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May 2014

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

In the context of the Second 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:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 9, 2014, following discussions that ended on March 14, 2014, with the officials of Mozambique on economic developments and policies underpinning the Policy Support Instrument. Based on information available at the time of these discussions, the staff report was completed on April 25, 2014
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Mozambique.

The following documents have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Mozambique*
Memorandum of Economic and Financial Policies by the authorities of Mozambique*
Technical Memorandum of Understanding*
Poverty Reduction Strategy Paper – Progress Report

*Also included in Staff Report

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

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International Monetary Fund
Washington, D.C.

REPUBLIC OF MOZAMBIQUE

April 25, 2014

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

KEY ISSUES

Context and outlook. Mozambique's macroeconomic outlook remains favorable and the PSI-supported program is broadly on track—all end-2013 assessment criteria were met and the structural reform program is on track. Economic growth is robust and inflation remains low. In spite of risks from the uncertain global outlook, growth is expected to be sustained in the medium term by the natural resource boom and infrastructure investment. Risks associated with the political/security environment moderated in early 2014, with general elections scheduled for mid-October.

Short-term policy framework. The main short-term challenges are to maintain the growth momentum while preserving fiscal and debt sustainability. The 2014 fiscal stance is expansionary and inflation developments will need to be monitored closely and the central bank will need to tighten if inflation rises significantly. Key structural reform priorities include improving VAT and overall tax administration, continuing public financial management reforms, strengthening capacity for transparent public investment management and borrowing, and enhancing financial sector development.

Medium-term challenges. Fiscal policy adjustment in 2015 and over the medium term will be essential to preserve debt sustainability and macroeconomic stability. Structural reforms focusing on public financial management, monetary policy tools and banking supervision, and business facilitation should be implemented vigorously to sustain growth and render it more inclusive. With foreign aid likely to decline over the medium term, increased nonconcessional borrowing can provide additional resources for improving both Mozambique's physical infrastructure and human capital. Further strengthening of investment planning and implementation, and debt management are essential to ensure the efficiency of investment and borrowing. Completion of the new mining and hydrocarbon legislation, the related fiscal regimes, and implementing regulations would facilitate the development of Mozambique's natural resources.

Approved By
David Robinson and Ranil Salgado

A staff team comprising Mmes. Ross (head), Masha, Messrs. Inui, Xiao (all AFR), and Perone (SPR) visited Maputo during February 26-March 14, 2014. The mission met with the Prime Minister Vaquina, Ministers Chang (Finance), Cuereneia (Planning and Development), and other line ministers and senior government officials (Energy, Agriculture, Natural Resources, Industry and Trade, and Transport and Communications), Bank of Mozambique Governor Gove, and other senior government officials. The mission also met with development partners and representatives of civil society, parliament and the private sector. It was assisted by Mr. Segura-Ubiergo (resident representative), Mr. Simione, and Ms. Palacio (resident representative office). Messrs. Tivane (OED), Revilla and Blanco Armas (World Bank) participated in some of the policy discussions.

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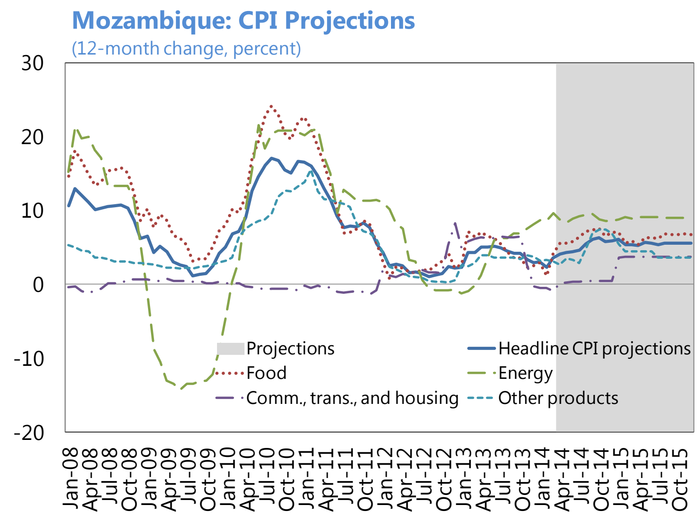
APPENDIX

BACKGROUND AND RECENT DEVELOPMENTS

MEFP ¶2

1. Mozambique's economy remains buoyant and recovered quickly from the severe floods in early 2013. Growth is estimated at 7 percent for 2013, with strong performance in coal mining, construction, transport and communications and financial services. Inflation remains low notwithstanding accommodative monetary policy and rapid credit expansion. The real effective exchange rate was broadly stable in 2013 and a nominal appreciation against the South African rand helped to limit inflation.



2. Fiscal performance was stronger than earlier projected. The estimated overall deficit (after grants) was 2.8 percent of GDP compared to 4.6 percent programmed, largely reflecting lower current spending (0.7 percentage points of GDP) and higher than expected grants (1.1 percentage points). Lower current spending resulted from delayed and lower budget support. With project support grants much higher than expected and lower project loans, investment spending was on target.

3. The external current account deficit narrowed in 2013 to an estimated 39 percent of GDP mainly reflecting a larger trade deficit that was more than offset by lower service imports and higher transfer receipts. Foreign direct investment (FDI) continued strong at about $5 billion, mostly for megaprojects. The Bank of Mozambique (BM) continued to build net international reserves (NIR) to cover about 4½ months of projected imports of non-megaproject goods and services.

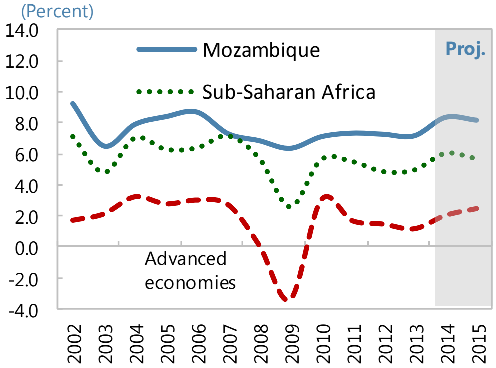
4. Program performance to date has been broadly satisfactory. All assessment criteria (AC) and all but one indicative target (IT) through end-December 2013 were met—the exception being the IT for expenditure in priority sectors, which according to the authorities was missed due to delays in the disbursement of donor flows. Two of the three structural benchmarks for end-February and end-March 2014 were met, and the third with a brief delay (MEFP Tables 1-2).

5. The political and security environment has improved. The February political agreement between the government and the opposition party Renamo paved the way for Renamo's participation in the mid-October general elections. Moreover, the selection of the ruling Frelimo party's presidential candidate, former Defense Minister Filipe Nyusi, removed the uncertainties about the Frelimo leadership candidate. Violent attacks and kidnappings have declined in early 2014, improving the overall security environment.

Figure 1. Mozambique: Impact of Global Developments

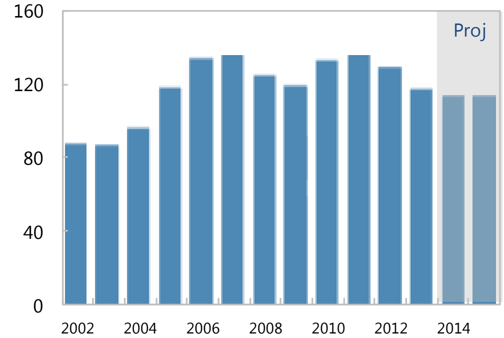
Despite the global weakness and floods in early 2013, Mozambique's growth outlook remains robust.

Real GDP Growth
(Percent)



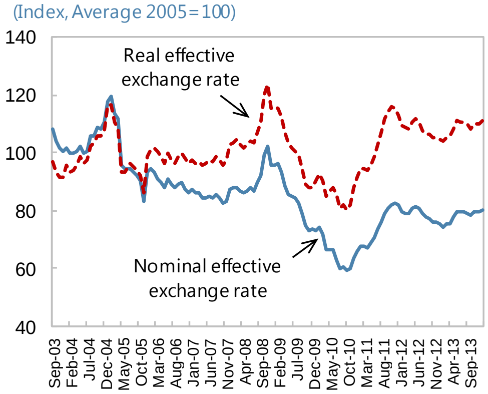
Terms of trade gains reversed since 2012 due to weakening international commodity prices…

Terms of Trade Index
(2005=100)



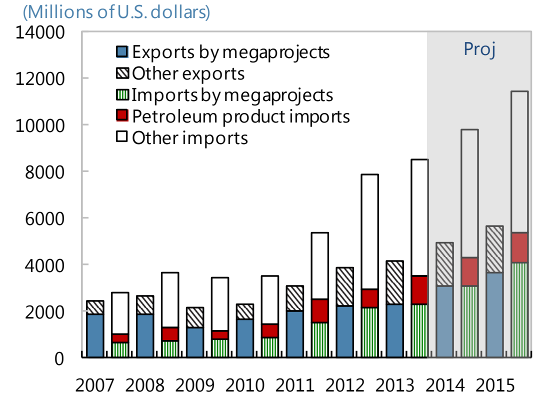
…while the metical has been broadly stable since 2012 in the low-inflation environment.

Nominal and Real Effective Exchange Rates
(Index, Average 2005=100)



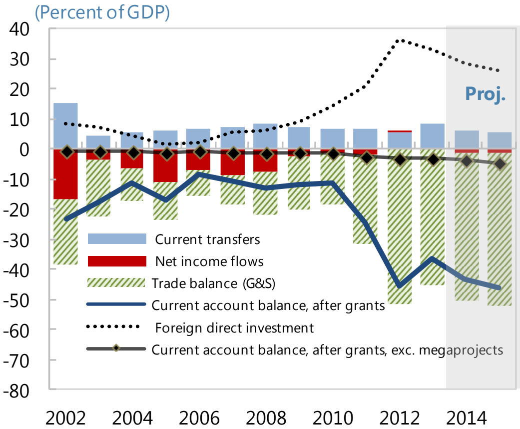
Megaprojects' strong export growth was counterbalanced by investment-related and fuel imports.

Merchandise Trade
(Millions of U.S. dollars)



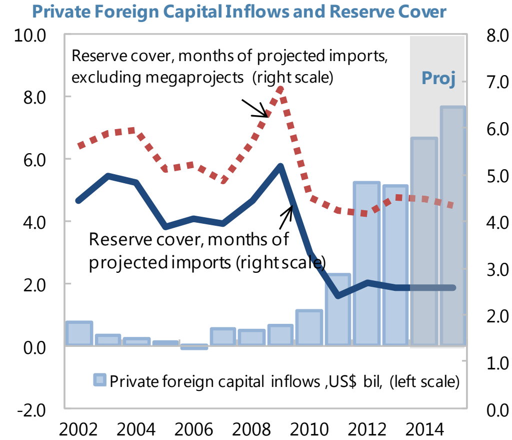
The current account deficit declined somewhat in 2013, but continues to reflect sizeable investment imports by the natural resource sector since 2011-12.

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



In the face of strong private capital inflows and import growth, the reserve cover was maintained at about 4 month of projected non-megaproject imports since 2010.

Private Foreign Capital Inflows and Reserve Cover

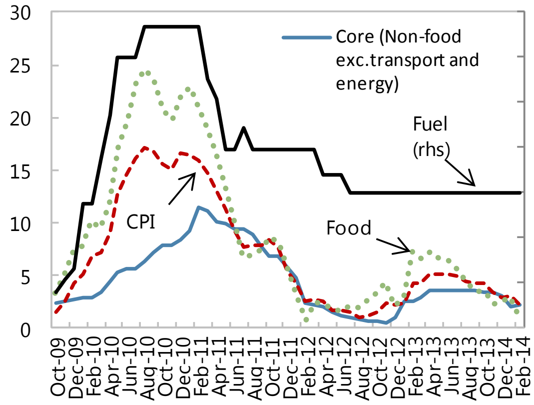


Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 2. Mozambique: Inflation and Monetary Developments

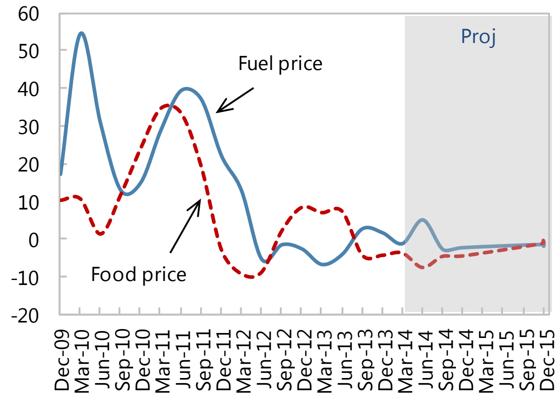
Inflation remained low, after a temporary rise related to the floods in early 2013.

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



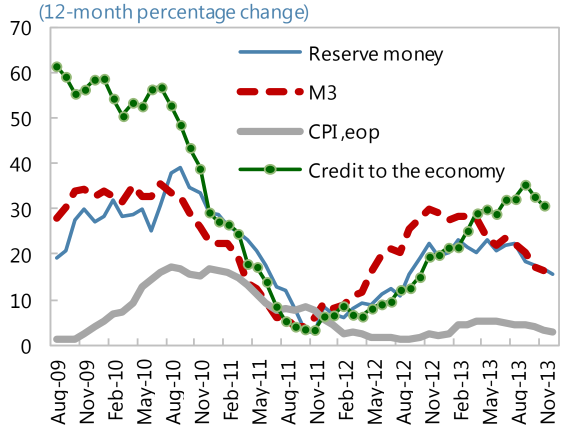
Low inflation was helped by favorable developments in international prices.

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



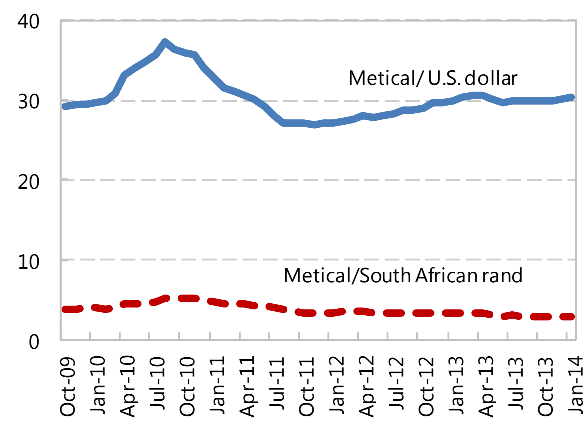
Slowing velocity and strong private sector credit growth signal financial deepening, but looser broad money since 2012 may generate some inflationary pressures.

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



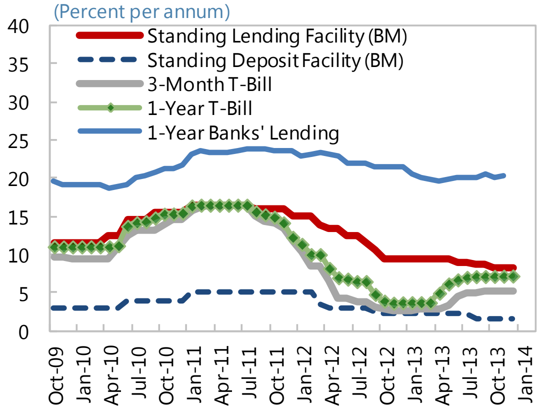
The Mt/$ exchange rate has depreciated somewhat since mid-2011, while the rate against the rand has appreciated slightly.

Bilateral Exchange Rates



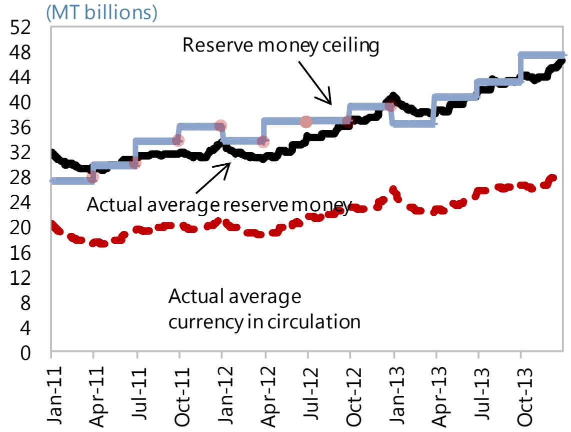
The BM's policy rates and the T-bill rates have come down, although banks' lending rate remains sticky.

Interest Rates
(Percent per annum)



Reserve money was in line with program targets.

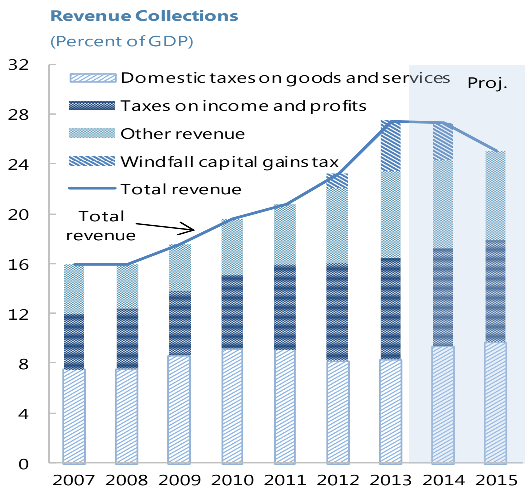
Reserve Money
(MT billions)



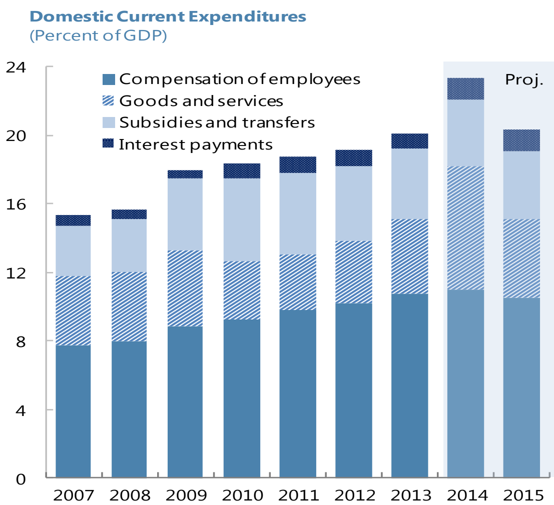
Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 3. Mozambique: Fiscal Developments

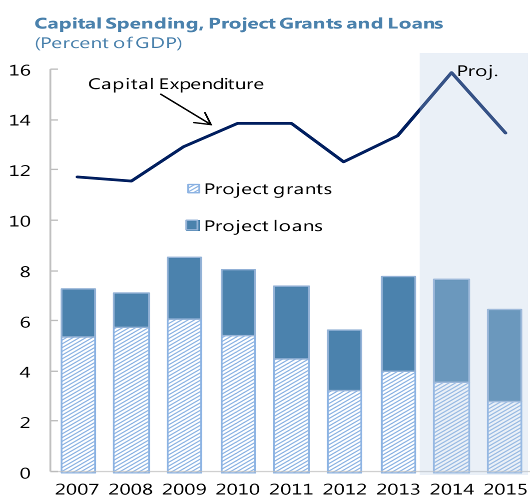
Windfall capital gains tax receipts in 2012-14 added to buoyant revenue collections.



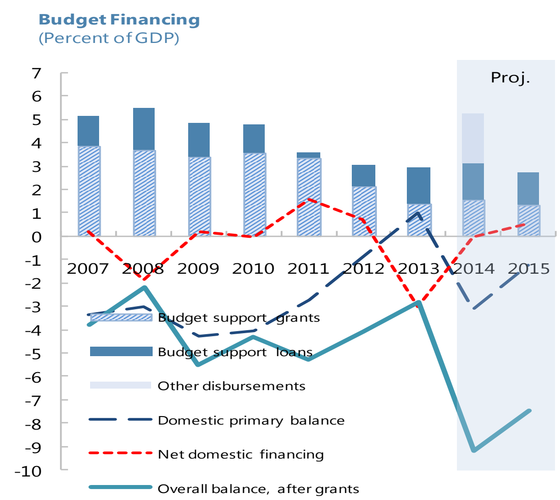
Election and other one-off expenses are major drivers of higher current spending in 2014.



External loans are gradually replacing grants for the financing of capital spending.



The swing in the domestic primary balance (and net domestic financing) reflects windfall revenues in 2013-14.



Sources: Mozambican authorities and IMF staff estimates and projections.

