Financial Statements Approval by the Board of Directors

The Board of Directors of the Banco de Moçambique is responsible for the preparation, integrity and accuracy of the Financial Statements and other information described in the present report.

The Executive Directors fulfill this responsibility primarily by establishing and maintaining accounting systems and practices adequately supported by internal accounting control procedures. Such control procedures provide assurance that the Bank assets are safeguarded, the respective transactions are executed in accordance with the norms and procedures adopted by the management and that the financial records are reliable.

In terms of articles 64 and 65 of the Law 1/92, of January 3rd, the Banco de Moçambique Organic Act, the Financial Statements for the year ended December 31st, 2007, detailed from page 2 to 20, were approved by the Board of Directors on May 8th, 2008 and are signed on its behalf by:

Drª Esselina Macome
Executive Director for
Currency Issuing, Accounting, Organization and Information Technology

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
BANCO DE MOÇAMBIQUE

We have audited the accompanying financial statements of **BANCO DE MOÇAMBIQUE,** which comprise the balance sheet as at 31 December 2007 (reflecting a total assets of 50.366.653 thousands of Meticais and reflecting a total equity of 2.674.928 thousands of Meticais, including a net result for the year of 290.344 thousands of Meticais), the income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the financial statements

Management is responsible for the preparation of these financial statements in accordance with accounting principles set out in the Central Bank Chart of Accounts. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. Except for the limitations set out below in the qualification paragraphs 1 and 2, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessment, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Qualifications

1. The reconciliation for Other Debtors – Exchange position reflecting a balance of 2.330.000 thousands of Meticais at Balance sheet date is still in progress. Until such time that this reconciliation is concluded, we are unable to determine the impact, if any, of the possible adjustments to results and assets on Balance sheet date.

2. In accordance with the last actuarial study carried out with reference to 31 December 2006, the responsibility of the Bank with regard to employee retirement pensions was estimated at 4.095.753 thousands of Meticais, for which a separate fund was constituted, valued at approximately 3.720.053 thousands of Meticais as at 31 December 2007. The lack of an updated actuarial study carried out with reference to 31 December 2007, does not allow us to evaluate the impact on the uncovered funding responsibility arising from possible changes to the employee retirement pension plan.

3. As mentioned in Note 15 to the Notes to the Financial Statements, the account Equity – other reserves includes an amount of 1.237.848 thousands of Meticais, related to the net effect of the exchange revaluation on foreign assets and liabilities held by the Bank as at 31 December 2007. This transaction is supported by the internal Service Order nº 19/2006 dated 28 August. Taking into consideration that the current law in force (Lei Orgânica do Banco de Moçambique), through the article 14, establish that the credit balance on the special account of revaluation reserve at year end should be transferred to a captive account on behalf of the Government, we are the opinion that the Bank should record that responsibility as a liability under the account Creditors and other accounts. As such, the Equity of the Bank is overstated and the Liabilities understated by that amount.

Qualified opinion

In our opinion, except for the effects of such adjustaments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the scope limitations stated in paragraphs 1 and 2 to above and except for the effects on the financial statements of the matter referred to in the qualification paragraph 3 above, the financial statements referred to above present fairly, in all material respects, the financial position of **BANCO DE MOÇAMBIQUE** at of 31 December 2007, and its financial performance and cash flow for the year then ended in accordance with accounting principles defined in the Central Bank Chart of Accounts.

Maputo, 9 April 2008

ERNST & YOUNG, LDA

BANCO DE MOÇAMBIQUE
Balance Sheet as at 31 December 2007
(Expressed in thousands of Meticais)

	Notes	2007	2006
Assets			
Property, plant and equipment	2	1.248.544	967.007
Loans and advances to Government	3	-	-
Investments	4	4.543.578	3.047.808
Amounts due by the Government	5	15.207	1.515.207
Gold and foreign exchange	6	37.167.888	34.401.973
Cash and cash equivalents	7	-	-
Debtors and other accounts	8	6.847.834	3.216.208
Other assets	9	543.602	410.636
Total assets		50.366.653	43.558.839
Liabilities			
Notes and coin in circulation	10	10.942.179	8.789.334
Deposit accounts	11	16.949.860	17.359.553
Treasury bills and monetary authority bills	12	14.213.411	9.475.935
Foreign loans	13	363.594	252.979
Creditors and other accounts	14	418.914	263.303
Employees' social welfare fund		206.865	240.610
Provisions	22	4.596.902	4.367.660
Total liabilities		47.691.725	40.749.374
Equity			
Share Capital	15	248.952	248.952
Non-distributable reserve	15	534.112	314.880
Undistributed profit	15	290.344	292.309
Statutory reserve	15	363.672	290.595
Other reserves	15	1.237.848	1.662.729
Total equity		2.674.928	2.809.465
Total liabilities and equity		50.366.653	43.558.839
Commitments and contingencies	16	520.036	136.664

Administrative and Finance Department

Felicidade Bauze

Board of Directors

BANCO DE MOÇAMBIQUE
Income Statement – for the Year Ended 31 December 2007
(Expressed in thousands of Meticais)

	Notas	2007	2006
Interest income	17	2.122.742	1.501.225
Interest expense	18	2.010.619	1.220.531
Net interest income		112.123	280.694
Other income			
Profits on gold operations	19	206.020	218.531
Profits on foreign currency operations	19	1.037.357	612.512
Other operational income	20	375.551	140.011
Total income		1.731.051	1.251.748
Operating costs			
Personnel costs	21	863.284	700.118
Other operating costs	21	490.984	234.718
		1.354.268	934.836
Operational profit		376.783	316.912
Prior year adjustments	23	(76.896)	(24.603)
		299.887	292.309
Provision	22	(9.543)	-
Profit for the year		290.344	292.309

Administrative and Finance Department

Felicidade Bauza

Board of Directors

BANCO DE MOÇAMBIQUE
Cash Flow Statement – for the Year Ended 31 December 2007
(Expressed in thousands of Meticais)

	2007	2006
Cash flow from operating activities		
Profit for the year	290.344	292.309
Adjustments to:		
Adjustments of statutory reserve	-	-
Depreciation	125.860	146.521
Noncash items	(120.289)	(231.444)
Movements in provision	229.242	(35.668)
Extraordinary items	-	-
Employees social welfare fund	(33.745)	225.350
Revaluation of foreign currency	(424.881)	1.638.729
Net cash generated by operating activities	66.531	2.035.797
Changes in working capital		
Decrease/(increase) in loans advanced to Government	-	2.300.636
Decrease/(increase) in amounts due by Government	1.500.000	1.500.000
Decrease/(increase) in debtors and other accounts	(3.631.626)	444.122
Decrease/(increase) in inventories	(132.966)	(327.491)
Decrease/(increase) in deposits accounts	(409.693)	3.422.797
Decrease/(increase) in creditors and other accounts	275.899	47.626
Decrease/ (increase) in treasury bills and monetary authority bills	4.737.476	(1.130.865)
Cash generated from/(utilised by) changes in working capital	2.339.090	6.256.825
Cash generated from/(utilized by) operating activities	2.405.621	8.292.622
Cash flow (utilised by)/from investing activities		
(Purchase) and disposal of property, plant and equipment	(407.397)	(159.786)
(Purchase) and disposal of the investments	(1.495.770)	(1.510.573)
(Revaluation (purchase)/disposal of gold and foreign exchange	(2.765.914)	(4.533.676)
	(4.669.081)	(6.204.035)
Cash flow from the financing activities		
(Decrease)/ increase notes and coin in circulation	2.152.845	1.453.554
(Revaluation and (decrease)/ increase in foreign loans	110.615	(3.542.141)
Foreign loan transfer to the Government	-	-
	2.263.460	(2.088.587)
Net (decrease)/ increase in cash and cash equivalents	-	-
*Cash and cash equivalent at begining of the year	-	-
*Cash and cash equivalent at the end of the year	-	-

Administrative and Finance Department

Board of Directors

* Due to its role in the issuing and withdrawal of money, the Bank has no cash balances on its balance sheets.

BANCO DE MOÇAMBIQUE
Notes to The Financial Statements – for the Year Ended 31 December 2007
(Expressed in thousands of Meticais)

1. ACCOUNTING POLICIES

a) Basis of presentation

BM – Bank of Mozambique, with its head office in Maputo, is the country's central bank. Its capital has been fully subscribed and paid for by the State of the Republic of Mozambique.

These financial statements present the financial position of the Bank at 31 December 2007, and the results of its operations for the year then ended.

The financial statements were prepared in conformity with the Chart of Accounts of the Bank of Mozambique, on the basis of historical costs, except for the situations described below, and in accordance with fundamental principles of prudence, going concern, substance over form and materiality.

Except for the the format of the presentation and summarization, the financial statements presented are identical those presented to board of directors for approval at the annual board meeting.

b) Recognition of income and expenses

Costs and revenues are recorded in the period to which they relate, regardless of the timing of the receipt or payment, according to the accrual basis of accounting.

c) Transactions in foreign currency / Gold

The accounting records of Bank of Mozambique are maintained in Meticais. Transactions in foreign currency are converted at the rate of exchange ruling at the date of the transaction. Balances denominated in foreign currency are translated to Meticais at the official exchange rates at the reporting date.

According to the terms of article 14º of Law 1/92, revaluation gains or losses on foreign assets and liabilities are for the account of the Government. As from 31 May 2002 up to the 2003 financial year, revaluations on foreign assets were for the account of the Bank as per agreement with the Government.

Since 23 August 2006, in accordance with internal Service Order n.º 19/2006 of the Bank Governor, gains and losses are recoded as following: (i) if the net difference is a gain, the amount is recorded in the Revaluation reserve of foreign currency; (ii) if the net difference is a loss, the amount is recorded in the Revaluation reserve of foreign currency up to the limit of the balance of this account. The remaining amount is recorded in the profit and loss account.

During the year, gains and losses form gold and foreign currency transactions are calculated currency by currency by the difference between the transaction amount and the weighted average cost of the day, which is calculated based on the "net daily cost method".

d) Property plant and equipment

Buildings are revalued on a timely basis. Other fixed assets are shown at cost less accumulated depreciation.

Depreciation is calculated on a straight line basis on maximum rates allowed for tax purposes, which does not substantially differ from estimated useful life:

	Number of years
• Buildings	50
• Information technology equipment	4
• Vehicles	4 – 5
• Other assets	10
• Intengible assets	3

Intangible assets include capitalized costs, which includes costs with issuing notes and coins which are amortized over 3 years.

e) Investments

Investments are stated at cost and are written down if there is in the opinion of management, a significant and permanent decrease in value. Where investments are shown at the written down value, adjustments to the carrying value are taken to the income statement.

f) Loans to the Government

Under the article 18 of Law 1/92 the bank has been empowered to extend credit to the Government. As per the bank policy, no provision is required to be raised against such type of credit.

g) Treasury bills and Monetary authority bills

Treasury bills and monetary authority bills are recorded at cost on inception. The difference between the initial cost and maturity value are treated as interest and accrued evenly over the life of the securities.

2. PROPERTY, PLANT AND EQUIPMENT

The movements in Property, plant and equipment accounts, during 2007, are as follows:

	Balance 1 January	Additions	Disposals	Regularizations	Balance 31 December
Cost					
Land and buildings	645.725	259.213	-	-	904.938
Equipment	507.763	52.630	-	-	560.393
Furniture and other fixed assets	2.980	117.529	-	-	120.509
Work in progress	268.029	239.489	-	(259.213)	248.305
Intangible assets	443.915	982	-	4.016	440.881
	1.868.412	669.843	-	(255.197)	2.275.026
Accumulated deprecioan					
Land and buildings	196.174	13.156	-	-	209.330
Equipment	227.795	51.664	-	1	279.460
Furniture and other fixed assets	127.137	24.650	-	-	151.787
Intangible assets	350.299	36.390	-	784	385.905
	901.405	125.860	-	785	1.026.482
Net book value	967.007				1.248.544

3. LOANS AND ADVANCES TO GOVERNMENT

Comprises of the following:

		2007	2006
Loans to the central Government	3.1	-	-
Loans to the local Governments		-	-
		-	-

3.1 At 31 December 2007 no funding had been granted to Central Government. Refer to note 12 to the Notes to the Financial Statements.

		2007	2006
Treasury bonds	4.1	4.500.000	3.000.000
Special drawing rights		6.758	8.578
International Bank for Reconstruction and Development	4.2	12.798	12.798
Africa Export and Import Bank	4.3	23.820	25.970
International payment agreements	4.4	202	462
		4.543.578	3.047.808

4. INVESTMENTS

Includes:

4.1 The treasury bonds refers to the bonds issued by the State on behalf of Bank of Mozambique in order to settle the State debt according to the article 14º of Law 1/92, with perpetual maturity and an interest rate of 5,8%.

4.2 The contribution to the International Bank for Reconstruction and Development (IBRD) represent the commitments paid by the Bank on behalf of the Republic of Mozambique.

4.3 The subscribed capital in African Export – Import Bank amounts to USD 1.000.000 (2006 – USD 1.000.000). The Bank has made the exchange revaluation of this investment in 2007.

4.4 International payment agreement balances represent the net position in respect of bilateral commercial arrangements with African countries.

5. AMOUNTS DUE BY THE GOVERNMENT

This balance is analysed as follows:

	2007	2006
Foreign Exchange losses payable by the Government to be settled over the 1 year	-	1.500.000
Uncommited foerign Exchange losses payable by the Government	15.207	15.207
	15.207	1.515.207

Reconciliation of closing balance:

	2007	2006
Opening balance	1.515.207	3.015.207
Debt transfer to Government	-	-
Reimbursements done by the State during the year (by treasury bonds)	(1.500.000)	(1.500.000)
	15.207	1.515.207
Assumed Exchange gains and losses due by the Government from previous years to date of transfer	-	-
Balance with Government after transference	15.207	1.515.207
Exchange movements subsequent to debt transfer	-	-
	15.207	1.515.207

This balance is required to be settled by the Government in accordance with the terms of article 14º of Law 1/92. The balance is the result of the revaluation of foreign assets and liabilities.

In respect of the 2006 balance, the Government agreed to repay a total amount of 1.500.000 thousands of Meticais by issuing securities, in favor of the Bank during 2007.

In July 2005 and June 2006 and 2007, the Government issued treasury bonds amounting to 1.500.000 thousands of Meticais, each one, on behalf of Bank of Mozambique. Refer to note 4 to the Notes to the Financial Statements.

6. GOLD AND FOREIGN EXCHANGE

This balance is analysed as follows:

		2007	2006
Gold in coin and bullion	6.1	1.887.053	1.571.563
External asset managers	6.2	11.821.699	12.918.611
Term deposits		16.819.933	12.429.207
Treasury bills		5.256.876	3.978.687
Call accounts		1.312.489	3.397.474
Foreign currency held in cash		69.838	106.431
		37.167.888	34.401.973

6.1 At 31 December 2007, the reserves of approximately 95.189 ounces of gold (2006 – 95.189) were valued at USD 79.221.382 (2006 – USD 60.487.659), on the basis of the average price in USD quoted on the London gold market at the year-end.

6.2 Asset Managers refers to investments under the control of external asset managers appointed by the bank. Under separate agreements with them, the fund managers use the funds placed with them for investments specified in the agreements. Increases in the value of portfolios under management during the year are accounted for as income after deducting management fees and commission payable to the asset managers. The management fees vary between 0.5 per cent and 2 per cent of the average net asset value of the investments. In 31 December 2007 the investments were revaluated to the market value and the difference was accounted for on Fair Value Revaluation Reserve account.

7. CASH AND CASH EQUIVALENTS

This balance is analysed as follows:

	2007	2006
Cash and cash equivalents	-	-
	-	-

This balance is analysed as follows:Notes and coin held by the Bank as cash on hand at the end of the financial year have been netted off against the liability for notes and coin in circulation because it does not represent currency in circulation.

8. DEBTORS AND OTHER ACCOUNTS

This balance is analysed as follows:

		2007	2006
Foreign debtors		18.038	25.739
Deposits held for pension fund obligation		3.720.053	2.379.600
Staff loans	8.1	240.854	223.183
Other loans and debtors	8.2	1.994	461
Loans to external parties (consigned resources)		109.664	336.950
Interest receivable – deposits		246.056	214.706
Cheques in course of collection		192.463	18.430
Other receivables		2.318.712	17.139
		6.847.834	3.216.208

8.1 This amount represents deposits at commercial banks to cover future pensions fund obligations. These deposits are under control of the bank and are not included as plan assets in the last actuarial valuations of the pension fund obligation. Refer to note 28 of the Notes to the Financial Statements.

9. OTHER ASSETS

This balance is analysed as foolows:

	2007	2006
Stationary	19.970	18.039
Cost of notes	507.390	376.306
Other assets	16.242	16.294
	543.602	410.636

The cost of notes comprises the notes and coins manufacturing costs which are reversed to income statement in accordance of money issuing.

10. NOTES AND COINS IN CIRCULATION

This balance is analysed as follows:

	2007	2006
Notes	10.573.940	8.481.321
Coin	368.239	308.013
	10.942.179	8.789.334

Notes and coin held by the Bank as cash on hand at the end of the financial year have been netted off against the liability for notes and coin in circulation because it does not represent currency in circulation.

Monetary reserve

In accordance with article 15º of Law 1/92, the excess of the total value of the notes and coins issued by the Bank over its foreign reserves must be fully covered by:

- Loans to the State;
- Securities included in the Bank's investment portfolio;
- Loans made to credit institutions resulting from credit transactions secured by gold; and
- Treasury bills and foreign public sector bills granted to credit institutions in terms of article 41º.

Article 12º of Law 1/92 defines foreign reserves as comprising of gold in coins, bars or ingot, pure silver or platinum, special drawing rights, foreign Exchange reserves and other assets denominated in foreign currency.

At the 31 December 2007 the total value of notes and coins in issue was 10.942.179 thousands of Meticais (2006 – 8.789.334 thousands of Meticais), increasing the value of foreign assets to 37.167.888 thousands of MTn (2006 – 34.401.973 thousands of Meticais).

11. DEPOSIT ACCOUNTS

This balance is analysed as follows:

		2006	2006
Deposit in local currency:			
Government		3.319.227	3.782.221
Financial Institutions	11.1	6.761.515	5.828.390
Third party funds	11.2	6.364	6.364
Guarantee deposits		1.524	4.861
International monetary fund		11.648	10.792
IBRD		219	1.112
Foreign banks		29.840	10.786
Other current accounts		40.313	15.138
		10.170.650	9.659.664
Deposits in foreign currencies			
Government		6.246.602	6.775.962
Financial Institutions	11.1	118.250	118.250
Third party funds	11.3	414.017	805.336
Guarantee deposits		341	341
		6.779.210	7.699.889
		16.949.860	17.359.553

The Government and financial institution deposits are non interest bearing.

11.1 This represents deposit accounts from local commercial banks.

11.2 This represents the local currency equivalent of loans received from the World Bank and other financial institutions for onward lending to beneficiaries.

11.3 This refers to balances of special Project accounts held on behalf of the Treasury and other residents.

12. TREASURY BILLS AND MONETARY AUTHORITY BILLS

This balance is analysed as follows:

		2007	2006
Treasury bills	12.1	14.015.655	9.475.935
Deposits auctions	12.2	71.072	-
Permanent facility deposits	12.2	126.684	
		14.213.411	9.475.935

12.1 Treasury bills are debt securities issued by the Bank of Mozambique for a term of three or six months. Treasury bills are issued to manage liquidity in the Money market though open-market operations in the domestic financial market and to provide short term funding to the Government of Mozambique. Funds raised from the issuance of treasury bills are transferred to the Government on request at the same interest rate as issued to the market and with a maturity agreed with the Government. Interest on treasury bills varied between 14,4% and 16,5% during the year. The outstanding nominal value at year end was 14.888.000 thousands of MTn.

12.2 Deposit auctions are debt securities issued by the Bank of Mozambique for a term between four days to a year. Deposits auctions are issued to manage liquidity in the Money market though open-market operations in the domestic financial market. At 31 December 2007 no deposit auctions were in course.

13. FOREIGN LOANS

Comprises the following:

	2007	2006
International financial organizations	363.594	252.979
	363.594	252.979

This balance refers to loans received from International Monetary Fund on behalf of Poverty Reduction and Growth Facility (PRGF) program. The terms and conditions of these loans are honoured by the Bank.

14. CREDITORS AND OTHER ACCOUNTS

This balance is analysed as follows:

	2007	2006
Foreign creditors	128.435	200.069
Domestic creditors	15.087	18.014
Clearing accounts	1.056	1.100
Other creditors	133.287	33.101
Fair value revaluation reserve - bills	141.049	11.019
	418.914	263.303

15. EQUITY

	Share capital	Non-distributable reserve2	Undistributed profit/(loss)	Statutory reserve	Other reserves	Total capital and reserves
Balance at 1 January 2006	248.952	242.283	96.796	266.396	24.000	878.427
Net profit for the year	-	-	292.309	-	-	292.309
Transfer to non-distriibuted reserves	-	72.597	(72.597)	-	-	-
Transfer to statutory reserve	-	-	(24.199)	24.199	-	-
Forex revaluation	-	-	-	-	1.638.729	1.638.729
Balance at 1 January 2007	**248.952**	**314.880**	**292.309**	**290.595**	**1.662.729**	**2.809.465**
Net profit for the year	-	-	290.344	-	-	290.344
Transfer to non-distriibuted reserves	-	219.232	(219.232)	-	-	-
Transfer to statutory reserve	-	-	(73.077)	73.077	-	-
Forex revaluation	-	-	-	-	(424.881)	(424.881)
Balance at 31 December 2007	**248.952**	**534.112**	**290.344**	**363.672**	**1.237.848**	**2.674.928**

15.1 SHARE CAPITAL

The capital of the Bank is fully subscreibed by the Government of the Republic of Mozambique.

15.2 NON-DISTRIBUTABLE RESERVE

This reserve is due to the revaluation of the Bank assets, mainly the buildings.

15.3 STATUTORY RESERVE AND TRANSFER TO GOVERNMENT

In conformity with Article 65 of Law 1/92, the prior year profit for distribution should be presented by the Board of Director's and approved by the Government.

For 2006, the Board of Director's proposed the application of 75% to non-distributable reserve and 25% to the statutory reserve (2005: 75% to non-distributable reserve and 25% to the statutory reserve).

15.4 FOREX REVALUATION

Since 2006, in accordance with the internal Service Order 19/2006 of 28th August 2006, the net effect of the revaluation differences on foreign assets and liabilities are transferred from the Income Statement directly to the equity. Up to 31st December 2005, those revaluation differences were transferred to Government account according to the terms of article 14º of Law 1/92.

16. COMMITMENTS AND CONTINGENCIES

This balance is analysed as follows:

	2007	2006
Guarantees given	175.264	-
Letter of credit, issued and outstanding	344.772	136.664
	520.036	136.664

The Board of Director's does not believe that there will be any loss arising from these outstanding operations, which will result in a material impact on the financial statements.

17. INTEREST INCOME

Includes:

	2007	2006
Interest on loan advances	12.843	62.282
Interest on call accounts	53.316	45.645
Interest on term deposits	827.130	491.740
Interest on external fund managers	573.660	633.140
Interest on treasury bonds and bills	551.925	195.844
Other interest	103.868	72.574
	2.122.742	1.501.225

18. INTEREST EXPENSE

Includes:

	2007	2006
Interest on loans and advances	-	703
Interest on call accounts	12.159	9.746
Interest on Money market deposits	1.998.460	1.210.082
	2.010.619	1.220.531

19. PROFIT ON GOLD AND FOREIGN CURRENCY OPERATIONS

The balance of these accounts reported on the financial statements as at 31 December 2006 were incorrect due to a classificatiom error occurred in the process of recording of forex losses on foreign currency operations by the application of the weighted average rate method.

	Reported at 31.12.06	Correction	Reported at 31.12.07 (comparatives)
Profits on gold operations	(705.877)	924.408	218.531
Profit on foreign currency operations	1.536.920	(924.408)	612.512
	831.043	-	831.043

20. OTHER OPERATIONAl INCOME

This balance is analysed as follows:

	2007	2006
Commission on banking services		
Handling fees	23.000	31.183
Commission on transaction	1.728	1.853
Penalties to financial institutions for not complying with minimum statutory reserves	-	-
Reversal of general provion (Note 21)	270.754	-
Regularisations of accounting balances	53.377	88.301
Other services	26.692	18.663
Interest on gold deposits	-	11
	375.551	140.011

21. PERSONNEL AND OTHER OPERATING COSTS

The balance of this account is broken-down as follows:

	2007	2006
Personnel cost	863.284	700.118
Salaries	831.993	670.665
Social and other personnel expenses		
Other operating expenses	31.291	29.453
Cost of supplies	490.984	234.718
Service costs	47.108	36.163
Depreciation	231.293	193.124
Other expenses	125.860	146.521
Other (gains)/ losses	44.803	14.074
	41.920	(155.164)
	1.354.268	934.836

22. PROVISIONS

This balance is analysed as follows:

	Notes	General provision	Provion for doubtful assets	Provion for general credit risks	Provision for employee incentives	Pension fund	2007 Total
Balance 1 January 2006		2.254.605	-	1.153	-	2.147.570	4.403.328
Provision in 2006 financial year		(1.983.851)	-	-	-	1.948.183	(35.668
Balance 1 January 2007		270.754	-	1.153	-	4.095.753	4.367.660
Increase		-	9.543	-	-		
Adjustment of pension fund		-	-	-	-	490.453	490.453
Reversal		(270.754)	-	-	-	-	(270.754
Balance at 31 December 2007		-	9.543	1.153	-	4.586.206	4.596.902

The movement of the provisions, is as follows:The balance of pension fund amounting to 4.586.206 thousands of Meticais includes an amount of 866.163 thousands of Meticais which will be transferred to the separate fund during 2008.

23. PRIOR YEAR ADJUSTMENTS

This balance is analysed as follows:

	2007	2006
Regularisations of accounting balances	-	(34.690)
Others (various)	(76.902)	10.087
	(76.902)	(24.603)

24. RELATED PARTY INFORMATION

During the year, the Bank and its branches, in the ordinary course of business, entered into various transactions. These transactions were made on commercial terms and conditions at market rates.

25. SEGMENT REPORTING

Due to the integrated nature of the activities of the Bank and its branches, the presentation of segmental information is not considered appropriate.

26. COMPARATIVE FIGURES

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

27. NUMBER OF EMPLOYEES

The bank's personnel numbered 813 at 31 December 2007 (31 December 2006: 652).

28. PENSION FUND

The Bank has constituted a separate Pension Fund to cover pension fund obligations of the bank arising after 1 January 1993. This fund was instituted in accordance with a resolution of the Board of Directors.

The policy established by the bank is to assume full responsibility in relation to retirement benefits to employees including benefits to widows, minor orphans and disabled employees.

According to the last actuarial valuation carried out at 31 December 2006, the Bank pensions fund obligation was 4.095.753 thousands of Meticais.

Deposits at a commercial bank to the amounting of 3.720.053 thousands of Meticais (2006: 2.397.600 thousands of Meticais) are kept by the bank to cover future pension fund obligations. These deposits are under the control of the Bank and are not included as plan assets in the actuarial valuation of the pension fund obligation. Refer to note 8 of the Notes to the Financial Statements.

Reconciliation of fund provision:

	2007	2006
Balance at 1 January	4.095.753	2.147.570
Transfer from general provision	-	1.746.394
Regularisation (adjustment of deposits done)	490.453	201.789
Balance at 31 December	4.586.206	4.095.753

The retrenchment age considered was first opportunity, that is the verification of the first of the following conditions: 35 years of service to the bank (recognizing additional service where applicable), or at 55 years old for the woman and 60 years old for the men.

The principal actuarial assumptions used in the last actuarial study were:

Number of retrenchment package	13 monthly installments
Number of salary package	13 monthly installments
Mortality table	PM 60/64
Invalidly table	EKV80
Salary increment rate	3,5%
Pension actualization rate	2,5%
Discount rate	6,0%
Technical interest rate	6,0 %
Percentage of married	70%
Age differences	Women 3 years younger than respective partners

29. TAXATION

In accordance with Article 69 of Law nº 1/92 of January, 3 (Lei Orgânica do Banco), the Bank has exemption on all tax and duties as a State Government entity. However, the referred exception does not cover the obligation on withholding tax. For this purpose the Government Tax Department has the right to review the tax declaration of the bank during 10 (ten) years. Such a review can result in different interpretations for tax legislation and lead to adjustments. However, the Board of Directors of the bank believe that eventual adjustments on the tax returns regarding to the abovementioned obligations, as a result of those revisions, will not have a significant impact on the attached Financial Statements.

Administrative and Finance Department

Felicidade Bauze

Board of Directors

Haccone

1. EXECUTIVE SUMMARY

The growth of the world economy slowed down to 4.9 per cent in 2007, after standing above 5 per cent in the previous three years, which represents a reduction of 10 basis points, when compared to 2006. This behaviour has been determined, mainly, by the slowdown recorded in the major world economies, particularily the USA, Euro Zone and Japan. The performance of the world economy reflected essentially, (i) the impact of the crude oil price increase, (ii) the global financial crisis in the north american subprime sector and (iii) the rise of the cereal prices in the international market, which contributed to the main focus of inflationary pressure along the year, mainly in the emerging economies and in the developing countries, where food goods and oil products have considerable weight in the Consumer Price basket.

Meanwhile, the slowdown in the economic growth from the major world economies was followed by the rise of inflation in 2007 and the growth of unemployment rate. In order to offset the risks of an occasional economic recession, the central banks from the main economies took a set of anti-cyclical measures. Thus, in the last three meetings of the year, the Fed decided, successively and cummultively, to cut its reference interest rate by 100 basis points, standing at 4.25 per cent at the end of December 2007, while the Bank of Japan and the European Central Bank – the latter after two increases at the begining of the year to restrain the inflationary pressure – decided to keep their policy interest rates unchanged.

In the African continent the economic growth stood at 6.2 per cent in 2007, 30 basis points higher than that of the previous year, fueled by the strong contribution from the Sub-Saharian African countries that in 2007 recorded a growth rate of 6.8 per cent, determined essentially by the performance of the oil exporting countries, the increase of domestic and foreign investments and the improvement of productivity.

At the SADC level, the highlight goes to South Africa - the major economy in the region – that grew by 5 per cent in 2007, 10 basis points lower than the one from 2006 and whose prospect for 2008 indicates a slowdown of the economic activity as a consequence of the world financial crisis along with the energy crisis that has affected the industrial production and the economy as a whole, since the end of 2007. On its turn, the South Africa annual inflation, measured by the CPI, accelerated by 3.9 percentage points, comparatively to 2006 and stood at 8.6 per cent in December 2007, by 2.6 percentage points beyond the upper limit of the band established by the authorities as the inflation target.

At the internal level, preliminary data from the Ministry of Planning and Development indicate that global production has grown by 7.8 per cent in 2007, 1.4 percentage points lower than the value observed in 2006. The agricultural sector, which employs the majority of active population grew by 8.6 per cent, boosted by the livestock sub-sector which expanded by 33.5 per cent. Preliminary data published by the National Institute of Statistics (INE – acronym in Portuguese) indicate that the real GDP grew nearly 7.3 per cent in 2007, against 8.5 per-cent in 2006.

The annual inflation, measured by the Maputo City CPI, stood at 10.26 per-cent in December 2007, 80 basis points higher than the one from the same period of 2006, with the food component contributing by 7.59 percentage points to the total variation. The annual inflation acceleration in 2007 reflected among other factors: (i) the deterioration of cereal prices in the international market; (ii) the increase of fuel prices; (iii) the worsening of prices in South

Africa – the main source of imports of food goods. Meanwhile, the annual average inflation maintained the decelerating trend along the year, slowed down to 8.16 per cent, following 13.25 per cent in 2006. Excluding the prices of food products and energy, the inflation rate stood at 5.1 per cent.

The Metical remained stable throughout the year under analysis, witnessing however, meaningfull gains in the last two months over the US dollar, which led to an nominal annual appreciation of 8.2 per-cent, following a deppreciation of 8.9 per cent recorded in 2006. The Metical behaviour reflected: (i) The depreciation of the US dollar in the international market; (ii) the substantial inflow of external funds in the country; and (iii) the reforms performed in the Interbank Foreign Exchange Market (MCI[1]-Portuguese abbreviation), which led to the removal of the exchange rates variation bands in 2007, allowing to an increase of confidence amongst the operators and the consequent increment in their transactions .

With regards to the monetary aggregates, the broad money (M3), expanded at an annual rate of 25.3 per cent and the money supply component denominated only in domestic currency increased by 22.9 per cent. The Reserve Money – the monetary policy operational variable – increased by 20.9 per cent along the year, standing above the initial forecasts, due to the unusual behaviour of Notes and Coins in Circulation, observed in the last two weeks of the year, reflecting a precautional attitude from the banking system along the two long weekends, characterised by high level of withdrawals of notes and coins to satisfy the demand was observed in that period. The expansion of monetary aggregates reflected the State financial operations in the framework of the budget execution, the inflow of external funds to public enterprises and private sector and the internal banking financing.

The monetary policy was performed prudently, focusing mainly on the Banco de Moçambique (BM) interventions in the money and foreign exchange interbank markets, aiming at regulating the liquidity in the system. In 2007 the BM decided to make a downward review of the mandatory reserve coefficient and regime. The year under analysis has been remarked also by the reformulation of the Monetary Policy Committee in order to adjusting to the international practices , with the begining of the publication of a Press Release at the end of each session. Alongside this measure, at the end of 2006 a medium and long term Monetary Policy Strategy of the Banco de Moçambique has been published, a document that resumes the main aspects that guide the acting of this institution in the framework of monetary policy management.

Preliminary data on budget execution indicate that the revenues share on the GDP stood at 16.5 per cent, in the presence of a growth of the total expenditure beyond the programmed – including the net loans, which contributed for the overall deficit before grants to stand at 31.7 percentage points below the programmed value.

At the external sector level, the stock of the current account, including the mega-projects, deteriorated by 2.8 per cent, increasing the annual deficit to USD 759 million, due to a higher increase of imports over exports. Nevertheless, the country, through the Banco de Moçambique, accumulated in 2007 international reserves in a total amount of USD 277 million, prompting to a rise of the Net International Reserves (NIR´s) to USD 1,508 million, amount to cover 4.9 months of imports of goods and non factor services.

[1] Introduction of the new Interbank Foreign Exchange Market regulation in mid-December 2006.

2. INTERNATIONAL ECONOMIC OVERVIEW

The year 2007 has been broadly characterised by a slowdown in economic growth, inflation acceleration and a depreciation of the US dollar against the main currencies. Contributed for this behaviour, the crisis of the subprime sector, originated in the USA and the swift growth of crude oil and cereal prices in the international market. Thus, that world production grew at an annual rate of 4.9 per cent in 2007, which corresponds to a slowdown of 10 basis points in comparison to the expansion recorded in 2006, as a result of the deceleration observed in the USA and the Euro Zone.

The table 1 below resumes the GDP and inflation behaviour from the main world region.

Table 1 – Evolution of Real GDP and Inflation

Region	Real GDP (%)				CPI (%)[b]			
	2006	2007	2008[a]	2009[a]	2006	2007	2008[a]	2009[a]
World Economy	5.0	4.9	3.7	3.8	n.d	n.d	n.d	n.d
Advanced Economies	3.0	2.7	1.3	1.3	2.4	2.2	2.6	2.0
Emerging and Developing Econ.	7.8	7.9	6.7	6.6	n.d	n.d	n.d	n.d
Asia	8.9	9.1	7.5	7.8	3.7	4.8	5.5	3.9
Europe	6.7	5.8	4.4	4.3	5.4	5.7	6.4	4.3
Latin America	5.3	5.6	4.3	3.6	5.2	5.3	6.5	6.1
Africa	5.9	6.2	6.3	6.4	6.4	6.3	7.5	5.9
Sub-Saharian Africa	6.4	6.8	6.6	6.7	7.3	7.2	8.5	8.6

Source: World Economic Outlook; a – Projections b – expressed in terms of annual average

Regarding to inflation, the advanced economies as well as the emerging economies observed strong pressures, since the mid-2007 until the end of the year, reflecting mainly a rise on food, oil and its derivates prices, factors which led to the acceleration, in general.

