THE MOZAMBICAN

LEASING SECTOR

November 2007

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1. Introduction. General information.

1.1. INTRODUCTION.

The current study focuses on financial leasing to finance, at medium term, the investments in productive equipments. The main factors related to the present leasing market study in Mozambique are the following:

- Important progress and economic development in Mozambique during the past ten years.
- Huge potential in natural resources (raw materials: coal, minerals, oil, gas, etc.), hydroelectric-power and agriculture.
- Limited and small sized local market. Low GDP per capita.
- A vast process of national infrastructure reconstruction.
- Limited national industrial production with small contribution to Mozambican exports.
- An economy dominated by the commercial and service sector.
- Strong dependency on imports.
- A strong dependency on foreign financial aid.
- A profound transformation of the Mozambican economy. New culture of "market economy".
- A strong focus on the primary sector and a small number of mega-projects: Mozal (aluminum), Moatize (coal mines), Pande Temane gas project, etc.
- A large informal economy.
- A regional integration process in progress (SADC: Free trade agreement between the countries of the southern African region) - the consequences of which are not predictable. What will be the role of Mozambique in the SADC? Will the country have the capacity to attract foreign direct investment - in other sectors than the mega projects – in order to develop the industrial and agriculture sectors which would generate employment? Or, on the contrary, will Mozambique play mostly the role of supplier of raw materials and energy?

1.2. SOW and limitations.

The scope of the work (SOW) is to analyze the feasibility of leasing operations and leasing industry in Mozambique.

The SOW is mainly limited to financial leasing and more precisely to “full-payout Assets leasing” to finance productive investments in order to contribute to the economic development of the country. This was initially the orientation chosen by the Mozambican authorities.

This feasibility review has been carried out in Maputo from August to September 2007. The dissemination seminar took place on Nov.16, 2007 in Maputo.

In this report we will examine the following aspects:

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1 Throughout the present report, by “productive equipments” we mean "production machinery, industrial equipments, all machinery & heavy equipments for public works and construction, vehicles for transportation etc...".
2 Throughout the present report please understand “financial leasing” when the term “leasing” is used.
3 SADC : South African Development projects: an annex of this study is dedicated to this issue.
1.3. GENERAL INFORMATION.

- **Population.**
  In 2007, Mozambique has around 20,530,740 inhabitants\(^4\), which turns in a population density of 25.6 Hab./Km\(^2\).
  The Growth rate of the Population is around 2.4 %. Women represent 52 % of the population and the men 48 %.
  The population in Mozambique consists: Native 99,6 % (Makua-Lomwe, Shona-Karanga, Tsonga, Lomwe, Seine, Makonde, etc.), Europeans 0.2 %, Euro-Africans 0.2 %, Indians 0.08 %.\(^5\)

- **Geographical situation.**
  Mozambique is situated on the oriental coast of Austral Africa, limited on the north by Zambia, Malawi and Tanzania, on the east the Channel of Mozambique and the Indian Ocean, on the south is South Africa and to the west is Swaziland and Zimbabwe.
  The capital of Mozambique is Maputo (Lourenço Marques during the Portuguese colonization).
  The northern half (on the north of the river Zambezi) is a great upland, and the south half is characterized by a wide coastal plain of alluvium, covered by savannas and cut by the valleys of several rivers, among which the most important thing is the river Limpopo.

- **Historical context.**
  In the XVI century the Portuguese established in this region, which was always considered strategic in the route via the sea for India. Their presence was confined to the coast, in special to two strategic points: Sofala and the Island of Mozambique, creating fortresses and factories.
  In 1884-1885, the conference of Berlin imposes to the colonizing powers the obligation of effective occupation of the territories. But Portugal had not sufficient population to occupy Mozambique, then it asked for help from foreigners, beginning so a long history of external dependence, namely from South Africa, which was recruiting in the south of

\(^{4}\) [www.ine.gov.mz](http://www.ine.gov.mz)  
Mozambique labor force for its mines, whereas the north was leased to foreign companies, mainly English. The infrastructures developed in Mozambique, namely ports and roads of communication, were built in the perspective of serving the English colonies in the interior of the continent.

From the 20th century, more specifically in the years 1930s, the new Portuguese state tries to create a more solid productive base, developing the cultivation of cotton and tobacco and introducing new agricultural products like the cashew fruit and the coconut. With this economical endeavor, the development of the cities, the transports and the tourism soar, which led to a great economical growth that attracted a new wave of Portuguese settlers during the 50 years and 60.

A while after the revolution of April 25, 1974 in Portugal, the negotiations begin with sight to the independence of Mozambique, which will be formally proclaimed on June 25th of 1975 after a liberation war that lasted around 10 years. The Independence, of July 25, 1975 was not the beginning of an Era of prosperity, but of an open conflict that degenerated quickly into a catastrophe:

a long civil war that caused a million deaths and four millions refugees, destroying all the structures of the country. Instead of progress, Mozambique became one of the poorest countries of the world, living merely on helps from the international community.

- **Demographic Indicators.**
  
  **Age structure:**
  
  - 0-14 years: 44.7% (male 4,692,126/female 4,647,960)
  - 15-64 years: 52.5% (male 5,345,618/female 5,633,511)
  - 65 years and over: 2.8% (male 244,886/female 341,484) (2007 est.).

  **Infant mortality rate:** Total: 107.9 deaths/1,000 born alive

  **Life expectancy:** Total population: 39.82 years men: 39.53 years women: 40.13 years (est. 2006)

  **Literacy:** definition: age 15 and over can read and write

  - total population: 47.8%
  - male: 63.5%
  - female: 32.7% (2003 est.)

- **Health.**

  After the civil war, Mozambique did great progresses concerning the reconstruction of the system of public health services. Nevertheless, the use and the access to the essential services for the poor layers is still a problem. The mortality rate are very elevated and there are considerable regional discrepancies.

  The epidemic standard is principally of infectious diseases and in the great form connected with the poverty and bad nutrition. The tuberculosis, the malaria and AIDS are diseases that has taken the life of millions Mozambicans in the past. Malaria keeps on being the biggest cause of mortality; this disease is responsible for 40 % of children’s deaths in hospitals.

  The World Health Organization (WHO) recommends a doctor for each group from five to ten thousand inhabitants, but Mozambique has around 650 doctors and 4,220 nurses to answer around 20 million inhabitants. This represents a doctor for each 30 thousand persons and a nurse for 4 thousand.

  One of the biggest challenges of Mozambique is to use his economical receipts to improve the health and childcare and mothers well-being to the middle and long term, and to reduce poverty.

- **Culture.**

  Mozambique has a very rich cultural diversity as a consequence of a long tradition of coexistence of different races, ethnic and religious groups, which together create the identities of modern Mozambique.

  Mozambique always affirmed its cultural strengths with outstanding interventions, at international level, in the field of the architecture, painting, music, literature and poetry.

  Important also and representative of the artistic and creative spirit of the Mozambican people is the craftwork that is shown in several areas, like outstanding sculptures of the Macondes of the North of Mozambique

- **Language.**

  With the objective to create a national identity, the Portuguese was adopted like official language after the independence. Nonetheless, there is in Mozambique a great linguistic diversity, specially in rural zones. The most spoken language in Mozambique is the Emakhuwa (26.3 %). In the second place is the Portuguese (25%) widely spoken in the large provincial Capital (Maputo) and less in rural areas (in fact Portuguese is the home language only for near 5% of the population). In third place is the Xichangana (11.4 %) and in fourth place the Elomwe (7.9 %).

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8 INE
Religion.
Mozambique is a secular state and, in this way, the freedom of religion is guaranteed by the Constitution and respected by the government. The catholic religion comes first (23.8 %), followed by the Muslims (17.8 %) and, almost at the same level, the religion sião/zione (17.5 %). The majority of the population, (approximately 60 %) belongs to African religions.

Politics.
The fight for National independence was directed by the FRELIMO (Front for the liberation of Mozambique established in 1962). The first president of the FRELIMO, Eduardo Mondlane, was murdered on February 3rd, 1969. Samora Moisés Machel succeed him and proclaim The independence of the Country on June 25, 1975. Politically, Mozambique adopted a socialist system with only party (FRELIMO), with a Leninist-Marxist ideology. From the beginning of the 80’s, the Country was a stage for an armed conflict directed by the RENAMO (National Resistance of Mozambique) supported by the South African regime of the Apartheid. With the aggravation of the socio-economical and the failure of the socialist experience the government had to appeal again to the international community. FRELIMO renounces to the Marxist ideology to embrace the market economy. In 1986 Samora Machel died in a airplane accident and Joaquim Chissano occupies his place. With the fall of the Soviet regime at the end of the decade of 1980 and with the political transformations in the nearby South Africa, RENAMO, (the only remaining political that had maintained the ideology), finally renounces as well. On October 4th, 1992, after two years of attempts, an peace agreement between the two main political parties - the FRELIMO and the RENAMO - wax signed, in Rome. Mozambique considered at world level as an example in the resolution and management of conflicts after the General Agreement of Peace in 1992.
In 1990, a new constitution was approved that turned the state into a plural democracy. The Frelimo remained in the power up to today, gaining three times the plural elections carried out in 1994, 1999 and 2004. The Renamo is the principal opposition party. The political system of Mozambique is characterized by plural democracy. The president of the republic and the deputies of the National Assembly are elected every five years by universal suffrage. The division in three powers – executive, legislative and judicial – is declared in the constitution of 1990.

External relations.
Mozambique is a member of the Organization of the Unity African (OAU), of the Organization of the United Nations (UNO), of the Movement of the Non-aligned Countries, of the Commonwealth, of the Community of the Countries of Portuguese Language (CPLP). In Southern Africa, he was one of seven States of the “FRONT LINE” (with Tanzania, Zambia, Zimbabwe, Botswana, Namibia and Angola) and founding member of the Community of Development of Southern Africa (SADC). It is also a member of the ACP, International Monetary Fund (IMF) and World Bank, African Development Bank (ADB), International Chamber Commerce (ICC), etc... It is also a signatory of the Convention of Ottawa on the eradication of the mines. On June 13 of 2000, it signed the Agreement Cotonou, which came into force to on April 1st of 2003, and substitute the Conventions of Lomé which during decades framed the cooperation relations between the EU and the countries of Africa, the Caribbean and Pacific (ACP). With a period of validity of 20 years, this agreement establishes a new legal regulating framework of cooperation between the parties, the treaty is aimed at the reduction of poverty while contributing to a sustainable development and to the gradual integration of ACP countries into the world economy.
See Annex B:Mozambique and SADC relations.
See also Annex B: Mozambique and Portugal relations.
2. REGULATORY FRAMEWORK.

2.1. LEGAL FRAMEWORK.

2.1.1. The banking legislation.

INTRODUCTION.

The following paragraphs are focused on the aspects of the Banking Act related with the financial leasing sector. The Banking Act and its regulations are contained in the following documents:


◆ History.

It is important to mention briefly the Law 15/99 mainly for the following reasons:

- 1) The article 2 established the “Institutions of Credit” status.
- 2) The article 3 (Categories of Credit Institutions), indicated: “Are considered Institutions of Credit: .... paragraph b : The financial leasing institution”.
- 3) The Article 4, N°1: “Banks can practice the following activities: a) reception of deposits from the public etc. ..... ; b) operations of credit..... EXCEPT LEASING.....”.

This rule prohibited Banks from entering into financial leasing operations. The regulation of the Law confirmed the regime of “Exclusive rights10” of this activity in favor of specialized and authorized Lessors. This scheme was altered by the Law 9/2004 which had and has great consequences on the leasing industry in Mozambique.

◆ Current picture of the financial activity.

The Bank Law 9/2004 of 21 of July 2004 (Article 1, Object of the Law) regulates the establishment and the exercise of the activity of credit institutions and financial companies.

The new Banking law establishes, as in the past, the category and status of “Credit Institutions”, but it re-defines them in the following way:

"Art. 2, number 1, paragraph a: “Companies ...., which activity consists, specifically in receiving deposits or funds from the public .... if the specific status of the company allows it, in order to use those funds to offer loans at their own risk...”.

◆ Definitions (financial leasing; leasing companies; missions).

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10 Market monopoly.
With respect to the Lessors, the same article 2, number 2, paragraph 1, redefines the status of leasing companies, their activities and economical purpose as follows:

“Credit Institutions whose principal objective is the exercise of financial leasing activities. Financial leasing is understood as a contract by which one party (Lessor) allows, against instalments' payments, to another party (Lessee) the temporary use of a thing, movable or immovable, acquired or built according to the lessee’s indications, which could or could not be used in a productive investment or a service with a clear economic or social interest, and which the Lessee could buy after an agreed period and for a determined or determinable price through the simple application of the criteria fixed in the contract”.

This very ample definition has very important consequences which are developed further down in the comment of the Article 37 of the Decree 56/2004 regulating the leasing activity.

**LAW 9/2004 OF JULY 21ST, 2004 (ANNEX 1b): issues related with leasing.**

- **Categories of “Credit Institutions“**.
  The article 3 mentions, as indicated above: “Are considered Institutions of Credit:.... Paragraph b: the Leasing companies”.

- **Constitution of the Leasing sector**.
  The article 4, Number 1, paragraph b no longer mentions the “market exclusiveness” in favor of the Leasing companies. Furthermore the same article, number 2 states: “Banks can still be authorized to practice the activity of leasing....”.

- **Funding**.
  Article 8, Number 1, of the Law states an important fact for the “funding” of the Leasing Companies: “Under the current Law, the funds obtained through issuance of bonds as defined in the Code of Commerce are not considered as reimbursable funds received from the public”.

- **Licensing of a Leasing Company**.
  The process of authorization (licensing) of a leasing company is the same as for all Credit Institutions as described in article 13 and the following articles.

  The licensing application contains mainly the presentation of the following:
  - The capital and the founding shareholders,
  - The Company Charter,
  - The business plan (3 years),
  - A list of the members of the administration; organization chart; controls and auditing...
  - The suitability and professional experience of Board members and Managing Directors, etc....

  After the authorization, the shareholders have a very short period of time to implement the company (3 months) and to begin activity (12 months).

  The licensing application is presented by the founders to the Central Bank (Bank of Mozambique) for study and routine verifications of suitability and further authorization. The Bank of Mozambique has a short period of time to decide (article 15: 90 days). The permission is given by the Finance Minister
according to the recommendations of the Bank of Mozambique.

- **Miscellaneous arrangements.**

The other articles of the Law regulate the following general issues:

Statutory alterations; fusion, cession and dissolution; activities abroad of credit institutions and financial companies incorporated in Mozambique; general requirements, minimum capital and activities in Mozambique of credit institutions and financial companies incorporated abroad; obligation to register (article 40); rules of conduct; technical competence; relations with the clients; interest rates and commissions; information obligations; defense of the freedom of competition; code of conduct; professional secret; information on credit risks and centralization (Article 50; see also CRC article 76); supervision and controls of the Bank of Mozambique (articles 55, 72 ...); guarantee of the deposits (article 59); prudent and careful management; prudential standards (own capital, reserves; ratios and prudential limits; qualified participations; public auditors; streamlining; providences; liquidation; breaches and sanctions, etc....


Decree 56/2004, in Chapter II, presents the specific regulations for each type of institution beginning with the Banks.

Section I, article 31, number 1, establishes the concept of universal Bank: the Banks are now authorized to carry out ... the plurality of the financial activities with exception of the insurance activity which remains separate for the moment.

The paragraphs of this Decree which relate to Leasing are presented and evaluated in the Leasing chapter below.
2.1.2. The leasing legislation.

Introduction.

This legislation is very similar (principally in the characteristics of the operation) to the Portuguese legislation. Portugal has tight links with Mozambique historically and is a country where the leasing activity is dynamic and regulated in a modern way.

