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Republic of Mozambique and the IMF

Press Release:
IMF Completes Fifth Review Under the Policy Support Instrument for Mozambique
December 21, 2012

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Republic of Mozambique: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

December 7, 2012

The following item is a Letter of Intent of the government of Republic of Mozambique, which describes the policies that Republic of Mozambique intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Republic of Mozambique, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

MOZAMBIQUE—LETTER OF INTENT

Maputo, Mozambique
December 7, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the fifth review under the Policy Support Instrument (PSI). In support of this request, we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews implementation of our economic program under the PSI and sets out the Government's objectives and policies over the short and medium term.

The Government's economic program aims to maintain macroeconomic stability, promote inclusive growth through public investment and the promotion of productive employment, and reduce poverty. The program aims to support the implementation of the Poverty Reduction Strategy Paper (PARP) for 2011–14, which the Government formally adopted in May 2011.

The Government is of the view that the policies outlined in the MEFP are adequate to achieve the objectives of the PSI-supported program. We stand ready to take any additional measures necessary to achieve our policy objectives. The Government will consult with the IMF—at its own initiative or whenever the Managing Director requests such a consultation—should revisions be contemplated regarding the policies contained in the attached MEFP.

The Government will provide the IMF with such information as the IMF may request to be able to assess the progress made in implementing the economic and financial policies and achieving the objectives of the program.

Sincerely yours,

/s/	/s/
Manuel Chang	Ernesto Gouveia Gove
Minister of Finance	Governor
	Bank of Mozambique

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REPUBLIC OF MOZAMBIQUE

ATTACHMENT 1. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (MEFP)

December 7, 2012

I. INTRODUCTION

1. This updated MEFP (i) describes recent developments and performance of the Government's economic program under the three-year Policy Support instrument (PSI) to date and (ii) elaborates on economic and structural policy intentions. It builds on the MEFPs underlying the initial PSI request of May 2010 and those for its four reviews, the last of which was completed in June 2012.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. Mozambique's economy remains remarkably robust, despite a deteriorating global economic environment.

- Reflecting the rapid start-up of coal production and exports, real GDP grew by 7.2 percent in the first half of 2012. The extractive industry was the fastest-growing sector, while the transport and communication sectors also performed strongly. This compensated for slower growth in agricultural production due to devastating crop diseases in oil palm and cashew plantations.

- After peaking at 16.6 percent at end-2010, twelve-month headline inflation continued to decelerate sharply reaching 1.5 percent in October 2012, the lowest rate in SADC. Inflationary expectations have been tamed, as core inflation (excluding food, transport and energy prices) declined from 8.4 percent at end-2010 to less than 1 percent in October 2012. This reflects the lagged effects of our determined monetary tightening in 2011, lower-than-expected prices of imported food, and stable administered prices.

- The external current account deficit widened in 2011. The data is very preliminary and is being revised to better capture high FDI and related imports, especially investment in the coal industry. The widening of the current account deficit reflects also the impact of lower aluminum prices, the biggest export product, which was partly offset by the start-up of coal exports and sustained traditional exports. There were lesser effects from increases in electricity import costs; technical problems which reduced electricity exports, and plant diseases which devastated cashew exports.

- Strong FDI and aid disbursements contributed to a stronger-than-projected international reserve position.

3. We largely met the objectives underlying our economic program:

- All quantitative targets for end-June 2012 were met except for the assessment criterion (AC) on net credit to the government and the indicative target on government revenue. The latter reflected a shortfall in customs revenue due to technical problems with the introduction of the single trade facilitation window. With expenditure implementation largely on track, this resulted in higher-than-programmed net credit to the government (NCG) by end-June.

- Program performance strengthened through end-September. Customs revenue has picked up since June and a windfall payment of capital gains taxes of about 1¼ percent of GDP ($176 million) on the sale of shares in a major gas project between private parties was registered in September. As a result, we have met all the end-September fiscal targets. All monetary targets through end-September have also been met, as the Bank of Mozambique (BM) maintained its commitment to its monetary program.

- The Government has taken up nonconcessional borrowing (NCB) for the rehabilitation of the Maputo airport and the construction of the Nacala airport ($147 million), and the construction of the ring road around Maputo ($300 million with a 34 percent grant element). In addition, in July 2012 we signed a loan of $682 million for a connecting road to the South African border (Maputo-Ponta d´Ouro) and a toll bridge across the Maputo Bay (Maputo-Katembe). This project will help decongest traffic in the Maputo area, develop the tourism potential of Southern Mozambique, and improve trade with South Africa. We also contracted a $250 million loan (34 percent grant element) in September 2012 for improvements in the quality of electricity supply in the Maputo area. Our NCB usage since 2009 under the PSI stands at $1,380 million as of end-September 2012, within the $1,500 million program ceiling.

