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Mozambique: 2000 Article IV Consultation and Second Review Under the Poverty Reduction and Growth Facility--Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Authorities of Mozambique

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV Consultation and Second Review Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV Consultation and Second Review Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **September 21, 2000** with the officials of Mozambique on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 1, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **December 18, 2000** updating information on recent economic developments.
- a Public Information Notice (PIN) and a Press Release, summarizing the **views of the Executive Board as expressed during its December 18, 2000 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of Mozambique.

The document(s) listed below have been or will be separately released.

Letter of Intent by the authorities of the member country*
Memorandum of Economic and Financial Policies by the authorities of the member country*
Selected Issues and Statistical Appendix
Technical Memorandum of Understanding*

*Also included in the Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Staff Report for the 2000 Article IV Consultation and Second Review Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Anupam Basu and Leslie Lipschitz

December 1, 2000

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EXECUTIVE SUMMARY

- Economic developments since the last Article IV consultation in June 1999 have been marked by a slowdown of economic growth, a rekindling of inflation, and a weakening external current account—linked in large part to the serious flooding that afflicted Mozambique in February–March 2000.

- All quantitative and structural performance criteria for the present program review were observed. Government expenditure and the primary budget deficit through mid-2000 remained well within program limits, while revenue exceeded its target by a small margin. The central bank's net domestic assets stayed below the program ceiling, but broad money expanded more rapidly than programmed, fueling higher inflation.

- Liquidity and solvency problems at two commercial banks with minority shareholding by the government are being addressed through recapitalization and restructuring. In the case of Mozambique's largest bank, shareholders have reached a firm agreement. In the third-largest bank, a decision is still pending, but bank supervision has taken strong safeguard measures.

- Following a review of the system of tax and customs exemptions, the government has recently adopted some immediate administrative improvements and will proceed under the program with a more substantial reform, including of the legal basis of tax incentives. These and other tax reform measures promise a sustained increase in revenue from 2002.

- A significant increase in government expenditure in 2000–01 reflects outlays for flood reconstruction, higher social sector spending, a boost in the government wage bill, and onetime outlays for bank recapitalization. In the absence of a near-term increase in revenue, the budget deficit will rise, to be financed by debt relief under the HIPC Initiative, higher concessional foreign borrowing, and a progressive drawdown of government deposits at the central bank.

- The usefulness of the new quarterly budget execution reports will soon be enhanced by including information on HIPC Initiative debt relief and poverty-related expenditures. A fully satisfactory tracking of such expenditures will have to await the reform of the public expenditure management system recently launched by the government. The World Bank has agreed with the authorities to carry out a public expenditure review, work on which has begun.

- The authorities remain committed to preparing the full PRSP, and meeting the other conditions for reaching the completion point under the enhanced HIPC Initiative, by end-March 2001. Much work on the PRSP will be required to achieve this goal.

- Based on the authorities' recent actions and policy intentions in the areas of revenue and expenditure management, monetary policy, and bank restructuring, the staff recommends that the Executive Board complete the second review of the current PRGF arrangement.

I. Introduction

1. Mozambique remains scarred by the devastating floods that hit the southern and central parts of the country in February-March 2000. After a slow start, recovery from the floods has recently gained momentum; it is being helped by significant donor assistance—pledged at an international reconstruction conference in May and a Consultative Group meeting in June 2000—and by deep debt relief under the original and enhanced Heavily Indebted Poor Countries (HIPC) Initiatives. The present report describes the government's program for 2000–01 in the context of an up-to-date medium-term macroeconomic framework that takes into account a new assessment of the flood impact, the flow of assistance under the HIPC Initiative, and the expanded poverty focus of the Poverty Reduction and Growth Facility (PRGF).[1]

2. Continued implementation of a program supported by the Fund under the PRGF constitutes an important condition for reaching the completion point under the enhanced HIPC Initiative. Special importance thus attaches to the next steps under the PRGF arrangement (Table 1) and to Mozambique's actual performance under the program (Tables 2 and 3). The following sections of this report describe recent economic developments, the government's medium-term poverty reduction and growth strategy, and the program for 2000–01. The government's letter of intent and policy memorandum of economic and financial policies (MEFP) relating to the second review of the PRGF arrangement and a supporting technical memorandum of understanding are presented in Appendix I. Other appendices summarize Mozambique's relations with the Fund and the World Bank Group, discuss statistical issues, and present selected social and demographic indicators.

II. Recent Economic Developments

3. **Economic developments since the last Article IV consultation have been marked by a slowdown of economic growth, a rekindling of inflation, and a weakening external current account—linked in large part to the serious flooding that afflicted Mozambique in February-March 2000**. Real GDP growth in 2000 is now projected at only 3.8 percent,

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[1] Discussions for the 2000 Article IV consultation and the second review under the PRGF arrangement were held in Maputo during September 10–21, 2000 by a staff team comprising Mr. Reitmaier (head-AFR), Ms. Fabrizio (AFR), Ms. Scott (AFR), Mr. Rebucci (PDR), Mr. Manoel (FAD), Mr. Schwidrowski (Resident Representative), Mr. Arnone (AFR), and Ms. Arantes (assistant-AFR). The mission met with the Ministers of Planning and Finance (Ms. Diogo), Industry and Commerce (Mr. Morgado), State Administration (Mr. Chichava), and Justice (Mr. Abudo), with the Governor of the Bank of Mozambique (Mr. Maleiane), and with other senior officials, including the Executive Director of the National AIDS Council (Ms. Mondlane). The mission collaborated closely with World Bank staff from headquarters and the resident mission.

compared with a preliminary result for 1999 of 7.3 percent and a preflood forecast for 2000 of 7 percent (Tables 4 and 5 and Figure 1).[2] The recent pickup in flood reconstruction and strong activity at the Mozal aluminum smelter, including an earlier-than-expected start-up of production in June 2000, helped contain the economic slowdown but also masked a deep impact of the floods on agriculture, small manufacturing, and services in wide areas of the country.

4. **The 12-month rate of inflation, which had rarely exceeded 4 percent during 1998–99, rose to 13 percent in April 2000, in the immediate aftermath of the floods, and then further, to 16.8 percent, by October 2000** (Figure 2).[3] These price developments reflect a monetary expansion well in excess of the programmed path since the latter part of 1999, but they have no doubt also been fueled by temporary shortages caused by the floods and the pass-through of higher oil prices.[4] **The recent monetary tightening promises a slowdown of inflation toward the end of the year, although further oil price increases pose an upward risk.**

5. Despite the large real shock of the floods, the metical depreciated only moderately in nominal effective terms during the first nine months of the year, reflecting the relative weakness of the South African rand and the euro. Meanwhile, the rise in domestic inflation—gradual at first and more pronounced after the floods—caused a real effective appreciation of some 3 percent over the same period (Figure 3). **The spread between the market exchange rate (applied by the central bank in its dealings with commercial banks) and the parallel rate (applied by exchange bureaus),** which had first appeared in November 1999 in the run-up to the general elections and had widened to almost 10 percent in March 2000 in the wake of the floods, has since narrowed, albeit slowly (Figure 3 and Box 1).

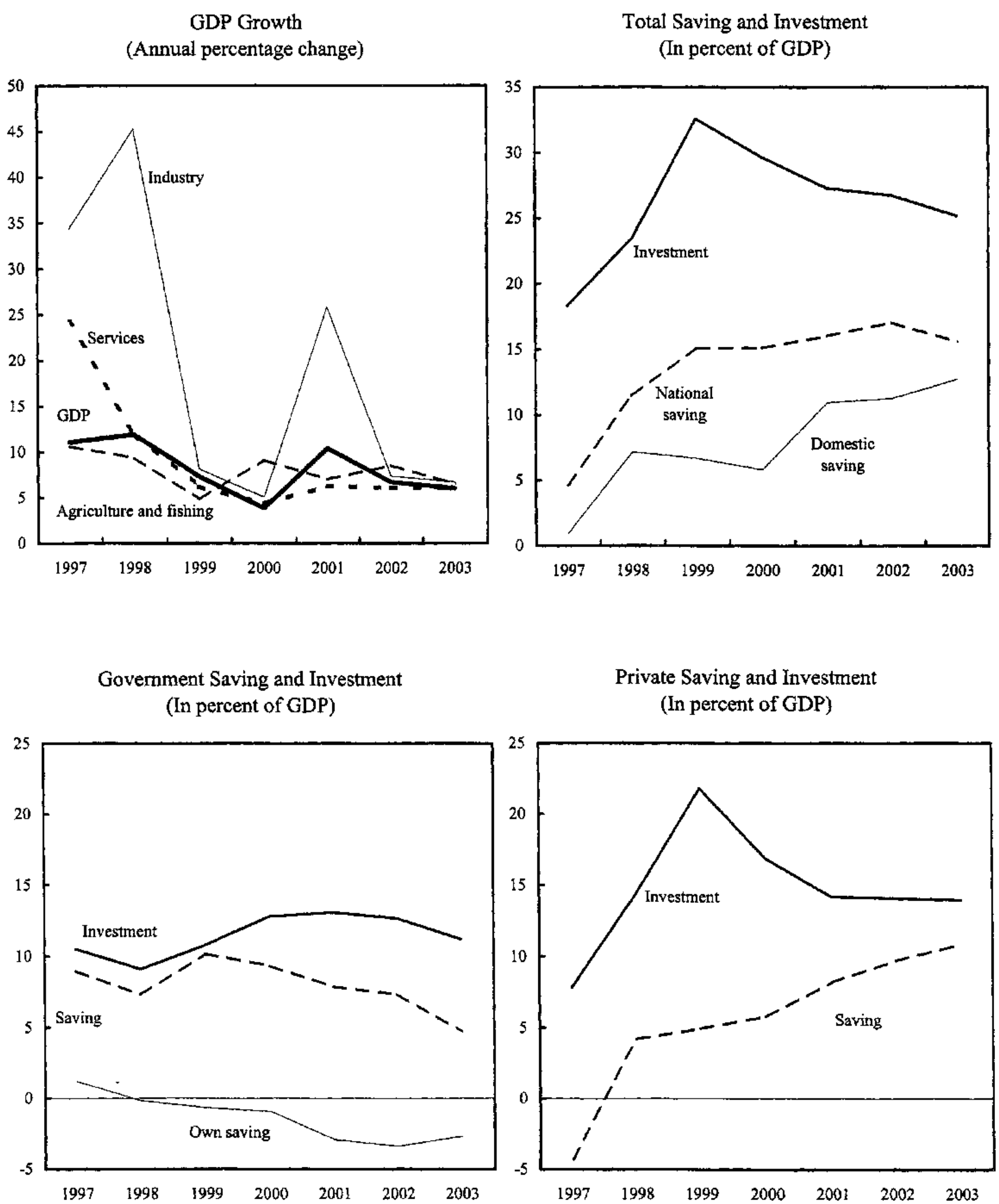
6. Parliamentary consideration of the government budget for 2000 had first been postponed because of the December 1999 elections and was then further delayed by the floods. The quarterly budgetary program for the year that was finally retained in March attempted to take account of these delays, as well as of the then-expected impact of the

[2] National accounts data were recently revised to incorporate the results of the 1998 census (see Appendix IV).

[3] The current consumer price index represents prices only for the city of Maputo; a broader index, incorporating prices for three major cities, is under preparation (see Appendix IV).

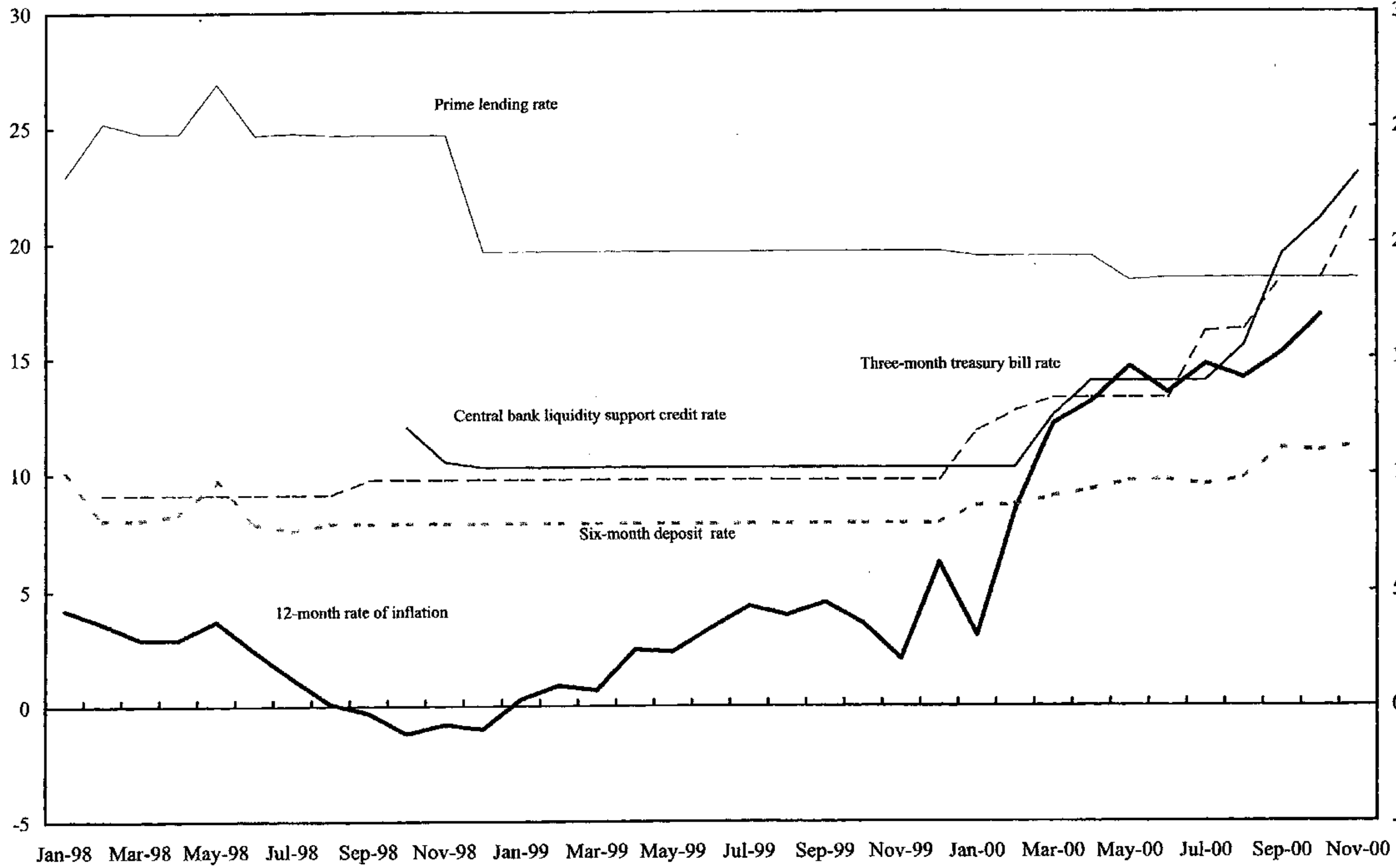
[4] Domestic retail prices of petroleum products are reviewed monthly and adjusted if import prices during the preceding 90-day period show a variation of more than 3 percent. In 2000, prices have been adjusted four times, resulting in price increases for gas oil of 104 percent and for gasoline of 38 percent. The most recent change took place in October, when the price of gas oil was raised by 24.5 percent and that of gasoline reduced by 7.1 percent, reflecting temporarily lower import prices from the region.

Figure 1. Mozambique: GDP, Savings, and Investment, 1997-2003



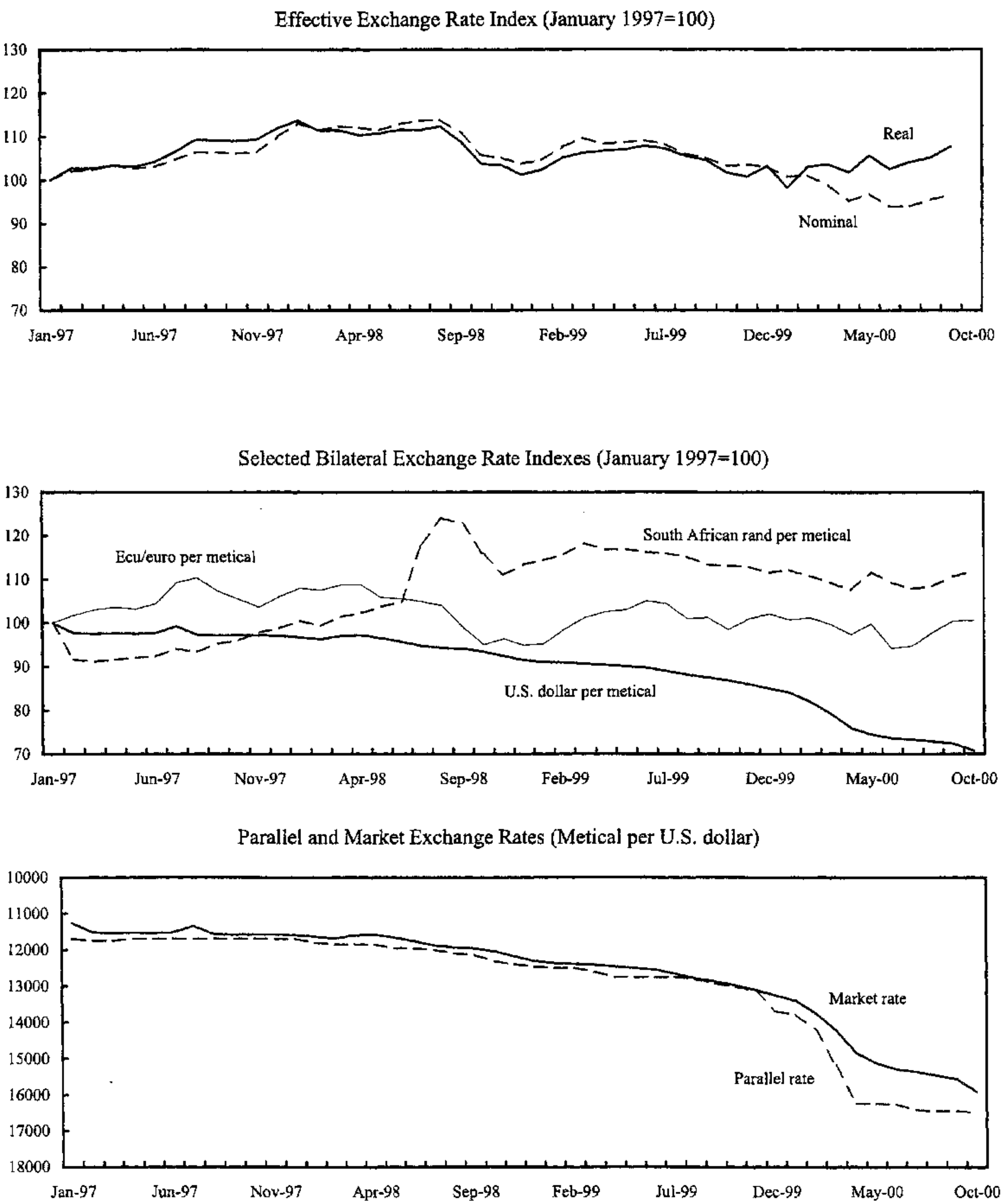
Sources: Mozambican authorities; and IMF staff estimates and projections.

Figure 2. Mozambique: Inflation and Interest Rates, January 1998 - November 2000
(In percent)



Source: Mozambican authorities.

Figure 3. Mozambique: Exchange Rates, January 1997 - October 2000



Sources: Mozambican authorities; and IMF, Information Notice System.

Box 1. Foreign Exchange Markets Development and Policies

Until the mid-1990s, the central bank allocated scarce foreign exchange for the uses indicated by the government or requested by the donor. This practice was at the root of a sizable and persistent spread between the (official) market and parallel exchange rates.

More recently, the partial privatization of the banking system, the creation of an interbank foreign exchange market, the legalization of exchange bureaus, and, more generally, the measures taken to liberalize the current account of the balance of payments created the basis for the emergence of **a unified and relatively well-functioning retail foreign exchange market.** As a result, the spread between the market and the parallel exchange rates has decreased substantially, fluctuating around 1–2 percent since the beginning of 1997 (Figure 3).

The spread between the exchange rate applied by commercial banks ("market rate" in Figure 3) and that applied by exchange bureaus ("parallel rate") reappeared in November 1999, widening to almost 10 percent in March 2000 in the wake of the floods and returning to more normal levels only in October 2000, after having persisted at about 6 percent for several months. Both demand and supply factors underlay these developments.

On the demand side, the uncertainty related to the elections toward the end of 1999 and the floods at the beginning of 2000, as well as a delayed response of monetary policy to the progressive erosion of the real return on metical-denominated assets, caused a strong portfolio demand for U.S. dollar balances. This demand is evidenced also by the increase in the foreign currency-denominated components of the commercial banks' balance sheet during this period (Table 7).

On the supply side, fearing a sharp depreciation of the metical, the Bank of Mozambique reacted to the increased demand for U.S. dollars by letting the metical depreciate moderately, accompanied by some intervention. For their part, commercial banks—which were doing little or no trading in foreign exchange among themselves—kept offering U.S. dollars to their preferred clients at rates close to those offered by the central bank.

The imbalance between the demand and supply of U.S. dollars surfaced, therefore, in the parallel bureau market, where a limited amount of foreign exchange sold by the private sector was fetching a sizable premium. Finally, in mid-October 2000, the Bank of Mozambique took a number of **measures to address this imbalance and strengthen the functioning of the interbank and retail foreign exchange markets.** In particular, it replaced the daily publication of the official market rate with the publication of a more representative rate in the form of the weighted-average rate of all licensed operators' (commercial banks and exchange bureaus) transactions with the public, and began to use this information for its own trading with commercial banks. The inflow of foreign donor assistance is also no longer advertised by the central bank, to prevent it from being misinterpreted by the private sector as a sign of ready availability of foreign exchange from the central bank. Instead, the Bank of Mozambique has started to publish regularly a set of monetary indicators, in addition to the data on foreign exchange reserves already available. As a result of these actions, which should boost competition among commercial banks and exchange bureaus for foreign exchange offered by the private sector, and following the central bank's decision to let the metical depreciate more freely vis-à-vis the U.S. dollar, **the exchange rate spread fell quickly to its pre-election level.**

The authorities have indicated in the past their **intention to accept the obligations under Article VIII, Sections 2, 3, and 4.** Even though momentum seems now to have slowed down, the authorities informed the staff that they are preparing the documentation of current exchange regulations and practices in Mozambique necessary for the Fund to determine whether restrictions on current transactions are absent.

floods and subsequent reconstruction needs. **In the event, government expenditure remained significantly below the program target for midyear, while revenue exceeded its target by a small margin**. The performance criterion for the domestic primary balance for end-June 2000 was thus observed, as was the benchmark target for government revenue (Tables 2 and 6).

