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Republic of Mozambique: Third Review Under the Poverty Reduction and Growth Facility—Staff Report and News Brief

In the context of the third review under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the third review under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **June 22, 2001** 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 September 5, 2001.** 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.

- News Brief summarizing the **views of the Executive Board as expressed during its September 20, 2001 discussion** of the staff report that completed the review.

The documents listed below have been separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper
Letter of Intent by the authorities of the member country*
Poverty Reduction Strategy Paper
Technical Memorandum of Understanding*

*May also be included in Staff Report.

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

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REPUBLIC OF MOZAMBIQUE

Third Review Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Jürgen Reitmaier and Michael Hadjimichael

September 5, 2001

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EXECUTIVE SUMMARY

- Economic activity in Mozambique has rebounded from the devastating effects of the February-March 2000 floods, but inflation has recently increased to 7.4 percent in July following exchange rate weakness during the first half of 2001. The current account has narrowed with the initiation of aluminum exports and new large foreign investments are in the pipeline.

- All quantitative performance criteria for end-December and end-June were observed, in the case of official reserves and net domestic assets by wide margins. Budgetary developments have also been in line with the program, with shortfalls in capital expenditure contributing to smaller-than-programmed deficits.

- The two structural performance criteria for end-March 2001 were not observed. In the case of the envisaged public accounting law, the government decided instead on a broader scope public financial management law that was submitted to the National Assembly in September; in the case of the recapitalization of Banco Austral (BA), the majority private shareholder withdrew and it did not take place.

- Given the importance of a transparent and financially sound resolution for BA, the review was delayed while the staff worked closely with the authorities to find a way forward. The government intervened in BA, but, from the outset, announced its plans to resell it to a reputable foreign bank. One such buyer was identified in August and negotiations are ongoing. In the meantime, BA's interim management has pursued loan recovery and implemented safeguards to minimize losses.

- The government has approved its first full PRSP and met other conditions for reaching the completion point under the enhanced HIPC Initiative. It also increased social priority spending in the context of the 2001 budget and enhanced monitoring of such expenditures, including from HIPC-debt relief, with the publication since May of more detailed quarterly budget reports. Further gains in this area will stem from the adoption in June 2001 of a new, more detailed public expenditure classification system.

- The program for the remainder of 2001 aims at consolidating recent gains and addressing the financial repercussions of BA's divestment. Under the program, liquidity conditions have been tightened to stem pressures on the exchange rate and domestic prices. The major structural reform will be the overhaul of personal and corporate income taxes drawing on FAD's technical assistance recommendations.

- The 2002 budget will be discussed during a forthcoming staff visit. The staff supports the framework presented in the PRSP, which calls for a significant fiscal adjustment in 2002 through a reduction in spending, as flood-related expenditures and bank restructuring costs decline sharply, and revenues are increased.

- A series of prior actions and contingencies in connection with the BA resolution was agreed with a view to avoiding financial and systemic repercussions. Added importance has been placed on enhancing banking supervision and concrete steps are being taken.

- In view of the consequences of the delay in completing the third PRGF review on the original disbursement schedule, it is proposed, with the authorities concurrence, that the arrangement be rephased.

- Based on the authorities' recent actions and policy intentions in the areas of revenue and expenditure management, monetary policy, and bank restructuring, the staff recommends that the Executive Board complete the third review of the current PRGF arrangement.

I. Introduction

1. **In the attached letter of intent, the Mozambique authorities present their program through the remainder of 2001 and request waivers for the nonobservance of two performance criteria and completion of the third review under the Poverty Reduction and Growth Facility (PRGF) arrangement.** Completion of this review was delayed following the nonobservance of the performance criterion at end-March that included the recapitalization of Mozambique's third largest and insolvent bank, Banco Austral (BA). The former private shareholder declined to recapitalize BA, and the government bought back its shares for a nominal amount. In view of the need to resolve the bank and the implications of this operation for public finances and the soundness of the financial system, staff, in consultation with the staff of the World Bank, worked closely with the authorities to find a way forward. Discussions on the review began in February 2001 in Maputo, continued in Washington during the spring meetings, and were concluded in Maputo in June 2001.[1]

2. **The letter of intent also describes the observance of quantitative targets for end-June 2001, which were originally set as performance criteria for the fourth review.** However, in view of the delay in completing the third review—which also delayed the establishment of structural performance criteria for the fifth disbursement—it is proposed, with the authorities' concurrence, that the arrangement be rephased. As indicated in Table 1, the fourth review would be scheduled to be completed by April 30, 2002. This review will, inter alia, assess the observance of quantitative performance criteria for end-December 2001 and the structural performance criterion for end-December 2001, as proposed in the attached letter of intent, and allow for the presentation of the government's program for 2002, taking into account discussions on the budget for 2002 to be held later this year.

3. **The government's approval, in April 2001, of its first full poverty reduction strategy paper** (PRSP, or PARPA as designated under its Portuguese acronym) represents a milestone in refocusing Mozambique's adjustment strategy to address more decisively the country's social problems, and constitutes a key element of the steps needed for Mozambique to reach its completion point under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative). Endorsement of the full-PRSP by the Executive Boards of the

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[1] The following staff participated in the discussions: Mr. Andrews (head, from April), Mr. Reitmaier (former head), Mr. Lopes, Ms. Scott, and Mr. Flores (all AFR), Mr. Rebucci, Ms. Glennerster, and Mr. Kalonji (PDR), Mr. Manoel (FAD), and Mr. Schwidrowski (Resident Representative). Mr. Ize (MAE) participated in the discussions on banking sector issues. Mr. Fajgenbaum (AFR) participated in some of the discussions. The missions collaborated closely with the staff of the World Bank, in particular as regards banking sector issues, the poverty reduction strategy paper (PRSP) and the completion point under the enhanced HIPC Initiative. Ms. Patel, Advisor to the Executive Director for Mozambique, participated in the discussions during the February mission and the spring meetings.

Bank and the Fund[2] is also a condition to completing the third review under the PRGF. During the discussions, the authorities made clear that they attach high priority to implementing the PRSP policies and that they look forward to doing so with the involvement of the international community, including the Fund in the context of programs supported by the PRGF arrangement.

4. **Continued implementation of the PRGF–supported program is also a condition for reaching the completion point under the enhanced HIPC Initiative** making Mozambique's performance under the PRGF arrangement (Tables 2 and 3) all the more decisive. The government's letter of intent is presented in Appendix I, while Appendices II and III cover relations with the Fund and World Bank Group.

II. Recent Developments and Program Implementation

5. **Social and economic conditions in Mozambique have improved over more than a decade of economic reforms.** Real GDP growth averaged more than 10 percent a year in 1997-99, reflecting in part large-scale foreign investment in connection with the MOZAL aluminum smelter and the rehabilitation of the Cahora-Bassa dam and power distribution network. However, Mozambique is still very vulnerable to natural disasters, as underscored by the severe floods that reduced economic growth to 2.1 percent in 2000 (Table 4). In addition, the country is highly dependent on external assistance, which in 2000 was equivalent to 14 percent of GDP and half of budgetary expenditures. Notwithstanding significant progress, social conditions remain difficult; an estimated two out of three Mozambicans live below the poverty line, and one in six adults is HIV positive.

6. **Despite a sharp increase in external support following the floods in 2000, inflation surged** as a result of flood-related shortages and an accommodating monetary policy, reaching a 12-month peak of 17 percent in October 2000. The government's primary domestic deficit increased from 3.4 percent of GDP in 1999 to 6.5 percent of GDP in 2000 but was still 1 percent of GDP smaller than targeted, as it was not possible to spend budgeted amounts effectively (Table 5). Nevertheless, as indicated in Box 1, domestically financed expenditures on priority areas increased by 2.1 percent of GDP in 2000, or by more than the reduction in debt service payments during the year. The overall deficit after grants rose from 1.5 percent of GDP in 1999 to 4.4 percent, compared with a program target of 6.1 percent of GDP, as externally financed capital spending was also lower than expected. In the monetary sector, the ceiling on net domestic assets of the central bank was observed despite continued liquidity support to the banking system, as this was offset by lower-than-programmed government borrowing. The central bank acted to tighten monetary conditions in the second

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[2] The Bank's Executive Board is scheduled to discuss the PRSP and the joint staff assessment (JSA) on September 20, 2001 together with Mozambique's attainment of the completion point under the enhanced HIPC Initiative

Box 1. Debt Relief and Priority Spending

Expenditures in priority areas identified in the PARPA (or PRSP) have a wider coverage than health and education, which account for 55 percent of the total. Budgetary data indicate that in 2000 expenditures in these areas, using domestic resources, increased by 2.1 percent of GDP to 9.4 percent of GDP. Cash payments of debt services, as recorded by the budget, declined by 0.9 percent of GDP in 2000. At the same time, the central bank transferred the equivalent of 0.8 percent of GDP of HIPC assistance from the IMF to the budget. Thus, in total, the increase in domestically financed PARPA spending exceeded resources made available to the budget from lower debt service payments by 0.4 percent of GDP.

	1999	2000	Difference
Domestically financed PARPA expenditures			
In billions of meticais	3,790	5,654	1,864
In millions of U.S. dollars	298	376	78
As a percent of GDP	7.3	9.4	2.1
External debt service paid by the budget			
In billions of meticais	801	386	-415
In millions of U.S. dollars	63	26	-37
As a percent of GDP	1.5	0.6	-0.9
Transfer to the budget of HIPC assistance from the IMF			
In billions of meticais	0	485	485
In millions of U.S. dollars	0	32	32
As a percent of GDP	0	0.8	0.8

Source: Ministry of Planning and Finance

half of 2000, but the benchmark on reserve money was exceeded, and broad money grew by 42 percent during 2000, compared with the programmed expansion of 34 percent (Table 6).

7. **The external current account deficit after grants narrowed from 17.5 percent of GDP in 1999 to 11.6 percent in 2000**, as a sharp increase in net exports from MOZAL more than offset the flood-relief emergency imports (Table 7).[3] Production of cashew nuts, a socially important cash crop, was adversely affected by plummeting world prices and exports of raw cashew nuts (in U.S. dollar terms) to less than half their 1999 level, in contrast to exports of processed nuts, which increased by 10 percent. Gross international reserves of the central bank rose by more than programmed to US$745 million (the equivalent of over six

[3] The current account deficit after grants, and excluding the impact of large projects, widened by 4 percent of GDP to 8 percent of GDP over the same period.

months of imports of goods and nonfactor services), in part reflecting the shortfall in government spending.

8. **Limited available data suggest that, despite severe localized flooding in the lower Zambezi basin early in the year, growth has picked up so far in 2001; however, inflation has rebounded and the metical has depreciated sharply**. Aided by the first full year of output from the Mozal aluminum smelter and continuing reconstruction spending, real GDP growth is projected to reach almost 10 percent for the year as a whole. Inflationary pressures, which had subsided towards the end of 2000 as the effects of the 2000 floods tapered off, reemerged in the second quarter of 2001 bringing the 12-month rate of inflation to 7.4 percent in July. This resurgence of inflation in part reflected a persistent depreciation of the metical, which began in late 1999 with the relaxation of monetary policy and gathered pace in the opening months of 2001 in response to political uncertainties and concerns over the health of the banking system (Figure 1). The central bank responded by raising reserve requirements from just under 8 percent to 11.5 percent of deposits with effect from July and the central bank's interest rate on liquidity support from 22.5 percent to 34.5 percent (Figure 2); in addition, the market for treasury bills has been broadened by allowing direct sales to the nonbank private sector.

9. **In the first half of 2001, implementation of the financial program was broadly on track and all targets established as quantitative performance criteria were observed.** The program had been designed to accommodate significant spending on flood reconstruction carried over from 2000, higher social sector spending , a boost in the government wage bill, and onetime outlays for bank recapitalization. In the event, revenues were some 6 percent higher than expected, with all main revenue categories performing more strongly than envisaged. Although the pace of current non-interest expenditures, including the impact of a 17 percent general rise in civil service wages effective from April 1, increased, these expenditures and domestically financed capital spending were lower than programmed. As a result, the domestic primary balance was about 0.3 percent of GDP lower than programmed, after adjusting for lower expenditures for bank recapitalization. Aided by this fiscal outcome and consequent lower recourse to domestic borrowing, net domestic assets were held well within the program ceiling. However, monetary growth remained higher than envisaged under the program because of the strong accumulation of net foreign assets and their valuation at a more depreciated exchange rate; through June, the 12-month rate of growth of reserve money was 46 percent, compared with the growth of 29 percent underlying the benchmark on reserve money.

10. **Despite progress in several areas, there were important slippages in the implementation of structural reforms, which led to the nonobservance of two end-March 2001 performance criteria.** The performance criterion covering the submission to parliament of a new public accounting law was not met because the government decided to prepare a broader government financial management law for enactment later in 2001; a draft of this law, prepared with technical assistance from the World Bank, was submitted to the parliament in early September. The other end-March 2001 structural performance criterion

concerned the recapitalization of two troubled domestic banks—Banco Comercial de Moçambique (BCM) and Banco Austral (BA)—with the costs to be shared between the government and the private shareholders in proportion to their respective equity holdings. While the recapitalization of BCM took place as expected, the private shareholders of BA decided at the last moment to withdraw, thus making it impossible to carry out the programmed capital injection.

11. **As regards other structural measures included in the program**, in March the government approved the legal basis for the creation of a special large taxpayer unit. In May 2001, the government adopted a more detailed functional classification of budgetary expenditures, which will allow enhanced monitoring and tracking of social allocations starting in 2002, and published data on social expenditures using the new interim monitoring system in its budget report for the first quarter of 2001. Also, in May, the government produced a new draft code on fiscal incentives, which is expected to go into effect for the fiscal year 2002; as indicated in the authorities' memorandum of economic and financial policies (MEFP) of September 2000, this is expected to yield a revenue gain of approximately 1 percent of GDP during the year. In June 2001, the government finalized plans for the creation of a central revenue authority. The interbank computerized clearing system also became operational in July (see Box 2 on streamlined conditionality in the program).

12. **In addition, the government made progress implementing other reforms,** including, as described in the HIPC Initiative completion point document, those established as conditions for reaching the completion point under the enhanced HIPC initiative. At the time of the decision point it was envisaged that an integrated plan for the reform of the judicial system would be completed by end-2000. The nature of this plan has now been clarified to include the independent judiciary and the attorney general as well as the Ministry of Justice, and its scope broadened with the participation of key stakeholders. A detailed schedule for the preparation of this plan has been drawn up, and, with the participation of a bilateral donor, work is proceeding to complete the plan by end-2001. In addition, the government has issued a statement on the role and functions of the Ministry of Justice and is taking a number of steps to improve the functioning of the legal system, including revisions to the penal, civil, and commercial codes, and concrete measures to expedite court proceedings and improve prison administration. In April 2001, the government published its policy for the remaining public enterprise sector, as well as a strategic plan for reform of the public service, and approved the new Health Sector Strategic Plan.

Box 2. Structural Conditionality

Coverage of structural conditionality in the current program

Structural conditionality in the program for the remainder of 2001 focuses on consolidating reforms in the areas of taxation, expenditure control, and financial regulations (Table 3 LOI) that remain key to economic growth and poverty reduction. In addition, a series of prior actions (Table 1, LOI) in connection with the resolution of Banco Austral was established in view of the potential adverse implications of the resolution of BA for the program's macroeconomic and social objectives and the soundness of the banking system.

