July 2007
IMF Country Report No. 07/262

Republic of Mozambique: 2007 Article IV Consultation, Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criterion, Financing Assurance Review, and Request for a Three-Year Policy Support Instrument—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2007 Article IV consultation with the Republic of Mozambique, sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for a waiver of a performance criterion, financing assurance review, and request for a three-year Policy Support Instrument, the following documents have been released and are included in this package:

- The staff report for the combined 2007 Article IV Consultation, Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criterion, Financing Assurance Review, and Request for a Three-Year Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on March 28, 2007, with the officials of the Republic of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 30, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement on the joint World Bank/IMF debt sustainability analysis.
- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its June 18, 2007 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- A statement by the authorities of the Republic of Mozambique.

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

Letter of Intent sent to the IMF by the authorities of the Republic of Mozambique*
Memorandum of Economic and Financial Policies by the authorities of the
Republic of Mozambique*
Selected Issues Paper
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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REPUBLIC OF MOZAMBIQUE

Staff Report for the 2007 Article IV Consultation, Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criterion, Financing Assurances Review, and Request for a Three-Year Policy Support Instrument

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

Approved by David Nellor and Anthony Boote

May 30, 2007

- Discussions for the sixth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Maputo during March 14–28, 2007 by a staff team comprising Messrs. Clément (head), Peiris, Lledó, and Saxegaard (all AFR), and Ms. Kvintradze (PDR). Mr. Sulemane (OEDAE) also participated in the meetings. The team was assisted by Mr. Fischer, the Resident Representative in Mozambique, and Ms. Bosten. Messrs. Baxter, Binkert, Nicholas and Nucifora (all World Bank) joined the discussions. The mission met with the honorable Prime Minister; and the Ministers of Finance, Education, Health, Transport, Justice, Mining, Labor, and Trade and Industry; the Governor of the Bank of Mozambique, and other senior government officials. The mission coordinated its work with a Joint Review of Program Aid Partners (PAPs), including the World Bank.
- The government's successful reform efforts have produced solid growth and price stability. These efforts have been supported by a PRGF program (2004–07). Building on sustained macroeconomic stability and recent refinements to the PRGF program, the authorities request a three-year Policy Support Instrument (PSI) based on the reform agenda articulated in the *Plano de Acção para Redução da Pobreza Absoluta* (PRSP II or "*PARPA II*" in Portuguese) for 2006–09. Donor support is expected to continue to be significant. Provincial elections are due in late 2007, presidential and assembly elections in 2009.
- The attached letter of intent (LOI) and memorandum of economic and financial policies (MEFP) from the Minister of Finance and the Governor of the Bank of Mozambique (Appendix I) reviews performance on the PRGF arrangement from October 2006 through March 2007, and sets out policies and program monitoring aspects of the request for a three-year PSI arrangement. Detailed program monitoring plans for the rest of 2007 are defined in the technical memorandum of understanding (TMU).
- The Mozambican authorities appreciated the advice provided by the Executive Board in the context of the Article IV consultations, including the latest, which was concluded on April 13, 2005. They agreed that after an impressive performance over the past decade, a "second wave of reforms" is needed to deepen and accelerate structural changes, in order to sustain high and broad-based growth. They also found the cooperation and candidness of discussions with Fund staff very effective. They stressed the importance of continued Fund technical assistance in buttressing administrative capacity.
- Mozambique avails itself of the transitional arrangements under Article XIV of the Fund's Articles of Agreement. Although it has eliminated all Article XIV exchange restrictions, it maintains restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII. Mozambique intends to eliminate these restrictions and accept the obligations of Article VIII, Section 2, 3 and 4.

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EXECUTIVE SUMMARY

- **Sustaining Mozambique's impressive growth performance is crucial to further reducing poverty.** Now that the postconflict rebound has largely run its course and first-generation reforms are completed, a second wave of reforms is needed to sustain broad-based growth and further reduce poverty. Achieving the non-income-related Millennium Development Goals (MDGs) also requires scaling up basic services without undermining macroeconomic stability.

- **The current PRGF program helped maintain macroeconomic stability in the face of exogenous shocks and addressed the structural weaknesses identified in the Ex post Assessment (IMF/04/53)**. Performance under the program has improved considerably since the new government took office in early 2005 after slippages in the run-up to elections in 2004. All quantitative and structural performance criteria from March 2005 through March 2007 were met except one: base money was above target at end-year 2006 due to a temporary rise in currency demand related to the currency reform. This good performance has helped the authorities maintain monetary and inflation control and complete outstanding first-generation reforms identified in the Ex post Assessment.

- **PARPA II (2006–09) recognizes that if growth is to be sustained there must be more emphasis on productivity growth and a greater role for the private sector.** This is to be achieved by (i) consolidating macroeconomic stability; (ii) reducing the costs of doing business; and (iii) improving governance and the management of natural resources.

- **The three-year PSI (2007–10) will consolidate macroeconomic stability to sustain Mozambique's growth takeoff in the context of scaled-up foreign aid.** Fiscal policy will be reinforced to finance additional priority spending in a sustainable manner and ensure that a scaling-up of aid-financed expenditures reaches the most productive and pro-poor sectors. Monetary control will anchor inflationary expectations while a flexible exchange rate regime will help maintain competitiveness and a comfortable level of international reserves to cushion against exogenous shocks.

- **The PARPA II also accelerates the implementation of a second wave of reforms to achieve the MDGs.** The structural program aims at improving the business environment by deepening the financial system and reducing the cost of doing business, as well as strengthening the fiscal and transparency regime of the natural resource sector.

- **The outlook for 2007 is for continued strong growth, single-digit inflation, and a sustainable external and fiscal situation.** Real GDP growth is expected to decelerate to its trend of about 7 percent in 2007 after recording 8 ½ percent growth in 2006. The 2007 budget is largely unchanged; it envisages a scaling up of aid-financed expenditures supported by a continued rise in domestic revenue of 0.5 percent of GDP. The Bank of Mozambique (BM) will continue to target base money and facilitate absorption of the additional foreign aid while strengthened public financial management (PFM) systems, both national and subnational, will ensure that spending is better monitored.

I. Economic Resilience Supported by Prudent Macroeconomic Policies

1. **Mozambique's macroeconomic performance has been strong since the 2005 Article IV consultation.** After some slippages, notably fiscal overruns as the December 2004 elections approached, President Guebuza's new government has shown firm commitment to prudent macroeconomic policies in an uninterrupted PRGF-supported program. The stronger policy framework and reinvigorated structural reform agenda have helped make the economy more resilient to exogenous shocks; robust growth; moderate inflation; and a sustainable fiscal and external position have prevailed:

Mozambique: Selected Economic Indicators 2004-07

	2004	2005 Est.	2006 Est.	2007 Proj.
Real GDP growth (%)	7.5	6.2	8.5	7.0
Inflation end of period (%)	9.1	11.2	9.4	6.0
Interest rate (T-bill, %)	10.5	10.0	16.0	…
Broad money growth (%)	16.7	22.1	25.8	17.3
Real effective exchange rate (% change)	17.5	-6.3	1.8	…
Foreign reserves (in months of imports)	5.8	4.6	4.4	4.2
Overall fiscal balance (incl. grants, % GDP)	-4.5	-2.2	-1.5	-4.4
Overall fiscal balance (excl. grants, % GDP)	-12.1	-8.6	-11.4	-15.8
Government domestic revenue (% GDP)	12.6	13.6	14.0	14.4
Current account balance (incl. grants ,% GDP)	-5.2	-9.1	19.6	-6.2
Exports (US$ millions)	1,504	1,744	2,391	2,580
Of which : aluminum	915	1021	1401	1385
Imports (US$ millions)	2,035	2,467	2,878	3,120
Of which : oil	214	261	346	353
Terms of trade (% change)	25.3	22.5	59.0	1.9
Foreign direct investment (US$ millions)	245	105	154	299

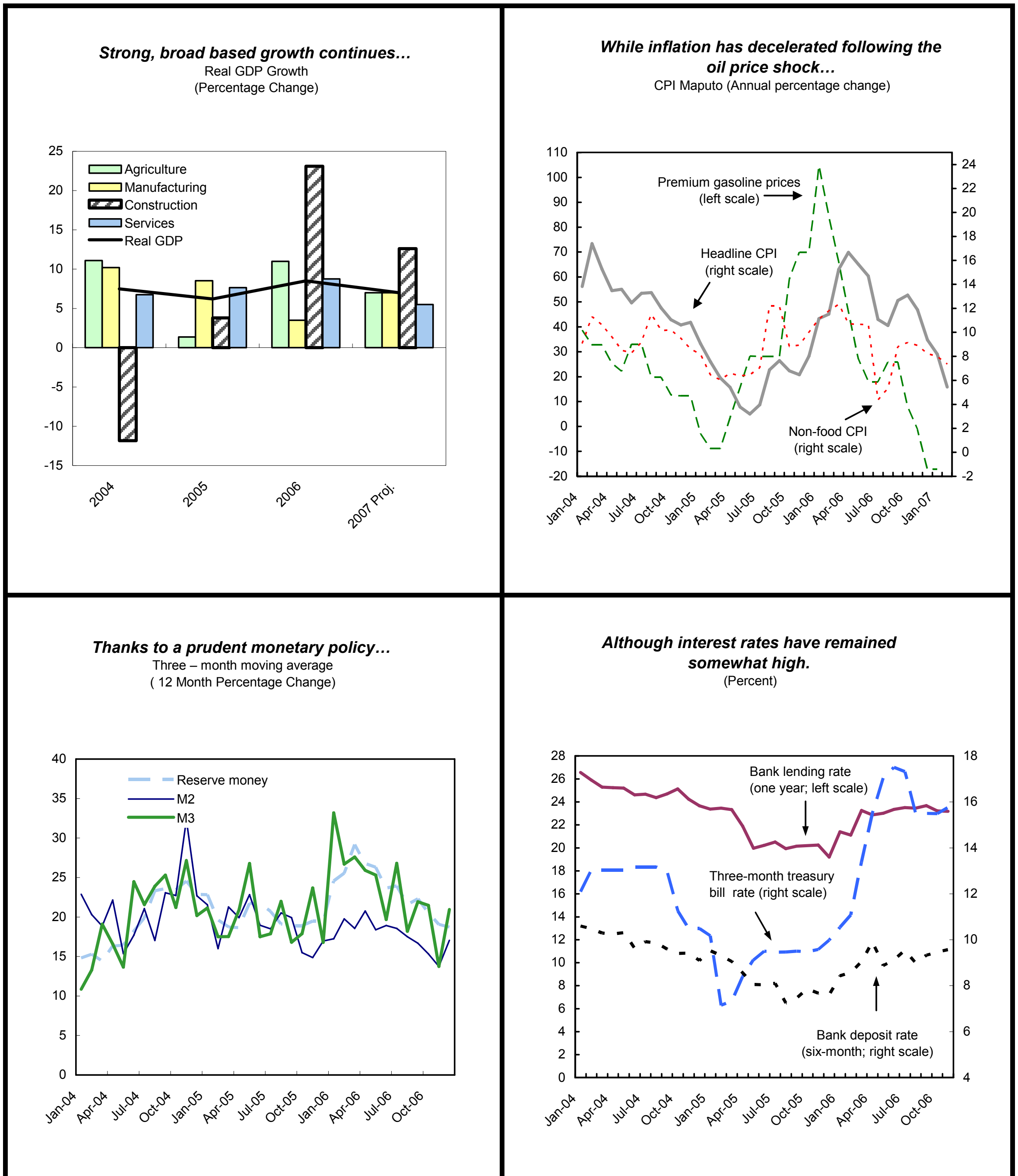
Source: Mozambican authorities; and IMF staff estimates and projections.

- *Real GDP growth accelerated to about 8 ½ percent in 2006*, led by a rebound in agricultural production after the localized drought of 2005 and by continued activity in the construction sector (related to megaprojects and donor-financed projects).[1]

- *Prudent monetary policy helped lower core (nonfood) inflation to single digits* in the second half of 2006, reversing a temporary rise after a spike in petroleum prices. Headline inflation declined to 4.9 percent in March 2007 after being above target at the end of year 2006 because of an unexpectedly large seasonal increase in food prices.

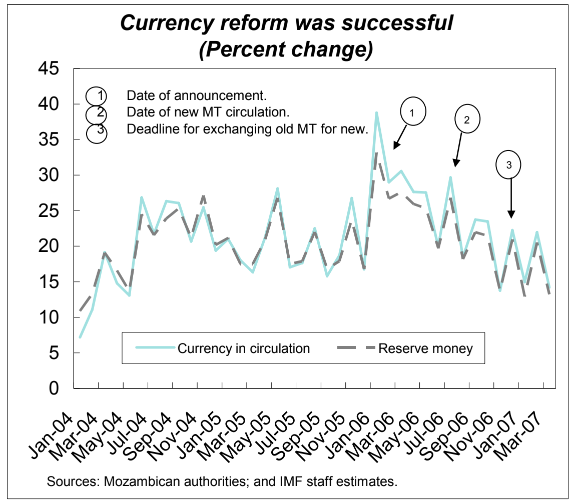
[1] Historical national accounts data will be revised and rebased to 2000 in the coming months.

Figure 1. Recent Economic Developments

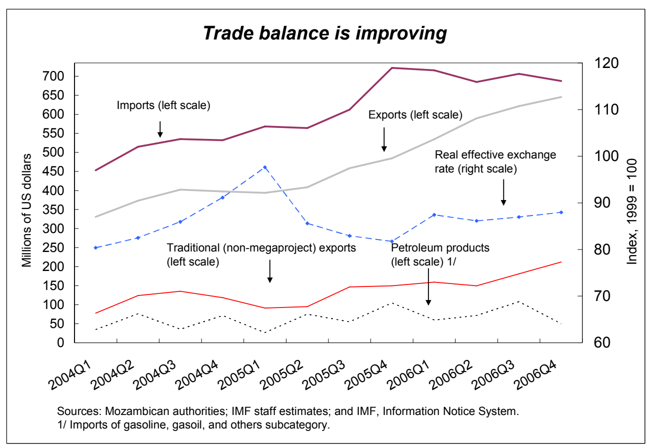


Sources: Mozambican authorities; and Fund staff estimates and projections.

- *The 2006 currency reform went smoothly.* The BM introduced new meticais (MT) on July 1, 2006 (1,000 old MTs equal one new one); about 95 percent of MT in circulation by the end of March 2007 were new. Because of volatility in currency demand around the deadline for exchanging old currency for new, base money was above the end-year 2006 target (a performance criterion), though it fell below by January 2007 and was within the indicative target for March 2007.

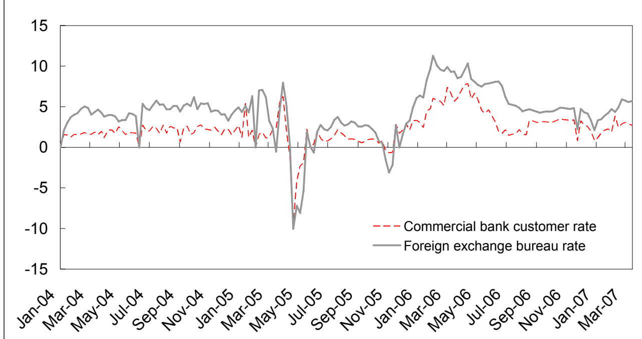


- *The trade balance has gradually improved despite the oil price shock.* With prices for commodities (particularly aluminum) booming, megaproject exports have surged over the past two years; nonmegaproject exports (cashews, sugar, and seafood) also rebounded after the 2005 drought and the MT appreciation of 2004 began reversing. Strong exports, along with sustained foreign aid inflows, helped keep net international reserves (NIR) at a comfortable level (about US$ 165 million higher than programmed at the end of 2006).



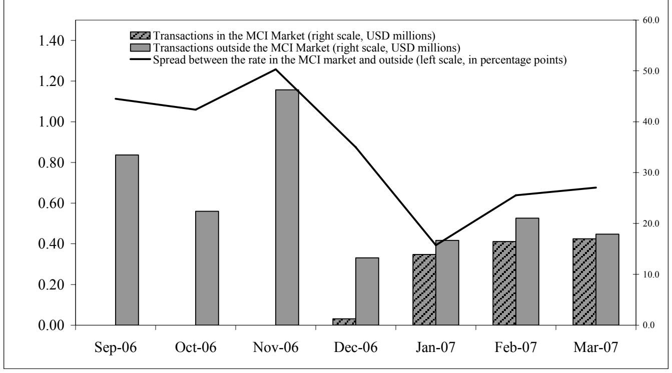
- *The foreign exchange market has stabilized.* Mozambique experienced bouts of rapid exchange rate depreciation after January 2005, when it moved to a more flexible exchange rate regime by introducing foreign exchange auctions. The volatility appears to have stemmed in part from correction of a somewhat overvalued exchange rate at the end of 2004, lumpy oil import transactions, and portfolio shifts in the shallow foreign exchange market. In response the BM introduced a temporary band in both the foreign exchange auctions and interbank market (MCI) in November 2005. Initially, the band in the auction market led to widening of the premium between the auction rate and the rate banks charged customers and foreign exchange bureaus. The band in the MCI market also discouraged transactions between banks at quoted rates, although such transactions continued outside the MCI market. However, as the BM gradually widened the bands in both the auction and MCI markets, the spread between the auction rate and rates for bank customers and bureaus fell to pre-band levels. Transactions in the MCI market also increased as onscreen quotations by banks were able to move closer to the rate outside the MCI market. The deepening of the MCI market was supported by a code of conduct among banks and measures to facilitate firm quotations.

Exchange rate spreads are narrowing
Premium on Auction Rate (Percent; on a weekly basis)

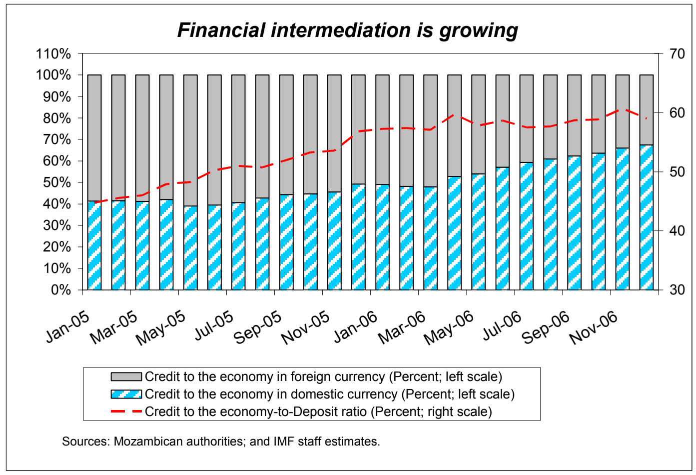


Source: Mozambican authorities.

The widening of the band in the MCI market has activated transactions and reduced the spread between the MCI rate and transaction rate outside the MCI



- *The financial system has deepened since the banking system was restructured.* Sound financial policies and cleaned-up balance sheets, especially at the largest bank, have restored confidence in the banking sector, prompting broad money growth to outpace nominal GDP growth (Table 3) and credit to the private sector to almost double in just two years. These developments reflect structural factors associated with banks again taking on consumer credit (e.g., credit cards and loans to purchase durable goods) and lending for industrial activities, as well as borrowing by domestic petroleum distributors related to the syndication of larger oil import transactions. Lending to the agriculture and rural sector, however, remains minimal. According to a prudential measure introduced in July 2005, banks must provision 50 percent of foreign currency-denominated loans to nonexporters. This has led to a substitution from foreign currency to domestic currency lending partly because of an increase in interest rates on foreign-currency borrowing relative to domestic currency lending. Importantly, this measure has reduced banks' exposure to unhedged borrowers and does not seem to have hampered financial intermediation as indicated by a steadily rising credit-to-deposit ratio.



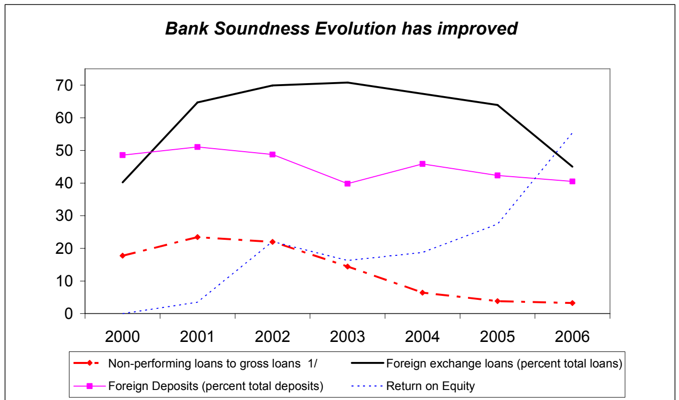
Credit to the Economy has nearly doubled in two years

Sectoral Contribution to Credit Growth 1/ , 2005-6

	Dec.2005	Dec.2006
Economic Activity	In percent of total credit growth	
Agriculture	9.8	-0.4
Industry	2.4	42.1
of which :		
Extractive Industry	-0.9	19.8
Manufacturing Industry	-2.2	13.7
Construction	5.2	11.6
Commerce 2/	42.2	27.5
Transport and Communications	5.1	7.4
Other	35.3	11.7
of which :		
Monetary and Financial Institutions	2.3	-3.6
Private 3/	14.6	15.6
Housing	-2.7	3.4
Diverse 4/	21.2	-3.6
Total	100	100
Memorandum Items :		
Credit Growth- Monthly Credit Survey	56.6	25.0
Credit Growth -Monetary Survey	57.0	29.2

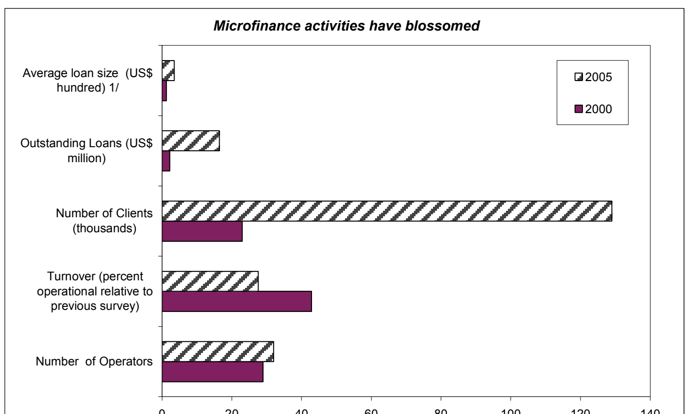
Source : Bank of Mozambique - Monthly Credit survey.
1/ Total and sectoral growth on a 12-month basis and derived from BM's Monthly Credit Survey. This survey covers only a sample of the universe of financial institutions covered in BM's monetary survey.
2/ Includes all loans to finance domestic and foreign trade activities such as oil and food imports.
3/ Includes credit cards and consumer credit lines for vehicle and durable goods
4/ Non-classified activities

- *The soundness of Mozambique financial system has continued to improve.* Bank profitability was particularly good in 2006. Nonperforming loans (NPL) have also fallen to less than 5 percent of all loans according to Mozambican accounting standards (Table 6). Banks have also become more efficient. In particular, noninterest expenses to gross income, and to a lesser extent personal expenses to noninterest expenses, have been declining since 2004. Greater confidence in the banking system has also led to a significant decrease in liability dollarization and thus less financial vulnerability. On the other hand, while capital adequacy ratios are still above the minimum, they have continued to decline as a result of increased lending—the credit boom needs close monitoring. Recapitalization of the Bank of Mozambique is on schedule; the first and second tranche of government securities, each amounting to MT 1.5 million, were issued in June 2005 and June 2006. The last is expected to be issued in June 2007.



Source: Bank of Mozambique.
1/ Non- performing loans are defined according to Mozambican accounting standards (they include only part of the past due loans).

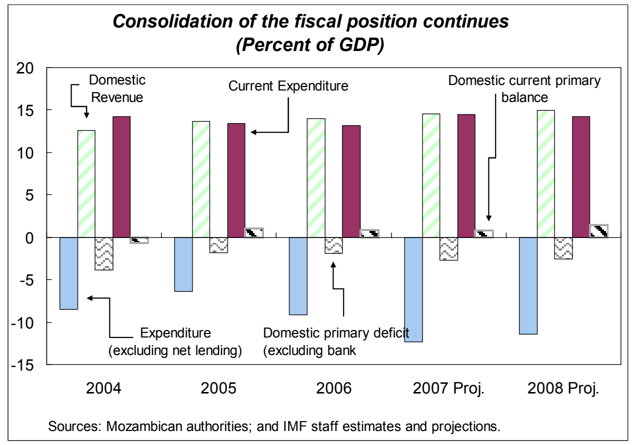
- *Microfinance institutions (MFI) have grown significantly in the last decade.* Between 2000 and 2005 there was about a five-fold increase in the number of clients and a seven-fold increase in outstanding loans. Consolidation also seems to be underway: 3 institutions out of about 35 control more than 68 percent of the active loan portfolio. However, MFI outreach is very limited. Rural areas account for less than 12 percent of total borrowers. However, growth has been accompanied by a substantial improvement in performance. The percentage of MFI with recovery rates considered acceptable (90 percent or above) increased from 16 percent in 1997 to about 30 percent in 2005.



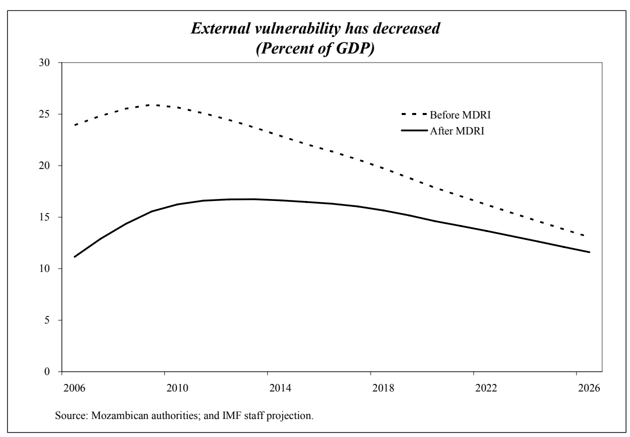
Source : Mozambique Microfinance Facility, Survey of Microfinance Operators.

- *The fiscal position is more sustainable because of higher revenues and current spending restraint (Table 2).*

Revenue collections in 2006—which were nearly 1½ percent of GDP higher than in 2004—were led by buoyant corporate tax collections (including arrears) and nontax revenues related to the boom in commodity prices. Domestic-related expenditures, which in 2005 were far lower than expected because of late budget approval after the December 2004 elections, also picked up in 2006. At the same time, the composition of spending improved, supported by donor-financed projects. The share of priority expenditures consistently exceeded the 65 percent PARPA target (Table 5). Thanks to these trends, and restraint on current spending, the domestic current primary balance has improved. The unexpectedly high external program aid in 2006 also meant that net credit to the government from the banking system (NCG) declined more than expected.

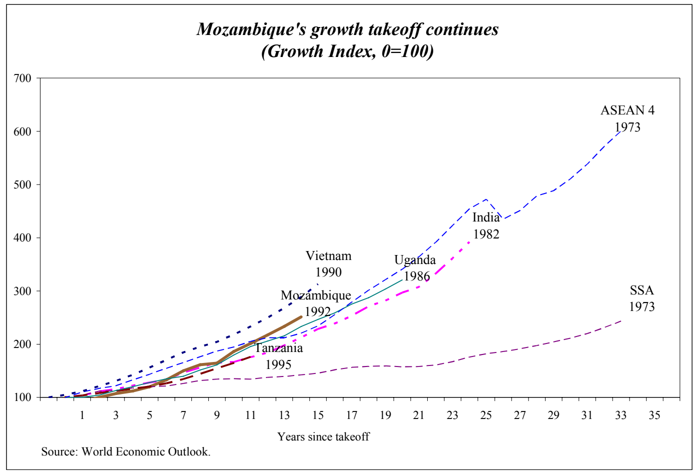


- *MDRI aid delivery has decreased external vulnerabilities,* though megaproject-related transactions will require vigilance. As a result of MDRI, the net present value of public external debt was halved (from about 22 percent to about 12 percent of GDP), slightly more than previously estimated. An agreement signed in October 2006 will transfer majority ownership of the Cahora Bassa hydropower plant from Portugal to Mozambique. The authorities are committed to financing large infrastructure projects in the pipeline, including Cahora Bassa, through nonrecourse financing and private participation to unlock Mozambique's growth potential while keeping debt sustainable (MEFP ¶35).



II. Policy Challenges and Lessons from the PRGF-Supported Program

2. **Sustaining Mozambique's impressive growth takeoff is crucial to further reducing poverty.** Since the end of its civil war in 1992, Mozambique has grown 8 percent a year, on average; it reduced its poverty headcount index from 69 percent in 1997 to 54 percent in 2003. Poverty levels declined more in rural areas than in urban ones, making Mozambique the second country in the world (other than Vietnam) to see such reductions. However, now that the post-stabilization rebound has largely run its course and first- generation reforms are completed, a lot more also needs to be done to address the large human capital and infrastructure gaps. The aim of achieving nonincome-related MDGs in areas like primary school completion, gender equality, and HIV/AIDS require a scaling up of basic services without undermining macroeconomic stability.



Selected Human Capital and Infrastructure Indicators	China	India	Mozambique	Uganda	South Africa	Vietnam	Tanzania	SSA	Asean 4
Human development index rank [1]	81.0	126.0	168.0	145.0	121.0	109.0	162.0	n.a.	82.0
Life expectancy at birth (total years) [2]	71.4	63.5	41.8	48.9	44.6	70.3	46.2	46.2	70.5
Adult literacy rate [2]	90.9	61.0	33.5	66.8	82.4	90.3	69.4	n.a.	77.3
Reduction of infant mortality from 1970 to 2004	59.0	65.4	63.6	19.8	n.a.	37.6	50.6	41.4	49.0
Infant mortality (per 1,000 live births) [2]	26.0	61.6	104.4	80.2	54.0	17.4	78.4	100.5	21.0
Poverty headcount ratio at national poverty line (% of population) [3]	17.0	28.6	54.0	33.8	n.a.	37.4	35.7	n.a.	32.0
Gini coefficient [2]	43.4	37.8	40.3	43.0	59.3	36.1	38.2	n.a.	42.9
GDP per capita (constant 2000 US$) [4]	1444.8	586.5	291.7	267.4	3534.6	539.0	329.9	559.7	2231.1
Primary completion rate, total (% of relevant age group) [2]	n.a.	83.6	29.0	61.1	95.6	100.8	55.6	61.1	96.5
Primary school enrolment ratio [2]	n.a.	89.7	71.0	n.a.	90.0	93.0	85.9	n.a.	89.3
Improved water source (% of population with access) [2]	77.0	86.0	43.0	60.0	88.0	85.0	62.0	56.2	90.0
Irrigated land (% of cropland) [2]	35.3	32.9	2.6	0.1	9.5	33.4	3.6	3.6	15.1
Mobile phone subscribers (per 1,000 people)	258.3	43.8	36.4	41.9	428.5	60.4	43.6	74.1	389.6
Electric power consumption (kWh per capita) [2]	1378.5	435.3	338.5	n.a.	4503.7	433.1	54.4	513.0	1456.7
HIV prevalance [4]	0.1	0.9	16.1	6.7	18.8	0.5	6.5	6.2	0.5

Source: Human Development Report 2006, UNDP; and World Development Indicators, World Bank.

[1] 2006 data.

[2] 2004 data.

[3] 2000 data except Mozambique (2002)

[4] 2005 data.

3. **The current PRGF program helped maintain macroeconomic stability in the face of exogenous shocks and addressed structural weaknesses identified in the Ex Post Assessment (EPA).** The request for the program targeted fiscal consolidation in the face of an expected decline in aid inflows after the aid surge and high inflation (2000–03) related to the flooding in 2000. Fiscal consolidation limited recourse to monetary financing and helped reduce inflation to single-digit levels, relieving pressure on domestic interest rates. The improved structural program performance since March 2005 has also helped the authorities complete outstanding first-generation reforms identified in the EPA—particularly in strengthening revenue mobilization by creating a central revenue authority (ATM), improving expenditure efficiency through the rollout of a government financial management information system (e-SISTAFE), and addressing vulnerabilities in the financial system.