7. **The first year of operation of the value-added tax (VAT; introduced in June 1999) has been encouraging**, with VAT revenue expected to reach the equivalent of 7.5 percent of GDP in 2000. On the administrative side, additional efforts are needed to streamline refund procedures, strengthen audit capacities, and disseminate information on VAT procedures to the private sector. Following the recent expiry of a customs management contract with a foreign private company, the government has decided to retain the firm in an advisory role for another three years in order to allow for a more gradual return of customs management into Mozambican hands than originally envisaged. To facilitate the phasing in of local staff into key functions, the new contract focuses on training and strengthening internal controls. Meanwhile, **stronger customs enforcement measures are being taken and widely publicized in the local media**. Finally, with technical assistance from the Fund, the authorities completed a review of the system of tax and customs exemptions, thus observing a performance criterion under the program for end-August 2000. Follow-up action on this review constitutes an important aspect of the program for the coming period (see paragraph 27).

8. **Government expenditure was significantly below program levels through mid-2000**. Expenditure shortfalls occurred in the government wage bill (because of a delay in this year's wage round), goods and services (because of the delay in budget approval), and especially in foreign-financed capital expenditure, where projects were delayed as flood reconstruction took some time to gain momentum and critical flood-related bottlenecks in the transportation system persisted. Meanwhile, some repayments of government lending failed to materialize, and discrepancies among government revenue, expenditure, and financing suggest still unallocated expenditures equivalent to 0.3 percent of GDP.

9. **The use of HIPC Initiative assistance and the need to track poverty-related expenditures pose important challenges for fiscal management in Mozambique**. The publication of quarterly budget execution reports, started as a performance criterion under the current program, constitutes important progress toward greater fiscal accountability. Nonetheless, a recent Report on the Observance of Standards and Codes (ROSC) in fiscal transparency identified several areas where improvements are needed: budget coverage, the functional classification of expenditure, the accounting system, and reporting (Box 2).

10. **At the time of the first PRGF review in March 2000, a stronger-than-programmed expansion of money and credit and a progressive erosion of real interest rates during 1999 led to calls for a tightening of monetary policy** (Table 7 and Figure 2). The Bank of Mozambique responded by using its newly acquired authority to issue treasury bills for monetary control purposes and by raising the required reserve ratio from 6 percent to 7.95 percent. In the event, however, the 12-month rate of expansion of broad money

Box 2. Fiscal Transparency

A Report on the Observance of Standards and Codes (ROSC) in fiscal transparency for Mozambique is about to be finalized; its main findings can be summarized as follows.

Legal framework. The central government's relation with lower levels of government, as well as with public enterprises, are well-defined. The government still retains equity participation in a large number of private enterprises and in commercial banks, reflecting not only the past central planning but also the ongoing process of disengagement. The Bank of Mozambique is formally independent and does not engage in quasi-fiscal activities (although these are not prohibited by the current legislation). While fiscal management responsibilities are clearly defined and coordinated by the Ministry of Planning and Finance, some critical weaknesses, such as in the recording of commitments and verification of the expenditure process, exist. The budget includes a contingency, and its use is guided by transparent rules. Tax legislation is transparent, and information on the tax system is widely available, including on the Internet. More than 90 percent of tax revenues, including the value-added tax (VAT), excise taxes, and customs duties, are subject to clear, up-to-date legislation and to established and published regulations and procedures. The legislation for the remaining taxes is being reformed.

Extrabudgetary activities and weaknesses in budgeting. Despite a legal requirement for universal coverage of the budget, significant extrabudgetary activities lead to serious limitations in the conduct and analysis of fiscal and other macroeconomic policies. Budgetary entities engage in significant extrabudgetary spending that is funded through direct foreign aid flows or through directly collected revenue. The activities of some special funds and of the National Social Security Institute are also not registered in the budget. Budgetary revenues are classified as current (fiscal and nonfiscal) and capital, while expenditures are classified according to organizational, functional, and economic criteria. The functional classification is too broad and does not allow the tracking of spending by project or subcategories. The budget document limits its assessment of the fiscal situation to the overall balance (which is incomplete as a large part of foreign-financed spending is not captured). The government prepares, and revises annually, a five-year fiscal outlook, but this is neither part of the budget proposal nor otherwise published. The budget does not include information on government guarantees, endorsements, or contingent liabilities. Budgetary legislation and the annual budget for the current and preceding year are available on the Internet.

Fiscal reporting and accountability. Under the law, the annual government general accounts are the main instrument of fiscal reporting; however, the accounts for 1998 were recently the first to be compiled since independence. The time limits for preparing these accounts are excessively long: the government has nine months after the close of the fiscal year to submit them to the Administrative Tribunal, which must then issue its report by August of the following year. In mid-2000, the government began to publish quarterly budget execution reports. The Administrative Tribunal, a relatively new institution that still lacks sufficient human and other resources, has responsibility for the external financial control of government entities, while the General Inspectorate of Finance is in charge of internal controls. However, the inspectorate also suffers from serious resource deficiencies.

Reform steps during the program period include the submission of a new accounting law by March 2001. In addition, an interim system is being developed to allow the tracking of poverty-related expenditures through new subcodes within the existing broad functional classification code; such information will be included in the quarterly budget execution reports beginning with the first quarter of 2001.

Recommendations for long-term improvements. The main challenges ahead are the integration of the different instruments of budget planning (including the annual budget, medium-term fiscal outlook, and costed poverty-reduction strategy); the gradual integration of extrabudgetary activities into the budget; the provision of more detailed budget execution data; and the strengthening of internal and external controls. Also, the consolidation of the legal framework for all budgetary activities into one law would be helpful.

increased from 35 percent at end-1999 to 48 percent by end-June 2000, and that of credit to the economy from 30 percent to 36 percent, even though, after adjustment for a calculated shortfall in required reserves, the program ceiling on the central bank's net domestic assets was observed. Meanwhile, the share of bank deposits and loans denominated in foreign exchange continued to increase, now accounting for 47 percent and 35 percent of the respective totals, up from 43 percent and 34 percent, respectively, at end-1999.

11. **The staff reiterated its concerns about the risk of reigniting inflation and the possible loss of monetary control and advised the authorities to let interest rates rise more sharply**. In particular, the staff argued that the amounts offered at treasury bill auctions should be determined by the objectives of monetary policy, rather than by the amount of excess liquidity in the banking system that could be mopped up without having too much impact on interest rates. **Eventually, the authorities permitted the treasury bill rate to rise significantly over successive auctions during the third quarter of 2000**; they also adjusted the interest rate on central bank liquidity support credits to let it exceed the treasury bill rate, in order to establish central bank credit as a last-resort facility and thus encourage more active liquidity management and trading among banks. Monetary expansion has begun to respond to these policy changes, as the 12-month rate of increase of broad money slowed to 44 percent by September 2000.

12. The ability of the Bank of Mozambique to follow a prudent monetary policy during the past 12 months may have been constrained by **serious liquidity and solvency problems at two important commercial banks** that would only have been exacerbated by higher interest rates. The problems of the Banco Comercial de Moçambique (BCM) were recently addressed by the shareholders—including the government, with a 49 percent share—through a commitment to recapitalize the bank by end-March 2001. In the case of the Banco Austral (BA), the government—holding a 40 percent share—is committed to finding a similar solution, but it has not yet been able to secure an unequivocal commitment from the private shareholders to participate in the necessary recapitalization. The BA's shareholders commissioned a new financial due diligence review and agreed to decide by mid-December 2000 on the amount and modalities of recapitalization and on a recovery strategy for the bank.

13. **The staff estimates that the overall impact of the floods on the external current account before grants will be about US$130 million, or 3.3 percent of GDP in 2000, primarily in the form of higher imports.**[5] This compares with a program estimate of approximately US$90 million, evenly distributed between lower exports and higher imports. Meanwhile, the impact of higher oil import prices is expected to be partially offset by a continued decline in the dollar price of imported manufactured goods.

[5] This estimate excludes about US$80 million of emergency assistance distributed directly to the population in the affected areas without being recorded in the balance of payments.

14. **Total export growth in 2000 will benefit from the completion of the Mozal aluminum smelter ahead of schedule.** Mozal is expecting to export approximately US$70 million worth of aluminum in 2000, thereby more than offsetting Mozambique's loss of earnings in traditional exports, related to supply constraints in the cashew and cotton sectors.

15. **Foreign program assistance through mid-2000 exceeded program expectations,** notwithstanding some delay in the delivery of flood relief pledged at the reconstruction conference in May. The correspondingly adjusted targets for net international reserves for end-March and end-June 2000 were met with relative ease, in part because higher-than-expected debt relief had not been included as trigger for the adjustment clause (Table 2). The indicative net internatonal reserves target for end-September was also met.

16. **The government has been broadly on track in implementing the structural reforms under the PRGF-supported program,** including, as noted above, the observance of two structural performance criteria in the public finance area. Some of the actions shown in Table 3 as structural benchmarks under the PRGF-supported program will henceforth be monitored closely by the World Bank staff, including further steps toward a new commercial code and the follow-up on the authorities' policy statement regarding the future of public enterprises (statement submitted to the Council of Ministers in June 2000).[6] Among judicial reforms, completion of the draft of the new commercial code has been delayed until December 2000, although parts of it were already discussed with the private sector at a seminar in September. The adoption of a strategic plan for the justice system, which was envisaged in the last policy framework paper (EBD/99/70; 6/14/99) for October 2000, will be delayed until October 2002.[7] While the Center for Judicial Studies and Training is now holding courses, the dissemination of legal texts to legal professionals is foundering for lack of funds. Two other program benchmarks, relating to the attainment of a target level of customs personnel by end-April 2000 and the completion by end-June 2000 of actuarial analyses of the pension scheme of the public sector and of the National Social Security Institute, will both be observed with some delay in December 2000 (Table 3).

17. **The government remains determined to support the rebuilding of the sugar industry in Mozambique and has therefore decided to uphold the increase in import surcharges for sugar granted in September 1999.** At the time, the staff had viewed the

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[6] The policy statement on the future of public enterprises explores in general terms four possible scenarios ranging from a regime of very limited further privatization to one of a substantial withdrawal of the government from all but the provision of basic services; the document stops short, however, of recommending one of the scenarios for approval by the Council of Ministers.

[7] The authorities justified this delay with the need to broaden the scope of the plan beyond the Ministry of Justice, to include the courts and district attorneys. The staff expressed concern about the length of the delay.

increase in protection as troubling evidence of an inward-oriented industrial policy, quite apart from its running counter to the government's commitment not to adopt new, or increase existing, general import surcharges under the program. In the face of the authorities' wish to maintain the higher import surcharges, and raise them further according to a preannounced schedule, the staff suggested that at least the further increases be put on hold, pending the outcome of a cost-benefit analysis of the intended policy, including its impact on the poor. At the invitation of the government, the Food and Agriculture Organization (FAO) undertook this analysis, coming out in support of the government's approach. The staff accepted this position but recommended that the additional protection granted in September 1999 be cut back again over a preannounced period of five years, broadly in line with the time investors thought necessary for the rebuilding of the industry. The government did not accept the staff's recommendation and instead retained discretion to review annually the level of protection based on domestic and international sugar market developments.

18. **A similar situation arose in October 1999 with respect to protection for the cashew-processing industry**, when the National Assembly passed a law providing for an increase in the export tax on raw cashew nuts from 14 percent to 18-22 percent and for a first right to purchase raw nuts for the benefit of indigenous processors. In the wake of this law, the World Bank sponsored an assessment of competitiveness and employment in the cashew-processing industry in Mozambique. This study recommended the liquidation of several nonviable processing plants, with financial support from the government for the settlement of outstanding wage claims. The study also found that newer factories, using a more labor-intensive technology, did not require any special assistance. Following these recommendations, the government decided in September 2000 on a new policy for the cashew sector. It set the export tax at 18 percent for the current crop year, invited the cashew exporters and processors to agree among themselves on possible modalities for the first right to purchase, and accepted in principle the liquidation of unviable processing plants. The government also expressed support for the Mozambican Cashew Institute's efforts, formalized in a master plan, to stimulate farm production of cashew nuts, which, for reasons of inadequate tree maintenance and plantings, remains near a historical low. **The staff welcomed these decisions, in particular the emphasis put on expanding cashew production and solving the problems of the processing industry.**[8]

III. Medium-Term Poverty Reduction and Growth Strategy

19. **The key medium-term planning instrument in Mozambique is the Government Program 2000–04**, which was adopted by the new government after the December 1999 elections. Other instruments include the Medium-Term Fiscal Scenario and the Action Plan for the Reduction of Absolute Poverty (PARPA).

[8] Developments in other areas of government trade policy, including Mozambique's accession to the Southern African Development Community (SADC) free trade area, are described in Box 3.

Box 3. Trade Policy

International trade liberalization has been instrumental in transforming Mozambique from a highly regulated to a market-based economy. Import and export activities started to be liberalized in 1987, and the tariff structure was first simplified in 1991. After a partial reversal of early reforming steps during 1992–95, the foundations of the current system were laid in 1996. **Today, Mozambique enjoys a relatively liberal trade regime both in comparison to neighboring countries and in absolute terms**—as evidenced by its overall good score on the Fund's trade restrictiveness index.

The current tariff structure is based on ad valorem tariffs of 2.5 percent on raw materials, 5 percent on capital goods, 7.5 percent on intermediate goods, and 30 percent on consumer goods. The average tariff rate is 10 percent, and there are no import quotas or seasonal tariffs. There are also no significant nontariff barriers, and state trading as well as price controls have been abolished. There are no export subsidies and only one export tax (on raw cashew nuts), but there are import surcharges on sugar, cement, and steel. Also, a complex system of exemptions and tax incentives for investment is only now beginning to be rationalized.

Trade liberalization has taken place in a multifaceted process, involving unilateral, regional, and multilateral initiatives. Since the beginning of the adjustment operations in Mozambique, unilateral trade liberalization has aimed at laying the foundation for faster growth, increased investment, and improved standards of living for the poor. Mozambique has been a member of the **World Trade Organization (WTO)** since 1995 and is now finalizing its participation in the **Southern African Development Community (SADC)** free trade area. The government ratified the SADC trade protocol in December 1999 and agreed with its partners on certain amendments to the protocol in August 2000; it has until end-February 2001 to deposit the implementation documents relative to the agreed chapters. Negotiations on the chapters not yet agreed, including those regarding the textile and clothing, beverage, and automobile sectors, are continuing with South Africa and other SADC members on the basis of a detailed proposal recently formulated.

Unilateral trade liberalization suffered a setback toward the end of 1999 when trade protection of cashew processing and sugar production was tightened in order to support the rehabilitation of the respective industries. The export tax on raw cashew nuts was raised from 14 percent to 18 percent (the latter could be raised to 22 percent), and local cashew processors were offered priority in purchasing raw nuts. The coverage of the surcharge on sugar imports was broadened to include refined sugar, and a schedule of rising surcharges was agreed with the industry. In explaining these measures, the authorities cited distorted processing margins in India's cashew sector and the large sugar producer subsidies and high sugar tariffs in the European Union and neighboring African countries. They had also felt compelled to respond to a perception in the country that the benefits of the sustained growth of the past few years had not yet paid off in terms of increased employment opportunities. Furthermore, in the case of sugar, the authorities held that a significant production capacity in the past had been all but destroyed, putting the industry on a par with an infant industry that merited special import protection. In response, the staff argued that the world sugar market offered little export potential for Mozambique, and that the new measures, by tending to lower cashew producer prices and raise sugar consumer prices, might not only be anti-poor in the short run, but would likely divert resources away from outward-oriented activities holding greater promise for Mozambique's long-term development. The staff therefore recommended that the costs and benefits of these measures be analyzed thoroughly, and different stakeholders consulted, before final decisions were taken.

Recent setbacks notwithstanding, the staff believes that **the government remains committed to trade liberalization in principle.** For example, the government has resisted recent pressures to increase trade protection for maize in the face of a difficult market situation. It has also restated its **intention to reduce the top tariff rate from 30 percent to 25 percent by January 2002.**

20. **The Government Program contains four primary objectives**: (i) the reduction of absolute poverty through programs in health, education, and rural development; (ii) the attainment of rapid and sustainable growth through the creation of a favorable environment for the private sector, together with the improvement of the country's fiscal position; (iii) economic development of rural areas, in order to reduce regional inequality; and (iv) the consolidation of peace, national unity, justice, and democracy. An ambitious list of subprograms to support these objectives is set out under the broad rubrics of social and economic development and modernization of the state.

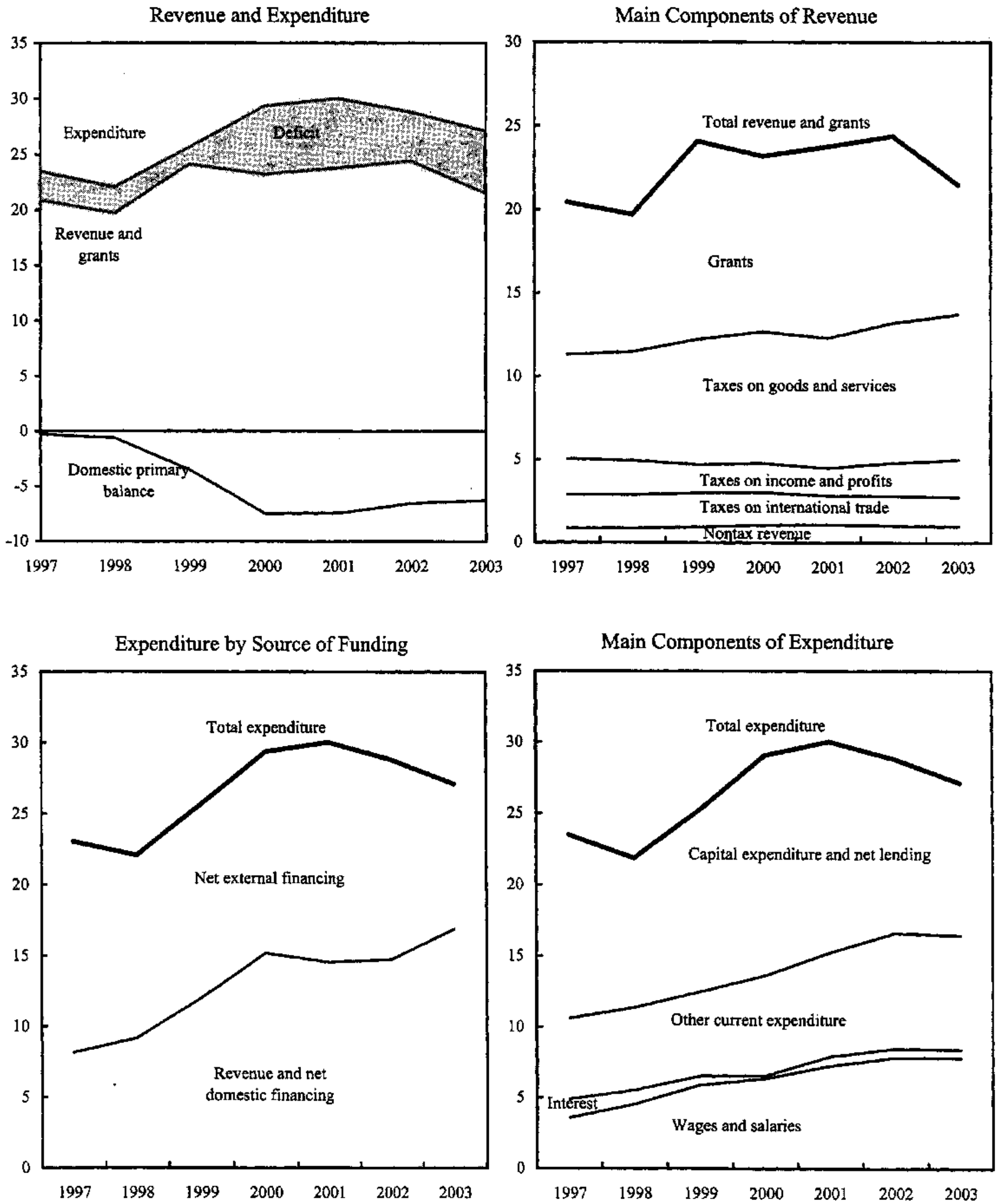
21. The growth strategy includes the development of agriculture and agro-industry, labor-intensive export-oriented manufacturing, transport, telecommunications, and energy. Growth is to radiate from three "development corridors" linking Mozambique to South Africa, Zimbabwe, and Malawi. **The Government Program recognizes the importance of the modernization of the state and the implementation of sound fiscal, monetary, and trade policies to maintain macroeconomic stability and attract private sector investment.** A reduction of red tape and improvements in justice, control of corruption, and decentralization are all mentioned in the Government Program.

22. **The PARPA was drawn up during 1999 and incorporated into the interim poverty reduction strategy paper (PRSP).** It is a medium-term poverty reduction strategy for 2000–04 to support the first objective of the Government Program. The PARPA consists primarily of a number of poverty-focused actions and targets in the priority areas of education, agriculture and rural development, physical infrastructure, health (including nutrition and HIV/AIDs), employment, social welfare, and food security. **As part of their preparation for the full PRSP, the authorities are expanding the scope of the PARPA to include the government's priority macroeconomic and structural policies.** A program of research is under way to trace the links between these policies and poverty reduction.

23. Over the last six years, foreign loans and grants financed more than 60 percent of total government expenditure and almost 80 percent of capital expenditure (Figure 4). The authorities share the donors' concern that this **high degree of aid dependence is not sustainable** and that the government could face difficulties in later years in meeting the running costs entailed by the country's poverty reduction strategy. **The authorities therefore aim to increase revenue**—from 12 percent of GDP in 1999 to about 15 percent in 2005—by reducing tax exemptions, improving tax administration, and reforming the tax system.

24. The medium-term macroeconomic outlook includes **GDP growth of more than 10 percent in 2001,** as the Mozal aluminum smelter will produce at full capacity and flood-related reconstruction activity will peak. **In subsequent years, GDP growth is projected to average 6 percent a year** (Table 5). Inflation is expected to decline in 2001 and remain at about 5 percent in the medium term. Over the period 2001–02, **gross national saving is projected to increase** to about 17 percent of GDP; a drop in 2003 would be due to developments in government saving, led by growing poverty-related expenditures and a drop

Figure 4. Mozambique: Central Government Finances, 1997-2003
(In percent of GDP)



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

in grants, once the bulk of flood-related assistance has been disbursed. Subsequently, national saving is projected to increase again as a proportion of GDP, reflecting increasing private sector saving and government efforts to raise revenue. The decline of private investment in 2001 reflects the completion of the construction phase of the Mozal aluminum smelter. **The contribution of foreign savings to financing investment will drop correspondingly in 2001; it will continue to decline to about 8 percent of GDP thereafter.**

IV. Program for 2000–01

25. In line with the government's medium-term poverty reduction and growth strategy, the program for the coming year aims at establishing the conditions for a recovery of economic growth to levels achieved in the years prior to the floods and at making this growth more pro-poor. In this regard, special emphasis is being placed in the program on budget management and accountability—in the interest of a strong and credible focus of expenditure policy on poverty reduction—and on macroeconomic stability, which has begun to be threatened by an overly accommodating monetary policy and by weaknesses in the banking sector.