It is important to point out that this Decree will not be read only by experienced professionals (up to now a great number of them are still not familiar with leasing) but, also, by persons with little knowledge in legal matters in general, in leasing contracts and in leasing legislation and leasing fiscal rules.

The Decree serves also as a base for the writing of leasing contracts. Hence it has to be perfectly clear and unambiguous in order to avoid any doubts on the part of the Magistrates and all stakeholders.

Therefore, it is essential to reach a crystal clear Decree and the following comments are presented with this purpose.

Objectives.
The objective of the present chapter is to analyze the viability of leasing in terms of the legal, regulatory, fiscal and judicial framework in Mozambique.

The present study only refers to financial leasing operations more specifically “full-pay out assets leasing” as a tool to finance investments with the purpose of developing the economy of the country. This was the principle elected initially by the authorities of Mozambique as a base for the Mozambican legislation related to financial leasing.

At present, in Mozambique most of the necessary legal modern arrangements are in place to allow a reasonable development of the Leasing industry.

In general, the legal, regulatory, fiscal and judicial framework is adapted to the activity of financial leasing, with the exception of some issues that will be presented later on, namely:

- The VAT issue.
- The modification of certain legal arrangements in order to avoid the risk of conflicts or lawsuits between Lessors and Lessees (see for instance: Art.37 of Decree 56/2004 below).
- The clarification of some terms and the improvement of a few legal arrangements with the intention of avoiding the risk of incomprehension among the Lessors, the professionals in this field and the Public Administration. This is especially important for leasing which is a relatively a new business in Mozambique, where the legislation is still unknown to most people.

The leasing framework in Mozambique is very close to the Portuguese one, for two main reasons:

- The official language of Mozambique is the Portuguese language and both countries have strong historical links.
- Many Mozambican lawyers and judges studied at Portuguese universities.

The benchmarking between the Mozambican and the Portuguese legal and fiscal frameworks will be made throughout this report.

The experience and Portuguese maturity in the field of financial leasing can also contribute to the improvement of the leasing’s legal framework in Mozambique.
Impacts of the modifications.

History of the legal framework and impact of the legal context modifications.

Leasing activity was first established in 1994 with Decree 45/94.

As indicated above financial leasing is now ruled by Decree 56/2004, which revokes the former texts: Decree 45/94 (October 12, 1994) and decree N°11/2001 (March 20, 2001).

It is particularly important to comment on the arrangements revoked because of the consequences of the modifications.

Decree 45/94 of October 12, 1994, that initially regulated the leasing contract, established in Article 5 (eligible institutions) that:

- "Only Leasing companies (Lessor), officially constituted under the applicable legislation, can enter ...... into leasing contracts with a client (i.e. Lessee)".

This principle of "market exclusiveness" was revoked in 2004 and some of the impacts are:

- loss of advantages of specialization;
- limitation of competition (i.e. less opportunity for non-bank lessors);
- effects on the distribution of the product;
- fiscal disadvantages;
- effect on the competitiveness of leasing.

These subjects are developed below in the comments of the Article 34 of the Decree 56/2004.

- Funding. The revocation of decree N°11/2001 of March 20th, 2001, altered the “funding” of the leasing companies. The Article 2 (number 4) revokes the possibility for Lessor to receive deposits from the public, but does not offer any new alternative. This subject is developed below in the comments on Article 35 of Decree 56/2004. Note: As a matter of fact, the revoked situation was not very sound as it could produce an unadvisable "transformation risk".

Function attributed initially by the Government to the leasing sector in the Mozambican economy (Articles 2 and 3 of the Decree 45/94).

- Article 2 (leasing of movable assets): Leasing of movable assets refers to “equipments entitled to be used in productive investment or to services of obvious economical or social interest”.

- Article 3 (leasing of real estate): Leasing of real estate assets refers to assets “entitled to be used in the activities mentioned in the previous article”.

Results:

- These two articles of Decree 45/94 were revoked. Hence, the initial economical purpose disappeared from the legislation.

- The “retail leasing” activity was authorized (see below: Article 37 of Decree 56/2004).

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12 Market monopoly.
2.1.3. **Current legal framework: Decree 56/2004.**

The part II (section II in the Portuguese text) of Decree 56/2004 published in the Official gazette I series N° 48 (Supplement 2) of December 10, 2004, is dedicated to financial leasing.

**DECREES STRUCTURE.**

- General Arrangements (sub-section I - articles 33 up to 36).
- The leasing contract (sub-section II - articles 37 to 41).
- The legal status and "duties and rights" of the Lessor (article 42).
- The legal status and "duties and rights" of the Lessee (article 43).
- Miscellaneous arrangements (articles 44 to 47).

**ANALYSIS of the DECREE.**

**SUBSECTION I. Activities of Leasing companies.**

**Article 33 - Other Operations.**

This article allows the leasing companies to alienate, give in, re-lease to another party ... the repossessed assets in the case of default or in the case that the Lessee does not exercise the option of purchase... as well as to enter into leasing contracts.

**Introduction to the following articles 34 and 35.**

The articles 34 and 35, do not contain much favorable elements to the development of the leasing sector. **Comment:** In the current legal, fiscal and regulatory context, an investor group will probably prefer to invest in similar activities not governed by the financial laws, instead of investing in a Leasing company submitted to numerous legal and regulatory constrains and with few advantages.

**Article 34 - Market exclusiveness.**

This article constitutes the most important regulation modification as follows:

**Number 1 of the article 34.**

It states: "**Besides the banks ... only Lessors can enter ... into leasing contracts.**"

**Impacts.**

*The Lessors lost the exclusiveness*\(^{13}\) of this activity. Consequences:

- **Loss of the advantages of specialization.** The principle of “market exclusiveness” was the form to recognize the fact that leasing is a very specific activity and is, in great part, different from the banking activity.
- **Loss of energy and competition.** In many countries “non-bank Lessors” were or still are an energizing element of the leasing sector because they stimulate the competition, are efficient in terms of distribution and marketing of the product, they favor sound investments in productive equipments and are competitive in terms of services and interest rates. One of the reasons is that the non-bank Lessors have no other alternative, unlike banks, to be viable and profitable than to be efficient in their field. Hence, the elimination of the principle of “market exclusiveness” reduced the competition in this sector.

\(^{13}\) Monopoly.
As a matter of fact, some vendors consider today that the leasing departments of the main Mozambican banks are undergoing a period of slackening.

- **Distribution Channels.** It is opportune to remember that the Lessors are not necessarily supported by a network of bank branches. On the contrary, historically**, the leasing business was essentially connected with manufacturers and suppliers of goods and equipments. These manufacturers were the modern inventors of the profession. This relationship with the vendors needs to be maintained, in one form or another, to contribute to the dynamism of the leasing sector.

  ** The "financial leasing" offered by the banks was developed historically later on and has limitations. For instance, banks sell leasing in their branches, in a sedentary way; banks’ branches are more motivated by the "retail leasing" operations.

- **Disadvantage in comparison with competing products. Fiscal disadvantage.** The elimination of the principle of "market exclusiveness"¹⁴, worsened the VAT issue, which reduces the competitiveness of leasing in comparison with other competing products sold by the same banks (medium term loans). It is not clear at present, the way in which a banker advises his clients in order to allow them to choose between the different available solutions and their respective advantages and disadvantages. Often the fiscal aspect is not entirely understood, and, sometimes, both parties are completely obvious to it. In practice, it is the bank that decides almost alone, whether the operation will be a medium term loan or a leasing contract and this sometimes lead to very peculiar situations.

**Article 35 - Funding.**

At present, the Leasing companies can, in practice, operate mainly as follows: 

a) with their own funds; b) with credit lines obtained from institutional sources; c) in the future (according to the Stock Exchange market development) issuing bonds (see more, in the paragraph on the Commercial Code further down); d) Note: For a non-bank Lessor, the access to the Interbank Money Market (IMM) requires a special authorization of the Central Bank (ANNEX 4g).

These arrangements do not constitute a stimulating opportunity for the leasing industry. In fact, it is a clear disadvantage for any "non-bank Lessor". The revocation of Decree 11/2001 was not accompanied by any new alternative and it had a negative impact on the existing "non-bank Lessor".

**Recommendation:** in order to stimulate the leasing sector and the country development, a regulation permitting the Lessors to issue notes or certificates of deposit of a duration superior to 18 months or 24 months for instance, would be an alternative to compensate for the revocation of Decree N°11/2001. Of course those deposits should be used exclusively to buy and lease productive equipments.

**Article 36 - Partnerships (pools).**

It is an obvious method that did not need regulation. In practice, it might show up for great operations that are, at this moment, unlikely for the delicate VAT situation (see explanation further down).

**SUBSECTION II. Leasing Contract.**

**Article 37 - Legal definition of Leasing, and similar operations.**

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¹⁴ Market monopoly.
Number 1 of article 37. According to the paragraph 2 of number 2 of article 2 of the Law of Credit Institutions, it is understood by leasing contract: “a contract by which one party (the Lessor), against installment payments, allows to another party (the Lessee) the temporary use of a thing, movable or unmovable, acquired or built by indication of the Lessee, which will be, or not, used in productive investment or in services with an obvious economical or social interest, and that the Lessee will be able to buy, passed the contractual period, at a determined or determinable price by means of the simple application of the criteria stated in the contract”.

Comments and recommendations.

- **Notion of Leasing.** The Legislator opted not to make reference to the supplier (vendor, manufacturer ...) of the equipments (movable asset) or contractor of the asset (real estate asset), in the definition of the Leasing operation.

  *Recommendation*: The words “by indication of the Lessee” above are insufficient. It is vital to specify that it is the Lessee who independently specifies the asset to be financed and who selects the supplier or contractor. The Lessee independently negotiates the price and all the other purchasing conditions. This reference could also be mentioned in the article 43 referring to the duties of the Lessee.

- The existing definition is pretty wide and has very important consequences in many fields such as: 1) The customers targeted by the Lessors (for example: private or corporate), 2) The types of operations targeted (small ticket or big ticket), 3) The choice of the assets that a Lessor would prefer to finance (for instance: cars or industrial equipments).

Whereas, at present, "retail leasing ", even for luxury goods, is very appealing for Leasing companies, the percentage of the leasing operations in "investment in productive equipments" and "of obvious economical and social interest" is far from representing the majority of the new contracts as it would be desirable in a country involved in a major process of reconstruction and economical and social development.

- **Recommendation.** As will be seen further down, the regulations should: a) create more motivations or incentives to favor the Leasing of investments in productive assets as a tool to boost the development of the economy with the intention of promoting the creation of jobs, b) to establish caps to the "retail leasing" (for instance a limited amount in terms of portfolio or a limited percentage of the portfolio) without forbidding it, because this activity is probably necessary to reach a reasonable level of profitability.

**Article 38 - Forms and publicity.**

This article clearly establishes the rules for drafting and publishing the leasing contract so to avoid a situation of judicial weakness in case of a lawsuit. As a consequence, this detailed article emphasizes the following cases: a) Leasing of real state assets and b) Leasing of movable assets subject to registration.

**Article 39 – Rentals, residual value and regulatory power of the BM.**

Number 1 of the article 39. **Two comments:**

a) The terms "the recuperation of more than half of the capital..." may cause confusions in case of default. Moreover, the setting of the contractual conditions should be freely negotiated between the Lessor and the Lessee, and should be only limited by usual commercial norms, - as it is obvious for any other business -.

b) The expression the “residual value of the asset” can lead to misunderstandings and/or
problems of interpretation in case of default. See also the comment on number 4 of article 41 and the concrete example of the transportation sector.

**Number 3 of the article 39. Comments and recommendation:**

This paragraph is a source of serious conflicts in Court. Thus it is essential to modify or remove it because it states that “the malfunctioning of the asset (or its inferior performance to what was expected) will induce a modification (reduction) of the rentals”.

This is no reason to reduce the amount of the rentals. The responsibility of this kind of problem can be either on the Lessee side (perhaps the Lessee does not use the asset properly or does not carry out proper maintenance) or on the side of the supplier, manufacturer or seller of the asset, but never the responsibility of the Lessor.

It is very important to remember that it is the Lessee who has independently selected the supplier or manufacturer and the leased asset (see suggestion about article 1) and negotiated the price and all the other conditions (see recommendation to the article 37, number 1). The Lessor only buys the asset and rents it to the Lessee. Moreover, the Lessor pays the totality of the asset to the supplier, only by written instruction and authorization of the Lessee (contained in “the reception voucher of the asset”). Even more, this text contradicts the number 1 of article 45 which states: “the Lessor is not responsible for the defects of the asset or for its inadequacy…”.

This kind of provision (number 3, article 39) caused major stalemates in other countries. Therefore, this text has to be revoked as it has been revoked in Portugal and elsewhere.

**Number 4 of the article 39.**

The establishment of norms (interest rate) by the BM to calculate the rentals and other aspects of the contract are against contractual freedom. The regulation should come from market free competition and not from state imposed regulations.

*Recommendation.* The establishment of very precise and restrictive rules does not favor the development of the leasing sector in Mozambique.

**Article 40 - Term (duration) of the Leasing contract.**

The rules are the following ones: a) Term (duration) of the contract for the movable assets: 18 months minimum. b) Term (duration) of the contract for real estate assets: 7 years minimum. c) Duration of a contract for movable assets: it should correspond with the period of business utilization (economic life). d) Maximum term (duration) for any contract: 30 years. e) Contract without limit (?): the limits are those indicated in the number 1 of this article.

*Comment.* The establishment of this kind of detailed norms creates problems. For instance, the application of the number 2 of this article (which states that the duration of a contract for a movable asset should correspond with the “economic life”) is unrealistic to finance the transportation sector because it could mean that a truck has to be financed over 10 years (for instance) or more? Which Lessor would accept such a risk? What about the used vehicles whose age is uncertain? What is the solution for the Lessor: not to finance the transportation sector which is so important for the development of the country?

*Recommendation.* At least the number 2 and the number 4 of this article could be removed.

**Article 41 - Validity of the contract and destiny of the asset at the end of the duration of the contract duration.**

**Number 4 of article 41.** The definition of the leasing operation was enough clear on this aspect and this
Number 4 was unnecessary and needs clarification.

*Comment* of the expression “the residual value (RV) of the asset”: In common language it can be zero if the asset is destroyed. What would be the interpretation if an asset worth 500 000 $ and leased with a residual value of 5% is destroyed? Is the residual value 0 $ or 25 000 $? (see also the comment of the number 1 of article 39).

*Recommendation.* It would be necessary to modify the text. For example: “the residual contractual value” or “the residual value of the contract” instead of “the residual value of the asset”.

*Note:* surprisingly a bank and a lessor realized leasing contracts with zero RV?

**Article 42 - Legal status of the Lessor.**

*General comment and recommendation.* The number 1 of this article refers to the duties of the Lessors. It would be useful to complement the initial sentence in some way, as for example: "1. The obligations of the Lessor are the following, whenever the Lessee did fulfill all his contractual obligations, etc......"

**Paragraph a number 1 of article 42. Comments and recommendation:**

This part of the article 42 seems to be a conceptual mistake on the leasing profession and could cause serious conflicts in Court. The words “or to build” (“ou construir” in Portuguese) must be removed because the Lessor is not an equipment manufacturer or a real estate contractor. This is not the Lessor's obligation. On the contrary, it is the Lessee's obligation to handle this issue (especially in the case of real estate leasing). The only function of the Lessor is to "buy and pay the asset" and not to "build the asset".

**Paragraph c, number 1, article 42.**

Recommendation: “the residual value of the contract” instead of “the residual value of the asset” (see number 4, article 41).

