INTERNATIONAL MONETARY FUND

Staff Country Reports

Republic of Mozambique: 2005 Article IV Consultation, Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criteria, and Modification of Performance Criteria—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2005 Article IV consultation with the Republic of Mozambique, second review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for a waiver of performance criteria, and modification of performance criteria, the following documents have been released and are included in this package:

- the staff report for the combined 2005 Article IV Consultation, Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criteria, and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on April 13, 2005, with the officials of the Republic of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 6, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of June 22, 2005 updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its June 22, 2005, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of the Republic of Mozambique.

The documents listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper Annual Progress Report
Letter of Intent sent to the IMF by the authorities of the Republic of Mozambique*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Mozambique*
Poverty Reduction Strategy Paper
Poverty Reduction Strategy Paper Annual Progress Report
Selected Issues Paper and Statistical Appendix
Technical Memorandum of Understanding*
*May also be included in Staff Report

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REPUBLIC OF MOZAMBIQUE

Staff Report for the 2005 Article IV Consultation, Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criteria, and Modification of Performance Criteria

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by David Nellor and Anthony Boote

June 6, 2005

- On July 6, 2004, the Executive Board approved a new Poverty Reduction and Growth Facility (PRGF) arrangement for Mozambique in an amount of SDR 11.36 million (10 percent of quota) to support the government's economic program for 2004–06. So far, Mozambique has drawn SDR 3.24 million under the arrangement. As of March 31, 2005, total Fund credit and loans outstanding to Mozambique amounted to SDR 125.3 million (110.3 percent of quota).
- Discussions for the 2005 Article IV consultation and the second review under the PRGF arrangement were held in Maputo during March 30 to April 13, 2005. The mission consisted of Mr. Clément (head), Mr. Manoel, Ms. Dabán, and Ms. Mendez (all AFR), and Mr. Joly (PDR). Mr. Perone, the Fund's Resident Representative, assisted the team. The mission met with the Prime Minister; the Ministers of Finance, Development and Planning, Agriculture, Education, Health, Justice, and Trade; the Governor of the Bank of Mozambique; and other senior government officials. The staff also met with representatives of the private sector and donor community. Ms. Patel from the Executive Director's office and Mr. Moll from the World Bank also participated in the discussions.
- In the attached letter dated May 26, 2005 (Appendix I), the authorities request waivers for the quantitative and structural performance criteria that were not observed at end-December 2004 (Appendix I, Attachment I) and the disbursement of the third loan under the arrangement in an amount of SDR 1.62 million (1.4 percent of quota) on the completion of the second review. The memorandum of economic and financial policies (MEFP), attached to the letter, reviews Mozambique's performance under the PRGF arrangement during October 2004–March 2005, and sets out program targets through end-December 2005.
- The Mozambican authorities appreciated the advice provided by the Executive Board in the context of the Article IV consultations, including the latest, which was concluded on December 10, 2003. They particularly welcomed its timeliness and agreed with the need to increase tax revenues, improve fiscal transparency and public expenditure management, address the remaining vulnerabilities in the financial sector, and remove obstacles to private sector development. They also found the cooperation and candidness of discussions with Fund staff very effective. They stressed the importance of continued Fund technical assistance in buttressing administrative capacity and helping the deepening of major reforms in revenue, expenditure management, and the monetary and exchange rate policy areas.

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EXECUTIVE SUMMARY

- The performance under the program supported by the Poverty Reduction and Growth Facility (PRGF) was mixed during October 2004–March 2005. All end-December 2004 quantitative performance criteria, except the one pertaining to the fiscal deficit, were met. One out of two structural performance criteria was breached, and only three out of eight structural benchmarks were met. These slippages primarily reflected a weakening of tax collections and delays in the implementation of the reform agenda caused by the political transition. The authorities are requesting waivers for nonobservance based on corrective actions, including four prior actions.
- After Mozambique's impressive performance over the past decade, it needs a second wave of reforms to deepen and accelerate structural changes to sustain high and broad-based growth, with stepped-up efforts to reach the Millennium Development Goals (MDGs). Reforms should focus on increasing tax revenues, strengthening public sector operations, reducing the costs of doing business, promoting labor-intensive sectors, and implementing a rural development strategy.
- In 2004, real GDP growth decelerated to 7.2 percent and inflation declined to 9.1 percent. The external position further improved, owing to strong export growth and higher-than-projected private capital inflows and foreign assistance. International reserves grew faster than envisaged, and the exchange rate appreciated significantly in real effective terms. The fiscal consolidation envisaged in the program for 2004 was not achieved. This mainly reflected a 1.1 percent of GDP revenue shortfall, only partially offset by some restraint in expenditure that negatively affected its composition. Broad money growth slowed down significantly, reflecting, in part, the impact of the appreciation of the metical on the foreign currency deposits.
- Prospects for 2005 remain favorable, including for strong growth, a further deceleration in inflation, and maintenance of a sustainable external position. The program envisages a 1 percent of GDP reduction in the domestic primary deficit through increasing revenue mobilization, containing nonpriority current expenditure growth, and strengthening public expenditure management. The authorities stressed their commitment to introduce contingency measures in 2005 to offset any revenue shortfall. The monetary program is consistent with a further reduction of inflation in the context of a managed floating exchange rate system. The authorities remain committed to completing a feasibility study on the government's divestment in the banking system and to strengthening the balance sheet of the Bank of Mozambique. To foster private sector development, the authorities will continue to implement measures to reduce the cost of doing business and improve governance. The authorities are also determined to revive public sector reform.
- The risks to the program include a continued weak revenue performance, a slowdown in implementing the structural reform agenda, and a shortfall in foreign aid, which could jeopardize macroeconomic stability over the medium term and imply significant delays in the achievement of the MDGs.

I. INTRODUCTION

1. **Mozambique, a post-conflict coastal country, is at a critical juncture in its development process.** During the past decade, Mozambique's strong commitment to sound macroeconomic policies and structural reform has led to a remarkable improvement in its economic performance, supported by substantial donor assistance. Real GDP growth averaged 8 percent a year (one of the highest in Africa), end-period inflation was reduced to single digits, public external debt shrank, the international reserves position strengthened, and the share of the population living in absolute poverty declined substantially. These achievements were facilitated by a stable political situation and the consolidation of the democratic system, as illustrated by the recent general elections that took place peacefully.

Millennium Development Goals: Selected Indicators, 1990-2003					
	1990	1995	2001	2002	2003
Population (in millions)	14.2	15.8	17.7	18.1	18.8
Population living on less than \$1 a day	...	38	...	20	...
GDP per capita (in U.S. dollars)	92	145	209	226	258
Adult literacy rate (percent of people ages 15 and over)	49	55	62	64	...
Youth literacy rate (percent ages 15-24)	48.8	54.7	61.7	62.8	62.8
Ratio of girls to boys in primary and secondary education	73.4	71	74.6	...	79
Under 5 mortality rate (per 1,000)	235	215	197	199	147
Prevalence of HIV, female (percent ages 15-24)	...	...	14.7	16.2	...
Access to an improved water source (percent of population)	...	...	57	...	42
Fixed-line and mobile telephones (per 1,000 people)	...	3.6	12.8	...	18.6
Life expectancy at birth (years)	43.4	44.6	41.7	41.1	40.7
Unemployment rate	...	...	...	...	...

2. **Although the economy responded positively to the reforms implemented in the last decade under successive Fund-supported programs, important weaknesses and vulnerabilities remain.** Mozambique now needs to launch a "second wave" of reforms to consolidate its macroeconomic environment, maintain a high rate of export-led growth, reduce poverty, and decrease aid dependency. Against this background, the government is preparing a new Plano de Acção para Redução da Pobreza Absoluta (PRSP or "PARPA" in Portuguese) for 2006–10, which is expected to be finalized during the first half of 2006.

3. Recent economic developments and performance under the program are presented in Section II. The Article IV discussions are presented in Section III with key lessons from the past decade and medium-term challenges in the future in Section III.A; the medium-term framework in Section III.B; and the program for 2005 in Section III.C. Program monitoring, safeguards assessment, and risks are presented in Section IV. The staff appraisal is in Section V.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

4. **Although the economy continued to perform well in 2004, performance under the program was mixed.** Some relaxation occurred in the fiscal stance in the period leading to the elections in December 2004 and the installation of the new government in early 2005. All quantitative performance criteria, except the one pertaining to the government's domestic primary deficit, were met (memorandum of economic

Selected Macroeconomic Indicators 1/				
	2002	2003	2004	2005
			Est.	Proj.
Real GDP growth	8.2	7.8	7.2	7.7
Inflation end of period	9.1	13.8	9.1	8.0
Real effective exchange rate	-6.3	-2.7	24.8	...
Broad money growth	21.5	18.7	5.9	14.5
Foreign reserves (in months of imports)	5.0	5.4	5.8	4.7
Overall fiscal balance (incl. grants, in percent of GDP)	-7.0	-4.5	-4.4	-6.0
Overall fiscal balance (excl. grants, in percent of GDP)	-17.3	-14.0	-11.7	-12.4
Government domestic revenue (percent of GDP)	12.4	12.9	12.3	13.2
External current account balance (incl. grants, percent of GDP)	-13.3	-9.2	-5.8	-7.1
Exports (in millions of US\$)	1,225	1,401	1,874	2,116
Imports (in millions of US\$)	-2,191	-2,404	-2,780	-3,330
Terms of trade (percent change)	-3.8	-1.4	13.4	2.2
External debt (in millions of US\$, NPV)	894	1,205	1,532	1,727
NPV of debt/exports (3 month average)	91.7	102.0	83.8	83.6
Debt service/GNFS exports	6.4	6.1	4.5	5.1

1/ Annual percentage change unless otherwise indicated.

and financial policies (MEFP), Table 1). Using the new GDP series (Box 1), real GDP growth decelerated to an estimated 7.2 percent, reflecting a slowdown in construction related to the completion of a number of private sector megaprojects and a decline in fishing production. Growth in all other sectors continued to be buoyant, including in agriculture (Figure 1). Inflation declined more than expected to 9.1 percent at end-December 2004 and to 4.5 percent at end-April 2005 driven by lower food prices and despite a sharp increase in petroleum prices.¹ The easing of inflation expectations also contributed to a reduction in interest rates.

5. Strong growth in traditional exports, the completion of two megaprojects, and improved terms of trade helped narrow the external current account deficit, excluding grants, by one-third to 13.8 percent of GDP in 2004. This, together with greater-than-anticipated donor support and large private capital inflows, helped to boost net international reserves (NIR), well above the program target, to about six months of imports. As a result, the metical appreciated by 25 percent in real effective terms in 2004, which reversed the depreciation of 8 percent over the previous four years. The exchange rate exhibited significant fluctuations in the aftermath of the introduction of the foreign exchange system in January 2005, which led the monetary authorities to increase significantly their foreign exchange sales to reduce volatility during the first quarter of 2005.

6. The envisaged fiscal consolidation was not achieved. The revenue-to-GDP ratio decreased from 12.9 percent of GDP in 2003 to 12.3 percent in 2004 and fell short by 1.1 percent of GDP of the program indicative floor for end-December 2004 (Table 2).

Collection of most taxes turned out lower than envisaged. The authorities attributed the revenue shortfall mainly to higher-than-projected value-added tax (VAT) reimbursements related to megaprojects, delays incurred by corporations in complying with the payments calendar under the new corporate income tax code, and the impact of the appreciation of the metical. Another important factor was the weakening of tax collection during the transition period leading to the nomination of a new government. The revenue shortfall was partially offset by cuts in current expenditures affecting negatively the composition of total expenditure. As a result, the share of priority expenditures to total expenditure (about 63 percent) was slightly lower than programmed. The domestic primary deficit fell short of the program target by 0.7 of GDP, and the overall fiscal deficit, after grants, was slightly higher than envisaged (using the new GDP series).

Selected Fiscal Indicators 2003-04 (In percent of GDP, unless otherwise specified)			
	2003	2004	
		Prog.	Est.
Total revenue and grants	22.5	21.9	19.6
Total revenue	12.9	13.4	12.3
Grants	9.5	8.6	7.3
Total expenditure and net lending	26.5	25.4	23.7
Primary current expenditure	13.2	13.2	12.9
Interest on public debt	1.2	1.1	1.0
Locally financed capital expenditure	3.2	3.4	3.0
Overall balance, before grants	-14.0	-12.0	-11.7
Domestic primary balance, before grants	-3.7	-3.1	-3.7
Total savings	8.1	7.6	5.7
Spending on priority sectors	15.8	15.7	13.9

Sources: Mozambican authorities; and IMF staff estimates.

¹ Domestic petroleum prices are adjusted on a monthly basis in line with developments in import prices.

7. Based on preliminary information, revenue collection in the first quarter of 2005 has improved but is slightly below the program target (0.1 percent of GDP). However, identified primary domestic expenditure is higher than programmed (0.4 percent of GDP), mainly on account of a higher-than-expected wage bill (0.6 percent of GDP) that was only partially offset by restraining locally financed capital expenditure by 0.2 percent of GDP. The higher-than-expected wage bill was due to the payment of the 13-month wage and pension bonus corresponding to 2004, which was paid in the first quarter of 2005 (instead of end-2004 as originally programmed).² In addition, the difference between the above-the-line recorded transactions and below-the-line financing shows an excess of unallocated expenditures equivalent to 0.4 percent of GDP. Overall, the indicative target on the domestic primary deficit may have been exceeded by 0.8 percent of GDP at end-March 2005. In addition, the 13-month payment of wage and pension related to 2005 fiscal year will be paid in January 2006 and this will be true respectively for the following years.

8. **Broad money growth slowed significantly in 2004, reflecting in part the impact of the appreciation of the metical on the foreign currency deposits** (Table 3). While the commercial banks were being restructured, the increase in credit to the private sector remained relatively modest, whereas net credit to the government (NCG) was slightly exceeded. However, the end-December indicative stock of reserve money was exceeded by a small margin, owing mainly to a larger-than-expected demand for domestic currency. Based on preliminary data, the indicative targets for end-March 2005 on net international reserves and net domestic assets of the central bank, as well as on reserve money, appear to have been met. In 2004 and early 2005, the Bank of Mozambique (BM) took several steps to strengthen monetary management, including using a more appropriate mix of its monetary instruments in the context of a managed floating exchange rate system. Since the second half of 2004, it has relied more on foreign exchange sales to control liquidity, following its heavy reliance on domestic monetary instruments. Despite the shift to the government of a large part of the net financial losses cumulated in 2002–03, the BM posted

² The bonus for fiscal year 2003 was paid in January 2004.

additional financial losses of 2.5 percent of GDP at end-2004 mainly on account of the impact of the appreciation of the metical on its net external liabilities.

9. **The situation of the commercial banking sector has continued to improve notably with a sharp decline in nonperforming loans** (Table 7). In particular, the largest bank's financial statements (Banco Internacional de Moçambique, BIM) through end-2004 show that it remains profitable and in compliance with prudential requirements. Following the external auditors' approval in early 2005 of the BIM's financial statements for 2004, the enhanced supervisory regime of the BIM was discontinued.

10. **Progress in implementing structural reforms has been slower than envisaged.** In particular, five out of eight benchmarks were missed and one of the two performance criteria was not observed (MEFP, Table 2), including in the monetary and fiscal areas.

Summary of Missed Performance Criteria and Benchmarks and Corrective Actions	
Performance criteria	Actions to be implemented
Banking sector reform • Complete a feasibility study on divestiture in the BIM by end-December 2004	A short divestiture strategy document already elaborated. Completion of the study by September 2005 with technical assistance from the World Bank (performance criterion).
Structural benchmarks	
Public expenditure management • Prepare the budget execution report for the third quarter of 2004 using e-SISTAFE by mid-November 2004	Elaborate by May 2005 a financial report for the first quarter of 2005; and complete by September 2005 the execution report for the first semester of 2005. Strengthening banks' compliance with the Treasury Single Account (one structural benchmark and one prior action).
Strengthening of banking system • Develop a resolution strategy for two small banks by end-October 2004. • Develop a timetable to move to IFRS by end-December 2004. • Include in the 2005 draft budget provisions for strengthening the balance sheet of the BM by end-October 2004.	Strengthening of one of the two banks in progress. The resolution strategy for a small cooperative still being studied. Timetable approved in March 2005. Issuance of government bonds included in the 2005 draft budget submitted to the Assembly in March 2005 (performance criterion).
Governance • Establish an anti-money-laundering investigation unit by end-December 2004.	Finalization of an action plan to create a financial investigation unit by end-May 2005 (prior action)

11. **The implementation of fiscal reforms has continued but with some delays.** A draft general tax law and a law creating the Central Revenue Authority (CRA) were submitted to the assembly in mid-2004 but have not yet been adopted. Progress has been made in facilitating the merger of the General Directorates of Domestic Taxes (DGI) and Customs (DGA) into the CRA by end-2005 with the approval of the internal regulations for the DGI in late 2004. On the expenditure side, at the beginning of 2005, the new electronic financial administration system (e-SISTAFE) began to record and classify all disbursements to line ministries. In addition, work is progressing to strengthen the functioning of the Treasury Single Account (TSA). In this context, the transactions between the BM and commercial banks are now reconciled daily. However, given the delay in the approval of the

2005 budget (which took place in May 2005), the e-SISTAFE could not be used to register all stages of expenditure execution. Consequently, the elaboration of the budget execution report for the first quarter of 2005 was also delayed.

12. **Key structural measures in the banking system are also being implemented with some delay.** The BM has finalized a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and bring loan classification and provisioning in line with best international practices. The reviews of the four largest banks, finalized in February 2005, show that they are ready to move to IFRS. The regulations of the newly adopted Financial Institutions Law were approved by the Council of Ministers in late 2004, and the revision of the regulatory framework for microfinance activities was completed.

13. **Reforms in other sectors have encountered some difficulties.** Reforms in the judicial system were hampered by capacity constraints and delays in approving relevant legislation. The creation of a financial investigation unit was delayed due to the pending amendment to the current anti-money-laundering law. Progress on land tenure reform was hindered by the difficulty of reaching a consensus on such a sensitive issue (MEFP, paragraph 35). The new procurement legislation was not approved on account of delays related to the consultation process.

III. REPORT ON THE DISCUSSIONS

14. **As part of the Article IV consultation, the staff took a fresh look, with the authorities and representatives of civil society and the international community, at developments in Mozambique since the early 1990s,** to assess its achievements in implementing its economic and reform agenda, with a view to drawing lessons and identifying remaining challenges. In addition, the staff discussed with the authorities the effectiveness of past Fund surveillance, in particular on fiscal consolidation and monetary and exchange rate policy. The discussions were held against the background of the significant revision of the national accounts for the 2000–03 period (see Box 1).

15. **In the context of the second review under the PRGF arrangement, discussions focused on the implementation of corrective actions to bring the program back on track and the policy agenda for the remainder of 2005.** The authorities acknowledged the program slippages and the urgent need for an acceleration of structural reforms, including four prior actions, the implementation of measures aimed at reversing the revenue shortfall registered in 2004 and enhancing public expenditure management. Moreover, the authorities recognized the need to enhance the existing multi-agency committee, with a view to establishing a monthly monitoring of the program, especially in the fiscal area. Understandings were reached on indicative targets for end-September 2005 and performance criteria for end-June and end-December 2005 (MEFP, Table 1).

Box 1. Revision in the GDP Figures

Due to important delays in the compilation of GDP data by the National Institute of Statistics (NIS) since 2000, the Mozambican authorities have relied on the GDP figures estimated by the Ministry of Finance (MF).

The new official GDP figures released in the spring of 2005 by the NIS deviate significantly from MF's old estimates and are on average 10 percent higher in 2000-03. Most of the adjustment is due to revisions to sectoral GDP deflators. The table below summarizes how key ratios involving GDP have been affected by this revision.

Mozambique: Effects of the New GDP Series, 2000-04 (In percent of GDP, unless otherwise specified)										
	2000		2001		2002		2003		2004	
	Old	New	Old	New	Old	New	Old	New	Prel. Act. 1/	Prel. Act.
Public finances										
Tax revenue	12.1	11.8	11.8	11.0	12.5	11.0	13.3	12.0	12.6	11.3
Grants received	8.0	7.8	14.8	13.7	11.8	10.3	10.6	9.5	8.1	7.3
Total expenditure and net lending	27.3	26.7	34.6	32.1	34.1	30.0	29.4	26.5	26.3	23.7
Spending on priority sectors	19.0	18.5	19.4	18.0	18.0	15.8	17.5	15.8	15.3	13.9
Overall balance, before grants	-14.0	-13.7	-21.4	-19.9	-19.7	-17.3	-15.5	-14.0	-13.0	-11.7
Domestic primary balance, before grants	-6.8	-6.6	-8.5	-7.9	-5.9	-5.2	-4.1	-3.7	-4.2	-3.7
Total government debt	152.0	148.3	164.1	152.5	104.7	92.1	97.1	87.6	67.9	61.9
External sector										
Current account (incl. grants)	-19.8	-19.3	-12.5	-11.6	-15.1	-13.3	-10.2	-9.2	-6.3	-5.8
Current account (excl. grants)	-31.8	-31.0	-28.1	-26.1	-26.2	-23.0	-22.1	-19.9	-15.2	-13.8
GDP at market prices (billions of meticals)	56,917	58,355	71,135	76,545	85,206	96,883	102,753	113,811	125,275	137,425
GDP at market prices (billions of US\$)	3.6	3.7	3.4	3.7	3.6	4.1	4.3	4.8	5.5	6.1
Per capita GDP (in US\$)	210.8	216.1	194.6	209.4	199.1	226.4	233.1	258.2	292.0	320.3
Real GDP growth rate (in percent)										
Agriculture	-10.8	-10.8	13.0	13.1	7.4	8.2	7.1	7.8	7.8	7.2
Industry	12.2	11.8	19.8	19.7	32.0	23.9	1.0	2.3	25.2	38.8
Of which: mining	52.8	52.8	12.4	12.4	66.2	66.2	34.5	34.5	141.6	215.7
Services	6.5	6.4	11.4	11.5	-0.2	-1.0	5.7	6.0	9.0	5.0
GDP deflator (in percent)	8.0	10.3	10.6	16.0	11.5	17.0	12.6	9.0	13.1	12.6
Agriculture	4.7	7.2	11.5	13.4	10.5	16.1	15.0	1.4	30.0	4.4
Industry	-3.9	5.7	6.6	13.3	13.6	10.2	1.7	29.7	50.7	7.7
Of which: mining	84.0	55.5	9.7	7.0	-5.5	1.5	17.1	3.9	29.4	-26.5
Services	8.1	12.1	11.5	17.6	8.3	19.5	7.7	3.8	10.5	25.1
Sector GDP shares (in percent)										
Agriculture	28.3	28.2	28.2	28.0	28.2	27.8	28.3	27.8	28.3	28.0
Industry	24.1	22.8	25.5	25.7	29.0	28.9	29.5	29.0	29.2	29.6
Of which: mining	0.4	0.2	0.4	0.4	0.6	0.5	0.7	0.6	1.6	1.8
Services	47.6	49.0	46.3	46.3	42.8	43.3	42.2	43.2	42.5	42.4

Sources: Mozambican authorities; and IMF staff estimates.

1/ The GDP ratios in this column refer to preliminary actual outcomes for 2004 divided by the GDP projected at the time of the IMF Country Report No. 05/168.

A. Key Achievements and Main Challenges Ahead

Key achievements

16. Over the past decade, Mozambique has successfully implemented an impressive “first wave” of structural reforms while stabilizing the macroeconomic environment. The predominant role of the government in the economy was diminished through an important privatization program, a sharp reduction in subsidies and military spending, and the elimination of the central bank financing of the government deficit. The main economic distortions were removed through the liberalization of most administrative prices, the trade

and exchange systems, and interest rate regime. The number of tariff rates and the maximum tariff rate were reduced, and ad hoc exemptions eliminated. Substantive progress was made in modernizing and simplifying the tax system, broadening the tax base, and strengthening tax administration. Budgetary operations were made more transparent with the enactment of a new public finance administration law, which calls for quarterly budget execution reports and the implementation of a public expenditure management system.³ Monetary management was improved in the context of a managed floating exchange rate system. The legal and institutional frameworks of the financial sector were reformed. The efficiency and competition in the banking system were enhanced following privatization, restructuring, establishment of a supervisory regime, and the strengthening of reporting practices.⁴ In the area of governance, the legal framework was strengthened with the enactment of the anti-corruption and anti-money-laundering laws. Finally, actions have been taken to reduce the costs of doing business by easing the licensing requirements for commercial activities and labor regulations.

17. These reforms contributed to a remarkable macroeconomic performance. Real GDP growth averaged 8 percent, quite above regional peers, despite the devastating floods that hit the country in 2000. Initially, growth was mainly supported by traditional sectors, while, in recent years, it has been stimulated by the after-flood recovery of agriculture, and foreign investment flows in megaprojects (Box 2).⁵ In spite of

Mozambique and Sub-Saharan Africa: Selected Economic Indicators, 1994-2004				
	Sub-Saharan Africa	Mozambique		
	1994-2004 Average	1994	1994-2004 Average	2004
(Annual percentage change)				
Real GDP	3.6	7.0	7.9	7.2
Agriculture	...	-0.4	6.9	7
Fishing	...	-6.5	1.8	-4
Industry	...	6.5	20.1	38.8
Services	...	14	5	5
Real GDP growth per capita	0.7	4.6	5.7	6.1
CPI inflation (average)	21.0	63.1	21.5	12.6
(In percent of GDP)				
Overall balance, before grants	-4.2	-19.3	-14.1	-11.7
Domestic primary balance, before grants	...	-2.3	-2.6	-3.7
Revenue	21.3	11.5	12.0	12.3
Grants	1.1	13.9	9.9	7.3
Expenditure and net lending	25.5	30.8	26.0	23.7
Gross domestic investment	18.2	24.8	26.7	20.1
Gross domestic savings	17.9	-15.1	2.4	6.2
External current account (excluding grants)	-3.7	-39.9	-24.3	-13.8

Sources: Mozambican authorities; and IMF staff estimates.

³ Several recommendations of the 2001 Fiscal Report on Standards and Codes (ROSC) and its subsequent updates have been implemented.

⁴ A number of the 2003 FSAP's recommendations have been implemented.

⁵ See the accompanying selected issues paper for an analysis of the factors that have contributed to real GDP growth in the last decade in Mozambique.

the tariff reduction, the banking system restructuring, and some other exogenous factors (2000 and 2003 droughts), the authorities succeeded in narrowing the deficit and taming inflation. Total exports and foreign investment soared largely because of megaprojects. The external current account deficit, after grants, narrowed and the international position strengthened substantially. Thanks to debt relief from Heavily Indebted Poor Countries (HIPC) Initiative, the net present value (NPV) of the public external debt was reduced from 500 percent of exports at end-1998 to below 100 percent.

Box 2. Economic Growth and Poverty Reduction in Mozambique¹

Mozambique has achieved impressive economic growth and a reduction of poverty since 1992. The economy grew by 8 percent annually between 1996 and 2003, and the poverty headcount fell from 69 percent in 1996/97 to 54 percent in 2002/03. There has been a remarkable agricultural “catch-up” and a fast expansion in tourism, construction, and certain manufacturing sectors. Nevertheless, the country remains poor; infrastructure is inadequate; and there are still unmet education and health needs.

The composition of growth has changed. While GDP grew at 8 percent between 1992 and 2003, **private consumption** grew at 2-4 percent. Consumption growth led to a sharp reduction in poverty. Total exports, propelled by the megaprojects grew at 22 percent annually in dollar terms during 1996-03, though traditional exports grew at only 2.3 percent. The **agricultural sector** (which supports 80 percent of the population) grew at 5.6 percent a year during 1992-2003 (half of the growth was due to area expansion). The contribution of **megaprojects** to GDP rose from zero in 1996 to about 7 percent in 2003. Some parts of the **private formal sector**—manufacturing, transport, communications, services, and mining—grew substantially, with annual rates between 5 and 15 percent. External aid, which has financed 50 percent of total expenditures, has been successful in improving access to and quality of services (education, health, and roads).

Preliminary estimates suggest that the contribution to real GDP growth of total factor productivity was 50 percent in the period of 1996-2004.

