August 2020
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ECONOMIC OUTLOOK

AND INFLATION FORECASTS

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Full-fledged members

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[1] Internal and/or external guests may also participate in Monetary Policy Committee meetings, whenever necessary, at the invitation of the body's Chairman.

Foreword

The primary mandate of the Banco de Moçambique (BM) is to maintain price stability so as to ensure the protection of the purchasing power of citizens. This implies keeping inflation low, at one digit, and stable in the medium term. The mandate to make this objective possible is exercised by the Monetary Policy Committee (MPC), a body composed of the Governor, Vice-Governor, BM Administrators and permanent guests. At the same time, the BM is responsible for supervising and maintaining the stability of the financial system.

Price stability also fosters balanced and sustainable economic growth. Price stability reduces the degree of uncertainty of the economic agents and makes it possible to ensure more attractive interest rates, enabling a favorable environment for savings and investment.

To ensure price stability, the MPC defines the policy interest rate, known as the Mozambique interbank money market rate (MIMO). This rate, introduced on 17 April 2017, signals the stance of monetary policy and serves as an anchor for operations in the Interbank Money Market (MMI). It is expected that, through its influence on the overnight interest rates formed in the MMI, the MIMO rate will affect inflation through the expectations, exchange rate and credit channels.

The decision on the MIMO rate is primarily based on inflation projections, always weighing the risks and uncertainties associated with such projections and the economic environment. The MPC recognizes that its decisions affect the economy with a certain time lag, so it adopts a monetary policy stance based on an assessment of the economic and financial outlook and its risks and uncertainties over a time horizon of at least eight quarters. Where inflation projections deviate materially from the primary monetary policy objective set for the medium term, the MPC shall take appropriate policy measures to reverse the trend.

The MPC convenes ordinarily once every two months and, exceptionally, whenever economic conditions so require. The calendar of ordinary MPC meetings is announced at the beginning of each year. However, the body may convene extraordinarily to deliberate on monetary policy aspects, whenever macroeconomic circumstances so require.

The BM values transparency in the communication of its monetary policy. Monetary policy decisions are announced publicly, through the Communiqué of the MPC and/or of a Press Conference chaired by the BM Governor, issued on the same day of the committee meeting.

The Economic Outlook and Inflation Forecasts (CEPI) Report is an additional means for communicating the Monetary Policy Committee's (MPC) decisions. The aim of the CEPI report is to disseminate the factors and rationale behind the measures taken by the MPC, broadening the public´s understanding of objectives and conduct of monetary policy.

Rogério Lucas Zandamela

Governor

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Executive Summary

The Monetary Policy Committee (MPC) of the Banco de Moçambique decided to keep the monetary policy interest rate, MIMO rate, at 10.25%. The decision is based on a worsening of the medium-term inflation outlook and risks and uncertainties amidst a further contraction in economic activity in 2020 and a slower recovery in 2021.

The MPC also decided to maintain the Standing Deposit Facility (SDF) and the Standing Lending Facility (SLF) rates at 7.25% and 13.25% respectively, and to maintain the Reserve Requirement (RR) ratios for liabilities in national currency and in foreign currency at 11.50% and 34.50% respectively.

Inflation is expected to accelerate in the short and medium term. In July, Mozambique's annual inflation stood at 2.80%, up from 2.69% in the previous month. For the short and medium term, prices are projected to rise, mainly reflecting the effect of the depreciation of the Metical and the recovery in fuel prices on the international market, despite weak domestic demand. Nevertheless, inflation is expected to be in the single-digit band, in line with the expectations of the economic agents surveyed in August 2020.

Prospects for contraction of economic activity until the end of 2020 have worsened, followed by a slower recovery in 2021. Domestically, despite the gradual easing of restrictions on economic activity, the adverse effects of COVID-19 on production and demand are expected to continue in the medium term, leading to further contraction in 2020 and a more timid recovery in 2021. In the second quarter of 2020, the economy contracted by 3.25%, after growing by 1.68% in the first quarter.

The availability of foreign exchange in the economy remains at comfortable levels. Since the beginning of the year, the national banking system has bought foreign currency in the domestic market in the amount of USD 3.309 million and sold USD 3.269 million. Moreover, the balance of gross international reserves amounted to USD 3.8 billion, a level that allows covering more than 6 months of imports of goods and services. However, the Metical maintained its trend of depreciation, albeit at decreasing rates.

Fears of pressure on public finances are growing. The forecast of a contraction of economic activity in 2020, associated with the spread of COVID-19 in the country and the escalation of military conflicts in Cabo Delgado, increases the concern of greater pressure on public spending, with emphasis on health, as well as defense and security. Since the last MPC session, domestic public debt, excluding loan agreements and lease contracts and liabilities in arrears, has increased from 160.135 million to 162.424 million meticais.

For the short and medium term, risks and uncertainties in the domestic economy have increased. Since the last MPC, risks and uncertainties have worsened, with emphasis on the community spread of COVID-19 at domestic level and the intensification of military instability in the north of the country. The prolongation of this situation may affect the profile of economic and financial indicators and determine the adoption of corrective measures by the MPC. The next ordinary meeting of the body is scheduled for October 21, 2020.

Chapter I. Recent Developments in International Economy

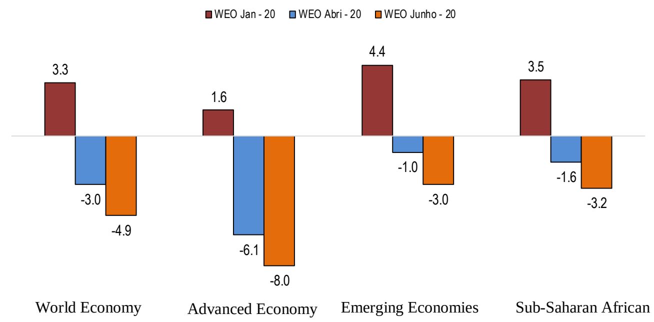
The timid and unsynchronized removal of restrictive measures imposed by the authorities of major economies to mitigate the impact of COVID-19, in a context of increasing numbers of infections, led to a contraction of economic activity in the second quarter of 2020 and confirmed the worsening of the negative growth outlook for 2020 and a slower recovery in 2021. However, the gradual recovery in activity in some economies has stimulated aggregate demand with an impact on inflation, in a context in which the prices of oil and of Mozambique's main export goods have recovered.

Table 1-1: WEO GDP Growth Projections (%) in June 2020

Region	Achieved	Projection	
	2019	2020	2021
World Economy	**2.9**	**-4.9**	**5.4**
Advanced	**1.7**	**-8.0**	**4.8**
U.S.	2.3	-8.0	4.5
Euro Area	1.3	-10.2	6
Germany	0.6	-7.8	5.4
Japan	0.7	-5.8	2.4
United Kingdom	1.4	-10.2	6.3
Emerging and Developing	**3.7**	**-3.0**	**5.9**
Brazil	1.1	-9.1	3.6
India	4.2	-4.5	6.0
China	6.1	1.0	8.2
Sub-Saharan Africa	**3.1**	**-3.2**	**3.4**
South Africa	0.2	-8.0	3.5

Source: IMF

Chart 1-1: Growth Prospects for 2020 (%)



Source: IMF

1.1. Recent Economic Activity and Outlook

Worsening of recession prospects for the main economic blocs.

In the June's edition of the World Economic Outlook (WEO), the International Monetary Fund (IMF) worsened the prospects for negative growth of the world economy for 2020, having updated the projections to -4.9%, against -3.0%, anticipated in April (Table 1-1 and Chart 1-1).

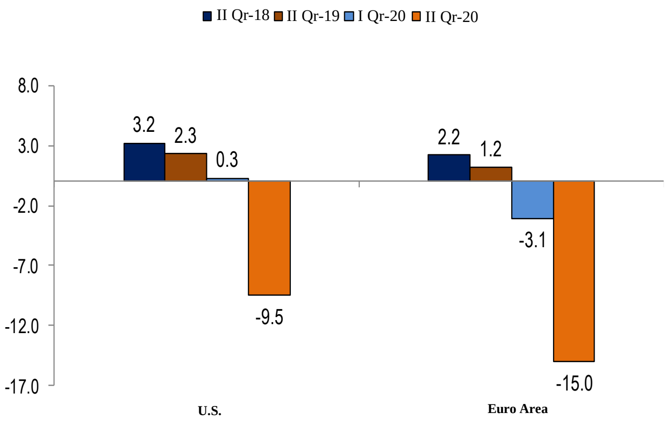
The IMF's new projections are supported by a: (i) synchronized contraction in economic activity in the second quarter; (ii) prolonged and more intense impact of the pandemic in some regions; (iii) limited mobility of people and goods, even with the easing of restrictive measures; (iv) weak global trade; and (v) weak labor market.

