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Foreword

In light of Law 1/92 of January 3, the Banco de Moçambique (BM) shall preserve the value of the national currency and promote a sound and inclusive domestic financial sector.

In the pursuit of this mission, the BM implements macro-prudential policy, aimed at ensuring that the financial system, especially the banking sector, maintains adequate levels of solvency and liquidity, enabling it to contribute to crisis resolution and management, whilst minimising global systemic risk.

The BM defines financial stability as maintaining a robust, efficient and resilient financial system, both to shocks and financial imbalances, that ensures the preservation of confidence among economic agents and contributes to mitigating systemic risk.

To assess systemic risk, the BM relies on a quantitative matrix that presents the dynamics of risk in the domestic financial system, with a view to measuring the resilience of the financial system and enabling timely action to be taken.

The BM produces the Financial Stability Bulletin, to strengthen communication on financial stability between the central bank and the general public. In this edition it highlights the main vulnerabilities and risks in the international and domestic macro-financial context, as well as the performance of the Mozambican financial system in the first half of 2022.

The Governor

Rogério Lucas Zandamela

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Acronyms and abbreviations

Bp	Basis points
BM	Banco de Moçambique
CE/GDP	Ratio of Credit to the Economy to Gross Domestic Product
COVID-19	Infectious disease caused by SARS-CoV-2, discovered in 2019.
D-SIBs	Domestic systemically important banks
DTI	Debt-to-income ratio
FC	Foreign currency
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
ICSF	Credit Institutions and Financial Companies
ISSM	Insurance Supervision Institute
LTV	Loan-to-value ratio
MEF	Ministry of Economy and Finance
MVM	Securities Market
MZN	Metical
NPL	Non-performing loan
Pp	Percentage points
ROA	Return on assets
ROE	Return on equity
SADC	Southern African Development Community
TD	Time Deposits
USD	United States Dollar

Executive summary

In the first half of 2022, the global economy faced increasing risks to economic activity, price and financial stability, in an environment of high uncertainty due to the outbreak of war between Russia and Ukraine and the reintroduction of restrictive measures to contain the COVID-19 pandemic in Asia. These events justified the downward revision of economic growth by the International Monetary Fund and World Bank for the current year, amid increased risks to financial stability, especially in advanced economies, but with no record of a global systemic event affecting financial institutions or markets.

In the domestic context, the 4.37% economic growth contributed to the ongoing moderate systemic risk, reflecting the continued improvement in demand and the recovery of the sectors most affected by COVID-19, following the easing of restrictive domestic and external measures. Even so, the domestic financial system suffered from some vulnerabilities, particularly military instability in the north of the country, coupled with extreme weather events.

The banking sector remained solid and resilient during the period concerned, with growth in earnings and adequate levels of capitalization and liquidity. Meanwhile, in terms of asset quality, the non-performing loan ratio stood at 10.02%, above the acceptable benchmark of 5.00%.

The banking sector recorded an annual increase in the solvency ratio of 116 basis points (bp) to 26.76%, a growth in assets of 6.13% (to 847 billion meticais), an increase in profits of approximately 52.71% and liquidity that enables the continuity of financing operations without any significant change in asset quality (10.02%). In turn, overall production by companies in the insurance sector fell by 6.60% to 4,594.61 million meticais, explained by the decrease in demand by companies, with greater expression for subscription of insurance services. Market capitalization, the main indicator for the Securities Market, recorded a positive variation of 3.73% (reaching 130.365 million meticais).

In the period under review, systemic risk remained moderate, despite the increase in the financial stability index by 3.13 percentage points (pp) compared to December 2021, standing at 40.97% in June 2022. This deterioration was influenced by the increase in the risk sub-indices of the macroeconomic risk and market risk categories.

In order to contain the risks and mitigate the vulnerabilities of the domestic financial system, the BM decided to maintain all the macroprudential policy instruments. In the period concerned, the conservation buffers for domestic systemically important and quasi-systemically important banks remained at 2.0% and 1.0% respectively. The macroprudential lending requirements imposed on credit institutions and financial companies (ICSFs), namely the loan-to-value ratio (LTV) and the debt service to income ratio (DTI), both remained capped at 100%.

I. INTERNATIONAL MACRO-FINANCIAL ENVIRONMENT

The global economy faces increasing risks to economic activity and financial and price stability in an environment of high uncertainty.

The Russia-Ukraine[1] war outbreak's impact on the energy sector, particularly the gas distribution chain, and the reintroduction of restrictive measures to contain the COVID-19 pandemic in Asia, has led to a downward revision of economic growth for 2022.

These events have also strengthened global inflationary pressures, which are mainly associated with the increase in energy and agricultural commodity prices.

The uncertainty created by the war has caused significant volatility in global financial markets, particularly in the countries of Eastern Europe and the Middle East, because of their strong trade ties with Russia.

This scenario contributed to lower equity valuations and higher financing costs, in a context of anticipated normalization of monetary policy in response to the persistent rise in prices.

The acceleration of inflation in the main economies has led central banks to intensify the withdrawal of the monetary stimuli implemented in recent years, to minimise the impact of the crisis caused by the COVID-19 pandemic.

Despite the tightening of monetary policy, real yields on most assets remain negative, which may lead investors to seek riskier opportunities or investments in the real estate market.

Risks to financial stability have increased in the advanced economies, but there is no record of a global systemic event affecting financial institutions or markets.

In developed countries and emerging market economies, financial institutions maintain robust levels of capital and liquidity.

Stress tests conducted by the Central Banks against these settings indicate that the global financial system remains prepared to withstand additional shocks, with

[1] Most notable global event in the half year marked by Russia's invasion of Ukraine on February 24, 2022.

prudential indicators pointing to capital levels above the minimum required.

The hostilities in Europe contributed to a sharp increase in risk premium and large falls in asset prices in advanced economies, including those of systemically important financial institutions, with an impact on the rest of the world.

Emerging market economies, particularly those in Latin America and Eastern Europe, which have large fiscal deficits and heavy dependence on external financing, remain vulnerable to capital outflows as a result of rising interest rates in advanced economies.

In these economies, challenges remain as a result of rising debt as conditions for external financing become tighter, exacerbated by the depreciation of the respective currencies and capital outflows.

The continued rise in housing prices and credit growth has led some regulators to express concerns about the risks of such price adjustments and high household indebtedness.

Corporate indebtedness also remains a concern in some countries, where higher interest rates may increase debt servicing costs.

In addition, international bodies continue to be attentive to areas with cross-border implications for financial stability, namely cyber threats and climate change.

In fact, the focus remains on addressing cyber risks - which are currently considered high - and the resilience of financial systems to those risks.

Regarding climate change, the Financial Stability Board[2] has a roadmap to address climate-related financial risks.

On the other hand, the growth of crypto-assets, including 'stablecoin'[3], continues to be the subject of regulatory attention.

The Financial Stability Board’s assessment points out that this rapidly evolving market segment poses a threat to global financial stability due to its size, structural vulnerabilities and increasing interconnection with the traditional financial system.

[2] The Financial Stability Board is an international body that monitors and makes recommendations on the global financial system. Hosted and funded by the Bank for International Settlements, the board is based in Basel, Switzerland.

[3] It is a type of cryptocurrency with collateral, unlike the others, i.e., it is anchored in real assets, so there is a corresponding asset for each unit of the currency. Like any cryptocurrency, stable coins are created on a block chain, a kind of virtual ledger.

II. VULNERABILITIES AND RISKS IN THE MOZAMBICAN FINANCIAL SYSTEM

The first semester of 2022 was marked by a 4.37% growth in economic activity, reflecting the continued improvement in demand and the recovery of the sectors most affected by COVID-19, following the easing of restrictive measures, at home and abroad.

Such economic performance contributed to maintaining systemic risk moderate, although the domestic financial system did suffer from some vulnerabilities, particularly military instability in the north of the country and extreme weather events (cyclones and floods).

2.1. System vulnerabilities

Despite the vulnerabilities resulting from the successive shocks that have been hindering the domestic economy, the national financial system continued to develop its financial intermediation and payment services activities without disturbance.

Key vulnerabilities include continuing military instability in Cabo Delgado, adverse climatic factors, notably Cyclone Gombe and Tropical Depression Ana, public sector debt and the international market's confidence in the country.

2.1.1. Military instability in the north of the country

The first semester of 2022 was marked by continued military instability in the north of the country, particularly in Cabo Delgado province, despite the reduction in the intensity and frequency of attacks, in a context of calm in the central region of the country, although the Disarmament, Demobilisation and Reintegration process has not yet been concluded.

