INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/223

REPUBLIC OF MOZAMBIQUE

August 2015

FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR MODIFICATION OF ASSESSMENT CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF MOZAMBIQUE

In the context of the fourth review under the Policy Support Instrument and request for Modification of Assessment Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 1, 2015, following discussions that ended on May 8, 2015, with the officials of the Republic of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 16, 2015.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Mozambique.

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 IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 15/315
FOR IMMEDIATE RELEASE
July 2, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Policy Support Instrument for Mozambique

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Mozambique's economic performance under the program supported by the Policy Support Instrument (PSI).[1] In completing the review, the Board also approved the modification of three assessment criteria and one indicative target for June 2015 in line with the updated economic outlook for Mozambique.

The PSI for Mozambique was approved by the Executive Board on June 24, 2013 (see Press Release No. 13/231)

Following the Executive Board's discussion, Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"Mozambique's continued strong growth performance and low inflation are commendable. Investments in large coal and natural gas projects underpin a positive medium-term outlook, but low commodity prices have increased near-term risks.

"Recent program performance under the Fund's Policy Support Instrument has been mixed. While structural reforms have been proceeding, there were macroeconomic policy slippages and reserve losses in late 2014. With a strong fiscal adjustment envisaged in the current budget and a recent tightening of liquidity conditions, needed steps to maintain macroeconomic stability are now in place. The decline in international reserves has largely been reversed, and greater exchange rate flexibility will help the economy to better respond to external shocks in the period ahead.

[1] The PSI is an instrument of the IMF designed for countries that do not need balance of payments financial support. The PSI helps countries design effective economic programs that, once approved by the IMF's Executive Board, signal to donors, multilateral development banks, and markets the Fund's endorsement of a member's policies (see http://www.imf.org/external/np/exr/facts/psi.htm). Details on Mozambique's PSI program are available at http://www.imf.org/mozambique.

"The strong fiscal adjustment in the budget appropriately calls for revenue mobilization and expenditure restraint, while safeguarding social programs. Recent fiscal reforms have strengthened the policy framework but more needs to be done to improve public financial management, including by stronger controls over state-owned enterprises and enhanced management of fiscal risk.

"Ongoing progress on a broad range of structural reforms, including the passage of the new mining and hydrocarbon legislation, is encouraging. Nonetheless, further measures are needed to make poverty more responsive to growth and strengthen the business climate."

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

June 16, 2015

FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR MODIFICATION OF ASSESSMENT CRITERIA

KEY ISSUES

Context and policy challenges. The economic outlook remains positive. Growth is expected to reach 7 percent in 2015 and inflation to remain low. Substantial policy adjustment is underway to respond to slippages around the elections and new balance of payment pressures from low commodity prices. Fiscal adjustment, greater exchange rate flexibility and stronger liquidity management are essential to preserve macroeconomic stability and continue to attract foreign investment to support growth, including in the oil and gas sector where projected investments could reach $100 billion over the next decade.

Short-term policy framework. Preserving fiscal sustainability and rebuilding buffers against balance of payment shocks are key priorities. The 2015 budget appropriately places public finances on a more sustainable path, with an implied fiscal adjustment of over 3 percent of GDP. The Bank of Mozambique is committed to greater exchange rate flexibility, strengthening liquidity management and building international reserve buffers. Key structural reform priorities include improving VAT administration, strengthening capacity for transparent public investment management, and deepening financial sector reforms.

Medium-term reforms. Maintaining fiscal discipline over the medium term through a more prudent debt management strategy will be essential to preserve debt sustainability. This will require measures to contain current spending pressures and greater rigor and transparency in the analysis and selection of public investment projects. Structural reforms focusing on public financial management, modernization of the framework for monetary policy and further improving the business environment should be implemented vigorously to sustain growth and render it more inclusive.

Staff supports completion of the review. While program performance at end-2014 was mixed, the implementation of the structural reform agenda has improved and the new government has expressed strong commitment to program implementation, including through strong policy adjustment, credible corrective measures, and new steps to improve fiscal transparency.

Approved By
David Robinson and Ranil Salgado

A staff team comprising Mr. Segura-Ubiergo (mission chief and resident representative), Messrs. Xiao, Inui, Medina (all AFR), and Henn (SPR) visited Maputo during April 27-May 8, 2015. The mission met with Ministers Maleiane (Economy and Finance), Couto (Natural Resources and Energy), Mesquita (Transports and Communications), Bank of Mozambique Governor Gove and other senior government officials. The mission also met with development partners and representatives of civil society, and the private sector. It was assisted by Ms. Palacio and Messrs. Simione and Sousa (resident representative office). Messrs. Tivane (OED) and Revilla and Blanco Armas (World Bank) participated in some of the policy discussions. Mr. Robinson (AFR) joined the mission during the second week.

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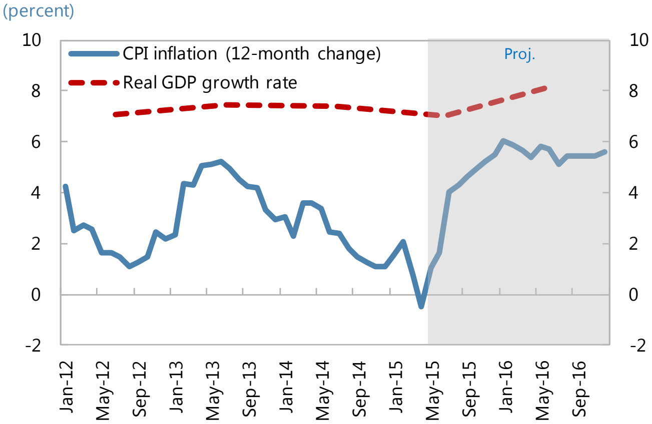
BACKGROUND AND RECENT DEVELOPMENTS

1. **The political situation after the October 2014 elections is stable though some political tension has reemerged in recent months.** The renewal last September of the peace agreement that had ended the civil war two decades ago paved the way for peaceful elections and President Nyusi was sworn into office in January. However, tensions have reemerged as the main opposition party (Renamo) contested the results and initiated a call for political decentralization. The new government has expressed strong commitment to the PSI-supported program.

2. **Strong growth and low inflation continued in 2014.** Real GDP expanded by 7.4 percent led by financial services, extractive industries, and agriculture. A large fiscal expansion also supported activity in other key sectors, including construction. End-year inflation fell to one percent thanks to a stable exchange rate against the South African rand, low food prices, and stable administered prices (fuels, public transportation, and utilities). The depreciation of the metical against the US dollar, and long overdue adjustments in some administered prices are likely to push inflation up in the second half of 2015.

MEFP ¶2

Mozambique: GDP growth and CPI inflation projections
(percent)



3. **Fiscal policy was highly expansionary in 2014, with the overall fiscal deficit increasing from 2.8 to 10.4 percent of GDP, notwithstanding continued strong revenue performance.** The domestic primary balance worsened from a surplus of 0.9 percent of GDP to a deficit of 4.1 percent. One-off factors explain about half of the fiscal loosening, with electoral spending accounting for 0.9 percent of GDP, and the inclusion in the budget of the non-commercial spending of EMATUM representing 2.8 percent of GDP (see Box 1).

4. **Pressures emerged in the foreign exchange market in late 2014 and net international reserves (NIR) declined.** Lower international commodity prices hit exports and FDI, and the supply of dollars dried up while imports (excluding megaprojects) remained sticky, as fuel import arrangements delayed the beneficial effects for Mozambique of lower international fuel prices. Uncertainties surrounding the elections may also have increased incentives to hold dollars by private economic agents. In an attempt to stabilize the foreign exchange market, the Bank of Mozambique (BM) intervened heavily. NIR declined by $600 million, and the metical depreciated by 14.4 percent versus the US dollar between September 2014

and March 2015.[1] Conditions started to normalize in the second quarter of 2015, as political uncertainty abated, seasonal inflows of dollars returned, and the BM moderated its interventions.

5. Program performance has been mixed.

- **Three end-December assessment criteria were not met.** Net credit to the government (NCG) and reserve money exceeded the program targets by small margins. The slight deviation in reserve money growth did not have macroeconomic consequences as inflation remained well below the BM's target range. Similarly, the NCG target was missed by a small margin as the authorities compensated with domestic financing some delays in foreign disbursements for public investment projects. However, the December 2014 NIR target was missed by a large margin ($265 million). The December indicative target on priority spending was not met due to delays in the execution of some externally-financed projects, but the scope of priority spending is being redefined to make the target more effective (Annex II). Foreign exchange market pressures continued through March 2015, and the indicative target on NIR was missed by $478 million. The March target on NCG was met, while the reserve money target was missed again by a small margin.

Program Performance

	Dec 2014 AC	Mar 2015 IT
Assessment Criteria		
Net credit to the government	▲	●
Stock of reserve money	▲	▲
Stock of net international reserves	▲	▲
Nonconcessional external debt	●	●
Stock of short-term external public debt	●	●
External payments arrears	●	●
Indicative Targets		
Government revenue	●	●
Priority spending	▲	…

● met ▲ not met

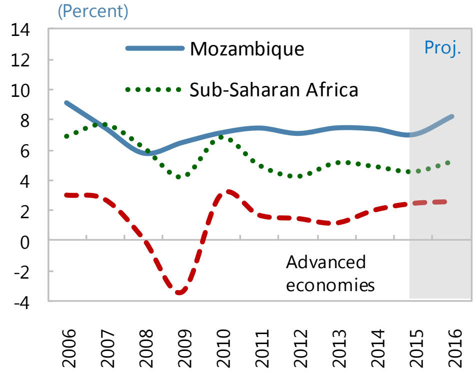
- **The structural reform agenda is on track.** The March structural benchmark on the securitization of a stock of MT 8.2 billion (1.5 percent of GDP) in outstanding VAT refunds was met, and the 2015 budget included a rule on the use of windfall revenues (June benchmark). Other structural reforms are also advancing. The May benchmark on public investment project evaluation requirement was not met, and is proposed to be rephased to July to align it with the budget preparation cycle, while the June benchmark on the IT application for e-tax is on track.

[1] The BOP financial account excluding megaprojects, which is more pertinent to analyze pressures on the domestic foreign exchange market, suggests that there was no large-scale capital flight. The $1.4 billion of other financial account outflows reported in Table 5 was driven by shifts in offshore deposits between megaprojects and their parent companies.

Figure 1. Mozambique: Impact of Global Developments

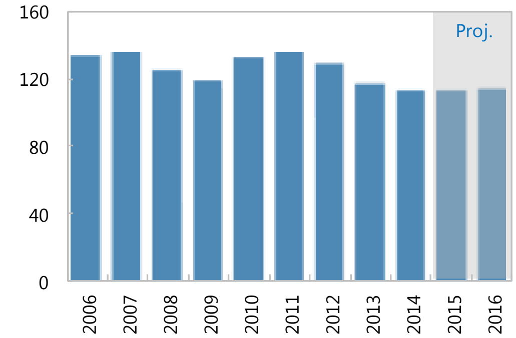
Mozambique's growth outlook remains robust, outperforming other SSA countries.

Real GDP Growth
(Percent)



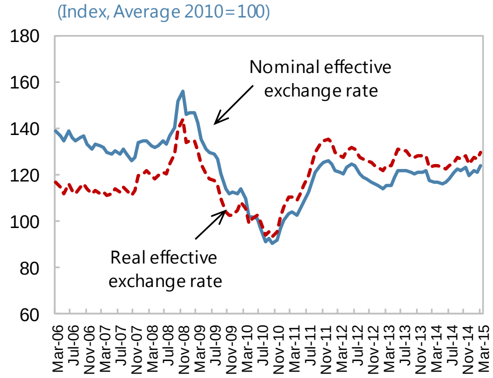
Terms of trade gains reversed since 2011 due to weakening international commodity prices…

Terms of Trade Index
(2005=100)



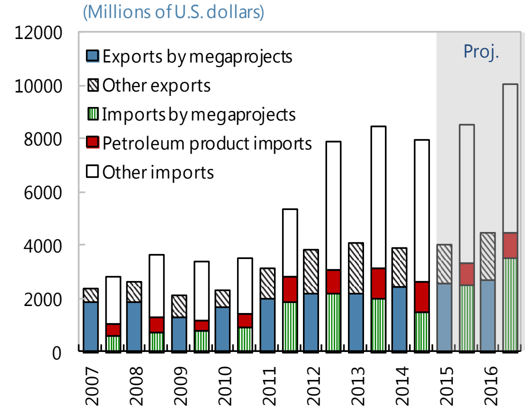
…while the metical has been broadly stable since 2012 in a low-inflation environment.

Nominal and Real Effective Exchange Rates
(Index, Average 2010=100)



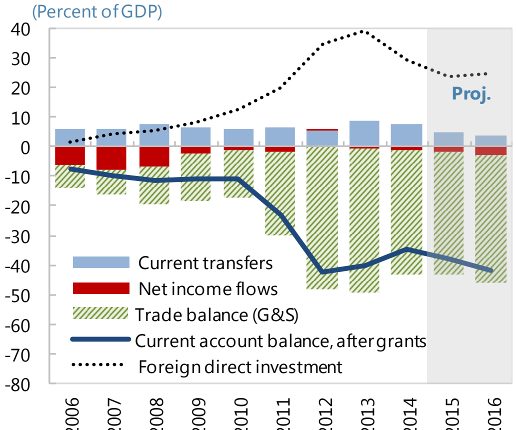
While overall trade deficit has narrowed, the non-megaproject trade deficit has increased due to lower export prices and sizeable fuel imports.

Merchandise Trade
(Millions of U.S. dollars)



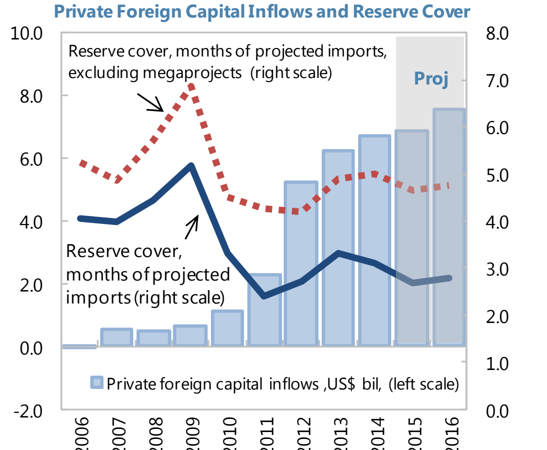
The current account deficit remains large, but continues to reflect sizeable investment imports by the natural resource sector since 2011-12.

Current Account Balance and Foreign Direct Investment
(Percent of GDP)



The overall reserve cover declined markedly in 2014, but a large fall in megaproject imports kept reserve coverage (excl. megaprojects) at a still reasonable level.

Private Foreign Capital Inflows and Reserve Cover

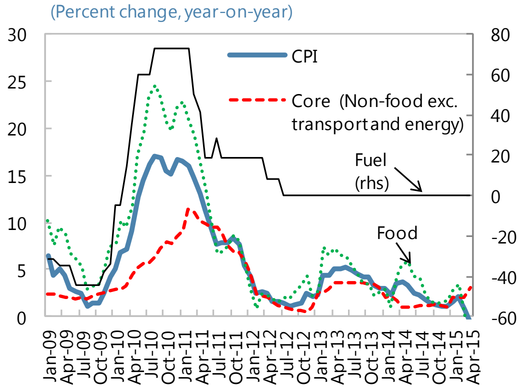


Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 2. Mozambique: Inflation and Monetary Developments

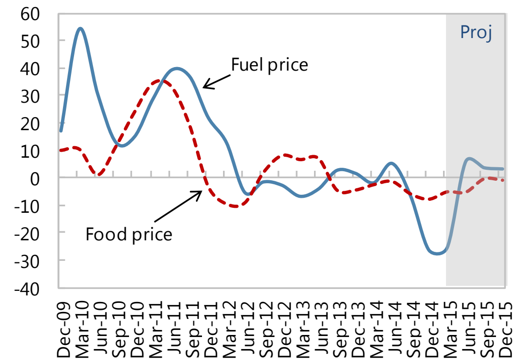
Inflation has remained well-contained since 2012…

CPI and Components
(Percent change, year-on-year)



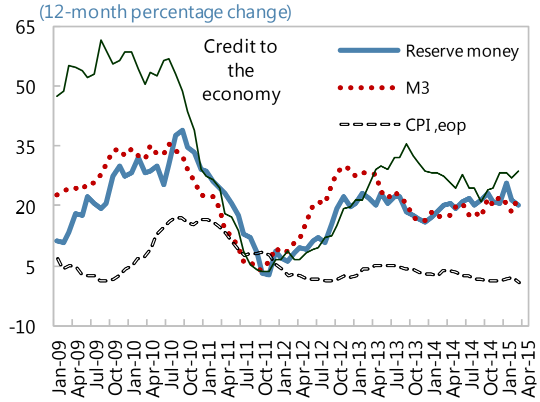
supported by favorable developments in international food prices.

International Food and Fuel Price Change
(Percent change, year-on-year)



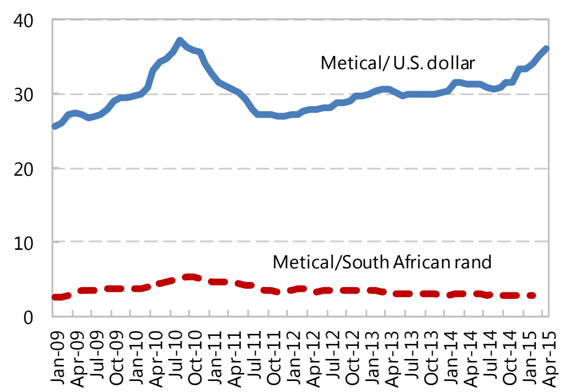
Strong private sector credit growth signals financial deepening, but loose money growth since 2012 may generate some inflationary pressures.

Money, Credit and Inflation
(12-month percentage change)



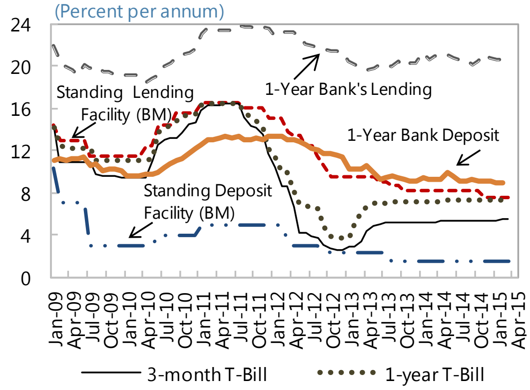
The Mt/$ exchange rate remained relatively stable since early 2012 but started to depreciate in 2014Q4, while the rate against the rand has appreciated slightly.

Bilateral Exchange Rates



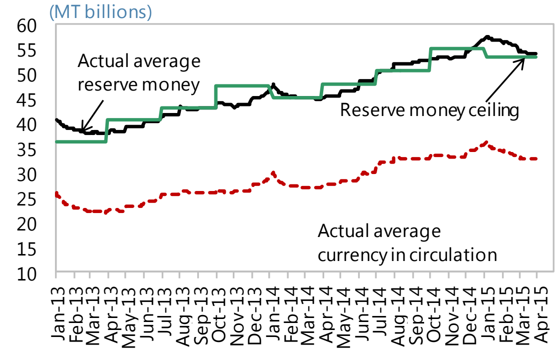
The Central Bank's policy rates and the T-bill rates have been stable, but banks' lending rate remains very high.

Interest Rates
(Percent per annum)



Reserve money exceeded its program targets slightly in December 2014 as currency in circulation picked up.

Reserve Money
(MT billions)

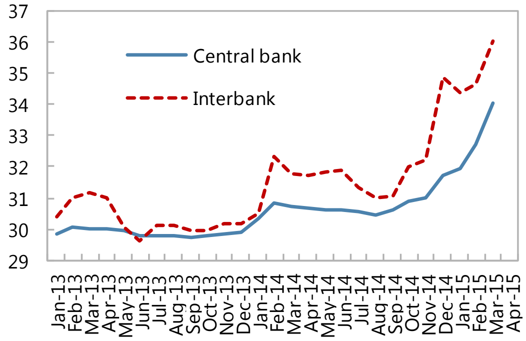


Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 3. Mozambique: Selected External Sector Developments

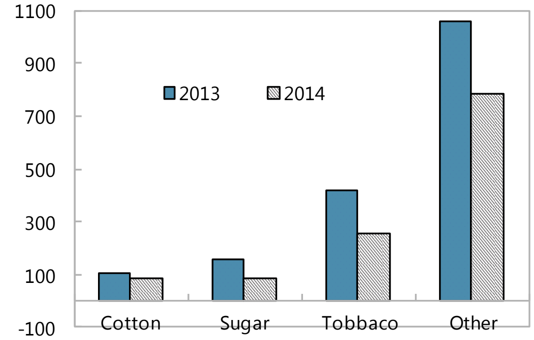
Significant exchange rate pressure emerged in the foreign exchange market in 2014Q4 …

Nominal Exchange Rate
(Metical/U.S. dollar)



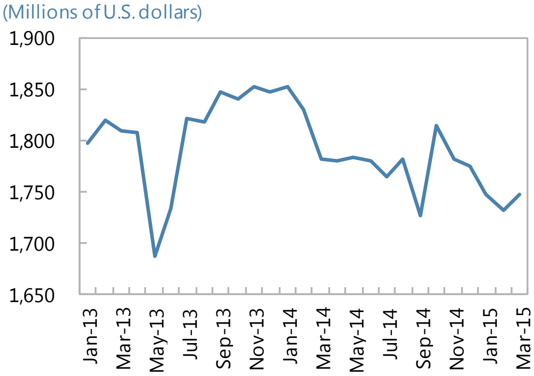
due to a substantial fall in traditional exports,…

Selected Traditional Exports
(Millions of U.S. dollars)



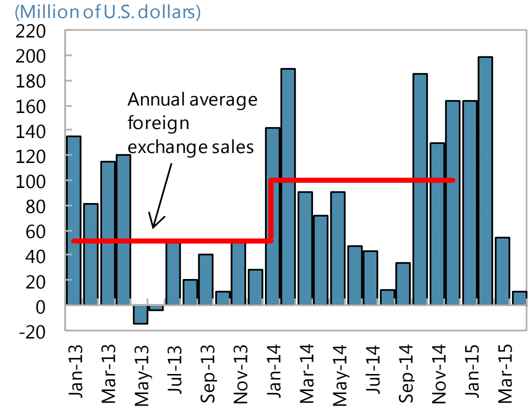
… while dollar deposits in the banking system declined.

Banks Foreign Currency Deposits
(Millions of U.S. dollars)



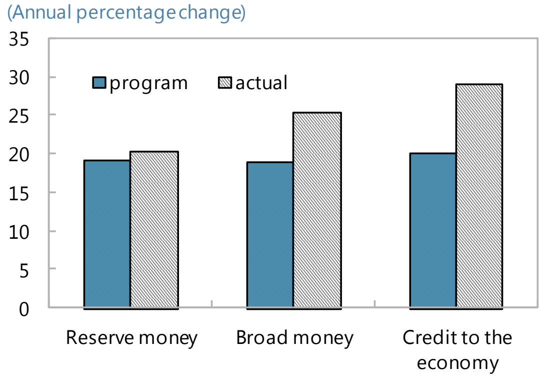
And the central bank intervened aggressively in the foreign exchange rate market….

Net Central Bank Foreign Exchange Sales
(Million of U.S. dollars)



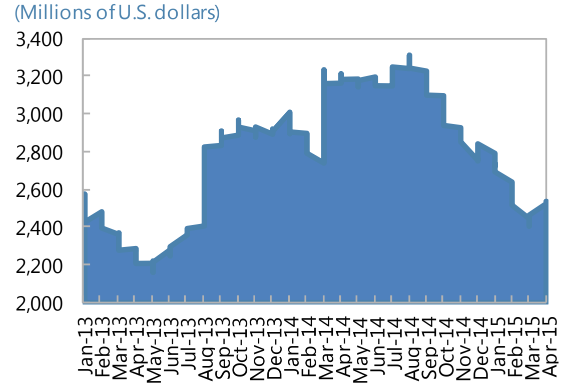
…at a time when reserve money, broad money and credit to the economy were expanding excessively fast,

Monetary Aggregates at end-March 2015
(Annual percentage change)



… leading to an unprecedented loss of international reserves.