4. **Performance under the PRGF program was satisfactory in 2006**. All quantitative and structural performance criteria from September 2006 through March 2007 were met except one: base money was above target at end-year 2006 (MEFP Table 1 and 2). A waiver for the missed performance criterion is justified as it was temporary and related to the currency reform. The indicative target on utilization of the Moatize coal mine deposit was also missed due to higher spending on the construction of a bridge over the Zambezi. Three out of four structural benchmarks were met for the final review; the benchmark related to the treasury single account (CUT) has been delayed to the end of September 2007 due to capacity constraints.

5. **While reiterating the commitment to improving the quality of and access to public services, the government's PARPA II (2006–09) recognizes that to sustain growth, more emphasis must be placed on productivity growth and a greater role for the private sector.** This is to be achieved by:

- consolidating macroeconomic stability and maintaining competitiveness through prudent monetary and fiscal policies in the context of a flexible exchange rate regime;
- improving the investment climate and promoting employment generation by reducing the cost of doing business; and
- improving governance and the management of natural resources.

6. **These near- and medium-term challenges are addressed in a three-year PSI designed to consolidate macroeconomic stability and sustain rapid economic growth.** Given its economic stability, comfortable level of international reserves, policy performance, and lack of need for balance of payments support, Mozambique is well-placed to graduate to a PSI when its current PRGF arrangement expires in July 2007. The government favors such an arrangement to monitor its ambitious reform program and send a signal to donors of its commitments. The authorities have asked that the PSI proposal be presented to the Executive Board before the current arrangement expires to avoid a vacuum between the two programs.

This approach has been closely coordinated with the World Bank's new Country Partnership Strategy (2007–11) and the joint Performance Assessment Framework (PAF) of the government and donor community.

7. **Recent refinements to the design of the PRGF program should allow for a smooth transition to a PSI.** The streamlining of quantitative performance criteria and adjusters at the completion of the fourth review seems to have helped focus the quantitative program, particularly in accommodating both spending and absorption of foreign aid as needed.[2] The replacement of the domestic primary deficit by an asymmetric ceiling on NCG with regard to external financing and the removal of the indicative target on the wage bill were particularly useful in reinforcing the management of foreign aid once it became clear that the decline in aid in 2004–05 would be reversed. Further streamlining of structural conditionality and strengthening of the interministerial committee monitoring the program have helped build ownership and allow for regular updating of reform priorities. The likelihood of a further scaling up of foreign aid and strong program performance over the last three reviews points to a continuation of the present program design under the proposed PSI.

8. **Close collaboration between the partners and targeted capacity building will need to continue to facilitate the realization of the reform agenda.** The World Bank and the Fund have worked together very closely on, among other projects, the Poverty Reduction Support Credit and PRGF program content, the Cahora Bassa hydropower project, and reform of the fiscal code governing mineral resources. The practice of holding joint Bank-Fund missions has had synergistic benefits and has also reduced the burden on the government of preparing for multiple missions. The authorities have welcomed the close coordination between the Bank, the Fund, and the donor community in Maputo. Continuous Fund technical assistance, provided in close coordination with donors (for example, in the area of tax reform), has helped build administrative capacity to take the reform process forward. More recently, PFM reforms, an area where past performance was poor, are progressing well. These reforms were initiated with substantial Fund technical assistance on the ground; this has evolved to a more advisory role, and the medium-term PFM reform plan is being financed by a multidonor common fund. This highlights how intensive and well-coordinated technical assistance can catalyze progress in the early stages of a major reform that through time can help build ownership and sustain the reform momentum.

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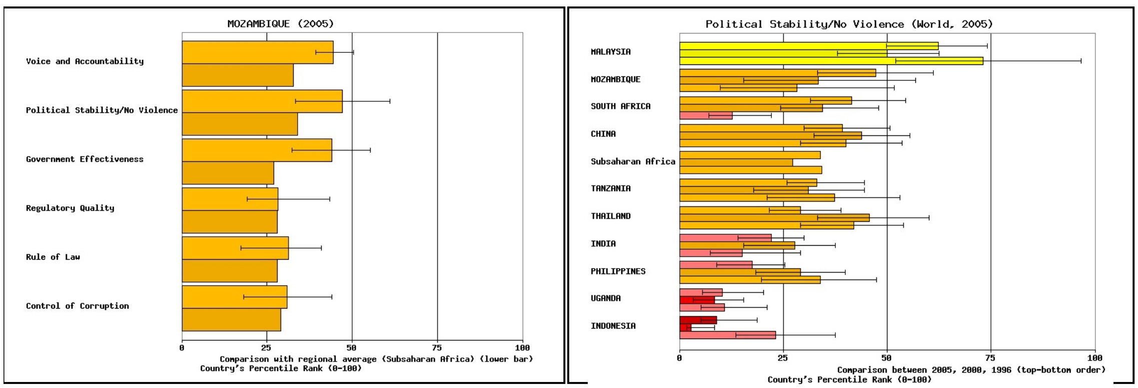
[2] Aid absorption is defined as the extent to which a country's nonaid current account deficit (in foreign currency terms) widens in response to an increase in aid inflows.

III. Article IV Policy Challenges

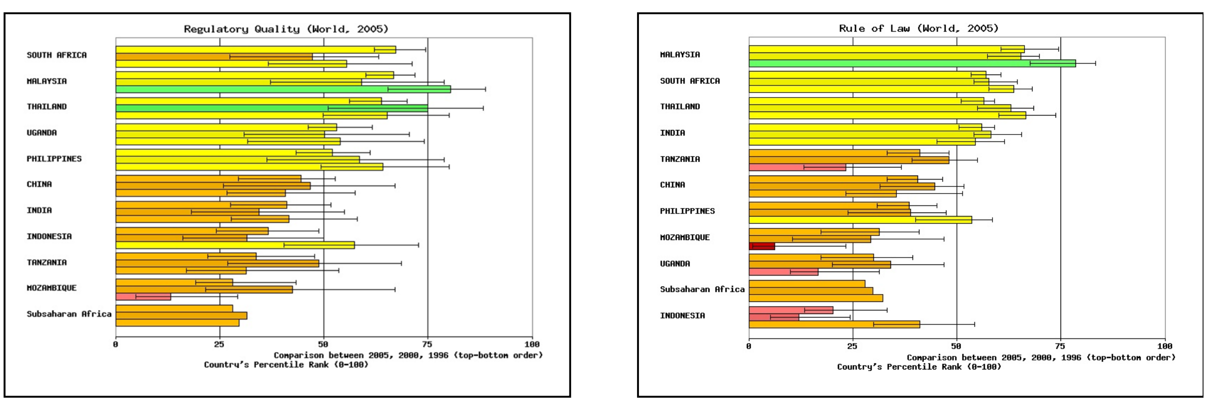
9. **The main theme of the Article IV discussions was consolidating macroeconomic stability and accelerating the second wave of reforms in PARPA II to sustain broad-based growth and further reduce poverty.** The mission discussed the results of a benchmarking exercise comparing the characteristics of fast-growing Asian and sub-Saharan African (SSA) countries with that of Mozambique to identify potential constraints on rapid growth. As the exercise shows, Mozambique is well placed to sustain its growth takeoff given its sound political institutions, geography (coastal and close to South Africa), and relative equality. On the other hand, regulatory quality and enforcement of the law are institutional weaknesses that may be detrimental to sustaining Mozambique's growth takeoff.

Political institutions are relatively sound



Source: Kaufmann, Kraay, and Mastruzzi (2006).
Note: Percentile rank indicates the percentage of countries worldwide that rate below selected country subject to a margin of error. The statistically likely range of the indicator is shown as a thin black line.

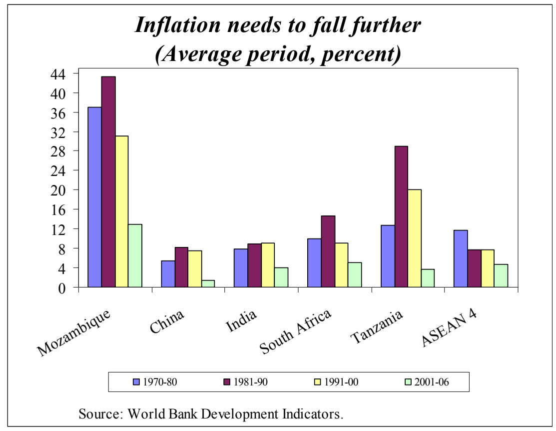
Although a number of institutional weaknesses remain



Source: Kaufmann, Kraay, and Mastruzzi (2006).
Note: Percentile rank indicates the percentage of countries worldwide that rate below selected country subject to a margin of error. The statistically likely range of the indicator is shown as a thin black line.

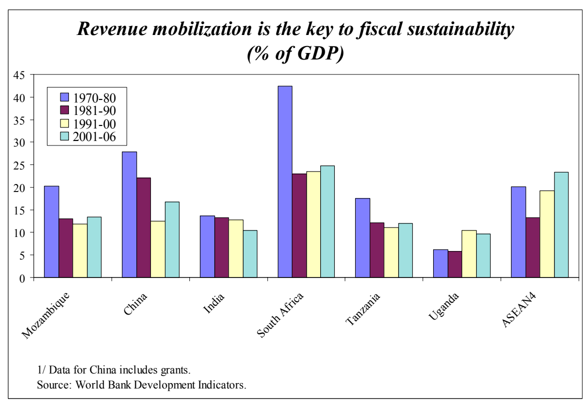
10. **The major challenges now are to:**

- *Consolidate macroeconomic stability.* Inflation is still higher in Mozambique than in ASEAN-4 countries and in South Africa, its main trading partner. To avoid stymieing growth it must also guard again real exchange rate misalignments. The authorities described the PARPA II three-pronged approach to macroeconomic stability:



  - *Priority spending.* Continue to monitor the additional priority spending, including MDRI resources, by strengthening PFM systems while embarking on a public sector reform program to improve efficiency and public service delivery.

  - *Increased revenues.* Given the low tax-to-GDP ratio and the need to guard against aid volatility and gradually reduce dependence on donors, target (through the medium-term fiscal framework CFMP), an annual average revenue increase of 0.5 percent of GDP, to be achieved by broadening the tax base and improving revenue administration.[3]



  - *Monetary and exchange rate policy framework.* Keep inflation in the single digits through monetary control and pursue greater exchange rate flexibility to cushion against exogenous shocks and maintain adequate reserves.

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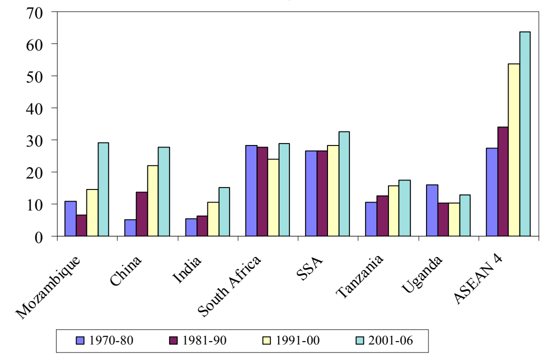
[3] The CFMP does not envisage significant revenues from megaprojects and natural resources more generally.

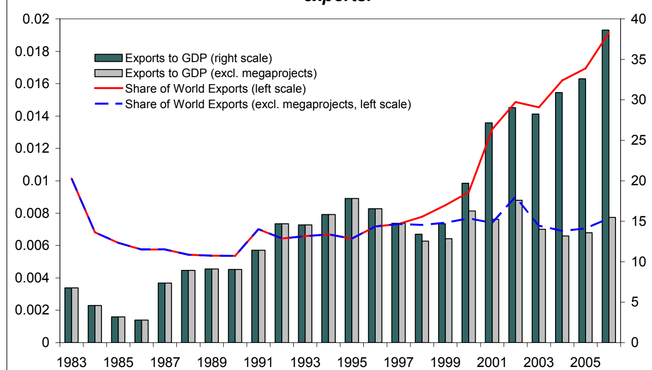
- *Reduce the costs of doing business.* Export levels for Mozambique, as elsewhere in SSA, are comparable to the ASEAN-4 during their initial growth takeoff. Its share of world trade has been expanding but is attributable to only a few sectors (Box 1). Mozambique's exports are dominated by capital-intensive megaprojects;[4] sustained growth tends to be associated with considerable manufacturing exports. The authorities agreed that the lack of manufacturing exports may partly reflect the wide gap in competitiveness between Mozambique and the ASEAN-4 and regional competitors, as measured by the World Bank's *Doing Business* indicators. Therefore, lowering the costs of doing business must be at the core of the authorities' strategy to promote export diversification. Priorities are to improve access to finance, build a manufacturing base, and generate jobs by fostering small- and medium-sized enterprises (SMEs).

Export growth needs to be sustained...
(Percent of GDP)



Source: World Bank Development Indicators.

...Through greater diversification of non-megaprojects exports.



Source: IMF staff estimates and projections.

> ➢ Business surveys in 2002 and 2006 found the high cost of credit to be the most binding constraint to business; more than 70 percent of firms surveyed said they lacked access to bank loan or overdraft facilities. Access to credit is a particular problem in the agriculture sector, which is dominated by poor farmers who lack collateral.

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[4] Total employment by Megaprojects in 2010, excluding the construction phase work, will be about 9,000 full-time positions or under 2 percent of urban private sector employment.

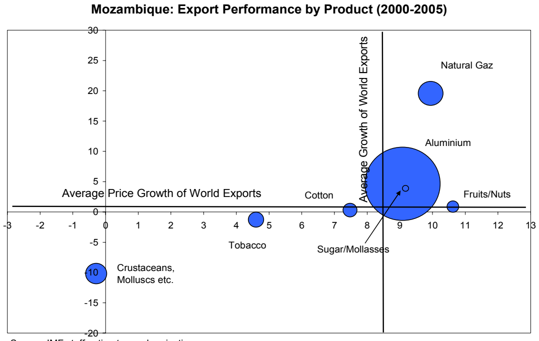
Box 1. Mozambique's Competitiveness

Although Mozambique's share of world exports has increased in the past decade, this is due to the increase in megaproject exports. Excluding megaprojects, its export-to-GDP ratio and its share of world trade have been relatively stable for the past decade and the contribution of non-megaproject exports to economic growth has been subdued. Because of the limited linkages between megaprojects and the economy as a whole, and their susceptibility to swings in commodity prices, there is a need to raise the contribution of non-megaproject exports. This is particularly true for manufacturing exports, which are often thought to be the engine of export-led productivity growth.

The real effective exchange rate (REER) has been relatively stable for a decade, although there are signs that it may currently be somewhat overvalued. Estimates of the fundamental equilibrium exchange rate (FEER) model for Mozambique suggest that the REER has appreciated in response to improved terms of trade and productivity and to increases in government consumption, investment, and foreign direct investment, and it has depreciated in response to increasing openness. Thus, although the evolution of the REER does not indicate that Mozambique is becoming less competitive**,** econometric results suggest that the REER may be overvalued by about 10 percent, though with some statistical uncertainty about the precise magnitude. As a result, export performance may be weaker than it could have been if the REER had been aligned with its underlying equilibrium rate.

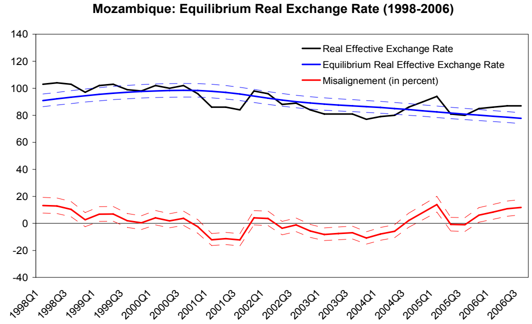
Diversifying exports into products that are dynamic in the global market place should be part of Mozambique's strategy to raise the contribution of the nonmegaproject export sector. Nonmegaproject exports tend to be concentrated in products that have had below average growth in world markets. This, together with relatively low price increases, suggests declining demand for these products. Megaproject exports are concentrated in products for which world demand is increasing, though commodity prices are volatile. Overall, to help sustain economic growth, there is a need to rebalance export growth toward non-megaproject exports by diversifying into labor-intensive sectors, in particular manufacturing exports.

Mozambique: Export Performance by Product (2000-2005)



Source: IMF staff estimates and projections.

Mozambique: Equilibrium Real Exchange Rate (1998-2006)



Source: IMF staff estimates and projections.

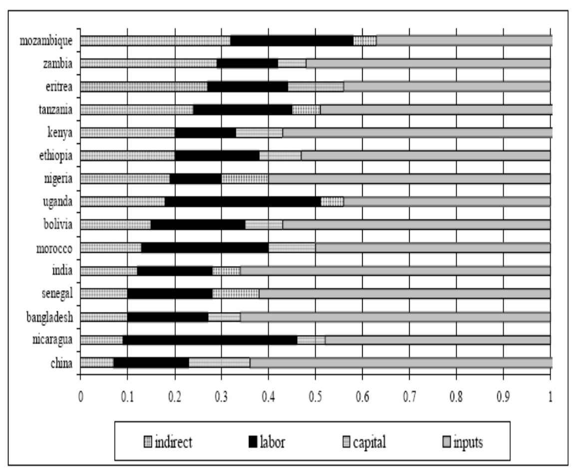
Developments in Perceived Constraints

	2002 Survey			2006 Survey			Changes	
	Mean 1/	Major/Severe obstacle (percent)	Rank	Mean 1/	Major/Severe obstacle (percent)	Rank	Means	Rank
Cost of credit	3.28	84	1	3.00	72	1	-0.28	0
Access to domestic credit	3.08	75	2	2.42	58	3	-0.66	1
Access to foreign credit	2.93	73	3	1.55	38	9	-1.38	6
Electricity	2.65	64	4	2.06	46	6	-0.59	2
General corruption	2.76	64	5	2.11	46	7	-0.65	2
Macroeconomic instability	2.75	63	6	2.65	63	2	-0.1	-4
Anti-competitive practices	2.59	60	7	1.45	32	14	-1.14	7
Unpredictability of policies	2.58	58	8	2.03	44	8	-0.55	0
Tax rates	2.45	55	9	2.15	50	4	-0.3	-5
Crime, theft and disorder	2.47	54	10	1.79	35	11	-0.68	1
Customs	2.11	49	11	1.70	38	10	-0.41	-1
Tax administration	2.19	48	12	1.74	35	12	-0.45	0
Labor Regulations	1.80	38	13	2.07	48	5	0.27	-8
Skills/education of workers	1.79	34	14	1.68	35	13	-0.11	-1
Business registration	1.44	28	15	0.86	10	18	-0.58	3
Transportation	1.43	27	16	1.44	26	15	0.01	-1
Access to land	1.24	27	17	0.82	18	16	-0.42	-1
Telecommunications	1.28	20	18	0.76	14	17	-0.52	-1

Souces: Ministry of Planning and Development , Government of Mozambique (MPD), National Directorate of Studies and Policy Analysis
Note : Average across firms of judgements on how constraining listed factors are for the operation and growth of their business. Where 0 = no obstacle, 1 = slight, 2 = moderate, 3 = major and 4 = serious obstacle).

- Improving competitiveness is key to uncapping Mozambique's export potential (Box 1). The limited number of skilled workers and labor market rigidities explain both relatively high labor costs and low productivity in manufacturing. High indirect costs and loss of output because of inadequate infrastructure and burdensome regulation also impede manufacturer and SME growth. Further trade reform would also reduce the cost of imported inputs because Mozambique's export-tax equivalents of tariff barriers may still be relatively high.[5]

Labor and indirect costs are high in Mozambique



Sources: Eifert, Benn, Alan Gelb, and Vijaya Ramachandran, 2005

- *Better manage natural resources.* Mozambique has proven resources of coal, hydropower potential, gas, titanium, and oil, but countries with abundant natural resources have seldom attained sustained growth.[6] To avoid the "resource curse" that

[5] Trade liberalization could also promote competition in the domestic economy and improve institutional quality.

[6] In this regard, Botswana and Chile's experience is more encouraging, although their initial economic institutions were probably stronger than Mozambique's.

has plagued much of SSA, Mozambique needs (i) an efficient tax and regulatory regime to attract investment while maximizing benefits to the economy; and (ii) more transparent management of resource revenue.

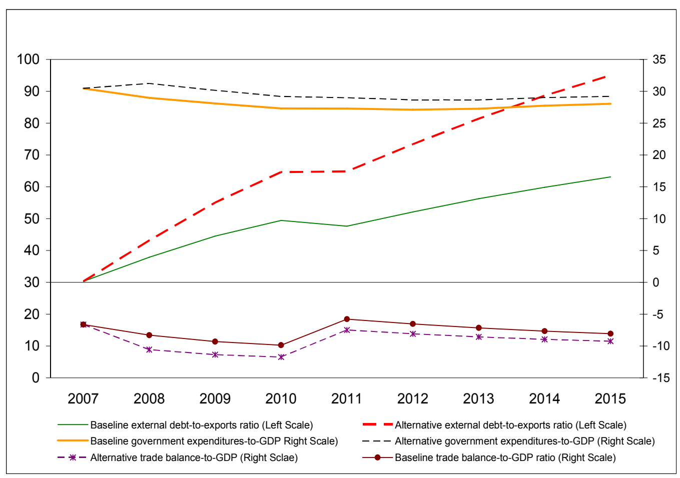
IV. The PSI: Addressing Medium-Term Challenges 2007–10

A. Medium-Term Outlook

11. **The baseline medium-term macroeconomic framework, which assumes that macroeconomic stability will be consolidated and the second-wave reforms in PARPA II accelerated, envisages real GDP growth of about 7–8 percent a year (Table 1).**[7] This means persevering with stabilization efforts with the CFMP largely unchanged, particularly a 0.5 percent of GDP annual increase in revenues and moderating current expenditures related to efficiency gains from the public sector reform program (MEFP ¶¶ 16 and 17). This would allow private sector credit to expand further while maintaining competitiveness through a flexible exchange rate regime. Monetary control will target inflation of 5–6 percent. The impact of recent floods and cyclone has been localized, and should not unduly affect the near-to-medium term outlook. The external current account deficit will continue to be largely financed by scaled-up concessional foreign aid; a comfortable level of international reserves will help cushion against exogenous shocks.

12. **Managing scaled-up aid will be a challenge.** Donors have indicated foreign aid may be scaled up by about US$200 million (2 percent of Mozambique's 2008 GDP) over the medium term. The mission therefore discussed an alternative scenario to identify challenges in spending and absorbing additional external borrowing. The authorities agreed that unless all spending is on imports (as has not previously been the case), the higher demand for domestic goods will tend to appreciate the real exchange rate and thus discourage the expansion of exports to widen the trade deficit and absorb aid. Thus harm may be done to

Debt remains below the DSA threshold under the alternative scaling-up borrowing scenario, although the absorption of the additional foreign aid may require a real exchange rate appreciation



[7] The Joint Staff Advisory Note (IMF Country Report No. 07/38) summarizes the pillars of the PARPA II (IMF Country Report No. 07/37) and staff advice on priorities for strengthening PARPA II and ensuring that it is effectively implemented.

long-term growth. The mission emphasized that the additional spending must effectively reach the most economically and socially productive priority sectors (e.g., infrastructure, education, and health) to elicit a supply response and mitigate any Dutch disease effects.[8] The fiscal framework will also need to rely more on revenue mobilization as an exit strategy from aid dependence in the long-run and to ensure that at least recurrent spending can be financed from own resources.

13. **Megaprojects are expected to make a growing contribution to poverty reduction and fiscal sustainability.** Natural resource–based megaprojects can help reduce poverty indirectly by bringing in more revenue and linking to the economy.[9] Beyond the PARPA II period, strong growth and increased fiscal revenues from megaprojects—such as the multibillion-dollar Moatize coal mine and the Pande-Temane gas project (still in its cost recovery phase)—would help Mozambique gradually decrease its dependence on donors.[10]

14. **The medium-term structural reform agenda is designed to** (i) reinforce fiscal policy to manage scaled-up foreign aid; (ii) refine monetary and exchange rate policy; (iii) enhance the business environment; and (iv) improve natural resource management (MEFP ¶17). The proposed PSI, drawn up in close collaboration with the World Bank and other donors, will support these priorities. The main risks to the medium-term program are inclement weather, too hasty decentralization, and poor fiscal performance in the run-up to elections.

B. Strengthening Fiscal Policy and Institutions

15. Total domestic revenue is envisaged to rise 0.5 percent of GDP by (i) increasing the number of taxpayers and audits to broaden the tax base; (ii) strengthening border control and limiting unwarranted customs exemptions; (iii) collecting tax arrears amounting to about 0.3 percent of GDP; (iv) again updating the specific fuel tax rate quarterly and recovering the real reduction resulting from not indexing in 2005;[11] (iv) bringing in more nontax revenues based on buoyant commodity prices; and (v) continuing to improve tax administration in line with recent TA from the Fund (MEFP ¶22). Priority public investments will increase significantly (Table 6). Most of these expenditures will be financed by foreign grants and

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[8] Although the MDGs have not been fully costed in Mozambique, an accompanying Selected Issues paper discusses illustrative scaling-up scenarios to identify possible medium- to long-term macroeconomic outcomes, and measures and policies that would not only help absorb more aid but also ensure that it is used efficiently.

[9] Forward and backward input and output linkages can have an impact from related infrastructure developments and user fees from their use.

[10] Fiscal revenues from natural resource-based megaprojects could range between 2–3 percent of GDP.

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

accompanied by sufficient counterpart funds and current spending for maintenance. The wage bill is unchanged relative to the CFMP; about 10,000 teachers and 3,000 health workers are to be hired. Transfer payments in 2007 are higher as spending is gradually decentralized, particularly through an increase in the investment budgets to each districts that began in 2006. If revenue falls short, the authorities have agreed to cut nonpriority expenditures to meet the NCG target. Overall, scaled up program aid will permit a higher domestic primary deficit with no recourse to domestic financing, which should bring a healthy increase in credit to the economy.

16. **The emergency response to the floods along the Zambezi river and Cyclone Favio is expected to be accommodated within the 2007 budget ceilings, with the assistance of the international community.**[12] The government drew up a reconstruction plan estimated at US$71 million and the UN Office for the Coordination of Humanitarian Affairs launched an emergency appeal for a further US$29 million to meet short- to medium-term needs of those affected. The government has asked the donor community to cover most of the cost of the reconstruction plan. However, if donor financing is inadequate, the government may consider using the program adjustor to accommodate emergency outlays (TMU, paragraph 18).

17. **Tax reforms are designed to improve tax system efficiency and achieve the medium-term revenue targets.** A comprehensive review undertaken by Fund TA found the tax system to be generally sound and appropriate for a low-income country like Mozambique, but it also identified a few tax policy measures that might compensate for the further reduction in external tariffs scheduled for 2008 and thus help meet the authorities' medium-term revenue targets. The government is thinking about including some of these measures in the 2008 budget (MEFP ¶21). An external audit of VAT refunds outstanding, including any arrears in payments to large infrastructure contractors, will also be completed in 2007 to address concerns of stakeholders about delayed payments while maintaining the integrity of the VAT system.[13] The next phase of revenue administration reforms (2007–10) are designed to establish the ATM as a sustainable, semi-autonomous institution and improve its operations. The phased integration of the core functions of both tax and customs administration in 2007 will be supported by putting into operation the strategic plan of the

[12] It is also expected that compensation to victims of the recent explosion of an ammunition store facility near Maputo can be accommodated within the 2007 budget ceilings.

[13] The government will set an arrears payment schedule, if needed, and ensure that the final contract price includes VAT on project supplies.

ATM, drawing up an IT plan to support the ATM, and setting up the tax tribunals (MEFP ¶22).

18. **The implementation of the medium-term PFM plan (2007–09) will help maintain macroeconomic stability by supporting the monitoring of priority expenditures.** A cornerstone of the PFM plan is the timely implementation of the e-SISTAFE Action Plan and Budget (APB) agreed with the donors and financed through a multi-donor common fund. Its main elements are rollout of the budget execution module to all central and provincial entities, and its customization for districts and municipalities; introduction of Phase II of the budget formulation module; and the design of new modules and functions. For 2007 (MEFP ¶23), the milestones are:

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

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

Source: Authorities' PFM APB (2006)

- Development of an integrated and e-SISTAFE–compatible payroll database—registry of state employees (CAF)—so that the Ministry of Finance can pay salaries via e-SISTAFE by the end of June 2007 (structural benchmark).

- Rollout of e-SISTAFE to all remaining ministries at the central and provincial levels listed in the TMU by end-December 2007 (structural benchmark).

- Increase the level of effective direct budget execution (according to the sequence of commitment, verification, and payment) for goods and services to 30 percent by the end of September 2007 and 50 percent by the end of December 2007 (structural assessment criterion); and

- Pilot test the multicurrency single treasury account (CUT) by the end of September 2007 (structural benchmark) with a goal of full production by January 2008 to facilitate inclusion of all donor-financed projects.[14]

19. **Reinvigoration of Phase II of the public sector reform program under the auspices of the new public service authority (ANFP) must be carefully sequenced to retain accountability and fiscal control.** The pillars of the program are (MEFP ¶40):

- *Civil service census.* Completion of the census of all civil servants in the second quarter of 2007 will produce a unique number of total civil servants as the basis for an integrated payroll database. It should identify "ghost" workers and help control the wage bill as more frontline sectors recruit teachers, nurses, etc.

- *Wage reform.* The government will identify reform options and set a timetable for improving incentive structures and performance by the end of June 2007; approval of a new wage policy is expected by the end of 2007, to be implemented in the 2009 budget (MEFP ¶40).

- *Decentralization.* The government should be very cautious about devolving resources to subnational levels through June 2008 until e-SISTAFE is rolled out at the local level and a decentralization strategy is approved (MEFP ¶40). The strategy should include, among other things, a clear legal, regulatory, and institutional framework for the revenue and spending responsibilities of subnational units (provinces, districts, and municipalities) and monitoring of subnational fiscal operations. This would help address concerns about the accountability and transparency of district spending.[15] The World Bank will take the lead on capacity-building assistance for local procurement reform and internal and external audit.

- *Anti-corruption strategy*. In 2006 five ministries drew up operational plans; their implementation will be closely monitored by the National Anti-Corruption Forum with broad stakeholder participation and leadership from the highest levels (MEFP ¶41). The Central Office for the Fight Against Corruption is also expected to improve on its performance of 2006 where of 271 cases, 9 were shelved, 4 sent to other institutions, and only 18 were prosecuted.

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

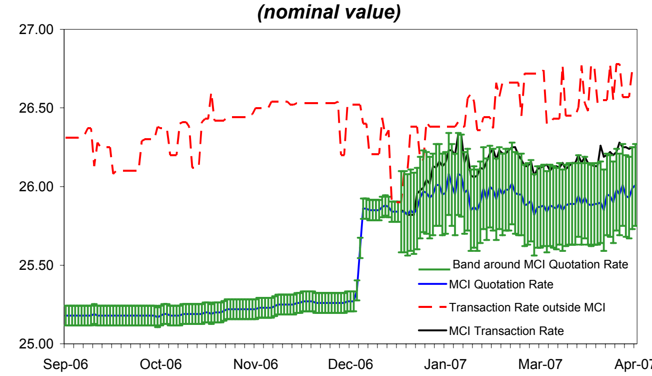
[15] This is particularly important to avoid politically motivated spending at times of elections.

C. Monetary and Exchange Rate Policy

20. **The monetary program will continue to target base money aimed at keeping inflation at 5–6 percent (Table 3).** Recent trends in monetary aggregates have helped anchor inflation expectations, keeping the monetary program largely unchanged for 2007. The impact of the recent flooding on food prices will need to be closely analyzed; no change in monetary targets is envisaged if core inflation remains subdued.[16] The mission supported the reduction in required bank reserves from 11.5 percent to 10.15 percent of deposits beginning in April 2007 because it may help reduce the spread between deposit and lending rates, which is high by regional standards. The BM will need to keep a close watch on the liquidity impact, however, and mop up any excess liquidity to meet the base money targets. In general, the BM though it would continue to rely mostly on foreign exchange sales to mop up structural excess liquidity and absorb foreign aid–financed expenditures, and issue treasury bills to smooth seasonal liquidity fluctuations.