ECONOMIC OUTLOOK AND POLICY DISCUSSIONS

A. Outlook and Risks

MEFP ¶4

6. Mozambique's economic outlook remains favorable. In 2014, growth is projected to accelerate to 8.3 percent with increasing coal production and infrastructure construction. Inflation is projected to remain within the BM's target range of 5-6 percent, but there are upside risks due to inflationary pressures in the region, the expansionary fiscal policy stance in 2014 and accommodative monetary policy. In the medium term, growth is projected at 8 percent. The large investments in natural resource projects financed by FDI and private funding will continue to dominate the balance of payments, further widening the current account deficit to 50 percent of GDP over the next 4-5 years as the construction of the gas liquefaction plants picks up.

7. Notwithstanding the favorable outlook, Mozambique is exposed to risks. These include exogenous shocks like climate disasters, commodity price shocks and global demand for its major export or import commodities (coal, gas, fuel), or financing risks for megaprojects; staff see these risks as low to moderate. Other risks appear contained, including shifts in donor sentiments, political tensions in an election year, governance weaknesses, and fiscal risks stemming from public enterprises (SOEs) and public-private partnerships (PPPs).

MEFP ¶5-14

8. In view of this outlook, staff and the authorities updated understandings on a macroeconomic policy mix for 2014 consistent with the objectives of the three-year PSI-supported program. The main objectives are to maintain growth and render it more inclusive, preserve a low-inflation environment while facilitating credit to the economy, maintain fiscal sustainability, and support an expansion in public and private investment, including in priority social programs.

B. Fiscal Policy and Reforms

Mozambique: Key Fiscal Indicators

	2012	2013		2014	
	Act.	CR 14/20	Est.	CR 14/20	Revised Prog.
	(Percent of GDP, unless otherwise stated)				
Total revenue	23.5	27.4	27.5	23.7	27.3
Total expenditure and net lending	32.9	36.3	35.6	40.1	41.6
Overall balance, before grants	-9.6	-8.9	-8.3	-16.3	-14.3
Overall balance after grants	-4.1	-4.6	-2.8	-12.6	-9.2
Domestic primary balance	-1.0	0.0	0.9	-6.1	-3.0
Net domestic financing	0.7	-2.0	-3.0	2.9	-0.1
Memorandum items:					
Real GDP growth (percent)	7.2	7.0	7.1	8.5	8.3
Average CPI inflation (percent)	2.1	5.5	4.4	5.6	5.6

Sources: Mozambican authorities and IMF staff estimates and projections.

9. Since the adoption of the expansionary 2014 budget in late 2013 that was described in the first PSI review, the fiscal outlook has improved. Additional windfall revenue of $520 million (3 percent of GDP) was received in March, the last such windfall expected from recent sales of shares in natural gas projects. The authorities are preparing a supplementary budget to cover the new spending commitments entered into in the political agreement with Renamo ($36 million, mostly for hiring additional election staff, but on a permanent basis, thus further inflating the wage bill) and for investment projects left incomplete with the withdrawal of some donor resources last year ($25 million) due to inadequate progress in implementing these projects. As a result, the overall fiscal deficit (after grants) is now projected to widen from 2.8 percent of GDP in 2013 to 9.2 percent in 2014, which is projected to be financed in full from external sources. Most of this funding is either already in hand (EMATUM), or project financing, i.e. project execution will reflect the disbursement of the financing, and if there were significant shortfalls in foreign funding the project execution would be delayed.

Tax Revenue

10. **Total revenue is projected to remain at about 27 percent of GDP in 2014.** Abstracting from capital gains tax windfalls and small but rising coal royalties, the underlying tax effort in 2014 is projected to increase by about 1 percentage point of GDP, of which about half reflects changes in the tax code (Box 1), including tax equalization of various financial instruments, and the other half represents increased tax collection efforts.

Mozambique: Contributions to Tax Revenues

	2010	2011	2012	2013	2014
					Revised
	Act.	Act.	Act.	Est.	Prog.
	(Percent of GDP)				
Total revenues	19.6	20.8	23.3	27.5	27.3
Tax revenues	17.0	18.1	19.8	23.3	23.3
Coal revenues	0.0	0.0	0.0	0.1	0.2
Non-coal tax revenues	17.0	18.1	19.8	23.3	23.1
Of which capital gains	0.0	0.0	1.2	4.2	3.0
Of which other tax revenues	17.0	18.1	18.6	19.1	20.1
	(Percent of non-coal GDP)				
Non-coal revenues	19.8	20.8	23.5	27.7	27.5
Non-coal tax revenues	17.3	18.2	20.0	23.5	23.5
Non-coal, non-capital gains tax revenues	17.3	18.2	18.8	19.3	20.4
	(Billions of MT)				
Coal GDP	4.1	0.9	4.8	5.3	8.4
Non-coal GDP	311	364	403	456	519

Sources: Mozambican authorities and IMF staff estimates and projections.

Box 1. Changes to Mozambique Tax Code in 2014

The Revenue Authority estimates that tax changes effective in 2014 will add about 0.5 percent of GDP to tax revenue. While changes to corporate income tax focus mainly on clarifying the existing treatment of capital gains from the natural resource sector, changes to personal income taxes were simplified to broaden the tax base. The main changes are:

Corporate income tax

- Capital gains resulting from a direct or indirect transfer between nonresidents of assets located in Mozambique are deemed subject to Mozambican taxes, regardless of where the sales takes place and regardless of whether the transfer is gratuitous or against compensation.
- Interest payments and other forms of remuneration on loans granted to shareholders of a company are not tax deductible if they exceed the domestic interbank reference rate plus 2 percent. Similarly, interest income from treasury securities, listed debt securities, or interbank placements is subject to a 20 percent withholding tax.
- Income of non-resident entities, including providers of services related to maintenance and freight of aircraft, is subject to a 10 percent withholding tax.

Personal income tax

- Employment income will be taxed through a final withholding tax.

11. Staff reiterated past advice to establish an explicit budget rule for the use of windfall or above-budget revenue. In effect, the authorities operate a stabilization account in parallel to Treasury execution, but they consider that its formalization should be left to the new government.

12. The authorities continue to strengthen revenue administration. They prepared a note on the validation of VAT refund requests as of end-2013 (structural benchmark for March 2014) and intend to process and pay or securitize valid requests by end-2014. They are also working to present/implement VAT on a net basis in/from the 2015 budget. Other efforts are ongoing, albeit somewhat slow, and include strengthening the large taxpayer unit, broadening e-tax and tax payments via banks for VAT and the simplified small tax payer regime, and reforms of transfer price provisions. The revised fiscal regime for the new mining and hydrocarbon laws have been submitted to the Council of Ministers in March, albeit staff continued to voice concerns over some provisions that do not reflect best international practice.

MEFP ¶16,20

Expenditure

13. Total expenditure is projected to rise by 6 percentage points of GDP in 2014 compared to 2013 largely as anticipated during the first PSI review, reflecting a combination of one-off and longer-term factors.

MEFP ¶12

- **Two percentage points of GDP of the increase in expenditure ($350 million) reflects the bringing on to the budget of the quasi-fiscal operations of EMATUM** (tuna company). While this is understood to be related to maritime security operations, for lack of detail on its composition, staff has included this as current spending. The authorities indicated that such spending will be covered in the regular treasury execution reports. To address concerns on the transparency of the operation, the Ministry of Finance will monitor EMATUM's operations—funded in 2013 with $500 million in government-guaranteed international borrowing—on a quarterly basis and publish its audited accounts.

  MEFP ¶23

- **Other current spending is projected to rise by 1 percent of GDP, reflecting mostly the direct cost of the elections**. Staff noted concern over the ballooning wage bill that stands at 11 percent of GDP, and the authorities agreed that efforts would be needed in the future to limit further increases and bring the wage bill down to 8–9 percent of GDP over the medium term.

Box 2. Fiscal Anchors and Public Debt Sustainability in Mozambique

Mozambique's public debt level remains sustainable, but fiscal risks are on the rise. Total public debt in Mozambique has been rising fast since it received debt relief (HIPC in 2001 and MDRI in 2005-6). Public debt is expected to reach 57 percent of GDP in 2014, about 21 percent of GDP higher than the sub-Saharan African average. Public debt is also above the threshold that the Fund typically uses to assess fiscal vulnerabilities for low-income countries (40 percent of GDP for countries at medium capacity).1 The debt sustainability analysis (DSA) suggests that public debt will remain sustainable, assuming some fiscal consolidation beginning in 2015. Without adjustment, fiscal deficits at the projected 2014 level (about 9.2 percent of GDP) would drive up Mozambique's public debt by 3–4 percent of GDP per year.

What would be an appropriate fiscal anchor to prevent Mozambique encountering debt sustainability problems? The domestic primary balance (which excludes grants, interest spending and externally-financed capital expenditures) has so far been the main fiscal indicator. While it has the advantage of being under the control of the authorities, it does not set limits on external borrowing to finance capital spending. Staff noted that it does not provide a direct link to debt sustainability, limiting its effectiveness as a fiscal anchor when debt is rising fast. To begin a discussion of alternatives, staff noted that the overall fiscal balance (i.e. total revenues and grants minus total spending) measures the net financial position (i.e. whether the government is accumulating or reducing financial wealth), and is more adequate to anchor public debt on a sustainable path. The increasingly larger share of the budget funded from revenue, combined with greater donor coordination, would make the use of this indicator more relevant for policy makers.

Prior to the expected arrival of substantial revenues from the ongoing LNG projects (by around 2022), an overall fiscal deficit of 5-6 percent of GDP would seem appropriate for Mozambique. One reason is that an overall fiscal deficit of about 6 percent of GDP would help stabilize public debt.[2] To illustrate this, under current projections of gradual fiscal consolidation, this deficit level would be achieved by 2018, stabilizing public debt at the 2014 level. While there are risks, this debt level would be sustainable and provide enough flexibility to avoid a larger and more disruptive fiscal adjustment. Reducing the deficit slightly (towards the 5 percent level) would allow Mozambique to build some buffers against shocks and fiscal vulnerabilities (from 2017 on). This is necessary because the DSA is based on the maintenance of relatively favorable interest rate-growth differential (i.e. high growth and low interest rates) that may be difficult to sustain over time. Also, fiscal indicators only cover the central government at a time when fiscal risks from the ambitious PPP program, and contingent liabilities from public enterprises, are on the rise.

It does not seem advisable to run larger fiscal deficits in anticipation of natural resource revenues.[3] First, Mozambique is still several years away from becoming a resource-rich country, and there is uncertainty on the magnitude and temporal profile of these resource revenues. Second, public spending levels are already high, there are absorptive capacity constraints, and adequate efficiency of spending needs to be ensured. Finally, Mozambique will need to define its fiscal framework to manage resource wealth, and, once resource revenues becomes significant, shift from the overall fiscal balance to a fiscal anchor more appropriate at that point (e.g. non-resource primary balance).

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[1] See 2013 Low-Income Countries Global Risks and Vulnerabilities Report. http://www.imf.org/external/np/pp/eng/2013/090613.pdf

[2] The debt-stabilizing primary deficit is about 4.5 percent of GDP. With average interest payments at 1.5 percent of GDP, the debt-stabilizing overall fiscal deficit is about 6 percent of GDP.

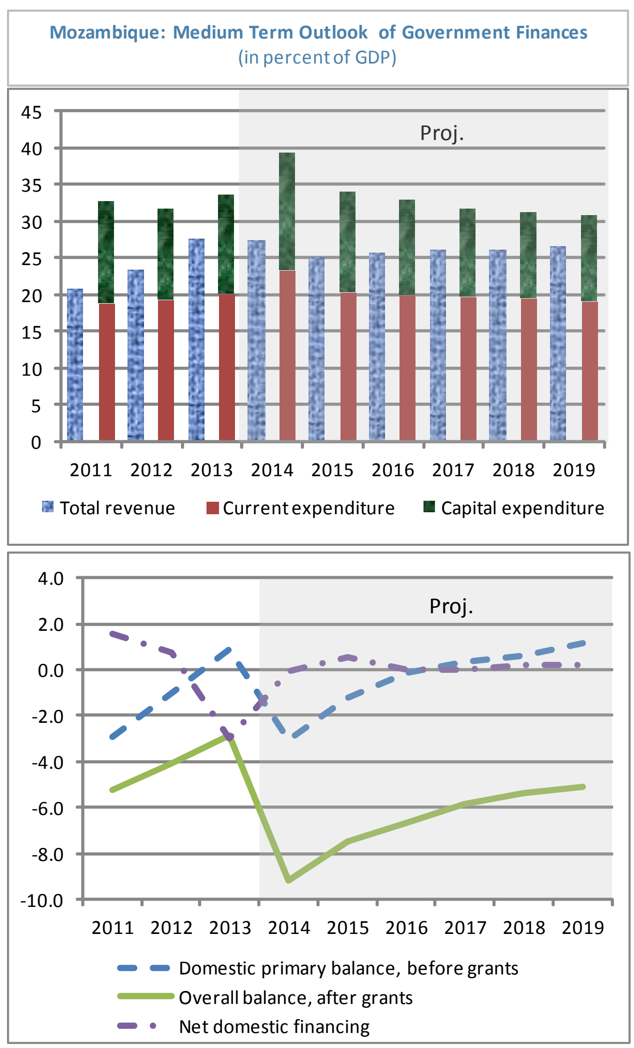
[3] See IMF country report 13/200, Appendix V "Natural Gas, Public Investment and Debt Sustainability."

- **Public investment expenditure is projected to increase further by 2½ percentage points to 16 percent of GDP in 2014, a very high level by international comparison.** While acknowledging Mozambique's infrastructure gap, staff observed that capacity is being stretched. Ensuring value-for-money would suggest a more moderate pace of capital spending while investment selection, implementation and monitoring capacity is being built, particularly for commercially-funded projects. Staff also advised taking into account that new infrastructure required adequate budgeting for recurrent maintenance expenditure, an area already underserved at present. The authorities noted they have already taken some steps to strengthen investment management and agreed that greater efforts in this area were warranted. They indicated that difficulties in recruiting and retaining qualified staff were a major constraint.

14. Meeting priority spending targets has proven a challenge repeatedly in the past. The 2014 targets for priority spending seek to reflect the historical implementation rate on projects, to provide a more accurate indication of the likely execution of such spending. After delays in donor disbursements in the last quarter of 2013, some disbursements were released at the end of the year, but came too late to be spent in 2013 and thus provide some additional margin for priority spending in 2014.

Medium-term fiscal outlook and risks

15. Fiscal policy over the medium term should ensure debt sustainability while allowing the authorities to address development challenges. A gradual process of fiscal consolidation will be necessary to ensure that debt accumulation remains within appropriate bounds. As laid out in Box 2, targeting an overall fiscal deficit (after grants) of 5-6 percent of GDP and a small domestic primary surplus would be an appropriate anchor for Mozambique in the medium term. Staff noted that this seemed feasible as (i) revenue efforts were expected to continue; (ii) submitting public investment projects to a more rigorous assessment process would likely result in some moderation in the pace of external borrowing; (iii) one-off spending in 2014 mainly related to bringing on-budget the quasi-fiscal operations of EMATUM and to the elections, which would not continue in 2015; and (iv) the authorities acknowledged that the wage bill and purchases of goods and services should rise by less than the projected 14



Sources: Mozambique authorities, and staff projections.

percent growth in nominal GDP. The authorities agreed that the 2014 fiscal stance was expansionary and that some consolidation would be needed beginning in 2015. They noted that preparations for the 2015 budget had not yet begun, and that specific decisions on the medium-term fiscal stance would need to be taken by the new government. At the same time, they considered fiscal sustainability a key objective of their medium-term fiscal program.

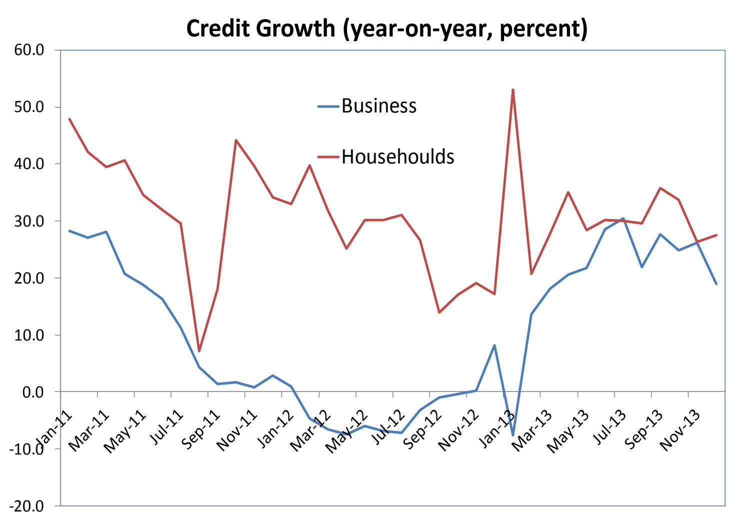
16. **The recent fiscal transparency assessment highlighted the presence of considerable fiscal risks.** The risks stem from reliance on donor support for external financing, susceptibility to exogenous shocks from natural disasters, activities of public enterprises, major and multi-annual contracts for infrastructure, guarantees granted, contingent liabilities and quasi-fiscal activities. Apart from risks to external financing, no fiscal risk is recognized or analyzed in budget documents, and there is no strategy for managing them. To address this, the authorities agreed with the staff 's recommendation to set up a fiscal risk unit in the Ministry of Finance to better understand the risks, particularly those arising from government guarantees, the operations of public enterprises, and PPPs. While this will take time, the authorities are taking some steps to strengthen the financial oversight over public enterprises, and agreed to build capacity to assess and monitor PPPs. The Risk Unit will be tasked with preparing a comprehensive statement on fiscal risks for inclusion in the annual budget documents.

MEFP ¶24

C. Monetary Policy and Financial Sector Reforms

17. The BM's recent monetary policy stance has sought to balance price stability and private sector credit growth. The cuts in the BM's deposit and lending rates in 2013 had little impact on banks' rates, as the monetary transmission mechanisms are weak reflecting major structural constraints in a banking system dominated by 3 or 4 large banks. Staff noted that reforms to promote competition, transparency, and financial literacy such as the establishment of private credit registries, should over time help lower the credit risk to banks and the cost to borrowers. Staff pointed out that credit growth remained brisk; the authorities noted that household credit was generally backed by salaries and that business credit was picking up from a low base and was slowing down so that risks were low. Staff advised, and the authorities agreed, that they needed to be vigilant and dampen the planned monetary and credit expansion if inflation rises significantly over the medium-term target of 5-6 percent. The authorities are also strengthening the BM's inflation analysis and forecasting capacity, and continue to improve its communications on monetary policy decisions.

MEFP ¶7, 25,26



Source: Mozambique authorities.

18. Reforms will also continue to enhance bank supervision and crisis management tools. Quarterly stress testing is envisaged, and data collection is being improved to address the main obstacle identified by Fund technical assistance. The definition of non-performing loans was aligned to international standards as of January 2014. The BM will continue to develop risk-based surveillance, and began implementing Basel II standards in January 2014. The banking system is resilient, but credit portfolio concentration remains the main source of risk. Work is proceeding slowly on making the Financial Sector Contingency Plan and the Deposit Insurance Fund operational. A new Payment Systems Oversight Unit in the BM will perform on-site inspections and will produce a monthly report to the BM Board; the first annual oversight report will be completed by end-November 2014 (structural benchmark).

MEFP ¶27

19. Follow-up has been slow on the Financial Sector Development Strategy (FSDS) approved a year ago. A draft National Financial Inclusion Strategy is planned for end-2014. The law on the creation of private credit registry bureaus [was] submitted to Parliament in February 2014 (structural benchmark). A draft Movable Collateral Bill, which will supplement the existing immovable collateral framework and facilitate credit to small and medium-sized enterprises, is expected to be submitted to the Council of Ministers by end-December 2014 (structural benchmark). Regulations to implement the Law on Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) approved in August 2013 were submitted to the Council of Ministers in March 2014.