According to the IMF, the outlook for the world economy remain surrounded by uncertainties in the face of the pandemic's persistence.

In the second quarter of 2020, the economic activity of Mozambique's main trading partners had a mixed profile.

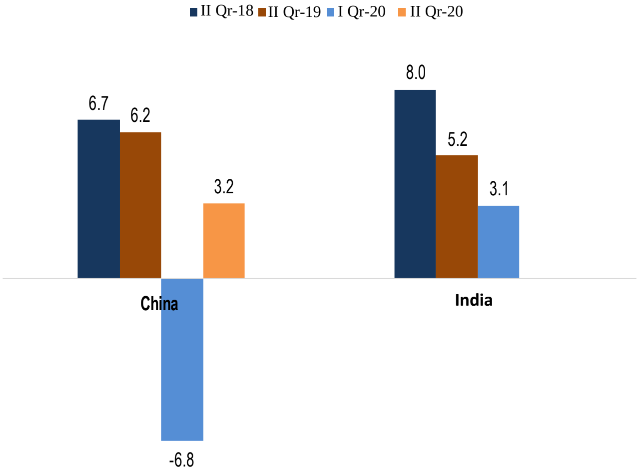
The economic activity contracted in the U.S. and the Euro Area. Preliminary data for the second quarter of 2020 show an economic contraction of 9.5% and 15.0% in the U.S. and Euro Area, respectively (Chart 1-2).

Chart 1-2: U.S. and Euro Area GDP Developments (%)



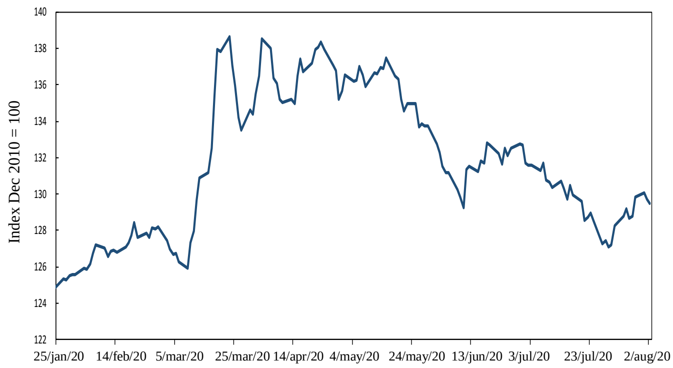
Source: Reuters and Trading Economics

Chart 1-3: Real GDP of China and India (%)



Source*: Reuters* and *Trading Economics*

Chart 1-4: Composite Index of USD against Currencies of Major Trading Partners



Source: *Reuters*

In the period under review, the U.S. became the epicenter of the pandemic, having recorded the highest number of infections, which led to the aggravation of the restrictive measures, leading to a reduction in exports, investment and consumption.

In the Euro Area, negative economic growth is justified by the unsynchronized adoption of policies to combat the virus by Member States, which combined with the restrictions implemented in most of their trading partners, has limited the economic bloc's performance.

China stands out for its signs of recovery. In the second quarter of 2020, China recorded a recovery in economic activity, reflecting positive growth of 3.2% (Chart 1-3).

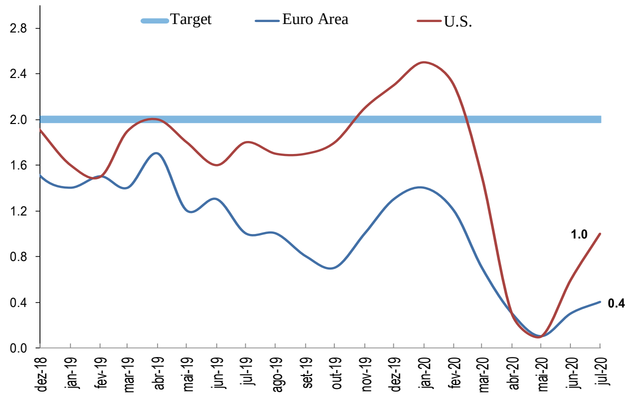
With the pandemic under control, China gradually opened the economy, a factor that allowed progress in investment and domestic consumption. However, a weak performance of the external sector, due to restrictions in the main trading partners, has limited further expansion.

U.S. dollar continues to weaken, reflecting the uncertainties associated with COVID-19.

The prolongation of the pandemic and the significant increase in the number of infections in the U.S. continue to limit its economic activity. This scenario has weakened the dollar in the international market.

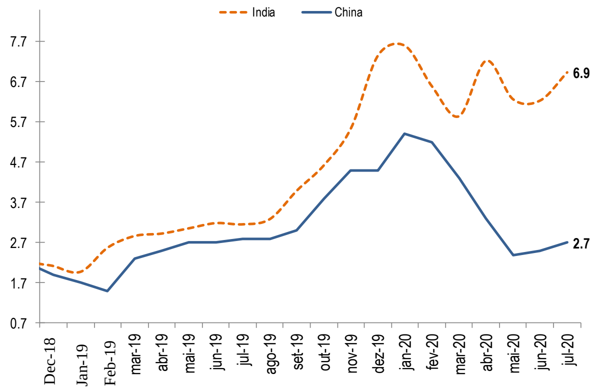
In fact, from the last MPC date up to the second week of August 2020, the USD Composite Index recorded accumulated losses of around 2.38%, mainly against the Euro and the Yuan, which have evolved in the opposite direction, benefiting from the gradual removal of restrictive measures in the Euro Area and China, respectively (Chart 1-4).

Chart 1-5: U.S. and Euro Area GDP Developments (%)



Source: *Reuters and Trading Economics*

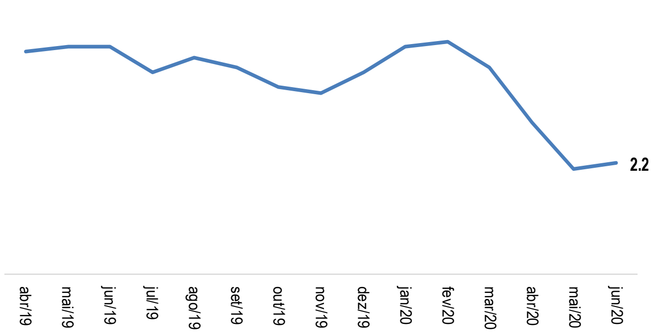
Chart 1-6: Inflation in China and India



Source*: Reuters* and *Trading Economics*

Chart 1-7: Inflation in South Africa (%)

South Africa – Annual Inflation (%)



Source*: Reuters* and *Trading Economics*

Gradual recovery in economic activity generates inflation in the main trading partners.

Preliminary data show that in July 2020, annual inflation in the U.S. and the Euro Area accelerated by 10 basis points (bps) and 40 bps, respectively, reflecting the gradual resumption of economic activity with the relaxation of restrictive measures (Chart 1-5).

In emerging economies, China's inflation accelerated by 20 bp, reflecting a revival in domestic demand, to 2.70% in July.

In India, Inflation accelerated due to the disruption of supply chains brought due to the pandemic. Thus, in July, inflation stood at 6.9%, 70 bp above that observed in the previous month (Chart 1-6).

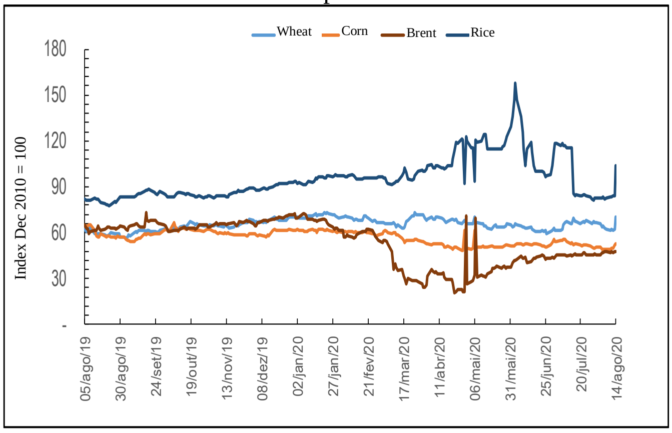
In South Africa, inflation remains stable, reflecting the combination of a pressure on food prices and the drop of fuel and transport prices. In June, the figure was 2.2% (Chart 1-7).

Since the last MPC to date, there has been a general trend towards the maintenance of the reference interest rates. This may reflect the necessary verification of the future performance of the economies after the cuts, in a context where there are some signs of an acceleration in the rate of inflation. However, in response to the COVID-19 effects, the South African Reserve Bank (SARB) reduced the reference rate for the fourth time in a row in July to 3.50%.