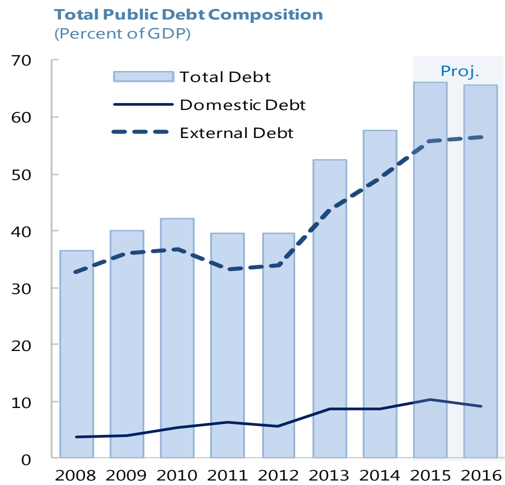
Net International Reserves
(Millions of U.S. dollars)



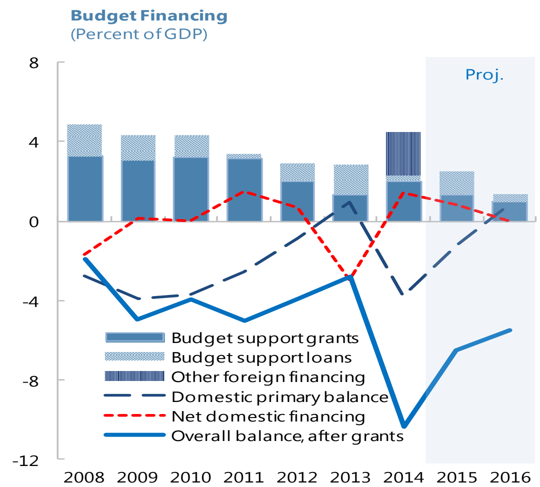
Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 4. Mozambique: Fiscal Developments

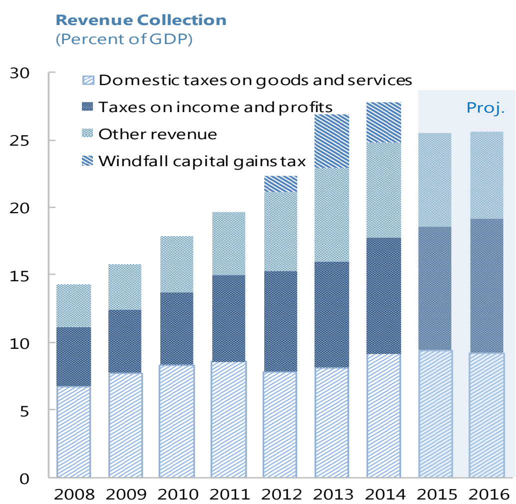
Public Debt has been rising fast since 2012…



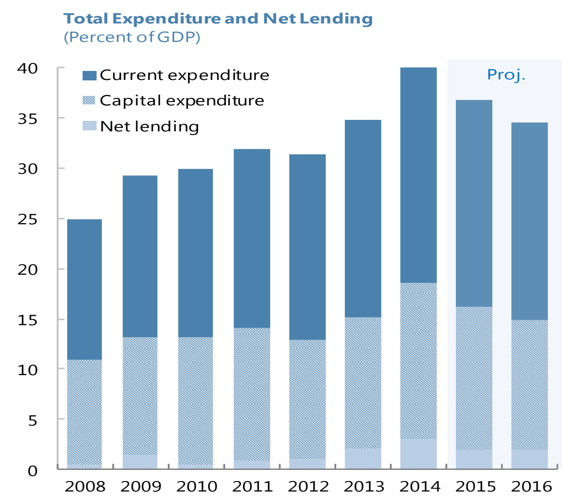
And the overall fiscal stance deteriorated markedly in 2014…



Large windfall revenues in 2013-2014…



Were used to finance a sharp increase in expenditure, generating a serious need for consolidation beginning in 2015.



Sources: Mozambican authorities and IMF staff estimates and projections.

ECONOMIC OUTLOOK AND POLICY DISCUSSIONS

Discussions focused on updating the economic outlook and the macroeconomic policy mix. The main objectives are to reverse the recent rapid expansion of government expenditure and external borrowing in order to maintain fiscal sustainability, adjust economic policies to help rebuild international reserves, and reinvigorate the structural reform agenda.

A. Outlook and Risks

MEFP ¶5

6. Mozambique's economic outlook remains positive. Growth of 7 percent is expected in 2015, revised down by ½ percent mainly due to the impact of the floods earlier in the year, though the negative impact on agricultural production was less severe than initially anticipated. Despite the sizable fiscal adjustment[2], growth in 2015 is projected to remain strong, supported by buoyant activity in the transport, communications, and service sectors. The expansion in mining production is expected to slow down due to low international commodity prices. In the medium term, growth is projected to remain in the 7½-8 percent range, supported by large natural gas projects. In spite of the depreciation of the metical during the first quarter of 2015, the acceleration of inflation in 2015 is expected to remain moderate due to the quick recovery from the floods, low international prices, and the tightening of policies during the year.

Mozambique: Mining Sector Indicators

	2002-11 Average	2012	2013	2014	2015 Proj.	2016 Proj.
	(In percent, unless otherwise stated)					
Mining GDP (nominal, in MT million)	3,422	13,333	15,405	16,823	18,559	23,173
Mining GDP (share in total nominal GDP)	1.3	3.1	3.3	3.2	3.1	3.4
Mining real growth	20.4	65.5	13.8	13.0	5.0	18.2
Mining contribution to total GDP growth (in percentage points)	0.2	1.1	0.4	0.4	0.1	0.5
Memorandum items:						
Total real GDP growth	7.6	7.1	7.4	7.4	7.0	8.2
Non-mining real GDP growth	7.5	6.1	7.3	7.4	7.1	7.9

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

7. Economic risks have increased but remain manageable. If the global coal prices fall further than the baseline assumptions, the expansion plans in the coal mines could be threatened. This would dampen growth in 2016 by as much as ½ percentage point. However, despite the decrease in global gas prices, the main oil and gas companies (Anadarko and ENI) remain confident in the feasibility of their projects.[3] The current account deficit is expected to hover around 40-50 percent of GDP over the next 4-5 years with the construction of gas liquefaction plants, but it does not present a significant balance of payment risk as the construction is financed by foreign direct investment and private funding through offshore special purpose vehicles (SPVs). These SPVs will mobilize the large financing required, process

[2] The fiscal multiplier is expected to be low as most of the fiscal adjustment falls on public investment, which has a high import content, and government's efforts to increase cost efficiency and value-for-money in public procurement, where there is substantial scope to generate savings through greater use of competitive tenders.

[3] As liquefied natural gas (LNG) production is expected to start only in 2020-21, these developments have little effect on fiscal revenues in the near term, but could improve substantially the debt sustainability outlook as fiscal revenues expected from these projects could reach $1 trillion over a period of 30-40 years.

loan repayments, handle contracts with LNG clients, and collect and distribute export receipts according to contractual arrangements, where the government will obtain 65-70 percent of the net revenues once the projects reach maturity. Over the medium term, growth will have to be more inclusive to be sustainable. The elasticity of poverty to growth is very low by international standards and employment opportunities remain limited beyond large corporation in booming sectors of the economy.

8. A debt sustainability update indicates that the external debt risk rating remains moderate. All variables remain below the relevant thresholds in the baseline scenario but several breach thresholds under various shock scenarios (see DSA update).

B. Fiscal Policy and Reforms

9. The 2015 budget places public finances on a more sustainable path. The overall fiscal deficit (after grants) is envisaged to decline to 6.5 percent of GDP—a level that is estimated to stabilize public debt[4]—and the domestic primary balance will improve by about 2.7 percent of GDP. Fiscal adjustment is driven by a reduction of about 2.6 percent of GDP (excluding one-off factors) in public spending. A substantial part of the fiscal adjustment will fall on public investment. This is appropriate given the high levels of public investment (15½ per-cent of GDP in 2014) and the limited progress achieved so far to improve the system of public investment management. As public investment has a high import content, this should reduce foreign exchange pressures and mitigate the potentially negative impact of fiscal consolidation on domestic demand.

MEFP ¶9

Mozambique: Key Fiscal Indicators

	2012	2013	2014			2015		2016
	Act.	Act.	3rd Rev. CR15/12	Prel.	Neutral	3rd Rev. CR15/12	Proj.	Proj.
	(Percent of GDP, unless otherwise stated)							
Total revenue	22.4	26.9	27.3	27.8	24.8	25.4	25.5	25.7
of which capital gain tax	1.2	3.9	3.1	3.1	0.0	0.0	0.0	0.0
Total expenditure and net lending	31.4	34.9	42.0	43.3	39.5	36.4	36.9	34.6
of which current expenditures	18.5	19.7	24.1	24.3	20.6	20.4	20.7	19.7
of which maritime security	0.0	0.0	1.9	2.8	0.0	0.0	0.0	0.0
Overall balance, before grants	-9.1	-8.1	-14.7	-15.4	-14.7	-11.1	-11.4	-8.9
Grants	5.2	5.3	4.0	5.1	5.1	3.6	4.9	3.4
Overall balance after grants	-4.0	-2.8	-10.6	-10.4	-9.7	-7.5	-6.5	-5.5
Net external financing	3.3	5.8	9.4	8.9	6.0	6.4	5.7	5.4
Net domestic financing	0.7	-3.0	1.2	1.4	3.7	1.1	0.8	0.0
Memorandum items:								
Domestic primary balance	-1.0	0.9	-2.9	-4.1	-3.6	-0.9	-1.2	0.8
Real GDP growth (percent)	7.1	7.4	7.4	7.4	7.4	7.0	7.0	8.2
Average CPI inflation (percent)	2.1	4.2	2.3	2.3	2.3	4.0	4.0	5.6

Sources: Mozambican authorities and IMF staff estimates and projections.

[1] IMF Neutral adjusts for one-off receipts and expenses. Revenues exclude USD 520 million capital gain taxes for the natural resource sector (or 3.1 percent of GDP), while expenditures exclude one-off maritime security spending of 2.8 percent of GDP (EMATUM, see Box 1), and temporary election-related expenditures (0.8 percent of GDP).

Tax Revenue

10. Total revenues are projected to expand by 0.7 percent of GDP in 2015[5]. This reflects ongoing efforts to improve tax administration, which have generated annual average increases of

[4] Excluding the effects of exchange rate movements and the one-off securitization operation to clear VAT arrears.

[5] This increase is based on an analysis that compares revenue effort in 2015 (measured by total revenues) compared with revenue collections in 2014 excluding one-off factors (i.e. exceptional capital gain taxes). For the purposes of comparing underlying fiscal trends, the appropriate comparison is between projections for 2015 and

(continued)

1¼ percentage of GDP over 2010-14, excluding windfall taxes. Revenue mobilization efforts will include reforms to broaden the taxpayer base, an expansion of the electronic tax payment (e-Tax) system, enhanced tax audits, and modernizing the Tax Authority to improve its efficiency.

11. Good progress continues to be made in strengthening tax administration:

- **The stock of valid VAT refund arrears as of end-2014 (MT 8.2 billion) was securitized through a private placement of Treasury bills (structural benchmark for March 2015).** The operation was well received by the private sector as the VAT refund backlog had become a serious concern, especially for commodity exporters that were facing a liquidity crunch with the fall in commodity prices. Staff stressed that the government needs to continue to strengthen VAT administration to avoid further refund backlogs.

MEFP ¶24

- **An ex-ante rule for the use of windfall revenue was included in the 2015 Budget Law** (structural benchmark for June 2015). The rule seeks to ensure the use of these resources only for public investment, debt repayment, and national emergencies. Staff welcomed this measure, as it will help manage more prudently than in the past any new capital gain taxes associated with transfers of ownership stakes in large natural resource projects that might occur. The authorities agreed with staff on the importance of developing an effective medium-term fiscal framework with a more formal fiscal anchor to guide the allocation of resources.

MEFP ¶22

Expenditure Policy

12. Total expenditure in the 2015 budget is 6.4 percent of GDP lower than in 2014 (or 2.6 percent of GDP lower excluding one-off factors).

MEFP ¶11

- **The government plans to reduce the wage bill by 0.5 percent of GDP in 2015** through a deceleration in the pace of new hiring and enhancing controls on salary payments.

- **Public investment projects will be subject to more rigorous evaluation procedures to enhance investment efficiency and ensure greater value for money.** No project exceeding $50 million will be authorized for inclusion in the multi-year list of priority investment without a prior feasibility study from the sectors and a technical evaluation by the Ministry of Economy and Finance.

- **Fiscal adjustment will proceed without negatively affecting critical social programs,** as priority spending still accounts for 63.5 percent of total expenditure in the 2015 budget (see Annex II).

the column "neutral" (text table), which excludes one-off factors and therefore provides a proxy of structural revenues.

Fiscal Transparency and Risk Management

13. The authorities are strengthening their supervision of enterprises with state participation. This includes legislative initiatives to strengthen controls, enforcement of requirements to publish annual reports, and a new system to track and monitor financial information. Transparency around the operations of EMATUM has also improved (Box 1).

MEFP ¶32

14. The government published the Fiscal Transparency Evaluation (FTE) and is committed to implementing its recommendations, including through improved management of fiscal risks[6]. The 2015 budget started reporting information on potential sources of fiscal risk, including a list of PPPs. The government will prepare a new annex on fiscal risks for inclusion in the 2016 budget, covering general fiscal risks associated with potential changes in key underlying macroeconomic assumptions and specific risks from public and publicly guaranteed debt, PPPs and SOEs. The creation of a fiscal risk unit will also support this objective in the future.

MEFP ¶21

[6] While the report covered a number of areas, fiscal risk management was identified as one the greatest weaknesses and source of fiscal transparency issues.

Box 1. Fiscal Transparency: Lessons and Reforms Triggered by the EMATUM Case

Background. In 2013 a newly created public sector tuna fishing company (EMATUM) obtained an $850 million loan from international banks. The loan was guaranteed by the government and was repackaged as private loan participation notes to international investors in September 2013.[1] The project integrated a focus on tuna fishing (where the country only had one vessel fishing with a Mozambican flag) with a maritime security component (protecting the coast against piracy and securing the future investments in the oil and gas sector). The project was not part of the official list of priority public investments (Integrated Investment Plan), and the government guarantee breached the ceiling set in the Budget Law. The feasibility study only covered part of the loan ($500 million) and underlying assumptions were overly optimistic. Procurement proceeded without tender through a turn-key proposal from a single source (Privinvest/Abu Dhabi Mar). The lack of transparency surrounding the project raised serious governance concerns.

Corrective Actions. The government took steps to address these concerns starting in late 2013. Parliament requested that the non-commercial part of the operation (which included purchases for maritime security) should be incorporated in the 2014 budget documents, and it authorized an increase in the ceiling for guarantees to regularize the initial transaction. The Audit Court then certified the amount that had been spent through the procurement contract and the government started to disclose information on guarantees in budget reports. EMATUM published its 2013 audited financial accounts in December 2014. In May 2015, additional steps were taken: the audited 2014 accounts were published ; the authorities increased the maritime security component associated with the initial loan from $350 million to $500 million, and amended fiscal tables and the general government account ledger(*Conta Geral do Estado*) to be sent to the Audit Court.

Lessons from the Operation. While the loan to EMATUM did not follow adequate procedures, over time it generated a healthy debate with Parliament, civil society, and donors about how the government sets its priorities. With one of the longest coast lines in Africa, the need for a coastal patrol force to protect critical infrastructure for the gas sector (and more generally against risks of piracy) could have been justified as a priority project, but it should have competed more transparently with other key projects given Mozambique's massive development needs. If approved, procurement for the project should have proceeded on a competitive basis by looking at various cost options to obtain the necessary equipment, rather than granting the contract to one supplier and paying in advance. Stepping back, the decision to set up a public sector tuna fishing company without tangible private investment seems more questionable: if this was a viable business opportunity, the private sector could have pursued the project without requiring a government guarantee. Going forward, the government will need to restructure the debt of EMATUM, taking over in full the maritime security component ($500 million), and re-assessing whether the company will be able to service the rest of the loan ($350 million). EMATUM thus remains a source of substantial fiscal risk. Attracting private capital, through partial or full privatization, should be considered as an option to limit potential losses to the government.

[1] The initial loan carried an interest rate of 6.3 percent; the notes were sold at a discount (around 8 percent). In its report, the Audit Court indicated that the value of the goods procured amounted to $762 million, while administrative fees, commissions and other costs were about $88 million.

C. Monetary and Exchange Rate Policies and Financial Sector Reforms

15. **Policy adjustment is needed to rebuild international reserves buffers.** Intervention in late 2014 and early 2015 provided liquidity and reduced turbulence in the foreign exchange market in light of a weaker BOP and uncertainty around the elections. However, staff expressed concern about the magnitude of the intervention, noting that some exchange rate flexibility would have limited reserve losses and would have been justified by movements in international currency markets—while the Metical depreciated against the dollar, it did not depreciate against main trade partner currencies and is now likely overvalued by 5-10 percent (see the updated external assessment, Annex 1).

- While international reserves remain broadly adequate, it is important to rebuild buffers over time given the country's increasing dependence on commodity exports. Based on updated balance of payments flows in 2015, staff and the authorities agreed that an end-year target of $2.9 billion NIR could be targeted, implying an accumulation of $400 million from the end-March level and resulting in an adequate cover of 4.7 months of non-megaproject imports (Annex I).

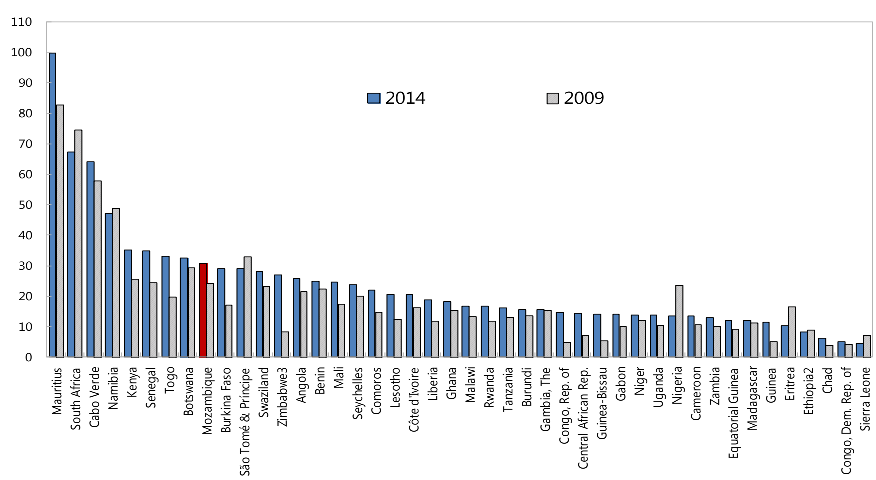
- To support this objective, the authorities envisage a large and front-loaded fiscal adjustment. The BM expressed a strong commitment to exchange rate flexibility and has already reduced significantly its foreign exchange sales since March, resulting in a gradual recovery of NIR. This should also help reduce the spread between the central bank's auction exchange rate and the interbank rate, which had increased since September 2014 (Figure 1).

16. The BM intends to moderate reserve money growth to support the policy adjustment, including the objective of rebuilding NIR buffers. This should also bring about some moderation in broad money and credit growth. Staff noted that, following several years of rapid credit expansion, private sector credit as a share of GDP stands among the highest in Sub-Saharan Africa, and argued that the limited access to credit by small and medium-sized enterprises (SMEs) and the high borrowing costs are mainly due to structural rigidities. Reforms to promote competition and information sharing on credit risk, including through the establishment of private credit registries, would help lower credit risk and borrowing costs. The BM shared staff's analysis, highlighting ongoing efforts to support financial inclusion, and emphasized the importance of facilitating access to credit by SMEs.

MEFP ¶6-8

Credit to Private Sector in Sub-Saharan African Countries

(Percent of GDP)



Source: IMF staff calculations.

17. The BM continues to strengthen its analytical tools, inflation forecasting capacity, and monetary policy operations framework. An enhanced inflation forecasting model, supported by IMF technical assistance, has been developed and is currently being tested to inform decisions by the Monetary Policy Committee. Efforts to improve the liquidity forecasting model are also ongoing.

MEFP ¶34-38

Other reforms, however, have experienced delays. It was agreed that allowing T-bonds as collateral in money market operations would facilitate the development of domestic financial markets and enhance the monetary policy transmission mechanism (September 2015 structural benchmark).

18. Reforms are continuing to strengthen bank supervision, crisis management tools, and financial sector development. Bank soundness indicators suggest that banks are well capitalized, with low non-performing loans (NPLs). Stress tests also point to a resilient banking system, with credit concentration remaining the main source of risk. Staff stressed that rapid credit expansion continues to pose a potential risk and needed to be carefully monitored. The authorities argued that credit growth figures should be interpreted with care given the low initial base, but agreed to monitor the situation to assess whether additional measures might be needed. Staff welcomed the simulation exercise of the Financial Sector Contingency Plan that was completed in the first quarter of 2015 with the support of the World Bank. Key milestones such as the adoption of the Law on the Creation of Private Credit Registry Bureaus, the launch of the National Financial Inclusion Strategy, and the drafting of a Movable Collateral Bill are all expected this year, but active follow-up and coordination across several institutions will be required to ensure success.

MEFP ¶39-44

D. Medium Term Reforms

19. Staff urged the authorities to reinvigorate capacity development in investment planning and project evaluation. Reforms have experienced repeated delays in this area. The most important immediate step is the requirement that all new public investment projects, exceeding $50 million (about 0.3 percent of GDP), should be subject to a mandatory centralized technical assessment before adding them to the list of priority investments (Integrated Public Investment Plan) and/or inclusion in the 2016 budget (July and December 2015 structural benchmarks).

MEFP ¶12

20. The quality of public debt data has improved, but public debt management capacity should be further strengthened. The government is considering measures to improve institutional coordination between public investment planning and debt management. The authorities will revise their Debt Management Strategy by end August 2015.

MEFP ¶13

21. Managing natural resources. The authorities have made substantial headway towards development of massive gas reserves with the legislation that provides fiscal stability to the investors and covers key development aspects of the project (labor regulations, rules on foreign exchange and project financing). Remaining issues such as project structure for financing and marketing of liquefied natural gas (LNG) involves complex decisions that can have tax implications that should be assessed carefully. Negotiations should proceed so that a final investment decision can be secured in 2015. The authorities published the 5th EITI Report (based on 2012 data) according to the calendar of the International EITI Secretariat.

MEFP ¶28-31

MEFP ¶11

22. The government has requested technical assistance from the Fund and World Bank to initiate crucial reforms in the Energy Sector. Energy prices have not been adjusted since 2011 and an increase of at least 25 percent seems needed to prevent operational losses of the National Electricity Company (EDM). The authorities are also seeking funding to finance short-term emergency investment projects to stabilize distribution grids, which will require careful project appraisal and assessment against other competing projects. The system of fuel imports requires reforms to increase the transparency of the tender process, limit the impact on NIR, audit import volumes and eliminate existing subsidies. The government is open to the reforms, though it noted that changes need to be introduced carefully to avoid unexpected disruptions and should take into account political economy factors and the need to protect the poor.

PROGRAM ISSUES

23. Waivers are requested for the non-observance of three assessment criteria (ACs) for December 2014 and modifications are proposed for three ACs for June 2015, to reflect recent developments. Waivers for the non-observance of ACs on reserve money and net credit to government at end-December 2014 are requested on the basis that the deviations were minor and temporary and have not affected the achievement of the program's objectives. A waiver for the non-observance of the AC on NIR is requested based on stronger than initially anticipated balance of payment pressures, the still broadly adequate NIR level, the authorities' ambitious target for 2015, and a strong commitment to policy adjustment. Revised ACs on NCG, reserve money, and NIR for June 2015 are proposed to reflect recent developments.

24. One structural benchmark (SB) is proposed to be rescheduled. The May benchmark on the requirement that projects that exceed $50 million should be subject to mandatory assessment by the Investment Evaluation Committee before inclusion in the 2016 budget is proposed for rescheduling to July because of the delays in the 2016 budget preparation cycle due to the formation of the new government—the 2015 budget was only approved in May.

25. ACs (for end-December 2015), indicative targets (ITs) and new SBs through end-2015 are proposed (MEFP Tables 1 and 2). The five new SBs proposed are aimed at further strengthening public financial management (public investment planning, fiscal risk management, public expenditure monitoring) and deepening financial sector reforms.

STAFF APPRAISAL

26. Mozambique's economy remains robust. A strong track record of high growth and low inflation is expected to continue in 2015 and over the medium term. The outlook remains tied to the development of the natural resource sector, where the approval of the enabling legislation in late 2014 has improved prospects for timely investment in the gas sector and other large private investment projects in the coal and energy sector are under active consideration. The country's strategic location in Southern Africa, with a central position on major trade routes, offers good prospects to attract foreign direct investment in other sectors as well.

27. Following policy slippages in 2014, the new government is taking appropriate measures. The overall fiscal deficit in 2014 exceeded 10 percent of GDP—one of the highest in Sub-Saharan Africa—and public debt (including guarantees) has been rising fast and could exceed 60 percent of GDP in 2015. The 2015 budget puts public finances back on a sustainable path, with an implicit fiscal adjustment of over 3 percent of GDP. Rigorous implementation will now be essential. The BM's commitment to tighten liquidity and build reserve buffers while allowing exchange rate flexibility provides another key policy anchor. Finally, following questions raised by the EMATUM borrowing in 2013, the authorities have taken corrective measures to improve transparency and fiscal risk management.

28. Over the medium term, the key challenges remain those highlighted during the 2014 *Africa Rising* conference in Maputo. Growth is high, but not broad-based. The elasticity of poverty to growth (at 0.1 percent) is one of the lowest in the world, and more inclusive policies are needed, including focused public spending on social and pro-poor programs. Infrastructure gaps remain in all key sectors (roads, ports, electricity, water and sanitation) but debt has been rising fast and fiscal space is limited. This requires special attention to how the country prioritizes public investment. Positive steps have already been taken with (i) the merger of the Planning and Finance Ministries; (ii) new rules to prepare lists of priority investment projects; (iii) knowledge exchanges with other countries (Chile and South Africa) with a strong tradition of project appraisal and management; and, (iv) lessons derived from the EMATUM case.

