MOZAMBIQUE ECONOMIC UPDATE

Setting The Stage For Recovery

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The World Bank's Mozambique Economic Update (MEU) series is designed to present timely and concise assessments of current economic trends in Mozambique considering the country's broader development challenges. Each edition includes a section on recent economic developments and a discussion of economic outlook, followed by a thematic section that analyzes issues of importance. The focus section in this edition explores the implications of COVID-19 for the economy, businesses and households. It provides recommendations for moving forward—in the short-term relief phase, as well as over the medium and longer term in order to 'build back better'. The MEU series seeks both to inform discussions within the World Bank and to contribute to a robust debate among government officials, the country's international development partners, and civil society regarding Mozambique's economic performance and key macroeconomic policy challenges.

Cover picture taken from: https://www.ft.com/content/08af2802-9372-11e9-aea1-2b1d33ac3271

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Abbreviations and Acronyms

INE	National Statistics Institute *(Instituto Nacional de Estatística)*
SOE	State-owned enterprise
BdM	Bank of Mozambique *(Banco de Moçambique)*
BNI	National Bank of Investments
BoP	Balance of payments
BVM	*Bolsa de Valores de Moçambique*
CAD	Current-account deficit
CGT	Capital gains tax
COVID-19	Corona virus disease 2019
CPI	Consumer Price Index
CTA	Confederation of private sector associations
DSSI	Debt Service Suspension Initiative
ENH	National Hydrocarbons Company *(Empresa Nacional de Hidrocarbonetos)*
FAO	Food and Agriculture Organization of the United Nations
FDD	State Development Fund *(Fundo de Desenvolvimento Estatal)*
FDI	FForeign direct investment
FPC	Standing Lending Facility *(Facilidade Permanente de Cedência)*
FPD	Standing Deposit Facility *(Facilidade Permanente de Depósito)*
GDP	Gross domestic product
FX	Foreign exchange
GEP	Global economic prospects
GIEWS	FAO Global Information and Early Warning System
HFS	High Frequency Survey
IAE	Economic Activity Index *(Índice de Actividade Económica)*
ICE	Economic Climate Index *(Índice de Confiança Económica)*
IMF	International Monetary Fund
INE	National Statistics Institute *(Instituto Nacional de Estatística)*
INSS	National Institute of Social Security
IOF	Household Survey *(Inquérito sobre Orçamento Familiar)*
IRPC	Corporate income tax
LICs	Low-income countries
LNG	Liquefied natural gas
MEF	Ministry of Economy and Finance *(Ministério da Economia e Finanças)*
MIMO	Interbank Reference Interest Rate
Mt	Metric ton
MZN	New Mozambican metical
NPL	Non-performing loan
PMI	Purchasing Managers Index
PPP	Purchasing power parity
SDG	Sustainable Development Goals
SSA	Sub-Saharan Africa
UNICEF	United Nations Children's Fund
US	United States
USD	United States dollar
WB	World Bank
WDI	World Development Indicators
WEO	World Economic Outlook
ZAR	South African rand

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Executive Summary

Recent Economic Developments.

COVID-19 continues to spread globally, with a second wave now resurfacing. Mozambique has been spared the worst of the pandemic so far but confirmed cases have been growing rapidly since the lifting of the State of Emergency in early September. The country has taken unprecedented measures to contain the spread of the virus, although at the expense of bringing the economy to near standstill. It has now started to gradually reopen its economy amid high socio-economic fallouts.

This Economic Update explores the implications of COVID-19 for the economy, businesses and households. It makes recommendations for moving forward—in the short-term relief phase, as well as over the medium and longer term in order to 'build back better'.

The global pandemic has taken a heavy toll on the economy. In 2020, Mozambique is expected to experience its first economic contraction in nearly three decades. COVID-19 hit the economy as it was attempting to recover from the slowdown triggered by the hidden debt crisis and the tropical cyclones in 2019. Real gross domestic product (GDP) is projected to decline by 0.8 percent in 2020, compared to a pre-Covid estimate of 4.3 percent, as external demand falls, domestic lockdown measures disrupt supply chains and depress domestic demand, and liquified natural gas (LNG) investments are delayed.

COVID-19 has jeopardized years of hard-won development gains, with about 850,000 people projected to slip into poverty in 2020 (as measured by the international poverty line of US$1.90 per day). The pandemic is further delaying Mozambique's already slow progress towards the Sustainable Development Goals (SDGs), undoing the substantial gains made on health and education, among others. While there is great uncertainty about the path of the pandemic, the economy is expected to gradually recover from 2021 as aggregate demand rebounds and LNG investments and extractive production gain momentum. Despite the expected recovery, the development and widespread deployment of COVID-19 vaccines will be at the core of a resilient recovery. The economy cannot recover fully until mobility is restored, hence the critical importance of ensuring broad, rapid and affordable access to vaccines once they come onstream.

Fiscal challenges are significant, and the crisis will further delay fiscal consolidation efforts. The fiscal deficit will increase substantially in 2020, owing to lower fiscal revenues and COVID-19-related expenditures. This is in a context of debt overhang, a growing wage bill and rising military spending. Mozambique is in debt distress with debt-to-GDP projected to surge this year due to the balance sheet effect of currency depreciation and falling GDP. Once the COVID-19 crisis has receded, fiscal consolidation will be central to generate the fiscal space needed for recovery measures. Further progress in improving debt management and transparency, combined with debt restructuring, will be crucial to enhance debt sustainability.

Finally, the slowdown in foreign direct investment and capital inflows has tightened external constraints. The current account deficit will increase sharply this year due to poor export performance and increased imports of LNG-related services. The economic downturn in key trading partners, and the commodity price slump, represent key sources of external risk. In addition, if left unchecked, the large influx of foreign currency to finance LNG projects in the coming years could erode Mozambique's external competitiveness.

COVID-19 Has Hurt Businesses and Households

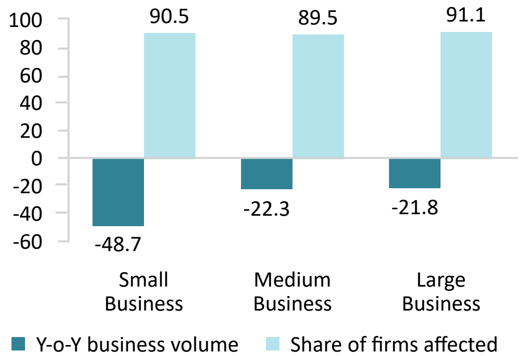
As elsewhere, firms, workers and households in Mozambique are bearing the economic brunt of the pandemic. COVID-19 has caused a sudden income loss for enterprises and households, worsening living conditions, especially for the urban poor largely engaged in the informal sector. According to the National Institute of Statistics, as of June 2020, about 120,000 jobs were lost and 63,000 employment contracts suspended, with women being the most affected. Around 2.9 percent of the firms affected were forced to cease their activity. The northern region, currently facing an escalation of insurgency, experienced a temporary or permanent closure of 38 percent of businesses. The capacity of firms to respond to such massive shocks is very limited in Mozambique. Firm survival time in the absence of revenues is short, estimated at between 6 to 10 weeks in Mozambique. While the impact is significant across the board, small firms are worst affected.

Although almost no sector has been spared, service activities are the hardest hit. The tourism and hospitality industry has suffered a steep decline in revenues, with about 7.5 percent of firms estimated to have terminated operations as of June 2020. The transport sector has also recorded heavy losses. Further, the extractive sector (notably the coal industry) has seen a sharp drop in production.

Households are feeling the impacts of COVID-19 through loss of earnings and employment. This particularly affects urban low-income households engaged in formal and informal services. Job losses have undermined food security, with more than 50 percent of urban households reportedly running out of food, though rural households are less affected. This is likely to hold back urban poverty reduction. Furthermore, school closures to combat COVID-19 could set back progress in building human capital.

The impact on sales volume has been particularly severe for small businesses

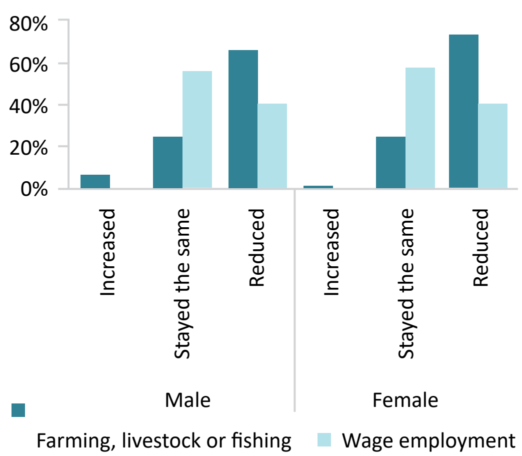
Formal firms: Percentage change in sales volume in the first half of 2020 (year-on-year)



Source: INE (2020b).
Note: Y-o-Y: year on year, comparing the first half of 2020 with the same time period in 2019.
Source: Based on INE (2020b)

Households have suffered substantial income losses

Share of households reporting changes in income since COVID outbreak



Source: WB staff based on HFS

How to Respond?

Mozambique has adopted policies that were broadly similar to those of other countries in the region, but design and implementation issues have undermined their effectiveness. As the pandemic unfolded, the government increased priority social expenditures and expanded coverage to households most affected by the shock. The Bank of Mozambique took several stimulus measures, including cutting the monetary policy rate, providing a line of credit in foreign currency, and measures to ensure financial sector stability. Although the authorities provided support to firms through discounted credit lines, the funds were too limited to meet demand and relieve firms of financial distress. Steps were also taken by commercial banks to restructure existing loans by extending maturities and offering grace periods on loan principals. Moreover, fiscal measures were taken to support small firms, but their impact was limited due to overly restrictive eligibility criteria. Overall, the measures were either insufficient or else hindered by procedural bottlenecks. Direct support (transfers) were not among the measures taken and government support was not conditioned on the preservation of jobs.

The road to a resilient and inclusive recovery will be long. In the short-term, measures to support viable firms need to be strengthened. Once a vaccine becomes available, efforts should be directed at deploying it effectively to make sure that implementation does not put substantial pressure on the already overstretched health system. As the pandemic subsides, the agenda of structural reforms will have to be reignited. The focus should be on firms that were most affected by the crisis and were economically viable before the crisis. In the short term, it will be key to provide targeted support, such as employment subsidies, to firms to encourage worker retention and minimize layoffs. Support to previously viable firms should be made conditional on job protection to minimize the loss of productive capacity, and maximize the cost-effectiveness of the policies. The government should also consider extending the moratorium on tax payments to a wider share of small companies, with the support of development partners. In the recovery phase, policies need to support economic transformation and job creation, especially for the youth.

Social protection programs should be scaled up, including food assistance, to support informal (self-employed) entrepreneurs. Targeted interventions are also needed to support women and alleviate existing gender inequalities, including expanding access to finance and inputs, and harnessing the power of mobile technology. Once schools re-open, there is a need for measures to encourage children to return to school; these may include one-time cash transfers contingent on re-enrollment and attendance.

In the longer term, Mozambique needs to diversify away from the current megaproject-driven growth toward a more interconnected and competitive economy. Growth needs to be made more inclusive through improved resource allocation to services, small-scale manufacturing, and agribusiness. The development impact of resource revenues could be maximized through public investment programs that are better targeted toward underserved areas and savings for future generations. On the fiscal side, efforts to enhance revenue mobilization, combined with measures to increase spending efficiency and rationalize civil service renumeration, will help meet development needs while maintaining fiscal sustainability.

Part One: Recent Economic Developments and Outlook

Economic Growth

In 2020 the Mozambican economy will experience its first contraction in almost three decades as COVID-19 reduces domestic demand and delays liquified natural gas (LNG) investments.

Mozambique's economy is expected to contract for the first time in 28 years. The global pandemic hit the country as it was attempting to recover from the economic slowdown triggered by the hidden debt crisis and the tropical cyclones in 2019. Growth declined sharply from an average of 8 percent in 2001–2015 to 3 percent in 2016–2019. In 2020, weak global demand, low commodity prices and strict measures to contain the virus have seen trade decline and domestic consumption shrink, with output contracting by 3.3 and 1.1 percent in the second and third quarters (year-on-year), respectively. In addition, oil price shocks and unfavorable financial market conditions have delayed the Mozambique Rovuma liquefied natural gas (LNG) project. As a result, real GDP is expected to decline by 0.8 percent this year (Figure 2), compared to a pre-COVID estimate of 4.3 percent.

Although the government has taken important steps to respond to the outbreak (Boxes 1, 3 and 5), the economic contraction has had a significant impact on households and firms. A recent survey by the National Statistics Institute, covering about 90,000 firms, estimated as of June 2020 that firms' revenue losses represented 7 percent of GDP, about 120,000 jobs had been lost, and about 62,000 employment contracts had been suspended.[1] Income per capita is estimated to fall from US$519 in 2019 to US$461 in 2020, pushing the poverty rate up from 62.5 to 64.0 percent. This means about 850,000 more people would slip into poverty in 2020, as measured by the international poverty line (US$1.9 PPP per day) (See Part 2).

Agriculture and public services are expected to be the only sectors that could contribute to growth in 2020. Favorable weather conditions have helped agricultural production to recover from the impact of the tropical cyclones, with output increasing by 3 percent in the third quarter of 2020, compared to the same period in 2019.[2] While public services output contracted during the same period, this is anticipated to be offset by the expansion of health capacity and social protection programs related to the COVID-19 response.[3] The government's COVID-19 response, combined with additional

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1 INE (2020b).

2 The growth rate in the third quarter of 2020 was significantly higher than the -1.9 percent decline registered in the same period of 2019 and the 2 percent growth in 2018.

3 The authorities plan to expand social services in 2020 to include financial support to households and firms affected by the pandemic crisis by increasing the number of cash transfer beneficiaries to more than 1 million from about 600,000 in 2019.

military spending to combat insurgents in the north and center of the country, should drive increased activity in the public sector.

The extractives sector is struggling in the face of low commodity prices, muted global demand and depressed production. The sector was already struggling even before COVID-19 because of reduced production capacity at the main coal plant due to operational difficulties. This has been worsened by the disruptions in global supply chains and lower commodity prices, leading to a sharp decline in Mozambique's extractive production. Coal production fell by 40 percent in the third quarter of 2020 (year-on-year) (Figure 3). As inventories accumulated due to subdued sales, Vale do Rio Doce, the operator of the country's largest coal mine, temporarily suspended production in June 2020. As a result, the extractives industry is expected to contract by 12 percent in 2020, having already seen a negative growth of 1 percent in 2019.

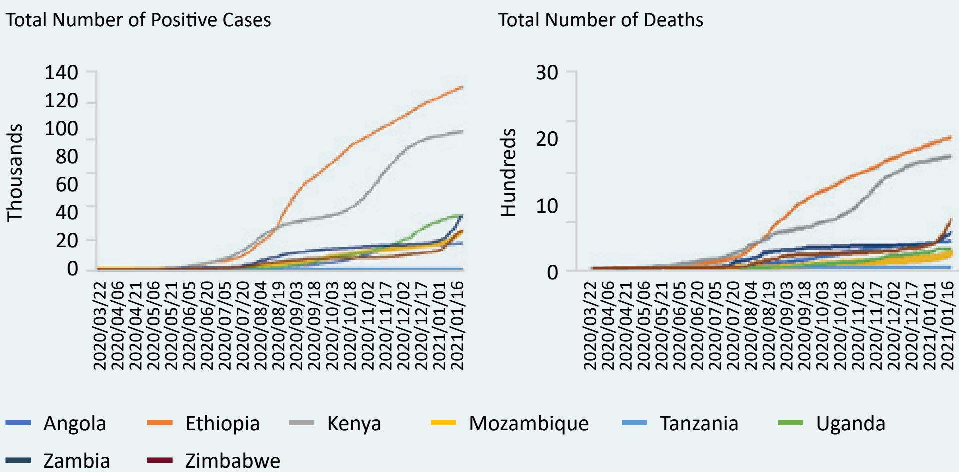
The decline in domestic demand that followed the introduction of lockdown measures constrained private sector services and manufacturing output. Private sector services output, which had been recovering in the previous two years (Figure 4), dropped by 3 percent in the third quarter of 2020, after falling by 5 percent in the second quarter (Figure 5). Output in the hospitality and restaurant industry declined by 31 percent due to travel restrictions and social distancing measures.

