

FINANCIAL SECTOR WORKING GROUP REPORT

A – EXECUTIVE SUMMARY

Overall performance in 2005 was mixed with limited progress against the 2005 PAF targets but positive developments in the sector and good prospects for reaching the 2006 PAF targets.

The forensic audit of the Banco Austral was completed but the Bankruptcy Law and Social Security Law have not yet been submitted to Parliament. The BIM strategy had to be revised, and the actuarial study of the INSS delayed to accompany information needs. However, all 2006 PAF targets are expected to be reached except the actuarial study, which will not be completed within 2006.

The banking sector shows positive developments with 48% nominal credit growth relative to 2004, and a reduction in average interest rate spreads from 13.8% to 10.8%. The share of non-performing loans improved from 6.5% to 3.8% in 2005. The microfinance sector saw 27% growth in client numbers and 37.5% nominal credit growth. 54 percent of microfinance clients are women. The number of banking branches increased from 204 to 219, of which 45% are in Maputo province. The microfinance sector has a new licensed operator and is opening up more branches, particularly in the Central and Northern provinces. INSS Social Security coverage increased from 9.2% to 10.3% of the economically active population, but there was a decrease in the number of beneficiaries and active contributors.

B - PAF PERFORMANCE 2005

1. The forensic audit of the Banco Austral was completed in January 2006 and the report has already been handed over to MoF.
2. The LFL (Bankruptcy Law) has already been drafted and submitted to the Counsel of Ministers for appraisal. However, the parliament has not yet approved it.
3. A strategy for the government to give up its shares in banking system has been worked out and submitted to the treasury. Because this process is going to be gradual, a chronogram of implementation activities is expected.
4. The Social Security law was initially discussed and approved by the Council of Ministers in 2004 with some recommendations. However, the government that came into office after the 2005 elections recommended a review to the law in order for it to be in line with the Government's programme. This explains why the law has not yet been submitted to the parliament in accordance with the timetable previously designed. The law has now been reviewed and submitted to the Council of Ministers for appraisal.

5. In 2002, INSS commissioned work on the actuarial study. However because the database was manual, and therefore unreliable, INSS was requested to computerize all its information so that a more trustworthy actuarial study could be produced. Thus, in February 2004, INSS started a global computerization process. According to the initial timetable this process should have been finalised in August 2005. The actuarial study was expected to have started end of 2005 in accordance with the PAF target. However, the computerization process did not go as planned; it is still underway. Thus the actuarial study is expected to start end 2006 when a reasonable data base should be available.

C – SECTOR PERFORMANCE IN 2005

1 . The Banking Sector saw 48 % credit growth in Metical terms, partly because of the depreciation of the metical. The solvency ratio fell from 18.7 % in 2004 to 16% in 2005, following the depreciation of the metical which affected significantly the assets of the institutions, on the one hand, and due to the negative performance of some institutions on the other hand. The share of non-performing loans improved from 6.5% in 2004 to 3.8% in 2005.

In 2005 there were 219 bank branches, of which 45% in Maputo province, against 204 in the year 2004. The modernisation of the payment system, boosted the national financial system; it became more secure and dynamic through the introduction of ATM and EFT/POS in most parts of the country. By 31 December, 2005, there were 746.724 debit cards in circulation, 2.035 EFT/POS and 334 ATMs across the country.

2 . At the level of micro-finance there was a growth in deposits, credit, and the number of clients compared with 2004, corresponding to 17.1%, 37.5% and 27.3% respectively. This was influenced by the entrance of new operators in the market.

3. The number of microfinance operators has been fairly stable at 52, but some reorganization has happened as a new microfinance institution (MFI) was created out of the portfolio of smaller ones. The new operator, Banco Oportunidade, also received a banking license, bringing the count to 3 MFIs with banking licenses. It is expected that the new entrant (who has a focus in the provinces) will show strong growth and enlarge the current group of leading 3 MFIs (who have 75% of the market in portfolio size) to a 4th operator.

The provincial perspective shows that the development of microfinance outside the capital is increasing as the number of operators and branches in the Central and Northern provinces are growing. Nevertheless, there is still a big under-supply due to the higher costs involved for operators (transport, security, communication). There are about 24 operators active in Maputo and 6 in Gaza, while there is no other province with more than 4 operators.

