INTERNATIONAL MONETARY FUND

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REPUBLIC OF MOZAMBIQUE

January 2014

First Review Under the Policy Support Instrument and Request for Modification of Assessment Criteria—Staff Report; Press Release

In the context of the first review under the policy support instrument and request for modification of assessment criteria, the following documents have been released and are included in this package:

- The **Staff Report** for the First Review Under the Policy Support Instrument and Request for Modification of Assessment Criteria, prepared by a staff team of the IMF for the Executive Director's consideration on lapse of time basis, following discussions that ended on October 30, 2013, with the officials of Mozambique on economic developments and policies underpinning the IMF arrangement under the Policy Support Instrument. Based on information available at the time of these discussions, the staff report was completed on December 27, 2013.
- A **Press Release**.

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

Letter of Intent sent to the IMF by the authorities of Mozambique*
Memorandum of Economic and Financial Policies by the authorities of Mozambique*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOZAMBIQUE

December 27, 2013

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

KEY ISSUES

Context and outlook. Mozambique's macroeconomic outlook remains favorable and the PSI-supported program is broadly on track. All assessment criteria were met and most indicative targets, but there was some slippage on structural reforms. Economic growth is robust and inflation remains moderate. In spite of risks stemming from the uncertain global economy, growth is expected to be sustained in the medium term by the natural resource boom and infrastructure investment. A recent government guarantee for large-scale borrowing by a public enterprise has raised transparency and prioritization issues that point to the need to strengthen investment and macroeconomic planning. New risks associated with the political/security environment have emerged.

Short-term policy framework. The main short-term challenge is to maintain the growth momentum and to contain the fiscal expansion envisaged in 2014, reflecting both election year pressures and the spending of one-off revenue windfalls and of external borrowing. Key fiscal priorities include improving VAT administration, using windfall revenue to build buffers and invest, strengthen investment implementation capacity, and ensure transparency and adherence to due process for investment selection and borrowing. Monetary policy will need to be vigilant and monitor inflation developments closely.

Medium-term challenges. Structural reforms along a broad policy spectrum should be implemented vigorously to foster sustained and more inclusive growth. With foreign aid likely to decline over the medium term, increased nonconcessional borrowing can provide additional resources for improving physical infrastructure and human capital. Further strengthening debt management and investment planning and implementation are essential to ensure the efficiency of investment and borrowing. Completion of the new mining and hydrocarbon legislation, the related fiscal regimes, and implementation regulations would facilitate the economic development of Mozambique's natural resources.

Approved By
David Robinson and Vivek Arora

A staff team comprising Mmes. Ross (head), Masha, Messrs. Inui, Xiao (all AFR), and Perone (SPR) visited Maputo during October 16–30, 2013. Mr. Robinson (AFR) joined during October 23-24. The mission met with the Prime Minister Vaquina, Ministers Chang (Finance), Cuereneia (Planning and Development), and other line ministers and senior government officials (Energy, Agriculture, Natural Resources, Industry and Trade, Women and Social Action), Bank of Mozambique Governor Gove, and other senior government officials. The mission also met with development partners, civil society, academia, and the private sector. It was assisted by Mr. Segura-Ubiergo (resident representative), Mr. Simione, and Ms. Palacio (resident representative office). Messrs. Saidy (OED), Revilla and Blanco Armas (World Bank) participated in some of the policy discussions.

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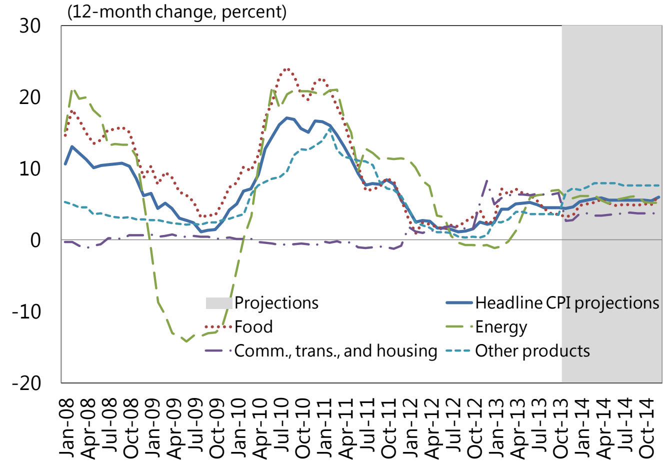
BACKGROUND AND RECENT DEVELOPMENTS

MEFP ¶2

1. **Economic growth remains robust with a quick recovery from the severe floods in early 2013.** Heavy rainfall caused flooding mostly in the South of the country in early 2013 that resulted in major damage to crops, transport infrastructure and electricity transmission lines. Nonetheless, real GDP is estimated to have expanded by 6.6 percent in the first half of 2013, spurred by the extractive industries, financial services, transport and communications, and government services. Damage to transport infrastructure has been largely repaired later in the year. Overall in 2013, agriculture is projected to grow at about 5 percent, while overall growth is to reach 7.1 percent.

Mozambique: CPI Projections
(12-month change, percent)



2. **Inflation remains moderate.** Annual inflation stood at 3.3 percent in November, helped by a prudent macroeconomic policy mix, a slight appreciation of the metical, stability in administered prices (fuels, public transport, utilities), as well as the recovery of domestic production of fruits and vegetables after the floods. Notwithstanding the active monetary policy stance of the Bank of Mozambique (BM) to stimulate credit expansion, end-year inflation is projected to remain around 4½ percent, below the authorities' medium-term target.

3. **Fiscal outcomes have exceeded program targets, as revenues were boosted by sizeable windfall capital gains tax receipts (4.2 percent of GDP).** After the receipt of $224 million early in the year, in August the government received another $400 million capital gains tax from the sale of shares between investors in gas concessions in the Rovuma basin (off the shore of Northern Mozambique). The initial windfall was used in the supplementary budget for 2013 (adopted in August) mainly to fund flood recovery measures and wage concessions to settle health sector strikes. The second windfall receipt is to be spent in the 2014 budget. Excluding windfall receipts, revenue performance was in line with the program through September. Expenditure execution, especially the capital budget, was slower than programmed partly reflecting delays in donor disbursements. As a result, net credit to the government was well below its program ceiling.

4. **The external current account deficit widened in the first half of the year, although the windfall capital gains tax receipts helped bolster net international reserves (NIR).** Exports dropped in the first half of 2013 compared to a year earlier, largely due to the disruptions caused by the floods. At the same time, merchandise and service imports continued to increase, reflecting megaproject activity financed by foreign direct investment. Delays in donor

disbursement also contributed to a deterioration in the NIR position, yet the $400 million capital gains tax receipts in August more than offset the earlier loss.

5. **Foreign borrowing remained within the program ceiling, despite the issuance of a large government guarantee.** The government guaranteed Loan Participation Notes of $850 million (6 percent of GDP) for *Empresa Moçambicana de Atum, S. A.* (EMATUM)—the Mozambican Tuna Company, which was established in August 2013 by three public entities. In early September EMATUM's subsidiary (EMATUM Finance registered in the Netherlands) issued $500 million of 7-year notes in a private offer; this was topped up to $850 million in late September. The effective interest rate was 8.5 percent, somewhat higher than recent sovereign issues of Sub-Saharan African countries. While the stated purpose of EMATUM is to establish a tuna fishing fleet, the scope of this operation is broader, including quasi-fiscal activities in the area of defense/maritime security. It was Mozambique's first international debt issue and established a benchmark for Mozambican borrowers in international capital markets.

6. **Program performance remains broadly satisfactory—all end-June assessment criteria (ACs) were met but there was some slippage on structural reforms.** All but one indicative target (ITs) for June and September were also met; priority spending fell some 10 percent short in both periods (Table 7). Donor disbursements were lower than envisaged, but implementation was also constrained by limited administrative capacity at the sectoral level, weaknesses in the procurement system, and there may have been some statistical underreporting. A catch-up is expected in the last quarter; going forward, the authorities intend to strengthen the execution of priority spending (MEFP para. 3). The authorities continued their structural reform program; they met 4 of 7 structural benchmarks (SBMs), another 2 are expected to be met with up to 3 months delay, but a critical benchmark on the Integrated Investment Plan (IIP) was missed. While an IIP was approved with a delay, it is not consistent with the program as it lacks specificity and operational links to the budget and DSA (Table 8).

Program Performance

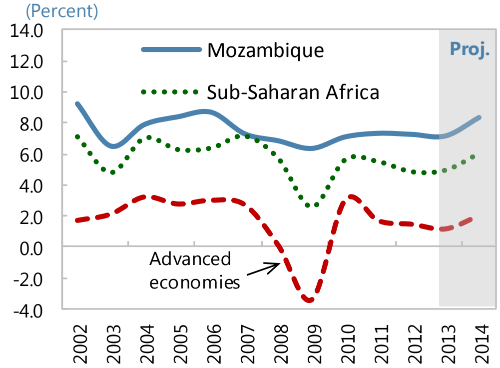
	June 2013 AC	Sept 2013 IT
Assessment Criteria		
Net credit to the government	●	●
Stock of reserve money	●	●
Stock of net international reserves	●	●
Nonconcessional external debt	●	●
Stock of short-term external public debt	●	●
External payments arrears	●	●
Indicative Targets		
Government revenue	●	●
Priority spending	▲	▲

● met ▲ not met

Figure 1. Mozambique: Impact of Global Developments

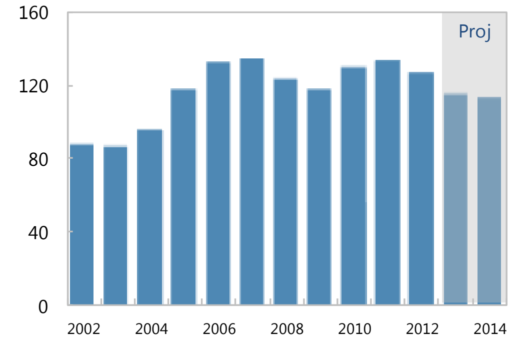
Despite the global weakness, Mozambique's growth outlook is robust.

Real GDP Growth
(Percent)



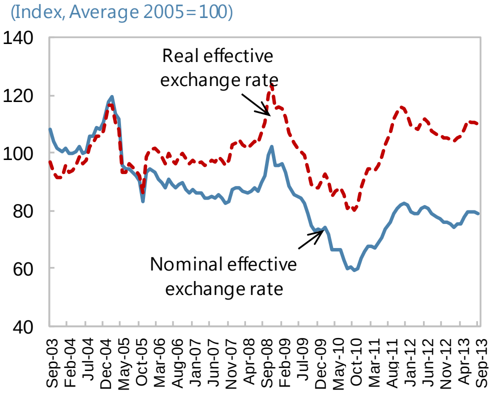
Mozambique's terms of trade have weakened with international commodity prices...

Terms of Trade Index
(2005=100)



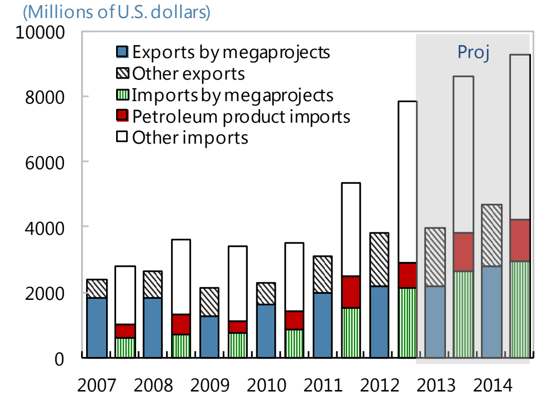
...while the real effective exchange rate has been broadly stable in the past two years.

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



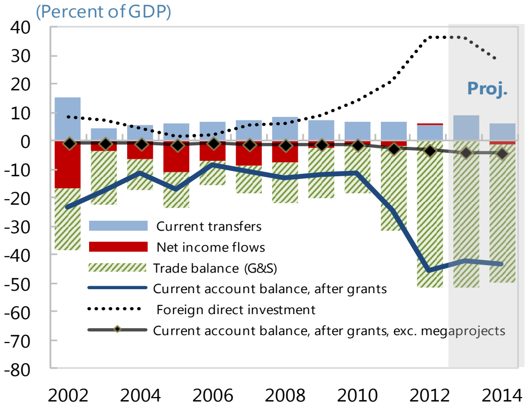
Megaprojects' export growth was counterbalanced by investment-related and fuel imports.

Merchandise Trade
(Millions of U.S. dollars)



The current account deficit has widened, reflecting sizeable investment imports for natural resource development.

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



Despite strong private capital inflows, the reserve cover declined owing to rapid import growth.

Private Foreign Capital Inflows and Reserve Cover

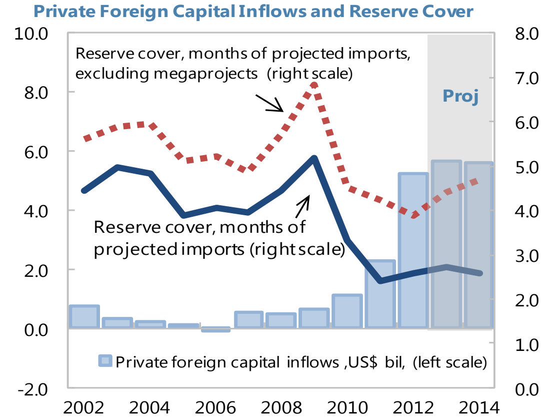
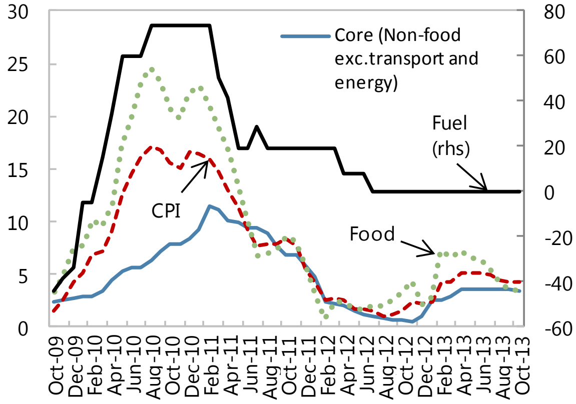


Figure 2. Mozambique: Inflation and Monetary Developments

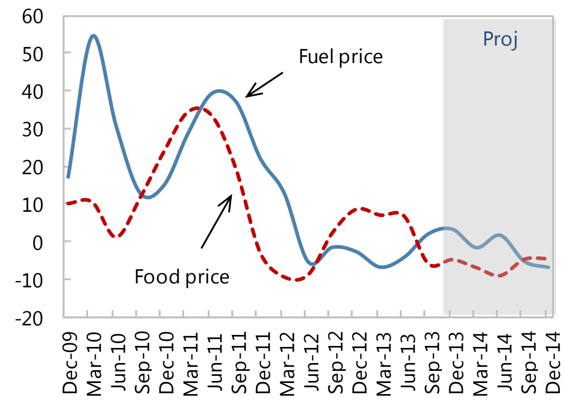
Inflation remained low, after a temporary rise after the floods in early 2013.

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



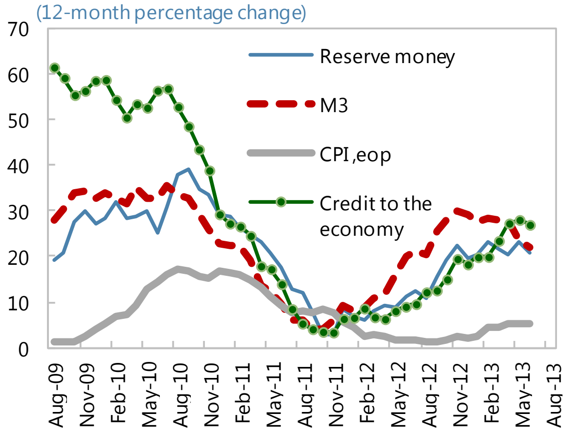
Low inflation was helped by favorable developments in international prices and...

