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Republic of Mozambique: Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Financing Assurances Review—Staff Report; Staff Statement; 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 three-year arrangement Under the Poverty Reduction and Growth Facility, and financing assurances review, the following documents have been released and are included in this package:

- the staff report for the Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on October 25, 2006, 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 December 1, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff statement of December 18, 2006 updating information on recent developments;

- a Press Release summarizing the views of the Executive Board as expressed during its December 18, 2006 discussion of the staff report that completed the review; and

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

The documents listed below have been or will be separately released.

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper
Letter of Intent sent to the IMF by the authorities of the Republic of Mozambique*
Memorandum of Economic and Financial Policies by the authorities of the Republic of Mozambique*
Poverty Reduction Strategy Paper
Technical Memorandum of Understanding*
*Also included in Staff Report

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 Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Financing Assurances Review

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

Approved by David Nellor and Anthony Boote

December 1, 2006

- Discussions for the fifth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Maputo during October 11–25, 2006 by a staff team comprising Messrs. Clément (head), Peiris, Lledó, and Hartley (all AFR), and Ms. Kvintradze (PDR). Mr. Sulemane (OEDAE) also participated in the meetings. The team was assisted by Mr. Fischer, the Resident Representative in Mozambique. Mr. Baxter, Mr. Binkert, and Mr. Nucifora (all World Bank) joined the discussions. The mission overlapped with a MCM multi-topic mission, and benefited from recommendations of recent Fund Technical Assistance (TA) missions on the reform of the tax system and public financial management. The mission met with the honorable Prime Minister, and Ministers of Finance, Development and Planning, Justice, Mining, Labor, Trade and Industry, the Governor of the Bank of Mozambique, and senior government officials. The mission coordinated its work with a Joint Review of Program Aid Partners (PAPs) including the World Bank.
- The attached letter of intent (LOI) and memorandum of economic and financial policies (MEFP) from the Minister of Finance and Governor of the Bank of Mozambique (Appendix I) reviews the performance under the PRGF arrangement during April-September 2006, and sets out the policies and program monitoring issues for the remainder of 2006 and 2007. The authorities are requesting changes to the adjustors on the indicative targets on the Net International Reserves (NIR) for 2007, as defined in the technical memorandum of understanding (TMU).
- The government that took office in 2005 has shown a strong commitment to implement and monitor the PRGF-supported program. Provincial elections are due in 2007, followed by Presidential and Assembly elections in 2009. The structural reform agenda articulated in the *Plano de Acção para Redução da Pobreza Absoluta* II (PRSP II or "PARPA II" in Portuguese) for 2006–09 that has been submitted to the World Bank and Fund by the Government includes the implementation of a second wave of reforms. As a result, donor support is expected to remain strong.

Contents Page

EXECUTIVE SUMMARY

- **Macroeconomic performance has remained strong in 2006.** Growth has picked up led by strength in the construction sector and a recovery in agricultural production. Despite the spike in domestic petroleum prices, the core inflation rate decelerated to single digit levels supported by a prudent monetary policy, making the end-year headline inflation target within reach. Despite a higher oil import bill, an improvement in the trade balance and sustained donor inflows should lead to a comfortable external position.

- **Program performance in 2006 is satisfactory**. All quantitative and structural performance criteria were met while three out of five structural benchmarks were met, with the remaining two measures implemented with a slight delay. Preliminary data show that all indicative quantitative targets for end-September have also been met. Overall, the 2006 quantitative and structural program has remained broadly unchanged.

- **A revenue over-performance and restraint on current spending underpins a better-than-programmed fiscal consolidation in 2006.** Revenue collections are 0.4 percent of GDP above target while domestic-related expenditures are roughly in line with the program at end-June 2006. The domestic primary deficit will be slightly lower than originally envisaged for 2006 reflecting higher revenues and lower current expenditure. Importantly, the share of priority expenditure is expected to be above the PARPA I target for 2006 as donor-financed project execution picks up at the end of the year.

- **The strategy to consolidate macroeconomic stability in the context of a scaling-up of foreign aid should sustain strong growth.** A key macroeconomic challenge is to strengthen fiscal policy to finance additional priority spending in a sustainable manner and ensure that a scaling-up of aid financed expenditures reaches the most productive and pro-poor sectors without jeopardizing macroeconomic stability. Monetary control will anchor inflationary expectations in the context of a flexible exchange rate regime.

- **The outlook for 2007 is a continuation of strong growth, a further deceleration of inflation, and the maintenance of a sustainable external and fiscal situation.** The 2007 budget envisages a scaling-up of aid financed expenditures supported by a continued 0.5 percent of GDP rise in domestic revenue. The Bank of Mozambique (BM) will continue to target base money and facilitate absorption of the additional foreign aid while a strengthening of Public Financial Management (PFM) systems ensure a better monitoring of expenditures.

- **The PARPA II accelerates the implementation of a second wave of reforms to sustain broad-based growth and achieve the Millennium Development Goals (MDGs).** In the fiscal area, reforms will focus on establishing the Central Revenue Authority (ATM), the rollout of e-SISTAFE (Public Financial Administration System) to all tiers of government, and reinvigorating the public sector reform program. The structural program also aims at improving governance and reducing the costs of doing business as well as strengthening the tax and transparency regime of the natural resource sector and megaprojects.

I. BACKGROUND

1. **Mozambique is a success story in Sub-Saharan Africa, benefiting from sustained large foreign aid inflows, strong and broad-based growth and deep poverty reduction.** The main achievements during the PARPA I period (2000–05) were sustaining economic growth of 8 percent per year on average, and reducing the poverty headcount index from 69 percent in 1997 to 54 percent in 2003. Substantial progress was also made in the social sectors including a doubling of the number of children in primary school, reductions in infant and maternal mortality, and beginning the provision of Anti-Retro-Viral (ARV) treatment for HIV infection, partly financed by resources made available by the Highly Indebted Poor County (HIPC) initiative.

Sub-Saharan Africa: Growth and Poverty Reduction Episodes

Country	Period	Growth[1]	Poverty[2]
Ghana	1988-1998	2	-1.86
Uganda	1993-2003	3.2	-3.9
Kenya	1989-1998	-0.2	-0.94
Tanzania	1992-1999	0	0.53
Botswana	1984-1994	4.8	-4.5
Mozambique	1996-2003	6.3	-2.6

1/ Annual average percentage change in real per capita GDP (national currency, constant prices).
2/ Average annual change in incidence of poverty (headcount index).
Source: PARPA II

2. **Mozambique's prospects of achieving the MDGs depend critically on consolidating macroeconomic stability in the context of a scaling-up of aid and the implementation of a second wave of reforms.** Now that the post-conflict rebound has largely run its course and first generation reforms are completed—there is a need for a second wave of reforms to sustain rapid pro-poor growth. In addition, the achievement of non-income-related MDGs in areas such as primary school completion, gender equality, and HIV/AIDS call for a scaling-up of basic services without jeopardizing macroeconomic stability. The key macroeconomic challenges are:

- Managing a continued scaling-up of foreign aid by strengthening fiscal policy to finance and monitor additional priority spending in a sustainable manner;
- Fine-tuning of monetary and exchange rate policy in coordination with fiscal policy to efficiently "spend and absorb" foreign aid while cushioning against exogenous shocks and maintaining competitiveness;
- Reducing the cost of doing business to improve the investment climate and promote employment generation; and
- Buttressing the management of natural resources.

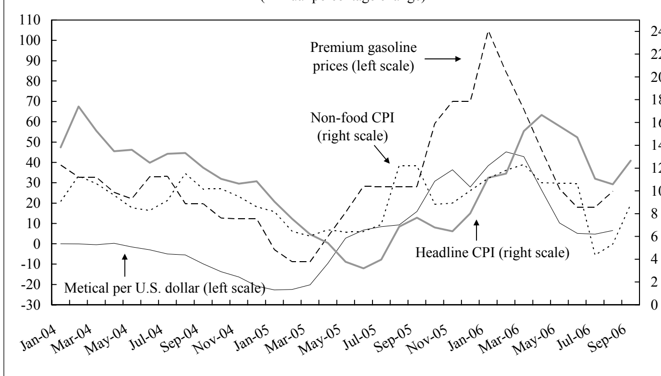
3. **Without these reforms and perseverance with the macroeconomic stabilization effort, economic growth and poverty reduction could suffer.** Given Mozambique's track-record of strong macroeconomic performance and relatively high foreign exchange reserves, it would seem well-placed to request a Policy Support Instrument (PSI) as a successor to the current PRGF-supported arrangement expiring in July 2007, as a mechanism to monitor its

own ambitious reform and stabilization program and provide a signal for continued strong donor support.

II. An Economic Rebound Supported by a Good Program Performance

4. **The economy remains resilient to exogenous shocks in 2006.** Real GDP growth is expected to accelerate to about 8 percent in 2006 led by strong growth in the construction sector and a rebound in agricultural production as a result of good rainfall, which ended the localized drought of 2005.[1] A prudent monetary policy helped bring down core (non-food) inflation to single-digit levels despite the impact of the spike in domestic petroleum prices. The cumulative headline inflation rate has also slowed down since May to 4.8 percent in September reflecting lower food prices, putting the year-end inflation target, 7 percent, within reach, though continued global oil price volatility poses some inflationary risk (Table 1 and Figure 1).

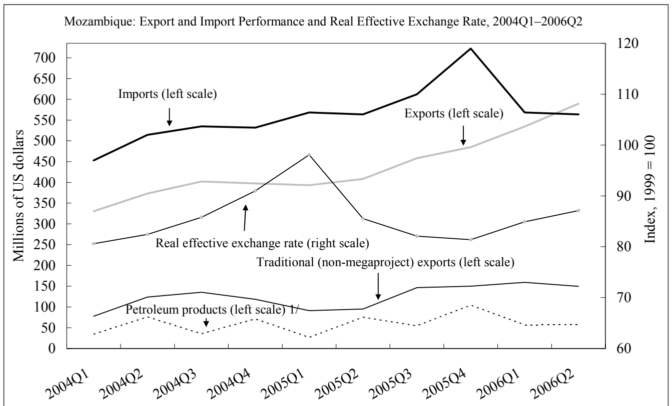
Mozambique: Exchange Rate, Consumer Price Index and Oil Prices, January 2004–September 2006
(Annual percentage change)



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

5. **The external position strengthened led by a strong export performance.** Megaproject exports remained buoyant (29 percent year-on-year growth) in the first semester of 2006 supported by the continued boom in commodity prices, particularly aluminum while traditional exports surged by 66 percent in U.S. dollar terms led by a recovery in cashew, sugar and seafood export volumes. On the other hand, imports grew by less than 12 percent due to the impact of the pass-through of higher oil prices on private consumption and lower than expected donor-financed project imports. This improvement in the trade balance contributed to a relatively stable and liquid foreign exchange market. The net international reserve (NIR) targets for end-June and September 2006 were met while the real effective exchange rate has appreciated by nearly 10 percent since end-2005, partly owing to the rand's depreciation

Mozambique: Export and Import Performance and Real Effective Exchange Rate, 2004Q1–2006Q2



Sources: Mozambican authorities; and IMF staff estimates; and IMF, Information Notice System.
1/ Imports of gasoline, gasoil, and others subcategory.

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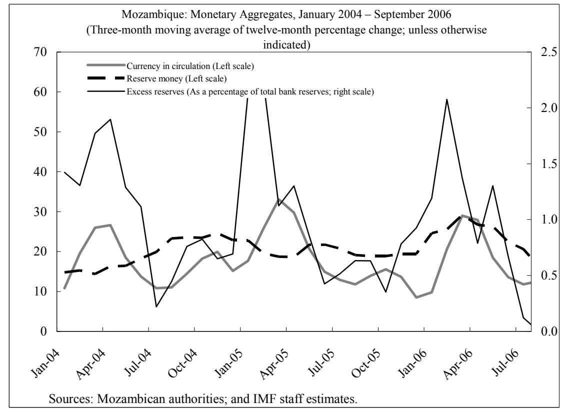
[1] Real GDP growth of 7.7 percent in 2005 may be revised slightly downward due to the impact of the drought.

against the U.S. dollar (Figure 2). Reflecting these trends, the NIR target for end-2006 is within reach.

6. **A revenue over-performance and restraint on current spending underpins a better-than-programmed fiscal consolidation in 2006 (Table 2).** Revenue collections are 0.4 percent of GDP above target in the first semester of 2006, led by buoyant corporate and VAT tax collections including 0.1 percent of GDP in tax arrears. Domestic-related expenditures, particularly the wage bill and public investment are in line with the program to end-June, albeit with slightly lower spending on goods and services. This combined with higher than anticipated budget support in the first semester resulted in a higher than programmed decline in Net Credit to the Government (NCG). The domestic primary deficit will be slightly lower than envisaged for end-2006 due to lower spending on goods and services and a partial savings of the revenue overperformance compared to the original indicative target, albeit with domestic revenues remaining at 14.4 percent of GDP. The share of priority expenditures was below the 65 percent PARPA I target for end-June 2006, but is expected to be above target by end-December as the execution of donor-financed projects and priority spending contingent on the MDRI picks up at the end of the year (Table 6). NCG will be slightly higher than originally expected at end-2006 in line with the program adjustors due to lower external financing in meticais for the year as a whole.

7. **The fiscal structural reform agenda is broadly on track** (MEFP, paragraphs 4 and 5). The implementing regulations for the central revenue authority (ATM) law were approved by the Council of Ministers with a slight delay in July 2006 (structural benchmark) and the finalized ATM strategic plan for 2006–10 is being discussed with donors for financing. The organic law of domestic tax tribunals was also approved in April 2006, and tribunals established (structural benchmark for end-June). The Homoine version of software for e-SISTAFE was finalized in June 2006, and rolled out to the relevant six ministries in July (structural performance criterion for end-July) at the central and provincial level for goods and services and capital expenditure following the introduction of the new family of meticais (MTn). Good progress was also made in integrating donor-financed projects into the 2007 budget ceilings, accounting for over 90 percent of projects, although the majority of these projects remain outside the treasury single account (CUT) and e-SISTAFE, resulting in poor financial reporting in the quarterly budget execution reports. Finally, to cap the significant progress made in the PFM area, a prioritized plan was developed to progressively rollout e-SISTAFE to districts based on their capacity (structural benchmark for end-September).

8. **Base money control helped the introduction of the currency reform proceed smoothly**. The base money target was met at end-June and end-September. This helped keep inflationary expectations under control and ensured the successful introduction of the MTn on July 1, 2006.[2] Treasury bill interest rates increased following the removal of interest rate caps in government securities auctions in March and the rise in demand for liquidity in the run up to the currency reform, albeit declining since August following a reduction in the central bank discount rate (MEFP paragraph 6). With M2 and inflation broadly in line with the program, the base money target for end-2006 is unchanged (Figure 3).[3]



Sources: Mozambican authorities; and IMF staff estimates.

9. **The level of financial intermediation continues to expand in a prudent manner** (MEFP, paragraph 7). The growth in credit to the private sector has remained strong (at about 37 percent year-on-year, and reaching more than a 50 percent loan to deposit ratio at end-September) and healthy on the basis of a non-performing loan (NPL) ratio remaining below 5 percent (Table 7).[4] The prudential measure to provision 50 percent of their foreign currency-denominated loans to nonexporters introduced in July 2005 has led to a substitution from foreign currency to domestic currency bank borrowing, resulting in a decrease in foreign currency induced credit risk by reducing exposure to unhedged borrowers, and a higher net foreign asset position of the banks.

10. **The structural reform agenda is being reinvigorated** (MEFP, paragraphs 9 and 10). The Phase II public sector reform program (2006–11), approved by the Council of Ministers in October, is now under a public service authority (ANFP) that is directly accountable to the President's office, to provide greater focus and achieve visible results. A draft new labor law has also been submitted to the Assembly for consideration that is a significant improvement on the current law in terms of labor market flexibility and procedures. However, the law includes provisions that do not sufficiently address labor

[2] About 65 percent of the old notes have been replaced by September 2006 and the BM expects about 90 percent of MTn in circulation by end-2006.

[3] M3 has, however, remained higher than programmed due to greater foreign currency deposits in the banking system.

[4] As it is the case in other African countries, improvements in banking soundness indicators need to be taken with caution given deviations relative to international standards of some indicators. In particular, NPL ratios are based on Mozambican standards that, unlike international best practices, allow banks to provision only for the part of the loan that is past due. In the same vein, capital adequacy ratios definitions are not fully compliant with Basel Core Principles.

market rigidities to substantially reduce the World Bank's cost of doing business indicator on labor costs. In January 2006, the maximum import tariff rate applicable to SADC (Southern African Development Community) trading partners was lowered from 25 to 20 percent, and will be extended to all trading partners in January 2007. Notwithstanding the progress made in these areas, weaknesses remain in the justice sector including a slow contract enforcement process, which makes debt collection costly. In addition, there is a need for concrete actions to implement the recently approved anti-corruption strategy.

11. **Performance under the program has been satisfactory so far in 2006.** All end-June quantitative performance criteria and the structural performance criterion through end-July were met. Two out of five structural benchmarks for end-June 2006 and end-September were not met but the ATM implementation regulations were approved with a delay of a month and the revision of the Chart of Accounts of the commercial banking system, consistent with IFRS, will be issued by end-November 2006 (MEFP, Table 2). Preliminary information also shows that all quantitative indicative targets for end-September 2006 have been met while all end-2006 quantitative targets are unchanged.

III. Policy Framework

12. **The medium-term policy framework aims at consolidating macroeconomic stability in the context of a scaling-up of foreign aid** (MEFP paragraph 12). The authorities recognize that effectively spending and absorbing foreign aid amounting to more than 15 percent of GDP at present is a key challenge for the medium-term.[5] As such, the 2007 and medium-term macroeconomic framework envisages a spending and absorption of a scaling-up of foreign aid (Table 1 and Figure 4).[6] To minimize potential "Dutch-Disease" effects, the additional spending including MDRI resources will continue to be allocated to the most economically and socially productive priority sectors and closely monitored through a strengthening of PFM systems (Box 1 and Table 6). In addition, to guard against aid volatility and gradually reduce donor-dependence in the long-term, the Medium-Term Fiscal Framework (CFMP) targets an average revenue increase of 0.5 percent of GDP per year. A more consistent monetary and exchange rate policy also has a role to play by firmly controlling inflation to single-digits levels and cushioning against exogenous shocks through monetary control and exchange rate flexibility, respectively.

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[5] The review mission and the authorities exchanged preliminary views on assumptions and policy-tradeoffs in developing scaling-up scenario's. These scenarios will be further elaborated and presented during the Article IV discussions in early 2007.

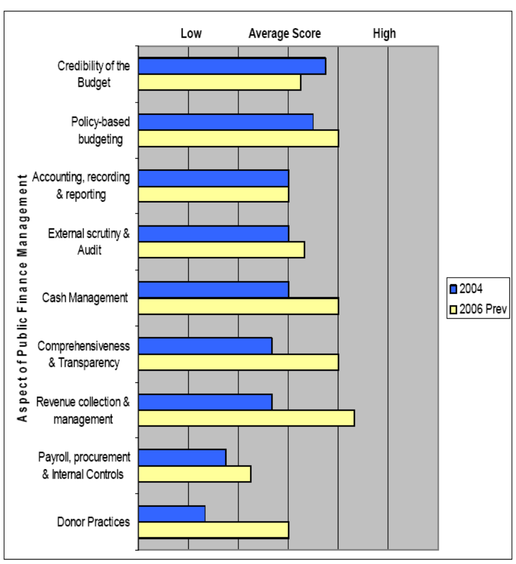
[6] The medium-term macroeconomic framework has been revised to take into account the 2007 budget, scaling-up of foreign aid, as well as domestic and international economic developments.

Box 1. Scaling-up of Aid and PFM reforms in Mozambique

While a scaling-up of aid can play an important role in achieving the MDGs, it also poses a number of macroeconomic challenges that could be partially mitigated by strengthening PFM systems. The macroeconomic consequences of aid inflows depend critically on what the government decides to do with the additional resources. Given Mozambique's social needs and infrastructure gaps, it is clear that additional aid should be spent but in a prudent manner. Unless all spending is on imports, this higher demand for domestic goods will induce an appreciation of the real exchange rate and thus discourage the expansion of exports, thereby hurting long-term growth. This is what is often called the 'Dutch Disease' effect of aid. To illicit a supply response, particularly productivity growth in the non-tradable sector, a strengthening of PFM systems is key to ensure resources reach the most economically and socially productive priority sectors (e.g., infrastructure, education, and health).

PFM systems in Mozambique have shown major improvements according to the latest PEFA assessment, and will be further strengthened through the implementation of a medium-term e-SISTAFE Action Plan and Budget (APB) for 2006–09. The CFMP is closely aligned with the PARPA II priorities. It was for the first time, approved by the Council of Ministers in 2006, making it a credible tool to guide the preparation of subsequent budgets. It should be possible from next year to identify programs through the budget formulation module of e-SISTAFE, and to track priority expenditures defined in PARPA II on a real time basis. According to the APB, e-SISTAFE will be extended to all line ministries by mid-2007, and progressively rolled out to districts and municipalities. New functionalities will also be implemented, particularly a payroll and pension module in 2007[1] as it was identified by the PEFA assessment to be a major remaining fiduciary risk. Challenges remain in executing donor-financed projects through the CUT and e-SISTAFE. In addition, the use of national procedures such as procurement, financial reporting and audit needs to be further strengthened in close collaboration with donors, particularly at the subnational level.

Figure 1: Overview of 2004 PEFA scores and identified 'potential scores' for 2006



Source: PEFA (2006)

Text Box 1: Projected e-SISTAFE Outputs, 2006-2009

1. Financial and budget execution in operation in all ministries at the central, provincial and district levels, and in the municipalities and public enterprises.
2. The module of payment of salaries and pensions implemented.
3. The budget formulation module implemented (Phase II).
4. The asset management module and procurement interface implemented.
5. The ATM revenue management module implemented.
6. Program budgets under preparation by ministries.
7. The debt management module implemented.
8. The internal audit module implemented.
9. The Data Processing Centre (CPD) operating as an effective and sustainable unit.
10. Project Implementation Unit for SISTAFE operating as an effective and sustainable unit.

Source: Authorities' PFM APB (2006)

1/ Payments of salaries continue to be executed centrally by the accounting department of the Ministry of Finance.

13. **The acceleration of the structural reform agenda, as detailed in the PARPA II strategic matrix, should sustain strong broad-based growth (about 7–8 percent) and thus promote poverty reduction.**[7] In addition to a prudent monetary and fiscal policy framework in the context of a flexible exchange rate regime, deeper institutional reforms aim to: (i) promote good governance; (ii) buttress the investment climate and ease growth constraints; and (iii) strengthen the transparency of natural resource management and megaprojects.

A. Strengthening Fiscal Policy and Institutions to Manage a Scaling-up of Aid

14. **The 2007 budget envisages a scaling-up of foreign aid and an associated increase in spending focused towards achieving the PARPA II targets (Table 2).** Despite a nearly 0.2 percent of GDP revenue loss related to tariff reform, total domestic revenue is envisaged to rise by about 0.5 percent of GDP through: (i) a rationalization of unwarranted tax exemptions (e.g., VAT, and interest income on treasury bills); (ii) collection of new tax arrears amounting to about 0.2 percent of GDP; (iii) the resumption of quarterly updating of the specific fuel tax rate including recovering the real reduction due to non-indexation in 2005[8]; (iv) higher non-tax revenues related to buoyant commodity prices; (v) and a continued improvement in tax administration in line with recent Technical Assistance (TA) from the Fund (MEFP, paragraph 15). Priority public investments will increase significantly. Most of these expenditures will be financed by foreign grants, and will be accompanied by sufficient counterpart funds and current spending for maintenance and operations (Table 6). The wage bill will increase to 7.5 per cent of GDP as envisaged in the CFMP, including a hiring of about 10,000 teachers and 3,000 health workers in line with their sectoral strategies. Transfer payments in 2007 are higher due to pension payments and the on-going gradual decentralization of spending. If a revenue shortfall materializes, the authorities have agreed to cut non-priority expenditures to meet the NCG target. Overall, the scaling-up of program aid will permit a higher domestic primary deficit with no recourse to domestic financing, allowing for a healthy increase in credit to the economy.

