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

December 20, 2013

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.

Letter of Intent

**Maputo, Mozambique
December 20, 2013**

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

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the first review under the Policy Support Instrument (PSI) and the modification of several assessment criteria and indicative targets for December 2013. In support of this request we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews implementation of the current PSI and establishes policy objectives and assessment criteria and indicative targets for 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 is in line with our Poverty Reduction Strategy Paper (PARP) for 2011–14 and with our plans regarding its successor strategy.

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 on the adoption of these measures, and—at its own initiative or whenever the Managing Director requests such a consultation—in advance of any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. 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.

The Government authorizes the publication of this Letter of Intent, its attachments and the associated staff report.

Sincerely yours,

/s/

**Manuel Chang
Minister of Finance**

/s/

**Ernesto Gouveia Gove
Governor
Bank of Mozambique**

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

Attachment 1: Memorandum of Economic and Financial Policies

1. This MEFP describes recent developments and performance under the government's economic program supported by the Policy Support Instrument (PSI). It focuses on recent economic developments and prospects up to the end of 2013, as well as the economic outlook and policies in support of the program for 2014.

RECENT ECONOMIC DEVELOPMENTS AND PROGRAMME PERFORMANCE

2. **The performance of the Mozambican economy remains robust.**

- **Economic growth remains strong.** In the first half of 2013 it reached 6.6 percent despite the negative impact of the floods in early 2013, and helped by the strong recovery in the second quarter. This demonstrates the resilience of the Mozambican economy to exogenous shocks and its capacity to recover from natural disasters.
- **Following a rapid acceleration of inflation in the first quarter of the year inflationary pressures abated.** The 12-month rate of inflation (Maputo City CPI) reached 4.3 percent in September (3.9 percent on average) reflecting (i) the recovery of domestic production of fruits and vegetables after the floods, (ii) the appreciation of the Metical vis-à-vis the Rand and the stable exchange rate in relation to the US Dollar, (iii) a drop in import prices, (iv) unchanged administered prices, and (v) base money growth in line with the financial program.
- **Fiscal performance in the first half of 2013 reflected delays in donor disbursements.** The indicative revenue target for June was met, and revenue collections were further boosted in the third quarter following the receipt of an unanticipated US\$400 million (2.7 percent of GDP) capital gains tax from the sale of a gas concession in the Rovuma basin. Income and goods and services taxes also performed better than programmed. While current spending was in line with the program so far in 2013, capital expenditure has been lower than budgeted as some foreign financed projects did not come on stream and others were affected by delayed donor disbursements. A supplementary budget was approved by parliament in August to incorporate windfall revenue received in the first quarter (\$224 million), and address pressing needs for flood rehabilitation and improved salaries, facilities and services in health, education and the judiciary. We are confident that the budget will be fully implemented during the remainder of 2013, containing the domestic primary deficit (before the additional windfall revenue of \$400 million received in August that will be allocated in the 2014 budget only) somewhat below the programmed 2.7 percent of GDP.
- **Government-guaranteed foreign borrowing.** *Empresa Moçambicana de Atum, S. A. (EMATUM)*—the Mozambican Tuna Company--was established in August 2013 by 3 public entities (*IGEPE*--State Holding Company for Public Enterprises, *Emopesca*—State Fisheries Company, and *GIPS*—Investment, Participation and Services, following the adoption by the Government of the Strategic Plan for Development of Tuna Fishery in July 2013. In early

September EMATUM launched a private offer and issued \$500 million of government-guaranteed 7-year Loan Participation Notes. This was topped up to \$850 million (6 percent of GDP) in late September to finance the purchase of 24 tuna fishing vessels and 3 patrol vessels, as well as other vessels and related equipment for coastal protection and other related economic activities. This was Mozambique's first international debt issue and established a benchmark for Mozambican borrowers in the international capital markets.

- **The external current account deficit is widening** financed mainly by strong flows of foreign direct investment (FDI) and public and private borrowing. In 2012, the deficit reached 45 percent of GDP, up from 24 per-cent in 2011. This reflected large imports of goods and services for mining and natural gas projects. In the first half of 2013 exports were 28 percent lower than a year earlier due to the disruptions caused by the floods. Traditional exports of timber, cashews, banana and shrimp also reflected weak prices, trade restrictions imposed on Iran (main market for bananas), and weak demand in the European market (shrimp). At the same time, merchandise imports were 5 percent higher than a year earlier and service imports increased reflecting megaproject activity. Foreign direct investment reached \$3.1 billion, mostly in extractive industries.
- **Net international reserves (NIR) weakened in the first half of 2013**, but benefitted from a \$400 million payment of windfall profits on the sale of shares in the natural gas sector in August. NIR at the end of September stood at \$2.9 billion, exceeding program objectives.

3. **The quantitative targets for June and September were largely observed.**

- All assessment criteria for June and indicative targets for September were met, with the exception of the indicative targets on priority spending for June and September, which were not met due to several factors, including delays in program execution associated with delays in donor disbursements. However, there may also have been some statistical underreporting as a significant share of priority spending is financed externally, outside the Treasury single account, and data is adjusted manually with a substantial delay. As result, the level of execution is expected to have accelerated substantially in the last quarter of the year. Going forward, the government will pay particular attention to the strengthening of planning, implementation and reporting instruments to limit problems of under execution of priority spending.

