

## AFRICA RISK CONSULTING

### Mozambique Monthly Briefing August 2016

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#### Mozambique Summary 18 August 2016

*Resistencia Nacional Moçambicana (Renamo) gunmen launch attacks in Tete, Sofala, Zambezia and Niassa Provinces. Italy-based ENI reportedly reaches a deal with United States (US)-based Exxon Mobil for the sale of a portion of its interest in the offshore gas block known as Area 4. The attorney general's office is to investigate sovereign borrowing for potential wrongdoing or criminality, while the finance ministry hires consultants to help ascertain the full extent of Mozambique's sovereign debt profile. A creditor group of bondholders of state-owned tuna fishing company Empresa Moçambicana de Atum SA (Ematum) reportedly explores the possibility of suing the government. Parliament passes a bill that amends the 2016 budget. Standard & Poor's revises Mozambique's sovereign credit outlook to negative.*

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#### Renamo launches several attacks

**Resistencia Nacional Moçambicana (Renamo)** gunmen have conducted several attacks over the last month. The attacks will delay an eventual meeting between president **Filipe Nyusi** (2015-present) and Renamo leader **Afonso Dhlakama**, as Nyusi has stated that any face-to-face meeting is conditional on an immediate ceasefire.<sup>1</sup> Dhlakama has ruled out any immediate ceasefire and said the government has intensified attacks on Renamo in recent weeks.<sup>2</sup>

*"Mozambique's political and security environment is still uncertain, although a joint commission between the government and Renamo has reached an agreement for further discussions on a package of issues regarding Renamo appointing provincial governors for the six provinces where it claimed victory in the 2015 election [see previous ARC Briefings Mozambique]. The final result of this and the other matters to be discussed – including the cessation of hostilities and the disarming of Renamo – will be decided in the long-awaited high level face-to-face meeting between Nyusi and Dhlakama ... who is believed to be hiding in the mountains of **Gorongosa**, and says is surrounded by government forces and may have no way to leave."<sup>3</sup>*

Because of the slow progress towards a meeting between Nyusi and Dhlakama, Renamo attacks have intensified, particularly in **Niassa, Tete, Zambezia** and **Sofala Provinces**.<sup>4</sup> Renamo gunmen attacked a **Brazil-based Vale-owned** train in **Becanta** in **Cheringoma District** (Sofala Province) on 25 July.<sup>5</sup> The train was transporting coal from **Moatize District** (Tete Province) to the port of **Beira** along the **Sena Railway**.<sup>6</sup> A train conductor and security guard were slightly injured in the attack.<sup>7</sup> Vale and other users of the Sena Railway line are increasing security along the route because this is the second attack on a coal train along the Sena Railway.<sup>8</sup> On 7 June Renamo gunmen attacked another Vale coal

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<sup>1</sup> VOA Portugues, 2 Aug 2016.

<sup>2</sup> VOA Portugues, 2 Aug 2016.

<sup>3</sup> Source, political analyst, Maputo

<sup>4</sup> Source, political analyst, Maputo

<sup>5</sup> Lusa, 26 Jul 2016.

<sup>6</sup> Lusa, 26 Jul 2016.

<sup>7</sup> Lusa, 26 Jul 2016.

<sup>8</sup> Lusa, 26 Jul 2016.

train, also in Cheringoma District.<sup>9</sup> The attack was the first time Renamo has targeted a commercial train, since it stepped up hostile action this year (see previous *ARC Briefing* for Mozambique).<sup>10</sup>

Renamo gunmen attacked a police position in Moatize District on 1 August.<sup>11</sup> The attack came 48 hours after Renamo gunmen attacked a health facility in **Tsengano District** (Tete province), attacked the village of **Maiaca** (Niassa Province), and attacked another village in **Mopeia District** (Zambezia Province). The attacks came a week after alleged Renamo gunmen attacked a Vale coal train (see above).<sup>12</sup>

Renamo gunmen attacked a government administration building and health centre at **Nacuma** in the **Metarica District** (Niassa Province) on 8 August.<sup>13</sup> Security forces did not report any casualties from the attack, which is the third in Niassa over the last few weeks.<sup>14</sup>

### ENI reportedly reaches deal with Exxon Mobil for sale of interest in Area 4

International media reported on 5 August that **Italy**-based **ENI** has reached a deal with **United States**-based **Exxon Mobil** for the sale of some of its interest in the offshore gas block known as **Area 4**.<sup>15</sup> However, neither ENI nor Exxon Mobil has publicly released information on the deal.<sup>16</sup> Two Exxon Mobil officials with knowledge of the issue said, “*The deal is done but will not be announced for several months at Exxon’s request.*”<sup>17</sup> ENI declined to comment on the reported deal and a spokesperson for Exxon Mobile said, “*We do not comment on market rumours or speculation.*”<sup>18</sup> The deal will allow ENI to bring in Exxon Mobil as a partner with deep pockets and technical know-how to build the onshore liquefied natural gas (LNG) export terminal that is required to commercialise Area 4’s offshore gas reserves.<sup>19</sup> Moreover, any final deal will include significant capital gains tax, which will help relieve the government’s current fiscal pressure (see previous *ARC Briefing* for Mozambique).<sup>20</sup> Unconfirmed government sources indicate the government may receive \$1.2 billion in capital gains tax revenue.<sup>21</sup> However, the capital gains tax may

