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News reports & clippings
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Interest rates and inflation up

Economic paradox – part 1
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Government says stress on big projects
Devaluation of the Metical

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Attached files: This report in PDF (with exchange rate charts) and interviews with Prakash Ratilal and Dipac Jaintilal (in Portuguese)
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Interest rates and inflation up

Sharp increases in inflation and interest rates were announced yesterday (22 September) by the Bank of Mozambique. The annual inflation rate in Maputo at the end of August (the time of the 1-3 September price rise riots) was 17%. By comparison, September 2008 to August 2009 inflation had been only 1%, although September 2007 to August 2008 had been 11%.

AIM reports that the Bank's spokesperson, Waldemar de Sousa, said yesterday that food prices were the major factor behind the surge in inflation. In the first six months of the year, the average price of fruit and vegetables rose by 34%. The sharpest rises were for lettuce (94%), cabbage (64%), tomatoes (55%) and onions (37%). These price rises are so steep because much of the fruit and vegetables consumed in Maputo is imported from South Africa, and the metical has depreciated sharply against the South African rand. Fuel prices also drove inflation, because the freeze on fuel prices imposed by the government in 2009 ended in March, and by the end of June fuel prices had risen by 44%.

The rapid depreciation of the metical against the rand this year is due explicitly to IMF policy, and is discussed more below. There are currently 5 meticais to the rand, compared to 3.7 at the beginning of the year.

de Sousa also announced another increase in the base interest rate (taxa de juro da facilidade permanente de cedência). It had reached a low of 11.5% in 2009 and was raised to 12.5% in April, 14.5% in June, and now 15.5%. The higher base interest rates will push commercial interest rates to well over 20%. The changes are explicitly intended to restrict credit to the economy, curb inflation, and stabilise the metical.

Interest rate rises were reported in the "June" issue of the Bank of Mozambique "Preços e Conjuntura Financeira", which was published on 21 September and reports on the Monetary Policy Committee meeting of 13 September.
http://www.bancomoc.mz/Files/DEE/PCF%20Junho_2010.pdf

The consumer price index is on http://www.ine.gov.mz/home_page/indicadores_macro_economicos/ipc

The Mozambique 'paradox'

"Mozambique is a paradox. A case of success, yet still one of the poorest countries in the world", according to Shaun Cleary, British High Commissioner (ambassador) in Maputo, cited in MediaFax Monday. The use of the word is not new. UNICEF in 2006 and the World Bank in 2007 pointed to what they both called the "paradox" of rising chronic child malnutrition in the face of rapid GDP growth – and praise for the Mozambique success story.

The riots of 1-3 September have forced Mozambican economists to question the Mozambican development model. And Mozambique is not alone. Questions are being raised globally about the failure of the Washington Consensus model across Africa, even with various modifications. In this issue of *News reports and clippings*, we look at the debate over the Mozambican "paradox". The discussion will be continued in the next issue, next week.

(*MediaFax* 20 Sept: "De acordo com Cleary, 'Moçambique é um paradoxo. Um caso de sucesso, mas ainda um dos países mais pobres do mundo'.")

Prakash Ratitlal:
State must invest to promote development

"Inequalities, particularly in the cities, are growing alarmingly," warns Prakash Ratilal, chair of Moza Banco and a former governor of the Bank of Mozambique. "Our country is admired by the entire world as a continuing success story ... but from one day to the next it toppled. And the violence returned." Statistics are repeated to show national GDP growth, but groups are left behind. "Those who have nothing left to lose raised their voice and screamed, reacting against the rise in prices of essential goods. They were protesting against bread rising in price by 1 metical, which is less than 3 US cents, an amount that surely seems paltry in the West, but in our country is a real measure of our poverty, our fragility, and the threshold of our vulnerability."

What happened on 1 and 2 September 2010 and 5 February 2008 demands a "profound reflection" to reach a new consensus on how to move forward. In an interview in *Noticias* (10 September 2010) Ratilal argues that "a strong intervention of the state is necessary to induce development, principally to promote production."

"I know that in defending a more interventionist role for the state to overcome market failures and to promote development, I am rowing against the tide of those who defend the ideas of neo-liberalism, pure and hard. But the truth is that the neoliberal prescriptions have roundly failed in Mozambique, and also in most other countries. After billions of dollars injected into our economy, we continue to be mired in inequality," Ratilal continued. "Mozambique is confronted by serious structural inequalities, and implementing the policies of the World Bank and IMF, year after year, has not reversed these inequalities."