29. Staff recommends the completion of the fourth PSI review.

- While program performance has been mixed, the authorities have taken corrective measures to adjust policies. In particular, the 2015 budget confirms a commitment to strong fiscal adjustment. Recent debates in Parliament and civil society discussions suggest that there is broad consensus about the need to consolidate public finances and rein in public debt, which makes the implementation of the fiscal adjustment more credible. The BM has started to accumulate reserves after the trough observed at end-March, and will tighten liquidity conditions to support this policy objective. The authorities also reiterated their commitment to a flexible exchange rate regime, with the metical depreciating by about 14 percent (in nominal terms) against the dollar since September 2014 after two years of relative stability.

- The attached MEFP outlines the macroeconomic objectives and policies for the period ahead. Staff supports the waivers for the non-observance of three ACs at end-December 2014 on the basis that either the deviations were minor and have not harmed the achievement of the program objectives or the authorities have made a strong commitment to remedial actions. Structural reforms are ongoing, although capacity building efforts should continue to support limited implementation capacity. Staff also supports the authorities' request to modify the end-June ACs, the modification of the structural benchmark agenda for 2015-16, and the setting of ITs for end-September 2015 and ACs for end-December 2015, as the new targets better reflect recent developments and continue to be consistent with the achievement of the core program objectives.

Table 1. Mozambique: Selected Economic and Financial Indicators, 2012-20

	2012	2013	2014		2015		2016	2017	2018	2019	2020
	Act.	Act.	CR 15/12	Est.	CR 15/12	Proj.	Projections				
(Annual percentage change, unless otherwise indicated)											
National income and prices											
Nominal GDP (MT billion)	424	470	526	526	595	591	676	770	878	1000	1242
Nominal GDP growth	10.2	10.9	11.9	11.8	13.1	12.5	14.3	13.9	14.0	13.9	24.1
Real GDP growth	7.1	7.4	7.5	7.4	7.5	7.0	8.2	7.9	8.0	7.9	17.6
GDP per capita (US$)	590	605	637	630	694	626	685	746	813	887	1055
GDP deflator	2.9	3.2	4.1	4.1	5.2	5.1	5.6	5.6	5.6	5.6	5.6
Consumer price index (annual average)	2.1	4.2	2.6	2.3	5.0	4.0	5.6	5.6	5.6	5.6	5.6
Consumer price index (end of period)	2.2	3.0	3.0	1.1	5.5	5.5	5.6	5.6	5.6	5.6	5.6
Exchange rate, MT per US dollar, eop	29.8	30.1	...	33.6	...	...	...	...	...	...	...
Exchange rate, MT per US dollar, per.avg.	28.5	30.1	...	31.5	...	...	...	...	...	...	...
External sector											
Merchandise exports	23.6	6.9	11.8	-5.0	7.5	2.9	11.7	19.8	19.1	17.0	44.3
Merchandise exports, excluding megaprojects	52.5	14.3	4.2	-22.6	13.8	0.0	19.5	15.1	24.7	20.9	5.4
Merchandise imports	47.2	7.3	8.5	-6.2	19.2	7.7	17.4	-1.4	28.9	4.4	-1.1
Merchandise imports, excluding megaprojects	62.7	13.5	9.5	-0.1	5.5	-6.5	7.5	9.0	8.5	3.9	5.9
Terms of trade	-5.7	-9.0	-3.3	-3.3	-0.1	-0.1	0.7	-0.1	-0.3	-0.3	-0.3
Nominal effective exchange rate (annual average)	7.6	-1.7	...	0.3	...	...	...	...	...	...	...
Real effective exchange rate (annual average)	7.8	-0.7	...	-1.4	...	...	...	...	...	...	...
(Annual percentage change, unless otherwise indicated)											
Money and credit											
Reserve money	19.7	15.7	19.0	20.5	18.5	16.5	15.2	15.2	15.0	15.3	14.8
M3 (Broad Money)	29.4	16.3	18.1	22.2	19.0	17.1	15.5	15.5	15.3	15.6	15.1
Credit to the economy	19.9	28.7	20.0	28.3	18.1	17.5	15.5	15.9	15.6	15.5	15.4
(Percent of GDP)	27.8	32.2	34.6	37.0	36.1	38.7	39.1	39.8	40.3	40.8	38.0
(Percent of GDP)											
Investment and saving											
Gross domestic investment	54.1	56.0	49.0	48.4	54.1	48.6	51.6	48.8	56.4	53.4	49.1
Government	12.9	15.2	17.8	18.6	16.0	16.2	14.9	15.3	15.6	14.3	13.1
Other sectors	41.1	40.8	31.2	29.8	38.1	32.4	36.7	33.5	40.9	39.1	36.0
Gross domestic savings (excluding grants)	7.0	9.0	6.8	7.7	6.0	7.2	7.2	7.0	9.9	9.2	9.4
Government	3.9	7.2	3.2	3.5	5.0	4.9	6.0	6.6	7.0	7.3	7.5
Other sectors	3.1	1.8	3.6	4.2	1.1	2.4	1.2	0.4	2.9	1.9	1.9
External current account, before grants	-47.1	-47.0	-42.2	-40.7	-48.0	-41.4	-44.3	-41.8	-46.6	-44.2	-39.7
External current account, after grants	-42.3	-40.0	-39.4	-34.7	-45.7	-38.2	-42.1	-39.9	-45.0	-42.9	-38.7
Government budget											
Total revenue [1]	22.4	26.9	27.3	27.8	25.4	25.5	25.7	25.9	26.0	26.1	26.1
Total expenditure and net lending	31.4	34.9	41.9	43.3	36.4	36.9	34.6	34.6	34.6	33.1	31.7
Overall balance, before grants	-9.1	-8.1	-14.1	-15.4	-11.1	-11.4	-8.9	-8.7	-8.6	-7.0	-5.6
Total grants	5.2	5.3	4.0	5.1	3.6	4.9	3.4	2.9	2.4	2.0	1.5
Overall balance, after grants	-4.0	-2.8	-10.1	-10.4	-7.5	-6.5	-5.5	-5.8	-6.2	-5.0	-4.1
Domestic primary balance, before grants	-1.0	0.9	-2.9	-4.1	-0.9	-1.2	0.8	1.9	2.5	3.0	3.1
External financing (incl. debt relief)	3.3	5.8	9.4	8.1	6.4	5.7	5.4	6.4	6.8	5.9	4.5
Net domestic financing	0.7	-3.0	1.2	1.4	1.1	0.8	0.0	-0.5	-0.6	-0.9	-0.4
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total public debt [2]	41.1	46.9	56.8	55.4	60.9	61.2	61.7	60.8	59.0	57.0	50.8
Of which: external	35.5	38.1	48.4	46.7	51.1	50.9	52.7	53.3	53.1	52.7	47.7
Of which: domestic	5.6	8.8	8.4	8.7	9.8	10.3	9.1	7.4	5.9	4.2	3.0
(Millions of U.S. dollars, unless otherwise indicated)											
External current account, before grants	-6,997	-7,341	-7,119	-6,788	-9,040	-7,033	-8,445	-8,883	-11,054	-11,705	-12,777
External current account, after grants	-6,284	-6,253	-6,655	-5,797	-8,596	-6,481	-8,016	-8,483	-10,682	-11,359	-12,455
Overall balance of payments	377	396	150	-106	250	40	418	415	484	509	604
Net international reserves (end of period) [3]	2,604	2,995	3,147	2,881	3,398	2,889	3,273	3,655	4,107	4,583	5,185
Gross international reserves (end of period) [3]	2,798	3,191	3,340	3,071	3,555	3,079	3,463	3,845	4,297	4,773	5,375
Months of projected imports of goods and nonfactor services	2.7	3.3	2.6	3.1	2.5	2.7	2.8	2.6	2.6	2.6	2.8
Months of projected imports of goods and nonfactor services, excl. megaprojects	4.2	4.9	3.9	5.0	4.0	4.7	4.8	4.9	5.2	5.3	5.3

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

[1] Net of verified VAT refund requests.

[2] Consistent with DSA definition, the nonconcessional Portuguese credit line is included under the external debt. Domestic debt projections include planned securitization

[3] Includes disbursements of IMF resources under the ESF and August 2009 SDR allocation.

Table 2. Mozambique: Government Finances, 2012-16

(Billions of Meticais)

	2012	2013	2014		2015		2016
	Act.	Act.	CR15/12	Prel.	CR15/12	Proj.	Proj.
Total revenue[1]	94.8	126.6	144.0	146.4	151.0	151.0	173.5
Tax revenue	80.9	107.6	123.2	125.2	128.6	128.6	147.9
Income and profits	36.8	55.8	57.2	61.3	54.0	54.0	66.8
Of which:							
Capital gain tax	5.0	18.6	16.2	16.2	0.0	0.0	0.0
Others	31.7	37.3	41.1	45.1	54.0	54.0	66.8
Goods and services[1]	33.3	38.3	49.4	48.3	55.8	55.8	62.5
Of which : on petroleum products	1.3	2.2	2.5	1.8	2.9	2.9	13.9
International trade	7.6	10.0	10.8	11.4	12.2	12.2	13.9
Other	3.2	3.5	5.7	4.1	6.6	6.6	4.7
Nontax revenue	14.0	19.0	20.8	21.2	22.4	22.4	25.6
Total expenditure and net lending	133.1	164.2	221.2	227.6	216.9	218.2	233.7
Current expenditure	78.3	92.6	126.9	128.0	121.4	122.3	133.2
Compensation to employees	41.5	49.5	58.4	59.8	63.4	64.4	71.1
Goods and services[1]	15.1	20.4	41.6	41.1	27.3	26.0	25.0
Of which: Maritme security	...	...	10.2	14.9	0.0	0.0	...
Interest on public debt	4.1	4.0	6.1	6.0	6.9	8.2	10.1
Domestic	2.9	2.2	3.5	2.8	4.2	4.2	4.4
External	1.2	1.7	2.6	3.2	2.7	4.1	5.7
Transfer payments	17.5	18.8	20.8	21.0	23.7	23.6	27.0
Capital expenditure	50.4	61.6	76.5	81.5	82.7	84.6	87.1
Domestically financed	24.7	33.6	40.0	44.0	41.2	43.7	44.5
Externally financed	25.6	28.0	36.5	37.5	41.5	40.9	42.6
Net lending	4.5	10.0	17.7	16.1	12.8	11.3	13.4
Domestically financed	-0.4	-0.3	0.8	0.3	0.9	0.3	0.4
Externally financed loans to public enterprises	4.9	10.3	16.9	15.9	11.9	11.0	13.0
Unallocated revenue (+)/expenditure (-) [2]	-0.4	-0.5	0.0	-1.9	0.0	0.0	0.0
Domestic primary balance, before grants, above the line	-4.1	4.2	-15.2	-21.8	-5.5	-7.0	5.6
Overall balance, before grants	-38.7	-38.1	-77.2	-81.2	-65.9	-67.2	-60.1
Grants received	21.9	24.9	21.1	26.6	21.2	28.7	23.2
Project support	13.3	18.5	14.1	15.9	17.2	20.7	16.5
Budget support	8.7	6.4	7.0	10.7	4.0	8.0	6.8
Overall balance, after grants	-16.8	-13.1	-56.0	-54.6	-44.7	-38.5	-36.9
Net external financing	13.8	27.1	49.3	47.0	38.3	33.6	36.6
Disbursements	15.4	29.6	53.2	50.2	42.4	38.1	41.8
Project	6.7	12.2	22.1	16.1	24.3	20.3	26.1
Nonproject support	8.7	17.5	20.1	18.5	18.1	17.9	15.7
Other disbursements	...	...	10.9	15.6	0.0	0.0	...
Cash amortization	-1.6	-2.5	-3.9	-3.2	-4.1	-4.5	-5.1
Net domestic financing	2.9	-13.9	6.4	7.6	6.4	4.9	0.3
Memorandum items:							
Overall balance excluding windfall receipt and one-off expenses	-21.8	-31.7	-72.2	-55.2	-44.7	-38.5	-36.9
Gross aid flows	37.4	47.4	50.8	40.4	58.5	58.9	57.2
Budget support	12.5	13.6	10.5	12.4	10.2	14.9	9.4
Nonbudget support	24.8	33.8	49.2	43.8	51.0	46.3	51.0
Project support	20.0	30.7	36.5	32.0	41.5	40.9	42.6
Concessional	20.0	30.7	27.5	16.3	40.0	38.7	39.4
Nonconcessional	0.0	0.0	9.0	15.8	2.8	2.2	3.2
Concessional loans to public enterprises	4.9	3.1	12.7	11.7	9.5	5.4	8.4

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

[1]VAT presented on a net basis (collection minus requested VAT refunds).

[2]Residual discrepancy between identified sources and uses of funds.

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

Table 3. Mozambique: Government Finances, 2012-20

(Percent of GDP)

	2012	2013	2014		2015		2016	2017	2018	2019	2020
	Act.	Act.	CR15/12	Prel.	CR15/12	Proj.	Projections				
Total revenue [1]	22.4	26.9	27.3	27.8	25.4	25.5	25.7	25.9	26.0	26.1	26.1
Tax revenue	19.1	22.9	23.4	23.8	21.6	21.7	21.9	22.1	22.2	22.3	22.3
Capital gain tax	1.2	3.9	3.1	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	3.3	4.0	4.0	4.0	3.8	3.8	3.8	3.8	3.8	3.8	3.8
Total expenditure and net lending	31.4	34.9	42.0	43.3	36.4	36.9	34.6	34.6	34.6	33.0	31.7
Current expenditure	18.5	19.7	24.1	24.3	20.4	20.7	19.7	19.3	19.0	18.8	18.6
Compensation to employees	9.8	10.5	11.1	11.4	10.7	10.9	10.5	10.2	9.9	9.6	9.6
Goods and services [1]	3.6	4.3	7.9	7.8	4.6	4.4	3.7	3.4	3.3	3.3	3.2
Of which: Maritme security	0.0	0.0	1.9	2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest on public debt	1.0	0.8	1.2	1.1	1.2	1.4	1.5	1.7	1.8	1.8	1.8
Transfer payments	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Capital expenditure	11.9	13.1	14.5	15.5	13.9	14.3	12.9	12.3	11.8	10.9	9.9
Domestically financed	5.8	7.1	7.6	8.4	6.9	7.4	6.6	6.3	6.2	6.1	6.1
Externally financed	6.0	6.0	6.9	7.1	7.0	6.9	6.3	6.0	5.7	4.7	3.8
Net lending	1.1	2.1	3.4	3.1	2.1	1.9	2.0	3.0	3.7	3.4	3.2
Domestically financed	-0.1	-0.1	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Externally financed loans to public enterprises	1.1	2.2	3.2	3.0	2.0	1.9	1.9	3.0	3.7	3.4	3.1
Unallocated revenue (+)/expenditure (-) [2]	-0.1	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic primary balance, before grants, above the line	-1.0	0.9	-2.9	-4.1	-0.9	-1.2	0.8	1.9	2.5	3.0	3.1
Overall balance, before grants	-9.1	-8.1	-14.7	-15.4	-11.1	-11.4	-8.9	-8.7	-8.6	-7.0	-5.6
Grants received	5.2	5.3	4.0	5.1	3.6	4.9	3.4	2.9	2.4	2.0	1.5
Project	3.1	3.9	2.7	3.0	2.9	3.5	2.4	2.0	1.7	1.4	1.1
Investment projects	1.7	2.1	1.4	0.9	1.4	1.8	1.2	1.0	0.8	0.7	0.5
Special programs	1.4	1.8	1.2	2.1	1.5	1.7	1.3	1.0	0.9	0.7	0.6
Budget support	2.0	1.4	1.3	2.0	0.7	1.4	1.0	0.8	0.7	0.6	0.4
Overall balance, after grants	-4.0	-2.8	-10.6	-10.4	-7.5	-6.5	-5.5	-5.8	-6.2	-5.0	-4.1
Net external financing	3.3	5.8	9.4	8.9	6.4	5.7	5.4	6.4	6.8	5.9	4.5
Disbursements	3.6	6.3	10.2	9.5	7.1	6.5	6.2	7.3	7.9	7.3	6.0
Project	1.6	2.6	4.2	3.1	4.1	3.4	3.9	4.0	4.0	3.3	2.7
Nonproject support	2.1	3.7	3.9	3.5	3.0	3.0	2.3	3.3	3.9	4.0	3.3
Other disbursement	0.0	0.0	2.1	3.0	0.0	0.0	...	...	...	...	...
Cash amortization	-0.4	-0.5	-0.7	-0.6	-0.7	-0.8	-0.8	-0.9	-1.1	-1.4	-1.5
Net domestic financing	0.7	-3.0	1.2	1.4	1.1	0.8	0.0	-0.5	-0.6	-0.9	-0.4
Memorandum items:											
Overall balance excluding windfall receipt and one-off expens	-5.1	-6.7	-13.7	-10.5	-7.5	-6.5	...	...	...	...	...
Gross aid flows	8.4	10.1	9.6	7.7	9.8	10.0	8.5	8.5	8.4	7.1	7.2
Budget support	3.0	2.9	2.0	2.4	1.7	2.5	1.4	1.2	1.0	1.2	0.6
Nonbudget support	5.4	7.2	9.4	8.3	8.6	7.8	7.5	7.9	7.9	6.9	
Project support	4.7	6.5	6.9	6.1	7.0	6.9	6.3	6.0	5.7	4.7	3.8
Nominal GDP	424	470	526	526	595	591	676	770	878	1000	1242

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

[1] VAT presented on a net basis (collection minus requested VAT refunds).

[2] Residual discrepancy between identified sources and uses of funds.

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

Table 4. Mozambique: Monetary Survey, 2012-15

(Billions of Meticais, unless otherwise specified)

	2012	2013	2014	2014	2015 Q1	2015 Q1	2015 Q2	2015 Q2	2015 Q3	2015 Q3	2015 Q4	2015 Q4
	Act.	Act.	CR 15/12	Act.	CR 15/12	Est.	CR 15/12	Proj.	CR 15/12	Proj.	CR 15/12	Proj.
Bank of Mozambique												
Net foreign assets	73.1	85.7	93.4	91.5	88.9	86.9	91.4	83.8	96.8	86.8	104.3	95.5
(US$ billions)	2.5	2.8	3.0	2.7	2.8	2.3	2.9	2.4	3.0	2.5	3.3	2.7
Net international reserves	77.5	90.1	98.0	96.8	93.8	93.1	96.3	89.3	101.9	92.8	109.0	101.1
(US$ billions)	2.6	3.0	3.1	2.9	3.0	2.5	3.0	2.6	3.2	2.7	3.4	2.9
Net domestic assets	-32.0	-38.1	-36.9	-34.2	-35.0	-32.5	-31.6	-24.6	-33.7	-24.7	-37.3	-28.8
Credit to government (net)	-27.6	-45.7	-45.7	-51.0	-49.0	-50.8	-55.0	-52.5	-58.8	-53.4	-46.7	-50.7
Credit to banks (net)	-12.7	-10.0	-9.0	-4.4	-2.3	-0.6	8.0	21.6	6.0	18.0	-5.5	4.6
Credit to the economy	1.3	1.3	1.3	1.7	1.4	1.6	1.7	1.7	1.5	1.5	1.3	1.7
Other items (net; assets +)	6.9	16.2	16.5	19.5	14.8	17.4	13.7	4.6	17.6	9.3	13.6	15.7
Reserve money	41.1	47.5	56.6	57.3	53.9	54.4	59.9	59.2	63.1	62.1	67.0	66.7
Currency in circulation	26.2	30.4	36.0	36.3	32.4	32.7	37.2	37.5	39.8	39.5	42.8	42.5
Bank deposits in BM	14.8	17.2	20.6	21.0	21.4	21.7	22.6	21.7	23.3	22.6	24.2	24.2
Commercial Banks												
Net foreign assets	21.3	14.3	20.7	13.3	21.1	18.0	21.5	18.4	20.5	15.3	31.9	21.6
(Millions of U.S. dollars)	0.7	0.5	0.7	0.4	0.7	0.5	0.7	0.5	0.6	0.4	1.0	0.6
Net domestic assets	143.9	178.1	208.6	222.1	210.1	222.0	220.5	227.0	230.7	231.0	241.5	256.5
Banks' reserves	22.2	24.3	30.1	32.0	28.9	30.5	30.7	29.8	32.2	31.5	36.1	35.1
Credit to BM (net)	12.3	10.1	9.0	2.5	2.3	1.0	-8.0	-21.6	-6.0	-18.0	5.5	-4.6
Credit to government (net)	27.5	31.7	25.6	42.1	33.0	39.3	30.5	28.6	33.0	31.0	33.0	37.0
Credit to the economy	116.5	150.3	180.7	193.0	188.2	202.2	200.4	209.1	206.1	207.4	213.6	227.0
Other items (net; assets +)	-34.5	-38.3	-36.7	-47.5	-42.2	-51.0	-33.1	-18.8	-34.6	-21.0	-46.7	-38.0
Deposits	165.3	192.4	229.2	235.4	231.1	240.0	242.0	245.5	251.2	246.3	273.5	278.1
Demand and savings deposits	108.4	122.0	145.3	152.5	142.5	152.8	154.6	156.8	159.6	156.4	172.9	175.8
Time deposits	56.8	70.4	83.9	82.9	88.6	87.2	87.5	88.6	91.6	89.9	100.6	102.3
Monetary Survey												
Net foreign assets	94.4	100.0	114.1	104.7	110.0	104.9	112.9	102.2	117.3	102.1	136.2	117.1
(US$ billions)	3.2	3.3	3.7	3.1	3.5	2.8	3.6	2.9	3.7	2.9	4.2	3.3
Net domestic assets	91.6	116.5	141.6	159.8	146.1	160.6	158.3	172.6	164.7	174.8	168.2	192.6
Domestic credit	117.7	137.6	161.8	185.8	173.5	192.3	177.6	186.8	181.8	186.5	201.2	215.0
Credit to government (net)	-0.1	-14.0	-20.1	-8.9	-16.0	-11.5	-24.5	-23.9	-25.8	-22.4	-13.8	-13.7
Credit to the economy	117.8	151.7	182.0	194.6	189.5	203.8	202.1	210.7	207.6	208.9	215.0	228.7
Cred. economy in foreign currency	28.8	34.4	37.7	39.5	40.9	39.7	41.9	43.6	45.7	46.0	43.8	46.6
Other items (net; assets +)	-26.1	-21.2	-20.2	-26.0	-27.4	-31.7	-19.4	-14.2	-17.0	-11.7	-33.1	-22.4
Money and quasi money (M3)	186.0	216.4	255.7	264.5	256.1	265.5	271.2	274.9	282.0	276.9	304.4	309.7
Foreign currency deposits	53.3	55.6	64.9	59.7	65.6	64.7	65.2	66.9	65.7	62.4	77.5	69.9
(US$ billions)	1.8	1.8	2.1	1.8	2.1	1.7	2.1	1.9	2.1	1.8	2.4	2.0
M2	132.7	160.8	190.8	204.9	201.8	203.0	214.6	213.2	226.8	238.8	258.2	272.6
Currency outside banks	19.7	22.7	26.5	27.5	25.0	24.5	29.2	29.4	30.9	30.6	30.9	31.6
Domestic currency deposits	113.1	138.1	164.3	177.4	176.8	178.5	185.4	183.8	196.0	208.2	227.3	241.0
Memorandum Items												
Avg daily reserve money in 3rd month of quarter	40.3	46.5	55.3	55.3	53.6	54.1	58.9	58.2	62.9	61.9	65.5	64.4
12-month percent change	21.1	15.4	19.0	19.0	19.0	20.2	20.3	19.0	19.4	17.5	18.5	16.5
Avg daily currency in 3rd month of quarter	25.0	28.9	34.3	34.6	32.2	32.5	35.8	36.1	38.7	38.4	40.7	40.5
12-month percent change	18.0	15.7	18.6	19.7	18.9	20.0	19.0	20.0	19.0	18.0	18.9	17.1
NCG stock (prog def.)	-9.8	-27.2	-24.6	-23.1	-20.5	-25.6	-26.5	-25.9	-30.3	-26.9	-18.2	-18.2
NCG flow (prog def.) cum from end-year	2.9	-17.4	2.6	4.1	4.1	-2.5	-1.9	-2.8	-5.7	-3.8	6.4	4.9
12-month percent change												
Reserve money	19.7	15.7	19.0	20.5	19.0	20.2	20.3	19.0	19.4	17.5	18.5	16.5
Currency in circulation	19.8	15.7	18.6	19.7	18.9	20.0	19.0	20.0	19.0	18.0	18.9	17.1
Currency outside banks	12.5	15.5	16.5	21.2	16.7	14.6	16.9	17.9	15.6	15.9	16.8	15.0
Currency in banks	48.8	16.1	24.9	15.1	26.5	39.6	27.3	28.4	32.5	25.9	24.8	23.6
Bank reserves	19.6	15.8	19.7	22.0	19.2	20.6	22.5	17.3	20.0	16.6	17.8	15.5
M2	25.6	21.2	18.6	27.4	18.9	25.3	19.0	20.0	19.0	18.0	18.9	17.1
Domestic deposits	28.1	22.2	19.0	28.4	19.2	26.9	19.3	20.4	19.4	18.4	19.2	17.4
M3	29.4	16.3	18.1	22.2	18.4	22.7	18.5	20.0	18.6	17.6	19.0	17.1
Credit to the economy	19.9	28.7	20.0	28.3	19.9	29.0	19.2	24.1	18.7	19.4	18.1	17.5
Money multiplier (M2/reserve money)	3.23	3.38	3.37	3.58	3.54	3.69	3.44	3.51	3.43	3.45	3.38	3.59
Velocity (GDP/M2)	3.20	2.93	2.76	2.57	…	…	…	…	…	…	2.62	2.47
Nominal GDP	424	470	526	526	595	591	595	591	595	591	595	591
Nominal GDP growth	10.2	10.9	11.9	11.8	13.1	12.5	13.1	12.5	13.1	12.5	13.1	12.5
Policy lending rate (end-of-period)	9.5	8.3	…	7.5	…	7.5	…	…	…	…	…	…
T-bill 91 days rate	2.6	5.2	…	5.4	…	5.5	…	…	…	…	…	…

