ECONOMIC OUTLOOK AND INFLATION FORECASTS

December 2020

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

Foreword

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

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

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

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

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

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

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

Rogério Lucas Zandamela

Governor

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Executive Summary

The Monetary Policy Committee (MPC) of the Banco de Moçambique has decided to keep the monetary policy interest rate, MIMO rate, at 10.25%. The decision is sustained by the continuous prospects of prices increase in the medium term, associated with the high risks and uncertainties, in a context of an expected slow recovery of economic activity in 2021. The Committee reaffirms that the mitigation of the prevailing risks and promotion of sustainable and inclusive growth requires deepening structural reforms.

The MPC also decided to keep the Standing Deposit Facility (SDF) and the Standing Lending Facility (SLF) interest rates at 7.25% and 13.25%, respectively, as well as the Reserve Requirement ratio for liabilities in domestic and foreign currency at 11.50% and 34.50%, respectively.

Inflation is expected to accelerate in the near and medium term, while remaining at a single-digit. Annual inflation accelerated for the third month in a row to 3.27% in November, from 3.20% in October. For 2021, domestic prices are expected to increase, reflecting essentially, the end of part of the government's administrative measures to contain prices in context of the COVID-19, the upward trend of food prices on the international market, and the gradual recovery of demand for goods and services. However, the extension of exemption on the Value Added Tax (VAT) on essential goods until 2023 may dampen inflation, thus remaining at single-digit, in line with the expectations of economic agents surveyed in the first half of December 2020.

Economic activity is estimated to contract less in 2020, followed by a timid recovery in 2021. After a significant drop in Gross Domestic Product (GDP) in the second quarter of 2020 (-3.25%), real GDP reduced by 1.10% year-on-year in the third quarter, and therefore economic activity is expected to contract less in 2020. For 2021, economic activity is expected to recover, although slowly, stimulated by the development of gas exploration projects and by the recovery in external demand, in the face of the discovery of the COVID- 19 vaccine.

A sound and sustainable growth of economic activity requires deepening structural reforms. Given the limits of the effects of monetary policy, the MPC reaffirms that achieving sustainable and inclusive growth in the medium term requires the simultaneous implementation of other economic policies, as well as deepening other structural reforms aimed at strengthening institutions, improving the business environment, attracting investment and creating jobs.

Pressure on public finances remains. The financial needs to cover expenses related to defense, security and social support to populations affected by military instability in the central and northern regions of the country, as well as eventual spending due to the effects of climate shocks and logistics for administering the COVID-19 vaccine, raise concerns about the fiscal stance for 2021. It is expected that the government will continue to rely on internal deficit financing in view of the challenges faced by most cooperation partners in the context of the pandemic. Since the last MPC, domestic public debt, excluding loan and lease contracts and past due liabilities, increased from 174.638 million meticais to 182.325 million meticais.

For the near and medium term, the risks and uncertainties associated with inflation forecast remain high. Since the last MPC, the risks and uncertainties remain high, underlining at the domestic level, the on-going of military conflicts in the central and northern parts of the country, the concerns surrounding the evolution of the COVID-19 pandemic and its impact on the economy, as well as the likelihood of above-normal rainfall in the central and southern regions of the country. On the external side, it is highlighted the volatility of prices of major commodities.

The next MPC meeting is scheduled for 27 January 2021.

Chapter I. Recent Developments in International Economy

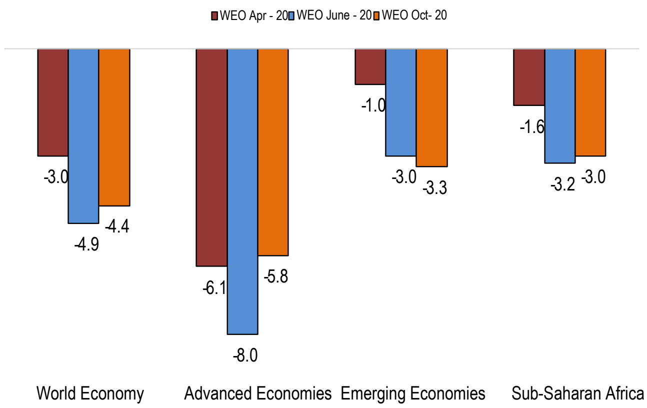
The easing of restrictive measures to contain COVID-19 was decisive for (i) a less severe contraction of gross domestic product (GDP) in the third quarter of 2020 and projections of minor retraction in 2020 and (iii) faster recovery of global economic activity in 2021. Meanwhile, inflation remained stable in most countries, in a context where expectations on roll-out of massive production and use of the COVID-19 vaccine contributed to the recovery in the price of oil and to expectations of a better performance of the world economy in the medium term.

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

Region	Achieved	Projection	
	2019	2020	2021
World Economy	**2.8**	**-4.4**	**5.2**
Advanced	**1.7**	**-5.8**	**3.9**
U.S.	2.2	-4.3	3.1
Euro Area	1.3	-8.3	5.2
Germany	0.6	-6.0	4.2
Japan	0.7	-5.3	2.3
United Kingdom	1.5	-9.8	5.9
Emerging and Developing	**3.7**	**-3.3**	**6.0**
Brazil	1.1	-5.8	2.8
India	4.2	-10.3	8.8
China	6.1	1.9	8.2
Sub-Saharan Africa	**3.2**	**-3.0**	**3.1**
South Africa	0.2	-8.0	3.0

Source: IMF

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



Source: IMF

1.1. Recent Economic Activity and Forecasts

The world economy is expected to contract less in 2020 and to recover more in 2021.

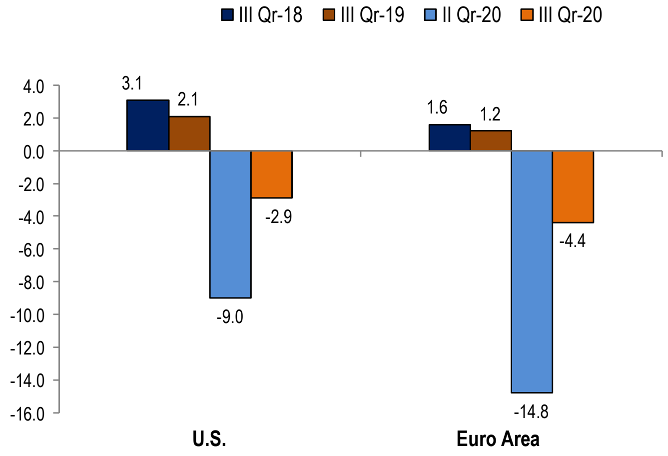
In October's edition of the World Economic Outlook (WEO), the International Monetary Fund (IMF) updated the growth forecasts of the world economy for 2020 to -4.4%, against the figure of -4.9% advanced in June (Table 1-1 and Chart 1-1).

The review follows from (i) the gradual reopening of economic activity in several regions of the globe, amid the relaxation of restrictive measures in the context of COVID-19; (ii) the consolidation of the recovery of the Chinese economy, with reflection on global trade; and (iii) the positive impact of fiscal and monetary policies adopted in several countries to alleviate the effects of the pandemic.

In the third quarter of 2020, the economic activity of the main trading partners was marked by a less severe contraction than anticipated.

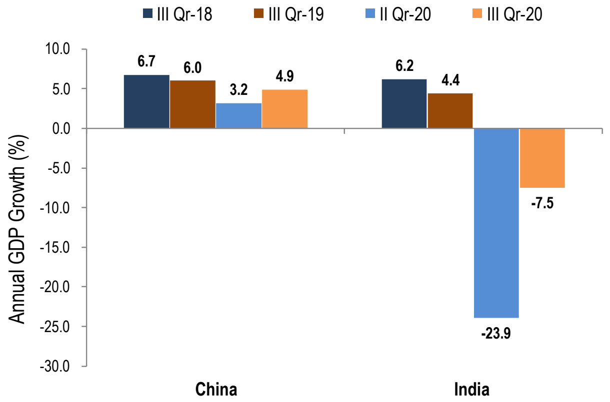
Economic activity improved in the US and Euro Area. Relaxing restrictive measures and gradually opening production centers contributed to a less severe recession in these economies (Chart 1-2).

