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Republic of Mozambique: Second Review Under the Policy Support Instrument and Request for Waiver of Nonobservance of Assessment Criteria; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

In the context of the second review under the Policy Support Instrument and request for a waiver of nonobservance of an assessment criteria, the following documents have been released and are included in this package:

- The staff report for the Second Review Under the Policy Support Instrument and Request for Waiver of Nonobservance of Assessment Criteria, prepared by a staff team of the IMF, following discussions that ended on April 1, 2008, with officials of the Republic of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 9, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of May, 28, 2008 updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its May 28, 2008 discussion of the staff report that completed the review.
- A statement by the Executive Director for the Republic of Mozambique.

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

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Second Review Under the Policy Support Instrument and Request for Waiver of Nonobservance of Assessment Criteria

Prepared by the African and Policy Development and Review Departments
(In consultation with other departments)

Approved by David Nellor and Anthony Boote

May 9, 2008

- Discussions for the second review of the Policy Support Instrument (PSI) were held in Maputo March 19–April 1, 2008, by a taff team comprising Mr. Clément (head), Mr. Staines, Mr. Lledó, Ms. Ocampos (all AFR), and Ms. Kvintradze (PDR). Mr. Sulemane (OEDAE) also participated. The mission was assisted by Mr. Fischer, the resident representative in Mozambique and by Ms. Bosten and Mr. Wane in the resident representative's office. Messrs. Baxter, Nicholas, Binkert and Nucifora (World Bank) joined the discussions.
- The review mission was followed by a joint World-Bank IMF mission on improving the management of Mozambique's natural resources.
- The mission met with the Prime Minister, Ministers of Finance, Planning and Development, Justice, Energy, Mineral Resources, Trade and Industry, Civil Service; State Administration; the Governor of the Bank of Mozambique; senior government officials; and representatives of the donor community, the private sector, and the press.
- In the Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP), attached as Appendix I, the authorities review performance under the PSI-supported program to end-December 2007 and outline their policies for the remainder of 2008. The authorities request waivers for the nonobservance of the end-December 2007 quantitative assessment criteria on net credit to government and reserve money and the end-February 2008 structural assessment criterion on the excise tax law. They also request modifications to the quantitative assessment criteria for end-June 2008 and the adjuster on base money for December 2008, as described in the MEFP and the Technical Memorandum of Understanding (TMU).
- Since taking office in 2005, the government has shown a strong commitment to implement a second wave of reforms. The provincial elections due in early 2008 have been postponed and will take place before end-2009.

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EXECUTIVE SUMMARY

Mozambique made strong progress on its key macroeconomic objectives during 2007. Real GDP rose more than envisaged, inflation declined despite strong international price pressures, external reserves increased more than programmed, and the real effective exchange rate (REER) appreciated in line with fundamentals.

Overall performance under the program was satisfactory but encountered unexpected challenges. Domestic revenues were stronger than envisaged, but the end-December 2007 assessment criterion (AC) on net credit to government (NCG) was missed largely because of aid shortfalls for on-lending to public enterprises and deficiencies in cash-flow management that are being addressed. Monetary policy remained prudent, but the end-year AC on reserve money was missed because of an unusually strong currency demand during the end-year festive season, that was reversed in January 2008.

The government maintained the momentum on its extensive reform agenda. Strong progress was made on improving public financial management, the tax system, monetary operations and the business environment. In particular, the government met its program objectives for implementing the integrated management information system (e-Sistafe) and for promulgating regulations for the new mining and petroleum fiscal regime laws. However, the submission of a draft excise tax law to Parliament has been temporarily delayed to May 2008 (end-February structural AC). The government also approved a medium-term strategy to strengthen the business environment.

Prospects for 2008 remain positive. Output growth is projected to remain robust. Inflation will decelerate, though less than previously envisaged. External reserves will remain at a comfortable level. Fiscal and monetary policy will remain prudent in the context of a flexible exchange rate regime.

The momentum on the structural reform agenda will be maintained. Public financial management (PFM) will continue to be strengthened. The government has initiated steps to declare its adherence to the Extractive Industries Transparency Initiative (EITI) during 2008. The Bank of Mozambique (BM) will further deepen financial markets by introducing repos and Treasury bill operations in the secondary market. The BM will also implement measures to further strengthen its internal audit.

I. The Economy in 2007 Remains Resilient

1. **During the second half of 2007, Mozambique continued to meet its macroeconomic objectives under its medium-term development strategy *Plano de Acção Para a Reduçao da Pobreza Absoluta II* (PARPA II). The economy remained resilient to climatic and external price shocks, but social vulnerabilities have emerged**.

A. Economy Resilient to Climatic and External Price Shocks

2. **Overall macroeconomic performance in 2007 was satisfactory**. Output growth exceeded expectations, despite extensive flooding late in the year and large international import price increases. Average inflation nevertheless declined and core inflation (excluding food and energy) was contained around 5 percent. Large foreign direct investments and an increased reliance on foreign exchange reserve sales to sterilize excess liquidity led to an appreciated REER. External reserves were higher than envisaged.

3. **Recent increases in international food and oil prices have exposed potential social vulnerabilities**. In the 12 months to March 2008, gasolene and food prices rose 27 and 15 percent respectively. Large domestic fuel price increases in February 2008 triggered riots and led to the introduction of a temporary and well-targeted transportation subsidy.

Mozambique-Selected Indicators, 2006-11

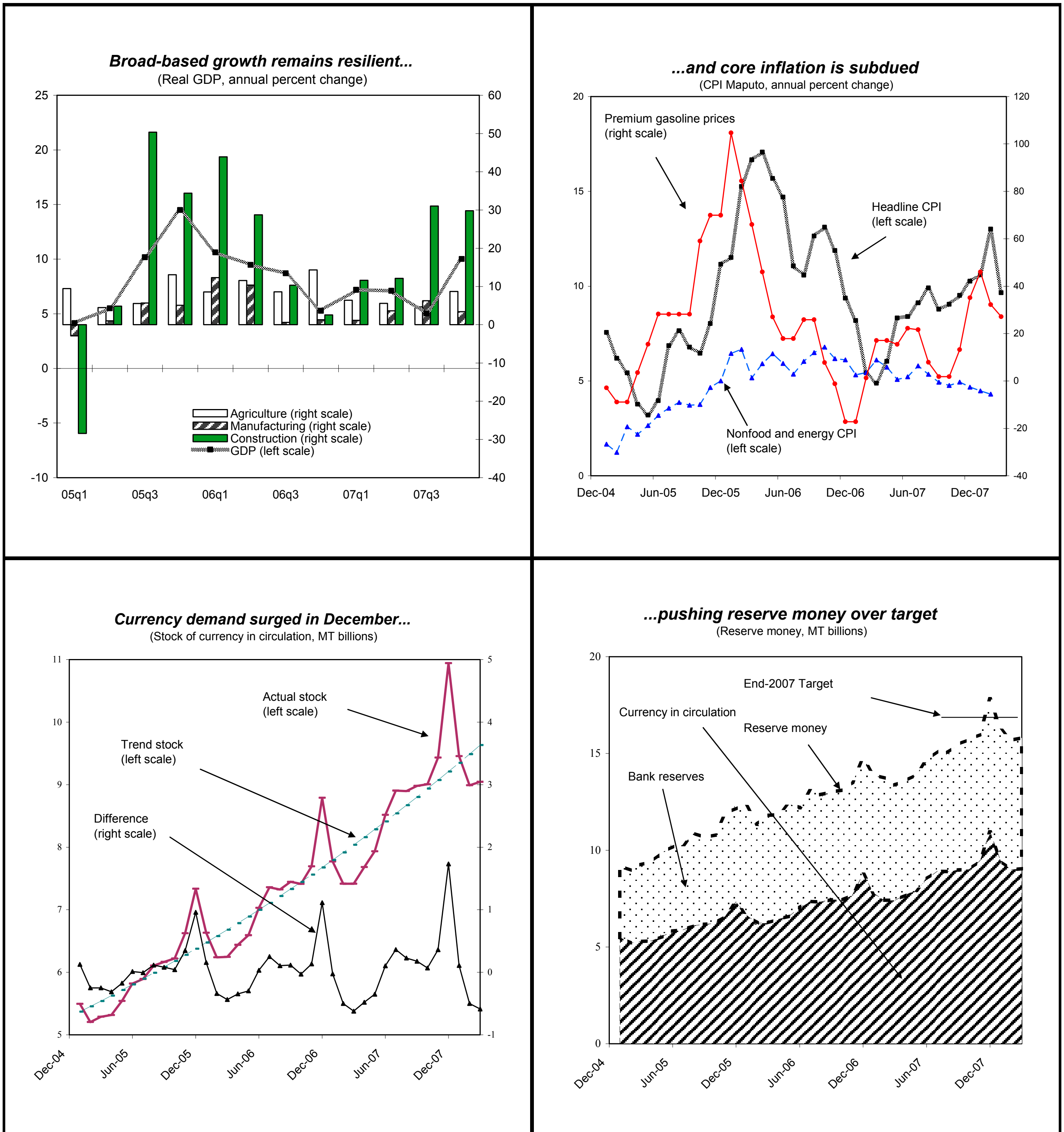
	2006 Act.	2007 Act.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.
Real GDP, percent change	8.5	7.3	7.0	7.0	7.0	7.0
CPI, per avg., percent change	13.2	8.2	7.3	5.5	5.3	5.1
CPI, eop., percent change	9.4	10.3	6.0	5.2	5.1	5.1
REER, percent change	1.8	6.5	...	...	...	...
Current account balance (before grants), percent of GDP	-15.9	-16.4	-20.8	-20.2	-18.5	-17.3
External reserves coverage, months of imports	4.4	5.0	4.6	4.6	4.6	4.6

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

4. **Fiscal policy implementation during the second semester was broadly as envisaged, but budget execution was constrained by project aid shortfalls**. Domestic tax revenues exceeded expectations by 0.4 percent of GDP and current spending was in line with the program, despite emergency spending related to floods. However, project aid shortfalls, including from the health common fund, led to capital under-spending (4.6 percent of GDP). As a result, priority expenditures' share of total spending fell below the 65 percent target. The end-year AC on NCG was missed by 0.8 percent of GDP, mainly because of aid shortfalls for on-lending to public enterprises (without a corresponding reduction in on-lending) and deficiencies in cash-flow management.[1] These deficiencies are being addressed, particularly by strengthening the e-Sistafe and better coordination with the BM (see below).

[1] The BM made technical revisions in January 2008 to the monetary survey back to 1997, according to which the adjusted end-December 2007 target on net credit to the government was missed by only 0.2 percent of GDP.

Figure 1: Recent Economic Developments, 2005-07



Sources: Mozambican authorities; and IMF staff estimates.

5. **Monetary policy remained prudent, but encountered unexpected challenges**. The deceleration of inflation allowed the BM to reduce the interest rates on its standing facilities in January 2008, but real interest rates nevertheless remain high. As intended, the BM increased its reliance on foreign exchange sales to sterilize excess liquidity during the second semester. However, this was not enough to compensate for the unusually strong seasonal demand for currency during the end-year festive season.[2] As a result, the end-year reserve money target was breached, but was back in line with the program in early 2008.

Monetary Policy Mix

	2006		2007		
	Sept.	Dec.	Jun.	Sept.	Dec.
	(Billions of MT)				
Total sterilization	8.6	11.9	7.8	11.5	15.0
Net foreign exchange sales	8.9	12.4	5.5	7.7	10.2
Net T-bill issuance	-0.3	-0.5	2.3	3.8	4.7
Memo:					
	(Percentage of total sterilization)				
Net foreign exchange sales	104	104	70	67	68
Net T-bill issuance	-4	-4	30	33	32
	(Millions of US$)				
Net foreign exchange sales	362	476	211	300	430

Sources: Mozambican authorities; and Fund staff estimates.

B. Structural Reform Momentum Maintained

6. **Efforts to strengthen fiscal operations have progressed faster than expected (MEFP ¶6-8)**. The government implemented extensive measures to improve tax administration and collections and Parliament approved new codes for income and value added taxes in December. Good progress has been made in implementing the first two phases of the e-Sistafe project.

7. **The BM has continued to strengthen its operations (MEFP ¶9, 12)**. It has expanded its range of instruments to control liquidity. An agreement in November to shift the costs of monetary policy to the Ministry of Finance (MF) will increase its financial independence and help ensure that monetary policy decisions are not constrained by financial considerations. These costs will be included in the 2009 budget. The BM also continued to strengthen its banking sector supervision to comply with Basel I principles.

8. **The government has stepped up efforts to reduce the cost of doing business and strengthen its natural resource management (MEFP ¶13, 18).** It approved a new strategic plan in February 2008 to strengthen the business environment, simplified the licensing process and completed a study to facilitate cross border trade. It also issued regulations in February for the mining and petroleum fiscal regime laws approved by Parliament in June 2007. Several SADC countries, including Mozambique, concluded an interim-Economic Partnership Agreement with the EU in November, providing continued free access to EU markets, in exchange for reciprocal free access from July 2008.

[2] Currency demand was unusually strong because both Christmas Day and the New Year fell on weekdays. The same will occur in 2008.

II. Macroeconomic Policies in 2008

9. **Mozambique has progressed in cementing macroeconomic stability towards becoming a full mature stabilizer.** Maintaining prudent macroeconomic policies will remain important for further sustaining growth, but will need to be buttressed by strengthening fiscal and monetary operations. Mozambique will need to continue relying more heavily on second-wave reforms for further impetus to growth. Strengthening the business environment for private sector development, especially small and medium-sized enterprises, is a priority to spread the benefits of Mozambique's natural resources more widely and to avoid the emergence of a dual economy.

A. Maintaining Prudent Macroeconomic Policies

10. **Macroeconomic prospects for 2008 remain positive.** Real GDP growth is expected to remain robust despite localized floods (MEFP ¶3), while inflation is projected to decline, though less than previously envisaged because of higher international oil and food prices. The current account will likely widen mainly because of higher imports from the projected scaling-up of aid and high international oil prices. External reserves will remain at a comfortable level.

11. **The fiscal objectives are in line with the revised medium-term fiscal framework.** There will be no recourse to monetary financing to make room for credit to the private sector. The government aims to raise domestic revenues by 0.5 percent of GDP, while mitigating revenue losses from trade liberalization, by improving revenue administration, implementing tax measures, and from higher Cahora Bassa hydroelectricity concession fees. The fiscal framework accommodates a temporary transportation subsidy (0.15 percent of GDP) and costs related to the flooding and cyclone through the budget's contingency line.[3] Donor's firm commitments, on which aid projections are based, imply a substantial scaling-up of project aid—largely for capital spending—by over 5 percent of GDP.

12. **The BM will maintain a prudent monetary policy stance in the context of a flexible exchange rate.** The BM will continue to target base money with a view to achieving an average headline inflation of 7–8 percent in 2008. The adjuster on the outstanding stock of currency for end-December 2008 has been increased to take into account the seasonal increase in the demand for currency during the festive season in the fourth quarter of the year (TMU ¶19). Program adjustments also reflect technical revisions to the monetary survey.[4]

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[3] The adjuster of MT 500 million for natural disasters could also help accommodate additional spending.

[4] The monetary survey was revised to incorporate more detailed banking information on the residency and use of monetary instruments.

13. **The government is considering how to mitigate the social impact of further increases in oil and food prices.** A seminar to that effect is scheduled in May, organized by the IMF and the World Bank to identify best practices in this area.

14. **The government is committed to program implementation.** Despite the economy's increased resilience, implementation will continue to face risks from natural calamities. Performance could be affected by adverse movements in international prices and further oil and food price increases could heighten social vulnerabilities. Approaching the elections, the government will need to resist pressures for additional spending that are not sustainable.

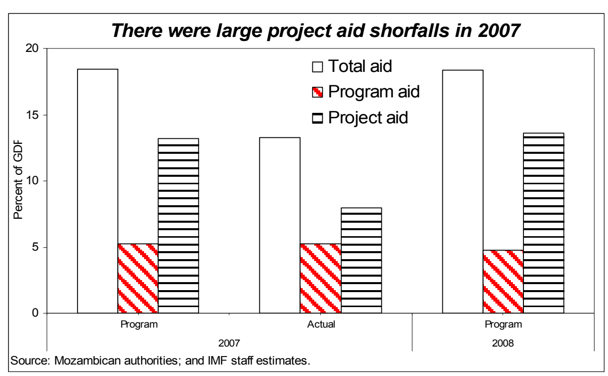
B. Strengthening Policy Operations

Fiscal operations

15. **Measures to mobilize revenue collection play an important role in consolidating fiscal and macroeconomic stability (MEFP ¶26–27)**. The government will continue to implement its medium-term program to improve the efficiency of the tax system. This includes simplifying the tax system for small and medium sized enterprises, a new code on tax benefits, and the computerization of the entire chain of revenue collection (e-Tributação). A law updating excise taxes is expected to be submitted to Parliament by end-May 2008.

16. **Strengthening PFM is also central to fiscal policy implementation (MEFP ¶29).** The government is committed to completing the first two phases of the e-Sistafe project, relating to budget execution, control and evaluation. It will start using e-Sistafe to pay civil service salaries by end-April 2008 and will define a list of additional districts and municipalities for the rollout of e-Sistafe by end-June 2008 (both structural benchmarks). E-Sistafe will be expanded to allow for program budgeting for the 2009 budget and for selected pension payments starting in early 2009. The government will facilitate the transfer of project aid through the single treasury account (CUT), for which a pilot is currently underway. Timely donor support for the implementation of the third phrase of the e-Sistafe is important.