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

Table 5. Mozambique: Balance of Payments, 2012-20

(Millions of U.S. dollars, unless otherwise specified)

	2012	2013		2014		2015		2016	2017	2018	2019	2020
	Act.	CR/15/12	Est.	CR/15/12	Est.	CR/15/12	Proj.	Projections				
Current account balance	-6,284	-5,892	-6,253	-6,655	-5,797	-8,596	-6,481	-8,016	-8,483	-10,682	-11,359	-12,455
Trade balance for goods	-4,048	-4,357	-4,357	-4,594	-4,035	-6,010	-4,531	-5,551	-4,524	-6,360	-5,837	-2,361
Of which: Megaprojects	47	267	263	567	943	-733	27	-830	512	-1,230	-941	2,840
Exports, f.o.b.	3,856	4,123	4,123	4,610	3,916	4,958	4,031	4,501	5,392	6,422	7,513	10,843
Megaprojects	2,173	2,201	2,196	2,604	2,429	2,675	2,544	2,724	3,346	3,871	4,427	7,592
Other	1,682	1,922	1,926	2,006	1,487	2,284	1,487	1,777	2,045	2,551	3,086	3,251
Imports, f.o.b.	-7,903	-8,480	-8,480	-9,204	-7,952	-10,969	-8,562	-10,052	-9,916	-12,783	-13,349	-13,204
Megaprojects	-2,143	-1,934	-1,934	-2,037	-1,487	-3,407	-2,516	-3,554	-2,834	-5,101	-5,368	-4,752
Other	-5,760	-6,546	-6,546	-7,167	-6,465	-7,562	-6,046	-6,498	-7,082	-7,682	-7,981	-8,452
Trade balance for services	-3,073	-2,802	-3,259	-3,230	-2,932	-3,196	-2,546	-2,762	-3,930	-4,069	-4,910	-7,338
Income balance	7	-52	-59	-162	-202	-246	-246	-459	-792	-1,030	-1,412	-3,628
Of which: Dividend payments by megaprojects	0	-1	-1	-127	0	-135	0	-70	-179	-208	-242	-1,958
Current transfers balance	829	1,319	1,421	1,331	1,372	857	842	755	763	777	798	872
Of which: External grants	538	460	460	464	471	444	551	429	399	371	345	321
Capital and financial account balance	6,748	6,240	6,627	6,805	5,665	8,846	6,521	8,434	8,898	11,167	11,869	13,059
Capital account balance	456	486	423	560	372	611	499	478	492	510	534	597
Financial account balance	6,292	5,754	6,204	6,245	5,293	8,234	6,022	7,955	8,406	10,656	11,335	12,462
Net foreign direct investment	5,215	5,935	6,175	4,230	4,902	4,833	4,048	4,706	4,858	5,248	5,876	7,508
Net foreign borrowing by the general government	546	1,055	1,058	1,673	1,412	1,162	942	1,055	1,359	1,565	1,471	1,391
Net foreign borrowing by the nonfin private sector	516	148	-92	411	354	1,845	1,023	2,192	2,196	3,849	3,993	3,586
Other [1]	14	-1,385	-937	-69	-1,375	395	10	3	-6	-6	-5	-24
Net errors and omissions	-87	49	22	0	26	0	0	0	0	0	0	0
Overall balance	377	396	396	400	-106	250	40	418	415	484	509	604
External financing	-377	-396	-396	-400	-418	-250	-40	-418	-415	-484	-509	-604
Reserve assets [1]	-375	-393	-393	-397	120	-214	-7	-384	-382	-452	-476	-602
Net use of credit	-2	-3	-3	-3	-14	-36	-33	-34	-33	-33	-33	-2
Of which: Net use of Fund credit	-2	-3	-3	-3	-3	-36	-33	-34	-33	-33	-33	-2
Memorandum items:												
Current account balance (percent of GDP)	-42.3	-37.7	-40.0	-39.4	-34.7	-45.7	-38.2	-42.1	-39.9	-45.0	-42.9	-38.3
Excluding external grants	-47.8	-40.7	-49.1	-42.2	-43.0	-48.0	-43.1	-46.1	-43.5	-48.3	-45.9	-41.4
Excluding Mega-Projects	-21.1	-25.5	-25.4	-30.7	-25.6	-31.1	-28.4	-26.1	-27.2	-17.9	-14.4	-17.8
Net foreign assets	2,457	2,745	2,849	2,056	2,722	2,305	2,762	3,180	3,594	4,079	4,588	5,192
Net international reserves [1]	2,604	2,996	2,995	3,147	2,881	3,398	2,889	3,273	3,655	4,107	4,583	5,185
Gross international reserves [1,2]	2,798	3,192	3,191	3,340	3,071	3,555	3,079	3,463	3,845	4,297	4,773	5,375
Months of projected imports of goods and nonfactor services	2.7	2.8	3.3	2.6	3.1	2.5	2.7	2.8	2.6	2.6	2.6	2.8
Months of projected G&S imports (excl. megaproject imports)	4.2	3.9	4.9	3.9	5.0	4.0	4.7	4.8	4.9	5.2	5.3	5.3
Percent of broad money (M2)	62.7	59.7	59.7	54.5	50.4	50.3	44.9	44.9	44.0	43.6	42.9	42.9

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

1 Includes net portfolio investment and other investment assets.

2 The ratio to short term debt is not presented due to availability of the data.

Table 6. Mozambique: Financial Soundness Indicators for Banking Sector, 2008-14

	2008	2009	2010	2011	2012	2013	2014
Capital adequacy							
Regulatory capital to risk-weighted assets	13.9	15.1	14.4	17.1	17.9	16.9	15.1
Regulatory Tier I capital to risk-weighted assets	12.4	13.0	13.7	16.1	16.9	16.0	13.6
Capital (net worth) to assets	7.5	7.7	8.0	9.0	9.5	9.5	9.4
Asset composition and quality							
Foreign exchange loans to total loans	32.8	32.4	29.5	25.1	28.1	21.9	20.6
Nonperforming loans to gross loans [1]	1.9	1.8	1.9	2.6	3.2	2.3	3.3
Nonperforming loans net of provisions to capital [1]	2.5	5.9	5.6	6.6	6.8	4.5	16.8
Earnings and profitability							
Return on assets	3.5	3.0	2.6	2.5	1.9	2.0	2.1
Return on equity	44.7	36.6	32.9	26.5	19,.6	21.0	22.2
Interest margin to gross income	58.8	55.7	59.4	64.9	58.9	55.6	55.9
Noninterest expenses to gross income	58.7	58.4	59.7	61.3	66.1	65.3	62.6
Personnel expenses to noninterest expenses	45.1	45.9	45.5	47.1	49.1	47.6	47.0
Trading and fee income to gross income	40.5	44.3	23.8	17.2	19.5	17.0	20.9
Funding and liquidity							
Liquid assets to total assets [2]	36.2	27.9	22.4	27.8	33.4	30.7	30.0
Customer deposits to total (non-interbank) loans	165.7	138.2	131.2	131.6	143.8	132.5	127.1

Source: Bank of Mozambique (BM).

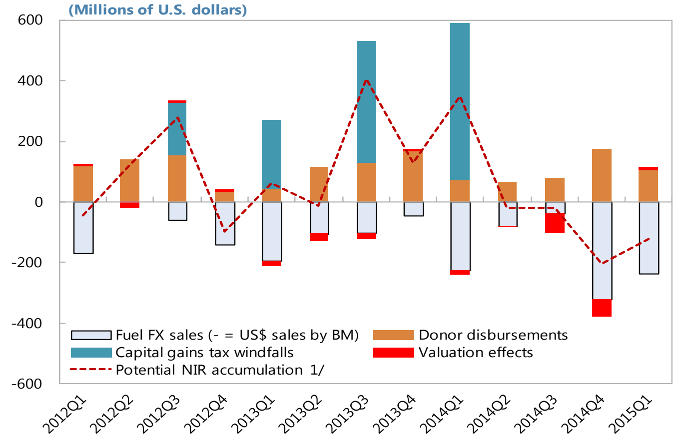
[1] Prior to 2014, nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).
[2] Includes deposits at parent banks.

Annex I. Mozambique: External Balance and Reserve Adequacy Assessment[1]

This annex provides an assessment of external balance and reserve adequacy in Mozambique. It updates and extends the analysis presented in June 2013 (IMF Country Report 13/200). The annex focuses on three interrelated questions. First, it discusses practical issues with reserve accumulation in Mozambique, using information that goes beyond the overall balance of payment aggregates, which can be misleading given the role of megaprojects in the economy. Second, it provides an assessment—based mostly on the EBA-lite methodology—to evaluate whether the exchange rate is in line with underlying economic fundamentals. This question is particularly important given the strong depreciation pressures observed between October 2014 and March 2015. Third, it uses several metrics to assess reserve adequacy, which is a key issue in light of the declines in net international reserves during this period as a result of the Bank of Mozambique (BM)'s interventions to contain depreciation pressures.

On the first question, historical experience suggests that the potential for international reserve accumulation in Mozambique is associated with four factors: (i) donor disbursements; (ii) capital gains taxes from natural resource companies (which are paid in US$); (iii) fuel imports; and (iv) valuation changes. Two of these four factors—donor disbursements (budget support) and capital gains tax revenue windfalls — unambiguously boost reserves. In contrast, fuel imports have a direct negative impact on reserves to the extent that the BM is called upon to provide foreign exchange to a syndicate of banks that finance fuel imports for the Imopetro consortium.[2] Fourth, valuation effects on the stock of reserves can go either way. The BM does not typically build reserves through outright dollar purchases from the market, and hence interventions have been mostly one-sided.

Factors determining potential NIR accumulation, 2012Q1-present
(Millions of U.S. dollars)



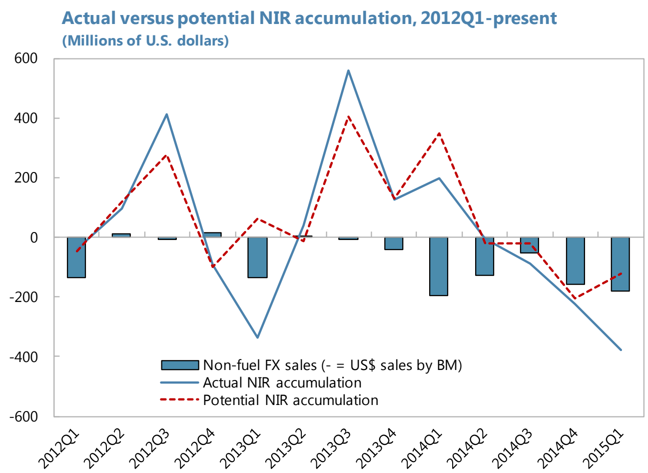
1/ Combines the determinants of reserve accumulation into one series assuming that (i) capital gains tax windfalls and (ii) donor budget support disbursements go entirely toward domestic fiscal procurement and can be saved as reserves and then adding actual realizations of (iii) reserves sold for fuel purchases and (iv) reserve valuation effects.

[1] Prepared by Christian Henn and Keiichiro Inui.

[2] IMOPETRO has the monopoly to organize the importation of refined oil products and processed gas on behalf of retailers in the domestic market. These purchases are currently financed by a bank syndicate for each cargo for all retailers involved as a group. The BM stands ready to provide foreign exchange to the bank syndicate as requested, so that it does not need to make dollar purchases in the domestic foreign exchange market. These oil imports are seasonal (with peaks in Q1 and Q4) that would place unusual pressure on the foreign exchange rate if the BM did not provide some foreign exchange liquidity.

Actual reserve accumulation has not fallen substantially short of potential[3]. A single series for potential reserve accumulation is derived by combining these four factors driving reserve accumulation. While this allows identification of periods during which reserve accumulation may have exceeded or fallen short of potential, the series have continued to track each other closely. Reserve accumulation only tends to falls short of potential during the first quarter. This is caused by the BM intervening with FX sales in light of the BOP's seasonal weakness in that quarter characterized by low export revenues and low donor inflows. However, the amounts dedicated to such Q1 non-fuel intervention have only been slightly more elevated in 2014 and 2015 than during the previous years.[4]

BOP weakness explains most of recent reserve losses. Starting in the second quarter of 2014, potential reserve accumulation started an atypically long dip into negative territory. In the mechanics of the analysis, this is driven by higher demand by the Imopetro consortium for hard currency from the BM for fuel imports. In turn, their higher demand, however, is a direct result of the BOP experiencing a terms-of-trade shock and suffering from political uncertainty surrounding the elections which caused foreign exchange scarcity in the domestic market.



Non-fuel related intervention only explains up to a quarter of reserve losses. In the twelve months after potential reserve accumulation turned negative, Mozambique lost US$700 million in reserves. However, only up to US$180 million can be explained by more heavy handed intervention unrelated to fuel imports. Some of this stronger intervention by the BM may have been justified to smooth out higher potential volatility in light of the tightening domestic FX market.[5] In contrast, fuel-related FX sales amounted to US$673 million during that period, markedly above their 2009-13

[3] The measure of "potential accumulation" should be used with care as it is endogenous to policy decisions. For example, the central bank can decide that it will not provide more than a fixed amount to finance fuel imports, or it could have purchased $ during periods of higher market liquidity (typically in Q2 and Q3) to finance the future sales. Potential accumulation is also driven to a large extent by the fiscal stance, where public investment has a large import content.

[4] Such non-fuel intervention was $197 million in 2014 and $180 million to date in 2015 compared to an average of $167 million during the 2009-2012 period.

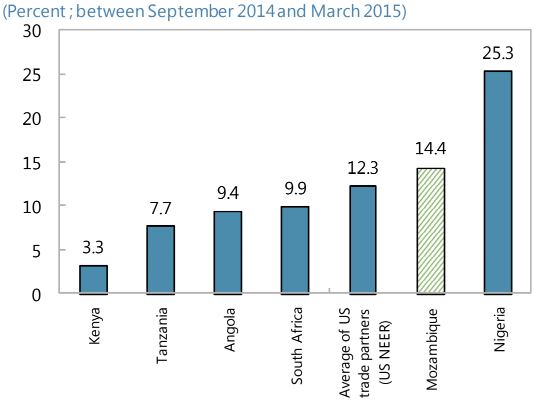
[5] Non-fuel interventions during Q2 2014 through Q1 2015 amounted to a total of $523 million compared to $345 million on average during 2009-13 mainly. This was driven mainly by high intervention in the second and fourth quarters (averages for 2009-13 in parentheses): Q2 2014: $129m ($60m); Q3 2014: $53m ($69m); Q4 2014: $160m ($55m); Q1 2015: $180m ($161m).

average of roughly US$300 million. Valuation losses of reserves in light of dollar appreciation vis-à-vis other reserve currencies also explain about US$120 million of reserve losses and were concentrated in the second half of 2014.

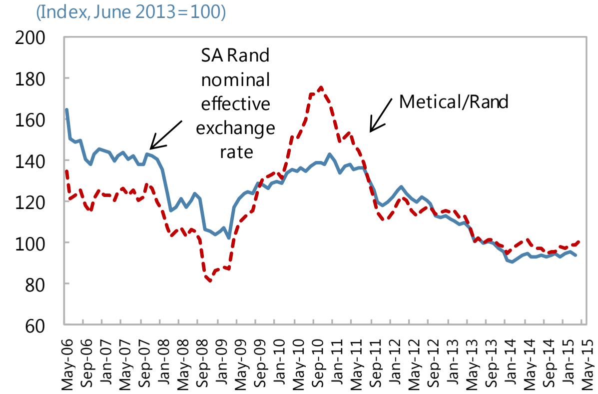
Capital gains tax windfalls provided a cushion for higher intervention, but are not likely to be available going forward. While these taxes are paid in dollars, the government spends these proceeds largely in meticais, leading to some reserve accumulation (though part is lost through higher imports for government projects). Such capital gains tax windfalls were large during 2012 to 2014Q1, totaling over US$1.3 billion, and as a result net international reserves still exceed their pre-windfall levels by over US$350 million. With no further large capital gains tax payments expected in the immediate future, any extraordinary intervention will have to be considered carefully to safeguard reserve buffers.

Turning to the second question, while the metical has nominally depreciated against the US dollar since late-2014, its real effective exchange rate has remained stable (Figure 1). The metical depreciated by about 14 percent against the US dollar from September 2014 to March 2015.

Nominal depreciation of selected currencies versus the US dollar
(Percent ; between September 2014 and March 2015)



Metical/SA rand and SA rand Nominal Effective Exchange Rate
(Index, June 2013=100)



This depreciation closely mimics the appreciation of the dollar on a global basis, as measured by the US nominal effective exchange rate (NEER), though it is relatively strong compared to many Sub-Saharan Africa peers. Nonetheless, the absence of a faster depreciation of the metical may be surprising in light of the adverse terms-of-trade shocks having affected Mozambique, with lower coal and traditional export prices (sugar, cotton) and pass-through of lower fuel prices being delayed in light of hedging contracts. Moreover, since the last exchange rate assessment of June 2013, the metical has actually appreciated against the South African rand, the currency of Mozambique's main trade partner.[6] With the metical remaining stable against the rand since the onset of the weakening BOP position, the exchange rate movements may have fallen short of what was needed to facilitate adjustment and limit NIR losses.

[6] This has also closely tracked the South African rand's depreciation against trade partners.

The exchange rate assessment approaches suggest that the metical may be slightly overvalued by 5-10 percent. Such overvaluation may represent one reason why the BOP weakness emerging in the second half of 2014 translated into such strong pressures in the domestic foreign exchange market. Staff assessed the exchange rate using the EBA-lite approach, supplementing it with three types of CGER estimates as robustness checks, which have been adapted, as in past analyses, to the particularities of Mozambique (EBS/13/76).

- **EBA-lite suggests an overvaluation on the order of 13 percent.** The EBA-lite estimates the normative current account balance (CAB) when a country implements desirable policies in the medium term and assesses the current account gap and exchange rate misalignment by comparing the normative CAB and the actual CAB. Staff assumes that the desirable policy for Mozambique is to gradually tighten fiscal policy in line with medium-term projections. The adjusted CAB used in EBA-lite is derived for the non-megaproject economy. This excludes in particular the large investments in the coal and LNG sectors, which drive the country's large CA deficit, but are mostly financed by FDI and do not immediately affect external stability. According to the EBA-lite approach, Mozambique's current account deficit is about 6 percent of GDP higher than the level consistent with desirable policies. This implies overvaluation of 13 percent.[7]

- **Two of the three CGER estimates also point to a slight overvaluation.** The external sustainability approach derives the CAB consistent with long-term external debt sustainability. For its calculation, staff focused only on the non-megaproject economy and the resulting estimate is very similar to EBA-lite. The purchasing power parity approach suggests a smaller overvaluation of roughly 3 percent, while the equilibrium real exchange rate approach points to a 7 percent undervaluation.

With EBA-lite and two of the other three approaches suggesting that the Metical is overvalued and taking into account the strength of recent exchange rate pressures, staff assess that the metical may remain overvalued by 5-10 percent.

Estimate of the Valuation of the Metical for 2015

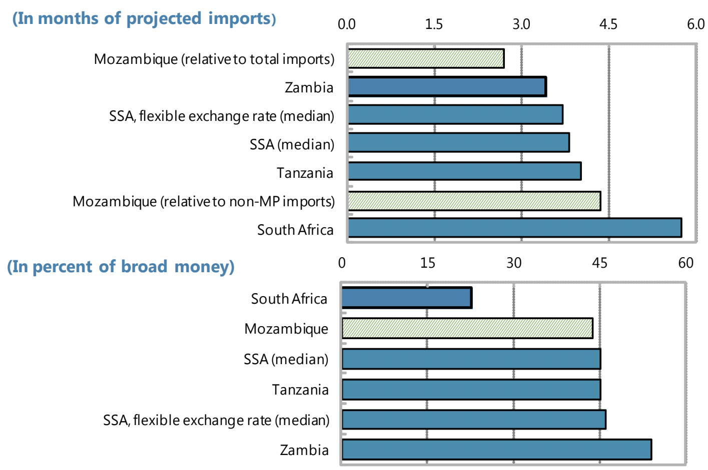
Approach	Current Account Gap (percent of GDP)	Overvaluation (+) / Undervaluation (-)
EBA-Lite	-6.3	12.9
Equilibrium Real Exchange Rate (ERER)	-	-7.2
External Sustainability (ES)	-5.2	10.5
Purchasing Power Parity (PPP)	-	2.9

Source: IMF staff estimates.

[7] As in past analyses, the Tokarick (2010) elasticity is used to translate the current account gap into the implied overvaluation, because it is derived on a small-country assumption (see EBS/13/76, p. 81).

In spite of the recent sizable reserve losses, Mozambique's reserve cover remains broadly in line with peers, although this result is not without caveats. The analysis is based on Mozambique's reserve levels at end-March 2015, when NIR reached its lowest level for the year. Low-income countries hold reserves primarily for smoothing consumption/absorption in the event of external shocks, and, to a lesser degree, to cover against episodes of capital flight. For the former the adequate measure for Mozambique is reserve cover relative to non-megaproject imports, which stood at 4.3 months, slightly higher than most peers. However, recent revisions to Balance of Payments data have increased this ratio by around one month, as services imports previously attributed to the traditional economy were reclassified as megaproject imports in line with improved survey data obtained from the megaprojects. While such data improvements are welcome, cover ratios have to be interpreted with caution while such improvements remain ongoing and it is important to keep this in mind when charting out a prudent future reserve path.[8] To judge reserve adequacy against capital flight, the standard measure is reserve cover relative to broad money. At 44 percent, Mozambique's reserves also remain in line with peers on this metric.[9] Finally, Mozambique's reserves are amply comfortable relative to its short-term debt, which they cover six-fold.[10]

Gross International Reserve Coverage Ratios Relative to Peers



Note: End-March 2015 reserves used for Mozambique in numerator of ratios. End-2014 reserves for all other countries.

In evaluating optimal reserve levels for Mozambique, the country's high cost of holding reserves needs to be taken into account. This net holding cost can safely be assumed to exceed 6 percent. Evidence from the government-guaranteed EMATUM external loan and domestic Treasury Bonds suggest that yields for Mozambique lie in the 8-10 percent range. The marginal product of public capital—another opportunity cost of devoting investible resources to reserves—

[8] For instance, work remains ongoing to separately identify such import activity of Mozambican firms that is directly related to supplying megaprojects. Such imports have seemingly led to a level upward shift in imports by the traditional economy from 2012 onwards. For the purpose of the exchange rate assessments using the EBA-lite and external sustainability approaches, staff introduced an ad hoc adjustment to imports to account for this.

[9] Reserve ratios relative to short-term debt are not explored, because short-term crossborder financial transactions remain scarce for the traditional economy, with recent increases mainly driven by megaprojects and transacted off shore.

[10] Short-term debt stock data relate to end-2013 and reserve stock is taken at its trough at end-March 2015.The standard adequacy rule-of-thumb threshold typically cited for this measure is that reserves should cover (once) the country's short-term debt. Peer data are not reported because they are patchy for this measure.

may be higher in light of the country's immense development needs, although work remains in systematically identifying high-yield projects. In line with global interest rates, the return on hard currency reserves is low, below 2 percent.

