December 2009
IMF Country Report No. 09/327

Republic of Mozambique: Fifth Review Under the Policy Support Instrument, First Review Under the Twelve-Month Arrangement Under the Exogenous Shocks Facility, and Request for Modification of Assessment/Performance Criteria—Staff Report and Press Release

The following documents have been released and are included in this package:

- The staff report for the Fifth Review Under the Policy Support Instrument, First Review Under the Twelve-Month Arrangement Under the Exogenous Shocks Facility, and Request for Modification of Assessment/Performance Criteria , prepared by a staff team of the IMF, following discussions that ended on September 23, 2009, 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 November 23. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board.

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

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*
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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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Fifth Review Under the Policy Support Instrument, First Review Under the Twelve-Month Arrangement Under the Exogenous Shocks Facility, and Request for Modification of Assessment/Performance Criteria

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

Approved by Roger Nord and Dominique Desruelle

November 23, 2009

Discussions for the fifth review under the Policy Support Instrument (PSI) and first review under the Exogenous Shocks Facility (ESF) were held in Maputo September 9–23. The mission team consisted of Mr. Mueller (head), Ms. Gerling, Mr. Rosa and Mr. Staines (all AFR), Mr. Vitek (SPR), Mr. Fischer (resident representative), and Ms. Bosten and Mr. Wane (resident representative office). Mr. Nicholas (Acting Country Director) and Mr. Nucifora (both World Bank) also participated in the policy discussions.

The mission met with the Ministers of Finance, Planning and Development, Energy, Mineral Resources, and Industry and Trade; the Governor of the Bank of Mozambique (BM); other senior government officials, and representatives of the private sector, civil society, and the donor community.

The Executive Board approved a three-year PSI on June 18, 2007. It concluded the fourth PSI review and approved a one-year ESF arrangement on June 30, 2009. The nature of the Fund's involvement in Mozambique from mid-2010 will be discussed with the authorities during the next review.

In the attached Letter of Intent (LoI) and Memorandum of Economic and Financial Policies (MEFP), the authorities review program performance and outline their policies for the remainder of 2009 and for 2010.

Since taking office in 2005, the government has demonstrated a firm commitment to reform. The incumbent President was re-elected and the majority party confirmed in the presidential and parliamentary elections held on October 28, 2009.

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EXECUTIVE SUMMARY

Mozambique's overall macroeconomic performance has been more resilient to the global economic crisis than anticipated. There have been large declines in export receipts, private capital inflows and project aid. However, the government has responded promptly to mitigate the impact by easing macroeconomic policies and containing the spillover effects to the domestic economy. The outlook for 2010 has been brightened by the emerging rebound of global economic activity and the anticipated recovery of international credit markets.

Mozambique's balance of payments has deteriorated because of the global crisis. However, external reserves have been sustained by the SDR allocation and by Fund resources under the ESF and have benefited from an acceleration of a large World Bank disbursement.

The country's track record of prudent policies has provided ample space for easing macroeconomic policies in 2009. Revenues surpassed expectations in the first semester and the fiscal program was on track at end-September, although the government missed its end-June 2009 assessment/performance criterion (A/PC) on net domestic credit very marginally. The BM eased monetary policy further than anticipated to accommodate higher private sector credit, arising in part from the substitution of foreign with domestic sources of credit. Monetary operations have also been challenged by unusually high currency demand. The BM thus met its end-June 2009 A/PC on net international reserves, but exceeded its target on reserve money, although the gap narrowed at end-September. The exchange rate has depreciated in real effective terms.

The government reiterated its commitment to its medium-term strategy of prudent macroeconomic policies and views the policy easing as temporary. It therefore plans to gradually tighten policies in 2010 as economic activity rebounds in line with the recovery of the global economy and international credit markets. The draft budget for 2010 reflects this beginning of a gradual unwinding of the expansionary fiscal policy stance, working mainly through the unwinding of the automatic cyclical stabilizers. Monetary policy will remain eased compared to 2008 but will be cautiously tightened to ward off pressures on inflation, while preserving room for private sector credit.

The government is committed to its structural reform agenda to enhance Mozambique's medium-term growth prospects. All the structural benchmarks were met except the one on the tax administration pilot project. The structural reform agenda under the program aims to improve the effectiveness of macroeconomic policy formulation and implementation, strengthening the financial sector, and make the business environment more conducive to private sector development.

Staff supports the government's request for waivers for the nonobservance of end-June 2009 A/PCs, the modification of end-December 2009 A/PCs, and the completion of the fifth PSI review and the first review under the ESF arrangement.

I. The Impact of the Global Turmoil

A. Transmission Channels

1. **The impact of the global economic crisis on Mozambique has been contained to real sector channels through the external sector** (Figure 1). Mozambique's financial sector is largely insulated from the global economy and has so far weathered the crisis.

- **Export receipts declined sharply in the first half of 2009 in tandem with commodity prices, but volumes appear to have been only modestly affected** (Box 1). Moreover, the current account has improved, as lower export receipts have been offset by reduced dividends and declining import payments because of lower international fuel and food prices and the currency depreciation.
- **Private capital inflows, including trade credit, stalled with the onset of the global financial crisis in late 2008 and have remained well below the high levels seen in recent years**. However, firms have been able to source alternative financing from domestic banks and plans for the large investment projects have been broadly sustained.
- **Project aid disbursements encountered shortfalls in the first half of 2009 because of donors' budget constraints and delays in implementation**. The outlook for project aid in 2009 has therefore been revised below levels budgeted to be more in line with actual donor commitments and to avoid the substantial end-year shortfalls of recent years.
- **Mozambique has also been affected by the spill-over effects from the large economic contraction in South Africa.** This resulted in lower tourism receipts and FDI.

Box 1. Mozambique: Impact of Lower Prices for Aluminum Exports

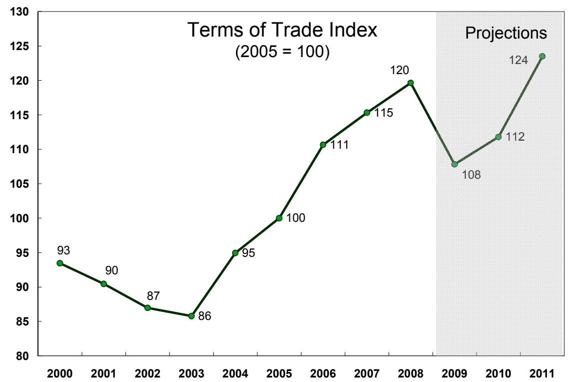
The aluminum smelter Mozal provides about half of Mozambique's export receipts and 70 percent of the manufacturing sector's output in 2008. The global downturn has affected Mozal mainly through falling aluminum prices. Production and sales volumes remain largely unchanged, as Mozal's high-quality product has a relatively assured market. Also, the high fixed costs typical of the industry encourage output smoothing in response to short-term demand fluctuations.

However, the large decline in sales receipts has reduced profit margins, tax payments and dividend payments. Accordingly, Mozal has substantially cut operating costs, especially domestic expenditures on employment, maintenance and other services.

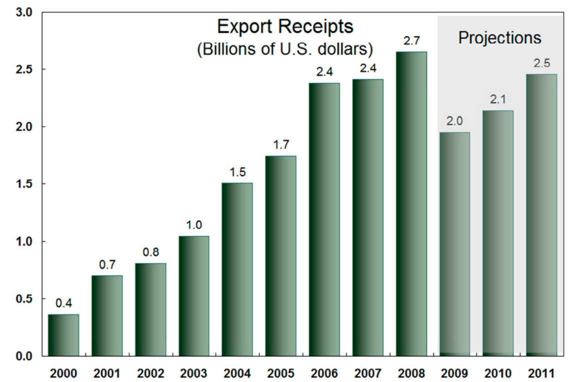
2. **In line with the WEO projections, prospects for Mozambique's external environment have brightened in tandem with the strengthening of the global economic outlook.** In addition, private capital inflows should benefit from the anticipated recovery of international credit markets over the coming year.

Figure 1. Mozambique: Impact of the Global Crisis

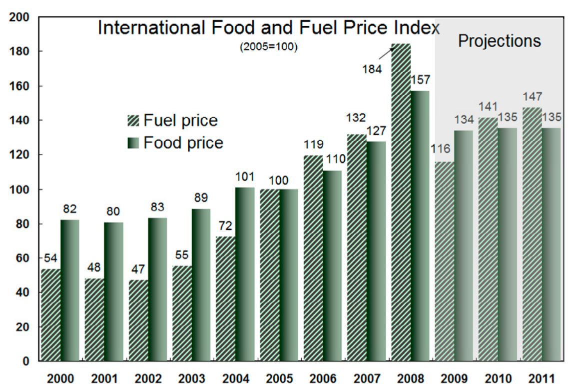
The fall in global demand and commodity prices, including a 60 percent drop in aluminum prices,…



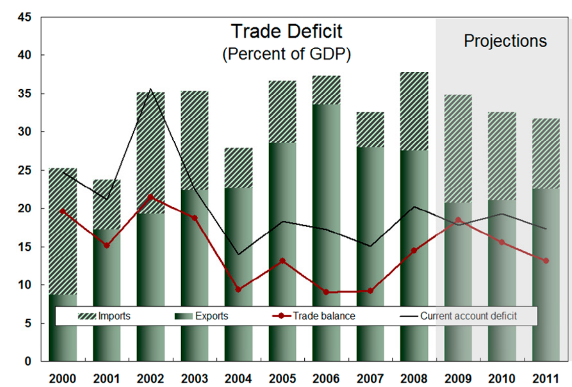
…led to a large fall in export receipts …



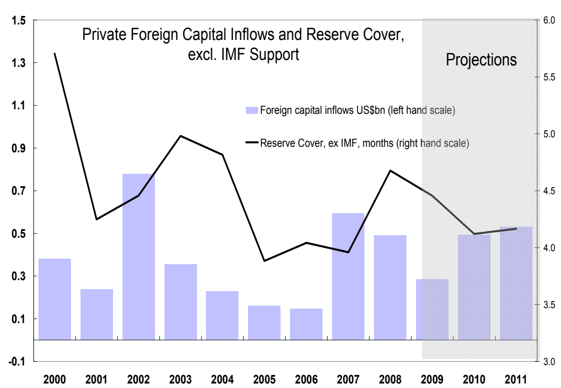
…while falling international food and fuel prices helped reduce import spending.



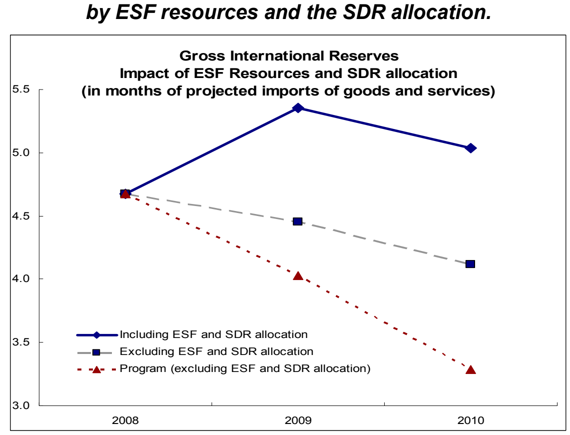
The trade balance deterioration was modest. Lower income outflows (especially dividends) strengthened the current account…



…but the large fall in private capital inflows has put pressure on the country's reserves.



The impact of the crisis on gross reserves in 2009 is milder than expected, but reserves have been supported by ESF resources and the SDR allocation.



Sources: Mozambican authorities and IMF staff estimates and projections.

B. Macroeconomic Developments and Outlook

3. **The direct impact of the crisis via reduced exports and foreign-financed investment, though limited, has been accentuated through indirect channels.** These arose from the spill-over effects on incomes and overall business confidence. However, the government has countered by easing macroeconomic policies (Figure 2).

Mozambique: Selected Economic Indicators, 2006–11

	2006 Act.	2007 Act.	2008 Act.	2009 Proj.	2010 Proj.	2011 Proj.
Real GDP, percent change	8.7	7.3	6.7	4.5	5.4	6.0
CPI, per avg., percent change	13.2	8.2	10.3	3.5	9.5	5.8
CPI, eop., percent change	9.4	10.3	6.2	5.4	8.0	6.0
REER, percent change	-0.2	6.5	24.3	...	...	...
Current account balance (after grants), percent of GDP	-10.9	-9.1	-12.2	-11.0	-11.5	-9.5
Gross external reserves coverage, months of imports	4.0	4.0	4.7	5.4	5.0	5.0

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

4. **As a result, Mozambique's growth prospects are somewhat brighter than previously envisaged**. Nevertheless, real GDP growth in 2009 is cautiously projected to soften to about 4½ percent, pushing both growth and the level of economic activity below trend. Growth in 2010 will depend on the rebound of global economic activity and the recovery of international credit markets and is cautiously projected to pick up to 5½ percent. The government is making every effort to enhance growth, but this is not expected to revert to trend until 2011.

5. **Inflation is currently subdued, mainly because of low commodity prices, but is expected to rise**. Twelve-month inflation fell to about 1 percent in September, restrained by weak domestic pressures, falling international food prices, and fuel price subsidies introduced in May. Underlying inflationary pressures are expected to remain modest, but the recent depreciation, rising international fuel and food prices and especially the removal of the fuel subsidy could raise inflation to about 8 percent by end-2010.[1] Over the medium term, inflation should hover between 5 and 6 percent.

6. **The country's external position has weathered the global crisis better than expected.** Despite a deteriorating trade balance and a shortfall in private capital inflows, Mozambique's balance of payments was temporarily bolstered by the acceleration of World Bank budget support, as well as the SDR allocation and Fund resources under the ESF. As a result, gross reserve coverage is expected to approach 5½ months at end-2009.[2] The strengthening external environment will help alleviate pressures in 2010 on the current account and private capital inflows, but reserve coverage is nevertheless expected to dip to five months by end-2010.

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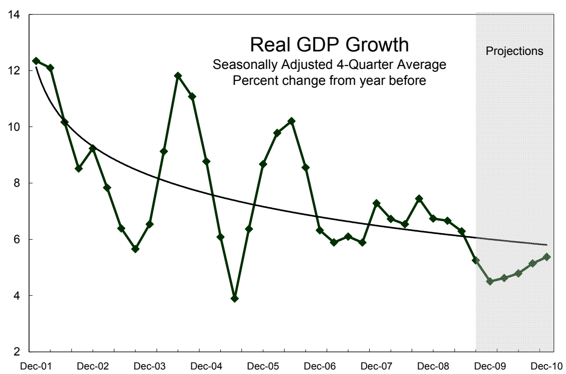
[1] The government introduced a fuel subsidy in May 2009 and is committed to removing it by end-March 2010.

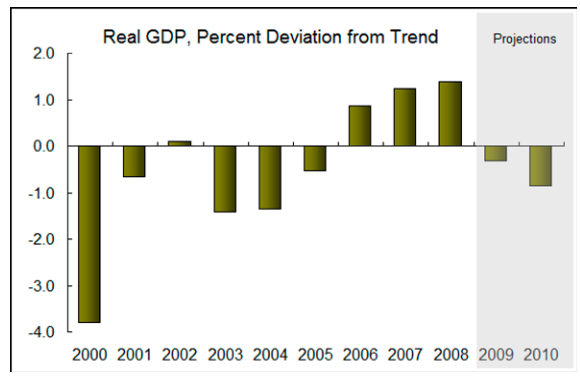
[2] The government does not currently have plans to use the SDR allocation. With the envisaged unwinding of the fiscal expansion, the allocation would in the first instance strengthen external reserves. However, its availability provides some additional flexibility should the current crisis deepen or be prolonged.