Chart 1-2: US and Euro Area GDP Developments (%)



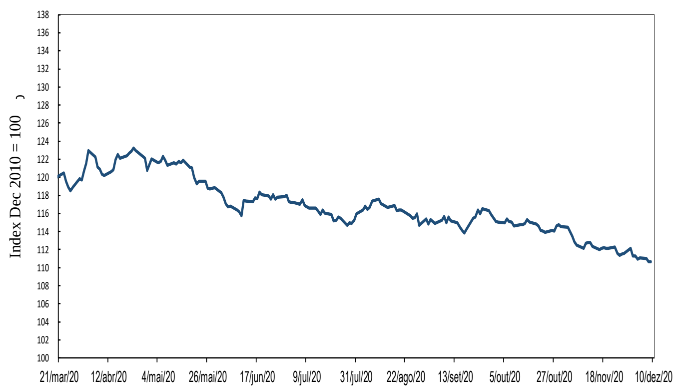
Source*: Reuters* and *Trading Economics*

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



Source*: Reuters and Trading Economics*

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



Source: *Reuters*

In the emerging economies block, China has consolidated its recovery trend. In the third quarter of 2020, China recorded an annual economic growth of 4.9%, while India experienced a contraction of 7.5% (Chart 1-3).

In the case of China, which contained the COVID-19 spread in the first quarter of 2020 and reopened its economic activity earlier, the relaxation of restrictive measures in the third quarter of the current year in several countries boosted Chinese exports, with an impact on its GDP.

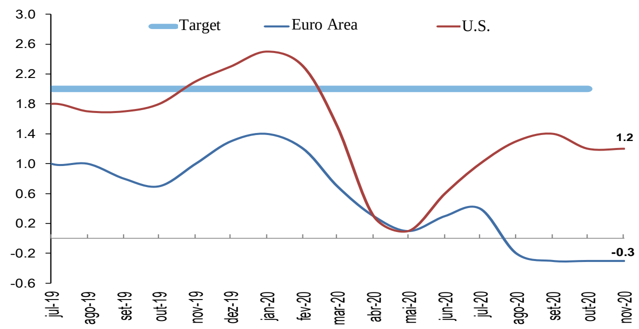
Meanwhile, the contraction of the Indian economy reflects the effect of the current restrictive measures, although the trend towards its gradual relaxation has mitigated the fall in GDP in the third quarter of 2020.

Nonetheless, the US Dollar remains weak, reflecting the uncertainties associated with the second wave of the COVID-19 spread.

The number of daily infections continues to grow in the US, exacerbating uncertainties around the effectiveness of the restrictive measures imposed, with a reflection on the weakening of the dollar in the international market. Indeed, from the last MPC (October/2020) until the second week of December 2020, the USD Composite index against some major trading currencies (Euro, Rand, Pound and Yen) recorded accumulated losses of 3.55%. In annual terms, the loss was 1.78% (Chart 1-4).

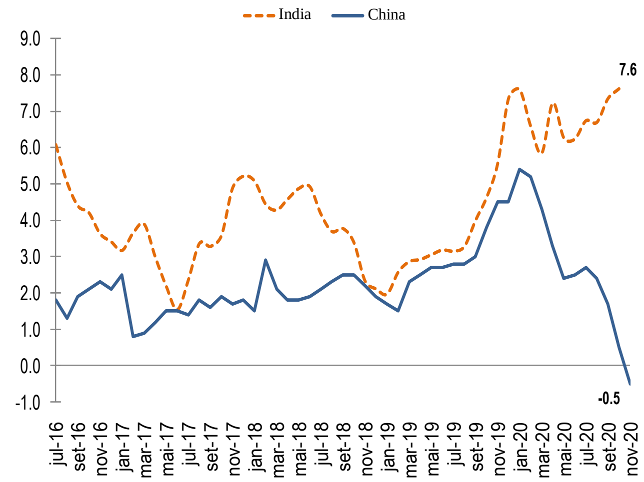
The volatility of food and energy prices, coupled with the gradual resumption of economic activity, generate a mixed behavior in the

Chart 1-5: US and Euro Area GDP Developments (%)



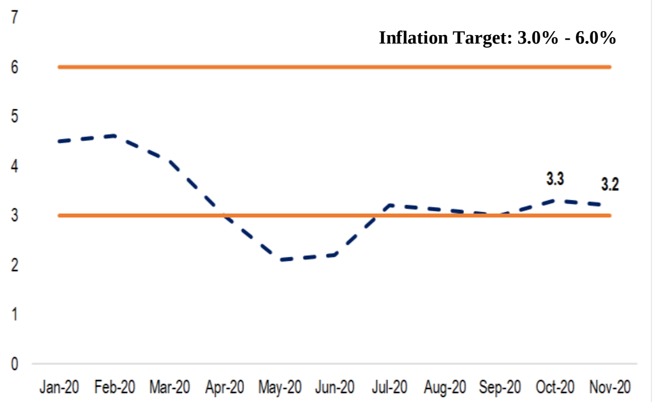
Source: *Reuters and Trading Economics*

Chart 1-6: Inflation in China and India



Source*: Reuters and Trading Economics*

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



Source*: Reuters and Trading Economics*

annual inflation of the main trading partners.

In November 2020, available data show that annual inflation in the US and the Euro Area remained stable, reflecting the fall in the price of energy and medical services, which in general overcame the pressure of rising food prices, in a context where the economic activity of these trading partners remains timid amid fears of the effects of the spread of the second wave of infections (Chart 1-5).

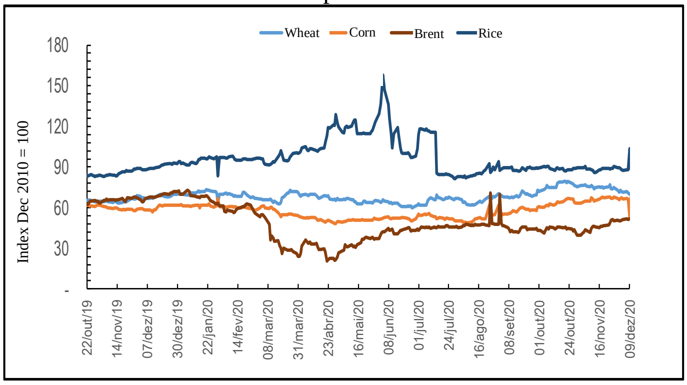
In the Emerging Economies group, China's overall price level fell historically to -0.5% in November 2020. The observed deflation reflected the reduction in the price of pork, a product that has regained its supply after the country was deeply affected by African swine fever since August 2018.

In India, in the month of October, annual inflation accelerated 34 bps and was set above the inflation target (2% -6%). This performance reflects strong demand, especially for food, amid the festive season (Chart 1-6).

In South Africa, inflation remained stable, as a corollary to the reduction in transport prices (due to the fall in the oil price), which supplanted the slight pressure on food and non-alcoholic drinks prices, in a context of gradual recovery of economic activity in that country (Chart 1-7).

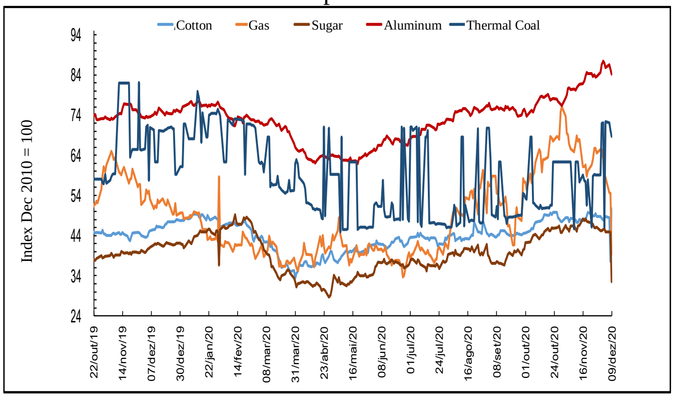
In most countries, monetary policy interest rates remain unchanged. Since the last MPC to date, there continues to be a widespread trend towards maintaining policy interest rates, with almost a consensus among central banks that there is limited scope for monetary policy to continue to contribute to mitigating the effects of the pandemic on the economy.

Chart 1-8: Price Index of Imported Goods



Source: *Reuters*

Chart 1-9: Price Index of Exported Goods



Source: *Reuters*

1.2. Main Commodities Prices

Expectations of success in containing COVID-19, with the start of mass production of the vaccine, lead to prospects for a faster recovery in global demand, with an impact on the prices of some commodities.

Indeed, since the last MPC until the second week of December, the price of brent oil recorded cumulative gains of 13.9%, being quoted at 52.60 USD/barrel on December 10 (Chart 1-8). The upward trend was also observed in the prices of some Mozambican export products, such as aluminum (7.4%) and coal (1.0%) (Chart 1-9).

