March 2023
No.49|year 12

ECONOMIC OUTLOOK AND INFLATION FORECASTS

ECONOMIC OUTLOOK

AND INFLATION FORECASTS

March 2023

Members of the Monetary Policy Committee[1]

Full-Fledged Members

Rogério Lucas Zandamela
Governor (Chairman)

Gertrudes Adolfo Tovela
Board Member

Jamal Omar
Board Member

Benedita Guimino
Board Member

Silvina de Abreu
Board Member

Maria Esperança Mateus Majimeja
Board Member

Permanent Guests

Umaia Mahomed
Adviser to the Governor

Ingunn Valvatne
Adviser to the Governor

Luísa Samuel Navele
Adviser to the Governor and Director of the Governor's Office

Paula Libombo
Director of the Governor's Office

Luís Alberto Poio
Director of the Macroprudential Analysis Department

Pinto Fulane
Director of the Prudential Supervision Department

Paulo Mandlate
Director of the Foreign Exchange Licensing Department

Emílio Rungo
Director of the Communications Office

Carlos João Baptista
Director of the Markets and Reserves Management Department

Pinho José Ribeiro
Director of the Economic Research Department

Domingos Fumo
Director of the Statistics and Reporting Department

---

[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 Board Members 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 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 April 17, 2017, signals the monetary policy stance and serves as an anchor for operations in the Interbank Money Market (IMM). It is expected that, through its influence on overnight interest rates formed in the IMM, 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 outlook. The MPC recognizes the delayed effect of its decisions on the economy, so its policy stance is based on the assessment of the economic and financial outlook, including risks and uncertainties, over eight quarters at least. 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 extraordinarily whenever economic conditions so require. The schedule of regular 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 an MPC Communiqué and / or a Press Conference Communiqué led by the BM Governor, 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 CEPI report discloses the factors and rationale behind measures taken by the MPC, broadening the public's understanding of objectives and conduct of monetary policy.

Rogério Lucas Zandamela

Governor

Contents

Boxes

Tables

Charts

Decisions of Session No. 2 of the Monetary Policy Committee, of March 29, 2023

The Monetary Policy Committee (MPC) of the Banco de Moçambique has decided to keep the MIMO policy rate unchanged at 17.25%. This decision is underpinned by the maintenance of single-digit inflation prospects in the medium term, despite the materialization and exacerbation of some risks associated with inflation forecasts, in particular, the occurrence of natural disasters and increased pressure on public expenditure.

Risks and uncertainties associated with inflation forecasts have worsened. Domestically, the uncertainties regarding the short-term impact of recent climate shocks on the prices of goods and services, and the increased pressure on public spending are particularly highlighted. On the external side, the uncertainties with regard to the effects of the volatility in global financial markets and the protracted Russia-Ukraine conflict stand out.

Single-digit inflation is expected in the medium term. In February 2023, annual inflation accelerated from 9.78% to 10.30%, mainly driven by the rise in food prices amidst climate shocks and the increase in administered prices. Meanwhile, core inflation, which excludes fruit and vegetables and administered prices, remained stable. In the medium term, inflation is expected to remain within a single-digit, underpinned by the impact of the measures taken by the MPC, the exchange rate stability and the downward trend in commodity prices in the global market.

Moderate economic growth is anticipated. These forecasts mainly reflect the prevailing tight global financial conditions, resulting in lower expansion of global economic activity, and consequently, a reduction in export commodity prices in the global market. Excluding the ongoing energy projects in the Rovuma Basin, a lower Gross Domestic Product growth is expected, mainly due to the impact of recent climate shocks on agricultural production and various infrastructures.

Domestic public debt has worsened. Domestic public debt, excluding loan and lease agreements and overdue liabilities, stands at 301.3 billion meticais, a 26.1 billion increase compared to December 2022.

The MPC shall continue to monitor the developments of the risks and uncertainties associated with inflation forecasts, and will not hesitate to take the necessary corrective measures.

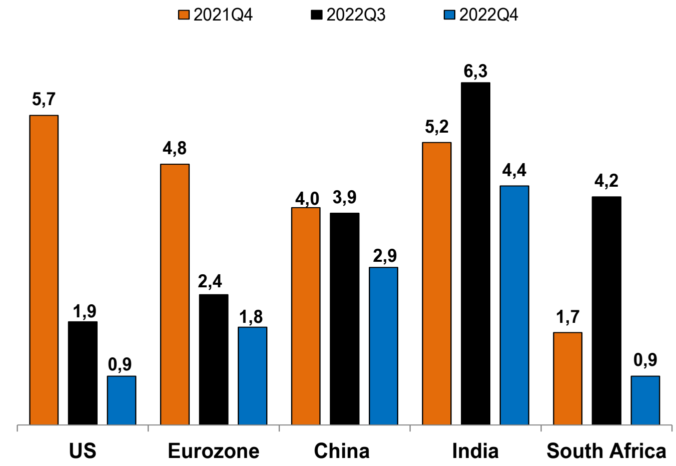
The next regular MPC meeting is scheduled for May 31, 2023.

Rogério Lucas Zandamela
Governor

Chapter I. Recent Developments in International Economy and Forecasts

In 2022, global growth was moderate and should remain below its 3.8% historic average (2000-2019) in 2023 and 2024, amidst the prevailing tight financial conditions, and the volatility of financial markets, against a backdrop of prevailing uncertainties due to the protracted Russia-Ukraine conflict. Inflation is slowing, despite remaining high. The US dollar, however, is showing signs of recovery against the main currencies, amid the slump in prices of the main commodities.

Chart 1-1: GDP Developments (%)



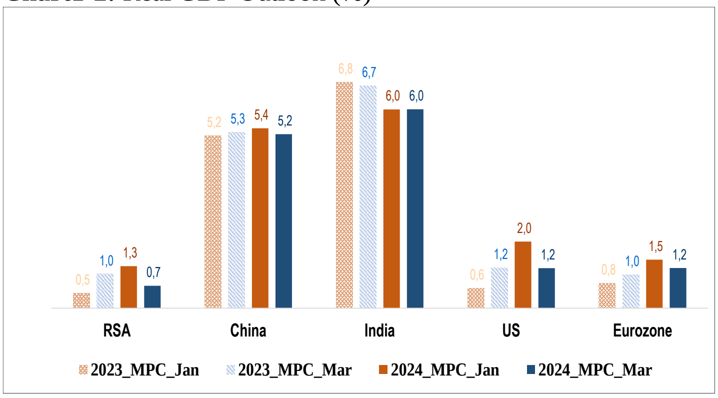
Source: *Trading Economics*

Table 1-1: Global GDP Projections – 2022 and 2023 (%)

Region	Estimate 2022	Projection 2023	Projection 2024	Difference from WEO Oct/22 2023	Difference from WEO Oct/22 2024
World Output	**3,4**	**2,9**	**3,1**	**0,2**	**(0,1)**
Advanced Economies	**2,7**	**1,2**	**1,4**	**0,1**	**(0,2)**
United States	2,0	1,4	1,0	0,4	(0,2)
Euro Area	3,5	0,7	1,6	0,2	(0,2)
Germany	1,9	0,1	1,4	0,4	(0,1)
Japan	1,4	1,8	0,9	0,2	(0,4)
United Kingdom	4,1	(0,6)	0,9	(0,9)	0,3
Emerging Market & Developing Economies	**3,9**	**4,0**	**4,2**	**0,3**	**(0,1)**
China	3,0	5,2	4,5	0,8	0,0
India	6,8	6,1	6,8	0,0	0,0
Brazil	3,1	1,2	1,5	0,2	(0,4)
Sub-Saharan Africa	**3,8**	**3,8**	**4,1**	**0,1**	**0,0**
South Africa	2,6	1,2	1,3	0,1	0,0

Source: IMF, WEO (January 2023)

Chart1-2: Real GDP Outlook (%)



Source: *Global Projection Model Network*

1.1. Economic Activity and Inflation

In the fourth quarter of 2022, a modest performance was observed in the economic activity of the country's main trading partners.