Figure 2. Mozambique: Macroeconomic Developments

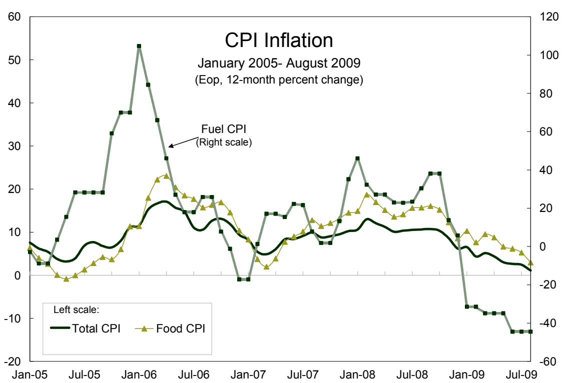
Real GDP growth has recently fallen below trend…



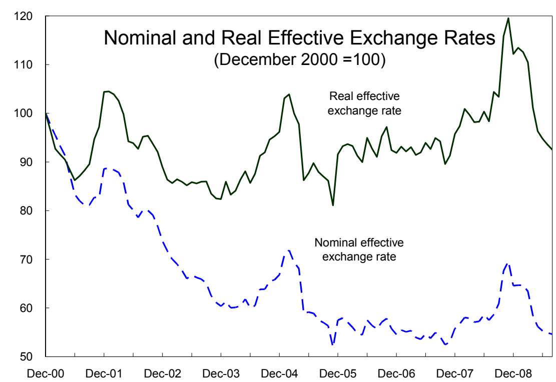
…opening up an output gap that will expand in 2010 as growth remains below trend.



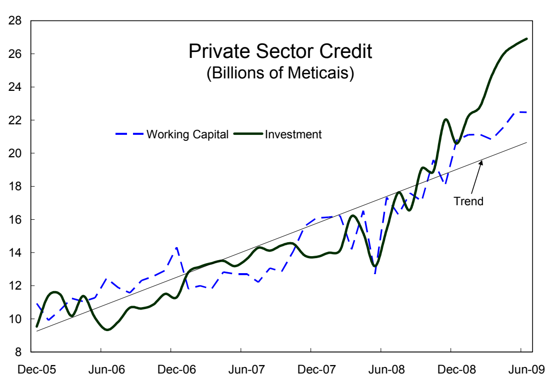
Inflation has benefited from falling international food and fuel prices, but is expected to rise over the medium term.



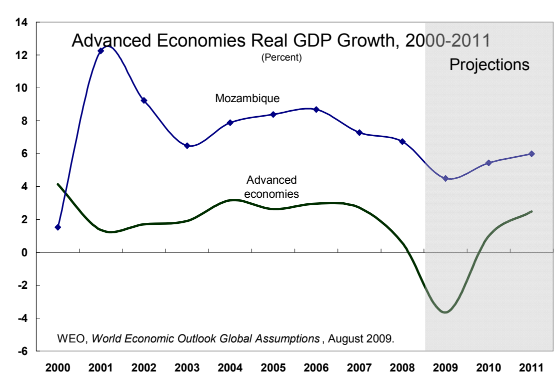
The currency depreciated in nominal and real effective terms during 2009, reversing the increases in 2008.



Private credit has surged, notably for investment purposes, as firms substitute foreign financing with domestic sources.



The external environment has improved because of the global economic rebound and rising commodity prices.



Sources: Mozambican authorities and IMF staff estimates and projections.

Mozambique: Reserve Import Coverage, 2008-10

	2008	2009	2010
Gross international reserves, US$ millions	1660	1929	1904
Months of projected imports of goods and services	4.7	5.4	5.0
Support from IMF		324	22
IMF ESF		155	22
IMF SDR allocation		169	0
Other major changes to external assistance			
World Bank budget support [1]		110	-80
Gross international reserves, US$ millions, ex. IMF		1605	1558
Months of projected imports of goods and services		4.5	4.1
Gross international reserves, US$ millions, program projections [2]	1660	1440	1294
Months of projected imports of goods and services	4.7	4.0	3.3

Source: Mozambican authorities and IMF staff estimates and projections.
Excluding IMF support
[1] The World Bank's projected budget support for 2010 was originally US$80 million and then increased to US$110 million and advanced to 2009.
[2] Excluding IMF support and assuming US$80m World Bank disbursement in 2010.

7. **Credit to the private sector has increased by half over the past year**. This partly reflects easier monetary conditions and a few large loans. Firms have responded to the contraction of foreign capital inflows by substituting foreign borrowing with recourse to domestic banks. The expansion in foreign currency credit has been particularly large and has been partly financed by banks' own foreign borrowing and drawdown of foreign assets. Though accommodated by a monetary expansion, the high credit growth has triggered increased competition for deposits and a liquidity squeeze for some banks that has led to a decline in liquidity ratios. So far, there have not been any indications of a deterioration in credit quality, but the BM has nevertheless stepped up its monitoring of the sector. Domestic credit demand is expected to ease in 2010 as international credit markets recover.

C. Comparison to Other Countries

8. **Mozambique has weathered the global economic crisis better than other countries in the region, but will also benefit less from the global recovery.** This reflects the different transmission channels of the global shock and the scope for macroeconomic policy easing.

Mozambique: Comparison with Sub-Saharan Africa, Selected Indicators, 2000-10 [1]

	Mozambique				SSA				SSA Non-fuel commodity exporters			
	2000-08	2008	2009	2010	2000-08	2008	2009	2010	2000-08	2008	2009	2010
Real GDP, % change	7.6	6.7	4.5	5.4	5.9	5.5	1.1	4.1	3.6	5.3	3.6	4.4
CPI period average, % change	11.4	10.3	3.5	9.5	10.5	11.6	10.5	7.2	7.5	10.0	6.0	5.0
REER, % change	2.0	24.3	…	…	1.8	3.5	…	…	…	…	…	…
Current account balance after grants, % of GDP	-13.8	-12.2	-11.0	-11.5	0.2	1.3	-4.8	-2.4	-1.3	-1.7	-3.1	-0.8
Gross international reserves, months of imports	3.9	4.7	5.4	5.0	4.6	5.3	5.8	5.5	3.7	3.2	4.3	3.9
Overal fiscal balance, inc grants, % of GDP	-3.8	-2.3	-4.3	-3.9	0.2	1.3	-4.8	-2.4	32.0	32.3	29.3	29.2
Broad money, % of GDP	28.9	33.7	39.1	40.0	42.2	48.6	52.5	52.3	23.2	25.9	27.1	27.0
Credit to the private sector, % of broad money	52.0	55.8	64.2	63.9	75.4	75.9	77.5	76.5	54.1	58.0	58.5	59.5

[1] Source: REO database, latest available data. Data for 2009/10 are preliminary projections.

II. Responding to the Crisis

A. Macroeconomic Policy Temporarily Eased

9. **Mozambique's government responded to the crisis by easing macroeconomic policies** (Figure 3). A strong track record of prudent macroeconomic policies—resulting in low inflation and public debt—and earlier indications of an overvalued currency provided scope for easing policies. The government's economic program under the PSI and ESF has been adjusted to support an accommodating policy stance. As it turned out, while the overall policy stance has eased further than anticipated, monetary policy has been more supportive, and fiscal policy somewhat less accommodating, than expected.

10. **Beyond the near term, the government remains committed to its medium-term strategy**. It aims to consolidate macroeconomic stability by maintaining low inflation and limiting recourse to domestic financing to make room for private sector credit. The policy easing is therefore expected to be temporary and to gradually reverse as economic activity recovers in 2010. The return to a prudent fiscal policy stance will be conducive to preserving Mozambique's low debt indicators and low risk of debt distress.[3]

11. **Continued strong performance in economic management and structural reforms, as well as in good governance, are essential to maintain the high levels of donor support of recent years.** In this context, the final assessment of the external observers of the October elections will be important for several donors in determining their future level and form of support.

Easing fiscal policy

MEFP ¶6-10

12. **The government temporarily loosened fiscal policy in 2009 compared to 2008 and the budget** (Figure 4). This entailed an increase in both the structural and the cyclical components of the domestic primary deficit. The automatic cyclical stabilizers have operated largely through reduced revenues, mainly because of the weak export sector. However, though lower than budgeted, revenues in the first semester surpassed expectations because of a more resilient economic activity and a strong administrative effort, such as the introduction of a simplified tax of small taxpayers. The government also accelerated discretionary expenditures, including as a result of a faster implementation of the new civil service pay scale and the newly-introduced fuel subsidy, which have been only partially offset with cuts in non-priority areas. The fiscal program was on track at end-September, but the end-June fiscal target was very narrowly missed, with virtually zero recourse to the banking system (see Figure 4, last panel). The acceleration of a large World Bank disbursement to end-2009 will allow a lower recourse to domestic borrowing for the year.

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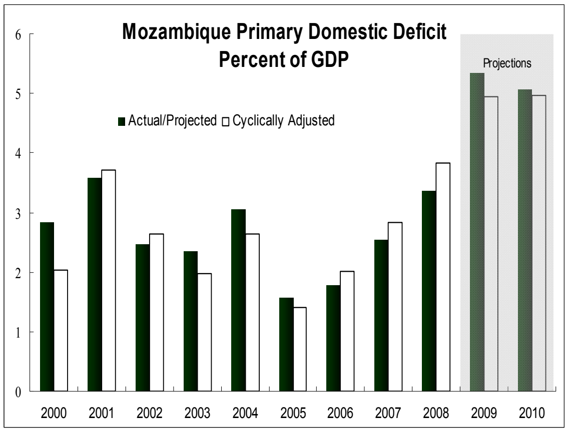
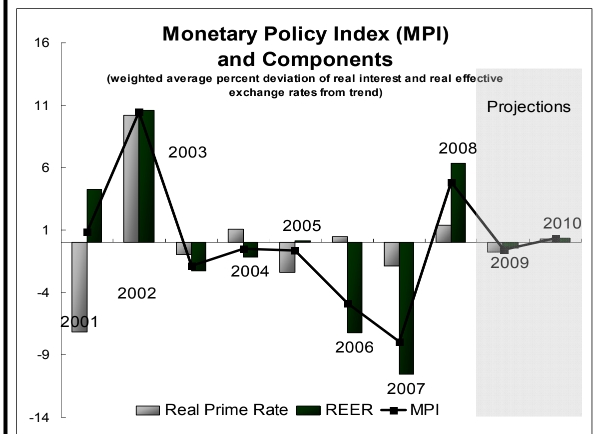
[3] See the Update to the Debt Sustainability Assessment, Country Report No. 09/227, July 2009.

Figure 3. Mozambique: Macroeconomic Policy Stance

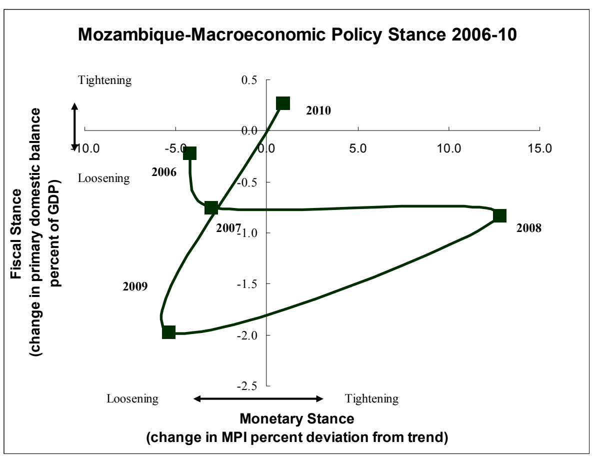
The primary domestic fiscal deficit expanded in 2009 because of both discretionary and automatic elements. Discretionary policy will remain unchanged in 2010, but the deficit will improve along with the economy.



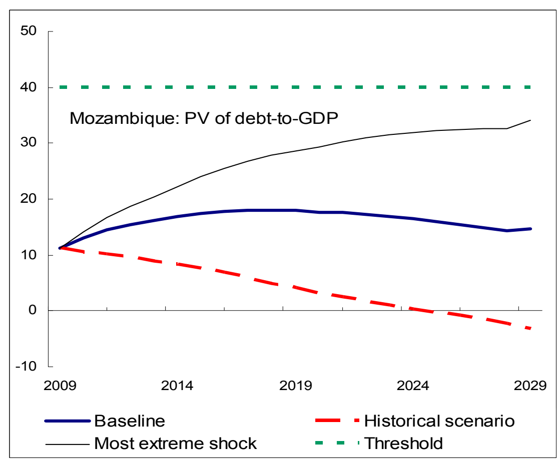
Monetary policy conditions eased in 2009 as interest rates declined and the real effective exchange rate depreciated. Conditions are expected to tighten mildly in 2010.



As a result, the overall stance of macroeconomic policy will become mildly tighter.



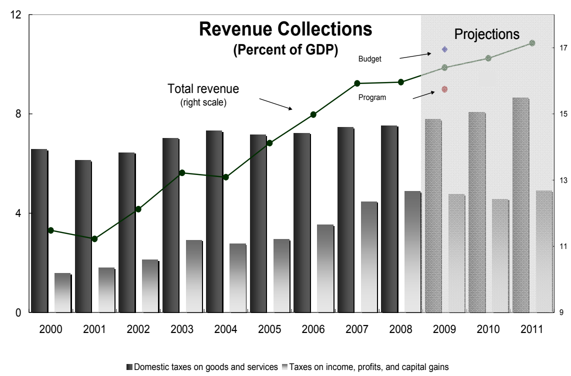
The more accommodating policy stance, if temporary, will not jeopardize macroeconomic stability as debt indicators are well below critical thresholds.



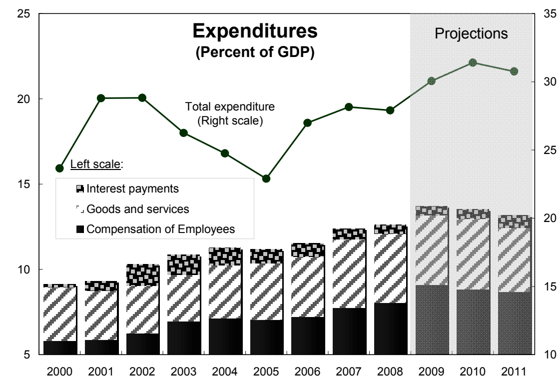
Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 4: Mozambique: Fiscal Developments

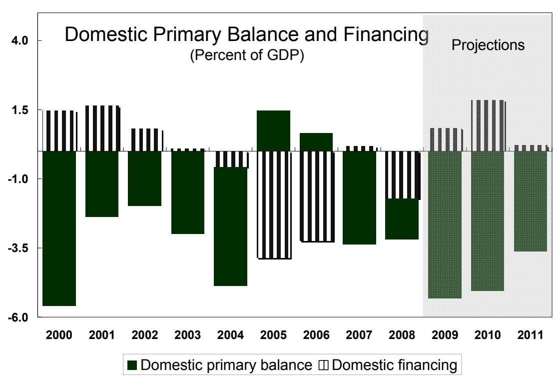
Taxes on income suffered from the crisis, but collections in 2009 have been stronger than expected thanks to the tax administration efforts and resilient growth.



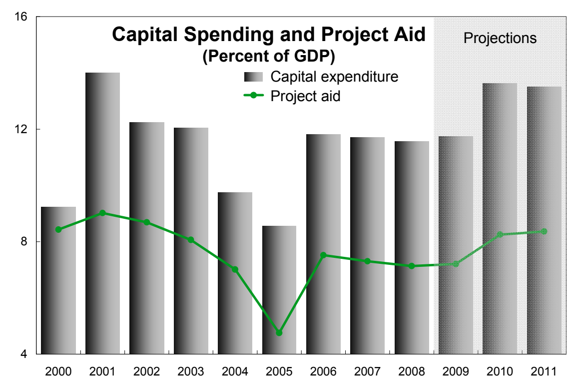
The increase in spending from 2008 to 2009 was mainly driven by the introduction of the new wage policy.



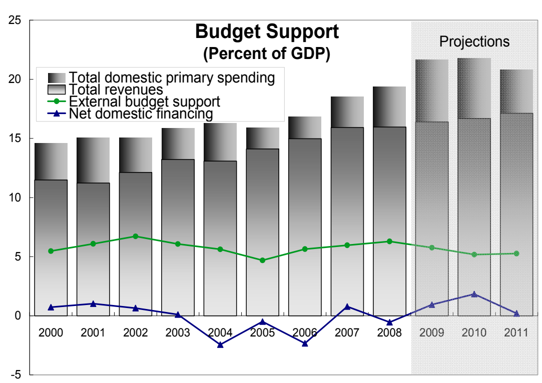
The temporary widening of the domestic primary deficit in 2009 will be gradually reversed from 2010 to allow for a return to a prudent medium-term fiscal policy stance.