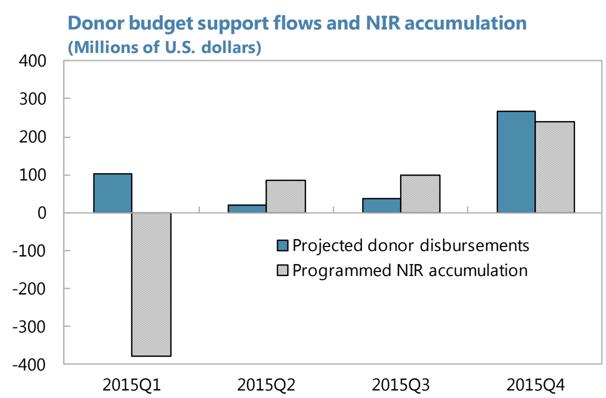
Mozambique's reserves remain largely adequate, but returning to a path of gradual reserve buildup is important. Estimates based on the IMF (2015) contrast this cost with the benefits of holding reserves to cover tail risks. The estimates refer to import cover ratios, which currently need to be interpreted with caution. While cover of imports excluding megaprojects is the more economically relevant measure, the total import cover also needs to be taken into account and it currently stands at the optimal level of 2.7 months. This, in turn, suggests that with respect to non-megaproject imports, 4.5 months are at present a prudent reserve cover. The estimates further illustrate that it is important for the country to continue to rely on exchange rate flexibility to absorb external shocks, as reserve levels may need to be substantially higher otherwise. Finally, the analysis shows that resuming a gradual path of reserve build-up is important to deal with increasing importance of terms-of-trade shocks in the future, as Mozambique will become more reliant on natural resource exports in the next years with coal production planned to expand further and the coming onstream of LNG production.

Projected and Optimal Level of Reserves at end-2015
(months of 2016 imports) 1/

Actual Reserves	
Months of non-MP imports	4.7
Months of total imports	2.7
Optimal level of reserves 2/	
Baseline 3/	2.7
Natural resource rich	3.6
Fixed exchange rate	6.8
Fixed exchange rate and natural resource rich	9.3

1/ Assumes 6 percent cost of holding reserves.
2/ Estimates based on IMF(2015) methodology.
3/ Flexible exchange rate, not resource rich.

The authorities have been adjusting policies as envisaged in their program. Windfall capital gains tax revenues of the last years are not expected to recur going forward. Therefore, policies indeed needed to be adjusted to avoid further losses to reserves and return to a path of reserve accumulation consistent with growth of the economy and evolving risks, while being mindful of the high cost of holding reserves. The absence of capital gains tax windfalls makes donor inflows a natural cap to possible reserve accumulation.[11] Against this backdrop, the authorities will limit FX intervention only to smooth volatility in order to rebuild reserves buffers, elevating reserve cover from its current 4.3 months of projected imports (excluding megaprojects) to above 4.5 months by year end.



Note: Actuals for 2015Q1. Program projection for 2015Q2-Q4.

11 A tight domestic foreign exchange market limits the Bank of Mozambique's ability to rebuild reserves through outright dollar purchases without causing artificial depreciation pressures, making donor inflows a natural cap to possible reserve accumulation.

References

IMF (2015). "Assessing Reserve Adequacy – Specific Proposals", IMF Policy Paper, April, http://www.imf.org/external/np/pp/eng/2014/121914.pdf.

Tokarick, Stephen (2010). "A Method for Calculating Export Supply and Import Demand Elasticities", IMF Working Paper 10/180.

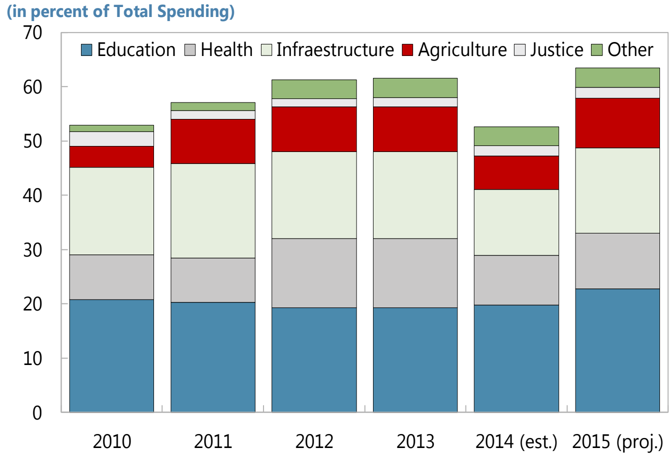
Annex II. Assessing Priority Spending Under Mozambique's PSI-Supported Program[1]

An indicator on priority spending was introduced in the second PSI-supported program (2010-13), and continued under the current PSI-supported program (2013-16). The objective of this indicator was to protect critical social spending from limited budgetary resources and help implement the Poverty Reduction Strategic Paper (PARPA) of the authorities.

The scope of this indicator was rather broad. It covered all budget allocations for certain administrative spending units. This included spending on unequivocally social and pro-poor programs such as education, health, and social protection. However, it also included many other sectors considered as "priority" by the authorities, including infrastructure (public works, energy, water, sanitation and natural resources), agriculture, labor, public administration and interior affairs (including planning, police, and justice). The quarterly targets for priority sectors averaged over 60 percent of total spending. In the 2015 budget, the authorities narrowed the scope slightly, removing some sectors (e.g. police and public administration).

This indicator played a useful role to protect priority spending (Figure 1). In particular, the share of spending in the priority sectors has grown steadily over time, resulting in an increase of about 10 percentage points (from 52.9 percent in 2010, to 63.5 percent in the recently approved 2015 budget). However, 2014 was an exception due to the spending on maritime security, initially arranged through borrowing by EMATUM (see Box 1). It is also important to highlight that spending on social protection and job creation ("other" category in Figure 1) tripled over the period, from 1.2 to 3.6 percent of total spending.

Figure 1.- Priority Spending 2010-15
(in percent of Total Spending)



Sources: Authorities' Budget and Accounting Data and IMF Staff calculations.

However, this indicator has three limitations that hamper the effective monitoring of critical social spending:

- **First, it is too broad and does not prioritize across program types within the same expenditure category**. Even with the revised definition adopted in 2015, close to 60 percent of spending, on average, was considered "priority" over the last six years. In addition, some of the

[1] Prepared by Esther Palacio.

spending items included within a particular priority sector could be questionable. For example, spending on basic education (e.g school materials) and/or critical health (e.g. purchase of vaccines) would be considered a priority to the same degree as spending for other items that are less likely to have the same impact on social indicators. Similarly, without a focus on particular programs, the expenditures of entire ministries would be considered a priority. For example, overhead costs, use of cars and purchase of office equipment in the Ministries of Health and Education would have the same priority as critical social programs to reduce infant mortality or chronic malnutrition, among others.

- **Second, monitoring this indicator has been challenging due to lack of comprehensive timely data**. Priority spending is partially financed by external sources. Although several donors now channel their contributions through the treasury single account (TSA), there is still an important share that is executed outside the system and thus reported with some delays (around three months). As a result, targets that had been initially missed were considered met in subsequent reviews due to data revisions.

- **Third, targets based on this indicator depend on donor disbursements beyond the control of the authorities.** Historically, the performance of domestically financed priority spending has been largely as expected. However, external disbursement can be affected by both the implementation capacity of Mozambique and budgetary constraints in donor countries. When donor disbursement fell short, the related priority spending declined and, in most cases, the priority spending target was missed.

The authorities are in the process of redefining priority spending. A new Five-year Government Plan (PQG) was approved in April 2015, which also includes the national poverty reduction strategy. Within this context, reforms are ongoing to strengthen the link between planning instruments, budget execution and actual results. The government is currently preparing a more detailed program classifier for the 2016 budget, which will have a greater level of detail to better identify and prioritize critical spending. These efforts will help define a new indicator that will narrow the scope of priority spending. Budget execution reports will also have to be modified to use the same classification to ensure consistency with initial budget allocations.

Appendix I. Letter of Intent

Maputo, Mozambique
June 12, 2015

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

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the fourth review under the Policy Support Instrument (PSI) and the modification of three assessment criteria and one indicative target for June 2015 to account for our revised projections, which aim to correct the trends observed since late 2014: a substantial decline in net international reserves amid strong balance of payment pressures, valuation changes on reserves, and slightly higher-than-projected expansion of monetary aggregates. We also request (i) to set assessment criteria and indicative targets for end-December 2015, and indicative targets for end-September, (ii) to reschedule one existing structural benchmark and set new structural benchmarks for 2015-16, in part reflecting delays in the implementation of earlier benchmarks. In support of this request, we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews the implementation of the program supported by the current PSI and establishes policy objectives and assessment criteria and indicative targets for the short and medium term.

The Government in April approved its five-year program for 2015-19 which aims to improve the living standards of Mozambicans through prudent macroeconomic management, efficient public investment, and inclusive growth. Mozambique is also taking decisive steps to be a reference in Sub-Saharan African on fiscal risk management, after becoming the first country in the region to request and publish a Fiscal Transparency Evaluation from the IMF.

The Government is of the view that the policies outlined in the MEFP are adequate to achieve the objectives of the PSI-supported program. We stand ready to take any additional measures necessary to achieve our policy objectives.

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

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

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

Sincerely yours,

/s/	/s/
Adriano Maleiane	**Ernesto Gouveia Gove**
Minister of Economy and Finance	**Governor**
	Bank of Mozambique

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

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

June 12, 2015

1. This MEFP describes recent developments and performance under the Government's economic program supported by the three-year Policy Support instrument (PSI) and elaborates on economic and structural policy objectives. It builds on the MEFP underlying the third PSI review of January 2015.

I. RECENT ECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

2. The Mozambican Economy remains strong, despite fragile prospects in the global commodity market

- **Economic growth remains high**. In 2014 the economy performed well, with an estimated growth rate of 7.4 percent that was in line with program projections. This robust growth was mainly driven by the rebound in agriculture (a recovery from the 2013 floods) and manufacturing, and a vibrant financial services sector. Growth also remained high in the mining sector, albeit somewhat decelerating due to a less favorable outlook in the global coal market.

- **Inflation and monetary policy.** Inflation fell to 1.1 percent at end-December 2014, lower than the 3 percent observed in the same period in 2013. Average inflation reversed the trend of acceleration observed in 2013 and also declined to 2.3 percent in 2014. Low inflation was influenced by unchanged administered prices, increases in agricultural production, and relative stability of the metical during large part of the year. However, given the specificities of 2014, monetary aggregates exceeded initial program projections reflecting a higher demand for money, particularly for currency in circulation.

- **Exchange rate**. In the fourth quarter of 2014 and first quarter of 2015, there was a remarkable increase in the demand for foreign currency in the domestic market, which led to a depreciation of the metical *vis-à-vis* the US dollar of 14 percent in the interbank market which, together with FX transactions between commercial banks and the public, account for about 85 percent of all FX transactions. Pressures on the metical reflected several factors, including (i) the strengthening of the US dollar in international markets; (ii) a high level of imports (excluding megaprojects); (iii) a lower level of non-megaproject exports, which are one of the most important sources of foreign exchange. In order to prevent excessive volatility in the exchange rate, the Central Bank intervened by selling USD 320 million in the last quarter of 2014 and USD 469 million in the first quarter of 2015, but FX sales were moderated substantially (reaching only USD 12 million in April). This led to a reduction in net international reserves, which nonetheless remain at broadly adequate levels.

- **External current account.** Despite a 5 percent fall in merchandise exports due to lower commodity prices, the current account deficit declined by 7 percent to USD 5,797 million in

2014. This represents a current account deficit of 36 percent of GDP compared to 42 percent in 2013. However, the non-megaproject current account balance provides a more direct indication of the sustainability of the external position and deteriorated during 2014. This was driven mainly by a decrease of 2½ percent of GDP in merchandise exports on the back of declining commodity prices. Meanwhile non-megaproject imports remained broadly stable as lower fuel import prices are still to pass through to the domestic economy given the impact of the existing long term contract for fuel imports. This explains in part the exchange rate depreciation pressures that emerged in late 2014.

- **Budget implementation**.
  - The overall fiscal deficit after grants increased from 2.8 percent in 2013 to 10.4 percent of GDP in 2014, while the domestic primary balance decreased from 0.9 percent to -4.1 percent of GDP. The fiscal expansion supported growth and was also associated with one-off factors that will not be repeated in 2015, including electoral spending (0.9 percent of GDP) and the inclusion in the budget of the maritime security component of the loan to EMATUM (2.8 percent of GDP).
  - Revenue collection remained buoyant throughout the year, reaching 27.8 percent of GDP in 2014. Robust performance was supported by strong collection of taxes on income and goods and services.
  - Total public spending at end-December 2014 reached 43.3 percent of GDP, an increase of 8.4 percent of GDP compared with 2013.
- **FDI, aid flows and international reserves**. In 2014, cumulative FDI inflows declined by 21 percent to USD 4,902 million reflecting megaproject cycles, although non-megaproject FDI increased. Gross aid flows stood at USD 1,466 million, with budget support representing USD 393 million. The stock of reserves declined to USD 2,882 million at end-December, a decline of $113 million compared with 2013.

3. Program Performance

- **Three assessment criteria (AC) were not met and all indicative targets were met through end-December 2014**. The reserve money target was exceeded by a small margin (1.5 percent faster growth than the program) due to higher than expected demand for currency in circulation following the electoral process and higher than expected incidence base reflecting the dynamics of the economic activity. Net International Reserves target was missed by US$ 265 million, while the cumulative flow of Net Credit to Government exceeded the target by about 0.2 percent of GDP as a result of unexpected expenditures in the context of the electoral process and the peace agreement.
- **Recent Developments indicate that the performance through end-March 2015 was mixed.** The net international reserve target continued to fall short by a substantial amount in 2015Q1,

suggesting that foreign exchange market pressures continued, and the reserve money target was not observed by a smaller margin 0.1 percent of GDP reflecting difficulties in the process of currency return to the banking system following the floods in central and northern Mozambique in early 2015. The NCG target was met by a large margin.

- **Structural Benchmarks.** The end-March structural benchmark related to the payment or securitization of the stock of VAT refund requests was met. The transaction was completed in March, though a revision on the amounts was introduced in early April 2015 due to a reassessment of some claims by certain companies. The remaining measures expected for June and September of 2015 are on track.

II. MACROECONOMIC POLICIES

A. Economic Objectives

4. The Government's Five Year Program (2015-2019). The Government Program was approved in February 2015, and it outlines the main priorities and strategic actions for the next five years. Emphasis is placed on employment creation, poverty reduction, and greater competitiveness through higher productivity. The national development strategy focuses on five priorities: (i) consolidation of national unity, peace and sovereignty; (ii) development of human and social capital; (iii) promotion of employment, productivity and competitiveness; (iv) development of economic and social infrastructure; and (v) sustainable and transparent management of natural resources and the environment. These priorities are supported by the three following pillars: (i) democratic rule of law, good governance and decentralization; (ii) promoting balanced and sustainable macroeconomic environment; and (iii) strengthening international cooperation.

5. Economic outlook for 2015 and the medium-term.

Macroeconomic policy in 2015-19. Fiscal policy will be geared towards maintaining debt at sustainable levels, gradually reduce dependence on external financing, as well as minimizing the exposure of the debt portfolio to currency risk. In addition to ensuring price stability, monetary policy will create an environment conducive to high growth of credit to the private sector and maintaining adequate reserve levels. In particular,

- **GDP growth**. The government expects growth to reach 7.0 percent in 2015 and accelerate towards the 7-8 percent range during 2016-2019, supported by agriculture, construction and financial services, and spearheaded by expanding coal productions and construction works for LNG projects.

- Average **Inflation** is projected at 4.0 percent and end of period at 5.5 percent in 2015, and will subsequently remain within our medium-term objective of 5-6 percent.

- **External Current account**. The current account deficit will remain high in 2015 (38.2 percent of GDP), but will be financed by FDI.

- **Fiscal Policy**. The overall fiscal deficit (after grants) will decline from 10.4 percent of GDP in 2014 to 6.5 percent of GDP in 2015. Over the medium-term, it will remain in the 5-6 percent of GDP range—a level that will help stabilize public debt while providing adequate fiscal space to reach the government's development objectives.

B. Monetary and Exchange Rate Policy

6. Monetary policy stance for 2015. The Bank of Mozambique (BM) will continue to intervene in the money and foreign exchange markets in order to ensure reserve money growth consistent with our price stability and NIR objectives. The BM will seek to keep reserve money growth at 16.5 percent in 2015, slightly above nominal GDP growth and will aim at maintaining reserves in 2015 at least at the level observed at end-2014.

7. We remain committed to a flexible exchange rate regime. The BM will allow the exchange rate to adjust freely to evolving patterns of trade and financial flows and closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies, with a view to ensuring external competitiveness and a comfortable level of international reserves.

8. The Mozambican authorities remain committed to their obligations under Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. The BM will continue to monitor the implementation of the new foreign exchange regulations, its implementation norms, as well as the functioning of the foreign exchange market, with a view to avoiding practices that could turn out to be inconsistent with Article VIII principles. We will keep IMF staff informed of any developments that could potentially run against those principles.

C. Fiscal Policy

9. Fiscal policy objectives. Revenue is expected to grow by 0.8 percent of GDP (excluding any possible one-off revenues from capital gain taxes and VAT refunds) in 2015, in line with past historical averages and the revenue effort potential demonstrated. Expenditures are expected to decline by 6.4 percent of GDP.[2] As a result, the overall fiscal deficit (after grants) is expected to decline to 6.5 percent of GDP.

10. Revenue outlook. We are committed to continuing our efforts to strengthen revenue collections gradually, continuing our trajectory of improving revenue administration over the medium term. The Revenue Authority is currently updating its reform program after the report of the recent Tax Diagnostic Assessment Tool (TADAT) mission from the IMF.

11. Expenditure policy. The 2015 budget will contribute to poverty reduction by prioritizing the allocation of resources to economic and social infrastructure, human capital, expansion and

[2] One-off expenditures in 2014 will not be repeated this year. This includes the maritime security component of the initial borrowing by EMATUM (2.8 percent of GDP), and the temporary component of election related spending (0.8 percent of GDP).

diversification of public goods and services and public sector reforms. Spending priorities include (i) post-flood reconstruction and social reintegration; (ii) implementation of technological Pilot Census to ensure more efficient and effective planning; (iii) provision of basic infrastructure (roads, bridges, power, water and sanitation); (iv) continuation of social protection programs; and (v) operationalization of the Fund for Peace and National Reconciliation.

- **Wage bill policy**. We expect a reduction in the wage bill in the medium term through (i) a deceleration in the pace of new hiring and in the creation of new institutions in Public Administration; (ii) payment of wages via direct bank transfer in order to prevent circumvention of the salary fund; (iii) enhancing the rigor of the institutions in the payment of allowances related to extra hours; and (iv) verification of the civil servants registry (e-CAF) in 2015.The wage bill is expected to decline to 10.9 percent of GDP in 2015. This will be made possible through a reduced number of new hiring of civil servants (about 11,019 new hires) with focus on the education and health sectors. The bulk of the wage increase in 2015 will be associated with salary adjustments for primary school teachers, nurses and police guards, given their comparatively low wages.

- **Strengthening social protection**. The number of beneficiaries of social protection programs will increase by 25 percent, from 439,144 in 2014 to 550,000 in 2015. Continuous implementation of the Basic Social Protection program in 2015 will absorb about 0.6 percent of GDP. Over the 2016-19 period, the percentage of GDP for Basic Social Protection programs will gradually increase by around 0.1 percent per year, achieving a percentage of one percent of GDP by the end of this period.

- **Subsidies for petroleum products**. The Government continued to subsidize only diesel prices for general consumption (other than megaprojects, construction, public works and other large consumers), but not other fuels. The amount of compensation paid to fuel importers in 2014 was 0.14 percent of GDP related to fuel sales in 2013; the amount due in 2014 was (4.6 billion meticais) to be paid in 2015 through a combination of budget payments and/or cost recovery through the price-setting formula.

- The fuel price for large consumers including megaprojects was adjusted on April 16, 2015 to equalize the price with general consumer market prices. Meanwhile, the Government continues to monitor trends in international markets and domestic market dynamics. The government is studying ways to make the system of fuel imports more transparent and limit the impact on net international reserves, and we intend to adjust the price formula if domestic and international market factors justifies.

- **Other subsidies.** The Government continues to subsidize the price of bread flour, public transportation, and school feeding programs in order to hold down the cost of living for the population and increase school enrollment and learning. These subsidies play an important social role and have a modest impact on the budget – estimated at 0.5 percent of GDP in 2015 (the same level as in 2014).

- **Electricity tariffs.** Current electricity tariffs from 2010 make EDM financially unsustainable. The discussion on tariff adjustment study is ongoing with a view to restoring the financial position of EDM and protecting low income consumers. It is expected that the revised tariff proposal will be submitted to the cabinet by June 2015.

- **EDM performance contract**. According to the public enterprise law, the new board of EDM already submitted the proposal to the Government and it is expected to be signed by July 2015. This is an opportunity to disclose cross transfers between the Government and EDM.

III. PUBLIC FINANCE STRUCTURAL REFORMS

Investment Planning and Debt Management

12. Public Investment Management. We developed budget guidelines for a mandatory technical assessment of investment projects exceeding the value of $50 million for inclusion in the revised integrated investment plan. All new projects added to the revised Integrated Investment Plan, and subject to budget allocations starting in the 2016 budget will be required to have a mandatory assessment by the Investment Evaluation Committee, or any other governmental body created to replace this Committee in the new MEF structure (**structural benchmark**). The Government will continue to improve public investment management, including through a closer analysis of the relationship between public investment and debt sustainability. In addition, institutions in charge of the design and implementation of public investment projects will be strengthened so that public investment project selection and evaluation conforms to sound practices. A mission was sent to Chile in November 2014 to learn from their successful experience in public investment management.

13. Strengthening public debt management: We upgraded our debt management software (CSDRMS2000+) in September 2014, and we continue to reconcile the stock of public external debt with creditors. The annual debt reports include the analysis of the cost and risk associated with the public debt portfolio. We also remain committed to including such analysis in the budget execution reports. By end August 2015, we will revise our Debt Management Strategy with technical assistance from the World Bank, which will consider domestic borrowing strategies to develop the domestic capital markets. The 2015 budget was approved by the Parliament, and the 2015 domestic borrowing plan will be elaborated by end June 2015.

14. Guarantee management policy. The projects that benefit from guarantees are regularly monitored by the Ministry of Economy and Finance to minimize the risk of default. We have built a database to manage all guarantees and we plan to develop capacity to assess the probability and impact of potential default of this exposure with technical assistance from the World Bank and IMF.

Public Financial Management (PFM)

15. PFM Reform Process. We prepared the Terms of Reference to establish the SISTAFE National Meeting and the SISTAFE User Forum, to allow the analysis, discussion, evaluation and dissemination of SISTAFE reforms, which in the future will cover the whole spectrum of PFM reforms. These instruments are intended to enhance the communication channels and consultation between line ministries, provinces, private sector and development partners. We will also revise our PFM vision by end 2015, updating the underlying macroeconomic assumptions and the action plan according to the lessons learned during the first phase of its implementation (2010-2014).

16. Expenditure coverage and tracking. We registered progress in the coverage of the integrated financial management system (e-SISTAFE). By end 2014 the share of expenditures paid through e-SISTAFE directly to the beneficiary reached 67.83 percent of total spending, more than the 65 percent initially planned. We remain committed to increasing the coverage of the expenditures paid directly and, achieve the target of 70 percent planned for end 2015, and 75 percent in 2016. This requires completion by end 2015[3] of the system's geographical roll out, technical conditions permitting.

17. Real time registration of commitments. This reform will improve the efficiency in the management of the expenditure tracking software (e-SISTAFE) and allow greater control of budget execution. We conducted the test phase with the payment of debt service, and now we are discussing the use of the different stages of the expenditure chain for the payment of wages. Work is in progress to implement the revised procedures for the payment of wages established in the Ministerial Diploma no. 210/2014, of December 9. To make further progress in this regard, the government intends to develop and make operational the asset module of e-SISTAFE by making the real-time recording of the commitment and verification of expenditures mandatory for all units operating within e-SISTAFE by January 2016 **(structural benchmark)**. This reform will make it possible to better align the stages of commitment, verification and payment with the timing of the various economic transactions.

18. Wage bill management. The process of expansion of e-Folha for State agencies and institutions that have e-SISTAFE is under way. At end of March 2015, 294,322 civil servants and State agents had been registered in the e-CAF system. Of the total staff registered in e-CAF, 254,016 are paid through direct transfers, including 232,085 which are paid through e-Folha. Our plan is to increase the percentage of staff registered in e-CAF being paid by e-Folha to 95 percent by end-2015. We intend to undertake a Proof of Life audit to all registered civil servants in 2015.

19. Cash management. We remain committed to extending the use of the treasury single account (CUT). In order to reduce the number of bank accounts outside the CUT (Circular No. 02/GAB-MF/2014), consultations are ongoing with all line ministries and commercial banks to map all government bank accounts outside the CUT. This process is expected to be concluded by June 2015 and it will be followed by an action plan to ensure that all revenues are transferred into the CUT, including own revenues of budgetary institutions.

[3] 81.1 percent of spending units (UGB's) currently have direct access to the system (1,247 of a total of 1,538).

20. Scope of the public sector. The revision of the SISTAFE Law which is expected to take place by January 2016 will broaden the scope of the public sector and make it consistent with international standards. In addition, a new law defining the statute of public funds and autonomous entities has been drafted and is under revision.

21. Fiscal risk management. The new Government recently merged the Ministries of Finance and Planning and Development into the Ministry of Economy and Finance. A new structure for the Ministry is being designed. It will incorporate a fiscal risk management unit by end December 2015. We are also committed to preparing an initial statement of fiscal risks for inclusion in the 2016 budget documentation by October 2015. The statement will be prepared with IMF technical assistance and will highlight general risks to the budget stemming from possible changes in macroeconomic assumptions, and possible risks associated with state guarantees, PPPs, and large public sector, or public sector participated, corporations (**structural benchmark**). Follow up technical assistance from the IMF should also help implement the recommendations of the 2014 fiscal transparency evaluation report.