*“ ... reduce government’s efforts in costs control; as well as the implementation of a realistic budgetary restraint programme; and in carrying out an international forensic audit for secret loans [see below] ... The problem in relying on tax from stake deals is that they are unpredictable, and can only serve as an immediate and unsustainable solution for the economic crisis. Another problem is deadlines, surely the government is uncertain about when the transaction will be closed. In earlier experiences, after closing the deal, negotiations began afterwards with the government for agreeing on capital.”<sup>22</sup>*

The two sources familiar with the discussions between ENI and Exxon Mobil said the companies have agreed terms and “*sealed*”<sup>23</sup> a deal that could give Exxon Mobil its desired operating stake in the onshore LNG export plant while ENI would retain control over the Area 4 gas fields feeding it.<sup>24</sup> ENI CEO **Claudio Descalzi** publicly reiterated ENI’s desire to remain operator of the gas fields.<sup>25</sup>

<sup>9</sup> Multiple sources: Reuters, 7 Jun 2016; AIM, 7 Jun 2016.

<sup>10</sup> Multiple sources: Reuters, 7 Jun 2016; AIM, 7 Jun 2016.

<sup>11</sup> VOA Portugues, 2 Aug 2016.

<sup>12</sup> Lusa, 26 Jul 2016.

<sup>13</sup> AIM, 8 Aug 2016.

<sup>14</sup> AIM, 8 Aug 2016.

<sup>15</sup> Reuters, 5 Aug 2016.

<sup>16</sup> Reuters, 5 Aug 2016.

<sup>17</sup> Reuters, 5 Aug 2016.

<sup>18</sup> Reuters, 5 Aug 2016.

<sup>19</sup> Reuters, 5 Aug 2016.

<sup>20</sup> Source, journalist, Maputo

<sup>21</sup> Source, government official, Maputo

<sup>22</sup> Source, journalist, Maputo

<sup>23</sup> Reuters, 5 Aug 2016.

<sup>24</sup> Reuters, 5 Aug 2016.

<sup>25</sup> Reuters, 5 Aug 2016.

*"Our model is to remain and keep the operatorship or keep, in any case, a clear control on the asset – the asset that we discovered."*<sup>26</sup>

In 2013, ENI sold 20% of its Area 4 licence to **China-based China National Petroleum Corp (CNPC)** for \$4.2 billion.<sup>27</sup>

### Attorney general to investigate sovereign borrowing scandal

Assistant attorney general **Taibo Mucobora** said, on 15 July, that the attorney general's office will seek help to investigate \$1.35 billion in undeclared sovereign borrowing (see previous *ARC Briefing* for Mozambique).<sup>28</sup> The investigation is a step in the right direction to meet the demands of the international donor community, which the government needs to have onside to alleviate its unsustainable debt profile.<sup>29</sup> Mucobora said,

*"The attorney general's office will request the appointment of national and international experts with profound expertise in these issues so that we can obtain relevant and reliable information."*<sup>30</sup>

Mucobora also noted that the attorney general's investigations to date indicate that officials may have committed criminal abuse of office when contracting the undisclosed sovereign loans,<sup>31</sup> in apparent breach of parliamentary borrowing limits.<sup>32</sup> Mucobora did not indicate how long the investigation would take.<sup>33</sup>

Meanwhile, the international media reported on 18 July that the economy and finance ministry has hired **United Kingdom (UK)-based Lazard Ltd** and UK-based **White & Case LLP** as financial and legal advisers respectively, to help assess its foreign debt.<sup>34</sup> A full analysis of Mozambique's foreign debt is necessary to get a better understanding of Mozambique's total sovereign obligations, following the scandal over undisclosed sovereign debt.<sup>35</sup> A statement from Lazard said it would,

*"... assist the ministry with the assessment of Mozambique's current external debt situation ... The ministry has started to work closely with its advisers, and looks forward to engaging collaboratively in the near future with the various stakeholders of Mozambique."*<sup>36</sup>

The length of the economy and finance ministry's contract with Lazard and White & Case is not clear.<sup>37</sup>

### Ematum bondholders may sue government, VTB & Credit Suisse

A creditor group made up of bondholders of state-owned tuna fishing company **Empresa Moçambicana de Atum SA (Ematum)** bonds, who swapped their bonds for Mozambique government bonds (see previous *ARC Briefing* for Mozambique), has hired an unnamed law firm to explore the possibility of suing the Mozambique government and the bonds' lead arrangers, **Switzerland-based Credit Suisse** and **Russia-based VTB**.<sup>38</sup> The potential lawsuit is over the alleged failure to fully disclose the extent of Mozambique's hidden sovereign debt prior to the swap.<sup>39</sup> A

<sup>26</sup> Reuters, 5 Aug 2016.

<sup>27</sup> Reuters, 5 Aug 2016.

<sup>28</sup> Reuters, 15 Jul 2016.