With regard to food, during the period under review there was a slight recovery in the price of rice (0.6%) and a fall in the price of wheat (10.0%) (Chart 1-9).

The slight recovery in the price of rice on the international market is justified by increased demand, especially from Chinese imports, in a context of limited supply from the largest producers (Thailand, Myanmar and Vietnam). With regard to the fall in the price of wheat, good weather conditions favored the harvest prospects.

Chapter II. Recent Developments in Domestic Economy

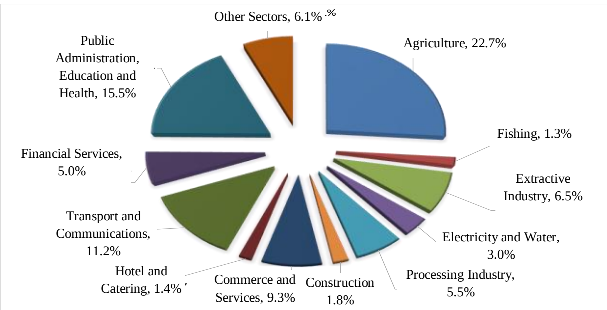
The continuous easing of domestic and external restrictive measures contributed to a gradual recovery in economic activity and a consequent lower contraction in GDP in the third quarter of 2020, a trend that is expected to continue until the end of the year. Meanwhile, in the short term, inflation is still expected to accelerate, while remaining low at a single digit. This dynamic is expected to reflect, essentially, the effect of the lifting of part of the price containment measures decreed by the government in the COVID-19 context.

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

Activity Sectors	2019	2020		
	III	I	II	III
Primary Activity	**-3.3**	**-0.3**	**-2.6**	**-1.9**
Agriculture	-1.9	2.9	3.5	3.2
Fishing	-9.1	1.5	-1.8	-2.8
Extractive Industry	-6.1	-11.7	-25.6	-16.2
Secondary Sector	**0.1**	**3.2**	**-2.4**	**0.6**
Electricity and Water	4.1	6.5	6.3	4.1
Processing Industry	-0.8	2.5	-5.3	-0.9
Construction	-3.0	1.7	-0.9	-0.2
Tertiary Sector	**1.6**	**1.3**	**-4.1**	**-2.4**
Commerce and Services	-3.2	2.9	-5.7	0.2
Hotel and Catering	-0.7	-1.4	-35.8	-31.4
Transport	4.5	5.0	-4.7	-1.2
Financial Services	1.8	-0.1	-0.6	-1.9
Public Administration, Education and Health	1.2	-3.0	-2.5	-1.8
Other Sectors	4.4	2.8	2.0	0.1
GDP and cost factor	**-0.3**	**1.0**	**-3.3**	**-1.9**
Tax on products	13.2	6.2	-2.5	4.5
GDP	**1.2**	**1.7**	**-3.3**	**-1.1**

Source: INE

Chart 2-1: Sectoral Structure of GDP in the Third Quarter of 2020



Source: INE

Table 2-2: Balance of Payments (million USD)

	Incl. GP			
	I Qr 20	II Qr 20	III Qr 20	Accumulated up to September 20
Current Account	**-1,177**	**-1,026**	**-1,384**	**-3,587**
Balance of Goods	-886	-545	-453	-1,885
Exports	**898**	**724**	**908**	**2,530**
Imports	1,784	1,269	1,361	4,414
Balance of Services	-325	-489	-1,037	-1,851
Balance of Primary Income	-64	-59.7	-71	-195
Balance of Secondary Income	98	**68**	**177**	**344**
Capital Account	45	19	29	94
Financial Account	**932**	**1,693**	**1,417**	**4,042**
comprising				
FDI	**714**	**34**	**786**	**1,533**
Other investments	217	1,656	624	2,496

Source: BM

II.1. Economic Activity

The economy contracted less in the third quarter, reflecting the positive effect of relief of internal and external restrictive measures to contain the pandemic. Preliminary data from the National Institute of Statistics (INE) show an annual change in GDP of -1.09% in this quarter, after the contraction of 3.25% observed in the second quarter of 2020 (Table 2-1).

This performance was driven by growth in the trade and services sectors, as well as a smaller contraction in the construction, transport and communications sectors and in the extractive and manufacturing industries. The maintenance of positive dynamics in the agriculture and electricity and water sectors, with a cumulative weight of 25.7%, also favored the reduced contraction observed in the third quarter (Table 2-1 and Chart 2-1).

In fact, despite the persistent current account deficit, the slight recovery in external demand, as mentioned above, made it possible to reduce the deficit in the balance of goods (Table 2-2) and contraction in the activity of the extractive and manufacturing industries. After the sharp decline in export revenues in the peak quarter of the pandemic, in the third quarter there was an increase in exports, reflecting both the recovery in international prices of the main commodities and the largest quantities sold to the rest of the World (Table 2-3). However, on the import side, the prevailing increase in the acquisition of capital goods (machinery) and construction material is highlighted, goods that, despite COVID-19, showed a relative rigidity (Table 2-4)

Table 2-3: Exported Goods (million USD)

	I Quarter 20	II Quarter 20	III Quarter 20
Mineral Coal	195	140	156
Aluminum Bars	229	212	220
Heavy Sands	51	66	30
Tobacco	31	2	58
Aluminum Cables	22	11	18
Sugar	6	2	17
Cotton	6	1	4
Electric Power	121	101	126

Source: BM

Table 2-4: Imported Goods (million USD)

	I Quarter 20	II Quarter 20	III Quarter 20
Machinery	314	209	237
Fuels	213	139	104
Raw aluminum	95	62	79
Construction Material	145	122	131
Cars	76	49	67
Fertilizers	9	15	14

Source: BM

Table 2-5: : Execution of Public Expenditure in 2020 (million MT)

State Budget and its Execution up to the III Quarter/2020				
(million meticais)	III Paid-in	Revised Budget	IIITrim2020 Paid-in	Annual Change
Total Revenue	**164,060**	**214,142**	**171,049**	**4.3%**
Net Expenditure and Loans	**184,601**	**333,603**	**265,727**	**43.9%**
Current Expenditure	**140,302**	**231,046**	**161,963**	**15.4%**
Staff Expenditure	84,574	124217,1	91,807	8.6%
Goods and Services	16,744	40,308	22,366	33.6%
Debt Service	18,721	28,675	22,165	18.4%
Current Transfers	18,929	31,466	23,087	22.0%
Investment Expenditure	**40,193**	**90,571**	**43,530**	**8.3%**
Donations	5,810	39,273	16,130	177.6%
Loans	10,266	26,525	17,143	67.0%
Balance after Donations	**(14,731)**	**(80,188)**	**(78,548)**	**………**
Net Domestic Financing **Net Loans to the Government (CLG)**	8,855	37,033	44,775	……….
Use for Added Value	5,275	16,631	14,274	170.6%
Primary Balance	**3,990**	**(34,883)**	**(39,752)**	……….

Source: Ministry of Economy and Finance (MEF)

Table 2-6: Domestic Public Debt in the form of Treasury Bills and Bonds and BM advances (million MT)

Domestic Public Debt in the form of T-Bills, T-Bonds and BM advances (million MT)					
	Use of T-Bills	Treasury Bonds	In the BM	Total Debt	Debt as GDP %
Dec – 2015	23,475	30,665	4,500	58,640	9.9%
Dec – 2016	11,812	39,566	35,159	86,536	12.6%
Dec – 2017	21,634	39,566	37,757	98,957	12.3%
Dez - 2018	20,957	50,986	40,978	112,921	12.6%
Dec - 2019	**29,671**	**61,817**	**48,067**	**139,555**	**14.6%**
Mar-20	34,672	71,226	54,267	160,165	15.7%
Jun – 2020	39,309	71,869	49,754	160,932	15.8%
Sep – 2020	39,309	78,775	49,754	167,838	16.5%
Oct – 2020	39,309	79,809	52,569	171,687	16.8%
Nov – 2020	44,220	83,157	52,569	179,946	17.7%
Dec – 2020	44,220	85,536	52,569	182,325	17.9%
Flow (Oct-Dec.)	**4,911**	**5,727**	**-**	**10,638**	

Source: BM

Finally, in terms of aggregate demand components, the most pronounced realization of expenditures by the State stands out in the period, with emphasis on investment and those related to the mitigation of the negative impacts of COVID-19 (Table 2-5). In the period, the State also raised its level of domestic debt in the form of Treasury bills and bonds. (Table 2-6).

In the near term, the economy is expected to maintain the trend towards gradual recovery.