At the exchange market level, the year 2007 has been broadly marked by a persistent depreciation of the US dollar over the main international currencies, which contributed to the acceleration, in the year, of the major international commodities prices, particularly, gold and crude oil.

The global economic growth forecasts for 2008 has been generally reviewed downwardly due to a rapid fall of confidence from the economic agents, the prevailing crisis in the financial market and the increase of oil price in the international market.

2.1. Macroeconomic Performance

A. Developed Economies

United States of America. According to data from the Bureau of Economic Analysis (BEA), the real GDP expanded by 2.2 per cent in 2007, after standing at 2.9 per cent in 2006, a slowdown that reflects, essentially, a fall of investment in residential fixed assets and the private portofolio investiment and a deceleration in the area of equipment and softwares. However, the growth of the GDP in 2007 was sustained by an increase of private consumption , exports and government expenditure.

The seasonally adjusted annual inflation, measured by the Consumer Price Index for all Urban Consummers (CPI-U), published by the Bureau of Labor Statistics (BLS), accelerated to 4.1 per cent in 2007, after standing at 2.5 per cent in 2006 and 3.5 per cent in 2005. The increase of the prices of energy (29.4 per cent), transports (8.3 per cent), medical care (5.2 per cent), food and beverages (4.8 per cent) and housing (3.0 per cent), contributed to the worsening of the general prices level.

Preliminary information published by BEA, indicate that the current account deficit improved by 9 per cent to USD 738.6 billion, determined by the surplus of the partial accounts of services and income amounting to USD 74.3 and USD 106.9 billion, respectively, and the contraction of the partial account of goods by 2.7 per cent to USD 815.4 billion.

In face of a slowdown in GDP growth, the unemployment rate accelerated by 60 basis points, comparatively to December 2006 to 5 per cent, mainly justified, by a fall of the employment volume in the manufacturing and construction sectors.

Taking into consideration the economy behaviour and the slowdown risks of the economic activity, the Fed decided to, successively and cummultively, lower its reference interest rate by 100 basis points, in the last three meetings of the year, moving from 5.25 per cent in December 2006 to 4.25 per cent in December 2007.

For the same reasons, the Fed made a downward review of the economic growth forecasts for 2008 to a range between 1.3 -2 per cent, against the previous forecast of 1.8 - 2.5 per cent, proposed in October 2007. The forecast of the unemployment rate for the same year has been adjusted upwardly, falling in a range of 5.2 - 5.3 per cent, against an initial forecast of 4.8-4.9 per cent. The inflation projections were adjusted upwardly for an interval between 2.1 - 2.4 percent against the last projection of 1.8 - 2.1 per cent.

Japan. According to the Economic and Social Research Institute, preliminary estimates indicate that the Japanese economy recorded a real growth of 2.1 per cent in 2007, 30 basis points higher than that of 2006, essentially determined by the domestic demand which grew by 1.9 per cent, in the year, influenced by the increase of the private and public sectors demand by 1.8 and 2.4 per cent, respectively.

Data from the Japan Statistics Bureau pointed out that the year-on-year inflation, measured through the Toquio Consumer Price Index from the Ku-area, stood at 0.4 per cent in December 2007, which corresponds to a decline of 10 basis points in comparison to that of the same period of 2006. On its turn, the unemployment rate reduced by 20 basis points, to 3.8 per cent in December 2007.

Considering the above mentioned facts and taking into account the instability of international financial markets, after reviewing upwardly by 25 basis points to 0.5 per cent in February 2007, the Bank of Japan decided to keep its policy interest rate unchanged.

For 2008, the latest forecasts published by the Consensus Forecast[2] points out to a real GDP growth between 1.2 and 1.7 per cent and an inflation between 0.3 and 0.6 per cent.

Euro Zone[3]. The first estimates from the Eurostat[4] indicate that the real GDP recorded an annual growth of 2.6 per cent in 2007, after being at 2.8 per cent in 2006. On its turn, the seasonally adjusted unemployment rate, from the European Union countries, reduced to

[2]International organization that conducts projections of the main macroeconimics indicators for more than seventy countries, including industrialized, Latin America, East Europe and Pacific (Asia) countries.
[3]Since January 1st, two more countries joined Euro Zone, namely: Chipre, Malta, totalising fifteen (15) countries.
[4]Statistical Office of the European Communities.

7.2 per cent in December 2007, after standing at 7.6 per cent in December 2006, with the following countries recording the lowest rates: Netherlands with 2.9 per cent, Austria with 4.3 per cent and Ireland with 4.5 per cent while Spain with 8.6%, Portugal and Greece with 8.2 per cent have the highest rates.

The deceleration of the economic growth and the reduction of the unemployment rate, occurred in a context of high inflation, which moved from 1.9 per cent in December 2006 to 3.1 per cent in December 2007, 1.1 percentage points above the target established by the monetary authority. The components of education (9.4 per cent), transport (5.6 per cent) and food (4.8 per cent) were the major contributors for the acceleration of inflation in the year.

To avoid the high inflationary pressure which was affecting the economy, the ECB Council of Governors decided in two occasions, to increase by 50 basis points, its policy interest rates, namely: (i) the main refinancing operations minimum rate; (ii) Standing Lending Facility and, (iii) the Standing Deposit Facility, passing from 3.5, 4.5 and 2.5 per cent, to 4.0, 5.0 and 3.0 per cent, respectively.

The projections of the inflation rate in the Euro Zone for the year 2008, published by the European Central Bank (ECB) point to a moderate inflation in a range of 2 - 3 per cent, justified by an eventual slowdown of future prices of oil and food products. With regards to economic growth, the ECB prospects are not much optimistics, pointing to an annual growth between 1.5 - 2.5 per cent, reflecting the impact of the slowdown of the american economy over the economic activity in Europe and in the global economy.

United Kingdom. In 2007, the British economy recorded a growth of 3.0 per cent, after 2.9 per cent, in 2006, boosted by an expansion of domestic demand associated with an increase of employment and investment.

On its turn, the annual inflation decelerated by 90 basis points to 2.1 per cent in December 2007, 10 basis points lower than the target established by the monetary authority, mainly as a result of a reduction of non-food prices by 3.2 per cent, which offset the upward trend of crude oil prices.

Taking into account the evolution of the main macroeconomic indicators, the Bank of England decided to review upwardly its policy interest rate from 5.0 per cent at the end of December 2006 to 5.5 per cent in December 2007, which is equivalent to an upward review of 50 basis points.

The economic growth projections for 2008, point to a slowdown of 50 basis points to 1.8 percent, reflecting the impact of the crisis from the financial markets and the upward trend of oil prices in the international market.

Box 1: The Subprime Sector Crisis in the United States of America (Subprime Mortgages) and the Impact on the International Markets

I. The "Subprime Mortgages"

In recent periods, the term "subprime"' has spread throughout the world, signaling direct or indirectly a scenario of expanded financial crisis. The subprime mortgages existing in the United States of America is a highly risk credit segment to housing addressed to lower income clients, with instable economic conditions. In this context, the only guarantee (colateral) required during credit assessment for loans granted to these group of clients is the real estate. This credit market segment is exclusive to the United States, not existing in any other countries an exact paralelism.

The main condition for the borrower to have access to credit, he or she should own a house. However, given the high risk assumed by the credit institutions, the interest rates are high when compared to those adopted by the ordinary market.

II. The USA Subprime Mortgage Crisis

Although the subprime mortages have been in place for more than two decades, it did not expand significantly until the second half of the 1990´s. The growth of this market segment in the last decade resulted from innovations in financial markets, including the development of more sophisticated and simplified mechanisms of credit risk assessment, which allowed borrowers to access credit.

Background and origins

The current global crisis whose starting point is the US real estate market, has really began in early 2000, when the fall of interest rate[1] and the expansion of the american economy stimulated the expansion of the real estate market, housing construction and rehabilitation. The expansion has been basically influenced by the credit allowance based on the so called subprime mortgages for the payment of the debt from the real state purchased and/or rehabilitated. With the credit expansion, the prices of real estate grew, allowing the renewal of mortgages through the contraction of new credits, always greater than the initially granted, thus giving chance to the debtors to pay up the former credit and still have on their possession a stock for purchasing other goods and services[2] . This feature enabled the enlargement and acceleration of household consumptions, which in turn, boosted the american economy, creating a cycle of consumption-production-employment.

However, the rapid growth of subprime mortgages, coupled with an increasing strong dynamic speculative credit, moved the mortgages to the CDO (Collaterilized Debt Obligations – which observed a growing demand mainly for foreign capitals by fixed rent assets) which were comprised of investment funds (USA, Japan and Europe) that started trading profitably in the major world financial markets.

The belief that the CDOs and the real estate could become worth in future looked more like a speculative result, as there was a growth of credit for acquisition of real estates. The breakout point of this phenomenn in the real estate market, began in 2004 when the FED adopted a restrictive policy which lasted until June 2006. The bond yields interest rates grew from 1 per cent to 5.25 per cent on a year-on-year basis, prompting an increase of the debtors non-compliance level, which moved to 12.6 per cent in the fourth quarter of 2006, against 11.7 per cent recorded in the similar period of the previous year. In the same context, there was a fall of real estate prices, which was first observed in the lowest segment, (the subprime mortgages) and by extension, in the real estate market as a whole, with an overall liquidity reduction and credit contraction.

According to the Fed Monetary Policy Report submitted to the Congress on February 27, 2008, the non-compliance rate of the Subprime Adjustable-rate Mortgages (ARMs), that been showing a rising trend since 2006, reached one-fifth of the loans in December 2007.

III. Impact of the Crisis for the World Economy

The global financial losses resulting from the crisis in the US subprime mortgage market exceeded the most pessimistic forecasts, partly reflecting the increased investors uncertainty as to risk assessment of a variety of financial products involved and the growing risk aversion. The positive assessment on bond returns developments produced by the american agencies of risk assessment which then resulted in greater investment losses, led once again to a confidence crisis and uncertainties in the financial markets.

The negative performance of the US real estate market as well as the bankruptcy of many companies operating in the mortgage segment have been having significant and tangible impacts in the international financial markets. The extension, depth and speed of the crisis is complex because it has been affecting the behaviour of the main world stock exchange markets, which by the end of 2007 recorded significant falls, expecting it to last until 2009, thus affecting the world GDP growth. The sharp fall of the markets performance results from a massive liquidation of shares by investors, fearing that new crisis symptoms may affect even more the international financial system.

In response to the real estate sector crisis, the Fed adjusted the procedures regarding the access to rediscount facility and simultaneously, it undertooksuccessive and cummulative cuts of the reference interest rate by 100 basis points, in the last three meetings of the year under analysis, setting it at 4.25 per cent. Nevertheless, as the financial market is still in turbulance, the FED has been forced to allocate liquidity amounting to USD 41 billion, at the beginning of November, the highest amount ever injected in the market since the terrorist attacks on September 11, 2001, in order to restrain liquidity crisis affecting several banks.

The negative synergies of the crisis have been spreading to other countries as proved by the reduction of american imports, affecting directly the Japanese and Chinese economies and, indirectly to the remainder economies that were being leveraged by the latter country economic growth and increased imports.

What was seen as an increase in the demand for liquidity by some enterprises/companies and other market segments resulted in imbalances between the supply and demand, especially in Europe, where a large number of institutions have been too exposured to the american subprime mortgage crisis. Likewise the Fed, some central banks responded to the crisis increasing liquidity in the financial system in order to reverse the cash shortage growing tendency. With this measure, the central banks aimed at stabilizing the money market so that the upward pressure on the interest rates could gradually stabilize in the short term.

The table below summarises the measures adopted by some central banks towards the subprime market crisis.

Table 1: Measures adopted by some of the Major Central Banks.

	Major World Central Banks						
	RBA	BoC	ECB	BoJ	SNB	BoE	Fed
Exceptional fine- tuning measures	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Exceptional long-term open market operations	No	No	Yes	No	Yes	Yes	Yes
Change in the standing lending facility	No	No	No	No	No	No	Yes
Expansion of eligible collateral	Yes	Yes	No	No	Yes (1)	Yes	Yes
Change in bank reserves requirements	No	No	No	No	No	Yes	No
Other changes in money supply	No	No	Yes	No	No	No	No

(1) In force since 1st October and not related to the financial subprime crisis.

Sources:

- **Hordahl , Peter & Fender,** Ingo. 2007. BIS (Quarterly Review)
- **IMF. 2006. December.** Financial Update – Monetary and Capital Markets Department, Global Markets Monitoring and Analysis Division
- **Federal Reserve. 2008.** Monetary Policy Report. 27 February;
- **Ben S Bernanke. 2007.** BIS (Quarterly Review). Subprime Mortgage Lending and mitigating foreclosures Washington DC, 20 September
- **Luís Filqgueiras.** Setembro 2007 UFBA
- **Millennium BCP. 2007.** Newsletter de Investimentos Nº 60.
- **Millennium BCP. 2007.** Newsletter de Investimentos Nº 64.
- http://www.federalreserve.gov/boarddocs/hh/2008/february/
- http://news.goldseek.com/
- http://www.bloomberg.com/news/economy/

[1] The interest rate reached 1 per cent on year-on-year basis for the American Government bonds.
[2] Luís Filgueiras September 2007. UFBA.

Hand operated certifying machine Addo-X - 1896/1969

B. Emerging Economies

China. According to preliminary information from the National Bureau of Statistics of China, the pace of economic growth remained accelerated and strong in 2007, with the real GDP expanding at an year-on-year rate of 11.4 per cent, which is equivalent to 30 basis points above the level observed in the previous year, allowing this way to the fifth consecutive year of economic growth rates above 10 per cent, number that may increase to six, if , the forecasts advanced by the *World Economic Outlook* be confirmed, which indicates that the Chinese economy may grow at an annual rate of 10 per cent in 2008.

In 2007, the inflation, measured by the CPI accelerated to 4.8 per cent, 3.3 percentage points higher than that of 2006, due, basically, to an increase of food (12.3 per cent) and housing prices (4.5 per cent).

Data from the labour market indicate that the economy recorded a fall of the urban unemployment rate by 10 basis points standing at 4 per cent at the end of 2007.

India. The indian economy decelerated by 90 basis points to 9.0 per cent, in 2007, reflecting a relative slowdown of exports. However, the economic growth recorded in the year has been mainly determined by the annual increment of industrial production by 2.5 percentage points to 7.1 per cent, in 2007. The annual inflation mesured by the CPI, decelerated by 83 basis points, standing at 5.5 per cent by the end of 2007.

C. The African Continent

The African economy grew at 6.2 per cent in 2007, 30 basis points higher than that of the previous year, fueled, mainly, by the strong contribution from the Sub-Saharian African countries that in 2007 recorded a growth rate of 6.8 per cent, 40 basis points higher than that from 2006, determined essentially by the performance of the oil exporting countries, the increase of domestic and foreign investments, as well as the improvement of productivity in some countries.

The economic growth recorded in the continent, has been broadly followed by a deceleration of the annual average inflation by 10 basis points to 6.3 per cent, in 2007, due to a fall of prices in the sub-saharian region by 7.3 per cent in 2006 to 7.2 per cent in the year under analysis. The fall of the inflation indicator resulted from the macroeconomic stability observed in the majority of the countries, along with the increase of the food supply, the implementation of tight monetary policies and the reduction of fiscal deficit financing through bank credit.

The SADC Region Economies

South Africa. Data published by the Statistics South Africa, the official statistic office of South Africa, indicate that the real GDP grew by 5.0 per cent in 2007, after 5.4 per cent, in 2006 and 5.1 per cent in 2005. The main sectors that contributed for the 2007 economic performance were the financial, real estate and services that, with a total share of 19.6 per cent over the GDP, contributed as a whole with 1.6 percentage points for the total variation. On its turn, the manufacturing and construction sectors, with a relative share of 16.3 and 3.1 per cent, respectively, contributed with 0.6 of a percentage point for the GDP expansion.

Data published by the same source indicate that annual inflation, measured by the CPIX (index which excludes the mortgage interest rate), accelerated to 8.6 per cent, in December 2007, standing, this way, 2.6 percentage points beyond the upper limit of the range established by the monetary authority as the inflation target. The inflation behaviour in the year under analysis was, essentially, determined by the increase of food and fuel prices. Furthermore, the inflation rate stood at 4.7 per cent in 2006 and 3.4 per cent in 2005.

After remaining unchanged at 9.0 per cent during the first five months of the year, the SARB reviewed upwardly, for four times, its policy interest rate, totalising 200 basis points in the year to 11 per cent in December 2007. These adjustments intended to contain the inflationary pressures that the economy had been facing which resulted in consecutive months of inflation levels above the target established by the monetary authority.

According to recent information from the latest labour force survey[5] published by the Statistics South Africa, the unemployment rate in the country remained relatively stable and stood at 25.5 per cent in 2007, after 25.6 per cent in 2006.

Tanzania. According to the IMF[6] estimates the real GDP increased at an annual rate of 6.8 per cent in 2007, 1.1 percentage points higher than that of 2006, explained by an increase of the country's exports.

According to the National Bureau of Statistics from Tanzania, the annual inflation fell to 6.4 per cent, in December 2007, 30 basis points lower than that of 2006.

Malawi. IMF estimates indicate that the Malawian economy grew at an annual rate of 4.8 per cent, a level that represents a slowdown of 1.6 percentage points in comparison to the growth rate recorded in 2006. For 2008, the estimates point out to a real growth of 5.1 per cent.

According to the National Statistics Office, the annual average inflation rate stood at 8 per cent in 2007 after being at 13.9 per cent, in 2006. On its turn, the annual inflation decelerated by 2.6 percentage points over the rate recorded in 2006, standing at 7.5 per cent, in December 2007, reflecting a reduction of 1.1 percentage points in the price index from non-food component to 8.5 per cent, in December 2007.

In 2007, considering the slowdown trend of the economy and the behaviour of macroeconomic indicators, the Reserve Bank of Malawi decided for two times, to lower its policy interest rate from 20 per cent in December 2006, to 17.5 per cent in July 2007 and 15 per cent, in October, the rate that was in force until the end of the year.

Zambia. Preliminary information indicate that for the ninth consecutive year, the Zambian economy recorded a positive real growth, standing at 6 per cent in 2007, 20 basis points higher than the one observed in 2006. Contributed to this growth the expansion of the following sectors: construction by 13.3 per cent, manufacturing by 3.4 per cent and tourism by 6.4 per cent.

On its turn, the annual inflation rate stood at 8.9 per cent, in December 2007, 10 basis points lower than the target set and 70 basis points higher than that of the previous year. The acceleration of inflation was due to the rise of food products (2.9 percentage points) and non-food products (6 percentage points) prices.

[5] The results of the survey report to month of March 2007, however, the publication was effective from September 2007.
[6] African Economic Outlook 2007

At the external sector, preliminary information show that in 2007 the country recorded a favourable performance, which resulted in the accumulation of Gross International Reserves, in a global amount of USD 1.1 billion, which corresponds to an increment of about 42 per cent relatively to the same period of 2006.

Botswana. The annual inflation rose by 40 basis points to 8.1 per cent, in December 2007, standing above the upper limit of the inflation target range of 4-7 percent established by the monetary authority. The behaviour of this indicator has been determined, essentially, by the rise of the food (15.6 percent) and transport (10.1 percent) price indexes.

After remaining unchanged at 15 percent from Februray 2006, the Monetary Policy Committee of the Bank of Botswana decided to review downwardly its policy interest rate to 14.5 percent, in June of 2007, remaining at this level until the end of the year under analysis, reflecting, generally, the behaviour of the main macroeconomic indicators and of the inflation, in particular.

Mauritius. Data from the Central Statistics Office, indicate that, after standing at 8.9 per cent, in 2006, the annual inflation decelerated to 8.8 per cent, in December 2007, favoured by a reduction of food and alcoholic beverages prices.

Taking into account the developments of the economy, in general, and the financial sector in particular, the Monetary Policy Committee of the Bank of Mauritius decided to review upwardly its directory interest rate by 75 basis points, in June 2007, after remaining unchanged at 8.5 per cent since December 2006, standing at 9.25 per cent, until the end of the year.

Front View of Tete Branch

Box 2: The Process of Regional Integration in the SADC

1. Historic Background

The SADC (Southern Africa Development Community) was created in a Heads of State and Government Conference, held in Windhoek in August 1992, in replacement of the SADCC (Southern África Development Coordination – SADCC) – which emerged from the Front Line States, with an eminently political purpose - to provide more dynamism to the regional economic integration project. South Africa, the main regional economic power, adhered to the SADC in 1994, at the end of the apartheid regime.

The main objectives of the SADC are: (i) To promote a sustainable and equitable economic growth and development that ensures the poverty alleviation in the region; (ii) To promote a self-sustaining development on the basis of collective self-reliance on the interdependence among the Member States; (ii) To promote common values and political systems; (iii) to consolidate, defend and maintain democracy, peace, security and stability; (iv) To promote and maximise productive employment and utilization of the resources of the region; and (v) Combat HIV and AIDS and other deseases.

2. The Economic Situation of the SADC Countries

The SADC is composed by 14 countries with a total population of 240 million inhabitants and a Gross Domestic Product of USD 350 billion. South Africa Produces about 68 per cent of this GDP, with the remaining countries producing, each one of them, below 10 per cent of the total GDP of the region, with Angola (the second major SADC economy) accounting for 7 per cent, while Lesotho (the region smallest economy) has a GDP below 0.5 percent. Mozambique is the fifth economy of the SADC region, representing 3 per cent of the total GDP.

In terms of per capita[7] income, Botswana (USD 5,790), South Africa (USD 5,321), and Mauritius (USD 5,220) lead the list of countries from the region, where the Democratic Republic of Congo, with a per capita income of USD 709 is the poorest country. Mozambique ranks tenth position with USD 1,459.

There is a big discrepancy among the member countries, in terms of the GDP distribution by sectors of activities. In South Africa, Mauritius and Swaziland, more than 60 percent of the GDP comes from the manufacturing Industry, while in countries like Angola, Botswana the mining sector contributes for more than 80 per cent of the GDP. In the DRC, Madagascar and Tanzania, the agriculture contributes with more than 60 per cent. In Mozambique the agriculture contributes with about 25 per cent of the GDP structure.

Excluding Zimbabwe, that has inflation rates above 1000 per cent, the average inflation on SADC countries in 2007 stood at 8.4 percent.

3. Main Guidelines of the Integration

A considerable number of agreements and protocols have been approved in the course of the years, aiming at creating the basis for the regional integration of the countries, whith particular emphasis to the following:

Trade Protocol - Signed in 1996 and came into force in 2000.Tthis document establish a gradual reduction of the tariffs and the removal of non- tariffs barriers until 2008, period in which 85 per cent of the goods will have a zero tariff, allowing the establishment of the free trade zone in the region. Of the 14 SADC member countries, only Angola and DRC have not ractified the trade protocol.

Since January 2008, about 85 per cent of the products in the custom list in force in Mozambique are already liberalised, with some products with an impact in the domestic production been excluded in this phase and should be gradually liberalised until 2012. Products that have been liberalised are still subject to the payment of the VAT on imports and other taxes on the external trade. Besides, the trade protocol does not cover second hand goods which will remain with rates currently in use for the purpose of check-in in border posts, importers will have to exhibit a certificate of origin of such a product.

R***egional Indicative Strategic Development Plan (RISDP)*** – Approved in 2004, in the Summit of Head of States and of Governments of the SADC which took place in Arusha, it is seen as the gathering tool of the actions and goals from all sectors of activities, with the following specific objectives: (i) to provide a strategic direction for the efficient implementation of programs and actions for the next 15 years; and (ii) to align the objectives and a long term comprehensive development goals with the respective policies and define the main areas of interventions.

[7] Based on the approach of Power of Coin Acquisition (PPP)

The following tables show the key macroeconomic convergence indicators for the homogeneity of the regional economies contained in the RISDP:

Table 1: The Main Macroeconomic Convergence Indicators:

Indicators in %	2008	2012	2018	Moz/ 2006
Inflation	Single digit	5	3	8
Deficit/GDP	<5	3	3 - 1	10
Debt/GDP	60	60	60	53
Current Account/GDP	9	9	3	8

RISDP contains other complementary indicators:

Table 2: Other complementary Indicators

Indicatorsin %	2008	2012	2018	Moç/2006
GDP (*)	7	7	7	8
NIR`s (**)	3	6	6	5
Central Bank Credit to theGovernment(***)	10	5	5	0
Domestic Savings (%GDP)	25	30	30	11
Domestic Investment (% GDP)	30	30	30	22

(*) Growth Rate: (**) Coverage Months; (***) in percentage of Fiscal Revenues

The convergence indicators listed above aim at achieving the following main stages of integration of the region´s economies:

Steps	Year
Definition of Free Trade Areas	2008
Customs Union	2010
Common Market	2015
Monetary and Economic Union	2016
Single Currency	2018

Finance and Investment Protocol (FIP) – Signed by the Head of States in August 2006, it aims to improve the economic environment in the region and to promote public and private investment. The FIP contains the main basis for the harmonization of the general policy objectives in the region.

4. Financial System and Regional Integration

The regional integration also implies the existence of integrated and competitive financial markets, based on international norms and practices in order to ensure the maximization of its contribution for promoting savings, investments and, thus, the economic growth. It is under this framework that, it was created, in 1995 the CCBG (Committee of Central Bank Governors) with the objective of: (i) Coordinate the integration process of the financial and capital markets of the SADC countries; and (ii) harmonise monetary and exchange policies aiming at creation of a SADC Central Bank and a common currency.

The CCGB meet twice a year and is composed by several sub-committees, which are listed below and their respective chairships: (i) Sub Committee of Foreign Exchange Control (Bank of Namibia), (ii) Sub Committee of Banking Supervision (Bank of Mauritius), (iii) Sub Committee of Payment Systems (South Africa Reserve Bank), (iv) Sub Committee of Information and Technology (Banco de Moçambique), (v) Sub Committee of Human Resources Development (Bank of Zimbabwe), (vi) Sub Committee of Stock Exchange (Bank of Botswana), (vii) Sub Committee of Legal Affairs (Bank of Zambia), and (viii) Sub Committee of Macroeconomics (Bank of Tanzania).

Among several accomplishments, highlight goes to the elaboration and approval of a set of memoranda of understanding, some in the framework of the cooperation among Cantral Banks, namely: (i) Payment System, Clearance and Settlement , (ii) Cooperation on Iinformation and Communication Technologies, (iii) Harmonisation of the Legal and Operational Framework and of Central Banks, (iv) Cooperation and Coordination in the Domain of Foreign Exchange Control, and (v) Cooperation among bank supervisors and other (MoU's) oriented to the cooperation under the regional Capital and Financial Markets framework, namely: (i) Regulation and Supervision of non-banking Financial Services, (ii) Development of Financial and Capital Markets, and (iii) Cooperation among several Stock Exchanges.

Currently, it is a priority at the CCGB level, the elaboration and conclusion of the Organic Law of the future SADC Central Bank, an instrument that is expected to facilitate the process of setting up the monetary and economic union through the harmonisation of the organic laws of central banks, the main purpose of monetary and foreign exchange policies, as well as the strengthening and uniformisation of payment systems, upgrading of the role of bank supervision, amongst other factors.

2.2. Commodity Prices

The prices of the main goods with considerable weight in the balance of payments of Mozambique and in the behaviour of domestic inflation, had in general an unstable behaviour with an upward trend during 2007, as shown in the table 2 below.

Meanwhile, the oil prices observed an upward trend throughout the year increasing by 46.8 per cent until December 2007, reaching its highest value of the year. Similar behaviour was recorded in the prices of Gold, Rice and Wheat, which closed up the year, comparatively to the closure of December 2006. With regard to the natural gas and sugar, the prices tended to decrease until September 2007, period since when was marked by an ascending evolution until the end of December 2007, not reaching, however, the levels from the same period of 2006. On its turn, alluminium was the only commodity whose behaviour was atypical, opposing to the behaviour that has been exhibiting from the previous years, given that the prices fell throughout the year, accumulating losses of 15.6 per cent by the end of December 2007 over the corresponding period of 2006.

Table 2: International Prices of Selected Commodities[8]

Product	Un	Dec/04	Dec/05	Dec/06	Mar/07	Jun/07	Sept/07	Dec/07	annual var.(%)
Brent	USD/b	39.65	56.75	62.31	62.14	71.32	77.13	91.45	46.77
Aluminium	USD/mt	1852.9	2250.9	2823.7	2757.1	2681.3	2395.0	2382.8	-15.61
Gold	USD/ounc	442.13	509.13	627.9	649.6	667.0	680.11	789.28	25.70
Nat. Gas	USD/mt	156.24	250.56	311.40	302.04	281.88	280.44	308.16	-1.04
Sugar	USc/pound	8.8	13.93	11.7	10.37	9.26	9.85	10.45	-10.68
Wheat	USD/mt	153.9	164.44	204.31	199.1	223.04	326.54	368.62	80.42
Rice	USD/mt	278.43	277.27	309.29	326.18	326.29	330.0	378.0	22.22

***Source**: Reuters & IMF*

Brent. After closing at USD 62.31/barrel in December 2006, the Brent price recorded successive deterioration during the fourth quarters of 2007, closing the year, at an average price of USD 91.45/barrel, corresponding to an accumulated increase of 46.8 per cent in comparison with the corresponding period of 2006.

Amongst several factors that contributed for the persistent increase of oil barrel price in 2007, the following are highlighted: (i) strong increase of crude demand due to the accelerated economic growth of China and India and the maintenance of consumption of western economies; (ii) persistent depreciation of the US dollar against the major currencies in the international market; and (iii) geopolitical conflicts in the middle east.

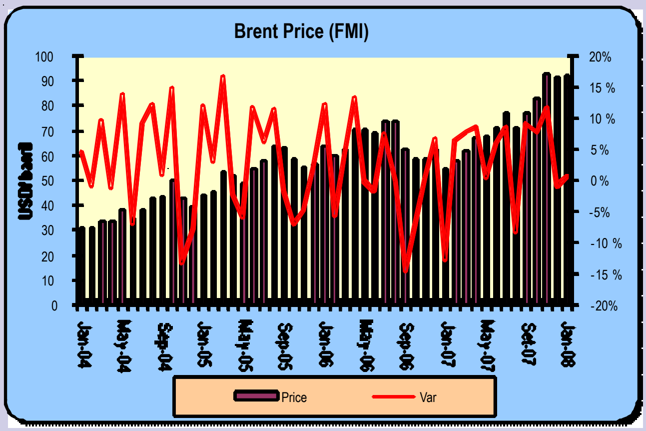


Chart 1

[8] The weights used in the calculation of the commodities price indexes were updated based on the World Trade Data 2002-2004 (previously 1995-1997) and the reference year has been revised to 2005 (previously 1995).

Additionally to the above listed reasons, it is highlighted, the temporary closure of some refinaries by the ends of October 2007 and early November in the United Arab Emirates, as a result of the bad weather that affected the North Sea region and to financial issues resulted from the US subprime sector crisis.

For the year 2008, the forecasts from the International Energy Agency point out to a downward revision of oil global consumption by 200 million barrels/day to 87.6 million barrels/day – reflecting a scenario of a slowdown of economic growth from the major world economies, in 2008, as well as the price impact over demand.

Gold. The price of Gold, along the period, reacted in line with the oil market behaviour, appreciating by 25.7 per cent in cumulative terms in December 2007, as it traded, according to the Reuters, at USD 789.28/Ounce at the end of December 2007. Still according to *Reuters,* the price acceleration in 2007 resulted from: (i) the US dollar depreciation in the international market; (ii) the increase of the crude price; (iii) the instability of financial markets; and (iv) the fall of interest rates in the USA. Before these facts, the expectations for 2008, point out to a continuous increase of gold price in the international market, situating in the range of USD 815/Ounce to USD 900 /Ounce.

Sugar. The reduction of the price of sugar in the first three quarters of 2007 in the international market has been sustained, among other factors: (i) by the increase of international supply, resulting from the excess of production in Brazil, China, Cuba, Dominican Republic, Guatemala, India, Paquistan, Thailand and Vietnam; (ii) expansion of the cultivation area and processing capacity; (iii) exports incentives allocation to domestic producers in India; and (iv) the US dollar depreciation against the main international currencies. Regarding to the annual trade of the the sugar in the last day of December, there is a reduction of the rate. The quotation of USD 10.45 cents/pound shows a reduction in 10.7 per cent in comparison with the same period of 2006.

Cereals. According to the UN – Food Aid Organization (FAO) report of 2007, in the last years the prices of agricultural products, excepting sugar, have been increasing rapidly, with particular emphasis to the cereals. The main reasons for the growth of the price of those products can be grouped into two parts, namely, the supply and the demand.

- **From the supply side:** (i) The production from the eight major world producers, which represents half of the world production, fell by 4 and 7 per cent in 2005 and 2006 respectively, with a relative growth recorded in 2007, fueled by price increase; (ii) gradual reduction of stock level – since the last remarkable increase of prices observed in 1995, the global level of stocks has been reducing by an average of 3.4 per cent per year; and (iii) increase of production and transports expenses to the marketing points, as a result of the increasing of the price of the fuel.

- **From the demand side:** (i) The economic development and the increase of revenue in the emerging economies, specially China and India, have been gradually changing the world demand structure; and, (ii) the rapid increase of oil price and the consequent emergency of the biofuel market have been an additional source of demand pressure. Products such as sugar, maize, cassava, palm oil that were traditionally used as food, nowadays they are demanded to produce biofuels.

Among the above mentioned cereals, the highlight goes to wheat, due to its significant weight in the CPI basket of Maputo city. Effectively, this product, had an upward trend along the year standing at USD 368.62 metric/tons on the closing day of December 2007, prompting to a cumulative increment of 80.4 per cent over the quotation of the last day of December 2006.

Recent estimates published by the FAO indicate that in 2007, the world wheat production reached about 602 million tons. It means an increase of 1 per cent against the volume recorded in 2006, a level which stood under the early expectations.

3. DOMESTIC OVERVIEW

3.1. Real Sector

3.1.1. Prices

Data published by the National Institute of Statisitcs indicate that the Consumer Price Index of the Maputo City – the official indicator of inflation in Mozambique, recorded an annual variation of 10.26 per cent in December 2007, which is equivalent to an acceleration in 89 basis points comparatively to the variation observed in the same period of 2006. A different behaviour was observed in the annual average inflation (12-months moving average) that, after being at 13.25 per cent in December 2006, fell continuously along 2007, standing at 8.16 per cent, in December - which is in line with single digit inflation foreseen in the Government Economic and Social Plan for 2007.

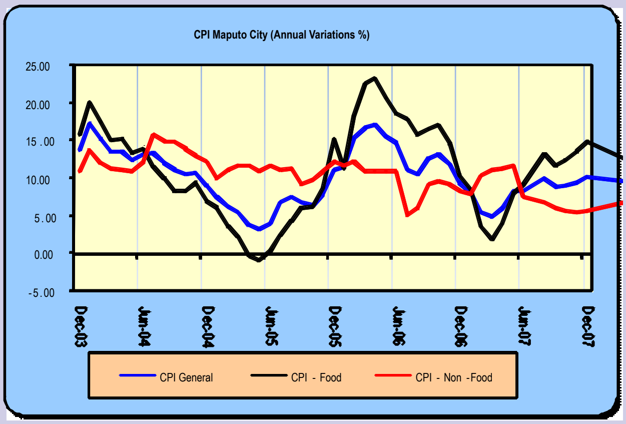


Chart 2

The behaviour of the annual inflation along the year presents three distinct phases. The first covers the first quarter – characterized by a deceleration of the general indicator to 4.9 per cent in March, determined basically, by the fall of food inflation by 8.5 percentage points to 1.9 per cent in March. The following period, goes from April to August, also determined by foodstuffs prices which inverted the trend and increased by 11.3 percentage points contributing for the acceleration of the annual inflation in the period by 5.0 pecentage points, thus, rising the indicator to 9.9 per cent in August. The third period covers the last four months of the year, in which there was a mixed behaviour, i.e., a decrease in September, followed by a new increase in the following months allowing to a variation of 10.26 per cent in December.