In advanced economies, the United States (US) particularly stands out, due to a slowing Gross Domestic Product (GDP), mainly driven by the slump in real estate investment.

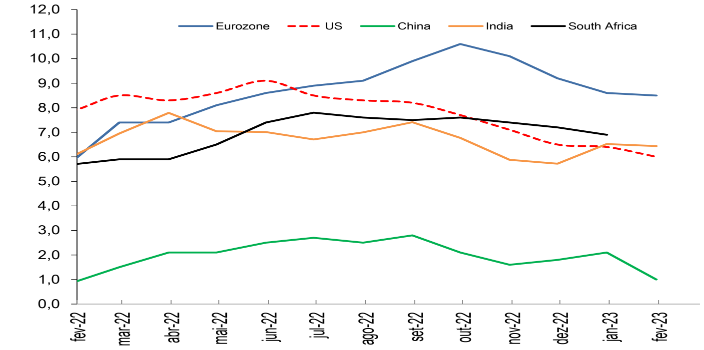
As for emerging economies, South Africa and China are highlighted, having recorded a substantial slowdown in economic growth, reflecting the deterioration of the energy crisis (South Africa) and the ongoing restrictive measures amidst the rising cases of COVID-19 contamination cases (China) - Chart 1-1.

Prospects of a world economy remain for 2023.

January 2023's edition of the World Economic Outlook (WEO) envisages a slowdown in the world economy in 2023 (2.9%), a decline from 2022's figure (3.4%). This reflects (i) the prevailing tight financing conditions, (ii) the over-indebtedness of emerging economies, as well as (iii) the protracted Ukraine-Russia military conflict (Table 1-1).

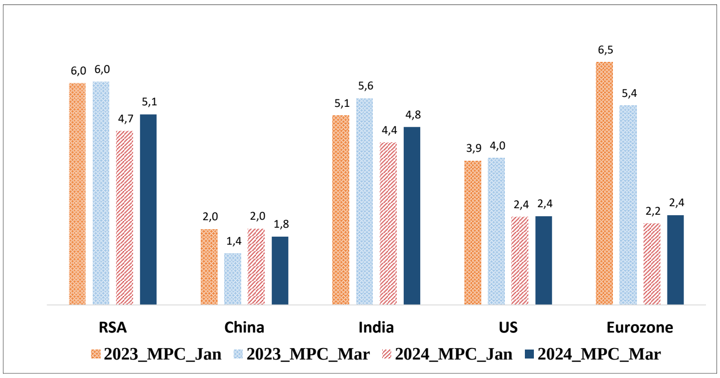
These prospects are in line with projections by the Global Projection Model Network (GPMN) for 2023, which foresees a moderate global growth around 2.5%. Meanwhile, prospects of monetary tightening remain, as well as, difficulties in access to finance and volatility in financial markets, arising from the recent turmoil in the US and Europe banking systems, which may cool global growth in 2023, with a stronger impact in 2024 (Chart 1-2).

Chart 1-3: Inflation Developments (%)



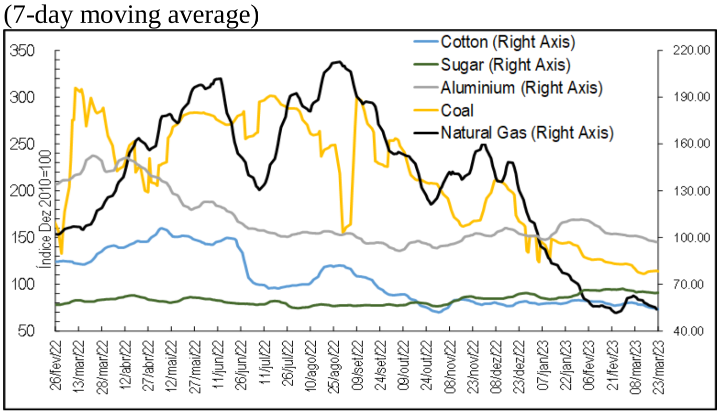
Source: *Refinitiv* and *Trading Economics*

Chart 1-4: Inflation Outlook (%)



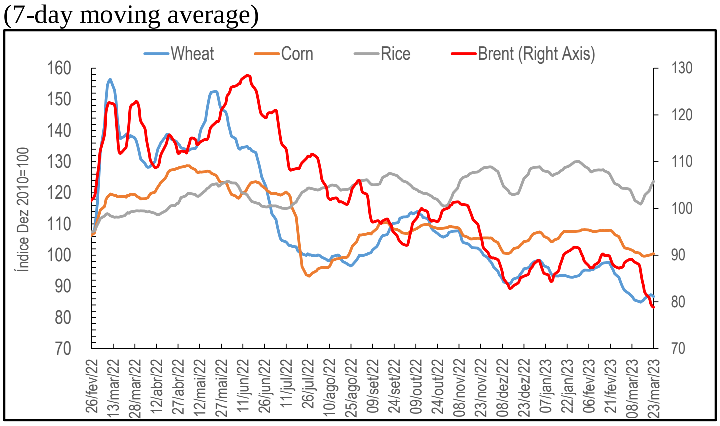
Source: *Global Projection Model Network*

Chart 1-5: Price Index of Exported Goods (7-day moving average)



Source: *Refinitiv*

Chart 1-6: Price Index of Imported Goods (7-day moving average)



Source: *Refinitiv*

In February 2023, inflation slowed in advanced economies and emerging markets.

In fact, inflation slowdown stands out for the US and Europe, as the result of the drop in food and energy prices, respectively.

Similarly, China and India experienced an inflation slowdown, driven by the fall in food and fuel prices (Chart 1-3).

Despite inflation trending downwards, it remains persistent and above the medium-term targets in most economies. In this light, in March 2023, the European Central Bank and the Federal Reserve (Fed) decided to hike policy rates by 50 bp and 25 bp, standing at 3.50% and in the range of 4.75% to 5.00%, respectively.

The short and medium-term inflation prospects of the country's main trading partners are mixed.

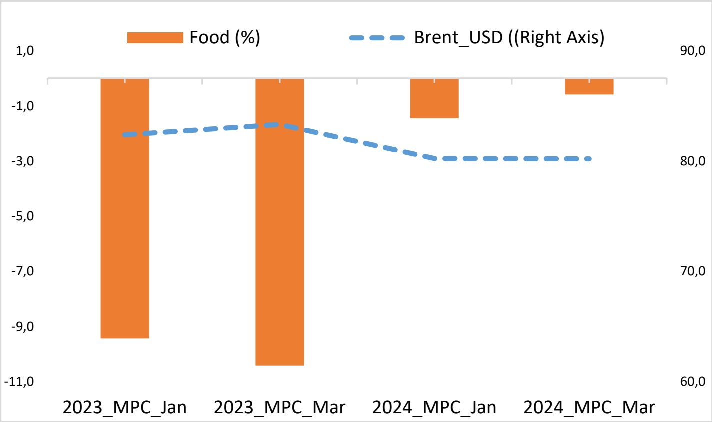
For 2023, the GPMN revised the Eurozone and China's inflation outlook downwards, driven by falling natural gas price to pre-pandemic levels, coupled with lower than expected consumption in Europe. For China, these forecasts are mainly due to the strong base effect and the fall in the price of pork, amid prospects of rising demand.