**Article 43 - Legal status of the Lessee.**

**Paragraph d of number 1 of article 43.**

*Comment.* The expression "with authorization of the Lessor" is vague and it introduces a legal risk for the Lessor in case of lawsuit in Court.

*Recommendation.* After “authorization” is necessary to add “previous and written by a registered letter with notice of reception”, otherwise the Lessee will be able to say that it had obtained the verbal authorization of the Lessor.

**Paragraph f of number 1 of article 43.**

*Recommendation.* It would be useful to add: "and the Lessee will directly support the respective costs or expenses "or "being the respective costs on behalf of the Lessee" or something equivalent.

**Paragraphs g and h, of the number 1 of article 43.**

*Comments:* Some legal risks are possible. At the end of this paragraph g, the expression "except if the Law allows it" presents an unsolvable problem. In such a case, a leasing operation would be unfeasible.

The paragraph h brings another legal risk because it could be understood that the Lessee is allowed to give up the use of the asset and inform “afterwards” the Lessor. Such a situation would be abnormal.
Recommendation. After “the Lessor to authorize” it is necessary to add “previously and in written by a registered letter with notice of reception”, otherwise the Lessee will be able to say that it had obtained the verbal authorization of the Lessor.

Paragraph i of number 1 of article 43.

Recommendation. It would be convenient to remove the expression "since the fact is ignored by the Lessor". In practice, the negligent Lessee always says: “The Lessor knew!”.

Paragraph j of number 1 of article 43. Insurances.

Recommendation. It would be useful to add: “The insurance has to be taken with a first class insurance company acceptable for the Lessor”. Otherwise the leasing activity becomes less viable.

Paragraph k of number 1 of article 43.

Recommendation. After the words “end of the contract”, it would be useful to add: “subject to the condition that the Lessee has fulfilled all his obligations, particularly the payment of all the rentals, taxes, and other contractual expenses such as the interests for late payment - if any - etc...” or “after having fulfilled all his contractual obligations”, or something equivalent.

Paragraph c of number 2 of article 43.

Comment: This part of the article 43 is quite unusual. It states mainly an obvious general concept. Or, perhaps, it anticipates any Lessor's wrongful conducts? That is quite improbable. On the contrary, and unfortunately, wrongdoers lessees are numerous and do not need this kind of legal text to default with bad faith.

Recommendation. It is strongly advisable to add, before the expression “even against the Lessor”: “after having fulfilled all his contractual obligations” (see other expressions above: paragraph k of number 1 of article 43).

Paragraph d of number 2 of article 43.

Recommendation. It would be useful to add: "notified previously by a registered letter with notice of reception”.

Paragraph f of number 2 of article 43.

Recommendation. It is necessary to establish condition to the purchasing option right and to add:

a) the word “contractual” after “residual value” (in the Portuguese version; in English it would be: contractual residual value).

b) “and after payment of all the rentals and other amounts stipulated in the leasing contract”.

Article 44 - Transmission of the legal positions.

General comment: In this article, the expression “equipment assets” appears for the first time; in this case, it is supposed to mean “movable assets”. In the number 2 it is supposed to mean “real estate assets”. It could be clarified.

Number 2 of article 44.

Recommendation. It would be better to add, at the end of the sentence, the word “financial" (in Portuguese: "locação financeira") after the word "lease". Otherwise “financial leasing” could be confused in Court with "common rental" or "common sale by installments" agreed directly with the buyer by a manufacturer or supplier.
Article 45 - *Others, expenses, risks and relations between the Lessee and seller or contractor.*

**Number 2 of article 45.**

*Recommendation.* It is necessary to add the terms “in the leasing contract” after the expression “except stipulation of the opposite” at the beginning of number 2 of article 45.

**Number 3 of article 45.**

*Recommendation.* At the end of the sentence, it is necessary to add the terms “in the leasing contract” after the expression “Except stipulation of the contrary”.

Article 46 – *Delay on the payment of rents and termination of the contract.*

**Number 1 of article 46.**

*Comment.* The text seems contrary to the contractual freedom. The Legislator should not set a term (60 days) because in some cases (for example: ceasing of payments or bankruptcy, a Lessee with several contracts in different levels of non fulfillment, could escaped abroad with a vehicle of the Lessor..). When necessary, the contractual resolution must be immediate.

**Number 2 of article 46.**

*Recommendation.* After the expression “proceeding to the payment”, it is necessary to add the words “in cash”. (It cannot be a check of the Lessee (possibly without funds) handled to the Lessor to win time as it frequently happens in practice).

- **Number 4 of article 46.**

*Comment.* The text is constraining and restrictive. It is seems contrary to the contractual freedom because there are many situations that justify the ceasing of a leasing contract or of a classic bank loan. For example: ceasing of the payments, news about difficulties to pay other debts, important delay in other contracts with the same Lessor, etc.
2.1.4. **Bad debts Collection; assets’ repossesion.**

**INTRODUCTION.**

In Mozambique, there are no other means, besides the common procedures to recover either bad debts or unpaid leased contracts. The required periods of time are the usual ones for everybody and they are too long. The leasing law highlights the right of the Lessee to oppose the Lessor according to art. 43, number 2, paragraph c of decree 56/2004 of December 10, 2004: "c) Use of possession actions, even against the Lessor", which is a rather unusual article in this kind of legislation.

**CONSEQUENCES.**

Hence the consequences are: 1) A higher credit risk. 2) A more severe credit policy. 3) Stronger guarantees requirements. 4) High interest rates.

**PROCEDURES.**

In a general way, the procedure for the Lessors to recover bad credits and leased assets are the following:

1) **First step of the credit recovery actions. Sending of a letter to the Lessee:**
   a) On the first delayed rental: a notice letter is sent to ask for payment.
   b) On the second delayed rental (the delays differ according to the Lessors; for example 60 days of delay): a more emphatic letter is sent.
   c) On the third delayed rental: a phone call is made to the Lessee to try to get back the asset (this includes the signing of a restitution letter freeing the Lessor from any accusation of wrongdoing).
   d) At the same time, the contract is relayed to the legal department.

2) **Ending of the contract**

   It is the legal department that proceeds to end the contract.
   It sends a registered letter with a reception notification to the Lessee to indicate that the contract has ended.
   In the culmination letter it is required to the lessee to pay: -a) all the delayed rentals, -b) the interests on the delayed rentals, -c) the outstanding capital, -d) Interests on “a” and “c” counted on a daily basis, -e) the restitution of the asset, (art 42 number 2, paragraph e of Decree 56/2004 of the official Gazette series I, number 48 of December 10, 2004) in the case it has not been returned voluntarily to the Lessor before proceeding to end the contract.

3) **In the case the asset has been returned to the Lessor:**

   The legal department normally waits until the asset has been sold before sending the case to the Court to collect the remaining amount of the credit.

4) **Once the asset has been sold there are two scenarios.**
   
   **First scenario:** If the outcome of the sell is superior than the debt, thus the exceeding amount goes to the Lessee.
   
   **Second scenario:** If the outcome of the sell is inferior than the debt, two possibilities exist:

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15 This is not the general case. On the contrary, each Lessor choose a different number of days.
1. **First possibility:** The Lessee has to sign a liability document – recognizing the remaining debt - and make an agreement for payment. In this way the case does not go to the Court.

2. **Second possibility:** If there is no recognition of the remaining debt by the Lessee and no payment agreement, the case goes immediately to the Court. Furthermore, the Lessor will probably execute the additional guarantees of the leasing contract.

5) **Sending of the case to a Court:** In the lawsuit filled in the Court, the Lessor requires:

   A) That the Lessee pays all the expenses made for the ceasing of the contract. The whole process is normally very lengthy and may take from 6 to 7 years.\(^{16,17}\)

   B) An “Order issued by a Judge outside of Court proceedings”\(^{18}\) in the case the asset has not been returned.

   Note: For that purpose, the Lessor has to present all the documents and the testimony of a Credit collection officer.

   C) After the “Judge Order” has been obtained, if the asset is a car, it is necessary to warn police authorities at a national level so they can repossess it in the case it has been detected.

   D) The execution of the additional guaranties of the leasing contract is managed differently depending on the situations and has to be dealt on a case by case basis.

6) **“Order issued by a Judge outside of Court proceedings”**

   6.1) It takes between 30 to 60 days for a Judge to give that kind of Order.

   6.2) Execution of the “Judge Order”\(^{19}\): The execution date depends on the availability of the judicial officer. In the case that the region of the country where the Lessee resides is not the same as the one of the Court where the Lawsuit has been filled in, this Court has to send an explanatory letter to the Court in the region where resides the Lessee, so it could set a date for the implementation and execution of the “Judge Order” mentioned above.

   In the execution of the “Judge Order” should be present: A) A judicial officer; B) The police; C) A “loyal holder” (a staff member of the company that is held responsible for custody of the asset until a judgment has been reached by the Court and the asset has been given a destination according to the judgment). D) The necessary means (organized under the “loyal holder” responsibility) to remove the asset and stock it securely in the case of a movable asset. E) The Lessee could be present – at the time of the removal – but does not necessarily needs to be informed about when the execution of the "Judge Order" is going to be made. F) After the “Judge Order” has been executed, the designated official will create a proving report with all the supporting information about the place, the time, the result - if the asset was or was not repossessed – the state of the asset -, the identification of the participants (needing their signatures in the report).

   Note: In the case the asset has not been repossessed, the legal department will fill in a new lawsuit in Court by stating a robbery's allegation. The Lessor notifies the insurance company and will only pay the insurance up to the date of the robbery notification.

7) **Selling of repossessed assets.**

   Lessors usually sell the asset after repossession according to the official procedures set for the sell of assets and goods: A) A newspaper add stating : 1) the description of the asset for sell (auctioning); 2)
the base price of the asset; 3) the buying propositions should be sent to the Lessor through a sealed letter. B) The asset is then sold to the best bidder. 

Note: In some cases, the propositions received are not interesting enough. In this case the Lessor will make a second add to try to obtain a higher price.

8) **Insurance of the leased assets.**

The insurance is usually paid each trimester or each year.

Leasing companies, being the beneficiaries for the insured assets have agreements with the insurance companies so they will be timely informed about the lack of payment of the asset’s insurance.

Some Lessors use to pay the insurance when the Lessee fails to do it, and continue to do so up to the moment in which the asset is repossessed or up to the moment in which a robbery lawsuit is filled in.

9) **Lessee substitution/contractual transfer after contract ceasing.**

Leasing companies are open to this kind of solution at any moment.

In case of acceptation, a new agreement is entered and remains tightly linked to the initial contract.

For the substitution of Lessee to take place, it is usual to ask for: a) The payment of the delayed rentals; b) The same kind of additional guaranties; c) A debt confession made by the first lessee.

Note: This new agreement does absolutely not free the first Lessee from his liabilities if the new Lessee does not comply with his contractual obligations.

**CONCLUSION.**

The collection of bad debt and the assets' repossession are quite difficult in Mozambique. This is the "Aquiles' heel" of the financial activity for two main reasons: a) The judicial system needs more resources in order settle the numerous lawsuits that are still after many years without solution; b) the secondary market is quite limited (see below).

This is even more important in the case of the financial leasing contract which is widely unknown.

**Recommendations:**

1) Improve the legislation (see above).

2) Launch a leasing “awareness program” for those in the judicial system.

**SECONDARY MARKET.**

As is the Mozambican market, the secondary market is very limited. The limited size of the secondary market contributes to the problems with the collection of bad debts.

With respect to the main scope of this study (investments in productive equipments) and, as indicated above, the access to the secondary market is as follows: 1) mainly newspapers adds made by the Lessor; 2) Lessee's substitution (see above) generally organized by the Lessee himself; 3) very few cases of "repurchase agreements" with the few equipments suppliers with their own offices in Maputo or Matola.

The secondary market will also depend on the growth of the industrial sector.
2.1.5. **Prudential rules and supervision norms.** (ANNEX 4b)

The accounting norms of credit institutions are included in the notification of the BM no° 4/GBM/2007 published in the Official Gazette N°18 series I, of May 2, 2007 and the note 1 and 2/SHC/2007 of June 12, 2007.\(^{20}\)

The prudential rules are contained in the official gazette N°18 series I, of May 2, 2007. The main points related to leasing are the followings:

- **Ratios and prudential limits**: Note 6/GBM/2007, essentially related to:
  - **Big risks** (< 10% of Own Funds) (Article 3, no° 4).
  - **Shareholding control** (article 3, no° 5 en following);
  - **Capital adequacy ratio** (> 8%) (articles 4 and 5). The regulation for averaging the Assets is annexed in the mentioned Note. The Capital adequacy ratio (own funds vs. averaged asset in function of the credit risk) which allows to control the level of stable resources face to the eventual losses as result of risks, was 12.5% at the end of 2006 (13.4% the previous year).
  - **Risk concentration**: maximum credit for one client : 25% of the own funds (article 6 and the followings).
- **Participation limit** in other companies' equity: article 14 & 15. Synthetically:
  - a) Each participation has to be < 15% of the own funds.
  - b) The total of the participations has to remain < 60% of the own funds.
  - c) Maximum of rights of vote in a participated company: < 25%.
  - d) Participation of a credit institution in another credit institution subject to the supervision and approval of the BM: the limits above do not apply.
- **Provision**: Note 7/GBM/2007. This note states:
  - a) The rules and provisions for NPL;
  - b) The kind of risks;
  - c) The general provision on the portfolio (2% of the total portfolio excluding the NPL and the doubtful loans);
  - d) Credits in foreign currency.
- **Supervision on consolidated basis**: Note 8/GBM/2007.

The prudential rules are applicable to the Lessors. Furthermore, they are applied automatically to the leasing portfolio when this activity is integrated as a department within a Bank.

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\(^{20}\) See the BM website for the Portuguese translation of IFRS and [www.iiasb.org](http://www.iiasb.org)
2.1.6. **Other legal aspects.**

Some other legal aspects are not very relevant for the purpose of the present study.

**Unidroit** (Ottawa 1988)(ANNEX 10).

The current Mozambican legislation contains a set of rather modern arrangements. Compared with Unidroit, the purchase option is perhaps stronger in Unidroit arrangements. Unidroit gives more importance to the fact that the purchase option has to be totally optional and unpredictable. Also, the RV cannot be zero as it happens in some cases in Mozambique (see article 41 of Decree 56/2004).

**Civil code.**

According to the Mozambican lawyers, the Mozambican Civil Code doe not contain any constraints for the leasing business.

However an aspect remains always important. In case of lawsuit it is necessary to avoid, in the Court, any misunderstanding or confusion between “financial leasing” and "common rental" or "common sale by installments" agreed directly with the buyer by a manufacturer or supplier, which legislations contains strong protections for the Lessee and major constraints and difficulties for the owner of the asset (Lessor).(see comments of article 44 (number 2) of Decree 56/2004).

**Commercial code.** (Law 10/2005 / December 23, 2005).

With respect with the leasing activity, this Code contains the general norms for issuing bonds. Those rules are the same for any kink of company: “credit institutions” or ordinary companies. Of course, in the case of a “credit institution” the Central Bank has to be informed step by step. See “Código Comercial, Livro II, Titulo II, Chapter VI, Secção III”: Bonds. Article 386 to 409.

**Other.**

As mentioned earlier, the legal and fiscal benchmarking has been realized with respect to the closest legislation which is the Portuguese one. The results and comments are presented all over the study of the Banking Law and regulatory Decree when it was pertinent.

2.1.7. **Property, Constitution and Leasing.**

In the present paragraph are highlighted some aspects of the Mozambican Constitution which: a) are related with the present study, particularly with the real estate leasing, b) make part of the global context of the economical activities.

