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Republic of Mozambique: Fifth Review Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion—Staff Paper; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

In the context of the fifth review under the Poverty Reduction and Growth Facility and request for waiver of performance criterion, the following documents have been released and are included in this package:

- the staff paper for the fifth review under the Poverty Reduction and Growth Facility and request for waiver of performance criterion, prepared by a staff team of the IMF, following discussions that ended on **April 23, 2003**, with the officials of the Republic of Mozambique on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 5, 2003**. 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 Press Release summarizing the **views of the Executive Board as expressed during its June 20, 2003 discussion** of the staff report that completed the review.

- a statement by the Executive Director for the Republic of Mozambique.

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

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REPUBLIC OF MOZAMBIQUE

Fifth Review Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion

Prepared by the African Department
(In consultation with other departments)

Approved by Anupam Basu and Michael T. Hadjimichael

June 5, 2003

A three-year PRGF was approved on June 28, 1999. The arrangement was extended for a period of 12 months and expires on June 28, 2003. Five tranches have been disbursed and the sixth tranche of SR 8.4 million will become available upon the completion of this review.

Performance under the program supported by the PRGF arrangement has been broadly favorable, but the conclusion of this review was delayed because of vulnerabilities in the banking system. All the quantitative performance criteria through end-June 2002 were observed, with the exception of the performance criterion on the domestic primary deficit, which was exceeded by a small margin. All the program indicative targets for end-December 2002, except for that on government revenue, and the program's two structural performance criteria were also observed. **Real GDP growth** remained strong at 7.7 percent in 2002 (9 percent in the program). **Inflation** (end of period) declined to 9 percent during 2002 from 22 percent in 2001, but it has risen in recent months mainly because of exogenous factors.

The government's program for 2003 envisages real GDP growth of 7 percent. The 12-month rate of inflation is targeted to decline to below 11 percent in December, from 14.7 percent in April 2003, and net international reserves are programmed to increase somewhat over the year. The fiscal program calls for a further strengthening of tax revenue and containment of domestic primary spending. The program also envisages the implementation of diagnostic reviews of the four largest banks on the basis of International Accounting Standards, and further measures to improve tax administration, public expenditure management, and bank supervision.

The government has recently published its first PRSP progress report. The Joint Staff Assessment (JSA) of this report prepared by Fund and World Bank staff concludes that progress is being made in attaining the poverty reduction objectives of the PRSP.

The authorities have expressed a **strong interest in a successor program** to tackle important unfinished reforms.

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ABBREVIATIONS

BA	Banco Austral
BCP	Banco Comercial Português
BIM	Banco Internacional de Moçambique
DBS	Department of Banking Supervision of the Bank of Mozambique
DFID	United Kingdom Department for International Development
DRI	Debt Relief International
EMPSO	Economic Management and Private Sector Operation of the IDA
FRELIMO	Frente de Libertação de Moçambique (Political Party)
FSAP	Financial Sector Assessment Program
FSSA	Financial Sector Stability Assessment
GATT	General Agreement on Tariffs and Trade
GDDS	General Data Dissemination System
GNFS	Goods and Non-Factor Services
HIPC	Heavily Indebted Poor Countries
IAS	International Accounting Standards
IDA	International Development Agency
INSS	Instituto Nacional de Segurança (Social Security)
JSA	Joint Staff Assessment
MEFP	Memorandum of Economic and Financial Policies
NPV	Net Present Value
PARPA	Action Plan for Reducing Absolute Poverty (Equivalent to PRSP)
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
RENAMO	Resistencia Nacional de Moçambique (Political Party)
ROSC	Report on Observance of Standards and Codes
SAM	Social Accounting Matrix
SIM	Seguradora Internacional de Moçambique (Insurance Company)
SISTAFE	Integrated Financial Management System (Portuguese Acronym)
VAT	Value Added Tax
WTO	World Trade Organization

I. Introduction

1. The discussions for the fifth review under the Poverty Reduction and Growth Facility (PRGF) arrangement with Mozambique were conducted in Maputo on October 7-24 and December 4-14, 2002 and on April 9-23, 2003.[1] The missions met with the Minister of Planning and Finance, the Governor of the Bank of Mozambique, other senior government officials, and representatives of the private sector and the donor community. The letter of intent and a memorandum of economic and financial policies (MEFP) describing the progress made under the PRGF arrangement during the second half of 2002, as well as the government's economic program for the remainder of 2003, are presented in Appendix I. At the time of the completion of the fourth review, the current PRGF arrangement was extended for an additional year until June 28, 2003.

2. **The conclusion of the discussions on the fifth review was delayed to allow time for developing a plan to deal with vulnerabilities in the financial sector.** The authorities have taken some initial steps to address these vulnerabilities, which would need to be followed by other reforms in the context of a possible successor arrangement. In the attached letter of intent, the authorities request the completion of the review and disbursement of the sixth loan under the arrangement, as well as a waiver for the nonobservance of the end-June 2002 performance criterion for the domestic primary government deficit, which was exceeded by a small margin. The sixth and final review of the program will not be completed.

3. Local authority elections are scheduled to take place in October 2003, and presidential and parliamentary elections in late 2004. The main contenders in the elections are the ruling party, Frente de Libertação de Moçambique (FRELIMO), and the largest opposition party, the Resistencia Nacional de Moçambique (RENAMO). President Joaquim Chissano has announced that he will retire after his second term in office, which expires in December 2004.

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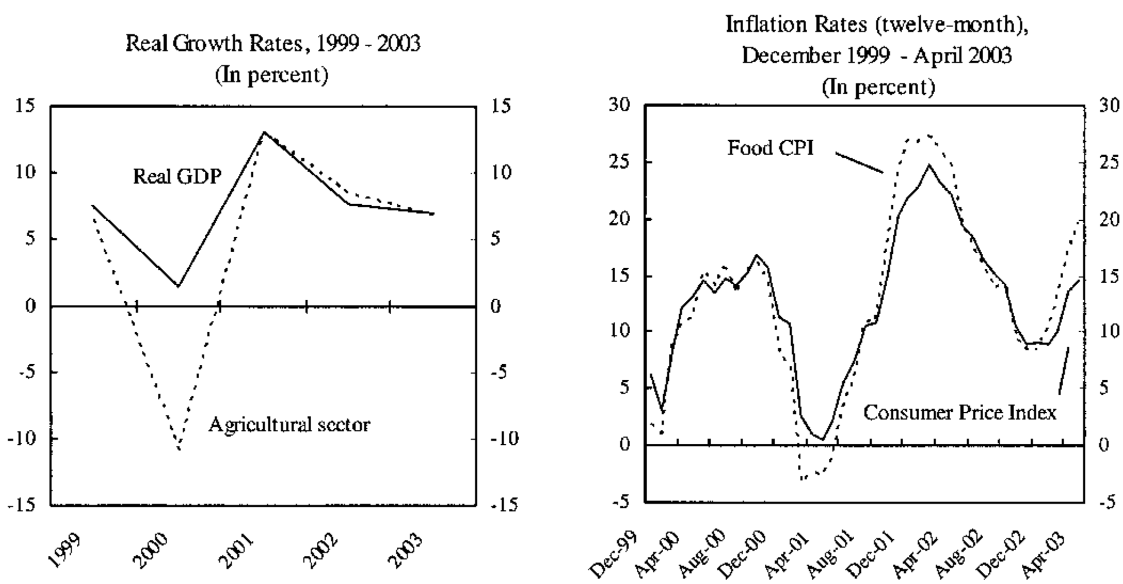
[1] Staff participating in one or more of the missions included Messrs. Di Tata (Head of the 2003 mission), Andrews (Head of the 2002 missions), Alvesson, Engelke, and Manoel (all AFR), Kim (PDR), and Frécaut and Piris Chavarri (MFD). Mr. Schwidrowski (Resident Representative in 2002) and Perone (Resident Representative since 2003) assisted the missions. The missions collaborated closely with World Bank staff, a team that conducted an assessment of the financial system under the Financial Sector Assessment Program (FSAP), and an FAD technical assistance mission (headed by Mr. Castro) that visited Mozambique in October 2002. Ms. Patel, Advisor to the Executive Director for Mozambique, participated in the discussions.

II. Recent Economic Developments

4. **Real GDP growth remained strong at 7.7 percent in 2002 (9 percent in the program)** (Table 1 and Figure 1). Agricultural production grew by 8½ percent, owing to the continued recovery from the effects of the 2000 floods and the favorable performance of cash crops, including sugar. In addition, construction activity increased sharply (albeit less than originally envisaged), owing to post flood reconstruction and the ongoing work on two "megaprojects" (the expansion of MOZAL, the aluminum smelter, and the initiation of a gas pipeline). The manufacturing and commercial sectors also expanded in 2002, albeit at a more moderate pace than programmed, partly because of the adverse effects of tight credit conditions prevailing during most of the year. Although the regional drought has had negative effects on some crops, particularly in the southern and central parts of the country, its overall impact on the agricultural sector has not been serious. At the same time, the effects of recent floods have been largely limited to localized areas.

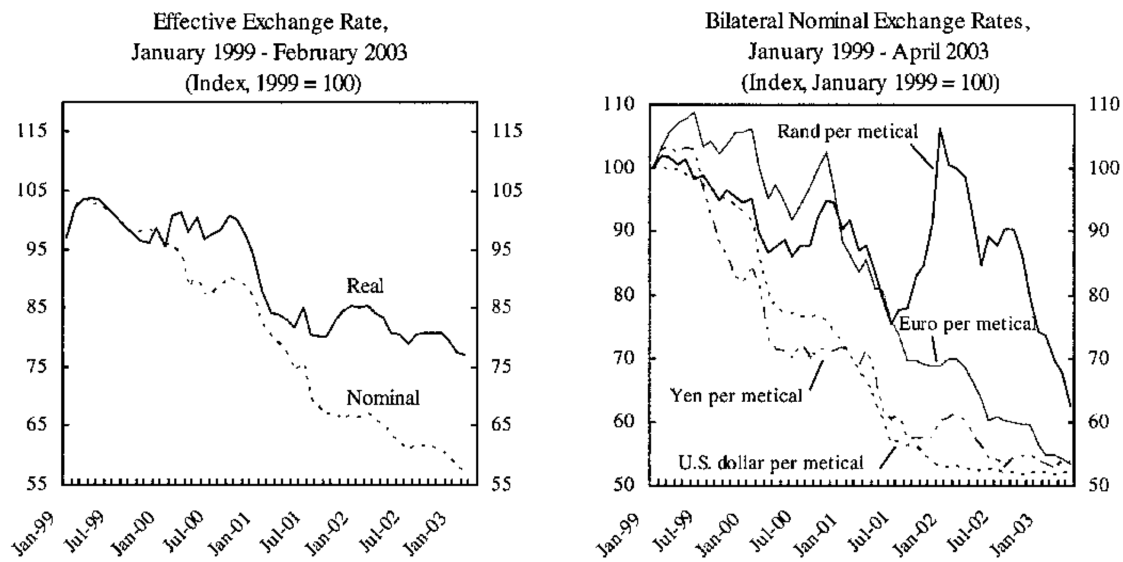
Figure 1. Mozambique: Real Growth Rates and Inflation



Source: National Institute of Statistics.

5. **Inflation (end of period) declined from 22 percent during 2001 to 9 percent in 2002, but the 12-month rate rose to 14.7 percent in April 2003.** There was a sharp drop in inflation through October 2002, owing to tighter liquidity conditions and the weakening of the South African rand, but prices rose at a faster pace subsequently because of the effects of the drought on some agricultural items, the recent strengthening of the South African rand, and the increase in oil import prices. The metical weakened by 2.3 percent against the U.S. dollar during 2002 (Figure 2). It depreciated more markedly *vis-à-vis* the rand because of the sharp appreciation of the rand against the U.S. currency after August 2002. In real effective terms, the metical depreciated by 7 percent during 2002.

Figure 2. Mozambique: Exchange Rates



Sources: Mozambican authorities; and IMF, *International Financial Statistics*.

6. **Performance under the program during 2002 and so far in 2003 has been broadly favorable.** All the quantitative performance criteria through end-June 2002, as well as the indicative target on base money, were observed, with the exception of the performance criterion on the domestic primary deficit (excluding bank restructuring costs), which was missed by a small margin because of lower-than-targeted revenues (MEFP, Table 1). Moreover, all the program indicative targets for end-December 2002, except for the indicative target on government revenue, were observed.

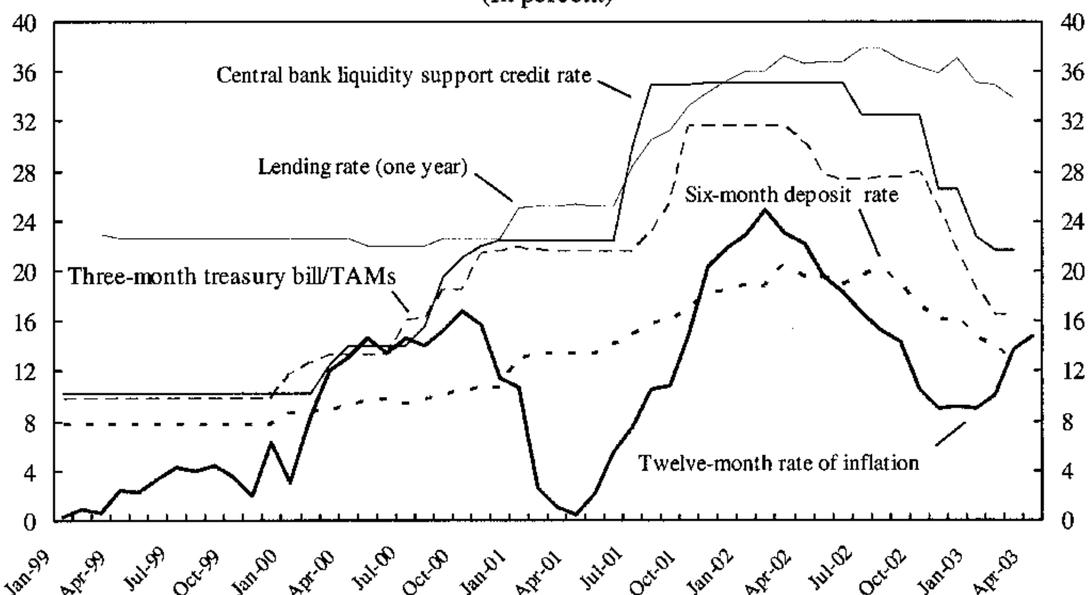
7. Although the **domestic primary deficit** in nominal terms was somewhat lower than targeted in 2002, the deficit is estimated at 3.6 percent of GDP, compared with the 3.4 percent envisaged in the program, owing to a smaller-than-projected GDP.[2] Total revenue increased to 14.2 percent of GDP in 2002, from 13.3 percent in 2001, but it was lower than expected in nominal terms, mostly because of a shortfall in the collection of excise and import taxes (Table 2). Fuel taxes accounted for about half of the shortfall owing to a decline in petroleum imports and a further erosion of the specific fuel taxes, which continued to be kept unchanged in meticals. At the same time, the income tax and the value-added tax (VAT) performed strongly in 2002 on account of the expansion in economic activity and the establishment of new large-taxpayer administration units in Maputo and Beira. Domestic primary spending in nominal terms was contained below program projections in 2002, as the

[2] A downward revision in the GDP deflator for 2001, together with the slower-than-projected growth in 2002, significantly lowered nominal GDP estimates for 2002 and 2003.

authorities more than offset overruns in the wage bill by restraining outlays on goods and services and locally financed capital expenditure. **The overall government deficit (after grants)** was equivalent to 7.9 percent of GDP in 2002, compared with the 6.7 percent envisaged in the program, reflecting the revenue shortfall and higher capital outlays financed with external project loans and grants.

8. **Monetary policy was tightened early in 2002, and broad money growth declined to 20 percent during the year from 30 percent in 2001** (Table 3). Substantial placements of central bank bills led to a marked increase in interest rates through August, as well as to a significant decline in credit growth to the private sector (bank lending rates peaked in that month) (Figure 3). Monetary conditions have eased subsequently as interest rates on central bank instruments have been lowered gradually. The decline in central bank rates, however, has not yet translated into significantly lower bank lending rates.[3] Net international reserves increased by US$107 million to US$638 million during 2002, compared with an adjusted program target of US$546 million, as the import coverage of gross reserves rose to six months of imports of goods and nonfactor services by end-2002.

Figure 3. Mozambique: Inflation and Interest Rates, January 1999 - April 2003
(In percent)

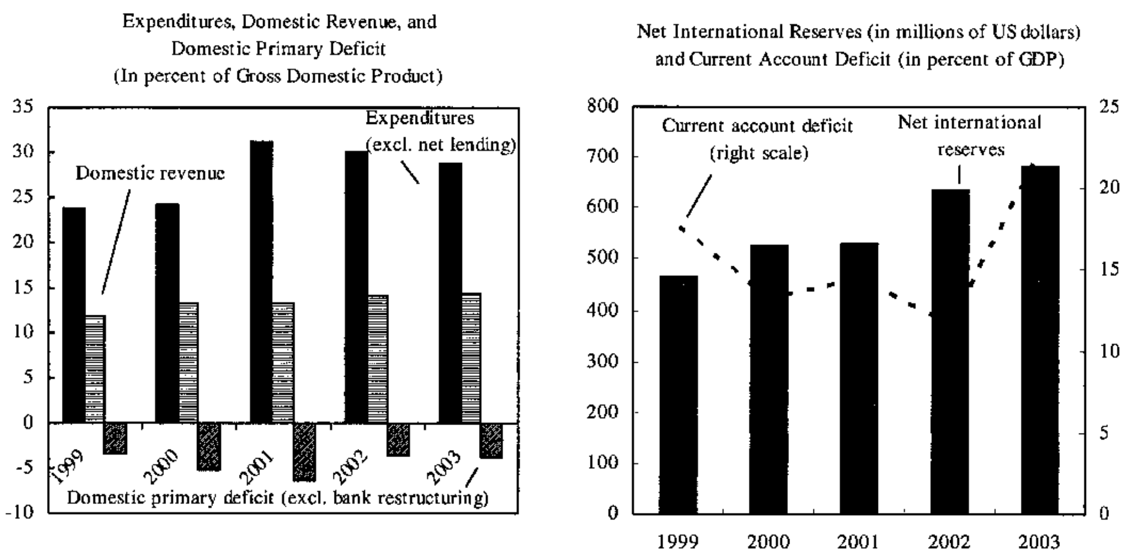


Source: Mozambican Authorities.