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



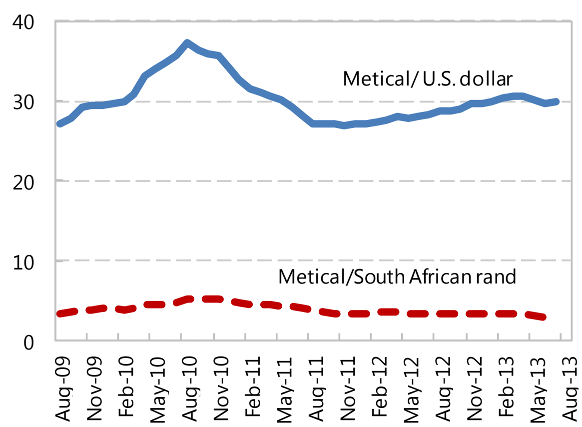
...the monetary tightening during 2010-11. Looser broad money since 2012 fed private sector credit growth and may generate some inflationary pressures.

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



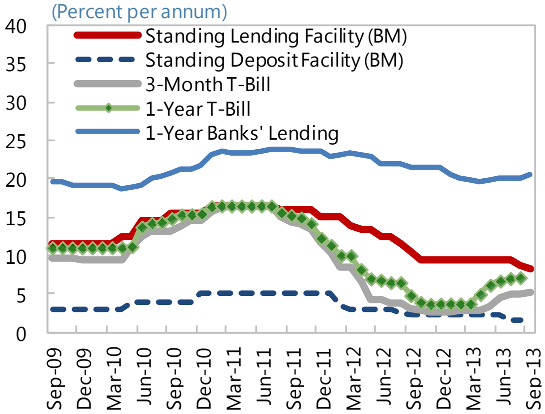
The Mt/$ exchange rate depreciated somewhat in 2012 but has been fairly stable in 2013. The rate against the rand appreciated in 2013.

Bilateral Exchange Rates



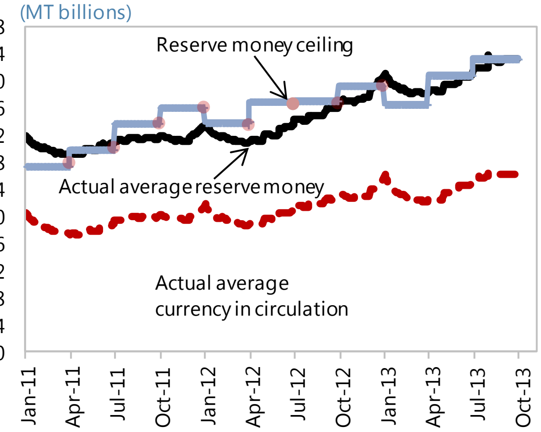
The BM's policy rates and the T-bill rates have come down, although banks' lending rate remains sticky.

Interest Rates
(Percent per annum)



Reserve money was in line with program targets, helping to maintain a low inflation environment.

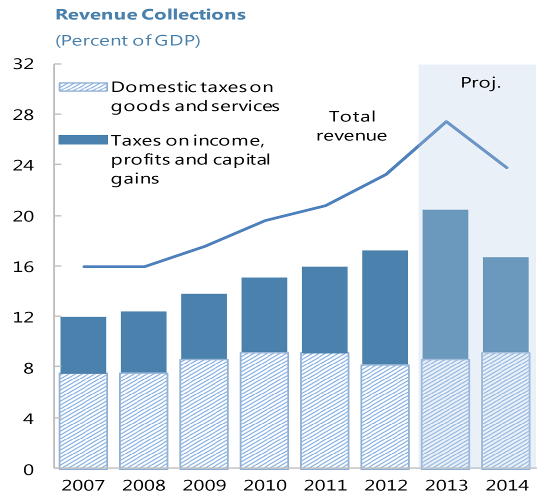
Reserve Money
(MT billions)



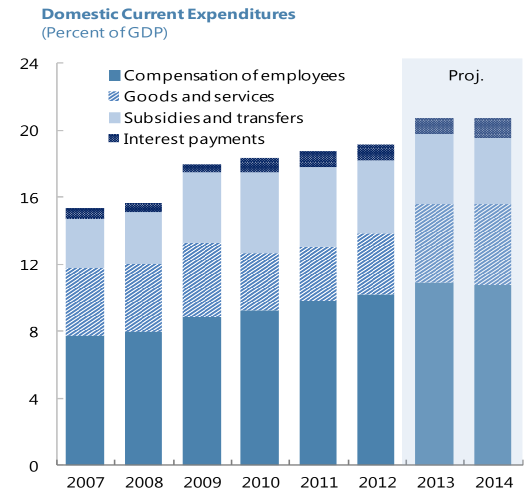
Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 3. Mozambique: Fiscal Developments

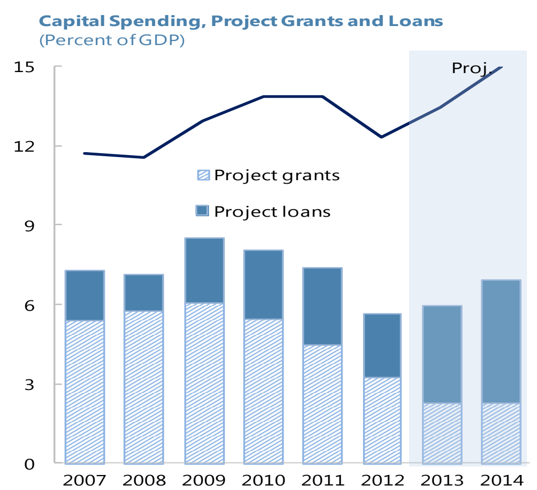
Windfall revenues in 2013 boosted revenue collections temporarily.



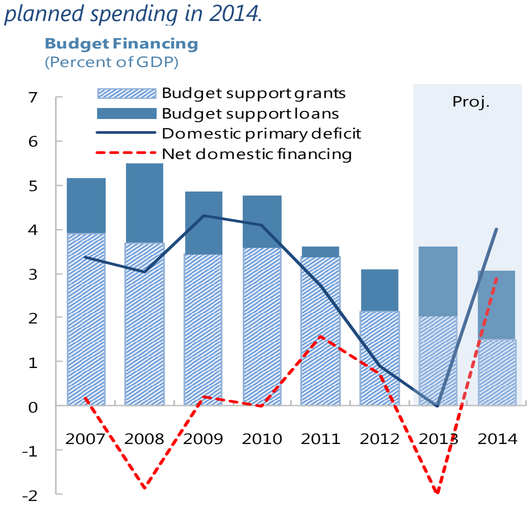
Spending on subsidies, especially the fuel subsidy, was contained, providing room for other spending. The rising wage bill should be reined in.



Capital spending financed by external borrowing as well as domestic financing is rising as project grants decline.



The domestic primary deficit (and net domestic financing) reflects the saving of windfall revenues in 2013 and the planned spending in 2014.

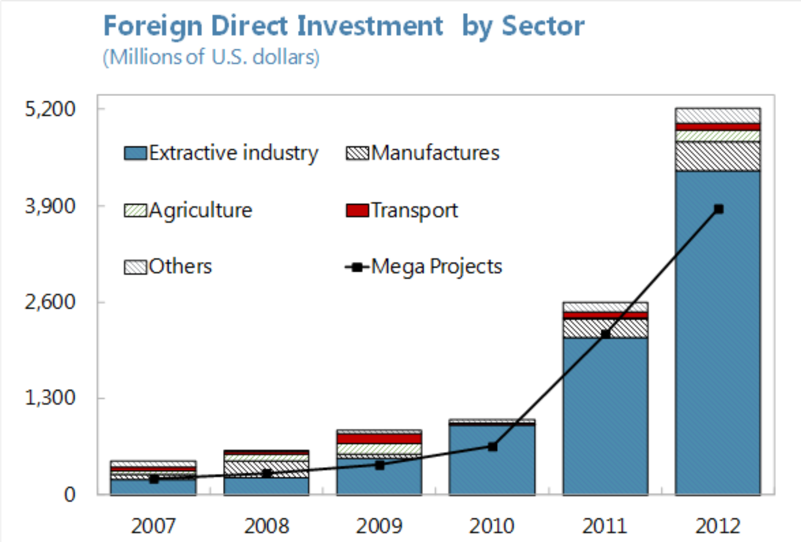


Sources: Mozambican authorities and IMF staff estimates and projections.

ECONOMIC OUTLOOK AND POLICY DISCUSSIONS

7. **Economic momentum is expected to remain strong in the medium term, buttressed by mining exports and investment in the natural gas industry. In 2014, economic growth is expected to accelerate** to over 8 percent with a strong recovery of agriculture after the floods, increased capacity of the major railway and implementation of several infrastructure projects. In the next five years, the increased contribution from coal production and exports, LNG plant construction, and the boost in the transport, communication and construction sectors are projected to raise economic growth to close to 8 percent per year. The BM maintains a medium-term target for inflation of 5-6 percent per year; low import prices and a vigilant monetary policy could keep inflation that in 2014. Before the end of the decade, when LNG is projected to reach the export stage, large investments are required in these projects (financed by FDI and private borrowing) and consequently the current account deficits (excluding grants) are projected at some 45 percent of GDP.

MEFP ¶6



Source: Mozambican authorities.

8. **Risks to this outlook remain moderate although new vulnerabilities have emerged.** Mozambique has been relatively isolated from the global slowdown, the large FDI inflows critical for growth have not been interrupted, and the Portuguese-dominated banking sector is funded locally and operates independently from developments in Europe. Nonetheless, Mozambique is exposed to risks of climate disasters, commodity price shocks for its major export or import commodities (coal, gas, fuel), and a decline in donor funding. Domestic risks include delays in upgrading transport infrastructure, especially railways and ports, and electricity supply constraints. New vulnerabilities relate to possible policy slippages in the run-up to the October 2014 presidential elections, and intensified security concerns in certain regions of the country.

9. **In view of this outlook, staff and the authorities reached an understanding on a macroeconomic policy mix for 2014 consistent with the objectives of the three-year PSI program**. The main objectives are to preserve macroeconomic stability, ensure strong public and private investment and facilitate credit to the economy, while preserving a low-inflation environment and continuing structural reforms.

MEFP ¶7-8

A. Fiscal Policy and Reforms

10. The 2014 budget embodies an expansionary impulse. While the underlying revenue effort continues, total expenditure is to rise from 36.3 percent of GDP in 2013 to 40 percent in 2014, reflecting mainly (i) the allocation of $400 million of the capital gains taxes received in 2013 mostly for one-off needs such as organizing the elections and capital expenditure; and (ii) and a 2.3 percent of GDP increase in goods and services spending reflecting in particular the quasi-fiscal part of EMATUM's operations (2.1 percent of GDP), to establish a coast guard and maritime security system (mostly imported equipment). As a result, the overall deficit after grants is projected to rise from 4½ to 12½ percent of GDP, and the domestic primary balance to turn into a deficit of 6 percent of GDP. However, the domestic demand impact is expected to be less as the start-up of maritime security and capital expenditure have a large import component. While foreign borrowing is projected to increase with the inclusion of the quasi-fiscal part of EMATUM's nonconcessional external borrowing ($350 million), domestic borrowing reflects largely the drawdown of deposits accumulated in 2013.

Mozambique: Key Fiscal Indicators

	2011	2012	2013		2014		
	Act.	Act.	CR 13/20	Staff Proj.	CR 13/200	Auth.	Staff Proposal
	(Percent of GDP, unless otherwise stated)						
Total revenue	20.7	23.5	24.5	27.4	23.5	26.0	23.7
Total expenditure and net lending	33.6	32.9	36.3	36.3	35.5	40.6	40.0
Overall balance, before grants	-13.1	-9.6	-11.8	-8.9	-12.0	-14.6	-16.3
Overall balance after grants	-5.3	-4.1	-6.7	-4.6	-7.2	-8.9	-12.5
Domestic primary balance	-2.9	-1.0	-2.7	0.0	-1.7	-1.4	-6.1
Net domestic financing	1.6	0.7	1.0	-2.0	0.8	1.0	2.9
Memorandum items:							
Real GDP growth (percent)	7.3	7.2	7.0	7.1	8.5	8.0	8.5
Average CPI inflation (percent)	10.4	2.1	5.5	4.4	5.6	5.6	5.6

Sources: Mozambican authorities and IMF staff estimates and projections.

11. It was agreed that there was a continued need to reinforce revenue administration. The Tax Authority is working to strengthen the large taxpayers unit, implement the single taxpayer database, as well as foster tax payments through banks.

- **Revenue effort.** Excluding one-off tax receipts and coal royalties, the budget envisages that the underlying revenue effort would raise collections by 1 percent of GDP in 2014 based on higher corporate profitability and collection efforts, higher than the trend in the recent past. Staff and the authorities reached an understanding on using a more conservative revenue increase for the program baseline, and identified contingent expenditure cuts if the budgeted

Mozambique: Contributions to Tax Revenues

	2010	2011	2012	2013	2014
	Act.	Act.	Est.	Proj.	Proj.
	(Percent of GDP)				
Total revenues	19.6	20.8	23.3	27.4	23.7
Tax revenues	17.0	18.1	19.8	23.5	19.8
Coal revenues	0.0	0.0	0.1	0.3	0.5
Non-coal tax revenues	17.0	18.1	19.7	23.2	19.3
Of which capital gains	0.0	0.0	1.2	4.2	0.0
Of which other tax revenues	17.0	18.1	18.5	19.1	19.3
	(Percent of non-coal GDP)				
Non-coal revenues	19.8	20.9	23.7	28.1	24.2
Non-coal tax revenues	17.3	18.3	20.2	24.0	20.1
Non-coal, non-capital gains tax revenues	17.3	18.3	19.0	19.7	20.1
	(Billions of MT)				
Coal GDP	4.1	2.5	9.8	15.9	20.7
Non-coal GDP	310.8	362.2	398.1	445.6	507.7

Sources: Mozambican authorities and IMF staff estimates and projections.

revenue scenario does not materialize.[1]

- **Improving VAT administration.** The government has prepared a plan to gradually reduce the stock of pending VAT arrears, avoid accumulation of new arrears, and optimize the administration and refund process (structural benchmark for end-October 2013). The plan envisages a validation process for VAT reimbursement requests pending as of end-2013 by end-March 2014 (proposed structural benchmark) and to clear the backlog of refund requests, possibly including through securitization, by end-2014. An action plan for the transition to managing the VAT on a net basis has been prepared that will enable the government to provide better forecasts for VAT reimbursements and start budgeting VAT collections on a net basis from 2015 onwards (proposed structural benchmark for end-October 2014).

MEFP ¶16

- **Managing windfall receipts.** Staff suggested a budget rule that channels windfall revenue mainly towards investment and bars the possibility of using one-off receipts, such as unanticipated capital gain taxes, to finance increases in recurrent spending that could compromise fiscal sustainability over the medium term. The government noted that the annual budget law already limited the use of revenue windfalls beyond the amounts budgeted to investment spending or debt reduction; deviations from this would only be considered in exceptional cases, such as natural disasters. While recognizing this intra-year constraint and the de facto carry-over of 2/3 of the revenue windfall from 2013 into 2014, staff noted that a clearly stated and broader budget rule with a medium-term timeframe would be preferable, and that the Fund stands ready to assist in developing such a rule.

MEFP ¶21

12. The mission supported the authorities' emphasis on priority spending in the 2014 budget and suggested to closely align the composition of spending with the medium-term priorities of the Poverty Reduction Strategy (PARP).

