International Monetary Fund

Republic of Mozambique and the IMF

Press Release:
IMF Executive Board Completes Third Review Under the Three-Year PRGF Arrangement for Mozambique and Approves US$2.3 Million Disbursement
December 19, 2005

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Republic of Mozambique: Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

October 17, 2005

The following item is a Letter of Intent of the government of Republic of Mozambique, which describes the policies that Republic of Mozambique intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Republic of Mozambique, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Maputo, Mozambique
October 17, 2005

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

Dear Mr. de Rato:

1. On behalf of the Government of Mozambique, we hereby transmit the attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the Government intends to implement in the remainder of 2005 and in 2006, as well as the underlying macroeconomic policy framework consistent with the PARPA. The attached technical memorandum of understanding (TMU) defines the terms and conditions of the program.

2. The Government of Mozambique continues to make progress in implementing the 2004-06 program supported by the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Fund's Executive Board on July 6, 2004. Following the general elections that took place last December, the new Government is implementing with determination its program. All quantitative performance criteria and the structural performance criteria at end-June 2005 were observed as well as the structural performance criteria through end-September 2005. The program for the remainder of 2005 remains largely unchanged while the medium term framework has been slightly revised to take into account domestic and international economic developments, particularly oil prices.

3. We look forward to a prompt agreement on the new multilateral debt cancellation initiative. We intend to take into account its impact on the execution of the 2006 budget in the first half of 2006. This would be discussed before it is implemented with the Fund staff during the forthcoming fourth review mission scheduled tentatively for April 2006.

4. In support of its objectives and policies, the Government of Mozambique hereby requests the disbursement of the fourth loan under the PRGF in the amount of SDR 1.62 million (1.4 percent of quota) on the completion of the third review.

5. Looking ahead, the policies set out in the MEFP continue to aim to consolidate macroeconomic stability and sustain strong broad-based growth in order to continue to reduce poverty. The performance criteria and benchmarks for the fourth review will be based on the end-December 2005 and end-March 2006 targets as set out in Tables 1 and 3 of the MEFP. The fifth review, which will make available the sixth disbursement, is expected to be

completed by December 31, 2006, and will be based on the observance of the end-June 2006 performance criteria set forth in Table 1 and Table 3 of the MEFP. Additional conditionality for the sixth disbursement will be established at the time of the fourth review.

6. We request a modification of the performance criteria on net international reserves (NIR) and net domestic assets (NDA) for end-December 2005, mainly to reflect higher-than expected grain imports triggered by the ongoing drought affecting part of the country.

7. Moreover, the Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. The revisions to the foreign exchange law will be submitted to the Assembly in early 2006.

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

9. The Government of Mozambique believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of its economic program for 2005 and 2006 supported by the PRGF arrangement, but it will take further measures to that end if deemed necessary. During the implementation of the arrangement, the Government of Mozambique will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, at the initiative of the Government or whenever the Managing Director requests such a consultation.

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Adriano Afonso Maleiane
Governor
Bank of Mozambique

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

Memorandum of Economic and Financial Policies of the Government of Mozambique for the Third Review Under the PRGF Arrangement

October 17, 2005

1. The Government of Mozambique is committed to continue to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and structural reforms. The strategy to achieve these goals in 2001–05 is set out in the *Plano de Acção Para a Redução da Pobreza Absoluta* (PARPA) approved by the Government in 2001, and the second PARPA covering 2006–09 is in the process of being prepared. The Government's economic program is supported by the International Monetary Fund (IMF) with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved on July 6, 2004. This Memorandum of Economic and Financial Policies (MEFP) reviews the performance under the program (April 2005–September 2005) and describes the policies and targets for 2006.

I. Recent Performance Under the PRGF-Supported Program

2. In 2005, economic performance is expected to remain favorable. Real GDP growth is expected to be broad-based and pick up to 7.7 percent as envisaged. The drought that has affected parts of the country seems to be localized with only a modest impact on aggregate production. However, about 500,000 people need food aid until the next crop season starting in March 2006, resulting in higher grain imports. Despite the cumulated increase in domestic petroleum prices of about 40 percent from January to September 2005, the cumulated inflation rate is only 4.2 percent in September, so that the program target of 8 percent for end-2005 is likely to be reached. Most of the real effective appreciation of the metical in 2004 was reversed in the first half of 2005. In the wake of the introduction of the foreign exchange auction system in January 2005, significant exchange rate depreciation pressures emerged, prompting the Bank of Mozambique (BM) to increase foreign exchange sales. However, market conditions have stabilized since June 2005 and the NIR target for end-June 2005 was met.

