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Republic of Mozambique: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Modification of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

In the context of the third review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for a modification of performance criteria, the following documents have been released and are included in this package:

- the staff report for the Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on October 17, 2005, with the officials of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 5, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of December 15, 2005 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its December 19, 2005 discussion of the staff report that completed the review.

- a statement by the Executive Director for the Republic of Mozambique.

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

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

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

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REPUBLIC OF MOZAMBIQUE

Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Modification of Performance Criteria

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

Approved by David Nellor and Anthony Boote

December 5, 2005

- Discussions for the third review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Maputo during October 4–17, 2005 by a staff team comprising Messrs. Clément (head), Peiris, Lledo, and Hartley (all AFR), and Mr. Joly (PDR). The team was assisted by Mr. Perone, the Resident Representative in Mozambique. The mission overlapped with a Fund Technical Assistance (TA) mission on the reform of domestic taxes and their administration, and benefited from recommendations of a recent Fund TA mission on monetary and exchange rate policy operations and banking supervision. The mission met with the Ministers of Finance; Development and Planning; Justice; Mining; Energy; Public Works; Agriculture; and Trade and Industry; the Governor of the Bank of Mozambique; and senior government officials. The mission coordinated its work with a Mid-Year Review of Program Aid Partners including the World Bank.
- The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) from the Minister of Finance and Governor of the Bank of Mozambique (Appendix I) review the performance under the PRGF arrangement during April 2005-September 2005, and sets out the policies and program monitoring issues for the remainder of 2005 and 2006. The authorities are requesting a modification of the performance criteria on net international reserves and net domestic assets for end-December 2005, mainly to reflect higher-than expected grain imports triggered by the ongoing drought affecting part of the country.
- The President and new administration took office in early 2005, and reiterated their commitment to implement the PRGF-supported program. A stable political situation (with a comfortable majority in parliament for the ruling party, *FRELIMO*), augurs well for the implementation of a new *Plano de Acção para Redução da Pobreza Absoluta* (PRSP or "PARPA" in Portuguese) for 2006–09, which is expected to be finalized during the first half of 2006. As a result, donor support is expected to remain strong.

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EXECUTIVE SUMMARY

- **Macroeconomic performance has remained strong in 2005.** Despite a drought that has affected parts of the country, real GDP growth is expected to remain at around 7 ½ percent while headline inflation has continued to decline. As expected, the external current account deficit, excluding grants, has widened due to a rise in imports, but international reserves remain comfortable, reflecting an increase in donor inflows and private capital flows.

- **Performance under the program has been broadly satisfactory so far in 2005.** All quantitative and structural performance criteria have been met through end-September. The two structural benchmarks for end-June were not met; however, one of the corresponding measures was implemented in August and the other is expected to be implemented by end-April 2006. The structural benchmark for end-September was met while preliminary data show all quantitative targets for end-September have been met except for the NIR target.

- **The fiscal program is on track.** The domestic primary deficit at end-June 2005 was about 1 percent of GDP lower than programmed, almost entirely explained by expenditure restraint, including the wage bill. Importantly, the share of priority expenditure remained above the PARPA target. Revenue performance was close to program.

- **Mozambique's medium-term prospects and achievement of the Millennium Developments Goals depend critically on its pursuit of prudent macroeconomic policies and implementation of a "second wave" of reforms.** The main macroeconomic objectives over the medium term are for a continued broad-based economic growth (about 7 percent), further deceleration of inflation in the context of a flexible exchange rate regime, and the maintenance of a sustainable fiscal and external position, consistent with the medium-term goal of sustaining poverty reduction.

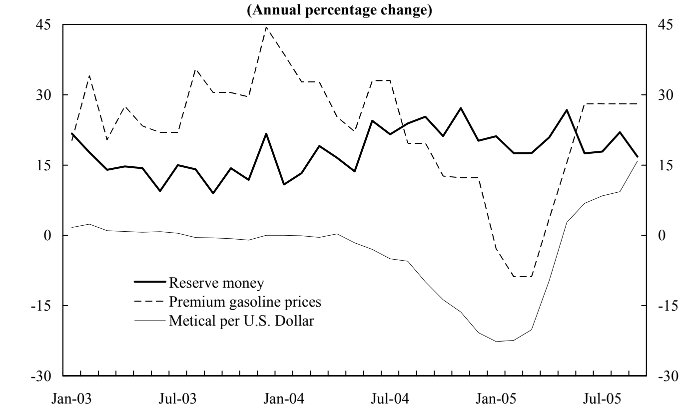
- **The outlook for 2006 is favorable.** Real GDP growth is expected to increase to nearly 8 percent, reflecting strong growth in construction, manufacturing, and megaproject activities. The 2006 fiscal framework envisages a consolidation of the domestic primary deficit of nearly 1 percent of GDP through strengthened revenue mobilization and expenditure management. The monetary program aims to maintain inflation to about 7 percent. The external current account deficit is likely to narrow slightly thanks to a scaling-up of official transfers, although the deficit excluding grants will remain high due to international oil prices. International reserves are targeted to remain at comfortable levels.

- **The structural reform effort is being reinvigorated.** In the fiscal area, reforms will focus on establishing the Central Revenue Authority and strengthening expenditure management and control through the rollout of e-SISTAFE (public financial management information system) to all line ministries. The structural program also aims at fostering a more efficient and deeper financial system, strengthening public sector operations, reducing the costs of doing business, and improving governance.

I. Economy Remains Strong and Program Performance Improves

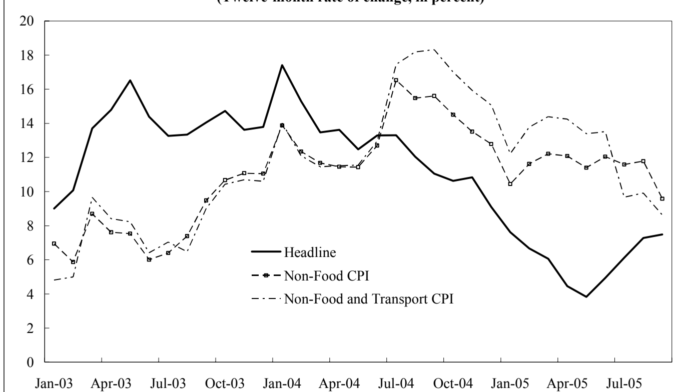
1. **The economy continues to perform well in 2005**. Real GDP growth is expected to remain at around 7 ½ percent in 2005 led by the construction and manufacturing sector, and by the continued contribution of megaprojects (Table 1 and Figure 1). The drought that has affected parts of the country seems to be localized with only a modest impact on aggregate production. Good rainfall has started, auguring well for the next harvest. However, about 800,000 people need food aid until the next crop season starting in March 2006, which has resulted in higher grain imports. Driven by a decline in the prices of a number of food items (despite the grain shortage), the consumer price index increased by only 4.2 percent between December 2004 and September 2005. Nonfood inflation, on the other hand, has remained at double-digit figures fueled by the pass-through of a rise in petroleum prices (about 50 percent since December 2004). Most of the real effective appreciation of the metical in 2004 has been reversed since the introduction of the foreign exchange auction system in January 2005 (Figure 2).

Mozambique: Exchange Rate, Reserve Money and Oil Prices, January 2003 - September 2005
(Annual percentage change)



Sources: Mozambican authorities; and IMF staff estimates; and IMF, *Information Notice System* (INS).

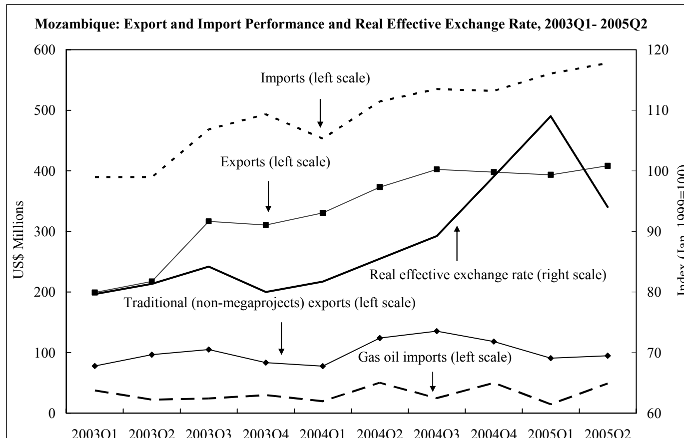
Mozambique: Headline, Non-food, and Non-food and Transport Inflation, January 2003 - September 2005
(Twelve-month rate of change, in percent)



Sources: Mozambican authorities; and IMF staff estimates; and IMF, *Information Notice System* (INS).

2. **The trade deficit deteriorated in the first half of 2005.** The performance of some traditional exports—prawns, sugar, and tobacco—were below expectation, reflecting mostly temporary adverse factors. Imports increased significantly, partly due to the real exchange rate appreciation of the second half of 2004, but also on account of higher cereal imports triggered by the drought affecting

Mozambique: Export and Import Performance and Real Effective Exchange Rate, 2003Q1- 2005Q2



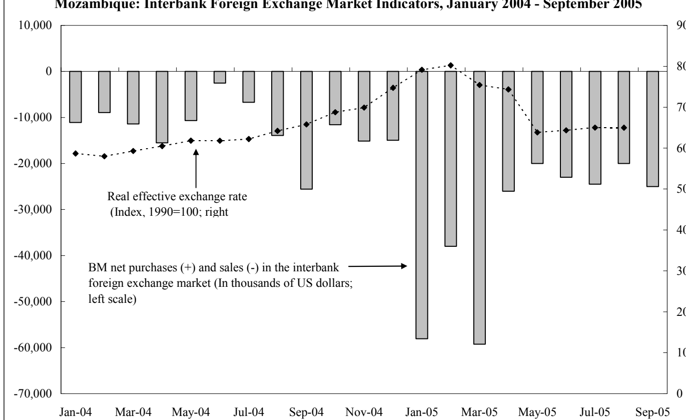
Sources: Mozambican authorities; and IMF staff estimates; and IMF, *Information Notice System* (INS).

part of the country. Taking into account higher-than-expected donor and private capital inflows, the net international reserves (NIR) target for end-June 2005 was met. However, preliminary information shows that the indicative target for end-September (adjusted for the excess of net foreign program aid) was missed by a small margin (MEFP, Table 1).

3. **The stabilization effort has been underpinned by fiscal restraint.** The fiscal slippages that occurred during the political transition were corrected and the fiscal program was brought back on track. The domestic primary deficit at end-June 2005 was better than programmed (about 1 percent of GDP) due to lower current and locally financed investment expenditure related to the imposition of the 2004 expenditure limits until the 2005 budget was approved in May. The wage bill was contained within its indicative ceiling while the share of priority expenditure in total expenditure was above target at end-June 2005. Following disappointing collections in the first quarter of the year, preliminary information through September indicates a significant improvement in revenue performance, led by corporate income taxes, coming in close to the program target.

4. **Performance under the fiscal structural program has improved (MEFP, paragraphs 4 and 5)**. Revenue administration has been significantly strengthened by completing audits of compliance with all taxes of large taxpayers, identification (and progressive collection) of tax arrears, and increasing the number of taxpayers and strict tax enforcement. Reform of Public Expenditure Management (PEM) systems continues to move forward, albeit with some delay. A budget execution report for the first semester of 2005 based on the e-SISTAFE was produced by end-September. However, the authorities still face administrative capacity and technical problems in the rollout of e-SISTAFE, as is the case in most other African countries, but are on track to rollout the e-SISTAFE to the Ministry of Finance, Planning and Development, and Education and Culture by end-2005.

Mozambique: Interbank Foreign Exchange Market Indicators, January 2004 - September 2005



Sources: Bank of Mozambique (BM); and IMF staff estimates.

5. **The program targets for reserve money growth were met through end-September 2005.** Broad money (M3) growth was higher than programmed mainly reflecting the impact of the depreciation of the metical on the foreign currency deposits (Table 3). Treasury-bill rates have remained relatively stable and positive in real terms. However, the yield curve is relatively flat because of the existing interest cap on Treasury bill auctions. In the first few months following the introduction of the foreign exchange auction system,[1] exchange rate volatility

[1] In January 2005, the Bank of Mozambique stopped setting the exchange rate at which foreign exchange was sold to the market and introduced instead a foreign exchange auction system.

increased as the market and the monetary authorities gradually adjusted to the new system. Exchange rate volatility has, however, declined more recently as market participants have become more accustomed to the new system. This was reinforced by better liquidity management and, in part, the implementation of a 50 percent provisioning requirement on loans in foreign currencies to nonexporters. In hindsight, it seems that the exchange rate appreciation in 2004 may have led to a somewhat overvalued level, which was corrected with the introduction of the foreign exchange auction system.

6. **The balance sheet of the Bank of Mozambique (BM) was strengthened, while prudential ratios of the banking system remain sound** (Table 7). The issuance of Mt 1.5 trillion government securities in June to the BM has enhanced the credibility of monetary operations. The banks are better capitalized and their nonperforming loan portfolios have come down significantly with the implementation of new prudential regulations and enhanced supervision. The BM has taken further steps to strengthen accounting and supervisory functions. The BM is keeping to a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and strengthen provisioning in line with international best practices.

7. **Performance under the program has been broadly satisfactory so far in 2005.** All quantitative and structural performance criteria have been met through end-September (MEFP, Tables 1 and 2). The two structural benchmarks for end-June were not met; however, one of the corresponding measures was implemented in August and the other is expected to be implemented by end-April 2006 (MEFP, Table 2). The benchmark for end-September was met while preliminary information shows that all quantitative indicative targets have been met except for the NIR target.

II. Policy Framework

A. Overview

8. **The primary objective of Mozambique's medium-term strategy is to sustain broad-based growth and to make further inroads into poverty reduction**.[2] Since the cessation of the civil war in 1992, Mozambique has made impressive progress in terms of economic growth (around 8 percent from 1994–2004) and poverty reduction (from 69 percent in 1996/97 to 54 percent in 2002/03) through the implementation of prudent macroeconomic policies, structural reform, and substantial donor assistance. Growth has been "pro-poor", meaning the rate of consumption growth of people below the poverty line was strongly positive due to agricultural expansion, greater nonfarm activities in rural areas, and a rise in employment income. As such, it has one of the lowest levels of inequality in Africa. However, growth may begin to moderate, absent of further reform, because the agricultural catch-up is now largely exhausted and the first generation reforms are mostly complete. Mozambique appears well placed to achieve the key Millennium Development Goal (MDG) of halving the poverty rate by 2015 as long as growth remains above 5 percent.

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[2] The government's medium-term objectives and policies are defined in the Five-Year Plan 2006–09.

9. **The challenge is now through a "second wave of reforms" to consolidate macroeconomic stability and support private sector development while building human capital, infrastructure, and maximizing the benefits of natural resources and megaprojects**.[3] The authorities recognize that continued financial support from the donor community is essential to achieve the Millennium Developments Goals (MDGs), but that sustainability ultimately depends on the establishment of an outward-oriented and predictable economic environment conducive to private sector activity. Central to this "second wave of reforms" will be a gradual fiscal consolidation through enhanced revenue mobilization to crowd-in private investment and lessen aid dependency, while monetary restraint helps anchor inflationary expectations. Public expenditure will continue to focus on priority sectors (particularly, health, education, HIV/AIDS, and infrastructure) with emphasis on expenditure management reforms to enhance fiscal transparency and secure better value for money, as highlighted in the Medium-Term Financial Framework (MTFF). The stabilization effort will be complemented by reducing the cost of doing business, deepening the financial system, and improving governance. The authorities also intend to launch an agricultural and rural strategy to enhance the trickling down of growth to the poorest segments of the population. In addition, the transparency of natural resource management and megaprojects will need to be strengthened to promote sustainability, and ensure that the country benefits more from their activities, including through the State budget (MEFP, paragraphs 32-34). In this context, a unit at the Ministry of Finance will be created to monitor the megaproject activities.

10. **The implementation of a "second wave of reforms" is expected to help maintain growth at about 7-8 percent along a gradual disinflation path over the medium term.** On the basis of current aid inflow projections, the domestic primary deficit and overall fiscal deficit, excluding grants, are projected to decline gradually underpinned by an increase in revenue of 0.5 percent of GDP per annum.[4] The strengthened fiscal position should promote a healthy growth in credit to the economy and help maintain a viable external position together with a flexible exchange rate system that cushions against exogenous shocks.[5]

B. Macroeconomic Outlook and Policies for 2005 and 2006

11. **The outlook and program for the remainder of 2005 has remained largely unchanged from the last staff report** (Table 1). The fiscal program is unchanged, generating an adjustment of the domestic primary deficit of 1 percent of GDP compared to 2004. The improved revenue performance since the first quarter and expenditure restraint means that the end-2005 fiscal targets are within reach. The resumption of the monthly adjustment of petroleum product prices in October 2005 (about 20 percent) after a three-month interruption due to social pressures has lifted a potential fiscal risk. The price

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[3] The "second wave of reforms" will be articulated in the new PARPA covering 2006–09 (expected by March 2006).

[4] A comprehensive IMF tax policy mission is expected in early 2006 at the request of the authorities to provide recommendations to help realize the medium-term revenue objectives.

[5] The deterioration in the current account deficit in 2007 is related to megaproject imports.

adjustments will gradually recover losses accumulated by the state-owned oil distributor (PETROMOC) and other importers when the domestic prices were held constant.[6] The oil price shock and prolonged drought do, however, constitute downside risks to the macroeconomic outlook, and the performance criterion on NIR (and correspondingly on net domestic assets (NDA)) for end-December 2005 was requested by the authorities and recommended by the staff to be modified downward on this account (LOI, paragraph 6). Overall, NIR should remain above five months of imports (excluding megaprojects).

Scaling-up aid flows and the 2006 program

12. **Prospects for 2006 are for continued broad-based and strong economic growth (7.9 percent), a further deceleration of inflation (to 7 percent), and the maintenance of a sustainable fiscal and external position** (Table 1). 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 (Table 4).