17. **To realize the projected scaling-up of aid and ensure that priority spending targets are met,** the government and donors are committed to address the causes of previous shortfalls in aid disbursement of projects and special programs (financed by the Common Fund for the health sector) and related spending. Measures will include routing externally financed projects through the CUT.



18. **To avoid further fiscal overruns, the MF, together with the BM, needs to improve its cash-flow management and be ready to take timely corrective measures**. To

that effect a study, with the support of technical assistance, will be undertaken by December 2008 (structural benchmark). This study will serve as a basis for drafting a public enterprise law requiring monthly financial report to the MF.

19. **The government is working to conclude debt rescheduling agreements with bilateral creditors under the HIPC Initiative**. It is currently negotiating with Bulgaria and Libya, has scheduled discussions with Iraq and Portugal and has invited Angola, Poland and Algeria to negotiate.

Fine-tuning central bank operations and safeguards

20. **Over 2008, the BM will move progressively towards a monetary framework that better reflects the determinants of price stability (MEFP ¶25, 31)**. The BM will further strengthen its control of liquidity by introducing repo operations in June 2008 and by adapting the main interbank money market system (Meticalnet) to allow for outright operations of Treasury bills in the secondary market (end-June 2008 structural benchmark). To strengthen liquidity forecasting, especially with respect to fiscal transactions, the MF is committed to communicating its cash-flow projections to the BM on a weekly basis.

21. **The BM will implement measures to strengthen its financial reporting and internal audit (MEFP ¶32).** These measures include: publication of audited financial statements prepared in accordance with IFRS (starting with the financial year 2008), an external quality assurance review of the internal audit function, the adoption of an internal audit charter, and periodic reporting to the BM's Executive Board on the implementation of the audit recommendations (end-July 2008 structural benchmark); following SADC's approval of a model law, the submission to the Council of Ministers (CM) of a new central bank law in line with best international practices and including a revision to the composition of the audit committee. As an interim measure, the Audit Board will assume the role of the audit committee with a focused mandate (end-June 2008 structural AC).

22. **The BM has continued to strengthen its supervision of the banking sector to comply with Basel I principles (MEFP ¶32–33)**. The BM will report its financial statement for 2008 in compliance with the IFRS and is working with the banking sector to facilitate the publication of IFRS-compliant accounts in 2008. The government will conclude a medium-term IFRS Strategic Implementation Plan by end-April 2008 to extend the standards to the corporate sector.

23. **Mozambique has committed to introducing current account convertibility.** A new foreign exchange law was submitted to Parliament in September 2007. Following its approval, the government intends to accept the obligations under Article VIII sections 2, 3, and 4 of the IMF's Articles of Agreement (MEFP ¶35).

C. Implementing Second-Wave Reforms

24. **With the help of the World Bank and other development partners, the government is implementing second-wave reforms to support private sector development, management of the country's natural resources, and public sector governance.**

25. **The government aims to reduce the cost of doing business to make Mozambique's business environment the most competitive in SADC by 2015 (MEFP ¶37-38)**. As part of its new strategic action plan, the government will facilitate cross-border trade during 2008, consolidate business inspections by April 2008, and submit an insolvency law to the CM by June 2008 for implementation during 2008.

Box 1. Improving the Management and Boosting the Economic Benefits of Megaprojects[1]

Improving the management and boosting the domestic economic benefits of megaprojects is a central government objective. The MF's decision to implement a number of measures aiming at improving the overall fiscal risk management, accountability, and transparency of megaprojects is particularly welcome. In particular, to manage the budgetary and macroeconomic implications of megaprojects, the government intends in the short-term (2008–09) to:

- strengthen the monitoring of megaprojects by developing data gathering and analytical and forecasting capabilities at the MF in close coordination with other interested ministries and the Bank of Mozambique;
- enhance the oversight and control mechanism of the MF by ensuring that it formally agrees with the fiscal regime of new projects at the appropriate stages of the negotiations, and before its submission to the Council of Ministers. To this end, an appropriate legal instrument will be adopted before end-May 2008;
- strictly implement the mining and petroleum fiscal regime and related regulations and model contracts to all new projects;
- start to develop actions aimed to meet the steps necessary for the official declaration of Government to adhere to the Extractive Industry Transparency Initiative (EITI) in the course of 2008;
- continue to adopt nonrecourse financing clauses in future megaprojects; and
- draft a Public-Private Partnership law in 2009 which will also be applicable to megaprojects.

[1] For a comprehensive overview, see 'Post-Stabilization Economics in Sub-Saharan Africa– Lessons from Mozambique', Jean A. P. Clément and Shanaka J. Peiris (eds.), IMF, 2008, recently published.

26. **Measures are being implemented to improve the management and transparency of the country's natural resources and increase the benefits flowing to the country (MEFP ¶39)**. The government initiated steps in March towards declaring its adherence to the EITI during 2008. A joint World Bank and IMF mission in April discussed ways to improve

the management and boost the economic benefits of megaprojects, Public-Private Partnerships (PPPs) and concessions (**Box 1**).

27. **Strengthening public governance remains a key focus of the reform agenda (MEFP ¶40–41)**. The government is working on the reform of civil service compensation, paying due regard to fiscal sustainability. A decentralization strategy is being prepared, with the support of the World Bank and other development partners, for the CM's approval by end-2008. A restructuring plan of PETROMOC will be submitted to the CM by May 2008. Progress on judicial reforms is slower than envisaged. As part of its anti-corruption efforts, the government will complete in April a strategy, with specific objectives and actions, to improve Mozambique's governance indicators in 2008 and 2009.

III. Program Monitoring

28. The revised program incorporates modifications to the ACs for NCG, net international reserves (NIR), and reserve money for end-June 2008 for the third review (expected to be completed by end-December 2008). For end-June 2008, the NIR AC was modified to take into account technical revisions to the monetary survey, the AC on base money to take into account the reduced legal reserve requirement for banks, and the AC on NCG to take into account the revised schedule of disbursements of foreign program assistance (MEFP Table 1). ACs for end-December 2008 are proposed for the fourth review, expected to be completed by end-June 2009. The TMU has been updated. The adjuster on reserve money related to currency issued by the BM has been modified to take into account the seasonal increase in currency demand during the festive season in the fourth quarter of the year (TMU ¶19).

IV. Staff Appraisal

29. **Mozambique's overall macroeconomic performance during the second half of 2007 was satisfactory.** Economic growth was resilient to shocks and inflation continued to decline. However, the two end-December 2007 quantitative ACs on net credit to government and reserve money were missed mostly because of unforeseen challenges. The submission of the draft excise tax law to Parliament, a structural AC for end-February, has been temporarily delayed to May 2008.

30. **Staff welcomes the authorities' commitment to prudent fiscal and monetary policies in the context of a flexible exchange rate system and to avoid monetary financing of the budget.** Staff urges the authorities to ensure that the civil service wage and pension reform does not compromise fiscal sustainability.

31. **Strengthening fiscal and monetary operations will be important for policy implementation**. In the fiscal area, staff commends the authorities for the progress made in tax administration and on PFM. Implementation of the e-Sistafe project has progressed well, but timely donor financial support will be important for its completion. It will also be

important for the authorities and donors to promptly address the causes of the 2007 shortfalls in aid disbursement of projects and special programs and related spending to allow a scaling-up of aid in 2008. In the monetary area, the BM has made good progress in introducing new instruments. Staff welcomes BM's efforts to move towards a monetary framework that better reflects determinants of price stability and to buttress its internal audit. Staff also welcomes the Treasury's commitment to communicate its cash-flow projections to the BM on a weekly basis.

32. **Reforms to strengthen private sector development and management of the country's natural resources are a high priority.** Implementation of the medium-term strategic plan to improve the business environment is important for private sector development. Staff particularly welcomes the implementation of the regulations on the mining and petroleum fiscal regime laws and stresses the importance of the MF having oversight of the fiscal terms for new megaproject agreements. Adherence to the EITI is an important step forward in making Mozambique's business environment more transparent and spreading the benefits of Mozambique's natural resources.

33. **Staff welcomes the authorities' continued focus on improving governance** and urges the completion and timely implementation of its strategy to improve Mozambique's overall governance performance.

34. **A new foreign exchange law was submitted to the Assembly in September 2007**. Following approval of the new law and implementing regulations, the authorities intend to accept their obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. The staff recommends the approval of five exchange restrictions under Article VIII, Section 2(a) given the authorities' stated intention to remove these exchange restrictions within one year.

35. **Based on performance to date and their continued commitment to program implementation, staff supports the authorities' request for waivers for the non-observance of the two end-December 2007 quantitative assessment criteria on net credit to government and reserve money, and for the end-February 2008 structural assessment criterion on the excise tax law and recommends the completion of the second review under the PSI.**

Table 1. Mozambique: Selected Economic and Financial Indicators, 2006–2011 1/

	2006	2007		2008		2009	2010	2011
	Act.	Prog,	Act.	Prog,	Rev. Prog.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
Nominal GDP (millions of MT)	176,804	200,419	201,437	226,786	226,786	255,325	287,456	323,630
Nominal GDP growth	16.5	15.5	13.9	13.2	12.6	12.6	12.6	12.6
Real GDP growth	8.5	7.0	7.3	7.0	7.0	7.0	7.0	6.4
GDP per capita (in U.S. dollars)	355	378	386	410	453	474	512	553
Consumer price index (annual average)	13.2	7.9	8.2	5.7	7.3	5.5	5.3	5.1
Consumer price index (end of period)	9.4	8.0	10.3	5.5	6.0	5.2	5.1	5.1
External sector								
Merchandise exports	36.4	4.3	1.3	0.4	3.1	1.1	6.4	3.4
Merchandise exports, excluding megaprojects	41.3	1.2	-16.3	19.6	4.8	8.1	15.1	13.2
Merchandise imports	18.1	5.9	6.1	13.8	14.5	3.5	4.0	3.7
Merchandise imports, excluding megaprojects	8.3	11.5	8.7	18.5	18.4	1.9	3.4	3.9
Terms of trade	27.3	7.0	4.4	-11.7	-8.4	-7.0	-7.9	-7.0
Nominal effective exchange rate (end of period) 2/	-3.0	...	2.2	...	...	...	...	...
Real effective exchange rate (end of period) 2/	1.8	...	6.5	...	...	...	...	...
	(Annual changes in percent of beginning-of-period stock of money-M3, unless otherwise indicated)							
Money and credit /5								
Net foreign assets	31.3	18.5	14.3	10.5	14.8	3.5	3.6	3.4
Net domestic assets	-7.9	2.4	11.0	7.6	2.2	11.0	11.5	11.8
Of which : net credit to the government 3/	-9.6	0.6	6.1	-0.4	-3.1	-0.3	-0.5	-0.2
credit to the economy	14.3	10.8	7.8	10.3	12.1	13.0	13.5	13.4
Broad money-M3 (12-month percent change)	23.4	20.1	25.3	18.1	17.0	14.5	15.1	15.2
M2 (12-month percent change)	25.8	20.1	22.9	18.1	15.8	14.5	15.1	15.2
Velocity (GDP/M2)	5.1	4.8	4.7	4.6	4.6	4.5	4.4	4.3
Interest rate for 90-day treasury bills (percent; end of period)	16.0	...	14.8	...	...	...	...	...
	(Percent of GDP)							
Investment and saving								
Gross domestic investment	19.0	23.9	19.2	25.3	23.9	23.7	23.0	22.1
Government	12.0	16.7	12.1	17.8	16.6	16.2	15.3	14.5
Other sectors	6.9	7.2	7.1	7.4	7.3	7.5	7.7	7.7
Gross domestic savings (excluding grants)	3.1	3.2	2.8	2.5	3.1	3.5	4.5	4.8
Government	0.8	0.0	0.6	0.0	0.2	1.1	1.7	1.9
Other sectors	2.2	3.1	2.2	2.6	2.8	2.5	2.8	2.9
Current account, before grants	-15.9	-20.7	-16.4	-22.8	-20.8	-20.2	-18.5	-17.3
Government budget								
Total revenue	15.3	16.1	16.4	16.7	16.9	17.4	18.1	18.6
Total expenditure and net lending	27.5	34.4	29.0	36.7	35.1	34.5	33.4	32.6
Overall balance, before grants	-12.5	-18.3	-13.5	-20.0	-18.3	-17.0	-15.4	-14.1
Total grants	10.8	12.8	9.6	13.8	12.8	11.9	10.8	10.0
Overall balance, after grants	-1.7	-5.5	-3.9	-6.2	-5.5	-5.1	-4.5	-4.1
Domestic primary balance	-2.1	-3.3	-3.5	-3.5	-3.2	-3.1	-2.7	-2.6
Excluding bank restructuring	-2.1	-3.3	-3.5	-3.5	-3.2	-3.1	-2.7	-2.6
External financing (incl. debt relief) 4/	5.0	6.5	3.7	6.7	6.0	5.2	4.7	4.1
Net domestic financing	-3.3	-1.1	0.2	-0.5	-0.5	-0.1	-0.1	-0.1
Privatization 4/	0.0	0.1	0.0	0.1	0.1	0.0	0.0	0.0
	(Millions of U.S. dollars, unless otherwise indicated)							
Overall balance of payments	139	223	283	116	81	53	71	77
Net international reserves (end of period)	1,231	1,450	1,508	1,566	1,589	1,642	1,713	1,790
Gross international reserves (end of period)	1,241	1,464	1,524	1,581	1,605	1,658	1,729	1,806
In months of imports of goods and nonfactor services	4.4	4.7	5.0	4.5	4.6	4.6	4.6	4.6
In months of imports of goods and nonfactor services, excl. megaprojects	6.8	6.0	6.5	5.5	5.7	5.8	5.9	5.9
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports	7.3	8.2	8.2	8.1	7.9	8.1	8.2	8.3
Exchange rate (MT per U.S. dollar; end of period)	26.0		23.8					
Exchange rate (MT per U.S. dollar; per average)	25.0		25.7					

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

Note: Takes into account IMF delivery of MDRI in January 2006 and reflects changes in quantitative targets in line with projected program adjustors.

1/ 2004 and 2005 data incorporate revisions in GDP. Projections exclude several megaprojects such as the Moatize coal mine project, Cahora Bassa transfer, and Petroleum exploration.
2/ Minus sign indicates depreciation.
3/ Includes the issuance of government securities for the central bank recapitalization in years 2005-07.
4/ Includes movement in the government account set abroad with the proceed of the Moatize coal mine concession.
5/ Data from 2008 onwards based on data following technical revisions to monetary survey finalized in January 2008.

Table 2. Mozambique: Government Finances, 2006-2011

	2006	2007		2008		2009	2010	2011
	Act.	Prog,	Act.	Prog,	Rev. Prog.	Proj.	Proj.	Proj.
	(Millions of MT)							
Total revenue	26,997	32,274	33,058	37,773	38,239	44,527	51,903	60,053
Tax revenue	23,313	28,102	29,081	32,695	32,695	37,831	45,588	52,746
Taxes on income and profits	6,367	7,627	9,279	10,004	10,004	12,799	17,730	20,513
Taxes on goods and services	13,031	15,874	15,505	18,892	18,892	21,063	23,827	27,989
Of which : on petroleum products	1,830	2,545	2,258	3,155	3,155	3,396	3,635	4,206
Taxes on international trade	3,284	3,957	3,782	3,124	3,124	3,202	3,163	3,239
Other taxes	632	644	515	676	676	766	869	1,005
Nontax revenue	3,683	4,171	3,977	5,078	5,544	6,696	6,315	7,307
Total expenditure and net lending	48,546	68,896	58,448	83,220	79,713	88,041	96,129	105,566
Current expenditure	25,518	32,175	31,838	37,886	37,725	41,773	47,159	53,744
Compensation to employees	12,994	15,920	16,091	18,815	18,815	20,588	23,161	26,076
Goods and services	6,274	8,556	8,344	10,076	10,030	10,482	11,830	13,970
Interest on public debt	1,380	1,326	1,277	1,651	1,606	2,147	1,975	2,223
Domestic	916	889	872	1,122	1,122	1,481	1,285	1,447
External	464	437	404	529	483.9	667	689	776
Transfer payments	4,869	6,372	6,126	7,343	7,273	8,556	10,192	11,475
Domestic current primary balance	2,859	1,425	2,497	1,538	2,120	4,901	6,720	8,533
Capital expenditure	21,292	33,374	24,314	40,450	37,536	41,439	43,907	46,872
Grant finance projects	4,220	11,272	6,641	12,860	11,764	12,413	12,690	12,950
Projet loans	5,172	6,607	3,976	7,576	6,497	6,856	7,008	7,152
Locally financed	6,102	8,235	7,944	9,612	9,612	13,006	14,841	17,209
Grant-financed special programs	4,164	5,384	3,699	8,555	7,891	8,272	8,457	8,630
Direct financing	1,185	908	849	923	849	891	911	930
Expenditure financed with fund for the concession mine of Tete	450	968	1,204	923	923	0	0	0
Net lending	1,736	3,348	2,296	4,884	4,453	4,829	5,063	4,950
Lending to Public Enterprises	1,760	3,503	2,475	5,061	4,629	5,031	5,293	5,208
Locally financed	-24	-156	-179	-176	-176	-201	-230	-259
Domestic primary balance, before grants, above the line 1/	-3,218	-6,654	-5,268	-7,897	-7,316	-7,903	-7,892	-8,417
Unallocated revenue (+)/expenditure (-) /2	-507	0	-1,775	0	0	0	0	0
Overall balance, before grants (below the line)	-22,056	-36,623	-27,165	-45,447	-41,475	-43,514	-44,225	-45,512
Grants received	19,124	25,618	19,268	31,334	28,969	30,487	31,166	32,269
Project	9,569	17,564	11,189	22,338	20,504	21,577	22,057	22,511
Investment Projects	4,220	11,272	6,641	12,860	11,764	12,413	12,690	12,950
Special programs	4,164	5,384	3,699	8,555	7,891	8,272	8,457	8,630
Direct Investment	1,185	908	849	923	849	891	911	930
Nonproject	5,940	8,054	8,079	8,996	8,466	8,910	9,108	9,759
MDRI assistance via the central bank 3/	3,615	0	0	0	0	0	0	0
Overall balance, after grants	-2,932	-11,005	-7,897	-14,113	-12,505	-13,027	-13,060	-13,243
Central bank transfer of HIPC Initiative assistance by the IMF	0	0	42	0	0	0	0	0
Net external financing	8,767	13,012	7,473	15,193	13,586	13,206	13,482	13,411
Disbursements	9,401	12,773	8,290	15,275	13,582	14,478	14,950	15,065
Project	5,172	6,607	3,976	7,576	6,497	6,856	7,008	7,152
Nonproject	4,229	6,166	4,313	7,699	7,085	7,622	7,942	7,912
Budget Support	3,024	2,567	2,595	2,638	2,456	2,592		
Loan to Public Enterprises	1,205	3,599	1,718	5,061	4,629	5,031	5,293	5,208
Cash amortization	-1,084	-730	-817	-1,006	-919.9	-1,272	-1,468	-1,653
Investment abroad 4/	450	968	0	923	923	0	0	0
Net domestic financing 5/	-5,835	-2,111	382	-1,202	-1,202	-179	-422	-168
Of which: MDRI from the IMF	-3,615							
Privatization	0	104	0	122	122	0	0	0
Memorandum items:								
Domestic primary balance, before grants, below the line 1/	-3,725	-6,654	-7,043	-7,897	-7,316	-7,903	-7,892	-8,417
Grants and loan disbursements	28,525	38,391	27,558	46,609	42,551	44,965	46,116	47,334
Bonds issuance for strengthening the BM's balance sheet	1,501	1,500	1,500	0	0	0	0	
Nominal GDP	176,804	200,419	201,437	226,786	226,786	255,325	287,456	323,630

Table 2. Mozambique: Government Finances, 2006-2011 (cont.)