MEFP ¶28

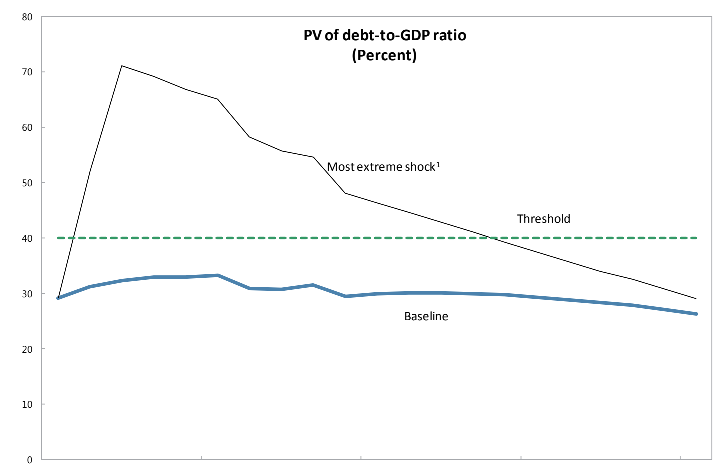
MEFP ¶29

D. Investment Planning and Debt Management

20. Capacity development in investment planning, project evaluation and debt management is ongoing. The Ministry of Planning and Development is working with line ministries to revise the Integrated Investment Plan, adding a summary description and appropriate financial information for each new project included in the 2014 budget and envisaged for 2015 so as to inform debt sustainability analysis (DSA), the medium-term budget framework, and the annual budget process (structural benchmark for end-June 2014).

MEFP ¶14

21. Mozambique remains at moderate risk of debt distress. Staff has prepared a DSA in collaboration with the authorities and the World Bank (see Supplement 1 to this report). The main changes since the last DSA was prepared in 2013 are: the use of a 5 percent discount rate, the incorporation of the commercial borrowing through EMATUM ($850 million or 6 percent of GDP in 2013) with a government guarantee, and delays in other



1/ Most extreme shock is a combination of real GDP and export value growth at historical averages minus one standard deviation in 2014-15.

borrowing plans. As in the last DSA, the impact of the standard shocks is heightened because of the structural change in the Mozambican economy since 2011with the large-scale exploitation of coal and discovery of natural gas, which have resulted in a large increase in related imports and the current account deficit, which are largely FDI-financed. The debt and debt-service profiles are similar to the last DSA, and highlight the need for the government to proceed with caution in contracting new borrowing.

22. The authorities have requested an increase in the non-concessional borrowing ceiling under the program of $300 million. The authorities' planned commercial borrowing is for the three infrastructure investments detailed in the DSA, for which the upgraded investment assessments in line with the June 2014 structural benchmark have been completed. The amount requested is within the amount originally envisaged in the PSI to facilitate scaling-up of investment and the DSA update implies that there is room for the additional non-concessional borrowing while maintaining debt at sustainable levels over the medium term. While the authorities voiced a strong preference for a program ceiling only on commercial borrowing, staff noted Mozambique's sizeable volume of concessional borrowing in recent years and advised to focus on overall borrowing as providing a better indicator of emerging fiscal and debt sustainability concerns.

E. PRSP Progress Report

23. The authorities' PRSP progress report (EBD/14/17) indicates that good progress has been made towards the end-2014 targets of the current PRSP (PARP) covering 2011–14. The new government is expected to prepare a successor PRSP next year. The Monitoring and Evaluation Unit in the Ministry of Planning and Development maintains a detailed matrix of indicators defined in cooperation with donors that is used to monitor progress by sectors and regions. These indicators cover mainly the objectives of (i) increasing production and productivity in agriculture and fisheries; (ii) employment creation; and (iii) human and social development. The remaining two objectives are governance and macroeconomic and fiscal management; the progress report does not touch on these as they are covered in an annual report on economic and social development that accompanies the budget proposal. Among the first three objectives, most progress was achieved on agricultural production, but less on the other two areas. While the progress report links the latter loosely to the lackluster global economy, staff noted that growth in Mozambique has been relatively strong, but should be made more inclusive in terms of employment including through small and medium-sized enterprises. The authorities plan to conduct the next household expenditure survey during 2014–15.

PROGRAM ISSUES

24. Modifications are proposed for three assessment criteria (ACs) for June 2014, including the continuous AC on nonconcessional external borrowing, and for the two indicative targets (ITs) for June, as well as the indicative targets for September-December to reflect the March windfall revenue and an increase in the ceiling on nonconcessional borrowing; new ACs are proposed for December 2014. Modifications are proposed to one structural benchmark to clarify the action sought to enable on-line tax declarations (for VAT and ISPC), and one new benchmark for end-December 2014 is proposed to clear the backlog of end-2013 VAT refund requests, a macro-critical revenue administration reform.

STAFF APPRAISAL

25. Mozambique's performance under the PSI-supported program remains broadly satisfactory. Economic policies helped to support growth while maintaining low inflation. All assessment criteria were met. However, priority spending in 2013 fell short of program targets and it will be important to improve expenditure execution going forward to ensure that such a shortfall is temporary. The implementation of the structural reform agenda is ongoing.

26. Implementation of the Poverty Reduction Strategy continues to progress, though little analysis is available beyond the matrix of indicators that the authorities are monitoring. Making growth more inclusive by generating more employment is clearly a major challenge, demonstrating the importance of improvements to human capital and the enabling environment for small and medium-sized enterprises that are typically the main source of employment creation.

27. Mozambique's economic outlook remains strong, yet there are external and domestic risks. The economy has been relatively insulated from global developments and the natural resource projects continue to attract large scale foreign investment. External risks (climate disaster, commodity prices, loss of FDI, drop in global demand) are low to moderate, and domestic risks appear contained (pre-election tensions, governance and fiscal risks).

28. **The policy stance for 2014 is expansionary, and fiscal consolidation will be needed in the medium term.** The budget envisages a significant expansion in spending related to holding the elections, Ministry of Defense operations, and public investment while revenue is benefitting from further large windfall revenues. The monetary policy stance is accommodative, but needs to be vigilant, with an eye to keeping inflation to its medium-term target and building foreign reserves to maintain an adequate import cover.

29. Structural reforms across a broad spectrum of areas are envisaged under the PSI-supported program, and their implementation could be invigorated. This includes in particular ongoing PFM reforms and the identification of fiscal risks. Strengthening institutional capacity will be important to prepare for managing the future LNG boom and make growth more inclusive. Progress has been made toward modernizing the fiscal and monetary policy regimes, and ongoing efforts to build capacity in macroeconomic analysis and management should be continued.

30. External borrowing can be used to fund the country's vast infrastructure needs, but should reflect transparent project selection based on the country's economic and social priorities and preserve debt sustainability. The expected gradual move from traditional donor financing to commercial borrowing requires the authorities to take charge of project analysis and selection, and monitor project implementation closely to ensure value-for-money. Transparency of decision-making and adherence to due process in investment planning, selection and financing need to be strengthened, and the authorities should be vigilant of the related debt dynamics.

31. Staff recommends the completion of the second PSI review. Program performance has been broadly satisfactory to date. The attached MEFP outlines the macroeconomic objectives and policies for the period ahead as well as modifications to the end-June assessment criteria to reflect the higher than anticipated fiscal revenues. Staff supports the authorities request to increase the NCB ceiling as this is in line with the PSI objective of facilitating a scaling up in infrastructure investment and it remains consistent with the DSA.

Table 1. Mozambique: Selected Economic and Financial Indicators, 2011-19

	2011	2012	2013		2014		2015	2016	2017	2018	2019
	Act.	Est.	CR 14/20	Est.	CR 14/20	Proj.	Projections				
	(Annual percentage change, unless otherwise indicated)										
National income and prices											
Nominal GDP (MT billion)	365	408	461	461	528	528	603	689	784	894	1017
Nominal GDP growth	15.8	11.8	13.0	13.0	14.4	14.4	14.2	14.3	13.9	14.0	13.7
Real GDP growth	7.3	7.2	7.1	7.1	8.3	8.3	8.2	8.2	7.9	8.0	7.7
GDP per capita (US$)	510	567	590	593	640	645	689	748	814	888	966
GDP deflator	7.9	4.3	5.5	5.5	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Consumer price index (annual average)	10.4	2.1	4.4	4.2	5.6	4.6	5.6	5.6	5.6	5.6	5.6
Consumer price index (end of period)	5.5	2.2	3.6	3.0	6.0	6.0	5.6	5.6	5.6	5.6	5.6
Exchange rate, MT per US dollar, eop	27.3	29.8	...	29.9	...	...	...	...	...	...	...
Exchange rate, MT per US dollar, per.avg.	29.1	28.5	...	30.1	...	...	...	...	...	...	...
External sector											
Merchandise exports	33.6	23.6	3.5	8.4	18.6	17.7	15.3	18.3	12.0	14.0	9.7
Merchandise exports, excluding megaprojects	65.8	48.4	9.9	12.4	6.9	0.4	8.1	7.2	9.2	14.9	10.8
Merchandise imports	52.8	47.2	9.2	8.5	7.8	15.6	16.2	5.2	19.3	8.5	-3.8
Merchandise imports, excluding megaprojects	46.2	50.8	3.3	8.6	6.1	8.7	8.7	9.8	8.4	7.4	8.5
Terms of trade	2.5	-5.2	-9.1	-9.2	-1.4	-2.6	-0.4	0.5	-0.1	-0.3	-0.3
Nominal effective exchange rate (annual average)	12.4	7.4	...	...	...	...	...	...	...	...	...
Real effective exchange rate (annual average)	19.7	5.4	...	...	...	...	...	...	...	...	...
	(Annual percentage change, unless otherwise indicated)										
Money and credit											
Reserve money	8.5	19.7	17.9	15.7	17.0	17.0	15.1	14.9	14.9	15.0	15.1
M3 (Broad Money)	9.4	29.4	20.0	16.3	18.5	18.5	15.3	15.2	15.1	15.1	15.2
Credit to the economy	6.4	19.9	32.3	28.7	17.4	20.7	16.4	16.3	16.5	16.4	16.4
(Percent of GDP)	26.9	28.9	33.4	32.9	34.2	34.7	35.4	36.0	36.8	37.6	38.5
	(Percent of GDP)										
Investment and saving											
Gross domestic investment	37.0	48.0	48.8	50.1	51.9	49.8	57.4	53.6	61.1	60.8	54.7
Government	14.9	13.4	15.6	15.5	17.2	18.3	16.3	16.0	15.3	15.0	15.0
Other sectors	22.1	34.5	33.2	34.5	34.6	31.5	41.2	37.6	45.8	45.8	39.8
Gross domestic savings (excluding grants)	5.7	-1.1	3.0	7.5	5.4	-0.5	7.8	7.5	7.1	6.9	6.9
Government	2.0	4.1	6.7	7.4	0.9	4.0	4.6	5.9	6.3	6.8	7.4
Other sectors	3.7	-5.2	-3.7	0.1	4.4	-4.5	3.1	1.6	0.7	0.2	-0.4
External current account, before grants	-31.3	-49.1	-45.8	-42.6	-46.5	-50.3	-49.7	-46.1	-54.1	-53.9	-47.8
External current account, after grants	-24.4	-45.4	-42.2	-39.5	-43.4	-46.9	-47.0	-43.8	-52.0	-52.0	-46.2
Government budget											
Total revenue [1]	20.8	23.3	27.4	27.5	23.7	27.3	25.0	25.7	25.9	26.1	26.4
Total expenditure and net lending	33.7	32.6	36.3	35.6	40.0	41.6	36.6	35.8	34.9	34.3	34.0
Overall balance, before grants	-13.1	-9.5	-8.9	-8.3	-16.3	-14.3	-11.6	-10.1	-9.0	-8.2	-7.6
Total grants	7.8	5.4	4.3	5.4	3.8	5.2	4.2	3.5	3.1	2.8	2.5
Overall balance, after grants	-5.3	-4.1	-4.6	-2.8	-12.5	-9.2	-7.5	-6.6	-5.8	-5.4	-5.1
Domestic primary balance, before grants	-2.9	-1.0	0.0	0.9	-6.1	-3.0	-1.2	-0.2	0.3	0.6	1.1
External financing (incl. debt relief)	3.7	4.2	6.6	7.0	9.6	9.2	6.9	6.6	5.8	5.2	4.9
Net domestic financing	1.6	0.7	-2.0	-3.0	2.9	-0.1	0.5	0.0	0.0	0.2	0.2
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]	39.6	42.7	44.3	53.1	46.9	56.5	58.3	58.3	57.7	56.5	55.5
Of which: external	32.9	36.9	39.2	44.2	42.1	49.2	51.4	52.3	52.4	51.6	51.0
Of which: domestic	6.7	5.8	5.2	8.9	4.8	7.3	6.9	6.0	5.3	4.9	4.5
	(Millions of U.S. dollars, unless otherwise indicated)										
External current account, before grants	-3,922	-7,023	-6,984	-6,523	-7,882	-8,592	-9,286	-9,578	-12,536	-13,951	-13,789
External current account, after grants	-3,059	-6,484	-6,442	-6,048	-7,364	-8,007	-8,781	-9,108	-12,067	-13,481	-13,320
Overall balance of payments	323	177	458	390	199	400	224	161	213	683	797
Net international reserves (end of period) [3]	2,239	2,605	3,061	2,996	3,262	3,397	3,623	3,784	3,997	4,680	5,477
Gross international reserves (end of period) [3]	2,428	2,799	3,252	3,192	3,449	3,591	3,781	3,905	4,081	4,727	5,489
Months of projected imports of goods and nonfactor services	2.4	2.6	2.7	2.5	2.6	2.6	2.5	2.2	2.1	2.3	2.5
Months of projected imports of goods and nonfactor services, excl. megaprojects	3.0	3.9	4.4	4.2	4.7	4.4	4.2	4.3	4.3	4.2	4.2

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.

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

Table 2. Mozambique: Government Finances, 2011-14[1]

(Billions of Meticais)

	2011	2012	2013		2014	
	Act.	Act.	CR 14/20	Est.	CR 14/20	Revised Prog.
Total revenue[1]	75.8	94.8	126.3	126.6	125.3	144.0
Tax revenue	66.2	80.9	108.2	107.6	104.5	123.1
Income and profits	24.9	36.8	54.5	55.8	39.9	57.2
Of which : capital gain tax	…	5.0	19.2	18.6	0.0	16.1
Goods and services[1]	33.0	33.3	39.7	38.3	48.1	49.4
Of which : on petroleum products	4.7	1.3		2.2		2.5
International trade	6.7	7.6	9.6	10.0	10.8	10.8
Other	1.5	3.2	4.4	3.5	5.7	5.7
Nontax revenue	9.6	14.0	18.1	19.0	20.8	20.8
Total expenditure and net lending	122.8	133.1	167.5	164.2	211.5	219.5
Current expenditure	68.5	78.3	95.6	92.6	120.5	123.1
Compensation to employees	35.7	41.5	50.5	49.5	57.0	57.9
Goods and services[1]	12.1	15.1	21.3	20.4	36.5	37.4
Of which: Maritme security	…	…	…	…	10.9	10.2
Interest on public debt	3.6	4.1	4.3	4.0	6.3	7.0
Domestic	2.6	2.9	2.4	2.2	3.7	3.7
External	1.0	1.2	1.9	1.7	2.6	3.3
Transfer payments	17.2	17.5	19.4	18.8	20.7	20.7
Capital expenditure	50.6	50.4	62.1	61.6	79.1	83.8
Domestically financed	20.3	24.7	34.6	33.6	42.5	43.1
Externally financed	30.3	25.6	27.5	28.0	36.6	40.7
Net lending	3.7	4.5	9.8	10.0	11.9	12.7
Domestically financed	0.4	-0.4	0.3	-0.3	0.8	0.8
Externally financed loans to public enterprises	3.3	4.9	9.5	10.3	11.1	11.8
Unallocated revenue (+)/expenditure (-) [2]	-0.8	-0.4	0.0	-0.5	0.0	0.0
Domestic primary balance, before grants, above the line	-10.7	-4.1	0.1	4.2	-32.2	-16.0
Overall balance, before grants	-47.8	-38.7	-41.2	-38.1	-86.2	-75.6
Grants received	28.6	21.9	19.8	24.9	19.9	27.2
Project support	16.4	13.3	10.5	18.5	12.0	18.8
Investment projects	6.7	7.3	3.8	9.9	3.7	9.1
Special programs	9.7	6.0	6.7	8.6	8.3	9.7
Direct financing	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	12.3	8.7	9.3	6.4	7.8	8.4
Overall balance, after grants	-19.2	-16.8	-21.4	-13.1	-66.3	-48.4
Net external financing	13.5	13.8	30.6	27.1	50.9	48.8
Disbursements	14.6	15.4	33.8	29.6	54.8	52.6
Project	10.5	6.7	17.0	12.2	24.5	21.6
Nonproject support	4.1	8.7	16.7	17.5	19.4	20.1
Loans to public enterprises	3.3	4.9	9.5	10.3	11.1	11.8
of which : nonconcessional	1.5	2.3	0.8	0.8	1.9	1.9
Budget support	0.8	3.9	7.3	7.2	8.3	8.2
Other disbursements	…	…	…	…	10.9	10.9
Cash amortization	-1.1	-1.6	-3.1	-2.5	-3.9	-3.9
Net domestic financing	5.7	2.9	-9.2	-13.9	15.5	-0.4
of which: VAT arrears	2.4	0.2	3.0	3.5	1.6	2.6
Net credit to government (program definition)	3.3	2.7	-12.2	-17.4	13.9	-3.0
Memorandum items:						
Overall balance excluding windfall receipt	…	…	-40.6	-31.7	-66.3	-64.5
Gross aid flows	41.7	35.1	52.7	48.3	42.2	58.1
Budget support	13.1	12.5	16.6	13.6	16.1	16.6
Nonbudget support	28.6	22.6	36.1	40.1	45.7	50.3
Project support	26.9	20.0	27.5	30.7	36.5	40.4
Concessional loans to public enterprises	1.8	2.6	8.6	9.4	9.2	9.9

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

[1]VAT presentation was changed to a net basis (collection minus requested VAT refunds).