13. **The agreed fiscal framework for 2006 targets an adjustment of the domestic primary deficit of close to 1 percent of GDP**. This deficit and the overall balance, excluding grants, is somewhat higher than envisaged at the time of the second review under the PRGF arrangement (Table 2) because of a scaling-up of aid inflows (program aid and total aid disbursements are higher by just over 2 percent and 4 percent of GDP, respectively), although the deficit, including grants, is lower due to a rise in the share of grants. The 2006 budget allows for an increase in expenditures that is 0.9 percent of GDP higher than the fiscal framework included in the MEFP. The additional expenditure in the budget is in part financed by higher revenues and in part reflected in a higher overall fiscal deficit. This expenditure will be contingent on higher revenues and on the implementation of the Multilateral Debt Relief Initiative (MDRI) reducing external debt-related payments below currently programmed levels.[7] To ensure consistency between the execution of the budget and the fiscal framework, the authorities are committed to issue a decree once the budget is approved by parliament limiting the allocations to the level agreed. Furthermore, the additional expenditures will be spent only after consultation with staff during the next review under the PRGF-supported program.

14. **Revenue mobilization will remain a priority while expenditures are geared toward helping the poor and vulnerable, and enhancing potential long-term growth**. Notwithstanding the decrease of the maximum tariff import rate from 25 percent to 20 percent to all trading partners in the context of the Southern African Development Community (SADC) trade protocol agreement, total revenues are projected to increase by 0.7 percentage point of GDP to 14.5 percent of GDP through buttressing revenue

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[6] A strategic option for the restructuring of PETROMOC will also be decided by end-March 2006, given implications to the consolidated fiscal accounts.

[7] The implementation of the MDRI is expected to reduce external debt-related payments by about 0.5 percent of GDP in 2006 assuming delivery of debt relief from January 1, 2006 for the IMF and the African Development Fund (AfDF), and from July 1, 2006 for the International Development Association (IDA).

administration, an increase in own-generated local government revenues (including through a few new local taxes), and the progressive collection of tax arrears amounting to 0.6 percent of GDP at end-August 2005 related to the personal and corporate income taxes for 2003–04 (MEFP, paragraph 12). Budgetary expenditures 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 and 2,000 health workers. The share of spending on priority sectors out of total primary expenditures will remain above the 65 percent PARPA target, led by capital outlays and "pro-poor" spending (Table 6).

15. **Structural fiscal reforms focus on continuing to improve efficiency of tax administration and strengthening PEM systems through the rollout of e-SISTAFE.** The establishment of the Central Revenue Authority (ATM) with better resources and systems will be the centerpiece of tax reform in 2006 (MEFP, paragraph 13). A key priority of the government is to ensure that all stages of expenditure (commitment, payments, accounting, and reporting) at the Ministries of Agriculture, Health, and Public Works will be executed through the e-SISTAFE at the central and provincial level by end-June 2006. Along with the three pilot ministries, e-SISTAFE would then cover a majority of PARPA expenditures by mid-2006 resulting in improved classifiers (e.g., functional, regional) to better evaluate poverty impacts. Moreover, off-budget project expenditures will progressively be executed through the Treasury Single Account (TSA) and included in e-SISTAFE giving a clearer picture of all development activities and their macroeconomic effects. The 2006 budget also decentralizes the management of investment activities and allocates US$300,000 per year to each district, in the context of the implementation of the Local State Entities Law. The government recognizes that its fiscal decentralization strategy needs to pay due regard to strengthening local administrative capacity, procurement procedures, and financial reporting and auditing (MEFP, paragraph 14).

16. **The public sector reform program needs to be reinvigorated**. The review of Phase I of the public sector reform (2001–05) was completed in October 2005 and provided lessons for the design of Phase II (2006–11), particularly the need to prioritize clearly and achieve visible results early on. A proposal to reform the wage system in order to link remuneration more closely with performance is now planned for end-June 2006, and an independent diagnostic of the three databases of the civil service will be completed by end-March 2006 in order to formulate an integrated payroll database and identify "ghost" workers. Moreover, the draft legislation on procurement in line with international standards will be implemented in early 2006, albeit with delay. On a positive note, the National Survey on Corruption and Governance was published in August 2005 and a Corruption Fighting Central Office (with more resources than the Anti-Corruption Unit) was created as part of the Anti-Corruption Law along with the approval of guidelines to develop a revised strategy by end-March 2006 (MEFP, paragraph 28).

Monetary policy and financial sector reform

17. **The BM, with a view to achieving its inflation target of 7 percent by end-2006, will continue to target reserve money** (Table 3). Broad money is projected to grow roughly in line with nominal GDP with a relatively constant money-multiplier, giving a reserve money growth ceiling of 15 percent for 2006. Bank credit growth to the economy, on the

other hand, is programmed to accelerate to about 25 percent supported by a rise in government savings.

18. **The BM is committed to strengthen its monetary framework** (MEFP, paragraphs 15-16). The interest rate cap in the Treasury-bill auctions will gradually be removed to be consistent with a monetary-targeting framework. This step will need to be done carefully and be accompanied by a strengthening of the liquidity forecasting framework and a deepening of debt markets and debt management in order to avoid an excessive level of interest rate volatility. The Ministry of Finance will also improve the preparation of cash-flow projections and execution, and will request TA from the Fund. In addition, the authorities have informed the staff that they plan to reform the local currency by introducing new metical bank notes that would be equivalent to 1,000 of the current metical. The staff stressed that such a reform should be well prepared, well sequenced, and well costed, and that an appropriate information campaign be launched covering the entire country.

19. **The deepening of the financial system will be facilitated by a strengthening of the supervisory framework, accounting standards, and financial institutions reform** (MEFP, paragraphs 17–21). The introduction of IFRS in the banking system in 2007 will enhance market discipline and support consolidated supervision by a strengthened BM. The divestiture of the remaining government shares in Banco Internacional de Moçambique (BIM) will be expedited with the assistance of the World Bank. The envisaged restructuring of the National Social Security Fund (INSS) will provide better returns, services, and free a large pool of financial savings to the domestic financial markets. However, significant changes to the benefits provided by INSS should be preceded by a full actuarial study to evaluate financial viability while an effective supervisory framework should be put in place for the entire pension system expeditiously.

Megaprojects and external sector issues

20. **External developments continue to be dominated by megaprojects** (Table 5). They account for about 60–70 percent of total exports and largely explain the relatively high trade openness ratio, although the overall impact on the balance of payments (BOP) is limited considering the outflows such as imported inputs, debt service, profit transfers, dividends, and royalty repatriation, as well as workers' remittances, which are predominantly transacted off-shore. Moreover, even though the impact of megaprojects is most visible on the external sector and by putting Mozambique on the map for foreign investors, their real promise lies in having a potentially significant impact on growth and poverty alleviation over the long term (Box 1). The realization of this potential largely hinges on raising their fiscal contribution, strengthening transparency, and promoting linkages to the rest of the economy while continuing to attract further investments. A memorandum of understanding transferring the majority ownership of the Cahora Bassa Dam from Portugal to Mozambique was signed recently. The financing modalities of this complex and sizable transaction are yet to be worked out, including with the assistance of the World Bank. The authorities assured the staff that the financing modalities will be consistent with the program and be discussed with the staff during the next review under the PRGF-supported program.

21. **Mozambique is eligible for the MDRI as it has already reached its completion point under the enhanced HIPC Initiative.**[8] Assuming full relief from the IMF, IDA, and the AfDF, the net present value (NPV) of public external debt would be more than halved to about 10 percent of GDP. Debt service in the next few years would be reduced by 0.5–0.6 percent of GDP. Final agreements have yet to be reached with one Paris Club creditor (Japan) and with most non-Paris Club creditors in the context of the enhanced HIPC Initiative.[9] The authorities intend to maintain contact with these creditors, as well as with their private creditors, and to continue their good faith negotiations, to facilitate a collaborative agreement with them. In this context, the authorities still expect the commercial debt buyback operation (consistent with comparability of treatment) to be carried out by end-2005, with the financial support of the World Bank and other donors. Staff finds that these renegotiations will not undermine Mozambique's adjustment efforts under the Fund-supported program and therefore, considers that adequate safeguards remain in place for further use of Fund resources.

22. **Exchange and trade system reforms continue**. The authorities confirmed their intention to reduce the maximum import tariff rate from 25 to 20 percent in January 2006 to all trading partners, and not only to SADC members as expected under the SADC trade protocol. The authorities also intend to submit a new foreign exchange law to parliament in early 2006 and accept their obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

Improving the investment climate

23. **The new administration is firmly focused on reducing the costs of doing business** (MEFP, paragraphs 25–31). A number of issues identified in Investment Climate Assessments (ICAs) and a diagnostic trade integration study are being addressed:

- Labor market reform to increase flexibility and contractual hiring.
- Upgrade infrastructure particularly roads, rail, ports, electricity, and telecoms.
- Improving governance including new procurement legislation.
- Judicial reform and strengthening of property rights.

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[8] Countries eligible for MDRI relief have to be assessed for qualification. Mozambique, together with 19 other countries, is currently being assessed by Fund staff for qualification for MDRI debt relief from the Fund. The assessment focuses on three key areas: macroeconomic performance, poverty reduction policies, and the quality of public expenditure management systems.

[9] An agreement with Portugal was reportedly reached in November 2005.

Box 1. Megaprojects and Economic Management

The megaprojects could become an important engine of economic growth and source of poverty alleviation for Mozambique. In the long term, employment generation, technology spillovers, and horizontal and vertical integration with the domestic economy should significantly increase the net contribution of megaprojects. The "linkage" program developed by the Center for the Promotion of Investment to promote industrial integration located around megaprojects holds promise in this regard. In the meantime, their capital-intensive nature, profit repatriation, and limited linkages to the local economy means that the megaprojects' main impact on poverty alleviation will need to be felt through fiscal contributions to the State budget (Table 10). Moreover, the megaprojects receive fiscal incentives and generally involve natural resource extraction, therefore, careful attention should be paid to their management so as to avoid corruption, minimize market and trade distortions, and sustain benefits for future generations.

The ability to attract large Foreign Direct Investments (FDI) to Mozambique is a success. Total cumulative investment has been over US$4 billion from 1997–2004 (about 60 percent of 2004 GDP). Megaproject contribution to GDP growth has increased to about 7 percent and that to exports to about 65 percent. Their success has put "Mozambique on the map." **Mozal**, an aluminum producer, makes up about 75 percent of the megaprojects contributions to GDP, BOP, and fiscal revenues. Mozal has made Mozambique one of the top aluminum suppliers in the world. The **Cahora Bassa dam (HCB)** has helped attract FDI as it produces cheap hydroelectricity. The shareholding structure of HCB is expected to change in 2006 with the government taking a majority stake following the signing of a final agreement with Portugal. The **Sasol** gas pipeline became operational in 2004 and the **Moma Titanium Minerals Project** consisting of titanium mining, smelter, and port is expected to become operational in 2006. Three other megaprojects (titanium, coal, and hydroelectricity) are at the feasibility stage.

The monitoring and transparency of megaproject activities needs to be improved. The availability, coverage, and timeliness of data on megaprojects, particular by regarding effective revenue contribution, including tax expenditures and quasi-fiscal activities, remain problematic. To better assess the megaprojects overall impact on the economy in the short and long term, it is essential that the centralized monitoring unit to be created by the Ministry of Finance effectively guide the policy toward megaprojects. In addition, there is a need to strengthen transparency and accountability and improve governance in natural resource management to ensure that revenues contribute to sustainable development and poverty reduction.

Megaprojects' net contribution to the State budget should be carefully looked at. Megaprojects were granted free industrial zone status with special tax regimes in terms of reduced corporate tax rates, tariff exemptions, and deduction of original investments through "public" infrastructure works they might undertake from their tax payments. As a result, their contributions to the State budget have been marginal and are not projected to rise significantly in the medium term. The government should seek to maximize domestic revenues from projects that are deemed highly profitable and location-dependent (exploitation of natural resources) through well-crafted contracts while continuing to attract further investments. Moreover, quasi-fiscal activities of the megaprojects, such as social or environmental expenditure, that are currently undertaken and deducted from their tax contributions, and all state participation in megaprojects should be clearly defined and described in budget documents. The application of the core principles of transparency and accountability of the Extractive Industries Transparency Initiative and Fiscal Responsibility Laws in Mozambique could be useful in this regard.

24. **A comprehensive and reliable statistical database is essential to the formulation of effective policies and poverty reduction strategy**. An improvement was made in this regard with the timely publication of the 2004 GDP estimates, but a revision policy and a timetable for disseminating national accounts data is also required. The priority should be to compile quarterly GDP estimates, revise the consumer price index with weights of the latest household survey, and report on megaprojects.

III. Program Monitoring and Risks

25. **The fourth review under the PRGF arrangement is expected to be completed not later than end-June 2006 and will make available the fifth disbursement, which will be subject to the end-December 2005 quantitative performance criteria and structural performance criteria and other relevant performance criteria through end-March 2006** (MEFP, Tables 1 and 3). The authorities are requesting a modification of the performance criteria on NIR and NDA for end-December 2005, mainly to reflect higher-than expected grain imports triggered by the ongoing drought affecting part of the country.[10] The sixth disbursement, which will become available upon completion of the fifth review scheduled for December 2006, will be subject to the end-June 2006 performance criteria specified in Tables 1 and 3 of the MEFP. Additional conditionality for the sixth disbursement will be established at the time of the fourth review. The attached Technical Memorandum of Understanding (TMU) details the design and monitoring of the program (Appendix I, Attachment II). Changes were made to the TMU, particularly to the adjustor related to net foreign financing and drought.

26. **The main risks to the program include a prolonged drought, a weaker-than-programmed revenue performance, delays in the rollout of e-SISTAFE, a hasty fiscal decentralization, fatigue in implementing structural reforms, and a shortfall in foreign aid,** which could jeopardize Mozambique's attainment of its medium-term fiscal objectives and imply significant delays in its achievement of the MDGs.[11] In addition, given the size of the Cahora Bassa Dam transaction, its financing could also constitute a risk to the program.

27. **The BM is continuing to address the remaining weaknesses identified in the Fund's safeguards assessment conducted in June 2004 as planned** (MEFP, paragraph 17).

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[10] Annual foreign program assistance assumed has been revised upwards while the NIR target for end-2005 remains $900 million. Foreign program assistance is used to adjust the NIR target upward/downward in the event of an excess/shortfall (see TMU, paragraph 21). The overall impact of this change is that the new NIR target, once adjusted for actual foreign program assistance, will be lower than the original one (after a corresponding adjustment).

[11] A 25 percent drop in external support could lower international reserves by about half a month of imports by 2008.

IV. Staff Appraisal

28. **The economy has continued to perform well in 2005**. Real GDP growth is expected to be broad based and pick up to 7.7 percent. The drought that has affected parts of the country seems to be localized. However, about 800,000 people need food aid until the next crop season starting in March 2006. Despite the spike in domestic petroleum prices, inflation is decelerating and net international reserves remain at comfortable levels

29. **Mozambique's program performance has improved and all quantitative and structural performance criteria through end-September 2005 have been met**. Following the slippages reported at the time of the last review related to the political transition, the fiscal program has now been brought back on track. The implementation of structural reforms has been satisfactory so far in 2005, although there have been delays in the publication of the anti-corruption survey and revision policy for disseminating national accounts data. It is important that the end-2005 quantitative targets are met through continued revenue enhancement, expenditure restraint, and vigilance by the Central Bank.

30. **The main challenge for Mozambique is to sustain high broad-based growth rates and make further inroads in alleviating poverty**. This will require persevering with the stabilization effort and working to improve the investment climate by lowering the cost of doing business, buttressing the legal and judicial system, strengthening governance, and launching an agricultural and rural strategy. Mozambique must efficiently manage the scaling-up of already large inflows of foreign aid in a manner that avoids crowding out private investment and export activities. Central to this strategy will be a gradual fiscal consolidation led by a stepped up domestic revenue effort and expenditure management reform. Public sector reform has also an important role to play by restructuring ministries, payroll, and supporting a well-sequenced decentralization in a way that leads to savings that can be allocated to the financing of higher priority expenditure. To elicit a sufficient supply response, the government should ensure that aid is allocated to the most economically and socially productive purposes.

31. **The 2006 fiscal framework is consistent with these objectives**. It envisages a reduction in the domestic primary deficit of nearly 1 percent of GDP relative to the program target in 2005, largely in response to an envisaged rise in tax collections and restraint in the wage bill. The 2006 budget allows for an increase in expenditures that is 0.9 percent of GDP higher than the fiscal framework. This expenditure will be contingent on higher revenues and on the implementation of the Multilateral Debt Relief Initiative (MDRI). This expenditure will be spent only after consultation with staff during the next review and should focus on priority spending, particularly public investment. Fiscal reforms should continue to be centered around enhancing expenditure management, particularly through the timely and effective rollout of e-SISTAFE to key line ministries by end-June 2006. Moreover, off-budget donor-funded projects should progressively be brought on budget and included in e-SISTAFE with the help of the donor community. Priority expenditures should continue to be ring-fenced and represent at least 65 percent of total expenditures.

32. **The appropriate sequencing of the governments' decentralization strategy is also critical to maintain fiscal control and macroeconomic stability**. There are some concerns that the policy requires further clarification of the division of roles and responsibilities between central, local governments (provincial and district), and municipalities, and the technical capacity of districts to effectively absorb and account for resources have lagged behind. The allocation to each district through the budget in 2006 needs to be closely monitored.

33. **The BM should continue to pursue reserve-money targeting, in conjunction with a flexible exchange rate regime**. This approach has served the country well when executed steadily, ensuring that the domestic liquidity impact of aid inflows is sterilized, that inflation is kept under control, and that reserves are maintained at comfortable levels. The BM is encouraged to lift gradually the interest cap on treasury-bill auctions to support the monetary-targeting framework while improving liquidity management in order to avoid excessive interest rate volatility.

34. **The health of Mozambique's banking system has improved and is now well placed to make a growing contribution to private sector development**. The authorities are taking further steps to promote financial stability and deepen access to credit, such as the introduction of consolidated supervision and IFRS. Now that a number of divestiture options have been identified, the staff encourages the authorities to move quickly in selling its remaining minority shares in BIM. Reform of the INSS and supplementary pension system could, if carefully sequenced, buttress social protection and promote long-term finance.