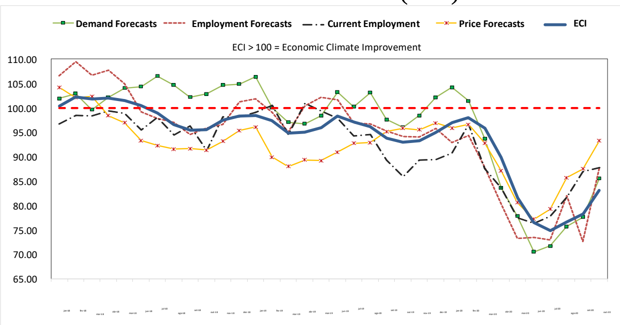
The adverse effects of COVID-19 will continue to condition economic activity until the end of 2020, however, in magnitude lower than observed in the third quarter, taking into account the gradual easing of restrictive measures and the continuous improvement of external demand. This outlook is in line with the continuous improvement of the Economic Climate Index (ECI) and the Purchasing Managers' Index (PMI) in October and November, respectively (Charts 2-2 and 2-3), as well as the increase in credit to the economy.

With regard to credit to the private sector, the growing trend stems from the gradual reduction of the monetary policy interest rate over the year and the support measures to the sector taken in the context of the pandemic. From July to September, credit expanded by 4.8%, contributing to a cumulative change to 13.0% in September, after 9.4% in July. In terms of annual change, credit to the economy accelerated from July to September by 3.1 pp, to 13.7% (Chart 2-4).

In terms of its distribution by institutional sectors, the private sector (companies and individuals) contributed the most to the cumulative change, and non-financial public companies observed less marked contributions (Chart 2-5).

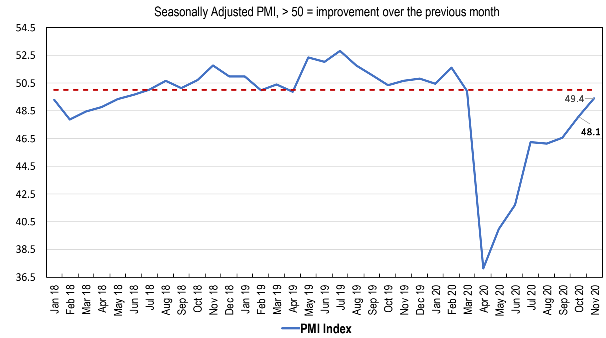
In terms of denomination, the national currency component contributed the most to the overall increase of this aggregate, with a share of 9.3 pp, in the total change, being the remaining (4.5 pp) of the foreign currency component (Chart 2-4). In the short term, this trend is expected to prevail.

Chart 2-2: Economic Climate Index (ECI)



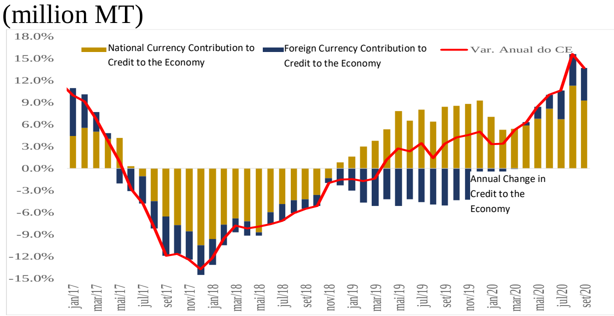
Source: BM

Chart 2-3: Purchasing Managers' Index (PMI)



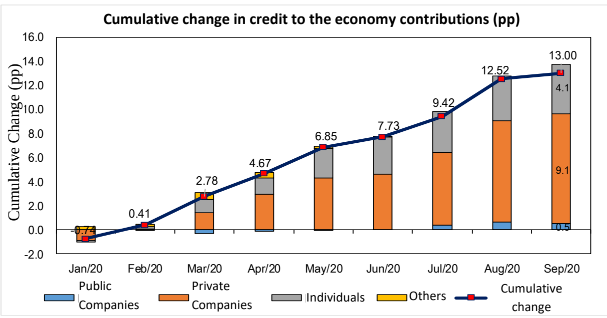
Source: HIS, Markit

Chart 2-4: Development of Credit to the Economy (million MT)



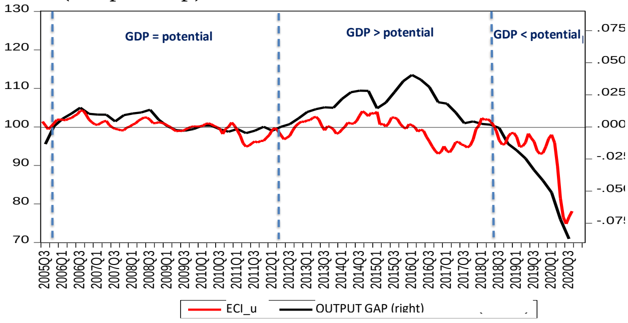
Source: BM

Chart 2-5: Contributions to the Cumulative Change in Credit to the Economy



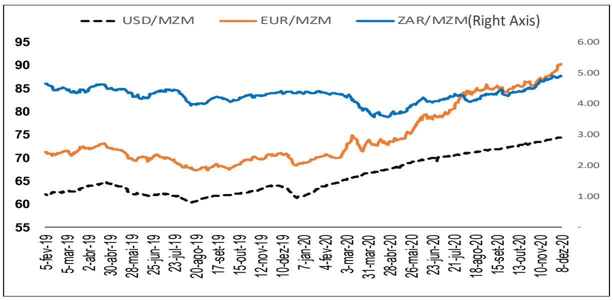
Source: BM

Chart 2-6: Difference between Potential and Observed GDP (Output Gap) and Economic Climate



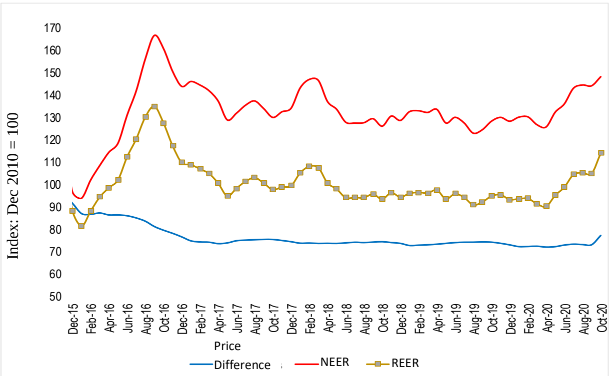
Source: BM and INE

Chart 2-7: Exchange Rate Developments



Source: BM

Chart 2-8: REER developments



Source: BM

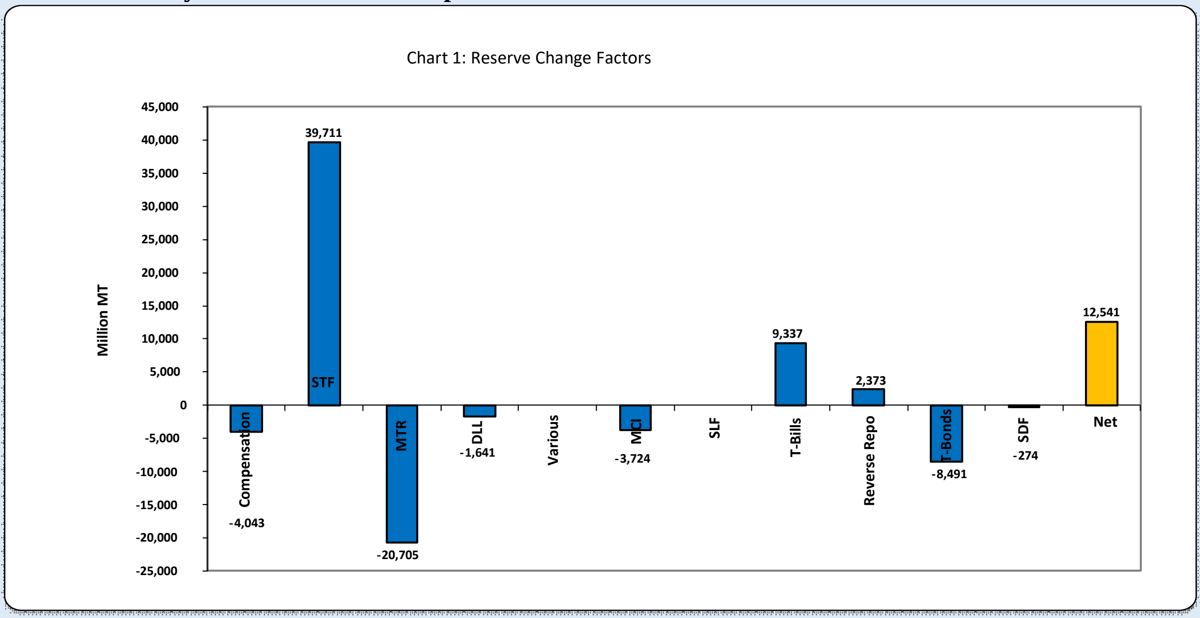
Despite the trend towards improvement in economic activity, it remains below its potential. Despite the ECI reversing the downward trend observed up to July 2020, the output gap remained negative in the third quarter and is expected to prevail in the short term (Chart 2-6).