Has growth made a positive impact on poverty reduction? Growth in the **agricultural sector**, owing partly to an increase in land under cultivation and partly due to improved productivity, reduced poverty directly in rural areas. **Migration** to the cities sharply increased the size of the informal sector (where earnings stagnated), and, in addition, the cost of living is higher in urban areas, so that poverty rates fell more slowly in the cities. **Government interventions and targeted priority expenditures**—backed up by donor support—played a role: increased trade permitted smallholder households to augment their incomes; higher educational levels and increased access to education permitted better earnings in the labor market and raised the productivity of informal sector operators; and improved health raised the productivity of workers. The impact of the megaprojects on poverty has been small because the employment generated is limited and their fiscal contributions have been insignificant.

¹ For more details, see the accompanying selected issues paper on the subject.

18. However, the authorities agreed that important structural problems remain.

Private sector development, especially in the agriculture sector, is still constrained by a lack of infrastructure, and access to credit due to wide interest rates spreads, high and volatile lending rates, and a poor lending environment that partly reflects inefficient judicial procedures for loan recovery and difficulties in obtaining land titles to serve as collateral. Moreover, the financial system remains small, bank-based, concentrated in urban areas and highly dollarized. The BM's capacity to supervise the banking system effectively has improved but still needs further strengthening. The cumbersome administrative procedures and rigid labor regulations impose heavy costs on business. Finally, a comprehensive reform of the civil service still needs to be launched.

19. The contribution of trade and investment liberalization to poverty reduction could be further enhanced.

The relatively small and undiversified traditional export sector still cannot fully exploit market access opportunities in developed countries despite preferential agreements. This is due mainly to weak transportation infrastructure and inability to meet

consistently developed countries' quality standards. Moreover, export-oriented megaprojects have so far been highly capital-intensive, geared to natural resource exploitation or both. In addition, although the government's investment strategy has been very effective in attracting a number of megaprojects, its granting of privileges to the megaprojects has limited their contribution to government revenue and foreign reserves.⁶

20. Mozambique has made limited progress in reducing aid dependency.

Based on the new GDP series, the ratio of tax revenue to GDP has stagnated at about 12 percent in the past few years, instead of steadily increasing as previously estimated (Box 3). Thus, more than 50 percent of total government expenditure is foreign-financed, and pro-poor expenditures are increasingly vulnerable to volatility in aid disbursements. The off-budget execution of most donor-financed projects significantly limits the effectiveness of the budget as a fiscal management instrument.

Box 3. Tax Reform in Mozambique: An Overview

Tax policy reforms started in 1996 with an overhaul of the tariff structure and continued with the modernization of consumption and income taxes. The reforms involved (i) the reduction of the level and dispersion of tariff rates and the removal of ad hoc exemptions; (ii) the introduction of well-designed VAT and excise taxes in 1999; (iii) the rationalization of tax incentives through the enactment of the Code of Tax Benefits for Investment; (iv) the introduction of two separate taxes on the overall incomes of corporations and individuals; and (v) the indexation of fuel taxes to prevent their erosion in real terms.

While initially focused on supporting the collection of certain taxes, a more comprehensive approach to tax administration reform has recently been adopted. Tax administration has been strengthened by (i) the modernization of customs legislation and management, including by contracting in 1997 a foreign private firm to run customs and train local staff; and (ii) the creation of a specialized VAT agency, with new computerized and audit procedures, including a new taxpayer registration system and a large taxpayers' unit. Since 2001, measures have focused on computerizing the collections of new taxes, training staff at all levels, and establishing tax tribunals, with a view to creating a central revenue authority by 2006.

In spite of Mozambique's low administrative capacity, the tax reform succeeded in increasing the tax revenue ratio to 11 percent in 2002–03. Key elements behind this success include (i) the strong ownership and commitment of Mozambican authorities; and (ii) the proactive and coordinated involvement of donors, including the Fund.

Despite having a well-crafted tax system, Mozambique's tax ratio is lower than in the rest of sub-Saharan Africa and has stagnated in the past few years. This points to several weaknesses, including, (i) a narrow tax base due to generous tax exemptions, especially for megaprojects; (ii) a high rate of noncompliance; and (iii) ineffective tax enforcement. Starting in 2005, the authorities began to implement an action plan to enhance tax enforcement by strengthening the regulations on tax audits, speeding up the computerization of collections of all taxes, recruiting more and better tax auditors, conducting compliance audits of all large taxpayers, and strengthening penalties.

Mozambique: Government Revenues 1987-2004 (In percent of GDP, unless otherwise specified)				
	1987	1996	2000-03	2004
Tax revenue	8.4	9.9	11.4	11.3
Taxes on income	2.2	1.9	2.2	2.6
Taxes on goods and services	4.3	5.3	6.9	6.9
Taxes on international trade	1.4	2.1	2.0	1.7

Sources: Mozambican authorities; and IMF staff estimates.

⁶ For details on megaprojects, see Table 5, and Box 1 in IMF Country Report No. 05/168.

21. **Although advances have been made in the areas of health and education, widespread poverty and AIDS remain major challenges.** Encouragingly, per capita real GDP has grown by 6 percent in the past decade, and the proportion of the population living in absolute poverty dropped by over 15 percentage points since 1996/97, to 54 percent in 2002/03, which is below the PRSP target of 60 percent for 2005. However, AIDS prevalence rates remain very high, and the third annual report on the implementation of the PARPA shows that the achievements of some of the Millennium Development Goals (MDGs) will require an increase in investment with donor support and an improvement in absorptive capacity (Table 9 and Figure 5).

Medium-term challenges

22. **Looking ahead, the government's major challenge is to balance its commitment to macroeconomic stability and strong and broad-based growth with stepped-up efforts to reach the MDGs.** To meet this challenge, the authorities agreed with staff on the following:

- **Further fiscal consolidation** is needed to limit the government's recourse to monetary financing, thereby easing pressures on exchange rate and interest rates and preventing the crowding out of private sector credit. Enhanced revenue mobilization and improvement of expenditure management will reduce aid dependency over the medium term. On the revenue side, this goal would call for a streamlining of tax exemptions and a strengthening of tax administration by establishing a central revenue authority, improving enforcement procedures (including tax payment controls and audits), training staff, creating tax tribunals, and enhancing the capacity and the number of customs offices. On the expenditure side, the authorities will need to strengthen the monitoring of expenditure by increasing the coverage of the budget, rolling out the new e-SISTAFE to all ministries, and including in the budgetary system all off-budget foreign-financed expenditures. A comprehensive civil service reform should also be launched with the help of the international community. Finally, procurement procedures should be revised to become fully transparent.
- **Maintain stable monetary conditions, in the face of continued large inflows of foreign aid.** While keeping reserve money as the nominal anchor, this would require a judicious mix of monetary instruments—primarily issuances of treasury bills and foreign exchange sales—to sterilize excess liquidity to avoid excessive interest volatility. Maintain the managed floating exchange rate system, which has helped cushion the impact of exogenous shocks.
- **Continue to improve the business environment for private sector investments through a deepening of structural reforms,** including by adopting more flexible labor regulations, creating an accountable judicial system and a transparent regulatory framework. In addition, access to credit should be increased by promoting competition in the banking system and facilitating the use of collateral, including through the modernization of land-use rights. The growth of microcredit institutions should continue to be encouraged and their supervision strengthened. Finally, financial intermediation should also be deepened through the reform of nonfinancial institutions, such as the social security institute (Instituto Nacional de Seguranga).

- **Implement a comprehensive rural development strategy to promote labor-intensive sectors, especially agricultural activities.** Poverty is primarily a rural phenomenon, and agriculture is by far the largest single source of income in rural areas. Agriculture expansion could be pursued by enhancing rural infrastructure and local government administrative capacity, developing rural financing services, and improving access to developed countries' markets.

B. The Medium-Term Outlook

23. **Mozambique's medium-term prospects depend critically on its pursuit of prudent macroeconomic policies and an accelerated pace of structural reforms.** The main macroeconomic objectives over the medium term are to maintain a rate of real growth between 6 and 8 percent and to continue to reduce gradually the inflation rate to 6 percent (Table 1) by pursuing prudent fiscal and monetary policies in the context of the flexible exchange rate system. Central to the medium-term strategy will be the consolidation of the fiscal stance, notably through a buttressing of tax administration coupled with more efficient expenditure. Priority expenditures in the PARPA will also be protected in order to contribute to the achievement of the MDGs. The authorities will continue to seek a higher share of external grants to buttress external debt sustainability. Measured by the domestic primary balance, a fiscal consolidation of about 2 percentage points of GDP is projected over the next three years resulting from a combination of stronger revenue collection, a broadening of the tax base, and a modest increase in current spending. The increase in projected annual revenue will amount to 0.5 percent of GDP.

24. **External account developments will continue to be dominated by megaprojects.** In particular, total exports would slow down, reflecting mostly a projected decrease in aluminum prices. The current account deficit, before grants, is expected to remain in the range of 13-15 percent of GDP. It would continue to be covered by foreign aid and higher private capital inflows, mainly related to the two new titanium ore megaprojects. Official international reserves would be kept at more than four months of imports of goods and services.

25. **External and public debt appears sustainable** (Appendix V). In the baseline scenario, the NPV of public external debt-to-GDP ratio is projected to hover around 20 percent in the next 10 years before declining gradually to 15 percent in 2025, and the public debt-to-GDP ratio is projected to decline steadily to 37 percent of GDP through 2020. The usual debt and debt-service ratios would remain well within the HIPC threshold. These results, however, hinge on Mozambique's receiving the full debt relief envisaged at the HIPC completion point, securing highly concessional foreign assistance, and increasing tax revenues. In addition, debt-management capacity needs to be strengthened.

C. Macroeconomic Outlook and Policies for 2005

26. **Prospects for 2005 are for continued strong growth, a further deceleration of inflation, renewed efforts at fiscal consolidation, and maintenance of a sustainable external position.** Real GDP growth is expected to increase to 7.7 percent, driven mainly by the recovery of the fishing sector, the continuous expansion of agriculture, and a pickup in construction resulting in the acceleration in the execution of the national road plan and the initiation of a titanium ore project. The inflation rate is projected to decrease to 8 percent.

Despite continued export growth, the external current account deficit, excluding grants, is projected to remain at about 14 percent of GDP, reflecting robust imports driven by the megaprojects, higher international oil prices, and higher dividend payments to the megaprojects' foreign shareholders. With the decrease in net capital inflows, NIR are expected to decrease by more than originally programmed while remaining at comfortable levels (4.7 months of imports).

Fiscal policy and public sector reform

27. **The authorities expressed satisfaction with the effectiveness of Fund advice and technical assistance (TA)**, which they considered a key factor in ensuring the success of fiscal reforms. They hope that Fund TA (including resident experts) will not be interrupted at this critical juncture in the reform process.

28. **The government is committed to bringing the fiscal stance back on track to maintain macroeconomic stability.** With revenue collections projected to return to a more normal path, the overall deficit, excluding grants, is targeted to increase to 12.4 percent of GDP, consistent with a domestic primary deficit of 2.8 percent of GDP (MEFP, paragraph 16). In the event of a shortfall in revenue, the program includes expenditure contingency measures while preserving priority expenditures.

29. **Total revenues, excluding grants, are projected to rise by 1 percentage point of GDP to 13.2 percent of GDP** (MEFP, paragraphs 17 and 18), reflecting the incorporation into the budget of the own-generated revenues of districts and some line ministries (0.4 percent of GDP) and a number of measures aiming at strengthening tax collection (0.6 percent of GDP). In particular, the new modern procedures for tax audits and inspection will be implemented as soon as they are approved by the Council of Ministers by end-May 2005 (prior action). Moreover, an audit for compliance with all taxes of large taxpayers will be completed by end-December 2005, while the collection of tax arrears for 2003–04 will continue. In addition, the VAT and customs IT systems will be linked to allow for the electronic cross-checking of related taxable domestic and import operations. Tax enforcement procedures will be strengthened by expanding taxpayers' registration, increasing the number of audits and auditors, implementing a monthly monitoring system for tax returns filed by large taxpayers and for megaprojects, and improving customs' control capacity. Finally, the government will discourage tax evasion and corruption by strengthening sanctions.

30. **The authorities are also committed to further enhancing tax administration.** Preparations will continue to establish the CRA by end-2005. To that end, the organizational and career structure of the DGI was approved by end-April 2005 (a prior action). In addition, within one month of the promulgation (presidential signature) of the new general tax law and the law that creates the CRA, the Council of Ministers will approve the corresponding regulations. Moreover, following the adoption of a new tax code for municipalities in late 2004, local tax collection will be strengthened during 2005. Consistent with the 2004 Organic Law for Tax Tribunals, tax tribunals will be established over time.

31. **On the public expenditure side, noninterest current expenditure will remain at about 13 percent of GDP** (MEFP, paragraph 19). The wage bill, which is projected to remain at 6.7 percent of GDP, accounts for the impact of an increase of close to 10,000 employees,

including 5,443 teachers and 1,767 health care providers. To accommodate this increase within the envisaged fiscal target, the general wage increase for government employees (effective retroactively on April 1, 2005) will be limited to 6.5 percent.⁷ Priority outlays are expected to increase from 63.3 percent of total primary expenditure in 2004 to 66.3 percent in 2005.

32. **The budget will be strengthened as an instrument for fiscal reporting and management** (MEFP, paragraph 20). The authorities noted that upon the assembly's approval of the 2005 budget, all budget operations from the beginning of 2005 will be entered into the e-SISTAFE using the new classifiers. As a result, a complete budget execution report for the first semester of 2005 will be finalized by end-September 2005. By end-2005, the system will be rolled out to two ministries (finance and education) and by end-2006 to all ministries. In addition, with the help of the donors, all off-budget project-related expenditure will be progressively included in the SISTAFE and executed through the TSA.

Monetary and financial sector policies

33. **Monetary policy, with reserve money as the anchor, will continue to be prudent.** Broad money is projected to grow by less than nominal GDP. The BM will continue to improve its liquidity management through daily liquidity forecasting and will judiciously mix sterilization instruments (foreign exchange and treasury bills sales) to mop up excess liquidity in the context of the managed floating exchange rate system. The staff welcomed the BM's intention to continue strengthening the banking supervision and research departments.

34. **The authorities agreed with the staff that measures were needed to address the BM's net financial losses** (MEFP, paragraph 23). As to the cumulated losses of 2002–03 and part of 2004, the 2005 budget envisages the issuance and transfer to the BM of Mt 1.5 trillion in government securities at market interest rates (end-June 2005 structural performance criterion). Further issuances in similar amounts will follow in 2006 and 2007. Regarding the BM's additional net financial losses in 2004, a decision will be made before mid-May 2005 on the issuance of additional government securities. Moreover, the BM is committed to reviewing its administrative expenses.

35. **The authorities and staff concurred on the need to maintain a flexible exchange rate regime.** The monetary authorities expressed their appreciation of the Fund's advice on exchange rate policy and of its timely technical assistance. The staff commended the authorities on the introduction of the foreign exchange auctions, which have increased the flexibility of the exchange rate system. In response to the authorities' concern about the volatility that followed the introduction of exchange auctions, the staff pointed out that some volatility was inevitable as market participants' expectations adjusted to the new system. The authorities and staff agreed that the BM intervention in the foreign exchange market should be limited to achieving NIR targets while preventing excessive short-term volatility.

⁷ Because of the consolidation of district accounts into the budget, the budgetary projections for wages and salaries and goods and services include expenditures previously classified as transfers to districts. Budget projections are also increased with respect to 2004 by the expenditures financed with own revenues of line ministries.

36. **Despite the metical's recent large real appreciation, the staff noted that it does not appear to be misaligned.** To the extent that the large capital inflows are permanent, the real appreciation of the metical could be interpreted as an equilibrium phenomenon reflecting a change in fundamentals. The staff encouraged the authorities to inquire further about the nature of these inflows, which are not well covered by statistics. Moreover, the 25 percent increase in traditional exports registered in 2004 does not point to a significant competitiveness problem related to the exchange rate.

37. **The authorities intend to reinforce further the supervisory regime and reporting practices of the banking system, with TA from the Fund and donors,** including by preparing a new inspection manual, developing models for the presentation of consolidated financial statements, training inspectors, and revising guidelines for credit provisioning. Preparations will start for the implementation of IFRS in the banking system, expected to be completed by 2007 (MEFP, paragraph 24).

38. **The authorities remain committed to completing a feasibility study on the divestment of the government's participation in the BIM,** with technical assistance from the World Bank, by end-September 2005. A short strategy document outlining the envisaged divestiture process was finalized in February 2005.

External sector and trade policy

39. **The staff encouraged the authorities to further reduce external protection.** The authorities confirmed their intention to reduce the top tariff rate to 20 percent from 25 percent in January 2006 (as agreed in the context of the Southern Africa Development Community). The staff impressed on the authorities the need to avoid promoting certain sectors through external protection. While the authorities agreed with this general principle, they stressed that certain sectors, such as the sugar sector, would continue to require protection until they are fully restructured. Although Mozambique has eliminated all Article XIV restrictions, it maintains restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII. The authorities intend to address these restrictions on approval of the new foreign exchange law being prepared by the BM, which aims to clarify and improve the existing legislation. This law is expected to be submitted to the assembly in the second half of 2005, and the authorities intend to accept their obligations under Article VIII, Sections 2, 3 and 4 of the Fund's Articles of Agreement following the approval of this law. However, since it is not clear when this new law is going to be approved by the assembly, nor the extent to which the remaining exchange restrictions will be addressed by it once it enters into effect, the staff is not in a position to recommend the retention of these restrictions at this stage.

40. **Limited progress has been made in the negotiation of bilateral debt-relief agreements in the context of the enhanced HIPC Initiative.** Mozambique signed a technical agreement with Portugal in February 2005, in which Portugal confirmed that it would cancel 100 percent of the debt.⁸ The prospects for obtaining relief from non-Paris Club creditors seem

⁸ While Japan has indicated its intention to provide 100 percent of debt relief, discussions have not yet been finalized.

extremely limited. In particular, Mozambique's negotiations with a few large oil-producing countries have reportedly stalled, with their nominal claims amounting to about 12 percent of GDP. The authorities are hopeful that a commercial debt-buyback operation, supported by the World Bank and a few bilateral donors, will be carried out by end-2005.

Other structural reforms

41. **The authorities renewed their commitment to continue the reform of the public sector** with the help of the World Bank and other donors (MEFP, paragraph 34). They agreed that civil service reform was a key aspect of the reform. In this context, preparations are under way to complete an independent audit of the civil service in 2005. In addition, a proposal to reform the wage system in order to link remuneration more closely with performance will be considered by end-September 2005. Finally, draft legislation on procurement in line with international standards is being prepared with the help of the World Bank and should be adopted by end-December 2005.

42. **The authorities agreed to continue to implement reforms to reduce the costs of doing business in Mozambique** (MEFP, paragraphs 29–36). Four additional “one-stop shops” for business registration outside Maputo will start operations by June 2005. Following progress made in 2004, the authorities will further streamline licensing procedures by devolving the authority to grant licenses to districts and provinces. On labor market reform, retrenchment costs, temporary employment, and employment of expatriates will be revised (MEFP, paragraph 31). A new labor law is expected to be submitted to the assembly during the second half of 2005. The authorities recognize that progress in reforming the judicial system in 2004 was limited (MEFP, paragraph 36), and they are preparing a draft law on judicial reform. The law will introduce, among other things, an intermediate level of courts to reduce the number of outstanding cases at the Supreme Court level. In addition, the authorities are making efforts to enhance the country's infrastructure with the help of the World Bank (MEFP, paragraph 32). Finally, the authorities are aware of the need to revise the regulations governing land-use titles to reduce the cost of transactions and make it easier to use them as collateral for obtaining credit. In this regard, the government remains committed to conducting a Poverty and Social Impact Analysis study on land regulations with the help of the World Bank (MEFP, paragraph 35).

43. **The authorities will renew their efforts to improve governance and combat corruption.** They will, for example, establish two more anticorruption units and are committed to publishing and disseminating the results of the National Survey on Governance and Corruption by end-June 2005. The government emphasized its commitment to amend the anti-money-laundering law in order to allow for the creation of a financial investigation unit (MEFP, paragraph 37). To that end, the government agreed to formulate an action plan by end-May 2005 (prior action) containing a description of the preparatory works to create such a unit and design a Mozambican model by end-November 2005 based on other countries' experiences.

Statistical issues

44. **The authorities recognize the urgent need to strengthen the country's statistical information.** Mozambique's core economic data are generally made available on a timely basis

for program monitoring and surveillance; however, the statistical system still presents several deficiencies that hinder the monitoring of economic developments (Appendix III). Although recent efforts of NIS to release a GDP series for 2000–03 are welcome, the national account, monetary, balance of payment, external debt, and public finance statistics still need improvement (MEFP, paragraphs 38–39).

IV. PROGRAM MONITORING, SAFEGUARDS ASSESSMENT, AND RISKS

45. **The third review under the PRGF arrangement will be completed not later than end-December 2005 and will make available the fourth disbursement, which will be subject to the end-June 2005 quantitative performance criteria and structural performance criteria through end-September 2005** (MEFP, Tables 1 and 4). The fifth disbursement, which will become available upon completion of the fourth review scheduled for May 31, 2006, will be subject to the end-December 2005 performance criteria specified in Table 1 of the MEFP. Additional conditionality for the fifth disbursement will be established at the time of the third review. The attached technical memorandum of understanding (TMU) (Appendix I, Attachment II) details the design of the program. Minor changes were made to the TMU to clarify a few definitions.

46. **The main risks to the program include a weaker-than-programmed revenue performance, slowdowns in implementing the structural agenda, and a shortfall in foreign aid**, which could greatly complicate Mozambique's attainment of its medium-term fiscal objectives and imply significant delays in its achievement of the MDGs.⁹

47. **The monetary authorities are continuing as planned to address the weaknesses identified in the Fund's safeguards assessment conducted in June 2004** (MEFP, paragraph 26). They have updated the procedures for converting balance sheet data to the monetary data reported to the Fund. At end-November 2004, the BM began to complete all reconciliations and make necessary adjustments on a monthly basis so that the balance in its accounting records matched those confirmed by third parties. Work is in progress to establish an electronic link, and the Bank staff is currently being trained to operate the system, which will be fully functional by end-September 2005. With a view to completing the transition in 2006, an IMF consultant is assisting the central bank in adopting IFRS.

V. STAFF APPRAISAL

48. **Mozambique's performance under the program was mixed, with several slippages during the period October 2004–March 2005.** Notably, its fiscal performance deviated from the program, reflecting mainly revenue shortfalls. The slippages primarily reflected a weakening of tax collection and delays in the implementation of the structural reform agenda. The authorities acknowledged the seriousness of the slippages and are committed to implementing strong measures to bring the program back on track and enhance its monitoring.

⁹ An alternative scenario with lower external support (25 percent lower than the baseline) shows that international reserves could drop by about half a month of imports by 2008.

49. **Mozambique is at a critical juncture in its development.** After its impressive performance of the past decade, a “second wave” of reforms is needed to deepen and accelerate structural changes, which will sustain a high and broad-based growth. Moreover, stepped-up efforts are needed to reduce poverty and to reach the MDGs with the help of the international community. Efforts should focus on increasing tax revenues, strengthening public sector operations, reducing the cost of doing business, promoting labor-intensive sectors, and implementing a rural development strategy. Without a strong commitment by the authorities to follow through with the needed reforms, the remarkable results the country has achieved so far could be reversed.

50. **The staff concurs that fiscal consolidation is needed and that the share of pro-poor expenditure should be increased.** Over the medium term, the government’s fiscal consolidation strategy hinges on increasing revenue mobilization, moderating the growth of the wage bill, and improving expenditure management. The strengthening of tax administration and enforcement, in particular, is key to the program. The staff also encourages the authorities to make the budget a more effective instrument of fiscal reporting and management through the timely rollout of the e-SISTAFE. With the help of the donors all project-related expenditures should be progressively included in the budget.

51. **The staff welcomes the authorities’ intention to revive the public sector reform,** including by launching a comprehensive civil service reform with the help of the World Bank. The staff appreciates the authorities’ renewed efforts to improve governance and combat corruption, through, among other things, procurement reform and the creation of a financial investigation unit.

52. **The staff commends the authorities for pursuing a prudent monetary policy and increasing the flexibility of the exchange rate system, which is essential to maintaining a stable macroeconomic environment.** The staff encourages the authorities to pursue a balanced mix of foreign exchange sales and to issue treasury bills to sterilize excess liquidity. The staff agrees with the authorities that the central bank intervention in the foreign exchange market should be limited to achieving NIR targets while preventing short-term volatility. At this juncture, there is no evidence that the real effective exchange rate is misaligned.

53. **The staff commends the authorities for maintaining a sound banking system.** The recent improvement in indicators of banking sector performance, including the sharp fall in nonperforming loans, is a welcome development. However, the staff encourages the authorities to continue to divest the government from the banking system and deepen the financial sector. The government should continue its efforts to develop microcredit institutions and reform land tenure titles to facilitate the provision of financial services to rural and urban households that have difficulty accessing commercial bank credit.

54. **The staff encourages the authorities to continue to strengthen the statistical system,** which still presents several deficiencies that hinder the monitoring of economic developments.

55. **The staff strongly encourages the authorities to reach agreement with bilateral and non-Paris Club creditors that have not yet provided debt relief under the enhanced HIPC Initiative.**

56. **On risks to the program,** the staff notes that a weaker-than-programmed revenue performance, a slowdown in the implementation of the structural agenda, and less foreign aid could jeopardize the government's fiscal and poverty reduction targets.

57. **The staff recommends completion of the second review under the PRGF arrangement and supports the authorities' request for waivers for the quantitative performance criterion and the structural performance criterion that were not observed at end-December 2004.** In addition, the staff recommends the modification of end-June 2005 quantitative performance criteria, based on new information on the cereal and tobacco harvest and on the quarterly profile of revenue and government expenditure. The staff notes that the authorities recognize that the performance under the program has weakened, and that they are committed to taking strong corrective actions to address the slippages while pursuing an appropriate overall policy framework for 2005.

58. Mozambique maintains exchange restrictions that are subject to Fund approval under Article VIII of the Fund's Articles of Agreement. In view of the absence of a clear timetable for their elimination, the staff does not recommend approval of the restrictions at this stage.

59. The staff welcomes the authorities' intention to make public the staff report, the letter of intent, and the MEFP. It is recommended that the next Article IV consultation with Mozambique be held under the 24-month consultation cycle in accordance with Decision No. 12794-(02/76) of July 15, 2002, as amended by Decision No. 12854-(02/96) of September 12, 2002.

Figure 1. Mozambique: Real Growth Rates and Inflation

Sources: Mozambican authorities; and IMF staff estimates.

Figure 2. Mozambique: Exchange Rates

Effective Exchange Rate, January 1999 - March 2005
(January 1999 = 100)

Bilateral Nominal Exchange Rates, January 1999 - April 2005
(January 1999 = 100)

Sources: Mozambican authorities; and IMF staff estimates.

Figure 3. Mozambique: Interest Rates, January 2002 - February 2005
(In percent)

Sources: Mozambican authorities; and IMF staff estimates.

1/ TAM = Monetary Authority Bill.

Figure 4. Mozambique: Fiscal and External Sector Indicators, 2000-06

Sources: Mozambican authorities and IMF staff estimates.

Figure 5. Mozambique: Progress in Meeting MDG's

Sources: World Bank; and Instituto Nacional de Estadística (INE) Household Surveys, 1996/97 and 2002/03.

1/ A household consumption survey was conducted between 1996 and 1997, and 2002 and 2003, to determine poverty incidence. The methodology includes determining a sum of food and nonfood poverty lines. Households are defined as poor if their daily per capita expenditure is less than the total poverty line.

2/ Measured in net terms and as a percentage of relevant age group.

3/ Under-5 infant mortality rate (per 1,000).

