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International Monetary Fund
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IMF Concludes Article IV Consultation with Mozambique

The IMF Executive Board on April 7, 1998 concluded the Article IV consultation[1] with Mozambique.

Background

After a difficult period in which the Mozambican economy suffered as a result of civil war and weak economic policies, in 1987 the government launched an Economic Rehabilitation Program (ERP) supported by the IMF. The program involved a fundamental shift to market-based economic policies and structural reforms. Major reforms undertaken since then include the unification and stabilization of the exchange rate; significant tariff reforms and trade liberalization; the elimination of most price controls; the privatization of about 900 public enterprises; and extensive financial sector reforms. Under the ERP, Mozambique has made impressive economic gains: real GDP and exports grew on average by 6.8 percent and 15.6 percent, respectively, in the 1987-97 period. Nevertheless, Mozambique remains a relatively poor country with social indicators that are below the average for sub-Saharan African countries.

Real GDP growth in 1997 was provisionally estimated at 7.9 percent, which is higher than the program forecast and the highest level in four years. Growth was broad-based, with transportation, industry, and services showing particularly encouraging outcomes. Agriculture grew by 5.9 percent, with a decline in cashew, but a strong increase in cotton (43 percent) and foodstuffs (22 percent). Good weather, prudent financial policies, and an increase in private investment linked to privatization explain the rising activity level. Inflation was 5.8 percent in 1997 (end of period), or less than half of the program target (14 percent) and the lowest inflation rate since

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[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. In this PIN, the main features of the Board's discussion are described.

independence in 1975. Inflation has declined steadily from 70 percent in 1994 as a result of greater monetary control, exchange rate stability, and the strong supply response in the economy.

Monetary expansion was 25 percent in 1997, faster than the program target of 20 percent, despite the fact that base money expanded by 16 percent only and remained well within its target for the year. Two factors explain the faster than programmed monetary expansion. First, money demand was higher than expected spurred by the more dynamic economy, increased confidence, and high real interest rates for deposits. Second, the money multiplier increased owing to a decline in the currency to deposits ratio and because of a shift toward time deposits, which are not subject to reserve requirements. The Bank of Mozambique accommodated the higher money demand by allowing credit to the economy to increase 21 percent more than programmed and by accumulating net foreign assets in excess of targets. This action avoided the negative effect on growth that might have resulted had the original monetary targets been observed.

The overall deficit before grants increased from 17.0 percent of GDP in 1996 to 20.1 percent in 1997, as foreign aid (grants and concessional loans) expanded. Total revenue increased from 18.0 percent in 1996 to 20.4 percent in 1997, owing mainly to a rise in tax revenue from 16.5 percent of GDP in 1996 to 18.9 percent in 1997. The increase in tax revenue stemmed from a strengthening of tax and customs administration, as well as from the quarterly adjustment of the petroleum tax rates. Total expenditure and net lending grew by 5.5 percent of GDP from 1996 to 1997, with current expenditure increasing from 15.9 percent of GDP in 1996 to 18.9 percent in 1997 and capital expenditure rising from 18.9 percent of GDP in 1996 to 21.5 percent in 1997. Current expenditure in health and education increased in real terms, while the growth in capital expenditure reflected primarily higher spending on transportation and the water sectors.

Merchandise exports increased from US$226 million in 1996 to US$234 million in 1997. The growth of merchandise exports other than cashews was much stronger, about 14 percent. Nontraditional exports and, in particular, apparel are expanding at rapid rates. The surrender requirement on exports proceeds was eliminated in January 1997. Imports declined by 1 percent to US$775 million in 1997, owing to import substitution. Gross international reserves of the Bank of Mozambique increased to more than six months of imports at end-December 1997. The metical depreciated by only 4 percent in 1996 and less than 2 percent in 1997. The spread between the market and the parallel exchange rate has narrowed to less than 2 percent in the first quarter of 1998.

Mozambique continues to make significant progress in several structural reform areas. Customs management was privatized in 1997 and a system of full reconciliation of import taxes due and taxes paid was set up, preparations are underway for the introduction of the value added tax, new budgetary recording and monitoring procedures have been introduced, public administration is being decentralized, and a civil service reform is being finalized for implementation in 1999. The privatization program is on track for completion in mid-1999, the legal and regulatory framework is being restructured to facilitate trade and investment, and labor legislation is being updated. The last remaining state-owned bank was privatized in September 1997, commercial bank accounting procedures were updated, a new Financial Institutions Law has been submitted to the Assembly of the Republic, and banking supervision is being strengthened. A series of steps were taken to prepare the introduction of indirect monetary policy instruments. Bank reserve requirements were lowered, extended to foreign currency deposits, and made more flexible; an interbank money market was established in September 1997; and the payments system is being modernized.

In September 1997 the Executive Boards of the IMF and the World Bank decided in their preliminary discussions that Mozambique qualified for assistance under the HIPC Debt Initiative. The Initiative is a key to reducing the debt burden to sustainable levels and to freeing resources to finance critical structural and social reforms. On April 7, 1998 the Executive Board of the IMF agreed that Mozambique had reached the decision point under the Initiative, and that the completion point would be reached in mid-1999. Together with a similar decision by the IDA Board also on April 7, 1998, this means that Mozambique now qualifies for interim assistance under the Initiative.