15. **The implementation of medium-term revenue mobilization and PFM strategies will help maintain macroeconomic stability.** The government is currently embarking on a medium-term tax policy and revenue administration reform effort benefiting from Fund TA that will be closely monitored within the Ministry of Finance (MEFP, paragraph 16 and 17). The focus in 2007 will be on preparing the ground work for further tax policy reform in the 2008 budget, and undertaking audits of VAT refunds and any related payment arrears to

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[7] The Joint Staff Advisory Note (JSAN) provides a summary of the key pillars of the PARPA II and staffs' advice on key priorities for strengthening PARPA II and for ensuring effective implementation.

[8] The updating of the specific fuel tax started in October 2006.

large infrastructure contractors.[9] In addition, the phased integration of the core functions of both tax and customs administration will be supported by initiating the implementation of the strategic plan of the ATM. Among others, specific measures in the PFM APB for 2007 include (MEFP, paragraph 18):

- rolling out e-SISTAFE to 22 additional ministries and organs at the central and provincial levels by end-January 2007 (structural benchmark);
- the development of a payroll and pensions e-SISTAFE functionality by mid-2007, based on a integrated payroll database; and
- the opening of a limited number of separate foreign currency accounts within the CUT by end-March 2007 (structural benchmark) to facilitate inclusion of all donor-financed projects.[10]

16. **Improving public service delivery and ensuring value for money in spending will also require steadfast pursuit of the Phase II of the public sector reform program** (MEFP paragraph 36)**.** The clear action plans of Phase II, such as the installation of an integrated payroll database, based on a comprehensive census completed by end-April 2007 (structural benchmark, MEFP Table 3) are important steps in the right direction. This process and the restructuring of line ministries should also be supported by a strengthening of the sectoral strategies. The government's gradual approach to devolving resources to provinces and districts until e-SISTAFE is rolled out to the local level, while undertaking a comprehensive review of the institutional framework for the revenue and spending responsibilities of subnational units by end-June 2007, will also allow for improved accountability and fiscal control.

B. Fine-tuning Monetary and Exchange Rate Policy

17. **A key monetary policy challenge is to sterilize the liquidity injected by the government spending foreign aid.** With a view to achieving its inflation target and anchoring expectations, the BM approved a long-term monetary policy strategy document that defines a broad money intermediate target compatible with the base money operational target. This document will be communicated to

Mozambique: Intervention Policy Mix

	2005		2006	
	Sept.	Dec.	Jun.	Sept.
	(In millions of MTn)			
Total sterilization	7,193	9,557	5,148	8,572
Net foreign exchange sales	5,798	8,461	6,493	8,906
Net T-bill issuance	1,395	1,096	-1,345	-334
Memo:				
	(In percentage of total sterilization)			
Net foreign exchange sales	80.6	88.5	126.1	103.9
Net T-bill issuance	19.4	11.5	-26.1	-3.9
	(In millions of USD)			
Net foreign exchange sales	289	393	260	355

Source: Bank of Mozambique

[9] The government will develop an arrears payment schedule, if needed, and ensure that VAT charged on supplies of projects is included in the final price of a contract.

[10] While a single currency CUT has technical and transparency benefits, this measure can be seen as a transition measure for donors that are constrained by their own rules. All donors should be encouraged to put their funds into the CUT as soon as possible.

financial markets (MEFP, paragraph 19). In 2007, base money growth will be limited to 15 percent to reach the inflation objective of 6 percent at end-2007. Excess liquidity will be mopped up relying mostly on foreign exchange sales (up to a maximum of the NIR floor, as in 2006) to absorb foreign aid financed expenditures with treasury bill issuances to smooth seasonal liquidity fluctuations.

18. **To avoid undue movements in inflation and the exchange rate a fine-tuning of the monetary and exchange rate policy operations will also be needed.** The BM will continue to improve liquidity forecasts with the help of the MF and introduce repurchase operations (repo's) to fine-tune daily liquidity variations (MEFP, paragraph 20). The BM also recognizes that greater exchange rate flexibility will support the monetary-targeting framework and help cushion against exogenous shocks by maintaining a comfortable level of international reserves. In this context, the BM will gradually remove the temporary band in the foreign exchange market when conditions permit. The strong growth in non-traditional exports point to no significant loss of competitiveness since end-2005. Measures to deepen the interbank market through a code of conduct, facilitating firm quotation and encouraging forward transactions as envisaged under MCM TA should also help minimize excess volatility and an overshooting of the exchange rate in a relatively thin market.

C. Management of Natural Resources

19. **Megaprojects in the mining and petroleum sectors have put Mozambique on the global Foreign Direct Investment (FDI) map, which should be accompanied by international best practices in the tax and transparency regime.**[11,12] Now that investor confidence in Mozambique is stronger, the authorities recognize that the fiscal contribution of new projects in these sectors could be substantially increased by reducing generous tax exemptions (MEFP paragraph 32). As such, the Council of Ministers will approve a new draft Mining Fiscal Regime law in line with international best practice (structural performance criterion, end-December 2006). In the interim, the Government will ensure that any new mineral resource project agreements will adhere to the principles of the new draft Mining Fiscal Regime law. In the petroleum sector, the government will avoid signing any new Exploration and Production Concession (EPCs) contracts that are not now under negotiation until a more specific petroleum tax regime is in place to avoid case by case negotiation of petroleum tax and production sharing terms. The government is also considering following the Extractive Industries Transparency Initiative (EITI) principles to improve transparency, revenue management and governance in the oil, gas and mining

[11] The mining sector is broadly interpreted to include Mozal, a megaproject, which produces aluminum billets from imported alumina using electricity generated by the Cahora Bassa hydroelectric plant.

[12] To date, the only major petroleum project operating in Mozambique is the Pande-Temane gas extraction project including a pipeline to South Africa. More recently, four international companies have been granted the right to start drilling for oil.

sectors as well as any expansion of related megaprojects to continue to attract quality investments and ensure sustainable exploitation of natural resources.

20. **The transfer of ownership of Cahora bass dam to Mozambique is an historical event that needs to be carefully secured.** An agreement to transfer majority ownership of the 2,075 MW Cahora Bassa hydropower plant from Portugal to a Mozambican parastatal, Hidroelectrica de Cahora Bassa (HCB) was signed on October 31, 2006. This opens up the possibility of further hydropower development on the Zambezi, in particular a proposed Mphanda Nkuwa project (1,300 MW in the first stage with potential for 2,275 MW) 60 km downstream of Cahora Bassa, and the development of a second, 600 MW, power house on the North Bank of Cahora Bassa itself, providing tremendous potential for export of power, energy intensive industries, and benefits to agriculture and aquaculture from better water control. The agreement calls for a payment of US$950 million to Portugal in installments during the course of 2006–2007. In this regard, the government has reiterated its commitment to:[13]

- Seek nonrecourse financing for the purchase of majority ownership so not to increase the government's liabilities to commercial creditors;
- Ensure transparency of both the process and the final financing package; that HCB is managed in a commercially efficient manner; that HCB is audited by external auditors; and that HCB is subject to the regular concession and tax regimes; and
- Identify and incorporate into the fiscal accounts and budget documents fiscal risks and quasi-fiscal transactions, if any, with TA from the international community.

D. Improving the Investment Climate

21. **To make Mozambique the location of choice for FDI and employment generating domestic investment, the government will implement a strategic plan to reduce the cost of doing business with the assistance of the Fund and World Bank (**MEFP, paragraph 30). Financial sector reforms in 2007 to reduce the cost of finance and improve access include: (i) deepening domestic debt markets; (ii) preserving the BM's net worth while strengthening its supervisory functions and modernizing its accounts; (iii) making all banks compliant with international accounting, loan classification and provisioning standards; and (iv) supporting a sound expansion of the non-bank financial sector (MEFP, paragraphs 20–25). In November, 2006, the Assembly also approved the first reading of the bill to reduce customs duties on consumer goods from 25 to 20 percent to all trading partners in January 2007 (MEFP, paragraph 28). The PARPA II strategic matrix is,

[13] A joint IMF-World Bank-IFC-MIGA mission will take place soon to discuss the financing modalities of the ownership transfer.

however, sparse on actions to accelerate the contract enforcement process, address the backlog of legal cases and labor disputes, and use of land-use titles as collateral (MEFP, paragraphs 37–38). In addition, the provision of infrastructure services, partly in the hands of state-owned or public-participating institutions remains weak.[14] This calls for a clear strategy to address the infrastructure gaps including through transparent sales of remaining public-participating enterprises (MEFP, paragraph 11 and 31).[15]

E. Other Issues

22. **Progress was made in reaching debt rescheduling agreements in the context of the enhanced HIPC Initiative and maintaining external debt sustainability.** In October, 2006, the Japanese government cancelled all of Mozambique's commercial debt to Japan. Portugal (the remaining Paris club creditor to provide HIPC relief) has expressed an intention to sign an agreement by end-2006. Of the remaining non-Paris Club creditors that have not delivered debt relief, negotiations with Algeria, Libya and Iraq are proving difficult. In this respect, the authorities look forward to continuing support from the Fund. Negotiations were completed with Romania in October, 2006, and the authorities continue to maintain contact with non-Paris club and commercial creditors, and continue their good faith negotiations, to facilitate a collaborative agreement with them. External financing appears to be secured to cover the total outstanding debt to four private creditors (Brazil, India, Czech Republic and Former Yugoslavia) by the commercial debt buy-back operation. Authorities expect to carry out the debt buy-back once the World Bank finalizes procedures for the financing of the operation. As part of the financing assurances review, the staff finds that adequate safeguards remain in place for further use of Fund resources related to these renegotiations.

23. **Mozambique is building a consensus to introduce current account convertibility.** A new foreign exchange law will be submitted with a slight delay to the Assembly by end-March 2007. Following approval of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

24. **The statistical agency is in the process of revising its historical national accounts series**, and requires further assistance to compile and disseminate quarterly GDP estimates, trade and producer price statistics, and report on megaprojects.

[14] Public-participating institutions are defined as enterprises with some private equity participation.

[15] The restructuring of public and public-participating enterprises are not expected to result in an absorption of liabilities to the budget.

IV. Program Monitoring and Risks

25. **The sixth review under the PRGF arrangement is expected to be completed no later than end-June 2007 conditional on meeting the end-December 2006 quantitative and structural performance criteria (MEFP, Tables 1 and 3).** The government intends to continue to monitor its program with the existing multi-disciplinary committee, and the research department of the MF will collect and analyze information on megaprojects and state-owned public-participating enterprises by end-March 2007 (MEFP, paragraph 12).

26. **On the risks to the program, the staff notes that a weaker-than-programmed revenue performance, a continuing rise in global oil prices, and a hasty implementation of fiscal decentralization,** could undermine the government's macroeconomic targets.

27. **The BM is continuing to address the remaining weaknesses identified in the Fund's safeguards assessment** (MEFP, paragraph 26).

V. Staff Appraisal

28. **The pursuit of prudent macroeconomic policies and a first wave of structural reforms have yielded good results in terms of strong growth and moderate inflation.** Mozambique achieved most of the key PARPA I targets including poverty reduction and progress in social sectors supported by a satisfactory program performance and substantial donor assistance. Debt relief under the HIPC initiative also played a role. Program implementation has remained good in 2006, with all quantitative and structural performance criteria met through July 2006 and a largely unchanged program for end-2006, setting the stage for a continued robust macroeconomic performance.

29. **The economy is rebounding from the drought and oil price shock.** Real GDP growth has picked up in 2006 led by a recovery in agricultural production while the trade balance is improving due to a surge in exports. The end-year headline inflation target is within reach anchored by a prudent monetary stance, with some risks related to the evolution of food and domestic fuel prices. The outlook for 2007 is a continuation of strong growth, a further deceleration of inflation, and a widening of the external current account deficit financed by a scaling-up of foreign grants.

30. **The strategy to consolidate macroeconomic stability in the context of a continued scaling-up of aid and the implementation of a second wave of reforms should help sustain strong broad-based growth.** A key macroeconomic challenge is to strengthen fiscal policy to finance additional priority spending in a sustainable manner and ensure that a scaling-up of aid reaches the most productive and pro-poor sectors. The staff would also like to emphasize the importance of adopting a new mining fiscal regime by end-2006 and adherence to the principles of the EITI. A better monitoring of megaprojects and public-

participating enterprises is also essential. Without these reforms, institutions may not keep pace with the rapid structural transformation of the economy, and growth could suffer.

31. **The 2007 fiscal framework envisages spending the scaled-up foreign aid to pursue the MDGs.** To maintain macroeconomic stability, a continued 0.5 percent of GDP rise in domestic revenue is targeted while the share of priority expenditures will exceed 65 percent of total spending. The rollout of e-SISTAFE to most public entities at the central and provincial level by end-January 2007 should ensure a better monitoring of these expenditures. Moreover, donor-funded projects brought on budget should, with the help of the donors, be included in the CUT and e-SISTAFE.

32. **Public sector and governance reforms need to be closely monitored.** The installation of a clean integrated payroll database based on a civil service census should help rightsizing the civil service in line with more comprehensive sectoral strategies. The lack of visible results of the anti-corruption strategy and judicial sector reform also needs to be addressed to improve public perceptions and maintain a constituency for reform.

33. **The government's fiscal decentralization strategy should be clarified before a further devolution of resources**. Ambiguities concerning the division of revenue raising and spending responsibilities of subnational units, and concerns regarding the capacity of some districts and municipalities to effectively absorb and account for resources need to be addressed. This will help clarify the fiscal implications of the decentralization process.

34. **A more consistent monetary policy framework should help consolidate price stability and maintain a viable external position.** The staff welcomes the BM's clear policy statement to continue to target base money in the context of a flexible exchange rate regime to control inflation and cushion exogenous shocks. In this regard, it is important to bestow greater exchange rate flexibility and eliminate the temporary exchange rate band when the conditions permit. Undue exchange rate fluctuations could be minimized by a fine-tuning of operations and deepening interbank markets.

35. **The Cahora bassa dam transaction should be prudently managed.** The staff welcomes the renewed commitment to seek non-recourse financing for the transfer of majority ownership of the Cahora Bassa hydropower plant from Portugal to HCB so not to increase the government's liabilities to commercial creditors, and ensure transparency and accountability.

36. **The development of a strategic plan to reduce the World Bank's cost of doing business indicators will be important to attract investment and generate employment.** In this regard, while the new draft labor law represents an improvement on the current law, it

does not significantly improve Mozambique's ranking in labor market flexibility in the region. As such, staff would welcome steps to address remaining rigidities down the road.

37. **Mozambique's financial system is expanding in a sound manner**. Risk based supervision and the introduction of international accounting, loan classification and provisioning standards should help ensure stability of the banking system. The restructuring of the national pension fund (INSS) and strengthening of the supervisory framework for the growing non-bank financial sector is also important.

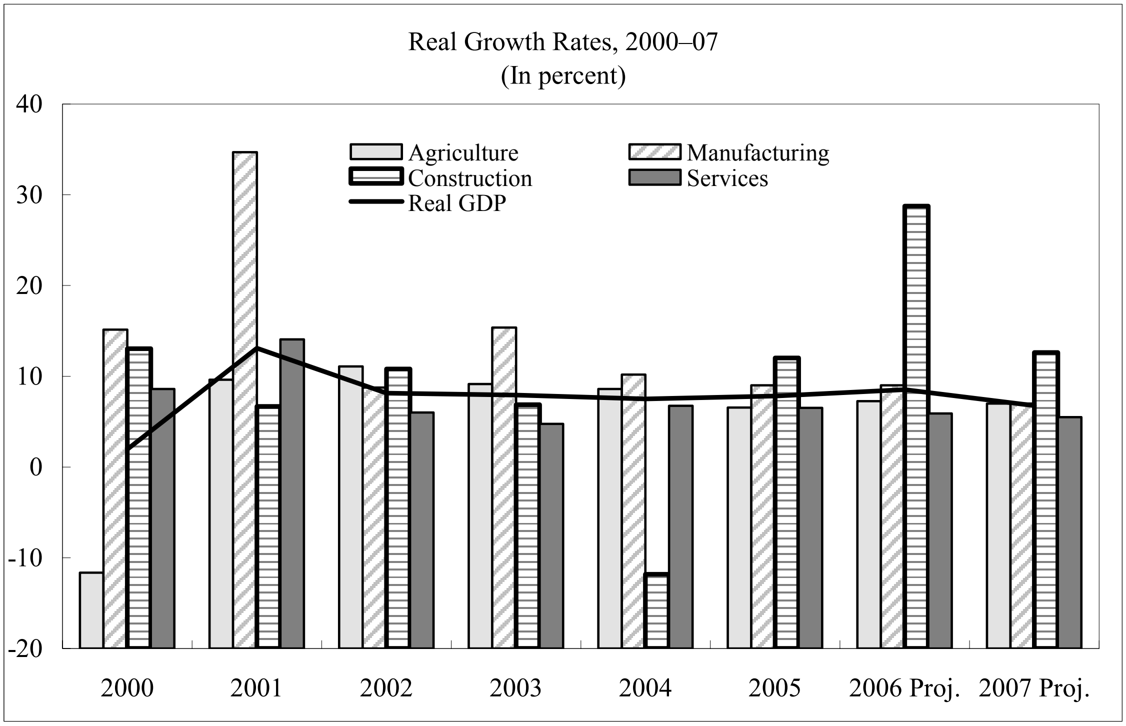
38. **The staff welcomes progress in liberalizing trade, debt rescheduling, and exchange system reforms.** The staff looks forward to the lowering of the maximum tariff level to all trading partners and submission of a new foreign exchange law consistent with Article VIII, Sections 2, 3 and 4 of the Fund Articles of Agreement in the context of the authorities' stated intentions to accept the obligations of Article VIII, Sections 2, 3 and 4 in the near future. The authorities are encouraged to continue to negotiate in good faith with all of their external creditors to reach an agreement consistent with that provided by the Paris Club.

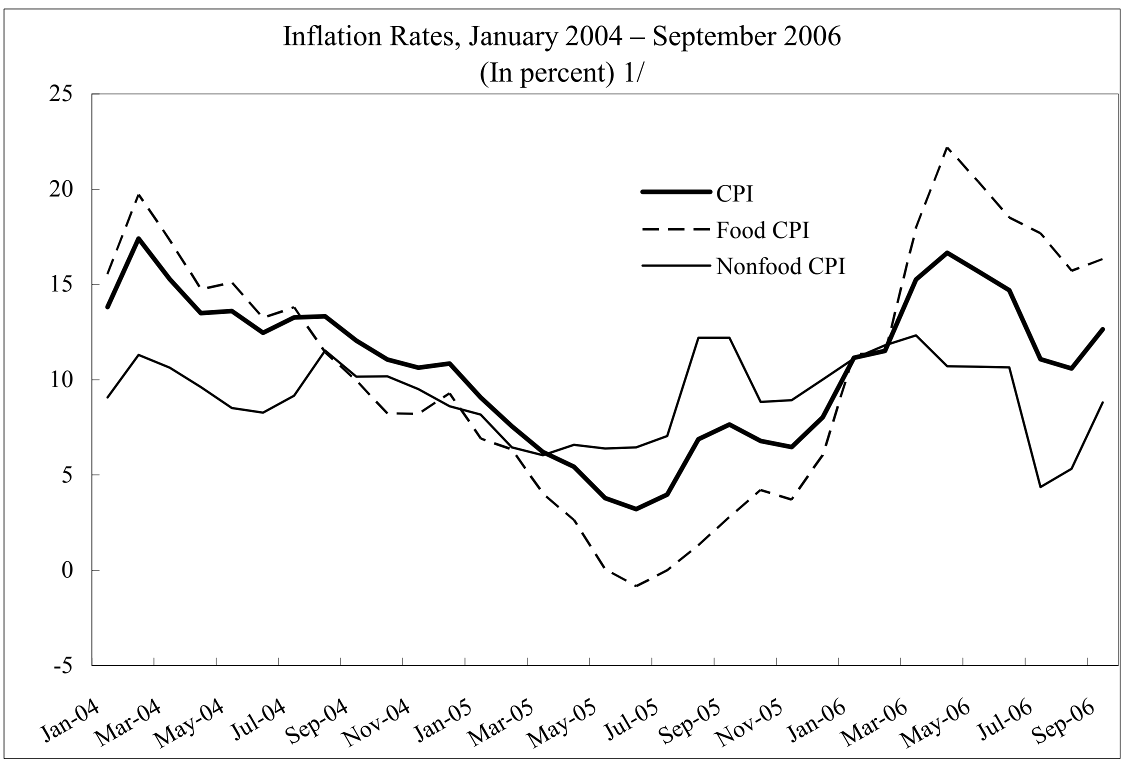
39. **Given Mozambique's track-record of strong macroeconomic performance and program implementation, the authorities' consideration to request a PSI is welcome.** A PSI could be an ideal mechanism to monitor the government's ambitious reform program over the medium-term and sustain the growth momentum.

40. **The staff recommends completion of the fifth review and financing assurances review under the PRGF arrangement.**

41. **The staff welcomes the intention of the authorities to make public the staff report, the letter of intent, and the MEFP**.

Figure 1. Mozambique: Real Growth Rates and Inflation

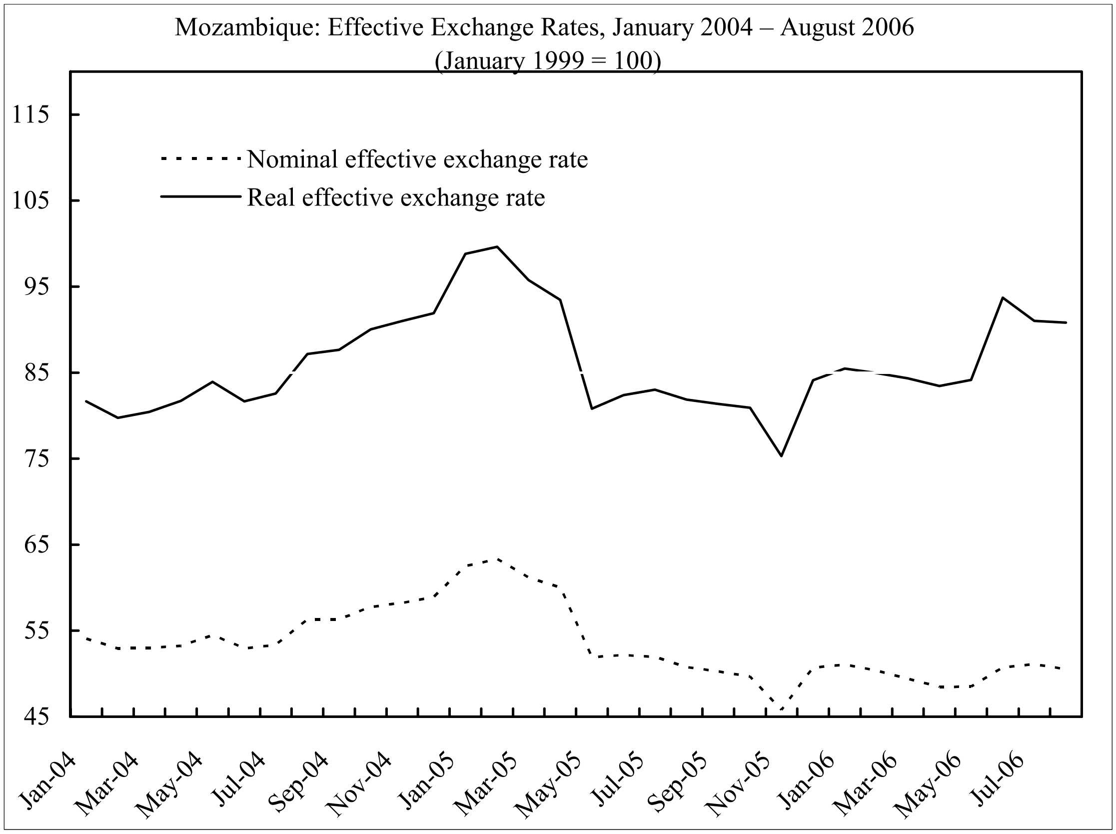


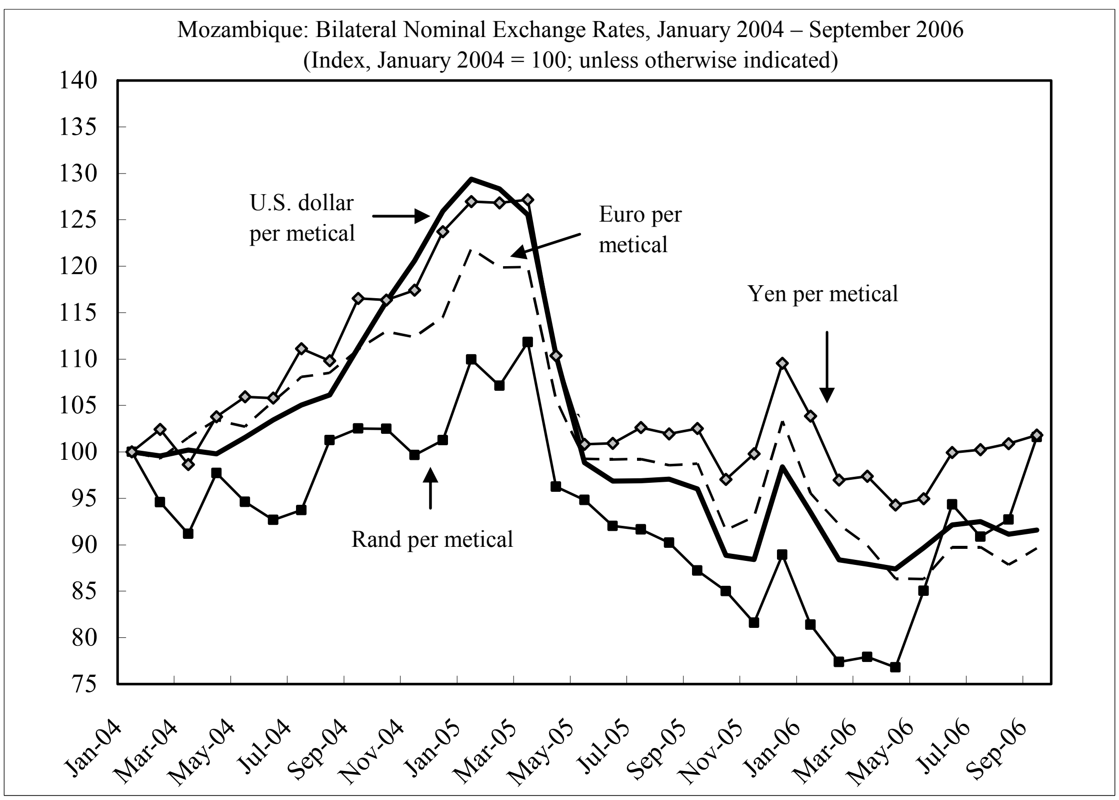


Sources: Mozambican authorities; and IMF staff estimates and projections.