3. Fiscal performance for the first half of 2005 was better than programmed. The domestic primary deficit was lower by about 1 percent of GDP compared to the program. This over performance was almost entirely explained by restrained expenditure, both current and locally financed capital expenditures. The wage bill was contained within its indicative ceiling for end–June 2005. Collection of most taxes, which began to improve in the second quarter, was close to program projections through August. The primary fiscal deficit target for end-2005 is within reach.

4. Progress has been made in reforming revenue administration and widening the tax base. Following a weakening of tax collection during the political transition, a number of measures have been put in place since April 2005. The statute for the staff of the domestic revenue administration (DGI) and the new regulations for tax auditing and inspection were

approved by the Council of Ministers in April and May, respectively. Moreover, the draft general tax law and the draft law creating the Central Revenue Authority (ATM) are expected to be approved by end-December 2005. The implementing regulations are being prepared so that they can be approved by the Council of Ministers within 30 days once the ATM law is approved and promulgated. The audits of the compliance of large taxpayers with all taxes were completed (a structural benchmark for end-September). Compliance audits will continue to be done on a regular basis. In addition, the following measures were implemented: (i) identifying and collecting tax arrears related to the personal and corporate income taxes for 2003–04; and (ii) increasing the number of taxpayers, and audits.

5. Reforms on Public Expenditure Management (PEM) have moved ahead, since the Assembly's approval of the 2005 budget in May 2005. The budget operations have been entered into the e-SISTAFE (Financial Administration System) using the new budget classifiers. In this context, the production of the budget execution report based on the e-SISTAFE for the first semester of 2005 was produced at end-September (a structural performance criterion for end-September). Recent efforts have been aimed at stabilizing the functioning of the treasury single account, integrating it into the SISTAFE, and developing updated software to allow for direct budget execution in preparation for the full rollout of the system in the core areas (accounting, budget, and treasury) to the Ministry of Finance (MF) and the Ministry of Education and Culture (MEC), a structural benchmark for end-2005, as well as the Ministry of Planning and Development (MPD). In addition, off budget project expenditures financed by external aid are starting to be integrated gradually into the e-SISTAFE with the help of the donor community, including the World Bank.

6. Monetary policy has continued to be prudent and since May 2005 BM's interventions in the exchange market have been solely geared to achieve its NIR target. The targets for base money growth were met for end-June. Broad money (M3) and credit growth have risen, mainly because of the valuation effect of the depreciation of the metical but also due to higher foreign currency deposits, and loans in US dollars and meticais. Treasury-bill rates have remained relatively stable.

7. Prudential ratios of the banking system remain sound. Since July 2005, commercial banks are required to provision 50 percent of their foreign currency-denominated loans to nonexporters. The BM is implementing a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and strengthen loan classification and provisioning in line with international best practices. In addition, in order to strengthen the balance sheet of the BM, securities in an amount of MT 1.5 trillion were issued to BM in June 2005 (a structural performance criterion).

8. Progress on other structural reforms so far in 2005 has been slower than envisaged, particularly with regard to public sector reform and restructuring of public enterprises. A proposal to reform the public wage system is still under discussion while the independent audit of the civil service has been delayed due to the complexities involved. On a positive note, the National Survey on Corruption and Governance was published in August 2005 and a well-funded Anti-Corruption Central Office was created as part of the Anti-Corruption

Law. Finally, "one-stop shops" have been created in all provinces to facilitate and reduce cumbersome licensing procedures.

II. The Policy Agenda for the Remainder of 2005 and 2006

9. The policy framework, which aims at a gradual fiscal consolidation, disinflation, and maintenance of a viable external position, is consistent with the medium-term goal of sustaining poverty reduction through strong economic growth. The Government is committed to continue to implement measures to strengthen the transparency and monitoring of the budget execution, to improve the coherency of monetary policy, and to reinvigorate and accelerate the structural reform agenda. Furthermore, the Government intends to continue to enhance the existing multi-disciplinary committee with a view to strengthening the monitoring of the program, particularly the coordination between the BM and the MOF; and to continue strengthening administrative capacity with the help of a few donors.

10. For the remainder of 2005, the fiscal program will remain unchanged, implying a narrowing of the primary domestic deficit of about 1 percent of GDP compared to 2004. Domestic revenue outturn is expected to be in line with the program, given the improved performance in the second and third quarters of the year and the good implementation of structural measures to strengthen revenue administration. On the expenditure side, the imposition of the 2004 expenditure limits until the 2005 budget was approved in late May is likely to result in lower-than-budgeted locally financed investment expenditures while current expenditures will be restrained, particularly wages. After a three-month interruption, the monthly adjustment of petroleum product prices has resumed in October 2005. Prices will be adjusted on a monthly basis to not only reflect international prices but also gradually recover losses accumulated by the oil importers when the domestic prices were held constant.