- We made progress in implementing the program's structural benchmarks through October 2012: (i) in May 2012, the BM published its first quarterly monetary policy report, which is intended to enhance communications and explain the BM's policy decisions; (ii) in June 2012, the government completed the rollout of the electronic salary payment system (e-FOLHA) to all 170 provincial directorates; (iii) the new single tax payer database was developed by mid-year and we began implementation; (iv) the Ministry of Finance (MF) approved a time-bound action plan for IPSAS-compatible reporting in October 2012; and (v) the amendment to the Corporate Income Tax Law reflecting the equalization of the tax treatment of Treasury bills and bonds was submitted to Parliament in November with a two-month delay, still allowing it to be effective as of 2013.

III. IMPLEMENTATION OF THE POVERTY REDUCTION STRATEGY (PARP)

4. The Government is proceeding with the implementation of its 2011–14 PARP to accelerate poverty reduction through more inclusive growth. The PARP's three main pillars are:

- ***Enhancing production and productivity in agriculture***. Guided by our Agricultural Reform Strategy (PEDSA), we aim to reach an average growth of agricultural output by 7 percent per year, doubling production by 2020, mainly through an increase in productivity, but also through an expansion of the cultivated area. Productivity gains will be facilitated through the promotion of improved farming techniques to more than half million farmers in 2013 and by increasing extension services to 12 and 15 percent of agricultural producers by 2013 and 2014, respectively. On-going upgrades in irrigation schemes in the South (Chokwe district, Limpopo area) will further boost productivity. A new agricultural investment plan was approved by the Council of Ministers (CM) on December 4, 2012, and will be disseminated to donors and investors. The plan seeks to attract private investment to the tune of $3½ billion over the next five years, and to prioritize public investment in rural areas. It includes measures to strengthen producers' access to markets such as rehabilitation of district roads (feeder and non-classified roads), construction of grain silos, setting up an agricultural commodity exchange in 2013, and initiatives such as the Beira Agricultural Growth Corridor, which seeks to expand irrigation and provide financing to early-stage agro-businesses.

- ***Creating employment.*** We plan to create about 200,000 new jobs in the public and private sectors each year. We have continued our efforts to foster an environment that is more conducive to private sector activity. With support from the World Bank (WB) and the International Finance Corporation (IFC), we finalized an initial inventory of all licensing requirements in November 2012 and expect to streamline procedures for commercial activities and for industrial activities by end-March 2013. We have finalized a draft law to regulate credit registry bureaus, which is currently under public consultation (see ¶27). In late November Parliament approved a new competition law and delegated to government powers to rule on all bankruptcy matters. Our successor five-year Strategic Plan to Improve the Business Environment 2013–17 will be submitted to the CM by end-2012. We also aim to launch by end-June 2013 the first Labor Market Monitoring Group (Observatório do Mercado de Trabalho), which is intended to monitor developments in the labor market and the implementation of labor-related policies.

- ***Enhancing social and human development.*** The Government continues to improve access to, and the quality of, social services and infrastructure. We plan to reach the target of 69 health workers to 100,000 inhabitants in 2014 (from 66 in 2012) through recruitment and training, and will ensure that 80 percent of the children are vaccinated by end-2014. To achieve the target rate of schooling at age 6 in first grade of 80 percent in 2014, we will recruit 6,500 new teachers for primary education in 2013 and continue implementing programs that target the participation and retention of students in the right age. We expect to invest $333.2 million (Mt 10.5 billion) in 2013 to improve access to water, basic sanitation, electricity, housing, and urban transport services. With support from the ILO, UNICEF, the World Bank, and the IMF, we continue to enhancing our social protection systems (see ¶17).

IV. MACROECONOMIC POLICIES

A. Economic Objectives

5. We expect Mozambique's medium-term outlook to remain positive reflecting our booming extractive industry, but the deteriorating global economic environment poses risks.

- Over the next five years the contribution of coal production and exports, the implementation of large infrastructure projects, including of liquefied natural gas plants, and healthy growth across other sectors are projected to keep economic growth at 7½percent per year, in line with our objectives.

- Absent any unforeseen external price shocks, we are confident to achieve our average inflation (CPI) objective of around 6 percent during the period.

- In the short run, the deteriorating external environment could lower economic growth owing to the moderation of external demand and add inflationary pressures in case of increases in international food or fuel prices.

- Nonetheless, the external current account deficit (before grants) is set to improve slightly this year and but is projected to increase to 31 percent of GDP in 2013 reflecting rising investment in the extractive industries and related imports, as well as increasing electricity imports. At end-2011 the reserve coverage of contemporaneous (projected) imports stood at 3.8 (3.3) months, or over 5 months excluding megaproject imports. Reserves are projected to increase in the medium term as investment in the coal sector winds down and coal exports increase.