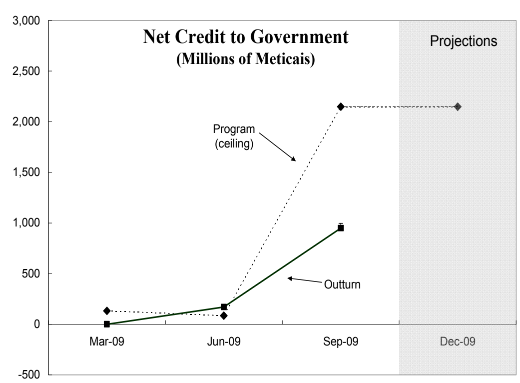
Capital spending relies heavily on external project support, and…



…external budget support results in a limited domestic financing requirement.



Net credit to government until end-September met the program target by an ample margin.



Sources: Mozambican authorities and IMF staff estimates and projections.

13. **The improved outlook for 2010 allows a gradual tightening of fiscal policy, consistent with the medium-term strategy.** This will work mainly through the unwinding of the automatic cyclical stabilizers, leaving the structural domestic balance broadly unchanged. Relative to GDP, the draft 2010 budget envisages a moderate increase in revenues due to efficiency gains and stronger economic growth and broadly unchanged domestic spending. Within the expenditure envelope, priority outlays will be further increased. The draft budget creates space to further implement the new civil service pay scale, hire additional civil servants mainly in priority sectors, and clear tax refund arrears. The government intends to gradually phase out the fuel subsidy in early 2010 and will explicitly and transparently show its cost in the budget. The accelerated disbursement of World Bank budget support from 2010 in 2009 will result in a larger domestic financing requirement in 2010.

Easing monetary policy

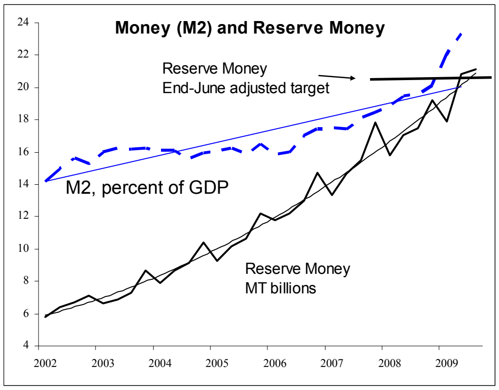
MEFP ¶17-18

14. **The BM eased monetary conditions significantly in 2009 compared to 2008** (Figure 5)**.** This was done to accommodate the planned increase in fiscal borrowing needs and a large expansion in private sector credit, partly in compensation for lower foreign private capital inflows. The BM has reduced interest rates on its standing lending and deposit facilities, lowered banks' reserve requirements, and left unanticipated foreign exchange inflows unsterilized. The BM's management of reserve money has continued to encounter challenges arising from structural shifts and an unusually high mid-year seasonal surge in currency demand, partly resulting from the payment of tobacco growers with local currency instead of the traditional payment in the Malawian kwacha. As a result, the BM met its end-June target on net international reserves comfortably, but exceeded the target on reserve money. Reserve money also surpassed the end-September target, though by a smaller margin.

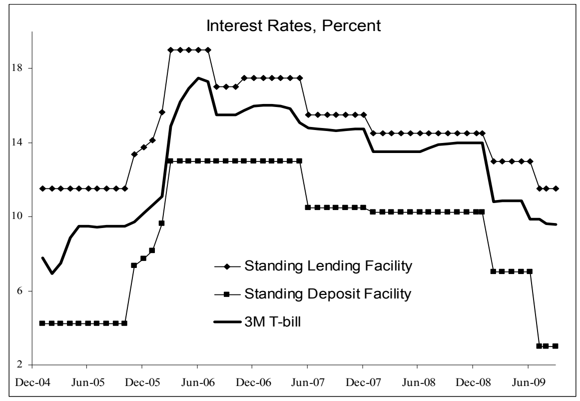
15. **The deterioration in the balance of payments and an easier monetary policy have put pressure on the currency to depreciate.** The BM intervened heavily in late 2008 and early 2009 to support high market demand for foreign exchange for import payments, but has since shifted its sterilization operations away from foreign exchange sales. In the same vein, in line with staff advice during the recent Article IV consultations, the BM has shifted its exchange rate policy away from a sole focus on the US dollar towards a broader basket of currencies. As a result, in the year to September, the currency depreciated 10 percent against the US dollar and 16 percent in real effective terms, largely reversing the 2008 appreciation.

Figure 5. Mozambique: Financial Developments

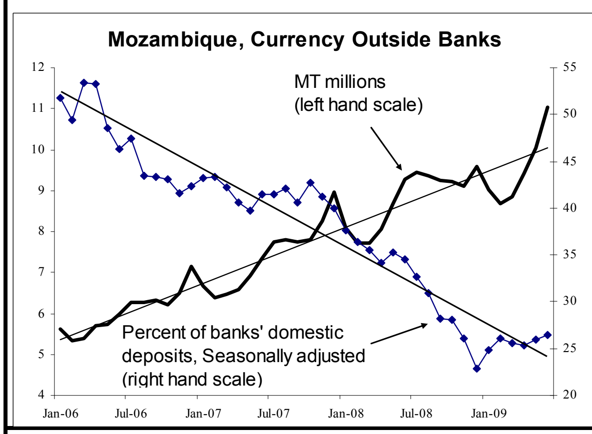
Money aggregates rose faster than expected and reserve money exceeded its end-June and end-September targets.



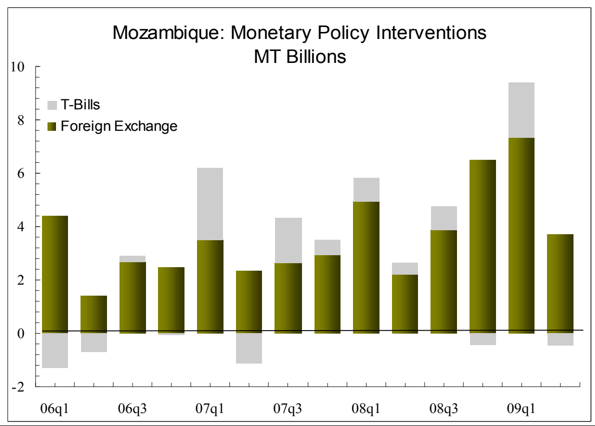
This reflected the BM's easing of monetary conditions, with lower interest rates and banks' reserve requirements…



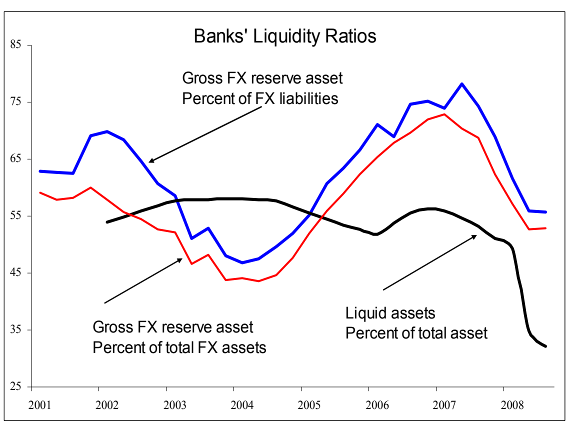
…as well as a structural shift and an unusually strong seasonal surge in currency demand outside banks....



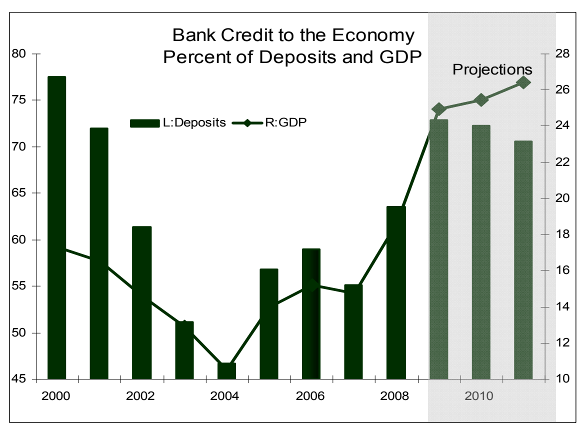
…while the reduced reliance on FX sales helped reverse the past real appreciation of the currency.



Even so, the large expansion in private sector credit has tightened liquidity conditions and banks' overall and FX liquidity ratios have declined sharply.



Private sector credit is expected to ease as a share of deposits as monetary policy tightens and government borrowing rises, but will still rise relative to GDP.



Sources: Mozambican authorities and IMF staff estimates and projections.

16. **Inflation risks and the real effective depreciation of the currency have reduced the scope for further easing in 2010.**[4] In addition, a continued large expansion of private sector credit could threaten credit quality and banks' liquidity ratios. Considering these risks, and in tandem with the expected recovery in the global economy and looser international credit conditions, the BM thus intends to pursue a slightly less accommodating policy stance in 2010 than in 2009. The mild tightening will still preserve room for government borrowing and a modest deepening of private sector credit relative to GDP.

B. Structural Measures to Sustain Growth

MEFP ¶11-16, 19-23

17. **The government remains committed to its structural reform agenda as a vehicle for enhancing medium-term growth**. All the structural benchmarks were met except the one on the tax administration pilot project because of a shift in strategy.[5] The government aims to improve the effectiveness of macroeconomic policy formulation and implementation and to make the business environment more conducive to private sector development. Close coordination with and support by the IMF, World Bank, and other development partners is key to achieve these objectives.

Mozambique: Structural Conditionality, 2010

Actions	Macroeconomic relevance	Expected Date of Implementation
1. Approval by the Minister of Finance of the *e-Tributação* (e-tax) Strategic Planning Document	Shore up the government's medium-term fiscal strategy, by increasing tax collections, improving tax efficiency, and enhancing the business environment.	May 15, 2010
2. Strengthening the Revenue Authority (*Administração Tributária* , AT): enhancing the management IT system and approving the new organic structure. (i) enhancement of the management information system; (ii) submission to the Council of Ministers of two decrees to approve the new organic structure and remuneration status AT's staff; and (iii) approval of a resolution by the Interministerial Committee of Civil Service of a resolution that approves the AT´s new career structure.		May 31, 2010
3. Creation of an EITI Secretariat	Improve the public management of the country's large natural resource endowment, by increasing benefits spilling over to domestic economy, strengthening transparency, and limiting budgetary liabilities.	March 31, 2010
4. Adoption of a financial sector contingency plan	Strengthen the supervisory framework and safeguard the soundness of the banking system.	May 31, 2010

- **Fiscal**: The government is committed to reforms in revenue administration and public financial management (PFM). These are essential to shore up the government's medium-term fiscal strategy and to mitigate fiscal risks. Tax administration measures center on simplifying tax collections and helping improve the strategic framework and organizational structure underpinning the reform

MEFP ¶12-15

[4] The introduction of the fuel subsidy held inflation low in 2009, while its removal will add about 3 percentage points to inflation in 2010. Inflation over 2009 and 2010 will average about 6½ percent, broadly consistent with the medium-term inflation objectives.

[5] The delay in the completion of the pilot to 2010 reflects additional conceptual work required to redesign the e-Tax strategy, in line with IMF technical assistance.

effort. The PFM-related measures focus on improving the management information system and streamlining operations, so as to help raise the quality and efficiency of spending, particularly for pro-growth infrastructure investment.

MEFP ¶17-21

- **Financial sector**: The BM is pressing ahead to strengthen its monetary policy instruments and operations, with a view to possibly moving away from reserve money targeting towards inflation targeting in the medium-term. The authorities aim to deepen financial intermediation and further strengthen the banking sector and its supervision. To this end, supported by technical assistance, the BM will finalize an action plan to implement the recommendations of the 2009 Financial Sector Assessment Program Update and develop a financial sector contingency plan that would strengthen the authorities' ability to deal with banks in financial distress.

MEFP ¶22

- **Business environment**: Mozambique's business environment ranks poorly compared to other countries in the region and is impeding private sector activity and external competitiveness. The government, in consultation with the World Bank, has identified specific measures that it intends to put on a fast track and implement by end-2010. This is intended to improve the business environment, help raise the growth potential, diversify exports, and stimulate new investment.

MEFP ¶16

- **EITI**: A key priority is to improve the public management of the country's large natural resource endowment, with a view to increasing the benefits spilling over to the domestic economy, strengthening transparency, and limiting budgetary liabilities. The government sees full membership in the EITI as critical for these objectives. Following the acceptance of Mozambique as an EITI candidate country in May 2009, the creation of an EITI Secretariat will help carry the reform process forward and ensure that Mozambique will be able to comply with EITI requirements during the country's two-year candidacy status.

18. **The government intends to accept the obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement**. The official communication will be sent once the implementing regulations become effective.

C. Addressing Mozambique's Developmental Needs

19. **The authorities are determined to redouble their efforts to address the country's developmental needs, especially with respect to the infrastructure gap.** They consider upgrading the road network in the vast country a key priority and instrumental to raising its growth and export potential. In their assessment, there are not enough concessional resources available to support this objective.

20. **In early September, the authorities signed a four-partite framework agreement for a €300 million credit line to help finance infrastructure investment.** Contractual partners are the governments of Mozambique and Portugal, the Portuguese savings bank

(CGD), and a local bank (BCI). It allows for the extension of external loans to BCI and on-lending of these funds to a domestic public entity to finance road infrastructure. The terms are nonconcessional, with an estimated grant element of the loan package of less than 20 percent. The government refrained from providing an external guarantee but guaranteed loan repayment to the domestic bank. As such, the framework agreement in itself does not implicate the nonconcessional external debt A/PC under the program, but nevertheless raises questions about financing of public infrastructure projects.[6] The government has initiated the identification and assessment of possible projects that could benefit from the framework agreement. It intends to firm up its intentions by the time of the next program review mission and consult with Fund and Bank staff to ensure the projects' compatibility with the macroeconomic framework, debt sustainability, and effective use of borrowed resources.

21. **Looking forward, the development of a well-defined borrowing strategy to help achieve the country's developmental objectives is urgently needed.** This will be discussed in the context of the next program review mission, based on an updated joint DSA that could help identify the country's borrowing space.

III. Staff Appraisal

22. **Mozambique's overall macroeconomic performance in 2009 has shown resilience to challenges from the external environment**. While the global crisis has noticeably affected the balance of payments, spillovers to the domestic economy have been limited. Support from the IMF and an accelerated World Bank disbursement have provided a cushion to counter the impact of the global crisis on the external accounts.

23. **The authorities have responded commendably to the external shock through timely and appropriate policies.** In this context, their readiness to consult closely with staff is welcome. A track record of prudent policies has provided the scope for easing macroeconomic policies in 2009. Notwithstanding a strong revenue effort, the authorities missed the end-June fiscal target marginally, but brought budget implementation back on track by end-September. The BM appropriately expanded monetary policy more than programmed to accommodate strong private sector credit growth, as firms substituted domestic for foreign sources of credit and because of an unusually high currency demand. This has resulted in the need for waivers for the non-observance of the end-June A/PCs on net credit to government and on reserve money, which the staff support. Finally, the program for the remainder of 2009 has been revised to reflect recent developments, including the SDR allocation, the advancement of the World Bank budget support, and the shifts underlying reserve money growth. These proposed modifications to the end-December A/PCs do not fundamentally change the underlying policy stance.

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[6] Staff will determine whether this guarantee implicates the nonconcessional external debt A/PC based on the individual project-based financing agreements once they are signed and become effective.

24. **The currency's real effective depreciation is timely and appropriate**. It comes when inflation pressures are low and largely reverses the appreciation in 2008. Staff commends the BM for its management of the exchange rate, focusing on a broader range of currencies and trading partners, consistent with past Fund policy advice.