- **Spending for priority sectors will continue to rise**, reaching 68 percent of primary expenditures (excluding net lending). This includes an allocation of MT 2.5 billion (0.5 percent of GDP) to social protection. Poor physical infrastructure continues to represent a significant obstacle to improved living standards and productivity in this large and thinly populated country. Public investment is set to accelerate in 2014, reaching 15 percent of GDP, slightly less than half being financed by external resources. In light of the experience of slower-than-expected execution earlier in 2013, staff urged the authorities to strengthen budget implementation and work closely with donors to remove any bottlenecks that hinder disbursements.

MEFP ¶12

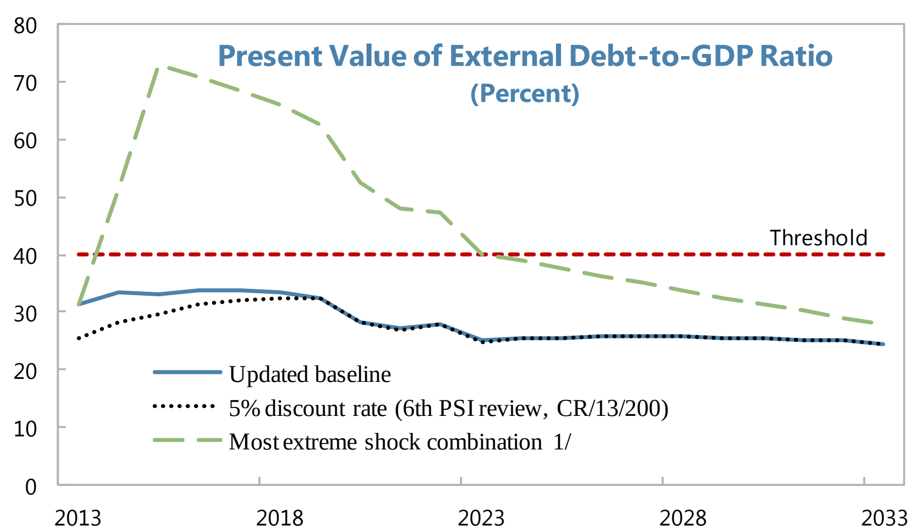
[1] The budget provides for a contingency of 10 percent of expenditure that is subject to special approval by the Ministry of Finance in the last quarter of the year.

- **At 11 percent of GDP, the public wage bill is high by international standards, and needs to be managed carefully to avoid crowding out other priority spending**. The wage bill is budgeted to rise by 13 percent in nominal terms in 2014 (after a 22 percent rise in 2013), reflecting both additional hiring, particularly in the social sectors, and wage increases. Over the medium term, the authorities intend to contain the wage bill. In the near term, they plan to further strengthen control of the wage bill execution and complete the rollout of the electronic wage payment system (e-Folha) to all central government entities registered in the integrated database (e-CAF).

MEFP ¶13

- **Domestically financed investment spending is budgeted to increase to 8 percent of GDP in 2014.** The authorities acknowledged that such high levels of investment spending are likely not sustainable over the medium term, but noted that in 2014 they will be financed by the windfall receipts received in 2013 and that further windfall revenues are expected to be received in late 2013/early 2014. Staff advised stronger efforts to ensure value-for-money on the government's large public investment program, and to allocate adequate resources for operating and maintaining the new infrastructure being built. Enhancing the efficiency of public investment is particularly important as debt levels are approaching the indicative risk threshold (40 percent of GDP in NPV terms). More broadly, staff suggested to strengthen the link between investment spending and the PARP; given the large share of the population (about ¾) making a living on agriculture, investment should focus more toward improving productivity in agriculture, and thus make growth more inclusive and improve the life or the average Mozambican.

MEFP ¶12



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

13. The mission discussed with the authorities options for enhancing transparency on the government guarantee for EMATUM's large nonconcessional borrowing and its macroeconomic implications.

- In light of the scale of this borrowing ($850 million or 6 percent of GDP), the authorities intend to delay the contracting of other nonconcessional debt in the pipeline to remain within the PSI external debt ceiling ($1.2 billion). Projects likely to be delayed somewhat include a new road, the development of a free trade zone, and the Moamba Major dam. The medium-term economic impact of delaying these projects due to the EMATUM activities is unclear. Staff prepared a preliminary update of the DSA, which shows that the debt sustainability outlook is not significantly affected by the extension of the guarantee for EMATUM as long as some other nonconcessional debt in the pipeline for 2013-14 is delayed.[2] The response of the donor community is still unclear, adding uncertainty on the level of budget support in 2013–14.

- However, staff noted concerns, shared in the donor community, about the lack of transparency regarding the use of the funds and the secretive manner in which the project was evaluated, selected, and implemented outside the government's macro-economic strategy and PARP priorities. Staff suggested to hold more comprehensive discussions of overall expenditure priorities with all stakeholders. In the context of the parliamentary debate, the authorities included the quasi-fiscal operations of EMATUM, which they indicated were related to coast guard/maritime security services, in the 2014 budget (as mentioned above). Furthermore, staff noted that a normal sovereign Eurobond issue--instead of a privately-placed loan participation note--would likely have reduced borrowing costs to Mozambique and would have been preferable as a benchmark for Mozambican borrowers in international capital markets.

- With the 2014 budget parliament also approved an increase in the guarantee limit to accommodate the $500 million guarantee extended to EMATUM.

- The government noted that EMATUM will be subjected to strict financial controls and will have its accounts audited.

- The governments intends to reform the Organic Budget Law to require an Annex on Fiscal Risks, including guaranteed debt and other risks such as associated with quasi-fiscal operations and public-private partnerships.

14. The government intends to strengthen its oversight over the state-owned enterprises (SOEs), which are rising in importance. After the approval of the State Enterprise Act in February 2013, implementation regulations are being prepared to strengthen oversight over SOE activities. IGEPE, the government body that has oversight responsibilities for 117 SOEs, aims to reduce the number of SOEs by about half over time through liquidation and privatization. It agreed on business plans with five large enterprises. Staff agreed with IGEPE's aim to improve financial reporting from SOEs to the government with assistance from the World Bank/DfID. The

[2] The "moderate" risk of debt distress rating is maintained.

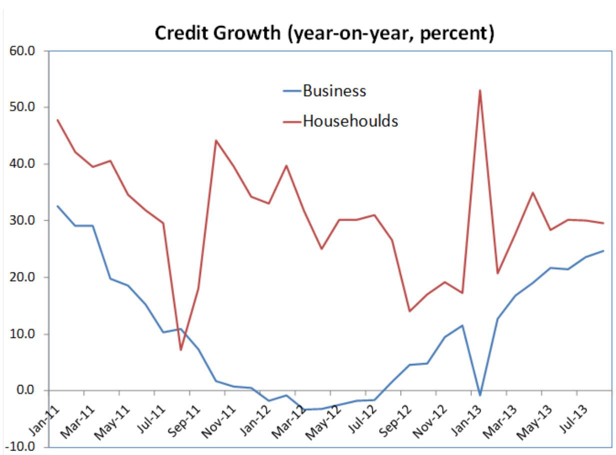
government is also working on a strategy for the government's participation of SOEs in infrastructure projects (including electricity generation and distribution and LNG production) with support from the World Bank.

15. The work on the new fiscal regime for the mining and hydrocarbon sectors has advanced substantially. The authorities appreciated the extensive technical assistance received from the Fund in this area and incorporated a number of suggestions, including the need to prevent an excessively burdensome fiscal regime that could discourage investment in the sector. Following public consultation, the legal texts are being revised based on the inputs from stakeholders, which should align them more with international best practice and combine the relevant tax issues in a single legal document to allow for easy reference and interpretation. Submission of the draft fiscal regimes to Parliament is expected to take place in time for the next ordinary session in May 2014.

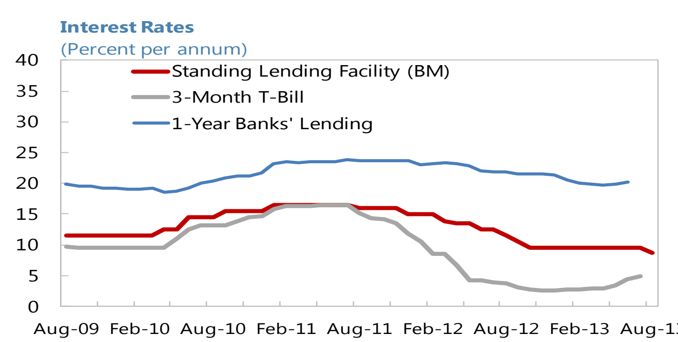
MEFP ¶19

B. Monetary Policy and Financial Sector Reforms

16. Staff acknowledged the BM's effort to mop up excess liquidity in the banking system. The BM stepped up its liquidity management operations to preserve the reserve money path under the program, consistent with preserving a low-inflation environment. Slower-than-expected government funding needs through end-September provided room for the expansion of credit to the economy, which grew 35 percent year-on-year by September, up from 18.3 percent at end-2012. Household credit growth remains high, while the growth of credit to business has accelerated. Staff urged the BM to monitor credit growth and distribution closely; the authorities were less concerned noting that household credit was generally backed by salaries and that business credit was picking up from a low base and would slow down.



17. Banks' lending rates remain high. The interest rate transmission channel is still weak: while the BM cut its policy rate by 3.75 percentage points between mid-2012 and August 2013, banks' average lending rates have hardly moved and the interbank market remains segmented between the 3-4 dominant large banks that serve large corporate customers and the smaller banks serving largely smaller



enterprises. The authorities are very concerned about the high level of lending rates and low access to credit by SMEs. While acknowledging these factors, staff highlighted underlying structural rigidities that would best be addressed over time through reforms that lower the risks for lenders, promote financial literacy, and improve the business climate more broadly.[3]

18. Staff and the authorities agreed that monetary policy should maintain a low-inflation environment in 2014. The authorities intend to dampen reserve money growth slightly. Staff noted that the unwinding of the sizeable government deposits accumulated in 2013 will provide a significant monetary impulse and will require closer coordination between the Treasury and the BM. The authorities acknowledged this but pointed to the modest inflation outlook reflecting favorable import price prospects. In light of the weak monetary policy transmission, staff emphasized the importance of closely monitoring inflation developments and the growth and composition of credit, and of tightening monetary policy if inflation picks up. The programmed reserve money path through 2014 implies a gradual deceleration in the growth of monetary aggregates and credit to the economy throughout 2014.[4]

MEFP ¶9

19. The BM is continuing to enhance its monetary policy framework and tools. Staff acknowledged that significant progress has been achieved in reforms aiming at developing the domestic repo market to help improve money market management and the liquidity of government securities. The BM is also refining its policy formulation and communication processes, through its quarterly monetary reports and the ongoing project to strengthen its inflation forecasting capacity, with technical assistance from the Fund.

MEFP ¶26-27

20. The BM agreed with staff on the importance of shoring up its supervision and crisis management framework, but staff suggested accelerating follow-up actions. There are no signs of spillover from developments in European financial markets, as the Portuguese-dominated banking sector is funded locally and operates independently. While the financial soundness indicators remain robust and banks are profitable, the potential risk from recent rapid credit growth warrants close monitoring. Building on the experience of its first stress test conducted in the spring of 2013, the BM plans to conduct stress tests regularly, but has been slow in strengthening data collection and the stress-testing methodology. New legislation aligning the classification of non-performing loans to international standards will become effective as of January 2014.[5] Risk-based supervision has started and the Basel II Capital Accord will become effective by January 2014. Staff noted that the implementation of the Financial Sector

MEFP ¶28-29

[3] Mozambique's ranking in the World Bank's Doing Business Indicators improved slightly--from a position of 142 in 2013 to 139 in the 2014 ranking, mainly due to improvements in construction licensing.

[4] Staff noted the stability of the Metical, which has remained generally within a 2 percent range against the US dollar for more than six months. At the same time, the BM's interventions in the foreign exchange market have been to provide foreign currency rather than targeting a particular exchange rate level.

[5] The BM does not expect a significant impact on the financial soundness indicators due to the new classification.

Contingency Plan, which was published in June 2013, is starting very slowly with the preparation only by late 2014 of a plan to conduct simulation exercises. The Deposit Insurance Fund (DIF) is to become operational by end-2013 with the expected initial funding and the establishment of the system's fee structure and the guarantee limit.

21. **Dissemination and implementation of the Financial Sector Development Strategy (FSDS) for 2013-22 is beginning.** In April 2013, the Council of Ministers approved the FSDS, an important strategy in strengthening, broadening and deepening the financial sector. The BM is developing a National Financial Inclusion Strategy in order to implement the FSDS, and noted that legislation and regulations required considerable lead times before specific implementation steps could start. Staff acknowledged that transforming financial services in Mozambique remained a long-term challenge, and stressed the need for close coordination within the BM and various ministries to move this forward and galvanize the support of donors. Under the FSDS, the law on the creation of private credit registry bureaus was to be submitted to the Parliament in November 2013 (structural benchmark), but this has been delayed. The government intends to work on a collateral bill with a view to establishing a moveable collateral registry by end-2014 (proposed structural benchmark).

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22. **The authorities are improving Mozambique's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework** with the help of IMF technical assistance. New legislation was approved in August 2013, and the respective regulations are being prepared; new guidelines for commercial banks on AML/CFT are also at an advanced stage. Likewise, the Law [14/2007] establishing the Financial Intelligence Unit of Mozambique is under review. The Government adopted in July 2013 the Action Plan for the implementation of GAFI/FATF Standards.

MEFP ¶31-32

23. **Beyond the enactment of new laws and regulations the authorities need to take steps to strengthen the effectiveness of the AML/CFT framework.** Concerns about the lack of transparency in the use of funds associated with EMATUM underscore the importance of achieving this objective. Strengthening the capacity of the BM's Banking Supervision Department (BSD) and the Financial Intelligence Unit are essential steps towards the development of an effective framework. The IMF has already provided initial training to assist BSD to commence the development of risk-based approaches to the oversight of institutions' management of money laundering and terrorist financing risks.

C. Investment Planning and Debt Management

24. **The authorities have made some progress in strengthening investment planning and debt management, but major weaknesses remain.** The Ministry of Finance prepared an updated DSA as part of the 2014 budget process, yet without including the EMATUM guarantee. The government approved an Integrated Investment Program (IIP) in September 2013, which identifies major investment projects for 2014-17. Staff pointed out, however, that the IIP is not prioritized and does not contain sufficient

MEFP ¶15

financial information to align the budget and the DSA with the IIP. While the Ministry of Planning and Development's (MPD's) Consultative Council approved a Public Project Preparation and Selection Manual, including a summary form with project information, this remains to be disseminated to sectoral ministries and its use should be made mandatory for inclusion of projects into the budget. Staff indicated that effective use of such planning tools will be essential to ensure that the investment projects undertaken have the highest economic and social returns. More systematic follow-up and monitoring of project implementation is also needed, and capacity in this area requires substantial reinforcement.

25. Staff and the authorities agreed that efforts to strengthen investment planning and debt management could include the following actions:

- Strengthen the linkage among the budget, the IIP, and the Public Debt Management Strategy. The authorities noted that they will incorporate the analysis of costs and risks associated with the public debt portfolio, including guarantees, in the quarterly budget execution reports, and extend the Debt Management Strategy at its first review to explicitly include government guarantees.

- Strengthen the IIP. The authorities noted that they will include in the IIP financial information for projects for which financing has been secured to inform the DSA, medium-term fiscal framework, and the budget by mid-2014. The revised IIP will also include summary project descriptions in line with the project summary table already developed (proposed structural benchmark).

- Strengthen project evaluation. The authorities indicated that they will publish the Public Project Preparation Selection Manual and the summary form for projects approved by the Council of Ministers on its webpage, and ensure that the preparation of the 2015–17 Medium-Term Fiscal Framework incorporate the main project selection and evaluation criteria identified in the Manual.