	2006	2007		2008		2009	2010	2011
	Act.	Prog,	Act.	Prog,	Rev. Prog.	Proj.	Proj.	Proj.
	(Percent of GDP, unless otherwise specified)							
Total revenue	15.3	16.1	16.4	16.7	16.9	17.4	18.1	18.6
Tax revenue	13.2	14.0	14.4	14.4	14.4	14.8	15.9	16.3
Taxes on income and profits	3.6	3.8	4.6	4.4	4.4	5.0	6.2	6.3
Taxes on goods and services	7.4	7.9	7.7	8.3	8.3	8.2	8.3	8.6
Of which : on petroleum products	1.0	1.3	1.1	1.4	1.4	1.3	1.3	1.3
Taxes on international trade	1.9	2.0	1.9	1.4	1.4	1.3	1.1	1.0
Other taxes	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	2.1	2.1	2.0	2.2	2.4	2.6	2.2	2.3
Total expenditure and net lending	27.5	34.4	29.0	36.7	35.1	34.5	33.4	32.6
Current expenditure	14.4	16.1	15.8	16.7	16.6	16.4	16.4	16.6
Compensation to employees	7.3	7.9	8.0	8.3	8.3	8.1	8.1	8.1
Goods and services	3.5	4.3	4.1	4.4	4.4	4.1	4.1	4.3
Interest on public debt	0.8	0.7	0.6	0.7	0.7	0.8	0.7	0.7
Domestic	0.5	0.4	0.4	0.5	0.5	0.6	0.4	0.4
External	0.3	0.2	0.2	0.2	0.2	0.3	0.2	0.2
Transfer payments	2.8	3.2	3.0	3.2	3.2	3.4	3.5	3.5
Domestic current primary balance	1.6	0.7	1.2	0.7	0.9	1.9	2.3	2.6
Capital expenditure	12.0	16.7	12.1	17.8	16.6	16.2	15.3	14.5
Grant finance projects	2.4	5.6	3.3	5.7	5.2	4.9	4.4	4.0
Projet loans	2.9	3.3	2.0	3.3	2.9	2.7	2.4	2.2
Locally financed	3.5	4.1	3.9	4.2	4.2	5.1	5.2	5.3
Grant-financed special programs	2.4	2.7	1.8	3.8	3.5	3.2	2.9	2.7
Direct financing	0.7	0.5	0.4	0.4	0.4	0.3	0.3	0.3
Expenditure financed with fund for the concession mine of Tete	0.3	0.5	0.6	0.4	0.4	0.0	0.0	0.0
Net lending	1.0	1.7	1.1	2.2	2.0	1.9	1.8	1.5
Lending to Public Enterprises	1.0	1.7	1.2	2.2	2.0	2.0	1.8	1.6
Locally financed	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic primary balance, before grants, above the line 1/	-1.8	-3.3	-2.6	-3.5	-3.2	-3.1	-2.7	-2.6
Unallocated revenue (+)/expenditure (-) /2	-0.3	0.0	-0.9	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants (below the line)	-12.5	-18.3	-13.5	-20.0	-18.3	-17.0	-15.4	-14.1
Grants received	10.8	12.8	9.6	13.8	12.8	11.9	10.8	10.0
Project	5.4	8.8	5.6	9.8	9.0	8.5	7.7	7.0
Investment Projects	2.4	5.6	3.3	5.7	5.2	4.9	4.4	4.0
Special programs	2.4	2.7	1.8	3.8	3.5	3.2	2.9	2.7
Direct Investment	0.7	0.5	0.4	0.4	0.4	0.3	0.3	0.3
Nonproject	3.4	4.0	4.0	4.0	3.7	3.5	3.2	3.0
MDRI assistance via the central bank 3/	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, after grants	-1.7	-5.5	-3.9	-6.2	-5.5	-5.1	-4.5	-4.1
Central bank transfer of HIPC Initiative assistance by the IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	5.0	6.5	3.7	6.7	6.0	5.2	4.7	4.1
Disbursements	5.3	6.4	4.1	6.7	6.0	5.7	5.2	4.7
Project	2.9	3.3	2.0	3.3	2.9	2.7	2.4	2.2
Nonproject	2.4	3.1	2.1	3.4	3.1	3.0	2.8	2.4
Budget Support	1.7	1.3	1.3	1.2	1.1	1.0	0.0	0.0
Loan to Public Enterprises	0.7	1.8	0.9	2.2	2.0	2.0	1.8	1.6
Cash amortization	-0.6	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5
Investment abroad 4/	0.3	0.5	0.0	0.4	0.4	0.0	0.0	0.0
Net domestic financing 5/	-3.3	-1.1	0.2	-0.5	-0.5	-0.1	-0.1	-0.1
Of which: MDRI from the IMF	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization	0.0	0.1	0.0	0.1	0.1	0.0	0.0	0.0
Memorandum items:								
Domestic primary balance, before grants, below the line 1/	-2.1	-3.3	-3.5	-3.5	-3.2	-3.1	-2.7	-2.6
Grants and loan disbursements	16.1	19.2	13.7	20.6	18.8	17.6	16.0	14.6
Bonds issuance for strengthening the BM's balance sheet	0.8	0.7	0.7	0.0	0.0	0.0	0.0	0.0
Nominal GDP (million of MT)	176,804.0	200,419.2	201,436.7	226,786.1	226,786.0	255,325.2	287,455.9	323,630.0

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

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

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

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

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

5/ Excludes recapitilization bonds issued to the Bank of Mozambique.

Table 3. Mozambique: Monetary Survey, 2006–2011 /1
(Millions of MT, unless otherwise stated)

	2006	2007			2008		2009	2010	2011
	Act./1	Prog. /2	Act./2	Act./3	Prog. /2	Rev. Prog./3	Proj./3	Proj./3	Proj./3
Central bank									
Net foreign assets	34,348	40,230	37,124	37,654	43,400	42,154	44,448	47,253	50,313
(millions of U.S. dollars)	1,323	1,531	1,559	1,569	1,612	1,642	1,695	1,766	1,843
Net international reserves	31,912	38,093	35,901	36,404	42,152	40,807	43,072	45,850	48,881
(millions of U.S. dollars)	1,231	1,450	1,508	1,528	1,566	1,589	1,642	1,713	1,790
Net domestic assets	-19,612	-23,326	-19,241	-19,832	-24,066	-23,220	-23,237	-23,366	-23,385
Credit to government (net) /4	-17,433	-19,454	-18,585	-18,900	-19,194	-19,596	-18,715	-16,976	-16,976
Credit to banks (net)	552	-26	-85	92	-24	92	109	117	130
Credit to the economy	16	16	16	308	16	308	308	308	308
Other items (net; assets +)	-2,747	-3,862	-586	-1,333	-4,864	-4,024	-4,940	-5,864	-6,848
Reserve money	14,736	16,904	17,822	17,822	19,334	18,934	21,211	23,887	26,928
Currency in circulation	8,789	10,133	10,942	10,942	11,486	11,659	12,971	14,450	16,164
Bank Deposits in BM	5,947	6,771	6,880	6,880	7,848	7,275	8,240	9,437	10,763
Required reserves	6,090	6,377	6,535	6,535	7,448	6,875	7,840	9,037	10,363
Free reserves	-143	394	345	345	400	400	400	400	400
Deposit money banks									
Net foreign assets	13,618	17,663	18,514	17,334	21,292	22,733	23,219	23,692	24,175
(millions of U.S. dollars)	524	672	777	717	791	885	885	885	885
Net domestic assets	32,816	38,688	39,663	40,214	45,610	46,085	55,253	66,870	80,007
Banks' reserves	7,687	8,470	8,751	8,751	9,720	9,274	9,795	10,950	11,875
Credit to central bank (net)	-209	26	-115	-5	24	-92	-109	-117	-130
Credit to government (net)	5,823	8,161	10,270	8,968	7,620	7,605	6,525	5,297	4,157
Credit to the economy	27,398	33,186	31,595	30,570	39,868	38,711	48,941	61,113	74,959
Of which: in foreign currency	8,759	7,651	8,452	7,532	7,974	7,742	8,565	10,695	13,118
(in millions of U.S. dollars)	337	291	355	311	296	302	327	400	480
Other items (net; assets +)	-7,883	-11,155	-10,838	-8,070	-11,621	-9,413	-9,899	-10,372	-10,855
Deposits	46,434	56,352	58,177	57,548	66,902	68,818	78,472	90,562	104,181
Demand and savings deposits	31,240	37,239	36,888	36,813	44,462	45,803	52,146	60,237	69,246
Time deposits	15,194	19,113	21,289	20,735	22,440	23,015	26,327	30,325	34,936
Monetary survey									
Net foreign assets	47,966	57,894	55,637	54,989	64,691	64,887	67,667	70,945	74,488
Net domestic assets	5,620	6,892	11,551	12,111	11,824	13,591	22,221	32,554	44,746
Domestic credit	15,803	21,909	23,296	20,947	28,310	27,027	37,059	48,790	62,449
Credit to government (net)	-11,610	-11,293	-8,315	-9,931	-11,574	-11,991	-12,189	-12,631	-12,818
Credit to government (net) Prog.	-9,449	-11,560	-9,067	-10,415	-12,760	-11,617	-11,796	-12,218	-12,387
Credit to government (net flows) Prog.	-5,835	-2,111	382	-646	-1,200	-1,201	-179	-422	-168
Credit to the economy	27,414	33,202	31,611	30,878	39,884	39,019	49,249	61,421	75,267
Of which: in foreign currency	8,759	7,977	8,452	7,532	5,103	7,804	8,619	10,749	10,442
Other items (net; assets +)	-10,183	-15,016	-11,745	-8,836	-16,486	-13,437	-14,839	-16,236	-17,702
Money and quasi money (M3)	53,586	64,786	67,127	67,099	76,516	78,477	89,888	103,499	119,234
Foreign currency deposits	18,809	23,032	24,384	24,326	27,214	28,941	33,149	38,169	43,971
(in millions of U.S. dollars)	724	876	1,024	1,021	1,011	1,127	1,264	1,426	1,610
M2	34,777	41,754	42,743	42,774	49,301	49,536	56,739	65,331	75,263
Currency outside banks	7,152	8,434	8,950	8,950	9,614	9,660	11,416	12,937	15,053
Deposits	46,434	56,352	58,177	58,149	66,902	68,818	78,472	90,562	104,181
Domestic currency deposits	27,625	33,320	33,793	33,823	39,688	39,877	45,323	52,393	60,210
Of which: foreign currency deposits	18,809	23,032	24,384	24,326	27,214	28,941	33,149	38,169	43,971
Memorandum items:									
(percent change of beginning period M3)									
Net foreign assets	31.3	18.5	14.3	13.4	10.5	14.8	3.5	3.6	3.4
Net domestic assets	-7.9	2.4	11.0	9.6	7.6	2.2	11.0	11.5	11.8
Credit to government (net)	-9.6	0.6	6.1	3.1	-0.4	-3.1	-0.3	-0.5	-0.2
Credit to the economy	14.3	10.8	7.8	8.0	10.3	12.1	13.0	13.5	13.4
Other items (net; asset +)	-12.5	-9.0	-2.9	-1.6	-2.3	-6.9	-1.8	-1.6	-1.4
M3 (percent change)	23.4	20.9	25.3	23.0	18.1	17.0	14.5	15.1	15.2
M2 (percent change)	25.8	20.1	22.9	19.9	18.1	15.8	14.5	15.1	15.2
M3 (percent of GDP)	30.3	32.3	33.3	33.3	33.7	34.6	35.2	36.0	36.8
M2 (percent of GDP)	19.7	20.8	21.2	21.2	21.7	21.8	22.2	22.7	23.3
Credit to the economy (percent change)	29.2	21.1	15.3	16.6	20.1	26.4	26.2	24.7	22.5
Credit to the economy (percent of GDP)	15.5	16.6	15.7	15.3	17.6	17.2	19.3	21.4	23.3
Currency outside banks (percent of M3)	13.3	13.0	13.3	13.3	12.6	12.3	12.7	12.5	12.6
Foreign currency deposits (percent of M3)	35.1	35.6	36.3	36.3	35.6	36.9	36.9	36.9	36.9
Reserve money (percent change)	20.9	14.7	20.9	20.9	14.4	6.2	12.0	12.6	12.7
Money multiplier (M2/reserve money)	2.4	2.5	2.4	2.4	2.6	2.6	2.7	2.7	2.8
Velocity (GDP/M3)	3.3	3.1	3.0	3.0	3.0	2.9	2.8	2.8	2.7
Velocity (GDP/M2)	5.1	4.8	4.7	4.7	4.6	4.6	4.5	4.4	4.3

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

1/ Following the adoption of a Chart of Accounts in line with the IFRS, the monetary survey was revised back to January 1997 to incorporate more detailed information provided by banks regarding the residency and use of monetary instruments. As a result, deposit standing facilities previously included as part of base money are now excluded.

2/ Based on data prior to the technical revisions to the monetary survey in January 2008.

3/ Based on data after the technical revisions to the monetary survey in January 2008.

4/ Includes MDRI assistance which was transferred to a government blocked deposit account at the BM. The balance is being drawn down by 0.5 percent of GDP per annum in line with an agreed increase in MDRI-financed government expenditures.