25. **The policy easing should begin to be unwound in tandem with the recovery of the global economy and international credit markets.** Staff welcomes the authorities' intention to gradually tighten policies in 2010 and revert to their traditionally prudent macroeconomic policy stance. Nonetheless, the authorities need to be prepared to maintain the accommodating policy stance should the external environment strengthen more slowly than envisaged. In the same vein, given its importance for Mozambique's external and fiscal accounts, the authorities need to carefully monitor prospective donor support and stand ready to adjust their policy mix should any shortfalls materialize. Finally, staff is concerned that the large expansion in private sector credit could undermine credit quality and thus welcomes the BM's enhanced monitoring of the sector, envisaged implementation of FSAP recommendations, and preparation of a contingency plan to help deal with banks in distress.

26. **The authorities have continued to make noticeable progress in implementing structural reforms**. This is essential to shoring up Mozambique's medium-term growth prospects. Strengthening policy formulation and implementation will help cement macroeconomic stability. Rapid and tangible improvements in the business environment will be essential to support private sector development. Furthermore, Mozambique needs a concerted effort to move ahead on implementing the EITI to meet its commitments under the Initiative.

27. **The authorities should urgently develop a borrowing strategy to help address Mozambique's significant development needs.** In doing so, they will need to ensure that any future domestic and external nonconcessional borrowing is used effectively and is consistent with fiscal and debt sustainability. In particular, staff urges the authorities to ensure that the implementation of the recently signed framework agreement, which provides nonconcessional financing for infrastructure development, does not threaten the stability of Mozambique's overall macroeconomic framework.

28. **Based on performance to date and Mozambique's continued commitment to program implementation, staff recommends completion of the fifth PSI review and the first review under the ESF arrangement.** Staff also supports: (i) the authorities' request for waivers for the non-observance of the end-June A/PCs on net credit to government and reserve money, since the deviations were, respectively, minor and temporary and due to unexpected shifts in currency demand; and (ii) the authorities' request for modifications to the end-December A/PCs to reflect recent developments.

Table 1. Mozambique: Selected Economic and Financial Indicators, 2008–14

	2008	2009		2010		2011	2012	2013	2014
	Act.	Prog.	Proj.	Prog.	Proj.	Projections			
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Nominal GDP (MT billion)	240	261	260	288	300	337	378	425	479
Nominal GDP growth	15.5	9.1	8.2	10.2	15.5	12.4	12.2	12.5	12.6
Real GDP growth	6.7	4.3	4.5	5.0	5.4	6.0	6.2	6.5	6.5
GDP per capita (US$)	465	440	445	445	471	496	521	551	587
Consumer price index (annual average)	10.3	6.1	3.5	5.6	9.5	5.8	5.6	5.6	5.6
Consumer price index (end of period)	6.2	5.8	5.4	5.7	8.0	6.0	5.7	5.6	5.6
External sector									
Merchandise exports	10.0	-29.3	-26.5	25.7	9.8	14.7	8.8	6.6	7.2
Merchandise exports, excluding megaprojects	41.1	-14.7	-22.3	6.2	4.3	6.2	8.3	9.2	10.3
Merchandise imports	29.6	-3.5	-10.0	-1.8	0.8	4.5	9.6	7.6	7.6
Merchandise imports, excluding megaprojects	34.7	-11.6	-6.4	14.1	-1.7	0.7	9.7	8.2	8.2
Terms of trade	4.6	-21.2	-12.7	6.4	4.3	12.5	2.1	1.9	2.5
Nominal effective exchange rate (end of period)	22.5	...	...	...	...	...	...	...	...
Real effective exchange rate (end of period)	24.3	...	...	...	...	...	...	...	...
	(Annual changes in percent of beginning-of-period stock of money, M3, unless otherwise indicated)								
Money and credit									
Net foreign assets	4.0	-0.1	5.2	0.2	4.7	6.2	4.5	7.3	6.6
Net domestic assets	16.3	15.1	20.4	13.5	13.6	12.2	11.2	8.8	9.7
Of which : net credit to the government	-2.0	5.8	3.0	2.5	5.4	0.6	0.3	0.3	0.4
Of which : credit to the economy	21.1	15.6	24.9	11.7	11.4	10.6	10.2	9.9	10.2
Reserve money, (12-month per cent change)	7.8	15.0	18.0	13.7	16.0	13.4	12.1	12.7	12.9
Broad money, M3 (12-month percent change)	20.3	15.0	25.6	13.7	18.3	18.4	15.7	16.1	16.3
M2 (12-month percent change)	26.0	15.8	28.6	14.3	20.4	17.3	16.3	16.7	16.9
Velocity (GDP/M2)	4.4	4.2	3.7	4.0	3.6	3.4	3.3	3.2	3.1
	(Percent of GDP)								
Investment and saving									
Gross domestic investment	15.7	21.9	15.9	22.7	19.7	19.9	20.6	21.3	21.7
Government	11.6	15.6	11.7	16.8	13.6	13.5	13.6	14.4	14.7
Other sectors	4.1	6.3	4.1	5.9	6.1	6.4	6.9	7.0	7.0
Gross domestic savings (excluding grants)	-4.6	-1.1	-1.9	-0.5	0.4	2.5	2.7	3.4	4.0
Government	0.3	-1.0	-1.3	-0.6	-0.3	0.7	0.9	1.6	2.0
Other sectors	-4.9	-0.1	-0.6	0.1	0.7	1.8	1.8	1.8	2.0
External current account, before grants	-20.3	-22.9	-17.8	-23.2	-19.3	-17.3	-17.9	-17.9	-17.7
External current account, after grants	-12.2	-10.9	-11.0	-9.1	-11.5	-9.5	-10.1	-10.1	-9.9
Government budget									
Total revenue	16.0	15.7	16.4	16.0	16.7	17.1	17.6	18.0	18.3
Total expenditure and net lending	27.9	33.1	30.1	34.4	31.4	30.8	31.0	31.5	31.8
Overall balance, before grants	-11.8	-17.4	-13.7	-18.4	-14.7	-13.6	-13.5	-13.5	-13.5
Total grants	9.4	11.8	9.3	14.0	10.8	10.9	10.9	10.9	10.9
Overall balance, after grants	-2.3	-5.6	-4.3	-4.3	-3.9	-2.7	-2.5	-2.5	-2.5
Domestic primary balance, before grants	-3.2	-5.6	-5.3	-5.2	-5.1	-3.6	-3.6	-3.6	-3.5
External financing (incl. debt relief)	4.0	3.4	3.1	3.5	2.1	2.5	2.4	2.4	2.4
Net domestic financing	-1.7	1.8	0.8	0.8	1.8	0.2	0.1	0.1	0.1
	(US$ millions, unless otherwise indicated)								
External current account, before grants	-1,958	-2,135	-1,677	-2,229	-1,959	-1,891	-2,090	-2,261	-2,430
External current account, after grants	-1,179	-1,019	-1,034	-877	-1,167	-1,040	-1,177	-1,276	-1,360
Overall balance of payments	120	-223	114	-146	-48	164	113	115	151
Net international reserves (end of period) [1]	1,643	1,421	1,758	1,275	1,711	1,874	1,987	2,102	2,253
Gross international reserves (end of period) [1]	1,660	1,440	1,929	1,294	1,904	2,065	2,176	2,288	2,436
Months of projected imports of goods and nonfactor services	4.7	3.9	5.4	3.6	5.0	5.0	4.9	4.8	4.9

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

[1] Includes disbursements of Fund resources under the ESF and August 2009 SDR allocation.

Table 2. Mozambique: Government Finances, 2008–14

(MT Billions)

	2008	2009			2010		2011	2012	2013	2014
	Act.	H1 - Prog.	H1 - Prel.	Proj.	Prog.	Proj.	Projections			
Total revenue	38.27	19.86	21.00	42.55	46.13	49.98	57.71	66.39	76.61	87.79
Tax revenue	34.02	17.41	18.54	37.21	40.52	44.18	51.19	59.07	68.37	78.52
Income and profits	11.72	5.56	6.61	12.35	14.55	13.71	16.50	19.17	22.34	25.38
Goods and services	18.05	9.74	9.74	20.18	22.10	24.20	29.12	33.55	38.77	44.81
International trade	3.59	1.75	1.83	3.85	3.03	4.00	4.57	5.22	5.98	6.85
Other	0.65	0.37	0.36	0.83	0.83	2.28	0.99	1.13	1.29	1.46
Nontax revenue	4.25	2.45	2.46	5.34	5.61	5.80	6.52	7.32	8.23	9.27
Total expenditure and net lending	66.90	35.43	34.89	77.99	98.95	94.11	103.57	117.29	133.92	152.20
Current expenditure	37.63	21.39	21.80	45.90	47.85	50.84	55.34	62.99	69.80	78.16
Compensation to employees	19.27	10.81	11.45	23.62	24.19	26.46	29.28	32.99	36.35	40.48
Goods and services	9.71	5.58	5.53	10.55	12.10	12.42	12.57	14.47	15.95	17.98
Interest on public debt	1.26	0.71	0.62	1.39	1.61	1.61	2.48	2.87	3.25	3.65
Domestic	0.80	0.46	0.38	0.85	0.90	0.90	0.88	0.86	0.82	0.80
External	0.45	0.26	0.24	0.54	0.72	0.72	1.60	2.00	2.43	2.85
Transfer payments	7.40	4.29	4.21	10.34	9.95	10.35	11.00	12.67	14.25	16.05
Of which : fuel subsidy	…	…	…	1.69	…	1.69	…	…	…	…
Domestic current primary balance	1.89	-0.82	-0.19	-1.96	-0.11	0.76	4.85	6.27	10.06	13.28
Capital expenditure	27.74	13.20	12.42	30.46	48.48	40.86	45.49	51.56	61.06	70.60
Domestically financed	10.93	4.83	5.24	11.76	15.07	16.13	17.32	19.96	25.49	30.54
Externally financed	16.81	8.38	7.18	18.70	33.42	24.73	28.17	31.60	35.57	40.05
Net lending	1.52	0.84	0.67	1.63	2.61	2.41	2.74	2.74	3.07	3.44
Domestically financed	-0.13	-0.05	-0.05	-0.05	-0.23	-0.23	-0.26	-0.26	-0.30	-0.35
Externally financed loans to public enterprises	1.66	0.89	0.72	1.68	2.84	2.64	3.00	3.00	3.37	3.79
Domestic primary balance, before grants, above the line [1]	-8.06	-5.59	-5.38	-13.67	-14.95	-15.15	-12.21	-13.43	-15.13	-16.91
Unallocated revenue (+)/expenditure (-) [2]	0.42	0.00	-1.22	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Overall balance, before grants	-28.21	-15.57	-15.12	-35.44	-52.82	-44.13	-45.86	-50.90	-57.31	-64.41
Grants received	22.64	13.46	12.03	24.16	40.41	32.31	36.83	41.33	46.51	52.37
Project support	13.80	7.19	6.20	14.66	28.86	20.31	23.13	25.95	29.20	32.88
Budget support	8.84	6.28	5.83	9.50	11.55	12.00	13.71	15.38	17.31	19.49
Overall balance, after grants	-5.57	-2.10	-3.09	-11.28	-12.41	-11.81	-9.03	-9.58	-10.81	-12.04
Net external financing	9.65	1.76	2.82	8.09	10.06	6.30	8.33	9.10	10.36	11.35
Disbursements	9.56	2.41	3.09	9.49	11.67	7.93	9.05	10.16	11.43	12.87
Project	3.31	1.53	1.57	4.04	4.56	4.42	5.04	5.66	6.37	7.17
Nonproject support	6.25	0.89	1.52	5.45	7.12	3.51	4.01	4.50	5.07	5.70
Cash amortization	-0.75	-0.65	-0.27	-1.40	-1.61	-1.63	-0.72	-1.06	-1.08	-1.52
Net domestic financing [3,4]	-4.08	0.08	0.17	2.15	2.35	5.52	0.70	0.48	0.45	0.69
Net privatization	0.00	0.26	0.10	1.04	0.00	0.00	0.00	0.00	0.00	0.00
Memorandum items:										
Net aid flows	30.99	14.97	14.61	31.71	49.75	37.90	43.56	48.42	54.44	60.87
Gross aid flows	32.20	15.88	15.12	33.65	52.08	40.24	45.89	51.48	57.94	65.24
Project support	17.11	8.71	7.78	18.70	33.42	24.73	28.17	31.60	35.57	40.05
Loans to public enterprises	1.92	0.89	0.72	1.68	2.84	2.64	3.00	3.37	3.79	4.27
Budget support	13.17	6.28	6.63	13.27	15.82	12.88	14.72	16.51	18.58	20.92
External debt service	1.21	0.91	0.52	1.94	2.33	2.35	2.32	3.06	3.50	4.37

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

[1] Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.

[2] Residual discrepancy between identified sources and uses of funds. For 2009, reflects expenditure initiated outside the PFM IT system resulting in unclassified spending that will be regularized later.

[3] Excludes recapitilization bonds issued to the Bank of Mozambique.

[4] A World Bank disbursement of US$80 (US$110) million budget support designated for 2009 (2010) was advanced to 2008 (2009).

Table 3. Mozambique: Government Finances, 2008–14 (cont.)
(Percent of GDP)

	2008	2009		2010		2011	2012	2013	2014
	Act.	Prog	Proj.	Prog	Proj.	Projections			
Total revenue	16.0	15.7	16.4	16.0	16.7	17.1	17.6	18.0	18.3
Tax revenue	14.2	13.6	14.3	14.1	14.7	15.2	15.6	16.1	16.4
Nontax revenue	1.8	2.2	2.1	1.9	1.9	1.9	1.9	1.9	1.9
Total expenditure and net lending	27.9	33.1	30.1	34.4	31.4	30.8	31.0	31.5	31.8
Current expenditure	15.7	16.7	17.7	16.6	17.0	16.4	16.7	16.4	16.3
Compensation to employees	8.0	8.9	9.1	8.4	8.8	8.7	8.7	8.5	8.5
Goods and services	4.0	4.1	4.1	4.2	4.1	3.7	3.8	3.8	3.8
Interest on public debt	0.5	0.5	0.5	0.6	0.5	0.7	0.8	0.8	0.8
Transfer payments	3.1	3.1	4.0	3.5	3.5	3.3	3.4	3.4	3.4
Of which : fuel subsidy	…	…	0.6	…	0.6	…	…	…	…
Domestic current primary balance	0.8	-0.4	-0.8	0.0	0.3	1.4	1.7	2.4	2.8
Capital expenditure	11.6	15.6	11.7	16.8	13.6	13.5	13.6	14.4	14.7
Domestically financed	4.6	5.2	4.5	5.2	5.4	5.1	5.3	6.0	6.4
Externally financed	7.0	10.4	7.2	11.6	8.3	8.4	8.4	8.4	8.4
Net lending	0.6	0.8	0.6	0.9	0.8	0.8	0.7	0.7	0.7
Domestically financed	0.7	0.9	0.6	1.0	0.9	0.9	0.8	0.8	0.8
Externally financed loans to public enterprises	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic primary balance, before grants, above the line [1]	-3.4	-5.6	-5.3	-5.2	-5.1	-3.6	-3.6	-3.6	-3.5
Unallocated revenue (+)/expenditure (-) [2]	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	-11.8	-17.4	-13.7	-18.4	-14.7	-13.6	-13.5	-13.5	-13.5
Grants received	9.4	11.8	9.3	14.0	10.8	10.9	10.9	10.9	10.9
Project	5.8	7.7	5.7	10.0	6.8	6.9	6.9	6.9	6.9
Nonproject	3.7	4.1	3.7	4.0	4.0	4.1	4.1	4.1	4.1
Overall balance, after grants	-2.3	-5.6	-4.3	-4.3	-3.9	-2.7	-2.5	-2.5	-2.5
Net external financing	4.0	3.4	3.1	3.5	2.1	2.5	2.4	2.4	2.4
Disbursements	4.0	3.9	3.7	4.1	2.6	2.7	2.7	2.7	2.7
Project	1.4	2.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5
Nonproject support	2.6	1.2	2.1	2.5	1.2	1.2	1.2	1.2	1.2
Loans to public enterprises	0.8	0.9	0.6	1.0	0.9	0.9	0.9	0.9	0.9
Budget support	1.8	0.3	1.5	1.5	0.3	0.3	0.3	0.3	0.3
Cash amortization	-0.3	-0.5	-0.5	-0.6	-0.5	-0.2	-0.3	-0.3	-0.3
Net domestic financing [3,4]	-1.7	1.8	0.8	0.8	1.8	0.2	0.1	0.1	0.1
Net privatization	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Net aid flows	12.9	15.0	12.2	17.3	12.6	12.9	12.8	12.8	12.7
Gross aid flows	13.4	15.7	13.0	18.1	13.4	13.6	13.6	13.6	13.6
Project support	7.1	10.4	7.2	11.6	8.3	8.4	8.4	8.4	8.4
Loans to public enterprises	0.8	0.9	0.6	1.0	0.9	0.9	0.9	0.9	0.9
Budget support	5.5	4.4	5.1	5.5	4.3	4.4	4.4	4.4	4.4
External debt service	0.5	0.8	0.7	0.8	0.8	0.7	0.8	0.8	0.9

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

[1] Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.