1/ Twelve-month rate of change.

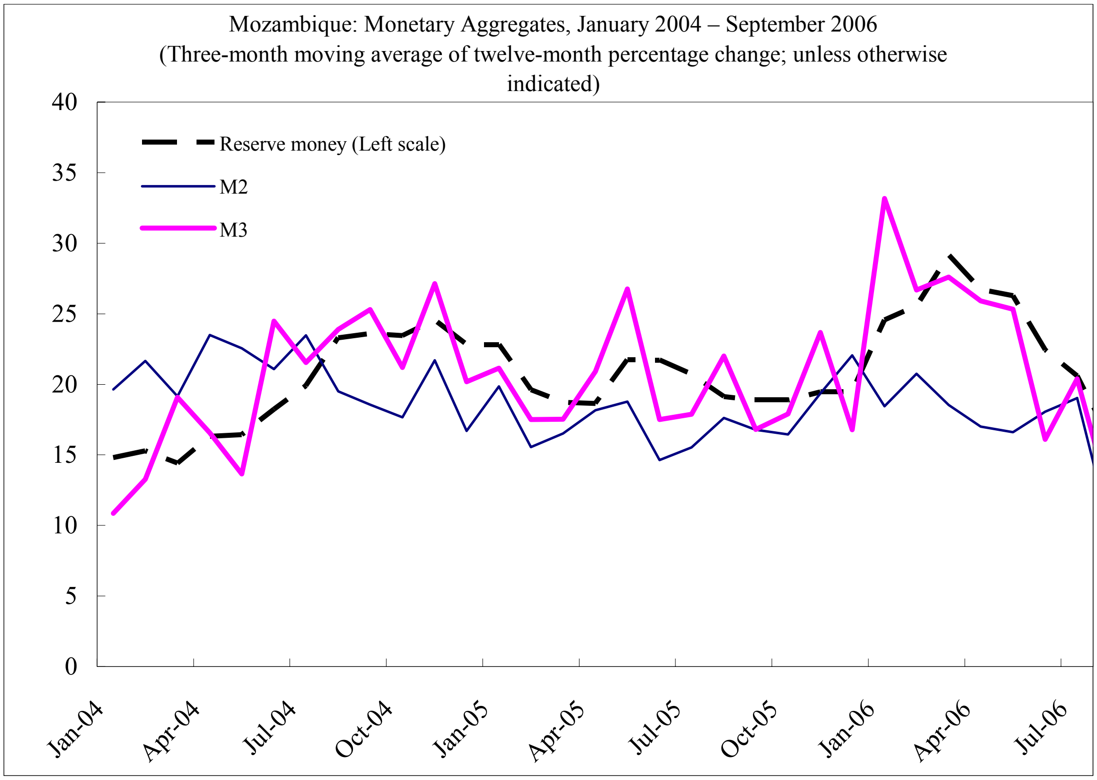
Figure 2. Mozambique: Exchange Rates

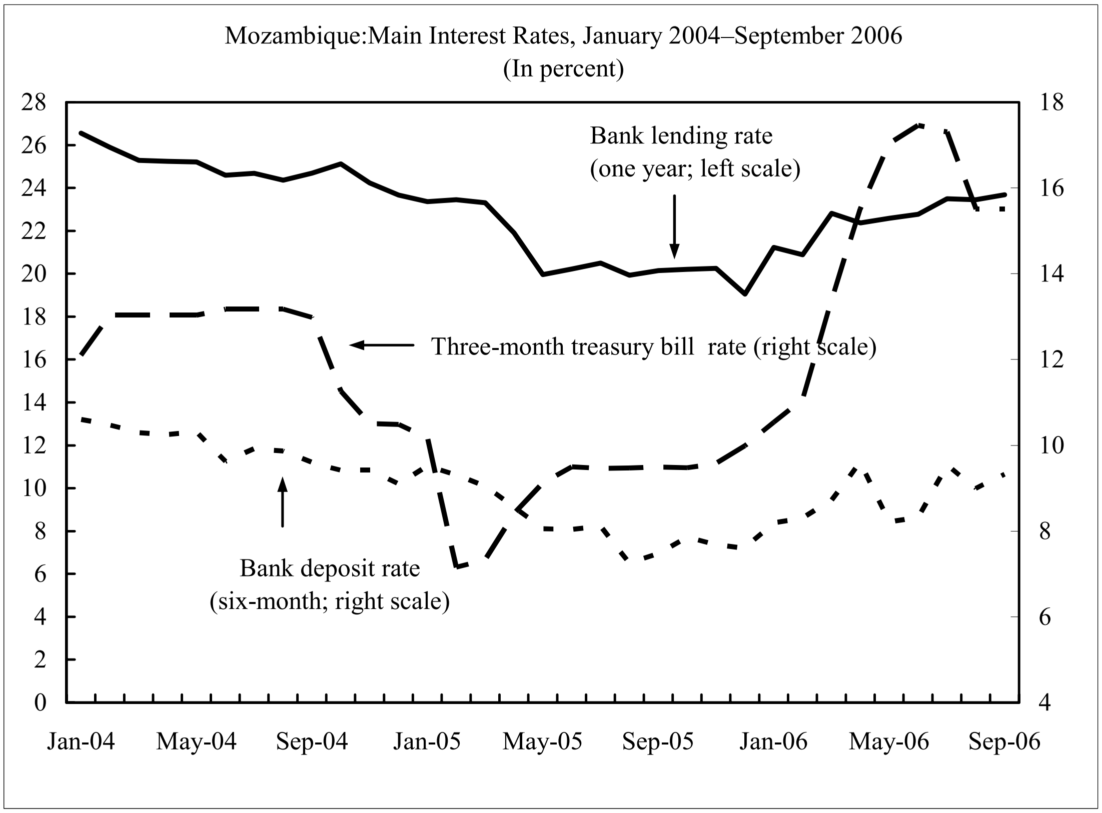




Sources: Mozambican authorities; and IMF staff estimates; and IMF, Information Notice System.

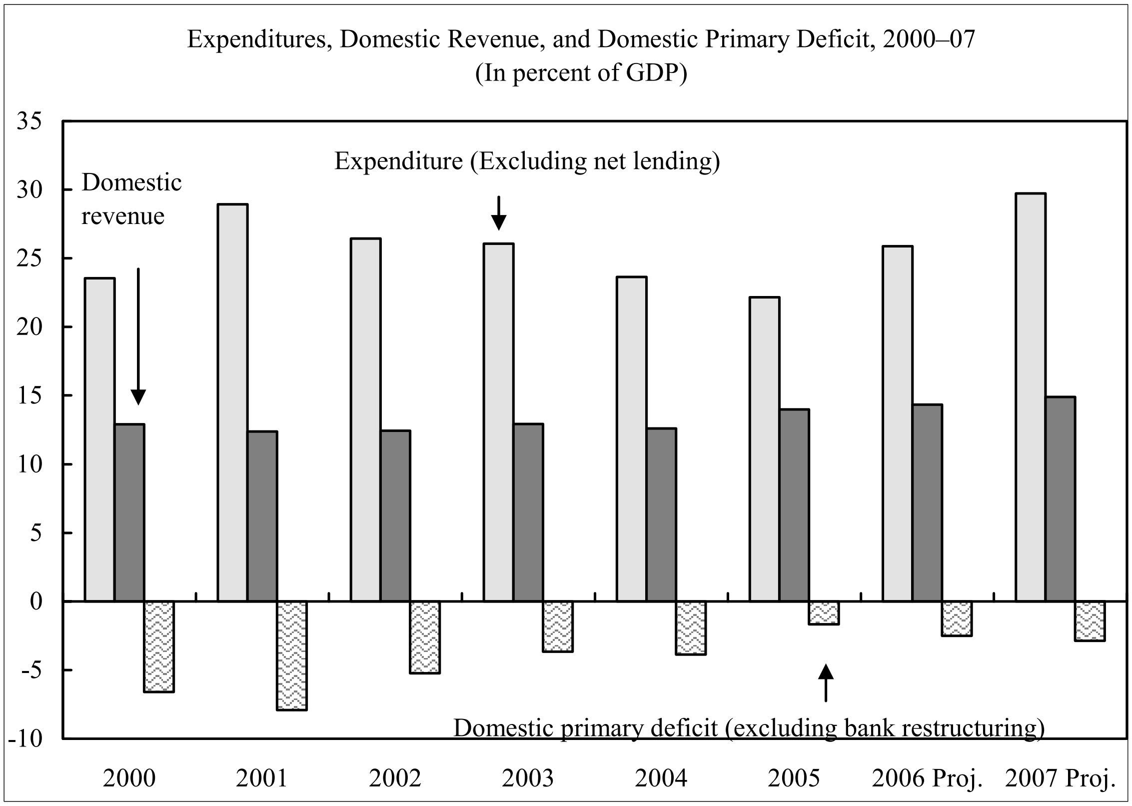
Figure 3. Monetary Aggregates and Interest Rates

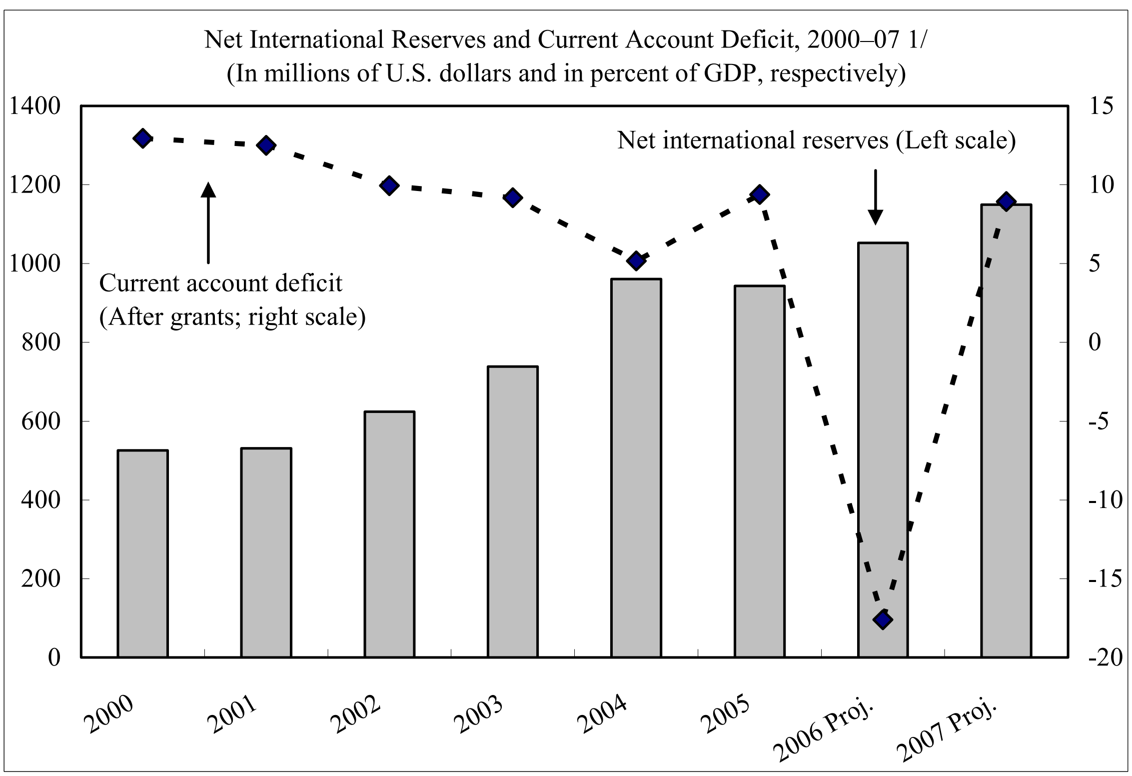




Sources: Mozambican authorities; and IMF staff estimates.

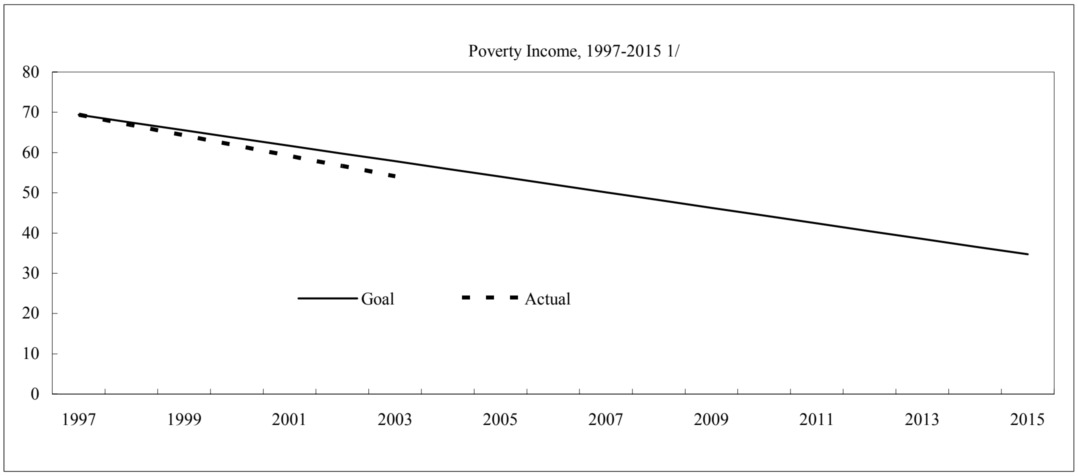
Figure 4. Mozambique: Fiscal and External Sector Indicators

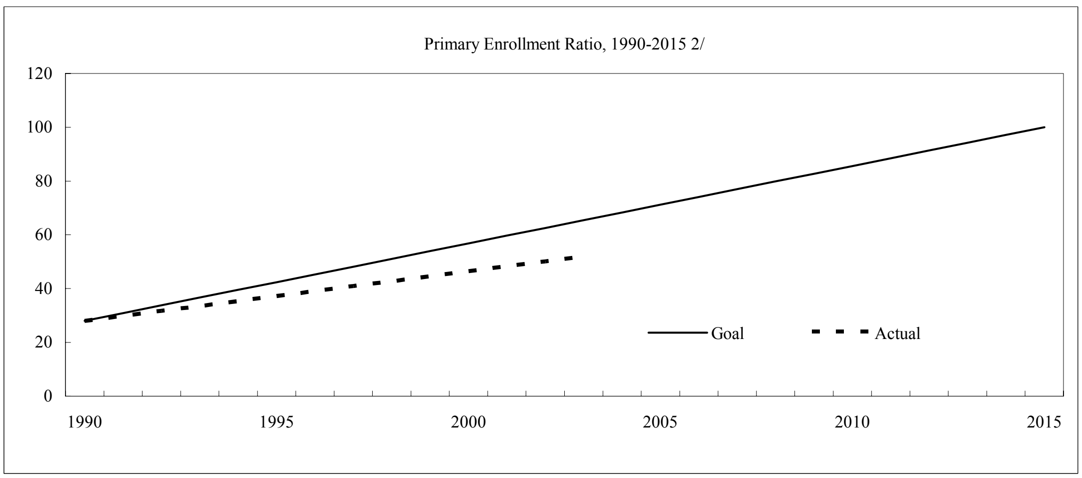


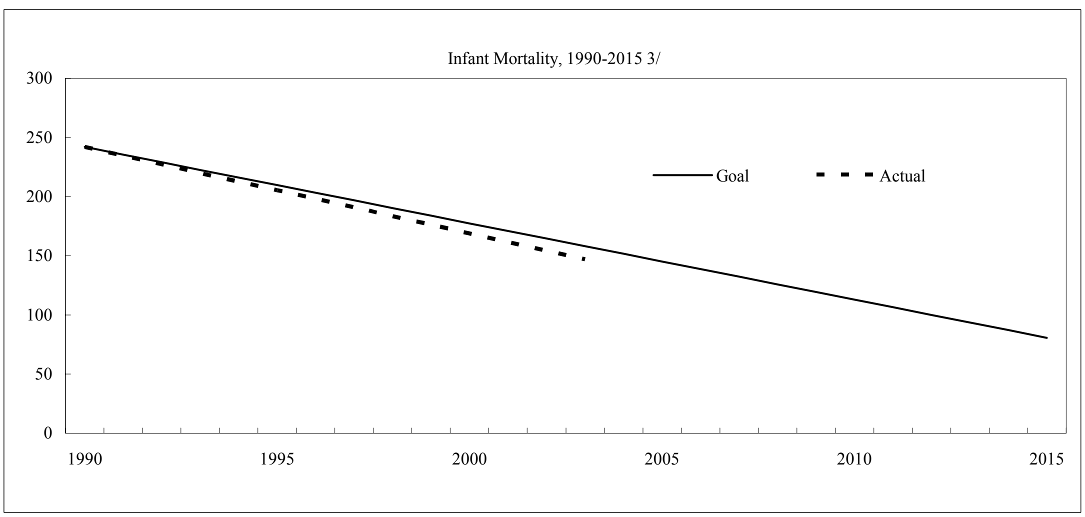


Sources: Mozambican authorities; and IMF staff estimates and projections.
1/ The external current account deficit in 2006 reflects the MDRI.

Figure 5. Mozambique: Progress in Meeting the Millenium Development Goals







Sources: The World Bank; and Instituto Nacional de Estatistica, Household Surveys, 1996/97 and 2002/03.

1/ A household consumption survey was conducted between 1996 and 1997, and 2002 and 2003, to determine poverty incidence. The methodology includes determining a sum of food and nonfood poverty lines. Households are defined as poor if their daily per capita expenditure is less than the total poverty line.
2/ Measured in net terms and as a percentage of relevant age group.
3/ Under-five infant mortality rate (per 1,000).

Table 1. Mozambique: Selected Economic and Financial Indicators, 2004–09

	2004	2005	2006		2007		2008	2009
		Est.	Orig. Prog.	Prog.	Orig. Prog.	Prog.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
Nominal GDP (in millions of MTn)	133,510	153,041	180,831	185,696	208,970	210,490	238,125	268,531
Nominal GDP growth	17.2	14.6	17.6	21.3	15.7	13.4	13.1	12.8
Real GDP growth	7.5	7.7	7.9	7.9	7.0	7.0	7.0	7.0
GDP per capita (in U.S. dollars)	309	339	346	364	357	382	399	420
Consumer price index (annual average)	12.6	6.4	9.5	12.5	8.0	5.9	5.7	5.4
Consumer price index (end of period)	9.1	11.2	7.0	7.0	6.0	6.0	5.5	5.3
External sector								
Merchandise exports	44.1	16.1	20.4	28.9	6.9	4.4	-0.9	5.1
Merchandise exports, excluding megaprojects	25.4	6.0	10.2	18.0	7.2	8.3	8.2	8.9
Merchandise imports	16.9	21.2	10.5	11.5	6.8	16.1	2.7	3.1
Merchandise imports, excluding megaprojects	22.0	19.3	9.9	10.2	4.7	16.5	5.2	4.0
Terms of trade	12.9	9.9	4.7	26.1	-9.8	-8.7	-12.7	-9.3
Nominal effective exchange rate (end of period) 1/	10.7	-14.0	...	...	...	...	...	...
Real effective exchange rate (end of period) 1/	17.5	-8.5	...	...	...	...	...	...
	(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)							
Money and credit								
Net foreign assets	37.5	23.1	20.4	20.9	8.2	9.2	6.2	5.7
Net domestic assets 2/	-31.5	4.0	-7.2	0.8	5.6	8.3	10.4	9.1
Of which : net credit to the government 3/	-9.7	-2.2	-6.9	-5.0	2.4	2.1	-2.2	-4.0
credit to the economy	-2.5	22.5	17.1	17.5	13.0	15.3	16.2	16.4
M2 (12-month percent change)	16.7	22.1	18.5	21.8	17.5	17.5	16.8	15.0
Velocity (GDP/M2)	5.9	5.5	5.5	5.5	5.4	5.3	5.2	5.1
Interest rate for 90-day treasury bills/TAMs (in percent; end of period) 4/	10.5	10.2	14.5	17.5	...	...	...	...
	(In percent of GDP)							
Investment and saving								
Gross domestic investment	22.6	20.4	24.9	24.8	25.1	27.7	27.6	27.8
Government	9.4	8.4	11.9	11.7	12.2	14.7	13.9	13.5
Other sectors	13.2	12.0	12.9	13.1	12.9	13.1	13.7	14.3
Gross domestic savings (excluding grants)	8.5	4.1	7.7	8.6	7.4	6.7	7.5	9.6
Government	-1.6	0.2	-0.4	0.1	-0.1	-0.2	0.5	1.2
Other sectors	10.1	3.9	8.2	8.5	7.4	6.9	7.0	8.4
Current account, before grants	-14.1	-16.3	-17.1	-16.2	-17.8	-21.0	-20.1	-18.2
Government budget								
Total revenue	12.6	14.0	14.4	14.4	14.9	14.9	15.4	16.0
Total expenditure and net lending (incl. residual)	24.4	22.6	27.8	27.1	28.3	31.4	30.0	29.3
Overall balance, before grants	-12.0	-8.8	-13.4	-12.7	-13.4	-16.5	-14.7	-13.4
Total grants	7.5	6.5	11.1	10.7	8.8	11.9	11.3	10.6
Overall balance, after grants	-4.5	-2.3	-2.4	-2.0	-4.6	-4.6	-3.4	-2.7
Domestic primary balance	-3.9	-1.9	-2.6	-2.5	-2.4	-2.9	-2.7	-2.5
External financing (incl. debt relief) 5/	3.2	3.5	4.8	4.2	5.0	5.2	4.3	3.8
Net domestic financing	-0.5	-1.5	-2.5	-2.2	-0.4	-0.6	-1.0	-1.1
Privatization 5/	1.9	0.3	0.1	0.1	0.1	0.0	0.1	0.1
	(In percent of exports of goods and nonfactor services)							
External debt service (nonfinancial public sector)								
Scheduled, after additional bilateral assistance and MDRI	3.4	2.0	2.0	1.2	2.2	0.9	0.9	1.1
	(In millions of U.S. dollars, unless otherwise indicated)							
Overall balance of payments	213	-57	-31	-40	122	99	90	104
Net international reserves (end of period)	960	943	1,063	1,053	1,182	1,149	1,239	1,343
Gross international reserves (end of period)	1,160	1,103	1,074	1,063	1,195	1,162	1,252	1,356
In months of imports of goods and nonfactor services	5.8	4.6	4.1	4.0	4.2	3.7	3.9	4.1
In months of imports of goods and nonfactor services, excl. megaprojects	7.0	5.7	5.1	5.8	5.3	4.6	4.7	4.9
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports	...	...	...	6.2	...	6.5	6.6	6.8
Exchange rate (MTn per U.S. dollar; end of period)	18.9	24.2	...	...	...	...	…	…

Sources: Mozambican authorities; and Fund staff estimates and projections.
Note: Takes into account delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.

