July 2022

No.46 | year 11

ECONOMIC OUTLOOK AND INFLATION FORECASTS

ECONOMIC OUTLOOK

AND INFLATION FORECASTS

JULY 2022

Members of the Monetary Policy Committee[1]

Full-Fledged Members

Rogério Lucas Zandamela
Governor (Chairman)

Gertrudes Adolfo Tovela
Board Member

Felisberto Dinis Navalha
Board Member

Jamal Omar
Board Member

Benedita Guimino
Board Member

Silvina de Abreu
Board Member

Permanent Guests

Umaia Mahomed
Adviser to the Governor

Maria Mateus Majimeja
Adviser to the Governor and Director of the Governor's Office

Ingunn Valvatne
Adviser to the Governor

Luís Alberto Poio
Director of the Macroprudential Analysis Department

Pinto Fulane
Director of the Prudential Supervision Department

Paulo Mandlate
Director of the Foreign Exchange Licensing Department

Emílio Rungo
Director of the Communications Office

Carlos João Baptista
Director of the Markets and Reserves Management Department

Pinho José Ribeiro
Director of the Economic Research Department

Domingos Fumo
Director of the Statistics and Reporting Department

---

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

Foreword

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

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

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

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

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

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

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

Rogério Lucas Zandamela

Governor

Contents

Boxes

Tables

Charts

Decisions of Session No. 4 of the Monetary Policy Committee, of July 21, 2022

The Monetary Policy Committee (MPC) of the Banco de Moçambique has decided to keep the policy rate, MIMO, unchanged at 15.25%. This decision follows from forecasts of inflation decelerating to a single digit in the medium term, driven by the slowdown in external demand and the resulting decline in international commodity prices, against a backdrop of exchange rate stability. However, in the short term, prices are expected to continue to rise, reflecting the pass-through of high oil and food costs in the international market to the domestic economy.

Inflation is expected to accelerate in the short term and slow down in the medium term. In June, annual inflation accelerated to 10.8%, following 9.3% in May, mainly driven by the rise in prices of administered goods, especially fuel and transport. Core inflation, which excludes prices of administered goods and services, as well as fruit and vegetables, and is affected by monetary policy, has accelerated slightly, essentially reflecting the pass-through of prices of administered goods to other goods and services. In the medium term, inflation is expected to remain at a single digit, favored by the Metical's stability and lower international commodity prices, resulting from the slowdown in external demand.

Risks and uncertainties associated with inflation forecasts remain high. Domestically, uncertainties associated with the adjustment of the prices of administered goods prevail, especially regarding fuel, and the magnitude of its impact on the prices of other goods and services. On a global scale, the uncertainties regarding the prolongation of the Russia-Ukraine geopolitical conflict also remain.

Prospects for economic recovery in 2022 and 2023 remain, despite the slowdown in external demand. In the short and medium term, prospects for economic recovery remain, mainly backed by the implementation of energy projects in the Inhambane province and the Rovuma basin and the kick-off of liquefied gas exports, in a setting of resumption of the program with the International Monetary Fund and foreign aid from other cooperation partners.

Domestic public debt remains high. Domestic public debt, excluding loan and lease agreements and overdue liabilities, stands at 248.2 billion meticais, an increase of 29.4 billion, compared to December 2021.

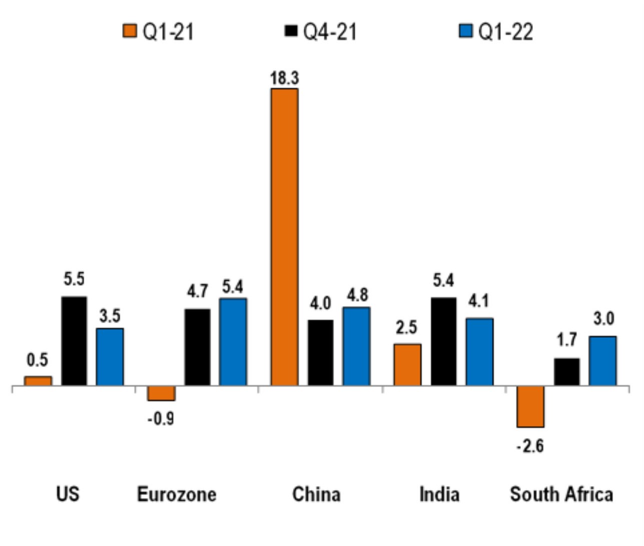
The current macroeconomic outlook is consistent with maintaining the MIMO rate in the short term. However, in the event of the exacerbation of the risks and uncertainties associated with inflation forecasts, the MPC shall not hesitate to increase the MIMO rate in order to ensure single-digit inflation in the medium term.

The next regular meeting of the MPC is scheduled for September 15, 2022.

Chapter I. Recent Developments in International Economy and Forecasts

Prospects of a further global growth slowdown in 2022 have been consolidated, in view of the protracted Russia-Ukraine conflict and the upward adjustment of monetary policy rates, in order to contain growing inflationary pressure, particularly by central banks from advanced and emerging markets economies.

Chart 1-1: GDP Developments (%)



Source: *Trading Economics*

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

Region	Realized 2021	Projection 2022	Projection 2023	Difference From Jan/22's WEO 2022	Difference From Jan/22's WEO 2023
World economy	**6.1**	**3.6**	**3.6**	**(0.8)**	**(0.2)**
Advanced	**5.2**	**3.3**	**2.4**	**(0.6)**	**(0.2)**
US	5.7	3.7	2.3	(0.3)	(0.3)
Eurozone	5.3	2.8	2.3	(1.1)	(0.2)
Germany	2.8	2.1	2.7	(1.7)	0.2
Japan	1.6	2.4	2.3	(0.9)	0.5
United Kingdom	7.4	3.7	1.2	(1.0)	(1.1)
Emerging and Developing	**6.8**	**3.8**	**4.4**	**(1.0)**	**(0.3)**
Brazil	4.6	0.8	1.4	0.5	(0.2)
India	8.9	8.2	6.9	(0.8)	(0.2)
China	8.1	4.4	5.1	(0.4)	(0.1)
Sub-Saharan Africa	**4.5**	**3.8**	**4.0**	**0.1**	**0.0**
South Africa	4.9	1.9	1.4	0.0	0.0

Source: IMF, WEO (April, 2022)

1.1. Recent Economic Activity and Inflation

In the first quarter of 2022, the Mozambican economy main trading partners experienced a mixed performance in economic activity.

The United States experienced a slowdown in the gross domestic product (GDP) growth, driven by the combined effect of government spending and an unprecedented trade deficit. In contrast, the Eurozone has recorded an acceleration, due to the impact of the increase in net exports and investment, which boosted employment, offsetting the negative effects of the Russia-Ukraine conflict.

In emerging economies, China has experienced a GDP slowdown, reflecting the rise in economic activity in the industrial and service sectors (Chart 1-1).