21. **The BM also recognized that more exchange rate flexibility will support monetary targeting.** The mission noted that the emergence of a possible overvaluation at the end of 2005 (Box 1) coincided with the introduction of regulations limiting daily exchange rate movements and is consistent with evidence of depreciation pressure in the MCI market, where transactions are taking place at the upper end of the band. That suggests that removing these restrictions may help bring the REER back to equilibrium and improve competitiveness. The BM noted its intention to eliminate the temporary band in both the auction and MCI market, conditions permitting. Finally, to enhance the credibility of the BM and address its financial weaknesses, the BM and MF are to agree in a memorandum of understanding to shift the costs of sterilization to the budget.

Exchange rate depreciation pressures remain (nominal value)



Source: IMF staff estimates and projections.

22. **To avoid undue movements in both interest rates and the exchange rate, monetary and exchange rate policy operations must be fine-tuned.** Staff encouraged the BM to improve liquidity forecasts, introduce repurchase operations, and with the help of Fund TA stimulate secondary government securities markets. The mission also discussed the recent reforms to the MCI market, including the widening of the band in December 2006,

[16] Core inflation is not the official indicator that the BM follows, which remains to be headline inflation.

that seem to have activated interbank transactions based on firm quotations by narrowing the spread between the transaction rate among banks outside the market and the MCI mid-rate. The authorities also agreed to continue the present auction system until all price restrictions are lifted and the MCI is sufficiently liquid; the BM could then undertake foreign exchange sales for sterilization directly through the MCI market.

D. Strengthening the Business Environment

23. **To make Mozambique the most competitive economy in the South African Development Community (SADC) by 2015 and the region's location of choice for FDI, the authorities, with the assistance of the World Bank, have drawn up a strategic action plan to build the business environment** MEFP ¶32).

- *Financial sector strategy.* The mission, in close collaboration with the Financial Sector Technical Assistance Program (FSTAP), which is based on the FSAP recommendations, agreed with the BM on a three-year financial sector strategy to increase access to credit and lower financing costs.[17] The key elements are to (i) reinforce the BM's supervisory functions and make all banks compliant with international accounting, loan classification, and provisioning standards (MEFP ¶27); (ii) address structural impediments to lending, such as the cost of enforcing contracts, lack of collateral, and inadequate information on creditors (Figure 2); and (iii) support sound expansion of the nonbank sector, including *microfinance*, pension, and insurance institutions (MEFP ¶28).
- *Trade liberalization.* The mission welcomed the reduction in customs duties on consumer goods from 25 percent to 20 percent for all trading partners in January 2007; this extends the preferential access granted to SADC countries in 2006.[18] By observing the most favored nation (MFN) principle, Mozambique should minimize the possibility of welfare-reducing trade diversion as a result of its membership in a regional trade arrangement (RTA). The authorities were concerned by delays in moving forward with the SADC trade protocol among all members but reiterated its commitment to being a member of only one RTA. The mission encouraged the authorities to move towards further broad-based MFN trade liberalization while at the same time striving to make SADC less discriminatory to non-RTA members and to promote liberal rules of origin. However, as discussed in the Diagnostic Trade Integration Study, realizing Mozambique's full export potential and promoting export diversification will depend on reducing the cost of doing business.

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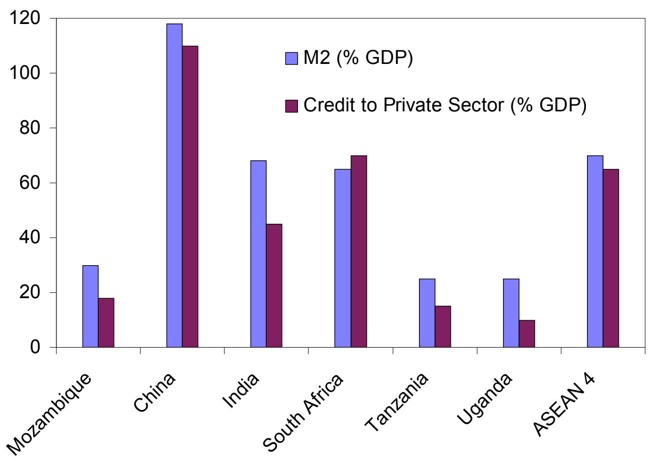
[17] An accompanying Selected Issues paper summarizes the forward-looking strategy, which benefited from an overlapping World Bank FSTAP mission. An FSAP update planned in FY 2008 will take stock of reforms and update the reform strategy.

[18] A Selected Issues paper addresses trade policy and market access issues facing Mozambique.

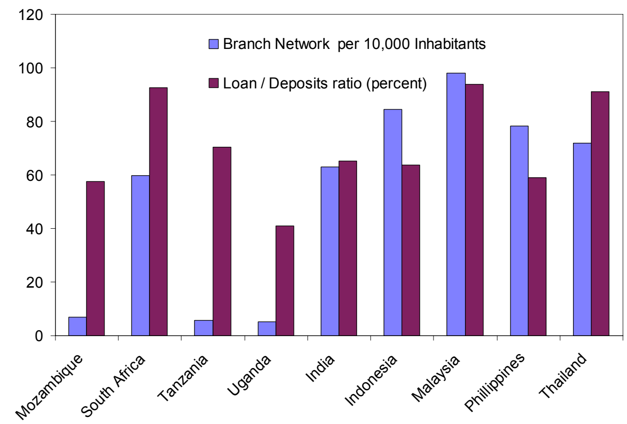
Figure 2. Financial Sector Challenges

The financial system remains shallow despite recent expansion...

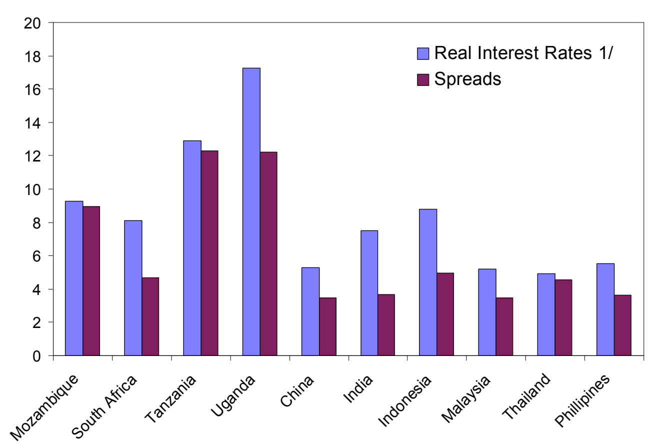
(Percent of GDP; 2006)



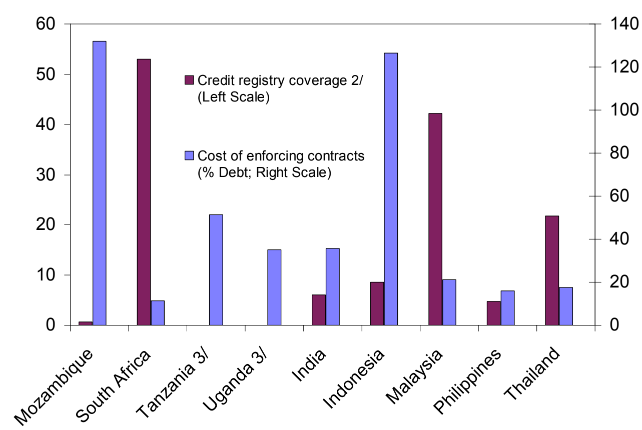
Access is relatively narrow due to low bank branch and MFI density...



The high cost of finance is explained by the large spread between deposit and lending rates...



Calling for a strategy to reduce credit risk, including by improving the institutional lending environment.



Sources: Mozambican authorities; and Fund staff estimates and projections.
1/ Real lending rate, in percent; per annum.
2/ Index of measures affecting scope, access and quality of credit information.
3/ Index was zero for those countries.

- *Reducing the costs of doing business.* The government action plan would accelerate business registration, reduce employment costs, simplify trade regulations, and reduce the time it takes to register property. Staff recognized recent progress in authorizing firms to publish their bylaws electronically and approval of a new labor law that significantly decreases the costs of hiring and firing workers but expressed concern about the substantial rise in fees charged for scanning freight in the Maputo harbor. Moreover, infrastructure services, which are partly in the hands of state-owned or public-participating institutions, are inadequate.[19] This calls for a clear diagnostic of who provides infrastructure and a coherent multisector strategy to address gaps, through such means as transparent sales of remaining public-participating enterprises and public-private partnerships PPPs).[20]

Action plan to to reduce the costs of doing business.

	2006	2007	2010	2012	2015
Ease of Doing Business (overall rank)	153	110	60	45	26
Starting a Business	139	70	45	35	25
Dealing with Licenses	103	70	45	28	15
Hiring and Firing Workers	157	70	60	47	40
Registering Property	105	95	65	40	23
Paying Taxes	80	70	55	36	14
Trading Across Borders	141	90	72	46	32
Closing businesses	126	110	60	50	35
Enforcing Contracts	168	130	70	45	28
Cost and quality of electricity					
Cost in Kwh (US Cents)	...	4	3	2	2
Number of power outages/month	60	50	40	28	12
Transportation cost (US $)					
Beira/Maputo 20 foot container (by land)	770	700	450	425	400
Value added per worker (US$)	1,000	1,500	2,000	2,500	3,000

Source : World Bank staff estimates

E. Management of Natural Resources

24. **The government is committed to following international best practices in the tax and transparency regime related to mining and petroleum resources** (MEFP ¶¶ 37 and 38).[21] Now that investors have more confidence in Mozambique, the authorities recognize that generous tax exemptions that limit the contribution of new projects in these sectors are not needed to attract quality investment. The Council of Ministers therefore approved a new mining fiscal law (structural PC for the end of December 2006) and a new petroleum fiscal

[19] Public-participating institutions are enterprises with some private equity participation.

[20] The restructuring of public-participating enterprises is not expected to result in the budget absorbing liabilities, although PPPs should be carefully managed to minimize fiscal risks by transparently reporting contingent liabilities or quasi-fiscal operations in budget documents. The authorities have requested TA from the Fund to improve the PPP regime.

[21] To date, the only major petroleum project operating in Mozambique is the Pande-Temane natural gas extraction project including a pipeline to South Africa. More recently, four international oil companies have been granted the right to start drilling for oil in the Rovuma Basin, and a multinational mining company announced that mining and heavy mineral concentrate production has started at its Moma Titanium Minerals Mine in the northern Mozambican province of Nampula.

law that reduces such exemptions, which were approved by the Assembly in May 2007.[22] Implementing regulations will be approved within 90 days. The Government will also adopt the new model contracts for mining concessions (structural assessment criterion for the end of June 2007), and exploration and production concession (EPC) contracts in the petroleum sector by the end of September 2007 (structural assessment criterion) to complement the new laws. In the interim, the government will ensure that any sizeable new mineral resource project or EPC contracts in the petroleum sector will adhere to the new fiscal regime. The government is also thinking about following the Extractive Industries Transparency Initiative (EITI) principles to improve transparency, revenue management, and governance in the mining and petroleum sectors, as well as to govern expansion of related megaprojects.

25. **The transfer of ownership of the Cahora Bassa dam to Mozambique will adhere to the principles agreed to in the PRGF-supported program (**MEFP ¶35). An immediate priority is to secure nonrecourse financing for the transfer of majority ownership of the hydropower plant through the dam operating company, Hidroelétrica de Cahora Bassa (HCB), so as not to increase the government's liabilities to commercial creditors. The government also reiterated its commitment to

- *Sustain transparency and accountability.* Besides transparency of both the process and the final financing package, authorities must ensure that HCB is (i) managed in a commercially efficient way; (ii) audited by external auditors; and (iii) subject to the regular concession and tax regimes.

- *Report on risk.* Authorities must identify and incorporate into the fiscal accounts and budget documents fiscal risks and any quasi-fiscal transactions.

F. Other Issues

26. **The risk of debt distress for Mozambique is low (Appendix II).** The joint Bank-Fund DSA shows that debt dynamics are sustainable under the baseline and stress tests, though susceptible to a ratcheting up of nonconcessional and concessional external borrowing. The authorities should therefore continue to rely as much as possible on concessional borrowing and grants; the scope for undertaking large infrastructure projects on commercial terms without jeopardizing debt sustainability is limited. Mozambique reached bilateral agreements in the context of the Heavily Indebted Poor Country Initiative with all Paris Club creditors except Portugal and Japan.[23] Despite Mozambique's best efforts, it has

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[22] The Fund and the World Bank have collaborated closely to assist the authorities strengthen the mining and petroleum fiscal regime.

[23] The authorities are making best efforts to reach agreements with Portugal and Japan in 2007.

been less successful in negotiating debt relief agreements with most of its non-Paris Club bilateral creditors. Of those that have not delivered debt relief, negotiations with Algeria, Libya, and Iraq are proving difficult. In this respect, the authorities look forward to continuing support from the Fund to reach an orderly and rapid rescheduling with these creditors. Mozambique is expected to benefit from a commercial debt buy-back operation in 2007 covering virtually all outstanding commercial debt in arrears (about US$175 million or 5 percent of total debt). A commitment to finance most of the operation has been secured from the Government of Norway and the World Bank. The Fund concludes that the authorities are making best efforts to conclude bilateral agreements with Japan, Portugal, and its non Paris Club creditors with whom they have not yet reached bilateral agreements. Further, the authorities are making good faith efforts to reach a collaborative agreement with their commercial creditors.

27. **Mozambique has built a consensus to move toward current account convertibility.** Although Mozambique has eliminated all Article XIV restrictions, it maintains restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII.[24] The authorities intend to address these restrictions at the time of approval of the new foreign exchange law, which was submitted to the Assembly in May 2007 with a slight delay, and the issuance of related regulations. Following the approval of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. The recent regulation pertaining to the import and export transactions (Aviso 2) remains suspended and will be replaced by the issuance of a new one.

28. **The statistical agency is revising its historical national accounts series**. It intends to launch a new national accounts framework, including revision of annual GDP data rebased to 2000 and dissemination of quarterly estimates, by the end of June 2007. TA in this area could seek to support the efforts of the statistical agencies to accelerate dissemination of final GDP estimates and improve the accuracy of national account aggregates, particularly in trade and agricultural production. With regard to monetary statistics the BM, which is committed to aligning its chart of accounts with the Monetary and Financial Statistics Manual, has requested TA from the Fund.

[24] The restrictions pertain to: (i) the discretionary prior approval for remittances of family living expenses, (ii) the authorization for the purchase of foreign exchange in excess of US$5,000 for certain transactions, (iii) the prohibition for the conversion of balances of nonresidents' domestic currency accounts into foreign currency or transfer abroad, (iv) the prohibition on advance payments for a service, and (v) the prohibition on advance payments for the import of goods.

V. PROGRAM MONITORING AND RISKS

29. **The first year of the new three-year PSI will be monitored through quantitative assessment criteria, quantitative indicative targets, and structural assessment criteria and benchmarks set in the MEFP, Tables 1 and 3.** Program conditionality is flexible, accommodating as needed both spending and absorption of foreign aid, as in the last two reviews of the PRGF-supported program. The performance criterion on the zero ceiling on nonconcessional external debt is relaxed slightly, to be consistent with the budget law that allows for accumulating a very small amount (US$2–3 million, less than 0.1 percent of total debt) of nonconcessional debt. This aligns the program with the authorities' own procedures and supports independent oversight of government borrowing. Any future non-concessional financing of large projects will need to be considered on a case-by-case basis based on their economic return, availability of concessional finance, debt management capacity, and impact on debt sustainability. Progress in finalizing the draft debt management strategy and building capacity at the MF debt management unit will be closely monitored. The government intends to continue using its current multidisciplinary committee to monitor the program, and the research department of the MF will gather information on megaprojects and state-owned and public-participating enterprises initiated early in 2007 (MEFP ¶39).

30. **With regard to risks, the staff notes that external shocks, fiscal slippages related to upcoming elections, large nonconcessional external borrowing, and a hasty implementation of fiscal decentralization,** could undermine the government's macroeconomic targets.

31. **While the BM is making progress in implementing recommendations of the safeguards assessment, weaknesses remain in financial reporting practices and the internal audit function.** The authorities are considering whether to request a voluntary safeguards assessment with respect to the proposed Policy Support Instrument. The new Anti-Money Laundering law was also approved by the Assembly in its current session, paving the way for the creation of a financial intelligence unit (MEFP ¶42).

VI. STAFF APPRAISAL

32. **The economy has been resilient to numerous exogenous shocks.** Real GDP growth has picked up in 2006 led by a recovery in agricultural production and constructions activities while the trade balance improved due to a surge in exports. The core and headline inflation rates have fallen to single digit levels anchored by a prudent monetary stance, although they were temporarily higher due to the evolution of food and domestic fuel prices. The outlook for 2007 is for continued strong growth, 5–7 percent inflation, and a sustainable fiscal and external position, though with some risks related to recent calamities and a further rise in oil prices.

33. **There are policy challenges related to sustaining Mozambique's growth takeoff and achieve the MDGs.** Impressive growth and foreign aid, including debt relief, helped reduce poverty and improve social indicators. This was supported by the PRGF program, which helped stabilize the economy in the face of exogenous shocks and monitored completion of a first wave of reforms. The experience of countries that have kept growth accelerating over the long run suggests a need to consolidate macroeconomic stability and implement second-generation reforms, including a scaling-up of basic services to address human capital and infrastructure gaps.

34. **The PSI is focused on consolidating macroeconomic stability as foreign aid is scaled up.** A major challenge is to firm up fiscal policy to finance additional priority spending sustainably and ensure that aid-financed spending reaches the most productive and propoor sectors. Emphasis should be given to collecting taxes and dividends from state shareholding, particularly of natural resources, and managing the fiscal risks of PPPs.

35. **Institutional and capacity building need to keep pace with the rapid structural transformation of the economy and facilitate the implementation of second-generation reforms.** The structural program aims at improving the business environment by deepening the financial system and reducing the cost of doing business. Adoption of new model contracts in the mining and petroleum sectors, and adherence to the principles of the new fiscal regime and EITI will be important to ensure a virtuous cycle of natural resource use. A better monitoring of megaprojects, and public and public-participating enterprises as well as concessions to the private sector is also essential.

36. **The 2007 fiscal framework includes scaled-up foreign aid to pursue the MDGs.** To maintain macroeconomic stability, a continued 0.5 percent of GDP rise in domestic revenue is targeted while the share of priority expenditures will exceed 65 percent of total spending. The rollout of e-SISTAFE to all public entities at the central and provincial level, and direct execution of a greater share of current spending should improve monitoring of expenditures. The finalization of guidelines to include donor-funded projects in the CUT and e-SISTAFE as well as the opening of a multicurrency CUT should be expedited to encourage the donors to transfer projects on CUT. Performance budgeting could also be piloted alongside a strengthening of sector strategies.

37. **The public sector reform program is at a critical juncture** The installation of a clean integrated payroll database based on a civil service census should help rightsizing the civil service and improving service delivery. The implementation of the anti-corruption strategy and judicial sector reform needs to be reinvigorated and results publicized, in order for public perceptions of lack of progress to be reversed.

38. **The government's fiscal decentralization strategy should be well sequenced**. Lack of clarity on the division of revenue raising and spending responsibilities of subnational units, and concerns regarding the capacity of some districts and municipalities to effectively

absorb and account for resources need to be addressed first. Budgetary resources should not be increased to subnational units that do not provide spending plans and report on their use.

39. **Greater exchange rate flexibility should help improve competitiveness.** The exchange rate level appears to be somewhat overvalued at present and thus staff calls on the BM to eliminate the temporary exchange rate band as soon as possible. A flexible exchange rate regime has served Mozambique well, helping to cushion against exogenous shocks and maintain a comfortable level of international reserves. A fine-tuning of liquidity management and deepening of interbank markets should also lead to a smoother transmission of monetary policy actions.

40. **Large infrastructure projects should be carefully managed.** The staff welcomes the renewed commitment to seek non-recourse financing for the transfer of majority ownership of the Cahora Bassa hydropower plant from Portugal so not to increase the central government's liabilities to commercial creditors, and ensure transparency and accountability. These principles should be applied to all future infrastructure projects whilst encouraging greater private participation to reduce risks to debt sustainability.

41. **The implementation of the strategic action plan to reduce the cost of doing business will be key to promote export diversification and generate employment.** In this regard, a good start has been made with regard to business registration but recent proposals related to the labor market (both the draft labor and minimum wage legislation) need to be implemented in a manner that reduces labor costs to firms. The high fees charged for scanning freight should also be reviewed to help lower export/import transaction costs and make Maputo a transshipment hub in Southern Africa.

42. **Mozambique's banking system is making a growing contribution to private sector development**. Introduction of risk-based supervision and international reporting standards should facilitate monitoring of capital adequacy during a period of strong credit growth. The sustainability of the national pension fund (INSS) needs to be secured through a restructuring based on an actuarial study. A strengthening of the supervisory framework for the growing non-bank financial sector is becoming more important. However, the high cost of and limited access to credit to SMEs and the agriculture sector indicates the need to step up reform efforts to improve the institutional lending environment, as well as measures to improve banks and MFI outreach in rural areas.

43. **The staff welcomes progress in liberalizing trade, debt rescheduling, and exchange system reforms.** The staff encouraged further broad-based MFN trade liberalization and early adoption of a new foreign exchange regime to realize the authorities' stated intentions to accept the obligations of Article VIII, Sections 2, 3 and 4 in the near future. The authorities are encouraged to continue to negotiate in good faith with all of their external creditors to reach an agreement consistent with that provided by the Paris Club.

44. **The authorities are encouraged to undertake a voluntary safeguards assessment in the context of the proposed PSI.**

45. **Given Mozambique's track-record of strong macroeconomic performance and program implementation, the staff welcomes the authorities' request for a PSI.**

46. **The staff recommends completion of the sixth review and financing assurances review under the PRGF arrangement.** Staff recommends a waiver for the missed performance criterion on base money at end-year 2006 as it was temporary and related to the currency reform. The staff also recommends the approval of foreign exchange restrictions under Article VIII given the authorities stated intention to remove exchange restrictions within one year.

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

48. **It is recommended that the next Article IV consultation with Mozambique take place within 24-months subject to the provisions of the decision on consultation cycles in program countries.**

Table 1. Mozambique: Selected Economic and Financial Indicators, 2004–10 1/

	2004	2005	2006		2007		2008	2009	2010
		Est.	Orig. Prog.	Est.	Orig. Prog.	Prog.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Nominal GDP (millions of MT)	133,319	157,345	185,696	193,322	210,490	220,150	249,051	280,851	315,946
Nominal GDP growth	17.0	18.0	21.3	22.9	13.4	13.9	13.1	12.8	12.5
Real GDP growth	7.5	6.2	7.9	8.5	7.0	7.0	7.0	7.0	7.0
GDP per capita (in U.S. dollars)	309	348	364	386	382	397	421	453	488
Consumer price index (annual average)	12.6	6.4	12.5	13.2	5.9	6.4	5.7	5.4	5.1
Consumer price index (end of period)	9.1	11.2	7.0	9.4	6.0	6.0	5.5	5.3	5.0
External sector									
Merchandise exports	44.1	16.1	28.9	37.0	4.4	7.9	-1.5	0.9	4.7
Merchandise exports, excluding megaprojects	25.4	6.0	18.0	45.5	8.3	22.6	13.7	13.4	15.5
Merchandise imports	16.9	21.2	11.5	16.7	16.1	8.4	5.0	5.9	7.9
Merchandise imports, excluding megaprojects	22.0	19.3	10.2	7.4	16.5	13.4	7.2	7.7	8.6
Terms of trade	25.3	22.5	26.1	59.0	-8.7	1.9	-20.5	-20.4	-16.9
Nominal effective exchange rate (end of period) 2/	10.7	-14.0	...	-3.0	...	...	...	...	...
Real effective exchange rate (end of period) 2/	17.5	-6.3	...	1.8	...	...	...	...	...
	(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)								
Money and credit									
Net foreign assets	37.5	23.1	20.9	31.3	9.2	10.4	3.0	3.8	4.6
Net domestic assets	-31.5	4.0	0.8	-7.9	8.3	5.7	12.5	11.1	10.1
Of which : net credit to the government 3/	-9.7	-2.2	-5.0	-9.6	2.1	1.0	-2.4	-3.9	-3.6
credit to the economy	-2.5	22.5	17.5	14.3	15.3	15.9	17.0	16.7	15.2
M2 (12-month percent change)	16.7	22.1	21.8	25.8	17.5	16.2	15.4	14.9	14.7
Velocity (GDP/M2)	5.9	5.7	5.5	5.6	5.3	5.4	5.3	5.2	5.1
Interest rate for 90-day treasury bills (percent; end of period)	10.5	10.0	17.5	16.0	...	...	...	...	...
	(percent of GDP)								
Investment and saving									
Gross domestic investment	22.6	21.5	24.8	24.9	27.7	28.8	28.9	29.3	29.6
Government	9.4	8.2	11.7	11.0	14.7	14.4	13.5	12.9	12.3
Other sectors	13.2	13.2	13.1	13.9	13.1	14.5	15.4	16.4	17.3
Gross domestic savings (excluding grants)	8.5	5.6	8.6	11.3	6.7	10.9	11.8	12.3	12.7
Government	-1.6	0.2	0.1	0.8	-0.2	0.0	0.7	1.3	1.8
Other sectors	10.2	5.4	8.5	10.5	6.9	10.9	11.1	10.9	10.8
Current account, before grants	-14.1	-15.8	-16.2	-13.6	-21.0	-17.9	-17.0	-17.0	-16.9
Government budget									
Total revenue	12.6	13.6	14.4	14.0	14.9	14.5	15.0	15.5	16.0
Total expenditure and net lending	24.5	22.1	27.1	25.1	31.4	30.5	29.0	28.1	27.3
Overall balance, before grants	-12.1	-8.6	-12.7	-11.4	-16.5	-15.9	-14.0	-12.6	-11.3
Total grants	7.5	6.3	10.7	9.9	11.9	11.5	10.7	9.9	9.1
Overall balance, after grants	-4.5	-2.2	-2.0	-1.5	-4.6	-4.5	-3.3	-2.7	-2.3
Domestic primary balance	-3.9	-1.8	-2.5	-1.9	-2.9	-2.7	-2.6	-2.4	-2.1
External financing (incl. debt relief) 4/	3.2	3.4	4.2	4.5	5.2	5.2	4.3	3.7	3.2
Net domestic financing	-0.5	-1.5	-2.2	-3.0	-0.6	-0.7	-1.0	-1.0	-1.0
Privatization 4/	1.9	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
	(percent of exports of goods and nonfactor services)								
External debt service (nonfinancial public sector)									
Scheduled, after additional bilateral assistance and MDRI	3.4	2.0	1.2	0.8	0.9	0.7	0.9	1.1	1.7
	(millions of U.S. dollars, unless otherwise indicated)								
Overall balance of payments	213	-57	-40	139	99	74	54	96	88
Net international reserves (end of period)	960	943	1,053	1,229	1,149	1,300	1,354	1,451	1,538
Gross international reserves (end of period)	1,160	1,103	1,063	1,241	1,162	1,315	1,369	1,466	1,553
In months of imports of goods and nonfactor services	5.8	4.6	4.0	4.4	3.7	4.2	4.2	4.2	4.2
In months of imports of goods and nonfactor services, excl. megaprojects	7.0	5.7	5.8	6.8	4.6	5.3	5.2	5.2	5.0
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports	...	...	6.2	7.3	6.5	7.1	6.8	6.8	6.6
Exchange rate (MT per U.S. dollar; end of period)	18.9	24.2	...	26.0	...	...	…	…	…

Sources: Mozambican authorities; and Fund staff estimates and projections.
Note: Takes into account IMF delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.
1/ Projections exclude the Moatize coal mine project, Cahora Bassa transfer, and Petroleum exploration.
2/ Minus sign indicates depreciation.
3/ Includes the issuance of government securities for the central bank recapitalization in years 2005-07.
4/ Includes movement in the government account set abroad with the proceed of the Moatize coal mine concession.