A. Fiscal Policy and Budgetary Transparency

26. **The revised budgetary program for 2000-01 accommodates significantly higher expenditures than recorded in 1999 or anticipated at the time of the last PRGF review for 2000-01** (Table 6 and Figure 4). The increase in expenditure in 2000–01 from 1999 reflects mainly the outlays for flood reconstruction, higher social sector spending, a boost in the government wage bill, and onetime outlays for bank recapitalization. In the absence of a notable increase in government revenue,[9] the higher expenditures feed into larger budget deficits, which, in turn, are being financed by debt relief under the HIPC Initiative, higher foreign borrowing, and a progressive drawdown of government deposits in the central bank. In line with the higher domestic financing of the budget, Mozambique's dependence on foreign aid, as measured by the share of total expenditure financed by grants and net foreign borrowing, will decline from 53 percent in 1999 to 52 percent in 2001.

27. **Following a review of the system of tax and customs exemptions (with technical assistance from the Fund), the government has recently adopted some immediate measures to improve the administration of exemptions and will proceed under the program with a more substantial reform, including of the legal basis of tax incentives.**[10]

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[9] Relative to GDP, government revenue will even decline in 2001, as GDP will be boosted by the full-year activity of the Mozal aluminum smelter operating under a free-zone regime.

[10] As described in paragraph 7 of the government's memorandum of economic and financial policies for 2000-01 (MEFP; Appendix I), this reform will include the drafting of a new code of fiscal incentives for investment by mid-May 2001.

In addition to improving the effectiveness of the exemptions system, the changes in fiscal incentives are expected to yield a **significant net revenue gain by 2002**. Beyond these changes, and to sustain a better revenue performance over time, the government is envisaging a comprehensive **reform of the tax system**, including a streamlining of income and profit taxes, a review of the stamp tax, creation of a tax court, and a review of appeals procedures.[11]

28. On the expenditure side, **noninterest current outlays are expected to rise from 11.9 percent of GDP in 1999 to 14.5 percent in 2001**, with the wage bill continuing to account for about half of the total. The increase in the wage bill over the two years to 7.3 percent of GDP, while somewhat higher than staff had recommended, reflects a number of positive elements. These include a further step in the ongoing salary decompression, the introduction of new career streams in 1999, a 10 percent increase in the police force in 2000, and a planned 4.5 percent increase in the number of teachers and nurses in 2001.[12] In the absence of a full functional breakdown of expenditures, the authorities indicated that **expenditures in sectors enjoying priority in the PRSP are budgeted to rise from just under 12 percent of GDP in 1999 to 16 percent in 2001.**[13] **The government's share in the recapitalization of two partly state-owned commercial banks** is expected to cost the equivalent of 2.9 percent of GDP spread over 2000 and 2001; in addition, the government will pay a total of about 0.6 percent of GDP for the acquisition of claims uncollected from an earlier preferential credit scheme for small and medium-sized enterprises, and for the buyback of some real estate not taken up by one bank under the terms of its 1997 (partial) privatization agreement.[14]

29. Under the new program, the authorities will **enhance the usefulness of the quarterly budget execution reports by including information on HIPC Initiative debt relief and**

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[11] In addition, several measures are envisaged to improve tax administration, including planning for the creation of a central revenue authority within the next three-five years (MEFP, paragraph 8).

[12] The salary decompression and new career streams are part of a multi-year donor-supported program to enable the government to recruit, motivate, and retain qualified managers and technicians. The World Bank staff is preparing a study of further pay reforms in the civil service.

[13] Partly overlapping with these and other expenditure categories, the one-time donor-funded flood reconstruction outlays are expected to total the equivalent of about 6.5 percent of GDP during 2000–01, absorbing roughly 60 percent of the assistance pledged at the international reconstruction conference in May 2000.

[14] The government will finance its contribution to the bank recapitalization through a mix of treasury bills and bonds at market interest rates.

poverty-related expenditures, beginning in the first quarter of 2001. To this end, the authorities are preparing an interim system for the tracking of such expenditures, while the more comprehensive reform of the public expenditure management system described in paragraph 10 of the MEFP is being carried out. As a keystone of this reform, the submission of a new public accounting law to the National Assembly by end-March 2001 constitutes a performance criterion under the program.

30. **The World Bank has agreed with the authorities to carry out a public expenditure review (PER) and has requested Fund participation in it.** The first phase has already started and is addressing the following areas: legal framework, budget institutions, budget planning, classification, accounting and reporting, extrabugetary activities and off-budget flows, internal and external control, and fiscal decentralization. The second phase, which is planned to take place during the second half of 2001, will cover sectoral expenditure analyses, including cost efficiency and cost effectiveness, and outcome-based budgeting.

B. Monetary Policy and Financial Sector Issues

31. **Bearing down on inflation through a slowdown of monetary expansion, and restoring health to the banking system are the most important objectives of monetary and financial sector policy for the forthcoming program period.** Following a reassessment of the Bank of Mozambique's approach to determining the amounts of treasury bills on auction and in light of its renewed willingness to let interest rates rise in the pursuit of monetary stability, the conditions appear to be in place for the authorities to rebuild confidence in their implementation of a prudent monetary policy. Under the program, the 12-month rate of broad money growth is expected to be reduced from 44 percent in September 2000 to 34 percent by December 2000 and further, to 16 percent, by end-2001 (Table 7). In recognition of the uncertainty surrounding the projected demand for money, the performance criterion under the program continues to relate to the net domestic assets of the central bank. At the same time, the central bank will closely monitor changes in the stock of reserve money as an important and early indicator of the expansion of broad money and of liquidity conditions in the system.

32. As noted, **banking sector soundness in Mozambique has been undermined by problems in two large commercial banks** that have lingered beyond their partial privatization in 1996–97. In the case of the largest bank, the BCM, the recent shareholders' agreement to restore capital adequacy by end-March 2001, and the central bank's intention to supervise closely the implementation of a restructuring plan constitute important progress. In the case of the third-largest bank, the BA, a similar shareholders' agreement has so far proved elusive. To stabilize the BA's situation and prevent improper actions, the Bank of Mozambique adopted a number of safeguard measures, as described in paragraph 12 of the MEFP. Meanwhile, the shareholders intend to decide by mid-December 2000, on the basis of a new review of due diligence, on the amount and modalities of recapitalization and on a recovery plan for the bank. Closure on the recapitalization operation for the BCM and BA will constitute a performance criterion under the program for end-March 2001.

C. Other Structural Reforms

33. **The government is continuing to pursue a strong structural reform agenda.** In particular, it is enrolling the assistance of the World Bank under a planned new adjustment operation to strengthen the financial sector (beyond the immediate needs of the two banks in recapitalization), effect the inclusion of off-budget flows in the government budget, and reform the regulatory framework for the telecommunications and energy sectors. World Bank assistance will also be sought for a second phase of civil service reform and for implementation of broader public sector reforms.[15]

34. **Comprehensive judicial reform will be key to improving the environment for private sector development.** Although the adoption of a strategic plan for the justice system will likely be delayed for two years to October 2002, some steps are being taken to improve the legal environment. A new commercial code will finally be submitted to the National Assembly by July 2001. A money laundering law has been drafted and will be presented to the Council of Ministers in December 2000. The legal basis and operating conditions for the community courts will be strengthened, regulations for the newly established arbitration court will be adopted, and labor courts will start operating during 2001.

D. Program Financing and External Sector Issues

35. **The external financing requirements of the program (US\$1.6 billion in 2000 and US\$1.3 billion in 2001) are fully covered** by a mix of grants, concessional loans, private investment flows, and debt relief (Table 9). Projected private sector capital flows over the program period include lower direct investment following the completion of the Mozal aluminum smelter; an inflow of about US\$100 million as the share of the foreign private partners in the recapitalization of two commercial banks; and an outflow of almost the same amount, on the assumption that the capital increase is initially invested abroad.

36. **Debt relief in 2000–01 will accrue to Mozambique faster than expected under the original program.** Mozambique is receiving assistance under the original HIPC Initiative from all multilateral creditors except the European Investment Bank (EIB) and the Organization of Petroleum Exporting Countries (OPEC) Fund, with whom delivery agreements should be reached in the coming months. All multilateral creditors have expressed their intention to participate in the enhanced HIPC Initiative, and the IMF and IDA

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[15] In the latter area, a technical unit for the reform of the public sector now reports directly to an interministerial commission headed by the Prime Minister. Other steps recently taken by the government include the granting of a concession to operate the port of Maputo, and the simplification of visa procedures so as to encourage business contacts and boost tourism receipts.

are already providing interim assistance, heavily front loaded because of the floods.[16] For the same reason, the Paris Club creditors have granted a deferral of all debt service due until the completion point under the enhanced HIPC Initiative, or until June 2001, whichever comes first. **Mozambique is continuing to seek the participation of non-Paris Club creditors in the original and enhanced Initiative, and a renewed request for such assistance was sent to the respective creditors in July–August 2000.**

37. Part of the exceptionally large amount of external financing made available to Mozambique by the international community in 2000 did not find early and effective use, because flood reconstruction started later than previously expected and poverty-related expenditures were constrained by the government's budgetary and administrative capacity. The revised program, therefore, foresees **no change in net international reserves in 2000** from the drawdown of US$65 million previously projected (Tables 8 and 9). A drawdown of nearly this magnitude is now expected for 2001. Gross reserves will rise to close to six months of imports in 2000, before falling back to about five months of imports in 2001.

38. **The Bank of Mozambique will continue to pursue a flexible exchange rate policy under the program.** It is committed to abstaining from intervention in the foreign exchange market for the purpose of influencing the exchange rate (except for smoothing short-term fluctuations), but it will continue to sell its structural surplus of foreign exchange stemming from the transfer of official foreign assistance to the central bank. The Bank of Mozambique has also taken some structural measures to improve the functioning of the foreign exchange market and facilitate interbank trading (Box 1 and MEFP, paragraph 15).

E. Program Monitoring and Statistical Issues

39. Implementation of the program will be monitored with the help of quantitative and structural performance criteria and benchmarks, as specified in Tables 1 and 2 of the MEFP (Appendix I), with further definitions and explanations contained in the technical memorandum of understanding annexed to the MEFP. The third review under the PRGF arrangement is expected to be completed by the end of April 2001, at which time the conditions for the fourth review will be specified.

40. **The government attaches growing importance to improving the accuracy, coverage, and timeliness of statistical data.** As laid out in Appendix IV, there are weaknesses in national accounts, fiscal, balance of payments, employment, and income statistics. Mozambique has good poverty data for 1996–97, which will be an important baseline for monitoring poverty trends. A monitoring system consisting of annual administrative data, together with a survey of core welfare indicators undertaken this year

[16] HIPC Initiative assistance delivered by the Fund accrues to the Bank of Mozambique; the latter transfers an equivalent amount in local currency to the budget without delay.

and to be repeated every two years, will be the basis for monitoring the impact of the PRSP on poverty.

V. Medium-Term Balance of Payments Outlook

41. **Mozambique's external financing requirements will remain substantial in the medium term** (Tables 8 and 9). The current account deficit before grants will decline gradually over the projection period, falling below 10 percent of GDP only in 2005. The projected deficits reflect initially the impact of the floods, which will be felt well into 2002, as well as the size of the export base, which will still be small despite an expected recovery in key export sectors, such as cashew and cotton, and sustained growth in the tourism and transportation sectors. Imports are projected to grow at an above-average rate during 2001–02 because of the floods, fall in 2003, stabilize in 2004, and grow in line with real GDP thereafter.

42. **Official foreign assistance** will be exceptionally high during the period 2000–02 in order to finance reconstruction activities. Thereafter, assistance is expected to stay roughly unchanged in nominal terms—slightly above US$500 million per year. **Overall debt relief**—projected in line with the last debt sustainability analysis presented in the staff report for the decision point under the enhanced HIPC Initiative—implies average net debt-service payments on public sector external debt of approximately US$60 million per year throughout the period. **Foreign direct investment** will be boosted in 2000–01 by inflows for the recapitalization of two commercial banks, but is otherwise projected conservatively in the range of US$50–100 million per year. **Gross official reserves** should fall from about six months of imports in 2000 to about three months of imports by 2004–05.

43. **Debt service to the Fund after total HIPC Initiative assistance** will be zero in 2000 (assuming full disbursements under the current PRGF arrangement); it will average about US$7 million during 2001–05 and US$24 million during 2006–10 (Table 10). This rising profile reflects the heavily front-loaded path of IMF debt relief and a large disbursement made available under the PRGF arrangement to Mozambique last April because of the floods. In relation to exports of goods and nonfactor services, debt service to the Fund will average 0.6 percent during 2001–05 and 1.7 percent during 2006–10.

44. **Several factors indicate that Mozambique will have the capacity to service its debt to the Fund.** First, Mozambique's strong structural adjustment effort resumed after having slowed somewhat in the context of the 1999 elections and the 2000 floods. Second, thanks to the support of the international community, the country's international reserve position is strong. Third, Mozambique's capacity to service its external debt, which has been strengthened considerably by its participation in the HIPC Initiative, could improve further should voluntary bilateral debt cancellations materialize. Nevertheless, given Mozambique's vulnerability to weather-related problems and heavy dependence on foreign aid, large and persistent shocks could adversely affect Mozambique's capacity to repay the Fund.

VI. Progress Toward a Full PRSP and the HIPC Initiative Completion Point

45. **The authorities remain committed to preparing the full PRSP and meeting the other conditions for reaching the completion point under the enhanced HIPC Initiative by end-March 2001** (MEFP, paragraph 18). Progress has been made with the development of analytical work to broaden the policy framework of the PARPA to include macroeconomic policies and structural reforms. An initial draft policy matrix was agreed by all the relevant ministries and is being developed further. The planned consultation and monitoring strategies were completed, although with some delay. However, few activities to implement these strategies had been carried out by early November, and the work on PRSP costings had barely begun. Much thus remains to be done, and it might prove difficult to finalize the full PRSP within the government's timeframe.

46. In addition to presentation of a full PRSP, the conditions for reaching the completion point include continued observance of the PRGF-supported program—the subject of the present and following program reviews—and satisfactory performance on a set of **key policy measures in social development, public sector reform, and the legal and regulatory framework.**[17] Progress with these measures has been broadly satisfactory, in that activities are under way in most areas and some have already been completed. The provincial poverty profiles have been completed, and a new three-year policy matrix has been drafted. The draft Health Sector Strategic Plan is expected to be ready by December; the HIV/AIDS Council and Secretariat have been set up, and activities to implement the HIV/AIDS strategic plan are being organized; also, the share of recurrent health and education expenditures in total recurrent expenditure increased in the 2000 budget and is expected to increase further in the 2001 budget. Quarterly budget execution reports, including a functional classification of expenditures (albeit still very broad), have been prepared since the first quarter of 2000. The system of tax and customs exemptions has been reviewed, an interministerial commission and technical unit have been created to develop a strategic plan for public sector reform, and broad policy options regarding the remaining public enterprises have been laid out. Regulations for private sector involvement in the telecommunications and energy sectors have been approved by the Council of Ministers. However, as noted above (paragraph 16), there have been delays in the preparation of a draft of the new commercial code, as well as of a strategic plan for the justice system.

VII. Staff Appraisal

47. The Mozambican authorities deserve credit for sustaining their good record of program implementation across close elections at the end of 1999 and devastating floods in early 2000. To be sure, program targets were modified after the floods, and emergency

[17] These are set out in Box 2 of the decision point document under the enhanced HIPC Initiative (EBS/00/62; 3/30/00).

assistance was mobilized—including from the Fund through an increase in access under the PRGF arrangement—but the observance of all quantitative and structural performance criteria for the present review remains commendable.

48. Not everything went well, though, in 2000. Some problems lingered (such as inflation and rapid monetary expansion), others came to the fore (difficulties at two important banks), and new ground was not broken as easily as planned (e.g., preparation of the PRSP). This implies important challenges, which the authorities intend to meet in the coming program period. First, adequate monetary restraint needs to be established; second, the problems afflicting the banking sector have to be resolved; and third, the pursuit of poverty reduction—already topping the government's long-term agenda—needs to become an integrated part of government planning, budgeting, and reporting. In all three areas, important actions have already been taken on which to build.

49. After largely ineffective attempts at monetary tightening during the first half of the year, the authorities changed their monetary stance in mid-2000, accepting a significant increase in interest rates and making central bank liquidity support credits more expensive than treasury bills. Nonetheless, measured against the 12-month rate of inflation, real interest rates on bank deposits remain negative, far from the strongly positive levels needed to curb inflationary expectations. Similarly, expected returns on local currency deposits still fail to match those available on foreign exchange deposits. As the share of foreign exchange deposits in total deposits is now approaching one-half, the authorities need to tighten monetary policy still more decisively to reassert monetary control. The addition of the stock of reserve money as a benchmark to the monitoring system and the regular publication of monetary indicators will send useful signals to the public.

50. Over the past two months, important progress has been made in addressing the liquidity and solvency problems of the two large commercials banks in which the government still holds a substantial minority interest. At the demand of the government, shareholder meetings were held at both banks, yielding, in the case of Mozambique's largest bank, a firm commitment from the private owners to join the government in recapitalizing the bank. At the third-largest bank, a firm decision on recapitalization was postponed until December 2000, but the principal private partner has reaffirmed his commitment to the survival of the bank, and, importantly, the Bank of Mozambique has put in place safeguard measures intended to prevent losses from accumulating in the interim. The authorities should strictly enforce these safeguards and insist on an equitable burden sharing among the owners. In view of the high, but inevitable, budgetary cost of bank recapitalization, it is all the more important that bank supervision henceforth strictly enforce prudential standards and insist on competent bank management. Meanwhile, the government should seek out opportunities to sell its remaining shares in commercial banks.

51. The challenge of operationalizing the objective of poverty reduction needs to be taken up in several areas: prioritizing government programs in a participatory process and discussing the choices in the full PRSP; embedding priority programs in a detailed functional classification of the annual budget; reporting on budget execution in the same detail; and,

importantly, submitting the budget results to timely audit and parliamentary scrutiny. The staff recognizes recent efforts in all these areas and welcomes the further steps being planned for the coming program period. Even if the authorities' target date for the full PRSP (March 2001) should prove too ambitious, the recent formulation of consultation and monitoring strategies and the beginning of a costing exercise show that progress is being made in critical areas. A fully satisfactory tracking of poverty-related expenditures from budget planning to execution will have to await a comprehensive reform of the public expenditure management system. In this context, the staff welcomes the government's intention to submit a new public accounting law to the National Assembly by end-March 2001. The recently launched publication of quarterly budget execution reports, the design of an interim system for the tracking of poverty-related expenditures, and the recent submission to parliament of the 1998 budget results are also to be welcomed.

52. The government's objective of significantly lifting the revenue-GDP ratio over the coming years is commendable and will be supported by Fund technical assistance in tax policy and tax administration, as already requested by the authorities. A larger revenue effort is indeed needed to sustain the recent expansion of government current expenditure, especially the wage bill. Following earlier technical assistance from the Fund, the authorities are beginning to address the problem of tax and customs exemptions, first through a series of administrative improvements that have already been set in motion, and then through a new code of fiscal incentives for investment. The dual objective of this undertaking of rationalizing the incentive system and raising revenue should be kept firmly in sight.

53. Despite its critical importance for the private sector, the pace of judicial reform is disappointing, all the more so as the adoption of a strategic plan for the justice system has been put off for two years. Work on the new commercial code ought now to be brought to a close, more than three years after it first appeared on the program agenda. The inadequate dissemination of legal texts to legal professionals, along with other constraints on the working of the judicial system, is likely to diminish the effectiveness of the training being provided by the new Center for Judicial Studies and Training, whose start-up earlier this year is of course to be welcomed.

54. By publishing a more representative exchange rate—drawn from all licensed operators' transactions with the public—the authorities hope to contribute to a better functioning of the wholesale and retail foreign exchange markets. The staff welcomes this step and recommends that the authorities refrain from intervening in support of the metical and rely instead on a prudent monetary policy to promote the stability of the national currency.

55. Based on the authorities' recent actions in the important areas of revenue and expenditure management, monetary policy, and bank restructuring, the staff expects that the authorities will follow through as envisaged under the proposed program, and it recommends that the Executive Board complete the second review of the current PRGF arrangement. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

VIII. Proposed Decision

The following draft decision, which may be adopted by a majority of votes cast, is proposed for adoption by the Executive Board:

1. The Republic of Mozambique has consulted with the Fund in accordance with paragraph 2(e) of the three-year arrangement for the Republic of Mozambique under the Poverty Reduction and Growth Facility (PRGF) (EBS/99/96 Supplement 1, July 2, 1999) and paragraph 4 of the letter dated June 10, 1999 from the Minister of Planning and Finance and the Governor of the Bank of Mozambique in order to review program implementation and reach understandings regarding the phasing and conditions for the fourth and fifth disbursements under the arrangement.

2. The letter from the Minister of Planning and Finance and the Governor of the Bank of Mozambique dated December 1, 2000 (the "December 1, 2000 Letter"), with its attached Memorandum of Economic and Financial Policies (the " December 1, 2000 Memorandum") shall be attached to the PRGF arrangement, and the letters dated March 17, 2000 and June 10, 1999, with their attached Memoranda of Economic and Financial Policies, shall be read as supplemented and modified by the December 1, 2000 Letter and the December 1, 2000 Memorandum.