Status of structural conditionality from earlier programs

Although Mozambique did not observe the two key structural measures that constituted performance criteria under the 2000-01 program (Table 2, LOI), the government took adequate follow-up actions that warranted the staff's support for waivers. The other structural measures constituting program benchmarks were met.

Structural areas covered by World Bank lending and conditionality

Recent World Bank lending has been limited to sectoral projects, in the context of which specific implementation goals are flexibly agreed on as a form of conditionality. The World Bank staff has played a key role in choosing and monitoring structural conditionality as agreed for PRGF-supported programs and the HIPC compilation processes.

Other relevant structural measures not included in current program

Implementation of key structural reforms was required for reaching the completion point under the enhanced HIPC Initiative. As noted in the HIPC Completion Point document, all of these measures covering the areas of the poverty reduction strategy, social development, public sector reform and legal and regulatory reforms were implemented satisfactorily. These steps included progress towards the elaboration of an integrated strategy for reform of the judicial system embracing all the main institutions of the judicial system, which have now been brought into a consultative process, with the aim of completing the plan by end-2001.

III. THE PROGRAM THROUGH END-2001

13. **As emphasized in the first full PRSP, rapid growth lies at the heart of the strategy for poverty reduction.** The main thrust of the program for 2001 therefore continues to be establishing conditions for a rapid and sustainable recovery of economic growth to pre-flood levels by safeguarding macroeconomic stability, which had begun to be threatened by a relaxed monetary policy and weaknesses in the banking sector (see Box 3 on the PRGF-supported program and the links to poverty reduction). Real GDP is now projected to grow by 9.6 percent, underpinned by the first full year of MOZAL's production and by buoyancy in the commerce and communications sectors. Agricultural production is expected to recover by a more modest 4.5 percent, reflecting the adverse impact of the 2001 floods in the major producing areas of the Zambezi River basin.

Box 3. The PRGF-Supported Program and the Links to Poverty Reduction

The macroeconomic strategy for poverty reduction. Mozambique's first full PRSP, which has been issued to the Executive Board and is discussed in the Joint Staff Assessment, emphasizes rapid growth as a prerequisite for poverty reduction over the medium- and long-term. After the reduction in the inflation rate to single digits, from the average of about 50 percent a year in the mid-1990s, growth has been rapid, at an average of 10 percent in the three years before the floods in 2000. As well as supporting growth, low inflation is important for the strategy of poverty reduction in that the poor are generally most vulnerable to the adverse effects of inflation. The PRGF supported program therefore seeks to maintain hard-won macroeconomic stability and the authorities' recent good performance in limiting inflation, inter alia, by a tightening of monetary policy.

Poverty and social impact analysis. To date, there has not been a comprehensive poverty and social impact analysis (PSIA) of Fund-supported programs in Mozambique. An analysis of trends in income poverty, including a fuller assessment of policies on poverty reduction, will only be possible after the conclusion of a new household survey currently underway. However, assessments by the World Bank and donors of sectoral and local impacts of specific measures, such as the lifting of restrictions on cashew nut exports have been conducted

Poverty reduction and the sources of growth. The government's strategy also recognizes that growth will need to be broad-based to benefit the poor. Growth in agricultural production—including a further recovery from the losses resulting from floods—is expected to contribute to the incomes of the poor, together with the expansion in internal trade, transport and services. The direct and immediate benefits to the poor from large-scale private foreign investments (such as a the MOZAL aluminum smelter) are likely to be relatively modest, at least in comparison with their contribution to overall growth, given that these projects are capital and import intensive. In addition, the revenue yield from these projects—and by implication the contribution to financing essential social spending—is currently modest. Nevertheless, as indicated in the JSA, the success of these mega projects send a strong signal of Mozambique's openness to private foreign investment which is needed, inter alia, for diversification in the "development corridors" anchored around these projects.

Increasing resources for human development. Particularly in view of the large role of the mega projects, and as indicated in the PRSP, supporting policies need to ensure that growth is favorable to the poor. The program supports this objective by including higher budgetary allocations for expenditures on human capital development, facilitated by both the external resources and improved domestic resource mobilization. Expenditure on health and education, which rose from 6.2 percent of GDP in 1999 to 8.2 percent in 2000 is projected to reach 9.3 percent of GDP in 2001. Resources freed through HIPC debt relief are being tracked using an interim system; beginning in 2002, the full use of the new budget classification will enhance tracking of these expenditures. In addition, the introduction of a new public financial management law—a key structural reform under the program—will support much needed improvements in the management of, and accountability in, the use of public resources. This process will also be supported by the Public Expenditure Review that is now underway with the assistance of the World Bank and steps being discussed with the World Bank staff for the inclusion of extrabudgetary spending within the budget.

Resolution of Banco Austral is essential for macroeconomic stability and to improve the health of the financial system. The strategy supported by the program seeks to minimize the budgetary costs of resolving BA, thereby protecting essential social spending.

14. **The PRSP recognizes that growth must be accompanied by specific pro-poor measures.** In this vein, the program gives special emphasis to strengthening budget management and accountability, to support a strong and credible focus of expenditure on poverty reduction. These efforts, which are initially focused on the development and introduction of a new public financial management law, will also facilitate strengthening the tracking of all social spending. In addition, in line with a key objective of the PRSP, namely, improving resource mobilization to reduce the current very high level of aid dependency, the program supports an extension of tax reforms to broaden and simplify the system of corporate and personal income taxation.

A. Economic and Financial Objectives for 2001

15. **The financial program for the remainder of 2001 was designed with an immediate concern of containing the depreciation of the metical and the associated increase in the rate of inflation.** Higher reserve requirements and an increase in interest rates have helped the metical to hold steady against the U.S. dollar since end-June, but, partly as a result of a the earlier depreciation, the 12-month rate of inflation reached over 7 percent in July. Nonetheless, the authorities reaffirmed their target of 7 percent inflation for end-2001. Reaching this target will require a repetition of the price seasonality seen last year when the consumer price index declined in the final months of the year. To this end, liquidity conditions are to be kept tight to support a continuation of the more recent stability of the metical. Accordingly, the monetary program now aims at a sharp deceleration in broad money growth from 42 percent during 2000 to 19 percent during 2001.

16. **Fiscal policy in 2001 is to remain in line with the program as originally envisaged, but with allowances made for the financial impact of BA's resolution.** Taking into account the revenue performance to date, total tax and nontax revenues are expected to be slightly higher than budgeted, at 12.4 percent of GDP. Current noninterest expenditures are projected to be in line with the budget, while capital spending is expected to be2.4 percent of GDP higher than budgeted. Although the latter includes a carryover of reconstruction spending initially envisaged for 2000, the bulk of the increase reflects the impact of the depreciation of the metical on the valuation of capital expenditures financed with donor assistance. The domestic primary deficit, net of the costs of resolving BA, would be limited to 6.2 percent of GDP, as initially targeted.[4]

17. **The 2001 fiscal program also aims at further enhancing the level and composition of social expenditure, including through the full allocation of HIPC Initiative-related debt relief to relevant areas.** In this regard, the government is hiring

[4] The costs of recapitalizing BA and the cost of the government's assumption of the obligations of BA's pension fund are reflected in the increase in net lending to 3.8 percent of GDP in 2001 from 1.5 percent of GDP in 2000.

4,800 new health and education professionals and is beginning implementation of other PRSP sectoral programs. In all, spending on health and education is programmed to increase to 9.3 percent of GDP in 2001 from 8.2 percent in 2000.

18. **Income tax reform is a priority in the government's policy agenda for the remainder of 2001.** Drawing on technical assistance from the Fund and a bilateral donor, the tax reform will overhaul corporate, personal, and complementary taxes and introduce simplified computation and payment procedures (Appendix I, para. 14). In this manner, the government aims to consolidate the administrative, distributional, and revenue gains achieved during 1999-2000 through the rationalization of indirect taxes and introduction of the value-added tax (VAT). The government intends, with technical assistance from the Fund, to finalize a draft of the new income tax law by October 2001 for submission to the National Assembly by end-December 2001 (a performance criterion), so that collections will begin to reflect the new income tax regime during 2003. In addition, by end–2001, a large taxpayer unit will be launched in Maputo, and the new code of fiscal incentives for investment is expected to be in place.

19. **Despite the increase in the overall deficit in 2001 to meet the costs of resolving BA, total domestic financing needs are expected to be limited to 1.4 percent of GDP** because external assistance in the form of budget support is also now expected to be higher than originally envisaged. This reflects both an increase of some US$70 million in external loans and grants, including the first tranche of an Economic Management and Private Sector Operation (EMPSO) credit expected from IDA, and the effect of the depreciation of the metical on the valuation of this assistance. The resulting lower recourse to domestic financing will be instrumental in easing inflationary pressures and freeing up credit for the private sector. At the same time, net official reserves are projected to remain at their end-2000 level, instead of declining by some US$60 million as originally programmed.

20. **The external outlook for 2001 points to deterioration in the current account after grants to 16.3 percent of GDP, as large-scale private foreign investment resumes.** The surge in aluminum exports, from MOZAL's first full year of operation, will be to some extent offset by higher imports of raw materials. More significantly, massive capital imports are expected in connection with the second phase of the MOZAL project (launched in June 2001) and the natural gas pipeline to South Africa (to be launched later in the year).

21. **The external financing requirements of the program in 2001 (US$1.4 billion) are fully covered by a mix of grants, concessional loans, private investment flows, and debt relief** (Table 8). Although official support has slowed in line with the scaling back of post-flood reconstruction activities, the bulk of the financing requirements will still be provided in the form of new disbursements of official loans and grants. Private sector financing is expected to reach a lower level in 2001 than in the last two years, reflecting the completion of the first phase of the Mozal aluminum smelter. Total debt relief in 2001 would be somewhat lower than in 2000, reflecting the steps taken at the HIPC Initiative decision point to front-

load assistance, including by the Fund (Table 9), and thereby aid emergency and reconstruction efforts following the floods of early 2000.

22. **While significant measures have been implemented to stabilize the metical,** the Bank of Mozambique will continue to pursue a flexible exchange rate policy and abstain from foreign currency sales other than import-support funds from official external assistance.

B. Fiscal Accountability

23. **The program for 2001 aims at increasing the efficiency and transparency of government operations, in particular as regards poverty reduction**. To this end, a new public accounting law that regulates all stages of expenditure, including commitment and verification was to have been submitted to parliament by March 2001 (a performance criterion). Instead, the government decided to prepare a more comprehensive public financial management law, which, inter alia, addressed the issues raised in Mozambique's Report on the Observance of Standards and Codes (ROSC) on fiscal transparency, which had been published in February 2001. With technical assistance from the World Bank, a final draft of this law was completed in June 2001 and submitted to the National Assembly in September. The government is preparing regulations for the new law, which will include provisions for (i) integrating all main areas of budget execution (budget preparation, treasury and debt management operations, tax collection, accounting and control) by using standard accounting principles and compatible and integrated databases; (ii) recording all stages of expenditure execution (allocation, commitment, verification, payment, and reporting); (iii) reducing the lengthy carryover period; (iv) improving cash management through better and more centralized control of actual receipts and payments; and (v) adopting modern principles of fiscal responsibility and transparency.

24. **One of the objectives of the public accounting law as initially envisaged was to introduce a detailed expenditure classification and monitoring system.** This has been separately achieved through the adoption of a new functional expenditure classification system in May 2001. The new system is based on the IMF's Government Finance Statistics (GFS) and the United Nations' Classification of the Functions of Government (COFOG) and is underpinned by a detailed classification of government expenditure under 14 functional headings and over 150 subheadings that comprise priority tracking areas such as primary education and basic public health services. This new system is being implemented in the preparation of the 2002 budget, with particular attention paid to coverage of poverty-related expenditures as set out in the government's PRSP.

25. **The full PRSP was completed in April 2001. It provides a single, comprehensive document that will guide government expenditure in the areas of social development and poverty reduction**. The PRSP identifies targets and sets out procedures on expenditure monitoring in a more detailed and focused manner than previously available in the government's policy outline documents. Despite some shortcomings on costing and expenditure prioritization, as explained in the joint staff assessment (JSA), the PRSP is

expected to serve as operating framework for government policy. Work will continue towards the implementation in 2002 of the full-tracking system for PRSP spending on the basis of the newly introduced classification of expenditure.

26. **Other measures to improve fiscal accountability** are being addressed in the context of the World Bank's public expenditure review (PER) that was initiated last year. Under the PER, a review of the fiscal management system has been undertaken encompassing formulation, execution and reporting; public accounting; cash and asset management; and internal control and auditing. In this context, the Bank has supported the preparation of the new financial management law and is discussing with the Ministry of Planning and Finance how to incorporate "off-budget" operations into budgetary procedures (budget preparation, execution and reporting). These operations, which were identified in the ROSC, concern essentially external aid funds (grants) and autonomous revenues generated by specific government agencies and departments.

C. Financial Sector Issues

27. **The issue of how to handle BA, given its insolvency and history of problems, became a key focus of the recent discussions with Fund and World Bank staffs.** Following the decision of BA's private shareholders not to participate in its recapitalization, the government purchased their equity for a nominal sum of US$1 and the central bank intervened in the operations of BA on April 3, appointing an interim management team. From the outset, the authorities' preferred option was to pursue the sale of the bank as a going concern to a reputable foreign bank.[5] Maintenance of the bank's network of branches—the largest of any bank in Mozambique—was an important consideration for the authorities. They recognized that a sale would take some time to conclude and that, in the interim, the bank could incur further significant losses that would be borne by the government.

28. **Against this background, the staff and the authorities reached understanding on a series of prior actions for the completion of the review.** In this manner, a balance was sought between the need for assurances that a suitable and cost-effective resolution of BA would be concluded within a reasonable time, addressing the concerns outlined above, on the one hand, and the desire to avoid an undue delay in the completion of the review on the other. In line with the first of these prior actions, the authorities selected a reputable bidder from among those who submitted bids in late July; the potential buyer has begun conducting due diligence and negotiations for the purchase.

29. **Safeguards have also been put in place to minimize further losses**. With the aid of international consultants, the authorities are securing all loan documentation and preparing a

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[5] The government is seeking to sell 80 percent of the equity; the remaining 20 percent would be retained for issuance to the bank's employees in line with existing requirements.

full inventory of assets. BA has also been barred from committing to lending beyond existing contracts, so as to avoid any increase in total credit outstanding. The interim management has initiated efforts to recover assets, including delinquent loans under a recovery plan to be underpinned by the full extent of the law. Accordingly, the 100 largest delinquent debtors were privately summoned to discuss settlement of overdue claims, after which a list with the names of all delinquent borrowers who did not begin to regularize their debts was published in June.

30. **The government recognizes the importance of rigorous implementation of a transparent process of loan recovery** to make clear that debtors must meet their obligations and thereby minimize the use of public monies in the resolution of the bank. To this end, the government developed a loan recovery strategy involving focusing on collections from the 80 largest borrowers (who account for three–fourths of the bad debt portfolio). This strategy, which was elaborated with the assistance of international consultants, takes account of Mozambique's legal framework, as reflected in the report provided to World Bank and Fund staffs on the legal remedies available for loan recovery. In the event that the nonperforming assets of BA are not included in the sale and thus become direct obligations to the government, the authorities will look into options to use the powers of "fiscal execution" that are available by virtue of the authority to collect taxes.