The Mozambican Constitution of 1990 was approved by the Parliament on 16 of November 2004. Although a paragraph on this subject is not usual in this type of report, it seem convenient to refer to the Constitution because
it contains the philosophy and the spirit that the Mozambicans did choose to manage their country, its economy and enterprises, particularly in the financial sector.

**THE ECONOMY IS A FREE MARKET ECONOMY.**

After stating the main objective of development and improvement of the conditions of life of the people (article 96), the Legislator approves and ratifies, among other basic concepts, the concept of market (supply and demand), the personal initiative (individuals or corporate), and the concept of property (articles 97 and 82) in the next terms:

- Article 97. a) the value of work; b) the strength of the market; c) the initiative of the economical agents; d) the coexistence of the public sector with the private sector, the cooperative and social sector; e) the public property of the natural resources and production's tools, in accordance with the collective interest; f) the protection of the cooperative and social sector; g) the action of the State as regulator and promoter of the growth and economical and social development.

- Article 107 (national Business community).
  - The State promotes and supports the active participation of the national business community.
  - The State creates the incentives destined to provide the growth of the national business community in the whole country, especially in rural zones.

**THE RIGHT OF PROPERTY.**

- Article 82 establishes the right of property in the next terms:
  - The State recognizes and guarantees the right of property.
  - The expropriation can only take place for public usefulness or interest, defined in the terms of the law and gives place to just compensation.

- Article 98 (State property and public domain).
  Number 1: Natural resources on the soil, in the subsoil, in inland waters, territorial sea, and continental platform are State property.
  See also paragraph e of the article 97.

- Article 99. (Sectors of property of the production's tools).
  Number 3. The private sector is constituted by the production's tools which property or management belongs to private individuals or corporations.
  The two other sectors are the public sector and the cooperative and social sector.

**PROPERTY OF THE LAND.**

- Article 109. (Land).
  Number 1: The land is a State's property.
  Number 2. The land cannot be sold, or ....alienated, not even mortgaged or pledged.
  *Comments.* The buildings and houses (except the particular case further down) may be mortgaged.
  This is confirmed in the following Decree:

  **DECREE 60/2006.** Regulation of the urbane grounds, Chapter V, Section Rights III and duties, Article 33: Rights of the holders.
  Number 2, letter d: .... To constitute mortgage on the real estate ...... built on the land or on which it has acquired the right of property.

- Article 110. (Use and profit of the land).
  1. The State determines the conditions of use and profit of the land.
2. The right of use and profit of the land is given to individuals or companies according to the social or economical purpose of the land

Comments.
The interviewed persons mentioned frequently and spontaneously the "LAND ISSUE" (property).
-a) Most persons, with the exception of two persons, think that this situation limits the development of the agriculture.
-b) The leasing business (essentially of movable assets), in its "economical justification" considers the possession and utilization of a productive asset more "beneficial" than the property, not for doctrinal reasons but because we live in a highly competitive world with a constant innovation of the products and quickly obsolete industrial equipments.
Special case: the nationalized (in 1975) houses obey to a particular regime but the corresponding legal reference was not available up to the present date.
-c) the use of the land is materialized in practice under the form of concession:
Law n.º19/97, Chapter Right III of Use and profit of the land, Article 17, (TERM):
Number 1. The right of use and profit of the land for economical activities is subject to a term of 50 years, renewable for equal periods.

FOREIGN INVESTMENT.

- Article 108.
  Number 1. The State guarantees the foreign investment.
  Number 2. The foreign undertakings are authorized in the whole national territory and in all the economical sectors, except those reserved to the property or exclusive use of the State. (see also FDI data below).

GENERAL ASPECTS.

- The financial system is treated in the article 126 and the fiscal system in the article 127 followed the economical and social plan (PES) (article 128).
- The judicial system is described in the articles 212 etc....
- The basic rights are treated in the articles 35 etc....
- In the articles 91, 92 and following ones, the Constitution presents the rights of the citizens (dwelling, education, culture, sport etc.) and the rights of the consumers are defined.
- The system of government is described in the articles 133 etc.
2.2. **THE FISCAL SITUATION.**

2.2.1. **The VAT issue.**

I) **INTRODUCTION.**

Basically for all Mozambican companies, the VAT rules apply in the same way as in Portugal. In Portugal, leasing activity does not present any difficulty with respect to VAT. In Mozambique the current VAT situation with regard to leasing is controversial and needs to be clarified.

All the fiscal experts of the main international audit firms are unanimous in saying that the situation is unclear. Moreover, some fiscal experts consider that it could be advisable to return to the former system of the "exclusiveness" of the leasing industry to separate the leasing from the banks and handle VAT differently without interfering with the bank's VAT rules.

It is a workable idea and the situation would be clearer, even if such an idea seems troublesome at this point. Both systems could perhaps coexist and the free market forces will choose.

Note: the VAT issue concerns mainly Corporate lessees and investments in productive equipments.

II) **CURRENT SITUATION.**

For a better understanding we will take a simplified example as follows.

- **LEASED ASSET.** For instance, a Lessor purchases an asset to be leased, which price is 1000 MT. The VAT is 170 MT (VAT rate: 17%). Therefore, the Lessor's payment to the supplier is 1.170 MT.

- **LESSORS.**
  
  They consider that the whole leasing operation **IS VAT EXEMPTED**:
  
  a) They calculate the rentals on a capital amount which is the “asset's price VAT included” (in the example above = 1170 MT).
  
  b) They **do not charge VAT to the rentals** (which it is understandable for the “interests” portion of the rentals, as interests are VAT exempted according to the VAT Code).
  
  c) Consequently, they do not offset the VAT supported at the moment of the asset's purchase.

- **LESSEES.**
  
  The Lessee pays “rentals exempted of VAT”.
  
  But in fact, the Lessee supports financially a cost of 17% since the rentals are calculated on an higher capital amount (i.e the “asset's price VAT included” = 1170 MT in the example above). However, during the leasing contract period (3 years in general) in spite of having supported the above mentioned cost of 17% incorporated within the rentals, the Lessee has not officially

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21 Lessors separated from Banks and market monopoly for the lessors.
supported VAT upstream that he could offset from the VAT collected downstream to his clients when selling his products.

*Comments:* For the Lessee, this is a prejudicial system in terms of treasury and other fiscal aspects.

Instead of offsetting VAT related to rentals or cash acquisition of the asset, the Lessee makes the fiscal annual depreciation of the asset over a lengthy period.

In the example above, the Lessee will make the fiscal depreciation of 1170 MT (VAT 170 MT + 1000 MT) along the legal period prescribed in the general official chart which is commonly 4 years or more.

For instance, if the asset is amortized in 5 years, the Lessee will finish compensating the 170 MT of the example above on the sixth year (after closing the fifth year's accounts) which is prejudicial.

### III) STANDARD METHOD.

- **INTRODUCTION.**

As the general legislation and fiscal rules in Mozambique and Portugal are very similar, this study now presents below the current Portuguese standard method.

This method is well known and accepted by the Mozambican fiscal independent experts and independent auditors as well as by the IRS.

This method is advisable for the Lessees because it is clear, classical and does not interrupt the VAT chain.

- **LESSOR.**

  a) The Lessor supports VAT: 170 MT in the example.

  c) The base of calculation of the rentals (capital amount of the loan) is the asset's price "VAT excluded" (1000 MT).

  d) Calculation of the rentals:

      Note: To make a few simplified calculations, let's suppose that the contract has 1 year of duration, the interest rate is 20% p.a. and the contract has only one annual rental (installment) and has no RV (residual value). The calculations are the following ones:

  e) Rentals:

      Rentals calculated on 1000 MT: 1000MT + (20% x 1000) = 1200 MT.

  f) Invoice of the rentals with 17% VAT:

      Total rental(s) VAT included: 1200 MT x 1.17 = 1404 MT.

  g) The VAT collected by the Lessor is 204 MT.

  h) Offsetting of the VAT: 204 MT - 170 MT = 34 MT\(^{22}\)

      The VAT to be handed over to the Internal Revenue Service (IRS) by the Lessor is: 34 MT which is effectively equal to 17% of 200 MT (which is the value added amount: 1200 MT - 1000 MT).

  i) The Lessor should apply also the VAT on the RV (NOTE: on purpose, there is no RV (residual value) in the simplified example above).

\(^{22}\) See also conclusions below.
Comments:

1) This is an unusual method in the leasing business and it corresponds to method followed nowadays in Portugal. The market leader - a subsidiary of the most important Mozambican bank - implemented the formula above mentioned when starting activities (2000-2001). It seems that, at some moment, the Internal Revenue Service (IRS) rejected it.

2) At the same moment, a non-bank Lessor used a different method: the Lessee paid the VAT to the supplier (on behalf of the Lessor-buyer of the equipment). Thus the Lessee was in condition to offset the VAT supported from the VAT collected downstream. Disadvantages of such method: a) The procedure is economically clear but risky (not 100% proof against controversy with the IRS) . b) The Lessee uses his cash to pay 17% of VAT and consequently do not take full advantage of the credit capacity offered by leasing operation which is therefore less competitive.

LESSEE or Client.

If the investment is made by the Client directly (i.e. without financing), he purchases the equipment directly and pays cash. Hence the Client supports IMMEDIATELY 17% of VAT in the purchase (170 MT in the example above) (Day 1).

If the investment is made through a leasing contract, the Client will support 17% of VAT on the rentals (204 MT in the example above) over the contract period (instead of DAY 1 as above).

The Lessee benefits by keeping his cash untouched with respect to the capital amount as well as the VAT amount diluted over the whole contractual period.

Throughout the leasing contractual period the Lessee will offset the VAT paid to the Lessor (upstream) from the VAT collected (downstream) to his clients when selling his products.

IV) CONCLUSIONS.

The VAT issue relating to the leasing activity seems neither profound nor insolvable. Basically, the value added tax (VAT) is an intermediate tax handed over to the Internal Revenue Service, spread all over an uninterrupted chain, by the economical operators and businesses which buy assets and services that will be integrated in the products they manufacture and sell. At the end of the chain, it is the consumer who pays the totality of the VAT. In short, the difference “sales - purchases” constitutes the added value (that is the tax base of the VAT) of each one of the economical operators.

From the moment in which the leasing activity was integrated into the banks, according to the new 9/2004 Banking Act of the 21st of July 2004 and Decree 56/2004 of December 10th, 2004 (regulating the Banking Act) the above mentioned VAT chain was interrupted, at the leasing operation level, by the exemption of the VAT granted to the Banks (See below extracts of the VAT Code).

Hence, the leasing operation constitutes an unjustified exception to the general rule.

For corporate Lessees, leasing nowadays represent a less attractive option than the classical medium term loan. Leasing is also less competitive than leasing contracts prior to December 2004.

For the Lessors, as VAT is an intermediate tax, there would be no practical problem to conform to the above mentioned method, if the leasing activity was performed in a bank's subsidiary to avoid any conceptual VAT confusion within the bank.

The interruption of the VAT chain produces doubts of all kinds:

a) In commercial aspects: Lessor: how to sell the product?; Lessee : which product is better?.
b) In conceptual matters; in terms of accounting standardization, in terms of management and in the financial aspect (for the Lessee).

- Additionally, to the fact that leasing works perfectly without being VAT exempted, there are examples that demonstrate that the VAT exemption is not, in the eyes of the Legislator, a doctrinal principle related to the financial leasing operation:
  1. 1) The exclusion of certain types of assets (cars etc... see below “retail leasing”) of the right to VAT exemption23.
  2. 2) There is no VAT exemption on “cross-border leasing”. The Lessee has to make the withholding tax (VAT and Income tax).
  3. 3) While the interests on loans are VAT exempted, some other products sold by banks are subject to VAT (see below comment of article 9, number 23, of the VAT Code).

### 2.2.2. Extracts of the VAT Code related to leasing.

A few extracts of the VAT Code, related to the leasing activity, are presented below.

The current VAT Code, which came into force on June 1st, 1999, was approved by the Decree 51/98 of September 29th, 1998.

The VAT is applied on sales and imports of goods and services in the national territory effectuated by residents, private or corporate (called “passive subjects”).

In relation with the financial leasing, the doubts expressed more above and the lack of knowledge of the subject by some operators require the presentation of the following minimum extracts of the VAT Code.

- **Article 3 (Transmission of goods), number 1.**
  It is considered, in general, a transmission of goods the onerous transfer of the right of property of goods.

- **Article 3, number 3, letter a.**
  The material delivery of goods in execution of a financial leasing contract containing a transfer of property's clause.
  *Comment*: the transfer of property against payment of the residual value “RV” at the end of the leasing contract should be subject to the VAT.

- **Article 6 (Location of the operations), number 1.**
  Are taxable the transmissions of goods that are situated in the national territory from the moment in which starts the delivery transportation towards the buyer.

- **Article 6, number 7, letter f and letter j.**
  See separated text related to “cross-border leasing” and withholding tax.

- **Article 7 and article 8.**
  *Comment*: The VAT would become payable on the maturity date of a rental, ... based on the invoice made by the Lessor (article 31, number 1) within five days of the maturity date of a rental (Note24).

- **Article 9 (Transmission of goods and services EXEMPTED).** Are VAT exempted:
  **Number 23**: The bank and financial operations.
  *Comments*: The added value of the bank and financial operations are mainly the interests which are VAT exempted.

---

23 Article 19 (number 1, letter a) of the VAT Code
24 In practice the Lessor prepares an invoice several days before the maturity date and send it to the Lessee quite in advance to avoid delayed payments.
But some bank operations are not VAT exempted such as debts collections; sales of gold coins; administration, management and keeping of bonds etc.

Therefore the principal problem is the partial VAT deduction of the VAT supported upstream: deduction only for some operations and no deduction for other operations like financial leasing.

Note: Exempted persons or companies are excluded of the right of deduction (ie. offsetting).

As indicated above, the current problem would not exist for the leasing activity if carried out, with character of exclusiveness\(^\text{25}\), in a specialized company (Lessor) apart from the bank. For more, the added value of the leasing is called traditionally "margin" of the given service; it is not designated by the word "interest" for both fiscal and commercial reasons. As a matter of fact, Law 9/2004 (article 2, number 2, letter t) and Decree 56/2004 (article 37) make use of the term "remuneration".

**Number 25**: The financial lease of real estate, excluding however:

**Letter c.** The financial lease of machines and other equipments integrated to the real estate asset, as well as any real estate lease implying the onerous transfer of the utilization of commercial or industrial premises.

*Comment*: This confirms, for the real estate, the number 23 of this article 9. Moreover there is not any article which establishes the rules for movable assets. For the movable assets the number 3, of article 3 (above) has to be considered and it creates a serious doubt.

* Article 19 (Exclusion of the right to deduction), number 1, letter a.

1. Are also kept out of the right of exclusion the tax contained in the following expenses:
   a) expenses related to (i) the purchase or import, (ii) the lease including the financial lease, (iii) the financial utilization, (iv) the use of tourism vehicles, recreational boats, helicopters, airplanes, motorbikes and motorcycles. Is considered as a tourism vehicle, all motorcars with inclusion of the tow, which, for his type of construction and equipment, is not destined exclusively to the transport of goods or to a use related with agriculture, commerce or industry or which, being mixed or for passengers' transportation, does not have more than nine places driver included.

2.2.3. **Other taxes; Cross-border leasing.**

**Other taxes.**

It is principally the IRPC (in Portuguese "Imposto sobre Rendimentos de pessoas Colectivas"). The IRPC is the "Corporate Income Tax". The applicable rules are the general rules for the Mozambican enterprises.

**Cross-border leasing.**

The rules related to "cross-border leasing" and withholding tax are the following:

- **Legislation.**

  1) IRPC Code : the principal related articles is the article 5 (number 2 and number 3, c, vii), the article 77 (number 1 and 2: the rate is 20 %) and the article 83 (I number 1, opening line f and number 2).