[3] Bank lending and deposit rates declined, on average, from 38 percent and 21½ percent in August 2002 to about 34 percent and 15 percent, respectively, in March 2003. Interest rates on central bank instruments, meanwhile, fell more rapidly from 27 ½ percent to 16 ½ percent over the same period.

9. **The external current account deficit (after grants)** narrowed from 14.5 percent of GDP in 2001 to 11.7 percent in 2002 (29 percent in the program) (Table 4 and Figure 4). The lower-than-anticipated deficit is explained by lower imports for the large-scale projects and a very strong performance by transportation receipts associated with the distribution of food aid to other drought-affected countries in the region. Notwithstanding an increase in exports of aluminum and electricity, total exports fell by 3 percent as exports of prawns dropped sharply because of the drought and lower international prices. Although imports grew by almost 19 percent in 2002, the increase was less than programmed, reflecting mainly a slower execution of the megaprojects. In the capital account, the disbursements of loans to both the public and private sectors turned out to be larger than envisaged, while foreign direct investment related to the megaprojects was substantially below program projections.

Figure 4. Mozambique: Fiscal and External Sector Indicators, 1999-2003



Sources: Mozambican authorities; and IMF, *International Financial Statistics*.

10. **In the structural area,** further progress was made during 2002 in implementing tax reforms and strengthening bank supervision. In particular, the program's two structural performance criteria were observed with the introduction in June 2002 of a new fiscal incentives code establishing transparent rules for investors in large projects, and the approval in July 2002 of the codes for the new corporate and personal income taxes, which were introduced starting in 2003. All the other structural performance benchmarks, which dealt mainly with banking supervision and expenditure management issues, were also met (Box 1, and MEFP, Table 2).

11. In 2002, the government concluded the phased recapitalization of **Banco Austral** (BA), which had been taken over in 2001 before being resold to Amalgamated Banks of South Africa (ABSA), and of the **Banco Internacional de Moçambique** (BIM), the largest

Box 1. Structural Measures

Coverage of structural reforms under the current program

The 2003 program focuses on implementing recent tax reforms, improving public expenditure management (PEM) through the gradual introduction of the new financial administration system (SISTAFE), and addressing vulnerabilities in the financial system. The implementation of a new income tax law, a new fiscal incentives code, and an increase in the specific taxes on petroleum products will strengthen the revenue performance, while further improvements in PEM will increase efficiency in the use of resources, including donor assistance. The financial sector has continued to show serious weaknesses and the gradual adoption of International Accounting Standards (IAS) and the Basel Core Principles for Effective Supervision is crucial for a healthy development of the sector. In this connection, an independent audit of the four largest banks (including the Banco Internacional de Moçambique, BIM) will be conducted, based on IAS. The program includes several prior actions for completing the review and structural benchmarks to support these reforms, as well as structural measures envisaged by the government for the period after the expiration of the arrangement through end-2003.

Status of structural conditionality included in the earlier program

The following actions related to structural conditionality have been taken:

- In May 2002 the BIM was recapitalized. Subsequently, an on-site inspection conducted by the Bank of Mozambique concluded that BIM's provisions for nonperforming loans still fell short of requirements under existing regulations in Mozambique. In late 2002, BIM took several steps to meet domestic provisioning requirements. These actions were certified in May by its external auditors (KPMG). An assessment of earlier losses related to the merger in 2001 of BIM with the Banco Comercial de Moçambique (BCM), a troubled bank, is subject to World Bank conditionality under an Economic Management and Private Sector Operation (EMPSO).
- The reprivatized Banco Austral (BA) has transferred loans to the government that were fully provided for but considered unrecoverable by the BA. The government is committed to using its fiscal powers to recover these loans. The EMPSO includes conditionality on this matter (see below).
- Structural performance criteria related to the approval of a new code of fiscal incentives and the new codes for the corporate and personal income taxes were met in June 2002 and July 2002, respectively.
- All the structural benchmarks were also met. These included (i) approval of regulations eliminating the stamp tax on transactions subject to the VAT; (ii) approval of regulations on the new vehicles tax; (iii) adoption of a standardized and comprehensive reporting format for all inspections conducted by the Banking Supervision Department; (iv) production of quarterly reports for each financial institution; and (v) publication of a decree establishing regulations under the Financial Management Law.

Structural areas covered by World Bank and other donor lending and conditionality

Under the EMPSO, which was approved on August 29, 2002, the World Bank has taken the lead in supporting reforms of the judicial and regulatory systems and further privatization in the energy, telecommunications, and transportation sectors. The EMPSO also envisages several steps to strengthen the financial system, including conditionality for the recovery of loans from Banco Austral (BA) and accountability for the losses incurred by BA and the BIM group. The EMPSO seeks to improve transparency in budget execution by incorporating into the annual budget the ministries' own sources of revenue and financing, which stem mainly from donor project support. This is a complementary step to the implementation of SISTAFE.

bank in the country with a market share of 45 percent.[4] However, an on-site inspection conducted by the Department of Banking Supervision (DBS) of the Bank of Mozambique in October 2002 concluded that BIM's provisions for nonperforming loans did not meet existing regulations in Mozambique, which fall short of International Accounting Standards (IAS). This issue was a key factor behind the delay in completing this review. In late 2002, BIM took several steps to meet domestic provisioning requirements. In addition, in January 2003 BIM submitted a business plan to the DBS. An annual review completed recently by KPMG (the bank's external auditors) concluded that the transactions carried out by BIM in December to satisfy Mozambican requirements were appropriate.

12. **In February 2003, the government published the progress report for the first year of implementation of the PRSP (PARPA under its Portuguese acronym), which is analyzed in the joint staff assessment (JSA) prepared by Fund and World Bank staff.** The report and the JSA conclude that, in broad terms, progress is being made in attaining the objectives stated in the PRSP; however, the JSA recommends improvements in several areas, including the need to strengthen the participatory process, focus on pending structural reforms, and further improve the monitoring of the PARPA. Regarding the latter, there is a need to strengthen the coverage, quality, and timeliness of the data, including the poverty indicators. World Bank-sponsored public expenditure reviews are expected to help address this issue. Moreover, the PARPA's underlying macroeconomic framework needs to be revisited to incorporate the results of ongoing work on the impact of HIV/AIDS on growth and public expenditure. In late 2002, the government took an important step to improve the monitoring and dissemination of information through the establishment of a Poverty Observatory (OP), which will allow for broader participation of stakeholders.

13. Preliminary information indicates that, as expected, **government spending on the priority sectors** (education, health, agriculture, infrastructure, and governance) fell from 19.1 percent of GDP in 2001 to 18.4 percent in 2002, owing to a decline in post flood reconstruction expenditure. Total outlays on the priority sectors were equivalent to 64½ percent of total budgetary expenditure in 2002, only slightly below the PARPA target. A National Household Survey is being conducted that will provide important information about social conditions, with the first results expected to become available in the latter part of 2003.

III. The Program for the Remainder of 2003

14. **The authorities remain committed to the poverty reduction strategy presented in the 2001 PARPA report.** In line with such a strategy, the government's program for 2003 seeks to sustain rapid growth through the maintenance of macroeconomic stability and an

[4] BIM is controlled by Banco Comercial Português (BCP), a large private Portuguese bank (67 percent of capital); minority stakes are held by the government of Mozambique (23 percent), the state social security agency (INSS) (4.8 percent), and other public and private entities.

environment conducive to private sector development, to continue addressing remaining weaknesses in the financial system, and to deepen other structural reforms. The fiscal program calls for a further strengthening of tax revenue, in line with the PARPA's medium-term objectives of reducing aid dependence and poverty.

15. **The economic program for 2003** envisages real GDP growth of 7 percent as a result of more moderate expansion in the agricultural and transportation sectors. Following the recent impact on prices of the exogenous shocks referred to in paragraph 5 above, the 12-month rate of inflation is targeted to fall to below 11 percent in December 2003, in line with a programmed decline in broad money growth (see Table 1). Net international reserves are targeted to increase by US$45 million to US$683 million by end-2003 (equivalent to five months of imports of goods and services), a level considered prudent in light of the uncertainties associated with aid flows. In accordance with the PARPA objectives, government spending on the priority sectors is expected to increase to 18.7 percent of GDP in 2003, with the share of priority outlays in total expenditure rising to 68 percent.

A. Fiscal Policy and Public Expenditure Management

16. **The fiscal program for 2003 seeks to contain the domestic primary deficit of the government (excluding bank restructuring) at 3.7 percent of GDP (3.6 percent in 2002)** (see Table 2 and Figure 4). At the same time, the overall deficit (after grants) is expected to narrow by 4 percentage points of GDP to 3.9 percent of GDP, mainly reflecting a decline in externally financed capital expenditure and the completion of the bank restructuring program in 2002. The deficit would be more than covered by external financing, which, in turn, would allow for a reduction in the net indebtedness of the government with the domestic banking system.

17. Based on conservative assumptions, **total revenue** is projected to rise slightly to 14.3 percent of GDP in 2003, as an increase in tax revenue would be largely offset by a decline in nontax receipts from the relatively high levels achieved in 2002 through sales of assets and the recovery of nonperforming loans from BA. Tax revenue would rise by 0.7 percentage point of GDP. The increase would be supported by the new income tax approved in 2002, which reduces deductions and introduces the taxation of civil servants' incomes through a withholding tax (about ½ percentage point of GDP). Also, the implementation of a new vehicles tax approved in 2002 and the full effect of the new fiscal incentives code is expected to more than offset a possible loss associated with a recent reduction of the top import tariff. In addition, in May 2003 the authorities took advantage of the recent softening in oil import prices to raise the specific tax on domestic petroleum products by an average 62 ½ percent, thereby offsetting most of the erosion experienced by these taxes in recent years because of inflation. The authorities indicated that this step would be followed in early 2004 by a further increase in these taxes and the adoption of an automatic mechanism of adjustment. In this connection, a Poverty and Social Impact Analysis (PSIA) conducted in October 2002, which was supported by the United Kingdom Department for International Development (DFID), concludes that the impact of increasing fuel taxes on the poor in Mozambique is relatively modest (Box 2).

18. **Revenue collections will also be strengthened through continued efforts at improving tax and customs administration.** Important measures have been taken in the customs service with the recent appointment of a new management, the retrenchment of hundreds of staff members without proper qualifications, and improved procedures to deal with disciplinary cases. At the same time, with technical support from FAD, the authorities are taking steps to further improve control of large taxpayers, modernize tax penalties and the appeal process, and implement a central revenue authority by January 2005 (an action plan for this purpose was approved recently). In addition, as part of the process to increase budgetary transparency, the 2003 budget includes a more comprehensive coverage of the own receipts (licenses and fees) of the line ministries, which will be expanded in the future.

19. **Regarding expenditure,** in early April 2003 a tripartite commission agreed on an increase of 21 percent in the minimum wage, effective April 1, which would translate into an average wage increase of 17 percent for government employees. This wage adjustment, together with a planned increase in public employment in the areas of health, education, and security (in line with the PARPA) and full compensation of tax payments for those government employees who became subject to the income tax, is projected to increase the government's wage bill to 7.6 percent of GDP in 2003 from 7.3 percent in 2002. At the same time, spending on goods and services is expected to rise somewhat owing to the cost of the local elections. The authorities agreed to largely offset the envisaged increase in current outlays by restraining locally financed capital expenditure. The fiscal program includes a contingency reserve of 0.3 percentage point of GDP to cover any needs related to drought and floods—an amount that, based on available information, appears to be sufficient for this purpose.

20. **The staff expressed concern about the magnitude of the wage increase and the rapid growth of the wage bill in recent years and noted that the envisaged reduction in capital outlays could affect adversely poverty-alleviating projects.** Moreover, the staff observed that a policy of wage restraint was necessary in the future in light of expected additional fiscal pressures, including the possible need to recapitalize the central bank. The authorities recognized that the recent growth in the wage bill had been excessive. They indicated that this issue would need to be addressed in the context of a reform of the public sector to be initiated in some key ministries during the second half of the year (see paragraph 31 below). In the meantime, efforts would be made to protect the social sectors by curtailing non-priority outlays.

Box 2. Poverty and Social Impact Analysis (PSIA): the Case of Petroleum Taxes in Mozambique

In October 2002, a group of consultants concluded a PSIA report that was supported by the DFID. The study assessed the impact of an **increase in fuel taxes** in Mozambique. Fuel taxes, which are specific, had not been increased for five years and their real value had been substantially eroded. As a result, the share of these taxes in government revenue, which had traditionally been around 10 percent, had been reduced to 7 percent.

The study focused on **two policy scenarios**: (i) updating the fuel tax in line with inflation, which would involve a 65 percent increase in these taxes and would lead to a 13.5 percent increase in fuel prices; and (ii) updating the taxes to protect their dollar value, which would involve a 100 percent adjustment and would result in a 20.7 percent increase in prices. Taking into account the potential impact on vulnerable groups and the goal of maintaining price consistency with South Africa, the study recommended the first scenario.

Main effects

Given the very small share of fuel in the economy, the PSIA suggested that the net economic impact would be smaller than generally envisaged, as fuel imports have amounted to only 3 percent of GDP in recent years, with fuel taxes accounting for slightly more than 1 percent of GDP. In this connection, the study concluded that the impact of an increase on the poor would be relatively modest, and that any increase may be more constrained by the need to preserve consistency with South African prices than by concerns about its impact on poverty.

Fuel prices in Mozambique affect other prices in the economy mainly through their effect on transport costs. In this regard, models of transport operations usually assume that fuel accounts for a high proportion of direct operating costs, but other sources of information used in the PSIA (such as a social accounting matrix, SAM) suggest that fuel accounts for a much smaller share of all transport costs (about 10 percent). These differences may be explained by the fact that the SAM coefficient is an average involving many types of transport, while models of transport operations concentrate on motor vehicle transport, which has the highest fuel content.

In the course of the study, key Mozambican stakeholders were of the view that an increase in fuel taxes would have a significant negative impact on poverty levels. Although some activities are more sensitive to fuel price changes, the PSIA argued that the aggregate impact on purchasing power of the fuel price change associated with a 100 percent increase in the fuel tax (the second and stronger policy option referred to above) would not be large, as the cost of living would increase by only 0.42 percent (pushing 28,500 people below the poverty line).

Further analysis and comparative assessment

The PSIA did not look at the impact of the alternative revenue measures that would be required to generate an increase in tax receipts similar to that envisaged in the exercise. Furthermore, the report did not incorporate in the analysis the positive effect on poverty of the higher expenditure level that would be associated with the increase in fuel taxes. More emphasis should also be given to the need to introduce an automatic mechanism of adjustment for these taxes in order to avoid their erosion with inflation over time.

21. **The government continues to give high priority to improving transparency and efficiency in the management of public funds.** To that end, in October 2002 the Ministry of Planning and Finance approved the conceptual framework for a new financial administration system (SISTAFE) and the action plan for its implementation. Donor support has also been secured to finance this project. SISTAFE is expected to start functioning in the Ministry of Planning and Finance and the Ministry of Education by end-October 2003.

B. Monetary and Financial Sector Policies

22. **The monetary program for 2003 envisages a reduction in the 12-month rate of growth of broad money to 18½ percent in December 2003 from about 20 percent in February, in line with the targeted decline in inflation** (see Table 3). Given the programmed reduction in net credit to the government and the planned small buildup of net international reserves, the monetary target provides scope for increasing credit to the private sector, which has remained virtually flat through March 2003, by about 15 percent for the year as a whole. The stock of central bank bills placed with banks rose markedly during 2002 and the first quarter of 2003 as the authorities relied on open market operations to sterilize the impact of the larger reserves accumulation. The latter followed after the central bank's sales of foreign exchange fell short of aid disbursements. **The authorities will ensure that interventions in the exchange market are limited to cushioning the impact of temporary shocks and achieving the program's foreign reserves target;** at the same time, they will seek to better coordinate the pace of expenditures financed with external budget support with the central bank's sales of foreign exchange, in order to facilitate an adequate sterilization of excess liquidity. Consistent with this monetary framework, the exchange rate will be allowed to respond to underlying market pressures, and the central bank will stand ready to adjust the interest rates on its monetary instruments as needed to achieve the inflation target.

23. **The Mozambican banking system remains highly concentrated and heavily constrained by lending risk,** a situation that is reflected in high lending rates and wide intermediation margins. Dealing with these issues requires improving the institutional environment, including the judicial system, to facilitate loan recovery; fostering healthy competition in the sector; and strengthening monetary management to reduce volatility. To dispel uncertainties as to the overall soundness of the financial system, the authorities agreed with the staff to subject the four largest banks to diagnostic reviews by reputable international accounting firms on the basis of IAS[5]. This action is in line with recommendations made by the recent FSAP missions that helped identify other structural deficiencies (Box 3). For this purpose, terms of reference are being prepared in consultation with Fund and World Bank staff, and donor financing is being identified. Based on the findings of these reviews, the authorities will develop a timetable to move gradually toward

[5] Work on these audits is tentatively scheduled to begin in August and its completion is likely to require 3-4 months.

IAS. The authorities indicated that they would continue to monitor developments in the financial system very closely and be ready to act in consultation with Fund and World Bank staff if problems were to develop.

24. **As a parallel process, the authorities made a commitment in the MEFP to gradually strengthen prudential regulations in order to comply with the Basel Core Principles for Effective Banking Supervision** (MEFP, paragraph 23). Also, shortly after the completion of the diagnostic reviews, the DBS will develop a timetable for implementing provisioning standards for loan losses consistent with accepted international practices. Moreover, before end-October 2003, the Bank of Mozambique will issue instructions to financial institutions detailing practical steps to move toward supervision on a consolidated basis. In March 2003, a new Financial Institutions Law was submitted to parliament that gives the Bank of Mozambique sole responsibility for issuing and revoking licenses for financial institutions; provides for automatic penalties for noncompliance with prudential regulations; and makes managers of financial institutions personally liable for gross violations of banking regulations. This legislation is expected to be passed before the end of 2003.