31. **The still uncertain costs of resolution of BA are expected to significantly exceed the amounts initially included in the program,** whereby the costs of recapitalization were to be shared with the then private owners. While the modalities remain subject to negotiation with the buyer, the authorities concurred that the recapitalization should take place mainly through the issuance of government securities to the buyer, so as to limit the immediate liquidity implications of the sale and avoid the moral hazard of a large cash injection into the bank. The government has stated that there will be no capital injection into BA before a sale is concluded.

32. **Although prudential requirements are generally observed by other banks operating in Mozambique, the experience with BA has served to highlight weaknesses in banking supervision.** While the regulatory framework is for the most part considered adequate,[6] implementation shortcomings are being addressed. In July 2001, regulations were published for the implementation of the 1999 Financial Institutions Act. The central bank has, in consultation with the staffs of the World Bank and Fund, reviewed current regulations on connected lending, in the light of international best practices, and, as a result, revised regulations are to be issued to clarify the definition of connected lending and establish lower limits in relation to bank capital. The central bank is also preparing for the introduction of

[6] The World Bank's report, *Mozambique Financial Sector Study, 2001*, considered the technical framework for supervision to be basically sound. It also noted that problems of nonperforming loans were concentrated in BCM, which has been recapitalized, and BA.

consolidated supervision of related financial institutions effective January 1, 2002 and is seeking to reinforce working ties with the central banks of the home jurisdictions of the foreign commercial banks doing business in Mozambique. Both the Fund and the World Bank are to provide technical assistance. A Fund advisor has been assigned to provide technical assistance to, inter alia, strengthen on- and off-site supervision and risk assessment, and develop early warning systems.

IV. The Macroeconomic Framework for 2002–04

33. **The medium-term framework in the PRSP is geared to rapid growth—averaging 8 percent per annum**—with further private investment in megaprojects playing a key role. The framework emphasizes policies to maintain macroeconomic stability and an inflation rate of 5-7 percent, while reducing Mozambique's high aid dependency. Although there are risks to the scenario, including the need for contingency plans in the event that growth and government revenue does not meet expectations, the framework is considered broadly sound in the JSA.

34. **The medium-term fiscal targets set out in the PRSP appropriately call for significant fiscal consolidation** to support macroeconomic stability and a reduction in aid dependency. An initial adjustment to halve the domestic primary deficit from the projected level of over 10 percent in 2001 is expected to result mainly from a significant reversal of the recent sharp increase in expenditures to a projected peak of over 35 percent of GDP in 2001. While discussions on the program for 2002 will be held to coincide with the preparation of the budget later this year, it is currently envisaged that, as emergency and reconstruction costs relating to the recent floods taper off and large bank recapitalization operations come to an end, total expenditures would decline to under 30 percent of GDP in 2002. The authorities recognize that the interest costs of the resolution of BA (to be paid in bonds), and estimated at around 0.7 percent of GDP in 2002, will need to be accommodated through cuts in nonessential spending so as not to jeopardize increases in priority spending. Over the medium term, expenditure rationalization is expected to be supported by improving expenditure control and the effectiveness of the spending through, inter alia, the implementation of the new financial management law. In addition, efforts are needed to bring revenues from the current level of 12.4 percent of GDP toward the target level of 15 percent of GDP in 2005—again as set out in the PRSP. In 2002, initial gains are expected from the introduction of the new fiscal incentives code as well as administration improvements; thereafter, the new income tax law is expected to begin yielding higher revenues in 2003.

35. **Overall external sector developments are expected to be dominated by investment, and related imports, in the megaprojects**. Thus, in 2002, the current account deficit after grants is projected to rise by almost 30 percent of GDP to 45 percent of GDP, reflecting a surge in imports of goods and service for investment in the second phase of the Mozal smelter. These imports will be financed by corresponding increases in foreign direct investment and private borrowing—without government guarantee. Despite a projected decline in the level of official transfers, the current account deficit, after grants and excluding

the impact of large project investments, is projected to decline from 10.3 percent of GDP in 2001 to 8.8 percent of GDP in 2002 and continue to narrow over the medium term despite a projected decline in official transfers.

36. **Over the medium term, new external public borrowing is projected to decline, with disbursements falling by about one-third from US$250 million in 2001 to stabilize at US$160 million in 2003.**[7] This decline in external borrowing, coupled with a projected decline in grants, would bring a significant decline in aid dependency over the medium term. The updated DSA represented in the completion point document indicated that, under this scenario, Mozambique's debt position after assistance under the original and enhanced HIPC Initiative framework would be sustainable.

V. Staff Appraisal

37. Mozambique's commendable record of successful policy implementation has, over more than a decade, brought stability and rapid growth in one of the world's poorest countries. Progress has continued in many areas, and, despite the severe setback caused by the floods in 2000, there have been further important signs of the gains from recent policies, including further large–scale foreign direct investment. At the same time, the authorities have, through the completion of the first full PRSP, reinforced their commitment to poverty reduction, established policy priorities, and set in train a participatory process to monitor implementation. The macroeconomic framework underlying the PRSP is sound and provides an appropriate context for the elaboration of the government's annual economic programs.

38. Despite these positive developments, difficulties in the banking sector and lingering problems of monetary control rose to the fore during the first half of 2001. The last–minute decision of the private majority shareholder not to participate in the recapitalization of BA, the third–largest bank, resulted in the nonobservance of a key performance criterion for end-March and posed a difficult and many-faceted policy challenge. The authorities' intervention in early April prevented the immediate adverse consequences that a loss of public confidence in BA would have implied for the rest of the banking system. Although the authorities intended to seek a rapid sale of BA, the complex issues that needed to be addressed led to some delay in the completion of the program review.

[7] In the five years to 1998, public borrowing averaged US$267 million per year. The level of such borrowing fell back sharply in 1999 as IDA provided HIPC Initiative assistance by transforming a US$150 million credit into a grant and remained low in 2000 as donors provided flood assistance, mainly in the form of grants. In 2001, external public borrowing is expected to show a temporary increase to the levels seen in the mid-1990s, reflecting continued reconstruction activity and new program lending from IDA. Throughout this period, Mozambique has borrowed at highly concessional terms, with the average grant element staying roughly constant at about 60 percent over the last four years

39. The strategy eventually developed by the authorities strikes an appropriate balance among the various issues. It keeps the costs of the resolution to a minimum; it sends a strong signal to delinquent borrowers and all those involved in banking operations that they must live up to their obligations; and it addresses adequately the budgetary and liquidity implications of the resolution. The staff welcomes the safeguards, and attendant close monitoring, that have been put in place at BA to minimize its operating losses during the interim period before sale. While some slippage in the timetable—which envisages a completion of the sale during September—may occur, it is appropriately ambitious to help minimize the period during which new losses continue to accumulate. The staff also welcomes the authorities' commitment to the pursuit of a transparent, equitable, and efficient loan recovery program.

40. The staff welcomes the authorities' intention not to recapitalize BA before it has been transferred to new owners. While the precise form of this recapitalization will be a subject of negotiations with prospective buyers, the staff supports the government's approach to the recapitalization of BA, mainly through the issuance of government securities with a maturity structure designed to limit the immediate liquidity implications of the sale. This would also help avoid the moral hazard of providing a large cash injection into BA. Preparation of the 2002 budget, which will be discussed with the staff shortly, will need to take careful account of the interest costs arising from the recapitalization of BA, with every effort made to safeguard essential spending.

41. The experience of BA has underscored the need for effective banking supervision. With the recent publication of regulations to implement the Financial Institutions Act and begin consolidated supervision of financial institutions, the required framework for supervision is in place. It is crucial for the future health of the banking system that borrowers and lenders live up to their respective obligations; in particular, the staff stresses the importance of ensuring that connected lending is adequately addressed by the banking regulatory and supervisory framework. The staff welcomes the authorities' use of technical assistance from the Fund and others to strengthen the supervision capacity. To be effective, this supervision must be backed by a determination to enforce strictly the regulations, so as to identify and resolve potential problems at an early stage.

42. The authorities are to be commended for their recent monetary policy actions—marked increases in reserve requirements and interest rates—to stem growing pressure on the metical and the attendant reemergence of inflationary pressures. While these actions have helped stabilize the metical, the authorities need to remain vigilant and take additional measures to contain those pressures, as necessary. Given the large contribution of external financing to budgetary operations in Mozambique and the resulting liquidity implications, it is also important that government spending and central bank sales of foreign exchange be carefully coordinated.

43. The authorities have continued to implement the other aspects of the program, including the strengthening of public administration and accountability. Following the

introduction of interim procedures for tracking priority spending and the publication of the first results in quarterly budget execution reports, the staff welcomes the government's intention to implement in full the new functional classification of expenditures at every stage of the 2002 budget, from preparation through to execution and reporting. The broadening of the coverage of the proposed public accounting law into a comprehensive public financial administration law entailed a delay (and nonobservance of a performance criterion for end-June). The draft law, which was submitted to the National Assembly in September, provides a sound basis for centralized budgetary control and reporting and adopts modern principles of fiscal responsibility and transparency.

44. The staff strongly endorses the government's objective of strengthening the revenue effort; higher revenue will be crucial to reduce the current high levels of dependence on external assistance over the medium term. Following the successful implementation of the VAT, the reform of the income tax system should further improve the buoyancy of revenues by broadening the tax base and simplifying administration. At the same time, adoption of a revised code of fiscal incentives is essential to ensure that more activities are brought progressively within the tax net. The staff urges the authorities to press ahead in both of these areas without delay, so that the revised income tax law is submitted to the National Assembly by year's end and the tax yield from the revised fiscal incentives code is factored into the budget for 2002.

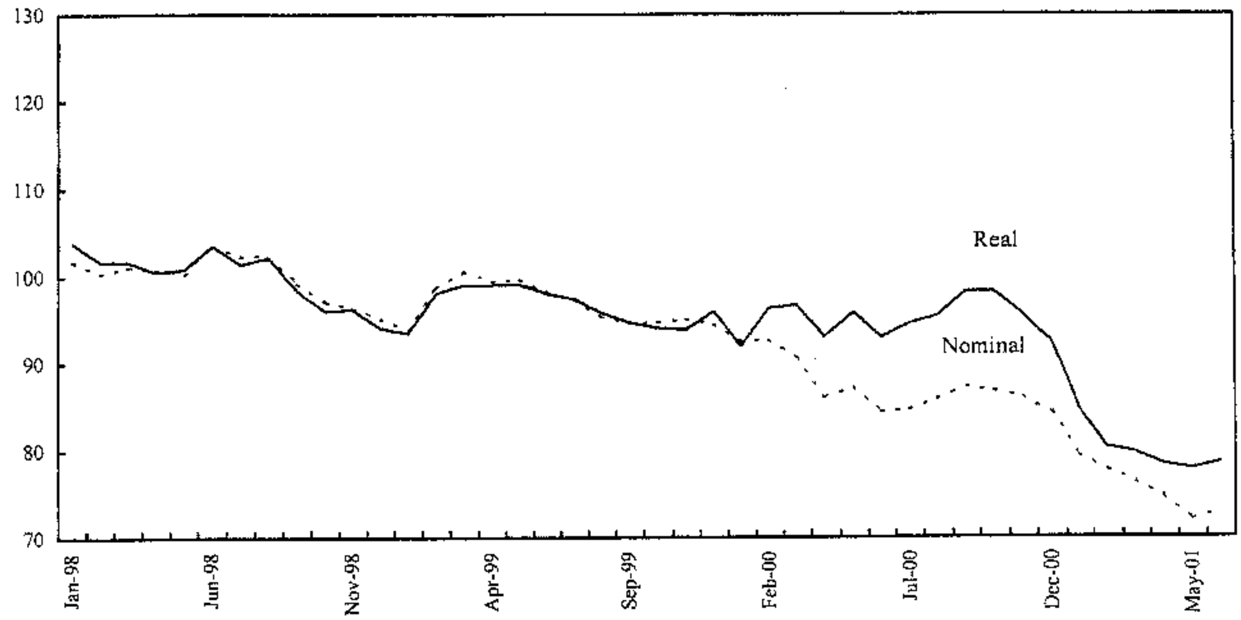
45. The authorities have also implemented measures that were established as conditions for reaching the completion point under the enhanced HIPC Initiative. Tangible steps have been taken to reform the Ministry of Justice and the commercial code. In the staff's view, these steps need to be carried through to ensure a comprehensive reform of the judicial system that will, inter alia, help to promote private investment.

46. In sum, the authorities have continued to make strong efforts to implement the program—including key reforms to improve the management of public resources and revenue mobilization, the recent strengthening of monetary policy, the actions taken so far to address the resolution of BA and the revision of the public accounting law—and other structural reforms.

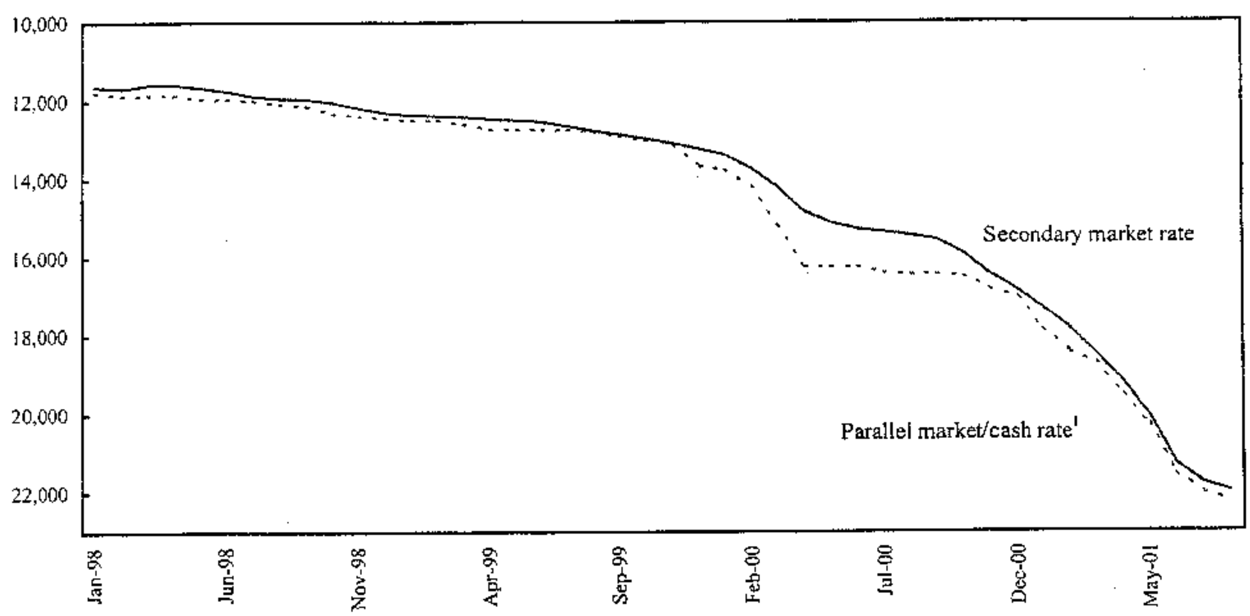
47. The staff recommends the granting of waivers as requested by the authorities, the rephasing of disbursements under the arrangement, and the completion of the third review.