Table 1. Mozambique: Selected Economic and Financial Indicators, 2003-08

	2003	2004 1/			2005	2006	2007	2008
		Prog.	Rev. Proj.	Act.	Rev.	Rev. proj.	Rev. proj.	Rev. proj.
(Annual percentage change, unless otherwise indicated)								
National income and prices								
Nominal GDP (in billions of meticals)	113,811	125,781	125,275	137,425	159,912	184,289	208,813	235,193
Nominal GDP growth	17.5	22.4	21.9	20.7	16.4	15.2	13.3	12.6
Real GDP growth	7.8	8.4	7.8	7.2	7.7	7.4	6.4	6.4
GDP per capita (in U.S. dollars)	258	285	292	320	424	460	491	522
Consumer price index (annual average)	13.4	12.9	12.6	12.6	8.0	7.3	6.5	5.9
Nonfood consumer price index (annual average)	8.2	...	...	13.5	...	...	...	...
Consumer price index (end of period)	13.8	11.0	9.1	9.1	8.0	7.0	6.0	5.8
Nonfood consumer price index, excl. food (end of period)	11.0	...	...	12.8	...	...	...	...
External sector								
Merchandise exports	28.9	42.8	40.7	44.1	13.9	1.9	1.8	6.3
Merchandise exports, excl. megaprojects	6.4	...	0.0	25.4	6.0	9.7	9.2	9.1
Merchandise imports	12.8	0.0	14.7	16.9	15.6	2.8	10.0	2.9
Merchandise imports, excl. megaprojects	23.0	...	...	22.8	13.0	5.4	3.7	5.4
Terms of trade	-1.4	0.5	2.7	13.4	2.2	-7.3	-8.9	-2.8
Nominal effective exchange rate (end of period) 2/	-10.9	...	...	17.9	...	...	...	...
Real effective exchange rate (end of period) 2/	-2.7	...	...	24.8	...	...	...	...
(Annual change in percent of beginning-of-period stock of money, unless otherwise indicated)								
Money and credit								
Net foreign assets	8.6	16.2	14.0	30.0	0.8	2.6	6.2	7.4
Net domestic assets 3/	10.1	14.2	22.1	-24.0	13.7	11.6	7.1	6.3
Which : net credit to the government 4/	0.3	-1.1	-1.2	-2.3	9.6	6.4	6.5	0.0
f credit to the economy	-0.8	9.1	5.4	-2.5	5.8	9.1	5.2	4.4
Broad money (M3)	18.7	15.0	12.0	5.9	14.5	14.2	13.3	13.6
Velocity (GDP/ average M3)	4.0	3.6	3.7	4.2	4.4	4.4	4.4	4.3
Interest rate for 90-day treasury bills/TAMs (in percent; end of period) 5/	12.1	...	...	10.5	...	...	...	...
(In percent of GDP)								
Investment and savings								
Gross domestic investment	25.9	23.3	22.2	20.1	21.3	21.3	23.8	22.5
Government	11.7	12.0	11.2	9.1	10.8	9.8	9.7	9.9
Other sectors	14.2	11.3	11.0	10.9	10.5	11.5	14.1	12.6
Gross domestic savings (excl. grants)	6.0	10.9	6.5	6.2	7.4	8.4	8.8	9.4
Government	-1.4	-1.0	-1.5	-1.6	-0.5	0.4	0.5	1.0
Other sectors	7.4	11.9	8.0	7.8	7.9	7.9	8.3	8.4
Current account, before grants	-19.9	-12.4	-15.7	-13.8	-13.9	-12.9	-15.0	-13.1
Government budget								
Total revenue	12.9	14.6	14.0	12.3	13.2	14.0	14.6	15.1
Total expenditure and net lending (incl. residual)	26.5	27.7	27.2	23.7	25.6	24.2	24.5	24.8
Overall balance, before grants	-14.0	-13.1	-13.2	-11.7	-12.4	-10.2	-10.0	-9.7
Total grants	9.5	9.4	8.3	7.3	6.4	5.8	5.6	5.5
Overall balance, after grants	-4.5	-3.8	-4.9	-4.4	-6.0	-4.4	-4.4	-4.2
Domestic primary balance	-3.7	-3.3	-3.6	-3.7	-2.8	-1.6	-1.7	-1.5
External financing (incl. debt relief) 6/	4.4	4.1	3.2	3.2	4.9	4.4	4.3	4.1
Net domestic financing	0.1	-0.3	-0.3	-0.5	1.1	0.0	0.0	0.0
Privatization 6/	0.0	0.0	2.1	1.8	0.0	0.1	0.1	0.0
(In percent of exports of goods and nonfactor services)								
External debt service (nonfinancial public sector)								
Scheduled, after additional bilateral assistance	6.1	4.8	4.7	4.5	5.1	5.3	5.4	5.2
(In millions of U.S. dollars, unless otherwise specified)								
Overall balance of payments	122	0	48	212	-84	-30	59	97
Net international reserves (end of period)	738	738	813	960	900	902	994	1,123
Gross international reserves (end of period)	947	931	1,002	1,159	1,076	1,045	1,104	1,201
In months of imports of goods & nonfactor services	5.4	6.1	5.1	5.8	4.7	4.4	4.1	4.3
In months of imports of goods & nonfactor services, excl. megaprojects	6.8	7.9	6.1	6.9	5.6	5.2	5.2	5.4
Exchange rate (meticals per U.S. dollar; end of period)	23,857	...	...	18,899	...	...	...	...

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ The GDP ratios corresponding to the program and the revised projection are calculated with the GDP projected at the time of the publication of the respective documents.

2/ A minus sign indicates depreciation.

3/ The percentage change for net domestic assets in the revised projection for 2004 has been adjusted to take account of the shifting of the external liabilities of the BM to the government.

4/ Includes the issuance of government securities for strengthening the balance sheet of the BM in years 2005-07, which are not included in the net domestic financing of the government finances table.

5/ TAMs stands for monetary authority bill. TAMs are debt instruments issued by the Bank of Mozambique; this particular instrument was not issued in 2002.

6/ Includes movement in the government account set abroad with the proceeds of the Moatize coal mine concession.

Table 2. Mozambique: Government Finances, 2003-08

(In billions of meticaís)

	2003	2004 1/			2005			2006	2007	2008
	Act.	Orig. prog.	Rev. proj.	Act.	Rev. Proj.	Budg. 6/	Rev. prog.	Proj.	Proj.	Proj.
Total revenue	14,714	18,350	17,595	16,838	21,654	21,706	21,091	25,888	30,386	35,596
Tax revenue	13,629	17,036	16,353	15,598	19,503	19,503	18,923	23,106	27,005	31,484
Taxes on income and profits	3,236	4,099	3,772	3,548	4,694	4,694	4,445	5,649	6,865	8,203
Taxes on goods and services	7,799	9,827	9,740	9,416	11,503	11,503	11,522	13,817	15,920	18,402
<i>Of which</i> : on petroleum products	1,305	1,605	1,715	1,663	1,983	1,983	2,089	2,627	3,079	3,629
Taxes on international trade	2,229	2,641	2,421	2,284	2,765	2,765	2,398	2,902	3,432	4,042
Other taxes	366	469	419	350	541	541	558	739	787	837
Nontax revenue	1,085	1,314	1,242	1,241	2,151	2,203	2,167	2,782	3,380	4,112
<i>Of which</i> : previously off-budget own-generated revenues of line-ministries and districts	...	...	...	...	646	622	622	803	980	1104
Total expenditure and net lending	30,184	34,888	34,131	32,607	43,360	43,432	40,987	44,605	51,198	58,293
Current expenditure	16,341	19,670	19,553	19,006	22,625	22,604	21,890	25,132	29,244	33,263
Compensation to employees	7,734	9,218	9,357	9,195	11,052	11,045	11,045	12,711	14,428	16,411
<i>Of which</i> : financed with own-generated revenues	...	...	...	...	145	145	145	163	187	210
financed with previously classified transfers to districts	...	...	...	...	206	206	206	232	265	299
Goods and services	4,039	5,074	4,698	4,727	6,061	6,051	5,651	6,413	7,460	8,315
<i>Of which</i> : financed with own-generated revenues	...	...	...	...	499	261	261	301	341	384
financed with previously classified transfers to districts	...	...	...	...	136	124	124	143	143	162
Interest on public debt	1,318	1,518	1,458	1,321	1,283	1,284	1,244	1,637	2,130	2,662
Domestic	1,002	1,099	955	910	921	921	921	1,030	1,408	1,811
External	317	418	503	411	361	362	323	607	722	851
Transfer payments	3,250	3,860	4,040	3,763	4,230	4,225	3,950	4,371	5,226	5,874
Domestic current primary balance	-309	198	-501	-847	312	385	445	2,393	3,271	4,996
Capital expenditure	13,362	15,138	13,854	12,543	18,908	19,001	17,226	18,119	20,302	23,212
<i>Of which</i> : locally financed	3,662	4,643	4,201	4,074	5,169	5,242	4,942	5,631	6,899	8,547
expenditure financed with fund for the concession mine of Tete	...	...	...	...	519	520	464	321	188	194
Net lending	481	80	724	1,058	1,826	1,826	1,870	1,354	1,652	1,818
<i>Of which</i> : locally financed	-261	-239	-135	-79	-16	-16	-16	-224	-33	-27
Domestic primary balance, before grants, above the line 2/	-3,710	-4,207	-4,566	-4,842	-4,841	-4,841	-4,481	-3,014	-3,594	-3,524
Unallocated revenue (+)/expenditure (-) 3/	-457	0	0	-310	0	0	0	0	0	0
Overall balance, before grants	-15,927	-16,537	-16,537	-16,078	-21,706	-21,726	-19,896	-18,716	-20,813	-22,697
Grants received	10,841	11,771	10,380	10,053	11,509	11,544	10,288	10,630	11,719	12,840
Project	6,671	7,333	6,167	6,185	7,566	7,573	6,766	6,948	7,641	8,367
Nonproject	4,170	4,438	4,212	3,868	3,943	3,971	3,522	3,682	4,077	4,472
Overall balance, after grants	-5,086	-4,766	-6,157	-6,025	-10,197	-10,183	-9,608	-8,087	-9,095	-9,857
Central bank transfer of HIPC Initiative assistance by the IMF	237	360	497	484	368	368	329	334	209	112
Net external financing	4,757	4,774	3,454	3,787	8,375	8,396	7,483	7,651	8,778	9,631
Disbursements	5,348	5,649	6,767	6,937	8,676	8,696	7,750	8,004	9,346	10,234
Project	2,780	3,161	3,486	3,564	5,655	5,666	5,054	5,219	5,575	6,104
Nonproject	2,569	2,488	3,281	3,373	3,021	3,030	2,696	2,785	3,772	4,130
Cash amortization	-591	-875	-832	-668	-819	-820	-731	-674	-756	-797
Investment abroad 4/	...	...	-2,482	-2,482	519	520	464	321	188	194
Net domestic financing	92	-386	-399	-728	1,453	1,419	1,797	0	0	0
Privatization 5/	0	18	2605	2482	0	0	0	102	108	114
Memorandum items:										
Domestic primary balance, before grants, below the line 2/	-4,167	-4,207	-4,566	-5,151	-4,841	-4,841	-4,481	-3,014	-3,595	-3,525
Grants and loans disbursements	16,189	17,421	17,147	16,990	20,184	20,239	18,038	18,633	21,065	23,073
Bonds issuance to strengthen the balance sheet of the central bank	...	...	...	...	1,500	1,500	1,500	2,500	2,899	0
Nominal GDP	113,811	125,781	125,275	137,425	144,939	144,207	159,912	184,289	208,813	235,193

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ The quasifiscal deficit of the Bank of Mozambique, amounting to Mt 3,455 billion (or 2.5 percent of GDP), is not included.

2/ Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending. Unallocated revenue and expenditure are included in the primary balance.

3/ Residual discrepancy between identified sources and uses of funds.

4/ Tracks the movements in the government account set up abroad with the proceeds of the Moatize coal mine concession.

5/ In 2004, it includes the US\$123 million concession fee for the Moatize coal mine.

Table 2. Mozambique: Government Finances, 2003-08 (concluded)
(In billions of meticaís)

	2003	2004 1/			2005			2006	2007	2008	
	Act.	Orig. prog.	Orig. prog. new GDP	Rev. proj.	Act.	Budg. 6/ old GDP	Budg. 6/ new GDP	Rev. Prog. new GDP	Proj.	Proj.	Proj.
(In percent of GDP, unless otherwise specified)											
Total revenue	12.9	14.6	13.4	14.0	12.3	15.1	13.6	13.2	14.0	14.6	15.1
Tax revenue	12.0	13.5	12.4	13.1	11.3	13.5	12.2	11.8	12.5	12.9	13.4
Taxes on income and profits	2.8	3.3	3.0	3.0	2.6	3.3	2.9	2.8	3.1	3.3	3.5
Taxes on goods and services	6.9	7.8	7.2	7.8	6.9	8.0	7.2	7.2	7.5	7.6	7.8
<i>Of which</i> : on petroleum products	1.1	1.3	1.2	1.4	1.2	1.4	1.2	1.3	1.4	1.5	1.5
Taxes on international trade	2.0	2.1	1.9	1.9	1.7	1.9	1.7	1.5	1.6	1.6	1.7
Other taxes	0.3	0.4	0.3	0.3	0.3	0.4	0.3	0.3	0.4	0.4	0.4
Nontax revenue	1.0	1.0	1.0	1.0	0.9	1.5	1.4	1.4	1.5	1.6	1.7
<i>Of which</i> : previously off-budget own-generated revenues of line-ministries and districts	...	...	...	...	...	0.4	0.4	0.4	0.4	0.5	0.5
Total expenditure and net lending	26.5	27.7	25.4	27.2	23.7	30.1	27.2	25.6	24.2	24.5	24.8
Current expenditure	14.4	15.6	14.3	15.6	13.8	15.7	14.1	13.7	13.6	14.0	14.1
Compensation to employees	6.8	7.3	6.7	7.5	6.7	7.7	6.9	6.9	6.9	6.9	7.0
<i>Of which</i> : financed with own-generated revenues	...	...	...	...	...	0.1	0.1	0.1	0.1	0.1	0.1
financed with previously classified transfers to districts	...	...	...	...	...	0.1	0.1	0.1	0.1	0.1	0.1
Goods and services	3.5	4.0	3.7	3.8	3.4	4.2	3.8	3.5	3.5	3.6	3.5
<i>Of which</i> : financed with own-generated revenues	...	...	...	...	...	0.2	0.2	0.2	0.2	0.2	0.2
financed with previously classified transfers to districts	...	...	...	...	...	0.1	0.1	0.1	0.1	0.1	0.1
Interest on public debt	1.2	1.2	1.1	1.2	1.0	0.9	0.8	0.8	0.9	1.0	1.1
Domestic	0.9	0.9	0.8	0.8	0.7	0.6	0.6	0.6	0.6	0.7	0.8
External	0.3	0.3	0.3	0.4	0.3	0.3	0.2	0.2	0.3	0.3	0.4
Transfer payments	2.9	3.1	2.8	3.2	2.7	2.9	2.6	2.5	2.4	2.5	2.5
Domestic current primary balance	-0.3	0.2	0.1	-0.4	-0.6	0.3	0.2	0.3	1.3	1.6	2.1
Capital expenditure	11.7	12.0	11.0	11.1	9.1	13.2	11.9	10.8	9.8	9.7	9.9
<i>Of which</i> : locally financed	3.2	3.7	3.4	3.4	3.0	3.6	3.3	3.1	3.1	3.3	3.6
Net lending	0.4	0.1	0.1	0.6	0.8	1.3	1.1	1.2	0.7	0.8	0.8
<i>Of which</i> : locally financed	-0.2	-0.2	-0.2	-0.1	-0.1	0.0	0.0	0.0	-0.1	0.0	0.0
Domestic primary balance, before grants, above the line 2/	-3.3	-3.3	-3.1	-3.6	-3.5	-3.4	-3.0	-2.8	-1.6	-1.7	-1.5
Unallocated revenue (+)/expenditure (-) 3/	-0.4	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	-14.0	-13.1	-12.0	-13.2	-11.7	-15.1	-13.6	-12.4	-10.2	-10.0	-9.7
Grants received	9.5	9.4	8.6	8.3	7.3	8.0	7.2	6.4	5.8	5.6	5.5
Project	5.9	5.8	5.3	4.9	4.5	5.3	4.7	4.2	3.8	3.7	3.6
Nonproject	3.7	3.5	3.2	3.4	2.8	2.8	2.5	2.2	2.0	2.0	1.9
Overall balance, after grants	-4.5	-3.8	-3.5	-4.9	-4.4	-7.1	-6.4	-6.0	-4.4	-4.4	-4.2
Central bank transfer of HIPC Initiative assistance by the IMF	0.2	0.3	0.3	0.4	0.4	0.3	0.2	0.2	0.2	0.1	0.0
Net external financing	4.2	3.8	3.5	2.8	2.8	5.8	5.3	4.7	4.2	4.2	4.1
Disbursements	4.7	4.5	4.1	5.4	5.0	6.0	5.4	4.8	4.3	4.5	4.4
Project	2.4	2.5	2.3	2.8	2.6	3.9	3.5	3.2	2.8	2.7	2.6
Nonproject	2.3	2.0	1.8	2.6	2.5	2.1	1.9	1.7	1.5	1.8	1.8
Cash amortization	-0.5	-0.7	-0.6	-0.7	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	-0.3
Investment abroad 4/	...	...	...	-2.0	-1.8	0.4	0.3	0.3	0.2	0.1	0.1
Net domestic financing	0.1	-0.3	-0.3	-0.3	-0.5	1.0	0.9	1.1	0.0	0.0	0.0
Privatization 5/	...	0.0	0.0	2.1	1.8	0.0	0.0	0.0	0.1	0.1	0.0
Memorandum items:											
Domestic primary balance, before grants, below the line 2/	-3.7	-3.3	-3.1	-3.6	-3.7	-3.4	-3.0	-2.8	-1.6	-1.7	-1.5
Grants and loans disbursements	14.2	13.9	12.7	13.7	12.4	14.0	12.7	11.3	10.1	10.1	9.8
Gross national government saving	8.1	8.3	7.6	6.7	5.7	7.4	6.7	5.9	6.2	6.2	6.5
Domestic public debt 6/	4.3	...	1.9	2.0	1.9	...	...	2.1	4.5	4.0	3.5
Bonds issuance for strengthening the balance sheet of the central bank	...	...	...	...	...	1.0	...	0.9	1.4	1.4	0.0
Nominal GDP (in billions of meticaís)	113,811	125,781	137,425	125,275	137,425	144,207	159,912	159,912	184,289	208,813	235,193

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ The quasifiscal deficit of the Bank of Mozambique, amounting to Mt 3,455 billion (or 2.5 percent of GDP), is not included.

2/ Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending. Unallocated revenue and expenditure are included in the primary balance

3/ Residual discrepancy between identified sources and uses of funds.

4/ Tracks the movements in the government account set up abroad with the proceeds of the Moatize coal mine concession.

5/ In 2004, it includes the US\$123 million concession fee for the Moatize coal mine.

6/ Includes government securities issued to strengthen the balance sheet of the Bank of Mozambique.

Table 3. Mozambique: Monetary Survey, December 2003-December 2008

	2003	2004		2005		2006	2007	2008
	Act.	Rev. Proj.	Act.	Rev. Proj.	Rev. prog.	Proj.	Proj.	Proj.
(In billions of meticaís, unless otherwise specified)								
Central bank								
Net foreign assets	7,104	17,555	19,184	18,702	18,893	19,699	22,295	25,845
(in millions of U.S. dollars)	298	857	1,015	830	955	957	1,049	1,178
Net international reserves 1/	17,606	16,649	18,141	17,751	17,801	18,563	21,122	24,634
(in millions of U.S. dollars)	738	813	960	788	900	902	994	1,123
Medium- and long-term foreign liabilities 2/	-11,806	-102	-57	-158	-59	-62	-64	-65
Other	1,304	1,008	1,100	1,109	1,152	1,198	1,237	1,277
Net domestic assets	1,578	-7,190	-8,750	-6,982	-6,947	-6,052	-6,832	-8,274
Credit to government (net)	-5,961	-5,759	-8,925	-4,031	-10,234	-7,598	-6,150	-8,357
Credit to banks (net)	-3,208	-4,787	-3,859	-5,707	-77	-77	-77	-77
Credit to the economy	1	1	1	1	1	1	1	1
Other items (net; assets +)	10,746	3,355	4,033	2,755	3,362	1,622	-606	159
Reserve money	8,682	10,365	10,433	11,720	11,946	13,647	15,463	17,571
Currency outside banks	4,259	5,094	5,225	5,729	5,982	6,834	7,743	8,799
Bank reserves	4,423	5,271	5,209	5,990	5,964	6,813	7,720	8,772
Currency in banks	752	864	978	994	1,091	1,247	1,413	1,605
Deposits	3,671	4,406	4,231	4,996	4,872	5,566	6,307	7,167
Deposit money banks								
Net foreign assets	7,308	6,103	4,900	6,083	5,461	5,680	5,865	6,054
(in millions of U.S. dollars)	306	298	259	270	276	276	276	276
Net domestic assets	20,690	24,930	24,050	29,554	27,684	32,186	37,041	42,701
Banks' reserves	4,423	5,271	5,209	5,990	5,964	6,813	7,720	8,772
Central bank liabilities with commercial banks (net)	3,472	4,787	4,009	5,707	77	77	77	77
Credit to government (net)	2,420	1,820	4,656	3,011	9,262	9,126	10,577	12,784
Credit to the economy	14,320	16,071	13,512	18,495	15,488	19,057	21,369	23,580
Other items (net; assets +)	-3,945	-3,018	-3,336	-3,649	-3,106	-2,887	-2,702	-2,512
Deposits	27,998	31,034	28,950	35,637	33,145	37,866	42,905	48,755
Demand and savings deposits	18,901	19,893	19,255	22,747	21,544	24,613	27,889	31,691
Time deposits	9,097	11,141	9,695	12,890	11,601	13,253	15,017	17,064
Monetary survey								
Net foreign assets	14,412	23,658	24,084	24,785	24,354	25,380	28,160	31,900
Net domestic assets	17,845	12,470	10,091	16,582	14,774	19,321	22,489	25,654
Domestic credit	10,779	12,133	9,244	17,476	14,517	20,586	25,797	28,008
Credit to government (net)	-3,541	-3,939	-4,269	-1,020	-972	1,528	4,427	4,427
Credit to the economy	14,320	16,072	13,513	18,496	15,489	19,058	21,370	23,581
Other items (net; assets +)	7,066	337	847	-894	257	-1,265	-3,308	-2,354
Money and quasi money (M3)	32,257	36,128	34,174	41,366	39,127	44,701	50,649	57,554
Foreign currency deposits	12,845	10,086	11,522	14,219	13,192	15,071	16,894	18,964
(In millions of U.S. dollars)	538	492	610	631	667	732	795	865
M2	19,412	26,042	22,653	27,147	25,935	29,630	33,755	38,590
Currency outside banks	4,259	5,094	5,225	5,729	5,982	6,834	7,743	8,799
Domestic currency deposits	15,153	20,948	17,428	21,418	19,953	22,796	26,011	29,790
Memorandum items:								
Broad money (M3) (12-month change in percent)	18.7	12.0	5.9	14.5	14.5	14.2	13.3	13.6
M2 (12-month change in percent)	24.3	34.2	16.7	19.8	14.5	14.2	13.9	14.3
M3-to-GDP ratio (percent)	28.3	28.8	24.9	28.5	24.5	24.3	24.3	24.5
M2-to-GDP ratio (percent)	17.1	20.8	16.5	18.7	16.2	16.1	16.2	16.4
Currency outside banks-to-M3 ratio (percent)	13.2	14.1	15.3	13.9	15.3	15.3	15.3	15.3
Foreign currency deposits-to-M3 ratio (percent)	39.8	29.9	33.7	34.4	33.7	33.7	33.4	33.0
Money multiplier (M2/reserve money)	2.2	2.5	2.2	2.3	2.2	2.2	2.2	2.2
Money multiplier (M3/reserve money)	3.7	3.5	3.3	3.5	3.3	3.3	3.3	3.3
Velocity (GDP/average M3)	4.0	3.8	4.2	3.7	4.4	4.4	4.4	4.3
Velocity (GDP/M3)	3.5	3.5	4.0	3.5	4.1	4.1	4.1	4.1
Velocity (GDP/average M2)	6.7	5.5	6.7	5.4	6.6	6.6	6.6	6.5
Velocity (GDP/M2)	5.9	4.8	6.1	5.3	6.2	6.2	6.2	6.1
Nominal GDP growth	17.5	21.9	20.7	21.9	16.4	15.2	13.3	12.6

Sources: Bank of Mozambique; and IMF staff estimates and projections.

1/ The net international reserves (NIR) program and actual figures for 2004 and the NIR actual for 2003 have been revised downward by deducting from gross reserves some deposits held by the central bank abroad are encumbered for specific imports. The proceeds of the Moatize coal mine concession are not included.

2/ In July 2004, part of the medium- and long-term foreign liabilities of the central bank (11,023.5 billions of meticaís or US\$489 million) were transferred to the treasury.

This account was offset by "other items" in net domestic assets.

Table 4. Mozambique: Balance of Payments, 2003-08
(In millions of U.S. dollars, unless otherwise specified)

	2003	2004		2005		2006	2007	2008
	Actual	Rev. proj.	Prel.	Rev. proj.	Rev. prog..	Proj.	Proj.	Proj.
Trade balance	-697	-526	-531	-731	-639	-674	-883	-848
Exports, f.o.b.	1,044	1,469	1,504	1,529	1,713	1,746	1,778	1,889
Large projects	681	1,094	1,049	1,132	1,230	1,216	1,199	1,259
Other exports	363	375	455	398	483	529	578	631
Imports, c.i.f.	-1,741	-1,996	-2,035	-2,260	-2,353	-2,419	-2,661	-2,737
Large projects	-337	-363	-312	-460	-407	-369	-536	-496
Other imports	-1,403	-1,633	-1,723	-1,800	-1,946	-2,050	-2,125	-2,241
Services and incomes (net)	-257	-335	-312	-532	-504	-511	-618	-581
Receipts	358	384	370	410	402	449	500	555
Expenditures	-614	-719	-682	-942	-906	-960	-1,118	-1,136
<i>Of which</i> : interest on public debt	-26	-27	-18	-29	-28	-35	-39	-44
Current account, before grants	-953	-862	-843	-1,262	-1,143	-1,184	-1,502	-1,429
Unrequited official transfers	514	483	491	556	557	558	585	614
<i>Of which</i> : multilaterals' HIPC assistance grants	22	23	24	26	27	28	24	19
Current account, after grants	-440	-379	-352	-707	-586	-627	-916	-814
Capital account	433	402	320	634	478	546	925	861
Trade credit (net)	-94	0	43	0	54	53	55	70
Foreign borrowing	395	409	463	620	610	607	855	834
Public 1/	236	294	315	405	405	402	450	474
Private 2/	160	115	148	215	205	205	405	361
Amortization	-210	-238	-303	-266	-325	-332	-369	-391
Public 1/	-68	-66	-63	-74	-78	-79	-81	-79
Private	-142	-172	-240	-192	-247	-254	-288	-312
Direct investment (net)	342	353	241	256	115	202	374	348
<i>Of which</i> : Moatize coal mine	0	123	123	0	0	0	0	0
Other investment of the government 3/	0	-123	-123	24	24	16	9	0
Short-term capital and errors and omissions (net) 4/	129	25	244	25	25	50	50	50
Overall balance	122	48	212	-48	-84	-30	59	97
Financing	-122	-48	-212	48	84	30	-59	-97
<i>Of which</i> : Bank of Mozambique gross reserve assets (increase -)	-122	-48	-212	48	84	30	-59	-97
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Use of Fund credit (net)	-9	-20	-19	-23	-24	-32	-33	-32
Current account deficit (percent of GDP)								
Before grants	19.9	15.6	13.8	19.0	13.9	12.9	15.0	13.1
After grants	9.2	6.8	5.8	10.6	7.1	6.8	9.2	7.5
After grants, excluding large projects	10.4	15.0	13.1	13.8	11.7	11.1	9.9	9.2
Net international reserves 4/	738	813	960	788	900	902	994	1,123
Gross international reserves 4/	947	1,002	1,159	954	1,076	1,045	1,104	1,201
In months of imports of goods and nonfactor services (excluding megaprojects)	5.4	5.1	5.8	4.3	4.7	4.4	4.1	4.3
In months of imports of goods and nonfactor services (excluding megaprojects)	6.8	6.1	6.9	5.3	5.6	5.2	5.2	5.4
Gross foreign assets of the government	...	123	123	99	99	83	74	74
Debt Indicators (in percent) 5/								
Net present value of public external debt/GDP	25.2	24.6	25.2	23.0	21.0	20.9	21.3	21.6
Net present value of public external debt/exports	102.0	91.9	83.8	92.6	83.6	89.5	96.0	99.3
Debt service due/exports	6.1	4.7	4.5	4.6	5.1	5.3	5.4	5.2

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ Including IMF.

2/ Private borrowing, not guaranteed by the government or the Bank of Mozambique.

3/ Tracks the movements in the government account set up abroad with the proceeds of the coal mine concession.

4/ Errors and omissions have been adjusted (compared with IMF Country Report No. 05/168) to make the balance of payments consistent with the latest information available on gross international reserves/net international reserves in 2004. Net international reserves accumulation has been kept unchanged in 2005-06.