Table 4. Mozambique: Balance of Payments, 2006–2011
(Millions of U.S. dollars, unless otherwise specified)

	2006	2007		2008		2009	2010	2011
	Act.	Prog.	Act.	Prog.	Rev. Prog.	Proj.	Proj.	Proj.
Trade balance	-533	-602	-681	-1,017	-1,052	-1,149	-1,136	-1,184
Exports, f.o.b.	2,381	2,483	2,412	2,494	2,488	2,515	2,676	2,768
Megaprojects	1,699	1,793	1,841	1,669	1,889	1,867	1,931	1,942
Other exports	682	690	571	825	599	647	745	825
Imports, c.i.f.	-2,914	-3,085	-3,093	-3,511	-3,540	-3,664	-3,811	-3,951
Megaprojects	-701	-618	-688	-586	-693	-764	-812	-834
Other imports	-2,213	-2,468	-2,404	-2,925	-2,847	-2,900	-2,999	-3,117
Services and incomes (net)	-592	-1,005	-605	-940	-901	-876	-907	-924
Receipts	558	560	684	593	693	710	743	771
Expenditures	-1,150	-1,565	-1,289	-1,533	-1,594	-1,586	-1,650	-1,695
Of which : interest on public debt	-19	-16	-16	-21	-21	-31	-42	-52
Current account, before grants	-1,125	-1,607	-1,286	-1,957	-1,954	-2,025	-2,043	-2,107
Unrequited official transfers	2,570	1,023	790	1,223	1,244	1,251	1,239	1,581
Of which: MDRI relief from the IMF	120	0	0	0	0	0	0	0
MDRI relief from IDA	1,319	0	0	0	0	0	0	0
MDRI relief from AfDF	465	0	0	0	0	0	0	0
Of which : HIPC grant from the IMF	34	0	0	0	0	0	0	0
Current account, after grants 1/	1,445	-584	-496	-733	-710	-775	-804	-526
Capital account	-1,422	807	752	850	791	828	875	603
Trade credit (net)	-32	0	0	0	0	0	0	0
Foreign borrowing	603	752	1,464	848	832	954	999	1,019
Public (including IMF)	370	494	325	579	563	569	574	567
Private 2/	233	258	1,139	269	269	386	425	452
Amortization	-2,147	-320	-1,140	-326	-406	-447	-472	-507
Public	-1,954	-30	-32	-16	-16	-18	-19	-23
Of which: IMF 3/	-154	0	0	0	0	0	0	0
Private 4/	-193	-290	-1,108	-310	-390	-429	-453	-483
Direct investment (net) 5/	154	321	427	343	457	489	524	557
Other investment of the government 6/	0	0	0	0	0	0	0	0
Short-term capital and errors and omissions (net)	115	0	27	0	0	0	0	0
of which change in commercial bank NFA (- = increase)	182	148	253	119	108	0	0	0
Overall balance	139	223	283	116	81	53	71	77
Financing	-139	-223	-283	-116	-81	-53	-71	-77
Of which : Bank of Mozambique gross reserve assets (increase -)	-139	-223	-283	-116	-81	-53	-71	-77
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Use of Fund credit (net)	-149	2	2	0	0	0	0	-2
Current account deficit (percent of GDP)								
Before grants	15.9	20.7	16.4	22.8	20.8	20.2	18.5	17.3
After grants	-20.4	7.5	6.3	8.5	7.6	7.7	7.3	4.3
Net international reserves 7/	1,231	1,450	1,508	1,566	1,589	1,642	1,713	1,790
Gross international reserves	1,241	1,464	1,524	1,581	1,605	1,658	1,729	1,806
In months of imports of GNFS	4.4	4.7	5.0	4.5	4.6	4.6	4.6	4.6
In months of imports of GNFS, excluding megaprojects	6.8	6.0	6.5	5.5	5.7	5.8	5.9	5.9
In months of imports of goods and nonfactorservices, excl. megaprojects and foreign financed capital imports	7.3	8.2	8.2	8.1	7.9	8.1	8.2	8.3

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

1/ Since this presentation still follows the fourth balance of payments manual, MDRI and HIPC grants from the IMF are included in the current account.
2/ Private borrowing, not guaranteed by the government or the Bank of Mozambique. Includes HCB borrowing in 2007.
3/ The large amortization in 2006 reflects the repayment of IMF debt with MDRI resources.
4/ Includes HCB amortization in 2007.
5/ Projections are underestimated due to lack of information on new megaproject investments.
6/Tracks the movements in the government account set up abroad with the proceeds of the coal mine concession.
7/ Based on the new monetary survey from 2008.

Table 5. Mozambique: Balance of Payments of Megaprojects, 2006–11 1/
(Millions of dollars)

	2006 Act.	2007 Act.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.
Trade balance	998	1,152	1,196	1,103	1,119	1,108
Exports, f.o.b.	1,699	1,841	1,889	1,867	1,931	1,942
Imports, c.i.f.	-701	-688	-693	-764	-812	-834
Services and incomes (net)	-702	-801	-980	-947	-987	-1,004
Current account, before grants	295	351	216	156	132	104
Current account, after grants	295	351	216	156	132	104
Capital account	30	-67	34	199	247	99
Foreign borrowing	114	883	151	261	294	312
Amortization	-129	-989	-267	-266	-296	-329
Direct investment (net)	46	39	151	204	250	115
Overall balance before short-term capital inflows 2/	326	284	250	355	379	203

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

1/ Megaprojects include Mozal (aluminum production); Sasol (gas production and pipeline); the Cahora-Bassa dam (hydro-power); and two titanium ore projects.

2/ This line significantly overestimates the contribution of megaprojects to international reserve accumulation, because most of their financial operations are conducted outside the domestic banking system. Only a small fraction of foreign exchange proceeds are actually repatriated in Mozambique. However, information on the latter is not available.

Table 6. Mozambique: Expenditure in PARPA Priority Sectors, 2006-2009 1/

(Millions of meticais, unless otherwise indicated)

	2006 Est.	2007 Est.	2008 Proj.	2009 Proj.
Total revenues	26,997	33,058	38,239	44,527
Total expenditure, excluding bank restructuring costs and net lending	46,810	56,152	75,261	83,212
Total expenditure (excl.bank restruct. costs, net lending, and interest payments)	45,430	54,875	73,655	81,065
Interest payments on public debt	1,380	1,277	1,606	2,147
Total expenditure in PARPA priority sectors	29,575	33,734	51,116	57,070
in percent of GDP	16.7	16.7	22.5	22.4
in percent of total expenditure (excl. bank restruct costs, net lending, and interest payments)	65.1	61.5	69.4	70.4
Education	9,109	12,145	13,552	17,186
Health	6,628	7,351	9,501	9,728
Infrastructure development	7,435	7,538	12,890	11,187
Agriculture and rural development	1,522	1,920	5,524	5,269
Governance and judicial system	5,671	4,262	6,334	8,025
Other priority areas	510	518	3,314	1,946
Total PARPA expenditures in percent of GDP				
Education	5.2	6.0	6.0	6.7
Health	3.7	3.6	4.2	3.8
Infrastructure development	4.2	3.7	5.7	4.4
Governance and judicial system	3.2	2.1	2.8	3.1
Other priority areas	0.3	0.3	1.5	0.8
Total PARPA expenditures in percent of total expenditures				
Education	20.1	22.1	18.4	21.2
Health	14.6	13.4	12.9	12.0
Infrastructure development	16.4	13.7	17.5	13.8
Agriculture and rural development	3.4	3.5	7.5	6.5
Governance and judicial system	12.5	7.8	8.6	9.9
Other priority areas	1.1	0.9	4.5	2.4

Source: Mozambican authorities (Ministry of Finance); and staff estimates and projections.
1/ PARPA stands for National Action Plan for the Reduction of Absolute Poverty.

Table 7. Mozambique: Financial Soundness Indicators for Banking Sector, 2001–07
(Percent unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007
Capital adequacy							
Regulatory capital to risk-weighted assets	5.49	14.01	17.03	18.65	16.00	12.53	14.21
Regulatory Tier I capital to risk-weighted assets	6.03	11.97	14.67	15.97	13.57	10.72	12.32
Capital (net worth) to assets	8.22	9.42	9.01	9.51	8.04	6.06	6.35
Asset composition and quality							
Sectoral distribution of loans to total loans							
Agriculture	18.00	15.00	12.73	9.45	8.49	6.39	9.42
Industry	25.00	22.00	16.94	11.94	16.77	22.15	19.51
Construction	4.00	4.00	5.20	3.35	4.13	5.64	5.74
Commerce	20.00	17.00	18.13	21.29	27.36	27.40	24.44
Transportation and communication	7.00	5.00	7.08	7.19	5.83	6.15	12.18
Other	27.00	36.00	37.14	36.18	35.05	32.27	28.7
of which: Private 2/			7.63	12.12	13.03	13.54	14.38
Housing			7.10	8.18	4.24	4.07	3.69
Diverse 3/			22.41	15.87	17.78	14.66	10.63
Foreign exchange loans to total loans	64.69	69.87	70.77	67.33	63.91	45.04	29.68
Nonperforming loans to gross loans 4/	23.43	21.98	14.43	6.42	3.82	3.26	2.62
Nonperforming loans net of provisions to capital 4/	11.00	9.39	7.91	1.70	0.89	2.17	0.16
Earnings and profitability							
Return on assets	0.14	1.59	1.24	1.43	1.81	3.51	3.46
Return on equity	3.51	22.10	16.29	18.73	27.42	55.39	47.69
Interest margin to gross income	10.22	61.39	56.83	60.15	58.01	63.07	49.39
Noninterest expenses to gross income	16.92	67.03	72.18	71.24	65.85	54.10	43.7
Personnel expenses to noninterest expenses	51.71	44.67	45.68	45.21	45.35	44.35	45.02
Trading and fee income to gross income	33.09	39.68	45.49	41.87	43.78	32.15	47.48
Spread between reference loan and deposit rates (90 days, local currency)	14.00	19.00	17.39	14.67	11.48	14.57	11.43
Funding and liquidity							
Liquid assets to total assets 5/	34.64	53.93	57.74	58.12	55.52	51.87	55.9
Customer deposits to total (non-interbank) loans	217.00	240.00	227.97	283.07	191.90	179.34	191.81
Foreign exchange liabilities to total liabilities	63.30	61.26	46.39	41.38	45.26	42.75	43.88

Source: Bank of Mozambique (BM).

1/ Data as of September 2007.
2/ Includes credit cards and consumer credit lines for vehicle and durable goods.
3/ Includes credit to all other sectors not discriminated above or yet to be identified.
4/ Nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).
5/ Includes deposits at parent banks.

Table 8. Mozambique: Indicators of External Vulnerability, 2002-07
(percent of GDP, unless otherwise indicated)

	2002	2003	2004	2005	2006	2007
Financial indicators						
Net present value of public sector debt 1/	21.3	25.8	26.9	26.3	10.0	12.6
Broad money (percent change, 12-month basis)	21.5	18.7	5.9	27.1	23.4	25.3
Private sector credit (percent change, 12-month basis)	4.2	-1.4	-5.6	57.0	29.2	15.3
External indicators						
Exports of goods (percent change, 12-month basis in U.S. dollars)	15.2	28.9	44.1	16.1	36.4	1.3
Imports of goods c.i.f. (percent change, 12-month basis in U.S. dollars)	45.1	12.8	16.9	21.2	18.1	6.1
Terms of trade (percent change, 12-month basis)	-3.7	-1.3	9.4	5.3	27.3	4.4
Current account balance (after grants)	-9.7	-9.4	-5.4	-9.8	18.7	-6.3
Capital and financial account balance	20.7	9.3	5.9	5.3	-20.1	9.6
Of which : foreign direct investment (net)	9.0	7.3	4.3	1.6	2.2	5.4
Gross international reserves (in millions of U.S. dollars)	825	988	1,160	1,103	1,241	1,524
(In months of imports of goods and services)	5.4	5.4	5.8	4.6	4.4	5.0
(In months of imports of goods and services, excluding megaprojects)	7.6	6.8	7.0	5.7	6.8	6.5
Net international reserves (in millions of U.S. dollars)	625	779	961	943	1,231	1,508
Net international reserves (in percent of foreign currency deposits)	129	145	158	144	170	147
Net foreign assets of commercial banks (in millions of U.S. dollars)	342	306	264	342	524	777
Total short-term external debt to reserves (in percent)	8.4	7.6	4.9	7.3	3.1	2.6
Net present value of total external debt 1/	21.3	25.8	26.9	26.3	10.0	12.6
Of which : net present value of public sector external debt 1/	22	25	8	18	18	19
Net present value of public external debt-to-exports of goods and services (in percent) 1/	92	102	92	108	63	55
Public external debt-service payments to exports of goods and services (in percent) 2/	3.0	3.9	3.4	2.0	1.2	1.1
Exchange rate (MT per U.S. dollar; end of period) 3/	23.9	23.9	18.9	24.2	26.0	23.8
REER depreciation (-) (12 month basis)	-14.3	-8.5	17.5	-6.3	1.8	6.5

Sources: Mozambican authorities; and IMF staff estimates.

1/ Historical NPV estimates are based on previous debt sustainability analyses.

2/ Cash interest and amortization payments, after HIPC assistance.

3/ Official exchange rate.

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

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

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

1/ Figures in italics refer to periods other than those specified.

2/ A household survey was conducted between 1996–97 and 2002–03 to determine poverty incidence. The methodology included a basket of goods that satisfies basic calorie needs. The cost of this basket represents the food poverty line in each domain; a nonfo

APPENDIX I

Maputo, Mozambique
March 31, 2008

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

Dear Mr. Strauss-Kahn:

1. The Government of Mozambique is implementing a financial and economic program with support from the Fund through its Policy Support Instrument (PSI). We recently held discussions with the Fund staff on the second review of our PSI supported program. On behalf of the Government, we hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP). This document reviews recent economic developments, progress in the implementation of our 2007/08 objectives and policies, and sets out the policies that are consistent with our *Plano de Acção para a Redução da Pobreza Absoluta II* (PARPA II) and that the Government intends to pursue covering the period 2008-2010. The attached technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. Overall, implementation of the 2007 program has been satisfactory through December 2007. However, two quantitative assessment criteria (ACs) for end-December 2007 and one structural AC through end-February 2008 were missed. The end-December 2007 AC for base money was missed by a narrow margin because of an unanticipated and temporary increase in money demand over the festivity season. The adjusted Net credit to the Government (NCG) at end-December was higher by 0.8 percent of GDP mainly due to a shortfall in net foreign financing. In addition, net lending to public enterprises exceeded available external financing. The Government has decided to strengthen the monitoring of the transfers of public enterprises and to revise the pubic enterprise law to avoid recurrences of such slippages in the future. The structural AC related to submission to Parliament of the excise tax on alcoholic beverages, beer, and tobacco is delayed from February to May 2008, due to the need to draft a more comprehensive law. In light of the progress achieved and the measures taken in the implementation of the program, the Government of Mozambique requests waivers for the non-observance of the two quantitative ACs and the structural AC and the completion of the second review under the PSI.

3. The Government is committed to pay due regard to fiscal sustainability to avoid jeopardizing macroeconomic stability in the design of the reform of the new public sector salary policy and the National Institute of Social Security (INSS). In order to boost private sector development the Council of Ministers adopted a new medium-term strategy to reduce the cost of doing business and decided to start developing actions aimed to meet the steps necessary for the official declaration of Government to adhere to the Extractive Industry Transparency Initiative (EITI) in the course of 2008. In addition, Mozambique's credit rating by Standards and Poor was upgraded from BB to B+ (with stable outlook).

4. Looking ahead, the policies set out in the MEFP continue to aim at consolidating macroeconomic stability and sustain strong broad-based growth through a second wave of reforms in order to achieve the Millennium Development Goals (MDGs). The ACs for Net International Reserves (NIR) and reserve money for end-June 2008 for the third review (expected to be completed by end-December 2008) were modified. For end-June 2008, the NIR AC was modified to take into account technical revisions to the monetary survey, the AC on base money to take into account the reduced legal reserve requirement for banks, and the AC on NCG to take into account the revised schedule of disbursements of foreign program assistance, as set out in Table 1. Our PSI supported program also proposes ACs for end-December 2008 for the fourth review, which is expected to be completed by June 2009. Our Technical Memorandum of Understanding has been updated. The adjuster on base money related to currency issued by Bank of Mozambique has been modified to take into account the seasonal increase in demand for currency during the festive season in the fourth quarter of the year.

5. The Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement following the approval of the new foreign exchange law which was submitted to the Assembly in September 2007, and issuance of related regulations. The Government remains committed to a flexible exchange rate regime.

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

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

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

Attachment I

Memorandum of Economic and Financial Policies of the Government of Mozambique for the Second Review of the PSI Supported-Program (March 2008–June 2010)

March 31, 2008

1. The Government of Mozambique is committed to continuing to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and a second wave of structural reforms. The strategy to achieve these goals is set out in the *Plano de Acção Para a Redução da Pobreza Absoluta II* (PARPA II) for wh ich a Joint Staff Advisory Note was approved by the Boards of the International Monetary Fund (IMF) and World Bank (WB) in December 2006. The current Government's economic program is supported by the IMF with a three-year Policy Support Instrument (PSI) approved on June 18, 2007. This Memorandum of Economic and Financial Policies (MEFP) reviews the performance under the PSI program through March 2008 and describes the policies and targets for the rest of 2008.

I. Recent Performance and Policy Under the PSI-Supported Program

2. In 2007, economic performance remained strong despite exogenous shocks. The 7.3 percent increase in real GDP is higher than targeted. Thanks to prudent monetary policies, core (nonfood and energy) inflation was contained to 5.1 percent and average head line inflation declined from 13.2 percent in 2006 to 8.2, albeit somewhat higher than programmed on account of international food and oil prices. In January 2008, the Bank of Mozambique (BM) reduced interest rates on its lending and deposit standing facilities from 15.5 to 14.5 and from 10.5 to 10.25 percent respectively. End-December net international reserves (NIR) exceeded the program target despite a deceleration in traditional exports.

3. In response to the floods and a cyclone, which affected part of Mozambique in early 2008, the Government, with foreign aid, is assisting the affected population. Over 100,000 people had to be moved to resettlement centers and measures were taken to contain a cholera pandemic. The UN has launched a funding appeal to the donor community to cover the reconstruction plans. The Government may consider using the program adjustor to accommodate emergency fiscal outlays (up to a maximum of about MT500 million) in the event that donor financing is inadequate. In early February, a large increase in negotiated transportation fares for private minibuses resulted in riots in a number of cities. The Government revoked the increase and agreed to temporarily subsidize fuel for minibus operators (at a cost of 0.15 percent of GDP).

4. The Bank of Mozambique (BM) has continued to strengthen its monetary and exchange rate policy and operations. Interest rates on government securities and the exchange rate have continued to be market determined. The spread between exchange rates quoted on the interbank market and by banks nevertheless remained stable at around 1 percent, while the real effective exchange rate has appreciated by about 6.5 percent, in line with fundamentals and increased private inflow of capital.

5. On the fiscal side, revenues were higher than targeted due to buoyant direct domestic taxes (0.4 percent of GDP), while current expenditures were in line with the program. However, investment expenditures were substantially lower than envisaged (4.6 percent of GDP) on account of a significant shortfall in the disbursement of external financing, including from the Health Common Fund. The share of priority spending was about 62 percent (below the 65 percent target) due to the low execution rate of the donor-financed projects. Overall, the adjusted Net credit to the government (NCG) at end-December was higher by 0.8 percent of GDP mainly due to a shortfall in net foreign financing. In addition, net lending to public enterprises exceeded available external financing.

