

Mozambique Risk Outlook, May 2020

In this month's issue, Zitamar Consulting will look at:

- 1) The latest developments in the Cabo Delgado conflict — insurgents, the government response, and involvement of mercenary groups
- 2) Expected delays to Area 1 and Area 4 Mozambique LNG projects
- 3) Mozambique's economic outlook in the context of covid-19

Alternative topics would have been:

- 4) Covid-19: how effective have the government's measures been, what can we expect over the next few weeks?
- 5) The drugs trade in Mozambique: what is the significance of Fuminho's capture?
- 6) Analysis of the new advisors appointed to the President and Prime Minister
- 7) Update on the payments of the "hidden debts"
- 8) New tactics of the Renamo Military Junta

Analysis

1. The latest developments in the Cabo Delgado conflict — insurgents, the government response, and involvement of mercenary groups

In Cabo Delgado, the last month has seen a new evolution in the conflict between ISIS-associated insurgents and the Mozambican government. On the government side, the search for effective external counterinsurgency partners continued, with Maputo turning from Russia to sources closer to home to improve their aerial capability. Dyck Advisory Group (DAG), a security company led by Zimbabwean Lionel Dyck, took on a short-term contract of up to three months, to provide three helicopters to the government's effort. DAG immediately lost one of the helicopters — a Westland (Sud Aviation) 341B Gazelle AH1 registered to a company co-owned by former Executive Outcomes mercenary Cobus Claassens — after small arms fire forced an emergency landing. No one was hurt, but ISIS later released photos of insurgent fighters celebrating on the charred remains of the helicopter.

The introduction of DAG reflects an urgency on the government's part to halt the insurgency's growing momentum. Having graduated from night raids and village burnings, the insurgency occupied the strategically located towns of Mocimboa da Praia, Quissanga, and Namacande (Muidumbe) for short periods, easily brushing aside government resistance in the three district capitals. In addition to gathering weapons and medical supplies, the insurgents used their time in control of the towns to launch concerted public relations efforts. They distributed food and cash, swore to avoid civilian casualties, and preached a new form of governance for the occupied areas, based on Sharia law. These short shows of strength and political messaging, reminiscent of Somali Al Shabaab's *kormeer* tactic during its territorial expansion, offer the insurgents a low-cost method to expand their base and deter civilian collaboration with the government.

The Mozambican forces also claim to have killed 129 insurgents between 7-13 April, in Muidumbe and Ibo districts — though these operations appear to have come at a heavy civilian cost too. News reports and opposition party Renamo claim that the Defence and Security Forces killed civilians, not insurgents, in their operations on Ibo and Quirimba islands - something which has been strongly denied by the government. The government says a successful operation in Muidumbe district, where they claim to have killed 39 insurgents, is what led insurgents to take revenge on the village of Xitaxi, massacring 52 young men there.

However, the DAG-supported counter-insurgency effort's biggest success so far may be turning back an offensive on Metuge district, north of Pemba, the provincial capital, in the last week of April. There were conflicting reports suggesting DAG also got a ground unit to support the helicopter operation, as well as using reconnaissance from South Africa made drones.

At strategic level, after indecision on how to characterize the “enemy forces” — the government was reluctant to admit there was any Islamic element to the insurgency because members of the Muslim community provide funding for the Frelimo party — the National Council for Defence and Security announced the country was facing an external aggression from ISIS. This move prompted a meeting between President Filipe Nyusi and Zimbabwe president Emmerson Mnangagwa, who is the head of SADC Defence and Security body, potentially signalling regional involvement in the conflict.

This was a month of mutual escalation. The jihadist insurgency now appears to be moving in bigger units and using speed boats to attack islands close to the coast. Meanwhile, the involvement of a foreign force has clearly boosted the morale of government troops, and a number of conscripts have been sent for training in counter-insurgency tactics.

We predict an escalation in the violence in the three month outlook, with coastal areas between Mocimboa da Praia and Pemba being particularly at risk.

2. Expected delays to Area 1 and Area 4 Mozambique LNG projects

The Afungi LNG project has become the hotspot for covid-19 in Mozambique, and so work on Total's site has been cut back to the minimum: security, logistics, and the services needed to maintain the camp in some readiness for the restart of activities.