11. Prospects for 2006 are for continued broad-based and strong economic growth (7.9 percent), further deceleration of inflation (7 percent), and the maintenance of a sustainable fiscal and external position. To continue the fiscal consolidation started in 2005, the domestic primary deficit is programmed to narrow by nearly 1 percent of GDP in 2006 while the overall fiscal deficit, including grants, is projected to narrow even further. Despite a further increase in the oil import bill expected in 2006, the external current account deficit, including grants, is projected to decrease, mainly on account of a scaling up of foreign grants. To achieve the inflation objective, base money growth will be limited to 15 percent or slightly lower than nominal GDP growth. The exchange rate will continue to be market-determined to cushion against exogenous shocks. Overall, NIR will increase and remain above four months of imports and nonfactor services (five months excluding mega projects imports).

12. The budget proposal for 2006, which was submitted to the Assembly at end-September 2005, indicates that the Government's domestic primary deficit is programmed to decrease to 2.1 percent of GDP in 2006. As a result, net credit to the government from the banking system will be reduced by about 1.3 percent of GDP (excluding the securities issued to strengthen the balance sheet of the BM). Total domestic revenue is envisaged to rise by

about 0.7 percent of GDP compared to 2005, while the expenditure side will reflect a nearly constant level of current expenditures in percent of GDP, including the wage bill—despite the hiring of about 10,000 teachers. The additional revenue effort required in 2006 is expected to come from improvements in revenue administration, a broadening of the tax base through taxpayer registration, an increase in own-generated revenues, and the progressive collection of tax arrears amounting to about 0.6 percent of GDP as of end-August 2005. The share of spending on priority sectors out of total primary expenditures will remain above the 65 percent level. Total expenditures will rise, owing to a substantial increase in capital outlays financed with project loans and grants and part of the resources from the mining license for the exploration of the Moatize coal mine. Moreover, the budget submitted to the Assembly allows for a contingent increase in expenditures in priority sectors of 0.9 percent of GDP in the event that external debt-related payments are below what is currently programmed as a result of the implementation of the new multilateral debt cancellation initiative and revenues are higher due to continued buoyancy in tax collections. The technical memorandum of understanding (TMU) has been changed accordingly.

13. In 2006, emphasis in the revenue area will be given to the following priorities: (i) continuing to modernize the tax administration apparatus through the establishment of the ATM; (ii) the strengthening of auditing, inspection and enforcement procedures, and human resource management; (iii) upgrading the taxpayer information system and improving taxpayer services; and (iv) establishing tax tribunals in Maputo, Beira, and Nampula for domestic taxes (structural benchmark for end-June 2006).

14. During 2006, the Government will also intensify its efforts to improve public expenditure management through the implementation of SISTAFE. Building on the rollout of the e-SISTAFE to the Ministries of Finance, Planning and Development, and Education and Culture at the end of 2005, by end-June 2006, all stages of expenditure (commitment, liquidation, payment, accounting, and reporting) at the Ministries of Agriculture, Health, and Public Works will be executed through the e-SISTAFE, at the central and provincial levels (a structural performance criterion). By end-December 2006, all financial and budgetary operations of DAFs (Financial Management Departments) of all line ministries, at the central and provincial levels, will be executed through the e-SISTAFE. In addition, by end-June 2006, with the help of the donor community, off-budget project expenditures executed outside the Treasury Single Account will be progressively included in the e-SISTAFE. Moreover, to buttress the functioning of the Treasury Single Account, the information system of the BM (STF) will be upgraded to allow the system to record all transactions to and from the Government accounts in the commercial banks to beneficiaries on a real time basis by November 25 2005 (a prior action). The Government will continue to implement its fiscal decentralization strategy with due regard to sequencing, in particular the need to buttress local administrative capacity and financial reporting and auditing. The budgetary deconcentration to local entities, particularly to districts, in the context of the implementation of the Local State Entities Law, will decentralize the management of the investment component of the state budget in 2006 with due regard to procurement procedures and reporting requirements. The e-SISTAFE will be gradually rolled out to all districts.

15. On monetary policy, with a view to achieving a further deceleration of inflation and a stable environment for financial intermediation and the foreign exchange market, the BM will continue to target base money. Broad money (M3), including foreign currency deposits, is projected to expand by 16 percent, while bank credit to the private sector is expected to increase by 11.3 percent of the beginning-of-period stock of broad money. The BM will continue to improve its liquidity management framework and foster financial market development by preparing and evaluating quarterly, weekly, and daily liquidity forecasts, reviewing the performance of primary dealers, and deepening the interbank foreign exchange market. The Ministry of Finance (MF) will improve the preparation of daily, weekly, and monthly cash-flow projections and execution, and will request technical assistance (TA) from the Fund.