4. **Progress with structural reforms continued through several important measures, including:**

- Approval of the Action Plan for the Expansion of the Electronic Payment System (including the e-folha) and the Civil Service Integrated Database (e-CAF).
- The Integrated Investment Plan was submitted to the Council of Ministers at end-July. The Government will work further in order to ensure the link with the debt sustainability analysis.

- The 2nd Strategic Plan to Improve the Business Environment (EMAN II) was submitted to the Council of Ministers as planned.
- The VAT arrears reduction plan to prevent accumulation of new arrears and optimise the administration and processing of refunds was developed.
- Staffing a payment systems oversight unit in the Bank of Mozambique (BM) was done as planned in November 2013.

5. **The remaining structural reform measures foreseen for the fourth quarter 2013 are underway.** Submission of the draft law for the creation of private credit registry bureaus to Parliament was subject to a small delay and is expected to be completed before February 2014. In addition, full implementation of the payment of salaries by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE, which was expected by December 2013, will require more time and the government expects to finalize this reform by March 2014.

MACROECONOMIC POLICY

A. Economic Objectives

6. **Medium-term economic growth is expected to remain high**, supported by the strong expansion of the mining and hydrocarbon industries. However, the country's vulnerability to natural disasters and the weak outlook for the world economy are risk factors to near-term growth.

- In 2014, economic growth is expected to reach 8.3 percent owing to strong recovery of agriculture after the floods, increased capacity of the major railway and implementation of several infrastructure projects. In the next five years, the increased contribution from coal production and exports, infrastructure projects, LNG production and the boost in the transport, communication and construction sectors are projected to raise economic growth to close to 8 percent per year.
- Despite the adverse effect of the floods at the beginning of 2013, inflation has evolved in line with our objectives. We maintain a medium-term target for inflation of 5-6 percent per year.
- Balance of payments developments in coming years will be dominated by large investments in natural resource projects. Current account deficits excluding grants of some 45 percent of GDP are projected until the end of the decade when LNG is projected to reach the export stage.

B. Macroeconomic Policy Mix

7. **The authorities will continue pursuing a combination of fiscal and monetary policies** aimed at maintaining macroeconomic and financial stability, as well as promoting economic and financial inclusion.

8. **In light of the parliamentary elections scheduled in October 2014**, fiscal policy will be somewhat expansionary, while monetary policy will aim to contain the resulting domestic demand

pressure to keep inflation low. This effort is likely to be helped by favorable developments in international prices.

C. Monetary and Exchange Rate Policy

9. **Monetary policy will continue to pursue the objective of price stability, in line with the medium-term inflation objective of 5-6 percent.** The BM will target base money growth slightly above nominal GDP with a view to creating monetary space to increase credit to the private sector and thereby support economic growth. As fiscal policy will become expansionary, the BM will step up its liquidity management efforts and base money growth in 2014 will be kept lower than in 2013 to contain demand pressures.

10. **We remain committed to a flexible exchange rate regime.**

D. Fiscal Policy

11. **Fiscal Policy Objectives.** The government's fiscal policy objectives continue to be informed by the need to preserve macroeconomic stability and support the poverty reduction strategy.

- Changes in the macroeconomic outlook resulted in the revision of the 2013 budget; the revenue target (net VAT) was revised up to 24.3 percent of GDP to reflect revenue from capital gains. Expenditure was increased to 36.3 percent of GDP mainly to cover the salary readjustment costs, additional funds for municipal elections, and the post-floods reconstruction plan. However, the overall deficit before grants remained at around 12 percent of GDP, and the primary deficit is 2.6 percent of GDP.
- For 2014, the government has proposed a budget to parliament that includes the \$400 million windfall revenue received in August 2013, and also reflects continued efforts to strengthen tax administration (see below). Total spending will reach about 40 percent of GDP (PSI-supported program definition)¹, owing to the need to expand investment in priority sectors and one-off factors associated with the general elections, as well as the setting up of a coast guard/maritime security services. The domestic primary balance before grants is projected at 6.1 percent of GDP.

12. **Expenditure Policy.**

- **Resource allocation for priority sectors:** the 2014 budget allocates 64.2 percent of total expenditure, (excluding debt and financial operations) for priority sectors, focusing on education (18.1 percent); infrastructure (14.8%); agriculture and rural development (10.5 percent); and health (9.1 percent).

¹ There are some statistical differences between the 2014 Budget as approved by Parliament and the government commitments under the PSI-supported program. The differences do not affect the overall analysis of fiscal performance and are mostly associated with the treatment of the capital gains tax, the processing of VAT refunds, and the treatment of the quasi-fiscal operations of EMATUM.

- **Wage bill.** The Government is aware that the current level of wages and salaries in percent of GDP is high by international standards. In order to attract, retain and resettle civil servants, we will continue with the implementation of the wage policy. Its aim is to harmonise wage scales, maintaining the philosophy of equity and salary decompression, the hiring, promotion and progressions plans, as well as the resettlement subsidy, without neglecting the need to ensure that the growth of the wage bill is sustainable. In fact, the wage bill in 2014 is proposed at 10.6 percent of GDP against 10.8 percent in the revised budget for 2013. We aim, in the medium term, to reduce the wage bill to 8.5-9 percent of GDP.
- **Further public investment** in priority sectors is key to cover large infrastructure and social gaps, but measures are needed to improve the link between the investment program, strategic priorities and debt sustainability. This is particularly important given that public investment is budgeted to exceed 15 percent of GDP in 2014 – one of the highest in Sub-Saharan Africa.
- **Financing.** The overall fiscal deficit (after grants) is projected to reach 12.5 percent of GDP in 2014. Most of the deficit will be financed externally (9.6 percent of GDP), while domestic financing will reach 2.9 percent of GDP, including the drawdown of deposits associated with the capital gains tax (2 percent of GDP).

