



What price are mozambicans paying for the unsustainable public debt?

Summary

The present *Desenvolvimento Review* (DesR) shows that the unsustainability of the Mozambican public debt, which resulted from the legalisation of the “hidden debts” by the country’s parliament, the Assembly of the Republic, and the consequent insertion of the debts into the 2015 State Budget, has increased the cost of living for Mozambicans through its effects on bank interest rates, and on the depreciation (loss of value) of the metical in comparison with the US dollar.

1. Introduction

The almost general opposition of Mozambican society to the intention of the Government to pay the financial costs resulting from contracting the so-called “hidden debts”, based on their illegality, as determined by the Constitutional Council, has as its backdrop the potential negative implications for the growth and development of our country. This matter returned to public debate in late October, following the release from the Ministry of Economy and Finance, which indicated that the government has paid about 38 million US dollars to the holders of the *Eurobonds* as part of the restructuring of the “hidden debts” (the paper “O País”, 2019). Although the Bank of Mozambique and the International Monetary Fund (IMF) have publicly recognised

that the Mozambican public debt is increasingly unsustainable, these financial institutions did not refer to the possible economic impacts of this unsustainability on the country and on Mozambicans. This is the context in which the present *DesR* analyses the relationship between the public debt (domestic and foreign) and the evolution of prices in the economy, and shows that, between 2015 and 2017, the foreign debt service precipitated the sharp depreciation of the metical against the US dollar by about 23%. Over the same period, the cost of the metical on the credit market increased by 40 percentage points (pp.). These two effects combined caused a general rise in the level of prices, and hence led to an increase in the cost of living by about 450 pp.

2. Effects of the Unsustainable Public Debt on the State Budget and on Prices in the Mozambican Economy

This section shows that the insertion of the “hidden” debts into the 2015 General State Account (CGE) worsened the budget deficit and contributed to the rise in

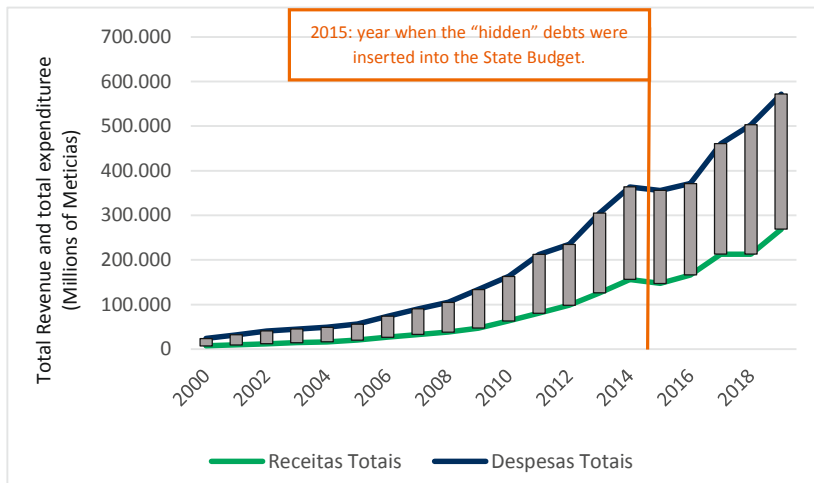
the level of prices, both on the financial market and on the market for goods and services.

2.1. The “legalisation” of the “hidden” debts sharpened the discrepancy between total revenue and total State expenditure by an annual average of 20.4 billion Meticaís.

Historically, the Mozambican state budget (OE) has always been in deficit, as a consequence of the small tax base of the economy, combined with the continued need for public investment as a result of the conjunctural and structural conditions of the Mozambican economy. Indeed, as shown in Figure 1 below, between 2000

and 2014 the public deficit (the difference between total revenue and total expenditure) increased at an annual average of 28.4 billion meticaís, and this discrepancy accelerated to an annual average of 48.8 billion meticaís between 2015 and 2019, the period corresponding to the inclusion of the hidden debts in the CGE.

Figure 1: Evolution of the total revenue and expenditure of the Mozambican State (2000-2019)