Box 1: COVID-19 trends in Mozambique and the Government's response

Mozambique registered its first case of COVID-19 on March 22, 2020. As of end December, the number of positive cases reached more than 18.5 thousands. However, given weak testing capacity, the official numbers may understate the true number of infections. The country is doing relatively well in controlling the virus (Figure 1). Up to end 2020, about 90 percent of the total positive cases had recovered, and the mortality rate was relatively low with 166 deaths attributed to the virus.

However, the number of positive cases has been growing at an increasing rate. In the first half of January 2021, the total number of positive cases reached almost 30 thousand. Of this, more than 40 percent was registered in the last 45 days. According to the National Institute of Health (*Instituto Nacional de Saúde* – INS), Mozambique currently has one of the fastest reproduction rates in Africa.

Figure 1: Mozambique is faring well compared to regional peers



Source: COVID-19 Data Repository by the Center for Systems Science and Engineering (CSSE) at Johns Hopkins University.

Mozambique declared a State of Emergency (SE) on April 1, which was extended up to August 2020. Since September, it has been in a State of Public Health Calamity (SPHC). Key features of the SE and SPHC include the following:

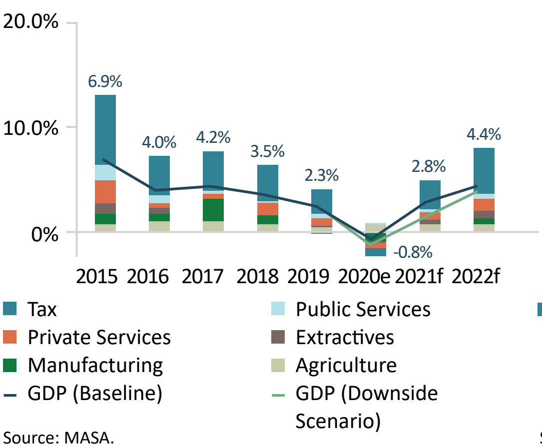
- Measures to prevent and mitigate the propagation of COVID-19, such as mask wearing, limiting public gatherings, and the number of passengers allowed on public transport.
- Information campaigns stressing the need for handwashing and mask wearing in public and hygiene protocols.
- Closure of borders for non-goods transit; suspension of travel and visa issuance until September 2020.
- Ramping up the health sector response capacity.

The country continues under the SPHC, but as of end-October the president announced resumption of the issuance of tourist visas and no need for quarantine for those who arrive in the country with a negative test. However, amid the growing number of COVID-19 cases, as 2021 began, government tightened social distancing measures including limitation of public gatherings, introduction of a curfew and closure of services considered non-essential.

The slowdown in activity is reflected in economic indicators, which reached historical lows in the second quarter of 2020. The Purchasing Manager's Index (PMI), an indicator of private companies' perception of market conditions, averaged 45.8 points in the first ten months of the year, having fallen to a trough of 37 points in April, from an average of 51 points in 2019.[4] The Economic Climate Index (ICE), which assesses business sentiment, fell to a 16-year low in June as expectations on demand, prices and employment deteriorated.[5] According to the Economic Activity Index (IAE), the tourism and transport sectors experienced the sharpest decline in economic activity in June. Manufacturing activity also fell, exhibiting a large drop in prices, production and turnover in the first half of 2020.[6] Despite the relative recovery observed in the last months of the year, the economic activity indexes for these sectors are still well below the 2019 levels.

Figure 2: **Growth is expected to decline in 2020, but gradually recover over the medium term**

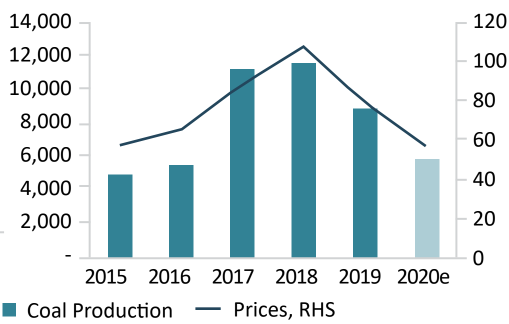
GDP growth (% change), 2015–2022



Source: MASA.

Figure 3: **COVID-19 depressed coal production in 2020...**

Coal production (metric tons) and prices (% change)



Source: Vale Mozambique.

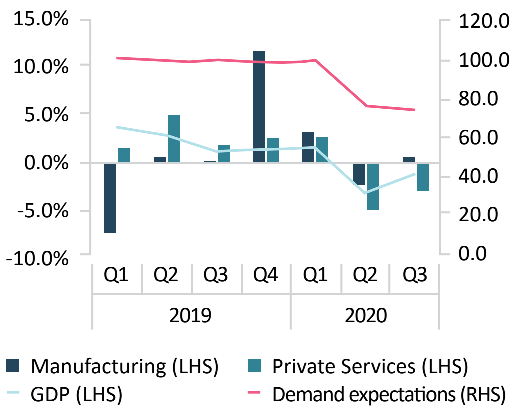
4 The Purchasing Managers' Index™ (PMI) published by Standard Bank is a weighted average of the following five indices: new orders (30 percent), output (25 percent), employment (20 percent), suppliers' delivery times (15 percent) and stocks of purchases (10 percent). Mozambique's PMI covers about 400 private companies in the agriculture, mining, manufacturing, construction, wholesale and retail sectors. PMI values below 50 percent indicate a contraction in economic activity.

5 The ICE is published by the National Statistics Institute (INE). Its assessment of business expectations is based on demand, prices, employment expectations, and actual employment. The index covers companies in the non-financial sector, specifically manufacturing, construction, transport, commerce, and other non-financial services.

6 The IAE is also published by INE. It provides a monthly index that reports companies' performance in terms of turnover, employment and remunerations. It covers manufacturing, extractives, energy, commerce, transport, hotels, restaurants and other services.

Figure 4: ...whilst falling domestic demand led to a sharp drop in services and manufacturing

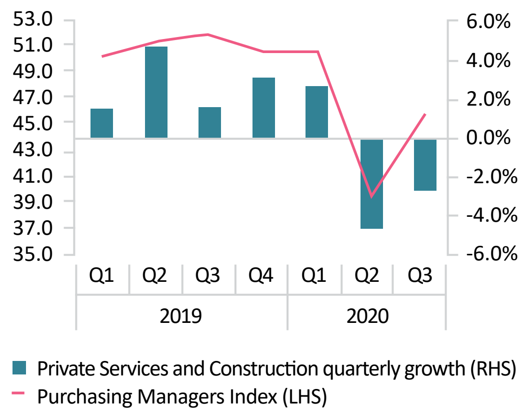
Manufacturing and services quarterly growth (y-o-y)



Source: INE data, various years; World Bank staff estimates

Figure 5: ...with overall economic sentiment deteriorating

Quarterly growth (% change) and Purchasing Managers Index (<50 deterioration), 2019-2020



Source: IHS Markit (2019, 2020); INE data, various years

Growth is projected to recover in the medium term assuming a rebound in global demand, additional stimulus from LNG projects, and the roll-out of a COVID-19 vaccine in 2021.

The economy is expected to gradually pick up over the coming years as the global demand for commodities and domestic demand for services recover, and LNG investments gain momentum. Growth prospects are evaluated under two scenarios depending on the impact of COVID- 19. While both scenarios consider that the recovery begins in 2021, the baseline scenario looks at the impacts of a severe but contained outbreak. Under this scenario, growth is expected at 2.8 percent in 2021 and 4.4 percent in 2022 under the assumption that global demand will pick up positively impacting exports, and the roll-out of a COVID-19 vaccine in 2021 will allow people to circulate and economic activity to resume in sectors affected by the social distancing. An additional stimulus is expected under this scenario as the development of LNG projects progresses, which besides supporting investment growth, would support private sector activity, especially in sectors with linkages to the industry such as transport, real estate and manufacturing. The recovery path will accelerate further in 2023 as LNG production begins (Table 1).

Table 1: Growth outlook 2020-2023

Real GDP, Δ%	2020e	2021p	2022p	2023p
Baseline scenario	-0.8	2.8	4.4	6.3
Downside scenario	-1.4	1.4	3.8	6.2

Source: World Bank staff estimates. e = estimate; p = projection

The outlook is subject to significant downside risks. As the number of COVID-19 cases continues to grow domestically and a second wave of COVID-19 is experienced by important trade partners, more stringent social distancing measures could constrain domestic and external demand further. Entering a recovery path will require rolling out a COVID-19 vaccine effectively (Box 2) and strengthening support to households and viable firms affected by the crisis (see Part Two in this Economic Update). This should be complemented by strengthening awareness campaigns to support the lifting of containment measures. An inability to implement an effective counter-insurgency campaign in Cabo Delgado could cause additional challenges for developing LNG facilities led by multinational energy corporations while posing further fiscal and monetary policy pressures.

The downside risks could push growth to as low as -1.4 percent in 2020. Under the downside scenario, growth would reach 1.4 percent in 2021, lower than the 2.8 percent in the baseline scenario. This scenario assumes that delays in the roll-out of the vaccine in advanced, emerging markets and developing economies will slow the recovery in global demand and commodity prices, negatively impacting the country's exports. In addition, oil price shocks, unfavorable market conditions, and military instability would continue to delay LNG investments. On the production front, agriculture and manufacturing sectors would have a weaker performance in 2021 compared to the baseline, and the services sectors would continue to contract due to subdued aggregated demand. This scenario could lead to a further deterioration of the macro-fiscal aggregates and the standards of living.[7] With population growth at 2.8 percent, GDP per capita could fall to U$460 in 2020 from U$520 in 2019. Besides, as per the projections from the World Meteorological Organization Mozambique has been affected by tropical cyclones in 2021, depending on the impact, these could disrupt projections of growth recovery in 2021, which are partly driven by the agriculture sector.

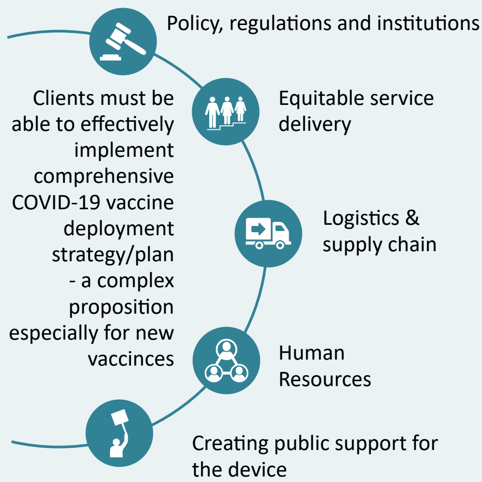
Box 2: Mozambique needs to put in place the enabling conditions for starting vaccination

There has been enormous progress in developing a COVID-19 vaccine over the last few months. Several candidate vaccines have delivered promising efficacies, above 90 percent. Global initiatives such as COVAX – a multilateral venture to ensure the vaccine's acquisition and deployment to low- and middle-income countries – have been established. COVAX seeks to ensure up to 20 percent vaccine coverage free of charge, focusing on frontline workers and vulnerable populations. The World Bank will contribute with additional financing to expand this coverage and strengthen the systems required to supply and deploy the vaccine. Mozambique will benefit from these initiatives.

However, multiple challenges remain. The country will face multiple institutional and logistical challenges when implementing such a large-scale vaccination campaign. According to the World Bank's preliminary estimates, vaccine costs (including transport and deployment) in Mozambique could reach about US$260 million. It is yet unclear whether the selected vaccine will require special cold-chain requirements. The most efficacious vaccines require storage at temperatures below 80^{0}C, for which there is no capacity in Mozambique. A rapid assessment is currently analyzing these logistical constraints and how financiers can support the vaccine roll-out. Identifying vulnerable groups is also non-trivial in a setting where diagnosing comorbidities is challenging. The subsequent outreach to these patients is also a constraint that may require approaches different from the standard hospital or health facility delivery approach. There have already been reports of disrupted essential services, leading to morbidity and, presumably, mortality that may exceed that caused by the COVID-19 virus alone. The health system needs to be strengthened in planning, budgeting, and human resources to effectively out a vaccine.

Essential areas of activity to support the purchase and administration of vaccines include: (i) Planning and management, including the identification of target

[7] *Ceteris paribus,* in 2020, total public debt levels would increase by 1 percentage point to 122 percent of GDP under the downside scenario and the overall deficit increases by almost 10 basis points, to 8.4 percent of GDP.



populations and the development of micro-plans to promote equitable access to vaccines; (ii) supply and distribution: purchase of vaccines and vaccination materials, logistics management and cold chain requirements; (ii) implementation: community awareness creation and surveillance of vaccine safety; (iv) support systems and infrastructure, including strengthening existing data and monitoring systems and improving the basic infrastructure of primary health units.

Deploying the vaccine is necessary but it should take into account the already overstretched health system. Additional activities that need reinforcing are: (i) developing and strengthening decentralized laboratory surveillance capacities, including lab equipment, testing reagents, essential commodities, and support for training personnel; (ii) ensuring adequate preparedness management of positive cases through the allocation of personnel to isolation centers and the purchase of equipment including X-rays, ventilators and heart-rate monitors; and (iii) provision of personal protective equipment to health facility and lab personnel throughout the country.

Medium-term challenges include counteracting the pandemic's long-term impact on potential growth, and promoting economic diversification, using gains from the LNG sector to support inclusive growth and job creation, notably for the youth. Beyond the short-term effects, COVID-19's impact on human capital, investment, trade, and public service delivery may leave lasting scars on potential output. Economic policies should focus on boosting growth fundamentals while bringing diversification and shock resilience center-stage. The government can achieve these objectives through, among others, policies that enhance local linkages with the LNG industry and use the LNG gains to promote inclusive growth. These policies include investing in human and physical capital and supporting the development of other sectors, especially services, small-scale manufacturing, and agribusiness. Mozambique needs to diversify away from its dual focus on capital-intensive megaprojects and low-productivity subsistence farming into a more interconnected and competitive economy. It is also essential to strengthen economic management to prevent adverse effects from the expected large foreign currency inflows for LNG investments and ensure continued commitment to macroeconomic stability.

Embarking on a path of productivity-driven growth that creates more, better, and inclusive jobs—including for lower-income, lower-skilled people—is essential. The Jobs and Economic Transformation (JET) agenda provides a policy framework for charting the course for a steady recovery in Mozambique in the post-COVID-19 period.[8] It rests on two pillars: creating and connecting to markets, and building capabilities and connecting workers to jobs. Efficient implementation of these policies would enable African economies to recover faster and thrive in the post-COVID-19 world.

It is essential to protect the economy against scarring and a costly loss of potential GDP. Resources should be directed to previously viable firms. As discussed in Part 2, Mozambican firms have limited cash flow to stay afloat for long periods. If the crisis is extended, viable firms could

[8] World Bank (2020e).

go bankrupt. This could lead to a loss in production capacity which may take a long time to recover. Thus, interventions to support the private sector should take into consideration the relevance of selected sectors and firms for potential growth.

Sustained economic recovery would also require addressing the military insurgency in Cabo Delgado. Since 2017, the country has been struggling to control an insurgency orchestrated by militants linked to the Islamic State. The conflict has already costed the country more than 2 thousand lives and led to about 500 thousand displaced, in the past three years. This has contributed to exacerbate the levels of social vulnerability in Cabo Delgado, already one of Mozambique poorest provinces according to the 2014/5 household survey. The progress of the LNG projects, crucial to the recovery of economic growth, have been affected as attacks have occurred in areas closer to the projects operations site. Additionally, the already tight public budget has seen significant pressures from increased military spending.