35. **The authorities' medium-term framework and MTFF provide a firm basis to formulate the new PARPA for 2006–09, to be articulated during the first half of 2006.** The commitment to prudent macroeconomic policies and launching of a "second wave of reforms" along with donor assistance should help Mozambique achieve a number of MDGs. The staff welcomes the willingness to strengthen the transparency of natural resource management, and ensure that the country benefits more from the activities of the megaprojects, including through the State budget. In this regard, the core principles—transparency and accountability—of the Extractive Industries Transparency Initiative (EITI) and Fiscal Responsibility Laws (FRLs) could provide a useful tool to not only address natural resource management and megaprojects, but fiscal transparency in general. The staff welcomes the intention of the authorities to create a unit at the Ministry of Finance, which will monitor the megaprojects' activities.

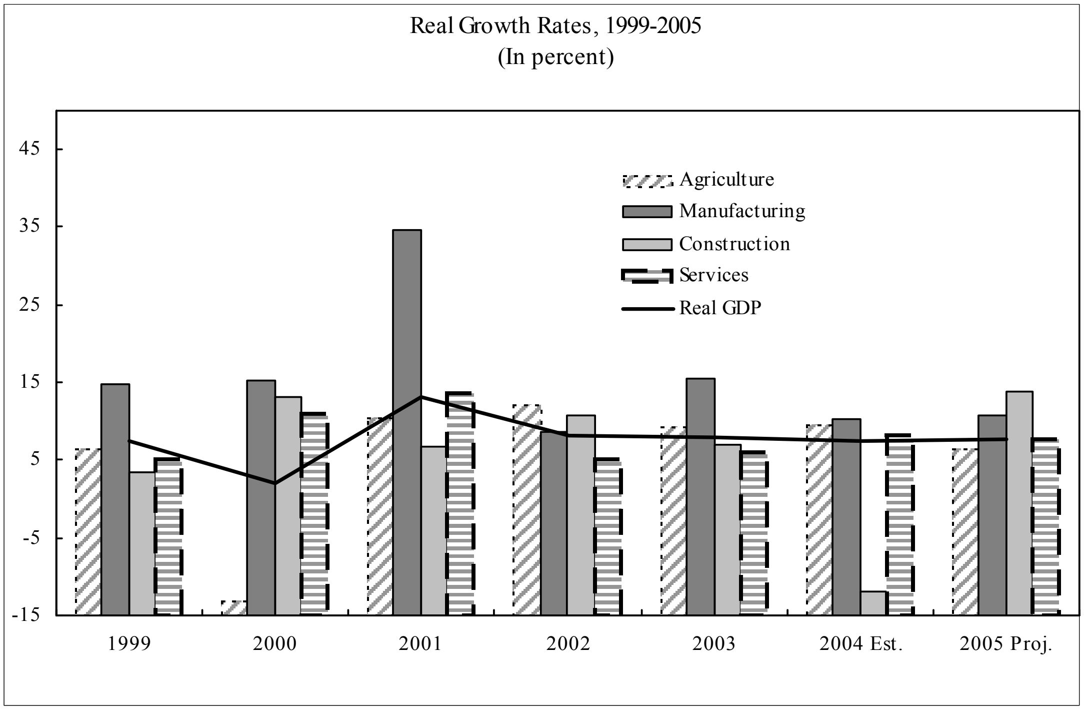
36. **The staff welcomes the intention of the authorities to reduce the maximum import tariff rate from 25 to 20 percent in January 2006 to all trading partners**. However, the staff regrets the delay in finalizing the draft new foreign exchange law and encouraged the authorities to submit it to parliament in early 2006. The staff welcomes the intention of the authorities to accept their obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

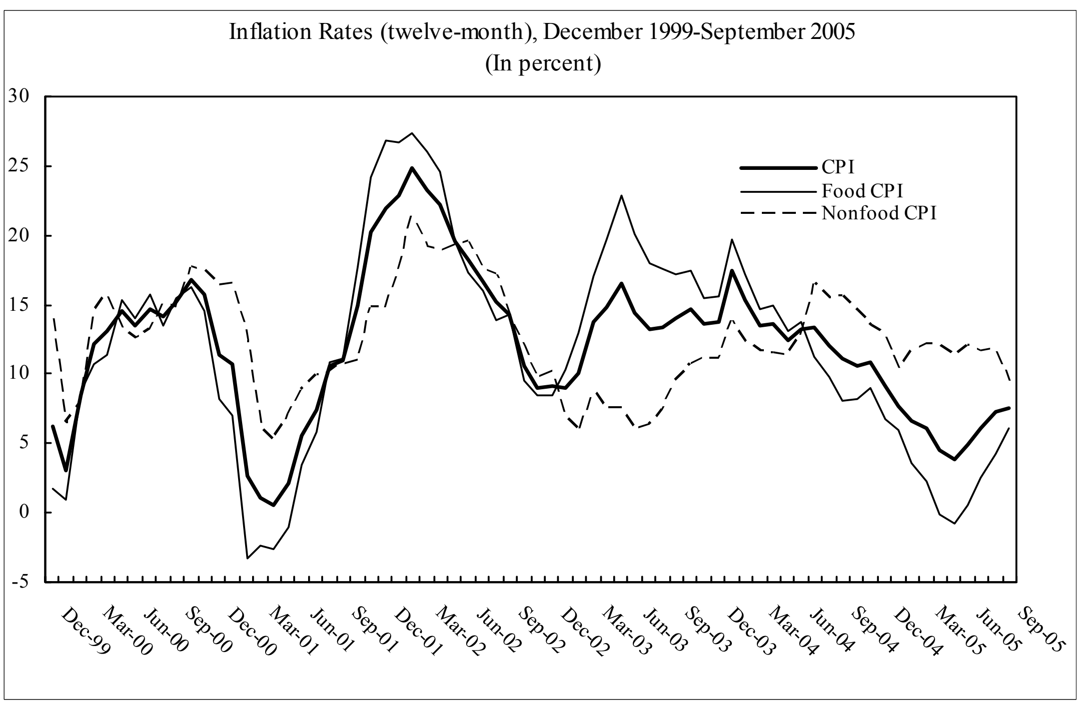
37. **On the risks to the program, the staff notes that a weaker-than-programmed revenue performance, a hasty implementation of fiscal decentralization, a delay in the implementation of the structural agenda** (including the e-SISTAFE), and less foreign aid could jeopardize the government's fiscal and poverty reduction targets. In addition, given the size of the Cahora Bassa Dam transaction, its financing could also constitute a risk to the program.

38. **The staff recommends completion of the third review under the PRGF arrangement and supports the modification of the NIR and NDA performance criteria for end-December 2005 to take into account the impact of the drought on grain imports**.

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

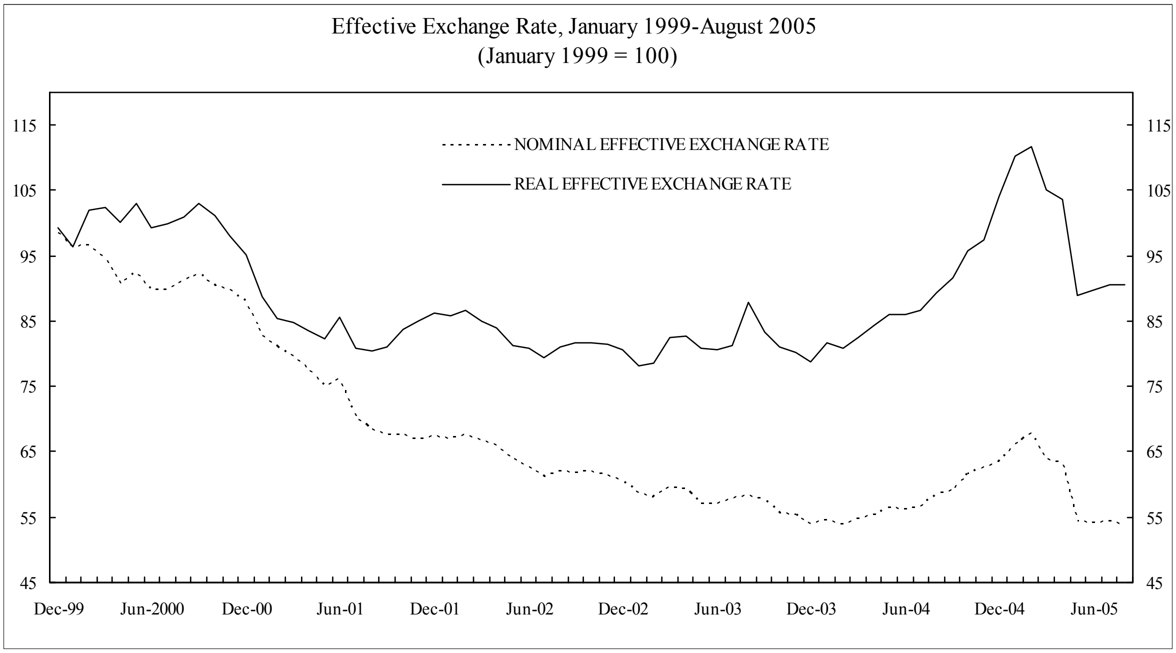
Figure 1. Mozambique: Real Growth Rates and Inflation

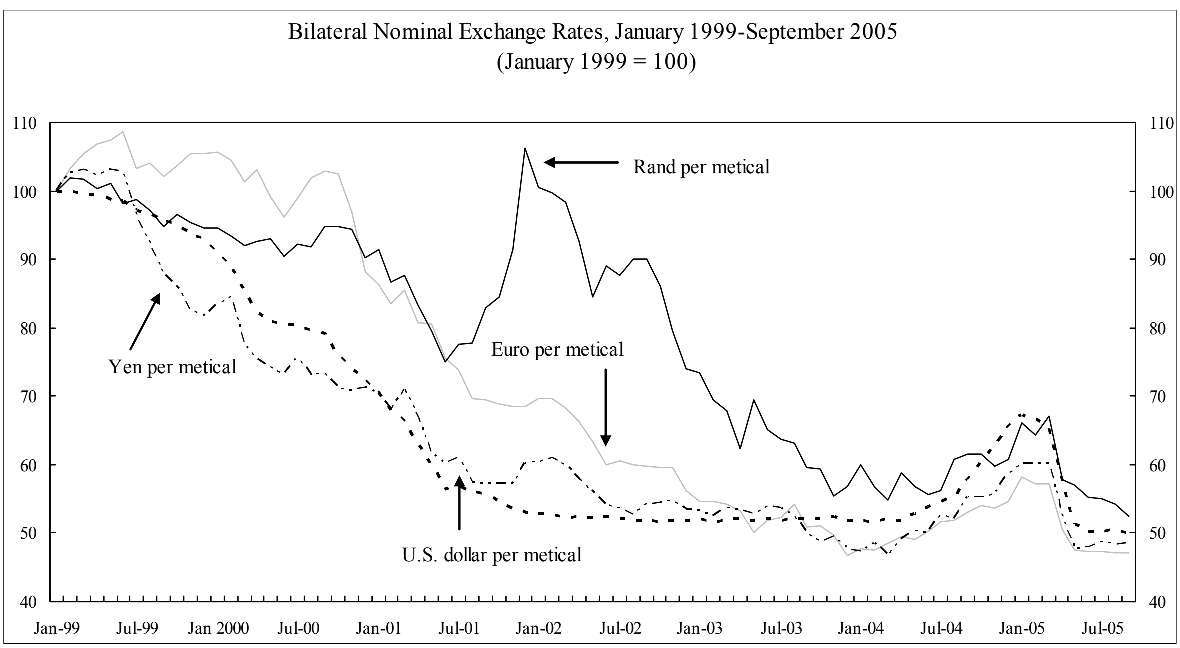




Sources: Mozambican authorities; and IMF staff estimates.

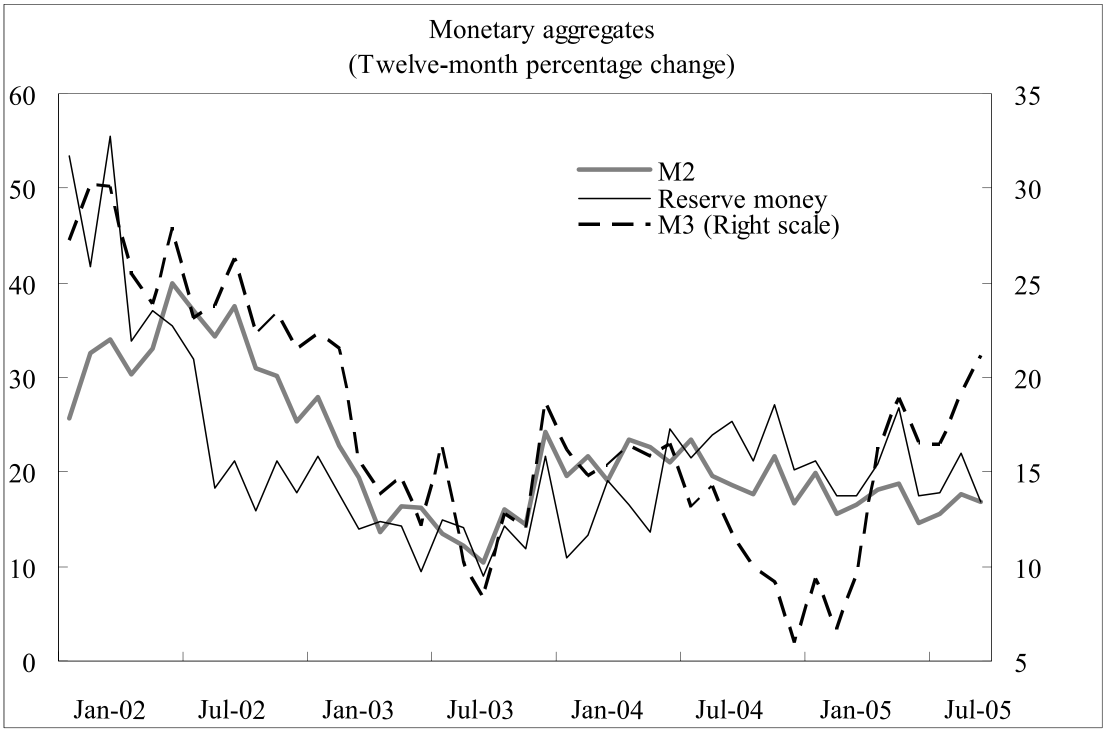
Figure 2. Mozambique: Exchange Rates

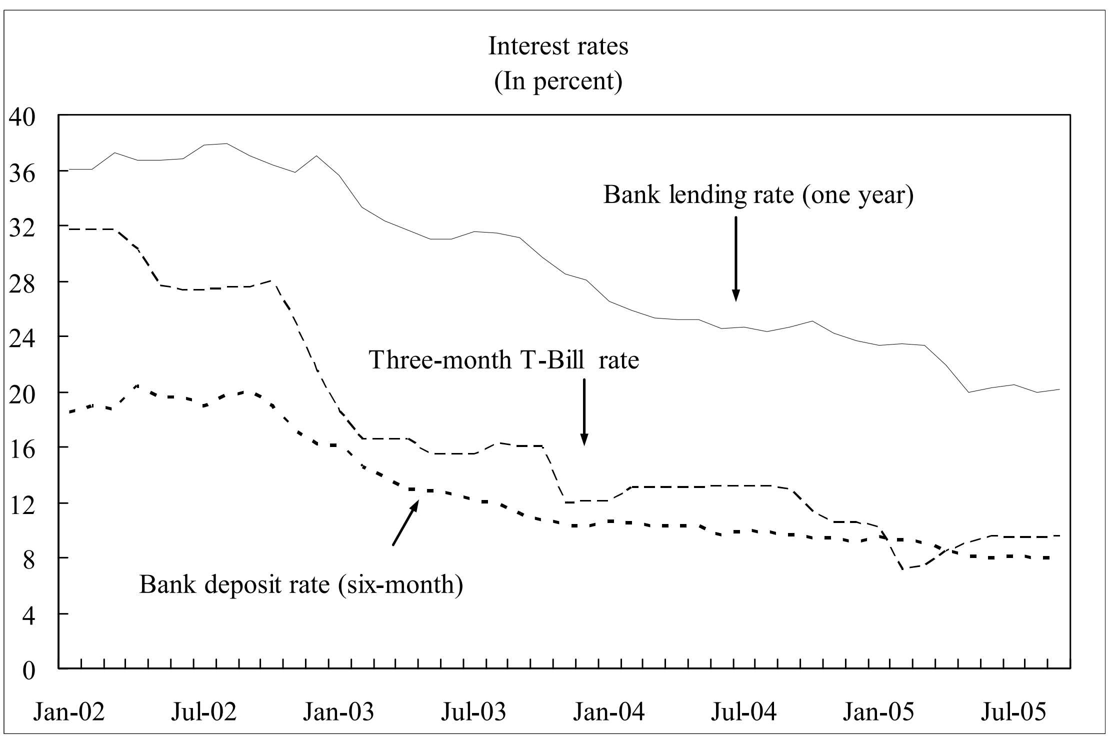




Sources: Mozambican authorities; and IMF staff estimates.