This instability led to the maintenance of the suspension[4] of Mozambique LNG's onshore project – "TotalEnergies located in the Afungi peninsula".

The uncertainty about the resumption of the exploration activities of the energy resources in the Rovuma basin affects the prospect of economic growth for the country as a result of the expected revenues, despite the progress made in offshore gas exploration, off the Afungi peninsula, by ENI.

[4] Since April 2021.

Military instability in Cabo Delgado is a bottleneck to economic activity and increases government spending on military logistics and humanitarian assistance, while limiting financial inclusion.

2.1.2. Adverse climatic factors

Climate change and environmental degradation have consequences on the financial system and the economy on a global scale.

Mozambique's geographical location exposes the country and makes it vulnerable to adverse weather events, posing a huge threat to macroeconomic stability and the national financial system.

In the first half of 2022, the center and north of the country were affected by Cyclone Gombe and Tropical Depression Ana, confirming the increased frequency of extreme weather events, with an impact on infrastructure (roads, factories, crop fields, among others) and on the well-being of the population, generating economic and social costs.

These extreme events impacted the country's production levels, as a result of the destruction of infrastructure and production, along with the ability of families and companies to honour their commitments with the banking sector.

2.1.3. Public sector debt

In the first half of 2022, the prevalence of pressure on public sector debt with the financial system was noteworthy.

The State's stance drives systemic risk developments, amid high interest rates in auctions of public securities, which leads to greater demand and subscription of these securities by the system.

In fact, domestic public debt increased by 24.26 billion meticais in the first six months of 2022, reflecting the use of Treasury bills to finance the current deficit.

Despite such domestic debt developments, the total debt stock improved, influenced by the reduction in external debt (Table 1).

Table 1. Public debt stock - billions of meticais

Description	**Jun-21**	**Dec-21**	**Jun-22**
External debt	630,10	725,77	657,41
Domestic debt	218,78	226,40	250,66
Total debt	**848,88**	**952,17**	**908,07**

Source: MEF

The inflow of funds from partners for direct support to the State Budget in the period concerned may have contributed to offsetting the pressure on domestic sources of public debt.

The budget execution for the first half of 2022 (Table 2) shows that the pressure on the public expenditure side resulted from general public services, justified by the effort to promote good governance, quality public service delivery, decentralization and integrity of public administration.

Table 2. Evolution of public revenue and expenditure – billions of meticais			
Description	**Jun-20**	**Jun-21**	**Jun-22**
State Revenue	110,21	127,42	**133,89**
State Expenditure	141,87	165,85	**174,19**
Deficit/Financing	**31,66**	**38,43**	**40,30**
Source: MEF			

2.1.4. International market confidence in the country

The first half of 2022 was marked by the resumption of the programme with the IMF, which signals the gradual improvement of the international market's confidence in the country.

The main rating agencies maintained the country's rating at substantial risk in the international market.[5]

Despite the improvement, the substantial risk classification on the international market still imposes restrictions on access to financial markets, which may increase market risk in the domestic financial system[6] in the exchange rate and interest rate components (table 3).

Table 3. Country ranking in the international market[7]

Agency	Dec-19	Dec-20	Dec-21	Jun-22
Moody's	Caa2 (stable)	Caa2 (stable)	Caa2 (stable)	Caa2 (positive)
Standard & Poor's	CCC+ (stable)	CCC+ (stable)	CCC+ (stable)	CCC+ (stable)
Fitch Ratings	CCC	CCC	CCC	CCC

Source: https://countryeconomy.com/ratings

Compared to other SADC countries, Mozambique has one of the lowest ratings, which may be a penalising factor in attracting investment to the country (table 4).

Table 4. International market ranking of SADC countries

Country/Agency	**Moody's**	**Standard & Poor's**	**Fitch Ratings**
Mozambique	Caa2 (positive)	CCC+ (stable)	CCC
South Africa	Ba2 (stable)	BB-(stable)	BB-
Angola	B3 (stable)	B-(stable)	B-(stable)
Zambia	A3 (stable)	SD	RD
Botswana	A3	BBB+ (stable)	
Mauritius	Baa3 (stable)		
Malawi			B-(stable)

Source: https://countryeconomy.com/ratings

[5] Investors use the international market's confidence in the country in order to make investment decisions in a given economy.

[6] Considering the weight of the banking sector in the domestic financial system.

[7] **CCC+**: substantial risk; **Caa2:** substantial risk; **Caa3: substantial risk**; **CCC**: substantial risk; **SD:** default; **RD:** default.

2.2. Systemic risk assessment

Systemic risk can be defined as the risk of disruption in the provision of financial services caused by problems in some or all institutions of the financial system, with negative consequences for the real economy.

In order to assess systemic risk[8], the Banco de Moçambique uses a quantitative tool composed of 19 indicators, grouped into six risk categories, namely:

(i) macroeconomic risk;
(ii) sovereign risk;
(iii) profitability and solvency risk;
(iv) credit risk;
(v) funding and liquidity risk; and
(vi) market risk.

On the other hand, systemic risk is measured through a financial stability index and can be classified as low, moderate, high or severe.

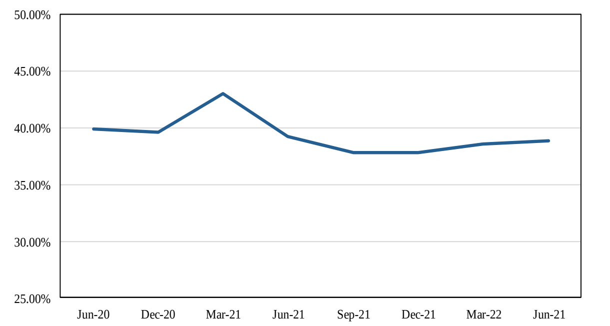
In the period concerned, systemic risk remained moderate, despite the increase in the financial stability index by 3.13 pp compared to December 2021, standing at 40.97% in June 2022.

Such exacerbation was influenced by the increase in the risk sub-indices of the macroeconomic risk and market risk categories, which rose from 50.00% and 31.25%, in December 2021, to 62.50% and 37.50%, respectively, in June 2022.

Year-on-year, the financial stability index increased by 1.73 pp, after 39.24% recorded in June 2021.

Charts 1 and 2 show the evolution of systemic risk at the global level and in the categories that make up the financial stability index, from June 2020 to June 2022, and from December 2021 to June 2022, respectively.

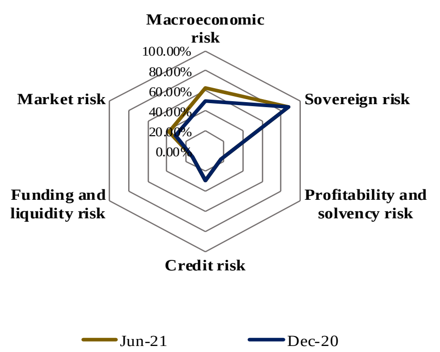
Chart 1. Global systemic risk index



Source: BM

[8] In the Mozambican banking sector

Chart 2. Systemic risk developments (%)



Source: BM

The analysis by risk category shows the following:

2.2.1. Macroeconomic risk

In June 2022, the macroeconomic risk remained high[9], influenced by inflation rate exacerbation, despite the improvement in the performance of the economy during the semester.

Table 5. Macroeconomic risk indicators

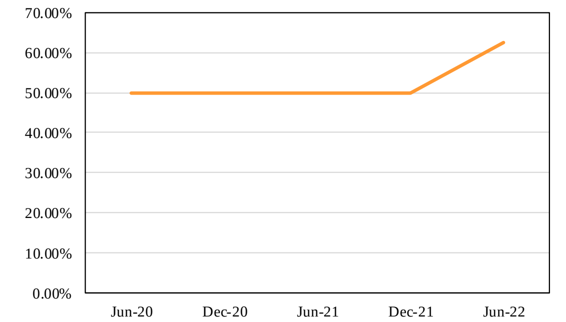
Macroeconomic risk (recorded values)					
	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
GDP - growth rate	-3.54%	-1.77%	1.96%	3.32%	4.59%
Inflation	2.69%	3.52%	5.52%	6.74%	10.81%

Source: BM and INE

In fact, Gross Domestic Product (GDP) grew, in annual terms, by 4.59% in June 2022, following 3.32%, signalling moderate risk, in December 2021, which largely contributed to maintaining macroeconomic risk high.