Prospects for a further slowdown in world economy growth in 2022 have become more evident, amid the lingering effects of the Russia-Ukraine conflict. In April 2022, the WEO again[2] revised downwards the world economy growth prospects for 2022 to 3.6% (Table 1-1).

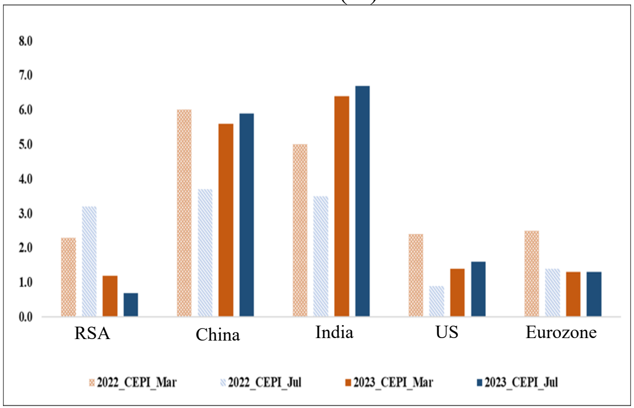
This revision reflects the prolonged Russia-Ukraine conflict, which is contributing to rising inflationary pressure for most advanced and emerging countries, resulting in further monetary policy tightening.

Most recently, in its June 2022 edition of Global Economic Prospects, the World Bank forecasts foresees a much weaker global growth (2.9%), driven, in addition to the reasons above, by the rising (i) financing costs, especially in emerging markets, and (ii) the risk of stagflation in some countries.

Furthermore, the June 2022 report of the Global Project Model Network (GPMN) points to a further

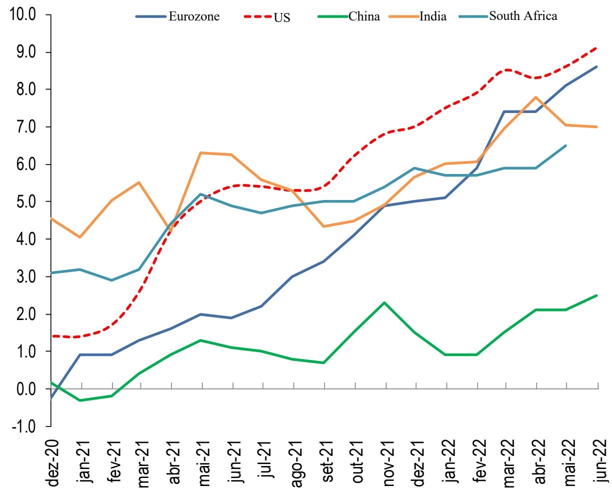
[2] January 2022's World Economic Outlook (WEO) revised global growth prospects for the current year downwards to 4.4%.

Chart 1-2: Real GDP Outlook (%)



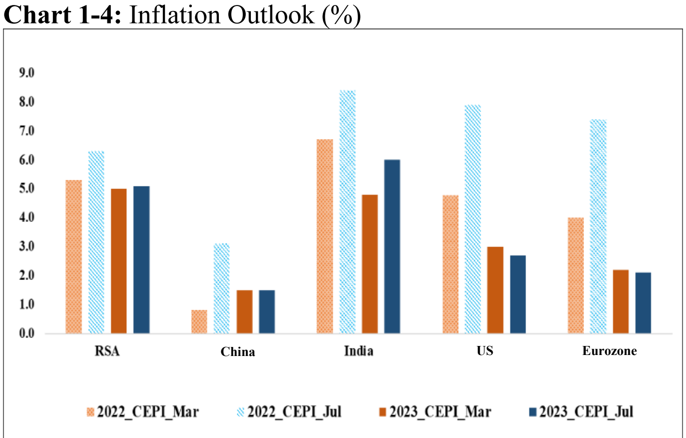
Source: *Global Projection Model Network*

Chart 1-3: Inflation Developments (%)



Source: *Refinitiv and Trading Economics*

Chart 1-4: Inflation Outlook (%)



Source: *Global Projection Model Network*

slowdown in global GDP growth to 2.8% in 2022 (Chart 1-2).

The main risks to these the outlook includes: (i) the continued strengthening of the US dollar in the international market, (ii) the re-emergence of supply chain bottlenecks and (iii) the geographical broadening of the Russia-Ukraine conflict.

Global inflationary pressure is on the rise, despite the recent downward trend in the prices of some foodstuffs in the international market. Advanced and emerging markets economies experienced an acceleration in annual inflation in June, which mainly reflects the persistence of the high costs of liquid fuels, electricity and food. Thus, US and Eurozone inflation stood at 9.1% and 8.6%, respectively (Chart 1-3).

Near-term inflation forecasts have been revised upwards for all of the country's trading partners. However, medium-term forecasts show a mixed trend. Compared to the previous MPC session, the GPMN has revised the 2022 inflation forecasts upwards for all of Mozambique's partner economies.

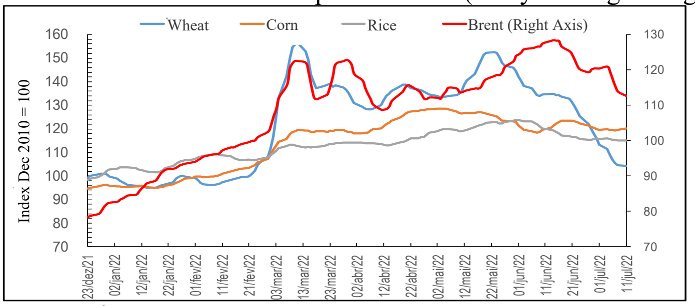
However, the outlook is mixed for 2023. Prices are expected to increase in South Africa and India; the US and Eurozone should expect a decrease; and China's outlook should remain unchanged (Chart 1-4).

In light of the increasing global inflationary pressure, almost all central banks are leaning towards tightening monetary conditions. This led the World Bank to consider a greater risk of global stagflation, driven by a further tightening of monetary conditions aimed at containing inflationary pressure, against a backdrop of slowdown in global economy growth.

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

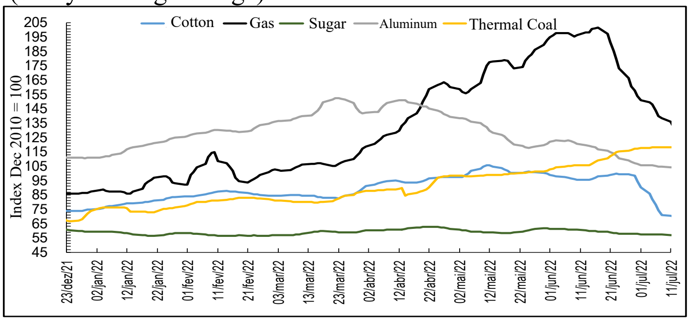
Prospects for slowing growth in the global economy contribute to price deceleration of most commodities. Growing fears of global economy slowdown are already driving the decrease in prices of most commodities in the international market.