Table 2. Mozambique: Government Finances, 2004-10

	2004 1/	2005	2006		2007		2008	2009	2010
	Est.	Est.	Orig. Prog.	Est.	Orig. Prog.	Prog.	Proj.	Proj.	Proj.
	(In millions of MT)								
Total revenue	16,838	21,418	26,669	26,997	31,342	31,941	37,256	43,558	50,458
Tax revenue	15,598	18,534	23,660	23,313	27,367	27,852	32,163	37,889	44,093
Taxes on income and profits	3,548	4,469	6,115	6,367	7,105	7,241	9,165	11,469	14,418
Taxes on goods and services	9,416	10,873	13,274	13,031	15,717	15,974	18,012	20,738	23,422
Of which : on petroleum products	1,663	1,806	2,321	1,830	2,744	2,768	3,199	3,669	3,926
Taxes on international trade	2,284	2,816	3,680	3,284	3,856	3,936	4,203	4,794	5,247
Other taxes	350	376	591	632	687	701	783	889	1,007
Nontax revenue	1,241	2,884	3,010	3,683	3,975	4,089	5,093	5,669	6,364
Total expenditure and net lending	32,607	34,734	50,281	48,546	66,106	67,052	72,171	78,934	86,290
Current expenditure	19,006	21,092	26,457	25,518	31,681	31,841	35,489	39,835	44,687
Compensation to employees	9,195	10,691	13,274	12,994	15,683	15,683	17,944	20,235	22,764
Goods and services	4,727	5,012	6,639	6,274	7,812	7,812	8,703	9,813	11,038
Interest on public debt	1,321	1,248	1,433	1,380	2,078	2,238	1,877	1,916	1,991
Domestic	910	789	1,073	916	1,818	1,818	1,271	1,127	948
External	411	459	360	464	260	420	606	789	1,043
Transfer payments	3,763	4,141	5,111	4,869	6,109	6,109	6,965	7,870	8,895
Domestic current primary balance	-847	1,574	1,645	2,859	1,739	2,338	3,643	5,639	7,761
Capital expenditure	12,543	12,971	21,667	21,292	30,881	31,667	33,526	36,161	38,737
Grant finance projects	3,085	1,918	4,915	4,220	11,672	11,767	12,272	12,558	12,820
Projet loans	3,564	3,148	4,522	5,172	4,296	4,331	4,516	4,622	4,718
Locally financed	4,074	4,335	6,465	6,102	7,927	8,527	10,250	12,555	14,638
Grant-financed special programs	1,197	2,151	3,886	4,164	5,034	5,075	5,293	5,416	5,529
Direct financing	623	869	1,463	1,185	937	952	988	1,011	1,032
Expenditure financed with fund for the concession mine of Tete	...	550	417	450	1,014	1,014	207	0	0
Net lending	1,058	671	2,157	1,736	3,544	3,544	3,155	2,938	2,866
Of which: locally financed	-79	-94	-174	-24	-156	-156	-178	-203	-231
Domestic primary balance, before grants, above the line 2/	-4,842	-2,667	-4,646	-3,218	-6,033	-6,033	-6,429	-6,713	-6,646
Unallocated revenue (+)/expenditure (-) 3/	-310	-141	0	-507	0	0	0	0	0
Overall balance, before grants (below the line)	-16,079	-13,457	-23,612	-22,056	-34,764	-35,111	-34,915	-35,376	-35,832
Grants received	10,053	9,975	19,905	19,124	24,992	25,313	26,661	27,694	28,714
Project	6,185	4,938	10,263	9,569	17,644	17,795	18,552	18,985	19,381
Nonproject	3,868	5,037	6,027	5,940	7,348	7,519	8,109	8,710	9,333
MDRI assistance via the central bank 6/		0	3,616	3,615			0	0	0
Overall balance, after grants	-6,026	-3,482	-3,706	-2,932	-9,772	-9,797	-8,254	-7,682	-7,118
Central bank transfer of HIPC Initiative assistance by the IMF	484	388	0	0	0	0	0	0	0
Net external financing	3,788	5,035	7,753	8,767	10,965	11,521	10,628	10,321	9,976
Disbursements	6,937	5,219	8,033	9,401	10,682	10,768	10,646	10,555	10,620
Project	3,564	3,148	4,522	5,172	4,296	4,331	4,516	4,622	4,718
Nonproject	3,373	2,071	3,511	4,229	6,386	6,438	6,129	5,934	5,902
Cash amortization	-668	-734	-697	-1,084	-730	-261	-224	-234	-643
Investment abroad 4/	-2,481	550	417	450	1,014	1,014	207	0	0
Net domestic financing	-728	-2,335	-4,151	-5,835	-1,297	-1,828	-2,493	-2,774	-3,009
Of which: MDRI from the IMF			-3,616	-3,615					
Privatization 5/	2482	394	104	0	104	104	119	134	151
Memorandum items:									
MDRI debt relief from IDA	...	... .	31,034	31,897	...	...	...	...	...
MDRI debt relief from the AfDF	...	... .	13,468	11,233	...	...	...	...	...
MDRI saving on total debt service	...	... .	851	1,115	981	1,215	1,079	1,113	1,304
Domestic primary balance, before grants, below the line 2/	-5,152	-2,808	-4,646	-3,725	-6,033	-6,033	-6,429	-6,713	-6,646
Balance on MDRI deposit account with the central bank	0	0	2,688	2,687	1,792	1,792	897	0	0
Grants and loan disbursements	16,990	15,194	27,939	28,525	35,673	36,082	37,307	38,249	39,333
Bonds issuance for strengthening the balance sheet of the central bank	...	1,500	1,501	1,501	1,500	1,500	0	0	0
Nominal GDP	133,319	157,345	185,696	193,322	210,490	220,150	249,051	280,851	315,946

Table 2. Mozambique: Government Finances, 2004-10 (Concluded)

	2004 1/	2005	2006		2007		2008	2009	2010
	Est.	Est.	Orig. Prog.	Est.	Orig. Prog.	Prog.	Proj.	Proj.	Proj.
	(percent of GDP, unless otherwise specified)								
Total revenue	12.6	13.6	14.4	14.0	14.9	14.5	15.0	15.5	16.0
Tax revenue	11.7	11.8	12.7	12.1	13.0	12.7	12.9	13.5	14.0
Taxes on income and profits	2.7	2.8	3.3	3.3	3.4	3.3	3.7	4.1	4.6
Taxes on goods and services	7.1	6.9	7.1	6.7	7.5	7.3	7.2	7.4	7.4
Of which: on petroleum products	1.2	1.1	1.2	0.9	1.3	1.3	1.3	1.3	1.2
Taxes on international trade	1.7	1.8	2.0	1.7	1.8	1.8	1.7	1.7	1.7
Other taxes	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	0.9	1.8	1.6	1.9	1.9	1.9	2.0	2.0	2.0
Total expenditure and net lending	24.5	22.1	27.1	25.1	31.4	30.5	29.0	28.1	27.3
Current expenditure	14.3	13.4	14.2	13.2	15.1	14.5	14.2	14.2	14.1
Compensation to employees	6.9	6.8	7.1	6.7	7.5	7.1	7.2	7.2	7.2
Goods and services	3.5	3.2	3.6	3.2	3.7	3.5	3.5	3.5	3.5
Interest on public debt	1.0	0.8	0.8	0.7	1.0	1.0	0.8	0.7	0.6
Domestic	0.7	0.5	0.6	0.5	0.9	0.8	0.5	0.4	0.3
External	0.3	0.3	0.2	0.2	0.1	0.2	0.2	0.3	0.3
Transfer payments	2.8	2.6	2.8	2.5	2.9	2.8	2.8	2.8	2.8
Domestic current primary balance	-0.6	1.0	0.9	1.5	0.8	1.1	1.5	2.0	2.5
Capital expenditure	9.4	8.2	11.7	11.0	14.7	14.4	13.5	12.9	12.3
Of which: locally financed	3.1	2.8	3.5	3.2	3.8	3.9	4.1	4.5	4.6
Net lending	0.8	0.4	1.2	0.9	1.7	1.6	1.3	1.0	0.9
Of which: locally financed	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic primary balance, above the line 2/	-3.6	-1.7	-2.5	-1.7	-2.9	-2.7	-2.6	-2.4	-2.1
Unallocated revenue (+)/expenditure (-) 3/	-0.2	-0.1	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants (below the line)	-12.1	-8.6	-12.7	-11.4	-16.5	-15.9	-14.0	-12.6	-11.3
Grants received	7.5	6.3	10.7	9.9	11.9	11.5	10.7	9.9	9.1
Project	4.6	3.1	5.5	4.9	8.4	8.1	7.4	6.8	6.1
Nonproject	2.9	3.2	3.2	3.1	3.5	3.4	3.3	3.1	3.0
MDRI assistance via the central bank 6/	0.0	0.0	1.9	1.9	0.0	0.0	0.0	0.0	0.0
Overall balance, after grants	-4.5	-2.2	-2.0	-1.5	-4.6	-4.5	-3.3	-2.7	-2.3
Central bank transfer of HIPC assistance by the IMF	0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	2.8	3.2	4.2	4.5	5.2	5.2	4.3	3.7	3.2
Disbursements	5.2	3.3	4.3	4.9	5.1	4.9	4.3	3.8	3.4
Project	2.7	2.0	2.4	2.7	2.0	2.0	1.8	1.6	1.5
Nonproject	2.5	1.3	1.9	2.2	3.0	2.9	2.5	2.1	1.9
Cash amortization	-0.5	-0.5	-0.4	-0.6	-0.3	-0.1	-0.1	-0.1	-0.2
Investment abroad 4/	-1.9	0.3	0.2	0.2	0.5	0.5	0.1	0.0	0.0
Net domestic financing	-0.5	-1.5	-2.2	-3.0	-0.6	-0.8	-1.0	-1.0	-1.0
Privatization 5/	1.9	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Domestic primary balance, before grants, below the line 2/	-3.9	-1.8	-2.5	-1.9	-2.9	-2.7	-2.6	-2.4	-2.1
Balance on MDRI deposit account with the central bank	0.0	0.0	1.4	1.4	0.9	0.8	0.4	0.0	0.0
Grants and loans disbursements	12.7	9.7	15.0	14.8	16.9	16.4	15.0	13.6	12.4
Bonds issuance for strengthening the balance sheet of the central bank	...	1.0	0.8	0.8	0.7	0.7	0.0	0.0	0.0
Nominal GDP (in millions of meticais)	133,319	157,345	185,696	193,322	210,490	220,150	249,051	280,851	315,946

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

1/ The quasi-fiscal deficit of the Bank of Mozambique, amounting to MT 3,455 billion (or 2.5 percent of GDP) is not included.

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

3/ Residual discrepancy between identified sources and use of funds.

4/ Tracks the movements in the government account set up abroad with the proceeds of the Moatize coal mine concession.

5/ Includes the US$123 million (2.0 percent of GDP) concession fee for the Moatize coal mine concession.

6/ Includes the transfer of both MDRI and HIPC assistance from the central bank to the budget in 2006.

Table 3. Mozambique: Monetary Survey, 2004–10

	2004	2005	2006		2007		2008	2009	2010
			Orig. Prog.	Est.	Orig. Prog.	Prog.	Proj.	Proj.	Proj.
	(Millions of MT, unless otherwise specified)								
Central bank									
Net foreign assets	21,504	26,113	31,011	34,348	34,937	38,808	40,294	42,711	46,170
(millions of U.S. dollars)	1,138	1,080	1,173	1,323	1,229	1,380	1,399	1,450	1,538
Net international reserves	18,154	22,809	27,820	31,912	32,671	36,566	39,009	42,721	46,181
(millions of U.S. dollars)	961	943	1,053	1,229	1,149	1,300	1,354	1,451	1,538
Medium- and long-term foreign liabilities	-57	-3	0	-11	0	-11	-11	-11	-11
(millions of U.S. dollars)	-3	0	0	0	0	0	0	0	0
Other	3,408	3,308	3,191	2,447	2,266	2,253	1,296	0	0
(millions of U.S. dollars)	180	137	121	94	80	80	45	0	0
Net domestic assets	-11,071	-13,929	-17,023	-19,612	-18,917	-22,788	-22,552	-23,123	-24,602
Credit to government (net)	-11,245	-15,168	-15,568	-17,433	-13,464	-16,820	-15,192	-14,816	-14,825
Credit to banks (net)	-3,859	408	1,729	552	1,625	1,175	730	700	85
Credit to the economy	1	1	16	16	16	16	16	16	16
Other items (net; assets +)	4,033	831	-3,200	-2,747	-7,095	-7,159	-8,107	-9,023	-9,878
Reserve money	10,433	12,185	13,988	14,736	16,020	16,020	17,742	19,587	21,569
Currency outside banks	5,225	6,110	6,611	7,152	8,045	7,272	7,695	7,975	9,065
Bank reserves	5,209	6,075	7,377	7,584	7,975	8,748	10,047	11,612	12,504
Currency in banks	978	1,226	1,158	1,637	622	2,377	2,319	2,499	1,959
Deposits	4,231	4,849	6,219	5,947	7,353	6,371	7,728	9,113	10,544
Required reserves	4,231	4,913	6,196	6,090	7,325	6,344	7,694	9,074	10,499
Free reserves	3,814	-64	24	-143	28	27	33	39	45
Deposit money banks									
Net foreign assets	4,994	8,270	12,449	13,618	13,387	14,748	15,106	15,443	15,743
(millions of U.S. dollars)	264	342	471	524	471	524	524	524	524
Net domestic assets	23,955	29,061	33,825	32,816	40,694	40,232	49,061	59,166	69,904
Banks' reserves	5,295	6,015	7,377	7,687	7,975	8,748	10,047	11,612	12,504
Credit to central bank (net)	4,009	-235	-1,729	-209	-1,625	-1,175	-730	-700	-85
Credit to government (net)	4,561	7,748	5,965	5,823	4,979	5,742	2,608	-542	-3,542
Credit to the economy	13,512	21,215	28,807	27,398	36,900	35,930	46,508	58,504	71,035
Other items (net; assets +)	-3,422	-5,681	-6,594	-7,883	-7,533	-9,013	-9,371	-9,708	-10,008
Deposits	28,950	37,331	46,274	46,434	54,082	54,980	64,167	74,610	85,647
Demand and savings deposits	19,255	26,177	30,672	31,240	35,753	36,615	43,092	50,422	57,896
Time deposits	9,695	11,154	15,602	15,194	18,328	18,365	21,075	24,188	27,751
Monetary survey									
Net foreign assets	26,499	34,383	43,460	47,966	48,324	53,556	55,400	58,154	61,913
Net domestic assets	7,676	9,058	9,425	5,620	13,803	8,696	16,462	24,431	32,798
Domestic credit	6,829	13,795	19,220	15,803	28,431	24,868	33,940	43,162	52,684
Credit to government (net)	-6,684	-7,420	-9,603	-11,610	-8,485	-11,078	-12,584	-15,358	-18,367
Credit to the economy	13,513	21,215	28,823	27,414	36,916	35,946	46,524	58,520	71,893
Other items (net; assets +)	847	-4,737	-9,795	-10,183	-14,628	-16,172	-17,478	-18,732	-19,886
Money and quasi money (M3)	34,174	43,441	52,885	53,586	62,127	62,253	71,862	82,585	94,712
Foreign currency deposits	11,522	15,793	19,197	18,809	22,545	21,851	25,224	28,987	33,244
(in millions of U.S. dollars)	610	653	726	724	793	777	876	984	1,107
M2	22,653	27,648	33,687	34,777	39,583	40,402	46,639	53,598	61,468
Currency outside banks	5,225	6,110	6,611	7,152	8,045	7,272	7,695	7,975	9,065
Domestic currency deposits	17,428	21,538	27,077	27,625	31,537	33,130	38,943	45,623	52,403
Memorandum items:									
Currency in circulation (millions of MT)	6,203	7,336	7,769	8,789	8,667	9,649	10,015	10,474	11,024
MDRI assistance via the central bank 1/	0	0	3,615	0	0	0	0	0	0
(millions of U.S. dollars)	0	0	154	154	0	0	0	0	0
Balance on MDRI deposit account with the central bank 2/	0	0	-2,687	0	-1,792	-1,792	-897	0	0
	(Annual growth in percentage of beginning of period M3, unless otherwise specified)								
Net foreign assets	37.5	23.1	20.9	31.3	9.2	10.4	3.0	3.8	4.6
Net domestic assets	-31.5	4.0	0.8	-7.9	8.3	5.7	12.5	11.1	10.1
Credit to government (net)	-9.7	-2.2	-5.0	-9.6	2.1	1.0	-2.4	-3.9	-3.6
Credit to the economy	-2.5	22.5	17.5	14.3	15.3	15.9	17.0	16.7	15.2
Other items (net; asset +)	-19.3	-16.3	-11.6	-12.5	-9.1	-11.2	-2.1	-1.7	-1.4
Broad money (M3) (12-month change in percent)	5.9	27.1	21.7	23.4	17.5	16.2	15.4	14.9	14.7
M2 (12-month change in percent)	16.7	22.1	21.8	25.8	17.5	16.2	15.4	14.9	14.7
M3-to-GDP ratio (percent)	25.6	27.6	28.5	27.7	29.5	28.3	28.9	29.4	30.0
M2-to-GDP ratio (percent)	17.0	17.6	18.1	18.0	18.8	18.4	18.7	19.1	19.5
Credit to the economy (12-month change in percent)	-5.6	57.0	35.8	29.2	28.1	31.1	29.4	25.8	21.4
Credit to the economy-to-GDP ratio (percent)	10.1	13.5	15.5	14.2	17.5	16.3	18.7	20.8	22.5
Currency outside banks-to-M3 ratio (percent)	15.3	14.1	12.5	13.3	13.0	11.7	10.7	9.7	9.7
Foreign currency deposits-to-M3 ratio (percent)	33.7	36.4	36.3	35.1	36.3	35.1	35.1	35.1	35.1
Reserve money growth (12 month change in percent) 3/	20.2	16.8	14.8	20.9	14.5	8.7	10.8	10.4	10.1
Money multiplier (M2/reserve money)	2.2	2.3	2.4	2.4	2.5	2.5	2.6	2.7	2.8
Velocity (GDP/M2)	5.9	5.7	5.5	5.6	5.3	5.4	5.3	5.2	5.1
Nominal GDP growth	17.0	18.0	21.3	22.9	13.4	13.9	13.1	12.8	12.5

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

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

1/ Mozambique's liability to the Fund rests with the Bank of Mozambique. MDRI assistance is immediately transferred to a government blocked deposit account at the Bank of Mozambique.
2/ Balance declines from MDRI assistance by 0.5 percent of GDP corresponding to an agreed increase in government expenditures contingent on MDRI assistance.
3/ On an annual average basis from December 2006 to December 2007, reserve money growth is 15.5 percent.

Table 4. Mozambique: Balance of Payments, 2004–10

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

	2004	2005	2006		2007		2008	2009	2010
		Est.	Orig. Prog.	Est.	Orig. Prog.	Proj.	Proj.	Proj.	Proj.
Trade balance	-531	-721	-500	-487	-844	-539	-732	-903	-1,057
Exports, f.o.b.	1,504	1,745	2,250	2,391	2,349	2,580	2,542	2,566	2,686
Megaprojects	1,049	1,263	1,681	1,689	1,733	1,719	1,563	1,456	1,404
Other exports	455	483	569	702	617	861	979	1,110	1,282
Imports, c.i.f.	-2,035	-2,467	-2,750	-2,878	-3,194	-3,119	-3,275	-3,469	-3,742
Megaprojects	-322	-423	-498	-683	-569	-630	-607	-595	-621
Other imports	-1,712	-2,044	-2,253	-2,195	-2,625	-2,489	-2,668	-2,873	-3,122
Services and incomes (net)	-301	-360	-682	-569	-803	-917	-771	-749	-755
Receipts	370	464	577	559	589	597	624	655	696
Expenditures	-671	-824	-1,259	-1,128	-1,392	-1,514	-1,396	-1,404	-1,451
Of which : interest on public debt	-18	-22	-19	-19	-15	-20	-26	-32	-37
Current account, before grants	-832	-1,081	-1,181	-1,055	-1,647	-1,456	-1,504	-1,652	-1,812
Unrequited official transfers	527	461	2,466	2,570	947	950	966	981	984
Of which: MDRI relief from the IMF	0		120	120	0	0	0	0	0
MDRI relief from IDA	0		1,156	1,319	0	0	0	0	0
MDRI relief from AfDF	0		502	465	0	0	0	0	0
Of which : HIPC grant from the IMF	0	15	34	34	0	0	0	0	0
Current account, after grants 1/	-305	-620	1,284	1,515	-700	-506	-538	-671	-827
Capital account	333	347	-1,324	-1,411	799	580	592	767	915
Trade credit (net)	-3	5	20	-20	67	0	0	0	0
Foreign borrowing	463	463	630	603	702	572	593	707	750
Public (including IMF)	315	221	357	370	375	354	348	343	354
Private 3/	148	242	273	233	327	218	244	364	396
Amortization	-291	-251	-2,104	-2,147	-316	-307	-328	-336	-358
Public	-51	-71	-1,839	-1,954	-26	-16	-18	-19	-23
Of which: IMF 2/	-9	-30	-154	-154	0	0	0	0	0
Private	-240	-179	-265	-193	-290	-290	-310	-316	-334
Direct investment (net)	245	105	207	154	323	299	304	357	403
Of which: Moatize coal mine	123	0	0	0	0	0	0	0	0
Other investment of the government 4/	-123	24	16	0	24	0	0	0	0
Short-term capital and errors and omissions (net)	185	216	0	34	0	0	0	0	0
of which change in commercial bank NFA (- = increase)	42	-78	-93	182	0	0	0	0	0
Overall balance	213	-57	-40	139	99	74	54	96	88
Financing	-213	57	40	-139	-99	-74	-54	-96	-88
Of which : Bank of Mozambique									
gross reserve assets (increase -)	-213	57	40	-139	-99	-74	-54	-96	-88
Financing gap	0	0	0	0	0	0	0	0	0
Memorandum items:									
Use of Fund credit (net)	-6	-30	-149	-149	2	2	0	0	0
Current account deficit (percent of GDP)									
Before grants	14.1	15.8	16.2	13.6	21.0	17.9	17.0	17.0	16.9
After grants	5.2	9.1	-17.6	-19.6	8.9	6.2	6.1	6.9	7.7
Net international reserves	960	943	1,053	1,229	1,149	1,300	1,354	1,451	1,538
Gross international reserves	1,160	1,103	1,063	1,241	1,162	1,315	1,369	1,466	1,553
In months of imports of GNFS	5.8	4.6	4.0	4.4	3.7	4.2	4.2	4.2	4.2
In months of imports of GNFS, excluding megaprojects	7.0	5.7	5.8	6.8	4.6	5.3	5.2	5.2	5.0
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports			6.2	7.3	6.5	7.1	6.8	6.8	6.6

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

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

Table 5. Mozambique: Balance of Payments of Megaprojects, 2002–10 1/

	2002	2003	2004	2005	2006	2007	2008	2009	2010
				Est.	Prel. Est.	Proj.	Proj.	Proj.	Proj.
	(Millions of dollars, unless otherwise specified)								
Trade balance	66	344	726	840	1,006	1,089	957	860	784
Exports, f.o.b.	468	681	1,049	1,263	1,689	1,719	1,563	1,456	1,404
Imports, c.i.f.	-402	-337	-322	-423	-683	-630	-607	-595	-621
Services and incomes (net)	-233	-228	-305	-455	-702	-958	-804	-763	-759
Current account, before grants	-167	116	421	385	304	131	153	97	24
Current account, after grants	-167	116	421	385	304	131	153	97	24
Capital account	644	229	-57	50	-15	109	114	268	316
Foreign borrowing	439	62	5	110	114	134	151	261	294
Amortization	-40	-66	-117	-120	-129	-171	-187	-197	-227
Direct investment (net)	245	234	55	60	0	146	151	204	250
Overall balance before short-term capital inflows 2/	477	344	364	435	289	240	267	365	340

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

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

Table 6. Mozambique: Expenditure in PARPA Priority Sectors, 2004-2007 1/

(In millions of meticais, unless otherwise indicated)

	2004 Est.	2005 Est.	2006 Proj.	2007 Proj.
Total revenues	16,838	21,418	26,997	31,941
Total expenditure, excluding bank restructuring costs and net lending	31,549	34,063	46,810	63,508
Total expenditure (excl.bank restruct. costs, net lending, and interest payments)	30,228	32,815	45,430	61,270
Interest payments on public debt	1,321	1,248	1,380	2,238
Total expenditure in PARPA priority sectors	19,033	21,756	29,575	41,719
in percent of GDP	14.3	13.8	15.3	19.0
in percent of total expenditure (excl. bank restruct costs, net lending, and interest payments)	63.0	66.3	65.1	68.1
Education	6,317	6,542	9,109	12,508
Primary	5,325	5,572	7,556	12,407
Health	3,183	4,159	6,628	8,011
HIV/AIDS	123	218	665	850
Infrastructure development	3,982	6,131	7,435	11,440
Roads	3,112	4,641	4,501	7,361
Sanitation and public works	870	1,490	2,742	2,730
Agriculture and rural development	1,322	1,290	1,522	3,774
Governance and judicial system	2,936	2,913	5,671	4,021
Security and public order	1,753	1,453	1,943	2,597
Governance	483	601	2,719	343
Judicial system	699	859	1,009	1,081
Other priority areas	1,170	727	510	970
Social actions	201	210	329	527
Labor and employment	123	108	181	198
Total PARPA expenditures in percent of GDP				
Education	4.7	4.2	4.7	5.7
Primary	4.0	3.5	3.9	5.6
Health	2.4	2.6	3.4	3.6
HIV/AIDS	0.1	0.1	0.3	0.4
Infrastructure development	3.0	3.9	3.8	5.2
Roads	2.3	2.9	2.3	3.3
Sanitation and public works	0.7	0.9	1.4	1.2
Agriculture and rural development	1.0	0.8	0.8	1.7
Governance and judicial system	2.2	1.9	2.9	1.8
Security and public order	1.3	0.9	1.0	1.2
Governance	0.4	0.4	1.4	0.2
Judicial system	0.5	0.5	0.5	0.5
Other priority areas	0.9	0.5	0.3	0.4
Social actions	0.2	0.1	0.2	0.2
Labor and employment	0.1	0.1	0.1	0.1
Total PARPA expenditures in percent of total expenditures				
Education	20.9	19.9	20.1	20.4
Primary	17.6	17.0	16.6	20.3
Health	10.5	12.7	14.6	13.1
HIV/AIDS	0.4	0.7	1.5	1.4
Infrastructure development	13.2	18.7	16.4	18.7
Roads	10.3	14.1	9.9	12.0
Sanitation and public works	2.9	4.5	6.0	4.5
Agriculture and rural development	4.4	3.9	3.4	6.2
Governance and judicial system	9.7	8.9	12.5	6.6
Security and public order	5.8	4.4	4.3	4.2
Governance	1.6	1.8	6.0	0.6
Judicial system	2.3	2.6	2.2	1.8
Other priority areas	3.9	2.2	1.1	1.6
Social actions	0.7	0.6	0.7	0.9
Labor and employment	0.4	0.3	0.4	0.3

Source: Mozambican authorities (Ministry of Finance); and staff estimates and projections.

1/ PARPA stands for National Action Plan for the Reduction of Absolute Poverty, which is the Portuguese acronym.

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

	2000	2001	2002	2003	2004	2005	2006
Capital adequacy							
Regulatory capital to risk-weighted assets	-2.13	5.49	14.01	17.03	18.65	16.00	12.53
Regulatory Tier I capital to risk-weighted assets	-2.07	6.03	11.97	14.67	15.97	13.57	10.72
Capital (net worth) to assets	-2.70	8.22	9.42	9.01	9.51	8.04	6.06
Asset composition and quality							
Sectoral distribution of loans to total loans							
Agriculture	19.00	18.00	15.00	12.73	9.45	8.49	6.39
Industry	27.00	25.00	22.00	16.94	11.94	16.77	22.15
Construction	5.00	4.00	4.00	5.20	3.35	4.13	5.64
Commerce	23.00	20.00	17.00	18.13	21.29	27.36	27.40
Transportation and communication	5.00	7.00	5.00	7.08	7.19	5.83	6.15
Other	22.00	27.00	36.00	37.14	36.18	35.05	32.27
of which: Private 1/				7.63	12.12	13.03	13.54
Housing				7.10	8.18	4.24	4.07
Diverse 2/				22.41	15.87	17.78	14.66
Foreign exchange loans to total loans	40.24	64.69	69.87	70.77	67.33	63.91	45.04
Nonperforming loans to gross loans 3/	17.76	23.43	21.98	14.43	6.42	3.82	3.26
Nonperforming loans net of provisions to capital 3/	35.00	11.00	9.39	7.91	1.70	0.89	2.17
Earnings and profitability							
Return on assets	0.04	0.14	1.59	1.24	1.43	1.81	3.51
Return on equity	...	3.51	22.10	16.29	18.73	27.42	55.39
Interest margin to gross income	...	10.22	61.39	56.83	60.15	58.01	63.07
Noninterest expenses to gross income	...	16.92	67.03	72.18	71.24	65.85	54.10
Personnel expenses to noninterest expenses	...	51.71	44.67	45.68	45.21	45.35	44.35
Trading and fee income to gross income	...	33.09	39.68	45.49	41.87	43.78	32.15
Spread between reference loan and deposit rates (90 days, local currency)	...	14.00	19.00	17.39	14.67	11.48	11.91
Funding and liquidity							
Liquid assets to total assets 4/	41.51	34.64	53.93	57.74	58.12	55.52	51.87
Customer deposits to total (non-interbank) loans	188.00	217.00	240.00	227.97	283.07	191.90	179.34
Foreign exchange liabilities to total liabilities	54.53	63.30	61.26	46.39	41.38	45.26	42.75

Source: Bank of Mozambique (BM).

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

Table 8. Mozambique: Indicators of External Vulnerability, 2004-07
(percent of GDP, unless otherwise indicated)

	2004	2005	2006 Est.	2007 Proj.
Financial indicators				
Net present value of public sector debt 1/ 2/	8.0	18.3	17.7	19.0
Broad money (percent change, 12-month basis)	5.9	27.1	23.4	16.2
Private sector credit (percent change, 12-month basis)	-5.6	57.0	29.2	31.1
External indicators				
Exports of goods (percent change, 12-month basis in U.S. dollars)	44.1	16.1	37.0	7.9
Imports of goods c.i.f. (percent change, 12-month basis in U.S. dollars)	16.9	21.2	16.7	8.4
Terms of trade (percent change, 12-month basis)	25.3	22.5	59.0	1.9
Current account balance (after grants)	-5.2	-9.1	19.6	-6.2
Capital and financial account balance	5.6	5.1	-18.2	7.1
Of which : foreign direct investment (net)	4.1	1.5	2.0	3.7
Gross international reserves (in millions of U.S. dollars)	1,160	1,103	1,241	1,315
(In months of imports of goods and services)	5.8	4.6	4.4	4.2
(In months of imports of goods and services, excluding megaprojects)	7.0	5.7	6.8	5.3
Net international reserves (in millions of U.S. dollars)	960	943	1,229	1,300
Net international reserves (in percent of foreign currency deposits)	158	144	170	167
Net foreign assets of commercial banks (in millions of U.S. dollars)	264	342	524	524
Net present value of total external debt 1/ 2/	46.7	30.7	27.3	27.9
Net present value of public external debt-to-exports of goods and services (in percent) 2/	83.8	31.1	24.5	30.3
Public external debt-service payments to exports of goods and services (in percent) 3/	3.8	4.3	2.5	1.1
Exchange rate (MT per U.S. dollar; end of period) 4/	19	24	26	...
Real effective exchange rate (end of period) 5/	17.5	-6.3	1.8	...

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

1/ Domestic public debt and private sector external debt are valued at par in the net present value calculation.
2/ Historical NPV estimates are based on previous debt sustainability analyses.
3/ Cash interest and amortization payments, after HIPC assistance.
4/ Official exchange rate.
5/ Minus sign indicates depreciation.

Table 9. Mozambique: Millennium Development Goals, 1990–2004

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

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

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

Appendix I

Maputo, Mozambique
March 28, 2007

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

Dear Mr. de Rato:

1. The Government of Mozambique requests a three-year arrangement under the Policy Support Instrument (PSI) before the expiration on July 5, 2007 of the current arrangement under the Poverty Reduction and Growth Facility (PRGF). This request is made at this stage to avoid a vacuum between the two arrangements. The main elements of the new program are consistent with our *Plano de Acção para a Redução da Pobreza Absoluta II* (or PARPA II) and are described in the attached memorandum of economic and financial policies (MEFP) covering the period 2007–2010. The MEFP also sets forth the objectives and policies that the Government intends to pursue during 2007. The attached technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. The Government of Mozambique continues to make progress in implementing its PRGF-supported program despite the severe floods that affected parts of the country during the first months of 2007. All end-December quantitative performance criteria (PCs) were met, except for the PC on base money, due to the temporary surge in currency in circulation at the end of 2006 which was related to the currency reform. The structural PC and benchmarks through end-March 2007 were also achieved, except for the benchmark related to the treasury single account (CUT) which has been delayed to end-September 2007. In light of the progress achieved in the implementation of our program, the Government of Mozambique requests a waiver for the non-observance of the quantitative PC on base money.

3. The resources released as part of the MDRI have been incorporated in the execution of the 2007 budget and included in the medium-term fiscal framework (CFMP) to be spent on poverty-reducing priority expenditures identified in the PARPA II.

4. Looking ahead, the policies set out in the MEFP continue to aim to consolidate macroeconomic stability and sustain strong broad-based growth through a second wave of reforms in order to achieve the Millennium Development Goals (MDGs). Our PSI supported program proposes assessment criteria for the performance target dates of end-June and end-

December 2007 for the first and second reviews as set out in Tables 1 and 3 of the MEFP, which are expected to be completed by end-December 2007 and end-June 2008, respectively.

5. The Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement following the approval of the new foreign exchange law which will be submitted to the Assembly by end-April 2007. The government remains committed to a flexible exchange rate regime.

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

7. The Government of Mozambique believes that the policies set forth in the MEFP are adequate to achieve the objectives of our PSI program; it will take additional measures to that end if deemed necessary. During the implementation of the arrangement, the Government of Mozambique will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the PSI, at the initiative of the Government or whenever the Managing Director requests such a consultation.

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

Attachment I

Memorandum of Economic and Financial Policies of the Government of Mozambique for the Sixth Review Under the PRGF Arrangement and for the PSI Supported-Program (June 2007–June 2010)

March 28, 2007

1. The Government of Mozambique is committed to continuing to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and a second wave of structural reforms. The strategy to achieve these goals is set out in the *Plano de Acção Para a Redução da Pobreza Absoluta II* (PARPA II) for which a Joint Staff Advisory Note was approved by the Boards of the International Monetary Fund (IMF) and World Bank (WB) in December 2006. The current Government's economic program is supported by the IMF with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which expires on July 5, 2007. The new program for 2007–2010 would be supported by the IMF with a three-year arrangement under the Policy Support Instrument (PSI). This Memorandum of Economic and Financial Policies (MEFP) reviews the performance under the PRGF-supported program (October 2006-March 2007) and describes the policies and targets for the remainder of 2007.

I. Recent Performance Under the PRGF-Supported Program

2. In 2006, economic performance has been strong. Economic growth accelerated to 8.5 percent, led by a rebound in agricultural production after the localized drought of 2005 ended, as well as continued strength in the construction sector (related to megaproject activity and a pick-up in donor-financed project execution). Prudent fiscal and monetary policies helped lower the 12-month headline inflation rate down from its peak in April of 17.7 percent to 9.4 percent in December 2006, and further to 5.4 percent in February 2007. Strong exports, along with sustained foreign aid inflows, helped keep net international reserves at a comfortable level (over 4 months of imports).

3. The foreign exchange market has remained stable following the introduction of a temporary exchange rate band in the interbank foreign exchange market (MCI) in November 2005. The spread between the MCI rate and the rates charged by banks fell below pre-band levels thanks to the measures taken by the Bank of Mozambique (BM) to deepen the MCI through the introduction of a code of conduct among banks and facilitating firm quotation.

4. The 2006 currency reform went smoothly. The BM introduced a new family of Meticais on July 1, 2006—1,000 Meticais equals to one of the new family of Metical (MT). By end of February 2007, 94 percent of currency in circulation corresponded to the new family of Metical. Because of the volatility in currency demand around the deadline to exchange the old currency for the new, the PC on base money was missed at end-2006, though it declined below the end-year target in January 2007.