Executive Board Assessment

Executive Directors noted that the Republic of Mozambique's overall economic performance had continued to improve in 1997, as evidenced by higher growth, falling inflation, an improvement of the external current account, and the stability of the nominal exchange rate. These positive developments had further bolstered confidence, and private investment was on the upswing.

Directors commended the authorities for adhering to their macroeconomic program for 1997/98, as well as for their determined efforts to implement the wide-ranging structural reforms set out in the policy framework paper. Most Directors agreed that the unexpectedly strong money demand and the need to avoid slowing growth had warranted the somewhat higher than programmed monetary expansion, especially as it appeared to have no adverse impact on prices. However, they advised the authorities to closely monitor economic developments and to take quick action to curtail money and credit growth if there are signs of overheating.

Directors noted that, despite the recent economic gains, Mozambique still faced major economic problems, notably widespread poverty, an inadequate social and economic infrastructure, and a heavy external debt burden. They stressed the need for firm adherence to the program, through continued prudent financial management and an acceleration of the remaining structural reforms, in order to consolidate the gains already achieved and to place the economy on a path of strong and sustainable growth.

In this context, Directors endorsed the proposed policy framework for 1998. They observed that the continued heavy dependence on foreign aid indicated a need to raise public sector savings, boost export growth, and increase financial deepening. Directors welcomed the significant strengthening of tax revenues in 1997, and urged the authorities to maintain or increase the momentum of improvements in tax and customs administration and to broaden the tax base. They recommended an early introduction of a value-added tax, to be accompanied by a public information program. They also urged the authorities to undertake a review of the pension system in order to reduce the burden of pension payments on the budget. Directors welcomed the introduction of a new budgetary accounting framework, which would further enhance budgetary transparency and facilitate a reallocation of resources to social programs.

Several Directors stressed that the authorities should pay attention to the efficiency—as well as the level—of investment, the absorptive capacity constraints facing the economy, and the implications of higher investment spending for recurrent costs. They agreed that an improvement in aid coordination would help achieve better resource allocation, and advised the authorities to continue their discussions with donors to resolve the outstanding issues.

Directors welcomed the near-completion of the privatization program and the efforts to restructure the remaining public enterprises. They encouraged the authorities to consider full privatization of the remaining enterprises under the program. They also urged the authorities to give high priority to the reforms of public administration and the pension system.

Directors noted the high level of dollarization of the economy. Directors emphasized the importance of maintaining prudent monetary policies, adequate bank supervision, and a prudent level of gross international reserves. While noting that the evidence on external competitiveness is mixed, Directors cautioned that a further real effective appreciation of the metical should be avoided.

A few Directors were disappointed by the slower progress toward trade reform in the most recent period. The authorities were encouraged to further reduce tariff spreads and exemptions. Directors also suggested that the recently signed free trade protocol with the Southern African Development Community (SADC) could provide an added opportunity to set more ambitious trade reform objectives. Directors also encouraged the authorities to accept the obligations of Article VIII, Sections 2, 3, and 4 within the year.

Directors also considered the final document on the Heavily Indebted Poor Countries (HIPC) Initiative for Mozambique. They agreed that Mozambique is eligible and qualifies for assistance under the HIPC Initiative. The consensus view was that the completion point should be in June 1999, subject to the conclusion of the midterm review under the third annual arrangement under the current three-year enhanced structural adjustment arrangement, and approval of a new three-year enhanced structural adjustment arrangement by that date. They welcomed the exceptional efforts that are to be made by all of Mozambique's creditors in a spirit of equitable burden sharing. They also agreed that the external debt sustainability target for the net present value of the debt-to-exports ratio for Mozambique at the completion point will be 200 percent and the target of the debt-service-to-exports ratio will be 20 percent. Directors emphasized that access to enhanced debt relief under the HIPC Initiative was conditional upon satisfactory implementation of a strong program of structural reform and actions in the social area.

Press Information Notices (PINs) are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Mozambique: Selected Economic Indicators, 1994-98

	1994	1995	1996	1997	1998 Proj.
			(In percent)		
Domestic economy					
Change in real GDP	4.5	1.4	6.2	7.9	9.4
Change in consumer prices (end of period)	70.2	54.1	16.6	5.8	6.0-10.0
			(In millions of U.S. dollars)[1]		
External economy					
Exports, f.o.b.	164	174	226	234	325
Imports, f.o.b.	881	727	783	775	965
Current account balance[2]	-300	-338	-359	-260	-453
Direct investment and project grants	333	274	296	335	365
Capital account balance	-10	64	237	162	196
Current account balance (percent of GDP)[2]	-20.5	-22.7	-20.6	-13.4	-20.9
Change in real effective exchange rate (in percent; +appreciation)	-3.2	-4.4	14.9	14.7	...
			(In percent of GDP)[1]		
Financial variables					
Gross national savings	30.5	28.5	27.5	31.8	31.4
Gross domestic investment	51.0	51.2	48.2	45.2	52.3
Central government balance (before grants)	-29.7	-20.8	-17.0	-20.1	-19.4
Primary balance	-28.0	-17.4	-14.4	-17.6	-16.5
Change in broad money (in percent)	57.6	54.7	21.1	25.4	22.2

Sources: Data provided by the Mozambican authorities; and IMF staff estimates.

[1]Unless otherwise indicated.
[2]Including grants.