1/ A minus sign indicates depreciation.
2/ The percentage change for net domestic assets in the estimate for 2004 was adjusted to take account of the shifting of the external liabilities of the Bank of Mozambique to the government.
3/ Includes the issuance of government securities for the central bank recapitalization in years 2005-07.
4/ TAMs stands for 'titulos das autoridades monetarias'. TAMs are debt instruments issued by the Bank of Mozambique. Data for 2006 are at end-June.
5/ Includes movement in the government account set up abroad with the proceeds of the Moatize coal mine concession.

Table 2. Mozambique: Government Finances, 2004–09

	2004 1/	2005	2006		2007		2008	2009
	Est.	Est	Orig. Prog.	Prog.	Orig. Prog.	Prog.	Prog.	Prog.
				(In millions of MTn)				
Total revenue	16,838	21,418	26,052	26,669	31,089	31,342	36,556	42,858
Tax revenue	15,598	18,534	23,043	23,660	27,672	27,367	32,163	37,889
Taxes on income and profits	3,548	4,469	5,488	6,115	6,953	7,105	9,165	11,469
Taxes on goods and services	9,416	10,873	13,283	13,274	15,813	15,717	18,012	20,738
Of which : on petroleum products	1,663	1,806	2,321	2,321	2,778	2,744	3,199	3,669
Taxes on international trade	2,284	2,816	3,680	3,680	4,211	3,856	4,203	4,794
Other taxes	350	376	591	591	694	687	783	889
Nontax revenue	1,241	2,884	3,010	3,010	3,418	3,975	4,393	4,969
Total expenditure and net lending	32,607	34,582	50,355	50,281	59,140	66,106	71,456	78,746
Current expenditure	19,006	21,092	26,832	26,457	31,232	31,681	35,286	39,605
Compensation to employees	9,195	10,691	13,345	13,274	15,747	15,683	17,944	20,235
Goods and services	4,727	5,012	6,907	6,639	7,639	7,812	8,703	9,813
Interest on public debt	1,321	1,248	1,576	1,433	2,416	2,078	1,674	1,686
Domestic	910	789	1,081	1,073	1,875	1,818	1,271	1,127
External	411	459	496	360	541	260	403	559
Transfer payments	3,763	4,141	5,003	5,111	5,430	6,109	6,965	7,870
Domestic current primary balance	-847	1,574	797	1,645	2,274	1,739	2,943	4,939
Capital expenditure	12,543	12,819	21,592	21,667	25,474	30,881	33,015	36,204
Grant finance projects	3,085	1,918	5,030	4,915	5,424	11,672	12,372	12,952
Projet loans	3,564	3,148	4,783	4,522	5,478	4,296	4,553	4,767
Locally financed	4,074	4,335	5,670	6,465	7,445	7,927	9,550	11,855
Grant-financed special programs	1,197	2,151	4,764	3,886	5,451	5,034	5,336	5,586
Direct financing	623	717	928	1,463	999	937	996	1,043
Expenditure financed with fund for the concession mine of Tete	...	550	417	417	677	1,014	207	0
Net lending	1,058	671	1,931	2,157	2,434	3,544	3,155	2,938
Of which: locally financed	-79	-94	-137	-174	-161	-156	-178	-203
Domestic primary balance, before grants, above the line 2/	-4,842	-2,667	-4,736	-4,646	-5,010	-6,033	-6,429	-6,713
Unallocated revenue (+)/expenditure (-) 3/	-310	-293	0	0	0	0	0	0
Overall balance, before grants (below the line)	-16,079	-13,457	-24,303	-23,612	-28,050	-34,764	-34,900	-35,888
Grants received	10,053	9,975	19,992	19,904	18,462	24,992	26,879	28,565
Project	6,185	4,938	10,722	10,263	11,875	17,644	18,704	19,581
Nonproject	3,868	5,037	5,655	6,027	6,587	7,348	8,175	8,983
MDRI assistance via the central bank 6/		0	3,615	3,615	0		0	0
Overall balance, after grants	-6,026	-3,482	-4,310	-3,707	-9,589	-9,772	-8,021	-7,323
Central bank transfer of HIPC Initiative assistance by the IMF	484	388	0	0	0	0	0	0
Net external financing	3,788	5,035	8,725	7,753	10,356	10,965	10,234	10,117
Disbursements	6,937	5,219	9,256	8,033	10,643	10,682	10,733	10,887
Project	3,564	3,148	4,783	4,522	5,478	4,296	4,553	4,767
Nonproject	3,373	2,071	4,473	3,511	5,165	6,386	6,179	6,120
Cash amortization	-668	-734	-948	-697	-964	-730	-706	-770
Investment abroad 4/	-2,481	550	417	417	677	1,014	207	0
Net domestic financing 7/	-728	-2,335	-4,518	-4,150	-872	-1,297	-2,332	-2,928
Of which: MDRI from the IMF			-3,615	-3,615				
Privatization 5/	2482	394	104	104	104	104	119	134
Memorandum items:								
MDRI debt relief from IDA	...	... .	...	31,034	...	...	...	...
MDRI debt relief from the AfDF	...	... .	...	13,468	...	...	...	...
MDRI saving on total debt service	...	... .	...	851	...	981	1151	1326
Domestic primary balance, before grants, below the line 2/	-5,152	-2,960	-4,736	-4,646	-5,010	-6,033	-6,429	-6,713
Balance on MDRI deposit account with the central bank	0	0	2,687	2,687	1,792	1,792	897	0
Grants and loan disbursements	16,990	15,194	29,248	27,938	29,105	35,673	37,611	39,452
Bonds issuance for strengthening the balance sheet of the central bank	...	1,500	1,500	1,501	1,500	1,500	1,500	0

Table 2. Mozambique: Government Finances, 2004-09 (Concluded)

	2004 1/	2005	2006		2007		2008	2009
	Est.	Est.	Orig. Prog.	Prog.	Orig. Prog.	Prog.	Proj.	Proj.
	(In percent of GDP, unless otherwise specified)							
Total revenue	12.6	14.0	14.4	14.4	14.9	14.9	15.4	16.0
Tax revenue	11.7	12.1	12.7	12.7	13.2	13.0	13.5	14.1
Taxes on income and profits	2.7	2.9	3.0	3.3	3.3	3.4	3.8	4.3
Taxes on goods and services	7.1	7.1	7.3	7.1	7.6	7.5	7.6	7.7
Of which: on petroleum products	1.2	1.2	1.3	1.2	1.3	1.3	1.3	1.4
Taxes on international trade	1.7	1.8	2.0	2.0	2.0	1.8	1.8	1.8
Other taxes	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	0.9	1.9	1.7	1.6	1.6	1.9	1.8	1.9
Total expenditure and net lending	24.4	22.6	27.8	27.1	28.3	31.4	30.0	29.3
Current expenditure	14.2	13.8	14.8	14.2	14.9	15.1	14.8	14.7
Compensation to employees	6.9	7.0	7.4	7.1	7.5	7.5	7.5	7.5
Goods and services	3.5	3.3	3.8	3.6	3.7	3.7	3.7	3.7
Interest on public debt	1.0	0.8	0.9	0.8	1.2	1.0	0.7	0.6
Domestic	0.7	0.5	0.6	0.6	0.9	0.9	0.5	0.4
External	0.3	0.3	0.3	0.2	0.3	0.1	0.2	0.2
Transfer payments	2.8	2.7	2.8	2.8	2.6	2.9	2.9	2.9
Domestic current primary balance	-0.6	1.0	0.4	0.9	1.1	0.8	1.2	1.8
Capital expenditure	9.4	8.4	11.9	11.7	12.2	14.7	13.9	13.5
Of which: locally financed	3.1	2.8	3.1	3.5	3.6	3.8	4.0	4.4
Net lending	0.8	0.4	1.1	1.2	1.2	1.7	1.3	1.1
Of which: locally financed	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic primary balance, above the line 2/	-3.6	-1.7	-2.6	-2.5	-2.4	-2.9	-2.7	-2.5
Unallocated revenue (+)/expenditure (-) 3/	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants (below the line)	-12.0	-8.5	-13.4	-12.7	-13.4	-16.5	-14.7	-13.4
Grants received	7.5	6.5	11.0	10.7	8.8	11.9	11.3	10.6
Project	4.6	3.2	5.9	5.5	5.7	8.4	7.9	7.3
Nonproject	2.9	3.3	3.1	3.2	3.2	3.5	3.4	3.3
MDRI assistance via the central bank 6/	0.0	0.0	2.0	1.9	0.0	0.0	0.0	0.0
Overall balance, after grants	-4.5	-2.0	-2.4	-2.0	-4.6	-4.6	-3.4	-2.7
Central bank transfer of HIPC assistance by the IMF	0.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	2.8	3.3	4.8	4.2	4.9	5.2	4.3	3.8
Disbursements	5.2	3.4	5.1	4.3	5.1	5.1	4.5	4.1
Project	2.7	2.1	2.6	2.4	2.6	2.0	1.9	1.8
Nonproject	2.5	1.4	2.5	1.9	2.5	3.0	2.6	2.3
Cash amortization	-0.5	-0.5	-0.5	-0.4	-0.5	-0.3	-0.3	-0.3
Investment abroad 4/	-1.9	0.4	0.2	0.2	0.3	0.5	0.1	0.0
Net domestic financing	-0.5	-1.5	-2.5	-2.2	-0.4	-0.6	-1.0	-1.1
Privatization 5/	1.9	0.0	0.1	0.1	0.1	0.0	0.1	0.1
Memorandum items:								
Domestic primary balance, before grants, below the line 2/	-3.9	-1.7	-2.6	-2.5	-2.4	-2.9	-2.7	-2.5
Balance on MDRI deposit account with the central bank	0.0	0.0	1.5	1.4	1.3	0.9	0.4	0.0
Grants and loans disbursements	12.7	9.9	16.1	15.0	13.9	16.9	15.8	14.7
Bonds issuance for strengthening the balance sheet of the central bank	...	1.0	0.8	0.8	0.7	0.7	0.6	0.0
Nominal GDP (in millions of MTn)	133,510	153,041	180,831	185,696	208,970	210,490	238,125	268,531

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

Note: Takes into account delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.

1/ The quasi-fiscal deficit of the Bank of Mozambique, amounting to MTn 3,455 million (or 2.5 percent of GDP) is not included.
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/ Residual discrepancy between identified sources and use of funds.
4/ Tracks the movements in the government account set up abroad with the proceeds of the Moatize coal mine concession.
5/ Includes in 2004 the US$123 million (2.0 percent of GDP) concession fee for the Moatize coal mine concession.
6/ Includes the transfer of both MDRI and HIPC assistance from the central bank to the budget in 2006.

Table 3. Mozambique: Monetary Survey, 2004–09

	2004	2005	2006		2007		2008	2009
			Orig. Prog.	Prog.	Orig. Prog	Prog.	Proj.	Proj.
			(In millions of MTn, unless otherwise specified)					
Central bank								
Net foreign assets	21,504	26,113	33,485	31,011	37,241	34,937	38,185	41,719
(in millions of U.S. dollars)	1,138	1,080	1,184	1,173	1,279	1,229	1,284	1,343
Net international reserves	18,154	22,809	30,057	27,820	34,402	32,671	36,847	41,719
(in millions of U.S. dollars)	961	943	1,063	1,053	1,182	1,149	1,239	1,343
Medium- and long-term foreign liabilities	-57	-3	-85	0	-87	0	0	0
(in millions of U.S. dollars)	-3	0	-3	0	-3	0	0	0
Other	3,408	3,308	3,514	3,191	2,926	2,266	1,338	0
(in millions of U.S. dollars)	180	137	124	121	101	80	45	0
Net domestic assets	-11,071	-13,929	-19,498	-17,023	-21,221	-18,917	-20,162	-21,653
Credit to government (net)	-11,245	-15,168	-13,713	-15,568	-12,017	-13,464	-13,396	-14,174
Credit to banks (net)	-3,859	408	24	1,729	120	1,625	1,956	2,994
Credit to the economy	1	1	1	16	1	16	16	16
Other items (net; assets +)	4,033	831	-5,810	-3,200	-9,324	-7,095	-8,739	-10,489
of which Valuation Adjustments	0	-3,102	-4,769	-2,531	-2,014	-2,394	-1,644	-1,750
Reserve money	10,433	12,185	13,988	13,988	16,020	16,020	18,023	20,066
Currency outside banks	5,225	6,110	6,784	6,611	8,811	8,045	8,389	8,678
Bank reserves	5,209	6,075	7,204	7,377	7,209	7,975	9,633	11,388
Currency in banks	978	1,226	1,694	1,158	1,169	622	850	1,146
Deposits	4,231	4,849	5,509	6,219	6,040	7,353	8,783	10,242
Required reserves	4,231	4,913	5,485	6,196	6,034	7,325	8,750	10,203
Free reserves	3,814	-64	24	24	6	28	33	39
Deposit money banks								
Net foreign assets	4,994	8,270	9,702	12,449	9,985	13,387	14,004	14,631
(in millions of U.S. dollars)	264	342	343	471	343	471	471	471
Net domestic assets	23,955	29,061	32,678	33,825	37,167	40,694	50,061	59,906
Banks' reserves	5,295	6,015	7,204	7,377	7,209	7,975	9,633	11,388
Central bank liabilities with commercial banks (net)	4,009	-235	-24	-1,729	-120	-1,625	-1,956	-2,994
Credit to government (net)	4,561	7,748	3,712	5,965	3,174	4,979	3,566	1,416
Credit to the economy	13,512	21,215	28,640	28,807	35,039	36,900	46,967	58,873
Other items (net; assets +)	-3,422	-5,681	-6,853	-6,594	-8,136	-7,533	-8,149	-8,777
Deposits	28,950	37,331	42,380	46,274	47,151	54,082	64,064	74,537
Demand and savings deposits	19,255	26,177	21,190	30,672	30,648	35,753	42,816	50,165
Time deposits	9,695	11,154	21,190	15,602	16,503	18,328	21,248	24,372
Monetary survey								
Net foreign assets	26,499	34,383	43,187	43,460	47,225	48,324	52,188	56,350
Net domestic assets	7,676	9,058	5,976	9,425	8,737	13,803	20,265	26,865
Domestic credit	6,829	13,795	18,640	19,220 0	26,198	28,431	37,154	46,132
Credit to government (net)	-6,684	-7,420	-10,001	-9,603	-8,843	-8,485	-9,830	-12,758
Credit to the economy	13,513	21,215	28,640	28,823 0	35,040	36,916	46,983	58,889
Other items (net; assets +)	847	-4,737	-12,663	-9,795	-17,461	-14,628	-16,888	-19,266
Money and quasi money (M3)	34,174	43,441	49,164	52,885 0	55,962	62,127	72,454	83,215
Foreign currency deposits	11,522	15,793	16,401	19,197	17,466	22,545	26,216	30,041
(in millions of U.S. dollars)	610	653	580	726	800	793	882	967
M2	22,653	27,648	32,763	33,687 0	38,496	39,583	46,238	53,174
Currency outside banks	5,225	6,110	6,784	6,611	8,811	8,045	8,389	8,678
Domestic currency deposits	17,428	21,538	25,979	27,077	29,685	31,537	37,849	44,497
Memorandum items:								
Currency in circulation (in millions of MTn)	6,203	7,336	8,478	7,769 0	9,980	8,667	9,239	9,824
MDRI assistance via the central bank 1/	0	0	3,615	3,615	0	0	0	0
(in millions of U.S. dollars)	0	0	154	154	0	0	0	0
Balance on MDRI deposit account with the central bank 2/	0	0	-2,687	-2,687	-1,792	-1,792	-897	0
			(Annual growth in percentage of beginning of period M3, unless otherwise specified)					
Net foreign assets	37.5	23.1	20.4	20.9	8.2	9.2	6.2	5.7
Net domestic assets	-31.5	4.0	-7.2	0.8	5.6	8.3	10.4	9.1
Credit to government (net)	-9.7	-2.2	-6.9	-5.0	2.4	2.1	-2.2	-4.0
Credit to the economy	-2.5	22.5	17.1	17.5	13.0	15.3	16.2	16.4
Other items (net; asset +)	-19.3	-16.3	-17.5	-11.6	-9.8	-9.1	-3.6	-3.3
Broad money (M3) (12-month change in percent)	5.9	27.1	13.2	21.7	13.8	17.5	16.6	14.9
M2 (12-month change in percent)	16.7	22.1	18.5	21.8	17.5	17.5	16.8	15.0
M3-to-GDP ratio (percent)	25.6	28.4	27.2	28.5	26.8	29.5	30.4	31.0
M2-to-GDP ratio (percent)	17.0	18.1	18.1	18.1	18.4	18.8	19.4	19.8
Credit to the economy (12-month change in percent)	-5.6	57.0	35.0	35.8	22.3	28.1	27.3	25.3
Credit to the economy-to-GDP ratio (percent)	10.1	13.9	15.8	15.5	16.8	17.5	19.7	21.9
Currency outside banks-to-M3 ratio (percent)	15.3	14.1	13.8	12.5	15.7	13.0	11.6	10.4
Foreign currency deposits-to-M3 ratio (percent)	33.7	36.4	33.4	36.3	31.2	36.3	36.2	36.1
Reserve money growth (12 month change in percent)	20.2	16.8	15.1	14.8	14.5	14.5	12.5	11.3
Money multiplier (M2/reserve money)	2.2	2.3	2.3	2.4	2.4	2.5	2.6	2.7
Velocity (GDP/M2)	5.9	5.5	5.5	5.5	5.4	5.3	5.2	5.1
Nominal GDP growth	17.2	14.6	17.6	21.3	15.7	13.4	13.1	12.8

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

Note: Takes into account delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.

1/ Mozambique's liability to the Fund rests with the Bank of Mozambique. MDRI assistance is immediately transferred to a government blocked deposit account at the Bank of Mozambique.
2/ Balance declines from MDRI assistance by 0.5 percent of GDP corresponding to an agreed increase in government expenditures contingent on MDRI assistance.

Table 4. Mozambique: Balance of Payments, 2004–09 1/
(In millions of U.S. dollars, unless otherwise specified)

	2004	2005	2006		2007		2008	2009
		Est.	Orig. Prog.	Proj.	Orig. Prog.	Proj.	Proj.	Proj.
Trade balance	-531	-721	-623	-500	-663	-844	-952	-937
Exports, f.o.b.	1,504	1,745	2,101	2,250	2,246	2,349	2,329	2,447
Megaprojects	1,049	1,263	1,570	1,681	1,676	1,733	1,662	1,720
Other exports	455	483	532	569	570	617	667	727
Imports, c.i.f.	-2,035	-2,467	-2,725	-2,750	-2,909	-3,194	-3,281	-3,383
Megaprojects	-322	-423	-478	-498	-557	-569	-519	-511
Other imports	-1,712	-2,044	-2,246	-2,253	-2,352	-2,625	-2,762	-2,872
Services and incomes (net)	-301	-362	-565	-682	-639	-803	-727	-702
Receipts	370	464	547	577	649	589	602	618
Expenditures	-671	-826	-1,111	-1,259	-1,287	-1,392	-1,329	-1,320
Of which : interest on public debt	-18	-24	-21	-19	-33	-15	-20	-22
Current account, before grants	-832	-1,083	-1,188	-1,181	-1,302	-1,647	-1,679	-1,639
Unrequited official transfers	527	461	793	2,466	661	947	963	974
Of which: MDRI relief from the IMF	0	0	120	120	0	0	0	0
MDRI relief from IDA	0	0	0	1,156	0	0	0	0
MDRI relief from AfDF	0	0	0	502	0	0	0	0
Of which : HIPC grant from the IMF	0	15	34	34	0	0	0	0
Current account, after grants 2/	-305	-622	-395	1,284	-641	-700	-715	-664
Capital account	333	394	364	-1,324	762	799	805	768
Trade credit (net)	-3	5	20	20	50	67	67	67
Foreign borrowing	463	470	585	630	701	702	712	718
Public (including IMF)	315	228	357	357	375	375	359	351
Private 4/	148	242	228	273	326	327	353	366
Amortization	-291	-256	-464	-2,104	-336	-316	-362	-397
Public	-51	-71	-199	-1,839	-45	-26	-25	-26
Of which: IMF 3/	-9	-30	-154	-154	0	0	0	0
Private	-240	-184	-265	-265	-290	-290	-337	-371
Direct investment (net)	245	150	207	207	323	323	363	354
Of which: Moatize coal mine	123	0	0	0	0	0	0	0
Other investment of the government 5/	-123	24	16	16	24	24	25	26
Short-term capital and errors and omissions (net)	185	171	0	0	0	0	0	0
Overall balance	213	-57	-31	-40	122	99	90	104
Financing	-213	57	31	40	-122	-99	-90	-104
Of which : Bank of Mozambique								
gross reserve assets (increase -)	-213	57	31	40	-122	-99	-90	-104
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Use of Fund credit (net)	-6	-23	-149	-149	2	2	0	0
Current account deficit (percent of GDP)								
Before grants	14.1	16.3	17.1	16.2	17.8	21.0	20.1	18.3
After grants	5.2	9.4	5.7	-17.6	8.8	8.9	8.5	7.4
Net international reserves	960	943	1,063	1,053	1,182	1,149	1,239	1,343
Gross international reserves	1,160	1,103	1,074	1,063	1,195	1,162	1,252	1,356
In months of imports of GNFS	5.8	4.6	4.1	4.0	4.2	3.7	3.9	4.1
In months of imports of GNFS, excluding megaprojects	7.0	5.7	5.1	5.8	5.3	4.6	4.7	4.9
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports		...	...	6.2	...	6.5	6.6	6.8

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

Note: Takes into account delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.

1/ The impact of the transfer of ownership of the Cahora Bassa dam has not been included.
2/ Since this presentation still follows the fourth balance of payments manual, MDRI and HIPC grants from the IMF are included in the current account.
3/ The large amortization in 2006 reflects the repayment of IMF debt with MDRI resources.
4/ Private borrowing, not guaranteed by the government or the Bank of Mozambique.
5/ Tracks the movements in the government account set up abroad with the proceeds of the coal mine concession.

Table 5. Mozambique: Balance of Payments of Megaprojects, 2002–08 1/

	2002	2003	2004	2005	2006	2007	2008
				Est	Proj.	Proj.	Proj.
	(In millions of dollars, unless otherwise specified)						
Trade balance	66	344	726	840	1,183	1,164	1,142
Exports, f.o.b.	468	681	1,049	1,263	1,681	1,733	1,662
Imports, c.i.f.	-402	-337	-322	-423	-498	-569	-519
Services and incomes (net)	-233	-228	-305	-455	-851	-853	-756
Current account, before grants	-167	116	421	385	333	311	386
Current account, after grants	-167	116	421	385	333	311	386
Capital account	644	229	-57	50	-66	109	114
Foreign borrowing	439	62	5	110	45	134	151
Amortization	-40	-66	-117	-120	-170	-171	-187
Direct investment (net)	245	234	55	60	59	146	151
Overall balance before short-term capital inflows 2/	477	344	364	435	266	419	500

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

1/ Megaprojects include Mozal (aluminum production); Sasol (gas production and pipeline); the Cahora-Bassa dam (hydro-power); and two titanium ore projects.
2/ This line significantly overestimates the contribution of megaprojects to international reserve accumulation, because most of their financial operations are conducted outside the domestic banking system. Only a small fraction of foreign exchange proceeds are actually repatriated in Mozambique. However, information on the latter is not available.