C. Balance of Payments and External Sector Issues

25. **Mozambique's external current account deficit (after grants) is projected to rise to 22 percent of GDP in 2003** from 11.7 percent in 2002, reflecting a strong increase in imports for the megaprojects and a decline in transportation receipts to more normal levels (Table 4). Exports would grow by 23 percent, owing to increased production by MOZAL, whose capacity will double by the end of the year, and to a recovery in prawn exports. Imports would rise by almost 30 percent reflecting strong investment in MOZAL and the gas pipeline and the rapid growth of other imports. As a result, the country's total external financing needs will increase by 20 percent in 2003 to US$1.7 billion (Table 5). This financing requirement is expected to be covered by a mix of grants, concessional loans, and

Box 3. Financial Sector Assessment Program (FSAP) for Mozambique

Against the background of repeated difficulties in the financial sector, two joint Fund/World Bank missions conducted an assessment of the financial sector under the FSAP during the first quarter of 2003. The missions observed that the growth of the banking system, notwithstanding considerable progress made in the last decade, remained constrained by lending risk, resulting in part from weaknesses in the institutional environment. In addition, the missions noted that the system was characterized by high levels of foreign ownership, concentration, and dollarization, and a low level of intermediation. Among the causes of low intermediation are wide interest rate spreads (which reached 19 percentage points in 2002) and relatively high and volatile real interest rates (bank lending rates are on the order of 20 percent in real terms). Lack of an effective land title that could serve as collateral and an inefficient judicial system were identified as important causes behind the high incidence of nonperforming loans which, in turn, induced the system to maintain wide interest spreads.

The missions concluded that a further strengthening of banking supervision was crucial to improve the soundness of the financial system. In this regard, they recommended that the authorities (i) undertake diagnostic reviews of the four largest banks to assess the impact of introducing International Accounting Standards; (ii) establish regular communication with the head offices of foreign banks and with foreign supervisors; (iii) bring the current loan classification and loan loss provisioning systems gradually in line with international practices; (iv) establish trigger points to prompt legal action once a bank's capital falls below minimum requirements; and (v) take decisive steps to build the core knowledge of supervisory staff.

The missions also made a number of recommendations in other areas. In particular, they underlined the need to (i) strengthen monetary management by making it more transparent, proactive, and forward-looking; (ii) provide the central bank with appropriate instruments to conduct monetary policy; (iii) improve central bank intervention in the foreign exchange market, including through the introduction of foreign exchange auctions;(iv) strengthen public debt management; and (v) implement key institutional and legal reforms to facilitate lending, enhance risk diversification and management, and improve access to financial services by the poor. In addition, the FSAP missions identified that while the central bank is reporting a positive capital, there is a need for recapitalization once valuation adjustments are properly accounted for.

The implementation of the above-mentioned recommendations will require a comprehensive program of technical assistance stretching well into the future.

The Financial Sector Stability Assessment (FSSA) will be discussed in the context of the next Article IV consultation.

large private investment flows. The external current account deficit would decline, on average, to about 9 percent of GDP over the medium term as exports from the megaprojects increase and the construction phase of these projects is gradually completed.

26. **Total disbursements of official loans and grants** (excluding debt relief under the Initiative for Heavily Indebted Poor Countries (HIPC initiative) provided by multilaterals in the form of grants) are projected to increase only slightly to about US$640 million in 2003, including the disbursement of the second tranche of an Economic Management and Private Sector Operation (EMPSO) credit from IDA. Private sector capital flows, including both borrowing and foreign direct investments, would rise to almost US$1 billion, with private inflows unrelated to the megaprojects expected to increase sharply to about US$280 million. The major recipients of such flows would be the services and agro-processing sectors. This development, if maintained over the medium term, would contribute to export diversification and a more balanced growth.

27. Mozambique signed bilateral HIPC initiative debt relief agreements with eight Paris Club creditors,[6] and the agreements with Brazil and Sweden are expected to be concluded shortly. The government has also continued to seek agreements with the two remaining Paris Club creditors as well as with non-Paris club creditors on comparable terms. To that end, the deadline for reaching bilateral agreements with Paris Club creditors has been extended to end-June 2003. Negotiations are also continuing to settle a dispute with one Paris Club creditor on a small amount of debt-service payments. Regarding non-Paris Club creditors, negotiations were concluded successfully with China and Kuwait in 2002, and an agreement with India is expected to be signed in the near future. In addition, Mozambique has offered alternatives for the resolution of its sovereign debt of a commercial nature, including debt buybacks and conversion options, in the context of the IDA Debt Reduction Facility.

28. The authorities, after having achieved a sustainable debt level through the HIPC Initiative, should maintain a **sound debt management policy** to ensure that existing external obligations are met and that new borrowing is consistent with the country's payments capacity. The government has made progress in this regard, with technical assistance from Debt Relief International (DRI) and the Commonwealth Secretariat, and financial support from Sweden. The public debt database was updated in March 2003 and is expected to be reviewed by the Commonwealth Secretariat in the coming months.

29. **Steps have also been taken to further liberalize the trade system.** Specifically, effective January 2003, the top tariff rate was reduced from 30 percent to 25 percent. In addition, legislation to accept Article 7 of the General Agreement on Tariffs and Trade (GATT) and move from the current Brussels system of valuation to the more uniform and transparent World Trade Organization (WTO) system was approved by the Council of Ministers in 2002.

[6] Austria, France, Germany, Italy, Russia, Spain, the United Kingdom, and the United States.

D. Other Structural Reforms, Governance Issues, and Statistical Issues

30. **Other structural reforms under way focus on further enhancing the role of the private sector in some sectors, increasing efficiency in the public sector, and improving governance by strengthening the judicial system and fighting corruption.** In the context of the EMPSO supported by the World Bank, and in line with PARPA objectives, the authorities intend to increase the role of the private sector in the telecommunications, air transport, oil, and coastal shipping sectors. To that end, a draft telecommunications law separating the operational arm of the state telecommunications company (TdM) from its regulatory arm and allowing for competition in the sector has been submitted to parliament. Meanwhile, TdM has set up its wireless communications business as a separate company, and a competitor is expected to start operations shortly. In addition, privatization strategies are being developed for the national airline and the state oil company. It is expected that these privatizations will be implemented over the next three to four years.

31. In addition to customs reform and the introduction of SISTAFE, the authorities are working on a **comprehensive reform of the public sector** to increase its efficiency, decentralize activities, and improve the quality of the civil service. In this regard, by end-August 2003 all the ministries are expected to have completed an assessment of their operations and to have identified areas for restructuring. Subsequently, some key ministries, including those related to PARPA priorities, will begin the restructuring process. The staff encouraged the authorities to adopt a cautious approach toward decentralization, to avoid additional fiscal pressures on the central government.

32. **Steps have also been taken to reform the judicial and legal systems in the context of the EMPSO.** The reform, which would be implemented over a period of four years through 2006, seeks to improve the quality of judicial services, decentralize and speed up the administration of justice, and combat corruption. Following a complex consultation process, the National Council for Legal and Judicial Issues has formally endorsed the reform strategy, including detailed plans for the four judicial branches (Ministry of Justice, Office of the Attorney General, Supreme Court, and Administrative Court). Moreover, an anticorruption unit has been established in the office of the attorney general and new anticorruption legislation is expected to be approved during the remainder of 2003.

33. **Progress in improving the accuracy, timeliness, and coverage of the macroeconomic statistics has been slow.** The data module of the Report on Observance of Standards and Codes (ROSC) was published in March 2003 (Box 4). The report concludes that there is a need for improvements in several areas, including the national accounts, price data, and the balance of payments statistics. The government intends to address these issues with technical assistance from the Fund, the World Bank, and donors. Although Mozambique reports gross international reserves data with the required periodicity and timeliness, an exercise is still under way to complete the reserves template. In recent months, some technical problems in updating the computer system led to delays in the provision of relevant macroeconomic information. The government made a commitment to resume the publication of the budget execution report of the preceding quarter with a time lag not exceeding

Box 4. Mozambique's Data Dissemination Practices and the Quality of Its Statistics

In March 2003 the Fund published the data module of the Report on the Observance of Standards and Codes (ROSC) prepared by STA, and an in-depth assessment of the quality of the national accounts, consumer price index, government finance statistics, monetary accounts, and balance of payments statistics. These reports concluded that there was a need to improve some statistical practices and databases to minimize the potential for detracting from an accurate and timely analysis of economic and financial developments, and to help formulate appropriate policies. The authorities remain strongly committed to adhering to internationally accepted standards and good practices, as demonstrated by their recent decision to participate in the General Data Dissemination System (GDDS) project.

On **data dissemination practices,** the report points out the following:

- With the exception of the monetary statistics, there are limitations in the coverage of all comprehensive frameworks and indicators recommended in the GDDS.
- With respect to periodicity, most GDDS recommendations are met, with the exception of (i) the manufacturing production index, which is compiled only on a quarterly basis; and (ii) data on imports/exports, which are compiled on a quarterly basis.
- Regarding timeliness, statistics that do not meet the GDDS recommendations are the annual data on comprehensive central government operations and debt, which are disseminated with 18-month lags.

On the conditions within the agencies in Mozambique in charge of producing macroeconomic statistics that have an impact on data quality **(prerequisites of data quality)**, the report identified the following issues:

- Although the statistical agencies have a broadly adequate legal and institutional framework that supports statistical programs, the responsibility for the compilation and dissemination of external trade data is not clearly specified.
- Limited awareness of the importance of compiling and disseminating government finance statistics in accordance with international standards hampers the analytical usefulness of available fiscal aggregates.
- In the areas of balance of payments, government finance, and national account statistics, human and technological resources are severely constrained.

With regard to **data integrity** (adherence to objectivity in the collection, compilation, and dissemination of statistics so as to maintain users' confidence), the reports concludes that, in general, all institutions demonstrate professionalism, pursue transparency in their statistical practices and policies, and provide ethical guidelines to their staff.

On the **methodological soundness** of available data, although the methodologies for compiling macroeconomic statistics follow, to some extent, international standards and guidelines, in general there are shortcomings in the classifications and sectorization, and the scope of most data sets is not comprehensive.

As regards the features that contribute to the goal that data portray reality—**accuracy and reliability—** there are important shortcomings in the data sources, in particular for the national accounts and the consumer price index. Moreover, assessment and validation of intermediate data and statistical outputs are limited, especially in the areas of government finance and balance of payments statistics.

Finally, looking at the extent to which the data meets users' needs **(serviceability)** and their availability **(accessibility)**, an informal survey conducted among the main users—academics, media, international organizations, bilateral donors, banks, and public sector agencies—showed that the disseminated information did not appear to fully meet their needs. Specifically, there is significant room for improving the presentation and dissemination formats for all macroeconomic statistics, as comprehensive metadata are not available for most data sets and contact information and support services for users are limited.

45 days, starting in May 2003. Moreover, the data corresponding to monthly government revenues will be provided with a lag not exceeding one month.

E. Monitoring Indicators

34. To evaluate its implementation, the program includes several prior actions for completing the review and structural benchmarks. In addition, to monitor economic performance beyond the program's expiration in June, indicative quarterly targets have been set for end-June, end-September, and end-December 2003, and the government has provided a list of structural measures envisaged for the second half of the year (see MEFP, Tables 1, 3, and 4).

F. The Unfinished Agenda

35. **Over the last four years, significant progress has been made under the PRGF arrangement in addressing macroeconomic imbalances and structural issues** (Box 5). Real GDP has grown at a strong pace, inflation has been reduced since 2001 (though it is still high and volatile), and fiscal policy has been managed prudently. Government revenue has been strengthened through the introduction of important reforms, and progress is being made in improving public expenditure management. In addition, several steps have been taken to strengthen bank supervision and regulation, and the government has reduced its role in the financial system by withdrawing from the BA.

36. **Looking ahead, the authorities should tackle decisively the important unfinished agenda of reforms, in order to sustain high growth and achieve the PARPA objectives.** This agenda includes key reforms to strengthen the financial system, improve liquidity management, consolidate and expand the gains made in tax policy and administration and public expenditure management, restructure the public sector to increase efficiency, reduce labor market rigidities, and improve judicial institutions. Addressing these issues is crucial in order to stimulate private sector development.

37. **The authorities have expressed a strong interest in reaching agreement on a successor program to support these reforms.** Given that Mozambique is a prolonged user of Fund resources, the staff will develop a country strategy paper dealing with the main issues that would need to be addressed in the context of a possible new program, and it will discuss this paper with the authorities at the time of the next Article IV consultation mission (tentatively scheduled for September 2003). Satisfactory performance against the indicative targets set for the second half of 2003 in the current program would be an important element in considering any follow-up arrangement.

IV. Staff Appraisal

38. Mozambique's performance under the program supported by the PRGF continued to be satisfactory in 2002 and the first quarter of 2003. Real GDP growth remained strong, inflation declined markedly in 2002 following a tightening of monetary conditions, and the

Box 5. Main Accomplishments Under the Current PRGF Arrangement

The main macroeconomic performance accomplishments are as follows:

- **Average economic growth** reached 7.4 percent a year during the program period 2000-02 (7.7 percent a year in the program), despite the devastating impact of the floods that hit the country in 2000, which reduced growth to 1.5 percent in that year. Growth in agriculture, which exceeded 10 percent a year in 1995-99, declined to 3.6 percent a year in 2000-02 (this incorporates an 11 percent decline in production on account of the floods). Foreign direct investment in the large-scale projects and reconstruction led to a rapid recovery of the economy after the floods.
- **Inflation** (end of period) was reduced to 9.1 percent in 2002 (8 percent in the program), from 21.9 percent in 2000, but it remains volatile. The inflation rate is expected to increase in 2003 owing mainly to the impact of exogenous factors.
- **Fiscal policy** was a decisive factor behind the improved macroeconomic performance. Government revenue increased from 12 percent of GDP in 1999 to 14.2 percent of GDP in 2002. The performance of the VAT and income taxes has been particularly strong. The domestic primary deficit has been reduced in line with the program, and recourse to domestic financing has declined.
- **The value of exports** almost doubled during 2000-02, and export earnings are projected to more than double over the medium term relative to 2002 levels, owing to the contribution of the large investment projects. The international reserves position strengthened during the program period, with the import coverage of gross reserves increasing from 4 months of imports of goods and services (GNFS) at end-1999 to 6 months at end-2002 (4.4 months of imports in the program).
- **The NPV of the total external debt** declined from 212 percent of exports of GNFS at end-1999 to 92 percent at end-2002 (100 percent in the program).

The following structural reforms were implemented under the current PRGF arrangement:

- Substantive progress was made in the area of revenue mobilization through (i) the introduction of a new code of fiscal incentives in 2002, which streamlines exemptions and increases transparency for granting tax incentives; and (ii) implementation in January 2003 of a new income tax that broadens the tax base.
- In the area of tax administration, a new common taxpayer identification number was introduced, controls over large taxpayers have been strengthened, and the government has initiated a process to establish a central revenue authority.
- On public expenditure management, the government has increased transparency by publishing quarterly budget execution reports. Moreover, a new public financial administration law that modernizes budgetary execution procedures and introduces greater fiscal transparency has been approved. The law calls for the government-wide implementation of a modern and automated system to manage government financial transactions (SISTAFE) in January 2004.
- Several steps were taken to strengthen on- and off-site inspections and the provision of information by financial institutions.
- The government sold its shares in Banco Austral and has been divesting its minority shareholdings in privatized enterprises.
- The top import tariff rate was reduced from 30 percent to 25 percent in January 2003.

The completion point under the **HIPC Initiative** was achieved in September 2001. The first PRSP progress report, issued in February 2003, shows progress in line with PRSP objectives.

reserves position was strengthened. The government's continued commitment to the implementation of a broad-based reform agenda was underscored by the observance of all the performance criteria, indicative targets, and structural benchmarks under the 2002 program, with the exception of the end-June performance criterion on the domestic primary deficit, which was exceeded by a small margin. Vulnerabilities in the financial system, however, led to delays in completing the discussions for this review.

39. The authorities remained strongly committed to the poverty reduction strategy presented in the 2001 PARPA. The progress report on the PARPA indicates that advances are being made in achieving the government's poverty reduction objectives, and the establishment of a Poverty Observatory is a commendable initiative that will allow for greater participation of stakeholders in the PARPA process. However, there is a need to focus on pending reforms to sustain growth, update the medium-term macroeconomic framework, and improve the coverage and quality of data, including poverty indicators.

40. The government's economic program for 2003 seeks to maintain prudent macroeconomic management, continue addressing remaining weaknesses in the financial system, and deepen other structural reforms. The fiscal program for 2003 calls for a further strengthening of tax revenue, in line with the PARPA's objectives of reducing aid dependence and combating poverty. Achieving the program's objectives of containing the domestic primary deficit at a level broadly similar to that of 2002 while protecting the social sectors will require a close monitoring of developments in the wage bill so as to avoid overruns, and a careful implementation of the envisaged cuts in capital outlays to preserve poverty alleviating projects. Efforts should be continued to strengthen tax administration in order to ensure the proper implementation of recent tax reforms, and to further improve public expenditure management by adhering to the schedule for introducing SISTAFE. Moreover, there is a need to move ahead with public sector reform by completing the ongoing assessment of the operations of all ministries in order to identify areas for restructuring. This process should pay particular attention to addressing the excessive growth of the government's wage bill in recent years. The recent decision to adjust the specific taxes on fuels which had been eroded because of inflation, is welcome, and consideration should be given to introducing an automatic mechanism of adjustment for these taxes to preserve their real value in the future.

41. Inflation has risen in recent months, owing mainly to exogenous factors, including the impact of the regional drought on some crop items, the strengthening of the South African rand, and higher oil import prices. During the remainder of the year, it is essential to bring inflation down to support sustained growth. In this regard, the central bank should monitor price developments closely and be ready to adjust the interest rates on its monetary instruments as needed to achieve the inflation target. The exchange rate should be allowed to respond to market forces, and the central bank's sales of foreign exchange should be better coordinated with the pace of expenditure financed with external support to ensure an adequate sterilization of excess liquidity.

42. The prospects for sustaining strong growth depend critically on addressing remaining vulnerabilities in the financial system and fostering a healthy competitive environment, so as

to reduce bank spreads. The authorities' decision to move ahead with a diagnostic review of the main banks based on IAS is an important step that would provide further information on the condition of the system that could be used to implement appropriate remedial actions. In addition, the approval by parliament of the new Financial Institutions Law would permit a further strengthening of the prudential framework. The authorities should continue to monitor developments in the financial system very closely and be ready to act quickly in consultation with Fund and World Bank staff if problems develop.

43. The authorities should continue their ongoing efforts to strengthen the debt-management capacity, in order to ensure that obligations are met and that the contraction of new debt remains within the country's payments capacity. They should also press to complete the agreements with remaining Paris Club creditors, and to reach agreements with non-Paris Club creditors and commercial creditors on comparable terms.

44. A determined effort should be made to improve the accuracy, timeliness, and coverage of the national statistics, based on the recommendations of the recent ROSC exercise.