On the other hand, the inflation rate rose by 4.07 pp, from 6.74%, signalling high risk, in December 2021, to 10.81%, signalling severe risk, in June 2022, driving an increase in the sub-index of the category risk, from 50.00% to 62.50%. The year-on-year increase was 5.52 pp, after inflation of 5.52%, signalling moderate risk, in June 2021.

Chart 3. Developments in macroeconomic risk



Source: BM and INE

2.2.2. Sovereign risk

In June 2022, sovereign risk remained at the severe level[10], influenced by continued high levels of State debt.

In June 2022, the ratio of Government loans to total loans increased by 0.66 pp compared to December 2021, to 45.40%.

Table 6. Sovereign risk indicators

Sovereign risk (recorded values)					
	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
Credit to Government/Total Credit	45.14%	39.76%	44.64%	44.74%	45.40%
Public debt/GDP	89.58%	97.35%	87.11%	92.19%	87.92%

Source: BM and INE

[9] The macroeconomic risk category index settled at 62.50% in June 2022, after 50.00% in December and June 2021, respectively.

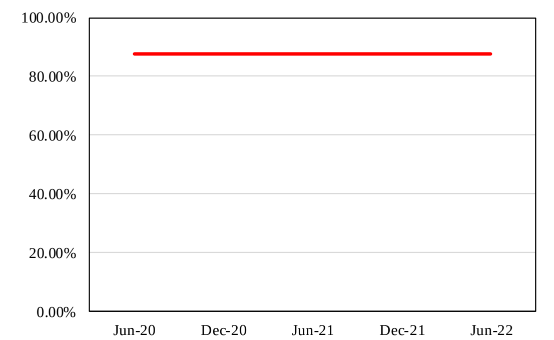
[10] In June 2022, the sovereign risk category index stood at 87.50%, a percentage also recorded in December and June 2021, respectively.

In year-on-year terms, the ratio increased by 0.75 pp, after 44.64%, signalling severe risk.

In turn, the ratio of public debt to GDP decreased by 4.27 pp, from 92.19% in December 2021 to 87.92% in June 2022, although the indicator remained severe. In year-on-year terms, the ratio of public debt to GDP increased by 0.81 pp.

This variation was influenced by the fall in total debt by 4.63%, specifically in the external component (with the greatest weight in the total), which fell by 9.42%, even though the internal component registered an increase of 10.72%.

Chart 4. Evolution of sovereign risk



Source: BM and INE

2.2.3. Profitability and solvency risk

Profitability and solvency risk remained low[11] during the first half of 2022, signalling that the system remains profitable, financially robust and resilient to the negative effects of the adversities faced recently.

Table 7. Profitability and solvency indicators

Rendibility and sovency risk (recorded values)	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
ROA	2.41%	2.20%	2.92%	3.10%	3.29%
ROE	20.17%	18.75%	24.62%	25.15%	26.40%
Cost-to-Income	62.45%	62.05%	57.08%	53.75%	53.34%
NPL Coverage	75.00%	74.09%	75.26%	72.63%	67.99%
Leverage	11.69%	12.46%	12.20%	13.27%	12.92%
Solvency ratio	25.44%	27.18%	26.62%	26.71%	27.33%

Source: BM and INE

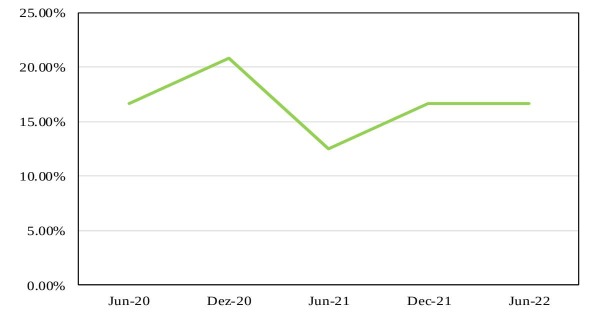
Regarding profitability, the indicators show a growth in results, with return on assets (ROA) increasing by 0.19 pp compared to December 2021, to 3.29% in June 2022.

In addition, return on equity (ROE) increased by 1.24 pp, to 26.40%, in the same period, which favoured the maintenance of the category's low risk.

Profitability also experienced a year-on-year increase, given that ROA and ROE increased by 0.37 pp and 1.30 pp, respectively.

[11] In June 2022, the yield and solvency risk category index stood at 16.67%, after 16.67% in December 2021 and 12.50% in June 2021.

Chart 5. Evolution of profitability and solvency risk



Source: BM and INE

The good performance of the banking sector in the semester contributed to the strengthening of solvency levels, with the basic solvency ratio standing at 27.33% in June 2022, following 26.71% and 26.62% in December and June 2021, respectively.

2.2.4. Credit risk

In June 2022, credit risk remained moderate[12] , driven by the stability of the indicators concerned.

Table 8. Credit Risk Indicators

Credit risk (recorded values)					
	Jun-20	Dez-20	Jun-21	Dez-21	Jun-22
CE/GDP ratio	-4.15%	-2.82%	-3.87%	-2.77%	-5.30%
NPL	12.63%	9.83%	9.92%	10.60%	10.02%
Credit to economy - growth	9.75%	14.62%	8.90%	2.66%	1.20%

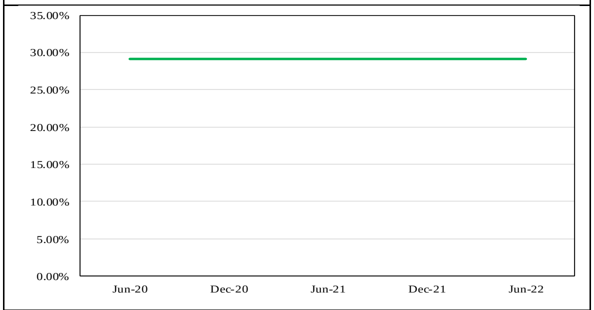
Source: BM and INE

In fact, the growth in credit to the economy slowed by 1.46 pp, from 2.66% in December 2021 to 1.20% in June 2022, equivalent to the low risk.

As regards the gap in the CE/GDP ratio, it evolved in the same direction and remained at low risk, standing at -5.30% in June 2022, following -2.77% and -3.87% in December and June 2021, respectively.

On the other hand, in June 2022, the ratio of non-performing loans stood at 10.02%, signalling high-risk, following 10.60% and 9.92% in December and June 2021, respectively.

Chart 6. Evolution of credit risk



Source: BM and INE

2.2.5. Funding and liquidity risk

Funding and liquidity risk remained low[13], reflecting the high liquidity in the market and the slowdown in the growth of credit to the economy.

Table 9. Funding and liquidity risk indicators

Funding and liquidity risk (recorded values)					
	Jun-20	Dez-20	Jun-21	Dez-21	Jun-2
Loans/Deposits ratio	53.64%	48.94%	51.07%	50.22%	48.07
Short term liquidity coverage ratio	57.80%	58.54%	56.90%	68.30%	68.81

Source: BM and INE

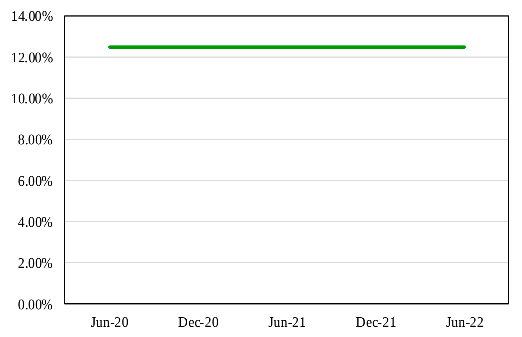
[12] In June 2022, the credit risk category index stood at 29.17%, a percentage also recorded in December and June 2021.

[13] In June 2022, the funding and liquidity risk category index stood at 12.50%, a percentage also recorded in December and June 2021.

In fact, the short-term liquidity coverage ratio remained low and stood at 68.81% in June 2022, following 68.30% and 56.90% in December and June 2021, respectively.

Regarding the ratio of transformation of deposits into loans, this registered a reduction of 2.15 pp and 3.00 pp, compared to December and June 2021, respectively, standing at 51.07% in June 2022.

Chart 7. Evolution of funding and liquidity risk



Source: BM and INE

2.2.6. Market risk

In June 2022, market risk was slightly higher than in December 2021, influenced by the increase in the Prime Rate of the financial system, despite remaining moderate.