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



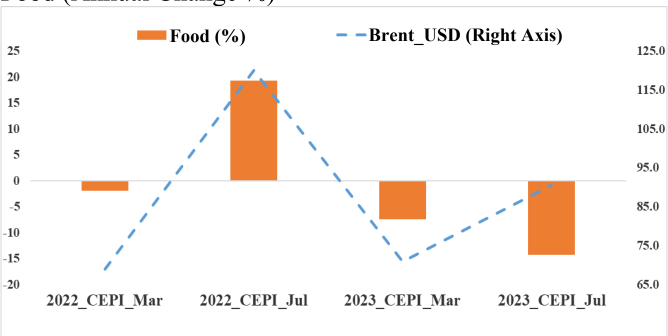
Source: *Refinitiv*

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



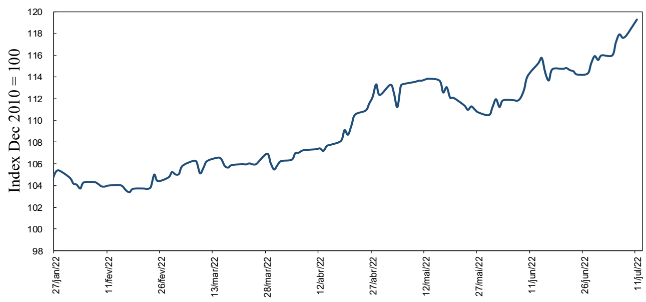
Source: *Refinitiv*

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



Source: *Global Projection Model Network*

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



Source: *Refinitiv*

On the imports side, brent and wheat are highlighted, with prices declining by 5% and 28%, respectively, compared to the figures reported in the May 2022's MPC session. As for export commodities, the drop of the liquefied natural gas price (-21%) is highlighted, in a context of rising thermal coal prices (+17%), driven by the greater demand for this commodity in Europe (Chart 1-5 and 1-6).

In the medium term, despite figures remaining high (Chart 1-7), forecasts estimate a sharp slump in food prices in the international market (-89%) and a slight drop in the price of brent (-5.8%).

The US Dollar continues to strengthen against major currencies. From the last MPC session to the third week of July 2022, the USD Composite Index recorded cumulative gains against the main trading currencies (Euro, Rand, Pound and Yen), as shown in Chart 1-8. Among the determining factors for this trend, the following are highlighted: (i) the FED's[3] policy rate hike and the signaling for increases at upcoming meetings this year and (ii) the ongoing geopolitical tension in Europe.

[3] Federal Reserve of the United States

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

Real GDP grew by 4.1% in the first quarter of 2022, driven by the steadily growing demand and recovery of the sectors most affected by COVID-19, following the easing of domestic and foreign restrictive measures. In the short term, prospects for economic recovery still prevail, in face of (i) the reopening of the economy, (ii) the kick-off of the implementation of structural projects in the energy field in the country and (iii) the resumption of the program with the International Monetary Fund (IMF). These factors may boost economic activity, despite prospects of slowing external demand related to the protracted Russia-Ukraine geopolitical conflict. The aforementioned conflict is having a severe impact on inflation and its short-term prospects, via the surge in prices of administered goods and its pass-through to the prices of other goods and services.

2.1. Short-Term Economic Activity

Real GDP grew by 4.1% in the first quarter of 2022. Preliminary data from the National Statistics Institute (INE) indicate that, in annual terms, GDP grew by 4.1% in the first quarter of 2022 (Table 2-1).

Table 2-1: Mozambique Real GDP by Sector - Annual Change (%)

Activity Sectors	2021				2022	
	I	II	III	IV	I	Contr.(pp)
Primary Sector	**1.0**	**2.2**	**5.7**	**5.7**	**4.6**	**1.4**
Agriculture	4.9	1.7	5.0	4.2	4.0	1.0
Fishing	1.9	3.3	2.4	2.1	0.9	0.0
Mining Industry	-15.1	4.5	8.8	10.7	8.6	0.4
Secondary Sector	**-1.8**	**0.2**	**3.6**	**2.9**	**4.3**	**0.5**
Electricity and Water	0.8	-7.0	5.2	0.9	6.3	0.2
Processing Industry	-1.5	2.0	2.9	3.1	3.8	0.3
Construction	-7.6	3.2	3.1	4.7	3.6	0.1
Tertiary Sector	**-1.2**	**2.7**	**2.2**	**2.9**	**3.7**	**1.6**
Trade and Services	-0.0	3.0	2.8	3.3	3.2	0.3
Hotel and Catering	-18.7	-0.4	0.6	2.7	11.4	0.2
Transport and Communications	-9.1	3.5	2.7	5.6	7.3	0.7
Financial Services	2.2	1.7	2.3	2.0	1.7	0.1
Public Adm., Education and Health	4.9	3.2	1.8	1.5	2.7	0.3
Other Sectors	1.1	0.9	1.6	1.6	1.2	0.1
GDP at factor cost	**-0.6**	**2.2**	**3.6**	**3.7**	**4.1**	**3.6**
Tax on products	5.5	1.6	3.1	2.2	4.2	0.6
GDP	**0.2**	**2.1**	**3.5**	**3.6**	**4.1**	**4.1**

Source: INE

The performance observed in the first quarter of 2022 was driven by the continued easing of restrictive measures, at home and abroad, which contributed to the steady improvement in demand and recovery of the sectors most affected by COVID-19, notably the mining and processing industries, trade and transport services and hotel and catering.

With regards to aggregate demand components, the following are highlighted:

i) The improvement in external demand, which boosted exports in the first quarter of 2022. In effect, in the period in question, the value of goods exports increased by USD 724 million, compared to the same period in the previous year, of which USD 575 million concern major projects, reflecting the combined effect of the surge in volume and prices of commodities in the international market (Table 2-2). The mining and industrial sectors contributed the most to total exports, especially mineral coal and aluminum (Table 2-3). Meanwhile, the balance of goods has deteriorated due to the significant increase in imports, driven by the import of the Coral South LNG floating platform.[4] Exports are expected to continue to increase in the short and

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

	Q1 2021	Q1 2022	Change
Current Account	**-928**	**-5,351**	**-4,423**
Balance of Goods	-603	-4,609	-4,006
Exports	940	1,664	724
Imports	1,543	6,273	4,731
Balance of Services	-346	-792	-446
Primary Income Balance	-95	-100	-5
Secondary Income Balance	116	150	34
Capital Account	30	38	7
Financial Account	**819**	**4,983**	**4,163**
comprising			
FDI	1,016	1,392	375
Other investments	-186	3,602	3,788

Source: BM

[4]The platform that arrived in the country in area 4 of the Rovuma basin early January this year.