B. Macroeconomic Policy Mix

6. The government intends to maintain a prudent macroeconomic policy mix over the medium term. Fiscal and monetary policies will be geared toward safeguarding macroeconomic stability and debt sustainability, with an emphasis on investment and social development to sustain high and inclusive economic growth. We are preparing to prudently manage future natural resource revenues to accommodate a temporary surge in public investment over the next few years, close the huge infrastructure gap, and support the PARP's social and human development objectives, including the expansion of social protection. While this stance will keep overall fiscal deficit above 6 percent of GDP for most of the period, the strong revenue effort and restraint in domestic current spending will limit the domestic primary deficit to around 2 percent of GDP. The continued support of development partners and moderate NCB will ensure that recourse to domestic bank financing will remain below 1 percent of GDP, thus providing ample room for private sector credit expansion. Monetary policy will be sufficiently accommodating to support this objective while primarily aiming to preserve low inflation. The envisaged rise in money demand will keep reserve money expansion slightly above nominal GDP growth.

7. Our policy stance for 2013 will continue to support economic growth. After our monetary tightening in 2011, our supportive policy stance in 2012 helped to sustain economic growth and enhance credit to the private sector, while benefitting from the absence of major inflationary pressures. We plan to continue our policy stance in 2013 to preserve the low inflation environment, while continuing to ensure strong public investment and facilitate credit provision to the private sector.

8. The Government intends to implement its infrastructure investment plans with due regard to macroeconomic stability and debt sustainability. Priority investments through mid-2013 require an increase in the NCB program ceiling from $1.5 billion to $1.6 billion. This has become necessary as over the course of lengthy negotiations some loans (totaling $550 million) slipped marginally under the 35 percent grant element requirement, but still continue to be on very favorable terms. Guided by our recently approved Medium-Term Debt Strategy (MTDS), we will reassess our borrowing needs over the medium term in light of projected natural resource revenues with a view towards slowing the pace of contracting new debt. We intend to proceed prudently and focus new borrowing on investments in transportation and energy infrastructure.

C. Monetary and Exchange Rate Policies

9. Monetary policy will continue to support credit growth, while preserving our medium-term inflation objective. Building on our successful disinflationary efforts in 2011, we remain committed to maintain inflation (CPI) around 6 percent over the medium term. We will aim for reserve money growth slightly above nominal GDP growth to support financial deepening and the provision of credit to the economy.

10. Enhancing the framework for monetary policy operations remains a priority. This entails the following specific measures:

- ***Monitoring government accounts***. The BM and the MF will continue to improve the timely exchange of information as envisaged in our 2011 Memorandum of Understanding.

- ***Developing the domestic repo market to help improve money market management and the liquidity of government securities.*** Since July 2012 the BM has allowed the repeated use of the same securities for repo transactions and made all treasury bills (BT) equally eligible for BM repo transactions. The planned modifications in the electronic platform (Meticalnet Module) of the Interbank Money Market (MMI) for the BM to accept as collateral for repo operations both BM-issued BTs and government bonds (OTs) issued by the stock exchange has been delayed to end-May 2013 pending an impact study on tax equalization that has just been concluded. With IMF TA support we have also assessed the impact of possible measures to equalize the tax treatment between collateralized and uncollateralized interbank market operations. We have submitted an amendment to the Corporate Income Tax Law that reflects such equalization measures in November 2012 (**structural benchmark**). Following IMF TA advice, we will also turn the standing deposit facility into a repo operation by end-May 2013 so as to shift market preference from uncollateralized to collateralized operations.

11. Progress in monetary policy formulation and implementation has been achieved, with support from IMF TA, to lay the foundations for an inflation-targeting (IT) framework in the medium to long term. In May 2012, the BM began to publish a quarterly monetary policy report (**structural benchmark**) to communicate monetary policy intentions in a transparent way. A second report was published in July and the third in October 2012. The BM will continue to improve data collection and analysis, inflation forecasting, forward-looking communication, short-term liquidity forecasting, and reflect this work in its publications.

12. We remain committed to a flexible exchange rate regime. The BM will allow the exchange rate to adjust freely to evolving patterns of trade and financial flows and closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies, with a view to ensuring external competitiveness and a comfortable level of international reserves.

13. The Mozambican authorities remain committed to their obligations under Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. The BM will continue to monitor the implementation of the new foreign exchange regulations, its implementation norms, as well as the functioning of the foreign exchange market, with a view to avoiding practices that could turn out to be inconsistent with Article VIII principles. We will keep IMF staff informed of any developments that could potentially run against those principles.