PROGRAM ISSUES

26. Modifications are proposed for several assessment criteria and the indicative targets to reflect the over-performance related to the receipt of revenue windfalls and expenditure developments through end-September. The end-December 2013 ACs on net credit to the government and net international reserves and the indicative floors on government revenues and priority spending are proposed for modification. New ACs for June 2014 are proposed, new adjusters for further revenue windfalls are introduced, and new structural benchmarks are proposed for 2014. Structural benchmarks for 2014 are also proposed.

STAFF APPRAISAL

27. Mozambique's performance under the program supported by the PSI has been broadly satisfactory, though progress on the structural reform agenda is slow. Strong macroeconomic policies helped to support growth while maintaining low inflation. Fiscal performance was broadly on track even excluding the windfall receipts, but the latter also helped to strengthen the international reserve position. The lower-than-programmed priority spending partly reflected delays in external financing and did not compromise the policy objectives of the program. There was some slippage on structural reforms as the authorities met 4 of 7 structural benchmarks,

28. While the outlook remains strong, significant external and domestic risks remain, calling for continued strong implementation of the authorities' policy agenda. While Mozambique has been relatively isolated from the global slowdown, risks remain including from commodity price developments. New domestic risks have also emerged, including pressures for policy reversals in the run-up to the elections and renewed civil disturbances.

29. The policy stance for 2014 is expansionary. The budget envisages a significant expansion in infrastructure spending that could support growth, financed by the windfall capital gain taxes saved from 2013. It also includes a sizeable pick-up in goods and services outlays, financed in part by nonconcessional external borrowing. Budget implementation in the priority areas needs to be strengthened, including through closer tie-in with the PARP pillars and more effective cooperation with donors. Monetary policy has also been expansionary, and a more prudent approach would, together with the favorable outlook for international prices, facilitate the achievement of the medium-term inflation target.

30. Tapping into nonconcessional external borrowing can help to finance the country's vast infrastructure needs, but such borrowing should be based on clear investment priorities as it carries significant risks. Mozambique's public debt level has been rising and there is a need to ensure that borrowing finances public investment projects that are transparently prioritized, monitored, and evaluated in order to ensure value-for-money, maximize the efficiency of investment and preserve debt sustainability. In this context, transparency and adherence to due process in investment planning, selection and financing need to be strengthened to enhance the efficiency of such investments as well as to continue to attract donor support and other external financing.

31. Structural reforms across a broad spectrum of policies envisaged under the PSI should be implemented vigorously to prepare for the natural resource boom and make growth more inclusive. Staff welcomed the progress made toward modernizing the fiscal regimes for the booming mining and emerging hydrocarbon sectors. Ongoing reforms in public financial management, tax administration, and financial sector development should raise the country's macroeconomic management capacity. Reforms to improve the enabling environment for the private sector will be needed to facilitate employment opportunities outside the resource sector and take advantage of the infrastructure improvements under way.

32. Staff recommends completion of the first review under the PSI. Program performance has been satisfactory with all ACs for end-June met, the authorities' solid ownership of the Fund-supported program, and the actions taken to address the transparency and governance issues raised by the guarantee provided on the external borrowing of a public enterprise. Staff also recommends the proposed modifications of ACs and ITs for December 2013, the setting of ACs and ITs for March and June 2014, and of SBMs for 2014 (Tables 7–9).

Table 1. Mozambique: Selected Economic and Financial Indicators, 2010-18

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Act.	Act.	Est.	CR 13/200	Proj.	CR 13/200	Proj.	Proj.			
	(Annual percentage change, unless otherwise indicated)										
National income and prices											
Nominal GDP (MT billion)	315	365	408	454	461	520	528	601	684	779	887
Nominal GDP growth	18.3	15.8	11.8	12.3	13.0	14.6	14.4	13.9	13.7	14.0	13.9
Real GDP growth	7.1	7.3	7.2	7.0	7.1	8.5	8.3	7.9	7.7	7.9	7.8
GDP per capita (US$)	398	510	567	640	590	684	640	698	759	827	900
GDP deflator	10.5	7.9	4.3	5.0	5.5	5.6	5.6	5.6	5.6	5.6	5.6
Consumer price index (annual average)	12.7	10.4	2.1	5.5	4.4	5.6	5.6	5.6	5.6	5.6	5.6
Consumer price index (end of period)	16.6	5.5	2.2	6.1	3.6	5.4	6.0	5.6	5.6	5.6	5.6
Exchange rate, MT per US dollar, eop	32.6	27.3	29.8	...	...	...	...	...	...	...	...
Exchange rate, MT per US dollar, per.avg.	33.0	29.1	28.5	...	...	...	...	...	...	...	...
External sector											
Merchandise exports	8.7	33.6	23.6	13.8	3.5	20.9	18.6	17.4	21.6	13.3	19.7
Merchandise exports, excluding megaprojects	-20.5	65.8	48.4	4.0	9.9	26.2	6.9	9.2	11.2	11.3	15.8
Merchandise imports	2.6	52.8	47.2	15.3	9.2	11.3	7.8	14.4	4.4	19.6	7.1
Merchandise imports, excluding megaprojects	-0.7	46.2	50.8	15.2	3.3	8.4	6.1	2.9	9.7	5.2	5.5
Terms of trade	10.4	2.3	-4.9	-1.9	-9.1	-0.1	-1.4	0.4	0.4	-0.2	-0.3
Nominal effective exchange rate (annual average)	-22.4	12.4	7.4	...	...	...	...	...	...	...	…
Real effective exchange rate (annual average)	-15.1	19.7	5.4	...	...	...	...	...	...	...	…
	(Annual percentage change, unless otherwise indicated)										
Money and credit											
Reserve money	29.2	8.5	19.7	17.9	17.9	15.0	17.0	15.0	14.9	14.9	14.9
M3 (Broad Money)	22.8	9.4	29.4	19.0	20.0	15.5	18.5	15.3	15.1	15.1	15.1
Credit to the economy	29.3	6.4	18.3	21.5	32.3	19.1	17.4	15.1	15.0	15.0	15.0
(Percent of GDP)	29.3	26.9	28.5	31.1	33.4	32.3	34.2	34.6	35.0	35.3	35.6
	(Percent of GDP)										
Investment and saving											
Gross domestic investment	19.5	37.0	48.2	49.4	48.8	51.8	51.9	53.1	54.7	57.2	48.9
Government	14.5	14.9	13.4	16.2	15.6	17.2	17.2	15.4	15.3	14.5	13.7
Other sectors	5.0	22.1	34.7	33.2	33.2	34.6	34.6	37.7	39.3	42.8	35.3
Gross domestic savings (excluding grants)	0.9	5.7	-1.2	6.0	3.0	7.0	5.4	6.9	12.6	9.4	2.2
Government	1.2	2.0	4.1	3.8	6.7	3.6	0.9	4.0	4.8	5.4	5.8
Other sectors	-0.2	3.7	-5.3	2.2	-3.7	3.4	4.4	2.9	7.8	3.9	-3.5
External current account, before grants	-18.5	-31.3	-49.4	-43.4	-45.8	-44.8	-46.5	-46.2	-42.1	-47.9	-46.7
External current account, after grants	-11.7	-24.4	-45.6	-39.9	-42.2	-41.3	-43.4	-43.6	-39.9	-46.1	-45.2
Government budget											
Total revenue [1]	19.6	20.8	23.3	24.5	27.4	23.5	23.7	24.4	24.9	25.5	25.6
Total expenditure and net lending	32.9	33.7	32.6	36.3	36.3	35.5	40.0	35.8	35.5	34.5	33.5
Overall balance, before grants	-13.2	-13.1	-9.5	-11.8	-8.9	-12.0	-16.3	-11.4	-10.6	-9.0	-7.9
Total grants	9.0	7.8	5.4	5.1	4.3	4.8	3.8	3.2	2.6	2.2	1.9
Overall balance, after grants	-4.3	-5.3	-4.1	-6.7	-4.6	-7.2	-12.5	-8.2	-7.9	-6.8	-6.0
Domestic primary balance, before grants	-4.1	-2.9	-1.0	-2.7	0.0	-1.7	-6.1	-2.1	-1.5	-0.7	-0.1
External financing (incl. debt relief)	4.2	3.7	4.2	5.7	6.6	6.4	9.6	6.7	6.4	5.4	4.7
Net domestic financing	0.0	1.6	0.7	1.0	-2.0	0.8	2.9	1.6	1.5	1.4	1.3
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total public debt [2]	45.8	39.6	41.9	47.8	44.3	50.9	46.9	49.3	51.6	52.6	52.5
Of which: external	39.9	32.9	36.1	41.6	39.2	44.7	42.1	43.5	45.1	45.4	45.0
Of which: domestic	6.0	6.7	5.8	6.2	5.2	6.2	4.8	5.7	6.6	7.1	7.6
	(Millions of U.S. dollars, unless otherwise indicated)										
External current account, before grants	-1,770	-3,922	-7,056	-6,373	-6,984	-7,158	-7,882	-8,738	-8,882	-11,276	-12,272
External current account, after grants	-1,113	-3,059	-6,517	-5,854	-6,442	-6,608	-7,364	-8,252	-8,429	-10,855	-11,872
Overall balance of payments	608	323	236	100	458	320	199	462	679	812	758
Net international reserves (end of period) [3]	1,908	2,239	2,605	2,704	3,061	3,023	3,262	3,725	4,404	5,215	5,974
Gross international reserves (end of period) [3]	2,099	2,428	2,799	2,894	3,252	3,211	3,449	3,877	4,519	5,294	6,017
Months of projected imports of goods and nonfactor services	3.3	2.4	2.6	2.8	2.7	2.6	2.6	2.7	2.7	2.8	3.2
Months of imports of goods and nonfactor services, excl. megaprojects	4.2	3.0	3.9	3.7	4.4	3.7	4.7	4.9	5.8	5.4	5.3

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

[1] Net of verified VAT refund requests.

[2] Consistent with DSA definition, the nonconcessional Portuguese credit line is included under the external debt.

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

Table 2. Mozambique: Government Finances, 2010–14[1]

(Billions of Meticais)

	2010	2011	2012	2013		2014	
	Act.	Act.	Act.	CR 13/200	Proj.	CR 13/200	Proj.
Total revenue[1]	61.6	75.8	94.8	111.4	126.3	122.5	125.3
Tax revenue	53.7	66.2	80.9	92.8	108.2	101.1	104.5
Income and profits	18.5	24.9	36.8	38.4	54.5	34.2	39.9
Of which : capital gain tax	…	…	5.0	6.8	19.2	0.0	0.0
Goods and services[1]	28.8	33.0	33.3	39.9	39.7	50.4	48.1
International trade	5.3	6.7	7.6	9.6	9.6	11.2	10.8
Other	1.1	1.5	3.2	5.0	4.4	5.4	5.7
Nontax revenue	7.9	9.6	14.0	18.6	18.1	21.3	20.8
Total expenditure and net lending	103.5	122.8	133.1	164.9	167.5	184.6	211.5
Current expenditure	57.9	68.5	78.3	94.3	95.6	103.7	120.5
Compensation to employees	29.1	35.7	41.5	49.2	50.5	55.9	57.0
Goods and services[1]	10.7	12.1	15.1	20.0	21.3	18.5	36.5
Of which: Maritme security	…	…	…	…	…	…	10.9
Interest on public debt	2.7	3.6	4.1	5.6	4.3	6.8	6.3
Domestic	1.9	2.6	2.9	3.6	2.4	4.1	3.7
External	0.8	1.0	1.2	2.1	1.9	2.7	2.6
Transfer payments	15.4	17.2	17.5	19.5	19.4	22.5	20.7
Domestic current primary balance	6.4	10.8	20.7	22.7	35.0	25.5	11.1
Capital expenditure	43.7	50.6	50.4	66.5	62.1	73.8	79.1
Domestically financed	20.0	20.3	24.7	34.7	34.6	34.0	42.5
Externally financed	23.7	30.3	25.6	31.8	27.5	39.8	36.6
Net lending	1.9	3.7	4.5	4.1	9.8	7.1	11.9
Domestically financed	-0.4	0.4	-0.4	0.3	0.3	0.4	0.8
Externally financed loans to public enterprises	2.3	3.3	4.9	3.7	9.5	6.7	11.1
Unallocated revenue (+)/expenditure (-) [2]	0.4	-0.8	-0.5	0.0	0.0	0.0	0.0
Domestic primary balance, before grants, above the line [3]	-12.9	-10.7	-4.1	-12.3	0.1	-8.8	-32.2
Overall balance, before grants	-41.5	-47.8	-38.7	-53.5	-41.2	-62.2	-86.2
Grants received	28.3	28.6	21.9	22.9	19.8	24.8	19.9
Project support	17.1	16.4	13.3	13.8	10.5	15.7	12.0
Investment projects	7.2	6.7	7.3	7.0	3.8	7.0	3.7
Special programs	9.9	9.7	6.0	6.8	6.7	8.7	8.3
Direct financing	0.0	0.0	0.0		0.0	0.0	0.0
Budget support	11.2	12.3	8.7	9.1	9.3	9.2	7.8
Overall balance, after grants	-13.2	-19.2	-16.8	-30.6	-21.4	-37.3	-66.3
Net external financing	13.2	13.5	13.8	26.0	30.6	33.2	50.9
Disbursements	14.3	14.6	15.4	29.2	33.8	37.3	54.8
Project	8.2	10.5	6.7	18.0	17.0	24.1	24.5
Nonproject support	6.1	4.1	8.7	11.2	16.7	13.2	19.4
Loans to public enterprises	2.3	3.3	4.9	3.7	9.5	6.7	11.1
Budget support	3.8	0.8	3.9	7.5	7.3	6.5	8.3
Other disbursement	…	…	…	…	…	…	10.9
Cash amortization	-1.0	-1.1	-1.6	-3.2	-3.1	-4.1	-3.9
Net domestic financing	0.0	5.7	2.9	4.5	-9.2	4.1	15.5
Memorandum items:							
Overall balance excluding windfall receipt	…	…	…	…	-40.6	-37.3	-66.3
Gross aid flows	42.6	41.7	35.1	50.9	52.7	57.5	61.8
Budget support	15.0	13.1	12.5	16.6	16.6	15.6	16.1
Nonbudget support	27.6	28.6	22.6	34.3	36.1	41.8	45.7
Project support	25.3	26.9	20.0	31.8	27.5	39.8	36.6
Concessional loans to public enterprises	2.3	1.8	2.6	2.5	8.6	2.0	9.2

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

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

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

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

Table 3. Mozambique: Government Finances, 2010–18[1]