5. The fiscal position at end-2006 was better than programmed. Revenue collection in 2006 is slightly above target led by continued buoyancy in corporate and personal tax collection (including collection of tax arrears) and non-tax revenue. Current spending, including the wage bill and locally financed investment was slightly lower than programmed, resulting in a greater than expected consolidation of the domestic primary deficit. Higher than anticipated program aid in 2006 also meant that net credit to the Government from the banking system declined more than programmed (performance criteria). The composition of spending improved, supported by donor-financed project, with the share of priority expenditures in line with the 65 percent PARPA target.

6. Progress has been made in reforming revenue administration and in widening the tax base. The new Central Revenue Authority (ATM) is now fully operational with all the senior and lower management appointed. The current reforms focus on establishing the ATM as a sustainable, semi-autonomous agency with the aim of improving operational performance and tax compliance. Three new collegial bodies were created as part of the new ATM: (i) the High Tax Council; (ii) the "Directive" Council; and (iii) the Fiscal Council, a consultative council. Progress has been made in incorporating the former customs and tax directorates into the ATM and to create the General Directorate for Common Services, an Office of Planning, Research and International Cooperation, and Office of Internal Control. Legal, human resource and systems integration work have also been prepared. A draft IT-strategy is ready for internal discussion and approval. In addition, the following measures were implemented in 2006: (i) tax arrears continued to be identified and collected; (ii) the number of taxpayers was increased by about 100,000 to 391,719; and (iii) about 500 tax audits were conducted. An ATM seminar held on February 2007 concluded that there was a need to: (i) immediately prepare studies and formulate recommendations in response to the revenue losses related to the Southern African Development Community (SADC) tariff reductions in 2008; (ii) to continue the process of simplification, decentralization, and broadening of the tax base; (iii) to prepare a study (to be finalized by end 2007), operationalizing an "electronic one-stop-window" through an integrated IT system in which both customs and tax IT systems are incorporated; and (iv) to elaborate a plan to create a technical tax training institute by end-December 2007.

7. In the area of tax policy, the Council of Ministers approved and submitted to the Assembly three laws on specific taxes and fiscal incentives in the mineral resource and the petroleum sectors in December 2006 (structural performance criteria). A new fiscal code for succession and donations, and a draft municipal finance and asset law was also submitted to the Assembly. The latter aligns the finance and asset management of the municipalities with the new financial and fiscal systems implemented over the last six years.

8. Public Financial Management (PFM) reforms have made good progress. The medium-term fiscal framework (CFMP) is closely aligned with the objectives of PARPA II, and was, for the first time, approved by the Council of Ministers in May 2006. The 2006 budget also included an investment budget for each district supported by strengthened planning capacity in some districts, though the reporting of utilization of

funds needs to be further strengthened. Specific measures in the medium-term PFM Action Plan and Budget (APB) for 2006-2009 under implementation include:

a. After an initial 6 ministries, all budgetary operations for goods and services of Financial Management Departments (DAFs) of 22 additional ministries and organs, at the central and provincial levels, are since January 2007 executed through the e-SISTAFE (structural benchmark). This enables an effective direct budget execution according to the sequence of commitment, verification, and payment. However, the level of direct budget execution has increased slowly to about five percent of payments for goods and services made through e-SISTAFE, while 95 percent of payments continue to be made on the basis of advance payments.

b. The Inhassoro functionality allowing for the closure of the 2006 budget and the production of the financial accounts of the State within e-SISTAFE is operational since end-2006.

c. The census of the civil service is ongoing and is expected to be completed as scheduled by end-April 2007 (structural benchmark).

d. The e-SISTAFE reporting functionality has been developed and is being implemented.

e. Most G-18 donor-financed projects have been integrated into the 2007 budget ceilings. However, the opening of a limited number of separate foreign currency accounts in the Single Treasury account (CUT)—a benchmark for end-March 2007—is delayed until end-September 2007 (structural benchmark). In addition, the guidelines to facilitate the inclusion of donor-financed projects on the CUT have not yet been issued and are now envisaged by mid-May 2007.

9. Monetary policy has remained prudent. Interest rates on government securities continued to be determined by market forces following the removal of interest rate caps in March 2006. Money velocity continued to decrease pointing to a deepening of the financial sector. Credit growth to the economy has remained strong especially due to the financing of petroleum imports and consumer loans. Net credit to the government (NCG) was lower than programmed (performance criteria) while net international reserves exceeded the floor by US$166 million (performance criteria). The indicative target on the balance of the Government’s saving account set up abroad with the proceeds from the coal mine exploration contract was lower than the floor programmed at end-December 2006 and end-March 2007. The funds were used for priority investment projects. In December 2006, the BM widened the band in the MCI from 0.25 percent to 1 percent. In addition, in order to strengthen the balance sheet of the BM, securities in an amount of MT 1.5 billion were issued to BM in June 2006 as envisaged in the program.

10. Prudential ratios of the banking system have remained sound. The ratio of nonperforming loans to total loans has remained below 5 percent while the requirement to provision 50 percent of their foreign currency-denominated loans to nonexporters since July 2005 has led to a deceleration in foreign currency credit growth. The commercial banks are highly profitable but their level of capital adequacy is being closely monitored in light of the overall strong growth in credit to the economy.

11. To strengthen Bank supervision, a proposal on the new organizational structure of the banking supervision department consistent with the Integral Strengthening Plan for Banking Supervision was approved by end-December 2006. In addition the new regulation on the assessment, classification and provisioning of credit and the regulation on integral risk management for credit institutions and finance companies were approved by end-March 2007. The Chart of Accounts of the commercial banking system was made consistent with IFRS with some delay in March 2007.

12. The remaining measures needed to address weaknesses identified in the context of the Fund's safeguard assessment mission conducted in June 2004, have now been implemented. In the area of accounting, the BM has issued its 2006 financial statements in compliance with IFRS in parallel to the financial statement prepared under the current accounting standard. The reconciliation of monetary data with audited financial statements and its review by the internal audit department was completed by end-December 2006.

13. Progress was also made to increase access to finance, in particular for rural financing. The BM has reduced the legal reserves requirement from 11.51 to 10.15 percent, a level that is in line with the practice in the region. This should help bring down the spread between deposit and lending rates along with other measures to reduce overhead costs and improve competition among banks including by encouraging greater transparency of fees and charges. Progress was also made improving the institutional lending environment. In order to accelerate dispute settlement and debt recovery of unsecured lending, the government has implemented a new Commercial Code, and established commercial sections of the judicial tribunals in the cities of Maputo, Beira, and Nampula. It has also set a strategy to promote rural financing through fiscal incentives and measures to reduce operating costs, including the opening of five BM agencies (with due regard to its cost) to facilitate the payment system and transfer of cash to commercial bank branches.

14. Progress on structural reforms also accelerated, particularly in the areas of the public sector, cost of doing business, and governance reforms. The Council of Ministers in October 2006 approved the second phase of the public sector reform strategic action plan (2006–11). The Ministry of Industry and Trade has finalized a draft strategy for reducing the cost of doing business climate in March 2007 as envisaged under the program. In the area of trade reforms, in January 2007, the maximum import tariff rate for consumer goods applicable to all trading partners was lowered from 25 to 20 percent. With regard to the Justice sector, the Supreme Court concluded 66 percent more cases in 2006 than in the previous year while activities in provincial courts increased by

48 percent thus reducing the backlog of cases by 34,019 cases to 68,433 outstanding cases. To accelerate the enactment of approved laws, the production of the Gazette of the Republic has been assigned to the Ministry of Justice. However, the Penal Procedure Code was not approved by Council of Ministers in December 2006 as envisaged under the program.

15. Some progress has been made in collecting the necessary information to monitor adequately the megaprojects and public enterprises. While a unit to monitor the megaprojects has not been created as envisaged under the program, the government has decided to assign that responsibility to the research department within the Ministry of Finance, whose functions include gathering information on megaprojects and public enterprises.

II. Objectives and Policies for the Three-Year PSI

16. Our overriding objective is to sustain a high rate of growth and to further reduce poverty in line with the PARPA II. Consolidating macroeconomic stability in the context of scaled-up foreign aid is a necessary condition to meet this challenge by maintaining a single digit inflation rate and preserving a comfortable level of foreign reserves. This is to be achieved by implementing sound fiscal and monetary policies in the context of a flexible exchange rate regime, as well as prudent public debt management and public finance reforms. In this regard, the CFMP will be revised taking into account the latest external financing envelope while continuing to target an average revenue increase of 0.5 percent of GDP a year and no recourse to financing from the domestic financial system. The gradual strengthening of sector strategies and costing of programs in PARPA II will help inform the revision of the CFMP, though addressing the variable quality of work on the costing of policies and programs at the sector and district level remains a priority to improve the overall planning and budgeting framework.

17. At the same time, we need to persevere with the timely implementation of our second wave of reforms to continue to improve public service delivery and create an enabling environment for private sector activity. Particular emphasis will be on implementing the second phase of the public reform program (2006–10) which consist of three pillars; (i) human resource management including payroll systems; (ii) performance evaluation and wage policy; and (iii) decentralization policy. Improving governance will remain a priority through the firm implementation of our anti-corruption strategy at all levels of the public service. We are also determined to make Mozambique's business environment one of the most competitive in Africa so as to achieve broad based growth, and to benefit from Foreign Direct Investment (FDI) and technology spillovers. We will also ensure that our natural resources are managed transparently following the principles of the Extractive Industries Transparency Initiative (EITI) so that future generations reap the maximum benefit of Mozambique's rich endowment. The fight against pandemics, and the improvement of human and physical capital, particularly infrastructure would continue with the help of the international community. The Government intends to continue to monitor its program with the existing multi-disciplinary committee, especially through reinforced coordination between the BM and the Ministry of Finance (MF).

III. The Policy Agenda for 2007

18. Economic prospects for 2007 remain favorable with continued strong economic growth and deceleration in inflation, albeit with risks related to the recent floods and cyclone. Central to achieving these objectives will be a strengthening of fiscal policy backed by a revenue increase of 0.5 percent of GDP and a prudent monetary policy. To maintain competitiveness and a comfortable level of international reserves, the BM will bestow greater exchange rate flexibility in the foreign exchange market. The structural reform agenda is in line with the PARPA II strategic matrix.

19. The 2007 budget envisages a scaling-up of aid and an associated increase in priority spending focused towards achieving the PARPA II targets including sufficient counterpart funds to ensure a smooth execution of donor-financed projects. There will be no recourse to domestic financing. Despite a nearly 0.2 percent of GDP revenue loss related to tariff reform, total domestic revenue is envisaged to rise by 0.5 percent of GDP by broadening the tax base through a continued increase of the number of taxpayers (by about 100,000), strengthening border control and limiting unwarranted customs exemptions (revenues amounting to about 0.2 percent of GDP), collection of new tax arrears amounting to about 0.3 percent of GDP, and quarterly updating of the specific fuel tax rate. In line with our 2007 budget, the expenditure side will reflect a hiring of about 10,000 teachers and 3,000 health workers while counterpart funds have been increased to cover scaled-up project financing. The share of spending on priority sectors (above 65 percent), particularly education, health, and infrastructure, has been agreed with the donors and will be closely monitored.

20. Following the immediate emergency response by the Disaster Management National Institute (INGC) to the victims of the floods along the Zambezi river and Cyclone Favio, the government developed a reconstruction plan estimated at US$71 million and the UN Office for the Coordination of Humanitarian Affairs launched an emergency appeal for a further US$29 million to meet the short-to-medium term needs of those hit by the flooding and by the Cyclone. The government, with the financial assistance of the donor community, will assist the affected population and enterprises with their basic needs and reconstruction of damaged infrastructure. However, in the event that donor-financing is inadequate to cover the reconstruction plan, the government may consider using the program adjustor to accommodate emergency fiscal outlays (up to a maximum of about US$20 million).

21. The government will continue to improve the efficiency of the tax system by sequentially implementing its medium-term tax policy reform program benefiting from Fund technical assistance. Progress on tax reform will be closely monitored within the MF. By end-June 2007, the government will study options on how to compensate for the further reduction in external tariffs that take place in 2008. In this regard, tax policy measures will be defined to equalize the treatment of interest income on different assets, streamline and simplify the tax system for small and medium-sized enterprises, update excise tax rates, rationalize income tax benefits, and reduce VAT exemptions. An external quantitative audit which sets the amount of arrears on VAT reform due to

contractors of large infrastructure projects, particularly in the road and water sectors, will be conducted with financial support from donors by end-September 2007, to be approved and decided upon by the Government by end-December 2007. On the basis of this audit a payment schedule will be defined to clear the arrears. Going forward, the government will ensure that VAT charged on supplies of projects be included in the final price of a contract.

22. The next phase of the revenue administration reforms (2007–10), to be supported by a multi-donor common fund, will focus on implementing the ATM strategic plan, and improving operational performance to help achieve the medium-term revenue targets. The ATM will be established through three stages: a transition period to end-2007, a gradual integration of the tax and customs agencies that will take place during 2008, and further strengthening and consolidation in 2009 and 2010. Revenues administration measures envisaged in 2007 include: (i) initiating procedures to recover tax arrears generated during 2006; (ii) providing a better service to taxpayers by reducing the average time to resolve VAT refund claims; (iii) implementing an audit plan for 2007 encompassing at least 675 audits at the DGI aimed at broadening audit coverage for domestic taxes; (iv) facilitating trade through the reduction of the average time to release imported goods at the border; and (v) implementing the IT Plan (PDTI). The ATM will initially use a basic information scoreboard and a basic set of operational performance indicators to monitor progress in reforms. In the course of 2008, ATM will put in place a modern management information system to measure performance of the tax administration's core functions at both strategic and operational level to evaluate the tax administration's efficiency and effectiveness, to guide management decisions, and to measure progress in the implementation of ATM's strategy.

23. A number of specific measures in the medium-term PFM APB will be implemented in 2007.

- Following the completion of the census of the civil service, an integrated and e-SISTAFE compatible payroll database will be developed—register of the state employees (CAF)—enabling the MF to carry out salary payments via e-SISTAFE by end-June 2007 (structural benchmark). The pensioners census will be executed in a slightly different timeframe and the pension functionality in e-SISTAFE will be completed by end-September 2007. In addition, by end-September 2007, the government will decide on the institutional responsibilities for keeping the payroll and pension database updated.

- Even with the introduction of the CAF, the calculation of salaries and pensions (value of payment, value of tax to be retained, and classifications) will continue to be made outside e-SISTAFE, and global salary payments to civil servants who do not have a banking account will continue to be paid into the line ministries salary accounts. As such, a business case (BC) will be developed by end-September 2007 for a second phase allowing for the automatic calculation of payroll and pension payments, as well as execution of salaries and pension payments directly to recipients' bank accounts, through e-SISTAFE on a transactional basis.

- UTRAFE will elaborate a BC presenting the various options with relation to e-SISTAFE rollout to the districts. Conditioned on the approval of the BC, it is foreseen that by the end of October 2007 a total of 27 districts will be operating e-SISTAFE. By end September 2007, UTRAFE will present a plan for further district and autarquia rollout in 2008.

- The e-SISTAFE will be rolled out to all the remaining ministries at the central and provincial levels listed in the TMU by end-December 2007 (structural benchmark).

- A business case will be finalized by end-September 2007, defining a list of State organs at the central level for which the e-SISTAFE will be progressively rolled out.

- The Phase II of the budget formulation module will be tested and ready for use and training by end-June 2007, to fit in with the 2008 budget calendar and pilot cases of program budgeting. The latter uses a conceptual model agreed between the MF and the Ministry of Plan and Development.
- In close coordination with the ATM, a fully articulated BC will be prepared by end-June 2007 to implement a revenue collection network (RCN) with which all government revenues collection will be automated and classified before being transferred to the CUT. UTRAFE is aiming at testing a functional prototype by April 2008.
- To facilitate the inclusion of all donor-financed projects within the CUT, UTRAFE will put in production a pilot test of the multi-currency CUT by end-September 2007 aiming at full production by January 2008.
- For the implementation of the asset management system and procurement interface to e-SISTAFE, the development of requirement specifications will be finalized and a tender launched by end-June 2007.
- Through the development of a reliable and updated supplier data base and the implementation of findings by the Government task force, the level of effective direct budget execution (according to the sequence of commitment, verification, and payment) for goods and services will be increased to 30 percent by end-September 2007, 50 percent by end-December 2007 (structural assessment criterion), and 75 percent by end-March 2008, and 90 percent by end-June 2008.

24. On monetary policy, the BM will continue to target base money with a view to achieving its inflation target. A long-term monetary policy strategy document was approved by the executive board of the BM in October 2006 that defines an intermediate target compatible with the base money operational target, a new format for the monetary policy committee, and its communication policy. To achieve the inflation objective of 6 percent by end-2007, broad money growth will be limited to about 16 percent—or slightly higher than nominal GDP growth— to take into account the ongoing financial deepening. In addition, the monetary authority remains committed to a flexible exchange

rate regime and to that effect will continue to gradually widen the temporary exchange rate band in the foreign exchange market when conditions permit.

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

26. In the area of public debt management, FSTAP supported reforms at the MF and BM has gained momentum and is expected to intensify after the second quarter of 2007. Following recommendations made in a debt management assessment report prepared by an FSTAP consultant, the government intends to realign its debt management institutional framework along international best practices. The MF intends to strengthen its staffing complement, launch a multi-year training program, consolidate the debt database for all public debt, start to publish debt reports regularly and design an integrated debt strategy by end-2007.

27. The BM will also continue to strengthen and modernize its supervisory functions and implement the recently approved organizational changes in view of strengthening on-site and off-site monitoring. In this regard, training to adopt a risk-based supervision approach will start in 2007, at which time the new inspection manuals will also be used. The BM is implementing a timetable to adopt IFRS in the banking system in 2007. Based on the results of the FSTAP study, to be completed by mid-2008, the application of IFRS will also be extended to the corporate sector in January 2009 for large companies. This will improve the ability of the financial system to evaluate the quality of their loan portfolios. Further, new regulation on the assessment, classification and provisioning of credits as well as a regulation on integral risk management for credit institutions and finance companies have been approved and will become effective during the first semester of 2007. The BM will issue its own 2006 financial statements in line with IFRS in 2007.

28. The Government is committed to supporting a sound expansion of the non-bank financial sector. The BM will continue to license and supervise microfinance deposit-taking institutions to facilitate enhanced access to finance by rural households and small-and-medium sized enterprises. Both the FSTAP and the IFAD supported Fundo de Apoio à Reabilitação Económica (FARE) and the Rural Finance Support Program (RFSP) will support the government's efforts to improve access to finance, especially in rural areas. The strengthening of the social security and supplementary pension system is also being undertaken as part of a new law on social protection, which has been approved by the Assembly. As part of the restructuring of the National Social Security Institute (INSS), an actuarial study will be completed before the end of 2007. In the meantime, guarantees of minimum benefits will be limited until the full study is carried out. Efforts to strengthen

the regulatory and supervisory framework of the insurance sector as well as the institutional capacity of the *Inspecção Geral de Seguros* (IGS) are under way. The Insurance Law is being reviewed to bring it in line with international best practices, revised prudential and solvency requirements for Mozambican insurers are being developed, while new IFRS-compliant Chart of Accounts for insurers would also be designed. New supplementary pension funds regulations are to be presented to the Council of Ministers for approval by September 2007.

29. Regarding the foreign exchange system, a new foreign exchange law taking into account comments from all stakeholders and the Fund, will be submitted to the Assembly by end-April 2007. Following approval of the new law, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement. The recent regulation (Aviso 2/06) pertaining to the current import and export transactions remains suspended and will be replaced by the issuance of a new one.

30. In order to improve the trade regime, the government will continue in 2007 ongoing Economic Partnership Agreement (EPA) negotiations, with technical advice under the Integrated Framework. The government is also pursuing bilateral free trade arrangements as recommended in the Diagnostic Trade Integration Study (DTIS).The government is continuing its negotiations with Angola, Tanzania and Zambia in order to reach trade agreements similar to the ones concluded with Zimbabwe and Malawi in 2005.

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

32. The Government of Mozambique is conscious that despite its efforts to improve its investment climate during the year 2006, its ranking in the ease of doing business, as assessed in the Doing Business report 2007, has worsened to 140th place. The recent authorization to publish the bylaws of firms electronically would help to improve the ranking. However, it is not sufficient to make Mozambique's business environment the most competitive in SADC by 2015. To address this challenge and significantly improve the investment climate in Mozambique, the Ministry of Industry and Commerce has developed a draft strategic action plan for 2007–12 covering business start-up and registration, licensing, business inspections, labor costs, access to credit, cost of energy, and property registration. The World Bank has provided comments on the strategy and will provide further assistance in the development of the strategic action plan. An interministerial committee has been setup to monitor the implementation of this plan. In 2007, the two key actions envisaged will include:

(i) Reducing the cost of inspections and fines while improving compliance. The authorities intend to adopt a system of inspections that will be simplified, business friendly and harmonized across the several ministries that undertake inspections; and

(ii) Simplifying the procedures of closing businesses. Through a new insolvency law that will be submitted to the Council of Ministers by end-September 2007, the Government intends to simplify the business closing process and increase the recovery rate with the objective of helping viable businesses to overcome a short-term cash flow crisis, and insolvent businesses to be rapidly liquidated.

33. In 2008, the three key actions envisaged are:

(i) Reducing the licensing burden. To speed up the licensing process, the Ministry of Industry and Trade is in the process of setting up "One-Stop-Shops" for licenses at the provincial level. Additionally, through the Inter-Ministerial Commission mechanism, the licensing process will be streamlined, and the number of licenses required will be reduced;

(ii) Facilitating trading across borders. The Government will carry out a review of the import and export procedures, with financial assistance from the international community and will implement the recommendations of that study with the specific aim of reducing documents, signatures and the amount of time required for both importing and exporting; and

(iii) Improving the system for VAT reimbursement. The Directorate of Taxes and Audits will implement a system to improve collection, including through the prosecution of non-compliant institutions and expediently channeling these funds back to those firms that are in compliance with the VAT system.

34. In 2009, the four key actions envisaged are:

(i) Consolidate the progress in streamlining and reducing licenses for all sectors;

(ii) Consolidate the progress in facilitating trading across the borders. By end 2009, Mozambique should be as efficient at its borders as South Africa in the clearance of goods for both imports and exports. This will require reducing the number of documents filled out by at least half.;

(iii) Simplification of Tax Filing. Electronic filing of taxes should be provided and forms should be simplified to reduce the time required for tax preparation; and

(iv) Property Registration. Amendment of the relevant legislation to speed up the registration process by improving communication among different government agencies and developing an electronic database for the real estate registry. All registrable acts will be exempted from the requirement of prior execution of public deeds.

35. The Government will continue to restructure and encourage public-private partnerships, particularly in infrastructure services. Public-private partnerships and sale of

state assets (and concessions) will be undertaken transparently in line with international best practices. A decision was made by the Council of Ministers in May 2006 to develop a new restructuring plan for PETROMOC that would improve efficiency. The new restructuring plan will be completed by end-June 2007 for its adoption by the Council of Ministers by end-September 2007. For the purchase of shares in Cahora Bassa, the Government remains committed to a non-recourse financing of the outstanding payment of US$700 million to Portugal and ensuring transparency of the financing package and operations. While strengthening the investment planning capacity of the Ministry of Energy, the Government, with the assistance of its financial advisors, is now in the process of selecting strategic investors for: (i) Temane gas-fired generation project (about 750MW); (ii) Moatize coal power project (about 1,500MW); and (iii) Mphanda Nkuwa hydropower plant (about 1,300MW). To support these new generation projects, there would be a need to build a major transmission line to distribute the power to the Mozambican market and for export. For all these projects, the Government will ensure, with the help of the World Bank and other partners, that: (i) financing is non-recourse and does not increase central government liabilities; and (ii) maximizes private sector investments through the use of public-private partnerships with any equity stake by the state-owned electricity company (Electricidade de Moçambique, EDM) raised through concessional borrowing or without government guarantees. The Government with the help of the World Bank and other partners will also continue to put in place measures to assist EDM to improve its performance, including through a performance contract and the operationalization of the regulator (CNELEC) by end-June 2007. In general, the government will, across all sectors seek to buttress regulatory bodies, including monitoring of concessions.

36. Aeroportos de Moçambique (ADM) commissioned a project-financed report on options for airport infrastructure financing which was completed in August 2006. While the proposed Maputo Airport Concession (ACSA) has been cancelled, ADM is now seeking to mobilize funds for its Investment Plan, estimated at US$94 million, including the Modernization of Maputo Airport Infrastructure (about US$46 million) through only concessional borrowing.

37. To strengthen the management of natural resources, the government will issue regulations to the new Mining and Petroleum Fiscal Regime laws within 90 days once they have been approved by the Assembly. The Government will adopt the new model contract for mining concessions to complement the new law submitted to the Assembly (structural assessment criterion at end-June 2007). The model contract for the petroleum sector will be adopted by end-September 2007 (structural assessment criterion).The Government also remains committed to ensuring that any new mineral resource project agreements will adhere to the principles of the new law and its proposed regulations, and is using a model mining contract in its current round of negotiations, as well as new fiscal model to develop the capacity to undertake timely feasibility studies and financial modeling. The Government has also requested TA from the Fund to make the model petroleum contract more specific, and narrow the range of items for bidding or negotiation. In the interim, the Government is committed to avoiding signing any new Exploitation and Production Concession Contracts (EPCs) in the petroleum sector until a

new comprehensive petroleum fiscal regime is in place that would be embodied in the general tax law so as to avoid case by case negotiation of petroleum tax terms.

38. Improving transparency remains a priority for the Government. The Government intends to follow the EITI principles with regard to management of natural resources. The Government has already participated in a seminar in Oslo in 2006 on the EITI principles and will participate in a seminar in Maputo in 2007. The Government will consider becoming a member of the EITI in the future. In this regard, an EITI scoping study is planned under the Ministry of Planning and Development to assess the barriers to implementation and the net financial benefits and improvement in investment climate likely to accrue to Mozambique from the adoption of the EITI principles. Thereafter all new related agreements, in particular the future exploitation of coal, oil, titanium and natural gas as well as any new megaprojects (or expansion of existing megaprojects) will follow the EITI principles.

39. The monitoring of megaprojects and public enterprises in the research department of the MF will be further strengthened including through the compilation of a comprehensive database of financial information.

40. The Council of Ministers approved the Phase II of the public sector reform program (2006–11) building on the lessons from the implementation of the Phase I of this program (2001–05). The Phase II document sets four priorities for the public sector reform program: (i) the improvement of the delivery of public services to citizens and the private sector; (ii) the strengthening of the capacity of the local organs of the state which includes the implementation of a decentralization policy and strategy; (iii) the professionalization of public servants including introduction of performance evaluation systems and wage policy; and (iv) the strengthening of governance and anti-corruption systems. A special role is provided to districts as the focus of development which will be supported by improved planning, financial control, and operation of the new procurement system up to the district level. Public sector accountability through external and internal audits will be improved by reinforcement of the capacity of the Tribunal Administrativo, the supreme audit institution in Mozambique, and capacity building of the Inspector General of Finances. Importantly, a decentralization policy will be appraised by the Council of Ministers by end-June 2007 and submitted to the Assembly. Subsequently, a decentralization strategy will be approved by the Council of Ministers by June 2008. The strategy will propose, among other things, a clear legal, regulatory, and institutional framework for revenue raising and spending responsibilities and functions of subnational units (provinces, districts, and municipalities) and monitoring of subnational fiscal operations. The sequencing of the strategy will pay due regard to the administrative capacity of subnational units and need to maintain fiscal control. The results of the census will be incorporated in a preliminary wage policy to be discussed by the Council of Minister by end-November 2007 and implemented in the context of the 2009 budget. The next steps include the collection of baseline data for monitoring and evaluation of the results of the activities to be undertaken within the aforementioned priorities.

41. With regard to government's anti-corruption strategy, operational plans were developed in five sectors (Judicial, Interior, Finance, Education and Culture, and Health) in 2006 and completed in January 2007. Such plans form the National Action Plan to Fight Corruption and were submitted to the first session of the Anti-Corruption Forum in March 2007. The dissemination of the actions and outcomes to be undertaken by these sectors was initiated in a national workshop for the launching of the oversight and monitoring organs of the anti-corruption strategy that took place in March 2007 and was opened by the President of the Republic. The main organ that was set is the National Anti-corruption Forum chaired by the Prime Minister and having the Attorney-General as vice-chair. The Forum has 78 members and its other members include parliamentarians, religious leaders, representatives of business associations, trade unions, NGOs, and of the 11 provincial anti-corruption forums. Expected to meet once a year its routine work will be undertaken by small technical supervisory unit, headed by the director of the Central Office for the Fight Against Corruption (which operates from the Attorney-General's Office). The next step will be the setting of the baseline data for the monitoring of the various indicators included in the National Action Plan to Fight Corruption.

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

43. The urban land use Regulation was approved by the Council of Ministers in October 2006, which will facilitate the reduction of costs and time involved in transactions. The Lei do Ordenamento do Território has been submitted to the Assembly for approval. The Government remains committed to conducting an economic analysis of urban land markets with a view to understanding how these function in practice, as well as assessing the associated poverty reduction impact analysis of urban tenure regulations and monitoring the implementation of the Land Law and its regulations. The survey of land holding in some selected districts in the southern part of the country will end in June 2007 and the titling after digitization is expected to be completed by the end of 2007. Finally, the Government is also preparing a draft strategy for slum upgrading.

44. The Government is committed to reinvigorate the reform of the judicial reform with the help of the international community. The main priority for the coming year is the redrafting of an integrated strategic plan for the justice system by June 2007, to set up a joint monitoring system for the entire legal sector, to strengthen mechanisms of sector coordination, and to draw up a vision of justice. The organic law of judicial tribunals is expected to be approved by the Assembly in the current session of the Assembly. Commercial and labor sections of the judicial tribunals will be expanded with the help of the international community. A new bankruptcy law and the Code of Penal Procedures will also be approved by the Council of Ministers and submitted to the Assembly by end-September 2007.

45. The Government is continuing its efforts to improve the quality of macroeconomic statistics in order to improve policy formulation and the monitoring of economic developments. To that end, the INE is aiming to launch a new national accounts

framework, including revision of annual GDP data and quarterly estimates by end-June 2007. With regards to monetary statistics, the BM is committed to aligning the chart of accounts with the Monetary and Financial Statistics Manual, including a breakdown between local and foreign-currency denominated accounts. The BM is also aiming to improve the quality of its external sector statistics, including by improving the coverage of megaprojects. With regards to government finance statistics, significant improvements have been made as a result of the launch of e-SISTAFE. However, the Government understands that further work is needed to expand the institutional and transactional coverage sufficient for compilation of the Funds in accordance with Government Finance Statistics (GFS) manual of 2001.

IV. Program Monitoring

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

47. The Government understands that the completion of the first review is contingent upon the observance of the assessment criteria for end-June 2007 set out in Table 1 and 3; which is expected to take place before end-December 2007. In reviewing developments under the program during the first review, particular attention will be paid to the implementation of measures aimed at broadening the tax base and further developing e-SISTAFE, the 2008 budget, monetary and financial sector reform, reducing the cost of doing business, infrastructure financing with due regard to debt sustainability, and improving the fiscal regime and transparency of natural resource exploitation and megaprojects as well as their net contribution.