D. Fiscal Policy

14. Fiscal policy will support the Government's quest for more inclusive growth under the PARP and continued macroeconomic stability. The Tax Authority will strive to achieve the ambitious tax revenue targets under the 2012 and 2013 budget law, helped by some tax enforcement measures and, in 2012, by windfall revenue from capital gains taxes that more than compensated for customs revenue shortfalls. We will maintain our spending program covering the large investment needs and social development objectives, to pursue the country's transformation agenda under the PARP. As a result, the overall fiscal deficit is expected to increase somewhat to 6½ percent of GDP in 2013, while the domestic primary balance will rise to 2¼ percent of GDP, and the NCG will be kept below ¾ percent of GDP. The 2013 budget law includes a revenue contingency.

15. The implementation of our wage policy will remain supportive of the recruitment needed for the PARP priority sectors and in line with fiscal sustainability. Our wage bill under the 2013 budget is projected to remain at about 10 percent of GDP, reflecting in part hiring in the priority sectors, including education and health. In line with our 2009 wage bill strategy, we remain vigilant of the need to ensure a fiscally sustainable wage bill and thus committed to decelerate the decompression of the salary scale and the pace of recruitment in non-priority areas and institutions. We will also continue to strengthen our control of the wage bill execution and complete the rollout of the electronic wage payment system (e-Folha) to all central government entities registered in the integrated database (e-CAF) by end-May 2013 and later on to all other entities (outside e-Folha).

16. Spending for priority sectors under the PARP will continue to rise. The Government aims to raise such spending from MT 73 billion in 2012 to MT 89 billion in 2013, or from 55 to 58 percent of expenditures (excluding net lending). We are aligning the composition of spending in the budget with the medium-term priorities of the PARP (see ¶18).

17. We are aware of the substantial direct and indirect cost of across-the-board energy subsidies and intend to reduce these gradually in light of their social and political sensitivity, while enhancing social protection programs to shelter the poorest strata of the population.

- ***Subsidies on petroleum products***. In October 2012, the Government completed the payments to importers of the fuel subsidies owed for 2011. The increase in diesel prices paid by megaprojects and public works contractors (since November 2010) and developments in import prices in 2012 have reduced the need for compensation payments to fuel importers (payable in 2013). For the time being, we continue the payment of separate subsidies to private minibus operators as they provide the bulk of transport services to the public.

- ***Electricity tariffs.*** Tariffs were last adjusted two years ago, but the financial situation of Mozambique's public electricity company (EDM) remains difficult. The government recognizes the need to ensure its sustainability both to continue the electrification of the country and to make new investments including mobilization of required funding. The Government is negotiating a new performance contract with EDM, and is also working on partial debt forgiveness of its claims on this utility. For its part, EDM is preparing a tariff study with a view to resuming gradual tariff adjustments, while preserving some cross-subsidization for low-income households.

- ***Enhancing social protection.*** The Government will continue to finance the expansion of the basic social protection programs approved by the CM in September 2011, including cash transfers and public works programs. Government allocations to social protection under the 2013 budget have risen to about Mt 1.7 billion (0.3 percent of GDP). We will continue to increase budget allocations towards 0.8 percent of GDP to reach some 900,000 beneficiaries and to raise the level of cash transfers towards the poverty line over the next few years. Pilot programs for public works are being implemented in 2 municipalities (Maputo and Manjakaze) since July 2012 and in 10 districts since August 2012 reaching to about 9,600 households. The Ministry for Women and Social Action is strengthening its targeting procedures, payments and monitoring systems for the effective delivery of cash transfers and the broader launch of public works programs with WB assistance in mid-2013. The Government is working on a proposal for the establishment of a common fund for social protection for consultation with development partners during 2013.

V. STRUCTURAL REFORMS

A. Public Financial Management and Reporting

18. We are committed to improving the coverage, classification, reporting, monitoring, and control of budget procedures. The following measures are key:

- ***Expanding budget system coverage and integration.*** At end-2011, nearly half of the 983 existing spending units (UGBs) were operating directly in the e-SISTAFE system, corresponding to 84 percent of the government budget for that year. The rollout of the e-SISTAFE will be completed by 2014, expanding the system by 70 units per year. The Budget Action Plan 2012–2014 included an IT plan consistent with the "2011–25 Public Finance Strategy."

- ***Enhancing the quality of PFM processes.*** We will seek to introduce real-time recording of the commitment, verification, and payment phases of the expenditure process. Following IMF TA recommendations, we will separately approve quotas/ceilings for commitments and payments by execution units (UGEs), and align the IT system to allow recording of these phases separately in e-SISTAFE (currently all phases are recorded at the time of payment). We will implement these changes starting with the entity handling the domestic debt by June 2013, and expect to roll out real-time recording of the expenditure chain to all UGEs by January 2014, with the aim of ultimately covering the provincial and district levels.