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Act.	Act.	Act.	CR 13/200	Proj.	CR 13/200	Proj.		Proj.		
						(Percent of GDP)					
Total revenue [1]	19.6	20.8	23.3	24.5	27.4	23.5	23.7	24.4	24.9	25.5	25.6
Tax revenue	17.0	18.1	19.8	20.4	23.5	19.4	19.8	20.5	21.0	21.6	21.7
Taxes on income and profits	5.9	6.8	9.0	8.4	11.8	6.6	7.6	7.9	8.5	9.2	9.8
Of which: capital gain tax	…	…	1.2	1.5	4.2	…	…	…	…	…	…
Taxes on goods and services [1]	9.2	9.1	8.2	8.8	8.6	9.7	9.1	9.4	9.3	9.1	8.6
Taxes on international trade	1.7	1.8	1.9	2.1	2.1	2.1	2.1	2.1	2.1	2.2	2.2
Other taxes	0.4	0.4	0.8	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1
Nontax revenue	2.5	2.6	3.4	4.1	3.9	4.1	3.9	3.9	3.9	3.9	3.9
Total expenditure and net lending	32.9	33.7	32.6	36.3	36.3	35.5	40.1	35.9	35.5	34.6	33.6
Current expenditure	18.4	18.8	19.2	20.8	20.7	19.9	22.8	20.4	20.2	20.1	19.9
Compensation to employees	9.2	9.8	10.2	10.8	11.0	10.7	10.8	10.6	10.3	10.1	9.9
Goods and services [1]	3.4	3.3	3.7	4.4	4.6	3.6	6.9	4.5	4.4	4.4	4.3
Of which: Maritme security	…	…	…	…	…	…	2.1	…	…	…	…
Interest on public debt	0.8	1.0	1.0	1.2	0.9	1.3	1.2	1.3	1.5	1.6	1.7
Transfer payments	4.9	4.7	4.3	4.3	4.2	4.3	3.9	4.0	4.0	4.0	4.0
Domestic current primary balance	2.0	3.0	5.1	5.0	7.6	4.9	2.1	5.3	6.2	7.0	7.4
Capital expenditure	13.9	13.9	12.3	14.7	13.5	14.2	15.0	12.8	12.6	11.4	10.7
Domestically financed	6.4	5.6	6.1	7.6	7.5	6.5	8.1	7.3	7.6	7.6	7.4
Externally financed	7.5	8.3	6.3	7.0	6.0	7.6	6.9	5.5	5.0	3.8	3.3
Net lending	1.0	1.0	1.1	0.9	2.1	1.4	2.3	2.7	2.8	3.0	2.9
Domestically financed	-0.1	0.1	-0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Externally financed loans to public enterprises	0.7	0.9	1.2	0.8	2.1	1.3	2.1	2.5	2.6	2.9	2.8
Unallocated revenue (+)/expenditure (-) [2]	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic primary balance, before grants [3]	-4.1	-2.9	-1.0	-2.7	0.0	-1.7	-6.1	-2.1	-1.5	-0.8	-0.2
Overall balance, before grants	-13.2	-13.1	-9.5	-11.8	-8.9	-12.0	-16.3	-11.4	-10.6	-9.1	-8.0
Grants received	9.0	7.8	5.4	5.1	4.3	4.8	3.8	3.2	2.6	2.2	1.9
Project	5.4	4.5	3.3	3.0	2.3	3.0	2.3	1.9	1.6	1.3	1.1
Investment projects	2.3	1.8	1.8	1.5	0.8	1.3	0.7	0.6	0.5	0.4	0.4
Special programs	3.1	2.7	1.5	1.5	1.4	1.7	1.6	1.3	1.1	0.9	0.8
Budget support	3.6	3.4	2.1	2.0	2.0	1.8	1.5	1.2	1.0	0.9	0.7
Overall balance, after grants	-4.3	-5.3	-4.1	-6.7	-4.6	-7.2	-12.6	-8.3	-8.0	-6.9	-6.1
Net external financing	4.2	3.7	3.4	5.7	6.6	6.4	9.6	6.7	6.4	5.4	4.7
Disbursements	4.5	4.0	3.8	6.4	7.3	7.2	10.4	7.4	7.1	6.3	5.7
Project	2.6	2.9	1.6	4.0	3.7	4.6	4.6	3.6	3.4	2.5	2.2
Nonproject support	1.9	1.1	2.1	2.5	3.6	2.5	3.7	3.8	3.7	3.8	3.5
Loans to public enterprises	0.7	0.9	1.2	0.8	2.1	1.3	2.1	2.5	2.6	2.9	2.8
Budget support	1.2	0.2	0.9	1.6	1.6	1.2	1.6	1.3	1.1	0.9	0.8
Other disbursement	…	…	…	…	…	…	2.1	…	…	…	…
Cash amortization	-0.3	-0.3	-0.4	-0.7	-0.7	-0.8	-0.7	-0.7	-0.7	-0.8	-1.0
Net domestic financing	0.0	1.6	0.7	1.0	-2.0	0.8	2.9	1.6	1.6	1.4	1.4
Memorandum items:											
Overall balance excluding windfall receipt	…	…	…	…	-8.8	-7.2	-12.6	-8.3	-8.1	-7.1	-6.4
Gross aid flows	13.5	11.9	8.7	11.2	11.4	11.0	11.7	9.4	8.3	6.5	5.6
Budget support	4.8	3.6	3.1	3.7	3.6	3.0	3.1	2.6	2.1	1.8	1.5
Nonbudget support	8.8	8.3	5.6	7.6	7.8	8.0	8.7	6.8	6.1	4.7	4.1
Project support	8.0	7.4	4.9	7.0	6.0	7.6	6.9	5.5	5.0	3.8	3.3
Concessional loans to public enterprises	0.7	0.9	0.7	0.5	1.9	0.4	1.7	1.3	1.1	0.9	0.8
Nominal GDP	314	365	408	454	461	520	528	601	684	779	887

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

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

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

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

Table 4. Mozambique: Monetary Survey, 2010-14

(Billions of Meticais, unless otherwise specified)

	2010	2011	2012	2013							2014			
				Q1	Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Act.	Act.	Act.	Act.	CR/13/200	Act.	CR/13/200	Prel.	CR/13/200	Proj.		Proj.		
Bank of Mozambique														
Net foreign assets	56.9	56.9	73.1	64.8	68.3	64.9	77.7	81.9	81.9	89.7	86.9	90.5	97.8	98.8
(US$ billions)	1.7	2.1	2.5	2.1	2.2	2.2	2.5	2.7	2.6	2.9	2.8	2.9	3.1	3.1
Net international reserves	62.2	61.1	77.5	69.3	72.8	68.8	82.4	85.5	86.6	93.8	91.5	94.5	101.6	103.0
(US$ billions)	1.9	2.2	2.6	2.3	2.4	2.3	2.6	2.9	2.7	3.1	3.0	3.0	3.2	3.3
Net domestic assets	-25.2	-22.6	-32.0	-27.2	-26.7	-23.8	-33.0	-38.4	-33.4	-41.3	-42.3	-42.0	-46.8	-42.1
Credit to government (net)	-20.6	-26.8	-27.6	-26.8	-29.1	-33.7	-25.8	-48.7	-38.5	-36.0	-35.2	-36.0	-33.7	-22.4
Credit to banks (net)	0.4	-3.8	-12.7	-1.6	-1.0	-1.6	-8.3	0.2	2.6	-11.0	-11.7	-8.5	-12.1	-15.9
Credit to the economy	0.5	0.9	1.3	1.2	1.2	1.2	1.2	1.3	1.2	1.3	1.2	1.2	1.3	1.3
Other items (net; assets +)	-5.6	7.1	6.9	0.0	2.3	10.3	-0.1	8.7	1.2	4.5	3.4	1.3	-2.3	-5.1
Reserve money	31.6	34.3	41.1	37.7	41.6	41.1	44.7	43.4	48.4	48.4	44.7	48.5	51.0	56.7
Currency in circulation	20.4	21.9	26.2	22.3	25.9	25.5	27.7	26.5	30.7	29.4	26.7	30.4	31.6	35.0
Currency outside banks	17.4	17.5	19.7	17.5	20.9	20.2	23.5	...	25.5	23.4	20.6	23.7	24.0	27.3
Currency in Banks (Cash in Vault)	3.1	4.4	6.6	4.8	5.0	5.3	4.3	...	5.3	6.0	6.1	6.7	7.6	7.7
Bank deposits in BM	11.2	12.4	14.8	15.4	15.8	15.6	17.0	17.0	17.7	19.0	18.5	18.9	20.2	22.0
Required reserves	10.8	11.4	13.6	14.6	15.1	14.7	15.7	15.7	16.5	17.8	17.7	18.0	19.0	20.8
Free reserves	0.4	1.0	1.2	0.8	0.7	0.9	1.3	1.2	1.2	1.3	0.8	0.9	1.2	1.3
Commercial Banks														
Net foreign assets	22.8	16.1	22.6	29.3	25.2	23.6	25.6	18.6	30.5	25.5	27.6	23.4	27.0	25.7
(Millions of U.S. dollars)	0.7	0.6	0.8	1.0	0.8	0.8	0.8	0.6	1.0	0.8	0.9	0.8	0.9	0.8
Net domestic assets	92.5	109.1	142.6	135.6	144.1	145.2	155.3	160.6	165.5	174.3	170.6	178.9	187.9	211.5
Banks' reserves	14.3	16.8	22.2	21.5	20.8	22.2	21.3	24.1	23.0	25.1	24.6	25.6	27.8	29.7
Credit to BM (net)	-0.3	4.0	12.3	8.4	1.0	4.1	8.3	3.9	-2.6	11.0	11.7	8.5	12.1	15.9
Credit to government (net)	8.4	21.1	27.5	19.8	18.0	24.8	21.9	26.2	33.9	18.4	18.4	17.5	18.4	16.1
Credit to the economy	91.9	97.3	114.9	121.1	128.9	129.5	131.2	143.4	140.0	152.5	148.5	157.6	167.9	179.0
Other items (net; assets +)	-21.8	-30.1	-34.3	-35.3	-24.6	-35.4	-27.4	-37.0	-28.9	-32.7	-32.6	-30.3	-38.2	-29.2
Deposits	115.3	125.3	165.3	164.9	169.3	168.8	180.9	179.2	196.0	199.8	198.2	202.3	214.9	237.1
Demand and savings deposits	73.0	79.1	108.4	103.3	104.7	108.4	113.2	114.8	123.8	127.1	123.0	125.0	135.2	150.3
Time deposits	42.3	46.2	56.8	61.6	64.6	60.5	67.7	64.4	72.2	72.8	75.2	77.3	79.7	86.8
Monetary Survey														
Net foreign assets	79.6	73.0	95.7	94.2	93.6	88.5	103.3	100.5	112.3	115.2	114.5	113.9	124.8	124.4
(US$ billions)	2.4	2.7	3.2	3.1	3.0	3.0	3.3	3.4	3.5	3.8	3.7	3.7	4.0	3.9
Net domestic assets	51.8	70.8	90.3	89.1	96.6	101.4	101.1	100.4	109.1	108.0	104.4	112.1	114.2	140.0
Domestic credit	80.2	92.6	116.2	115.4	119.0	121.8	128.5	122.2	136.7	136.2	133.5	141.1	154.7	174.3
Credit to government (net)	-12.2	-5.7	-0.1	-6.9	-11.1	-8.9	-3.9	-22.5	-4.5	-17.7	-16.8	-18.5	-15.3	-6.4
Credit to the economy	92.4	98.3	116.2	122.3	130.1	130.8	132.4	144.7	141.3	153.8	150.3	159.7	170.0	180.6
Cred. economy in foreign currency	-21.8	21.8	28.8	29.1	28.8	30.8	29.3	33.6	29.7	32.4	33.1	34.8	37.0	37.4
Other items (net; assets +)	-28.3	-21.8	-25.9	-26.4	-22.3	-20.4	-27.4	-21.8	-27.7	-28.2	-29.1	-29.0	-40.5	-34.2
Money and quasi money (M3)	131.5	143.8	186.0	183.2	190.2	190.0	204.4	200.8	221.4	223.2	218.8	226.0	239.0	264.5
Foreign currency deposits	46.2	38.1	53.3	55.0	52.6	51.9	55.5	55.3	63.5	62.6	64.9	61.1	65.0	73.4
(US$ billions)	1.4	1.4	1.8	1.8	1.7	1.7	1.8	1.8	2.0	2.0	2.1	2.0	2.1	2.3
M2	85.3	105.7	132.7	128.2	137.6	138.0	148.8	145.6	157.9	160.6	153.9	164.9	174.0	191.1
Memorandum Items														
Avg daily reserve money in 3rd month of quarter	31.8	33.3	40.3	38.0	40.8	40.7	43.8	43.2	47.5	47.5	45.1	48.0	50.7	55.6
12-month percent change	35.0	4.5	21.1	23.6	22.3	22.0	21.8	20.0	17.9	17.9	18.5	18.0	17.4	17.0
Avg daily currency in 3rd month of quarter	20.4	21.2	25.0	22.1	24.8	24.5	27.0	25.7	29.3	28.0	26.6	29.3	30.7	33.3
12-month percent change	30.1	3.7	18.0	18.8	19.7	17.9	20.2	14.7	17.1	12.0	20.0	19.5	19.5	19.0
NCG stock (prog def.)	-15.8	-12.5	-9.8	-17.3	-15.7	-20.0	-8.3	-34.7	-8.9	-22.1	-21.2	-23.0	-19.7	-10.8
NCG flow (prog def.) cum from end-year	-1.2	3.3	2.9	-7.5	-5.9	-10.1	1.5	-24.9	0.9	-12.2	0.9	-0.9	2.3	11.3
12-month percent change														
Reserve money	29.2	8.5	19.7	21.7	22.3	20.7	21.8	18.3	17.9	17.9	18.5	18.0	17.4	17.0
M2	17.6	23.9	25.6	23.9	21.6	22.0	24.4	21.7	19.0	21.0	20.0	19.5	19.5	19.0
M3	22.8	9.4	29.4	28.0	22.0	21.8	22.5	20.4	19.0	20.0	19.4	19.0	19.0	18.5
Credit to the economy	29.3	6.4	18.3	23.5	26.4	27.0	23.9	35.4	21.5	32.3	22.8	22.1	17.5	17.4
Money multiplier (M2/reserve money)	2.70	3.08	3.23	3.40	3.30	3.36	3.33	3.35	3.26	3.32	3.45	3.40	3.41	3.37
Velocity (GDP/M2)	3.69	3.45	3.07	...	...	...	...	...	2.87	2.87	...	...	...	2.76
Nominal GDP	315	365	408	...	...	...	...	...	454	461	528	528	528	528
Nominal GDP growth	18.3	15.8	11.8	...	...	...	...	...	12.3	13.0	14.4	14.4	14.4	14.4
Policy lending rate (end-of-period)	15.50	15.00	9.50	9.50	...	9.00	...	8.75	...	...	...	...	...	...
T-bill 91 days rate	14.7	11.8	2.6	2.8	...	4.4	...	5.1	...	...	...	...	...	...