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

	2006			2007			
	End-Dec. Perf. Criteria	End-Dec. Perf. Criteria	End-Dec. Perf. Criteria	End-March Indicative Target	End-June Assessment Criteria	End-Sep. Indicative Target	End-Dec. Assessment Criteria
	Prog.	Adj.	Prel. Act.	Prog.	Prog.	Prog.	Prog.
Net credit to the government (cumulative ceiling)	-4,518	-4,518	-5,835	-938	-1,948	-1,713	-1,828
Stock of reserve money (ceiling)	14,038	14,288	14,736	13,596	14,235	14,990	16,020
Stock of net international reserves of the BM (floor, in millions of U.S. dollars)	1,063	1,029	1,229	1,253	1,283	1,341	1,300
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling)	0	0	0	0	3	3	3
Stock of short-term external public debt outstanding (ceiling)	0	0	0	0	0	0	0
External payments arrears (ceiling)	0	0	0	0	0	0	0
Indicative targets:							
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars)	83	83	75	76	55	35	35
Government revenue (floor)	26,052	...	26,997	6,321	14,594	22,711	31,942

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

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

Table 2. Mozambique: Structural Performance Criterion and Benchmarks Under the 2006 and 2007 PRGF-Supported Program (October 2006–April 2007)

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

Table 3. Mozambique: Structural Assessment Criteria and Benchmarks Under the 2007 Policy Supported Instrument (June 2007–December 2007)

Actions	Expected Date of Implementation	Comments
Structural assessment criteria		
Adoption of the new model contract for mining concessions.	End-June 2007	
Adoption of the new model contract for the petroleum sector.	End-September 2007	
The level of effective direct budget execution via e-SISTAFE (according to the sequence of commitment, verification, and payment) for goods and services will be increased to 50 percent.	End-December 2007	
Structural benchmarks		
An integrated and e-SISTAFE compatible payroll database will be developed —register of the state employees (CAF)—enabling the Ministry of Finance to carry out salary payments via e-SISTAFE.	End-June 2007	
A limited number of separate foreign currency accounts will be opened within the CUT.	End-September 2007	
A memorandum of understanding will be agreed between the Ministry of Finance and the Bank of Mozambique, to shift the costs of managing monetary policy to the budget.	End-September 2007	
All budgetary operations for goods and services of Financial Management Departments (DAFs) of all remaining ministries at the central and provincial levels will be executed through the e-SISTAFE.	End-December 2007	

Attachment II

Technical Memorandum of Understanding on Selected Concepts, Definitions, and Data Reporting Under Mozambique's Policy Support Instrument Program

March 28, 2007

1. This technical memorandum of understanding (TMU) purpose is to describe the concepts and definitions that will be used in monitoring the Policy Support Instrument (PSI) program, including the following:

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

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

Net Claims on the Central Government by the Banking System

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

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

Government revenue and financing

4. Revenue is defined to include all receipts of the Domestic Tax Administration (Administração Tributaria de Impostos or DGI), the National Directorate of Customs (Direcção Nacional de Alfândegas, DNA), and nontax revenue, including certain own-generated revenues of districts and some line ministries as defined in the budget. Net receipts

from privatization received by the National Directorate of State Assets (Direcção Nacional do Patrimônio do Estado) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

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

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

Money supply

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

Net international reserves

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

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

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

10. The term "debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000. Government debt is outstanding debt owed or guaranteed by the central government or the Bank of Mozambique (but does not include debt of any political subdivision or government-owned entity with a separate legal personality that is not otherwise owed or guaranteed by the central government).

11. The central government will limit contracting or guaranteeing external debt up to US$3 million with original maturity of one year or more with a grant element of less than 35 percent, calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the Budget Law. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. This assessment criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

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

External payments arrears

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

Foreign program assistance

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

Actual external debt-service payments

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

Adjusters

16. The quantitative targets (floors) for the central bank's net international reserves will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted downward by 100 percent of any shortfall in external program aid (up to a maximum of US$50 million) and any excess in external debt service payments, compared to the program baseline (Table 1). The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-

year figures corresponding to the previous year. They will also be adjusted upward for the full amount of any external privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments. The quantitative targets (floors) for the central bank's net international reserves will be adjusted equivalently downward up to a maximum of US$50 million per annum by the amount that the projected fuel import bill is higher due to a rise in the average global oil price (average petroleum spot price of West Texas Intermediate, U.K. Brent, and Dubai Fateh crude). This adjustment will be equal to the difference between the realized and the projected average global oil price, multiplied by the volume of total fuel imports projected for each quarter (Table 2). In addition, the quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) by the amount of donor-financed projects deposited in the MT single treasury account (CUT) if they are higher (lower) than projected for each quarter (Table 1)

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

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

19. The base money ceiling will be adjusted equivalently upward up to a maximum of MT 300 million at end-June 2007, end-September 2007, and end-December 2007 to the extent that the outstanding stock of currency issued by the BM exceeds those projected in Table 3.

Data reporting

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

21. The government will continue to provide Fund staff with the data corresponding to monthly government revenues (in detail according to the fiscal table), with a lag not exceeding one month. In addition, the government will continue to publish and provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.

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

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

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

	2007				
	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
Foreign program assistance	3319.5	3195.5	3211.5	452.9	10179.5
Program grants	1469.6	2384.5	3211.5	452.9	7518.6
Program loans	1849.9	811.0	0.0	0.0	2660.9
External debt service	-154.7	-115.9	-115.9	-115.9	-502.4
Disbursement of donor-financed projects (in millions of US dollars)	0.0	0.0	0.0	0.0	0.0

Source: Mozambican authorities; and Fund staff estimates.

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

	2006		2007			
	IMF 07/36	Act.	End-Mar. Prog.	End-Jun. Prog.	End-Sept. Prog.	End-Dec. Prog.
Fuel Import Bill	312.1	345.8	71.0	84.3	116.6	81.3
Forecast Oil price (US$ per barrel)	61.3	62.5	56.5	60.5	62.5	63.5
Volume of fuel imports (in metric tons)	520,969	552,905	151,213	140,514	202,246	122,416

Sources: Mozambican authorities and Fund staff projections.

Table 3: Currency Issued by the BM
(In millions of MTn, stock)

	2006		2007			
	End-December IMF 07/36	End-December Actual	End-March Prog.	End-June Prog.	End-September Prog.	End-December Prog.
Currency issued by BM	7,690	8,789	7,305	7,800	8,797	9,649

Source: Mozambican authorities; and Fund staff projections.

SISTAFE Implementation Plan

Action	Expected date
Rollout to the following Ministries and Organs: 1. Ministry of Labor; 2. Ministry of Former Combatants 3. Ministry of Youth and Sports 4. Ministry of Foreign Affairs and Cooperation	end-December 2007

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND

MOZAMBIQUE

Joint World Bank/IMF Debt Sustainability Analysis

Prepared by the staffs of the International Development Association and the International Monetary Fund

Approved by Vikram Nehru and Sudhir Shetty (World Bank) and David Nellor and Anthony Boote (IMF)

May 16, 2007

This analysis assesses the sustainability of Mozambique's external public and domestic debt. The debt sustainability analysis (DSA) was conducted jointly by the staffs of the IMF and the World Bank using the joint Bank-Fund framework for debt sustainability analysis for low-income countries. The bilateral external debt data underlying this DSA were provided by the Mozambican authorities. The multilateral debt data provided by the authorities were reconciled with information obtained from the creditors. On the basis of this DSA, the staffs conclude that the risk of external debt distress for Mozambique is low.

I. Background

1. **At end-2006, Mozambique's external public and publicly guaranteed (PPG) debt stock, including arrears,**[1] **stood at US$3.2 billion in nominal terms or US$706.6 million in NPV terms (Table 1).** Of this, 36 percent was owed to multilateral creditors, 59 percent to bilateral creditors, and about 5 percent to commercial creditors. Thanks to the Multilateral Debt Relief Initiative (MDRI), from the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF), the debt stock fell by US$1.9 billion in nominal terms in 2006.[2]

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[1] Arrears to bilateral creditors amounted to approximately US$1.2 billion, and include moratorium arrears to Portugal and Japan. Arrears to commercial creditors, US$157 million were covered by the debt-buy back facility.

[2] The amount of MDRI relief provided by the IMF was US$120.6 million; IDA provided US$1.3 billion; and AfDF provided US$464.5 million.

2. **Previously, Mozambique has benefited from HIPC assistance provided by multilateral and Paris Club bilateral creditors.**[3] Bilateral agreements were reached with all Paris Club creditors except Portugal and Japan, who together account for about 20 percent of total Paris Club debt at end-2000 in NPV terms.[4] The Mozambican authorities are making best efforts, however, to reach debt cancellation agreements with Portugal and Japan in 2007. Mozambique signed an agreement with France regarding the cancellation of all outstanding debts in April 2007. Russia recently announced its intention to cancel 100 percent of debt to HIPCs that reach completion point. Mozambique authorities are in touch with the Russian embassy in Maputo to finalize this process.

Table 1. Mozambique: External and Domestic Nominal Debt Outstanding at End-2006

	In millions of U.S. dollars	In percent of GDP
Total Domestic and External PPG Debt	**3833.3**	**49.6**
Total Domestic Debt	**606.9**	**7.8**
Total External Public and Privatly Guaranteed Deb	**3226.4**	**41.7**
Multilateral Creditors	**1149.0**	**14.9**
IDA	667.3	8.6
IMF	4.7	0.1
African Development Bank	187.1	2.4
Other Multilaterals	289.9	3.7
Bilateral Creditors 1/	**1902.0**	**24.6**
Paris Club	801.2	10.4
Non-Paris Club	1100.9	14.2
Commercial Creditors 1/	**175.4**	**2.3**
Total Private Non-guaranteed and Short Term Debt	**1404.6**	**18.2**
Memo items:		
Total External Debt	**4631.0**	**59.9**
NPV of Total External Debt	**2111.2**	**27.3**
NPV of External PPG Debt	**706.6**	**9.1**

[3] See "Mozambique−HIPC Debt Initiative: President's Memorandum and Recommendation and Completion Point Document" (IDA/R99–139), and "Mozambique – Enhanced HIPC Debt Initiative: President's Memorandum and Recommendation and Completion Point Document" (IDA/R2001–0150).

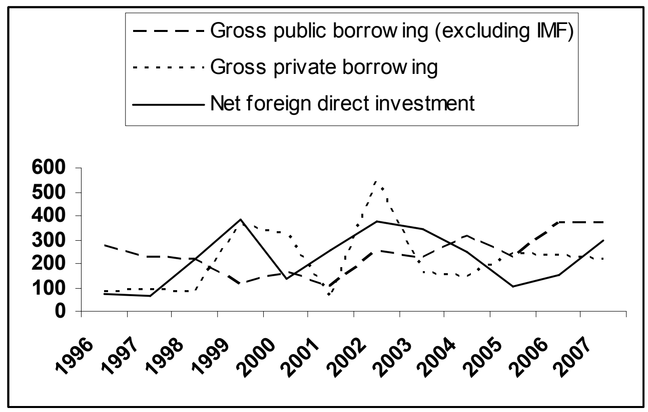
[4] In February 2005, Mozambique signed a technical memorandum with Portugal, in which Portugal confirmed that it would provide 100 percent debt service reduction. Subsequently, however, Portugal added a clause to this agreement which Mozambique has refused to accept, because it considers it to be not on comparable terms. Japan, has also repeatedly indicated intentions for 100 percent debt reduction, but an agreement has not yet been signed due to delays of an administrative nature.

3. **Thus far, Mozambique has not been that successful in negotiating debt relief agreements with some of its non-Paris Club bilateral creditors.** Negotiations with Algeria, Libya, and Iraq are proving difficult despite Mozambique's best efforts. Negotiations with India are reportedly progressing slowly. The Chinese government cancelled Mozambique's outstanding debt in February 2007 and Kuwait provided comparable treatment with the Paris Club.

4. **Mozambique benefited from a commercial debt buy-back operation in 2007.** This operation covered all outstanding commercial debt in arrears, which was estimated at US$175.4 million at end-2006. The Government of Norway and the World Bank (IBRD) financed the operation.

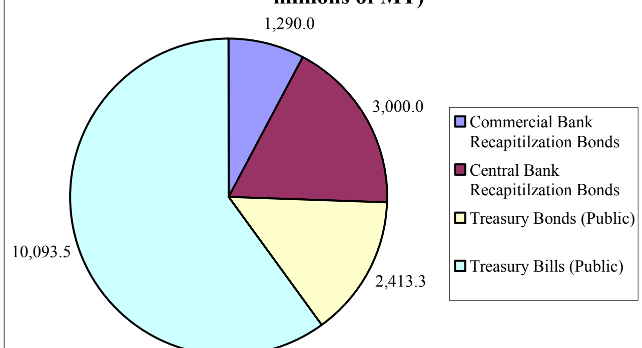
5. **Total external debt in Mozambique has a significant private component due to "megaproject" related lending.** Private external debt averaged 24 percent of the country's total external debt during the period 2001–06. Most of the megaproject investments were debt-creating, as evidenced by the correlation between FDI inflows and private borrowing (text chart).[5]

Gross public and private borrowing, 1996–2007
(In million of U.S. dollars)



6. **Mozambique's domestic public debt stock is dominated by recapitalization bonds and treasury bills issued to mop up excess liquidity.** The total stock of domestic public debt (treasury bills and bonds) was about 8 percent of GDP at end-2006, which is low by regional levels. The Ministry of Finance ceased issuing treasury bills for deficit financing purposes in 2006, therefore the total stock of outstanding treasury bills have been issued by the Bank of

Composition of End-Year 2006 Domestic Debt (in millions of MT)



Source: Mozambican authorities; and World Bank and IMF staff estimates.

[5] Gross private borrowing includes gross private external borrowing by megaprojects and other private companies, including net borrowing by commercial banks from 2002, but is based on the limited information available and may not cover all private enterprises.

Mozambique on behalf of government for sterilization purposes. The majority of the stock of treasury bonds are accounted for by bonds issued to recapitalize the central bank in 2005 and 2006 (following losses incurred during 2004), and related to the process of restructuring commercial banks, which is now complete. The rest of the treasury bonds with a maturity ranging from 1–10 years are held by the general public and financial sector.

II. METHODOLOGY AND KEY ASSUMPTIONS

7. **Following the guidelines of the LIC debt sustainability framework, staffs have analyzed the evolution of the external public debt stock and debt service indicators for Mozambique under a baseline scenario and a series of stress tests.**[6] The stress tests are designed to assess the probability of a country facing debt distress in the future under common shocks. In addition, staffs have considered the effect of an increase in nonconcessional external new borrowing by US$1 billion in 2008[7] and a persistent scaling-up of external borrowing of US$200 million from 2008–15.[8] The purpose of the first country-specific scenario is to illustrate the potential impact of undertaking large infrastructure projects that increase the central government's liabilities to commercial creditors. The scaling-up scenario is intended to illustrate the fiscal space available to scale-up concessional external borrowing focused on achieving the Millennium Development Goals (MDGs).[9]

8. **The analysis is guided by indicative, performance-based debt burden thresholds, which take into account the empirical finding that the debt levels that a low-income country can sustain increase with the quality of its policies and institutions.** The quality of policies and institutions is measured by the three-year average Country Policy and Institutional Assessment (CPIA) of the World Bank, according to which Mozambique ranks as a 'medium performer'. The indicative external debt burden thresholds for countries in this category are an NPV of debt-to-exports ratio of 150 percent, NPV of debt-to-revenue ratio of 250 percent, a NPV of debt-to-GDP ratio of 40 percent, and debt-service-to-exports and revenues ratios of 20 and 30 percent, respectively.[10]

[6] The Executive Boards of the Fund and the Bank approved the Operational Framework for Debt Sustainability Assessments in Low-Income Countries in April 2005 (http://www.imf.org/External/np/pp/eng/2005/032805.htm) and IDA/R2005-0056).

[7] The assumed terms of this loan are a grace period of one year, total maturity of 10 years, and an interest rate of 8 percent.

[8] External borrowing from bilateral donors is assumed to be higher by US$200 million each year from 2008 onwards until 2015.

[9] It is also based on the indication from donors of a possible further scaling-up of foreign aid of about US$200 million (or 2 percent of 2008 GDP) over the medium term, which is unlikely to be all grants.

[10] The NPV of external debt-to-revenue ratio excludes all grants.

9. **The baseline scenario is subject to a number of assumptions.** The underlying macroeconomic assumptions, which are summarized in Box 1, are consistent with the medium-term macroeconomic framework described in the staff report. In addition, the external debt numbers assume the full delivery of HIPC debt relief by all creditors, 100 percent debt reduction by France, Russia, Japan China, and completion of the commercial debt buyback operation. Finally, the authorities are assumed to borrow predominantly from the IDA and AfDF, resulting in an average grant element on new borrowing of 41 percent. This assumption is based on the authorities' medium-term projections, which were informed by consultations with donors.[11]

III. External Debt Sustainability

10. **Under the baseline scenario presented in Table 2, the debt indicators all remain below their respective thresholds.** The NPV of PPG external debt-to-GDP ratio is projected to rise from 11.6 percent in 2007 to 16.1 percent by 2013, after which it slowly declines over the remainder of the projection period to 9.9 percent by 2027. It thus remains well below the country-specific threshold of 40 percent. The NPV of PPG debt-to-exports ratio increases from 30.3 percent in 2007 to 63.3 percent by 2016—also far below the threshold of 150 percent—before falling back to about 44 percent again by 2027. The NPV of PPG debt-to-revenue ratio increases to a peak of 94.5 percent in 2010, significantly below the threshold of 250 percent. It then declines rapidly to 35.9 percent by 2027, driven in part by the assumed increase in revenue collection.

11. **The debt service indicators also remain below their thresholds under the baseline.** As a result of the assumed full delivery of remaining HIPC debt relief in 2007, PPG debt service falls in 2007. The PPG debt service-to-exports ratio, which has a threshold at 20 percent, falls from 2.5 percent in 2006 to 1.1 percent in 2007, peaking at 4.6 percent in 2021 and then gradually decreasing to 3.8 percent in 2027, always well below the threshold. The ratio of PPG debt service to fiscal revenues falls from 6.6 percent in 2006, to 2.9 percent in 2007, increasing slowly to 5.1 percent in 2011 and declining to 3.1 by 2027, well below the 30-percent threshold (Table 2).

12. **External debt sustainability appears resilient to a number of shocks, although the DSA shows that the debt service burden could rise significantly in the event of a large increase in nonconcessional external commercial borrowing.**[12] As Table 3 shows,

[11] Staffs have undertaken additional analysis that shows that the results of the DSA are not sensitive to a lowering of the grant element. Stress Test A2 underscores this finding.

[12] Both, last year's DSA and this one, concluded that the risk of external debt distress for Mozambique is low, even with the inclusion of the domestic debt, which was absent in the 2006 DSA. However, some of the expected bilateral agreements envisaged in the 2006 DSA did not materialized but are expected to be concluded during the course of this year. Regarding the assumptions for MDRI, the expected relief was greater than previously estimated, which further improved the debt situation.

all the stress tests results show that debt sustainability indicators are well below the relevant thresholds. However, stress test B7 shows that debt sustainability may be susceptible to a significant increase in the amount of nonconcessional commercial debt in 2008. While still remaining below the thresholds, the debt burden indicators rise sharply, and more than double compared to the baseline (Table 3 and Figure 1). The alternative scenario of higher concessional borrowing from 2008–15 also remains below the indicative thresholds but almost doubles the NPV of debt to GDP by 2015.

IV. Public Sector debt sustainability

13. **Mozambique's public debt (including domestic debt) is expected to decline over the medium-to-long term under the baseline scenario (Table 2a and Figure 1a).** As a result of the gradual redemption of bonds issued to restructure the banking system and predominant use of foreign exchange sales for sterilization purposes, public debt is projected to decline from about 27 percent of GDP in 2007 to 30 percent in 2011, and to 14 percent by 2027 while the NPV of public sector debt-to GDP ratio is projected to fall from 19 percent in 2007 to 9 percent by 2027 (Table 2a). The nonrecourse to domestic financing over the medium-term whilst only gradually increasing domestic financing of the fiscal deficit from 2012 onwards contributes to such a path for public debt. On the other hand, this projection rests on the assumption that the revenue to GDP ratio increases and foreign aid gradually falls as a percentage of GDP (Box 1), requiring only a modest increase in domestic debt financing to maintain a roughly unchanged level of government expenditure.

14. **Public sector debt dynamics are driven by the external debt, given the low and declining level of domestic debt** (Table 1a). The large proportion of external debt makes the public debt projection vulnerable to the same set of shocks as the external debt sustainability assessment, albeit with some additional risks related to the sterilization needs to mop up excess liquidity; which would increase in the event of lower revenues and/or higher expenditures (even if financed by higher aid), and aid volatility and/or reluctance to sell foreign exchange due to possible Dutch-Disease effects. The stress tests indicate that public sector debt ratios are most vulnerable to a permanently lower GDP growth, which shows an increasing path of public debt.

Box 1. Macroeconomic Assumptions 2007–27

The medium-term assumptions in the baseline scenario for 2007–27 are consistent with the authorities' medium-term macroeconomic framework described in the government's Plano de Acção para Redução da Pobreza Absoluta II (PARPA II).

Real GDP growth is projected to average 7.0 percent per year during 2007–10 and 6.5 percent thereafter, representing a deceleration from its annual average of 8.6 percent during 2001–06. The 6.5–7.0 percent projection falls within the 5–8 percent range projected by the World Bank in its most recent Country Economic Memorandum for Mozambique (Report No. 32615-MZ).

Consumer price inflation is projected to fall to 5 percent in the medium-to-long term, as oil prices stabilize and inflation converges to levels closer to Mozambique's main trading partner (South Africa).

The real effective exchange rate is expected to remain broadly unchanged, in line with the relative stability observed over the past decade.

Export growth is projected to accelerate slowly from 5.5 percent in the medium term to 6.1 percent in the long term. This is driven to a large extent by traditional (nonmegaproject) exports that grow at the rate of Mozambique's trade partner import demand growth and megaproject exports that are affected by world prices on aluminum and gas.

Import growth is projected to decelerate slowly from 6.6 percent in medium term to 6.3 percent in the long-term. Import growth associated with megaprojects is assumed to equal the rate of megaproject export growth, assuming that the import content of megaprojects remains roughly constant on average. All other imports are assumed to grow at the rate of real GDP growth.

The noninterest current account deficit after grants is projected to expand slowly from 3.2 percent of GDP during 2007–12 to 3.7 percent in 2013–2026, due to slightly higher import growth than export growth.

Fiscal revenues are expected to rise from 14 percent in 2006 to 16 percent of GDP in 2010 reflecting a 0.5 percent of GDP annual revenue effort on account of improved revenue administration and broadening of the tax base. Beyond 2010, nontax revenues from natural resource exploitation particularly megaprojects are expected to make a growing fiscal contribution. The tax to GDP ratio is projected to reach about 22 percent in the long-term; the level estimated as Mozambique's potential tax ratio by a number of studies.[13] Total expenditures remain roughly constant as a percent of GDP in the long term, resulting in a domestic primary deficit ranging between 2–4 percent of GDP from 2007–27.

External grants to the government are projected to remain high at an average of 9 percent of GDP during the medium term, which will help finance the "second wave of reforms" needed to sustain broad-based growth and achieve the MDGs by 2015. No grant financing is assumed to come forward from IDA. The share of program and project grants versus lending is assumed to fall over time: grants are assumed to fall from approximately 8 percent of GDP in 2006 to around 2.3 percent of GDP by 2027.

[13] IMF Country Report No. 05/311.

V. CONCLUSIONS

15. **In staffs' view, Mozambique faces a low risk of debt distress.** Mozambique's external debt levels are expected to remain well below their indicative thresholds for debt distress both under the baseline and under various stress tests. Mozambique's public debt is expected to decline over the medium-to-long term under the baseline, while the stress tests indicate that public sector debt ratios are most vulnerable to a permanently lower GDP growth.

16. **A prudent new borrowing policy remains important.** Where possible, the authorities should continue to rely on concessional borrowing and grants to minimize future debt service, and any nonconcessional financing of new projects ought to be considered case by case based on economic return, impact on debt sustainability, and potential effects on the financing decisions of donors and concessional lenders. Also, the authorities would still need to closely monitor any substantial scaling-up of concessional external borrowing and the issuance of domestic debt to sterilize the additional liquidity injected from increased government spending.

Table 2. Mozambique: External Debt Sustainability Framework, Baseline Scenario, 2004–27 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 7/	Standard Deviation 7/	Projections								
	2004	2005	2006			2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027
External debt (nominal) 1/	**96.0**	**89.5**	**59.8**			**36.5**	**36.8**	**37.4**	**37.6**	**37.1**	**36.6**		**33.0**	**23.6**
o/w public and publicly guaranteed (PPG)	73.9	69.5	41.7			20.1	22.5	23.9	24.7	25.3	25.4		23.6	14.9
Change in external debt	-16.2	-6.6	-29.6			-23.4	0.4	0.5	0.2	-0.4	-0.5		-0.8	-0.8
Identified net debt-creating flows	-20.2	-5.4	-32.1			-1.4	0.3	0.9	1.6	-4.2	-3.0		-0.6	1.8
Non-interest current account deficit	**2.7**	**7.0**	**-21.6**	**3.8**	**9.9**	**3.8**	**3.6**	**4.6**	**5.8**	**0.2**	**1.3**	**3.2**	**3.3**	**5.1**
Deficit in balance of goods and services	9.4	10.7	6.1			7.9	9.3	10.6	11.2	6.9	7.5		8.1	6.3
Exports	31.0	31.7	37.3			38.1	34.9	32.1	30.5	33.0	30.6		24.4	22.4
Imports	40.4	42.4	43.5			46.1	44.3	42.8	41.7	39.9	38.2		32.5	28.7
Net current transfers (negative = inflow)	-8.9	-6.8	-33.2	-12.6	7.7	-11.7	-10.9	-10.1	-9.2	-10.4	-9.7		-7.7	-3.6
o/w official	-8.9	-6.8	-33.2			-11.7	-10.9	-10.1	-9.2	-10.4	-9.7		-7.7	-3.6
Other current account flows (negative = net inflow)	2.2	3.1	5.5			7.6	5.2	4.1	3.8	3.6	3.4		2.9	2.5
Net FDI (negative = inflow)	**-4.1**	**-1.5**	**-2.0**	**-5.1**	**3.0**	**-3.7**	**-3.4**	**-3.7**	**-3.8**	**-3.7**	**-3.6**		**-3.1**	**-2.8**
Endogenous debt dynamics 2/	**-18.7**	**-10.9**	**-8.6**			**-1.6**	**0.1**	**-0.1**	**-0.4**	**-0.7**	**-0.7**		**-0.8**	**-0.6**
Contribution from real GDP growth	-6.8	-5.2	-6.7			-4.0	-2.4	-2.3	-2.4	-2.2	-2.2		-2.0	-1.5
Contribution from price and exchange rate changes	-14.4	-7.7	-3.9			...	...	...	...	...	...		...	...
Residual (3-4) 3/	**4.0**	**-1.2**	**2.5**			**-21.9**	**0.1**	**-0.4**	**-1.4**	**3.7**	**2.4**		**-0.1**	**-2.5**
NPV of external debt 4/	...	...	27.3			27.9	27.6	27.8	27.9	27.5	27.1		24.8	18.5
In percent of exports	...	...	73.1			73.3	79.0	86.6	91.5	83.6	88.5		101.6	82.7
NPV of PPG external debt 5/	**...**	**...**	**9.1**			**11.6**	**13.2**	**14.3**	**15.1**	**15.7**	**16.0**		**15.3**	**9.9**
In percent of exports	**...**	**...**	**24.5**			**30.3**	**37.9**	**44.5**	**49.5**	**47.6**	**52.1**		**63.0**	**44.0**
In percent of government revenues	**...**	**...**	**65.4**			**79.7**	**88.5**	**92.3**	**94.5**	**93.9**	**91.7**		**73.0**	**36.0**
Debt service-to-exports ratio (in percent)	**23.9**	**18.0**	**13.9**			**16.2**	**17.7**	**17.8**	**17.2**	**18.3**	**18.7**		**18.1**	**15.6**
PPG debt service-to-exports ratio (in percent)	**3.8**	**4.3**	**2.5**			**1.1**	**1.2**	**1.4**	**1.6**	**1.5**	**2.3**		**3.8**	**3.8**
PPG debt service-to-revenue ratio (in percent)	**9.3**	**10.0**	**6.6**			**2.9**	**2.8**	**2.9**	**3.0**	**3.0**	**4.0**		**4.4**	**3.1**
Total gross financing need (billions of U.S. dollars)	0.4	0.8	-1.4			0.5	0.6	0.6	0.8	0.3	0.4		0.9	2.5
Non-interest current account deficit that stabilizes debt ratio	18.9	13.6	8.0			27.2	3.2	4.1	5.6	0.6	1.8		4.0	5.9
Key macroeconomic assumptions														
Real GDP growth (in percent)	7.5	6.2	8.5	8.2	3.3	7.0	7.0	7.0	7.0	6.5	6.5	6.8	6.5	6.5
GDP deflator in US dollar terms (change in percent)	14.7	8.8	4.5	1.5	9.0	-1.8	1.4	3.0	3.0	2.9	2.9	1.9	2.0	1.0
Effective interest rate (percent) 6/	2.7	2.5	2.5	2.9	0.6	4.2	7.4	6.8	5.8	4.6	4.4	5.5	4.1	3.8
Growth of exports of G&S (US dollar terms, in percent)	35.1	18.4	33.6	20.2	11.7	7.3	-0.6	1.4	4.7	18.4	2.0	5.5	7.1	6.9
Growth of imports of G&S (US dollar terms, in percent)	10.4	21.4	16.2	13.1	11.0	11.4	4.2	6.5	7.4	4.9	5.0	6.6	6.6	6.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	41.2	40.9	40.6	40.5	40.4	40.4	40.7	40.4	40.4
Government revenues (excluding grants, in percent of GDP)	12.6	13.6	14.0	12.6		14.5	15.0	15.5	16.0	16.7	17.4	15.8	21.0	27.4
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...		13.5	12.4	11.3	10.4	9.6	8.8	11.0	5.6	2.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...		82.8	83.5	84.0	84.3	84.6	84.3	83.9	83.0	83.1
Memorandum item:														
Nominal GDP (billions of US dollars)	5.9	6.8	7.7			8.1	8.8	9.7	10.7	11.7	12.9		20.0	42.6
Nominal dollar GDP growth	23.3	15.6	13.4			5.1	8.5	10.2	10.2	9.6	9.6		8.6	7.5
NPV of PPG external debt (in billions of US dollars)			0.7			0.9	1.2	1.4	1.6	1.8	2.1		3.1	4.2
(NPVt-NPVt-1)/GDPt-1 (in percent)						3.0	2.8	2.5	2.3	2.1	1.8	2.4	1.0	0.2

Source: Staff simulations.

