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- Post-Election Crisis

THE PERSISTENCE OF POPULAR PROTESTS AGAINST THE RESULTS OF THE GENERAL ELECTIONS MAY INCREASE MOZAMBIQUE'S SOVEREIGN CREDIT RISK

By: Gift Essinalo and Teresa Boene

1. Introduction

Mozambique is facing a post-electoral crisis that has lasted for more than a month since the release of the results by the National Electoral Commission (CNE), on October 24, 2024, giving a fraudulent victory to the Frelimo Party and its candidate Daniel Chapo. These results generated a wave of protest, manifested in popular demonstrations that have had a direct impact on the economy, reducing the business volume due to the restrictions on the movement of people and goods, directly and severely impacting commerce, logistics and tourism.

These protests could cause setbacks in several areas, including the sovereign credit rating[1]. The most recent assessment by Standard & Poor's (S&P), dated October 18, 2024, gave the country a highly speculative rating, keeping its external credit at CCC+ and downgrading its domestic credit to CCC. This adjustment in the domestic credit rating reflects the persistence of liquidity restrictions, in a context of high domestic indebtedness and the accumulation of arrears in payments to suppliers and contractors[2].

The persistence of the demonstrations increases the perception of sovereign credit risk[3], as the drop in business volume and increased insecurity compromise tax revenue collection targets, as well as reducing the attractiveness of Foreign Direct Investment (FDI), including capital outflows, mainly from frightened political and economic elites, and temporary disinvestment by local companies. In addition, the demonstrations may increase the pressure for a rise in public expenditure, both to cover the costs of security, the replacement of destroyed infrastructure and for social assistance for vulnerable families, which will generate additional pressure on the fiscal accounts.

Therefore, the continued post-election crisis could result in an increase in the budget deficit and, consequently, in the growing need for financing. In a climate of reduced confidence on the part of external creditors, this situation could further intensify domestic public debt, which has already reached unsustainable levels.

1 A sovereign credit rating is a ranking or classification that reflects a country's ability to fulfil its financial obligations to creditors, having a direct impact on financing costs and investors' confidence. A good rating attracts foreign investment, reduces borrowing costs and strengthens currency stability, while a low rating increases interest rates, places pressure on inflation and reduces economic credibility. It also influences the private sector and citizens' living conditions, since high public financing costs can lead to high taxes and cuts in services. Thus, maintaining a positive rating is crucial to promoting economic growth and fiscal stability.

2 Newspaper Semanário Económico (2024). Available at: <https://www.oeconomico.com/sp-global-reduz-a-classificacao-de-mocambique-para-ccc-devido-a-pressoes-de-liquidez-interna/>. Accessed on 12.11.2024.

3 For the purposes of this research, sovereign credit risk is understood as the likelihood that a government (or country) may fail to meet its financial obligations, including the repayment of external or domestic debt. This risk reflects the possibility of a country defaulting on either the interest or the principal of the debt issued to investors, both foreign and domestic. Agencies such as Moody's, Standard & Poor's, and Fitch assess this risk and assign a rating. The lower the rating, the higher the perceived risk. An increase in credit risk can lead to higher interest rates for new loans or even a withdrawal of creditors, limiting the government's options for mobilizing the resources needed to finance its expenditures.

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This text examines the risk of degradation in Mozambique's sovereign credit rating, driven by the intensification of popular protests as a result of the contestation against the election results. This analysis is based on the factors used by rating agencies such as Standard & Poor's in assessing sovereign credit ratings.

2. Sovereign Credit Risk

Mozambique is at risk of suffering a downgrade in its sovereign credit rating due to the heightened perception of risk among investors, creditors, and other stakeholders, because of protests triggered by public demonstrations against electoral fraud.

The sovereign credit rating, awarded by agencies such as Fitch, Moody's and S&P, reflects the ability and likelihood of a government to honor its sovereign commercial debt obligations within the agreed terms and conditions. These agencies classify a government as being in default when it fails to make full repayment of both capital and interest on a specific debt or instrument within the time period and under the terms agreed, including situations in which there is a coercive or involuntary renegotiation or restructuring of the debt or financial instrument to less favorable conditions for creditors, whether due to a change in maturity, coupon or interest rate, or payment currency.