13. **Fiscal Transparency.** In December, Parliament recommended changes to the budget law to better reflect the operations associated with EMATUM. In response, the Government

- submitted a revised budget proposal for 2014 that incorporates the non-commercial activities of EMATUM (equivalent to \$350 million), as part of the appropriations for the Ministry of Defense. This proposal was approved by Parliament on December 13, 2013. The Government believes that this increase in the budget of the Ministry of Defense is necessary to provide protection services along the coast of Mozambique, including for natural resource companies operating offshore.
- submitted and obtained authorization for an amendment to Art. 11 of the budget law, requesting an increase in the ceiling on government guarantees by \$500 million to support the commercial activities of EMATUM.
- will subject EMATUM to strict financial controls and will have its accounts audited.
- Based on advice from the recent Fiscal Transparency Assessment (FTA), the government intends to improve the system for fiscal risk disclosure and management. This will involve several reforms, including changes to the Organic Budget Law (SISTAFE Law) to require the inclusion of a mandatory Annex on Fiscal Risks in the annual budget law, with sufficient information to assess risks associated with guarantees, quasi-fiscal activities, including those conducted by public enterprises, and public-private partnerships.

STRUCTURAL REFORMS

A. Public Financial Management

14. The Government will continue to implement reforms to strengthen Public Financial Management.

- **Wage Bill Management.** The action plan to expand the system for direct salary payments to civil servants and agents in institutions with direct access to e-SISTAFE is being implemented (structural benchmark in MEFP-June 2013). The expansion of the payment of salaries by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE will be completed by March 2014 (structural benchmark). The Government will expand e-Folha to all civil servants in institutions with direct access to e-SISTAFE (about 90% of all civil servants) by end-2014 (structural benchmark). In addition, we also remain committed to expanding e-Folha to all State Bodies and Institutions, including those who do not use e-SISTAFE (e.g. defence and police sectors).
- **Expenditure Execution:** The roll out of e-SISTAFE has reached 69 percent of all spending units (including at the district level). By end-2014 e-SISTAFE should reach 75 percent of spending units and a full rollout is expected by end-2015. On July 1, 2013, the commitment component of e-SISTAFE was activated. This will help to improve tracking all phases of the expenditure chain, from the commitment to the payment.
- **International Accounting Standards:** We have prepared a proposal for a new legal framework (*Normas e Plano de Contas*) to meet international public sector accounting standards based on IPSAS. This proposal has been submitted to public consultation and will be submitted to the cabinet for approval in the first quarter of 2014. The implementation of this framework will require the approval by the Parliament and the subsequent revision of the SISTAFE Law, both expected by end-2014. We will then introduce the new accounting standards and make the required adjustments to e-SISTAFE software in 2015, to start the pilot implementation of the accrual accounting based on the IPSAS in 2016.
- **Economic Classification of Revenue:** We have prepared a new revenue classification, which is expected to be used in the 2015 budget, in line with best international practice.

B. Investment Planning and Debt Management

15. Priority areas include:

- **Strengthening Investment Planning:** in September 2013 the Government approved the Integrated Investment Programme (IIP), which identifies priority infrastructure projects for 2014-2017. As a next step by June 2014, the Ministry of Planning and Development will approve, and share with IMF staff, an enhanced IIP by adding financial information for projects for which financing has been secured to inform the DSA, MTF and the budget. The revised IIP will also include summary project descriptions in line with the project summary table already developed (structural benchmark). The IMF and the World Bank

are providing assistance to build capacity in public project preparation, assessment and selection, and the linkage between IIP financing needs and debt sustainability.

- **Strengthening Project Selection Instruments:** The Ministry of Planning and Development's Consultative Council approved a Public Project Preparation and Selection Manual, containing a summary form with project information. Going forward, the summary form for projects approved by the Council of Ministers will be published on MPD's webpage. To enforce the use of the Public Project Preparation and Selection Manual, MPD and MF will revise the Methodological Guidelines for the preparation of the 2015-17 Medium-Term Fiscal Framework to incorporate the main selection and evaluation criteria identified in the Selection Manual, as well as publish the manual on the MPD website to encourage its use for project preparation and appraisal by line ministries (December 2014).
- **Strengthening Public Debt Management:** The Government prepared a DSA as part of the preparation of the 2014 Draft Budget, which showed that the debt remains sustainable. In the medium term, we remain committed to (i) incorporating the analysis of costs and risks associated with the public debt portfolio, including guarantees, in the budget execution reports, and (ii) to extend the Debt Management Strategy, at the time of its review in 2015, to explicitly include government guarantees. These steps aim to strengthen the linkage with the budget, the Integrated Investment Plan, and the Public Debt Management Strategy. We have already included the guarantee in the 2013 third quarter budget execution report and will also expand the coverage of the quarterly public debt report to include government guarantees from the first quarter of 2014.