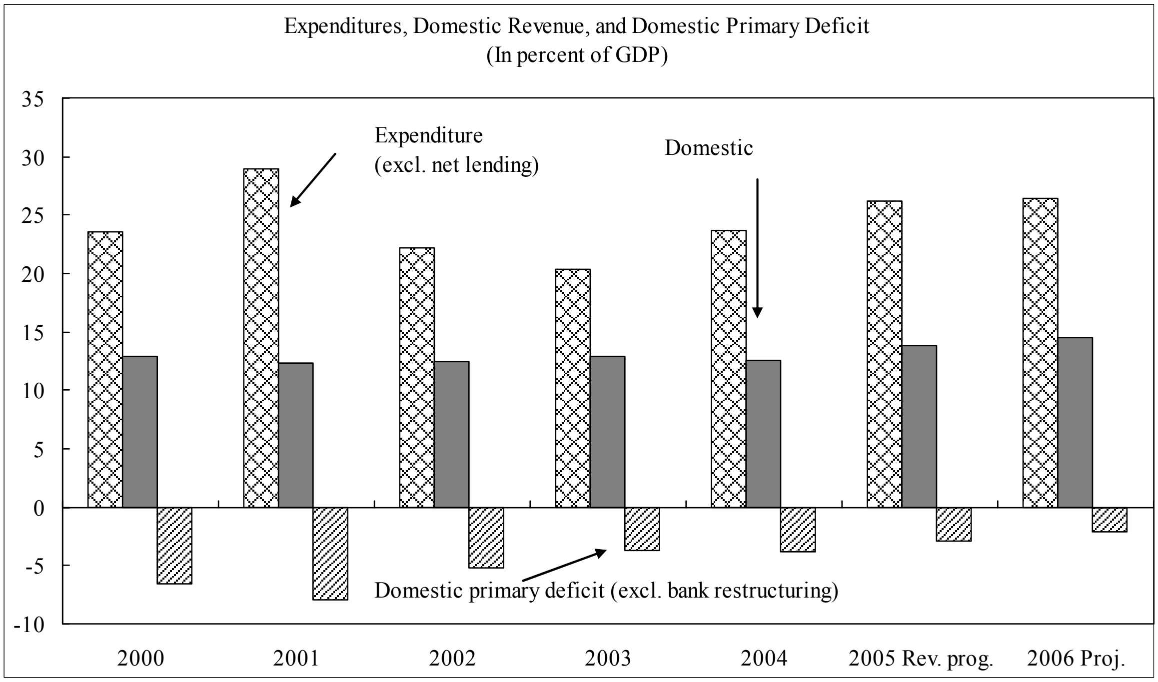
Figure 3. Mozambique: Monetary Aggregates and Interest Rates,
January 2002- September 2005

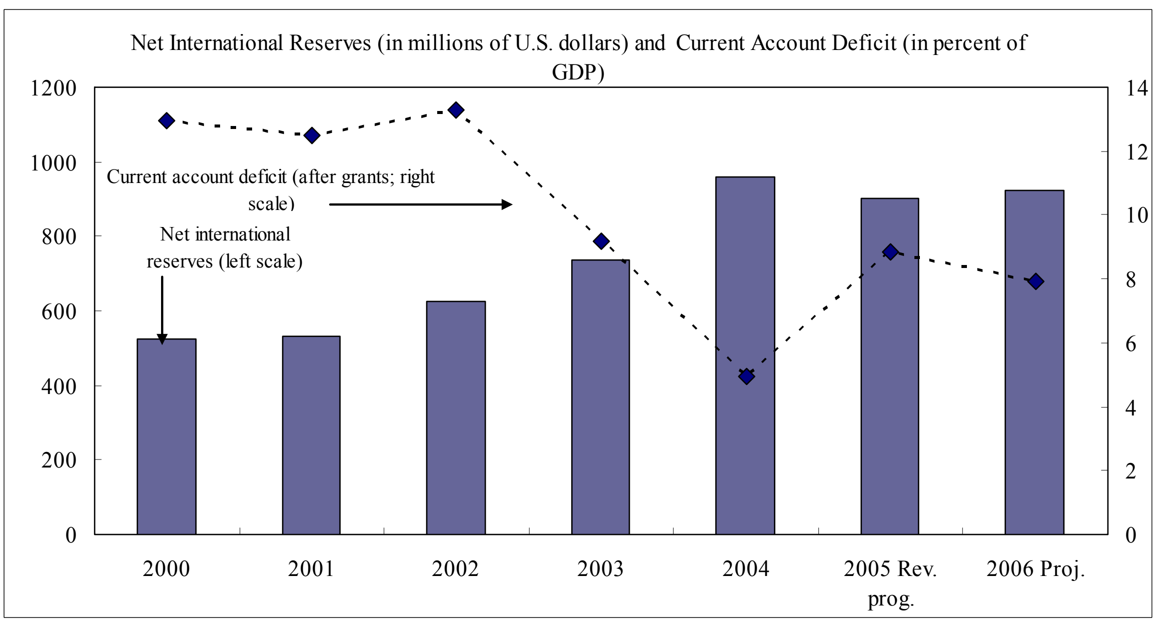




Sources: Mozambican authorities; and IMF staff estimates.

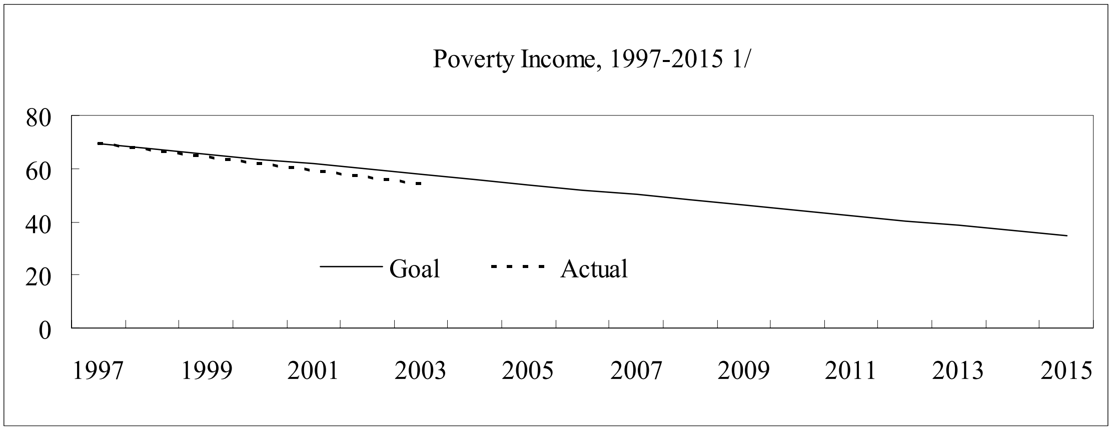
Figure 4. Mozambique: Fiscal and External Sector Indicators, 2000-06 Projection

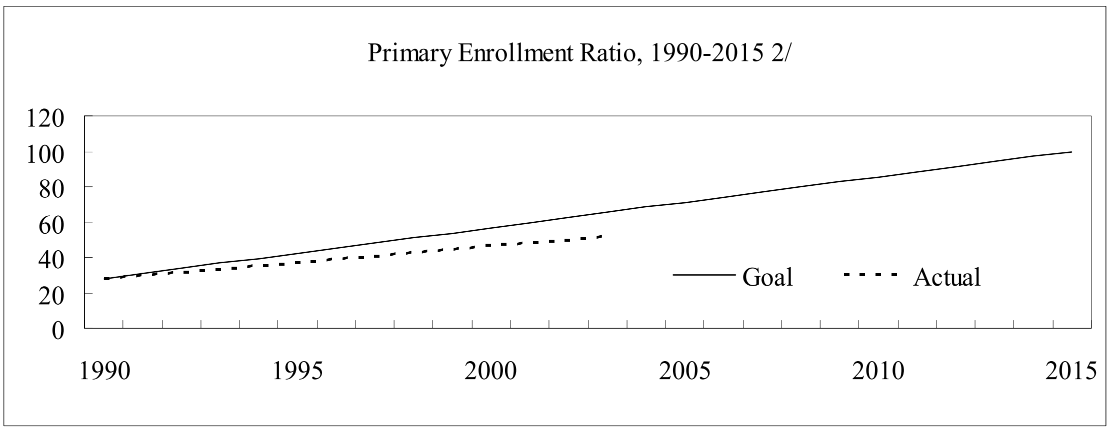


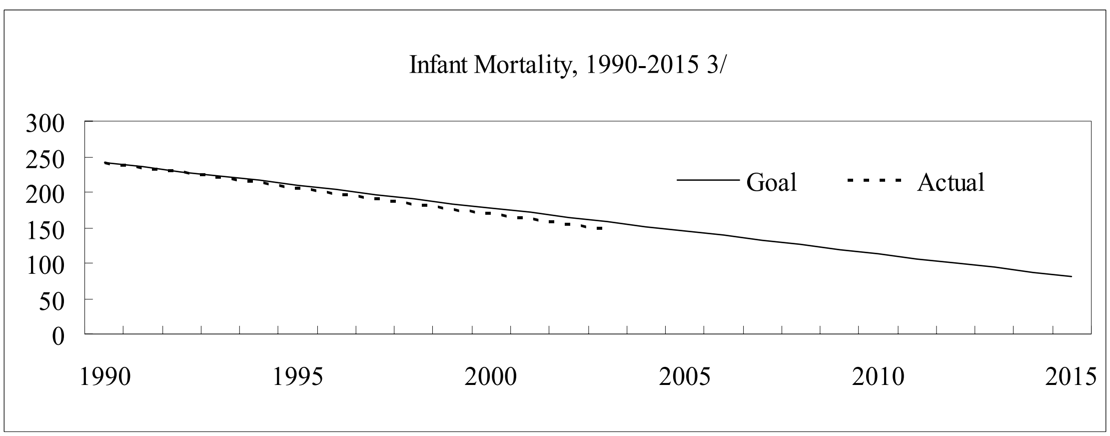


Sources: Mozambican authorities; and IMF staff estimates.

Figure 5. Mozambique: Progress in Meeting the Millenium Development Goals







Sources: The World Bank; and Instituto Nacional de Estadistica (INE) Household Surveys, 1996/97 and 2002/03.

1/ A household consumption survey was conducted between 1996 and 1997, and 2002 and 2003, to determine poverty incidence. The methodology includes determining a sum of food and nonfood poverty lines. Households are defined as poor if their daily per capita expenditure is less than the total poverty line.
2/ Measured in net terms and as a percentage of relevant age group.
3/ Under-five infant mortality rate (per 1,000).

Table 1. Mozambique: Selected Economic and Financial Indicators, 2004–08

	2004	2005		2006		2007	2008
	Est.	Orig. Prog.	Proj.	Orig. Prog.	Prog.	Proj.	Proj.
		(Annual percentage change, unless otherwise indicated)					
National income and prices							
Nominal GDP (in billions of meticais)	133,510	159,912	152,894	184,289	177,268	201,906	228,377
Nominal GDP growth	17.2	16.4	14.5	15.2	15.9	13.9	13.1
Real GDP growth	7.5	7.7	7.7	7.4	7.9	7.0	7.0
GDP per capita (in U.S. dollars)	311	424	345	460	345	370	396
Consumer price index (annual average)	12.6	8.0	6.3	7.3	7.5	6.5	5.7
Nonfood consumer price index (annual average)	13.5	...	...	...	...	...	...
Consumer price index (end of period)	9.1	8.0	8.0	7.0	7.0	6.0	5.5
Nonfood consumer price index, excl. food (end of period)	12.8	...	...	...	...	...	...
External sector							
Merchandise exports	44.1	13.9	14.8	1.9	4.2	5.8	2.9
Merchandise exports, excl. megaprojects	25.4	6.0	3.0	9.7	8.7	11.1	8.8
Merchandise imports	16.9	15.6	17.3	2.8	5.4	10.1	2.0
Merchandise imports, excl. megaprojects	22.8	13.0	14.7	5.4	6.6	4.2	7.0
Terms of trade	12.7	2.2	5.8	-7.3	-4.1	-5.9	-6.8
Nominal effective exchange rate (end of period) 1/	17.8	...	...	...	...	...	...
Real effective exchange rate (end of period) 1/	32.5	...	...	...	...	...	...
		(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)					
Money and credit							
Net foreign assets	37.2	0.8	18.7	2.6	5.6	9.6	6.1
Net domestic assets 2/	-31.2	13.7	6.3	11.6	10.4	6.1	8.3
Of which : net credit to the government 3/	-9.5	9.6	6.7	6.4	-0.8	-1.0	-4.0
credit to the economy	-2.5	5.8	11.7	9.1	11.3	7.6	10.2
Broad money (M3)	5.9	14.5	25.0	14.2	16.0	15.7	14.4
Velocity (GDP/ average M3)	4.1	4.4	4.0	4.4	4.0	3.8	3.7
Interest rate for 90-day treasury bills/TAMs (in percent; end of period) 4/	10.5	...	...	...	...	...	...
		(In percent of GDP)					
Investment and saving							
Gross domestic investment	20.7	21.3	22.2	21.3	23.8	26.4	24.6
Government	9.4	10.8	11.7	9.8	11.8	11.8	11.5
Other sectors	11.3	10.5	10.5	11.5	11.9	14.6	13.0
Gross domestic savings (excl. grants)	6.6	7.4	5.2	8.4	6.3	6.6	6.9
Government	-1.6	-0.5	-0.7	0.4	-0.1	0.7	1.3
Other sectors	8.2	7.9	5.9	7.9	6.4	5.9	5.6
Current account, before grants	-14.1	-13.9	-17.0	-12.9	-17.4	-19.8	-17.7
Government budget							
Total revenue	12.6	13.2	13.8	14.0	14.5	15.3	15.5
Total expenditure and net lending (incl. residual)	24.4	25.6	27.1	24.2	27.5	27.8	26.8
Overall balance, before grants	-12.0	-12.4	-13.3	-10.2	-13.0	-12.4	-11.3
Total grants	7.5	6.4	7.7	5.8	9.1	8.5	8.0
Overall balance, after grants	-4.5	-6.0	-5.6	-4.4	-3.9	-3.9	-3.3
Domestic primary balance	-3.9	-2.8	-2.9	-1.6	-2.1	-1.9	-1.7
External financing (incl. debt relief) 5/	3.2	4.9	5.4	4.3	5.1	5.2	4.6
Net domestic financing	-0.5	1.1	0.2	0.0	-1.3	-1.3	-1.3
Privatization 5/	1.9	0.0	0.0	0.1	0.1	0.0	0.0
		(In percent of exports of goods and nonfactor services)					
External debt service (nonfinancial public sector)							
Scheduled, after additional bilateral assistance	4.5	5.1	5.1	5.3	5.3	5.4	5.2
		(In millions of U.S. dollars, unless otherwise specified)					
Overall balance of payments	212	-84	-83	-30	-8	98	52
Net international reserves (end of period)	960	900	900	902	923	1,053	1,136
Gross international reserves (end of period)	1,159	1,076	1,076	1,045	1,068	1,166	1,218
In months of imports of goods and nonfactor services	5.8	4.7	4.6	4.4	4.4	4.2	4.3
In months of imports of goods and nonfactor services, excl. megaprojects	7.0	5.6	5.6	5.2	5.2	5.4	5.3
Exchange rate (meticais per U.S. dollar; end of period)	18,899	...	...	...	...	...	…

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

1/ A minus sign indicates depreciation.

2/ The percentage change for net domestic assets in the estimate for 2004 was adjusted to take account of the shifting of the external liabilities of the Banco de Mozambique (BM) to the government.

3/ Includes the issuance of government securities for the central bank recapitalization in years 2005-07.

4/ TAMs stands for "Titulos das Autoridades Monetarias". TAMs are debt instruments issued by the BM.

5/ Includes movement in the government account set abroad with the proceed of the Moatize coal mine concession.

Table 2. Mozambique: Government Finances, 2004–08

(In billions of meticais)

	2004 1/	2005		2006		2007	2008
	Est.	Orig. Prog.	Proj.	Orig. Prog.	Prog.	Proj.	Proj.
Total revenue	16,838	21,090	21,089	25,889	25,685	30,915	35,410
Tax revenue	15,598	18,923	18,923	23,106	22,762	27,279	31,278
Taxes on income and profits	3,548	4,445	4,445	5,649	5,487	7,132	8,612
Taxes on goods and services	9,416	11,522	10,845	13,817	13,015	15,350	17,436
Of which : on petroleum products	1,663	2,089	2,089	2,627	2,631	2,969	3,358
Taxes on international trade	2,284	2,398	3,075	2,902	3,552	4,044	4,352
Other taxes	350	558	558	739	708	752	879
Nontax revenue	1,241	2,167	2,167	2,783	2,773	3,636	4,132
Total expenditure and net lending	32,607	40,986	41,408	44,605	48,697	56,033	61,122
Current expenditure	19,006	21,890	22,099	25,132	25,788	29,530	32,519
Compensation to employees	9,195	11,045	11,045	12,711	13,148	15,215	17,209
Goods and services	4,727	5,651	5,520	6,413	6,031	7,439	8,270
Interest on public debt	1,321	1,244	1,309	1,637	1,567	1,571	1,630
Domestic	910	921	921	1,030	1,080	1,076	1,114
External	411	323	388	607	487	495	516
Transfer payments	3,763	3,950	4,225	4,371	5,041	5,305	5,410
Domestic current primary balance	-847	444	299	2,394	1,465	2,956	4,521
Capital expenditure	12,543	17,226	17,942	18,119	20,990	23,905	26,360
Grant Finance Projects	3,085	5,868	4,528	6,642	4,916	5,084	5,245
Project Loans	3,564	5,054	5,373	5,219	4,712	5,245	5,467
Locally financed	4,074	4,942	4,797	5,631	5,357	6,949	8,583
Grant Financed Special Programs	1,197	702	2,212	105	4,686	5,056	5,334
Direct Financing	623	196	489	201	907	937	966
Expenditure financed with fund for the concession mine of Tete	...	464	544	321	411	634	766
Net lending	1,058	1,870	1,367	1,354	1,920	2,598	2,242
Of which : locally financed	-79	-16	-16	-224	-138	-157	-180
Domestic primary balance, before grants, above the line 2/	-4,842	-4,482	-4,481	-3,013	-3,754	-3,836	-3,882
Unallocated revenue (+)/expenditure (-) 3/	-310	0	0	0	0	0	0
Overall balance, before grants (below the line)	-16,078	-19,896	-20,319	-18,716	-23,012	-25,118	-25,712
Grants received	10,053	10,287	11,791	10,630	16,155	17,254	18,239
Project	6,185	6,766	7,229	6,948	10,509	11,076	11,545
Nonproject	3,868	3,521	4,562	3,682	5,645	6,178	6,694
Overall balance, after grants	-6,025	-9,609	-8,528	-8,087	-6,857	-7,864	-7,473
Central bank transfer of HIPC Initiative assistance by the IMF	484	329	366	334	428	268	144
Net external financing	3,787	7,483	7,931	7,651	8,587	10,144	10,273
Disbursements	6,937	7,750	8,297	8,004	9,108	10,409	10,373
Project	3,564	5,054	5,373	5,219	4,712	5,245	5,467
Nonproject	3,373	2,696	2,925	2,785	4,395	5,164	4,906
Cash amortization	-668	-731	-909	-674	-932	-899	-866
Investment abroad 4/	-2,482	464	544	321	411	634	766
Net domestic financing	-728	1,798	231	0	-2,259	-2,643	-3,056
Privatization 5/	2,482	0	0	102	102	96	113
Memorandum items:							
Domestic primary balance, before grants, below the line 2/	-5,151	-4,482	-4,481	-3,013	-3,754	-3,836	-3,882
Grants and loans disbursements	16,990	18,037	20,088	18,633	25,262	27,663	28,612
Bonds issuance for strengthening the balance sheet of the central bank	...	1,500	1,500	2,500	1,500	1,500	0
Nominal GDP (in billions of meticais)	133,510	159,912	152,894	184,289	177,268	201,906	228,377

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

1/ The quasifiscal deficit of the Bank of Mozambique, amounting Mt 3,455 billion (or 2.5 percent of GDP) is not included.