Exchange Rate and Inflation

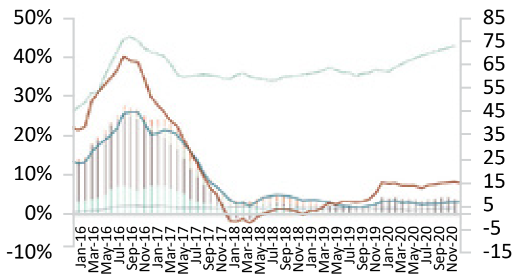
Inflation has remained broadly contained given the sharp drop in domestic demand, despite continued currency depreciation.

Inflation stood at 3.5 percent in December 2020 (year-on-year), reflecting weak demand and lower fuel prices. Food inflation, which accounts for just under a third of the consumer price index (CPI) basket, rose by 8.2 percent (year-on-year) in November (Figure 6). High food inflation is due to a combination of factors, including challenges in sourcing inputs from South Africa in the early stages of the pandemic, disruptions in domestic agri-food supply chains during the State of Emergency, and a depreciation of the metical against the US dollar. However, lower fuel prices and easing trade restrictions helped dampen inflationary pressures. Average inflation closed at 3.1 per cent in December above the 2.8 per cent registered in 2019.

Mozambique's USD nominal exchange rate, an important determinant of inflation, depreciated by 18 percent between January and November 2020. The depreciation was driven by the decline in exports, investment flows and domestic

Figure 6: Moderate non-food price increases helped contain overall inflation

Contributions to inflation (%, left-hand axis), ZAR/MZN, and USD/MZN exchange rate (right-hand axis), 2016-2020



Source: World Bank staff based on INE data

absorption. However, the deflationary effect of falling demand more than offset the upward pressures from the depreciation. A more stable exchange rate between South Africa's rand, a key trading partner, and the metical helped stabilize inflation. In the medium term, as the economy recovers from the crisis and LNG projects progress, inflation is expected to rise and the metical to appreciate in line with the expected large investment inflows. Nonetheless, inflation would remain within single digits, reflecting prudent monetary policy and a gradual recovery in demand.

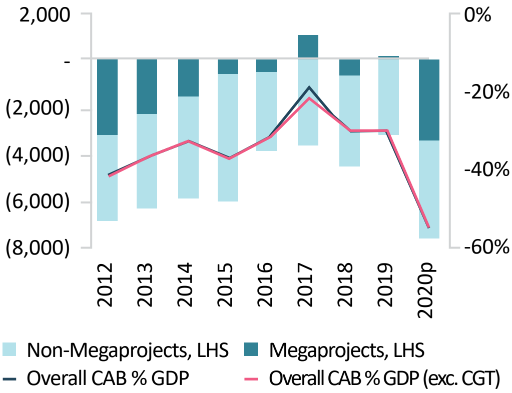
The External Sector

Mozambique's current account deficit (CAD) is expected to widen significantly in 2020 owing to poor export performance and a sharp increase in imports of LNG-related services.

The CAD, excluding receipts from capital gains, is expected to increase from 25.5 percent of GDP in 2019 to 54 percent in 2020 (Figure 7). It increased by 28 percent in the first nine months of 2020 (year-on-year), reflecting the combined effects of a fall in export volumes and commodity prices (Figure 7). Foreign direct investment (FDI), mostly for LNG megaprojects, financed about 43 percent of the CAD in the first nine months of the year. This, together with private external borrowing, helped to keep gross international reserves equivalent to seven months of imports (excluding megaprojects imports) in November. Megaproject services imports are forecast to more than double in 2020 (Figure 8). The megaproject deficit is expected to rise to 24.4 percent of GDP in 2020, up from a 1 percent surplus in 2019. The non-megaproject deficit is forecast at 39.5 percent of GDP in 2020, up from 26 percent in 2019, mostly reflecting a contraction in agricultural and manufacturing exports (Table 2). An external financing gap of 6 percent of GDP is anticipated in 2020, which should be financed by donor budget support, debt service suspension (DSSI), and savings from past capital gains receipts and reserves.

Figure 7: The CAD is set to widen in 2020…

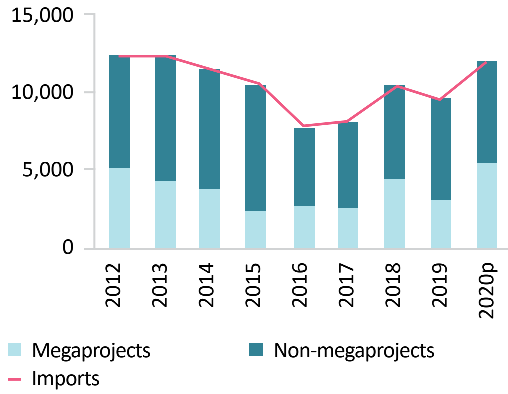
Current account balance (USD millions, left-hand axis), and % of GDP (right-hand axis), 2011-20



Source: BdM data, various years; World Bank staff estimates.

Figure 8: …due to higher import levels

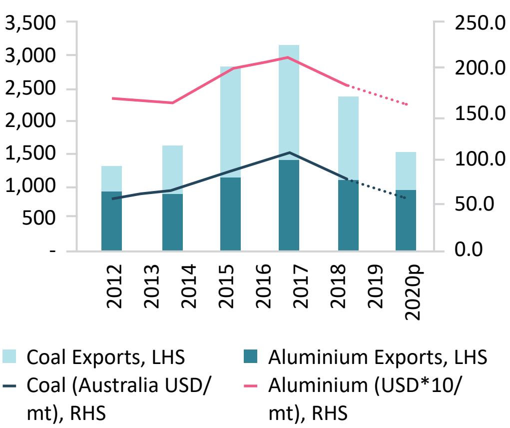
Goods and services imports (USD million), 2011-20



Source: BdM data, various years; World Bank staff estimates.

Figure 9: … and a drop in commodity exports

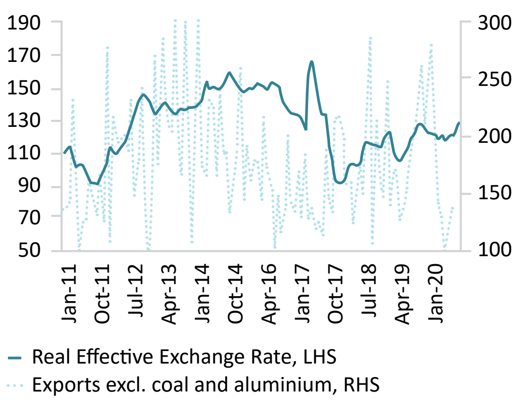
Exports (USD million) and price index (2005 = 100), of key goods, 2016-19



Source: BdM data, various years; World Bank staff estimates, World Bank Commodities Price Forecast.

Figure 10: … despite favorable real exchange rate movements

Real effective exchange rate index (2010 = 100) and exports (USD millions), 2011–19

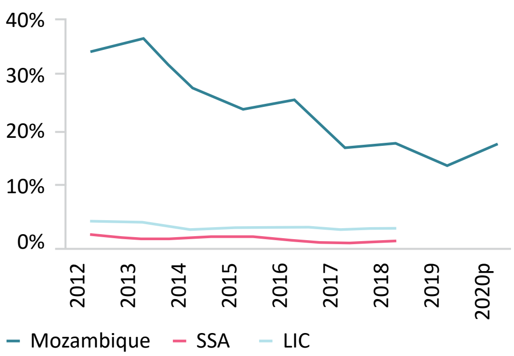


Source: World Bank staff estimates based on BdM and INE data.

Despite favorable real exchange rate (RER) movements, commodity exports in 2020 have been hit hard by lower global demand and the decline in commodity prices owing to COVID-19. Mozambique's RER currently sits well below historical levels (Figure 10), which is supportive of export competitiveness. However, goods exports contracted by 26 percent in the first nine months of the year compared to the same period of last year, reflecting lower demand and prices for key export commodities and the disruption in coal production. Together, coal and aluminum account for about 50 percent of exports and experienced significant declines in their prices in 2020 (Figure 9). Coal prices at the end of October 2020 were 21 percent lower than in the same period of 2019, while aluminum prices fell by 11 percent over the same period. Coal exports decreased by 53 percent in the first nine months of 2020 compared to the same period last year and are forecast to contract by 64 percent in 2020. Similarly, exports of aluminum bars dropped by 8 percent in the same period and are forecast to shrink by 17 percent in 2020. Non-megaproject exports, which had seen double-digit annual growth between 2016 and 2019, have been severely affected by the crisis. Nine-month data show a decline in key exports such as tobacco, cotton, sugar, prawns and wood.

Figure 11: High FDI levels continue to support the external position

Net foreign direct investment (% of GDP), 2012-19



Note: SSA: Sub-Saharan Africa; LIC: Low-income countries
Source: BdM, various years; World Development Indicators.

Investment flows, mainly directed to megaprojects, have come under pressure given the global financial conditions, but the CAD is expected to be fully financed in 2020.

The CAD will be primarily funded by FDI and, increasingly, LNG project financing. Net FDI flows contracted by 21 percent in the first nine months of the year compared to the same period in 2019, owing to COVID-induced uncertainties in the transport and communication sectors (Figure 11). The growing CAD was financed by loans, mostly LNG-project financing, and short-term financing such as trade credits. FDI inflows will remain the main source of external financing. Private external debt, which finances LNG investments, is also playing an important role in closing the financing gap. Large CADs will continue through the mid-2020s as LNG investments proceed to the construction phase. The deficit will remain well above the SSA and LIC averages (Figure 11). At an average of 64 percent of GDP over 2020–2023, the projected CAD would remain large, but it is expected to be mostly funded through FDI and project financing.

Gross international reserves are expected to reach approximately USD 3.2 billion by the end of 2020, covering about 6.1 months of imports (excluding megaprojects). This places Mozambique's reserves at an adequate level which helps cushion potential shocks.

The global economic recession and falling commodity prices present a less favorable external outlook.

The medium-term external outlook remains positive but subject to high uncertainty. Falling global demand and commodity prices represent key sources of external risk for Mozambique (Table 3). Global growth in 2020 was revised downward from 2.5 percent to –4.4 percent.[9] The slowdown in the global economy is delaying investments in the gas sector. Investment flows into auxiliary services (e.g. construction, legal and financial services) for the gas industry will likely be delayed given large uncertainties, travel restrictions and weak investor confidence. Continued low commodity prices remain a cause for concern. The growing Islamist insurgency in the north of the country could also slow the pace of development of LNG projects. There are also some upside risks. In the medium term, export revenues are expected to rise as coal and aluminum production volumes rebound, complemented by a rise in global demand and prices.

[9] World Bank (2020a).

Table 2: The balance of payments

(USD millions, unless otherwise stated)

	2017 Actual	2018 Actual	2019 Actual	2020 Estimate	Δ 17/18	Δ 18/19	Δ 19/20
Current Account (% of GDP)	-19.6	-30.3	-19.7	-54.1	...	...	...
Megaproject	8.0	-4.6	0.9	-24.5	...	...	...
Non-megaproject	-27.6	-25.8	-20.6	-29.6	...	...	...
Current Account (% of GDP), excl. capital gains	-22.2	-30.3	-25.5	-54.1	...	...	...
Current Account	-2,586	-4,502	-3,012	-7,529	74%	-33%	150%
Trade Balance	-2,830	-4,545	-3,961	-8,089	61%	-13%	104%
Goods, net	-498	-973	-2,081	-3,585	95%	114%	72%
Exports	4,725	5,196	4,718	3,181	10%	-9%	-33%
Megaproject	3,657	3,913	3,278	2,211	7%	-16%	-33%
Non-megaproject	1,068	1,282	1,439	969	20%	12%	-33%
Imports	5,223	6,169	6,799	6,766	18%	10%	0%
Megaproject	733	1,277	1,405	1,385	74%	10%	-1%
Non-megaproject	4,490	4,892	5,394	5,381	9%	10%	0%
Services, net	-2,332	-3,571	-1,880	-4,504	53%	-47%	140%
Income and transfers, net	244	42	949	560	-83%	2139%	-41%
Capital & Financial Account	3,838	4,255	3,823	6,743	11%	-10%	76%
of which							
FDI, net	2,293	2,692	2,212	2,264	17%	-18%	2%
Megaproject	912	2,013	954	1,687	121%	-53%	77%
Non-megaproject	1,381	679	1,258	576	-51%	85%	-54%
Other, net (1)	1,342	1,399	1,010	4,347	4%	-28%	330%
Overall Balance	1,253	-247	810	-786	...	...	...

Source: World Bank staff estimates, BdM data; Δ=percentage change

(1) Other flows include net portfolio investment; net currency and deposits; loans; insurance, pensions and standardized guarantee schemes (net); net trade credits and advances; net other accounts payable/receivable.

Table 3: External outlook

	2018	2019	2020p	2021p	2022p
Nominal Commodity Price					
Aluminum USD/mt	2,108	1,794	1,660	1,680	1,713
Coal, Australia USD/mt	107	77	57	57	58
Hard coking coal, Australia USD/t	194	184	138	140	141
Liquefied Natural Gas, Japan USD/mmbtu	10	10	8	8	8
Tobacco USD/mt	4,866	4,579	4,500	4,529	4,558
Current Account Deficit, % of GDP	-30	-19	-60	-72	87
Financial and Capital Account, % of GDP	26	22	51	69	85
Net Foreign Direct Investment, % of GDP	18	14	17	24	30

Note: mmbtu = Metric Million British Thermal Unit; mt = metric ton; p = projection

Source: World Bank staff estimates; World Bank Commodities Price Forecast; KPMG (2020)

Large forex inflows in the medium to long term are expected to help strengthen Mozambique's external buffers. Mozambique is set to receive a large influx of foreign currency to finance LNG projects in the coming years. However, if not well managed, this could significantly strengthen the metical, eroding Mozambique's external competitiveness and placing further pressure on the CAD.

Fiscal Policy

COVID-19 has added significant budgetary pressures to an already constrained fiscal context characterized by low revenue collection, a high public debt burden and a growing wage bill.

The Government of Mozambique had to revise the 2020 budget due to growing COVID-19 fiscal pressures. Budgetary pressures are not yet fully reflected in fiscal data. The overall fiscal deficit six months into 2020 was lower than the same period in 2019.[10] This reflects weak budget execution, particularly development expenditure financed by grants, and the fact that most COVID-19-related spending to date has been off-budget and financed by development partners. However, as growth was revised downwards and spending needs kept rising, a modified budget for 2020 was adopted in November. The fiscal deficit was revised to 8.3 percent of GDP, from 4 percent in the original budget.[11] Besides a 1 percent downward revision in total public revenues, the 2020 supplementary budget adds 3 percentage points of GDP to original expenditures. Of these, about 2 percent are COVID-19 related measures, and the remainder is additional military spending.

Assumptions in the 2020 revised budget appear optimistic and are subject to significant risks. GDP growth is forecast at 0.8 percent and inflation at 4 percent. The growth estimate seems optimistic compared to contractions of 0.5 percent and 0.8 percent forecasted by the International Monetary Fund (IMF) and the World Bank, respectively. This difference mainly arises because the government foresees a smaller contraction in the extractives sector and minor private services growth. This outlook may be unrealistic considering the economy's 1 percent contraction in the first nine months of the year. Achieving 0.8 percent annual growth would imply 6 percent growth in the fourth quarter of the year. Besides being unlikely, considering the current economic setting, this would be higher than the growth observed in the fourth quarter of 2018 and 2019, when the economy was in a better position. In addition, while inflation is in line with recent developments, the deflator assumption seems inconsistent with the 4 percent inflation foreseen.[12] Despite the government projecting positive growth in 2020, nominal GDP appears to contract. These GDP figures imply that total public debt may reach 130 percent of GDP in 2020.