22. Fiscal rule for windfall revenue. Large and regular influx of natural resource revenue from LNG is expected to start in a decade. But we expect that additional capital gain taxes associated with transactions involving transfers of ownership stakes in large natural resource projects might occur in the next few years. To ensure the use of these resources only for public investment, debt repayment, and national emergencies[4], the Draft 2015 Budget Law includes an ex-ante rule for the use extraordinary revenues, including windfall revenue (structural benchmark June 2015).

23. **Public Expenditure and Financial Accountability (PEFA)**. We plan to conduct the Fourth PEFA evaluation to cover 2012 -2014, given that in 2015 we are initiating a new programming cycle of 5 years, and the fact that 4 years have already passed since the last PEFA assessment. The assessment intends to provide an independent assessment of progress on public financial management (PFM) in Mozambique based on the current PEFA methodology using information over the period 2012-2014 and comparing the results with the 2011 last PEFA exercise.

Revenue administration

24. VAT administration. The securitization of the stock of unpaid VAT refund requests for a total amount of about 8.2 billion meticais (cumulative stock as of end 2014 reconciled with creditor companies) occurred through a private placement of debt (securitization) that was completed in April 2015, with a slight delay due to the need for data reconciliation between the revenue authority and one of the major creditor companies. All the technical work had been completed by March as planned. The net VAT system was also successfully introduced in the 2015 budget. We plan to

[4] In case of temporary severe cash constraints generated by unexpected shortfalls in budget support, windfall deposits could be used on a temporary basis.

conduct an assessment of the VAT system for megaprojects with technical assistance from the IMF by end September 2015, and an action plan is expected in order to revise the VAT Code accordingly.

25. Implementation of e-Tax. The registration of taxpayers into the new electronic system advanced considerably, reaching 55 percent of all VAT taxpayers by March 2015. Further progress is expected to achieve our target of 65 percent by end-2015, which is a considerable achievement given that this is the first year of implementation of this reform. Starting in November 2014, we rolled-out the e-tax collection system for VAT and ISPC, with a current coverage that includes 14 of the largest tax offices. We are committed to expanding collections of the VAT and ISPC taxes through e-tax by end-2015 in 32 tax offices of a total of 66 offices, technical conditions permitting Work is also ongoing to publicly launch the online taxpayers' portal connected to e-tax by end November 2015.

26. Tax payment through banks. We successfully worked on the alignment of procedures to validate and conduct bank payment reconciliations with two banks. We are currently preparing the contracts to be signed with other commercial banks to formalize the process. With a view to launching the facility to the public, we will conduct public campaigns through the media and invite taxpayers to join the system. By end 2015 we expect to cover the majority of tax payers. This will allow having electronic control of the revenue collected by DGI.

27. Modernizing the Revenue Authority (AT) to improve revenue collection. We assessed the revenue administration using the TADAT diagnostic tool with technical assistance from the IMF in March and a report was concluded in May 2015. We will elaborate an action plan by the third quarter of 2015 to address the recommendations from the diagnostic. Main weaknesses are related to the integrity of the registered taxpayers base, and low ratios of ontime filling of tax returns and payment of tax obligations. Through the task force created, we remain committed to assessing the AT current organization structure with a view to improving managerial practices, with the IMF technical assistance, also by the third quarter of 2015. We also plan to revise the customs tariffs with a view to promoting the agriculture sector, namely, to reduce costs of production factors and agricultural inputs.

Natural Resource Management

28. Extractive Industry Transparency Initiative (EITI). The 5th EITI Report (based on 2012 data) was prepared and published on the Mozambican EITI website according to the calendar of the International EITI Secretariat. It was launched to the public in Maputo in April, 2015 and will be disseminated throughout the country shortly. The report contains information about 56 companies (gas sector and mining) and the overall discrepancy between payments and receipts is less than 1.5 percent, below the limits stipulated by the EITI Coordination Committee in Mozambique (which is 3 percent). The report covers comprehensive information on the sector, including legal regime, production and employment data, and other requirements of the new EITI standards. Mozambique fully complies with the new EITI standards. We already started the preparation of the 6th EITI report, which will incorporate 2013 and 2014 data.

29. Mining and Hydrocarbon Legislation. The Law on Hydrocarbon and Mining was approved in August 2014. The preparation of its regulations is ongoing and expected to be submitted to the Cabinet by end-July 2015 for approval.

30. Strengthening the Mining and Hydrocarbon Tax Regime. The regulations of the mining and hydrocarbon fiscal regimes which benefited from IMF technical assistance are under consultation with all stakeholders and are expected to be submitted to the Cabinet for approval by end-June 2015.

31. Development of natural gas liquefaction. The Decree-Law as the instrument to operationalize the development of natural gas liquefaction plants in the Rovuma Basin Project was approved in December 2014. At present, discussions are ongoing to amend the Exploration and Production Concession Contract (EPCC) requested by the Concessionaire of Area 1. Both concessionaires of Area 1 and 4 are currently engaged in discussions of trade agreements with a view to implementing LNG projects in the Rovuma Basin, focus on the development of deposits in the fields of Golfinho and Coral, respectively, and further develop the unused deposits of Prosperidade and Mamba, which will require a unitization agreement.

Public Enterprises and Enterprises with State Participation

32. Strengthening supervision of public enterprises and enterprises with State participation.

- The 2013 Annual Reports and financial accounts of the six largest State Owned Enterprises (SOE's) were published as envisaged in December 2014 MEFP; and the summary report on the operations and fiscal risks of all 14 SOEs was elaborated and is expected to be submitted to the Council of Ministers by end September 2015.

- The proposal for a Law on the Corporate Sector of the State, with a focus on the companies were the state has a participation below 100 percent, was submitted to the Council of Ministers at end-2014 and is expected to be discussed in June 2015. Then it will be submitted to Parliament for approval.

- Furthermore, with respect to enterprises with State participation, IGEPE is consolidating the State portfolio including through privatization and liquidation. A stronger system to follow-up and control of state corporations is also being introduced. In particular, a new software to report financial information will become operational by end-July 2015. This software will allow the collection and analysis of financial statements and the identification of potential fiscal risks. Beginning in August 2015, a pilot system will start with the 5 largest corporations, which will also be subject to performance contracts.

33. EMATUM. In an effort to increase transparency associated with the operations for this company, (i) the external audit report on EMATUM 2013 operations was published in December 2014, and (ii) the additional defense equipment purchased by the company for the Ministry of Defense ($150 million) has been added transparently into the 2014 State financial accounts (CGE), bringing the total portion of spending for maritime security to $500 million. The 2014 external audit report of EMATUM was published on May 29th 2015. The company will also publish its revised business plan by end-July 2015. The Government will take over the part of the loan ($500 million) that was not associated with commercial tuna fishing activities and will monitor the operations of EMATUM through the company's quarterly reports.

FINANCIAL SECTOR POLICIES

Strengthen Monetary Policy Formulation and Implementation

34. Monetary policy framework. The BM will continue to strengthen the monetary policy framework and to improve its analytical tools and communication as part of its monetary policy decision-making process, including by improving its inflation forecast model with technical assistance from the IMF.

35. **Inflation forecasting model**. The Forecasting and Policy Analysis System that includes a money block has been finalized and the analysis of the properties of the new system has been tested successfully. Shadow forecasts under the new framework have been monitored by the BM Monetary Policy Committee since December 2014.

36. The BM has made considerable progress towards improving its liquidity management framework. A new liquidity forecasting framework has been developed, with the support of IMF technical assistance. The preliminary results show that the new framework performs better than the previous model in terms of forecasting for currency demand and the impact of government operations. However, technical work is still in progress in order to further improve the forecast of impact stemming from government operations as well as to extend the forecasting horizon. We plan to adopt the new liquidity forecasting framework by December 2015.

37. Information sharing and coordination between the MEF and BM. Progress has been achieved in the coordination between the MF and BM in recent years to improve liquidity management. Under the MoU between BM and MF, the latter has been sharing, on a weekly basis, relevant short-term statistics on government operations with BM. The MF will provide the BM with historical information on classifications of payments to help improve its forecasting accuracy.

38. Money market management. The legal issues pertaining to the functionality of the money market under the reform towards allowing T-bonds as collateral in money market operations have been resolved and wait for approval. The IT issues are not concluded yet, as some adjustments need to be done to the BM IT platform. This action is expected to be completed by September 2015 **(structural benchmark).** We also remain committed to increasing the level of trading activity in the monetary market, especially for the secured transactions. In this regard, we expect to implement fully by end-January 2016 the law that requires 20 percent withholding tax on interests earned on T-bills, OTs, secured and unsecured interbank transactions **(structural benchmark)**.

Financial Sector Surveillance

39. The BM remains committed to strengthening of banking system supervision and crisis management

40. Stress testing and non-performing loans (NPLs). Stress testing has been carried out on a quarterly basis and the BM continues to strengthen the data collection process in order to obtain more granular data. The December 2014 stress test report was produced and submitted to the Board of BM. While the results show low risk of financial sector distress, credit concentration remains the largest source of risk. The adoption of the revised NPL definition started in January 2014. At end-December 2014, the NPL ratio remained relatively low at 3.3 percent.

41. Risk-based supervision and Basel II adoption. By end-February 2015, four large banks had been subject to on-site inspections. Four new inspections are currently taking place and expected to be finalized by end-June 2015, one in a large bank and three in medium-size banks. The on-site inspection activity will gradually cover the whole banking sector under the new methodology. In order to complete the revision of the draft regulation on concentration limits, including investment abroad, by end-September 2015, a study assessing the compatibility of the draft regulation with Basel II principles has been finalized and an analysis is ongoing to determine the prudential weights to be under the new regulation.

42. Financial Sector Contingency Plan. Following the approval by the Board of BM of an action plan in November 2014, the first crisis simulation exercise was carried out on April 25, 2015, with the technical support from the World Bank. We expect that a detailed report from this exercise will be submitted to the BM board by end-September 2015, and an action plan will be developed later to address the risks identified in the simulation exercise.

43. Deposit Insurance Fund (DIF). The Executive Board of DIF plans to submit its report on funding and implementing the DIF to the BM Board by June 2015. The Government has committed its initial contribution of MT 60 million in the 2015 budget, which is expected to be disbursed in the third quarter of 2015. The commercial banks have already made their initial contributions of MT 15 million in January 2015, while the Executive Board of DIF continues to work with KfW to secure its disbursement of €3.5 million. The remaining funding gap will be closed through investment returns on the initial contributions of these three sources, which is expected to take 4-5 years. However, the Executive Board of DIF is actively seeking additional financial support from the government and international institutions, which would shorten the period before the DIF becomes fully functional.

Financial Sector Development

44. Financial Sector Development. The Financial Sector Development Strategy (FSDS) 2013-2022 main objectives are to: (i) maintain financial sector stability; (ii) increase access to financial services and products, eliminating structural constraints in the economy, specifically those that limit financial intermediation and access to financial services; and (iii) increase the supply of private capital to support private sector development. On the implementation of the FSDS in the first half of 2014 the findings were that most of the planned activities were implemented, some of them as prior actions of the World Bank's DPO I. These actions were focused on adopting reforms in the areas of (i) financial stability; (ii) financial inclusion and education; and (iii) debt market as detailed below. While some activities could not be undertaken due to insufficient financial resources, the World Bank has committed technical assistance to support the development of debt market and preparation of the national financial inclusion strategy. Consistent with the new Government structure, a proposal is under consideration for the revision of the FSDS Steering Committee Membership.

- **Promoting financial inclusion.** The BM intends to submit to the Council of Ministers the National Financial Inclusion Strategy by end-December, 2015 **(structural benchmark)**. Two regulations, Notice 1/GBM/2015 on "bank agencies opening criteria" and Notice 2/GBM/2015 on "connection to the single national electronic payment network", were published in the official Gazette in April 2015. The Notice on the "Regime of Access and practicing of banking agents activity" was approved in April 2015 while the Notice on "cash recirculation" is expected to be finalized by end-September 2015. These 3 governor´s notices are intending to contribute in the improvement of the access and usage of financial services throughout the country.

- **Establishing credit registry bureaus** (CRB). The proposal of Law on the creation of private credit registry bureaus was submitted to Parliament in February 2014, but was not discussed due to a very heavy parliamentary agenda in 2014. Given the change in Government, the Law will be resubmitted to the Parliament by end-June 2015.

- **Promotion of mobile banking**. A new regulation on electronic money has been drafted and submitted to the BM board for approval expected by end-June 2015. The new regulation imposes a requirement for the E-money issuers to deposit the funds received against issuing of E-money in a custody account (termed "trust account") as a mean of protection of the money owed to E-money holders, should they need to redeem it.

- **Promotion of competition within the banking sector.** The first stage of the revision of the Notice 05/GBM/2009 has been completed. The new Notice seeks to include a new and broad list of denomination of free of charge financial products and services.
  The draft Notice will follow a process of dissemination amongst the main stakeholders, before its final approval by end-December 2015.

- **Centralizing the registry of security holdings**. The establishment of the Central Securities Depository in June 2014 allowed all transactions to be done through the central securities depository. This improved the process of (i) clearing and settlement trading; (ii) coding of securities; (iii) registration of securities and holders; (iv) registration of issuer entities not listed in Mozambique Stock Exchange; and (v) payments of interest and dividend. As a result, the volume of transactions increased as they now occur in every working day rather than 3 days a week. The number of securities listed in the Stock Exchange increased from 34 in early 2014 to 43 at end-2014; in 2014 the trading volume increased by 127 percent (to 4,606 million MT) relative to 2013. The capitalization level increased to about 42,214 million MT at end-December 2014, corresponding to an increase of 17 percent compared to 2013. The Stock Exchange is in the process of drafting the terms of reference for the acquisition of a new system with the view to modernize the existing trading system, as a way to complement the improvements brought by the Central Securities Depository.

- **Moveable collateral framework**. The draft Law on the moveable collateral will be finalized by end-June 2015, following the discussions with the technical assistance from GIZ. Given the cross-cutting nature of the draft Law, a workshop is envisaged to take place in July 2015 in order to consult with the main stakeholders, which will delay its submission to Council of Ministers by mid-November 2015 **(rephased structural benchmark for September 2015).**

45. AML/CFT Framework. The guidelines for commercial banks on AML/CFT have been finalized and approved by the BM Board in May 2015. The Guidelines include standards to promote compliance with the obligations described in Law no. 14/2013 and its Regulation.

Payment System

46. Reforms in the Payment System

- **Developing the retail payments network (SIMO).** A new regulation on the connection to the single national electronic payment network has been approved, awaiting its publication. The new regulation (Notice 02/GBM/2015) includes, among other issues, the migration schedule within 12 months agreed with the banks.

Business Environment

47. The implementation of the Business Environment Improvement Strategy (EMAN II 2013-2017) is underway.

- **The registration and licensing of economic activities is speeding up.** The e-BAU platform is currently being installed in Maputo (Matola), Gaza, Inhambane, Sofala, Tete, Nampula and Cabo Delgado, and completion is expected by June 2015. The installation phase will be followed by on-the-job training activities for front and back offices officials. In order to improve disclosure of business-relevant information to the private sector, the website www.portaldocidadão.gov.mz will also be upgraded by June 2015.

- The time for licensing commercial activities reduced and can be done in one day or next day, if there is a need to conduct inspections in the business locations. This is being implemented in the provinces and City of Maputo, Xai-Xai, Inhambane, Beira Nampula, Pemba and Tete. The Industrial licensing of big projects is now done on average within 15 days and the simplified licensing reduced to 1 day.

- The process of interoperability between institutions is underway, including the Ministry of Justice, Constitutional Affairs and Religious, Revenue Authority, Ministry of Agriculture and Food Security, Ministry of Labour, Employment and Social Security and Ministry of Land, Environment and Rural Development

- In the medium term we are committed to review the policies and strategies for the industry and small and medium business;

Program Monitoring

48. The proposed assessment criteria and indicative targets up to December 2015 are shown in Table 1. Table 2 included a list of existing and proposed structural benchmarks. The 5th PSI review is expected to be completed by end-December 2015 (as specified in the MEFP date December 12, 2014) and the 6th review by June 15, 2016.

Table 1. Assessment Criteria and Indicative Targets

(Millions of meticais, unless otherwise specified)

	2014				2015											
	End-Dec Assessment Criteria				End-Mar Indicative Target				End-June Assessment Criteria		End-Sept Indicative Target		End-Dec Assessment Criteria			
	Prog.	Adj. Target	Act.	Status	Prog.	Adj. Target	Prel.	Status	Prog.	Proposed	Prog.	Proposed	Proj.	Proposed
Assessment Criteria for end-June/December														
Net credit to the central government (cumulative ceiling)	2,594	2,594	4,122	NM	4,146	4,146	-2,532	M	-1,902	-2,826	-5,675	-3,785	6,391	4,895
Stock of reserve money (ceiling)	55,299	55,299	56,969	NM	53,559	53,559	54,112	NM	58,866	58,230	62,940	61,938	65,529	64,411
Stock of net international reserves of the BM (floor, US$ millions)	3,147	3,147	2,881	NM	2,990	2,990	2,512	NM	3,048	2,550	3,201	2,650	3,398	2,889
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US$ millions)[2]	1,500	1,500	1,298	M	1,500	1,500	1,298	M	1,500	1,500	1,500	1,500	1,500	1,500
Stock of short-term external debt contracted or guaranteed by the central government (ceiling)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
External payments arrears of the central government (ceiling, US$ millions)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
Indicative targets														
Government revenue (cumulative floor)	143,957	143,957	146,397	M	30,200	30,200	30,833	M	69,460	70,093	110,230	110,230	151,000	151,000
Priority spending (cumulative floor)[3]	119,000	119,000	115,698	NM	…	…	…	…	…	…	…	…	…	…

Sources: Mozambican authorities and IMF staff estimates.

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

[2] Assessed on a continuous basis.

[3] Targets will be set in the 5th PSI review after the authorities revise the definition.

Table 2. Mozambique: Structural Benchmarks for 2015-16

Structural Benchmarks	Date of Implemen-tation	Comment	Macroeconomic Relevance
The Government will issue budget guidelines requiring a mandatory technical assessment by the Investment Evaluation Committee for new public investment projects to be included in the 2016 and subsequent budgets of a value of $50 million or more. (¶17 of the MEFP dated December 12, 2014)	End-May 2015	Not met. Proposed to be rescheduled to July 2015	Strengthening public investment management
The government will either pay or securitize the stock of valid VAT reimbursement requests submitted up to end-2014. (¶ 27 of the MEFP dated December 12, 2014)	End-March 2015	Met	Strengthening tax administration
The Government will finalize and fully operationalize the IT application for payments of VAT, ISPC, and corporate and personal income taxes through banks. (¶29 of the MEFP dated December 12, 2014)	End-June 2015	Approved in 3rd Review	Strengthening tax administration
The use of T-bonds as collateral in money market operations will become operational. (¶41 of the MEFP dated December 12, 2014)	End-September 2015	Approved in 3rd Review	Deepening capital markets
The Government will include in the draft 2015 budget a fiscal rule on the use of windfall revenue only for investment spending, debt reduction and exceptional needs. (¶26 of the MEFP dated December 12, 2014)	End-June 2015	Approved in 3rd Review	Ensuring fiscal sustainability
The draft law on the establishment of a movable collateral registry will be submitted to the Council of Ministers. (¶47 of the MEFP dated December 12, 2014 and ¶44 of this MEFP)	End-September 2015	Not expected to be met. Proposed to be rescheduled to November 2015	Deepening financial markets

Table 2. Mozambique: Structural Benchmarks for 2015-16 (concluded)

Produce an assessment on fiscal risks for inclusion in the 2016 budget documents. (¶21 of this MEFP)	End-October 2015	Proposed	Improving the management of fiscal risks (PFM)
Complete mandatory assessments by the Investment Evaluation Committee (or any other government body created to replace this Committee in the new MEF structure) of all public investment projects exceeding $50 million that are included in the 2016 budget and/or the revised integrated investment program (IIP). (¶12 of this MEFP)	End-December 2015	Proposed	Strengthening public investment management (PFM)
Submit to the Council of Ministers the National Financial Inclusion Strategy by the Bank of Mozambique. (¶44 of this MEFP)	End-December 2015	Proposed	Increasing access to financial services
Issue a decree or administrative order that makes the real-time recording of the commitment and verification of expenditures mandatory for all units operating within e-SISTAFE. (¶17 of this MEFP)	End-January 2016	Proposed	Strengthening expenditure coverage and tracking (PFM)
Enforce the law that requires 20 percent withholding tax on interests earned on T-bills, OTs, secured and unsecured interbank transactions. (¶38 of this MEFP)	End-January 2016	Proposed	Developing the Interbank Money Market

Sources: IMF staff and the Mozambique authorities.

Attachment II. Technical Memorandum of Understanding

June 12, 2015

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

DEFINITIONS

A. Net credit to the central government

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

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

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

B. Government revenue and financing

5. Revenue is defined to include all receipts of the General Directorate of Tax (*Direcção Geral dos Impostos*, DGI), the General Directorate of Customs (*Direcção Geral das Alfândegas,* DGA), and nontax revenue, including certain own-generated revenues of districts and some line ministries, as defined in the budget. Revenue is gross revenue net of verified VAT refund requests (*pedidos verificadas de reembolsos solicitados*). Net receipts from privatization received by the National Directorate of State Assets (*Direcção Nacional do Património do Estado*) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

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

C. Priority social spending

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

D. Reserve money

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

E. Net international reserves

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

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

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

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

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

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

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

H. External payments arrears of the central government

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

I. Foreign program assistance

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

J. Actual external debt service payments

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

ADJUSTERS

K. Net international reserves

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

- downward by the shortfall in external program aid less debt service payments (up to US$200 million), compared to the program baseline (Table 1);
- upward by any windfall capital gain tax receipts in excess of US$30 million collected during

the program period;

- downward/upward for any revision made to the end-year figures corresponding to the previous year; and
- downward to accommodate higher external outlays because of natural disasters, up to US$20 million.

L. Net credit to central government

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

- upward by the shortfall in the MT value of external program aid receipts less debt service payments (up to the MT equivalent of US$200 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
- downward by any windfall capital gain tax receipts in excess of US$ 30 million collected during the program period;
- downward by privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings accounts abroad;
- downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector; and
- upward to accommodate the higher locally-financed outlays because of natural disasters, up to the MT equivalent of US$20 million at exchange rates prevailing at the respective test dates.

M. Reserve money

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

N. Government revenue

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

DATA AND OTHER REPORTING

20. The Government will provide Fund staff with:

- monthly and quarterly data needed to monitor program implementation in relation to the program's quantitative targets and broader economic developments;
- weekly updates of the daily data set out in Table 1;

- weekly data set out in Table 4 of the TMU dated May 26, 2005;
- monthly updates of the foreign exchange cash flow of the BM;
- monthly data on government revenues (in detail according to the fiscal table) with a lag not exceeding one month;
- monthly data on verified VAT refund requests;
- monthly information on the balance of government savings accounts abroad;
- monthly data on domestic arrears;
- monthly data on external arrears;
- monthly budget execution reports (that will also be published) with a time lag not exceeding 45 days;
- the "mapa fiscal" with a time lag not exceeding 60 days;
- monthly monetary survey data with a time lag not exceeding 30 days;
- monthly data on gross international reserves, with the composition by original currencies and converted to US dollars at the actual exchange rates; and
- quarterly balance-of-payments data with a time lag not exceeding 65 days;
- monthly disbursements on the nonconcessional Portuguese credit line with a time lag not exceeding 30 days.

21. 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.