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

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

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

5/ In 2004, it includes the US$123 million concession fee for the Moatize coal mine.

Table 2. Mozambique: Government Finances, 2004-08 (concluded)

	2004 1/	2005		2006		2007	2008
	Est.	Orig. Prog.	Proj.	Orig. Prog.	Prog.	Proj.	Proj.
	(In percent of GDP, unless otherwise specified)						
Total revenue	12.6	13.2	13.8	14.0	14.5	15.3	15.5
Tax revenue	11.7	11.8	12.4	12.5	12.8	13.5	13.7
Taxes on income and profits	2.7	2.8	2.9	3.1	3.1	3.5	3.8
Taxes on goods and services	7.1	7.2	7.1	7.5	7.3	7.6	7.6
Of which : on petroleum products	1.2	1.3	1.4	1.4	1.5	1.5	1.5
Taxes on international trade	1.7	1.5	2.0	1.6	2.0	2.0	1.9
Other taxes	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Nontax revenue	0.9	1.4	1.4	1.5	1.6	1.8	1.8
Total expenditure and net lending	24.4	25.6	27.1	24.2	27.5	27.8	26.8
Current expenditure	14.2	13.7	14.5	13.6	14.5	14.6	14.2
Compensation to employees	6.9	6.9	7.2	6.9	7.4	7.5	7.5
Goods and services	3.5	3.5	3.6	3.5	3.4	3.7	3.6
Interest on public debt	1.0	0.8	0.9	0.9	0.9	0.8	0.7
Domestic	0.7	0.6	0.6	0.6	0.6	0.5	0.5
External	0.3	0.2	0.3	0.3	0.3	0.2	0.2
Transfer payments	2.8	2.5	2.8	2.4	2.8	2.6	2.4
Domestic current primary balance	-0.6	0.3	0.2	1.7	0.8	1.5	2.0
Capital expenditure	9.4	10.8	11.7	9.8	11.8	11.8	11.5
Of which : locally financed	3.1	3.1	3.1	3.1	3.0	3.4	3.8
Net lending	0.8	1.2	0.9	0.7	1.1	1.3	1.0
Of which : locally financed	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Domestic primary balance, above the line 2/	-3.6	-2.8	-2.9	-1.6	-2.1	-1.9	-1.7
Unallocated revenue (+)/expenditure (-) 3/	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants (below the line)	-12.0	-12.4	-13.3	-10.2	-13.0	-12.4	-11.3
Grants received	7.5	6.4	7.7	5.8	9.1	8.5	8.0
Project	4.6	4.2	4.7	3.8	5.9	5.5	5.1
Nonproject	2.9	2.2	3.0	2.0	3.2	3.1	2.9
Overall balance, after grants	-4.5	-6.0	-5.6	-4.4	-3.9	-3.9	-3.3
Central bank transfer of HIPC assist. once by the IMF	0.4	0.2	0.2	0.2	0.2	0.1	0.1
Net external financing	2.8	4.7	5.2	4.2	4.8	5.0	4.5
Disbursements	5.2	4.8	5.4	4.3	5.1	5.2	4.5
Project	2.7	3.2	3.5	2.8	2.7	2.6	2.4
Nonproject	2.5	1.7	1.9	1.5	2.5	2.6	2.1
Cash amortization	-0.5	-0.5	-0.6	-0.4	-0.5	-0.4	-0.4
Investment abroad 4/	-1.9	0.3	0.4	0.2	0.2	0.3	0.3
Net domestic financing	-0.5	1.1	0.2	0.0	-1.3	-1.3	-1.3
Privatization 5/	1.9	0.0	0.0	0.1	0.1	0.0	0.0
Memorandum items:							
Domestic primary balance, before grants, below the line 2/	-3.9	-2.8	-2.9	-1.6	-2.1	-1.9	-1.7
Grants and loans disbursements	12.7	11.3	13.1	10.1	14.3	13.7	12.5
Gross national government savings	5.9	5.9	7.1	6.2	9.1	9.2	9.3
Domestic public debt 6/	1.9	1.6	2.2	…	4.7	4.1	3.6
Bonds issuance for strengthening the balance sheet of the central bank	...	0.9	1.0	1.4	0.8	0.7	0.0
Annual average exchange rate	22,581	19406	22752	25757	20120	26761	27610
Nominal GDP (in billions of meticais)	133,510	159,912	152,894	184,289	177,268	201,906	228,377

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

1/ The quasifiscal deficit of the Bank of Mozambique, amounting Mt 3,455 billion (or 2.5 percent of GDP) is not included.
2/ Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending. Unallocated revenue and expenditure are included in the primary balance.
3/ Residual discrepancy between identified sources and uses of funds.
4/ Tracks the movements in the government account set up abroad with the proceeds of the Moatize coal mine concession.
5/ Includes in 2004 the US$123 million (2.0 percent of GDP) concession fee for the Moatize coal mine.
6/ Includes government securities issued for strengthening the balance sheet of the Bank of Mozambique.

Table 3. Mozambique: Monetary Survey, 2004–08

	2004	2005		2006	2007	2008
	Rev. Actual	Orig. Prog.	Rev. Proj.	Prog.	Proj.	Proj.
	(In billions of meticais, unless otherwise specified)					
Central bank						
Net foreign assets	21,504	18,893	25,423	26,701	31,162	34,427
(in millions of U.S. dollars)	1,138	955	998	1,004	1,133	1,216
Net international reserves 1/	18,141	17,801	22,929	24,547	28,934	32,134
(in millions of U.S. dollars)	960	900	900	923	1,052	1,135
Medium- and long-term foreign liabilities	-57	-59	-76	-80	-83	-85
Other	3,421	1,152	2,571	2,234	2,310	2,378
Net domestic assets	-11,071	-6,947	-13,218	-12,663	-15,138	-16,100
Credit to government (net)	-11,245	-10,234	-13,493	-12,582	-14,497	-16,412
Credit to banks (net)	-3,859	-77	0	24	-6	2
Credit to the economy	1	1	1	1	1	1
Other items (net; assets +)	4,033	3,362	274	-107	-636	309
Reserve money	10,433	11,946	12,205	14,038	16,024	18,327
Currency outside banks	5,225	5,982	5,983	6,937	7,598	8,324
Bank reserves	5,209	5,964	6,222	7,100	8,426	10,003
Currency in banks	978	1,091	822	836	1,610	2,728
Deposits	4,231	4,872	5,400	6,265	6,816	7,276
Deposit money banks						
Net foreign assets	4,900	5,461	7,388	8,510	8,801	9,058
(in millions of U.S. dollars)	259	276	290	320	320	320
Net domestic assets	24,050	27,684	29,347	34,105	40,948	48,231
Banks' reserves	5,209	5,964	6,222	7,100	8,426	10,003
Central bank liabilities w/coml. banks (net)	4,009	77	0	-24	6	-2
Credit to government (net)	4,656	9,262	9,178	7,920	9,325	8,950
Credit to the economy	13,512	15,488	17,515	22,353	26,144	31,975
Other items (net; assets +)	-3,336	-3,106	-3,568	-3,243	-2,953	-2,695
Deposits	28,950	33,145	36,735	42,616	49,748	57,290
Demand and savings deposits	19,255	21,544	23,878	27,700	32,337	37,238
Time deposits	9,695	11,601	12,857	14,915	17,412	20,051
Monetary survey						
Net foreign assets	26,404	24,354	32,811	35,211	39,963	43,486
Net domestic assets	7,770	14,774	9,907	14,341	17,384	22,128
Domestic credit	6,923	14,517	13,201	17,691	20,973	24,514
Credit to government (net)	-6,590	-972	-4,315	-4,663	-5,172	-7,462
Credit to the economy	13,513	15,489	17,516	22,354	26,145	31,976
Other items (net; assets +)	847	257	-3,294	-3,350	-3,589	-2,386
Money and quasi money (M3)	34,174	39,127	42,718	49,553	57,347	65,614
Foreign currency deposits	11,522	13,192	16,361	19,177	22,415	25,477
(in millions of U.S. dollars)	610	667	642	721	815	900
M2	22,653	25,935	26,357	30,376	34,932	40,137
Currency outside banks	5,225	5,982	5,983	6,937	7,598	8,324
Domestic currency deposits	17,428	19,953	20,373	23,439	27,334	31,813
Memorandum items:						
	(Annual growth in percentage of beginning of period M3, unless otherwise indicated)					
Net foreign assets	37.2	0.8	18.7	5.6	9.6	6.1
Net domestic assets	-31.2	13.7	6.3	10.4	6.1	8.3
Credit to government (net)	-9.5	9.6	6.7	-0.8	-1.0	-4.0
Credit to the economy	-2.5	5.8	11.7	11.3	7.6	10.2
Other items (net; asset +)	-19.3	-1.7	-12.1	-0.1	-0.5	2.1
Broad money (M3) (12-month change in percent)	5.9	14.5	25.0	16.0	15.7	14.4
M2 (12-month change in percent)	16.7	14.5	16.4	15.2	15.0	14.9
M3-to-GDP ratio (percent)	25.6	24.5	27.9	28.0	28.4	28.7
M2-to-GDP ratio (percent)	17.0	16.2	17.2	17.1	17.3	17.6
Cred. economy (12 month change in percent)	-5.6	14.6	29.6	27.6	17.0	22.3
Cred. economy (12 month change at constant end-year exchange rate)	8.8	10.8	8.3	24.8	15.4	20.8
Credit to the economy-to-GDP ratio (percent)	10.1	9.7	11.5	12.6	12.9	14.0
Currency outside banks-to-M3 ratio (percent)	15.3	15.3	14.0	14.0	13.2	12.7
Currency outside banks-to-M2 (percent)	23.1	23.1	22.7	22.8	21.8	20.7
Foreign currency deposits-to-M3 ratio (percent)	33.7	33.7	38.3	38.7	39.1	38.8
Reserve money growth (12 month change in percent)	20.2	14.5	17.0	15.0	14.1	14.4
Money multiplier (M2/reserve money)	2.2	2.2	2.2	2.2	2.2	2.2
Money multiplier (M3/reserve money)	3.3	3.3	3.5	3.5	3.6	3.6
Velocity (GDP/average M3)	4.1	4.4	4.0	4.0	3.8	3.7
Velocity (GDP/M3)	3.9	4.1	3.6	3.6	3.5	3.5
Velocity (GDP/average M2)	6.5	6.6	6.2	6.3	6.2	6.1
Velocity (GDP/M2)	5.9	6.2	5.8	5.8	5.8	5.7

Sources: Bank of Mozambique (BM); and IMF staff estimates and projections.
1/The NIR actual figures for 2004 has been revised downward by deducting from gross reserves some deposits held by the central bank abroad which are encumbered for specific imports. The proceeds of the Moatize coal mine concession are not included.

Table 4. Mozambique: Balance of Payments, 2004–08
(In millions of U.S. dollars, unless otherwise specified)

	2004	2005		2006		2007	2008
	Prel.	Orig. Prog.	Rev. Proj.	Orig. Prog.	Prog.	Proj.	Proj.
Trade balance	-531	-639	-661	-674	-716	-865	-866
Exports, f.o.b.	1,504	1,713	1,726	1,746	1,799	1,903	1,959
Megaprojects	1,049	1,230	1,257	1,216	1,289	1,337	1,343
Other exports	455	483	469	529	509	566	616
Imports, c.i.f.	-2,035	-2,353	-2,387	-2,419	-2,514	-2,768	-2,824
Megaprojects	-312	-407	-411	-369	-407	-573	-475
Other imports	-1,723	-1,946	-1,976	-2,050	-2,107	-2,196	-2,349
Services and incomes (net)	-301	-504	-483	-511	-485	-631	-598
Receipts	370	402	381	449	422	477	528
Expenditures	-671	-906	-864	-960	-906	-1,108	-1,126
Of which : interest on public debt	-18	-28	-26	-35	-23	-36	-39
Current account, before grants	-832	-1,143	-1,144	-1,184	-1,200	-1,496	-1,463
Unrequited official transfers	539	557	550	558	654	670	682
Of which : multilaterals' HIPC assistance grants	24	27	27	28	28	25	22
Current account, after grants	-293	-586	-594	-627	-546	-827	-781
Capital account	279	478	441	546	488	875	783
Trade credit (net)	-3	54	0	53	20	50	60
Foreign borrowing	463	610	561	607	562	797	758
Public 1/	315	405	356	402	357	391	376
Private 2/	148	205	205	205	205	406	383
Amortization	-303	-325	-279	-332	-319	-344	-374
Public 1/	-63	-78	-71	-79	-81	-79	-78
Private	-240	-247	-207	-254	-239	-265	-296
Direct investment (net)	245	115	135	202	209	348	310
Of which Moatize coal mine	123	0	0	0	0	0	0
Other investment of the government 3/	-123	24	24	16	16	24	28
Short-term capital and errors and omissions (net)	226	25	69	50	50	50	50
Overall balance	212	-84	-83	-30	-8	98	52
Financing	-212	84	83	30	8	-98	-52
Of which: Bank of Mozambique							
gross reserve assets (increase -)	-212	84	83	30	8	-98	-52
Financing gap	0	0	0	0	0	0	0
Memorandum items:							
Use of Fund credit (net)	-19	-24	-23	-32	-31	-32	-31
Current account deficit (percent of GDP)							
Before grants	14.1	13.9	17.0	12.9	17.4	19.8	17.7
After grants	5.0	7.1	8.8	6.8	7.9	11.0	9.4
After grants, excluding large projects	12.4	11.7	15.3	15.3	14.0	13.0	12.8
Net international reserves	960	900	900	902	923	1,053	1,136
Gross international reserves	1,159	1,076	1,076	1,045	1,068	1,166	1,218
In months of imports of G&NFS	5.8	4.7	4.6	4.4	4.4	4.2	4.3
In months of imports of GNFS, excl. megaprojects	7.0	5.6	5.6	5.2	5.2	5.4	5.3
Gross foreign assets of the government	123	99	99	83	83	59	32
Debt Indicators (in percent)							
NPV of public external debt/GDP	25.2	19.7	21.0	20.9	20.9	21.3	21.6
NPV of public external debt/exports	83.8	91.1	83.6	89.5	89.5	96.0	99.3
Debt service due/exports	4.5	4.6	5.1	5.3	5.3	5.4	5.2

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

1/ Including IMF.

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

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

Table 5. Mozambique: Balance of Payments of Megaprojects, 2002-08 1/
(In millions of U.S. dollars, unless otherwise specified)

	2002	2003	2004	2005		2006	2007	2008
	Act.	Act.	Prel.	Orig. Prog.	Rev. Proj.	Proj.	Proj.	Proj.
Trade balance	66	344	736	824	847	882	765	868
Exports, f.o.b.	468	681	1,049	1,230	1,257	1,289	1,337	1,343
Imports, c.i.f.	-402	-337	-312	-407	-411	-407	-573	-475
Services and incomes (net)	-233	-228	-305	-433	-444	-455	-588	-567
Current account, before grants	-167	116	431	391	403	428	177	301
Current account, after grants	-167	116	431	391	403	428	177	301
Capital account	644	229	-62	-53	-24	-40	278	151
Foreign borrowing	439	62	5	75	75	45	235	179
Amortization	-40	-66	-117	-153	-143	-144	-146	-163
Direct investment (net)	245	234	50	25	45	59	189	134
Overall balance before short-term capital inflows 2/	477	344	369	338	379	388	454	452

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

1/ Megaprojects include: Mozal (aluminum production); Sasol (gas production and pipeline); the Cahora-Bassa dam (hydro-power); and 2 titanium ore projects.