As measured by Gross International Reserves (GIR), the country's external position remains at comfortable levels, despite the COVID-19 effects on external accounts. In the second week of December, the GIR balance stood at USD 3,859 million, sufficient to cover over 6.0 months of imports of goods and services, excluding imports from major projects.

Metical maintains the trend towards depreciation against the currencies of major trading partners. In the period from the last MPC until December 8, 2020, the Metical depreciated against the Dollar (2.20%), the Euro (4.82) and the Rand by 10.63%. In cumulative and annual terms, the national currency recorded nominal losses against the dollar of 20.51% and 16.45%, respectively (Chart 2-7), in a context in which commercial banks recorded net purchases of foreign exchange from the public on the foreign exchange market.

Metical's performance in the reporting period resulted in annual gains in competitiveness in the country's exports, measured in terms of the Real Effective Exchange Rate Index (REER), as a result of the depreciation of the Nominal Effective Exchange Rate Index (15.56%), in a context of continued stability of the differential between domestic prices and those of the country's main trading partners (Chart 2-8).

Box 1 : Monetary and Financial Developments



Excess liquidity in the Interbank Money Market (IMM) prevails and is trending upwards. In fact, between October and December 2020 (interval between the two MPC sessions), bank reserves in national currency increased by 12,541.0 million meticais, as reported in Chart 1.

Chart 1: Reserve change factors

Source: BM

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

- State Transfers to the economy via the Electronic Funds Transfer System (STF) of 39.711,0 million meticais; and
- Net reimbursement of Treasury Bills (T-Bill) of about 9,337.0 million meticais;
- Positive net impact of reverse repo operations of 2,373.0 million meticais.

This trend was curbed by the following factors:

- Net negative impact of electronic transfers between commercial banks in real time (MTR) of 20,705.0 million meticais;
- Debt to credit institutions resulting from the issuance of Treasury Bonds (T-Bond) of 8,491.0 million meticais.
- Losses of commercial banks in compensation of about 4,043.0 million meticais;
- Net foreign exchange sales to commercial banks by the BM in the Interbank Foreign Exchange Market (IFEM) of 3,724.0 million meticais;
- Net cash withdrawals (DLLs) of 1,641.0 million meticais;
- Negative net impact of Standing Deposit Facility (SDF) operations of about 274,0 million meticais;

In the periods of constitution of mandatory reserves from October 7 to November 6 and from November 7 to December 6, 2020, commercial banks complied with the requirement for mandatory reserves. In fact, bank liquidity (bank reserves minus reserve requirements) was fixed at meticais 961.0 and 2074.0 million meticais, respectively, in the above periods. The extended liquidity, which incorporates overnight maturity transactions carried out by credit institutions with the bank, increased to 106,023.0 million meticais, compared with 93,988.0 million observed in the previous constitution period.

In turn, potential liquidity, which incorporates Treasury Securities (T-Bills and T-Bonds), increased, on average, to 280.673,0 million meticais in the period of establishment of mandatory reserves, from July 7 to August 6, 2020, due to the increase in overnight reverse repo and T-Bonds (Table 1), despite the decline of T-Bonds in the portfolio (Table 1).

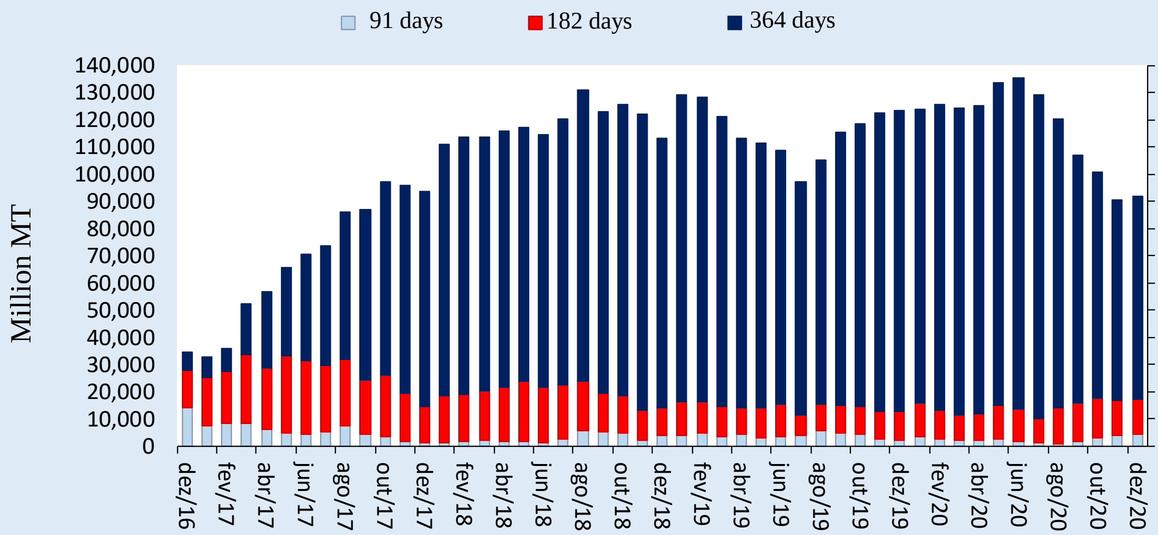
Table 1: Distribution of Bank Liquidity (million MT)[2]

Description	Aug 11	Oct 7 – Nov 6	Nov 7 – Dec 6	Dec 9
a) Restricted Liquidity = Bank Reserves (RR) - Reserve Requirements (Average Basis)	**-6.668**	**961**	**2.074**	**-6.348**
SDF	1.210	808	1.951	2
Reverse Repo	76.598	92.219	101.997	106.281
SLF	0	0	0	0
Repo	0	0	0	0
b) Broad Liquidity = (a) + SDF + R. Repo – SLF - Repo	**71.140**	**93.988**	**106.023**	**99.935**
Treasury Bills (T-Bills)	118.194	100.505	92.682	90.406
Treasury Bonds (T-Bonds)	73.361	80.811	81.968	85.536
(c) Potential Liquidity = (b) + T-Bills + T-Bonds	**262.695**	**275.305**	**280.673**	**275.877**

Source: BM

Thus, as a result of the net repayment of T-Bills, its stock in the portfolio decreased to 91,832.0 million meticais (Chart 2), divided by the following maturities: (i) 91 days: 4,355.0 million meticais; (ii) 182 days: 12,672.0 million meticais; and (iii) 364 days: 74,805.0 million meticais. In terms of concentration, the maturity of 364 days is the most preferred by credit institutions, with about 81.50% of the total value in the portfolio.