3. Accordingly,

a. paragraph 1(c)(ii) of the arrangement shall be amended to read:

"(ii) the second disbursement in the amount equivalent to SDR 8.4 million, will be available after December 31, 1999 at the request of Mozambique and subject to paragraph 2 below."

b. a new paragraph 1(ccc) shall be added to the arrangement to read as follows:

"(ccc) During the second year of the arrangement,

(i) the fourth disbursement under the arrangement, in an amount equivalent to SDR 8.4 million, will be made available on or after April 30, 2001 at the request of Mozambique and subject to paragraphs 2, 3, and 4 below; and

(ii) the fifth disbursement under the arrangement, in an amount equivalent to SDR 8.4 million, will be made available on or after October 31, 2001 at the request of Mozambique and subject to paragraphs 2, 3, and 4 below;"

c. a new paragraph 1(ddd) shall be added to the arrangement to read as follows:

"(ddd) Further conditions for the fifth disbursement, and the phasing of, and conditions for, further disbursements, shall be determined in the context of a review, the timing of which shall be established at the time of the third review contemplated in paragraph 2 (e);"

d. a new paragraph 2(aaa) shall be added to the arrangement to read as follows:

"(aaa) Mozambique will not request:

(i) the fourth disbursement referred to in paragraph 1(ccc) above if the data as of end-December 2000 indicate that any of the performance criteria referred to in paragraphs 2(a)(i) through 2(a)(v) of this arrangement, as specified in Table 1 of the December 1, 2000 Memorandum, was not observed, and

(ii) the fifth disbursement referred to in paragraph 1(ccc) above if the data as of end-June 2001 indicate that any of the performance criteria referred to in paragraphs 2(a)(i) through 2(a)(v) of this arrangement, as specified in Table 1 of the December 1, 2000 Memorandum, was not observed."

e. a new paragraph 2(ccc) shall be added to the arrangement to read as follows:

"(ccc) if, with respect to the fourth disbursement, Mozambique has not carried out, by end-March 2001, its intentions with regard to the following structural performance criteria:

(i) the submission of a new public accounting law to the National Assembly, that regulates all stages of expenditure, including commitment and verification,

(ii) the completion of the recapitalization of BCM and BA,

as specified in paragraphs 10 and 12 and Table 2 of the December 1, 2000 Memorandum."

f. paragraph 2(e) shall be amended to read as follows:

"(e) until the Trustee has determined that, with respect to the third and fourth disbursements, the corresponding review contemplated in Paragraph 4 of the Letter and Paragraph 4 of the December 1, 2000 Letter has been completed, and with respect to the fifth disbursement, a fourth review, to be specified at the time of the third review, has been completed."

4. The Fund decides that the second review as contemplated in paragraph 2(e) of the three-year PRGF arrangement for the Republic of Mozambique has been completed.

Table 1. Mozambique: Revised Phasing of Performance Criteria, Reviews, and Disbursements Under the PRGF Arrangement, 1999-2002

Expected Date	Expected Disbursement		Event
	Millions of SDRs	Percent of Quota	
June 1999	8.4 (Disbursed)	7.4	Board approval of PRGF arrangement
September 1999	--	--	Test date for quantitative performance criteria[1]
March 2000	28.4	25.0	Approved augmentation of access
	8.4 (Disbursed)	7.4	Completion of first review
June 2000	--	--	Test date for quantitative performance criteria for second review[1]
December 2000	8.4	7.4	Completion of second review and endorsement of annual program
December 2000	--	--	Test date for quantitative performance criteria for third review[1]
April 2001	8.4	7.4	Completion of third review
June 2001	--	--	Test date for quantitative performance criteria for fourth review[1]
October 2001	8.4	7.4	Completion of fourth review and endorsement of annual program
December 2001	--	--	Test date for quantitative performance criteria for fifth review[1]
April 2002	8.4	7.4	Completion of fifth review and request for extension of PRGF arrangement
June 2002	--	--	Test date for quantitative performance criteria for final review[1]
October 2002	8.4	7.4	Completion of final review
Total	87.2	76.8	

[1] Structural performance criteria had or will have test dates at or near the same date as quantitative performance criteria.

Table 2. Quantitative Performance Criteria and Benchmarks
Under the PRGF Arrangement, December 1999-September 2000 (End of Period)

	1999	2000					
	December	March		June		September	
	Actual	Proj.	Actual	Performance Criteria	Actual	Indicative Benchmarks	Prelim.
	(In billions of meticais)						
Central government domestic primary deficit (ceiling) 1/ 2/	1,780	703	369	1,191	1,026	1,812	...
Central government revenue (floor; benchmark only) 2/	6,207	1,614	1,620	3,270	3,321	5,197	...
Stock of net domestic assets of the Bank of Mozambique (ceiling) 3/ 4/ 5/	4,501	5,008	4,749	5,127	3,934	5,232	4,340
	(In millions of U.S. dollars)						
Stock of net international reserves of the Bank of Mozambique (floor) 6/	469	434	451	424	480	419	459
New nonconcessional borrowing contracted or guaranteed by the government or the Bank of Mozambique with maturity of more than one year (ceiling) 2/	0	0	0	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 7/	9	9	9	9	9	9	9
External payments arrears (ceiling) 2/ 8/	0	0	0	0	0	0	0
Memorandum item:							
Foreign program assistance (grants and loans) 2/	218	30	28	72	98	97	115

1/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.
2/ Cumulative from the beginning of the calendar year.
3/ Defined as reserve money minus net foreign assets of the Bank of Mozambique. The foreign currency component of reserve money and the net foreign assets are valued at program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term liabilities.
4/ To be adjusted upward/downward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item. The original program ceilings of Mt 5,168 billion for March, Mt 5,668 billion for June, and Mt 5,736 billion for September 2000 have been adjusted accordingly.
5/ To be adjusted downward to the extent that eligible bank reserves fall short of 7.95 percent of deposits in commercial banks at the end of each quarter. At end-March 2000, this ratio was 6.3 percent, giving rise to a downward adjustment of Mt 188 billion to the program ceiling. At end-June 2000, this ratio was 6.55 percent, giving rise to a downward adjustment of Mt 175 billion to the program ceiling. At end-September 2000, this ratio was 6.1 percent, giving rise to a downward adjustment of Mt 248 billion.
6/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item. The original targets of US$436 million for March, US$398 million for June, and US$401 million for September 2000 have been adjusted accordingly.
7/ Loans of 0-1 year's maturity, excluding normal import-related credit. Non-U.S. dollar debt converted to U.S. dollars at actual exchange rates.
8/ Continuous; excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

Table 3. Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, April-October 2000[1]

Actions	Date of Implementation (End of period)	Status as of End-October 2000
Taxes and customs		
Attain target level of customs personnel (1,100 staff).	April 2000	Delayed to December 2000
Complete review of the system of tax and customs exemptions (paragraph 9). (*)	August 2000	Observed
Implement adequate physical controls around the industrial free zones and adopt a mechanism of tax and customs surveillance to prevent leakages.	April 2000	Observed
Governance, transparency, and legal environment		
Complete review of transparency of fiscal management in relation to the Code of Good Practices on Fiscal Transparency.	May 2000	Observed
Begin publication of quarterly disaggregated budget execution reports, including tables according to the economic and functional classification of expenditure (paragraph 11):		
• publish results for first quarter of 2000; and	May 2000	Observed
• publish results for first two quarters of 2000. (*)	August 2000	Observed
Complete draft of new commercial code, covering company and contract law.	August 2000	Delayed to December 2000
Trade policy		
Complete a review of sugar sector policy, with a view to determining (i) whether support for the sector is warranted, and (ii) the amount, duration, and form of any such support.	August 2000	Observed
Public enterprise reform		
Submit to the Council of Ministers a policy statement regarding the future of public enterprises and of companies with majority state ownership.	June 2000	Observed
Social sector		
Publish a set of social and development indicators.	May 2000	Observed
Complete actuarial analyses of the pension scheme of the public sector and of the National Social Security Institute.	June 2000	Delayed to December 2000

[1] An asterisk (*) denotes a performance criterion. The paragraph reference is to the government's letter to the Fund of March 17, 2000.

Table 4. Mozambique: Selected Economic and Financial Indicators, 1998-2001

	1998	1999	2000 Prog.	2001 Proj.
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Nominal GDP (in billions of meticais)	46,427	50,827	58,887	68,939
Nominal GDP (in millions of U.S. dollars)	3,918	4,005	3,922	4,197
Real GDP	11.9	7.3	3.8	10.4
GDP per capita (in U.S. dollars)	231.6	231.5	221.7	232.0
GDP deflator	2.4	2.0	11.6	6.0
Consumer price index (annual average)	0.6	3.1	12.3	5.7
Consumer price index (end of period)	-1.3	6.2	11.0	7.0
External sector				
Merchandise exports	6.3	10.8	15.4	119.0
Merchandise imports	7.5	46.8	-3.2	1.4
Terms of trade	5.3	-0.1	-1.5	1.5
Nominal effective exchange rate (end of period) 1/ 2/	-5.7	0.0	-8.2	...
Real effective exchange rate (end of period) 1/ 2/	-9.7	1.7	3.4	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)			
Money and credit				
Net domestic assets	9.3	23.9	25.0	13.3
Of which : net credit to the government	-16.0	0.0	12.5	9.8
credit to the rest of the economy	17.8	22.9	26.3	16.5
Broad money (M2)	17.6	35.1	34.0	16.0
Velocity (GDP/ average M2)	5.7	5.2	4.3	4.0
Prime rate (in percent; end of period) 3/	19.6	19.6	18.4	...
	(In percent of GDP)			
Investment and saving				
Gross domestic investment	23.5	32.6	29.7	27.3
Government	...	...	12.8	13.1
Other sectors	...	...	16.9	14.2
Gross national savings	11.5	15.1	15.1	16.0
Government	...	...	9.3	7.8
Other sectors	...	...	5.8	8.2
Government budget				
Total revenue	11.5	12.2	12.7	12.3
Total expenditure and net lending	21.8	25.2	29.1	30.0
Overall balance before grants	-10.6	-13.4	-16.7	-17.7
Total grants	8.2	11.9	10.5	11.5
Overall balance after grants	-2.4	-1.6	-6.1	-6.3
Domestic primary balance	-0.6	-3.5	-7.5	-7.4
Domestic bank financing	-2.3	-0.3	2.5	2.2
External sector				
Current account balance before grants	-21.3	-30.1	-28.5	-18.8
Current account balance after grants	-12.4	-19.2	-17.6	-8.8
	(In percent of exports of goods and nonfactor services)			
Net present value of total external debt outstanding 4/	538.2	202.0	163.0	150.0
External debt service (nonfinancial public sector)				
Scheduled, before HIPC Initiative assistance (Naples terms)	20.0	26.1	31.3	20.2
Scheduled, after original HIPC Initiative assistance	...	15.3	12.2	8.2
Scheduled, after enhanced HIPC Initiative assistance	...	...	4.4	5.8
	(In millions of U.S. dollars, unless otherwise specified)			
External current account after grants	-436	-770	-690	-403
Overall balance of payments	-204	-243	-478	-488
Gross international reserves (end of period)	625	669	700	634
In months of imports of goods and nonfactor services	7.0	5.2	5.7	5.0
In percent of broad money	82.7	76.0	70.5	56.8
Exchange rate (meticais per U.S. dollar; end of period) 3/	12,366	13,300	16,244	...
Use of Fund resources (in millions of SDRs)				
Purchases/disbursements	25.2	21.0	45.2	16.8
Repurchases/repayments	18.1	22.8	22.2	21.0
Credit outstanding	147.2	145.4	168.5	164.3
Quota	84.0	113.6	113.6	113.6

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.
2/ The figure for 2000 is the actual rate at the end of September.
3/ The figure for 2000 is the actual rate at the end of November.
4/ Public and publicly guaranteed, in percent of the three-year average of exports. Data for 1998 reflect the impact of applying traditional debt-relief mechanisms (Naples terms). The data for 1999-2000 include the impact of total debt relief granted under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) and new borrowing.

Table 5. Mozambique: National Accounts, 1998-2005

	1996 weights	1998	1999	2000	2001	2002	2003	2004	2005
					(In units indicated)				
Overall GDP									
Nominal (in billions of meticais)		46,427	50,827	58,887	68,939	78,078	86,990	96,756	107,353
Real (percentage change)		11.9	7.3	3.8	10.4	6.7	6.0	5.9	5.7
Deflator (percentage change)		2.4	2.0	11.6	6.0	6.1	5.1	5.0	5.0
					(Annual percentage change in real terms, unless otherwise specified)				
Sectoral components of GDP									
Agriculture	30.5	8.9	9.0	2.4	5.5	7.0	5.0	5.0	4.0
Fishing	4.0	0.5	-4.2	6.7	1.5	1.5	1.5	1.5	1.5
Industry	15.6	45.3	8.1	5.1	25.9	7.3	6.7	6.7	6.8
Mining	0.2	15.1	-33.7	-4.1	10.0	15.0	15.0	15.0	15.0
Manufacturing	8.6	15.9	4.5	6.5	54.5	8.6	7.4	7.4	7.4
Electricity and water	0.4	288.2	59.7	20.9	-1.0	1.3	1.3	1.3	1.3
Construction	6.3	36.9	3.1	-1.4	2.0	7.0	7.0	7.0	7.0
Services	50.1	12.0	6.2	4.3	6.3	6.1	6.1	5.9	6.0
Demand components of GDP									
Consumption	101.3	5.5	7.2	4.1	4.8	6.5	4.4	3.8	4.0
Government 1/	10.3	8.5	9.4	9.9	21.3	18.4	5.2	5.0	4.9
Other sectors	91.0	5.7	6.7	3.4	2.4	4.5	4.2	3.6	3.8
Investment	20.5	41.1	47.1	-9.0	-0.9	3.9	0.5	7.3	7.2
Government 1/	10.1	...	...	18.6	10.2	2.6	-5.5	7.0	6.4
Other sectors	10.5	...	...	-22.7	-9.3	5.1	6.0	7.5	7.8
Foreign balance 2/	21.8	-1.8	-10.4	2.9	6.2	-0.1	2.0	0.9	0.6
Exports	10.9	10.7	16.4	14.6	55.4	5.6	5.6	5.7	5.5
Imports	32.7	10.2	43.3	-3.2	2.6	3.4	-3.2	0.5	1.5
					(In percent of GDP)				
National saving and investment									
Government 1/									
Saving		...	...	9.3	7.8	7.3	4.7	4.8	5.2
Of which									
Own saving 3/		...	...	-0.9	-2.9	-3.4	-2.7	-2.0	-1.2
Investment		...	...	12.8	13.1	12.7	11.2	11.3	11.3
Balance		...	...	-3.5	-5.2	-5.3	-6.5	-6.4	-6.1
Nongovernment sectors									
Saving		...	...	5.8	8.2	9.7	10.9	12.1	12.9
Investment		...	...	16.9	14.2	14.1	14.0	14.1	14.4
Balance		...	...	-11.1	-6.0	-4.4	-3.1	-2.0	-1.5
All sectors									
Saving		11.5	15.1	15.1	16.0	17.0	15.6	17.0	18.1
Of which									
Domestic saving		7.2	6.7	5.8	10.9	11.3	12.7	14.5	15.9
Investment		23.5	32.6	29.7	27.3	26.7	25.2	25.4	25.7
Foreign saving (-) 4/		-12.0	-17.5	-14.6	-11.3	-9.7	-9.6	-8.5	-7.6

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

1/ Projections for the government sector are derived from the government budget.

2/ Figures represent the contribution of the change in the foreign balance to growth.

3/ Domestic saving plus net factor income from abroad.

4/ External current account, including grants (interest payments on a cash basis).

Table 6. Mozambique: Government Finances, 1998-2002

12/1/00 11:44	1998	1999	2000				2001				2002
			Q1-Q2		Year		Q1	Q1-Q2	Q1-Q3	Year	
					Original	Rev.					
	Act.	Act.	Prog.	Act.	Prog.	Prog.	Prog.		Proj.		Proj.
	(In billions of meticais)										
Total revenue	5,324	6,207	3,270	3,321	7,430	7,471	1,893	3,902	5,647	8,481	10,304
Tax revenue	4,932	5,733	3,050	3,049	6,904	6,858	1,727	3,569	5,118	7,744	9,516
Taxes on income and profits	963	867	350	371	990	1,037	188	410	360	1,145	1,564
Taxes on goods and services	2,882	3,638	2,132	2,013	4,654	4,419	1,197	2,464	3,678	5,091	6,219
Taxes on international trade	937	1,046	466	549	1,043	1,165	275	560	867	1,212	1,399
Other taxes	150	183	102	116	217	237	67	135	213	296	335
Nontax revenue	392	474	221	272	525	613	166	333	529	737	788
Total expenditure and net lending	10,141	12,815	7,154	5,860	15,198	17,114	4,854	9,256	13,993	20,700	22,486
Current expenditure	5,268	6,332	3,818	3,418	7,562	8,023	2,548	5,095	7,903	10,502	12,958
Compensation to employees	2,097	2,995	1,758	1,502	3,740	3,736	962	2,193	3,432	5,002	6,118
Goods and services	1,834	1,928	1,369	1,199	2,224	2,502	1,094	1,849	2,663	3,105	3,980
Interest on public debt	463	324	53	56	107	121	62	188	318	456	496
Domestic	21	6	9	5	17	15	4	71	130	196	237
External	442	318	44	51	90	106	58	117	187	260	260
Transfer payments	874	1,085	639	661	1,491	1,664	430	865	1,490	1,939	2,363
Capital expenditure	4,575	6,001	3,281	2,431	7,317	7,862	1,512	3,109	4,880	9,495	10,261
Of which: locally financed	993	1,765	858	807	2,339	2,666	658	1,308	1,981	2,919	3,695
Net lending	298	482	55	11	319	1,229	794	1,052	1,210	703	-733
Of which: locally financed	-291	-6	-162	11	-214	1,147	784	717	673	650	-733
Unallocated revenue (+)/expenditure (-) 1/	-106	-220	0	-167	0	-167	0	0	0	0	0
Overall balance before grants	-4,923	-6,828	-3,884	-2,706	-7,768	-9,810	-2,961	-5,354	-8,346	-12,220	-12,181
Grants received	3,818	6,035	2,413	2,677	4,734	6,192	984	2,452	3,293	7,905	8,740
Project	1,894	2,748	1,355	1,138	2,815	3,395	469	1,032	1,732	4,981	3,933
Nonproject	1,924	3,287	1,058	1,539	1,918	2,797	514	1,421	1,561	2,924	4,807
Overall balance after grants	-1,105	-793	-1,470	-29	-3,034	-3,618	-1,977	-2,902	-5,053	-4,315	-3,441
Bank of Mozambique transfer of HIPC Initiative assistance by the IMF 2/	0	0	0	161	0	631	65	235	301	474	340
Net external borrowing	2,172	910	946	372	2,174	1,518	1,080	1,308	1,547	2,294	1,906
Disbursements	2,671	1,394	1,018	509	2,321	1,803	1,229	1,614	2,011	2,930	2,325
Project	1,641	1,394	1,018	509	2,063	1,598	385	769	1,167	1,593	1,441
Nonproject	1,030	0	0	0	257	206	844	844	844	1,337	883
Cash amortization	499	483	72	137	146	285	149	305	465	636	419
Net domestic financing	-1,067	-117	525	-505	860	1,469	833	1,359	3,205	1,546	1,195
Of which: net bank credit	-1,067	-177	525	-505	860	1,469	833	1,359	3,205	1,546	1,195
Memorandum items:											
Domestic primary balance before grants 3/	-289	-1,780	-1,191	-1,026	-2,150	-4,411	-2,035	-3,031	-4,593	-5,135	-5,120

Table 6. Mozambique: Government Finance, 1998-2002 (concluded)

	1998	1999	2000		2001	2002
	Act.	Act.	Original Prog.	Rev. Prog. 1/	Prog.	Proj.
	(In percent of GDP, unless otherwise specified)					
Total revenue	11.5	12.2	12.3	12.7	12.3	13.2
Tax revenue	10.6	11.3	11.5	11.6	11.2	12.2
Taxes on income and profits	2.1	1.7	1.6	1.8	1.7	2.0
Taxes on goods and services	6.2	7.2	7.7	7.5	7.4	8.0
Taxes on international trade	2.0	2.1	1.7	2.0	1.8	1.8
Other taxes	0.3	0.4	0.4	0.4	0.4	0.4
Nontax revenue	0.8	0.9	0.9	1.0	1.1	1.0
Total expenditure and net lending	21.8	25.2	25.3	29.1	30.0	28.8
Current expenditure	11.3	12.5	12.6	13.6	15.2	16.6
Compensation to employees	4.5	5.9	6.2	6.3	7.3	7.8
Goods and services	4.0	3.8	3.7	4.2	4.5	5.1
Interest on public debt	1.0	0.6	0.2	0.2	0.7	0.6
Domestic	0.0	0.0	0.0	0.0	0.3	0.3
External	1.0	0.6	0.1	0.2	0.4	0.3
Transfer payments	1.9	2.1	2.5	2.8	2.8	3.0
Capital expenditure	9.9	11.8	12.2	13.4	13.8	13.1
Of which: locally financed	2.1	3.5	3.9	4.5	4.2	4.7
Net lending	0.6	0.9	0.5	2.1	1.0	-0.9
Of which: locally financed	-0.6	0.0	-0.4	1.9	0.9	-0.9
Unallocated revenue (+)/expenditure (-) 1/	-0.2	-0.4	0.0	-0.3	0.0	0.0
Overall balance before grants	-10.6	-13.4	-12.9	-16.7	-17.7	-15.6
Grants received	8.2	11.9	7.9	10.5	11.5	11.2
Project	4.1	5.4	4.7	5.8	7.2	5.0
Nonproject	4.1	6.5	3.2	4.8	4.2	6.2
Overall balance after grants	-2.4	-1.6	-5.0	-6.1	-6.3	-4.4
Bank of Mozambique transfer of HIPC Initiative assistance by the IMF 2/	0.0	0.0	0.0	1.1	0.7	0.4
Net external borrowing	4.7	1.8	3.6	2.6	3.3	2.4
Disbursements	5.8	2.7	3.9	3.1	4.3	3.0
Project	3.5	2.7	3.4	2.7	2.3	1.8
Nonproject	2.2	0.0	0.4	0.3	1.9	1.1
Cash amortization	1.1	1.0	0.2	0.5	0.9	0.5
Net domestic financing	-2.3	-0.2	1.4	2.5	2.2	1.5
Net bank credit	-2.3	-0.3	1.4	2.5	2.2	1.5
Securities	0.0	0.1	0.0	0.0	0.0	0.0
Memorandum items:						
Domestic primary balance bef. grants 3/	-0.6	-3.5	-3.6	-7.5	-7.4	-6.6
Total expenditure in education	3.2	3.4		4.5	6.4	...
Total expenditure in health	2.8	2.9		3.6	3.0	...
Current expend. on defense & security	2.1	2.5		2.5	2.7	...
Nominal GDP (in billions of meticais)	46,427	50,827	60,177	58,887	68,939	78,078

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

1/ Statistical discrepancy between the fiscal and the monetary accounts.

2/ In 2000, figures include also a transfer of Mt.161 billion from other multilaterals under the original HIPC Initiative.