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

Table 6. Mozambique: Expenditure in PARPA Priority Sectors, 2004-06 1/
(In billions of meticais, unless otherwise indicated)

	2004 Est.	2005 Proj.	2005 First semester	2006 Proj.
Total revenues	16,838	21,089	8,979	25,685
Total expenditure, excluding bank restructuring costs and net lending	31,549	40,041	14,862	46,778
Total expenditure (excl.bank restructuring costs, net lending, and interest payments)	30,228	38,732	14,213	45,210
Interest payments on public debt	1,321	1,309	649	1,567
Total expenditure in PARPA priority sectors	19,033	25,679	9,514	31,438
In percent of GDP	14.3	16.8	6.2	17.7
In percent of total expenditure (excl. bank restructuring costs, net lending, and interest payments)	63.0	66.3	66.9	69.5
Education	6,317	7,722	3,332	9,065
Primary	5,325	6,577	2,953	7,507
Postsecondary	992	1,145	379	1,558
Health	3,183	4,909	1,678	6,637
HIV/AIDS	123	257	106	660
Infrastructure development	3,982	7,237	2,062	7,245
Roads	3,112	5,478	1,344	4,527
Sanitation and public works	870	1,759	718	2,718
Agriculture and rural development	1,322	1,523	683	1,494
Governance and judicial system	2,936	3,438	1,279	5,678
Security and public order	1,753	1,715	817	1,938
Governance	483	710	109	2,725
Judicial system	699	1,014	352	1,015
Other priority areas	1,170	858	374	659
Social actions	201	248	83	331
Labor and employment	123	128	54	143
Mineral resources and energy	846	482	238	185
Total PARPA expenditures in percent of GDP				
Education	4.7	5.0	2.2	5.1
Primary	4.0	4.3	1.9	4.2
Postsecondary	0.7	0.7	0.2	0.9
Health	2.4	3.2	1.1	3.7
HIV/AIDS	0.1	0.2	0.1	0.4
Infrastructure development	3.0	4.7	1.3	4.1
Roads	2.3	3.6	0.9	2.5
Sanitation and public works	0.7	1.1	0.5	1.5
Agriculture and rural development	1.0	1.0	0.4	0.8
Governance and judicial system	2.2	2.2	0.8	3.2
Security and public order	1.3	1.1	0.5	1.1
Governance	0.4	0.5	0.1	1.5
Judicial system	0.5	0.7	0.2	0.6
Other priority areas	0.9	0.6	0.2	0.4
Social actions	0.2	0.2	0.1	0.2
Labor and employment	0.1	0.1	0.0	0.1
Mineral resources and energy	0.6	0.3	0.2	0.1
Total PARPA expenditures in percent of total expenditures				
Education	20.9	19.9	23.4	20.1
Primary	17.6	17.0	20.8	16.6
Postsecondary	3.3	3.0	2.7	3.4
Health	10.5	12.7	11.8	14.7
HIV/AIDS	0.4	0.7	0.7	1.5
Infrastructure development	13.2	18.7	14.5	16.0
Roads	10.3	14.1	9.5	10.0
Sanitation and public works	2.9	4.5	5.1	6.0
Agriculture and rural development	4.4	3.9	4.8	3.3
Governance and judicial system	9.7	8.9	9.0	12.6
Security and public order	5.8	4.4	5.8	4.3
Governance	1.6	1.8	0.8	6.0
Judicial system	2.3	2.6	2.5	2.2
Other priority areas	3.9	2.2	2.6	1.5
Social actions	0.7	0.6	0.6	0.7
Labor and employment	0.4	0.3	0.4	0.3
Mineral resources and energy	2.8	1.2	1.7	0.4

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

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

Table 7. Mozambique: Financial Soundness Indicators for Banking Sector, 2000-05
(In percent unless otherwise indicated)

	2000	2001	2002	2003	2004	2005 3/
Capital adequacy						
Regulatory capital to risk-weighted assets	-2.13	5.49	14.01	17.03	18.65	16.77
Capital (net worth) to assets	-2.70	8.22	7.83	5.63	6.54	4.86
Asset composition and quality						
Sectoral distribution of loans to total loans						
Agriculture	19.00	18.00	15.00	12.73	9.45	9.27
Industry	27.00	25.00	22.00	16.94	11.94	17.83
Construction	5.00	4.00	4.00	5.20	3.35	4.53
Commerce	23.00	20.00	17.00	18.13	21.29	21.69
Transportation and communication	5.00	7.00	5.00	7.08	7.19	5.69
Other	21.00	26.00	37.00	39.92	46.78	40.99
Foreign exchange loans to total loans	40.24	64.69	69.87	70.77	67.33	69.45
Nonperforming loans to gross loans 1/	17.76	23.43	20.80	26.76	6.42	4.59
Nonperforming loans net of provisions to capital 1/	35.00	11.00	17.00	12.00	2.60	2.77
Earnings and profitability						
Return on assets	0.04	0.14	1.59	1.24	1.43	0.73
Return on equity	...	3.51	22.10	16.29	18.73	9.60
Interest margin to gross income	...	10.22	3.40	26.00	11.65	8.19
Noninterest expenses to gross income	...	16.92	27.67	31.97	14.44	9.09
Personnel expenses to noninterest expenses	...	51.71	47.81	47.20	43.13	46.83
Trading and fee income to gross income	...	33.09	39.68	8.37	2.65	2.22
Spread between reference loan and deposit rates (90 days, local currency)	...	14.00	19.00	17.39	14.67	12.74
Funding and liquidity						
Liquid assets to total assets 2/	41.51	34.64	46.23	29.46	34.67	30.87
Customer deposits to total (non-interbank) loans	188.00	217.00	240.00	227.97	283.07	201.88
Foreign exchange liabilities to total liabilities	54.53	63.30	61.26	80.30	75.52	77.65

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.

3/ Data as of June 2005.

Table 8. Mozambique: Indicators of External Vulnerability, 2002-05
(In percent of GDP, unless otherwise indicated)

	2002	2003	2004 Prel.	2005 Proj.
Financial indicators				
Net present value of public sector debt 1/ 2/	21.8	25.2	27.0	21.0
Broad money (percent change, 12-month basis)	21.5	18.7	5.9	25.0
Private sector credit (percent change, 12-month basis)	4.2	-1.4	-5.6	29.6
External indicators				
Exports of goods (percent change, 12-month basis in U.S. dollars)	15.1	28.9	44.1	14.8
Imports of goods c.i.f. (percent change, 12-month basis in U.S. dollars)	45.1	12.8	16.9	17.3
Terms of trade (percent change, 12-month basis)	-3.4	-2.1	12.7	5.8
Current account balance (after grants)	-13.3	-9.2	-5.0	-8.8
Capital and financial account balance	21.3	9.0	4.7	6.6
Of which : foreign direct investment	9.3	7.1	4.1	2.0
Gross international reserves (in millions of U.S. dollars)	825	947	1159	1076
(In months of imports of goods and services)	5.0	5.4	5.8	4.6
(In months of imports of goods and services, excluding megaprojects)	6.9	6.8	7.0	5.6
Net international reserves (in millions of U.S. dollars)	624	738	960	900
Net international reserves (in percent of foreign currency deposits)	170	195	216	218
Net foreign assets of commercial banks (in millions of U.S. dollars)	341	306	259	290
Total short-term external debt to reserves (in percent)	8.4	7.6	4.9	7.3
Net present value of total external debt 2/	55.6	54.4	46.7	36.3
Of which: net present value of public sector external debt	21.8	25.2	25.2	21.0
Net present value of public external debt-to-exports of goods and services (in percent) 2/	91.7	102.0	83.8	83.6
External debt-service payments to exports of goods and services (in percent) 3/	6.4	6.1	4.5	5.1
Exchange rate (meticais per U.S. dollar, period average) 4/	23,180	23,341	22,123	...
REER depreciation (-) (12 month basis)	-6.3	-2.7	32.5	...

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

1/ Domestic public debt and private sector external debt are valued at par in the net present value calculation.

2/ Data as of last debt sustainability analysis.

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

4/ Official exchange rate.

Table 9. Mozambique: Millennium Development Goals, 1990-2003 1/

	1990	1994	1997	2000	2003
Goal 1: Eradicate extreme poverty and hunger					
Percentage share of income or consumption held by poorest 20 percent	...	...	6.5	...	...
National household survey poverty incidence 2/			*69.4*		54.1
Population below $1 a day (percent)	...	...	*37.8*	...	...
Population below minimum level of dietary energy consumption (percent)	...	...	58.0	...	*47.0*
Poverty gap ratio at $1 a day (incidence x depth of poverty)	...	...	*12.0*	...	...
Poverty headcount, national (percent of population)	...	...	69.4	...	...
Prevalence of underweight in children (under five years of age)	...	*27.0*	26.1	...	...
Goal 2: Achieve universal primary education					
Net primary enrollment ratio (percent of relevant age group)	44.7	...	*47.3*	54.1	*55.3*
Primary completion rate, total (percent of relevant age group)	28.0	25.0	29.0	38.0	52.0
Proportion of pupils starting grade 1 who reach grade 5	32.7	...	*41.8*	51.9	...
Youth literacy rate (percent ages 15-24)	48.8	53.5	57.0	60.6	*62.8*
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliament (percent)	16.0	...	25.0	*30.0*	30.0
Ratio of girls to boys in primary and secondary education (percent)	73.0	...	*73.2*	75.6	*79.0*
Ratio of young literate females to males (percent ages 15-24)	47.9	53.4	57.5	61.5	*64.3*
Share of women employed in the nonagricultural sector (percent)	15.2	...	...	...	...
Goal 4: Reduce child mortality					
Immunization, measles (percent of children ages 12-23 months)	59.0	65.0	61.0	71.0	77.0
Infant mortality rate (per 1,000 live births)	146.0	*129.0*	...	110.0	101.0
Under-5 mortality rate (per 1,000)	242.0	*206.0*	...	167.0	147.0
Goal 5: Improve maternal health					
Births attended by skilled health staff (percent of total)	...	...	44.2	...	48.0
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	1,000	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Contraceptive prevalence rate (percent of women ages 15-49)	...	...	5.6	...	17.0
Incidence of tuberculosis (per 100,000 people)	158.4	260.8	333.4	395.8	456.6
Number of children orphaned by HIV/AIDS	...	...	...	*330,000*	470,000
Prevalence of HIV, total (percent of population aged 15-49)	...	...	...	*12.1*	12.2
Tuberculosis cases detected under DOTS (percent)	...	*55.6*	47.7	45.1	45.1
Goal 7: Ensure environmental sustainability					
Access to an improved water source (percent of population)	...	...	...	...	*42.0*
Access to improved sanitation (percent of population)	...	...	...	...	*27.0*
Access to secure tenure (percent of population)	...	...	...	...	...
CO_2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1	...
Forest area (percent of total land area)	39.8	...	...	39.0	...
GDP per unit of energy use (2000 PPP $ per kg oil equivalent)	1.2	1.5	1.8	2.2	*2.3*
Nationally protected areas (percent of total land area)	...	...	...	...	8.4
Goal 8: Develop a global partnership for development					
Aid per capita (current US$)	70.8	77.8	57.0	49.6	55.0
Debt service (percent of exports)	...	...	...	...	...
Fixed line and mobile phone subscribers (per 1,000 people)	3.4	3.9	4.4	8.0	*18.6*
Internet users (per 1,000 people)	...	...	0.1	1.2	*2.8*
Personal computers (per 1,000 people)	...	...	1.9	3.5	*4.5*
Unemployment, youth female (percent of female labor force ages 15-24)	...	...	...	...	...
Unemployment, youth male (percent of male labor force ages 15-24)	...	...	...	...	...
Unemployment, youth total (percent of total labor force ages 15-24)	...	...	...	...	...
Other					
Fertility rate, total (births per woman)	6.3	*5.6*	5.3	...	5.0
Gross national income per capita, Atlas method (current US$)	170.0	130.0	180.0	210.0	210.0
Gross national income, Atlas method (current US$ billions)	2.3	2.0	2.9	3.7	3.9
Gross capital formation (percent of GDP)	22.1	25.3	20.6	36.6	27.9
Life expectancy at birth, total (years)	43.4	...	45.5	*43.1*	40.7
Literacy rate, adult total (percent of people ages 15 and above)	33.5	37.5	40.6	44.0	*46.5*
Population, total (millions)	14.2	15.4	16.6	17.7	18.8
Trade (percent of GDP)	44.2	61.6	42.2	51.8	62.1

Source: World Development Indicators database, April 2005.

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

2/ A household survey was conducted between 1996/1997 and 2002/2003 to determine poverty incidence. The methodology included a basket of goods that satisfies basic calorie needs. The cost of this basket represents the food poverty line in each domain; a nonfood poverty line was also obtained. Households are defined as poor if their daily per capita expenditure is less than the total poverty line (sum of food and nonfood poverty lines).

Table 10. Mozambique: Megaprojects, Summary 2002-10 1/
(In millions of US dollars; unless indicated otherwise)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Balance of Payments									
Trade balance									
Exports, goods and services	472	509	990	1,192	1,240	1,385	1,454	1,515	1,581
Imports, goods and services	-342	-246	-326	-466	-442	-422	-402	-450	-517
Capital account									
Foreign borrowing	202	60	0	0	0	0	0	0	0
FDI	393	235	26	120	84	11	0	0	0
Amortization	29	59	71	77	76	76	91	89	88
Interest	60	62	76	53	41	37	22	12	8
Dividends	0	110	113	115	118	120	122	125	127
Government Revenue									
Tax on salaries	1.0	4.3	3.6	3.6	4.0	5.0	4.9	4.8	4.9
Turnover/Corporate tax	1.8	3.7	4.3	7.9	9.8	10.2	10.2	10.4	10.8
Dividends	0.0	0.4	3.9	6.9	6.5	7.7	4.4	5.2	7.3
Real sector									
Turnover	629	632	915	1,084	1,086	1,076	1,088	1,088	1,114
Operating profit (before tax, after int. pay.)	20	-131	320	426	345	344	352	333	304
Total wages paid	17	30	48	55	64	68	68	68	68
Memorandum items:									
Exports, goods and services (in percent of total)	38.5	36.3	52.9	56.6	55.9	58.2	58.5	56.4	52.1
Of which : exports of goods (in percent of total goods)	45.0	42.1	62.3	67.2	66.9	69.2	71.5	67.0	59.9
Imports, goods and services (in percent of total)	15.8	10.4	12.0	14.3	12.9	10.9	10.2	10.7	11.2
Tax revenue (in percent of GDP)	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Tax revenue (in percent of revenues)	0.6	1.4	1.1	1.4	1.6	1.5	1.3	1.2	1.1

Sources: INE; and Ministry of Planning; and Bank of Mozambique (BM); and IMF staff estimates and projections.

1/ Preliminary data. Includes Mozal, Cahora Bassa dam, Moma and Sasol projects.

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
	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 Country Report No. 05/168 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 Prog.	Q2 Prog.	Q3 Prog.	Q3 Prog.	Year 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.

Mozambique: Relations with the Fund

(As of October 31, 2005)

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

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

SDR Department	SDR Million	% Allocation
Holdings	0.06	n.a.

Outstanding Purchases and Loans	SDR Million	% Quota
Poverty Reduction and Growth Facility (PRGF) arrangements	113.58	99.98

Latest Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	07/06/04	07/05/07	11.36	4.86
PRGF	06/28/99	06/28/03	87.20	78.80
ESAF	06/21/96	06/27/99	75.60	75.60

Projected Payments to Fund (without HIPC Assistance)

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	3.78	24.58	23.32	21.22	17.02
Charges/Interest	0.29	0.49	0.37	0.26	0.16
Total	4.07	25.07	23.69	21.48	17.18

Projected Payments to Fund; (with Board-approved HIPC Assistance)

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	1.50	14.17	16.17	17.94	16.57
Charges/Interest	0.29	0.49	0.37	0.26	0.16
Total	1.79	14.66	16.54	18.20	16.74

Implementation of HIPC Initiative:

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

Safeguards Assessment

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

Exchange Arrangements

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

Mozambique still avails itself of the transitional arrangements under Article XIV of the Fund Articles of Agreement, but has eliminated all Article XIV restrictions. It maintains, however, restrictions on the making of payments and transfers for current international transactions subject to Fund approval under Article VIII, as evidenced by (i) the discretionary prior approval for remittances of family living expenses; (ii) the authorization for the purchase of foreign exchange in excess of US$5,000 for certain transactions; (iii) the prohibition for the conversion of balances of nonresidents' domestic currency accounts into foreign currency or transfer abroad; and (iv) the need of proof of performance of a service prior to authorizing its payment. At the authorities' request, an Article VIII mission was conducted by LEG and PDR in March 2004. The mission encouraged the authorities to remove all existing the exchange restrictions. The authorities indicated their intention to accept their obligations under Article VIII sections 2,3, and 4 of the Fund's Articles of Agreement after the approval of the new foreign exchange law which is scheduled to be submitted to the assembly in 2005.

Article IV Consultation

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

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

FSAP Participation and ROSCs

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

Management Recent Visit

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

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	October 2005	Fourth multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	May 2005	Inspection mission	Public expenditure management	Ministry of Finance
	April-May 2005	Mid-term review of the joint IMF/SECO/DANIDA domestic tax and administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	November 2004	Inspection mission, and coordination with bilateral donors	Public expenditure management	Ministry of Finance
	October 2004	Joint IMF/SECO/ DANIDA project; short-term consultant training advisor (total 4 months in 3 visits)	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Third multipartite review of the joint IMF/SECO/ DANIDA tax and customs administration reform project; inspection mission	Reform of the tax system and its administration	Ministry of Finance
	September 2004	Joint IMF/SECO/ DANIDA project: short-term advisor (total 2 months in 4 visits)	Reform of the tax system and its administration; strategic issues on the establishment of the Central Revenue Authority (visit 1 of 4)	Ministry of Finance
	July 2004	Inspection mission	Public expenditure management	Ministry of Finance
	May 2004	Mid-term review of the joint IMF/SECO/DANIDA tax and customs administration reform project	Reform of the tax system and its administration; advice on the creation of a Central Revenue Authority.	Ministry of Finance
	March 2004	Installation mission and coordination with bilateral donors	Public expenditure Management	Ministry of Finance
	October 2003	Inspection mission and coordination with	Public expenditure Management	Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
		bilateral donors		
	September 2003	Joint IMF/SECO/DANIDA project; long-term consultant and training advisor mission	Reform of the tax system and its administration	Ministry of Finance
	April/May 2003	Mid-term review of the joint IMF/SECO/ DANIDA tax and customs administra-tion reform project	Reform of the tax system and its administration	Ministry of Finance
	April 2003	Inspection mission	Public expenditure management	Ministry of Finance
Legal	February 2004	Mission	Advising government on the implications of accepting the obligations under Article VIII section 2,3 and 4 of the Fund's Articles of Agreement	Ministry of Finance, Bank of Mozambique
	2004	Correspondence	Advice on tax legislation	Ministry of Finance
	July 2003	Mission	Stamp tax	Ministry of Finance
	June-July 2003	Mission	General Tax Code	Ministry of Finance
Monetary and Financial Systems	September 2005	Mission	Post- FSAP TA assessment Banking supervision Monetary operations/monetary policy	Bank of Mozambique
	October 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	September 2004	Short-term consultant	Monetary operations/monetary policy	Bank of Mozambique
	September 2004	Short-term consultant	Central Bank Accounting	Bank of Mozambique
	July 2004	Short-term consultant	Banking supervision	Bank of Mozambique and Ministry of Finance
	April 2004	By correspondence	Advice on foreign exchange operations	Bank of Mozambique
	April 2004	Short-term consultant	Banking supervision	Bank of Mozambique
	March - April 2004	Mission	Banking supervision, monetary and foreign exchange operations	Bank of Mozambique
	February-March 2004	Mission	Bank restructuring	Bank of Mozambique
	October 2003	Mission	Advising on accounting issues at the central bank	Bank of Mozambique and Ministry of Finance

IMF Technical Assistance Provided to Mozambique (Over the Last Two Years)				
Departments	Timing	Form	Purpose	Counterparts
	September 2003	Mission	Concluding FSAP and discussion of technical assistance in the area	Bank of Mozambique and Ministry of Finance
	Mar.-Apr. 2003	Joint mission IMF/World Bank	FSAP mission follow-up	Bank of Mozambique and Ministry of Finance
	February 2003	Joint mission IMF/World Bank	FSAP mission	Bank of Mozambique and Ministry of Finance
Statistics	June-July 2005	Mission	Consumer price statistics	National Institute of Statistics
	May 2005	Mission	ROSC Data Module Update	National Institute of Statistics
	October 2002-March 2004	Long-term consultant	National accounts statistics	National Institute of Statistics
	November 2004	Mission	Balance of payments statistics	Bank of Mozambique
	September 2004	Mission	Monetary and financial statistics	Bank of Mozambique
	May 2004	Mission	Balance of payment statistics	Bank of Mozambique
	May 2004	Mission	Consumer price statistics	National Institute of Statistics (INE)
	November 2003	Mission	GDDS mid-term review	National Institute of Statistics
	August 2003	Mission	Balance of payments statistics	Bank of Mozambique
	May 2003	Mission	Government finance statistics	Ministry of Finance

Resident Representative: Mr. Perry Perone has been IMF's Resident Representative to Mozambique since February 1, 2003.