Figure 1. Mozambique: Exchange Rates

Effective Exchange Rate, January 1998 - June 2001
(Index, 1998 = 100)



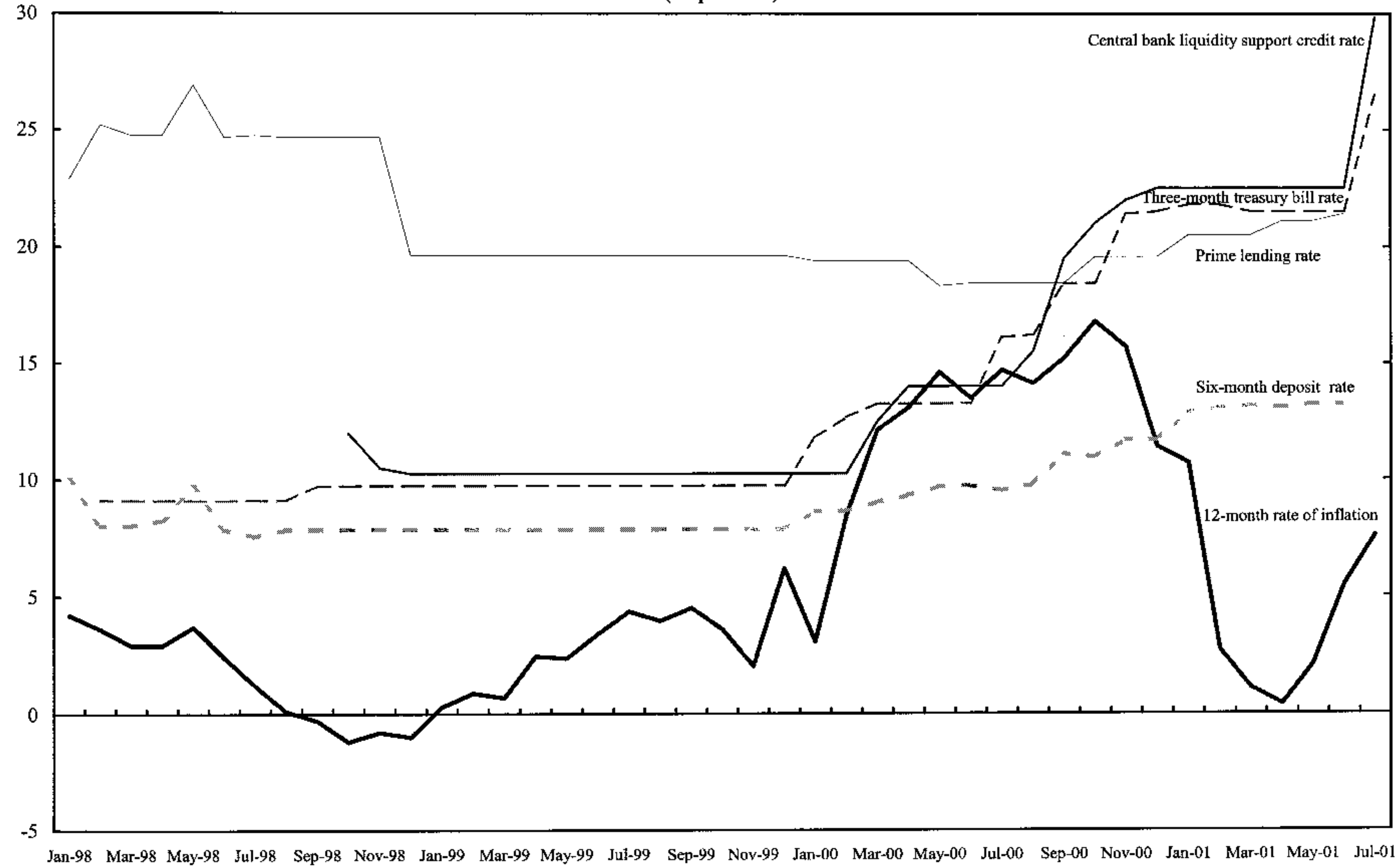
Parallel and Market Exchange Rates, January 1998 - August 2001
(Meticais per U.S. dollar; period average)



[1] A more depreciated rate for the metical is usually offered on cash denominations transacted without record by informal operators and some foreign exchange bureaus.

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

Figure 2. Mozambique: Inflation and Interest Rates, January 1998 - July 2001
(In percent)



Source: Mozambican authorities.

Table 1. Mozambique: Revised Phasing of Performance Criteria, Reviews, and Disbursements Under the PRGF Arrangement, 1999-2003

Expected Date	Expected Disbursement		Event
	Millions of SDRs	Percent of quota	
June 1999	8.4 (Disbursed)	7.4	Board approval of PRGF arrangement
September 1999	n.a.	n.a.	Test date for quantitative performance criteria[1]
March 2000	28.4	25.0	Approved augmentation of access
	8.4 (Disbursed)	7.4	Completion of first review
June 2000	n.a	n.a	Test date for quantitative performance criteria for third disbursement[1]
December 2000	8.4 (Disbursed)	7.4	Completion of second review and endorsement of annual program
December 2000	n.a	n.a	Test date for quantitative performance criteria for fourth disbursement[1]
September 2001	8.4	7.4	Completion of third review
December 2001	n.a	n.a	Test date for quantitative performance criteria for fifth disbursement[1]
April 2002	8.4	7.4	Completion of fourth review, endorsement of annual program and request for extension of PRGF arrangement
June 2002	n.a	n.a	Test date for quantitative performance criteria for sixth disbursement[1]
October 2002	8.4	7.4	Completion of fifth review
December 2002	n.a	n.a	Test date for quantitative performance criteria for seventh disbursement[1]
April 2003	8.4	7.4	Completion of final review
Total	87.2	76.8	

[1] Structural performance criteria had or will have test dates at or near the same date as quantitativeperformance criteria.

Table 2. Quantitative Performance Criteria and Benchmarks
Under the PRGF Arrangement, December 2000-June 2001 (End of Period)

	December 2000			March 2001			June 2001		
	Performance criteria		Actual	Benchmarks		Actual	Perf. criteria		Estimate
	Program	Adjusted		Program	Adjusted		Program	Adjusted	
	(In billions of meticais)								
Central government domestic primary deficit (ceiling) 1/ 2/ 3/	4,411	4,014	3,923	2,035	1,417	1,227	3,031	2,613	2,145
Central government revenue (floor; benchmark only) 2/	7,471	7,471	7,463	1,893	1,893	2,043	3,902	3,902	4,140
Stock of net domestic assets of the Bank of Mozambique (ceiling) 4/ 5/ 6/	5,827	4,126	4,039	6,046	5,365	3,987	6,229	4,980	3,246
Stock of reserve money (ceiling; benchmark only) 6/	4,171	3,770	3,940	4,130	3,642	3,729	4,133	4,133	4,697
	(In millions of U.S. dollars)								
Stock of net international reserves of the Bank of Mozambique (floor) 7/	469	508	526	454	425	518	444	385	525
New nonconcessional borrowing contracted or guaranteed by the government or the Bank of Mozambique with maturity of more than one year (ceiling) 2/	0	0	0	0	0	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 8/	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling) 2/ 9/	0	0	0	0	0	0	0	0	0
	(In billions of meticais, unless otherwise indicated)								
Memorandum items:									
Foreign program assistance (grants and loans; in million of U.S. dollars) 2/	178	...	217	82	...	53	139	...	80
Exchange rate (Meticais per U.S. Dollar)	15,932	...	17,140	16,093	...	18,667	16,245	...	21,788
Bank recapitalization costs	1,351	...	954	852	...	234	852	...	434
Required reserves shortfall	0	...	-401	0	...	-488	0	...	0
Adjustment to BoM's NDA at program exchange rates	0	...	-10	0	...	11	0	...	-399
Adjustment to reserve money	0	...	-17	0	...	-24	0	...	-30
Adjustment to NFA	0	...	7	0	...	36	0	...	-369
Stock adjustments in medium and long term liabilities	9,360	-662	8,698	9,461	-667	8,794	9,550	-1,803	7,747

1/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.
2/ Cumulative from the beginning of the calendar year.
3/ To be adjusted downward in December, March, and June by the shortfalls in bank recapitalization/restructuring relative to the programmed amounts.
4/ Defined as reserve money minus net foreign assets (NFA) of the Bank of Mozambique. The foreign currency component of reserve money and NFA are valued at program exchange rates; NFA are defined to exclude the effect of any stock adjustments in medium- and long-term liabilities.
5/ To be adjusted upward/downward to the extent of any shortfall/excess of foreign program assistance valued at program exchange rates.
6/ To be adjusted downward to the extent that eligible bank reserves fall short of 7.95 percent of deposits in commercial banks at the end of each quarter. At end-December 2000, this ratio was 6.7 percent, giving rise to a downward adjustment of Mt 401 billion to the program ceiling. At end-March 2001 the downward adjustment was Mt 484 billion.
7/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item.
8/ Loans of 0-1 year's maturity, excluding normal import-related credit. Non-U.S. dollar debt converted to U.S. dollars at actual exchange rates.
9/ Continuous performance criterion; excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

Table 3. Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, October 2000-June 2001

Actions	Date of Implementation (End of period)	Status
Tax policy and administration		
Approve the legal basis for the creation of a special section within the tax directorate to handle tax collection, audits, and control with respect to large taxpayers.	March 2001	Observed
Draft new code of fiscal incentives for investment.	May 2001	Observed
Prepare a plan for the creation of a central revenue authority.	June 2001	Observed
Fiscal accountability		
Submit a new public accounting law to the National Assembly that regulates all stages of expenditure, including commitment and verification 1/	March 2001	Observed (September 2001)
Include in quarterly budget execution reports (beginning with first quarter of 2001) information on budgetary allocations and actual expenditures on programs specified in the PARPA.	May 2001	Observed
Financial sector		
With respect to recapitalization and restructuring of Banco Comercial de Moçambique (BCM) and Banco Austral (BA),		
• obtain shareholders' commitment to recapitalize and restructure the BA; and	December 2000	Observed
• complete the recapitalization of the BCM and BA 1/	March 2001	Observed for BCM but not for BA
Introduce computerized clearing system	June 2001	Observed

1/ Structural performance criteria.

Table 4. Mozambique: Selected Economic and Financial Indicators, 1998-2004

	1998	1999	2000 Prog.	2000 Est.	2001 Prog.	2001 Rev. Prog.	2002 Proj.	2003 Proj.	2004 Proj.
	(Annual percentage change, unless otherwise specified)								
National income and prices									
Nominal GDP (in billions of meticais)	46,908	52,079	58,887	60,103	68,939	70,178	82,282	93,849	108,228
Nominal GDP (in billions of U.S. dollars)	3.96	4.10	3.92	3.83	4.20	3.31	3.56	3.98	4.46
Real GDP	12.6	7.5	3.8	2.1	10.4	9.6	9.8	7.5	9.0
GDP deflator	2.4	2.0	11.6	13.1	6.0	6.6	6.7	6.1	5.8
Consumer price index (annual average)	0.6	2.9	12.3	12.7	5.7	5.1	5.8	5.0	5.0
Consumer price index (end of period)	-1.3	6.2	11.0	11.4	7.0	7.0	5.0	5.0	5.0
External sector									
Merchandise exports (in U.S. dollars)	6.3	16.0	15.4	28.3	119.0	104.4	4.7	4.0	122.9
Merchandise imports (in U.S. dollars)	7.5	46.8	-3.2	-3.6	1.4	16.8	57.6	-3.4	-7.2
Terms of trade (in U.S. dollars)	-1.5	1.5	-1.5	1.7	1.5	0.9	0.8	0.8	0.0
Nominal effective exchange rate (end of period) 1/	-3.8	-0.7	-8.2	-10.9	...	...	...	...	...
Real effective exchange rate (end of period) 1/	-7.7	2.0	3.4	2.3	...	...	...	...	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)								
Money and credit									
Net domestic assets	9.3	23.9	25.0	11.6	13.3	7.4	13.9	16.3	17.8
Of which: net credit to the government	-16.0	0.0	12.5	4.1	9.8	2.4	-3.3	4.0	5.1
credit to the economy (in percent)	17.8	22.9	26.3	30.1	16.5	19.7	25.5	14.5	17.0
Broad money (M2)	17.6	25.1	34.0	42.4	16.0	19.0	17.2	14.1	16.3
Velocity (GDP/ average M2)	5.7	5.2	4.3	4.2	4.0	3.8	3.8	3.7	3.7
Prime rate (in percent; end of period)	19.6	19.6	18.4	19.6	...	...	...	...	...
	(In percent of GDP)								
Investment and saving									
Gross domestic investment	23.2	31.8	29.7	29.8	27.3	31.6	60.1	51.0	25.3
Government	9.8	11.5	12.8	13.0	13.1	16.0	13.1	11.6	10.1
Other sectors	13.5	20.3	16.9	16.7	14.2	15.6	47.0	39.4	15.2
Gross national savings	12.2	14.3	12.1	18.2	17.7	15.3	14.9	16.5	16.2
Government	3.1	3.7	9.3	5.1	7.8	4.4	3.1	3.6	3.1
Other sectors	9.1	10.6	2.8	13.1	9.9	10.9	11.8	12.9	13.0
Current account (after grants)	-11.0	-17.5	-17.6	-11.6	-9.6	-16.3	-45.2	-34.5	-9.1
Government budget									
Total revenue	11.4	11.9	12.7	12.4	12.3	12.4	13.2	14.2	14.8
Total expenditure and net lending (incl. residual)	21.6	24.6	29.1	27.8	30.0	35.3	29.5	28.5	26.9
Overall balance before grants	-10.5	-13.1	-16.7	-15.8	-17.7	-23.0	-16.2	-14.3	-12.0
Total grants	8.1	11.7	10.5	11.4	11.5	14.1	12.5	10.0	7.8
Overall balance after grants	-2.3	-1.4	-6.2	-4.4	-6.2	-8.9	-3.8	-4.3	-4.3
Domestic primary balance	-0.6	-3.4	-7.5	-6.5	-7.4	-10.1	-5.3	-5.2	-5.1
Excluding bank restructuring	-0.6	-3.4	-5.2	-4.9	-6.2	-6.2	-5.3	-5.2	-5.1
External financing (incl. debt relief)	4.6	1.7	3.7	3.6	4.0	7.5	4.6	3.3	3.0
Domestic bank financing	-2.3	-0.3	2.5	0.8	2.2	1.4	-0.8	1.0	1.3
	(In percent of exports of goods and nonfactor services)								
Net present value of total external debt outstanding 2/	549.1	212.0	163.0	194.4	150.0	113.2	101.6	94.5	76.5
External debt service (nonfinancial public sector)									
Scheduled, after original HIPC Initiative assistance	...	15.3	12.2	5.5	8.2	4.4	8.6	8.3	4.5
Scheduled, after enhanced HIPC Initiative assistance	...	...	4.4	2.5	5.8	2.8	6.2	5.0	3.2
Scheduled, after additional bilateral assistance	...	...	...	...	...	2.7	5.2	5.0	2.7
	(In millions of U.S. dollars, unless otherwise specified)								
External current account after grants	-435	-718	-690	-443	-403	-538	-1,613	-1,371	-405
Overall balance of payments	-204	-236	-478	-351	-488	-425	-399	-393	-325
Gross international reserves (end of period)	625	670	700	745	634	729	740	744	755
In months of imports of goods and nonfactor services	7.8	5.5	5.7	6.1	5.0	5.5	3.7	3.9	4.2
In percent of broad money	88.6	75.6	70.5	76.1	56.8	83.9	73.6	67.2	60.6
Exchange rate (meticais per U.S. dollar; end of period)	12,366	13,300	16,244	17,140	...	...	...	...	...
Use of Fund resources (in millions of SDRs)									
Purchases/disbursements	25.2	21.0	45.2	45.2	16.8	8.4	16.8	8.4	0.0
Repurchases/repayments, before HIPC Initiative assistance	18.1	22.8	22.2	23.0	21.0	21.0	17.7	15.4	15.9
Credit outstanding	147.2	145.4	168.4	167.6	163.4	155.0	154.1	147.1	131.1

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.

