closing and liquidating banks, managing bidding processes for private sector take-overs, temporary public ownership, and emergency liquidity assistance.

The financial system has been the fastest growing sector, and overall financial intermediation has deepened. There are still high borrowing costs but the interest rate spread between loan and deposit rates is falling (from 15% in 2006 to 12% in 2010). Private sector credit to GDP remains moderately high at 29.8% in 2010. Capital markets are very small, and the stock market mostly trades government debt. Microfinance institutions have expanded rapidly in recent years, increasing the outreach of the banking sector. The insurance sector remains underdeveloped, accounting for less than 1% of GDP.

The new Foreign Exchange Law of 11 March 2009 entered into force on 11 July 2011 and eliminated the remaining exchange restrictions on the payments and transfers for current international transactions. The law also introduced a compulsory requirement for repatriation of foreign earnings and automatic conversion of 50% of export revenues into local currency. This may hinder private investment initiatives. Progress has been made in addressing the shortcomings of the national payment system, but further follow-through is needed. The priority is to complete the implementation of the real-time gross settlement (RTGS) system and especially the regulations related to the rights and obligations of various participants in the system. The financial system remains both small and limited and levels of financial exclusion are very high, with the poor having little access to credit.

Public Sector Management, Institutions & Reform

Property rights are poorly protected and the judiciary is perceived as corrupt. There is a shortage of qualified legal personnel, and the case backlog is substantial. Enforcement of contracts and legal redress through the courts cannot be assured, leading to most commercial disputes being settled privately. Mozambique faces challenges with its governance and anti-corruption framework. Government accountability (executive, legislative, judicial) and the civil service are all rated as weak. However, there have been improvements in the business licensing and regulations, taxes and customs services and functioning of Supreme Audit Institutions. Cabinet approved the revision of the Anti-Corruption Law 6/2004 in July 2011, and the laws 4/1990 and 7/1998 on the declaration of assets are due in 2012 as part of a new package of anti-corruption legislation. After an increase of ten places in 2010, Mozambique's rating in *Transparency International's Corruption Perceptions Index* in 2011 lowered by four places, now at 130th out of 180 countries, with corruption perceived as widespread. Bribe-seeking by officials is considered to be a problem. The level of conflict of interest between senior officials' public roles and their private business interests is increasing and seldom investigated.

Natural Resource Management & Environment

Climate change poses a major environmental challenge to Mozambique. A 2010 World Bank report, *Mozambique: Economics of Adaptation to Climate Change*, indicates that the impact of climate change over the

next 40 years would lead to a 2% to 4% decrease in yields of major crops, and a modest reduction in energy supply, in the range of 1.4%. The government should press ahead for a climate change strategy, but so far only an action plan for climate changes has been approved. The government is currently preparing a Strategic Program for Climate Resilience under the Pilot Program on Climate Resilience (PPCR). The PPCR, implemented by the government with the support of the African Development Bank, the World Bank and the International Finance Corporation, is the first program under the *Strategic Climate Fund* of the Climate Investment Funds, which has Mozambique as one of three African pilot countries selected for its implementation. The objective of the PPCR is to provide incentives for scaled-up action and transformational change through pilot projects that demonstrate how to integrate climate risk and resilience into core development planning. Mozambique is also actively making efforts to reduce deforestation through the mechanism of Reduction of Emissions from Deforestation and Forest Degradation (REDD). This initiative has facilitated the implementation of drought-mitigating measures in the Limpopo basin in southern Mozambique as well as water conservation interventions in the central province of Tete.

The Extractive Industries Transparency Initiative (EITI) validation process has made significant strides. The country has set up institutional arrangements towards validation through the publication of the first EITI reconciliation report and the submission of the validation report to the EITI International Board in May, 2011. The country scored well in 15 out of the 18 indicators, although weaknesses were raised regarding: i) the weak engagement of civil society; ii) the limited scope of dissemination; and iii) the discrepancies in the mineral resources revenues reported by the government of Mozambique and the private investors. Nonetheless, the country was granted an extension to mitigate these weaknesses and will submit a revised scoping study and an EITI action plan for the period 2011-13 for EITI Board consideration.

Political Context

The ruling party, Frente de Libertação de Moçambique (Frelimo), is set to remain the dominant figure in the political and economic landscape throughout the forecast period. President, Armando Guebuza, has consolidated his influence although concerns remain that the leader's management style is undermining the effectiveness of government decision. The underlying political pressure in support of a younger figure for the office has intensified.

