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The creation of MGF should not exempt the need to review monetary policy, which remains suffocating for the private sector

- A Mutual Guarantee Fund (MGF) is being constituted as part of the 20 measures presented by the Executive branch in August 2022, to promote economic acceleration. However, it is important to recognize that the fund alone is not enough to solve the financing challenges faced by Mozambican Small and Medium Enterprises (SMEs).

While financing at affordable rates through the future MGF is an important step, it could marginalize a significant part of the private sector and limit the achievement of the objective of accelerating the economy. To effectively face these challenges, the Central Bank must review the overly restrictive stance of monetary policy and improve coordination with the Ministry of Economy and Finance.

Within approximately four months, the Office for the Coordination of Economic Reforms (GCRE), the executive branch of the Ministry of Economy and Finance (MEF), will conclude the process of setting up the long-awaited Mutual Guarantee Fund (MGF).

This is a promise made in response to one of the main obstacles reported by Mozambican SMEs, namely poor access, and the high cost of financing. It will be the first MGF created by the Government of Mozambique and it is estimated that, in an initial phase, it will be valued at USD 250 million. The Executive branch is optimistic concerning this reform, as it foresees that banks will, as a result, make more financial resources available at more accessible interest rates than those that are normally applied in the national financial system - considered to be among the highest of the African continent.

The problem of poor access to credit in Mozambique results from the restrictive monetary position adopted by the Central Bank since the beginning of 2021, which has resulted in the worsening cost of bank loans to overwhelming positions, making it almost impossible to obtain a loan for viable investment.

It is worth remembering that the MGF is introduced as one of the 20 measures of the Economic Acceleration Package (PAE), instituted on August 9, 2022, in response to the structural weaknesses of the economy in the context of successive internal and external shocks. Shocks include the effects of climate change, violent extremism in the north of the country, the COVID-19 pandemic, and more recently, the conflict in Ukraine.

Although the introduction of the MGF is a positive measure, this article argues that it will not be enough for the fund, by itself, to establish sufficient bases to reactivate the economy as intended, therefore, the monetary policy must review the position finance in the banking sector.

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Companies go through credit restrictions in times of weak economic performance

Credits: Club of Mozambique

Data from the National Institute of Statistics (*Instituto Nacional de Estatisticas*, INE) indicate that the Economic Climate Indicator (ECI) has shown negative signs, meaning unfavorable economic performance. This result is dictated by the outlook for demand and employment, which have been registering consecutive declines. Demand reached the lowest level of the last three quarters, while the employment perspective indicator continued to fall in relation to the previous quarter, keeping both balances below the average of their respective historical series.

While the business sector has been operating below its potential, the restrictive policies adopted by the Central Bank further restrict demand and prevent companies from accessing financial resources for investment through increases in interest rates.

This fact has already been presented several times by companies, so much so that at the opening ceremony of the IX Business Environment Monitoring Council (CMAN), the Confederation of Economic Associations of Mozambique (CTA), representing the private sector, said that the reference interest rate applied within the framework of monetary policy, in addition to raising the cost of financing and reducing access facilities for SMEs, constitutes a barrier that impedes the competitiveness of the business sector.

The Central Bank has already had room to lower interest rates[1] and act through unconventional monetary policy measures to stimulate aggregate demand and employment. However, the regulator preferred to remain rigid in the interest rate cuts, assuming a position of super-protectionism.

The main criticism of the model adopted by the Bank of Mozambique has to do with the fact that, even in periods of the threat of inflationary shocks caused by constraints on the supply of goods and services, the Monetary Policy Committee (CPMO) does not hesitate to restrict the aggregate demand,

[1] https://cddmoz.org/wp-content/uploads/2021/05/Banco-de-Mocambique-deve-reduzir-as-taxas-de-juro-de-referencia-para-estimular-a-recuperacao-economica.pdf

forcing a lower price level, ignoring the implications for the private sector and employment.