The primary deficit is expected to widen to 4.9 percent of GDP in 2020, up from a pre-COVID-19 estimate of 1.1 percent of GDP. The overall fiscal deficit is expected to reach 8.3 percent of GDP in 2020, from 5.3 percent in 2019 and a pre-COVID estimate of 4.5 percent, reflecting lower revenue collection and an increase in COVID-related spending in the second half of the year (Table 4). Revenue collection is anticipated to fall as demand declines and COVID-19 tax relief measures for firms take effect.[13] On the expenditure side, implementation of COVID-response measures, estimated at 2.2 percent of GDP, will push total spending to almost 33 percent of GDP, from 30 percent in 2019. COVID-19 is expected to create a fiscal financing gap of 3.6 percent of GDP in 2020 (Figure 13). This occurs in a context of limited fiscal space due to low revenue collection, over-indebtedness, as well as a growing wage bill and military spending.[14] Participation in the DSSI,

[10] The half-year fiscal deficit stood at MZN 9 billion, which is 9 percent lower than the deficit registered in the same period of 2019.

[11] The modified 2020 budget proposal increases total expenditure to 33 percent from 30 percent of GDP in the initial budget.

[12] The value of the deflator may be a result of changes in the GDP structure. But this may have to be confirmed when the third quarter GDP data is released. It is also important to note that the number differs from the 10 percent GDP deflator used in the 2021-2023 Medium Term Fiscal Framework.

[13] The Decree Law 23/2020 of April 27 exempted companies affected by COVID-19 with an annual turnover below US$ 40,000 (MZN 2.5m) from corporate income tax advanced payments normally made during the year; see Part Two in this publication.

[14] Military spending during the first half of the year doubled to 1 percent of GDP compared to the same period of 2019, as terrorist insurgencies continued to escalate in the north and center of the country. Also, the 2020 suplementary budget added 1 percent of GDP in military spending to originally planned.

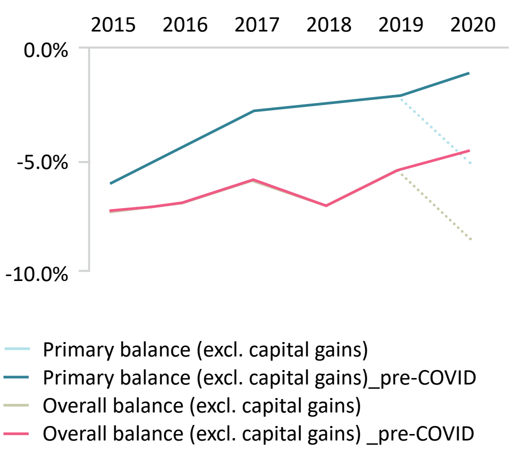
budget support from donors, and drawdown of savings from past capital gains receipts are expected to help close the financing gap.[15]

COVID-19 will further delay fiscal consolidation efforts (Figure 12). Mozambique has made significant progress on fiscal consolidation in recent years, which helped reduce the primary deficit from 6 percent of GDP in 2015 to 2 percent in 2019. With total revenue (excluding capital gains) remaining unchanged at 23 percent of GDP between 2015 and 2019, fiscal adjustment focused on the expenditure side. Spending fell from 33 to 30 percent of GDP between 2015 and 2019, despite additional fiscal pressures brought by the elections and the tropical cyclones in 2019. Spending cuts were mostly borne by the investment budget.

In recent years, the government has made significant progress in fiscal and debt management, and arrears clearance. Primary and secondary legislation was passed on debt and guarantees management, state-owned-enterprises (SOEs) and public investment management. More recently, credit risk assessment methodologies to better support financial operations by SOEs and a manual to guide macro-fiscal projections were approved. In addition, the government continues to prepare financial risk statements in line with the budget cycle.[16] Moreover, the verified stock of domestic suppliers' arrears was reduced from 1.6 percent of GDP in 2017 to 0.1 percent by 2019. However, COVID-19 has created significant additional fiscal pressures, which make the continued implementation of structural reforms more pressing.

Figure 12: The COVID-19 shock delayed fiscal consolidation efforts...

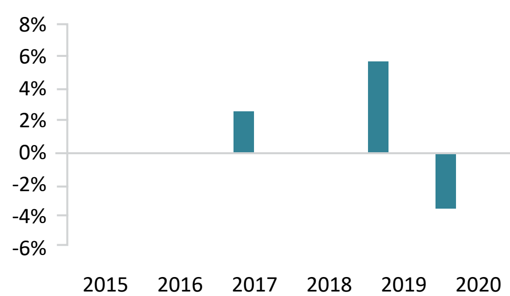
Fiscal balances (% of GDP), 2015 - 19



Source: MEF, IMF, and World Bank staff calculations

Figure 13: ... as the COVID-19 response resulted in a significant financing gap

Financing gap (% GDP), 2015-2020



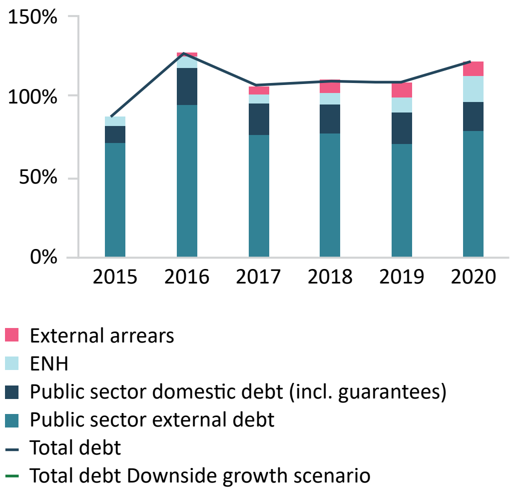
Source: MEF, IMF, and World Bank staff calculations

[15] According to the government update on COVID-19 donors' disbursements, as of September 2020 donor support to Mozambique for COVID-19 totaled US$ 452 million (about 3 percent of GDP). Of this amount, US$ 309 million were from the International Monetary Fund, US$ 40 million from the African Development Bank, US$ 41 from the World Bank and the rest from other donors. Details of the disbursements can be found on the Ministry of Finance website: https://www.mef.gov.mz/index.php/covid-19/1037--243.

[16] SOEs' debt and guarantees were at the heart of the 2016 debt crisis, so improving credit operations with SOEs is key to addressing debt vulnerabilities.

Figure 14: ... while GDP contraction and currency depreciation led to rising external debt levels

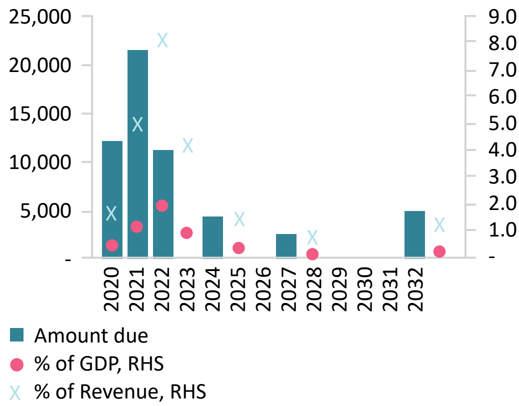
Public sector debt (% GDP), 2015-2020



Note: ENH: National Hydrocarbons Company
Source: 2020 DSA

Figure 15: ... and domestic debt pressures remaining significant

Treasury bonds amortization profile



Source: World Bank staff calculations based on data from Bolsa de Valores de Mocambique (BVM)

The authorities continue to prioritize spending on social and key economic sectors. Despite significant budgetary pressures arising from a growing wage bill and debt service, the authorities have managed to maintain spending levels on priority sectors at 14-15 percent of GDP.[17] In alignment with the government's five-year development plan, spending on education, health and infrastructure absorbed about 80 percent of the priority spending budget. According to recent findings from a fiscal incidence analysis exercise, this expenditure prioritization is equity-enhancing.[18] However, there is still room to enhance spending effectiveness. Despite having a similar level of social spending (in percent of GDP), Mozambique lags behind peers with similar income levels in terms of lowering inequality and increasing access to social services.

As the pandemic unfolded, the government focused on protecting social expenditures to maintain service delivery. The authorities strengthened health sector capacity and provided support to businesses and households worst affected by the crisis (Box 5 in Part Two of this report). In its attempts to combat the pandemic, the government increased the annual health budget from 3 to 4 percent of GDP. Social assistance to families is expected to double to 1.1 percent of GDP (compared with 0.6 percent of GDP in 2019), as coverage was expanded to households most affected by COVID-19.[19] In addition, a package of measures equivalent to 1 percent of GDP was introduced to support firms (see Part Two).

Mozambique remains in debt distress and COVID-19 has exacerbated debt vulnerabilities.

Debt levels are projected to grow in 2020 due to currency depreciation and GDP contraction. After falling steadily to 108 percent of GDP in 2019 (from 127 percent of GDP in 2016), total public debt is projected to reach 120 percent in 2020 (Figure 14). This is mainly driven by an anticipated rise in external debt from 89 percent in 2019 to 103 percent of GDP in 2020, largely reflecting

17 Mozambique's medium-term development plan considers education, health, infrastructure, agriculture, transport and communication, and social action as priority sectors.
18 See Baez et al. (forthcoming).
19 Refers to social assistance to families excluding pensions.

the depreciation of the metical/USD nominal exchange rate since January 2020, the contraction in projected GDP and borrowing related to the participation of the Empresa Nacional de Hidrocarbonetos (ENH) in LNG projects.[20]

External and total public debt are projected at around 94 and 111 percent of GDP in 2020, respectively, when excluding ENH (Figure 14). The variation in these ratios when excluding ENH reflects the contribution of Mozambique's LNG financing to the debt stock. Debt service levels remain substantially high. Initial projections indicated that external and public debt service-to-revenue ratios could reach 13 and 48 percent, respectively, by the end of 2020. The country's participation in the DSSI between October and December would provide an estimated relief amounting to 0.6 percent of GDP (about 2 percent of public revenue). Further, the country will benefit from the 6-month DSSI extension in 2021.[21]

Domestic debt has also continued to grow. Central government domestic debt increased to 19 percent of GDP in the third quarter of 2020, from 16 percent in 2019. This trend will likely continue till year-end as the 2020 supplementary budget projects almost 1.5 percent points of GDP in additional net domestic financing, above the 1.2 percent of GDP planned in the original budget. Apart from the budgetary pressures posed by COVID-19, the increase in domestic debt reflects the short-term financing needs of underperforming SOEs and debt servicing on treasury bonds maturing in 2020. The domestic debt profile presents considerable levels of maturity concentration. Almost 75 percent of the treasury bonds' stock is due between 2020 and 2022, which increases the likelihood of debt rollovers (Figure 15). With domestic interest rates at an average of 20 percent since the start of the year, domestic debt service in 2020 is estimated at 8 percent of GDP, compared to 5 percent in 2019.

Following progress in resolving the MOZAM bond default, the authorities are now challenging another undisclosed loan, the Proindicus. The authorities concluded negotiations with bondholders on the US$ 727 million MOZAM 2023 in 2019, resulting in a swap to a US$ 900 million bond. Under the agreement, the maturity was extended from 2023 to 2031, while the annual coupon rate was reduced from 10.5 to 5 percent until 2023 and 9 percent from 2023 onwards. They also took steps to legally challenge the US$ 622 million Proindicus-linked debt, seeking the cancelation of the related debt and compensation for damages and losses.[22] This debt is part of the US$ 2 billion package contracted over 2013–2014 to finance security companies backed up by state guarantees deemed unconstitutional. The next trial session for the Proindicus-linked debt by the London court, scheduled for Feb. 2021, will evaluate Mozambique's claim.[23]

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[20] Mozambique's national hydrocarbons company, which represents the government in the LNG investments.

[21] Total external bilateral debt service for 2021 is estimated at 3 percent of GDP.

[22] Besides the MOZAM and the Proindicus debts, the US$ 535 million Mozambique Asset Management (MAM) debt is also pending, which is another part of the package of the loans considered to be unconstitutional.

[23] Details can be seen here: https://clubofmozambique.com/news/mozambique-at-credit-suisses-request-london-court-agrees-to-hear-former-president-noticias-report-174474/

Table 4: Government finances (commitment basis)

(In percent of GDP)	2015 Actual	2016 Actual	2017 Actual	2018 Actual	2019 Actual	2020 Estimates
Revenue + grants (excl CGT)	**26.0**	23.9	24.6	25.8	24.4	24.8
Total revenue	23.2	22.0	25.1	23.8	28.9	22.8
Tax revenues	19.5	18.4	20.0	20.5	25.0	19.7
of which: capital gains			2.5		5.7	
Non-tax revenue (incl. capital revenue)	3.7	3.6	5.1	3.2	3.9	3.2
Grants	2.8	1.9	1.9	2.0	1.2	2.1
Total expenditure & net lending	**33.1**	**30.6**	**30.3**	**31.2**	**29.8**	**33.1**
Current expenditure	20.0	19.2	19.4	21.3	20.6	24.2
of which:						
Compensation to employees	10.0	10.4	10.6	10.8	11.8	13.3
COVID expenditure						0.7
Interest on public debt	1.2	2.5	3.0	4.4	3.3	3.4
of which: arrears		0.5	1.5	0.0	0.3	0.2
Capital expenditure	12.0	8.1	6.7	8.1	7.6	7.7
Domestically financed	5.3	3.2	3.2	3.7	4.7	4.0
Externally financed	6.7	4.9	3.5	4.4	2.9	3.7
Supplier arrears	0.5	1.2	0.3	0.3	0.0	0.0
Unallocated expenditure/revenue	0.0	0.4	0.9	-1.4	0.1	
Net lending	0.7	1.8	3.0	1.6	1.5	1.2
Fiscal balance - commitment basis						
Primary balance	-5.9	-4.3	-0.3	-2.4	3.6	-4.9
Overall balance	-7.1	-6.7	-3.3	-6.8	0.3	-8.3
Primary balance (excluding capital gains tax)	-5.9	-4.3	-2.8	-2.4	-2.1	-4.9
Overall balance (excluding capital gains tax)	-7.1	-6.7	-5.7	-6.8	-5.3	-8.3
Financing						
Overall financing	7.1	6.7	5.7	6.8	5.3	4.7
External financing	4.0	3.9	6.8	3.3	2.2	0.9
Domestic financing needs (residual)	3.2	2.9	-1.1	3.6	3.2	3.8
Financing gap	0.0	0.0	-2.5	0.0	-5.7	3.6
Government capital gains tax						0.1
World Bank Development Policy Operation						0.7
EU budget support						0.4
IMF Rapid Credit Facility/Extended Credit Facility						1.2
African Development Bank						0.3
Debt suspension						0.8

Source: MEF and IMF data, World Bank staff calculations

Though Mozambique remains in debt distress, debt is assessed to be sustainable in a forward-looking perspective. Under the baseline scenario of the latest debt sustainability analysis (DSA),[24] external debt indicators breach the policy relevant thresholds in the near and medium term. In particular, the present value of external public debt (as a share of GDP) is projected to remain above the prudent threshold over the medium term. However, the ratios are projected to drop below the thresholds by 2029 as LNG production contributes to higher growth, exports and fiscal revenues. Debt sustainability ratios improve faster when ENH's debt is excluded. This is because total external debt in the medium-term is largely driven by ENH borrowing to finance its equity participation in LNG megaprojects, and issuance of sovereign guarantees to ENH to cover its share in the borrowing package for one of the projects (Box 3).

Box 3: Impact of COVID-19 on the LNG portfolio of Empresa Nacional de Hidrocarbonetos (ENH)[1]

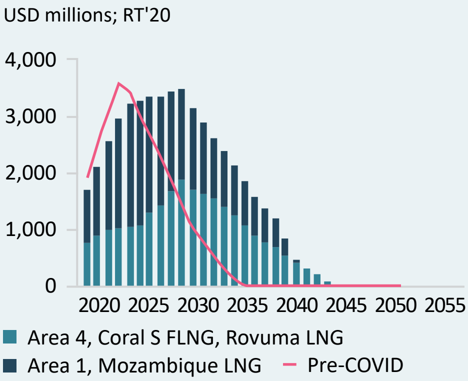
Recent simulations suggest that the economic breakout from the COVID-19 may increase ENH debt costs by 21 percent and expand the debt servicing period by a decade. Scenario analysis by the World Bank explores the impact on the two projects underway, Coral South FNLG (Area 4) and Mozambique LNG (Area 1), of further delays of six months and a year, respectively. This scenario also assumes that the Rovuma LNG project's final investment decision (FID), expected to take place between 2020 and 2021, may now only occur in 2025, and that production may only start in 2030. These delays, combined with lower commodity prices at the early stages of production, are expected to reduce ENH's available cash flow. As a result, debt-servicing capacity is anticipated to decrease, especially in the initial repayment years, which will lead to interest accumulation and increased debt exposure (Figures 16 and 17).