With the next general election scheduled for 2014, political debate has revolved around the effectiveness of current strategies for poverty reduction, the changes to electoral law and the implications of the outcomes of the mayoral by-elections held in the cities of Cuamba, Quelimane and Pemba. Despite contrary recommendations from international and local electoral observation bodies, and strong opposition from other parties, the Frelimo controlled parliament passed an electoral law amendment resolution which allows political parties to be members of the National Elections Commission. In spite of earlier threats by the opposition Resistência Nacional de Moçambique (Renamo) leader to boycott the mayoral by-elections, the electoral process ran smoothly, although turnout stood only at 20%, well below the almost 40% from the previous local elections in 2008. The ruling party, Frelimo, achieved overall victories, with the exception of Quelimane where the third party, Movimento Democrático de Moçambique (MDM) achieved a historic victory with the first mayor elected, outside Beira where the MDM leader, Daviz Simango is already mayor. Mozambique's political and social context were characterised by some instability due to the recurring threats of the major opposition party leader, Afonso Dhlakama, to organise nationwide insurgency to protest against the "dictatorship" of the ruling party Frelimo. Opposition will undergo significant change over the next few years, as the previously dominant opposition party, Renamo, is in disarray and may gradually be supplanted by a new challenger, the MDM, to which it is losing talent and support. There are signs of a split emerging within Renamo, with many members growing frustrated with the leadership of Afonso Dhlakama, who is viewed as becoming increasingly out of touch. However, the MDM will have to work hard to capitalise on Renamo's weakness, as the party has yet to make much impact outside Beira, where its leader is mayor.

Social Context & Human Development

Building Human Resources

There have been significant advances in relation to key indicators of human and social development, with a substantial decrease in the areas of child and maternal mortality and an increase in net enrolment rates. According to the United Nations Development Program (UNDP) *Human Development Report 2011*, Mozambique ranks in the top 25 highest performers in the world, measured in absolute term increases, with an average increment of 2.49% since 2000. Despite the loss of one place in the ranking this year, the country fares well in regard to indicators for life expectancy and expected years of schooling. The current low ranking of 184th out of 187 countries is mostly due to a long-lasting low average of the Mean Years of Schooling indicator, by nature slow to upgrade.

Total resources allocated to priority sectors for 2012 amount to 23 355 million meticals (MZN), of which the Education and Health sectors have absorbed MZN 9,609 million, corresponding to 41.1% and 20.3% of total expenditure, excluding Debt Charges Grants. In past years, all efforts were directed to expand access to education and health. The 2012-16 Strategic Plan for Education was submitted to the Council of Ministers. The plan will continue to concentrate on primary education, the main objectives of the sector being to *i*) ensure universal access and retention in schools; *ii*) improve student learning; and *iii*) ensure good governance. However, there is a substantial shift in trends in the Education sector, from high growth to contraction, with fewer students than expected enrolled in 2011. The number of students in primary school ("EP1" cycle) decreased by 3%; and the number of students in upper primary ("EP2" cycle) by 15%. Nevertheless, there has been a slight improvement in pupil-teacher ratio, which was last reported at 58 in 2010, down from 61 in 2009. In 2012 it is estimated that only 8 500 teachers will be hired, of the 15 000 needed.

The shift in primary education to the "cycles and promotion by cycles of learning" is failing to deliver the desired results, leading to a reduction of the completion rates in primary education and negatively impacting the desired completion rates up to 7th grade. Overall completion rates in 2010 suffered a reduction in success rates in all grades. Failure rates were particularly high in final grades, with completion rates at: 63% for the 5th grade; 64% for the 7th grade; 51% for the 10th grade; and only 7% for the 12th grade. In technical and vocational education and training (TVET) and night courses the success rates were even lower. Given those numbers, the achievement of the Millennium Development Goals (MDGs) in education appears less likely.

The major cause of disease and mortality in the country is malaria. Mozambique also has one of the highest incidence of tuberculosis, ranking among the 22 highest TB burdened countries in the world. It is estimated that yearly there are about 40 000 new positive smear cases. Analysis of trends in the health budget show that there has been almost no increase in the recurrent budget allocations, in spite of the fact that salary burden in the budget is anticipated to increase and that the growing health network requires a higher recurrent budget (for maintenance, staff, etc.).

Poverty Reduction, Social Protection & Labour

In Mozambique 80% of the workforce has not completed upper primary school and only 13% completed secondary school. The skills profile poses serious challenges to the country in terms of improving productivity and employability of the labour force. The Government is pursuing an ambitious reform agenda to align the technical and vocational training system to the needs of the market, and to promote the financial sustainability of the professional education system to cope with the challenges of expansion of both quantity and quality of the training provided. This includes increasing private sector involvement in vocational training and monitoring the dynamics of a fast-growing labour force and a fast-changing economy (creation of the Labour Market Observatory).

The September 2010 riots have raised the profile of social protection in the development agenda, which currently represents less than 0.2% of the general budget and covers no more than 8.3% of poor households. The biggest initiative consists of an unconditional cash transfer system to vulnerable groups (elderly, disabled and chronically sick) reaching out to about 150 000 people. In general, the existing schemes have limited coverage, offer fragmented assistance and are not well resourced. In order to implement the National Strategy for Basic Social Security (ENSSB 2010-14) the Government approved the set of Programs for Basic Social Protection in 2012.