Table 2-3: External Trade (million USD)

Exports	Q1 2021	Q1 2022	Change
Mineral Coal	154	541	387
Aluminum Bars	270	397	128
Heavy Sands	103	118	14
Electricity	129	136	7
Aluminum Cables	26	41	15
Natural Gas	50	89	39
Imports	**Q1 2021**	**Q1 2022**	**Change**
Fuels	154	246	93
Construction Material	150	152	2
Machinery	268	4,696	4,428
Raw Aluminum	84	126	42
Vehicles	63	89	26

Source: BM

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

	Q1 2021	2022 Budget	Q12022	Annual Change
Income	59,867	293,917	59,879	0.0%
Total expenditure	75,921	450,577	86,569	14.0%
Current Expenses	57,157	284,908	66,691	16.7%
Investment Expenses	9,487	114,703	6,931	-26.9%
Deficit (before donations)	*(16,054)*	*(156,660)*	*(26,690)*	
Domestic Loans	13,392	53,082	21,227	58.5%
Application of Capital Gains	2,500	2,500	5,000	100.0%
External Financing	*5,138*	*98,578*	*4,222*	-17.8%

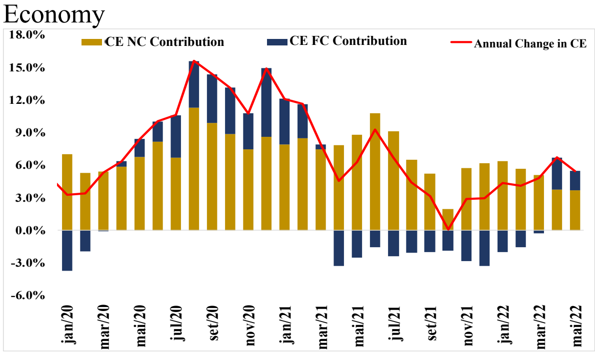
Source: Ministry of Economy and Finance (MEF)

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

	Use of T-Bills	Treasury Bonds	In the BM	Total Debt	Debt as % of GDP
Dec - 2019	29,671	61,817	48,067	139,555	14.6%
Dec – 2020	44,220	88,100	54,885	187,205	21.0%
Dec – 2021	59,399	102,415	57,009	218,823	21.2%
Jan –2022	69,927	102,415	58,764	231,105	22.4%
Feb –2022	73,592	106,323	59,179	239,094	23.1%
Mar –2022	74,570	104,395	59,640	238,605	23.1%
Apr – 2022	80,570	105,365	60,146	246,081	23.8%
Mai –2022	80,570	107,350	60,790	248,710	24.1%
Jun –2022	80,570	109,700	62,446	252,716	24.5%
Jul – 2022	73,570	112,200	62,446	248,216	24.0%
Flow (Jun-Dec/21)	14,171	9,785.30	5,437	29,393	

Source: BM

Chart 2-1: Annual Developments in Credit to the Economy



Source: BM

medium-term, driven by the kick-off of gas exports scheduled for the fourth quarter of 2022;

ii) Current public expenditure in the first quarter of 2022 increased by 16.7%, compared to the same quarter in 2021, basically reflecting the reopening of the economy, against a backdrop where public investment continues to be constrained by the State's limited financial resources (Table 2-4). However, disbursements of foreign aid funds for direct budget support under the new financial program with the IMF, are expected to boost public expenditure, especially the investment component that in recent years has been set aside to ensure the functioning of the economy (table 2-4).

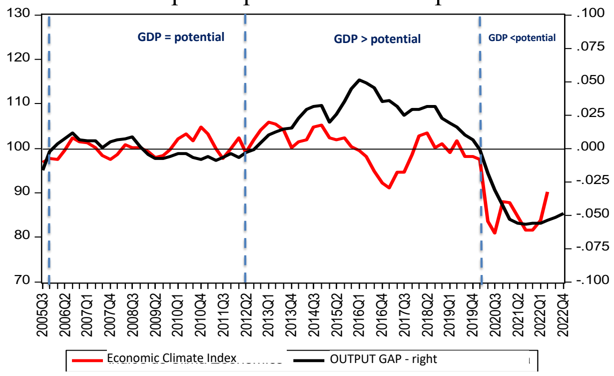
iii) The slight growth in credit to the private sector continues to constrain the recovery in consumption and investment of the sector, which may grow at a slower pace compared to other components of aggregate demand, with a limited impact on inflation.

Pressure on domestic indebtedness persisted in the second quarter. Cumulatively, domestic public debt increased by 29,393.00 million meticais to 248,216.00 million meticais by June, reflecting the surge in interest rates which resulted in greater demand and subscription of treasury bonds (Table 2-5). In the medium term, the inflow of partner funds for direct support to the State budget will help offset the pressure on domestic sources of public debt.

Signs of economic activity recovery have been consolidated. The prospects for recovery are underpinned by, among others, the easing of restrictive measures, at home and abroad, coupled with the implementation of structural projects in the energy field in the country and the resumption of the program with the IMF, despite the prospects of a slowing external demand. These forecasts are in line with the favorable assessment of economic players, as measured by trends in the economic climate and industrial production indexes (Chart 2-2 and 2-3). Despite such a recovery, economic activity will remain below the country's maximum production capacity – Chart 2-2.

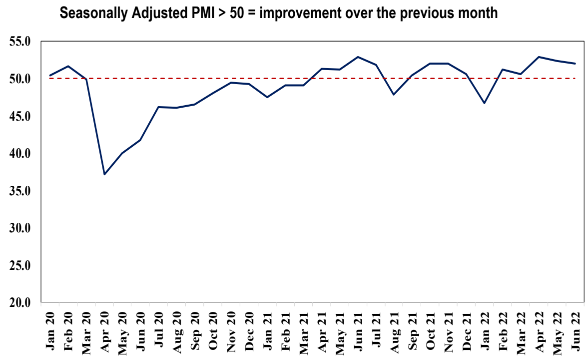
The country's net international reserves remain sound. In effect, the external position of the

Chart 2-2: Output Gap and ECI Developments



Source: INE/BM

Chart 2-3: Purchasing Managers Index (PMI)



Source: HIS, Markit

country, measured by the Gross International Reserves (GIR) remains satisfactory, standing at USD 3,029 million in the second half of July, the equivalent to about 5.0 months of imports of goods and services, excluding imports from major projects.

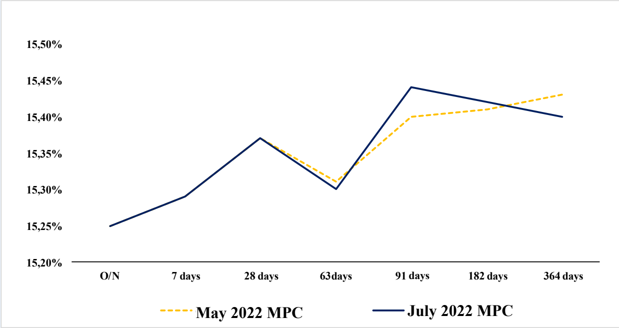
Box 1 : Monetary and Financial Developments

I. Interest Rate Developments

a) Money Market Interest Rates

Between the previous two MPC sessions (May and July 2022), the money market yield curve became steep at the 364-day maturity. Indeed, the overnight to 28-day maturity interest rates remained unchanged; 63 and 364-day rates saw a slight 1 and 3 bp reduction, respectively, while 91 and 182-day maturities experienced increases of 1 and 4 bp, respectively (Chart 1).