2/ Public and publicly guaranteed, in percent of the three-year average of exports. Data for 1998 reflect the impact of applying traditional debt-relief mechanisms (Naples terms). The data for 1999-2000 include the impact of total debt relief granted under the original HIPC Initiative. Data for 2001-04 include the impact of total debt relief under the enhanced HIPC, additional bilateral assistance, and new borrowing.

Table 5. Mozambique: Government Finances, 1998-2001

	1998	1999	2000		2001				
			Year		Jan.-Mar.	Jan.-Jun.		Jan.-Dec.	
	Act.	Act.	Prog.	Act.	Act.	Prog. EBS/00/250	Act.	Prog. EBS/00/250	Prog.
					(In billions of meticais)				
Total revenue	5,324	6,207	7,471	7,463	2,043	3,902	4,140	8,481	8,670
Tax revenue	4,932	5,733	6,858	6,857	1,778	3,569	3,723	7,744	7,824
Taxes on income and profits	963	867	1,037	1,008	246	410	541	1,145	1,190
Taxes on goods and services	2,882	3,638	4,419	4,331	1,173	2,464	2,444	5,091	5,126
Taxes on international trade	937	1,046	1,165	1,297	313	560	628	1,212	1,212
Other taxes	150	183	237	221	46	135	111	296	296
Nontax revenue	392	474	613	606	265	333	418	737	846
Total expenditure and net lending	10,141	12,815	17,114	16,735	5,043	9,256	9,897	20,700	24,780
Current expenditure	5,268	6,332	8,023	7,836	2,512	5,095	4,829	10,502	10,699
Compensation to employees	2,097	2,995	3,736	3,844	893	2,193	1,996	5,002	5,002
Goods and services	1,834	1,928	2,502	1,976	1,155	1,849	1,752	3,105	3,129
Interest on public debt	463	324	121	118	21	188	135	456	538
Domestic	21	6	15	14	7	71	97	196	270
External	442	318	106	104	14	117	38	260	268
Transfer payments	874	1,085	1,664	1,664	443	865	946	1,939	2,030
Capital expenditure	4,575	6,001	7,862	7,826	2,023	3,109	4,183	9,495	11,210
Of which: locally financed	993	1,765	2,666	2,532	761	1,308	1,647	2,919	2,919
Net lending	298	482	1,229	1,073	507	1,052	885	703	2,871
Of which: locally financed	-291	-6	1,147	914	230	717	462	650	2,686
Unallocated revenue (+)/expenditure (-) 1/	-106	-220	-167	-221	213	0	518	0	0
Overall balance before grants	-4,923	-6,828	-9,810	-9,493	-2,787	-5,354	-5,239	-12,220	-16,109
Grants received	3,818	6,073	6,192	6,855	2,106	2,452	3,378	7,905	9,893
Project	1,894	2,787	3,395	3,810	979	1,032	1,887	4,981	5,653
Nonproject	1,924	3,287	2,797	3,045	1,127	1,421	1,492	2,924	4,239
Overall balance after grants	-1,105	-754	-3,618	-2,638	-681	-2,902	-1,860	-4,315	-6,216
Central Bank transfer of HIPC assistance by the IMF	0	0	631	485	163	235	323	474	664
Net external borrowing	2,172	910	1,518	2,238	211	1,308	763	2,294	4,587
Disbursements	2,671	1,394	1,803	1,956	284	1,614	909	2,930	5,241
Project	1,641	1,394	1,598	1,484	284	769	649	1,593	2,637
Nonproject	1,030	0	206	472	0	844	260	1,337	2,604
Cash amortization	-499	-483	-285	-282	-72	-305	-146	-636	-655
Net domestic financing	-1,067	-156	1,469	-85	307	1,359	774	1,546	965
Of which: net bank credit	-1,067	-177	1,469	479	342	1,359	774	1,546	404
Memorandum items:									
Domestic primary balance before grants 2/	-289	-1,780	-4,411	-3,923	-1,227	-3,031	-2,145	-5,135	-7,096
Bank restructuring net lending	0	0	1,351	954	234	852	434	852	2,745

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

1/ Residual discrepancy between identified sources and uses of funds.

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.

Table 5. Mozambique: Government Finances, 1998-2001 (concluded)

	1998	1999	2000		2001	
	Act.	Act.	Prog.	Act.	Prog. EBS/00/250	Prog.
	(In percent of GDP, unless otherwise specified)					
Total revenue	11.4	11.9	12.7	12.4	12.3	12.4
Tax revenue	10.5	11.0	11.6	11.4	11.2	11.1
Taxes on income and profits	2.1	1.7	1.8	1.7	1.7	1.7
Taxes on goods and services	6.1	7.0	7.5	7.2	7.4	7.3
Taxes on international trade	2.0	2.0	2.0	2.2	1.8	1.7
Other taxes	0.3	0.4	0.4	0.4	0.4	0.4
Nontax revenue	0.8	0.9	1.0	1.0	1.1	1.2
Total expenditure and net lending	21.6	24.6	29.1	27.8	30.0	35.3
Current expenditure	11.2	12.2	13.6	13.0	15.2	15.2
Compensation to employees	4.5	5.8	6.3	6.4	7.3	7.1
Goods and services	3.9	3.7	4.2	3.3	4.5	4.5
Interest on public debt	1.0	0.6	0.2	0.2	0.7	0.8
Domestic	0.0	0.0	0.0	0.0	0.3	0.4
External	0.9	0.6	0.2	0.2	0.4	0.4
Transfer payments	1.9	2.1	2.8	2.8	2.8	2.9
Capital expenditure	9.8	11.5	13.4	13.0	13.8	16.0
Of which: locally financed	2.1	3.4	4.5	4.2	4.2	4.2
Net lending	0.6	0.9	2.1	1.8	1.0	4.1
Of which: locally financed	-0.6	0.0	1.9	1.5	0.9	3.8
Unallocated revenue (+)/expenditure (-) 1/	-0.2	-0.4	-0.3	-0.4	0.0	0.0
Overall balance before grants	-10.5	-13.1	-16.7	-15.8	-17.7	-23.0
Grants received	8.1	11.7	10.5	11.4	11.5	14.1
Project	4.0	5.4	5.8	6.3	7.2	8.1
Nonproject	4.1	6.3	4.8	5.1	4.2	6.0
Overall balance after grants	-2.4	-1.4	-6.1	-4.4	-6.3	-8.9
Central Bank transfer of HIPC assistance by the IM	0.0	0.0	1.1	0.8	0.7	0.9
Net external borrowing	4.6	1.7	2.6	3.7	3.3	6.5
Disbursements	5.7	2.7	3.1	3.3	4.3	7.5
Project	3.5	2.7	2.7	2.5	2.3	3.8
Nonproject	2.2	0.0	0.3	0.8	1.9	3.7
Cash amortization	-1.1	-0.9	-0.5	-0.5	-0.9	-0.9
Net domestic financing	-2.3	-0.3	2.5	-0.1	2.2	1.4
Net bank credit	-2.3	-0.3	2.5	0.8	2.2	0.6
Securities	0.0	0.1	0.0	0.0	0.0	0.8
Memorandum items:						
Domestic primary balance before grants 2/	-0.6	-3.4	-7.5	-6.5	-7.4	-10.1
Excluding bank restructuring net lending	-0.6	-3.4	-5.2	-4.9	-6.2	-6.2
Total expenditure in education	3.1	3.4	4.5	5.0	6.1	6.0
Total expenditure in health	2.8	2.9	3.6	3.2	3.2	3.2
Current expend. on defense and security	2.1	2.4	2.5	2.4	2.7	2.6
Nominal GDP (in billions of meticais)	46,908	52,079	58,887	60,103	68,939	70,178

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

1/ Residual discrepancy between identified sources and uses of funds.

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.

Table 6. Mozambique: Monetary Survey, December 2000 - December 2001

	2000		2001				
	December		Mar.	June		Sep.	Dec.
	Prog.	Act.	Act.	Prog.	Act.	Prog.	Prog.
Central bank (BoM)	(In billions of meticais, unless otherwise specified)						
Net foreign assets	-1,656	-99	-258	-2,096	1,451	-115	-115
(in millions of U.S. dollars)	-104	-6	-14	-129	66	-5	-5
Net international reserves	7,472	9,015	9,677	7,218	11,517	12,166	12,096
(in millions of U.S. dollars)	469	526	518	444	525	526	526
Medium- and long-term foreign liabilities	-9,360	-9,357	-10,200	-9,550	-10,390	-12,607	-12,535
Other	232	243	265	236	324	326	324
Net domestic assets	5,827	4,039	3,987	6,229	3,246	5,133	5,412
Credit to government (net)	-5,202	-5,433	-6,055	-4,695	-5,645	-4,805	-4,189
Credit to banks (net)	1,555	483	674	1,550	1,604	650	300
Credit to the economy	74	1	1	74	1	1	1
Other items (net; assets +)	9,400	8,989	9,367	9,300	7,286	9,288	9,300
Reserve money	4,171	3,940	3,729	4,133	4,697	5,018	5,297
Currency outside banks	2,708	2,425	2,419	2,638	2,621	2,528	2,668
Bank reserves	1,462	1,515	1,309	1,495	2,076	2,489	2,629
Currency in banks	274	428	321	283	343	280	340
Deposits in meticais	1,089	845	813	1,122	1,614	2,064	2,145
Required reserves (calculated)	1,064	1,246	1,301	1,097	1,456	2,054	2,135
Free reserves (calculated)	25	-401	-488	25	158	10	10
Deposits in foreign currencies	100	242	175	90	119	145	144
(in millions of U.S. dollars)	6	14	9	6	5	6	6
Deposit money banks (DMBs)	(In billions of meticais, unless otherwise specified)						
Net foreign assets	3,448	4,449	3,985	4,135	5,817	5,633	6,405
(in millions of U.S. dollars)	217	260	213	255	265	243	278
Net domestic assets	9,635	9,904	11,232	9,465	11,108	10,966	10,893
Banks' reserves	1,462	1,545	1,338	1,495	2,249	2,489	2,629
Liabilities to central bank (net)	-1,540	-959	-293	-1,535	-1,967	-904	-554
Credit to government (net)	1,055	296	1,260	1,907	1,281	1,236	-544
Of which: government deposits	-300	-1,316	-1,144	-200	-1,388	-1,250	-1,250
Credit to the economy	11,748	11,343	11,725	12,257	12,150	12,319	13,578
Of which : in foreign currency	3,887	4,350	4,431	3,737	4,822	5,248	5,206
(in millions of U.S. dollars)	244	254	237	230	220	227	226
Other items (net; assets +)	-3,090	-2,321	-2,797	-4,659	-2,605	-4,174	-4,216
Deposits	13,083	14,353	15,217	13,600	16,926	16,599	17,299
Demand and savings deposits	9,928	10,775	11,358	10,320	12,093	11,985	12,490
Time deposits	3,155	3,579	3,859	3,280	4,833	4,615	4,809
Monetary survey	(In billions of meticais, unless otherwise specified)						
Net foreign assets	1,792	4,350	3,727	2,039	7,268	5,517	6,291
Net domestic assets	14,000	12,429	13,909	14,199	12,279	13,610	13,676
Domestic credit	7,675	6,207	6,930	9,543	7,788	8,751	8,845
Credit to government (net)	-4,147	-5,137	-4,795	-2,788	-4,363	-3,569	-4,733
Credit to the economy	11,822	11,344	11,726	12,331	12,151	12,319	13,578
Other items (net; asset +)	6,325	6,222	6,979	4,656	4,491	4,860	4,831
Of which: discrepancy in BoM/DMBs net claims	15	-446	408	15	-190	-254	-254
Money and quasi money (M2)	15,791	16,779	17,637	16,238	19,547	19,128	19,967
Currency outside banks	2,708	2,425	2,419	2,638	2,621	2,528	2,668
Deposits	13,083	14,353	15,217	13,600	16,926	16,599	17,299
Of which : foreign currency deposits	5,891	7,107	7,876	5,767	9,358	9,650	9,614
(in millions of U.S. dollars)	370	415	422	355	427	417	418
Memorandum items:							
M2-growth (12-month percent change)	34.0	42.4	40.7	19.2	43.5	34.1	19.0
Credit to the economy (12-month percent change)	35.6	30.1	26.6	23.3	21.5	27.6	19.7
Currency/M2 (in percent)	17.2	14.5	13.7	16.2	13.4	13.2	13.4
Reserve money (12-month percent change)	4.27	26.4	21.2	28.7	46.3	39.1	34.4
Money multiplier (M2/reserve money)	3.79	4.26	4.73	3.93	4.16	3.81	3.77

Sources: Bank of Mozambique, and Fund staff estimates and projections.

Table 7. Mozambique: Balance of Payments, 1999-2005

(In millions of U.S. dollars, unless otherwise specified)