As a matter of fact, the Prime Rate of the financial system increased by 2.00 pp during the semester, rising from 18.60%[14], in December 2021 to 20.60% in June 2022, equivalent to severe risk.

Table 10. Market risk indicators

Market risk (recorded values)					
	Jun-20	Dez-20	Jun-21	Dez-21	Jun-22
USD/MZM volatility	5.07%	3.62%	-5.84%	0.00%	0.05%
Credit in Foreign currencies/Total credit	21.08%	21.63%	21.14%	17.53%	20.40%
Deposits in foreign currencies/Total deposits	28.86%	28.46%	25.49%	25.84%	27.45%
Prime Rate - Financial system	16.90%	15.90%	18.90%	18.60%	20.60%

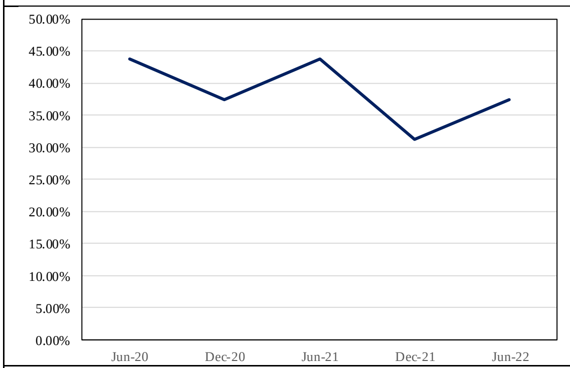
Source: BM and INE

This rise in the Prime Rate resulted in the market risk sub-index increasing by 6.25 pp to 37.50% in June 2022.

The ongoing moderate market risk during the period concerned was driven by the stability of the other indicators in the category.

In fact, the ratio of foreign currency (FC) loans to total loans, ratio of FC deposits to total deposits and quarterly volatility of the MZN/USD exchange rate remained at low and moderate risk, respectively.

Chart 8. Evolution of market risk



Source: BM and INE

[14] Corresponding to high risk level.

Box 1. Methodology for the calculation of the financial stability index

The systemic risk assessment is based on a financial stability index that is determined through a systemic risk matrix, composed of 19 risk indicators and grouped into six risk categories, which correspond to the main sources of systemic risk in the Mozambican banking sector, namely:

- macroeconomic risk;
- sovereign risk;
- profitability and solvency risk;
- credit risk;
- funding and liquidity risk; and
- market risk.

Four risk levels were established for each indicator, characterised by limits that define them, namely: i) range of values associated to low risk; ii) range of values associated to moderate risk; iii) range of values associated to high risk; and iv) range of values associated to severe risk.
Given the disparate nature of the indicators and different measurement units, the observed values are coded according to the corresponding risk ranges, as illustrated in the table below:

Table 11. Level Risk Classification

Risk levels	**Low**	**Moderate**	**High**	**Severe**
Risk ranges	0% - 25%	25% - 50%	50% - 75%	75% - 100%
Risk weights	12.50%	37.50%	62.50%	87.50%

Table 12 shows the risk ranges of the 19 systemic risk indicators.

The first step in determining the general financial stability index is to calculate the index for each risk category, which is obtained from the average of the weighted risk values of the respective indicators. In turn, the financial stability index is determined through the average of the indices of the risk categories.

Systemic risk can be classified as low, moderate, high and severe in accordance with the risk range in Table 4, corresponding to the percentage of the financial stability index.

Table 12. Risk ranges of the 19 systemic risk indicators

Indicators	Low	Moderate	High	Severe	Risk direction	
Macroeconomic risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
GDP growth	8,00% - 5,00%	5,00% - 3,00%	3,00% - 1,50%	≤ 1,5%	100.00%	-100.00%
Inflation	2,00% - 4,00%	4,00% - 6,00%	6,00% - 10,00%	≥ 10%	-100.00%	100.00%
Sovereign risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
Credit to Government/Total Credit	< 10,00%	10,00% - 20,00%	20% - 30,00%	≥ 30%	0.00%	100.00%
Public Debt/GDP	< 40,00%	40,00% -60,00%	60,00% - 80,00%	≥ 80%	0.00%	100.00%
Rendibility and solvency risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
ROA	> 2,00%	2,00% - 0,75%	0,75% - 0,25%	≤ 0,25%	100.00%	-100.00%
ROE	> 10,00%	10,00% - 5,00%	5,00% - 2,50%	≤ 2,50%	100.00%	-100.00%
Cost-to-Income	< 60,00%	60,00% - 80,00%	80,00% - 90,00%	≥90,00%	0.00%	100.00%
NPL Coverage	>75,00%	75,00% - 50,00%	50,00% - 25,00%	≤ 25,00%	100.00%	0.00%
Leveraage	> 10,00%	10,00% - 8,00%	8% - 6,00%	≤ 6,00%	100.00%	0.00%
Solvency ratio	> 16,50%	16,50% - 12,00%	12,00% - 10,00%	≤10%	100.00%	0.00%
Credit risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
CE/PIB Hiato	< 0,00	0,00 - 0,02	0,02 - 0,03	≥0,03	-1.00	1.00
NPL	< 5,00%	5% - 10,00%	10% - 15.00%	≥ 15%	0.00%	100.00%
Credit to economy - growth	< 15,00%	15.00% - 20.00%	20% - 30%	≥ 30%	-100.00%	100.00%
Funding and liquidity risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
Loans/Deposits ratio	< 70,00%	70,00% - 85,00%	85,00% - 90,00%	≥ 90%	0.00%	100.00%
Short term liquidity coverage ratio	> 40,00%	40,00% -15,00%	15,00% - 10,00%	≤ 10%	100.00%	0.00%
Market risk						
Indicators	**Risk range**				**Risk direction**	
	Low	**Moderate**	**High**	**Severe**		
USD/MZM volatility	0,00% - 2,00%	2,00% - 4,00%	4,00% - 6,00%	≥ 6.00%	0.00%	100.00%
Credit in foreign currencies/Total credit	< 25,00%	25.00% - 50.00%	50.00% - 75.00%	≥ 75.00%	0.00%	100.00%
Deposits in foreign currencies/Total deposits	< 25,00%	25.00% - 50.00%	50.00% - 75.00%	≥ 75.00%	0.00%	100.00%
Prime Rate - Financial system	< 10,00%	10.00% - 15.00%	15.00% - 20.00%	≥ 20.00%	0.00%	100.00%

Box 2. Methodology for calculating D-SIBs

Background

As provided by Aviso No. 10/GBM/2018 (Notice), of October 22, the BM periodically carries out, for macroprudential purposes, the identification of systemically important credit institutions operating in the Mozambican financial system, with the aim of minimising the negative repercussions that imbalances in this type of institution may cause on the economy, as well as preserving their normal operation in the following areas:

(i) Making resources available to the public and the economy at large, in satisfactory quantity and quality;

(ii) Taking deposits and granting credit to companies, households and the public sector;

(iii) Exchanges of funds among themselves in the Interbank Money Market;

(iv) Provision of resources to the State through the acquisition of bonds, bills and other treasury securities; and

(v) Other basic functions related to financial intermediation and the payment mediation business.

Thus, all credit institutions in the Mozambican banking sector are important in the sense that most receive deposits or other types of (repayable) funds from the public in order to apply them for their own account by granting credit, and seek to ensure that savings are channelled into investment in the financial markets through the purchase and sale of financial products.

The difference between a normal domestic credit institution and a systemically important domestic credit institution (D-SIB) is that, should the latter collapse, it has the potential to cause significant disruption to the banking sector, the financial system and economic activity in general.

Methodology

The determination of systemically important domestic credit institutions is based on an average score of three key pillars, with different weights:

Category	Indicators		Weight
Size (50%)	Balance sheet total assets	A	25%
	Number of branches	B	25%/3
	Number of ATMs	C	25%/3
	Number of POS	D	25%/3
Interconnection (25%)	Intra-financial system resources (assets)	E	25%/3
	Liabilities of the intra-financial system	F	25%/3
	Securities in portfolio	G	25%/3
Substitutability (25%)	Payment activity	H	25%

It should be noted that the Resources and Liabilities of the intra-financial system are the liquidity swaps in the IMM (liquidity loans between banks, mostly without collateral) where the originator credit institutions' transactions are Resources (assets), and the acquirers are Liabilities;

Payment activity refers to all debit and credit operations from each credit institution's account with the Bank of Mozambique carried out in December of each year.