For 2024, the GPMN revised India and South Africa's inflation forecasts upwards, reflecting the acceleration in grain prices for the former and rising food prices due to the protracted energy crisis in the latter. Moreover, US inflation forecasts remain unchanged (Chart 1-4).

1.2. Prices of Main Commodities and Trading Partners' Currency Dynamics

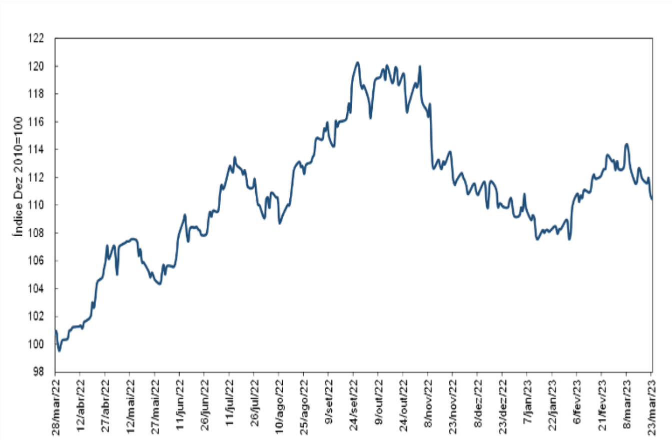
Prospects of a global economy slowdown, coupled with the prevailing tight monetary policies and the base effects, contribute to the deceleration of commodity prices. On the imports' side, brent and wheat are particularly highlighted, with prices dropping by 13.2% and 12.0%, respectively, compared to figures reported in January 2023's MPC session. With regard to export goods, the fall in liquefied natural gas and thermal coal (-26.8% and -18.5%) is highlighted, driven by a milder winter in the US and the Eurozone (Charts 1-5 and 1-6).

Chart 1-7: Outlook of Brent (USD) and Food – Annual Change (%)



Source: *Global Projection Model Network*

Chart 1-8: USD Composite Index against the Currencies of the Main Trading Partners



Source: *Refinitiv*

For 2023, the pace in the slowdown in food and brent price should remain in place, converging to levels last seen prior to the outbreak of the military conflict in Europe (Chart 1-7).

The US dollar strengthened against major currencies.

From the previous MPC up to March 23, the USD Composite Index recorded cumulative gains against the Euro, Rand, Pound and Yen, mainly driven by the Fed's ongoing monetary tightening policy (Chart 1-8).

Chapter II. Recent Developments in Domestic Economy and Short-Term Forecasts

Real GDP grew by 4.2% in the fourth quarter of 2022, reflecting the improvement in external demand, combined with the normalization of the economy and execution of energy projects. In the near term, moderate GDP growth is anticipated, excluding natural gas projects, mainly due to the impact of recent climate shocks on economic activity. With regard to prices, annual inflation picked up in February 2023, due to an increase in prices of administered goods and services and food, amidst climate shocks. Near-term inflation should follow a similar pattern. Meanwhile, the risks associated with these forecasts tend to exacerbate, highlighting (i) the high pressure on public spending and (ii) the magnitude of the impact of recent climate shocks.

Table 2-1: Mozambique Real GDP Dynamics by Sectors – Annual Change (%)

Sectors	2021		2022		
	IV	Year	IV	Year	Year Contr. (pp)
Primary Sector	**5,7**	**3,5**	**7,4**	**5,6**	**1,7**
Agriculture	4,2	3,8	5,3	4,6	1,1
Fishing	2,1	2,5	-1,2	1,4	0,0
Mining	10,7	2,5	14,9	10,6	0,6
Secondary Sector	**2,9**	**1,1**	**-3,2**	**0,6**	**0,1**
Electricity, Gas and Water	0,9	0,0	2,0	2,8	0,1
Manufacturing	3,1	1,5	-5,2	-0,1	-0,0
Construction	4,7	1,0	-0,9	0,6	0,0
Tertiary Sector	**2,9**	**1,6**	**6,1**	**4,4**	**2,0**
Trade and Services	3,3	2,2	4,8	2,9	0,3
Accommodation and Catering	2,7	-4,8	17,2	12,8	0,2
Transport and Communication	5,6	0,6	14,4	9,4	1,0
Financial Services	2,0	2,0	2,9	2,9	0,2
Public Adm.Education and Health	1,5	2,7	1,8	2,5	0,3
Other Sectors	1,6	1,3	3,0	2,0	0,1
GDP at factor cost	**3,7**	**2,2**	**5,0**	**4,3**	**3,8**
Tax on products	2,2	3,2	-2,3	2,8	0,3
GDP	**3,6**	**2,3**	**4,2**	**4,1**	**4,1**

Source: INE

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

	2021	2022	Annual Change
Current Account	**-3.601**	**-6.455**	**-2.854**
Balance of Goods	-2.252	-5.119	-2.867
Exports	5.583	8.218	2.636
Imports	7.834	13.337	5.503
Balance of Services	-1.736	-1.417	319
Primary Income Balance	-340	-724	-384
Secondary Income Balance	726	805	78
Capital Account	**65**	**61**	**-4**
Financial Account	**2.756**	**5.811**	**3.055**
comprising			
FDI	5.102	1.873	-3.228
Other Investments	-2.328	3.962	6.289

Source: BM

2.1. Near-Term Economic Activity

GDP grew by 4.2% in the fourth quarter of 2022. Preliminary data from the National Bureau of Statistics (INE) point to an annual GDP growth of 4.2%, in annual terms, in the fourth quarter of 2022, which contributed towards a cumulative increase of 4.1% for the year (Table 2-1).

This performance was determined by the improvement of external demand, which had a positive impact on the extractive industry, as well as the resumption to the normal functioning of the economy, following restrictions implemented amid COVID-19, which favored the tertiary sector, with emphasis on trade, transport, and hotel and restaurant services, amid the outset of liquefied natural gas exports from the Rovuma basin.

In terms of aggregate demand components, the following drivers of good GDP performance stand out:

i) The increase in exports, due to the upturn in external demand. In the period, the value of goods exports increased compared to 2021, reflecting the combined effect of the increase in volume and prices of major goods in the international market (Table 2-2). Meanwhile, the balance of goods has deteriorated due to a substantial increase in imports, essentially justified by the import of the floating platform of the Coral Sul project (Table 2-2). In terms of export products, the highlight goes to coal, aluminum, heavy sands and natural gas (Table 2-3).