45. The Republic of Mozambique has submitted its PRSP progress report to the Fund and the Bank (EBD/03/31). Staff recommends that the Board conclude that the progress report provides a sound basis for Fund concessional assistance. The Bank Board's consideration of Mozambique's PRSP progress report is scheduled for July 2003, which is after the June 28, 2003 expiration of Mozambique's PRGF arrangement. Staff recommends that, given Mozambique's submission of the PRSP progress report to the Fund and the Bank, the Board complete the fifth review under Mozambique's PRGF arrangement and approve the authorities' request for a waiver concerning the nonobservance of the end-June 2002 quantitative performance criterion on the government's domestic primary deficit, and thereby allow for the sixth disbursement within the arrangement period, without waiting for the Bank Board's consideration of the PRSP progress report.

Table 1. Mozambique: Selected Economic and Financial Indicators, 1999-2003

	1999	2000	2001	2002		2003
				Prog.	Prelim.	Proj.
	(Annual percentage change, unless otherwise specified)					
National income and prices						
Nominal GDP (in billions of meticais)	51,913	56,917	71,135	95,151	85,206	102,749
Nominal GDP (in billions of U.S. dollars)	4.1	3.6	3.4	3.9	3.6	4.2
Real GDP growth	7.5	1.5	13.0	9.0	7.7	7.0
GDP per capita (in U.S. dollars)	243	210	195	214	199	229
GDP deflator	2.9	8.0	10.6	16.9	11.2	12.7
Consumer price index (annual average)	2.9	12.7	9.0	16.6	16.8	12.7
Consumer price index (end of period)	6.2	11.4	21.9	8.0	9.1	10.8
External sector						
Merchandise exports	16.0	28.3	93.2	1.1	-3.0	22.5
Merchandise imports	46.8	-3.1	-8.6	58.3	18.8	29.4
Terms of trade	-13.6	1.8	-1.6	3.5	....	...
Nominal effective exchange rate (end of period) 1/	-0.7	-10.8	-23.4	...	-10.7	...
Real effective exchange rate (end of period) 1/	2.0	-3.7	-9.3	...	-7.1	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)					
Money and credit						
Net domestic assets	23.9	11.6	9.1	12.0	5.5	1.8
Of which: net credit to the government	0.0	4.1	5.3	7.0	4.3	-2.7
credit to the economy	22.9	22.3	15.5	14.1	6.4	5.2
Broad money (M2)	35.1	42.4	29.7	19.2	20.2	18.4
Velocity (GDP/ average M2)	5.2	4.0	3.7	4.0	3.6	3.6
Rate for 90-days treasury bills/TAMs 2/ (in percent; end of period)	11.8	21.8	31.7	...	18.5	...
	(In percent of GDP)					
Investment and saving						
Gross domestic investment	36.7	36.4	37.9	57.7	41.1	45.9
Government	11.6	10.6	16.6	12.6	14.3	12.7
Other sectors	25.1	25.8	21.3	45.1	26.8	33.2
Gross national savings	19.1	23.2	23.5	28.8	29.4	23.7
Government	11.5	11.8	12.3	8.9	10.1	8.9
Other sectors	7.7	11.5	11.2	19.8	19.3	14.9
Current account, after grants	-17.5	-13.2	-14.5	-28.9	-11.7	-22.2
Government budget						
Total revenue	12.0	13.2	13.3	13.0	14.2	14.3
Total expenditure and net lending (incl. residual)	25.1	31.3	33.5	29.9	33.8	28.7
Overall balance, before grants	-13.2	-18.0	-20.1	-16.9	-19.7	-14.4
Total grants	11.7	12.0	13.5	10.1	11.8	10.5
Overall balance, after grants	-1.5	-6.0	-6.6	-6.7	-7.9	-3.9
Domestic primary balance	-3.4	-10.8	-7.3	-6.1	-5.9	-3.7
Excluding bank restructuring	-3.4	-9.1	-5.1	-3.4	-3.6	-3.7
External financing (incl. debt relief)	1.8	4.3	4.7	4.6	7.0	4.5
Domestic financing	-0.3	1.7	1.9	2.1	0.9	-0.6
	(In percent of exports of goods and nonfactor services)					
Net present value of total external debt outstanding 3/	212.0	194.4	109.7	100.3	91.7	87.7
External debt service (nonfinancial public sector)						
Scheduled, after original HIPC Initiative assistance	15.3	5.5	5.8	8.1	8.2	7.6
Scheduled, after enhanced HIPC Initiative assistance	...	2.5	3.6	5.2	5.4	5.2
Scheduled, after additional bilateral assistance	...	...	3.5	4.1	4.3	4.2
	(In millions of U.S. dollars, unless otherwise specified)					
External current account, after grants	-718	-478	-497	-1,120	-421	-942
Overall balance of payments	-236	-352	-421	26	107	45
Net international reserves (end of period)	465	526	531	540	638	683
Gross international reserves (end of period)	669	746	727	733	823	858
In months of imports of goods and nonfactor services	5.5	6.1	5.8	4.4	6.0	5.0
In percent of broad money	75.5	76.2	77.9	73.5	75.0	69.4
Exchange rate (meticais per U.S. dollar; end of period)	13,300	17,140	23,320	26,000	23,854	...
Use of Fund resources (in millions of SDRs)						
Purchases/disbursements	21.0	45.2	8.4	16.8	8.4	8.4
Repurchases/repayments, before HIPC Initiative assistance	22.8	22.2	21.0	17.1	17.1	14.8
Credit outstanding	145.4	167.6	155.8	155.5	147.1	140.7

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.

2/ TAMs stands for 'Titulos das Autoridades Monetarias'. TAMs are debt instruments issued by the Bank of Mozambique.

3/ Public and publicly guaranteed, in percent of the three-year average of exports. The data for 1999-2000 include the impact of total debt relief granted under the original HIPC Initiative. Data for 2001-03 include the impact of total debt relief under the enhanced HIPC initiative, additional bilateral assistance, and new borrowing.

Table 2. Mozambique: Government Finances, 1999-2003

	1999	2000	2001	2002				2003			
	Act.	Act.	Act.	Prog.	Act.	Prog.	Prel.	Prog.	Prog.	Prog.	Prog.
	Year	Year	Year	Q1-Q2	Q1-Q2	Year	Year	Q1	Q1-Q2	Q1-Q3	Year
	(in billion of meticais)										
Total revenue	6,207	7,535	9,469	5,383	5,321	12,406	12,057	3,063	6,375	10,257	14,703
Tax revenue	5,733	6,862	8,400	4,853	4,678	11,208	10,629	2,812	5,730	9,305	13,554
Taxes on income and profits	867	1,034	1,519	717	789	1,969	2,116	530	1,086	2,139	3,203
Taxes on goods and services	3,638	4,314	5,169	3,133	2,954	6,888	6,404	1,699	3,497	5,393	7,783
Of which: on petroleum products	759	771	824	490	382	1,027	865	213	469	746	1,020
Taxes on international trade	1,046	1,279	1,477	854	813	2,011	1,851	447	900	1,428	2,083
Other taxes	183	235	235	149	122	340	258	136	246	344	484
Nontax revenue	474	672	1,070	530	644	1,198	1,428	251	645	952	1,150
Total expenditure and net lending	12,815	15,556	24,579	14,041	13,189	28,460	29,037	7,051	13,359	21,223	29,524
Current expenditure	6,332	7,685	10,345	6,197	6,200	13,581	13,469	3,739	7,291	11,572	16,392
Compensation to employees	2,995	3,817	4,946	2,462	2,454	6,042	6,206	1,490	3,200	5,313	7,809
Goods and services	1,928	2,052	2,715	2,104	1,996	3,333	3,163	1,389	2,362	3,492	4,012
Interest on public debt	324	109	477	510	561	1,430	1,274	72	444	592	1,165
Domestic	6	11	330	342	379	924	952	32	320	427	923
External	318	99	147	168	182	506	322	41	124	165	242
Transfer payments	1,085	1,677	2,208	1,121	1,189	2,776	2,826	788	1,285	2,175	3,406
Capital expenditure	6,001	6,060	11,808	5,141	5,101	11,984	12,155	3,260	6,053	9,656	13,097
Of which: locally financed	1,765	2,046	3,140	1,608	1,673	3,313	3,167	1,134	2,133	3,169	3,503
Net lending	482	1,812	2,426	2,704	1,889	2,895	3,414	53	15	-5	34
Of which: locally financed	-6	1,812	2,426	2,619	1,440	2,725	1,970	-22	-96	-171	-205
Unallocated revenue (+)/expenditure (-) 1/	-220	42	-101	0	-98	0	209	0	0	0	0
Overall balance, before grants	-6,828	-7,980	-15,211	-8,658	-7,966	-16,054	-16,771	-3,989	-6,984	-10,966	-14,820
Grants received	6,073	4,576	10,520	4,384	4,101	9,656	10,027	3,190	6,090	8,279	10,790
Project	2,787	2,112	7,044	2,513	1,545	6,463	6,733	1,676	2,873	4,873	7,059
Nonproject	3,287	2,464	3,475	1,871	1,887	3,193	3,294	1,514	3,217	3,406	3,731
Overall balance, after grants	-754	-3,403	-4,691	-4,274	-3,864	-6,398	-6,744	-798	-894	-2,687	-4,030
Central bank transfer of HIPC assist. by the IMF	0	455	513	218	365	453	539	62	153	206	330
Net external borrowing	910	1,983	2,797	1,610	1,692	3,912	5,405	379	832	1,264	4,270
Disbursements	1,394	2,268	3,108	1,820	1,921	4,271	5,891	583	1,259	1,875	5,161
Project	1,394	1,724	1,624	1,020	1,285	2,208	2,514	450	1,047	1,614	2,536
Nonproject	0	544	1,484	800	635	2,063	3,377	133	212	261	2,625
Cash amortization	-483	-286	-311	-210	-229	-359	-486	-205	-427	-611	-891
Net domestic financing	-156	966	1,382	2,446	1,807	2,032	800	358	-91	1,217	-569
Net bonds issued for bank restructuring	0	745	700	2,190	1,331	2,030	1,828	0	0	0	-200
Other	-156	221	682	256	476	2	-1,028	358	-91	1,217	-369
Memorandum items:											
Domestic primary balance, before grants 2/	-1,780	-3,856	-6,065	-4,531	-3,528	-5,784	-5,066	-1,716	-2,509	-3,721	-3,821
Excluding bank restructuring net lending	-1,780	-2,902	-4,480	-1,971	-2,031	-3,224	-3,068	-1,716	-2,509	-3,721	-3,821
Bank restructuring net lending	0	954	1,585	2,560	1,497	2,560	1,998	0	0	0	0

Table 2. Mozambique: Government Finances, 1999-2003 (concluded)

	1999	2000	2001	2002		2003
	Act.	Act.	Act.	Prog.	Prel.	Prog.
	(In percent of GDP, unless otherwise indicated)					
Total revenue	12.0	13.2	13.3	13.0	14.2	14.3
Tax revenue	11.0	12.1	11.8	11.8	12.5	13.2
Taxes on income and profits	1.7	1.8	2.1	2.1	2.5	3.1
Taxes on goods and services	7.0	7.6	7.3	7.2	7.5	7.6
Taxes on international trade	2.0	2.2	2.1	2.1	2.2	2.0
Other taxes	0.4	0.4	0.3	0.4	0.3	0.5
Nontax revenue	0.9	1.2	1.5	1.3	1.7	1.1
Total expenditure and net lending	24.7	27.3	34.6	29.9	34.1	28.7
Current expenditure	12.2	13.5	14.5	14.3	15.8	16.0
Compensation to employees	5.8	6.7	7.0	6.3	7.3	7.6
Goods and services	3.7	3.6	3.8	3.5	3.7	3.9
Interest on public debt	0.6	0.2	0.7	1.5	1.5	1.1
Domestic	0.0	0.0	0.5	1.0	1.1	0.9
External	0.6	0.2	0.2	0.5	0.4	0.2
Transfer payments	2.1	2.9	3.1	2.9	3.3	3.3
Capital expenditure	11.6	10.6	16.6	12.6	14.3	12.7
Of which: locally financed	3.4	3.6	4.4	3.5	3.7	3.4
Net lending	0.9	3.2	3.4	3.0	4.0	0.0
Of which: locally financed	0.0	3.2	3.4	2.9	2.3	-0.2
Unallocated revenue (+)/expenditure (-) 1/	-0.4	0.1	-0.1	0.0	0.2	0.0
Overall balance, before grants	-13.2	-14.0	-21.4	-16.9	-19.7	-14.4
Grants received	11.7	8.0	14.8	10.1	11.8	10.5
Project	5.4	3.7	9.9	6.8	7.9	6.9
Nonproject	6.3	4.3	4.9	3.4	3.9	3.6
Overall balance, after grants	-1.5	-6.0	-6.6	-6.7	-7.9	-3.9
Central bank transfer of HIPC assist. by the IMF	0.0	0.8	0.7	0.5	0.6	0.3
Net external borrowing	1.8	3.5	3.9	4.1	6.3	4.2
Disbursements	2.7	4.0	4.4	4.5	6.9	5.0
Project	2.7	3.0	2.3	2.3	3.0	2.5
Nonproject	0.0	1.0	2.1	2.2	4.0	2.6
Cash amortization	-0.9	-0.5	-0.4	-0.4	-0.6	-0.9
Net domestic financing	-0.3	1.7	1.9	2.1	0.9	-0.6
Net bonds issued for bank restructuring	0.0	1.3	1.0	2.1	2.1	-0.2
Other	-0.3	0.4	1.0	0.0	-1.2	-0.4
Memorandum items:						
Domestic primary balance, before grants 2/	-3.4	-6.8	-8.5	-6.1	-5.9	-3.7
Excluding bank restructuring net lending	-3.4	-5.1	-6.3	-3.4	-3.6	-3.7
Total expenditure in education	3.5	5.5	6.8	4.9	4.9	4.9
Total expenditure in health	2.9	3.6	3.1	3.7	3.8	4.3
Current expend. on defense and security	2.4	2.5	2.5	2.2	2.3	2.4
Domestic public debt 3/	0.1	1.4	2.2	3.4	3.8	3.1
Nominal GDP (in billions of meticais)	51,913	56,917	71,135	95,151	85,206	102,749

Sources: Mozambican authorities; and staff estimates and projections.

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

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

3/ Domestic public debt refers to treasury securities only.

Table 3. Mozambique: Monetary Survey, December 1999 - December 2003

	1999	2000	2001	2002						2003		
	Dec. Actual	Dec. Actual	Dec. Actual	June Prog.	June Actual	Sep. Prog.	Sep. Actual	Dec. Prog.	Dec. Actual	June Prog.	Sep. Prog.	Dec. Prog.
Central bank												
				(In billions of meticais, unless otherwise specified)								
Net foreign assets	-1,384	-99	1,764	2,186	1,727	2,352	1,721	2,200	4,181	4,445	4,365	5,506
(in millions of U.S. dollars)	-104	-6	76	88	73	92	72	85	175	185	179	220
Net international reserves	6,242	9,015	12,384	13,538	12,538	14,034	12,643	14,040	15,216	15,572	15,668	17,105
(in millions of U.S. dollars)	469	526	531	546	533	550	530	540	638	648	641	683
Medium- and long-term foreign liabilities	-7,819	-9,357	-10,964	-11,640	-11,102	-11,980	-11,258	-12,224	-11,524	-11,604	-11,803	-12,099
Other	193	243	344	289	290	297	336	384	489	477	500	500
Net domestic assets	4,501	4,039	4,293	4,225	4,640	4,579	4,962	5,250	2,953	2,954	3,350	2,904
Credit to government (net)	-5,175	-5,433	-4,581	-4,886	-5,082	-4,684	-3,707	-4,482	-4,488	-4,540	-3,940	-4,540
Credit to banks (net)	408	483	476	575	469	575	-1,105	575	-2,222	-3,486	-3,930	-4,248
Credit to the economy	74	1	0	1	1	1	1	1	1	1	1	1
Other items (net; assets +)	9,194	8,989	8,397	8,536	9,252	8,687	9,773	9,157	9,663	10,979	11,219	11,691
Reserve money	3,117	3,940	6,056	6,412	6,366	6,931	6,683	7,450	7,134	7,399	7,714	8,410
Currency outside banks	2,174	2,425	2,970	2,975	2,970	3,299	3,132	3,624	3,486	3,374	3,550	4,111
Bank reserves	943	1,515	3,086	3,437	3,396	3,632	3,551	3,826	3,648	4,025	4,164	4,299
Currency in banks	391	428	610	505	357	609	473	714	612	456	486	550
Deposits in meticais	237	845	2,211	2,759	2,837	2,831	2,890	2,904	3,036	3,202	3,325	3,516
Required reserves (calculated)	710	1,246	2,386	2,734	2,718	2,806	2,858	2,879	2,824	3,116	3,239	3,413
Free reserves (calculated)	-473	-401	-175	25	118	25	32	25	212	86	86	103
Deposits in foreign currencies	315	242	265	174	202	191	189	208	0	367	354	234
(in millions of U.S. dollars)	24	14	11	7	9	8	8	8	0	8	8	8
Deposit money banks												
Net foreign assets	2,109	4,449	6,046	6,722	6,743	7,009	7,921	7,235	8,215	8,043	8,406	9,868
(in millions of U.S. dollars)	159	260	259	271	287	275	332	278	344	335	344	394
Net domestic assets	7,502	9,904	12,747	14,165	14,863	14,594	15,041	15,084	14,444	17,146	17,817	17,847
Banks' reserves	1,013	1,545	3,307	3,437	3,449	3,632	3,692	3,826	3,774	4,025	4,164	4,299
Central bank liabilities with commercial banks (net)	-307	-959	-628	-655	-431	-655	1,124	-655	2,029	3,486	3,930	4,248
Credit to government (net)	-441	296	334	1,769	3,257	1,769	2,004	1,769	1,093	1,053	1,761	575
Credit to the economy	8,645	11,343	13,943	15,382	14,430	16,196	14,011	17,011	14,523	15,584	15,693	16,701
Of which: in foreign currency	2,934	4,350	5,405	5,915	5,658	6,361	6,018	6,760	6,676	7,836	7,286	7,486
(in millions of U.S. dollars)	221	254	232	239	240	249	252	260	280	326	298	299
Other items (net; assets +)	-1,408	-2,321	-4,210	-5,768	-5,841	-6,349	-5,791	-6,867	-6,974	-7,002	-7,731	-7,977
Deposits	9,611	14,353	18,793	20,886	21,605	21,602	22,961	22,319	22,659	25,189	26,223	26,871
Demand and savings deposits	7,293	10,775	14,034	15,849	15,399	15,597	16,570	16,667	16,367	18,644	19,462	20,443
Time deposits	2,318	3,579	4,759	5,037	6,206	6,006	6,391	5,652	6,292	6,545	6,761	6,428
Monetary survey												
Net foreign assets	725	4,350	7,810	8,908	8,469	9,361	9,642	9,434	12,395	12,488	12,770	15,374
Net domestic assets	11,059	12,429	13,954	14,953	16,106	15,540	16,451	16,508	13,750	16,075	17,003	15,608
Domestic credit	3,104	6,207	9,697	12,265	12,605	13,281	12,310	14,298	11,128	12,098	13,515	13,119
Credit to government (net)	-5,616	-5,137	-4,246	-3,117	-1,826	-2,915	-1,702	-2,713	-3,396	-3,487	-2,179	-3,965
Credit to the economy	8,720	11,344	13,944	15,382	14,430	16,196	14,012	17,011	14,523	15,585	15,694	16,702
Other items (net; assets +)	7,956	6,222	4,256	2,689	3,502	2,259	4,141	2,210	2,622	3,977	3,488	3,714
Money and quasi money (M2)	11,785	16,779	21,763	23,861	24,575	24,901	26,093	25,942	26,145	28,563	29,773	30,982
Currency outside banks	2,174	2,425	2,970	2,975	2,970	3,299	3,132	3,624	3,486	3,374	3,550	4,111
Deposits	9,611	14,353	18,793	20,886	21,605	21,602	22,961	22,319	22,659	25,189	26,223	26,871
Of which: foreign currency deposits	4,151	7,107	9,897	10,567	10,714	11,107	11,034	11,554	11,544	12,742	12,667	13,677
(in millions of U.S. dollars)	312	415	424	426	455	435	462	444	484	530	518	546
Foreign currency deposits (in percent of total deposits)	43.2	49.5	52.7	50.6	49.6	51.4	48.1	51.8	50.9	50.6	48.3	50.9
				(12-month percent change, unless otherwise indicated)								
Memorandum items:												
M2 growth	35.1	42.4	29.7	22.1	25.7	18.0	23.6	19.2	20.1	16.2	14.1	18.5
M2 growth at constant end-of-year exch. rates	31.7	29.3	12.5	14.9	21.5	10.3	19.4	13.3	18.9	15.2	13.0	15.9
Credit to the economy	29.7	30.1	22.9	18.8	17.0	19.0	3.0	22.0	4.2	8.0	12.0	15.0
Currency/M2 (in percent)	18.4	14.5	13.6	12.5	12.1	13.2	12.0	14.0	13.3	11.8	11.9	13.3
Reserve money growth	5.16	26.4	53.7	36.5	35.5	25.6	21.1	23.0	17.8	16.2	15.4	17.8
Money multiplier (M2/reserve money)	3.78	4.26	3.6	3.7	3.9	3.6	3.9	3.5	3.7	3.9	3.9	3.7
Velocity (GDP/average M2)	5.06	3.99	3.7	4.4	3.9	4.1	3.6	0.0	3.6	3.5	3.4	3.6
Market exchange rate (Meticais per U.S. dollar)	13,300	17,131	23,320	24,794	23,530	25,517	23,877	26,000	23,854	...	...	...