Mozambique: Relations with the World Bank Group

(As of November 3, 2005)

Partnership in Mozambique's Development Strategy

1. The Mozambican government's development strategy is set forth in the poverty reduction strategy paper (PRSP), termed the PARPA (Plano de Acção para a Redução da Pobreza Absoluta e Promoção do Crescimento Económico, or Action Plan for the Reduction of Absolute Poverty), which was approved in April 2001 by the council of ministers and endorsed in September 2001 by the Boards of the World Bank and the IMF. The PARPA focuses on six "fundamental areas" aimed at promoting human development and creating an environment for broad-based growth: macroeconomic and financial management, good governance, education, health, agriculture, and basic infrastructure (roads, water, and energy). The overall perspective is that poverty can most quickly be reduced by pursuing a strategy of broad economic growth, which, in turn, is crucially dependent on the maintenance of democratic and sociopolitical stability. The government issued progress reports on the PARPA in 2003, 2004 and 2005, restating its commitment to reduce poverty by pursuing policies that help to create an environment for broad-based growth. In addition, the Program Assistance Partners, which include 16 donors and the World Bank, with the IMF as an observer, undertook reviews, jointly with the government, of the entire government program in May and in September 2005, using a common performance asssesment framework (PAF), in order to serve as the basis for a further shift from project finance toward budget support. It has harmonized and streamlined donor conditionality and is expected to reduce government transaction costs.

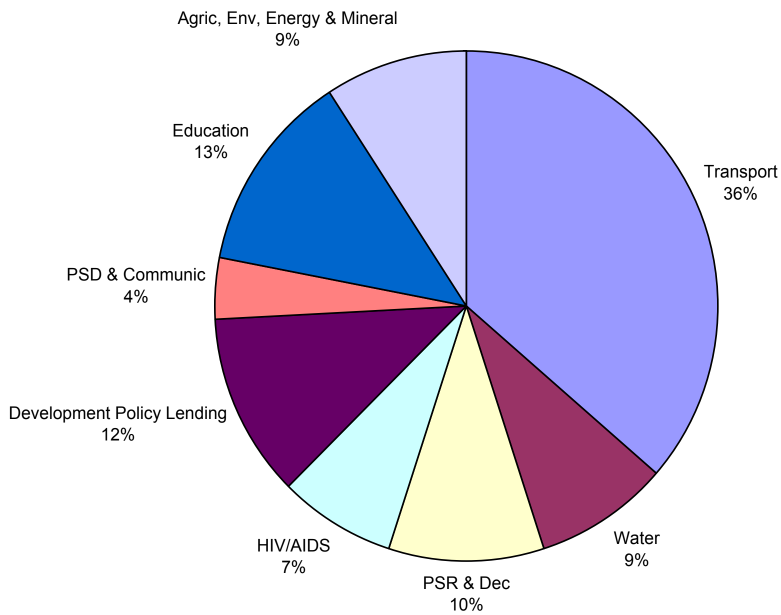
2. The Fund and the World Bank will continue to cooperate closely, within their respective mandates, in assisting the government to implement its medium-term poverty reduction and growth strategy and the related reform agenda, as presented in the PARPA and updated in the annual progress report and PAF.

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

Bank Group Country Assistance Strategy

4. The World Bank supports the implementation of the PARPA through its Country Assistance Strategy (CAS, FY04-07). The three pillars of the CAS are (i) improving the investment climate, (ii) expanding service delivery, and (iii) building capacity and accountability. The focus of the Bank's lending program is on programmatic support through three rolling Poverty Reduction Support Credits (PRSCs). Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic

lending through the PRSCs was underpinned by the Bank's core diagnostic economic and sector work, including the public expenditure review and PSIA. While a series of PRSCs is the largest single element in the lending program, the shift from traditional investment lending to program lending is being phased in gradually. Selected investment projects are targeting institutional strengthening, capacity building, transport infrastructure, water, agriculture, and communications.



5. To date, the World Bank Group has approved 7 adjustment operations, 2 development policy operations, one investment guarantee and 43 investment operations totaling approximately US$2.8 billion. The current portfolio includes 17 operations for a total of US$1 billion, with an undisbursed balance of US$574 million. Sixteen of these operations are investment projects and one is an adjustment operation. Four operations for a total of US$65.5 million are planned for approval by the Board in the current fiscal year in the financial, environment, legal and education sectors. The graph above illustrates the distribution of the current portfolio by main sectors.

6. The World Bank has been actively supporting the government of Mozambique's macroeconomic program since 1986 through a series of **structural adjustment operations**. The last, the Economic Management and Private Sector Operation (EMPSO), was approved by the Bank Board in August 2002 for US$120 million. The EMPSO supported the government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It included measures to make the budget more transparent (including accounting for external aid flows), conduct a public

expenditure review, strengthen the financial sector while aiming to eliminate government ownership in the sector, and liberalize the telecommunications and air transport sectors in order to facilitate further private participation. Since 2004, the Bank's quick-disbursing assistance has taken the form of development policy lending through PRSCs, which have been developed in tandem with the Joint Review/Performance Assessment Framework process referred to above. The first two PRSCs were presented to the Board in July 2004 and in September 2005; they were valued at US$60 million and US$120 million respectively.

7. The World Bank has been an active partner in supporting the government in improving **education** and strengthening capacity building in key public institutions. The Education Sector Strategic Program (US$71 million—FY99) supports the implementation of the National Education Strategy, whose objectives are the promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. This is complemented by the Public Sector Capacity Building Project (US$25.5 million—FY03), which aims to increase the capacity of the government's Technical Unit for the Reform of the Public Sector. The Higher Education Project (US$60 million—FY02) supports the entire higher education system, including both public and private institutions of higher education. A Technical and Vocational Education and Training project is currently under preparation.

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

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

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

11. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. The current Bank CAS has been prepared jointly with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). IDA currently has one operation, the Enterprise

Development Project (US$26 million—FY00, scheduled to close in FY06) which aims at broadening the base of private participation in the Mozambican economy. The Mineral Resource Management Capacity Building Project (US$18 million—FY01) seeks to increase institutional capacity in the sector, and alleviate poverty. The Communications Sector Reform Project (US$14.9 million—FY02) seeks to increase private sector participation in the postal, air transport, and telecommunications sectors.

12. As regards **public sector reform**, the Public Sector Project (US25.6 million—FY03) seeks to upgrade the quality of public services, reduce red tape, and improve access to public services. The Municipal Development Project (US$33.6 million—FY01) aims to strengthen the institutional capacity of municipal government and pilot a municipal grant mechanism to finance investment. Finally, the Decentralized Planning Financing Project (US$42 million—FY04) supports improvements to the institutional capacity of district administrations.

13. The Bank is also involved in **agriculture**, **energy, and the environment.** The Agricultural Sector Public Expenditure Program (US$30 million—FY99), which will close at the end of 2005, is a sectorwide assistance program (SWAP) that seeks to improve the impact of public expenditure in developing an enabling environment for sustainable and equitable growth in the rural sector. The Gas Engineering Project (US$26 million—FY94), which closed in 2003, supported pre-investment in the Pande-Gas Project and provided capacity building to the government for negotiation of megaprojects. This operation supported capacity and technical assistance for negotiation and implementation of the Southern Africa Gas project, a pipeline financed by SASOL of South Africa with equity participation if IFC and guarantee coverage of MIGA (US$30 million—FY04. The Energy Reform and Access Project (US$40.2 million—FY04), which supports reform of the power sector, in particular the separation of distribution, transmission, and generation functions, aims at increasing the number of electricity connections and solar energy distributors and seeks to provide. The World Bank Group is also supporting sustainable use of natural resources with two operations in environment: the Coastal and Marine Biodiversity Management Project (US$9.7 million—FY00), which pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas, and the second credit of a Transfrontier Conservation Areas and Tourism project (to be approved in December 2005 for US$20 million plus US$10 million in a Global Environment Facility grant).

14. The Bank's **proposed lending program** for FY06 comprises a Financial Sector Capacity Technical Assistance Project of US$10.5 million, which builds on recommendations of the Financial Sector Assessment conducted with the IMF in FY04. A Transfrontier Conservation Areas and Tourism Project of US$20 million, a Legal Sector Capacity Project of US$5 million, a technical and Vocational Education and Training grant of US$20 million, and Market-led Smallholder Development project of US$30 million.

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

- Improving the Investment Climate. Economic and sector work completed over the past two fiscal years included a strategy for rural growth and income creation and a country economic memorandum on sustainable growth and poverty reduction, which also analyzed the sources of growth. Technical assistance is currently being provided in procurement reform, mining and on commercial debt reduction. A PSIA on labor market and a PSIA on land are planned for preparation in FY06-FY07, together with a study on regional growth poles.

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

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

IMF-World Bank Collaboration in Specific Areas

16. Fund and Bank staff maintain a close working relationship, especially with respect to (i) analyses and reforms in public expenditure management; (ii) the PARPA and accompanying annual updates and joint staff assessments; (iii) the financial sector and banking supervision; (iv) PSIA; (v) tax issues; and (vi) trade issues:

- **Public expenditure management**. The Fund and the Bank jointly emphasize the urgent need to further improve public expenditure management, accountability, and transparency. The two institutions support policy reforms in the areas of budget formulation, execution, and monitoring. The IMF assists the authorities in introducing the integrated financial management information system (SISTAFE), and several donors, including the World Bank, provide financial support and policy advice for this reform. Under the Fund’s leadership, a group of 10 donors set up a common fund for this large undertaking. The Bank’s PRSC emphasizes budget comprehensiveness and budget execution reporting. The Bank and the government have worked together since September 2000 on a public expenditure review, the first volume of which was issued in December 2001 and the second in September 2003.

- **Poverty reduction strategy paper.** The Fund and Bank worked together with the government during 1999-2001, while the PARPA was being produced, and drafted the joint staff review, which was presented to the Board in September 2001. The government issued annual progress reports in 2003, 2004 and 2005 and the staff presented their joint staff assessments to their respective Boards. The Fund and the Bank will continue to work jointly with the authorities as they prepare the successor program, the PARPA II.

- **Financial sector.** The Fund and the Bank have worked together on the financial sector. The banking sector in Mozambique has repeatedly shown weaknesses in the past, requiring recapitalizations and intervention. Following the FSAP conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision and accounting standards to prevent the recurrence of such problems in the future. A technical assistance program is under preparation.

- **PSIA.** As part of the preparation for future Bank budget support and a possible successor program supported by a new Poverty Reduction and Growth Facility (PRGF) arrangement, the Fund and the Bank have agreed to review closely the poverty and social impact of the key reforms that are being implemented. A pilot PSIA, advising the government on the impact of an increase in specific fuel taxes, was undertaken in 2002. A second PSIA, on the impact of reducing primary schooling fees, was completed in October 2004. A third PSIA will be undertaken during FY06 with a focus on Land, and a fourth one in FY07 on Labor Market.

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

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

17. Between 2005 and 2007, disbursements under World Bank investment projects are expected to reach around US$125 million on average a year.

World Bank Loan and Grant Operations, 1999-2005 [1]
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005
	Actual					Est.	Est.
I. Project Credit Disbursements	79.4	97.5	51.6	85.2	89.4	140.6	169.8
Established operations							
Household Energy (6/89) [2/]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89)[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education II (12/90)[2/] 2/	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89)[2]	7.6	2.0	0.0	0.0	0.0	0.0	0.0
Agricultural Service Rehabilitation Development (2/92)[2]	2.5	0.7	0.0	0.0	0.0	0.0	0.0
First Road and Coastal Shipping (6/92)[2]	12.5	4.0	0.0	0.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	11.3	4.5	2.8	0.0	0.0	0.0	0.0
Capacity Building: Public Sector & Legal Institutional Development (11/92)	0.9	0.7	0.0	0.0	0.0	0.0	0.0
Maputo Corridor (1/93)[2]	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Rural Rehab.(3/93)[2]	3.8	2.0	0.3	0.0	0.0	0.0	0.0
Food Security (4/93)[2]	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Local Government (6/93)[2]	3.1	0.0	0.0	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94)[2]	16.9	26.5	11.4	9.7	17.5	0.0	0.0
Financial Sector Capacity Building (4/94)[2]	2.0	1.4	0.3	0.0	0.0	0.0	0.0
Gas Engineering (6/94)[2/] 2/	1.5	1.1	1.6	1.8	0.4	0.0	0.0
Health Sector Recovery (11/95)[2]	12.0	17.2	17.4	14.4	5.6	0.0	0.0
National Water I (2/98)	1.3	1.7	2.4	3.9	4.5	7.5	7.70
Agricultural Sec. PEP (2/99)	0.5	0.9	4.2	3.8	3.9	3.9	3.8
General Education (2/99)	1.0	0.5	1.2	6.9	14.7	19	159
Railway and Port Restructuring (10/99)	0.0	1.9	3.6	22.3	8.2	22.6	10
National Water II (6/99)	0.0	1.4	2.8	4.4	5.1	9.1	22.7
Enterprise Development (01/00)	0.0	2.3	3.0	2.9	3.4	4.5	4.6
Flood Emergency Recovery (4/00)	0.0	28.7	-0.2	0.0	0.0	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.0	0.3	0.4	0.3	3.7	1.6
Newest operations							
Municipal Development (7/01)	0.0	0.0	0.3	4.3	4.6	3.6	6.4
Roads and Bridges I (7/01)	0.0	0.0	0.0	4.3	0.5	39.1	44.6
Communications (11/01)	0.0	0.0	0.0	1.2	2.8	1.8	2.0
Mineral Resources Project (3/01)	0.0	0.0	0.2	1.4	4.1	5.5	3.2
Higher Education Project 1 (3/02)	0.0	0.0	0.0	3.4	9.2	10.0	14.2
HIV/AIDS (3/03)	0.0	0.0	0.0	0.0	2.7	2.3	10
Public Sector Reform (3/03)	0.0	0.0	0.0	0.0	1.2	1.5	1.5
Energy Reform and Access Project (8/03)	0.0	0.0	0.0	0.0	0.0	1.6	5.4
Decentralization Planning (11/03)	...	...	...	...	...	4.9	4.5
Beira Railway (10/04)						0	7.5
Treatment Acceleration Program (6/04)						0	4.3
II. Adjustment operations	150.0	0.0	0.0	63.5	70.7	60.0	60
Economic Management Reform Operation (12/98)[2 3]	150.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation	0.0	0.0	0.0	63.5	70.7	0.0	0.0
PRSC 1 (06/04)	...	...	...	...	...	60.0	...
PRSC 2	...	...	...	...	...	...	60

Source: World Bank

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

Mozambique: Statistical Issues

1. An STA mission visited Maputo in May 2005 to update the Data Module of the Report on the Observance of Standards and Codes (ROSC) prepared in June 2002. The mission noted that significant efforts have been made to address the shortcomings identified by the 2002 ROSC mission, a clear indication of the increased awareness at all levels of the importance of compiling and disseminating statistics that follow international standards and good practices. The improvements in the institutional environment and the increased allocation of resources for the compilation of national accounts, balance of payments, and more recently, government finance statistics address important weaknesses in the prerequisites for the quality of the statistics. The methodological soundness, accuracy, and reliability of the macroeconomic statistics are starting to show improvements as a result of these actions.

2. However, the overall quality of macroeconomic statistics still hinders policy formulation and monitoring of economic development. Moreover, despite the increase in budget resources allocated to the compilation of official statistics, continued high reliance on external funding raises concerns about the sustainability of the National Institute of Statistics (NIS) programs.

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

National accounts

4. The national accounts are prepared by the NIS. Since 1991, revised series have been compiled in accordance with the *1993 System of National Accounts* (*1993 SNA*). The NIS compiles and disseminates (i) annual GDP at current and constant (1996) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; and (iii) annual value added components at current prices by activity. Work is well underway to compile the new benchmark year (2003) with new and improved data sources and methodology. The NIS launched a new household income and expenditure survey and new economic censuses leading to a new business registry. Furthermore, the NIS is compiling more comprehensive and timely foreign trade data based on improved classification systems. The new national accounts framework will also include compilation of quarterly estimates expected to start being disseminated by September 2006. The STA real sector advisor to the Lusophone African Countries has been stationed in Maputo since October 2002.

Prices and labor market

5. The consumer price index (CPI) for Maputo is based on weights derived from the 1996-97 household survey. Consistent time series have been available since 1998. However, the outdated weights and their concentration on a few basic food staples with relatively volatile prices compromise the CPI's representativeness and make it prone to significant swings. A preliminary national index obtained by integrating the indices for Maputo, Beira, and Nampula has been published. The NIS is preparing an updated CPI,

based on the results of the Household Budget Survey 2002/03, which it plans to disseminate in February 2006. The IMF is providing technical assistance in price statistics in the context of the GDDS Regional Project for Lusophone African Countries.

6. There are very little sectoral labor market and employment data, and, where available, they have limited coverage. A one-year labor market survey was launched in October 2004 covering all the country; and NIS expects to have the first data by end-2005. This survey was undertaken by NIS in collaboration with the Labor Ministry.