5/ Figures in net present value terms for 2004 and beyond are derived from the external debt sustainability analysis are not directly comparable to those for the following years as a result of a different methodology.

Table 5. Mozambique: Balance of Payments of Megaprojects, 2002-08 1/
(In millions of U.S. dollars, unless otherwise specified)

	2002	2003	2004		2005		2006	2007	2008
	Act.	Act.	Rev. proj.	Prel.	Rev. proj.	Rev. prog.	Proj.	Proj.	Proj.
Trade balance	66	344	731	736	671	824	847	664	762
Exports, f.o.b.	468	681	1,094	1,049	1,132	1,230	1,216	1,199	1,259
Imports, c.i.f.	-402	-337	-363	-312	-460	-407	-369	-536	-496
Services and incomes (net)	-233	-228	-267	-305	-448	-433	-450	-573	-556
Current account, before grants	-167	116	464	431	224	391	397	91	206
Current account, after grants	-167	116	464	431	224	391	397	91	206
Capital account	644	229	-63	-62	42	-53	-99	243	135
Foreign borrowing	439	62	0	5	85	75	45	235	179
Amortization	-40	-66	-104	-117	-128	-153	-159	-169	-179
Direct investment (net)	245	234	41	50	85	25	15	177	134
Overall balance before short-term capital inflows 2/	477	344	401	369	265	338	298	334	340

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ Megaprojects include Mozal (aluminum production), Sasol (gas production and pipeline), the Cahora-Bassa dam (hydropower), and two titanium ore projects.

2/ This line overestimates the contribution of megaprojects to international reserve accumulation, because most of their financial operations are conducted outside the domestic banking system. Only a small fraction of foreign exchange proceeds are actually repatriated in Mozambique. However, information on the latter is not available.

Table 6. Mozambique: Expenditure in PARPA Priority Sectors, 2003-05 1/
(In billions of meticaís, unless otherwise indicated)

	2003	2004	2004	2005	2005
	Est. 2/	Prog. 2/	Est. 2/	Budg. 2/	Proj. 2/
Total expenditure (excl. bank restruct. costs, net lending, and interest payments)	28,385	33,290	30,228	40,322	37,872
Total expenditure in PARPA priority sectors	17,996	21,639	19,134	26,733	25,109
In percent of GDP	15.8	15.7	13.9	18.5	15.7
In percent of total expenditure (excluding bank restructuring costs, net lending, and interest payments)	63.4	65.0	63.3	66.3	66.3
Education	5,734	7,091	6,252	7,500	7,044
Primary	4,825	5,792	5,310	5,806	5,454
Postsecondary	908	1,298	942	1,694	1,591
Health	3,009	3,695	3,295	5,000	4,696
HIV/AIDS	85	233	139	282	265
Infrastructure development	3,917	4,594	4,142	7,500	7,044
Roads	3,122	2,131	3,188	5,685	5,340
Sanitation and public works	795	2,463	953	1,814	1,704
Agriculture and rural development	1,391	2,097	1,318	1,694	1,591
Governance and judicial system	2,668	3,229	2,881	3,871	3,636
Security and public order	539	1,631	1,648	847	795
Governance	1,590	832	523	2,056	1,931
Judicial system	539	766	710	968	909
Other priority areas 3/	1,135	699	1,121	887	833
Social actions	199	266	200	242	227
Labor and employment	85	133	121	121	114
Mineral resources and energy	852	300	801	524	492
Total PARPA expenditures in percent of GDP					
Education	5.0	5.2	4.5	5.2	4.4
Primary	4.2	4.2	3.9	4.0	3.4
Postsecondary	0.8	0.9	0.7	1.2	1.0
Health	2.6	2.7	2.4	3.5	2.9
HIV/AIDS	0.1	0.2	0.1	0.2	0.2
Infrastructure development	3.4	3.3	3.0	5.2	4.4
Roads	2.7	1.6	2.3	3.9	3.3
Sanitation and public works	0.7	1.8	0.7	1.3	1.1
Agriculture and rural development	1.2	1.5	1.0	1.2	1.0
Governance and judicial system	2.3	2.3	2.1	2.7	2.3
Security and public order	0.5	1.2	1.2	0.6	0.5
Governance	1.4	0.6	0.4	1.4	1.2
Judicial system	0.5	0.6	0.5	0.7	0.6
Other priority areas 3/	1.0	0.5	0.8	0.6	0.5
Social actions	0.2	0.2	0.1	0.2	0.1
Labor and employment	0.1	0.1	0.1	0.1	0.1
Mineral resources and energy	0.7	0.2	0.6	0.4	0.3
Total PARPA expenditures in percent of total expenditures (excluding bank restructuring costs, net lending, and interest payments)					
Education	20.2	21.3	20.7	18.6	18.6
Primary	17.0	17.4	17.6	14.4	14.4
Postsecondary	3.2	3.9	3.1	4.2	4.2
Health	10.6	11.1	10.9	12.4	12.4
HIV/AIDS	0.3	0.7	0.5	0.7	0.7
Infrastructure development	13.8	13.8	13.7	18.6	18.6
Roads	11.0	6.4	10.5	14.1	14.1
Sanitation and public works	2.8	7.4	3.2	4.5	4.5
Agriculture and rural development	4.9	6.3	4.4	4.2	4.2
Governance and judicial system	9.4	9.7	9.5	9.6	9.6
Security and public order	1.9	4.9	5.5	2.1	2.1
Governance	5.6	2.5	1.7	5.1	5.1
Judicial system	1.9	2.3	2.3	2.4	2.4
Other priority areas 3/	4.0	2.1	3.7	2.2	2.2
Social actions	0.7	0.8	0.7	0.6	0.6
Labor and employment	0.3	0.4	0.4	0.3	0.3
Mineral resources and energy	3.0	0.9	2.7	1.3	1.3
Memorandum items:					
Nominal GDP	113,811	137,425	137,425	144,207	159,912
HIPC debt relief accruing to the budget					
In millions of U.S. dollars	10	15	21	17	17
In billions of meticaís	237	360	481	368	328
PARPA priority spending in million of U.S. dollars	757	878	847	1,228	1,294

Sources : Mozambican authorities; and IMF staff estimates and projections.

1/ PARPA stands for National Action Plan for the Reduction of Absolute Poverty, which is the Portuguese acronym for the Poverty Reduction Strategy Paper (PRSP).

2/ Figures for expenditures in priority sectors are estimated by applying the percentages reported by the authorities to the total expenditures in meticaís presented in Table 2.

3/ Relates to expenditures viewed complementary to PARPA priority areas and which contribute to income generation and employment opportunities.

Table 7. Mozambique: Financial Soundness Indicators for Banking Sector, 2000-04
(In percent unless otherwise indicated)

	2000	2001	2002	2003	2004
Capital adequacy					
Regulatory capital to risk-weighted assets	-2.13	5.49	14.01	17.03	18.65
Capital (net worth) to assets	-2.70	8.22	7.83	5.63	6.54
Asset composition and quality					
Sectoral distribution of loans to total loans					
Agriculture	19.00	18.00	15.00	12.73	9.45
Industry	27.00	25.00	22.00	16.94	11.94
Construction	5.00	4.00	4.00	5.20	3.35
Commerce	23.00	20.00	17.00	18.13	21.29
Transportation and communication	5.00	7.00	5.00	7.08	7.19
Other	21.00	26.00	37.00	39.92	46.78
Foreign exchange loans to total loans	40.24	64.69	69.87	70.77	67.33
Nonperforming loans to gross loans 1/	17.76	23.43	20.80	26.76	6.42
Nonperforming loans net of provisions to capital 1/	35.00	11.00	-17.00	12.00	2.60
Earnings and profitability					
Return on assets	0.04	0.14	1.59	1.24	1.43
Return on equity	...	3.51	22.10	16.29	18.73
Interest margin to gross income	...	10.22	3.40	26.00	11.65
Noninterest expenses to gross income	...	16.92	27.67	31.97	14.44
Personnel expenses to noninterest expenses	...	51.71	47.81	47.20	43.13
Trading and fee income to gross income	...	33.09	39.68	8.37	2.65
Spread between reference loan and deposit rates (90 days, local currency)	...	14.00	19.00	17.39	14.67
Funding and liquidity					
Liquid assets to total assets 2/	41.51	34.64	46.23	29.46	34.67
Customer deposits to total (non-interbank) loans	188.00	217.00	240.00	227.97	283.07
Foreign exchange liabilities to total liabilities	54.53	63.30	61.26	80.30	75.52

Source: Bank of Mozambique.

1/ Nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).

2/ Includes deposits at parent banks.

Table 8. Mozambique: Indicators of External Vulnerability, 2002-05
(In percent of GDP, unless otherwise indicated)

	2002	2003	2004 Prel.	2005 Proj.
Financial indicators				
Net present value of public sector debt 1/	25.2	29.5	27.0	23.0
Broad money (percent change, 12-month basis)	21.5	18.7	5.9	14.5
Private sector credit (percent change, 12-month basis)	4.2	-1.4	-5.6	14.6
External indicators				
Exports of goods (percent change, 12-month basis in U.S. dollars)	15.1	28.9	44.1	13.9
Imports of goods c.i.f. (percent change, 12-month basis in U.S. dollars)	45.2	12.8	16.9	15.6
Terms of trade (percent change, 12-month basis)	-3.8	-1.4	13.4	2.2
Current account balance (after grants)	-13.3	-9.2	-5.8	-7.1
Capital and financial account balance	21.3	9.0	5.3	5.8
<i>Of which</i> : foreign direct investment	9.3	7.1	4.0	1.4
Gross international reserves (in millions of U.S. dollars)	825	947	1159	1076
(In months of imports of goods and services)	5.0	5.4	5.8	4.7
(In months of imports of goods and services, excluding megaprojects)	6.9	6.8	6.9	5.8
Net international reserves (in millions of U.S. dollars)	624	738	960	900
Net foreign asset of commercial banks (in millions of U.S. dollars)	341.0	306.0	259.0	276.0
Total short term external debt to reserves (in percent)	8.4	7.6	4.9	7.3
Net present value of total external debt 1/	55.6	54.4	46.7	36.3
<i>Of which</i> : net present value of public sector external debt	21.8	25.2	25.2	21.0
Net present value of public external debt to exports of goods and services (in percent)	91.7	102.0	83.8	83.6
External debt-service payments to exports of goods and services (in percent) 2/	6.4	6.1	4.5	5.1
Exchange rate (meticaïs per U.S. dollar, period average) 3/	23,180	23,341	22,123	...
REER depreciation (-) (12 month basis)	-6.3	-2.7	24.8	...

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ Domestic public debt and private sector external debt are valued at par in the net present value calculation.

2/ Cash interest and amortization payments, after HIPC assistance.

3/ Official exchange rate.

Table 9. Mozambique: Millennium Development Goals, 1990-2003 1/

	1990	1994	1997	2000	2003
Goal 1: Eradicate extreme poverty and hunger					
Percentage share of income or consumption held by poorest 20 percent	...	...	6.5	...	...
National household survey poverty incidence 2/			<i>69.4</i>		<i>54.1</i>
Population below \$1 a day (percent)	...	...	<i>37.8</i>	...	...
Population below minimum level of dietary energy consumption (percent)	...	...	58	...	<i>47</i>
Poverty gap ratio at \$1 a day (incidence x depth of poverty)	...	...	<i>12</i>	...	...
Poverty headcount, national (percent of population)	...	...	69.4	...	...
Prevalence of underweight in children (under five years of age)	...	27	26.1	...	...
Goal 2: Achieve universal primary education					
Net primary enrollment ratio (percent of relevant age group)	44.7	...	<i>47.3</i>	54.1	<i>55.3</i>
Primary completion rate, total (percent of relevant age group)	28	25	29	38	52
Proportion of pupils starting grade 1 who reach grade 5	32.7	...	<i>41.8</i>	51.9	...
Youth literacy rate (percent ages 15-24)	48.8	53.5	57	60.6	<i>62.8</i>
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliament (percent)	16	...	25	<i>30</i>	30
Ratio of girls to boys in primary and secondary education (percent)	73	...	<i>73.2</i>	<i>75.6</i>	<i>79</i>
Ratio of young literate females to males (percent ages 15-24)	47.9	53.4	<i>57.5</i>	61.5	<i>64.3</i>
Share of women employed in the nonagricultural sector (percent)	15.2	...	...	...	...
Goal 4: Reduce child mortality					
Immunization, measles (percent of children ages 12-23 months)	59	65	61	71	77
Infant mortality rate (per 1,000 live births)	146	<i>129</i>	...	110	101
Under-5 mortality rate (per 1,000)	242	<i>206</i>	...	167	147
Goal 5: Improve maternal health					
Births attended by skilled health staff (percent of total)	...	...	44.2	...	48
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	1000	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Contraceptive prevalence rate (percent of women ages 15-49)	...	...	5.6	...	17
Incidence of tuberculosis (per 100,000 people)	158.4	260.8	333.4	395.8	456.6
Number of children orphaned by HIV/AIDS	...	...	...	<i>330,000</i>	<i>470,000</i>
Prevalence of HIV, total (percent of population aged 15-49)	...	...	...	<i>12.1</i>	12.2
Tuberculosis cases detected under DOTS (percent)	...	<i>55.6</i>	<i>47.7</i>	45.1	45.1
Goal 7: Ensure environmental sustainability					
Access to an improved water source (percent of population)	...	...	...	...	<i>42</i>
Access to improved sanitation (percent of population)	...	...	...	...	<i>27</i>
Access to secure tenure (percent of population)	...	...	...	...	...
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1	...
Forest area (percent of total land area)	39.8	...	...	39	...
GDP per unit of energy use (2000 PPP \$ per kg oil equivalent)	1.2	1.5	1.8	2.2	2.3
Nationally protected areas (percent of total land area)	...	...	...	...	8.4
Goal 8: Develop a global partnership for development					
Aid per capita (current US\$)	70.8	77.8	57	49.6	55
Debt service (percent of exports)	...	...	...	...	...
Fixed line and mobile phone subscribers (per 1,000 people)	3.4	3.9	4.4	8	<i>18.6</i>
Internet users (per 1,000 people)	...	...	0.1	1.2	<i>2.8</i>
Personal computers (per 1,000 people)	...	...	1.9	3.5	<i>4.5</i>
Unemployment, youth female (percent of female labor force ages 15-24)	...	...	...	...	...
Unemployment, youth male (percent of male labor force ages 15-24)	...	...	...	...	...
Unemployment, youth total (percent of total labor force ages 15-24)	...	...	...	...	...
Other					
Fertility rate, total (births per woman)	6.3	5.6	5.3	...	5
Gross national income per capita, Atlas method (current US\$)	170	130	180	210	210
Gross national income, Atlas method (current US\$ billions)	2.3	2	2.9	3.7	3.9
Gross capital formation (percent of GDP)	22.1	25.3	20.6	36.6	27.9
Life expectancy at birth, total (years)	43.4	...	45.5	<i>43.1</i>	<i>40.7</i>
Literacy rate, adult total (percent of people ages 15 and above)	33.5	37.5	40.6	44	<i>46.5</i>
Population, total (millions)	14.2	15.4	16.6	17.7	18.8
Trade (percent of GDP)	44.2	61.6	42.2	51.8	62.1

Source: World Development Indicators database, April 2005.

1/ Figures in italics refer to periods other than those specified.

2/ A household survey was conducted between 1996/1997 and 2002/2003 to determine poverty incidence. The methodology included a basket of goods that satisfies basic calorie needs. The cost of this basket represents the food poverty line in each domain; a nonfood poverty line was also obtained. Households are defined as poor if their daily per capita expenditure is less than the total poverty line (sum of food and nonfood poverty lines).

Maputo, Mozambique
May 26, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Dear Mr. de Rato:

1. On behalf of the Government of Mozambique, I hereby transmit the attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the Government intends to implement the remainder of 2005, as well as the underlying macroeconomic policy framework consistent with the PARPA. The attached technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. The Government of Mozambique has made substantial progress in implementing the 2004-06 program supported by the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Fund's Executive Board on July 6, 2004. The general elections took place on December 1 and 2, 2004 and, as international observers noted, they were in general transparent and fair. However, some slippages in the implementation of the program occurred during the period leading to elections. One out of five quantitative performance criteria at end-December 2004 was not observed (i.e., the performance criterion on the domestic primary deficit). The breach of this criterion was the result of low revenue collections arising from larger-than-programmed reimbursements of the value-added tax (VAT), the appreciation of the metical, and delays incurred by corporations in complying with the payments calendar under the new corporate income tax code. In addition, some delays occurred in the implementation of structural reforms during October 2004-March 2005. Three out of eight benchmarks were observed while one of the two performance criteria was missed (the completion of a feasibility study on the divestment of the Government's participation in a commercial bank, which is now expected by end-September 2005).

3. The Government of Mozambique recognizes the significance of the fiscal slippage and some delays in the implementation of structural reforms. The Government will take strong corrective measures to address the slippages. It is also determined to intensify efforts in the remainder of 2005 to strengthen tax administration and accelerate the pace of reforms with the timely help of the international community. Moreover, in the event that revenue collection falls short of quarterly program targets, the Government of Mozambique will implement contingency expenditure measures as described in the MEFP in order to reach the targets set for the remainder of 2005.

4. On this basis, the authorities request waivers respectively for the quantitative performance criterion as well as the structural performance criterion that were not observed at end-December 2004. In addition, the authorities request the modification of quantitative performance criteria for end-June 2005 to take into account the performance at end-2004 and new seasonality of revenue and government expenditure.

5. In support of our objectives and policies the Government of Mozambique hereby requests the disbursement of the third loan under the PRGF in the amount of SDR 1.62 million (1.4 percent of quota) on the completion of the second review.

6. Looking ahead, the policies set out in the MEFP aim to consolidate macroeconomic stability and sustain strong broad-based growth in order to promote employment and further reduce poverty. The performance criteria and benchmarks for the third review will be based on the end-June 2005 and end-September 2005 targets as set out in Tables 1 and 4 of the MEFP. The fourth review, which will make available the fifth disbursement, is expected to be completed by May 31, 2006, and will be based on the observance of the end-December 2005 quantitative performance criteria set forth in Table 1 of the MEFP. Additional conditionality for the fifth disbursement will be established at the time of the third review.

7. Moreover, the Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement as soon as the revisions to the foreign exchange law are approved by the Assembly.

8. The Government of Mozambique will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

9. The Government of Mozambique believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of its economic program for 2005 supported by the PRGF arrangement, but it will take further measures to that end if deemed necessary. During the implementation of the arrangement, the Government of Mozambique will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, at the initiative of the Government or whenever the Managing Director requests such a consultation.

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Adriano Afonso Maleiane
Governor
Bank of Mozambique

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Memorandum of Economic and Financial Policies of the Government of Mozambique for the Second Review Under the PRGF Arrangement

1. The Government of Mozambique is committed to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and structural reforms. The strategy to achieve these goals is set out in the Plano de Acção Para a Redução da Pobreza Absoluta (PARPA) approved by the Government in 2001. The Government's economic program is supported by the International Monetary Fund (IMF) with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved on July 6, 2004. This memorandum of economic and financial policies (MEFP) reviews the performance under the program (October 2004-March 2005) and describes the policies and targets for the remainder of 2005.

I. RECENT PERFORMANCE UNDER THE PRGF-SUPPORTED PROGRAM

2. During the last decade, Mozambique's strong commitment to sound macroeconomic policies and structural reform has led to a remarkable improvement in economic performance, supported by substantial donor assistance. These efforts have resulted in robust economic growth, accompanied by a significant reduction in poverty, end-period inflation was reduced markedly to single digits, and international reserves rose to comfortable levels. These achievements were facilitated by a stable political situation and the consolidation of the democratic system, as illustrated by the recent presidential and parliamentary elections.

3. The economy continued to perform well in 2004. Real GDP growth is estimated to have decelerated to 7.2 percent (7.8 percent programmed), reflecting a slowdown in construction related to the completion of a number of private sector megaprojects, as well as a decline in fishing production as a result of climate fluctuations. Growth in all other sectors continued to be buoyant, including agriculture. End-period inflation declined to 9.1 percent in 2004 (below the program target of 11.0 percent) despite a sharp rise in petroleum prices. Megaproject-led exports have contributed to a significant decrease in the trade deficit, which coupled with higher-than-projected donor support and private capital inflows, boosted reserve accumulation well above the program target. This contributed to a 25 percent appreciation of the real effective exchange rate reversing its 8 percent depreciation over the past four years. This appreciation is in line with the changes in economic fundamentals characterized by a sharp increase in exports and capital inflows.

4. In the first quarter of 2005, inflation continued to decline to 6.1 percent at end-March. The exchange rate exhibited significant fluctuations in the aftermath of the introduction of the foreign exchange auction system in January 2005 (a structural benchmark for end-February 2005), which led the monetary authorities to increase sharply their foreign exchange sales (US\$160 million) to reduce volatility during the first quarter of 2005. As a result, the metical depreciated by 4 percent vis-à-vis the U.S. dollar during January–mid-April 2005.

5. Fiscal consolidation was below expectations during the second half of 2004. This resulted in the nonobservance of the performance criterion on the government's domestic primary deficit by 0.6 percent of GDP (using the new GDP series). The revenue-to-GDP ratio fell short by 1.1 percent as compared with the programmed 13.4 percent. Collection of most taxes turned out to be lower than envisaged owing mainly to higher-than-projected reimbursements of the value-added tax (VAT) largely related to megaprojects, delays incurred by corporations in complying with the payments calendar under the new corporate income tax code, the weakening of the tax collection, and the appreciation of the metical. The revenue shortfall was partly compensated by cuts in current expenditures (0.5 percent of GDP) impacting negatively on their composition. Total priority expenditures reached 63.3 percent of total expenditure (excluding interest payments and net lending) instead of the programmed 65 percent. However, the end-December indicative target on the wage bill was observed. The overall deficit, after grants, exceeded the program target by 0.9 percent of GDP. However, net credit to the government was only slightly higher than programmed because of higher net external financing.

6. Based on preliminary information, revenue collection in the first quarter of 2005 has improved but is slightly below the program target (0.1 percent of GDP). However, identified primary domestic expenditures are higher than programmed (0.4 percent of GDP), mainly on account of a higher-than-expected wage bill (0.6 percent of GDP) that was only partially offset by restraining locally financed capital expenditure by 0.2 percent of GDP. The higher-than-expected wage bill was due to the payment of the 13-month wage and pension bonus corresponding to 2004, which was paid in the first quarter of 2005 (instead of end-2004 as originally programmed). In addition, the difference between the above-the-line recorded transactions and below-the-line financing shows an excess of unallocated expenditures equivalent to 0.4 percent of GDP. Overall, the indicative target on the domestic primary deficit may have been exceeded by 0.8 of GDP at end-March 2005.

7. Implementation of fiscal reforms encountered some delays. On the revenue side, a draft general tax law creating the Central Revenue Authority (ATM) was submitted to the Assembly in early August 2004 (a structural benchmark criteria for end-July 2004) and the internal regulations for the Domestic Tax General Directorate (DGI) were approved in December 2004. On the expenditure side, the e-SISTAFE (Financial Administration System) was partly implemented in the Ministry of Finance because of delays in the approval of the 2005 budget by the Assembly. In this context, the production of the budget execution report based on the e-SISTAFE for the first quarter 2005 was delayed. The rollout of SISTAFE to the Ministry of Education and Culture (MEC) will also be delayed in spite of the progress made in early 2005. At the beginning of 2005, the system began to record and classify all disbursements to line ministries. Recent efforts have been aimed at stabilizing the functioning of the treasury single account and its integration into the SISTAFE in preparation for the rollout to MEC. In particular, the clearance of transactions between the BM and commercial banks is now being completed on the same day that the transactions are initiated in accordance with the Diploma Ministerial do Ministro das Finanças sobre as regras de funcionamento de Conta Unica do Tesouro.

8. Broad money growth expanded less rapidly than programmed, reflecting in part the impact of the appreciation of the metical on foreign currency deposits. The end-December 2004 performance criterion on net domestic assets of BM was observed, as well as the end-March 2005 indicative target. The end-December 2004 indicative target for the stock of reserve money was exceeded by a small margin, owing mainly to a larger-than-expected demand for domestic currency. However, the related indicative target for end-March 2005 was in line with the program. The performance criteria on the stock of net international reserves of the BM was observed with a significant margin at end-December 2004, as well as the related indicative target at end-March 2005. In light of the decline in inflation, the BM decreased its reference rates by 400 basis points in 2004 and by a further 200 basis points by end-March 2005. Commercial nominal lending rates declined to 24 percent and the interest spread narrowed to 14 percent, although they still remain relatively high. Credit to the private sector decreased due to valuation effects on loans in foreign currency. Excluding the latter effect, private sector credit increased by 8.8 percent of beginning of period money stock.

9. In late 2004 and early 2005, the BM took several steps to strengthen monetary management. In particular, in the second half of 2004 it improved the mix of its sterilization instruments relying more on the sale of foreign exchange to control liquidity. As noted, the BM also increased the flexibility of the exchange rate system through the introduction of foreign exchange auctions in January 2005 to reflect better changes in economic fundamentals. Steps were also taken to continue to improve coordination between the BM and the Ministry of Finance in implementing the Treasury Single Account.

10. In order to strengthen the balance sheet of the BM, the 2005 budget includes the issuance of securities in an amount of Mt 1.5 trillion, together with the corresponding interest payments. In early 2005, with the help of Fund technical assistance and the donor community, the BM finalized a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and strengthen loan classification and provisioning in line with best international practices (end-February 2005 benchmark). As a result of the appreciation of the metical, the BM posted a net loss as the value of its assets fell below the amount of its liabilities (equivalent to 2.5 percent of GDP) at end-December 2004.

11. The commercial banking sector remained sound with a sharp decline in the ratio of nonperforming loans to gross loans, from 27 percent at end-2003 to 6 percent at end-2004. A number of steps were taken during 2004 to strengthen banking supervision, including the implementation of the new inspection manual and the preparation of models for the presentation of consolidated financial statements. The reviews of the four largest banks, which were finalized in February 2005, show that the banks are ready to move to IFRS.

12. The Government recognizes the importance of timely debt-service payments in view of Mozambique having reached its enhanced HIPC Initiative completion point in September 2001 and an agreement with the Paris Club creditors in November 2001. In this regard, the Government has already concluded bilateral agreements with 10 out of 12 Paris Club creditors, including an agreement with Brazil signed in August 2004. The technical

negotiations with Portugal were concluded in February 2005. Progress with non-Paris Club creditors, however, has been limited.

II. THE POLICY AGENDA FOR THE REMAINDER OF 2005

13. The Government is committed to implement immediately corrective measures to bring the fiscal program back on track, and to reinvigorate and accelerate the structural reform agenda. Furthermore, the Government intends to enhance the existing multi-disciplinary committee with a view to strengthen the monitoring of the program, particularly in the fiscal area. On a monthly basis, this committee will review progress in implementing the performance criteria, benchmarks, and measures of the program, and will report this to Fund staff. Particular attention will be given to buttress the transparency and monitoring of the budget execution, and to continue strengthening administrative capacity with the help of the international community.

14. Prospects for 2005 are for continued strong economic growth, further deceleration of inflation, renewed efforts at fiscal consolidation, and maintaining a sustainable external position. The end of the stimulus to economic growth in 2004, resulting from the coming on line of Mozal II and the gas pipeline is expected to be more than compensated for by a pickup in construction activity related to higher-than-projected execution rates of the national road plan and the initiation of a titanium ore project. Growth in the fishing sector is expected to resume, while agriculture will continue to expand. Overall, real GDP growth is projected to increase by 7.7 percent in 2005. Inflation is targeted to decline further to 8 percent. To achieve the inflation objective, the BM will limit the rate of growth of base money to 14.6 percent during the year. To reverse the fiscal relaxation related to the 2004 revenue shortfall, the domestic primary deficit is programmed to narrow to 2.8 percent of GDP and the overall fiscal deficit, including grants, is projected to remain at 6 percent of GDP. The external current account deficit, including grants, is projected to increase to 7.1 percent of GDP. Strong export growth, led by a significant increase in international aluminum prices and gas production, is expected to offset robust import growth, associated with the higher international prices for petroleum products, as well as higher dividend payments to the megaprojects' foreign shareholders. Net capital inflows are expected to decrease by about 2 percent of GDP. Net international reserves are programmed to decrease by US\$ 60 million in 2005 to 4.7 months of goods and nonfactor services and to 5.6 months, excluding megaproject-related imports.