Table 2-3: External Trade (USD million)

Exports	2021	2022	Annual Change
Mineral Coal	1.466	2.852	1.387
Aluminum Bars	1.259	1.646	387
Heavy Sands	470	562	92
Precious stones	158	123	-35
Electricity	570	571	1
Natural Gas	271	542	270
Imports	**2021**	**2022**	**Annual Change**
Fuels	919	1.966	1.047
Construction material	844	652	-192
Machinery	1.184	5.449	4.265
Raw Aluminum	363	466	103
Vehicles	346	369	23

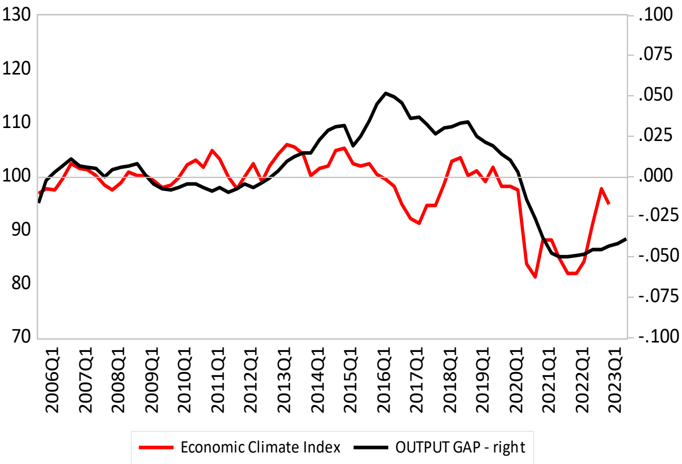
Source: BM

Table 2-4: State Budget Implementation (MZN million)

	2021	2022 Budget	2022	Annual Var.
Income	265.936	293.917	283.143	6,5%
Total Expenditure	318.759	438.789	385.706	21,0%
Current Expenses	247.028	315.413	313.339	26,8%
Investment Expenses	68.636	118.532	69.435	1,2%
Deficit (before donations)	-52.824	-144.872	-102.563	94,2%
Domestic Loans	52.257	65.067	63.494	21,5%
Application of Capital Gains	5.898	7.617	7.617	29,2%
External Financing	41.931	103.079	68.837	64,2%
Stock Variation	13.493		6.486	

Source: Ministry of Economy and Finance (MEF)

Chart 2-1: Output Gap and ECI Developments



Source: BM

ii) The increase in public expenditure, with emphasis on current expenditure. Among the key drivers of this increase, stand out expenses with salaries, due to the implementation of the Single Salary Table (TSU), against a backdrop of slight recovery of investment expenditures (Table 2-4). For 2023, the pressure on current expenditure is expected to worsen, considering the ongoing TSU adjustments, increased resource needs to address the impacts of climate shocks, as well as expenditures on goods and services associated with election processes.

Economic activity continues to show signs of recovery. GDP growth in 2022 signals the gradual recovery of the economy, following the shock caused by COVID-19, coupled with output gap developments (Chart 2-1).

In the near term, moderate economic growth is expected. Excluding natural gas projects, the dynamic of tertiary sector is expected to contribute to the moderate GDP growth, against a backdrop where the effects of climate shocks and the fall in prices of major export commodities can dampen economic activity. These forecasts fall in line with the assessment of industrial economic agents (Chart 2-2).

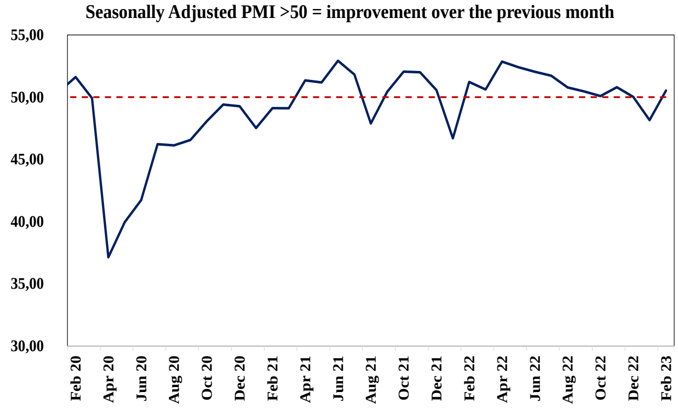
Private sector expenditure, which has improved compared to the same period in 2022, also supports this forecast. This dynamic is backed by the annual increase in credit granted by the banking system in January of this year, albeit timidly (Chart 2-3).

On the external side, ongoing near-term growth of exports value is expected, due to the gradual increase in the volume of liquefied natural gas and coal exports.

Domestic public debt has worsened.

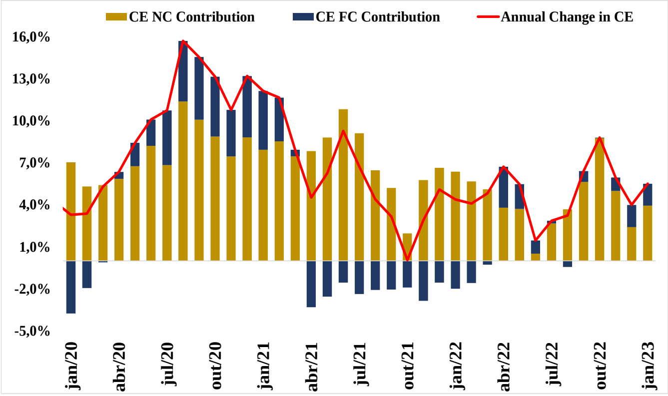
In 2022, domestic financing remained the main source of funding for the fiscal deficit. Between the last two MPC sessions, domestic public debt has increased to 301.3 billion meticais, which cumulatively stands for an increase of 11.8 billion meticais, mainly driven by the increased state financing by the BM, by means of treasury bonds, offset by the reduction in the balance of treasury bills (Table 2-5). In the near term,

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



Source: HIS, Markit

Chart 2-3: Developments in Credit to the Economy



Source: INE/BM

Table 2-5: Domestic Public Debt (MZN million)

	Use of T-Bills	Treasury Bonds	In the BM	M Total Debt	Debt as % of GDP
Dec – 2019	29.671	61.817	48.067	139.555	14,5%
Dec – 2020	44.220	88.100	54.885	187.205	18,1%
Dec – 2021	59.399	102.415	57.009	218.823	19,6%
Mar – 2022	74.570	104.395	59.640	238.605	20,5%
Jun – 2022	80.570	109.700	63.631	253.901	21,8%
Sep – 2022	68.370	124.990	65.118	258.478	22,2%
Dec – 2022	69.872	142.056	63.186	275.114	23,6%
Jan – 2023	79.872	142.056	67.485	289.413	21,9%
Feb – 2023	76.872	142.067	68.117	287.056	21,7%
Mar – 2023	74.260	146.882	80.117	301.259	22,8%
Flow (Jan/23 - Mar/23)	**-5.612**	**4.826**	**12.632**	**11.846**	

Source: BM

pressure on domestic financing sources is expected to grow, amidst restrained access to external sources and weak disbursement of funds by cooperation partners.

The country's international reserves remain at comfortable levels. As measured by the Gross International Reserves (GIR), the country's external position remains satisfactory, with a cumulative balance of about USD 2,790 million as at March 20, 2023, enough to cover over 3 months of imports of goods and services, excluding mega projects.

Box 1 : Monetary and Financial Developments

I. Interest Rate Developments

a) Money Market Interest Rates

Between the January and March MPC cycles, money market interest rates observed a mixed performance. In fact, overnight to 28-day maturity interest rates observed no change, and the 63-day maturity interest rate moved to 17.60%. In turn, longer maturity interest rates have risen to 17.73% (91-day), 17.75% (182-day) and 17.80% (364-day) (Chart 1).