1.2. Prices of Main Goods

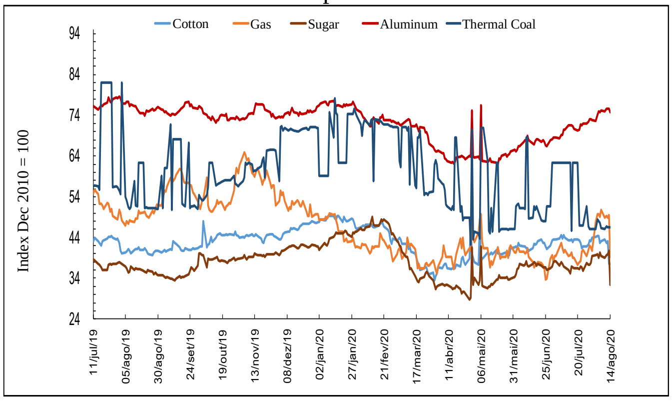
Prices of goods in the international market, with emphasis on oil and Mozambique's main export goods react to the gradual resumption of global demand.

Chart 1-8: Price Index of Imported Goods



Source: *Reuters*

Chart 1-9: Price Index of Exported Goods



Source: *Reuters*

The reduction of crude oil reserves in the U.S., combined with increased demand in the face of the opening of some importing countries, dictated the recovery of the international price of oil.

In fact, from the last MPC to the second week of August, the Brent oil price recorded cumulative gains of 4.4%, being quoted at 47.74 USD / barrel (Chart 1-8).

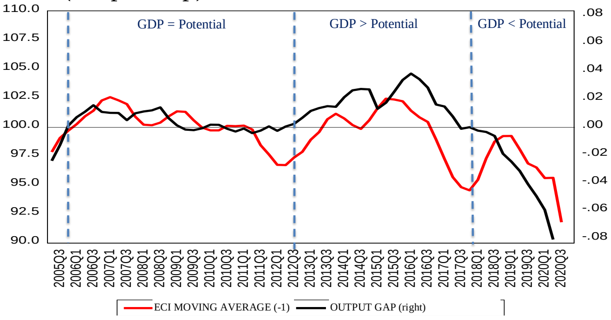
In the same period, the recovery in the price of export products from Mozambique, such as natural gas, aluminum and coal, stands out, with cumulative increases of 42.70%, 9.70% and 8.2%, respectively.

With regards to food, there was mixed behavior during the period under review, with the price of rice falling by 15.10% due to good production prospects in the main exporters. In turn, wheat and sugar prices increased by 4.20% and 10.50%, respectively, reflecting some production concerns in the European Union and Brazil (Chart 1-9).

Chapter II. Recent Developments in Domestic Economy

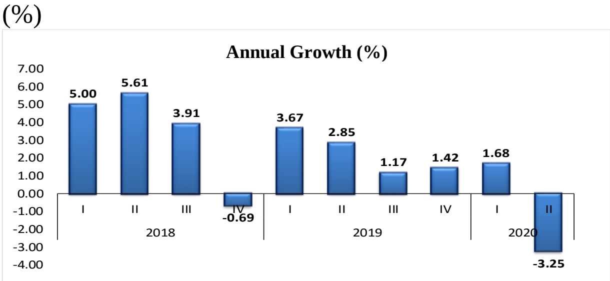
GDP contracted sharply in the second quarter, mainly due to restrictions imposed at global and national levels to mitigate the COVID-19 spread, which supports the forecast of a weak performance of economic activity in 2020. However, the continued increase in credit to the economy and the relative improvement of the Purchasing Managers' Index (PMI) may signalize a minor deterioration of GDP in the III and IV quarters of 2020. Inflation is expected to remain low until the end of the year.

Chart 2-1: Difference between Potential and Observed GDP (Output Gap) and Economic Climate



Source: BM and INE

Chart 2-2: Quarterly real GDP growth - Mozambique (%)



Source: INE

Table 2-1: Dynamics of Mozambique's real GDP by Sector -Annual change (%)

Activity Sectors	**2019**	**2020**	
	II	**I**	**II**
Primary Sector	**1.0**	**-0.3**	**-2.6**
Agriculture	0.4	2.9	3.5
Fishing	6.6	1.5	-1.8
Extractive Industry	2.0	-11.7	-25.6
Secondary Sector	**0.5**	**3.2**	**-2.4**
Electricity and Water	-5.0	6.5	6.3
Processing Industry	2.1	2.5	-5.3
Construction	1.0	1.7	-0.9
Tertiary Sector	**3.4**	**1.3**	**-4.1**
Commerce and Services	1.9	2.9	-5.7
Hotel and Catering	2.4	-1.4	-35.8
Transport and Communications	6.5	5.0	-4.7
Financial Services	9.0	-0.1	-0.6
Public Administration, Education and Health	0.4	-3.0	-2.5
Other Sectors	4.7	2.8	2.0
GDP and cost factor	**2.1**	**1.0**	**-3.3**
Tax on products	9.6	6.2	-2.5
GDP	**2.9**	**1.7**	**-3.3**

Source: INE

II.1. Economic Activity

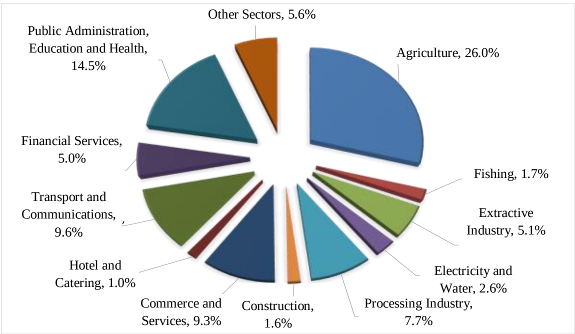
The economy continues to operate below its productive capacity, compounded by the adverse effects of COVID-19. In fact, the output gap, an indicator of the macroeconomic situation that illustrates the observed deviation of GDP from its potential, remains negative, a trend that can be observed in the third quarter of 2020 (Chart 2-1).

The negative performance observed in most sectors of activity reflects the greater severity of the COVID-19 impacts on the domestic economy in the second quarter. Preliminary data from the National Statistics Institute (INE) show that, in annual terms, the economy contracted 3.25% in the II quarter of 2020, after the 1.7% growth observed in the previous quarter (Chart 2-2).

This performance was determined by the deterioration of economic activity in most sectors, notably the extractive and processing Industries, trade, transport and communications, and hotel and catering services. The acceleration of growth in agriculture, with a weight of 26.0%, dampened the negative performance observed in these sectors (Table 2-1 and Chart 2-3).

Weak external demand (Table 2-2), combined with domestic constraints, contributed to the deterioration in the performance of extractive and manufacturing industries, as well as hotels and tourism. In fact, there has been a reduction in exports, reflecting both lower prices charged and lower quantities sold to the rest of the world. With the exception of natural gas, revenues from all products exported by major projects fell during the period under review (Chart 2-4).

Chart 2-3: Sectoral structure of GDP in the second quarter of 2020



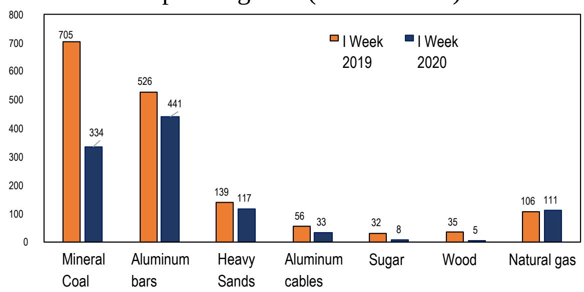
Source: INE

Table 2-2: Trade Balance (million USD)

Description	I Week 19	I Week 20	Change
Balance of goods (1-2)	**-859.85**	**-1,291.74**	**-431.89**
1. Exports of goods - fob	**2,242.38**	**1,711.25**	**-531.14**
Major Projects	1,675.03	1,258.96	**-416.07**
Excluding Major Projects	567.36	452.28	**-115.07**
2. Imports of goods - fob	**3,102.24**	**3,002.99**	**-99.25**
Major Projects	420.49	368.45	-52.04
Excluding Major Projects	2,681.75	2,634.54	-47.21
Balance of Major Projects	**1,254.54**	**890.51**	**-364.03**

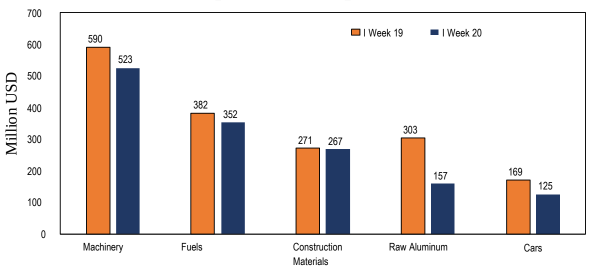
Source: BM

Chart 2-4: Exported goods (million USD)



Source: BM

Chart 2-5: Development of imports (million USD)



Source: BM

On the import side, there is a slight decrease in capital goods (machinery), fuels and building materials, which, despite COVID-19, showed relative rigidity (Chart 2-5).