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

Table 4. Mozambique: Balance of Payments, 1999-2003
(In millions of U.S. dollars, unless otherwise specified)

	1999	2000	2001	2002		2003
				Program	Prelim.	Proj.
Trade balance	-916	-798	-360	-1,058	-581	-799
Exports, f.o.b.	284	364	703	711	682	835
Large projects	76	127	441	424	468	589
Other exports	208	237	263	287	213	246
Imports, c.i.f.	-1,200	-1,162	-1,063	-1,769	-1,263	-1,634
Large projects	-514	-118	-231	-781	-390	-628
Other imports	-685	-1,044	-832	-987	-873	-1,007
Services (net)	-236	-243	-606	-502	-259	-614
Receipts	356	405	311	360	545	385
Expenditures	-592	-648	-917	-862	-804	-999
Of which: interest on public debt	-162	-161	-147	-32	-27	-28
Current account, before grants	-1,152	-1,042	-967	-1,560	-841	-1,413
Unrequited official transfers	434	564	469	440	420	470
Of which: multilaterals' HIPC assistance grants	...	...	...	48	46	44
Current account, after grants	-718	-478	-497	-1,120	-421	-943
Capital account	613	279	35	1,188	675	1,038
Trade credit (net)	...	...	...	...	-128	...
Foreign borrowing	472	484	156	664	809	729
Public	112	162	104	171	248	211
Private 1/	360	322	52	493	561	518
Amortization	-240	-344	-376	-120	-163	-154
Public	-201	-306	-306	-32	-39	-42
Private	-40	-38	-71	-87	-124	-112
Direct investment (net)	382	139	255	644	156	464
Short-term capital and errors and omissions (net)	-131	-153	41	-61	-147	-50
Overall balance	-236	-351	-421	7	107	45
Financing	-808	-98	-5	-7	-107	-45
Of which: Bank of Mozambique net						
international reserves (increase -)	-47	-98	-5	-7	-107	-45
Financing gap before debt relief	1,044	449	426	0	0	0
Financing gap after debt relief	0	0	0	0	0	0
Memorandum items:						
Debt relief 2/	1,044	449	426	416	416	404
Current account deficit (percent of GDP)						
Before grants	28.2	26.8	28.1	39.0	23.3	33.3
After grants	17.5	11.8	14.5	28.9	11.7	22.2
After grants, excluding large projects	4.2	8.2	12.9	6.1	5.1	10.8
Net international reserves	465	526	531	540	638	683
Gross international reserves	669	746	727	733	823	858
In months of imports of goods						
and nonfactor services (GNFS)	5.5	6.1	5.8	4.4	6.0	5.0
In months of imports of GNFS, excl. large projects	8.5	6.9	6.9	7.2	7.9	7.2
Debt indicators (in percent)						
Net present value (NPV) debt/GDP	19.8	24.6	24.9	24.1	24.8	23.3
NPV debt/exports	212.0	194.4	109.7	100.3	91.7	87.7
NPV debt/revenue	165.4	193.9	187.0	184.9	175.4	162.9
Debt service due/exports	15.3	9.1	3.5	4.1	4.3	4.2
Debt service due/revenue	17.5	9.4	5.9	7.5	8.2	7.8

Sources: Mozambican authorities; and staff estimates and projections.

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

2/ The balance of payments presentation changed in 2002: debt relief was incorporated above the line so that debt service to official bilateral and commercial creditors reflects what is owed after relief. Debt service to multilaterals is still shown before debt relief, but with HIPC assistance grants a new entry has been set under "unrequited official transfers." The memorandum item shows total debt relief.

Table 5. Mozambique: External Financing Requirements and Sources, 1999-2007
(In millions of U.S. dollars)

	1999	2000	2001	2002		2003	2004	2005	2006	2007
				Program	Prelim.	Proj.	Proj.	Proj.	Proj.	Proj.
External financing requirements	2,360	1,696	1,317	1,768	1,396	1,673	1,101	1,237	1,106	1,157
Current account, excluding grants	1,152	1,042	967	1,560	841	1,413	882	1,044	810	900
Amortization 1/	272	373	403	141	185	175	177	247	250	265
Trade credit (net, increase +)	0	0	0	0	128	0	0	0	0	0
Changes in arrears (increase -)	762	0	0	0	0	0	0	0	0	0
Changes in reserves (increase +) 2/	44	129	-11	6	96	35	42	-54	46	-8
Short-term capital and errors and omissions (net; outflow +) 3/	131	153	-41	61	147	50	0	0	0	0
Total identified financing	1,317	1,247	892	1,768	1,396	1,673	1,101	1,237	1,106	1,157
Disbursements from existing and new commitments	935	1,108	636	1,124	1,239	1,210	771	978	893	938
Grants 4/	434	564	469	440	420	470	426	430	421	418
Loans	501	544	167	685	819	740	345	548	473	520
Bilateral	0	0	0	0	0	0	0	0	0	0
Multilateral 1/	140	222	115	192	259	222	160	160	160	160
IDA	79	125	30	110	148	152	90	90	90	90
IMF	29	60	11	21	11	11	0	0	0	0
Other	33	37	74	61	100	59	70	70	70	70
Private sector	360	322	52	493	561	518	185	388	313	360
Direct foreign investment	382	139	255	644	156	464	330	259	213	219
Debt relief 5/	1,044	449	425	0	0	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Total reduction in debt service due (debt relief) 6/	1,044	449	425	416	416	404	351	292	166	149
Assistance on traditional mechanisms	973	299	282	286	286	270	216	156	35	19
Assistance under the original HIPC Initiative	51	104	99	93	93	95	96	96	91	89
Assistance under the enhanced HIPC Initiative	0	10	17	27	27	27	28	30	31	32
Assistance under additional bilateral relief	0	0	1	10	10	11	10	10	10	9
Paris Club deferral (flood relief)	21	37	26	0	0	0	0	0	0	0
Official grants and loans, excl. multilateral HIPC assistance 2/	546	726	573	563	622	637	541	541	531	531

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.
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 Paris Club deferral; and the application of traditional rescheduling mechanisms by non-Paris Club creditors.
6/ Since debt relief is no longer shown as a below-the-line item once a country passes its completion point, the memorandum items provide the data on debt relief after 2001.

Maputo, June 4, 2003

Dear Mr. Köhler:

The Executive Board of the IMF approved a three-year arrangement for Mozambique under the Poverty Reduction and Growth Facility (PRGF) on June 28, 1999. At the time of the fourth review, which was completed on June 17, 2002, this arrangement was extended for a period of 12 months, providing more time for the implementation of the government's reform agenda. In the attached memorandum, the Government of Mozambique describes progress in implementing its program and lays out its policy intentions through the end of the current arrangement. The government has also prepared a Progress Report on the implementation of the National Action Plan for the Reduction of Absolute Poverty (PARPA), which has been submitted to the Executive Boards of the IMF and the World Bank.

As indicated in paragraph 7 of the memorandum, all structural performance criteria under the program have been observed. However, the end-June 2002 quantitative performance criterion on the primary deficit was exceeded by a small margin because of a shortfall in revenues. Domestic primary expenditures were contained below the program projection during the second half of the year, and the end-December 2002 indicative target for the domestic primary deficit was observed. Steps have also been taken to address vulnerabilities in the banking system, a major factor behind the delay in completing this review.

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, and will take any further measures that may become appropriate for this purpose. On this basis, the government requests (i) a waiver in respect of the non-observance of the quantitative performance criterion on the domestic primary deficit, (ii) the completion of the fifth review, and (iii) the disbursement of the sixth loan under the arrangement. The government understands that the current extended PRGF arrangement will expire before it is able to request disbursement of the seventh loan.

After the expiration of the current 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 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. 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.

Sincerely yours,

/s/
Luísa 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 the Period through December 2003

I. Recent Developments and Program Implementation

1. Macroeconomic developments under the program supported by the PRGF arrangement have been favorable, with real GDP growth estimated at 7.7 percent in 2002. Construction activity associated with large-scale foreign investment projects has been very strong, while agricultural output growth is estimated at 8 ½ percent in 2002 owing to a continued recovery in food crops from the effects of the 2000 floods and important increases in some cash crops, particularly sugar. At the same time, the 12-month rate of inflation declined from 21.9 percent at end-2001 to 9.1 percent at end-2002. Following a sharp decline in inflation through October 2002, prices have risen at a faster pace in recent months largely because of the effects of drought and floods on some agricultural products, the increase in oil import prices in the last quarter of 2002 and early 2003, and the recent strengthening of the South African rand. As a result, the 12-month rate of inflation rose to 14.7 percent in April 2003.

2. Although revenue collections relative to GDP were higher than programmed in 2002, total revenue in nominal terms turned out lower than the program's indicative target. Income tax revenue performed strongly, but the collection of import taxes and excises failed to meet expectations, with petroleum taxes accounting for about half of the revenue shortfall. Since domestic primary spending in nominal terms was lower than programmed, the end-December indicative target for the domestic primary deficit (excluding bank restructuring costs) was observed. Relative to GDP, the deficit was equivalent to 3.6 percent, compared with 3.4 percent in the program, because of a lower than projected GDP. The end-June 2002 performance criterion on the domestic primary deficit, however, was exceeded by a small margin.

3. The government's domestic financing needs amounted to Mt 800 billion (0.9 percent of GDP) in 2002 due to the issuance of government bonds to complete the recapitalization of Banco Austral, in line with the terms of its sale to Amalgamated Banks of South Africa (ABSA) in 2000. Excluding these bonds, net domestic borrowing turned out negative in 2002, as external budget support (net of debt service payments) exceeded the amount envisaged in the program.

4. A total of Mt 133 billion corresponding to the recovery of non-performing loans from Banco Austral (BA) was transferred to the government during 2002. These resources were used for the retirement of bonds issued to recapitalize BA. In addition, nonperforming loans that are fully provided for and considered unrecoverable by BA have been transferred to the government for a nominal sum of one metical, and the government has begun to pursue the collection of these loans using special powers (execução fiscal) where necessary. Since the

last quarter of 2002, the government has been reporting on its debt collection efforts in the quarterly budget execution reports.

5. Spending on PARPA priorities accounted for 18.4 percent of GDP and almost 65 percent of noninterest current and capital spending in 2002, compared with 66 percent in 2001. Within this total, expenditures on education and health were equivalent to 4.9 and 3.8 percent of GDP, respectively, while other priority spending, including rural development, governance, justice and security, accounted for 9.7 percent of GDP.

6. Monetary policy was tightened in line with the program during 2002, which contributed to the improved inflation performance. The end-June 2002 performance criteria for the net domestic assets of the central bank and net international reserves and the indicative target for reserve money were observed, as well as all the indicative targets for these variables for end-September and end-December 2002. A slowdown in the growth of broad money to 20 percent during 2002, from 30 percent in 2001, contributed to a greater stability of the metical, which depreciated by only 2.3 percent against the US dollar during 2002, compared with 36 percent the previous year. Placements of Treasury bills led to a marked increase in interest rates through August 2002, which was accompanied by a significant decline in credit growth to the private sector. Monetary conditions have eased somewhat subsequently, as interest rates on central bank instruments have been lowered gradually.

7. Further progress was made in 2002 in implementing reforms in the areas of tax policy and public expenditure management, and in strengthening banking supervision (Table 2). The program's two structural performance criteria were observed with the introduction in June 2002 of a new fiscal incentives code that establishes standard concessions for foreign investors, including transparent rules for investors in large projects, and the approval in July of the codes for new corporate and personal income taxes that were introduced in 2003. Structural benchmarks covering other tax policy measures were also met, including the introduction of regulations eliminating the stamp tax on transactions subject to the VAT and the approval of regulations for a new vehicle tax. Moreover, key steps were taken towards implementing a new system of public expenditure management (SISTAFE) with the publication of a decree establishing regulations under the Financial Management Law and the contracting of local and foreign experts to develop supporting software systems. In line with the program's other two benchmarks, a standardized and comprehensive reporting format was adopted in June for all inspections conducted by the Department of Banking Supervision (DBS), and quarterly reports in this format are being prepared for all the institutions supervised by the Bank of Mozambique (BM).

II. Program for the Remainder of 2003

A. Implementation of the PARPA

8. The policies set out in this memorandum are in line with the poverty reduction strategy presented in the 2001 PARPA and the first progress report on its implementation,

which was completed by the government in February 2003. In particular, the government will seek to achieve the PARPA targets and outcomes for 2003, ensuring that the budgetary allocations and other policy interventions reflect these priorities. The attainment of high and sustainable growth through the creation of an enabling environment for the private sector, supported by the maintenance of macroeconomic stability, remains central to this strategy.

B. The Macroeconomic Framework

9. With a moderation in the pace of agricultural growth, the government's economic program for 2003 assumes a real GDP growth of about 7 percent. Following the recent impact on prices of exogenous shocks and the strengthening of the rand, policies will be geared at lowering the 12-month rate of inflation to below 11 percent in December 2003, from 14.7 percent in April 2003. Net international reserves are targeted to increase by US$45 million during 2003, to US$683 million by year's end (about 5 months of imports of goods and services), a level considered prudent in light of the uncertain timing of external aid flows. Mozambique will continue to pursue a flexible exchange rate policy under the program, and the sales of foreign exchange by the BM will be managed in a manner consistent with sterilizing the monetary expansion that would otherwise result from externally financed government expenditure.

Fiscal Policy, Tax Reform, and Public Expenditure Management

10. Fiscal policy in 2003 will continue to support macroeconomic stability and the objective of reducing aid dependence over the medium term. The government's fiscal program envisages a further increase in tax revenue relative to GDP, a slight increase in the domestic primary deficit, and a decline in the net indebtedness of the government with the banking system. At the same time, with no further outlays for bank recapitalization– other than debt service on bonds already issued for this purpose—and lower external assistance, total government spending and the overall fiscal deficit after grants would both decline to 28.7 percent of GDP and 3.9 percent of GDP, respectively, in 2003.

11. Total revenue is projected at 14.3 percent of GDP in 2003. Tax receipts are expected to rise by 0.7 percentage point of GDP, with most of this increase accounted for by the new income tax introduced this year, while nontax revenue would fall owing to lower receipts from privatization and an expected decline in the recovery of nonperforming loans from Banco Austral relative to the high levels achieved in 2002. Within tax revenue, the taxation of civil servants' incomes through withholding is expected to yield 0.3 percent of GDP. In addition, the government is confident that the smaller deductions envisaged in the new tax law will more than compensate for any loss arising from the decision to reduce the rate of the corporate tax from 35 to 32 percent. In any event, corporate tax collections have been projected conservatively, recognizing that a drop in administrative efficiency may occur while the tax service becomes fully familiar with the new simplified system. Further administrative gains are also expected in VAT collections because of recent efforts to combat smuggling. These gains, however, will be partly offset by the impact on customs revenue of a reduction in the top import tariff rate from 30 percent to 25 percent. The

government has taken all necessary steps to ensure that the new income tax law is fully applicable to incomes generated from January 1, 2003. All the required legal and regulatory procedures have been established. With donor support, a publicity campaign is underway, tax officials have been trained, and the required computer systems will be put in place by August 2003.

12. Regarding excise taxes, in May the government increased by a weighted average of 62½ percent the specific taxes on petroleum products, in order to offset in part the erosion experienced by this tax because of inflation in recent years. This step will be followed in early 2004 by a further increase in these taxes and the adoption of an automatic mechanism of adjustment.