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); the full delivery of the HIPC debt releif by all creditors; 100 percent debt reduction by France, Russia, Japan, and China; completion of commercial debt buy-back operation; changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ NPV for 2006 excludes arrears.
6/ Current-year interest payments divided by previous period debt stock.
7/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
8/ Grant financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

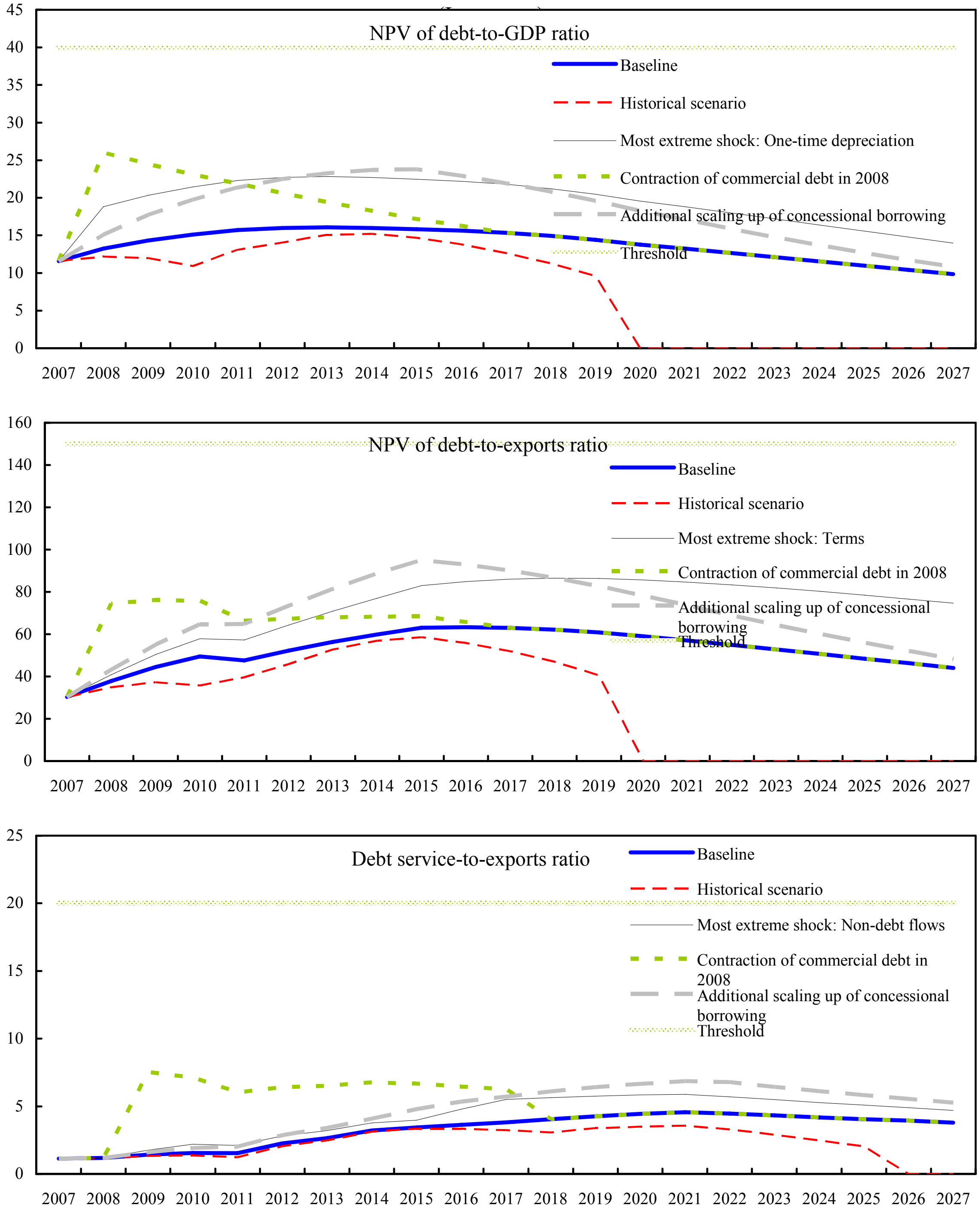
Table 3. Mozambique: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	**2017**	2027
NPV of debt-to-GDP ratio								
Baseline	12	13	14	15	16	16	**15**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	12	12	12	11	13	14	**13**	-7
A2. New public sector loans on less favorable terms in 2008-27 2/	12	14	16	18	19	20	**21**	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	12	14	15	16	16	17	**16**	10
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	12	11	9	10	11	12	**12**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	12	15	17	18	19	19	**19**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	12	18	23	23	23	23	**20**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	12	12	9	11	12	12	**13**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	12	19	20	21	22	23	**22**	14
B7. Contraction of commercial debt	12	26	25	23	22	21	15	10
B8. Additional scaling up of concessional borrowing	12	15	18	20	21	22	22	11
NPV of debt-to-exports ratio								
Baseline	30	38	45	49	48	52	**63**	44
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	30	35	37	36	40	46	**52**	-31
A2. New public sector loans on less favorable terms in 2007-26 2/	30	41	50	58	57	64	**86**	75
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	30	38	45	49	48	52	**63**	44
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	30	30	24	29	29	32	**43**	33
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	30	38	45	49	48	52	**63**	44
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	30	51	70	75	70	75	**84**	52
B5. Combination of B1-B4 using one-half standard deviation shocks	30	29	20	24	24	27	**37**	29
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	30	38	45	49	48	52	**63**	44
B7. Contraction of commercial debt	30	74	76	76	66	67	63	44
B8. Additional scaling up of concessional borrowing	30	43	55	65	65	73	90	48
NPV of debt-to-revenue ratio								
Baseline	80	88	92	95	94	92	**73**	36
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	80	82	77	68	78	81	**60**	-26
A2. New public sector loans on less favorable terms in 2007-26 2/	80	95	104	111	113	113	**100**	61
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	80	90	96	98	98	95	**76**	37
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	80	75	59	64	66	67	**58**	32
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	80	97	113	115	115	112	**89**	44
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	80	118	146	144	138	132	**97**	42
B5. Combination of B1-B4 using one-half standard deviation shocks	80	82	60	66	69	70	**62**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	80	126	131	134	133	130	**104**	51
B7. Contraction of commercial debt	80	174	158	145	131	118	73	36
B8. Additional scaling up of concessional borrowing	80	101	114	124	128	129	104	39
Debt service-to-exports ratio								
Baseline	1	1	1	2	2	2	**4**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	1	1	1	1	1	2	**3**	1
A2. New public sector loans on less favorable terms in 2008-27 2/	1	1	1	2	2	2	**4**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	1	1	1	2	2	2	**4**	4
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	1	1	1	1	1	2	**2**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	1	1	1	2	2	2	**4**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	1	1	2	2	2	3	**6**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	1	1	1	1	**2**	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	1	1	1	2	2	2	**4**	4
B7. Contraction of commercial debt	1	1	8	7	6	6	6	4
B8. Additional scaling up of concessional borrowing	1	1	2	2	2	3	6	5
Debt service-to-revenue ratio								
Baseline	3	3	3	3	3	4	**4**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	3	3	3	3	2	4	**4**	1
A2. New public sector loans on less favorable terms in 2008-27 2/	3	3	3	3	4	4	**5**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	3	3	3	3	3	4	**5**	3
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	3	3	3	2	2	3	**3**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	3	3	4	4	4	5	**5**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	3	3	4	4	4	5	**6**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	2	3	4	**3**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	3	4	4	4	4	6	**6**	4
B7. Contraction of commercial debt	3	3	16	14	12	11	7	3
B8. Additional scaling up of concessional borrowing	3	3	3	4	4	5	7	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	39	39	39	39	39	39	**39**	39

Source: Staff projections and simulations.

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 baseline.
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 the shock (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 1. Mozambique: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2007-2027



Source: Staff projections and simulations.

Table 1a.Mozambique: Public Sector Debt Sustainability Framework, Baseline Scenario, 2004-2027
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2004	2005	2006	Historical Average 5/	Standard Deviation 5/	2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
Public sector debt 1/	68.5	81.7	52.0			26.9	27.8	28.7	29.1	29.7	29.7		25.5	14.5	
o/w foreign-currency denominated	60.5	73.7	43.9			19.9	22.2	24.8	25.8	25.9	26.3		24.1	13.2	
Change in public sector debt	-18.9	13.2	-29.7			-25.1	0.9	0.9	0.4	0.6	0.0		-0.5	-1.2	
Identified debt-creating flows	-25.6	5.6	-32.5			1.3	0.6	0.0	-0.5	-0.5	-0.7		0.2	0.5	
Primary deficit	3.3	1.3	0.5	2.8	2.1	3.4	2.6	2.1	1.6	1.4	1.3	2.1	2.0	1.7	2.1
Revenue and grants	20.2	20.0	23.9			26.0	25.7	25.4	25.1	25.1	25.1		25.4	24.7	
of which : grants	7.5	6.3	9.9			11.5	10.7	9.9	9.1	8.4	7.7		4.8	1.9	
Primary (noninterest) expenditure	23.5	21.3	24.4			29.4	28.2	27.4	26.7	26.5	26.4		27.4	26.4	
Automatic debt dynamics	-26.7	4.8	-10.0			-2.1	-1.9	-2.0	-2.1	-1.8	-1.9		-1.8	-1.1	
Contribution from interest rate/growth differential	-7.0	-5.3	-7.3			-3.4	-1.6	-1.7	-1.9	-1.6	-1.7		-1.5	-1.0	
of which : contribution from average real interest rate	-0.9	-1.2	-0.9			0.0	0.2	0.1	0.0	0.1	0.1		0.0	-0.1	
of which : contribution from real GDP growth	-6.1	-4.0	-6.4			-3.4	-1.8	-1.8	-1.9	-1.8	-1.8		-1.6	-1.0	
Contribution from real exchange rate depreciation	-19.7	10.0	-2.8			1.3	-0.4	-0.3	-0.2	-0.2	-0.2		...	...	
Other identified debt-creating flows	-2.2	-0.5	-23.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-1.9	-0.3	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)	-0.4	-0.2	-23.0			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	6.7	7.6	2.8			-26.4	0.3	0.9	0.9	1.1	0.7		-0.7	-1.7	
NPV of public sector debt	8.0	18.3	17.7			19.0	19.1	18.5	18.7	19.8	19.7		16.7	9.6	
o/w foreign-currency denominated	0.0	10.3	9.5			12.0	13.5	14.6	15.4	16.0	16.3		15.3	8.4	
o/w external	...	10.3	9.5			12.0	13.5	14.6	15.4	16.0	16.3		15.3	8.4	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.0	2.7	2.1			4.6	3.4	2.8	2.5	2.4	2.2		2.8	2.3	
NPV of public sector debt-to-revenue and grants ratio (in percent)	39.5	91.7	74.2			72.9	74.6	72.9	74.6	78.7	78.5		65.7	39.0	
NPV of public sector debt-to-revenue ratio (in percent)	...	134.4	126.7			130.6	127.9	119.3	117.1	118.4	113.0		80.8	42.3	
o/w external 3/	...	75.7	68.3			82.8	90.3	94.1	96.2	95.6	93.3		74.3	36.7	
Debt service-to-revenue and grants ratio (in percent) 4/	7.4	6.3	5.3			4.7	3.3	3.0	3.3	4.2	3.9		3.3	2.4	
Debt service-to-revenue ratio (in percent) 4/	11.8	9.3	9.1			8.4	5.6	4.9	5.2	6.3	5.6		4.0	2.6	
Primary deficit that stabilizes the debt-to-GDP ratio	22.2	-11.9	30.2			28.6	1.6	1.2	1.3	0.8	1.3		2.5	2.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.5	6.2	8.5	8.5	3.3	7.0	7.0	7.0	7.0	6.5	6.5	6.8	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	0.4	0.6	0.4	0.4	0.2	0.5	1.4	1.4	1.5	1.6	1.6	1.3	1.5	1.3	1.4
Average real interest rate on domestic currency debt (in percent)	11.1	-3.3	-5.3	-4.9	12.3	4.8	2.5	2.5	3.3	8.2	5.1	4.4	15.8	1.6	4.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-25.7	17.9	-4.1	2.2	15.6	3.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.9	11.1	13.2	10.3	4.4	6.4	5.7	5.4	5.1	5.0	5.0	5.4	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.5	-3.7	24.4	8.9	14.3	29.1	2.6	4.0	4.1	5.9	6.0	8.6	6.4	5.9	6.5

Sources: Country authorities; and Fund staff estimates and projections.
1/ General government gross debt.
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 2a.Mozambique: Sensitivity Analysis for Key Indicators of Public Debt 2007-2027

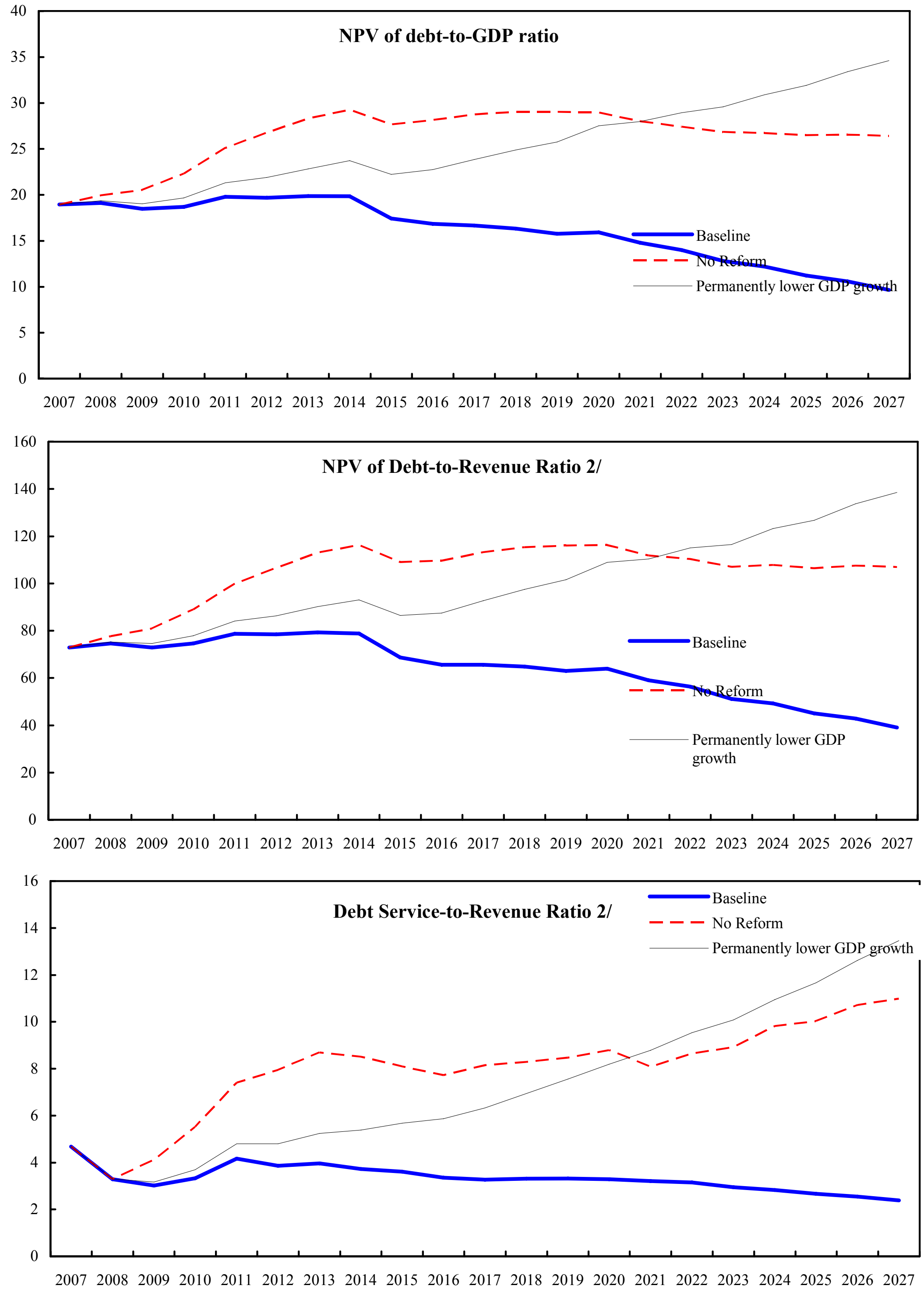
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	19	19	18	19	20	20	17	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	19	19	20	22	23	22	19
A2. Primary balance is unchanged from 2007	19	20	21	22	25	27	29	26
A3. Permanently lower GDP growth 1/	19	19	19	20	21	22	24	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	19	20	20	21	22	23	22	18
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	19	21	23	23	24	24	20	12
B3. Combination of B1-B2 using one half standard deviation shocks	19	20	21	21	22	22	19	11
B4. One-time 30 percent real depreciation in 2008	19	23	22	21	22	22	18	11
B5. 10 percent of GDP increase in other debt-creating flows in 2008	19	28	27	27	28	27	23	13
NPV of Debt-to-Revenue Ratio 2/								
Baseline	73	75	73	75	79	78	66	39
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	73	75	76	81	90	94	90	80
A2. Primary balance is unchanged from 2007	73	78	81	89	100	107	113	107
A3. Permanently lower GDP growth 1/	73	75	75	78	84	86	93	139
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	73	76	77	81	87	89	85	74
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	73	83	92	93	96	95	79	47
B3. Combination of B1-B2 using one half standard deviation shocks	73	79	84	85	89	88	73	43
B4. One-time 30 percent real depreciation in 2008	73	92	85	85	88	86	71	45
B5. 10 percent of GDP increase in other debt-creating flows in 2008	73	111	107	107	110	108	89	53
Debt Service-to-Revenue Ratio 2/								
Baseline	5	3	3	3	4	4	3	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	5	3	3	4	6	7	6	8
A2. Primary balance is unchanged from 2007	5	3	4	6	7	8	8	11
A3. Permanently lower GDP growth 1/	5	3	3	4	5	5	6	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2008-2009	5	3	3	4	5	5	5	6
B2. Primary balance is at historical average minus one standard deviations in 2008-2009	5	3	6	8	6	5	4	4
B3. Combination of B1-B2 using one half standard deviation shocks	5	3	5	6	5	5	4	3
B4. One-time 30 percent real depreciation in 2008	5	3	4	4	5	5	4	3
B5. 10 percent of GDP increase in other debt-creating flows in 2008	5	3	16	8	7	6	5	5

Sources: Country authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

Figure 1a. Mozambique: Indicators of Public Debt Under Alternative Scenarios, 2007-2027 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2017.
2/ Revenue including grants.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Staff Report for the 2007 Article IV Consultation, Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criterion, Financing Assurances Review, and Request for a Three-Year Policy Support Instrument—Informational Annex

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

May 30, 2007

Contents Page

Mozambique: Relations with the Fund
(As of March 31, 2007)

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

II. General Resources Account	SDR Million	% Quota
Quota	113.6	100.0
Fund holdings of currency	113.6	100.0
Reserve position in Fund	0.01	0.01

III. SDR Department	SDR Million	%Allocation
Holdings	0.15	n.a.

IV. Outstanding Purchases and Loans	SDR Million	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	8.10	7.13

V. Latest Financial Arrangements

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

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

	Forthcoming				
	2007	2008	2009	2010	2011
Principal				0.16	0.97
Charges/Interest	0.04	0.04	0.04	0.04	0.04
Total	0.04	0.04	0.04	0.20	1.01

VII. Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC Initiative assistance			
Decision point date	4/7/98	4/7/2000	
Assistance committed (end-1998 NPV terms)			
Total assistance (US$ million)	1,716.0	306.0	2,022.0
Of which: Fund assistance (US$ million)	124.6	18.5	143.1
Completion point date	6/29/99	9/20/01	
Delivery of Fund assistance (SDR million)			
Amount disbursed	93.2	13.7	106.9
Interim assistance	…	2.3	2.3
Completion point	93.2	11.4	104.6
Additional disbursements of interest income	...	1.1	1.1
Total disbursements	93.2	14.8	108.0

VIII. Implementation of MDRI Assistance:

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

Debt Relief by Facility (SDR Million)

Eligible Debt

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

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

Safeguards assessment

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

Exchange arrangements

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

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

Article IV consultation

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

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

Ex Post Assessment of performance under Fund-Supported Programs

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

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

FSAP participation and ROSCs

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

Management's visit

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

IMF Technical Assistance Provided to Mozambique (Over the Last Three Years)				
Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	April-May 2007	Mission	Petroleum Fiscal Regime	Ministry of Finance Ministry of Mineral Resources
	April 2007	Mission	Tax Administration inspection	Ministry of Finance
	December 2006	Mission	Tax Administration	Ministry of Finance
	March 2006	Mission	Tax Policy review	Ministry of Finance
	November 2005	Inspection mission	Public expenditure management	Ministry of Finance
	October 2005	Fourth multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	May 2005	Inspection mission	Public expenditure management	Ministry of Finance
	April-May 2005	Mid-term review of the joint IMF/SECO/DANIDA domestic tax and administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	November 2004	Inspection mission, and coordination with bilateral donors	Public expenditure management	Ministry of Finance
	October 2004	Joint IMF/SECO/ DANIDA project; short-term consultant training advisor (total 4 months in 3 visits)	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Third multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Joint IMF/SECO/ DANIDA project: short-term advisor (total 2 months in 4 visits)	Reform of the tax system and its administration; strategic issues on the establishment of the Central Revenue Authority (visit 1 of 4)	Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Three Years)				
Departments	Timing	Form	Purpose	Counterparts
	July 2004	Inspection mission	Public expenditure management	Ministry of Finance
	May 2004	Mid-term review of the joint IMF/SECO/DANIDA tax and customs administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	March 2004	Installation mission and coordination with bilateral donors	Public expenditure Management	Ministry of Finance
Legal	February 2004	Mission	Advising government on the implications of accepting the obligations under Article VIII section 2,3 and 4 of the Fund's Articles of Agreement	Ministry of Finance, Bank of Mozambique
	2004	Correspondence	Advice on tax legislation	Ministry of Finance
Monetary and Capital Markets	April 2007	Short-term consultant	Banking supervision	Bank of Mozambique
	October 2006	Mission	Post- FSAP TA assessment Banking supervision Monetary, and exchange rate operations, monetary policy	Bank of Mozambique
	March 2006	Short-term consultant	Banking supervision	Bank of Mozambique
	Feb-March 2006	Mission	AML/CFT legislation	Bank of Mozambique
	Jan-Feb 2006	Short-term consultant	Monetary policy framework	Bank of Mozambique
	Jan-Feb 2006	Short-term consultant	Monetary operations	Bank of Mozambique
	January 2006	Short-term consultant	Exchange rate management	Bank of Mozambique
	September 2005	Mission	Post- FSAP TA assessment Banking supervision Monetary operations/monetary policy	Bank of Mozambique
	October 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	September 2004	Short-term consultant	Monetary operations/monetary policy	Bank of Mozambique
	September 2004	Short-term consultant	Central Bank Accounting	Bank of Mozambique
	July 2004	Short-term consultant	Banking supervision	Bank of Mozambique and Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Three Years)				
Departments	Timing	Form	Purpose	Counterparts
	April 2004	By correspondence	Advice on foreign exchange operations	Bank of Mozambique
	April 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	March - April 2004	Mission	Banking supervision, monetary and foreign exchange operations	Bank of Mozambique
	February-March 2004	Mission	Bank restructuring	Bank of Mozambique
Statistics	July 2005	Mission	Government finance statistics	National Institute of Statistics
	June–July 2005	Mission	Consumer price statistics	National Institute of Statistics
	May 2005	Mission	ROSC Data Module Update	National Institute of Statistics
	October 2002–March 2004	Long-term consultant	National accounts statistics	National Institute of Statistics
	November 2004	Mission	Balance of payments statistics	Bank of Mozambique
	September 2004	Mission	Monetary and financial statistics	Bank of Mozambique
	May 2004	Mission	Balance of payment statistics	Bank of Mozambique
	May 2004	Mission	Consumer price statistics	National Institute of Statistics (INE)
	August 2005-July 2006	Long-term consultant	National accounts statistics	National Institute of Statistics
	May 2005	Mission	Balance of payments Statistics	Bank of Mozambique
	June-July 2006	Mission	Consumer price statistics	National Institute of Statistics (INE)

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

Mozambique: Relations with the World Bank Group

(As of May 7, 2007)

Partnership in Mozambique's development strategy

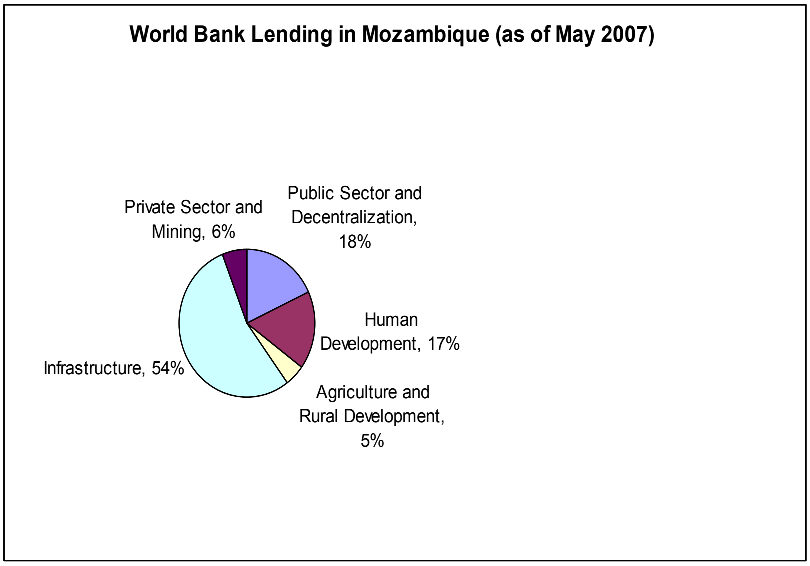
1. The Mozambican government's development strategy is set forth in its second generation poverty reduction strategy paper (PRSP), termed the PARPA-II (Plano de Acção para a Redução da Pobreza Absoluta, or Action Plan for the Reduction of Absolute Poverty), which was approved in May 2006 by the council of ministers and endorsed by the Boards of the Fund and the Bank in December 2006, when they discussed a Joint Staff Advisory Note of PARPA II. The Fund and the World Bank will continue to cooperate closely, within their respective mandates, in assisting the government to implement its medium-term poverty reduction and growth strategy and the related reform agenda, as presented in the PARPA-II and updated in the annual progress report and PAF.

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

Bank group country assistance strategy

3. The current CAS (FY04–07) is a Results-based strategy, prepared jointly with IFC and MIGA. Preparation of a new Country Partnership Strategy jointly with four donors has started in support of the agenda of the Paris Declaration on Harmonization. The Bank is coordinating with partners through a peer review process and harmonization of analysis and results frameworks. The three pillars of the current CAS are (i) improving the investment climate, (ii) expanding service delivery, and (iii) building capacity and accountability. A CAS Progress Report, an evaluation of the Bank's program during the first two years of implementation has been completed and presented to the Board in March 2006. The focus of the Bank's lending program is on programmatic support through four rolling Poverty Reduction Support Credits (PRSCs), of which the first two credits have been approved and fully disbursed. Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic lending through the PRSCs was underpinned by the Bank's core diagnostic economic and sector work, including the public expenditure review and PSIA. While a series of PRSCs is the largest single element in the lending program, the shift from traditional investment lending to program lending is being phased in gradually. Selected investment projects are targeting institutional strengthening, capacity building, transport infrastructure, water, agriculture, and communications. The new Country Partnership Strategy for Mozambique (FY08—11) will be discussed by the Board on May 22, 2007.

4. To date, the World Bank Group has approved 7 adjustment operations, 3 development policy operations, one investment guarantee and 48 investment operations totaling approximately US$3.2 billion. The CAS financing plan for FY04–07 included lending financing, grant resources and guarantee coverage for US$560 million, of which $538 million (US$288 in investment operations and US$250 million in three Poverty Reductions Support Program credits) and US$30 million in an IBRD guarantee have been approved. One additional investment operation is scheduled to be delivered before the end of the CAS period. The graph below illustrates the distribution of the current portfolio by main sectors.



5. The World Bank has been actively supporting the government of Mozambique's macroeconomic program since 1986 through a series of **structural adjustment operations**. The last, the Economic Management and Private Sector Operation (EMPSO), was approved by the Bank Board in August 2002 for US$120 million. The EMPSO supported the government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It included measures to make the budget more transparent (including accounting for external aid flows), conduct a public expenditure review, strengthen the financial sector while aiming to eliminate government ownership in the sector, and liberalize the telecommunications and air transport sectors in order to facilitate further private participation. Since 2004, the Bank's quick-disbursing assistance has taken the form of development policy lending through PRSCs, which have been developed in tandem with the Joint Review/Performance Assessment Framework. Three PRSCs have been presented to the Board so far (in July 2004, September 2005, and January 2007), valued at US$60 million, US$120 million, and US70 million respectively. The third PRSC credit is the first operation to support the PARPAII.

6. The World Bank has been an active partner in supporting the government in improving **education** and strengthening capacity building in key public institutions. The Education Sector Strategic Program (US$71 million—FY99, closed in December 31, 2007) supported the implementation of the National Education Strategy, whose objectives are the

promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. The Higher Education Project (US$60 million—FY02) supports the entire higher education system, including both public and private institutions of higher education. The Technical and Vocational Education and Training project (US$30 million —FY06) is the first operation in the tertiary and vocational education area.

7. In **health**, the Health Sector Recovery Project (US$98.7 million—FY96, closed in 2003) supported the government's broad Health Sector Recovery Program, especially by reducing infant and child mortality. The HIV/AIDS Project (US$55 million—FY03) assists the government in carrying out its National Strategic Plan to Combat STDs and HIV/AIDS. The HIV/AIDS Treatment Acceleration Project (US$21 million—FY04) assists the Government in scaling up ongoing HIV/AIDS treatment initiatives using a combination of public/private/NGO partnerships to serve vulnerable groups. A new health operation is under preparation for FY08.

8. In the area of **transport and infrastructure**, the Bank has three active projects. The Railways and Ports Restructuring Project (US$100 million—FY00) aims at increasing the operating efficiency of the three major port-rail systems in Mozambique. The Roads and Bridges Project (US$162 million—FY02) aims at improving road infrastructure, sector policies, and management, and the Beira Railway Project (US$110 million—FY05) aims to improve the cost-effectiveness and efficiency for freight and passenger rail transport in the Zambezi Valley and beyond. The second phase of the Roads and Bridges project (US$100 million) will be presented to the Board on May 22, 2007.

9. In the **water** sector, one project—the National Water Development Project I (NWDP I) (US$36 million—FY98)—closed on October 31, 2006, the National Water Development Project II (NWDP II) (US$75 million plus US$15 supplemental—FY99, FY04)—support improvements in service delivery standards, coverage, water resources management, and management capacity in both rural and urban areas. The NWDP II also supports private sector management of water services in five major cities.

10. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. The current Bank CAS has been prepared jointly with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). IDA recently closed the Enterprise Development Project (US$26 million—FY00,) which aimed at broadening the base of private participation in the Mozambican economy. The Mineral Resource Management Capacity Building Project (US$18 million—FY01) seeks to increase institutional capacity in the sector, and alleviate poverty. The Communications Sector Reform Project (US$14.9 million—FY02) seeks to increase private sector participation in the postal, air transport, and telecommunications sectors.

11. As regards **public sector reform**, the Public Sector Project (US25.6 million—FY03) seeks to upgrade the quality of public services, reduce red tape, and improve access to public services. The Municipal Development Project (US$33.6 million—FY01, closed in February 2007) aimed to strengthen the institutional capacity of municipal government and

pilot a municipal grant mechanism to finance investment. The Maputo Municipal Development Program (US$30 million, FY07) aims to strengthen the capacity of the Maputo City Council to develop, manage and maintain quality service delivery to its citizens. Finally, the Decentralized Planning Financing Project (US$42 million—FY04) supports improvements to the institutional capacity of district administrations. The **Financial Sector** Technical Assistance project (US$10.5 million—FY06) supports implementation of the recommendations of the Financial Sector Assessment Program jointly conducted with the Fund in 2003.

12. The Bank is also involved in **agriculture**, **energy, and the environment**. The Agricultural Sector Public Expenditure Program (US$30 million—FY99, closed in December 2006)), was a sectorwide assistance program (SWAP) that sought to improve the impact of public expenditure in developing an enabling environment for sustainable and equitable growth in the rural sector. The Gas Engineering Project (US$26 million—FY94), which closed in 2003, supported pre-investment in the Pande-Gas Project and provided capacity building to the government for negotiation of megaprojects. This operation supported capacity and technical assistance for negotiation and implementation of the Southern Africa Gas project, a pipeline financed by SASOL of South Africa with equity participation of IFC and guarantee coverage of MIGA (US$30 million—FY04. The Energy Reform and Access Project (US$40.2 million—FY04), which supports reform of the power sector, in particular the separation of distribution, transmission, and generation functions, aims at increasing the number of electricity connections, solar energy distributors, and seeks to provide a more efficient service. The World Bank Group is also supporting sustainable use of natural resources with two operations in environment: the Coastal and Marine Biodiversity Management Project (US$9.7 million—FY00), which pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas, and the second credit of a Transfrontier Conservation Areas and Tourism project (US$20 million plus US$10 million in a Global Environment Facility grant—FY06). A Market-led Smallholder Development project of US$30 million was approved in FY06.

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

- Improving the Investment Climate. Economic and sector work completed over the past two fiscal years included a strategy for rural growth and income creation and a country economic memorandum on sustainable growth and poverty reduction, which also analyzed the sources of growth. Technical assistance is currently being provided in procurement reform, mining and on commercial debt reduction. A PSIA on labor market and a PSIA on land are planned for preparation in FY06–07, together with a study on regional growth poles.

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

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

- Monitoring and Evaluation. The Bank provided technical assistance to the Government to finalize and monitor its first PRSP M&E system, the Strategic Matrix of PARPAII. The Bank is currently supporting the preparation of a Monitoring Plan to implement the Strategic Matrix.