- ***Migrating to IPSAS-compatible reporting.*** In October 2012, the Government has approved an action plan to gradually adjust its accounting system to international public accounting standards (IPSAS). This includes a public consultation on the proposed changes by end-August 2013, parliamentary approval by end-2013, and subsequently preparation of all accounting systems to generate directly the budget execution report consistent with IPSAS.

- ***Improving budget classification***. We are working on the mapping of priority spending according to the PARP pillars through a more detailed budget classification by spending programs, and expect this to be completed by mid-2013 for the 2014 budget. As an intermediate step, for 2013 we will introduce the economic classification of expenditure and a more detailed classification by expenditure units in our accounting system.

B. Investment Planning and Debt Management

19. The Government will give priority to modernizing its debt management and investment planning procedures. The following areas are priority.

- ***Strengthening investment planning.*** Taking into account comments by the IMF and the WB, we have prepared a revised Integrated Investment Program (IIP), which lays our strategic vision for investment priorities, our selection procedures, and our current assessment of a list of top priority projects. We will submit the IIP to the CM by end-2012.

- ***Strengthening project selection tools.*** With TA from the WB a draft Project Preparation Manual was prepared in June 2012; it is now being revised and simplified. It includes a project evaluation template to better focus the information provided from line ministries to the Project Coordination Committee (PCC). We aim to have the manual and template approved by end-2012, and to be used systematically by the PCC from 2013 on.

- ***Enhancing debt management.*** The CM approved our enhanced MTDS in September 2012. We will refine this strategy to reflect changing circumstances and further analysis. The Minister of Finance approved in September 2012 an Operating Procedures Manual intended to improve data quality and the management of the country's debt service, and to ensure a high-quality analysis of borrowing proposals. We expect to finalize our 3rd DSA by end-2012. Since the last quarter of 2011, we have published quarterly public debt reports on the evolution of public and publicly-guaranteed debt, the contracting of loans, and starting in December 2012, they will provide cost and risk indicators and links to the budget and the MTDS scenarios.

- ***Completing the first Annual Domestic Borrowing Plan for 2013.*** Building on the MTDS, we are drawing up a first annual domestic borrowing plan for 2013 to be published by end-January 2013 **(structural benchmark)**. The plan will improve internal planning and help communications with the market, thereby reducing potential issuance cost in the long term. It will include quarterly financing and repayment projections and be consistent with the projected cash flow and net annual financing needs.

- ***Investment and Debt Advisory Committees.*** The Debt Management Committee (DMC) and the PCC have continued to meet regularly. The PCC has provided guidance on the drafting of IIP and all project selection documents, and has issued summary reports to the Minister of Planning and Development (MPD) and the Investment Council. The authorities are strengthening their technical expertise for project analysis, and will assess the social and economic impact of the projects presented to the CM against the backdrop of the IIP, DSA, MTDS, and Annual Borrowing Plan. The DMC has also provided guidance on the improvement of the MTDS, the drafting of the DSA, and other debt management documents. The Ministry of Planning and Development will publish short summary evaluations of the projects and related financing after their approval by the CM.

C. Tax Policy and Administration

20. We will sustain our revenue mobilization efforts while aiming to make the tax system more business-friendly. The focus will be on refinements in tax policy and the adoption of modern tax administration practices.

- ***Ensuring prompt refunds of VAT on inputs.*** We are concerned about the accumulation of pending VAT refunds (both arrears and pending refund requests). Thus we commit to prioritize the use of revenue collection in 2012 that exceeds the budget targets to reduce the stock of pending VAT refunds. While the 2013 budget allocation for VAT refunds remains constrained, we will process new VAT refund requests expeditiously. We will request technical assistance and prepare a study to optimize the implementation of the VAT by end-May 2013, and we intend to submit to Parliament, if needed, an amendment to the VAT code to record VAT revenue on a net rather than a gross basis by end-July 2013.

- ***Implementing the single taxpayer database.*** We expect to roll out the single taxpayer database to all three large taxpayers units of the country (Maputo, Beira, and Nampula) by end-2012, which cover 90 percent of large taxpayers. We expect that by June-2013, some 20 percent of individual taxpayers and all large taxpayers will be registered in the database, and 80 percent of all taxpayers will be registered by end-2013.

- ***Enhancing tax payment efficiency.*** We are developing a new electronic tax system (e-tax) to foster tax payments through banks. We will prepare implementation plans for VAT and the simplified tax for small taxpayers (ISPC) by end-2012, and develop the IT functionalities to pilot e-tax for these two taxes by September 2013. E-tax for corporate and personal income taxes (IRPC and IRPS) are expected to be introduced subsequently by July 2014.