[2] Residual discrepancy between identified sources and uses of funds. For 2009, reflects expenditure initiated outside the PFM IT system resulting in unclassified spending that will be regularized later.

[3] Excludes recapitilization bonds issued to the Bank of Mozambique.

[4] A World Bank disbursement of US$80 (US$110) million budget support designated for 2009 (2010) was advanced to 2008 (2009).

Table 4. Mozambique: Monetary Survey, Quarterly, 2008-10[1]

	2008	2009				2010			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Act.	Act.		Proj.		Proj.			
	(Mt Billions, unless otherwise stated)								
Bank of Mozambique									
Net foreign assets	41.8	42.9	45.2	45.3	45.1	45.6	49.3	51.6	46.6
(US$ billions)	1.6	1.5	1.7	1.7	1.6	1.6	1.7	1.8	1.6
Net international reserves	41.9	42.7	44.6	49.2	49.2	49.9	53.6	55.8	51.0
(US$ billions)	1.6	1.5	1.7	1.9	1.8	1.7	1.8	1.9	1.7
Net domestic assets	-22.6	-25.0	-24.4	-24.8	-22.4	-24.6	-25.5	-27.6	-20.3
Credit to government (net)	-23.9	-25.9	-25.5	-23.4	-21.0	-21.5	-22.7	-25.8	-16.9
Credit to banks (net)	-1.2	-0.3	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Credit to the economy	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other items (net; assets +)	2.1	0.8	1.0	-1.3	-1.3	-3.0	-2.7	-1.7	-3.3
Of which: valuation adjustment	-2.2	-2.4	-0.8	-2.4	-2.4	-4.2	-4.2	-3.5	-5.3
Reserve money	19.2	17.9	20.8	20.5	22.7	21.0	23.8	23.9	26.3
Currency in circulation	12.0	10.6	13.1	13.5	15.0	13.3	15.6	15.5	17.3
Bank deposits in BM	7.2	7.3	7.7	7.1	7.7	7.8	8.2	8.4	9.0
Commercial Banks									
Net foreign assets	15.1	13.9	14.4	14.6	16.1	15.4	18.3	18.0	19.3
(in millions of U.S. dollars)	0.6	0.5	0.5	0.6	0.6	0.5	0.6	0.6	0.6
Net domestic assets	55.4	59.0	63.0	66.3	72.7	74.3	77.1	80.4	86.3
Banks' reserves	10.2	9.1	9.9	9.4	10.1	10.0	11.5	11.1	12.0
Credit to BM (net)	1.0	0.1	0.3	0.5	0.5	0.5	0.5	0.5	0.5
Credit to government (net)	12.2	14.5	14.0	14.4	12.1	12.7	13.2	17.9	13.6
Credit to the economy	44.7	49.1	52.5	55.6	64.7	66.5	67.4	66.2	76.3
Other items (net; assets +)	-12.8	-13.8	-13.8	-13.7	-14.7	-15.4	-15.5	-15.3	-16.0
Deposits	70.5	72.9	77.4	80.9	88.8	89.7	95.4	98.4	105.6
Demand and savings deposits	43.6	46.0	49.0	52.2	57.0	57.0	60.2	62.9	66.9
Time deposits	26.7	26.9	28.4	28.7	31.8	32.8	35.2	35.5	38.6
Monetary Survey									
Net foreign assets	56.9	56.8	59.6	59.9	61.2	61.0	67.6	69.6	65.9
Net domestic assets	23.8	25.5	29.6	32.1	40.2	39.7	40.2	41.7	54.0
Domestic credit	33.7	38.6	41.9	47.1	56.3	58.0	58.3	58.7	73.3
Credit to government (net)	-11.3	-10.9	-11.0	-8.9	-8.9	-8.9	-9.5	-7.9	-3.3
Credit to the economy	45.0	49.5	52.9	56.0	65.1	66.9	67.8	66.6	76.7
Cred. economy in foreign currency	14.1	16.8	17.0	17.6	20.1	20.9	20.5	19.5	21.7
Other items (net; assets +)	-10.0	-13.1	-12.3	-15.0	-16.0	-18.4	-18.1	-17.0	-19.3
Money and quasi money (M3)	80.7	82.3	89.2	92.0	101.4	100.7	107.8	111.2	119.9
Foreign currency deposits	26.8	28.7	29.6	29.7	32.1	32.2	35.1	34.6	36.6
(US$ billions)	1.1	1.0	1.1	1.1	1.1	1.1	1.2	1.2	1.2
M2	53.9	53.6	59.5	62.3	69.3	68.5	72.7	76.6	83.4
Memorandum Items									
NCG stock (prog def.) [2]	-14.8	-14.8	-14.6	-12.5	-12.6	-12.7	-13.1	-11.4	-7.1
NCG flow (prog def.) cum from end-year [2]	-4.1	0.0	0.2	2.3	2.1	-0.1	-0.4	1.2	5.5
NIR at program exchange rate [3]	1.7	1.7	1.7	1.9	1.8	1.7	1.8	1.9	1.7
12-month percent change									
Reserve money	7.8	13.3	22.3	17.2	18.0	17.5	14.5	16.6	16.0
Currency in circulation	9.6	17.0	21.8	25.2	25.1	25.4	19.5	14.9	15.3
M2	26.0	26.7	29.8	28.5	28.6	27.7	22.1	23.0	20.4
M3	20.3	24.3	25.8	24.5	25.6	22.3	20.9	20.9	18.3
Credit to the economy	45.9	55.4	52.3	45.5	44.6	35.1	28.1	18.8	17.8
FX credit to the economy	87.4	90.9	80.7	50.5	42.6	24.4	20.6	10.8	8.0

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

[1] Includes disbursements of Fund resources under the ESF and the August 2009 SDR allocation.

[2] As defined in the TMU, this equals the NCG in the monetary survey excluding Moatize deposits, earmarked donor funds, and bonds issued to capitalize the BM.

[3] As defined in the TMU, this equals the NIR in the BM accounts evaluated at the program exchange rates versus the U.S. dollar specified in Table 1 of the TMU.

Table 5. Mozambique: Balance of Payments, 2008−14
(Millions of U.S. dollars, unless otherwise specified)

	2008	2009	2010	2011	2012	2013	2014
	Actual			Projection			
Current account balance	-1,179	-1,034	-1,167	-1,040	-1,177	-1,276	-1,360
Trade balance for goods	-990	-1,328	-1,163	-996	-1,113	-1,224	-1,329
Of which: Megaprojects	1,150	802	894	1,040	1,129	1,195	1,271
Exports, f.o.b.	2,653	1,951	2,142	2,457	2,673	2,849	3,054
Of which: Megaproject exports	1,851	1,328	1,492	1,767	1,925	2,032	2,153
Imports, f.o.b.	-3,643	-3,279	-3,305	-3,453	-3,786	-4,073	-4,383
Of which: Megaproject imports	-702	-526	-597	-727	-795	-837	-882
Trade balance for services	-410	-411	-416	-436	-476	-513	-553
Income balance	-631	-63	-460	-545	-592	-622	-655
Of which: Dividend payments by megaprojects	-492	-23	-367	-445	-485	-507	-530
Current transfers balance	852	768	871	936	1,004	1,083	1,176
Of which: External grants	778	643	792	852	913	985	1,070
Capital and financial account balance	1,188	1,188	1,120	1,203	1,290	1,391	1,512
Capital account balance	420	432	447	480	515	555	603
Financial account balance	768	756	673	723	776	836	909
Net foreign direct investment	587	532	472	507	543	586	637
Net foreign borrowing by the general government	342	354	248	267	286	308	335
Net foreign borrowing by the nonfinancial private sector	-97	-247	21	23	25	27	29
Other [1]	-64	116	-68	-73	-78	-85	-92
Of which: SDR allocation	0	169	0	0	0	0	0
Net errors and omissions	112	-40	0	0	0	0	0
Overall balance	120	114	-48	164	113	115	151
External financing	-120	-114	48	-164	-113	-115	-151
Reserve assets	-140	-269	26	-162	-111	-112	-148
Net use of Fund credit [2]	0	155	22	-2	-2	-3	-3
Exceptional financing	19	1	0	0	0	0	0
Memorandum items:							
Effective exchange rate indexes (percent change)							
Nominal effective exchange rate	11.1	…	…	…	…	…	…
Real effective exchange rate	12.0	…	…	…	…	…	…
Terms of trade index (percent change)	4.6	-12.7	4.3	12.5	2.1	1.9	2.5
International aluminum price	-2.3	-37.9	12.5	22.2	9.1	4.2	4.0
International food price index	23.4	-14.9	1.2	0.1	0.5	0.9	0.8
International fuel price index	40.1	-37.2	21.9	4.2	2.0	2.5	2.4
Current account balance (in percent of GDP)	-12.2	-11.0	-11.5	-9.5	-10.1	-10.1	-9.9
Excluding external grants	-20.3	-17.8	-19.3	-17.3	-17.9	-17.9	-17.7
Gross aid inflows (in percent of GDP)	14.7	13.8	13.6	13.6	13.6	13.6	13.6
Of which: Budget support	5.7	5.3	4.4	4.4	4.4	4.4	4.4
Of which: Project support	7.2	7.5	8.4	8.4	8.4	8.4	8.4
Net foreign assets	1,641	1,610	1,563	1,726	1,840	1,955	2,106
Net international reserves [1, 2]	1,643	1,758	1,711	1,874	1,987	2,102	2,253
Gross international reserves [1, 2]	1,660	1,929	1,904	2,065	2,176	2,288	2,436
In months of projected imports of goods and nonfactor services	4.7	5.4	5.0	5.0	4.9	4.8	4.9

Sources: Data from Government of Mozambique and projections by IMF staff.

[1] Accounts for disbursement of an SDR allocation of SDR 108.8 million in 2009Q3 above the line under other investment assets of the general government.

[2] Based on an ESF-HAC arrangement of SDR 113.6 million (100 percent of quota) to be disbursed in three tranches: SDR 85.2 million (75 percent of quota) already disbursed following completion of the fourth PSI review and approval of the ESF arrangement; SDR 14.2 million (12.5 percent of quota) to be disbursed upon completion of the fifth PSI and first ESF review; and SDR 14.2 million (12.5 percent of quota) to be disbursed upon completion of the sixth PSI and second ESF review.

Table 6. Mozambique: Indicators of Capacity to Repay the Fund

	Projection												
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Fund obligations based on existing credit													
Principal (millions of SDRs)	0.0	0.2	1.0	1.5	2.0	2.0	1.8	1.0	0.5	0.0	0.0	0.0	9.8
Charges and interest (millions of SDRs)	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Fund obligations based on existing and prospective credit [1]													
Principal (millions of SDRs)	0.0	0.2	1.0	1.5	2.0	2.0	20.3	23.7	23.2	22.7	22.7	4.3	123.4
Charges and interest (millions of SDRs)	0.3	0.6	0.6	0.6	0.6	0.6	0.5	0.4	0.3	0.2	0.1	0.0	4.7
Total obligations based on existing and prospective credit [1]													
In millions of SDRs	0.3	0.7	1.6	2.1	2.6	2.5	20.8	24.1	23.5	22.9	22.8	4.3	…
In millions of U.S. dollars	0.4	1.2	2.5	3.2	4.0	3.9	32.1	37.3	36.4	35.4	35.3	6.6	…
In percent of exports of goods and services	0.0	0.0	0.1	0.1	0.1	0.1	0.8	0.8	0.8	0.7	0.6	0.1	…
In percent of debt service	0.7	1.6	3.1	3.8	4.3	4.0	30.1	32.4	29.3	26.5	24.5	4.3	…
In percent of GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.0	…
In percent of gross international reserves	0.0	0.1	0.1	0.1	0.2	0.2	1.2	1.4	1.2	1.1	1.0	0.2	…
In percent of quota	0.2	0.7	1.4	1.8	2.2	2.2	18.3	21.2	20.7	20.1	20.0	3.8	…
Outstanding Fund credit													
In millions of SDRs	94.9	123.2	122.2	120.8	118.8	116.9	96.6	72.9	49.7	27.0	4.3	0.0	…
In millions of U.S. dollars	145.5	191.7	189.9	187.5	184.3	180.9	149.6	112.9	77.0	41.8	6.6	0.0	…
In percent of exports of goods and services	5.8	7.0	6.1	5.6	5.1	4.7	3.6	2.6	1.6	0.8	0.1	0.0	…
In percent of debt service	262.1	260.9	240.4	221.4	201.9	182.4	140.0	98.0	62.0	31.2	4.6	0.0	…
In percent of GDP	1.5	1.9	1.7	1.6	1.5	1.3	1.0	0.7	0.4	0.2	0.0	0.0	…
In percent of gross international reserves	7.5	10.1	9.2	8.6	8.1	7.4	5.8	4.1	2.6	1.3	0.2	0.0	…
In percent of quota	83.6	108.4	107.6	106.3	104.6	102.9	85.0	64.2	43.8	23.8	3.8	0.0	…
Net use of Fund credit (millions of SDRs)	85.2	28.2	-1.0	-1.5	-2.0	-2.0	-20.3	-23.7	-23.2	-22.7	-22.7	-4.3	-9.8
Disbursements [1]	85.2	28.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	113.6
Repayments	0.0	0.2	1.0	1.5	2.0	2.0	20.3	23.7	23.2	22.7	22.7	4.3	123.4
Memorandum items:													
Nominal GDP (millions of U.S. dollars)	9417	10159	10920	11709	12624	13718	14781	15923	17156	18488	19917	21459	…
Exports of goods and nonfactor services (millions of U.S. dollars)	2522	2745	3105	3368	3599	3868	4121	4403	4721	5082	5494	5970	…
External PPG debt service (millions of U.S. dollars)	56	73	79	85	91	99	107	115	124	134	144	155	…
Gross international reserves (millions of U.S. dollars) [1, 2]	1929	1904	2065	2176	2288	2436	2573	2730	2923	3169	3485	3926	…
Quota (millions of SDRs)	113.6	113.6	113.6	113.6	113.6	113.6	113.6	113.6	113.6	113.6	113.6	113.6	…
SDR exchange rate (SDR/USD)	0.65	0.64	0.64	0.64	0.64	0.65	0.65	0.65	0.65	0.65	0.65	0.65	…

Sources: Data from Government of Mozambique and projections by IMF staff.

[1] Based on an ESF-HAC arrangement of SDR 113.6 million (100 percent of quota) to be disbursed in three tranches: SDR 85.2 million (75 percent of quota) already disbursed following completion of the fourth PSI review and approval of the ESF arrangement; SDR 14.2 million (12.5 percent of quota) to be disbursed upon completion of the fifth PSI and first ESF review; and SDR 14.2 million (12.5 percent of quota) to be disbursed upon completion of the sixth PSI and second ESF review.

[2] Accounts for disbursement of an SDR allocation of SDR 108.8 million in 2009Q3. The projected interest obligations do not incorporate the expected temporary interest relief and new structure of interest rates.