"If the private sector is to be the principal force for economic change, it requires substantial support, which should be given without complexes," he continues. If the priority is to be agriculture and food production, then that sector needs more money and capacitation. Bank credit to agriculture is falling dramatically, and is now only 9% of total credit. Private banks are not willing to lend for agriculture, so Ratilal repeats his call for "a development bank, professionally managed and without political interference." Such banks "are the basis of the successes in Brazil, South Africa, Malaysia, Indonesia, and many other countries."

He calls on "development partners to support the necessary economic changes" and to "give more space to Mozambican technicians and specialists who know the country, have international experience, and have demonstrated high capacity."

But in the wide-ranging interview Ratilal does not restrict his criticism to donors and the IMF. "The Mozambican people, during many years of war and the era of cabbage and carapau [a cheap bony fish], faced huge shortage and accepted immense sacrifices. But there was an ambient of less social inequality and a generalised perception that the elite and government leaders were not separate and were concerned with the living conditions of the people." But now, the elite is "ostentatious" with its "superfluous" spending. Leaders much given an example, and shift spending from their own consumption to investing in development.

Dipac Jaintilal
IMF restricting development

IMF policies, particularly those set out in the most recent agreement, are restricting Mozambican development, according to Dipac Jaintilal, a former senior economist at the World Bank and director at the Banco de Moçambique. In a long interview spread over two weeks in *Savana* (3 and 10 September 2010) he says "it has become essential that we seriously re-evaluate the policies, strategies, plans and programmes that have been in force until now."

The IMF argues that the international crisis is over and thus Mozambique's temporary expansionist policies – fiscal, monetary and credit – of 2009 should now be reversed, and this has been agreed in the government's Letter of Intent of 24 May to the IMF and subsequent IMF Executive Board approval on 14 June.

The Letter of Intent sets out significantly new terms, Jaintilal argues. Credit to the economy is to be sharply restricted. It grew 47% in 2008 and 59% in 2009, but will increase only 19% this year. Interest rates rose 3% in three months. The devaluation of the metical is to continue. And the government will continue to maintain reserves of $2 billion, which Jaintilal considers double what is necessary.

Reserves are probably largely held in US bonds, so Mozambique is effectively lending $1 billion – which it received in aid – to the United States instead of spending it on development and poverty reduction. This at a time when Jaintilal points to a "sharp rise in urban poverty and inequality." He adds: "more than half the Mozambican population is living below the minimum considered absolutely necessary."

IMF pressure for further devaluation is intended to promote exports and reduce imports, but Jaintilal thinks this is highly unlikely to be successful. Increasing exports requires more than devaluation. He argues that the devaluation was too quick and is already "excessive".

The 1-3 September riots were in protest against a rapid rise in the cost of living in Maputo, which in turn was triggered in large part by an increase in the cost of food imported from South Africa. (An important question raised by Jaintilal and Ratilal is why this food is not produced in Mozambique.) This, in turn, was triggered by the quite rapid devaluation of the metical this year. Jaintilal cites four reasons for this. First was the donor strike, which reduced the flow of dollars to Mozambique in the first three months of the year. Second was IMF policy, which led Mozambique to devalue quite rapidly. Third was the US designation of Mohamed Bachir Suleman (MBS) as a "drug kingpin", which had an impact on the informal trading of dollars. Fourth was a set of knock-on "psychological effects", which probably led people to want to hold more dollars in cash.

Finally Jaintilal calls for renegotiating the terms of the mega-projects – Mozal aluminium, Sasol gas, and the Moma heavy sands – to ensure that they pay more taxes. Small taxpayers now pay proportionately more than these big projects, and many countries in the world have been able to re-negotiate mining contracts when the environment changes.

Jaintilal argues that Mozambique has been systematically giving benefits to the mega-projects that it does not give to its own business people, perhaps because "it is easier to deal with the preoccupations of a few economic agents than with the vast problems of thousands of smaller businesses." But Mozambique has to give support to small and medium enterprises, especially in agriculture. "Without the growth of national companies it will be difficult to sustain the economic fabric of the country and create jobs, to channel the energies of young people into productive activities and thus assure peace and social tranquillity."

