

Ernesto Gouveia Gove: Central Bank of Mozambique's review of 2006 and prospects for 2007

Speech by Mr Ernesto Gouveia Gove, Governor of the Bank of Mozambique, on the occasion of the 2006 Financial Year Closing Ceremony, Maputo, 20 December 2006.

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Distinct Members of the Board of Directors of the Banco de Moçambique
Distinct Presidents and Representatives of Commercial Banks and Financial Institutions
Dear Guests
Ladies and Gentlemen,

First of all, I would like to thank you, on behalf of the Board of Directors of the Banco de Moçambique and personally, for your presence in this traditional meeting of the end of the year in which we make the first analysis of the financial year ending and present our perspectives for the 2007 financial and economic year.

Introduction

The year 2006 was marked by important events for the country and our institution. The agreement on the reversion of Cahora Bassa Hydroelectric (HCB) plant to the Mozambican Government was indeed an event with an historic and economic dimension. Under this agreement, the Mozambican Government became the holder of 85% of the shares of that important undertaking, which empowers the government greater autonomy to make use of the HCB immense potential for social and economic development of the country as well as the whole SADC region.

We congratulate our Government for this important victory and hope that Cahora Bassa becomes, more and more, a strong instrument of promotion of national interests and implementation of the national strategy of internal development and in the context of Southern African region.

In 2006, the IMF Board, World Bank and African Development Bank, decided to include Mozambique in the list of poor countries, which benefited of debt relief, in the context of Multilateral Debt Relief Initiative, widely known as MDRI. For our country, this decision meant a write-off of about USD 2 billion in the stock of external debt, being USD 1.3 billion from the World Bank, 540 million from the African Development Bank and 154 million from the IMF. This gesture encourages us and confirms the commitment of the international community in relation to the performance of the Government in the implementation of PARPA (Plan of Action for the Reduction of Absolute Poverty) and macroeconomic stability and development programs. With this forgiveness, the ratios of Mozambique external position become greatly improved, allowing the Government to resort to external financing, on the basis of a criteria based management indebtedness, to pursue the multiple purposes of its development program and fight against absolute poverty.

The international recognition of the Government positive performance was once more expressed by the International Monetary Fund (IMF) when on December 18th, 2006, approved the PRGF program (Poverty Reduction and Growth Facility) that Mozambique has with that multilateral financial institution, a fact that offers good perspectives for the consolidation of international cooperation.

It is worth referring to the changes that took place at the top management level of our institution during the present year. On this occasion, I would like, once again, to express our tribute to Dr. Adriano Maleiane who until mid of the present year was the Governor of the Banco de Moçambique. This recognition is extended to the colleagues of the Board of Directors who have also retired. They left a legacy of unselfish work in favour of our institution and the Mozambican financial system that we are all invited to preserve and to deepen.

We would also like to praise the *Associação Moçambicana de Bancos* (Mozambican Association of Banks) for, most recently, having achieved a consensus in relation to a code of conduct for all its members.

Main goals for 2006

At the end of the last year, when we met in this same venue, we announced that our performance in 2006 aimed at contributing to the success of the Government's agenda, established in the Economic and Social Plan and Government Budget, documents that pointed out to 7.9% economic growth, 9.5% average inflation and an external position measured by gross international reserves equivalent to four months of imports of goods and non-factorial services. Our intermediary objectives pointed out to 14.5% money supply and a growth of the credit to the economy in line with the GDP nominal growth.

At that moment, we explained that our agenda for 2006 would basically comprise multi-faced actions aimed at implementing the Law n° 7/2005, which defines the Conversion Rate of the Metical of the New Family.

Performance of the monetary and foreign exchange policy

Ladies and Gentlemen

We began the year 2006 in an adverse international environment, due to the oil price volatility, which in the present year reached a new historic record of about USD 78/barrel. Fortunately, the signs reported this part towards the end of the year give us a certain optimism.