C. Tax Administration Policies

16. Tax Administration

- **VAT administration and reimbursements.** We have prepared a plan to gradually reduce the stock of pending VAT arrears, avoiding accumulation of new arrears, and optimize the administration and refund process (structural benchmark for end-October 2013). This plan has been further refined with technical assistance from the IMF. The implementation of this plan will involve several critical steps. By March 2014, the Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 (structural benchmark). A note with the validation process and final amounts of effective VAT refunds will be shared with IMF staff. The stock of valid reimbursement requests will be either fully paid or securitized by end-2014. The Government will also prevent delays in the processing of new refund requests through the implementation of new legal, accounting and budgeting procedures to ensure that reimbursements are paid in a timely manner. The Government will ensure that the 2015 budget proposal includes VAT collections on a net basis (structural benchmark for end-October 2014).
- **Implementation of e-tax and payment via banks for VAT and ISPC (simplified tax for small taxpayers).** We are gradually implementing a modern e-tax system and simplifying the process for tax payments through banks. VAT and ISPC are the first taxes that will be

collected via this new system. In order to make the new system operational, we will ensure that all relevant taxpayers are duly registered in the single e-tax database with a single taxpayer identification number (NUIT). About half of the 1,205 large taxpayer records have been updated already, and all 127,000 VAT and ISPC taxpayer records will be updated by end-September 2014. A new, simplified and more accurate system of tax payments via banks will thus be possible for VAT and ISPC beginning in October 2014. The revenue authority will issue a notice informing taxpayers of the new procedures (structural benchmark). Payments via banks will be further improved with the introduction of the online taxpayers portal through which taxpayers will be able to calculate their tax assessments and make payments.

- **Strengthening of Large Taxpayer Units (UGCs and DCAT):** the Large Taxpayer Unit (UGCs) Management Database was fully installed in Beira and Nampula, and the respective connections established; it is currently operational in the three UGCs (Maputo, Beira and Nampula). The human resources of the Large Taxpayer Units will be reinforced in light of their contribution of total revenue collection by end-2014, including strengthening the specialized natural resource unit (DCAT).
- **Tax Policy:** the Government is conducting a study to verify possible inconsistencies between the general ISPC regime and the simplified taxation regimes for VAT, IRPC and IRPS. It is expected to be completed by the end of 2013.
- **Transfer Prices:** the draft Transfer Price Regulations is near completion with technical assistance from the IMF. It will be submitted to the Council of Ministers for approval by June 2014 following the Action Plan for its implementation.
- **Double Taxation Agreements (DTAs):** Mozambique ratified agreements to prevent double taxation with 9 countries. These agreements are currently being renegotiated, mostly to reduce revenue losses resulting from the deliberate incorporation of companies in countries with which Mozambique has signed a double taxation agreement.

D. Improving Gains from Mineral Resources Exploitation

17. **Data management:** A central database on Mozambique's natural resources is now available online through the Ministry of Natural Resources. It is now being upgraded and expanded nationwide. Sector databases are in operation at the Planning Directorate, National Geology Directorate (DNG), National Petroleum Institute (INP) and National Hydrocarbon Company (ENH), and capacity building programs will be implemented for database management officials.

18. **Extractive Industry Transparency Initiative (EITI).** The preparation of the 4th EITI Reconciliation Report is underway. This report will present information on payments from the extractive industry and on government revenue, for 2011, and publication is expected by the end of 2013. In addition, the new EITI rules approved at the EITI Global Conference in May 2013, are under implementation, and will be adopted in the 4th EITI Reconciliation Report. Similarly, the publication of contracts and their respective fiscal terms, signed and approved by the Administrative Tribunal as of 2011, has been adopted in the Mining Law proposal submitted to Parliament.

19. **Mining and Hydrocarbon Legislation:** the Mining and Hydrocarbon Acts have been submitted to Parliament. The revised Hydrocarbon Act includes the regulatory framework for the LNG industry (Liquefied Natural Gas).
20. **Strengthening the Mining and Hydrocarbon Tax Regime.** Following public consultation, the inputs from stakeholders are now being harmonised into a revised mining and hydrocarbon tax regime proposal, aimed at aligning them more with international best practices and combine the relevant tax issues in a single legal document to allow for easy reference and interpretation by economic agents. Submission of the draft to Parliament is expected to take place by May 2014.
21. **Use of Windfall Revenue.** The Government is aware that one-off receipts, including those that stem from capital gain taxes, should not finance recurrent spending increases that could compromise fiscal sustainability over the medium term. To this end, fiscal revenue windfalls, including from direct or indirect natural resource taxation, will be saved or used only for investment spending or debt reduction.