16. The BM is committed to reform its monetary policy operations gradually. It will continue to target base money and allow interest rates to become market-determined, and repurchase operations will gradually become the main instrument for fine-tuning liquidity. To this end, and with technical assistance from the Fund, the interest rate cap in the Treasury bill auctions will gradually be removed starting with the 91-day issues by end-March 2006 and the 182-day and 364-day issues by end-June 2006. Moreover, with technical assistance, the BM will finalize a master repurchase agreement by end-June 2006. With help from the Fund and World Bank, BM will develop a domestic debt strategy for monetary policy and market development. In this regard, BM will work to develop a deeper market for a short-term government debt instrument, and BM and the MF will agree by end-June 2006 (through a memorandum of understanding) to shift gradually the costs of managing monetary policy to the budget. Finally, in order to conduct monetary policy in a more transparent manner the BM, with Fund technical assistance, will adopt by end-December 2006 a Long-Term Monetary Policy Strategy, which will define the intermediate target, a new format for the monetary policy committee, and specify its communication policy.

17. The BM will also continue to work to strengthen and modernize its supervisory functions and accounting. In this regard, the new inspection manuals will be approved and the new organizational structure of the banking supervision department consistent with Integral Strengthening Plan for Banking Supervision will be implemented (both by end-March 2006). In the area of accounting, the Charter of Accounts will be amended by end-March 2006 to allow for: (i) the valuation of foreign exchange gains/losses consistent with IFRS; and (ii) the preparation of BM's financial statements for 2005 in compliance with IFRS in parallel to the financial statement prepared under the current accounting standard by March 2006.

18. The Government remains committed to strengthening the balance sheet of the BM. To this end, in line with articles 14 and 66 of the BM's Act, the Government will issue securities at market interest rates. The first issuance of securities in an amount of Mt 1.5 trillion was effected in June 2005, the second issuance at market interest rates will take place no later than end-June 2006. Given that the net financial position of the BM has improved considerably in the first semester of 2005, thanks largely to the depreciation of the metical, the issue of government securities to cover BM's net financial losses accumulated

from May to December 2004 is no longer necessary. The BM will continue to strive to contain its administrative expenditures.

19. The authorities continue to be committed to implementing the IFRS in the banking system, with the help of technical assistance from the Fund and the donor community. In this regard, the timetable of actions to adopt IFRS in the commercial banking system and strengthen loan classification and provisioning in line with international best practices will be implemented on a timely basis. The BM will continue to move forward with the necessary training and other preparations with the aim of fully implementing IFRS in the BM and the banking system starting in 2007. Moreover, a draft of a new regulation on the assessment, classification, and provisioning of credits is under preparation.

20. The government is committed to support the sound expansion of the financial sector. A feasibility study on the options for divestment of the Government's participation in BIM was completed (structural performance criterion for end-September 2005) with the help of the World Bank. The strengthening of the social security and supplementary pension system is also being undertaken as part of a new law on social protection, which is under preparation. As part of the pension reform, the restructuring of the National Social Security Fund (INSS) will be expedited to improve operations, investment performance, and governance. As such, guarantees of minimum benefits will be limited until a full actuarial study is completed in 2006 with a view to switching to a defined contributory system. It will also be important to enhance the regulatory and supervisory framework for supplementary pensions and INSS together with the insurance sector, including by strengthening the capacity of the *Inspecção Geral de Seguros* (IGS), the industry regulator.

21. The BM is committed to implement the remaining actions needed to address weaknesses identified in the context of the Fund's safeguards assessment mission conducted in June 2004. In particular, the electronic link of the monetary data to the balance sheet will be implemented by November 25, 2005.

22. Regarding the exchange and trade system, a revision to the foreign exchange law to clarify and improve the existing legislation, will be submitted to the Assembly in early 2006. Following approval of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

23. No significant changes in the area of trade policy are expected to take place during 2006. The Government remains committed to lowering the maximum import tariff rate applicable to all trading partners from 25 to 20 percent in January 2006.

24. The Government looks forward to completing a buyback of its commercial debt, with the financial assistance of the World Bank and other donors, by end-2005. The Government recognizes the importance of reaching agreements with all bilateral creditors in the context of the enhanced HIPC Initiative. It intends to intensify its discussions with Paris Club and non-Paris Club creditors to reach agreements as soon as possible.

25. The Government recognizes the importance of removing a number of obstacles to private sector development. In this regard, steps are being taken to (i) reduce the cost of doing business in Mozambique; (ii) address rigidities in the labor market; (iii) improve basic infrastructure; and (iv) modernize procurement regulations. In addition, the Government remains committed to promoting good governance and transparency in the management of public resources, improving the functioning of the judicial system, and reforming the public sector.

