FINANCIAL STABILITY AND INCLUSION COMMITTEE

FINANCIAL STABILITY BULLETIN - 2024

DECEMBER 19, 2024

Foreword

In compliance with the Organic Law, the powers of the Banco de Moçambique (BM) encompass the supervision of credit institutions and financial companies. Credit institutions and financial companies are supervised using a combination of microprudential and macroprudential instruments that work in concert in order to ensure the stability of the financial system.

Financial stability suposes a sound, robust and resilient financial system, which restrains the likelihood of disruptions severe enough to hinder the real economy.

The BM implements macroprudential policy with the aim of preserving financial stability by strengthening the resilience of the banking sector to financial shocks and imbalances and averting systemic risk. To this end, the BM has various policy instruments in place to prevent and mitigate excessive credit and leverage growth, market illiquidity, exposure concentrations and excessive risk-taking by systemically important institutions.

The powers of banking resolution authority of the BM have been reinforced by Law No. 20/2020, of December 31. This legal framework strengthens the mechanisms and instruments for the resolution of institutions at risk of non-viability or insolvency, so as to ensure timely intervention and the orderly recovery or liquidation thereof to minimize the negative effects on the financial system.

The Financial Stability Bulletin is semiannual instrument for reporting on the macroprudential policy adopted by the BM. The bulletin includes the drivers of the international and domestic environment, as well as the systemic risk assessment which supports macroprudential policy decisions.

THE GOVERNOR

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Acronyms

BCI	Banco Comercial e de Investimentos, S.A.
BIM	Banco Internacional de Moçambique, S.A.
BM	Banco de Moçambique
BVM	Mozambique Stock Exchange
CE	Credit to the Economy
CE/ GDP	Ratio of Credit to the Economy to Gross Domestic Product
D-SIBs	Domestic Systemically Important Banks
DTI	Debt-to-Income
FATF	Financial Action Task Force
FGD	Deposit Guarantee Fund
GDP	Gross Domestic Product
IMF	International Monetary Fund
INE	National Statistics Institute
ISSM	Mozambique Insurance Supervision Institute
LICSF	Credit Institutions and Financial Companies Act
LTV	Loan-to-Value
MVM	Securities Market
NPL	Non-Performing Loan
T-Bill	Treasury Bills
T-Bond	Treasury Bonds
ROA	Return on Assets
ROE	Return on Equity
SADC	Southern Africa Development Community
USA	United States of America

Executive Summary

Global financial markets remained resilient despite growing risks and vulnerabilities. In the first half of 2024, global financial markets continued to show resilience, reflecting the macroeconomic stability driven by lower inflation and dynamics of economic activity, amidst the prevalence of risks and vulnerabilities to financial stability.

Global risks and vulnerabilities have focused primarily on the real estate and fiscal sectors, coupled with the rise in uncertainty regarding the future stance of monetary policy. Moreover, the rise in cyber risks, spurred by the increased digitalization of the financial system, climate risks, uncertainties regarding the outcome of electoral processes in several countries, and increasing geopolitical tensions, particularly in the Middle East, have affected the pillars of international financial stability.

International financial stability prevailed in the first half of 2024 amidst reduced monetary policy interest rates. Overall, interest rates trended downwards in most economies. Furthermore, financial markets remained stable and leaning towards improvement over the short term. Moreover, in the semester under review, central banks macroprudential tools were enhanced, in an effort to minimize systemic risk and ensure financial stability.

Domestically, the financial system grew moderately. In the first half of 2024, the financial system cumulative growth rate slowed to 2.92% from 6.13% in the same period of the previous year, underpinned by increased risks and vulnerabilities at home and abroad.

The normalization of the MIMO rate[1] contributes to strengthening the pillars of financial stability over the medium term. In line with the trend of monetary policy decisions, the reference interest rate for credit, prime rate, continues to decline. The same behavior is observed in the interest rates that banks charge their customers.

[1] Monetary policy interest rate

With regard to the banking sector, economic and financial indicators attest that it remains profitable. Net banking sector income grew by 9.90% year-on-year in the reporting period, following 9.15% in the same period of 2023, highlighting the prominent input from systemically important banks, with a share equivalent to 66.58%.

Indeed, return on assets (ROA) and return on equity (ROE) stood at 4.52% and 18.75% in the half-year under review, following 4.64% and 18.38% in the same period of 2023, respectively.

The banking sector remains sound, capitalized and resilient. The capital adequacy ratio stood at 26.33% in June 2024, above the regulatory minimum of 12.00%. On the other hand, the short-term liquidity coverage ratio stood at 47.73%, also above the regulatory minimum of 25%.

The ratio of non-performing loans (NPL) to total gross loans is trending downwards. In June 2024, this indicator stood at 8.30%, following 10.58% calculated in the same period of 2023, although above the internationally recommended ceiling of 5.0%. Moreover, the NPL coverage ratio stood at 67.84% in June 2024, compared to 70.61% in the same period of 2023.

Market share concentration prevails in the banking sector. In June 2024, banking sector activity remains concentrated in D-SIBs, with shares of assets, deposits, and loans, respectively, at 61.73%, 66.14%, and 54.53%.

Pension funds proved to be a less prominent source of financing for the banking sector, notwithstanding significant to the MVM. Pension fund deposits accounted for 1.38% of total deposits in the banking sector. Furthermore, the weight of the value of securities held by pension funds over the total securities of the MVM sector stood at 29.52 %.

The insurance segment grew, driven by the increase in turnover and the expansion of the number of market operators. Indeed, overall output increased by 4.65%, compared to the same period of 2023.

The Securities Market (MVM) remains dominated by investments in government bonds. In this context, government bonds account for 85.21% of the total market capitalization and the banking sector is the largest investor in this market, with 32.21% of the total value of the securities listed therein.

Systemic risk remains moderate. This behavior was supported by the prevalence of sovereign, market, liquidity and profitability and solvency risks. In contrast to this dynamic, macroeconomic and credit risks have receded, due to favorable developments in inflation, exchange rate stability, and improved asset quality.

In order to absorb the potential losses arising from the materialization of risks and vulnerabilities in the financial system, the BM decided to maintain all macroprudential policy instruments in place. Thus, the capital buffers for D-SIBs and quasi-D-SIBs remained at the minimums of 2.0% and 1.0%, respectively.

In addition, the loan-to-value (LTV) ratio and the debt-to-income (DTI) ratio remained capped at 100%.

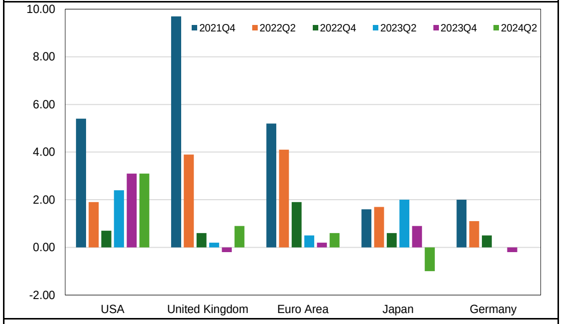
I. INTERNATIONAL FINANCIAL SYSTEM

Global financial markets continued to show resilience in the first half of 2024, underpinned by the dynamics of economic activity and slowing inflation, amidst monetary policy interest rate downs, despite prevailing high interest rates.

The appreciation of shares and the increase in the return on corporate bonds in the reporting half-year contributed to the positive performance of global financial markets.

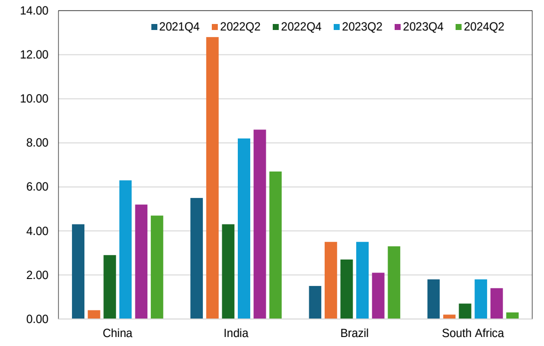
In addition, the momentum of advanced and emerging market economies over the six reporting months supported the decrease in volatility in global financial markets, although at a slower pace for the latter (Charts 1, 2 and 3).

Chart 1: Advanced Economies — Annual Real GDP Growth



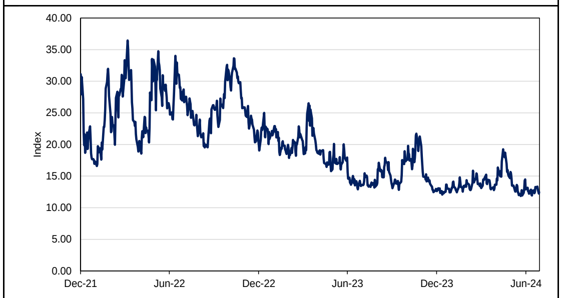
Source: *Trading Economics*, 2024

Chart 2: Emerging Market Economies — Annual Real GDP Growth



Source: *Trading Economics*, 2024

Chart 3: US Share Price Volatility — VIX Index[2]



Source: *Trading Economics*, 2024

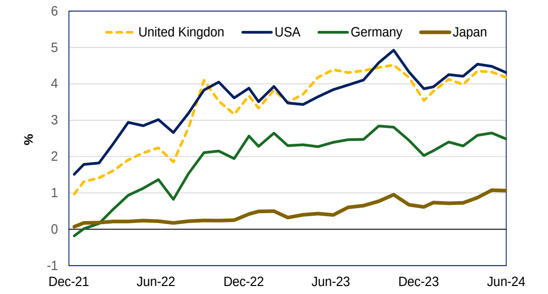
[2] The VIX index is an indicator that estimates the expected volatility of the United States stock market.

Interest rates worldwide continue to lean downwards. In advanced economies, real interest rates remain high and corporate and sovereign lending spreads declined sharply. On the other hand, most emerging market economies reported a high-risk appetite, as measured by investments in sovereign bonds.

Sovereign bond yields in advanced economies have risen due to higher real interest rates, which has contributed to lower debt attractiveness of emerging market economies, giving rise to lower capital flows and higher costs in taking on new debt for these economies, thereby exacerbating their fiscal deficits (Charts 4 and 5).

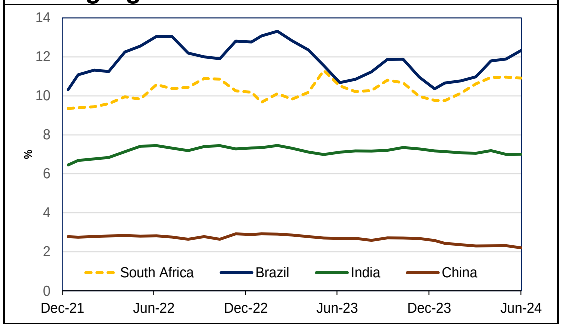
Despite the relative stability of financial markets, risks associated with real estate prevail, given the concentration of real estate lending in the banking sector of the United States of America (USA) and the Eurozone, exacerbated by interest rates, which remain high in these economies, and by declining real estate prices in China (Chart 6).

Chart 4: Government Bond Yields – Advanced Economies



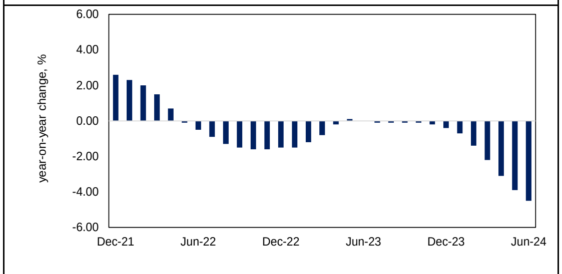
Source: *Bloomberg*, 2024

Chart 5: Government Bond Yields – Emerging Market Economies



Source: *Bloomberg*, 2024

Chart 6: Real Estate Prices – China



Source: *Trading Economics*, 2024

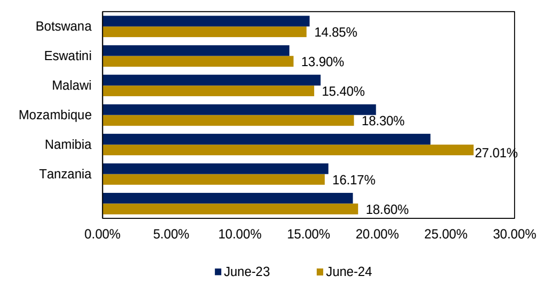
The banking sectors of the Southern African Development Community (SADC) region remain stable and resilient, with the ability to absorb potential adverse shocks in the sector.