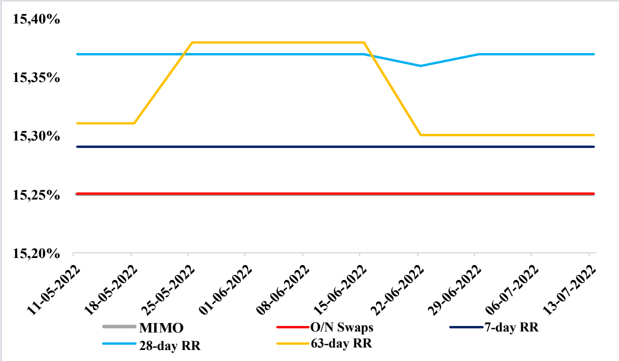
Chart 1: Money Market Yield Curve



Source: BM, 2022

The Banco de Mozambique's policy rates for shorter maturities (reverse repo) remained unchanged. In effect, with the exception of the interest rate for the 63-day maturity that fell slightly by 1 bp, all the remaining rates on repurchase agreements operations were stable, standing at 15.25%, 15.29% and 15.37%, respectively for overnight, 7-day and 28-day maturities.

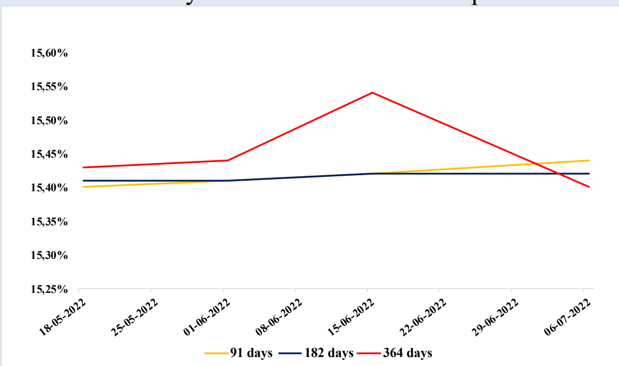
Chart 2: IMM Interest Rate Developments



Source: BM, 2022

Between the two MPC sessions, T-Bill interest rates recorded opposing trends. In effect, interest rates for 91 and 182-day maturities increased by 1 and 4 bp, while the 364-day rate decreased by 3 bp. It should be noted that the T-Bill interest rate for the 364-day maturity stands 15 bp above the MIMO rate (Chart 3).

Chart 3: Treasury Bill Interest Rate Developments

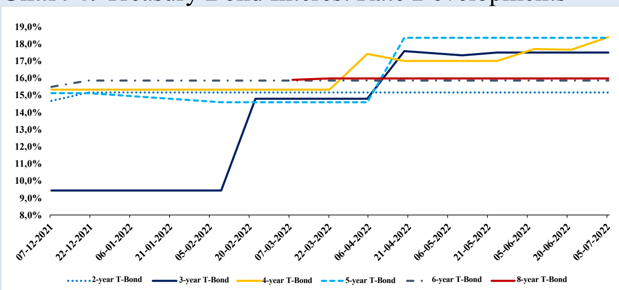


Source: BM, 2022

b) Treasury Bond Interest Rates

The 3 and 4-year treasury bond (T-Bond) interest rates increased. In effect, during the period under review, the State continued to issue T-Bonds in line with the standard schedule, which resulted in average weighted rates of 17.49% and 18.42%, an increase of 16 and 142 bp, for the 3 and 4-year maturity auctions, respectively. The State did not issue securities for the other maturities. Chart 4 shows the T-Bond rate developments.

Chart 4: Treasury Bond Interest Rate Developments



Source: BVM, 2022

c) Retail interest rates

Between March and May, retail interest rates fell despite an increase in the prime rate. In effect, the prime rate increased to 20.60% in June, following 18.60% in March. However, the interest rate on lending operations for a one-year maturity decreased by 50 bp to 18.40% in May 2022, a similar trend observed in the rate of liability operations for the same maturity that decreased by 40 bp to 8.9%, which contributed to the decrease in the spread to 9.5%, from 9.6% in March 2022 (Chart 5).

II. Exchange Rate Developments

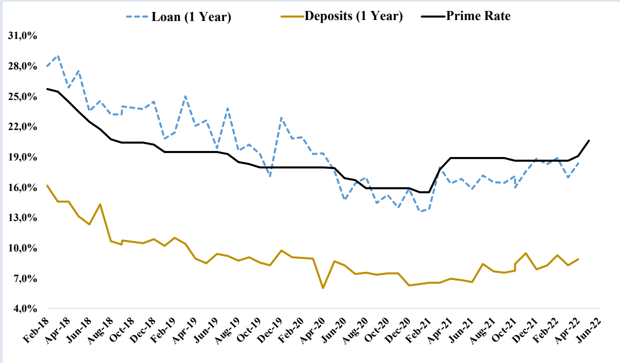
a) Metical Exchange Rate against the US Dollar

Stability of Metical (MZN) Exchange Rate against the US Dollar (USD). In effect, between May and July (the interval between the two MPC cycles), the benchmark exchange rate of the MZN against the USD went from MZN/USD 63.83 to MZN/USD 63.86, while the effective exchange rate (resulting from transactions between commercial banks and the general public) rose from MZN/USD 63.83 in May to MZN/USD 63.87 in July. On the other hand, the exchange rate for transactions between foreign exchange bureaus increased from MZN/USD 64.17 to MZN/USD 64.22 (Chart 6).

b) Metical Exchange Rate against the Rand

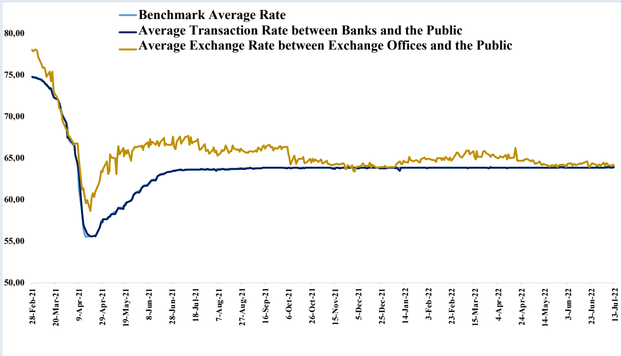
Appreciation of the Metical exchange rate (MZN) against the Rand (ZAR). In effect, between the two MPC cycles, the benchmark exchange rate of the MZN against ZAR went from MZN/ZAR 4.01 to MZN/ZAR 3.76; the rate of the commercial banks with the general public went from MZN/ZAR 4.03 to MZN/ZAR 3.74; and the foreign exchange bureau rate with the general public went from MZN/ZAR 4.07, following MZN/ZAR 4.20 in the previous session.