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

Table 3. Mozambique: Government Finances, 2011-19[1]

(Percent of GDP)

	2011	2012	2013		2014		2015	2016	2017	2018	2019
	Act.	Act.	CR 14/20	Est.	CR 14/20	Revised Prog.	Projections				
					(Percent of GDP)						
Total revenue [1]	20.8	23.3	27.4	27.5	23.7	27.3	25.0	25.7	25.9	26.1	26.4
Tax revenue	18.1	19.8	23.5	23.3	19.8	23.3	21.0	21.7	22.0	22.2	22.4
Taxes on income and profits	6.8	9.0	11.8	12.1	7.6	10.8	8.2				
Of which : capital gain tax	…	1.2	4.2	4.0	0.0	3.0	0.0				
Taxes on goods and services [1]	9.1	8.2	8.6	8.3	9.1	9.4	9.6				
Taxes on international trade	1.8	1.9	2.1	2.2	2.1	2.1	2.1				
Other taxes	0.4	0.8	1.0	0.8	1.1	1.1	1.1				
Nontax revenue	2.6	3.4	3.9	4.1	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Total expenditure and net lending	33.7	32.6	36.3	35.6	40.1	41.6	36.6	35.8	34.9	34.3	33.9
Current expenditure	18.8	19.2	20.7	20.1	22.8	23.3	20.4	19.8	19.6	19.4	19.0
Compensation to employees	9.8	10.2	11.0	10.7	10.8	11.0	10.5	10.0	9.7	9.4	9.0
Goods and services [1]	3.3	3.7	4.6	4.4	6.9	7.1	4.6	4.5	4.5	4.4	4.4
Of which: Maritme security	…	…	…	…	2.1	1.9	…	…	…	…	
Interest on public debt	1.0	1.0	0.9	0.9	1.2	1.3	1.3	1.4	1.5	1.6	1.7
Transfer payments	4.7	4.3	4.2	4.1	3.9	3.9	4.0	3.9	3.9	3.9	3.9
Capital expenditure	13.9	12.3	13.5	13.4	15.0	15.9	13.5	13.1	12.0	11.8	11.8
Domestically financed	5.6	6.1	7.5	7.3	8.1	8.2	7.0	7.2	7.4	7.7	7.8
Externally financed	8.3	6.3	6.0	6.1	6.9	7.7	6.4	5.8	4.7	4.2	4.0
Net lending	1.0	1.1	2.1	2.2	2.3	2.4	2.8	2.9	3.2	3.1	3.2
Domestically financed	0.1	-0.1	0.1	-0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Externally financed loans to public enterprises	0.9	1.2	2.1	2.2	2.1	2.2	2.7	2.7	3.1	3.0	3.0
Unallocated revenue (+)/expenditure (-) [2]	-0.2	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic primary balance, before grants, above the line	-2.9	-1.0	0.0	0.9	-6.1	-3.0	-1.2	-0.2	0.3	0.6	1.1
Overall balance, before grants	-13.1	-9.5	-8.9	-8.3	-16.3	-14.3	-11.6	-10.1	-9.0	-8.2	-7.6
Grants received	7.8	5.4	4.3	5.4	3.8	5.2	4.2	3.5	3.1	2.8	2.5
Project	4.5	3.3	2.3	4.0	2.3	3.6	2.8	2.4	2.1	1.9	1.7
Investment projects	1.8	1.8	0.8	2.2	0.7	1.7	1.5	1.2	1.1	1.0	0.9
Special programs	2.7	1.5	1.4	1.9	1.6	1.8	1.3	1.1	1.0	0.9	0.8
Budget support	3.4	2.1	2.0	1.4	1.5	1.6	1.4	1.1	1.0	0.9	0.8
Overall balance, after grants	-5.3	-4.1	-4.6	-2.8	-12.6	-9.2	-7.5	-6.6	-5.8	-5.4	-5.1
Net external financing	3.7	3.4	6.6	5.9	9.6	9.2	6.9	6.6	5.8	5.2	4.9
Disbursements	4.0	3.8	7.3	6.4	10.4	10.0	7.6	7.3	6.7	6.2	6.1
Project	2.9	1.6	3.7	2.6	4.6	4.1	3.6	3.5	2.6	2.3	2.3
Nonproject support	1.1	2.1	3.6	3.8	3.7	3.8	4.0	3.8	4.1	3.9	3.8
Loans to public enterprises	0.9	1.2	2.1	2.2	2.1	2.2	2.7	2.7	3.1	3.0	3.0
Budget support	0.2	0.9	1.6	1.6	1.6	1.6	1.3	1.1	1.0	0.9	0.8
Other disbursement	…	…		…	2.1	2.1	…	…	…	…	
Cash amortization	-0.3	-0.4	-0.7	-0.6	-0.7	-0.7	-0.7	-0.7	-0.8	-1.0	-1.3
Net domestic financing	1.6	0.7	-2.0	-3.0	2.9	-0.1	0.5	0.0	0.0	0.2	0.2
of which: VAT refund arrears	0.7	0.1	0.7	0.8	0.3	0.5					
Net credit to government (program definition)	0.9	0.7	-2.6	-3.8	2.6	-0.6					
Memorandum items:											
Overall balance excluding windfall receipt	…	…	-8.8	-6.9	-12.6	-12.2	…	…	…	…	…
Gross aid flows	11.9	8.7	11.4	10.5	8.0	11.0	9.3	8.2	7.4	6.7	6.2
Budget support	3.6	3.1	3.6	3.0	3.0	3.1	2.7	2.2	2.0	1.8	1.6
Nonbudget support	8.3	5.6	7.8	8.7	8.7	9.5	7.9	7.1	5.8	5.2	4.9
Project support	7.4	4.9	6.0	6.7	6.9	7.7	6.4	5.8	4.7	4.2	4.0
Concessional loans to public enterprises	0.9	0.7	1.9	2.0	1.7	1.9	1.5	1.2	1.1	1.0	0.9
Nominal GDP	365	408	461	461	528	528	603	689	784	894	1017

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

[1] VAT presentation was changed to a net basis (collection minus requested VAT refunds).

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

Table 4. Mozambique: Monetary Survey, 2011-14

(Billions of meticais, unless otherwise specified)

	2011	2012	2013	2013	2014	2014	2014	2014	2014
						Q1	Q2	Q3	Q4
	Act.	Act.	CR 14/20	Est.	CR 14/20	Proj.	Proj.	Proj.	Proj.
Bank of Mozambique									
Net foreign assets	56.9	73.1	89.7	85.7	86.9	92.7	91.8	95.9	103.1
(US$ billions)	2.1	2.5	2.9	2.8	2.8	3.1	3.0	3.1	3.3
Net international reserves	61.1	77.5	93.8	90.1	91.5	97.2	95.8	99.7	107.7
(US$ billions)	2.2	2.6	3.1	3.0	3.0	3.2	3.1	3.2	3.4
Net domestic assets	-22.6	-32.0	-41.3	-38.1	-42.3	-48.0	-43.3	-44.9	-47.5
Credit to government (net)	-26.8	-27.6	-36.0	-45.7	-35.2	-60.9	-53.7	-59.4	-48.6
Credit to banks (net)	-3.8	-12.7	-11.0	-2.1	-11.7	3.0	1.9	9.9	2.0
Credit to the economy	0.9	1.3	1.3	1.3	1.2	1.2	1.2	1.3	1.3
Other items (net; assets +)	7.1	6.9	4.5	8.4	3.4	8.6	7.2	3.3	-2.1
Reserve money	34.3	41.1	48.4	47.5	44.7	44.7	48.5	51.0	55.6
Currency in circulation	21.9	26.2	29.4	30.4	26.7	26.7	30.4	31.6	36.1
Currency outside banks	17.5	19.7	23.4	22.7	20.6	20.6	23.7	24.0	27.4
Currency in Banks (Cash in Vault)	4.4	6.6	6.0	7.6	6.1	6.1	6.7	7.6	8.8
Bank deposits in BM	12.4	14.8	19.0	17.2	18.5	18.5	18.9	20.2	21.0
Required reserves	11.4	13.6	17.8	16.7	17.7	17.7	18.0	19.0	20.0
Free reserves	1.0	1.2	1.3	0.4	0.8	0.8	0.9	1.2	1.0
Commercial Banks									
Net foreign assets	16.1	21.3	25.5	14.3	27.6	23.1	18.5	21.8	21.2
(Millions of U.S. dollars)	0.6	0.7	0.8	0.5	0.9	0.8	0.6	0.7	0.7
Net domestic assets	109.1	143.9	174.3	178.1	170.6	175.8	183.8	193.2	207.9
Banks' reserves	16.8	22.2	25.1	24.3	24.6	24.6	25.6	27.8	29.7
Credit to BM (net)	4.0	12.3	11.0	10.1	11.7	-3.0	-1.9	-9.9	-2.0
Credit to government (net)	21.1	27.5	18.4	31.7	18.4	22.9	22.9	22.9	22.9
Credit to the economy	97.3	116.5	152.5	150.3	148.5	155.7	163.6	175.9	180.3
Other items (net; assets +)	-30.1	-34.5	-32.7	-38.3	-32.6	-24.3	-26.3	-23.5	-23.0
Deposits	125.3	165.3	199.8	192.4	198.2	198.8	202.3	214.9	229.1
Demand and savings deposits	79.1	108.4	127.1	122.0	123.0	123.4	125.0	135.2	145.0
Time deposits	46.2	56.8	72.8	70.4	75.2	75.5	77.3	79.7	84.2
Monetary Survey									
Net foreign assets	73.0	94.4	115.2	99.9	114.5	115.8	110.2	117.6	124.3
(US$ billions)	2.7	3.2	3.8	3.3	3.7	3.8	3.6	3.8	3.9
Net domestic assets	70.8	91.6	108.0	116.5	104.4	103.7	115.8	121.3	132.2
Domestic credit	92.6	117.7	136.2	137.6	133.5	119.4	134.8	141.5	157.3
Credit to government (net)	-5.7	-0.1	-17.7	-14.0	-16.8	-38.0	-30.8	-36.5	-25.8
Credit to the economy	98.3	117.8	153.8	151.7	150.3	157.4	165.6	178.1	183.1
Cred. economy in foreign currency	21.8	28.8	32.4	34.4	33.1	34.7	36.1	38.8	37.9
Other items (net; assets +)	-21.8	-26.1	-28.2	-21.1	-29.1	-15.7	-19.1	-20.2	-25.2
Money and quasi money (M3)	143.8	186.0	223.2	216.4	218.8	219.5	226.0	239.0	256.5
Foreign currency deposits	38.1	53.3	62.6	55.6	64.9	65.1	61.1	65.0	65.1
(US$ billions)	1.4	1.8	2.0	1.8	2.1	2.1	2.0	2.1	2.1
M2	105.7	132.7	160.6	160.8	153.9	154.4	164.9	174.0	191.4
Currency outside banks	17.5	19.7	23.4	22.7	20.6	20.6	23.7	24.0	27.4
Domestic currency deposits	88.2	113.1	137.2	138.1	133.3	133.8	141.2	149.9	164.0
Memorandum Items									
Avg daily reserve money in 3rd month of quarter	33.3	40.3	47.5	46.5	45.1	45.1	48.0	50.7	54.4
12-month percent change	4.5	21.1	17.9	15.4	18.5	18.5	18.0	17.4	17.0
Avg daily currency in 3rd month of quarter	21.2	25.0	28.0	28.9	26.6	26.6	29.3	30.7	34.4
12-month percent change	3.7	18.0	12.0	15.7	20.0	20.0	19.5	19.5	19.0
NCG stock (prog def.)	-12.5	-9.8	-22.1	-27.2	-21.2	-42.4	-35.2	-40.9	-30.2
NCG flow (prog def.) cum from end-year	3.3	2.9	-12.2	-17.4	0.9	-15.2	-8.0	-13.7	-3.0
12-month percent change									
Reserve money	8.5	19.7	17.9	15.7	18.5	18.5	18.0	17.4	17.0
Currency in circulation	7.1	19.8	12.0	15.7	20.0	20.0	19.5	19.5	19.0
Currency outside banks	0.5	12.5	18.8	15.5	17.9	17.9	17.4	17.4	20.4
Currency in banks	45.0	48.8	-8.3	16.1	27.8	27.9	27.7	26.8	14.7
Bank reserves	11.1	19.6	28.3	15.8	19.9	20.0	21.0	19.2	22.1
M2	23.9	25.6	21.0	21.2	20.0	20.0	19.5	19.5	19.0
Domestic deposits	30.0	28.1	21.4	22.2	20.3	20.3	19.9	19.8	18.8
M3	9.4	29.4	20.0	16.3	19.4	19.4	19.0	19.0	18.5
Credit to the economy	6.4	19.9	32.3	28.7	22.8	26.9	24.8	23.0	20.7
Money multiplier (M2/reserve money)	3.08	3.23	3.32	3.38	3.45	3.46	3.40	3.41	3.44
Velocity (GDP/M2)	3.45	3.07	2.87	2.87	…	…	…	…	2.76
Nominal GDP	365	408	461	461	528	528	528	528	528
Nominal GDP growth	15.8	11.8	13.0	13.0	14.4	14.4	14.4	14.4	14.4
Policy lending rate (end-of-period)	15.0	9.5	…	8.3	…	…	…	…	…
T-bill 91 days rate	11.8	2.6	…	5.2	…	…	…	…	…

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

Table 5. Mozambique: Balance of Payments, 2011-19

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

	2011	2012	2013		2014		2015	2016	2017	2018	2019
	Act.	Est.	CR/14/20	Est.	CR/14/20	Proj.					
Current account balance	-3,059	-6,484	-6,621	-6,048	-7,364	-8,007	-8,781	-9,108	-12,067	-13,481	-13,320
Trade balance for goods	-2,249	-4,048	-4,640	-4,393	-4,570	-4,990	-5,839	-5,395	-6,930	-7,102	-5,675
Of which: Megaprojects	468	75	-187	110	28	-40	-450	577	-475	-347	1,595
Exports, f.o.b.	3,118	3,856	3,989	4,179	4,729	4,920	5,673	6,712	7,516	8,569	9,398
Megaprojects	2,015	2,219	2,249	2,430	2,807	3,071	3,675	4,571	5,178	5,882	6,421
Other	1,103	1,637	1,741	1,749	1,922	1,849	1,998	2,141	2,338	2,687	2,977
Imports, f.o.b.	-5,368	-7,903	-8,629	-8,572	-9,299	-9,910	-11,512	-12,107	-14,446	-15,671	-15,074
Megaprojects	-1,547	-2,143	-2,435	-2,319	-2,779	-3,111	-4,125	-3,994	-5,653	-6,229	-4,826
Other	-3,820	-5,760	-6,194	-6,252	-6,520	-6,799	-7,387	-8,113	-8,793	-9,442	-10,248
Trade balance for services	-1,482	-3,273	-3,201	-2,969	-3,688	-3,950	-3,737	-4,021	-4,834	-5,674	-6,524
Income balance	-190	7	-6	13	-176	-176	-284	-797	-1,478	-1,964	-2,469
Of which: Dividend payments by megaprojects	-157	0	-6	-6	-159	-166	-173	-558	-1,098	-1,336	-1,536
Current transfers balance	863	829	1,226	1,300	1,070	1,109	1,079	1,106	1,176	1,259	1,348
Of which: External grants	785	538	541	475	519	585	505	470	470	470	470
Capital and financial account balance	3,364	6,748	6,998	6,388	7,563	8,407	9,005	9,270	12,279	14,164	14,116
Capital account balance	432	456	375	371	396	583	591	607	648	693	743
Financial account balance	2,933	6,292	6,623	6,017	7,166	7,824	8,414	8,662	11,632	13,471	13,373
Net foreign direct investment	2,599	5,215	5,519	5,055	4,703	4,883	4,935	5,006	5,444	6,720	6,726
Net foreign borrowing by the general government	531	546	1,095	1,017	1,414	1,776	1,307	1,317	1,278	1,177	1,257
Net foreign borrowing by the nonfin private sector	-39	516	-274	-99	751	902	1,875	2,021	4,466	4,922	4,558
Other [1]	-159	14	284	44	298	264	297	318	443	652	831
Net errors and omissions	17	-87	81	50	0	0	0	0	0	0	0
Overall balance	323	177	458	390	199	400	224	161	213	683	797
External financing	-323	-177	-458	-390	-199	-400	-224	-161	-213	-683	-797
Reserve assets [1]	-321	-273	-455	-387	-196	-397	-188	-124	-176	-647	-762
Net use of credit	-2.1	-4.3	-2.9	-3.0	-3.0	-3.0	-35.9	-37.2	-36.8	-36.4	-35.3
Of which: Net use of Fund credit	-2.3	-2.2	-2.9	-3.0	-3.0	-3.0	-35.9	-37.2	-36.8	-36.4	-35.3
Exceptional financing	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Current account balance (percent of GDP)	-24.4	-45.4	-43.4	-39.5	-43.4	-46.9	-47.0	-43.8	-52.0	-52.0	-46.2
Excluding external grants	-31.3	-49.1	-47.0	-42.6	-46.5	-50.3	-49.7	-46.1	-54.1	-53.9	-47.8
Excluding Mega-Projects	-2.8	-3.4	-4.1	-3.8	-4.4	-4.4	-4.9	-5.6	-5.2	-5.2	-6.6
Net foreign assets	2,082	2,349	2,866	2,739	1,005	2,221	2,445	2,606	2,819	3,502	4,299
Net international reserves [1]	2,239	2,605	3,061	2,996	3,262	3,397	3,623	3,784	3,997	4,680	5,477
Gross international reserves [1, 2]	2,428	2,799	3,252	3,192	3,449	3,591	3,781	3,905	4,081	4,727	5,489
Months of projected imports of goods and nonfactor services	2.4	2.6	2.7	2.5	2.6	2.6	2.5	2.2	2.1	2.3	2.5
Months of projected G&S imports (excl. megaproject imports)	3.0	3.9	4.4	4.2	4.7	4.4	4.2	4.3	4.3	4.2	4.2
Percent of broad money (M2)	62.7	62.7	62.0	59.4	57.0	59.5	55.8	51.4	47.6	48.9	50.3

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, 2008-13

	2008	2009	2010	2011	2012	2013
Capital adequacy						
Regulatory capital to risk-weighted assets	13.9	15.1	14.4	17.1	17.9	16.9
Regulatory Tier I capital to risk-weighted assets	12.4	13.0	13.7	16.1	16.9	16.0
Capital (net worth) to assets	7.5	7.7	8.0	9.0	9.5	9.6
Asset composition and quality						
Foreign exchange loans to total loans	32.8	32.4	29.5	25.1	28.1	22.3
Nonperforming loans to gross loans [1]	1.9	1.8	1.9	2.6	3.2	2.8
Nonperforming loans net of provisions to capital [1]	2.5	5.9	5.6	6.6	6.8	5.8
Earnings and profitability						
Return on assets	3.5	3.0	2.6	2.5	1.9	1.8
Return on equity	44.7	36.6	32.9	26.5	19,.6	20.0
Interest margin to gross income	58.8	55.7	59.4	64.9	58.9	55.9
Noninterest expenses to gross income	58.7	58.4	59.7	61.3	66.1	65.8
Personnel expenses to noninterest expenses	45.1	45.9	45.5	47.1	49.1	48.0
Trading and fee income to gross income	40.5	44.3	23.8	17.2	19.5	16.5
Funding and liquidity						
Liquid assets to total assets [2]	36.2	27.9	22.4	27.8	33.4	30.9
Customer deposits to total (non-interbank) loans	165.7	138.2	131.2	131.6	143.8	134.8

Source: Bank of Mozambique (BM).

[1] Nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).

[2] Includes deposits at parent banks.

REPUBLIC OF MOZAMBIQUE

Appendix I—Letter of Intent

Maputo, Mozambique
April 23, 2014

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

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the second review under the Policy Support Instrument (PSI) and the modification of three assessment criteria and two indicative targets for June 2014 to account for our revised projections, which reflect receipt of new windfall revenues in March 2014, and the need to approve a supplementary Budget for 2014. It also requests (i) an increase of $300 million in the nonconcessional borrowing ceiling to accommodate financing requirements for high priority investment projects; (ii) to set assessment criteria and indicative targets for end-December 2014; (iii) the modification of one structural benchmark on tax payments through banks and the addition of a new end-December 2014 benchmark on pending VAT reimbursement requests. In support of this request, we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews 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's economic program aims to maintain macroeconomic stability, promote inclusive growth through public investment and the promotion of productive employment, and reduce poverty. The program is in line with our Poverty Reduction Strategy Paper (PARP) for 2011–14, and with our plans regarding its successor strategy.

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, and—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/
Manuel Chang	**Ernesto Gouveia Gove**
Minister of Finance	**Governor**
	Bank of Mozambique

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

Attachment 1. Republic of Mozambique: Memorandum of Economic and Financial Policies

April 23, 2014

RECENT ECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

1. This MEFP (i) describes recent developments and performance of the Government's economic program under the three-year Policy Support Instrument (PSI) since the 1st review, and (ii) elaborates on economic and structural policy intentions. It builds on the MEFP underlying the First PSI Review of December 2013.

2. The Mozambican economy remains strong and may benefit from the projected gradual recovery of the global economy.

- **Economic growth**. The economy remained robust in 2013, despite the effects of the floods early in the year. In 2013, economic activity grew by 7.0 percent, on a preliminary basis, in line with the projected growth for the year. The main growth sectors were the production of coal, transport and communications, financial services and construction.

- **Inflation and monetary policy.** Inflation remained low in 2013 with an annual average rate of 4.2 percent, representing a slight acceleration compared with the previous year. The Bank of Mozambique's (BM) prudent management of liquidity helped to achieve the low inflation outcome, combined with stable administered prices and recovery of food production after the floods. End-2013 reserve money was slightly below the program target, while broad money expanded by 16.3 percent year-on-year. Credit growth, while still high at 28.7 percent, started to slow down.

- **Exchange rate.** The Metical remained stable in the foreign exchange markets as a result of a greater availability of foreign currency in the market following the increase in foreign direct investment. The BM intervened in the foreign exchange market to smoothen temporary volatilities.

- **External current account deficit.** Notwithstanding lower international commodity prices, our exports strengthened in the first 9 months of 2013, and the current account deficit improved in the first three quarters of 2013, compared with the same period of 2012, owing to the favorable performance of current transfers and services. The impact of the floods on the current account was limited.

- **Fiscal Policy.** Fiscal operations in 2013 generated an estimated overall deficit (after grants) of 3 percent of GDP against 4.6 percent programmed. Revenue was largely in line with the program, aided in part by the receipt in August 2013 of $400 million (2.1 percent of GDP) capital gains taxes from the sale of shares in a gas concession in the Rovuma basin. All categories of current spending were slightly lower than programmed, while capital expenditure was implemented largely as programmed. Preliminary data on priority spending, which accounts for 2/3 of the budget, fell short of the rather ambitious target we had set, reflecting shortfalls in donor funding and implementation lags. Project grant receipts exceeded expectations, but budget support grants were lower than programmed. The smaller than programmed overall deficit allowed the government to build its deposits in the banking system despite a shortfall in net external financing.