Preliminary information, based on data of the first semester of 2006, pointed out that the Mozambican economy may experiment a real growth around 7.9%. Moreover, differently from the last years, GDP growth was influenced by the construction, mining, transports and communication, and cattle-raising activity sectors, which revealed themselves to be more dynamic and with greater relative contribution than the major projects. That is really positive for our growth sustainability, as it results from the activity of small and medium enterprises, which greatly absorb resources and local labour force and, which has greater impact on the process of the fight against absolute poverty and reflect the diversification of the productive activity in the country.

As we know, the main mission of our institution is to ensure price stability. The evaluation we make is that inflation recorded a stable behaviour in 2006, compared with the year 2005, even taking into account that it was characterized by three different moments. Until April, we observed a rising trend of prices, period in which the annual variation rate peaked to 17%. Between May and August inflation slowed down, having the monthly variations been successively negative, prompting the annual rate to decline to 10%, the lowest level observed in the whole year.

Seasonally, at the end of the year, inflation tends to rise. However, the Consumer Price Index (CPI) monthly variation in November differs from that of the similar period of 2005, which makes it possible to record one-digit cumulative inflation at the end of 2006, even if in terms of average rate, we stand slightly above the projections of the beginning of the year.

The main instrument of monetary policy we use to restrain and maintain inflation under control were the Interbank Money Market operations supported by a strong vigilance over the requirement of compulsory reserve, which stand at 11.51% and by the rise of our intervention interest rate announced at the end of the first semester.

The oil price rise in the international market had a considerable impact on fuel and related products domestic prices. This factor influenced the inflation, but the combination of policies by different macroeconomic management institutions and the performance of real sector of the economy have allowed to soften this shock.

In 2006, the National Institute of Statistics (INE) introduced a new CPI basket, changing the year-base for 2004 and adjusting the weighing factors of several products comprising the basket. We congratulate the INE for this effort that reinforces the comparability of our statistics with those of other SADC countries, thus contributing to a greater integration of our economies.

After a year of clear disturbances, in 2006, the Metical revealed to be well more stable against the main currencies traded in various segments of the foreign exchange market. The exceptional measures announced late 2005 revealed to be important to abate the market and endow it with greater discipline and professionalism. We would like to praise the results obtained with the adjustments undertaken in the whole chain of the complex process of fuel imports, in order to stabilize the exchange rate. The Metical depreciation in relation to the USD in 2006 was less than 10%, against 27% recorded in 2005; in relation to the Rand, our currency inverted the loss of 11% recorded last year, as it appreciated by about 3.3%.

The Banco de Moçambique continued to be the main supporter of the Interbank Foreign Exchange Market (IFEM), in terms of foreign currency sales, having to date allocated a total of USD 435 million net, in auctions and bilateral sales, against 393 million recorded in 2005. The foreign exchange market witnessed an increased confidence among its operators and this is proved by the increased volume and frequency of foreign exchange transactions among commercial banks, which peaked to 181.4 million in 2006, against 39.5 million in 2005.

External sector developments (BoP)

Ladies and Gentlemen

According to information reported to September 2006, our Balance of Payments shows encouraging results. However, it still depends significantly on external support, making us more exposed to exogenous shocks, whose macroeconomic impacts are not always easy to predict.

Our Country is totally dependent on imports of liquid fuels. The rise of Brent price in the international market results prejudicial in the behaviour of domestic inflation and international reserves. The fuel bill until September 2006 had amounted to about USD 300 million, against 218 million recorded in 2005. This figure worries us, taking into account that our exports, excluding the mega projects effect, are of only USD 600 million, in other words, about a half of the country export revenues are set to finance fuel bill.

Until September 2006, Mozambique current account deficit had improved 38% compared with the similar period of 2005, if we include mega projects, and 9% excluding the operations of such projects. In the overall, we continue to import more than we export, having the amount of imports risen 23% in the first nine months of the current year, amounting to about USD 2 billion, whereas that of total exports amounted to USD 1.750 million.

Thanks to a relatively more dynamic growth of goods export than that of imports, the imports coverage rate by exports improved again, representing 89.4% in September 2006, including mega projects (10 percentage points rise in comparison with the similar period of 2005), or 32.9%, when excluding mega projects.

Even though, this level may be considered low, requiring additional efforts in order to promote greater diversification of exports, which must be done via increased production aimed at replacing imports, a condition to reduce the strong external dependence of our economy.