26. Regarding labor regulations, the draft of a new labor law is expected to be submitted to the Assembly by end-March 2006. This law will increase labor market flexibility by addressing in particular retrenchment costs and facilitating contractual hiring.

27. The Government will continue to restructure and encourage private participation in public enterprises, particularly infrastructure services. A strategic option for the restructuring of PETROMOC, the state-owned petroleum distributor, will be decided by end-March 2006 (a structural benchmark). The Government will examine the options for restructuring the state-owned telecommunication and electricity company to increase their efficiency and investment with the help of the World Bank.

28. Improving governance remains a priority of the government. The revised anti-corruption strategy will be approved by the Council of Ministers by end-March 2006 (a structural benchmark). A draft decree establishing procurement regulations in line with international standards will be adopted by the Government by end-December 2005. In the context of the implementation of the Anti-Money Laundering Law, the Government is committed to creating a financial investigation unit by end-June 2006.

29. In the area of public sector reform, with support from the World Bank and other donors, work has continued in the context of a long-term program aimed at restructuring the civil service, decentralizing service delivery, and improving governance. In this context, the restructuring strategy for six major ministries (Education, Commerce, Health, Agriculture, State Administration, and Finance) based on their functional analysis will start to be implemented by end-March 2006. A draft policy for the wage system that links remuneration more closely with performance will be submitted to the Council of Ministers by end-June 2006. An independent diagnostic of the three databases of the civil service will be completed by end-March 2006. On this basis, an approach will be defined to formulate an integrated payroll database and eliminate "ghost" workers that have been identified. The financial implications of the restructuring, decentralization, and the new pay policy will respect the spending ceilings established by the Medium-Term Financial Framework.

30. The Government is making progress in reforming the judicial system. The new Commercial Code, the Commercial Registration Code, and the Civil Procedure Code are expected to be approved by the Government by end-2005. The Organic Law for Judicial Tribunals, the Penal Procedure Code, and the new Insolvency Law are expected to be approved by end-June 2006. Commercial sections in the Judicial Tribunals of the city of

Maputo will also be established by end-June 2006 and in the provinces of Sofala and Nampula by end-September 2006.

31. A decree on urban land use will be approved by the council of ministers by end-June 2006, which will also facilitate the reduction of costs and time involved in transactions. In addition, the Government remains committed to conducting a Poverty and Social Impact Analysis (PSIA) study on rural land tenure regulations, with the help of several donors, including the World Bank.

III. Medium-Term Macroeconomic Policy

32. The government's medium-term objectives and priorities are defined in the 2005–09 Five-Year Plan, which sets forth as the foremost priority the reduction of absolute poverty through policies that ensure macroeconomic stability, greater private investment, and sustainable economic growth. The authorities have carried out the third annual report on the implementation of their PARPA, which together with the Five-Year Plan, will be instrumental in the preparation of a new PARPA covering the period 2006–09, which is expected to be ready by March 2006. This annual report shows that a number of the Millennium Development Goals are within reach but that the achievement of others will require further efforts, investment, and additional help from the international community.

33. The main macroeconomic objectives over the medium term are to maintain a rate of growth of about 7 percent and to continue to reduce gradually the inflation rate through the pursuit of prudent fiscal and monetary policies in the context of the flexible exchange rate system. The medium-term economic policies will focus on spurring export-led private sector growth, while enhancing fiscal and external viability. Central to this strategy will be the consolidation of the fiscal position, in order to increase credit to the private sector and to maintain a competitive exchange rate. Priority expenditures in the PARPA will continue to be ring-fenced in order to contribute to the achievement of the MDGs. The authorities will also seek a higher share of external grant financing to buttress external debt sustainability.

34. The structural reform agenda to be articulated in the new PARPA will include the launching of a "second wave of reforms." The focus will be on increasing tax collection, strengthening public expenditure management and fiscal transparency, implementing an agricultural and rural development strategy, reducing the cost of doing business (including by reducing corruption), reforming the judicial sector and strengthening the financial system. An additional emphasis will be put on accelerating the engines of growth by promoting human capital formation, infrastructure investments, and maximizing the net contribution of natural resources and megaprojects to the economy. With respect to the latter, the government will continue to strengthen the transparency of natural resource management and exploitation, and ensure that the country benefits more from the activities of the megaprojects, including through the State budget.

IV. Program Monitoring

35. The semiannual quantitative performance criteria for end-December 2005 and end-June 2006, as well as the indicative targets that will be used to evaluate the implementation of the program for the remainder of 2005 and in 2006 are shown in Table 1 of this memorandum, with further definitions and explanations contained in the annexed Technical Memorandum of Understanding. In addition, the Government has specified in Table 3 a list of structural performance criteria and benchmarks for 2005 and 2006.