Table 7. Mozambique: Financial Soundness Indicators for Banking Sector, 2001–09

(Percent unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	Mar-09	Jun-09
Capital adequacy										
Regulatory capital to risk-weighted assets	5.5	14.0	17.0	18.7	16.0	12.5	14.2	13.9	17.0	18.1
Regulatory Tier I capital to risk-weighted assets	6.0	12.0	14.7	16.0	13.6	10.7	12.3	12.4	14.9	16.2
Capital (net worth) to assets	8.2	9.4	9.0	9.5	8.0	6.1	6.4	6.7	8.2	8.1
Asset composition and quality										
Sectoral distribution of loans to total loans										
Agriculture	18.0	15.0	12.7	9.5	8.5	6.4	9.4	8.1	7.7	8.0
Industry	25.0	22.0	16.9	11.9	16.8	22.2	19.5	16.7	21.8	19.3
Construction	4.0	4.0	5.2	3.4	4.1	5.6	5.7	4.2	4.7	5.1
Commerce	20.0	17.0	18.1	21.3	27.4	27.4	24.4	25.6	24.7	22.9
Transportation and communication	7.0	5.0	7.1	7.2	5.8	6.2	12.2	11.2	12.4	11.6
Other	27.0	36.0	37.1	36.2	35.1	32.3	28.7	34.2	28.7	28.5
of which: Private 1/			7.6	12.1	13.0	13.5	14.4	19.9	17.3	18.1
Housing			7.1	8.2	4.2	4.1	3.7	3.7	3.7	3.5
Diverse 2/			22.4	15.9	17.8	14.7	10.6	10.0	7.2	6.9
Foreign exchange loans to total loans	64.7	69.9	70.8	67.3	63.9	45.0	31.5	40.1	36.1	33.1
Nonperforming loans to gross loans 3/	23.4	22.0	14.4	6.4	3.8	3.3	0.9	2.0	2.0	2.2
Nonperforming loans net of provisions to capital 3/	11.0	9.4	7.9	1.7	0.9	2.2	15.5	12.2	11.0	5.5
Earnings and profitability										
Return on assets	0.1	1.6	1.2	1.4	1.8	3.5	1.9	3.5	0.9	1.6
Return on equity	3.5	22.1	16.3	18.7	27.4	55.4	25.1	40.7	1.8	18.1
Interest margin to gross income	10.2	61.4	56.8	60.2	58.0	63.1	56.2	57.0	57.0	57.6
Noninterest expenses to gross income	16.9	67.0	72.2	71.2	65.9	54.1	58.3	61.1	59.1	59.1
Personnel expenses to noninterest expenses	51.7	44.7	45.7	45.2	45.4	44.4	44.4	45.3	47.3	46.6
Trading and fee income to gross income	33.1	39.7	45.5	41.9	43.8	32.2	43.4	43.0	43.0	40.8
Spread between reference loan and deposit rates (90 days, local currency)	14.0	19.0	17.4	14.7	11.5	14.6	11.2	10.7	10.6	11.0
Funding and liquidity										
Liquid assets to total assets 4/	34.6	53.9	57.7	58.1	55.5	51.9	53.3	49.3	34.8	32.2
Customer deposits to total (non-interbank) loans	217.0	240.0	228.0	283.1	191.9	179.3	198.2	170.6	158.6	155.4
Foreign exchange liabilities to total liabilities	63.3	61.3	46.4	41.4	45.3	42.8	35.5	32.2	28.5	27.6

Source: Bank of Mozambique (BM).

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

Table 8. Mozambique: Structural Conditionality in 2009

Actions	Expected Date of Implementation	Comments
The Ministry of Finance will approve a PFM vision pape for 2009-2011.	End-March 2009	Met. The vision paper was approved by of the Ministry of Finance mid-July, with recommendations.
The Government will formally submit a request to start the process to become a member of EITI.	End-June 2009	Met.
The Ministry of Industry and Trade will issue a decree streamlining the business inspection process.	End-July	Met. A single National Inspectorate of Economic Activities (INAE) was created, which incorporates the inspection of activities of a number of sectors.
The Ministry of Finance in coordination with the Ministry of Public Service will prepare an estimate of the new pay policy for the fiscal years 2010-2012.	End-August 2009	Met. Following IMF advice, the Budget Directorate, jointly with the Ministry of Public Service, is now preparing alternative scenarios for slower speed of implementation and estimating the fiscal impact over 2010-24.
A draft public enterprises law will be submitted to the Council of Ministers.	End-September 2009	Met. On August 7, 2009, a draft Public Enterprise Law was submitted to the Council of Minister. The Council of Ministers recommended a revision of the draft law with the involvement of the Instituto de gestao das Participacoes do Estatod (IGEPE). A revised draft law will be submitted to the Council of Minister by end-May 2010.
The central revenue authority and UTRAFE, will implement the pilot project on corporate income tax for the revenue collection module (e-Tributação) of the e-Sistafe.	End-September 2009	Not met. Following advice from FAD, the measure was modified to focus on the finalization of the strategic framework underpinning the reform of the tax collection system, to be implemented in early 2010.
The BM will issue new regulations that redefine the loan classification rules to make them consistent with international best practices.	End-September 2009	Met.
The BM with technical assistance support of the Fund will design a plan to strengthen the Monetary Policy framework comprising all intermediate steps, including agreement on a core inflation indicator.	End-December 2009	Met.

APPENDIX I

REPUBLIC OF MOZAMBIQUE: LETTER OF INTENT

November 18, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

On behalf of the Government of Mozambique, we would like to transmit to you the attached Memorandum of Economic and Financial Policies (MEFP). It provides an overview of the progress made in implementing our economic program under the Policy Support Instrument (PSI) and the arrangement under the Exogenous Shocks Facility (ESF) and sets out the objectives and policies that the Government intends to pursue over the short and medium term.

The economic and financial policies outlined in the MEFP are consistent with the Government's medium-term *Plano de Acção para a Redução da Pobreza Absoluta II* (PARPA II) for 2006-09, which was extended to 2010, and aim at maintaining macroeconomic stability, promoting diversified and strong economic growth, and reducing poverty. With these medium-term objectives in mind, we have pursued a temporary easing of fiscal and monetary policies to help Mozambique weather the impact of the global economic crisis. We believe that our strong economic fundamentals and prudent macroeconomic policy mix over the past decade provide us with the necessary flexibility in this regard.

With respect to the program, we met all quantitative performance/assessment criteria (P/AC) through end-June 2009, except for base money and net credit to the Government, for which we request waivers. Base money exceeded the program ceiling, as demand for currency was unusually high due to the buoyant activity in agriculture as well as a substantial increase in credit to the economy to compensate for the shortfall in foreign financing to support economic expansion. Although net credit to the Government was virtually flat and close to zero at end-June 2009, it marginally exceeded the relevant program ceiling. All structural benchmarks but one through end-September were met.

The Government of Mozambique believes that the policies set forth in the MEFP are adequate to achieve the objectives of our PSI and ESF-supported program. Our economic program for the remainder of the year has been revised to reflect recent developments, and we request modifications to the end-December 2009 assessment and performance criteria for net credit to government, reserve money and net international reserves. Given our dedication to macroeconomic stability, we stand ready to take additional measures as may be necessary to achieve our policy objectives. The Government will consult with the IMF—at its own initiative or whenever the IMF Managing Director requests such a consultation—should revisions be contemplated regarding the policies contained in the attached MEFP. On the basis of Mozambique's macroeconomic performance and our continued commitment to implementing our economic program, we request completion of the fifth PSI review and the first review under the ESF arrangement.

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

Sincerely yours,

/s/

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

REPUBLIC OF MOZAMBIQUE: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

November 18, 2009

1. This updated MEFP (i) describes performance under the Government of Mozambique's economic program under the three-year Policy Support Instrument (PSI) and the one-year arrangement under the Exogenous Shocks Facility (ESF) through September 2009; (ii) summarizes the Government's policy intentions over the short- and medium-term; and (iii) elaborates on the specific policies and targets for 2009/10.

I. PERFORMANCE UNDER THE PSI AND ESF ARRANGEMENT

2. Most program targets have been met. Except for base money and net credit to the Government, we observed all quantitative performance/assessment criteria (P/AC) through end-June 2009. Base money exceeded the program ceiling, as buoyant activity in agriculture resulted in an unusually high demand for currency, particularly related to the commercialization of tobacco where metical (instead of the Malawian currency) is now being used as currency of payment. Another factor was the increase in credit to the economy in order to compensate for the shortfall in foreign financing. On the other hand, the floor on net international reserves was met comfortably. Fiscal performance during the first half of 2009 was broadly in line with program projections, with virtually zero net credit to the Government (NCG), although the relevant program ceiling was slightly missed. Structural reforms are on track as well. All structural benchmarks through end-September were met, except for the one on the tax administration pilot project, which has been delayed because of the re-definition of the project's development strategy, consistent with IMF technical assistance advice.

II. OBJECTIVES AND POLICIES LOOKING FORWARD

3. The Government of Mozambique is committed to its medium-term strategy of pursuing prudent macroeconomic policies and implementing second-generation structural reforms to safeguard macroeconomic stability, sustain high economic growth, and reduce poverty. These objectives and underlying policies are consistent with our poverty reduction and growth strategy (*Plano de Acção para a Redução da Pobreza Absoluta II (PARPA II))* for 2006-09, which was extended to 2010. We have started to review this plan and are preparing a new strategy for 2011-14, relying on a participatory approach involving the private sector, civil society, and development partners.

4. Within this medium-term framework, the Government has embarked on a temporary easing of macroeconomic policies to help mitigate the impact of the global economic crisis. Mozambique has been affected by the crisis, as economic growth is projected to have slowed, the overall balance of payments to have deteriorated, and the import coverage of reserves

(before the ESF and SDR allocation) to have suffered. Mozambique's strong economic fundamentals and prudent macroeconomic policy mix over the past decade offer the necessary flexibility to address these challenges. The accommodating policy stance will be limited in time and unwound as soon as signs of the expected economic recovery become evident.

5. Following the temporary softening of economic growth in 2009, economic activity is expected to strengthen to 5½ percent in 2010 and 6 percent over the medium term. However, the Government intends to make every possible effort to achieve a higher rate of growth. The recovery in external demand should help stabilize the external current account deficit (after grants) at around 10 percent of GDP over 2010-12. This should help buttress our international reserves, which are also benefiting from the IMF's SDR allocation and are projected to average five months of imports during the period. We expect average inflation to remain at about 6 percent over the medium term, below its historical levels, although establishing the full pass-through of international oil prices will contribute to a peak in average inflation of 9½ percent in 2010.

A. Fiscal Policy

6. The Government remains committed to its medium-term fiscal strategy geared toward preserving debt sustainability, containing inflationary pressures, and limiting recourse to domestic financing to make room for sustainable private sector credit growth. The prudent fiscal policy stance to date has created the space enabling the Government to temporarily loosen fiscal policies in 2009 in response to the global crisis. Current indications should allow a careful unwinding of the fiscal expansion in 2010, in tandem with the improved economic outlook.

7. For 2009, we expect the overall fiscal deficit (after grants) to widen by two percentage points, to 4½ percent of GDP, resulting in a domestic financing need of 0.8 percent of GDP. The recourse to domestic financing should be lower than envisaged earlier, reflecting an advance disbursement from the World Bank. A strong revenue administration effort should shore up tax collections, although some taxes have been affected by the impact of the global economic crisis. The Government intends to adhere to the overall budget envelope for expenditure approved by Parliament. Higher than expected spending on wages and pensions (0.2 percent of GDP) resulting from the early initiation of the decompression of the new civil service pay scale, as well as the cost of fuel subsidies (0.6 percent of GDP), will be accommodated by cutting other expenditures. This may entail limited temporary cuts in priority expenditures; however, such spending will still rise to a projected 66.9 percent of total domestic spending in 2009, from 66.7 percent a year earlier.

8. The expected strengthening of economic activity in 2010 should permit a gradual tightening of fiscal policy, with a view to begin reverting to the medium-term fiscal policy stance. This entails reducing the overall fiscal deficit (after grants) to about 4 percent of GDP

in 2010, consistent with a net domestic financing requirement of 1.8 percent of GDP, which also reflects a deposit drawdown related to the World Bank disbursement from late 2009.

9. The draft 2010 budget envisages a revenue increase by 0.3 percent of GDP, reflecting further efficiency gains in tax administration, while domestic current and capital spending will remain broadly unchanged, at about 22 percent of GDP. It also aims at further strengthening priority spending to 67.1 percent of total domestic spending. The draft budget includes allocations to (i) further implement the new civil service pay scale (0.4 percent of GDP); (ii) hire 16,000 additional civil servants, two-thirds of which will be for education and health (0.5 percent of GDP); (iii) pay for the expected costs of the fuel subsidies (0.6 percent of GDP); and (iv) continue clearing post-2003 commercial VAT arrears (0.1 percent of GDP), based on the audit of 2008 and consistent with the Government's commitment to eliminate all remaining arrears by end-2012.

10. The Government aims to protect vulnerable segments of the population from economic hardship, including from adverse developments in international prices for fuel products. In doing so, it strives to strike the appropriate balance between safeguarding macroeconomic stability, providing temporary relief, and ensuring an appropriate targeting of the support. In light of the sharp reduction of inflation in Mozambique over the past few months and the broad stabilization of international oil prices at less than half their peak-2008 level, the Government intends to gradually phase out the current system of fuel subsidies by end-March 2010. This will allow a full pass-through of international prices to consumers, which the Government will maintain going forward. It will consider replacing the fuel subsidies with better targeted and more effective alternative measures benefiting those truly in need, making use of the overall ceiling of MT 1.7 billion for such measures in the 2010 draft budget. The fuel subsidies will be transparently shown in the budget documents.

B. Fiscal Structural Reform

11. With a view to shoring up our medium-term fiscal strategy and mitigating fiscal risks, we will strengthen our revenue administration and public financial management (PFM). We have benefited in both areas from ongoing cooperation with the IMF, the World Bank, and other development partners.

12. Our focus in tax administration is to reinforce management capacity and streamline operations. Key measures in the short run will include:

- *Rolling out the electronic tax system e-Tributação (e-tax):* The Minister of Finance (MF) will approve by May 15, 2010, the *e-Tributação* Strategic Planning Document, which will outline the roadmap for *e-Tributação's* implementation, especially with respect to the prioritization of steps, business process reviews, cost-benefit analysis, organizational set-up, and capacity building efforts (**structural benchmark**). The strategy will include an *e-Tributação* pilot that will focus on the corporate income tax in two main collection directorates (the Large Tax Payer Unit in Maputo and the Revenue Directorate of Maputo City (*Primeiro Bairro Fiscal*)) and be completed by end-2010. The delay in the completion of the pilot to 2010 reflects additional conceptual work to redesign the e-Tax strategy, in line with IMF technical assistance.

- *Strengthening the Revenue Authority (Administração Tributária, AT):* This will entail (i) enhancement of its management information system, by improving the system of data collection, defining core management performance indicators, and making effective use of the system in decision-making; (ii) submission to the Council of Ministers of two decrees to approve the new organic structure and the remuneration status of the staff, consistent with the Government's overall approach to civil service wage policy; and (iii) approval by the Interministerial Committee of Civil Service of a resolution that approves the AT´s new career structure. These three steps will be completed by end-May 2010 (**structural benchmark**).
- *Improving monitoring of own revenues:* A diagnostic study will be completed on the sources of own revenues by end-2009. On this basis, the Minister of Finance will issue regulation (*circular*) by end-March 2010 specifying which own revenues would be included in the budget execution system (e-SISTAFE).
- *Reinforcing large taxpayers unit (LTU):* The three regional LTUs will be put under one national coordination unit by end-June 2010, which will be responsible for planning and monitoring all large taxpayers in the country, including the mega projects.
- *Implementing new taxes and special regimes:* While striving for strong tax collections overall, the AT will devote particular attention to introducing the new code for excise taxes on alcoholic beverages and tobacco as of January 1, 2010, strictly applying the new fiscal benefits code, and broadening the application of the simplified tax for small contributors.
- *Strictly adhering to mega project framework:* The Government will implement the mining and petroleum fiscal regime, related regulations, and model contracts for all new projects, and adopt non-recourse financing clauses in future mega projects.

13. Further improvements to PFM are a priority of the Government. Based on the PFM vision paper for the coming ten years approved on July 20, 2009, we intend to strengthen the institutional and operational framework for budget preparation, execution, monitoring, and control and strive to make the new public financial management (PFM) system (SISTAFE) fully operational. Specifically, we intend to take the following key measures in the short run:

- *Promoting implementation of SISTAFE:* Following the end-September 2009 adoption by the Minister of Finance of Phase III of the SISTAFE action plan and budget, the electronic budget execution system e-SISTAFE will be further rolled out to districts and state institutions. The objective is to gradually increase direct budget execution through e-SISTAFE to 37.5 percent of the total executed budget by end-2010, as agreed with development partners.