In turn, the coverage ratio of imports of goods and nonfactorial services by gross international reserves stood at 4.7 months in November, above the four programmed months, including the mega projects.

Ladies and Gentlemen

One of our objectives is to foster a sound, strong and competitive financial system. In the period under analysis, we improved the evaluation instruments of the risk of financial sector through CAMEL methodology – Capital, Asset Quality, Management Quality, Earnings and Liquidity.

Financial system and banking supervision

Available data showed that, in the overall, our institutions are more sound and robust today, with the main indicators evolving positively and with more encouraging perspectives. The level of capitalization of the institutions continues to grow, standing at a position that can be considered satisfactory.

The improvement of the soundness of financial system indicators reflects a combined effort of the Central Bank through the banking supervision and that of the credit institutions in strengthening their internal management and control processes.

We can assert that today our system is more prepared to face several risks that the financial activity brings about. In effect, the ratio of non-performing loan reduced to 3.6%, while the solvency ratio grew to 16.7%, against the minimum of 8% required, according to the Basel I Convention terms or 12% under Basel II terms.

Metical of the New Family

Simultaneously, we continued to undertake efforts aiming at modernizing our payment systems. The process of implementation of the Law N° 7/2005, regarding the introduction of the notes and coins of the Metical of the New Family began on July 1st, 2006, contributed to the fulfillment of this objective. We launched a broad advertising and civic education campaign addressed to resident citizens and our expatriates, about the details of this process.

We praise the involvement of everyone, credit institutions, the local authorities, community leaders and the media, in the campaign of the Metical of the New Family, process running calmly, with no disturbances, having the notes and coins of the Metical of the New Family been accepted widely. We are grateful for having achieved, until now, a rate of substitution of the notes and coins of the former families of the Metical by that of the New Family above 85%, expecting it to stand above 90% by the end of the year, which is a really satisfactory level for our conditions.

We would like to remind all the citizens that as from January 1st, 2007, the notes and coins of the former families of the Metical will no longer have a legal tender for any payment, otherwise they should be deposited or exchanged at any banking institution. Therefore, I would like, once again, to invite everyone to change the former families of the Metical by that of the new family through the commercial, banking and financial services existing in the country.

Such as established in the Law, during 2007 the currency exchange should be done at the commercial banks, but even so, the people who by serious reasons are unable to change their money during this period, they will have the opportunity to do it at the Banco de Moçambique until 2012.

Moreover, we would like to stress that as also prescribed in the Law, December 31st, 2006, marks the end of the use of the register designation "MTn" and the return to the designation "MT", as well as the end of the mandatory double indication of prices in force since March 31st, 2006.

Territorial expansion (branches)

Ladies and Gentlemen,

The strategy defined by the Government setting districts as the poles of planning and development of our economy, brings increased challenges to the financial sector. We are expected to give our contribution towards this objective, expanding our services throughout the national territory, especially to the less favoured areas but with enormous wealth and business potential.

The financial sector should be sensible to the current low saving indices that the country records, which require pragmatic initiatives to encourage saving habits on our population. The increased demand of credit to finance public and private investment projects requires more dynamism in financial savings.

On December 15th, 2006, we inaugurated the first branch of the Banco de Moçambique, in Quelimane city and within a few days we are going to Maxixe with a similar purpose. In the coming months we are going to open Tete, Pemba and Lichinga branches. This decision opens a new era in the activity of the Mozambican financial system and within our performance philosophy, as the issuing and supervisory bank of the financial and non-financial institutions.

With this measure, we showed a great sign to the banking system on the urgent need to do our best in order to enlarge the financial services and decentralisation of banks throughout the country.

The branches of the Banco de Moçambique will enable our mission in terms of issuance and circulation of notes and coins of good quality, modernization of the national payment systems, reduction of storing costs and transport of notes and coins by commercial banks, enable the Government financial operations, in the context of the Treasury single account and more decentralized financial administration, as well as everything related with licensing, support and supervision of micro-finance institutions. Our branches are being open in a decisive stage of the process of introduction of the Metical of the New Family.