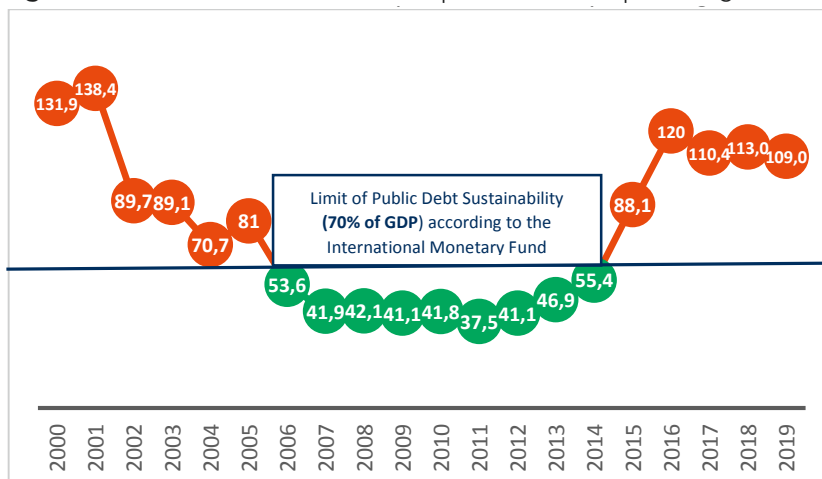


Source: Bank of Mozambique (2019), General State Account (2016, 2017, 2018)
(Green line = total revenue; blue line = total expenditure)

2.2. With the insertion of the “hidden” debts into the State Budget in 2015, the Mozambican public debt accelerated towards levels of unsustainability, according to the criteria of the International Monetary Fund.

The continual deficit on the public accounts has obliged the Mozambican government to go into debt, both domestically (domestic public debt) and externally (foreign public debt).

Figure 2: Evolution of the Mozambican public debt as a percentage of GDP (2000-2019)



Fonte: Trading Economics (2019)

As Figure 2 above shows, after a period of almost 10 years (2006 to 2014) when the public debt was within the patterns of sustainability defined by the International Monetary Fund (FMI), the insertion, in 2015, of the “hidden” debts into the CGE precipitated the acceleration of the public debt to unsustainable levels,

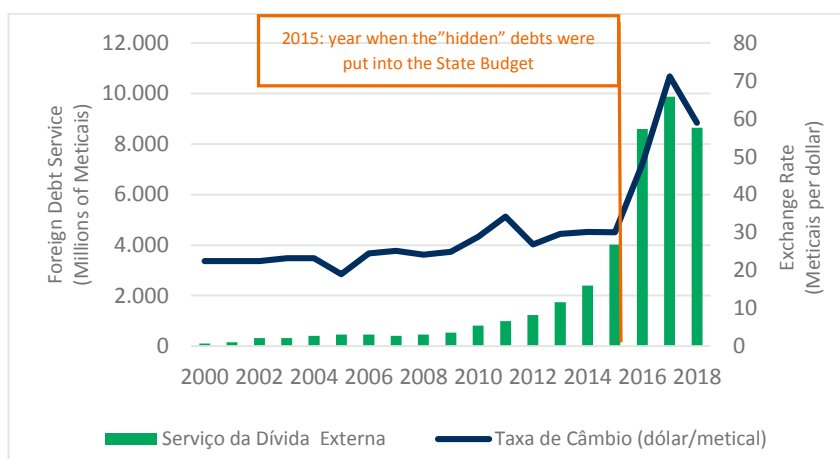
and in 2017 placed Mozambique, in eighth position in the world ranking of public debt, which was equivalent to 115.2% of the GDP. Mozambique was thus in third position in Africa – after Cape Verde (133.8%) and Gambia (116.1%) – among the economies with the highest levels of public debt (Colson, 2017).

2.3. The increase in the foreign debt service as a result of contracting the hidden debts contributed to a sharp depreciation (23%) of the Metical against the US dollar.

The foreign debt service (interest and other financial charges incurred to amortise debt instalments owed to an international creditor) involved the use of the US dollar since this is the monetary unit of reference in international transactions. Thus by servicing the debt, the Government puts pressure on the demand for this for-

ign currency (to the detriment of the metical), which results in the depreciation of the metical (worsening of the exchange rate) against the American currency. As a result, the number of meticais needed to buy one US dollar rose from 30.1 in 2015 (the year when the hidden debts entered the State Budget to 71.23 in 2017.

Figure 3: Relation between the Foreign Debt Service and the Dollar/Metical exchange rate



Source: Bank of Mozambique (2019), National Statistics Institute (2019) and OANDA (2019)