Table 6. Mozambique: Expenditure in PARPA Priority Sectors, 2004–07 1/

(In millions of meticais, unless otherwise indicated)

	2004 Est.	2005 Est.	2006 Proj.	2007 Proj.
Total revenues	16,838	21,418	26,669	31,342
Total expenditure, excluding bank restructuring costs and net lending	31,549	34,457	48,124	62,562
Total expenditure (excl.bank restruct. costs, net lending, and interest payments)	30,228	33,209	46,691	60,484
Interest payments on public debt	1,321	1,248	1,433	2,078
Total expenditure in PARPA priority sectors	19,033	22,017	32,468	41,184
in percent of GDP	14.3	14.4	17.5	19.6
in percent of total expenditure (excl. bank restruct costs, net lending, and interest payments)	63.0	66.3	69.5	68.1
Education	6,317	6,621	9,362	12,823
Primary	5,325	5,639	7,753	10,403
Health	3,183	4,209	6,855	7,258
HIV/AIDS	123	220	682	484
Infrastructure development	3,982	6,205	7,482	8,347
Roads	3,112	4,697	4,675	3,871
Sanitation and public works	870	1,508	2,807	4,476
Agriculture and rural development	1,322	1,306	1,543	3,931
Governance and judicial system	2,936	2,948	5,864	5,988
Security and public order	1,753	1,470	2,001	2,964
Governance	483	608	2,815	1,573
Judicial system	699	869	1,048	1,452
Other priority areas	1,170	736	680	1,452
Social actions	201	213	341	484
Labor and employment	123	109	147	242
Total PARPA expenditures in percent of GDP				
Education	4.7	4.3	5.0	6.1
Primary	4.0	3.7	4.2	4.9
Health	2.4	2.8	3.7	3.4
HIV/AIDS	0.1	0.1	0.4	0.2
Infrastructure development	3.0	4.1	4.0	4.0
Roads	2.3	3.1	2.5	1.8
Sanitation and public works	0.7	1.0	1.5	2.1
Agriculture and rural development	1.0	0.9	0.8	1.9
Governance and judicial system	2.2	1.9	3.2	2.8
Security and public order	1.3	1.0	1.1	1.4
Governance	0.4	0.4	1.5	0.7
Judicial system	0.5	0.6	0.6	0.7
Other priority areas	0.9	0.5	0.4	0.7
Social actions	0.2	0.1	0.2	0.2
Labor and employment	0.1	0.1	0.1	0.1
Total PARPA expenditures in percent of total expenditures				
Education	20.9	19.9	20.1	21.2
Primary	17.6	17.0	16.6	17.2
Health	10.5	12.7	14.7	12.0
HIV/AIDS	0.4	0.7	1.5	0.8
Infrastructure development	13.2	18.7	16.0	13.8
Roads	10.3	14.1	10.0	6.4
Sanitation and public works	2.9	4.5	6.0	7.4
Agriculture and rural development	4.4	3.9	3.3	6.5
Governance and judicial system	9.7	8.9	12.6	9.9
Security and public order	5.8	4.4	4.3	4.9
Governance	1.6	1.8	6.0	2.6
Judicial system	2.3	2.6	2.2	2.4
Other priority areas	3.9	2.2	1.5	2.4
Social actions	0.7	0.6	0.7	0.8
Labor and employment	0.4	0.3	0.3	0.4

Source: Mozambican authorities (Ministry of Finance); and staff estimates and projections.
1/ PARPA stands for National Action Plan for the Reduction of Absolute Poverty, which is the Portuguese acronym.

Table 7. Mozambique: Financial Soundness Indicators for Banking Sector, 2000–06
(In percent unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006 1/
Capital adequacy							
Regulatory capital to risk-weighted assets	-2.13	5.49	14.01	17.03	18.65	16.00	13.10
Regulatory Tier I capital to risk-weighted assets	-2.07	6.03	11.97	14.67	15.97	13.57	11.39
Capital (net worth) to assets	-2.70	8.22	9.42	9.01	9.51	8.04	6.42
Asset composition and quality							
Sectoral distribution of loans to total loans							
Agriculture	19.00	18.00	15.00	12.73	9.45	8.49	8.40
Industry	27.00	25.00	22.00	16.94	11.94	16.77	20.07
Construction	5.00	4.00	4.00	5.20	3.35	4.13	5.86
Commerce	23.00	20.00	17.00	18.13	21.29	27.36	26.93
Transportation and communication	5.00	7.00	5.00	7.08	7.19	5.83	6.59
Other	22.00	27.00	36.00	37.14	36.18	35.05	27.75
of which: Private 2/				7.63	12.12	13.03	13.42
Housing				7.10	8.18	4.24	4.00
Diverse 3/				22.41	15.87	17.78	10.33
Foreign exchange loans to total loans	40.24	64.69	69.87	70.77	67.33	63.91	54.18
Nonperforming loans to gross loans 4/	17.76	23.43	21.98	14.43	6.42	3.82	3.71
Nonperforming loans net of provisions to capital 4/	35.00	11.00	9.39	7.91	1.70	0.89	2.16
Earnings and profitability							
Return on assets	0.04	0.14	1.59	1.24	1.43	1.81	2.26
Return on equity	...	3.51	22.10	16.29	18.73	27.42	32.84
Interest margin to gross income	...	10.22	61.39	56.83	60.15	58.01	59.16
Noninterest expenses to gross income	...	16.92	67.03	72.18	71.24	65.85	54.02
Personnel expenses to noninterest expenses	...	51.71	44.67	45.68	45.21	45.35	58.20
Trading and fee income to gross income	...	33.09	39.68	45.49	41.87	43.78	42.46
Spread between reference loan and deposit rates (90 days, local currency)	...	14.00	19.00	17.39	14.67	11.48	15.00
Funding and liquidity							
Liquid assets to total assets 5/	41.51	34.64	53.93	57.74	58.12	55.52	53.34
Customer deposits to total (non-interbank) loans	188.00	217.00	240.00	227.97	283.07	191.90	185.66
Foreign exchange liabilities to total liabilities	54.53	63.30	61.26	46.39	41.38	45.26	46.22

Source: Bank of Mozambique (BM).

1/ Data as of June 2006.
2/ Includes credit cards and consumer credit lines for vehicle and durable goods
3/ Includes credit to all other sectors not discriminated above or yet to be identified.
4/ Nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).
5/ Includes deposits at parent banks.

Table 8. Mozambique: Millennium Development Goals, 1990–2004

	1990	1994	1997	2000	2003	2004
Goal 1: Eradicate extreme poverty and hunger						
Income share held by lowest 20 percent	..	..	6.0	..	..	..
National household survey poverty incidence 2/	..	..	*69.4*	..	54.1	..
Malnutrition prevalence, weight for age (percentage of children under 5)	..	..	26.0	26.0	24.0	*24.0*
Poverty gap at 1 U.S dollar a day (PPP) (in percent)	..	..	*12.0*	..	..	..
Poverty headcount ratio at 1 U.S dollar a day (PPP) (percentage of population)	..	..	*38.0*	..	..	..
Poverty headcount ratio at national poverty line (percentage of population)	..	..	69.0	..	..	..
Prevalence of undernourishment (percentage of population)	..	..	58.0	..	45.0	*45.0*
Goal 2: Achieve universal primary education						
Literacy rate, youth total (percentage of people ages 15-24)	49.0	..	..	..	..	..
Persistence to grade 5, total (percentage of cohort)	..	..	..	52.0	..	..
Primary completion rate, total (percentage of relevant age group)	24.9	24.5	*25.4*	16.2	*22.1*	29.0
School enrollment, primary (percentage, net)	..	..	..	56.0	*56.0*	71.0
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliament (in percent)	16.0	..	25.0	*25.0*	30.0	30.0
Ratio of girls to boys in primary and secondary education (in percent)	..	..	..	75.1	*78.6*	82.3
Ratio of young literate females to males (percentage ages 15–24)	47.9	..	..	..	..	..
Share of women employed in the nonagricultural sector (in percent of total nonagricultural employment)	11.0	..	..	..	..	..
Goal 4: Reduce child mortality						
Immunization, measles (percentage of children ages 12–23 months)	59.0	65.0	61.0	71.0	77.0	77.0
Mortality rate, infant (per 1,000 live births)	158.0	..	..	122.0	..	104.0
Mortality rate, under-5 (per 1,000)	235.0	..	..	178.0	..	152.0
Goal 5: Improve maternal health						
Births attended by skilled health staff (in percent of total)	..	..	44.2	..	48.0	*48.0*
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	1,000	..	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Children orphaned by HIV/AIDS	..	..	..	..	470,000	*470,000*
Contraceptive prevalence (percentage of women ages 15-49)	..	..	6.0	..	17.0	*17.0*
Incidence of tuberculosis (per 100,000 people)	167.1	..	..	..	..	460.2
Prevalence of HIV, female (percentage ages 15-24)	..	..	..	..	..	..
Prevalence of HIV, total (percentage of population ages 15-49)	..	..	..	..	12.0	*12.0*
Tuberculosis cases detected under DOTS (in percent)	..	..	46.8	44.5	45.5	45.9
Goal 7: Ensure environmental sustainability						
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1	*0.1*	..
Forest area (percentage of land area)	26.0	..	..	25.0	..	..
GDP per unit of energy use (constant 2,000 PPP U.S. dollars per kilogram of oil equivalent)	1.0	2.0	2.0	2.0	2.0	*2.0*
Improved sanitation facilities (percentage of population with access)	..	..	..	..	*27.0*	..
Improved water source (percentage of population with access)	..	..	..	..	*42.0*	..
Nationally protected areas (percentage of total land area)	..	..	..	..	8.4	8.4
Goal 8: Develop a global partnership for development						
Aid per capita (current U.S. dollars)	74.7	78.3	56.6	49.0	54.5	63.2
Debt service (PPG and IMF only, percentage of exports, excluding workers' remittances)	17.0	30.0	18.0	2.0	5.0	3.0
Fixed line and mobile phone subscribers (per 1,000 people)	3.5	3.7	4.1	7.6	26.9	*26.9*
Internet users (per 1,000 people)	0.0	..	0.1	1.1	4.4	7.1
Personal computers (per 1,000 people)	..	..	1.8	3.3	5.0	5.8
Total debt service (percentage of exports of goods, services and income)	26.0	31.0	19.0	12.0	6.0	5.0
Unemployment, youth female (percentage of female labor force ages 15-24)	..	..	..	..	..	..
Unemployment, youth male (percentage of male labor force ages 15-24)	..	..	..	..	..	..
Unemployment, youth total (percentage of total labor force ages 15-24)	..	..	..	..	..	..
Other						
Fertility rate, total (births per woman)	6.2	..	5.9	5.7	5.4	5.4
GNI per capita, Atlas method (current U.S dollars)	170	140	170	210	230	270
GNI, Atlas method (billions of current U.S. dollars)	2.3	2.1	2.9	3.8	4.4	5.3
Gross capital formation (% of GDP)	22.1	25.5	20.6	33.5	25.9	20.1
Life expectancy at birth, total (years)	43.2	..	43.8	42.6	41.9	41.8
Literacy rate, adult total (percentage of people ages 15 and above)	33.5	..	..	..	..	..
Population, total (millions)	13.4	15.3	16.7	17.9	19.1	19.4
Trade (in percent of GDP)	44.2	62.1	41.9	61.3	72.3	68.3

Source: World Development Indicators database, April 2006; and Mozambican authorities.

1/ Figures in italics refer to periods other than those specified.

2/ A household survey was conducted between 1996–97 and 2002–03 to determine poverty incidence. The methodology included a basket of goods that satisfies basic calorie needs. The cost of this basket represents the food poverty line in each domain; a nonfood poverty line was also obtained. Households are defined as poor if their daily per capita expenditure is less than the total poverty line (sum of food and nonfood poverty lines).

APPENDIX I

Maputo, Mozambique
October 24, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

1. On behalf of the Government of Mozambique, we hereby transmit the attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the Government intends to implement in the remainder of 2006 and 2007, as well as the underlying macroeconomic policy framework consistent with the PARPA II. The attached revised technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. The Government of Mozambique continues to make progress in implementing the 2004-06 program supported by the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Fund's Executive Board on July 6, 2004. All quantitative performance criteria at end-June 2006 and the structural performance criterion through end-July 2006 were achieved. The program for the remainder of 2006 is broadly unchanged while the 2007 and the medium term framework have been revised to take into account the 2007 budget, a scaling-up of foreign aid, domestic and international economic developments, and *Plano de Acção Para a Redução da Pobreza Absoluta II* (PARPA II).

3. The resources released as part of the MDRI have been incorporated in the execution of the 2006 budget and included in the medium term fiscal framework (MTFF) to be spent on poverty-reducing "priority" expenditures identified in the PARPA II.

4. In support of its objectives and policies, the Government of Mozambique hereby requests the disbursement of the sixth loan under the current PRGF arrangement in the amount of SDR 1.62 million (1.4 percent of quota) on the completion of the fifth review.

5. Looking ahead, the policies set out in the MEFP continue to aim to consolidate macroeconomic stability and sustain strong broad-based growth through a second wave of reforms in order to achieve the Millennium Development Goals (MDGs). The performance criteria and benchmarks for the sixth and final review under the PRGF arrangement will be

based on the end-December 2006, and through end-April 2007 targets as set out in Tables 1 and 3 of the MEFP. While the current PRGF arrangement expires in July 2007, indicative targets for end-June 2007, end-September 2007 and end-December 2007 are also set forth in Table 1.

6. The Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement following the approval of the new foreign exchange law which will be submitted to the Assembly by end-March 2007. The delay in the submission of the new draft foreign exchange law to the Assembly is related to the need to build a consensus among all stakeholders. The government remains committed to a flexible exchange rate regime.

7. The Government of Mozambique will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

8. The Government of Mozambique believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of its economic program for 2006 and 2007 supported by the PRGF arrangement, but it will take further measures to that end if deemed necessary. During the implementation of the arrangement, the Government of Mozambique will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, at the initiative of the Government or whenever the Managing Director requests such a consultation.

9. The government of Mozambique is considering the possibility to request a Policy Support Instrument (PSI) at the end of the current PRGF-supported program. As such, the government wishes to negotiate the new PSI at the time of sixth review under the current PRGF arrangement.

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

ATTACHMENT I

Memorandum of Economic and Financial Policies of the Government of Mozambique for the Fifth Review Under the PRGF Arrangement

October 24, 2006

1. The Government of Mozambique is committed to continue to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and a second wave of structural reforms. The strategy to achieve these goals in 2006–09 is set out in the *Plano de Acção Para a Redução da Pobreza Absoluta II* (PARPA II) that has been recently submitted to the management of both the International Monetary Fund (IMF) and World Bank. The Government's economic program is supported by the IMF with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved on July 6, 2004. This Memorandum of Economic and Financial Policies (MEFP) reviews the performance under the PRGF-supported program (January 2006–September 2006) and describes the policies and targets for the remainder of 2006 and 2007.

I. RECENT PERFORMANCE UNDER THE PRGF-SUPPORTED PROGRAM

2. In 2006, economic performance remains favorable. Led by strength in the agriculture and construction sectors, real GDP growth has continued to be broad-based and is expected to accelerate slightly, from 7.7 percent in 2005 to 7.9 percent in 2006. Good rainfall, following the 2005 drought, resulted in a regular harvest season and has improved food security. Reflecting lower food prices, the cumulative headline inflation rate has slowed down since May to 4.8 percent in September, putting the year-end inflation target, 7 percent, within reach, although higher world oil prices may add pressures on price stability. The foreign exchange market has remained stable following the introduction of a temporary exchange rate band in the interbank foreign exchange market (MCI) in November 2005. The net international reserves (NIR) target for end-June 2006 was met and spread between the MCI rate and rates quoted by banks and bureaus has narrowed, and the real effective exchange rate has appreciated by about 5 percent since end-2005.

3. Fiscal performance for the first semester of 2006 was better than programmed. Revenue collection is above target led by buoyant corporate and VAT tax collections, and domestic-related expenditures are in line with the program. This resulted in a lower domestic primary deficit. However, the share of priority spending was somewhat below target reflecting a low rate of project execution so far.

4. Progress has been made in reforming revenue administration and widening the tax base. The general tax law and the law creating the Central Revenue Authority (ATM) were promulgated in February 2006. The implementing regulations for the ATM law were approved by the Council of Ministers with a slight delay in July 2006 (structural benchmark) and the ATM strategic plan has been completed. The organic law of tax tribunals was also approved in April 2006, and operationalized with the selection of professional judges. In addition, the following measures were implemented:

(i) identifying and collecting tax arrears; (ii) increasing the number of taxpayers to 360,000; and (iii) conducting a larger number of tax audits.

5. Public Financial Management (PFM) reforms have made good progress. The medium-term fiscal framework (CFMP) is closely aligned with the objectives of PARPA II, and was, for the first time, approved by the Council of Ministers in May 2006. The Government is implementing a new version of the e-SISTAFE (Homoine version) software to enable effective direct budget execution (according to the sequence of commitment, verification, and payment) for goods and services, and rolled out the system to the Ministries of Finance, Planning, Education, Agriculture, Health, and Public Works, at the central and provincial levels (structural performance criterion) since July 2006. To avoid having to go through a cumbersome process of converting the budget proposals into e-SISTAFE, a simplified new IT system (Phase I of the new budget formulation module) was implemented, and was ready in time to support the preparation of the 2007 budget. Good progress was made in integrating donor-financed projects into the 2007 budget ceilings including through the issuance of accounting guidelines, while challenges remain in bringing those projects on to the treasury single account (CUT). Pending the implementation of a new revenue collection network, revenue departments current's IT system (RCN) was updated to classify revenues according to SISTAFE's needs when they are transferred to the CUT and help with the treasury's financial programming capacity. Finally, a prioritized strategy was developed by end-September 2006 (structural benchmark) to progressively rollout e-SISTAFE to districts based on their administrative and infrastructure capacity.

6. Monetary policy has remained prudent. The performance criterion on base money was met for end-June 2006. This helped the introduction of the new family of meticais (MTn) proceed smoothly on July 1, 2006. Interest rates increased following the removal of interest rate caps in government securities auctions completed in March, albeit declining in August following the Bank of Mozambique's (BM) decision to lower its *Facilidade Permanente de Cedência (FPC)* rate alongside the deceleration in inflation. Net credit to the government (NCG) was lower than programmed, which also contributed to keeping broad money growth below its end-June target.

7. Prudential ratios of the banking system have remained sound. The ratio of non-performing loans to total loans has remained below 5 percent while the requirement to provision 50 percent of their foreign currency-denominated loans to nonexporters since July 2005 has led to a deceleration in foreign currency loan growth. Moreover, credit growth to the economy has remained strong, and the commercial banking system appears to be well capitalized. Finally, in order to strengthen the balance sheet of the BM, securities in an amount of MTn 1.5 billion were issued to BM in June 2006 as envisaged in the program.

8. In the area of accounting, the BM adjusted its Chart of Accounts in September 2006 (structural benchmark) to allow for: (i) the valuation of foreign exchange gains/losses consistent with International Financial Reporting Standards (IFRS); and (ii) the preparation of BM's financial statements for 2005 in compliance with IFRS in parallel to the financial statement prepared under the current accounting standard. The revision of the Chart of Accounts of the commercial banking system, consistent with

IFRS, is being finalized, but a circular will be issued by end-November 2006 (originally planned by end-September 2006; structural benchmark).

9. Progress on structural reforms in 2006 accelerated, particularly in the areas of public sector, labor market, and trade-related reforms. The government is strengthening efforts in the area of public sector reform through the second phase of the strategic action plan (2006-2011). The plan was approved by the Council of Ministers in October 2006, with a special focus on decentralization. A public service authority (ANFP) was recently established, reporting directly to the President, to give the reform a stronger impetus. In addition, a preliminary draft of a strategy paper on decentralization has been prepared including fiscal issues. The new draft Labor law has been approved by the Council of Ministers and submitted to the Assembly. In the area of trade reforms, in January 2006, the maximum import tariff rate applicable to SADC trading partners was lowered from 25 to 20 percent. With respect to the latter, the government continued negotiations with Angola, Tanzania and Zambia in order to reach agreements similar to the ones concluded with Zimbabwe and Malawi in 2005. In addition, the Government has continued with streamlining licensing procedures through "one stop shops", computerizing the company registry, and the e-Government portal, and pursuing bilateral free trade arrangements as recommended in the Diagnostic Trade Integration Study (DTIS).

10. However, less progress was made to increase access to finance through deeper reforms that would improve the lending environment, such as legal and judicial reform, the use of collateral, and availability of creditor information, as well as deepening of domestic debt markets. Despite the initiation of commercial sections in the Judicial Tribunals of the city of Maputo, Sofala and Nampula, further capacity building is needed with the help of donors, including the World Bank. The remaining weaknesses in the justice sector and backlog of cases are also causing an increasing impediment not only in dealing with criminal cases and corruption, but in relation to labor issues and the development of a vibrant private sector. In addition, challenges remain in the implementation of new national procedures such as procurement, accounting, reporting and audit which needs to be further strengthened with close collaboration with donors, in particular at the district level

11. Little progress has been made in collecting the necessary information to monitor adequately the mega-projects and the eleven public enterprises, as well as the 164 participating enterprises. While the unit to monitor the megaprojects has not been created as envisaged under the program, the government has decided to create a research department within the Ministry of Finance in 2006, with a key function to gather information on megaprojects, and public and participating enterprises.

II. The Policy Agenda for 2006 and 2007

12. The policy framework, which aims at consolidating macroeconomic stability, is consistent with the medium-term goal of sustaining poverty reduction through strong broad-based economic growth. The Government is committed to continue to implement measures to strengthen revenue mobilization and the transparency and monitoring of the budget execution including the MDRI resources, to fine-tune monetary policy, and to reinvigorate and accelerate the structural reform agenda in the context of PARPA II.

Furthermore, the Government intends to continue to monitor its program with the existing multi-disciplinary committee, particularly through reinforced coordination between the BM and the Ministry of Finance (MF). The research department of the Ministry of Finance will collect and analyze information on megaprojects and public enterprises by end-March 2007.The pricing mechanism will continue to be implemented automatically and transparently for all petroleum products.

13. All end-2006 quantitative targets are within reach. The 2006 fiscal stance will reflect additional priority expenditures identified in the 2006 budget that were contingent on the MDRI while domestic revenues are expected to reach 14.4 percent of GDP as originally envisaged. It is also anticipated that the share of spending on priority sectors out of total primary expenditures will exceed the 65 percent target as donor-financed project execution picks up at the end of year. Overall, the domestic primary deficit will be 2.5 percent of GDP with a negative net domestic banking financing of 2.5 of GDP. This along with an unchanged base money target will help achieve the 7 percent inflation target while the comfortable level of international reserves will help cushion against exogenous shocks.

14. Prospects for 2007 remain favorable with a continuation of strong economic growth and control of inflation to single digit levels. Central to achieving these objectives will be a gradual fiscal strengthening backed by an average revenue increase of 0.5 percent of GDP per year and a prudent monetary policy. The 2007 budget is based on the CFMP. The structural reform agenda, as detailed in the PARPA II strategic matrix, includes a second wave of reforms to sustain broad-based growth and poverty reduction. In addition to fiscal reforms to increase revenue mobilization and strengthen expenditure management, the Government will deepen institutional reforms to (i) promote good governance, (ii) buttress the investment climate and ease growth constraints, and (iii) strengthen the transparency of natural resource management and megaprojects. To maintain competitiveness and a comfortable level of international reserves, the BM will bestow greater exchange rate flexibility in the foreign exchange market.