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



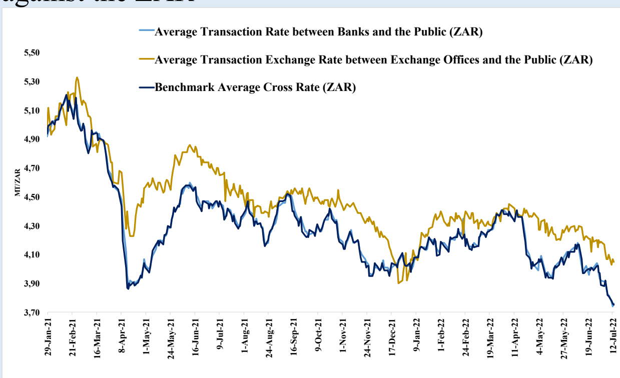
Source: BM, 2022

Chart 6: Metical Exchange Rate Developments against the US Dollar



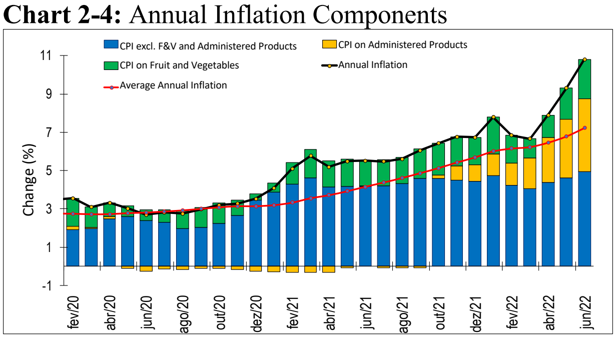
Source: BM, 2022

Chart 7: Metical Exchange Rate Developments against the ZAR



Source: BM, 2022

Chart 2-4: Annual Inflation Components



Source: INE/BM

2.2. Recent Inflation Developments and Short-Term Prospects

In June 2022, annual inflation[5] continued to accelerate, reflecting the adjustment in the prices of administered of goods and the increase in food prices. Indeed, annual inflation rose from 9.31% in May to 10.81% in June. Similarly, average annual inflation held its upward trend, rising to 7.22% in June, following 6.78% in May (Chart 2-4).

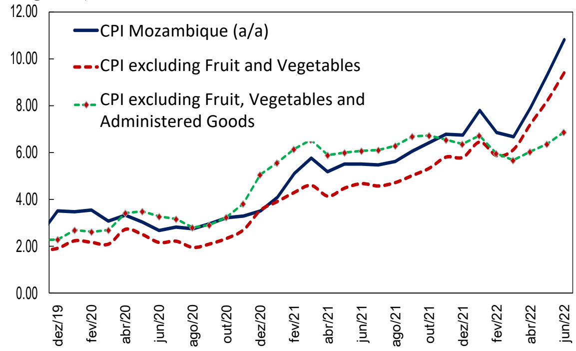
[5]Measured by the change in the consumer price index.

Table 2-6: Core Inflation - Mozambique (Annual Change %)

	dec/21	jan/22	feb/22	mar/22	apr/22	may/22	jun/22
CPI	6.74	7.80	6.84	6.67	7.90	9.31	10.81
Food	9.82	10.92	8.96	7.80	10.25	13.51	15.90
Cereals and byproducts	2.95	2.76	2.72	2.34	6.66	14.17	18.00
Fruit and vegetables	17.21	22.27	16.31	11.90	14.71	20.84	26.23
Administered	3.96	5.49	5.49	7.66	11.27	14.63	18.18
Liquid Fuels	9.91	9.91	9.91	16.49	23.50	26.38	34.13
CPIxF&V	5.80	6.45	5.87	6.14	7.22	8.22	9.41
CPIxAdmin.	7.47	8.42	7.19	6.43	7.04	7.96	8.91
CPIxF&V and Admin.	6.35	6.74	5.98	5.68	6.04	6.34	6.85

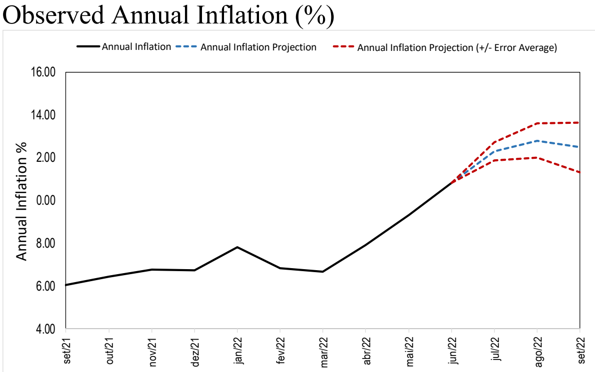
Source: INE

Chart 2-5: Annual Inflation and Core Inflation (Annual Change %)



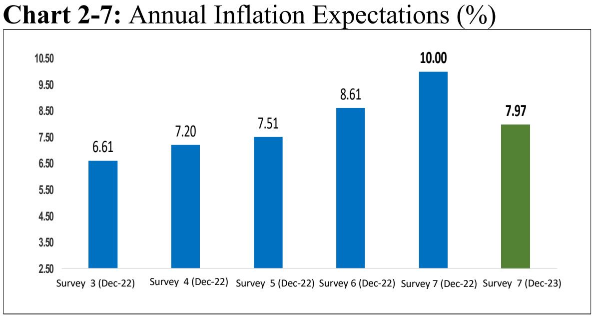
Source: INE

Chart 2-6: Short-Term Annual Inflation Projections and Observed Annual Inflation (%)



Source: BM

Chart 2-7: Annual Inflation Expectations (%)



Source: BM

The recent inflation dynamics is driven by the lagged effect of the fuel price adjustment, which took place in late May 2022, and by the surge in prices for wheat bread and food (Table 2-6).

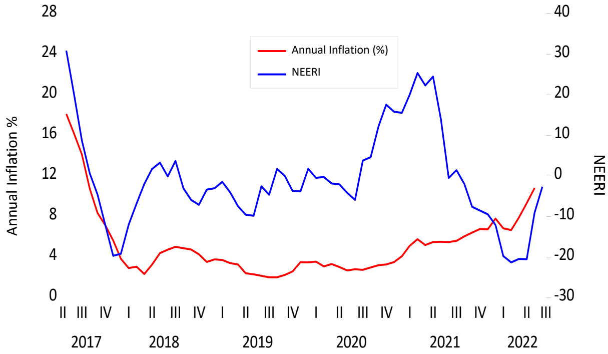
Meanwhile, core inflation recorded a relatively milder acceleration. Indeed, excluding the fruit and vegetable component – the most volatile of the Consumer Price Index (CPI) – as well as the component of products with administratively determined prices, annual core inflation rose from 6.34% in May to 6.85% in June (Table 2-6 and Charts 2-4 and 2-5).