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

TMU Table 1. Mozambique: Net Foreign Assistance, 2014Q4-2015Q4

	2014	2015			
	Q4	Q1	Q2	Q3	Q4
	Act.	Act.	Projections		
Net foreign program assistance (US$ mn)	90	69	-56	-54	221
Gross foreign program assistance	176	103	19	36	268
Program grants	122	80	19	36	95
Program loans	54	24	0	0	173
External debt service	86	35	75	90	47
Cumulative net foreign program assistance in US dollars	113	69	13	-41	181
Gross foreign program assistance	394	103	123	159	427
External debt service	281	35	109	200	247
Net foreign program assistance (MT mn)	2,924	2,355	-1,943	-1,890	7,746
Gross foreign program assistance	5,705	3,540	676	1,274	9,380
Program grants	3,956	2,731	676	1,274	3,332
Program loans	1,750	809	0	0	6,048
External debt service	2,781	1,185	2,619	3,165	1,634
Cumulative Net foreign program assistance in MTN millions	3,610	2,355	412	-1,478	6,268
Gross foreign program assistance	12,490	3,540	4,217	5,491	14,870
External debt service	8,880	1,185	3,804	6,969	8,602

Source: Mozambican authorities and IMF staff estimates.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

June 16, 2015

Approved By
David Robinson and Ranil Salgado (IMF)

Prepared by the staff of the International Monetary Fund (IMF)

This debt sustainability analysis (DSA) updates the joint IMF/IDA DSA from April 2014.[1] *Mozambique remains at moderate risk of external public debt distress. While key indicators continue to remain below the thresholds in the baseline scenario, gradual fiscal consolidation, as agreed under the program, is needed to keep debt sustainable. Against this backdrop, further improvements in debt management and investment planning capacity are essential to appropriately balance this consolidation with the importance of public investment for development. This is particularly important as there is a current large pipeline of upcoming investments, which need to be appropriately scrutinized and contracted at a measured pace to retain debt sustainability. As public debt is largely external, the evolution of total public debt indicators mirrors that of public external debt. Private external debt is expected to increase rapidly in importance, driven by investment in the natural gas sector, and to comprise the majority of external debt by the end of this decade. The authorities were in broad agreement with the DSA outlook and presentation. Their technical comments have been taken on board.*

[1]The DSA presented in this document is based on the standard low-income countries (LIC) DSA framework. See "Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries" (http://www.imf.org/external/pp/longres.aspx?id=4827) and World Bank Report No. ACS6956, 10/23/13). Under the World Bank Country Policy and Institutional Assessment (CPIA); updated on July 25, 2014 with the 2013 CPIA rating, Mozambique maintains the medium policy performer rating, albeit close to the threshold of 3.75 for strong performers, with an average rating of 3.67 during 2011–13; the DSA uses the indicative threshold for medium performers for 2014-15.

UNDERLYING DSA ASSUMPTIONS

1. **This DSA is consistent with the macroeconomic framework outlined in the Staff Report for the Fourth Review under the PSI** (Box 1). Compared to the previous DSA,[2] the main changes in this DSA are as follows:

a. **The medium-term macroeconomic framework has been updated but is similar to the last DSA** (Text Table 1). The economic outlook remains positive, although somewhat less buoyant than projected during last DSA, with economic growth at 7.4 percent in 2014 and projected at 7 percent in 2015 (compared to 8.3 and 8.2 percent respectively). The main reasons being slower-than-expected increases in coal production, political uncertainties before the presidential election in 2014, and the effects of the floods in early 2015. Nevertheless, growth is expected to accelerate over the medium term on the back of extractive industries and infrastructure investments. The overall fiscal deficit was higher in 2014, with expenditure loosening influenced by the electoral cycle and one-off spending on maritime security (2.8 percent of GDP). To ensure debt sustainability, substantial fiscal consolidation is expected in 2015, mainly through a reduction in public spending and continued improvement in domestic revenue mobilization.[3] The current account deficit is projected to remain in the range of 38-45 percent of GDP over the medium term reflecting significant imports of goods and services related to the development of the gas and coal sectors. These imports are financed primarily by non-debt creating FDI.

Text Table 1: Evolution of Selected Macroeconomic Indicators between DSA Updates

	2013	2014	2015	2016	2017
			Projections		
Real GDP growth (%)					
Previous DSA	7.1	8.3	8.2	8.2	7.9
Current DSA	7.4	7.4	7.0	8.2	7.9
Nominal GDP (US$ billion)					
Previous DSA	15.3	17.1	18.7	20.8	23.2
Current DSA	15.6	16.7	17.0	19.0	21.2
Overall fiscal deficit (% of GDP)					
Previous DSA	2.8	9.2	7.5	6.6	5.8
Current DSA	2.7	10.3	6.5	5.1	5.5
Current account deficit (% of GDP)					
Previous DSA	39.5	46.9	47.0	43.8	52.0
Current DSA	40.0	34.7	38.2	42.1	39.9
FDI (% of GDP)					
Previous DSA	36.5	33.0	28.6	26.4	24.1
Current DSA	39.5	29.4	23.8	24.7	22.9

[2] See IMF Country Report No. 14/148.

[3] From 2020 onwards staff adopts a relatively conservative approach with public debt stocks falling by less than implied by projected growth (and the fiscal deficit path) due to the uncertainty surrounding the LNG development, which constitutes a major growth driver in this period. This results in modestly positive residuals in the analysis of public debt.

Box 1. Macroeconomic Assumptions 2015–35

The medium-term assumptions in the baseline scenario for 2015-35 are consistent with the medium-term macroeconomic framework underlying the Staff Report for the Second Review under the Policy Support Instrument.

Real GDP growth is projected to be in the 7-8 percent range on average in the longer term. Growth is expected to accelerate over the medium term, supported by the expansion in coal mining and infrastructure investments, including support for coal exports and LNG manufacturing. A sharp increase in growth in 2020 reflects the assumed coming on line of the first natural gas production plant ("train") and related exports in that year. Growth is sustained in the long term by strong population/labor force growth, continued infrastructure investment, and related productivity gains. Risks to growth include public and private investment not achieving expected payoffs and thus limiting productivity gains, and the possibility of Dutch disease.

LNG sector. LNG plants are assumed to be under construction during 2016–22. The projection assumes a moderate-sized plant consisting of four LNG manufacturing units ("trains"). One train is assumed to start production in 2020, followed by a second train in 2021, and the third and the fourth train will start production in 2023. Total investment is projected at $40 billion. The sector's contribution to GDP is expected to be small during the construction period due to high import content. Annual LNG output will reach 20 million tons in 2023, contributing more than 20 percent of nominal GDP by then. These assumptions are conservative given the potential size of the project, but remain adequate before a final investment decision is made by the investors.

Consumer price inflation is projected to remain in the authorities' target range of 5–6 percent over the medium term.

Export Growth is projected to remain around 7 percent a year in the longer term as coal and LNG exports stabilize. In the short term, export growth rates show sharp changes as a result of large coal and LNG development project cycles. In particular the growth rate of exports would almost double in 2020-23 due to LNG exports coming on line.

Imports are projected to show abrupt jumps in 2016-2023 during the LNG plant construction phase but their growth would stabilize at around 8 percent a year in the long term.

The non-interest external current account deficit is projected to rise to over 40 percent of GDP in the medium term largely driven by LNG-related imports.[4] The deficit will be primarily financed through FDI and private external borrowing. It would then average 14 percent of GDP in the long term as coal exports increase with transport capacity and as LNG exports start.

The non-interest primary fiscal deficit is projected to widen in 2014, reflecting an expansionary budget in an election year, including one-off expenditure on maritime security (2.8 percent of GDP). The fiscal balance would improve in the medium to long term as revenue efforts continue, the wage bill and public investment taper off to more sustainable levels and other non-interest current expenditure falls in percent of a fast-growing GDP. The fiscal balance is expected to improve further beyond 2020 once LNG revenue commences.

[4] Meanwhile, the non-megaproject current account is expected to remain on the order of 11-12 percent during the next years.

b. External borrowing profile. New borrowing has generally been contained since the last DSA, but the amount of pending applications for large bilateral loans has increased and now surpasses US$ 2.2 billion (Text Table 2), although it does not include all priority projects of the government's five-year investment plan.[5] This pipeline is expected to lead to an increase in external borrowing compared to the previous DSA, with more costly domestic financing being scaled back to achieve the envisaged fiscal consolidation.[6] While about two-thirds of this external loan pipeline is envisaged to be contracted on concessional terms, the total borrowing approaches the pipeline of 2012-13 (US$ 3 billion), which ultimately elevated the risk of debt vulnerability rating from low to moderate (Country Report 13/200).

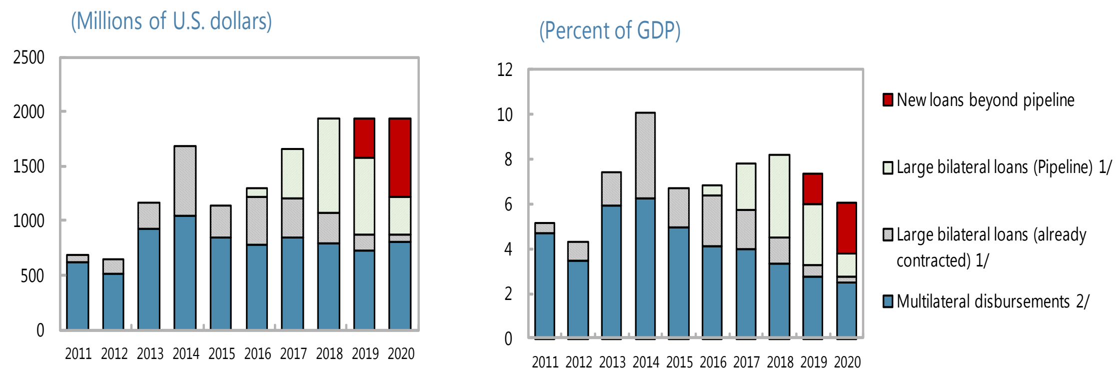
Text Table 2. Large Bilateral Loans in the Pipeline, as of June 2015

	Signed on	Loan amount (US$ millions)
Total		**2,259.5**
Non-concessional loans		**799.8**
China		
Fiber Optic in Metropolitan Areas	EXIMBANK is evaluating feasibility study.	185.4
Transmission line Caia-Nacala	EXIMBANK is evaluating feasibility study.	400.0
Road N380 Chimuarra - Namacurra	EXIMBANK is evaluating feasibility study.	120.0
Road N1 Sunate - Macomia	EXIMBANK is evaluating feasibility study.	94.4
Bilateral concessional loans		**1,459.7**
China		
3 Grocery Warehouses	Financing agreement is under negotiation.	60.0
Rehabilitation of Chipembe Dam	EXIMBANK is evaluating feasibility study.	90.3
Road/Bridge Rio Lurio	EXIMBANK is evaluating feasibility study.	65.4
Modernization of Irrigation in Chokwe	EXIMBANK is evaluating feasibility study.	78.0
Digital Migration I	EXIMBANK is evaluating feasibility study.	60.0
Digital Migration II	Proposal sent to China; awaiting response.	223.0
Maputo Exposition Grounds	Under consideration. No financing yet requested from EXIMBANK.	150.0
Hydropower Dam Lurio	Under consideration. No financing yet requested to EXIMBANK.	450.0
Japan		
Nacala Port Phase II	Signature expected by mid-2015.	283.0

[5] Non-concessional borrowing had been high in 2013 because of the government guarantee for Loan Participation Notes (LNP) of $850 million (6 percent of GDP) issued on behalf of the newly created enterprise EMATUM (tuna fishing). Of this amount, the government incorporated $500 million as government debt in the 2014 budget, which were related to maritime security (under the budget of the Department of Defense). This change does not have an impact on the DSA, which already included publicly-guaranteed debt..

[6] The authorities only envisage to sign most of the loans of Text Table 2 (and all its non-concessional ones) only after their ongoing work on the medium term fiscal framework has been completed.

Text Figure 1. Public Sector External Debt Disbursement Path



Note: Excludes US$ 850 million EMATUM guarantee in 2013, but includes government assumption of US$500 million of this debt issue in 2014.
1/ Large bilateral loans are those with amounts exceeding US$60 million.
2/ Also includes disbursements on small bilateral loans.

c. **Private sector debt stocks and medium-term borrowing have been revised further upwards**. The International Investment Position data now puts private external debt at 31 percent of GDP in 2014. It is projected to rise to some 85 percent by 2020, i.e. somewhat less steeply than in the previous DSA in response to the financing of gas liquefaction capacity, because more of this financing is now expected to be through equity financing. The ratio is expected to fall back to 49 percent by 2025 when LNG is exported and private borrowing is being amortized. This debt is mobilized and repaid entirely through offshore SPVs, which limits risk to the domestic financial system.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

2. Total external debt is projected to rise rapidly during this decade, reflecting mainly private sector investment in the natural gas sector. External debt (both public and private) is expected to peak at about 137 percent of GDP in 2020. By then time private sector debt will represent about two thirds of total external debt. With investment in the coal sector projected to be financed through foreign direct investment, this increase in private external debt is mostly driven by investments in the natural gas sector. The significant build-up of private sector external debt needs to be monitored by the authorities to contain vulnerabilities, though risks (as noted above) are limited due to the financing structures through SPVs offshore. With renowned global companies leading investments in the natural resource sector, however, the risk for government contingent liabilities or other vulnerabilities beyond those specific to the natural resource operations is deemed modest.[7]

[7] Likewise, the risk of BOP pressures emerging as a direct result of megaproject-related investment activity is considered to be low. Care will have to be taken in the long term, however, once revenues from these ventures materialize, as these may be volatile reflecting world commodity prices and in relation to imports. Moreover, large natural resource exports then also hold competitiveness risks emerging from a possible exchange rate appreciation, which will have to be carefully managed.

3. All public external debt indicators remain below their respective thresholds in the baseline (Figure 1).[8] The PV of debt in terms of GDP now peaks around 35.6 percent (in 2019), compared to a peak of 33 percent in the previous DSA. The beginning of LNG production and the ensuing surge in GDP would reduce the ratio down to a 30-32 percent range in the next decade (Table 1).

4. External debt ratios are sensitive to FDI, terms-of-trade and exchange rate shocks.9 The threshold for the PV of debt to GDP ratio is breached under the most extreme stress tests for a sustained period.10 A combination shock consisting of reductions in non-debt creating FDI, export prices and growth in 2016-2017 would push the PV of debt/GDP ratio well above the 40 percent threshold during the next 15 years, with a peak of about 70 percent (Figure 1). Apart from this combination shock, a sharp depreciation of the metical in 2016, or a shock to FDI lead to significant overshooting of the threshold for a sustained period.11 The pattern of these impacts is broadly consistent with the previous DSA. In these three shock scenarios the PV of debt will also breach the debt/exports threshold of 150 percent of exports.12

5. Ensuring that LNG production materializes is crucial for Mozambique's debt sustainability. The authorities have made significant progress in establishing legal frameworks for the sector, but further time-sensitive steps need to be taken this year to ensure that LNG investment can move forward. The LNG sector is expected to contribute significantly to GDP, exports and government revenue. A gradual public investment scaling-up, as under the baseline scenario, anticipating some LNG revenue would be appropriate given Mozambique's infrastructure investment needs. If, however, there are delays in project take-off or LNG production or revenue is much lower than expected, the debt ratios would be higher over the medium to long term.

PUBLIC SECTOR DEBT SUSTAINABILITY

6. The evolution of public debt indicators (including domestic debt) mirrors that of the external indicators because of the predominance of external debt (Table 3 and Figure 2). The medium-term increase in public debt reflects the gradual contraction of loans currently in the pipeline leading to a temporary buildup in externally-financed public investment toward the end of this decade. The DSA assumes that about 10 years after the start of LNG exports the public sector will dedicate an increasing share of resources to pay back debt. Under the baseline scenario, the PV of public debt

[8] Following the previous DSA, the historical scenario has been excluded from Figure 1. The reason for the exclusion is that such a scenario shows unrealistically fast declines of public debt ratios over the medium term, because it fixes the current account deficit at an historical average of 19.2 percent of GDP. This is much lower than the 38-45 percent of GDP deficits. With private debt accumulation assumed to remain unchanged compared to the baseline, this assumption then results in unrealistically fast declines of public debt ratios.

[9] The impact the of the standard shocks in the DSA template is heightened by the fact that the standard stress tests revert to historical values, which are significantly different from current and expected values because of the structural change in the Mozambican economy resulting from the large-scale exploitation of coal and natural gas since 2011.

[10] The scenario in which variables are at their historical levels has been omitted given that it generates negative debt as a result of the large changes in variables in the baseline arising from LNG activities.

[11] The charts in Figure 1 display the stress test with the most adverse outcome in 2025.

[12] This breach, however, should not be overemphasized as a fall in FDI would likely be linked to lower imports rather than higher borrowing as implicitly assumed in the standard shock scenario.

remains below 45 percent of GDP throughout, therefore remaining well contained and below the indicative benchmarks that research has linked to increased probability of debt distress.[13]

7. The public DSA illustrates that it is essential for debt sustainability to prioritize appropriately the investment projects currently in the pipeline. This is particularly important as funding may also be needed for other important investment projects, including in the energy sector, which are currently not yet in the pipeline. This borrowing plan will need to be consistent with the envisaged gradual reduction in the fiscal primary deficit over the medium run to place public debt on a downward trajectory.

CONCLUSION

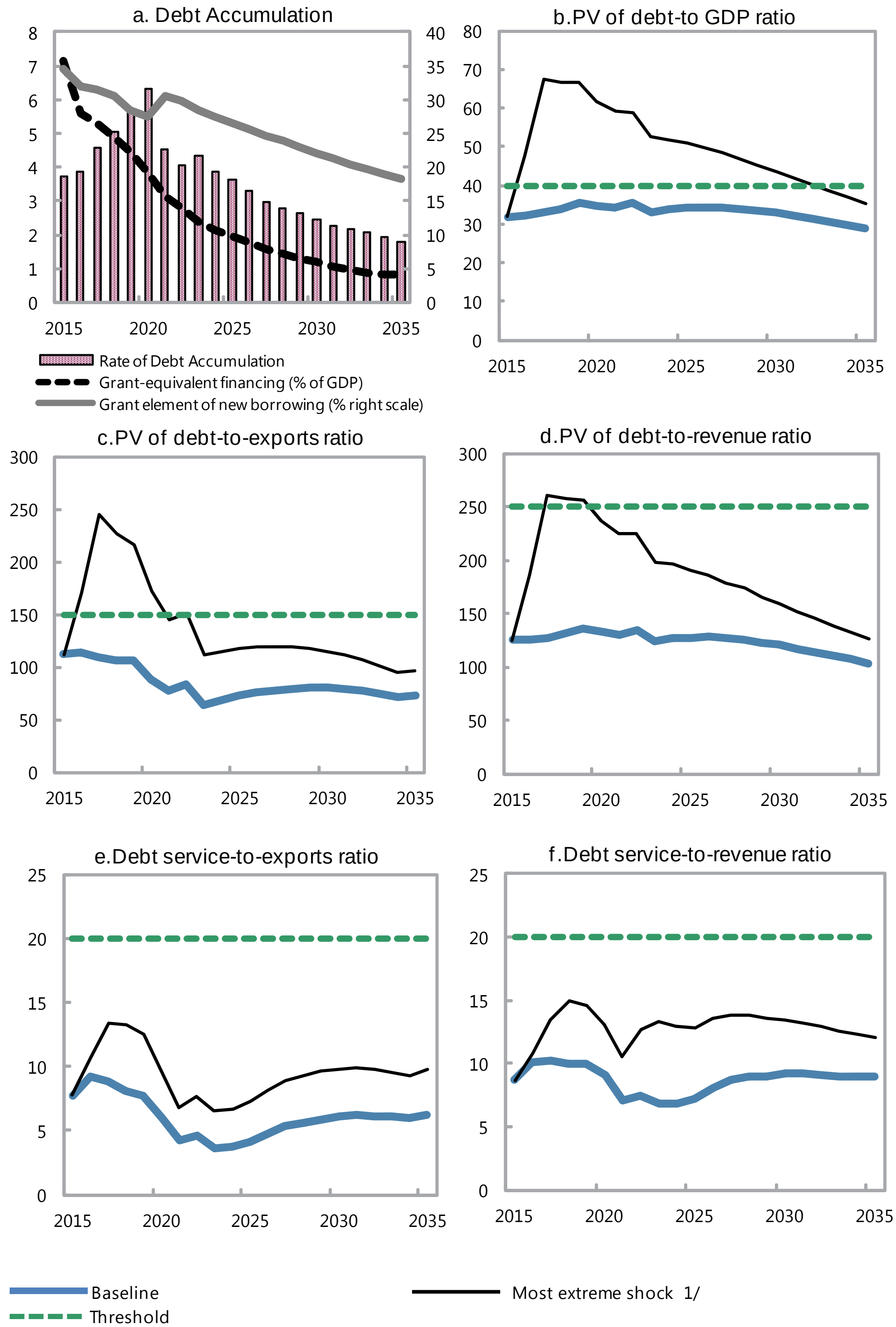
8. While the standard DSA shocks indicate that Mozambique would be in the moderate risk of external public debt distress category, public investment should continue to move forward. However, in light of a large loan pipeline, projects need to be appropriately prioritized to maintain debt sustainable. Even against the background of a temporarily accelerated pace of disbursements toward the end of this decade, the baseline debt trajectories remain below their respective thresholds throughout. Importantly, debt service indicators remain substantially below their thresholds, including under stress tests, and reflect conservative assumptions regarding the grant element for future borrowing.14 The breaches under the stress tests would be reversed by the coming on stream of LNG production, and seem manageable against the backdrop of the authorities' strong track record of prudent economic management. Moreover, the impact of shocks is heightened by the fact that the standard stress tests revert to historical values, which are significantly different from current and expected values because of the structural change in the Mozambican economy resulting from the large-scale exploitation of coal and natural gas.

9. This analysis highlights three important points for debt sustainability. First, it will be important to continue to improve debt management and investment planning capacity to ensure that the most deserving public investment projects are selected and yield their desired payoff. This is becoming even more important, because of the full loan pipeline. Second, it will be important for the authorities to commence the gradual fiscal consolidation envisaged in their program to place public debt on a gradual downward trajectory over the medium term while addressing key public investment priorities. Third, it continues to be important—including from a debt sustainability perspective—to take the essential time-sensitive steps to ensure that LNG production materializes in order to lock in the beneficial effects on GDP and fiscal revenue.

[13] At Mozambique's CPIA rating, the indicative public debt benchmark signaling higher risk of debt distress lies between 56 and 74 percent for the PV of debt-to-GDP ratio. See IMF, 2012, "Revisiting the Debt Sustainability Framework for Low-Income Countries."

[14] Moreover, these indicators do not account for other buffers, such as comfortable levels of international reserves relative to non-megaproject imports.