The table 3 shows the desagregation of the annual inflation by foodstuffs and non-foodstuffs components, as well as the respective more unstable components, namely, fruits and vegetable prices and liquid fuels prices.

Table 3: Annual Change of the CPI of Maputo City (in percentage)

	Weight	2006		2007	
		Variation (%)	Contribution (pp)	Variation (%)	Contribution (pp)
General CPI 1	**100**	**9.4**	**9.4**	**10.3**	**10.3**
Foodstuffs	49.6	10.4	5.2	14.9	7.5
Fruits and Vegetable	17.7	12.5	2.2	8.1	1.6
Excluding Fruits and Vegetable	31.9	10.0	3.2	17.6	5.7
Non-foodstuffs	50.4	11.2	4.2	5.6	2.8
Liquid Fluels	2.0	12.4	0.2	21.3	0.5
Excluding Liquid Fuels	48.4	8.1	3.9	4.6	2.3

Source : INE

According to the data above, the behaviour of the inflation along the year has been determined by the evolution of foodstuff prices whose index deteriorated by 14.9 per cent on annual basis, which corresponds to a contribution of about 7.5 percentage points in the variation of the global index, reflecting, essentially, the accelaration in the prices of the following products:

- **Wheat bread, rice and spaghetti:** Increment of 22.4, 13.8 and 37.8 per cent respectively, due to a rise of prices in the international market;

- **Onion and Potatoes:** Increase of 39.4 per cent in the price of onion and 31.7 per cent in the price of potatoes. The high rates of the prices of these products has been more expressive in the last months of the year reflecting, on the one hand, the increasing of prices of such products in South Africa and, on the other hand, the speculative attitude of some traders – the sazonal characteristic of the month of December.

- **Frozen Mackerel:** The increase of the price in 21 per cent in the year, was associated to the high costs of imports as a result of a cut in supply from Namibia.

In the year under analysis, the prices fruits and vegetables increased by 8.1 per cent (a contribution of 1.6 percentage points in the annual variation), which, comparatively to 2006, corresponds to a deceleration of 4.4 percentage points, in the meanwhile it can be concluded that, excluding fruits and vegetables, the annual price increment from other food products stood at 17.6 per cent, comparatively to 10.0 per cent, observed in the same period of the previous year.

Regarding to non-foodstuffs price indexes, the increasing of liquid fuels prices at about 21.3 per cent was associated with the adjustments made in domestic prices as a consequence of the price increasing in the international market. Dispite that, it recorded a positive annual variation of 5.6 per cent against 11.2 per cent observed in the previous year. The price index of non-foodstuffs excluding liquid fuels, observed an annual variation of 4.6 per cent, which corresponds to a deceleration of 3.5 percentage points comparatively to December 2006.

The table that follows (Table 4) shows the products with major positive and negative variation in its prices.

Table 4: Products with Greater Contribution to the Annual Inflation

Inflationary			Deflationary		
Products	**Contrib. (pp)**	**Var. (%)**	**Products**	**Contr. (pp)**	**Var. (%)**
Wheat Bread	1.511	22.4	Tomato	-0.483	-15.6
Frozen Mackerel	1.144	21.12	Batteries for/ vehicles	-0.042	-35
Rice	0.683	13.8	2nd hand Automobile Veh.	-0.022-	-2.1-7.2
Onion	0.505	39.4	Green Pepper	0.018	18.8
Fresh fish	0.994	29.1	Green Beans	-0.017	-06.0
Firewood	0.474	27.4	Tangerines	-0.008	-2.7
Fresh potato	0.390	31.7	Tyres	-0.008	-5.0
Coconut	0.351	23.4	Dresses	-0.008	-2.9
Paraffin	0.322	41.5	Women's Shoes	-0.007	-0.8
Spaghetti	0.314	37.8	*Capulanas*	-0.006	-3.6
Chicken	0.285	37.8	Women's Trousers	-0.005	
Others	4.448		Others	-0.032	
Sub-total	**10.921**		**Sub-total**	-0.684	

Source : INE

From the desaggregation of the factors that influenced the behaviour of inflation in 2007, from external and internal points of view, the emphasis goes to the following:

a) At International level:

- The increase of international oil price – according to the Reuters data, the average oil price traded at 91.45 USD/barrel in December 2007, increased by 48 per cent, a variation with direct and indirect impact on the costs of production and on the household expenditures, particularly those related to transport;

- Food supply deficit, due to, mainly, to resource allocation deviation from the cereal production sector to the bio-fuels production, which resulted in the increasing of international prices of cereals, which had a direct impact in the internal prices of wheat, bread, rice and spaghetti, products with considerable weight in the CPI basket. Consequently , the first grade wheat has been traded at USD 368.62 metric/tons in the international market by closing day of December 2007, which corresponds to an accumulated increment of 80.4 per cent over the quotation from the end of December 2006. On the other hand, the food deficit in the international markets affected the domestic economy considering the reduction of food aids inflows;

- The annual inflation acceleration in South Africa from 4.7 per cent in December 2006 to 8.6 per cent in December 2007, one of the major sources of foodstuffs imports; and

- Reduction of some foodstuffs supply with considerable weight in the domestic CPI, for example, the Mackerel imported from Namibia, whose supply did not match the demand observed in the period.

b) At domestic level:

- Lack of warehousing capacity for frozen products contributing for the stock out in periods of great demand pressure, associated with price speculation;

- Imperfection in the marketing circuits, particularly in December, which results in price disparities amongst the wholesalers (more stabilized prices) and retailers (substantial rise of prices); and

- Assimetrical information among the several market stakeholders about the availability of products and prices in different supply centres, working as a source of prices fluctuations.

It is worth to mention that the impact of the above mentioned factors were in the year, smoothed by the annual nominal appreciation of the Metical against the US dollar and the South African Rand by 8.1 and 5.7 per cent respectively, as a result of the Banco de Moçambique interventions in the interbank markets, which allowed not only to increase the operators confidence in the various market segments, as well as to ensure that the market was working with an adequate level of foreign currency.

3.1.2. Production[9]

The report of Economic and Social Plan Balance of 2007, produced by the Ministry of Planning and Development, based on preliminary data supplied by the different sectors of the economy, indicates that the total production recorded a real growth of 7.8 per cent in 2007, i.e., 0.6 percentage points above the forecast, representing a slowdown of 1.4 percentage points relatively to that of 2006.

Table 5: Global and Sectoral Production – Growth Rates (in percentage)

Institutional Sectors	2005 – Real	2006 – Real	2007- Forecast	2007 – Real
Agriculture, Livestock and Forestry	1.8	10.4	11..2	8.6
Agriculture	1.5	11.1	12..2	6.7
Livestock	0.7	8.1	9.7	33.5
Forestry and Forest Exploitation	5.6	4.7	2.9	2.5
Fishery	3.4	-3.5	3.5	-3.3
Mineral Extraction Industry	11.1	13.0	11.0	10.0
Manufacturing	3.6	3.6	3.9	2.8
Electricity and Water	12.8	9.9	9.0	8.4
Construction	25.8	23.6	8.0	9.9
Commerce	2.1	4.2	5.5	9.0
Repair Services	1.1	4.5	0.6	0.6
Restaurants and Hotels	6.1	15.2	8.5	12.8
Transport and Communications	19.5	21.2	14..2	20.4
Financial Services	2.9	2.9	2.4	2.7
Real Estate rentals	2.4	2.4	2.4	2.4
Services rendered to Companies	5.6	4.8	3.5	4.0
Government Services	21.0	4.5	9.1	4.9
Other Services	1.4	4.3	0.1	0.1
Total Production	**8.4**	**9.2**	**7.2**	**7.8**

Source: PES 2007 Balance

According to table 5 above, excluding the fisheries sector that in the last two years recorded a negative real growth, the other sectors recorded positive variations, with focus to the livestock, trading and Government services, whose growth rates accelerated over 2006.

By sectors, the performance in 2007 was the following:

(i) Agriculture, Livestock and Forestry: Slowdown of production growth from 10.4 per cent in 2006 to 8.6 per cent in 2007, as a result of the following performance from the respective sub-sectors:

a) Agriculture, production increase by 6.7 per cent in 2007 after 11.1 per cent in 2006, reflecting, mainly, the adverse weather conditions observed along the year, namely the floods in the Zambezi valley and in some regions of Nampula and Cabo Delgado as well as the lack

[9] Preliminary data from the Instituto Nacional de Estatistica, show that real GDP grew by 7.3 per cent in 2007, 1.2 percentage points higher than the expansion recorded in 2006.

of rain in the southern region of the country which affected the first season production. The private and household sectors decelerated relatively to 2006 by 21 and 2.9 percentage points to 0.7 and 7.3 per cent respectivelly. In terms of destination of the household production, the traded production increased by 11 per cent while the self-consumption increased by 4.9 per cent.

b) Livestock, annual increase of 33.5 per cent, about four times more than the growth recorded in 2006 reflecting the increase registered in the production of beef (41per cent), pork meat (13.5 per cent), chicken (73 per cent), eggs for consumption (34 per cent) and a decrease in milk production by 0.3 per cent. It is to note that the growth of the poultry farming sector (chicken and eggs) is parcially justified by the entrance of new operators and by the increase of credit to this sector, fact that contributed to the reduction of imported chicken.

c) Forestry and Forestry exploitation, 2.5 per cent growth, 2.2 percentage points less compared to the growth observed in 2006. The production of timber increased by 3 per cent as a result of the entrance of new operators, the increase of exploitation of volumes of wood authorized in previous campaigns, and the growing internal demand by the construction sector.

(ii) Fishery: The production of this sector decreased by 3.3 per cent in 2007, after decreasing by 3.5 per cent in 2006. The private sector was the main responsible for this behaviour by recording a fall in 6.2 per cent against an increase in 0.8 per cent of the household sector production. The marketed household production fell by 1.7 per cent while the production for self-consumption increased by 2.4 per cent.

(iii) Electricity and Water: The production increase by 8.4 per cent mainly due to the increase in electricity provided by Cahora Bassa Dam (HCB – acronym in portuguese). In 2007, the Electricidade de Moçambique purchased 38 per cent more of the electricity generated by HCB and increased the number of new contracts (connections) by 11per cent. The growth of water supply to the rural areas allowed the enlargement in the country's coverage to 48.5 per cent, so that contributed positively to the growth of the sector.

(iv) Construction: A growth of about 9.9 per cent, against 23.6 per cent recorded in 2006, reflecting a nominal increase of 19 per cent recorded in the private sector and the public investments on roads, bridges and social infra-structures.

(v) Trade: Growth of the activity in 9 per cent in 2007, enhanced by the incresase observed in the production in the agricultural and extractive industry sectors and by the volume of external trade.

(vi) Transport and Communications: expansion of 20.4 per cent, boosted by transportation through pipelines, that grew in 35.1 per cent, air transport (28 per cent), communication services (28.4 per cent), marine services and cabotage (19.7 per cent) and road transport (14.8 per cent). The road transport was the only category with negative variation during the period.

Table 6: Entrepreneurial Production Growth Rates and Smallholder Sector Trade (in percentage)

	2005 Real	2006 Real	2007 Real
Exporting Products	**30.1**	**-1.7**	**-13.3**
Cashew nut	142.7	-39.8	18.4
Cotton	-12.6	46.3	-40.8
Copra	0.0	8.3	0.0
Sugar cane	19.0	-8.3	-1.6
Citrus fruit	0.0	6.7	5.5
Tea Leaf	5.7	0.0	10.4
Basic Food Products	**-4.2**	**33.3**	**27.7**
Maize	1.8	16.4	10.6
Rice Grain	-11.7	24.8	15.0
Mapira	-6.5	97.1	32.3
Cassava	3.5	11.1	13.3
Peeled peanuts	-0.2	13.7	66.9
Beans	3.2	90.0	-16.4
Horticulture	-26.8	28.8	87.0
Onion	-66.5	23.9	88.1
Industry Products	**24.1**	**10.2**	**-0.6**
Tobacco	33.9	-9.2	-1.3
Tomato	4.3	93.7	0.9
Total	**4.8**	**14.9**	**11**

Source: Economic and Social Plan (PES-acronym in Portuguese) 2007

Analysing by products, according to the above box, shows for the private sector and the marketed production of the household sector a decrease in the production of export goods by 13.3 per cent after a fall of 1.7 per cent in 2006 and a slowdown of basic food products by 33 per cent in 2006 to 27.7 per cent in 2007. The goods that recorded in the period higher increases were the vegetables (87 per cent), onion (88.1per cent), and peanuts (66.9 per cent). The products from the industry recorded a fall of 0.6 per cent.

The negative performance in the production of exports reflects, essentially, the fall of cotton production (41 per cent) and of sugar cane (1.6 per cent). It is justified for the case of cotton by the reduction in the number of producers and consequently of cultivated areas, while the irregularity of rains, the defficiency in the irrigation systems and the electric energy access problems were the main constraints for the sugar sector. The table below shows the production of the manufacturing industry, by areas of activity.

Table 7: Trend of the Industrial Production per Area of Activity (Annual Change in %)

Items	2006	2007
Beverage and Food Industries	6	12.3
Tobacco Industry	40	-3.3
Textiles Manufacturing	33	2.7
Clothing Industry	-44	-3.8
Tanning and Shoes Manufacturing	-5	-18
Manufacturing of Paper, Cardboard and Related	5	-1
Products	-11	47.9
Editing, Printing and Copying	-12	9.1
Manufacturing of Chemical Products	6	-4.9
Manufacturing of Rubber and Plastic products		
Base Metallurgical Industry	1	0.8
Manufacturing of Metal Products	-31	- 0.1
Manufacturing of Machines and Equipment	2	10.9
Manufacturing of Electronic Machines and Devices	29	68.0
Manufacturing of Motor vehicles and Trailers	145	-30.1
Manufacturing of Other Transport Equipment	-49	-49.3
Manufacturing of Furniture and Other Industries	-4	16.5
Other Mining Industries	30	-30.3
Total	3.2	3.0

Source: Economic and Social Plan (PES-acronym in Portuguese) 2007

The data contained in table 7, show that the increase of industrial production was determined by the following sectors of activity:

- Manufacturing Industry: The production of this sector in 2007 was MZN 7,911.9 million - about 15 per cent of the total industrial production and represents an annual growth of 12.3 per cent, after 6 per cent in 2006. The expansion of capacity in the areas of production of mineral water, beverages and food oil were the main factors that determined the positive performance of the sector.

- Base Metalurgical Industry: having a weight of 75 per cent in the GDP structure, this sector registered a growth of 0.8 per cent. This outcome can be related to the entry into force of the Diploma nr. 99/2003 from August, 13th, which exempts the manufacturing industry of customs duties.

- Manufacturing of Chemical Products: after having recorded a production fall in 2006, this sector showed signs of recovering, having its production increased in 9.1 per cent.

- Textile Manufacturing Industry: it recorded a growth of 2.7 per cent as a result of major participation of the area related companies, in supplying orders to the Health, Education, Defence, Police sectors and others.

3.2. Public Finance

During the year 2007, the public revenue ascended to MZN 33,059 million, value that corresponds to a nominal growth of 22.5 per cent compared to the value of 2006, which surplus the programmed in 2.4 percentage points. The revenue collected represented 16.5 per cent of the GDP, more 0.9 percentage points in relation to 2006 and 0.6 percentage points above the inicial forecasts. Contributed to this level the revenue collection, the Fiscal Revenues with a level collection above the programmed in 3.5 percentage points due, fundamentally, to the improvement in the efficiency of fiscal administration, concerning to the charging of revenues, associated to the allocation of 190,019 new NUIT´s against the 150,000 foreseen, which means an accomplishment of 27 per cent above the forecasts for the whole country, from which 186,368 NUIT´s were addressed to individuals and 3,651 to corporate.

Second floor vestible **Oil decorative panel** *Garizo do Carmo*

Table 8: Program of Budget Execution (MZN million)

Items	Achievements 2006	Achievements 2007	Achiev./Prog 2007 (per cent)	Nominal Variation (per cent) 2007	GDP per cent 2007
Total Revenues	**26,997**	**33,059**	**102.4**	**22.5**	**16.5**
Fiscal Revenues	23,314	29,081	103.5	24.7	14.5
Taxes on Income and Profits	6,367	9,279	121.7	45.7	4.6
Taxes on Goods and Services	13,031	15,505	97.7	19.0	7.7
Customs Duties	3,284	3,782	95.6	15,2	1.9
Other Taxes	632	515	80.0	(18.5)	0.3
Non Fiscal Revenues	1,036	1,612	98.3	55.6	0.8
Own-generated Revenues	1,622	1,110	91.5	(31.5)	0,6
Capital Revenue	526	606	88.5	15.3	0.3
Tax and Consigned Revenues	499	649	102.7	30.1	0.3
Total expenditures and Net Loans	**46,871**	**58,203**	**84.3**	**24.2**	**29.0**
Current Expenditures	25,661	31,838	99.0	24.1	15.9
Investment Expenditures	18,635	24,277	72.7	30.3	12.1
Net Loans	1,634	2,295	65.2	40.5	1.1
Other Expenditures/ Revenues	941	(207)	-	(122.0)	(0.1)
Grants	**17,957**	**19,289**	**75.3**	**7.4**	**9.6**
Indicators of Fiscal Performance					
Overall Balance before Grants	(19,874)	(25,144)	68.3	26.5	(12.5)
Overall Balance after Grants	(1,917)	(5,855)	52.4	205.4	(2.9)
Domestic Primary Balance	(4,303)	(5,060)	76.0	17.6	(2.5)
Net Credit (Domestic)	(5,690)	382	(20.9)	(106.7)	0.2

Source: Ministry of Finance

The public total expenditure, including the net loans to public enterprises, recorded in the year under analysis totalized an amount of about MZN 58,203 million, corresponding to 29 per cent of the GDP (increase of 2.0 percentage points compared to 2006). This level of public expenditure corresponds to 84.3 per cent of the value initially forecasted.

In the same period, the current public expenditure increased by 24.1 per cent in nominal terms, totalizing MZN 31,838 million, equivalent to 15.9 per cent of the GDP and 99 per cent of the targeted for the year. Investment expenditure increased nominally in 30.3 per cent, reaching the value of MZN 24,277 million (12.1 per cent of the GDP), amount financed through grants and foreign debt (62.3 per cent), whose value grew in the year, comparatively to 2006 in 4.6 per cent, fixing, however, in 24.7 percentage points below the programme value, which ended up determining the level of accomplishment of the investment expenditure as a whole, which was fixed at 72.7 per cent compared to the value targeted for the year.

According to the data in the table 8 (above), the primary balance[10] worsened in relation to 2006 in 17.6 per cent to a deficit of MZN 5,060 million.

Table 9: Selected Budgetary Indicators (as percentage of GDP)

Items	2003	2004	2005	2006	2007
Total Revenues	13.3	12.9	9.3	15.6	16.5
Total Expenditure	26.1	25.,6	16.9	27.0	29.0
Overall Balance Before Grants	-12.7	-12.7	-7.6	-11.5	-12.5
Grants	9.0	8.4	5.4	10.3	9.6
Overall Balance After Grants	-3.6	-4.3	-2.2	-1.1	-2.9
Net Credit to the Government	0.7	0.0	0.6	-3.3	0.2
Net External Loans	4.9	3.8	1.4	4.1	2.5
Domestic Primary Balance	-5.0	-4.0	-2.7	-2.5	-2.5

Source: Ministry of Finance

[10] Obtained from total revenues minus total expenditures deducted from charges with debt and capital expenditures and net loans locally financed.

The global deficit before grants, was fixed at MZN 25,144 million, corresponding to 12.5 per cent of the GDP, which is equivalent to 1 percentage points above the registered in 2006. However, in terms of nominal value the deficit determined in the year represents an increase of 26.5 per cent, i.e., 31.7 percentage points below the programme. When incorporated the grants, the global budget deficit reduces to MZN 5,855 million (about 2.9 per cent of the GDP).

Despite the inflow of: (i) grants amounting MZN 19,289 million (9.6 per cent of the GDP); (ii) net external loans of MZN 5,432 million (2.7 per cent of the GDP); and (iii) the utilization of MZN 1,204 million from funds resulting from the award of the Moatize Coal Exploitation Licence to "Companhia do Vale do Rio Doce" (CVRD), contrarily to the program which predicted a net constitution of savings in the year, the Government recorded a deterioration of its position in the financial system.

3.2.1. Revenues

From the MZN 33,059 million of revenues collected by the Government, MZN 29,081 million are fiscal, equivalent to about 88 per cent of the resources collected by the internal revenue system and represent a nominal growth of 24.7 per cent, exceeding the indicative target in 3.5 percentage points.

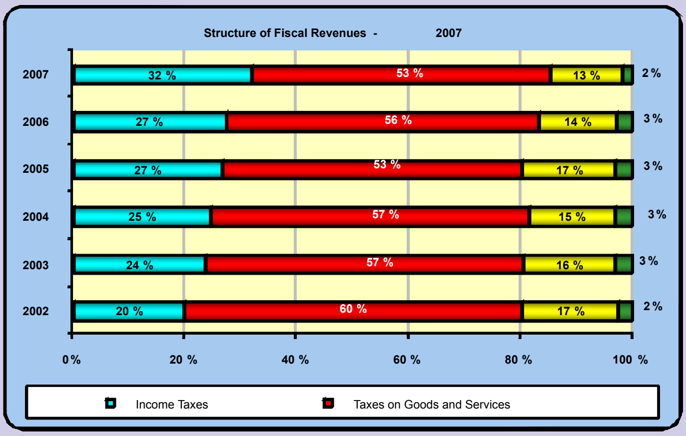


Chart 3

The detailed analysis of the fiscal revenue shows the following:

- The collection of income tax resulted in an amount of about MZN 9,279 million, which represents an annual nominal growth of 45.7 per cent, 21.7 percentage points more in relation to the target.

Both the IRPS (Personal Income Tax) and the IRPC (Collective Person Income Tax) surplus the levels programed in 13.6 percentage points and 32 percentage points, respectively, as a result of the expansion of the economic activity, continuous improvement in the process of administration of tax collection and the end of the period of fiscal incentives for some IRPC contributors. It should yet be refered that the weight of these taxes in the total of the internal revenue system has been increasing, as it is illustrated in the Chart 3. In the period in analysis, the proportion of income tax in the fiscal revenue increased in 5 percentage points, comparatively to same period of 2006, to 32.0 per cent.

- Taxes on goods and services, whose value was fixed in MZN 15,505 million, placed in 2.3 percentage points below the forecasts, due to the weak performance of the Specific Consumption Tax of National Products (reduction in 3.9 percentage points), of Imported Products (in 17 percentage points) and Fuel Tax (in 11.2percentage points). Customs Duties – which represent 13.0 per cent of the total fiscal revenue – registered a nominal growth of 15.2 per cent, having reached the value of MZN 3,782 million. It is worth stressing that the proportion of customs duties in the fiscal revenues has been decreasing in the last years due to the process of suppressing customs tariff – in the context of the SADC regional integration - which started in 2000 with a gradual reduction of tariffs (preferential tariffs) and the application of the zero tariff for 85 per cent of the products included in the Tariff Code in January 2008 and that will culminate with the total liberalization in 2012.

- Other taxes, whose collected value was MZN 515 million MT, stood 20 percentage points below the programmed for the year, which is equivalent to 2 per cent of the total fiscal revenues, 1 percentage points less compared to 2006.

The over-accomplishment of the fiscal revenue in 3.5 percentage points above the forecast was enhanced by the increase in economic activities associated with an improvement in the performance of the fiscal administration.

The non fiscal revenues were fixed below the goal in 1.7 percentage points, which corresponds to 0.8 per cent of the GDP, while the Own-generated and Capital Revenues had an accomplishment below the programmed in 8.5 percentage points and 11.5 percentage points, respectivelly, with the taxes and consigned revenues being collected above the programmed in 2.7 percentage points.

3.2.2. Total Expenditures and Net Loans

The disaggregation of the public expenditure shows the following:

A. Current Expenditure

The Current Expenditure (Chart 4) was fixed in MZN 31,838 million (15.9 per cent of the GDP), 1 per cent below the value programme for the year, due, fundamentally, to the contribution of the following sub-items:

- Expenditures with personnel - which represent 28.8 per cent of public expenditure, excluding the net loan – increased by 23.8 per cent in nominal terms, reaching MZN 16,091 million (8 per cent of the GDP and 1.1 percentage points above the programme), not having changed significantly its weight in the structure of expenditure recorded in 2006.

- Expenditures on Goods and Services, excluding the net loans – which has a weight of 11.7 per cent in the total public expenditure – recorded a nominal growth of 20.2 per cent, totaling MZN 6,568 million. The level of accomplishment was 99.2 per cent of the programme value.

- Public Debt Charges – which represent 2.3 per cent of the total of the public expenditure, excluding the net loans – decreased in 7.5 per cent in nominal terms, reaching the value of MZN 1,277 million (96.3 per cent of the programmed), due to the reduction on payment of interest. From the total value paid, 68.3 per cent refers to the obligations with the internal debt and 31.7 per cent with the external debt.

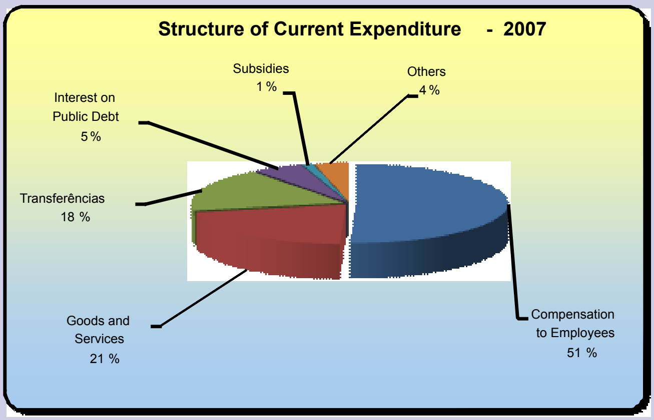


Chart 4

- Current transfers – representing 10.3 per cent of the total public expenditure, excluding the net loans – grew by 26.9 per cent in nominal terms (18 per cent of the total from Current Expenditure), ascending MZN to 5,782 million from which MZN 1,088 million are allocated to public administration, MZN 259 million to private administration and MZN 4,308 million to households (MZN 3,319 million in form of pensions). The expenditures on current transfers were below the programmed in 3.5 percentage points.

B. Investment Expenditure

The 2007 budget programme had set the capital expenditures in MZN 33,374 millions, of which MZN 24, 277 million would be financed by external resources, and the remaining with domestic resources.

The inflow of external resources (grants and credits) below the programmed values, determined the accomplishment of the investment expenditure in MZN 24,277 million (72.7 per cent of the programmed), in a context where the financing of the investment expenditure through domestic resources was equal to MZN 9,147 million, which corresponds to 0.6pp below the forecast amount, where is worth stressing the use of funds for CVRD by MZN 1,204 million.

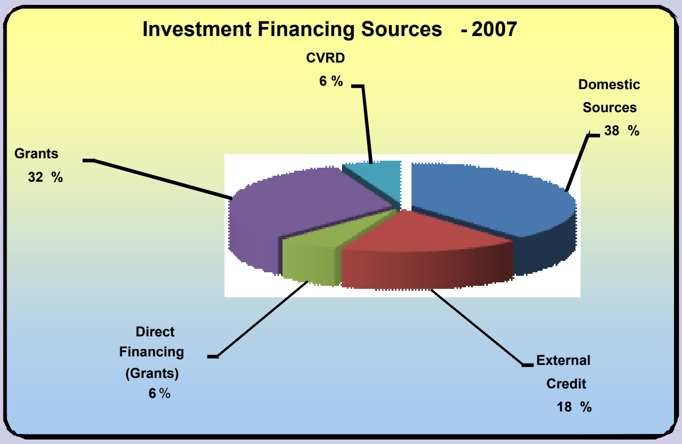


Chart 5

In terms of weight, the capital expenditure in the total expenditure (including the net loans) increased in 1 percentage points to 41.7 per cent, in result from the annual nominal increase of 30.3 per cent. As previously mentioned, the execution of the investment expenditure below the programmed value was essentially determined by the supply of external resources, whose total value disbursed stayed 58.1per cent below the programmed.

C. Net Loans

The treasury net loans to enterprises amounted to MZN 2,296 million, and basically derived, from external loans to the public enterprises guaranteed by the Government in the value of MZN 2,475 million and from financial restruturing and Government share participations in enterprises in a value of MZN 113 million. On its turn, the treasury recovered MZN 293 million pertaining to equivalent amounts collected, but not actually but not generated over the period.

3.2.3. Budget Balance and Financing Sources

The collection of revenues above the forecast figures in scenario in which the expenditure and the net loans were below the budget forecasted, led the budget deficit before grants to be 31.7 percentage points below the programme. However, in relative terms, the total deficit of MZN 25,144 million reached in 2007 (12.5 per cent of the GDP) was 1 percentage points above the recorded in 2006.

For the coverage of the above deficit, the government used the following sources of financing:

- Grants, that reached the value ofMZN 19,289 million, equivalent to an accomplishment of the value programmed in 75.3 per cent, in spite of the nominal growth of 7.4 per cent;

- Net external loans, in the value of MZN 5,432 million corresponding to an accomplishment of 45.1 per cent and the nominal reduction of 23.1 per cent. It should be mentioned that the government reimbursed the external debt in the year in a total amount of MZN 817 million, standing beyond the programmed amounted about of 11.9 percentage points.

- Transfers of funds from the Banco de Moçambique in the amount of MZN 42 million in the context of HIPC innitiative; and

- Utilization of funds from CVRD in the amount of MZN 1,204 million, against the MZN 968 million initially forecasted in the budget.

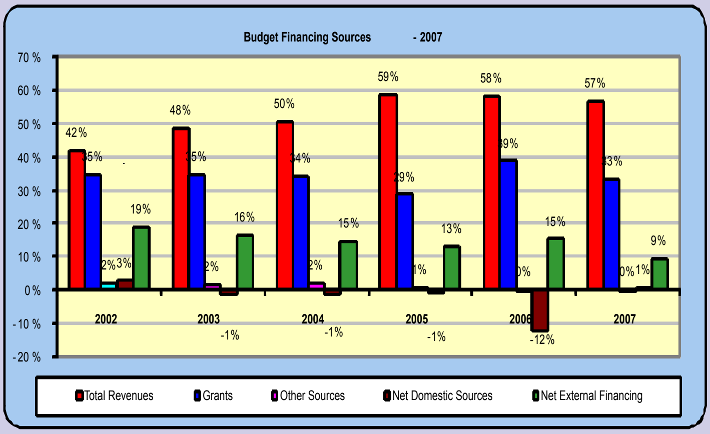


Chart 6

Box 3: Some Fiscal-Budget Policy Measures Implemented in 2007

In the Framework of the Tax System

The following actions were executed:

- Enacting by the Parliament of the Acts on the new codes of VAT, IRPC and IRPS

- Reformulating and approval of the new tax Code on Sucession and Donation, with moderate rates and simplification of the procedures for the determination and payment of that tax.

- Reformulating and approval of the Finances and Local Council Property Act, which introduced changes to the previous Local Council Finances Act.

- Continuity on aligning national legislation to International Conventions, particularly the Kyoto Convention, about the simplifiction of customs proccedures and the convention on the Harmonized System of Commodities Coding.

- Tarrif discount from 25 to 20 per cent in the commercial relations with third party countries, and, for the SADC, from 20 to 10 per cent, from 7,5 to 4,0 per cent and from 5,0 to 3,0 per cent, for goods from categories B1, B21 and B22, respectivelly, from the Customs Tarrif.

- Designing of implementation project for Ressano Garcia Dry Port and signing with South Africa, of an agreement for establishing One-Stop Border among the two countries.

In the Context of e-SISTAFE Expansion

The following actions were concluded:

- The decentralization of power and capacity to budget execution through the e-SISTAFE, implementing it in all Ministeries and some Central and provincial level bodies.

- The implementation since September 2007, of the proccedure of paying expenses directly to the creditor's account, which allowed that, till the end of November 2007, 94,87 per cent of budget execution was accomplished through this instrument.

- Implementation of the Mult - Currency Single Treasury Account in order to integrate into the budget and Single Treasury Account of the off-budget and external funds.

- The development of the e-SISTAFE Module for Budget Elaboration (MEO), which allowed the Adminstration and Finance Department to design the 2008 budget directly in that Application.

Front View of Maxixe Branch

3.2.4. Structure of Budgetary Resources

The domestic resources collected by the Government (Total Revenues and Domestic Net Credit) managed to cover 57.5 per cent of the Total Expenditure, being that the remaining 42.5 per cent were satisfied through External Resources, namely Grants, External Loans and Transfers (HIPC). With effect, the internal budget resources totalized MZN 33,441 million, while the external resources reached the amount of MZN 24,763 million , reducing, this way, its weight in 11.6 percentage points to 42.5 per cent, level close to the accomplished in 2006.

Table 10 : Structure of Budgetary Resources (in percentage)

Items	2003	2004	2005	2006	2007
Domestic Resources	**47.9**	**49.9**	**58.5**	**45.9**	**57.5**
Total Revenues	49.2	51.4	55.1	58.2	56.8
Domestic Credit (Net)	-1.4	-1.4	3.4	-12.3	0.7
Foreign Resources	**52.1**	**50.1**	**41.5**	**54.1**	**42.5**
Grants	35.4	35.1	32.1	38.7	33.1
External Loans	16.7	15	8.3	15.2	9.3
Transfers (HIPC)	0	0	1.1	0.2	0.1
Budget Resources	100	100	100	100	100

Source: Ministry of Finance

Thus, in the context of financial program assessment, the government operations in the national financial system resulted in a decrease of its savings in the banking system in the value of MZN 382 million, until the end of December 2007, against a program that forecasted the constitution of net savings in the amount of MZN 1,828 million.

3.3. Monetary Sector

3.3.1 Monetary Program

The Monetary Program for 2007 was established in accordance with the ultimate goals of the economic policy of the government which forecasts: (i) GDP real growth at 7 per cent ; (ii) annual average inflation of single digit; and (iii) balance of Net International Reserves of USD 1,300 million, to ensure at least four months of imports of goods and non-factory services by gross international reserves. These ultimate goals presupposed as intermediate goals, a monetary expansion not exceeding 20.9 per cent, a growth of the reserve money (operational variable), of 18.1 per cent, besides of the accumulation of net savings from the government, in the national banking system, in the amount of MZN 1.828 million MT.

To ensure the achievement of these objectives and, especially that of inflation, the monetary policy continued to focus on open market operations, made by the Interbank Money Market (IMM), for the regulation of liquidity in the system, by means of issuing and allocating the Treasury Bills (TB's), reinforced in July 2007 with the operations *Repo/Reverse - Repo* and the sale of foreign currency in the Interbank Exchange Market.

Table 11 shows the targets (mandatory and indicative targets) of the monetary program for 2007, and the level of accomplishment during the year.

Table 11 : Main Targets of the Monetary Program and Achievements in 2007

Aggregates	Achievements		Targets
	Dec-06	Dec-07	Dec-07
NIR - 10^6 USD	1,231	1,508.3	1,300
BaM – 10^6 MZN	14,736	17,822.0	17,404(*)
NCG_{system} – Flow	-5,835	382	-1,828
M3 - 10^6 MZN	53,583	67,121	64,786
M2 - 10^6 MZN	34,777	42,737	41,754
Multiplier	3.6	3.8	3.8
CE_{system} – 10^6 MZN	27,414	31,610.9	33,202
Annual Inflation	9.37%	10.26%	one digit
Annual Average Inflation	13.3%	8.2%	one digit
MZN/USD	8.80%	-8.12%	-
M3	23.4%	25.3%	20.9%
M2	25.8%	22.9%	20.1%
BaM	20.9%	20.9%	18.1%

(*) Targets adjusted in MZN 500 million to accommodate abnormal changes in banknotes and coins in circulation.