Government tells IMF it will stress big projects & mining

In its Letter of Intent to the IMF, the government says it will concentrate on big projects and mining. Agriculture is mentioned only with respect to "social spending". Nothing is said about supporting Mozambican entrepreneurs. "The focus of the central government's investment strategy will be in transport and electricity infrastructure", the government tells the IMF. "Priority will be given to projects that could have a catalytic effect on private investment."

In a quite remarkable list, the government says "the following specific projects enjoy the highest priority at present":
+ The international airport of Nacala;
+ The rehabilitation of the port of Beira;
+ Expansion of electricity production at the Cahora-Bassa dam;
+ The construction of a power line between the Cahora-Bassa dam and Maputo;

+ Expansion and rehabilitation of the road network
The IMF is to allow Mozambique to take commercial, non-concessional loans for these projects.

"To create an environment conducive to strong private sector activity," the government intends to:
(i) maintain macroeconomic stability;
(ii) encouraging additional national and foreign direct investment in the natural resources export sector;
(iii) significantly increase public investment in transport and electricity infrastructure, partly through nonconcessional external borrowing and/or Public-Private Partnerships (PPP);
(iv) improve the business climate; and
(v) reap benefits from regional integration.

Also, "the Bank of Mozambique (BM) will begin to reverse, in tandem with the expected recovery of global credit markets, the sharp easing of monetary policy that facilitated substitution of foreign borrowing with domestic credit in the wake of the crisis in 2009."

IMF papers on the web:
+ Letter of Intent, 24 May 2010
http://www.imf.org/external/np/loi/2010/moz/052410.pdf
+ 6th review under PSI, 23 June 2010
http://www.imf.org/external/pubs/cat/longres.cfm?sk=23983.0
+ IMF Executive Board Approves New Three-Year PSI, 14 June 2010
http://www.imf.org/external/np/sec/pr/2010/pr10242.htm

Devaluation of the metical

At the beginning of 2009, there were only 2.5 meticais to the rand, whereas it is now 5 to the rand. This means South African imports cost double what they did 20 months ago. The explanation for this rests with the triangle of metical-dollar-rand exchange rates. (To see this correctly, it is easier to use the attached pdf file which has three charts of exchange rates.)

The metical remained stable at roughly 25 to the US dollar from 2002 until early 2009, and then drifted up to 28 in late 2009. Then the government implemented the IMF policy and the metical was devalued 33% against the dollar in just five months, reaching 37 in August.

Meanwhile, between 2002 and 2005 the rand was devalued from 12 to 6 to the US$, which sharply reduced the cost of imports to Mozambique. The rand rose slowly to 8 in 2008, then suddenly jumped to 10 in 2009 with the global financial crisis and the jump in gold prices. Later in 2009 it fell back to 8 to the US$, where it remains.

So what did this mean for the metical? First, the high value of the rand at the end of 2008 led to the very unusual rate of 2.5 meticais to the rand, conveniently just at the time of elections in Mozambique. This helped to keep Maputo inflation very low. But as the rand devalued, it reached 4 meticais to the rand by the end of 2009. Then the rand became stable, but this year under IMF pressure Mozambique devalued, pushing the exchange rate up to the record level of 5 meticais to the rand.

So Maputo inflation levels have been caused by a deteriorating metical-rand exchange rate, in turned due to a combination of rand fluctuations (2008-09) and IMF policy (2010).

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Two working papers on the web

Poverty is not being reduced in Mozambique
LSE Crisis States Research Centre Working Paper No. 74 (series 2)
Benedito Cunguara and Joseph Hanlon
http://www.crisisstates.com/Publications/wp/WP74.2.htm
June 2010 também em Portugues

Mozambique's Elite – Finding its Way in a Globalized World and Returning to Old Development Models
Joseph Hanlon and Marcelo Mosse September 2010
WP/105 UNU-WIDER: The Role of Elites in Economic Development project
http://www.wider.unu.edu/publications/working-papers/2010/en_GB/wp2010-105/

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Also on the web: Previous newsletters and other Mozambique material are posted on
tinyurl.com/mozamb
(If links do not work, copy and paste the address in your browser)
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This mailing list is used to distribute two publications, both edited by Joseph Hanlon. This is my own sporadic "News reports & clippings", which is entirely my own responsibility. This list is also used to distribute the *Mozambique Political Process Bulletin*, published by CIP and AWEPA, but those organisations are not linked to "News reports & clippings"
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Mozambique media websites:
Noticias: www.jornalnoticias.co.mz
O Pais: www.opais.co.mz
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