E. Management of State-Owned Companies

22. **Strengthening Oversight of State-Owned Companies.** After the approval of the State Enterprise Act in February 2013, the draft Regulation has been prepared and is expected to be approved by the Council of Ministers by end-2013. The Regulation will limit current expenditures that public enterprises can make and will define the documents that need to be submitted to support their analysis of debt sustainability.
23. **Ensuring Transparency.** Work on the analysis of state-owned enterprise management tools continued. The 2012 Report and Accounts of the Airport Company, the Railway Company (CFM), and the Hydrocarbon Company (ENH) have already been published. The report for the Electricity Company (EDM) will be published by the end of 2013.
24. **Electricity Company:** To contribute to the improvement of EDM's financial performance, a study on electricity tariff adjustments was prepared. A proposal to restructure the tariffs was assessed by the Ministry of Energy, and subsequently endorsed by the Price Commission. Once comments have been incorporated, a proposal will be submitted to the Council of Ministers.
25. **Government Strategy for the Participation of State-Owned Enterprises in Infrastructure Projects:** With support from the World Bank we are preparing a Strategy for the Government's Participation of State-Owned Enterprises in Infrastructure Projects. Our intention is to complete the first draft by the end of 2013.

FINANCIAL SECTOR POLICIES

A. Strengthen monetary policy formulation and implementation

26. **Strengthening the monetary policy framework.** The BM is strengthening the monetary policy framework and will continue to improve the analytical and communication capacity in the monetary policy decision-making process, including improving its inflation forecast model, with technical assistance.

27. **Strengthening money market management.** Significant progress was achieved in improving money market management and the liquidity of public securities, notably: (i) implementation of the IT platform by BM to allow the development of repo operations with fungible T-bills. The revamping of *Meticalnet* and all accounting specifications was completed and repo operations with fungible T-bills are already implemented since August 2013; (ii) coordination work with the Ministry of Finance with a view to accepting T-bonds as collateral in interbank money market operations is underway; (iii) since 21 August 2013 deposit facility operations (FPD) were transformed into repo operations to expand the use of collateralized operations; and (iv) the BM has narrowed the corridor between the lending and deposit rates (FPC and FPD rates).

B. Financial Sector Surveillance

28. **The BM will consolidate its efforts in enhancing banking system supervision and strengthening crisis management.**

- **Strengthening supervision of the banking system.** The BM has conducted its first stress testing exercise in July 2013 and used its results to inform supervision. The BM is seeking to strengthen data collection and the stress-test methodology. It is expected that this exercise will be performed by a designated team as part of the quarterly surveillance process, and another round of tests is planned before end-2013. The legislation pertaining to the classification of non-performing loans was revised to make it internationally comparable, and will be effective as of January 2014.
- **Risk-based supervision and Basel II adoption.** After the risk management guidelines and the legal and analytical framework for risk-based surveillance were adopted on March 14, 2013, the BM has conducted risk-based supervision in a pilot with two banks and expects to broaden risk-based surveillance to all banks in the course of 2014. The Basel II Capital Accord will be adopted effective January 1, 2014. The review of the regulations on concentration limits, including investment abroad, will continue.
- **Financial Sector Contingency Plan.** The Financial Sector Contingency Plan was published on June 11, 2013. An internal manual for its implementation is expected to be completed by end-2013, and an action plan for the simulation exercise will be prepared, approved by the Board, and shared with IMF staff, by end-November 2014 (structural benchmark).

29. **Deposit Insurance Fund (DIF).** The Executive Board and the Chairperson of the DIF were appointed in May 2013. The Board is working to make the DIF operational by end-2013, including ensuring the initial funding of the DIF and establishing the system's fee structure and the guarantee limit.

C. Financial Sector Development

30. **In April 2013, the Council of Ministers approved the Financial Sector Development Strategy (FSDS) for 2013-22.** Its main objectives are to: (i) maintain financial sector stability; (ii) increase access to financial services and products, eliminating structural constraints in the economy, specifically those that limit financial intermediation and access to financial services; and

(iii) increase the supply of private capital to support private sector development. Dissemination work has started, and the BM is developing a National Financial Inclusion Strategy in order to implement the FSDS.

- **Establishment of the credit registry bureaus.** The law on the creation of private credit registry bureaus has been delayed, but was approved by the cabinet on December 17th and will be submitted to Parliament by end-February 2014 (structural benchmark). Within six months after Parliament's approval, the BM will prepare the regulation of the law providing information on the requirements needed to apply for a private credit bureau license.
- **Promotion of mobile banking.** Specific regulations governing mobile banking services are being drafted by a task force at the BM and expected to be completed in June 2014. A second mobile banking operator, M-Pesa, was licensed in 2012 after M-Kesh in 2009.
- **Promotion of competition within the banking sector.** The revision of Notice 05/GBM/2009, of June 10, is underway, promoting the transparency of prices and commissions for financial services and products.
- **Developing the domestic capital markets.** The issuance of government bonds by auction in the Stock Exchange began in 2013 and a financial market education program has been designed. In 2014, the registry of security holdings will be centralized in order to increase transparency, facilitate trading, investor protection, and taxation. Currently 25 securities are listed by companies in the stock exchange. The stock exchange has a program to increase financial literacy and to promote capital market transactions
- **Strengthening the insolvency framework and the collateral framework.** The legal basis for insolvency procedures was established with the publication, on April 29, 2013, of the legislation on emergency liquidity assistance, which aims at assisting deposit-taking institutions and guiding their intervention in the mitigation of systemic risks. The Government intends to work on a Collateral Bill with a view to establishing a moveable collateral registry by end-2014 (structural benchmark).