The comparative analysis of capitalization levels in the region showed that the Tier I capital adequacy ratios of the banking sector of the countries are adequate, and that Mozambique reports one of the highest ratios (Chart 7).

In the reporting period, return on equity ratios in the region were satisfactory (Chart 8).

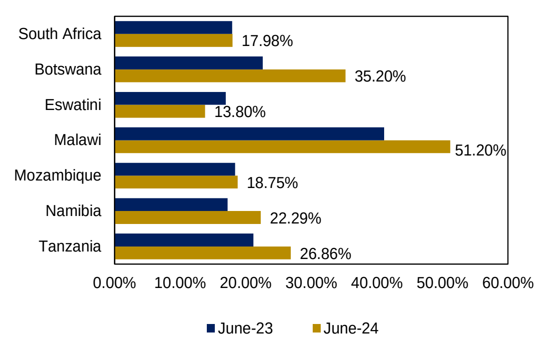
However, the non-performing loans ratio in most countries in the region is above the internationally recommended ceiling of 5%, which reinforces the need to monitor this asset quality indicator (Chart 9).

Chart 7: Tier I Capital Adequacy Ratio – SADC Countries



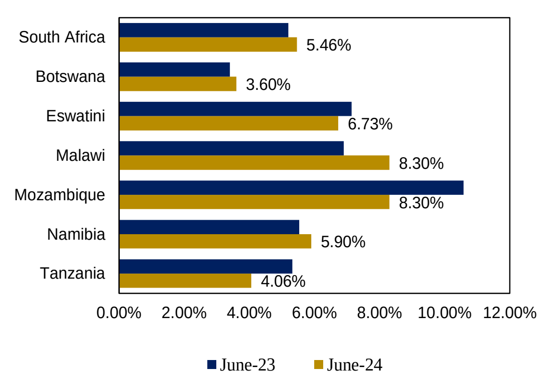
Source: International Monetary Fund, 2024

Chart 8: Return on Equity – SADC Countries



Source: International Monetary Fund, 2024

Chart 9: Non-Performing Loans Ratio – SADC Countries



Source: International Monetary Fund, 2024

In the reporting period, the risks and vulnerabilities with impact in the global financial stability prevail. The vulnerabilities of the real estate and fiscal sectors, coupled with the cyber, climate and geopolitical risks, are highlighted.

Global financial markets remain exposed to the **real estate sector**, due to the concentration of real estate loans in the US and Eurozone banking systems, which can affect financial stability prospects.

Moreover, falling real houses prices continue to mark the Chinese real estate market.

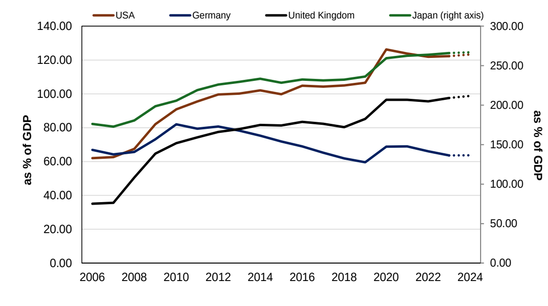
Extended periods of high interest rates continued to exacerbate vulnerabilities that impact the stability of the global financial system.

The **public debt**-to-gross domestic product (GDP) ratio increased in advanced economies, driven by the rise in public spending.

A deterioration in the financial system's perceptions of the trajectory of government debt could drive volatility in global financial markets, which could lead to tighter credit conditions for households and businesses.

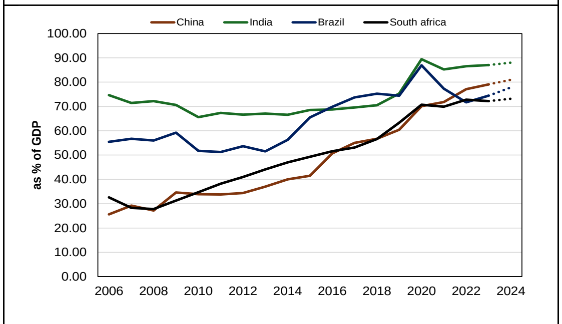
In addition, the current **geopolitical environment**, marked by increasing risks and uncertainties, can further pressure public levels in both advanced and emerging market economies, with negative consequences for global financial stability (Charts 10 and 11).

Chart 10: Public Debt – Advanced Economies



Source: *Trading Economics*, 2024

Chart 11: Government Debt – Emerging Market Economies



Source: *Trading Economics*, 2024

Cyber incidents are one of the most prominent sources of operational risk.

The *Global Financial Stability Report* October 2024, a biannual publication of the International Monetary Fund, forecasts the increase in manipulation in financial markets and cyber risks, driven by the sophistication of fraud and disinformation, amidst rapid advancement of artificial intelligence.

Banks are also vulnerable to the adverse impact of physical risks arising from climate-related events, given their exposure to certain geographical areas and economic sectors vulnerable to the effects of climate change.

With regard to transition risks, banks with significant exposure to carbon-intensive sectors such as energy and transport are most at risk of facing unrecoverable assets and increased defaults on their balance sheets.

The political uncertainties associated with the outcome of the electoral process in several countries this year, particularly the US elections, may increase pressures on sovereign debt, which could impact financial markets.

II. DOMESTIC FINANCIAL SYSTEM

The main financial indicators show that the Mozambican financial system remains stable, sound and well capitalized, despite the prevalence of internal and external shocks. The financial system grew cumulatively by 2.92% in the first half of 2024, from 6.13% in the same period of 2023.

2.1. Banking Sector

The banking sector remained profitable and stable, with adequate capitalization and liquidity levels, and satisfactory profitability, during the first half of 2024. In this regard, the capital adequacy ratio stood at 26.33%, above the regulatory minimum of 12.00% and sufficient to ensure that capital buffers remain in place to withstand any financial shocks and imbalances.

Net income amounted to 16.10 billion meticais, a growth of 9.90% compared to the same period in 2023. 10.71 billion meticais (66.58 %) of results were earned by the three domestic credit institutions identified as D-SIBs, namely BCI, BIM and Standard Bank.

On the other hand, banking sector liquidity remained satisfactory (47.73%), above the regulatory limit of the liquidity ratio (25.00%).

Furthermore, regarding asset quality, the NPL ratio remains above the internationally recommended ceiling of 5.00%, at 8.30%, despite the downward trend in recent years.

2.1.1. Banking Sector Concentration

In the reporting period, D-SIBs jointly accounted for 61.73%, 66.14% and 54.53% of the assets, deposits, and credit of the banking sector, respectively, compared to 60.99%, 66.07% and 54.07% in the same period of 2023, and 60.78%, 66.16% and 54.37% in December 2023 (table 1).

The Herfindahl-Hirschman[3] indicates the prevalence of market share concentration in D-SIBs. In general, in recent years this indicator has been leaning downwards, which suggests a

[3] The Herfindahl-Hirschman Index (HHI) is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers to measure the degree of concentration in a market. Values below 1000 indicate no concentration, values above 1800 indicate high concentration, and values between 1000 and 1800 indicate reasonable concentration. "*Think Finance Forum* - Internet, February 2012".

dynamic performance and competitiveness in the sector.

Indeed, a few non-D-SIBs have made headway in the market.

However, compared to the same period in 2023, the D-SIBs market shares of assets, deposits, and loans showed positive changes of 0.74 percentage points (pp), 0.07 pp and 0.46 pp, respectively (table 1).

Table 1: Banking Sector Concentration – Herfindahl-Hirschman Index

	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24
IHH - Assets	**1501**	**1503**	**1533**	**1432**	**1410**	**1434**
Three largest banks (D-SIBs)	63.16%	63.67%	64.45%	60.99%	60.78%	61.73%
Five largest banks	76.67%	76.53%	77.74%	76.41%	75.68%	75.57%
Ten largest banks	91.05%	90.23%	89.77%	89.35%	88.55%	87.84%
IHH - Deposits	**1703**	**1719**	**1707**	**1657**	**1657**	**1660**
Three largest banks (D-SIBs)	67.63%	68.45%	68.01%	66.07%	66.16%	66.14%
Five largest banks	82.39%	82.36%	82.04%	81.50%	81.43%	80.96%
Ten largest banks	94.62%	94.07%	93.68%	94.84%	95.24%	94.98%
IHH - Credits	**1388**	**1342**	**1294**	**1286**	**1320**	**1365**
Three largest banks (D-SIBs)	56.80%	55.53%	54.23%	54.07%	54.37%	54.53%
Five largest banks	74.71%	73.20%	72.63%	72.51%	72.09%	72.29%
Ten largest banks	90.05%	90.23%	89.81%	90.17%	89.68%	90.50%

Source: BM, 2024

2.1.2. Balance Sheet Structure

2.1.2.1. Assets

Banking activity, measured by total assets, stood at 961.68 billion meticais in June 2024, an annual growth of 8.38%, compared to the same period in 2023, and 4.70% compared to the previous half-year. This performance reflects the increase in investments arising from deposits in credit institutions and financial assets held for trading.

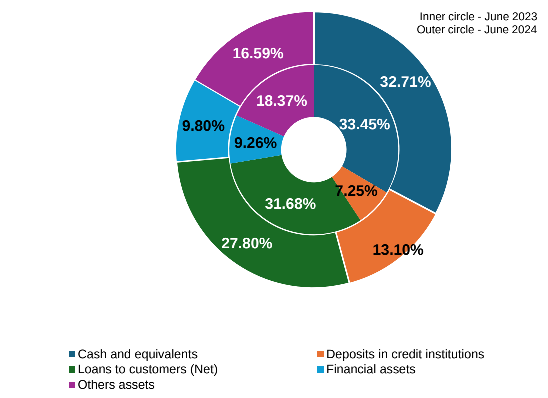
It should be noted that the increase in investments in credit institutions arose from the increase in interbank money market operations, and purchases with resale agreements, as well as from investments made in other credit institutions abroad and at their parent companies. The increase in financial assets held for trading reflects the dynamics of government bonds.

The performance of the credit portfolio remains vital for gross income growth, despite the 4.87% contraction in the first half of 2024 compared to the same period in 2023, remaining almost unchanged compared to the previous half-year.

In June 2024, in the composition of assets, the banking sector continued to favor investment in assets with high liquidity and profitability. Cash and equivalents (314.61 billion meticais) and net loans (267.37 billion meticais) continue to lead the first and second positions in the asset structure, with weights of 32.71% and 27.80%, against 33.45% and 31.68%, in the same period of 2023, and 32.68% and 29.10% in the previous semester, respectively.

In the reporting period, investments in credit institutions grew by 95.78%, compared to the same period in 2023, and 6.18% compared to the previous semester, placing fourth with a share of 13.10 % (Chart 12).

Chart 12: Structure of Asset



Source: BM, 2024

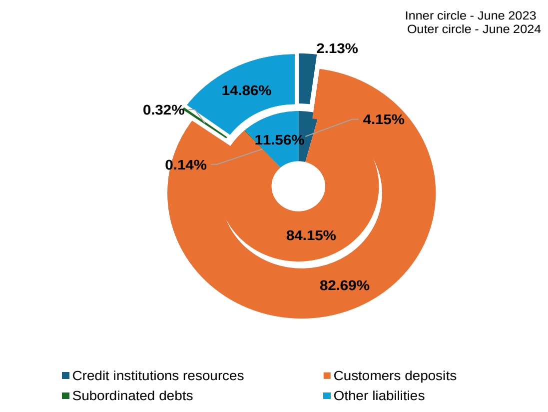
2.1.2.2. Liabilities

The total liabilities of the banking sector stood at 795.27 billion meticais in June 2024, a growth of 8.72% and 6.43% compared to June and December 2023, respectively.

In the structure of liabilities, the share of deposits reduces by 1.47 pp, compared to June 2023, standing at 82.69 %, despite remaining the largest and the main source of financing for banking activity (Chart 13).

In the reporting period, deposits stood at 642.61 billion meticais, a growth of 10.64% compared to the same period in 2023 and 5.99% compared to the previous semester.

Chart 13: Structure of Liability



Source: BM, 2024

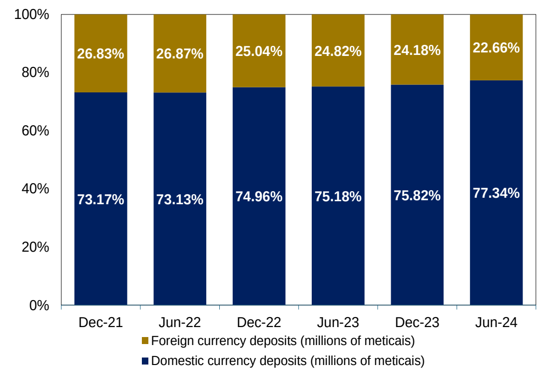
This increase mainly reflects the developments in resident deposits, underpinned by the competitive market dynamics regarding fundraising.