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

Table 7. Mozambique: Monetary Survey, 1998-2001
(In billions of meticais, unless otherwise specified)

	1998	1999	2000							2001			
	Dec.	Dec.	March	June		Sep.		Dec.		Mar.	June	Sept.	Dec.
			Act.	Prog.	Act.	Prog.	Act.	Orig. Prog.	Rev. Prog.	Prog.	Prog.	Proj.	Proj.
Central bank													
Net foreign assets	-1,973	-1,384	-1,752	-2,463	-798	-2,451	-1,150	-2,429	-1,656	-1,916	-2,096	-2,755	-2,825
(in millions of U.S. dollars)	-160	-104	-120	-175	-52	-172	-74	-169	-104	-119	-129	-164	-164
Net international reserves	5,214	6,242	6,557	5,606	7,342	5,719	7,166	5,810	7,472	7,311	7,218	6,874	7,049
(in millions of U.S. dollars)	422	469	451	398	480	401	459	404	469	454	444	409	409
Medium- and long-term foreign liabilities	-7,338	-7,819	-8,520	-8,273	-8,360	-8,376	-8,503	-8,447	-9,360	-9,461	-9,550	-9,873	-10,125
Other	151	193	210	204	220	206	186	208	232	234	236	244	250
Net domestic assets	4,665	4,501	4,828	5,668	4,009	5,736	4,456	6,081	5,827	6,046	6,229	7,058	7,393
Credit to government (net)	-4,898	-5,175	-5,595	-4,650	-6,235	-4,182	-5,961	-4,315	-5,202	-5,221	-4,695	-2,849	-4,508
Credit to banks (net)	454	408	886	996	1,042	570	1,108	1,022	1,555	1,843	1,550	583	2,627
Credit to the economy	75	74	74	74	74	74	74	74	74	74	74	74	74
Other items (net; assets +)	9,033	9,194	9,464	9,247	9,128	9,273	9,235	9,300	9,400	9,350	9,300	9,250	9,200
Reserve money	2,692	3,117	3,076	3,204	3,211	3,284	3,306	3,653	4,171	4,130	4,133	4,303	4,568
Currency outside banks	1,650	2,174	1,935	1,881	1,975	1,961	2,049	2,298	2,708	2,662	2,638	2,747	2,931
Bank reserves	1,042	943	1,141	1,323	1,236	1,323	1,257	1,355	1,462	1,468	1,495	1,556	1,637
Currency in banks	269	391	224	246	284	256	253	300	274	278	283	288	293
Deposits in meticais	639	237	728	870	820	913	835	955	1,089	1,095	1,122	1,183	1,264
Required reserves (calculated)	530	710	914	845	995	888	1,082	930	1,064	1,070	1,097	1,158	1,239
Free reserves (calculated)	109	-473	-186	25	-175	25	-248	25	25	25	25	25	25
Deposits in foreign currencies	134	315	189	208	132	154	169	100	100	95	90	85	80
(in millions of U.S. dollars)	11	24	13	15	9	11	11	7	6	6	6	5	5
Deposit money banks (DMBs)													
Net foreign assets	1,721	2,109	2,632	1,916	2,918	1,940	3,295	1,956	3,448	3,791	4,135	4,594	5,038
(in millions of U.S. dollars)	139	159	181	136	191	136	211	136	217	236	255	274	293
Net domestic assets	5,350	7,502	7,971	7,849	8,731	8,371	9,188	8,877	9,635	9,464	9,465	9,774	10,349
Banks' reserves	1,310	1,013	1,084	1,323	1,237	1,323	1,337	1,355	1,462	1,468	1,495	1,556	1,637
Liabilities to central bank (net)	-337	-307	-809	-862	-1,028	-453	-1,412	-922	-1,540	-1,828	-1,535	-568	-2,612
Credit to government (net)	-714	-441	-315	-481	-207	-481	-244	-481	1,055	1,907	1,907	1,907	1,907
Of which: government deposits	-724	-824	-897	-864	-871	-864	-1,133	-864	-300	-200	-200	-200	-200
Credit to the economy	6,649	8,645	9,184	9,024	9,925	9,324	10,325	10,256	11,748	12,530	12,257	11,771	14,358
Of which: in foreign currency	1,918	2,934	3,326	3,025	3,563	3,126	3,664	3,438	3,887	4,021	3,737	3,768	4,050
(in millions of U.S. dollars)	155	221	229	215	233	219	235	239	244	250	230	224	235
Other items (net; assets +)	-1,559	-1,408	-1,173	-1,155	-1,196	-1,343	-818	-1,330	-3,090	-4,613	-4,659	-4,892	-4,941
Deposits	7,070	9,611	10,604	9,764	11,649	10,311	12,483	10,833	13,083	13,255	13,600	14,369	15,387
Demand and savings deposits	5,370	7,293	8,062	7,322	8,707	7,732	9,253	8,124	9,928	10,058	10,320	10,903	11,676
Time deposits	1,701	2,318	2,542	2,442	2,942	2,579	3,229	2,709	3,155	3,197	3,280	3,465	3,711
Monetary survey													
Net foreign assets	-253	725	880	-547	2,120	-511	2,145	-473	1,792	1,875	2,039	1,839	2,213
Net domestic assets	8,973	11,059	11,659	12,193	11,504	12,783	12,387	13,604	14,000	14,042	14,199	15,276	16,105
Domestic credit	1,112	3,104	3,348	3,968	3,557	4,736	4,194	5,534	7,675	9,290	9,543	10,903	11,831
Credit to government (net)	-5,612	-5,616	-5,910	-5,131	-6,442	-4,663	-6,205	-4,796	-4,147	-3,314	-2,788	-942	-2,601
Credit to the economy	6,725	8,720	9,258	9,099	10,000	9,399	10,399	10,330	11,822	12,604	12,331	11,845	14,432
Other items (net; asset +)	7,860	7,956	8,310	8,226	7,946	8,048	8,193	8,070	6,325	4,752	4,656	4,373	4,274
Of which: discrepancy between central bank and DMBs	386	170	19	134	15	117	-223	100	15	15	15	15	15
Money and quasi money (M2)	8,720	11,785	12,539	11,646	13,624	12,272	14,532	13,131	15,791	15,917	16,238	17,115	18,318
Currency outside banks	1,650	2,174	1,935	1,881	1,975	1,961	2,049	2,298	2,708	2,662	2,638	2,747	2,931
Deposits	7,070	9,611	10,604	9,764	11,649	10,311	12,483	10,833	13,083	13,255	13,600	14,369	15,387
Of which: foreign currency deposits	3,045	4,151	4,736	4,119	5,535	4,205	5,880	4,277	5,891	5,834	5,767	5,836	5,855
(in millions of U.S. dollars)	246	312	326	293	362	295	376	298	370	363	355	348	340
Memorandum items:													
Money growth (12-month percent change)	17.6	35.1	42.0	26.4	47.9	21.9	44.4	15.0	34.0	26.9	19.2	20.0	16.0
Credit to the economy (12-month percent change)	24.4	29.7	34.0	24.1	36.4	19.6	32.3	19.2	35.6	36.1	23.3	22.7	22.1
Currency/M2 (in percent)	18.9	18.4	15.4	16.2	14.5	16.0	14.1	17.5	17.2	16.7	16.2	16.0	16.0
Velocity of money (average)	5.72	5.16						4.90	4.27				4.04

Sources: Bank of Mozambique, and Fund staff estimates and projections.

Table 8. Mozambique: Balance of Payments, 1998-2005
(In millions of U.S. dollars, unless otherwise specified)

	1998	1999	2000		2001	2002	2003	2004	2005
		Rev. Est.	Org. Prog.	Rev. Prog.	Prog.	Proj.	Proj.	Proj.	Proj.
Trade balance	-572.7	-928.9	-844.2	-848.4	-492.1	-488.7	-391.5	-354.0	-329.2
Exports (f.o.b.)	244.6	270.9	250.7	312.6	684.6	735.4	789.9	849.3	910.2
Large projects	34.5	62.9	62.3	121.0	457.6	475.9	494.7	514.2	534.5
Other exports	210.1	208.0	188.4	191.6	227.0	259.5	295.2	335.1	375.6
Imports (c.i.f.)	-817.3	-1,199.8	-1,094.9	-1,161.0	-1,176.7	-1,224.1	-1,181.4	-1,203.3	-1,239.4
Large projects	-87.3	-514.6	-174.4	-203.7	-173.2	-178.6	-184.0	-189.5	-195.0
Other imports	-730.0	-685.2	-920.5	-957.3	-1,003.5	-1,045.5	-997.4	-1,013.8	-1,044.4
Services (net)	-176.3	-275.0	-279.9	-270.6	-369.7	-334.5	-289.5	-278.8	-264.2
Receipts	332.5	353.4	355.0	362.5	353.6	371.3	389.8	409.3	429.8
Expenditures	-508.8	-628.4	-644.9	-633.1	-723.3	-705.8	-679.4	-688.1	-694.0
Of which: interest on public debt	-150.2	-161.6	-160.8	-160.8	-145.9	-132.1	-118.2	-104.9	-93.2
interest on private debt	-13.0	-36.1	-69.7	-70.6	-76.9	-78.3	-73.4	-180.0	-164.9
Current account, excluding grants	-749.0	-1,203.9	-1,124.1	-1,119.0	-861.8	-823.2	-681.0	-632.8	-593.4
Unrequited official transfers 1/	313.2	434.1	369.6	429.3	458.6	490.0	352.0	352.0	352.0
Of which: flood reconstruction relief	0.0	0.0	0.0	59.9	177.9	182.2	0.0	0.0	0.0
Current account, including grants	-435.8	-769.8	-754.5	-689.7	-403.2	-333.2	-329.0	-280.8	-241.4
Capital account	262.8	613.4	262.4	269.8	-8.5	-101.6	-119.3	-113.4	-72.6
Foreign borrowing	299.5	472.0	505.8	548.3	218.2	219.6	219.6	219.6	219.6
Public	218.1	111.7	164.8	117.9	178.6	180.0	180.0	180.0	180.0
Private 2/	81.4	360.3	341.0	430.4	39.6	39.6	39.6	39.6	39.6
Amortization	-249.4	-240.3	-362.9	-362.9	-362.7	-384.8	-406.3	-404.4	-372.3
Public	-211.2	-200.7	-306.5	-306.5	-305.9	-308.6	-316.3	-277.1	-235.4
Private	-38.3	-39.6	-56.4	-56.4	-56.9	-76.1	-90.0	-127.3	-136.9
Direct investment (net)	212.7	381.7	119.5	57.4	60.0	63.6	67.4	71.5	80.0
Bank restructuring	0.0	0.0	0.0	27.0	76.0	0.0	0.0	0.0	0.0
Short-term capital and errors and omissions (net)	-31.4	-86.0	0.0	-58.0	-76.0	0.0	0.0	0.0	0.0
Of which: commercial banks (NFA; increase -)	15.3	-20.4	0.0	-58.0	-76.0	0.0	0.0	0.0	0.0
Overall balance	-204.4	-242.5	-492.1	-477.9	-487.7	-434.8	-448.3	-394.2	-314.0
Financing	204.4	242.5	492.1	477.9	487.7	434.8	448.2	394.2	314.0
Bank of Mozambique (NFA; increase -)	-77.2	-50.7	65.0	0.0	60.0	34.8	60.8	58.8	33.7
Gross international reserves (increase-) 3/	-92.9	-44.4	33.3	-30.6	65.5	35.2	80.6	79.3	61.4
Use of IMF credit (net)	9.6	-2.5	31.7	30.6	-5.5	-0.4	-19.8	-20.6	-27.7
Other (net)	6.1	-3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net change in arrears (increase +)	20.4	-761.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief 4/	261.2	1,054.7	427.2	477.9	427.7	400.0	387.4	335.4	280.4
Debt relief on traditional mechanisms	261.2	1,003.4	320.7	320.8	309.9	297.9	283.4	230.0	175.0
Assistance under the original HIPC Initiative	0.0	51.3	95.7	103.6	98.9	92.7	95.2	96.4	96.2
Assistance under the enhanced HIPC Initiative	0.0	0.0	11.2	17.2	19.0	18.2	17.6	17.9	18.0
Paris Club deferral (flood relief)	0.0	0.0	0.0	36.3	0.0	-8.8	-8.8	-8.8	-8.8
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account deficit (in percent of GDP)									
Before grants	21.3	30.1	26.2	28.5	18.8	16.5	12.6	10.8	9.4
After grants	12.4	19.2	17.6	17.6	8.8	6.7	6.1	4.8	3.8
Gross international reserves	624.9	669.3	611.7	699.9	634.4	599.1	518.5	439.1	377.8
(in months of imports of goods and nonfactor services)	7.0	5.2	5.2	5.7	5.0	4.6	4.0	3.4	2.8
Debt-service ratio 5/									
Before HIPC Initiative assistance (Naples terms)	20.0	26.1	30.4	31.3	20.2	13.4	13.0	12.4	12.2
After original HIPC Initiative assistance	...	15.3	12.0	12.2	8.2	5.7	5.6	5.3	5.4
After enhanced HIPC Initiative assistance	...	...	9.9	4.4	5.8	4.2	4.2	4.0	4.1

Sources: Mozambican authorities; and staff estimates and projections.

1/ In 1999 includes US$150 million of grants provided by IDA as interim assistance under the original HIPC Initiative.

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

3/ Defined as monetary gold, untied foreign exchange deposits, foreign banknotes, and SDRs.

4/ Includes the 1996 Paris Club flow rescheduling on Naples terms; the rescheduling of the debt to Russia after an up-front discount of 80 percent; the 1997 commercial debt rescheduling with the Bank of Brazil; total assistance under the HIPC Initiative; the recent Paris Club deferral; and the application of traditional rescheduling mechanisms by non-Paris Club creditors.

5/ Nonfinancial public sector, in percent of exports of goods and nonfactor services.

Table 9. Mozambique: External Financing Requirements and Sources, 1998-2005
(In millions of U.S. dollars)

	1998	1999	2000 Rev. Prog.	2001 Prog.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
External financing requirements	1,121	2,371	1,600	1,263	1,196	1,026	979	932
Current account, excluding grants	749	1,204	1,119	862	823	681	633	593
Amortization 1/	274	272	392	390	408	426	425	400
Changes in arrears (increase -)	-20	762	0	0	0	0	0	0
Changes in reserves (increase +) 2/	87	48	31	-66	-35	-81	-79	-61
Short-term capital and errors and omissions (net; outflow +) 3/	31	86	58	76	0	0	0	0
Total identified financing	860	1,317	1,122	835	796	639	643	652
Disbursements from existing and new commitments	647	935	1,038	699	732	572	572	572
Grants 4/	313	434	429	459	490	352	352	352
Loans	334	501	608	240	242	220	220	220
Bilateral	0	0	0	0	0	0	0	0
Multilateral 1/	252	140	178	201	202	180	180	180
IDA	133	79	86	78	130	130	130	130
IMF	34	29	60	22	22	0	0	0
Other	85	33	32	101	50	50	50	50
Private sector	81	360	430	40	40	40	40	40
Direct foreign investment	213	382	84	136	64	67	71	80
Debt relief 5/	261	1,055	478	428	400	387	335	280
Debt relief on traditional mechanisms	261	1003	321	310	298	283	230	175
Assistance under the original HIPC Initiative	0	51	104	99	93	95	96	96
Assistance under the enhanced HIPC Initiative	0	0	17	19	18	18	18	18
Paris Club deferral (flood relief)	0	0	36	0	-9	-9	-9	-9
Remaining gap	0	0	0	0	0	0	0	0

Sources: Mozambican authorities; and staff estimates and projections.

1/ Including the Fund.
2/ Excluding the Fund.
3/ Including commercial banks accumulation of net foreign assets (increase +).
4/ Includes IDA interim assistance under the original HIPC Initiative in 1999 (US$150 million).
5/ Includes the 1996 Paris Club flow rescheduling on Naples terms; the rescheduling of the debt to Russia after an up-front discount of 80 percent; the 1997 commercial debt rescheduling with the Bank of Brazil; total assistance under the HIPC Initiative; the recent Paris Club deferral; and the application of traditional rescheduling mechanisms by non-Paris Club creditors.

Table 10. Mozambique: Indicators of Fund Credit, 1998-2010

	Actual		Projections											Averages	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2001-05	2006-10
Debt service to the Fund 1/															
In millions of U.S. dollars	25.1	31.5	30.5	29.0	23.9	20.7	21.2	28.0	34.4	33.7	31.7	24.9	27.3	24.6	30.4
After assistance under the HIPC Initiative		17.7	0.0	2.4	4.6	7.3	7.7	10.8	18.9	23.3	26.3	24.1	27.3	6.6	24.0
In millions of SDRs	18.5	23.5	23.0	21.9	18.0	15.6	16.0	21.1	25.9	25.4	23.9	18.8	20.6	18.5	22.9
After assistance under the HIPC Initiative		13.3	0.0	1.8	3.5	5.5	5.8	8.2	14.2	17.6	19.8	18.2	20.6	4.9	18.1
In percent of exports of goods and nonfactor services	4.7	5.4	4.8	2.9	2.2	1.8	1.7	2.2	2.6	2.5	2.3	1.7	1.8	2.2	2.2
After assistance under the HIPC Initiative		3.0	0.0	0.2	0.4	0.6	0.6	0.8	1.4	1.7	1.9	1.7	1.8	0.6	1.7
In percent of debt service of nonfinancial public sector	24.1	21.5	17.7	17.5	14.8	12.4	12.6	15.7	18.2	17.2	15.6	12.4	12.8	14.6	15.2
After assistance under the HIPC Initiative		20.7	0.0	5.1	9.0	13.4	14.1	18.0	27.8	31.1	32.2	28.1	28.1	11.9	29.5
In percent of debt service to multilaterals	41.0	44.5	40.7	40.8	36.5	31.8	31.2	39.3	49.3	50.7	49.3	44.4	51.0	35.9	48.9
After assistance under the HIPC Initiative		44.9	0.0	33.6	44.9	52.3	50.5	71.4	137.7	161.7	175.4	137.9	158.0	50.6	154.1
In percent of gross international reserves	4.0	4.7	4.4	4.6	4.0	4.0	4.8	7.4	8.3	7.9	7.2	5.5	6.0	5.0	7.0
After assistance under the HIPC Initiative		2.7	0.0	0.4	0.8	1.4	1.7	2.9	4.5	5.5	6.0	5.4	6.0	1.4	5.5
Memorandum items:															
Gross Fund financing															
In millions of U.S. dollars	34	28	60	22	22	0	0	0	0	0	0	0	0	9	0
In millions of SDRs	25	21	45	17	17	0	0	0	0	0	0	0	0	7	0
In percent of Mozambique's financing needs 2/	3	1	4	2	2	0	0	0	0	0	0	0	0	1	0
Fund credit outstanding															
In millions of U.S. dollars	200	194	224	218	218	198	178	150	117	84	52	27	0	192	56
In millions of SDRs	147	145	168	164	164	149	134	113	88	63	39	21	0	145	42
In percent of quota	175	128	148	145	144	131	118	100	77	55	35	18	0	128	37
In percent of exports of goods and services	38	33	35	22	20	17	15	12	9	6	4	2	0	17	4
In percent of total debt outstanding	3	3	4	4	4	3	3	3	2	2	1	1	0	3	1
U. S. dollar per SDR exchange rate	1.356	1.337	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327	1.327

Sources: Mozambican authorities; and staff estimates and projections.

1/ Existing and prospective obligations.

2/ Gross financing needs are defined as the sum of the current account deficit before grants, amortization of medium- and long-term debt, repayment to the Fund, reduction in payments arrears, targeted accumulation of gross assets of the central bank, and short-term capital and errors and omissions.

December 1, 2000

Dear Mr. Köhler:

1. The Executive Board of the Fund approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Mozambique on June 28, 1999. The purposes of this letter and attached memorandum of economic and financial policies are to inform you of the progress in implementing the first-year economic program; to set out the objectives and policies that the government of Mozambique intends to pursue during the program period; and to request that the third loan under the arrangement in an amount equivalent to SDR 8.4 million be disbursed following the completion of the second review under the arrangement.

2. The government of Mozambique will provide such information as the Fund requests in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

3. The government of Mozambique believes that the policies and measures set out in the attached memorandum are adequate to achieve the objectives of its program; it will take any further measures that may become appropriate for this purpose. During the remaining period of the three-year PRGF arrangement, Mozambique will continue to consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation. Moreover, after the period of the three-year PRGF arrangement and while Mozambique has outstanding financial obligations to the Fund arising from loans under the arrangement, the government will consult with the Fund from time to time, at the initiative of the government or whenever the Managing Director requests consultation on Mozambique's economic and financial policies.

4. The government of Mozambique will conduct with the Fund the third review of the three-year PRGF arrangement not later than end-April 2001, based on quantitative and structural performance criteria for end-December 2000 and end-March 2001, respectively.

Sincerely yours,

/s/
Luisa Dias Diogo
Minister of Planning and Finance

/s/
Adriano Afonso Maleiane
Governor
Bank of Mozambique

Attachment

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Memorandum of Economic and Financial Policies of the Government of Mozambique for 2000–01

I. Recent Developments and Medium-Term Context

1. The government of Mozambique presents this memorandum in support of its request for the third loan disbursement under the Poverty Reduction and Growth Facility (PRGF) arrangement for Mozambique approved by the Executive Board of the Fund on June 28, 1999. The economic and financial policies and related structural reforms described in this memorandum are intended to secure the stable macroeconomic framework that is critical to the successful implementation of the government's poverty reduction strategy. This strategy is published in the government's interim poverty reduction strategy paper (PRSP) of March 2000, which incorporates in full the National Action Plan for the Reduction of Absolute Poverty (PARPA) developed in the course of 1999. The strategy is being further developed as part of the preparation of the full PRSP, expected to be completed by end-March 2001, in consultation with civil society and donors.

2. Implementation of the first-year program under the current PRGF arrangement was marred by the devastating floods that hit Mozambique in early 2000. Although the resettlement of the displaced population is proceeding well, some critical flood-related bottlenecks persist, particularly in the transportation system, and reconstruction has only recently gathered speed. As a result, the government had to revise the expected rate of economic growth in 2000 from 6 percent in the immediate aftermath of the floods to less than 4 percent.

3. Despite the large burden of flood reconstruction facing the country, the conditions of program implementation in the first half of 2000 remained such that all quantitative performance criteria and benchmarks under the program were observed. The two structural performance criteria relating to a review of the system of tax and customs exemptions and to the publication of quarterly budget execution reports were also observed. However, a rapid monetary expansion over the past year has required a reorientation of monetary policy. In addition, in response to problems in two commercial banks with minority government shareholding, the government has acted decisively to bring about their restructuring and recapitalization.