13. The fiscal program for 2003 envisages an increase in the nominal wage bill of 25.8 percent relative to 2002 owing to (i) an adjustment of 21 percent in the minimum wage effective April 1, 2003, which translates into an average wage increase of 17 percent for government employees; (ii) automatic promotions under the new career system; (iii) the hiring of 6,900 people in the PARPA priority areas of health, education, and security, which in line with current practices will be certified by the administrative tribunal; and (iv) full compensation of tax payments for those employees who became subject to the income tax this year. Because of the above, the wage bill is expected to rise to 7.6 percent of GDP in 2003, from 7.3 percent in 2002. The government intends to use the results of the annual proof of identity for all civil servants (*prova de vida*) to update the payroll and the personnel information system (SIP) database. The fiscal program also provides for an increase in spending on goods and services to 3.9 percent of GDP to meet the cost of opening new schools and health posts and the local elections scheduled for October 2003. Capital spending would fall by 1½ percentage points of GDP, to 12.7 percent of GDP, largely because of a decline in external project financing, while net lending would decline by 4 percentage points of GDP owing mainly to the completion of the bank restructuring program and lower assistance to public entities. The domestic primary deficit would be contained at 3.7 percent of GDP in 2003.

14. In 2003, spending on PARPA priorities would account for almost 68 percent of noninterest current and capital spending and would increase to 18.7 percent of GDP. Within this total, outlays on health and education are projected at 4.9 percent of GDP and 4.3 percent of GDP, respectively. The 2003 budget includes a contingency reserve of around Mt 350 billion (0.3 percent of GDP) to cover expenditure that may arise because of drought and floods.

15. Reforms are also continuing in tax administration. Key steps have been taken to ensure that the customs service operates effectively when the three-year program of management support from Crown Agents expires in mid-2003. Also, a General Director of Customs has been appointed and the remaining four key management positions have been filled. At the same time, other problems which had been an obstacle to the development of a well-motivated and fully staffed service have been addressed. In particular, 257 customs officials who were not meeting the minimum requirements for the new customs career

stream were removed from the payroll in December 2002, and there is no longer a backlog of pending staff disciplinary cases. Improved procedures have been put in place to deal with disciplinary issues, including the appointment of an experienced lawyer to ensure expedited action in the future. At the same time, local staff have been assuming responsibilities previously met by international consultants, and additional technical assistance is being provided to the customs department in the areas of internal investigation and information technology.

16. The government is preparing for the establishment of a central revenue authority (Autoridade Tributária de Moçambique) (ATM) that will comprise the Domestic Tax Administration Directorate (DNIA) and the General Directorate of Customs (DGA). Initial work has focused on defining the scope of the ATM, its degree of legal autonomy, the relationship with the Ministry of Planning and Finance (MPF), and its organizational structure. In addition, an action plan for the implementation of the ATM was approved by the MPF by end-May 2003. The plan addresses the crucial issue of the relationship between the reforms being undertaken by DNIA and the DGA and the transition to the ATM. To support public confidence in the tax regime through a transparent system of tax appeals, before end-May 2003 the government will submit to the National Assembly an organic law for the tax tribunals. Moreover, before end-October 2003 the government will approve a new statute transforming the DNIA into a General Directorate.

17. The government gives high priority to implementing the new financial administration system (SISTAFE), which is expected to play an important role in improving transparency and efficiency in the management of public resources. In October 2002, the conceptual model for SISTAFE and the action plan for its implementation were finalized by the coordination unit (UTRAFE) and approved by the MPF. The action plan calls for the implementation of the SISTAFE in 2003 in the Ministries of Planning and Finance (MPF) and Education, and for its extension to all ministries, including their provincial branches and all districts and municipalities, by end-2004. To facilitate an effective coordination of all external support for the implementation of the plan, a memorandum of understanding has been agreed with donors, specifying their role and the rules and modalities of their support. Based on these rules, UTRAFE has hired international consultants to strengthen the unit's implementation capacity in key areas and to define the technical requirements of the computer system. In this connection, the procurement process for the prototype of the computer system was initiated in late April 2003, and the tender process for the pilot project will begin by end-June 2003. Implementation of this pilot project in the MPF and the Ministry of Education will start by end-October 2003. In preparation for the implementation of the SISTAFE, the government has begun to request quarterly information on the execution of all donor-financed projects. The last quarterly budget execution report for 2002 already includes information on these projects.

Monetary Policy and the Financial Sector

18. Monetary policy will be aimed at reducing the 12-month rate of inflation to below 11 percent in December 2003. In line with this objective, the BM will seek to contain the

growth of broad money at 18 ½ percent during the year. Reflecting the impact of relatively high interest rates and the restructuring of the two largest banks, the growth of credit to the private sector slowed during 2002. The monetary program for 2003 envisages an increase of 15 percent in credit to the private sector. The central bank will monitor price developments closely and will be ready to adjust the interest rates on its instruments as needed to achieve the program's inflation objective.

19. In line with recommendations made by a recent Fund-World Bank mission that conducted an evaluation of the financial system under the Financial Sector Assessment Program (FSAP), the Bank of Mozambique (BM) intends to improve liquidity management. To that end, in the second half of 2003 technical assistance needs will be identified and steps will be taken to streamline traded monetary instruments and develop a core inflation index. Moreover, the accounting standards used to compute the net profits of the central bank will be reviewed.

20. Important steps will be taken during 2003 to strengthen the health of the banking system. In this regard, the progress made by the Banco Internacional de Moçambique (BIM) to improve its financial position and increase its operational efficiency will be monitored closely. Moreover, the government remains committed to implementing International Accounting Standards (IAS) for banking institutions, a complex process that will be carried out gradually and will require substantial technical assistance. To manage this process, by end-July 2003 the BM will identify training requirements for its staff and will assess the next steps to implement IAS, including the establishment of a steering committee with representation from the BM, audit firms, and the commercial banks, in line with recommendations made by the FSAP mission.

21. To assess the possible impact of the move toward IAS on the financial sector, the four largest banks of the system will be subjected to diagnostic reviews that will be undertaken by reputable international accounting firms in accordance with international audit standards, including on confidentiality. For this purpose, terms of reference are being prepared in consultation with Fund and World Bank staff, and donor funding for the reviews is being sought. Once the auditing firms are selected, the reviews are expected to be completed within the following three to four months.

22. The reviews will indicate the impact of implementing IAS on the entire balance sheets (as well as off-balance sheet items) of the four banks, and should provide information regarding the adequacy of each bank's reserves, provisions, and capital position under IAS. Additional tasks of the diagnostic reviews will include (i) the identification of changes to laws, regulations, and the current Mozambican Chart of Accounts that would be required to enable IAS implementation; (ii) an assessment of training needs and other costs for the DBS to allow effective supervision of banks operating under IAS; and (iii) the provision of recommendations regarding the timetable for implementing IAS in the banking sector.

23. As a parallel process to the convergence to IAS, the government is also committed to complying with the Basel Core Principles on Effective Supervision (BCP). In this regard,

based on an assessment prepared by the FSAP mission and the information to be provided by the diagnostic reviews referred to above, within two months after the completion of the diagnostic reviews the DBS will develop a timetable for implementing loan-loss provisioning standards consistent with accepted international practices. Moreover, before end-October 2003 the BM will issue instructions to financial institutions detailing the practical steps for consolidated supervision, in view of ongoing efforts to introduce supervision on a consolidated basis. In addition, the BM will start negotiations to sign protocols for cooperation with the supervisory authorities of Portugal and South Africa. The FSAP identified several areas where technical support is required in order to strengthen the DBS. The BM will work closely with Fund and World Bank staff to identify priorities for technical assistance and will seek donor support for this purpose.

24. In addition to the above, the BM will continue with other efforts to strengthen supervision. On-site inspections of each bank will be conducted at least once every 12 months, and the newly required bank quarterly reports will be used to follow-up on the implementation of actions identified in the context of on- and off-site inspections. Moreover, the DBS will apply existing procedures to ensure that those institutions that have not yet submitted plans for unwinding connected lending do so without further delay.

25. A new Financial Institutions Law was submitted to Parliament in March 2003, which gives the BM sole responsibility for issuing and revoking licenses for financial institutions; provides for automatic application of most penalties for non-compliance with prudential regulations; and makes managers of financial institutions personally liable for gross violations of banking regulations.

External Sector Issues

26. Further efforts aimed at liberalizing the trade system have been made in recent months. Specifically, effective January 2003 the government reduced the top tariff rate from 30 percent to 25 percent. In addition, legislation to accept Article 7 of the GATT and move from the current Brussels system of valuation to the more uniform and transparent WTO system was approved by the Council of Ministers in 2002.

27. The government recognizes the crucial importance of timely debt-service payments in view of Mozambique having reached its enhanced HIPC Initiative completion point in September 2001 and agreement with the Paris Club creditors in November 2001. The government has already signed bilateral agreements with eight Paris Club creditors under the aegis of the Agreed Minute of November 2001, and has continued to seek agreement with four other Paris Club creditors as well as with non-Paris club creditors on comparable terms. To that end, the deadline for reaching bilateral agreements with the remaining Paris Club creditors has been extended to end-June 2003. An agreement on HIPC terms with India is expected to be signed in the near future, and efforts are being made to settle a dispute with one Paris Club creditor regarding a small amount of debt service payments. Moreover, commercial creditors have been offered alternatives for debt resolution, including debt buy-back and conversion options.

28. The government has decided to strengthen its debt management capacity to ensure debt sustainability. As a first step, the existing database for public debt was fully updated in March 2003. Technical assistance is being provided by Debt Relief International and other donors, and a debt strategy workshop will be held during the third quarter of 2003.

29. 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; and will not impose or intensify import restrictions for balance of payments reasons. Furthermore, the government will not incur any external payments arrears (continuous performance criterion). In this connection, delays in payments related to cases where debt-restructuring agreements are still pending notwithstanding good faith efforts by the government will not be considered arrears.

C. Other Structural Reforms, Governance, and Statistical Information

30. Progress has also been made towards the reform of the legal and judicial system. In particular, the strategic plan for the entire system and the operational program for reforming its four branches (Ministry of Justice, the Supreme Court, the Administrative Court, and the Attorney-General) have been completed and are being discussed with World Bank staff. Moreover, an inter-ministerial legal reform commission (CIREL) was created in August 2002 to oversee the reform process. The government recognizes that the reform of the sector will be a lengthy process, and is therefore focusing on some immediate actions that would yield quick results. Priority areas include a selective revision of the civil process law, a strengthening of the capacity of the notary registries, and the establishment of a judicial inspection unit to improve the quality of judicial services.

31. The government has decided to accelerate plans for public sector reform, focusing on decentralizing government activities, addressing corruption, and improving the effectiveness of the civil service through training and salary reforms. By August 2003, all ministries are expected to complete a mapping of current operations and an identification of those areas that should be restructured. Restructuring plans are being integrated under a central policy unit in charge of the reform and it is expected that key ministries, including some related to PARPA priority areas, will begin the restructuring process during the remainder of 2003. Salary reform will be introduced in each ministry after an assessment of staffing needs.

32. In recent months some technical problems in updating the computer system have led to delays in the provision of relevant macroeconomic information. The government is fully committed to addressing these problems and to regularizing the flow of information as soon as possible to permit a timely assessment of developments under the program. In this regard, starting in May 2003 the government will resume publication and will provide Fund staff with the budget execution report corresponding to the preceding quarter, with a lag not exceeding 45 days. Moreover, the data corresponding to monthly government revenues (in detail according to the fiscal table) will be provided to Fund staff with a lag not exceeding one month, starting in April 2003. In addition, the government has begun work to broaden

the coverage of debt statistics to include the non-guaranteed debt of the domestic private sector.

D. Program Monitoring

33. The indicative targets and structural benchmarks that will be used to evaluate the implementation of the program are shown in Tables 1 and 3 of this memorandum. In addition, the government has specified in Table 4 a list of structural measures to be taken during the second half of 2003. As in the past, the program's floor on net international reserves (NIR) and the ceiling on net domestic assets (NDA) will be adjusted for higher or lower disbursements of external budget support than envisaged in the program. In addition, a similar adjustor has been included for external debt-service payments. A number of prior actions drawn from this memorandum are shown in Table 3. The government understands that its ability to request disbursement of the sixth loan under the extended PRGF arrangement will be contingent upon the observance of these actions and continued non-incurrence of external payments arrears.

Table 1: Quantitative Performance Criteria and Benchmarks, and Indicative Targets under the PRGF Arrangement, December 2001-December 2003

(End of period)

	2002									2003		
	June			September			December			June	September	December
	Performance criteria (unless otherwise noted)			Indicative targets			Indicative targets			Indicative targets	Indicative targets	Indicative targets
	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Program	Program
Central government domestic primary deficit excluding bank recapitalization costs (ceiling) 1/ 2/	1,971	....	2,031	3,579	....	3,273	3,224	....	3,068	2,509	3,721	3,821
Central government revenue (floor; benchmark only) 2/	5,383	....	5,321	8,409	....	8,200	12,406	....	12,057	6,375	10,257	14,703
Stock of net domestic assets of the Bank of Mozambique (BoM) (ceiling) 3/ 4/ 5/	4,225	4,896	4,640	4,579	5,600	4,962	5,313	5,145	2,953	2,954	3,350	2,904
Stock of reserve money (ceiling; benchmark only) 5/	6,412	....	6,366	6,931	....	6,683	7,450	....	7,134	7,399	7,714	8,410
Stock of net international reserves of the BoM (floor) 6/	546	516	533	550	506	530	540	546	638	648	641	683
New nonconcessional borrowing contracted or guaranteed by the government or the BoM with maturity of more than one year (ceiling) 2/	0	....	0	0	....	0	0	....	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 7/	0	....	0	0	....	0	0	....	0	0	0	0
External payments arrears (ceiling) 2/ 8/	0	....	0	0	....	0	0	....	0	0	0	0
Memorandum items:												
Foreign program assistance (grants and loans; in millions of U.S. dollars) 2/	117	....	88	173	....	129	215	....	225	135	143	246
Actual external debt service payments (in millions of U.S. dollars) 2/	19	....	21	29	....	29	39	....	43	23	31	47
Net flows	98		68	144		100	176	....	182	112	112	199
Exchange rate (Meticais per U.S. dollar; end of period)	24,549	....	23,530	25,264	....	23,877	26,000	....	23,854	...	...	...
Shortfall in required reserves	...	0	....	...	0	...	...	0	...	...	...	...
Adjustment to BoM's net domestic assets at program exchange rates	...	671	....	...	1,021	...	...	183	...	...	...	...
Adjustment to reserve money	...	0	....	...	0	...	...	0	...	...	...	...
Adjustment to NDA due to adjustment of NFA	...	749	....	...	1109	...	...	-151	...	...	...	...
Stock adjustments in medium- and long-term foreign liabilities	...	-78	....	...	-88	...	...	334	...	...	...	...
Medium- and long-term foreign liabilities (in millions of U.S. dollars)	475	-3	472	475	-3	472	470	13	483	-483	-483	-483

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. Foreign program assisstance includes special programs. Debt service includes debt service to the IMF and on new debt.

3/ Defined as reserve money minus net foreign assets (NFA) of the Bank of Mozambique. The foreign currency component of reserve money and NFA are valued at program exchange rates; NFA 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 valued at program exchange rates and to be adjusted downward/upward to the extent that actual payments of external debt service exceed/fall short of programmed amounts.

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

6/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the programmed amount and to be adjusted upward/downward for the extent that actual payments of external debt service fall short of/exceed programmed amounts.

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 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, March-December 2002

Actions	Expected Date of Implementation According to the Program	Outcome
Structural performance criteria		
Approval by the Council of Ministers of the new code of fiscal incentives	June 2002	Observed (decree 16/2002 of June 27, 2002)
Approval by the Council of Ministers of the new codes for the corporate and personal income taxes	July 2002	Observed (decree nos. 20/02 and 21/02 of July 30, 2002)
Structural benchmarks		
Approval by the Council of Ministers of the regulations eliminating the stamp tax on transactions subject to the value-added tax (VAT)	June 2002	Per decree 15/2002 of June 11, 2002
Approval of regulations on new vehicle tax	July 2002	Approved
Adoption of a standardized and comprehensive reporting format for all inspections conducted by the banking supervision department, so as to facilitate the identification of corrective measures as needed.	June 2002	Done
Production, for the use of the banking supervision department, of quarterly reports on each financial institution, covering all aspects of banking soundness identified in the new reporting format.	September 2002	Done
Publication of a decree establishing regulations under the Financial Management Law.	June 2002	Published

Table 3. Prior Actions and Structural Benchmarks

Actions	Implementation Date (End of period)
Prior actions	
Agreement on terms of reference prepared in consultation with Fund and Bank staff and identification of donor funding for the diagnostic review of the four major banks in Mozambique, in order to assess the impact of moving toward international accounting standards.	
In May, the government will resume publication and will provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.	
The government will provide Fund staff with the data corresponding to monthly government revenues (in detail according to the fiscal table), with a lag not exceeding one month starting in April 2003.	
In May, the government increased by a weighted average of 62½ percent the specific taxes on petroleum products.	
Structural Benchmarks	
Submit to parliament amendments to the financial institutions law giving the Bank of Mozambique sole responsibility for issuing and revoking licenses for financial institutions; providing for the automatic application of most penalties for non-compliance with prudential regulations; and making managers of financial institutions personally liable for gross violations of banking regulations.	Completed in April 2003
Approval of the implementation plan for the Autoridade Tributaria de Moçambique (ATM) by the MPF	May 2003
Submission to the National Assembly of the organic law for tax tribunals	May 2003

Table 4. Structural Measures Envisaged by the Authorities for the Second Half of 2003

Initiation of tender process for the pilot SISTAFE to be implemented in the MPF and Ministry of Education	End-June 2003
Install computerized system for the registration of personal and corporate income tax payments	August 2003
Develop a timetable for implementing loan-loss provisioning standards consistent with accepted international practices.	Within two months of completion of the banks' reviews
Approval by the Council of Ministers of a new statute transforming the DNIA into a General Directorate as part of the integration of current reforms and the transition to the CRA	October 2003
Issuance of instructions to financial institutions detailing the practical steps for consolidated supervision	October 2003
Implement the pilot SISTAFE in the MPF and Ministry of Education	December 2003

Mozambique: Relations with the Fund
(As of March 31, 2003)

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	144.38	127.09

Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR million)
ESAF/PRGF	6/28/99	06/27/2003	87.20	70.40
ESAF	6/21/96	06/27/1999	75.60	75.60
ESAF	6/01/90	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 03/31/03	2003	Forthcoming 2004	2005	2006	2007
Principal	0.0	7.4	7.3	10.4	14.2	16.2
Charges/Interest	0.0	0.7	0.6	0.5	0.4	0.3
Total	0.0	8.1	7.9	10.9	14.6	16.5

Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC assistance			
Decision point date	4/7/98	4/7/2000	
Assistance committed (end-1998 NPV terms)			
Total assistance (US$ million)	1,716	306	2,022
Of which: Fund assistance (SDR million)	124.6	18.5	143.1
Completion point date	6/29/99	20/9/01	
Delivery of Fund assistance (SDR million)			
Amount disbursed	93.2	13.7	106.9
Interim assistance	...	2.3	2.3
Completion point	93.2	11.4	104.6

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bank of Mozambique is subject to the transitional procedures with respect to the PRGF arrangement that require a review of only the Bank of Mozambique's external audit mechanism to assess whether the bank's annual financial statements are independently audited in accordance with internationally accepted standards.