Deposits in domestic currency dominate the structure of customer funds, with a weight of 77.34% of the total, continuing the growth trend seen in recent semesters. Indeed, in the first half of 2024, this item amounted to 496,99 billion meticais, equivalent to a growth of 13.82% and 8.12% compared to the same period in 2023 and the previous half, respectively (Chart 14).

Overall, foreign currency deposits did not show significant changes compared to the same period and the previous six months which registered a reduction of 2 pp.

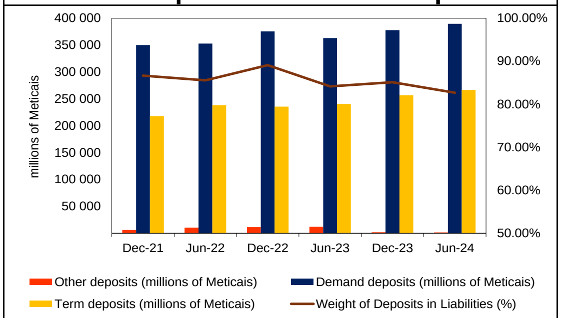
With regard to the structure of customer deposits, demand deposits remain the most significant in the total portfolio, reaching 389.62 billion meticais (59.25%), followed by term deposits, with 40.53% (Chart 15).

Chart 14: Weight of Deposits by Currency



Source: BM - Statistics, 2024

Chart 15: Deposit trend and Composition



Source: BM, 2024

2.1.3. Financial Soundness Indicators

2.1.3.1. Capital Adequacy

In the first half of 2024, capital adequacy indicators remained historically high. In fact, the capital adequacy ratio stood above the regulatory minimum of 12.00% at 26.33%[4], against 23,34% in the same period of 2023, and 25.68% observed in the previous semester.

This year-on-year change of 2.99 pp is the result of a more than proportional increase in total capital (16.17 %) in relation to risk-weighted assets (2.96 %).

Following the same trend, the Tier I capital adequacy ratio[5] rose from 23.87% to 27.01% and is expected to increase due to the incorporation of positive income from the previous financial year, taking into account the strong dependence of the Tier I capital adequacy ratio on changes in core capital.

In general, the high levels of capitalization evidenced by the capital adequacy ratio show that the national banking sector remains solid and stable

[4] The capital adequacy ratio lower than the Tier I capital adequacy ratio is explained by deductions following the calculation of Total Equity, in particular by the value of fixed assets received in repayment of own credit and by the amount exceeding the risk concentration limits in compliance with Notice No. 15/GBM/2013.

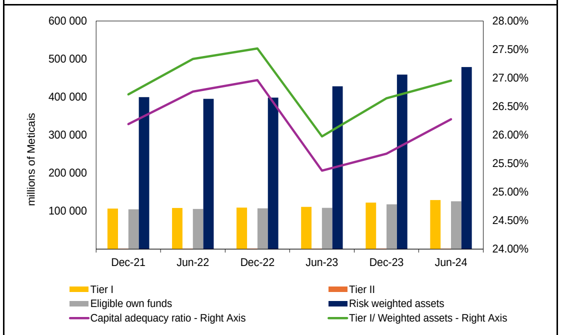
[5] Tier I over risk-weighted assets.

and that the disruptions that struck the international financial market have not exerted any noticeable pressure on the equity of institutions. This condition arose from the fact that credit institutions operating in the country were not materially exposed to that market.

In addition, the predominance of banks with capital adequacy ratios above the regulatory minimum, including systemically important banks, gives the banking sector a greater ability to withstand any significant losses on the balance sheet and income statement, ensuring the continuity of its financial intermediation function (Chart 16).

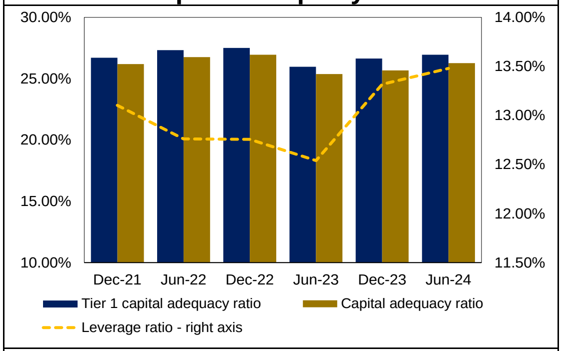
The leverage ratio, which measures the proportion of debt to equity, in the reporting period, stood at 13.48%, compared to 12.54% in the same period in 2023, and 13.32% in the previous half (Chart 17).

Chart 16: Tier I, Tier II, Equity, Risk-Weighted Assets and Capital Adequacy Ratio



Source: BM, 2024

Chart 17: Capital Adequacy



Source: BM, 2024

2.1.3.2. Asset Quality

The NPL ratio continued to trend downwards, notwithstanding in the reporting half-year, it remained almost unchanged, standing at 8.30%, against 8.23% in the previous semester and 10.58% in the same period of 2023, remaining above the internationally recommended ceiling of 5.0%.

Non-performing loans made up 26.70 billion meticais against 33.41 billion meticais and 26.50 billion meticais in the same period of 2023 and in the previous half-year, respectively, a reduction of 20.24% compared to the same period of 2023 and an increase of 0.004% compared to the previous half-year.

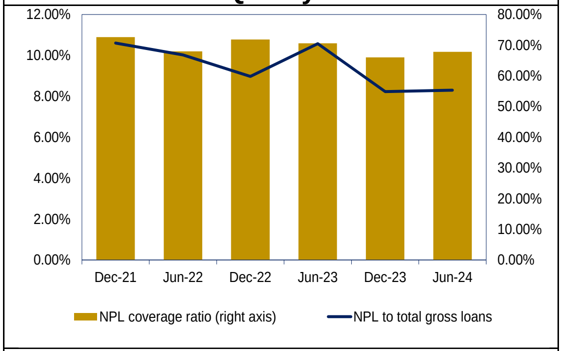
The contraction in non-performing loans was most evident in D-SIBs. This trend towards contraction arises, among other factors, from prudence in risk assessment and recoveries by banking sector institutions, without neglecting the improvement of the post-pandemic economic and financial environment.

The NPL coverage ratio shows a gradual reduction over time, standing at 67.84%, compared to 70.61% in the same period of 2023 and 66.02% in the previous semester (Chart 18).

Regarding the distribution of the weight of the NPL by sectors of economic activity, trade saw the highest concentration, with 29.50%, followed by Transport and Communications, with 22.92%, and Industry, with 18.58% (Chart 19).

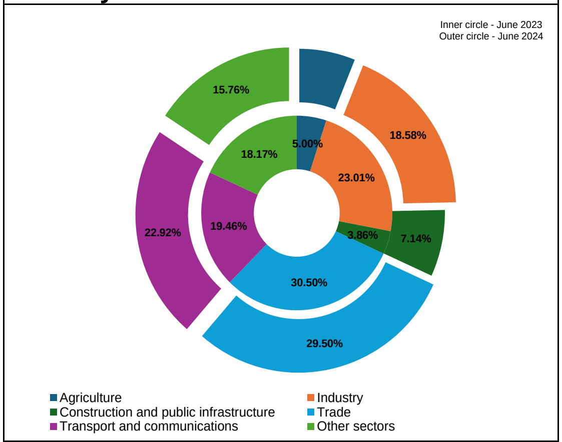
In the reporting period, total restructured loans amounted to 27.58 billion meticais, i.e., 9.62% of the total credit portfolio. The Transport and Communications sector accounted for 39.57% weight in total restructured loans, followed by Trade, with 13.09%, Construction and Public Works, with 9.68%, and the other sectors that make up 37.65% (Chart 20).

Chart 18: Credit Quality



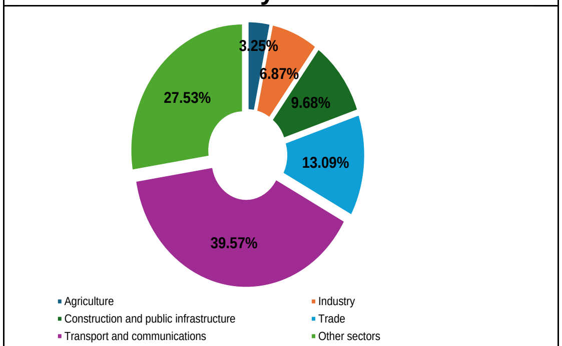
Source: BM, 2024

Chart 19: NPL Weight by Economic Activity Sectors



Source: BM, 2024

Chart 20: Restructured loans by sectors of economic activity – June 2024



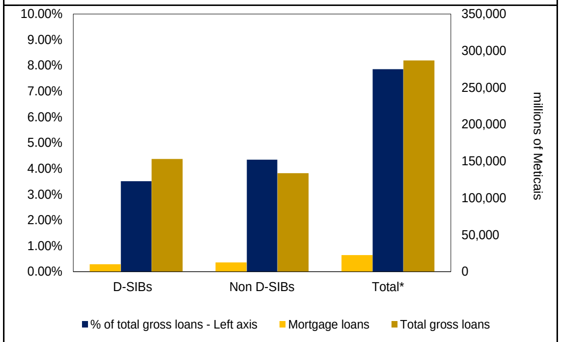
Source: BM, 2024

2.1.3.3. Mortgage Loans

Low exposure of the banking sector to financing mortgage loans.

In the reporting period, the volume of mortgage loans stood at 22.53 billion meticais, i.e., 7.85% of the total portfolio. D-SIBs represent 44.67% of financing secured by real estate (Chart 21).

Chart 21: Weight of mortgage loans in total credit



Source: BM, 2024

2.1.3.4. Profitability

The favorable performance of net interest income continues to make a significant contribution to income growth, with a share of 66.25% on the gross income, despite having seen a slight decrease of 1.51% compared to the same period in 2023. In addition, net commissions and income from financial operations represent 14.70% and 10.79%, respectively.

It should be noted that the reduction in net interest income is supported by the more than proportional growth of interest and charges, compared to interest and income.

Historical data show that the differential interest rates between active and passive operations do not vary considerably, despite the prevalence of the competitive pressure that has marked the Mozambican banking sector.

In the reporting period, net profits stood at 16.09 billion meticais, up 9.90% compared to the same period in 2023. This change is justified by the increase in other operating income of 1.32 billion meticais, mainly influenced by the positive contribution in earnings from non-financial assets.

The year-on-year income trend show that, over the last three years, income for the year grew at volatile rates, reflecting, in part, the slowdown in the growth of net interest income due, among other factors, from the narrowing and/or widening of the spread between credit and deposit interest rates, which has not been offset by the volume effect.

The main profitability indicators, namely ROA, ROE, cost-to-income ratio and net interest income ratio remain at comfortable levels.

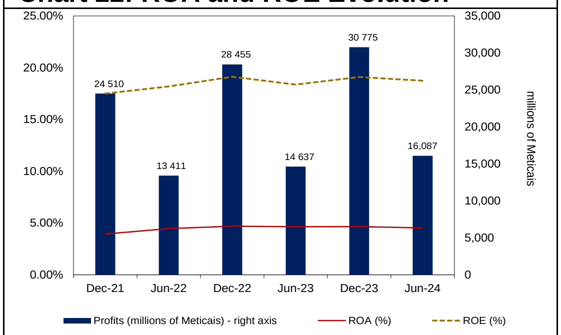
In the reporting period, ROA and ROE stood at 4.52% and 18.75%, compared to 4.64% and 18.38% in the same period of 2023, respectively (Chart 22).

The weight of net interest income in gross income stood at 66.25%, against 69.03% in the same period of the previous year, which shows the decrease in the contribution of financial intermediation to income generation.

The cost-to-income ratio stood at 57.55%, which represents a slight increase of 3.13 pp, compared to the same period in 2023, mainly explained by the increase in operating costs of 8.02%.

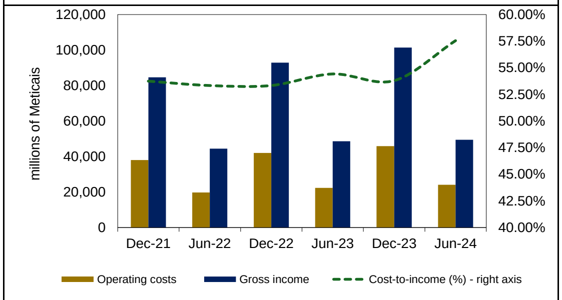
It should be noted that the growth in operating costs arose from increases in banking sector staff earnings, grants, pension fund charges, and staff hiring, driven primarily by digital expansion and innovation initiatives (Chart 23).