Finally, the sharp reduction in investment expenditure by the State, in the context of the health crisis triggered by COVID-19, contributed to the contraction of other sectors of activity, especially trade, transport and communication, and public administration (Tables 2-1 and 2-3).

GDP is expected to continue to contract in the third quarter. Despite the gradual easing of restrictive measures imposed on the productive sector from June, the disbursement of funds from partners to respond to urgent and priority expenditure in the health, education and aid sectors, the weak performance of economic activity is expected to continue in the third quarter of 2020.

Meanwhile, the improvement in the Purchasing Managers Index' (PMI) in July 2020 may signal a smaller contraction in economic activity in the third quarter of 2020 (Chart 2-6).

Credit to the economy maintains the growth trend, which may soften the negative performance of GDP in the third quarter. Credit to the private sector continues to increase, reflecting the reduction in the monetary policy interest rate, rising by 2.9% between May and June, from a cumulative change of 7.7% in June to 6.9% in May. In annual terms, credit to the economy increased from 7.8 pp to 10.1% in June 2020 (Chart 2-7).

The distribution of credit to the economy by institutional sector shows that the private sector (companies and individuals) contributed the most to the cumulative change, while non-financial public companies made less significant contributions (Chart 2-8).

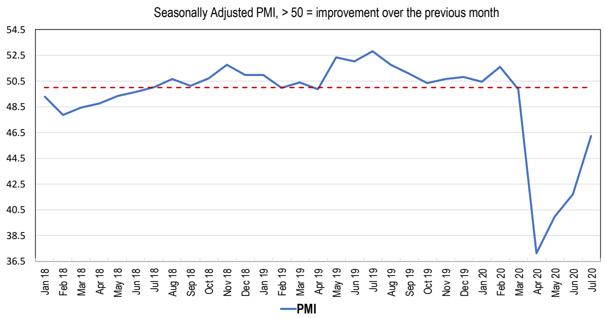
In turn, the breakdown of credit by currency shows that the component in national currency is the one that contributed most to the overall increase of this aggregated value, with a share of

Table 2-3: Implementation of Public Expenditure in 2020 (million MT)

Implementation of Public Expenditure in the I Semester/2020				
(million meticais)	**2020 Law**	**I Week/19 Paid-in**	**I Week/20 Paid-in**	**Change 2020/19**
Current Expenditure	**228,349**	**93,898**	**104,420**	**11.2%**
Staff Expenditure	124,085	56,280	62,288	10.7%
Goods and Services	34,588	10,922	11,763	17.4%
Debt Service	37,323	12,986	14,090	8.5%
Current Transfers	28,645	13,665	15,334	12.2%
Families	22,622	11,000	12,243	11.3%
Investment Expenditure	**70,992**	**23,328**	**9,890**	**-57.6%**

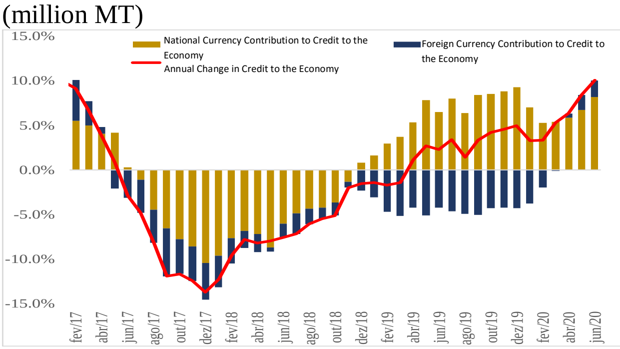
Source: Ministry of Economy and Finance (MEF)

Chart 2-6: Purchasing Managers' Index (PMI)



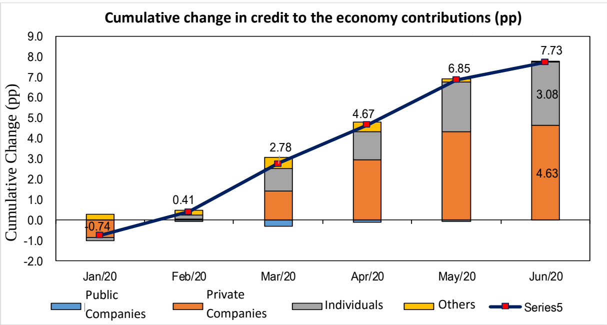
Source: HIS, Markit

Chart 2-7: Development of credit to the economy (million MT)



Source: BM

Chart 2-8: Cumulative change in credit to the economy contributions



Source: BM

8.2 percentage points (pp), in the total change, being the remaining (of 1.9 pp) of the component in foreign currency. (Figure 2-8). With the government's initiatives to support the business sector, in the context of mitigating the impacts of COVID-19, especially on small and medium-sized companies, credit is expected to continue to grow in the coming months.

Despite the improvement in financing conditions, the risks and uncertainties to the national economy remain high, to be assessed by the increase in domestic public debt (Table 2-4).

As measured by Gross International Reserves (GIR), the country's external position remains at comfortable levels, despite the COVID-19 effects on external accounts. In the second half of August, the GIR balance was set at USD 3,895 million, sufficient to cover more than 6.0 months of imports of goods and services, excluding imports from major projects.

The Metical maintains the trend of depreciation against the U.S. Dollar. Since the last MPC, until August 10, 2020, the Metical depreciated against the dollar (1.89%) and the Euro (6.65%), and gained value against the Rand (0.24%). In annual terms, the Metical depreciated against the dollar by 17.37% (Chart 2-9).

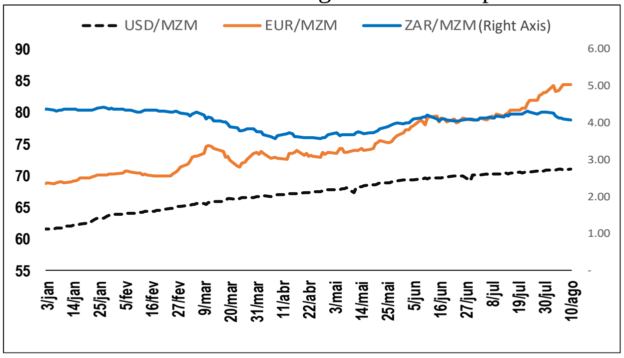
The evolution of the Real Effective Exchange Rate Index (REER) in the period under review shows that Mozambique recorded annual gains in the competitiveness of its exports, as a result of the depreciation of the Nominal Effective Exchange Rate Index (4.62%), in a context of continued stability of the differential between domestic prices and those of the country's main trading partners (Chart 2-10).

Table 2-4: Domestic Public Debt in the form of Treasury Bills and Bonds and BM advances (million MT)

Domestic public debt in the form of T-Bills, T-Bonds and BM advances (million MT)					
	Use of T-Bills	Treasury Bonds	In the BM	Total Debt	Debt as GDP %
Dec – 2014	8,400	18,759	4,500	31,659	6.0%
Dec – 2015	23,475	30,665	4,500	58,640	9.9%
Dec – 2016	11,812	39,566	35,158	86,536	12.6%
Dec – 2017	21,634	39,566	37,757	98,957	12.3%
Dec – 2018	20,957	50,986	40.978	112,921	12.6%
Dec – 2019	**29,671**	**61,817**	**48,067**	**139,555**	**14.6%**
Mar – 2020	34,672	71,226	54,267	160,165	15.7%
Jun – 2020	39,309	71,869	49,754	160,932	15.8%
Jul – 2020	39,309	72,661	49,754	161,724	15.9%
Aug – 2020	39.309	73,361	49,754	162,424	15.9%
Flow (Jun-Aug).	-	**1,492**	-	**1,492**	