It is estimated that 300 000 youths join the labour force every year. To address the pressing challenges of vulnerability and urban unemployment, the creation and rolling-out of safety nets are currently being pursued by the Strategic Plan for the Reduction of Urban Poverty (PERPU) aimed at the inclusion of youth and unemployed people in urban areas in the labour market, by empowering them with adequate skills.

Gender Equality

Mozambique has produced a set of well-designed and well-articulated gender policies over the last decade based on the nation's commitment to gender, including a National Gender Policy since 2006. At this stage in the country's development, the dilemma is how to translate gender policy into action. For example, although the issue of women's and girls' rights to education is widely accepted, at community level much needs to be done to translate these rights into changed structures and practices. HIV/AIDS poses a greater challenge as the prevalence rates show that women, especially young women, are most affected.

Although primary school enrolment of girls has expanded, more needs to be done in order to narrow gender gaps and to increase enrolment of girls in upper primary, secondary levels and in the technical and vocational sector. In higher education, the proportion of women students has remained constant in recent years with a Gender Parity Index (GPI) of 0.49. The country continues to progress in increasing the representation of women in politics and decision-making structures, including at decentralised levels. Strategic actions are also needed to reduce the gender role disparities in rural areas and in formal business.

Thematic analysis: Promoting Youth Employment

Youth unemployment is a key development issue for Mozambique, with a high population growth rate of 2.8% and an estimated 300 000 new entrants into the labour market every year. The country has enjoyed high rates of economic growth in the past decade. However, growth has been largely driven by capital-intensive projects, particularly in extractive industries. Consequently growth has failed to generate sufficient employment and underemployment is widespread. The formal economy is largely urban in nature and accounts for only 32% of all employment. As a result, many of the new entrants into the labour market are forced into marginal jobs in the informal economy, both in rural and urban areas. Poverty is widespread both in rural and urban areas with 54.7% of the population living below the national poverty line of about USD 0.65 (18 MZN) a day. Reduction of poverty levels has stagnated over the past six years, largely due to the failure to generate employment and increase productivity in the agricultural sector.

The civil conflict which came to an end in 1992 left the economy and the education system in ruins and consequently jeopardized attempts to kick-start economic development. The two sectors of the economy which traditionally generate significant employment for youth are agriculture and small and medium-sized enterprises (SME). However, both of these sectors are facing significant constraints. Some 70% of the population lives in rural areas and depends on agriculture for its livelihood. The agricultural sector largely consists of subsistence farming with 99.6% of all farms being classified as small. Agricultural productivity has stagnated over the past ten years with only a minority of farms having access to services and markets. Overall SME growth is constrained by lack of access to affordable capital, heavy red tape and a poor business climate. Currently the SME sector accounts for 42.8% of employment in the country and has been growing at 7% a year. Consequently, the ability of the two sectors to generate employment at a sufficiently high rate, either directly in the sector or indirectly through linkages, is currently limited and will require significant investments and reforms by the government.

Mozambique is estimated to have the lowest education level among its adult population in the world at 1.2 years of formal education. The low skills level of the labour force remains a significant issue both for employers who are unable to engage qualified labourers as well as for promoting a culture of entrepreneurship. Though the education level is improving, net attendance rate for secondary school is only 20%. Education is free, but there are costs associated with uniforms and school supplies which present a burden for the most vulnerable households. The increase in intake in the schools has put the quality of education under pressure and has led the government to lower the requirements for becoming a teacher in order to meet demand. There are indications that the absorption of youth into the education system has meant a temporary reduction of the growth of the labour force which is currently growing at an estimated 0.4% per year. Furthermore, the low education level further makes training of employees a challenge and has led some foreign companies to resort to importing labour to fill key positions. To counter this trend and to promote the “mozambication” of new projects, the government has established quotas for foreign workers, which range from 10% in small enterprises, to 5% in big projects.

The national Vocational Training Institute (IEFP) is turning out 156 000 graduates per year and since 2006 has had in place an Integrated Program for Professional Education (PIREP) with the support of the World Bank and other donors. However, in order to meet labour market demands, IEFP needs to increase its output and update its training courses' curricula. The government already has a draft legislative package under analysis to create a National Authority for Professional Education with a comprehensive steering committee composed of the Ministries of Education and Labour, labour unions and private sector representatives. The new entity will be responsible for co-ordinating the decentralisation and rollout to the provinces of professional education centres, and will be supported by a new Professional Education fund, to be financed through a 1% levy on private sector wages. The provincial centres will be steered by local representatives, and work in co-ordination with the employment centres.

The government's development strategies include a 5-year plan (2010-14), PARP (2011-14) and Urban Poverty Reduction Strategy (2010-14) where employment is a priority. However, there is no specific strategy for promoting youth employment. Following the disturbances in Maputo and elsewhere in September 2010, the pressure on the government to create employment has increased. The government has indicated its interest in expanding work guarantee schemes to include youth, combined with social protection measures for the most vulnerable.

The International Labour Organization (ILO) has developed a Decent Work Country Programme which has youth employment as a key area of focus. However, the programme is not yet fully financed. The Government plans to create an employment observatory in 2012.