Monetary accounts

7. An STA mission that visited Mozambique in September 2004 prepared a work plan for the implementation of the *Monetary and Financial Statistics Manual* (*MFSM*) and the development of an integrated database to meet the needs of the Bank of Mozambique, AFR, and STA. The mission noted the progress achieved in the information technology system, and in the periodicity and timeliness of the data compiled. However, the mission found that the chart of accounts of the Bank of Mozambique was inadequate to obtain a proper sectorization of the institutional units and it did not distinguish between local and foreign-currency-denominated accounts. The mission recommended improving the classification and valuation of some financial instruments, and expanding the coverage of the survey on other depository corporations by including the credit cooperatives. The new standardized forms for reporting monetary statistics to STA were derived during the mission stay and are now being tested to replace the existing forms. The analytical framework for compiling monetary statistics has been aligned with internationally accepted practices and the data are derived exclusively from accounting records.

External sector statistics

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

9. The BM has now an adequate institutional framework for the compilation of BOP statistics and the IIP, and has implemented many of the recommendations made by the four technical assistance missions that have taken place since mid-2003. The allocation of substantial additional resources to the compilation of balance of payments statistics, including the establishment of a specialized unit within the Research Department of the BOM and an interagency Working Group on External Trade Statistics, has led to improvements in trade data and the quality of the source data for balance of payments statistics. The gradual improvements in the response rate of the BOP surveys are paving the way for setting a solid basis for this important source of information. Moreover, the improvement program that Customs undertook following the May 2004 mission recommendations is contributing to enhance the coverage and timeliness of trade data.

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

Mozambique: Table of Common Indicators Required for Surveillance

(As of November 15, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	Nov. 2005	Nov. 2005	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]							
Reserve/Base Money	Oct. 2005	Nov. 2005	M	M	M	LO, O, LO, O	LO, LO, O, O, LO
Broad Money	Oct. 2005	Nov. 2005	M	M	M		
Central Bank Balance Sheet	Oct. 2005	Nov. 2004	M	M	M		
Consolidated Balance Sheet of the Banking System	Oct. 2005	Nov. 2005					
Interest Rates[2]	Nov. 2005	Nov. 2005	M	M	M		
Consumer Price Index	Jul. 2005	Sep. 2005	M	M	M	O, LO, LNO, O	LNO, LO, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]						LO, LNO, LO, O	LO, O, LO, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government							
Stocks of Central Government and Central Government-Guaranteed Debt[5]							
External Current Account Balance	Sept. 2005	Nov. 2005	Q	I	I	LO, LNO, LO, O	LO, LNO, LO, LO, LNO
Exports and Imports of Goods and Services							
GDP/GNP	Dec. 2004	Apr. 2005	A	I	I	O, LO, O, LO	LNO, LO, LO, O, LO
Gross External Debt							

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

Statement by the IMF Staff Representative on the Republic of Mozambique
December 19, 2005

The following information has become available since the issuance of the staff report for the third review of the three-year arrangement under the Poverty Reduction and Growth Facility. The thrust of the staff appraisal remains unchanged.

1. **Prior action.** The information system of the Bank of Mozambique (STF) was upgraded on November 17, 2005 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.

2. **Other measures under the program.** Based on preliminary information, the following measures have been implemented: (i) the e-SISTAFE was rolled-out to the Ministry of Education along with the abolishment of disbursement of funds (Structural Benchmark for end-December); (ii) the parliament passed on December 7th the final reading of a bill to create a new national Tax Authority and the law to create the Central Revenue Authority; and (iii) the Bank of Mozambique (BM) implemented the link of the monetary data to the balance sheet.

3. **Inflation.** Reflecting an increase in domestic petroleum prices of about 20 percent in October and 8 percent in November as well as the prices of some imported food items, inflation between December 2004 and November 2005 reached 8 percent (and an annual average of 6.5 percent).

4. **Fiscal.** Based on preliminary information, the fiscal stance continued to be broadly in line with the program at end-September 2005. Revenues were slightly below program while current expenditure was lower resulting in a smaller domestic primary deficit.

5. **Foreign exchange system**. While the exchange rate has been relatively stable during April-October 2005, the metical depreciated by nearly 15 percent in November on account of a sharp increase in foreign exchange demand related to a few large oil import transactions. To avoid such erratic fluctuations, and given the thinness of the foreign exchange market, the Bank of Mozambique (BM) in November modified the foreign exchange system, including the implementation of a temporary exchange rate band which is centered on the previous day's average exchange rate. This temporary band will be gradually widened until it becomes non-binding. The authorities have reiterated their commitment to a flexible exchange rate regime.

6. **Currency reform.** The National Assembly approved on November 24, 2005 the Government's proposed law to reform the currency by introducing new metical bank notes that would be equivalent to 1,000 of the current metical.

7. **Cahora Bassa dam**. The Government of Portugal and Mozambique signed a memorandum of understanding on November 2, 2005, on the transfer of the Cahora Bassa dam operating company's, Hidroelétrica de Cahora Bassa (HCB), ownership from majority Portuguese to majority Mozambican ownership. The main element of the memorandum is an

agreement that a repayment of US$950 million will clear all HCB's outstanding debt to Portugal (approximately US$2.3 billion), and increase Mozambique's ownership in HCB from 18 percent to 85 percent. The memorandum indicates that, of the US$950 million, US$250 million will need to be paid in two installments in 2006 and the remaining US$700 million 12-18 months after the signing of the final Minutes of Negotiation. The World Bank, on the basis of the preliminary information, is of the view that a viable financing plan for the HCB debt repayment appears to be feasible, one which, through non-recourse financing, does not increase the Government's liabilities to commercial creditors. The government of Mozambique is committed to ensure (i) the transparency of the process and the final financing package, (ii) that HCB is managed in a commercially efficient manner and will be audited by external auditors, and (iii) that HCB would be subject to the regular concession and tax regimes.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
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IMF Executive Board Completes Third Review Under the Three-Year PRGF Arrangement for Mozambique and Approves US$2.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Mozambique's economic performance under an SDR 11.4 million (about US$16.4 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 04/153).

The completion of the review enables the release of an amount equivalent to SDR 1.6 million (about US$2.3 million), which will bring total disbursements under the PRGF arrangement to an amount equivalent to SDR 6.5 million (about US$9.4 million).

The Executive Board also agreed to a modification of the performance criteria on net international reserves and net domestic assets for end-December 2005, mainly to reflect higher-than expected grain imports triggered by ongoing drought affecting part of the country.

Following the Executive Board's discussion on Mozambique's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

“The Mozambique economy continued to perform well in 2005 despite the spike in petroleum prices and the impact of the drought. However, the drought has left about 800,000 people in need of food aid until the next crop season starting in March 2006—an area of great concern. The authorities are to be commended on their improved program performance, which has helped maintain macroeconomic stability and contributed to robust economic growth. The good fiscal performance is especially noteworthy.

“Looking ahead, the main challenge will be to maintain high and broad-based economic growth and make further progress in alleviating poverty. This will require persevering with the stabilization effort, improving the investment climate, and pursuing a gradual fiscal consolidation through enhanced domestic revenue collection and a reform of expenditure management.

“Under the 2006 fiscal framework, the revenue effort is to be supported by the establishment of a Central Revenue Authority. Recurrent spending is to be contained in order to ensure that priority spending, especially in the social sector and on infrastructure, can be maintained. Furthermore, the authorities will aim to ensure that inflows of foreign aid are allocated to the most economically and socially productive purposes. The recent agreement transferring majority ownership of the Cahora Bassa dam operating company to Mozambique, which is to be welcomed, provides the authorities with the opportunity to pursue further the infrastructure development of the country that is needed to reduce poverty.

“The authorities’ commitment to strengthen public expenditure management and improve the quality of government spending is commendable. At the same time, there is a need to reinvigorate public sector reform, and implement fiscal decentralization in a manner that leads to enhanced accountability and better service delivery, while avoiding wasteful spending. Administrative capacity and financial reporting at the district level require further strengthening. The donor community is encouraged to help bring off-budget donor-funded projects on-budget.

“The Bank of Mozambique is encouraged to continue to target reserve money to control inflation, and pursue a flexible exchange rate regime to cushion against exogenous shocks. Introduction of consolidated supervision and international financial reporting standards should strengthen the banking system and deepen access to credit. The currency reform scheduled for 2006 should be well sequenced and accompanied by an information campaign covering the entire country.

“To improve governance and reduce the costs of doing business, the authorities will work on a revised anti-corruption strategy and new procurement, labor market, and commercial legislation.

“The authorities’ medium term framework provides a firm basis for the new Plano de Acção para Redução da Pobreza Absoluta (Action Plan for the Reduction of Absolute Poverty--PARPA) for 2006–09. Prudent macroeconomic policies, the launching of a second wave of reforms, and continued donor assistance should help Mozambique move toward achievement of the Millennium Development Goals,” Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Peter J. Ngumbullu, Executive Director for Republic of Mozambique and Joseph Tekman Kanu, Advisor to Executive Director
December 19, 2005

1. The Mozambican authorities have exhibited strong commitment towards consolidation of macroeconomic stability and the achievement of sustained economic growth and poverty reduction through the implementation of prudent macroeconomic policies and structural reforms. Macroeconomic performance in 2005 remains strong. Real GDP growth is expected to remain at 7.5 percent and inflation will continue its downward trend inspite of the sustained increase in international oil prices. In addition, international reserves are at comfortable levels, a clear manifestation of increased donor and private capital inflows. Program performance continues to be satisfactory, with all quantitative and structural performance criteria through end-September being met. The Mozambican authorities are in broad agreement with the thrust of the staff report.

Recent Developments under the PRGF Program

2. The effects of the severe drought in the last crop season has resulted in higher demand for grain imports until the next harvest. However, inspite of the sharp increase in domestic oil prices between January and September 2005, the program target for reducing annual average inflation to 6.5 percent has been met. Fiscal policy remains strong given the restraint in expenditures and that the wage bill is within the ceiling for end-June 2005. As a result the domestic primary deficit will be lower than programmed. Considerable progress has been made in reforming revenue administration and widening the tax base, including a number of other new measures that have been introduced to strengthen revenue generation. The strengthened revenue collection effort is yielding positive results and the program target will be met. In addition, the final reading on the bill establishing the Central Revenue Authority has been passed by parliament, while the draft general tax law will be approved by end-December 2005.

3. In the area of public expenditure management, budgetary operations are being conducted through a new system, the e-SISTAFE, through the use of budget classifiers. Efforts are on-going to integrate the single account of the treasury into the e-SISTAFE, and develop updated software. This is expected to allow for direct budget execution in preparation for the full roll-out of the system in the core areas of accounting, budget and treasury in the Ministry of Finance. In addition, integration of the off-budget project expenditures into the e-SISTAFE have been met. The information system of the BM is now well upgraded and as such allows recording of all transactions to and from the government accounts in the commercial banks to beneficiaries on timely basis.

4. The central bank's intervention in the foreign exchange market has been geared towards achieving its NIR target, and to smoothen fluctuations in the exchange rate. The increase in foreign exchange sales by the Bank of Mozambique (BM) has stabilized market conditions, thus resulting in the reversal of the real effective appreciation of the meticais. Higher foreign deposits and loans acquired in foreign currency and also in meticais, have in part, resulted to an increase in broad money and credit growth. Treasury bill rates remain

stable while prudential ratios of the banking system remain sound. Implementation of the timetable to adopt International Financial Reporting Standards (IFRS) in the system is on track, thereby assisting the authorities effort to strengthen loan classification and provisioning in line with international standards.

5. The Mozambican authorities are cognizant of the major challenges currently facing the economy, especially with regards to sustaining high broad-based growth and reduction of poverty. They are committed to ensuring prudent management of the large inflows of foreign aid to ensure economic benefits without creating instability. Such aid will be directed towards the most economically and socially viable productive sectors. The authorities' macroeconomic policy framework for the remainder of 2005 remains consistent with the medium-term goal of sustaining poverty reduction through high economic growth. They continue to exhibit strong commitment towards implementation of measures to strengthen the transparency and monitoring of budget execution.

6. The authorities will continue to improve the coherency of fiscal, monetary and exchange rate policies, as well as reinvigorate and accelerate the structural reform agenda. Given this development, they will continue to enhance the existing multi-disciplinary committee with a view to strengthen program monitoring, especially through coordination of both the central bank (BM) and Ministry of Finance (MOF), and further strengthening of administrative capacity. The fiscal program for the remainder of 2005 will therefore remain unchanged. In view of the improved performance in the second and third quarters of the year and the strong implementation of structural measures to strengthen revenue administration, domestic revenue out-turn is expected to be in line with program objectives. The authorities are determined to achieve the end-2005 quantitative targets. Given this, they will continue to implement revenue enhancing policies, exercise control on expenditures, in addition to ensuring proper vigilance by the central bank on monetary policy.

Projected Program Outcome for 2006

7. In continuing with the on-going fiscal consolidation, the domestic primary deficit will narrow by 1 percent in 2006, while the overall fiscal deficit is projected to narrow further. In this regard, prospects for the period include pursuit of continued broad-based and strong economic growth, further reduction in inflation and maintenance of a sustainable fiscal and external position. To achieve these, base money growth will be limited to 15 percent of nominal GDP growth. In order to forestall against exogenous shocks, the exchange rate will be market determined, while the NIR is expected to increase beyond four months of imports cover.

8. There are prospects for enhanced improvement in government finances. The authorities will continue to intensify efforts to improve public expenditure management through implementation of the e-SISTAFE. They will, in addition, also implement a fiscal decentralization strategy. This will take due regard to sequencing, especially the need to buttress local administrative capacity and financial reporting and auditing. Therefore, resource allocation to each district through the 2006 budget will be closely monitored. Although the budget permits an increase in expenditures of 0.9 percent of GDP, it is,

however, contingent on higher revenues being realized and on the implementation of the MDRI. As a result, and in order to match the subsequent increase in expenditures, more emphasis will be directed at modernizing the tax apparatus through the revenue authority (ATM) that has been approved by parliament, strengthen audit inspection and enforcement procedures, including human resource management; upgrade the taxpayer information system and improve services, among others. Additional measures will be taken also to improve revenue generation through improvements in administration, broadening of the tax base and increase collection of tax arrears to about 0.6 percent of GDP.

9. As regards monetary policy, the authorities will continue to target base money while ensuring that interest rates continue to be market determined. Repurchase operations will serve as the main instrument for fine-tuning liquidity. In addition, there will be further improvements in the liquidity management framework and efforts will be directed at fostering financial market development. Broad money is projected to expand by 16 percent while bank credit to the private sector is expected to increase by 11.3 percent. With technical assistance from the Fund and other development partners, the interest rate cap on treasury bill auctions will be gradually lifted and a master repurchase agreement is expected to be finalized by end-June 2006. This will support the monetary targeting framework and avoid excessive interest rate volatility. Furthermore, a domestic debt strategy for monetary policy and market development will be developed by the authorities, while ensuring pursuit of a deepened market for trading in short-term government debt instruments.

10. In order to promote transparency, the authorities expect to adopt and define by end-December 2006, a long-term strategy that will identify targets for implementation in the medium and long term. This will be the new format for the monetary policy committee, including specification of its communication policy. More effort will be directed at strengthening and modernizing the supervisory and accounting functions of the central bank. The new inspection manuals will be approved by end-March 2006, and the new organizational structure of the banking supervision department will be implemented. In addition, the amendment of the Charter of Accounts is expected to be completed by end-March 2006.

11. On exchange rate, the authorities will be submitting revisions to the foreign exchange law to the National Assembly for approval. This will help to clarify improvements on existing legislation. In view of this, the authorities will accept obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement, and also will continue to exhibit strong commitment in support of expansion of the financial sector and strengthen financial intermediation in the economy, promote financial stability and deepen access to credit through consolidated supervision and integrated financial reporting standards (IFRS).

12. The social security and supplementary pension systems will be strengthened through introduction of a new law on social security protection that is currently on-going. They will expedite the restructuring of the National Social Security Fund (INSS) in order to improve operations, investment performance and governance. Further efforts will be directed at enhancing the regulatory and supervisory framework for supplementary pensions and the INSS in connection with the insurance sector. This will include strengthening of the capacity of the Inspecção Geral de Seguros (IGS), the primary regulator of industry.

13. With technical assistance from the World Bank and the donor community, the authorities are in the process of completing a commercial debt buy-back scheme by end-2005. They intend also to intensify discussions with Paris Club and non-Paris Club creditors to reach debt relief agreements as soon as possible.

14. The authorities will continue to implement prudent reforms in the areas of governance, the public sector and the judicial sector. They will continue with the restructuring and encourage private participation in public enterprises, especially in infrastructure. In addition, a decree on the use of urban land will be approved in order to reduce transaction costs and improve efficiency in doing business by end-June 2006.

Medium-Term Outlook

15. The authorities Five-Year plan clearly outlines the major priorities for poverty reduction through implementation of macroeconomic policies that ensure stability, increased levels of private sector investment and sustainable growth. The current report on the implementation of the PARPA clearly shows that some of the MDGs are within reach while others will require additional assistance from the international community to meet the intended targets. The authorities will ensure that more effort is directed towards this goal, in addition to provision of the requisite environment for investment opportunities.

16. More focus will be geared towards promoting export-led private sector growth and enhance fiscal and external viability. The fiscal position will be consolidated to ensure increased credit to the private sector while trying to maintain a competitive foreign exchange rate. The authorities will continue to promote priority expenditures in the PARPA to enable them contribute positively to achieving the MDGs.

17. On the structural front, efforts will include the launching of a second generation of reforms that will focus on increasing tax collection, strengthen public expenditure management and fiscal transparency, implementation of an agricultural and rural development strategy, reduction in transaction costs for initiating business activity and reform of the judicial sector and ensure a strengthened financial system. Emphasis will be placed on promoting human capital formation, infrastructure investments, as well as maximization of the net contribution of natural resources and the economy's mega-projects. In view of this, the authorities will commit additional effort in order to strengthen transparency in the management of natural resources and their exploitation, while ensuring that more benefits are being derived from the activities of such projects. To achieve this, a new unit will be created and located in the Ministry of Finance in order to monitor such activities. This is also expected to assist in the promotion of overall fiscal transparency.

Conclusion

18. Development within the Mozambican economy continues to be favorable. The authorities have also expressed strong commitment towards program implementation, especially on the underlying macroeconomic policy framework consistent with the PARPA objectives. In view of this, the authorities request completion of the third review under the

PRGF arrangement, including modifications to the NIR and NDA performance criteria for end-December 2005, to take into consideration the impact of the drought which has necessitated the country's increased food imports. In support of its objectives and policies, the authorities are also requesting disbursement of the fourth loan under the PRGF arrangement.