15. The 2007 budget envisages a scaling-up of aid and an associated increase in priority spending focused towards achieving the PARPA II targets including sufficient counterpart funds to ensure a smooth execution of donor-financed projects. There will be no recourse to domestic financing. Total domestic revenue is envisaged to rise by 0.5 percent of GDP compared to 2006 by broadening the tax base through a continued increase of the number of taxpayers, elimination of unwarranted tax exemptions, collection of new tax arrears amounting to about 0.2 percent of GDP, and quarterly updating of the specific fuel tax rate, and finalize discussions with the interested parties on the efficient use of container scanners. The expenditure side will reflect a 7.5 percent ratio of the wage bill to GDP as envisaged in the MTFF, including a hiring of about 10,000 teachers and 3,000 health workers. The share of spending on priority sectors (above 65 percent), particularly education, health, and infrastructure, has been agreed with the donors and will be closely monitored.

16. The government will continue to improve the efficiency of the tax system by sequentially implementing its tax policy reform benefiting from Fund technical assistance. Progress on tax reform will be closely monitored within the MF. In the first semester of 2007, tax policy measures will be defined to equalize the treatment of interest

income on different assets, streamline and simplify the tax system for small and medium-sized enterprises, and reduce VAT exemptions. An external audit will be undertaken with the assistance of donors to assess the amount of arrears on VAT refunds due to contractors of large infrastructure projects, particularly in the road sector. On the basis of this audit a payment schedule will be defined to clear the arrears. Going forward, the government will ensure that VAT charged on supplies of projects be included in the final price of a contract.

17. The next phase of the revenue administration reforms (2007-10), to be supported by a multi-donor common fund, will focus on establishing the ATM as a sustainable, semi autonomous institution, and improving operational performance to help achieve the medium term revenue targets. The Government is committed to supporting the phased integration of the core functions of both tax and customs administration by initiating the implementation of the strategic plan of the ATM in late 2006 and 2007 following the appointment of a President of the ATM in October 2006. Revenues administration measures envisaged in 2007 include: (i) reducing the levels of stop filing, especially with respect to large taxpayers; (ii) initiating procedures to recover tax arrears generated during 2005 and 2006; (iii) providing a better service to taxpayers by reducing the average time to resolve VAT refunds claims; (iv) establishing an audit plan for 2007 at the DGI aimed at broadening audit coverage for domestic taxes; (v) facilitating trade through the reduction of the average time to release imported goods at the border; and (vi) implementing the IT Plan (PDTI).

18. The medium term PFM Action Plan and Budget (APB) for 2006–2009 agreed with the donors includes the following main elements: rollout of the budget execution module to all central and provincial entities, and its customization to district and municipalities needs; the introduction of Phase II of the budget formulation module; and the development of new modules and functionalities. Specific measures of the APB include:

- First, all budgetary operations for goods and services of Financial Management Departments (DAFs) of at least 22 additional ministries and organs (see attached list in the TMU), at the central and provincial levels, will be executed through the e-SISTAFE by end-January 2007 (structural benchmark).

- Second, the Inhassoro version, the software that will allow for the closure of the 2006 budget and the production of the financial accounts of the state within e-SISTAFE, as well as the report generation facility will be operational by end-2006.

- Third, the development of a payroll and pensions functionality is a high priority for 2007. It is, however, dependent on the census of the civil service scheduled to be completed by end-April 2007 (structural benchmark). This census will provide a unique biometric identification number for each public employee and be used to develop an integrated payroll database that will be compatible with e-SISTAFE. Following this, the e-SISTAFE payroll functionality will be ready by end-June 2007 and the pension functionality by end-September 2007.

- Fourth, a district version of e-SISTAFE, customized to their needs, will be rolled out to only 27 out of 128 districts in 2007, duly taking into account their administrative capacity and infrastructure conditions.

- Fifth, the Phase II of the budget formulation module will be tested and ready for use by end-June 2007, to fit in with the 2008 budget calendar.

- Sixth, to automate revenue collection and classify all government revenues before transferring the funds to the CUT, a fully articulated business case will be prepared by end-June 2007 to implement a revenue collection network (RCN) based on the already developed IT structure of e-SISTAFE.

- Seventh, to facilitate the inclusion of all donor-financed projects within the CUT, a limited number of separate foreign currency accounts will be opened within the CUT by end-March 2007 (structural benchmark), and be subject to the SISTAFE regime.

- Finally, the implementation of the asset management system and procurement interface to e-SISTAFE will be moved forward by the development of requirement specifications and tender by end-June 2007.

19. On monetary policy, the BM will continue to target base money with a view to achieving its inflation target. A long-term monetary policy strategy document was approved by the executive board of the BM in October 2006 that defines an intermediate target compatible with the base money operational target, a new format for the monetary policy committee, and specifies its communication policy. To achieve the inflation objective of 6 percent by end-2007, base money growth will be limited to 15 percent or slightly higher than nominal GDP growth to take into account the ongoing financial deepening. In addition, the monetary authority remains committed to a flexible exchange rate regime and to that effect will gradually widen the temporary exchange rate band in the foreign exchange market when conditions permit.

20. The BM will continue to improve liquidity management, and deepen financial markets as part of the Financial Sector Technical Assistance Program (FSTAP). In this context, the MF, in turn, will improve the preparation of cash-flow projections and communicate it to the BM in a timely manner with Fund technical assistance. Moreover, with World Bank technical assistance, the BM will finalize a master repurchase agreement by end-May 2007. The BM and the MF will agree, through a memorandum of understanding, to shift the costs of managing monetary policy to the budget starting in 2008 with Fund technical assistance.

21. The BM introduced a new family of meticais on July 1, 2006 (1000 old family of metical is equal to one new family of meticais, MTn). The BM expects about 90 percent

of MTn in circulation by end-2006. The BM intends to open five provincial agencies, (three before end-December 2006) to help complete the introduction of the MTn and enhance the payment system.

22. The BM will also continue to strengthen and modernize its supervisory functions. In this regard, training to adopt a risk-based supervision approach will start in 2007, at which time the new inspection manuals will also be used. A proposal on the new organizational structure of the banking supervision department consistent with the Integral Strengthening Plan for Banking Supervision will be approved by end-December 2006. These organizational changes will also strengthen on-site and off-site monitoring.

23. The Government remains committed to strengthening the balance sheet of the BM. To this end, the Government will issue the last tranche of 1.5 billion MTn recapitalization bond to the BM by end-June 2007.

24. The BM is implementing a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and strengthen loan classification and provisioning in line with international best practices in 2007. The BM will issue its financial statements in line with IFRS in 2007. The BM will also ensure compliance with the new standards in the banking sector. The new regulation on the assessment, classification and provisioning of credits as well as a regulation on integral risk management for credit institutions and finance companies will be approved by end-2006, and become effective beginning 2007.

25. The Government is committed to supporting a sound expansion of the non-bank financial sector. The BM will continue to license and supervise microfinance deposit-taking institutions to facilitate enhanced access to finance by rural households and small-and-medium sized enterprises. The strengthening of the social security and supplementary pension system is also being undertaken as part of a new law on social protection, which has been submitted to the Assembly. As part of the restructuring of the National Social Security Fund (INSS), an actuarial study will be completed before the end of 2007. In the meantime, guarantees of minimum benefits will be limited until the full study is carried out. The Government also plans to enhance the regulatory and supervisory framework for supplementary pensions and INSS together with the insurance sector, including by strengthening the capacity of the *Inspecção Geral de Seguros* (IGS), the industry regulator.

26. The BM is committed to implement in 2007 all the remaining actions needed to address weaknesses identified in the context of the Fund's safeguards assessment mission conducted in June 2004. In particular, progress is being made in making the necessary adjustments so that the balances in the BM's accounting records match the balances confirmed by the correspondents and other third parties. The reconciliation of monetary data with audited financial statements and its review by the internal audit department will be completed by end-December 2006.

27. Regarding the foreign exchange system, a new foreign exchange law taking into account comments from all stakeholders and the Fund, will be submitted with a slight delay to the Assembly by end-March 2007. Following approval of the new law and

issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

28. The Government expects to further liberalize the trade regime during 2007 by extending the reduction of the maximum import tariff rate from 25 to 20 percent for all trading partners, and has submitted a legislative authorization bill to the Assembly to this effect. During 2007, the government will continue ongoing Economic Partnership Agreement (EPA) negotiations, with technical advice under the Integrated Framework.

29. The Government looks forward to completing the buyback operation for its commercial debt in early 2007 with the financial assistance of the World Bank and the Government of Norway. The Government recognizes the importance of reaching rescheduling agreements with all bilateral creditors in the context of the enhanced HIPC Initiative. It has intensified efforts to negotiate with good faith with all Paris Club and non-Paris Club creditors that have not yet delivered debt relief, and hopes that progress would be made in reaching agreements with its remaining creditors as soon as possible including commercial creditors. In this regard the Government of Mozambique looks forward to the continuing support of the Bretton-Woods institutions.

30. The Government of Mozambique is conscious that despite its efforts to improve its investment climate during the year 2006, its ranking in the ease of doing business, as assessed in the Doing Business report 2007, has worsened to 140th place. The recent authorization to publish the bylaws of firms electronically may help to improve the ranking. However, it is not sufficient to make Mozambique's business environment the most competitive in SADC by 2015. To address this challenge and significantly improve the investment climate in Mozambique, the Government will develop a strategic action plan by end-March 2007 with the assistance of the World Bank to implement key reforms covering the period 2007-15. In 2007, the four key actions envisaged will include:

- Further simplifying the process to start up a business by expanding the computerization of the registration process to all the provinces.

- Adopting a system of inspections that would be business friendly and better coordinated across the several ministries that undertake inspections.

- Making it less costly and time-consuming to close a business by simplifying process and increasing the recovery rate for viable businesses to overcome a short-term cash flow crisis, and insolvent businesses to be rapidly liquidated.

31. The Government will continue to restructure and encourage private participation in public enterprises, particularly infrastructure services. A decision was made by the Council of Ministers in May 2006 to develop a new restructuring plan for PETROMOC that would improve efficiency. The new restructuring plan will be completed by end-June 2007 for its adoption by the Council of Ministers by end-September 2007. The Government with the help of the World Bank will continue to put in place measures to assist the state-owned electricity company (Electricidade de Moçambique, EDM) to

improve performance, including through a performance contract and the operationalization of the regulator (CNELEC) by end-June 2007.

32. The Government recognizes the importance of improving the fiscal regime of mineral and petroleum resource projects. Accordingly, the Council of Ministers will, before the end of November 2006, approve a new draft Mining Fiscal Regime law (structural performance criterion, end-December 2006). A law would be submitted to Parliament for its first session of 2007. In the interim, the Government will ensure that any new mineral resource project agreements will adhere to the principles of the new draft Mining Fiscal Regime law. While the new draft law will be the essential foundation for an improved mining fiscal regime, the Government will also strengthen its negotiating tools, including by developing a model contract and the capacity to undertake timely feasibility studies and financial modeling. With regards to the petroleum sector, the government will request for technical assistance from the international community to make the model contract more specific, and narrow the range of items for bidding or negotiation. After December 31, 2006 the Government will avoid signing any new *Exploitation and Production Concession Contracts* (EPCs) in the petroleum sector until a new comprehensive petroleum fiscal regime is in place that would be embodied in the general tax law so as to avoid case by case negotiation of petroleum tax terms.

33. Improving governance remains a priority of the Government. The Government is considering following the Extractive Industries Transparency Initiative (EITI) principles with regard to management of natural resources. The Government is already participating in a number of seminars on the EITI principles ending with a seminar in Maputo in January 2007. It is expected that the Government will consider to adhere to the EITI principles after the January seminar. Thereafter all new related agreements, in particular the future exploitation of coal, oil and natural gas as well as any expansion of related megaprojects will follow the EITI principles.

34. With regard to the governments' anti-corruption strategy, operational action plans will be developed in five sectors by end-December 2006. The actions and outcomes undertaken by those sectors will be disseminated and closely monitored by dedicated committees within the reform umbrella, and a number of pending cases in the central bureau for anti-corruption will be executed in 2007.

35. In the context of the implementation of the Anti-Money Laundering Law, the Government is also committed to creating a financial investigation unit as soon as the law is adopted by the Assembly, hopefully during its March 2007 session.

36. Building on the lessons highlighted in the review of Phase I of the public sector reform program (2001–06), the Phase II document (2006-10) consists of three pillars: (i) human resource management including payroll systems; (ii) performance evaluation and wage policy; and (iii) decentralization and improving public service delivery. As part of its initial tasks the ANFP, is now carrying out a census of all civil servants to clean up the database and arrive at a unique number of total civil servants that may identify possible inexistent workers. By end-June 2007, the government will also identify clear options and a timetable for the wage reform, which is expected to result in the approval of a new wage policy in 2008. In addition, a decentralization strategy will be approved by the Council of Ministers by end-June 2007 that proposes, among other things, a clear

legal, regulatory, and institutional framework for revenue raising and spending responsibilities of subnational units (provinces, districts, and municipalities) and monitoring of subnational fiscal operations.

37. The *Decreto Lei do Ordenamento do Território* and the urban land use regulations were approved by the Council of Ministers in October 2006. This decree will enact a policy for land use which facilitates the reduction of costs and time involved in transactions, and which would then be submitted to the Assembly for approval. The government remains committed to conducting an economic analysis of urban land markets (formal and informal) as well as an associated poverty and social impact analysis (PSIA) of urban land tenure regulations, with the assistance of the World Bank. The government is preparing a draft strategy for slum improvement.

38. The Government will reinvigorate the reform of the judicial reform with the help of the international community. The Penal Procedure Code will be approved by Council of minister by end-December 2006 and submitted to the next session of the Assembly. The organic law of judicial tribunals is expected to be approved by the Assembly in the next session of the Assembly in early 2007. A new insolvency law is also under preparation and will be submitted to the Assembly in early 2007.

III. PROGRAM MONITORING

39. The semiannual quantitative performance criteria for end-December 2006 and indicative targets for end-March 2007, will be used to evaluate the implementation of the program for the remainder of 2006 and 2007 are shown in Table 1 of this memorandum, with further definitions and explanations contained in the annexed Technical Memorandum of Understanding. In addition, the Government has specified in Table 3 a list of structural performance criteria and benchmarks for 2006 and 2007.

40. The Government understands that its ability to request the disbursement of the seventh loan under the PRGF arrangement will be contingent upon the observance of the performance criteria for end-December 2006 set out in Table 1 and 3; and the completion of the sixth review under the program, which is expected to take place before end-June 2007. In reviewing developments under the program during the sixth review, particular attention will be paid to the implementation of measures aimed at broadening the tax base and rolling out the e-SISTAFE, the 2007 budget, monetary and financial sector reform, reducing the cost of dong business, and improving the fiscal regime and transparency of mineral resource exploitation and megaprojects as well as their net contribution.

Table 1. Mozambique: Quantitative Performance Criteria and Indicative Targets, 2006-2007 1/
(In millions of MTn, unless otherwise specified)

	2006						2007			
	End-June Perf. Criteria	End-June Perf. Criteria	End-June Perf. Criteria	End-Sep. Indicative Target	End-Sep. Indicative Target	End-Dec. Perf. Criteria	End-March Indicative Target	End-June Indicative Target	End-Sep. Indicative Target	End-Dec. Indicative Target
	Prog.	Adj.	Prel. Act.	Prog.	Prel. Act.	Prog.	Prog.	Prog.	Prog.	Prog.
Net credit to the government (cumulative ceiling)	-3,800	-3,800	-7,413	-4,300	-5,760	-4,518	-938	-1,948	-1,713	-1,296
Stock of reserve money (ceiling)	12,033	12,283	12,201	13,209	12,999	14,038	13,596	14,031	14,990	16,020
Stock of net international reserves of the BM (floor, in millions of U.S. dollars)	1,097	1,084	1,156	1,073	1,107	1,063	1,101	1,142	1,150	1,149
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of more than one year (ceiling)	0	0	0	0	0	0	0	0	0	0
Stock of short-term external public debt outstanding (ceiling)	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling)	0	0	0	0	0	0	0	0	0	0
Indicative targets:										
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars)	83	83	100	83	83	83	76	65	55	35
Government revenue (floor)	11,232	...	11,865	18,314	...	26,052	6,281	14,554	22,671	31,342

1/ For definition and adjustors see the attached Program Monitoring Section of Memorandum of Economic and Financial Polices and the Technical Memorandum of Understanding.

Note: While the new family of meticais (MTn) was introduced in July 2006, values in this tables have been converted to MTn to reflect this change for ease of comparison.

Table 2. Mozambique: Structural Performance Criterion and Benchmarks Under the 2006 PRGF-Supported Program (April–December 2006)

Actions	Expected Date of Implementation, According to the Program	Comments
Structural performance criterion		
The Government will develop and test a new version of the e-SISTAFE software (Homoine version) to enable effective direct budget execution (according to the sequence of commitment, verification, and payment) in the Ministries of Finance, Planning, Education, Agriculture, Health, and Public Works, at the central and provincial levels.	End-July 2006	Met
Structural benchmarks		
The implementing regulations for the ATM law will be approved by the Council of Ministers.	End-June 2006	Not met. Met in July 2006
Establish tax tribunals in Maputo, Beira, and Nampula for domestic taxes.	End-June 2006	Met
The Government will complete a prioritized plan to gradually rollout e-SISTAFE to all districts.	End-September 2006	Met
Adjustments to the BM's Chart of Account will be approved.	End-September 2006	Met
The Chart of Accounts of commercial banks will be made consistent with IFRS.	End-September 2006	Not met. Delayed to November 2006
All budgetary operations for goods and services of Financial Management Departments (DAFs) of at least 22 additional ministries and organs (see attached list in the TMU), at the central and provincial levels, will be executed through the e-SISTAFE.	End-December 2006	

Table 3. Mozambique: Structural Performance Criterion and Benchmarks Under the 2006 and 2007 PRGF-Supported Program (October 2006–June 2007)

Actions	Expected Date of Implementation	Comments
Structural performance criterion		
Approval of the new draft Mining Fiscal Regime law by the Council of Ministers.	End-December 2006	
Structural benchmarks		
All budgetary operations for goods and services of Financial Management Departments (DAFs) of at least 22 additional ministries and organs (see attached list in the TMU), at the central and provincial levels, will be executed through the e-SISTAFE.	End-January 2007	
A limited number of separate foreign currency accounts will be opened within the CUT.	End-March 2007	
Completion of the civil service census.	End-April 2007	

ATTACHMENT II

TECHNICAL MEMORANDUM OF UNDERSTANDING ON SELECTED CONCEPTS, DEFINITIONS, AND DATA REPORTING UNDER MOZAMBIQUE'S PRGF-SUPPORTED PROGRAM

October 24, 2006

1. This technical memorandum of understanding (TMU) purpose is to describe the concepts and definitions that will be used in monitoring the Poverty Reduction and Growth Facility (PRGF)-supported program, including the following:

- net claims on the central government by the banking system;
- government revenue;
- net international reserves, and reserve money of the Bank of Mozambique;
- new nonconcessional external debt contracted or guaranteed by the central government or the Bank of Mozambique with a maturity of more than one year;
- short-term external public debt outstanding;
- external payments arrears; and
- foreign program assistance and external debt service.

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

Net Claims on the Central Government by the Banking System

2. **Net claims on the central government (NCG)** by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts with the banking system and proceeds from the signing fee for coal exploration. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in net claims on the central government by the banking system will be cumulative beginning end-December 2006 for the 2007 program.

3. The government encompasses all institutions whose revenue and expenditure are included in the state budget (*orçamento do Estado)*: central government ministries, agencies, and the administration of 11 provinces. Although local governments (33 municipalities or autarquias) are not included because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

Government revenue, and financing

4. Revenue is defined to include all receipts of the Domestic Tax Administration (Administração Tributaria de Impostos or DGI), the National Directorate of Customs (Direcção Nacional de Alfândegas, DNA), and nontax revenue, including certain own-

generated revenues of districts and some line ministries as defined in the budget. Net receipts from privatization received by the National Directorate of State Assets (Direcção Nacional do Património do Estado) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

5. For the purpose of program monitoring, revenue is considered as collected at the time when it is received by the DGI from private agents or other government collecting agencies, in cash or checks, or through transfers into a DGI bank account.

6. An indicative target consisting of semiannual floors on the resources in the government's savings fund abroad has been added to monitor the use of the proceeds from the signing fee for coal exploration.

Money supply

7. **Base money** is defined as the sum of currency issued by Bank of Mozambique (BM) and the commercial banks' deposits in the BM. The commercial bank deposits include the statutory required reserves and excess reserves held at the BM. The base money ceilings for 2007 will be the total stock of base money outstanding at end-June 2007, end-September 2007 and end-December 2007, and will be monitored by the monetary authority and provided to the IMF by the BM.

Net international reserves

8. **Net international reserves** of the Bank of Mozambique are defined as reserve assets minus reserve liabilities. The Bank of Mozambique's reserve assets include (a) monetary gold; (b) holdings of SDRs; (c) reserve position at the IMF; (d) holdings of foreign exchange; and (e) claims on nonresidents, such as deposits abroad (excluding the government's savings account related to the Moatize coal mine concession). Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guarantee for a third–party external liability (assets not readily available.) The Bank of Mozambique's reserve liabilities include (a) all short-term foreign exchange liabilities to nonresidents with original maturity of up to and including one year; and (b) all liabilities to the IMF.

9. The Bank of Mozambique will publish the exchange rates quoted by commercial banks on average as the market rates.

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

10. The term "debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Government

debt is outstanding debt owed or guaranteed by the central government or the Bank of Mozambique (but does not include debt of any political subdivision or government-owned entity with a separate legal personality that is not otherwise owed or guaranteed by the central government).

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

Stock of short-term external public debt outstanding

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

External payments arrears

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

Foreign program assistance

14. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through Bank of Mozambique accounts excluding those related to projects (Tables 1).

Actual external debt-service payments

15. Actual external debt-service payments are defined as cash payments on external debt-service obligations of the government and central bank, including obligations to Paris Club and other bilateral creditors rescheduled under enhanced HIPC Initiative completion point terms, multilateral creditors, and private creditors, but excluding obligations to the IMF (Table 1).

Adjusters

16. The quantitative targets (floors) for the central bank's net international reserves will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted downward by 100 percent of any shortfall in external program aid (up to a maximum of US$50 million) and any excess in external debt service payments, compared to the program baseline (Table 1). The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year. They will also be adjusted upward for the full amount of any external privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments. The quantitative targets (floors) for the central bank's net international reserves will be adjusted equivalently downward up to a maximum of US$50 million per annum by the amount that the projected fuel import bill is higher due to a rise in the average global oil price (average petroleum spot price of West Texas Intermediate, U.K. Brent, and Dubai Fateh crude). This adjustment will be equal to the difference between the realized and the projected average global oil price, multiplied by the volume of total fuel imports projected for each quarter (Table 2). In addition, the quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) by the amount of donor-financed projects deposited in the MTn single treasury account (CUT) if they are higher (lower) than projected for each quarter (Table 1).

17. The quantitative targets (ceilings) for net claims on the central government (NCG) will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted upward by 100 percent of any shortfall in external program aid (up to a maximum of US$50 million) and any excess in external debt service payments, compared to the program baseline (Table 1). These targets will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. The government expenditures contingent on higher disbursements of foreign program assistance (and lower external debt service) will be used to finance greater "priority" spending identified in the budget.

18. The quantitative target (ceiling) for net claims on the central government (NCG) for end-December 2006, end-March, end-June 2007, end-September 2007 and end-December 2007 will be adjusted upward (and the floors on net international reserves adjusted downward) to accommodate the possible need for higher locally financed government outlays to deal with a drought, up to a total limit of MTn 500 million.

19. The base money ceiling will be adjusted equivalently upward up to a maximum of MTn 250 million at end-December 2006, end-March, end-June 2007, end-September 2007,

and end-December 2007 to the extent that the outstanding stock of currency issued by the BM exceeds those projected in Table 3.

Data reporting

20. In addition to providing the monthly and quarterly data needed to monitor program implementation in relation to the programs' quantitative targets and broader economic developments, the authorities will provide weekly updates of the daily data set out in Table 3 as well as the weekly data set out in Table 4 of the TMU dated May 26, 2005. Monthly updates will also be provided of the foreign exchange cash flow of the Bank of Mozambique.

21. The government will continue to 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. In addition, the government will continue to publish and provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.

22. In addition, the government will provide monthly information on the balance of its savings account abroad and will start developing and providing information on domestic arrears on a quarterly basis.