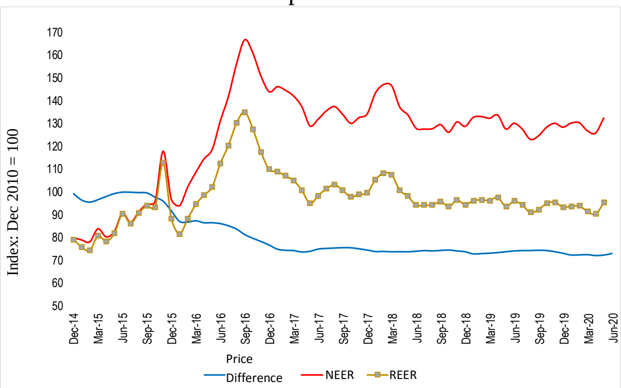
Source: BM

Chart 2-9: Nominal Exchange Rate Developments



Source: BM

Chart 2-10: REER developments

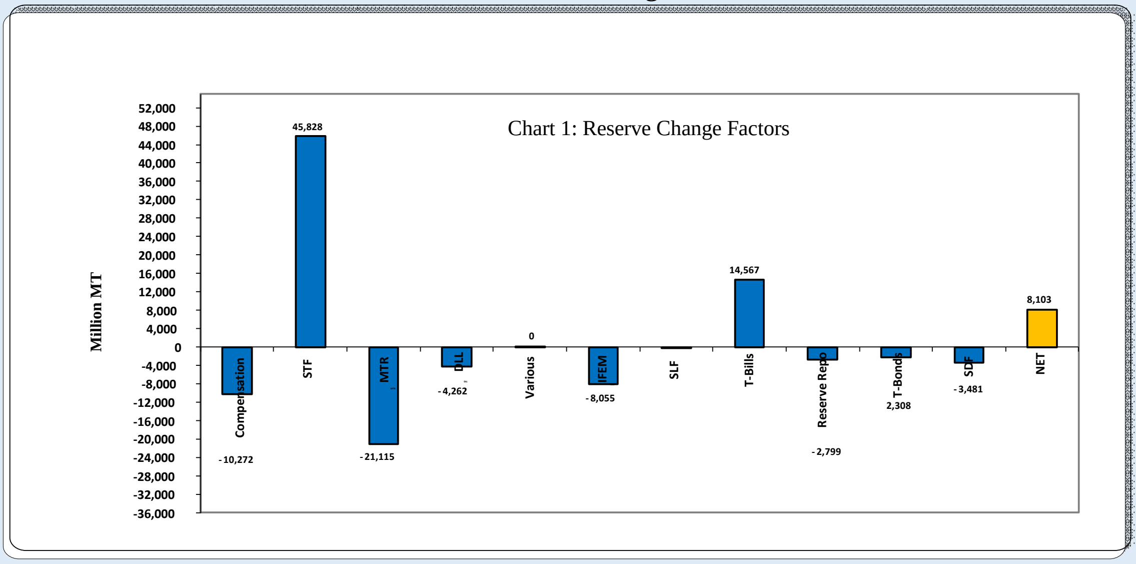


Source: BM

Box 1 : Monetary and Financial Developments

The interbank money market (MMI) continues to be characterized by excess liquidity with an increasing trend. To illustrate this, in the interval between the two sessions of the MPC, the Bank reserves in national currency increased in the order of 8,100.0 million meticais, as illustrated in Chart 1.

Chart 1: Reserve change factors



Source: BM

The increase in bank reserves is mainly justified by the following factors:

- Transfers from the state to the economy via the Electronic Funds Transfer System (STF) in the order of 45,800.0 million meticais; and
- Net reimbursement of treasury bills (T-Bill) in about 14,500.0 million meticais;

However, the increase in bank reserves in national currency was mitigated by the following factors:

- Net negative impact of electronic transfers between commercial banks in real time (MTR), in the order of 21,100.0 million meticais;
- Losses of commercial banks in check clearing of about 10,200.0 million meticais;
- Net foreign exchange sales to commercial banks by the BM in the Interbank Foreign Exchange Market (MCI), in the order of 8,000.0 million meticais;
- Net cash withdrawals, in the order of 4,262.0 million meticais;
- Negative net impact of the Standing Deposit Facility (SDF) operations of around 3,400.0 million meticais;
- Negative net impact of reverse repo operations, in the order of 2,800.0 million meticais; and
- Debt to credit institutions resulting from the issuance of Treasury Bonds (T-Bond), in the order of 2,300.0 million meticais.

Credit institutions complied with the requirement for reserve requirements in the periods of establishment from June 7 to July 6 and from July 7 to August 6, 2020. In fact, bank liquidity (bank reserves minus reserve requirements) was fixed at 982.0 million meticais and 780.0 million meticais respectively in the above periods. The extended liquidity, which includes overnight operations carried out by commercial banks with the BM, increased to 61,269.0 million meticais, after having stood at 49,470.0 million meticais in the previous establishment period.

In turn, potential liquidity, which incorporates Treasury Securities (T-Bills and T-Bonds), increased, on average, to 263,602.0 million meticais in the period of establishment of reserve requirements, from July 7 to August 6, 2020, due to the increase in overnight reverse repo and portfolio T-Bonds (Table 1).

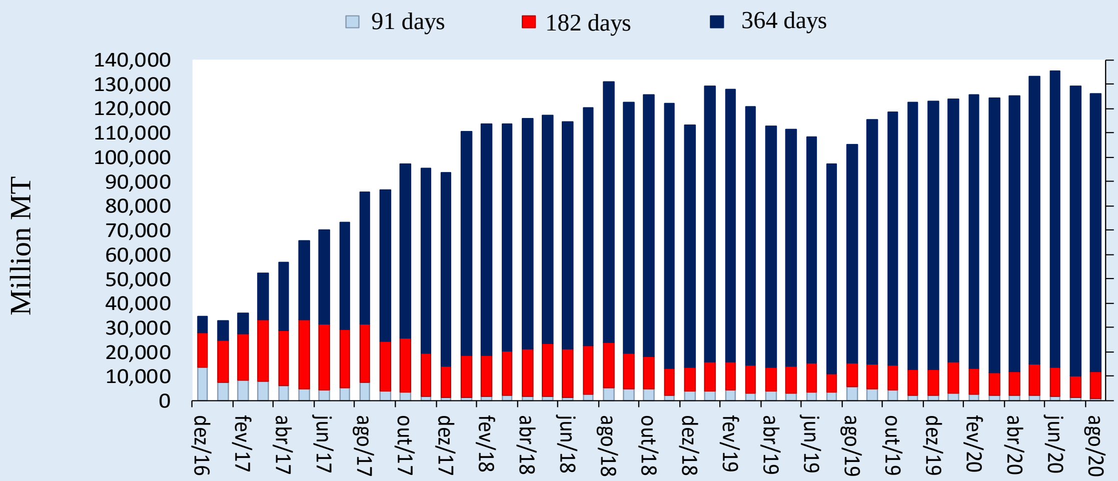
Table 1: Distribution of Bank Liquidity (million MT)[2]

Description	6 – Jun	7 Jun – 6 Jul	7 Jul – 6 Aug	11- Aug
a) Restricted Liquidity = Bank Reserves (RR) - Reserve Requirements (Average Basis)	**723**	**982**	**780**	**-6,668**
SDF	5,157	1,241	1,163	1,210
Reverse Repo	45,613	47,247	59,325	76,598
SLF	170	0	0	0
Repo	0	0	0	0
b) Broad Liquidity = (a) + SDF + R. Repo – SLF - Repo	**51,322**	**49,470**	**61,269**	**71,140**
Treasury Bills (T-Bills)	137,350	137,461	129,646	118,194
Treasury Bonds (T-Bonds)	71,188	71,311	72,687	73,361
(c) Potential Liquidity = (b) + T-Bills + T-Bonds	**259,790**	**258,241**	**263,602**	**262,695**

Source: BM

Thus, in the face of the net repayment of T-Bills, its portfolio stock decreased to 126,214.0 million meticais (Chart 2), divided by the following maturities: (I) 91 days: 910.0 million meticais; (ii) 182 days: 11,189.0 million meticais; and (iii) 364 days: 114,115.0 million meticais, keeping the 364-day term as the most preferred by commercial banks and financial companies, with about 90.41% of the global portfolio.