The information above shows that, at the end of the year, the execution of the monetary program resulted in the following:

- The stock of Reserve Money – operational variable of the Banco de Moçambique monetary policy –stood at MZN 17,822 million in December 2007 , representing an expansion of 20.9 per cent in relation to the target of 18.1 per cent;

- The net position of the Government accounts at the banking system (NCG) – measured by the net credit to the Government, excluding consigned deposits assigned to special projects and those deriving from the award of Moatize Coal mine exploration to the CVRD – recorded a shortfall of MZN 382 million, against the target of 1,828 million;

- The constitution of International Reserves of about USD 277 million (equivalent to a stock of USD 1,508 million), corresponding to USD 208 million above the target figure, allowed the country to reach about 4.9 months of imports coverage of goods and non-factor services, including mega project operations.

As to reduce the effects of monetary expansion over the domestic prices, coupled with the the goods price rise in the international market, the monetary authorities reinforced its interventions in the interbank markets, throughout 2007, as recommended by the Monetary Policy Committee, aimed at maintaining the level of liquidity in the economy in line with the inflation objectives, which contributed to the strong stability of the Metical against the US dollar and the South African rand, softening, in part, the inflationary pressures.

2.1.1 Reserve Money

The stock of Reserve Money (BaM) by the end of December 2007 stood at MZN 17,822 million, representing a 3,086 million annual flow (20.9 per cent) – the same observed in 2006, of which MZN 2,153 million (24.5 per cent) correspond to the banknotes and coins in circulation (NCC) outside the Central Bank and MZN 933 million in the form of bank reserves (of which MZN 659 million are denominated in national currency and the remainder in foreign currency).

The expansion of the NCC in 2007 was associated with the increased demand for cash by commercial banks at the BM in June, November and December, with emphasis on the last week of June and December in response to the clients' increased demand observed within the banking system.

The periods of increased demand for banknotes and coins, were equally associated to the fact that holidays resulted in long weekends, coinciding with the salary pay week, in a situation where the purchase of goods and services via electronic means is still not widespread and at an early stage.

In fact, the highest net cash withdrawals were observed in June, November and December in the amounts of MZN 388 million, MZN 368 million and MZN 1,441 million, respectively. The following table below shows the evolution of the BaM components.

Table 12: Evolution of the BaM and Its Components – in 10^6 MZN, except different indications

	Dec-06 Real	Dec-07 Real	Adjusted Target	Change 2006/2007
	Stock in Millions of MZN			
BaM	14,736	17,822	17,404	20.9%
NCC	8,789	10,942	10,633	24.5%
Bank Reserves	5,947	6,880	6771	15.7%
	Struture (%)			
BaM	100%	100%	100%	
NCC	59.6%	61.4%	61.1%	
Bank Reserves	40.4%	38.6%	38.9%	

In terms of structure of the BaM, the NCC have increased their weight by 1.8pp, in relation to 2006, thus representing 61.4 per cent of the aggregate under analysis, in 2007.

Regarding the change of liquidity, the main factors that prompted the increase of bank reserves are the following :

(i) Government net allocation of MZN 14,298 million in the banking system, of which MZN 13,535 million in the context of budget execution and MZN 763 million through Treasury Bonds operations;

(ii) MZN 6 million in interests deriving from net maturity of reverse repo bills.

*(iii)*Several operations that resulted in liquidity allocation amounting to MZN 395 million;

Meanwhile, as shown in the table above, the Bank Reserves evolved in line with the forecasts, despite the slight excess in relation to the target of MZN 126 million, greatly deriving from the increase, above the target, of deposits of the banking system denominated in foreign currency, at the Banco de Moçambique.

Provided the above factors of liquidity creation, the foreign currency sales in the Interbank Foreign Exchange Market (IFEM) revealed, once more, to be an effective instrument to restrain the trend of liquidity in the banking system, as they allowed the collection of MZN 10,492 million. In the same framework, there was a net issuance of TB´s, which contributed to the sterilization of liquidity in MZN 2,712 million.

The table below summarizes the main factors of bank reserves variation in cumulative terms, in the year under analysis.

Table 13: Bank Reserves Variation Factors in 2007

Factors – in 10^6 MZN	Increase		Reduction
Government	13,535	Net cash withdrawals	451
Several	395	Sales in IFEM	10,492
Treasury Bond Operations	763	FPC	230
Repo Operations	6	Net TB´s	2,712
		DA operations	68
		FPD operations	87
TOTAL	**14,699**		**14,040**

3.3.2. Interbank Markets

As regards to liquidity management, in 2007 the Banco de Moçambique continued to focus on the monetary policy instruments available in the Interbank markets (Foreign Exchange and Money Markets), of which the Foreign Exchange Market is the segment that sterilized the greatest part of the liquidity.

In relation to the Instruments at disposal

In 2007, the Banco de Moçambique interventions in the Interbank Markets resulted in the following:

a) In the Interbank Money Market

- The volume of Treasury Bills issued and traded in the period corresponded to MZN 20,501 million (nominal value), against the nominal reimbursement of MZN 15,708 million, which resulted in a net issuance of MZN 4,793 million, prompting the increase of TB's portfolio to MZN 14,886 million at the end of 2007, of which MZN 11,566 million were subscribed for the maturity period of 364 days (about a double of that recorded in 2006), revealing the preference of commercial banks for longer maturity periods, associated to the expectations of a decline of TB's interest rates in the Interbank Money Market;

- As to Repo/Reverse-Repo operations introduced in 2007 as another instrument of liquidity sterilization, the BM issued and traded bills worth MZN 360 million;

- In the framework of operations performed under Credit Institutions' initiative, MZN 137 million in average per operation were traded within the Standing Lending Liquidity facility (FPC-acronym in Portuguese), against the average of MZN 71 million recorded in 2006. In turn, within the Standing Deposit Facility (FPD-acronym in Portuguese), the average application per operation increased to MZN 478 million, after MZN 138 million in the previous year.

- In the segment of liquidity swaps, Credit Institutions traded among themselves, about MZN 38 million in average per operation, MZN 8 million more than the average amount per operation recorded in 2006.

The table below shows the summary of operations performed and the respective rates.

Table 14: Interbanking Markets

	2005		2006		2007	
	BM operations in Interbank Markets – Cumulative amounts in the year					
IMM						
TB´s Issued [11] (10^6 MZN)	19,177		21,697		20 501	
TB´s Reimbursed (10^6 MZN)	14,906		22,175		15,708	
IFEM						
Foreign Currency sold (USD 10^6)	394		459		416	
Foreign Currency purchsed (USD 10^6)	1.2		1.0		7.9	
	Sterilized liquidity, in MZN million					
IMM (TBs and Repo)	-1,096		-483		-2,706	
IFEM	-8,461		-11,476		-10,493	
	IMM – Stock in MZN million					
TB´s	10,576		10,094		14,886	
91 days	950		2,065		1,029	
182 days	3,453		2,565		2,291	
364 days	6,173		5,464		11,566	
	IMM - Operations					
	Average (10^6 MZN)	Nr. of operations	Average (10^6 MZN)	Nr. of operations	Average (10^6 MZN)	Nr. of operations
FPA/FPD	136.33	564	137.72	586	478	158
FPC	102.47	375	70.72	344	137	125
Swaps	26.06	1,342	30	1,261	38	1,874
	IMM – Interest Rate					
FPC	13.8		17.50		15.50	
TB´s						
91 days	10.20		16.00		14.75	
182 days	11.11		16.25		14.95	
364 days	11.42		16.50		15.04	
Swaps	9.8		15.98		13.94	
FPA/FPD	7.75		13.0		10.50	
	IFEM					
Exchange Rates - Cotations	23.67		25.77		23.6	
Transactions (among Banks – IFEM- million USD)	132.0		187.1		291.1	

IMM Interest Rates

In general, the IMM interest rates witnessed a decreasing trend in 2007, as a result of, on one hand, the new approach assumed by the Central Bank in relation to Treasury Bill operations and, on the other hand, the deceleration of the average inflation throughout the year. Hence, the monthly average interest rates applied in Treasury Bills operations for 91, 182 and 364 maturity days witnessed a decreasing trend from March of the year under analysis, having decreased by 124bp, 130bp and 145bp, standing, at 14.75 per cent, 14.95 per cent and 15.04 per cent, in December, respectively.

The average interest rate for liquidity swaps among credit institutions followed the same behaviour as of the TB´s interest rates and, in the last day of the year, it stood at 13.9 per cent, 210bp less than the average observed in December 2006. The decline of TB´s interest rates and those of liquidity swaps among credit institutions and, the persistent slowdown of the annual average inflation, created a favourable environment for the Central bank to decide for a reduction of its intervention rates in July (FPC and FPD) by 200bp and 250bp to 15.5 per cent and 10.5 per cent, respectively.

[11] Nominal Value

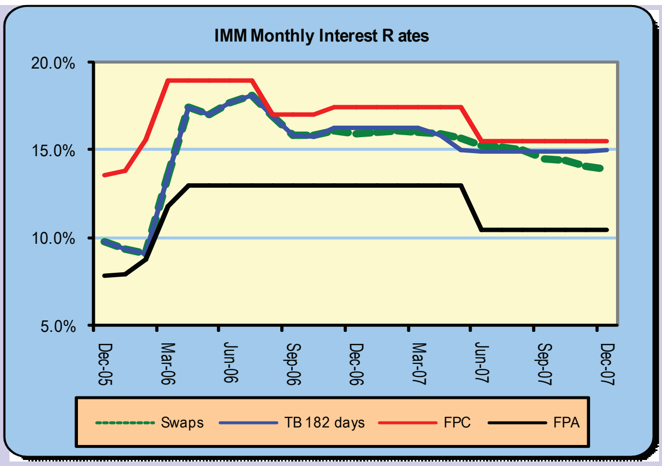


Chart 7

In real terms, the IMM interest rates have decreased compared to those observed in 2006, as a result of the fall of nominal interest rates in the overall products traded within the IMM, against a slight increase of annual inflation.

b) In the Interbank Foreign Exchange Market

In 2007, the Foreign Exchange Market (IFEM) showed a remarkable performance in relation to the IMM, considering the amount of liquidity sterilized and the volume of foreign currency traded among the Credit Institutions, revealed by the number of operations and the total amount traded, a fact that associated to the interventions of the Central Bank has contributed to the stability of the Metical exchange rate in relation to the US dollar and the rand.

Actually, the Foreign Exchange Market operations performed in 2007 resulted in the following:

- Net sale of foreign currency by the BM to the Credit Institutions in the amount of USD 408 million (about MZN 10,493 million), against USD 458 million (MZN 11,476 million) recorded in 2006. USD 265 million of the total sales were realized through foreign currency auctions and the remainder via bilateral sales.

- Besides the foreign currency purchase operations at the BM, the Credit institutions traded foreign currency among themselves in a cumulative amount of USD 291 million, in 740 operations, of which USD 24 million (realized in 473 operations) were performed under firm quotation regime. In 2006, the Credit Institutions traded among themselves a total of USD 187.1 million, in 263 operations.

Box 4: Measures adopted in the scope of Monetary Policy Management

- Approval of the Governor's Notice nr. 02/GGBM/2007, dated February 28, that modifies the Regime of Mandatory Reserves, with effects from the period of constitution that begins on April 7, 2007. It is a Notice that encompasses measures in the scope of the set of initiatives that the authorities have been implementing in order to encourage the expansion of financial services to rural areas. Among the main aspects of such initiative, it is worth stressing the reduction of the mandatory reserve coefficient from 11.51 per cent to 10.15 per cent.

- In the framework of refining the Interbank Markets, the Banco de Moçambique published the Governor's Notice nr.11/GBM/2007, which approves the regulation on Repo and Reverse Repo operations

- Approval of the Governor's Notice nr. 12/GBM/2007 that revokes number 2 of the article 6 of the Interbank Exchange Market Regulation approved by the Governor's Notice nr. 05/GGBM/2006, which establishes that the purchasing rate of every institution operating in the Interbank Exchange Market should not be greater than the global average purchasing rate of the system, determined at the end of the previous working day added to a percentage margin to be defined by the BM.

- The Board of the BM decided in June 2007 to revise its intervention interest rates downwards, namely the Standing Lending Facility (FPC) and the Standing Deposit Facility (FPD) by 200bp and 250bp to 15.5 per cent and 10.5 per cent, respectively.

In the framework of improving the model for analysis and decision on monetary policy acts and foster transparency in the monetary policy management and, in accordance with the international practices on the matter, the Banco de Mocambique reviewed , in July 2007, the format and content of the Monetary Policy Committee (CPMO), where, among other aspects, it is worth highlighting the fact that the decisions taken by the board should thereafter be published upon each session. This decision preceeded the publication of the Medium and Long Term Monetary Policy Strategy in the website of the Banco de Moçambique (www.bancomoc.mz) late December 2006, aimed at informing the market operators and the public in general about the purposes and instruments of the Banco de Moçambique in the short and medium terms.

3.3.2. Exchange Rates

During the year on the whole, the Metical recorded monthly gains in relation to the US dollar, except in April, August and October when the national currency accumulated nominal losses, prompting the exchange rate to stand at MZN 23.60, in the last day of the year, level equivalent to a 8.27 per cent annual appreciation, after a 8.8 per cent depreciation in 2006.

The valuing exchange rate[12] in the last day of the year stood at MZN 23.82, which also represents 8.28 per cent annual appreciation, against 7.39 per cent annual depreciation recorded in the previous year.

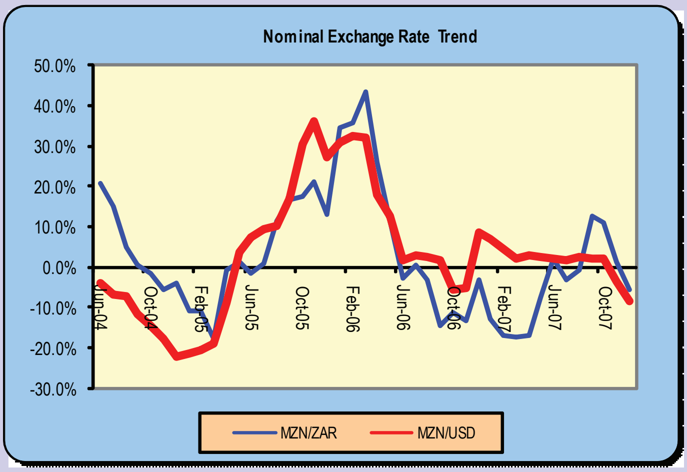


Chart 8

[12] Compiled through an algorithm established by the Governor's Notice nr 3/GGBM/2005, dated May 20.

The Metical cross exchange rate in relation to the US dollar and the latter currency in reltaion to the Rand and Euro in London market, resulted in MZN/ZAR 3.45 and MZN/Euro 34.32, in the last day of December, which equal to 5.7 per cent nominal gains in the year, in relation to the South African rand and 1.1 per cent nominal losses in relation to the Euro.

The exchange rate stability reflected the measures[13] adopted in the Foreign Exchange Market operation late 2006 and in the first half of 2007, having contributed to the increase of the market flow and reinforced confidence among its operators, as evidenced by the significant increase of the volume and frequency of foreign currency transactions among commercial banks.

As regards to the spread - the differential between the valuing exchange rates and the IFEM quotations – witnessed a decreasing trend, as it moved from 0.9 per cent in December 2006 to 0.7 per cent in December 2007. However, the parallel market exchange rates and the valuing rates showed a mixed behaviour during the year, as the spread among them stood at 2.9 per cent, after 1.4 per cent in 2006.

3.3.3. Money Supply

The stock of the M3 aggregate – comprised of banknotes and coins of the Metical outside the banking system and deposits of residents in national and foreign currency within the national banking system, excluding those of the Government and monetary institutions – stood at MZN 67,121 million late December 2007, which corresponds to MZN 13,538 million on increase of (25.3 per cent). Detailed analysis of the M3 components shows that there was a great increase of deposits (+MZN 11,740 million) given the increase of the banknotes and coins in circulation (NCC) by MZN 1,798 million, as shown in table 15.

Table 15 : Trend of Total Means of Payment (10^6 MMZ)

	Dec-06	Dec-07	Annual Change	
			Nominal	
NCC	7,152.0	8,950.4	1,798.3	25,1
Deposits in NC	27,622.3	33,786.7	6,164.4	22,3
M2	34,774.3	42.737.1	7,962.7	22,9
Deposits in FC	18,809.0	24,384.2	5,575.2	29,6
FC – USD	7,24.3	1,023.3	299,0	41,3
M3	53,583.0	67,121.3	13,537.9	25,3
Exchange Rate Impact	1,296.4	-1,.557.0		
M3 without Exchange Rate Impact	52,286.9	69,311.0		
Deposits FC as percentage of the M3	35,1	36,3		

Total Deposits

	Stock- MZN million		Structure		Annual Change	
	Dec-06	Dec-07	Dec-06	Dec-07	Nominal	
NC	**27,622**	**33,793**	**59,5%**	**58,1%**	**6,164**	**22,3**
Companies	12,452	14,404	26,8%	24,8%	1,952	15,7
Others	15,170	19,389	32,7%	33,3%	4,212	27,8
FC	**18,809**	**24,384**	**40,5%**	**41,9%**	**5.575**	**29,6**
Companies	11,301	15,359	24,3%	26,4%	4.058	35,9
Others	7,508	9,025	16,2%	15,5%	1.518	20,2
	31,238	**36,888**	**67,3%**	**63,4%**	**5.650**	**18,1**
Companies	16,734	19,642	36,0%	33,8%	2.908	17,4
Others	14,504	17,246	31,2%	29,6%	2.742	18,9
	15,194	**21,283**	**32,7%**	**36,6%**	**6.089**	**40,1**
Companies	7,020	10,116	15,1%	17,4%	3.096	44,1
Others	8,174	11,167	17,6%	19,2%	2.993	36,6

[13] Adoption of the new regulation on the Foreign Exchange Market in mid December 2006 and the removal of bands in exchange rate quotations in June/07

From the table above, the following can be observed:

- Increased deposits in National Currency (NCC) by about MZN 6,164 million (+ 22.3 per cent), of which MZN 4,212 million in individual bank accounts. However, its weight in the M3 decreased by 1.2pp to 50.3 per cent;

- Increased deposits in Foreign Currency (FC) by MZN 5,575 million (USD 299 million), of which MZN 4,058 million in company´s bank accounts; and

- Increased weight of time deposits in the total deposits, moving from about 33 per cent late 2006 to 37 per cent in December 2007.

The main sources of monetary expansion in the year under analysis were the following:

- Government liquidity allocation through cheque clearing operations and electronic transfer system (STF-acronym in Portuguese) in the amount of MZN 13,535.4 million, in the context of budgetary execution.

- Net external financing to the private sector, excluding mega projects, in the amount of USD 188 million; disbursements in favour of government institutions amounting to USD 67.1 million, operations that contributed to the increase of deposits denominated in foreign currency. In turn, the mega projects received foreign funding in the amount of USD 858.5 million, having reimbursed in the same period USD 1,052.5 million (USD 958.8 million in capital and USD 100.7 million in interests).

- Increased domestic credit to the economy by MZN 4,197 million.

As a result of the Metical appreciation[14] in relation to the US dollar by 8.3 per cent in the year, the exchange rate impact on the M3 annual change was negative by MZN 1,557.0 million. Excluding the exchange rate impact, the M3 expands by 28.7 per cent.

3.3.4. Private Sector Indebtedness

At the Domestic Market

The stock of credit to the economy in the last day of 2007 stood at MZN 31,611 million, which represents a MZN 4,197 million annual increase (15.3 per cent). This change represents a 13,9pp slowdown in comparison with that observed in 2006.

14 Based on the valuing exchange rate used in the compilation of monetary account for the conversion of values in USD to meticais.

Table 16: Behaviour of Credit to the Economy

	Stock in 10^6MMZ		Change	
	Dec-06	Dec-07	Nominal	
National Currency	18,657	23,159	4,502	24
Foreign Currency	8,757	8,452	-305	-3.5
FC – USD	337	355	18	5.2
Exchange Rate Impact	604	-759		
CE w/ Exchange Rate Impact	27,414	31,611	4,197	15.3
Recoveries	4,264	4,687	424	9.9
Total w/ recoveries	31,678	36,298	4,691	14.6

Creditors

	Stock in MZN		As % of the Total		Change		
	Dec-06	Dec-07	Dec-06	Dec-07	Nominal		do Total
Total	**27,414**	**31,611**	**100**	**100**	**4,197**	**15.3**	**100.0**
Companies	20,630	23,097	75.3	73.1	2.467	12.0	58.8
Others	6,784	8,514	24.7	26.9	1.730	25.5	41.2
NC	**18,656**	**23,159**	**68.1**	**73.3**	**4,503**	**24.1**	**107.3**
Companies	13,693	16,387	49,9	51,8	2694	19,7	64,2
Others	4,963	6,772	18,1	21,4	1809	36,5	43,1
FC	**8,757**	**8,452**	**31,9**	**26,7**	**-305**	**-3,5**	**-7,3**
Companies	6,936	6,710	25,3	21,2	-226	-3,3	-5,4
Others	1,821	1,742	6,6	5,5	-79	-4,3	-1,9

The expansion of credit to the economy was determined by the component granted in meticais that has increased by MZN 4,503 million, against the reduction of credit in foreign currency by 305 million (3,5 per cent), which prompted the increased weight in the overall component in national currency by 5.3pp to 73.3 per cent.

The credit flow granted in 2007, both in national and foreign currencies was mainly addressed to companies, which, as a whole, received funds amounting to 2,467 million (58,8 per cent of the total flow).

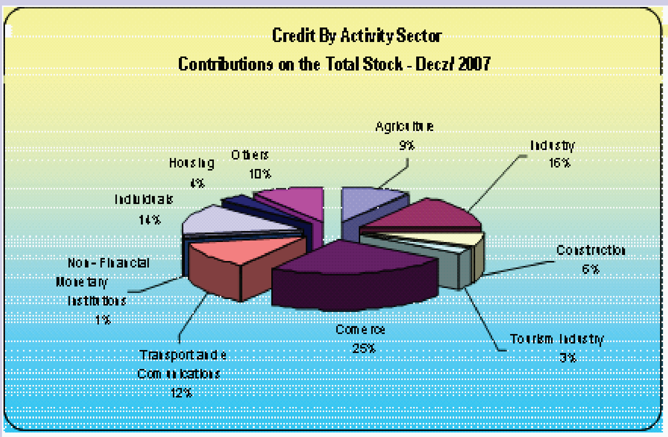


Chart 9

The distribution of credit flow by sectors of activity, reveals that the trade sector absorbed the major credit volume, about MZN 7,293 million, followed by the industrial sector with MZN 4,826 million, individuals with an amount of MZN 4,291 million and transport with MZN 3,634 million, as it can be seen from chart 9.

At the External Market

In addition to funding from the national banking system, available information pointed out that the resident economic agents, particularly the companies, resorted to external indebtedness, and the net amount, excluding mega projects, peaked to USD 188 million (MZN 4,486 million), which corresponds to a USD 147 million increase (MZN 3,507 million) in relation to the amount recorded in December 2006.

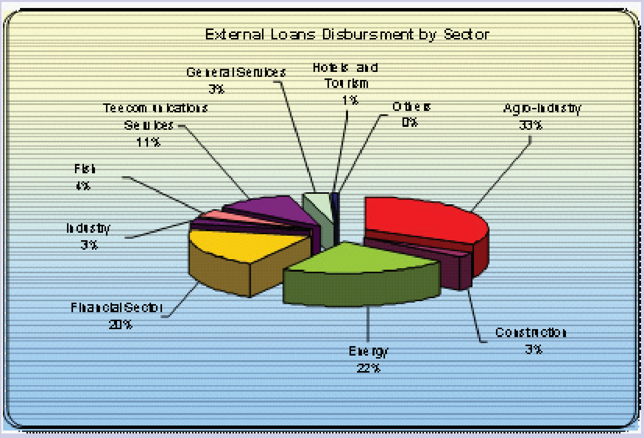


Chart 10

In global terms, the above mentioned net indebtedness, resulted from the contraction of new loans in the amount of USD 256 million (MZN 6,112 million) against the reimbursement of USD 68 million (MZN 1,626 million) in the year,, of which USD 42 million in capital and USD 26 million in interests. In respect of new disbursements, the major beneficiaries were the agriculture sector with USD 84 million (33 per cent), energy with USD 58 million (22 per cent), financial services with USD 52 million (20 per cent), transport and telecommunications with USD 28 million (11 per cent).

The mega projects made net payments amounting to USD 194 million (MZN 4,624 million), which correspond to about 64 per cent growth, against the amount recorded in December 2006, taking into account that they benefitted of foreign funding in the amount of USD 859 million (MZN 20,458 million) and repaid USD 1,053 million (MZN 25,082 million), of which USD 952 million in capital and the remainder (USD 101 million) in interests.

Aggregating the domestic and foreign credit, the private sector indebtedness flow (excluding mega projects) stood, in December 2007, at MZN 7.966 million, against about MZN 6,734 million, recorded in the similar period of 2006, that is, 18.3 per cent increase. In the same line, the mega projects made net reimbursements to the tune of MZN 8,549 million, equivalent to 63 per cent growth, against that observed in 2006.

3.3.5. Retail Interest Rates

The nominal loan and deposit interest rates applied by commercial banks in operations with their clients have witnessed a rising trend throughout the first half of the year, and by contrast they recorded successive falls from August, which culminated with lower average interest rates than those observed in December 2006.

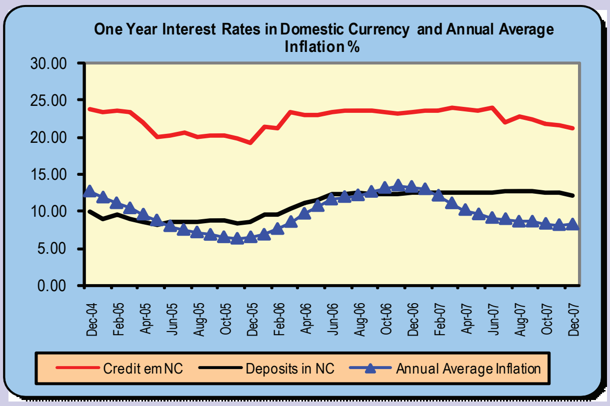


Chart 11

In fact, the nominal average interest rate of loans in national currency for 1 year maturity period reduced by 200bp in the year to 21.18 per cent in December 2007, the lowest since October 2005. In the same period, the return average interest rate for one year period deposits in national currency evolved in the same direction, having reduced by 41bp to a 11.96 per cent average, in December 2007.

The *prime rate* observed equal behaviour, as it decreased from 20.28 per cent in December 2006 to 18.85 per cent in December 2007. The trend of nominal interest rates in the second half of the year prompted the *spread* between the loan and deposit interest rates, which had risen from 10.88 per cent in December 2006 to 11.49 per cent in June, to reduce to 9.22 per cent in December 2007, standing for the first time at a single digit level.

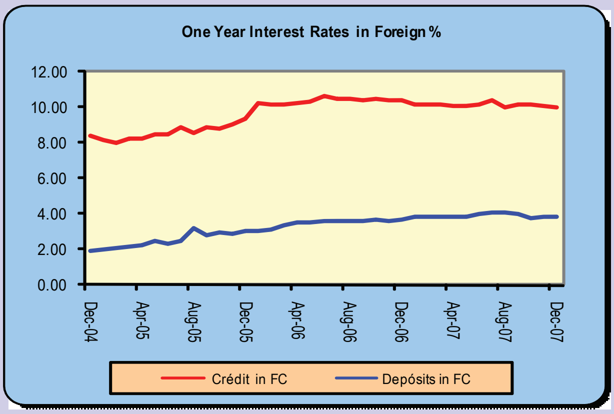


Chart 12

In real terms, the average interest rates for loans remained positive throughout the year, however, in annual terms, it recorded a 305bp increase to 13.02 per cent in December 2007, due to the fall of inflation rate. The real interest rate for deposits was negative in December 2006 and January 2007, and by contrast, it showed an increasing trend from February, having reached 3.8 per cent in December 2007, after 0.88 per cent recorded in the similar period of 2006.

As regards to foreign currency operations, the nominal average interest rate for one year maturity period loans fell from 10.15 per cent in December 2006 to 9.97 per cent in December 2007, while that for deposits rose by 195bp to 3.85 per cent in December 2007.

The effective interest rate – the weighted average interest rates of several maturity periods effectively applied in loan and deposit operations - recorded a mixed behaviour throughout 2007. However, comparing the year end rates – December 2006 to December 2007 - the trend is similar to that observed in nominal interest rates. The effective interest rate for credit operations reduced from 21.99 per cent in December 2006 to 19.64 per cent in December of the year in analysis, whilst that for deposits, that appeared to be rigid , decreased by 71bp to 11.21 per cent.

3.4. Developments in the National Financial System

The national financial system has been recording a remarkable growth in the last few years, particularly with respect to the number of institutions, as well as in the diversification of financial products provided. Nevertheless, the increased number of institutions was not being followed by an expansion of services to the rural areas, as proved by greater concentration of services in the main urban areas, particularly in Maputo city. This situation forced the Banco de Moçambique to launch in January 2007, in coordination with the Government, a strategy aimed at expanding financial services to the areas with less banking services, in order to contribute in the promotion of national savings and local investments.

3.4.1. Deepening the Banking Services in the Economy

The results achieved until the end of 2007 showed that the financial operators responded positively to the authorities' innitiative, as the number of bank branches rose from 228 in 2006 to 275 in 2007, whose details are as follows:

- Increase of the number of districts served by the banking network from 28 in 2006 to 33 in December 2007, about 25.8 per cent of the total districts existing in the country (128);

- Each bank branch covers 2.565 km² in average, against 3.506 km² in December 2006;

- The ratio of the average number of people covered by each bank branch reduced from about 90 thousand in December 2006, to nearly 74 thousand people by branch;

- A slight reduction of the banking service concentration in Maputo city, from 45.2 per cent in 2006 to 44.9 per cent in 2007, which means an addition of 20 branches in Maputo city, from a total of 47 new branches authorized to operate in the country.

The following table shows the geographical distribution of the financial institutions and the network of bank branches

Table 17 : Distribution of Financial Institutions and Network of Bank Branches

Provinces	Branches		Credit Unions.		Microcredit Inst.		Microfinance	
	Dec-06	Dec-07	Dec-06	Dec-07	Dec-06	Dec-07	Dec-06	Dec-07
Maputo City	103	123	6	6	34	43	1	1
Maputo Province	18	26	3	3	10	10		
Gaza	14	15	1	1	1	1		
Inhambane	13	16	0	0	1	1		
Sofala	22	26	0	0	0	1		
Manica	12	14	0	0	1	1		
Tete	8	11	1	1	0	1		
Zambezia	10	10	0	0	0	1		
Nampula	17	22	0	0	0	2		
Cabo Delgado	7	8	0	0	10	10		
Niassa	4	4	0	0	0	0		
Total	**228**	**275**	**11**	**11**	**57**	**71**	**1**	**1**

The number of micro-credit institutions increased by 14, to 71 by the end of 2007, as new institutions were authorized to operate in Maputo city and Province (9), Sofala (1), Tete (1), Zambezia (1) and Nampula (2) provinces.

In relation to bank branches, the 47 new branches opened in the period, are distributed, as follows: Maputo city (20), Maputo province (8), Nampula (5), Sofala (4), Inhambane (3) Tete (3), Manica (2), Cabo Delgado (1) and Gaza (1).

3.4.2. Solvency, Non-Performing Loan and Qualification of Institutions

The growth of financial sector is being accompanied by a greater soundness of the national financial institutions, with the main indicators improving and revealing encouraging prospective. The level of capitalisation of the institutions has been increasing, now standing at a satisfactory position.

In fact, the ratio of non-performing loan has been reducing from time to time, having stood at 2.62 per cent, in December 2007, after 10 per cent in 2003, while the solvency ratio rose to 15.54 per cent in 2007, against the benchmark of 8 per cent, according to Basel I Principles

Table 18: Risk Profile of Credit Institutions and Financial Corporations

Degree of Risk	Number of Credit Institutions		Number of Credit Institutions ()		As Percentage of total assets of the system		Credit Institutions and Financial Corporations
	2006	2007	2006	2007	2006	2007	2007
I	3	1	16.7	5.88	3.0	0.65	Microfinance Bank - 1
II	10	13	55.5	76.47	92.0	98.82	Commercial Banks -8, Microfinance Banks- 2; and Credit Unions - 3
III	3	1	16.7	5.88	5.0	0.02	Credit Union – 1
IV	2	2	11.1	11.76	0.1	0.52	Commercial Bank-1, Leasing Company – 1
Total	**18**	**17[15]**	**100**	**100**	**100**	**100**	

Regarding the permanent monitoring, the Banco deMoçambique uses the CAMEL *(Capital Adequance, Asset Quality, Management, Earnings and Liquidity)* as the financial sector performance assessment tool since 2006. Table 18 summarizes the classification of credit institutions, reported to the IV quarter of 2007, where the following is observed:

[15] The reduction of the number of Credit Institutions derived from the merger by incorporation of the BCI-Leasing by the BCI-Fomento.

- Greater number of credit institutions remained at degree of risk I and II (low risk), with 99.6 per cent of the total assets of the system.

- The nature, dimension and level of institutions with a high risk profile (degree of risk III and IV) recorded in 2007 do not represent a matter of concern, in the sense of generating a general harmful constraint to the system, considering that this group of institutions represent a residual percentage of total assets (0.54 per cent).

Box 5: Reforms undertaken in the Financial sector and within the Payments System

- Approval of the Governor's Notice nr. 3/GBM/2007, dated February 28, which establishes the obligation of all financial institutions to have an internal regulation that lists clearly the documents of identification required to customers and stated in the article 8 of the Decree nr. 37/2004, of September 8, with the content updated by the Decree nr. 1/2006, of February 28. Besides that, the notice in reference establishes that the financial institutions may state in their regulations other means of identification of clients, such as:

o Those accepted under bank practices and uses, namely, the personal knowledge and a guarantee subscribed by witnesses;

o The Identification Card of the Refuge Petitioner issued by the Ministry of Foreign Affairs and Cooperation (MINEC-acronym in Portuguese);

o The Declaration of Identification of the Refuge Petitioner issued by the National Institute for Refugee Support (INAR-acronym in Portuguese).

- With the purpose of harmonizing the accounting system of the credit institutions and financial corporations withthe International Financial Reporting Standards (IFRS), in the context of increased internacionalization of financial activities, the Banco deMoçambique published the folowing Notices:

- Governor's Notice nr. 4/GBM/2007, which establishes general rules governing the accounting regime of institutions under supervision of the Banco de Moçambique;

- Governor's Notice nr. 5/GBM/2007, which accommodates the rules for determining the credit institutions and financial corporations own funds to the international standards on the matter;

- Governor's Notice nr. 6/GBM/2007, which establishes the prudential ratios and limits and the necessary adjustments for the case of financial institutions that do not produce their financial statements according to the IFRS.

- Governor's Notice nr. 7/GBM/2007, which requires the financial institutions to calculate the minimum regulatory provisions and the necessary adjustments for the case of financial institutions that do not produce their financial statements in accordance with the IFRS;

- Governor's Notice nr. 8/GBM/2007, which determines the situations in which credit institutions and financial corporations are subject to consolidated based supervision adjusted by the Banco de Moçambique and establishes the rules regarding the consolidation of accounts and the calculation of own funds in consolidated basis; and,

- Governor's Notice nr. 9/GBM/2007, which defines the concepts of conglomerate entities and connected lending and the conditions for granting connected lending to conglomerate entities, according to the International Accounting Standard (IAS 24), complementing the Norms of Conduct established in the Law nr. 15/99, of November 1.

- In line with the strategy regarding the expansion of financial services to rural areas, the Banco de Moçambique published, besides the Governor's Notice nr.2/GGBM/2007, of February 28 (See box nr.4), the Governor's Notice nr. 10/GBM/2007, dated May 25, which establishes the special regime aplicable to banks and microfinance institutions intending to expand their activities to rural areas, through the establishemnet of branches or other forms of representation. The Notice in reference foresees that the aforementioned institutions have the incentive of including, in the calculation of mandatory reserves , among eligible assets, the stock of cash held by the branch operating in the rural areas. Additionally, for the microfinance institutions, the total resources obtained via resident or non resident loans are excluded from the base of incidence for the purpose of compulsory reserves constitution. Furthermore, the Notice establishes other incentives and benefits, the access to which require a special request, under the terms of the applicable law, such that the requests to be submitted to the Banco de Moçambique should have a detailed list of investments in fixed assets to be undertaken in the branch or representation object of the request. Moreover, the requesting institution may address other requests prescribed in other legal instruments namely, those of fiscal or customs nature, being the responsibility of the Banco de Moçambique to pursue proceedings at the competent entities.