15. For the remainder of 2005, emphasis in the fiscal area will be given to the following priorities: (i) strengthening the mobilization of revenue through the buttressing of tax administration, including the strengthening of auditing, inspection, and enforcement procedures; (ii) identifying expenditure savings in nonpriority sectors and containing the wage bill; and (iii) improving public expenditure management and increasing transparency through the effective implementation of the e-SISTAFE. Until the approval by the Assembly of the 2005 budget, expected for May 2005, public expenditure will continue to be executed in line with the 2004 budget appropriations. If the revenue realization on a quarterly basis

turns out to be below programmed levels, contingency cuts in nonpriority domestic expenditures will be implemented to offset any shortfalls.

16. The Government's domestic primary deficit is programmed to decrease to 2.8 percent of GDP in 2005, with a view to limiting recourse to domestic financing to 1.1 percent of GDP (excluding the recapitalization of the BM). The overall deficit, after grants, would increase to 6 percent of GDP, owing to a substantial increase in capital outlays financed with concessional project loans and part of the resources from the mining license for the exploration of the Moatize coal mine.

17. Total revenue is projected to rise to 13.2 percent of GDP in 2005, albeit less than the 13.6 percent in the 2005 budget (using the new GDP series). This increase reflects (i) the incorporation into the budget of the own-generated revenues of districts and some line ministries (equivalent to 0.4 percentage point of GDP); (ii) the introduction of the new computerized system (SCIR) to support tax collection in early 2005 and its roll out to main cities in the country; (iii) the finalization of the identification (and progressive collection, starting in April 2005) of tax arrears related to the personal and corporate income taxes for 2003-04 by end-September 2005; (iv) the increase of registered taxpayers by 50,000; (v) the interface of the value-added tax and customs computer systems by end-May 2005 to permit the electronic exchange of information on a real time basis; (vi) the increase in the number of audits and inspections (which started in March 2005), particularly regarding services and tourism, as well as the intensification of training of auditors (and an increase in their number); (vii) the enforcement of the application of an increased 35 percent rate in corporate income tax for unjustified expenditures in accordance with the corporate income tax code (Imposto sobre Rendimento de Pessoas Colectivas); (viii) the submission for approval by the Council of Ministers before mid-May 2005 of the new regulations for auditing and inspections (a prior action) and their approval by the Council of Ministers before end-May 2005; (ix) the implementation of monthly monitoring systems for tax returns filed by large taxpayers and megaprojects in Maputo and the other main cities by end-May 2005; (x) the completion of the strengthening of monitoring and control capacity at borders in the southern region, especially at Namaacha and Ressano-Garcia by end-September 2005; and (xi) the combat of corruption through the strengthening of sanctions on delinquent taxpayers and officers at all levels. These measures on tax revenue are expected to yield at least 0.6 percent of GDP.

18. In addition, the program for 2005 includes several key measures to continue to strengthen the tax system. Preparations will continue for establishing the ATM by end-2005. To strengthen its operations and facilitate its subsequent integration with the customs office (DGA), following the December 2004 approval of the internal regulations for the domestic revenue administration (DGI), the statute for its staff will be approved by end-April 2005 (a prior action). Moreover, within one month of the promulgation (Presidential signature) of the new general tax law and the law to create the ATM, the Council of Ministers will approve all complementary regulations for these two pieces of legislation. In addition, a revised tax code for the municipalities has been submitted to the Council of Ministers. The new modern procedures and regulations for tax audits and inspection will be implemented as soon as they

are approved by the Council of Ministers by end-June 2005. Finally, in light of the weaker-than-expected performance of revenues in 2004, the Government will complete audits on compliance with all taxes of large taxpayers by end-September 2005.

19. Noninterest current expenditure will be limited to slightly less than 13 percent of GDP (or a 0.1 percent increase), including the incorporation into the budget of the expenditures associated with the own revenue from districts and line ministries referred to above. Excluding wage outlays associated with the previously off-budget revenue, the Government's wage bill is programmed to remain at 6.7 percent of GDP in 2005. This projection includes the impact of an increase of close to 10,000 in the number of government employees, most of which is concentrated in the priority sectors, including 5,443 teachers and 1,767 health care providers. To accommodate such an increase within the envisaged fiscal target, the average general wage increase for government employees that will become effective retroactively on April 1, 2005, will be limited to 6½ percent. In addition, the 13-month payment of wage and pension related to 2005 fiscal year will be paid in January 2006 and this will be true respectively for the following years. Locally financed capital expenditure is programmed to increase relative to its 2004 level. The expenditure projections for 2005 include the impact on the interest bill of servicing the external debt liabilities of the BM transferred to the Government and of the additional domestic debt associated with the issuance of government securities to strengthen the BM's balance sheet. Spending on PARPA priorities is expected to increase from 63.3 percent of total primary expenditure in 2004 to 66.3 percent in 2005.

20. During 2005, the Government will also intensify its efforts to implement the SISTAFE. By end-May, a report on the financial operations of all ministries, at the central and provincial levels, for the first quarter of 2005 will be elaborated by the Ministry of Finance. Provided that the 2005 budget is approved by end-May 2005, the complete budget execution report, at the central and provincial levels, for the first semester of 2005 will be elaborated by end-September 2005 and all stages of expenditure (commitment, liquidation, payment, accounting, and reporting) of the Ministry of Finance and MEC will be executed through the e-SISTAFE, at the central and provincial levels, by end-December 2005. This implies that all financial transactions, including payments of expenditure, will be executed through the Treasury Single Account with the help of the donor community. In addition, by end-December 2005, with the help of the donor community, all budgetary expenditures financed and executed outside the Treasury Single Account of the Ministry of Finance and MEC will be included in the e-SISTAFE. In the meantime, a complete list of off-budget operations will be prepared by all line ministries with the help of donors to allow the roll out of the e-SISTAFE to all line ministries with the help of the donor community, at central and provincial levels, in the course of 2006. By end-December 2006, all financial and budgetary operations of DAFs (Financial Management Departments) of all line ministries, at the central and provincial levels, will be executed through the e-SISTAFE. In addition, to buttress the functioning of the Treasury Single Account (inter alia, the transmission of information and the transfer of balances in real time), Aviso 006/GBM/ 2004, will be revised by end-April 2005 (a prior action) to guarantee immediate penalties on noncomplying commercial banks. The Government will continue to implement its fiscal decentralization strategy with due

regard to sequencing, in particular the need to buttress local administrative capacity. The e-SISTAFE will be gradually rolled out to all districts.

21. On monetary policy, with a view to achieving a further deceleration of inflation and a stable environment for financial intermediation and the foreign exchange market, the BM will continue to target reserve money. Broad money (M3), including foreign currency deposits, is projected to expand by 14.5 percent (slightly lower than nominal GDP), while bank credit to the private sector is expected to increase by 5.8 percent of the beginning-of-period stock of broad money. Net credit to the government (including recapitalization of the BM) will increase by 9.6 percent of the beginning-of-period money stock. The BM will continue to improve its liquidity management framework and foster financial market development, preparing and evaluating daily liquidity forecasts, reviewing the performance of primary dealers, and facilitating foreign exchange transactions.

22. In the conduct of monetary policy, the BM will judiciously mix sterilization instruments (foreign exchange and treasury bill sales) to mop up excess liquidity in the context of the floating exchange rate system. The BM will limit its intervention in the exchange market to achieving the international reserve target and managing exchange rate policy flexibly in line with economic fundamentals.

23. The Government remains committed to strengthening the balance sheet of the BM. To this end, in line with Articles 14 and 66 of the BM's Act, the Government will issue securities at market interest rates. The first issuance of securities in an amount of Mt 1.5 trillion, together with the corresponding interest payments, was included in the draft 2005 budget, which is expected to be approved soon by the Assembly. These securities will be issued and transferred to the BM no later than end-June 2005, and further issuances in similar amounts will take place in 2006 and 2007. In addition, on the basis of the final external audit of the balance sheet of the BM (expected for end-April 2005), a decision will be taken before mid-May 2005 on the issuance of securities by the Government to cover BM's net financial losses in 2004. These measures will be accompanied by additional steps to shift the cost of managing monetary policy over time to the budget, and by strictly limiting the administrative expenses of the BM.

24. The authorities are also committed to implementing the IFRS in the banking system, with the help of technical assistance from the Fund and the donor community. In this regard, the BM has elaborated a timetable of actions to adopt IFRS in the commercial banking system and strengthen loan classification and provisioning in line with best international practices (end-February 2005 structural benchmark). The BM will continue to move forward with the necessary training and other preparations with the aim of fully implementing IFRS in the BM and the banking system starting in 2007.

25. In the area of banking supervision, progress is being made in drafting an inspection manual, preparing models for the presentation of consolidated financial statements, in application of the Regulation on Consolidated Supervision, and increasing the staff and capabilities of the Department of Banking Supervision with the support of a Fund expert.

Moreover, a draft of a new regulation on the assessment, classification, and provisioning of credits is under preparation. Finally, a feasibility study on the Government participation in the BIM has taken longer than envisaged; however, it is now expected to be completed by end-September 2005 with the help of the World Bank.

26. The BM is taking actions to address weaknesses identified in the context of the Fund's safeguards assessment mission conducted in June 2004. In particular, (i) the Economic Research and Statistics Department of the BM has already established updated procedures for converting balance sheet data to the monetary data reported to the Fund; (ii) starting end-November 2004, the BM began to complete all reconciliations and necessary adjustments on a monthly basis so that the balances in its accounting records match those confirmed by the correspondents, external managers, and other third parties; and (iii) work is in progress for linking the monetary data to the balance sheet electronically. Staff are currently being trained to operate this system, which will be fully functional by end-September 2005.

27. No significant changes in the area of trade policy are expected to take place during 2005. Regarding the exchange system, the central bank is preparing a draft of a revision to the foreign exchange law to clarify and improve the existing legislation, which will be submitted to the Parliament in the second half of 2005. Following approval of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement. The Government remains committed to lowering the maximum import tariff rate applicable to all trading partners from 25 to 20 percent in January 2006.

28. The Government will continue its efforts aimed at completing negotiations on enhanced HIPC Initiative debt relief agreements with remaining Paris Club creditors, and to reach agreements with non-Paris Club official creditors and commercial creditors on comparable terms. Regarding the commercial debt, the World Bank has decided to finance a debt-reduction operation through the IDA Debt-Reduction Facility and is assisting the Government to finalize a proposal by end-2005.

29. The Government recognizes the importance of removing a number of obstacles to private sector development. In this regard, steps are being taken to (i) reduce the cost of doing business in Mozambique; (ii) address rigidities in the labor market; (iii) improve basic infrastructure; and (iv) modernize procurement regulations. In addition, the Government remains committed to promoting good governance and transparency in the management of public resources, improving the functioning of the judicial system, reforming the public sector.

30. The authorities have taken further steps to lower the cost of doing business. The Government is in the process of establishing "one-stop shops" for business registration in another four locations (Cabo Delgado, Tete, Inhambane and Nampula) that will all be operating by June 2005. Business licensing procedures are being changed so as to bring a larger share of small and medium enterprises into the formal registration system. The first

step was taken in 2004 with the simplification of licensing procedures (by decree). Arrangements are being made for further simplification by allowing decentralization of the relevant decisions for licensing to the district and provincial level where appropriate. In addition, there will be limits set on the time that the relevant authority will take to issue the license, the maximum of these being one month, at the central level. The Government is running a campaign to encourage registration. Actions will also be taken to provide tax identification numbers to the new license holders.

31. Regarding labor regulations, progress has been made in streamlining the procedures for hiring expatriates following the approval of a decree in 2004. In addition, in late 2004 the Government approved the terms of reference for the preparation of a revised labor law aimed at increasing flexibility in the labor market. Moreover, early this year the procedures and structure of the tripartite commission (CCT) were improved to allow for a more flexible and inclusive negotiating process. After consultation with the interested parties, the draft of the law is expected to be submitted to the Assembly during the second half of 2005.

32. The Government has continued to make efforts to enhance Mozambique's infrastructure in the context of several project loans from the World Bank. This year the number of mobile telephone subscribers will increase to over 1 million and costs will be reduced as a result of the introduction of competition in the mobile segment of the market in late 2003. The tenders for the restructuring of the State-owned telecommunications company and the national airline are expected to be launched in 2005. Management contracts for water systems have been completed in five major cities and private concessions have been granted to operate some ports, including Maputo. In addition, the Government is considering strategic options for the restructuring of PETROMOC, the state-owned petroleum distributor. The Government is also assessing the proposals it has received for private participation in the Maputo International Airport to determine whether one of these proposals meets its requirement in terms of investment and improvement of the airport's performance.

33. A draft decree establishing procurement regulations in line with international standards is under preparation with assistance from the World Bank and bilateral donors. Two key aspects, still under discussion, to bring Mozambique's legislation in line with best international practice are the need for an independent regulatory body and an appeals mechanism. Since the discussions on these points have occasioned some delay, the expected date of approval of the decree has been moved from end-June 2005 to end-December 2005.

34. In the area of public sector reform, with support from the World Bank and other donors, work has continued in the context of a long-term program aimed at restructuring the civil service, decentralizing service delivery, and improving governance. Several key components are under way: (i) the functional analyses of six major ministries (Education, Commerce, Health, Agriculture, State Administration, and Finance) were completed in 2004 but are presently being revised by the new government in the light of the overall study of the structure of central government, which was also completed in 2004. The revised functional analyses, with their accompanying restructuring plans, will be the basis for restructuring of these ministries over a three-year period. The financial implications of the functional

analyses will respect the spending ceilings established by the Medium-Term Financial Framework; (ii) a proposal to reform the wage system in order to link remuneration more closely with performance will be considered by the Inter-ministerial Commission for the Reform of the Public Service Commission (CIRESP) by end-September 2005. The focus is on creating incentives for attracting and retaining high-level technical staff and decentralizing skilled staff while still maintaining restraint of the wage bill; (iii) the National Survey on Governance and Corruption aimed to obtain the opinion of citizens regarding the functioning of the public sector, was completed. The Government intends to publish and disseminate the results to the public by end-June 2005; and (iv) preparations are under way to complete an independent audit of the civil service during 2005. This will occur in the context of work to unify the three data sources for the civil service establishment: the payroll held by the Ministry of Finance, and the lists of civil servants held by the Ministry of State Administration and by the Administrative Tribunal.

35. The Government is aware of the need to revise land use titles regulations to reduce the cost and time involved in transactions, which involve land for both private individuals and businesses. The Government is of the view that, in light of the sensitive nature of the issues involved, any reforms of land tenure should be preceded by a process of broad consultation with interested parties. Accordingly, a draft proposal to strengthen property rights in urban areas is being reconsidered by the new administration. In addition, the Government remains committed to conducting a Poverty and Social Impact Analysis (PSIA) study on land tenure regulations. Several donors, including the World Bank, have expressed interest in providing support for this purpose, and donors and the Government are developing the project in the context of the Policy Assessment Framework (PAF) for 2005.

36. The Government recognizes that progress in reforming the judicial system was limited during 2004, partly as a result of capacity constraints and delays in approving relevant legislation. A draft law of judicial reform is under preparation. This will *inter alia* introduce an intermediate level of courts so as to reduce the overload at the Supreme Court level. The World Bank is also assisting the authorities to strengthen the training of legal and judicial officers through the recently founded training institute. The anti-corruption unit has been active since 2004, and it is expected that further units will be established in Nampula and Beira. Other important pieces of legislation, including the new commercial code, the Penal Code, the Penal Procedure Code, the Civil Procedure Code, and the Notary Code are still being considered by the Assembly or the Council of Ministers.

37. In the context of combating organized crime, the Assembly approved the Anti-Money Laundering law and the Government approved corresponding regulations in 2004. The Government is committed to create the related financial investigation unit through an amendment to the law. In this regard the following actions will be taken: (i) the Government will finalize an action program by end-May 2005 (a prior action); (ii) other countries' experiences with the operation of such a unit will be studied; (iii) a Mozambican model will be elaborated by end-November 2005; (iv) a project for the amendment of the law and all complementary regulations will be elaborated by end-March 2006; and (v) the proposed amendment and regulation will be submitted to the Council of Ministers by end-May 2006

and adopted by end-June 2006. The Government has already requested technical assistance for this project from the World Bank.

38. The Government recognizes the urgent need to strengthen statistical information. The statistical system still presents several deficiencies that hinder policy implementation and the surveillance of economic developments. In particular, and with the help of the international community, efforts are being made to strengthen administrative capacity to improve the national accounts, the monetary data, the balance of payments, external debt management, and public finance statistics. In particular, by end-June 2005 the National Statistics Institute (INE) will compile and disseminate preliminary data on the 2004 GDP and will publish a revision policy for compiling and disseminating final national accounts data (structural benchmark for end-June 2005).

39. Following the completion of the National Household Survey in 2003, several studies are being conducted by public and private institutions, including on the determinants of poverty, education attendance, demographic trends, and health services, and the relationship between employment and poverty. Moreover, INE is expected to finalize a labor force survey by September 2005 that will provide information on unemployment using a variety of definitions.

III. MEDIUM-TERM MACROECONOMIC POLICY ISSUES

40. The policy agenda for 2005 is consistent with the medium-term goals of sustaining poverty reduction by maintaining strong economic growth. The authorities have carried out the third annual report on the implementation of their PARPA, which will be instrumental in the preparation of a new PARPA covering the period 2006-10, which is expected to be ready by February 2006. It shows that a number of the Millennium Development Goals are within reach but that the achievement of others will require further progress and investment with the help of the international community.

41. The main macroeconomic objectives over the medium term are to maintain a rate of growth between 6 and 8 percent and to continue to reduce gradually the inflation rate through the pursuit of prudent fiscal and monetary policies in the context of the flexible exchange rate system. The medium-term economic policies will focus on spurring export-led private sector growth, while enhancing fiscal and external viability. Central to the fiscal strategy will be the consolidation of the fiscal situation, notably through a buttressing of tax administration coupled with a better efficiency of expenditures. Priority expenditures in the PARPA will continue to be ring-fenced in order to contribute to the achievement of the MDGs. The authorities will also seek a higher share of external grant financing to buttress external debt sustainability.

IV. PROGRAM MONITORING

42. The semiannual quantitative performance criteria for end-December 2005 and the indicative targets that will be used to evaluate the implementation of the program for the

remainder of 2005 are shown in Table 1 of this memorandum, with further definitions and explanations contained in the annexed Technical memorandum of understanding. In addition, the Government has specified in Table 4 a list of structural performance criteria and benchmarks for 2005.

43. The Government understands that its ability to request the disbursement of the fourth loan under the PRGF arrangement will be contingent upon the observance of the semiannual quantitative performance criteria for end-June 2005 set out in Table 1; the structural performance criteria set out in Table 4 through end-October 2005; and the completion of the third review under the program, which is expected to take place, by end-December 2005. In reviewing developments under the program during the third review, particular attention will be paid to the strengthening of the revenue administration, the rollout of SISTAFE, the preparation of the inclusion into the budget of off-budget operations in MEC, and the draft budget for 2006. The fourth review, which will make available the fifth disbursement, is expected to be completed by May 31, 2006, and will be based on the observance of the end-December 2005 quantitative performance criteria set forth in Table 1 of the MEFP. Additional conditionality for the fifth disbursement will be established at the time of the third review.

Table 1. Mozambique: Quantitative Performance Criteria and Indicative Targets for 2004 and 2005

(In billions of meticaís, unless otherwise specified)

Country Report Numbers	2004											2005					
	End-June Performance Criteria				End-Sep. Indicative Targets				End-Dec. Performance Criteria			End-Mar. Indicative Target	End-Mar. Indicative Target	End-June Perf. Criteria	End-June Perf. Criteria	End-Sep. Indicative Target	End-Dec. Perf. Criteria
	04/342		05/168		04/342		05/168		04/342			05/168	05/168		05/168	05/168	05/168
	Prog.	Rev. Adj.	Act.	Rev. Act.	Prog.	Rev. Adj.	Act.	Rev. Act.	Prog.	Adj.	Actual	Prog.	Prel.Act.	Prog.	Rev.Prog.	Rev.Prog.	Rev.Prog.
Government domestic primary deficit (excluding bank recapitalization costs (ceiling) 1/ 2/ 3/ 4/	2,117	...	1,692	1,692	3,259	...	3,268	3,268	4,207	...	5,151	857	2,392	1,764	3,438	3,986	4,481
Stock of net dom. assets of Bank of Mozambique (BM) (ceiling) 1/ 5/ 6/ 7/	1,931	2,323	1,573	1,613	1,650	-10,652	-12,398	-12,398	3,299	-8,836	-14,582	-9,967	-10,828	-9,373	-7,582	-6,980	-6,947
Stock of net international reserves of the BM (floor, in millions of U.S. dollars) 1/ 8/12/	708	692	747	747	731	756	837	837	738	750	960	848	885	844	874	863	900
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of more than one year (ceiling) 9/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 9/ 10/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
External payments arrears (ceiling) 3/ 9/ 11/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars, indicative target)	...	...	...	...	...	...	...	...	...	...	...	...	...	99	99	...	99
Government revenue (floor, indicative target) 3/	8,255	...	7,881	7,881	13,345	...	12,321	12,321	18,350	...	16,838	4,457	3,948	9,708	9,016	14,742	21,091
Stock of reserve money (ceiling, indicative target) 7/	8,303	...	8,676	8,716	8,630	...	9,126	9,126	10,247	...	10,433	9,317	9,249	10,110	10,597	11,140	11,946
Wage bill (ceiling, indicative target) 3/	4,485	...	4,479	4,479	6,772	...	6,858	6,858	9,218	...	9,195	2,123	2,656	4,708	5,462	8,324	11,045
Memorandum items:																	
Foreign program assistance; grants and loans (in millions of U.S. dollars) 3/	82	...	68	68	180	...	206	206	264	...	272	103	...	163	163	174	243
Actual external debt service payments (in millions of U.S. dollars) 3/	25	...	27	27	38	...	38	40	62	...	58	13	...	35	35	56	77
Net flows	57	...	41	41	141	...	168	166	202	...	214	90	...	128	128	118	166
Exchange rate (meticaís per U.S. dollar; end of period)	24,181	...	23,002	23,002	24,375	...	21,389	21,389	24,644	...	18,899	21,619	18,958	...	...	...	...
Shortfall in required reserves	...	0	...	...	...	0	...	...	...	0	...	...	...	...	...	...	...
Adjustment to BM's net domestic assets at program exch. rates	...	...	346	346	...	...	2637	2,637	...	...	5,831	...	2471	...	...	...	...
Adjustment to BM's NDA target	...	392	...	...	...	-12,302	...	...	...	-12,135	...	...	...	...	...	...	...
Adjustment to reserve money	...	-40	...	...	...	0	...	...	...	0	...	...	...	...	...	...	...
Adjustment to BM's NDA due to shortfall/excess of net program assistance	...	392	...	...	...	-602	...	...	...	-306	...	...	...	...	...	...	...
Stock adjustments in medium- and long-term foreign liabilities	...	0	...	...	...	-11700	...	...	...	-11829	...	...	...	...	...	...	...

1/ In 2004, constitute quantitative performance criteria for end-June and end-December, and in 2005 for end-June, and end-December for the revised program.

2/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending; to be measured from below the line based on financing items.

3/ Cumulative from the beginning of the calendar year. For March 2005, regarding the wage bill and the domestic primary deficit, the column for the IMF Country Report No. 05/168 revised program did not include the payment of the 13th wage and pension bonus related to 2004,

while it is included in the column for preliminary actual.

4/ To be adjusted upward for up to Mt400 billion to accommodate higher-than-budgeted locally financed drought-related expenditures. Also to be adjusted for end-December 2004 for up to Mt600 billion to accommodate additional capital outlays covered by higher-than-envisaged external budgetary grants.

5/ Defined as reserve money minus net foreign assets (NFA) of the BM. NFA are valued at program exchange rates; NFA are defined to exclude the effect of any used stock adjustments in medium- and long-term liabilities.

6/ To be adjusted upward/downward to the extent of any shortfall/excess in foreign program assistance valued at program exchange rates and to be adjusted downward/upward to the extent that actual payments of external debt service exceed/fall short of programmed amounts. In 2004, the downward adjustment for higher-than-programmed budgetary grants will not take place to the extent that the additional grants are to accommodate additional capital outlays, up to 25 million U.S. dollars. To be adjusted upward for up to Mt 400 billion to accommodate higher-than-budgeted locally financed drought-related expenditures.

7/ To be adjusted downward to the extent that eligible bank reserves fall short of 11.51 percent of deposits in commercial banks at the end of each quarter.

8/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the programmed amount and to be adjusted upward/downward to the extent that actual payments of external debt service fall short of/exceed programmed amounts. In 2004, the upward adjustment for higher-than-programmed external budgetary grants will not take place to the extent that the additional grants are used to accommodate additional capital outlays, up to 25 million dollars. To be adjusted downward for up to Mt 400 billion (or the equivalent amount in U.S. dollars at the program exchange rate) to accommodate higher-than-budgeted locally financed drought-related expenditures. Moreover, to be adjusted downward/upward for any revision made to the end-2003 and end-2004 figures.

9/ Continuous performance criterion.

10/ Loans of zero to one year's maturity, excluding normal import-related credits converted in U.S. dollars at actual exchange rates.

11/ Excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

12/ The NIR program and actual figures for 2004 and the NIR revised actual figure for end-2003 have been revised downward by deducting from gross reserves some deposits held by the central bank abroad which are encumbered for specific imports.

Table 2. Mozambique: Structural Performance Criteria and Benchmarks
Under the 2004 PRGF-Supported Program

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Submit to the National Assembly the draft general tax law (paragraph 23 of the memorandum of economic and financial policies (MEFP)).	End-June	Done
Strengthen the balance sheet of the Bank of Mozambique (BM) by shifting to the Government a large part of its external debt liabilities, as set forth in paragraph 28 of the MEFP and the technical memorandum of understanding (TMU).	End-July	Done
Keep in place the enhanced supervisory regime for the Banco Internacional de Moçambique (BIM), as described in the TMU, until approval of the financial statements for 2004 by the external auditors.	Continuous	Observed
Complete a feasibility study on the divestment of the Government's participation in the BIM.	End-December	Not observed
Structural benchmarks		
Submit to the assembly the draft law creating the Autoridade Tributária de Moçambique.	End-July	Done August 7
Complete the revision of the regulatory framework for microfinance activities.	End-September	Done
Develop a resolution strategy for two weak small banks	End-October	Partially done
In the context of the 2005 budget, initiate the implementation of the three-year program to strengthen the balance sheet of the central bank. Include the corresponding allocation in the 2005 budget proposal.	End-October	Allocation included in the draft budget submitted to the Parliament in March 2005.
Prepare the budget execution report corresponding to the third quarter of 2004 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	November 15	Delayed until May 15, 2005
Develop timetables to move gradually to IFRS and to comply with loan classification and provisioning, based on best international practices.	End-December	Delayed until end-February 2005
Issue regulations of the anti-money laundering law and establish financial investigations unit	End-December	Regulations already issued, but FIU has not yet been established
Implement the SISTAFE in the Ministry of Planning and Finance, including the provincial directorates	End-December	Done

Table 3. Mozambique: Structural Performance Criteria and Benchmarks through end-June 2005
Under the 2005 PRGF-Supported Program

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Issue government securities in an amount of Mt 1.5 trillion at market interest rates and transfer these securities to the Bank of Mozambique to strengthen its balance sheet.	End-June 2005	
Keep in place the current supervisory regime for the Banco Internacional de Mozambique (BIM), as described in the technical memorandum of understanding, until approval of the financial statements for 2004 by the external auditors	Continuous	Observed
Structural benchmarks		
Introduce foreign exchange auctions	End-February 2005	Done January 2005
Develop firm timetables to move gradually to IFRS in the commercial banking system and to comply with loan classification and provisioning based on best international practices	End-February 2005	Done March 2005
Approve the internal regulations and the statute for the staff of the DGI	End-April 2005	
Prepare the budget execution report corresponding to the first quarter of 2005 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	May 15, 2005	Delayed
Rollout the SISTAFE to the Ministry of Education and abolish the disbursement of funds (adiantamento de fundos)	End-June 2005	Delayed until December
Compile and disseminate preliminary data on the 2004 GDP by expenditure and production approach at current and constant prices, and publish a revision policy and a timetable for compiling and disseminating final national accounts data.	End-June 2005	

Table 4. Mozambique: Structural Performance Criteria and Benchmarks Under the 2005 PRGF Arrangement (April-December 2005)

Actions	Expected Date of Implementation, According to the Program	Outcome
Prior Actions		
Approve the statute for the staff of the DGI	End-April	
Approval by the Council of Ministers of the new regulation for tax auditing and inspection	End-May	
Finalization of an action plan to create a financial investigation unit	End-May	
Revision of Aviso 006/GBM/ 2004 to guarantee immediate penalties on non-complying commercial banks.	End-April	
Structural performance criteria		
Issue government securities in an amount of Mt 1.5 trillion at market interest rates and transfer these securities to the Bank of Mozambique to strengthen its balance sheet.	End-June	
Complete a feasibility study on the divestment of the Government's participation in BIM.	End-September	
Prepare the budget execution report corresponding to the first semester of 2005 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	End-September	
Structural benchmarks		
Compile and disseminate preliminary data on the 2004 GDP by expenditure and production approach at current and constant prices, and publish a revision policy and a timetable for compiling and disseminating final national accounts data.	End-June	
Publication of Survey on Corruption and Governance	End-June	
Complete audits of compliance with all taxes of large taxpayers	End-September	
Rollout the SISTAFE to the MEC and abolish the disbursement of funds (adiantamento de fundos)	End-December	

Technical Memorandum of Understanding on Selected Concepts, Definitions, and Data Reporting Under Mozambique's PRGF-Supported Program

May 26, 2005

1. This technical memorandum of understanding (TMU) applies from January 1, 2005. Its purpose is to describe the concepts and definitions that will be used in monitoring the Poverty Reduction and Growth Facility (PRGF)-supported program, including the following:

- government domestic primary balance;
- government revenue;
- net domestic assets, net international reserves, and reserve money of the Bank of Mozambique;
- new nonconcessional external debt contracted or guaranteed by the central government or the Bank of Mozambique with a maturity of more than one year;
- short-term external public debt outstanding;
- external payments arrears; and
- foreign program assistance.