Based on banking sector data reported to December of the previous year, the final score of each credit institution is calculated using the following formula:

$$Pontuação_{ICi} = \left(\left[25\%\left(\frac{A}{\sum_i^n A}\right) + \frac{25\%}{3}\left(\frac{B_i}{\sum_i^n B} + \frac{C_i}{\sum_i^n C} + \frac{D_i}{\sum_i^n D}\right)\right] + \cdots + \frac{25\%}{3}\left(\frac{E_i}{\sum_i^n E} + \frac{F_i}{\sum_i^n F} + \frac{G_i}{\sum_i^n G}\right) + 25\%\left(\frac{H}{\sum_i^n H}\right)\right) * 1000$$

Classification

According to the score resulting from the application of the above-mentioned regulations, credit institutions are classified into:

- **Systemically important** - credit institutions whose score value exceeds 130 points **(D-SIBs);**
- **Quasi-systemically important** - credit institutions whose score is between 65 and 130 points **(Quasi D-SIBs);**
- **Without systemic importance** - credit institutions whose score is below 65 points.

Conservation buffers

D-SIBs and Quasi-D-SIBs are subject to a conservation buffer that complies with the tiers set out in the table below:

Buffers	Scores
Tier 4 (+5.0% Capital Tier 1 and 2)	430-529
Tier 3 (+4.0% Capital Tier 1 and 2)	330-429
Tier 2 (+3.0% Capital Tier 1 and 2)	230-329
Tier 1 (+2.0% Capital Tier 1 and 2)	131-229
Tier 0 (+1.0% Capital Tier 1 and 2)	065-130

III. PERFORMANCE OF THE FINANCIAL SYSTEM

3.1. Banking sector

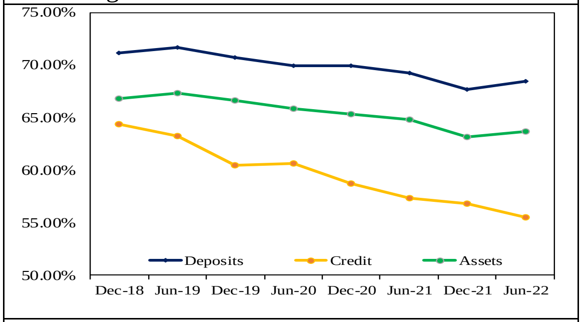
The banking sector remained solid and resilient during the period concerned, with growth in earnings and adequate levels of capitalisation and liquidity. Meanwhile, in terms of asset quality, the non-performing loan ratio stood at 10.02%, above the standard benchmark of 5.0%.

3.1.1. Concentration levels in the banking sector

Last June, the Mozambican banking sector showed moderate concentration according to the Herfindhal - Hirschman Index (HHI)[15].

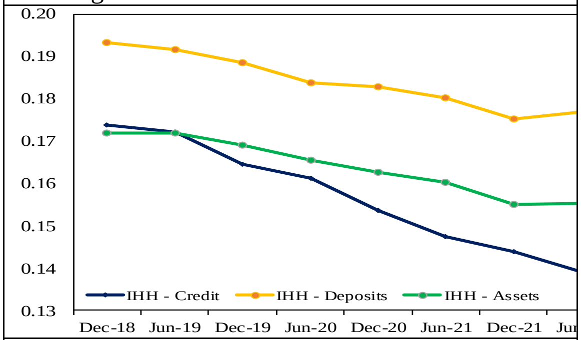
The three largest systemically important banks together concentrated 63.67% of total assets, 68.45% of deposits and 55.53% of credit in the banking sector (Chart 9), and the HHI concentration index stood at 0.150 (0.155 in June 21) for assets, 0.172 (0.175 in June 21) for Deposits and 0.134 (0.142 in June 21) for Credit (Chart 10).

Chart 9. Evolution of concentration levels of the three largest banks - June 2022



Source: BM

Chart 10. Evolution of concentration levels in the banking sector - HHI index - June 2022



Source: BM

3.1.2. Balance sheet structure

3.1.2.1. Assets

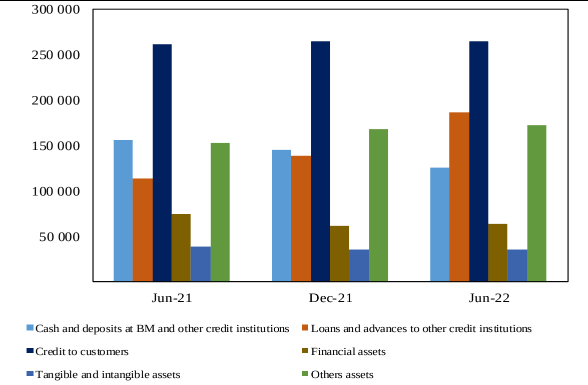
In the period under review, the banking sector's assets totalled 847 billion meticais, a growth of **3.99%** and **6.13%** compared to December and June 2021, respectively.

This positive variation in comparison with the same period of the previous year was essentially due to the 63.89% growth in short-term investments and other assets (12.97%), offset by the 19.84% and 15.28%

[15] Method for assessing the degree of concentration in a market, widely used by national and international entities to measure competition between institutions. It is calculated by summing the squares of the market shares of the institutions operating in a market and varies between 0 and 1. Values between 0 and 0.1 indicate that the level of market concentration is low; between 0.1 and 0.18 is moderate, and above 0.18 is considered high.

drop in cash and cash equivalents and financial assets, respectively.

Chart 11. Assets - June 2022



Source: BM

Structurally, net impaired credit continues to represent the substantial portion of the domestic banking sector's balance sheet, reaching the weight of 31.19% (**32.51%** in December 21 and **32.81%** in June 21).

In addition to credit, credit institutions have invested in more liquid and lower risk assets, namely liquid assets, investments in credit institutions and financial assets together representing 44.30% of total assets (42.50% in December 21 and 43.24% in June 21).

“Other assets” and “tangible and intangible assets” represent 20.36% (20.59% in December 21 and 19.13% in June 21) and 4.16% (4.40%, in December 21 and 4.82%, in June 21) of assets, respectively.

3.1.2.2. Liabilities and equity

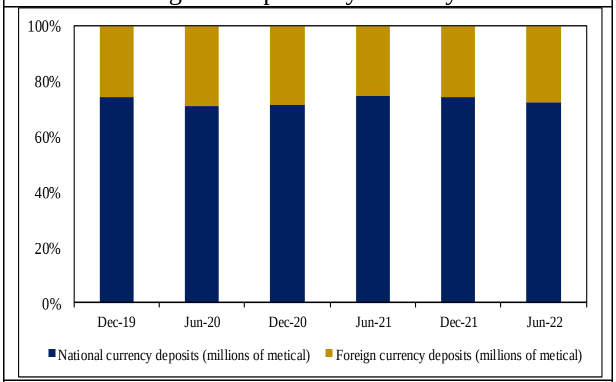
In June 2022, the total liabilities of the banking sector amounted to 703 billion meticais, an increase of **6.13%** and **6.66%** compared to December and June 2021, respectively.

Deposits, the main source of funding for banking activity, stood at 601 billion meticais, 72.55% of which in national currency and the remainder in foreign currency.

In relation to the same period of the previous year, deposits in national currency and foreign currency increased by 15.33% and 4.25%, respectively.

The weight of foreign currency deposits in the total deposit structure remains at around 27% (see Chart 12).

Chart 12. Weight of deposits by currency

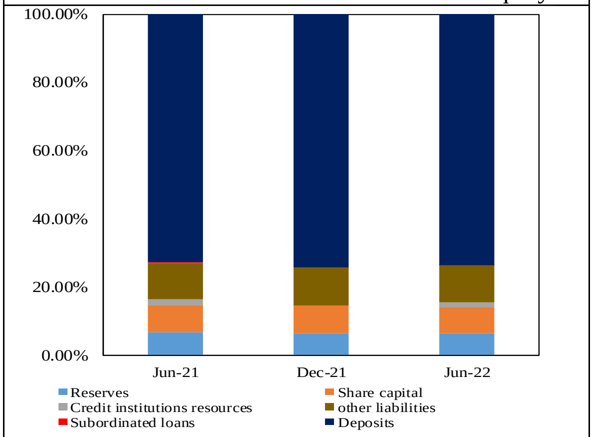


Source: BM

The banking sector's equity totalled 144.2 billion meticais, a 5.30% slump compared to December 2021 and an increase of 3.64% compared to June 2021.