Chart 2: Portfolio Balance of Treasury Bills

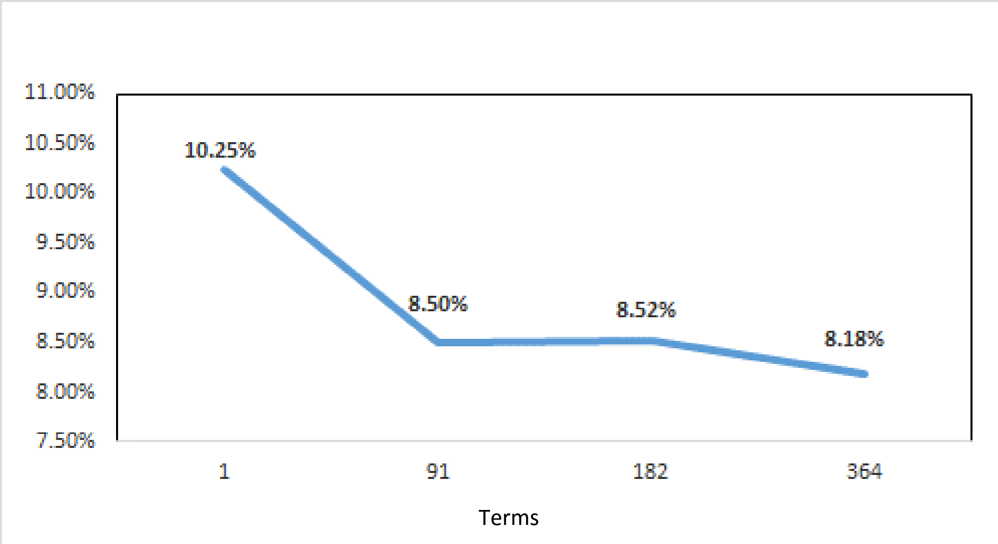


Source: BM

The trend of falling interest rates in the MMI continues, in line with the reduction of the monetary policy interest rate in June of this year and with liquidity conditions in the banking system. In fact, the results of the last T-Bills auction for the reference maturities (91, 182 and 364 days) prior to the August 2020 MPC, indicated that the T-Bills subscription interest rates were 8.50%, 8.52% and 8.18% respectively (Chart 3), representing a decrease of 144, 190 and 231 BP for the 91, 182 and 364-day maturities.

[2] Taking into account the change in the regime for the establishment of reserve requirements (daily to medium), with effect from July 7, 2017, the banks' liquidity is reported in terms of average in the period of establishment, as well as the position on the day of holding the MPC.

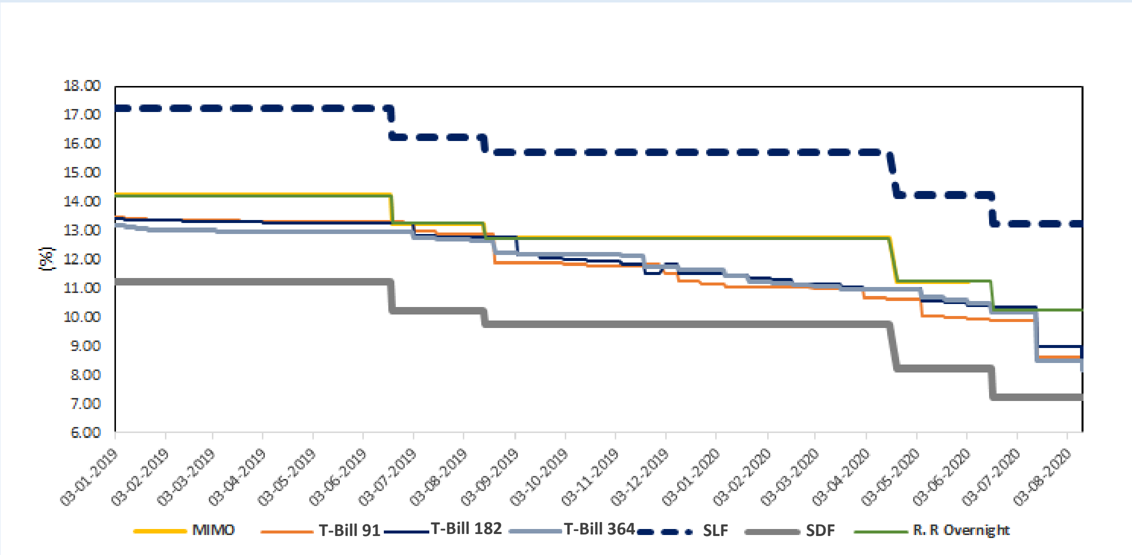
Chart 3: MMI interest rate curve



Source: BM

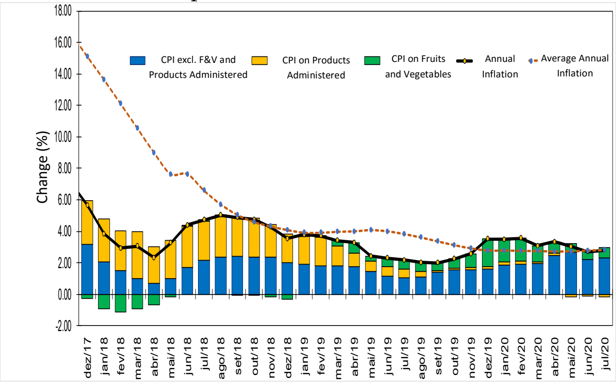
The remaining MMI interest rates continued their downward trend and are in a band bounded by the Standing Lending and Deposit facilities of 13.25% and 7.25% respectively, as shown in Chart 4.

Chart 4: Interbank Money Market Interest Rates



Source: BM

Chart 2-11: Components of Annual Inflation



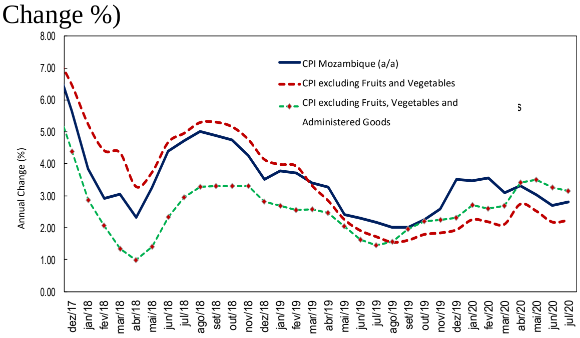
Source: INE / BM

Table 2-5: Core Inflation - Mozambique (Annual Change In %)

	jan/20	feb/20	mar/20	apr/20	may/20	jun/20	jul/20
CPI	**3.48**	**3.55**	**3.09**	**3.32**	**3.02**	**2.69**	**2.80**
Food	**7.65**	**7.88**	**7.29**	**7.34**	**7.23**	**6.59**	**7.40**
Cereals and Derivatives	6.98	6.77	6.17	5.99	3.56	2.82	4.73
Fruits and derivatives	19.28	20.94	14.92	10.38	9.43	9.42	10.69
Administered	**0.82**	**0.83**	**0.28**	**0.60**	**-0.53**	**-1.19**	**-0.67**
Liquid Fuels	-3.25	-3.25	-3.25	-2.31	-3.08	-4.75	-4.99
CPI x F&V	**2.24**	**2.17**	**2.10**	**2.73**	**2.51**	**2.17**	**2.22**
CPI x Admin.	**4.26**	**4.36**	**3.90**	**4.12**	**4.07**	**3.84**	**3.82**
CPI x F&V and Admin.	**2.70**	**2.60**	**2.68**	**3.41**	**3.50**	**3.26**	**3.16**

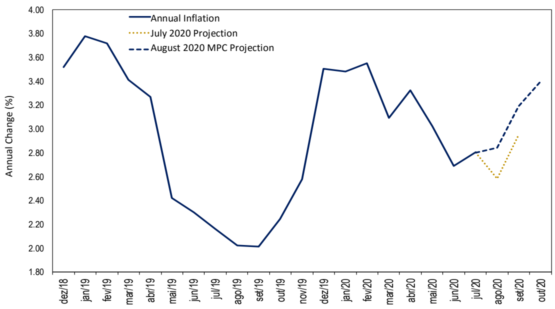
Source: INE

Chart 2-12: Annual Inflation and Core Inflation (Annual Change %)



Source: INE

Chart 2-13: Short-term annual inflation projections and observed annual inflation (%)



Source: BM

II.2. Recent developments in inflation

In July, annual inflation accelerated slightly, reflecting the increase in the prices of the division for "*alcoholic beverages and tobacco* "as well as for "*food and non-alcoholic beverages*". Even so, it is expected to remain low in the short term.

Annual inflation, measured by the change in the Consumer Price Index (CPI), rose from 2.69% in June to 2.80% in July. Meanwhile, annual average inflation consolidated its upward trajectory for the fourth consecutive month, standing at 2.86% in July, after 2.81% the previous month (Chart 2-11).

In terms of components, the acceleration of annual inflation is essentially explained by the increase in the price of cereals and derivatives (4.73%), coupled with the rise in the cost of fruits and vegetables (Table 2-5).

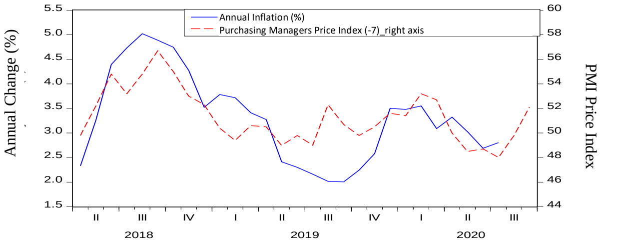
The relative stability of administrated prices favored by the annual decline in the prices of liquid fuels limited the increase in prices. (Table 2-5, Chart 2-11).