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

Table 5. Mozambique: Balance of Payments, 2010-18

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

	2010	2011	2012	2013		2014	2015	2016	2017	2018
	Act.	Act.	Est.	CR/13/200	Proj.	Proj.	Projections			
Current account balance	-1,113	-3,059	-6,426	-5,854	-6,621	-7,364	-8,252	-8,429	-10,855	-11,872
Trade balance for goods	-1,179	-2,249	-4,048	-3,163	-4,640	-4,570	-5,088	-4,356	-5,636	-5,078
Of which: Megaprojects	768	468	75	129	-187	28	-315	794	-218	391
Exports, f.o.b.	2,333	3,118	3,856	3,950	3,989	4,729	5,554	6,756	7,652	9,160
Megaprojects	1,668	2,015	2,219	2,623	2,249	2,807	3,454	4,420	5,052	6,147
Other	665	1,103	1,637	1,326	1,741	1,922	2,100	2,336	2,601	3,012
Imports, f.o.b.	-3,512	-5,368	-7,903	-7,112	-8,629	-9,299	-10,642	-11,112	-13,289	-14,237
Megaprojects	-900	-1,547	-2,143	-2,494	-2,435	-2,779	-3,769	-3,626	-5,269	-5,757
Other	-2,613	-3,820	-5,760	-4,618	-6,194	-6,520	-6,873	-7,487	-8,019	-8,481
Trade balance for services	-506	-1,482	-3,273	-3,225	-3,201	-3,688	-3,959	-4,318	-4,793	-5,943
Income balance	-85	-190	-35	-23	-6	-176	-310	-891	-1,604	-2,097
Of which: Dividend payments by megaprojects	0	-157	0	-17	-6	-159	-210	-652	-1,212	-1,447
Current transfers balance	657	863	929	557	1,226	1,070	1,105	1,136	1,179	1,245
Of which: External grants	605	785	538	520	541	519	487	453	421	400
Capital and financial account balance	1,663	3,364	6,748	5,954	6,998	7,563	8,714	9,108	11,666	12,630
Capital account balance	346	432	456	384	375	396	421	449	481	521
Financial account balance	1,318	2,933	6,292	5,571	6,623	7,166	8,293	8,659	11,185	12,109
Net foreign direct investment	1,340	2,599	5,215	4,719	5,519	4,703	4,629	4,709	4,653	5,130
Net foreign borrowing by the general government	468	531	546	961	1,095	1,414	1,306	1,351	1,264	1,139
Net foreign borrowing by the nonfin private sector	-348	-39	516	-43	-274	751	2,043	2,266	4,914	5,345
Other [1]	-142	-159	14	-66	284	298	315	333	354	495
Net errors and omissions	58	17	-87	0	81	0	0	0	0	0
Overall balance	608	323	236	100	458	199	462	679	812	758
External financing	-58	-323	-236	-100	-458	-199	-462	-679	-812	-758
Reserve assets [1]	-87	-321	-331	-97	-455	-196	-426	-642	-775	-723
Net use of credit	18	-2	-4	-3	-2.9	-3	-36	-37	-36	-36
Of which: Net use of Fund credit	20	-2	-2	-3	-3	-3	-36	-37	-36	-36
Exceptional financing	10	0	0	0	0	0	0	0	0	0
Memorandum items:										
Current account balance (percent of GDP)	-11.7	-24.4	-45.0	-39.9	-43.4	-43.4	-43.6	-39.9	-46.1	-45.2
Excluding external grants	-18.5	-31.3	-51.5	-43.4	-47.0	-46.5	-46.2	-42.1	-47.9	-46.7
Excluding Mega-Projects	-1.5	-2.8	-3.4		-4.1	-4.4	-4.0	-4.4	-3.6	-5.4
Net foreign assets	1,745	2,082	2,408	2,551	2,866	1,005	1,467	2,146	2,957	3,715
Net international reserves [1]	1,908	2,239	2,605	2,704	3,061	3,262	3,725	4,404	5,215	5,974
Gross international reserves [1,2]	2,099	2,428	2,799	2,894	3,252	3,449	3,877	4,519	5,294	6,017
Months of projected imports of goods and nonfactor services	3.3	2.4	2.6	2.8	2.7	2.6	2.7	2.7	2.8	3.2
Months of projected G&S imports (excl. megaproject imports)	4.2	3.0	3.9	3.7	4.4	4.7	4.9	5.8	5.4	5.3
Percent of broad money (M2)	80.2	62.7	62.7	58.7	62.0	57.0	55.8	57.6	59.6	59.9

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

[1] Includes net portfolio investment and other investment assets.

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

Table 6. Mozambique: Financial Soundness Indicators for Banking Sector, 2003–13

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	July 2013
Capital adequacy											
Regulatory capital to risk-weighted assets	16.5	18.0	13.4	12.5	14.2	13.9	15.1	14.4	17.1	17.9	15.1
Regulatory Tier I capital to risk-weighted assets	14.7	16.0	13.6	10.7	12.1	12.4	13.0	13.7	16.1	16.9	14.4
Capital (net worth) to assets	7.4	7.4	6.6	6.3	7.2	7.5	7.7	8.0	9.0	9.5	8.7
Asset composition and quality											
Foreign exchange loans to total loans	60.8	62.0	51.4	33.2	28.5	32.8	32.4	29.5	25.1	28.1	27.8
Nonperforming loans to gross loans [1]	13.8	5.9	3.5	3.1	2.6	1.9	1.8	1.9	2.6	3.2	3.0
Nonperforming loans net of provisions to capital [1]	8.8	3.8	1.9	3.6	0.5	2.5	5.9	5.6	6.6	6.8	7.2
Earnings and profitability											
Return on assets	1.4	1.5	1.9	4.0	3.8	3.5	3.0	2.6	2.5	1.9	2.0
Return on equity	18.6	20.6	26.9	60.8	50.7	44.7	36.6	32.9	26.5	19,.6	22.4
Interest margin to gross income	62.1	65.8	63.6	67.4	70.2	58.8	55.7	59.4	64.9	58.9	56.1
Noninterest expenses to gross income	81.9	81.6	75.2	60.2	60.8	58.7	58.4	59.7	61.3	66.1	64.5
Personnel expenses to noninterest expenses	42.4	43.1	43.5	42.6	46.3	45.1	45.9	45.5	47.1	49.1	49.5
Trading and fee income to gross income	37.9	34.2	36.4	32.6	29.5	40.5	44.3	23.8	17.2	19.5	191.0
Funding and liquidity											
Liquid assets to total assets [2]	45.2	38.3	31.1	33.9	36.0	36.2	27.9	22.4	27.8	33.4	28.4
Customer deposits to total (non-interbank) loans	193.6	205.0	177.6	169.5	184.9	165.7	138.2	131.2	131.6	143.8	136.6

Source: Bank of Mozambique (BM).

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

[2] Includes deposits at parent banks.

Table 7. Mozambique: Quantitative Assessment Criteria and Indicative Targets Under the 2013-16 PSI[1]
(Millions of meticais, unless otherwise specified)

	2013										2014			
	End-June Assessment Criteria				End-Sept Indicative Target				End-Dec Assessment Criteria		End-March Indicative Target	End-June Assessment Criteria	End-Sept Indicative Target	End-Dec Indicative Target
	Prog.	Adj.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Proposed	Proposed			
Assessment Criteria for end-June/December														
Net credit to the central government (cumulative ceiling)	-5,858	-2,835	-10,144	M	1,504	4,497	-24,874	M	895	-12,242	889	-3	2,316	13,605
Stock of reserve money (ceiling)	40,787	40,787	40,697	M	43,817	43,817	43,187	M	47,493	47,493	45,100	48,023	50,689	55,567
Stock of net international reserves of the BM (floor, US$ millions)	2,360	2,260	2,295	M	2,621	2,521	2,857	M	2,704	3,061	2,961	3,036	3,236	3,262
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US$ millions)[2]	1,200	1,200	0	M	1,200	1,200	895	M	1,200	1,200	1,200	1,200	1,200	1,200
Stock of short-term external debt contracted or guaranteed by the central government (ceiling)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
External payments arrears of the central government (ceiling, US$ millions)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
Indicative targets														
Government revenue (cumulative floor)[3]	55,760	55,760	57,738	M	81,891	81,891	98,685	M	111,419	126,285	25,519	58,036	91,537	125,266
Priority spending (cumulative floor)	43,748	43,748	39,210	NM	76,041	76,041	68,498	NM	119,025	117,617	20,686	45,244	79,007	135,716

Sources: Mozambican authorities and IMF staff estimates.

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

[2] Assessed on a continuous basis.

[3] Net of verified VAT refund requests.

Table 8. Mozambique: Structural Benchmarks for 2013

Structural Benchmarks	Expected Date of Implementation	Status
Government approval of the action plan for the expansion of the electronic payroll system (including e-Folha) and of the integrated civil service database (e-CAF). (¶21 of the MEFP date June 7, 2013)	End-June 2013	Met.
Completion of the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (¶21 of the MEFP date June 7, 2013)	End-December 2013	Not met. Proposed to be reset to March 2014.
Submission of Integrated Investment Plan to the Council of Ministers with sufficient specific information to analyze the impact of the related borrowing on debt sustainability. (¶22 of the MEFP date June 7, 2013)	End-June 2013	Not met. Less specific IIP submitted in July and approved in September 2013.
Submission of the 2nd Strategic Plan to Improve the Business Environment to the Council of Ministers (¶4 of the MEFP date June 7, 2013)	End-August 2013	Met.
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶37 of the MEFP date June 7, 2013)	End-November 2013	Not met. Proposed to be reset to February 2014.
Staffing a payment systems oversight unit in the BM and begin operations by end-November 2013. (¶40 of the MEFP date June 7, 2013)	End-November 2013	Met.
Preparation of a plan to gradually reduce the stock of pending VAT arrears, avoid accumulation of new arrears, and optimize the administration and refund process. (¶23 of the MEFP date June 7, 2013)	End-October 2013	Met.

Table 9. Mozambique: Proposed Structural Benchmarks for 2014

Areas For Structural Benchmarks	Date of Implementation
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶37 of the MEFP date June 7, 2013 and ¶30 of this MEFP)	End-February 2014
The Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 and provide a note to the Fund staff. (MEFP ¶16)	End-March 2014
The Government will complete the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (MEFP ¶14)	End-March 2014
The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget. (MEFP ¶15)	End-June 2014
The Government will present VAT collections on a net basis in the 2015 budget proposal documents. (MEFP ¶16)	End-October 2014
The Government will implement a simplified and more accurate system of tax payments through banks, within the new e-tax system (e-tributacao), and the Revenue Authority will issue a notice informing taxpayers about the new procedures (MEFP ¶16)	End-October 2014
The Board of BM will approve the action plan for the simulation exercise pertaining to the Financial Contingency Plan. (MEFP ¶28)	End-November 2014
The BM will issue the first annual payments systems oversight report. (MEFP ¶34)	End-November 2014
The Government will establish a moveable collateral registry. (MEFP ¶30)	End-December 2014

Appendix I: Letter of Intent

Maputo, Mozambique
December 20, 2013

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

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the first review under the Policy Support Instrument (PSI) and the modification of several assessment criteria and indicative targets for December 2013. In support of this request we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews implementation of the current PSI and establishes policy objectives and assessment criteria and indicative targets for the short and medium term.

The Government's economic program aims to maintain macroeconomic stability, promote inclusive growth through public investment and the promotion of productive employment, and reduce poverty. The program is in line with our Poverty Reduction Strategy Paper (PARP) for 2011–14 and with our plans regarding its successor strategy.

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

The Government will consult with the IMF on the adoption of these measures, and—at its own initiative or whenever the Managing Director requests such a consultation—in advance of any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The Government will provide the IMF with such information as the IMF may request to be able to assess the progress made in implementing the economic and financial policies and achieving the objectives of the program.

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

Sincerely yours,

/s/

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 1: Memorandum of Economic and Financial Policies

1. This MEFP describes recent developments and performance under the government's economic program supported by the Policy Support Instrument (PSI). It focuses on recent economic developments and prospects up to the end of 2013, as well as the economic outlook and policies in support of the program for 2014.

RECENT ECONOMIC DEVELOPMENTS AND PROGRAMME PERFORMANCE

2. **The performance of the Mozambican economy remains robust.**

- **Economic growth remains strong.** In the first half of 2013 it reached 6.6 percent despite the negative impact of the floods in early 2013, and helped by the strong recovery in the second quarter. This demonstrates the resilience of the Mozambican economy to exogenous shocks and its capacity to recover from natural disasters.

- **Following a rapid acceleration of inflation in the first quarter of the year inflationary pressures abated.** The 12-month rate of inflation (Maputo City CPI) reached 4.3 percent in September (3.9 percent on average) reflecting (i) the recovery of domestic production of fruits and vegetables after the floods, (ii) the appreciation of the Metical vis-à-vis the Rand and the stable exchange rate in relation to the US Dollar, (iii) a drop in import prices, (iv) unchanged administered prices, and (v) base money growth in line with the financial program.

- **Fiscal performance in the first half of 2013 reflected delays in donor disbursements**. The indicative revenue target for June was met, and revenue collections were further boosted in the third quarter following the receipt of an unanticipated US$400 million (2.7 percent of GDP) capital gains tax from the sale of a gas concession in the Rovuma basin. Income and goods and services taxes also performed better than programmed. While current spending was in line with the program so far in 2013, capital expenditure has been lower than budgeted as some foreign financed projects did not come on stream and others were affected by delayed donor disbursements. A supplementary budget was approved by parliament in August to incorporate windfall revenue received in the first quarter ($224 million), and address pressing needs for flood rehabilitation and improved salaries, facilities and services in health, education and the judiciary. We are confident that the budget will be fully implemented during the remainder of 2013, containing the domestic primary deficit (before the additional windfall revenue of $400 million received in August that will be allocated in the 2014 budget only) somewhat below the programmed 2.7 percent of GDP.

- **Government-guaranteed foreign borrowing.** *Empresa Moçambicana de Atum, S. A. (EMATUM*)—the Mozambican Tuna Company--was established in August 2013 by 3 public entities (*IGEPE*--State Holding Company for Public Enterprises, *Emopesca*—State Fisheries Company, and *GIPS*–Investment, Participation and Services, following the adoption by the Government of the Strategic Plan for Development of Tuna Fishery in July 2013. In early

September EMATUM launched a private offer and issued $500 million of government-guaranteed 7-year Loan Participation Notes. This was topped up to $850 million (6 percent of GDP) in late September to finance the purchase of 24 tuna fishing vessels and 3 patrol vessels, as well as other vessels and related equipment for coastal protection and other related economic activities. This was Mozambique's first international debt issue and established a benchmark for Mozambican borrowers in the international capital markets.

- **The external current account deficit is widening** financed mainly by strong flows of foreign direct investment (FDI) and public and private borrowing. In 2012, the deficit reached 45 percent of GDP, up from 24 per-cent in 2011. This reflected large imports of goods and services for mining and natural gas projects. In the first half of 2013 exports were 28 percent lower than a year earlier due to the disruptions caused by the floods. Traditional exports of timber, cashews, banana and shrimp also reflected weak prices, trade restrictions imposed on Iran (main market for bananas), and weak demand in the European market (shrimp). At the same time, merchandise imports were 5 percent higher than a year earlier and service imports increased reflecting megaproject activity. Foreign direct investment reached $3.1 billion, mostly in extractive industries.

- **Net international reserves (NIR) weakened in the first half of 2013**, but benefitted from a $400 million payment of windfall profits on the sale of shares in the natural gas sector in August. NIR at the end of September stood at $2.9 billion, exceeding program objectives.

3. **The quantitative targets for June and September were largely observed.**

- All assessment criteria for June and indicative targets for September were met, with the exception of the indicative targets on priority spending for June and September, which were not met due to several factors, including delays in program execution associated with delays in donor disbursements. However, there may also have been some statistical underreporting as a significant share of priority spending is financed externally, outside the Treasury single account, and data is adjusted manually with a substantial delay. As result, the level of execution is expected to have accelerated substantially in the last quarter of the year. Going forward, the government will pay particular attention to the strengthening of planning, implementation and reporting instruments to limit problems of under execution of priority spending.

4. **Progress with structural reforms continued through several important measures, including:**

- Approval of the Action Plan for the Expansion of the Electronic Payment System (including the e-folha) and the Civil Service Integrated Database (e-CAF).

- The Integrated Investment Plan was submitted to the Council of Ministers at end-July. The Government will work further in order to ensure the link with the debt sustainability analysis.

- The 2nd Strategic Plan to Improve the Business Environment (EMAN II) was submitted to the Council of Ministers as planned.

- The VAT arrears reduction plan to prevent accumulation of new arrears and optimise the administration and processing of refunds was developed.

- Staffing a payment systems oversight unit in the Bank of Mozambique (BM) was done as planned in November 2013.

5. **The remaining structural reform measures foreseen for the fourth quarter 2013 are underway.** Submission of the draft law for the creation of private credit registry bureaus to Parliament was subject to a small delay and is expected to be completed before February 2014. In addition, full implementation of the payment of salaries by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE, which was expected by December 2013, will require more time and the government expects to finalize this reform by March 2014.

MACROECONOMIC POLICY

A. Economic Objectives

6. **Medium-term economic growth is expected to remain high,** supported by the strong expansion of the mining and hydrocarbon industries. However, the country's vulnerability to natural disasters and the weak outlook for the world economy are risk factors to near-term growth.