Even before the coronavirus lockdown, logistical operations at the site had been complicated by heavy rains, which washed away key bridges in the province; and the concern over a more violent insurgency. However, the aerodrome that started operating at the site in February has made it cheaper and safer to bring staff into the site, and a second pier means more goods can be brought in by barge, rather than relying on the road.

Despite the challenges, work on the debt-financing for the \$20bn project is "moving well," according to one banker involved in the deal. Total is still aiming to make financing close on the project before the end of June. While the French oil major has said it will slash £3 billion from its 2020 spending plan, the Mozambique LNG project should not be impacted by this. First LNG exports are still expected in 2024.

In a recent report, S&P Global Platts analysts estimated that, with low oil and LNG prices, Exxon would delay start-up of its Rovuma LNG project until 2030, which would mean taking FID around 2025. However, this estimate looks too pessimistic. Deadlines set under the exploration and production concession contract means Exxon has to take FID on the project by 2024, or it loses the concession. However, it's unlikely Exxon will want to wait this long, and fall too far behind Total. Instead, the US supermajor will pressure EPC contractors JGC-Fluor-Technip to reduce costs further.

The schedule for the start-up of the Coral FLNG ship still looks on track for 2022. The Saipem 12000 drillship under contract to Eni has left the Coral South field [for maintenance in Maputo](#), but while drilling activities have been "rescheduled" by covid-19, this shouldn't impact project milestones, according to Eni.

We predict that Total will reach financial close by the end of Q3 2020. We predict that Exxon will delay FID until at least 2021.

3. Mozambique economic outlook

The seriousness of the coronavirus outbreak for Mozambique's economy is obvious from the scale of the response from the IMF, which has provided a \$309m Rapid Credit Facility (RCF) "to help Mozambique meet urgent balance of payment and fiscal needs stemming from the pandemic." The amount dwarfs the \$118.2m RCF the IMF lent last year for cyclone recovery, and is even greater than the \$282.9m Standby Credit Facility it granted Mozambique in 2015 — which was cancelled a few months in due to the 'hidden debt' revelations.

President Nyusi listed three major export commodities whose prices have fallen drastically: gas, by 30%, aluminium, by 9.1%, and oil, by 14%. He did not mention coal, whose price is down around a third on average since the start of 2020. Vale, Mozambique's biggest coal exporter, says its storage facilities in Mozambique are now full, as global demand for the commodity has dried up. The Bank of Mozambique also pointed to graphite and heavy sands as areas of concern. The Syrah graphite project has stopped producing since travel restrictions were put in place in Mozambique.

The Bank of Mozambique has foreign exchange reserves for six months' worth of imports, which — according to a Standard Bank note last week — it is likely to use to support fuel imports and the government's external debt service. Note, however, that Mozambique is receiving a repayment holiday from rich nation creditors through the crisis period. The central bank may also need to dip into reserves for food imports, Standard Bank said — noting too that "as a net importer of grains, there are upside risks to imported inflation as some major source markets impose export quotas." The price of rice, Nyusi noted on Monday night, has risen 33% during the crisis period.

The metical is also depreciating against the US dollar, and Standard Bank expects it to hit 70 by the end of the year. The effects of that are mitigated, however, by even greater weakness in the South African rand, which is now below 4 meticais — a major determinant for food prices, particularly in southern Mozambique.

Mozambique's own lockdown is taking a toll on the economy, of course; the IMF says significant disruptions are emerging in the services, transport, agriculture, manufacturing and communications sectors. A number of companies have already closed due to falling domestic demand — which in turn feeds into a vicious circle of higher unemployment and even lower demand. The IMF hopes its rescue package — which is a loan, albeit one on highly

concessional terms — will “catalyze” more aid from bilateral donors. These donors are still wary of giving untied aid, but if it came in the form of social protection — helping to provide a basic income, or something on Brazil’s ‘bolsa familia’ model — that could help Mozambique’s economy avoid a death spiral.

We predict that Mozambique will continue to resist a full-scale lockdown, aiming to mitigate the worst economic effects of the pandemic. Increased engagement from donors and in particular the IMF could lead to a greater focus on poverty reduction in the short term, reducing the chances of social unrest that had been feared in the case of a severe lockdown.