- **FDI, aid/loan disbursements, reserves.** The country continued to benefit from a strong inflow of foreign direct investment (an estimated 20 percent increase compared to 2012) associated mainly with the development of natural resources and related services. In addition, the economy has benefited from windfall gains from the sale of shares of companies in the natural gas sector, which helped to boost international reserves in the second half of the year. While the shortfall in foreign aid disbursement in the fourth quarter created some pressures on net international reserves, the stock at end-2013 reached $2.996 million (about 5 months of current imports of goods and non-factor services excluding mega projects).

3. Program Performance

- **All assessment criteria (AC) and indicative targets (IT) through end-December 2013 were met, except the IT for expenditure in priority sectors,** which was missed largely due to delays in the disbursement of donor flows. The quantitative target for net international reserves was met after adjusting for the shortfall in external program aid ($87 million). The target for reserve money – the operating target of monetary policy – was met. Revenue collection, bank credit to government and nonconcessional foreign borrowing were within the program targets (Table 1).

- **The structural benchmarks for end-February and end-March 2014 were met**, albeit one with a brief delay, concerning the submission to the Parliament of the draft law on the creation of private credit registry bureaus, the validation of pending VAT reimbursement requests (delayed to mid-April), and the expansion of direct salary payments by bank transfer. The remaining structural benchmarks for 2014 are under way and are expected to be completed in due time (Table 2).

MACROECONOMIC POLICIES

A. Economic Objectives

4. Economic outlook 2014-19: We expect that economic growth in the medium term holds up high and is robust, reflecting the boom in the mining industry and the hydrocarbon sector. In addition, the recovery of the world economy should support the dynamics in expanding sectors.

- **GDP growth.** The economy is expected to grow by 8.3 percent in 2014 as a result of strong growth in agriculture, extractive industries, transport and communications, financial services and the electricity sector. In the next five years, the expansion of the rail network should allow an increase in coal production and exports. The implementation of

other infrastructure projects, the development of natural gas liquefaction, the related activity in transport and communications and construction, and a continued strong performance in other sectors are projected to keep economic growth at an average of 8 percent a year.

- **Inflation:** In January and February 2014 the monthly inflation rates were 1.1 and 0.7 percent, respectively. For the rest of the year a slight acceleration of average inflation is expected to around 4.6 percent and year-on-year inflation of around 6 percent, in line with our medium term objective of 5-6 percent per annum. The main contributing factors are the strengthening of the US$ in the international market in light of the nascent recovery of the US economy, inflation pressures in the region, and expansionary fiscal policy.

- **External Current Account**: Balance of payment developments in the coming years (2014 – 17) will continue to be dominated by large investments in natural resource projects. In 2014, a current account deficit of around 44 percent of GDP is expected due to the increase in imports related to megaprojects. In light of the strong rise in imports in recent years, both of the megaprojects and other sectors of the economy, we plan to maintain a reserve cover of about 4½ months of projected imports of goods and services, excluding megaprojects.

B. Macroeconomic Policy Mix

5. Macroeconomic policy mix. The authorities will continue pursuing a combination of fiscal and monetary policies aiming at maintaining macroeconomic and financial stability, as well as promoting economic and financial inclusion.

6. Fiscal policy will maintain fiscal sustainability. Revenue efforts will be maintained to further strengthen revenue relative to GDP, with planned administrative measures and recent changes to the tax code allowing for uptick in income tax receipts in 2015. A gradual reduction in expenditure is envisaged, from around 42 percent of GDP in 2014 to around 34 percent of GDP in 2019. Most of the reduction would be achieved as expenditure returns to a normal path after the implementation of one-off outlays on elections and maritime security in 2014. In addition, we plan to reduce the wage bill gradually from its elevated level of 11 percent of GDP in 2014, and expenditure on goods and services and investment are also projected to ease somewhat, i.e. grow more slowly than GDP. Combined with an expected decline in grant support, we aim to reduce the overall deficit (after grants) from around 9 percent in 2014 to around 5 percent in 2019, while the domestic primary balance (before grants) would shift from a deficit of about 3 percent of GDP in 2014 to a 1 percent of GDP surplus by 2019. This could be financed by foreign borrowing and domestic market funding while maintaining fiscal and debt sustainability.

C. Monetary and Exchange Rate Policy

7. Monetary policy will continue to focus on the objective of price stability in line with the medium-term inflation objective of 5-6 percent. The BM will target base money growth slightly above nominal GDP to support financial deepening and to increase credit to the private sector. In light of the expansionary fiscal policy in 2014, the BM will step up its liquidity management efforts and keep base money growth to 17 percent in 2014 to contain demand pressures.

8. We remain committed to a flexible exchange rate regime. The BM will allow the exchange rate to adjust freely to reflect the 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 prudent level of international reserves.

9. 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.

D. Fiscal Policy

10. Objectives of fiscal policy. The Government is committed to maintaining macroeconomic stability, promote sustainable and inclusive economic growth, and rationalize the use of public resources.

- **The 2014 budget aims to continue revenue raising efforts and reflects strong expenditure pressures.** Excluding windfall receipts, revenue (net of VAT refund requests) is projected to reach about 24.3 percent of GDP, an increase from 23.3 percent in 2013. Current expenditure (incl. on maritime security) will rise to23.3 percent of GDP from 20.1 percent in 2013. Capital spending is budgeted to rise sharply to 15.9 percent of GDP from 13.4 percent in 2013 both financed from domestic and external resources as we are trying to improve the available public infrastructure.

- This will result in a sizeable increase in the overall deficit and weaken the domestic primary balance, while foreign financing is projected to surge.

11. Revenue outlook and supplementary budget

- **Further capital gains taxes** have been received ($520 million) in March 2014. We agree that such one-off receipts should not finance recurrent spending increases that could compromise fiscal sustainability over the medium term, but we are not prepared to set up a formal fiscal rule at this point and leave that for the new government to consider. However, we are committed to saving fiscal revenue windfalls, including from direct or indirect natural resource taxation, or use them only for investment spending, debt reduction, or exceptional needs. Given an already expansionary fiscal stance in 2014, seventy-five percent of the windfall tax receipts of March will be saved to provide a fiscal buffer for future budgets.

- **The Government will request an amendment to the Budget Law for 2014 in the first semester,** due to the recent approval of an Electoral Package-Law by the Parliament that mandates additional expenditures for the October 15 elections (about $36 million, bringing the total budgeted cost of the elections to $116 million). This, and additional spending required to complete investment projects that lost foreign support in 2013 ($25 million), will be financed by extraordinary revenues from the new capital gains revenue. We also plan to use some $100 million of the windfalls receipts to reimburse pending VAT refund requests.

12. Expenditure Policy

- **The surge in public spending in 2014** reflects (i) the 2013 wage increases and new hiring and promotions, especially in education, health, and justice; (ii) improved provision of services to the population, particularly through the national healthcare system; (iii) an increase in debt service; (iv) budget allocations for the general elections; (v) the setting up of some new districts and municipalities in 2013; and (vi) strengthening basic social programs, including military pensions.

  Expenditure in priority sectors. The Government is continuing its efforts to increase the resources allocated to the priority sectors of the PARP, which together represent 64.2 percent of total budget expenditures in 2014. Given the fact that (i) the rate of execution of externally-financed capital expenditures is projected to be lower than in the initial budget; and (ii) there are special one-off factors in 2014 (maritime security and election spending), we expect priority spending to decline from 67.3 percent in 2013 to 58 percent in 2014.

- **Wage bill policy.** The government has taken some measures to contain the increase in spending on wages and salaries in recent years, including, (i) ensuring greater control in the execution of public expenditure by expanding e-Sistafe to cover most of the existing spending units (UGBs)and expanding salary payments through bank transfers and; (ii) gradual implementation of the electronic personnel management system (e-Folha), with a view to ensuring an increasing rationalization and control of the payroll of civil servants. The further increase in the wage bill in 2014 to 11 percent of GDP also reflects election-related hiring due to the recent political agreement.

- **Strengthening social protection**. The Basic Social Protection programs continue to be expanded to cover more beneficiaries (increase of 23.5 percent from 2013 to 2014). In addition, transfer payments to families are budgeted to increase by12.6 percent in 2014 due to an increase in the number of pensioners.

- **Subsidies for petroleum products**. In 2013, the government paid fuel distributors an amount of 0.5 percent of GDP covering subsidies accrued in 2012 and2013. Fuel subsidies of 0.2percent of GDP have been budgeted in 2014, reflecting declines in international fuel prices. While diesel prices are currently subsidized for general consumption (other than megaprojects, construction, public works and other large consumers), the government is monitoring the evolution of prices in the international markets and analyzing their potential impact on domestic fuel markets.

- **Electricity tariffs.** The tariffs remain unchanged since 2010, but a study on tariff adjustment was completed in June 2013 and presented to the National Council of Investment and the Council of Ministers. The Government is currently undertaking an impact assessment on how various tariff increases will affect different consumer segments. EDM made a small operating profit in 2012, albeit system maintenance needs to be strengthened, and its Performance Contract with the government is being finalized in line with Decree 84/2013, of December 31.

- **Summary of other state subsidies.** The Government continues to subsidize the price of wheat flour for bread, public transportation, and school feeding programs for a total of 0.2 percent of GDP in 2013. These programs will continue in 2014 and 0.1 percent of GDP have been budgeted to cover the related costs.

13. **Deficit** and **Financing**. The supplementary budget will improve the overall fiscal stance for 2014.The domestic primary deficit (before grants) is now projected at 3.3 percent of GDP. With continued strong grant support, the overall balance (after grants) is now projected at 9.3 percent of GDP, allowing us, after planned external financing of 9.2 percent of GDP (up from 5.9 percent in 2013), to draw only very little in net domestic financing this year.

E. Investment Planning and Debt Management

14. Priorities for 2014 include:

- **Strengthening of investment planning.** The revision of the Integrated Investment Plan for 2014-17 (IIP) is under way. The main objective is to provide a summary description and include appropriate financial information for each project so as to inform the DSA, MTEF and the budget process and facilitate setting priorities among competing projects. The revision is expected to be completed by end-June 2014 **(structural benchmark).**

- **Strengthening project selection instruments.** The main selection and evaluation criteria for projects have now been spelled out in the MTEF methodology consistent with the Manual of Project Selection. Sectoral ministries and province administrations will have to observe these guidelines in the preparation of their project proposals for the state budget. Two training sessions were held to familiarize line ministries and provincial departments with the criteria for the analysis and selection of public investment projects. We intend to expand training in the use of sector-specific mechanisms for the preparation of investment project proposals.

- **Implementation and Monitoring of IIP Projects.** The implementation of projects in the IIP will be the result of the budget approved for each year, and the implementation and monitoring will be done by the line ministers. The Government's mid-year and year-end economic development reports (*Balanço do PES)* will include information on the implementation of the projects.

- **Strengthening public debt management:** The preparation of the DSA 2014 is underway, including scenarios for future borrowing and sensitivity analysis. We intend to complete this assessment by July 2014, in time for the next budget cycle. We are also committed to publishing the main results of the DSA. In the medium term, we remain committed to (i) incorporating the analysis of costs and risks associated with the public debt portfolio, including guarantees, in the debt and budget execution reports, (ii) revise the Debt Management Strategy at the time of its first review to ensure that it covers guaranteed debt and is aligned with the evolving macroeconomic framework, and (iii) develop the domestic capital markets. This will strengthen the links between the budget, the IIP, and public debt sustainability. We will expand the coverage of the DSA and the quarterly public debt reports to include government guarantees from the first quarter of 2014.

- **Guarantee management policy**. We will develop a policy to disclose all government guarantees, their beneficiaries, the gross exposures created by them, and assessment of the probability and potential impact.

- **Domestic Borrowing Plan for 2014.** We have requested technical assistance from IMF and World Bank to elaborate a domestic borrowing plan for 2014 with a view toward further development of the government bond market.

STRUCTURAL REFORMS

A. Public Financial Management and Reporting

15. Strengthening public financial management (PFM).

- **The Budget coverage of the PFM system (e-SISTAFE) continues to expand.** In 2013, the e-Sistafe was operating in 77 percent of the 939 total UGBs that compose the state budget. Our plan is to complete the roll-out of e-SISTAFE by 2015, covering 90 percent in 2014, and 95 percent in 2015 of the spending units, while developing solutions to overcome communication problems for the remaining spending units.

- **Extending the use of the treasury single account (CUT) remains a high priority**. It will help strengthen expenditure controls, cash management and PFM system integrity. As part of the program to reduce further the number of bank accounts outside the CUT, the Minister of Finance will issue an administrative order by end-September 2014, with clear rules to define conditions under which it is acceptable for state institutions to operate bank accounts outside of the single treasury account.

The order will also provide guidelines on the opening of such accounts, will provide a proper categorization, and mandate the closure of those accounts that do not meet the required standards.

- **Salary payment through direct transfer to bank accounts have also been expanded**. 76 percent of civil servants registered in the electronic civil servant registry (e-CAF) and included in the *Action Plan for Direct Payment of Salaries and Expansion of the electronic salary processing system (e-Folha)*, received their wages through direct payment in December 2013. About 2/3 of these direct payments were made through e-Folha. At end-February 2014, the share of state employees receiving their salary by direct payment had increased to 89 percent. We expect to reach the target of the direct payment process to 95% of the civil service registered in the e-CAF by March 2014 **(structural benchmark)**.

- **From March to December 2014 we will create the conditions to complete the expansion of e-Folha to all civil servants and agents in institutions with direct access to e-SISTAFE** (about 90 percent of all civil servants). In addition, we will prepare to verify the registers in e-CAF for all employees through a proof-of-life audit in 2015. We also remain committed to creating a new register (e-CAP) and extending e-Folha to pensioners after completing the civil service reform.

- **The public expenditure execution process was strengthened.** The e-SISTAFE system has been adjusted in line with international standards to enable the registration of the various phases of the expenditure process (commitment, verification, and payment). We are now preparing a Technical Note to separate payment and commitment authority and facilitate enforcement of these new guidelines with the 2015 budget exercise. After its approval by the Minister of Finance, the real-time recording of the commitment, verification and payment of expenditures will become mandatory for all units operating with e-SISTAFE. We are aware that this will take time and requires a major investment in change management processes and the enhancement of internal controls. To facilitate this, the government intends to set up a Public Finance Academy.

- **Adopting international accounting standards.** A preliminary draft on Standards and Chart of Accounts based on IPSAS has been prepared under the ongoing reform to gradually adopt the Accrual Accounting System based on commitments. The implementation will require the revision of the SISTAFE Law, which includes the current Public Chart of Accounts as an annex. While we had committed to the implementation of this measure by end-2014 in the previous PSI review, following advice from recent IMF technical assistance, the Government has postponed the introduction of IPSAS for later years given the complex nature of this reform.

- **Clarifying the scope of the public sector**. We will continue our efforts to define the number of (i) public funds, autonomous entities, and other bodies of public law with legal, administrative and financial autonomy ("*equiparados*"), (ii) public enterprises and corporations owned and/or controlled by the State, and (iii) indirect shareholdings of the State, via other public entities; with the purpose to having a clearer view of the scope of the public sector by end-2014. We have been working on the status of the public funds and autonomous entities for over two years and expect to complete these efforts by end-2014.

- **Improving the management of fiscal risks**. In the medium term, we are committed to produce a comprehensive statement on fiscal risks for inclusion in the annual budget documents. With support from the World Bank, we plan to set up a risk unit in the Ministry of Finance in 2014 to initiate this work.

- **The new Economic Classifier for Revenue (CER) is being finalized** and aligned with international standards and will be used in the preparation of the state budget for 2015. This will help advance several ongoing PFM reforms and contribute to a smoother recording of revenues in the new e-tax system.

B. Tax Policy and Administration

16. Revenue administration and reforms 2014-15.

- **VAT administration and reimbursements.** The implementation of the action plan to reduce the stock of outstanding VAT refund requests is ongoing and the **structural benchmark for end-March 2014** on the validation of the stock of requests pending at end-December 2013 has been met with a slight delay in mid-April and a report on this prepared. As the administrative period for the documentation and processing of refund claims is 6 months, those refund requests from the last quarter of 2013 still pending at end-March will be validated by end-June. Also, as about 1/3 of the pending claims are pre-2013 requests, in line with TA advice the Revenue Authority will set claimants a deadline of May 2014 to fully document their request or close the process and deny the refund request.

  The stock of valid reimbursement requests submitted up to end-2013 will either be paid or securitized by end-2014 **(structural benchmark)**. The Government will also speed up the processing of new refund requests and ensure that validated requests are paid in a timely manner.

  The Government will include VAT on a net basis in the 2015 budget proposal **(structural benchmark for end-October 2014)**, and the Revenue Authority will adapt its VAT collection and refund system accordingly, with technical assistance.

- **Implementation of e-Tax and payment via banks for VAT and ISPC (simplified tax for small taxpayers).** There has been modest progress in the implementation of the new e-tax system to promote tax transparency and efficiency. The universe of taxpayers updated in e-tax (NUIT register) is only 11 percent of active VAT taxpayers with actual payments and 34 percent of active ISPC taxpayers with actual payments. VAT and ISPC taxes can only be paid through e-tax by registered entities. The use of e-tax for collecting these taxes was initially planned from the beginning of 2014, but we consider it necessary to run a pilot in two decentralized tax offices (DAFs) before we roll out the new system to avoid revenue shortfalls. The IT application for tax payments through banks is being finalized and is expected to be fully operational by October 2014 **(structural benchmark).**

- **Strengthening the large taxpayer units** (UGCs and DCAT). We are setting up UGCs in Matola, Pemba and Tete to reinforce the three existing UGCs (in Maputo, Beira and Nampula). We have the DCAT central unit for coordinating support to large taxpayers and we intend to focus its mandate on strategic issues. With support from the IMF we will set up a natural resources unit focusing on gas and coal activity in the DCAT, by late 2014. This unit will be in charge of risk assessment, audit, specialized taxpayer services and fiscal regime interpretation activities. It will be duly staffed and start functioning, initially as part of the DCAT, by end-June 2014.

- **Tax policy.** The Government is conducting a study in consultation with the private sector to verify possible inconsistencies between the general ISPC regime and the simplified tax regimes for VAT, IRPC and IRPS. After some delays it is now expected to be completed by 2014**.**We expect the study to help improve the transparency of these tax regimes, free up tax administration resources to focus on large taxpayers and reduce fraud. Previous IMF technical assistance missions have recommended to maintain only the general ISPC simplified regime and to review it, including the ad valorem tax rate, the annual flat rate and the threshold for ad valorem taxation.

- **Transfer prices.** The draft *Transfer Price Regulation* is near completion with technical assistance from the IMF. We will consult with stakeholders, and plan to submit it to the Council of Ministers for approval by September 2014.

C. Improvement of Natural Resource Management

17. Data management. To improve the information available on Mozambique's mineral resources, the Government has made available a web-based information system of geological maps that is updated regularly. Mozambique currently has an airborne geophysical coverage of 75%, and a survey program is underway to expand this to full national coverage. In addition, a database of the occurrence of hydrocarbons and the mining cadastre are available online. It is expected that in the near future new applications for mining concessions will be processed online.

18. Extractive Industry Transparency Initiative (EITI). The fourth report on transparency initiative related to 2011 has been finalized and submitted to the international EITI Secretariat. This report covers all active mining and oil companies that satisfied the level of tax payment set by the Multi-Stakeholder Steering Committee of the EITI (Mt 500,000 or about $16,000). The Government is disseminating the EITI reports and raising public awareness of their contents through a public education campaign. In 2013 the Government started to publish the contracts in the mineral resources sector, including the applicable tax provisions.

19. Mining and Hydrocarbon Legislation. The revised Mining and Petroleum Laws have been submitted to Parliament and are expected to be approved by mid-2014. The revisions aim to: (i) update the laws to current challenges in the sector; (ii) attracts investment to the sector, and (iii) cover new products such as liquefied natural gas and methane gas. After the adoption of the Laws by Parliament, implementing regulations will be drafted.

20. Strengthening the Mining and Hydrocarbon Tax Regime. We have submitted these draft laws to the Council of Ministers in March 2014. After their approval they will be submitted to parliament and we expect these to be approved by end-2014.Once the new fiscal regime is approved, we will prepare its regulations. We expect to auction new exploration concessions after the Mining and Hydrocarbon Laws and associated Fiscal Regimes are approved.

21. To facilitate **the development of natural gas liquefaction** from Areas 1 and 4 of the Rovuma basis, the Government plans to request legislative authorization to establish a special regime for these operations.