Figure 1. Mozambique: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a Combination shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Exports shock and in figure f. to a Combination shock

Table 1. Mozambique: External Debt Sustainability Framework, Baseline Scenario, 2012-2035 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
	2012	2013	2014	Average	Deviation	2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**72.4**	**79.0**	**79.9**			**86.0**	**94.3**	**102.1**	**116.9**	**134.1**	**137.0**		**96.4**	**59.9**	
of which: public and publicly guaranteed (PPG)	35.2	43.4	48.9			50.6	50.5	51.4	52.5	54.2	51.6		47.6	36.5	
Change in external debt	2.3	6.5	0.9			6.1	8.3	7.8	14.8	17.2	3.0		-5.8	-1.8	
Identified net debt-creating flows	-0.5	-3.0	0.3			9.0	11.1	10.4	15.6	12.4	-4.0		-5.4	-9.1	
Non-interest current account deficit	**41.6**	**39.3**	**33.9**	**19.2**	**14.1**	**34.7**	**38.8**	**36.3**	**41.1**	**38.1**	**33.5**		**14.2**	**8.8**	13.4
Deficit in balance of goods and services	47.9	48.7	41.8			41.7	43.7	39.8	43.9	40.6	30.1		6.0	7.1	
Exports	33.3	30.5	27.8			28.4	28.3	30.1	32.0	33.6	39.2		47.1	39.8	
Imports	81.2	79.3	69.6			70.1	72.0	69.9	75.9	74.1	69.3		53.1	46.9	
Net current transfers (negative = inflow)	-5.6	-9.1	-7.6	-6.8	1.1	-5.0	-4.0	-3.6	-3.3	-3.0	-2.7		-2.1	-1.8	-2.0
of which: official	-4.8	-7.0	-5.9			-3.2	-2.3	-1.9	-1.6	-1.3	-1.0		-0.4	-0.1	
Other current account flows (negative = net inflow)	-0.7	-0.3	-0.2			-2.0	-0.8	0.1	0.4	0.6	6.1		10.3	3.5	
Net FDI (negative = inflow)	**-35.1**	**-39.5**	**-29.4**	**-15.8**	**14.3**	**-23.8**	**-24.7**	**-22.9**	**-22.1**	**-22.2**	**-23.3**		**-16.9**	**-16.5**	-17.1
Endogenous debt dynamics 2/	**-7.0**	**-2.8**	**-4.2**			**-1.9**	**-3.0**	**-3.1**	**-3.4**	**-3.5**	**-14.2**		**-2.7**	**-1.5**	
Contribution from nominal interest rate	0.7	0.7	0.8			3.6	3.3	3.6	3.9	4.8	5.2		3.8	2.4	
Contribution from real GDP growth	-4.4	-5.1	-5.5			-5.5	-6.3	-6.7	-7.3	-8.3	-19.4		-6.5	-3.8	
Contribution from price and exchange rate changes	-3.2	1.6	0.4			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**2.8**	**9.5**	**0.6**			**-2.8**	**-2.8**	**-2.6**	**-0.8**	**4.7**	**7.0**		**-0.4**	**7.3**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	61.5			67.2	75.8	83.6	98.3	115.5	120.0		83.0	52.3	
In percent of exports	...	...	221.0			236.5	267.5	277.8	307.3	344.1	306.2		176.4	131.4	
PV of PPG external debt	**...**	**...**	**30.4**			**31.9**	**32.0**	**32.9**	**34.0**	**35.6**	**34.5**		**34.1**	**28.9**	
In percent of exports	**...**	**...**	**109.4**			**112.1**	**113.1**	**109.2**	**106.2**	**106.0**	**88.1**		**72.5**	**72.5**	
In percent of government revenues	**...**	**...**	**109.3**			**124.8**	**124.8**	**127.0**	**130.8**	**136.5**	**132.2**		**127.5**	**103.7**	
Debt service-to-exports ratio (in percent)	**9.4**	**11.0**	**28.8**			**27.6**	**27.1**	**27.0**	**27.2**	**29.3**	**25.6**		**15.8**	**17.2**	
PPG debt service-to-exports ratio (in percent)	**1.9**	**2.7**	**15.5**			**7.8**	**9.2**	**8.8**	**8.1**	**7.7**	**6.0**		**4.1**	**6.3**	
PPG debt service-to-revenue ratio (in percent)	**2.8**	**3.1**	**15.5**			**8.7**	**10.1**	**10.3**	**10.0**	**10.0**	**9.0**		**7.2**	**9.0**	
Total gross financing need (Billions of U.S. dollars)	1.4	0.5	2.1			3.2	4.2	4.6	6.6	6.8	6.5		2.8	-1.1	
Non-interest current account deficit that stabilizes debt ratio	39.2	32.8	33.0			28.6	30.6	28.5	26.3	21.0	30.5		20.0	10.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.1	7.4	7.4	7.3	0.9	7.0	8.2	7.9	8.0	7.9	17.6	9.4	7.0	6.8	7.8
GDP deflator in US dollar terms (change in percent)	4.8	-2.2	-0.5	2.4	8.6	-4.9	3.6	3.4	3.4	3.5	3.5	2.1	2.4	2.4	2.5
Effective interest rate (percent) 5/	1.1	1.1	1.1	1.6	0.7	4.6	4.3	4.3	4.3	4.5	4.7	4.4	4.0	4.2	4.1
Growth of exports of G&S (US dollar terms, in percent)	28.3	-3.8	-2.7	11.2	15.9	4.1	11.7	18.4	18.8	17.1	41.9	18.7	4.8	3.6	11.0
Growth of imports of G&S (US dollar terms, in percent)	59.0	2.5	-6.3	19.2	24.3	2.6	15.1	8.3	21.4	9.0	13.7	11.7	10.3	7.6	7.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.5	31.9	31.5	30.6	28.5	27.5	30.7	26.6	18.2	24.1
Government revenues (excluding grants, in percent of GDP)	22.4	26.9	27.8			25.5	25.7	25.9	26.0	26.1	26.1		26.8	27.8	27.1
Aid flows (in Billions of US dollars) 7/	1.3	1.9	1.9			1.4	1.3	1.3	1.3	1.6	1.9		2.2	2.5	
of which: Grants	0.8	0.8	0.8			0.8	0.7	0.6	0.6	0.5	0.5		0.3	0.3	
of which: Concessional loans	0.5	1.0	1.1			0.6	0.6	0.7	0.7	1.0	1.4		1.8	2.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			7.2	5.6	5.3	4.9	4.5	3.8		1.9	0.8	1.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			62.0	54.8	49.9	46.3	41.8	38.6		34.2	22.9	30.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	14.9	15.6	16.7			17.0	19.0	21.2	23.7	26.5	32.2		58.0	141.7	
Nominal dollar GDP growth	12.2	5.1	6.8			1.8	12.1	11.6	11.7	11.6	21.6	11.7	9.6	9.4	10.4
PV of PPG external debt (in Billions of US dollars)			4.8			5.4	6.0	6.9	8.0	9.3	11.0		19.5	40.3	
(PVt-PVt-1)/GDPt-1 (in percent)						3.7	3.8	4.6	5.1	5.7	6.3	4.9	3.6	1.8	3.0
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		-0.1	-0.2	
PV of PPG external debt (in percent of GDP + remittances)	...	...	30.5			31.9	32.1	32.9	34.0	35.6	34.5		34.2	28.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	109.9			112.6	113.6	109.7	106.6	106.4	88.3		72.7	72.8	
Debt service of PPG external debt (in percent of exports + remittance	...	...	15.6			7.8	9.2	8.9	8.2	7.8	6.0		4.1	6.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Mozambique: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-2035

(In Percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	32	32	33	34	36	35	**34**	29
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	32	24	18	8	0	-3	**30**	87
A2. New public sector loans on less favorable terms in 2015-2035 2	32	33	36	39	42	42	**45**	43
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	32	32	33	35	36	35	**35**	29
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	32	35	43	43	44	42	**38**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	32	35	40	41	43	42	**41**	34
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	32	48	63	62	61	57	**46**	31
B5. Combination of B1-B4 using one-half standard deviation shocks	32	48	68	67	67	62	**51**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	32	45	46	47	50	48	**47**	40
PV of debt-to-exports ratio								
Baseline	112	113	109	106	106	88	**73**	73
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	112	85	59	23	1	-9	**64**	218
A2. New public sector loans on less favorable terms in 2015-2035 2	112	118	120	122	126	108	**95**	107
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	112	112	108	105	105	87	**71**	71
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	112	144	206	196	191	155	**117**	107
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	112	112	108	105	105	87	**71**	71
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	112	170	208	193	183	144	**98**	78
B5. Combination of B1-B4 using one-half standard deviation shocks	112	170	245	227	216	171	**117**	96
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	112	112	108	105	105	87	**71**	71
PV of debt-to-revenue ratio								
Baseline	125	125	127	131	137	132	**127**	104
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	125	94	69	29	1	-13	**113**	312
A2. New public sector loans on less favorable terms in 2015-2035 2	125	130	139	150	162	162	**167**	153
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	125	125	129	133	139	135	**129**	105
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	125	136	165	166	169	160	**141**	105
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	125	136	153	158	164	159	**152**	124
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	125	188	242	238	236	217	**171**	112
B5. Combination of B1-B4 using one-half standard deviation shocks	125	186	261	257	256	236	**190**	126
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	125	174	177	182	190	184	**176**	143

Table 2. Mozambique: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015-2035 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	8	9	9	8	8	6	**4**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	8	9	8	7	6	4	**1**	12
A2. New public sector loans on less favorable terms in 2015-2035 2	8	9	8	8	8	6	**6**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	8	9	9	8	8	6	**4**	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	8	11	13	13	12	10	**7**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	8	9	9	8	8	6	**4**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	8	9	11	11	10	8	**7**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	8	10	13	13	12	9	**8**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	8	9	9	8	8	6	**4**	6
Debt service-to-revenue ratio								
Baseline	9	10	10	10	10	9	**7**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	9	10	10	9	7	6	**2**	17
A2. New public sector loans on less favorable terms in 2015-2035 2	9	10	10	10	10	9	**11**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	9	10	11	10	10	9	**7**	9
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	9	10	11	11	11	10	**9**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	9	11	13	12	12	11	**9**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	9	10	12	14	13	12	**12**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	9	11	13	15	15	13	**13**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	9	14	14	14	14	13	**10**	13
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	24	24	24	24	24	24	**24**	24

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the b

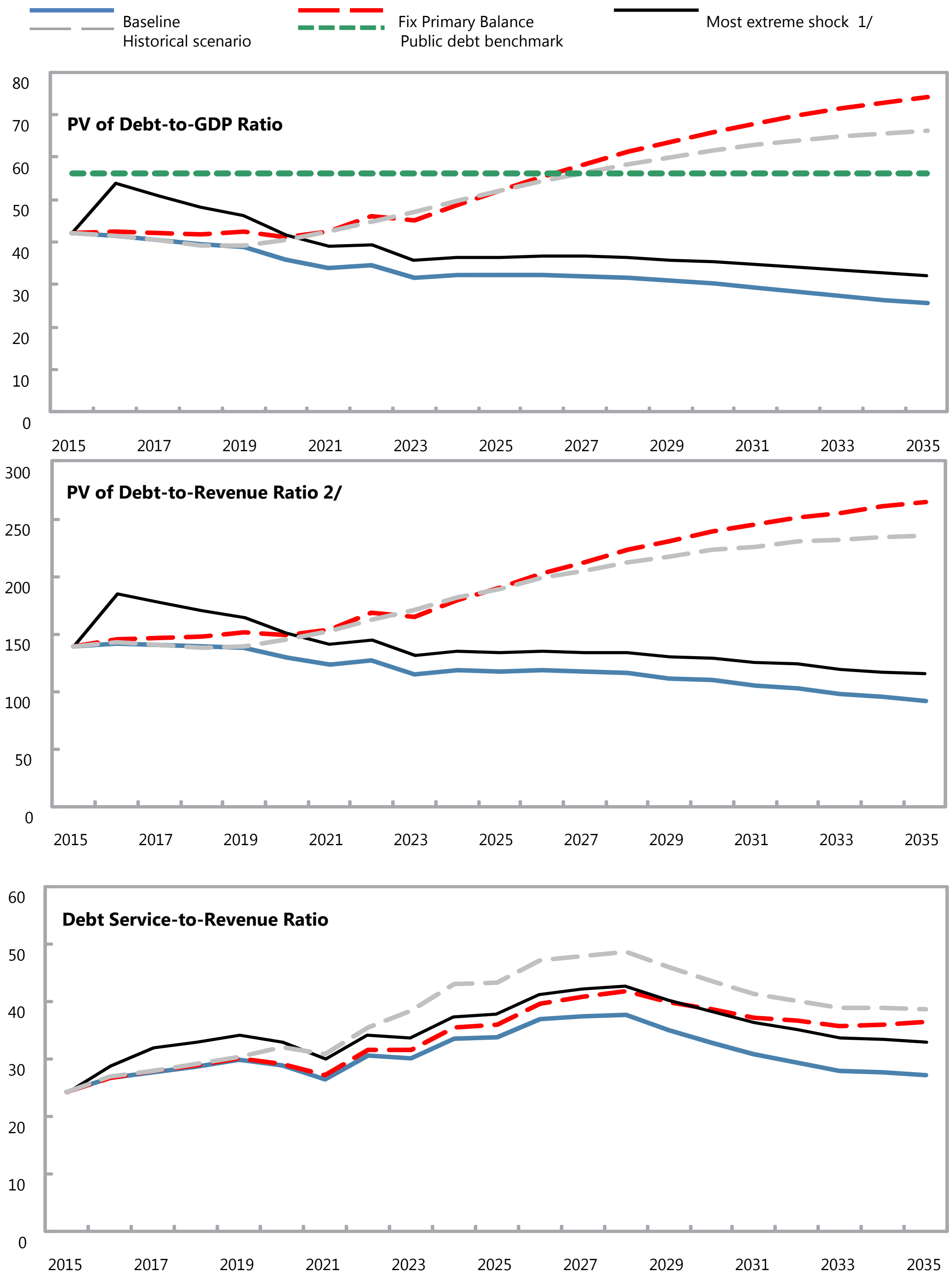
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after th an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2. Mozambique: Indicators of Public Debt Under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 3. Mozambique: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012-2035
(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	40.8	52.2	57.5			61.0	59.8	58.9	58.1	57.4	52.8		45.6	33.3	
of which: foreign-currency denominated	35.2	43.4	48.9			50.6	50.5	51.4	52.5	54.2	51.6		47.6	36.5	
Change in public sector debt	3.2	11.5	5.3			3.5	-1.2	-0.9	-0.8	-0.7	-4.5		-0.5	-1.4	
Identified debt-creating flows	2.9	-1.0	9.3			2.0	-1.4	-0.9	-0.6	-1.6	-6.5		-3.1	-2.6	
Primary deficit	2.9	1.8	9.3	3.5	2.2	5.0	3.6	4.0	4.2	2.9	2.1	3.6	-0.4	-1.0	-0.7
Revenue and grants	27.5	32.2	32.9			30.4	29.1	28.7	28.4	28.1	27.6		27.4	28.0	
of which: grants	5.2	5.3	5.1			4.9	3.4	2.9	2.4	2.0	1.5		0.6	0.2	
Primary (noninterest) expenditure	30.5	34.0	42.2			35.4	32.7	32.7	32.5	31.0	29.7		27.0	27.0	
Automatic debt dynamics	0.0	-2.8	0.0			-3.0	-5.0	-4.8	-4.8	-4.5	-8.6		-2.7	-1.6	
Contribution from interest rate/growth differential	-2.3	-2.6	-3.5			-3.1	-4.3	-4.3	-4.2	-3.9	-8.0		-2.6	-1.5	
of which: contribution from average real interest rate	0.2	0.2	0.0			0.6	0.3	0.0	0.2	0.3	0.5		0.3	0.7	
of which: contribution from real GDP growth	-2.5	-2.8	-3.6			-3.8	-4.6	-4.4	-4.4	-4.3	-8.6		-3.0	-2.2	
Contribution from real exchange rate depreciation	2.2	-0.2	3.6			0.1	-0.7	-0.5	-0.6	-0.6	-0.6		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.3	12.4	-4.0			1.5	0.1	0.0	-0.3	0.9	2.0		2.6	1.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	39.1			42.3	41.3	40.4	39.5	38.8	35.8		32.2	25.6	
of which: foreign-currency denominated	...	...	30.4			31.9	32.0	32.9	34.0	35.6	34.5		34.1	28.9	
of which: external	...	...	30.4			31.9	32.0	32.9	34.0	35.6	34.5		34.1	28.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.6	3.6	18.0			12.3	11.4	11.9	12.3	11.3	10.0		8.8	6.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	118.8			139.1	141.9	140.5	139.3	138.2	129.5		117.5	91.4	
PV of public sector debt-to-revenue ratio (in percent)	...	...	140.4			165.5	160.8	156.0	152.1	148.8	137.1		120.1	92.1	
of which: external 3/	...	...	109.3			124.8	124.8	127.0	130.8	136.5	132.2		127.5	103.7	
Debt service-to-revenue and grants ratio (in percent) 4/	6.0	5.4	26.4			24.2	26.7	27.6	28.5	29.7	28.7		33.7	27.1	
Debt service-to-revenue ratio (in percent) 4/	7.3	6.5	31.2			28.8	30.3	30.7	31.2	32.0	30.4		34.5	27.3	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.2	-9.6	4.0			1.5	4.8	4.9	5.0	3.6	6.6		0.1	0.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.1	7.4	7.4	7.3	0.9	7.0	8.2	7.9	8.0	7.9	17.6	9.4	7.0	6.8	7.8
Average nominal interest rate on forex debt (in percent)	0.9	1.2	1.1	0.5	0.5	1.9	2.0	2.0	2.0	2.1	2.1	2.0	2.0	2.6	2.2
Average real interest rate on domestic debt (in percent)	8.2	6.0	2.2	4.5	3.2	3.8	1.4	2.2	3.9	7.2	19.8	6.4	-34.5	-19.3	-31.9
Real exchange rate depreciation (in percent, + indicates depreciation	7.8	-0.6	8.8	3.0	11.6	0.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.9	3.2	4.1	5.5	2.3	5.1	5.6	5.6	5.6	5.6	5.6	5.5	5.6	5.6	5.6
Growth of real primary spending (deflated by GDP deflator, in percer	5.4	20.0	33.2	6.0	11.4	-10.3	0.1	7.8	7.5	2.7	12.7	3.4	5.6	8.0	7.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	34.5	31.9	31.5	30.6	28.5	27.5	30.7	26.6	18.2	...

Sources: Country authorities; and staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Mozambique: Sensitivity Analysis for Key Indicators of Public Debt 2015-2035

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	42	41	40	40	39	36	32	26
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	42	42	40	39	39	40	52	66
A2. Primary balance is unchanged from 2015	42	42	42	42	42	41	52	74
A3. Permanently lower GDP growth 1/	42	41	41	40	39	37	34	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	42	42	42	42	42	39	37	34
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	42	43	43	42	41	38	34	26
B3. Combination of B1-B2 using one half standard deviation shocks	42	43	42	42	41	39	36	32
B4. One-time 30 percent real depreciation in 2016	42	54	51	48	46	41	36	32
B5. 10 percent of GDP increase in other debt-creating flows in 2016	42	49	47	46	45	41	36	27
PV of Debt-to-Revenue Ratio 2/								
Baseline	139	142	140	139	138	130	117	91
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	139	142	140	138	139	145	189	235
A2. Primary balance is unchanged from 2015	139	145	147	147	151	149	190	264
A3. Permanently lower GDP growth 1/	139	142	141	141	140	132	125	114
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	139	145	147	148	149	141	136	121
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	139	147	150	149	147	137	123	94
B3. Combination of B1-B2 using one half standard deviation shocks	139	146	147	147	147	139	132	113
B4. One-time 30 percent real depreciation in 2016	139	185	177	170	164	150	133	115
B5. 10 percent of GDP increase in other debt-creating flows in 2016	139	168	165	162	160	148	130	98
Debt Service-to-Revenue Ratio 2/								
Baseline	24	27	28	29	30	29	34	27
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	24	27	28	29	30	32	43	39
A2. Primary balance is unchanged from 2015	24	27	28	29	30	29	36	36
A3. Permanently lower GDP growth 1/	24	27	28	29	30	29	34	29
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	24	27	28	29	31	30	35	29
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	24	27	28	29	30	29	34	27
B3. Combination of B1-B2 using one half standard deviation shocks	24	27	28	29	31	30	35	29
B4. One-time 30 percent real depreciation in 2016	24	29	32	33	34	33	38	33
B5. 10 percent of GDP increase in other debt-creating flows in 2016	24	27	28	30	30	29	35	28

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Statement by Ms. Chileshe Mpundu Kapwepwe, Executive Director for Mozambique and Mr. Amilca Paia Tivane Advisor to the Executive Director
July 1, 2015

1. Introduction

The Mozambican authorities appreciate the continued Fund engagement and value the constructive policy advice in the implementation of their National Development Agenda which is supported by the Policy Support Instrument (PSI) arrangement. The candid discussions held with staff during the fourth PSI review remain a valuable source of policy support in fostering sustainable development. Program performance remains broadly on track and in light of this, the authorities seek the Executive Board's approval of their request for the completion of the fourth review and modification of the assessment criteria.

2. Recent Economic Developments and Outlook

Prudent implementation of the authorities' economic development strategy has resulted in steady economic growth, averaging 7-8 percent over the past five years. The sources of economic growth have diversified and the incidence of poverty declined sharply, from 69.4 percent in 1996/97 to less than 54 percent in 2009, and is expected to reach 42 percent in 2014.

Economic growth in 2014 remained robust [7.4 percent], in spite of the downside risks stemming from commodity price and terms of trade shocks and the devastating impact of floods earlier in the year. This performance was driven by a rebound in agriculture and manufacturing and buoyant activity in financial sector services. Growth also remained strong in extractive sector, albeit decelerating due to a less favorable outlook in the coal market.

The medium term economic outlook remains robust and projected to be consistent with the average trend achieved over the past five years. However, boosting economic activity, particularly in sectors that generate the bulk of employment such as agriculture and manufacturing, still requires steadfast policy measures in order to reduce structural bottlenecks. In this regard, the Government's Five Year Plan (2015-2019) identifies strategic actions geared toward unleashing the country's growth potential. Focus is placed on employment creation, poverty reduction, and enhancing competitiveness and productivity, through augmentation of fiscal space for investment projects. Proposed reforms aim to improve the transportation logistics for small and medium sized enterprises and megaprojects, strengthen the value chain in agriculture and manufacturing sectors, bolster human capital development and create a friendly business environment.

The fiscal stance has been calibrated to support broad-based growth while preserving its sustainability. The 2014 budget law enacted in early 2015 was amended in May 2015 to increase the fiscal space for elections related-expenditures. Total revenues reached 28 percent of GDP in 2014, total expenditures including net lending amounted 40 percent of GDP, 5.1

percentage points higher than the same period of 2013, and mostly reflected transitory factors such as the need to accommodate elections-related expenditures. Revenue excluding the one-off capital gain tax is projected to rise by 0.9 percentage points of GDP in 2015; the total expenditure including net lending is projected to decline to 36.0 percent of GDP in 2015; and the overall fiscal deficit is expected to decline to 6.5 percent of GDP, from 11 percent of GDP reached in 2014.

The monetary and exchange rate policy is geared towards safeguarding price and exchange rate stability, and boosting competitiveness over the medium-term. Inflation expectations remained low for the whole 2014, in spite of supply disruptions caused by the floods earlier in the year. Annually inflation for twelve months ending in May was 1.2 percent, reflecting increased supply of agricultural products during the harvest season. Between the last quarter of 2014 and end-March 2015 there were heightened depreciation pressures, reflecting the strengthening of the US dollar *vis-a-vis* the Metical, a higher level of demand for imports excluding mega projects, weaker performance of non-mega projects exports, increase currency volatility in the run-up to the elections in 2014 and to some extent, the containment in budget support disbursement. To stabilize the exchange rate, the Bank of Mozambique (BM) intervened in the market by selling US$ 320 million in the last quarter of 2014, and US$ 478 million in the first quarter of 2015, which contributed to significant losses in reserves. Going forward, the BM will continue to adjust its policy to anchoring inflation expectations and improve economic competitiveness.

3. Program Performance

The authorities' commitment to enhance implementation of macroeconomic and structural reforms has led to substantial improvements in economic conditions over the past years. The program has remains broadly on track. Two out of six end-December performance criteria (PC) were missed by a small margin namely the net credit to the government (NCG) and the reserve money growth, whilst the assessment criteria on net international reserves (NIR) deviated from the target by US$ 265 million due to the necessity to address the increase in depreciation pressures and to lessen exchange rate volatility and its pass-through to domestic prices. This has been due to an array of interrelated factors including, the adverse impact of exogenous shocks coupled with expectation-driven factors in domestic market during the election period.

The slower than anticipated return of the currency in circulation into the banking system in the first quarter of 2015, has led to higher levels of money growth, and continuing depreciation pressures arising from a sluggish decline of demand for imports. In light of this, foreign exchange market pressures continued through March 2015 and the NIR was missed by US$ 478 million, whereas the reserve money target was missed marginally by US$ 15.3 million. Going forward, the authorities will recalibrate the monetary and exchange rate policy stance to *inter-alia,* contain the depreciation pressures by allowing more exchange rate flexibility to help absorb the impact of external shocks. The BM has taken measures to allow the Metical to depreciate further by about 7.0 percent from March to June, and will continue to adjust its policy instruments to gradually contain the money growth to support efforts to stabilize the exchange rate.

Significant progress has been made on the structural front. The end-March structural benchmark on securitization of VAT arrears amounting US$ 500 million has been met. In order to align the Integrated Investment Plan (IIP) with the new Government's Five Year Plan (2015-2019) and the budget preparation cycle for 2016, the authorities have rescheduled completion of the review of the IIP to end-December 2015.

4. Structural Policies

Policy priorities on the structural front envisage fostering inclusive growth, through invigoration of policies to accelerate economic diversification and transformation, enhance the fiscal stance and improve the monetary policy framework.

Fiscal Policy

The medium-term fiscal strategy is envisaged to achieve fiscal consolidation through strengthening fiscal structural reforms. More importantly, the authorities will continue enhancing reforms aimed at broadening the tax base while increasing efficiency of tax administration, in particular the taxation of rents from hydrocarbon sector, and improving the management of fiscal risks. Policy reforms will continue to accelerate the pace of implementation of e-Tax module which target to increase the registration of taxpayers into the new system to 55 percent of all VAT taxpayers in 2015. In addition, enhancement of tax payments through banks and modernization of the Revenue Authority will support the efforts to enhance revenue mobilization.

The medium-term expenditure policy focuses on increasing and diversifying the provision of public goods, including augmentation of fiscal space to priority sectors for accelerating poverty reduction, fostering inclusive growth, and improving efficiency and value for money of capital expenditures. In this regard, structural reforms are geared towards containing the pace of increase of recurrent expenditure, mostly of the wage bill; strengthening capacity development to improve the decision making process on project selection, implementation and monitoring. The authorities have also revamped efforts to enhance public debt management, removing from the pipeline of priority investments all projects that had not been subject to a robust feasibility study and evaluation. Starting from the next budget cycle, all projects exceeding US$ 50 million will be subject to a mandatory technical assessment and approval by the Investment Evaluation Committee prior to its inclusion on the budget.

Monetary and Exchange Rate Policy

Monetary and exchange rate policies in the medium-term remain tailored to the objective of maintaining price and exchange rate stability. The BM will continue to strengthen the monetary policy framework and to improve the analytical capacity, including its inflation forecasting model with the technical assistance from IMF, and communication in the monetary policy decision making-process. In addition, the BM will step up ongoing measures aimed at improving liquidity forecasting, enhancing banking supervision and macro-prudential regulations and to increase financial deepening and diversification.

Financial Sector Policies
Improving financial deepening and inclusion remains critical to foster inclusive growth and sustainable development. The authorities will continue to implement their Financial Sector Development Strategy (FSDS 2013-2022) with support from the development partners. Actions will focus on reforms in areas such as financial stability, financial inclusion and education, and improvement in the debt market. Other measures to support efforts to enhance financial deepening include establishing credit registry bureaus, promoting mobile banking, steering competition in the banking sector and creating a moveable collateral registry.

5. Concluding Remarks

The Mozambican authorities would like to reassure the Board of their commitment to pursue a comprehensive reform agenda to improve macroeconomic management and unleash the country's growth potential. Challenges remain significant, mostly related with uncertainty in the global environment and downside risks arising from exogenous shocks. Going forward, policy priorities will be centered on gradually removing the structural bottlenecks to economic competitiveness and productivity to enhance the country's economic resilience.