  2) VAT Code:

**Article 6, number 7, letter f and letter j. Text:** Are also taxable the services rendered mentioned below, which contractor or supplier has not in the national territory a stable establishment or residence ...... whenever the buyer is subject to the tax indicated in the letters a) and b) of the number 1 of the article 2, even if he realizes exclusively exempted operations without deduction right, which headquarters or stable establishment or domicile is situated in the

---

\(^{25}\) Monopoly.
national territory. Letter f. Bank, financial operations and insurance and re-insurance. Letter j. Leasing of movable fixed assets, as well as the financial leasing of the same assets.

- **Consequences.**

  In case of a cross-border leasing, the Lessee (buyer the financial service) must make the auto-calculation of the taxes showing up the value of the taxes related to the service provided by the non resident entity (foreign Lessor).

  When the provided service is invoiced as a rental, the Internal Revenue Service will most probably consider, as the easiest option, that the tax base is the "total amount of the rental" and the Lessee will have to make a 20% withholding tax of the IRPC (if there is no convention on double taxation *) and the 17% VAT (article 6 I number 1 and number 7 of the VAT Code). Consequently a cross-border financial leasing does not seem viable for Lessees*.

  In practice, mainly for heavy equipments (main public works’ contracts) the operators proceed to a temporary importation.

  * The conventions on double taxation are applied generally to the Income Tax (equivalent to the IRPC) but not to the VAT. Therefore VAT will always be collected at 17% while the withholding Income Tax rate can vary according the convention but will always be inferior to 20% indicated above.

2.2.4. **Accounting norms and fiscal depreciation.** (ANNEX 4d & 4e)

  The regulation adopted by the Mozambican authorities is in line with the international standards and corresponds to the methods currently used in Portugal.

  The guiding principle is the prevalence of the substance over the form (ANNEX 4d). Therefore, the leased asset has to be recorded as a “Fixed asset” only in the balance sheet of the Lessee.

  **LESSEE’S FINANCIAL STATEMENT.**

  **Asset and the correspondent Liability.**

  At the contract signing (and asset delivery), the asset is recorded in the balance sheet of the Lessee as any other tangible asset in an account “movable (or immovable) asset”. A liability is recorded in an account “Debts or Supplier of leased asset” for the same amount.

  Amount to be recorded in the Lessee’s book: the amount is the "Capital financed" as established by the Lessor. The amount is the price of the asset VAT included.

  **Payments of the rentals.**

  Each rental is divided in two parts: Capital amortization and margin (interests).

  a) **Liabilities**: the Capital amortization of each rental is allocated to liabilities to reduce the outstanding debt.

  b) **Profit and loss / expenses**: the margin or interests paid to the Lessor are booked as interest expenses.
**Fiscal depreciation of the leased Asset.**

It is made as indicated in the "VAT chapter" (§ 2.2.1, II current situation, Lessees) according the legal period prescribed in the general official chart ruling the fiscal depreciations for each category of asset.

- **LESSOR’S FINANCIAL STATEMENTS.**

The accounting method for the Lessor is coherent with the Lessee’s financial statements. The principal aspects are the following:

**Assets.**

The investment made by the Lessor constitutes a loan that is recorded in the assets column. The amount recorded is, in practice, the global amount financed as defined in the previous paragraph (Lessees financial statements).

Note 1: Obviously, in parallel to its leasing portfolio, the Lessor has in the liability column all the “debts” or credit lines that constitute his whole funding.

Note 2: The Lessor also keeps an account “suppliers” in order to better control its assets’ purchases.

Note 3: The Lessor creates a record to keep a control of all the rentals to be collected in the future for all the leasing contracts he handles.

**Profit and loss: Income.**

The part of each rental corresponding to the “leasing margin or interests” constitutes an income.

### 2.2.5. **Impact of the fiscal issue: Choice Leasing vs. Loan.**

In order to finance investments in productive equipments, the leasing alternative compared with a classical medium term bank loan, is, for the corporate Lessee, the less attractive option for the following reasons:

- Leasing does not contain any fiscal benefit such as a fiscal acceleration (in this aspect both solutions are equal).
- Leasing does not contain any financial benefit or advantage. Interest rates, guarantees and other credit conditions (down payment etc...) are equal and depend only on the credit risk evaluation made by the bank independently of the leasing department.
- The medium term loan is more widely known and is easier to understand and to implement than a financial leasing contract. Leasing is still a new concept in Mozambique.
- As most equipment is imported, a medium term loan permits the Client to take advantage of custom duty exemptions. Of course the Client has to register the investment in the CPI (Investment Promotion Center\(^{26}\)) in advance. Lessors are no longer entitled to custom duty exemptions; the lease back alternative is not very advisable because it contains some additional disadvantages and weaknesses in terms of credit risk.

\(^{26}\) [http://www.cpi.co.mz](http://www.cpi.co.mz)
● A medium term loan permits to the Client to offset 100% of the VAT amount (17% of the total price of the asset) immediately, while leasing would only have the same effect** over the whole contract duration.
  ** Indirectly through the fiscal depreciation.
● The cash management aspect of a financial leasing operation differs from one company to another depending of the tax bracket of each company.
3. THE MARKET.

3.1. THE ECONOMY.

The Mozambican country rating is improving (see Annex C). Among the facts and data reviewed, the most accurate information for the purpose of the present study is the following (not exhaustive list; See also annexes for more information).

3.1.1. General Indicators of the Mozambican Economy.

GDP.
The GDP is growing steadily. The GDP per capita is very low but improving.

<table>
<thead>
<tr>
<th>GDP growth</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>2003</td>
</tr>
<tr>
<td>8,2 %</td>
<td>7,9 %</td>
</tr>
<tr>
<td></td>
<td>231</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM)

<table>
<thead>
<tr>
<th>Nominal GDP</th>
<th>In millions MT</th>
</tr>
</thead>
<tbody>
<tr>
<td>133 319</td>
<td>157 345</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GDP per capita</th>
<th>in US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>309</td>
<td>347,4</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM) & IMF Country Report 07262 Table 1

EMPLOYMENT.
The number of employed persons is very modest and constitutes a tiny part of the active population (less than 8%).
The official “minimum salary” (see below) is the salary of most employees (1US $ = 25,2 MT). Most jobs are in Maputo City (in 2005 : 46,5 %) or near Maputo (in 2005 : 17,5 %) (remaining parts of the country : 36% in 2005), and many of them are unskilled jobs.

<table>
<thead>
<tr>
<th>EMPLOYEES (B)</th>
<th>% B/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>364 291</td>
<td>4,9 %</td>
</tr>
<tr>
<td>403 751</td>
<td>5,3 %</td>
</tr>
<tr>
<td>516 354</td>
<td>6,6 %</td>
</tr>
<tr>
<td>542 582</td>
<td>6,7 %</td>
</tr>
<tr>
<td>609 287</td>
<td>7,9 %</td>
</tr>
<tr>
<td>634 472</td>
<td>7,5 %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unemployed</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 212</td>
</tr>
<tr>
<td>15 395</td>
</tr>
<tr>
<td>14 956</td>
</tr>
<tr>
<td>21 039</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CONTRIBUTORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>11 540</td>
</tr>
<tr>
<td>12 730</td>
</tr>
<tr>
<td>14 125</td>
</tr>
<tr>
<td>16 384</td>
</tr>
<tr>
<td>17 974</td>
</tr>
<tr>
<td>20 063</td>
</tr>
</tbody>
</table>

Source: INE statistical yearbooks

The number of Contributors to the Social Security system (ie number of companies registered in the social security and health care system (INSS ”Instituto Nacional de Segurança Social”) is very low and gives an idea of the modest size of the formal market.
INFLATION.
According to the BM, average inflation, rose to 13.2% (average inflation) in December 2006. The Mozambican inflation index was mainly calculated in Maputo City, and more recently in 2 other cities (Beira and Nampula).

<table>
<thead>
<tr>
<th>General CPI</th>
<th>Dec 04</th>
<th>9.07 %</th>
<th>Dec 05</th>
<th>11.15 %</th>
<th>Dec 06</th>
<th>9.37 %</th>
<th>Dec 2007 e</th>
<th>6 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source : BM annual report 2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In 2005, within the annual average inflation, foods were responsible for about 66% of the increase. Serious drought affected some areas of the country. Part of the inflation comes from the rise of prices of foods in RSA the main supplier of Maputo City’s foods. Other factor in 2005: the depreciation of the Metical (MT) (nominal depreciation of 27% against the US $ in 2005).

Mozambique: Selected Economic Indicators, 2005–07

(Annual percentage change, unless otherwise indicated)

<table>
<thead>
<tr>
<th>National income and prices</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP (millions of MT)</td>
<td>157,345</td>
<td>193,322</td>
<td>220,150</td>
</tr>
<tr>
<td>Nominal GDP growth</td>
<td>16.0</td>
<td>22.9</td>
<td>13.9</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>6.2</td>
<td>8.5</td>
<td>7.0</td>
</tr>
<tr>
<td>GDP per capita (in U.S. dollars)</td>
<td>348</td>
<td>396</td>
<td>397</td>
</tr>
<tr>
<td>Consumer price index (annual average)</td>
<td>6.4</td>
<td>13.2</td>
<td>6.4</td>
</tr>
<tr>
<td>Consumer price index (end of period)</td>
<td>11.2</td>
<td>9.4</td>
<td>6.0</td>
</tr>
</tbody>
</table>

(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)

<table>
<thead>
<tr>
<th>Money and credit</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net foreign assets</td>
<td>23.1</td>
<td>31.3</td>
<td>10.4</td>
</tr>
<tr>
<td>Net domestic assets</td>
<td>4.0</td>
<td>-7.9</td>
<td>5.7</td>
</tr>
<tr>
<td>M2 (12-month percent change)</td>
<td>22.1</td>
<td>29.8</td>
<td>16.2</td>
</tr>
<tr>
<td>Interest rate for 90-day treasury bills (percent of period)</td>
<td>10.0</td>
<td>16.0</td>
<td>...</td>
</tr>
</tbody>
</table>

(Percent of GDP)

<table>
<thead>
<tr>
<th>Investment and saving</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic investment</td>
<td>21.5</td>
<td>24.9</td>
<td>28.8</td>
</tr>
<tr>
<td>Gross domestic savings (excl. grants)</td>
<td>5.6</td>
<td>11.3</td>
<td>10.9</td>
</tr>
<tr>
<td>Current account, before grants</td>
<td>-15.6</td>
<td>-13.6</td>
<td>-17.9</td>
</tr>
</tbody>
</table>

(Percent of exports of goods and nonfactor services)

<table>
<thead>
<tr>
<th>External debt service (nonfinancial public sector)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled, after additional bilateral assistance and MDRI</td>
<td>2.0</td>
<td>0.6</td>
<td>0.7</td>
</tr>
</tbody>
</table>

(Millions of U.S. dollars, unless otherwise indicated)

<table>
<thead>
<tr>
<th>External balance of payments</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall balance of payments</td>
<td>-57</td>
<td>139</td>
<td>74</td>
</tr>
<tr>
<td>Gross international reserves (end of period)</td>
<td>1,103</td>
<td>1,241</td>
<td>1,315</td>
</tr>
<tr>
<td>In months of imports of goods and nonfactor services</td>
<td>4.6</td>
<td>4.4</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Sources: Mozambican authorities; and Fund staff estimates and projections.
2. Projections exclude the Moatize coal mine project, Cahora Bassa transfer, and Petroleum exploration.
3. Minus sign indicates depreication.
4. Includes movement in the government account set abroad with the proceed of the Moatize coal mine concession.
3.1.2. Public finances.

Reduction of absolute poverty is the priority of the national agenda and absorbs 65% of Government expenditures. Education, Health and infrastructures are the 3 priority sectors within the Plan of Action for the Reduction of Absolute Poverty (PARPA II)(PRGF Poverty Reduction and Growth Facility).

REVENUES 2006.

Domestic resources account for 45% to 49% of the Governmental budget of resources and the difference comes from external resources (mainly grants - average 34.6% from 2002 to 2006 - and loans) as indicated below.

<table>
<thead>
<tr>
<th>Structure of Budget Resources</th>
<th>in %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002</td>
</tr>
<tr>
<td>Domestic Resources</td>
<td>45.6%</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>42.7%</td>
</tr>
<tr>
<td>Domestic Credit (Net)</td>
<td>2.8%</td>
</tr>
<tr>
<td>External Resources</td>
<td>54.4%</td>
</tr>
<tr>
<td>Grants</td>
<td>33.3%</td>
</tr>
<tr>
<td>External Loans</td>
<td>19.2%</td>
</tr>
<tr>
<td>Transfers (HIPC)</td>
<td>0</td>
</tr>
<tr>
<td>Budget Resources</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: BM annual report 2006 p.45 /Ministry of Finance

The government total revenues in 2006 amounted to MZN 26,997 million - 14% of GDP - a 17% real growth in relation to 2005.

The fiscal collection represents 62% of the public revenues in 2006 and is constituted mainly by:

--A) The Value Added Tax (VAT): 35% of the total public revenues amounting to MZN 13.031 million (6.7% of GDP),

--B) The income taxes: 24% of the total public revenues of which 13% IRPS (Private income tax), and 9.4% IRPC (Corporate income tax),

--C) The collection of taxes on foreign trade: 12.2% of the total public revenues amounting to MZN 3.284 million (1.7% of GDP). In the context of customs duty reduction, there was a cut of the tax on trade transactions among the SADC member countries, in January 2006, from 25% to 20%.

<table>
<thead>
<tr>
<th>Mozambique Government Revenues</th>
<th>in Millions MT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>16,838</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>15,598</td>
</tr>
<tr>
<td>Taxes on income and profits</td>
<td>3,548</td>
</tr>
<tr>
<td>Taxes on goods and services</td>
<td>9,416</td>
</tr>
<tr>
<td>Of which: on petroleum products</td>
<td>1,663</td>
</tr>
<tr>
<td>Taxes on international trade</td>
<td>2,294</td>
</tr>
<tr>
<td>Other taxes</td>
<td>380</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>1,241</td>
</tr>
</tbody>
</table>

Source: IMF Country Report 07262 Table 2
EXPENDITURES and DEFICIT 2006.
The total public expenditure was 46.871 millions MT (24.3% of GDP).

A) The Current expenditure totaled 25.661 millions MT (13.3% of GDP and 11.3% growth in real terms).

B) The Investment expenditure totaled 18.365 millions MT (9.6% of GDP and 25.6% real increase) of which 12.083 millions MT financed by grants and external loans (65% of investment expenditure).

C) The overall deficit before grants was 19.874 millions MT which represents 10.3% of GDP (9.8% in 2005).
The inflow of grants was 17 957 millions MT (9.3% of GDP) (38% of the public budget).

<table>
<thead>
<tr>
<th>Mozambique Government Expenditures and deficit</th>
<th>in Millions MT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004/1</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenditure and net lending</td>
<td></td>
</tr>
<tr>
<td>Current expenditure</td>
<td>32,637</td>
</tr>
<tr>
<td>Compensation to employees</td>
<td>9,195</td>
</tr>
<tr>
<td>Goods and services</td>
<td>4,727</td>
</tr>
<tr>
<td>Interest on public debt</td>
<td>1,321</td>
</tr>
<tr>
<td>Domestic</td>
<td>910</td>
</tr>
<tr>
<td>External</td>
<td>411</td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Capital expenditure</td>
<td></td>
</tr>
<tr>
<td>Grant finance projects</td>
<td>3,085</td>
</tr>
<tr>
<td>Projet loans</td>
<td>3,564</td>
</tr>
<tr>
<td>Locally financed</td>
<td>4,074</td>
</tr>
<tr>
<td>Grant-financed special program</td>
<td>1,197</td>
</tr>
<tr>
<td>Direct financing</td>
<td>623</td>
</tr>
<tr>
<td>Expenditure financed with fund</td>
<td>...</td>
</tr>
<tr>
<td>Net lending</td>
<td>1,058</td>
</tr>
<tr>
<td>Of which: locally financed</td>
<td>79</td>
</tr>
<tr>
<td>Domestic primary balance. before grants</td>
<td>-4,842</td>
</tr>
</tbody>
</table>

Source: IMF Country Report 07/62 Table 2

FOREIGN DEBT.
The Mozambican External Debt is very important. Mozambique, as a HIPC (Highly Indebted Poor Country) benefited of the MDRI approved by the G8 leaders in Scotland in 2005 (Multilateral Debt Relief Initiative: IMF, IDA (World Bank), BAD ...) which halved the Public External Debt in 2006 (from 22% of GDP to 12%).