This memorandum also describes the adjusters that will be applied to certain quantitative performance criteria of the program.

Government's domestic primary balance

2. The government's domestic primary balance is defined as government revenue, less noninterest current expenditure, less locally financed capital expenditure, less locally financed net lending. It excludes bank restructuring costs, the cost of recapitalizing the central bank, project expenditure, and capital expenditure financed with proceeds from the coal mining concession. Net lending is derived as gross lending to enterprises through *acordos de retrocessão* (excluding *acordos de retrocessão* that were required by donors), plus food aid disbursed but not collected in the period, minus repayments by enterprises of loans obtained through *acordos de retrocessão* and through refinancing agreements with the Bank of Mozambique, minus food aid collected but not disbursed in the period. Unallocated revenue or expenditure arising from discrepancies between the government balance measured from above the line and the balance measured from below the line will be part of the government's domestic primary balance.

3. The government encompasses all institutions whose revenue and expenditure are included in the state budget (*orçamento do Estado*): central government ministries, agencies, and the administration of 11 provinces. Although local governments (33 municipalities or *autarquias*) are not included because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

Government revenue, expenditure, and financing

4. Revenue is defined to include all receipts of the Domestic Tax Administration (Administração Tributária de Impostos or DGI), the National Directorate of Customs

(Direcção Nacional de Alfândegas, DNA), and nontax revenue, including certain own-generated revenues of districts and some line ministries as defined in the budget. Net receipts from privatization received by the National Directorate of State Assets (Direcção Nacional do Património do Estado) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

5. For the purpose of program monitoring, revenue is considered as collected at the time when it is received by the DGI from private agents or other government collecting agencies, in cash or checks, or through transfers into a DGI bank account.

6. Expenditure is defined as government outlays transferred from treasury accounts to other government accounts or private sector accounts, and includes spending reported to the National Directorate of Public Accounting (*despesas liquidadas*) and any further treasury advances (*operações de Tesouraria*) that have been transferred out of treasury accounts but whose use has not yet been reported to the National Directorate of Public Accounting. It also includes expenditure financed with the own-generated revenue of districts and some line ministries referred to above.

7. External financing of the government includes foreign grants, external loan disbursements minus amortization, changes in external arrears, and external privatization proceeds. Domestic financing of the central government is defined as including net financing provided by the banking system, net placements of government securities with nonbanks, and domestic privatization proceeds.

8. An indicative target consisting of semiannual floors on the resources in the government's savings fund abroad has been added to monitor the use of the proceeds from the signing fee for coal exploration.

Money supply

9. M_3 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, including foreign currency deposits. M_2 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, excluding foreign currency deposits.

Net domestic assets

10. The net domestic assets of the Bank of Mozambique are defined as reserve money minus the net foreign assets of the Bank of Mozambique. Net foreign assets will be valued at program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term external liabilities.

11. The central bank's foreign currency-denominated assets and liabilities are converted in its balance sheet to meticaïs at actual exchange rates. However, for purposes of program monitoring, these amounts will be converted into U.S. dollars at the average program exchange rate for the end of each quarter.

12. Stock adjustments in the central bank's medium- and long-term liabilities are understood to mean any changes that are not the result of foreign exchange flows, such as write-offs, interest capitalization, transfer of liabilities to the government, etc.

Net international reserves

13. The net international reserves of the Bank of Mozambique are defined as reserve assets minus reserve liabilities. The Bank of Mozambique's reserve assets include (a) monetary gold; (b) holdings of SDRs; (c) reserve position at the IMF; (d) holdings of foreign exchange; and (e) claims on nonresidents, such as deposits abroad (excluding the government's savings account related to the Moatize coal mine concession). Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guarantee for a third-party external liability (assets not readily available.) The Bank of Mozambique's reserve liabilities include (a) all short-term foreign exchange liabilities to nonresidents with original maturity of up to and including one year; and (b) all liabilities to the IMF.

14. The Bank of Mozambique will publish the exchange rates quoted by commercial banks on average as the market rates. The exchange rates at which the Bank of Mozambique will transact foreign exchange will take as reference the rates quoted by commercial banks.

New nonconcessional external debt contracted or guaranteed by the central government or the Bank of Mozambique with maturity of more than one year

15. The term "debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Government debt is outstanding debt owed or guaranteed by the Republic of Mozambique or the Bank of Mozambique (but does not include debt of any political subdivision or government-owned entity with a separate legal personality that is not otherwise owed or guaranteed by the Republic of Mozambique).

16. The government will not contract or guarantee external debt with original maturity of one year or more with a grant element of less than 35 percent, calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates. This performance criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. This performance criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

17. The government will not contract or guarantee external debt with original maturity of less than one year. This performance criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been

received. Excluded from this performance criterion are short-term, import-related trade credits. This performance criterion will be assessed on a continuous basis.

External payments arrears

18. The government undertakes not to incur payments arrears on external debt owed or guaranteed by the government, with the exception of external payments arrears arising from government debt that is being renegotiated with creditors, including Paris Club creditors. This performance criterion will be assessed on a continuous basis.

Foreign program assistance

19. Foreign program assistance is defined as grants and loans received by the Ministry of Planning and Finance through Bank of Mozambique accounts excluding those related to projects (Table 1).

Actual external debt-service payments

20. Actual external debt-service payments are defined as cash payments on external debt-service obligations of the government and central bank, including obligations to Paris Club and other bilateral creditors rescheduled under enhanced HIPC Initiative completion point terms, multilateral creditors, and private creditors (Table 1).

Adjusters

21. The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) for any excess (shortfall) in disbursements of foreign program assistance, compared to the program baseline; and downward (upward) to the extent that actual payments of external debt service exceed (fall short of) programmed amounts (Table 1). The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year; a symmetric adjustment will apply to the ceilings on the net domestic assets of the Bank of Mozambique. They will also be adjusted upward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

22. The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted upward (downward) for any shortfall (excess) in disbursement of external program grants and loans, compared to the program baseline; and downward (upward) to the extent that actual payments of external debt service fall short of (exceed) programmed amounts (Table 1). They will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than

envisaged proceeds, net of any costs related to the privatizations, including severance payments.

23. The quantitative targets (ceilings) for the central bank's net domestic assets and reserve money will be adjusted downward to the extent that eligible bank reserves fall short of 11.51 percent of resident deposits in commercial banks at the end of each quarter.

24. The quantitative target (ceiling) for the domestic primary balance (excluding bank restructuring costs) for end-June 2005 and end-December 2005 will be adjusted upward (and the floors on net international reserves and ceilings on net domestic assets downward/upward) to accommodate the possible need for higher locally financed government outlays to deal with drought, up to a total limit of Mt 400 billion.

Data reporting

25. In addition to providing the monthly and quarterly data needed to monitor program implementation in relation to the programs' quantitative targets and broader economic developments, the authorities will provide weekly updates of the daily data set out in Table 3 of this attachment, as well as the weekly data set out in Table 4. Monthly updates will also be provided of the foreign exchange cash flow of the Bank of Mozambique, as set out in Table 5.

26. The government will continue to provide Fund staff with the data corresponding to monthly government revenues (in detail according to the fiscal table), with a lag not exceeding one month. In addition, the government will continue to publish and provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.

27. In addition, the government will provide monthly information on the balance of its savings account abroad and will start developing and providing information on domestic arrears on a quarterly basis.

Table 1. Mozambique: Foreign Program Assistance and External Debt Service for 2005

(In millions of U.S. dollars)

	2005				
	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
Foreign program assistance	102.7	60.4	10.9	69.0	243.0
Program grants	102.7	60.4	10.9	9.0	183.0
Program loans	0.0	0.0	0.0	60.0	60.0
External debt service	13.4	22.0	20.5	21.0	76.8

Source: Mozambican authorities; and Fund staff estimates.

Table 2. Mozambique: External Grants and Loans in Support of the 2005 Fiscal Program

(In millions of US dollars)

	2005
	Prog.
I. Grants	529.8
I.1. Projects and special program grants	330.3
Projects grants	330.3
Special program grants	0.0
I.2. Direct financing grants	15.2
I.3. Budget support grants	183.0
I.4. Food aid in kind	1.3
II. Loans	397.6
II.1. Projects loans	259.2
II.1. Loans in support of the budget	
Budget support loans	60.0
Loans for public enterprises	78.4

Source: Mozambican authorities; and Fund staff estimates.

Table 3. Mozambique: Daily Foreign Exchange Rates and Foreign Exchange Transactions, Week of [month/day-month/day]

Exchange Rates								
Commercial banks		Foreign exchange bureaus		Bank of Mozambique		Transactions with BoM		
Buy	Sell	Buy	Sell	Buy	Sell	BoM sales	BoM purchases	Requests outstanding for BoM foreign exchange
Monday								
Tuesday								
Wednesday								
Thursday								
Friday								

Source: Bank of Mozambique.

Table 4. Mozambique: Weekly Financial Data

Exchange rates (in meticaïs per U.S. dollar; weekly average)
Bank of Mozambique
Buy
Sell
Secondary market
Buy
Sell
Foreign exchange bureaus
Buy
Sell
Interest rates (in percent per annum)
Permanent Access Facility (FPC)
Excess liquidity rate (FPA)
Treasury bills
28 days
63 days
1 day
162 days
364 days
Monetary authority bills (TAMs) (if any)
Open market operations (in billions of meticaïs)
Securities issues during week
Treasury bills
TAMs
Securities matured/called during week
Treasury bills
TAMs
Securities outstanding
By type
Treasury bills
TAMs
By holder
Financial institutions
Public
Amount used by the government – (Ministry of Planning and Finance)
Reserve money in (billions of meticaïs)
Currency in circulation
Bank reserves
Bank of Mozambique net foreign assets
In billions of meticaïs
In millions of U.S. dollars
Bank of Mozambique net international reserves (in millions of U.S. dollars)
External assistance disbursed (in millions U.S. dollars)
Net credit to the government (in billions of meticaïs)
Net credit to the government; flow (in billions of meticaïs)

Source: Bank of Mozambique

Table 5. Mozambique: Central Bank Monthly Foreign Exchange Cash Flow
(In millions of U.S. dollars)

Beginning stock of net international reserves (NIR)

Inflows

- Program loans and grants
- Miners' remittances
- Interbank exchange market purchases
- Foreign assets income
- Provisioning of commercial banks
- Other

Outflows

- External debt service
- Interbank exchange market purchases
- Transfers to commercial banks
- Government
- Traditional circuit

Source: Bank of Mozambique

Mozambique: Relations with the Fund
(As of March 31, 2005)

Membership Status: Joined 9/24/84; Article XIV

General Resources Account	SDR Million	% Quota
Quota	113.6	100.0
Fund holdings of currency	113.6	100.0
Reserve position in Fund	0.01	0.0

SDR Department	SDR Million	% Allocation
Holdings	0.05	n.a.

Outstanding Purchases and Loans	SDR Million	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	125.30	110.30

Latest Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	07/06/04	07/05/07	11.36	3.24
PRGF	06/28/99	06/28/03	87.20	78.80
ESAF	06/21/96	06/27/99	75.60	75.60

Projected Payments to the Fund (with Board-approved HIPC Initiative assistance) (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	9.02	14.17	16.17	17.94	16.57
Charges/interest	0.60	0.48	0.36	0.25	0.16
Total	9.61	14.65	16.53	18.19	16.73

Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC Initiative assistance			
Decision point date	4/7/98	4/7/2000	
Assistance committed (end-1998 NPV terms)			
Total assistance (US\$ million)	1,716.0	306.0	2,022.0
<i>Of which:</i> Fund assistance (US\$ million)	124.6	18.5	143.1
Completion point date	6/29/99	9/20/01	
Delivery of Fund assistance (SDR million)			
Amount disbursed	93.2	13.7	106.9
Interim assistance	...	2.3	2.3
Completion point	93.2	11.4	104.6
Additional disbursements of interest income	...	1.1	1.1
Total disbursements	93.2	14.8	108.0

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bank of Mozambique is subject to safeguards assessment with respect to the PRGF arrangement approved on July 6, 2004. The assessment, which was completed on August 18, 2004, identified weaknesses in the areas of financial reporting, internal audit, and the system of internal controls and proposed specific measures to address weaknesses. The implementation of these measures is being monitored by staff under the PRGF arrangement.

Exchange Arrangements

Mozambique's exchange system is a managed float. Commercial banks may buy and sell foreign exchange to individual customers on a fully negotiable basis. The Bank of Mozambique introduced a foreign exchange auction system in January 2005. Auctions are held weekly. As of April 30, 2005, the official exchange rate was Mt 22,699 per U.S. dollar.

Mozambique still avails itself of the transitional arrangements under Article XIV of the Fund Articles of Agreement, but has eliminated all Article XIV restrictions. It maintains, however, restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII, as evidenced by (i) the discretionary prior approval for remittances of family living expenses; (ii) the authorization for the purchase of foreign exchange in excess of US\$5,000 for certain transactions; (iii) the prohibition on the conversion of balances of nonresidents' domestic currency accounts into foreign currency or

transfer abroad; and (iv) the need for proof of performance of a service before payment is authorized its payment. At the authorities' request, an Article VIII mission was conducted by LEG and PDR in March 2004. The mission encouraged the authorities to remove all existing exchange restrictions. The authorities indicated their intention to accept their obligations under Article VIII sections 2,3, and 4, of the Fund's Articles of Agreement after the approval of the new foreign exchange law, which is scheduled to be submitted to the assembly in 2005.

Article IV Consultation

In accordance with Decision No 12794-(02/76), as amended by Decision No 12854-(02/96), Mozambique is on a 24-month Article IV cycle owing to the approval of a new PRGF arrangement in July 2004. The 2003 Article IV consultation was completed by the Executive Board on December 10, 2003 (IMF Country Report No. 04/50; 11/19/2003) and, at that time, the Board also considered the ex post assessment report prepared by the staff on Mozambique's performance under Fund-supported programs.

In concluding the 2003 Article IV consultation, Executive Directors commended the authorities for their pursuit of sound macroeconomic policies and wide-ranging structural reforms over the past 15 years and for the satisfactory implementation of their economic program in 2002 and 2003. They welcomed the government's program for 2004 and urged the authorities to persevere with their efforts to consolidate macroeconomic stability and deepen structural reforms, with a view to sustaining growth, encouraging employment creation, and further reducing poverty. Most Directors expressed readiness to consider a successor low-access PRGF arrangement to help the authorities implement the ambitious reforms still needed.

FSAP Participation and ROSCs

A Financial Sector Assessment Program (FSAP) for Mozambique was undertaken during the first quarter of 2003. The related Financial Sector Stability Assessment was circulated to the Executive Board on November 19, 2003 (IMF Country Report No. 04/52). A Report on the Observance of Standards and Codes (ROSC) data module was prepared in June 2002 and issued on March 5, 2003. A ROSC on fiscal transparency was issued on February 22, 2001. This ROSC was updated in the context of the 2002 Article IV consultation (IMF Country Report No. 02/140; 06/03/2002), and the 2003 Article IV consultation (IMF Country Report No. 04/50; 11/19/2003).

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	May 2005	Inspection mission	Public expenditure management	Ministry of Finance
	April-May 2005	Mid-term review of the joint IMF/SECO/DANIDA domestic tax and administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	January 2005	Three-month visit of an FAD advisor	Strengthening of tax administration	Ministry of Finance
	November 2004	One-month visit of an FAD advisor	IT strategic planning	Ministry of Finance
	November 2004	Inspection mission, and coordination with bilateral donors	Public expenditure management	Ministry of Finance
	October 2004	Joint IMF/SECO/DANIDA project; short-term consultant training advisor (total 4 months in 3 visits)	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Third multipartite review of the joint IMF/SECO/DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Joint IMF/SECO/DANIDA project: short-term advisor (total 2 months in 4 visits)	Reform of the tax system and its administration; strategic issues on the establishment of the Central Revenue Authority (visit 1 of 4)	Ministry of Finance
	July 2004	Inspection mission	Public expenditure management	Ministry of Finance
	May 2004	Mid-term review of the joint IMF/SECO/DANIDA tax and customs administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	March 2004	Installation mission and coordination with bilateral donors	Public expenditure Management	Ministry of Finance
	October 2003	Inspection mission and coordination with bilateral donors	Public expenditure Management	Ministry of Finance
	September 2003	Joint IMF/SECO/DANIDA project; long-term consultant	Reform of the tax system and its administration	Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
		and training advisor mission		
	April/May 2003	Mid-term review of the joint IMF/SECO/DANIDA tax and customs administration reform project	Reform of the tax system and its administration	Ministry of Finance
	April 2003	Inspection mission	Public expenditure management	Ministry of Finance
Legal	February 2004	Mission	Advising government on the implications of accepting the obligations under Article VIII section 2,3 and 4 of the Fund's Articles of Agreement	Ministry of Finance, Bank of Mozambique
	2004	Correspondence	Advice on tax legislation	Ministry of Finance
	July 2003	Mission	Stamp tax	Ministry of Finance
	June-July 2003	Mission	General Tax Code	Ministry of Finance
Monetary and Financial Systems	October 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	September 2004	Short-term consultant	Monetary operations/monetary policy	Bank of Mozambique
	September 2004	Short-term consultant	Central Bank Accounting	Bank of Mozambique
	July 2004	Short-term consultant	Banking supervision	Bank of Mozambique and Ministry of Finance
	April 2004	By correspondence	Advice on foreign exchange operations	Bank of Mozambique
	April 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	March -April 2004	Mission	Banking supervision, monetary and foreign exchange operations	Bank of Mozambique
	February-March 2004	Mission	Bank restructuring	Bank of Mozambique
	October 2003	Mission	Advising on accounting issues at the central bank	Bank of Mozambique and Ministry of Finance
	September 2003	Mission	Concluding FSAP and discussion of technical assistance in the area	Bank of Mozambique and Ministry of Finance
	Mar.-Apr. 2003	Joint mission IMF/World Bank	FSAP mission follow-up	Bank of Mozambique and Ministry of Finance
	February 2003	Joint mission IMF/World Bank	FSAP mission	Bank of Mozambique and Ministry of Finance
Statistics	May 2005	Mission	ROSC Data Module Update	National Institute of Statistics
	October 2002-	Long-term consultant	National accounts statistics	National Institute of

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
	March 2004			Statistics
	November 2004	Mission	Balance of payments statistics	Bank of Mozambique
	September 2004	Mission	Monetary and financial statistics	Bank of Mozambique
	May 2004	Mission	Balance of payment statistics	Bank of Mozambique
	May 2004	Mission	Consumer price statistics	National Institute of Statistics (INE)
	November 2003	Mission	GDDS mid-term review	National Institute of Statistics
	August 2003	Mission	Balance of payments statistics	Bank of Mozambique
	May 2003	Mission	Government finance statistics	Ministry of Finance

Resident Representative: Mr. Perry Perone has been the IMF's Resident Representative to Mozambique since February 1, 2003.

Mozambique: Relations with the World Bank Group (As of May 15, 2005)

Partnership in Mozambique's Development Strategy

1. The Mozambican government's development strategy is set forth in the poverty reduction strategy paper (PRSP), termed the PARPA (Plano de Acção para a Redução da Pobreza Absoluta e Promoção do Crescimento Económico, or Action Plan for the Reduction of Absolute Poverty), which was approved in April 2001 by the council of ministers and endorsed in September 2001 by the Boards of the World Bank and the IMF. The PARPA focuses on six "fundamental areas" aimed at promoting human development and creating an environment for broad-based growth: macroeconomic and financial management, good governance, education, health, agriculture, and basic infrastructure (roads, water, and energy). The overall perspective is that poverty can most quickly be reduced by pursuing a strategy of broad economic growth, which, in turn, is crucially dependent on the maintenance of democratic and sociopolitical stability. The government issued progress reports on the PARPA in 2003 and 2004, which restate its commitment to reduce poverty by pursuing policies that help to create an environment for broad-based growth. In addition, the Program Assistance Partners, which include 14 donors and the World Bank, with the IMF as an observer, undertook reviews, jointly with the government, of the entire government program in March and in September 2004, using a common performance assessment framework (PAF), in order to serve as the basis for a further shift from project finance toward budget support. It is expected that this will streamline donor conditionality and reduce government transaction costs.

2. The Fund and the World Bank will continue to cooperate closely, within their respective mandates, in assisting the government to implement its medium-term poverty reduction and growth strategy and the related reform agenda, as presented in the PARPA and updated in the annual progress report and PAF.

3. The Fund will continue to lead the policy dialogue on macroeconomic policy, (including fiscal, monetary, and exchange rate policies), the integrated financial management information system (SISTAFE), and tax and customs reforms. The Bank will continue to lead the policy dialogue on public expenditure management, sectoral structural reforms, the reform of the civil service, and the Poverty and Social Impact Analysis (PSIA). Areas of close collaboration include banking supervision and financial sector issues, trade issues, the PARPA and its further development, and external debt sustainability.

Bank Group Country Assistance Strategy

4. The World Bank supports the implementation of the PARPA through its Country Assistance Strategy (CAS, FY 04-06). The three pillars of the CAS are (i) broadening the base of growth and ensuring its sustainability, (ii) investing in people and making services work for the poor, and (iii) improving public sector capacity and accountability. The focus of the Bank's lending program is on programmatic support through three rolling Poverty

Reduction Support Credits (PRSCs). Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic lending through the PRSCs is being underpinned by the Bank's core diagnostic economic and sector work, including the public sector review and PSIA. While a series of PRSCs is the largest single element in the lending program, the shift from traditional investment lending to program lending is being phased in gradually. Selected investment projects are targeting institutional strengthening, capacity building, transport infrastructure, water, and communications.

5. To date, the International Bank for Reconstruction and Development (IBRD) has approved 7 adjustment operations and 43 investment operations totaling approximately US\$2.7 billion. The current portfolio includes 18 projects for a total of US\$923 million, with an undisbursed balance of US\$744 million. Seventeen are investment projects and one is an adjustment operation that has already been fully disbursed. The graph below illustrates the distribution of the current portfolio by main sectors.

6. The World Bank has been actively supporting the government of Mozambique's macroeconomic program since 1986 through a series of **structural adjustment operations**. The last, the Economic Management and Private Sector Operation (EMPSO), was approved by the Bank Board in August 2002 for US\$120 million. The EMPSO supported the government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It included measures to make the budget more transparent (including accounting for external aid flows), conduct a public expenditure review, strengthen the financial sector while aiming to eliminate government ownership in the sector, and liberalize the telecommunications and air transport sectors in order to facilitate further private participation. From 2004 onward, the Bank's quick-disbursing assistance will take the form of PRSCs, which are being developed in tandem with the Joint Review/Performance Assessment Framework process referred to above. The first PRSC was presented to the Board in July 2004 and was valued at US\$60 million.

7. The World Bank has been an active partner in supporting the government in improving **education** and strengthening capacity building in key public institutions. The Education Sector Strategic Program (US\$71 million—FY 99) supports the implementation of the National Education Strategy, whose objectives are the promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. This is complemented by the Public Sector Capacity Building Project (US\$25.5 million—FY 03), which aims to increase the capacity of the government's Technical Unit for the Reform of the Public Sector. The Higher Education Project (US\$60 million—FY 02) supports the entire higher education system, including both public and private institutions of higher education. A technical and vocational education project is currently under preparation.

8. In **health**, the Health Sector Recovery Project (US\$98.7 million—FY 96) supported the government's broad Health Sector Recovery Program, especially by reducing infant and child mortality. It closed in 2003, and, in the future, the Bank will support the health sector via the PRSCs referred to above. The HIV/AIDS Project (US\$55 million—FY 03) assists the government in carrying out its National Strategic Plan to Combat STDs and HIV/AIDS. The HIV/AIDS Treatment Acceleration Project (US\$21 million—FY04) assists the Government in scaling up ongoing HIV/AIDS treatment initiatives using a combination of public/private/NGO partnerships to serve vulnerable groups.

9. In the area of **transport and infrastructure**, the Bank has three active projects. The Railways and Ports Restructuring Project (US\$100 million—FY 00) aims at increasing the operating efficiency of the three major port-rail systems in Mozambique. The Roads and Bridges Project (US\$162 million—FY 02) aims at improving road infrastructure, sector policies, and management, and the Beira Railway Project (US\$110 million—FY05) aims to improve the cost-effectiveness and efficiency for freight and passenger rail transport in the Zambezi Valley and beyond.

10. In the **water** sector, three active projects—the National Water Development Project I (NWDP I) (US\$36 million—FY 98), the National Water Development Project II (NWDP II) (US\$75 million—FY 99) and the National Water II Supplemental (US\$15—FY 04)—support improvements in service delivery standards, coverage, water resources management, and management capacity in both rural and urban areas. The NWDP II also supports private sector management of water services in five major cities.

11. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. The Enterprise Development Project (US\$26 million—FY 00) aims at broadening the base of private participation in the Mozambican economy. The Mineral Resource Management Capacity Building Project (US\$18 million—FY 01) seeks to increase institutional capacity in the sector, and alleviate poverty. The Communications Sector Reform Project (US\$14.9 million—FY 02) seeks to increase private sector participation in the postal, air transport, and telecommunications sectors.

12. As regards **public sector reform**, the Public Sector Project (US\$25.6 million—FY03) seeks to upgrade the quality of public services, reduce red tape, and improve access to public services. The Municipal Development Project (US\$33.6 million—FY01) aims to strengthen the institutional capacity of municipal government and pilot a municipal grant mechanism to finance investment. Finally, the Decentralized Planning Financing Project (US\$42 million—FY04) supports improvements to the institutional capacity of district administrations.

13. The Bank is also involved in **agriculture, energy, and the environment**. The Agricultural Sector Public Expenditure Program (US\$30 million—FY 99) is a sectorwide assistance program that seeks to improve the impact of public expenditure in developing an enabling environment for sustainable and equitable growth in the rural sector. The Gas Engineering Project (US\$26 million—FY 94), which closed in 2003, supported pre-investment in the Pande-Gas Project. The Coastal and Marine Biodiversity Management Project (US\$9.7 million—FY 00) pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas. Most recently, the Energy Reform and Access Project (US\$40.2 million—FY 04), which supports reform of the power sector, in particular the separation of distribution, transmission, and generation functions, aims at increasing the number of electricity connections and solar energy distributors and seeks to provide capacity building to the government for negotiation of megaprojects.

14. The Bank's **proposed lending program** for FY 05 comprises a US\$70 million PRSC 2, a Sustainable Tourism Project of US\$20 million (grant), the Beira Rail Project of US\$60 million (which was approved by the Board in October 2004), the Financial Sector Capacity Project of US\$10 million, and the Legal Sector Capacity Project of US\$5 million. In FY 06, three projects will be presented: a PRSC 3 of US\$70 million, a technical and vocational education grant of US\$20 million, and the second phase of the Roads and Bridges APL of US\$85 million.