Near-term forecasts point out an acceleration in inflation in the coming months. This outlook is underpinned by (i) the adjustment in fuel prices in early July 2022; (ii) their pass-through to prices of other goods and services; in addition to (iii) the acceleration in inflation in South Africa (Chart 2-6). The impact of these factors may be offset by the stability of the domestic currency against the US dollar and the Rand.

Economic agents expect a further acceleration in inflation by the end of this year. The BM's July macroeconomic expectations survey based on economic agents reveals that, by the end of 2022, annual inflation may stand at about 10.0%, following the 8.6% revealed in the previous survey (Chart 2-7). However, economic agents expect that in the medium term the inflation will return to a single digit.

In the same period, the Nominal Effective Exchange Rate Index, one of the leading indicators of price trends, also foresees the prospects of rising prices in the forthcoming months (Chart 2-8).

Chart 2-8: Nominal Effective Exchange Rate Index and Annual Inflation



Source: BM

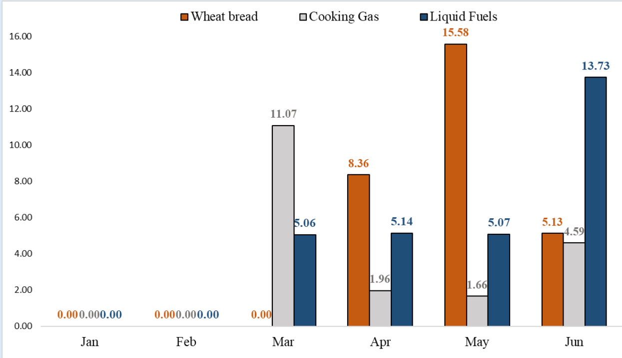
Box 2: Prices of Administered Goods and Services and Recent Inflation Developments in Mozambique

The increase in the prices of administered products and food has been the main driver of recent inflationary pressure in Mozambique. Similar to what has been observed worldwide, the Mozambican economy has been affected by inflationary pressure shocks, especially regarding administered goods and services[6], whose acceleration has been higher than the other CPI components. In fact, after having a cushioning effect on headline inflation until September 2021 (average contribution of -0.11%), from October 2021 to the present day, the administered products CPI has stood out as the component with the greatest contribution to the acceleration of headline inflation in Mozambique (Chart 1). Over the last nine months, the headline inflation is more correlated with the administered CPI (92%), than with the fruit and vegetables CPI (63%) and the CPI excluding fruit and vegetables and administered goods and services (55%), designated as core inflation[7].

1. Developments in the components of administered products

Liquid fuels[8], cooking gas and bread are the main sources of the acceleration of inflation on administered goods and services. In light of adjustments of administered goods and services since March 2022, Chart 1 shows that the average inflation for administered goods and services (1.1%) has become twice as high as headline inflation (0.50%). Liquid fuels, cooking gas and wheat bread stand out as the items that have strongest effect on inflation on administered goods and services, given their combined contribution growing by an average of 7% in the last three months (Chart 1).

Chart 1: Annual Change in Prices of Administered Products (%, First Half of 2022)

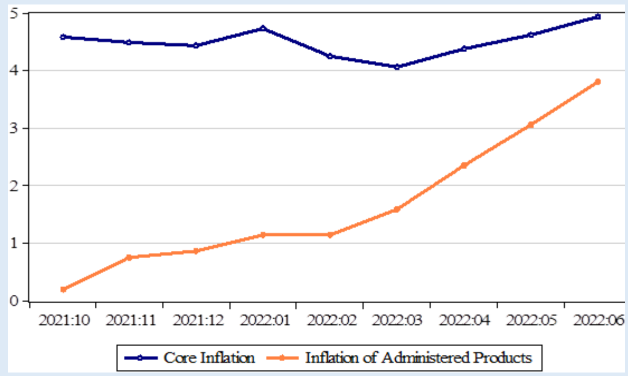


Source: INE (2022)

2. Relationship between Administered CPI and Core Inflation

Inflation on administered goods and services has been accelerating since March, but its pass-through to core inflation remains low. Considering that many of the administered goods and services are raw materials for the several economy sectors, changes in prices of administered goods and services should drive changes in non-administered goods, including goods and services that are an integral part of core inflation. However, over the past nine months, administered CPI has accelerated to a monthly average of 28 pp (percentage points), against the average of 1 pp for core inflation, which suggests that the pass-through from the former to the latter remains limited (Chart 2).

Chart 2*:* Inflation of Administered Products *vs.* Core Inflation

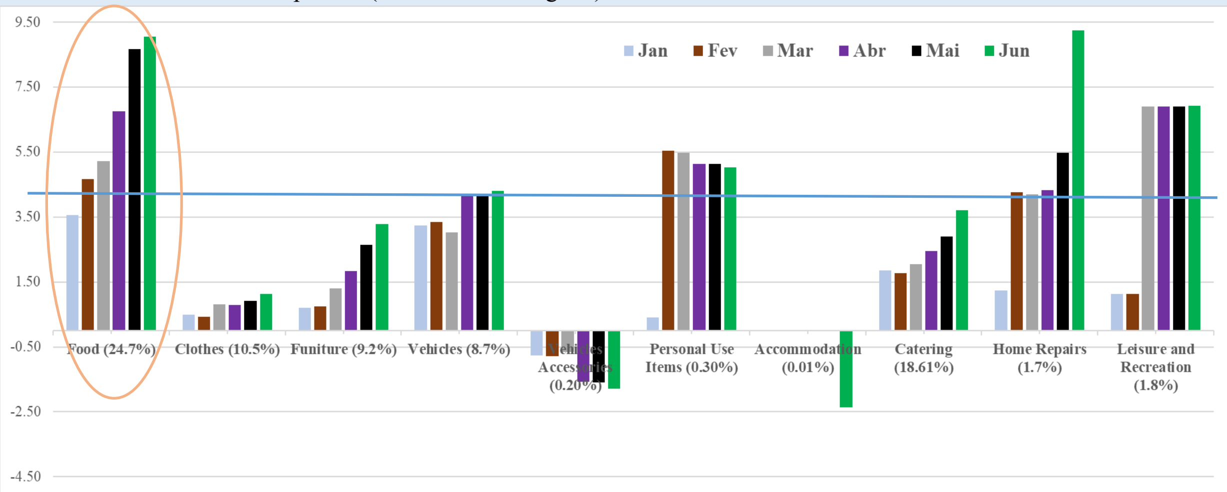


Source: INE (2022)

Excluding the effect of the food component, the prices of other components of core inflation remain stable, or with modest increases. Throughout the first half of 2022, in the main subcomponent of core inflation, the prices of three goods and services groups slumped (vehicle parts and accessories, personal use items and accommodation). The other three have experienced price containment or stability, such as the case of clothes and footwear, vehicles, and leisure and recreation. In general, excluding the high cost of food in the international market, which significantly impacted the food component of core inflation, most of the components of core inflation saw a cumulative price increase below 4% in the concerned period (Chart 3).