6. A number of administrative tax measures have been implemented to improve the operational capacity of the central revenue authority (AT) and increase tax collection by (i) the approval of regulating decrees on hiring and payment of AT staff; (ii) an intensified staff training program; (iii) the implementation of a performance measurement system since January 2008. As part of the IT Master Plan (PDTI), a revised version of the Business Case (BC) for a revenue collection network (e-Tributação) has been elaborated in February and has been submitted for approval to the Partnership Committee. A study on operationalizing the "electronic one-stop-window" through an integrated IT system that incorporates customs and tax IT systems has been completed in December 2007 and is ready to be implemented in the course of 2008, subject to funding from the international donor community. Construction of the first one-stop border will start in June 2008, which will lead to increased operating efficiencies, including reduction of release times of imported goods to one hour at the most important border crossing in Mozambique. At secondary borders, the Customs Directorate reduced the average release time of goods from two to one hour (for 70 percent of imports). The number of taxpayers increased by 190,019—or nearly double the target for 2007—to a total number of 587,205. New fiscal collection sites (postos de cobrança) are being created to bring AT closer to the taxpayers and tax declaration forms are being simplified. The audit function has been strengthened significantly, with 958 audits realized in 2007—or over 40 percent more than targeted. In support of AT's medium-term development 2007–2010, a multi-donor Tax Reform Common Fund was established in December 2007.

7. In the area of tax policy, Parliament approved a new income (personal and corporate) and value added tax (VAT) codes in December 2007. The new VAT-code eliminates VAT exemptions on industrial and commercial rents for industrial purposes, introduces partial exemptions for public works such as roads, bridges and dams as a transitory solution, while maintaining exemptions for the sugar, vegetable oil and soap industries until 2010. A

8. Public Financial Management (PFM) reforms are progressing well:

- By March 2008 e-Sistafe was successfully rolled out to 31 districts—or 4 districts more than initially envisaged—and to 10 State organs at the central level.

- The Ministry of Public Works (Road Program), Ministry of Agriculture (ProAgri) and Ministry of Education (Primary Education) initiated their program budgeting pilots and budget classifiers are relating their main planning documents—the Five Year Plan and the PARPA—directly to their budgets.

- All technical provisions were put in place for both General Finance Inspection and the Administrative Tribunal to access the e-Sistafe system for consulting purposes. Technical Unit for State Financial Administration Reform (Unidade Técnica de Reforma da Administração Financeira do Estado—UTRAFE), the comptroller General (Tribunal Administrativo—TA) and the internal finance control (Inspeção Geral das Finanças—IGF) are currently analyzing whether additional reporting facilities are required for audit purposes.

- The validation of the civil service staff database has been completed at a sector level and has been validated by the TA for salaries to be paid via e-Sistafe—initially for civil servants of the Ministry of Finance (MF)—by end-April 2008 (structural benchmark).

- In November 2007, the Council of Ministers approved a decree assigning the institutional responsibilities and updates of the civil servants database to the Ministry of Civil Service.

- A revised version of a revenue collection network (e-Tributação) BC was finalized in February 2008.

- In order to maximize the benefits from e-Sistafe, by the end of 2007, three donors started new pilots to bring externally financed projects into the domestic and foreign currency single treasury accounts and first results are expected by September 2008.

- A BC on Asset Management was approved internally by Government at end-2007, and due to lack of financing, including from the international community, the tender for the implementation of the asset management system and procurement interface to e-SISTAFE envisaged for December 2007, has not been launched yet.

9. Monetary policy has remained prudent. At end-December 2007, net international reserves exceeded the floor by US$208 million (assessment criteria) despite higher sales of foreign exchange. On account of an unanticipated and temporary strong increase in money demand over the festivity season—base money exceeded its end-December AC, but declined sharply again early January to levels consistent with the program. The BM reduced the legal reserve requirement (LRR) to the SADC average (excluding South Africa) from 10.15 to 9.0 percent, effective April 2008. Credit to the economy grew by 17 percent and has more than doubled in the last three years, albeit starting from a low base. In line with Fund recommendations, the BM started using reverse repo auctions in July 2007 to mop up excess liquidity and in February 2008 started to replace deposit auctions and to allow reverse repo operations on a daily basis using 1 to 7 days, 14 days and 21 days treasury bills. Monetary policy transparency and credibility were enhanced with the regular publishing of the meeting communiqués of the Monetary Policy Committee, which together with its regulations are available on the BM's website. An agreement between the BM and the treasury to shift the cost of monetary policy to the budget to enhance the BM's independence was finalized in November 2007.

10. Prudential ratios of the banking system have continued to improve. Capital adequacy ratio for the banking sector increased considerably to 14.2 percent in December 2007 from 12.5 percent in 2006, and non-performing loans decreased to 2.6 percent from 3.3 percent in 2006. The sector remains liquid with the liquidity ratio of 56 percent (2006: 52 percent). Banks are highly profitable with a return on equity in 2007 of 47.7 percent. Banks are also becoming more efficient with non-interest expenses to gross income and to a lesser extent personal expenses to non-interest expenses continuing to decline since 2004. In December 2007, the BM completed the first assessment of the impact of the International Financial Reporting Standards (IFRS) on banks' nonperforming loans and on prudential regulations indicating negligible impact on the quality of the loan portfolio. Interest rate spreads continued to decline from 10.9 percent in 2006 to 9.5 percent in 2007 but real interest rates remain relatively high.

11. Efforts continued to identify measures to reduce the cost of financing and to deepen financial markets. In late January, the BM presented the conclusions of a banking survey on the causes of higher than SADC average intermediation costs—in particular high fees and large interest rate spreads—and consequently the low intermediation. A working group consisting of commercial banks has been mandated to identify measures to make finance more affordable and the banking sector more competitive. The BM will closely monitor the progress made by the working group.

12. The BM has continued to strengthen the regulatory and supervisory framework in order to comply with Basel I principles. In the financial sector, 11 out of 12 banks and 4 of 5 cooperatives are compliant with the improved prudential regulations (representing 88 percent of all deposit taking financial institutions). The implementation of IFRS in the banking sector is proceeding well. New regulations on the assessment, classification and provisioning of credits in line with IFRS were approved in 2007. A new chart of accounts has been prepared, and the central bank is working with the commercial banks to facilitate the publication of IFRS compliant accounts in 2008.

13. The Government has stepped up its efforts to reduce the costs of doing business to make Mozambique's business environment the most competitive in SADC by 2015. In February 2008, the Council of Ministers approved a strategic action plan prepared under the leadership of the Ministry of Industry and Commerce—and in consultation with the World Bank—with clear responsibilities and a timetable to streamline the business environment and to remove constraints that inhibit private sector development. A high level Inter-Ministerial Committee on Business Reforms will monitor the implementation of the plan. The action plan is currently being costed while a donor mapping exercise was undertaken to present all ongoing and planned private sector development initiatives in Mozambique and to improve donor coordination. The following achievements were accomplished:

- In February 2008, the Government approved the simplification of the licensing process. The decree transfers the authority to issue licenses to the "One-Stop-Shops" at the provincial or the district level, thus simplifying the licensing process for micro and small businesses.

- A study outlining key recommendations for facilitating trade across borders has been completed. The study proposes the operationalization of an *"electronic one-stop-window"* through an integrated IT system in which both customs and tax IT systems are integrated to reduce documentation, signatures and time required for cross boarder trade. No changes in laws are necessary and the system is ready to be implemented contingent to financial support from the international community.

- With the strengthening of the organizational capacity of the VAT refund unit, VAT refunds are granted faster and more efficiently. Staff received training and is guided by performance targets. Furthermore, a first draft of an external audit on the amount of arrears on VAT refund due to contractors of large infrastructure projects, particularly in the road and water sectors, was produced in January 2008.

14. In some areas of the judicial reform, progress was slower than envisaged. Submission to the Council of Ministers of the draft Integrated Strategic Plan of the Justice Sector—key for mobilizing financial support from donors—and the draft law revising principles and regulation of Institute for the Provision of Judicial Assistance (Instituto de Patrocínio e Assistência Jurídica—IPAJ)—both envisaged for December 2007—is still pending.

Consistent with the approved Organic Law on Judiciary Courts and in view of relieving the Supreme Court's work program, preparations are under way for the first of three planned appeal courts. In 2007, for the first time the Government is employing judicial administrators to bring the judiciary closer to the public. Progress was achieved in 2007 in reducing the courts' large backlog of cases with 24 percent more cases closed compared to 2006—or substantially more compared to the targeted improvement of 15 percent.

15. The public sector reform program is being reinvigorated, particularly:

- In December 2007, the Council of Ministers approved the main outline for the public wage policy reform recognizing the need for fiscal sustainability.
- The TA and the IGF improved public sector accountability in 2007, compared with 2006, by increasing the number of internal and external audits at provincial and district levels by 92 and 67 percent respectively. In addition, a comparison of the external audit opinions of the TA shows a significant improvement in the comprehensiveness and quality of the analysis.
- Under the National Decentralized Planning and Finance Program (NDPFP) funds and planning and procurement responsibilities were transferred to province and district administrations. However, their human resource and management capabilities need further strengthening and the overall decentralization strategy has still to be developed.

16. In 2007, the Government took 2415 disciplinary measures against civil servants. 813 civil servants were expelled from the administration, 380 were fined, and 247 were demoted. The law obliges that all the admissions and dismissals in public sector to be published in the Official Gazette. In collaboration with the World Bank, a committee has defined a number of measures that will help improve several governance indicators for implementation during 2008 and 2009. A preliminary action plan was prepared in December 2007, while the final strategy including objectives and specific actions is to be completed in early April 2008. After the abolition of the Anti-Corruption Forum in January 2008, the implementation of the Anti-Corruption Strategy continues to be monitored as part of the public sector reform program by the Public Sector Interministerial Committee (Comite Interministerial da Reforma do Sector Publico—CIRESP), chaired by the Prime Minister, and comprising the Ministries of Justice, Finance, Interior, Heath, Education, Planning and Development, State Administration, Trade and Industry, Science and Technology, Labor, and Civil Service. Furthermore, several fora are monitoring progress in good governance, including the Development Observatory with a strong representation of the civil society, and district consultative councils.

17. To strengthen the management and transparency of natural resources, the Government issued regulations to the new Mining and Petroleum Fiscal Regime laws in 2008

18. In March 2008, the Government decided to start developing actions aimed to meet the steps necessary for the official declaration of Government to adhere to the Extractive Industry Transparency Initiative (EITI) in the course of 2008. For the implementation of the EITI, the Government will use already existing systems, procedures and fora. Public consultations will be made through the Development Observatories, which include the Government and the civil society, and which is to include in the future representatives of extractive industry through CTA. Fiscal data would be published in the budget execution reports, and audited by the internal finance inspection and the comptroller general.

19. In November 2007, Mozambique—together with a sub-group of SADC countries (SADC EPA) including Botswana, Lesotho and Swaziland—reached an interim Economic Partnership Agreement (EPA) with the European Union (EU). As a result, Mozambique will continue to benefit from a contractually binding quota- and duty free access to the EU market. From July 1, 2008, SADC EPA will open their markets on a reciprocal basis to EU exports, with the consequence of binding quota and duty free access to such exports. Negotiations with the EU on a final EPA agreement will continue together with other SADC countries. The Government is also pursuing bilateral free trade arrangements as recommended in the Diagnostic Trade Integration Study (DTIS). The Government is continuing its negotiations with Angola, Tanzania, and Zambia in order to reach trade agreements similar to the ones concluded with Zimbabwe and Malawi in 2005.

20. The Government recognizes the importance of reaching rescheduling agreements with all bilateral creditors in the context of the enhanced HIPC Initiative. Negotiations are still ongoing with Bulgaria and Libya and are scheduled with Iraq and Portugal. The Government has also invited Angola, Poland and Algeria to negotiate and awaits confirmation of dates. In this regard, the Government of Mozambique looks forward to the continuing support of the Bretton Woods institutions.

II. Objectives and Policies for the remainder of 2008

21. The outlook for 2008 remains positive. While the floods have had a severe humanitarian impact in part of the country, only three percent of cultivated land has been affected so that the overall economic impact is likely to be limited. The medium-term outlook is characterized by continued strong economic growth, single-digit inflation, and sustainable fiscal and external positions. Prices for the main export item aluminum are expected to decline slightly while international prices for petroleum products (12 percent of total imports) are expected to remain high, which will impact the trade balance. The external

current account is targeted to widen as a result of an acceleration of aid disbursements while international reserves will remain at comfortable levels. Nonetheless, risks remain related to natural calamities, a continued surge in international oil and food prices, and spending pressure during election times. Central to consolidating macroeconomic objectives will be the continuation of a prudent fiscal policy with strengthened management of public enterprises, and prudent monetary policy in the context of a flexible exchange rate regime.

22. The Government is committed to continue to timely implement the second wave of its reforms. Particular emphasis will be on implementing the second phase of the public sector reform program (2006–11) which consists of four pillars: (i) improving service delivery to the citizen and the private sector; (ii) strengthening the capacity of local governments, with special emphasis on the Districts (including the decentralization strategy); (iii) professionalization of the public sector (including payroll systems, performance evaluation and wage policy); and (iv) strengthening good governance systems and the fight against corruption. The Government remains determined to make Mozambique's business environment one of the most competitive in Africa to benefit from Foreign Direct Investment (FDI) and technology spillovers. We will also ensure that our natural resources are managed transparently following the principles of the EITI and with due regard to fiscal risk so that current and future generations reap the maximum benefit of Mozambique's rich endowment. The fight against pandemics, and the improvement of human and physical capital, particularly infrastructure would continue with the help of the international community. The Government intends to continue to monitor its program with the existing multi-disciplinary committee, especially through reinforced coordination between the BM and the MF.

23. The 2008 budget includes an acceleration of disbursements of foreign aid by about 1 percent of GDP and an associated increase in priority spending focused towards achieving the PARPA II targets and the Millennium Development Goals (MDGs) including sufficient counterpart funds to ensure a smooth execution of donor-financed projects. In view of the relatively low disbursement in 2007 of committed project financing and special programs (financed by the Common Fund for the health sector), the authorities will analyze with the international community the causes in time to accelerate aid disbursements in 2008. To further buttress public financial management, the authorities will continue to encourage the donor community to shift the foreign financed projects and special programs on the single Treasury account (CUT).

24. The budget envisages no recourse to domestic bank financing. The Government continues its efforts to increase revenues by 0.5 percent of GDP while the losses related to trade liberalization (0.4 percent of GDP) will be mitigated by bringing a number of off-budget line items on budget. The increase in domestic revenue is expected to come from improvements in revenue administration, and tax policy measures including revisions to the personal income and corporate income tax codes approved by the Parliament (0.2 percent of GDP), reduction in VAT exemptions (0.1 percent of GDP), collection of tax arrears (0.1 percent of GDP), continued adjustment of fuel taxes (0.1 percent of GDP) and an

increase in the number of tax payers by 100,000. Non tax revenues are expected to increase on account of higher concession fees from Hidroeléctrica de Cahora Bassa (HCB).

25. The MF will continue to improve its weekly and monthly cash-flow projections and communicate them to the BM on a weekly basis. Furthermore, in line with the memorandum of November 2007 between the MF and the BM the cost of monetary policy will be included in the budget starting in 2009.

26. The budgetary expenditure path is in line with the revised Medium-Term Fiscal Framework (Cenário Fiscal de Médio Prazo-CFMP) and based on consolidated aid commitments provided by the donors. Expenditures take into account the election related costs and the subsidies for minibus fares. The wage bill will reach 8.3 percent of GDP and includes hiring of 12,000 teachers, 5,000 health workers, and reinforcement of security forces. The subsidies and the flood and cyclone related costs will be accommodated through the budget's contingency line. Under the program, an adjuster of 500 million Meticais for natural disasters could also help accommodate additional spending. The share of spending on priority sectors (above 65 percent), particularly education, health, and infrastructure will be closely monitored. To strengthen the monitoring of net lending to public enterprises a study, with the support of technical assistance, will be undertaken that will serve as a basis for drafting the relevant law by December 2008 (structural benchmark), which will include the requirement for monthly financial reporting to the MF. The 2008 budget also identifies 0.5 percent of GDP contingent priority expenditures that will be executed if revenues or program aid is higher than expected. The Government is committed to continue to strengthen the national procurement system. In this context, the Government intends to finalize an evaluation of its system using the OECD/DAC methodology by May 2008. On the basis of this evaluation, measures will be defined to buttress the system in the second half of 2008.

27. The Government will continue to improve the efficiency of the tax system by implementing its medium-term tax policy reform program, with the support of the international community. The Government is preparing two new laws with tax policy measures to streamline and simplify the tax system for small and medium sized enterprises, and rationalize the code of tax benefits. The AT will continue to improve the management capacity and human resources policies. In collaboration with UTRAFE, AT will start the implementation of the approved IT Master Plan (PDTI). AT will further: (i) implement a detailed performance indicator framework using a modern management information system to measure performance of the tax administration's core functions and to guide management decisions by September 2008; (ii) develop and implement a tax collection system through banks; (iii) develop and implement an electronic filing and payment system starting with the large tax payers; and (iv) conduct 700 tax audits.