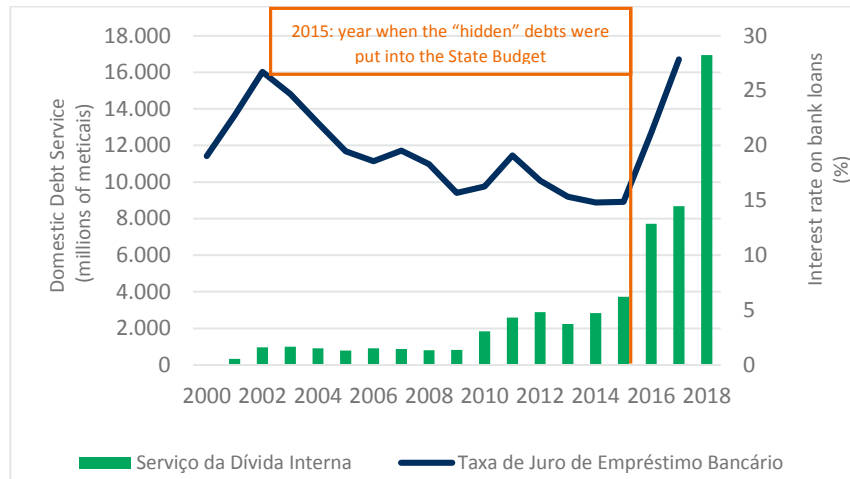
(Green line = Foreign Debt Service; Blue line = Dollar/metical exchange rate)

2.4. The increase in the domestic debt service as a result of contracting the hidden debts contributed to an acceleration of the cost of credit on the national banking market by 40 percentage points.

Figure 4 shows the relation between the evolution of the domestic debt service (interest and other financial charges incurred to amortise debt instalments owed to a creditor operating inside Mozambique), and the inter-

est rates on loans in the national banking system. Between 2002 and 2014, the evolution of the interest rates on bank loans showed a declining trend, with an annual average of 19.3%.

Figure 4: Relation between the Domestic Debt Service and the Interest Rates on Bank Loans



Source: Bank of Mozambique (2019)

(Green line = Domestic Debt Service; Blue line = interest rate on bank loans)

With the insertion of the “hidden” debts into the CGE, the cost of bank credit rose to an annual average of 27%, taking Mozambique to the 8th position in the world ranking (the fifth position in Africa,

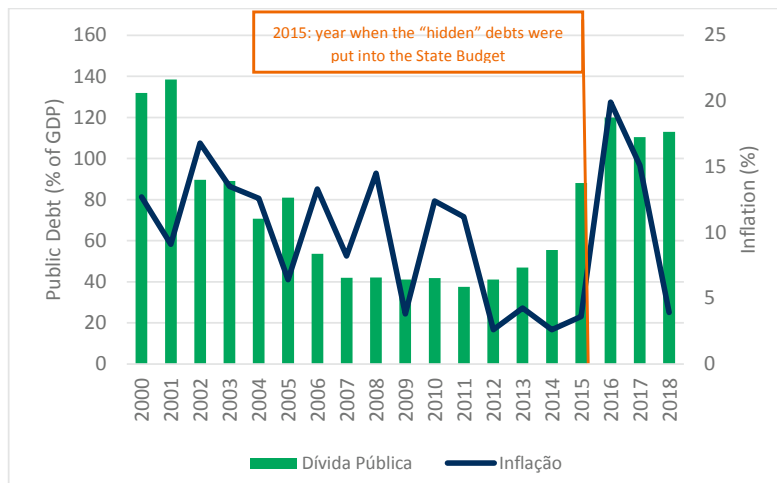
after Madagascar – 64%, the Democratic Republic of Congo – 35.9%, Gambia – 30.6% and Ghana – 29.3%) among countries with high costs of bank credit.

2.5. The inclusion of the “hidden” debts in the General State Account increased the cost of living by at least 453 percentage points between 2015 and 2017.

Figure 5 compares the evolution of the volume of public debt contracted by the Mozambican government and the behaviour of inflation in the period between 2000 and 2018. The graph shows that between 2000 and 2014, inflation (the measure of the cost of living) fell from 12.7% in 2000 to 2.6% in 2014 accompanying the declining trend in the pub-

lic debt, which fell from 131.9% of GDP in 2000 to 55.4% in 2014. However, with the inclusion of the “hidden” debts in the 2015 State Budget, annual inflation accelerated from 3.6% in 2015 to 19.9% in 2017, generating, in just two years, a deterioration in the cost of living of around 453 percentage points.

Figure 5: Relation between the Evolution of the Public Debt and Inflation in Mozambique (2000-2019)



Source: Trading Economics (2019)

(Green line = public debt; Blue line = inflation)

3. Conclusion

This *DevR* has analysed the nexus between the evolution of the public debt (domestic debt service and foreign debt service) and the behaviour of the main prices in the economy. The results of the study indicate the following:

- The foreign debt service contributed to the sharp depreciation of the metical against the US dollar, particularly as from 2015.
- The domestic debt service influenced the rise of lending interest rates, thus making access to credit for consumption and investment very expensive.
- In the final instance, the public debt led to a rise in the general level of prices and thus to a worsening in the cost of living of Mozambicans.

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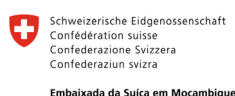


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