	1998	1999	2000 Prog.	2000 Revised	2001 Prog.	2001 Rev. Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
Trade balance	-572.7	-916.1	-848.4	-793.2	-492.1	-608.1	-1,352.3	-1,250.0	-106.6	211.5
Exports f.o.b.	244.6	283.7	312.6	364.0	684.6	744.0	778.6	809.6	1,804.8	2,233.4
Large projects	34.5	75.8	121.0	127.2	457.6	487.0	489.0	496.2	1,472.6	1,873.0
Other exports	210.1	207.9	191.6	236.8	227.0	257.0	289.6	313.4	332.2	360.4
Imports c.i.f.	-817.3	-1,199.8	-1,161.0	-1,157.2	-1,176.7	-1,352.1	-2,131.0	-2,059.6	-1,911.4	-2,022.0
Large projects	-87.3	-514.4	-203.7	-176.5	-173.2	-391.1	-1,117.1	-1,030.5	-861.8	-893.6
Other imports	-730.0	-685.4	-957.3	-980.7	-1,003.5	-961.0	-1,013.9	-1,029.1	-1,049.6	-1,128.4
Services (net)	-176.3	-236.0	-270.6	-213.5	-369.7	-376.4	-708.7	-520.6	-648.8	-697.9
Receipts	332.5	355.6	362.5	405.1	353.6	374.1	395.8	420.3	445.5	473.7
Expenditures	-508.8	-591.6	-633.1	-618.6	-723.3	-750.5	-1,104.5	-940.9	-1,094.2	-1,171.6
Of which: interest	-163.3	-197.7	-231.4	-204.7	-222.8	-220.4	-214.4	-225.1	-290.0	-291.9
Of which: interest on public debt	-150.2	-161.6	-160.8	-160.8	-145.9	-145.9	-132.1	-118.2	-104.9	-93.2
Current account, excluding grants	-749.0	-1,152.1	-1,119.0	-1,006.7	-861.8	-984.5	-2,061.0	-1,770.6	-755.4	-486.5
Unrequited official transfers 1/	313.2	434.1	429.3	563.9	458.6	446.4	448.3	400.0	350.0	350.0
Current account, including grants	-435.8	-718.0	-689.7	-442.8	-403.2	-538.1	-1,612.7	-1,370.6	-405.4	-136.5
Current account, excluding large projects	-286.2	-172.7	...	-309.0	...	-339.6	-323.0	-335.0	-364.1	-392.3
Current account, before grants and excl. large projects	-599.4	-606.8	...	-872.9	...	-786.0	-771.3	-735.0	-714.1	-742.3
Capital account	262.8	613.4	269.8	279.0	-8.5	131.1	1,214.5	978.5	81.2	-76.9
Foreign borrowing	299.5	472.0	548.3	483.8	218.2	374.0	825.5	845.7	366.0	291.0
Public	218.1	111.7	117.9	161.7	178.6	238.7	185.5	159.0	160.0	160.0
Private 2/	81.4	360.3	430.4	322.1	39.6	135.3	640.0	686.7	206.0	131.0
Amortization	-249.4	-240.3	-362.9	-344.0	-362.7	-396.3	-409.5	-479.7	-463.2	-443.7
Public	-211.2	-200.7	-306.5	-306.5	-305.9	-305.9	-319.1	-326.4	-286.6	-244.5
Private	-38.3	-39.6	-56.4	-37.5	-56.9	-90.4	-90.4	-153.3	-176.6	-199.2
Direct investment (net)	212.7	381.7	84.4	139.2	136.0	153.4	798.5	612.5	178.5	75.8
Short-term capital and errors and omissions (net)	-31.4	-131.3	-58.0	-187.4	-76.0	-17.5	0.0	0.0	0.0	0.0
Of which: commercial banks (net foreign assets; increase -)	15.3	-21.4	-58.0	-209.4	-76.0	-17.5	0.0	0.0	0.0	0.0
Overall balance	-204.4	-235.9	-477.9	-351.2	-487.7	-424.4	-398.2	-392.2	-324.2	-213.4
Financing	-56.8	-808.4	0.0	-98.0	60.0	0.0	-12.4	-13.3	-30.9	-84.2
Bank of Mozambique (net foreign assets; increase -)	-77.2	-46.9	0.0	-98.0	60.0	0.0	-12.4	-13.3	-30.9	-84.2
Gross international reserves (increase-) 3/	-92.9	-44.1	-30.6	-129.1	65.5	16.8	-11.0	-4.4	-10.8	-57.3
Use of IMF credit (net)	9.6	-2.8	30.6	31.1	-5.5	-16.8	-1.4	-8.9	-20.1	-26.9
Other (net)	6.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net change in arrears (increase +)	20.4	-761.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap before debt releif	261.2	1044.3	477.9	449.2	427.7	424.5	410.6	405.4	355.1	297.6
Debt relief 4/	261.2	1,044.3	477.9	449.2	427.7	424.4	410.6	405.5	355.0	297.6
Debt relief on traditional mechanisms	261.2	972.5	320.8	299.0	309.9	281.0	279.2	271.7	219.1	161.0
Assistance under the original HIPC Initiative	0.0	51.3	103.6	103.6	98.9	98.9	92.8	95.3	96.5	96.1
Assistance under the enhanced HIPC Initiative	0.0	0.0	17.2	10.0	19.0	17.4	27.1	27.3	28.4	29.6
Paris Club deferral (flood relief)	0.0	20.5	36.3	36.6	0.0	26.2	0.0	0.0	0.0	0.0
Assistance under additional bilateral	0.0	0.0	0.0	0.0	0.0	0.9	11.6	11.3	11.0	10.8
Financing gap after debt releif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Current account deficit (in percent of GDP)										
Before grants	18.9	28.1	28.5	26.3	18.8	29.8	57.8	44.5	16.9	10.0
After grants	12.4	17.5	17.6	11.6	8.8	16.3	45.2	34.5	9.1	2.8
Excluding large projects	7.2	4.2	...	8.1	...	10.3	9.1	8.4	8.2	8.1
After grants (excluding large projects)	-15.1	-14.8	...	-22.8	...	-23.8	-21.6	-18.5	-16.0	-15.3
Gross international reserves	624.9	669.3	699.9	745.4	634.4	728.6	739.6	744.0	754.8	812.1
(in months of imports of goods and nonfactor services)	7.8	5.5	5.7	6.1	5.0	5.5	3.7	3.9	4.2	4.3

Sources: Mozambican authorities; and staff estimates and projections.

1/ In 1999, includes US$150 million of grants provided by IDA as interim assistance under the original HIPC Initiative.

2/ Private borrowing, not guaranteed by the government or the Bank of Mozambique.

3/ Defined as monetary gold, untied foreign exchange deposits, foreign banknotes, and SDRs.

4/ Includes the 1996 Paris Club flow rescheduling on Naples terms; the rescheduling of the debt to Russia after an up-front discount of 80 percent; in 1997 commercial debt rescheduling with the Bank of Brazil; total assistance under the HIPC Initiative; the Paris Club deferral; and the application of traditional rescheduling mechanisms by non-Paris Club creditors.

Table 8. Mozambique: External Financing Requirements and Sources, 1999-2005
(In millions of U.S. dollars)

	1999	2000	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
External financing requirements	2,360	1,696	1,409	2,504	2,274	1,250	1,014
Current account, excluding grants	1,152	1,007	984	2,061	1,771	755	486
Amortization 1/	272	373	424	432	499	483	471
Changes in arrears (increase -)	762	0	0	0	0	0	0
Changes in reserves (increase +) 2/	44	129	-17	11	4	11	57
Short-term capital and errors and omissions (net; outflow +) 3/	131	187	18	0	0	0	0
Total identified financing	1,317	1,247	984	2,093	1,869	894	717
Disbursements from existing and new commitments	935	1,108	831	1,295	1,256	716	641
Grants 4/	434	564	446	448	400	350	350
Loans	501	544	385	847	856	366	291
Bilateral	0	0	4	15	0	0	0
Multilateral 1/	140	222	246	192	169	160	160
IDA	79	125	118	132	158	135	141
IMF	29	60	11	21	11	0	0
Other	33	37	117	39	1	25	19
Private sector	360	322	135	640	687	206	131
Direct foreign investment	382	139	153	798	613	178	76
Debt relief 5/	1,044	449	424	411	405	355	298
Debt relief on traditional mechanisms	972	299	281	279	272	219	161
Assistance under the original HIPC Initiative	51	104	99	93	95	96	96
Assistance under the enhanced HIPC Initiative	0	10	17	27	27	28	30
Assistance under additional bilateral	0	0	1	12	11	11	11
Paris Club deferral (flood relief)	21	37	26	0	0	0	0
Remaining gap	0	0	0	0	0	0	0

Sources: Mozambican authorities; and staff estimates and projections.

1/ Including the Fund.
2/ Excluding the Fund.
3/ Including commercial banks accumulation of net foreign assets (increase +).
4/ Includes IDA interim assistance under the original HIPC Initiative in 1999 (US$150 million).
5/ Includes the 1996 Paris Club flow rescheduling on Naples terms; the rescheduling of the debt to Russia after an up-front discount of 80 percent; the 1997 commercial debt rescheduling with the Bank of Brazil; total assistance under the HIPC Initiative; the Paris Club deferral; and the application of traditional rescheduling mechanisms by non-Paris Club creditors.

Table 9. Mozambique: Indicators of Fund Credit, 1998-2010

	Actual			Projections										Averages	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2001-05	2006-10
Debt service to the Fund 1/															
In millions of U.S. dollars	25.1	31.5	29.5	27.8	22.8	19.8	20.4	22.3	20.7	17.9	17.1	14.8	14.9	22.6	17.1
After assistance under the HIPC Initiative		17.7	0.0	0.0	3.6	6.1	6.6	5.2	5.3	7.5	11.7	14.0	14.9	4.3	10.7
In millions of SDRs	18.5	23.5	23.0	21.7	17.7	15.4	15.9	17.4	16.1	13.9	13.4	11.5	11.6	17.6	13.3
After assistance under the HIPC Initiative		13.3	0.0	0.0	2.8	4.7	5.2	4.1	4.1	5.9	9.1	10.9	11.6	3.4	8.3
In percent of exports of goods and nonfactor services	4.7	5.4	4.0	2.6	2.0	1.7	0.9	0.8	0.7	0.6	0.5	0.5	0.4	1.6	0.5
After assistance under the HIPC Initiative		3.0	0.0	0.0	0.3	0.5	0.3	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3
In percent of gross international reserves	4.0	4.7	4.0	3.8	3.1	2.7	2.7	2.7	2.4	1.9	1.6	1.3	1.3	3.0	1.7
After assistance under the HIPC Initiative		2.7	0.0	0.0	0.5	0.8	0.9	0.6	0.6	0.8	1.1	1.3	1.3	0.6	1.0
Memorandum items:															
Gross Fund financing															
In millions of U.S. dollars	34.2	28.1	60.3	10.6	21.0	10.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.4	0.0
In millions of SDRs	25.2	21.0	45.2	8.4	16.8	8.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.7	0.0
In percent of Mozambique's financing needs 2/	3.0	1.2	3.6	0.8	0.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0
U. S. dollars per SDR exchange rate	1.356	1.337	1.327	1.283	...	...	...	...	...	...	...	...	...	...	...

Sources: Mozambican authorities; and staff estimates and projections.

1/ Existing and prospective obligations.

2/ Gross financing needs are defined as the sum of the current account deficit before grants, amortization of medium- and long-term debt, repayment to the Fund, reduction in payments arrears, targeted accumulation of gross assets of the central bank, and short-term capital and errors and omissions.

Maputo, September 5, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. This letter supplements the government's letter, with annexed memorandum of economic and financial policies and technical memorandum of understanding, dated December 1, 2000. It describes progress under the government's program for July 2000–June 2001 supported by an arrangement under the Poverty Reduction and Growth Facility (PRGF) and proposes quantitative and structural performance criteria and benchmarks through the end of 2001.

2. The government regrets that the recapitalization of Banco Austral (BA) did not proceed as planned. However, as explained below, implementation of actions to resolve BA is now well advanced and prior actions (Table 1) relating to this issue have been put in place. On this basis, we are therefore requesting a waiver for non-observance of the related performance criterion for end-March on the recapitalization of BA. In addition, we are requesting a waiver of the performance criterion on the submission to the National Assembly of a new public accounting law; the government decided to delay submission of the law until September 2001 to allow time to develop a more comprehensive public financial administration law.

3. Mozambique's economic and social conditions were adversely affected in 2000 by the worst floods in Mozambique's history. Real economic growth fell from 7.5 percent in 1999 to 2.1 percent in 2000, the lowest rate in almost a decade. Despite a substantial increase in donor assistance for emergency and reconstruction imports, the metical depreciated sharply in the aftermath of the flood, and flood-related shortages of basic goods contributed to a surge in inflation; the 12-month change in the consumer price index rose to a peak of almost 17 percent in October, before declining to 11.4 percent in December.

4. All of the quantitative performance criteria for end-December 2000 were observed (Table 2). The domestic primary fiscal deficit increased from 3.4 percent of GDP in 1999 to 6.5 percent of GDP in 2000 to accommodate spending related to the floods as well as higher social spending. However, as a result of an initial delay in budget approval, both current expenditure on goods and services and capital outlays were somewhat lower than programmed. The increased spending was more than covered by considerable emergency assistance. The ceiling on net domestic assets of the central bank was observed, in part reflecting lower government borrowing. The floor on net international reserves was met by

a wide margin, with the gross international reserves of the central bank rising to US$745 million or the equivalent of more than six months of imports of goods and nonfactor services. This higher-than-programmed build-up in net foreign assets of the banking system translated into unforeseen growth in reserve money and broader monetary aggregates. The central bank acted to tighten monetary conditions by offering treasury bills in greater amounts and real interest rates on deposits became positive. However, broad-money growth still increased to 42 percent during 2000 as compared to the programmed expansion of 34 percent.

5. Despite severe localized flooding in the lower basin of the Zambezi river, economic activity is rebounding in 2001. Aided by the first full year of production at the new MOZAL aluminum smelter, and continuing reconstruction spending, economic growth is expected to reach 9.6 percent in 2001. All quantitative targets established as performance criteria for end-June were observed. During the first half of 2001, fiscal policy was in line with the program that envisaged the continuation of higher spending, including expenditures for flood reconstruction, financed with continued high external assistance. With higher revenues and lower current expenditures than budgeted for the first semester, the overall deficit (after grants) and the primary deficit was about 0.6 percent of GDP less than programmed. The ceiling on net domestic assets of the central bank was, with the aid of lower government borrowing, met by a comfortable margin as was the floor on net international reserves. However, reserve money was again higher than programmed, reflecting the accumulation of net foreign assets coupled with the valuation effects of the depreciation of the metical. After easing in the latter part of 2000, pressures on the exchange rate and domestic prices resumed. The metical depreciated by 28 percent between December 2000 and June 2001 and the 12 month rate of inflation which had fallen to less than one percent in the first quarter, reached 7.4 percent in July

6. Macroeconomic policies through the end of 2001 are geared to ensuring stability, containing the 12-month rate of inflation to 7 percent. Taking into account the revenue performance to date, total tax and nontax revenues are expected to be slightly higher than budgeted at 12.4 percent of GDP. Current non-interest expenditures are expected to be in line with the budget. The budgeted wage bill is sufficient to accommodate the costs of hiring 4,000 additional teachers and 800 nurses, a 17 percent wage increase for civil servants effective from April 1 and regular promotion and grade increases. Expenditures on goods and services and transfers are being contained to budget levels. Capital spending is expected to be 2.4 percent of GDP higher than budgeted, reflecting some carryover of donor-financed reconstruction spending initially envisaged for 2000, and the effect of the depreciation of the metical on the domestic currency valuation of foreign-financed capital spending. In addition, the costs of resolving BA (recapitalization net of sales proceeds, and the cost of funding the pension liabilities) are likely to exceed the costs of recapitalization included in the budget However, the domestic primary deficit, net of the costs of resolving BA will be limited to 6.2 percent of GDP, in line with the deficit as originally budgeted on the same definition. Given the uncertainties relating to these operations, for the purposes of program monitoring in the remainder of 2001, the performance criterion on the implementation of the fiscal program will be the domestic primary deficit, net of the costs of resolving BA (as defined in

the attached updated technical memorandum of understanding). The interest costs of the domestic debt to resolve BA (estimated at around 0.7 percent of GDP in 2002) will need to be accommodated in budgets for subsequent years through offsetting cuts in non-essential spending.

7. As explained below, the costs of resolving BA are expected to be met mainly through the issuance of government securities to the new owners. To the extent that payments in cash are required, the central bank will take offsetting actions to sterilize these amounts. The central bank has already acted to tighten monetary conditions. Reserve requirements were raised by over 3.5 percent to 11.5 percent with effect from July and the interest rate on liquidity support operations (*facilidade permanente de cedência*) was increased from 22.5 percent to 34.9 percent. At the same time, the central bank took steps to broaden the market for treasury bills by allowing direct sales to the non-bank private sector. As a result, the 12-month rate of growth of broad money is expected to decline from 43.5 percent at end June 2001 to 19 percent at end-December 2001.

8. Progress with structural policy implementation has been made in the areas of tax policy and administration, public sector reform, and fiscal accountability (Table 3). In respect to fiscal accountability, the government's efforts were underscored by the completion of a fiscal transparency assessment and its publication by the IMF. However, the submission of a new public accounting law to the National Assembly—a structural performance criterion for end-March 2001—was delayed as the government decided to expand the scope of this legislation by developing a more comprehensive public financial administration law. A final draft of this law was submitted to the Parliament in September 2001. The new law includes provisions for (i) integrating all main areas of budget execution (budget preparation, treasury and debt management operations, tax collection, accounting and control) by using standard accounting principles and compatible and integrated databases; (ii) recording all stages of expenditure execution (allocation, commitment, verification, payment, and reporting); (iii) reducing the lengthy carryover period; (iv) improving cash management through better and more centralized control of actual receipts and payments; and (v) adopting modern principles of fiscal responsibility and transparency. In parallel with the preparation of this law, the government will prepare the relevant regulations.