28. The final report on the amount of arrears on VAT refund due to contractors of large infrastructure projects is scheduled for approval by the MF in May 2008. Based on this audit, the Government will define a repayment schedule by August 2008 to be included it in the

2009 budget, and if necessary the budgets thereafter. Going forward, the Government will seek the support from the international community to ensure that VAT charged on supplies of projects is included in the final price of a contract and will further strengthen the coordination mechanisms between the relevant departments (Budget Directorate, Planning Directorate, line ministries, and AT).

29. The authorities are committed to fully implementing the first phase of the e-SISTAFE reform (budget execution and accounting functionality). The authorities look forward to a timely donor financing of the third phase of the e-SISTAFE implementation, which is key to continue to improve transparency in the management of public resources and the central, provincial, district and municipality levels. Specific measures include:

- For the consolidation of the first phase the Government will: (i) complete the sectional classification (by May 2008), (ii) issue a ministerial decree for the multi-currency CUT (by April 2008) to allow transactions through e-Sistafe to accounts abroad (by January 2009), (iii) clean and update the list of e-SISTAFE operators by September 2008 and use the new list by January, 2009, and (vi) finalize the system for program budgeting using e-SISTAFE (by end-June 2008).

- Salaries of civil servants of four line ministries and three central government institutions will be paid via e-SISTAFE by end-June 2008, a total of twelve line ministries and four central government institutions by end-September 2008 and the remaining ministries and central institutions by June 2009.

- Based on the roll-out experience of e-SISTAFE in the first 31 districts a list of additional district and municipalities will be defined by June 2008 (structural benchmark). The progressive roll-out of e-SISTAFE to State organs at the central level will continue in 2008.

- The census of pensioners will be made by June 2008 and database will be finalized by end-September 2008 in order for pension payments to be made through e-SISTAFE starting in January 2009 with pensioners with a bank account is paid through the banking system. The remainder of the pensioners will be paid through e-SISTAFE start in July 2009.

- To allow for a more strategic and systematic use of e-SISTAFE and benefiting from experience under the current pilot projects program budgeting will be further developed. Budgeted expenditures will relate to strategic outcomes and indicators and the financial reporting will be linked to outcomes at national and sub-national levels. By September 2008, to be ready for the 2009 budget, the concept of program budgeting will be rolled out to cover the ministries of public works, agriculture and education and culture, health and transport and communications. The Government intends to integrate all ministries, State organs and central government institutions in multi-year program budgets for the 2010 budget.

- To strengthen the existing control mechanisms of the General Finance Inspection for internal control and the Administrative Tribunal for external control, UTRAFE will facilitate that both institutions can use e-SISTAFE for consulting purposes—and if necessary with additional reporting facilities—by June 2008.

- Consistent with the approved revenue collection network BC (e-Tributação), the implementation of a pilot project for the personal income tax (IRPS) will start in January 2009, hopefully with donor financing, and will subsequently be expanded to all other taxes in the course of 2009.

30. On monetary policy, the BM will continue to target base money with a view to achieving an average inflation of 7-8 percent in 2008. The BM will continue to use foreign exchange sales to sterilize liquidity and thus avoid a build-up in domestic debt and crowding-out of the private sector.

31. The BM, with the help of Fund technical assistance will move towards a monetary framework that better reflects determinants of price stability. In this context, the BM will continue to fine-tune monetary operations, improve liquidity management, and deepen financial markets. The BM will gradually increase the use of reverse repo operations and starting in June 2008 introduce repo operations, and study the possibility of introducing repurchase agreements. By June 2008, the Meticalnet will be adapted to allow for outright operations for the secondary market (structural benchmark for June 2008).

32. The BM will implement a number of measures aiming at buttressing its internal audit with fund technical assistance:

- The BM will conduct an external quality assurance review of its internal audit function in accordance with international standards. By July 2008, the BM will adopt an internal audit charter and commence periodic reporting to the Executive Board on the implementation of audit recommendations (structural benchmark);

- A proposal of a new central bank law will be submitted to the Council of Ministers as soon as a SADC central bank model law has been approved. The draft law will reflect international best practice of the audit committee, including its composition.

- Pending the approval of the new central bank law, the Audit Board will assume the role of an audit committee. By end-June 2008 (structural AC), the terms of reference of the existing audit board will be simplified to make it more focused on matters related to accountability, transparency, and internal control and provide oversight over financial reporting, external and internal audits, and systems of internal control.

- The control over reserve management will be further enhanced by September 2008 through the installation of physical access controls in SWIFT operations, the recording of dealer communications regarding trading activities, and the introduction of tiered financial limits for authorization of SWIFT transactions.

- The BM is also committed to publishing its audited financial statements prepared in accordance with IFRS for the year ending December 31, 2008, by June 30, 2009. In this context, the MF and the BM will discuss issues arising form the BM's holding of government securities issued at non-market terms.

33. To improve the ability of the financial system to evaluate the quality of its loan portfolios the Government aims at extending IFRS to the corporate sector and for large enterprises in January 2010 and by 2011 for medium size companies. In this context, a firm has been selected to prepare the draft IFRS Strategic Implementation Plan by the end-April 2008. The final study, including the pertinent legislation will be approved in 2009. In order to buttress its analytical capacity, the BM will strengthen the human resource capacity of its Banking Supervision Department (BSD) (its regulatory division) for updating the regulatory framework, updating internal tools made available to inspectors, providing training to inspectors, researching issues related to banking supervision, preparing and monitoring of Financial Soundness Indicators, and reviewing its supervision manuals. Furthermore, the BSD will review by June 2008 the role assigned to external auditors of banks and issue regulations that give the BM access to audit reports, working papers, contracts and other documents produced by the external auditors and related to the audited institutions. The BSD intends by December 2008 to develop a framework for assessing market and operational risks, review banks' rating system (CAMEL) as a function of the banks' risks, create an information system within the BM intranet for all the managerial information of banks and financial system in the interest of supervisions, and design a plan for on-site inspections on the basis of banks' risk profile.

34. The Government is committed to supporting a sound expansion of the non-bank financial sector. The BM will continue to license and supervise microfinance deposit-taking institutions to facilitate enhanced access to finance by rural households and SMEs. Examiners of the BSD received training and are preparing two pilot onsite inspections in June 2008. The results of this exercise will be used for fine-tuning the draft prudential regulation to be issued by end 2008 and for designing a Microfinance Supervision Manual. Both the World Bank Financial Sector Technical Assistance Project (FSTAP) and the International Fund for Agricultural Development (IFAD) supported Economic Rehabilitation Support Fund (Fundo de Apoio à Reabilitação Económica—FARE) and the Rural Finance Support Program (RFSP) will support the Government's efforts to improve access to finance, especially in rural areas. Following the recent adoption of a new law on social protection, the authorities intend to strengthen the social security and supplementary pension system. As part of the restructuring of the National Social Security Institute (INSS), draft reports on an actuarial study and on a new investment management policy were finalized in early March

2008. The INSS is now preparing an action plan that will pay due regard to fiscal sustainability and will be ready by June 2008. Efforts to strengthen the regulatory and supervisory framework of the insurance sector as well as the institutional capacity of the Inspecção Geral de Seguros (IGS) are under way. The review of the Insurance Law will be finalized to bring it in line with international best practices, revised prudential and solvency requirements for Mozambican insurers are being developed, while new IFRS-compliant Chart of Accounts for insurers would also be designed.

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

36. During the remainder of 2008, the MF will: (i) continue the restructuring process of the Public Debt Unit and strengthen procedures and controls with the help of a resident public debt advisor, under the FSTAP project; (ii) finalize the consolidation and reconciliation of the debt database for all public debt in accordance with Commonwealth standards; (iii) strengthen information analysis and reporting with the help of an IT consultant under the FSTAP project; (iv) prepare regular debt sustainability analysis; and (v) improve the Treasury cash management policies and procedures with the technical support of the World Bank.

37. Based on the strategy approved in February 2008 and under the supervision of a high-level Inter-Ministerial Committee, the Government is accelerating reforms to reduce the costs of doing business to make Mozambique's business environment the most competitive in SADC by 2015. For the remainder of 2008, the following actions are envisaged:

- A decree will be submitted to the Council of Ministers in April 2008 to consolidate business inspections.

- A draft insolvency law for the corporate sector will be submitted to the Council of Ministers by end June 2008 to simplify the business closing process and increase the recovery rate with the objective of helping viable businesses to overcome a short-term cash-flow crisis, and insolvent businesses to be rapidly liquidated.

- Ensure sufficient capacity at provincial levels to administer the licenses and to raise awareness of the streamlined and simplified licensing procedures. The number of sectors covered under the "One-Stop-Shops" for licenses will be expanded and the licensing competencies at municipal level will be reviewed;

- Revoke the requirement for bank deposits when opening a company, and reduce the required minimum capital to start up the business;

- Implement the new insolvency law for the corporate sector once approved by the Parliament, with reduced legal intervention, increased private engagement, as well as simplified business recovery procedures;

- Implement the electronic one-stop window, facilitating trading across borders;

- Further improve and simplify the system of VAT refunds, through increased compliance with reduced VAT-refund processing times; and

- Initiate the implementation of the SME strategy.

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

- Consolidate the progress in streamlining and reducing licenses for all sectors, as well as the implementation of a new approach to inspection activities, focused on prevention and education.

- Consolidate the progress in facilitating trading across the borders. By end-2009, Mozambique should be one of the most efficient within SADC in the clearance of goods for both imports and exports. This will require reducing the number of documents filled out by at least half, implementing the one-stop border post with South Africa, and revitalizing the Development Corridors concept.

- Simplify the tax filing. Electronic filing of taxes should be provided and forms should be simplified to reduce the time required for tax filing; and

- Property Registration. Amend the relevant legislation to speed up the registration process by improving communication among different government agencies and developing an electronic database for the real estate registry.

39. The MF intends to implement a number of measures aiming at improving the overall fiscal risk management, accountability and transparency of megaprojects. To manage the budgetary and macroeconomic implications of megaprojects the Government intends in the short-term (2008–2009) to:

- strengthen the monitoring of megaprojects by developing data gathering and analytical and forecasting capabilities at the Ministry of Finance in close coordination with other interested ministries and the BM;

- enhance the oversight and control mechanism of the MF by ensuring that it formally agrees with the fiscal regime of new projects at the appropriate stages of the negotiations, and before its submission to the Council of Ministers. To this end, an appropriate legal instrument will be adopted before end-May 2008;

- strictly implement the mining and petroleum fiscal regime and related regulations and model contracts to all new projects;
- continue to adopt nonrecourse financing clauses in future megaprojects; and
- draft a Public-Private Partnership law in 2009 which will also be applicable to megaprojects.

40. The public sector reform program is being reinvigorated, particularly:

- A decentralization strategy is being prepared with the help of the World Bank and other partners and will be approved by the Council of Ministers by end-2008. The strategy will propose, among other things, a clear legal, regulatory, and institutional framework for revenue raising and spending responsibilities and functions of subnational units (provinces, districts, and municipalities) and monitoring of subnational fiscal operations. The sequencing of the strategy will pay due regard to the administrative capacity of subnational units and need to maintain fiscal control as well as fiscal sustainability, and should be aligned with the NDFPF.
- In close coordination with the development partners, including the World Bank, and on the basis of the recent census of civil servants, the Government is preparing a reform of the wage policy. The new policy will pay due regard to fiscal sustainability to avoid jeopardizing macroeconomic stability; and
- After some delay new restructuring plan of PETROMOC will be submitted to the Council of Ministers by May 2008 to improve its operational and financial performance and to ring-fence commercial activities.

41. The Government intends to approve the Integrated Strategic Plan of the Justice Sector by May 2008 and mobilize donor funding for the implementation of the strategy. The law revising principles and regulation of the Institute for the Provision of Judicial Assistance (Instituto de Patrocínio e Assistência Jurídica—IPAJ by September 2008) and the revision of Law of the Community Tribunals will be submitted to the Council of Ministers by 2009. The Penal Procedures Code is expected to be submitted to the Council of Ministers before end-June 2008. Once the Penal Procedures Code has been approved, a new Penal Code will be submitted to the Council of Ministers by end-December 2008. Following intensified training in 2008, the number of magistrates is to quadruple to 100, staring in 2009. In the context of the recently approved Organic Law on Judiciary Courts and in view of relieving the Supreme Court's work program, the Government will gradually open the Appeal Courts, out of a total of three, starting August 2008.

IV. Program Monitoring

42. The semiannual quantitative assessment criteria for end-June 2008 and end-December 2008 and indicative targets for end-September 2008, which will be used to evaluate the implementation of the program for 2008, are shown in Table 1 of this memorandum, with further definitions and explanations contained in the annexed Technical Memorandum of Understanding. In addition, the Government has specified in Table 3 a list of structural assessment criteria and benchmarks for 2008.

43. The Government understands that the completion of the third review is contingent upon the observance of the assessment criteria for end-June 2008 set out in Tables 1 and 3; which is expected to take place before end-December 2008. In reviewing developments under the program during the third review, particular attention will be paid to the implementation of measures aimed at broadening the tax base, the implementation of e-SISTAFE, the improvement of the overall fiscal risk assessment and reporting, the 2008 budget execution, the 2009 budget, monetary and financial sector reform, the reduction in the cost of doing business, and the management of natural resources.

Table 1. Mozambique: Quantitative Performance/Assessment Criteria and Indicative Targets, 2007-2008 1/
(Millions of MT, unless otherwise specified)

	2007			2008						
	End-Dec. Assessment Criteria 2/			End-March Indicative Target 2/	End-June Assessment Criteria 3/		End-Sept. Indicative Target 3/		End-Dec. Assessment Criteria 3/	
	Prog.	Adj.	Act.	Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Net credit to the government (cumulative ceiling) /2	-1,828	-1,133	382	-2,000	-1,600	-3,210	-700	-1,332	-1,200	-1,202
Stock of reserve money (ceiling)	16,904	17,404	17,822	15,859	17,394	17,044	17,747	17,347	19,334	18,934
Stock of net international reserves of the BM (floor, millions of U.S. dollars)	1,300	1,216	1,508	1,532	1,552	1,704	1,566	1,627	1,566	1,589
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling)	3		3	5	5	5	5	5	5	5
Stock of short-term external public debt outstanding (ceiling)	0		0	0	0	0	0	0	0	0
External payments arrears (ceiling)	0		0	0	0	0	0	0	0	0
Indicative targets:										
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, millions of U.S. dollars)	35		35	35	0	0	0	0	0	0
Government revenue (floor)	32,274		33,058	8,367	17,271	17,287	26,590	26,682	37,773	37,864

1/ For definition and adjustors see the attached Program Monitoring Section of Memorandum of Economic and Financial Polices and the Technical Memorandum of Understanding.
2/ Net credit to government, the stock of reserve money, and the stock of international reserves are based on data pior to the technical revision of the monetary survey in January 2008.
3/ Net credit to government, the stock of reserve money, and the stock of international reserves are based on data after the technical revision of the monetary survey in January 2008.

Table 2. Mozambique: Structural Assessment Criteria and Benchmarks Under the 2007/08 Policy Supported Instrument (December 2007—June 2008)

Actions	Expected Date of Implementation	Comments
Structural assessment criteria		
Submission to Parliament of a draft law on the excise tax on alcoholic beverages, beer, and tobacco.	End-February 2008	Delayed to Mid-May 2008
The level of effective direct budget execution via e-SISTAFE (according to the sequence of commitment, verification, and payment) for goods and services will be increased to 50 percent.	End-December 2007	met
Structural benchmarks		
All budgetary operations for goods and services of Financial Management Departments (DAFs) of all remaining ministries at the central and provincial levels will be executed through the e-SISTAFE.	End-December 2007	met
Adoption by the Council of Ministers of regulations for the new mining and petroleum fiscal regime laws.	End-February 2008	met
An integrated and e-SISTAFE compatible payroll database will start to be used by the Ministry of Finance to carry out salary payments via e-SISTAFE.	April 2008	
A list of additional district and municipalities for the rollout of e-SISTAFE will be defined.	End-June 2008	
The Meticalnet will be adapted to allow for outright operations of treasury bills for the secondary market.	End-June 2008	

Table 3. Mozambique: Structural Assessment Criteria and Benchmarks Under the 2007/08 Policy Supported Instrument (March—December 2008)

Actions	Expected Date of Implementation	Comments
Structural assessment criteria		
Finalization of a new terms of reference for the Audit Board of the Bank of Mozambique.	June 2008	
Structural benchmarks		
An integrated and e-SISTAFE compatible payroll database will start to be used by the Ministry of Finance to carry out salary payments via e-SISTAFE.	April 2008	
A list of additional district and municipalities for the rollout of e-SISTAFE will be defined.	End-June 2008	
The Meticalnet will be adapted to allow for outright operations of treasury bills for the secondary market.	End-June 2008	
The BM adopts an internal audit charter and commences periodic reporting to the Executive Board on the implementation of audit recommendations.	July 2008	
A study, with appropriate technical assistance, will be undertaken that will serve as a basis for drafting the public enterprises law.	December 2008	

Attachment II

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

March 28, 2008

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

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

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

Net Claims on the Central Government by the Banking System

2. Net claims on the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts with the banking system, recapitalization bonds issued to the Bank of Mozambique and commercial banks, and proceeds from the signing fee for coal exploration. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in net claims on the central government by the banking system for the 2008 program will be cumulative from end-December 2007.