The External debt represented 46.7% of the GDP in 2004, 30.71% in 2005, 27.3% in 2006 and is estimated to be 27.9% of GDP in 2007.  

According to Bank of Mozambique, the total External Debt of the country at End-2006 was 9,981,3 29 millions US $ of which a great part (47.8 %) correspond to the private FDI. During the period 2001-2006 the Mega-projects represented 24 % of the whole external debt of the country.

29 Source: BOP June 2007 DEE-BM p.84.
Additional information: see the joint World Bk-IMF Debt Sustainability Analysis of May 2007.

**INTERNATIONAL RESERVES.**

<table>
<thead>
<tr>
<th>Gross International Reserves</th>
<th>in millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>1160</td>
</tr>
<tr>
<td>2005</td>
<td>1103</td>
</tr>
<tr>
<td>2006</td>
<td>1241</td>
</tr>
<tr>
<td>2007 $e$</td>
<td>1315</td>
</tr>
<tr>
<td>2008 $proj.$</td>
<td>1369</td>
</tr>
<tr>
<td>2009 $proj.$</td>
<td>1466</td>
</tr>
<tr>
<td>2010 $proj.$</td>
<td>1553</td>
</tr>
</tbody>
</table>


### 3.1.3. **Foreign trade and BOP (balance of payments).**

**Exports.**

Exports are dominated by metals (more than 60% in 2005; mainly Aluminum) and minerals (near 15% in 2005). The weight of exports of raw materials and energy will probably increase significantly in the future.

The percentage of the exports implying a process of industrial transformation is reduced (10 to 15 % in 2005 compared with 75 % above for the exports of minerals and of metals). See also below: "External Sector".

<table>
<thead>
<tr>
<th>Exports f.o.b. (I)</th>
<th>in Millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>268</td>
</tr>
<tr>
<td>2000</td>
<td>364</td>
</tr>
<tr>
<td>2001</td>
<td>703</td>
</tr>
<tr>
<td>2002</td>
<td>680</td>
</tr>
<tr>
<td>2003</td>
<td>912</td>
</tr>
<tr>
<td>2004</td>
<td>1504</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM) & IMF Country Report 07262 and 07258

<table>
<thead>
<tr>
<th>Exports f.o.b. (II)</th>
<th>Millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1745</td>
</tr>
<tr>
<td>2006</td>
<td>2381</td>
</tr>
<tr>
<td>2007 $e$</td>
<td>2580</td>
</tr>
<tr>
<td>2008 $proj.$</td>
<td>25425</td>
</tr>
<tr>
<td>2009 $proj.$</td>
<td>2566</td>
</tr>
<tr>
<td>2010 $proj.$</td>
<td>2686</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM) & IMF Country Report 07262 and 07258; BOP bulletin of June 2007 DEE/BM.

**Imports.**

In addition to foods imports and goods, there is a significant volume of imports of equipments (see below).

<table>
<thead>
<tr>
<th>Imports c.i.f.</th>
<th>Millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>1171</td>
</tr>
<tr>
<td>2000</td>
<td>1162,3</td>
</tr>
<tr>
<td>2001</td>
<td>1063,4</td>
</tr>
<tr>
<td>2002</td>
<td>1180,1</td>
</tr>
<tr>
<td>2003</td>
<td>1753</td>
</tr>
<tr>
<td>2004</td>
<td>2035</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM) & IMF Country Report 07262 and 07258

<table>
<thead>
<tr>
<th>Imports c.i.f.</th>
<th>Millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>2467</td>
</tr>
<tr>
<td>2006</td>
<td>2878</td>
</tr>
<tr>
<td>2007 $e$</td>
<td>3119</td>
</tr>
<tr>
<td>2008 $proj.$</td>
<td>3275</td>
</tr>
<tr>
<td>2009 $proj.$</td>
<td>3469</td>
</tr>
<tr>
<td>2010 $proj.$</td>
<td>3742</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE, BM) & IMF Country Report 07262 and 07258

The rate coverage of total imports by exports reached 89,9% in 2006 (34,4%, when excluding the Mega projects imports (mainly ore) and exports.

Gross international reserves, moved from 4,6 months of imports in December 2005, to 4,4 months on December 2006 (November 2007: 4,7 months).
Balance of payment.

Traditionally in Mozambique, the commercial balance (goods account) and current accounts show an important deficit. Thanks to the increase of exports generated by the Mega-projects, the commercial balance is improving steadily.

The overall deficit of the BOP is compensated by capital inflows (mainly foreign aid, loans and FDI).

In 2006 the trend of financial resources outflows was only softened by capital inflow in the form of Foreign (FDI) of US $ 153.7 millions (42.5% growth). In 2006, the FDI flow was determined by mega projects. Non Mega-projects FDI decreased by 27.3% compared with 2005, to US $ 67.4 million in the period under analysis 30 (see below FDI).

<table>
<thead>
<tr>
<th>Table 4. Mozambique: Balance of Payments, 2004–10</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Millions of U.S. dollars, unless otherwise specified)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports, f.o.b.</td>
<td>-531</td>
<td>-721</td>
<td>-500</td>
<td>-487</td>
<td>-844</td>
<td>-539</td>
<td>-732</td>
</tr>
<tr>
<td>Megaprojects</td>
<td>1,504</td>
<td>1,745</td>
<td>2,250</td>
<td>2,391</td>
<td>2,346</td>
<td>2,580</td>
<td>2,542</td>
</tr>
<tr>
<td>Other exports</td>
<td>1,049</td>
<td>1,203</td>
<td>1,581</td>
<td>1,859</td>
<td>1,733</td>
<td>1,719</td>
<td>1,583</td>
</tr>
<tr>
<td>Imports, c.i.f.</td>
<td>-2,035</td>
<td>-2,467</td>
<td>-2,750</td>
<td>-2,878</td>
<td>-3,104</td>
<td>-3,119</td>
<td>-3,275</td>
</tr>
<tr>
<td>Megaprojects</td>
<td>-322</td>
<td>-423</td>
<td>-498</td>
<td>-683</td>
<td>-569</td>
<td>-630</td>
<td>-607</td>
</tr>
<tr>
<td>Services and incomes (net)</td>
<td>-301</td>
<td>-300</td>
<td>-562</td>
<td>-569</td>
<td>-803</td>
<td>-917</td>
<td>-771</td>
</tr>
<tr>
<td>Receipts</td>
<td>370</td>
<td>464</td>
<td>577</td>
<td>659</td>
<td>660</td>
<td>607</td>
<td>624</td>
</tr>
<tr>
<td>Expenditures</td>
<td>-671</td>
<td>-824</td>
<td>-1,269</td>
<td>-1,128</td>
<td>-1,362</td>
<td>-1,514</td>
<td>-1,368</td>
</tr>
<tr>
<td>Current account, before grants</td>
<td>-832</td>
<td>-1,381</td>
<td>-1,181</td>
<td>-1,055</td>
<td>-1,647</td>
<td>-1,458</td>
<td>-1,504</td>
</tr>
<tr>
<td>Unrequited official transfers</td>
<td>527</td>
<td>481</td>
<td>2,468</td>
<td>2,570</td>
<td>947</td>
<td>960</td>
<td>966</td>
</tr>
<tr>
<td>Of which: MDRI relief from the IMF</td>
<td>0</td>
<td>120</td>
<td>120</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MDRI relief from IDA</td>
<td>0</td>
<td>1,158</td>
<td>1,319</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MDRI relief from ADF</td>
<td>0</td>
<td>502</td>
<td>435</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Of which: HIPC grant from the IMF</td>
<td>0</td>
<td>15</td>
<td>34</td>
<td>34</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Current account, after grants 1/</td>
<td>-305</td>
<td>-920</td>
<td>1,284</td>
<td>1,515</td>
<td>-700</td>
<td>-508</td>
<td>-538</td>
</tr>
</tbody>
</table>

Source: IMF Country Report 07262 Table 4

3.1.4. Investments and FDI; Credit to the Economy; Conclusion.

INVESTMENTS and FDI (see more data below: Leasing sector and ANNEX 7a).

The investments main characteristics are the following:

- Domination of Mega-projects.
- A small part is directed to the industrial sector (non Mega-project).

30 Source: BM annual report 2006.
- A declining amount of FDI (non Mega-project) in 2006.

<table>
<thead>
<tr>
<th>FDI</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI Mega-projects</td>
<td>192</td>
<td>245</td>
<td>234</td>
<td>178</td>
<td>15</td>
<td>86.6</td>
</tr>
<tr>
<td>FDI non Mega-projects</td>
<td>63</td>
<td>103</td>
<td>103</td>
<td>67</td>
<td>93</td>
<td>67.4</td>
</tr>
<tr>
<td>TOTAL FDI</td>
<td>255</td>
<td>348</td>
<td>337</td>
<td>245</td>
<td>108</td>
<td>154</td>
</tr>
</tbody>
</table>

Source: Bulletin BOP June 2007 DEE/BM

The stock of FDI in Mozambique on December 31, 2006 amounted to 4,774.7 millions of US $\textsuperscript{31}, of which 78% correspond to Mega-projects\textsuperscript{32}.

Origin in 2006 of the capital invested in the Mozambique:
a) South Africa 113.8 million US $, b) Mauritius 3.0 million US $, c) United Kingdom 12.7 million US $, d) Brazil 6.5 million US $, e) Bahamas 5.6 million US $ etc. In 2005 the FDI came mainly from Portugal (20.3 millions US $) (followed by France 19.1 m US $, India 12.3 m US $, South Africa 12.3 m and Mauritius 8 m.

**CREDIT TO THE ECONOMY.**

The credit to the economy increased between 2004 and 2006 from 13.5 billions of MT to 27.4 Billions MT.
It is estimated to be 35.9 billions MT approximately in 2007 and 71 billions MT\textsuperscript{33} in 2010 (see more data below: Leasing sector).

**CONCLUSION.**

- The economy is dominated by a small number of mega-projects: (Production of aluminum (MOZAL); Gas production (SASOL); Dam and production of electricity (CAHORA BASSA); Minerals : Titanium (2 projects): Coal : mine MOATIZE); Gas - fire generation : TEMANE project).
- Excepting the Mega-projects, the situation is as follows:
- A high geographical concentration of most companies and industries in the region of Maputo. The principal industrial area of the country (Matola), close to Maputo, presents visible signs of difficulties in the heavy metals industry and metallic construction sector.
- A sector distribution of the economy characterized by a preponderant concentration in the service sector. A number of other sectors deserve a positive mention: the mining industry, construction, transportation and communications (See leasing market).

\textsuperscript{31} Source: Bulletin BOP, June 2007, DEE/BM p.84
\textsuperscript{32} Source: Bulletin BOP, June 2007, DEE/BM.
\textsuperscript{33} Sources: IMF country report 2007, BM (Bank of Mozambique), IMF projections and estimates.
3.2. THE FINANCIAL SECTOR.

3.2.1. Composition of the Financial sector.

- The Central Bank (Bank of Mozambique / "Banco de Moçambique") (see below).
- The Credit Institutions are mainly the following:
  - Commercial Banks: In total 9, the main ones are partially or completely owned by international or regional banks.
    b) Independent leasing companies: 2 (the second one was authorized in November 2007).
  - Micro-finance Institutions: 3. (ANNEX 8b & 8c). Note: Micro-finance are considered as banks and are governed by Decree 57/2004 (ANNEX 8a).
  - Cooperative credit groups: 6.
  - Financial companies: 23 (essentially Currency exchange office and one Investment institution, etc).
  - BVM (Bolsa de Valores de Mozambique): the Stock Exchange of Mozambique.
- Supervision: The Direction of Supervision of the Central Bank (DSB). The supervision of the Financial Sector is made by a special entity of the Central Bank: the DSB ("Direcção de Supervisão Bancária"). The prudential rules and other norms are presented in the "Legal Framework" chapter of this report.

3.2.2. The Central Bank. (ANNEX 4a)

The supervision institution is the Central Bank (BM i.e. Banco de Moçambique).
Its role, attributions and obligations are defined in the Law 1/92 of January 3, 1992 (ANNEX 4a).
The BM is the institution in charge of making the money (coins and bills) called METICAL (abbreviations: MZM or MT).

In 2006 the new METICAL was implemented (the former MT was divided by 1000). It will contribute to promote more confidence in the currency, in the future of the Mozambican economy and in the stability of the exchange market. (see BM annual report 2006 pages 108 to 110).

The functions of the BM correspond to those of most Central Banks. They are among other:
- To maintain prices stability.
- To assure a rigorous control and the correct functioning of the financial system.
- To elaborate the regulations applicable to the financial system.
- To collaborate with the government - mainly the Minister of Finance – in many domains such as: the economic policy, the monetary policy, and the currency exchange policy.
- To manage the international reserves of Mozambique.
- To advise the Government.
- To make financial and economic statistics, data, etc…

The law mentions clearly the autonomy of the BM and fixes the ruling period of the head of the Bank (Governador), the administrators, the advisory fiscal board, the external auditors, advisory council etc.
Some key aspects of the credit activity at end-2006.\textsuperscript{34}

- Concentration of the banking sector.
  Four commercial banks represent about 90\% of the total deposits and 85\% of the credits portfolio on a national level.

- Concentration of the credit portfolio.
  Access to credit is not difficult for corporate clients. The total amount of loans received by the 100 biggest debtors was 201 millions MT on December 2006 (compared to 15,3 millions on Dec. 2005) which represents 75,3 \% of the national credit portfolio.

- Sectoral concentration.
  \begin{itemize}
  \item Sectors. The credit portfolio is highly concentrated in the commerce and service sector. In average, for the period 2003-2006, the “agriculture & fishing” sector received 13\% of the total credits; the mining sector 3\%; the industry 12\%; the “transport –communication” sector together with the “construction and public infrastructure” sector 11\%; the remaining 61\% was assigned to “commerce, tourism, services and others” (among which consumer credit and housing) considered to be less risky.
  \item Leasing. At end-2006, Lessors represent 2,6\%\textsuperscript{35} of the national credit portfolio. In fact the overall leasing portfolio is much more significant (see leasing chapter below) because the main leasing company became part of its shareholder bank in December 2005.
  \end{itemize}

3.2.4. Main facts and indicators.

The capacity of banks to offer credits is far from its limit.

- Credit represents only 59 \% (see below) of the deposits and 38,5\% of the total assets.
- The banks’ portfolio of government bonds and other securities is important in relation to the total amount of credits: 98\% of the bonds’ portfolio is constituted by government bonds and treasury bills*.
- A high level of bank’s spreads which explains the high level of interest rates (see below).

* The important level of government bonds in the banks’ assets is explained by: the zero risk aspect (zero provision), the fiscal aspect, very attractive interest rates (a loan would only offer the same profitability if its interest rate is 20\% or more) and the optimum weighting in the calculation of the capital adequacy ratio.