Sovereign credit rating analysis generally considers the following key factors, namely: institutional effectiveness (institutional assessment), economic structure and growth prospects (economic assessment), external liquidity and international investment position (external assessment), fiscal flexibility and fiscal performance, combined with debt burden and contingent liabilities (fiscal assessment), and monetary flexibility (monetary assessment).

1. ***Institutional assessment –*** This is a qualitative indicator that assesses the capacity of government institutions and policies to ensure the sustainability of public finances, promote balanced economic growth, and respond effectively to economic and political shocks. The indicator also measures the risk of political events, such as wars, revolutions, civil unrest, or regime changes outside the constitutional framework that could jeopardize the sustainability of public finances. Additionally, it considers aspects such as respect for the rule of law, the level of political interference by institutions, the level of democratization, the concentration of power in the decision-making process, the clarity of leadership succession mechanisms, the independence of the judiciary, freedom of the press, human development, political consensus between parties and the results of previous contexts of tension.

2. ***Economic (perspective) assessment –*** these analyses economic prosperity, diversity, resilience and economic inequality, in addition to the estimated GDP per capita growth trend.

3. ***Fiscal assessment*** – it analyses revenue and expenditure performance, the budget balance, debt obligations, interest charges, off-budget liabilities and contingent liabilities.

4. ***Monetary assessment*** – measured by the behavior of basic inflation, this indicator reflects the sustainability of monetary and exchange rate policies.

5. ***External assessment –*** it assesses the capacity of the economy (including the government, central bank, commercial banks and private sector) to respond to external financial liabilities. The amount of public and private external debt, especially short-term debt, is a critical factor in external stability.

3. Analysis of the Factors that could affect Mozambique's Sovereign Credit Rating

Although all rating factors may be affected by the current wave of popular protests, in this section we highlight the aspects that the authors consider to be those that will be visibly most impacted. This element has to do with (i) political stability – linked to the institutional component; (ii) economic perspectives – related to economic assessment and; (iii) the flexibility of budgetary policy – linked to fiscal assessment.

3.1 Institutional Assessment

Political and social stability, which is generally linked to the role of institutions, is one of the main determinants of the sovereign credit rating, since it directly interferes with a government's ability to maintain a secure and predictable environment for conducting its economic policies and attracting investment.

In Mozambique's current case, the persistence of popular protests and the increase in violence associated with the post-election disputes have undermined the confidence of both the internal and external sectors in the country's governability. The insecurity generated by these protests could affect Mozambique's international image, reducing the confidence of foreign investors and increasing the costs associated with the risk of investing in the country. The persistence of these protests could also lead to greater social instability, with the potential for escalating into more serious conflicts.

Thus, perceptions of political and social instability could drive rating agencies to revise the country's sovereign credit ranking downwards, as instability directly impacts the government's ability to implement effective fiscal and monetary policies, as well as increasing pressure on the government to obtain financing at higher interest rates.

In the long term, a deterioration in political stability could consolidate an image of chronic instability, making it difficult for the country to regain international confidence even after the current crisis has been overcome.

3.2 Economic (Perspective) Assessment

The post-election crisis in Mozambique is further aggravating an economic scenario already characterized by rising poverty levels and low economic resilience.

In recent years, the country has faced significant challenges in promoting inclusive growth. With more than 18.6 million inhabitants living below the poverty line[4], a situation that has worsened due to the COVID-19 pandemic and internal economic difficulties, the current crisis makes the country even more vulnerable to internal and external shocks.

The decline in commercial flow, the weakening of tourism and the closing of businesses due to the increased violence have a direct impact on family income and employment, mainly affecting low-income populations and widening social inequality. The decline in purchasing power and the difficulty of access to formal jobs not only increases poverty levels, but also place additional pressure on the need to increase expenditure on social assistance programs.

The worsening poverty rates and the low diversification of economic growth sources limit Mozambique's ability to sustain stable growth and jeopardize its long-term prospects. This scenario is a cause of concern for rating agencies, which consider the potential for economic growth and its sustainability over time to be one of the crucial indicators when assessing sovereign credit. Should the current instability continue, it is likely that the negative impact on the country's economic prospects will be even more severe, hindering the recovery of growth and increasing the perception of credit risk.