Chart 2: Portfolio Balance of Treasury Bills

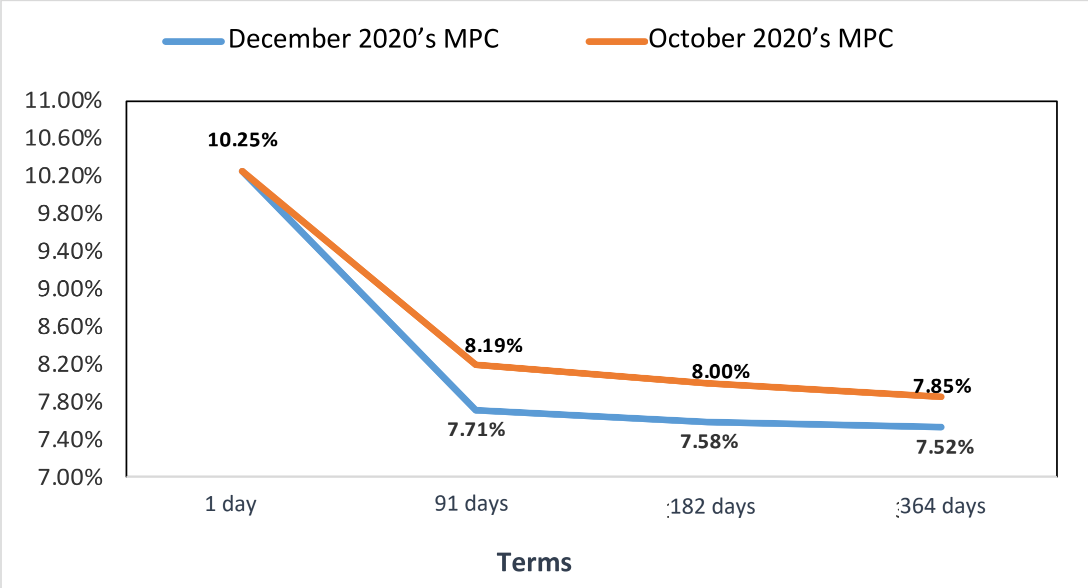


Source: BM

The downward trend in IMM interest rates prevails, in line with the fall of the MIMO (monetary policy interest rate) in June of the current year and with market liquidity conditions. In effect, the results of the last auction of T-Bills for the maturities of 91, 182 and 364-day, respectively, carried out before the December 2020 MPC, resulted on T-Bills subscription interest rates of at 7.71%, 7.58% and 7.52%, respectively (Figure 3), representing a reduction of 48, 42 and 33 bp for the above reference maturities compared to the October MPC.

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

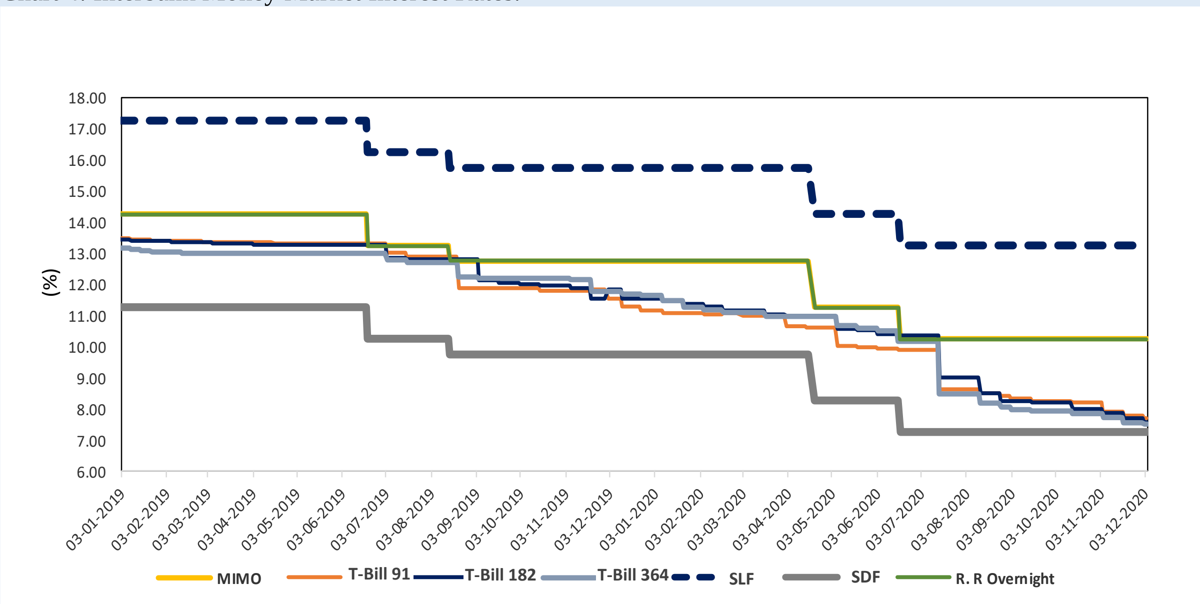
Chart 3: IMM interest rate curve



Source: BM

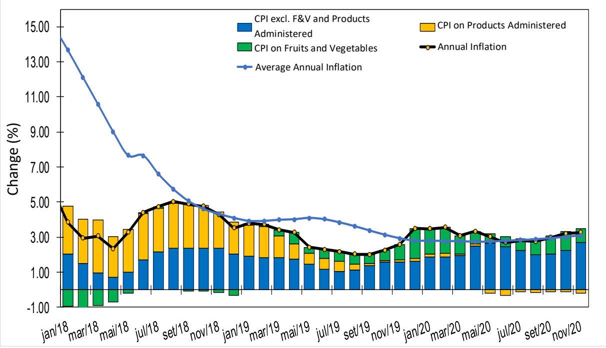
The remaining IMM interest rates continued their downward trend and stand at an interval bounded by the Standing Lending and Deposit facilities of 13,25% and 7,25% respectively, as shown in Chart 4.

Chart 4: Interbank Money Market Interest Rates.



Source: BM

Chart 2-9: Components of annual inflation



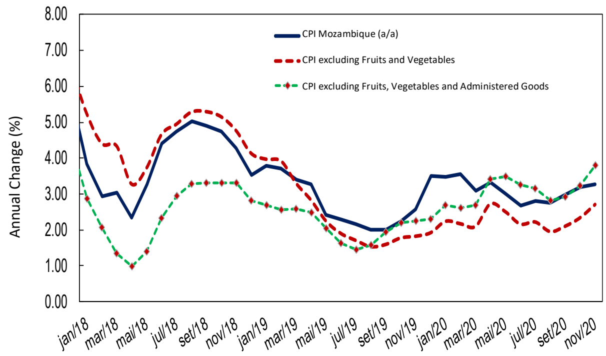
Source: INE / BM

Table 2-7: Core inflation - Mozambique (Annual Change In %)

	mar/20	jun/20	aug/20	sep/20	oct/20	nov/20
CPI	**3.09**	**2.69**	**2.75**	**2.98**	**3.20**	**3.27**
Food	**7.29**	**6.59**	**7.52**	**7.94**	**8.10**	**8.18**
Cereals and Derivatives	6.17	2.82	4.39	4.26	4.19	4.68
Fruits and Derivatives	14.92	9.42	13.93	16.32	15.19	10.61
Administered	**0.28**	**-1.19**	**-0.69**	**-0.43**	**-0.43**	**-0.76**
Liquid Fuels	-3.25	-4.75	-4.68	-4.04	-4.04	-5.06
CPI x F&V	**2.10**	**2.17**	**2.31**	**2.10**	**2.34**	**2.71**
CPI x Admin.	**3.90**	**3.84**	**4.19**	**3.97**	**4.26**	**4.44**
CPI x Comb.	**3.12**	**2.37**	**2.26**	**2.30**	**2.52**	**2.79**
CPI x F&V and Admin.	**2.68**	**3.26**	**3.29**	**2.92**	**3.23**	**3.81**

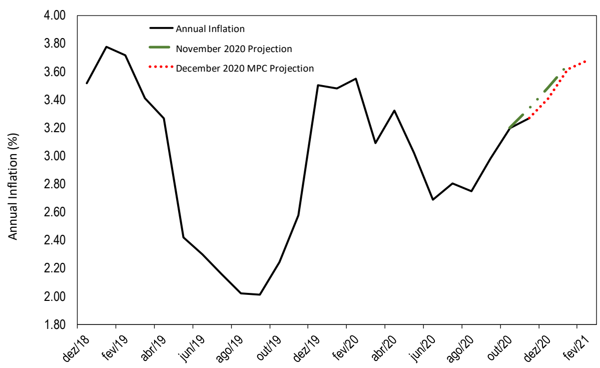
Source: INE

Chart 2-10: Annual Inflation and Core Inflation (Annual Change %)



Source: INE

Chart 2-11: Short-term annual inflation projections and observed annual inflation (%)



II.2. Recent Developments in Inflation

In November, annual inflation maintained the acceleration trend observed since August, reflecting the increase in food products. This upward trend is expected to continue in the near term.

Annual inflation, measured by the change in the Consumer Price Index (CPI), rose from 3.20% in October to 3.27% in November. In the same vein, annual average inflation consolidated its upward trajectory for the eighth consecutive month, rising from 3.08% in October to 3.14% in November (Chart 2-9).

The slight acceleration in inflation is the result of the increase in the prices of food products, especially those of imported fish and other frozen products, and the increase in the cost of domestically produced fruit and vegetables (Table 2-7).