15. The Bank's program also encompasses **economic and sector work** to support the three pillars of the CAS, involving work on the following:

- promoting sustainable growth—an investment climate assessment, a strategy for rural growth and income creation, and a country economic memorandum on sustainable growth and poverty reduction, which will also analyze the sources of growth;
- investing in people—a country status report on health, a public expenditure review, and work on labor markets and technical education; and
- improving governance—the recently published Country Procurement Assessment Report, a legal and judicial assessment, an institutional governance review, and the Public Expenditure Management and Financial Accountability Review.

IMF-World Bank Collaboration in Specific Areas

16. Fund and Bank staffs maintain a close working relationship, especially with respect to (i) analyses and reforms in public expenditure management; (ii) the PARPA and accompanying annual updates and joint staff assessments; (iii) the financial sector and banking supervision; (iv) PSIA; (v) tax issues; and (vi) trade issues:

- **Public expenditure management.** The Fund and the Bank jointly emphasize the urgent need to further improve public expenditure management, accountability, and transparency. The two institutions support policy reforms in the areas of budget formulation, execution, and monitoring. The IMF assists the authorities in introducing the integrated financial management information system (SISTAFE), and several donors, including the World Bank, provide financial support and policy advice for this reform. Under the Fund's leadership, a group of 10 donors set up a common fund for this large undertaking. The Bank's PRSC emphasizes budget comprehensiveness and budget execution reporting. The Bank and the government have worked together since September 2000 on a public expenditure review, the first volume of which was issued in December 2001 and the second in September 2003.
- **Poverty reduction strategy paper.** The Fund and Bank worked together with the government during 1999-2001, while the PARPA was being produced, and drafted the joint staff review, which was presented to the Board in September 2001. The government issued annual progress reports in 2003 and 2004, and the staff presented their joint staff assessments to their respective Boards. The Fund and the Bank will continue to work jointly with the authorities as they prepare the successor program, the PARPA II.
- **Financial sector.** The Fund and the Bank have worked together on the financial sector. The banking sector in Mozambique has repeatedly shown weaknesses in the past, requiring recapitalizations and intervention. Following the FSAP conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision and accounting standards to prevent the recurrence of such problems in the future. A technical assistance program is under preparation.
- **PSIA.** As part of the preparation for future Bank budget support and a possible successor program supported by a new Poverty Reduction and Growth Facility (PRGF) arrangement, the Fund and the Bank have agreed to review closely the poverty and social impact of the key reforms that are being implemented. A pilot PSIA, advising the government on the impact of an increase in specific fuel taxes, was undertaken in 2002. A second PSIA, on the impact of reducing primary schooling fees, was completed in October 2004. A third PSIA will be undertaken during FY 05, the subject matter of which has yet to be determined.
- **Taxes.** The Fund has taken the lead in this area. The government issued a new income tax law in 2002 and a revised code of fiscal incentives for investors. The Bank has been

supportive of the policies proposed. Further reforms to strengthen tax revenues and to improve the efficiency of tax administration are part of Mozambique's regular dialogue with the Fund.

- **Trade.** The Fund and the Bank have worked together since the early 1990s on trade issues concerning general reductions in tariffs, the variable tariff on sugar introduced in 1999, and the reduction in the export tariff on raw cashews. The Fund and the Bank are involved in reforming the customs administration in Mozambique. The Bank is cooperating with the donors (particularly USAID) and the government in executing the studies on trade policy required for the Integrated Framework.

17. Between 2005 and 2007, disbursements under World Bank investment projects are expected to reach around US\$125 million on average a year.

World Bank Loan and Grant Operations, 1999-2005 ¹
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005
	Actual					Est.	Proj.
I. Project Credit Disbursements	79.4	97.5	51.6	85.2	89.4	120.0	125.8
Established operations							
Household Energy (6/89) ^{2/}	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89) ²	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education II (12/90) ^{2/ 2/}	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89) ²	7.6	2.0	0.0	0.0	0.0	0.0	0.0
Agricultural Service Rehabilitation Development (2/92) ²	2.5	0.7	0.0	0.0	0.0	0.0	0.0
First Road and Coastal Shipping (6/92) ²	12.5	4.0	0.0	0.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	11.3	4.5	2.8	0.0	0.0	0.0	0.0
Capacity Building: Public Sector & Legal Institutional Development (11/92)	0.9	0.7	0.0	0.0	0.0	0.0	0.0
Maputo Corridor (1/93) ²	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Rural Rehab.(3/93) ²	3.8	2.0	0.3	0.0	0.0	0.0	0.0
Food Security (4/93) ²	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Local Government (6/93) ²	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94) ²	16.9	26.5	11.4	9.7	17.5	0.0	0.0
Financial Sector Capacity Building (4/94) ²	2.0	1.4	0.3	0.0	0.0	0.0	0.0
Gas Engineering (6/94) ^{2/ 2/}	1.5	1.1	1.6	1.8	0.4	0.0	0.0
Health Sector Recovery (11/95) ²	12.0	17.2	17.4	14.4	5.6	0.0	0.0
National Water I (2/98)	1.3	1.7	2.4	3.9	4.5	6.0	6.0
Agricultural Sec. PEP (2/99)	0.5	0.9	4.2	3.8	3.9	4.0	0.0
General Education (2/99)	1.0	0.5	1.2	6.9	14.7	18.0	15.0
Railway and Port Restructuring (10/99)	0.0	1.9	3.6	22.3	8.2	16.0	12.0
National Water II (6/99)	0.0	1.4	2.8	4.4	5.1	5.0	6.0
Enterprise Development (01/00)	0.0	2.3	3.0	2.9	3.4	4.0	4.0
Flood Emergency Recovery (4/00)	0.0	28.7	-0.2	0.0	0.0	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.0	0.3	0.4	0.3	1.0	1.0
Newest operations							
Municipal Development (7/01)	0.0	0.0	0.3	4.3	4.6	5.0	7.0

World Bank Loan and Grant Operations, 1999-2005 ¹
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005
	Actual					Est.	Proj.
Roads and Bridges I (7/01)	0.0	0.0	0.0	4.3	0.5	28.0	30.0
Communications (11/01)	0.0	0.0	0.0	1.2	2.8	2.5	3.0
Mineral Resources Project (3/01)	0.0	0.0	0.2	1.4	4.1	6.0	2.3
Higher Education Project 1 (3/02)	0.0	0.0	0.0	3.4	9.2	10.0	10.0
HIV/AIDS (3/03)	0.0	0.0	0.0	0.0	2.7	3.0	5.0
Public Sector Reform (3/03)	0.0	0.0	0.0	0.0	1.2	3.0	5.0
Energy Reform and Access Project (8/03)	0.0	0.0	0.0	0.0	0.0	3.0	10.0
Decentralization Planning (11/03)	...	...	...	...	...	5.0	8.0
National Water II Supplemental(2/04)	0	0	0	0	0	0.5	1.5
II. Adjustment operations	150.0	0.0	0.0	63.5	70.7	60.0	70.0
Economic Management Reform Operation (12/98) ^{2 3}	150.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation	0.0	0.0	0.0	63.5	70.7	0.0	0.0
PRSC 1 (06/04)	...	...	...	...	...	60.0	...
PRSC 2	...	...	...	...	...	...	70.0

¹ Date of Board approval in brackets.

² Closed.

³ Grant.

Mozambique: Statistical Issues

1. Against the background of a weak and deteriorating statistical infrastructure, Mozambique has made great efforts to rebuild its statistical system with assistance from the Fund, the World Bank, and donors. However, much remains to be done to improve the coverage, accuracy, and timeliness of macroeconomic statistics.
2. The data module of the ROSC for Mozambique, published in March 2003, included a detailed assessment of the quality of the country's macroeconomic statistics. The report concluded that there was a need for improvements in several areas, including the national accounts, prices, and the government finance and balance of payments statistics.
3. The authorities are committed to adhering to internationally accepted standards and good practices, as demonstrated by their participation in the IMF's General Data Dissemination System (GDDS) and, in particular, in the GDDS Regional Project for Lusophone African Countries. The Project's Regional Advisor and national accounts advisor has been stationed in Maputo since October 2002. Mozambican metadata are posted on the IMF's Data Standards Bulletin Board (DSBB) website, and also on the National Institute of Statistics' (NSI) website, which in August 2004, was replaced by a portal with search capabilities that substantially improved accessibility to the data and metadata disseminated.

National accounts

4. The national accounts are prepared by the NSI. Revised series starting in 1991 have been compiled in accordance with the *System of National Accounts 1993 (1993 SNA)*. The NSI compiles and disseminates (i) annual GDP at current and constant (1996=100) prices by activity, (ii) annual GDP by expenditure items at current and constant prices, and (iii) annual value-added components at current prices by activity. Annual accounts by institutional sectors were published for 1996 and 1997; the sector accounts and the economic integrated accounts for 1998-2003, are expected to be published in the second quarter of 2005. The 2002 ROSC data module assessment identified weaknesses in the accuracy and reliability of the national accounts source data. The NSI undertook a new household survey and sectoral censuses and work is well under way to compile the new benchmark year (2003) with new and improved data sources and methodology. The new national accounts framework will also include compilation of quarterly estimates expected to start being disseminated by mid-2006. The IMF is providing technical assistance in national accounts in the context of the GDDS project.

Prices and labor market

5. The consumer price index (CPI) for Maputo is based on weights derived from the 1996-97 household survey. Consistent time series are available starting from 1995. However, the outdated weights and their concentration on a few basic food staples with relatively volatile prices makes the CPI not very representative and prone to significant swings. A preliminary national index obtained by integrating the indices for Maputo, Beira, and Nampula has been published. The NSI is preparing a new CPI, based on the results of the household budget survey 2002/03. Dissemination of the new CPI series is planned to start in

May 2005. The IMF is providing technical assistance in price statistics in the context of the GDDS project, and a second mission is expected to take place in early July 2005.

6. There are very few sectoral labor market and employment data, and, where available, they have limited coverage. A one-year labor market survey was launched in October 2004 covering all the country; and NSI expects to have the first data about mid-2005. This survey is undertaken by NSI in collaboration with the Labor Ministry.

Monetary accounts

7. An STA mission visited Mozambique in September 2004, prepared a work plan for the implementation of the *Monetary and Financial Statistics Manual* and the development of an integrated database to meet the needs of the Bank of Mozambique, AFR, and STA. The mission noted the progress achieved in the information technology system, and in the periodicity and timeliness of the data compiled. However, the mission found that the chart of accounts of the Bank of Mozambique was inadequate to obtain a proper sectorization of the institutional units, and it did not distinguish between local and foreign-currency-denominated accounts. The mission recommended improving the classification and valuation of some financial instruments and expanding the coverage of the survey on other depository corporations by including the credit cooperatives. The new standardized forms for reporting monetary statistics to STA were derived during the mission stay and are now being tested to replace the existing forms. The mission also recommended updating the GDDS metadata and improving data accessibility to users through the Statistical Bulletin of the Bank of Mozambique.

External sector statistics

8. With assistance from STA technical assistance missions, the Bank of Mozambique has made significant progress toward compiling and disseminating balance of payments (BOP) and international investment position (IIP) statistics that are fully aligned with the fifth edition of the Balance of Payments Manual. This assistance is being provided in the context of the GDDS project

9. The Bank of Mozambique has now an adequate institutional framework for the compilation of BOP statistics and the IIP and has implemented many of the recommendations made by the three technical assistance missions that have taken place since mid-2003. The creation of the balance of payments service that reports directly to the Director of Economic Studies, the recruitment of three new staff, and the start of the project to computerize the BOP compilation and main data sources will contribute to the improvement of the quality of BOP statistics. The gradual improvements in the response rate of the BOP surveys are paving the way for setting a solid basis for this important source of information. Moreover, the improvement program that Customs undertook following the May 2004 mission recommendations helping to enhance the coverage and timeliness of trade data.

10. As a result of progress so far, the Bank of Mozambique has started to compile the IIP, which, however, is still at a test stage.

Mozambique: Table of Common Indicators Required for Surveillance
As of May 15, 2005

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶	Memo Items:	
						Data Quality – Methodological soundness ⁷	Data Quality Accuracy and reliability ⁸
Exchange Rates	Feb. 2005	Mar. 2005	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹							
Reserve/Base Money	Jan. 2005	Mar. 2005	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Jan. 2005	Mar. 2005	M	M	M		
Central Bank Balance Sheet	Jan. 2005	Aug. 2004	M	M	M		
Consolidated Balance Sheet of the Banking System	Jan. 2005	Mar. 2005					
Interest Rates ²	Feb. 2005	Feb. 2005	M	M	M		
Consumer Price Index	July 2004	Aug. 2004	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴						LO, LNO, LO, O	LO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government							
Stocks of Central Government and Central Government-Guaranteed Debt ⁵							
External Current Account Balance	Dec. 2003	Apr. 2004	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services							
GDP/GNP	Dec. 2003	Apr. 2004	A	I	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt							

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic nonbank financing.

⁴The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵Including currency and maturity composition.

⁶Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

⁷Reflects the assessment provided in the data ROSC published in March 2003, and based on the findings of the mission that took place during June 2002 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁸Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Mozambique: External and Public Debt Sustainability Analysis (DSA)

This appendix assesses the sustainability of Mozambique's external and public debt under the staff's baseline scenario, as well as its sensitivity to a number of standardized shocks. It is based upon the low-income country DSA templates developed by Fund and Bank staffs. Though this exercise was not conducted with Bank staff, the main assumptions were discussed jointly. The main conclusion of this DSA exercise is that, assuming full enhanced HIPC Initiative debt relief, continued fiscal prudence and funding strategy, and strong growth, Mozambique's external and public debt situations are sustainable and would remain so in the future.

A. Main Assumptions Underlying the Baseline Scenario

The baseline scenario covers 2005-25. The projection for 2005-08 is detailed in the staff report Tables 1-4. For the outer years, the main assumptions are the following:

- Annual real GDP growth would average 6.5 percent. This is about 1 percentage point lower than the historical average (Table 1), reflecting the likely negative impact of AIDS. Such a growth rate, however, still implicitly assumes the continuation of the reform drive.
- Inflation would be lowered to about 5 percent and maintained at this level thereafter. The real effective exchange rate would remain constant.
- Export growth would remain robust (7.5 percent), but the very high growth rates recorded recently due to megaprojects are not projected to be sustained. Imports would grow slightly faster than real GDP, leading to a gradual reduction of the noninterest current account deficit from about 7 percent of GDP in 2007 to about 2 percent in 2025.
- The baseline scenario assumes that bilateral agreements are signed with all non-Paris Club official creditors on terms consistent with the enhanced HIPC Initiative's completion point. Mozambique would continue to receive relatively large foreign aid inflows, although they would gradually decline as a share of GDP to about 5 percent in 2025. The share of grants in the total would remain at about 60 percent, while most of the new loans would be on IDA terms.
- Little information is available on private external debt. The stock at end-2004 was estimated using disbursements and amortization payments recorded in the balance of payments. Most of these debt have been contacted by megaprojects, whose main financial transactions are conducted mostly outside the country and do not affect the domestic banking system. Therefore, although the level of private external debt is not negligible (21 percent of GDP at end-2004), it does not directly raise sustainability issues for the country. The analysis will therefore

focus on public and publicly guaranteed (PPG) external debt. Analysis in this area, unfortunately, is hampered by weaknesses in the external debt database. Staff had to use different sources to reconcile, to the extent possible, the data provided by the authorities with those of Mozambique's main creditors.

- Fiscal policy would remain prudent. Projections are for a gradual increase in domestic revenues to 17-18 percent of GDP over the long run, which would allow for an increase in domestic primary expenditure (albeit lower than revenues). Thus, the domestic primary deficit would be reduced to 1 percent of GDP and the overall deficit (after grants) to 2 percent of GDP. Due to reduced gross financing need and single-digit inflation, the average interest rate of domestic public debt would decline.

B. External Debt Sustainability

In the baseline scenario, the stock of nominal external debt as a share of GDP decreases gradually from 93 percent at end-2004 to 36 percent in 2025, while the stock of PPG external debt would decrease from 72 percent to 29 percent (Table 1). Since the grant element in the latter is substantial, it is more meaningful to analyze PPG external debt in net present value (NPV) terms. The NPV of PPG external debt can then be scaled against GDP and exports. The ratio to GDP, which stood at 25 percent at end-2005, is projected to hover around 20 percent in the next 10 years and then to decline gradually to 15 percent in 2025. The ratio to exports, which stood at 84 percent at end-2004, is projected to remain in the 84-104 percent range in the next 20 years. The PPG debt service-to-export ratio would remain around 5 percent.

According to the World Bank's Country Policy and Institutional Assessment (CPIA) for 2003, Mozambique is a "medium" performer in terms of quality of policies and institutions. The indicative external debt sustainability thresholds corresponding to this rating are 40 and 150 percent for the ratio of NPV of external debt to, respectively, GDP and exports. The indicative ratio for debt service to exports is 20 percent. This suggests that sustainability is not an issue in the baseline scenario.

Standardized stress tests and alternative scenarios (A1-A2 and B1-B6 in Table 2) allow for exploring the sensitivity of external debt to a number of shocks. In all cases, Mozambique's debt ratios would remain below the indicative benchmarks. This result, however, hinges on the assumption that all non-Paris Club creditors agree to provide debt relief as expected at the HIPC Initiative completion point.

A country-specific alternative scenario (A3 in Table 2) was developed to assess the sensitivity of external debt to a less favorable composition of external assistance. It assumes

that the level of grants, in U.S. dollar terms, remains unchanged until 2025. The shortfall is made up by disbursements on IDA terms. The share of grants in total assistance drops to 20 percent at the end of the projection period. In this scenario, the NPV of debt to GDP ratio no longer decreases and even rises to about 25 percent in 2025. The ratio to exports also increases and almost reaches the indicative ceiling of 150 percent.

C. Public Debt Sustainability

Under the baseline scenario, public debt is projected to decline continuously from 62 percent of GDP in 2004 to 54 percent in 2010, and 38 percent of GDP in 2020 (Table 3). In NPV terms, the public-debt-to-GDP ratio, which stood at 23 percent at end-2004, is projected to hover around 25 percent in the next 10 years and then to decline gradually to 19 percent in 2020. The NPV of public-sector-debt-to-revenues (including grants) ratio, which stood at 117 percent at end-2004, is projected to peak at 127 percent of GDP in 2007 before declining to 96 percent by 2020. The public-debt-service-to-GDP ratio would gradually decline to 12 percent by 2020. Mozambique's public debt profile appears relatively robust to various shocks (Table 4). The most serious stress would come from a permanent reduction of GDP growth to 5 percent, or 1½ percentage points lower than in the baseline scenario.

Table 1. Mozambique: External Debt Sustainability Framework, Baseline Scenario, 2003-2025 1/
(In percent of GDP, unless otherwise indicated)

	Actual		Historical Average 6/	Standard Deviation 6/	Projections								2011-25 Average	
	2003	2004			2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	
External debt (nominal) 1/	112.3	93.2			72.3	68.0	67.1	65.6	64.4	63.0		53.6	36.3	
o/w public and publicly guaranteed (PPG)	83.1	71.7			56.9	54.7	53.8	53.0	51.9	50.8		43.8	28.8	
Change in external debt	-9.5	-19.1			-20.9	-4.2	-0.9	-1.5	-1.2	-1.5		-1.8	-1.5	
Identified net debt-creating flows	-15.6	-22.2			0.4	-0.2	1.4	0.3	-0.7	-1.3		-1.4	-1.2	
Non-interest current account deficit	6.1	3.4	7.5	3.1	4.6	4.4	6.9	5.4	4.3	3.6	4.9	2.9	1.8	2.6
Deficit in balance of goods and services	16.8	9.3			8.9	8.0	10.4	8.7	7.2	5.9		4.8	3.0	
Exports	28.3	30.0			25.1	23.4	22.2	21.8	21.7	22.4		20.3	16.7	
Imports	45.1	39.3			33.9	31.4	32.6	30.5	28.9	28.4		25.1	19.7	
Net current transfers (negative = inflow)	-10.7	-8.1	-10.8	2.7	-6.8	-6.1	-5.9	-5.6	-5.3	-5.1	-5.8	-4.3	-3.1	-3.9
Other current account flows (negative = net inflow)	0.0	2.1			2.5	2.5	2.3	2.3	2.5	2.8		2.4	1.9	
Net FDI (negative = inflow)	-7.1	-4.0	-6.5	2.3	-1.4	-2.2	-3.7	-3.2	-3.0	-2.9	-2.7	-2.5	-1.9	-2.3
Endogenous debt dynamics 2/	-14.6	-21.6			-2.8	-2.4	-1.8	-1.9	-2.0	-2.0		-1.8	-1.2	
Contribution from nominal interest rate	3.0	2.4			2.5	2.4	2.2	2.1	1.9	1.7		1.5	1.1	
Contribution from real GDP growth	-8.1	-6.4			-5.3	-4.8	-4.0	-3.9	-3.8	-3.8		-3.3	-2.2	
Contribution from price and exchange rate changes	-9.5	-17.6			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	6.0	3.0			-21.3	-4.1	-2.3	-1.8	-0.5	-0.2		-0.5	-0.3	
o/w exceptional financing	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	46.6			36.3	34.2	34.6	34.3	34.4	34.2		30.9	22.3	
In percent of exports	...	155.3			144.8	146.3	156.1	157.4	158.8	152.3		151.9	133.3	
NPV of PPG external debt	...	25.2			21.0	20.9	21.3	21.6	21.9	22.0		21.1	14.8	
In percent of exports	...	83.8			83.6	89.5	96.0	99.3	101.0	98.3		103.7	88.2	
Debt service-to-exports ratio (in percent)	26.3	24.6			25.6	25.8	26.8	25.9	25.5	23.9		23.6	21.2	
PPG debt service-to-exports ratio (in percent)	6.9	4.5			5.1	5.3	5.4	5.2	4.8	4.3		5.0	4.8	
Total gross financing need (billions of U.S. dollars)	0.3	0.4			0.8	0.8	0.9	0.9	0.8	0.8		1.1	1.8	
Non-interest current account deficit that stabilizes debt ratio	15.7	22.5			25.6	8.7	7.8	6.9	5.5	5.0		4.7	3.3	
Key macroeconomic assumptions														
Real GDP growth (in percent)	7.8	7.2	7.6	3.5	7.7	7.4	6.4	6.4	6.4	6.4	6.8	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	8.4	18.6	0.4	11.9	25.7	3.5	2.7	2.5	2.9	2.9	6.7	2.9	2.9	2.9
Effective interest rate (percent) 5/	2.9	2.7	3.0	0.6	3.6	3.7	3.6	3.3	3.1	2.9	3.4	3.0	3.1	3.0
Growth of exports of G&S (US dollar terms, in percent)	13.8	35.1	23.2	10.5	13.1	3.6	3.6	7.2	9.0	13.4	8.3	7.5	7.5	7.5
Growth of imports of G&S (US dollar terms, in percent)	8.9	10.9	13.9	12.8	16.9	2.7	13.6	2.1	3.5	7.6	7.7	7.0	7.0	7.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	47.6	47.7	48.6	48.7	48.7	48.7	48.3	48.8	49.0	48.9
Memorandum item:														
Nominal GDP (billions of US dollars)	4.8	6.1			8.2	9.2	10.0	10.9	11.9	13.1		20.7	51.9	

Source: IMF Staff simulations.

1/ Includes both public and private sector external debt. Ratios are calculated by converting GDP into U.S. dollars using average exchange rates.

2/ Derived as $[r - g - \rho(1+g)] / (1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the period 1998-2004, for data availability reasons.

Table 2. Mozambique: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Projections							
	2005	2006	2007	2008	2009	2010	2015	2025
NPV of debt-to-GDP ratio								
Baseline	21	21	21	22	22	22	21	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	21	20	20	20	20	21	22	21
A2. New public sector loans on less favorable terms in 2006-25 2/	21	21	22	23	24	25	25	19
A3. Grants frozen at their 2005 level in U.S. dollars	21	21	21	22	22	23	25	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	21	21	22	22	23	23	21	15
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	21	19	18	18	19	19	18	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	21	24	28	29	29	29	28	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	21	18	17	18	18	19	18	13
B5. Combination of B1-B4 using one-half standard deviation shocks	21	19	16	17	18	19	19	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	21	29	29	30	30	30	29	20
NPV of debt-to-exports ratio								
Baseline	84	89	96	99	101	98	104	88
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	84	87	89	90	93	93	108	124
A2. New public sector loans on less favorable terms in 2006-25 2/	84	91	100	106	111	110	122	113
A3. Grants frozen at their 2005 level in U.S. dollars	84	90	97	101	105	104	125	143
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	84	88	94	97	99	96	100	83
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	84	76	67	70	72	71	76	67
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	84	88	94	97	99	96	100	83
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	84	79	78	82	84	83	89	79
B5. Combination of B1-B4 using one-half standard deviation shocks	84	66	47	50	53	53	59	57
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	84	88	94	97	99	96	100	83
Debt service ratio								
Baseline	5	5	5	5	5	4	5	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	5	5	5	5	5	4	6	7
A2. New public sector loans on less favorable terms in 2006-25 2/	5	5	5	5	5	5	6	7
A3. Grants frozen at their 2005 level in U.S. dollars	5	5	5	5	5	4	6	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	5	5	5	5	4	4	5	5
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	5	5	4	4	4	3	4	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	5	5	5	5	4	4	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	5	5	5	5	4	4	5	5
B5. Combination of B1-B4 using one-half standard deviation shocks	5	4	4	3	3	3	3	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	5	5	5	5	4	4	5	5
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	48	48	48	48	48	48	48	48

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Mozambique: Public Sector Debt Sustainability Framework, Baseline Scenario, 2000-2020
(In percent of GDP, unless otherwise indicated)

	Actual	Historical Average 5/	Standard Deviation 5/	Projections									
	2004			2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2020	2011-20 Average
Public sector debt 1/	61.9			60.1	59.0	58.8	57.4	55.8	54.3		46.2	37.7	
Of which: foreign-currency denominated	60.0			58.0	56.0	54.8	53.9	52.7	51.6		44.7	36.8	
Change in public sector debt	-25.8			-1.8	-1.1	-0.2	-1.4	-1.6	-1.5		-1.7	-1.7	
Identified debt-creating flows	-30.2			-2.9	-2.7	-2.0	-1.9	-2.3	-2.4		-2.5	-2.2	
Primary deficit	3.3	2.8	1.9	5.2	3.5	3.3	3.1	2.9	2.7	3.4	2.2	1.5	2.3
Revenue and grants	19.6			19.6	19.8	20.2	20.6	20.8	21.1		21.0	20.8	
Of which : grants	7.3			6.4	5.8	5.6	5.5	5.3	5.1		4.3	3.7	
Primary (noninterest) expenditure	22.9			24.8	23.3	23.5	23.7	23.7	23.8		23.2	22.3	
Automatic debt dynamics	-28.6			-5.4	-5.0	-4.3	-3.9	-4.2	-3.9		-3.5	-2.9	
Contribution from interest rate/growth differential	-5.4			-3.7	-3.4	-2.7	-2.6	-2.6	-2.5		-2.2	-1.9	
Of which : contribution from average real interest rate	0.4			0.7	0.8	0.9	0.9	0.9	0.9		0.7	0.5	
Of which : contribution from real GDP growth	-5.9			-4.4	-4.2	-3.6	-3.5	-3.4	-3.4		-2.9	-2.4	
Contribution from real exchange rate depreciation	-23.1			-1.7	-1.7	-1.6	-1.3	-1.6	-1.4		...	...	
Other identified debt-creating flows	-4.9			-2.6	-1.2	-1.1	-1.1	-1.0	-1.2		-1.2	-0.8	
Privatization receipts (negative)	-1.8			0.0	-0.1	-0.1	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-4.8			-3.6	-1.9	-1.5	-1.4	-1.2	-1.2		-1.2	-0.8	
Other (specify, e.g. bank recapitalization)	1.7			1.0	0.7	0.5	0.3	0.2	0.1		0.0	0.0	
Residual, including asset changes	4.4			1.1	1.6	1.8	0.6	0.6	0.9		0.8	0.5	
NPV of public sector debt	27.0			23.0	23.9	25.2	25.1	25.0	24.7		22.7	19.1	
Of which: foreign-currency denominated	25.2			21.0	20.9	21.3	21.6	21.9	22.0		21.2	18.3	
Of which: external	25.2			21.0	20.9	21.3	21.6	21.9	22.0		21.2	18.3	
NPV of contingent liabilities (not included in public sector debt)	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Gross financing need 2/	9.1			9.2	7.2	7.1	6.6	6.1	5.8		4.8	3.9	
NPV of public sector debt-to-revenue ratio (in percent) 3/	138.1			117.4	120.6	125.2	122.1	120.1	117.3		108.2	91.9	
Of which: external	128.6			106.8	105.5	105.4	105.0	105.1	104.6		101.2	87.9	
Debt service-to-revenue ratio (in percent) 3/ 4/	28.7			20.9	17.8	17.8	16.1	14.3	13.8		12.0	11.7	
Primary deficit that stabilizes the debt-to-GDP ratio	29.1			6.9	4.6	3.6	4.4	4.5	4.2		3.9	3.2	
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	7.2	7.9	3.4	7.7	7.4	6.4	6.4	6.4	6.4	6.8	6.4	6.4	6.4
Average nominal interest rate on forex debt (in percent)	0.3	0.9	0.5	0.6	0.7	0.7	0.8	0.8	0.9	0.7	1.0	1.0	1.0
Average real interest rate on domestic currency debt (in percent)	...	-22.9	73.7	25.6	21.9	17.7	14.9	14.0	14.4	18.1	15.3	16.4	15.5
Inflation rate (GDP deflator, in percent)	12.7	21.4	19.7	8.1	7.3	6.5	5.9	5.5	5.2	6.4	5.2	5.2	5.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.8	9.2	14.8	16.8	1.1	7.3	7.1	6.8	6.7	7.6	5.5	5.1	5.7