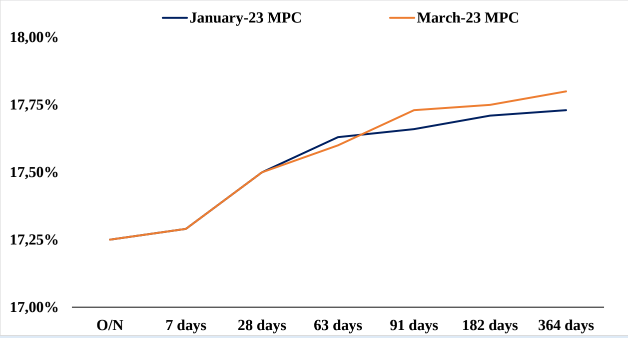
BM intervention interest rates for shorter maturities remained stabled. Interest rates on reserve repo security sale transactions for the 7 to 28-day maturities remained unchanged and the 63-day interest rate moved to 17.60% (-3 bp) (Chart 2).

Between January and March 2023, T-Bill interest rates increased. Indeed, the 91, 182 and 364-day interest rates (key reference maturities) increased to 17.73% (+7 bp), 17.75% (+3 bp) and 17.80% (+7 bp), respectively. It is worth noting that the T-Bill interest rate for the 364-day maturity stood 55 bp above the MIMO policy rate (Chart 3).

b) T-Bond Interest Rates

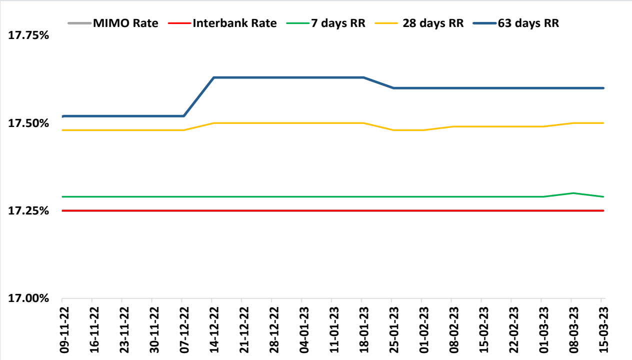
T-Bond interest rates have observed a mixed performance. Indeed, in February and March of the current year, the State only issued T-Bonds for the 4 and 5-year maturities, respectively. Thus, for the 4-year maturity the average weighted average rate stood at 21.15% (-48 bp compared to the latest auction for the maturity held in the previous year). The 5-year maturity weighted average rate stood at 21.51% (+401 bp, compared to the latest auction for the same maturity held in the previous year) (Chart 4).

Chart 1: Money Market Yield Curve



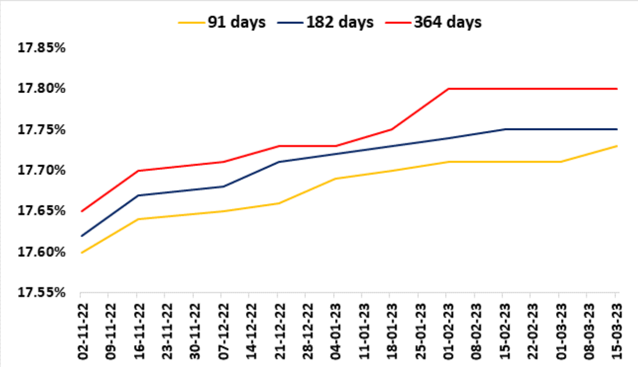
Source: BM, 2023

Chart 2: IMM Interest Rate Developments



Source: BM, 2023

Chart 3: Treasury Bill Interest Rate Developments



Source: BM, 2023

c) Retail Interest Rates

Available data reported on January 2023 show an increase in interest rates for retail market 1-year maturity loans and deposits. In fact, the average interest rates of the loans and deposits have increased by 157 bp and 434 bp to 21.67% and 14.64%, resulting in a spread reduction between both (active and passive interest rates) (Chart 5).

II. Exchange Rate Developments

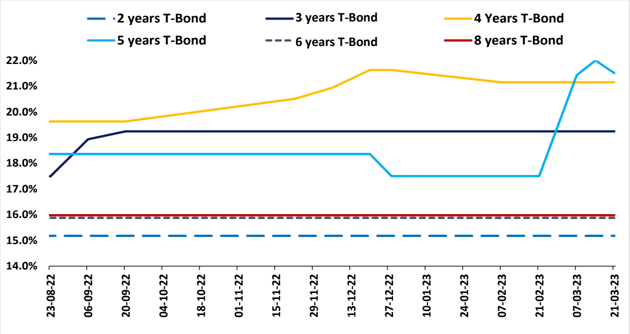
a) Metical Exchange Rate against the US Dollar

The Metical (MZN) remains stable against the US dollar (USD). Indeed, between the two MPC session cycles, the benchmark MZN exchange rate against the USD remained at MZN/USD 63.88 and the effective exchange rate resulting from transactions between commercial banks and the public dropped from MZN/USD 63.90 in January to MZN/USD 63.89 in March. In the exchange bureau segment, the Metical observed a slight depreciation from MZN/USD 65.32 to MZN/USD 66.54 (Chart 6).

b) Metical Exchange Rate against the Rand

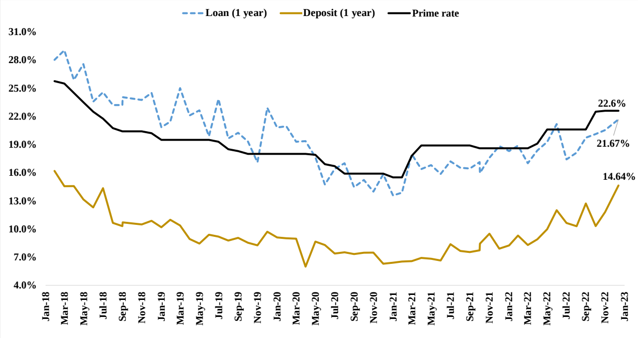
Metical (MZN) Appreciation against the Rand (ZAR). Indeed, the benchmark exchange rate of the MZN against the ZAR moved from MZN/ZAR 3.73 to MZN/ZAR 3.46. The rates of the other market segments followed the same trend (Chart 7).