Core inflation is slowing slightly. Between June and July, core inflation, which excludes the fruit and vegetable subgroup (the most volatile component of the CPI basket) and the administratively priced products subgroup, recorded a mild annual slowdown to 3.16% in July (Table 2-5 and Chart 2-12).

Short-term prospects point to maintaining the profile of a slight acceleration of annual inflation over the next three months, while remaining low and without compromising price stability objectives. The forecast of a slight acceleration in inflation is mainly justified by the following factors: (I) lower domestic food supply in the face of the end of the fresh season and (ii) easing of restrictive measures to mitigate the impacts of the COVID-19 pandemic (figure 2-13).

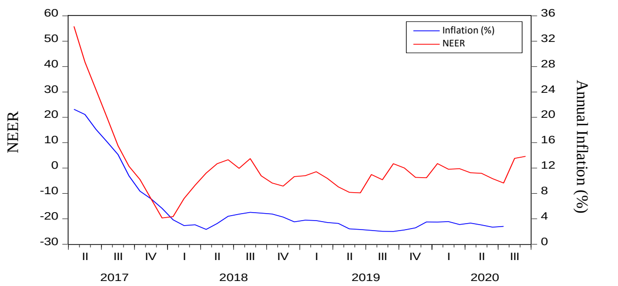
The Purchasing Managers Price Index (PMI) and the Nominal Effective Exchange Rate Index (NEER), considered as leading indicators of domestic price developments (Charts 2-14 and 2-15), support this

Chart 2-14: Price Index in production and annual inflation



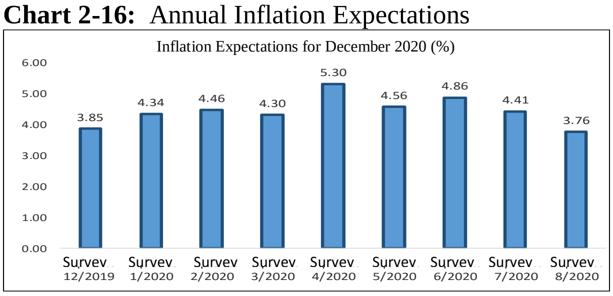
Source: INE / BM

Chart 2-15: Nominal Effective Exchange Rate Index and Annual Inflation



Source: INE / BM

Chart 2-16: Annual Inflation Expectations



Source: BM

Chart 2-17: Diffusion Index and Annual Inflation

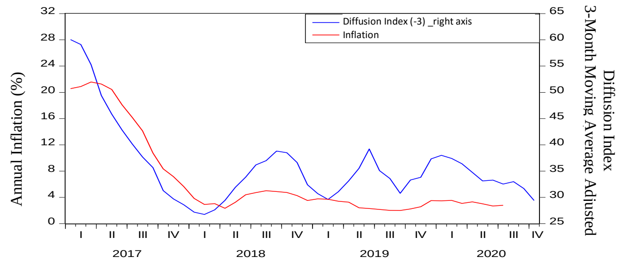
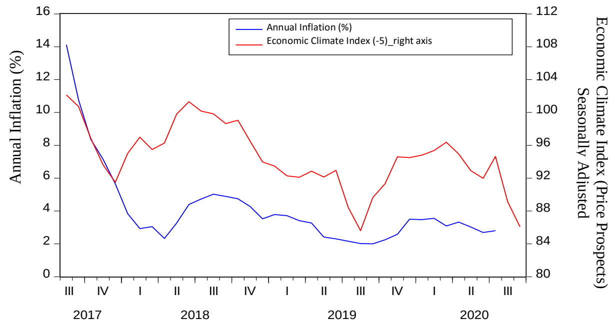


Chart 2-18: ECI and Annual Inflation

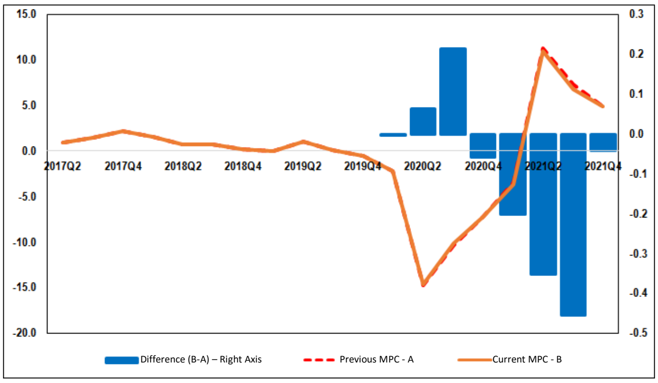


perspective, in a context where both the expectations (Chart 2-16) of annual inflation of economic operators and other leading indicators, specifically, the diffusion and price index of the Economic Climate Index (ECI), signal the easing of inflation pressure (Charts 2-17 and 2-18).

Chapter III: Medium Term Inflation Forecasts

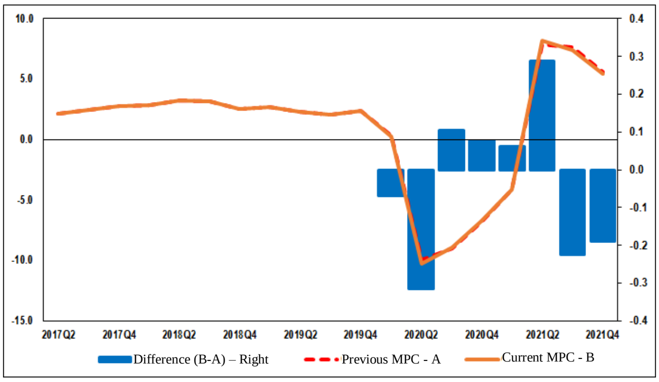
The forecasted inflation for the medium term is higher than in June, while remaining in the single-digit band. The most recent revision reflects mainly the effect of the Metical depreciation, the upward adjustment of the international oil price projections and the inflation observed in July 2020, which was slightly above the projected. Meanwhile, the forecasts of contraction in economic activity in 2020 worsened, reflecting the fall in GDP in the second quarter more sharply than previously anticipated, prolonged negative effects of the restrictions imposed under the COVID-19 prevention measures and the resurgence of military instability, especially in the Northern part of the Country. For 2021, expectations of a gradual recovery in economic activity remain, albeit at a more modest pace than initially anticipated. In view of this macroeconomic outlook and considering the risks associated with the inflation projections, the MPC decided to maintain the MIMO rate at 10.25%.

Chart 3-1: GDP developments in South Africa (%)



Source: GPMN (Global Projection Model Network) / BM

Chart 3-2: Annual growth of U.S. Real GDP (%)



Source: GPMN / BM

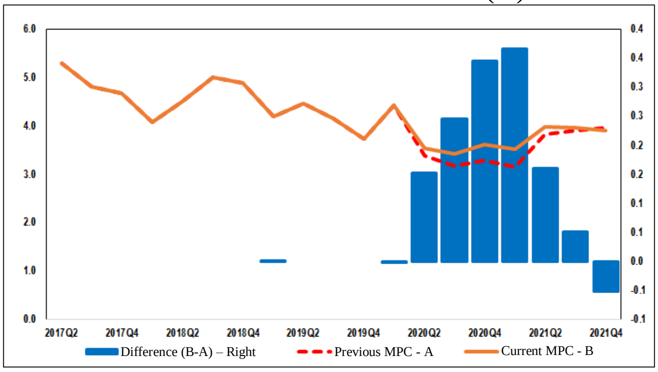
3.1. External Assumptions for Inflation Projections[3]

The prospects of a GDP contraction in South Africa and in the U.S. in 2020 and a gradual recovery in 2021 prevail. In comparison with the June's MPC meeting, the projections for 2020 remain of a contraction of economic activity in South Africa and the U.S. of around 8.6% and 6.4%, and of a gradual recovery in 2021 of around 4.7% and 4.2%, respectively (Charts 3-1 and 3-2).

Slight upward revision of inflation projections in South Africa and maintenance in the US in 2020, trending towards the target in 2021. Compared to June's MPC, inflation outlook for South Africa were revised slightly up to 3.8% in 2020, after 3.6%, while remaining within the 3-6% target. For 2021, the forecasts presented in June, at 3.8%, remain unchanged. In the U.S., the forecast continues to point to an inflation of around 0.9% in 2020 and 2.4% in 2021, against the target of 2% (Charts 3-3 and 3-4).