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

31. **AML/CFT Framework.** The New Law on Anti-Money Laundering the Combating the Financing of Terrorism was approved in August 2013, and the respective Regulations are now under preparation. The preparation by the Bank of Mozambique of guidelines for commercial banks on Anti-Money Laundering and Combating the Financing of Terrorism is also at an advanced stage. Likewise, the Law [14/2007] establishing the Financial Intelligence Unit of Mozambique is under review.

32. **The Government adopted in July 2013 the Action Plan for the implementation of GAFI/FATF Standards,** in coordination with the IMF's Legal Department. This Plan lists the priority actions to be undertaken and complements the previous plan prepared by the Mozambican authorities, following the Recommendations of the Mutual Assessment of Mozambique by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). Both Plans are being executed.

33. **There is a need for technical assistance for human resources capacity building** (GIFIM analysts, Criminal Investigation Police, Judicial Magistrates and Public Prosecutor's Office), in matters of financial and economic crimes and money laundering.

PAYMENT SYSTEM

34. **Reforms in the National Payment System**

- **Enhancing BM oversight practices.** The Oversight Manual has been approved in May 2013. A designated team of staff is already performing the oversight function, and the Oversight Unit was established in November 2013 (structural benchmark for November 2013). At the same time, the regulations on the Electronic Clearance of Cheques System are currently under review, and are expected to be approved and published in November 2013. Moving forward, the BM will draft an action plan on implementing the Oversight Manual by end-2013, and will produce the first annual oversight report by November 2014 (structural benchmark).
- **Developing the retail payments network (SIMO) shared by the BM and commercial banks.** Two commercial banks have connected to the SIMO network, while two additional banks are in the testing stage. By June 2014, the four largest banks in Mozambique will be covered by SIMO, including the Ponto 24 Network shared by a group of ten banks.

GOOD GOVERNANCE AND BUSINESS ENVIRONMENT

35. **Anti-Corruption Package.** Five laws comprise the complete anti-corruption package. The Penal and Penal Procedural Codes are scheduled for approval by Parliament. Following passage of the Anti-Corruption Law, an Action Plan for the effective implementation of Anti-Corruption Legislation is underway, and a draft has been produced, which is now being shared with the various stakeholders.

36. **Improvement in the Business Environment.** In order to ensure an improvement in the business environment to attract investment into the country, the Government approved the following instruments:

- **Business Environment Improvement Strategy (EMAN II 2013-2017).** This document seeks to decentralize responsibilities and simplify procedures with a view to speeding up the business start-up process.
- **Commercial Activity Licensing Regulations.** Decree 34/2013 of August 2013 has facilitated a 50 percent reduction in the time needed to issue a commercial license through the elimination of prior inspection for activities of limited risk. It also assigns to one-stop-shops and district governments the mandate for licensing commercial activities, which was previously under the authority of the Provincial Governor.
- **Business Registration.** This single registration form eliminates the need to fill out multiple forms and documents with a view to simplifying procedures as well as reducing costs to register and license business and start up activities.

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets Under the 2013-16 PSI¹
(Millions of meticaís, unless otherwise specified)

	2013								2014					
	End-June Assessment Criteria				End-Sept Indicative Target				End-Dec Assessment Criteria		End-March Indicative Target	End-June Assessment Criteria	End-Sept Indicative Target	End-Dec Indicative Target
	Prog.	Adj.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Proposed	Proposed	Proposed	Proposed	Proposed
Assessment Criteria for end-June/December														
Net credit to the central government (cumulative ceiling)	-5,858	-2,835	-10,144	M	1,504	4,497	-24,874	M	895	-12,242	889	-3	2,316	13,605
Stock of reserve money (ceiling)	40,787	40,787	40,697	M	43,817	43,817	43,187	M	47,493	47,493	45,100	48,023	50,689	55,567
Stock of net international reserves of the BM (floor, US\$ millions)	2,360	2,260	2,295	M	2,621	2,521	2,857	M	2,704	3,061	2,961	3,036	3,236	3,262
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) ²	1,200	1,200	0	M	1,200	1,200	895	M	1,200	1,200	1,200	1,200	1,200	1,200
Stock of short-term external debt contracted or guaranteed by the central government (ceiling) ²	0	0	0	M	0	0	0	M	0	0	0	0	0	0
External payments arrears of the central government (ceiling, US\$ millions) ²	0	0	0	M	0	0	0	M	0	0	0	0	0	0
Indicative targets														
Government revenue (cumulative floor) ³	55,760	55,760	57,738	M	81,891	81,891	98,685	M	111,419	126,285	25,519	58,036	91,537	125,266
Priority spending (cumulative floor)	43,748	43,748	39,210	NM	76,041	76,041	68,498	NM	119,025	117,617	20,686	45,244	79,007	135,716

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.

² Assessed on a continuous basis.

³ Net of verified VAT refund requests.