IMF-World Bank collaboration in specific areas

14. Fund and Bank staff maintain a close working relationship, with the lead taken by one or both institutions, especially with respect to (i) analyses and reforms in public expenditure management; (ii) the PARPA and accompanying annual updates and joint staff advisory notes; (iii) the financial sector and banking supervision; (iv) PSIA; (v) tax issues; (vi) trade issues; and (vii) external debt sustainability analysis:

- **Public expenditure management**. The Fund and the Bank jointly emphasize the urgent need to further improve public expenditure management, accountability, and transparency. The two institutions support policy reforms in the areas of budget formulation, execution, and monitoring. The IMF assists the authorities in introducing the integrated financial management information system (SISTAFE), and several donors, including the World Bank, provide financial support and policy advice for this reform. Under the Fund's leadership, a group of 10 donors set up a common fund for this large undertaking. The Bank's PRSC emphasizes budget comprehensiveness and budget execution reporting.

- **Poverty reduction strategy paper**. The Fund and Bank worked together with the government during 1999–2001, while the PARPA was being produced, and drafted the joint staff review, which was presented to the Board in September 2001. The government issued annual progress reports in 2003, 2004 and 2005 and the staff presented their joint staff assessments to their respective Boards. The Bank and the Fund worked again with the government during the preparation of PARPA II and elaborated the Joint Staff Advisory Note in 2006.

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

- **Financial sector**. The Fund and the Bank have worked together on the financial sector. The banking sector in Mozambique has repeatedly shown weaknesses in the past, requiring recapitalizations and intervention. Following the FSAP conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision and accounting standards to prevent the recurrence of such problems in the future. The Financial Sector Technical Assistance Project was approved in FY06.

- **PSIA**. As part of the ongoing Bank budget support and the programs supported by the IMF, the Fund and the Bank have agreed to review closely the poverty and social impact of the key reforms that are being implemented. A pilot PSIA, advising the government on the impact of an increase in specific fuel taxes, was undertaken in 2002. A second PSIA, on the impact of reducing primary schooling fees, was completed in October 2004. A third PSIA in FY07 analyzed the likely impact of the proposed new Labor Law. A PSIA following up on the previous study on the elimination of primary schooling fees will be finalized in FY08.

- **Taxes**. The Fund has taken the lead in this area. The government issued a new income tax law in 2002 and a revised code of fiscal incentives for investors. The Bank has been supportive of the policies proposed. Further reforms to strengthen tax revenues and to improve the efficiency of tax administration are part of Mozambique's regular dialogue with the Fund.

- **Trade.** The Fund and the Bank have worked together since the early 1990s on trade issues concerning general reductions in tariffs, the variable tariff on sugar introduced in 1999, and the reduction in the export tariff on raw cashews. The Fund and the Bank are involved in reforming the customs administration in Mozambique. The Bank is cooperating with the donors (particularly USAID) and the government in executing the studies on trade policy required for the Integrated Framework.

- **External sustainability analysis (DSA)**. The Bank and the Fund work jointly in preparing an annual DSA, in consultation with the authorities. The latest DSA was finalized in May 2007.

15. In 2007 and 2008, disbursements under World Bank investment projects are expected to reach around US$184 million on average a year.

World Bank Loan and Grant Operations, 1999-2006[1]
(In million U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006
I. Project Credit Disbursements	97.5	51.6	85.2	89.4	140.6	187.1	158.7
Established operations							
Household Energy (6/89) [2/]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89)[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education II (12/90)[2/] 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89)[2]	2.0	0.0	0.0	0.0	0.0	0.0	0.0
Agricultural Service Rehabilitation Development (2/92)[2]	0.7	0.0	0.0	0.0	0.0	0.0	0.0
First Road and Coastal Shipping (6/92)[2]	4.0	0.0	0.0	0.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	4.5	2.8	0.0	0.0	0.0	0.0	0.0
Capacity Building: Public Sector & Legal Institutional Development (11/92)	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Maputo Corridor (1/93)[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rural Rehab.(3/93)[2]	2.0	0.3	0.0	0.0	0.0	0.0	0.0
Food Security (4/93)[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Government (6/93)[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94)[2]	26.5	11.4	9.7	17.5	0.0	0.0	0.0
Financial Sector Capacity Building (4/94)[2]	1.4	0.3	0.0	0.0	0.0	0.0	0.0
Gas Engineering (6/94)[2/] 2/	1.1	1.6	1.8	0.4	0.0	0.0	0.0
Health Sector Recovery (11/95)[2]	17.2	17.4	14.4	5.6	0.0	0.0	0.0
National Water I (2/98)	1.7	2.4	3.9	4.5	7.5	13.6	0
Agricultural Sec. PEP (2/99)	0.9	4.2	3.8	3.9	3.9	6.7	4.1
General Education (2/99)	0.5	1.2	6.9	14.7	19	16.1	9.5
Railway and Port Restructuring (10/99)	1.9	3.6	22.3	8.2	22.6	10.2	13.7
National Water II (6/99)	1.4	2.8	4.4	5.1	9.1	21.8	12.3
Enterprise Development (01/00)	2.3	3.0	2.9	3.4	4.5	6.0	2.8
Flood Emergency Recovery (4/00)	28.7	0.0	0.0	0.0	0.0	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.3	0.4	0.3	3.7	1.8	1.7
Municipal Development (7/01)	0.0	0.3	4.3	4.6	3.6	6.1	9.5
Roads and Bridges I (7/01)	0.0	0.0	4.3	0.5	39.1	56.2	36.4
Communications (11/01)	0.0	0.0	1.2	2.8	1.8	1.1	2.2
Mineral Resources Project (3/01)	0.0	0.2	1.4	4.1	5.5	4.8	0.1
Higher Education Project 1 (3/02)	0.0	0.0	3.4	9.2	10.0	11.6	8.7
Newest operations							
HIV/AIDS (3/03)	0.0	0.0	0.0	2.7	2.3	7.6	13.5
Public Sector Reform (3/03)	0.0	0.0	0.0	1.2	1.5	1.3	2.4
Energy Reform and Access Project (8/03)	0.0	0.0	0.0	0.0	1.6	1.5	1.5
Decentralization Planning (11/03)	...	...	...	...	4.9	6.2	8.9
Beira Railway (10/04)						9.1	23.2
Treatment Acceleration Program (6/04)						5.3	4.0
TFCA & Tourism Development (12/05)							1.8
Financial Sector TA project (12/05)							1.3
Technical and Vocational Education (2/06)							1.1
Market Led Smallholder Development (6/06)							0.0

World Bank Loan and Grant Operations, 1999-2006[1]
(In million U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006
II. Adjustment operations	0.0	0.0	63.5	70.7	60.0	60.0	60.0
Economic Management and Private Sector Operation	0.0	0.0	63.5	70.7	0.0	0.0	
PRSC 1 (6/04)	...	...	...	...	60.0	...	
PRSC 2 (9/05)	...	...	...	...	...	60.0	60.0
…PRSC3 (1/07)							70.0

Source: World Bank.

[1] Date of Board approval in brackets.
[2] Closed.
[3] Grant.

Mozambique: Statistical Issues

1. Data provision to the Fund for surveillance purposes is adequate, but the overall quality of macroeconomic statistics still hinders policy formulation and monitoring of economic development. Moreover, despite the increase in budget resources allocated to the compilation of official statistics, continued high reliance on external funding raises concerns about the sustainability of the programs of the National Institute of Statistics (INE).

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

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

National accounts

4. The national accounts are prepared by the INE in accordance with the *1993 System of National Accounts* (*1993 SNA*). The INE compiles and disseminates (i) annual GDP at current and constant (1996) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; and (iii) annual value added components at current prices by activity. Work is under way to compile the new benchmark year (2000) with new and improved data sources and methodology. The INE has launched a new household income and expenditure survey and new economic censuses leading to a new business registry. Furthermore, the INE is compiling more comprehensive and timely foreign trade data based on improved classification systems. The new national accounts framework will also include compilation of quarterly estimates expected to be disseminated shortly.

Prices and labor market

5. A new consumer price index for Maputo based on weights derived from the 2002–03 household survey was released in February 2006. The previous series, available since 1998, was widely criticized for narrowly focusing on a few basic food staples with relatively volatile prices and, therefore, exhibiting large swings. A national index obtained by

integrating the indices for Maputo, Beira, and Nampula was released in April 2006. The IMF has provided technical assistance in price statistics in the context of the GDDS Regional Project for Lusophone African Countries. The last technical assistant mission (June 11–July 21, 2006) under the GDDS project found important advances regarding the use of the COICOP classification and the strengthening of human resources in the compilation of the new CPI. Several issues remain outstanding, however, such as price collection procedures not fully consolidate at the provincial level, imputation methods, and possible inconsistencies in the overlapping period between the new and old series.

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

Monetary statistics

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

8. Mozambique is already using the new standardized forms (SRFs) for reporting monetary data to STA. As a result, five-year historical enhanced data are being published in the IFS Supplement, first issued in September 2006. The IMD consistent with the SRFs is in the process of becoming fully operational, which will allow the derivation of accurate and timely monthly monetary statistics that meet the needs of STA, AFR, and the authorities, while reducing BM's reporting burden.

External sector statistics

9. With assistance from STA, the BM has made significant progress toward compiling and disseminating balance-of-payments (BOP) and international investment position (IIP) statistics that are fully aligned with the *Balance of Payments Manual, fifth edition* (*BPM5*). This assistance is also being provided in the context of the GDDS regional project.

10. The BM has an adequate institutional framework for the compilation of BOP and IIP statistics, and has implemented many of the recommendations made by the four technical assistance missions conducted since mid-2003. However, in order for the work on institution building to be consolidated, the Foreign Exchange Law has to be approved (incorporating the definition of residency in alignment with he BPM5 methodology), training on BOP statistics

has to be sustained, and the project to computerize the balance of payments compilation system has to be completed. The major improvements in the basic sources of data from the beginning of the project comprise (i) the distribution of the new BOP surveys to more than 35 enterprises, including the megaprojects; (ii) program improvements by Customs to ensure the quality of external trade data; (iii) improvements in the reports on foreign investment and private loans prepared by the BM; (iv) improvements in the reports on the external public debt provided by the Ministry of Finance; and (v) improvements in the banks' reports on foreign currency transactions.

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

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

Government finance statistics

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

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

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

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

Mozambique: Table of Common Indicators Required for Surveillance
(As of May 21, 2007)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	Mar. 2007	Apr. 2007	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]							
Reserve/Base Money	Mar. 2007	Apr. 2007	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Mar. 2007	Apr. 2007	M	M	M		
Central Bank Balance Sheet	Mar. 2007	Apr. 2007	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar. 2007	Apr. 2007					
Interest Rates[2]	Mar. 2007	Apr. 2007	M	M	M		
Consumer Price Index	Mar. 2007	Apr. 2006	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]						LO, LNO, LO, O	LO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government							
Stocks of Central Government and Central Government-Guaranteed Debt[5]							
External Current Account Balance	Dec. 2006	Mar. 2007	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services	Dec. 2006	Mar. 2007					
GDP/GNP	Dec. 2005	Mar. 2007	A	I	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt	Dec. 2005	Mar. 2006	A	I	I		

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/84
FOR IMMEDIATE RELEASE
July 24, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with Mozambique

On June 18, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mozambique.[25]

Background

The Mozambican economy has continued to perform well in recent years and is increasingly resilient to exogenous shocks. Real GDP growth has picked up in 2006 led by a recovery in agricultural production and construction activities while the trade balance improved due to a surge in exports. Headline inflation has fallen to single digit levels anchored by a prudent monetary stance. The outlook for 2007 is for continued strong growth, inflation in the range of 5-7 percent, and a sustainable fiscal and external position, with some risks related to a further rise in oil prices.

Policy challenges remain, however, in sustaining Mozambique's growth takeoff and achieving the Millennium Development Goals (MDGs). The stabilization effort and a first-wave of reforms helped sustain a growth of 8 percent a year, on average, since the early 1990s. Broad-based growth and foreign aid, including debt relief, helped reduce poverty and improve social indicators. The experience of countries that have kept growth accelerating over the long run suggests a need to consolidate macroeconomic

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[25] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

stability and implement second-generation reforms, including a scaling-up of basic services to address human capital and infrastructure gaps.

The arrangement under the Poverty Reduction and Growth Facility (PRGF) helped maintain macroeconomic stability in the face of exogenous shocks and addressed the structural weaknesses identified in the Ex Post Assessment (EPA, IMF/04/53). Overall performance under the program has been good, which has helped the authorities maintain inflation control and a comfortable level of international reserves in the face of exogenous shocks. The authorities also completed reforms identified in the EPA—particularly in strengthening revenue mobilization by creating a central revenue authority (ATM), improving expenditure efficiency through the rollout of a government financial management information system (e-SISTAFE), and addressing vulnerabilities in the financial system.

The three-year Policy Support Instrument (2007–10) is focused on consolidating macroeconomic stability to sustain Mozambique's growth takeoff in the context of scaled-up foreign aid. Fiscal policy will be reinforced to finance additional priority spending in a sustainable manner and ensure that a scaling-up of aid-financed expenditures reaches the most productive and pro-poor sectors. Monetary control will anchor inflationary expectations while a flexible exchange rate regime will help maintain competitiveness and a comfortable level of international reserves to cushion against exogenous shocks. The structural program aims at improving the business environment by deepening the financial system and reducing the cost of doing business, as well as strengthening the fiscal and transparency regime of the natural resource sector. Institutional and capacity building need to keep pace with the rapid structural transformation of the economy and facilitate the implementation of second-generation reforms.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. Directors commended the Mozambican authorities on the impressive macroeconomic performance and overall satisfactory program performance since the last Article IV consultation. They noted that the economy has been resilient to numerous exogenous shocks, and the outlook is for continued strong growth, moderate inflation, and a sustainable fiscal and external position. Progress has also been made in reducing poverty.

Directors agreed that there are policy challenges related to sustaining Mozambique's growth takeoff and to achieving the MDGs. The strategy to consolidate macroeconomic stability in the context of a continued scaling-up of foreign aid and the acceleration of a second wave of reforms outlined in the authorities' poverty reduction plan (PARPA II) for 2006–09, to be monitored under the new Policy Support Instrument arrangement, should help sustain strong broad-based growth.

Directors noted that consolidating macroeconomic stability would require persevering with sound fiscal and monetary policies, as well as prudent public debt management and public finance reforms. In this regard, the medium-term fiscal framework will need to continue to target an annual 0.5 percent GDP revenue increase and no recourse to financing from the domestic financial system. This should help contain inflation and allow private sector credit to expand further and decrease its cost, while maintaining competitiveness and debt sustainability and reducing aid dependency.

Directors agreed that the 2007 budget was appropriate as it targeted a 0.5 percent of GDP rise in domestic revenue with the share of priority expenditures exceeding 65 percent of total spending. The rollout of the public financial administration system (e-SISTAFE) to all public entities at the central and provincial level, and direct execution of a greater share of current spending should improve monitoring of expenditures. The finalization of guidelines to include donor-funded projects in the single treasury account (CUT) and e-SISTAFE as well as the opening of a multicurrency CUT should be expedited to encourage the donors to transfer projects on CUT.

Directors noted that the public sector reform program is at a critical juncture. They looked forward to the installation of a clean integrated payroll database based on a civil service census and the piloting of program budgeting. The government's decentralization strategy should be clarified and well sequenced with sufficient capacity building and reporting systems to ensure accountability of budgetary resources. This would help address concerns about the accountability and transparency of district spending. Directors looked forward to visible results of the anti-corruption strategy and judicial sector reform.

Directors supported the Bank of Mozambique's policy framework of base money targeting, in conjunction with a flexible exchange rate regime. They welcomed the abolition of the exchange rate band, which demonstrates the commitment of the authorities to a flexible exchange rate regime, and which should help cushion against exogenous shocks and improve competitiveness.

Directors emphasized that second-generation institutional reforms are critical to sustain economic growth. A private sector led growth strategy calls for a strengthening of the business environment, particularly a deepening of the financial sector while strengthening the supervisory framework. Directors welcomed the approval of the new mining and petroleum fiscal laws, and looked forward to the timely adoption of their implementing regulations. They also encouraged the adoption of new model contracts in the mining and petroleum sectors while ensuring that all new sizable projects abide by the principles of the new fiscal regime and the core principles of the Extractive Industries Transparency Initiative.

Directors welcomed the good progress made in seeking financing for the transfer of majority ownership of the Cahora Bassa hydropower plant from Portugal to Mozambique. They noted the authorities' renewed commitment to non-recourse financing so as not to increase the government's liabilities to commercial creditors, and ensure transparency and accountability. These principles could be applied to all future infrastructure projects, while encouraging greater private participation to reduce risks to debt sustainability.

Directors emphasized that the timely implementation of the strategic action plan to reduce the cost of doing business will be key to promote export diversification and generate employment. In this regard, high fees charged for scanning freight is a concern, as they increase export/import transaction costs.

It is expected that the next Article IV consultation with Mozambique will be held within 24 months, subject to the provisions of the Executive Board decision on consultation cycles in program countries.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Mozambique: Selected Economic Indicators, 2005–07

	2005 Actual	2006 Est.[1]	2007 Rev. Proj. [2]
	(Annual percentage change, unless otherwise indicated)		
National income and prices			
Nominal GDP (millions of MT)	157,345	193,322	220,150
Nominal GDP growth	18.0	22.9	13.9
Real GDP growth	6.2	8.5	7.0
GDP per capita (in U.S. dollars)	348	386	397
Consumer price index (annual average)	6.4	13.2	6.4
Consumer price index (end of period)	11.2	9.4	6.0
External sector			
Merchandise exports	16.1	37.0	7.9
Merchandise imports	21.2	16.7	8.4
Terms of trade	22.5	59.0	1.9
Real effective exchange rate (end of period)[3]	-6.3	1.8	...
	(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)		
Money and credit			
Net foreign assets	23.1	31.3	10.4
Net domestic assets	4.0	-7.9	5.7
M2 (12-month percent change)	22.1	25.8	16.2
Interest rate for 90-day treasury bills (percent; of period)	10.0	16.0	...
	(Percent of GDP)		
Investment and saving			
Gross domestic investment	21.5	24.9	28.8
Gross domestic savings (excl. grants)	5.6	11.3	10.9
Current account, before grants	-15.8	-13.6	-17.9
Government budget			
Total revenue	13.6	14.0	14.5
Total expenditure and net lending	22.1	25.1	30.5
Overall balance, before grants	-8.6	-11.4	-15.9
Total grants	6.3	9.9	11.5
Overall balance, after grants	-2.2	-1.5	-4.5
Domestic primary balance	-1.8	-1.9	-2.7
External financing (incl. debt relief)[4]	3.4	4.5	5.2
Net domestic financing	-1.5	-3.0	-0.7
	(Percent of exports of goods and nonfactor services)		
External debt service (nonfinancial public sector)			
Scheduled, after additional bilateral assistance and MDRI	2.0	0.8	0.7
	(Millions of U.S. dollars, unless otherwise indicated)		
Overall balance of payments	-57	139	74
Gross international reserves (end of period)	1,103	1,241	1,315
In months of imports of goods and nonfactor services	4.6	4.4	4.2

Sources: Mozambican authorities; and Fund staff estimates and projections.
[1] Takes into account IMF delivery of MDRI in January 2006.
[2] Projections exclude the Moatize coal mine project, Cahora Bassa transfer, and Petroleum exploration.
[3] Minus sign indicates depreciation.
[4] Includes movement in the government account set abroad with the proceed of the Moatize coal mine concession.

Press Release No. 07/135
FOR IMMEDIATE RELEASE
June 18, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Final Review of the PRGF Arrangement for Mozambique, Approves US$2.4 Million Disbursement and Approves a Three-Year Policy Support Instrument

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Mozambique's economic performance under an SDR 11.36 million (about US$17.1 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 04/153). The completion of this final review enables the release of an amount equivalent to SDR 1.64 million (about US$2.4 million).

The Executive Board has also completed a review of the country's financing assurances and granted Mozambique's request for a waiver for the non-observance of a performance criterion on base money at end-year 2006, as it was temporary and related to the currency reform.

The Executive Board also approved a Policy Support Instrument (PSI) for Mozambique under the IMF's PSI framework, which is intended to support the nation's economic reform efforts. The PSI for Mozambique is aimed at maintaining macroeconomic stability as foreign aid is scaled up, promoting structural reforms, as well as implementing the broader policy agenda as envisaged in the Mozambican authorities' national poverty reduction strategy, *Plano de Acção para Redução da Pobreza Absoluta* (PARPA II). Approval of Mozambique's PSI signifies IMF endorsement of the policies outlined in the program.

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. PSIs are voluntary and demand driven. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. Members' performance under a PSI is normally reviewed semi-annually, irrespective of the status of the program (see Public Information Notice No. 05/145).

The Executive Board also concluded the 2007 Article IV consultation with Mozambique.

In commenting on the Executive Board decisions, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"The Mozambican authorities are to be commended on the recent impressive macroeconomic performance and overall satisfactory program performance. The economy has been resilient to numerous exogenous shocks and the outlook for 2007 and medium-term is favorable. The authorities' graduation to a PSI sends a strong signal to donors and private investors regarding the favorable economic environment.

"The strategy to consolidate macroeconomic stability in the context of a continued scaling-up of aid and the acceleration of a second wave of reforms monitored under the three-year PSI should help sustain strong broad-based growth. This strategy would require a strengthening of fiscal policy and reducing the cost of doing business and continuing to squarely address governance issues. The approval of the new mining and petroleum fiscal laws, and intention to issue implementing regulations is welcome in this regard. The authorities are also encouraged to adopt new model contracts in the mining and petroleum sectors while ensuring that all new sizeable projects abide by the principles of the new fiscal regime and the core principles of the Extractive Industries Transparency Initiative.

"The 2007 budget should continue to target a 0.5 percent of GDP rise in domestic revenue, while the share of priority expenditures exceeds 65 percent of total spending. The rollout of e-SISTAFE (public financial administration system) to all public entities at the central and provincial level, and direct execution of a greater share of current spending should improve monitoring of expenditures. The finalization of guidelines to include donor-funded projects in the single treasury account (CUT) and e-SISTAFE as well as the opening of a multicurrency CUT should be expedited to encourage the donors to transfer projects on CUT.

"The public sector reform program is at a critical juncture. The installation of a clean integrated payroll database based on a civil service census is an important first step. The government's decentralization strategy should be clarified and well sequenced with sufficient capacity building and reporting systems to ensure accountability of budgetary resources. This would help address concerns about the accountability and transparency of district spending. Progress in the anti-corruption strategy and judicial sector reform will be crucial to further strengthen the business climate.

"Good progress has been made in seeking financing for the transfer of majority ownership of the Cahora Bassa hydropower plant from Portugal to Mozambique. The authorities reiterated their commitment to non-recourse financing so not to increase the government's liabilities to commercial creditors, and ensure transparency and accountability. These principles could be applied to all future infrastructure projects whilst encouraging greater private participation to reduce risks to debt sustainability.

"The Bank of Mozambique's policy framework of base money targeting, in conjunction with a flexible exchange rate regime, is appropriate. Greater exchange rate flexibility will help cushion against exogenous shocks and improve competitiveness, and in that regard the elimination of the temporary exchange rate band is a welcome step," Mr. Kato said.

Statement by Peter Gakunu, Executive Director for Republic of Mozambique and Jose Alves Sulemane, Advisor to Executive Director
June 18, 2007

The Mozambican authorities wish to acknowledge the Fund's engagement, support, and constructive dialogue and thank staff for the well written reports which clearly identify the challenges for its development process, as well as the various policy options facing the country in the medium to long term. They are in broad agreement with the thrust of the analyses, conclusions, and recommendations in the report.

Recent Macroeconomic Developments and Performance

Since the end of the civil war in 1992, growth has been strong in Mozambique, and has contributed to the reduction of the poverty. It was in line with this trend that real GDP growth accelerated from 6.2 percent in 2005 to an estimated 8.5 percent in 2006, propelled by a rebound in agricultural production and the continued strength of the construction sector. Implementation of prudent fiscal and monetary policies helped maintain inflation at a single digit at the end of 2006. Annual inflation declined from 11.2 percent at the end of 2005 to 9.4 percent at the end-December 2006, and reduced further to 8.3 percent in May 2007, despite the effects of high oil prices. Increased exports as well as sustained inflow of foreign aid kept net international reserves at over four months of imports cover, resulting in the foreign exchange market remaining stable during the year.

The authorities' fiscal policy stance was better than programmed as revenue collection was above target, with expenditure directed to priority areas, especially for poverty reduction, in line with the 65 percent target in the Poverty Reduction Strategy Paper (PARPA). Progress has been made in reforming the revenue administration and widening the tax base, while the new Central Revenue Authority (ATM) is now fully operational. In addition, during 2006, the number of taxpayers increased by more than 30 percent; while other measures undertaken contributed increased revenue collection.

In the area of tax policy, the Cabinet approved and submitted to the Parliament three laws on specific taxes and fiscal incentives in the mineral resources and petroleum sectors in December 2006. A new fiscal code for succession and donations, and a draft municipal finance and asset law were also submitted to the Parliament. The latter aligns the finance and asset management of the municipalities with the new financial and fiscal systems implemented over the last six years. Progress continues in Public Financial Management (PFM) reforms to improve budget preparation and monitoring at the central level, and on strengthening the planning capacity at sub-national institutions. At the end of April 2007, the Census of the civil service was completed that would help improve the planning of the wage bill. In order to improve coverage in the execution of the budget, guidelines were also issued to facilitate the inclusion of donor-financed projects on the Single Treasury Account (CUT). The reforms in this area have contributed to increased confidence on domestic mechanisms for aid delivery, and as at end April 2007, 19 donors are committed to giving general budget support to Mozambique under a specific memorandum of understanding.

The authorities pursued a prudent monetary policy stance in 2006, resulting in a smooth introduction of the new family of meticais (MTn). The financial system has continued to improve. In this regard, prudential ratios of the banking system remained sound and the ratio of non-performing loans to total loans was below 4 percent; commercial banks are highly profitable with their levels of capital adequacy being closely monitored in light of the overall strong growth in credit to the economy; and foreign currency loans in total loans have decreased from almost 64 percent in 2005 to 45 percent in 2006. In the process of increasing transparency and modernization, the Central Bank (BM) has adjusted its Chart of Accounts to allow for the valuation of foreign exchange gains/losses consistent with International Financial Reporting Standards (IFRS), and its financial statements for 2006 have been issued in compliance with IFRS and in parallel with the financial statement prepared under the current accounting standard.

Progress on implementation of structural reforms accelerated, particularly in the areas of the public sector, cost of doing business, and governance reforms. First, the second phase of the public sector reform strategic action plan (2006-2010) was approved by the Council of Ministers in October 2006. Second, the draft strategy for reducing the cost of doing business was finalized in March 2007, while in the Justice sector, the Supreme Court concluded 66 percent more cases in 2006 than in the previous year, with activities in the provincial courts increasing by 48 percent. This resulted in a reduction of the backlog of outstanding cases. Third, to accelerate the enactment of approved laws, the authorities have assigned the production of the Government Gazette to the Ministry of Justice. Finally, the Parliament has recently approved the Labor law, which is an important component of the cost of doing business.

Performance Under the PRGF

The authorities' commitment to implementation of the reforms has resulted in meeting all end-December 2006 quantitative performance criteria, except for base money for year-end target due to the temporary volatility in currency demand around the deadline to exchange the old currency for the new. In January 2007 the trend in this indicator was within the indicative target for March 2007. The structural performance criteria and benchmarks through end-March 2007 were also achieved, except for the benchmark related to the treasury single account which has been delayed to end-September 2007.

Outlook and Policies for 2007 and Under the Three-Year PSI

The authorities' medium term policy framework continues to focus on the consolidation of macroeconomic stability. The medium term challenges facing the economy relate to the timely implementation of the second wave of reforms, especially in facilitating improvements in service delivery in the public sector and the creation of an enabling environment for private sector development. Equally important is the need to improve governance through the enhancement of coordination mechanisms within the public sector and the generation of more domestic revenues from both the traditional tax system and also from the use of natural resources.

Given the focus on growth, the authorities will take advantage of the current and medium term favorable economic conditions to sustain growth at 7 percent and their effects to substantially reduce poverty. A key medium term challenge is the scaling up of aid and managing its macroeconomic implications. In this regard, the authorities will strike a balance between the development and benefits from mega-projects and the imperative to improve other sectors of the economy in order to expand exports in the traditional and in new sectors, as well as on the growth of the non-traded sector of the economy.

Fiscal Policy

The Government is committed to continuing with implementation of measures to enhance and strengthen domestic revenue mobilization and ensure raising revenues each year as part of the exit strategy to reduce aid dependency. In this context, there will be no recourse to domestic financing of the budget in 2007 and subsequent years. To reach the goals on domestic revenue mobilization, the authorities' revenue enhancing measures include increasing the number of taxpayers, elimination of unwarranted tax exemptions, collection of tax arrears, updating the specific fuel tax, and ensuring efficiency in the customs area.

The authorities are aware of the importance of maintaining prudent public financial management (PFM) and have agreed on a detailed action plan and budget (APB) with donors for the period 2007-2009. The APB will include, among other things, rollout of the budget execution module to all central and provincial entities, customization for districts and municipalities; introduction of Phase II of the budget formulation module; and developing new modules functionalities.

Monetary Policy

Monetary policy will continue to target base money to achieve single digit inflation in the medium term. In this regard, the BM will improve liquidity management to control base money, in particular, in the context of foreign aid financed expenditures. To this end, the Ministry of Finance will improve the preparation of cash-flow projections and ensure prompt communication to the Central Bank. The BM will continue to strengthen its supervisory functions and implement the organizational changes with a view to strengthening on-site and off-site monitoring. The process of adopting IFRS in the banking system will continue and will be extended to the corporate sector, in order to improve the ability to evaluate the quality of the loan portfolio. In addition, new regulations on the assessment, classification and provisioning of credit as well as a regulation of integral risk management for credit institutions and finance companies will become effective in 2007. The BM will support the expansion of the non-bank financial sector, and it will also continue to license and supervise the microfinance deposit-taking institutions to facilitate access to finance by SMEs and rural households.

Regarding the reforms in the foreign exchange system, a new foreign exchange law that includes comments from all stakeholders will be submitted to the Parliament in July 2007 as harmonization of various views took some time. Upon approval of the law and its related regulations, the authorities intend to accept obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

Structural Reforms

The reforms' agenda to tackle the structural constraints of the economy are still daunting, action-oriented, and well phased. Strong leadership in pursuing them is important, and the authorities are aware of these and are committed. In the next three years, the focus of the reforms will be centered on governance, improving the business environment and the effective management of the natural resources. The main pillars of the public sector reform are: (i) civil service reform, which includes the census and the wage bill reforms; (ii) decentralization and use of the momentum in PFM reforms to sub-national units (provinces, districts, and municipalities); (iii) the anti-corruption strategy which encompasses the development of operational plans in five sectors, and the development of oversight and monitoring mechanisms with ample participation of different stakeholders within the society.

The second wave of reforms puts emphasis on the business environment and the reduction of the cost of doing business in order to sustain high growth in the medium term and support the development of SMEs and transform Mozambique into a competitive economy as well as serving as a location for FDI. In this regard, the authorities plan to embark on developing the financial sector in order to increase access to credit and lower financing costs. The authorities are implementing an action plan designed to reduce the cost of doing business and accelerate business registration, reduce employment costs, simplify trade regulations, among other measures. At the same time, the authorities will play an important role in supplying public infrastructure and delivery of public services that will complement and enhance private sector investment and productivity.

The Mozambican authorities are conscious of the importance of FDI in enhancing the development of mining and other natural resources. In this regard, the government intends to commence application of international best practices in tax structure and transparency for these types of projects. A new legislation has recently been approved in the area of mining and petroleum products. The government is considering following the Extractive Industries Transparency Initiative (EITI), and is already participating in seminars and workshops on the subject to get more insights and information on the way forward.

Conclusion

Mozambique's experience with the PRGF arrangements in recent years was very positive and created the basis for macroeconomic stability and advancement with the first wave of reforms in the period after the end of the civil war. The prospects for the Mozambican economy remain favorable in the medium term and the authorities have expressed strong commitments to implementing the reform agenda as spelt out in PARPA II. The authorities request the completion of the sixth review and the financing assurances, and the waiver on the Performance Criterion. In addition, and based on the accumulated experience, the authorities also request for a Three-Year Policy Support Instrument. They strongly commit themselves to ensuring that the objectives and policies set forth under the PSI are achieved.