Chart 22: ROA and ROE Evolution



Source: BM, 2024

Chart 23: Cost-to-Income Ratio



Source: BM, 2024

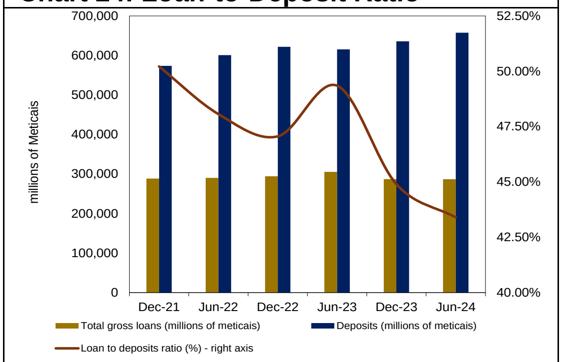
2.1.3.5. Liquidity and Funds Management

In the reporting period, liquidity indicators grew compared to the same period year-on-year, ensuring the continuity of financing operations in the banking sector (Table 2).

Customer deposits growth, coupled with the decrease in loans to customers supported the decline of the loan-to-deposit ratio from 49.35% in June 2023 to 43.40% in June 2024 (Chart 24).

In the reporting period, deposits accounted for a share of 97.08% of total resources, followed by credit institution deposits at 2.50%. The remaining items maintained a residual weight (Table 3).

Chart 24: Loan-to-Deposit Ratio



Source: BM, 2024

Table 2: Key Liquidity Indicators

Description	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24
Liquid assets to total deposits	67.98%	68.54%	69.49%	44.77%	49.62%	51.07%
Liquid assets to total assets	47.89%	48.65%	50.50%	30.72%	34.36%	34.92%
Liquid assets to short-term liabilities	68.30%	68.81%	69.79%	42.07%	47.42%	47.73%
Total gross loans to total deposits	50.22%	48.07%	47.06%	49.35%	44.90%	43.40%

Source: BM, 2024

Table 3: Sources of Banking Sector Financing Sources

Description	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24
Customers deposits	98.28%	98.02%	98.76%	95.15%	96.37%	97.08%
Demand	59.97%	57.53%	59.62%	56.09%	57.24%	57.52%
Term	37.32%	38.80%	37.37%	37.18%	38.87%	39.34%
Others	1.00%	1.70%	1.78%	1.87%	0.26%	0.22%
Central Banks resources	0.14%	0.12%	0.10%	2.22%	0.75%	0.04%
Subordinated debts	0.20%	0.16%	0.15%	0.16%	0.51%	0.37%
Credit institutions deposits	1.38%	1.70%	0.99%	2.47%	2.38%	2.50%

Source: BM, 2024

2.1.4. Mobile Money Operators

In the first half of 2024, banking activity remained marked by the development of new products, as well as the expansion of financial services and digital distribution channels.

Deposits in credit institutions dominate the structure of assets of mobile money operators, with a weight of 89.32% in total assets, in the reporting period, against 92.08% in the same period of 2023.

Customer funds remained the largest liabilities on the balance sheet of this segment of institutions with a weight of 86.54% of the total (against 87.21% in June 2023).

In June 2024, net profit stood at 1.44 billion meticais against 0.8 billion meticais in the same period of 2023, which, given the nature of mobile money operators, mainly consists of commissions, which account for 80.75% of the income (Table 4).

Table 4: Statement of Financial Position and Income Statement of Mobile Money Operators

Millions of meticais

Description	Jun-23	weight (%)	Jun-24	Weight (%)	variation
Deposits in credit institutions	15,458.4	92.08%	18,002.8	89.32%	16.46%
Others Assets	1,330.0	7.92%	2,153.0	10.68%	61.88%
Total Assets	**16,788.4**	**100.00%**	**20,155.8**	**100.00%**	**20.06%**
Customers deposits	10,163.3	87.21%	11,946.0	86.54%	17.54%
Other liabilities	1,490.9	12.79%	1,858.8	13.46%	24.68%
Total liabilities	11,654.2	**100.00%**	13,804.8	**100.00%**	**18.45%**
Net interest income	187.7	9.05%	315.9	9.43%	68.26%
Comissions	2,665.7	80.75%	2,704.9	80.75%	1.47%
Gross income	2,073.7	100.00%	3,349.6	100.00%	61.53%
Net results	846.3		1,442.4		**70.43%**

Source: BM, 2024

2.1.5. Domestic Systemically Important Banks[6]

Over the six-month reporting period, the BM identified three D-SIBs, namely BCI, BIM and Standard Bank, whose financial soundness indicators remained generally at comfortable levels, apart from the NPL ratio (Table 5).

Table 5: Financial Soundness Indicators for D-SIBs

	Jun-23		Dec-23		Jun-24	
Descrição	**D-SIBs**	**Sector**	**D-SIBs**	**Sector**	**D-SIBs**	**Sector**
Capital adequacy						
Capital adequacy ratio	24.67%	23.34%	27.39%	25.68%	27.25%	26.33%
Tier I/risk-weighted assets ratio	27.54%	23.87%	28.32%	26.65%	28.22%	27.01%
Asset quality						
NPL ratio	10.06%	10.58%	7.17%	8.23%	7.75%	8.30%
NPL coverage ratio	60.85%	70.61%	49.09%	66.02%	49.81%	67.84%
Profitability						
ROA	1.97%	4.64%	4.16%	4.66%	1.90%	4.52%
ROE	11.22%	18.38%	23.35%	19.11%	10.67%	18.75%
Liquidity and funding						
Short-term liquidity coverage ratio	44.48%	42.07%	50.63%	47.42%	49.88%	47.73%
Net assets to total deposits ratio	47.08%	44.28%	53.60%	49.62%	54.16%	51.07%
Loan-to-deposit ratio	40.35%	49.35%	38.19%	44.90%	35.20%	43.40%

Source: BM, 2024

[6] According to Notice No. 10/GBM/2018, they are those whose financial imbalance or insolvency could cause significant disruption to the overall financial system and economic activity.

2.1.5.1. Capital Adequacy

D-SIBs have met the minimum regulatory requirements for key capital adequacy ratios. Indeed, the aggregated and Tier I capital adequacy ratios rose to 27.25% and 28.22%, compared to 24.67% and 27.54% in the same period of 2023, and 27.39% and 28.32% in the previous half-year, respectively, revealing the capacity of these institutions to withstand potential losses arising from adverse shocks to their balance sheet.

2.1.5.2. Asset Quality

In June 2024, the NPL ratio of D-SIBs stood slightly below the system average (8.30%), at 7.75%, covered by 49.81% of the specific provisions (67.84% of the system).

2.1.5.3. Profitability

In the first half of 2024, net D-SIB profits trended upwards, albeit at a slowing pace, reaching 10.71 billion meticais, equivalent to a growth of 0.69% compared to the same period in 2023.

The favorable performance of D-SIBs income underpinned the satisfactory level of profitability, with ROA at 1.90% and ROE at 10.67%.

2.1.5.4. Liquidity and Funds Management

D-SIB deposits amounted to 434.9 billion meticais against 399.9 billion meticais in the same period of 2023, an annual growth of 8.75 %[7].

The more than proportional growth of D-SIB liquid assets compared to short-term liabilities supported the increase in the short-term liquidity coverage ratio, which stood at 49.88%, compared to 44.48% in the same period of the previous year, and 47.73% in the banking sector.

The growth in deposits not offset by the positive performance of the asset portfolio supported the growth of the liquid assets/total deposits ratio, which stood at 54.16 %, against 47.08% in the same period of 2023.

The loan-to-deposit ratio shifted downwards driven by the year-on-year reduction of the credit portfolio by 5.15 pp to 35.20% in the reporting period (Table 5).

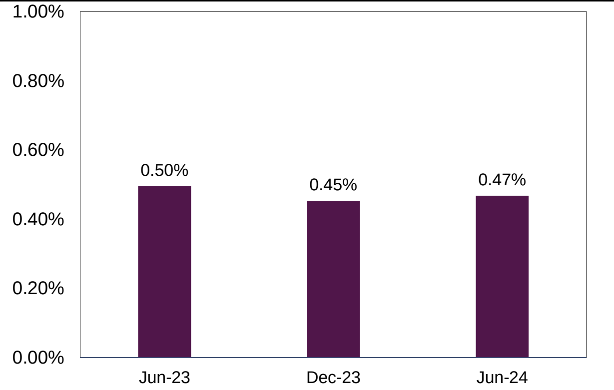
[7] 59.59% of this total account for demand deposits.

Box 1: Credit to the Real Estate Sector

As of June 30, 2024, housing, construction, and public works loans accounted for 8.85% of total credit and the weight of mortgage loans by total credit was 7.85%. These figures, coupled with the NPL level of 0.47% for these sectors, indicate that the banking sector has a very low credit risk exposure to the real estate sector, with little impact on the stability of the financial system (Chart 25).

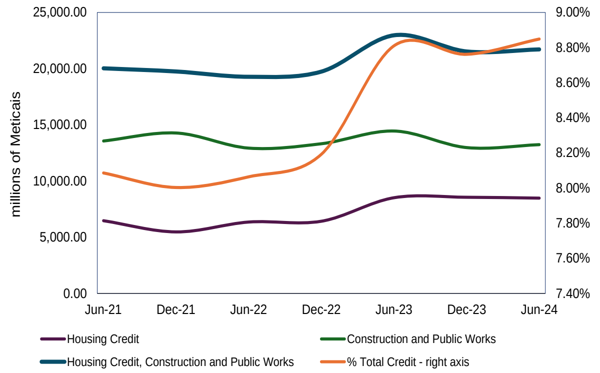
In recent years, the real estate sector has shown remarkable growth, with the emergence of new and imposing buildings, both for housing and business purposes and the rendering of public services. The growth of real estate stock contrasts with the nearly stable trend in lending to the housing, construction, and public works sectors in recent years (Chart 26), which leads to reservations in relation to certain real estate investments using bank financing.

Chart 25: NPL for Housing, Construction and Public Works



Source: BM, 2024

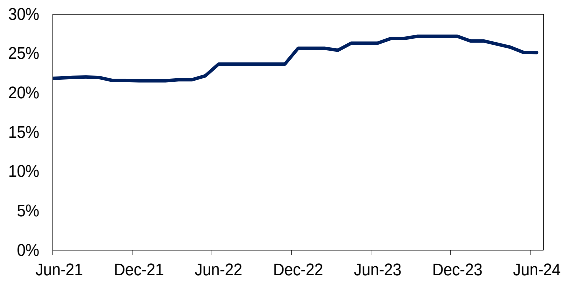
Chart 26: Loans for Housing, Construction and Public Works



Source: BM, 2024

In addition, housing loans have been constrained by low household disposable income (GDP per capita USD 646.00), coupled with the history of high interest rates for housing charged by commercial banks (Chart 27). In the Mozambican real estate market, the prices charged are merely speculative and not regulated, which is exacerbated by the absence of a formal criterion for their application, despite the existence of authorized agents to undertake the business of real estate intermediation. This is imperative for assessing the relationship of economic and financial indicators versus the valuation of real estate.

Chart 27: Indicative Interest Rate for Housing



Source: BM, 2024

2.2. Pension Funds[8]

In the reporting period, the pension funds sector proved to be a relevant source of funding for the MVM sector and less significant for the banking sector, which has a broader base of funding sources.

Due to their characteristics, pension fund institutions are expected to positively contribute to financial stability through their chain effects, including: (i) increased savings; (ii) increased availability of stable and long-term capital; and (iii) reduced capital market volatility.

Indeed, pension fund institutions capture savings from their participants by committing to repayment in the form of pension benefits over the long term but are unable to engage in high-risk investments due to regulatory constraints.

Similarly, these institutions are generally prohibited from borrowing and using derivative securities for speculative ends. On the other hand, given their long-term outlook, they are better positioned (depending on their size) to acquire sell-off assets from other institutional investors, particularly in times of financial crisis.

In this context, as a result of this possible countercyclical behavior (buying in the low season and selling in the high season), institutions can bring asset prices closer to their fundamental values and thus stabilize financial markets.

2.2.1. Weight of Pension Fund Deposits

As of June 30, 2024, the amount of pension fund deposits (compulsory and supplementary[9]) stood at approximately 9.07 billion meticais, which, compared to June of the previous year (18.2 billion meticais), reflects a reduction of about 50%.