Chart 4: Treasury Bond Interest Rate Developments



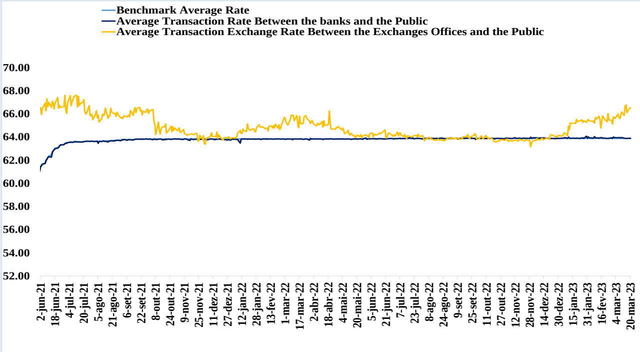
Source: BVM, 2023

Chart 5: Developments in Retail Interest Rates and the Prime Rate



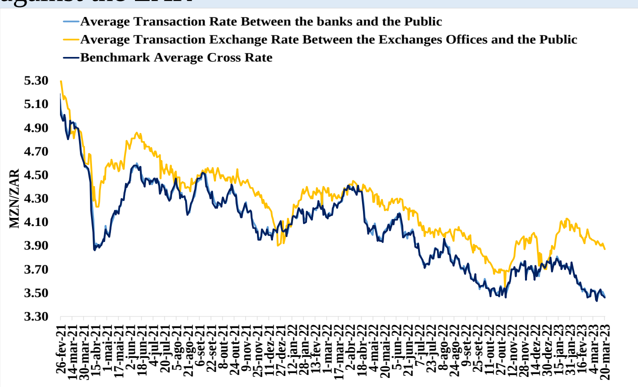
Source: BM, 2023

Chart 6: Metical Exchange Rate Developments against the US Dollar



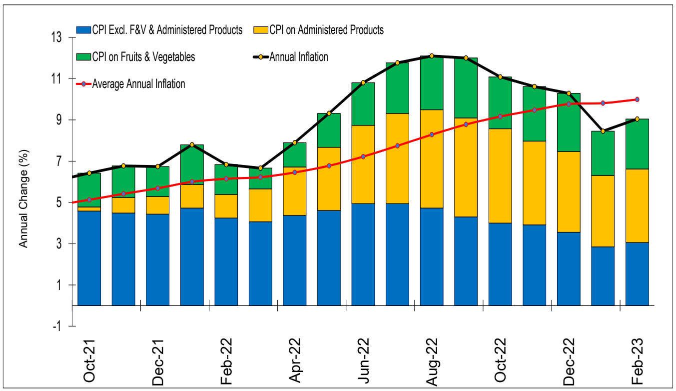
Source: BM, 2023

Chart 7: Metical Exchange Rate Developments against the ZAR



Source: BM, 2023

Chart 2-4: Annual Inflation Components – Three-City Index



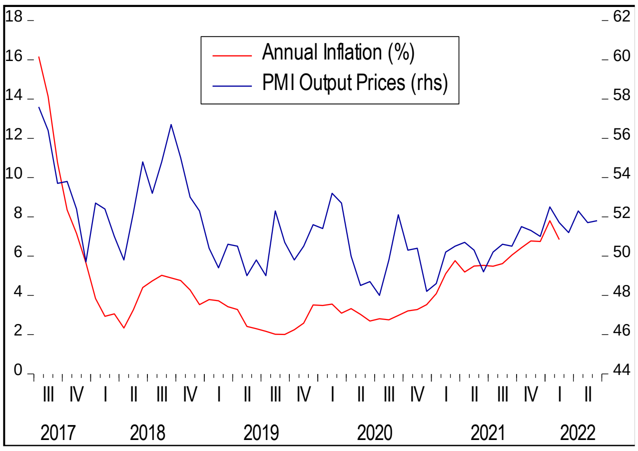
Source: INE/BM

Table 2-6: Core Inflation (%) – Eight-City Index

	set/22	out/22	nov/22	dez/22	jan/23	fev/23
CPI Mozambique	**12,71**	**11,83**	**11,25**	**10,91**	**9,78**	**10,30**
CPI (Maputo, Beira & Nampula)	**12,01**	**11,08**	**10,62**	**10,29**	**8,46**	**9,05**
Food	**17,38**	**15,89**	**17,15**	**16,86**	**13,40**	**14,77**
Cereals and by products	19,81	20,83	21,67	22,06	20,69	20,50
Fruits & Vegetables	35,20	29,65	32,02	33,00	21,89	25,02
Administered	**22,93**	**21,63**	**19,04**	**18,83**	**16,98**	**17,45**
Liquid Fuels	41,55	36,75	28,78	28,78	28,78	28,78
CPI x Frut. & Veg	**9,96**	**9,40**	**8,66**	**8,08**	**7,04**	**7,26**
CPI x Adm.	**9,22**	**8,37**	**8,42**	**8,11**	**6,29**	**6,92**
CPI x Frut. & Veg and Adm.	**6,21**	**5,85**	**5,58**	**4,94**	**4,12**	**4,28**

Source: INE

Chart 2-5: Purchasing Managers Index and Annual Inflation (%)



Source: HIS, Markit

2.2. Recent Inflation Developments and Short-Term Prospects

Annual inflation accelerated in February 2023, driven by the rise in food prices. As measured by change in the Mozambique Consumer Price Index (CPI)[2], annual inflation rose from 9.78% in January to 10.30% in February. Similarly, data gathered in the cities of Maputo, Beira and Nampula (MABENA) suggest that annual inflation rose from 8.46% in January to 9.05% in February (Chart 2-4).

Overall price developments in February is explained by the increase (i) in food prices especially fruit and vegetables, in the face of climatic shocks, (ii) school fees in public higher education and (iii) public transport tariff in Maputo city (2-6).

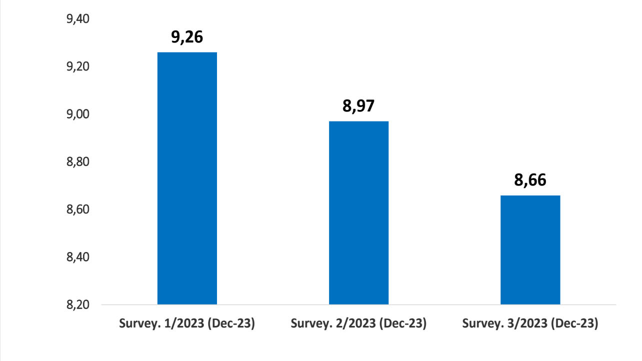
Core inflation remained stable. Excluding the subgroup of fruit and vegetables and administered products, annual core inflation rose from 4.12% in January to 4.28% in February (Table 2-6 and Chart 2-4). This performance reflects restrictive financial conditions, amidst ongoing Metical stability against the US Dollar and appreciation against the Rand. This drove price stability of imported goods, against a backdrop of below-potential aggregate demand, despite its upturn.

Near-term prospects point to inflationary pressure. These prospects reflect the lagging effect of the adjustment of the prices of public transportation in Maputo city and public higher education school fees at the end of February, in a context where the negative impact of climate shocks on production fields and related infrastructures remains prominent. The Purchasing Managers' Index, one of the leading indicators of price developments, also backs acceleration prospects for the coming months of the current year (Chart 2-5).

Prevailing risks and uncertainties include: (i) pressure on public expenditure for post-natural disaster reconstruction, holding elections and implementing the Single Salary Table, (ii) the magnitude of the impact of bad weather events,

[2] The INE started disclosing a new publication on the aggregate national CPI, compiled from 8 cities on October 2022.

Chart 2-6: Annual Inflation Expectations (%)



Source: BM/INE

and (iii) the unfolding effects of the Russia-Ukraine conflict.

Economic agents have revised their inflation prospects downwards for the end of the year. In March, the expectations of economic agents suggest that annual inflation may stand at about 8.66% in December 2023, following the 8.97% suggested in the previous survey (Chart 2-6). For the medium term, single-digit inflation expectations of economic agents are consolidating.

Box 2: Impact of the Revision of the Value Added Tax and Other Taxes on Goods and Services on Inflation

The Mozambican Government has introduced, with effect from January 2023, tax reforms in light of implementing the Economic Acceleration Package (PAE), highlighting (i) the reduction of the general rate of the Value Added Tax (VAT) by 1 percentage point (pp) to 16%; (ii) the application of 5% VAT for private education and health services and (iii) the revision of the tax on specific consumption (ICE) for some goods (alcoholic and non-alcoholic beverages and tobacco manufactured locally, animal feed and soft drinks). Goods and services covered by such reforms make up the Consumer Price Index (CPI) basket, so they affect price dynamics.