- *Ensuring compatibility of other IT systems with SISTAFE:* The MF will issue a decree ('diploma ministerial') by end-2009 requiring sectoral ministries to receive prior authorization for the procurement of new accounting or financial management systems complementary to e-SISTAFE.

- *Improving aid and debt management:* The MF will continue encouraging donors to use the single- and multi-currency treasury accounts at the BM for disbursing project aid. The Government will also strive to improve its external debt management. It will continue to seek to identify concessional resources to help finance the country's large development needs. However, concessional financing is not always available, which was behind our decision to sign a framework loan agreement with Portugal to help finance road infrastructure. The framework agreement allows for extension of external loans to a domestic bank and on-lending of these funds to a domestic public entity, up to a total of 300 million euros. Under the agreement, the government did not undertake to offer a guarantee on the external loans, but had to commit to provide a guarantee on future borrowings by the public entity from the domestic bank regarding the implementation of the framework agreement. The government has started the implementation process and identified potential projects to be financed under the framework agreement. It will firm up its intentions by the time of the next IMF review mission and consult with Fund and World Bank staff to ensure the projects' compatibility with the macroeconomic framework, debt sustainability, and financial viability so as to ensure that the road fund (Fundo de Estradas) generates sufficient resources to repay the loan.

- *Reinforcing investment planning, limiting fiscal and quasi-fiscal risks, and maximizing economic benefits:* By end May 2010, the MF will submit to the Council of Ministers a draft Public Private Partnership Law, which will also be applicable to mega projects and other concessions, including those in the power generation area.

- *Improving the framework for public enterprises*: A draft Public Enterprises Law will be submitted to the Council of Ministers by end-May 2010. It will include the requirement for quarterly financial reporting to the MF and the ring-fencing of commercial activities.

- *Enhancing procurement systems:* The Government intends to make reliable procurement information publicly available in 2011. By end-March 2010, it will initiate a study to develop a web-based monitoring and evaluation system.

14. The Government intends to continue implementing a reform of the civil service pay scale. It approved a new salary policy in September 2008 that it will phase in over the medium term in a very gradual manner, consistent with the need to preserve macroeconomic stability and fiscal sustainability. While raising the wage bill, the new policy aims to simplify

and rationalize the salary scales across ministries, decompress the scales consistent with qualification and responsibility, reform the system of housing and other allowances, and harmonize the salary policy with the pension system. Further technical work (supported by development partners) will be undertaken in 2010 to help determine specific elements and the sequencing of the reform steps.

15. To limit fiscal risks and improve governance and transparency, the Government is stepping up its efforts to strengthen the National Institute for Social Security (INSS). By end-December 2009, based on the work of an external consultant, the INSS Board will approve an investment strategy aimed solely at protecting the interests of the pensioners. The INSS also intends to finalize and publish its audited financial statements up to 2007 by the same date. These accounts will serve as a basis for an updated actuarial study that will help determine the possible need for adjustments to contribution rates and benefits. Finally, the INSS will introduce an IT system during 2010 to help improve registration of contributors and claimants and strengthen collection of contributions.

16. The Government is committed to becoming a full member of EITI within the envisaged timeframe of two years. To this end, a number of actions will be undertaken, including (i) the drafting of the first EITI progress report according to EITI standards; (ii) the hiring of an independent auditor; and (iii) the creation of a website for public information. With a view to launching the necessary work expeditiously, we will create an EITI Secretariat in early 2010, but not later than end-March 2010 (**structural benchmark**).

C. Monetary and Exchange Rate Policies

17. The Bank of Mozambique (BM) will continue to pursue a prudent monetary policy aimed at maintaining price stability within the context of a flexible exchange rate regime. Given inflation developments and the continued need to provide adequate room for financing the Government and the private sector, we see scope to maintain an eased monetary policy stance. The BM is mindful, however, that the bottoming out of international food prices, higher domestic retail fuel prices resulting from the phasing out of fuel subsides, and a possibly more depreciated currency could give rise to new inflationary pressures in the short run.

18. In its monetary policy implementation, the BM will pay closer attention to the level of the effective real exchange rate vis-à-vis a broad basket of currencies. This would allow the exchange rate to adjust more freely to existing patterns of trade and financial flows with other countries while safeguarding Mozambique's international reserves.

19. The BM will continue reinforcing its monitoring, analysis and forecasting of macroeconomic and monetary indicators. In particular, the BM will:

- Continue to focus on further strengthening liquidity management, paying particular attention to improving coordination with the Ministry of Finance on its cash flow projections and on its increased aid management through the single-and multiple-currency treasury accounts at the BM, and with banks on their liquidity requirements; and
- Broaden its use of repos and reverse repos to help strengthen the interbank market and liquidity management and safeguard international reserves, and build a flexible and realistic intervention corridor that reflects market conditions.

20. The Government intends to accept the obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement in due course. The official communication will be sent as soon as the implementation regulation has been brought in line with the new legislative framework that came into effect on March 11, 2009.

D. Financial Sector Policies

21. The Government and the BM will ensure expeditious follow-up to the recommendations of the 2009 Financial Sector Assessment Program (FSAP) update. The FSAP noted the overall soundness of the banking system and the improvements in banking supervision and regulation, while highlighting some remaining obstacles to financial intermediation and access to credit. Building on the progress to date, the Government and the BM intend to pursue the following initiatives:

- *Developing Financial Sector Action Plan:* The authorities will finalize an action plan to implement the FSAP recommendations by end-March 2010, supported by technical assistance. To this end, an interagency task force will be created that will develop measures to enhance access to finance and financial market development, strengthen compliance of the supervisory framework with the Basel Core Principles, and complete the modernization of the payments system. In its cooperation with the interagency task force, the BM will preserve the confidentiality of banking information.
- *Continuously monitoring developments in the banking system:* Because of the more challenging international environment and the rapid growth in credit over the last two years, the BM will closely monitor activities in the banking system and apply its supervisory framework. Close attention will be devoted to assessing liquidity conditions and the quality of loan portfolios.
- *Adopting Financial Sector Contingency Plan:* Although the global crisis has so far not directly affected the banking system, the authorities intend to develop a contingency plan that would create a set of tools to (i) enhance their ability to promptly and effectively respond to banks in financial distress; (ii) strengthen interagency coordination between the BM and Government, including information

sharing, analysis, decision-making, and communication; and (iii) develop a bank resolution framework. The Plan will be developed in cooperation with development partners and completed by end-May 2010 (**structural benchmark**).

E. Other Structural Policies

22. The Government is intensifying its reforms to improve the business environment to help raise Mozambique's growth potential, diversify exports, and stimulate new investment. In coordination with the World Bank, the Government has identified the following key measures that it intends to put on a fast track and implement by end-2010:

- Ease red tape to start and run a business by combining the three procedures related to tax registration of businesses, evenhandedly applying the labor code and reducing paperwork to hire workers, and making the new unified inspection agency (for all inspections except those on taxes and labor) operational;
- Submit legislation to streamline business-related licenses;
- Implement the new bankruptcy law once it has been adopted by parliament;
- Accelerate the registration of property by streamlining legislation and consolidating procedures; and
- Facilitate trading across borders by easing pre-arrival clearance.

23. The Government will strengthen the compilation and analysis of data on mega projects to be better able to assess their budgetary, macroeconomic and social implications. To this end, it will improve the coordination between the Ministry of Finance (MF), Ministry of Planning and Development (MPD), the BM, the Institute for National Statistics (INE), and line ministries and enhance the analytical and forecasting capabilities at the MF and MPD.

III. Program Monitoring

24. The revised quantitative P/AC for end-December 2009 and the new indicative targets for the first half of 2010 are shown in Table 1. Table 2 lists the structural benchmarks for 2010.

Table 1: Mozambique: Quantitative Assessment and Performance Criteria and Indicative Targets, 2009-10

(Mt millions, unless otherwise specified)

	2009									2010			
	End-March Indicative Target			End-June Performance/Assessment Criteria			End-Sept Indicative Target	End-Dec Performance/Assessment Criteria		End-March	End-June	End-Sept	End-Dec
										Indicative Targets			
	Prog.	Adj. Prog.	Act	Prog.	Adj. Prog.	Est.	Prog.	Prog.	Rev. Prog.	Projections			
Assessment/Performance Criteria for end-June/December													
Net credit to the government (cumulative ceiling)	133	133	0	85	85	171	2,148	4,716	2,148	-124	-446	1,182	5,515
Stock of reserve money (ceiling)	17,622	17,622	17,896	19,301	20,051	20,814	19,762	21,632	22,685	21,031	23,841	23,920	26,321
Stock of net international reserves of the BM (floor, US$ millions)	1,632	1,632	1,666	1,554	1,537	1,717	1,487	1,421	1,758	1,711	1,839	1,940	1,711
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling, US$ millions)	5	5	3	5	5	3	5	5	5	5	5	5	5
Stock of short-term external public debt outstanding (ceiling)	0	0	0	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling)	0	0	0	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, US$ millions)	0	0	0	0	0	0	0	0	0	0	0	0	0
Government revenue (floor)	9,075	9,075	9,152	19,861	19,861	20,995	30,624	41,095	42,553	10,810	23,773	36,560	49,983
Memorandum items [2]													
Stock of net crediit to the government (cumulative change)			367			249			2,443	-4	-662	966	5,515
Stock of net international reserves at the BM			1,539			1,670			1,758	1,711	1,839	1,940	1,711

Source: Mozambican authorities and IMF staff estimates

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

[2] From the monetary survey.

Table 2: Mozambique: Structural Conditionality, 2010

Actions	Expected Date of Implementation
1. Approval by the Minister of Finance of the *e-Tributação* (e-tax) Strategic Planning Document	May 15, 2010
2. Strengthening the Revenue Authority (*Administração Tributária* , AT): enhancing the management IT system and approving the new organic structure. (i) enhancement of the management information system; (ii) submission to the Council of Ministers of two decrees to approve the new organic structure and remuneration status AT's staff; and (iii) approval of a resolution by the Interministerial Committee of Civil Service of a resolution that approves the AT´s new career structure.	May 31, 2010
3. Creation of an EITI Secretariat	March 31, 2010
4. Adoption of a financial sector contingency plan	May 31, 2010

ATTACHMENT II

REPUBLIC OF MOZAMBIQUE: TECHNICAL MEMORANDUM OF UNDERSTANDING

November 18, 2009

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

I. DEFINITIONS

Net credit to the central government

2. Net credit to the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts with the banking system, recapitalization bonds issued to the BM, and proceeds from the signing fee for mineral resource exploration. Credits comprise bank loans, 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 NCG by the banking system will be cumulative from end-December of the previous year.

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 in the definition 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 General Directorate of Tax (*Direcção Geral dos Impostos*, DGI), the General Directorate of Customs (*Direcção Geral das Alfândegas,* DGA), and nontax revenue, including certain own-generated revenues of districts and some line ministries, as defined in the budget. 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 relevant government collecting agencies, in cash or checks, or through transfers into the respective bank account.

Reserve money

6. Reserve money is defined as the sum of currency issued by BM and commercial banks' holdings at the BM. The reserve money stock will be monitored by the monetary authority and provided to the IMF by the BM.

Net international reserves

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

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

8. 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 BM (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).

9. The central government will limit contracting or guaranteeing external debt up to US$5 million each year 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 in accordance with the annual Budget Law. This assessment (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 assessment (performance) criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

10. The central government will not contract or guarantee external debt with original maturity of less than one year. This assessment (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 assessment (performance) criterion are short-term, import-related trade credits. This assessment (performance) criterion will be assessed on a continuous basis.

External payments arrears

11. 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 assessment (performance) criterion will be assessed on a continuous basis.

Foreign program assistance

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

Actual external debt service payments

13. 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).

II. Adjusters

Net international reserves

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

- downward/upward in 2009/2010 by the shortfall/excess in the World Bank PRSC 6 program disbursements compared to the level envisaged in the program.
- downward by the shortfall in external program aid less debt service payments (up to US$100 million), compared to the program baseline (Table 1) and excluding the World Bank PRSC 6 disbursement,
- downward/upward for any revision made to the end-year figures corresponding to the previous year.

- downward to accommodate higher external outlays because of natural disasters, up to US$20 million.

Net credit to government

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

- upward/downward in 2009/2010 by the shortfall/excess in the MT equivalent of World Bank PRSC 6 program disbursements compared to the level envisaged in the program.
- upward by the shortfall in the MT value of external program aid receipts less debt service payments (up to the MT equivalent of US$100 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1), excluding the World Bank PRSC 6 disbursement.
- downward by privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings accounts abroad.
- downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector.
- upward to accommodate the higher locally financed government outlays because of natural disasters, up to the MT equivalent of US$20 million at exchange rates prevailing at the respective test dates.

Reserve money

16. The quantitative target (ceiling) for reserve money will be adjusted upward by the excess of the stock of currency issued by the BM above the level envisaged in the program, up to MT 750 million (Table 1). The maximum adjustment will be MT 1000 million at end-December because of the seasonal increase in the demand for currency during the end-year festive season.

III. Data and Other Reporting

17. The government will provide Fund staff with

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

- monthly data on government revenues (in detail according to the fiscal table) with a lag not exceeding one month;
- monthly information on the balance of government savings accounts abroad;
- monthly data on domestic arrears; and
- monthly budget execution reports (that will also be published) with a time lag not exceeding 45 days.
- monthly data on gross international reserves, with the composition by original currencies and converted to US dollars at the actual exchange rates.

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

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

Table 1. Mozambique: Net Foreign Assistance, 2009-10

	2009										2010				
	Q1		Q2		Q3		Q4		Year		Q1	Q2	Q3	Q4	Year
	Prog.	Act.	Prog.	Act.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	105	104	105	128	78	85	68	127	356	446	163	95	86	26	370
Gross foreign program assistance	116	116	117	138	98	103	82	144	413	501	182	113	104	44	444
Program grants	116	116	117	108	83	103	67	34	382	361	151	113	104	44	413
Program loans	0	0	0	30	15	0	15	110	30	140	30	0	0	0	30
External debt service	11	12	11	10	21	17	14	17	57	56	18	18	18	18	73
World Bank PRSC 6 Disbursement								110		110	0	0	0	0	0
Net foreign program assistance (MT mn)	2,735	2,715	2,643	3,400	2,434	2,331	1,740	2,885	9,552	11,331	4,843	2,539	2,549	600	10,531
Gross foreign program assistance	3,003	2,984	3,293	3,647	2,852	2,744	2,366	3,895	11,514	13,270	5,220	3,310	3,052	1,296	12,877
Program grants	3,003	2,984	3,293	2,845	2,412	2,744	1,922	928	10,632	9,500	4,344	3,310	3,052	1,296	12,002
Program loans	0	0	0	803	439	0	443	2,967	883	3,770	876	0	0	0	876
External debt service	268	268	650	247	418	413	626	1,010	1,962	1,939	376	770	503	697	2,346
World Bank PRSC 6 Disbursement								2,697		2,697	0	0	0	0	0
Stock of outstanding currency (MT bm)	10,587	10,587	11,677	13,085	11,857	13,462	12,763	15,004	12,763	15,004	13,278	15,634	15,473	17,298	17,298

Source: Mozambican authorities and IMF staff estimates

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Fifth Review Under the Policy Support Instrument, First Review Under the Twelve-Month Arrangement Under the Exogenous Shocks Facility, and Request for Modification of Assessment/Performance Criteria—Informational Annex

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

November 23, 2009

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MOZAMBIQUE: RELATIONS WITH THE FUND

(as of September 30, 2009)

I. Membership Status: Joined: September 24, 1984; Article XIV

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	113.60	100.00
Fund holdings of currency	113.60	100.00
Reserve Position	0.01	0.01
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Holdings	0.07	N/A

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangements	85.20	75.00
PRGF Arrangements	9.74	8.57

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	Jun 30, 2009	Jun 29, 2010	113.60	85.20
PRGF	Jul 06, 2004	Jul 05, 2007	11.36	11.36
PRGF	Jun 28, 1999	Jun 28, 2003	87.20	78.80
PRGF	Jun 21, 1996	Jun 27, 1999	75.60	75.60

VI. Projected Payments to Fund [1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal		0.16	0.97	1.46	1.95
Charges/Interest	0.22	0.48	0.48	0.47	0.46
Total	0.22	0.64	1.45	1.93	2.41

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative:

I. Commitment of HIPC assistance	Original Framework	Enhanced Framework	Total
Decision point date	Apr 1998	Apr 2000	
Assistance committed			
by all creditors (US$ Million) [1]	1,716.00	306.00	
Of which: IMF assistance (US$ million)	124.60	18.46	
(SDR equivalent in millions)	93.17	13.73	
Completion point date	Jun 1999	Sep 2001	

II. Disbursement of IMF assistance (SDR Million)			
Assistance disbursed to the member	93.17	13.73	106.90
Interim assistance	--	2.31	2.31
Completion point balance	93.17	11.42	104.58
Additional disbursement of interest income [2]	--	1.10	1.10
Total disbursements	93.17	14.83	108.00

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)[1]	106.56
Financed by: MDRI Trust	83.05
Remaining HIPC resources	23.51

II. Debt Relief by Facility (SDR Million)

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

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Safeguards assessment

At the request of the Bank of Mozambique (BM), FIN conducted a voluntary safeguards assessment that was concluded in June 2008, updating an earlier assessment conducted in 2004. An update safeguards assessment is currently in progress with respect to the Exogenous Shocks Facility. While the BM has implemented some recommendations of the 2008 assessment, the effectiveness of oversight over external and internal audits needs to be enhanced and the internal audit function strengthened.