4. The PRGF-supported program is part of Mozambique's medium-term development strategy, which is described in the Government Program for 2000–04, the interim PRSP, and a medium-term expenditure framework. The government's four medium-term objectives are (i) the reduction of absolute poverty; (ii) the attainment of high and sustainable growth through the creation of an enabling environment for the private sector; (iii) the reduction of regional inequalities; and (iv) the consolidation of peace, national unity, and democracy. Achievement of these objectives will be supported inter alia by the maintenance of a stable macroeconomic environment, public sector reform, and safeguards for freely functioning

domestic financial markets. The medium-term strategy has been translated into an annual budget and report on the social and economic program, which is being debated in the National Assembly.

5. The government recognizes the key role of good governance for the quality of public sector service delivery and the overall business and investment climate. Although the formulation of a strategic plan for the judicial system will be delayed, a comprehensive legal reform remains an important item on the government's medium-term agenda. Meanwhile, a number of concrete measures will be adopted over the next few months to strengthen controls and accountability in public administration. These steps include the renewal of the State Inspectorate's staff; the adoption of regulations to the Ethics Law, requiring, inter alia, the periodic disclosure of senior government officials' personal financial situation to the Supreme Court; and the dissemination of guides describing citizens' basic rights and rules in their dealings with public officials.

II. Program for the Period July 2000–June 2001

6. The objective of the program for 2000–01 is to establish the conditions for a recovery of economic growth to levels achieved in the years prior to the floods and to make this growth more pro-poor. The program period marks the first full year in which debt relief is flowing under the original and the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative). The government welcomes the important debt relief granted under the HIPC Initiative and considers it to be essential for the successful implementation of the country's poverty reduction strategy. At the same time, the government faces the continuous challenge of improving its planning, budgeting, and reporting systems to facilitate the execution of specific expenditure programs.

7. The government has recently set in motion important reforms in the tax system. A first set of measures in the area of tax incentives has been already implemented, based on the recommendations of two recent technical assistance studies charged with reviewing the system of tax and customs exemptions (one mission from the Fund in June 2000). The measures included the following: (i) establishment of a management unit in the tax directorate (DNIA) to analyze, coordinate, and follow up on the granting of all domestic tax incentives; (ii) adoption of procedures to require a technical opinion from the tax and customs directorates before granting exemptions for new investment projects; (iii) adoption of a decree limiting the special regime of industrial free zones to groups of enterprises or large projects in a demarcated geographical area, in order to better enforce customs control of the inflows and outflows of goods and services; (iv) adoption of a decree requiring the posting of a guarantee before granting tax incentives to rent-a-car activities; and (v) adoption of a decree setting up regulations and enforcement procedures allowing the tax and customs directorates to control and audit goods in domestic circulation. Beyond these administrative improvements, the government is proceeding with a rationalization of tax and customs exemptions that will include the preparation of a new code of fiscal incentives for investment, the renegotiation of permanent exemptions granted in the past to enterprises, and a reduction of miscellaneous other exemptions. After first adopting some basic principles for

the new incentive system by the end of 2000, a new code of fiscal incentives for investment will be drafted by mid-May 2001. In addition to aiming at greater effectiveness, the changes in fiscal incentives under this new code are expected to result in a net revenue gain in 2002 of about 1 percent of GDP; overall, the intended rationalization of tax and customs exemptions is expected to yield a full-year net revenue by 2003 of 1.5 percent of GDP. Finally, the government is envisaging a comprehensive reform of direct taxes, including the streamlining of income and profits taxes, the effective establishment of a tax court (*Tribunal Fiscal*), and a review of the appeals procedures (*contencioso tributário*).

8. In parallel with its efforts to reform tax policy, the government is also engaged in overhauling tax administration. In the area of the value-added tax (VAT), the government is simplifying refund procedures, intensifying the public information campaign, and strengthening audit capacities. In addition, the government is preparing to create a new career stream for tax administration and to set up a special section within the tax directorate to handle tax collection, audits, and control with respect to large taxpayers. Finally, in line with reforms of the tax and customs directorates, the government is taking steps to create a central revenue authority within the next three to five years that would integrate the tax and customs directorates into an autonomous entity.

9. In line with its poverty reduction strategy and its reconstruction program, the government has budgeted increases in noninterest current expenditure from 11.9 percent of GDP in 1999 to 13.4 percent in 2000 and 14.5 percent in 2001, and in capital expenditure from 11.8 percent of GDP in 1999 to 13.4 percent in 2000 and 13.8 percent in 2001. About two-thirds of the cumulative expenditure increase will be channeled into education, health, infrastructure, agriculture, and social action. Expenditure will also increase as a result of the government's contribution to the recapitalization and restructuring of two commercial banks (paragraph 12); this contribution will likely amount to Mt 2,200 billion and will be mostly financed by issuing marketable public debt. To facilitate the restructuring of the cashew processing industry (paragraph 13), the government expects to transfer about Mt 100 billion to various companies to pay for accumulated liabilities to the labor force before the end of this year. A higher-than-expected increase of 16 percent in wages this year will not affect the primary deficit, as the effective date of the increase was deferred by three months from April to July 2000. In 2001, the wage bill will increase by 34 percent, reflecting in large part the hiring of new teachers, nurses, and police officers at more competitive salaries and the full-year effect of the wage increase granted in mid-2000.

10. The publication of quarterly budget execution reports begun this year constitutes a major step in improving public accountability, but the government recognizes that much remains to be done in this area. The recent fiscal transparency assessment carried out by the Fund and approved by the government underlined weaknesses in specific areas of public expenditure management. In this regard, the government has initiated a reform of the public expenditure management system that envisages: (i) submitting a new public accounting law to the National Assembly by end-March 2001 that regulates all stages of expenditure, including commitment and verification; (ii) including all extrabudgetary activities in the budget in order to comply with standard budget procedures; (iii) improving the public

accounting system by recording and reporting on each major step in the spending process (allocation, commitment, verification, and payment); (iv) improving the budget classification system in order to track program-based expenditures; and (v) strengthening audit and reporting systems by staffing and training internal and external control units and expanding computing capabilities for budget execution. In the effort to implement such a reform, the government is seeking technical assistance from the Fund, as well as from the World Bank for a public expenditure review. Aware of the immediate need to track poverty-related expenditures, the government has decided to implement a simplified interim control system to monitor such spending. Based on current budget procedures, and with a specific expenditure classification, the interim system will report actual expenditures on programs specified in the PARPA in comparison with the respective budgetary allocation. Information on these programs will be included in the quarterly budget execution report, beginning with the first quarter of 2001.

11. In the light of the recent rapid expansion in monetary aggregates and in order to avoid fueling inflationary expectations, the monetary program seeks to limit broad money growth to 34 percent in 2000 and 16 percent in 2001—an objective that is consistent with reducing the 12-month rate of inflation to about 7 percent by end-2001 and will still leave room for a healthy expansion of bank credit to the private sector. The Bank of Mozambique has moved toward a tighter monetary stance by intensifying the placement of treasury bills in the money market, strictly enforcing statutory reserve requirements, and setting interest rates on its liquidity support credits (*facilidade permanente de cedência*, FPC) above the treasury bill rate. Thus, over the past two months, the FPC rate was raised from 16 percent to 23 percent, and is now higher than the treasury bill rate. As a result of these actions, the interbank money market rate rose from 17 percent in August to 23 percent in mid-November. Open market operations will continue to gain significance as a tool for monetary management. In light of the need for tighter monetary control, the Bank of Mozambique intends to monitor closely the supply of reserve money as an important and early indicator of money and credit growth. The Bank of Mozambique intends to introduce a computerized clearing system by end-June 2001.

12. The Bank of Mozambique has recently obtained greater clarity on the financial situation of the two commercial banks with minority government ownership that have continued to experience problems since their majority privatization in 1996-97. This diagnosis has revealed an urgent need for higher loan loss provisions and recapitalization. For its part, the government is prepared to recapitalize these banks in proportion to its shareholding. In the case of the Banco Comercial de Moçambique (BCM), the government recently obtained the commitment of the private shareholder to do likewise and to begin implementing a restructuring plan that will be tightly supervised by the Bank of Mozambique and that will include a strengthening of management. In the case of the Banco Austral (BA), the shareholders agreed in mid-October 2000 to (i) alleviate the immediate liquidity shortage through the extension of soft loans, (ii) commission a financial due diligence review by end-November 2000, and (iii) decide by mid-December 2000 on the amount and modalities of recapitalization and on a recovery strategy for the bank. The shareholders further directed the BA's management to provide all necessary information to the auditors undertaking the due

diligence review. Meanwhile, the Bank of Mozambique has put into place a series of safeguard measures requiring the BA to (i) limit the granting of loans to the amount resulting from the recovery of loans already granted; (ii) report weekly to the central bank on the evolution of the bank's situation; (iii) report daily to the central bank on the bank's cash flow; and (iv) seek the Bank of Mozambique's consent for the disposal of any assets, the releasing of any collateral, the amending of any agreements with third parties, the extension of any guarantees, or the incurrence of any other contingent liabilities. The government expects the necessary capital injection to be paid up, in the case of the BCM, mainly in the fourth quarter of 2000, with the balance in the first quarter of 2001, and, in the case of the BA, in the first quarter of 2001. The share of the government will be paid pari passu with the private shareholders' part. Closure on the recapitalization operation for the BCM and BA will constitute a performance criterion for end-March 2001. To accompany this restructuring operation and safeguard the stability of the banking system, the Bank of Mozambique will strengthen its supervision department.

13. The government is making progress in addressing the problems of the cashew sector. Thus, the government has accepted in principle the liquidation of several nonviable processing plants. It has also decided that the export tax on raw cashew nuts remain at 18 percent for the coming crop year, and that acceptable modalities for the first-right-to-purchase—granted by the law to local processors—be worked out by the exporters and processors themselves under the auspices of the Cashew Institute. The government has also endorsed the Cashew Institute's recent master plan for the promotion of farm production of cashew nuts. Acting on the recommendations of a recent study by the Food and Agriculture Organization (FAO) for the sugar sector in Mozambique, the government has decided to maintain the level of import protection for sugar granted in September 1999, and it will review this policy annually based on domestic and international sugar market developments.

14. The government ratified the Southern African Development Community (SADC) trade protocol in December 1999 and agreed with its partners on certain amendments to the protocol in August 2000; it has until end-February 2001 to deposit its implementation documents. The government is adhering to its stated intention to reduce the top tariff rate from 30 percent to 25 percent by January 2002.

15. The Bank of Mozambique has taken steps to improve the functioning of the foreign exchange market and encourage interbank trading of foreign exchange. Specifically, to improve the signal effect of its published rate, the Bank has begun to publish daily the weighted-average buying and selling rates for the U.S. dollar calculated from all transactions of commercial banks and exchange houses with their clients. At the same time, the Bank has ceased to publish the average interbank rate and is itself trading foreign exchange with commercial banks at the market rate. Furthermore, the Bank of Mozambique has ceased to advertise the inflow of foreign donor assistance, which had been interpreted by the private sector as a sign of availability of foreign exchange from the central bank. It also has begun to publish regularly a set of monetary indicators to enhance confidence in the currency.

16. Despite the very large financing requirements, including those caused by expenditures associated with the recent floods, the program for this year is fully financed through a balanced mix of grants, concessional borrowing, assistance under the HIPC Initiative, and the government's own resources. Recognizing the exceptional nature of the large amount of external financing made available by the international community to Mozambique, including in the form of external debt and flood relief, the government is firmly committed to saving any amount that should not find an early effective use. The Bank of Mozambique has transferred to the government all HIPC Initiative assistance delivered by the IMF and accrued since the beginning of 2000, and is now transferring this part of HIPC Initiative debt relief to the budget on a regular basis. The government is finalizing delivery agreements with the remaining multilateral creditors for actual delivery of assistance under the original HIPC Initiative, and is continuing to seek non-Paris Club creditors' participation in the original and enhanced HIPC Initiatives. A renewed request for such assistance was recently sent to all creditors.

17. In order to prevent the recurrence of debt problems, the government is continuing to strengthen its debt-management capacity. It has recently updated its information technology system to manage the external debt database. In preparation for the completion point under the enhanced HIPC Initiative, the government will prepare detailed projections for debt service and HIPC Initiative assistance as a basis for budgetary and economic planning. In this context, the government will also conduct a comprehensive assessment of the private sector's external indebtedness aimed at identifying short- and medium-term vulnerabilities in the sector's external position.

18. The government remains committed to fulfilling the conditions for the HIPC Initiative completion point, including the preparation of a full PRSP, by March 2001. A consultation strategy, monitoring strategy, and draft policy matrix have been prepared, and action plans have been drawn up to put these strategies into effect. A number of growth studies are under way and will be integrated into the policy matrix. Provincial governments are now developing decentralized, participatory poverty reduction strategies, and local development plans have been drawn up in some provinces. The government has organized some consultations on the PRSP at provincial and central levels, with civil society groups and donors. A consultation unit is shortly to be established to organize future activities set out in the consultation strategy. This unit will be attached to the PRSP technical working group, with representation from the government, donors, civil society groups, and the private sector. To date, progress with the preparation of PRSP costings and tracking of HIPC Initiative-related expenditure has been slower than originally intended, but the government recognizes the need for accountability to its citizens and the international community with respect to the use of HIPC Initiative debt relief.

19. During the period of the PRGF-supported program, the government will not impose or intensify restrictions on payments and transfers for current international transactions; will not introduce multiple currency practices; will not conclude bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement; and will not

impose or intensify import restrictions for balance of payments reasons. Furthermore, the government will not incur any new external payments arrears, except on payments that are subject to debt-rescheduling negotiations.

III. Program Monitoring

20. The quantitative performance criteria and benchmarks that will be used to evaluate the implementation of the financial program, as well as the test dates on which such evaluation will take place, are shown in Table 1 of this memorandum, with further definitions and explanations contained in a technical memorandum of understanding annexed to this memorandum. The first five quantitative targets represent key financial objectives of the program, the next two will help to maintain a sustainable external debt position, and the last one is intended to protect Mozambique's external creditworthiness. A number of structural performance criteria and benchmarks, drawn from this memorandum, are shown in Table 2. The government understands that its ability to request disbursement of the fourth loan under the three-year PRGF arrangement will be contingent upon the observance of the quantitative performance criteria for end-December 2000 set out in Table 1 and the structural performance criteria set out in Table 2, and the completion of the third review of the program, which is expected to take place by the end of April 2001.

Table 1. Quantitative Performance Criteria and Benchmarks
Under the PRGF Arrangement, July 2000-June 2001 (End of Period)

	2000		2001	
	June Actual	December Performance Criteria	March Benchmarks	June Performance Criteria
	(In billions of meticais)			
Central government domestic primary deficit (ceiling) 1/ 2/ 3/	1,026	4411	2,035	3,031
Central government revenue (floor; benchmark only) 2/	3,321	7,471	1,893	3,902
Stock of net domestic assets of the Bank of Mozambique (ceiling) 4/ 5/ 6/	4,009	5,827	6,046	6,229
Stock of reserve money (ceiling; benchmark only) 6/	3,211	4,171	4,130	4,133
	(In millions of U.S. dollars)			
Stock of net international reserves of the Bank of Mozambique (floor) 7/	480	469	454	444
New nonconcessional borrowing contracted or guaranteed by the government or the Bank of Mozambique with maturity of more than one year (ceiling) 2/	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 8/	0	0	0	0
External payments arrears (ceiling) 2/ 9/	0	0	0	0
Memorandum item:				
Foreign program assistance (grants and loans) 2/	98	178	82	139

1/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.
2/ Cumulative from the beginning of the calendar year.
3/ The performance criterion for end-December 2000 will be adjusted downward to the extent that the locally financed cost of bank recapitalization/restructuring in 2000 is lower than Mt 1,351 billion.
4/ Defined as reserve money minus net foreign assets of the Bank of Mozambique. The foreign currency component of reserve money and the net foreign assets are valued at program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term liabilities.
5/ To be adjusted upward/downward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item.
6/ To be adjusted downward to the extent that eligible bank reserves fall short of 7.95 percent of deposits in commercial banks at the end of each quarter.
7/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item.
8/ Loans of 0-1 year's maturity, excluding normal import-related credit. Non-U.S. dollar debt converted to U.S. dollars at actual exchange rates.
9/ Continuous performance criterion; excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

Table 2. Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, October 2000-June 2001

Actions	Date of Implementation (End of period)
Tax policy and administration	
Approve the legal basis for the creation of a special section within the tax directorate to handle tax collection, audits, and control with respect to large taxpayers.	March 2001
Draft new code of fiscal incentives for investment.	May 2001
Prepare a plan for the creation of a central revenue authority.	June 2001
Fiscal accountability	
Submit a new public accounting law to the National Assembly that regulates all stages of expenditure, including commitment and verification (**performance criterion**).	March 2001
Include in quarterly budget execution reports (beginning with first quarter of 2001) information on budgetary allocations and actual expenditures on programs specified in the PARPA.	May 2001
Financial sector	
Recapitalization and restructuring of Banco Comercial de Moçambique (BCM) and Banco Austral (BA):	
• obtain shareholders' commitment to recapitalize and restructure the BA; and	December 2000
• complete the recapitalization of the BCM and BA (**performance criterion**).	March 2001
Introduce computerized clearing system.	June 2001

Technical Memorandum of Understanding
On Selected Concepts and Definitions
Used in the Monitoring of the Second-Year PRGF Program

December 1, 2000

The purpose of this technical memorandum of understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of the second year of the Poverty Reduction and Growth Facility (PRGF)-supported program, including:

- Central government domestic primary deficit;
- Central government revenue;
- Net domestic assets, net international reserves, and reserve money of the Bank of Mozambique;
- New nonconcessional borrowing contracted or guaranteed by the government or the Bank of Mozambique with a maturity of more than one year;
- Short-term external public debt outstanding;
- External payments arrears;
- Foreign program assistance

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

Central government domestic primary deficit

The central government domestic primary deficit is defined as central government revenue, **less** noninterest current expenditure, **less** locally financed capital expenditure, **less** locally financed net lending. The latter is derived as gross lending to enterprises through *acordos de retrocessão* (excluding *acordos de retrocessão* that were required by donors), **plus** food aid disbursed, but not collected in the period, **minus** repayments by enterprises of loans obtained through *acordos de retrocessão* and through refinancing agreements with the Bank of Mozambique, **minus** food aid collected, but not disbursed, in the period, **plus** the cost of bank recapitalization/restructuring.

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

Central government revenue, expenditure, and financing

Revenue is defined to include all receipts of the National Directorate of Taxes and Audit (*Direcção Nacional de Impostos e Auditoria*, DNIA), the National Directorate of Customs (*Direcção Nacional de Alfândegas*, DNA), and the net receipts from privatization received by the National Directorate of State Assets (*Direcção Nacional do Património do Estado*).

For the purposes of program monitoring, revenue is considered as collected at the time when revenue is received by the DNIA from private agents or other government collecting agencies in cash, check, or through transfer into a DNIA bank account.

Expenditure is defined as government outlays transferred from Treasury accounts to other government accounts or private sector accounts and includes spending reported to the National Directorate of Public Accounting (*despesas liquidadas*) and any further Treasury advances (*operações de Tesuoraría*) that have been transferred out of Treasury accounts but whose use is not yet reported to the National Directorate of Public Accounting. Any expenditure arrears will be treated like expenditure for the purpose of monitoring the ceiling on the domestic primary deficit.

For program monitoring purposes, expenditure carried out in the current budget year but accounted for as expenditure under the previous budget (*período complementar*) is treated as spending during the current budget year.

The **financing** of the budget deficit is measured as transfers into treasury accounts and from these accounts to accounts of the institutions included in the central government, as defined above, and private sector accounts. All treasury accounts held at the central bank are being monitored for purposes of measuring the financing of the budget deficit. There are no treasury accounts outside the central bank.

Any discrepancy between the overall deficit (revenue less expenditure, as defined above) and its financing will be included as "unallocated revenue/expenditure" in the budget balance.

Net domestic assets

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

The central bank's foreign currency-denominated assets and liabilities are converted in its balance sheet to meticais at actual exchange rates. For purposes of program monitoring, these amounts are converted into U.S. dollars at the agreed program exchange rate.

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

Net international reserves

Net international reserves are defined as reserve assets **minus** reserve liabilities. The BM's reserve assets include: (i) monetary gold; (ii) holdings of SDRs; (iii) reserve position at the IMF; (iv) holdings of foreign exchange; and (v) claims on non-residents, such as deposits abroad. 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: (i) all short-term foreign exchange liabilities to non-residents with original maturity of up to and including one year; and (ii) all liabilities to the IMF.

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

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

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

Stock of short-term external public debt outstanding

The government will not contract or guarantee external debt with original maturity of less than one year. This performance criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are short-term import-related trade credits.

External payments arrears

The government undertakes not to accumulate payment arrears on external government debt with original maturity of one year or more owed or guaranteed by the government, with the exception of external payments arrears arising from government debt in the process of being renegotiated with creditors, including Paris Club creditors.

Foreign program assistance

Foreign program assistance is defined as grants and loans received by the Ministry of Planning and Finance through BM accounts.

Adjustors

The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) for any excess (shortfall) of foreign program assistance.

The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted upward (downward) for any shortfall (excess) of foreign program assistance.

The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted downward to the extent that eligible bank reserves fall short of 7.95 percent of resident deposits in commercial banks, excluding government-earmarked funds (*fundos consignados*), at the end of each quarter.

The ceiling on the central government's domestic primary deficit for end-December 2000 will be adjusted downward to the extent that the locally financed cost of bank recapitalization/restructuring in 2000 is lower than Mt. 1,351 billion.

Mozambique: Relations with the Fund
(As of October 31, 2000)

Membership Status:

Joined 9/24/84; Article XIV

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

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

Outstanding purchases and loans:	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/ Poverty Reduction and Growth Facility (PRGF) arrangements	166.11	146.2

Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR Million)
ESAF/PRGF	06/28/1999	06/27/2002	87.20	45.20
ESAF	06/21/1996	06/27/1999	75.60	75.60
ESAF	06/01/1990	12/31/1995	130.05	115.35

Projected Obligations to the Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	10/31/2000	2000	2001	2002	2003	2004
Principal	0	6.0	21.0	17.1	14.8	15.3
Charges/interest	0	0.4	0.8	0.7	0.6	0.5
Total		6.4	21.8	17.8	15.4	15.8

Exchange Arrangements

The exchange rate for Mozambique's currency, the metical (plural: meticais) is market determined. Commercial banks may buy foreign exchange from, and sell to, individual customers on a freely negotiable basis. The Bank of Mozambique publishes daily a representative exchange rate in the form of the weighted average rate of all licensed operators' transactions with the public of the previous day. As of end-October 2000, this rate was Mt 16,244 per U.S. dollar. Mozambique has expressed the intention to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement in the near future. In this regard, a detailed examination of the exchange system is being conducted in collaboration with the Fund staff. It is expected that Mozambique will formally accept the obligations of Article VIII, Sections 2, 3, and 4 following resolution of a few outstanding issues in this regard.