This reduction is associated with the increase in investments in long-term instruments traded on the securities market, rather than short-term investments in the banking sector.

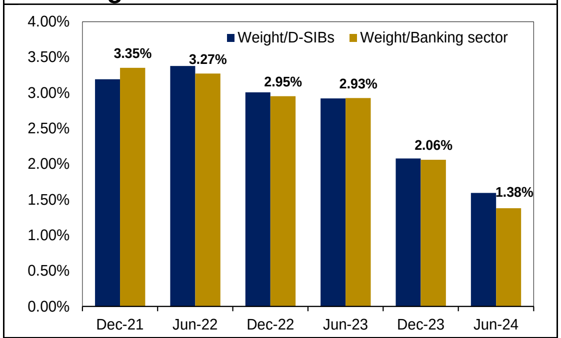
[8] For this analysis it consists of compulsory and supplementary funds.

[9] The supplementary social security aims to strengthen the benefits of compulsory social security (Decree No. 25/2009, of August 17, of the Council of Ministers).

In the reporting period, the weight of pension fund deposits over total deposits in the banking sector stood at 1.38%, compared to 2.93% in the same period of 2023.

This reduction in the weight of deposits with the banking system demonstrates that the resources of pension funds tend to be a smaller source of financing, with little impact on the assessment of liquidity risk (Chart 28).

Chart 28: Pension Fund Deposits in the Banking Sector



Source: BM, 2024

2.2.2. Weight of Pension Funds in the MVM

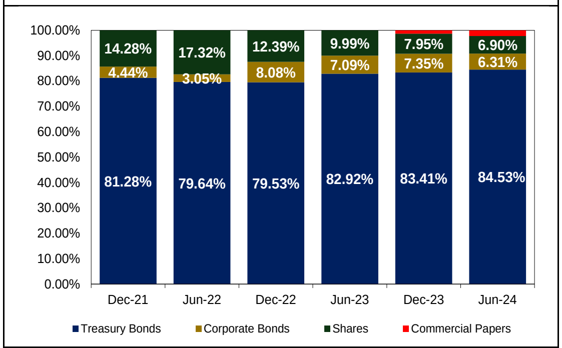
The evolution in the weight of the value of securities held by pension funds over the total value of securities in the MVM trended upwards (Chart 29).

In the reporting period, the weight of the value of securities held by pension funds over the total securities of MVM stood at 29.52%, i.e., an evolution of 7.58 pp, compared to the same period in 2023 (22.94%).

This trend, unlike the trend of dynamics of the weight of pension fund deposits on the total deposits of the banking sector, attests that the managers of these funds increasingly prefer to invest their resources in the MVM, in lieu of bank deposits.

Similar to the sovereign risk appetite evidenced by the banking sector, pension funds' investments in the MVM are also concentrated in treasury bonds (T-Bonds), rather than other securities available on the capital market, thus also exposing them to sovereign risk (Chart 29).

Chart 29: Pension Fund Investments in the MVM



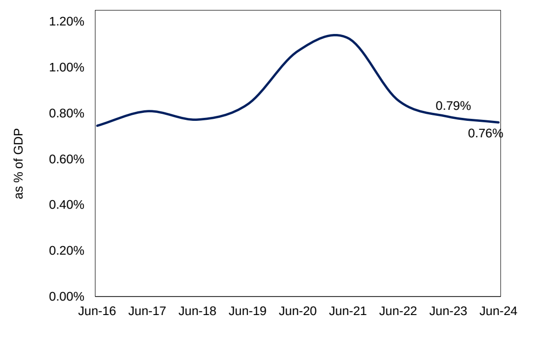
Source: BM, 2024

2.3. Insurance Sector

In the first half of 2024, the insurance market output stood at 11.27 billion meticais, a growth of 4.65% compared to the same period in 2023.
This annual growth reflects the increase in turnover of 1.30% and 5.25% in the life and non-life sectors, respectively, as well as the expansion in the number of market operators from 16 to 19.

In June 2024, the weight of the insurance sector's production on GDP stood at 0.76%, showing stability compared to the same period in 2023, whose weight stood at 0.79% (Chart 30).

Chart 30: Overall Insurance Industry Output



Source: ISSM, 2024[10]

2.3.1. Insurance Sector loans in the Banking Sector

Loans to the insurance sector accounts for 0.12% of the total credit portfolio of the banking sector in June 2024 (Table 6).

On the other hand, credit insurance accounts for 27.64% of the total credit portfolio of the banking sector, i.e., 79.28 billion meticais, of which 73.91% are held by D-SIBs (Table 7).

Table 6: Credit to Insurers – June 2024

billion meticais

	D-SIB´s	Sector
Total Credit Granted to Insurance Companies	0.32	0.36
Credit	**153.09**	**286.81**
Weight	0.21%	0.12%

Source: BM, 2024

Table 7: Credit Insurance in the Banking Sector – June 2024

billion meticais

	D-SIB´s	Sector
Credit insurance - Total	58.60	79.28
D-SIBs	73.91%	
Credit	**153.09**	**286.81**
Weight on Total Credit	38.28%	27.64%

Source: BM, 2024

2.3.2. Weight of Insurance Industry Investments in the MVM

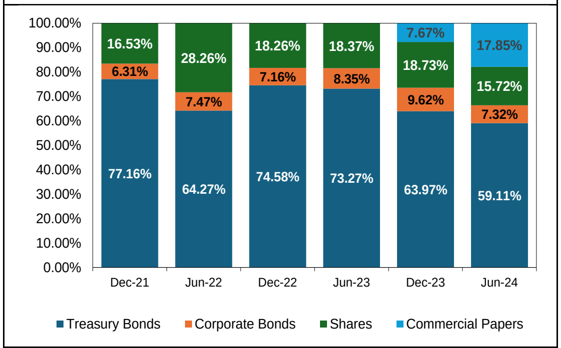
Similar to the sovereign risk appetite evidenced by the banking sector, insurance investments in the MVM are also mostly concentrated in T-Bonds (59.11%), rather than other securities

[10] Mozambique Insurance Supervision Institute

available on the capital market, thus making them equally exposed to sovereign risk.

Meanwhile, insurance sector investments in T-Bonds have declined, offset by the increase in the sector's investments in Commercial Paper[11] (Chart 31).

Chart 31: Weight of Insurance Sector Investments in the MVM



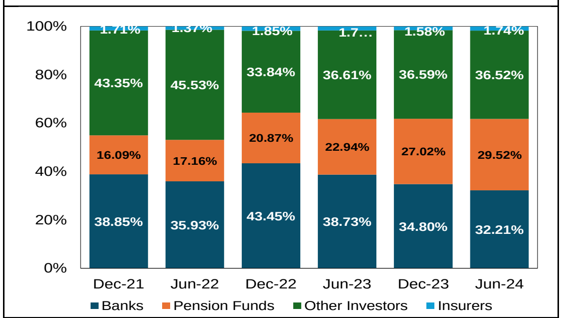
Source: BM, 2024

2.4. Securities Market

In June 2024, MVM's market capitalization stood at 203.85 billion meticais, against 175.35 billion meticais in June 2023, a weight of 13.27% and 13.10% in nominal GDP[12], respectively.

The MVM's activity is mainly supported by institutions that are part of the financial system, which hold 63.48% (63.39% in June 2023) of the value of investments. Indeed, the banking sector holds 32.21% (38.73% in June 2023) of the value of investments in the MVM, followed by the pension fund sector with 29.52% (22.94% in June 2023) and the insurance sector with 1.74% (1.72% in June 2023). The remaining 36.52% (36.61% in June 2023) are held by investors of another nature (Chart 32).

Chart 32: Weight of Financial System Sectors in the MVM



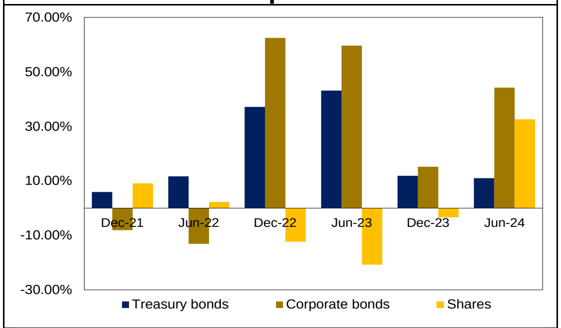
Source: BM, 2024

[11] Commercial paper is a short-term debt security (up to 1 year) traded on the capital market, where companies obtain financial resources by paying an interest rate and returning the amount invested until the end of the loan period. As of June 30, 2024, non-systemically important credit banks were the main issuers of this instrument in the MVM.

[12] Calculations made considering the projection of nominal GDP of 2024, according to the Economic and Social Plan and State Budget 2024, and nominal GDP of 2023, according to data from the National Statistics Institute.

The dynamics for the reporting period result from to the increase in market capitalization across all the main segments of MVM, namely, T-Bonds by 10.98% (17.18 billion meticais), corporate bonds by 44.2% (1.91 million meticais) and shares by 32.58% (4.72 billion meticais) (Chart 33).

Chart 33: Market Capitalization



Source: BVM, 2024

The increase in the market capitalization of T-Bonds was mainly due to the State's greater use of this window to meet its financing needs, resulting in a net issuance of 19.63 billion meticais.

However, the resulting impact of this demand from the State was slightly cushioned by price fluctuations due to market dynamics, which led to a reduction in the market capitalization of T-Bonds by about 2.40 billion meticais.

Moreover, developments in the market capitalization of corporate bonds were mainly driven by the net issuance of securities (net of maturities) in the amount of 1.89 billion meticais, due to the greater use of companies of this window to meet their financing needs.

This increase was slightly complemented by an increase in market capitalization of 12.50 million meticais, arising from price fluctuations typical of market dynamics.

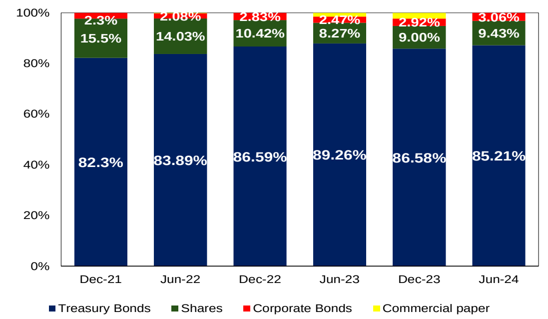
Regarding the stock market, price fluctuations were the main driver of the dynamics in the reporting period and gave rise to the increase in the market capitalization of this segment by approximately 4.05 billion meticais.

It should be noted that the positive dynamics of share prices (share appreciation) mainly arise from the increase in income and dividends per share achieved by companies in previous periods.

In addition, new shares were admitted to the stock exchange, which contributed slightly, by about 0.7 billion meticais, to complement the increase in the market capitalization of this market segment.

In June 2024, T-Bonds accounted for 85.21% of market capitalization, following 89.26% in June 2023, which persistently signals Sovereign financing using this market segment (Chart 34).

Chart 34: Weight of the MVM Various Segments in Market Capitalization



Source: BVM, 2024

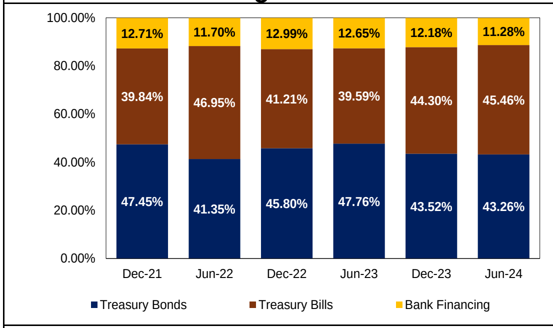
This behavior, coupled with the increase in domestic public debt with the use of T-Bills and direct financing from domestic banks (Chart 35), increases sovereign risk, with a potential influence on systemic risk and, therefore, on financial stability.

Regarding the volume of transactions by category of securities listed on the stock exchange, T-Bonds accounted for the largest weight, in June 2024, with 99.86% of the total, against 98.34% in June 2023 (Chart 36).

On the other hand, the low volume of transactions in the corporate shares and bonds segments suggests that the capital market continues to be less used as an alternative for financing the economy.