Table 2. Mozambique: Structural Benchmarks for 2013

Structural Benchmarks	Expected Date of Implementation	Status
Government approval of the action plan for the expansion of the electronic payroll system (including e-Folha) and of the integrated civil service database (e-CAF). (¶121 of the MEFP date June 7, 2013)	End-June 2013	Met.
Completion of the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (¶121 of the MEFP date June 7, 2013)	End-December 2013	Not met. Proposed to be reset to March 2014.
Submission of Integrated Investment Plan to the Council of Ministers with sufficient specific information to analyze the impact of the related borrowing on debt sustainability. (¶122 of the MEFP date June 7, 2013)	End-June 2013	Not met. Less specific IIP submitted in July and approved in September 2013.
Submission of the 2 nd Strategic Plan to Improve the Business Environment to the Council of Ministers (¶14 of the MEFP date June 7, 2013)	End-August 2013	Met.
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶137 of the MEFP date June 7, 2013)	End-November 2013	Not met. Proposed to be reset to February 2014.
Staffing a payment systems oversight unit in the BM and begin operations by end-November 2013. (¶140 of the MEFP date June 7, 2013)	End-November 2013	Met.
Preparation of a plan to gradually reduce the stock of pending VAT arrears, avoid accumulation of new arrears, and optimize the administration and refund process. (¶123 of the MEFP date June 7, 2013)	End-October 2013	Met.

Table 3. Mozambique: Proposed Structural Benchmarks for 2014

Areas For Structural Benchmarks	Date of Implementation
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶137 of the MEFP date June 7, 2013 and ¶30 of this MEFP)	End-February 2014
The Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 and provide a note to the Fund staff. (MEFP ¶16)	End-March 2014
The Government will complete the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (MEFP ¶14)	End-March 2014
The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget. (MEFP ¶15)	End-June 2014
The Government will present VAT collections on a net basis in the 2015 budget proposal documents. (MEFP ¶16)	End-October 2014
The Government will implement a simplified and more accurate system of VAT and ISPC tax payments through banks, within the new e-tax system (e-tributacao), and the Revenue Authority will issue a notice informing taxpayers about the new procedures (MEFP ¶16)	End-October 2014
The Board of BM will approve the action plan for the simulation exercise pertaining to the Financial Contingency Plan. (MEFP ¶28)	End-November 2014
The BM will issue the first annual payments systems oversight report. (MEFP ¶34)	End-November 2014
The Government will establish a moveable collateral registry. (MEFP ¶30)	End-December 2014

Attachment 2: Technical Memorandum of Understanding

December 20, 2013

1. This Technical Memorandum of Understanding (TMU) defines the quantitative assessment criteria, indicative targets, and structural benchmarks on the basis of which the implementation of the Fund-supported program under the Policy Support Instrument (PSI) will be monitored. In addition, the TMU establishes the terms and timeframe for transmitting the data that will enable Fund staff to monitor program implementation.

DEFINITIONS

A. Net credit to the central government

2. Net credit to the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts with the banking system, recapitalization bonds issued to the Bank of Mozambique (BM), and proceeds from the signing fee for mineral resource exploration. Credits comprise bank loans, advances to the central government and holdings of central government securities and promissory notes. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in NCG by the banking system will be cumulative from end-December of the previous year.

3. The central government encompasses all institutions whose revenue and expenditure are included in the state budget (*Orçamento do Estado*): central government ministries, agencies without financial autonomy, and the administration of 11 provinces. Although local governments (43 municipalities or *autarquias*) are not included in the definition because they are independent, part of their revenue is registered in the state budget as transfers to local governments.

4. For program purposes, net disbursements on the nonconcessional Portuguese credit line are excluded from the assessment criterion of NCG since the corresponding expenditure is not covered under the definition of central government specified in paragraph 3.

B. Government revenue and financing

5. Revenue is defined to include all receipts of the General Directorate of Tax (*Direcção Geral dos Impostos*, DGI), the General Directorate of Customs (*Direcção Geral das Alfândegas*, DGA), and nontax revenue, including certain own-generated revenues of districts and some line ministries, as defined in the budget. Revenue is gross revenue net of verified VAT refund requests (*pedidos verificadas de reembolsos solicitados*). 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).

6. For the purpose of program monitoring, revenue is considered as collected at the time when it is received by the relevant government collecting agencies, in cash or checks, or through transfers into the respective bank account.

C. Priority social spending

7. Priority social spending is based on the PARPA program categories expanded to incorporate all areas under the new PARP. Accordingly, it will include total spending in the following sectors: (i) education; (ii) health; (iii) HIV/AIDS; (iv) infrastructure development; (v) agriculture; (vi) rural development; a (vii) governance and judicial system, and (viii) social action, labor and employment.

D. Reserve money

8. For the purposes of program monitoring reserve money is defined as the sum of currency issued by the BM and commercial banks' holdings at the BM. The target is defined in terms of the average of the daily end-of-day stocks in the month of the test date. The reserve money stock will be monitored and reported by the BM.

E. Net international reserves

9. Net international reserves (NIR) of the BM are defined as reserve assets minus reserve liabilities. The BM'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 central government's savings accounts related to mineral resource extraction concessions). 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 BM'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.

F. New nonconcessional external debt contracted or guaranteed by the central government, the BM, and selected state-owned enterprises, with maturity of more than one year

10. The ceiling on nonconcessional external debt applies to external debt contracted or guaranteed by the central government, the BM, the Road Fund, the water authorities (FIPAG), the electricity company (EDM), and the hydrocarbon company (ENH), or by enterprises and agencies in which the above entities hold a majority stake. It also applies to debt contracted by these four state-owned enterprises from domestic banks or from other state-owned enterprises that is contractually inter-related to external nonconcessional loans.

11. The ceiling applies to external debt with original maturity of one year or more and with a grant element below 35 percent. The grant element is calculated using a discount rate of 5 percent.