Article IV Consultation

Mozambique is on the standard 12-month cycle for Article IV consultations. The 1999 Article IV consultation was completed by the Executive Board on June 28, 1999 (EBS/99/96; 6/14/99).

In considering the staff report, Executive Directors were pleased that Mozambique's economic performance had remained strong in 1998, as evidenced by double-digit economic growth, the stability of prices and of the exchange rate, and a comfortable level of foreign exchange reserves. Noting that the authorities' sustained commitment had been a key determinant of that performance, Directors commended their adherence to stability-oriented macroeconomic policies and to their program of structural reforms.

Directors endorsed the authorities' economic program and the medium-term policy framework, which would be supported by a new three-year ESAF arrangement. Directors noted the low level of domestic savings and Mozambique's resultant heavy reliance on external assistance. They were encouraged by the authorities' intention to reduce this reliance over time, in part through a strengthening of the fiscal position.

Regarding fiscal developments in 1998–99, Directors viewed the increase in the domestic primary budget deficit as the result of desirable policies to improve the tax system, stimulate the private sector, and strengthen public administration. At the same time, they emphasized that care would need to be taken not to jeopardize fiscal discipline in the medium term. Directors therefore stressed the need to raise revenue collection by continuing the efforts to strengthen tax administration and reduce exemptions.

Resident Representative

Mr. Schwidrowski has been Resident Representative since October 25, 1999.

IMF Technical Assistance, 1996–2000

Departments	Timing	Form	Purpose	Counterparts
Statistics	February 1996	Mission	Monetary statistics	Bank of Mozambique
	July-August 1997	Mission	Monetary statistics	Bank of Mozambique
	January 1999	Regional seminar	Monetary and financial statistics	Participants from Bank of Mozambique, Ministry of Planning and Finance
	April-May 1999	Mission	Balance of payments	Bank of Mozambique
Fiscal Affairs	April 1996	Mission	Value-added tax (VAT) preparation	Ministry of Finance
	July 1996	Mission	Tariff reform	Ministry of Finance
	December 1996	Mission	Customs administration, VAT	Ministry of Finance
	May 1997	Mission	Customs administration, VAT	Ministry of Finance
	1996-99	Long-term consultant	Implementation of customs reform program	Ministry of Finance
	1997-99	Long-term consultant	VAT preparation	Ministry of Finance
	March 1998	Mission	VAT preparation	Ministry of Finance
	July 1998	Mission	VAT preparation	Ministry of Finance
	Oct.-Dec. 1998	Mission	VAT preparation	Ministry of Finance
	February 1999	Mission	VAT preparation and customs reform	Ministry of Finance
	June 2000	Mission	Rationalization of tax incentives	Ministry of Finance
	June 2000	Mission	Code of Good Practices on Fiscal Transparency	Ministry of Finance
	September 2000	Mission	Review of VAT implementation	Ministry of Finance
Monetary and Exchange Affairs	Since September 1998	Long-term consultant	Banking supervision	Bank of Mozambique
	Jan.-Feb. 1999	Mission	Payments system and foreign exchange management	Bank of Mozambique
	May 1999	Mission	Foreign exchange management	Bank of Mozambique
	June 1999	Mission	Payments system	Bank of Mozambique
	June 2000	Mission	Bank restructuring	Bank of Mozambique
IMF Institute	June 1999	Regional course	Financial programming and policies	22 Mozambican participants

Mozambique: Relations with the World Bank Group

The World Bank has supported Mozambique's reform efforts through 31 investment credits and 7 adjustment operations. Currently, the Bank's active portfolio consists of 16 investment projects totaling about US$768 million, of which about US$462 million had yet to be disbursed as of August 31, 2000. The latest Bank adjustment operation, its sixth, is the Economic Management Reform Operation (EMRO). The EMRO was approved in December 1998 as a US$150 million grant and disbursed in 1999 as part of the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) interim measures. A new Country Assistance Strategy was finalized and approved in June 2000. The broad elements of the strategy include (i) promotion of private sector-led growth; (ii) capacity building and human resource development; and (iii) the strengthening of development partnerships. The World Bank's portfolio has been restructured, and new lending over the next three years will focus on agriculture, education, and infrastructure. Following the floods and cyclones that hit Mozambique in February and March 2000, the Bank approved in April 2000 a US$30 million Flood Emergency Recovery Project to help the government of Mozambique maintain macroeconomic stability as it finances critical imports necessary for the country's reconstruction efforts.

To strengthen capacity for policy analysis, economic management, and project implementation in Mozambique, economic and sector work was devoted in 1991 to issues of public sector pay and employment, training, decentralization to provincial and district levels, and capacity building. A second public expenditure review in 1992 addressed the composition and phasing of the investment budget, and the balance between recurrent and investment expenditure. Issues concerning mobilization of counterpart funds were reviewed in 1991 and early 1992. In 1992, a financial sector study and education sector review were completed. In early 1993, a joint Bank/donor mission looked at issues related to import support funds. Economic work in 1993–94 focused on the government's transition from an emergency situation to sustainable development. In 1994, a study on the impediments to industrial recovery and exports was carried out, and a country environmental strategy was produced. The World Bank, along with other donors, also assisted the government in the preparation of integrated investment programs in the roads and health sectors. In 1996, the Bank commenced a fiscal management review process with the government that has supported budgetary reform. In 1998, this effort focused on developing a medium-term fiscal framework. The Bank has assisted the government in developing sector-specific programs in education and agriculture. World Bank credits in support of the education sector program and of the agriculture sector program were approved by the Bank's Board in February 1999. In addition, the Bank is assisting the government in its public sector reform program and is finalizing a growth prospects study. A public expenditure review will be launched before end-2000. According to the Country Assistance Strategy (CAS) base scenario, the next Bank-supported adjustment operation is planned for FY2002. Also, the Bank has been providing technical assistance with respect to banking supervision, capacity building, the development of transit corridors, gas exploitation, and statistical issues.

World Bank Loan and Grant Operations, 1985-2000

Sector	Board Approval Date	Original Credit Amount	Cancellations	Disbursed as of 6/30/00	Percent Disbursed as of 6/30/00
		(Millions of U.S. dollars)			
Adjustment operations					
First import rehabilitation	6/85	45.0	0.3	55.6	123.5
Second import rehabilitation	8/87	70.0	0.1	72.7	103.9
Second import rehabilitation	8/87	18.6	0.5	18.8	100.9
Third import rehabilitation	5/89	90.0	1.0	91.2	101.4
Economic recovery credit	6/92	180.0	0.0	188.3	104.6
Second economic recovery credit	6/94	200.0	0.0	208.3	104.2
Third economic recovery credit	2/97	100.0	0.0	94.3	94.3
Economic Management Reform Operation 1/	12/98	150.0	0.0	150.0	100.0
Energy					
Energy TA/rehabilitation	5/87	20.0	1.6	20.1	100.4
Household energy	6/89	22.0	2.2	21.3	96.9
Gas engineering	6/94	30.0	0.0	21.9	73.0
Urban					
Urban rehabilitation	8/88	60.0	7.2	53.7	89.5
Local govt. reform/engineering	6/93	23.2	5.0	13.6	56.6
National water II	6/99	75.0	0.0	1.0	1.3
National water I	2/98	36.0	0.0	4.3	11.9
Social sectors					
Education and manpower development	5/88	15.9	0.1	16.3	102.7
Health and nutrition	3/89	27.0	0.0	30.2	111.9
Education II	12/90	53.7	0.0	53.9	100.4
Capacity building: Human Res. Dev.	11/92	48.6	0.0	40,2	82.7
Capacity building: public sector and legal inst. development	11/92	15.5	2.9	12.3	79.4
Food security	4/93	6.3	1.3	4.0	63.5
Health sector recovery	11/95	98.7	0.0	36.0	36.5
General education	2/99	71.0	0.0	1.3	1.8
Transport					
Transport rehab. (Beira Corridor)	9/89	40.0	12.8	30.2	75.4
Roads and Coastal Shipping I	6/92	74.3	0.0	73.5	98.9
Maputo corridor revitalization	1/93	9.3	0.0	5.9	62.9
Roads and Coastal Shipping II	4/94	188.0	0.0	138.1	73.5
Railway and port restructuring	10/99	100.0	0.0	0.9	0.9
Coastal and marine biodiversity	6/00	5.6	0.0	0.0	0.0
Industry and finance					
Industrial enterprise restructuring	12/89	50.1	0.0	51.4	102.6
Small/medium scale ent. dev.	12/89	32.0	3.4	32.0	100.1
Enterprise development	1/00	26.0	0.0	0.0	0.0
Public sector management					
Economic/financial management TA	10/89	21.0	0.6	22.9	109.0
Financial sector capacity building	4/94	9.0	0.0	8.1	90.0
Agriculture					
Agric. rehab./development	9/90	15.4	9.7	6.3	40.8
Agric. serv. rehab./development	2/92	35.0	12.3	17.0	48.6
Rural Rehabilitation	3/93	20.0	0.0	19.2	96.0
Agricultural sec. PEP	2/99	30.0	0.0	0.6	2.0
Other					
Emergency reconstruction credit	4/00	30.0	0.0	0.0	0.0
Total of all credits and grants		2,142.2	64.6	1,615.4	75.4

Memorandum items:
- Disbursements in FY 1993 (July 1, 1992-June 30, 1993) US$128.4 million
- Disbursements in FY 1994 (July 1, 1993-June 30, 1994) US$107.0 million
- Disbursements in FY 1995 (July 1, 1994-June 30, 1995) US$197.0 million
- Disbursements in FY 1996 (July 1, 1995-June 30, 1996) US$151.2 million
- Disbursements in FY 1997 (July 1, 1996-June 30, 1997) US$263.0 million
- Disbursements in FY 1998 (July 1, 1997-June 30, 1998) US$126.4 million
- Disbursements in FY 1999 (July 1, 1998-June 30, 1999) US$229.6 million
- Disbursements in FY 2000 to date US$87.6 million

1/ This is a grant.

Mozambique: Statistical Issues

In recent years, Mozambique's statistical capacity has increased with assistance from the Fund, World Bank, United Nations Development Program (UNDP), and two European statistical institutes. However, major efforts are still needed, not least in light of the challenges that the poverty reduction strategy paper (PRSP) poses in terms of monitoring social developments and tracking poverty-related expenditures.

National accounts

Mozambique's national accounts statistics are currently in transition, as two alternative series of accounts are compiled, one by the National Institute of Statistics (INE), and the other by the National Directorate of Planning (DNP) in the Ministry of Planning and Finance. The INE's current data are the official national accounts while the DNP's figures are used mainly as a base for projections, including in budget preparation. As agreed with the authorities, the staff has been constructing a consistent series by using the INE's historical data as the basis for projections that themselves draw on the DNP's growth indicators. A breakdown of public and private investment is not available for historical data; the DNP's budget figures are used to derive the expenditure composition of GDP for projections. In addition, figures for imports and exports in the national accounts and in the balance of payments differ because different sources and methodologies are used for their compilation by the INE and the Bank of Mozambique (BM). The Fund staff has urged the authorities on several occasions to resolve this inconsistency; however, not much progress has been made in this area. In February 2000, the INE revised the national accounts for 1991–98 to incorporate the 1998 census results. In September 2000, preliminary figures for 1999 were produced.

Consumer price index

In February 2000, the consumer price index (CPI) was rebased on weights stemming from the 1998 census. Although consumer price indices are available for the cities of Maputo, Beira, and Nampula, only that for Maputo is presently considered representative for the country. A preliminary national index obtained by integrating the three indices is under preparation.

Money and banking statistics

During the last two years, improvements in the BM's accounting practices have contributed to better-quality accounting information and monetary statistics. However, the BM still needs to eliminate discrepancies in the interbank positions, particularly between commercial banks and the BM. Currently, the BM publishes monetary data on a regular basis in its quarterly statistical bulletin and submits the same data to the Fund in electronic format. The African Department (AFR), the Statistics Department (STA), and the BM have undertaken a project to harmonize their presentations of the monetary accounts. The single data submission from the BM is now in line with international and Fund standards, and is used by STA for publication in *International Financial Statistics (IFS)* and AFR for program monitoring.

To improve the functioning of the foreign exchange market, the BM has begun to publish daily weighted-average buying and selling rates for the U.S. dollar calculated from all transactions of commercial banks and exchange houses with their clients. It has also started publication of a set of monetary indicators.

Data on foreign aid

Weaknesses in foreign aid data are affecting the quality of the balance of payments, fiscal, and national accounts. The difficulty lies in tracking disbursements made outside the budget (e.g., for some donor-funded projects) and outside the domestic financial system (e.g., for technical assistance). Although some efforts to improve the quality of these data have recently been made, data remain weak and problems of consistency among different sectors persist.

Fiscal accounts

In May 2000, the authorities started the publication of a quarterly budget execution report, a step toward improving fiscal transparency and accountability. However, there remain important weaknesses in the fiscal data: (i) the presence of important extrabudgetary operations not complying with budgetary procedures; (ii) a lack of reports on the uses of foreign aid by the budgetary units; (iii) weak monitoring of the generation and collection of counterpart funds; (iv) a lack of actual information on the foreign-financed portion of capital expenditure (currently estimated on the basis of the execution of the domestically financed portion); and (v) a lack of regular data on government debt and guarantees and on expenditure and revenue arrears. In this regard, the government has initiated a reform of the public expenditure management system that includes improving the public accounting system by recording and reporting on each major step in the spending process (allocation, commitment, verification, and payment), and by expanding the budget classification system in order to allow the tracking of program-based expenditures.

Mozambique does not report fiscal data for publication in the *Government Finance Statistics Yearbook* or *International Financial Statistics.*

External accounts

The quality of the external accounts is affected not only by the weakness of key data sources and absence of firm foreign aid statistics, but also by the lack of funding, coordination, and clear division of responsibilities among the government agencies involved in the production of these statistics (The BM, INE, DNP, customs, and the Ministry of Industry and Commerce). The BM has recently launched a number of initiatives to improve the quality of the balance of payments statistics. However, there has been a deterioration in the key data sources—customs documents, the commercial banks' foreign exchange reports, and exchange control records. Bringing Mozambique's balance of payments statistics in line with the fifth edition of the *Balance of Payments Manual* calls for concerted action, including improved reporting practices through existing data systems, greater use of survey data and computer technologies, additional technical support, and the commitment of additional financial and human resources to this task. At the BM's request, a STA mission in August 1999 undertook a comprehensive assessment of the balance of payments statistics and made recommendations for the implementation of the fifth edition of the *Balance of Payments Manual*. Having determined a need for further technical assistance, the STA is recruiting a peripatetic advisor who will work with the BM beginning in January 2001.

Poverty and social data

The main sources of data for poverty statistics in Mozambique are the National Poverty Assessment, based on a national household consumption survey carried out in 1996–97, a demographic and health survey (1997), and a population census (1997). The government also has relatively good administrative data, and recently published for the first time a set of social indicators for 1997–98 on population, education, health, crime and justice, social welfare, and the mass media. Together, these sources provide an important baseline for poverty monitoring. In addition, the INE is carrying out a Core Welfare Indicators Survey (QUIBB), with World Bank assistance, and plans to repeat this at two-year intervals. The QUIBB will be the principal source for monitoring the impact of the PRSP.

A major weakness of social statistics in Mozambique is the lack of up-to-date information on incomes and employment, which would be a basic requirement for the analysis of short-term responses to policy measures. At present, the only reliable source of labor market information is the National Poverty Assessment. In 2001, the QUIBB will add a module on employment, which will be an important new source for this topic. However, the current lack of basic information on such aspects as the skill and gender composition of the labor force, wage levels, labor mobility and migration, and the relationship between formal and informal employment and income, is a major handicap for economic and human resource planning.

Mozambique: Core Statistical Indicators

As of November 30, 2000

	Exchange Rates	Interna-tional Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Iindex	Exports/ Imports	Current Account Balance	External Debt/Debt Service	Overall Govern-ment Balance	GDP/ GNP
Date of latest observation	Nov. 00	Sep. 00	Sep. 00	Sep. 00	Sep. 00	Nov. 00	Oct. 00	Dec. 99	Dec. 99	June 00	June 00	Dec. 99
Date received	Dec. 00	Nov. 00	Nov. 00	Nov. 00	Nov. 00	Dec. 00	Nov. 00	Sep. 00	Sep. 00	Sep. 00	Sep. 00	Sep. 00
Frequency of data 1/	D	M	M	M	M	M	M	Q/V	V	Q	Q	V
Frequency of reporting 1/	W	M	M	M	M	M	M	Q/V	V	V	Q	V
Frequency of publication 1/	D	M	M	M	M	M	M	Q/V	V	V	Q	V
Source of data 2/	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 3/	C	C	C	C	C	C	C	C/V	V	C	C	V
Confidentiality 4/	C	D	C	C	C	C	C	C	C	C	C	C

1/ D=Daily; W=weekly; M=monthly; Q=quarterly; V=collected during mission.

2/ A=Direct reporting by central bank or relevant ministry.

3/ C=cable or fax; V=staff visit.

4/ C=unrestricted use; D=embargoed for a period of time.

Mozambique: Selected Social and Demographic Development Indicators 1/

(In percent, unless otherwise noted)

	Mozambique	Sub-Saharan Africa
Reducing extreme poverty		
Absolute poverty head count (national estimate) (1997) 2/	69	...
Poverty gap ratio (incidence times depth of poverty) (1997) 2/	29	...
Education		
Adult literacy rate (1997) 2/	40	...
Primary net enrollment rate (1997) 2/	49	...
Primary gross enrollment rate (1997)	60	78
Health		
Life expectancy at birth (years) (1998)	45	50
Infant mortality per 1,000 live births (1998)	134	92
Mortality under 5 years per 1,000 births (1998)	213	151
Prevalence of underweight children under 5 years (1992-98) 3/	26	33
Total fertility rate (births per woman) (1998)	5.2	5.4
Contraceptive prevalence rate (women aged 15-49) (1990-98) 3/	6	21
Adult HIV-1 sero-prevalence rate (per 100 adults) (1997)	14	7
Environment		
Access to safe water (percent of population) (1997) 2/	20	...
General indicators		
GNP per capita (U.S. dollars) (1998)	210	510
PPP GNP per capita (U.S. dollars) (1998)	740	1,440
Urbanization (1998)	38	33

1/ Based on World Bank, *World Development Indicators*, 2000, unless otherwise indicated.
2/ National Poverty Assessment, 1997 (published 1998).
3/ Data for most recent year available.

Statement by the IMF Staff Representative
December 18, 2000

The following information has become available since the issuance of the staff report for the 2000 Article IV consultation and the second review under the Poverty Reduction and Growth Facility (EBS/00/250; 12/4/00):

The 12-month rate of **inflation** fell from 16.8 percent in October 2000 to 15.7 percent in November. The two-month treasury bill rate edged slightly up in December, to 22.25 percent. Meanwhile, the 12-month rate of **broad money** growth remained unchanged in October 2000, at 44.6 percent.

The **fiscal outturn for September 2000** showed revenue closely in line with the indicative program benchmark, while total expenditure was lower than expected by the equivalent of 2.3 percent of GDP, mainly on account of lower foreign-financed capital outlays. Noninterest current expenditure was about 0.3 percent of GDP lower than expected, suggesting that the domestic primary deficit remained below the indicative program ceiling.

The **budget for 2001** was presented to the National Assembly. It is in line with the proposed program. The budget document highlights the consistency of the budget with the government's medium-term poverty reduction strategy, and notes the government's objective of progressive substitution of domestic resources for foreign financing. The document reports on the amount of assistance expected to accrue in 2001 under the HIPC Initiative (US$118 million) and its use in the areas of education, health, rural development, infrastructure, social action, and planning and monitoring poverty reduction.

Following the shareholders' meeting of **Banco Austral (BA)** in mid-October 2000, the foreign bank behind the domestic private shareholder has now formally endorsed the shareholders' agreement described in paragraph 12 of the Memorandum of Economic and Financial Policies. The financial due diligence review, expected in the shareholders' agreement for end-November 2000, is delayed until early January 2001, reportedly owing to difficulties in hiring the needed experts.

Among the **structural measures for 2000** that had experienced some delay, the draft new commercial code has now been completed, and the target level of customs personnel is within reach. Meanwhile, the actuarial analyses of the pension scheme of the public sector and of the National Social Security Institute will be further delayed, as the government saw a need to restart the work with a new consultant.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/4
FOR IMMEDIATE RELEASE
January 17, 2001

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

IMF Concludes Article IV Consultation with Mozambique

On December 18, 2000, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mozambique.[1]

Background

Since the conclusion of the last Article IV consultation in June 1999, economic developments in Mozambique have been marked by a slowdown in economic growth, a rekindling of inflation, and a weakening of the external current account, all linked in large part to the devastating floods that affected the country in February-March 2000. Flood reconstruction and production at the recently opened Mozal aluminum smelter helped contain the economic slowdown, and real GDP growth for 2000 is now expected at 3.8 percent. The exchange rate in real effective terms appreciated moderately during the year.

Inflation rose in the immediate aftermath of the floods, and continued to increase thereafter, to a 12-month rate of 16.8 percent in October 2000, reflecting in part a larger-than-expected monetary growth. The 12-month rate of expansion of broad money increased from 35 percent at end-1999 to 44 percent in September 2000. A recent monetary tightening, however, promises a slowdown of inflation – which declined to 15.7 percent in November –although further oil price increases might pose an upward risk.

Two important commercial banks have been experiencing liquidity and solvency problems, constraining the ability of the central bank to follow a tight monetary policy during the past year.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the December 18, 2000 Executive Board discussion based on the staff report.

The government, as a minority shareholder, and the private shareholders have agreed to recapitalize the banks. The completion of this task and the strengthening of bank supervision are important government objectives for the next few months.

Government revenue was in line with expectations during the first three quarters of 2000. The first year of operation of the value-added tax, which was introduced in June 1999, produced encouraging results. As part of its medium-term objective of broadening the revenue base, the government has recently tightened the administration of tax and customs exemptions and initiated a more fundamental reform of tax policy and tax administration. Preparation for this included a review of the system of tax and customs exemptions.

Government expenditure in 2000 is expected to increase significantly with respect to 1999, as a result of outlays for flood reconstruction, higher social expenditure, a higher government wage bill, and onetime outlays for bank recapitalization.

In the governance, transparency, and legal reform areas, a review of fiscal transparency in the context of the code of good practices on fiscal transparency was completed; the publication of quarterly budget execution reports was started; and a new commercial code was drafted. However, the adoption of a strategic plan for the justice system expected for October 2000 will be delayed as the government envisages a reform that encompasses all levels of the judicial system. To prepare for close monitoring of the poverty-reduction strategy, the National Statistical Institute published in mid-2000 a comprehensive set of social and development indicators.