D. Public Enterprise Management

22. Strengthening supervision of public enterprises.

- We have modernized the legislation applicable to fully-owned state enterprises created with social objectives under the public law regime (SOEs). This includes the Law 6/12on Public Enterprises and its implementing regulations (Decree 84/2013, of December 31, 2013).For better monitoring of the 14 SOEs operating under this regime, these enterprises will submit their plans, budgets, audited accounts and quarterly reports to the Ministry of Finance, and we plan to prepare summary reports on SOE operations for the Council of Ministers on an annual basis. Also, the monitoring of fiscal risks will be strengthened through the negotiation of performance contracts between the State and these SOEs.

- Aiming to strengthen the monitoring and supervision of other enterprises fully or partially owned by the State ("public corporations," around 156 of which are supervised by IGEPE), we will prepare and submit to the Council of Ministers a proposal for a Law on the Corporate Sector of the State, by end-October 2014.We will require them to disclose and quantify in their financial statements (i) all direct and indirect support, including transfers, between the government and public enterprises on an annual basis, and (ii) the cost of any provision of goods or services at below-market prices and any other quasi-fiscal activities.

- We are also working to consolidate the State's portfolio of enterprises over the medium term, including through privatization and liquidation, and are receiving some technical assistance on this from the World Bank.

23. Enhancing transparency of the operations of public enterprises.

- **EMATUM monitoring**, the mechanisms for financial control of EMATUM will be the same as those applied to fully-owned SOEs. This consists of the submission to the Ministries of Finance and Fishing of quarterly operating and financial reports starting in July 2014. EMATUM will also be subject to external audits and the publication of its accounts as of end-2014, by end-March 2015. The first year debt service on the private loan notes (PLN) it placed in 2013 of $850 million, which is due in March and September of 2014, was pre-financed by the borrowing operation. From 2015 on, the debt service on the $350m in PLNs allocated to the Ministry of Defense will be paid from the budget, and the debt service of the $500m PLNs remaining with EMATUM will be serviced from EMATUM's operations.

- **A strategy for the participation of state-owned enterprises in infrastructure projects** is under preparation with support from the World Bank.

24. Improving the monitoring and disclosure of fiscal risks. In order to help identify the fiscal risks associated with the activities of public corporations, we plan to:

(i) produce and publish an annual report on the overall financial performance of public enterprises (SOEs) and publicly-owned corporations (fully or majority-owned) on a timely basis for the budgetary preparation process; and
(ii) enforce the publication of the annual reports and audited accounts of large state-owned companies (including those created under commercial law).

FINANCIAL SECTOR POLICIES

A. Strengthen Monetary Policy Formulation And Implementation

25. Monetary policy framework. The BM will continue to strengthen the monetary policy framework and to improve the analytical and communication capacity in the monetary policy decision-making process, including improving its inflation forecast model with technical assistance.

26. The BM will continue pursuing reforms in its Monetary Policy Operations aimed at improving liquidity management.

- **Information sharing and coordination between Ministry of Finance (MF) and BM**. Progress has been achieved in the coordination between the MF and BM in recent years to improve liquidity management. This includes the supply of monthly data on the estimates of revenue and expenditure for one month ahead, but we will continue working on extending revisions of the near-term forecasts over a longer horizon within the annual budget framework.

- **Money market management and government securities liquidity.** The reforms introduced in 2013 allowed unlimited transferability of TB´s in the secondary market and boosted the use of securities in transactions between market participants. For 2014, the BM intends to (i) enhance the use of open market operations, (ii) reinforce the framework for liquidity forecasting, and (iii) continue the coordination work with the MF and the Stock Exchange aiming at accepting T-bonds as collateral in money market operations.

B. Financial Sector Surveillance

27. The BM will consolidate its efforts in enhancing banking system supervision and strengthening crisis management.

- **Strengthening bank supervision**. The results of the new round of stress test show that the banking system remains resilient to shocks on balance sheet and shocks to deposit distress, but credit portfolio concentration continues the main threat. Stress testing will be performed quarterly and the BM continues to strengthen data collection that was identified as the main obstacle to effective stress testing. In January 2014, the BM revised the regulations on nonperforming loans which includes a criterion for classification and provision of loans that is internationally comparable.

- **Risk-based supervision and Basel II adoption.** The BM will continue to conduct risk-based surveillance to all banks in the course of 2014 and to review of the regulations on concentration limits, including investment abroad. The implementation of the Basel II Capital Accord started on January 1st, 2014, as planned, following the approval and publication of the relevant regulations.[1]

- **Financial Sector Contingency Plan.** The Financial Sector Contingency Plan was published on June 11, 2013. An internal manual for its implementation is under preparation, and an action plan for the simulation exercise will be prepared, approved by the Board, by end-November 2014 **(structural benchmark**). The simulation exercise will be conducted with the technical assistance from the World Bank.

- **Deposit Insurance Fund (DIF).**While the Executive Board of the DIF has been working to make the DIF operational, the process is delayed by the need to revise the total deposit according to the developments in the banking system as at December 2013.With financial support from KFW, the Government is expecting to make its initial contribution

[1]Notices: (i) 11-13/GBM/2013 of October 31 on the basis for calculating minimum capital requirements to cover credit risk, operational risk and market risk; (ii) 14/GBM/2013 of October 31 on credit institution´s own funds; (iii) 15/GBM/2013 of October 31 ratios and prudential limits; (ii). 19-20/GBM/2013 of October 31 about Market discipline-Disclosure requirements and the Process of supervision review, respectively

to the Fund by the end of the third quarter of 2014, according to the initial capital approved by Decree 49/2010.

C. Financial Sector Development

28. In April 2013, the Council of Ministers approved the Financial Sector Development Strategy (FSDS) for 2013-22. Its 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. Dissemination work is ongoing. A multi-agency steering committee was set up to monitor the implementation of the FSDS, including based on quarterly performance targets for the different agencies involved. The authorities plan to establish a technical coordination unit shortly.

- **Promoting financial inclusion.** The BM is developing a National Financial Inclusion Strategy in order to implement this pillar of the FSDS. A draft will be prepared by end-December 2014.

- **Establishing credit registry bureaus** (CRB). The law on the creation of private credit registry bureaus [was submitted to Parliament in February 2014] **(structural benchmark).**The BM will prepare the regulation to implement the Law six months after its approval.

- **Promotion of mobile banking**. Specific regulations governing mobile banking services are being drafted by a task force at the BM and expected to be completed in June 2014.Two regulations were proposed and are under discussion, namely: (i) Procedures for the provision of electronic payment products and services and (ii) Protection of funds resulting from the issue of electronic money. The BM has also approved the Regulation for Bank Cards and concluded the Memorandum of Understanding to be signed with *Instituto Nacional de Comunicações de Moçambique*, the national supervisor of communications. The regulations are under discussions with all stakeholders, including banks,*Mkesh* and *M-pesa* (the current e-money issuing institutions)

- **Promotion of competition within the banking sector.** The revision of Notice 05/GBM/2009 is underway and will be completed by end-October 2014. It is aimed at promoting the transparency of prices and commissions for financial services and products.

- **Capital Market Development.** During 2013, the Stock Exchange's financial education program was implemented and included (i) visits and presentations to companies that are potential candidates for the Stock Market (big companies as well as small and medium enterprises); (ii) release of the compilation of the capital markets rules and regulations. We plan to continue these efforts in 2014 with a focus on small and medium-sized enterprises.

- **Centralizing the registry of security holdings**. The Central Securities Depository is expected to become operational by June 2014. This will enhance the efficiency of the market.

- **Strengthening the bank insolvency framework and the movable collateral framework.** The legal basis for insolvency procedures was established with the publication on June 11, 2013 of the regulations on emergency liquidity assistance, aimed at assisting the institutions that collect deposits and at guiding interventions to mitigate systemic risks. The BM is taking the lead to draft a Movable Collateral Bill, which is expected to be submitted to the Council of Ministers by end-December 2014 **(structural benchmark)**. Due to the unexpected complexity of the issue, the establishment of a moveable collateral registry is expected to be delayed to end-June 2015.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

29. AML/CFT Framework. The Law on Anti-Money Laundering and Combating the Financing of Terrorism was approved in August 2013, and the draft of the related regulations were finalized and submitted to the Council of Ministers in March 2014. The preparation by the BM of guidelines for commercial banks on Anti-Money Laundering and Combating the Financing of Terrorism is also at an advanced stage and will be harmonized once the Regulation Law on AML/CFT is approved. Likewise, the revision to the Law 14/2007 establishing the Financial Intelligence Unit of Mozambique was submitted to the Council of Ministers for approval in March 2014.

- **There is a need for technical assistance for human resources capacity building** (GIFIM analysts, Criminal Investigation Police, Judicial Magistrates and Public Prosecutor's Office), in matters of financial and economic crimes and money laundering**.**Further technical assistance will be discussed with the IMF Legal Department Mission scheduled for May 2014. We also expect assistance from the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG).

E. Payment System

30. The BM will continue with the Reforms in the Payment System

- **Enhancing BM oversight practices**. The Oversight Manual was approved by the BM Board in May 2013, and will be published once cleared by the Legal Department. A revised *Regulation on Interbank Clearing and Settlement* has been approved and published by Notice 17/GBM/2013 on December 31, 2013. The newly created Oversight Unit will perform on-site inspections and will produce a monthly report on the payment system to the BM Board; the first annual oversight report is in preparation and will be completed by end-November 2014 **(structural benchmark).** In 2014, the BM will conduct an on-site inspection of a mobile banking operator, with the aim of verifying the degree of compliance of the recommendations of the inspection carried out in 2012. It will produce some liquidity and credit risk indicators of this Payment System. Additionally, during the second half of 2014 the BM will gradually introduce the Principles for Financial Markets Infrastructure released by BIS in 2012, with the support of technical assistance.

- **Developing the retail payments network (SIMO) shared by the BM and commercial banks**. Three commercial banks have connected to the SIMO network, while one additional bank is in the testing stage. It is expected that by June 2014 three of the four largest banks in Mozambique will be covered by SIMO. The other banks, including a group of ten banks sharing the Ponto 24 Network, will migrate in due course under their MoU with the BM.

F. Good Governance and Business Environment

31. Anti-Corruption Package. Five laws comprise the anti-corruption package. The *Penal and Penal Procedural Codes* have been submitted to Parliament in 2011, and are still under discussion. Following passage of the *Anti-Corruption Law*, a draft *Action Plan* for the effective implementation of anti-corruption legislation has been produced and is expected to be submitted to the Council of Ministers in May 2014.

32. Improvement in the business environment. In order to ensure an improvement in the business environment to attract investment into the country, the Government approved the following instruments:

- **Business Environment Improvement Strategy (EMAN II 2013-2017).**This document seeks to decentralize responsibilities and simplify procedures with a view to speeding up the business start-up process; the Government is expecting to adopt a system to monitor the implementation of the actions contained in the EMANII and for that purpose various monitoring systems are being studied.

- Approval by the Council of Ministers of the Single Form which harmonizes procedures for registering companies, licensing economic activities, obtaining NUIT, statement on the commencement of activities, obtaining the working hours and registration of employees on the Social Security System (INSS). This will contribute significantly to reduce the time and cost for starting up a business.

- Approval by the Council of Ministers of the new Regulations for the Licensing of Industrial Activities. This instrument reduces the time, procedures, costs and decentralizes the competency to authorise the micro, small and medium-sized industries to the Municipalities, One-Stop-Shop (BAU's) and Provincial Governors, respectively.

- Launch the pilot phase of the electronic platform for registration and licensing services (e-BAÚ) in the provinces of Gaza, Inhambane, Sofala, Nampula, Cabo Delgado and Maputo City. This will allow the BAÚs to be computerized with regard to the licensing of activities covered by the simplified, commercial, industry and tourism regimes. By September 2014, this platform will cover the services of NUIT assignment, declaration of initiation of activity, registration of legal entities, authorization of work schedule and registration of workers in the National Social Security System (INSS).

G. Program Monitoring

33. The proposed assessment criteria and indicative targets up to December 2014 are shown in Table 1. Table 2 provides a list of the proposed structural benchmarks. The 3rd PSI review is expected to be completed by end-December 2014 and the 4th review by end-June 2015.

MEFP Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets under the 2013-16 PSI[1]
(Millions of meticais, unless otherwise specified)

	2013								2014		2014		
	End-Sept Indicative Target				End December Assessment Criteria				End-March Indicative Target	End-June Assessment Criteria	End-June Assessment Criteria	End-Sept Indicative Target	End-Dec Assessment Criteria
	Prog.	Adj.	Act.	Status	Prog.	Adj.	Actual	Status	Program		Proposed		
Assessment Criteria for end-June/December													
Net credit to the central government (cumulative ceiling)	1,504	4,497	-24,847	M	-12,242	-9,473	-17,368	M	889	-3	-7,985	-13,721	-2,954
Stock of reserve money (ceiling)	43,817	43,817	43,187	M	47,493	47,493	46,470	M	45,100	48,023	48,023	50,689	54,370
Stock of net international reserves of the BM (floor, US$ millions)	2,621	2,521	2,856	M	3,061	2,969	2,995	M	2,961	3,036	3,107	3,188	3,397
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)[2,3]	1,200	1,200	895	M	1,200	1,200	926	M	1,200	1,200	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
External payments arrears of the central government (ceiling, US$ millions)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0
Indicative targets													
Government revenue (cumulative floor)	81,891	81,891	98,685	M	126,285	126,285	126,589	M	25,519	58,036	75,365	112,616	143,957
Priority spending (cumulative floor)	76,041	76,041	68,498	NM	117,617	117,617	102,120	NM	20,686	45,244	46,299	80,738	121,294

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] For end-June 2014, this will become effective as of the date of IMF Executive Board approval of the 2nd PSI

MEFP Table 2. Mozambique: Structural Benchmarks for 2014

Structural Benchmarks	Date of Implementation	Status
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶37 of the MEFP date June 7, 2013 and ¶30 of the MEFP date December 20)	End-February 2014	Met
The Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 and provide a note to the Fund staff (¶16 of the MEFP date December 20, 2013)	End-March 2014	Not met (Implemented with delay)
The Government will complete the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and direct access to e-SISTAFE. (¶14 of the MEFP date December 20, 2013)	End-March 2014	Met
The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget. (¶15 of the MEFP date December 20, 2013 and ¶14 of this MEFP)	End-June 2014	
The Government will present VAT collections on a net basis in the 2015 budget proposal documents. (¶16 of the MEFP date December 20, 2013 and ¶16 of this MEFP)	End-October 2014	
The Government will finalize and fully operationalize the IT application for tax payments through banks for VAT and ISPC. (MEFP ¶16)	End-October 2014	Modified
The Board of BM will approve the action plan for the simulation exercise pertaining to the Financial Sector Contingency Plan. (¶28 of the MEFP date December 20, 2013 and ¶27 of this MEFP)	End-November 2014	
The BM will issue the first annual payments systems oversight report. (¶34 of the MEFP date December 20, 2013 and ¶30 of this MEFP)	End-November 2014	
The government will either pay or securitize the stock of valid VAT reimbursement requests submitted up to end-2013. (MEFP ¶16)	End-December 2014	Proposed
The Government will establish a movable collateral registry. (¶30 of the MEFP date December 20, 2013 and ¶28 of this MEFP)	End-December 2014	

Attachment 2—Technical Memorandum of Understanding

April 23, 2014

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.

12. 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

13. 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

14. 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

15. 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

16. 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

A. Net international reserves

17. 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$100 million), compared to the program baseline (Table 1);

- upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector (Table 2);
- 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.

B. Net credit to central government

18. 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$100 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
- downward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector (Table 2);
- 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; (Table 2) 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.

C. Reserve money

19. 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.

D. Government revenue

20. The quantitative targets (floors) for government revenue will be adjusted upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US$ 30 million collected during the program period (Table 2).

DATA AND OTHER REPORTING

21. 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.

22. 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.

23. 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, 2014

	2014			
	Q1	Q2	Q3	Q4
	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	24	-18	84	216
Gross foreign program assistance	76	41	146	275
Program grants	76	41	146	10
Program loans	0	0	0	266
External debt service	52	59	62	59
Cumulative net foreign program assistance in US dollars	24	5	89	305
Gross foreign program assistance	76	116	262	537
External debt service	52	111	173	232
Net foreign program assistance (MT mn)	713	-564	2,612	6,822
Gross foreign program assistance	2,286	1,244	4,533	8,693
Program grants	2,286	1,244	4,533	306
Program loans	0	0	0	8,388
External debt service	1,574	1,808	1,921	1,871
Cumulative Net foreign program assistance in MTN millions	713	149	2,761	9,583
Gross foreign program assistance	2,286	3,530	8,063	16,757
External debt service	1,574	3,381	5,302	7,174

Source: Mozambican authorities and IMF staff estimates.

TMU Table 2. Mozambique: Programmed VAT Requests and Refunds, 2014

	Q1	Q2	Q3	Q4	Total
Windfall capital gains tax, in millions of meticais	16,064	0	0	0	16,064
Windfall capital gains tax, in millions of dollars	520	0	0	0	520
Budgeted VAT refund payments, in millions of meticais	1,125	1,125	1,125	1,125	4,500
Budgeted VAT refund payments, in millions of dollars	37	37	36	36	146
Reduction of VAT arrears, in millions of meticais	0	0	0	0	0
Reduction of VAT arrears, in millions of dollars	0	0	0	0	0

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

SECOND REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

April 25, 2014

Approved By
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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

This debt sustainability analysis (DSA) updates the joint IMF/IDA DSA from June 2013.[2] *Mozambique remains at moderate risk of external public debt distress: since the last DSA there has been significant new non-concessional borrowing and the discount rate has been updated from 3 percent to 5 percent, but key indicators continue to remain below the thresholds in the baseline scenario. While staffs agree with the authorities on the importance of public investment for development and that it will need to be financed by at least some non-concessional borrowing, the potential increased risks to debt sustainability should be contained by moderating public external borrowing from its recent pace and through further improvements in debt management and investment planning capacity. 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.*

[2]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 Country Policy and Institutional Assessment (CPIA), Mozambique is rated as a medium performer, albeit close to the threshold of 3.75 for strong performers, with an average rating of 3.71 during 2010–12; the DSA uses the indicative threshold for medium performers.

UNDERLYING DSA ASSUMPTIONS

1. **This DSA is consistent with the macroeconomic framework outlined in the Staff Report for the Second Review under the PSI** (Box 1). Compared to the previous DSA,[3] 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). Economic growth was dampened in 2013 as a result of flooding early in the year that damaged agricultural output and transport infrastructure. Growth is projected to bounce back quickly and accelerate over the medium term as agriculture recovers, extractive industries boom, and infrastructure investments materialize. The fiscal deficit was lower in 2013, among other factors because of windfall capital gain tax revenues received. The current account deficit is projected to remain in the range of 39-41 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

	2012	2013	2014	2015	2016
			Projections		
Real GDP growth (%)					
Previous DSA	7.4	7.0	8.5	8.5	8.0
Current DSA	7.2	7.1	8.3	8.2	8.2
Nominal GDP (US$ billion)					
Previous DSA	14.2	14.7	16.0	17.9	20.1
Current DSA	14.3	15.3	17.1	18.7	20.8
Overall fiscal deficit (% of GDP)					
Previous DSA	4.2	6.7	7.2	6.7	6.7
Current DSA	4.1	2.8	9.2	7.5	6.6
Current account deficit (% of GDP)					
Previous DSA	36.5	39.9	41.3	41.4	39.8
Current DSA	45.4	39.5	46.9	47.0	43.8
FDI (% of GDP)					
Previous DSA	36.6	32.2	25.8	20.8	18.9
Current DSA	20.7	36.5	33.0	28.6	26.4
Use of NCB ceiling (% of GDP)					
Previous DSA	0.8	2.4	2.5	1.6	1.3
Current DSA	0.8	7.8	2.4	1.9	1.7
Disbursements under PTL (% of GDP) 1/					
Previous DSA	0.4	0.2	0.3	0.2	0.2
Current DSA	0.4	0.2	0.3	0.2	0.2

1/ Portuguese credit line.

[3] See IMF Country Report No. 13/200.

Box 1. Macroeconomic Assumptions 2014–34

The medium-term assumptions in the baseline scenario for 2014-34 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 around 8 percent on average in the longer term. Growth is expected to accelerate over the medium term, supported by recovery in agricultural production, 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 "train" and thus 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 effects.

LNG sector. LNG plants are assumed to be under construction during 2014–22. 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.