1. Mapping of the Direct Effect of Tax Changes on the CPI

The reduction in the general VAT rate cover 259 products that make up the CPI basket, with a weight of 72.3%. For their part, private health and education services and house rent, now subject to 5% VAT, have a cumulative weight of approximately 4.4% on the CPI, while goods that enjoyed the ECI reduction weigh 0.01% - Table 1.

Table 1: Mapping of CPI Basket Goods and Services with Tax Revisions

Description	No. of Products	Weight in CPI (2023) (%)
I. CPI Basket Goods and Services with Revised VAT		
1. Goods exempt from VAT	15	12.88
2. Goods and services with VAT reduced from 17.0% to 16.0%	259	72.33
3. Goods and services subject to VAT	9	4.39
Private education and health services (+5%)	*7*	*1.78*
House rents and funeral services (+16%)	*2*	*2.61*
II. CPI Basket Goods and Services with Revised ECI		
1. Reduction (- 10pp) - animal feed	1	0.01
III. Other CPI Basket Goods and Services, with Revised Taxes	9	10.39
Total	293	100.00

Source: Estimates based on INE data (2023)

In table 1, the category of other CPI basket goods and services with revised taxes and a weight of 10.4% includes those whose revision effect may lead to an increase (or reduction) in the tax burden.

Thus, tax revisions are estimated to contribute to price drops, considering that goods and services with reduced taxes accounts for a weight of 72.3% against a weight of 4.4% of those which have undergone tax increases and introductions. Indeed, the preliminary estimate made in January 2023, considering the price indexes observed in December 2022, suggested a price drop by 0.22 pp, ceteris paribus – Table 2.

Table 2: Preliminary Estimate of Tax Revision Effects on the CPI

	December 2022	January 2023	Change
	Observed	**Estimate**	
Monthly inflation (%)	1.19	0.97	-0.22

Source: Estimates based on INE data (2023)

2. Analysis of the Impact of the Tax Revision on January 2023's Inflation

In January 2023, monthly inflation slowed by 0.71 pp to 0.48%. Price developments for the products that make up the CPI show that, of the 293 products comprised in the basket, 188 (64%), with a weight of 85% in the basket, have recorded a negative change for the period concerned, and 90% (169 products) have undergone VAT reduction, with a weight of 63% in the CPI - Table 3.

The analysis of the developments in prices per CPI divisions shows that VAT reduction has contributed to the drop in the prices of food and non-alcoholic beverage and catering services, given that it covered 55 and 8 products with the reduction of prices in said divisions, weighing 21% and 12%, respectively.

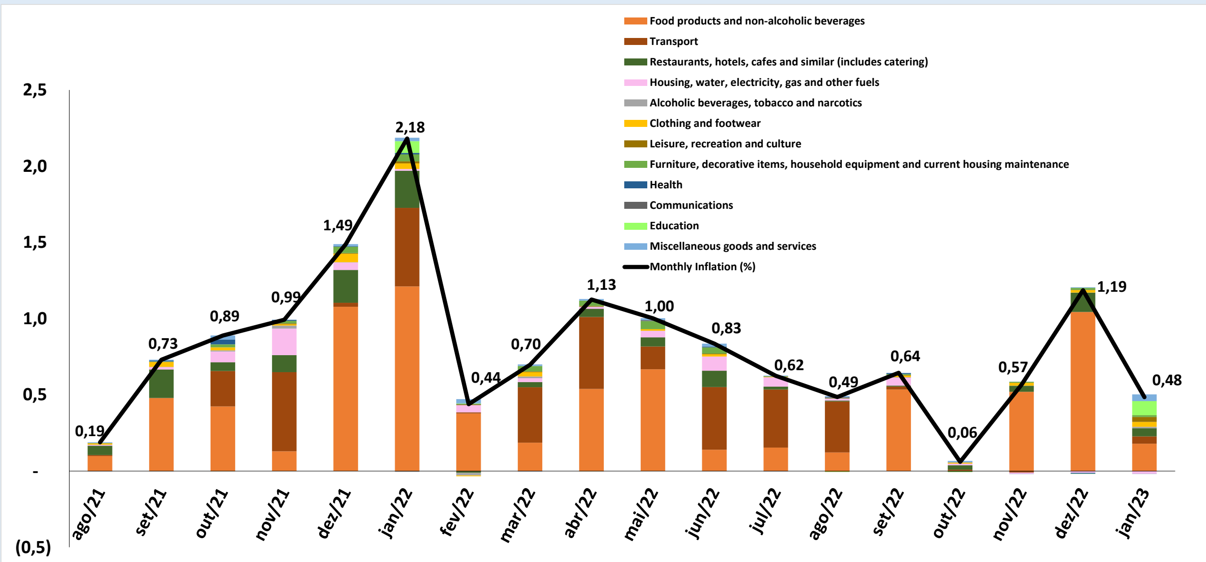
Table 3: VAT Reduction Impact per CPI divisions on January 2023's Inflation

Division		Price Reduction		No change of prices		Price increase	
		N. products	weight (%)	N. products	weight (%)	N. products	weight (%)
Food products and non-alcoholic beverages	Total	65	33	1	0	27	3
	w/ reduced VAT	55	21	1	0	26	3
Alcoholic beverages, tobacco and narcotics	Total	1	0			3	1
	w/ reduced VAT	1	0			2	0
Clothing and footwear	Total	29	5			11	1
	w/ reduced VAT	29	5			11	1
Housing, water, electricity, gas and other fuels	Total	6	4	4	3		
	w/ reduced VAT	6	4	3	1		
Furniture, decorative items, household equipment and current housing	Total	28	4	1	0	14	2
	w/ reduced VAT	27	4	1	0	14	2
Health	Total	7	1	2	0	2	0
	w/ reduced VAT	6	0	1	0	2	0
Transport	Total	14	18	4	0	7	0
	w/ reduced VAT	12	10	4	0	7	0
Communications	Total	1	4	1	0	1	1
	w/ reduced VAT	1	4	1	0		
Leisure, recreation and culture	Total	8	0	3	0	5	1
	w/ reduced VAT	7	0	3	0	4	0
Education	Total	5	1	4	1	3	1
	w/ reduced VAT	2	0				
Restaurants, hotels, cafes and similar (includes catering)	Total	9	12			2	1
	w/ reduced VAT	8	12			2	1
Miscellaneous goods and services	Total	15	2	3	0	7	1
	w/ reduced VAT	15	2	2	0	6	0
Grand Total		**188**	**85**	**23**	**4**	**82**	**11**
With a reduction in VAT		169	63	16	1	74	8

Source: Compiled from INE data (2023)

In fact, price performance for these divisions proved a driver of the inflation slowdown in January 2023. The contribution of food and non-alcoholic beverages and catering services on inflation declined from 1 pp and 0.13 pp in December 2022 to 0.18 pp and 0.05 pp in January 2023, respectively - Chart 1.