- Entry into force, on March 4, 2007, of the agreement signed on December 5, 2006 between the Banco de Moçambique and VISA International through which the Banco de Moçambique shall act as the Settlement Agent of all national transactions within VISA International network. With this agreement, VISA Internacional is no longer the Settlement Agent of national transactions within this network, as the Banco de Moçambique thereon shall provide the settlement services of all transactions performed in the country with Visa network cards issued by local banks, process that shall foster foreign currency savings for the country.

- The adoption in September 2007, of the requirement regarding the use of the Bank Identification Number (NIB-acronym in Portuguese), a code that exempts banks from checking the beneficiary's name, thus avoiding returns generated by discrepancies between the account number and the beneficiary.

- Reinforcement of the presence of the Banco de Moçambique throughout the country through the establishment of its branches in Tete, Pemba and Lichinga, during the year 2007, thus extending its network to eight provinces of the country.

Front View of Quelimane Branch

3.4.3. Means of Payment Alternative to Cash

The means of payment alternative to cash in Mozmbique generally consist of the following: (a) electronic cheque clearing and money transfers; and (b) electronic banking, comprised of ATM (Automated Teller Machines) and POS (Point of Sale). Both the ATM and the POS use debit and credit cards.

Table 19: Evolution of the Means of Payment Alternative to Cash

	2006	2007	As percentage of the total Dec/2006	As percentage of the Total Dec/2007
1. Electronic Cheque Clearing				
Volume				
Value (MZN milliom)	1.423.661	4,003.570	80,7	97,4
Money Transfers	88.420,13	136.054,00	68,2	73,5
Volume				
Value (MZN million)	341.445	105.412	19,3	2,6
	40.682,05	49,065,00	31,8	26,5
2. Electronic Banking				
Number of networks	5	5		
Number of ATM's	382	431		
Number of POS	3.248	3.645		
2.1. Transactions Performed				
ATM-Debit Card				
Volume	20.810.310	25.222.386	97,3	97,4
Value (MZN million)	20.788	27.468	91,4	84,9
ATM-Credit Card				
Volume	586.437	664.806	2,7	2,6
Value (MZN million)	1.950	4.896	8,6	15,1
POS-Debit Card				
Volume	1.320.901	1.843.536	68,2	71,1
Value (MZN million)	1.723	2.418	55,4	57,1
POS-Credit Card				
Volume	616.896	750.888	31,8	28,9
Value (MZN million)	1.388	1.816	44,6	42,9
2.2. Cash Transfer				
Volume	1.159.427	1.151.687		
Value (MZN million)	4.242	2.860		
2.3. Volume of cards operating as:				
Debit cards	**935.680**	**1.072.071**	**100,0**	**100,0**
Ofwhich Visa	889.054	1.021.763	95,0	95,3
Credit cards		936.716		
Of which Visa	46.626	50.308	5,0	4,7
	46.626	50.308		
2.4. Visa NNSS Clearing(MZN million)				
		339		
2.5. Direct Debits (MZN million)		7.038		
Nr. of people with bank accounts	767.832	1.038.489		
Number of bank accounts	1.004.730	1.237.548	100,0	100,0
In National Currency (NC)	958.848	1.161.840	95,4	93,9
In Foreign Currency (FC)	42.882	75.708	4,6	6,1
STF				
Volume	**102.231**	**134.266**		
Debit				
Credit				
Value (MZN million)	**39.622**	**48.578**		
Debit				
Credit				

Source: Currency Issuing and Payment Systems Department (DEP-acronym in Portuguese)

During 2007, the trend of these instruments was characterized by increased volume of operations, as well as, the amounts traded by users of the banking system. The information on table 19 , shows the following:

- In comparison with December 2006, the volume and the total number of used cheques has risen by 181.2 per cent and 53.9 per cent, respectively, whereas the volume of money transfers have decreased by 69.1 per cent, and the transferred amount has increased by 20.6 per cent. The evolution of transactions using cheques reflects their greater acceptance among the public.
- The number of ATM´s installed and in operation have increased by 12.8 per cent, to a total of 431 units. In the same period, the number of POS has increased by 12.2 per cent, to a total of 3.645 units throughout the country;
- The volume of electronic cards issued domestically has increased by 14.6 per cent, to a total of 1,072,000 cards, of which 95 per cent are debit cards and the remainder are credit cards;
- In net terms, the number of individual bank accounts has increased by 23.2 per cent, in 2007, corresponding to 232,818 new bank accounts (87 per cent in NC and 13 per cent in FC) to a total of 1,237,548, of which 95.4 per cent in NC and only 4.6 in FC; and,
- MZN 29,886 million were traded in 27.1 million operations performed in the POS and ATM using debit cards, which equals to an average amount of MZN 1,104 per operation, against an average of MZN 1,017 in 2006. The average amount per operation using credit cards was MZN 4,741, in the total of 1.4 million operations performed in the year.

Another aspect worth highlighting is the clearing of transactions amounting to about MZN 339 million, in line with the agreement with VISA International that empowers the BM to process domestically the settlement of funds deriving from operations performed using cards within VISA International network.These operations enabled the country to save of about USD 13.9 million.

Box 6: Fundamental Aspects of the Law on the National Payments System

The Law on the National Payments System was approved by the Parliament on the fourth quarter of 2008 and, it resulted from the need to regulate the mozambican payment systems and fulfill the legal gap that existed in the field, associated with the fact that there are financial risks in the banking system. Actually, the Law nr. 01/92, of January 3, Organic Act of the Banco de Moçambique, appear to be not clear enough to safeguard legal matters pertaining to the creation of a secure and efficient Payment Systems.

The law safeguards the following: (i) ensure legal support for the introduction of the funds transfer system in real time; (ii) establish the principle of purpose, unconditionality and irrevocability in the process of settlement when the funds are made available at the final beneficiary account; (iii) determine that the documents and electronic archives have full legal value and probate force in a situation where the majority of transactions are performed electronically, but with no legal instrument to regulate such operations; (iv) introduce the principle of multilateral clearing; and, (v) Assign to the BM the role of a supervisor of the National Payments System.

With the approval of the Law on the National Payments System, the financial system shall thereon benefit of a secure and reliable mechanism of payment settlement, through the funds transfer system in real time. It is an effective system in payment risk management, which consists of increasind efficiency and reducing/minimizing credit, liquidity and systemic1 risks.

The supervision of the National Payments System aims at ensuring the compliance with the norms that regulate the payment systems through evaluation, monitoring and induction of changes, whenever necessary.

In addition and within the project for the modernization of SADC payment systems began in June 1996, it is expected that until the end of the first half of 2008, the implementation of the Real Time Gross Settlement (RTGS) system takes place. This project aimed at supporting the SADC member countries individually in the implementation of a secure, efficient payment system, accepted internationally and capable of inter-linking with other payment systems in the region, in order to ensure the accomplishment of trans-border transactions in a free trade environment.

Liquidity Risk – is the one that occurs when the counter-party does not comply with the financial obligations on time or date agreed, but satisfies them in a later date or time; Credit Risk – the counterparty does not comply with the financial obligations on the date and/or time agreed and neither in a later date or time;

Systemic Risk – is the one that occurs due to the lack of payment bya participant debtor in the payment system who, due to the non-compliance of the first, leads to the impossibility of compliance of other participants by contagion effect.

3.5. External Sector

In 2007, the performance of the external sector of the Mozambican economy was marked by the following events:

ß The Executive Board of the IMF, in its meeting held on July 18, 2007, approved the new three year program for Mozambique denominated Policy Support Instrument (PSI), in substitution of the Poverty Reduction Growth Facility (PRGF), that ended in June 2007;

ß The Romenian Government has decided to cancel 90% of the total external debt (USD 126.8 million) held by Mozambique;

ß Completion of the process regarding the reversion of Cahora Bassa Hydroelectric (HCB-acronym in Portuguese) plant to the Mozambican Government, which had a strong impact on the capital and financial accounts of the country, given the magnitude of amounts involved; and

ß Unfavourable evolution of the terms of trade, which resulted in the price rise of imported goods, against a reduction of the majority of international prices of national exporting goods.

3.5.1. Net Interntional Reserves

The stock of Net International Reserves of the Banco de Moçambique had amounted to USD 1,508 million on December 31, 2007, representing a constitution of USD 277 million in relation to the stock recorded in 2006. This amount equals to 5 months of imports coverage of goods and non-factor services, by gross international reserves, against 4.4 months covered in December 2006. Excluding mega projects, the gross international reserves covered 6.4 months of imports of goods and non-factor services.

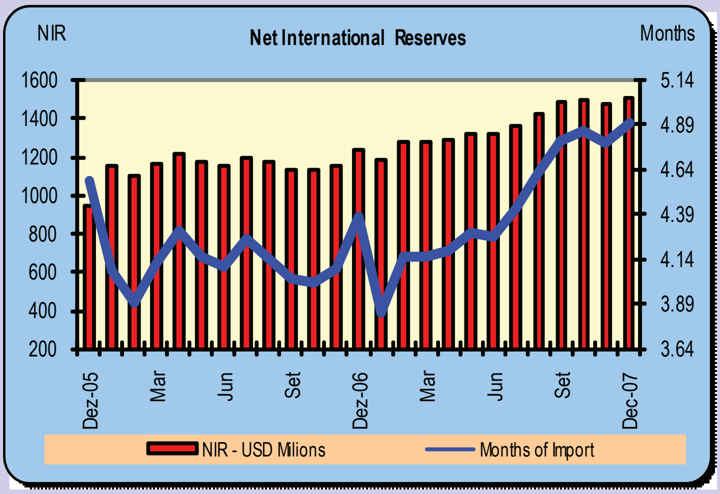


Chart 13

Among several factors that contributed to the constitution of the NIR´s, it is worth highlighting the following:

Inflows

- Disbursements of foreign support to finance the Government Budget and support the Balance of Payments in the amount of USD 412.5 million (of which USD 312.1 million in grants), an increase by USD 59 million in relation to that recorded in 2006.
- Miners' income transfers amounting to USD 60.8 million, representing an increase by USD 7.1 million compared to 2006 fiscal year.
- Net incomes deriving from application abroad amounting to USD 82.9 million, representing an increase by 42 per cent (USD 24.5 million) in comparison with the amount recorded in 2006.
- Several inflows of foreign currency to the Treasury Accounts addressed to investment projects, in a total amount of USD 211.6 million, USD 4.7 million less than that recorded in 2006.
- Purchase of foreign currency from IDA amounting to USD 54.5 million.
- Several inflows amounting to USD 28.0 million.

Outflows

- Net sale of foreign currency in the Interbank Foreign Exchange Market equivalent to USD 408.1 million.
- Payment of interests and external debt capital repayment in the amount of USD 47.6 million.
- Several payments on behalf of the Government amounting to USD 85.5 million.
- Net transfers performed by Credit Institutions to their correspondents banks abroad amounting to USD 22.7 million.
- Several operations amounting to USD 31.3 million.

3.5.2. Real Effective Exhange Rate Index

The Real Effective Exchange Rate Index (REERI), calculated on the basis of a basket comprising three currencies of the main trading partners of the country, assessed in accordance whith their relative weight, namely the ZAR with 54.5 per cent, the EURO with 39.9 per cent and the USD with with 6.4 per cent, showed, in terms of twelve-month moving average, a real effective appreciation of 3.2 per cent in 2007, after real gains of 1.2 per cent recorded in 2006.

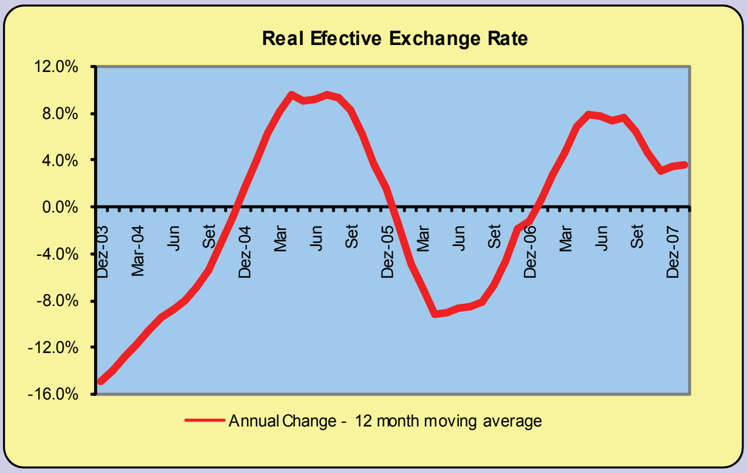


Chart 14

The behaviour of the REERI on the year reflected simmultaneously (i) the Metical nominal effective appreciation by 0.5 per cent in comparison with the basket of currencies of the main trading partners, basically determined by the Metical nominal gains in relation to the US dollar and ZAR by 0.7 per cent and 5.3 per cent, respectively, offset by 8.1 per cent nominal depreciation in relation to the EURO and, (ii) the spread between the domestic inflation and that of the partners, though it has reduced in relation to 2006, was not favourable, standing at 2.5 per cent.

The reduction of spread resulted from the combined effect of the fall of average domestic inflation from 13.3 per cent to 8.2 per cent, against an increase of the partners' average inflation by 1.3pp, to 5.1 per cent, strongly influenced by the behaviour of this indicator in

South Africa, where the general level of prices rose significantly in the period under analysis, when compared with the previous year, a fact that becomes more relevant provided that it has a greater weight in the basket of currencies of the main trading partners.

3.5.3. Balance of Payments

The external position of the country measured by the stock of the current account, has deteriorated by 2.8 per cent, moving the deficit to USD 795.0 million, reflecting the increased deficit of goods partial accounts deriving from the increased imports and total exports of goods, as well as the negative trend observed in the services account by 6.7 per cent. The impact of the variations above on the current account was offset by the improvement witnessed in the income partial accounts, whose deficit has reduced in relation to that recorded in the last period by 6.7 per cent, and the increased surplus or inflows from unilteral transfers amounting to USD 91.7 million.

The structural deficit of the current account continues to reflect essentially: (i) low demand for exports in relation to imports and, (ii) non-flexible productive structure that restrain the country from trading in highly competitive international markets.

The capital account has improved by 24.1 per cent, moving its stock to USD 415.1 million, basically reflecting the increase of grants channelled to the country for investment projects, notwithstanding the reduction of disbursements from international organizations for humanitarian purposes by 51.6 per cent.

Contrary to 2006, the financial account has recorded net inflow to the tune of USD 356.4 million, in the period under analysis. Excluding mega project operations, the financial account shows a net flow of USD 637.1 million, determined by (i) the increased foreign direct investment and (ii) private loans addressed to companies not classified as mega projects; (iii) External debt relief granted to Mozambique by Romenian Government by about 90 per cent of the total debt, which contributed to the improvement of the capital account.

The financial investments in securities made by the Monetary Authority and commercial banks, as well as the amortization of private sector debt, also contributed positively to the improvement of the financial account during the year.

A. Current Account

In line with the trend observed in the last years, in 2007, the stock of the current account stood at USD 795.0 million, which represents a 2.8 per cent deterioration when compared with 2006. In terms of GDP proportion, the deficit stood at 8.6 per cent, 3pp less than that recorded in the previous year. Excluding the impact of current transfers in the form of grants to the Government, the deficit has grown in the year by 8.9 per cent, moving the stock to USD 1,387.4 million.

Excluding the impact of mega projects, the current account deficit stood at USD 1,209.0 million - 13.1 per cent of the GDP, 1pp less than that observed in 2006, corresponding to a 28.4 per cent increase in comparison with that recorded in 2006. This reduction is explained by the increased deficit of goods and services partial accounts by 22.5 per cent and 12.7 per cent, respectively, offset by improvements of 6.8 per cent and 18.3 per cent observed in the income and transfers partial accounts, respectively.

Excluding the mega projects amounts and the current transfers, the country has accrued a deficit of about USD 1,815.8 million, which represents a 24.8 per cent increase, in relation to that recorded in 2006. The table below shows the trend of the main components of the current account in the last 5 years.

Table 20. Trend of the Current Account (USD million)

	2003	2004	2005	2006	2007	Var. 06/05 (%)	Var. 07/06 (%)
Current Account	**-816,5**	**-607,4**	**-760,6**	**-773,2**	**-795,0**	**1,7**	**2,8**
Current Accounts as % of GDP	17,6%	8,9%	12,1%	11,6%	8,6%	-0.5pp	-3pp
Goods	**-604,2**	**-345,8**	**-497,1**	**-267,7**	**-399,0**	**-46,1**	**49,0**
Export	1.043,9	1.503,9	1.745,3	2.381,1	2.412,1	36,4	1,3
Import	1.648,1	1.849,7	2.242,3	2.648,8	2.811,1	18,1	6,1
Services	**-270,0**	**-275,8**	**-306,6**	**-371,8**	**-396,8**	**21,3**	**6,7**
Revenues	303,9	255,6	341,9	386,3	458,7	13,0	18,7
Expenditures	574,0	531,4	648,6	758,1	855,6	16,9	12,9
Incomes	**-165,5**	**-299,5**	**-359,8**	**-634,5**	**-591,6**	**76,3**	**-6,8**
Direct Investment	-42,1	-167,6	-284,0	-471,3	-549,5	66,0	16,6
Remunerations	30,5	46,0	40,4	50,4	49,2	24,8	-2,4
Interests	-160,7	-184,0	-131,2	-241,4	-132,8	84,0	-45,0
Others	6,8	6,1	14,8	27,9	41,4	88,5	48,4
Transfers	**223,1**	**313,8**	**402,9**	**500,7**	**592,4**	**24,3**	**18,3**

A.1.Goods Account

In the period under analysis, the external trade between the country and the rest of the world has increased by 3.8 per cent to USD 5,223.2 million, compared to 2006, determined by the rise of imports by 6.1 per cent to USD 2,811.1 million and the increase of total exports by 1.3 per cent to USD 2,412.1 million, as shown in chart 15 below. Excluding the mega projects transactions, the external trade over the year fell to USD 2,753 million, representing a 1.8 per cent increase, in comparison with 2006.

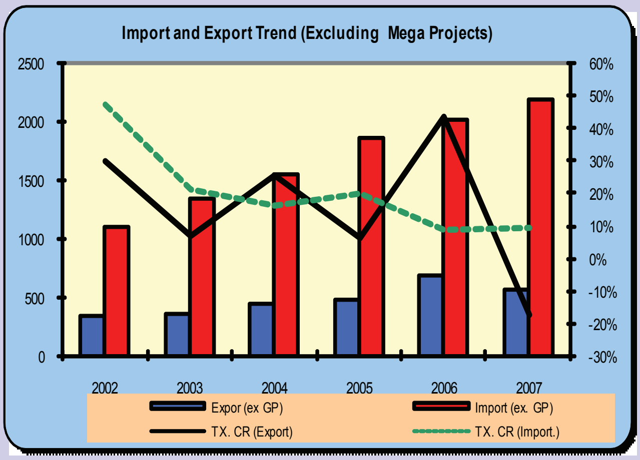


Chart 15

Chart 16 shows that the degree of disclosure of the Mozambican economy has increased during the last six years, as in 2007 it recorded 57 per cent, revealing a higher level of trade liberalization. The evidence also shows that the degree of disclosure of the economy has prompted an increase in economic growth rate.

The more significant increase of imports in relation to exports was determinant for the increased deficit of the goods partial account by 49 per cent, to USD 399 million, in comparison with the amount recorded in 2006.

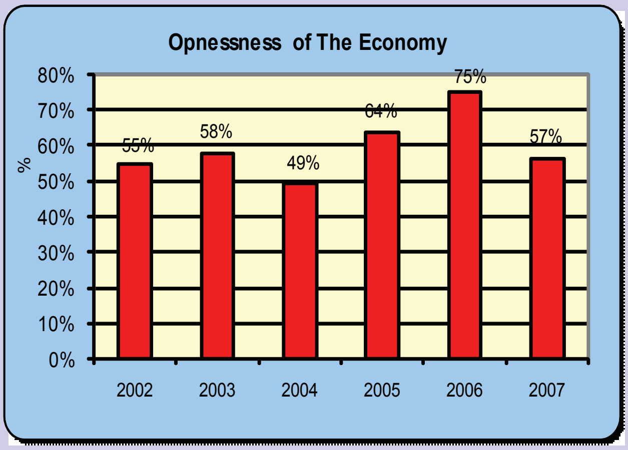


Chart 16

The growth of goods total exports by 1.3 per cent only reflected the impact of mega projects sales, whose revenues have increased by 9.2 per cent, which combined with the fall by 17.9 per cent recorded in exports revenues of the remainder economic sectors, resulted in incresed weight of mega projects exports to 76.4 per cent after 70.9 per cent recorded in 2006. As a result, the coverage rate of total imports by exports reduced by 4.1 pp to 85.8 per cent in comparison with 2006. Excluding the mega projects transactions, the coverage rate of total imports reduces to 26.0 per cent against 34.4 per cent recorded in 2006.

In general, the behaviour of exports over the year reflected the impact of several domestic and external factors namely, the decline of the average international prices of the main exporting products and the adverse climate conditions. In terms of major products, the following has been observed:

Positive Impacts:

- **Electricity:** The increase of revenues by 34.8 per cent to USD 239.7 million, as a result of the combined effect of incresed export turnover by 10.1 per cent to 11,82 million Mwh and the tariff adjustment from USD 1,7 cents per Kwh in 2006 to USD 2,0 cents per Kwh in 2007). It is worth pointing out that 74 per cent of electricity export was addressed to South Africa and the remainder to Zimbabwe.

- **Aluminium:** the revenues deriving from the sale of alluminium ingots stood at USD 1,480.2 million, 5.6 per cent greater than the amount recorded in 2006, due to the rise of sale price by 3.1 per cent.

- **Gas:** increase of sale amount by 10.1 per cent, to USD 120.7 million, as a result of increased turnover by 2.6 per cent to 100.468.934,7 GigaJoules, deriving from increased production to 104.790.155,21 GigaJoules; 2.7 per cent greater than the production of 2006, offset by the fall of the average price by 0.9 per cent.

- Iluminite: beginning of export operations of this product from one of the heavy sand projects in December 2007.

Negative Impacts:

- **Cotton:** decrease of revenues by 8.1 per cent, to USD 42.0 million, reflecting the combined effect of the fall in production by 40 per cent in 2006/07 campaign, to 72,175 tonnes, as a result of climate problems and producers demotivation owing to the delay of commercialization by some companies.

- **Prawns:** decrease of sales by 28.3 per cent to USD 62.1 million, explained by a decline of the average price by 1.4 per cent and low domestic capturing level by 5.2 per cent, due to the fact that many authorized boats could not start the fishing campaign at the beginning because of increased fuel costs and the obsolete fishing fleet.

- **Sugar:** reduction of revenues to USD 56.3 million, 21.1 per cent less than the amount recorded in 2006, determined by the decline of exports to the international market by 83.5 per cent (from 99.580 tonnes in 2006 to 16.402 tonnes in 2007), associated to the persistent declining trend of its average price. .

- **Cashew nut:** reduction of revenues by 54.6 per cent to USD 10.8 million, resulting from the fall of the average price in the internacional market (from USD 555.6 per tonne in 2006 to USD 505.7 in 2007) and exported quantities by 8.2 per cent to 24,175,75 tonnes.

- **Cashew kernel:** reduction of revenues by 31.9 per cent to USD 8.9 million, deriving from the non-operation of three cashew processing plants late 2006 due to the lack of funding to purchase unprocessed cashew.

- **Tobacco:** decrease of sales by 45.7 per cent to USD 42.5 million, due to climte problems, namely, the rain delay at the begining of the campaign and heavy rains just after germination.

- **Timber:** total revenues amounted to USD 31.9 million, 10.4 per cent less than that recorded in 2006, although the average price has increased by 7.6 per cent. The reduction of revenues derived from the fall of exports by 58.6 thousand cubic meters, 45.3 per cent less that that observed in 2006, associated to the implementation of Species Reclassification Diploma, which classifies Mondzo and Chanato as first class[16] species. The reduction of the number of single license operators due to greater control of the Forestry and Wildlife Provincial Services in assigning licences also contributed to the decline of exports.

- **Re-exports of fuels:** reduction of the amount by 9.7 per cent to USD 28.7 million, as a result of reduced demand by 12.9 per cent compared 2006, in Zimbabwe, Malawi and the Democratic Republic of Congo, which partialy derived from sharp increase in domestic price.

- **Bunkers:** reduction by 27.1 per cent to USD 20.9 million reflecting reduced demand by 18.4 per cent to 30,189.7 metric tonnes, owing to domestic price behaviour.

The exports main destination was Europe, with a weight of 66 per cent, (aluminium sales), South Africa (14.9 per cent) and other SADC countries (5.6 per cent) – Chart 15.

[16] Can not be exported in logs, it must be processed locally.

The imports in 2007 amounted to USD 2,811.1 million, representing an increase by 6.1 per cent, 12pp less than that recorded in 2006, as a result of imports made by the remainder sectors of the economy, taking into account that those of mega projects decreased in the period by 1.7 per cent, given the conclusion in the supply of machinery and aquipment.

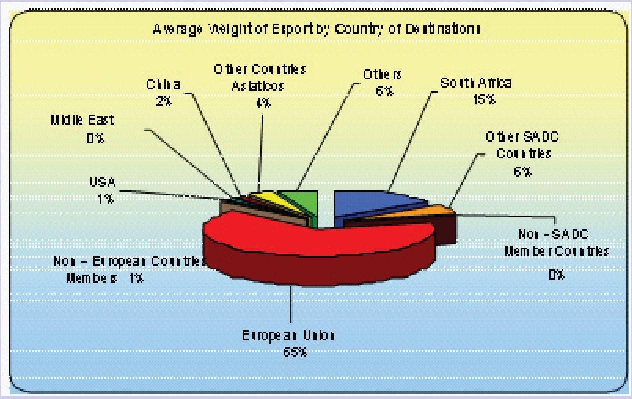


Chart 17

Therefore, excluding mega projects, the imports have amounted to USD 2,184.4 million, representing a 8.6 per cent growth, when compared to 2006. The categories of products that contributed to the increase of imports in 2007, were the following:

ß Consumption Goods: (i) The cereals, whose amount has increased by 7.8 per cent in relation to 2006, (USD 176 million), mainly due to the combined effect of increased quantities and the rise of crude oil prices in the international market and (ii) the motor vehicles with 4.1 per cent annual growth (USD 197 million), reflecting the increased demand.

ß Raw materials and intermediary Goods: (i) Fuel, with a 17.8 per cent growth compared to 2006, as it has amounted to USD 370.2 million, as a result of the combined effect of increased quantities and the rise of crude oil price in the international market and (ii) electricity (USD 107.9 million) recorded 41.8 per cent greater than that recorded in 2006, coupled with the rise of the average price by 46.5 per cent and increased quantities supplied to mega projects by 1.6 per cent, in comparison with the previous year.

ß Capital Goods: increased amount to USD 380.3 million, reflecting the purchases undertaken by the siderurgical, sugar, and transport and communicatios sectors.

The table 21 shows the trend of imports and the respective components during the last 5 years.

Table 21. Trend of Goods Imports (USD million)

	2003	2004	2005	2006	2007	Var (%) 06/05	Var (%)07/06
Goods Total Import	**1.648,1**	**1.849,7**	**2.242,3**	**2.648,8**	**2.811,1**	**18,1**	**6,1**
Other Sectors	1.341,5	1.556,8	1.858,0	2.011,5	2.184,3	8,3	8,6
Main Consumption Goods	245,9	285,0	328,7	393,7	422,1	19,8	7,2
Cereals	115,2	131,4	156,9	163,2	176,0	4,0	7,8
Sugar	8,7	17,8	9,0	4,3	1,1	-51,7	-74,2
Beer	1,9	1,3	1,8	1,2	1,4	-32,8	13,8
Medicines	17,0	27,3	24,3	35,7	46,6	46,6	30,5
Motor Vehicles	103,1	107,3	136,6	189,2	197,0	38,5	4,1
Others	632,8	727,7	906,6	865,8	903,8	-4,5	4,4
Main Raw materialsand Intermediategoods	204,1	266,9	309,5	390,5	478,1	26,2	22,4
Fuel	159,7	198,3	237,0	314,4	370,2	32,7	17,8
Electric Power	44,3	68,6	72,5	76,1	107,9	4,9	41,8
Main Capital Goods	258,8	277,2	313,2	361,5	380,3	15,4	5,2
Mega Projects	306,5	292,9	384,3	637,4	626,8	65,8	-1,7

The increased growth of imports of other sectors combined with the reduction of mega projects imports was enough to reduce the weight of mega projects imports from 24.1 per cent in 2006 to 22.3 per cent % in 2007.

In respect of the origin, 40 per cent of imported goods came from South Africa, followed by the European Union with a 24 per cent weight of the total amount.

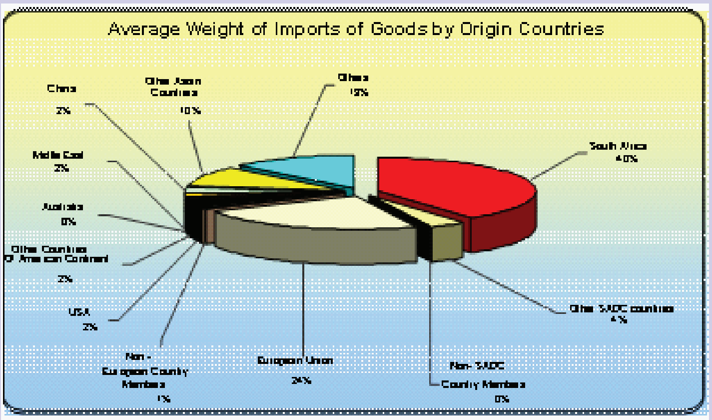


Chart 18

A.2. Services Account

In 2007 financial year, the stock of the partial services account recorded a deficit of USD 396.8 million, representing a 6.7 per cent deterioration in comparison with that recorded in the previous year, determined by the behaviour of the financial and enterpreneurial services, that have grown by USD 4.5 million and USD 99.3 million, respectively. In relation to 2006, the aforementioned growth represents a 14.6pp reduction, which resulted from the rapid increase of revenues (18.7 per cent) to a total amount of USD 458.7 million, against an increase of expenditure by 12.9 per cent (4pp less than that recorded in 2006) to a global amount of USD 855.6 million. Excluding the impact of mega projects, the services account deficit moves to USD 204.5 million, representing a 12.7% deterioration in relation to 2006.

Table 22. Trend of the Services Account (USD million)

	2003	2004	2005	2006	2007	Var (%) 06/05	Var (%) 07/06
Sevices Account	**-270.0**	**-275.8**	**-306,6**	**-371,8**	**-396,8**	**21,2**	**6,7**
Transport	-100.0	-110.7	-140,6	-168,1	-166,1	19,6	-1,2
Travel	-42.2	-38.9	-46,4	-39,8	-16,6	-14,2	-58,3
Construction	-49.1	-41.1	-56,5	-68,8	-42,9	21,7	-37,6
Others	-78.7	-85.1	-63,1	-95,0	-171,1	50,5	80,1

Moreover, the deceleration of the services partial account deficit reflected the improvements recorded in the following items:

ß **Travel:** deficit reduction by USD 23.1 million, owing to an increase of gross revenues by 17 per cent to USD 163.4 million, deriving from improvements introduced in the Tourism sector coupled with expenditure reduction by 0.3 per cent (1.5 per cent excluding mega projects).

ß **Construction:** deficit decline by USD 25.9 million compared to the figure recorded in 2006, due to the reduction of expedintures by 34.5 per cent, explained by the conclusion of constructions undertaken by mega projects. However, excluding the impact of mega projects, the stock of this item deteriorates by 84 per cent.

ß **Transport:** deficit reduction by 1.2 per cent, deriving from the increase of gross revenues by 22.4 per cent to USD 128.6 million, against the rising trend by 7.9 per cent (7.4 per cent excluding major projects) observed in the costs. The increase of gross revenue by USD 24 million was prompted by the traffic rise from the Ressano Garcia railway as well as the railway and port services in Maputo and Nacala Development Corridors. The increased expenditures resulted from: (i) increased freight costs; (ii) increased air tickets expenses and, (iii) rise of railway and port expenditures.

It is worth noting that the increased deficit of the services partial account was only determined by the trend of other services, whose deficit has worsened in relation to 2006 by USD 95 million. This situation reflected the increased deficit in financial services item by 42 per cent, to USD 15.2 million, coupled with the rise of financial intermediation costs witnessed by companies in mega projects component, as well as the transactions with international financial institutions and the enterpreneurial and technical services, whose deficit rose by USD 99.3 million.

The aforementioned stock amount derived from increased bills related to the business intermediation services (sales of goods produced in the country by the international trade intermediates)[17] and the technical assistance for financial consultancy provided by the non-residents to resident companies.

A.3. Income Account

The income partial account recorded a USD 591.6 million deficit in the period under analysis, corresponding to a 6.7 per cent improvement in relation to 2006, reflecting increased investments in securities and deposits abroad combined with the fall of private debt interests.

Excluding the impact of mega projects, the income account records a surplus, moving the stock to USD 4.5 million, against USD 46.0 million recorded in 2006, which represents

[17] Merchanting and other services related to trade.

a 90.3 per cent reduction, deriving from increased dividends transferred abroad by other Foreign Direct Investment (FDI) companies and maturity of governmental debt interests.

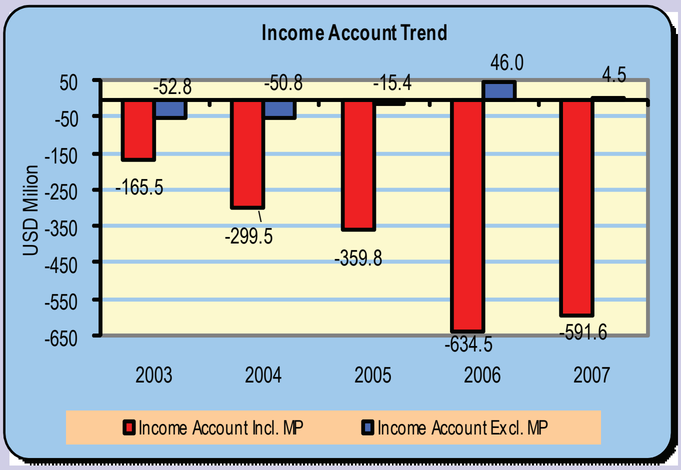


Chart 19

The items that prompted the reduction of the income account deficit were essentially the following:

ß Investment Portfolio Income that recorded a 48.7 per cent growth, to USD 41.4 million, explained by increased income deriving from commercial banks applications and mainly the monetary authority, in line with the strong constitution of its assets in debt securities abroad, which amounted to USD 77.9 million during the year, against USD 38 million recorded by commercial banks; and

ß Other investments whose deficit reduced by 45 per cent, compared to 2006, determined by interests deriving from applications abroad which have increased by 18 per cent (about USD 12 million) and by the reduction of external private debt interests by 54.2 per cent (about USD 150 million), notwithstanding the increase observed in matured Government debt interests by USD 30.3 million, to USD 84.5 million from 2006 to 2007, respectively. Excluding the effect of mega projects, the deficit has risen to USD 56.2 million, which represents USD 42.6 million greater than that recorded in 2006 financial year, basically explained by the public sector matured interests.

Contrary to the aforementioned trend, the deficit of the direct investment income has risen by 16.6 per cent, in the year under analysis, essentially explained by the payment of dividends by the FDI companies. The mega projects were responsible for USD 479.6 million, USD 114.2 million more in relation to 2006, and other FDI companies only repatriated USD 44.3 million, USD 19.2 million more as compared with 2006, of which it is worth highlighting the following sectors: (i) financial sector (USD 19.4 million); (ii) manufacturing (USD 11.5 million); and (iii) transport and communications (USD 9.3 million).