Spreads.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks’ average spread</td>
<td>15,8 %</td>
<td>13,8 %</td>
<td>10,7 %</td>
<td>10,6 %</td>
</tr>
<tr>
<td>Total loans (gross) vs Total deposits</td>
<td>51,6 %</td>
<td>48,8 %</td>
<td>56,3 %</td>
<td>59,0 %</td>
</tr>
</tbody>
</table>

\textsuperscript{34} Source: Central Bank (BM) annual report 2006.

\textsuperscript{35} Source: Central Bank (BM) annual report 2006.
Retail Interest Rates:
The nominal average interest rates in transaction in MT (MZM) showed a rising trend in 2006. The deposit average interest rate was 10.89% in December 2006. The loan average rate increased by 22.59% compared to the average recorded in December 2005. The prime rate in average terms, stood at 20.28% in December 2006.

Due to the annual average inflation between December 2005 and December 2006 it resulted in a fall of real interest rates, with that of credit declining from 12.8% to 8.3% and that of deposit rising from 0.3% to 2.1% negative.

For currency operation, the loan rate in US $ stood at 9.75% in December 2006 while the deposit average rate in US $ rose to 3.44%.

Assets' structure.

<table>
<thead>
<tr>
<th>Loans' portfolio (Including leasing since 2005) and Financial assets</th>
<th>(in Millions of MT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source: BM report 2006</td>
<td>Cash</td>
</tr>
<tr>
<td>01/2004</td>
<td>6.064,3</td>
</tr>
<tr>
<td>End-2004</td>
<td>6.793,0</td>
</tr>
<tr>
<td>End-2005</td>
<td>7.595,5</td>
</tr>
<tr>
<td>End-2006</td>
<td>10.680,9</td>
</tr>
</tbody>
</table>

Foreign currency loans.
The amount of credits in foreign currency, historically very high, has decreased progressively from the Notice 5/GCBM/2005 of May 20, 2005.

Since one year, the loans in local currency surpassed the loans in foreign currency.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign currency loans vs. total portfolio</td>
<td>60,8 %</td>
<td>62,0 %</td>
<td>51,4 %</td>
<td>33,2 %</td>
</tr>
<tr>
<td>Foreign currency loans vs. currency deposits</td>
<td>65,9 %</td>
<td>70,7 %</td>
<td>63,9 %</td>
<td>45,0 %</td>
</tr>
</tbody>
</table>

Non performing loans (NPL) portfolio.
The ratio NPL vs. total loan portfolio is high (see details in the paragraph “credit risk” below) however it has decreased progressively from 2.109,4 millions of MT (MZM) at the end of 2003 to 851,8 millions of MT at the end of 2006 because of the positive evolution of the credit risk policies, the positive evolution of the economy and perhaps some progresses in the efficiency of NPL collection.
Deposits.
In relation to the deposits mentioned above, the relation between on demand deposits and time deposits is the following (in millions of MT):

<table>
<thead>
<tr>
<th>Source: BM annual report 2006 (millions MT)</th>
<th>Time deposits</th>
<th>Demand deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/2004</td>
<td>6.868.3</td>
<td>21.439.9</td>
</tr>
<tr>
<td>End-2004</td>
<td>7.421.6</td>
<td>22.433.9</td>
</tr>
<tr>
<td>End-2005</td>
<td>8.535.6</td>
<td>29.111.1</td>
</tr>
<tr>
<td>End-2006</td>
<td>11.487.9</td>
<td>34.584.9</td>
</tr>
</tbody>
</table>

Liabilities' structure of the financial sector.

<table>
<thead>
<tr>
<th>Liability Structure in 1000 MT</th>
<th>Source: BM annual report 2006</th>
<th>Total Deposits</th>
<th>Own funds</th>
<th>Total Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-04</td>
<td>28.861.476</td>
<td>4.013.860</td>
<td>42.500.582</td>
<td></td>
</tr>
<tr>
<td>End-2005</td>
<td>37.892.398</td>
<td>4.386.426</td>
<td>54.578.604</td>
<td></td>
</tr>
<tr>
<td>End-2006</td>
<td>46.330.734</td>
<td>4.418.469</td>
<td>68.535.736</td>
<td></td>
</tr>
</tbody>
</table>

Growing Profitability of the Financial sector.
At end-2006, the profits of the Financial Sector amounted to 2.408.458 millions MT, highlighting an increase of 154.5% compared to 946.315 millions MT in 2005. The improvement of the financial margin increased 65.1% (compared to 2.726.713 millions account in 2005).

Capital adequacy ratio.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital adequacy ratio</td>
<td>16,5</td>
<td>18,0</td>
<td>13,4</td>
<td>12,5</td>
</tr>
</tbody>
</table>

Liquidity Risk and transformation ratios.
Those ratios are also improving steadily (see details in BM annual report 2006 p. 92 & 93)\footnote{The liquidity ratio permit to analyze the capacity of a bank to insure some of its immediate liabilities making use of highly disposable assets. The transformation ratio presents the average relation between the term of the deposits and the duration loans.}.

\footnote{The liquidity ratio permit to analyze the capacity of a bank to insure some of its immediate liabilities making use of highly disposable assets. The transformation ratio presents the average relation between the term of the deposits and the duration loans.}
3.2.5. **Credit risk.**

As mentioned before, credit risk is the weak element for the credit activity in Mozambique.

- **Credit risk level in Mozambique**

  The credit risk, historically high – improved progressively as indicate below.

<table>
<thead>
<tr>
<th>Structure of NPL portfolio</th>
<th>(in millions of MT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source: BM annual report 2006</td>
<td>Class I (&lt;3 months)</td>
</tr>
<tr>
<td>End-2003</td>
<td>44</td>
</tr>
<tr>
<td>End-2004</td>
<td>39</td>
</tr>
<tr>
<td>End-2005</td>
<td>55</td>
</tr>
<tr>
<td>End-2006</td>
<td>219</td>
</tr>
</tbody>
</table>

The year 2004 was apparently a year of radical cleaning characterized probably by an important volume of NPL rescheduling.

In all, the statistics above show a positive evolution because the major risks (class IV and VI) or intermediaries (Class II and III) decreased. An increase was only verified in the less risky class (class I) which, in 2006, was 26% of the NPL vs. 2% in 2003.

Note: See as well the paragraph “Prudential Rules” for the rules on provision (ANNEX 4b BM 7/GBM/2007).

- **Credit risk information.**

  The database CRC managed by the Central Bank contains the information of all credits. Today 20 participant institutions are sending all the credit data to the BM. The information available corresponds approximately to 100,000 clients (66.6% are clients of the 4 main banks of the country) and reach about 95% of the national credit portfolio.

  The 20 participant institutions have notably increase their consultations of the database CRC (4 times more in 2006 than in 2005) in order to improve the quality of their analysis of credit risk.
3.3. **THE LEASING SECTOR.**

3.3.1. **Introduction.**

The current study focuses on financial leasing to finance, at medium term, the investments in productive equipments. The main factors related to this leasing market's study in Mozambique are the following:

- Important progress and economic development in Mozambique during the past ten years.
- Huge potential, in natural resources (raw materials: coal, minerals, oil, gas), hydroelectric-power and in agriculture.
- Low GDP per capita and high poverty: a subsistence economy for the majority of the population; less than 10% of the active population earns a salary; 65% of the national budget is dedicated to fight poverty; important inequalities between the capital and the provinces.
- A vast process of national infrastructure construction.
- Limited national industrial production which contributes scarcely to some exports. In 2005 near 75% of exports were fuels and oils (14,5%) and metals (60,3%); most of the remaining exports were fish (4,9%), textile fibers (4,1%), vegetable products (3,7%), tobacco (2,5%), sugar (2,2%), wood (1,9%) etc.
- An economy dominated by the commercial and service sector.
- Strong dependency on imports.
- A strong dependency on foreign financial aid.
- A profound transformation process of the Mozambican economy. New culture of “market economy”.
- A strong focus on the primary sector and a small number of mega-projects: Mozal (aluminum), Moatize (coal mines), Pande Temane gas project, etc.
- A regional integration process in progress (SADC\(^{37}\): Free trade agreement between the countries of the southern African region) the consequences of which are not predictable. What will be the role of Mozambique in the SADC? Will the country have the capacity to encourage and attract foreign direct investment (in sectors other than the mega projects) in order to develop the industrial and agriculture sectors generators of employment? Or, on the contrary, will Mozambique play principally the role of supplier of raw materials and energy?
- A large informal economy and some distortions in the rules of the game (some under-valued importations of cars from Durban (RSA); parallel businesses).

Note: A new Metical (local currency: MZM or MT) was created. (See "Central bank paragraph and footnote\(^{38}\)).

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\(^{37}\) SADC : South African Development projects : One chapter of this study is dedicated to this issue.

\(^{38}\) Note: In July 2006 the Mozambican Central Bank implemented the Metical a new version of the currency (MT) by dividing the national currency by 1000. The current national currency is MT (MT=Metical or MZM) which exchange rate is between 25 and 26 MT by US $.
3.3.2. **Main constraints.**

The main constraints and issues for the leasing sector are the following:

- The rules concerning the VAT applied to leasing require clarification. The fiscal experts and independent auditors unanimously agree that the situation is unclear.
- The difficulties, obstacles and delays for the Lessors to exert their right of asset repossessing in case of default as well as the limited secondary market – these are the key constraint for credit activity in Mozambique.
- Funding difficulties for non-bank Lessors.
- High level of credit risk. Severe guarantee requirements.
- Limited and small sized local market.
- Limited reliable professional information.
- High concentration of the financial sector.
- High concentration of the leasing sector.
- Limited access to credit. Access to credit is much more difficult for SMEs than for other companies (see below Micro-finance. See banking sector: portfolio concentration).
- Banks and Lessors' interest rates are quite high. Micro-finance is even more expensive.
- Manufacturers, suppliers and vendors: locally their number is extremely reduced except in the case of cars dealers. Most equipment is negotiated directly in RSA and imported.
- Limited competitiveness of the local industries because of less favorable costs, salaries, prices and professional skills compared to the neighboring countries.
- Leasing as a financial product is barely attractive (mainly for fiscal reasons) for corporate clients in comparison with a medium term bank loan.

3.3.3. **Leasing sector.**

3.1/ **Legal framework of the leasing sector. Profound transformations.**

Basically, with the exception of the two major problems mentioned above (VAT and assets' repossess in case of default), the judicial and regulatory framework - as well as the accounting modalities for the Lessor and the Lessee – are adequate for the good functioning of leasing activities in the country.

The framework and reporting system correspond to international standards (IFRS) and regulations currently adopted in the profession.

In the same way, the Banking Act, the prudential rules, the supervision system of the Central Bank and the credit information system (Credit Registration Center) are adequate for the good functioning of leasing activities.

All the aspects above are analyzed with all details in the chapter “Legal framework” above.

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39 Small & middle size enterprises.
40 Republic of South Africa.
41 See recommendations in the next chapter.
Profound transformations in the leasing sector.

The leasing sector has gone through profound changes originated by various situations, among the most relevant are:

- The new Banking Act 9/2004 of July 21st of 2004 (changing part of Law 15/99 of November 1st 1999) and article 34 (market exclusiveness) of Decree 56/2004 of December 10, 2004 - which regulates the Banking Law – modified the shape of the sector permitting banks to enter directly into leasing contracts.

Consequently, since 2005, the leasing subsidiaries of banks have been progressively transferred to internal departments of the banks.

Before 2004, the law allowed cars dealers to finance with purchasing option the cars they sold, and prohibited this activity to the leasing sector. At that time - according to the articles 2 and 3 of the decree 45/94 of October 12, 1994 - the legislation limited the scope of leasing contracts to “productive investments or services with an intrinsic interest in the economic and social development of the country”.

Other effect or consequence of the referred law of 2004: The market “in terms of supply” is potentially fulfilled by all the commercial banks. Taking into consideration the limited dimension of the Mozambican market, the entrance of new operators does not seem easy.

- The regulation Nº 05/GGBM/2005 from May 20th 2005 imposed heavy financial provisions for credits in foreign currency (50% of credits if the client is a non exporting company). This regulation contributed to produce an important shift from real estate loans to real estate leasing.

3.2/ Historic of the leasing sector. Current structure.

The Mozambican Leasing sector began to develop in 1995 with the creation of the first leasing company (non-bank Lessor). This company dedicated itself mainly to the financing of investments in productive equipments.

In 2000 and 2001, the two main Mozambican banks entered the leasing market, each one creating, as required by the Law, its own leasing subsidiary.

In 2005, as a result of the 2004 new legislation (Banking Act Law 9/2004 and Decree 56/2004), each bank integrated its leasing activity as an internal department. One of the mentioned subsidiaries was officially absorbed by its main shareholder on Dec.31, 2005.

At the same time the legislation has enlarged the leasing market’s sphere. The new Law and the Central Bank stopped the activity of independent renting companies, in particular with regard to long term car rentals with a purchase option. Leasing companies were not clearly allowed (see articles 2 and 3 of the decree 45/94 of October 12, 1994) to perform such activity before the legislation of December 2004.

Currently, the composition of the sector leasing is as follows:

- 3 banks are active in the leasing field. Another one will start soon its leasing department.
- 1 leasing company (non-bank Lessor) that was the pioneer of the sector. This Lessor has today a very limited activity.
- 1 new independent company was authorized in November 2007.

The Leasing sector is highly concentrated. From 2005, 2 operators represent more than 95% of the leasing market.
From 3 leasing companies in 2004, only 2 remained in 2006. Nowadays, only 1 of this leasing companies remains; it is an independent non-bank Lessor and its client’s portfolio is pretty small. This company, which is the pioneer in the profession in Mozambique, had progressively found difficulties to stay afloat because of the reduction of custom duty exemptions, fiscal modifications and re-financing new limitations.

### 3.3/ Some figures of the leasing sector up to 2006.

The huge changes mentioned above, make it difficult to evaluate the leasing market. As of 2005, the leasing operations (and statistics) have been integrated into the portfolios of the banks. The 2005 annual report of the Central Bank mentions the existence of only 2 Lessors. This is technically right. However there were 3 operators as the main bank was also operating in leasing. The official portfolio of those 2 Lessors was 685.5 millions MT (2.6% of national credit portfolio, approximately equivalent to 26 millions US $). In reality, this amount represents only a small portion (around 25%) of the national leasing portfolio in 2005.

The Central Bank 2005 and 2006 annual reports and other sources do not provide official data about the total outstanding leasing portfolio and the annual volumes of new contracts, except for the second greatest Mozambican bank.

It is estimated that, at the end of 2004, the portfolio of the leasing sector in Mozambique was already close to 60 millions US $ and surpassed 90 millions US $ at the end of 2005.

The market was about 100/110 millions US $ at the end of 2006.

These figures do not include long term rental contracts (cars).

The main operator - that had around 75% of the leasing market share in 2005 - grew by more than 59 % that year and the second largest operator grew by more than 40 % the following year! These highly unusual figures have no logical relation to the real growth rate of the market which was significantly lower.

Such figures make the analysis more complicated and are caused by different technical factors such as: a) a shift, as indicated above, in the banks' strategies as a result of the regulation 05/GGBM/2005 already mentioned (ANNEX 4c), b) an effort to strengthen the guarantees of credit risk. All of these provoked an important shift from real estate loans to real estate leasing.

Moreover, the possibility offered by Law 9/2004 (article 2, paragraph 2, letter t) and the 2nd paragraph of article 37 of the Decree 56/2004, to practice “retail leasing” produced a different portfolio’s segmentation as well as new commercial priorities. It also provoked a redistribution of the whole business and an enlargement of the leasing market sphere.