Due to the COVID-19 pandemic, ENH's portfolio has become more vulnerable. The analysis suggests that worsening financial conditions posed by the crisis will make it impossible for ENH to pay its carry (money it borrows from venture partners) from the Coral South FLNG without a cross-subsidy from the Rovuma LNG (the FID on the latter is still pending). In a scenario where the Rovuma LNG project does not move ahead (Figure 17), ENH would end up with unpaid debt from the Coral South FLNG when the project reaches the end of its economic life (in 2047). The analysis suggests that ENH can no longer run Coral South FNLG as a ringfenced project. The pandemic's emerging impact stresses the need to evaluate other possible strategies to manage ENH's LNG portfolio, such as cross-subsidies and debt refinancing.

1 ENH is the state owned company that representes the state in the gas exploitation in the north of the country.

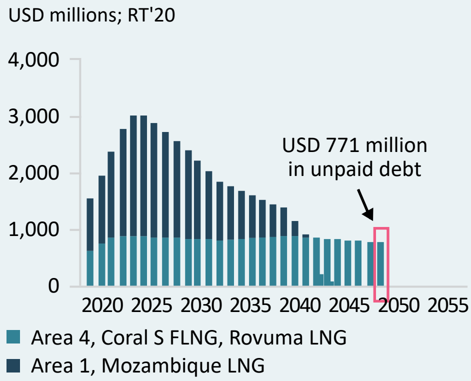
24 IMF (2020), ibid.

Figure 16: ENH debt post-COVID



Source: WBG estimates

Figure 17: ENH debt; post-COVID; no Rovuma LNG



Source: WBG estimates

While uncertainty remains high, fiscal consolidation efforts could resume from 2021.

Fiscal consolidation could resume in 2021, with a target of achieving a zero primary deficit by 2024. Once the COVID-19 crisis has receded, fiscal consolidation will be central to generate the necessary fiscal space to implement the recovery measures. The recently approved 2021 budget establishes a fiscal deficit of 2.6 percent, down from the 8.4 percent projected in 2020, signaling the government's continued commitment to fiscal consolidation. In the short-term, this improvement in the fiscal balance is expected to be driven by a strengthened tax administration, including through increased tax collection on income, goods and services. In the medium term, the authorities plan to achieve a primary surplus by widening the tax base, collecting some revenues from the early stages of LNG production, controlling wage bill growth through structural reforms, and improving spending efficiency. Further progress in improving debt and fiscal risk management, combined with debt restructuring, would help reduce debt vulnerabilities and enhance debt sustainability. These fiscal consolidation measures will be all the more critical under the downside scenario.

Achieving this fiscal consolidation will require continued strengthening of medium-term fiscal planning and a framework for managing the future inflow of resources. If Mozambique is to maximize the resource boom, the authorities will have to manage macro-fiscal risks adequately. There is a need for a medium-term fiscal framework that is anchored in appropriate fiscal targets and for establishing a well-designed stabilization fund to manage resource revenue in the future. [25] This should be complemented by a medium-term debt strategy underpinned by sustainable debt objectives. Finally, the implementation of the new regulatory framework for managing public investment should also contribute to fiscal stability, as investment projects are increasingly selected based on social and economic impact.

[25] After years of debate on the need of a framework to manage revenues from the exploitation of natural resources, the government published the first draft of a Sovereign Wealth Fund October for public consultation.

Monetary Policy

Mozambique's financial system entered this period of economic uncertainty with pre-existing vulnerabilities and risks, but the Central Bank's policy responses were resolute.

While maintaining a degree of caution, the authorities took several measures to provide monetary stimulus and avoid a deterioration in financial system conditions. The Central Bank reduced policy rates and took additional measures to ensure financial system liquidity. Since the beginning of the year and until September, the Central Bank's balance sheet had increased almost 50 percent (from MZN 387 billion to MZN503 billion). As part of the package of measures to mitigate the impact of COVID-19, the monetary policy rate and the standing lending facility rate were cut by 250 basis points to 10.25 and 13.25 percent, respectively, in the first half of the year. The Central Bank also reduced reserve requirement ratios for domestic and foreign currency by 150 basis points, to 11.5 and 34.5 percent of total deposits. However, monetary easing paused in June, with policy rates and reserve requirements unchanged since then amid concerns over inflationary pressures, mainly from the depreciation of the metical and fiscal constraints. The monetary authorities have also put forward complementary measures to support the financial system (Box 4), including: (i) a Central Bank credit line of US$ 500 million for financial institutions participating in the interbank foreign exchange market; (ii) removal of limits to access the standing lending facility; and (iii) easing of conditions for credit restructuring.[26] Credit to the private sector has slightly rebounded over the last six months, but the substantial increase in bank credit to government and SOEs has overshadowed this.

Box 4: Government measures taken to support the financial sector and resilient economic recovery

Measures to support the financial sector include:

- Cut in the policy interest rate from 12.75 to 10.25 percent.
- Reduction of the reserve requirement for local currency from 13 to 11.5 percent and for foreign currency loans from 36 to 34.5 percent.
- US$500 million forex credit line to commercial banks.
- Removal of specific provisioning requirements for forex lending to importers.
- Facilitating the restructuring of credits for Covid-19 affected firms if needed, before payments become due.

Structural reform measures to support resilient economic recovery:

- To improve debt transparency and fiscal risk management, the GoM published (i) an annual debt report with coverage of SOE and LNG debt from 2019 onwards; (ii) the financial statements of the national hydrocarbons company (ENH); and (iii) a credit risk assessment framework for SOEs.
- To enhance debt sustainability, the Council of Ministers approved a decree that establishes a regulatory framework for public investment management, which requires planned projects to be pre-appraised for social-economic impact before financing and consideration of disaster resilience for infrastructure projects.

26 Financial institutions were authorized to not constitute provisions for restructured loans because of the pandemic, provided that the loans were not overdue. Specific provisions on foreign currency loans were also waived.

Mozambique's financial system already had vulnerabilities and risks before the pandemic. These include a large share of bank assets and liabilities denominated in foreign currency, weak creditworthiness of the sovereign coupled with high bank exposure, and weak prudential and crisis management frameworks. Mozambique's deteriorating economic outlook will impact the financial sector, with potential spillovers to the real economy. Second-round effects could be exacerbated by these pre-existing vulnerabilities. Banks' aggregate capital levels are adequate, although provisioning levels are difficult to assess, given BOM's waivers. Funding is stable, mostly deposits which have continued to grow since the pandemic hit. Liquidity levels are higher than peer countries, reflecting banks' conservative approach and high reserve requirements for foreign exchange (FX) deposits. Non-performing loans (NPLs) are high at 10 percent and vary among financial institutions. Significantly, the two largest domestic systemically important banks (D-SIBs) have reported higher NPLs in 2020 (Table 5). Although their capital levels remain comfortably above minimum requirements, this is likely to constrain credit provision to the economy.[27] Loan loss provisions are high as most NPLs have been delinquent for more than 360 days. A fall in the value of the metical will have an automatic accounting impact on the capital position of many banks, as a quarter of assets and liabilities (system-wide) are denominated in foreign currency. Exposure to financially distressed SOEs is a key risk factor in Mozambique.

Table 5: **Selected prudential indicators for domestic systemically important banks, September 30, 2020**

Select ratios (percent)	BCI	BIM	SB	ABSA(1)	System
Total capital adequacy to risk-weighted assets	22.8	43.0	27.5	19.1	26.0
Total capital to total assets	11.4	19.7	13.6	17.1	11.8
Non-performing loans	13.0	24.0	2.8	2.8	11.8
Provisions	41.7	98.8	72.1	82.5	82.5
Return on assets	1.7	3.8	4.2	1.4	2.4
Return on equity	14.9	18.9	28.3	12.6	20.2
Liquid assets	36.8	48.6	69.4	49.6	39.7

Source: Bank of Mozambique data; Note: (1) As of 30 June 2020.

Having introduced higher prudential requirements, BOM has helped to maintain capital buffers at comfortable levels. From 2017 to 2020, the Central Bank has increased the minimum capital levels from 10 to 14 percent of risk-weighted assets, which are important buffers during periods of economic and financial stress. Capital ratios follow a Basel I regime and do not include operational and market risk charges. The Central Bank credit line of US$ 500 million for the interbank foreign exchange market was an important precautionary measure. Commercial banks had limited demand for the precautionary credit line, which signals that they had sufficient FX liquidity to meet their FX liabilities.

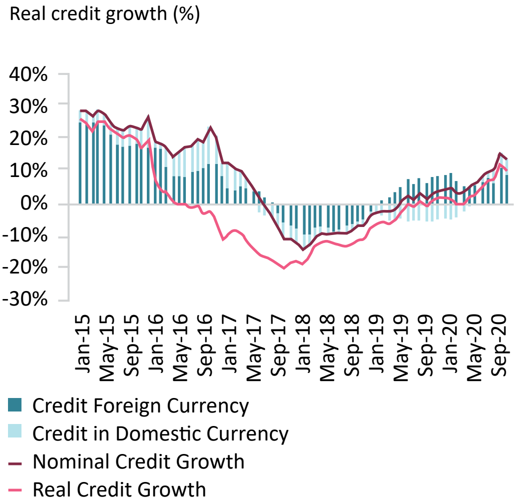
Central Bank measures have helped to maintain domestic credit growth and increase electronic transactions, but access to financial services remains a challenge.

In 2020, real credit growth has accelerated, but high interest rate spreads and structural issues remain. Mainly driven by domestic currency credits, real credit growth averaged 4 percent in the first seven months of the year (Figure 18). But credit to the private sector remains lower than the period leading to the 2016/17 economic and financial crisis (Figure 19). Risk aversion by banks, combined with reduced demand for credit, have further lowered the loan-to-deposit ratio,

[27] Bank of Mozambique has designated BCI, Millennium BIM, Standard Bank, and ABSA as D-SIBs.

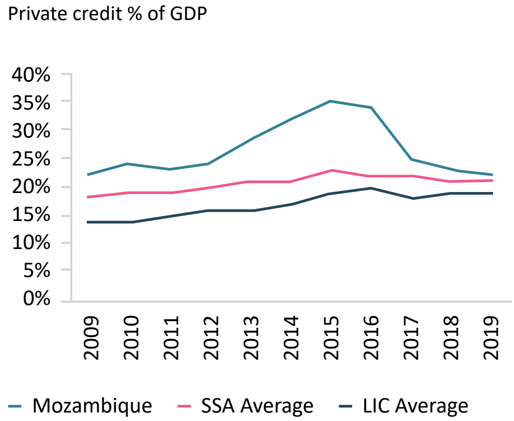
which was already low before the pandemic. Central bank measures have contributed to high liquidity levels in domestic currency, which may explain credit growth. However, lending rates remain elevated in real terms despite some reductions in response to the policy cuts. The benchmarking lending rate is 15.9 percent, which is still high in real terms, and the average rate for lending operations with a year maturity is 19 percent. This shows that the net interest rate spread (the difference between interest financial institutions receive on loans relative to what they pay on deposits and other liabilities) remains high in Mozambique. This high-interest rate spread reflects heightened risk aversion, structural issues including lack of credit information, limited availability of collateral, and limited competition in providing credit services to the private sector. The introduction of a single bank identification number will partly help address information asymmetry issues in the sector and the planned launch of a movable collateral registry in 2021.[28] A key instrument lacking in Mozambique is a partial credit guarantee scheme to help increase the risk appetite of financial institutions.

Figure 18: **Policy measures have supported credit growth**



Source: Bank of Mozambique data, World Bank staff calculations

Figure 19: **...but credit levels remain lower than pre-hidden debt levels**



Source: International Financial Statistics

The Central Bank has enacted a series of measures to ease cash flow constraints and promote digital transactions. It has mandated a reduction in fees and commissions for digital payments through commercial banks and mobile money platforms. These measures, combined with social distancing requirements, have contributed to a significant increase in the volume and number of electronic transactions, particularly on mobile platforms. However, although digital transaction increased in 2020, they were not as strong as in previous years, likely reflecting subdued economic activity.

The financial sector lacks capacity and key instruments to act as a channel for countercyclical measures. For example, the know-your-customer requirements for opening accounts and financial transactions result in high levels of exclusion as a large share of the population lacks identification documents. Mozambique also lacks a partial credit guarantee (PCG) facility, used by other countries to provide guarantees for loans most affected by credit deterioration in times of crisis. The overall financial safety-net and crisis management frameworks have important gaps. Deposit

28 The Central Bank announced in August the introduction of the single bank identification number, which will be required for customers to perform any operations with any financial and credit institutions. Details can be seen here: https://clubofmozambique.com/wp-content/uploads/2020/08/pt_432_n%C3%BAmero-%C3%BAnico-de-identifica%C3%A7%C3%A3o-banc%C3%A1ria.pdf

insurance is limited with reserves equivalent to less than 1 percent of insured deposits, and coverage is low at MZN 20,000 (US$ 275). Parliament is considering an amendment to financial sector legislation that would introduce a resolution authority and tools in line with the Financial Stability Board's Key Attributes of Effective Resolution Regimes.

Part Two:COVID-19 Has Hurt Businesses and Households. How to Respond?

Firms, workers and households in Mozambique are feeling the economic brunt of COVID-19.

COVID-19 has caused a sudden income loss for many enterprises and households in Mozambique, worsening living conditions, especially for the urban poor largely engaged in the informal sector. The capacity of firms in Mozambique to respond to such shocks is very limited. Therefore, the impact on performance and employment has been acute for both formal and informal enterprises. Households have also been severely affected by the crisis through loss of earnings, business activity, and employment. This part of the Mozambique Economic Update discusses the impact of the COVID-19 crisis on the private sector and on households. It outlines the measures taken by the government to overcome the impacts, and provides recommendations for recovery. It starts with a review of the impacts on the private sector and closes with the analysis of how households are affected.

What Does the Private Sector Look Like in Mozambique?

The private sector mostly consists of informal small-scale enterprises. The informal sector accounts for about 90 percent of enterprises in Mozambique and 31 percent of GDP. The number of formal firms has been increasing, albeit at a slow pace, reaching about 90,000 according to recent estimates.[29] Three-quarters of these formal firms are micro firms, employing fewer than 5 people, while only 2 percent employ 100 or more workers. Geographically, a large proportion of the firms are located in Maputo, with the density of firms decreasing as one moves away from the capital.

Market concentration remains high. In 2018, large firms employing 100 or more workers accounted for 52 percent of total sales volume and 54 percent of total employment. In turn, micro formal firms made up only 5 percent of total sales and 17 percent of total employment. Trade and retail, hospitality, manufacturing and other services represent the largest proportions of formal firms and formal sector jobs. The manufacturing sector is still small and underdeveloped, consisting mostly of micro businesses that produce basic goods to sell to individuals in their locality or region. The extractive sector is growing thanks to foreign investment. Half of the firms in the sector are exporters, but they account for less than 2 percent of total jobs.

The impact of COVID-19 on firms' sales and employment is severe

COVID-19 has affected firms through both external and domestic transmission channels.

[29] CEMPRE, the official census of the private sector published in 2017, reports 51,237 private firms. The latest reports published by INE in 2020 list 90,505 private firms registered, based on data sourced from the VAT Registry from the Tax Authority, the monthly statistical surveys, the folder of statistical units (FUE) and the Registry of legal entities.

