Metical in free fall

A sharp devaluation in the Mozambican currency has economists playing at guesswork to find out the cause

Crystal balls are still being gazed into and bones thrown to establish the causes of the sharp fall of Mozambique's currency over the last three months. After a long spell of relative stability, Mozambique's currency, the metical, took a sudden tumble in June that left local analysts baffled.

Local economic witches expounded theories ranging from too much media attention on the political instability, to unauthorized activity at the Central Bank. None sounded convincing enough.

The foreign exchange allocation system is being revamped with the ultimate goal of moving to a fully market-based allocation of resources. Major World Bank financial assistance to Mozambique seemed to be attached to strict compliance to this condition.

A secondary market, which had been in operation since 1990, was integrated into the single exchange rate mechanism in April 1992. Authorised importers can bid for foreign exchange from the untied aid and export earnings at commercial banks for imports.

However, due to Mozambique's dependence on imports and foreign aid, the liberalisation of the allocation of foreign exchange poses peculiar problems. The country's annual import bill is estimated at US$1.2 billion, while exports earnings were put at US$142 million in 1992. A thriving black market has turned US dollars and South African rand into alternative currencies in the country. This market is defying all predictions of local experts that "it would die a natural death".

How much is it worth?

The World Bank set aside some money for the establishment of an open market operations fund at the Central Bank in order to stabilize the currency whenever its slide became too much for the economy to handle.

But the mechanism was of no use when the currency began its plunge last June. Between May and August this year, the metical fell from 2,760 to 4,329 MT to the dollar, while on the black market, it is now trading in the 5,300 and 5,500 MT range.

Some analysts suggest that the Central Bank was unable to use the special fund to stabilize the currency, because there was a political element behind the fall. On the eve of the crash a group of demobilised soldiers of the former presidential guard had threatened to stage attacks in the city center and loot shops.

On the other hand, while it is true that last October's peace agreement has brought some optimism, by June things looked bleak with no progress in the implementation of vital aspects of the process such as demobilisation and slow preparation for general elections scheduled for 1994.

Cease-fire violations and threats of retaliation from both sides had made headlines. To top it all, Renamo leader Mr Afonso Dhlakama, had shown reluctance to travel to the Mozambican capital, Maputo, to hold talks with president Joaquim Chissano on how to speed up the process. This was interpreted as a signal that war could break out at any time.

One economist at the Central Bank told SAE that "political uncertainty may be pushing the meticais down". But he added another important factor: the plunge was becoming a self-inflicted destructive exercise as some dumped local currency and held firmly to their foreign exchange holdings. "The more we see headlines on the metical's fall, the weaker it gets," he said.

Others had different perceptions. The independent newsheet *Mediafax* quoted dealers as saying that the fall was sparked by "too much money in circulation, chasing a limited supply of dollars from the United Nations Peacekeeping Mission in Mozambique (Unomoz)".

But where did the excess liquidity come from? A theory expounded by one analyst in the newsletter was that after the peace agreement, millions of meticais Renamo captured during the war had re-entered the system creating an excess supply. But others doubt that Renamo could have saved billions of meticais given Mozambique's high inflation rate, estimated at above 50 per cent last year.

Another interesting, but equally unconvincing argument suggests that dollars are becoming scarce in Mozambique, because they are feeding the capital flight from violence-torn South Africa. According to South Africans, businessmen dump their rands on Maputo streets parallel market and collect US dollars.

The government blames the fall on the shortage of foreign exchange caused by the World Bank's withholding of funds. But a Bank representative in Maputo stated that "we are not convinced" by this argument.

Donors, including the World Bank, put the blame back on the government. A Bank expert says that since January, the government had allowed the spread between the official and the black market rates to overshoot the agreed limits (which is understood to be between 15 and 20 per cent).

Apparently the government resisted advice to bridge the widening gap arguing that it could lead to a rapid succession of devaluations. When time came for the disbursement of the "second tranche" of donor funding for the year, the donors refused to sign their cheques.

When foreign currency dried up, the government was forced to devalue, leading to a rapid fall in the metical, which the government was trying to avoid. It has now managed to stabilize over the past few weeks and World Bank sources expect it to stay on course, hopefully for sometime. □