The details of the segmentation of the annual new business volumes are not available. The operations to finance investments in productive equipments capable of generating employment (which was initially the central strategy fixed by the Mozambican authorities\(^{42}\)) are no longer the priority.

Some reasons are obvious. It is much easier – in the aspects of business initiation and credit analysis-, less risky and more profitable, to lease cars for instance (included luxury cars) and to lease offices rather than to lease industrial machinery.

\(^{42}\) This was mentioned in article 2& 3 of the decree 45/94 eliminated and substituted by Decree 56/2004 already mentioned.
Consequently, the possibility to offer leasing to the SMEs\textsuperscript{43} of the industrial sector is today more limited – even through credits from Micro-finance Institutions because of their very high interest rates which are incompatible with the profit margins manufactured products -.

In total the leasing sector although neither widely known nor clearly understood by many people in Mozambique, reached - for exogenous reasons- very good levels of volumes and profits thanks to the high local margins.

3.3.4. Economy and leasing. Market forecast.

With the entrance in 2007 of two new banks into the leasing market, leasing continue to grow because all the banks are now allowed to enter into leasing contracts directly.

In addition, the newcomers are going to create healthy competition.

As medium term financing of investments in assets and productive equipments is the priority of the current assignment, the elements of reference and perspectives for the market are the following:

- The sectors that are currently being most dynamically developed by the Lessors are mainly cars leasing and real estate leasing.
- The satellite enterprises or services providers of the mega-projects will regularly and progressively require financing of investments in equipments suitable for leasing.
- Sector distribution of the economy. With the exception of the preponderant service sector, other sectors “consumers” of equipments deserve a special mention: Infrastructures construction (schools, hospitals, bridges, roads); Mining; Transportation and communications and Industry.

Mining Industry.

In 2006, the mineral production grew by about 13\% reflecting good performance in natural gas extraction (+14.9\%), marine water waste products, tourmalines, marine and condensed water, talking into account their additional value in the overall mineral productions. The re-launching of coal mining production reached 40.000 tons in 2006.

Manufacturing Industry.

Contrary to growth expectations, the manufacturing industry production grew at a moderate pace in 2006 according to BM 2006 annual report. The national industrial production contributes scarcely to some exports. In 2005: a) near 75\% of exports are minerals (fuels, oils: 14,5\%) and metal (60,3\%); b) most of the remaining correspond to fish (4,9\%), textile fibers (4,1\%), vegetable products (3,7\%), tobacco (2,5\%), sugar (2,2\%), wood (1,9\%) etc..\textsuperscript{44}.

Construction.

In overall, "construction indicators pointed out to 23.6\% growth, which revealed the authority's ongoing efforts toward the effective implementation of public investment for infrastructure development, namely, the construction of bridges over the Zambezi, Limpopo and Lugela rivers, as well as the road widening works in the national road – and the rehabilitation of schools and

\textsuperscript{43} Small & middle size enterprises.

\textsuperscript{44} INE statistical yearbook 2005, pages 107/8/9.
hospitals'. The roads network represent a huge potential. According to INE, the network is as follows:

<table>
<thead>
<tr>
<th>Road Network</th>
<th>Paved roads</th>
<th>Gravel roads</th>
<th>Dirt roads</th>
<th>Total</th>
<th>Primary roads</th>
<th>Secondary roads</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 &amp; 2006</td>
<td>5.523</td>
<td>7.578</td>
<td>21.430</td>
<td>34.331</td>
<td>5.870</td>
<td>4.792</td>
</tr>
<tr>
<td>%</td>
<td>16 %</td>
<td>22 %</td>
<td>62 %</td>
<td>100 %</td>
<td>--</td>
<td>--</td>
</tr>
</tbody>
</table>

Sources: INE statistical yearbooks 2004, 2005, 2006 condensed

Hotels and Restaurants. Hotels and restaurants recorded a 15.2% growth in 2006. This sector deserved investors preference, as 116 investments projects were approved during the financial year ended, corresponding to a 60% growth (ANNEX 7a). The investments' amount approved totaled nearly US $ 615.8 million (BM annual report 2006).

Transport and Communications. The transport and communication sector grew by 21.2% in 2006. This growth was driven by communications, road and air cargo transport services.

- Imports.
  - The total imports (goods, equipments, vehicles, others, etc.) presents an average growth of 15% yearly over the last 5 years and passed from 1.753 millions US $ in 2003 to 2.585.5 millions US $ in 2006. In 2007 the total imports were approximately 2.844 millions US $ and are estimated to reach 3.785.4 millions US $ in 2010.

  Total imports would not continue to present the accelerated growth of the period 2003/2005 but will continue to grow at a rhythm of 6% to 10% per year until 2010.

  Equipments' total imports. From 2003, the equipments' total imports showed an average 16% annual increase.

  The imports of equipments for the mega-projects will slow down because the principal mega-projects are almost completely implemented. However, this should not affect the leasing market because the funding for these mega-projects was already included in the main foreign financing package (at interest rates much more inferior than the local ones). Moreover, other mega-projects are being planned and could offset this situation.

  The majority of the equipments and vehicles are imported (mainly from RSA).

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45 BM annual report 2006.
47 Sources: Mozambican public offices (INE & Customs).
49 Sources: IMF country report 2007, IMF projections and estimates, our staff own estimations.
50 Republic of South Africa.
Selected equipment imports. Official imports’ statistics of a selected list of equipments appropriate to be financed through leasing, had a growth superior to 18 % per year for equipments and more than 20% to 22 % per year for vehicles. However, the official statistics have to be taken into consideration cautiously because the real volume and the growth rate are more important than indicated above.

The motors vehicles’ imports deserve a special mention: the growth observed in motor vehicles in 2006 was superior to 38,5% (BOP bulletin/June 2007/DEE-BM).

<table>
<thead>
<tr>
<th>Equipments imports</th>
<th>in millions US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>442,0</td>
<td>476,5</td>
</tr>
</tbody>
</table>

Sources: Mozambican public offices (INE & Customs) & our staff projections.

- Conclusion: In the forecasts for 2007/2010 it is reasonable, for “equipments appropriate to be financed through leasing”, to use a conservative growth rate of 10 % per year.

- Gross domestic investment (Non government).

Private investments on 5 years had a growth rate estimated in 20 % per year. The former FBCF statistic (FBCF: Gross Fixed Capital Formation) is not available for all the considered years.

Between 2004 and 2006 investments increased from 17,6 billions MT to 26,9 Billions MT.

Private investments will probably surpass the 30 Billion MT in 2007 and are expected to be about 54 billions MT in 2010\(^{51}\).

<table>
<thead>
<tr>
<th>Gross domestic investment (non Gov.)</th>
<th>in millions MT</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 598</td>
<td>20 770</td>
</tr>
</tbody>
</table>

Sources: IMF country report 2007 (based on table 1 & 2 data), BM (Banco de Moçambique), IMF projections and estimates.

FDI. See also:
- § 3.1.4 Foreign Direct Investments above.

- Credits to the economy.

The credit to the economy evolved between 2004 y 2006 from 13,5 billions of MT to 27,4 Billions MT.

In 2006 the credit to the economy figure increased 29%.

It is estimated to be 35,9 billions MT approximately in 2007 and 71 billions MT\(^{52}\) in 2010.

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\(^{51}\) Sources: IMF country report 2007 (based on table 1 & 2 data), BM, IMF projections and estimates.

\(^{52}\) Sources: IMF country report 2007, BM (Banco de Moçambique), IMF projections and estimates.
Within the figures of credit to the economy (non government), the leasing sector reached an interesting level but it was for the exogenous reasons already mentioned.

<table>
<thead>
<tr>
<th>Credit to the economy (non Gov.)</th>
<th>in millions MT</th>
</tr>
</thead>
<tbody>
<tr>
<td>13 512</td>
<td>21 215</td>
</tr>
</tbody>
</table>

Sources: IMF country report 2007, BM (Banco de Moçambique), IMF projections and estimates, our staff estimates and projections.

- Forecast.

Taking into account the different references mentioned and the advice of the local and foreign experts, the leasing market in Mozambique is estimated in approximately 130 millions US $ in 2007 and would reach approximately of 200 to 220 millions US $ in 2010.

The final figures will probably be superior because of the real estate leasing high incidence, a Mozambican specific factor of the present period.

According to local specialists, within the total volume of leasing, the retail leasing share (mainly cars' leasing) represents today more than 15 % of the outstanding portfolio. In terms of new business in 2006 and 2007, cars' leasing represented around 40 % of the total amount (around 60% in number of contracts) while real estate leasing represented 30 % and will probably decrease to 20 % at the end of the period.

- New entrant Lessors opportunity.

The licensing process does not seem easy and rapid. A minimum capital of 1 million US $ will be required as well as an excellent business plan.

The main market barrier is the high supply potential of the market. Because of a limited market, banks can today enter at any moment into leasing contracts and they potentially fulfill the market in terms of supply. Hence, taking into consideration the limited dimension of the Mozambican market, the entrance of new operators does not seem easy.

The other difficulties are presented above in this report: clarification of VAT issue, improvement of the leasing legislation (Decree 56/2004), solution to the bad debts collection difficulties and assets repossession in case of default, etc...

As the legal and fiscal framework does not contain much favorable elements to the development of the leasing sector, an investor group will probably prefer to invest in similar activities not governed by the "Financial sector's laws and decrees", instead of investing in a leasing company submitted to numerous legal and regulatory constrains and with few advantages. However, none of the mentioned difficulties are unsolvable. The market is opened and spreads are very attractive. The key factors for success for a newcomer will be: highly committed shareholders, a highly skilled team, own funds well above 1 million US $, significant stand by credit lines and preferential interest rates (see below Conclusion # 8 and recommendation).

53 According to the 3 main leasing operators verbal indications.
3.4. CONCLUSIONS AND RECOMMENDATIONS.

- The forecasts indicated above, compared with the dimension of the Mozambican economy, the portfolio of credits of the banking sector (commercial banks) and the other parameters cited above, indicate a very good performance of the leasing sector which is exceptional compared to the current development stage of the country.

- The possibilities to finance the SMEs via leasing are limited.

- “Retail leasing” is becoming more important than “leasing for investment in productive equipments”. The timing for authorizing retail leasing in the legislation of late 2004 would correspond more preferably to: a) countries that have reached a stage of economic and social development no yet reached in Mozambique (for instance, a country like Portugal did not take such a step until later in its economic evolution); b) countries with a track record of lower inflation rate.

- The changes to the legal framework mentioned above were made without substitutive measures to promote investment in productive investments.
  
  Recommendation: it would be important to establish a substitutive formula in order to give again some priority to leasing for investment in productive investments.

- The VAT problem is now widely known.
  
  Recommendation: it would be highly advisable to do a follow up with the authorities on this issue.

- The recommendations about the legal framework need to be discussed in depth and the assets’ repossession issue needs to be addressed.
  
  Recommendation: it would be advisable to make a follow up on these two main issues.

- Development of non-bank Lessors is advisable.
  
  Recommendation: The development of two or more non-bank leasing companies would be an advisable solution to promote investment in productive equipment even if it seems difficult in the actual context.

- Credit lines dedicated to priority sectors a) in local currency (MT), b) with low interest rates, c) with specific criteria of credit risk, d) with rigorous monitoring of the application of the funds, e) with efficient rentals’ collection, could be a positive contribution to the economic development of the country.

- Human Resources and technical competencies: It is important to highlight some lack of experts in certain areas of management and in the day-to-day leasing activities. It is also important to highlight the high potential for improvement of the current human resources.
  
  Recommendation: technical assistance (TA) would be useful through the organization of seminars to form and strengthen the understanding of the leasing profession (which is very different, in many aspects, to the banking profession), its commercial methods and its role in the economy of the country.

- "Public awareness”.
  
  Recommendation: It would be useful to organize 3 or 4 information seminars to present the day-to-day business of leasing companies, the leasing product, the “modus operandi” and the contractual documents: a) for the general public, b) for professionals (for example lawyers), c) for the existing leasing teams who do not have enough knowledge yet about
the whole profession or of some specific fields (in particular tax issues) and d) for public servants (in particular Court civil servants, Central Bank managers, public register servants, etc.).

- Review.

  Recommendation: A brief yearly review would be advisable about: a) the priorities fixed to the leasing sector (adaptation of its definition in the law); b) the treatment of VAT; c) the implementation of the recommendations on the legislations; d) the qualitative evolution of the market and its commercial orientation (priorities).

- In conclusion, the future of the sector depends on:

  - The evolution of the role of Mozambique in the process of economic regional integration (SADC).
  - The clarification of the VAT problem and some articles in the current legislation.
  - The solution of the equipment’s repossessing problem in the case of NPL.
  - The development of non-bank lessors.
  - The redefinition of the priorities that should be fixed for leasing in a country that worries about its economic and social development.
  - The reduction of interest rates and improvement of access to credit.
  - A steady and strict follow up of all those topics.
  - Technical assistance (professional training).
  - A public awareness’ campaign targeted to common business stakeholders as well as high level managers.
ACKNOWLEDGMENTS

Many thanks to all those persons who kindly shared their time with our team and for their helpful contributions.

SOURCES.

The following documents were used among many other documents:

- The Banking Act 15/99 (Annex 1a).
- The Central Bank prudential rules (Annex 4b).
- The Constitution and documents related to the land property (Annex 4a, b, c, d)
- The VAT Code.
- The Bulletin BOP 2006 of the BM.
GLOSSARY - ABBREVIATIONS.

ADB  African Development Bank  
AMORTIZATION  Reduction of the outstanding balance of a debt. 
BM  Banco de Moçambique (Central bank).  
BOP  Balance of Payments 
CPI  “Centro de promoção de Investimentos”, Investment Promotion Center  
CPI-U  Consumer Price Index- Urban (ie Maputo)  
HICP  Harmonized Index of Consumer Prices  
DEPRECIATION  Periodic fiscal offset to income in order recover the amount of a purchased asset.  
FDI  Foreign Direct Investment (IDE : Investimento Directo Estrangeiro).  
FULL-PAYOUT ASSETS LEASING  Financial leasing contract of investments in productive assets that permit the Lessor to collect 100% of the financed Capital.  
GDP  Gross Domestic Product  
HIPC  Highly Indebted Poor Countries  
IMF  International Monetary Fund  
IMM  Interbank Money Market  
IRPC  Corporate Income Tax (Imposto sobre rendimentos das pessoas Colectiva).  
IRPS  Individuals Income Tax  
LA  Loans and Advances  
Lessor  Credit institution specialized in leasing operations. 
Lessee  Customer of a Lessor and user of a leased asset. 
MDRI  Multilateral Debt Relief Initiative  
MLTL  Medium and long term loans  
MT / MZM  Mozambican currency : Metical. 
PARPA  Plan of Action for the Reduction of Absolute Poverty : see PRGF  
PRGF (PARPA in portuguese) : A) PRGF = Poverty Reduction and Growth Facility. 
PURCHASE OPTION  : Option .given to the Lessee to buy the leased Asset at the end of the leasing contract provided that the Lessee paid all the rentals, the expenses and has fulfilled all its obligations.  
“PROVIDENCIA CAUTELAR (in Portuguese)” : Procedure for Assets’ repossession. It is a fast and effective non judicial process. Basically, it is an “order issued by a judge outside of court proceedings”.  
RESIDUAL VALUE  Amount to be paid by the Lessee to buy the leased asset from the Lessor to exert the buying option at the end of the leasing contract provided that the Lessee paid all the rentals, expenses etc…  
SADC  Southern African Development Community  
SARB  South African Reserve Bank  
SME  Small and medium sized company.  
STL  Short term loans.  
VAT  Value added tax (in Portuguese IVA (imposto sobre o valor agregado). Currently 17%.  

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