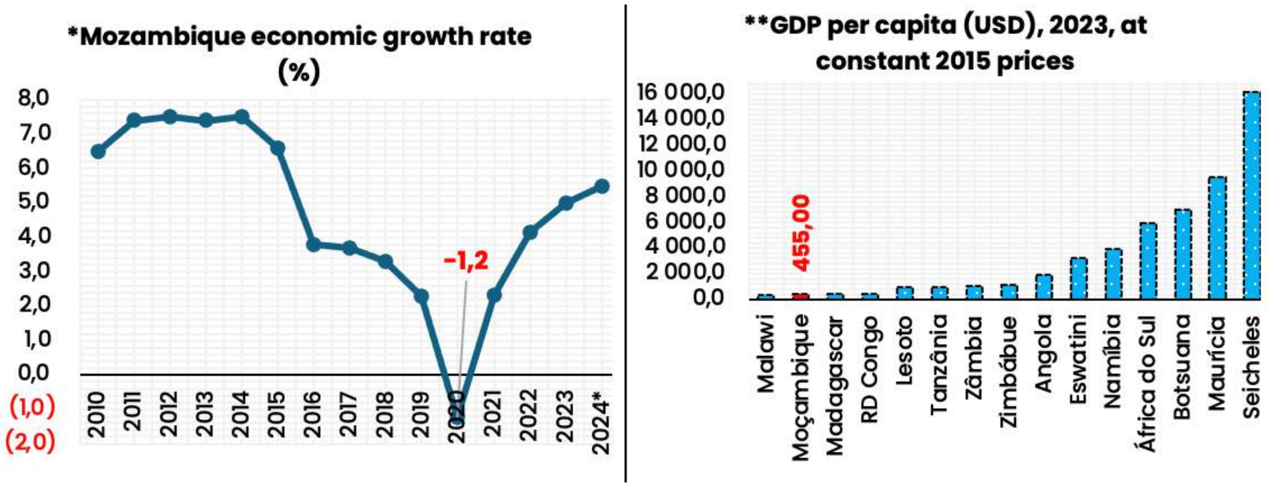
Graph 1, left, shows the evolution of economic growth and GDP per capita since 2010. The period prior to the revelation of the hidden debts was characterized by high economic growth rates of more than 6%.

With the disclosure of the hidden debts in 2013/2014, the country began to face a significant economic growth decline, which reached its lowest point in 2019, when the growth rate was negative at -1.2 per cent. During this period, the economy suffered the impacts of Cyclone Idai in 2017, followed by Cyclones Kenneth and Dineo in 2019. In 2020, the Covid-19 pandemic jeopardized the economic recovery. Since then, the economy has gradually recovered its growth rates.

The continuation of the protests following the contested election results could jeopardize this recovery, leading to a downward revision.

4 World Bank (2023), *Poverty Reduction Setback in Times of Compounding Shocks Mozambique*. Available at: https://documents1.worldbank.org/curated/en/099091123142528718/pdf/P17686006100df030b5b807d052b0ff880.pdf. Accessed on 09.11.2024.

Graph 1: Economic growth rate and GDP per capita.



Fonte: *Growth Rate – INE Statistical Yearbook, 2010-2022; CGE, 2023 and *PESOE 2024.

**GDP per capita – World Bank.

As regards the growth of GDP per capita, although data from the National Statistics Institute (INE) shows that the country is on a positive trend, Mozambique is nonetheless among the countries with the lowest GDP per capita in the Southern African region, with US$531, second only to Malawi, with US$481 (Graph 1, on the right). Despite this growth, the 2019/20 assessment of poverty, which points to the worsening of poverty conditions over the last five years, with around 62.8 per cent of the population living below the poverty line, compared to 48.4 per cent recorded in 2014/15, indicates that a significant part of the population does not benefit from economic growth, and, therefore, it is non-inclusive growth, generating social inequality and poverty.

Thus, the recent protests can be interpreted not only as a reaction to the electoral results, but also as an expression of accumulated frustration due to the lack of economic progress, deteriorating quality of life, lack of trust in government institutions, in addition to a growing perception of mismanagement or misappropriation of national resources. If the unrest and instability continue, it is likely that the economic growth projections for next year, 2025, will be revised downwards, directly impacting the country's sovereign credit rating.