36. The Government understands that its ability to request the disbursement of the fifth loan under the PRGF arrangement will be contingent upon the observance of the semiannual quantitative performance criteria for end-December 2005 set out in Table 1; and the completion of the fourth review under the program, which is expected to take place before end-June 2006. In reviewing developments under the program during the fourth review, particular attention will be paid to the new PARPA, the implementation of measures aimed at broadening the tax base and rolling out the e-SISTAFE, contingency expenditures in the 2006 budget, monetary and financial sector reform, the buttressing of governance and the legal system, and improving the availability of information on the megaprojects and their net contribution.

Table 1. Mozambique: Quantitative Performance Criteria and Indicative Targets for 2005 and 2006

(In billions of meticais, unless otherwise specified)

	2005										2006			
	End-Mar. Indicative Target	End-Mar. Indicative Target	End-June Perf. Criteria	End-June Perf. Criteria	End-June Perf. Criteria	End-Sep. Indicative Target	End-Sep. Indicative Target	End-Sep. Indicative Target	End-Dec. Perf. Criteria	End-Dec. Perf. Criteria	End-Mar. Indicative Target	End-June Perf. Criteria	End-Sep. Indicative Target	End-Dec. Indicative Target
	EBS/05/12		EBS/05/86			EBS/05/86			EBS/05/86					
	Prog.	Act.	Prog.	Adj.	Prel. Act.	Prog.	Adj.	Prel. Act.	Prog.	Rev. Prog.	Prog.	Prog.	Prog.	Prog.
Government domestic primary deficit (excluding bank recapitalization costs (ceiling) 1/ 2/ 3/ 4/	857	2,392	3,438	3,438	1,596	3,986	3,986	...	4,481	4,481	-800	-1,900	-2,404	-3,755
Stock of net dom. assets of Bank of Mozambique (BM) (ceiling) 1/ 5/ 6/ 7/	-9,967	-10,828	-7,582	-8,003	-9,729	-6,980	-7,867	-9,522	-6,947	-13,218	-15,911	-15,184	-13,546	-12,663
Stock of net international reserves of the BM (floor, in millions of U.S. dollars) 1/ 8/	848	885	874	890	906	863	904	888	900	900	979	981	959	923
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of more than one year (ceiling) 9/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 9/ 10/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling) 3/ 9/ 11/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars, indicative target)	...	...	99	99	100	99	99	100	99	99	99	83	83	83
Government revenue (floor, indicative target) 3/	4,457	3,948	9,016	9,016	8,979	14,742	14,742	...	21,091	21,090	5,357	11,609	18,609	25,685
Stock of reserve money (ceiling, indicative target) 7/	9,317	9,249	10,597	10,487	10,195	11,140	11,070	10,660	11,946	12,205	11,678	12,033	13,209	14,038
Wage bill (ceiling, indicative target) 3/	2,123	2,656	5,462	5,462	5,134	8,324	8,324	...	11,045	11,045	2,909	6,205	9,584	13,148
Memorandum items:														
Foreign program assistance; grants and loans (in millions of U.S. dollars) 3/	103	...	163	...	174	174	...	210	243	274	159	211	255	308
Actual external debt service payments (in millions of U.S. dollars) 3/	13	...	35	...	31	56	...	50	77	70	12	27	39	55
Net flows	90	...	128	...	144	118	...	159	166	205	147	184	216	253
Exchange rate (meticais per U.S. dollar; end of period)	21,619	18,958	19,557	...	24,569	19,736	...	24,784	...	...	...	...	...	...
Shortfall in required reserves	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Adjustment to BM's net domestic assets at program exch. rates	...	2,471	...	-421	...	...	-887	...	...	...	...	...	...	...
Adjustment to BM's NDA target	...	...	...	-421	...	...	-887	...	...	...	...	...	...	...
Adjustment to reserve money	...	...	...	-110	...	...	-70	...	...	...	...	...	...	...
Adjustment to BM's NDA due to shortfall/excess of net program assistance	...	...	...	-311	...	...	-817	...	...	...	...	...	...	...
Stock adjustments in medium- and long-term foreign liabilities	...	...	...	0	...	...	0	...	...	...	...	...	...	...

1/ Constitute quantitative performance criteria for end-December 2005, and for end-June 2006 .

2/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending; to be measured from below the line based on financing items.

3/ Cumulative from the beginning of the calendar year. For March 2005, regarding the wage bill and the domestic primary deficit, the column for the EBS/05/12 revised program did not include the payment of the 13th wage and pension bonus related to 2004, while it is included in the column for the March 2005 actual.

4/ To be adjusted upward for up to Mt 400 billion in 2005 and Mt500 billion in 2006 to accommodate higher-than-budgeted locally financed drought-related expenditures. To be adjusted upward by any shortfall in debt service payments (including obligations to the IMF) in 2006 attributable to the implementation of the new multilateral debt cancellation initiative.