Chart 1: Breakdown of Monthly Inflation by Divisions



Source: INE (2023)

3. Final Remarks

It is estimated that the reduction of taxes on consumption, especially VAT from 17.0% to 16.0%, contributed to the inflation slowdown in January 2023. This effect shall also pass-through to annual inflation in the remaining months of 2023, given the base statistical effect. Meanwhile, these estimates are subject to inaccuracies, given the income effect, which translate into an increased demand for goods and services grounded on the redirecting of savings due to lower tax. The effect of the reduction of prices following from the downward revision of VAT may also be offset by other inflationary effects, such as the climate shocks that have been striking the country.

Chapter III. Medium-Term Inflation and Economic Activity Forecasts

In the medium term, inflation is expected to remain within a single-digit, underpinned by the impact of the measures taken by the MPC, the exchange rate stability and the downward trend in commodity prices in the global market. Moderate economic growth is anticipated. Excluding the ongoing energy projects in the Rovuma Basin, a lower Gross Domestic Product is expected, mainly due to the impact of recent climate shocks on agricultural production and various infrastructures.

Amid the current macroeconomic framework and considering the risks and uncertainties associated with inflation forecasts, the MPC has decided to keep the MIMO policy rate unchanged at 17.25%.

Table 3-1: External Assumptions

	2022	2023	2024
US Real GDP	**2.1**	**1.2**	**1.2**
January 2023's MPC session	**1.9**	**0.6**	**2.0**
RSA Real GDP (%)	**2.5**	**1.0**	**0.7**
January 2023's MPC session	**1.8**	**0.5**	**1.3**
US Inflation (%)	**8.0**	**3.9**	**2.4**
January 2023's MPC session	**8.0**	**3.9**	**2.4**
RSA Inflation (%)	**6.7**	**6.0**	**5.1**
January 2023's MPC session	**6.8**	**6.0**	**4.7**
Brent Price (USD)	**98.9**	**83.3**	**80.2**
January 2023's MPC session	**99.0**	**82.4**	**80.2**
Food Prices (%)	**14.3**	**-10.4**	**-0.6**
January 2023's MPC session	**15.0**	**-9.2**	**-1.4**

Source: GPMN

3.1.Medium-Term Outlook Assumptions

The medium-term macroeconomic outlook (2023-2024) is mainly underpinned by the following assumptions: (i) the prevalence of high pressure on public expenditure, amid limited financing sources; (ii) Mozambican economy growth; (iii) ongoing geopolitical crisis in Europe; (iv) weak external demand; (v) global inflationary pressure slowdown; (vi) and lower global commodity prices.

a) External Macroeconomic Environment Assumptions

- Subdued external demand, especially due to the weak global economic growth associated with tighter global financial conditions, including bottlenecks to access international financial market, against a backdrop of the prevalence of uncertainties as to the impact of the protracted Russia-Ukraine conflict on global economy.

- Ongoing prospects of declining global inflationary pressure, despite remaining high (Table 3-1). This slowdown trend mainly reflects, (i) the maintenance of policy rate hike prospects; (ii) ongoing Russia-Ukraine export agreement, which has been contributing towards food price drops and (iii) weak demand for natural gas in Europe and US due to a milder winter. This fact has contributed to the maintenance of large

Chart 3-1: Mozambique Annual Inflation Projection (%)

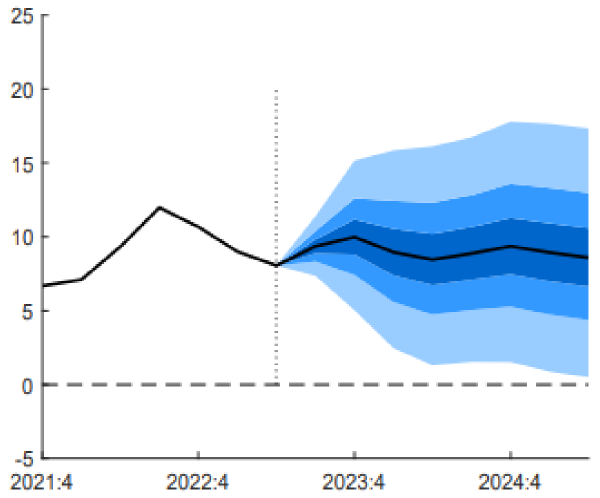
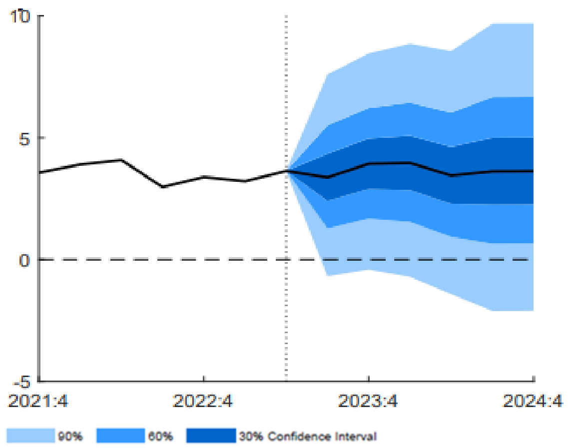


Chart 3-2: Mozambique Annual Real GDP Growth Projection (Excluding gas) (%)



reserves, in line with the increased brent production by non-members of the Organization of Petroleum Exporting Countries (OPEC).

b) Assumptions on the Dynamics of Domestic Macroeconomic Indicators

- Increase pressure on public expenditure, mainly due to the State having to cope with expenses regarding: (i) the restructuring and resettlement process following the recent natural disasters; (ii) electoral cycles schedule for the current and coming years; (iv) reconstruction and humanitarian assistance to population from the areas affected by terrorists and (v) the implementation of the Single Salary Table, with substantial impact on the state budget.

- Ongoing Metical exchange rate stability against the US dollar, in line with the outset of natural gas exports from the Rovuma basin, amid the maintenance of positive real interest rates.

3.2. Medium-Term Inflation Forecasts and Associated Risks

In light of the above assumptions, single-digit inflation is expected in the medium term (Chart 3-1), mainly driven by the impact of the measures taken by the MPC, exchange rate stability and the downward trend in commodity prices in the global market.

In addition, medium-term forecasts point to a **further moderate economic growth** (Chart 3-2), especially reflecting the prevalence of tighter global financial conditions, resulting in a lower expansion of global economic activity, and consequently, a reduction in export commodity prices in the global market. Excluding the ongoing energy projects in the Rovuma Basin, a lower Gross Domestic Product growth is expected, mainly due to the impact of recent climate shocks on agricultural production and various infrastructures.

Risks and uncertainties associated with inflation forecasts have worsened. Domestically, the uncertainties regarding the short-term impact of recent climate shocks on the prices of goods and services, and the increased pressure on public spending are particularly highlighted. On the external side, the uncertainties with regard to the effects of the volatility in global financial markets and the protracted Russia-Ukraine conflict stand out.

3.3. Monetary Policy Decision

The Monetary Policy Committee (MPC) of the Banco de Moçambique has decided to keep the MIMO policy rate unchanged at 17.25%.

This decision is underpinned by the maintenance of single-digit inflation prospects in the medium term, despite the materialization and exacerbation of some risks associated with inflation forecasts, in particular, the occurrence of natural disasters and increased pressure on public expenditure.

The MPC also issued the following decisions:

- Keep the Standing Lending Facility (SLF) at 20.25%;
- Keep the Standing Deposit Facility (SDF) rate unchanged at 14.25%;
- Keep Reserve Requirement ratios at 28% for domestic currency and 28.50% for foreign currency.