12. The term 'debt' will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted on August 3, 1979, as amended August 31, 2009, effective December 1, 2009. The concept of external debt is defined on the basis of the residency of the creditor. This assessment criterion is defined cumulatively from the beginning of the program and will be assessed on a continuous basis.

G. Stock of short-term external debt contracted or guaranteed by the central government

13. The central government will not contract or guarantee external debt with original maturity of less than one year. This assessment criterion applies to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted on August 3, 1979, as amended August 31, 2009, effective December 1, 2009. The concept of external debt is defined on the basis of the residency of the creditor. Excluded from this assessment criterion are short-term, import-related trade credits. This assessment criterion will be assessed on a continuous basis.

H. External payments arrears of the central government

14. The government undertakes not to incur payments arrears on external debt contracted or guaranteed by the central government, with the exception of external payments arrears arising from central government debt that is being renegotiated with creditors. This assessment criterion will be assessed on a continuous basis.

I. Foreign program assistance

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

J. Actual external debt service payments

16. Actual external debt service payments are defined as cash payments on external debt service obligations of the central 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, but excluding obligations to the IMF (Table 1).

ADJUSTERS

A. Net international reserves

17. The quantitative targets (floors) for net international reserves (NIR) will be adjusted:

- downward by the shortfall in external program aid less debt service payments (up to US\$100 million), compared to the program baseline (Table 1);
- upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US\$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector;
- downward/upward for any revision made to the end-year figures corresponding to the previous year; and
- downward to accommodate higher external outlays because of natural disasters, up to US\$20 million.

B. Net credit to central government

18. The quantitative targets (ceilings) for net credit to the central government (NCG) will be adjusted:

- upward by the shortfall in the MT value of external program aid receipts less debt service payments (up to the MT equivalent of US\$100 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
- downward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US\$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector;
- downward by privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings accounts abroad;
- downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector; and
- upward to accommodate the higher locally-financed outlays because of natural disasters, up to the MT equivalent of US\$20 million at exchange rates prevailing at the respective test dates.

C. Reserve money

19. The ceiling on reserve money for every test date will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirement on the liabilities in commercial banks. The adjuster will be calculated as the change in the reserve requirement coefficient multiplied by the amount of commercial banks' liabilities subject to reserve requirement, considered at the end of the period of constitution of the required reserves prior to the change in regulation.

D. Government revenue

20. The quantitative targets (floors) for government revenue will be adjusted upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US\$ 30 million collected during the program period.

DATA AND OTHER REPORTING

21. The Government will provide Fund staff with:

- monthly and quarterly data needed to monitor program implementation in relation to the program's quantitative targets and broader economic developments;
- weekly updates of the daily data set out in Table 1;
- weekly data set out in Table 4 of the TMU dated May 26, 2005;
- monthly updates of the foreign exchange cash flow of the BM;

- monthly data on government revenues (in detail according to the fiscal table) with a lag not exceeding one month;
- monthly data on verified VAT refund requests;
- monthly information on the balance of government savings accounts abroad;
- monthly data on domestic arrears;
- monthly data on external arrears;
- monthly budget execution reports (that will also be published) with a time lag not exceeding 45 days;
- the “mapa fiscal” with a time lag not exceeding 60 days;
- monthly monetary survey data with a time lag not exceeding 30 days;
- monthly data on gross international reserves, with the composition by original currencies and converted to US dollars at the actual exchange rates; and
- quarterly balance-of-payments data with a time lag not exceeding 65 days;
- monthly disbursements on the nonconcessional Portuguese credit line with a time lag not exceeding 30 days.

22. The monetary survey made available by the BM will clearly identify donor-financed project deposits (with a breakdown between foreign and domestic currency) included in net credit to the government in both the central bank’s and commercial banks’ balance sheets.

23. The Government will provide Fund staff with documentation concerning external loan agreements once these have been signed and become effective.

TMU Table 1. Mozambique: Net Foreign Assistance, 2013-14

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US\$ mn)	3	75	113	193	50	37	236	-10
Gross foreign program assistance	45	116	154	234	101	88	287	41
Program grants	45	67	124	74	101	88	22	41
Program loans	0	49	30	160	0	0	265	0
External debt service	41	41	41	41	51	51	51	51
Cumulative net foreign program assistance in US dollars	3	78	191	384	50	87	322	312
Gross foreign program assistance	45	161	315	549	101	189	476	517
External debt service	41	82	124	165	51	103	154	205
Net foreign program assistance (MT mn)	191	2,129	3,408	5,825	1,644	1,096	7,239	-394
Gross foreign program assistance	1,355	3,497	4,640	7,116	3,105	2,740	8,969	1,293
Program grants	1,355	2,012	3,731	2,252	3,105	2,740	679	1,293
Program loans	0	1,485	909	4,864	0	0	8,291	0
External debt service	1,164	1,369	1,232	1,291	1,461	1,644	1,731	1,687
Cumulative Net foreign program assistance in MTN millions	191	2,320	5,728	11,553	1,644	2,740	9,979	9,585
Gross foreign program assistance	1,355	4,852	9,493	16,608	3,105	5,845	14,815	16,107
External debt service	1,164	2,532	3,765	5,056	1,461	3,105	4,836	6,522

Source: Mozambican authorities and IMF staff estimates.