3.3 Fiscal Assessment

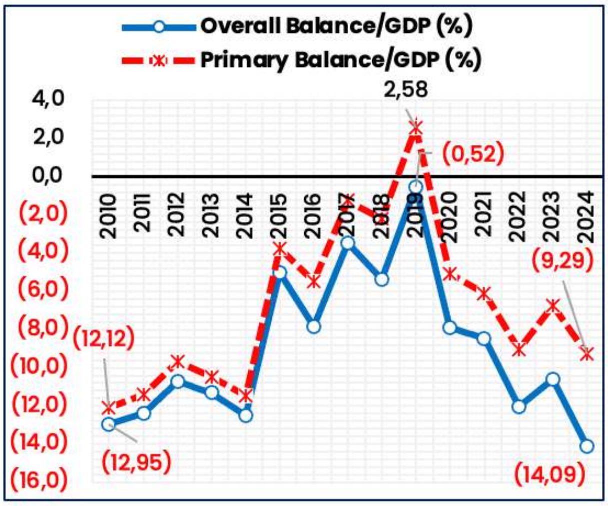
Budgetary flexibility refers to the government's ability to adjust its revenues and expenditure to meet financial obligations and react to economic emergencies.

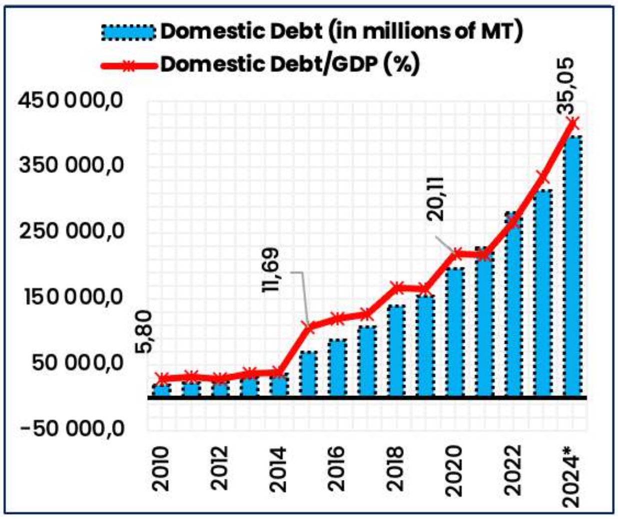
The current post-election crisis directly affects the country's economy, especially sectors such as transport, trade and tourism, which account for 12%, 10% and 2% of GDP, respectively[5]. In addition to the interruption of essential economic activities, this situation compromises tax revenues collection, which are already under pressure, and could worsen the budget deficit.

Graph 2, on the left, shows the evolution of the budget balance between 2010 and 2024, pointing to a trend of growing deficits, especially in recent years. This scenario reflects the inability to consolidate fiscal accounts, evidenced by the significant increase in public expenditure, especially on personnel and servicing public debt, which, by the end of the third quarter of 2024, had consumed more than 76.2 per cent of tax revenues. In addition, the difficulties in mobilizing tax revenue are further exacerbating the situation. Thus, if the crisis continues, this trajectory of deficits could worsen, driven by the growing need to increase spending on public security, reconstruction of destroyed infrastructure and social support programs.

5 Vd. PESOE 2024.

Graph 2: Evolution of the budget balance and domestic debt, 2020-2024.





Source: CGE 2010-2023; BdPESOE III Quarter 2024.

The increase in the budget deficit could be counterbalanced by an increase in debt. Graph 2, on the right, shows the growth of domestic debt from 2010 to 2024, pointing to a trajectory of continuous growth, driven by the need to cover growing deficits. This increase in domestic debt also reflects the difficulties in obtaining external credit, forcing the government to resort to domestic debt to cover the budget deficit.

Therefore, in a scenario characterized by the difficulty of generating tax revenues and the limited opportunities for attracting external credit, the unsustainable growth of domestic public debt may, ultimately, significantly restrict the margin for fiscal maneuver. Additionally, this situation tends to be negatively assessed by the rating agencies, given that the government's ability to honor its financial commitments, especially with creditors, will be weakened and this could undermine investor confidence and make it difficult to maintain economic stability, particularly in periods of crisis.