3. The government encompasses all institutions whose revenue and expenditure are included in the state budget (*Orçamento do Estado)*: central government ministries, agencies,

and the administration of 11 provinces. Although local governments (33 municipalities or autarquias) are not included because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

Government revenue and financing

4. Revenue is defined to include all receipts of the Domestic Tax Administration (Administração Tributária de Impostos or DGI), the National Directorate of Customs (Direcção Nacional de Alfândegas, DNA), and nontax revenue, including certain own-generated revenues of districts and some line ministries as defined in the budget. Net receipts from privatization received by the National Directorate of State Assets (Direcção Nacional do Património do Estado) and unrealized profits transferred by the central bank to the treasury will not be considered as revenue (above the line) and will be accounted for as other domestic financing (below the line).

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

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

Money supply

7. Base money is defined as the sum of currency issued by Bank of Mozambique (BM) and the commercial banks' deposits in the BM. The commercial bank deposits include the statutory required reserves and excess reserves held at the BM. The base money ceilings for 2008 will be the total stock of base money outstanding at end-March 2008, end-June 2008, end-September 2008 and end-December 2008, and will be monitored by the monetary authority and provided to the IMF by the BM.

Net international reserves

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

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

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

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

11. The central government will limit contracting or guaranteeing external debt up to US$5 million in 2008 with original maturity of one year or more with a grant element of less than 35 percent, calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the 2008 Budget Law. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. This assessment criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

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

External payments arrears

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

Foreign program assistance

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

Actual external debt-service payments

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

Adjusters

16. The quantitative targets (floors) for the central bank's net international reserves will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted downward by 100 percent of any shortfall in external program aid (up to a maximum of US$50 million) and any excess in external debt service payments, compared to the program baseline (Table 1). The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year. They will also be adjusted upward for the full amount of any external privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments. The quantitative targets (floors) for the central bank's net international reserves will be adjusted equivalently downward up to a maximum of US$50 million per annum by the amount that the projected fuel import bill is higher due to a rise in the average global oil price (average petroleum spot price of West Texas Intermediate, U.K. Brent, and Dubai Fateh crude). This adjustment will be equal to the difference between the realized and the projected average global oil price, multiplied by the volume of total fuel imports projected for each quarter (Table 2).

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

18. The quantitative target (ceiling) for net claims on the central government (NCG) for end-March 2008, end-June 2008, end-September 2008, and end-December 2008 will be adjusted upward (and the floors on net international reserves adjusted downward) to accommodate the possible need for higher locally financed government outlays to deal with natural disasters, up to a total limit of MT 500 million.

19. The base money ceiling will be adjusted equivalently upward up to a maximum of MT 500 million at end-March 2008, end-June 2008, end-September 2008, and to a maximum of MT 1000 million at end-December 2008 to the extent that the outstanding stock of currency issued by the BM exceeds those projected in Table 3. The maximum at end-December 2008 is higher by MT 500 million because of the seasonal increase in the demand for currency during the festive season in the fourth quarter of the year.

Data reporting

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

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

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

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

Table 1: Mozambique—Foreign Program Assistance and External Debt Service for 2007 and 2008 /1
(Millions of MT, unless otherwise indicated)

	2007		2008									
	Year		Q1		Q2		Q3		Q4		Year	
	Prog,	Act.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.
Net foreign program assistance per period	9,677	9,340	4,751	6,466	2,536	1,856	1,401	38	2,415	1,106	11,102	9,465
Foreign program assistance	10,179	10,591	4,878	6,756	2,673	2,419	1,531	335	2,550	1,359	11,631	10,870
Program grants	7,519	8,013	3,927	5,241	2,673	2,419	1,514	320	872	425	8,985	8,405
Program loans	2,661	2,577	951	1,515	0	0	17	16	1,678	934	2,646	2,465
External debt service	502	1,250	127	290	137	563	130	298	136	253	529	1,404

Source: Mozambican authorities and Fund staff estimates
1/ Foreign assistance excluding assistance for special programs, projects, and on-lending to public enterprises.

Table 2: Mozambique—Projected Fuel Import Bill for 2007 and 2008

	2007		2008									
	Year		Q1		Q2		Q3		Q4		Year	
	Prog,	Act.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.	Prog,	Rev. Prog.
Fuel import bill per period (millions of US dollars)	81	100	95	109	124	164	146	150	90	103	90	103
Forecast oil price (US$ per barrel)	64	88	77	87	75	87	75	86	74	85	74	85
Volume of fuel imports per period (metric tons)	122,376	126,119	123,673	125,467	163,757	194,512	199,386	183,274	120,686	133,759	120,686	133,759

Source: Mozambican authorities and Fund staff estimates.

Table 3: Mozambique—Currency Issued by the Bank of Mozambique
(Millions of MT)

	2007		2008									
	Year		Q1		Q2		Q3		Q4		Year	
	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Outstanding stock of currency, end of period	10,133	10,942	8,924	9,055	10,310	10,772	10,358	10,854	11,486	11,659	11,486	11,659

Source: Mozambican authorities and Fund staff estimates.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

Second Review under the Policy Support Instrument and Request for Waiver of Nonobservance of Assessment Criteria—Informational Annex

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

May 9, 2008

Contents Page

Appendix I
Mozambique: Relations with the Fund
(As of March 31, 2008)

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

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

III. SDR Department	SDR Million	%Allocation
Holdings	0.11	n.a.

IV. Outstanding Purchases and Loans	SDR Million	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	9.74	8.57

V. Latest Financial Arrangements

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

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

			Forthcoming		
	2008	2009	2010	2011	2012
Principal			0.16	0.97	1.46
Charges/Interest	0.05	0.05	0.05	0.05	0.04
Total	0.05	0.05	0.21	1.02	1.50

VII. Implementation of HIPC Initiative:

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

VIII. Implementation of MDRI Assistance:

MDRI Eligible Debt (SDR Million)[1]	106.56
Financed by MDRI Trust	83.05
Remaining HIPC Resources	23.51

Debt Relief by Facility (SDR Million)

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

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

Safeguards assessment

A FIN safeguards assessment mission with respect to Mozambique's PSI took place in February 12-20, 2008. This voluntary assessment, which has not yet been completed, will update the findings of the previous safeguards assessment, which was completed in August 2004. While the central bank is making progress in implementing the recommendations of the 2004 safeguards assessments, weaknesses remain in the internal and external audit function, financial reporting practices, and control systems.

Exchange arrangements

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

Mozambique still avails itself of the transitional arrangements under Article XIV of the Fund Articles of Agreement, but has eliminated all Article XIV restrictions. It maintains, however, restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII, as evidenced by (i) the discretionary prior approval for remittances of family living expenses; (ii) the authorization for the purchase of foreign exchange in excess of US$5,000 for certain transactions; (iii) the prohibition for the conversion of balances of nonresidents' domestic currency accounts into foreign currency or transfer abroad; (iv) the prohibition on advance payments for a service; and (v) the prohibition on advance payments for the import of goods. On June 18, 2007, the Fund granted approval for the retention of these five exchange restrictions until May 31, 2008. At the authorities' request, an Article VIII mission was conducted by LEG and PDR in March 2004. The mission encouraged the authorities to remove all existing the exchange restrictions. A new foreign exchange law was submitted to the Assembly in May 2007. Following enactment of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

Article IV consultation

In accordance with Decision No 12794–(02/76), as amended by Decision No 12854–(02/96), Mozambique is on a 24-month Article IV cycle due to the approval of a PSI in June 2007. The 2007 Article IV consultation was completed by the Executive Board on June 18, 2007 (Country Report No. 07/262).

In concluding the 2007 Article IV consultation, Executive Directors commended the Mozambican authorities on the impressive macroeconomic performance and overall satisfactory program performance since the last Article IV consultation. At the same time, they noted there are policy challenges related to sustaining Mozambique's growth takeoff and to achieving the MDGs. In this regard, they agreed that the strategy to consolidate macroeconomic stability in the context of a continued scaling-up of foreign aid and the acceleration of a second wave of reforms outlined in the authorities' poverty reduction plan for 2006-09 (PARPA II) would be essential to overcome such challenges. In particular, they looked forward to the timely implementation of reforms to (i) increasing tax revenues; (ii) strengthening public sector operations; (iii) reducing the costs of doing business; and (iv) improving the management of natural resources.

Ex Post Assessment of performance under Fund-Supported Programs

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

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

FSAP participation and ROSCs

A Financial Sector Assessment Program (FSAP) for Mozambique was undertaken during the first quarter of 2003. The related Financial Sector Stability Assessment was circulated to the Executive Board on November 19, 2003 (Country Report No. 04/52). A ROSC on fiscal transparency was issued on February 22, 2001. This ROSC was updated in the context of the 2002 Article IV consultation (Country Report No. 02/140) and the 2003 Article IV consultation (Country Report No. 04/50). A new update is expected soon following a FAD mission in August 2007. A Report on the Observance of Standards and Codes (ROSC) data module was prepared in June 2002 and issued on March 5, 2003. This data module was updated in August 2005.

Management's visit

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

IMF Technical Assistance Provided to Mozambique (2005–2008)				
Departments	Timing	Form	Purpose	Counterparts
Finance	February 2008	Mission	Update of safeguard assessment	Bank of Mozambique
Fiscal Affairs	Oct-Nov 2007	Mission	Tax Administration inspection	Ministry of Finance
	September 2007	Mission	Public Private Partnerships and Fiscal Risks	Ministry of Finance
	August 2007	Peripatetic expert	Tax Policy and Administration	Ministry of Finance
	August 2007	Mission	Fiscal ROSC update and Public Financial Management inspection	Ministry of Finance
	April-May 2007	Mission	Tax Administration inspection	Ministry of Finance
	April-May 2007	Mission	Petroleum Fiscal Regime	Ministry of Finance Ministry of Mineral Resources
	December 2006	Mission	Tax Administration	Ministry of Finance
	March 2006	Mission	Tax Policy review	Ministry of Finance
	November 2005	Mission	Public expenditure management	Ministry of Finance
	October 2005	Fourth multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	May 2005	Inspection mission	Public expenditure management	Ministry of Finance
	April-May 2005	Mid-term review of the joint IMF/SECO/DANIDA domestic tax and administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
Monetary and Capital Markets	December 2007	Mission	Implementation of IFRS for Central Bank accounts.	Bank of Mozambique
	August 2007	Mission	Post-FSAP TA assessment banking supervision, monetary Policy and operations	Bank of Mozambique
	April 2007	Short-term consultant	Banking supervision	Bank of Mozambique
	October 2006	Mission	Post- FSAP TA assessment banking supervision, monetary Policy and operations	Bank of Mozambique
	Feb-March 2006	Mission	AML/CFT legislation	Bank of

IMF Technical Assistance Provided to Mozambique (2005–2008)				
Departments	Timing	Form	Purpose	Counterparts
				Mozambique
	Jan-Feb 2006	Short-term consultant	Monetary policy framework	Bank of Mozambique
Monetary and Capital Markets	Jan-Feb 2006	Short-term consultant	Monetary operations	Bank of Mozambique
	January 2006	Short-term consultant	Exchange rate management	Bank of Mozambique
	September 2005	Mission	Post- FSAP TA assessment banking supervision, monetary Policy and operations	Bank of Mozambique
Statistics	March-April 2008	Mission	National accounts statistics	National Institute of Statistics
	February 2008	Mission	Balance of payments statistics	Bank of Mozambique
	December 2007	Mission	Balance of payments statistics	Bank of Mozambique
	November 2007	Mission	Monetary and financial statistics	Bank of Mozambique
	June-July 2006	Mission	Consumer price statistics	National Institute of Statistics (INE)
	August 2005-July 2006	Long-term consultant	National accounts statistics	National Institute of Statistics
	July 2005	Mission	Government finance statistics	National Institute of Statistics
	June–July 2005	Mission	Consumer price statistics	National Institute of Statistics
	May 2005	Mission	Balance of payments statistics	Bank of Mozambique

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

Appendix II
Mozambique: World Bank- IMF Joint Management Action Plan
(As of April 22, 2008)

Mozambique: World Bank-IMF Joint Management Action Plan

Title	Products	Timing of Missions	Expected delivery date
A. Mutual information on relevant work program in next 12 months			
Bank work program	CEM on export competitiveness and regional integration	February-May 2008	Nov-08
	PRSC5 supporting government reforms program in PFM, governance and economic development reforms	—	Nov-08
	FSTAP project support to financial sector reforms	Nov-08	ongoing
	ESW on inter-governmental fiscal architecture (for decentralization)	—	Sep-08
Fund work program	Third Review of the PSI	Oct-08	Dec-08
	Follow up mission on Tax Administration	Apr-08	May-08
	Inspection mission on PFM	Aug-08	Sep-08
	Follow up mission on Monetary Policy and Operations, Banking Supervision and Accounting	Sep-08	Nov-08
B. Requests for work program inputs with summary justification			
Bank request to the Fund	Updated Macro Framework data, and PSI reviews Staff Report on macro developments	PSI reviews	April and October 2008
	Board Chairman Summing up from PSI review discussion (or Assessment letter) not older than six-months	—	Sep-08
Fund request to the Bank	Updates on advancing structural reforms: procurement, decentralization, business environment, financial sector	—	March and September 2008
C. Agreements on joint products and missions			
Joint products	Policy advice on subsidies (food and energy)	May - September 2008	Dec-08
	Policy advice on improving the domestic impact of large investment projects	February - April - May 2008	May-08
	Policy advice on Public Sector Salary Reforms (incl. pensions)	ongoing	Oct-08
	FSAP	Fall 2008 (exact time to be determined)	Fall 2008 (exact time to be determined)
	PFM : update work plan for 2009-11 in light of findings from PEFA and ROSC)	Meeting in May 2008	Aug-08
	PFM : continue to monitor consolidation and expansion of e-SISTAFE	ongoing	ongoing
	DSA	Oct-08	Dec-08
	Support to EITI membership, and scoping report on EITI++	ongoing	Aug-08

Appendix III
Mozambique: Statistical Issues

1. Data provision to the Fund for surveillance purposes is adequate, but shortcomings hinder policy formulation and monitoring of economic development. Moreover, despite the increase in budget resources allocated to the compilation of official statistics, continued high reliance on external funding raises concerns about the sustainability of the programs of the National Institute of Statistics (INE). Mozambique participates in the IMF's General Data Dissemination System since November 2003. The metadata and plans for improving the statistical system that are posted on the Dissemination Standards Bulletin Board, however, need to be updated.

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

3. A successor project (GDDS2) of the General Data Dissemination System project for the Anglophone African countries was launched in 2006. Mozambique is among six countries which agreed to participate in the external sector module of GDDS2. Within this project, a three-year work plan is being developed with the view to improving the quality of balance of payments (BOP) and international investment position (IIP) statistics, with a particular focus on private sector cross border financial flows and stocks.

National accounts

4. The national accounts are prepared by the INE in accordance with the *1993 System of National Accounts* (*1993 SNA*). In August 2007, the INE released for the first time the quarterly GDP estimates at constant prices covering the 2000-2007 period, along with a revised annual GDP series for the period 1991-2006, having 2003 as the new base year. A recent STA mission (March-April 2008) advised the authorities on further improvements needed to advance the quarterly national accounts compilation at current prices, possibly starting in mid-2009. The INE compiles and disseminates (i) annual GDP at current and constant (1996) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; and (iii) annual value added components at current prices by activity. The INE has launched a new household income and expenditure survey and new economic censuses leading to a new business registry. Furthermore, it is compiling more comprehensive and timely foreign trade data based on improved classification systems.

Prices and labor market

5. A consumer price index for Maputo based on weights derived from the 2002–03 household survey was released in February 2006. The previous series, available since 1998, was widely criticized for narrowly focusing on a few basic food staples with relatively volatile prices and, therefore, exhibiting large swings. A national index obtained by integrating the indices for Maputo, Beira, and Nampula was released in April 2006. The IMF has provided technical assistance in price statistics in the context of the GDDS Regional Project for Lusophone African Countries. The last technical assistant mission (June 11–July 21, 2006) under the GDDS project found important advances regarding the use of the COICOP classification and the strengthening of human resources in the compilation of the new CPI. Several issues remain outstanding, however, such as price collection procedures not fully consolidated at the provincial level, imputation methods, and possible inconsistencies in the overlapping period between the new and old series.

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

Monetary statistics

7. An STA mission in September 2004 prepared a work plan for the implementation of the *Monetary and Financial Statistics Manual (MFSM*) and the development of an integrated monetary database (IMD) to meet the needs of the Bank of Mozambique (BM), AFR, and STA. The mission noted progress in the information system and in the periodicity and timeliness of the data compiled. The mission found that the BM's chart of accounts was not fully aligned with the *MFSM* in terms of the sectorization of the institutional units and the breakdown between local and foreign-currency-denominated accounts. The mission recommended improving the classification and valuation of some financial instruments, estimating the full instrument and sectoral breakdown based on available information, and expanding the coverage of the survey on other depository corporations by including the credit cooperatives, in the medium term.

8. Mozambique now reports monetary data to STA using the standardized forms (SRFs). As a result, five-year historical enhanced data are being published in the IFS Supplement.

9. A follow-up monetary and financial statistics mission that visited Maputo in November 2007 assisted the authorities in completion of the development of the IMD to be consistent with the SRFs. The IMD is now fully operational, which allow the derivation of accurate and timely monthly monetary statistics that meet the needs of STA, AFR, and the authorities, while reducing BM's reporting burden.