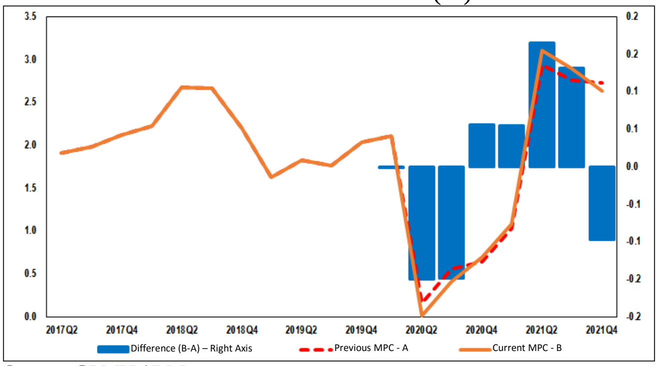
[3] Source: Global Projection Model Network (GPMN)

Chart 3-3: Annual inflation in South Africa (%)



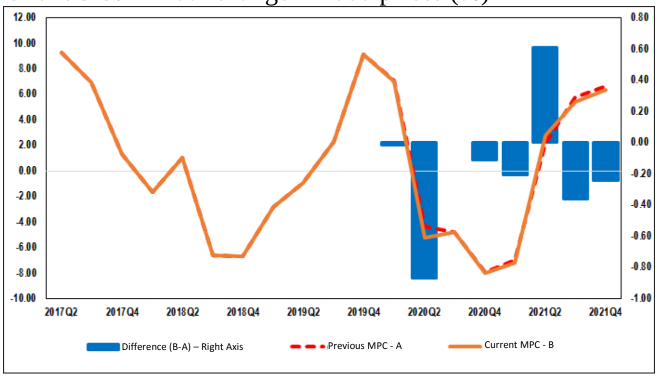
Source: GPMN / BM

Chart 3-4: Annual inflation in the U.S. (%)



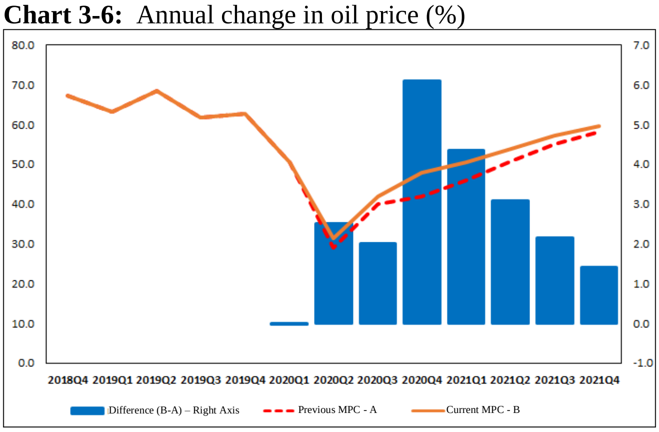
Source: GPMN / BM

Chart 3-5: Annual change in food prices (%)



Source: GPMN / BM

Chart 3-6: Annual change in oil price (%)



Source: GPMN / BM

Slight downward revision of the prospects for food prices in the international market. When compared to June, projections of food prices in the international market, as measured by the Global Projection Model Network (GPMN) price index, were revised slightly downwards, from an annual variation of -2.5% to -2.8% in 2020. On the other hand, for 2021, the trend of a price recovery of around 1.8% in the year remains (Chart 3-5). The downward revision of the projections of food prices on the international market in 2020 reflects a further decline in global demand in the face of prolonged global health crisis.

Upward revision of the oil barrel price in the international market in 2020 and 2021. In the current projections, the price of oil has been revised upwards, in line with the outlook for a gradual recovery in overall economic activity, within a context of cuts in production levels in OPEC member countries (Chart 3-6).

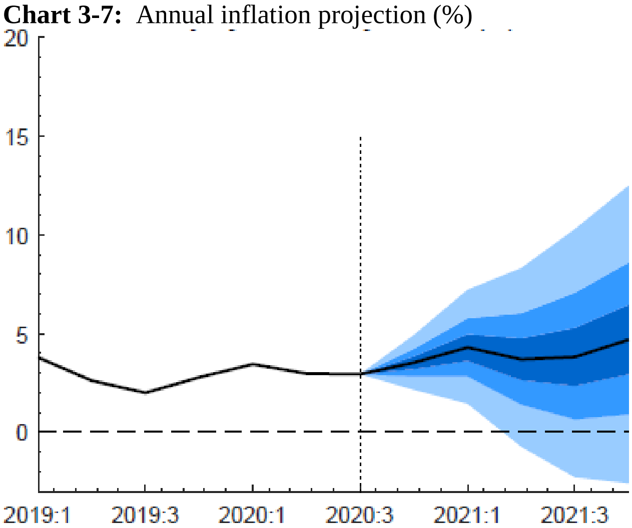
3.2. Internal Assumptions

Contained adjustment in administered goods prices in 2020 and greater likelihood of upward readjustment in 2021. In 2020, the prices of administered goods are assumed to be maintained, in line with the measures adopted by the government to mitigate the effects of COVID-19. However, by 2021, it is expected that those measures will be lifted impacting on prices.

Outlook of a lower exchange rate pressure in the medium term. Despite the accumulated depreciation up to June, the prospects of lower volatility of the Metical remain in the medium term, due to the exchange rate policy measures aimed at containing the COVID-19 impact on the economy, and the inflow of financial support from the cooperation partners, consistent with the reduction in the rate of depreciation observed in recent weeks.

The outlook for greater pressure on public spending remain. In the face of the COVID-19 spread and the resurgence of military instability in the north of the country, amidst prospects of falling public revenues associated with lower economic dynamic, a pressure on public deficit financing is expected to increase. However, the financial support guaranteed by the cooperation partners could ease the pressure.

Chart 3-7: Annual inflation projection (%)



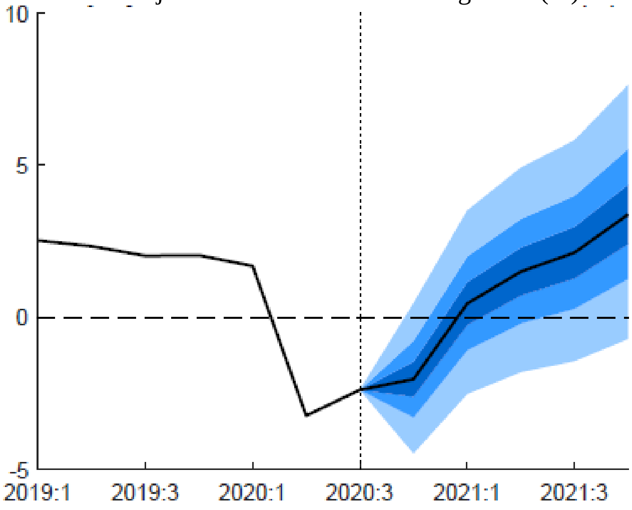
Source: BM

3.3. Forecast Results

Inflation projections were revised upwards in 2020 and 2021, while remaining in the single-digit band. In comparison with the June 2020 forecasts, current BM projections indicate an acceleration of annual inflation in Mozambique (Chart 3-7), essentially reflecting (i) the impact of the Metical depreciation, (ii) the upward revision of the oil price in the international market and (ii) the inflation observed in July 2020, which was slightly higher than previously forecast.

Contraction of GDP in 2020 and slight recovery in 2021. For 2020, the outlook for the contraction of economic activity worsened, reflecting the negative growth of GDP in the II quarter, which was above previous forecast, the increasing spread of the COVID-19 in the country, in addition to military instability in the Northern Zone. In 2021, a more moderate recovery in economic growth is expected, based on the prospects for gradual control of the COVID-19 in the country and globally (Chart 3-8).

Chart 3-8: Projection of annual Real GDP growth (%)



Source: BM

3.4. Assessment of Risks Associated with the Inflation Projections

Compared to the June 2020 session, the risks associated with inflation projections overall worsened.

At the domestic level, the main sources of risk are military instability in the northern and central regions of the country and uncertainties about the magnitude of the impact and spread of COVID-19 on the domestic economy.

Externally, uncertainties remain regarding the prolongation and impact of the COVID-19 pandemic, as well as the worsening of trade and geopolitical tension between the main international powers, which, if materialized, may further limit the prospects for the recovery of the world economy.

3.5. Monetary Policy Decision

Considering the worsening of medium-term inflation prospects, risks and uncertainties, amidst a contraction in economic activity in 2020 and a slower recovery in 2021, the MPC decided to keep the monetary policy interest rate, MIMO rate, at 10.25%.

The MPC also decided to maintain the Standing Deposit Facility (SDF) and the Standing Lending Facility (SLF) rates at 7.25% and 13.25% respectively, and to maintain the Reserve Requirements (RR) for liabilities in national currency and in foreign currency at 11.25% and 34.50% respectively.

The MPC will continue to monitor the economic and financial indicators and risk factors and their impact on inflation forecasts, and may take the necessary corrective measures before its next regular meeting, scheduled for October 21, 2020.