23. From December 2005 onwards, the monetary survey made available by the Bank of Mozambique will clearly identify donor-financed project deposits (with a breakdown between foreign and domestic currency) included in net credit to the government in both the central bank's and commercial banks' balance sheets.

Table 1 Mozambique: Foreign Program Assistance and External Debt Service for 2006 and 2007
(In millions of MTn; unless otherwise indicated)

	2006						2007				
	Q2 Prog	Q2 Prel Est.	Q3 Prog.	Q3 Prel Est.	Q4 Prog	Year Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
Foreign program assistance	1361.6	2050.3	1932.1	813.7	635.9	7908.3	5018.0	3885.5	2415.7	2415.2	13734.5
Program grants	1361.6	2050.3	1151.6	813.7	635.9	5624.9	2572.0	2572.0	1102.3	1102.3	7348.6
Program loans	0.0	0.0	780.5	0.0	0.0	2283.4	2446.0	1313.5	1313.5	1313.0	6385.8
External debt service	393.2	154.0	325.2	..	435.7	1461.6	-154.7	-191.4	-202.7	-181.2	-730.0
Disbursement of donor-financed projects (in millions of US dollars)	...	...	...	...	...	...	0.0	20.0	20.0	20.0	60.0

Source: Mozambican authorities; and Fund staff estimates.

Table 2. Projected Fuel Import Bill, 2006-07
(In millions of U.S. dollars, unless otherwise indicated)

	2006	2007			
		End-Mar.	End-Jun.	End-Sept.	End-Dec.
	Prog.	Prog.	Prog.	Prog.	Prog.
Fuel Import Bill	312.1	38.5	101.4	63.4	128.9
Forecast Oil price (US$ per barrel)	61.3	61.8	63.0	64.0	64.3
Volume of fuel imports (in metric tons)	520,969	76,466	166,893	106,061	193,426

Sources: Mozambican authorities and Fund staff projections

Table 3: Currency Issued by the BM (In millions of MTn, stock)					
Quarter	End- December 2006	End- March 2007	End- June 2007	End- September 2007	End- December 2007
Currency issued by BM	7,690	7,305	7,596	8,154	8,667

Source: Mozambican authorities; and Fund staff projections.

SISTAFE Implementation Plan

Action	Expected date
Implementation of Homoine in 6 sectors: 1. (MEC) Ministry of education and culture; 2. (MF) Ministry of Finance; 3. (MPD) Ministry of Planning and development; 4. (MISAU) Ministry of Health; 5. (MINAG) Ministry of Agriculture and, 6. (MOPH) Ministry of Public Works. All at Central and Provincial level, thereby gradually abolishing disbursement of funds by introducing direct budget execution and not including the external component.	31st of July 2006
Priorities for roll-out to Districts to be defined and elaborated	31st of September 2006
Rollout to the following Ministries and Organs: 1. (MAE) Ministry of Home affairs; 2. (MI) Ministry of Interior 3. (MD) Ministry of Defense 4. (MTS) Ministry of Technology and Science 5. Presidency of the Republic 6. Assembly of the Republic 7. Office of the Prime Minister 8. Conselho Superior da Magistratura 9. Casa Militar 10. Tribunal Administrativo 11. Conselho Constitucional 12. Tribunal Supremo 13. Procuradoria Geral da República 14. (MIC) Ministry of Industry and Commerce; 15. (ME) Ministry of Energy 16. (MRN) Ministry of Natural Resources 17. (MICOA) Ministry of Environmental Coordination 18. (MITUR) Ministry of Tourism 19. (MTC) Ministry of Transport and Communication 20. (MP) Ministry of Fishery 21. (MM) Ministry of Woman and Social Action 22. (MJ) Ministry of Justice	1st of January 2007

APPENDIX II

Mozambique: Relations with the Fund

(As of October 31, 2006)

I. Membership Status: Joined 9/24/84; Article XIV

II. 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	0.01

III. SDR Department	SDR Million	%Allocation
Holdings	0.17	n.a.

IV. Outstanding Purchases and Loans	SDR Million	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	6.48	5.70

V. Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	07/06/04	07/05/07	11.36	8.10
PRGF	06/28/99	06/28/03	87.20	78.80
ESAF	06/21/96	06/27/99	75.60	75.60

VI. Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					0.16
Charges/Interest	0.02	0.03	0.03	0.03	0.03
Total	0.02	0.03	0.03	0.03	0.19

VII. Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC Initiative assistance			
Decision point date	4/7/98	4/7/2000	
Assistance committed (end-1998 NPV terms)			
Total assistance (US$ million)	1,716.0	306.0	2,022.0
Of which: Fund assistance (US$ million)	124.6	18.5	143.1
Completion point date	6/29/99	9/20/01	
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
Additional disbursements of interest income	...	1.1	1.1
Total disbursements	93.2	14.8	108.0

VIII. Implementation of MDRI Assistance:

Total Debt Relief (SDR Million)[1/]	106.56
Of Which: MDRI	83.05
HIPC	23.51

Debt Relief by Facility (SDR Million)

Eligible Debt

Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	106.56	106.56

[1/] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Banco de Moçambique (BM) is subject to safeguards assessment with respect to the PRGF Arrangement approved on July 6, 2004. The assessment, which was completed on August 18, 2004, identified weaknesses in the areas of financial reporting, internal audit, and the system of internal controls and proposed specific measures to address weaknesses. The implementation of these measures is being monitored by staff under the PRGF arrangement.

Exchange Arrangements

Mozambique's exchange system is a managed float. Commercial banks may buy and sell foreign exchange to individual customers on a fully negotiable basis. The Bank of Mozambique introduced a foreign exchange auction system in January 2005. Auctions are held bi-weekly.

Mozambique still avails itself of the transitional arrangements under Article XIV of the Fund Articles of Agreement, but has eliminated all Article XIV restrictions. It maintains, however, restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII, as evidenced by (i) the discretionary prior approval for remittances of family living expenses; (ii) the authorization for the purchase of foreign exchange in excess of US$5,000 for certain transactions; (iii) the prohibition for the conversion of balances of nonresidents' domestic currency accounts into foreign currency or transfer abroad; and (iv) the need of proof of performance of a service prior to authorizing its payment. At the authorities' request, an Article VIII mission was conducted by LEG and PDR in March 2004. The mission encouraged the authorities to remove all existing the exchange restrictions. The authorities indicated their intention to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement after the approval of the new foreign exchange law which is scheduled to be submitted to the assembly by March 2007.

Article IV Consultation

In accordance with Decision No 12794–(02/76), as amended by Decision No 12854–(02/96), Mozambique is on a 24-month Article IV cycle due to the approval of a new PRGF arrangement in July 2004. The 2005 Article IV consultation was completed by the Executive Board on June 22, 2005 (Country Report No. 05/318).

In concluding the 2005 Article IV consultation, Executive Directors welcomed the substantial reduction in poverty realized over the past decade. At the same time, they stressed that stepped-up efforts are needed to further reduce poverty and, with the necessary financial assistance of the international community, reach the Millennium Development Goals. In particular, they looked forward to the new poverty reduction strategy paper for 2006–10. They noted, however, that a second wave of reforms is needed to deepen and accelerate structural changes to sustain high and broad-based growth. Directors emphasized that efforts should aim at (i) increasing tax revenues; (ii) strengthening public sector operations; (iii) reducing the costs of doing business; (iv) promoting labor intensive sectors; and (v) implementing a rural development strategy.

FSAP Participation and ROSCs

A Financial Sector Assessment Program (FSAP) for Mozambique was undertaken during the first quarter of 2003. The related Financial Sector Stability Assessment was circulated to the Executive Board on November 19, 2003 (Country Report No. 04/52). A ROSC on fiscal transparency was issued on February 22, 2001. This ROSC was updated in the context of the 2002 Article IV consultation (Country Report No. 02/140) and the 2003 Article IV consultation (Country Report No. 04/50). A Report on the Observance of Standards and Codes (ROSC) data module was prepared in June 2002 and issued on March 5, 2003. This data module was updated in August 2005.

Management Recent Visit

At the invitation of the authorities, Mr. Kato, Deputy Managing Director, visited Maputo, Mozambique in July 2005.

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	March 2006	Mission	Tax Policy review	Ministry of Finance
	November 2005	Inspection mission	Public expenditure management	Ministry of Finance
	October 2005	Fourth multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	May 2005	Inspection mission	Public expenditure management	Ministry of Finance
	April-May 2005	Mid-term review of the joint IMF/SECO/DANIDA domestic tax and administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	November 2004	Inspection mission, and coordination with bilateral donors	Public expenditure management	Ministry of Finance
	October 2004	Joint IMF/SECO/ DANIDA project; short-term consultant training advisor (total 4 months in 3 visits)	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Third multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Joint IMF/SECO/ DANIDA project: short-term advisor (total 2 months in 4 visits)	Reform of the tax system and its administration; strategic issues on the establishment of the Central Revenue Authority (visit 1 of 4)	Ministry of Finance
	July 2004	Inspection mission	Public expenditure management	Ministry of Finance
	May 2004	Mid-term review of the joint IMF/SECO/DANIDA tax and customs administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
	March 2004	Installation mission and coordination with bilateral donors	Public expenditure Management	Ministry of Finance
Legal	February 2004	Mission	Advising government on the implications of accepting the obligations under Article VIII section 2,3 and 4 of the Fund's Articles of Agreement	Ministry of Finance, Bank of Mozambique
	2004	Correspondence	Advice on tax legislation	Ministry of Finance
Monetary and Financial Systems	March 2006	Short-term consultant	Banking supervision	Bank of Mozambique
	Feb-March 2006	Mission	AML/CFT legislation	Bank of Mozambique
	Jan-Feb 2006	Short-term consultant	Monetary policy framework	Bank of Mozambique
	Jan-Feb 2006	Short-term consultant	Monetary operations	Bank of Mozambique
	January 2006	Short-term consultant	Exchange rate management	Bank of Mozambique
	September 2005	Mission	Post- FSAP TA assessment Banking supervision Monetary operations/monetary policy	Bank of Mozambique
	October 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	September 2004	Short-term consultant	Monetary operations/monetary policy	Bank of Mozambique
	September 2004	Short-term consultant	Central Bank Accounting	Bank of Mozambique
	July 2004	Short-term consultant	Banking supervision	Bank of Mozambique and Ministry of Finance
	April 2004	By correspondence	Advice on foreign exchange operations	Bank of Mozambique
	April 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	March - April 2004	Mission	Banking supervision, monetary and foreign exchange operations	Bank of Mozambique
	February-March 2004	Mission	Bank restructuring	Bank of Mozambique
Statistics	July 2005	Mission	Government finance statistics	National Institute of Statistics
	June–July 2005	Mission	Consumer price statistics	National Institute of Statistics
	May 2005	Mission	ROSC Data Module Update	National Institute of Statistics

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
	October 2002–March 2004	Long-term consultant	National accounts statistics	National Institute of Statistics
	November 2004	Mission	Balance of payments statistics	Bank of Mozambique
	September 2004	Mission	Monetary and financial statistics	Bank of Mozambique
	May 2004	Mission	Balance of payment statistics	Bank of Mozambique
	May 2004	Mission	Consumer price statistics	National Institute of Statistics (INE)

Resident Representative: Mr. Felix Fischer has been IMF's Resident Representative to Mozambique since March 1, 2006.

APPENDIX III

Mozambique: Relations with the World Bank Group

(November 8, 2006)

Partnership in Mozambique's Development Strategy

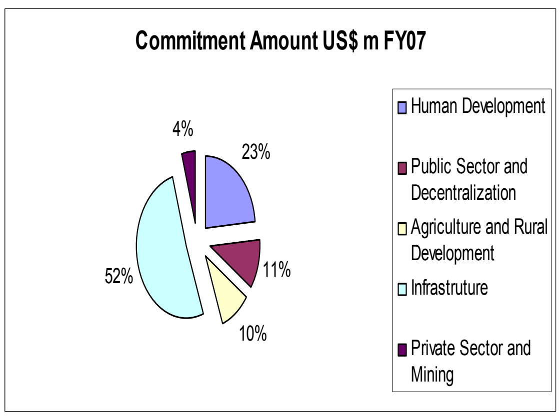
1. The Mozambican government's development strategy is set forth in the poverty reduction strategy paper (PRSP), termed the PARPA (Plano de Acção para a Redução da Pobreza Absoluta e Promoção do Crescimento Económico, or Action Plan for the Reduction of Absolute Poverty), which was approved in April 2001 by the council of ministers and endorsed in September 2001 by the Boards of the World Bank and the IMF. The PARPA focuses on six "fundamental areas" aimed at promoting human development and creating an environment for broad-based growth: macroeconomic 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 sociopolitical stability. The government issued progress reports on the PARPA in 2003, 2004 and 2005, restating its commitment to reduce poverty by pursuing policies that help to create an environment for broad-based growth. In addition, the Program Assistance Partners, which now includes 17 donors and the World Bank, with the IMF as an observer, has undertaken biannual reviews, jointly with the government, of the entire government program since 2004, using a common performance asssesement framework (PAF), in order to serve as the basis for a further shift from project finance toward budget support. It has harmonized and streamlined donor conditionality and is expected to reduce government transaction costs. The government is in the process of finalizing the second PARPA, which includes a monitoring and evaluation framework, the Strategic Matrix, which which will be reviewed by joint sector working groups until the next Joint Review of September 2006.

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 and PAF. The Fund and the Bank will initiate work on the Joint Staff Assessment on the PARPA II in the second half of 2006.

3. The Fund will continue to lead the policy dialogue on macroeconomic policy, (including fiscal, monetary, and exchange rate policies), the integrated financial management information system (SISTAFE), and tax and customs reforms. The Bank will continue to lead the policy dialogue on public expenditure management, sectoral structural reforms, the reform of the civil service, and the Poverty and Social Impact Analysis (PSIA). Areas of close collaboration include banking supervision and financial sector issues, trade issues, the PARPA and its further development, and external debt sustainability.

Bank Group Country Assistance Strategy

4. The current CAS (FY04-07) is a Results-based strategy, prepared jointly with IFC and MIGA. Preparation of a new Country Partnership Strategy jointly with four donors has started in support of the agenda of the Paris Declaration on Harmonization. The Bank is coordinating with partners through a peer review process and harmonization of analysis and results frameworks. The three pillars of the current CAS are (i) improving the investment climate, (ii) expanding service delivery, and (iii) building capacity and accountability. A CAS Progress Report, an evaluation of the Bank's program during the first two years of implementation has been completed and presented to the Board in March 2006. The focus of the Bank's lending program is on programmatic support through four rolling Poverty Reduction Support Credits (PRSCs), of which the first two credits have been approved and fully disbursed. Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic lending through the PRSCs was underpinned by the Bank's core diagnostic economic and sector work, including the public expenditure review and PSIA. While a series of PRSCs is the largest single element in the lending program, the shift from traditional investment lending to program lending is being phased in gradually. Selected investment projects are targeting institutional strengthening, capacity building, transport infrastructure, water, agriculture, and communications.



5. To date, the World Bank Group has approved 7 adjustment operations, 2 development policy operations, one investment guarantee and 47 investment operations totaling approximately US$3 billion The CAS financing plan for FY04-FY07 included lending financing, grant resources and guarantee coverage for $560 million, of which $438 million ($258 in investment operations and $180 million in two Poverty Reductions Support Program credits) and $30 million in an IBRD guarantee have been approved. A further two investment operations and one PRSC credit are scheduled to be delivered before the end of the CAS period. The graph above illustrates the distribution of the current portfolio by main sectors.

6. The World Bank has been actively supporting the government of Mozambique's macroeconomic program since 1986 through a series of **structural adjustment operations**. The last, the Economic Management and Private Sector Operation (EMPSO), was approved

by the Bank Board in August 2002 for US$120 million. The EMPSO supported the government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It included 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. Since 2004, the Bank's quick-disbursing assistance has taken the form of development policy lending through PRSCs, which have been developed in tandem with the Joint Review/Performance Assessment Framework process referred to above. The first two PRSCs were presented to the Board in July 2004 and in September 2005; they were valued at US$60 million and US$120 million respectively. A third PRSC credit, and the first operation supporting the PARPAII, is curently under preparation for delivery in FY07.

7. The World Bank has been an active partner in supporting the government in improving **education** and strengthening capacity building in key public institutions. The Education Sector Strategic Program (US$71 million—FY99) supports the implementation of the National Education Strategy, whose objectives are the promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. The Higher Education Project (US$60 million—FY02) supports the entire higher education system, including both public and private institutions of higher education. The Technical and Vocational Education and Training project (US$30 million —FY06) is the first operation in the tertiary and vocational education area.

8. In **health**, the Health Sector Recovery Project (US$98.7 million—FY96, closed in 2003) supported the government's broad Health Sector Recovery Program, especially by reducing infant and child mortality. The HIV/AIDS Project (US$55 million—FY03) assists the government in carrying out its National Strategic Plan to Combat STDs and HIV/AIDS. The HIV/AIDS Treatment Acceleration Project (US$21 million—FY04) assists the Government in scaling up ongoing HIV/AIDS treatment initiatives using a combination of public/private/NGO partnerships to serve vulnerable groups. A new health operation is under preparation for FY07.

9. In the area of **transport and infrastructure**, the Bank has three active projects. 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, and the Beira Railway Project (US$110 million—FY05) aims to improve the cost-effectiveness and efficiency for freight and passenger rail transport in the Zambezi Valley and beyond. The second phase of the Roads and Bridges project is under preparation for FY07

10. In the **water** sector, one project - the National Water Development Project I (NWDP I) (US$36 million—FY98) closed on October 31, the National Water Development Project II (NWDP II) (US$75 million plus US$15 supplemental—FY99, FY04) - support improvements in service delivery standards, coverage, water resources management, and

management capacity in both rural and urban areas. The NWDP II also supports private sector management of water services in five major cities.

11. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. The current Bank CAS has been prepared jointly with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). IDA currently has one operation, the Enterprise Development Project (US$26 million—FY00, scheduled to close in FY06) which 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. As regards **public sector reform**, the Public Sector Project (US25.6 million—FY03) seeks to upgrade the quality of public services, reduce red tape, and improve access to public services. The Municipal Development Project (US$33.6 million—FY01) aims to strengthen the institutional capacity of municipal government and pilot a municipal grant mechanism to finance investment. Finally, the Decentralized Planning Financing Project (US$42 million—FY04) supports improvements to the institutional capacity of district administrations. The **Financial Sector** Technical Assistance project (US$10.5 million—FY06) supports implementation of the recommendations of the Financial Sector Assessment Program jointly conducted with the Fund in 2003.

13. The Bank is also involved in **agriculture**, **energy, and the environment.** The Agricultural Sector Public Expenditure Program (US$30 million—FY99), which will close at the end of 2005, is a sectorwide assistance program (SWAP) that 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), which closed in 2003, supported pre-investment in the Pande-Gas Project and provided capacity building to the government for negotiation of megaprojects. This operation supported capacity and technical assistance for negotiation and implementation of the Southern Africa Gas project, a pipeline financed by SASOL of South Africa with equity participation of IFC and guarantee coverage of MIGA (US$30 million—FY04. The Energy Reform and Access Project (US$40.2 million—FY04), which supports reform of the power sector, in particular the separation of distribution, transmission, and generation functions, aims at increasing the number of electricity connections, solar energy distributors, and seeks to provide a more efficient service. The World Bank Group is also supporting sustainable use of natural resources with two operations in environment: the Coastal and Marine Biodiversity Management Project (US$9.7 million—FY00), which pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas, and the second credit of a Transfrontier Conservation Areas and Tourism project (US$20 million plus US$10 million in a Global Environment Facility grant—FY06). A Market-led Smallholder Development project of US$30 million was approved in FY06.

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

- Improving the Investment Climate. Economic and sector work completed over the past two fiscal years included a strategy for rural growth and income creation and a country economic memorandum on sustainable growth and poverty reduction, which also analyzed the sources of growth. Technical assistance is currently being provided in procurement reform, mining and on commercial debt reduction. A PSIA on labor market and a PSIA on land are planned for preparation in FY06–FY07, together with a study on regional growth poles.

- Expanding Service Delivery. Work completed has involved a country status report on health; a technical assistance on health budget management; a report on the status of the health Millennium Development Goals; a Poverty and Social Impact Assessment (PSIA) on primary school fees; an assessment on labor markets and technical education; a study on private sector competitiveness; a study on local service delivery; and a report on water resource management. Ongoing and planned studies include a poverty assessment, a rural strategy, a country environmental and social assessment.

- Building Capacity and Accountability Investing in People. Work completed includes a country procurement assessment report, a legal and judicial assessment, an institutional governance review including a survey on corruption, a public expenditure review and ongoing technical assistance on public expenditure management.

- Monitoring and Evaluation. The Bank is providing technical assistance to the Government in finalizing and monitoring its first PRSP M&E system, the Strategic Matrix of PARPAII. The Bank is also supporting preparation of a Monitoring Plan to implement the Strategic Matrix.

IMF-World Bank Collaboration in Specific Areas

15. 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; (iii) the financial sector and banking supervision; (iv) PSIA; (v) tax issues; and (vi) trade issues:

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. The IMF assists the authorities in introducing the integrated financial management information system (SISTAFE), and several donors, including the World Bank, provide financial support and policy advice for this reform. Under the Fund's leadership, a group of 10 donors set up a common fund for this large undertaking. The

Bank's PRSC emphasizes budget comprehensiveness and budget execution reporting. 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 in September 2003.

- **Poverty reduction strategy paper.** The Fund and Bank worked together with the government during 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 annual progress reports in 2003, 2004 and 2005 and the staff presented their joint staff assessments to their respective Boards.

- The Fund and the Bank are finalizing preparation of a JSAN on the Government's revised PARPA, officially approved at the end of September 2006. The PARPAII incorporates an M&E system. The Strategic Matrix.

- **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 FSAP conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision and accounting standards to prevent the recurrence of such problems in the future. A technical assistance program is under preparation.

- **PSIA.** As part of the preparation for future Bank budget support and a possible successor program supported by a new Poverty Reduction and Growth Facility (PRGF) arrangement, the Fund and the Bank have agreed to review closely the poverty and social impact of the key reforms that are being implemented. A pilot PSIA, advising the government on the impact of an increase in specific fuel taxes, was undertaken in 2002. A second PSIA, on the impact of reducing primary schooling fees, was completed in October 2004. A third PSIA will be undertaken during FY06 with a focus on Land, and a fourth one in FY07 on Labor Market.

- **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 Mozambique's 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 reforming the customs administration in Mozambique. The Bank is cooperating with the donors (particularly USAID) and the government in executing the studies on trade policy required for the Integrated Framework.

16. Between 2006 and 2007, disbursements under World Bank investment projects are expected to reach around US$125 million on average a year.