External channels include: (i) disruption in global value chains and trade; (ii) falling international commodity prices, such as coal and aluminum;[30] and (iii) lower foreign direct investment.[31] Domestically, the crisis is spilling over into the economy through two main channels: (i) economic disruptions caused by containment measures; and (ii) direct health impacts of COVID-19. Domestic containment measures have disrupted the flow of people, goods, and capital, amplifying the impact of external shocks on formal and informal firms.

Disruptions caused by the measures to contain the spread of the virus have reduced local demand for goods and services, affecting 90 percent of all formal firms and informal sectors. Firms have been mainly affected by low demand, losing 41 percent in business volumes during the first half of 2020 compared to the same period in 2019. In the second quarter (Q2), 75.5 percent of firms reported 53.5 percent compound losses in business volume. The fall in demand particularly affected the commerce and retail sectors, which represent more than 70 percent of the small firms in the country. Firms suffered from lack of liquidity and constrained working capital. Small, cash-dependent firms experienced financial distress and fell into arrears. Only a few trading companies were able to capitalize on the business opportunities arising from the pandemic, such as the provision of medical and sanitary equipment, and digital services.

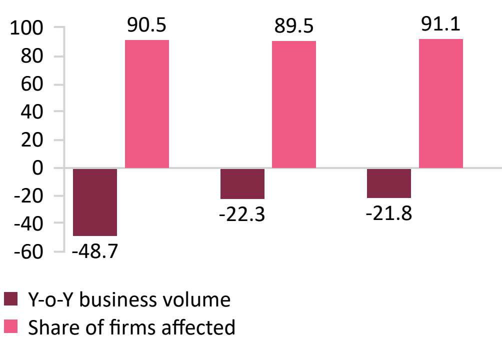
Small businesses were worst affected (Figure 20). Most of the firms affected by the crisis were small (86.5 percent), 12.8 percent medium-size firms and only 0.5 percent large. Small businesses recorded a reduction of 48.7 percent of business volume (y-o-y) in the second quarter (INE, 2020b). Small businesses have more fragile operating structures and have been more exposed to the reduction of demand, since they trade primarily in the retail sector with individual consumers. From a business-to-business perspective, small firms may also have been more affected by the reduction of business volumes of their larger contractors, which are more likely to reduce contracts with small providers than with bigger ones. Medium-sized firms suffered a 45 percent contraction in sales volume during the second quarter (y-o-y), whilst large firms recorded a 10.8 percent reduction. According to the confederation of private sector associations (CTA, 2020), given the greater weight, the decline experienced by large firms represents a higher share of the economy.

Firms have been affected by a combination of challenges, including liquidity constraints, maintaining international trade levels, lack of raw materials, and a forced reduction of workforce on site (Figure 21). Almost half of firms faced liquidity challenges given lower sales and inflexible cost structures. Difficulties in importing and exporting affected 44 percent of firms across the country due to reduced global trade, initial confusion over border procedures and speculative increases in transport costs. Workforce reduction affected 28 percent of firms, limiting their production capacity.

The capacity of firms in Mozambique to respond to this shock is limited, primarily due to their constrained financial capacity.

Figure 20: **The impact on sales has been particularly severe for small businesses**

Percentage change in sales volume of formal firms in the first half of 2020 (year-on-year)



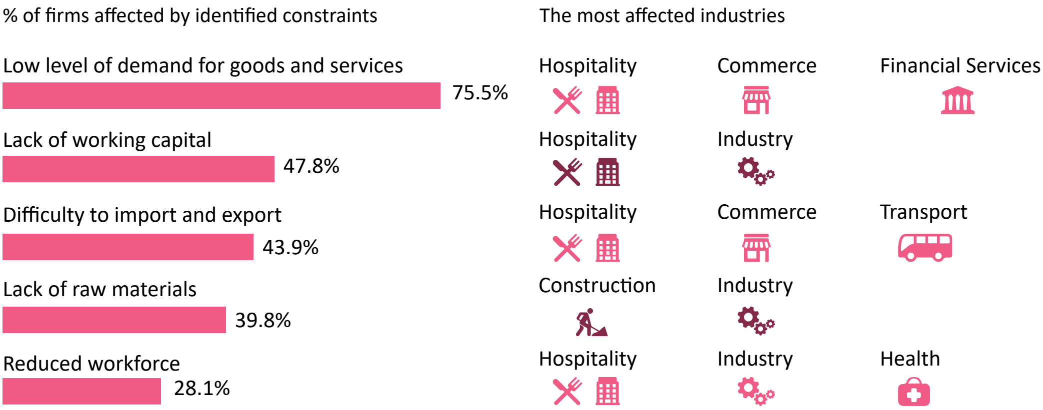
Note: Y-o-Y: year on year, comparing 2020 with the same period in 2019.
Source: INE (2020b).

[30] The disruptions to trade and value chains, and the decline in global commodity price, have been significant. Growth deceleration in Mozambique's key export destination markets, namely the European Union (accounting for 30.5 percent of the country's exports), South Africa (18.8 percent), and India (17 percent), led to a drop in demand for its export products.

[31] For instance, the highly anticipated Final Investment Decision (FID) of Area 4's gas investment (led by Exxon Mobil) was delayed for at least one year. The other major gas investment in Cabo Delgado, led by Total in Area 1, was forced to suspend operations for seven weeks after finding COVID-19 cases on its construction sites.

Most small firms do not fulfill the necessary collateral requirements to secure bank loans. Even for most medium and large firms, the cost of external financing is prohibitive. About 75 percent of firms are financially excluded. The International Finance Corporation (2017) estimated the financing gap of micro, small and medium enterprise (MSME) in Mozambique at 10 percent of GDP in 2017.[32] The median firm in Mozambique has 6 to 10 weeks of survival time without revenues (that is, assuming a collapse in business volumes and export demand, and no government subsidies for labor costs).[33] Retail companies have less survival time (about 5 weeks) than those in manufacturing (more than 13 weeks) and much less than those in the extractive industry (more than 20 weeks). Within manufacturing, exporting firms have lower survival probability given the cycle of payments they are subject to. These figures for Mozambique are not too far off those for other emerging economies.

Figure 21: **The fall in demand was firms' biggest constraint**



Source: INE (2020b).

Companies of all sizes responded to the drastic reduction in revenues by cutting their labor costs. Common actions by firms included reducing working hours, suspending, and terminating labor contracts (Figure 23). About 77,539 wage contracts (2.3 percent of the workforce) were terminated. As a result, at end-June 2020, 3.6 percent of the workforce had lost their jobs and another 62,000 had seen their contracts suspended, according to the provisions of Art.123 of the Labor Law. By the end of the second quarter, 20 percent of firms were paying lower salaries. About 2.9 percent of all the firms affected were forced to cease their activity (Figure 22). The closure of viable business and the loss of productive jobs will likely reduce productive capacity, with a possible negative impact on Mozambique's long-term growth potential.

Among the workers affected, women made up a larger share (7 percent of the women in the labor force) than men (5.5 percent of the men in the labor force). The women affected were primarily working in entertainment and recreation, hospitality and services. Men were mostly affected by suspension or interruption of contracts in the extractive, construction, and hospitality sectors.

[32] A difficult macroeconomic environment, limited domestic resource mobilization, lack of credit information, limited availability of collateral, limited access to credit risk-sharing facilities, and limited diversification of financial products all help explain this gap.

[33] Bosio, et al. (2020).

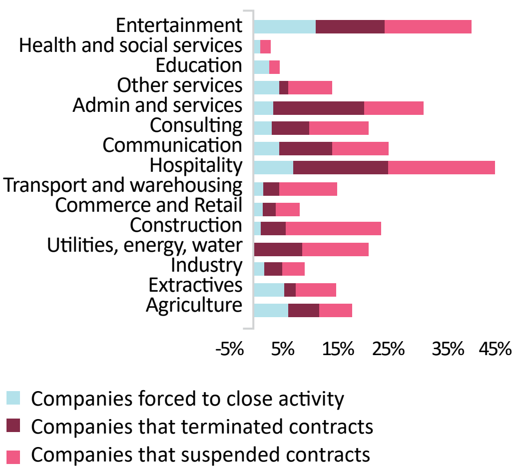
Additionally, 56 percent of firms adopted worker rotation, but only 19 percent followed the bi-weekly rotation schedule recommended by the Ministry of Health, raising questions about the effectiveness of the measure. The aggregate decrease in hours worked in Q2 corresponds to 17.6 percent of hours worked per person.

Salary cuts and layoffs reduced households' income and led to lower demand for goods. Financial institutions consulted indicate that a large share of wage employed workers leverage their salaries to access credit to finance formal or informal activities to help improve their living standards. These activities are often entrusted to family members, who in turn gain their own sources of income. As a result, salary reductions and job losses had a greater-than-expected impact on wage employed workers and their families.

Companies continue struggling despite the gradual opening of the economy. The construction, hospitality and retail sector remain the most affected sectors and are the most pessimistic: 61 percent of companies still faced limitations on activity at the end of the third quarter. The employment indicator in the third quarter was at its lowest level of the year. All sectors, except manufacturing, expect to see a price increase towards the end of the year, reflecting the common trend of the period (INE, 2020c).

Figure 22: **Hospitality and entertainment workers were the worst affected**

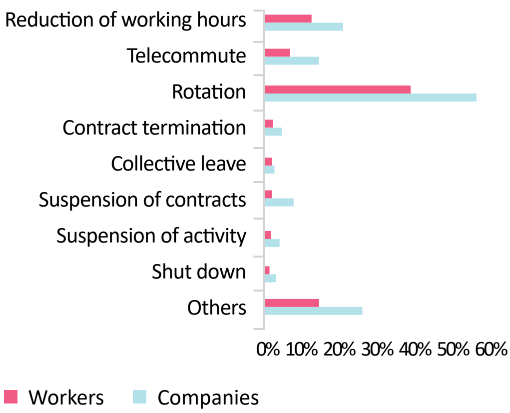
Percentage change in sales volume of formal firms in the first half of 2020 (year-on-year)



Source: INE (2020b).

Figure 23: **... firms resorted to cuts in labor costs**

Percentage change in sales volume of formal firms in the first half of 2020 (year-on-year)



Source: INE (2020b).

How Has the Government Responded to These Impacts?

The government and the Central Bank have provided support to the private sector through a combination of measures: (i) financial sector and credit market measures; (ii) fiscal measures; (iii) measures related to utility costs; and (iv) workforce measures. These are summarized in Box 5. The resources planned for private sector support amounted to about 1.5 percent of GDP, with available budget reaching 0.6 percent of GDP as of September 2020. However, only a small proportion of this has been disbursed so far. The effectiveness of the measures has been limited—either being of insufficient scope or else hindered by procedural bottlenecks. Also, direct support (transfers) were not among the measures adopted, and government support was not conditioned on keeping jobs. The loss of productive jobs and critical skills could have long-term implications for firms and the broader economy, thereby limiting the cost-effectiveness of the policies.

Financial sector and credit market measures.

The Central Bank and the government helped to alleviate the liquidity constraints of firms under financial distress. The government and the Social Security Institute financed a US$ 22.9mn credit line to provide direct liquidity support to firms. The credit lines are managed by Banco Nacional de Investimento (BNI) at a discounted interest rate of between 8 and 12 percent. However, the funds were too limited to relieve firms of financial distress and up to September, six months after the introduction of social distancing measures, no disbursement had been made. About 1,031 companies applied to the BNI credit line, with requests amounting to a total of US$ 152mn – 587 percent more than the funds allocated. Submissions of new proposals were halted in September due to excess demand.[34]

Commercial banks were incentivized to meet their private sector clients' need for liquidity by the reduction of the Central Bank's reserve ratio (see also Part One in this publication). This measure helped free up liquidity in the order of US$ 90mn for commercial banks. Additionally, the Central Bank relaxed conditions for credit restructuring of commercial banks' clients for up to US$ 500mn for six months, based on the assessment of borrowers' capacity to pay under the new terms.

Unattractive costs and uncertainty surrounding repayment conditions halted the adoption of the Central Bank's US$ 500mn credit line for import traders by commercial banks. The aim was to finance clients' commercial transactions linked to the imports of essential consumer goods, raw materials and equipment. Companies found this measure unattractive as it added 5.6 percent in costs to the six-month Libor premium, and because the conditions for repayment were uncertain. The measure was not attractive to banks either, due to low loan-to-deposit ratios in foreign currency.

Box 5: Government Support Measures for Households and Businesses

As of mid-October 2020, the Mozambican Government has implemented a range of measures to address the short-term impact of the COVID-19 pandemic and to support reforms that will aid the recovery:

Measures to support businesses:

- Postponement of income and corporate tax advance payments for small firms (turnover less than MZN 2.5 million) until 2021.
- Authorization of VAT tax credits compensation with other taxes owed until 31 December 2020.
- 10 percent reduction of electricity tariffs for businesses.
- Suspension of mobile money commission fees and increase in mobile money transaction limits for three months.
- Forgiveness of social contribution fines and reduction of interest rates for payments due.
- US$ 14.5m credit line to support small and medium-sized enterprises (SMEs) affected by the crisis for treasury and equipment acquisition.
- US$ 8.7m credit line repayable at 4 percent interest rate.

Measures to protect families:

- Expansion of beneficiaries of social protection programs from 592,179 to 1,695,004 households.
- Simplification of ID requirements for mobile money transfers to social protection beneficiaries.
- Establishment of a fuel price stabilization fund and allocating savings to the Covid-19 response.

[34] At the time of writing, 39 per cent of the proposals had been assessed. Of those, only 25 per cent were considered eligible, for a total allocation of US$ 14mn. However, disbursement is expected to take place only after in-depth due diligence on the collateral proposed by the applicants.

- Suspension of VAT on soap, oil and sugar until end 2020.
- Suspension of water charges for customers with consumption of up to 5 m3 and exemption from fines.
- Monitoring of market prices to curb opportunistic pricing.
- 50 percent reduction in electricity tariffs for low-income households during the state of emergency.
- Prohibition of eviction of tenants.
- Cross subsidies to kitchen gas bottles.

Digital payments were incentivized by removing transaction fees and increasing daily limits to promote cashless transactions. Transaction fees on mobile money were removed, whilst the daily limit was increased. E-money transaction limits doubled to US$ 757.50, whilst commission fees for transactions to mobile wallets fell by 50 percent. Though this step was welcomed, its effect was limited by the economy's lack of preparedness for going cashless.

Fiscal measures

Fiscal measures were introduced to support small firms. The corporate income tax "per account" was waived during 2020 for companies that subscribed to the organized regime (IRPC) and with an annual turnover of less than MZN 2.5mn (US$ 36,000). The special advance payment "Special per account" was also postponed to early 2021 for these companies. In addition, up until December 31, 2020, taxpayers with VAT credits were allowed to offset these credits against other taxes they owed, as long as the cases had already been decided in court.[35]

The impacts of these fiscal measures were limited by overly restrictive eligibility criteria. The targeting did not include the majority of small firms that are registered under the simplified tax regime. As a result, according to INE, 14.7 percent of firms did not pay any of their fiscal obligations at the end of Q2. However, as of June 2020, 8.9 percent of medium-sized businesses and 11.6 percent of large businesses – by far the most important fiscal contributors in absolute terms – reported having fallen into arrear (INE, 2020b).

Measures to reduce utility costs

A set of measures targeting household enterprises has been introduced to reduce utility costs. These include the suspension of water charges for small consumers and exemption from the collection of fines and reduced fuel prices. Electricity bills were reduced by 10 percent for companies, whilst 3,000 individual low-income customers who consume up to 125kW per month were allowed to postpone the fixed tax on electricity and saw their bill reduced by 50 percent.

Workforce measures

Temporary measures were introduced to regulate workforce relations. Only 50 percent of employees were allowed in the workplace, except for essential industries, with a turnover of service teams every 15 days. Simultaneously, remote working and the use of ICT were allowed. An independent survey reported that only 22 percent of firms still required all staff to work in the office. The National Institute of Social Security (INSS) forgave fines and reduced interest on late payments resulting from non-compliance with social security contributions. Remuneration for absences by employees who are infected by COVID-19, or by employees who have to take care of infected family members, are covered by the INSS.