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ It refers to gross debt of the central government. The foreign-currency debt ratio to GDP is converted into meticalais using the end-of-period ex-change rate.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues including grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Mozambique: Sensitivity Analyses for Key Indicators of Public Sector Debt , 2003-2020

		Projections							
	2004	2005	2006	2007	2008	2009	2010	2015	2020
NPV of Debt-to-GDP Ratio									
Baseline	27	23	24	25	25	25	25	23	19
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	27	22	22	23	22	22	21	19	17
A2. Primary balance is unchanged from 2004	27	22	23	24	24	24	24	24	23
A3. Permanently lower GDP growth 1/	27	23	25	26	27	27	27	29	29
B. Bound tests									
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	27	24	26	27	27	28	28	26	23
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	27	21	22	23	23	23	23	22	19
B3. Combination of B1-B2 using one half standard deviation shocks	27	22	24	25	25	25	24	22	19
B4. One time 30 percent real depreciation in 2005	27	31	30	31	30	29	28	23	19
B5. 10 percent of GDP increase in other debt-creating flows in 2005	27	32	32	32	31	30	30	25	21
NPV of Debt-to-Revenue Ratio 2/									
Baseline	138	117	121	125	122	120	117	108	92
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	138	110	111	113	109	106	102	94	85
A2. Primary balance is unchanged from 2004	138	112	115	120	118	117	116	116	110
A3. Permanently lower GDP growth 1/	138	118	123	129	128	128	128	134	137
B. Bound tests									
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	138	120	113	137	124	120	128	126	111
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	138	108	86	112	104	100	108	104	89
B3. Combination of B1-B2 using one half standard deviation shocks	138	114	99	126	111	106	113	107	91
B4. One time 30 percent real depreciation in 2005	138	158	136	155	134	125	129	112	92
B5. 10 percent of GDP increase in other debt-creating flows in 2005	138	163	138	162	140	132	137	121	100
Debt Service-to-Revenue Ratio 2/									
Baseline	29	21	18	18	16	14	14	12	12
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	29	21	16	16	14	12	12	10	11
A2. Primary balance is unchanged from 2004	29	21	17	17	15	14	13	13	15
A3. Permanently lower GDP growth 1/	29	21	18	18	17	15	15	16	19
B. Bound tests									
B1. Real GDP growth is at historical average minus one standard deviations in 2005-2006	29	21	19	19	17	16	16	15	15
B2. Primary balance is at historical average minus one standard deviations in 2005-2006	29	21	16	16	14	13	12	11	11
B3. Combination of B1-B2 using one half standard deviation shocks	29	21	17	17	16	14	13	12	11
B4. One time 30 percent real depreciation in 2005	29	21	19	19	17	15	15	13	13
B5. 10 percent of GDP increase in other debt-creating flows in 2005	29	21	18	18	16	14	14	12	12

Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

**Statement by the IMF Staff Representative
June 22, 2005**

The following information has become available since the issuance of the documents relating to the Article IV consultation and the second review of the three-year arrangement under the Poverty Reduction and Growth Facility. The thrust of the staff appraisal remains unchanged.

1. The 12-month rate of inflation declined further to 3.8 percent in May 2005, from 9.1 percent in December 2004, mainly on account of food prices. The metical has further depreciated against the U.S. dollar and, to a lesser extent, against the rand in the past few weeks. The cumulative depreciation against the U.S. dollar between end-December 2004 and June 3 reached 28 percent. Thus, part of the real effective appreciation of 2004 is likely to have been reversed.
2. The prices of petroleum products were increased on average by 20 percent on June 1, 2005, to reflect the increase in import prices. At the same time, the government granted a 50 percent reduction in the fuel tax on diesel to mitigate the impact on production costs.
3. The wages of public sector employees were increased—to be applied retroactively starting in April 1, 2005—by 14 percent for the lowest wage categories (including education and health services) and 7 percent for higher wage categories. This increase is consistent with the authorities' commitment in the MEFP to keep the ratio of the wage bill to GDP constant in 2005.
4. Very preliminary information indicates that fiscal and monetary developments during January-April 2005 were in line with the program.
5. As envisaged in the Letter of Intent, the authorities began to implement a series of measures aimed at improving revenue collection, in particular (i) the VAT and customs IT systems were interfaced to facilitate cross checking and auditing; and (ii) a monthly system for monitoring the tax returns by large taxpayers and megaprojects in Maputo began.
6. In addition, the following measures have been implemented: (i) a decision has been made on the issuance of securities by the government to cover the central bank's financial losses in 2004; (ii) four "one stop shops" for business registration were opened; and (iii) the government has formalized the anticorruption unit in Maputo and established new units in two other main cities.

Press Release No. 05/149
FOR IMMEDIATE RELEASE
June 22, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under the Three-Year PRGF Arrangement for Mozambique and Approves US\$2.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Mozambique's economic performance under an SDR 11.36 million (about US\$16.6 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see [Press Release No. 04/153](#)).

The completion of the review enables the release of an amount equivalent to SDR 1.62 million (about US\$2.4 million), which will bring total disbursements under the PRGF arrangement to an amount equivalent to SDR 4.86 million (about US\$7.1 million).

The Executive Board also agreed to waive the nonobservance of the end-December 2004 quantitative performance criterion on the central government's domestic primary deficit and the end-December 2004 structural performance criterion on the completion of a feasibility study on the divestment of the government's participation in the Banco Internacional de Moçambique.

Following the Executive Board's discussion on Mozambique's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

“Mozambique is at a critical juncture in its development. After its impressive performance of the past decade, a “second wave of reforms” is needed to deepen and accelerate structural changes, in order to sustain high and broad-based growth. In particular, efforts should focus on (i) increasing tax revenues; (ii) strengthening public sector operations; (iii) reducing the costs of doing business; (iv) promoting labor-intensive sectors; and (v) implementing a rural development strategy. Moreover, stepped-up efforts are needed to reduce poverty and, with the help of the international community, to reach the Millennium Development Goals (MDGs). In this context, the forthcoming poverty reduction strategy paper for 2006–10 should be aimed at reinvigorating such a reform process.

“Economic growth remained strong and inflation declined in 2004. However, slippages have occurred under the PRGF-supported program during October 2004–March 2005, primarily reflecting a weakening of tax collections and delays in the implementation of the structural reform agenda in the period leading up to the elections. The authorities have indicated their

commitment to implementing a strong set of measures to bring the program back on track and enhancing its monitoring.

“The authorities plan to sustain a higher rate of growth and to continue to reduce gradually the inflation rate by deepening structural reforms, and pursuing prudent fiscal and monetary policies in the context of the flexible exchange rate system. Central to the medium-term strategy will be the consolidation of the fiscal stance, notably by strengthening revenue mobilization and public expenditure management. Priority expenditures will also be protected in order to contribute to the achievement of the MDGs. In this regard, the ongoing measures implemented by the Mozambican authorities to increase tax collections in 2005 include strengthening tax enforcement, progress towards creating the Central Revenue Authority by end-2005, and the enactment of a general tax law. In addition, the timely rollout of the new electronic financial administration system (e-SISTAFE) and the inclusion in the budget of all project-related expenditures, with the help of the donor community, will be crucial to make the budget a more effective instrument of fiscal reporting and management.

“The revival of public sector reforms will also be important to increase the efficiency of government expenditure, combat corruption, and ensure appropriate wages for public employees. The authorities will renew their efforts to improve governance by strengthening the legal system, procurement, and creating a financial investigation unit.

“Monetary policy will continue to be prudent and aimed at reducing inflation in the context of a flexible exchange rate system. Intervention in the foreign exchange market will be limited to maintaining international reserves at comfortable levels, while preventing short-term volatility. Government divestiture from the banking system and further strengthening of banking system supervision and reporting should help deepen the financial sector.

“The authorities will continue to secure a higher share of external grants. In addition, they will make efforts to reach agreement with bilateral and non-Paris Club creditors that have not yet provided debt relief under the enhanced HIPC Initiative to buttress external debt sustainability. Creditors’ readiness and support in this regard are fundamental,” Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the [Poverty Reduction Strategy Paper \(PRSP\)](#). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

**Statement by Peter Gakunu, Alternate Executive Director for Republic of Mozambique
and Yasmin Patel, Senior Advisor to Executive Director
June 22, 2005**

1. The economic and financial developments in Mozambique are comprehensively and well documented in the staff reports. The Mozambican authorities are in broad agreement with the analysis and conclusions expressed in these reports regarding the policy challenges facing the economy and the direction of policy stance. They are appreciative of the exceptional cooperation received from Fund Management and staff, and for the generous bilateral and multilateral support extended to the country, which in no small measure, has contributed to the authorities' solid record of macroeconomic stability and far reaching structural reforms under successive PRGF programs. The authorities' strong commitment to prudent macroeconomic management and extensive reforms have been rewarded with considerable dividends, which are evident from the reported better performance than the average for sub-Saharan African countries in many respects, over the past decade. Despite Mozambique's notable achievements, particularly in terms of real GDP growth per capita, the gains from this strong growth have not been evenly distributed and fighting poverty will require further strengthening of the institutional capacity, especially in the rural areas.

Recent Economic Developments

2. Mozambique's overall performance under the PRGF arrangement approved last year, remained broadly satisfactory. The Mozambican authorities have pursued the basic objectives of growth with reduced inflation and a sustainable external position. In 2004, real GDP growth, although slightly lower than in 2003, remained broad-based and robust at 7.2 percent. This deceleration was due to a slowdown in construction related to the completion of some of the mega projects, as well as a climate-related contraction in the fishing industry. Inflation declined more than expected to 9.1 percent by year-end from 13.8 percent the previous year, to 4.0 percent in May 2005, which also contributed to a decline in interest rates. The external current account deficit has narrowed by more than 6 percentage points of GDP, mainly on account of strong export performance. Although the government's domestic primary deficit was exceeded by 0.6 percent of GDP in 2004, mainly as a result of a shortfall in revenue performance, the overall fiscal deficit before grants improved by more than 2 percentage points of GDP. Notwithstanding some delays experienced towards the end of 2004 in implementing some of the structural measures because of the election and transition to a new Administration, structural reforms continued to strengthen the basis for growth in the economy. As we stated during our last Board meeting on Mozambique, the new Government remains fully committed to the implementation of prudent economic and financial policies and the observance of the program targets.

3. All but one quantitative and one structural performance criteria for end-December 2004, were effectively observed. However, in the last quarter of 2004, the period that coincided with the electoral process, delays have been encountered in implementing structural reforms. The authorities, however, recognize the importance of, and remain fully committed to make further progress in this area, to match the gains in macroeconomic

stabilization to ensure that Mozambique reaches a new stage of development. They intend to take the necessary reform measures to maintain the high level of investment, continue to improve economic efficiency and competitiveness, while pursuing their goal for an increased regional and global economic integration process.

The Policy Agenda for 2005

4. The program for 2005, which builds on the significant economic achievements made so far, has been designed within the framework of a medium term strategy, as embedded in Mozambique's PARPA. This strategy is aimed at further reducing poverty levels by maintaining a strong and mainly export-led private sector economic growth of between 6 to 8 percent. To this end, the authorities remain fully committed to maintaining sound macroeconomic policies necessary to sustain strong economic fundamentals, to observe financial prudence through complementary fiscal and monetary policies, to promote sustainable growth with price stability, and to deepen structural adjustments to alleviate poverty.

5. The economy is expected to continue to perform well in 2005. Real GDP growth is projected to accelerate further to 7.7 percent, reflecting increased activity in agriculture and a pick-up in the construction and fishing sectors. Inflation is expected to decrease further during 2005, thus continuing the declining trend of the recent years. According to the most recent information, inflation has fallen further to about 4 percent in May 2005, indicating that the year-end objective is well within reach.

6. The new Administration attaches great importance to arresting the deterioration of the fiscal position, and is therefore, determined to renew its efforts on fiscal consolidation after last year's performance fell somewhat short of expectations. The authorities are cognizant of the need for fiscal adjustment to bring stability to domestic economic conditions, which are crucial to build confidence and improve investment climate. A combination of revenue and expenditure measures underpins the projected improvement in government finances. The high incidence of poverty in Mozambique, makes any increase in taxation a delicate matter. Hence, with a view to enhance revenue performance, the measures are oriented towards incorporating into the budget the own-generated revenues of districts and some line ministries and strengthening tax administration and tighter control in order to increase compliance and reduce tax avoidance. An important step in this regard, was the recent approval by the Cabinet of new regulations strengthening the auditing and inspections' activities. On the expenditure side, the objective is to contain expenditure growth by limiting the wage bill and non-priority outlays, while allowing social spending to be sustained at an adequate level. A decision has also been taken to address the central bank's 2004 net financial losses through the issuance of additional government securities starting with the 2008 budget. Priority will continue to be given to improving public expenditure management while improved efforts for effective implementation of the e-SISTAFE will greatly assist in further enhancing fiscal transparency. Efforts are also underway to improve the investment procedures.

7. Regarding monetary policy, the main objective is to tighten broad money, lower inflation, and strengthen the international reserves position. Monetary expansion will be limited to 14.5 percent, which is below the nominal GDP growth. The central bank will continue to monitor developments closely and stands ready to take any necessary measures to achieve the program's monetary target. The planned fiscal restraint and further development of financial markets and instruments should help the Banco de Moçambique in pursuing prudent monetary policies, particularly in light of continued large inflows of capital, while allowing increased financing to support private sector activity.

8. With technical assistance support from the Fund and donor community, the central bank is strongly committed to fully implementing the International Financial Reporting Standards (IFRS) in the banking system starting in 2007. In this respect, a timetable of action for the introduction of the IFRS has already been elaborated and efforts are under way for the necessary training to facilitate a smooth transition towards the adoption of the new reporting standards. Several measures are also being taken to reinforce further the supervisory regime, that include the preparation of a new inspection manual, training of inspectors, and revising guidelines for credit provisioning.

9. Regarding the divestment of government's participation in the Banco Internacional de Moçambique (BIM), although a strategy paper outlining the divestiture process was finalized in February of 2005, the feasibility study took longer than envisaged and is now expected to be completed by September 2005.

10. The flexibility of the foreign exchange system has been increased with the introduction of the foreign exchange auction system in January 2005. The authorities expressed, however, concern about the volatility that followed the introduction of the new system. The central bank intends to limit its intervention in the foreign exchange market to achieving its net international reserves target and avoid sharp short-term exchange fluctuations. To improve the existing legislation, the central bank is drafting a revision to the foreign exchange law. Pending its approval by Parliament in the second half of 2005, the authorities intend then to accept the obligations under Article VIII, sections 2, 3, and 4 of the Articles of Agreement.

11. The authorities intend to give continuity to their long process of structural reforms. They are determined to press ahead with the civil service reform. In this respect, an independent audit of the civil service is expected to be completed in 2005 and a reform of the wage system is being considered, which will envisage linking remuneration more closely to performance. Furthermore, with a view to removing the remaining obstacles to private sector development, several measures are being considered, including the preparation of a revised labor law aimed at increasing flexibility in the labor market, reducing the cost of doing business, and improving basic infrastructure. Given the sensitive nature of the issues involved in a potential reform of land tenure, the authorities intend to proceed with caution in this regard and only after a process of broad consultation with all parties is concluded. In the meantime, a draft proposal to strengthen property rights in urban areas is under consideration and a Poverty and Social Impact Analysis (PSIA) on land tenure regulations will be conducted with the support of some development partners.

Conclusion

12. Finally, although the magnitude of the challenges ahead is significant, we would like to reassure the Fund Board and Management of our Mozambican authorities' strong determination to continue with the reform process and implementing the necessary measures to reach the program objectives.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with the Republic of Mozambique

On June 22, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Mozambique.¹

Background

Mozambique's strong commitment to sound macroeconomic policies and structural reform has led to a remarkable improvement in economic performance, supported by substantial donor assistance. During the last decade, real GDP growth averaged 8 percent a year (the highest in Africa), end-period inflation was reduced to single digits, public external debt shrank, the international reserves position strengthened, and the share of the population living in absolute poverty declined substantially. These achievements were facilitated by a stable political situation and the consolidation of the democratic system, as illustrated by the recent general elections that took place peacefully.

The economy continued to perform well in 2004. Real GDP growth decelerated slightly to an estimated 7.2 percent. Despite a sharp increase in petroleum prices, inflation declined more than expected to 9.1 percent at end-December 2004 and to 4.5 percent at end-April 2005 driven by lower food prices. The easing of inflation expectations also contributed to a reduction in interest rates. Strong growth in traditional exports, the completion of two megaprojects,

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

and improved terms of trade helped narrow the external current account deficit, excluding grants, by one third to 13.8 percent of GDP in 2004. This, together with greater-than-anticipated donor support and large private capital inflows, contributed to boost net international reserves, well above program, to about six months of imports. This led to a strong appreciation of the metical in real effective terms in 2004.

Performance under the Fund-supported program was mixed. All quantitative performance criteria, except the one pertaining to the government domestic primary deficit, were met. The revenue to GDP ratio decreased from 12.9 percent of GDP in 2003 to 12.3 percent in 2004 and fell short by 1.1 percent of GDP of the program indicative floor for end-December 2004 (using the new GNP series). Collection of most taxes turned out lower than envisaged. The revenue shortfall was mainly due to higher-than-projected VAT reimbursements related to megaprojects, delays incurred by corporations in complying with the payments calendar under the new corporate income tax code, and the impact of the appreciation of the metical. Another important factor was the weakening of tax collection during the transition period leading the nomination of a new government. The revenue shortfall was partially compensated by cuts in current expenditures. However, the share of priority expenditures to total expenditure (about 63 percent) was slightly lower than programmed. As a result, the domestic deficit fell short of the program target by 0.7 of GDP and the overall fiscal deficit, after grants, was slightly higher than envisaged.

Broad money growth slowed down significantly in 2004, reflecting in part the impact of the appreciation of the metical on the foreign currency deposits. In the midst of the commercial banks restructuring, the increase in domestic credit to the private sector remained relatively modest while net credit to the government was slightly exceeded. However, the end-December indicative stock of reserve money was exceeded by a small margin, owing mainly to a larger-than-expected demand for domestic currency. In 2004 and early 2005, the Bank of Mozambique (BM) took several steps to strengthen monetary management, including a more judicious mix of its monetary instruments in the context of a managed floating exchange rate system. Since the second half of 2004, it has relied more on foreign exchange sale to control liquidity, following the heavy reliance on domestic monetary instruments.

Progress in implementing structural reforms has been slower than envisaged. In particular, five out of eight benchmarks were missed, while one of the two structural performance criteria was not observed, including in the monetary and fiscal areas.

Implementation of fiscal reforms has continued but with some delays. A draft general tax law and a law creating the Central Revenue Authority (CRA) were submitted to the Assembly in mid-2004 but have not yet been adopted. Progress has been made to facilitate the merger of the General Directorates of Domestic Taxes (DGI) and Customs (DGA) into the CRA by end-2005. On the expenditure side, at the beginning of 2005, the new electronic financial administration system (e-SISTAFE) began to record and classify all disbursements to line ministries. In addition, work is progressing to strengthen the functioning of the Treasury Single Account (TSA). In this context, the transactions between the BM and commercial banks are now reconciled on a daily basis.

Key structural measures in the banking system are also being implemented. Nonperforming loans have declined sharply. The BM has finalized a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and bring loan classification and provisioning in line with best international practices. The reviews of the four largest banks, finalized in February 2005, show that they are ready to move to IFRS. The regulations of the newly adopted Financial Institutions Law were approved by the Council of Ministers in late 2004, and the revision of the regulatory framework for microfinance activities was completed.

Reforms in other sectors have encountered some difficulties. Reforms in the judicial system were hampered by capacity constraints and delays in approving relevant legislation. The creation of a financial investigation unit was delayed due to the pending amendment of the current anti-money laundering law. Progress on land tenure reform was hindered by the difficulty of gathering consensus on such a sensitive issue. The new procurement legislation was not approved due to delays related to the consultation process.

Executive Board Assessment

Executive Directors noted that Mozambique is at a critical juncture in its development. After its impressive performance of the past decade, a second wave of reforms is needed to deepen and accelerate structural changes to sustain high and broad-based growth. The authorities' strong commitment to follow through with the needed reforms will help ensure that the remarkable results the country has achieved so far are not reversed. In that context, Directors emphasized that efforts should aim at (i) increasing tax revenues; (ii) strengthening public sector operations; (iii) reducing the costs of doing business; (iv) promoting labor-intensive sectors; and (v) implementing a rural development strategy.

Directors welcomed the substantial reduction in poverty realized over the past decade. At the same time, they stressed that stepped-up efforts are needed to further reduce poverty and, with the necessary financial assistance of the international community, reach the Millennium Development Goals. In particular, they looked forward to the new poverty reduction strategy paper for 2006–10.

Directors noted that performance under the PRGF-supported program has been mixed. They welcomed the continued strong growth, deceleration in inflation to single digits, and strengthened external position in 2004. Directors, however, regretted important slippages during the period October 2004–March 2005, which coincided with the elections and the installment of the new administration, in particular the weakening of tax collection and delays in the implementation of the structural reform agenda. They welcomed the authorities' commitment to bring the fiscal stance back on track in 2005, by strengthening tax collection, and implementing expenditure contingency measures to preserve priority outlays.

Directors concurred with the authorities' medium-term fiscal consolidation strategy, which rests appropriately on increasing revenue mobilization, moderating the growth of the wage bill, and enhancing public expenditure management. In this regard, Directors encouraged the Mozambican authorities to further improve tax administration procedures, noting that a significant part of potential taxes are not being realized, and to make the budget a more

effective instrument of fiscal reporting and management, through the timely rollout of the new electronic financial administration system. The new budget management system should, with the assistance of the donor community, include all project-related expenditures. Directors also encouraged the authorities to increase the share of pro-poor expenditures.

Directors commended the authorities for the steps they had already taken on the revenue side. They noted the progress made in establishing the Central Revenue Authority. They also welcomed the recent approval of the new regulations for tax auditing and inspection. On the expenditure side, Directors expressed concern at further delays in implementing the e-SISTAFE. However, they welcomed its rollout in the Ministry of Finance in late 2004, its use to record and classify all disbursements to line ministries, and the authorities' commitment to roll it out to the Ministry of Education and Culture in 2005. They also noted progress in strengthening the functioning of the Treasury Single Account.

Directors commended the authorities on keeping a prudent monetary policy stance and increasing the flexibility of the exchange rate. Directors noted that the flexible exchange rate regime has helped cushion the impact of exogenous shocks. They encouraged the authorities to continue pursuing a balanced mix of foreign exchange sales and issuance of treasury bills to sterilize excess liquidity. Intervention in the foreign exchange market should be limited to achieving the international reserve target and preventing short-term volatility. Directors welcomed the introduction of foreign exchange auctions. They also noted that there was no evidence of a real effective exchange rate misalignment.

Directors noted the recent improvement in the performance of the banking sector, including the sharp fall in nonperforming loans. They welcomed the authorities' commitment to strengthen the supervisory regime and the reporting practices of the banking system. They encouraged the authorities to continue to divest its ownership in the banking system and urged the authorities to continue their efforts to deepen the financial system by developing microcredit institutions and reforming land tenure titles to facilitate the provision of financial services to rural and urban households. Directors also welcomed the authorities' commitment to strengthen the balance sheet of the central bank.

Directors supported the authorities' renewed efforts to reduce the cost of doing business in Mozambique, expand and diversify the export base, and improve international competitiveness. They welcomed the authorities' plan to further remove the remaining restrictions on the making of payments and transfers for international current transactions. In addition, Directors encouraged the authorities to continue streamlining commercial licensing procedures and reforming labor market regulation, and the judicial system.

Directors strongly encouraged the authorities to reach agreement with bilateral non-Paris Club creditors that have not yet provided debt relief under the enhanced HIPC Initiative. At the same time, creditors' readiness and support in this regard are fundamental. They also encouraged the authorities to secure highly concessional foreign assistance. This, together with increasing tax revenue and the strengthening of the debt-management capacity, should contribute to keeping external and public debts sustainable.

Directors welcomed the authorities' commitment to revive the public sector reform with the help of the World Bank and other donors. They stressed that the reforms of the civil service and procurement legislation are necessary to improve the efficiency of government spending, combat corruption, and ensure appropriate wages for public employees.

Directors appreciated the authorities' renewed efforts to improve governance, which continue to cloud the investment climate. They welcomed the authorities' commitment to amend the anti-money laundering law and create a financial investigation unit. They also praised the authorities for their commitment to publish and disseminate the results of the National Survey on Governance and Corruption.

While welcoming recent improvements in the statistical system, especially in the national accounts series, Directors urged the authorities to continue to strengthen the statistical system, which still has deficiencies that hinder the monitoring of economic development.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Mozambique: Selected Economic and Financial Indicators, 2003-06

	2003	2004	2005	2006
		Act.	Rev. Proj.	Rev. Proj.
(Annual percentage change, unless otherwise indicated)				
National income and prices				
Nominal GDP (in billions of meticaïs)	113,811	137,425	159,912	184,289
Real GDP growth	7.8	7.2	7.7	7.4
Consumer price index (end of period)	13.8	9.1	8.0	7.0
External sector				
Merchandise exports	28.9	44.1	13.9	1.9
Merchandise imports	12.8	16.9	15.6	2.8
Terms of trade	-1.4	13.4	2.2	-7.3
Real effective exchange rate (end of period) 1/	-2.7	24.8	...	...
(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)				
Money and credit				
Net foreign assets	8.6	30.0	0.8	2.6
Net domestic assets 2/	10.1	-24.0	13.7	11.6
Broad money (M3)	18.7	5.9	14.5	14.2
Interest rate for 90-day treasury bills (in percent; end of period)	12.1	10.5	...	...
(In percent of GDP)				
Investment and saving				
Gross domestic investment	25.9	20.1	21.3	21.3
Gross domestic savings (excl. grants)	6.0	6.2	7.4	8.4
Current account, before grants	-19.9	-13.8	-13.9	-12.9
Government budget				
Total revenue	12.9	12.3	13.2	14.0
Total expenditure and net lending (incl. residual)	26.5	23.7	25.6	24.2
Overall balance, after grants	-4.5	-4.4	-6.0	-4.4
Domestic primary balance	-3.7	-3.7	-2.8	-1.6
(In percent of exports of goods and nonfactor services)				
Net present value of total public external debt outstanding	105.4	83.8	83.6	89.5
External debt service (nonfinancial public sector)				
Scheduled, after enhanced HIPC Initiative and additional bilateral assistance	6.1	4.5	5.1	5.3
(In millions of U.S. dollars, unless otherwise specified)				
Overall balance of payments	122	212	-84	-30
Gross international reserves (end of period)	947	1,159	1,076	1,045
In months of imports of goods & nonfactor services	5.4	5.8	4.7	4.4

Sources: Mozambican authorities; and IMF Staff estimates and projections.

1/ A minus sign indicates depreciation.

2/ The percentage change for Net Domestic Assets in the revised projection for 2004 has been adjusted to take account of the shifting of the external liabilities of the BM to the government.