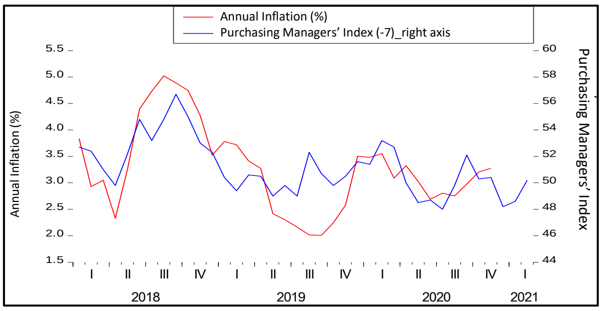
The reduction of prices of administered products stands out in curbing the upward trend of these prices, favored by the annual decline in the prices of liquid fuels. (Table 2-7, Chart 2-9).

Core inflation is accelerating. Between October and November, the core of inflation, which excludes the fruit and vegetable subgroup (the most volatile component of the CPI basket) and the subgroup of products with administratively determined prices, recorded an annual acceleration to 3.81% in November (Table 2-7 and Chart 2-10).

The outlook for the short term points to a slight acceleration in inflation. These forecasts derive mainly from the following factors: (i) termination of the administrative price control measures enacted in the context of COVID-19, (ii) restrictions on the movement of people and goods (military instability in the center and north of the country) and (iii) acceleration of food prices in South Africa. Meanwhile, maintaining the VAT exemption on essential goods until 2023 will dampen inflation dynamics (Chart 2-11).
Over the same period, leading indicators of price developments, such as the diffusion index and the

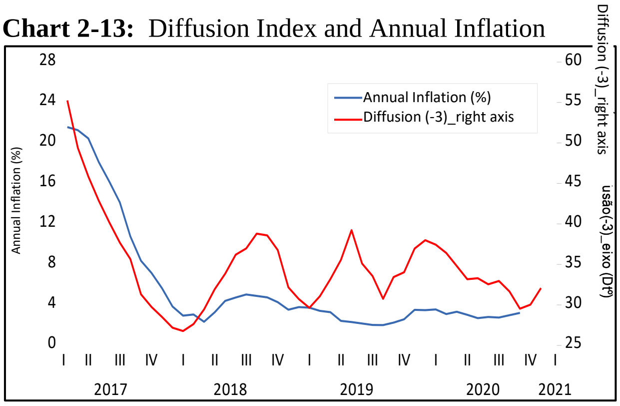
Source: BM

Chart 2-12: Purchasing Managers' Index and Annual Inflation



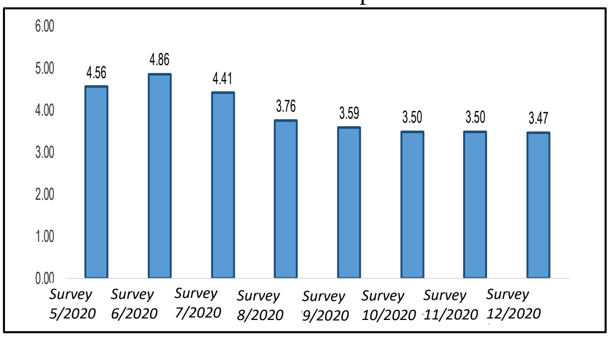
Source: INE / BM

Chart 2-13: Diffusion Index and Annual Inflation



Source: BM

Chart 2-14: Annual Inflation Expectations



Source: BM

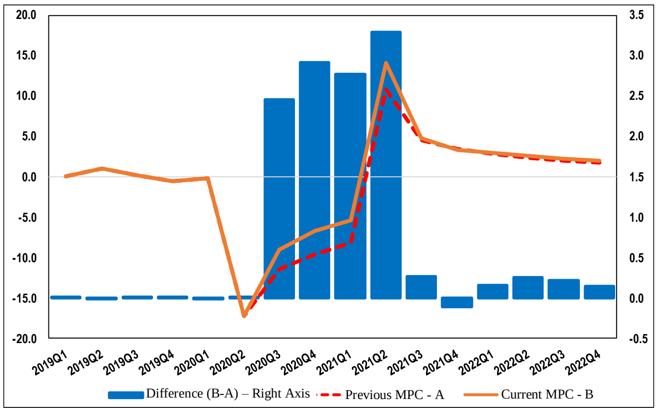
Purchasing Managers' Index (PMI), show a trend towards price acceleration until the first months of 2021, but are around single-digit levels (Charts 2-12 and 2-13).

Similarly, economic agents' expectations of annual inflation towards the end of 2020 support the BM's short-term projections. For December/2020, economic agents expect annual inflation to settle at 3.47% (Chart 2-14).

Chapter III: Medium-Term Outlook for Inflation and Economic Activity

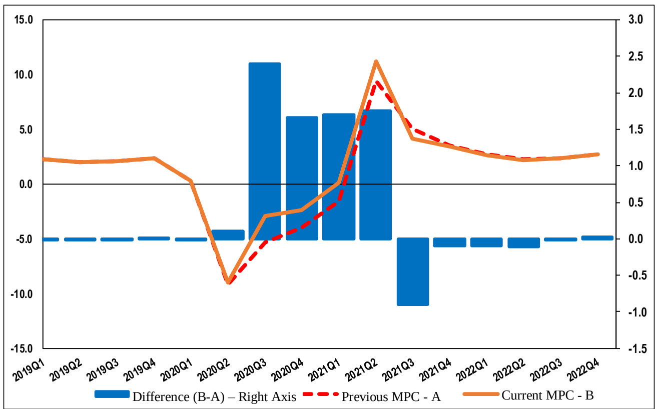
Inflation is expected to accelerate in the near and medium term, while remaining at a single-digit. For 2021, domestic prices are expected to increase, reflecting essentially, the end of part of the government's administrative measures to contain prices in context of the COVID-19, the upward trend of food prices on the international market, and the gradual recovery of demand for goods and services. Economic activity is estimated to contract less in 2020, followed by a timid recovery in 2021, justified by the less sharp contraction in GDP in the third quarter, compared to the previous estimates. For 2021, economic activity is expected to recover, although slowly, stimulated by the development of gas exploration projects and by the recovery in external demand, in the face of the discovery of the COVID- 19 vaccine. In light of this macroeconomic framework and the high risks and uncertainties associated with the inflation projections, the MPC decided to maintain the MIMO rate at 10.25%.

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



Source: GPMN (Global Projection Model Network) / BM

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



Source: GPMN / BM

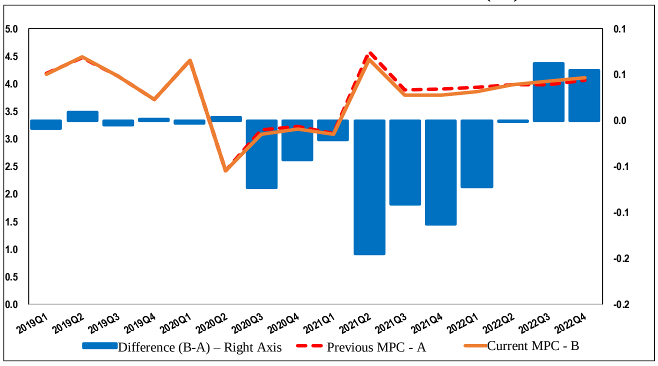
3.1. External Assumptions for Inflation Projections[3]

Forecasts of lower GDP contraction in South Africa and the US in 2020, followed by a faster recovery in 2021. Compared to the October MPC, the forecasts point to a smaller contraction in economic activity in South Africa and the US for 2020, at around 8.3% and 3.5%, and a more accelerated recovery in 2021, at around 4.7% and 4.2%, respectively (Charts 3-1 and 3-2).

Maintenance of the inflation forecasts in South Africa and the US in 2020 and slight downward revision for 2021. When compared to the October MPC, inflation forecasts for 2020 remain at 3.3% for South Africa (within the target of 3-6%) and 1.3% for the US (against the target of 2.0%). For 2021, inflation projections were revised slightly lower, from 3.9% to 3.8% for South Africa, and from 2.6% to 2.5% for the US (Charts 3-3 and 3-4).