We were pleased to note that in 2006 some credit institutions expanded their branch network and financial services throughout the country, which we encourage recognizing its importance in fostering savings.

Together with the Ministry of Finance we will continue to devise strategies and measures aimed at minimizing constraints that today are pointed out by the national banking system as impeditive of a

greater territory expansion and extension of financial services outside the main cities. The presence of banks in districts is going to foster the necessary savings for investments that the country really needs in order to face the millennium challenges, related to the fight against poverty.

Ladies and Gentlemen,

The Parliament has just analysed the Economic and Social Plan of the Government and the Budget for 2007, two important instruments of economic policy. In those instruments the Government envisages 7% real growth and 8% annual average inflation. For such purpose, our intermediate objectives will be set for 17.5% money supply, measured by the variation of stocks of the greater monetary aggregate (M3) and an expansion of Reserve Money, our instrumental variable, not above 14.5%.

In 2007, we will continue to deepen the reforms underway in the interbank monetary and foreign exchange markets, the main instruments of execution of our monetary policy. Once set the foreign exchange market stability, we assume to have the conditions created for a gradual removal of the transitional measures introduced in November 2005. We have just approved a new regulation of the Interbank Foreign Exchange Market (IFEM).

This normative instrument introduces procedures that were object of a long process of negotiation with commercial banks, namely: (i) inclusion of an adhesion requirement and obligation to quote firm to a reference amount of USD 50.000 (fifty thousand American Dollars), to a maximum of one call per day; (ii) enlargement of the spread between bid and offer rates, from the current 10 Ctn (ten cents) to 20 Ctn (twenty cents); (iii) definition with greater detail of the bilateral operations with the Central Bank; (iv) enlargement of the variation maximum limit of the daily rate to 1%, which appears reasonable for greater flexibility of the IFEM operators in the whole business environment, where the foreign exchange stability continues to be our major interest.

In order to offer greater credibility and transparency to the management of monetary policy, as well as to conform to the international good practices on the matter, after a long process of preparation, which included, among other aspects, the design of forecasting models and support monetary analysis to decision making, our committee on monetary policy is going to change its format and content, as from next year.

The model we are going to adopt will address special attention to communication with the public, with the purpose of disseminating the nature of measures that the Central Bank takes, throughout the market and the whole society, signalling more clearly the monetary policy pursued in the present and future, which will certainly help the process of formation of economic agents expectations.

The year 2007 is decisive for the implementation of the International Financial Reporting Standards (IFRS), thus marking the end of a transition process began in 2004. For such purpose, the banking supervision is going to address a future risk approach, conforming with the international practices on the matter.

As from February 2007, the Banco de Moçambique will start performing the clearance of visa network credit cards issued by national banks, with the purpose of ensuring that (i) all domestic transactions performed in Meticaís using cards issued by national banks, members of Visa are settled in Meticaís, (ii) the role of the Metical as national currency is reinforced, (iii) the foreign exchange risk is reduced, (iv) transactions performed with Visa payment cards are accompanied and recorded; (v) the absence of a single payment network is partially fulfilled, and (vi) the ATMs (Automated Teller Machines) and EFT/POS (Point of Sale) services are enlarged.

At the regional level, we will continue to give our contribution so that the objectives of macroeconomic convergence and integration defined by the SADC (Southern African Development Community) are achieved, particularly with respect to inflation, harmonization of procedures and legal framework that governs the central banks of the region.

Within the African continent, as a member of the Association of African Central Banks (AACB), we will continue to contribute to the objective of the creation of a central bank of the continent.

Final remarks

Ladies and Gentlemen,

We would like to express our profound recognition of the valuable contribution that all national economic agents, the society in general and the international community has been giving us in order to fulfil our mission, particularly in respect of the formulation and execution of a monetary policy in conformity with the objectives of economic growth, with low inflation.

Allow me to address special thanks to the employees of the national financial system and in particular, to the collaborators of the Banco de Moçambique, for their devotion and commitment demonstrated during the year.

I finish wishing you all and your distinct families, Merry Christmas and a prosperous New Year.

Thank you very much.