4. Conclusion e Recommendations

The post-election crisis in Mozambique, caused by the enormous electoral fraud that resulted from the poor management of the electoral process by the National Electoral Commission and the Technical Secretariat for Electoral Administration, which led to a massive contestation of the election results and was intensified by popular protests, could have a deep impact on the economy in general and public finances in particular, leading to a lowering of the country's sovereign credit rating.

The escalation of vandalism against public and private goods and services, together with often violent responses by the security forces, contributes to an environment of insecurity and instability. This situation reduces investor confidence, jeopardizes commercial and tourist activities and negatively affects economic growth and tax revenue collection. In addition, the situation may require further public expenditure on security, repairing damaged infrastructure and assisting vulnerable families, placing more pressure on the fiscal accounts. This pressure could result in a chronic deficit, and in a scenario of limited margin for external borrowing, lead to an unsustainable growth in domestic public debt.

The narrowing of the fiscal space induced by the current situation could lead to a downward revision of the country's rating, since this could be interpreted as an increase in the probability or possibility of the government being unable to fully honor its public debt service.

The current political, economic and social instability is also intensifying inequality and poverty, as well as fostering growing insecurity and distrust in public institutions. The crisis reflects, therefore, a multifaceted problem that goes beyond the electoral context and exposes structural problems in the country's economy and institutions. Addressing these challenges calls for a firm commitment to political and economic reforms, more transparent public management and a targeted focus on poverty reduction, to restore the confidence of both the population and the international community.

5. Recommendations

1. **Promoting Dialogue and Political Stability**: to contain the crisis, it is essential that the Mozambican government is accountable and demonstrates the political will to open channels of dialogue with opposition parties, religious bodies, academics, the private sector, representatives of civil society and society in general. Establishing a commitment to dialogue on electoral issues can help to reduce violence and gradually restore public order. Political stability and a reduction in social tensions are crucial for reversing the deterioration in investor confidence. More than 30 years after the establishment of democracy, Mozambique cannot afford to have continuous cycles of post-electoral instability, due to recurrent fraud in the electoral management process, which discredit the country at regional and international level, and, above all, establishes a climate of mistrust among Mozambicans in national institutions. If a local doesn't trust his institutions, it's very unlikely that a foreign investor will.

2. **Strengthening Public Security with Respect for Human Rights**: it is recommended that the methods used by the security forces be reviewed to avoid violent and disproportionate responses against demonstrators, prioritizing non-violent forms of containment. Transparent and respectful action by the security forces can help to reduce vandalism and restore public order, improving the country's image in the eyes of the international community and helping to minimize the negative impact on its credit rating.

3. **Protection of Infrastructure and Essential Services**: the government should focus on protecting strategic public and private goods and services, with a view to minimizing damage and interruptions that hinder the functioning of the economy. The implementation of protection measures for critical infrastructure and essential services may help to maintain some stability in the business environment, which is essential for tax collection and attracting direct investment.

4. **Economic Recovery Strategy and Support for Affected Sectors**: it is recommended to develop an economic recovery plan that would give priority to the most affected sectors, such as trade and tourism, with temporary incentives such as subsidies and tax breaks for businesses affected by the crisis. This strategy would help restore economic activity in the short term, demonstrating resilience and a coordinated response from the government, which would also be positive for rating agencies.

5. **Prudent Fiscal Management and International Support:** given the pressure on the budget, it is essential to adopt prudent fiscal management. Negotiating with international financial bodies for financial and technical support can contribute to stabilizing the budget, especially in priority areas such as the recovery of damaged infrastructure and the maintenance of essential services. Keeping up the dialogue with the rating agencies, demonstrating that specific measures have been taken to mitigate the crisis, can help prevent a further downgrading of the credit rating.

6. **Support for Families and Promoting Employment**: to reduce the social impact of the crisis, it is crucial to implement financial assistance programs for vulnerable families and promote initiatives to create formal jobs. These measures can mitigate the negative effects of the crisis on poverty and inequality, while strengthening the country's economic and social base.

By implementing these recommendations, Mozambique will be able to alleviate some of the negative impacts of the crisis on the sovereign credit rating and promote a more sustainable recovery, rebuilding internal and external confidence and securing a more sustainable and inclusive economic future.

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