- ***Strengthening the large taxpayers units (UGCs and DCAT).*** Modern management procedures will continue to be reinforced through assigning liaison agents to the large taxpayers units by March-2013 and training staff to build expertise on natural resources and strategic sectors over time. These agents are expected to enable targeted audits and help improve revenue forecasting; they will have access to a dedicated information system, which will run on a pilot in Maputo by end-2012, and be fully operational in all LTP units by end-2013. Collections by the LTP units are projected to rise from 52 percent of total collections in 2011, to 58 percent in 2012, 63 percent in 2013, and 70 percent in 2014.

- ***Streamlining tax policy***. In consultation with private sector representatives, the Government will (i) assess the possibility to eliminate the simplified tax regimes (for the VAT, and personal and corporate income taxes) and just keep the small taxpayer simplified tax (ISPC) by end-2013, and (ii) review the ISPC, including the ad valorem rate, the annual flat rate, and the threshold for the ad valorem taxation. We hope that these measures will improve transparency, free up tax administration resources to focus on larger taxpayers, and significantly reduce fraud.

D. Improving Natural Resource Management

21. Mozambique has become fully EITI compliant. Based on the actions we took with regards to the observance and implementation of previous recommendations, in July 2012 the EITI Board granted us a waiver from the requirement to pass a second full validation process, and we submitted to the EITI Secretariat our second reconciliation report of March 2012. On October 26, 2012, the EITI Secretariat declared Mozambique fully compliant with EITI requirements. We will continue our efforts to implement a best-practice framework to improve the transparency of the natural resource sector.

22. Enhancing the mining and hydrocarbon fiscal regime is a priority.

- ***Mining and petroleum legislation.*** The draft of revisions to the mining and petroleum laws have been submitted to the CM in September 2012, and are expected to be submitted to the parliament in early 2013. The revisions to the petroleum law provide a regulatory framework for LNG.

- ***Enhancing the mining and hydrocarbon fiscal regime***. With significant TA support from the IMF under the Topical Trust Fund for Managing Natural Resources Wealth (TTF-MNRW), we are reviewing our tax legislation in this area to ensure that an appropriate share of resource revenues is captured for Mozambique under new natural resource projects while remaining an attractive investment destination. We aim to bring together, as far as possible, all key fiscal terms for future mining and petroleum projects and clarify existing rules in new mining and petroleum fiscal laws. We have finalized draft laws, which we intend to discuss with local stakeholders by end-2012. We plan to submit the revised legislation to Parliament as soon as possible.

- ***Mitigating transfer pricing***. We are committed to implement modern procedures such as rules on advance pricing agreements and dispute resolution, applying international price benchmarks, and stipulating the methods to be applied when adjusting taxable income. To this effect, we will prepare an action plan for this long-term process once the above legislation has been approved by the parliament.

23. We will gradually strengthen our technical and institutional capacity to manage natural resources, with support from our partners. We intend to make best use of our prospective resource revenue stream over the medium term to foster inclusive growth and preserve macroeconomic stability. To this effect, with TA under the TTF-MNRW, we will reinforce our fiscal framework and prepare for the new key macro-fiscal challenges ahead, including managing revenue volatility, ensuring long-term sustainability, and addressing the exhaustibility of the resources. We intend to improve the quality of revenue and expenditure projections and of the fiscal policy analysis in budget and other policy documents. We will also seek IMF TA support under the TTF-MNRW to improve our statistics on natural resources during 2013.

E. Management of Public Enterprises

24. In order to update the legal framework for public enterprises to the government's economic priorities, a new Public Enterprise Law was approved by the Parliament in February 2012 and its regulation is under elaboration. The new law aims to promote, improve, consolidate and monitor in a continuous manner the operations of public companies, allowing the efficient use of resources, revenue collection through dividends and minimize fiscal risks. The Ministry of Finance supervises financial operations of public enterprises and plans to prepare an annual report on their financial results.

F. Good Governance Framework

25. The Government is committed to implement the new anti-corruption legislation. Parliament has approved three of the five laws proposed by Government as part of the anti-corruption package, namely (i) the Law of Ethics for Public Officials; (ii) the Witness Protection Law; and (iii) the amendments to the Organic Law of the Prosecution Service and to the Organic Law of the Judiciary. Parliamentary approval of the remaining two laws, i. e. (i) the revised and consolidated Criminal Code and (ii) the revised Criminal Procedure Code, is taking longer than expected given its complexity and the need for in depth discussions. Nonetheless, we will prepare a time-bound and costed action plan, including all the institutional reforms required to fully implement the anti-corruption legislation, by March 2013.