The external audit assessment was completed on October 11, 2001. The assessment concluded that the Bank of Mozambique's current external audit mechanism may not be adequate in certain respects, and appropriate recommendations have been made to the authorities, as reported in Box 6 of the staff report prepared for the 2002 Article IV Consultation (EBS/02/93). The Bank of Mozambique is taking steps to implement these recommendations.

Exchange Arrangements

The exchange rate for the 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 corresponding to the weighted average of all licensed operators' transactions with the public of the previous day. As of end-March 2003, this rate was Mt 23,853 per U.S. dollar. Mozambique is an Article XIV country but has expressed its intention to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement in the near future. The authorities are conducting a detailed examination of the exchange system based on the recommendations made by the recent FSAP missions.

Article IV Consultation

Mozambique is on the standard 12-month cycle for Article IV consultations. The 2002 Article IV consultation was completed by the Executive Board on June 17, 2002 (EBS/02/93; 6/03/02).

In considering the staff report, Executive Directors commended the Mozambican authorities for their continued implementation of broad-based reform, which formed an essential backdrop for the country's strong growth performance. They stressed that further progress in strengthening tax collection and improving public expenditure management would be fundamental to safeguard priority spending and reduce aid dependence. Directors urged a strengthening of banking supervision to significantly reduce financial sector vulnerabilities. They also encouraged the authorities to revise the medium-term macroeconomic framework of the current PRSP, especially to take into account the unfolding of the HIV/AIDS epidemic in Mozambique.

FSAP Participation and ROSCs

A Financial Sector Assessment Program (FSAP) for Mozambique has been undertaken during the first quarter of 2003. The related report is expected to be ready in July 2003. A Report on Observance of Standards and Codes (ROSC) – data module was prepared in June 2002 and issued on March 5, 2003. An ROSC on fiscal transparency was issued on February 22, 2001.

IMF Technical Assistance provided to Mozambique (over the last two years)

Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	April 2003	Inspection Mission	Public expenditure management	Ministry of Finance
	October 2002	Mission	Public expenditure management	Ministry of Finance
	June 2002/ June 2003	Long-term expert	Public expenditure management	Ministry of Finance
	May 2002	Mission	Public expenditure management	Ministry of Finance
	April 2002/March 2003	Joint IMF/Seco/Danida project; Long-term consultant and training advisor	Reform of the tax system and its administration	Ministry of Finance
	March 2002	Mission	Customs workshop	Ministry of Finance
	February 2002	Mission	Public expenditure management	Ministry of Finance
	September 2001	Mission	Tax policy and administration project formulation	Ministry of Finance
	April 2001/March 2003	Short-term consultant (total: 8 person/months)	Tax administration	Ministry of Finance
	Jan.-Feb. 2001	Mission	Income Tax reform	Ministry of Finance
	Jan.-Feb. 2001	Mission	Income Tax reform	Ministry of Finance
	September 2000	Mission	Review of VAT implementation	Ministry of Finance
	June 2000	Mission	Code of Good Practices on Fiscal Transparency	Ministry of Finance
	June 2000	Mission	Rationalization of tax incentives	Ministry of Finance
Legal	June 2002	Mission	Personal income tax law and corporate income tax law	Ministry of Finance
	April 2002	Mission	Income tax law	Ministry of Finance
	Aug.-Sep. 2001	Mission	Income tax law	Ministry of Finance
Monetary and Financial Systems Department	November 2002	Short-term consultant	Banking Supervision	Bank of Mozambique
	June-July 2002	Short-term consultant	Payments Systems	Bank of Mozambique
	June-July 2002	Short-term consultant	Real Time Gross Settlement System	Bank of Mozambique
	June 2002	Short-term consultant	Banking supervision	Bank of Mozambique
	March 2002	Short-term consultant	Banking supervision	Bank of Mozambique
	Aug.-Sep. 2001	Short-term consultant	Commercial bank restructuring	Bank of Mozambique/Banco Austral
	June 2001	Mission	Commercial bank restructuring	Bank of Mozambique

IMF Technical Assistance provided to Mozambique (over the last two years)

Departments	Timing	Form	Purpose	Counterparts
Statistics	May 2003	Peripatetic	GFS	Ministry of Finance
	October 02-Aug 03	Peripatetic	National Accounts	Institute of Statistics
	June 2002	Mission	ROSC data module	Ministry of Finance and National Institute of Statistics
	June 2002	Mission	GDDS Metadata development	National Institute of Statistics
	June-Oct 2002	Short-term consultant	Balance of payments statistics	Bank of Mozambique
	Jan-April 2001	Short-term consultant	Balance of payments statistics	Bank of Mozambique

Resident Representative

Mr. Perry Perone has been Resident Representative since February 1, 2003.

Mozambique: Relations with the World Bank Group
(As of April 30, 2003)

Partnership in Mozambique's Development Strategy

1. The Mozambican Government's development strategy is set forth in the Poverty Reduction Strategy Paper, termed the PARPA (Plano de Acção para a Redução da Probreza Absoluta, or Action Plan for the Reduction of Absolute Poverty—equivalent to the PRSP), approved in September 2001. The PARPA focuses on six "fundamental areas" aimed at promoting human development and creating an environment for broad-based growth: macro-economic and financial management, good governance, education, health, agriculture, and basic infrastructure (roads, water, and energy). The overall perspective is that poverty can most quickly be reduced by pursuing a strategy of broad economic growth, which in turn is crucially dependent on the maintenance of democratic and socio-political stability. In early 2003 the Government issued the first Progress Report on the PARPA, which restates its commitment to reducing poverty by pursuing policies which help to create an environment for broad-based growth.

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

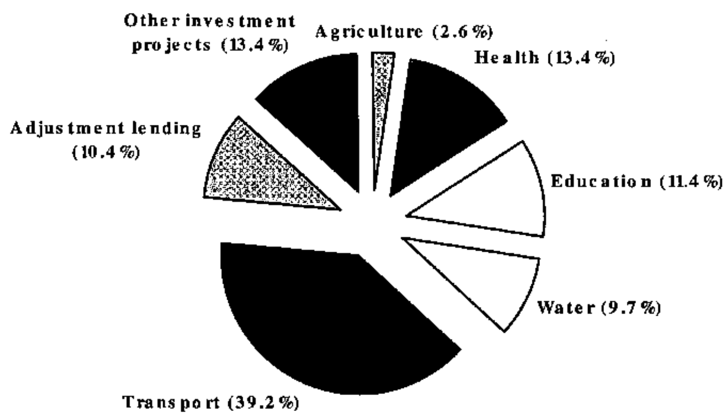
3. The Fund will continue to lead the policy dialogue on macroeconomic policy, (including fiscal, monetary and exchange rate policies) and in the following areas: the integrated financial management information systems (SISTAFE), and tax and customs reforms. The Bank will continue to lead the policy dialogue on public expenditure policy, sectoral structural reforms, and the reform of the civil service. Areas of close collaboration include banking supervision and banking sector issues, trade issues, the PARPA and its further development, external debt sustainability, and poverty and social impact analysis.

Bank Group Country Assistance Strategy

4. The World Bank supports the implementation of the PARPA through its Country Assistance Strategy (CAS, FY04-06). The three pillars of the CAS are (i) broadening the base of growth and ensuring its sustainability, (ii) investing in people and making services work for the poor, (iii) improving governance and empowerment. The focus of the Bank's lending program will be on programmatic support through three rolling Poverty Reduction Support Credits (PRSCs). Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic lending through the PRSCs will be underpinned by the Bank's core diagnostic economic and sector work, including the public sector review and poverty and social impact analysis. While a series of PRSCs will be the largest single element in the lending program, the shift from traditional investment lending to program lending will be phased in gradually. Selected investment projects will target

institutional strengthening, capacity building, transport infrastructure, water, and communications.

5. To date the International Bank for Reconstruction and Development (IBRD) has approved seven adjustment operations and 39 investment credits totaling approximately US$2.4 billion. The current portfolio includes 20 projects for a total of US$1,149.3 million with an undisbursed balance of US$731.2 million. Nineteen are investment projects and one is an adjustment operation. The graph below illustrates the sectoral distribution of the current portfolio by main sector.



6. The World Bank has been actively supporting the Government of Mozambique's macroeconomic program through a series of **structural adjustment operations** since 1986. The latest, the Economic Management and Private Sector Operation (EMPSO), was approved by the Bank Board in August 2002 for US$120 million. The EMSPO supports the Government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It includes measures to make the budget more transparent (including accounting for external aid flows), conduct a public expenditure review, strengthen the financial sector while aiming to eliminate Government ownership in the sector, and liberalize the telecommunications and air transport sectors in order to facilitate further private participation.

7. The World Bank has been an active partner in supporting the Government towards improving **education** and strengthening capacity building in key public institutions. *The Education Sector Strategic Program (ESSP)* (US$71 million-FY99) supports the implementation of the National Education Strategy (NES). The objectives of the NES are the promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. This is complemented by the

Public Sector Capacity Building Project (US$25.5 million-FY03) which aims to increase the capacity of the Government's Technical Unit for the Reform of the Public Sector (UTRESP). *The Higher Education Project* (US$60 million-FY02) supports the entire higher education system, including both public and private higher education institutions.

8. In **health**, the *Health Sector Recovery Project* (US$98.7 million-FY96) supports the Government's broad Health Sector Recovery Program. The objective of this program is to improve the health of the population in general, and reduce infant and child mortality in particular. The *HIV/AIDS Project* (US$55 million-FY03) assists the Government in carrying out its National Strategic Plan to Combat STDs and HIV/AIDS.

9. In the area of **transport and infrastructure**, the Bank currently has three active projects. *The Roads and Coastal Shipping Project (ROCS II)* (US$188 million-FY94) supports the rehabilitation and maintenance of priority roads and improvements in the management capacity of roads institutions. The *Railways and Ports Restructuring Project* (US$100 million-FY00) aims at increasing the operating efficiency of the three major port-rail systems in Mozambique. The *Roads and Bridges Project* (US$162 million-FY02) aims at improving road infrastructure, sector policies and management.

10. In the **water** sector, two active projects—the *National Water Development Project I* (US$36 million-FY98) and *National Water Development Project II* (US$75 million-FY99)— support improvements in service delivery standards, coverage, water resources management, and management capacity in both rural and urban areas. The NWDP II also supports contracts for the private sector management of 5 major cities.

11. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. *The Private Enterprise Development Project* (US$26 million-FY00) aims at broadening the base of private participation in the Mozambican economy. The *Mineral Resource Management Capacity Building Project* (US$18 million-FY01) seeks to increase institutional capacity in the sector, and alleviate poverty. The *Communications Sector Reform project* (US$14.9 million-FY02) seeks to increase private sector participation in the postal, air transport, and telecommunications sectors.

12. The Bank is also involved in **agriculture, energy and** the **environment.** The *Agricultural Sector Public Expenditure Program (PROAGRI)* (US$30 million-FY99) is a sector-wide assistance program (SWAP) which seeks to improve the impact of public expenditure in developing an enabling environment for sustainable and equitable growth in the rural sector. The Gas Engineering Project (US$26 million-FY94), closing in June 2003, supported pre-investment in the Pande-Gas project. *The Coastal and Marine Biodiversity Management Project* (US$9.7 million-FY00) pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas.

13. The Bank's **proposed lending program** for FY04 comprises a $60 million PRSC 1, the Sena Line project of $30 million, a Decentralized Planning and Finance Project of

$40 million (by grant), and a National Water supplemental of $10 million. In FY05, it is expected that three operations will be prepared for presentation to the Board: a $70 million PRSC 2, a Sustainable Tourism project of $20 million (grant), and a Technical and Vocational Education grant of $20 million. In FY06, two projects will be presented: a PRSC 3 of $80 million, and the second phase of the Roads and Bridges APL ($120 million).

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

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

IMF-World Bank Collaboration in Specific Areas

46. Fund and Bank staff maintain a close working relationship, especially with respect to (i) analyses and reforms in public expenditure management; (ii) the PARPA and accompanying annual updates and Joint Staff Assessments of these; (iii) the financial sector and banking; (iv) poverty and social impact analysis; (v) tax; and (vi) trade.

- **Public expenditure management**. The Fund and the Bank jointly emphasize the urgent need to further improve public expenditure management, accountability and transparency. The two institutions support policy reforms in the areas of budget formulation, execution and monitoring. Both institutions are involved in assistance to the authorities for the installation of the integrated financial management information system (SISTAFE). Under the Fund's leadership, a group of 10 donors set up a common fund for this large undertaking (approx. $20 million). The Bank's adjustment operation, EMPSO, has a strong focus on budget comprehensiveness; once the actions envisaged have been taken, budget comprehensiveness will in the long run be well served by SISTAFE. The Bank and the Government have worked together since September 2000 on a public expenditure review, the first volume of which was issued in December 2001; and the second (and final) is expected in June 2003.

- **Poverty Reduction Strategy Paper.** The Fund and Bank worked together with the Government during the period 1999-2001 while the PARPA was being produced, and drafted the Joint Staff Review which was presented to the Board in September 2001. The Government issued an Annual Progress Report in early 2003, and the staffs will present their Joint Staff Assessment to their respective Boards in June-July 2003. The

Fund and the Bank will work jointly with the authorities to ensure updating of the economic framework underlying the PARPA.

- **Financial sector.** The Fund and the Bank have worked together on the financial sector. The banking sector in Mozambique has repeatedly shown weaknesses in the past, requiring recapitalizations and intervention. Following the Financial Sector Assesment Program (FSAP) conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision to prevent the recurrence of such problems in the future, and provide technical assistance when required.

- **Poverty and Social Impact Analysis (PSIA).** As part of the preparation of future Bank structural adjustment lending and the IMF program supported by PRGF arrangements, the Fund and the Bank have agreed to review closely the poverty and social impact of key reforms that are being implemented. Since the fixed petroleum tax declined steadily in real terms between 1997 and 2002, a pilot PSIA, advising the government on the impact of an oil tax increase, funded by DfID and supervised by the Fund and the Bank, was undertaken in 2002. Further PSIAs in key reform areas are being planned.

- **Taxes.** The Fund has taken the lead in this area. The Government issued a new income tax law in 2002, and a revised Code of Fiscal Incentives for investors. The Bank has been supportive of the policies proposed. Further reforms to strengthen tax revenues and to improve the efficiency of tax administration are part of the regular dialogue with the Fund.

- **Trade.** The Fund and the Bank have worked together since the early 1990s on trade issues concerning general reductions in tariffs, the variable tariff on sugar introduced in 1999, and the reduction in the export tariff on raw cashews. The Fund and the Bank are involved in the process of reforming the customs administration in Mozambique. Quarterly consultations are held with the donor community. One of the key issues is the gradual transfer of management control over customs from Crown Agents to ministerial staff. Further reform efforts will be geared to strengthening the export capacity of traditional sectors.

Mozambique: Financial Relations with the World Bank Group

(As of April 30, 2003)

Over the next three years (**2003-2005**) disbursements under World Bank investment projects are expected to reach around US$90 million on average per year. Under the Country Assistance Strategy (CAS), the World Bank support to Mozambique will focus on agriculture, education and infrastructure. The adjustment operation, the Economic Management and Private Sector Operation (EMPSO), was approved by the Board in August 29, 2002. The first phase of a Public Expenditure Review, a collective effort between the Government of Mozambique, the World Bank and other donors, has been completed.

World Bank Loan and Grant Operations, 1999-2003 1/

	1999	2000	2001	2002	2003
	Actuals	(millions of US dollars)		Actual	Projected
I. Project credit disbursements	**79.4**	**97.5**	**51.6**	**85.2**	**91.3**
Household Energy (6/89) 2/	0.0	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89) 2/	0.0	0.0	0.0	0.0	0.0
Education II (12/90) 2/	2.5	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89) 2/	7.6	2.0	0.0	0.0	0.0
Agricultural Service Rehab. Development (2/92) 2/	2.5	0.7	0.0	0.0	0.0
First Road and Coastal Shipping (6/92) 2/	12.5	4.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	11.3	4.5	2.8	0.0	0.0
Capacity Building: Pub. Sector & Legal Inst.Dev. (11/92)	0.9	0.7	0.0	0.0	0.0
Maputo Corridor (1/93) 2/	-0.1	0.0	0.0	0.0	0.0
Rural Rehab.(3/93) 2/	3.8	2.0	0.3	0.0	0.0
Food Security (4/93) 2/	0.1	0.0	0.0	0.0	0.0
Local Government (6/93) 2/	3.1	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94)	16.9	26.5	11.4	9.7	0.0
Financial Sector Capacity Building (4/94) 2/	2.0	1.4	0.3	0.0	0.0
Gas engineering (6/94)	1.5	1.1	1.6	1.8	0.0
Health Sector Recovery (11/95)	12.0	17.2	17.4	14.4	0.0
National Water I (2/98)	1.3	1.7	2.4	3.9	4.0
Agricultural Sec. PEP (2/99)	0.5	0.9	4.2	3.8	4.5
General Education (2/99)	1.0	0.5	1.2	6.9	7.0
Railway and port restructuring (10/99)	0.0	1.9	3.6	22.3	24.1
National Water II (6/99)	0.0	1.4	2.8	4.4	8.0
Enterprise Development (01/00)	0.0	2.3	3.0	2.9	4.0
Flood Emergency Recovery (4/00)	0.0	28.7	-0.2	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.0	0.3	0.4	1.6

World Bank Loan and Grant Operations, 1999-2003 1/

	1999	2000	2001	2002	2003
	Actuals (in millions of U.S. dollars)			Actual	Projected
Newest Operations					
Municipal Development (7/01)	0.0	0.0	0.3	4.3	5.0
Roads and Bridges I (7/01)	0.0	0.0	0.0	4.3	10.0
Communications (11/01)	0.0	0.0	0.0	1.2	3.4
Mineral Resources Project (3/01)	0.0	0.0	0.2	1.4	3.0
Higher Education Project 1 (3/02)					
II. Adjustment operations	**150.0**	**0.0**	**0.0**	**63.5**	**60.0**
Economic Management Reform Operation (12/98) 2/3/	150.0	0.0	0.0	0.0	0.0
Third Economic Recovery Credit 2/	0.0	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation (8/02)	0.0	0.0	0.0	63.5	60.0

1/ Date of Board approval in brackets.