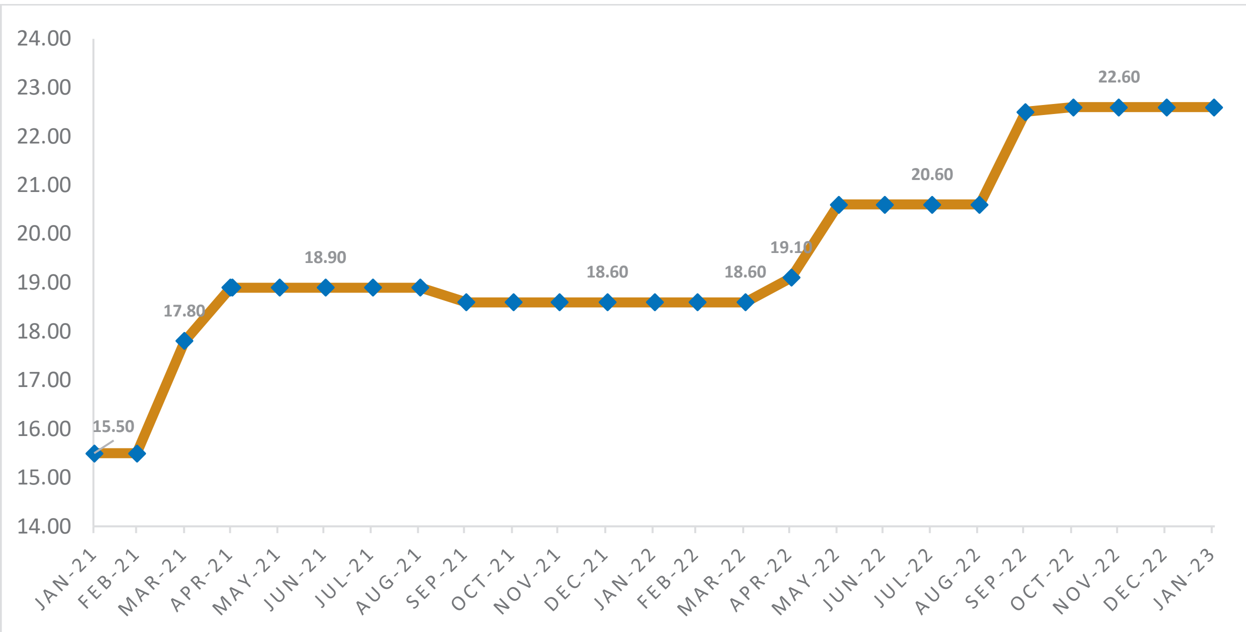
Even more worrying is the uncoordinated action between monetary and fiscal policy. In a context in which inflation is a global problem and the Central Bank has raised rates to historic levels, the current State accounts have registered significant increases in operating expenses, mainly with salaries and wages, resulting from the implementation of the Single Salary Table (Known as TSU – *Tabela Salarial Única*), acting contrary to the objectives of price stability. This pressure on current expenses should increase even more during the current year[2], as a result of the ongoing adjustments at the TSU, the increased need for resources to face the impacts of climate shocks, as well as expenses with goods and services associated with electoral processes.

This also concerns the excessive use of domestic public debt, with debt charges rising sharply due to the nature of domestic borrowing – which is highly costly. The forecast is that the internal sources of financing will be more pressured in the short term, given the limited access to external sources and the weak disbursement of resources by the cooperation partners[3].

As a result of this clash between monetary and fiscal policies, the Bank of Mozambique acts in an even more restrictive manner. As can be seen in the graph below, the *prime rate* - the single reference rate for variable interest rate credit operations - rose from 15.5% to 22.6%, showing a leap of around seven percentage points. This rate ranks in *the* top 10 highest lending rates on the African continent.

That is why the private sector asked the Government to urgently create the MGF to improve access to financing options and diversify the financial conditions of the business sector. Although the low-interest rates of the future MGF are expected to be beneficial, they will obviously not be enough to meet the financing needs of a large part of the

Chart: *Prime Rate (Jan 2021 – Jan 2023)*



SMEs in the country.

To achieve its main objectives, the Government must prioritize coordination between fiscal and monetary policies, as well as review the current position of monetary policy. After all, the Bank of Mozambique had already promised last year that it would gradually restore rates to single digits, following the resumption of external aid by cooperation partners. This promise must pass into a concrete plan of action because what has been witnessed is an opposite scenario, with rates driving weak economic activity and unemployment.

[2] BM. (2023). Economic Scenario and Inflation Prospects. Maputo: Bank of Mozambique.
[3] Idem

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