- In 2014, economic growth is expected to reach 8.3 percent owing to strong recovery of agriculture after the floods, increased capacity of the major railway and implementation of several infrastructure projects. In the next five years, the increased contribution from coal production and exports, infrastructure projects, LNG production and the boost in the transport, communication and construction sectors are projected to raise economic growth to close to 8 percent per year.

- Despite the adverse effect of the floods at the beginning of 2013, inflation has evolved in line with our objectives. We maintain a medium-term target for inflation of 5-6 percent per year.

- Balance of payments developments in coming years will be dominated by large investments in natural resource projects. Current account deficits excluding grants of some 45 percent of GDP are projected until the end of the decade when LNG is projected to reach the export stage.

B. Macroeconomic Policy Mix

7. **The authorities will continue pursuing a combination of fiscal and monetary policies** aimed at maintaining macroeconomic and financial stability, as well as promoting economic and financial inclusion.

8. **In light of the parliamentary elections scheduled in October 2014,** fiscal policy will be somewhat expansionary, while monetary policy will aim to contain the resulting domestic demand pressure to keep inflation low. This effort is likely to be helped by favorable developments in international prices.

C. Monetary and Exchange Rate Policy

9. **Monetary policy will continue to pursue the objective of price stability, in line with the medium-term inflation objective of 5-6 percent.** The BM will target base money growth slightly above nominal GDP with a view to creating monetary space to increase credit to the private sector and thereby support economic growth. As fiscal policy will become expansionary, the BM will step up its liquidity management efforts and base money growth in 2014 will be kept lower than in 2013 to contain demand pressures.

10. **We remain committed to a flexible exchange rate regime.**

D. Fiscal Policy

11. **Fiscal Policy Objectives.** The government's fiscal policy objectives continue to be informed by the need to preserve macroeconomic stability and support the poverty reduction strategy.

- Changes in the macroeconomic outlook resulted in the revision of the 2013 budget; the revenue target (net VAT) was revised up to 24.3 percent of GDP to reflect revenue from capital gains. Expenditure was increased to 36.3 percent of GDP mainly to cover the salary readjustment costs, additional funds for municipal elections, and the post-floods reconstruction plan. However, the overall deficit before grants remained at around 12 percent of GDP, and the primary deficit is 2.6 percent of GDP.

- For 2014, the government has proposed a budget to parliament that includes the $400 million windfall revenue received in August 2013, and also reflects continued efforts to strengthen tax administration (see below). Total spending will reach about 40 percent of GDP (PSI-supported program definition)6, owing to the need to expand investment in priority sectors and one-off factors associated with the general elections, as well as the setting up of a coast guard/maritime security services. The domestic primary balance before grants is projected at 6.1 percent of GDP.

12. **Expenditure Policy.**

- **Resource allocation for priority sectors:** the 2014 budget allocates 64.2 percent of total expenditure, (excluding debt and financial operations) for priority sectors, focusing on education (18.1 percent); infrastructure (14.8%); agriculture and rural development (10.5 percent); and health (9.1 percent).

[6] There are some statistical differences between the 2014 Budget as approved by Parliament and the government commitments under the PSI-supported program. The differences do not affect the overall analysis of fiscal performance and are mostly associated with the treatment of the capital gains tax, the processing of VAT refunds, and the treatment of the quasi-fiscal operations of EMATUM.

- **Wage bill**. The Government is aware that the current level of wages and salaries in percent of GDP is high by international standards. In order to attract, retain and resettle civil servants, we will continue with the implementation of the wage policy. Its aim is to harmonise wage scales, maintaining the philosophy of equity and salary decompression, the hiring, promotion and progressions plans, as well as the resettlement subsidy, without neglecting the need to ensure that the growth of the wage bill is sustainable. In fact, the wage bill in 2014 is proposed at 10.6 percent of GDP against 10.8 percent in the revised budget for 2013. We aim, in the medium term, to reduce the wage bill to 8.5-9 percent of GDP.

- **Further public investment** in priority sectors is key to cover large infrastructure and social gaps, but measures are needed to improve the link between the investment program, strategic priorities and debt sustainability. This is particularly important given that public investment is budgeted to exceed 15 percent of GDP in 2014 – one of the highest in Sub-Saharan Africa.

- **Financing**. The overall fiscal deficit (after grants) is projected to reach 12.5 percent of GDP in 2014. Most of the deficit will be financed externally (9.6 percent of GDP), while domestic financing will reach 2.9 percent of GDP, including the drawdown of deposits associated with the capital gains tax (2 percent of GDP).

13. **Fiscal Transparency**. In December, Parliament recommended changes to the budget law to better reflect the operations associated with EMATUM. In response, the Government

- submitted a revised budget proposal for 2014 that incorporates the non-commercial activities of EMATUM (equivalent to $350 million), as part of the appropriations for the Ministry of Defense. This proposal was approved by Parliament on December 13, 2013. The Government believes that this increase in the budget of the Ministry of Defense is necessary to provide protection services along the coast of Mozambique, including for natural resource companies operating offshore.

- submitted and obtained authorization for an amendment to Art. 11 of the budget law, requesting an increase in the ceiling on government guarantees by $500 million to support the commercial activities of EMATUM.

- will subject EMATUM to strict financial controls and will have its accounts audited.

- Based on advice from the recent Fiscal Transparency Assessment (FTA), the government intends to improve the system for fiscal risk disclosure and management. This will involve several reforms, including changes to the Organic Budget Law (SISTAFE Law) to require the inclusion of a mandatory Annex on Fiscal Risks in the annual budget law, with sufficient information to assess risks associated with guarantees, quasi-fiscal activities, including those conducted by public enterprises, and public-private partnerships.

STRUCTURAL REFORMS

A. Public Financial Management

14. **The Government will continue to implement reforms to strengthen Public Financial Management.**

- **Wage Bill Management.** The action plan to expand the system for direct salary payments to civil servants and agents in institutions with direct access to e-SISTAFE is being implemented (structural benchmark in MEFP-June 2013). The expansion of the payment of salaries by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE will be completed by March 2014 (structural benchmark). The Government will expand e-Folha to all civil servants in institutions with direct access to e-SISTAFE (about 90% of all civil servants) by end-2014 (structural benchmark). In addition, we also remain committed to expanding e-Folha to all State Bodies and Institutions, including those who do not use e-SISTAFE (e.g. defence and police sectors).

- **Expenditure Execution:** The roll out of e-SISTAFE has reached 69 percent of all spending units (including at the district level). By end-2014 e-SISTAFE should reach 75 percent of spending units and a full rollout is expected by end-2015. On July 1, 2013, the commitment component of e-SISTAFE was activated. This will help to improve tracking all phases of the expenditure chain, from the commitment to the payment.

- **International Accounting Standards:** We have prepared a proposal for a new legal framework (*Normas e Plano de Contas*) to meet international public sector accounting standards based on IPSAS. This proposal has been submitted to public consultation and will be submitted to the cabinet for approval in the first quarter of 2014. The implementation of this framework will require the approval by the Parliament and the subsequent revision of the SISTAFE Law, both expected by end-2014. We will then introduce the new accounting standards and make the required adjustments to e-SISTAFE software in 2015, to start the pilot implementation of the accrual accounting based on the IPSAS in 2016.

- **Economic Classification of Revenue:** We have prepared a new revenue classification, which is expected to be used in the 2015 budget, in line with best international practice.

B. Investment Planning and Debt Management

15. **Priority areas include:**

- **Strengthening Investment Planning:** in September 2013 the Government approved the Integrated Investment Programme (IIP), which identifies priority infrastructure projects for 2014-2017. As a next step by June 2014, the Ministry of Planning and Development will approve, and share with IMF staff, an enhanced IIP by adding financial information for projects for which financing has been secured to inform the DSA, MTFF and the budget. The revised IIP will also include summary project descriptions in line with the project summary table already developed (structural benchmark). The IMF and the World Bank are providing assistance to build capacity in public project preparation, assessment and selection, and the linkage between IIP financing needs and debt sustainability.

- **Strengthening Project Selection Instruments:** The Ministry of Planning and Development's Consultative Council approved a Public Project Preparation and Selection Manual, containing a summary form with project information. Going forward, the summary form for projects approved by the Council of Ministers will be published on MPD's webpage. To enforce the use of the Public Project Preparation and Selection Manual, MPD and MF will revise the Methodological Guidelines for the preparation of the 2015-17 Medium-Term Fiscal Framework to incorporate the main selection and evaluation criteria identified in the Selection Manual, as well as publish the manual on the MPD website to encourage its use for project preparation and appraisal by line ministries (December 2014).

- **Strengthening Public Debt Management:** The Government prepared a DSA as part of the preparation of the 2014 Draft Budget, which showed that the debt remains sustainable. In the medium term, we remain committed to (i) incorporating the analysis of costs and risks associated with the public debt portfolio, including guarantees, in the budget execution reports, and (ii) to extend the Debt Management Strategy, at the time of its review in 2015, to explicitly include government guarantees. These steps aim to strengthen the linkage with the budget, the Integrated Investment Plan, and the Public Debt Management Strategy. We have already included the guarantee in the 2013 third quarter budget execution report and will also expand the coverage of the quarterly public debt report to include government guarantees from the first quarter of 2014.

C. Tax Administration Policies

16. **Tax Administration**

- **VAT administration and reimbursements.** We have prepared a plan to gradually reduce the stock of pending VAT arrears, avoiding accumulation of new arrears, and optimize the administration and refund process (structural benchmark for end-October 2013). This plan has been further refined with technical assistance from the IMF. The implementation of this plan will involve several critical steps. By March 2014, the Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 (structural benchmark). A note with the validation process and final amounts of effective VAT refunds will be shared with IMF staff. The stock of valid reimbursement requests will be either fully paid or securitized by end-2014. The Government will also prevent delays in the processing of new refund requests through the implementation of new legal, accounting and budgeting procedures to ensure that reimbursements are paid in a timely manner. The Government will ensure that the 2015 budget proposal includes VAT collections on a net basis (structural benchmark for end-October 2014).

- **Implementation of e-tax and payment via banks for VAT and ISPC (simplified tax for small taxpayers).** We are gradually implementing a modern e-tax system and simplifying the process for tax payments through banks. VAT and ISPC are the first taxes that will be collected via this new system. In order to make the new system operational, we will ensure that all relevant taxpayers are duly registered in the single e-tax database with a single taxpayer identification number (NUIT). About half of the 1,205 large taxpayer records have been updated already, and all 127,000 VAT and ISPC taxpayer records will be updated by end-September 2014. A new, simplified and more accurate system of tax payments via banks will thus be possible for VAT and ISPC beginning in October 2014. The revenue authority will issue a notice informing taxpayers of the new procedures (structural benchmark). Payments via banks will be further improved with the introduction of the online taxpayers portal through which taxpayers will be able to calculate their tax assessments and make payments.

- **Strengthening of Large Taxpayer Units (UGCs and DCAT):** the Large Taxpayer Unit (UGCs) Management Database was fully installed in Beira and Nampula, and the respective connections established; it is currently operational in the three UGCs (Maputo, Beira and Nampula). The human resources of the Large Taxpayer Units will be reinforced in light of their contribution of total revenue collection by end-2014, including strengthening the specialized natural resource unit (DCAT).

- **Tax Policy**: the Government is conducting a study to verify possible inconsistencies between the general ISPC regime and the simplified taxation regimes for VAT, IRPC and IRPS. It is expected to be completed by the end of 2013.

- **Transfer Prices:** the draft Transfer Price Regulations is near completion with technical assistance from the IMF. It will be submitted to the Council of Ministers for approval by June 2014 following the Action Plan for its implementation.

- **Double Taxation Agreements (DTAs)**: Mozambique ratified agreements to prevent double taxation with 9 countries. These agreements are currently being renegotiated, mostly to reduce revenue losses resulting from the deliberate incorporation of companies in countries with which Mozambique has signed a double taxation agreement.

D. Improving Gains from Mineral Resources Exploitation

17. **Data management:** A central database on Mozambique's natural resources is now available online through the Ministry of Natural Resources. It is now being upgraded and expanded nationwide. Sector databases are in operation at the Planning Directorate, National Geology Directorate (DNG), National Petroleum Institute (INP) and National Hydrocarbon Company (ENH), and capacity building programs will be implemented for database management officials.

18. **Extractive Industry Transparency Initiative (EITI).** The preparation of the 4th EITI Reconciliation Report is underway. This report will present information on payments from the extractive industry and on government revenue, for 2011, and publication is expected by the end of 2013. In addition, the new EITI rules approved at the EITI Global Conference in May 2013, are under implementation, and will be adopted in the 4th EITI Reconciliation Report. Similarly, the publication of contracts and their respective fiscal terms, signed and approved by the Administrative Tribunal as of 2011, has been adopted in the Mining Law proposal submitted to Parliament.

19. **Mining and Hydrocarbon Legislation**: the Mining and Hydrocarbon Acts have been submitted to Parliament. The revised Hydrocarbon Act includes the regulatory framework for the LNG industry (Liquefied Natural Gas).

20. **Strengthening the Mining and Hydrocarbon Tax Regime**. Following public consultation, the inputs from stakeholders are now being harmonised into a revised mining and hydrocarbon tax regime proposal, aimed at aligning them more with international best practices and combine the relevant tax issues in a single legal document to allow for easy reference and interpretation by economic agents. Submission of the draft to Parliament is expected to take place by May 2014.

21. **Use of Windfall Revenue.** The Government is aware that one-off receipts, including those that stem from capital gain taxes, should not finance recurrent spending increases that could compromise fiscal sustainability over the medium term. To this end, fiscal revenue windfalls, including from direct or indirect natural resource taxation, will be saved or used only for investment spending or debt reduction.

E. Management of State-Owned Companies

22. **Strengthening Oversight of State-Owned Companies**. After the approval of the State Enterprise Act in February 2013, the draft Regulation has been prepared and is expected to be approved by the Council of Ministers by end-2013. The Regulation will limit current expenditures that public enterprises can make and will define the documents that need to be submitted to support their analysis of debt sustainability.

23. **Ensuring Transparency.** Work on the analysis of state-owned enterprise management tools continued. The 2012 Report and Accounts of the Airport Company, the Railway Company (CFM), and the Hydrocarbon Company (ENH) have already been published. The report for the Electricity Company (EDM) will be published by the end of 2013.

24. **Electricity Company**: To contribute to the improvement of EDM's financial performance, a study on electricity tariff adjustments was prepared. A proposal to restructure the tariffs was assessed by the Ministry of Energy, and subsequently endorsed by the Price Commission. Once comments have been incorporated, a proposal will be submitted to the Council of Ministers.

25. **Government Strategy for the Participation of State-Owned Enterprises in Infrastructure Projects:** With support from the World Bank we are preparing a Strategy for the Government's Participation of State-Owned Enterprises in Infrastructure Projects. Our intention is to complete the first draft by the end of 2013.

FINANCIAL SECTOR POLICIES

A. Strengthen monetary policy formulation and implementation

26. **Strengthening the monetary policy framework.** The BM is strengthening the monetary policy framework and will continue to improve the analytical and communication capacity in the monetary policy decision-making process, including improving its inflation forecast model, with technical assistance.

27. **Strengthening money market management.** Significant progress was achieved in improving money market management and the liquidity of public securities, notably: (i) implementation of the IT platform by BM to allow the development of repo operations with fungible T-bills. The revamping of *Meticalnet* and all accounting specifications was completed and repo operations with fungible T-bills are already implemented since August 2013; (ii) coordination work with the Ministry of Finance with a view to accepting T-bonds as collateral in interbank money market operations is underway; (iii) since 21 August 2013 deposit facility operations (FPD) were transformed into repo operations to expand the use of collateralized operations; and (iv) the BM has narrowed the corridor between the lending and deposit rates (FPC and FPD rates).