2/ Closed.

3/ Grant.

Mozambique: Statistical Issues

Against the background of a weak and deteriorating statistical infrastructure, Mozambique has made great efforts to rebuild its statistical system with assistance from the Fund, the World Bank, and donors. However, much remains to be done to improve the coverage, accuracy, and timeliness of macroeconomic statistics.

The Data Module of the Report on Observance of Standards and Codes (ROSC) for Mozambique, published in March 2003, includes a detailed assessment of the quality of the country's macroeconomic statistics. The report concludes that there is a need for improvements in several areas, including the national accounts, prices, and the government finance and balance of payments statistics.

The authorities are committed to adhering to internationally accepted standards and good practices, as demonstrated by their decision to participate in the IMF's General Data Dissemination System (GDDS) and, in particular, in the Project for African Lusophone Countries. Methodological descriptions (metadata) are being finalized for publication in the IMF's data dissemination website, and comprehensive metadata for all sectors are already posted in the National Institute of Statistics' (NIS) website.

National accounts

The national accounts are compiled by the NIS. Revised series starting in 1991 have been compiled in accordance with the *1993 System of National Accounts* (*1993 SNA*). The NIS compiles and disseminates (i) annual GDP at current and constant (1996=100) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; (iii) annual value added components at current prices by activity; (iv) annual accounts for the financial sector. The 2002 ROSC data module assessment identified some weaknesses in the accuracy and reliability of the national accounts source data. The NIS has been undertaking new household surveys and sectoral censuses in order to start compiling a new benchmark year (2003) with new and improved data sources and methodology. The IMF is providing technical assistance in national accounts in the context of the GDDS Project.

Prices and labor market

As of February 2000, a new consumer price index (CPI) for Maputo, based on weights revised on the basis of the 1996-1997 household survey, was implemented. Consistent time series are available starting from 1995. However, the concentration of the weights on a few basic food staples with relatively volatile prices makes the CPI prone to significant swings. A preliminary national index obtained by integrating the indices for Maputo, Beira, and Nampula has been published.

There are very little sectoral labor market and employment data, and, where available, they have limited national coverage.

Money and banking statistics

Although improvements in the Bank of Mozambique's accounting practices have contributed to better-quality accounting information, fully consistent monetary statistics have remained elusive because of significant discrepancies in cross balances between the commercial banks and the Bank of Mozambique.

Currently, the Bank of Mozambique publishes the monetary data on a regular basis in its quarterly statistical bulletin and uses a unified reporting system to submit data to the Fund (both AFR and STA) in an electronic format agreed with both departments. However, the data suffer from continuous revisions due to faulty commercial banks balance sheet data, and statistical adjustments are still made to obtain international reserves data. In addition, the modified plan of accounts for the commercial banks, implemented in January 2001, lacks the degree of detail needed for a complete sectorization of the analytical accounts for the depository corporations, as recommended by the IMF's *Monetary and Financial Statistics Manual.* Beginning in November 2002 the Bank of Mozambique introduced a new plan of accounts to compile improved monetary statistics. However, the monetary data obtained since the introduction of the new plan of accounts appear to indicate problems in the sectorization and/or classification of some accounts, which affects the consistency of the available time series. STA is currently working with Bank of Mozambique staff to clarify these issues and assist in deriving sound monetary data for policy and publication purposes.

Data on foreign aid flows

The absence of firm data on foreign aid flows and their uses is one of the main problems hampering the accuracy and reliability of balance of payments, fiscal, and national accounts statistics. The major difficulty lies in tracking disbursements made outside the domestic financial system, which is exacerbated by weaknesses in the customs records. In response to this situation, AFR missions have worked with the authorities and donors to set up reporting templates for periodic updates of donor assistance. Further progress would entail the institutionalization of this procedure under a national statistical agency.

Fiscal accounts

The lack of full information on external assistance undermines the accuracy and reliability of fiscal data because the foreign-financed portion of projects is estimated on the basis of domestically financed execution data and its assumed proportion to total financing. Similarly, the monitoring of counterpart funds generation and collection is weak. Moreover, the lack of reporting on the uses of foreign assistance prevents an accurate functional classification of donor-financed outlays. In 2001, a new classification of fiscal accounts was introduced, and starting with the 2002 budget, the reporting of expenditure execution by functional category has improved.

However, much remains to be done on the statistical consolidation of government operations. At present, there is little reporting on the accounts of government agencies, such as the Social Security Institute (INSS), and none for local and regional governments. In May 2000, the authorities started publishing quarterly budget execution reports. This action constitutes an important step toward improving fiscal transparency and accountability and allows the monitoring of PRSP related expenditures, including those financed by HIPC Initiative debt relief.

The IMF has started to provide technical assistance in government finance statistics in the context of the GDDS Project. Mozambique does not yet report government finance data for publication in the *Government Finance Statistics Yearbook* or *International Financial Statistics.*

External accounts

The quality of the external accounts has been hampered by weak key data sources, the absence of reliable foreign aid statistics, a large informal sector operating in foreign currency, and problems with the definition of residency under the Exchange Law and Regulations. Efforts to improve the situation have been undermined by lack of funding and coordination, and of a clear division of responsibilities among the government agencies involved in the production of these statistics (the Bank of Mozambique, the National Statistics Institute, the Ministry of Planning and Finance, and the Ministry of Industry, Commerce, and Tourism).

In response, STA fielded in 2001 a resident expert at the central bank to take stock of current practices and advise on improvements. The objective is to bring the statistics in line with the fifth edition of the *Balance of Payments Manual* through improved reporting practices, greater use of survey data and computer technologies, additional technical support, and the commitment of additional financial and human resources by the authorities. A new expert will continue providing assistance in the period ahead.

Reserve template data

Mozambique has begun an exercise to complete the reserves template. The results of the preliminary exercise indicate that Mozambique reports gross international reserves data with the required periodicity and timeliness. It reports that only the category of outflows of principal and interest is relevant with regard to the template section on "foreign currency loans, securities, and deposits," and that it has no contingent short-term net claims on foreign currency assets. With regard to outflows of principal and interest, data do not meet template requirements.

Social indicators

In the context of the program supported by the PRGF, Mozambique has made efforts to produce social indicators. In particular, in 2000 the INE started to publish selected social indicators based on surveys. However, the coverage and frequency of this information remain insufficient to monitor social conditions on a timely basis for an appropriate policy response.

Mozambique: Core Statistical Indicators

(May 13, 2003)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	External Debt/Debt Service	Overall Government Balance	GDP/ GNP
Date of latest observation	March 03	March 03	March 03	March 03	March 03	March 03	April 03	Dec 02	Dec 02	Dec 02	Dec. 02	Dec 02
Date received	May 03	May 03	May 03	May 03	May 03	April 03	May 03	April 03	April 03	April 03	April 03	April 03
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.

Statement by Ismaila Usman, Executive Director for Republic of Mozambique
June 20, 2003

Introduction

Our Mozambican authorities broadly concur with the thrust of the staff paper, which they have found to be concise and balanced, in reporting the country's recent economic performance. The authorities also would like to record their appreciation to the staff for the constructive policy dialogue and advice and for their assistance in addressing some complex issues that prevented the timely completion of the fifth review under the PRGF arrangement.

The program remains well on track and performance was broadly consistent with the program objectives, once again reflecting the authorities' resolute implementation of the policy measures for sustaining a widely based strong growth as a basis for raising people's living standards. Some difficulties encountered in the financial sector caused this review to be deferred from late 2002. In the meantime, all performance criteria and benchmarks under the program since end-June 2002, with the exception of one, were observed as were all the prior actions recently set for completing the current review. The performance criterion on domestic primary deficit for end-June 2002 was missed only by a small margin as a result of shortfall in revenue. Corrective actions taken in the meantime, allowed the end-December 2002 indicative target to be met. The authorities are therefore confident that the Board will acquiesce to their request for waiver for the missed performance criterion.

Recent Developments

Against the background of a less favorable external environment, including adverse weather conditions and high imported oil prices, the authorities have continued to press ahead with the economic reform to further strengthen the foundation for future economic progress that is responsive to the increasing social needs. As a result, in 2002, the economy continued to grow at a robust rate—recently revised upward to a preliminary figure of 8.3 percent—mainly on account of the continued recovery in agricultural production, expansion of the manufacturing, utilities and transportation sectors, as well as the development of the aluminum smelter and gas pipeline megaprojects. GDP growth has essentially remained broad-based, reflecting the continued success of the authorities' efforts to diversify the economy. A highly restrictive monetary policy contributed to the sharp decline in inflation from 22 percent in 2001 to 9 percent in 2002. However, the effect of the drought on some food items, the increase in imported oil prices and the appreciation of South African rand, an important currency for Mozambique's trade transactions, adversely impacted on the CPI, resulting in a rise to 16.5 percent in the 12-month rate of inflation in May 2003. International reserves increased more than envisaged in the program reaching a comfortable level equivalent to six months of imports. At the same time, the Metical/US dollar exchange rate remained broadly stable in nominal terms.

These mostly positive macroeconomic achievements were complemented by visible progress in the structural front, especially in implementing tax reforms, strengthening banking supervision, introducing a new financial administration system and a new fiscal incentives code, and increasing specific taxes on petroleum products.

Measures for the Remainder of 2003

For the remainder of 2003, the authorities will continue to direct their efforts towards giving continuity to the stability-oriented macroeconomic policies, promoting the development of private sector, increasing poverty-related expenditures, addressing the remaining weaknesses in the financial sector, and strengthening market-based structural reforms. Hence, for the year as a whole, GDP growth is projected to remain strong at 7 percent; inflation is expected to decline during the second half of the year in response to anticipated improvements on the supply side and tighter monetary policy, thus increasing the possibility of meeting the planned inflation rate of 11 percent in December 2003; also the net international reserves position is expected to remain strong.

My authorities are fully aware that sustained fiscal restraint is pivotal to successful economic reforms. They intend, therefore, to remain in the path of fiscal consolidation aimed at enhancing the prospects for achieving fiscal sustainability in the medium-term and consequently improving public sector savings, which in turn will be crucial for reducing the budget heavy dependence on foreign assistance. In line with these objectives, and while continuing to devote significant resources to poverty-related expenditures, the authorities intend to contain the domestic primary deficit at 3.7 percent of GDP, down from 5.9 percent in 2002. Also, the overall fiscal deficit is projected to decline significantly from 7.9 percent of GDP in 2002 to 3.9 percent in 2003, mainly on account of the completion of the bank restructuring program, but also due to a significant decline in externally financed capital outlays.

To achieve the fiscal objective, further efforts have been directed to strengthening revenue effort and contain overall spending, while redirecting expenditures with priority towards growth stimulating areas such as health, education, and other essential public investment. Despite the reduction in the top tariff rate from 30 percent to 25 percent, revenue is expected to increase to 14.3 percent of GDP, mainly on account of measures taken to broaden the tax base, the introduction of the new income tax, the increase in specific tax on petroleum products, and further strengthening of tax administration to enable more vigorous combating of smuggling and tax evasion. Measures are also contemplated to contain expenditure, which is projected to decline from 33.8 percent of GDP in 2002 to 28.7 percent in 2003. The wage bill has experienced a slight increase as a result of the adjustment made in the minimum wage of civil servants, promotions, and hiring of a significant number of teachers, health workers and for the security forces consistent with the strengthening of the PARPA priority areas.

The authorities share staff's concern about the growing trend experienced in the wage bill and intend to address the problem in the context of the reform of the public sector that will start to be implemented in the second half of 2003. Despite the pressures brought about by the increase in the wage bill as well as that pertaining to the cost of the local elections to be held in the later part of 2003, government spending on PARPA priority areas is expected to increase to 18.7 percent of GDP, accounting for 68 percent of total expenditure, and reflecting the authorities' strong commitment to protect priority social sectors. My authorities understand the potential negative impact on growth of the envisaged reduction in capital expenditures. However, they are hopeful that the implementation of the new financial administration system (SISTAFE), which is expected to result in improved transparency and efficiency in the management of public resources, will facilitate the achievement of the fiscal results in a manner more attuned with the medium-term growth objectives.

Monetary policy will be geared to supporting growth, inflation and foreign reserves objectives, as set under the PRGF program. The central bank will continue to maintain a tight reign on monetary policy. As a result of this restrictive stance, monetary expansion is expected to be contained at 18.5 percent, compared to 20.1 percent in 2002. The central bank will continue to use market-based instruments to conduct monetary policy and stands ready to make further adjustments in the interest rates on its instruments, if required, to meet the proposed inflation target. However, the authorities are concerned with the lack of response to past adjustments, and the persistence of high level of commercial lending rates and their impact on economic activity and in stifling the growth of private investors' initiatives. Exchange rate intervention will continue to be limited to smoothing out the impact of temporary shocks and safeguarding the international reserves position.

The authorities are mindful of the weaknesses afflicting the growing, yet highly concentrated banking system. They are grateful to the Fund for acceding to conduct an assessment of their financial system at this stage. The preliminary findings of the FSAP mission served essentially to corroborate the authorities' concerns, especially regarding the near monopoly of foreign ownership of the banking system, the high level of dollarization, and low level of intermediation that portrays the sector. The authorities are seriously considering the various recommendations of by the FSAP mission for improving the soundness of the financial system. Reflecting their determination to tackle the problems identified in the report, the authorities have already prepared the terms of reference, with the assistance of the Fund and the World Bank staff, to undertake the diagnostic reviews of the four largest banks to assess the impact of introducing International Accounting Standards. They realize the complexity of the vast tasks lying ahead for which they will require adequate technical assistance support. In the meantime, the authorities intend to redouble their efforts to reinforce banking supervision and further strengthen prudential regulations. A new Financial Institutions Law has been prepared and submitted to Parliament for approval before the end of 2003. It is envisaged that the law will enhance the supervisory role of the central bank.

As a result of the debt relief accorded to Mozambique under the enhanced HIPC Initiative, its external debt has been reduced to a more manageable level and the authorities are fully committed to maintain a sound debt management policy. They are taking steps to strengthen human and institutional capabilities in this area, but their efforts continue to be beset by the lack of progress in obtaining debt relief in terms comparable to those provided under the

HIPC Initiative, from its non-Paris Club creditors. Some progress has however, been made recently with few creditor countries but the resolution with many others is not in sight.

PRSP/PARPA

The authorities regard the process of preparing the report on implementation of the PARPA as providing an excellent opportunity to evaluate the progress made towards achieving the set goals and in identifying the weaknesses and difficulties encountered in the implementation of the poverty reduction strategy. The authorities' report is quite candid on both aspects and recognizes that, although progress has been made in a number of areas, much remains to be done to ensure the successful execution of the strategy. In broad terms, it acknowledges the need for further specific steps to improve the budget and planning system, for a broader and enhanced participatory process, particularly in the PARPA monitoring and evaluation processes, and seek greater integration of PARPA into sectoral planning and operations. With the recent establishment of the Poverty Observatory, the authorities have been able to resume the consultative process with the involvement of all stakeholders.

Conclusion

The extended and solid track record in policy implementation that my Mozambican authorities have established during the past 16 years, attests to their strong determination to pursue the reform process with a view to unleashing the country's economic potential, one that would meet the legitimate social demands of its population. They look forward to the completion of this review.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Review Under Mozambique's PRGF Arrangement and Approves US$11.84 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review of Mozambique's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. As a result, Mozambique will be able to draw up to SDR 8.4 million (about US$11.84 million).

In completing the review, the Board granted a waiver of nonobservance of the quantitative performance criterion on the domestic primary deficit. The Board also concluded that Mozambique's progress report on implementation of its poverty reduction strategy provided a sound basis for IMF concessional financial assistance.

Mozambique's economic program was originally supported by a three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) approved on June 28, 1999 (see Press Release No. 99/25) for SDR 58.8 million (about US$82.88 million). In March 2000, the commitment under the arrangement was increased to SDR 87.2 million (about US$122.91 million). So far, Mozambique has drawn SDR 70.4 million (about US$99.23 million) under the arrangement.

The PRGF is the IMF's most concessional facility for low-income countries, and is the successor to the ESAF. 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 PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

In commenting on the Board's discussion on Mozambique, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chair, stated:

"The Mozambican authorities are to be commended for a continued satisfactory performance under their PRGF-supported program. Real GDP growth has remained strong; the official reserves position has strengthened; inflation declined markedly in 2002; and encouraging progress was made towards meeting the government's poverty reduction objectives in the areas of health and education.

"In completing the fifth review under the program, the Executive Board welcomed the important measures which the authorities have taken to strengthen government revenue, including the adoption of new tax codes and the increase in fuel taxes to correct the erosion from past inflation. The recent establishment of a Poverty Observatory is an important step toward facilitating a greater involvement of stakeholders in the PRSP process.

"The government's program for 2003 seeks to sustain rapid growth by maintaining prudent macroeconomic policies and deepening structural reforms. To contain the primary fiscal deficit at the 2002 level will require a close monitoring of the government's wage bill and restraint in other non-priority outlays, as well as continued efforts to strengthen tax administration and improve public expenditure management. The authorities are also moving ahead with a comprehensive reform of the public sector to increase its efficiency and ensure an adequate allocation of resources to the social sectors over the medium-term.

"The Bank of Mozambique will maintain a sufficiently tight monetary stance to correct the recent rise in inflation owing to exogenous factors and to consolidate the gains towards price stability. Intervention in the foreign exchange market will be limited to cushioning the impact of temporary shocks and achieving the program's reserve target.

"The authorities are firmly committed to strengthening the banking system and fostering a healthy competitive environment. Their decision to conduct diagnostic reviews of the main banks based on international accounting standards is an important step in this regard. Sustained efforts in this area, further progress on fiscal and public sector reforms, and improvements in governance and the judicial system will be key to stimulating private sector development and ensuring strong growth and poverty reduction," Mr. Sugisaki stated.