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

Growth of exports is projected to stabilize at around 4 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 projects. 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 2014-2017 during the LNG plant construction phase but their growth would stabilize at around 7-8 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. 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 (2.1 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.

b. A revised public investment and external borrowing profile. Non-concessional borrowing was significantly higher in 2013 than previously projected because of the government guarantee for Loan Participation Notes (LNP) of $850 million (6 percent of GDP) issued by the newly created enterprise EMATUM (tuna fishing). With this, total non-concessional borrowing in 2013 amounted to almost 8 percent of GDP. Other projected disbursements of concessional and non-concessional debt are similar to the previous DSA (Text Table 2).

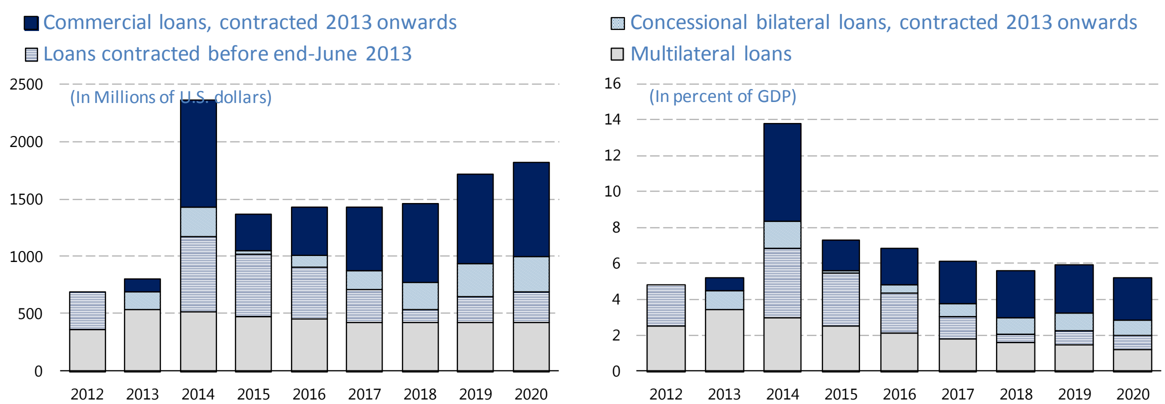
Text Table 2. Non-concessional Loans Contracted and in the Pipeline 2013-2014

	Signed on	Loan amount (US$ millions)	Before 2nd rev.	Before end-2014
Total non-concessional loans		**1,454**	**926**	**528**
Brazil				
Nacala Airport (Augmentation)	July, 2013	45	45	
Public Transport Maputo-Matola	Expect to sign by end-2014	135		135
Nacala Industrial Free Trade Zone	Expect to sign by end-2014	40		40
Dam Moamba Major	Expect to sign by end-2014	353		353
India				
Beira Port-Terminals, Storage Tanks, Etc	December 2013	31	31	
EMATUM*	September 2013	850	850	

* Government Guarantee

c. A revised grant element in financing terms in the medium term. The last DSA assumed that the grant element for new borrowing would experience a pronounced decline during the next two decades. The overall pattern is similar in the current DSA (given the decline in the long-run availability of traditional donor financing the assumption is that the government will rely increasingly on commercial borrowing) but grant financing in terms of GDP is somewhat higher in the near term reflecting updated information from donors.

Text Figure 1. Public Sector External Debt Disbursement Path



d. **Private sector debt stocks and medium-term borrowing have been revised upwards**. Private external debt is estimated at 24 percent of GDP in 2013, and projected to rise, financing the building of gas liquefaction capacity, to some 90 percent in 2019, but fall back to 44 percent by 2024 when LNG is exported and private borrowing amortized. The accumulation is significant and could pose a risk if the associated investments do not achieve the expected payoffs.[4]

e. **The increase in the DSA discount rate from 3 percent a year ago to 5 percent in this DSA** yields a lower present value of public debt/borrowing in this DSA compared to the previous one, but with the revisions in private debt/borrowing the overall debt is now slightly higher over the medium term than in the last DSA.

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 142 percent of GDP in 2019, at which time private sector debt will constitute 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. Public sector debt is expected to peak in 2019 at 33 percent of GDP (in PV terms). The significant build-up of private sector external debt needs to be monitored by the authorities to contain vulnerabilities. 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 currently considered to be low.[5]

3. **All public external debt indicators remain below their respective thresholds in the baseline** (Figure 1). With the unexpected (at the time of the last DSA) government guarantee of the EMATUM LNP, nominal debt is significantly higher in 2013 than previously projected, but the PV of debt is lower than in the last DSA as a result of the increase in the discount rate. The PV of debt in terms of GDP now peaks around 33 percent (in 2019), compared to a peak of 39 percent in the previous DSA. The beginning of LNG production and the ensuing surge in GDP would drop the ratio down to below 30 percent in the next decade (Table 1).

4. **External debt ratios remain vulnerable to FDI, growth, and exchange rate shocks.[6]** The threshold for the PV of debt to GDP ratio is breached under the most extreme stress tests for a

[4] Further analysis will be conducted at the time of the next review to evaluate the nature and extent of vulnerabilities

[5] 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.

[6] 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.

sustained period.[7] A sharp reduction in non-debt creating FDI and growth in 2014-2015 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 the FDI/growth shock, a sharp depreciation of the metical in 2014 or historical export growth also lead to breaches of this threshold (Table 2). All these shocks lead to a significant overshooting of the threshold for a sustained period.[8] The impact of these shocks is somewhat less than in the previous DSA primarily because of the increase in the discount rate. In three shock scenarios the PV of debt will also breach the debt/exports threshold of 150 percent of exports.[9]

5. **Ensuring that LNG production materilizes is crucial for Mozambique's debt sustainability.** The LNG sector will 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 temporary surge in public investment financed in part by external borrowing on non-concessional terms. 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 remains below 50 percent of GDP throughout, therefore remaining well contained and below the indicative benchmarks that research has linked to increased probability of debt distress.[10]

7. **The public DSA illustrates that it is essential for debt sustainability to moderate the pace of new borrowing as is planned by the authorities.** In other words, the fiscal primary balance will need to be reduced in the medium and long run. For illustrative purposes, the "Fix Primary Balance" scenario[11] shows the impact if the primary balance were fixed at values of its peak years 2013-15, i.e. if such a slowing in new borrowing would not take place,[12] debt ratios would

[7] 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.

[8] The charts in Figure 1 display the stress test with the most adverse outcome in 2023.

[9] 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.

[10] 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."

[11] See Figure 2 and Table 4 (lines A2).

[12] To provide this illustration, the "Fix Primary Balance" scenario was adapted for this analysis from the standard of fixing the primary balance at 2012, instead fixing the primary balance at its 2013-15 average value in percent of GDP.

(continued)

continue to rise throughout the projection period, quickly elevating risks to debt sustainability, no matter which assumptions are made on LNG production.

CONCLUSIONS

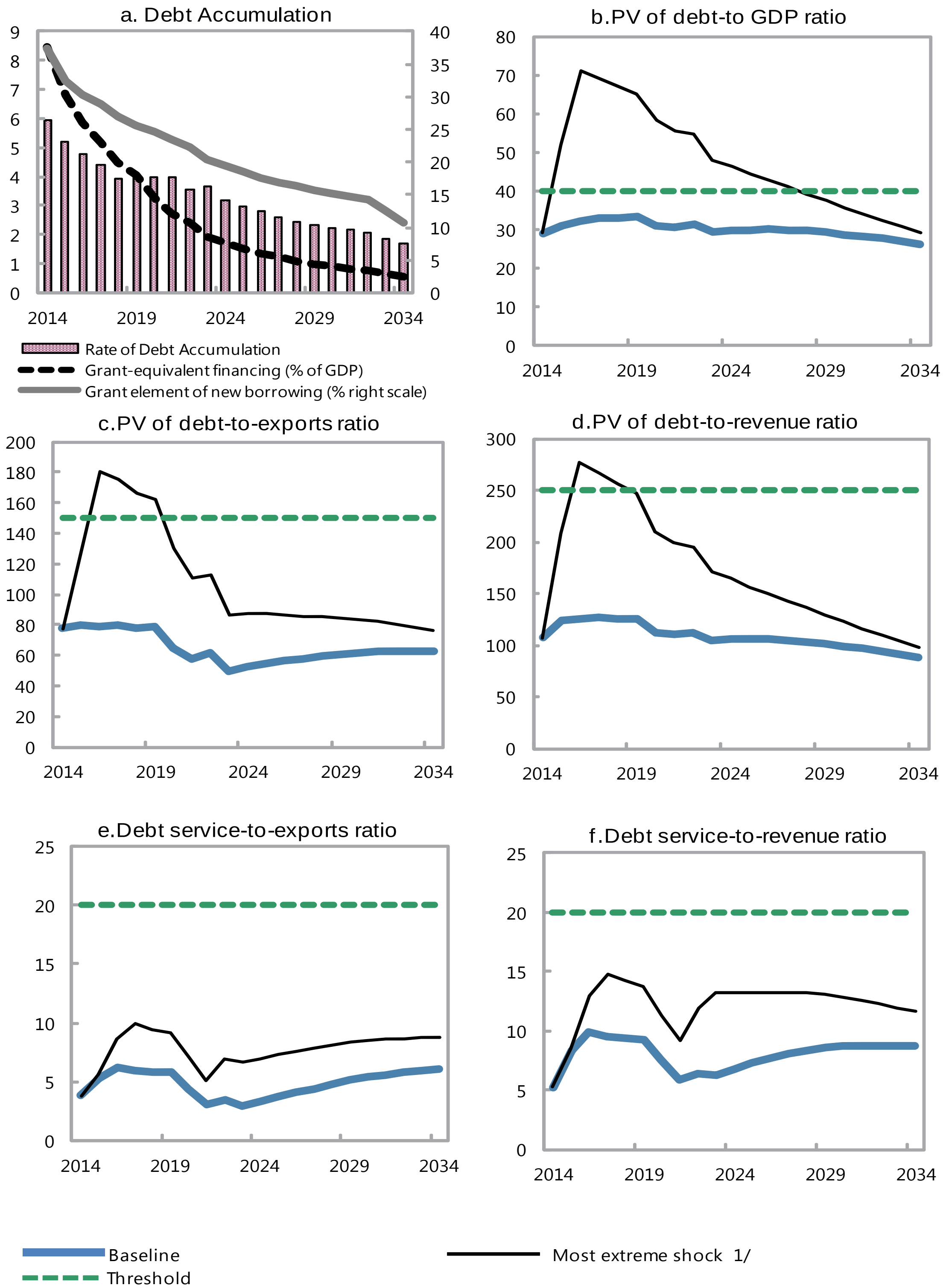
8. In staffs view, while the standard DSA shocks indicate that Mozambique would be in the moderate risk of external public debt distress category, public investment should continue to move forward but with a more moderate pace of public borrowing. Even against the background of a temporarily accelerated borrowing pace, 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.[13] 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 the 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. Second, it will be important for the authorities to moderate the pace of new borrowing to maintain debt sustainability, in line with their commitments. Third, it is becoming more important—including from a debt sustainability perspective—to ensure that LNG production materializes in order to lock in the beneficial effects on GDP and fiscal revenue.

This change was implemented, because the 2012 primary balance is low compared to those in the near future for two reasons: (i) because of windfall revenues in 2012, and (ii) because major investment projects are only starting.

[13] 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, 2014-2034 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 2024. In figure b. it corresponds to a Non-debt flows shock; in c. to a Combination shock; in d. to a Non-debt flows shock; in e. to a Combination shock and in figure f. to a Combination shock

Table 1 .Mozambique: External Debt Sustainability Framework, Baseline Scenario, 2011-2034 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**57.3**	**57.5**	**68.2**			**81.4**	**95.9**	**105.9**	**123.6**	**135.8**	**142.3**		**85.6**	**47.7**	
of which: public and publicly guaranteed (PPG)	32.9	36.9	44.2			49.2	51.4	52.3	52.4	51.6	51.0		41.4	32.8	
Change in external debt	-21.1	0.2	10.6			13.2	14.5	10.0	17.7	12.2	6.4		-6.1	-2.5	
Identified net debt-creating flows	-15.1	1.8	2.6			13.2	14.5	12.6	21.1	17.3	13.5		-2.9	-8.2	
Non-interest current account deficit	**22.9**	**44.0**	**38.0**	**17.4**	**13.4**	**44.8**	**44.5**	**41.2**	**49.4**	**49.4**	**43.7**		**15.5**	**5.9**	14.8
Deficit in balance of goods and services	29.7	51.2	48.0			52.3	51.2	45.3	50.7	49.3	42.3		3.6	6.4	
Exports	30.8	33.3	36.0			37.6	39.1	41.1	41.2	42.2	42.0		57.0	42.1	
Imports	60.5	84.5	84.1			89.9	90.4	86.3	91.9	91.5	84.3		60.6	48.5	
Net current transfers (negative = inflow)	-6.9	-5.8	-8.5	-7.0	1.0	-6.5	-5.8	-5.3	-5.1	-4.9	-4.7		-3.6	-3.2	-3.5
of which: official	-6.3	-5.0	-7.2			-7.5	-6.8	-6.4	-6.1	-5.9	-5.7		-4.7	-4.2	
Other current account flows (negative = net inflow)	0.0	-1.4	-1.5			-1.1	-0.9	1.2	3.8	5.0	6.1		15.5	2.6	
Net FDI (negative = inflow)	**-20.7**	**-36.5**	**-33.0**	**-13.2**	**12.7**	**-28.6**	**-26.4**	**-24.1**	**-23.5**	**-25.9**	**-23.3**		**-14.3**	**-11.9**	-14.5
Endogenous debt dynamics 2/	**-17.3**	**-5.7**	**-2.4**			**-3.0**	**-3.6**	**-4.5**	**-4.9**	**-6.2**	**-6.9**		**-4.0**	**-2.1**	
Contribution from nominal interest rate	1.5	1.3	1.4			2.1	2.5	2.6	2.6	2.6	2.5		1.5	1.1	
Contribution from real GDP growth	-4.4	-3.6	-3.8			-5.1	-6.1	-7.1	-7.5	-8.8	-9.3		-5.6	-3.2	
Contribution from price and exchange rate changes	-14.4	-3.4	0.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-6.0**	**-1.6**	**8.0**			**0.1**	**0.0**	**-2.6**	**-3.4**	**-5.1**	**-7.1**		**-3.2**	**5.6**	
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/	...	...	49.5			61.3	75.6	85.8	104.1	117.2	124.4		74.0	41.1	
In percent of exports	...	...	137.4			163.1	193.2	209.0	252.7	277.9	296.2		129.8	97.8	
PV of PPG external debt	**...**	**...**	**25.5**			**29.1**	**31.1**	**32.2**	**32.8**	**32.9**	**33.2**		**29.8**	**26.3**	
In percent of exports	**...**	**...**	**70.8**			**77.5**	**79.4**	**78.4**	**79.7**	**78.1**	**79.1**		**52.3**	**62.5**	
In percent of government revenues	**...**	**...**	**92.9**			**106.7**	**124.3**	**125.3**	**126.5**	**126.0**	**125.9**		**105.7**	**88.4**	
Debt service-to-exports ratio (in percent)	**19.4**	**12.0**	**12.0**			**14.3**	**14.9**	**15.2**	**12.9**	**12.1**	**11.7**		**7.7**	**7.2**	
PPG debt service-to-exports ratio (in percent)	**2.0**	**2.1**	**2.8**			**3.8**	**5.3**	**6.2**	**6.0**	**5.8**	**5.8**		**3.3**	**6.1**	
PPG debt service-to-revenue ratio (in percent)	**3.0**	**3.1**	**3.7**			**5.2**	**8.4**	**10.0**	**9.5**	**9.4**	**9.2**		**6.8**	**8.7**	
Total gross financing need (Billions of U.S. dollars)	1.0	1.6	1.4			3.7	4.5	4.9	7.3	7.4	7.3		3.1	-4.2	
Non-interest current account deficit that stabilizes debt ratio	44.0	43.8	27.4			31.5	30.0	31.2	31.8	37.2	37.3		21.6	8.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.3	7.2	7.1	7.4	0.7	8.3	8.2	8.2	7.9	8.0	7.7	8.0	6.7	6.9	8.4
GDP deflator in US dollar terms (change in percent)	22.4	6.2	0.1	5.3	9.8	2.8	1.2	2.8	3.4	3.4	3.5	2.9	2.4	2.4	2.5
Effective interest rate (percent) 5/	2.5	2.7	2.7	2.6	0.6	3.5	3.4	3.1	2.7	2.4	2.0	2.8	1.8	2.3	2.1
Growth of exports of G&S (US dollar terms, in percent)	29.7	23.1	16.1	16.0	14.4	16.2	13.9	16.7	11.9	14.3	11.0	14.0	4.9	6.9	11.6
Growth of imports of G&S (US dollar terms, in percent)	62.8	59.0	6.7	21.0	22.7	19.2	10.0	6.3	18.7	11.2	2.6	11.3	6.0	6.6	7.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	37.3	32.4	30.2	29.0	26.9	25.6	30.2	19.4	10.8	17.5
Government revenues (excluding grants, in percent of GDP)	20.8	23.3	27.5			27.3	25.0	25.7	25.9	26.1	26.4		28.2	29.7	28.7
Aid flows (in Billions of US dollars) 7/	1.6	1.3	1.9			1.9	1.8	1.7	1.7	1.7	1.8		1.8	2.0	
of which: Grants	1.0	0.8	0.8			0.9	0.8	0.7	0.7	0.7	0.7		0.5	0.2	
of which: Concessional loans	0.6	0.5	1.0			1.0	1.0	1.0	1.0	1.0	1.1		1.3	1.7	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			8.4	6.8	5.9	5.2	4.5	4.1		1.7	0.5	1.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			60.4	55.2	51.7	50.9	49.8	47.2		33.2	15.4	28.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	12.5	14.3	15.3			17.1	18.7	20.8	23.2	25.9	28.9		56.8	139.7	
Nominal dollar GDP growth	31.4	13.9	7.2			11.4	9.5	11.2	11.5	11.7	11.4	11.1	9.2	9.5	11.2
PV of PPG external debt (in Billions of US dollars)			3.9			4.8	5.7	6.6	7.5	8.4	9.5		16.7	36.2	
(PVt-PVt-1)/GDPt-1 (in percent)						**6.0**	**5.2**	4.8	4.4	3.9	4.0	4.7	3.2	1.7	2.8
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)	...	...	25.5			29.1	31.0	32.2	32.8	32.9	33.2		29.8	26.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	70.6			77.2	79.1	78.2	79.5	77.9	78.8		52.2	62.3	
Debt service of PPG external debt (in percent of exports + remittance	...	...	2.8			3.8	5.3	6.2	6.0	5.8	5.8		3.3	6.1	

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, 2014-2034 (continued)

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	**2024**	2034
PV of debt-to GDP ratio								
Baseline	29	31	32	33	33	33	**30**	26
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	29	19	10	-5	-18	-27	**-10**	54
A2. New public sector loans on less favorable terms in 2014-2034 2/	29	32	35	37	39	40	**39**	39
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	29	31	33	33	33	34	**30**	27
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	29	34	43	43	42	42	**34**	27
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	29	32	36	37	37	37	**33**	29
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	29	52	71	69	67	65	**46**	29
B5. Combination of B1-B4 using one-half standard deviation shocks	29	49	69	68	66	64	**47**	30
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	29	44	45	46	46	47	**42**	37
PV of debt-to-exports ratio								
Baseline	77	79	78	80	78	79	**52**	62
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	77	48	24	-13	-42	-64	**-18**	128
A2. New public sector loans on less favorable terms in 2014-2034 2/	77	83	86	91	92	95	**68**	93
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	77	78	77	79	77	78	**51**	61
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	77	98	134	133	129	128	**77**	82
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	77	78	77	79	77	78	**51**	61
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	77	133	173	168	159	155	**81**	69
B5. Combination of B1-B4 using one-half standard deviation shocks	77	128	180	175	166	162	**87**	77
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	77	78	77	79	77	78	**51**	61
PV of debt-to-revenue ratio								
Baseline	107	124	125	127	126	126	**106**	88
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	107	75	39	-21	-69	-102	**-36**	181
A2. New public sector loans on less favorable terms in 2014-2034 2	107	129	137	144	148	152	**137**	131
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	107	124	127	129	128	128	**107**	89
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	107	137	167	165	161	159	**121**	90
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	107	130	141	143	142	142	**119**	99
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	107	208	277	267	256	246	**164**	98
B5. Combination of B1-B4 using one-half standard deviation shocks	107	196	270	261	251	243	**165**	102
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	107	174	176	178	177	177	**148**	123