World Bank Loan and Grant Operations, 1999-2005[1]
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005
			Actual			Est.	Est.
I. Project Credit Disbursements	79.4	97.5	51.6	85.2	89.4	140.6	169.8
Established operations							
Household Energy (6/89) [2/]	0.0	0.0	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	0.0	0.0
Education II (12/90)[2/] 2/	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89)[2]	7.6	2.0	0.0	0.0	0.0	0.0	0.0
Agricultural Service Rehabilitation Development (2/92)[2]	2.5	0.7	0.0	0.0	0.0	0.0	0.0
First Road and Coastal Shipping (6/92)[2]	12.5	4.0	0.0	0.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	11.3	4.5	2.8	0.0	0.0	0.0	0.0
Capacity Building: Public Sector & Legal Institutional Development (11/92)	0.9	0.7	0.0	0.0	0.0	0.0	0.0
Maputo Corridor (1/93)[2]	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Rural Rehab.(3/93)[2]	3.8	2.0	0.3	0.0	0.0	0.0	0.0
Food Security (4/93)[2]	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Local Government (6/93)[2]	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94)[2]	16.9	26.5	11.4	9.7	17.5	0.0	0.0
Financial Sector Capacity Building (4/94)[2]	2.0	1.4	0.3	0.0	0.0	0.0	0.0
Gas Engineering (6/94)[2/] 2/	1.5	1.1	1.6	1.8	0.4	0.0	0.0
Health Sector Recovery (11/95)[2]	12.0	17.2	17.4	14.4	5.6	0.0	0.0
National Water I (2/98)	1.3	1.7	2.4	3.9	4.5	7.5	7.70
Agricultural Sec. PEP (2/99)	0.5	0.9	4.2	3.8	3.9	3.9	3.8
General Education (2/99)	1.0	0.5	1.2	6.9	14.7	19	159
Railway and Port Restructuring (10/99)	0.0	1.9	3.6	22.3	8.2	22.6	10
National Water II (6/99)	0.0	1.4	2.8	4.4	5.1	9.1	22.7
Enterprise Development (01/00)	0.0	2.3	3.0	2.9	3.4	4.5	4.6
Flood Emergency Recovery (4/00)	0.0	28.7	-0.2	0.0	0.0	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.0	0.3	0.4	0.3	3.7	1.6
Newest operations							
Municipal Development (7/01)	0.0	0.0	0.3	4.3	4.6	3.6	6.4
Roads and Bridges I (7/01)	0.0	0.0	0.0	4.3	0.5	39.1	44.6
Communications (11/01)	0.0	0.0	0.0	1.2	2.8	1.8	2.0
Mineral Resources Project (3/01)	0.0	0.0	0.2	1.4	4.1	5.5	3.2
Higher Education Project 1 (3/02)	0.0	0.0	0.0	3.4	9.2	10.0	14.2
HIV/AIDS (3/03)	0.0	0.0	0.0	0.0	2.7	2.3	10
Public Sector Reform (3/03)	0.0	0.0	0.0	0.0	1.2	1.5	1.5
Energy Reform and Access Project (8/03)	0.0	0.0	0.0	0.0	0.0	1.6	5.4
Decentralization Planning (11/03)	...	...	...	...	...	4.9	4.5
Beira Railway (10/04)						0	7.5
Treatment Acceleration Program (6/04)						0	4.3
II. Adjustment operations	150.0	0.0	0.0	63.5	70.7	60.0	60
Economic Management Reform Operation (12/98)[2 3]	150.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation	0.0	0.0	0.0	63.5	70.7	0.0	0.0
PRSC 1 (06/04)	...	...	...	...	...	60.0	...
PRSC 2	...	...	...	...	...	...	60

Source: World Bank
[1] Date of Board approval in brackets.
[2] Closed
[3] Grant

APPENDIX IV

Mozambique: Statistical Issues

1. An STA mission visited Maputo in May 2005 to update the data module of the Report on the Observance of Standards and Codes (ROSC) prepared in June 2002. The mission noted that significant effort has been made to address the shortcomings identified by the 2002 ROSC mission, a clear indication of the increased awareness of the importance of compiling and disseminating statistics that follow international standards and good practices. The improvements in the institutional environment and the increased allocation of resources for the compilation of national accounts, balance of payments, and more recently, government finance statistics address important weaknesses in the prerequisites for the quality of the statistics. The methodological soundness, accuracy, and reliability of the macroeconomic statistics are starting to show improvements as a result of these actions.

2. However, the overall quality of macroeconomic statistics still hinders policy formulation and monitoring of economic development. Moreover, despite the increase in budget resources allocated to the compilation of official statistics, continued high reliance on external funding raises concerns about the sustainability of the programs of the National Institute of Statistics (INE).

3. The authorities are committed to adhering to internationally accepted standards and good practices, as demonstrated by their participation in the IMF's General Data Dissemination System (GDDS) since November 2003. GDDS metadata are posted on the IMF's Data Standards Bulletin Board (DSBB) website, and on the INE's website. In August 2004, the INE's webpage was replaced by a portal with search capabilities to improve the accessibility of available data and metadata.

National accounts

4. The national accounts are prepared by the INE. Since 1991, revised series have been compiled in accordance with the *1993 System of National Accounts* (*1993 SNA*). The INE compiles and disseminates (i) annual GDP at current and constant (1996) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; and (iii) annual value added components at current prices by activity. Work is under way to compile the new benchmark year (2003) with new and improved data sources and methodology. The INE has launched a new household income and expenditure survey and new economic censuses leading to a new business registry. Furthermore, the INE is compiling more comprehensive and timely foreign trade data based on improved classification systems. The new national accounts framework will also include compilation of quarterly estimates expected to be disseminated shortly.

Prices and labor market

5. A new consumer price index for Maputo based on weights derived from the 2002–03 household survey was released in February 2006. The previous series, available since 1998, was widely criticized for narrowly focusing on a few basic food staples with relatively volatile prices and, therefore, exhibiting large swings. A national index obtained by integrating the indices for Maputo, Beira, and Nampula was released in April 2006. The IMF has provided technical assistance in price statistics in the context of the GDDS Regional Project for Lusophone African Countries. The last technical assistant mission (June 21–July 11, 2006) under the GDDS project found important advances regarding the use of the COICOP classification and the strengthening of human resources in the compilation of the new CPI. Several issues remain outstanding, however, such as price collection procedures not fully consolidate at the provincial level, imputation methods and possible inconsistencies in the overlapping period between the new and old series.

6. There are insufficient sectoral labor market and employment data, and where available, they have limited coverage. A one-year labor market survey of the entire country, undertaken by INE in collaboration with the Labor Ministry, was launched in October 2004. Preliminary data are due soon.

Monetary Statistics

7. An STA mission that visited Maputo in September 2004 prepared a work plan for the implementation of the *Monetary and Financial Statistics Manual* (MFSM) and the development of an integrated database to meet the needs of the Bank of Mozambique, AFR, and STA. The mission noted progress in the information technology system and in the periodicity and timeliness of the data compiled. The mission found that the Bank of Mozambique's chart of accounts was inadequate to compile monetary statistics fully aligned with the MFSM with regard to the sectorization of the institutional units and the breakdown between local and foreign-currency-denominated accounts. The mission recommended improving the classification and valuation of some financial instruments, and estimating the full instrument and sectoral breakdown based on available information. The mission also recommended expanding the coverage of the survey on other depository corporations by including the credit cooperatives, in the medium term.

8. Mozambique is already using the new standardized forms (SRFs) for reporting monetary data to STA, which permitted the inclusion of Mozambique in the first issue of the *IFS* Supplement. Mozambique is already using the new standardized forms (SRFs) for reporting monetary statistics to STA. This permitted publication of enhanced data in the September 2006 IFS Supplement.

External sector statistics

9. With assistance from STA technical assistance missions, the Bank of Mozambique (BM) has made significant progress toward compiling and disseminating balance-of-

payments (BOP) and international investment position (IIP) statistics that are fully aligned with the fifth edition of the *Balance of Payments Manual* (*BPM5*). This assistance is also being provided in the context of the GDDS regional project.

10. The BM has an adequate institutional framework for the compilation of BOP and IIP statistics, and has implemented many of the recommendations made by the four technical assistance missions conducted since mid-2003. However, in order for the work on institution building to be consolidated, the Foreign Exchange Law has to be approved, training on BOP statistics has to be sustained, and the project to computerize the balance of payments compilation system has to be completed. The major improvements in the basic sources of data from the beginning of the project comprise (1) the distribution of the new BOP surveys to more than 35 enterprises, including the megaprojects; (2) program improvements by Customs to ensure the quality of external trade data; (3) improvements in the reports on foreign investment and private loans prepared by the BM; (4) improvements in the reports on the external public debt provided by the Ministry of Finance; and (5) improvements in the banks' reports on foreign currency transactions.

11. Other important concerns include (1) the coverage and quality of the data obtained in the enterprise surveys, such as data from the other SASOL[16] projects; (2) the quality of external trade data, especially with regard to price and volume indices; (3) the coverage, time of recording, and classification of the data on foreign investment and private loans; (4) completeness of data for the Reserves Template and their reconciliation with the reserve component of the balance of payments; and (5) compiling the IIP using the sources that are used for the balance of payments compilation.

12. The BM has started to compile partial IIP data, which were published in the *2005 Balance of Payments Statistics Yearbook*.

Government Finance Statistics

13. In recent years, technical assistance on **government finance statistics** has been provided to Mozambique under the GDDS Project for Lusophone countries. The latest GFS technical assistance mission, on July 2005, found that while the authorities have made significant efforts to improve fiscal data, serious weaknesses remain.

14. The recent creation of a statistical unit in the MOF and the launching of the Integrated Management and Financial Information System (SISTAFE) will contribute to enhancing the analytical usefulness of government finance statistics in the near future. However, the mission found that the budget system while, in general, aligned to the *GFSM 1986* analytical framework, is inadequate for the compilation of GFS. In particular, further work is needed to improve institutional and transactional coverage.

[16] Conglomerate of five enterprises from South African Coal, Oil, and Gas Corporation.

15. Mozambique does not report fiscal data for publication in the *IFS* or the *Government Finance Statistic Yearbook (GFSY)*.

Mozambique: Table of Common Indicators Required for Surveillance
(At November 16, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	Sept. 2006	Nov. 2006	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]							
Reserve/Base Money	Sept. 2006	Nov. 2006	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Sept. 2006	Nov. 2006	M	M	M		
Central Bank Balance Sheet	Sept. 2006	Nov. 2006	M	M	M		
Consolidated Balance Sheet of the Banking System	Sept. 2006	Nov. 2006					
Interest Rates[2]	Sept. 2006	Nov. 2006	M	M	M		
Consumer Price Index	Aug. 2006	Sept. 2006	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]						LO, LNO, LO, O	LO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government							
Stocks of Central Government and Central Government-Guaranteed Debt[5]							
External Current Account Balance	June. 2006	Oct. 2006	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services							
GDP/GNP	Dec. 2004	Apr. 2005	A	I	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt	Dec. 2005	Mar. 2006	A	I	I		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extrabudgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), and Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published in March 2003 and based on the findings of the June 2002 mission for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO). No changes were proposed by the update mission of May 2005.
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies. No changes were proposed by the update mission of May 2005.

Statement by the IMF Staff Representative
December 18, 2006

The following information has become available since the issuance of the staff report for the Fifth review of the three-year arrangement under the Poverty Reduction and Growth Facility. The thrust of the staff appraisal remains unchanged.

1. **Inflation.** Reflecting an increase in domestic fuel oil and gas of about 20 percent in November, headline inflation between December 2005 and November 2006 reached 7.1 percent or slightly above the end-year 7 percent target.

2. **Fiscal.** Based on preliminary information, the fiscal stance continued to be broadly in line with the program at end-September 2006. Revenues were slightly below programmed at end-September (albeit in line at end-November) while current and locally financed investment expenditure were on target. Importantly, the latter has helped raise the share of priority expenditure in total spending above the 65 percent target at end-September 2006.

3. **Cahora Bassa dam**. The Assembly unanimously ratified the protocol agreement between the Mozambican and Portuguese governments, under which Mozambique's shareholding in the company that runs the Cahora Bassa dam, Hidroelétrica de Cahora Bassa (HCB) increases from the current 18 percent to 85 percent. In addition, the authorities have publicly reiterated their commitment to seek nonrecourse financing so not to increase the government's liabilities to commercial creditors. However, the government requested more time to prepare for the full joint IMF-World Bank group mission that is now scheduled for the last week of January 2007, to help them in exploring the financial options for an amount of US$700 million. The first payment of US$250 million was paid directly from an off-shore account of HCB as originally envisaged. The World Bank, on the basis of the preliminary information, is of the view that a viable financing plan for the HCB debt repayment appears to be feasible.

4. **Mining and petroleum fiscal regime**. The new mining and petroleum fiscal laws envisaged in the program have been submitted to the Council of Ministers taking into account comments by IMF and World Bank staffs, and are expected to be approved and sent to the Assembly in the next few weeks. The authorities intend to request technical assistance from the World Bank and IMF to help in the design of related regulations and a model contract for the mining and petroleum sectors, respectively. Finally, the feasibility study of the multi-billion dollar Moatize coal mine project has been recently submitted to the government by a Brazilian foreign direct investor.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/289
FOR IMMEDIATE RELEASE
December 18, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under the Three-Year PRGF Arrangement for Mozambique and Approves US$2.4 million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Mozambique's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement for Mozambique in an amount equivalent to SDR11.36 million (about US$17.0 million), see Press Release No. 04/153.

The completion of the review enables the release of an amount equivalent to SDR 1.62 million (about US$2.4 million), which will bring total disbursements under the PRGF arrangement to an amount equivalent to SDR 9.7 million (about US$14.6 million).

The Executive Board also accepted, as part of the financing assurances review, that adequate safeguards remain in place for further use of Fund resources.

Following the Executive Board's discussion on Mozambique's economic performance, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

"Mozambique's prudent macroeconomic policies, together with a first wave of structural reforms under its PRGF-supported program, have yielded strong economic growth, moderating inflation, and solid progress towards the objectives set out in its poverty reduction strategy. Continued solid policy implementation will play a pivotal role in consolidating macroeconomic stability, sustaining economic growth, reducing inflation, and enabling the efficient absorption of scaled-up foreign assistance, under the second wave of reforms envisaged in the *Plano de Acção para Redução da Pobreza Absoluta II* (PARPA II) for 2006–09. Donor-financed projects should be integrated into the Treasury Single Account and e-SISTAFE with the help of the donors while clear guidelines on the use of national systems for the disbursement of aid could be disseminated. Over the medium term, the links between PARPA II targets and the budget should be strengthened to reflect comprehensive fiscal planning and costing of programs and policies.

"The achievement of these objectives will require strengthened fiscal policy and an investment climate enhanced by lowering the cost of doing business and continuing to squarely address governance issues. While the new draft labor law represents an improvement on the current law, the authorities are encouraged to take steps to address the remaining rigidities to labor market flexibility. The authorities are also encouraged to adopt a new laws on the mining and petroleum fiscal regimes. Adherence to the core principles of the Extractive Industries Transparency Initiative should strengthen the transparency of natural resource management and megaprojects.

"In the context of scaled-up aid and acceleration of reforms, the 2007 budget envisages a 0.5 percent of GDP rise in domestic revenue with the share of priority expenditures exceeding 65 percent of total spending. The impending rollout of the new e-SISTAFE (public financial administration system) should also ensure a better monitoring of priority expenditures. A cautious approach is warranted in devolving resources to subnational levels, with proper sequencing, supported by sufficient administrative capacity—particularly at the district level.

"The reinvigoration of the public sector reform program under a new public service authority is welcome. In particular, the installation of a clean, integrated payroll database based on a civil service census should help rightsize the civil service in line with more comprehensive sectoral strategies. The anti-corruption and judicial sector reform should be accelerated, in order to improve public perceptions and strengthen the constituency for reform.

"The authorities' commitment to seek non-recourse financing for the transfer of majority ownership of the Cahora Bassa hydropower plant from Portugal to Mozambique will avoid an increase in the government's liabilities to commercial creditors, and to ensure transparency and accountability.

"The Bank of Mozambique's stated policy of pursuing base money targeting in conjunction with a flexible exchange rate regime is welcome. This framework will help keep inflation under control, and cushion against exogenous shocks. In this regard, a more consistent monetary policy stance will be supported by greater exchange rate flexibility, when conditions permit. Parliamentary approval of the new foreign exchange law will allow Mozambique to establish full current account convertibility.

"The Fund stands ready to remain engaged with Mozambique as it builds on its track record of strong macroeconomic performance and program implementation," Mr. Portugal said.

Statement by Peter Gakunu, Executive Director for Republic of Mozambique and Jose Alves Sulemane, Advisor to Executive Director December 18, 2006

The Mozambican authorities wish to thank staff for their constructive dialogue and well written reports, which clearly identify the challenges for macroeconomic stabilization and poverty reduction as well as the policy options available to the country. The authorities remain confident that the Fund will continue to be engaged to ensure that the objectives of the reform agenda are achieved. Mozambique's macroeconomic performance in 2006 continues to be strong, with international reserves at a comfortable level. Program performance has been satisfactory and all quantitative benchmarks and structural performance criteria for end June and September achieved. The real effective exchange rate has appreciated during 2006, essentially due to the Rand's depreciation against the US dollar. The authorities are in broad agreement with the thrust of the issues identified by staff in the report.

Recent Economic Developments

Growth Performance

Positive developments in agriculture and construction sectors facilitated a favorable economic performance in 2006. Real GDP growth increased slightly from 7.7 percent in 2005 to an estimated 7.9 percent in 2006. Annual inflation declined from 6.4 percent in 2005 to 4.8 percent in September 2006, despite the effects of high oil prices. The economy remained relatively resilient to exogenous shocks during 2006.

Fiscal Policy

Revenue mobilization was better than programmed for the first semester of 2006, due to improvements in corporate and VAT tax collections, and is expected to reach 14.4 percent of GDP in 2006. The general law and the law creating the Central Revenue Authority (ATM) were promulgated in February 2006, while implementation regulations were approved by the Cabinet in July 2006, and the strategic plan for the ATM completed. To improve the tax base as well as the efficiency of the tax collection authorities, measures taken include implementing the organic law for tax tribunals; identifying and collecting tax arrears; increasing the number of taxpayers; and conducting a larger number of tax audits.

Domestic expenditures are within program expectations, resulting in a lower domestic primary deficit. Positive developments have been achieved on implementation of public financial management (PFM) reforms. The medium term fiscal framework (CFMP) approved by the Council of Ministers, would be in line with the PARPA II. There have also been improvements in information technology (IT) packages for budget execution and its rollout to other line ministries, including phase I of the new budget formulation module. Good progress has also been made in integrating donor–financed projects into the budget ceilings, including issuance of accounting guidelines. In this regard, the budget for 2006 took into account the delivery of MDRI resources (January 2006), which will be allocated to identified expenditures.

Monetary Policy

The authorities have been pursuing a prudent monetary policy stance in 2006. The introduction of the new family of meticais (MTn) proceeded smoothly. Prudential ratios in the banking system have also remained sound and the ratio of non-performing loans to total loans maintained at below 5 percent. Growth in foreign currency loans has decelerated due to the requirement for commercial banks to provision 50 percent of their foreign currency-denominated loans to non-exporters. The Central Bank has adjusted its Chart of Accounts to allow for: (i) the valuation of foreign exchange gains/losses consistent with International Financial Reporting Standards (IFRS); (ii) the preparation of the Central Bank's financial statements for 2005 in compliance with IFRS and in parallel with the financial statement prepared under the current accounting standard.

Structural Reforms

Progress in structural reforms accelerated, especially in the areas of public sector, labor market, and trade-related reforms. Phase II of the strategic action plan for the period 2006-2010 was introduced and a public service authority (ANFP) reporting directly to the President established in the first semester of this year. The draft strategy paper on decentralization has been prepared with the inclusion of fiscal issues. In addition, the draft Labor law has been approved by Cabinet and submitted to the Parliament. In January 2006, the maximum tariff rate applicable to SADC trading partners was lowered from 25 to 20 percent, and legislation was submitted and discussed in Parliament for an extension of this measure to all applicable trading partners, beginning in 2007.

Bilateral trade negotiations are under way with Angola, Tanzania and Zambia on terms comparable to agreements concluded with Zimbabwe and Malawi in 2005. Moreover, the government has continued to streamline licensing procedures with the creation of "one stop shops", in addition to the computerization of the company registry, and the use of the e-Government portal as a means to ensure a friendly business environment.

Outlook and Policies for 2007

Growth Performance

The authorities' macroeconomic policy framework for 2007 is consistent with the medium term goal of sustaining poverty reduction by ensuring broad-based economic growth of about 7 percent as stated in PARPA II. To ensure compliance with program objectives, the authorities will continue to monitor the program through reinforcing coordination between the Ministry of Finance and the Central Bank. Information on the impact of large projects and public enterprises will be continuously monitored while the pricing mechanism for all petroleum products will be implemented automatically and transparently. Associated with this favorable economic condition, inflation is projected to remain at single digit levels.

Fiscal Policy

The Government is committed to continue to implement measures to enhance and strengthen domestic revenue mobilization and ensure transparency in budget execution, taking into account, priority expenditures defined in PARPA II. Revenues are projected to reach 14.9percent of GDP in 2007, an increase over 2006. The budget for 2007 envisages a scaling-up of aid and thus increased expenditure on priority areas. There is no recourse to domestic financing of the budget. Revenue enhancing measures relate to the increase in the number of taxpayers, elimination of unwarranted tax exemptions, collection of tax arrears, updating the specific fuel tax, and ensuring efficiency in the customs area. The government is strongly committed to the establishment of the ATM, given that all prior actions have been completed. These are expected to gradually evolve into an autonomous institution to ensure operational efficiency.

The authorities are aware of the importance of facilitating prudent public financial management (PFM) and have agreed on a detailed action plan and budget (APB) with donors for the period 2006-2009. The APB includes, rollout of budget execution module to all central and provincial entities; transformation to Phase II of the budget formulation module; and developing new module functionalities. Other aspects of the PFM reform include payroll and pensions functionalities; ways of addressing PFM in the context of decentralization; inclusion of donor-financed projects within the Treasury Single Account (CUT); and implementing the asset management system and procurement interface to e-SISTAFE.

Monetary Policy

Monetary policy will continue to target base money to achieve the inflation target for 2007. The long term monetary policy strategy defines the intermediate target compatible with the base money operational target, and the Bank of Mozambique (BM) will continue to improve liquidity management. To strengthen the balance sheet of the Central Bank, the government is committed to issuing the last tranche of 1.5 billion MTn by end-June 2007. In view of this, the Ministry of Finance will facilitate improvements on preparation of cash-flow projections and ensure prompt communication to BM. To enhance the payment system, BM intends to open five provincial agencies, starting at the end of 2006.

The BM will continue to modernize its supervisory functions and will also start to implement a timetable for adopting IFRS in the banking system. In addition, new regulations on the assessment, classification and provisioning of credit, including regulation on integral risk management for credit institutions and finance companies, will become effective in 2007. The BM will continue to license and supervise microfinance deposit-taking institutions to facilitate access to finance by SMEs and rural households. The authorities will also in coordination with the industry regulatory body, enhance regulatory and supervisory framework for pensions within the insurance sector,.

Regarding reforms in the foreign exchange system, a new foreign exchange law that will include comments from all stakeholders will be submitted to the Parliament by end-March

2007. Upon approval of the law and its related regulations, the authorities intend to accept obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

Structural Reforms

The authorities are aware of the structural challenges facing the economy and the requirements for an action-oriented approach that would include high level of commitment and leadership in pursuing the reform agenda. The government in collaboration with the World Bank, will develop a strategic action plan by end-March 2007 that will outline issues of simplification of processes to start up a business, expanding the computerization of the registry process in all provinces, adoption of inspections that are business friendly, including the cost of closing a business.

The authorities are conscious of the importance of FDI. In this regard, the government is applying international best practices in tax structure and transparency in mining and other natural resources projects. A draft Mining Fiscal Regime law will be approved before end-2006, and the government will avoid signing any new Exploitation and Production Concession Contracts in the petroleum sector until a new and comprehensive package is put in place. The government is considering to adopt the Extractive Industries Transparency Initiative (EITI), and is already participating in seminars and workshops on the subject to guide the way forward.

Improving governance remains a priority of the authorities, and progress achieved in Phase I of the public sector reform program (2001-2006) has resulted in the launching of Phase II for 2006-2010, based on three pillars relating to (i) human resources management including payroll systems; (ii) performance evaluation and wage policy; and (iii) decentralization and improving public service delivery. Another key activity is the completion of the census of civil servants and consequently the creation of a unique database to manage human resources within the public sector.

The government is committed to conducting an economic analysis of urban land markets (formal and informal). Related to this subject, Cabinet has, in October 2006, approved a Decree on urban land use regulations. This decree, when submitted to Parliament, will be enacted into a policy for land use to reduce transactions costs.

In addition to the above, the government will continue to make reforms in the judicial sector. The Cabinet is expected to approve by end December 2006 the Penal Procedure Code, which will then be submitted to Parliament. Two more legal packages will be analyzed by the Parliament in 2007, namely: the organic law of the judicial tribunals and a new insolvency law. Most of the reforms in this area are closely supported by international partners.

Conclusion

The prospects for the Mozambican economy remain favorable and the authorities have expressed strong commitments to implementing the reform agenda as spelled out within PARPA II. The authorities request the completion of the fifth review and the financing assurances under the PRGF. Finally, the authorities wish to thank the international community and the Fund for their continued support. They strongly commit themselves to ensure that the objectives and policies set forth under the PRGF are achieved.