5/ Defined as reserve money minus net foreign assets (NFA) of the BM. NFA are valued at program exchange rates; NFA are defined to exclude the effect of any used stock adjustments in medium- and long-term liabilities.

6/ To be adjusted upward/downward to the extent of any shortfall/excess in foreign program assistance valued at program exchange rates and to be adjusted downward/upward to the extent that actual payments of external debt service exceed/fall short of programmed amounts (except for any debt service payments shortfall related to the multilateral debt cancellation initiative) . To be adjusted upwards for up to Mt 400 billion in 2005 and Mt 500 billion in 2006 to accommodate higher-than-budgeted locally financed drought-related expenditures.

7/ To be adjusted downward to the extent that eligible bank reserves fall short of 11.51 percent of deposits in commercial banks at the end of each quarter.

8/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the programmed amount and to be adjusted upward/downward to the extent that actual payments of external debt service fall short of/exceed programmed amounts (except for any debt service payments shortfall related to the multilateral debt cancellation initiative). To be adjusted upwards for up to Mt 400 billion in 2005 and Mt 500 billion in 2006 (or the equivalent amount in U.S. dollars at the program exchange rate) to accommodate higher-than-budgeted locally financed drought-related expenditures.

9/ Continuous performance criterion.

10/ Loans of zero to one year's maturity, excluding normal import-related credits converted in U.S. dollars at actual exchange rates.

11/ Excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements.

Table 2. Mozambique: Structural Performance Criteria and Benchmarks Under the 2005 PRGF Arrangement (April-December 2005)

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Issue government securities in an amount of Mt 1.5 trillion at market interest rates and transfer these securities to the Bank of Mozambique to strengthen its balance sheet.	End-June	Met
Complete a feasibility study on the divestment of the Government's participation in BIM.	End-September	Met
Prepare the budget execution report corresponding to the first semester of 2005 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	End-September	Met
Structural benchmarks		
Compile and disseminate preliminary data on the 2004 GDP by expenditure and production approach at current and constant prices, and publish a revision policy and a timetable for compiling and disseminating final national accounts data.	End-June	Not met. Preliminary GDP data for 2004 was disseminated but a revision policy will be published by end-April 2006.
Publication of Survey on Corruption and Governance.	End-June	Not met. Implemented in August 2005.
Complete audits of compliance with all taxes of large taxpayers.	End-September	Met
Rollout the SISTAFE to the MEC and abolish the disbursement of funds (adiantamento de fundos).	End-December	On track

Table 3. Mozambique: Prior Action, Structural Performance Criterion and Benchmarks Under the 2005 and 2006 PRGF-Supported Program (October 2005-March 2006)

Actions	Expected Date of Implementation, According to the Program	Comments
Prior Action		
The information system of the BM (STF) will be upgraded to allow the system to record all transactions to and from the government accounts in the commercial banks to beneficiaries on a real time basis.		
Structural performance criterion		
All stages of expenditure (commitment, liquidation, payment, accounting, and reporting) at the Ministries of Agriculture, Health, and Public Works will be executed through the e-SISTAFE, at the central and provincial levels.	End-June 2006	
Structural benchmarks		
Rollout the SISTAFE to the MEC and abolish the disbursement of funds (adiantamento de fundos).	End-December 2005	
A decision will be made on the strategic option for the restructuring of PETROMOC, the state-owned petroleum distributor.	End-March 2006	
The approval of the revised anti-corruption strategy by the Council of Ministers.	End-March 2006	
Establish tax tribunals in Maputo, Beira, and Nampula for domestic taxes.	End-June 2006	

Technical Memorandum of Understanding on Selected Concepts, Definitions, and Data Reporting Under Mozambique's PRGF-Supported Program

October 17, 2005

1. This technical memorandum of understanding (TMU) applies from January 1, 2006. Its purpose is to describe the concepts and definitions that will be used in monitoring the Poverty Reduction and Growth Facility (PRGF)-supported program, including the following:

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

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

Government's domestic primary balance

2. The government's domestic primary balance is defined as government revenue, less noninterest current expenditure, less locally financed capital expenditure, less locally financed net lending. It excludes bank restructuring costs, the cost of recapitalizing the central bank, project expenditure, and capital expenditure financed with proceeds from the coal mining concession. Net lending is derived as gross lending to enterprises through *acordos de retrocessão* (excluding *acordos de retrocessão* that were required by donors), plus food aid disbursed but not collected in the period, minus repayments by enterprises of loans obtained through *acordos de retrocessão* and through refinancing agreements with the Bank of Mozambique, minus food aid collected but not disbursed in the period. Unallocated revenue or expenditure arising from discrepancies between the government balance measured from above the line and the balance measured from below the line will be part of the government's domestic primary balance.