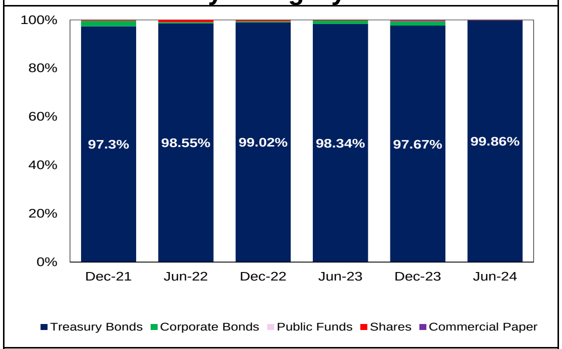
In addition, the T-Bonds segment holds the most instruments listed per each MVM segment (Table 8).

Chart 35: Structure of Domestic Public Debt to the Banking Sector



Source: Ministry of Economy and Finance (MEF) and BM, 2024

Chart 36: Weight of the Volume of Transactions by Category of Securities



Source: BVM, 2024

Table 8: BVM-Listed Issues

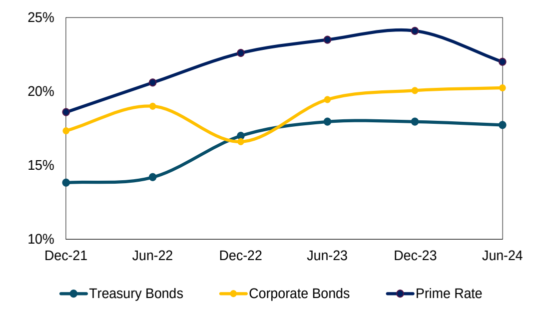
Description	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24
Treasury Bonds	33	34	39	40	43	46
Corporate Bonds	9	9	13	13	16	18
Public Funds	0	0	0	0	0	0
Shares	12	11	12	13	16	16
Commercial Paper	0	0	1	0	9	12
Total	**54**	**54**	**65**	**66**	**84**	**92**

Source: BVM, 2024

This dynamic does not support the expansion of financing alternatives for companies, which could, possibly, in some periods, contribute to reducing the cost of financing them.

Indeed, corporate bond interest rates have been more attractive over the past four quarters compared to the prime rate (Chart 37).

Chart 37: Interest Rates on BVM-listed Bonds and the Prime Rate

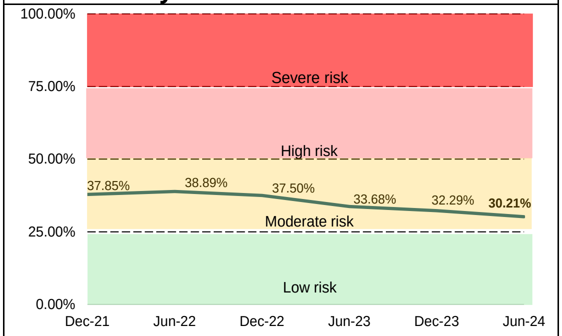


Source: BM and BVM, 2024

III. SYSTEMIC RISK ASSESSMENT

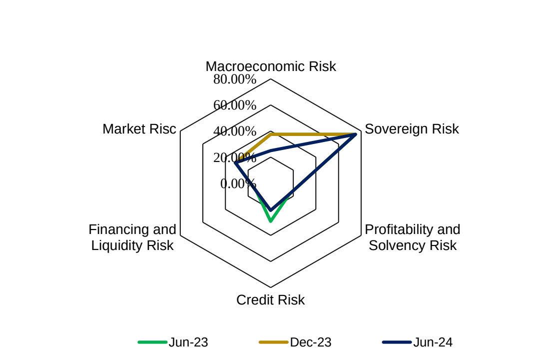
In June 2024, systemic risk index[13] stood at 30.21%, i.e., a reduction of 3.47 pp and 2.08 pp, compared to June and December 2023, respectively, having, however, remained moderate (Chart 38).

Chart 38: Systemic Risk Index



Source: BM, 2024

Chart 39: Systemic Risk Categories



Source: BM, 2024

The decrease in this indicator reflects:

- The reduction of credit risk, influenced by the improvement of the NPL ratio; and

[13] This index ranges from 0% to 100%. As it draws nearer to 0%, systemic risk is reduced and vice versa.

- The annual fall in the macroeconomic risk sub-index, mainly due to favorable inflation trends, partly driven by exchange rate stability (Chart 39).

The evaluation of the different risk categories indicates the following:

3.1. Macroeconomic risk

Macroeconomic risk remained moderate, driven by the following factors:

- Real GDP grew by 4.50% in the second quarter of 2024, i.e., a slowdown of 1.37 pp compared to the same period in 2023.

- Annual inflation slowed from 6.81% in June 2023 to 3.04% in June 2024, mainly reflecting the combined effect of tighter monetary policy and continued exchange rate stability.

  The variables in this risk category, particularly inflation, continued to benefit from the milder impact of geopolitical conflicts on the logistics chain and global market goods prices.

3.2. Sovereign risk

In June 2024, sovereign risk remained severe.

The prevalence of severe sovereign risk stems from rising ratios of government credit to total credit and public debt to GDP, which have increased, reflecting continued domestic public debt pressure.

3.3. Profitability and solvency risk

Profitability and solvency risk remained low.

Profitability indicators show that the banking sector had a positive financial performance, assessed by the stability of ROA and ROE, during the reporting period.

With regard to solvency, the sector remained robust and well capitalized, with the capital adequacy ratio standing at 26.33%, above the minimum regulatory requirement of 12.00%.

3.4. Credit risk

Credit risk decreased from moderate in June 2023 to low in June 2024.

This decrease in credit risk is explained by the reduction in the NPL ratio from

10.58% in June 2023 to 8.30% in June 2024.

It should also be noted that the CE/GDP gap remained in negative territory, signalling that the CE/GDP ratio remains below its long-term trend.

3.5. Liquidity risk

Liquidity risk remained low.

The variables in this risk category, namely the loan-to-deposit ratio and the short-term liquidity coverage ratio, registered favorable evolution in the reporting period.

Indeed, the loan-to-deposit dropped by 5.95 pp from June 2023, standing at 43.40% in June 2024.

Regarding the short-term liquidity coverage ratio, it increased from 42.07% in June 2023 to 47.73% in June 2024, above the regulatory requirement of 25.00%.

3.6. Market risk

Market risk remained moderate in June 2024, underpinned by continued exchange rate stability, directly supporting favorable growth in the ratios of foreign currency credit to total credit and foreign currency deposits to total deposits.

The prime rate of the financial system remains high, despite the successive reductions during the reporting period, supported by the MIMO policy rate normalization cycle that kicked off in January 2024.

3.7. Systemic risk outlook

The outlook for systemic risk evolution in the short and medium term is as follows:

Macroeconomic risk could see positive developments, considering single-digit inflation projections and moderate economic growth over the medium term.

However, uncertainties prevail regarding the impacts of climate shocks on agricultural production and various infrastructures that may hinder key macroeconomic indicators, with potential impact on systemic risk.

Moreover, **sovereign risk** should remain severe, given the ongoing pressure on domestic public indebtedness and the prevalence of military instability in some districts of Cabo Delgado.

With regard to **profitability and solvency risk**, the indicators concerned point to continued low risk in this category, since no major fluctuations are expected over the short and medium term.

As for **credit risk**, the MIMO policy rate normalization cycle that started in January 2024 is favorably driving the cost of loans, via downward adjustment of the prime rate of the financial system, which directly supports the improvement of asset quality.

Furthermore, **liquidity risk** is expected to remain stable in the short term, should the recent dynamics of the loan-to-deposit rate continue.

Market risk is expected to remain moderate. Despite prospects for (i) the reduction of the prime rate, arising from the normalization stance of the MIMO policy rate, and (ii) exchange rate stability, this is unlikely to be sufficient to reverse the trajectory of market risk to low level over the short term.

The overall outlook for developments in systemic risk components points to the systemic risk index remaining moderate.

IV. FINANCIAL SYSTEM VULNERABILITIES

The financial system performed positively in the first half of 2024, amid increased vulnerabilities at home and abroad.

During the reporting half-year, among several vulnerabilities, the continued pressure on public indebtedness to the financial system at high levels, military instability in some districts of the Cabo Delgado province, the country continued in the gray list of the Financial Action Task Force (FATF) and adverse climatic factors are highlighted.

Public indebtedness

The continued high pressure on public indebtedness was evident, particularly in the domestic component (Table 9). This reflects the increased use of T-Bonds and T-Bills to finance the cash deficit.

Table 9: Public Debt Stock

USD million

Description	2021	2022	2023	Jun-24
Internal debt	10,391.60	10,060.50	10,292.00	10,162.21
External debt	3,563.40	4,406.60	4,910.50	5,745.24
Public debt	**13,955.00**	**14,467.10**	**15,202.50**	**15,907.45**

Source: MEF, 2024

Regarding public external debt, out-of-court settlements reached with international creditors of undeclared debts are highlighted, which could potentially reduce debt burdens.

Military instability in some districts of Cabo Delgado province

Insecurity and military instability in this region have hindered the activities of economic agents, despite the progress made in the fight against violent extremism. In addition, this vulnerability has led to protracted uncertainty about the resumption of the onshore gas project of TotalEnergies in the Rovuma basin, besides limiting access to financial services, which impacts financial inclusion initiatives.

The country remains on the FATF grey list

Domestically, progress was made towards technical compliance (revised legal framework) and effectiveness in relation to the effective actions taken by the different authorities, as part of implementing the FATF Action Plan prepared by the Executive Committee for the Coordination of Anti-Money Laundering and Counter-Terrorist Financing Policies [14].

Remaining on the FATF grey list has negative implications and may result in vulnerabilities to the stability of its financial system, particularly restricted access to international financial markets, increased transaction costs and restricted capital flows.

Adverse climatic factors

In mid-March 2024, tropical storm Filipo made landfall in the provinces of Sofala, Inhambane, Gaza and Maputo, striking public and private buildings, infrastructures and production facilities, thus contributing to increased physical risks. This event hampered the ability of affected borrowers to honor their commitments to the financial system.

[14] Government institution responsible for coordinating and implementing the country's action strategy.

Box 2: Climate Risk and its Impact on Financial Stability

I. Background

Extreme weather events, such as rising global average temperatures, rising sea levels, changes in precipitation patterns, floods, droughts, cyclones, and earthquakes, have intensified and proliferated, significantly affecting the financial sector and the overall economy, both at home and abroad.

Mozambique has been repeatedly and severely affected by such events, whose magnitude and impact on financial institutions make the need for ongoing monitoring of associated risks imperative.

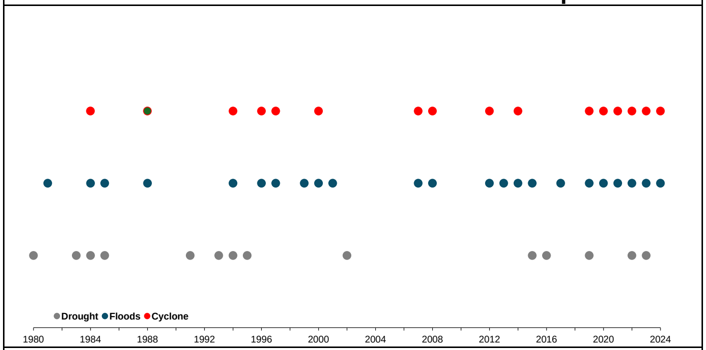
In recognition of the relevance and importance of this topic for central banks, the bank's strategic plan for 2024-2026 comprises actions related to regulating the approach to climate risks by the national financial system and the integration thereof into financial stability assessment.

Furthermore, as of March 7, 2024, the BM is a member of the plenary of the Network for Greening the Financial System (NGFS), a particularly relevant institution at a global level regarding the sharing of best practices and the effort to equip central banks and financial supervisors with the best tools to identify, assess and mitigate the impact of climate risks on the financial system.

II. Climate exposure and vulnerabilities in Mozambique

Mozambique is a country exposed to multiple climate-related hazards, particularly tropical storms, and periodic cyclones, which occur frequently between October and March, due to bordering one of the most active cyclonic zones in the Southwest Indian Ocean, in addition to droughts and floods.