In relation to the same period of the previous year, this variation was mainly due to the expansion of net profits for the year by 2.2 billion meticais (19.61%) (Chart 13).

Chart 13. Main liabilities and shareholders' equity



Source: BM

3.1.3. Financial soundness indicators

3.1.3.1. Capital adequacy

The banking sector's capital adequacy indicators remained at comfortable levels during the period concerned.

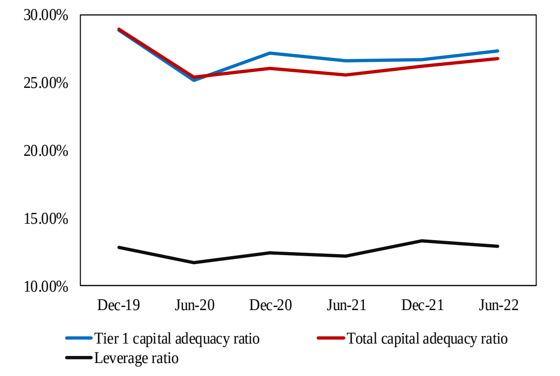
The aggregate solvency ratio stood at 26.76% (26.19% in December 21 and 25.60% in June 21), well above the regulatory minimum (12.0%).

In relation to the same period in the previous year, this variation was due to the 14.52% increase in own funds, which offset the 9.54% growth in risk-weighted assets.

The Tier 1 ratio[16] /Risk-weighted Assets stood at 27.33% (26.71% in December 21 and 26.62% in June 21) above the regulatory minimum (10.0%), driven by the growth in Tier I in greater proportions than risk-weighted assets. This variation translates into greater coverage of higher quality capital over risk-weighted assets (Chart 14).

The Leverage Ratio[17] , another capital adequacy indicator that provides an indication of the extent to which assets are financed by equity, stood at 12.92% (13.27% in December 21 and 12.20% in June 21), see Chart 14.

Chart 14. Capital Adequacy



Source: BM

[16] Tier I corresponds to the sum of original own funds, in accordance with Aviso No. 09/GBM/2017, of June 5.

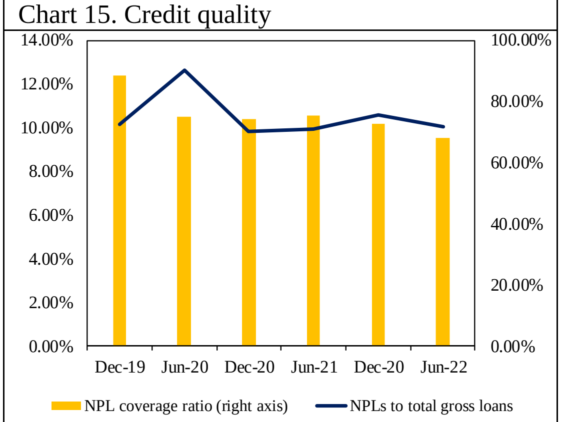
[17] It establishes the relationship between Tier 1 and total assets less intangibles.

3.1.3.2. Asset Quality

Asset quality, as measured by the ratio of 90 days past due loans (NPL) to total loans, remained relatively unchanged in the period under review. The NPL ratio stood at 10.02% (10.60% in December 21 and 9.92% in June 21), a figure above the standard benchmark of 5.0%.

Coverage of 90 days past due loans by specific provisions decreased, declining from 75.26% in June 2021 to 67.99% in June 2022, following 72.63% in December 2021 (Chart 15).

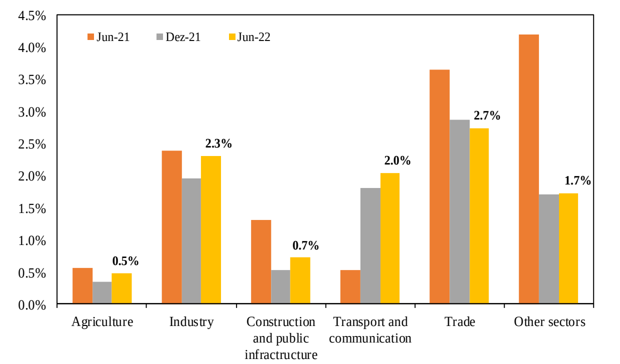
Chart 15. Credit quality



Source: IMF

In terms of the contribution of NPL by sectors of activity, in June 2022, trade had the largest contribution with 2.7%, followed by industry with 2.3% and transport and communications with 2.0% (Chart 16).

Chart 16. NPL contribution by activity sectors



Source: BM

3.1.3.3. Profitability

In June 2022, despite the current macro-financial situation, the banking sector continued to record profits, as net profits for the year increased by 2.2 billion meticais, in relation to the same period in the previous year, to 13.4 billion meticais.

This variation is justified by the increase in the exchange revaluation results by 1.1 billion meticais (28.88%), the results from financial operations by 0.9 billion meticais (20.29%), and net interest income by 4.4 billion meticais (15.98%).

The main profitability indicators recorded relatively higher values than in the same period of the previous year (Table 13).

Table 13. Key profitability indicators

Description	Dec-20	Jun-21	Dec-21	Jun-22
ROA	2,20%	2,92%	3,10%	3,29%
ROE	18,75%	24,62%	25,15%	26,40%
Net interest income ratio	65,89%	64,88%	64,08%	67,10%
Cost-to-income ratio	62,05%	57,07%	53,75%	53,34%

Source: BM

Return on Assets (ROA) stood at 3.29% (3.10% in December 21 and 2.92% in June 21) and Return on Equity (ROE) at 26.40% (25.15% in December 21 and 24.62% in June 21).

The net interest income ratio stood at 67.10% (64.08% in December 21 and 64.88% in June 21), which means that around 67% of net operating income comes from financial intermediation (capturing savings and granting credit).

The cost-to-income ratio stood at 53.34% (53.75% in December 21 and 57.08% in June 21), registering a decrease of 3.7 percentage points in relation to the same period in the previous year, which indicates an improvement in banking efficiency.

3.1.3.4. Liquidity and fund management

In June, the main liquidity indicators remained at high levels compared to the same period in the previous year, ensuring the continuity of the banking sector's financing operations (Table 14).

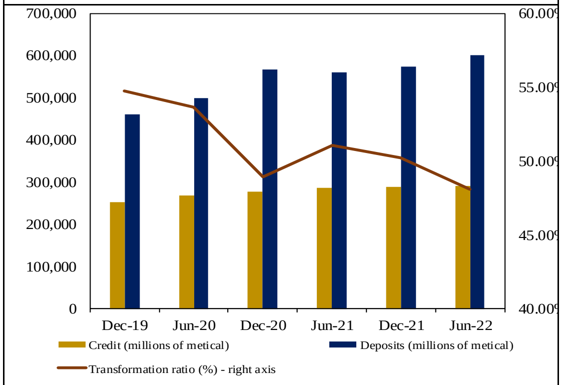
Table 14. Main liquidity indicators

Ratio	Jun-21	Dec-21	Jun-22
Net assets/total deposits	58,52%	67,98%	68,54%
Net assets/Total assets	41,17%	47,89%	48,65%
Short-term liquidity coverage	56,90%	68,30%	68,81%
Rate of transformation of deposits into credit	51,07%	50,22%	48,07%

Source: BM

The reduction in the transformation ratio was due to the increase in deposits (7.07%) at a faster rate than the growth in credit (1.27%) than in the previous year. While on the one hand, this resulted in an increase in available liquidity, on the other it had a negative impact on the profitability of credit institutions as credit is the main item in the assets portfolio (Chart 17).

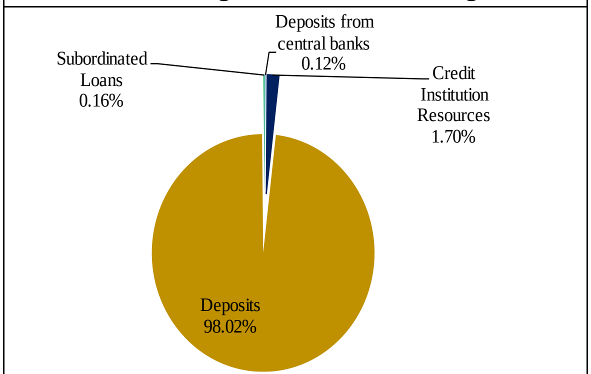
Chart 17. Credit, deposits and transformation ratios



Source: BM

Structurally, deposits continued to be the banking sector's main and most profitable source of funding, with a weight of 98.02% (98.30% in December and 97.72% in June 21) of the total, with the other sources of funds maintaining a residual weight (Chart 18).