Table 2. Mozambique: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014-2034 (concluded)

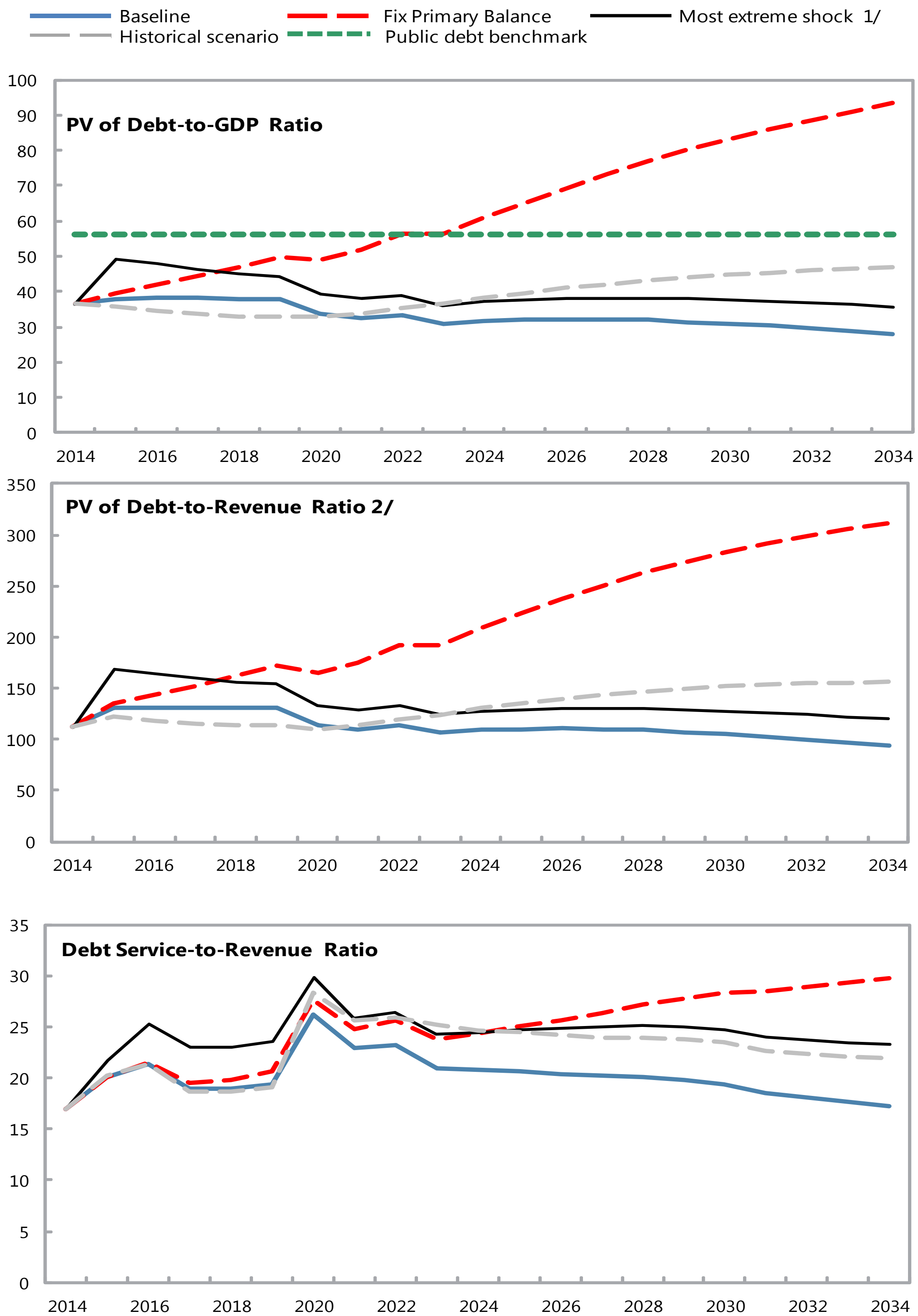
(In percent)

				Debt service-to-exports ratio				
Baseline	4	5	6	6	6	6	**3**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	4	5	5	4	2	1	**-2**	5
A2. New public sector loans on less favorable terms in 2014-2034 2/	4	5	6	6	6	6	**4**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	4	5	6	6	6	6	**3**	6
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	4	6	8	9	9	8	**6**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	4	5	6	6	6	6	**3**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	4	5	8	9	9	9	**7**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	4	6	9	10	9	9	**7**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	4	5	6	6	6	6	**3**	6
				Debt service-to-revenue ratio				
Baseline	5	8	10	10	9	9	**7**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	5	8	8	6	4	2	**-3**	7
A2. New public sector loans on less favorable terms in 2014-2034 2/	5	8	9	9	9	9	**9**	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	5	8	10	10	10	9	**7**	9
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	5	8	10	11	11	10	**9**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	5	9	11	11	11	10	**8**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	5	8	13	15	14	14	**13**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	5	9	13	15	14	14	**13**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	5	12	14	13	13	13	**10**	12
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	16	16	16	16	16	16	**16**	16

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 (implicitly assuming 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, 2014-2034 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 2024.
2/ Revenues are defined inclusive of grants.

Table 3. Mozambique: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011-2034

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	39.6	42.7	53.1			56.5	58.3	58.3	57.7	56.5	55.5		43.3	34.4	
of which: foreign-currency denominated	32.9	36.9	44.2			49.2	51.4	52.3	52.4	51.6	51.0		41.4	32.8	
Change in public sector debt	-6.2	3.1	10.4			3.4	1.8	0.0	-0.7	-1.2	-0.9		0.2	-1.4	
Identified debt-creating flows	-6.9	2.5	-2.0			4.8	1.7	0.5	-0.3	-0.7	-0.8		-0.9	-1.8	
Primary deficit	4.1	3.0	2.0	3.0	1.1	7.8	6.0	5.2	4.3	3.9	3.5	5.1	1.6	0.2	1.0
Revenue and grants	28.6	28.6	32.9			32.4	29.2	29.2	29.1	28.9	28.9		29.1	29.9	
of which: grants	7.8	5.4	5.4			5.2	4.2	3.5	3.1	2.8	2.5		0.9	0.2	
Primary (noninterest) expenditure	32.7	31.6	34.8			40.2	35.2	34.3	33.4	32.8	32.4		30.8	30.1	
Automatic debt dynamics	-10.8	-0.5	-3.9			-3.0	-4.3	-4.7	-4.6	-4.6	-4.3		-2.5	-2.0	
Contribution from interest rate/growth differential	-3.2	-2.4	-2.8			-3.8	-4.1	-4.2	-4.0	-3.9	-3.8		-2.5	-1.9	
of which: contribution from average real interest rate	-0.1	0.2	0.1			0.3	0.2	0.2	0.3	0.3	0.2		0.2	0.4	
of which: contribution from real GDP growth	-3.1	-2.7	-2.8			-4.1	-4.3	-4.4	-4.3	-4.3	-4.0		-2.7	-2.3	
Contribution from real exchange rate depreciation	-7.6	1.9	-1.2			0.8	-0.2	-0.4	-0.6	-0.7	-0.5		...	...	
Other identified debt-creating flows	-0.1	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)	-0.1	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	0.6	0.7	12.4			-1.4	0.1	-0.4	-0.3	-0.5	-0.2		1.0	0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	34.5			36.4	38.0	38.2	38.1	37.8	37.7		31.7	27.9	
of which: foreign-currency denominated	...	...	25.5			29.1	31.1	32.2	32.8	32.9	33.2		29.8	26.3	
of which: external	...	...	25.5			29.1	31.1	32.2	32.8	32.9	33.2		29.8	26.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.9	7.1	6.5			13.3	11.9	11.4	9.8	9.3	9.1		7.7	5.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	104.9			112.2	130.3	131.0	131.2	130.7	130.6		109.1	93.2	
PV of public sector debt-to-revenue ratio (in percent)	...	...	125.6			133.4	152.0	148.8	147.0	144.7	143.1		112.5	93.8	
of which: external 3/	...	...	92.9			106.7	124.3	125.3	126.5	126.0	125.9		105.7	88.4	
Debt service-to-revenue and grants ratio (in percent) 4/	20.3	14.4	13.9			17.0	20.0	21.4	19.0	18.9	19.4		20.7	17.3	
Debt service-to-revenue ratio (in percent) 4/	28.0	17.7	16.6			20.2	23.4	24.3	21.2	21.0	21.3		21.4	17.4	
Primary deficit that stabilizes the debt-to-GDP ratio	10.3	-0.1	-8.5			4.4	4.2	5.1	5.0	5.1	4.5		1.5	1.6	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.3	7.2	7.1	7.4	0.7	8.3	8.2	8.2	7.9	8.0	7.7	8.0	6.7	6.9	8.4
Average nominal interest rate on forex debt (in percent)	0.9	1.0	0.9	0.8	0.6	1.7	1.8	1.9	2.0	2.0	2.1	1.9	2.5	3.1	2.7
Average real interest rate on domestic debt (in percent)	5.5	7.3	3.7	3.8	3.3	3.2	4.3	4.1	5.4	6.8	7.8	5.3	9.2	9.0	6.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-20.8	6.3	-3.4	-1.8	14.0	2.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.9	4.3	5.5	7.4	2.1	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Growth of real primary spending (deflated by GDP deflator, in percent)	9.5	3.8	18.0	3.2	6.0	25.2	-5.4	5.6	4.9	6.0	6.4	7.1	6.5	7.0	7.8
Grant element of new external borrowing (in percent)	...	...	...	...	...	37.3	32.4	30.2	29.0	26.9	25.6	30.2	19.4	10.8	...

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 2014-2034

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	36	38	38	38	38	38	32	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	36	36	35	34	33	33	38	47
A2. Primary balance is unchanged from 2014	36	39	42	44	47	50	61	93
A3. Permanently lower GDP growth 1/	36	38	38	38	38	38	34	34
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20:	36	39	40	41	41	41	37	37
B2. Primary balance is at historical average minus one standard deviations in 2015-201	36	36	36	36	36	36	31	27
B3. Combination of B1-B2 using one half standard deviation shocks	36	36	36	36	37	37	34	33
B4. One-time 30 percent real depreciation in 2015	36	49	48	46	45	44	37	36
B5. 10 percent of GDP increase in other debt-creating flows in 2015	36	46	46	45	45	44	36	30
PV of Debt-to-Revenue Ratio 2/								
Baseline	112	130	131	131	131	131	109	93
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	112	122	118	116	114	113	130	157
A2. Primary balance is unchanged from 2014	112	135	143	152	162	172	209	312
A3. Permanently lower GDP growth 1/	112	131	132	132	132	133	116	114
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20:	112	133	137	139	141	142	127	123
B2. Primary balance is at historical average minus one standard deviations in 2015-201	112	125	123	124	124	124	105	91
B3. Combination of B1-B2 using one half standard deviation shocks	112	124	122	124	126	128	115	112
B4. One-time 30 percent real depreciation in 2015	112	169	164	160	156	154	127	120
B5. 10 percent of GDP increase in other debt-creating flows in 2015	112	159	158	156	154	153	123	101
Debt Service-to-Revenue Ratio 2/								
Baseline	17	20	21	19	19	19	21	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	17	20	21	19	19	19	25	22
A2. Primary balance is unchanged from 2014	17	20	22	19	20	21	24	30
A3. Permanently lower GDP growth 1/	17	20	21	19	19	20	21	19
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20:	17	20	22	20	20	20	22	19
B2. Primary balance is at historical average minus one standard deviations in 2015-201	17	20	21	19	19	19	20	17
B3. Combination of B1-B2 using one half standard deviation shocks	17	20	21	19	19	20	21	18
B4. One-time 30 percent real depreciation in 2015	17	22	25	23	23	24	24	23
B5. 10 percent of GDP increase in other debt-creating flows in 2015	17	20	22	20	20	20	22	18

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.

INTERNATIONAL MONETARY FUND

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Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review of Policy Support Instrument for Mozambique

The Executive Board of the International Monetary Fund (IMF) completed today the second review of Mozambique's economic performance under the program supported by the Policy Support Instrument (PSI). In completing the review, the Board approved the modification of three assessment criteria, including two end-June 2014 assessment criteria as the result of the higher than anticipated fiscal revenues and a continuous assessment criterion related to an increase of the non-concessional borrowing ceiling as this is in line with a PSI objective of facilitating a scaling up in infrastructure investment.

The PSI was approved by the Executive Board on June 24, 2013 (see Press Release No. 13/231). The IMF's framework for PSIs is designed for low-income countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their policies. The PSI is a voluntary and demand driven instrument, supported by strong country ownership (see Public Information Notice No. 05/145).

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

"Mozambique's strong growth performance and low inflation are commendable. Natural resource exploitation underpins the medium-term outlook and entails benefits as well as risks.

"The implementation of the Poverty Reduction Strategy is progressing, but it will be important to strengthen expenditure execution to ensure that the 2013 shortfall on priority spending was temporary. Making growth more inclusive will require generating more employment, and improving human capital and the enabling environment for small and medium-sized enterprises.

"The fiscal stance for 2014 is expansionary, partly reflecting some temporary factors—such as spending related to holding general elections—and public investment. Fiscal consolidation will be needed in the medium term. Monetary policy needs to remain vigilant and stand ready to take action to keep inflation to the authorities' medium-term target.

"The structural reform agenda is progressing, but implementation could be invigorated, especially in the areas of public financial management reforms and the identification of fiscal risks. Building institutional capacity is important to prepare for managing the future resource boom and making growth more inclusive. Financial sector development and business facilitation will also be essential.

"External borrowing can help fund infrastructure investments. However, using such resources effectively requires a transparent project analysis, prioritization and selection process, and should be informed by the implications for the debt sustainability. Furthermore, strict monitoring of project implementation is essential to ensure value-for-money in the use of public resources."

Statement by Mr. Momodu Bamba Saho, Executive Director for Mozambque
May 9, 2014

1. Introduction

The Mozambican authorities are appreciative of the Fund's continuous engagement and value their support under the Policy Support Instrument (PSI) arrangement. The authorities also appreciate the candid exchange of views with staff during discussions for the second review under the PSI.

2. Recent Economic Developments

The prudent implementation of the authorities' economic strategy has resulted in an impressive improvement in the country's economic and financial performance in recent years. As a result, in spite of the difficult global environment and floods earlier in 2013, the Mozambican economy grew by 7.0 percent driven by increased activity in the extractive industries, financial services and construction sectors. The inflation environment remains benign. The current account deficit improved in 2013, due mainly to lower service imports and higher transfer receipts. Gross international reserves accumulated by the Bank of Mozambique (BM) are equivalent to 4.5 months of imports of goods and non financial services.

Fiscal policy in 2013 was expansionary as the authorities increased spending on infrastructure and access to basic social services to mitigate the impact of floods in early 2013. Revenue performance was in line with the program, thanks to the receipt in August 2013 of $400 million (2.1 percent of GDP) capital gains taxes from the sale of shares in extractive industries sectors. The overall fiscal deficit including grants was estimated at 2.8 percent of GDP, lower than the program target of 4.6 percent of GDP.

The primary objective of Mozambique's monetary and exchange rate policies over the past few years was to anchor inflationary expectations and achieve exchange rate stability. As a result, the average annual inflation in 2013 was 4.2 percent, compared to a target of 7.0 percent. My authorities remain committed to enhancing the monetary policy framework to improve liquidity management, increase accessibility to a wide range of financial instruments tailored to small and medium size firms, and pursuing the implementation of the Financial

Sector Development Strategy (FSDS) which aims to foster financial inclusion and spur competitiveness in traded sectors.

3. Program Performance

Against the background of a difficult global environment and floods in early 2013, the authorities maintained macroeconomic stability and satisfactorily performed under the PSI. The program performance since the first review remains broadly on track. All quantitative assessment criteria and all indicative targets through end-December were observed, except the target for priority sectors expenditure, which was missed due to delays in the disbursement of donor funds. The structural benchmarks for end-February and end-March 2014 were met, although one with a brief delay.

4. Economic Outlook and Policies

My authorities' economic agenda in the near to medium term is to strengthen macroeconomic and structural policies to promote inclusive economic growth, create more jobs, spread the benefit of growth more widely and thereby reduce inequality. Consequently, they are determined to invest in key infrastructure and sectors that have high economic and social returns as well as expansionary economic benefits. To this end, economic growth is projected to accelerate to 8.3 percent in 2014, supported by buoyant dynamics in extractive industries and construction sectors. Inflation is projected to remain within the range of 5-6 percent and the exchange rate is expected to remain stable. The major risks to maintaining inflation within the target range of the BM are the expansionary fiscal policy in 2014, the accommodative monetary policy and the region's inflationary pressures. To cope with these risks and increase the economy's resilience to shocks, the authorities will continue to increase the allocation of resources to the development of infrastructure and also boost investments and human capital.

4.1 Fiscal Policy

My authorities remain committed to maintaining sustainable fiscal policy over the medium to long-term. In this regard, revenue collection efforts will be enhanced by further strengthening tax administrative measures, and changes in the tax code. Other ongoing revenue enhancing measures include the strengthening of the large taxpayer unit, broadening of e-tax and tax payment via banks for VAT coupled with the simplification of the small tax payer regime, and reforms of transfer price provisions. In addition, efforts are being made to establish a fiscal rule for the use of the windfall revenue. Accordingly, the Mozambican authorities have established a stabilization account to supplement any shortfalls in future revenue collection. The approval of the execution of the fiscal rule is envisaged in 2015.

To bring public finances to a sustainable path, the authorities plan to gradually reduce expenditure from around 42 percent of GDP in 2014 to about 34 percent of GDP in 2019. Most of the reduction would be achieved as expenditures return to a normal path after the implementation of one-off outlays on elections and maritime security in 2014. Additionally, the Mozambican authorities plan a measured reduction of the wage bill in 2015 and beyond. The authorities also expect that expenditures on goods and services and investments would grow more slowly than GDP.

To increase fiscal space while maintaining debt sustainability in the medium term, the authorities remain committed to continue enhancing public financial management by strengthening project selection instruments, improving public debt management, extending the use of the single treasury account (CUT), and expanding the roll out of salary payments through direct transfer to bank accounts.

4.2 Monetary and Exchange Rate Policy

The authorities' monetary policy framework will focus on anchoring inflationary expectations, improving liquidity management and strengthening financial surveillance. To accomplish these objectives, the BM will continue to enhance the use of open market operations and reinforce the framework for liquidity forecasting. Furthermore, the BM will improve the coordination work with the Ministry of Finance and the Stock Exchange to make T-Bonds attractive as collateral in money market operations.

The BM will maintain the floating exchange rate regime, intervening in the exchange rate market to smoothen volatilities in the foreign exchange market and build up international reserves. The BM will reinforce the implementation of the New Exchange Rate Law and continue to strengthen the framework for reserve management.

4.3. Financial Sector Policies

My authorities remain committed to pursuing the agenda on financial deepening and inclusion in order to create more opportunities and support private sector development and job creation. To this end, the authorities approved in 2013 the FSDS spanning the period 2013-2022. The FSDS aims amongst other objectives to maintain financial sector stability, increase access to financial services and products and eliminate structural constraints, specifically those that limit financial intermediation and access to financial services. Ongoing structural reforms to comply with the FSDS' objectives include developing a National Financial Inclusion Strategy by end-December 2014; drafting specific regulations governing mobile banking services by June 2014 and establishing the legal basis for insolvency procedures. Finally, the authorities intend to improve risk-based supervision and adopt Basel II to make the financial system robust.

5. Conclusion

My authorities would like to reiterate their commitment to pursue their comprehensive agenda of macroeconomic and structural reforms aimed primarily to unleash the economy's growth potential and gradually remove the structural bottlenecks to economic development. Despite the uncertainty in the global economic environment and adverse impact of exogenous shocks, economic performance under the new three year PSI remains strong. Structural reforms across a broad spectrum of areas are largely on track. Going forward, Mozambique stands ready to continue the fruitful engagement with the IMF to enhance the macroeconomic policy framework in the context of the natural resource boom, building on lessons from the country's current and past experiences. Furthermore, they are willing to engage with other international financial institutions to effectively mobilize adequate resources to fill the gap in infrastructure financing without compromising debt sustainability and macroeconomic stability. My authorities seek the Executive Board's approval of their request for the completion of the second review under the PSI and modification of assessment criteria.