Exchange arrangements

Mozambique has a floating exchange system. 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. Foreign exchange transactions are conducted mainly bilaterally and there is no pre-established frequency for auctions.

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; (iv) the prohibition on advance payments for a service; and (v) the prohibition on advance payments for the import of goods. On June 18, 2007, the Fund granted approval for the retention of these five exchange restrictions until May 31, 2008. At the authorities' request, an Article VIII mission was conducted by LEG and PDR in March 2004. A new foreign exchange law was submitted to the Assembly in May 2007 and came into effect on March 11, 2009. Following issuance of implementation regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

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 PSI in June 2007. The 2009 Article IV consultation was completed by the Executive Board on June 30, 2009 (Country Report No. 09/227).

In concluding the 2009 Article IV consultation, Executive Directors welcomed Mozambique's continued strong macroeconomic performance in 2008 despite a challenging external environment. They commended the authorities' flexible policy response to higher fuel and food import prices, which helped to mitigate the impact of these shocks. Directors noted that Mozambique remains vulnerable to the global economic slowdown and agreed that the country's strong track record of prudent macroeconomic policy implementation has provided room to ease fiscal and monetary policy in the near-term. In the medium term, Directors underscored the importance of further strengthening macroeconomic stability, and supported efforts to enhance domestic revenue mobilization and to improve public financial management. They welcomed the authorities' intention to limit recourse to domestic financing of the budget so as to preserve sufficient room for private sector credit growth. With respect to the overvaluation of the exchange rate in real effective terms, Directors suggested paying closer attention to a basket of currencies, which could help support Mozambique's competitiveness and economic diversification. Further progress in structural reforms and in developing and safeguarding the soundness of the banking system were seen as instrumental in supporting the business environment.

Ex-post assessment of performance under Fund-supported programs

An ex post assessment (EPA) of Mozambique's performance under Fund-Supported Programs since 1987 was undertaken in December 2003 under the guidelines on assessments of countries with a longer-term program engagement. The EPA was circulated to the Executive Board on November 21, 2003 (Country Report No. 04/53).

Directors commended the authorities for their pursuit of sound macroeconomic policies and wide ranging structural reforms over the past fifteen years which contributed to strong growth of the economy, and a steady decline in poverty rates. Noting that despite considerable progress Mozambique remains a very poor and vulnerable country, Directors urged the authorities to persevere in their efforts to consolidate macroeconomic stability and accelerate and deepen structural reforms with a view to sustaining economic growth, encouraging employment creation, and further reducing poverty.

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). An update to the FSAP took place in February 2009. 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). The ROSC on fiscal transparency was updated in May 2008. 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's visit

At the invitation of the authorities, Mr. Kato, Deputy Managing Director, visited Maputo, Mozambique in July 2005.The Managing Director visited Mozambique on August 2007 for a meeting with the African Consultative Group on Quotas, Voice, and Representation.

Resident representative

Mr. Felix Fischer has been the IMF's resident representative to Mozambique since March 14, 2006.

IMF Technical Assistance Provided to Mozambique (2006–09)				
Departments	**Timing**	**Form**	**Purpose**	**Counterparts**
Finance	February 2008	Mission	Update of safeguard assessment	Bank of Mozambique
Fiscal Affairs	May 2009	Mission	Tax Administration Reform	Ministry of Finance
	August 2008	Mission	Public Financial Management Reforms	Ministry of Finance
	April–May 2008	Mission	Revenue Administration reform	Ministry of Finance
	Oct–Nov 2007	Mission	Tax Administration inspection	Ministry of Finance
	September 2007	Mission	Public Private Partnerships and Fiscal Risks	Ministry of Finance
	August 2007	Peripatetic expert	Tax Policy and Administration	Ministry of Finance
	August 2007	Mission	Fiscal ROSC update and Public Financial Management inspection	Ministry of Finance
	April–May 2007	Mission	Tax Administration inspection	Ministry of Finance
	April–May 2007	Mission	Petroleum Fiscal Regime	Ministry of Finance Ministry of Mineral Resources
	December 2006	Mission	Tax Administration	Ministry of Finance
	March 2006	Mission	Tax Policy review	Ministry of Finance
Monetary and Capital Markets	May 2009	Mission	2009 FSAP follow-up mission	Bank of Mozambique
	February 2009	Mission	TA on Central Banking and Monetary Policy Formulation	Bank of Mozambique
	May 2008	Mission	Strengthening Monetary Policy Formulation and Implementation	Bank of Mozambique
	December 2007	Mission	Implementation of IFRS for Central Bank accounts.	Bank of Mozambique
	August 2007	Mission	Post-FSAP TA assessment banking supervision, monetary Policy and operations	Bank of Mozambique
	April 2007	Short-term consultant	Banking supervision	Bank of Mozambique
	October 2006	Mission	Post- FSAP TA assessment banking supervision, monetary Policy and operations	Bank of Mozambique
	Feb-March 2006	Mission	AML/CFT legislation	Bank of

IMF Technical Assistance Provided to Mozambique (2006–09)				
Departments	**Timing**	**Form**	**Purpose**	**Counterparts**
				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
Statistics	March–April 2008	Mission	National accounts statistics	National Institute of Statistics
	February 2008	Mission	Balance of payments statistics	Bank of Mozambique
	December 2007	Mission	Balance of payments statistics	Bank of Mozambique
	November 2007	Mission	Monetary and financial statistics	Bank of Mozambique
	June–July 2006	Mission	Consumer price statistics	National Institute of Statistics (INE)
	August 2005–July 2006	Long-term consultant	National accounts statistics	National Institute of Statistics
	July 2005	Mission	Government finance statistics	National Institute of Statistics

WORLD BANK-IMF JOINT MANAGEMENT ACTION PLAN

Mozambique: World Bank-IF Joint Management Action Plan			
Title	**Products**	**Timing of Missions**	**Expected delivery date**
A. Mutual information on relevant work program in next 12 months			
Bank work program	CEM on export competitiveness and regional integration	Feb-May 2008	June 2009
	PRSC6 supporting government reforms program in PFM, PSR and economic development reforms		November 2009
	Updated poverty analysis using the 2008/09 household survey		February 2010
	FSTAP project support to financial sector reforms		ongoing
Fund work program	Fifth PSI and First ESF Review	Sep-09	Dec-09
	Sixth PSI and Second ESF Review	Mar-10	Jun-10
B. Requests for work program inputs with summary justification			
Bank request to the Fund	Updated Macro Framework data and PSI review Staff Report	PSI reviews	December 2009 - April 2010
	Board Chairman Summing up from PSI review discussion (or Assessment letter) not older than six-months		December 2009
Fund request to the Bank	Updates on advancing structural reforms: procurement, decentralization, business environment, financial sector		December 2009 to June 2010
C. Agreements on joint products and missions			
Joint products	DSA	End-2009	Early 2010
	FSAP	February 2009	May 2009 (delivered)
	PFM: update work plan for 2009-11 in light of findings from PEFA and ROSC		October 2010
	PFM: continue to monitor consolidation and expansion of e-SISTAFE.	ongoing	ongoing
	Policy advice on Public Sector Salary Reforms (incl. pensions)	ongoing	ongoing
	Review of tax policy	tbd	tbd

MOZAMBIQUE: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance. 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). The authorities are making efforts to improve the quality and timeliness of economic and financial data through participation in the Fund's General Data Dissemination System (GDDS) and in the external sector module of the GDDS Project for Anglophone African Countries (funded by the U.K. Department for International Development (DFID)). GDDS metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since November 2003.

2. In May 2005, a STA mission updated 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 previously identified shortcomings. 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 should help to address weaknesses in the prerequisites for the quality of the statistics. The methodological soundness, accuracy, and reliability of macroeconomic statistics are starting to show improvements as a result of these actions.

National accounts

3. The national accounts are prepared by the INE in accordance with the *1993 System of National Accounts* (*1993 SNA*). In August 2007, the INE released for the first time quarterly GDP estimates at constant prices covering 2000–07, along with a revised annual GDP series for the period 1991–2006, having 2003 as the new base year. A (March–April 2008) STA mission advised the authorities on further improvements needed to advance the quarterly national accounts compilation at current prices, that could be released starting in mid-2009. The INE has launched a new household income and expenditure survey and new economic censuses leading to a new business registry. Furthermore, it is compiling more comprehensive and timely foreign trade data based on improved classification systems.

Prices and labor market

4. A revamped consumer price index for Maputo based on weights derived from the 2002–03 household survey was released in February 2006. A national index obtained by integrating the indices for Maputo, Beira, and Nampula was released in April 2006. A STA mission in June 2006 found important advances regarding the use of the COICOP classification and the strengthening of human resources in the compilation of the CPI. Several issues remain outstanding, however, such as price collection procedures not fully consolidated at the provincial level, imputation methods, and possible inconsistencies in the overlapping period between the new and old series.

5. 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.

Monetary statistics

6. A STA mission in September 2004 prepared a work plan for the implementation of the *Monetary and Financial Statistics Manual (MFSM*) and the development of an integrated monetary database (IMD) to meet the needs of the Bank of Mozambique (BM), AFR, and STA. The mission recommended improving the classification and valuation of some financial instruments, estimating the full instrument and sectoral breakdown based on available information, and expanding the coverage of the survey on other depository corporations to include credit cooperatives.

7. A follow-up monetary and financial statistics mission in November 2007 assisted the authorities in finalizing the IMD, which allow the derivation of accurate and timely monthly monetary statistics, while reducing BM's reporting burden. Mozambique now reports monthly monetary data to STA using the standardized reporting forms (SRFs). As a result, five-year historical enhanced data are being published in the *International Financial Statistics (IFS) Supplement*.

External sector statistics

8. With assistance from STA, provided in the context of the GDDS regional project, the 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 *Balance of Payments Manual, fifth edition* (*BPM5*).

9. 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 institutional capacity building to be consolidated, the Foreign Exchange Law has to be approved (incorporating the definition of residency in line with the *BPM5* methodology), training on BOP statistics has to be sustained, and the project to computerize the balance of payments compilation system has to be completed. Although, major improvements were achieved in the basic data sources since the beginning of the project, remaining concerns include (i) the coverage and quality of the data obtained in the enterprise surveys; (ii) the quality of external trade data, especially with regard to price and volume indices; (iii) the coverage, time of recording, and classification of the data on foreign investment and private loans; (iv) completeness of data for the International Reserves Template and their reconciliation with the reserve component of the balance of payments; and (v) compiling the IIP using the sources that are used for the balance of payments compilation. To improve the collection, timeliness, and quality of merchandise trade data, a panel on foreign trade

statistics was established, comprising representatives from the Directorate General of Customs, National Statistics Institute, and BM.

10. In 2007, the BM started to compile and report to the STA comprehensive IIP data. Previously, only partial IIP data had been reported and published in the *Balance of Payments Statistics Yearbook*.

Government finance statistics

11. A July 2005 STA mission found serious weaknesses in fiscal statistics. The budget accounting system, broadly aligned to the *GFSM 1986* analytical framework, had shortcomings relating to: definitions and coverage of institutional units included in the general government sector; budgetary classifications not fully meeting GFS needs; and the omission of certain revenues and expenditures. Moreover, data on arrears are not collected and compiled systematically. 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
(As of October 15, 2009)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	Aug. 2009	Sep. 2009	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Aug. 2009	Sep. 2009	D	W	D		
Reserve/Base Money	Aug. 2009	Sep. 2009	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Aug. 2009	Sep. 2009	M	M	M		
Central Bank Balance Sheet	Aug. 2009	Sep. 2009	M	M	M		
Consolidated Balance Sheet of the Banking System	July 2009	Aug. 2009					
Interest Rates[2]	Aug. 2009	Sep. 2009	M	M	M		
Consumer Price Index	Aug. 2009	Sep. 2009	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	July 2009	Aug. 2009	M	Q	Q	LO, LNO, LO, O	LO, O, LO, O, LNO
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec.2008	May. 2009	Q	Q	Q		
External Current Account Balance	June. 2009	Sep. 2009	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services	June. 2009	Sep. 2009					
GDP/GNP	2009 Q2	Sep. 2009	Q	Q	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt	Dec. 2008	Mar. 2009	A	I	I		
International Investment Position [6]	2007	May 2009	A	A	A		

[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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), and Not Available (NA).
[9] Reflects the assessment provided in the data ROSC or the Substantive Update 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); not observed (NO); and not available (NA).

Press Release No. 09/450
FOR IMMEDIATE RELEASE
December 8, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes the Fifth Review Under the Policy Support Instrument and the First Review Under the Exogenous Shocks Facility for Mozambique

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review under the three-year Policy Support Instrument (PSI) and the first review under the one-year Exogenous Shocks Facility (ESF). The completion of the first review under the ESF makes available a disbursement of SDR 14.2 million (about 22.6 US million dollars). The Board's decision was taken on a lapse of time basis.[1]

After a prolonged period of robust macroeconomic performance, Mozambique has been adversely affected by the global economic crisis. Nonetheless, the economy has shown unexpected resilience, partly because of the authorities' prompt response to temporarily ease macroeconomic policies. Growth, which averaged 7½ percent over the past three years, is expected to weaken to 4½ percent in 2009. Policy implementation has remained strong and broadly in line with the program. Most of the key quantitative targets for end-June 2009 were met —though net credit to the government and reserve money growth were higher than envisaged—and there has been good progress in implementing structural reforms.

Economic performance is expected to improve in 2010 in tandem with the global economic recovery, with a projected growth rate of 5½ percent. The stronger economic activity should allow the authorities to start unwinding the temporary fiscal and monetary policy stimulus. The authorities reiterated their commitment to their medium-term strategy of prudent macroeconomic policies and structural reforms to support private sector development.

The PSI for Mozambique was approved on June 18, 2007 (See Press Release No. 07/135) to support the country's economic reform efforts. It is aimed at consolidating macroeconomic stability and at achieving sustained economic growth and poverty reduction. The strategy to achieve this goal remains set in the Mozambican authorities' national poverty reduction strategy, *Plano de Acção para Redução da Pobreza Absoluta* (PARPA II).

[1] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

The ESF in the amount of SDR 113.6 million was approved on May 29, 2009 (see Press Release No. 09/247), and SDR 85.2 million was disbursed on approval. The ESF is designed to provide policy support and financial assistance on concessional terms to eligible low-income countries facing temporary exogenous shocks. The IMF financing for Mozambique was approved to help offset the deterioration of its balance of payments.