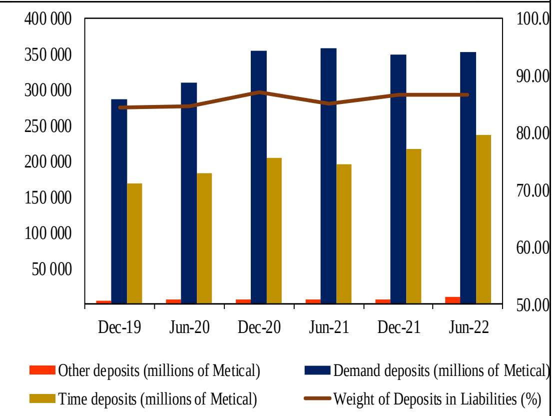
Chart 18. Financing sources of the banking sector



Source: BM

As regards the structure of deposits, 58.69% correspond to demand deposits, with the remainder being equivalent to time deposits (39.58%) and other deposits (1.73%). In relation to the same period of the previous year, time deposits and other deposits recorded increases equivalent to 20.97% and 51.49%, while demand deposits fell by 1.41%.

Chart 19. Evolution and composition of deposits



Source: BM

Box 3. Financial and business cycles in Mozambique

The financial cycle is defined as the deviation of financial variables (usually the ratio of credit to the economy to GDP) from their long-term trend. This cycle is characterised by periods of expansion followed by contraction in financial activity.

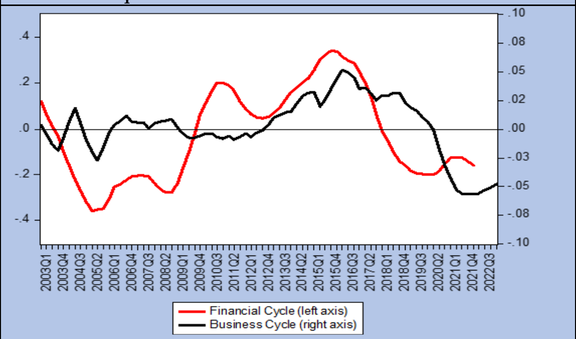
On the other hand, business cycles refer to the deviation of real economic activity from its long-term trend, characterised by periods of expansion followed by recession of economic activity. Essentially, the business cycle indicates the position of the economy as to balance and likely impacts on inflation developments.

The Chart below shows the evolution of the business and financial cycles in Mozambique[18], for the period from 2002Q4 to 2022Q2, indicating that at the end of the period under analysis, both the financial cycle and the business cycle are below potential and moving away from their long-term trend, a situation that denotes contraction of economic activity.

This situation can be explained by the vulnerabilities to which the economy has been subjected, namely the continued degradation of the investment environment due to military instability in the northern region of Cabo Delgado, adverse climatic factors, especially Cyclone Ana and Gombe, public sector debt and the international market's confidence in the country (although with tendencies for gradual improvement with the resumption of Programme discussions with the International Monetary Fund), notwithstanding the reduction in restrictive measures within the scope of the COVID-19 Pandemic, which permitted a slight improvement in the income and confidence of families and companies.

The longer duration of the financial cycle than that of the business cycle requires the conduct of monetary policy to be more forward-looking, in order to find the right balance between the maintenance of macroeconomic stability and financial stability, given the differences in the lengths of their cycles[19]. On the macroprudential side, the joint identification of the financial and business cycles, historically and in real time, complemented with the analysis of systemic risk in the country and of other financial variables will allow the choice of appropriate policy measures[20] to offset the impacts on monetary and financial stability.

Chart 20. Financial and business cycles in Mozambique



Source: INE and BM

[18] The cycles were determined using the Hodrick-Prescott filter (HP filter), a methodology recommended by the Basel III Committee as appropriate for this purpose.

[19] For example, in periods when the financial cycle expands considerably or reaches a high level during a business cycle contraction, monetary policy easing aimed at stimulating the economy can lead to a greater build-up of risks to financial stability, because lower borrowing costs encourage further credit expansion and asset price increases.

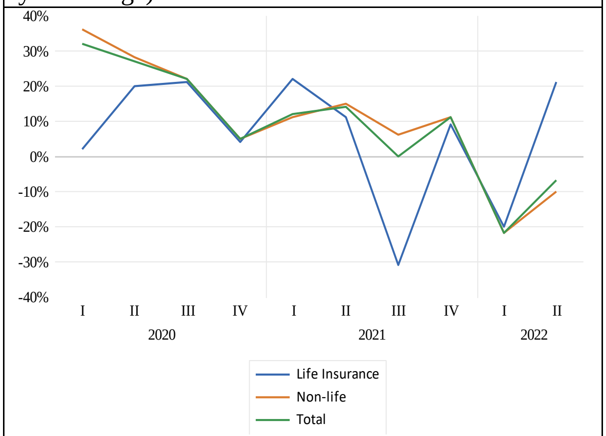
[20] Such measures might include, requiring larger countercyclical buffers and the use of tighter loan-to-value (LTV) ratios in circumstances, for example of rapid growth in house prices and credit (rather than just credit), as recessions associated with large changes in the two financial variables are longer and deeper. They may also include the use of capital or liquidity buffers) that would need to be larger for cases where markets tend to suffer deeper recessions, with more severe financial downturns, which at least until the global financial crisis of 2007-2009, happened more frequently in emerging markets.

3.2. Insurance sector

The insurance sector proved resilient amid the domestic economic environment, hindered by the worsening risks and uncertainties resulting from intensified military instability in the north of the country and the Russia-Ukraine geopolitical.

In the first half of 2022, the overall production of the insurance sector in Mozambique decreased by 6.60%, from 4,916.94 million meticais (June 21) to 4,594.61 million meticais (June 22), influenced by the drop in production in the non-life branch by 10.30% (Chart 21).

Chart 21. Overall production of insurers (year-on-year change)

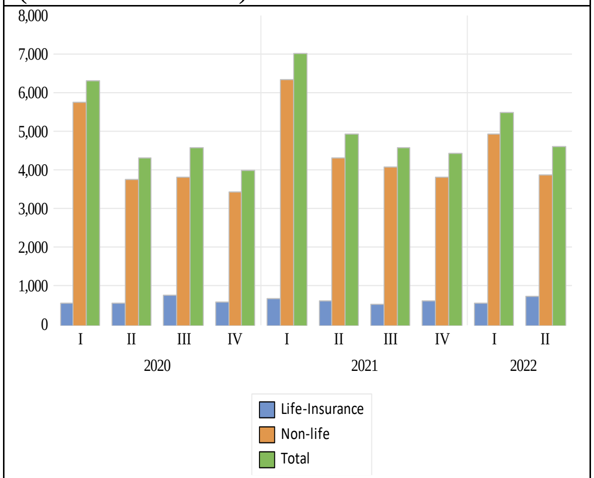


Source: ISSM

Contributing to the poor performance of the insurers was a decrease in demand from companies, with greater expression in subscriptions for insurance services, particularly with regard to fire, accidents at work, motor, general civil liability and maritime insurance.

In absolute terms, in the half year under review, total production fell by 322.33 million meticais, reflecting the fall in production in the non-life branch, by 446.28 million meticais (Chart 22).

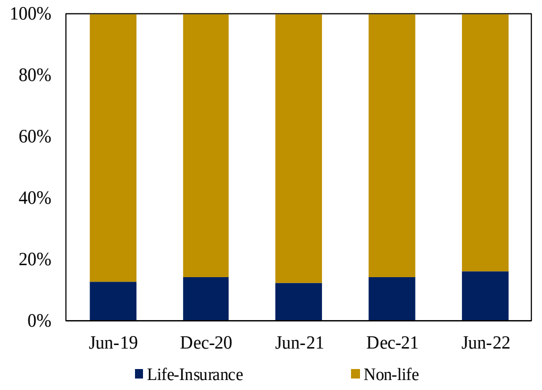
Chart 22. Overall production of insurance companies (millions of meticais)



Source: ISSM

With regard to the overall structure of the insurance sector, the non-life branch continues to represent the largest share of the insurance market, standing at over 80.00% (Chart 23).