External sector statistics

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

11. The BM has an adequate institutional framework for the compilation of BOP and IIP statistics, and has implemented many of the recommendations made by the four technical assistance missions conducted since mid-2003. However, in order for the work on institution building to be consolidated, the Foreign Exchange Law has to be approved (incorporating the definition of residency in alignment with he BPM5 methodology), training on BOP statistics has to be sustained, and the project to computerize the balance of payments compilation system has to be completed. The major improvements in the basic sources of data from the beginning of the project comprise (i) the distribution of the new BOP surveys to more than 35 enterprises, including the mega-projects; (ii) program improvements by Customs to ensure the quality of external trade data; (iii) improvements in the reports on transportation services, foreign investment, and private loans prepared by the BM; (iv) improvements in the reports on the external public debt provided by the Ministry of Finance; and (v) improvements in the banks' reports on foreign currency transactions. To improve the collection, timeliness, and quality of data on goods, a panel on foreign trade statistics was established, comprising representatives from the Directorate General of Customs, National Statistics Institute, and BM.

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

13. In 2007, the BM has started to compile and report to the STA comprehensive IIP data. Previously, only partial IIP data had been reported and published in the *2005 Balance of Payments Statistics Yearbook*.

Government finance statistics

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

15. The creation of a statistical unit in the MOF and the launching of the Integrated Management and Financial Information System (SISTAFE) will contribute to enhance the analytical usefulness of government finance statistics in the near future. However, the

mission found that the budget system, while broadly aligned to the *GFSM 1986* analytical framework, is inadequate to compile GFS. In particular, further work is needed to improve institutional and transactional coverage.

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

Mozambique: Table of Common Indicators Required for Surveillance
(As of April 22, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	Mar. 2008	Mar. 2008	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]							
Reserve/Base Money	Jan. 2008	Mar. 2008	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Jan. 2008	Mar. 2008	M	M	M		
Central Bank Balance Sheet	Jan. 2008	Mar. 2008	M	M	M		
Consolidated Balance Sheet of the Banking System	Jan. 2008	Mar. 2008					
Interest Rates[2]	Jan. 2008	Mar. 2008	M	M	M		
Consumer Price Index	Mar. 2008	Apr. 2008	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]						LO, LNO, LO, O	LO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government							
Stocks of Central Government and Central Government-Guaranteed Debt[5]							
External Current Account Balance	Dec. 2007	Mar. 2008	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services	Dec. 2007	Mar. 2008					
GDP/GNP	2006	Feb. 2007	A	I	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt	Dec. 2007	Mar. 2008	A	I	I		

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

Statement by the IMF Staff Representative
May 28, 2008

The following information has become available since the staff report was issued. It does not change the thrust of the staff appraisal.

- The following measures have been implemented: (i) the draft law on excise taxes for alcoholic beverages and tobacco was submitted to Parliament in mid-May (end-February 2008 structural assessment criterion); (ii) civil service salaries in the Ministry of Finance were paid through the integrated information management system (e-Sistafe) in April (April 2008 structural benchmark); (iii) the ministerial decree for the multi-currency single treasury account (CUT) was issued in early May; (iv) the draft strategic plan of the justice sector has been finalized and will be presented to the Council of Ministers by end-May.

- Preliminary data, subject to revision, suggests that the authorities met the indicative program targets for end-March on reserve money and net international reserves by comfortable margins.

- Monthly inflation has decelerated in the last three months, mainly because of weakening food price inflation in line with seasonality and in line with the program.

- Government and development partners attended a high-level meeting on May 19, 2008, organized by Fund and Bank staff, to discuss policy responses to the high world oil and food prices. There was broad agreement to avoid extensive interventions, including sweeping price subsidies and tariff reductions, in favor of well-targeted support efforts, including well-targeted subsidies and higher safety-net cash-transfers, and measures to raise agricultural production.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 08/123
FOR IMMEDIATE RELEASE
May 29, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under the Policy Support Instrument (PSI) for Mozambique

The Executive Board of the International Monetary Fund (IMF) has completed the second review of Mozambique's economic performance under a three-year Policy Support Instrument (PSI). The Executive Board also granted a waiver of nonobservance of two end-December 2007 quantitative assessment criteria pertaining to base money and to net credit to the Government, as well as one structural assessment criterion on a draft law on excise tax on alcoholic beverages.

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

Following the Board's discussion on Mozambique, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, made the following statement:

"Mozambique's overall macroeconomic performance under the Policy Support Instrument has been satisfactory, reflecting prudent fiscal and monetary policies in the context of a flexible exchange rate regime and the authorities' commitment to avoid monetary financing of the budget. Economic growth remains resilient to shocks, and average annual inflation has decelerated despite high oil and food import prices.

"The authorities are to be commended for the progress in improving tax administration and public financial management. Implementation of the e-SISTAFE (public financial administration system) has progressed well, but timely donor financial support will be important for its completion. The causes of the 2007 shortfalls in aid disbursements will need to be addressed to allow a scaling-up of aid in 2008. It will be important for the government to use well-targeted and fiscally sustainable measures to mitigate the social impact of further increases in oil and food prices, while at the same time resisting pressures for unsustainable additional spending related to the elections. It will also be important to ensure that the civil service wage and pension reforms do not compromise fiscal sustainability.

“The Bank of Mozambique has continued to strengthen its monetary policy framework and internal audit procedures. The Treasury’s commitment to provide weekly cash-flow projections to the central bank is an important step towards better liquidity management.

“Reforms to stimulate private sector development and improve management of Mozambique’s natural resources are a high priority. It will be important to implement the medium-term strategic plan to improve the business environment. Good progress has been made in implementing the mining and petroleum fiscal regime laws. It will be important to enhance the Ministry of Finance oversight of the fiscal terms of new megaproject agreements. Adherence to the Extractive Industries Transparency Initiative will help make Mozambique’s business environment more transparent.

“Strengthening public governance remains a key focus of the reform agenda, and implementation of the government’s governance strategy needs to be completed in a timely manner,” Mr. Portugal said.

The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. Members' performance under a PSI is reviewed semi-annually, irrespective of the status of the program (see Public Information Notice No. 05/145).

Statement by Peter Gakunu, Executive Director for Republic of Mozambique and Jose Sulemane, Advisor to Executive Director
May 28, 2008

1. The Mozambican authorities appreciate the continued support by the Fund and the valuable and constructive policy dialogue and advice given by staff. They broadly agree with the thrust of the analysis, conclusions, and recommendations in the staff report. They reaffirm their commitment to pursuing prudent policies under the PSI and request the completion of the second review.

Performance under the Program

2. The authorities remain committed to implementing reforms, as is evidenced by the satisfactory implementation of the 2007 program. However, two quantitative assessment criteria (ACs) for end-December 2007 and one structural AC through end-February 2008 were missed. The end-December 2007 AC for base money was missed by a narrow margin because of an unanticipated and temporary increase in money demand over the end-year festive season. The adjusted Net Credit to the Government (NCG) at end-December 2007 was higher by 0.8 percent of GDP mainly due to shortfall on foreign financing for on-lending to public enterprises and deficiencies in cash-flow management. To redress the latter, the government has decided to strengthen the monitoring of the transfers of public enterprises and to revise the public enterprise law to avoid recurrences of such slippages in the future. In this regard, the authorities request modifications to the quantitative assessment criteria and the adjuster on the base money, which are reflected in the Technical Memorandum of Understanding attached to the MEFP. The structural AC related to submission to Parliament of the excise tax on alcoholic beverages, beer, and tobacco was postponed from February to May 2008, due to the need to draft a more comprehensive legislation. The draft law has been submitted to the Parliament.

Recent Economic Developments

3. In 2007, economic performance remained strong despite the weather and external shocks. Real GDP growth was higher than targeted. Thanks to prudent monetary policies, core (nonfood and energy) inflation was 5.1 percent. However, average headline inflation declined from 13.2 percent in 2006 to 8.2 percent, somewhat higher than programmed, on account of the rise in international food and oil prices.

4. On the fiscal side, revenues were higher than targeted due to buoyant direct domestic taxes (0.4 percent of GDP), while current expenditures were in line with the program. However, investment expenditures were substantially lower than envisaged on account of a significant shortfall in the disbursement of external financing. The share of priority spending was below the 65 percent target, due to the low execution rate of the donor-financed projects. Overall, the adjusted Net Credit to the Government (NCG) at end-December was higher by 0.8 percent of GDP mainly due to a shortfall in net foreign financing.

5. Monetary policy has remained prudent. At end-December 2007, net international reserves exceeded the program target despite a deceleration in traditional exports, and higher sales of foreign exchange. Base money exceeded its end-December AC due to unanticipated and temporary strong increase in money demand over the end-year festive season, but declined sharply in early January 2008 to levels consistent with the program. In January 2008, the Banco de Moçambique (BM) reduced interest rates on its lending and deposit standing facilities, and reduced the legal reserve requirement to the SADC average (excluding South Africa) effective April 2008. To mop up excess liquidity, the BM started using reverse repo auctions in July 2007. Monetary policy transparency and credibility were enhanced with the regular publishing of the communiqués of the Monetary Policy Committee, which together with its regulations are available on the BM's website.

6. There has been considerable progress on structural reforms, particularly in the areas of improving the business environment. In February 2008, the Council of Ministers approved a strategic action plan prepared in consultation with the World Bank, with clear responsibilities and a timetable to streamline the business environment and to remove constraints that inhibit private sector development. The financial implications of the action plan are under preparation and efforts are being made to improve coordination of donor support in this area. In relation to the judicial reform, a key component on governance, progress was slower than envisaged. The submission to the Council of Ministers of the draft Integrated Strategic Plan of the Justice Sector and the draft law revising principles and regulation of the Institute for the Provision of Judicial Assistance (Instituto de Patrocínio e Assistência Jurídica—IPAJ) is pending. However, significant progress was made in reducing the courts' large backlog of cases in 2007.

7. The Government has initiated the necessary steps for official declaration of adherence to the Extractive Industry Transparency Initiative (EITI) in the course of 2008. In addition, the Cabinet met in April to discuss the adoption of an appropriate legal instrument, coordinated by the Minister of Finance, to strengthen the mechanism to ensure that megaprojects follow the fiscal regime before they are submitted to the Cabinet for approval.

Outlook and Policies for the Remainder of 2008 and the Medium Term

8. Looking ahead, the policies set out by the authorities continue to aim at consolidating macroeconomic stability and sustaining strong broad-based growth through a second generation of reforms. These will focus on the public sector reform, improving the business environment, and ensuring that natural resources are managed transparently in accordance with best practices for the benefit of current and future generations. An important aspect of the policy thrust is the development of human capital, in the context of the fight against pandemics such as HIV/AIDS and other diseases.

9. The outlook for 2008 remains positive. While the floods have had a severe humanitarian impact in some parts of the country, only 3 percent of cultivated land has been affected and the overall economic impact is likely to be limited. In this regard**,** economic expansion in Mozambique will continue its robust path in 2008, with growth across most sectors boosted by macroeconomic stability and continued donor support. The economy will benefit from a second wave of megaprojects, namely in coal and gas. Furthermore, policies

will be geared towards avoiding a dual economy by giving priority to improving the business environment with a view to strengthening small and medium-sized enterprises for employment generation and improving the standards of living of the population. The external current account deficit is targeted to widen because of an acceleration of aid disbursements, and international reserves will remain at comfortable levels. Nonetheless, there are risks related to natural calamities, a continued surge in international oil and food prices, and spending pressure during the election period.

10. Although poverty has been declining, several studies point to concerns on social inequalities. In this context, and given the current external shocks, the authorities have prioritized protection of vulnerable groups within the society as the country addresses its development challenges. Therefore, the authorities consider as critical, efforts to strengthen the monitoring of poverty, and will continue to develop mechanisms for public resource allocation in accordance with the priorities defined in PARPA II.

Fiscal Policy

11. Fiscal policy continues to evolve in line with medium- to long-term sustainability. The budget envisages no recourse to domestic bank financing, with Government efforts to increase revenues by 0.5 percent of GDP in 2008. The increase in domestic revenue is expected to come from improvements in revenue administration, and new tax policy measures including revisions to the personal income and corporate income tax codes, reduction in VAT exemptions, collection of tax arrears, continued adjustment of fuel taxes, and an increase in the number of tax payers by 100,000. Non-tax revenues are expected to increase on account of higher concession fees from Hidroeléctrica de Cahora Bassa (HCB). The losses related to trade liberalization will be mitigated by bringing a number of off-budget revenue items onto the budget.

12. Expenditures take into account the election related costs and the subsidies for minibus fares. The wage bill will reach 8.3 percent of GDP and includes hiring of additional teachers, health workers, and reinforcement of security forces. To strengthen the monitoring of net lending to public enterprises a study, with technical assistance, will be undertaken that will serve as a basis for drafting by December 2008 the relevant law with requirement for monthly financial reporting to the Ministry of Finance (MF). The government is committed to continue to strengthen the national procurement system. In this context, during the month of May, the government in collaboration with the World Bank and other development partners, concluded an evaluation of its procurement system using the OECD/DAC methodology. The final report will be available in June 2008.

13. In response to the floods and a cyclone in early 2008, the government, with the collaboration of development partners, assisted the affected population. Over 100,000 people had to be moved to resettlement centers. In addition, oil and food prices are having their impact on policy options. In early February, a large increase in negotiated transportation fares for private minibuses resulted in riots in a number of cities. The government revoked the increase and agreed to temporary subsidize fuel for minibuses operators, at a cost of 0.15 percent of GDP, resulting in a reallocation of resources in Budget 2008. The authorities are

analyzing the impact of the oil and food prices given the structure of the economy. Although the program allows for some safeguards, we urge the Board and Management to be more understanding by providing fiscal space to enable them to address these challenges and greater access to Exogenous Shock Facilities. Finally, recent developments in South Africa will also need some actions from the authorities, as many migrant workers are and will return to Mozambique.

14. In view of the relatively low disbursement in 2007 of committed project financing and special programs, the authorities together with the international community will explore the options for accelerating aid disbursements in 2008. To further enhance the public financial management (PFM), the authorities will continue to encourage the donor community to shift their foreign financial project and special programs to the Single Treasury Account (CUT).'

Monetary and Exchange Rate Policy

15. The central bank with its anti-inflation policies, will control the money supply and keep exchange rate stable with a view to containing imported inflation. On monetary policy, the BM will continue to target base money to achieve an average inflation of 7-8 percent in 2008. The BM will use foreign exchange sales to sterilize liquidity and thus avoid a build-up in domestic debt and a crowding-out of the private sector. The BM will fine-tune monetary operations, improve liquidity management, and deepen financial markets. The MF will improve its cash-flow projections and communicate them to the BM on a weekly basis. Furthermore, the BM is also keen to reduce lending rates, although there are structural issues to be tackled in this area. In this regard, the BM is reviewing and updating the regulatory framework, improving its ability to evaluate the quality of portfolios, supporting the expansion of non-bank financial sector and microfinance deposit-taking institutions to enhance the access to finance by rural households.

16. Regarding the foreign exchange system, a new law was submitted to Parliament in September 2007. Following approval of the new law and implementing regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

Structural Reforms

17. The Mozambican authorities are accelerating reforms to reduce the costs of doing business. To address this challenge and significantly improve the investment climate in Mozambique, actions are envisaged on business inspections, insolvency legislation, licensing at provincial level, simplification of VAT refunds, cross-border trading, and property registration. On other structural reforms, the public sector reform program is being reinvigorated, particularly on issues of decentralization, reform of the wage policy, and the implementation of the Integrated Plan of the Justice Sector. In relation to megaprojects, the MF intends to implement a number of measures aimed at improving the overall fiscal risk management, fiscal regimes, accountability and transparency.

18. Mozambique having reached agreement on an interim Economic Partnership Agreement (EPA) with the European Union (EU), will continue to benefit from quota and duty free access to the EU market. Negotiations with the EU on a final EPA agreement will continue together with other SADC countries. The Government is also pursuing bilateral free trade arrangements, recommended in the Diagnostic Trade Integration Study (DTIS), as an engine to promote economic growth.

Conclusion

19. The Mozambican authorities remain committed to implementing prudent policies and to advance with the reform agenda. They are, however, aware of the remaining challenges in the governance area that are a subject of concern that should be tackled in order to sustain the successful reforms undertaken in the last decade and a half. These will be achieved through effective implementation of the PSI arrangement within the framework of PARPA II, which seeks to attain macroeconomic stability, and enhance revenue mobilization and efficient use of public resources through the PFM reforms. At the same time, the country will face additional challenges in the wake of the food and oil price increases and reduced demand in major export markets. This will require boosting the agricultural sector, where most of the labor force is located. In addition, the authorities are cognizant of the need for inclusiveness in the growth process as critical for addressing inequalities and income distribution, while maintaining focus on environmental sustainability.

20. Implementing the second generation of reforms will require increased capacity within the domestic institutions of the public administration of Mozambique. In this regard, the authorities count on the Fund to provide them with a wide range of TA support to enable implement economic policies to spearhead further growth. They call on the Fund to ensure that in the implementation of its current policy on TA special attention is taken to safeguard the development objectives of the country. The authorities, therefore, call on the Board and Management that the momentum of reform efforts that has been achieved with Fund-supported programs is not jeopardized.

21. On April 30, 2008, the authorities and the Program Aid Partners (PAPs), known as the "G-19", completed the annual Joint Review (JR) of the general budget support. During the JR, both the authorities and the PAPs evaluated their performance in relation to a set of performance-indicators for the year 2007, based on the Paris Declaration principles and commitments. The JR concluded that there exists a satisfactory basis to continue to give budget support to Mozambique. In this context, the authorities are very grateful for the support from the Fund and the international community, and will continue to count on such support, while making efforts to transform the structure of the economy for the well-being of the Mozambican population.