VI. FINANCIAL SECTOR POLICIES

A. Financial Sector Surveillance

26. The BM continues to enhance its financial sector surveillance in a difficult global environment. It remains focused on:

- ***Strengthening supervision***. With IMF TA guidance, BM is improving its capacity to perform stress tests and a designated team will use them as a monthly supervisory process as of early 2013. In this context, the regulation pertaining to nonperforming loans accounting is being revised so as to make it internationally comparable. The authorities are also determined to restructure the Credit Records Center which is an essential tool to monitor banks' credit risk and conduct meaningful stress tests. Building on stress-testing results, the BM will also revise before end-June 2013 its regulation on concentration limits, including banks' placements abroad, and modify reporting requirements accordingly. We will seek IMF expertise prior to the finalization of these regulatory changes. Further steps to enhance risk-based banking supervision will also be taken through the migration to Basel II which should be concluded in 2014. The authorities also aim at finalizing their full compliance with the Basel Core Principles.

- ***Completing a financial sector contingency plan.*** The authorities are adjusting their draft plan by incorporating some of the recommendations from the March 2012 IMF TA mission, especially with respect to the modules on emergency liquidity assistance and bank resolution. We will seek IMF expertise prior to the finalization of these regulations and expect to have the plan operational by end-March 2013 (***structural benchmark***).

- ***Making Deposit Insurance Fund (DIF) operational.*** We have taken important steps to make the DIF an integral component of our framework to safeguard financial sector stability. We have secured funding from KfW to contribute to the DIF's initial functioning and have benefited from KfW recommendations on some DIF-related regulatory and operational issues. The MF will appoint the three Executive Board members of the DIF by end-2012, and we expect the DIF to become fully operational by end-April 2013.

B. Financial Sector Development

27. We will step up our efforts to improve financial inclusion as part of Mozambique's Financial Sector Development Strategy (FSDS) for 2012-21. After a prolonged but comprehensive review process, a draft FSDS will be submitted to the Council of Ministers for approval by end-2012 (**structural benchmark**). With support from the WB and other partners, we will hold a workshop shortly thereafter to launch the strategy's dissemination and secure financing for its implementation. One of the objectives of the FSDS is to increase access to finance by eliminating economy-wide structural impediments to financial intermediation that limit the number of creditworthy clients and increase the costs and risks of providing credit and financial services. Key priorities in these areas include:

- ***Establishing credit registry bureaus*** (CRB). The BM has drafted a law for the creation of private CRBs to compile information on current/past borrowers; this is intended to lower information cost and improve access to bank financing. The draft has undergone a public consultation process and the BM submitted to the MF in November 2012. We expect to submit it to the CM by end-March 2013.

- ***Promoting banking competition***. We will foster competition in the banking sector by (i) introducing laws and regulations that address anti-competitive practices, (ii) fostering transparent pricing for financial services to allow consumers to compare costs, and (iii) introducing low-cost online access to credit files. A consumer protection framework will be designed and outreach will promote financial awareness so as to allow consumers (including SMEs) to make better use of available financial services; to encourage competition and innovation amongst financial services providers; and to provide consumers with reasonable protections against unfair business practices, while ensuring financial institutions' soundness.

C. Fighting Money Laundering and Terrorism Financing

28. The AML/CFT framework is being improved. The MF has established, chaired, and appointed the members of the high-level AML/CFT National Task Force in December 2011. The AML/CFT Law was approved by the Council of Ministers and submitted to Parliament in April 2012. The authorities consider the passage of this comprehensive package of legislation and related regulations as a high priority. We will need to assess the adequacy of human and financial resources available to the various departments and agencies that have a role in the AML/CFT regime, and will seek further TA from the IMF and other providers to assist with the drafting of legislation and introduction of specific institutional reforms needed for full implementation of the revised FATF Standard.

D. Payment System

29. The BM will further enhance financial stability and promote market development through continuing national payment system reforms. This will mainly be achieved through refinements in BM oversight practices and development of retail payment systems.

- ***Enhancing BM oversight practices***. Based on IMF TA, the BM has approved a payment systems oversight policy strategy in March 2012 and will finalize and implement an oversight function by end-June 2013. Key actions would include (i) the implementation of an oversight internal manual, and (ii) the creation and implementation of an oversight unit. The revised regulation of the electronic clearing system (CEL) for checks will also be approved and published by end-June 2013.

- ***Further developing the retail payments network shared by BM and commercial banks***. Following the establishment of the retail payments processing company SIMO in June 2011, a pilot phase of card network interoperability is currently on-going. We expect the platform to cover the major banks and handle domestic retail transactions and other interbank services by end-June 2013.

VII. PROGRAM MONITORING

30. The proposed modifications of quantitative ACs and an indicative target for end-December 2012, the indicative quarterly targets for 2013 are shown in Table 1. Table 2 provides a list of the proposed structural benchmarks. The sixth and last PSI review is expected to be completed by June 13, 2013.