Executive Board Assessment

Executive Directors commended the Mozambican authorities for their generally good record of policy implementation despite the devastating floods at the beginning of the year. They welcomed the progress made on structural reforms under the PRGF-supported program, and noted the authorities' commitment to, and strong ownership of the reforms. Looking ahead, Directors considered that, in order to establish the conditions for economic recovery and equitable growth, special emphasis will need to be placed on budget management, prudent monetary and credit policy, and structural reforms.

Directors welcomed the authorities' objective of increasing the revenue-to-GDP ratio, as well as Fund technical assistance in this area. They stressed the importance of proceeding with the rationalization of tax and customs exemptions, improvements in tax administration, and the planned comprehensive reform of the tax system. These measures to increase revenues would help sustain the increasing expenditure needs, especially in the social sector. Directors underscored the importance of further improving expenditure management, accountability, and the transparency of government operations. They welcomed the publication of a quarterly budget execution report and the review of fiscal transparency undertaken in the context of the code of good practices on fiscal transparency. Directors underscored the importance of improving the tracking of poverty-related expenditures, particularly with regard to the use of resources that are freed up as a result of HIPC debt relief. They welcomed the authorities' intention to include information on poverty-related expenditures in the quarterly budget execution reports, beginning in the first quarter of 2001.

Directors noted that the rapid monetary expansion in 2000 poses a risk to macroeconomic stability, and stressed the importance of bringing inflation down to single digits. They therefore welcomed the recent actions by the central bank to reassert monetary control. They also welcomed the authorities' initiative of publishing a more representative exchange rate and considered it an important step to improve the functioning of the foreign exchange market.

On structural reforms, Directors commended the authorities for the progress made in addressing the liquidity and solvency problems of two commercial banks, and stressed the importance of restoring health in the banking sector. They urged the authorities to strictly enforce the safeguard measures put in place, and generally to strengthen prudential regulations and supervision of the banking sector. Directors also called for early adoption of the strategic plan for the justice system. Directors welcomed the authorities' commitment to trade liberalization. They urged them to stay the course of trade liberalization, and to resolve the problems of the cashew processing industry. A few Directors also stressed the need to avoid increasing protection of the sugar sector.

Directors urged the authorities to continue to improve the accuracy, coverage, and timeliness of statistical data.

Directors encouraged the authorities to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Table 1. Mozambique: Selected Economic and Financial Indicators, 1998-2001

	1998	1999	2000 Prog.	2001 Proj.
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Nominal GDP (in billions of meticais)	46,427	50,827	58,887	68,939
Nominal GDP (in millions of U.S. dollars)	3,918	4,005	3,922	4,197
Real GDP	11.9	7.3	3.8	10.4
GDP per capita (in U.S. dollars)	231.6	231.5	221.7	232.0
GDP deflator	2.4	2.0	11.6	6.0
Consumer price index (annual average)	0.6	3.1	12.3	5.7
Consumer price index (end of period)	-1.3	6.2	11.0	7.0
External sector				
Merchandise exports	6.3	10.8	15.4	119.0
Merchandise imports	7.5	46.8	-3.2	1.4
Terms of trade	5.3	-0.1	-1.5	1.5
Nominal effective exchange rate (end of period) 1/ 2/	-5.7	0.0	-8.2	...
Real effective exchange rate (end of period) 1/ 2/	-9.7	1.7	3.4	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)			
Money and credit				
Net domestic assets	9.3	23.9	25.0	13.3
Of which: net credit to the government	-16.0	0.0	12.5	9.8
credit to the rest of the economy	17.8	22.9	26.3	16.5
Broad money (M2)	17.6	35.1	34.0	16.0
Velocity (GDP/ average M2)	5.7	5.2	4.3	4.0
Prime rate (in percent; end of period) 3/	19.6	19.6	18.4	...
	(In percent of GDP)			
Investment and saving				
Gross domestic investment	23.5	32.6	29.7	27.3
Government	...	...	12.8	13.1
Other sectors	...	...	16.9	14.2
Gross national savings	11.5	15.1	15.1	16.0
Government	...	...	9.3	7.8
Other sectors	...	...	5.8	8.2
Government budget				
Total revenue	11.5	12.2	12.7	12.3
Total expenditure and net lending	21.8	25.2	29.1	30.0
Overall balance before grants	-10.6	-13.4	-16.7	-17.7
Total grants	8.2	11.9	10.5	11.5
Overall balance after grants	-2.4	-1.6	-6.1	-6.3
Domestic primary balance	-0.6	-3.5	-7.5	-7.4
Domestic bank financing	-2.3	-0.3	2.5	2.2
External sector				
Current account balance before grants	-21.3	-30.1	-28.5	-18.8
Current account balance after grants	-12.4	-19.2	-17.6	-8.8

	(In percent of exports of goods and nonfactor services)			
Net present value of total external debt outstanding 4/	538.2	202.0	163.0	150.0
External debt service (nonfinancial public sector)				
Scheduled, before HIPC Initiative assistance (Naples terms)	20.0	26.1	31.3	20.2
Scheduled, after original HIPC Initiative assistance	...	15.3	12.2	8.2
Scheduled, after enhanced HIPC Initiative assistance	...	...	4.4	5.8
	(In millions of U.S. dollars, unless otherwise specified)			
External current account after grants	-436	-770	-690	-403
Overall balance of payments	-204	-243	-478	-488
Gross international reserves (end of period)	625	669	700	634
In months of imports of goods and nonfactor services	7.0	5.2	5.7	5.0
In percent of broad money	82.7	76.0	70.5	56.8
Exchange rate (meticais per U.S. dollar; end of period) 3/	12,366	13,300	16,244	...
Use of Fund resources (in millions of SDRs)				
Purchases/disbursements	25.2	21.0	45.2	16.8
Repurchases/repayments, before HIPC Initiative assistance	18.1	22.8	22.2	21.0
Credit outstanding	147.2	145.4	168.5	164.3
Quota	84.0	113.6	113.6	113.6

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.
2/ The figure for 2000 is the actual rate at the end of September.
3/ The figure for 2000 is the actual rate at the end of November.
4/ Public and publicly guaranteed, in percent of the three-year average of exports. Data for 1998 reflect the impact of applying traditional debt-relief mechanisms (Naples terms). The data for 1999-2000 include the impact of total debt relief granted under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) and new borrowing.

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FOR IMMEDIATE RELEASE
December 19, 2000

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review under PRGF for Mozambique and Approves Second Annual PRGF Loan

The Executive Board of the International Monetary Fund (IMF) completed the second review of Mozambique's program under the Poverty Reduction and Growth Facility (PRGF)[1] and approved a second annual loan to support the government's economic program. The completion of this review enables Mozambique to draw an amount equivalent to SDR 8.4 million (about US$11 million) from the IMF.

Mozambique's three-year program, originally supported under the Enhanced Structural Adjustment Facility (ESAF), was approved on June 28, 1999 (see Press Release No 99/25), in an amount equivalent to SDR58.8 million (about US$76 million). In March 2000, the access under the program was augmented to the equivalent amount of SDR87.2 million (about US$113 million), of which an amount equivalent to SDR 45.2 million (about US$58 million) has been disbursed. On April 12, 2000, the IMF and the World Bank agreed that Mozambique had met the requirements to receive debt relief from its external creditors under the HIPC Initiative (see Press Release No 00/28).

In commenting on today's Executive Board discussion on Mozambique, Shigemitsu Sugisaki, Deputy Managing Director of the IMF and Acting Chairman of the session said:

"Mozambique has broadly maintained its good record of program implementation, despite the devastating floods at the beginning of 2000. The authorities recognize the risks to

[1] On November 22, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted.in a participatory process involving civil society and development partners, and articulated in a poverty reduction strategy paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Mozambique, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and the World Bank, the PRSP will provide the policy framework for future reviews under the PRGF arrangement. PRGF loans carry an interest rate of 0.5 percent a year and are repayable over 10 years with a 5 ½ year grace period on principal payments.

macroeconomic stability from the rapid monetary expansion during the current year and the consequent pickup in inflation, and have taken action to reassert monetary control. However, continued monetary restraint will be required in the period ahead to bring inflation down to single digits.

"The authorities' objective of raising significantly the revenue effort over the coming years is a crucial complement to external aid in supporting poverty reduction spending while consolidating the fiscal position. Close attention will be needed to ensure that spending in other areas, including wages, remains prudent, and that the efficiency of all spending continues to be enhanced.

"In their effort to improve transparency in government operations, the authorities have started the publication of a quarterly budget execution report and completed a review of fiscal transparency in the context of the code of good practices on fiscal transparency. In this regard, the authorities' commitment to including information on poverty-related expenditures in the quarterly budget execution report is particularly welcome.

"The government, as minority owner, and the private shareholders, have made progress in addressing the liquidity and solvency problems of two troubled banks in Mozambique. Concluding the recapitalization in the timeframe envisaged under the program is critical in the interest of a sound banking system. In the meantime, the safeguard measures put in place by the central bank should be strictly enforced.

"The authorities have taken steps to improve the functioning of the judiciary including the opening of a new center for judicial studies and training and the completion of a draft new commercial code. Looking ahead, the authorities should speed up their work on judicial reform," Mr. Sugisaki said.

ANNEX

Program Summary

Since the inception of the present PRGF arrangement in June 1999, economic developments in Mozambique have been marked by a slowdown of economic growth, a rekindling of inflation, and a weakening external current account linked in large part to the serious flooding that afflicted the country in February-March 2000.

The medium-term Government Program contains four primary objectives: the reduction of absolute poverty through programs in health, education, and rural development; the attainment of rapid and sustainable growth through the creation of a favorable environment for the private sector, together with the improvement of the country's fiscal position; the economic development of rural areas in order to reduce regional inequality; and the consolidation of peace, national unity, justice, and democracy. The medium-term macroeconomic outlook projects GDP growth of about 10 percent in 2001; in subsequent years, GDP growth is expected to average 6 percent a year.

Bringing down inflation through a slowdown of monetary expansion, and restoring health to the banking system are the most important immediate objectives of monetary and financial sector policy.

Following a review of the system of tax and customs exemptions, the government has recently adopted measures to improve the administration of exemptions and will proceed under the program with a comprehensive **fiscal reform**, including of the legal basis of tax incentives. These changes in fiscal tax policy and tax administration are expected to yield significant revenue gains by 2002.

A significant increase in government expenditure in 2001 reflects outlays for flood reconstruction, higher social spending, a boost in the government wage bill, and onetime outlays for bank recapitalization.

The government will continue to implement a strong **structural reform agenda.** The program aims at strengthening the financial sector, rationalizing tax policy and tax administration, and improving fiscal accountability. A new commercial code will also be submitted to the National Assembly by July 2001. Comprehensive reform in these and other areas will be key to improving the environment for private sector development.

The government remains committed to preparing the full PRSP and meeting the other conditions for reaching the completion point under the enhanced HIPC Initiative by end-March 2001. This will be an important step in implementing its **poverty reduction program. In** this regard, a draft health sector strategic plan is expected to be ready in the near future and activities to implement the HIV/AIDS strategic plan are being organized. Also, the share of recurrent health and education expenditures in total recurrent expenditure increased in the 2000 budget and is expected to increase further in the 2001 budget.

Mozambique joined the IMF on September 24, 1984, and its quota is SDR 113.6 million (about US$147 million). Its outstanding use of IMF financing currently totals SDR 166.1 million (about US$215 million).

Table 1. Mozambique: Selected Economic and Financial Indicators, 1998-2001

	1998	1999	2000 Prog.	2001 Proj.
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Nominal GDP (in billions of meticais)	46,427	50,827	58,887	68,939
Nominal GDP (in millions of U.S. dollars)	3,918	4,005	3,922	4,197
Real GDP	11.9	7.3	3.8	10.4
GDP per capita (in U.S. dollars)	231.6	231.5	221.7	232.0
GDP deflator	2.4	2.0	11.6	6.0
Consumer price index (annual average)	0.6	3.1	12.3	5.7
Consumer price index (end of period)	-1.3	6.2	11.0	7.0
External sector				
Merchandise exports	6.3	10.8	15.4	119.0
Merchandise imports	7.5	46.8	-3.2	1.4
Terms of trade	5.3	-0.1	-1.5	1.5
Nominal effective exchange rate (end of period) 1/ 2/	-5.7	0.0	-8.2	...
Real effective exchange rate (end of period) 1/ 2/	-9.7	1.7	3.4	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)			
Money and credit				
Net domestic assets	9.3	23.9	25.0	13.3
Of which: net credit to the government	-16.0	0.0	12.5	9.8
credit to the rest of the economy	17.8	22.9	26.3	16.5
Broad money (M2)	17.6	35.1	34.0	16.0
Velocity (GDP/ average M2)	5.7	5.2	4.3	4.0
Prime rate (in percent; end of period) 3/	19.6	19.6	18.4	...
	(In percent of GDP)			
Investment and saving				
Gross domestic investment	23.5	32.6	29.7	27.3
Government	...	...	12.8	13.1
Other sectors	...	...	16.9	14.2
Gross national savings	11.5	15.1	15.1	16.0
Government	...	...	9.3	7.8
Other sectors	...	...	5.8	8.2
Government budget				
Total revenue	11.5	12.2	12.7	12.3
Total expenditure and net lending	21.8	25.2	29.1	30.0
Overall balance before grants	-10.6	-13.4	-16.7	-17.7
Total grants	8.2	11.9	10.5	11.5
Overall balance after grants	-2.4	-1.6	-6.1	-6.3
Domestic primary balance	-0.6	-3.5	-7.5	-7.4
Domestic bank financing	-2.3	-0.3	2.5	2.2
External sector				
Current account balance before grants	-21.3	-30.1	-28.5	-18.8
Current account balance after grants	-12.4	-19.2	-17.6	-8.8
	(In percent of exports of goods and nonfactor services)			
Net present value of total external debt outstanding 4/	538.2	202.0	163.0	150.0

External debt service (nonfinancial public sector)				
Scheduled, before HIPC Initiative assistance (Naples terms)	20.0	26.1	31.3	20.2
Scheduled, after original HIPC Initiative assistance	...	15.3	12.2	8.2
Scheduled, after enhanced HIPC Initiative assistance	...	...	4.4	5.8
	(In millions of U.S. dollars, unless otherwise specified)			
External current account after grants	-436	-770	-690	-403
Overall balance of payments	-204	-243	-478	-488
Gross international reserves (end of period)	625	669	700	634
In months of imports of goods and nonfactor services	7.0	5.2	5.7	5.0
In percent of broad money	82.7	76.0	70.5	56.8
Exchange rate (meticais per U.S. dollar; end of period) 3/	12,366	13,300	16,244	...
Use of Fund resources (in millions of SDRs)				
Purchases/disbursements	25.2	21.0	45.2	16.8
Repurchases/repayments, before HIPC Initiative assistance	18.1	22.8	22.2	21.0
Credit outstanding	147.2	145.4	168.5	164.3
Quota	84.0	113.6	113.6	113.6

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.
2/ The figure for 2000 is the actual rate at the end of September.
3/ The figure for 2000 is the actual rate at the end of November.
4/ Public and publicly guaranteed, in percent of the three-year average of exports. Data for 1998 reflect the impact of applying traditional debt-relief mechanisms (Naples terms). The data for 1999-2000 include the impact of total debt relief granted under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) and new borrowing.

**Statement by C.D.R. Rustomjee, Executive Director
for Republic of Mozambique
December 18, 2000**

My Mozambican authorities would like to convey their appreciation for the constructive policy discussions with the staff during the Article IV consultation and review under the ongoing PRGF. They acknowledge the benefit of the useful advice and technical support extended to them, which has contributed significantly to the improvement of macroeconomic management and institutional strengthening. My authorities are also grateful for the staff's candid assessment of the Mozambican economy and broadly concur with the thrust of their appraisal.

Reflecting the benefits of prudent policies, Mozambique has over many years made noteworthy progress towards macroeconomic stability and in advancing the transformation of its economy by implementing a vast agenda of structural reforms. However, economic performance, particularly since early 2000, suffered mainly from the effects of the devastating floods that afflicted the country in February and March. Significant steps have been taken to bring normalcy to the flooded areas. Hence, while the process of resettlement of displaced population is well advanced, major bottlenecks persist in the transportation system. Moreover, delays in the disbursement of the pledged foreign assistance did not allow the flood-related reconstruction to be initiated at an early stage as envisaged. The flooding has caused a slowdown of economic growth, with real GDP expected to expand by only 3.8 percent compared to the initial projection of 7 percent for 2000 and the estimated growth of 7.3 percent in 1999. The impact of the flooding was most acutely felt on agricultural production, small-scale manufacturing and services in the affected areas. The shortages caused by the floods also translated into a higher inflation rate, although a rapid monetary expansion and higher oil prices were also contributing factors. The annual rate of inflation reached 15.7 percent in November up from the 2.0 percent in the comparable period in 1999.

Notwithstanding the postponement in the approval of the budget for 2000— caused by last December's elections and thereafter by the floods—as well as the unexpected additional flood-related requirements, fiscal performance has largely met or exceeded expectations. Estimates for the first half of 2000 point to a stronger-than-anticipated revenue outcome as a result of the strengthening of tax administration and smooth implementation of the VAT due to the extensive preparation and proper sequencing of measures taken prior to the launching of the VAT. Expenditure remained well below the target due to delays in the 2000 round of wage negotiations and particularly because foreign-financed capital expenditures failed to materialize in time.

The exchange rate depreciated only slightly (in nominal effective terms) and international reserves have been stable. The weakening of the external current account position reflects the impact of the floods in the form of higher imports. Progress made so far on structural reforms continued to be consolidated, focusing on taxes and customs, trade, privatization, social and transparency areas.

Despite the havoc inflicted by the floods and the additional requirements for reconstruction that have overburdened the country's limited human and financial resources, all quantitative and structural performance criteria and benchmarks for the first half of 2000 were observed.

The authorities' strong commitment to persevere with the implementation of sound economic and financial policies and efficiency-enhancing structural reforms aim at securing a stable macroeconomic framework to support the successful achievement of their poverty reduction strategy. The Fund's assistance under the PRGF arrangement remains fundamental in this regard.

The authorities' medium-term objectives, outlined in the Government Program for 2000-04, are fully consistent with their poverty reduction strategy delineated in the Interim PRSP and the Medium-Term Expenditure Framework. These objectives aim at achieving high quality sustainable growth in an environment where the private sector will continue to play a leading role, and reducing widespread poverty. The authorities will also be focusing on reducing regional inequalities and consolidating peace and democracy. Thus the medium-term outlook envisages a GDP growth of at least 10 percent in 2001, boosted by the full-year activity of the recently constructed aluminum smelter, and an average of 6 percent thereafter. Inflation is projected to be contained at 5 percent over the period; and gross national savings are planned to increase to about 17 percent of GDP, which will assist the authorities' efforts in curbing the country's traditional substantial reliance on foreign assistance.

In line with these objectives, the near-term goal, as set in the program for 2000-01, will be to establish the conditions for a return to high economic growth rates, such as those observed in the years prior to the floods and to ensure that the benefits of growth reach the poor. To this end, focus will be placed on maintaining macroeconomic stability with special emphasis being accorded to enhancing budget management and accountability. In turn, these efforts are expected to facilitate the execution of spending priorities in favor of social sectors and other poverty reduction programs.

Under the current program, expenditures are expected to grow significantly to address the flood-related reconstruction needs, higher spending for priority social sectors and wage adjustments. The increase in spending also reflects the one-time expenditure representing the government's contribution to the recapitalization of the two largest commercial banks in which they still hold a minority share. To minimize the impact of these higher expenditures, the authorities have undertaken to redouble their efforts aimed at enhancing revenue performance over time. In this respect, important steps are being taken to reform the tax system. Special emphasis is being accorded in reviewing the system of tax and customs exemptions. Based on the recommendations of a series of empirical studies, the authorities have already established a unit in the tax department that will be following closely all issues related to the administration of exemptions. They are also taking some initial steps in the context of a more comprehensive rationalization of tax and customs exemptions that include the preparation of a new code of fiscal incentives for investment. Improved revenue performance will also benefit from the strengthening of tax administration by improving the system of VAT collection.

Mindful of the need to improve the mechanisms for tracking and monitoring poverty-related expenditures—the latter which have consistently increased over the years—the authorities have decided to implement a simplified interim control system that will report on the actual spending on poverty reduction programs compared to respective budgetary allocation. Furthermore, to ensure a more detailed monitoring and tracking of expenditure for the priority social areas, the authorities are revising the public accounting law, which they intend to submit to the Parliament by March 2001. Consistent with the authorities' policy of improving public accountability, the quarterly budget execution reports will include detailed information on these priority sectors and their programs.

Monetary policy will continue to be geared to reach the authorities' inflation and balance of payments objectives. To this end, and consistent with the objective of reducing inflation to approximately 7 percent in 2001, monetary growth will be limited to 34 percent in 2000 and 16 percent in 2001. To reach these goals the authorities are making a more active use of indirect monetary policy instruments, including through placement of treasury bills in the money market and enforcing prudential regulations. As a result of the tighter monetary policy stance which has been pursued since mid 2000, inflation is showing signs of declining, and the authorities believe that the inflation target for 2000 will be only slightly exceeded.

Several measures have also been taken to address the financial problems of the two commercial banks where the government is participating as a shareholder. Regarding the largest commercial bank, Banco Comercial de Moçambique, an agreement has been reached among all shareholders on the restructuring and recapitalization of the bank. With respect to the latter, the government's share is to be met mainly through the issuing of government bonds. Regarding Banco Austral (BA), the same solution has been envisaged, but the recapitalization will take place only after the Financial Due Diligence study commissioned by the bank's management is finalized around the end of the year. Meanwhile, the central bank is monitoring BA's liquidity situation daily.

Although remarkable progress has been made so far on structural reforms, the authorities are fully aware of the need for further strengthening and deepening these reforms particularly in the public and financial sectors, which they view as essential for creating an enabling environment for private sector activity. In this regard, they are sensitive to the need for a comprehensive reform of the judicial system. The delay in preparing the respective strategic plan was determined by the need to extend the reform to all levels of the judicial system. In the meantime, measures to improve the legal environment will include the revision of the penal code.

The authorities have made significant efforts to meet the conditions to reach the completion point under the HIPC Initiative and remains confident in being able to complete the full PRSP as envisaged by March 2001 with extensive participation of various segments and at different levels of civil society.

Finally, my Mozambican authorities will like to reiterate their strong and continuous commitment to the adjustment and reform process which they consider fundamental to support their strategy to reduce poverty. They are also determined to meet the targets set under the ongoing PRGF program and look forward to Board's approval of the proposed decision. My authorities have acceded to publish the staff report for the 2000 Article IV consultation.