B. Financial Sector Surveillance

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

- **Strengthening supervision of the banking system.** The BM has conducted its first stress testing exercise in July 2013 and used its results to inform supervision. The BM is seeking to strengthen data collection and the stress-test methodology. It is expected that this exercise will be performed by a designated team as part of the quarterly surveillance process, and another round of tests is planned before end-2013. The legislation pertaining to the classification of non-performing loans was revised to make it internationally comparable, and will be effective as of January 2014.

- **Risk-based supervision and Basel II adoption.** After the risk management guidelines and the legal and analytical framework for risk-based surveillance were adopted on March 14, 2013, the BM has conducted risk-based supervision in a pilot with two banks and expects to broaden risk-based surveillance to all banks in the course of 2014. The Basel II Capital Accord will be adopted effective January 1, 2014. The review of the regulations on concentration limits, including investment abroad, will continue.

- **Financial Sector Contingency Plan.** The Financial Sector Contingency Plan was published on June 11, 2013. An internal manual for its implementation is expected to be completed by end-2013, and an action plan for the simulation exercise will be prepared, approved by the Board, and shared with IMF staff, by end-November 2014 (structural benchmark).

29. **Deposit Insurance Fund (DIF).** The Executive Board and the Chairperson of the DIF were appointed in May 2013. The Board is working to make the DIF operational by end-2013, including ensuring the initial funding of the DIF and establishing the system's fee structure and the guarantee limit.

C. Financial Sector Development

30. **In April 2013, the Council of Ministers approved the Financial Sector Development Strategy (FSDS) for 2013-22.** Its main objectives are to: (i) maintain financial sector stability; (ii) increase access to financial services and products, eliminating structural constraints in the economy, specifically those that limit financial intermediation and access to financial services; and

(iii) increase the supply of private capital to support private sector development. Dissemination work has started, and the BM is developing a National Financial Inclusion Strategy in order to implement the FSDS.

- **Establishment of the credit registry bureaus.** The law on the creation of private credit registry bureaus has been delayed, but was approved by the cabinet on December 17th and will be submitted to Parliament by end-February 2014 (structural benchmark). Within six months after Parliament's approval, the BM will prepare the regulation of the law providing information on the requirements needed to apply for a private credit bureau license.

- **Promotion of mobile banking**. Specific regulations governing mobile banking services are being drafted by a task force at the BM and expected to be completed in June 2014. A second mobile banking operator, M-Pesa, was licensed in 2012 after M-Kesh in 2009.

- **Promotion of competition within the banking sector.** The revision of Notice 05/GBM/2009, of June 10, is underway, promoting the transparency of prices and commissions for financial services and products.

- **Developing the domestic capital markets.** The issuance of government bonds by auction in the Stock Exchange began in 2013 and a financial market education program has been designed. In 2014, the registry of security holdings will be centralized in order to increase transparency, facilitate trading, investor protection, and taxation. Currently 25 securities are listed by companies in the stock exchange. The stock exchange has a program to increase financial literacy and to promote capital market transactions

- **Strengthening the insolvency framework and the collateral framework.** The legal basis for insolvency procedures was established with the publication, on April 29, 2013, of the legislation on emergency liquidity assistance, which aims at assisting deposit-taking institutions and guiding their intervention in the mitigation of systemic risks. The Government intends to work on a Collateral Bill with a view to establishing a moveable collateral registry by end-2014 (structural benchmark).

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

31. **AML/CFT Framework.** The New Law on Anti-Money Laundering the Combating the Financing of Terrorism was approved in August 2013, and the respective Regulations are now under preparation. The preparation by the Bank of Mozambique of guidelines for commercial banks on Anti-Money Laundering and Combating the Financing of Terrorism is also at an advanced stage. Likewise, the Law [14/2007] establishing the Financial Intelligence Unit of Mozambique is under review.

32. **The Government adopted in July 2013 the Action Plan for the implementation of GAFI/FATF Standards**, in coordination with the IMF's Legal Department. This Plan lists the priority actions to be undertaken and complements the previous plan prepared by the Mozambican authorities, following the Recommendations of the Mutual Assessment of Mozambique by the

Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). Both Plans are being executed.

33. **There is a need for technical assistance for human resources capacity building** (GIFIM analysts, Criminal Investigation Police, Judicial Magistrates and Public Prosecutor's Office), in matters of financial and economic crimes and money laundering.

PAYMENT SYSTEM

34. **Reforms in the National Payment System**

- **Enhancing BM oversight practices**. The Oversight Manual has been approved in May 2013. A designated team of staff is already performing the oversight function, and the Oversight Unit was established in November 2013 (structural benchmark for November 2013). At the same time, the regulations on the Electronic Clearance of Cheques System are currently under review, and are expected to be approved and published in November 2013. Moving forward, the BM will draft an action plan on implementing the Oversight Manual by end-2013, and will produce the first annual oversight report by November 2014 (structural benchmark).

- **Developing the retail payments network (SIMO) shared by the BM and commercial banks.** Two commercial banks have connected to the SIMO network, while two additional banks are in the testing stage. By June 2014, the four largest banks in Mozambique will be covered by SIMO, including the Ponto 24 Network shared by a group of ten banks.

GOOD GOVERNANCE AND BUSINESS ENVIRONMENT

35. **Anti-Corruption Package**. Five laws comprise the complete anti-corruption package. The Penal and Penal Procedural Codes are scheduled for approval by Parliament. Following passage of the Anti-Corruption Law, an Action Plan for the effective implementation of Anti-Corruption Legislation is underway, and a draft has been produced, which is now being shared with the various stakeholders.

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

- **Business Environment Improvement Strategy (EMAN II 2013-2017).** This document seeks to decentralize responsibilities and simplify procedures with a view to speeding up the business start-up process.

- **Commercial Activity Licensing Regulations.** Decree 34/2013 of August 2013 has facilitated a 50 percent reduction in the time needed to issue a commercial license through the elimination of prior inspection for activities of limited risk. It also assigns to one-stop-shops and district governments the mandate for licensing commercial activities, which was previously under the authority of the Provincial Governor.

- **Business Registration.** This single registration form eliminates the need to fill out multiple forms and documents with a view to simplifying procedures as well as reducing costs to register and license business and start up activities.

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

	2013										2014			
	End-June Assessment Criteria				End-Sept Indicative Target				End-Dec Assessment Criteria		End-March Indicative Target	End-June Assessment Criteria	End-Sept Indicative Target	End-Dec Indicative Target
	Prog.	Adj.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Proposed	Proposed			
Assessment Criteria for end-June/December														
Net credit to the central government (cumulative ceiling)	-5,858	-2,835	-10,144	M	1,504	4,497	-24,874	M	895	-12,242	889	-3	2,316	13,605
Stock of reserve money (ceiling)	40,787	40,787	40,697	M	43,817	43,817	43,187	M	47,493	47,493	45,100	48,023	50,689	55,567
Stock of net international reserves of the BM (floor, US$ millions)	2,360	2,260	2,295	M	2,621	2,521	2,857	M	2,704	3,061	2,961	3,036	3,236	3,262
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US$ millions)[2]	1,200	1,200	0	M	1,200	1,200	895	M	1,200	1,200	1,200	1,200	1,200	1,200
Stock of short-term external debt contracted or guaranteed by the central government (ceiling)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
External payments arrears of the central government (ceiling, US$ millions)[2]	0	0	0	M	0	0	0	M	0	0	0	0	0	0
Indicative targets														
Government revenue (cumulative floor)[3]	55,760	55,760	57,738	M	81,891	81,891	98,685	M	111,419	126,285	25,519	58,036	91,537	125,266
Priority spending (cumulative floor)	43,748	43,748	39,210	NM	76,041	76,041	68,498	NM	119,025	117,617	20,686	45,244	79,007	135,716

Sources: Mozambican authorities and IMF staff estimates.

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

[2] Assessed on a continuous basis.

[3] Net of verified VAT refund requests.

Table 2. Mozambique: Structural Benchmarks for 2013

Structural Benchmarks	Expected Date of Implementation	Status
Government approval of the action plan for the expansion of the electronic payroll system (including e-Folha) and of the integrated civil service database (e-CAF). (¶21 of the MEFP date June 7, 2013)	End-June 2013	Met.
Completion of the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (¶21 of the MEFP date June 7, 2013)	End-December 2013	Not met. Proposed to be reset to March 2014.
Submission of Integrated Investment Plan to the Council of Ministers with sufficient specific information to analyze the impact of the related borrowing on debt sustainability. (¶22 of the MEFP date June 7, 2013)	End-June 2013	Not met. Less specific IIP submitted in July and approved in September 2013.
Submission of the 2nd Strategic Plan to Improve the Business Environment to the Council of Ministers (¶4 of the MEFP date June 7, 2013)	End-August 2013	Met.
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶37 of the MEFP date June 7, 2013)	End-November 2013	Not met. Proposed to be reset to February 2014.
Staffing a payment systems oversight unit in the BM and begin operations by end-November 2013. (¶40 of the MEFP date June 7, 2013)	End-November 2013	Met.
Preparation of a plan to gradually reduce the stock of pending VAT arrears, avoid accumulation of new arrears, and optimize the administration and refund process. (¶23 of the MEFP date June 7, 2013)	End-October 2013	Met.

Table 3. Mozambique: Proposed Structural Benchmarks for 2014

Areas For Structural Benchmarks	Date of Implementation
Submission to Parliament of draft law on the creation of private credit registry bureaus. (¶37 of the MEFP date June 7, 2013 and ¶30 of this MEFP)	End-February 2014
The Government will finalize the validation process for the stock of VAT reimbursement requests pending as of end-December 2013 and provide a note to the Fund staff. (MEFP ¶16)	End-March 2014
The Government will complete the expansion of salary payments by direct bank transfer to all institutions covered by e-CAF and with direct access to e-SISTAFE. (MEFP ¶14)	End-March 2014
The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget. (MEFP ¶15)	End-June 2014
The Government will present VAT collections on a net basis in the 2015 budget proposal documents. (MEFP ¶16)	End-October 2014
The Government will implement a simplified and more accurate system of VAT and ISPC tax payments through banks, within the new e-tax system (e-tributacao), and the Revenue Authority will issue a notice informing taxpayers about the new procedures (MEFP ¶16)	End-October 2014
The Board of BM will approve the action plan for the simulation exercise pertaining to the Financial Contingency Plan. (MEFP ¶28)	End-November 2014
The BM will issue the first annual payments systems oversight report. (MEFP ¶34)	End-November 2014
The Government will establish a moveable collateral registry. (MEFP ¶30)	End-December 2014

Attachment 2: Technical Memorandum of Understanding

December 20, 2013

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

DEFINITIONS

A. Net credit to the central government

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

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

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

B. Government revenue and financing

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

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

C. Priority social spending

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

D. Reserve money

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

E. Net international reserves

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

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

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

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

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

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

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

H. External payments arrears of the central government

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

I. Foreign program assistance

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

J. Actual external debt service payments

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

ADJUSTERS

A. Net international reserves

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

- downward by the shortfall in external program aid less debt service payments (up to US$100 million), compared to the program baseline (Table 1);
- upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector;
- downward/upward for any revision made to the end-year figures corresponding to the previous year; and

- downward to accommodate higher external outlays because of natural disasters, up to US$20 million.

B. Net credit to central government

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

- upward by the shortfall in the MT value of external program aid receipts less debt service payments (up to the MT equivalent of US$100 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
- downward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector;
- downward by privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings accounts abroad;
- downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector; and
- upward to accommodate the higher locally-financed outlays because of natural disasters, up to the MT equivalent of US$20 million at exchange rates prevailing at the respective test dates.

C. Reserve money

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

D. Government revenue

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

DATA AND OTHER REPORTING

21. The Government will provide Fund staff with:

- monthly and quarterly data needed to monitor program implementation in relation to the program's quantitative targets and broader economic developments;
- weekly updates of the daily data set out in Table 1;
- weekly data set out in Table 4 of the TMU dated May 26, 2005;
- monthly updates of the foreign exchange cash flow of the BM;

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

22. The monetary survey made available by the BM will clearly identify donor-financed project deposits (with a breakdown between foreign and domestic currency) included in net credit to the government in both the central bank's and commercial banks' balance sheets.

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

TMU Table 1. Mozambique: Net Foreign Assistance, 2013-14

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	3	75	113	193	50	37	236	-10
Gross foreign program assistance	45	116	154	234	101	88	287	41
Program grants	45	67	124	74	101	88	22	41
Program loans	0	49	30	160	0	0	265	0
External debt service	41	41	41	41	51	51	51	51
Cumulative net foreign program assistance in US dollars	3	78	191	384	50	87	322	312
Gross foreign program assistance	45	161	315	549	101	189	476	517
External debt service	41	82	124	165	51	103	154	205
Net foreign program assistance (MT mn)	191	2,129	3,408	5,825	1,644	1,096	7,239	-394
Gross foreign program assistance	1,355	3,497	4,640	7,116	3,105	2,740	8,969	1,293
Program grants	1,355	2,012	3,731	2,252	3,105	2,740	679	1,293
Program loans	0	1,485	909	4,864	0	0	8,291	0
External debt service	1,164	1,369	1,232	1,291	1,461	1,644	1,731	1,687
Cumulative Net foreign program assistance in MTN millions	191	2,320	5,728	11,553	1,644	2,740	9,979	9,585
Gross foreign program assistance	1,355	4,852	9,493	16,608	3,105	5,845	14,815	16,107
External debt service	1,164	2,532	3,765	5,056	1,461	3,105	4,836	6,522

Source: Mozambican authorities and IMF staff estimates.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under the Policy Support Instrument for Mozambique

The Executive Board of the International Monetary Fund (IMF) has completed the first review under the three-year Policy Support Instrument (PSI) for the Republic of Mozambique.[7] The PSI for Mozambique was approved in June 2013 (see Press Release No. 13/231). The Board's decision was taken on a lapse of time basis.[8]

Mozambique's macroeconomic performance remains strong with real GDP growth for 2013 estimated at 7.1 percent and inflation remains moderate. The PSI-supported program is broadly on track. All assessment criteria were met and most indicative targets, but there was some slippage on structural reforms. In spite of risks stemming from the uncertain global economy, the outlook remains favorable and growth is expected to be sustained in the medium term by the natural resource boom and infrastructure investment. A recent government guarantee for large-scale borrowing by a public enterprise has raised transparency and prioritization issues that point to the need to strengthen investment and macro-economic planning. New risks associated with the political/security environment have emerged.

[7] 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. A country's performance under a PSI is reviewed bi-annually. The Executive Board approved Mozambique's 3rd three-year PSI on June 24, 2013 (see Press Release No 13/231.

[8] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

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The authorities' economic program for 2014 emphasizes preserving macroeconomic stability and debt sustainability while promoting social development. Real growth is projected at 8.3 percent. While recent monetary policy action has been expansionary, a more prudent approach in 2014, together with the favorable outlook for international prices could facilitate the achievement of the medium-term inflation target. The 2014 budget envisages a significant expansion in infrastructure spending that could support growth. It also includes a sizeable pick-up in goods and services outlays, financed in part by nonconcessional external borrowing.

Structural reforms along a broad policy spectrum should be implemented vigorously to foster sustained and more inclusive growth. With foreign aid likely to decline over the medium term, increased nonconcessional borrowing can provide additional resources for improving physical infrastructure and human capital. Further strengthening debt management and investment planning and implementation are essential to ensure value-for-money, maximize the efficiency of investment and preserve debt sustainability. Completion of the new mining and hydrocarbon legislation, the related fiscal regimes, and implementation regulations would facilitate the economic development of Mozambique's natural resources.