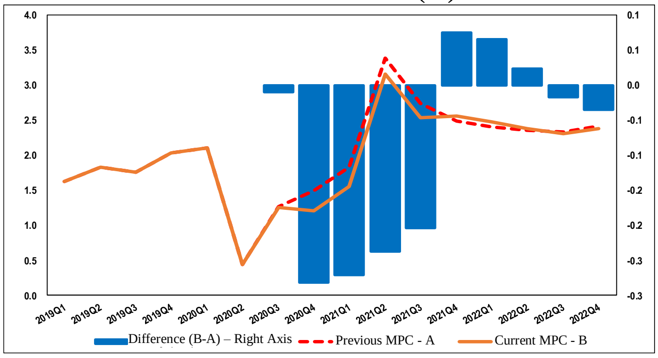
[3]Source: Global Projection Model Network (GPMN)

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



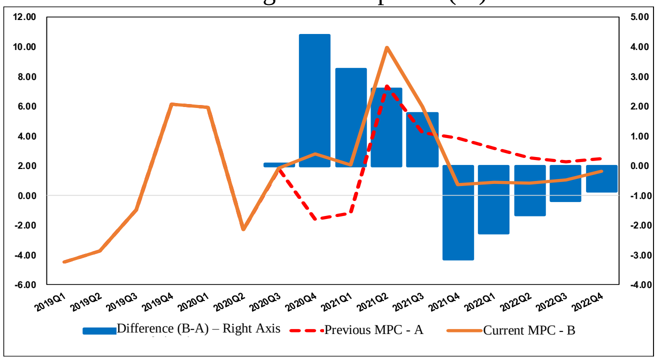
Source: GPMN / BM

Chart 3-4: Annual inflation in the US (%)



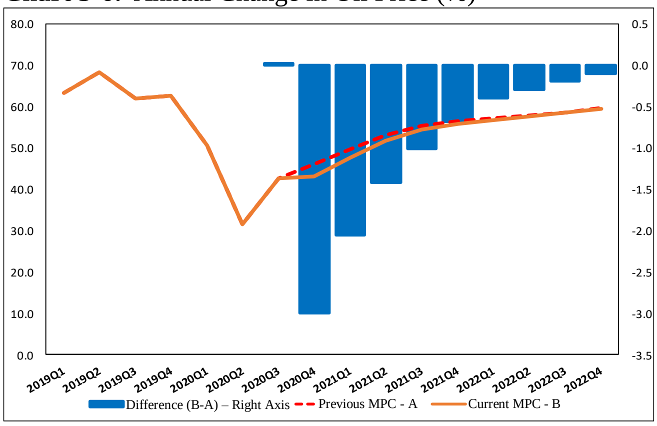
Source: GPMN / BM

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



Source: GPMN / BM

Chart 3-6: Annual Change in Oil Price (%)



Source: GPMN / BM

Upward revision of food price forecasts in the international market. Food price projections on the international market, as measured by the Global Projection Model Network (GPMN) price index, were revised upwards, from an annual change of 1.0% to 2.1% in 2020, and from 3.6% to 4.7% in 2021 (Chart 3-5). The upward revision of food price projections on the international market in 2020 and 2021 reflects a gradual strengthening of demand by China and a weaker harvest forecast in major producers, such as the US, Brazil and Argentina.

Slight downward revision of the price of a barrel of oil on the international market in 2020 and 2021. In the latest projections of the GPMN, the price of oil was revised slightly downwards, reflecting uncertainties regarding the timeliness of the distribution of the vaccine against COVID-19 and its likely effects on the recovery of the world economy, associated with the risk, still present, of an oversupply oil market (Chart 3-6).

3.1. Internal Assumptions

Adjustment in the administered prices in 2021, to a magnitude lower than initially expected. In 2020, the prices of administered goods are assumed to be maintained, which falls in line with the measures adopted by the government to mitigate the effects of COVID-19. For 2021, the prospect of lifting some measures and their consequent decompression remains. In the meantime, the extension of the VAT exemption on essential goods until 2023 and the still favorable development in the price of oil on the international market could help to smooth out the administratively defined price adjustments.

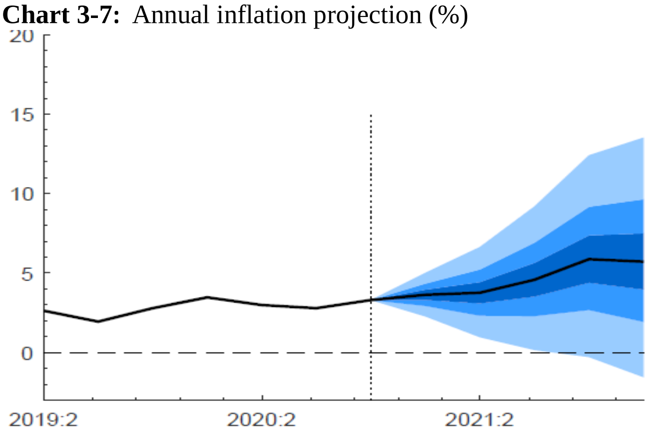
Forecasts of continuous exchange rate pressure in the medium term. Despite the fact that the foreign exchange market remains liquid in foreign currencies, the forecast of Metical volatility in the medium term remains. Regarding the October MPC session, Metical continues to depreciate, reflecting risks and uncertainties prevailing in the domestic economy.

Forecasts of greater pressure on public spending. Increased pressures are expected on the financing of the public deficit in 2021, resulting from expenditure related to defense and security and social support to populations affected by military instability in the center and north of the country, as well as possible expenses arising from the effects of climate shocks and logistics for the administration of the COVID-19 vaccine.

3.2. Result of Projections

Forecasts of increase in the prices in the medium term, while remaining at a single digit. With regard to the October 2020 forecasts, current BM projections indicate an acceleration in Mozambique's annual inflation (Chart 3-7), essentially reflecting (i) the effect of the lifting of part of the government's COVID-19 price containment measures, (ii) the upward trend in food prices on the international market, and (iii) the gradual recovery in demand for goods and services. In the meantime, extending the VAT exemption on essential goods until 2023 could help curb the acceleration of inflation while remaining in the single-digit band.

Chart 3-7: Annual inflation projection (%)

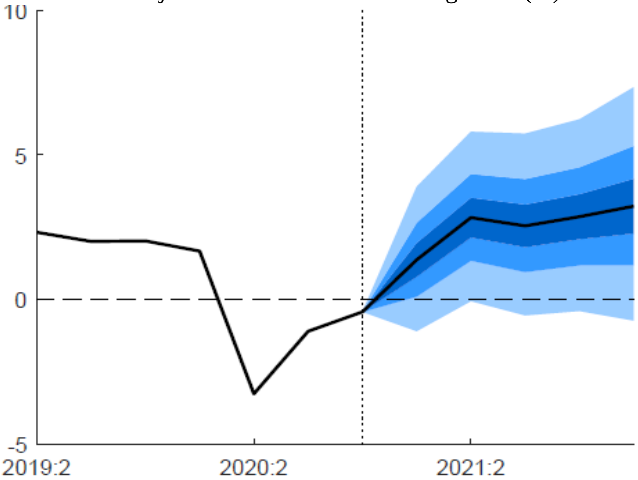


Source: BM

Lower GDP contraction in 2020 and slow recovery in 2021. After a significant contraction in GDP in the second quarter of 2020 (-3.25%), in annual terms real GDP contracted less in the third quarter (-1.10%), anticipating a smaller decline in economic activity in 2020. For 2021, although slow, the forecasts of positive growth remain, stimulated by the implementation activities of gas exploration projects and the trend towards recovery of external demand, in the face of the discovery of the COVID-19 vaccine.

Solid and sustainable growth in economic activity requires further structural reforms.

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



Source: BM

Taking into account the limits of the effects of monetary policy, achieving sustainable and inclusive growth in the medium term requires the support of other economic policies, as well as the deepening of structuring measures to ensure the strengthening of institutions, the improvement of the business environment, the attraction of investments and the creation of jobs.

3.3. Assessment of Risks Associated with Inflation Projections

Since October 2020's MPC, the risks and uncertainties remain high, underlining at the domestic level, the on-going of military conflicts in the central and northern parts of the country, the concerns surrounding the evolution of the COVID-19 pandemic and its impact on the economy, as well as the likelihood of above-normal rainfall in the central and southern regions of the country. On the external side, it is highlighted the volatility of prices of major commodities.

3.4. Monetary Policy Decision

The Monetary Policy Committee (MPC) of the Banco de Moçambique decided to keep the monetary policy interest rate, MIMO rate, at 10.25%. The decision is justified by the fact that the forecasts of rising prices for the medium term remain, in a context in which a slow recovery of economic activity is expected in 2021, even with the optimism regarding the developments of the COVID-19 vaccine. The MPC reiterates that mitigating prevailing risks and promoting sustainable and inclusive growth require further structural measures.

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

The MPC will continue to monitor economic and financial indicators and risk factors and their impact on inflation forecasts, and may take the necessary corrective measures before its next regular meeting, scheduled for January 27, 2021.