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

Government revenue, expenditure, and financing

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

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

6. Expenditure is defined as government outlays transferred from treasury accounts to other government accounts or private sector accounts, and includes spending reported to the National Directorate of Public Accounting (*despesas liquidadas*) and any further treasury advances (*operações de Tesouraria*) that have been transferred out of treasury accounts but whose use has not yet been reported to the National Directorate of Public Accounting. It also includes expenditure financed with the own-generated revenue of districts and some line ministries referred to above.

7. External financing of the government includes foreign grants, external loan disbursements minus amortization, changes in external arrears, and external privatization proceeds. Domestic financing of the central government is defined as including net financing provided by the banking system, net placements of government securities with nonbanks, and domestic privatization proceeds.

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

Money supply

9. M3 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, including foreign currency deposits. M2 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, excluding foreign currency deposits.

Net domestic assets

10. The net domestic assets of the Bank of Mozambique are defined as reserve money minus the net foreign assets of the Bank of Mozambique. Net foreign assets will be valued at

program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term external liabilities.

11. The central bank's foreign currency-denominated assets and liabilities are converted in its balance sheet to meticais at actual exchange rates. However, for purposes of program monitoring, these amounts will be converted into U.S. dollars at the program exchange rate for the end of each quarter.

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

Net international reserves

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

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

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

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

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

guaranteed for which value has not been received. This performance criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

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

External payments arrears

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

Foreign program assistance

19. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through Bank of Mozambique accounts excluding those related to projects (Tables 1 and 2).

Actual external debt-service payments

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

Adjusters

21. The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) by 50 percent of any excess (100 percent of any shortfall) in disbursements of foreign program assistance, compared to the program baseline. These targets will be adjusted downward (upward) to the extent that actual payments of external debt service exceed (fall short of) programmed amounts (Table 1). The upward adjustment will not apply to any shortfall in debt service payments attributable to the implementation of the new multilateral debt cancellation initiative. The quantitative targets (floors) for the

central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year; a symmetric adjustment will apply to the ceilings on the net domestic assets of the Bank of Mozambique. They will also be adjusted upward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

22. The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted upward (downward) by 100 percent of any shortfall (50 percent of any excess) in disbursement of external program grants and loans, compared to the program baseline. These targets will be adjusted downward (upward) to the extent that actual payments of external debt service fall short of (exceed) programmed amounts (Table 1). The downward adjustment will not apply to any shortfall in debt service payments attributable to the implementation of the new multilateral debt cancellation initiative. These targets will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

23. The quantitative targets (ceilings) for the central bank's net domestic assets and reserve money will be adjusted downward to the extent that eligible bank reserves fall short of 11.51 percent of resident deposits in commercial banks at the end of each quarter.

24. The quantitative target (ceiling) for the domestic primary balance (excluding bank restructuring costs) for end-June 2006 and end-December 2006 will be adjusted upward (and the floors on net international reserves and ceilings on net domestic assets downward/upward) to accommodate the possible need for higher locally financed government outlays to deal with drought, up to a total limit of Mt 500 billion. The quantitative target (ceiling) for the domestic primary balance (excluding bank restructuring costs) in 2006 will be adjusted upward by any shortfall in debt service payments (including obligations to the IMF) attributable to the implementation of the new multilateral debt cancellation initiative.

Data reporting

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

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

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

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

Table 1. Mozambique: Foreign Program Assistance and External Debt Service for 2005

(In millions of US dollars)

	2005							
	Q1-Q2	Q1-Q2	Q3		Q4		Year	Year
	Prog.	Act.	Prog.	Est.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Foreign program assistance	163.1	174.4	10.9	35.2	69.0	64.8	243.0	274.4
Program grants	163.1	172.0	10.9	35.2	9.0	4.8	183.0	212.0
Program loans	0.0	2.4	0.0	0.0	60.0	60.0	60.0	62.4
External debt service	35.4	30.5	20.5	19.7	21.0	19.6	76.8	69.8

Source: Mozambican authorities; and Fund staff estimates.

Table 2. Mozambique: Foreign Program Assistance and External Debt Service for 2006

(In millions of US dollars)

	2006				
	Q1	Q2	Q3	Q3	Year
	Prog.	Prog.	Prog.	Prog.	Prog.
Foreign program assistance	158.8	52.0	44.2	53.5	308.5
Program grants	98.8	52.0	44.2	23.5	218.5
Program loans	60.0	0.0	0.0	30.0	90.0
External debt service	11.6	15.0	12.5	16.1	55.2

Source: Mozambican authorities; and Fund staff estimates.