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets [1]
(Millions of meticais, unless otherwise specified)

	2012									2013			
	End-June Assessment Criteria			Status	End-Sept Indicative Target		Status	End-Dec Assessment Criteria		End-March Indicative Target	End-June	End-Sept	End-Dec
	Prog.	Adj.	Act.		Prog.	Act.		Prog.	Prop.	Prop.	Proj.	Proj.	Proj.
Assessment Criteria for end-June/December													
Net credit to the government (cumulative ceiling)	-2,645	112	1,900	NM	-745	-1,248	M	2,500	52	517	-3,432	-5,184	2,763
Stock of reserve money (ceiling)	36,923	36,580	33,350	M	37,031	35,975	M	39,985	39,264	36,495	40,187	43,207	46,490
Stock of net international reserves of the BM (floor, US$ millions)	2,207	2,107	2,282	M	2,323	2,693	M	2,438	2,530	2,544	2,595	2,681	2,685
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US$ millions)	1,500	1,500	1,129	M	1,500	1,379	M	1,500	1,600	1,600	1,600	...	...
Stock of short-term external public debt outstanding (ceiling)	0	0	0	M	0	0	M	0	0	0	0	0	0
External payments arrears (ceiling, US$ millions)	0	0	0	M	0	0	M	0	0	0	0	0	0
Indicative targets													
Government revenue (cumulative floor)	45,256	45,256	43,567	NM	69,687	73,619	M	94,568	99,043	23,656	53,224	81,989	111,762
Priority spending (cumulative floor)	24,500	24,500	25,136	M	35,934	...	...	72,563	72,563	10,797	28,792	49,486	89,975

Sources: Mozambican authorities and IMF staff estimates.
1 For definition and adjustors, see the Program Monitoring Section of the Memorandum of Economic and Financial Policies and the Technical Memorandum of Understanding.

Table 2. Mozambique: Structural Benchmarks Under the PSI

Structural Benchmarks	Expected Date of Implementation
The Ministry of Finance will submit to the Council of Ministers the draft Financial Sector Development Strategy (FSDS), as described in ¶26 of this MEFP.	End-December 2012
The Bank of Mozambique will finalize the draft financial sector contingency plan, as described in ¶25 of this MEFP.	End-March 2013
The Government will adopt an Annual Borrowing Plan for 2013, as described in ¶20 of the MEFP dated May 10, 2012.	End-January 2013

ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

December 7, 2012

The Technical Memorandum of Understanding (TMU) of May 10, 2012 remains valid with the following two modifications.

1. At the end of paragraph 17 on net credit to government, a new bullet is added:

- The ceiling for end-December 2012 on NCG will be adjusted upward (by up to Mt1.5 billion) for an increase in VAT reimbursement that exceeds the budget allocation (of Mt 3.5 billion) and is reflected in a reduction (by end-December 2012) in the stock of pending VAT reimbursement below its level of MT1,009 million on 10/29/2012.

2. Table 1 on net foreign assistance to government is updated.

TMU Table 1. Mozambique: Net Foreign Assistance, 2012-13

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	90	114	126	-7	159	102	156	-4
Gross foreign program assistance	118	141	153	21	187	129	184	23
Program grants	118	32	123	21	137	79	44	23
Program loans	0	109	30	0	50	50	140	0
External debt service	27	27	27	27	28	28	28	28
Cumulative net foreign program assistance in US dollars	90	204	330	324	159	261	418	413
Gross foreign program assistance	118	259	412	433	187	316	500	524
External debt service	27	54	82	109	28	55	83	110
Net foreign program assistance (MT mn)	2,444	3,138	3,591	-224	4,581	2,883	4,649	-331
Gross foreign program assistance	3,221	3,946	4,398	610	5,581	3,931	5,677	730
Program grants	3,221	900	3,532	610	4,088	2,413	1,347	730
Program loans	0	3,046	866	0	1,492	1,518	4,330	0
External debt service	777	808	807	834	1,000	1,048	1,029	1,061
Cumulative Net foreign program assistance in MTN millions	2,444	5,582	9,172	8,949	4,581	7,463	12,112	11,781
Gross foreign program assistance	3,221	7,167	11,565	12,175	5,581	9,512	15,189	15,919
External debt service	777	1,585	2,392	3,226	1,000	2,049	3,077	4,138
Stock of outstanding currency (MTm)	18,748	21,604	23,079	27,667	23,552	27,188	28,991	32,393
Stock of outstanding currency (MTm), Prog. Def	18,634	20,763	22,430	26,743	23,408	26,130	28,176	31,312

Source: Mozambican authorities and IMF staff estimates.