The employees income item has reduced by 2.4 per cent prompting the stock to move to USD 49.2 million, essentially determined by the appreciation of the Rand against the Metical, combined with the reduction of the number of miners by 3 per cent, when compared with 2006.

A.4. Current Transfers Account

The unilateral current transfers from abroad amounted to USD 592.4 million, representing a 18.3 per cent increase, equivalent to USD 91.7 million (6.0pp less than that recorded in 2006). The behaviour of this account was essentially determined by grants for programs and in cash, whose amount increased by USD 70.7 million and USD 21.4 million, respectively.

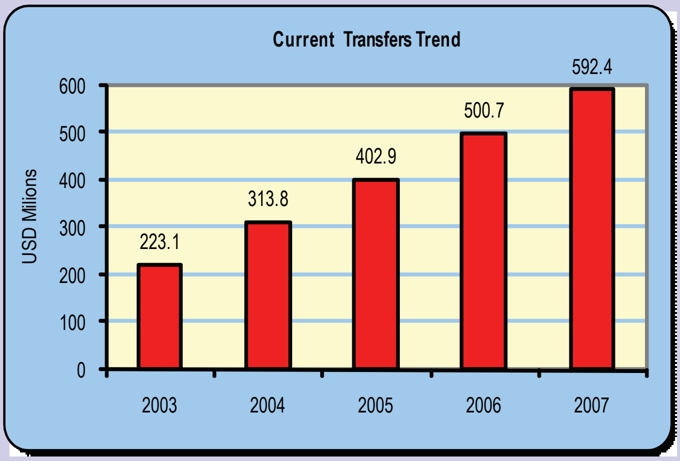


Chart 20

In sectoral terms, about 85.2 per cent of the total funds received in the year under analysis was addressed to finance Government activities, through direct support to the Government Budget in the amount of USD 505.0 million, which represent a 11.5 per cent growth, in relation to 2006.

The grants addressed to the Government Budget support are divided as follows: (i) USD 302.4 million for programs, which represents a 30.5 per cent increase, as compared to the previous year; (ii) USD 143.9 million for special programs (reduction by 13.5 per cent); (iii) USD 32.9 million for the importation of medicines (decline by 31 per cent); and, (iv) USD 28.8 million cash grants, USD 21.3 million greater than the amount of 2006.

As regards to other sectors, they received altogether funds amounting to USD 149.2 million, against the outflow of USD 61.8 million, which resulted in a net flow of USD 87.4 million prompted by cash provisioning made into the accounts of some NGOs operating in the country, in order to reinforce their financial positions in USD 82.4 million, and transfers by workers living abroad in the net amount of USD 5.0 million.

B. Capital and Financial Account

The capital and financial account recorded a net capital flow of USD 771.5 million - 8.3 per cent of the GDP – as a result of operations undertaken by mega projects and, basically, the net inflows of foreign funds pertaining to Direct Investment in Mozambique, against a net outflow of USD 1,167.2 million recorded in 2006, deriving from the public external debt relief within the MDRI (Multilateral Debt Relief Initiative) framework.

Table 23: Trend of Capital and Financial Account (USD million)

	2003	2004	2005	2006	2007	Var. 06/05	Var. 07/06
Capital and Financial Account	**643,5**	**290,2**	**282,6**	**-1.167,2**	**771,5**	-513,1%	-166,1%
Capital and Financial Account as percentage of GDP	*13,8%*	*4,3%*	*4,5%*	*-17,5%*	*8,3%*	-22pp	25.8pp
Capital Account	**270,7**	**263,1**	**187,9**	**334,5**	**415,1**	78,0%	24,1%
Public Sector	259,5	197,8	80,8	167,9	260,1	107,8%	54,9%
Grants for Investment	259,5	197,8	80,8	167,9	260,1	107,8%	54,9%
Other sectors	11,2	65,3	107,1	166,6	155,1	55,6%	-6,9%
Financial Account	**372,8**	**27,1**	**94,7**	**-1.501,7**	**356,4**	-	-123,7%
Direct Investment Abroad	0,0	0,0	0,0	-0,4	0,3	-	-184,4%
Direct Investment in the Country	336,7	244,7	107,9	153,7	427,4	42,5%	178,0%
Portfolio Investment	5,0	-25,5	-88,5	-123,8	-117,2	39,9%	-5,3%
Other Investments (Net)	31,1	-192,1	75,3	-1531,3	61,9	-	-104,0%
Financial Derivative Investments	0,0	0,0	0,0	0,0	-16,0	-	-

Excluding the mega projects operations, the above reported behaviour remains, that is, there is a move from a negative flow of USD 1215.7 million to a positive flow of USD 1,052.2 million, strongly determined by the foreign direct investment in other sectors and mainly by the substantial inflow of external funds to support the Government Budget.

B.1. Capital Account[18]

During the period under anlysis, the net flow of external capitals grew by 24.1 per cent, moving the stock to USD 415.1 million, against USD 334.5 million recorded in 2006. It is worth referring that 62.7 per cent of the net capital flow corresponds to inflows from the main partners of international cooperation to support to the Government Budget, in socio-economic infrastructures investment projects and those of international humanitarian orgnizations.

B.2. Financial Account

During the year 2007, the financial account recorded a net capital inflow of USD 356.4 million, against the capital outflows to the tune of USD 1,501.7 million observed in 2006 (explained by the public external debt relief operation mentioned above).

The inflow of funds throughout the period under analysis, corresponding to the net increase of external liabilities with the rest of the world, has basically resulted from the significant inflow as direct investment in Mozambique and as loans channelled to the Central Administration. Excluding mega project operations, which correspond to a net outflow of USD 280.7 million, the net inflow of funds have increased by USD 637.1 million, against a net outflow of USD 1,550.3 million recorded in 2006.

As to the Foreign Direct Investment in the year, the global flow amounted to USD 427.4 million, equivalent to a 178 per cent increase in relation to 2006, amount that has decreased to USD 207.2 million, representing a 207.5 per cent historical growth in comparison with that recorded in 2006, excluding the component of mega projects, which counters significantly to the trend of the last years, during which the flow of FDI was exclusively determined by inflows to mega projects.

[18] Excluding the effect of exceptional financing.

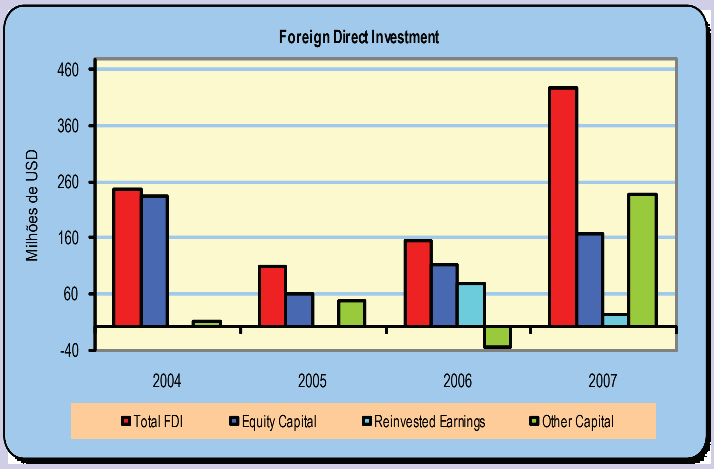


Chart 21

The total FDI recorded, in the period under analysis, inflows in the form of other capital to the tune of USD 235.9 million, against the net negative inflow of USD 35.2 million recorded in 2006. This result reflected the increased FDI of major companies in the form of supplies and loans in the global amount of USD 156.7 million, having other companies contributed with USD 79.2 million, especially the area of transports, warehousing and communications with USD 44.8 million and agriculture as well as animal production with USD 20.5 million.

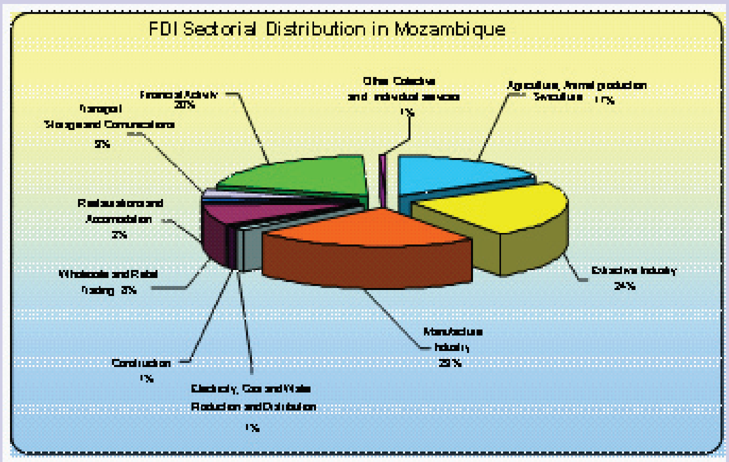


Chart 22

The shares and holdings also contributed to the capital net inflow in a total amount of USD 167.3 million, representing a 49.7 per cent growth in relation to the amount recorded in 2006 (the major projects only recorded a total of USD 39.4 million) and the reinvested profits contributed to a net inflow of USD 24.1 million, equivalent to a 68.8 per cent decrease, when compared to the amount recorded in 2006.

Regarding the beneficiary sectors, likewise the last years, the industry sector led the records again, where the mining industry recorded USD 39.3 million and the manufacturing with USD 39.1 million, followed by the financial sector with USD 33.7 million, agriculture with

USD 28.1 million, trade with USD 13.4 million, transport, warehousing and communications with USD 5.0 million, and accommodation and restaurants with USD 3.4 million.

In respect of the origin of capital invested in the country, South Africa stands in the first position for the second consecutive year with USD 176.2 million, followed by Brasil with USD 80.6 million, Switzerland with USD 45.2 million, Australia with USD 37.4 million, Mauritius with USD 29.1 million, India with USD 24.8 million and Portugal with USD 22.5 milhion. It is worth pointing out that the major change in the structure of capital was performed by Brazil that moved from the fourth position in 2006 to the second in 2007, while Mauritius fell from the second to the fifth position and the United Kingdom from the third to the eighth position.

C. Financing the Balance of Payments

In 2007, the trade and financial operations undertaken by the country with the rest of the world resulted in an overall surplus amounting to USD 56.1 million, against a deficit of USD 1,798.8 million recorded in 2006, basically determined by the capital and financial account which recorded overall net inflows that allowed the partial financing of the current account deficit.

Table 24: Balance of Payments Financing Sources (USD million)

	2003	2004	2005	2006	2007	Var 06/05 (%)	Var. 07/06 (%)
Financing Account	-17,1	183,0	181,6	1.798,8	-56,1	-	-
Reserve Assets	-181,4	-169,1	129,9	-29,4	-204,8	-	-
Gold Money	12,3	-18,6	-20,0	-11,5	-18,8	-	-
Foreign Currency	-193,8	-150,4	150,1	-17,8	-186,1	-	-
Other assets	0,1	0,0	-0,1	-0,1	0,0	0,0	-146,5
Use of the IMF Credit and Loans	9,1	-11,9	-40,4	-147,2	5,6	-	-
Exceptional Funding	155,3	363,9	92,1	1.975,4	143,1	-	-92,8
Debt Rescheduling Operartions	142,0	48,8	86,7	32,0	16,3	-63,1	-49,0
Capital	110,8	38,7	63,4	19,8	8,0	-68,8	-59,5
Interests	31,1	10,2	23,3	12,1	8,3	-48,1	-31,6
Debt Relief Operations	13,3	315,1	5,4	1.943,5	126,8	-	-93,5
Capital	13,3	274,9	3,3	1.943,4	66,2	-	-96,6
Interests	0,0	40,2	2,1	0,0	60,6	-100,0	-

The exceptional financing that amounted to USD 143.1 million in the year, 1,832.3 million less than the amount recorded in 2006 financial year, contributed to the settlement of operations above the line, being worth highlighting the contribution from Romenia through debt relief of 90 per cent of the total stock of the public external debt in the amount of EUR 108.4 million and the OCDE debt rescheduling of USD 13 million, of which USD 7.3 million from Portugal and USD 5.4 million from Japan.

Further to the financing account , there was an increase of net external liabilities with the IMF in the year under analysis, which resulted in a net disbursement of USD 5.6 million, against the use of about USD 147 million observed in 2006.

The financial operations undertaken between the country and the rest of the world allowed the constitution, through the Monetary Authority, of reserve assets amounting to USD 204.8 million to finance future imbalances of the balance of payments, against an accrual of USD 29.4 million recorded in 2006 and a shortfall of about USD 130 million in 2005.

3.5.4. External Debt

Disbursments of External Loans

In 2007, the country resorted to external savings to finance its investment programs, having the global amount of new contracted debt amounted to USD 1,437.3 million, corresponding to a 135.7 per cent increase, when compared with the flow recorded in 2006.

In fact, the increased debt basically reflected the financing operation of the process of reversion of Cahora Bassa Hydroelectric Plant to the Mozambican Government. Excluding the contracts undertaken by major companies, the total flow of external debt amounted to USD 578.8 million, which equals to a 16.7 per cent increase in comparison with the figure recorded in 2006.

Table 25: Disbursement of Foreign Loans (USD million)

	Including Mega Projects			Excluding Mega Projects		
	2006	2007	Var. (%)	2006	2007	Var. (%)
Total Disbursement	**609.9**	**1,437.3**	**135.7**	**495.8**	**578.8**	**16.7**
Central Administration	**377.0**	**322.3**	**-14.5**	**377.0**	**322.3**	**-14.5**
Disbursement for Programs	121.8	100.4	-17.6	121.8	100.4	-17.6
Disbursement for Projects	206.9	154.8	-25,2	206.9	154.8	-25.2
Disbursement tor Public Companies	48.3	67.1	39.0	48.3	67.1	39.0
Other Disbursements	0,0	0.0	-	0.0	0.0	-
Other sectors	**232.8**	**1,115.0**	**378.9**	**118.7**	**256.5**	**116.0**
Agro-Industry	61.7	84.0	36.0	61.7	84.0	36.0
Construction	2.0	7.8	-	2.0	7.8	-
Energy	15.7	57.6	-	15.7	57.6	-
Financial	0.7	52.0	-	0.7	52.0	-
Industrial	3.9	6.7	70.2	3.9	6.7	70.2
Fishery	3.1	9.9	223.9	3.1	9.9	223.9
Railway and Port services	6.8	0.0	-	6.8	0.0	-
Telecommunications Services	14.6	27.8	-	14.6	27.8	-
General Services	6.4	8.8	-	6.4	8.8	-
Tourism and hotels	1.9	1.8	-	1.9	1.8	-
Others	1.9	0.1	-	1.9	0.1	-
Mega Projects	114.1	858.5	652.3	-	-	-

In terms of indebtedness by sectors, the central administration has increased its indebtedness by 14.5 per cent (USD 83 million more) in comparison with the debt contracted in 2006, to USD 322.3 million annual flow shared by the following institutions:

- World Bank: in a total amount of USD 181.8 million (USD 87.5 million less than that recorded in2006), essencially addressed to finance Government programs (USD 69.7 million), projects for the construction and rehabilitation of roads and bridges (USD 30.3 million), Higher Education projects (USD 13.7 million) and the water development project (USD 7.9 million).

- African Development Bank (ADB): in the amount of USD 52.3 million (an increase by USD 20.3 million), allocated to finance Government programs (USD 30.7 million), project for the construction and rehabilitation of Massingir Dam (USD 6.6 million), urban sanitation project (USD 4.3 million), support project for rural financial intermediation (USD 3.6 million), and reinforcement of training programs in the education sector (USD 3.2 million).

ß The Organization of Petroleum Exporting Countries (OPEC): in the amount of USD 8.3 million (an increase by USD 6.2 million), addressed to the rehabilitation of Chokwé Irrigation Project (USD 5.0 million), Institutional Support Project to Eduardo Mondlane University (USD 1.8 million) and Roads Rehabilitation Project in Maputo (USD 1.5 million).

ß The Nordic Development Fund (NDF): USD 5.7 million (a reduction by USD 4.3 million) to finance the rehabilitation of secondary roads (USD 3.9 million), electrification project (USD 1.5 million) and, institutional capacity building project in mineral resources management (USD 1.31 million).

ß Other international financial institutions, namely, International Fund for Agricultural Development (IFAD) with USD 4.1 million (reduction by USD 5.3 million) addressed to agricultural areas and artisanal fishing and, Arabic Bank for Economic Development in Africa (ABEDA) with USD 2.9 million (reduction by USD 0.8 million) addressed to energy, roads and education.

In addition, the public companies resorted to external loans supported by the Central Administration to finance their investment projects, in the following amounts:

- World Bank (IDA) – USD 30.5 million, addressed to the rehabilittion of the railway & port sector, especially for the rehabilitation of Maputo and Beira ports and water development project.

- African Development Bank (BAD) – USD 13.4 million addressed to Water, Financial and Energy sectors in the context of urban sanitation projects, expansion of financial services to rural areas and the access to energy sources for the population in general.

- Arabic Bank for Economic Development in Africa (ABEDA) – USD 3.0 million addressed to telecommunications project;

- OPEC and Kuwait – in the amount of USD 0.9 million (reduction by about USD 2 million) addressed to electrification project in Matola Municipality.

As regards the private sector, there was also an increase of indebtedness with USD 1,115 million annual flow (USD 882.5 million more), representing a 378.9 per cent increase, in relation to the amount recorded in 2006.

About USD 858.5 million (equivalent to 77 per cent) of the global financiang to the private sector were addressed to mega projects, basically deriving from loans contracted by the Mozambican Government in the context of HCB reversion process, to settle the debt with the Portuguese Government. Therefore, excluding the HCB operation, the remainder mega projects received foreign financing in the amount of USD 117.7 million, which correspond to USD 16 million less than the amount recorded in 2006.

Amortization of External Loans

The overall matured external debt reached USD 1,311.5 million in 2007, of which 14.5 per cent held by the central administration (public sector) and 85.5 per cent by public sector. The mega projects were responsible for the reimbursement of 80.3 per cent of the overall matured private external debt.

Excluding the exceptional financing, the resources effectively transfered abroad for external debt service repayment amounted to USD 1,168.4 million, which represents USD 386.3 million increase in relation to the amount recorded in 2006. The table 26 below summarizes the amounts of matured and repaid debt in the last five years.

Table 26 : Reimbursement of Foreign Loans Capital and Interests (USD million)

	2003	2004	2005	2006	2007	Var 06/05 (%)	Var 06/05. (%)
Total reimbursement	**467.5**	**715.9**	**480.0**	**2,757.4**	**1,311.5**	**474.5**	**-52.4**
Central Administration	**205.4**	**421.5**	**159.3**	**2,036.9**	**190.7**	**1,179.0**	**-90.6**
Multilateral Institutions	34.5	40.9	50.8	45.6	35.8	-10.4	-21.5
Bilateral Institutions	15.6	16,7	16.4	16.0	11.8	-2.4	-26.0
OCDE group	10.8	11,8	10.5	9.5	10.1	-10.0	6.8
OPEC group	0.0	0,0	0.0	0.0	0.0	-	-
Eastern Countries	4.7	4,7	4.9	5.3	0.2	6.8	-95.4
Other Countries	0.1	0,2	0.9	1.3	1.5	35.2	17.6
Exceptional Financing	155.3	363.9	92.1	1,975.4	143.1	2,045.3	-92.8
Private Sector	**262.1**	**294.4**	**320.7**	**720.5**	**1,120.8**	**124.7**	**55.5**
Of which Mega Projects	148.5	218.2	206.6	642.6	1,052.5	211.1	63.8

Regarding the public sector, the amount of matured external debt service has reached USD 190.7 million, against USD 2,036.9 million recorded in 2006. However, for the public sector only USD 47.6 million were effectively paid using public resources, of which USD 35.8 million were addressed to multilateral institutions and the remainder to settle the bilateral debt service. In fact, 75 per cent (USD 143.1 million) of the public external debt service was settled resorting to exceptional financing.

The matured private external debt has increased by 55.5 per cent, to USD 1,120.8 million. This amount was fully repaid, being worth stressing that 93.9 per cent was covered by mega projects, especially the HCB.

With respect to the external debt sustainability, it is worth highlighting that provided the increased exports and the debt relief initiatives granted to Mozambiqur by the partners of international cooperation, the ratio of debt service in relation to goods exports, excluding the exceptional financing, moved from 38 per cent in 2006 to 20.4 per cent in 2007. Including mega projects, the ratio of debt service becomes worse, taking into account the increased external debt service contracted by the foreign direct investment undertakings. Moreover, the ratio of debt service in relation to exports of goods and services fell from 22 per cent in 2006 to 11.3 per cent in 2007.

Ground floor **Mural in carved marble** *Francisco Relógio*

1. INTRODUCTION

The Banco de Moçambique, among various duties, has the responsibility of controlling, monitoring and disciplining the activities of financial institutions including the stock market, in order to promote efficiency and public confidence as well as ensure the stability of the financial system. By doing so, the Banco de Moçambique is effectively performing its duties of a financial intermediary for the development of the economy.

This report summarizes the activities performed by the Banco de Moçambique in supervision of financial institutions, namely commercial banks, leasing companies, saving and credit unions, exchange bureaus, risk capital management companies, bulk purchasing corporations and partial foreign exchange operators.

The report is based on the accounting data and prudential reports submitted by the above mentioned institutions during the year 2007 and it analyses, among other aspects, the performance of the banking industry on the basis of the financial soundness indicators. The report also aims at promoting transparency and empowers the public understanding about domestic banking system, its risks and trends in order to assess the stability of the financial system.

This edition comprises five chapters. The first chapter describes the scope and the objective of the report. The second chapter makes a brief overview about the banking system, with special emphasis on its composition, geographical distribution and concentration. The third chapter focuses on the activities undertaken by the Banco de Moçambique, especially the new on-site supervision methodology as well as the new developments in the legal framework. The next chapter analyses the trends in the banking system, in terms of its assets, profitability, capital adequacy, credit risk, foreign exchange and liquidity risk. The last chapter addresses the challenges and perspectives of the banking supervision.

2. BANKING SYSTEM

2.1 General Overview

The Mozambican banking system has undergone enormous transformations deriving from developments in the legal framework, on one side, and from the increasing wave of mergers and acquisitions, on the other side.

In 2007, the banking system was marked by various events, among which it is worth highlighting the acquisition of Banco de Desenvolvimento e Comércio by FirstRand Holding Moçambique, which in turn changed its denomination and commercial brand; change in the denomination of Banco Austral to Barclays Bank; Novobanco to Procredit; ABC Leasing to African Leasing Company; União Comercial de Bancos to Mauritius Commercial Bank; merger of BCI Leasing with Banco Comercial e de Investimentos and changes in the shareholders composition of Banco Comercial e de Investimentos. All these developments changed the business philosophy and enhanced competition and financial innovation.

At the end of 2007, within the twelve banks operating in Mozambique, only one is totally held by local shareholder. The banking system also comprises one micro bank, six unions, one leasing company and eighty-three other non-banking financial institutions. Among the banks, two are doing microfinance business. During the year 2007, the Banco de Moçambique licensed two banks, three micro banks, one leasing company, one bureau of exchange and one bank cards issuer institution.

The banking business continued to be dominated by four largest banks which represented, at the end of 2007, 88.9 per cent of the total assets, 91.6 per cent of total deposits, 86.9 per cent of total loans, and 76.4 per cent of total capital of the banking system. This figures reveal that the banking system continues to showhigh levels of concentration. In the same period, the unions represented 1.22 per cent of total loans, 0.48 per cent of total deposits, 1.75 per cent of total assets and 3.0 per cent of total capital.

The number of employees in the banking system continued to rise as a result of the establishment of new branches in various provinces of the country, in order to provide better services to the customers. Notwithstanding the increase by 19.5 per cent in the number of branches, the geographical distribution remained unchanged. The districts continued to be less preferred by the majority of the institutions and most of them are still concentrated in Maputo.

Table 27: Growth and geographical distribution of branches

Provinces	2007	2006	Change
Maputo City	121	105	16
Maputo	27	18	9
Sofala	26	23	3
Nampula	22	17	5
Gaza	17	14	3
Inhambane	16	13	3
Manica	14	12	2
Tete	11	8	3
Zambézia	10	10	0
Cabo Delgado	8	7	1
Niassa	4	4	0
Total	**276**	**231**	**45**

Niassa and Zambezia provinces have not yet recorded any increase in the number of branches since 2005. Meanwhile, Gaza, Manica, Tete and Cabo Delegado provinces, which remained unchanged in 2006, recorded favourable increase in 2007.

2.2 Concentration in the Banking System

Herfindhal - Hirschman Index (HHI) and Gini Index are the most widely known indicators to measure banking concentration. Herfindhal - Hirschman Index is calculated by summing up the square of the market share of the institutions in the system. Index less than 0.10 indicates that there is no concentration; index greater than 0.10 indicates high level of concentration and index between 0.10 and 0.18 indicates reasonable concentration. On the other hand, Gini Index indicates the degree of inequality of institutions in terms of market shares. It ranges from 0-100, in which zero indicates perfect equality and 100 perfect inequality.

The banking system in Mozambique remains highly concentrated and the market shares are unequally distributed. HHI for assets recorded a slight decrease from 0.240 in December 2006 to 0.238 in December 2007. Likewise, HHI for deposits recorded a decrease over the same period (Chart 23). As for loans, HHI rose from 0.262 in December 2006 to 0.271 in December 2007.

Over the same period, the Gini Index increased from 75.61 to 76.30 index points. This trend in the concentration indexes reveals the dynamics in the banking market which is mainly dominated by the four big banks.

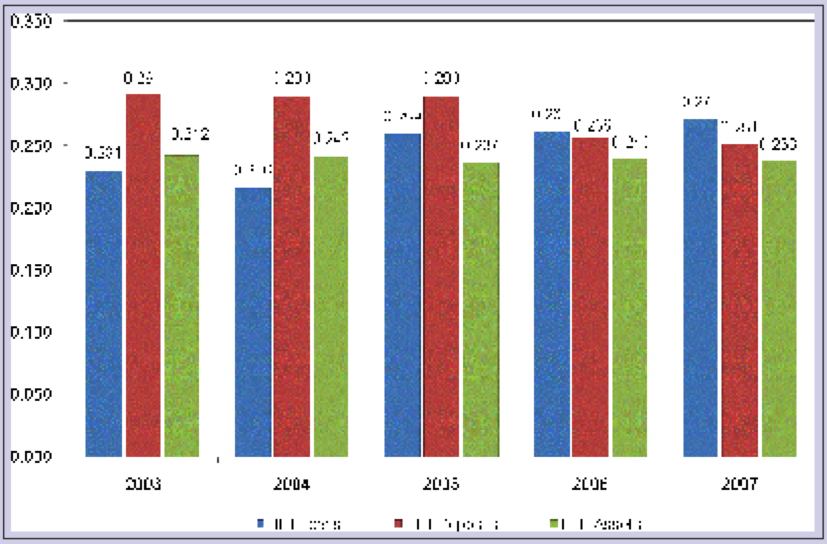


Chart 23: Herfindhal-Hischman Index for the Mozambican B anking system

3. ACTIVITIES IMPLEMENTED BY THE BANKING SUPERVISION DEPARTMENT

3.1 On-Site Supervision

3.1.1 Main Findings within Credit Institutions

The Banco de Moçambique conducted fourteen inspections, most of them applying the new method of supervision. Besides assessing the economic and financial situation and the compliance with the existing regulations, the inspections were also aimed to assess the quality of management, corporate governance, internal controls, and level of adherence to the credit policy and manual. In general, most institutions showed a stable economic and financial situation and a satisfactory risk profile. Nevertheless, some institutions revealed weaknesses in relation to corporate governance, internal audit management, information system and risk manangement.

Box 7: Inspection Process

On-site inspection is a process in which the evaluation of economic and financial situation is made through a visit to the institution. This process is, on one handin accordance with the assignment entrusted to the Banco de Moçambique in section VII of chapter IV of Law 1/92, Organic Law of the Banco de Moçambique, and on the other hand, in line with the good practices of banking supervision, particularly those issued by the Basel Committee. The Core Principle 20 (BCPs 20)*recommend that an effective system of supervision should be in both on-site and off-site supervision, as well as regular contact with the management of the bank".

However, the current environment in which the financial institutions operate has significantly affected the way they conduct their business. The developments in information technologies and communications have become a crucial factor in financial innovation and have changed not only the financial products and services, but mainly the procedures and the financial institutions risk profile. As a result, in the second quarter of 2007, the Banco de Moçambique began with the first steps towards the adoption of a new methodology of supervision, named risk based supervision).

Risk based supervision is a methodology whose emphasis is on understanding and assessing the appropriateness of risk management systems in use in banks, to identify, quantify, monitor and control risks in appropriate and timely way.

Unlike the traditional model of supervision (hitherto used by the Banco de Moçambique) which seeks to quantify the problems, identify the symptoms and limit the risks, risk based supervision seeks to assess the risk-management practices, the causes of the problems and make recommendations on options that each institution has to minimize the adverse consequences that may result from the risks taken. The institutions are treated differently in light of the risk profile and the capacity of each show for risk management.

Risk based supervision will require that you have a deep knowledge about the institution supervised and risk profile, in order to identify areas of greater risk and focus greater attention on them.

Full adoption of risk based supervision will allow, among other benefits, the following:

- Allocate resources only in areas of great risk, or in those institutions revealing greater risk profile, and whose failure could hasten systemic crises;
- Minimize the time spent on-site inspections;
- Promote greater soundness to the financial system, since the financial institutions will have to adopt appropriate risk management practices that, at least, have to be in line with the guidelines of principles and best practices for risk management to be defined by the supervision;
- Harmonize procedures and terminology, designed specifically for risk based supervision, with a view to assess the practices, policies and procedures in the context of risk management;
- Take early corrective action once identified the excessive involvement in risk activities;
- Greater interaction with the institutions, greater culture of risk management and greater value added to the institutions.

The full adoption of risk based supervision, does not necessarily imply the entire abandonment of the traditional model, because there will be cases where there will be a need for both approaches mainly in institutions with high risk profile.

* Basel Core Principles for Effective Banking Supervision is a set of principles issued by the Basel Committee on Banking Supervision, to help countries to assess its system of banking supervision and provide components for its agenda of reforms.

3.1.2 Main Findings within Financial Institutions

In 2007, the non-financial banking institutions comprised eighty-four financial institutions, thus distributed as follows: Twenty-four bureaus of exchange, of which three suspended their activities in the second half of the year, Administration and Finance Corporate for the Promotion of Small and Medium Enterprises, Risk and Capital Management Corporate, Bulk Purchasing Corporation and fifty-seven Partial Foreign Exchange Commerce Operators[19]. Most of the bureaus of exchange are concentrated in Maputo and others in Beira and Quelimane.

During the period under review, the Banco de Moçambique has conducted seventeen on-site inspections at bureaus of change, aimed at assessing the level of compliance with norms and procedures of administrative, accounting internal control and the norms established by the Banco de Moçambique.

Although there was a slight improvement on the number and size of irregularities, there are some irregularities identified in some bureau of exchange, such as:

- Non-compliance with the rules for accounting operations;
- Violations of rules and procedures on accounting and administrative internal control;
- The use of outdated rates for fixed assets amortization;
- Lack of verification and reconciliation of accounts;
- Use of accounting entries not foreseen in the accounting chart;
- Financing of activity with third party resources;
- Deficient organization of commercial documents and archives;
- Lack of records and submission of mandatory books;
- Non compliance with the 2 per cent spread limit;
- Sales above the ceiling established by law;
- Violation of the rules on “Due Diligence”;
- Use of inappropriate computer software;
- Adoption of exchange rates inappropriate to balance the market;
- Performing foreign exchange operations by non licensed operators.

[19] It involves institutions such as Hotels, Lodges, Travel Agencies, and Tourist Complexes. This institutions are not subject to prudential supervision, but only their monitoring, and production of reports on their foreign currency transactions.

3.2 Off - site Supervision

Off-site supervision is the analysis of economic and financial institutions subject to supervision, through the provision of regular information (e.g. prudential reports, balance sheet) and other sources such as reports of external auditors, media and information market. The purpose of the off-site supervision is to identify, quickly and timely, negative trends and potential problems of institutions in order to resolve them before they become so serious to the point of undermining the financial soundness of the institution.

After reviewing the information, and assessment based on CAMEL[20] factors (Capital, Assets, Management, Earnings and Liquidity), the institutions are classified in terms of risk profile. Table 2 gives the summary of the classification of banks in December 2007.

Table 28: Risk Profile of Credit Institutions and Non-Banking Financial Institutions in December 2007

Risk profile	Number and percentage of credit institutions	Percentage of total assets in the banking system	Credit I nstitutions and Non-Banking Financial institutionsCorporations
I	1 5.9% 0	.7%	1 Microfinance Bank
II 1	3 76.5%	98.8%	8 Commercial B anks; 2 Microfinance Bank and 3 Credit Unions
III	1 5.9% 0	.0%	1 Credit Union
IV 2	1 1.8% 0	.5%	1 Commercial B ank, 1 Leasing Company
Total	**17 I 00.0%**	**I00.0%**	

It is noted, however, that 76.5 per cent of the institutions (55.5 per cent in December 2006) have a low risk profile and represent the majority of the banking system institutions. For institutions which had a high risk profile in December 2006, no significant changes that could improve their classification have been recorded. Meanwhile, the weight of such institutions in the total assets of the banking system increased from 0.1 per cent in 2006 to 0.5 per cent in 2007.

3.3 Developments in the Banking Legal Framework

In order to discipline the activity of credit institutions and to align the current legal framework with international best practices, the Banco de Moçambique adopted various regulations, especially regarding to the International Financial Reporting Standards (IFRS):

- Governor´s Notice nr. 4/GBM/2007, of May 2nd[21], establishes the regulation for the Accounting Reports of Credit Institutions and Non-banking Financial Institutions, in line with the IFRS;

[20] There are four categories for each indicator. The Category I represents minor risk and the Category IV greater risk. The final classification is obtained through the weighed average of the classification obtained from several indicators.

[21] Published in Government Gazette, number 18, I Series

- Governor´s Notice nr. 5/GBM/2007, of May 2nd[22], which adjusts the rules for determining the Credit Institutions equity capital in accordance with the Governor´s Notice nr. 4/GBM/2007), of May 2nd;

- Governor´s Notice nr. 6/GBM/2007, of May 2nd[23], which regulates the ratios and prudential limits aligned with the IFRS terms;

- Governor´s Notice nr. 7/GBM/2007, of May 2nd[24], which updates the rules for the calculation of minimum provisions for Credit Institutions subject to supervision by the Banco de Moçambique based on the changes introduced by the Governor's Notice Nr. 4/GBM/2007, of May 2nd;

- Governor´s Notice nr. 8/GBM/2007, of May 2nd[25] , which introduces consolidated based supervision principle aligned with the IFRS terms;

- Governor´s Notice nr. 9/GBM/2007, of May 2nd[26] , which updates the limits of connected lending in line with the IFRS terms;

- Circular Letter nr. 1/SHC/2007, of June 12th, which informs institutions about the sources for the IFRS consultation;

- Circular Letter nr. 2/SHC/2007, of June 12th, which sets instructions on reporting the accounting information in line with IFRS terms;

- Circular Letter nr. 3/SHC/2007, of June 12th, which establishes the reporting of financial statements and other accounting reports for institution adopting the IFRS;

- Circular Letter nr. 4/SHC/2007, of June 12th,which addresses the publication of accounting reports by institutions under BM Supervision;

- Circular Letter nr. 5/SHC/2007, of June 12th , which sets procedures for reporting ratios and prudential limits for institutions adopting IFRS;

- Circular Letter nr. 6/SHC/2007, of June 12th, which addresses reporting procedures of ratios and prudential limits by institutions that produce their individual financial statements in accordance with the Governor´s Notice nr. 13/GGBM/99, about Chart of Accounts for Credit Institutions and Non-Banking Financial Institutions.

In addition, the Banco de Moçambique issued Governor's Notice nr. 3/GBM/2007, on February 28th[27], which allows the identifications of customers using other documents other than those set on Decree nr. 1/2006, of February 28th.