4 . The continued enrolment of the labour force on the INSS has resulted in an increase in the number of economically active people covered by the social

security system. On the other hand there was a decrease in the number of beneficiaries and active contributors from 2004 to 2005, due to the pull out of some companies as well as treasury related difficulties and the adjustments made on the INSS data base.

5 . In terms of gender microfinance operators show that a big percentage of financial service beneficiaries are women, with some operators ranging from 95% to 100%, with an overall average of 54%.

D – PERSPECTIVES

For the PAF 2006, the financial sector working group, set 5 goals, 5 actions to be taken and 3 objectives, related with the improvement of the financial intervention including those targeted at micro, small and medium enterprises and households that do not have access to a commercial bank, improvement of insurance and social protection sector and strengthen the responsibility of the banking sector.

In accordance with the current progress in the implementation of actions planned for 2006, the achievement of at least 4 targets, leaving the conclusion actuarial study on the social security for 2007.

It is also expected that by the end of the forth quarter of the regulation of funds for private pensions will have been drafted. Its approval depends on the approval of the law of Social Protection.

Annex tables:**Table 1: IMPACT INDICATORS FOR THE FINANCIAL SECTOR**

<u>BANKING SECTOR</u> (Millions of Contos)	<u>2004</u>	<u>2005</u>
- Solvability Ratio	18,65%	16,00%
- Client Deposit	30 009 695	37 740 321
- Total credit	13 245 230	19 555 135
- Deposit loan transformation rate	44,58%	52,62%
- Non-performing loans	868 404	757 460
- Non-performing loans/total credit	6,46%	3,80%
- Average lending interest rate	23,67%	19,05%
- Average savings interest rate	9,9%	8,23%
- Interest rate spread	13,77%	10,82%
- Public Credit registry coverage (%adults) (1)		0.8%
- Private credit registry coverage (%adults) (1)		0%
- Ease of getting credit (rank) (1)		70
<u>MICROFINANCE</u>		
- Client deposits	129 800	152 057
- Net credit outstanding	290 458	399 381
- Number of clients	54 494	69 385
<u>INSURANCE AND SOCIAL PROTECTION</u>		
- Insurance premiums (% GDP)	0,88%	0,88%
- Social security coverage (% economically active population)	9,2%	10,30%
- Number of registered participants (% private workers)	34,0%	37,3%
- % Active contributors to INSS		
1. Active Beneficiaries	30,4%	26,30%
2. Active Contributors	51,3%	46,30%
- Time taken for processing and payment of benefits (INSS)		
1. Pensions		51 days/case
2. Death benefits		29 days/case

Table 2: Status PAF 2005 targets

	Objective	Action	Target	Status
Financial system	Strengthen accountability in the banking sector	Conduct a financial audit of BAu commissioned through PGR	Finalised	The audit was concluded
	Improve financial intermediation including for micro, small, medium enterprises and unbanked households	Strengthen institutional capacity of BdM and other regulatory authorities	Approval and issue of LICSF regulation	The LFL was submitted to the Conselho de Ministros for approval. The regulations will be elaborated after approval of the law
		Implementation of BIM strategy, GoM interest brought to point of sale	√	The strategy was concluded. Implementation will start in 2006
	Improve insurance and social protection sectors	Improvement of social protection system	Submission of proposal of social protection law to Parliament	The law was deposited with the Conselho de Ministros for approval
			Beginning of actuarial study of social security system	The restart of the study is foreseen for the last trimester of 2006

Table 3: Prospects for reaching 2006 PAF targets

	Objective	Action	Target	Status
Financial system	Improve financial intermediation including for micro, small, medium enterprises and households without access to commercial banks	Reinforce the supervision capacity of the BoM	Submission of LFL legislation to Parliament and issue of regulations	Will be achieved
		Implement IFRS in the financial sector.	New chart of Accounts and tax regulations issued	Will be achieved
		Strengthen micro and rural finance institutions.	Prudential regulations published	Will be achieved
	Improve insurance and social protection sectors	Improvement of social protection system	Actuarial study on social security system concluded	Completion will be in 2007
	Strengthen accountability in the banking sector	Carry out a forensic audit of Bau through the AG's office	Follow-up action is taken	Follow-up action will be taken (permanent action)