9. The other structural performance criterion for end-March 2001 envisaged the recapitalization of two insolvent commercial banks in which the government held minority stakes. While the recapitalization of one of those banks (Banco Comercial de Moçambique) took place as envisaged, the private shareholders of Banco Austral (BA) ultimately declined to participate in its recapitalization. Fearing adverse systemic repercussions, the government purchased the private shares for US$1 and the central bank intervened the bank on April 3. An interim management team was appointed with a mandate to reassess BA's financial position, prepare it for reprivatization as soon as possible, collect amounts due on the loan portfolio, and implement adequate financial and operational safeguards.

10. The central bank instructed the interim management of BA not to commit to lending beyond existing contracts and to avoid any increase in the stock of outstanding loans. A team

of external experts has been hired to secure original contract documents for the bank's loans and assist in the preparation of a detailed inventory of all assets. BA's position is being closely monitored by the central bank, weekly reports (on liquidity) and monthly accounts, including movements in the loan portfolio, and the monthly profit and loss statement, are being supplied to the staffs of the Fund and the World Bank. As well as constituting a prior action for completion of the review, provision of these monthly reports will continue until the resolution of BA is finalized. Since intervention, the stock of BA's outstanding loans has declined. The government will not inject any capital into BA before the bank is taken over by the new owners.

11. An independent audit as of December 2000 confirmed that, in addition to relying on liquidity support from the central bank, BA is insolvent. The resolution of BA is likely to entail a total cost to the budget of the order of 4 percent of GDP. The government is determined to minimize this cost by controlling losses in the period before the bank is sold and by implementing a transparent, equitable and efficient asset recovery program, recognizing that this will be important for the credibility of the financial system and to demonstrate that the use of public funds is minimized. In addition, steps are being taken to minimize the liquidity implications of these costs.

12. The government has taken steps to recover assets and is determined to pursue recovery of overdue loans to the full extent of the law. To seek settlement of overdue claims, the interim management published a general call to delinquent debtors and privately contacted the 100 largest of them, after which all delinquent debtors who failed to pay were publicly summoned in the press to do so. A detailed loan recovery plan, as prepared by external consultants is now being implemented focusing on collections from the 80 largest borrowers (who account for 74 percent of the bad debt portfolio). Since the government intervened, judicial proceedings have been initiated to collect bad loans in the amount of Mt. 65 billion (out of a total of Mt. 737 billion). Should the potential buyer of BA decline the nonperforming loans, the government is considering options that would allow it to use the same powers (of "*execução fiscal*") it has to collect taxes in recovering the assets of BA's overdue borrowers. In addition, the central bank is, with assistance from a Fund advisor, revising restrictions on bank lending to employees and shareholders; new regulations on connected lending to be issued by end-October will introduce lower limits on this lending in relation to banks' capital.

13. The government contracted an international management consulting company to assist with BA's sale to a reputable international bank. Based on the advice received from this company and discussions with Fund and World Bank staff, the government developed a compressed schedule for the sale of BA. Following the distribution of a detailed information memorandum, the government received in late June letters from six parties reconfirming their interest; after further assessment of BA's financial situation, two of them submitted bids in late July. The government invited one of these bidders to begin negotiations, simultaneously with any enquiries that the bidder might want to undertake. The government intends to recapitalize BA mainly through the issuance of bonds and short term instruments

so as to minimize the immediate liquidity implications of the sale, and avoid the moral hazard of a large injection of cash into the bank.

14. The government has identified new high-priority areas for its structural reform agenda for 2001, which include the key measures listed in Table 4. Following the rationalization of indirect taxes and introduction of the VAT in 1999–2000, the government will proceed with a comprehensive reform of income and profit taxes in support of its objectives to increase medium-term revenue, simplify procedures for tax calculation and payment, and spread the tax burden more equitably by increasing the tax base. Drawing on technical assistance from the IMF and a bilateral donor, the tax reform will overhaul corporate, personal, and complementary taxes and introduce simplified computation and payment procedures. The government intends to prepare a draft of the new income tax law (*lei de bases do sistema tributário*) by October 2001 for submission to the National Assembly by end-December 2001 (a performance criterion). At the same time, the government intends to streamline the stamp tax; increase the rates of the current car license fee (*manifesto de veículos*), replace the fee by a more equitable and efficient annual tax in the context of the income tax reform; and implement the recently approved Municipal Tax Code.

15. The reforms in the areas of tax policy and administration included, as further significant steps during 2001, the drafting of a new code of fiscal incentives for investment that was completed in May and the preparation of a plan for the creation of a central revenue authority that was completed in June. Also, the Ministry of Planning is launching a large taxpayer unit in Maputo by the end of the year.

16. In July 2001, the government published the necessary regulations for the implementation of the 1999 Financial Institutions Act, thus completing the new regulatory framework for Mozambique's financial sector. By end-October the central bank will announce the legal framework for consolidated supervision and will start training its staff in order to initiate consolidated supervision of related financial institutions as soon as possible. The accounts of concerned institutions will be audited on this basis beginning from January 1, 2002. The central bank also started using in July 2001 a computerized clearing system for metical-denominated balances.

17. In April, the Council of Ministers approved the Action Plan for the Reduction of Absolute Poverty 2001–05 (PARPA), which is being presented to the Boards of the World Bank and the IMF as the full PRSP and will provide the framework for support under the PRGF arrangement. In this context, the government is committed to achieving further progress in reducing poverty and is prioritizing public expenditure towards that end

18. The government is tracking expenditures on all the PARPA priority areas, to which the resources freed by debt relief under the HIPC Initiative are allocated. It introduced the interim tracking procedures, and the first results were presented in the quarterly budget execution reports for the first and second quarters of 2001. To establish a permanent system of tracking expenditure programs and priorities, the government implemented a new functional classification of expenditure for the state budget that conforms to the IMF's

Manual on Government Finance Statistics. The new functional classification encompasses a more detailed breakdown of expenditure and will permit monitoring government outlays on particular areas. It will be linked through a coding system to budget preparation, approval, execution, and reporting. The new classification system is being applied beginning with the preparation of the budget for 2002.

19. The government is moving forward with legal reforms. Among ongoing projects, the new commercial code will be submitted to the National Assembly by end-December 2001 after consultations with the private sector; the new law on money laundering was cleared by the Council of Ministers in April and was submitted to the National Assembly. An arbitration court was created in Maputo in March 2001 based on a law passed in 1999 and additional courts are being established in the provinces. Meanwhile, the government has been working on proposals for a restructuring of the Ministry of Justice, which were considered at a seminar on March 21–22. In April, the government published a policy statement on the role and functions of the Ministry and began implementing measures to strengthen the Ministry and related agencies. Work is continuing on the preparation of the strategic plan for the whole justice system, which is expected to be finalized by the end of 2001. In the meantime, the Ministry of Justice has begun to implement actions to address issues which have already been identified, including measures to expedite court proceedings.

20. The government of Mozambique will provide such information as the Fund requests in connection with the progress made in implementing the economic and financial policies and achieving the objectives of he program.

21. The government of Mozambique believes that the policies and measures set forth in its letter and memorandum on economic and financial policies dated December 1, 2000, as well as in this letter, are adequate to achieve the objectives of the program, but it will take any further measures that may become appropriate for this purpose. During the remaining three year period of the PRGF arrangement, Mozambique will continue to consult wit the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation. Moreover, after the period of the three-year arrangement and while Mozambique has outstanding financial obligations to the Fund arising from the arrangement, the government will consult with the Fund from time to time, at the initiative of the government or whenever the Managing Director requests consultation on Mozambique's economic and financial policies.

22. In view of the measures taken or to be taken, and to permit completion of the third review under the PRGF arrangement, the government requests waivers for the nonobservance of the two structural performance criteria at end-March 2001. The government also requests disbursement of the fourth scheduled loan under the PRGF arrangement, in the amount of SDR 8.4 million, following the completion of the third review under the arrangement. In view of the delay in completing the third review, we agree to the setting aside of the end-June 2001 performance criteria and we now expect the fifth disbursement under the PRGF arrangement to be available on or after April 15, 2002, subject to completion of the fourth

review, and observance of the end-December 2001 quantitative and structural performance criteria set out in Table 4. The government of Mozambique will conduct with the Fund a fourth review of the three-year PRGF arrangement not later than April 30, 2002. At the time of the fourth review, we would present our program for 2002, and seek an extension and further rephasing of the arrangement. The government of Mozambique is determined to fully implement its program and to comply with the targets set out in this letter.

23. The government has recently finalized its PRSP and implemented a number of additional structural reforms specified at the time of the decision point in April 2000. On this basis, the government requests that the Boards of the Fund and the Bank reach a determination that Mozambique has reached its completion point under the enhanced HIPC Initiative. The government reiterates its commitment to see to it that debt service resources freed up following the completion point under the enhanced HIPC Initiative will be channeled to the priority areas identified in the PRSP and looks forward to continuing to work with the international community towards the objective of poverty reduction in Mozambique.

Sincerely yours,

/s/	/s/
Luísa Dias Diogo Minister of Planning and Finance Ministry of Planning and Finance	Adriano A. Maleiane Governor Bank of Mozambique

Table 1. Mozambique: Prior actions for completion of the Third Review Under the PRGF Arrangement

Actions	Status
Acceptance of bids from a short list of reputable international banks for the purchase of BA.	Observed
No recapitalization of BA by the government before the bank has been taken over by its new owners	Observed
Appointment of external experts to secure the documentation for the loans of BA and prepare a full inventory	Observed
Monthly reporting to the staffs of the Fund and World Bank of BA's balance sheet data to show compliance with the instruction not to provide new lending and thereby reduce the net credit outstanding	Observed
Publication of a list of all of BA's delinquent borrowers	Observed
Submission of a report to staffs of the World Bank and Fund considering the legal remedies for loan recovery	Observed
Preparation of a detailed loan recovery strategy for BA	Observed

Table 2. Quantitative Performance Criteria and Benchmarks
Under the PRGF Arrangement, December 2000-December 2001 (End of Period)

	December 2000			March 2001			June 2001			Sep. 2001	Dec. 2001
	Performance criteria		Actual	Benchmarks		Actual	Perf. criteria		Estimate	Benchmarks	Perf. criteria
	Program	Adjusted		Program	Adjusted		Program	Adjusted			
	(In billions of meticais)										
Central government domestic primary deficit (ceiling) 1/ 2/ 3/	4,411	4,014	3,923	2,035	1,417	1,227	3,031	2,613	2,145	...	...
Central government domestic primary deficit excluding bank recapitalization costs (ceiling) 1/ 2/	...	...	...	...	...	...	...	...	...	3,771	4,340
Central government revenue (floor; benchmark only) 2/	7,471	7,471	7,463	1,893	1,893	2,043	3,902	3,902	4,140	6,039	8,670
Stock of net domestic assets of the Bank of Mozambique (ceiling) 4/ 5/ 6/	5,827	4,126	4,039	6,046	5,365	3,987	6,229	4,980	3,246	5,133	5,412
Stock of reserve money (ceiling; benchmark only) 6/	4,171	3,770	3,940	4,130	3,642	3,729	4,133	4,133	4,697	5,018	5,297
	(In millions of U.S. dollars)										
Stock of net international reserves of the Bank of Mozambique (floor) 7/	469	508	526	454	425	518	444	385	525	526	526
New nonconcessional borrowing contracted or guaranteed by the government or the Bank of Mozambique with maturity of more than one year (ceiling) 2/	0	0	0	0	0	0	0	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 8/	0	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling) 2/ 9/	0	0	0	0	0	0	0	0	0	0	0
	(In billions of meticais, unless otherwise indicated)										
Memorandum items:											
Foreign program assistance (grants and loans; in million of U.S. dollars) 2/	178	...	217	82	...	53	139	...	80	215	322
Exchange rate (Meticais per U.S. Dollar)	15,932	...	17,140	16,093	...	18,667	16,245	...	21,788	23,133	23,000
Bank recapitalization costs	1,351	...	954	852	...	234	852	...	434	...	...
Required reserves shortfall	0	...	-401	0	...	-488	0	...	0	...	...
Adjustment to BoM's NDA at program exchange rates	0	...	-10	0	...	11	0	...	-399	0	0
Adjustment to reserve money	0	...	-17	0	...	-24	0	...	-30	0	0
Adjustment to NFA	0	...	7	0	...	36	0	...	-369	0	0
Stock adjustments in medium and long term liabilities	9,360	-662	8,698	9,461	-667	8,794	9,550	-1,803	7,747	12,607	12,535

1/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.
2/ Cumulative from the beginning of the calendar year.
3/ To be adjusted downward in December, March, and June by the shortfalls in bank recapitalization/restructuring relative to the programmed amounts.
4/ Defined as reserve money minus net foreign assets (NFA) of the Bank of Mozambique. The foreign currency component of reserve money and NFA are valued at program exchange rates; NFA are defined to exclude the effect of any stock adjustments in medium- and long-term liabilities.
5/ To be adjusted upward/downward to the extent of any shortfall/excess of foreign program assistance valued at program exchange rates.
6/ To be adjusted downward to the extent that eligible bank reserves fall short of 7.95 percent (11.51 percent after June) of deposits in commercial banks at the end of each quarter. At end-December 2000, this ratio was 6.7 percent, giving rise to a downward adjustment of Mt 401 billion to the program ceiling. At end-March 2001 the downward adjustment was Mt 484 billion.
7/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the amounts shown in the memorandum item.
8/ Loans of 0-1 year's maturity, excluding normal import-related credit. Non-U.S. dollar debt converted to U.S. dollars at actual exchange rates.
9/ Continuous performance criterion; excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

Table 3. Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, October 2000-June 2001

Actions	Date of Implementation (End of period)	Status
Tax policy and administration		
Approve the legal basis for the creation of a special section within the tax directorate to handle tax collection, audits, and control with respect to large taxpayers.	March 2001	Observed
Draft new code of fiscal incentives for investment.	May 2001	Observed
Prepare a plan for the creation of a central revenue authority.	June 2001	Observed
Fiscal accountability		
Submit a new public accounting law to the National Assembly that regulates all stages of expenditure, including commitment and verification 1/	March 2001	Observed (September 2001)
Include in quarterly budget execution reports (beginning with first quarter of 2001) information on budgetary allocations and actual expenditures on programs specified in the PARPA.	May 2001	Observed
Financial sector		
With respect to recapitalization and restructuring of Banco Comercial de Moçambique (BCM) and Banco Austral (BA),		
• obtain shareholders' commitment to recapitalize and restructure the BA; and	December 2000	Observed
• complete the recapitalization of the BCM and BA 1/	March 2001	Observed for BCM but not for BA
Introduce computerized clearing system	June 2001	Observed

1/ Structural performance criteria.