For the purpose of expansion of financial services to rural areas, the Banco de Moçambique approved Governor's Notice nr. 10/GBM/2007, on May 25th[28], which establishes special incentives for banks and microfinance institutions which intend to set their business in rural areas.

[22] Published in Government Gazette, number 18, I Series
[23] Ibidem
[24] Ibidem
[25] Ibidem
[26] Ibidem
[27] Published in Government Gazette, number 14, of April 4th
[28] Published in Government Gazette, number 27, of July 4th

3.4 Prevention and Combating Money Laundering

Given the transnational nature and frequent changes of the process underlying money laundering crimes and financing of terrorism, the Banco de Moçambique , under the FSTAP Project - Financial System Technical Assistance Program, has taken some steps towards the contracting of a specialized consultant who should provide, during the course of the current year, adequate technical capacity building for the banking supervision staff in order to face the challenges on the prevention and fight against illegal actions

The Banco de Moçambique has participated in multidisciplinary technical groups, which produced and submitted to the Parliament the Bill for the establishment of the Office of Financial Information and approved with number. 14/2007, of June 27th and then, the approval by The Cabinet of respective the regulation on the structure, organization and operation, which is under publication.

The Banco de Moçambique, under the activities of the multidisciplinary technical group, continued to participate in events related to money laundering, promoted by regional and international organizations.

3.5 Litigation

The litigation mainly refers to the instructions of legal proceedings against credit institutions and non-banking financial institutions breaching the normsso as to discipline their activities.

In the recent years, the number of legal proceedings instructed has declined substantially, due to the intensification of educational actions by the Banco de Moçambique and, on the other side, the awareness of the banks and non-banking financial institutions, on the need to comply with the provisions established in the regulations governing their activities.

In 2007 seven legal proceeding were instructed[29], five of which resulted in conviction and payment of fine, one on conviction with a suspended sentence and another in a reprimand.

3.6 Licensing

In 2007 there was a greater number of applications for licenses than the previous year, especially for microfinance institutions. As a matter of fact, two banks were authorized to operate, both based in Maputo city, three micro banks (one denominated "Caixa de Poupança Postal" dealing with savings, based in Lichinga, and two denominated "Caixa Financeira Rural", based in Maputo city and the district of Bárue, in Manica province, respectively), one financial leasing company, with its head-office in Maputo, one institution of credit cards issuing and management , with its head-office in Maputo and one bureau of exchange, with its head-office in Beira.

Additionally, forty-five new branches and fifteen micro-credit operators were authorized. It is worth referring that amongst the authorized new branches, seven are operating in places which had no bank representations before and one is a mobile branch focusing on microfinance segment, covering six districts, which have no credit institution representation.

[29] All legal proceedings instructed were against banks

3.7 Stock Market

The Banco de Moçambique, as the supervisor of the Securities Market, performed in 2007 a prudential and behavioural supervision of the Mozambique Stock Market (Bolsa de Valores de Moçambique) the financial intermediaries and issuers of securities, conducting a permanent monitoring of this market activity.

In view to the integration of the capital market in the region, the Banco de Moçambique has been involved in actions aimed at harmonizing the legislation, practices and procedures within the SADC countries.

The Cabinet approved the new Regulations on the Stock Exchange, through Decree Nr. 45/2007, of October 30th, in line with the modernization and improvement of the Mozambique Stock Exchange operation.

During the period under review, likewise 2006, the volume of transactions decreased significantly, from MZN 141.6 million to MZN 84 million. Unlike the trend observed in 2006, when the public debt quoted in the stock marked recorded a relative weight (80.2 per cent of total value traded in the period) in the overall stock capitalization, in 2007 it has dropped drastically from MZN 113.5 million to MZN 26 million. Whereas the private debt observed an opposite trend, as it increased by about 70 per cent when compared to the previous year.

Transactions within the Official Listing Market

Market	Traded Amount		Traded Amount (MZN Million)	
	2006	**2007**	**2006**	**2007**
Public Debt	1.135.255	295	113.520	26
Private Debt	429.056	828.197	27.190	82.167
Shareholder	53.926	53.200	910	1.807
Total	**1.618.237**	**881.692**	**141.620**	**84.000**

Source: Mozambique Stock Exchange (BVM) Listing Bulletin number 1092

The table above shows that the total volume of transactions has decreased to about a half of the value traded in the previous year, though the overall market capitalization recorded an insignificant change, as it moved from MZN 7,533 million in 2006 to MZN 7,245 million at the end of 2007, which means that investors still preferto keep their bills portfolio until its maturity.

However, the market activity continued to be dominated by bond trading, whereby there was a rise in the shareholder's market, as theCDM shares doubled, from MZN 910 million in 2006, to MZN 1807 million at the end of 2007.
Likewise the previous years, in 2007 there were some transactions outside the stock exchange market, and interest coupons of the securities admitted for listing were paid on time.

In the primary market, only oneoperation was recorded pertaining to the issuance of " Standard Bank Bonds", through a private subscription, representing a market capitalization amounting to MZN 260 million.

The Banco de Moçambique as a member of CISNA (Committee of Insurance, Securities and Non-Banking Financial Authorities) continued to participate in activities pertaining to this Committee aiming at promoting the harmonization of capital market in the region.

The prospects for 2008 point out to the enhancement of the cooperation with the counterparts institutions, aimed at improving the market examination and supervision techniques and training of the staff engaged in supervision of the securities market.

3.8 Credit Registration Centre

Credit Registration Centre (CRC – Central de Registo de Crédito) is a database stores information on credit operations provided by credit institutions. Currently, the CRC database stores information pertaining to operations of customers with responsibilities to become due, overdue, and yet the amounts granted by credit institutions to their customers through a letter of credit agreement.

The CRC is a tool used by the banking supervision to monitor the credit portfolio of financial institutions. Therefore, it plays an important role in ensuring the stability of the national financial system and in the prevention of crises, providing more facilities to debtors and greater transparency to the society. These data are shared with participating institutions, contributing to the reduction of bad debts and improve the credit risk management.

The number of customers recorded in the CRC has grown considerably, as it rose from 99.292 in December 2006 to 141.197 in December 2007 (Chart 24). Most of those customers belong to one of the four largest banks and one of the Microfinance Bank which, together represent 65.5 per cent of the customers recorded at the CRC.

The database consultations for various purposes, also recorded a sharp increase from 62.501 in December 2006 to 671.578 in December 2007[30], representing an increase of 974.5 per cent. This variation derives from the introduction in 2006 by one of the four largest banks of a new consumer credit product, less bureaucratic than the traditional one, which requires more rigorous analysis of credit risk. Since then, the number of consultations of the database has grown so rapidly, representing the largest number of applications for this product. The number of requests for information from the CRC is an indicative sign not only at the level of each bank credit activity, but especially the rigorous selection of new borrowers.

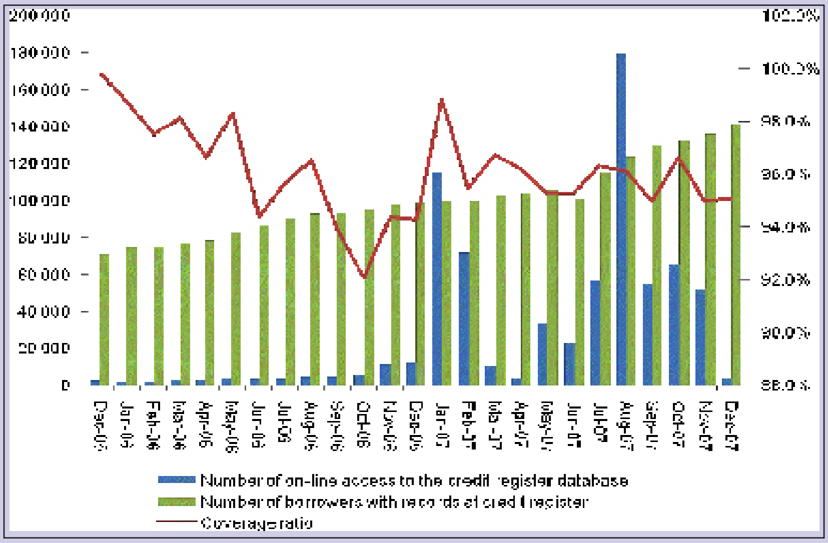


Chart 24: Indicators on the use of CRC database

[30] Coverage ratio within CRC refers to the relation between the credit reported to the CRC and that recorded in the balance sheet

During the period under review, the average ratio of coverage stood at 95.9 per cent, which means an increase by 0.13 percentage points in relation to the previous year. There are however, institutions that report to the CRC amounts lower than the balance sheet and others, higher amounts. In the case of institutions that report lower amounts, differences arise partly from difficulties in the registration of customers instead of Identity Cards "stubs" that are not accepted by the CRC software. To those which report higher amounts, the differences related to deficiencies in processing of information between the credit directions, accounts and transactions with the foreign country. Notwithstanding the above aspects, the information of the CRC and disseminated by the banking system, has an acceptable margin of error since the level of coverage is significant.

3.9 Training

To ensure the development of skills and knowledge of the banking supervision staff, the department continued to participate in various courses, workshops inside and outside the country such as the following:

- Work visit to Banco Central do Brasil, aimat gaining experiences in supervisory activities;
- Intermediate Banking Supervision Course organized by MEFMI (Macroeconomic Financial Management Institute of Eastern and Southern Africa) and held in Arusha, Tanzania;
- International Accounting & Auditing for Banks, organized by Financial Stability Institute and held in Basel, Switzerland.
- Integrating Off-Site and On-Site Banking Supervision, organized by African Development Bank in association with International Monetary Fund, held in Tunis – Tunisia;
- Global Trade Finance Operations, organized by International Chamber of Commerce, Johannesburg, South Africa;
- Regional Workshop on Financial Analysis, Statistical Analysis & Reporting for Supervisors, Kampala, Uganda;
- Advanced MS-Excel and Access Database, organized by GTZ, Maputo, Mozambique;
- Managing & Measuring Operational Risk organized by Euro Money Training, Tanzania;
- Course on Market Risk, organized by Financial Stability Institute/ International Organization of Securities and Commissions, Barcelona, Spain;
- Anti Money Laundering Course, organized by South African Reserve Bank;
- Workshop on AML & CFT, Financial Crime Awareness & Prevention Training Workshop, organized by Downtown Hill
- Operational Risk Management for Financial Institutions;
- Conference on Next Generation Microfinance: Gaining Scale and Reducing Costs with technology and Credit Scoring, organized by International Finance Corporation (IFC), and Consultive Group to Assist The Poor (CGPAP), in association with Visa International, Washington D.C;

- Regional Workshop on Supervision of Non Banks Financial Institutions (NBFI), organized by Macroeconomic & Financial Management institute of Eastern and Southern Africa (MEFMI), Harare –Zimbabwe.

The *FSI Connect* continued to play very important role as a learning tool on issues such as risk based supervision, new capital accord (Basel II), corporate governance, risk management (e.g. credit, liquidity, operational and market) and internal auditing duties. The tool is updated whenever is a development on supervisory issues and it covers more than 135 tutorials which allows the users to make self-assessment of the studied tutorials.

4. PERFORMANCE OF THE BANKING SYSTEM

4.1 Balance Sheet Structure

4.1.1 Assets

For the year 2007, the banking activity in aggregated basis, evaluated in terms of total assets, continued to record considerable growth, increasing by 20.3 per cent when compared to 2006 (chart 25). This growth was largely due to the growing of the following: the rise of interbank assets by 47.8 per cent (representing MZN 6.036.179 thousands); the growth of securities portfolio by 33.4 per cent (representing MZN 4.110.311 thousands ; and lending activities by 15,4 per cent (representing MZN 4.058.905 thousands).

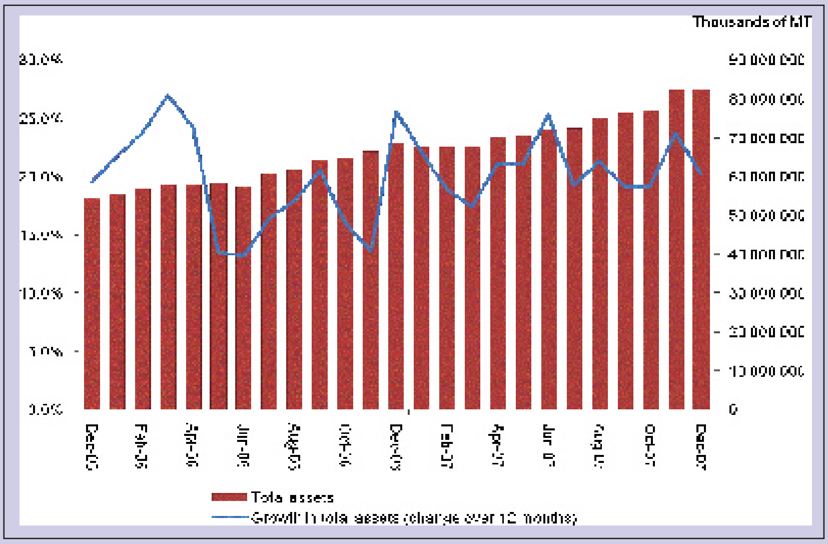


Chart 25: Growth in assets

Despite its considerable growth, the credit portfolio as a percentage of total assets did not record any significant changes. In December 2007, the contribution of credit portfolio in total assets decreased by 1.6 percentage points when compared to December 2006 (chart 26). This reduction resulted from the sharp increase in interbank assets.

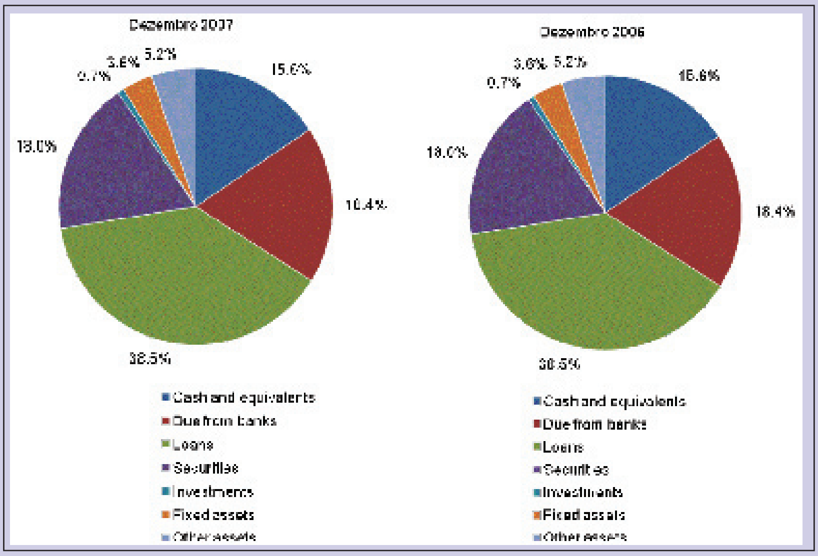


Chart 26: Composition of Assets

The weight of loans in foreign currency as a percentage of total portfolio and total assets continued to decrease, following the trend started in June 2005 (chart 27). As shown in chart 5, since April 2006, loans in local currency represent bigger share in total portfolio. This change in the trend was largely due to the Governor´s Notice nr. 5/GGBM/2005, of May 20th, which obliges the banks to make special provisions when granting loans in foreign currency to non-exporter borrowers.

Investment in securities portfolio amounted to MZN 16,413,.360 thousands , which represent an increase by 33.4 per cent in relation to December 2006. This was mainly due to the increase in amount of government securities (treasury bills and treasury bonds) which represented 98.7 per cent of total security portfolio. As a result, the contribution of securities in the aggregated balance sheet of the banking system increased 1.9 percentage points, when compared to 18.0 per cent recorded in December 2006. The investment in government securities continued to be more preferred by some banks since they have law risk, which in turn leads to law risk weight and capital requirements, and also due to their attractive interest rates.

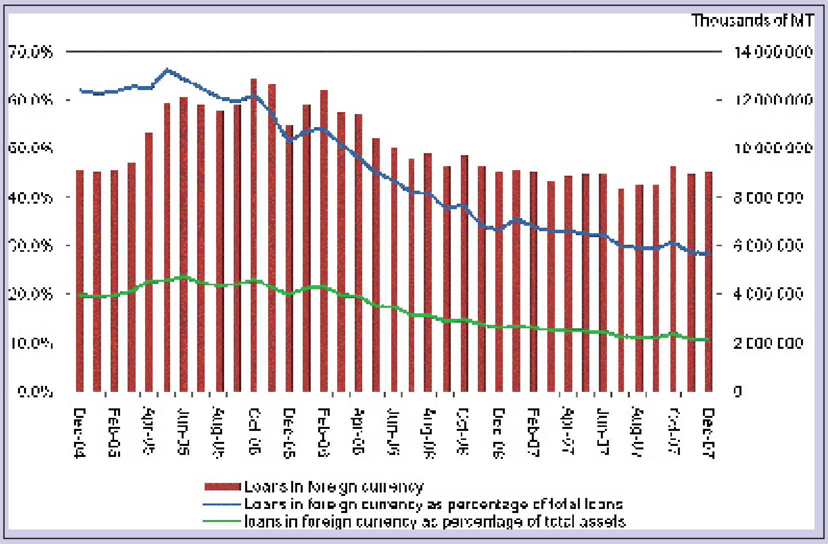


Chart 27: Growth in loans in foreign currency

Due from banks are one of the most dynamic balance sheet items, with an increase of 47.8 per cent, from December 2006 to December 2007, amounting to MZN 18,663,285 thousands. This trend increased the contribution of interbank assets in the balance from 17.2 per cent in December 2006 to 22.7 per cent in December of 2007. Most of these interbank assets (94.7 per cent) is time deposits in foreign credit institutions representing 73.9 per cent, amounting of MZN 13,711,899 thousands . At the end of December 2007, the time deposits foreign credit institutions kept it growth trend as of the previous years, by increasing 65.1 per cent when compared to December 2006.

4.1.2 Liabilities

In 2007, the total liabilities increased 19.8 per cent, as compared to 2006, amounting to MZN 72,116,826 thousands . As in the previous years, this growth was sustained by increased deposits, which in turn increased its contribution in the total liabilities from 77.0 per cent in December 2006 to 81.1 per cent in December 2007, amounting to MZN 58,473,098 thousands (Chart 28).

Contrary to what was recorded in the previous year, the growth of deposits was mainly determined by the growth of time deposits to an amount of 6,429,505 MZN thousands (+56.0 per cent than December of 2006). Even thought, the demand deposits continued to represent greater share in the deposits structure (chart 28).

The amount of other funds decreased 1.1 per cent in 2007. This was mainly attributed to the decrease in the amount of creditors liabilities by MZN 200,633 thousands (-40, 5 per cent), in the amount of liabilities backed by certificates, namely certificates of deposits and bonds, by MZN 121,298 thousands (-23.7 per cent) and other funds by MZN 122,.979 thousands (-1. 7 per cent). The repo operations and consigned funds represented 61.6 per cent of other funds.

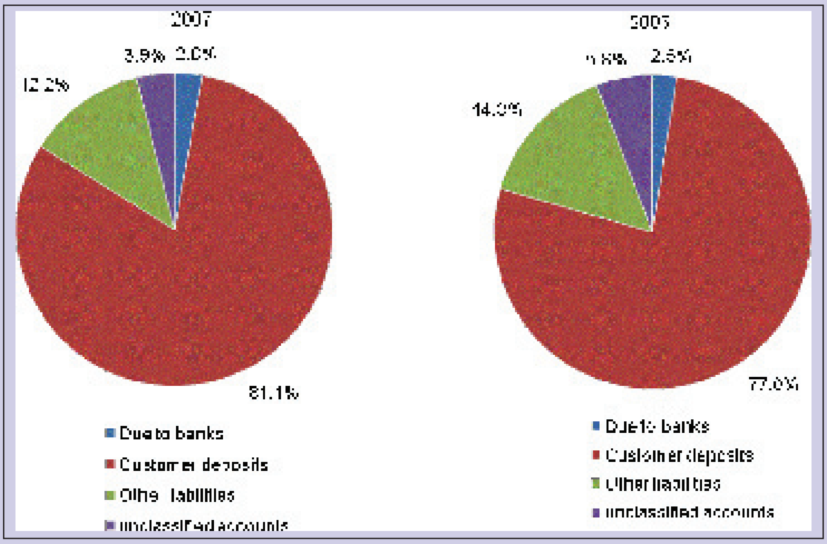


Chart 28: Liabilities

Capital and reserves grew by 29.1 per cent when compared to December 2006, and maintained the increasing trend recorded in the previous years. This growth was largely influenced by the increase in the amount of legal reserves and from the balance of the other reserves.

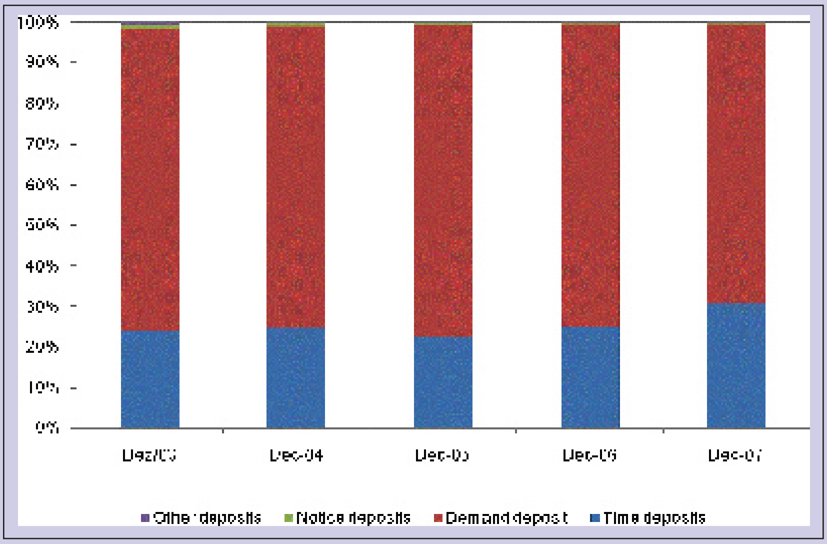


Chart 29: Structure of Deposits

4.2 Capital Adequacy

Capital adequacy ratio establishes the link between the banking institutions capital and its risk weighted assets. It is an indicator that measures the ability of a banking institution to meet its current liabilities and absorb losses arising from their assets. The main objective of this requirement is to provide stable funds to the banking institutions, in order to cover any loss which may incur as result of their activity.

According to the principles of the Basel Committee on Banking Supervision and the regulation in force in Mozambique, the banking institutions are required to maintain at all time, a minimum capital adequacy ratio of 8.0 per cent.

During the year under review, the banking system continued to present high level of capital. The capital adequacy ratio for the group of the institutions under analyses, increased 1.7 percentage points, standing at 14.2 per cent, which is well above the minimum requirement (chart 30). The growth is attributed to the greater increase in capital (36.2 per cent) than in the risk weighted assets (20.1 per cent). The *Tier 1* ratio[31] recorded an improvement of 1.4 percentage points, standing at 12.1 per cent in December 2007.

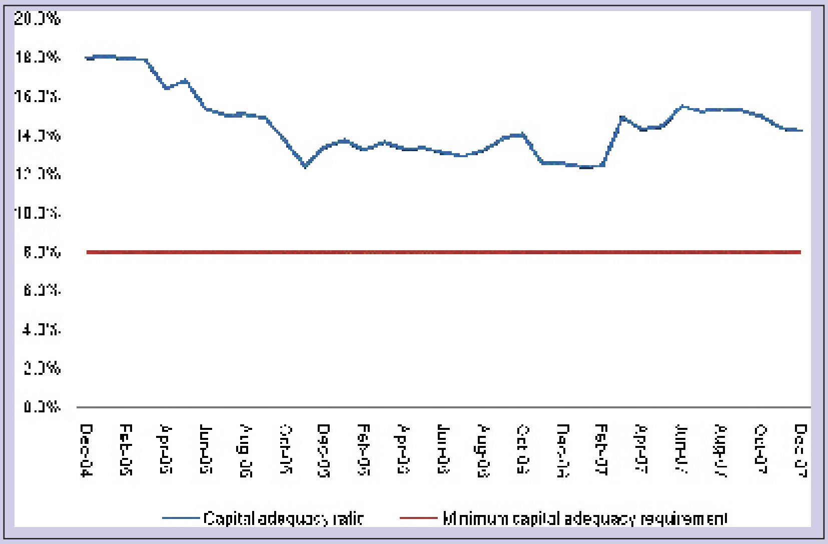


Chart 30: Capital adequacy ratio

The increase in total capital from MZN 4,347,459 thousands in 2006 to MZN 5,922,540 thousands in 2007, was largely due to: increase by MZN 1,327,886 thousands (+35.7 per cent when compared to December 2006) in *Tier I* components; increase by MZN 243,165 thousands (+36, 1 per cent when compared to December 2006) in supplementary capital and the decrease by MZN 3,962 thousands (-9.1 per cent than December of 2006) in the amount of deductions.

[31] The Tier I is a measure of capital in restricted sense, as defined in the Governor's Notice nr. 05/GGBM/2007 of May 2nd.

The rise in *Tier 1* capital was due to the following: increase in paid-up capital by MZN 107,061 thousands (+4.0 per cent compared to December 2006); increase in the legal, statutory and other reserves made up of retained profits by MZN 1,314,821 thousands (+113.2 per cent compared to December 2006) and the decrease of losses of the previous financial year by MZN 122,996 thousands (-87.8 per cent compared to 2006). Meanwhile the changes in supplementary capital (*Tier II*) were a result of the increase of subordinated debt with foreign financial institutions. The decrease in amount of deductions arises from the decrease of the amount of investment in equity of other institutions under supervision.

The distribution of banking institutions in terms of capital adequacy ratio reveals that as at the end of December 2007, there were 11.8 per cent (11.1 per cent as at the and December 2006) of institutions in the banking system - which corresponds to two institutions - did not meet the minimum required capital adequacy ratio of 8.0 per cent, while 44.0 per cent (29.4 per cent as at the end of December 2006) of institution presented capital adequacy ratio above 25.0 per cent (Chart 31).

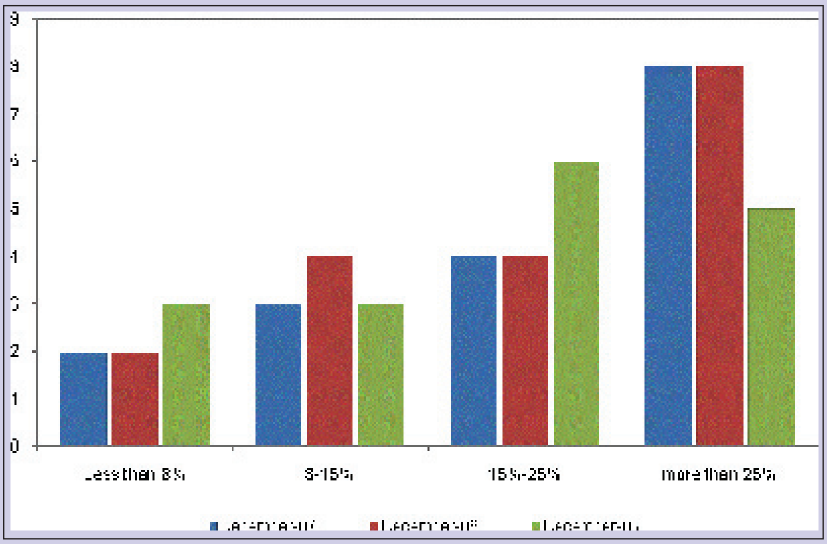


Chart 31: Distribution of banking institutions in terms of capital adequacy ratio

Chart 32 shows the distribution of banking institutions capital adequacy ratio as portion of total asset. The banking institutions with capital adequacy ratio above 25.0 per cent (47.1 per cent of the institutions) represented 6.7 per cent of the aggregated total asset of the banking system. The banking institutions with capital adequacy ratio between 8.0 per cent and 15.0 per cent (17.6 per cent of the institutions) represented 80.0 per cent of the total assets of banking system, while the banking institutions with capital adequacy ratio less than 8.0 per cent (11.8 per cent of the institutions) represented only 0.6 per cent of the total asset of the banking system (Chart 32).

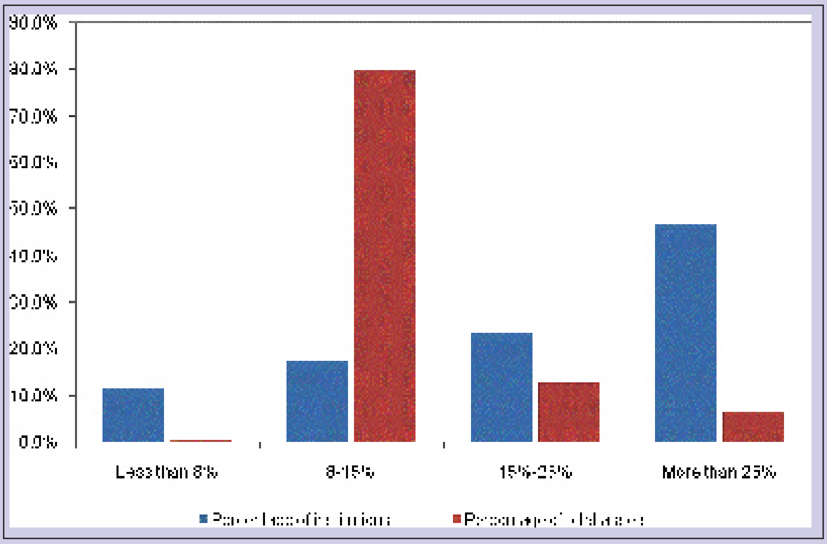


Chart 32: Capital adequacy ratio (sector distribution)

In the overall, the banking system has remained strong since most of the institutions are well capitalized. The growth of capital adequacy ratio inverted the trend of the previous years since February 2007. Moreover, the increased capital adequacy ratio has strengthened the ability of the banking system to absorb significant losses in the balance sheet and income.

4.3 Profitability

While in 2006, the net income increased by 154.5 per cent in relation to 2005, in 2007 the growth was only by 15.8 per cent, amounting to MZN 2,789,131 thousands (Chart 33).

The reduction of net income was strongly influenced by the moderate growth of financial margin by 27. 2 per cent in December 2007 (67.4 per cent in December 2006), combined with the weak performance of profits in financial operations, which decreased by 2.3 per cent in the same period.

Notwithstanding the reduction on the growth of financial margin, which may be associated to the narrowing of the spread between the credit and deposit interest rates (Chart 34), the relative weight of the gross income rose from 67.4 per cent in December 2006, to 70.2 per cent in December 2007.

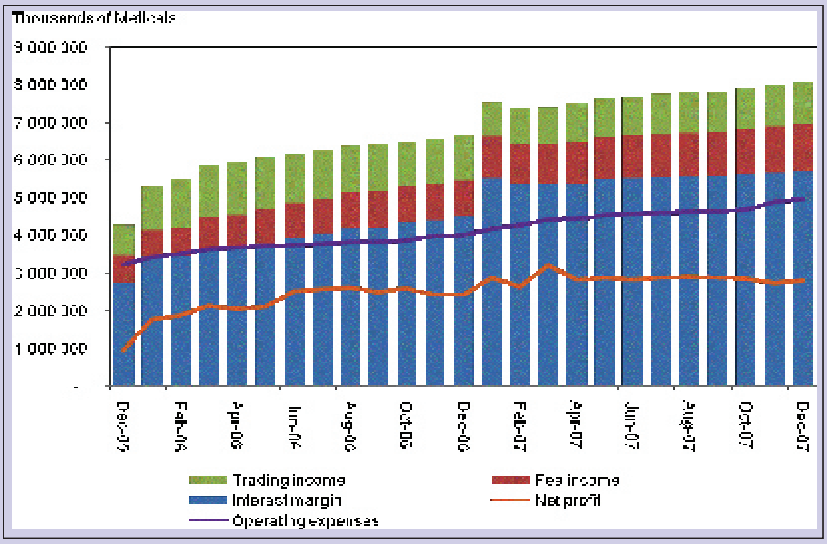


Chart 33: Composition of Income statement

In the structure of interest income, the credit interests represent 63.2 per cent (62.5 per cent in December 2006), followed by bond interests, 23.9 per cent (25.4 per cent in December 2006), applications in credit institutions 11.3 per cent (10.8 per cent in December 2006) and the remainder interest income result from several assets items.

The net commissions increased by 26.0 per cent in relation to MZN 987.220 thousands recorded in December 2006. This growth resulted in its increased weight in the gross income from 14.8 per cent to 15.3 per cent, in line with the increasing importance that this kind of profits have deserved in the profitability of institutions. It is worth highlighting the positive performance of the bank charges directly related with traditional banking services, such as annuity of debit and credit cards, money transfers and off balance sheet (letter of credit).

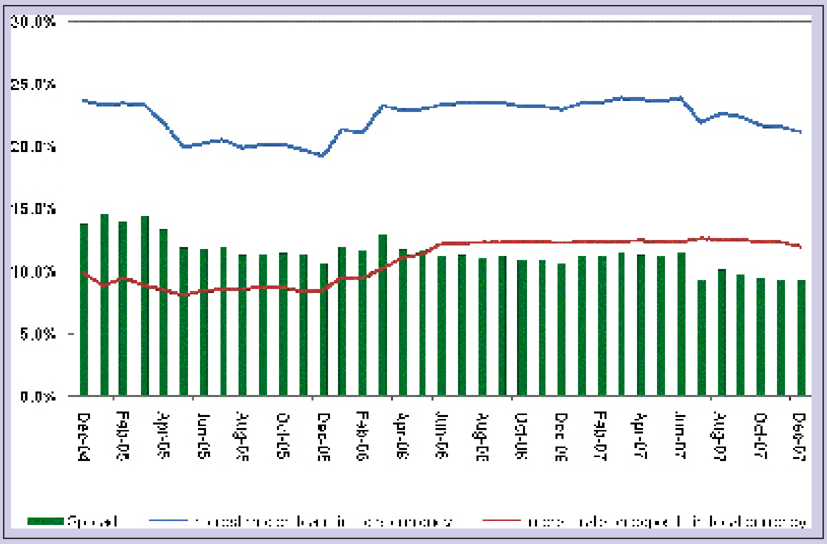


Chart 34: Spread between Interest rates

The results in financial operations showed an unfavorable evolution, decreasing by 2.7 per cent, as compared to December 2006. In contrast with the past years, the Metical appreciation against the main currencies was determinant for this reduction, provided that it prevented the banks from recording significant gains deriving from exchange rate re-valuations. As a result, the contribution of results in financial operations in the gross income decreased from 17.8 per cent in December 2006 to 14.2 per cent in December 2007.

As regards to the profitability indicator, there was a slight reduction in relation to the previous year, although it is still stands above the level observed in 2005 (Chart 35). The Return on Equity (ROE) stood at 46.9 per cent against 56.0 per cent in 2006 and the Return on Assets (ROA) at 3.4 per cent against 4.0 per cent in the same period. However, It is clear that the decreasing trend of the profitability indicator began in March 2007. According to the official data for 2006, the profitability of equity capital in the banking system is favourable, likewise the majority of the countries in the region (e.g. Kenya, Uganda, South Africa, Namibia and Tanzania).

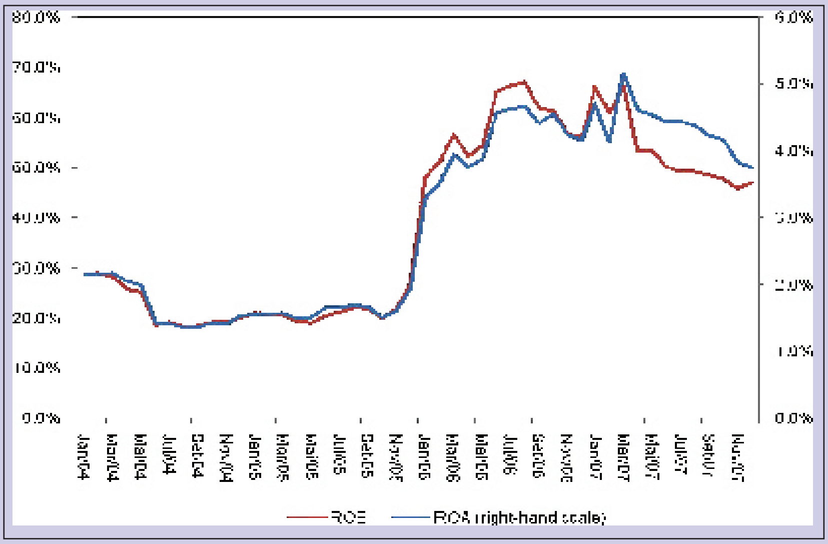


Chart 34: Profitability

In general, the high levels of profitability recorded in the last two years, have contributed to the stability of the system since the credit institutions reveal the capacity to produce stable incomes.