How to Help Businesses Move Forward?

In the short-term, measures to support viable firms need to be strengthened. Productive assets and jobs should be protected, while

[35] All legal procedures were initially suspended for 60 days. With the gradual re-opening of the economy, courts have reinstated service. Nevertheless, all time limits related to all court cases and procedures had been suspended, including procedural time limits for insolvency.

in the medium term, the agenda of structural reforms will have to be reignited. Support needs to focus on firms that were most affected by the crisis and were economically viable before the crisis. It will be important to promote the reallocation of resources to more efficient medium-size companies and avoid measures that risk propping up unviable firms or declining industries.[36] In the recovery phase, support should focus on productivity, economic transformation and job creation. This would include gradually eliminating relief measures and implementing policies that support firm capability, including the adoption of digitalization and improved production practices. This can facilitate linkages with mega-projects and exploring opportunities in the international markets.

The measures implemented so far did not fully target the sectors most affected by the pandemic, such as hospitality and tourism, transport, micro firms or household enterprises. Incentives, cash injections and tax relief were not tailored to the characteristics of firms in these industries. Looking ahead, it is crucial to tailor measures and their implementation to the different regional contexts in Mozambique. Support to the private sector needed to be more rapid, transparent and time bound to address immediate liquidity challenges, prevent widespread layoffs and limit firm bankruptcies effectively.[37] It is also essential to continue to improve transparency by publishing information on allocation and execution of COVID support to firms.

The sections below outline the support measures for businesses under two scenarios: scenario 1: COVID-19 outbreak with a significant second shock; and scenario 2: COVID-19 stabilizes, the economy enters recovery phase.

Scenario 1: COVID-19 outbreak with significant second shock

In the case of an acceleration of COVID-19 cases in trade partner countries, prolonged restrictive measures and lockdowns, and continued low levels of demand, business will need additional liquidity support through relief measures.

Focus policies on formal firms that are more affected by demand shocks and were economically viable before the crisis, to protect productive assets and avoid unemployment of productive workers. Data for more than 30 countries show that the main drop in sales due to the COVID-shock occurs around the peak of the health crisis and is persistently large after 16 weeks. Support to firms' treasury should be made conditional on job protection to defend critical skills and productive capacity in the longer term.

Tailor limitations on economic activity by region and sector for increased effectiveness. The results presented by the INE assessment of the COVID-19 crisis on the private sector suggest that firms suffered from heterogeneous causes and were impacted differently according to their sector and location . For example, over 36,000 firms were affected in the Province of Maputo, representing 44 percent of all firms affected during the crisis, followed by Nampula with 8 percent. This is a consequence of the degree of social distancing, the density of the population, and the mobility of workers.

Reinforce and extend discounted credit lines to meet demand, with the support of partnering countries or multilateral agencies. Making the credit lines accessible from commercial banks instead of only BNI may increase fund allocation efficiency, motivated by a competitive environment. In this case, a unique selection panel and database should be created to avoid double funding the same firms. The criteria to identify beneficiaries could be a mix of their results for the past three years and turnover, number of staff formally employed and a minimum number of years in operation. The success of the measure will depend on the capacity of the managing institutions to select beneficiaries transparently, provide quick feedback on applications, and rapidly disburse the funds.

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36 In particular, conditions need to be improved to reduce the number of "zombie firms" - those that earn just enough money to continue operating and service debt but are unable to pay off their debt, and in turn, unable to invest or grow, thus diverting resources away from healthy, viable firms Adalet McGowan et al. (2017). In Mozambique, "zombie firms" are likely to represent a significant share of registered MSMEs. Even in normal circumstances, many MSMEs struggle to grow due to a mix of factors, including low human capital, difficult access to credit, low capitalization, and poor financial and management practices.

37 World Bank (2020b).

Extend fiscal relief and payment postponement to a wider share of firms. This could be achieved by including those under the simplified tax regime (ISPC), and considering increasing the threshold for taxpayers under the organized regime (IRPC) to MZN 14.7mn (according to the definition of small businesses)[38] or US$ 1mn turnover (considered as small taxpayers). Additionally, the requirement for court cases to be resolved for VAT postponement should be reviewed. Given government's limited fiscal space, resources to implement these measures could be mobilized through different mechanisms: (i) savings from the DSSI; (ii) additional donor support; and (iii) a tax reform to expand the fiscal base.

Support informal self-employed (subsistence) entrepreneurs and household enterprises through social protection programs. The government's plan to offer micro firms cash grants of US$ 200 repayable in six months to offset loss of income is appropriate. However, the amount seems inadequate and difficult to implement at this scale.[39] Policies that are designed to target formal enterprises, even small ones, might be less effective for informal enterprises, which have lower levels of skills, human capital and access to finance. Mass underemployment is a structural and enduring feature of the Mozambican economy, and has been exacerbated by COVID-19. Even returning to business as usual means ongoing economic distress. Without resolute actions to address these structural constraints, the informal sector will remain a large part of the economy.

COVID-19 stabilizes, the economy enters recovery phase

Focus support to the formal private sector during the recovery phase on productivity and economic transformation and job creation. If the number of cases is kept under control and the normalization of economic activities continues, including in the country's main trade partners, the government could gradually start to phase out relief policies in favor of structural measures that improve the country's fiscal performance and the prospects of economic recovery.

Combine access to capital with efforts to improve the conditions under which the private sector operate, particularly SMEs. Facilitating access to capital is important, if paired with other interventions on the supply chain. As seen after the Tsunami that hit Sri Lanka in 2004,[40] and after the Great East Japan Earthquake in 2011,[41] lack of access to capital inhibits the recovery process. On the other hand, firms that received randomly allocated grants managed to recover profit levels almost two years before other damaged firms. Capital is important for the recovery of the retail sector, whilst the manufacturing and services sector require support to restore their broken supply chains. Additionally, SMEs can benefit from guidance to support business resilience. Examples of forward-looking support programs are the mentoring programs and financial workshops conducted in Queensland, Australia, to assist SMEs navigating periods of crisis.

Continue to improve the frameworks for secured transactions and insolvency. A new secured transactions law was enacted in 2019 and a movable collateral registry was expected to be launched in 2021. The framework for resolving insolvency in Mozambique is better than its peers, but creditors still face major challenges in debt recovery. The Insolvency Administrator Regulations were approved in 2019 but need to be complemented with capacity building and increased use of out-of-court settlement. The new framework can help MSMEs to have higher access to capital. Offering new financial products such as leasing and factoring will become more feasible.

Invest in skills, infrastructure development and conditions to support the development of a local transformative industry. This will increase the resilience of the economy in the face of external, global supply chain shocks, and help develop integrated local value chains. Mozambique ranked 84 (out of 160) economies in the 2016 Logistics Performance Index, performing poorly for its trade and transport infrastructure quality

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38 Decree No. 44/2011 of 21 September.

39 Extended review of conclusions from international experiences can be found in Gaffurini and Campos (2020).

40 Mel, McKenzie, Woodruff (2014).

41 Kashiwagi, 2019.

and for the competence and quality of its logistics services. Mozambique also has poor levels of electricity infrastructure, and problems with transmission and distribution losses.

Improve the private sector capacity to tap into opportunities by improving capabilities and promoting investment for worker training, management training, business development services, technology adoption. Mozambique's firms score low on capability measures. Weak management practices mean a lack of lean production mechanisms, limited development of talent, lack of planning and targeting, and limited use of documentation to capture lessons. Larger firms are more likely to employ more skilled workers and managers and provide additional training.[42]

Improve data digitalization and make integrated databases available to public institutions to improve the targeting of public policies and support measures to the private sector. Scarce public resources can therefore be invested more efficiently during the recovery phase and beyond. The authorities could provide an environment conducive to experimentation to innovative services and remove obstacles to the use of more efficient technologies by financial institutions. Digital technologies have proven to be game changers in times of crisis, but firms in Mozambique lag behind other African countries on the adoption of new business practices, such as digital platforms. To close the gap, (i) regulated institutions should be allowed to experiment with new products and services under oversight, with regulation following a need and proportionate risk-based approach; (ii) the regulatory sandbox for fintech (financial technology services) firms to pivot innovative solutions and business models in a controlled environment should be streamlined; and (iii) all market participants should have access to a level playing field.

Sector-specific measures

Improve framework conditions for the farming and food sector. Increasing access to agricultural inputs (seeds and fertilizer), equipment and transport services to sustain short-cycle crops such as horticulture and potatoes can guarantee food supplies – especially to urban centers – and support peri-urban farmers. Facilitating agreements between farmers and distributers in urban areas would streamline the food supply chain. The first step would be for the Ministry of Agriculture and Rural Development and the organizations working on farmer development to collaborate to update the mapping of producers and production.

Implement tailored measures to relaunch the hard-hit hospitality industry. Firstly, build investment promotion capacity to assess, develop and package investment opportunities. As international tourists are expected to only return slowly, promoting opportunities to fill gaps in mid-level accommodation can attract investment to respond to internal demand. Domestic tourism can be boosted by offering reduced airfares during off-peak seasons or as part of lower-cost packages. International visitors can be attracted by creating an online one-stop-shop for information to attract and inform potential tourists and respond to negative media coverage. Additionally, promoting links between the hospitality industry and local producers can increase their integration into the tourism value chain and reduce reliance on imports.

COVID-19 has mainly affected vulnerable urban households

The impacts of COVID-19 on households has mainly been felt through loss of earnings and employment, especially for the poor working in the informal sector. Mozambique still has a relatively small number of deaths and people falling ill from COVID-19 (Box 1). The pandemic is mainly affecting households through two interlinked channels: incomes and jobs, and poverty vulnerability.

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[42] Lemos & Scur (2014).

Due to the structure of the labor market, the impact of COVID-19 on employment and incomes has been mainly felt in the cities. Over 70 percent of the workforce is engaged in agriculture, either self-employed or in informal employment. Most of the remaining workers (24 percent) participate in the services sectors, with a small fraction (4.9 percent) employed in manufacturing. Social distancing measures and the shutdown of firms have largely reduced economic output, employment and incomes in the main cities.

The negative impact on income and jobs has been significant

The urban population has been hit hard. According to results of a high frequency survey (HFS) conducted by the National Statistics Institute (INE),[43] 67 percent of the urban population were not working in June 2020, whereas over one-third were working before COVID-19 in March (Figure 24). This indicates the large employment and income losses that are likely to be associated with the pandemic (Figure 28). Over 70 percent of workers indicated that they were unable to work normally – of these, only 9 percent received their wages in full. About 41 percent of the urban households interviewed reported a reduction in their wage income. In addition, most of the urban poor earn their income through self-employment in the informal economy, mostly in small-scale retail such as small shops, food stands, etc. Informal self-employment is also the main livelihood for the urban non-poor who are vulnerable to falling into poverty.

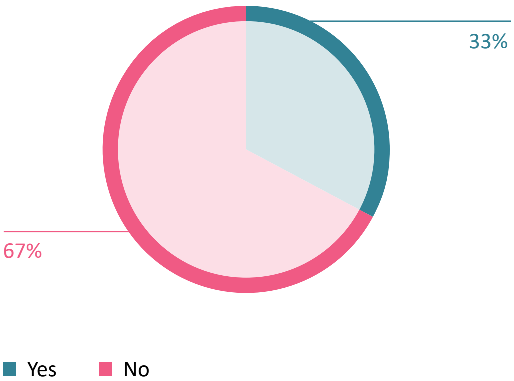
Job and income losses are concentrated in sectors and areas where the poor are predominant. The services sectors (retail, transport, restaurants, tourism, personal service, etc.), which employs most of the urban poor, accounted for 60 percent of the overall reduction in jobs recorded (Figure 28). The drop was observed across all provinces, but was particularly notable in Manica, Cabo Delgado, Niassa, and Zambezia, the latter three being among the poorest provinces (Figure 27) and also provinces where a significant share of households reported significant losses in income (Figure 28).

For rural households, the effect of COVID-19 on labor income is less important. Most rural households consist of smallholder farmers who earn their livelihoods mainly from traditional agriculture (85 percent), which is relatively less exposed to the negative effects of lockdown measures. Non-farm rural employment is at a higher risk, but its share is low, only 9 percent of all primary jobs. Most income from agriculture is in the form of auto-consumption and to a lesser extent from sales of production. Only 18 percent of farmers grow at least one cash crop and less than half of them sell any part of their production in markets. In addition, population density is much lower in rural areas, which helped reduce the spread of the virus. Of the total number of (registered) jobs lost due to COVID-19, only 5 percent was accounted for by agriculture. However, the impact of the crisis on the informal sector in urban areas may have exacerbated the vulnerability of rural households that rely on informality as a source a non-agricultural jobs.

[43] The survey was conducted between 19 and 30 June 2020 and focused on 1,185 urban households, corresponding to 5,938 individuals.

Figure 24: Significant employment losses occurred during the pandemic...

Individuals in work in the 7 days prior to the survey (%)



Source: World Bank staff based on HFS.

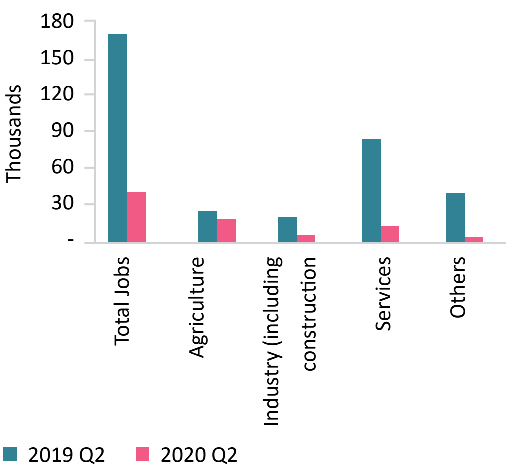
Figure 25: ... leading to declines in household income

Share of households reporting changes in income since COVID outbreak (%)

Source: World Bank staff based on HFS.

Figure 26: Job losses were concentrated in services, where the poor are largely employed

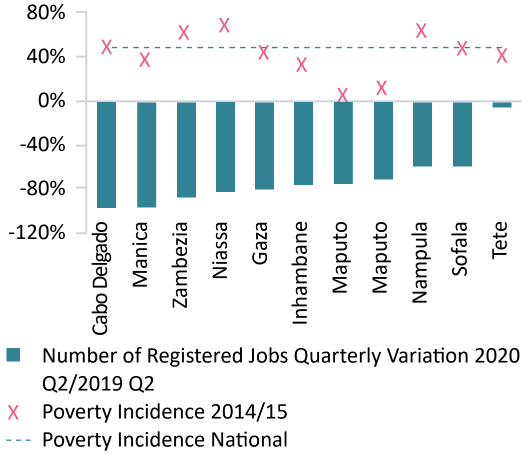
Number of jobs registered (thousands)



Source: World Bank staff based on Ministry of Labor Quarterly Bulletin.

Figure 27: The poorest provinces were particularly affected

Poverty levels and variation in recorded jobs (%)



Source: World Bank staff based on Ministry of Labor Quarterly Bulletin.

While remittances have fallen, the overall impact on households is expected to be limited. Total inflow of remittances stood at US$ 36.8 million in the first half of 2020, 26 percent lower than during the same period in 2019. But, unlike other countries in the region, Mozambique is not highly dependent on remittances from abroad. Remittance inflows accounted for 1.1 percent of GDP in 2018 and 0.9 percent in 2019.[44] Remittances are most important in the southern part of the country, which typically has a greater share of migrants to South Africa, the most affected country in the region. With the shutdown of the economy in South Africa to contain the spread of COVID-19, many Mozambiquan migrants returned home meaning they were no longer earning money to support their families. However, the recent easing of restriction measures in South Africa and the opening of the borders has allowed migrants to return to their workplace and will counteract the initial expected decline in remittances.