Table 4. Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, October 2001-December 2001

Actions	Date of Implementation (End of period)
Tax policy and administration	
Submit to the National Assembly a new income tax law("lei de bases do sistema tributario") to overhaul corporate, personal and complementary taxes and increase their yields by simplifying procedures for calculation and payment and increasing the bases for these taxes. 1/	December 2001
Launch operations of the large taxpayer unit in Maputo.	December 2001
Financial sector	
Issue regulations to commence consolidated supervision of related financial institutions.	October 2001
Tighten the regulations on connected lending by lowering limits on commercial bank lending to shareholders.	October 2001

1/ Performance criterion

**Technical Memorandum of Understanding
On Selected Concepts and Definitions
Used in the Monitoring of the Second-Year PRGF Supported Program**

September 5, 2001

The purpose of this technical memorandum of understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of the second year of the Poverty Reduction and Growth Facility (PRGF)-supported program, including the following:

- central government domestic primary deficit;
- central government revenue;
- net domestic assets, net international reserves, and reserve money of the Bank of Mozambique;
- new nonconcessional borrowing contracted or guaranteed by the 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

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

Central government domestic primary deficit

The central government domestic primary deficit is defined as central government revenue, **less** noninterest current expenditure, **less** locally financed capital expenditure, **less** locally financed net lending, and excluding the cost of bank restructuring/recapitalization. Net lending is derived as gross lending to enterprises through *acordos de retrocessão* (excluding *acordos de retrocessão* that were required by donors), **plus** food aid disbursed but not collected in the period, **minus** repayments by enterprises of loans obtained through *acordos de retrocessão* and through refinancing agreements with the Bank of Mozambique, **minus** food aid collected but not disbursed, in the period. The cost of bank recapitalization/restructuring is for the purpose of the program defined as the government's contribution to the costs of recapitalizing Banco Comercial de Moçambique (BCM) in 2001 (Mt 234 billion) and, in relation to Banco Austral (BA) the sum of (i) the cost of the real estate purchase from BA in April (Mt 200 billion); (ii) the conversion of the long-term loan of Mt 641 billion from the BM (Bank of Mozambique or BCM) to BA into a government obligation; and (iii) cash and government securities issued to the new owners of BA to raise the capital of the bank to meet minimum prudential requirements less (iv) the gross amount paid to the government by the purchasers of BA.

The central 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 government.

Central government revenue, expenditure, and financing

Revenue is defined to include all receipts of the National Directorate of Taxes and Audit (Direcção Nacional de Impostos e Auditoría, DNIA), the National Directorate of Customs (Direcção Nacional de Alfândegas, DNA), and the net receipts from privatization received by the National Directorate of State Assets (Direcção Nacional do Património do Estado).

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

Expenditure is defined as government outlays transferred from treasury accounts to other government accounts or private sector accounts and includes spending reported to the National Directorate of Public Accounting (*despesas liquidadas*) and any further treasury advances (*operações de Tesuoraría*) that have been transferred out of treasury accounts but whose use has not yet been reported to the National Directorate of Public Accounting. Any expenditure arrears will be treated like expenditure for the purpose of monitoring the ceiling on the domestic primary deficit.

For program monitoring purposes, expenditure carried out in the current budget year but accounted for as expenditure under the previous budget (*período complementar*) is treated as spending during the current budget year.

The **financing** of the budget deficit is measured as transfers into treasury accounts and from these accounts to accounts of the institutions included in the central government, as defined above, and private sector accounts. All treasury accounts held at the central bank are being monitored for purposes of measuring the financing of the budget deficit. There are no treasury accounts outside the central bank.

Any discrepancy between the overall deficit (revenue less expenditure, as defined above) and its financing will be included as "unallocated revenue/expenditure" in the budget balance.

Net domestic assets

Net domestic assets of the Bank of Mozambique are defined as reserve money **minus** net foreign assets of the Bank of Mozambique. The foreign currency component of reserve money and the net foreign assets are valued at program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term liabilities.

The central bank's foreign currency-denominated assets and liabilities are converted in its balance sheet to meticals at actual exchange rates. For purposes of program monitoring, these amounts are converted into U.S. dollars at the agreed program exchange rate.

Stock adjustments in the central bank's medium- and long-term liabilities are understood to mean any changes that are not the result of foreign exchange flows, such as write-offs, interest capitalization, etc.

Net international reserves

Net international reserves are defined as reserve assets **minus** reserve liabilities. The BM's reserve assets include (i) monetary gold; (ii) holdings of SDRs; (iii) reserve position at the IMF; (iv) holdings of foreign exchange; and (v) claims on nonresidents, such as deposits abroad. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guarantee for a third–party external liability (assets not readily available.) The BM's reserve liabilities include (i) all short-term foreign exchange liabilities to nonresidents with original maturity of up to and including one year; and (ii) all liabilities to the IMF.

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

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

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

Stock of short-term external public debt outstanding

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

External payments arrears

The government undertakes not to accumulate payment arrears on external government debt with original maturity of one year or more owed or guaranteed by the government, with the exception of external payments arrears arising from government debt in the process of being renegotiated with creditors, including Paris Club creditors.

Foreign program assistance

Foreign program assistance is defined as grants and loans received by the Ministry of Planning and Finance through BM accounts.

Adjusters

The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) for any excess (shortfall) of foreign program assistance.

The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted upward (downward) for any shortfall (excess) of foreign program assistance.

The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted downward to the extent that eligible bank reserves fall short of 11.51 percent of resident deposits in commercial banks, excluding government-earmarked funds (*fundos consignados*), at the end of each quarter.

Mozambique: Relations with the Fund
(As of July 31, 2001)

Membership Status

Joined 9/24/84; Article XIV

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	0.0

SDR Department	SDR Million	% Allocation
Holdings	0.05	n.a.

Outstanding purchases and loans	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/ Poverty Reduction and Growth Facility (PRGF) arrangements	166.11	146.2

Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR Million)
ESAF/PRGF	06/28/99	06/27/2002	87.20	45.20
ESAF	06/21/96	06/27/1999	75.60	75.60
ESAF	06/01/90	12/31/1995	130.05	115.35

Projected Obligations to the Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Overdue 7/31/00	Forthcoming 2001	2002	2003	2004
Principal	0.0	21.0	17.1	14.8	15.3
Charges/interest	0.0	0.8	0.7	0.6	0.5
Total	0.0	21.8	17.8	15.4	15.8

Implementation of HIPC Initiative

	Original Framework	Enhanced Framework	Total
Commitment of HIPC assistance			
Decision point date	4/7/98	4/7/00	
Assistance committed (end-1998 NPV terms)			
Total assistance (US$ million)	1,716.0	254.0	1,970.0
Of which			
Fund assistance (SDR million)	93.2	11.6	104.8
Completion point date	6/29/99	20/9/01	
Delivery of Fund assistance (SDR million)			
Amount disbursed	93.2	2.3	95.5
Interim assistance	...	2.3	2.3
Completion point	93.2	...	93.2
Amount applied against member's obligations (cumulative)	42.8	2.3	45.1

Safeguard–Assessment

Under the Fund's safeguards assessment policy, the Bank of Mozambique is subject to the transitional procedures with respect to the PRGF arrangement, which was approved on June 28, 1999, and is scheduled to expire on June 27, 2002. The transitional procedures require a review of only the Bank of Mozambique's external audit mechanism. This assessment determines whether the bank publishes annual financial statements that are independently audited in accordance with internationally accepted standards.

The external audit assessment is under way.

Exchange Arrangements

The exchange rate for Mozambique's currency, the metical (plural: meticais) is market determined. Commercial banks may buy foreign exchange from, and sell to, individual customers on a freely negotiable basis. The Bank of Mozambique publishes daily a representative exchange rate in the form of the weighted average rate of all licensed operators' transactions with the public of the previous day. As of end-July 2001, this rate was Mt 21,797 per U.S. dollar. Mozambique has expressed the intention to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement in the near future. In this regard, a detailed examination of the exchange system is being conducted in collaboration with the Fund staff. It is expected that Mozambique will formally accept the obligations of Article VIII, Sections 2, 3, and 4 following resolution of a few outstanding issues in this regard.

Article IV Consultation

Mozambique is on the standard 12-month cycle for Article IV consultations. The 2000 Article IV consultation was completed by the Executive Board on December 18, 2000 (EBS/00/62; 3/30/00).

In considering the staff report, Executive Directors commended the Mozambican authorities for their program implementation record and for their plans to improve fiscal management and banking sector soundness. They noted the authorities' commitment to meeting the conditions for the enhanced HIPC Initiative completion point by end-March 2001, but expressed concern about the realism of this timetable and emphasized the importance of quality over process. Directors also urged the authorities to improve tracking of poverty-related expenditures, particularly with regard to the use of resources freed up as a result of HIPC Initiative debt relief.

FSAP Participation, ROSCs, and OFC Assessments

Mozambique has not been subject to Financial Sector Assessment Program (FSAP) or OFC assessments. A Report on Observance of Standards and Codes (ROSC) on fiscal transparency was issued February 22, 2001 (doc.# 1155178).

Technical Assistance (over the last two years)

Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	September 2001	Mission	Tax policy and administration project formulation	Ministry of Finance
	Aug.-Sep. 2001	Short-term consultant	Income tax reform	Ministry of Finance
	Jan.-Feb. 2001	Mission	Income tax reform	Ministry of Finance
	September 2000	Mission	Review of VAT implementation	Ministry of Finance
	June 2000	Mission	Code of Good Practices on Fiscal Transparency	Ministry of Finance
	June 2000	Mission	Rationalization of tax incentives	Ministry of Finance
Legal Affairs	Aug.-Sep. 2001	Mission	Income tax law	Ministry of Finance
Monetary and Exchange Affairs	Sep.-Dec. 2001	Short-term consultant	Banking supervision	Bank of Mozambique
	Aug.-Sep. 2001	Short-term consultant	Commercial bank restructuring	Bank of Mozambique/ Banco Austral
	June 2001	Mission	Commercial bank restructuring	Bank of Mozambique
Statistics	Apr.-June 2001	Short-term consultant	Balance of payments statistics	Bank of Mozambique

Resident Representative

Mr. Schwidrowski has been Resident Representative since October 25, 1999.

Mozambique: Relations with the World Bank Group

During the period 2001–03, disbursements under the World Bank's investment projects are expected to average US$90 million per year. Under the new Country Assistance Strategy (CAS), covering the period 2000–03, World Bank support to Mozambique will focus on agriculture, education, and infrastructure. Under the new CAS baseline scenario, a new adjustment operation, the Economic Management and Private Sector Operation (EMPSO), is planned to start at the end of the fiscal year 2001. The World Bank and the Mozambican authorities, in collaboration with other donors, are currently undertaking a public expenditure review (PER), the completion of which is expected by end-2001.

World Bank Loan and Grant Operations, 1998–2002 1/
(In millions of U.S. dollars)

	1998	1999	2000	2001	2002
	Actual			Projected	
I. Project credit disbursements	**85.1**	**79.5**	**97.5**	**84.4**	**91.5**
Household Energy (6/89) 2/	4.2	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89) 2/	1.0	0.0	0.0	0.0	0.0
Education II (12/90) 2/	4.2	2.5	0.0	0.0	0.0
Industrial Enterprise (12/89) 2/	10.7	7.6	2.0	0.0	0.0
Agricultural Service Rehab.Development (2/92) 2/	2.1	2.5	0.7	0.0	0.0
First Road and Coastal Shipping (6/92) 2/	5.3	12.5	4.0	0.0	0.0
Capacity Building:Human Res.Dev.(11/92)	8.2	11.3	4.5	5.7	0.0
Capacity Building:Public Sector and Legal Inst.Dev.(11/92)	2.9	0.9	0.7	0.0	0.0
Maputo Corridor (1/93) 2/	0.4	0.0	0.0	0.0	0.0
Rural Rehab.(3/93) 2/	4.8	3.8	2.0	0.0	0.0
Food Security (4/93) 2/	1.3	0.1	0.0	0.0	0.0
Local Government (6/93) 2/	2.7	3.1	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94)	24.5	16.9	26.5	20.0	19.7
Financial Sector Capacity Building (4/94) 2/	1.4	2.0	1.4	0.0	0.0
Gas engineering(6/94)	1.9	1.5	1.1	3.8	3.8
Health Sector Recovery (11/95)	7.5	12.0	17.2	12.0	12.0
National Water I (2/98)	2.0	1.3	1.7	7.3	7.3
Agricultural Sec. PEP (2/99)	0.0	0.5	0.9	6.7	6.7
General Education (2/99)	0.0	1.0	0.5	10.0	10.0
Railway and port restructuring (10/99)	0.0	0.0	1.9	0.0	0.0
National Water II (6/99)	0.0	0.0	1.4	12.0	12.0
Enterprise Development (01/00)	0.0	0.0	2.3	4.5	4.5
Flood Emergency Recovery	0.0	0.0	28.7	1.3	0.0
Coastal and Marine Biodiversity	0.0	0.0	0.0	1.1	1.1
New Operations					
Municipal Development					2.6
Roads and Bridges					10.0
Communications					1.8
II. Adjustment operations	**46.5**	**150.0**	**0.0**	**0.0**	**100.0**
Economic Management Reform Operation (12/98) 2/3/	0.0	150.0	0.0	0.0	0.0
Third Economic Recovery Credit 2/	46.5	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation (end-2001)	0.0	0.0	0.0	5.0	50.0
Poverty Reduction Credit (mid-2002)	0.0	0.0	0.0	0.0	50.0

1/ Date of Board approval in brackets.

2/ Closed.

3/ Grant.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/93
FOR IMMEDIATE RELEASE
September 20, 2001

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

IMF Completes Third Review Under Mozambique's PRGF Arrangement and Approves In Principle US$11 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Mozambique's arrangement under the Poverty Reduction and Growth Facility (PRGF)[1] and approved in principle the disbursement of SDR 8.4 million (about US$11 Million).

A final decision by the IMF Executive Board is pending discussion of Mozambique's Poverty Reduction Strategy Paper (PRSP) by the World Bank Executive Board, which is expected to take place on October 2, 2001.

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[1] On November 22, 1999, the IMF's facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It is intended that PRGF-supported programs will in time be 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 each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. The government has designed a full PRSP in April 2001 with the view of refocusing Mozambique's adjustment strategy to address more decisively the country's social problems. PRSP loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½ grace period on principal payments.

Mozambique's three-year arrangement was approved on June 28, 1999 (see Press Release 99/25), for SDR 58.8 million (about US$76 million). In March 2000, the commitment under the arrangement was increased to SDR 87.2 million (about US$113 million). So far, Mozambique has drawn SDR 53.6 million (about US$69 million) under the arrangement.

After the Executive Board's discussion on Mozambique, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, made the following statement:

"Mozambique is to be commended for its successful record of policy implementation, which has, over more than a decade, brought stability and rapid economic growth to one of the world's poorest countries. Progress has continued in many areas, and after the severe setback caused by the floods in 2000, there have been further important signs of the gains from recent policies. As a result of sound policies and aided by large inflows of foreign direct investment, economic growth resumed in 2001.

"Mozambique has successfully completed its full PRSP, which provides a sound basis for the Fund's concessional assistance to Mozambique. The PRSP's ambitious objective of 8 percent annual growth will require continued macroeconomic stability and a deepening of structural reforms. Implementation of the PRSP will be key to raising further priority social spending and improving social indicators.

"Appropriate steps have been taken to address delays in structural policy implementation, in particular as regards the difficult resolution of the commercial bank Banco Austral (BA) and which were due to the broadening of the scope of the public accounting law and judicial system reform. In implementing its strategy to resolve the BA issue, the government needs to keep costs to a minimum, and address the potential liquidity and budgetary implications.

"The authorities also need to increase tax revenues, including through the prompt implementation of a revised code of fiscal incentives to ensure that exemptions are not excessively prevalent. The program for 2001 envisages the launching of a major reform of the country's income tax laws and it is important that this reform be pursued in a timely manner," Mr. Sugisaki said.