Chart 40: Extreme weather events in Mozambique



Source: geographic database, 2024 (www.dadosmundiais.com)

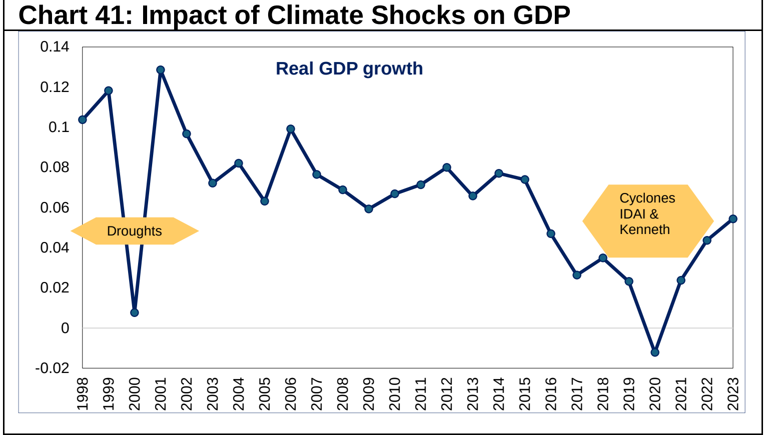
The increase in the frequency and severity of natural disasters has historically made Mozambique the most affected in Southern Africa, according to the *World Risk Report* (2022), thereby posing a threat to financial and macroeconomic stability.

The country has been hit by multiple climate-related shocks in the past 20 years, and in the first half of this year these events again constrained the performance of the domestic economy and financial sector, highlighting severe tropical storm Filipo, which struck the provinces of Zambézia, Sofala, Inhambane, Gaza and Maputo (Chart 40).

III. Impact of Climate Shocks on GDP

Chart 41 highlights the impact on GDP of the three major climatic events that have occurred in the country during the past 24 years (floods in 2000 and cyclones Idai and Kenneth in 2019).

Chart 41: Impact of Climate Shocks on GDP



Source: National Institute of Statistics

The fall in GDP, in the years in which the above events took place, was fundamentally driven by the negative performance of the following sectors: (i) agriculture, (ii) electricity and gas production and distribution, and (iii) water collection, treatment and distribution, in addition to the extractive industry, which in 2019 was hindered by adverse weather events, particularly the flooding of mines, which shows a correlation between the aforementioned climatic events and the level of domestic production.

IV. Impact of Climate Shocks on the Financial System

The most visible effect of climate shocks on the financial sector is the acceleration of the devaluation of real estate, due to exposure to risk, with consequences on the portfolio of assets of banks, insurers, and other financial institutions.

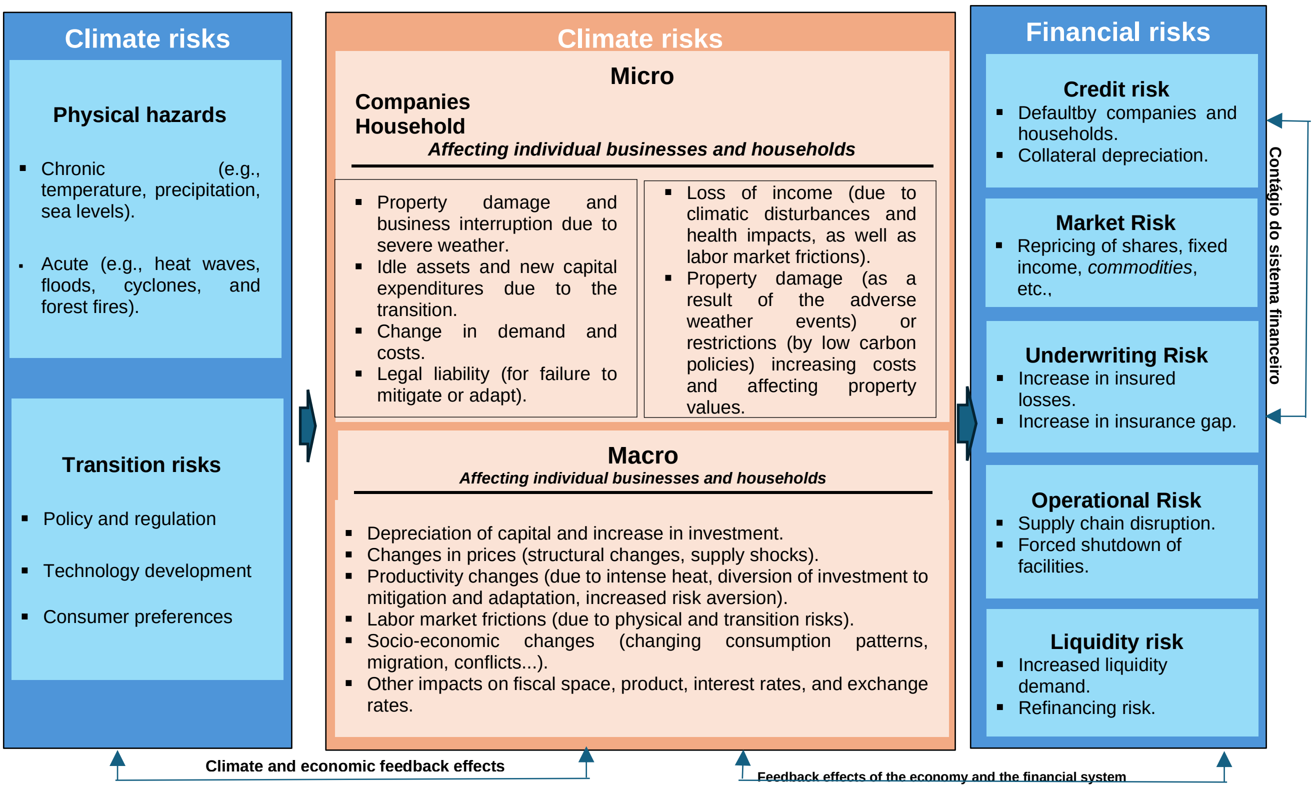
Weather events represent risks that are commonly presented in the following groups:

Physical risks - translate into economic costs and financial losses related to the destruction of infrastructures, factors, and means of production, due to the increased severity and frequency of extreme weather conditions, such as heat waves, landslides, forest fires, floods, storms, sea level rises, droughts, cyclones, among others; and

Transition risks – related to the adjustment process towards a low-carbon economy, including changes in government policies, legislation and regulation, changes in technology and the market, among others.

Physical and transition risks can be passed on to the financial system through their microeconomic impact on companies and households, as well as on macroeconomic variables, generating impacts for a set of financial risks, namely: credit risk, market risk, operational risk, liquidity risk and underwriting risk (Figure 1).

Figure 1. Transmission channels from climate risk to financial risk



Source: Adapted from Network for Greening the Financial System (2018)

Although Mozambique is repeatedly and severely affected by extreme weather events (cyclones and tropical storms), the domestic financial system has proven resilient to their impact.

This stability of the financial system may be related to the low exposure of banks to sectors likely to be affected by adverse climate effects, such as agriculture, electricity, and gas generation and distribution, water collection, treatment, and distribution, as well as tourism (Table 10).

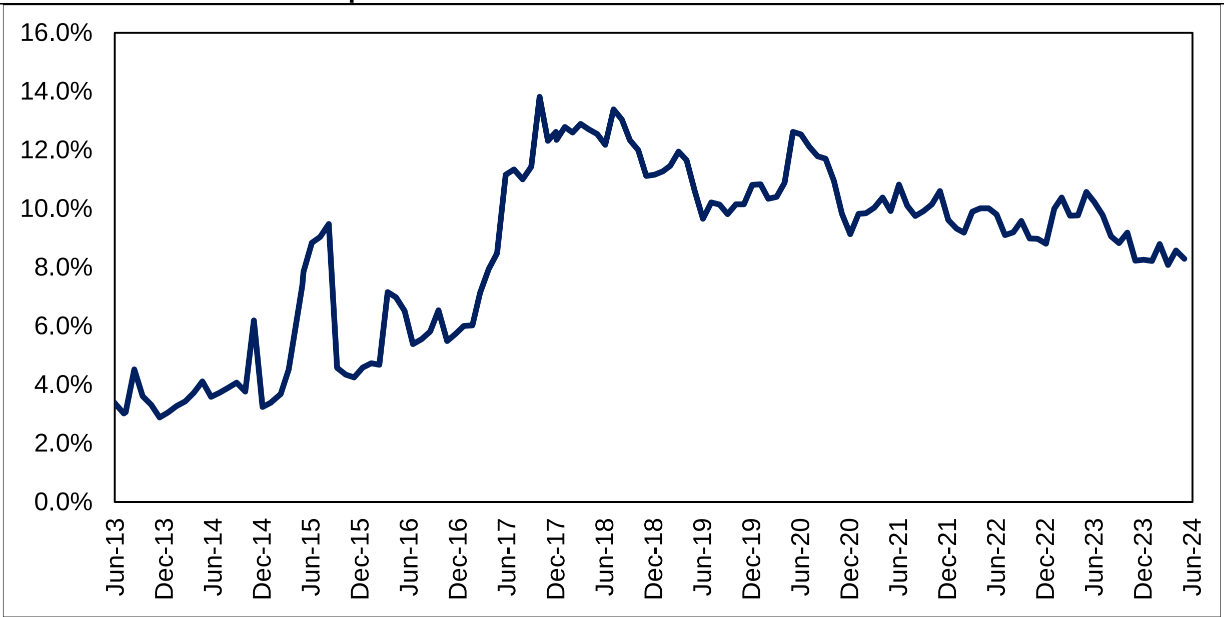
In addition, the restructuring of loans helps minimize the impacts of climate risks on credit quality. Indeed, as shown in Chart 42, default levels decreased in 2019 during cyclones Idai and Kenneth.

Table 10: Credit Distribution by Activity Sectors

Activity Sectors	Dec 2019		Dec 2020	Dec 2021	Dec 2022	Dec 2023	Jun 24
	Amount	%	%	%	%	%	%
1. AGRICULTURE	5,768,915	2.64%	2.40%	1.96%	1.87%	1.44%	1.36%
2. HUSBANDRY	863,614	0.39%	0.37%	0.33%	0.36%	0.26%	0.43%
3. SILVICULTURE AND FORESTRY	162,696	0.07%	0.07%	0.02%	0.03%	0.03%	0.03%
4. FISHERIES	1,316,125	0.60%	0.64%	0.42%	0.37%	0.35%	0.33%
5. EXTRACTIVE INDUSTRY	5,712,960	2.61%	4.04%	3.70%	2.48%	2.37%	2.68%
Coal	80,030	0.04%	0.04%	0.15%	0.01%	0.01%	0.00%
Other	5,632,930	2.58%	4.00%	3.56%	2.46%	2.35%	2.67%
6. MANUFACTURING INDUSTRY	29,043,895	13.28%	13.70%	12.62%	13.23%	9.55%	10.12%
6.1 Food, Beverages, and Tobacco	7,623,811	3.49%	3.27%	4.16%	2.89%	2.09%	1.66%
6.2 Textiles, Clothing and Footwear	586,893	0.27%	0.23%	0.14%	0.16%	0.15%	0.11%
6.3 Chemistry	1,849,422	0.85%	0.71%	0.56%	0.47%	0.12%	0.14%
6.4 Metalworking	2,969,750	1.36%	1.35%	1.05%	0.56%	0.42%	0.39%
6.5 Other	16,014,019	7.32%	8.14%	6.71%	9.14%	6.77%	7.82%
7. ELECTRICITY, GAS AND WATER	1,128,379	0.52%	0.66%	0.93%	0.68%	0.70%	0.63%
8. CONSTRUCTION AND PUBLIC WORKS	20,044,981	9.16%	6.75%	5.78%	5.53%	5.29%	5.40%
9. TOURISM INDUSTRY	3,315,004	1.52%	1.54%	1.39%	0.96%	0.80%	0.83%
10. TRADE	23,925,692	10.94%	11.26%	11.76%	11.73%	11.48%	9.99%
11. TRANSPORT AND COMMUNICATIONS	21,823,844	9.98%	9.88%	10.47%	12.97%	11.57%	10.85%
11.1 Rail Transport	98,914	0.05%	0.00%	0.39%	0.66%	0.51%	0.46%
11.2 Road Transport	3,554,720	1.63%	1.74%	1.82%	2.53%	2.18%	2.61%
11.3 Sea Transport	91,185	0.04%	0.02%	0.02%	0.03%	0.09%	0.05%
11.4 Others	18,079,026	8.27%	8.11%	8.23%	9.75%	8.79%	7.73%
12. NON-MONETARY FINANCIAL INSTRUMENTS	1,760,428	0.80%	0.57%	0.71%	1.55%	1.07%	1.38%
13. OTHER SECTORS	103,873,098	47.49%	48.13%	49.90%	48.25%	55.10%	55.98%
Particular	50,137,737	22.92%	24.49%	26.55%	29.26%	35.29%	37.92%
Housing	6,466,775	2.96%	2.83%	2.22%	2.66%	3.48%	3.45%
Miscellaneous	47,268,586	21.61%	20.81%	21.13%	16.33%	16.33%	14.61%
TOTAL	218,739,631	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: BM

Chart 42: NPL Ratio Developments



Source: BM, 2024

V. MACROPRUDENTIAL POLICY DECISIONS

The Financial Stability and Inclusion Committee decided, amid the assessment of systemic risk and the domestic and international macro-financial environment, to maintain the macroprudential policy measures in place unchanged in order to preserve financial stability, in particular:

- Capital buffer requirements for institutions identified as D-SIBs and Quasi-D-SIBs set at 2.0% and 1.0%, respectively;

- A 100.0% cap on the loan-to-value (LTV) ratio; and,

- 100% cap on the debt-to-income (DTI) ratio.