Concerning the operational costs, there was a continuous remarkable growth of expenses with the staff, supplies and third party services, although the weight of both items in the average asset has remained virtually unchanged.

The staff costs have increased by 34.1 per cent - essentially influenced by 29.2 per cent increase in the staff remuneration - while the expenses with supplies and third party services rose by 14.0 per cent (Chart 35). As a result, the operational costs rose by 23.4 per cent in 2007, against 24.6 per cent in 2006. However, its weight in the average asset remained relatively unchanged, as it has decreased from 6.6 per cent to 6.0 per cent in comparison with the last year.

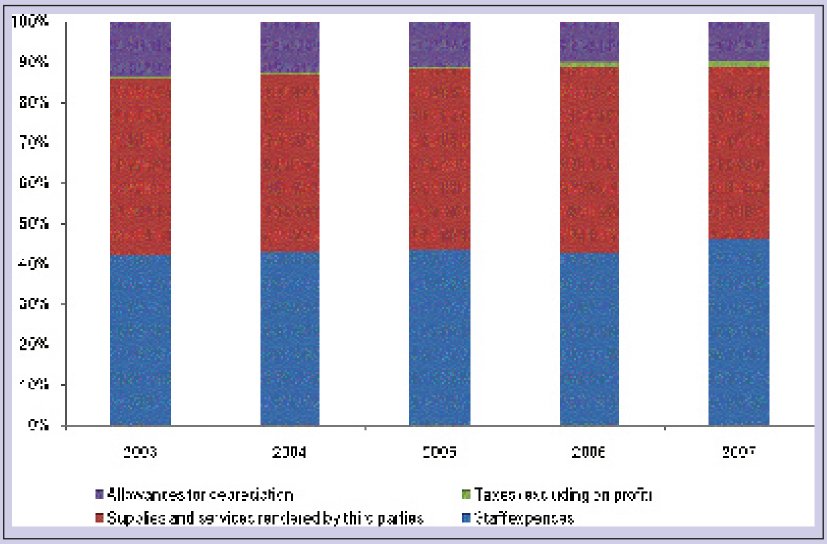


Chart 35: Structure of Operational Costs

The moderate growth of the gross income in relation to operational costs did not observe significant changes in the efficient indicators of the banking system. The ratio of operational costs to gross income[31] (cost to income ratio) has decreased 0.6 percentage points, as compared to December 2006, standing at 60.8 per cent. The slow down of the efficiency ratio resulted mainly from the increase of operational costs, which are in turn associated to the strategy of expansion of various banks, characterized by an increasing establishment of new bank branches, resulting in an increased the number of staff in the sector.

In general, the ratio of efficiency has witnessed a decreasing trend, as it has been recording, since August 2006, lower rates or very close to 60 per cent (Chart 36). For some banks, this ratio stood nearly 50 per cent and it reveals the measures of operational efficiency that those banks have undertaken. On other hand, there are institutions, especially the micro finance, that have recorded rates greater than 72 per cent. This situation may be associated with the high operational costs deriving from specific aspects of the business and credit methodology that characterizes this kind of institutions.

[31] The relationship between operational cost and the gross income is also known as ratio of efficiency

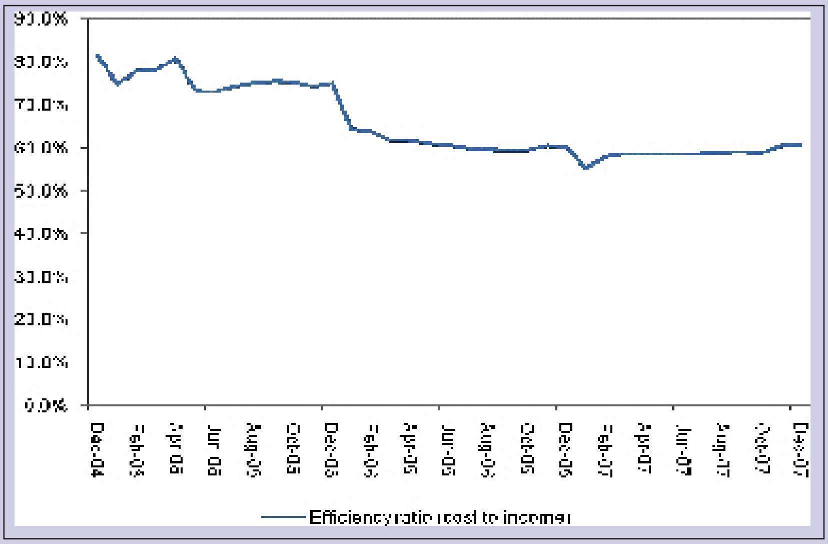


Chart 36: Efficiency Ratio

4.4 Credit Risk

The credit risk is the possibility of losses resulting from non-compliance of the third party with the contractual obligations. The credit risk is a typical risk of credit institutions since their role is that of financial intermediation. The matured loans and the ratios deriving therefrom are fundamental elements in credit risk analysis.

4.4.1 Evolution and Structure of Non-performing Loan

In December 2007, the non-performing loan amounted to MZN 821,326 thousands, which represent a 3.6 per cent reduction in relation to MZN 851,776 thousands recorded in December 2006. In terms of trend, the non-performing loan has increased and reached its peak in April 2007, as it recorded MZN 1,385million (Chart 16).

Even though, the non-performing loan continues to record the historically low levels. The trend observed in the non-performing loan is explained by a large set of factors, whose relative importance is hard to determine. However, it is worth highlighting amongst these factors, the improvements observed in credit risk management practices, reduction of interest rates, write-off on assets, increased efforts for credit recovery, including those that had been considered no-recoverable in the previous years
in December 2007, the write-off credit totalized to MZN 3,111,063 thousand, against MZN 3,051,978 thousand recorded in the similar period of the previous year.

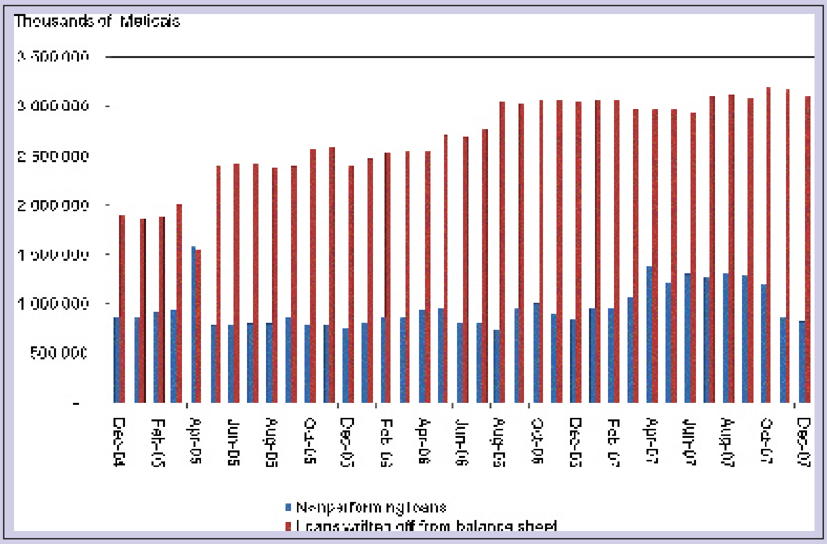


Chart 37: Non-Performing Loan

The net non-performing loan as percentage of the capital and reserves is an indicator that allows the evaluation of the capacity of the banking system to support the losses deriving from the overdue loans. This ratio reached the highest rate (10.5 per cent) of the last three years In April 2007, whereas in December 2007, it reached the lowest value (0.5 per cent). The sharp rise of capital and reserves and the reduction of non-performing loan owing to credit risk management improvement were determinant for the ratio to reach the minimum rate in December 2007. In the overall, the ratio has remained below 10 per cent and below the international benchmark set at 25 per cent (Chart 17).

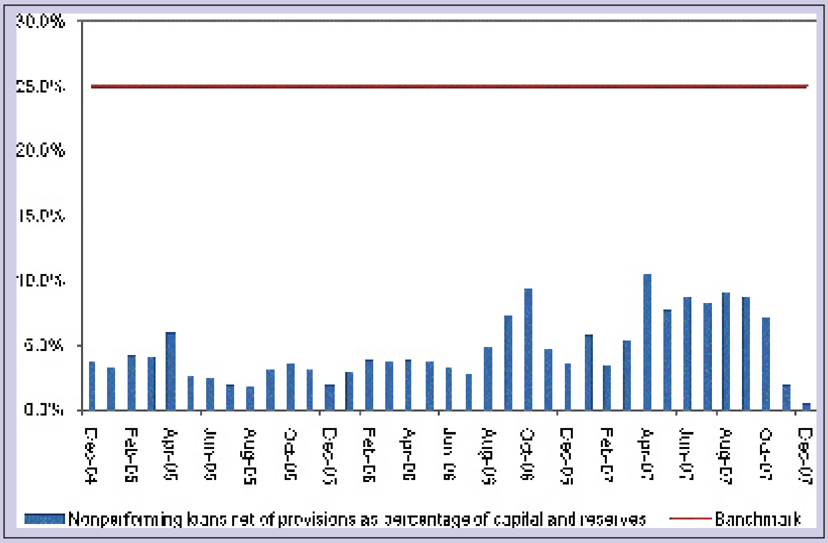


Chart 38: Non-Performing Loans as Percentage of Capital and Reserves

As a percentage of the total loan portfolio, the non-performing loan continued to improvement considerably, thus maintaining the decreasing tendency of the last three years (Chart 17). Between December 2003 and December 2006, the ratio of non-performing loans - total loans decreased from 13.8 per cent to 3.1 per cent. In December 2007, this ratio reached 2.6 per cent, the lowest rate of the last seven years. This decreasing trend is mainly prompted by the increase of credit portfolio, which results from favourable economic conditions.

In contrast with the structure of December 2006, which was greatly comprised of ninety-day non-performing loans (class I), in December 2007 the structure was dominated by non-performing loans for more than six months to a year (Class III) with 29.0 per cent, followed by ninety days non-performing loans (class I) with 25.8 per cent (Chart 18). It is clear that, while class I non-performing loans increase its weight in the portfolio of non-performing loans, class VI shows an opposite tendency (Chart 19).

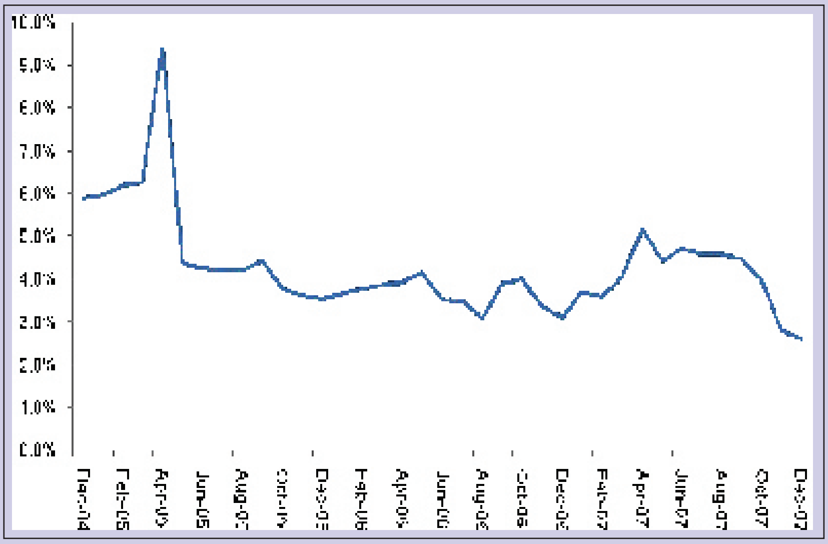


Chart 39: Non-performing Loans as Percentage of Total Loans

Ground floor **Mural in carved marble** *Francisco Relógio*

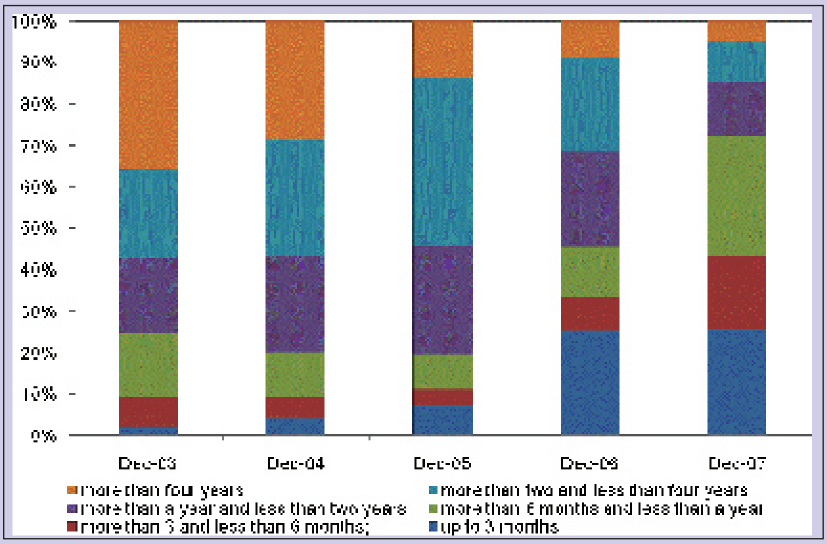
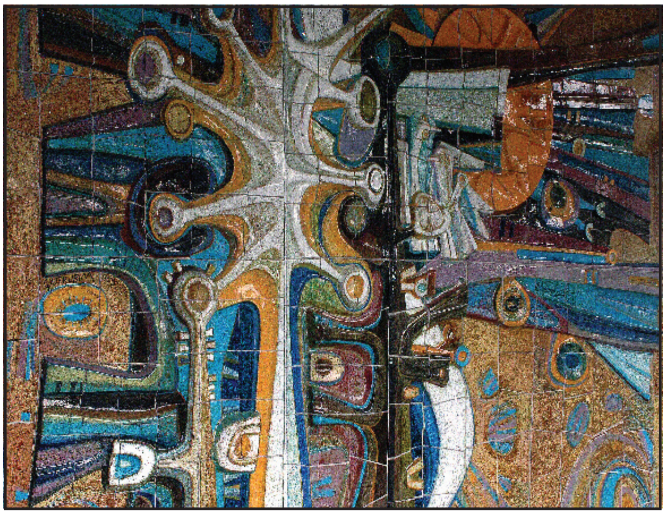


Chart 40: Composition of Non-Performing Loans

4.4.2 Provisions for Credit Risk Coverage

The banking system continues to show a satisfactory level of provisions. The provisions for non-performing loans have increased from MZN 703,512 thousands in 2006, to MZN 795.290 thousands in 2007, which represents an increase by 13.0 per cent. As a percentage of the total matured loans, the specific provisions have increased from 82.6 per cent at the end of 2006 to 96.8 per cent in December 2007, the highest rate of of the last three years (Chart 20).

The total provisions (which include specific provisions, provisions for uncertain credit collection and for general credit risks) rose to MZN 1,894,817 thousands and they represent an increase by 23.6 per cent, as compared to December 2006 and 10.0 per cent in relation to December 2005. As to matured credit portfolio, the total provisions represent 230.7 per



Polychromed Querubim Lapa

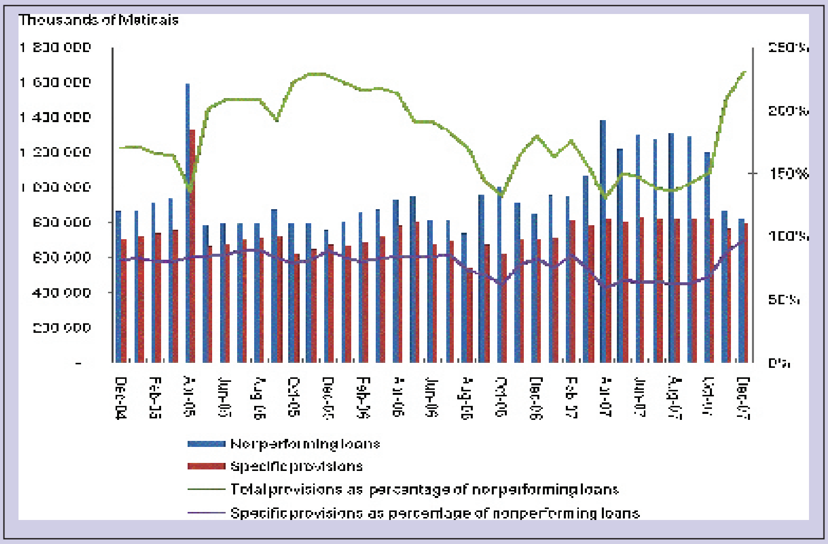


Chart 41: Provisioning of Non-Performing Loans

cent, well above 180.0 per cent observed late 2006.
It is clear that the level of coverage of overdue credit portfolio by special provisions remained stable until July 2006, with a period of instability that until April 2007, which recorded the lowest rate (59.2 per cent) of the last three years (Chart 20). The lowest rate resulted from a sharp increase of overdue loans, which did not increase proportionally to the level of provisioning.

4.4.3 Distribution of Credit Portfolio by Sectors

One of the determinant factors to reduce the vulnerability and losses in the banking system is the diversification of credit risk exposure by various sectors of activities and debtors. The distribution of credit portfolio by sectors of activity reveals that the banking system continues greatly exposed to commerce, which in December 2007 represented 24.4 per cent of the total portfolio, 3.0 percentage points lower than that recorded in December 2006 (Chart 21). This reduction is associated to the fact that the credit to other sectors has grown more than that addressed to commerce.

Transport and communications sector recorded a significant credit flow, as it amounted to MZN 2,057,708 thousands, corresponding to a130.5 per cent increase when compared to December 2006. This evolution resulted in increased weight in the total portfolio from 6.2 per cent in December 2006 to 12.2 per cent at the end of 2007. The credit to individuals and housing loans, which are in the group of other sectors, has increased by 29.3 per cent, thus representing 18.1 per cent in December 2007, against 17.6 per cent in December 2006.

Despite its relevance for economic development, and considering its growth from of 10.6 per cent from 2006 to 2007, the weight of credit to agriculture (which includes livestock, fishery, forestry, forest exploitation) in the credit portfolio of the banking system shows a decreasing tendency. In 2003, credit to agriculture represented 14.1 per cent of the portfolio, whereas in 2006, it decreased to 9.9 per cent and in 2007 it fell to 9.4 per cent.

As to the number of debtors, there is still a greater degree of concentration in the portfolio. The balance of credit portfolio (including off-balance sheet items) of the hundred major debtors of the banking system has increased from MZN 20,085,842 thousands in December 2006 to MZN 22,635,207 thousands in December 2007, which represents an increase by 12.7 per cent. As a result of this performance lower than the expansion of credit portfolio, the weight of the hundred major debtors reduced from 75.8 per cent to 73.5 per cent of the total portfolio. This behavior was also observed in relation to the weight in assets that reduced 1.8 percentage points and in own funds by 79.8 per cent.

The non-performing loan - excluding the write-off credit - of the hundred major debtors

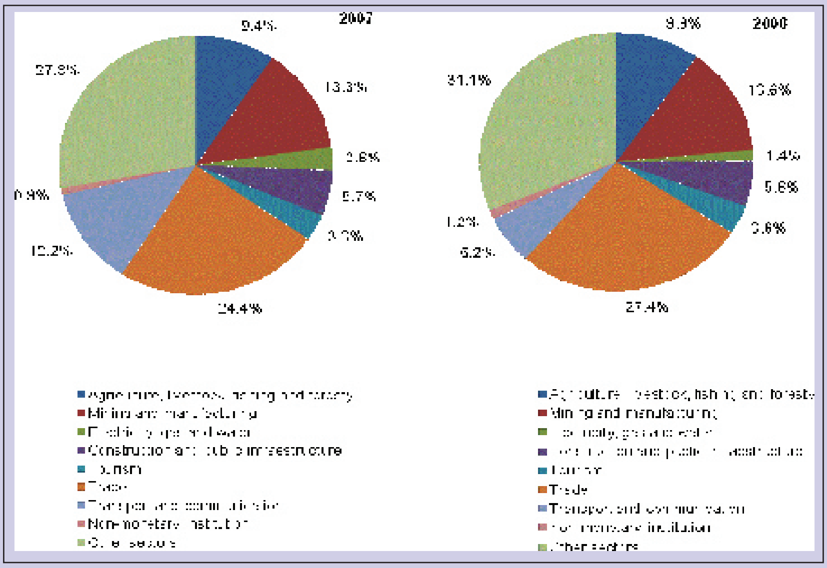


Chart 42: Distribution of credit by Sectors

represents 13.6 per cent of the overdue portfolio, against 17.9 per cent recorded at the end of 2006.

The distribution of debtors in group levels shows significant variations of balances between 51st and 100th major debtors, with an addition of 87.7 per cent (MZN 4,070,455 thousands) and between 21st and 50th major debtors, with a fall of 56.8 per cent (MZN 3,358,255 thousands), between 2006 and 2007. Contrary to the figure recorded in the previous year, the level of concentration of balances is now between 51st and 10th major debtors (Chart 22).

4.5 Exchange Risk

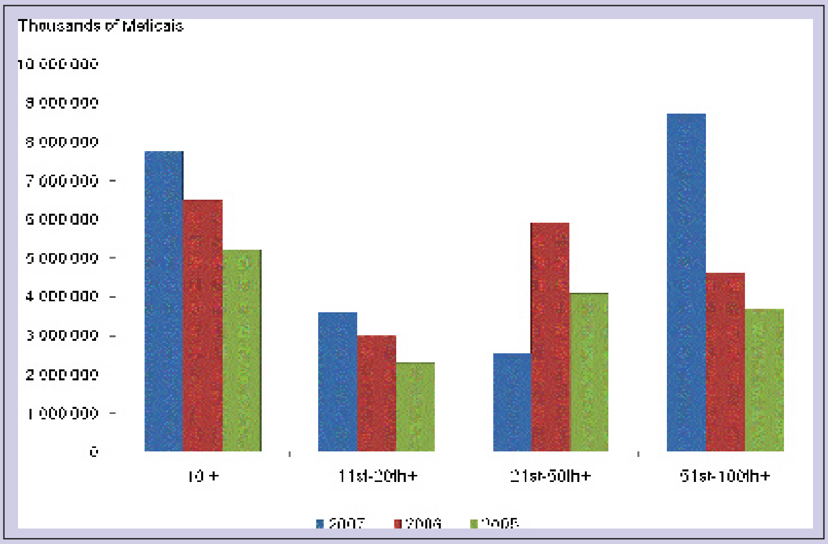


Chart 43: Distribution of top Debtors of the banking industry

The exchange risk is the possibility of losses resulting from floating exchange rate. In order to limit both the losses as well as the profits deriving from exchange positions, the Governor's Notice 21/GGBM/2007, of May 2nd, establishes that "the credit institutions can not record , at the end of each day, a global position greater than 20 per cent of the equity capital,, neither a global exchange position in each foreign currency that exceeds 10 per cent of the aforementioned funds.

In 2007, the aggregate global exchange position showed a rising trend when compared to 2006 (Chart 23). The position in US Dollars is the one that reveals greater contribution in the aggregate global position and it represents, in average, more than 50 per cent.

From December 2006 to December 2007, the aggregate global position reduced from MZN 376,636 thousands to MZN 341,543 thousands.

As a percentage of equity capital, the aggregate exchange position remained well below 20 per cent, as it stood at 5.8 per cent in December 2007 (8.7 per cent in December 2006)-

Ground floor **Mural in carved marble** *Francisco Relógio*

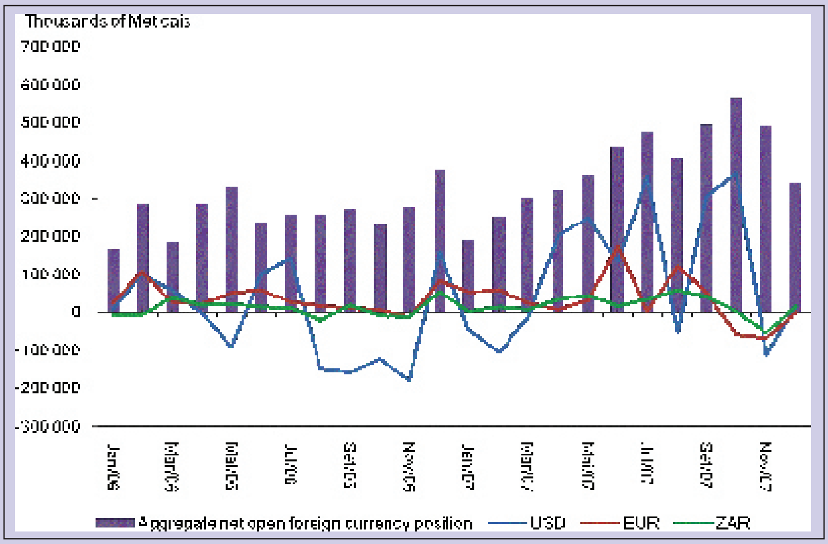


Chart 44: Aggregate Exchange Position

Chart 24.

The high standards of capitalization in the banking system have allowed the institutions to stand in comfortable position in relation to exchange position benchmarks.

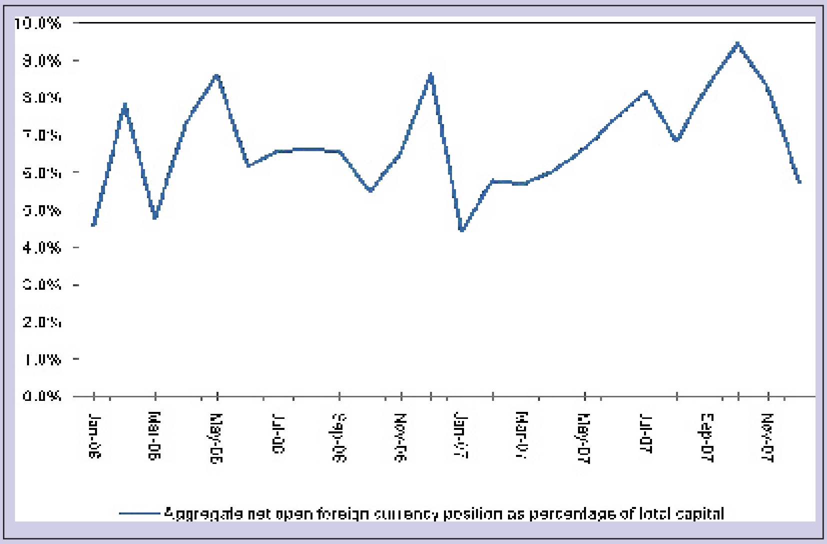


Chart 45: Aggregate Exchange Position as a Percentage of Total Capital

4.6. Liquidity Risk

Liquidity risk is the possibility of a bank to face difficulties to refund the short term liabilities, as well as in the re-financing of assets recorded in its balance sheet. The banks are institutions that, by nature of their activity, which consists of transforming deposits of clients into credit, are inherently exposed to such risk. Therefore, liquidity management is a crucial element for the permanent viability of any bank.
The liquidity risk represents a relatively complex approach of the banking activity, given the existence of distinct ways of assessing the exposure to this kind of risk. In this report, the risk exposure shall be assessed through the table of liability coverage and from the analysis of the relationship between credit and deposits.

4.6.1 Liability Coverage

The banking system continues to record deficits in the amount pertaining to on-site or 30-day term liability coverage (Chart 25). In December 2007, the deficit stood at MZN 1,309,164 thousands, which represents a 40.1 per cent improvement, when compared to the similar period of the last year.

Over the last years, it has been noticed that the deficit in liability coverage basically resulted from the deficit of two, of the four major banks of the system. The deposits in other credit institutions, the availabilities in terms of cash and equivalent amounts with maturity period not greater than 180 days, constitute the elements with greater contribution and represent altogether 74.5 per cent of the on-site or 30-day term coverage amounts.
Given the reduction of the deficit in coverage amounts, the ratio of on-site liabilitycoverage for assets with 180 maturity period days has increased 3.8 percentage points in relation to

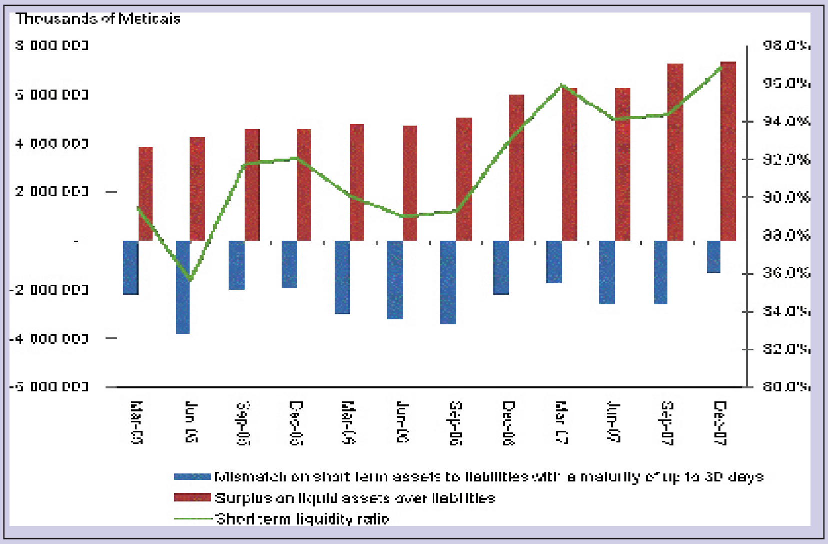


Chart 46: Liability Coverage

93.0 per cent observed in December 2006. The ratio of overall liquidity, measured through relationship between the total coverage amounts and the on-site liabilities or term liabilities longer than 30 days, has decreased 7.4 percentage points, against 139.3 per cent recorded in 2006. This reduction derived from the increased growth of liabilities demanded on site or in longer terms than 30 days in relation to the coverage amounts. The total surplus of the coverage amounted to MZN 7,328,139 thousands, representing a 21.5 per cent growth, as compared to December 2006.

4.6.2 Total Loans as Percentage of Total Deposits

Deposits are still one of the main income sources of credit institutions, provided its minor cost compared to other sources such as, the subordinate loans, bond issuance and bill operations. In December 2007, the ratio credit-deposits stood at 59.0 per cent, which represents a 4.9 percentage points reduction, in relation to the similar period of the previous year. The reduction was related to the recovery of some credit and simultaneously, the credit slowdown observed in the period. Notwithstanding the reduction observed in 2007, the ratio credit-deposits remained stable (Chart 26).

Chart 27 shows the trend of deposits and credit growth rates. The tendency of a sharp dec[…], as

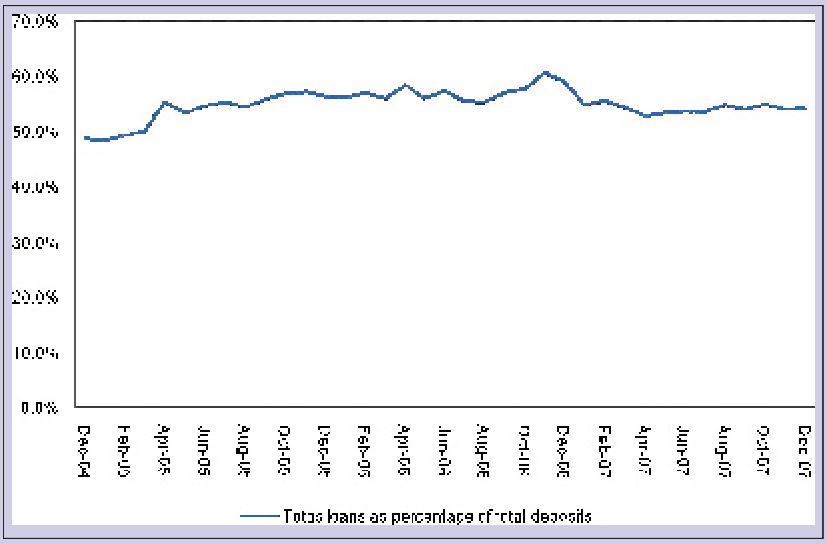


Chart 47: Total Loans as Percentage of Total Deposits

it witnessed a gradual recovery. Further in the same period, it was observed that the deposit rates were lower than those of credit, thus prompting the growth of ratio deposit-credit. Another interesting data is the fact that the deposit and credit growth rates are moving towards the same direction, although in a different magnitude, revealing the existing strong relationship between deposits and credits. The behaviuor of total deposits is significantly influenced by time deposits which, besides their greater weight in the total deposits, reveal greater volatility.

The impact of the Governor's Notice 5/GGBM/2005 regarding the special provisions for

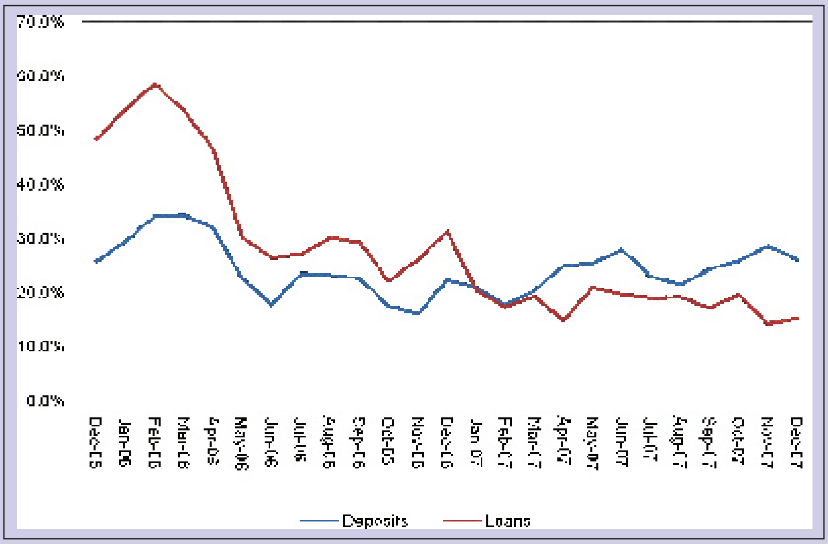


Chart 48: Deposits and Credit Rates (Annual change)

credit in foreign currency also influenced the relationship between credit and deposits in foreign currency. Since June 2005, the ratio credit and deposits in foreign currency has been reducing sharply, having stood at 35.1 per cent in December 2007 (73.9 in June 2005 and 45.0 in December 2006).

5. Prospects for Banking Supervision

Besides its commitment with the ordinary duties, the coming years will be of great challenge for the Banking Supervision Department, a period during which it is worth highlighting the following:

- Strengthen and consolidate the implementation of the Risk based Supervision;
- Monitor the process of transition to International Financial Reporting Standards;
- Establish a regulatory framework on the criteria for setting bank charges and fees for banking services;
- Improve the database of the Credit Registration Centre, particularly the coverage, access to information and the type of reports produced;
- Consolidate the compliance with the core principles for effective supervision;
- Monitor and consolidate the implementation of the regulation on the Securities Market and on the prevention and fight against money laundering in credit institutions and non-banking financial institutions;
- develop human resources technical skills through continuous training in order to address positively the new developments in banking supervision;

- Disseminate the legislation on microfinance institutions and incentives towards the expansion of banking services throughout the rural areas;
- Establish guidelines and norms on corporate governance;
- Define a strategy for the transition to the New Capital Accord (Basel II), including the conditions for implementation, considering the reality of the banking sector in Mozambique;
- Pursue with the initiatives and activities organized by the supervisory committees, such as, the Basel Committee on Banking Supervision and the Subcommittee of the SADC Banking Supervisors Group;
- Pursue the meetings with the managers of credit institutions to reach a common understanding on the philosophy of business and risk management process.

Front View of Pemba Branch