<sup>29</sup> Reuters, 15 Jul 2016.

<sup>30</sup> Reuters, 15 Jul 2016.

<sup>31</sup> www.macauhub.com.mo

<sup>32</sup> www.bloomberg.com

<sup>33</sup> www.macauhub.com.mo

<sup>34</sup> www.bloomberg.com

<sup>35</sup> www.bloomberg.com

<sup>36</sup> www.bloomberg.com

<sup>37</sup> www.bloomberg.com

<sup>38</sup> Reuters, 29 Jul 2016.

<sup>39</sup> Reuters, 29 Jul 2016.

possible lawsuit will further delay an eventual final settlement of Mozambique's sovereign debt crisis.<sup>40</sup> One fund manager who is part of the creditor group said,

*"We have decided to take legal action after we realised how bad the numbers were after the [International Monetary Fund] IMF made them disclose a couple of months ago ... Credit Suisse and VTB sold us the new issue, but it did not have full disclosure ... So we have hired the legal firm now and it is moving along."*<sup>41</sup>

Mozambique's finance ministry has not responded to the reports of a potential lawsuit.<sup>42</sup>

### Parliament approves revised 2016 budget

Mozambique's parliament, on 25 July, passed a bill that amends the 2016 budget. The amended budget reduces spending and lowers future growth rate expectations.<sup>43</sup> The total expenditure in the revised budget is 243 billion meticaís (\$3.6 billion), compared to 246 billion (\$3.8 billion) in the original budget.<sup>44</sup> The amended budget includes an increase in deficit spending to 11.3% of gross domestic product (GDP) compared to 10.2% in the original budget, which is mainly due to increased borrowing and a weaker currency.<sup>45</sup>

The revised budget also lowers Mozambique's economic growth projections from 7% to 4.5% for 2016; and has revised inflation forecasts upwards from 5.6% to 16.7% for 2016. The revised budget also indicates that Mozambique's net foreign reserves will decline to \$1.2 billion in 2016 compared to \$2.3 billion in December 2015.<sup>46</sup> The revised budget does not include the potential liabilities of the previously undisclosed sovereign borrowing linked to state-owned **Proindicus** and **Mozambique Asset Management (MAM)** (see previous *ARC Briefing* for Mozambique).<sup>47</sup>

### Standard & Poor's revises Mozambique's sovereign credit outlook to negative

International credit ratings agency **Standard & Poor's (S&P)** revised Mozambique's sovereign credit outlook to negative on 5 August.<sup>48</sup> However, S&P maintained Mozambique's foreign currency and local currency credit ratings at CCC and B- respectively. S&P's negative outlook indicates that it may view potential restructuring of MAM's external loans (see previous *ARC Briefing* for Mozambique) as a sovereign default.<sup>49</sup> The negative outlook indicates a possible future credit downgrade which will make government borrowing more expensive, and negatively impact its fiscal position. S&P expects Mozambique's net external liabilities to increase to nearly 10 times current account receipts by 2019, from an already high seven times in 2015.<sup>50</sup> However, S&P did note that there is a possibility of a ratings upgrade in 2017 if the government restores its relations with the IMF, which will help improve Mozambique's currently weak macroeconomic fundamentals.<sup>51</sup>

### Implications

The continued Renamo attacks will delay an eventual meeting between Nyusi and Dhlakama to finalise a peace and disarmament agreement, hence a higher degree of uncertainty will continue to characterise Mozambique's political and security environment in the short term.

<sup>40</sup> Reuters, 29 Jul 2016.

<sup>41</sup> Reuters, 29 Jul 2016.

<sup>42</sup> Reuters, 29 Jul 2016.

<sup>43</sup> [www.clubofmozambique.com](http://www.clubofmozambique.com)

<sup>44</sup> [www.clubofmozambique.com](http://www.clubofmozambique.com)

<sup>45</sup> Reuters, 26 Jul 2016.

<sup>46</sup> [www.clubofmozambique.com](http://www.clubofmozambique.com)

<sup>47</sup> [www.clubofmozambique.com](http://www.clubofmozambique.com)

<sup>48</sup> Reuters, 5 Aug 2016.

<sup>49</sup> Reuters, 5 Aug 2016.

<sup>50</sup> Reuters, 5 Aug 2016.

<sup>51</sup> Reuters, 5 Aug 2016.

ENI and ExxonMobil's reported Area 4 deal is a positive sign for the future of Mozambique's offshore gas sector, despite the low commodity price environment, which is hampering extractive sector investment. The deal will provide the government with a capital gains windfall, which will help mitigate the fallout from the sovereign debt crisis, but relying on capital gains taxes is not a viable longer-term solution to the government's fiscal challenges.

The attorney general's investigation into the sovereign debt crisis, the finance ministry's plan to ascertain the full picture of Mozambique's sovereign debt, and the revised budget are steps in the right direction and will help the government in its attempts to reestablish confidence with donors, international financial institutions and the international credit markets.

S&P's negative outlook on Mozambique is an indication of a possible future credit downgrade, which will increase borrowing costs, if the government does not take concrete steps to address the current fiscal and sovereign debt crises.

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### About Africa Risk Consulting:

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