The objective of macroprudential policy is to preserve financial stability by strengthening the resilience of the financial system to financial shocks and imbalances and preventing and mitigating systemic risk.

Box 3: Financial and Business Cycles in Mozambique

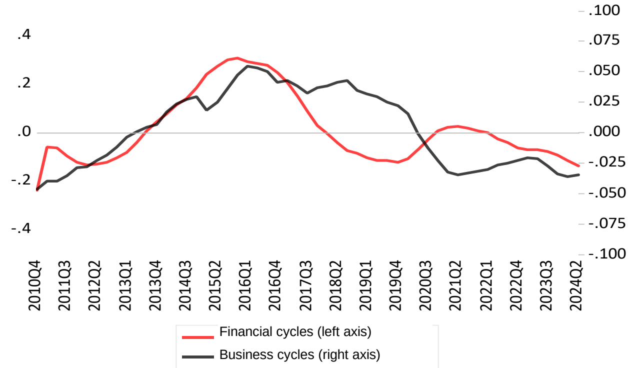
Financial cycles are defined as the deviation of financial variables (usually the ratio of credit to the economy to GDP) from their long-term trend and characterized by periods of expansion followed by contraction of financial activity. Furthermore, business cycles refer to the deviation of real economic activity from its long-term trend, characterized by periods of expansion followed by economic activity recession. In essence, the business cycle indicates the position of the economy as to its balance and likely impacts on inflation developments.

Financial cycles are usually associated with financial crises of domestic origin, which tend to occur near their peak, which is due to the excessive expansion of credit and the rise in asset prices during this period, indicating the prelude to a financial crisis. However, financial cycles are important because they can warn about excessive credit growth in the economy, allowing to timely identify the risks of an imminent financial crisis with good flexibility.

Chart 43 shows the developments in financial and business cycles in Mozambique from 2010Q4 to 2024Q2. At the beginning of the interval, both cycles showed an upward trend, stemming from a below-potential level, reaching the greatest distance from their long-term trend in the first half of 2015, reflecting the good performance of the economy and the positive trajectory of credit in financing economic activity.

In 2016, the financial cycle initiated a downwards shift, evidencing the shift away from its long-term trend, driven by the stance of banks, which began to favor the granting credit to the Government over credit to the economy, as a result of the levels of interest rates associated with T-Bills and T-Bonds, and by the government's demand for funds to finance public spending, in a context in which cooperation partners withdrew their support to the state budget on account of the undeclared debts' dossier.

Chart 43: Financial and Business Cycles in Mozambique



Source: National Statistics Institute and BM

This behavior continued until the end of 2019, when the financial cycle resumed movement towards its long-term trend, given the need to finance the economy amidst falling economic activity due to the impact of cyclones IDAI and Kenneth on the economy.
However, the recent trend shows that both cycles are below potential, but with signs of recovery of the business cycle, in line with the dynamics and prospects of the economy, while the financial cycle continues to shift away from its long-term trend, partly due to the State's competition in the credit available in the economy.

The forecast acceleration of economic activity in the half-year, supported by the improvement in the performance of the extractive industry and the tertiary sector, despite the occurrence of extreme weather events, explains the current trend of the business cycle.

Financial cycles longer than business cycles require more forward-looking monetary policy conduct, in order to strike the right balance between maintaining macroeconomic stability and financial stability, given their cycle duration differences.[15] 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 other financial variables, will allow for the proper policy [16]measures to be chosen in order to mitigate impacts on monetary and financial stability.

[15] For example, in periods when the financial cycle expands considerably or reaches a high level during a business cycle contraction, easing monetary policy in order to stimulate the economy can lead to a greater accumulation of risks to financial stability because lower borrowing costs encourage further credit expansion and higher asset prices.

[16]Such measures may include the requirement of larger countercyclical buffers and using stricter loan-to-value (LTV) ratios in circumstances, for example, of rapid housing price growth and credit (rather than just credit), since 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, which would have to be larger for cases where markets tend to suffer deeper recessions with more severe financial downturns, which, at least until the 2007-2009 global financial crisis, happened more frequently in emerging markets.

Box 4: The Role of the Deposit Guarantee Fund in Financial Stability

a) The importance of the Deposit Guarantee Fund in Protecting the Deposits of the Public

The Deposit Guarantee Fund (FGD) is the mechanism created by the government that guarantees the repayment of deposits made in banks, microbanks and credit unions. This fund ensures repayment to depositors in the event of bank insolvency.

Recently, the FGD's operating regulations were amended, as approved by Decree No. 49/2010, of November 11, through Decree No. 36/2024 of June 10, which adds to its mandate, among others.
Among the various changes provided by the new Decree, the main innovations relevant for their contribution to maintaining financial stability are as follows:

i. **Financing of resolution measures**, in compliance with Law No. 20/2020, of December 31, Credit Institutions and Financial Companies Act (LICSF)[17], in addition to the function of repayment of deposits held at participating institutions;
ii. **Extension of warranty coverage**, including deposits held by legal persons, in foreign currency and by non-resident entities;
iii. **Reduction of the term for repayment of depositors**, from three months to seven days;
iv. **Change of the frequency of contributions**, from annual to quarterly;
v. **Setting up the back-up funding mechanism.**

b) The Deposit Guarantee Fund and its Role in Resolution

The Credit Institutions and Financial Companies Act marks an important milestone in the financial legislation of Mozambique, having, among the innovations introduced, reinforced the function of Bank Resolution Authority of the BM.
With regard to the protection of depositors, the law broadened the FGD's mandate to include the financing component of resolution measures that may be decreed by the BM, in addition to the repayment of deposits.

In the Mozambican financial system, resolution proceedings that involve or require the participation of the FGD, according to Credit Institutions and Financial Companies Act are as follows:

- **Collateral for assets and liabilities:** the FGD may be used to guarantee the assets or liabilities of the institution undergoing resolution, a bridge institution or an asset management vehicle[18].
- **Lending:** the FGD may lend to a bridge institution or an asset management vehicle[19].
- **Asset acquisition:** may be used to acquire assets of the institution undergoing resolution[20].
- **Subscribe and realize share capital:** FGD may subscribe and pay up the share capital of a bridge institution or an asset management vehicle[21].
- **Compensation payments:** may pay compensation to shareholders and creditors of the institution undergoing resolution[22].

As stated above, the FGD, in the exercise of its powers, contributes to financial stability by reducing financial uncertainty and promoting confidence in the financial system.
The FGD contributes to the strengthening of the existing financial safety net, including supervision and emergency liquidity assistance, strengthening the financial system when a financial institution is insolvent.

Its importance is pivotal, since, on the one hand, it ensures the stability of the financial system and avoids the much-feared systemic risk, while, on the other, it guarantees the protection of depositors, particularly small-scale, bringing the fundamental value of trust. And this is so because the funds guarantee depositors that their deposits are guaranteed up to a certain amount, even in a banking crisis scenario, in which a certain credit institution faces liquidity and even capital adequacy problems, thus avoiding bank runs and their damaging effects.

With the current revision of the regulatory framework, the FGD has gained a “paybox plus” model version, where, in addition to ensuring the orderly repayment of deposits in the event of unavailability, its tasks are to finance resolution measures under the Credit Institutions and Financial Companies Act, participate in or conduct the dissolution and liquidation proceedings of participating institutions as determined by the BM, as well as promote and carry out actions that contribute to the development and consolidation of deposit insurance and to strengthening the stability of the financial system in general.

It can be concluded that the rapid repayment to depositors by the FGD acts as a mechanism to restrain bank runs in the event of a situation of deposit unavailability, while the application of resolution measures aims to[23] (i) "prevent serious consequences for financial stability, including avoiding contagion between financial institutions, including market infrastructures, and upholding market discipline", and (ii) "protect depositors whose deposits are guaranteed by the FGD".

[17] Article 60, of Law No. 20/2020, of December 31.
[18] Article 173 (1) (a), of Law No. 20/2020, of December 31.
[19] Article 173 (1) (b), of Law No. 20/2020, of December 31.
[20] Article 173 (1) (c), of Law No. 20/2020, December 31.
21 Article 173 (1) (d), of Law No. 20/2020, of December 31.
[22] Article 173 (1) (e), of Law No. 20/2020, of December 31.
[23] Article 131 (1) of Law No. 20/2020, of December 31.

Glossary

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

Cost-to-income – indicator calculated by the ratio of operating costs to banking income, which measures the efficiency of the organization.

Debt-to-income – ratio between the amount of the monthly installment calculated with all loans of the customer and their monthly income.

Equity – concept used in banking supervision as a fundamental reference for applying various ratios and various prudential standards.

Impairments –the book value in financial statements to account for expected asset-related losses. This amount shall be deducted from the value of the respective asset in order to correct its value, considering the risk of associated losses.

Global share market volatility index – the S&P 500 Volatility Index, also known as the CBOE Volatility Index or VIX, is an indicator that measures the expected volatility of the US stock market. Higher values indicate an expectation of greater volatility and uncertainty, while lower values suggest greater confidence and stability.

Loan-to-value - the ratio between the total amount of credit agreements secured by a given asset and the purchase price or appraised value of the secured asset.

NPL - short for non-performing loans, that is, loans that do not generate positive flows and profitability to banks.

Banking income – set of operating income receivable by a financial institution, arising from commissions, interest, trading, interbank operations.

Regulatory provisions - amounts recognized to meet losses related to the activities of financial institutions. They shall be constituted in accordance with the prudential regime determined by the supervisory authorities.

Solvency ratio - ratio of own funds to risk-weighted assets.

Risks – factors associated with uncertainties and that, should they materialize, jeopardize capital and income.

ROA – short for return on assets, obtained by dividing net income by total assets, and measures the profit generated by each monetary unit of assets.

ROE – short for return on equity, obtained by dividing net income by equity.

TIER I – core capital (Level 1), which includes the best quality capital (share capital, reserves and retained earnings) and responds primarily to the liabilities incurred by the institution.

Tier II – supplementary capital (Level 2), consisting of capital elements that are not core capital, and can be mobilized to absorb losses (subordinated loans, revaluation reserves, among others).

Vulnerabilities - set of characteristics that highlight the weaknesses of a particular system.

Banking Sector - set of credit institutions aimed at financial intermediation through deposit-taking and lending.

Financial system - set of financial institutions operating in Mozambique regulated by the Banco de Moçambique and the Mozambique Insurance Supervision Institute.

Annex 1: Key Financial Soundness Indicators

Description	Dec-21	Jun-22	Dec-22	Jun-23	Dez-23	Jun-24
Capital adequacy						
Capital adequacy ratio	26.19%	26.76%	26.96%	23.34%	25.68%	26.33%
Tier I capital adequacy ratio	26.71%	27.33%	27,52 %	23.87%	26.65.%	27.01%
Leverage ratio	13.27%	12.76%	12.76%	12.54%	13.32%	13.48%
Asset quality						
NPL ratio	10.60%	10.02%	8.97%	10.58%	8.23%	8.30%
NPL coverage ratio	72.63%	67.99%	71.84%	70.61%	66.02%	67.84%
Profitability						
ROA	3.93%	4.46%	4.69%	4.64%	4.66%	4.52%
ROE	17.52%	18.19%	19.13%	18.38%	19.11%	18.75%
Net interest income ratio	64.08%	67.10%	68.49%	69.03%	63.87%	66.25%
Cost-to-income ratio	53.75%	53.34%	53.84%	54.42%	53.79%	57.55%
Liquidity and funds management						
Liquid assets/total deposits ratio	67.98%	68.54%	69.49%	44.77%	49.62%	51.07%
Liquid assets/total assets ratio	47.89%	48.65%	50.50%	30.72%	34.36%	34.92%
Short-term liquidity coverage ratio	68.30%	68.81%	69.79%	42.07%	47.42%	47.73%
Loan-to-deposit ratio	50.22%	48.07%	47.06%	49.35%	44.90%	43.40%