Chart 23. Weight of non-life and life business in global insurance production



Source: ISSM

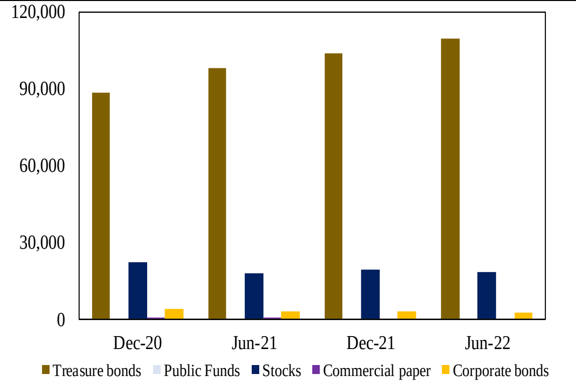
Regarding non-life, the growth, in the last semester, of the gross premiums issued for personal accident insurance (29%), for transported goods insurance (30%), which had greater demand in the period, representing a significant weight in the global structure of the insurance activity in the country, should be highlighted.

3.3. Securities Market

In June 2022, market capitalisation stood at 130.365 million meticais, representing an increase of 3.73% compared to December 2021 (126.105 million meticais) and 9.61% in relation to the same period in 2021 (118.936 million meticais).

This increase continues to be driven by the performance of Treasury Bonds, with an upward trend (Chart 24).

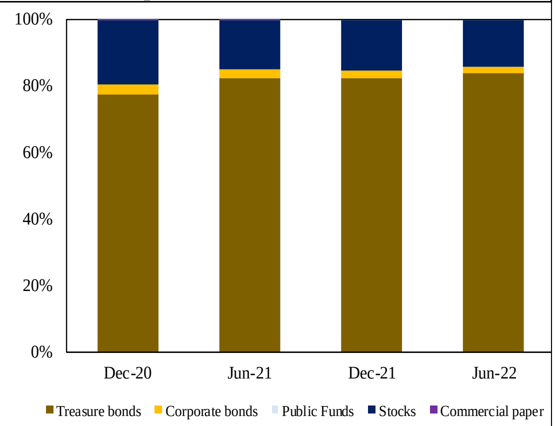
Chart 24. Market capitalisation (millions of meticais)



Source: BVM

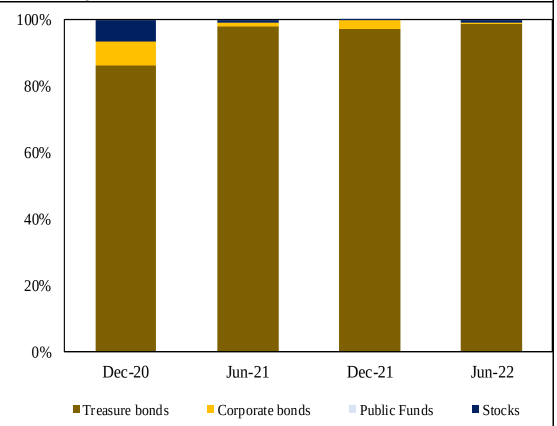
As regards the structure of securities traded on the BVM, Treasury Bonds accounted for 83.9% of the market capitalisation in the first half of 2022 (82.3% in December 2021 and June 2021), signalling the growing weight of the State in the securities segment (Chart 25).

Chart 25. Weight of the various MVM segments in market capitalisation



Source: BVM

Chart 26. Weight of trading volume by type of security



Source: BVM

The increase in the weight of Treasury Bonds in stock market capitalisation may increase the sovereign risk to which holders of these securities are subjected, with particular emphasis on those in the banking and insurance sectors, also influencing systemic risk and financial stability in general.

Similarly, as regards the volume of transactions per category of securities, Treasury Bonds continued to have the greatest weight, with 98.6% of the total in the period under analysis, with shares (0.9%) and corporate bonds (0.5%) completing the ranking (Chart 26).

The capital market continues to have no expression in private corporate financing, which is attested by the reduced volume of transactions in the equity and corporate bond segments in the semester under review.

Regarding issues listed on the stock exchange (Table 15), the greater weight of Treasury Bonds also stands out, which represents 63.0% of the total, followed by shares (20.4%) and corporate bonds (16.7%).

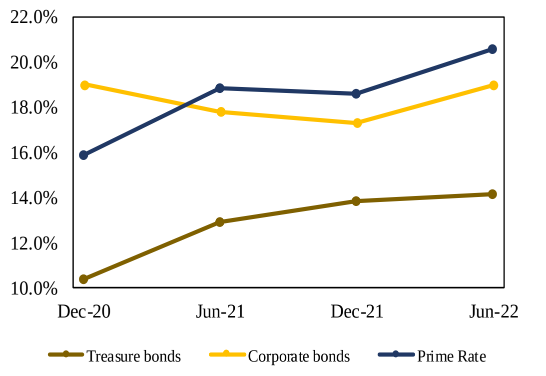
Table 15. Issues listed on the BVM

	Dec-20	Jun-21	Dec-21	Jun-22
Treasure bonds	35	36	33	34
Corporate bonds	13	9	9	9
Public Funds	0	0	0	0
Stocks	11	11	12	11
Commercial paper	3	1	0	0
Total	**62**	**57**	**54**	**54**

Source: BVM

The interest rate on corporate bonds has been below the Prime Rate of the Mozambican Financial System (Chart 27) since June 2021, due to the increase in the monetary policy interest rate (300 bp in January 2021 and 200 bp in March 2022).

Chart 27. Interest rates on bonds listed on the BVM and Prime Rate



Source: BVM

Should this situation continue, financing through the Securities Market is a less costly alternative to financing from the banking sector.

IV. MACRO-PRUDENTIAL POLICY DECISIONS

The BM, as the national macroprudential authority, lays down and enforces macroprudential policy. The BM regularly analyses the financial system to identify current and future vulnerabilities and risks under more likely and adverse settings, i.e., identifying, monitoring and assessing systemic risks.

The macro-prudential policy sets out to make the financial system resilient to risk absorption, ensuring adequate levels of financial intermediation and contributing to sustainable economic growth.

In the first half of 2022, the BM decided to maintain the macroprudential policy measures already established to mitigate systemic risk, namely:

- Conservation buffer for D-SIBs set at a minimum of 2.0%;
- Conservation buffer for domestic quasi-systemically important banks (Quasi D-SIBs) set at 1.0%;
- 100.0% limit on the LTV indicator in the granting of credit to customers of credit institutions and financial companies;

- 100% cap on DTI indicator in loans to customers by credit institutions and financial companies;

- Establishment of the countercyclical capital buffer of own funds as a tool to prevent and mitigate excessive credit growth and excessive leverage.

It is important to note that the countercyclical capital buffer is an additional capital requirement aimed at smoothing the effects of variations in the economy's credit cycle.

The non-activation of this buffer is due to low or negative nominal growth of credit to the economy and the fact that the Credit/GDP ratio maintains growth below the potential long-term trend.

Glossary

Risk weighted assets (RWA) - the result of weighting each asset by a risk coefficient for the purpose of calculating the solvency ratio. Its determination complies with the requirements provided by Aviso No. 09/GBM/2017 (Notice), of June 5.

Cost-to-income - indicator calculated by the ratio between operational costs and banking product, which measures the efficiency of the organisation.

Operating costs - sum of staff costs, other administrative costs and depreciation and amortisation for the year.

Economic scarring - deterioration of the financial situation of individuals and of the economy as a whole, which may result from the prolongation of a recessionary situation.

Forward-looking - prospective vision of a certain policy, model or situation.

Own funds/Equity - concept used in banking supervision as a fundamental reference for the application of several ratios and prudential rules.

Impairments - the book value recorded in the financial statements to cover expected losses related to assets. This amount should be deducted from the value of the respective asset, with the objective of correcting its value considering the probability of associated losses.

NPL - non-performing loans, i.e., loans that do not generate positive flows and profitability for banks.

Banking product - set of revenues received by a financial institution: commissions, interest, trading, interbank operations.

Provisions - amounts recognised to cover losses related to credit institutions' activities. These are set up in accordance with the prudential regime determined by the supervisory authorities.

Solvency ratio - the ratio between own funds and risk-weighted assets.

Risks - factors associated with uncertainties and which, should they materialise, have an impact on targets and results.

ROA - return on assets obtained by dividing net income by net assets. It measures the profit generated by each monetary unit of assets.

ROE - return on equity obtained by dividing net profits by shareholders' equity.

TIER 1 - core capital, includes the best quality capital (share capital, reserves and retained earnings) and is primarily responsible for the commitments assumed by the institution.

Vulnerabilities - set of characteristics that show the weaknesses of a certain system.

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