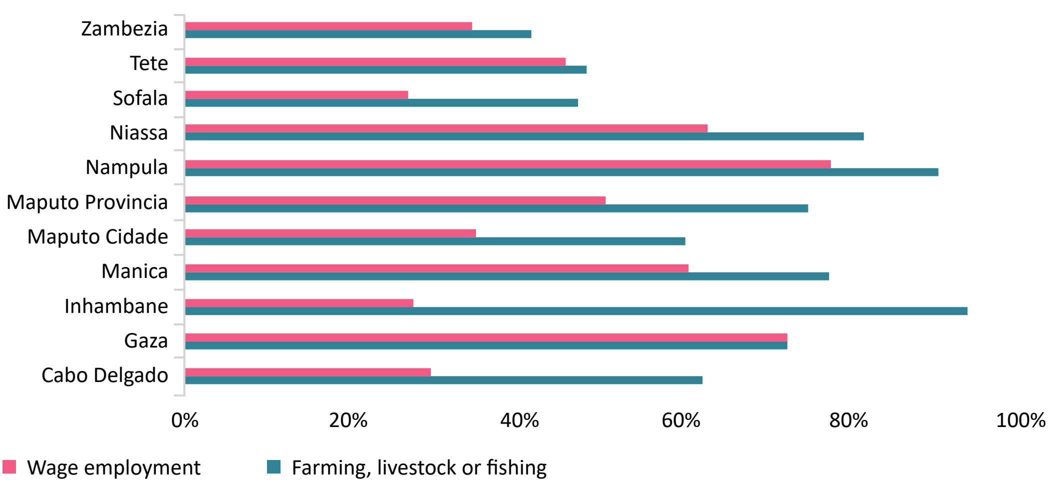
[44] World Bank (2020e).

Income lost directly due to deaths and illness was limited. The number of deaths and positive COVID-19 cases is still low in Mozambique (Box 1). Results from the HFS show that most urban households were aware of COVID-19 and complied with the preventive measures. Out-of-pocket health care expenditures did not affect households much either. Members of poor and vulnerable households who fell ill were treated through the National Health System, which is more affordable than private sector clinics. Results from the HFS indicate that urban households have faced no problems in accessing general medical treatment.

COVID-19 has led to food insecurity. Results from the HFS show that, as of June, 76 percent of the urban households interviewed expressed concerns about not having enough food and 37 percent had gone a day without eating. Food prices rose by nearly 8 percent year-on-year in August, up from 3.4 percent in the same period of 2019. The consumption budgets of both poor and non-poor but vulnerable households are vulnerable to increases in food prices. On average, rural and urban households spend 60 and 40 percent of their income on food, respectively, and these shares are even higher for low-income households. In normal times, 1 in 4 households are considered chronically food insecure. Mozambique is a net importer of basic staples such as maize and rice, which heightens the risks of food scarcity and price rises due to supply disruptions. For instance, 94 percent of maize imports come from South Africa.

Figure 28: Income losses were greatest for households in the poorest provinces

Households reporting losses in income (%)



Source: World Bank staff based on HFS.

COVID-19 could wipe out much of the recent gains in poverty reduction

The pandemic hit Mozambique when it was already facing high levels of socioeconomic vulnerability. According to the methodology applied by the World Bank in its latest Poverty Assessment of Mozambique,[45] and using data from the 2014/15 household budget survey[46] and a national poverty line of 25.9 MZN per person per day, 48.4 percent of the population are classified as poor—56 percent of rural households and 32 percent of urban households. Nearly 8 out of 10 poor people live in rural areas. When assessed against the international poverty line (US$1.9 PPP), the poverty headcount ratio rises to 62.9 percent nationally. The second largest group are the "non-poor but vulnerable to fall into poverty", representing 25 percent of the population. Even a slight drop in consumption would push many of these households into poverty as well. The vulnerability of poor households is further

45 World Bank (2018).

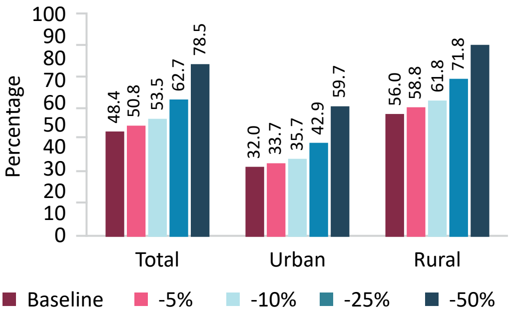
46 Inquérito sobre o Orçamento Familiar 2014/2015

compounded by low asset holdings and limited access to basic services, especially in rural areas.

Simulations suggest that at least 1.4 million more Mozambicans could fall below the national poverty line. A first scenario that assumes a decline in consumption for the entire population was used to estimate the size of the effects.[47] The results, shown in Figure 29, underscore the high levels of vulnerability. A short to medium-term reduction of 10 percent in consumption per capita by all households – a reasonable assumption given the scale of the crisis (see Box 1) – would raise the poverty rate by more than 5 percentage points, from 48.4 to 53.4 percent. This is equivalent to 1.4 million more Mozambicans slipping below the poverty line. This shock would wipe out half of the gains in poverty reduction achieved between 2008 and 2015, the period with the fastest growth in consumption expenditures. A more negative scenario could see the poverty rate rise to 62.7 percent, well above the levels recorded in 2002/03. This scenario is based on a reduction of 25 percent in consumption (Figure 29).

Figure 29: Poverty will increase in even the most optimistic scenarios

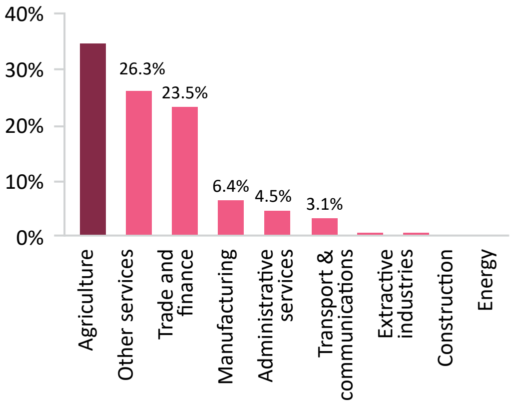
Modelled impact of consumption decreases on poverty share



Source: World Bank staff calculations.

Figure 30: Most urban jobs are in sectors likely to be hardest hit

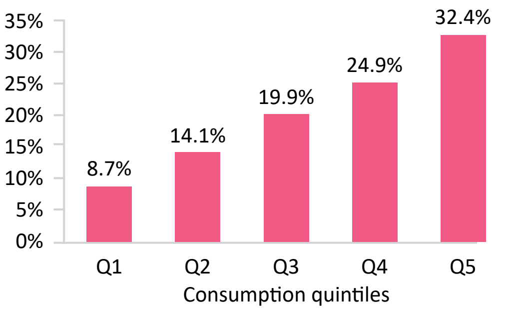
Share of urban workers by economic sector



Source: World Bank based on IOF-2014/15.

Figure 31: A large share of at-risk jobs is held by vulnerable people

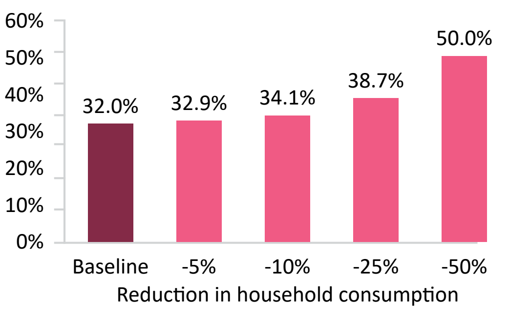
Share of urban workers by consumption vulnerability



Source: World Bank.

Figure 32: A fall in consumption could see urban poverty increase significantly

Modelled poverty impact on households with members employed in at-risk sectors



Source: World Bank based on IOF-2014/15.

[47] The national household budget survey does not collect comprehensive income data.

Job losses or reduced working hours can have significant effects on urban poverty and inequality. About 64 percent of the jobs in the urban economy are in sectors most at risk from being negatively affected by COVID-19 (colored in pink in Figure 30). Further disaggregation shows that 42.7 percent of these at-risk jobs are held by low- and medium-skilled workers (i.e. those in the first three quintiles, roughly representing the poor and vulnerable) (Figure 31). Job losses or reduced working hours in these sectors can have significant effects on urban poverty and downward economic mobility. To examine this, simulations were modelled for different reductions in consumption to see the impact on households with at least one worker in the "at-most-risk" sectors. These found that a transitory drop in consumption of 10 percent would increase the urban poverty headcount by over 2 percentage points (from 32 to 34.1 percent), adding nearly 250,000-300,000 extra poor to the 3,400,000 urban individuals already in poverty. A scenario that assumes a decline of 25 percent in household consumption would double the poverty effects (Figure 32).

Human capital is undermined by school closures

The disruptions to service delivery are expected to affect human capital in the medium to longer term. Schools were closed during the State of Emergency. While this was an important measure to prevent the spread of the virus, it interrupted teaching for about 6.5 million children in primary and 1.2 million children in secondary education. While other countries moved to teaching students online, there is virtually no capability for Mozambique to do this, as only 7 percent of the population has access to internet.[48] School closures meant lost learning time for students.[49] With dropout rates already high, school closures may have further reduced the low retention rates. Before the pandemic, one in four students who started in first grade had dropped out of school by third grade (World Bank, 2018). In addition, 47 percent completed only the first level of primary education, while only 20 percent completed full primary education.

Nearly half of rural children are considered chronically malnourished. Disruptions to existing systems[51] to deliver food rations to children have worsened the nutrition status of children, undermining their short and long-term physical and cognitive development.

Taken together, these impacts are likely to slow Mozambique's progress toward achieving the Sustainable Development Goals (SDGs), as discussed in Box 6.

48 According to the 2017 census results.

49 This is likely to affect rural households more, as assessment of COVID impact based on the High Frequency Survey (HFS) found that as of June 2020, more than 80 percent of the urban households interviewed had managed to find alternative educational activities following school closures.

50 These figures are based on analysis of the 2017 Population and Housing Census. The analysis was restricted to children aged 11 years for the first level of primary education and 13 years for full primary education.

51 Mostly school-based but covering a very small fraction of children.

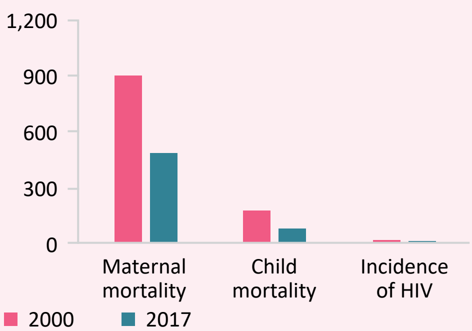
Box 6: How will COVID-19 affect Mozambique's ability to reach the Sustainable Development Goals (SDGs)?

COVID -19 is exacerbating Mozambique's already slow progress towards achieving the SDGs. The share of population living in extreme poverty was declining slowly between 2009 and 2015, from 69 percent to 63 percent. COVID-19, which comes on top of the hidden debt shock in 2016 and tropical cyclones in 2019, has reversed the downward trend in poverty incidence. Malnourishment, already on the rise before COVID-19, is expected to further increase alongside stunting among children younger than five. On gender equality, women experiencing violence by an intimate partner, which fell by only 5 percentage points to 20 percent between 2000 and 2017, has seen risks aggravated by the containment measures. The limited movement allowed under the State of Emergency, besides exposing girls and women to longer periods with their partners, reduced households' sources of income (constituting a source of conflict in the household).

The pandemic will disrupt the substantial gains observed on health and education indicators. The maternal mortality ratio practically halved between 2000 and 2015, from 915 to 489 per 100,000 live births. Between 2000 and 2017, child mortality reduced to almost a third from 170 to 72 per 1,000 live births (Figure 33), and the incidence of HIV dropped from 18 to 9 per 1,000 uninfected adults. These health gains are expected to shrink as resources are diverted to other health areas and households avoid making use of health facilities. Education, which had been a success story in terms of access since the 2000s, will be set back. Besides the interruption in the learning process due to the efforts to contain the spread of the virus, COVID-19 has exacerbated inequality both in educational access and quality. In a context of already limited education quality, the ability of pupils to attend remote classes is a positive function of household income, which sees privileged pupils in private schools in urban areas. Pupils from poor urban and rural families are expected to fall substantially behind in educational access and quality, which in turn will affect their labor market prospects.

COVID-19 has also brought challenges for monitoring SDG progress. Disruption in field data collection operations due to social distancing measures, and funding cuts in statistical offices in low-income countries have limited the availability of data necessary to monitor progress toward the SDGs. Thus, the COVID-19 pandemic is not only creating a massive setback in the realization of the 2030 Agenda for Sustainable Development, but it is also exacerbating global data inequalities. Mozambique's household survey, the main source for monitoring progress in poverty reduction, was interrupted in April 2020 to contain the spread of the virus. Fortunately, with the application of strict biosafety measures, fieldwork activities resumed and the survey is expected to be completed in December 2020.

Figure 33: Maternal and child mortality have fallen significantly



Note : Maternal and child mortality data are per 100,000 live births and 1000 live births respectively. Incidence of HIV is per 1,000 uninfected adults.

How to support households?

The government has taken some measures to help vulnerable families weather the COVID storm (summarized in Box 5). The following policy responses could also be introduced in the short and medium term to mitigate the devastating health and economic effects of the virus, especially for the poor:

Use cash transfer programs to sustain household income. The National Social Action Institute aided the 570,000 existing beneficiaries of the productive safety net program with an additional one-off payment of US$50, equal to three months of regular subsidies. An additional 290,000 vulnerable households in urban and peri-urban areas were included in the Direct Social Assistance Plan. They receive a bimonthly cash transfer of US$ 50 for six months, paid as an incentive to stay at home. Of these, 40,000 are informal workers, who are registered at the INSS. The World Bank provided US$ 21.7m to fund these programs (MEF, 2020).

Protect lives by continuing to strengthen the health system capacity. While COVID-19 response capacity has significantly improved (see Box 1), in general the health care system is very weak and under-resourced, especially in rural areas. Access to testing should expand further and contacts traced to prevent further spread. Additional donor support to fundprograms for people with co-morbidities, such as malaria, TB or HIV, could also help mitigate vulnerability and avoid neglecting existing strains on the healthcare system. While efforts have been made to ensure that health facilities have separate flows for patients with COVID-19, greater communication is needed to persuade people to continues to use health services.

Target incentives to encourage firms to retain workers and provide capital (loans and grants) to formal and informal firms to help them recover from the pandemic. Employment subsidies can help firms bridge a period of inactivity while retaining employees who might otherwise be laid off, face a potentially long unemployment episode and fall into poverty. However, achieving this would require mobilizing fiscal space, already pressured by the high debt service and wage bill. This highlights the importance of a wage bill reform, and the coordination between fiscal and monetary policies on debt management. Such subsidies can also support the recovery of aggregate demand. In terms of implementation, partnerships with existing micro-credit and micro-savings organizations should be leveraged to reach informal firms where the majority of the poor work.

Scale up safety nets, especially food assistance, for the poor. Given the projected losses of employment, drops in consumption, and increases in the poverty rate, ensuring the food security of poor and newly poor households is of paramount importance. In particular, the nutritional needs of children must be prioritized to prevent long-term negative impacts from stunting and compromised human capital development. It is important to ensure the implementation of the plan to expand the number of family beneficiaries of cash transfer programs from 600,000 to 1.7 million, as well as increasing the generosity of the transfer.

Mitigate the negative effects on human capital. To ensure that children's human capital development is not further jeopardized, or their future labor market prospects compromised, once COVID-19 is under control and schools re-open, policies to encourage children to go back to school will be critical. This could entail one-time cash transfers contingent on re-enrollment and attendance. Another option would be to roll out school meal programs with donors support, which typically motivate children (and their parents) to attend school and can also be a way to ensure ongoing nutritional support for children.

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