The increase in the MIMO to 15.25% in March, and consequently the prime rate of the financial system to 20.6% in June, will contribute towards cushioning the pressure on core inflation.

Chart 3: Core Inflation Developments (Cumulative Change %)



Source: INE (2022) | Note: values in parentheses represent weights of each of the core inflation components

[6] In the context of calculating inflation, administered goods and services are those whose prices are set by the Government and, therefore, their prices are not determined by market supply and demand. Currently, administratively priced goods are made up of 23 items that jointly weigh 20.35% in the general CPI composition.

[7] The basket used to calculate core inflation consists of products whose prices are susceptible to changes in aggregate demand-side factors and, therefore, may be influenced by monetary policy.

[8] Fuel, diesel and lamp oil.

Chapter III. Medium-Term Inflation and Economic Activity Forecasts

Inflation is expected to decelerate to a single digit in the medium term, driven by the slowdown in external demand and the resulting decline in international commodity prices, against a backdrop of ongoing exchange rate stability. Economic activity recovery prospects for 2022 and 2023 prevail, despite prospects of slowing external demand. In light of this outlook and the risks and uncertainties associated with inflation forecasts, the MPC has decided to maintain the MIMO rate unchanged at 15.25%.

Table 3-1: External Assumptions

	2021	2022	2023
US Real GDP	**5.8**	**2.3**	**1.4**
May MPC/2022		3.1	1.9
RSA Real GDP (%)	**5.5**	**3.0**	**1.7**
May MPC/2022		1.7	2.1
US Inflation (%)	**4.7**	**8.3**	**5.6**
May MPC/2022		8.0	5.3
RSA Inflation (%)	**4.6**	**6.2**	**5.8**
May MPC/2022		5.6	5.0
Brent price (USD)	**70.4**	**113.2**	**106.6**
May MPC/2022		104.6.1	92.3
Food prices (%)	**28.3**	**23.9**	**2.6**
May MPC/2022		34.1	4.2

Source: GPMN / IMF

3.1. Medium-Term Outlook Assumptions

The medium-term macroeconomic forecasts are mainly grounded on the following assumptions: (i) global inflationary pressure containment (ii) a slump in external demand; (iii) easing of commodity supply chain bottlenecks; and (iv) protracted geopolitical crisis in Europe.

a) External assumptions

- Slump in external demand, mainly resulting from tighter monetary conditions as a response by central banks to the rising inflation trend in several economies worldwide.

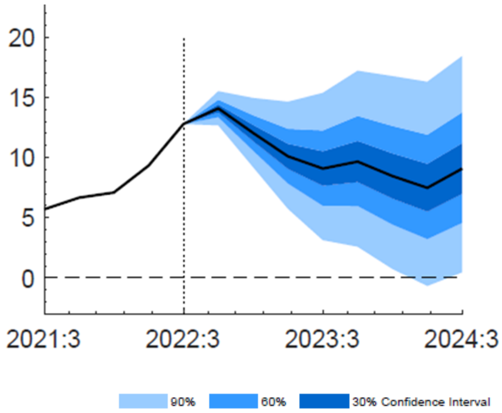
- Prospects of persistent high oil prices (Table 3-1), mainly resulting from difficulties by the OPEC+ members in fulfilling production targets set by them.

- Forecasts of food price drops in the international market, amid the easing of supply chain bottlenecks and prospects of weaker global demand.

b) Internal assumptions

- Continued Metical exchange rate stability against the US dollar, in line with (i) the resumption of the financial support from the IMF and other cooperation partners, (ii) the gains reaped from favorable developments in the prices of main Mozambique's main export commodities, and (iii)

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



the forecasted kick-off of exports of natural gas from the Rovuma basin, starting in the fourth quarter of 2022.

- Ongoing pressure on public expenditure, especially associated with the need for basic social assistance by the Government to cope with the increase in the cost of living, mainly caused by the surge in prices of administered goods and services, and the effect of its pass-through to the prices of other domestic goods and services.

The pressure on public expenditure may be further exacerbated by the need to (i) uphold security in Cabo Delgado and provide humanitarian assistance to the displaced families; (ii) ensure the implementation of the reconstruction plan in zones affected by the insurgency in the north of the country; and (iii) expenses associated with subsidies for basic social assistance in order to mitigate the escalation of cost of living.

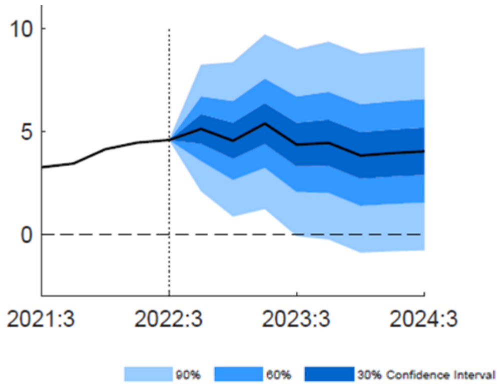
Meanwhile, such fiscal pressure may be lessened by the resumption of foreign aid from partners directly supporting the State budget.

3.2. Medium-Term Inflation Forecasts and Associated Risks

In view of the above assumptions, inflation is expected to slow down to a single digit in the medium term (Chart 3-1). These forecasts arise from the slump in external demand (associated with the tightening of monetary conditions worldwide), the effect of the MIMO hike in March, and lower volatility of Metical exchange rate.

The macroeconomic forecasts framework also foresees continued prospects for economic activity upturn, despite the prevailing risks of slowing external demand**.** These forecasts are mainly the result of the implementation of energy related projects underway in the country and the boost

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



from the resumption of the program with the IMF (Chart 3-2).

The risks and uncertainties associated with inflation forecasts remain high, especially given the prolongation and magnitude of the (i) impact of the Russia-Ukraine geopolitical conflict, with implications such as slowing external demand and rising inflationary pressure; and (ii) consequently, greater pressure on prices of administered goods, as well as their pass-through to other essential domestic goods and services.

3.3. Monetary Policy Decision

The Monetary Policy Committee (MPC) of the Banco de Moçambique has decided to maintain the policy rate, MIMO, unchanged at 15.25%.

This decision follows from forecasts of inflation decelerating to a single digit in the medium term, driven by the slowdown in external demand and the resulting decline in international commodity prices, against a backdrop of exchange rate stability. However, in the short term, prices are expected to continue to rise, reflecting the pass-through of high oil and food costs in the international market to the domestic economy.

In addition, the MPC also decided to:

- Maintain the Standing Lending Facility (SLF) rate unchanged at 18.25%;
- Maintain the Standing Deposit Facility (SDF) rate unchanged at 12.25%; and
- Maintain Reserve Requirement ratios for liabilities in domestic currency and foreign currency unchanged at 10.50% and 11.50%, respectively.