International Monetary Fund

Republic of Mozambique and the IMF

Press Release: IMF Completes Second Review Under the Policy Support Instrument (PSI) for Mozambique
May 29, 2008

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

March 31, 2008

The following item is a Letter of Intent of the government of Republic of Mozambique, which describes the policies that Republic of Mozambique intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Republic of Mozambique, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Strauss-Kahn:

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

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

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

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

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

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

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

Sincerely yours,
Manuel Chang
Minister of Finance

Ernesto Gouveia Gove
Governor
Bank of Mozambique

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


March 31, 2008

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

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

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

3. In response to the floods and a cyclone, which affected part of Mozambique in early 2008, the Government, with foreign aid, is assisting the affected population. Over 100,000 people had to be moved to resettlement centers and measures were taken to contain a cholera pandemic. The UN has launched a funding appeal to the donor community to cover the reconstruction plans. The Government may consider using the program adjustor to accommodate emergency fiscal outlays (up to a maximum of about MT500 million) in the event that donor financing is inadequate. In early February, a large increase in negotiated transportation fares for private minibuses resulted in riots in a number of cities. The Government revoked the increase and agreed to temporarily subsidize fuel for minibus operators (at a cost of 0.15 percent of GDP).
4. The Bank of Mozambique (BM) has continued to strengthen its monetary and exchange rate policy and operations. Interest rates on government securities and the exchange rate have continued to be market determined. The spread between exchange rates quoted on the interbank market and by banks nevertheless remained stable at around 1 percent, while the real effective exchange rate has appreciated by about 6.5 percent, in line with fundamentals and increased private inflow of capital.

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

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

7. In the area of tax policy, Parliament approved a new income (personal and corporate) and value added tax (VAT) codes in December 2007. The new VAT-code eliminates VAT exemptions on industrial and commercial rents for industrial purposes, introduces partial exemptions for public works such as roads, bridges and dams as a transitory solution, while maintaining exemptions for the sugar, vegetable oil and soap industries until 2010. A
simplified personal and corporate income tax code introduced a withholding tax of 10 percent for interests on deposits and securities traded at the stock exchange. In addition, the laws on Municipal Finances and Property, as well as on Inheritance and Donations were approved in November 2007. Following the approval by Parliament in June 2007 of the mining and petroleum fiscal regime laws, the Government approved their implementing regulations in February 2008. A first draft law updating excises taxes on alcoholic beverages, beer and tobacco was submitted to the Council of Ministers in February 2008. A revised and more comprehensive version will be submitted to the Council of Ministers and subsequently to Parliament in end-May 2008 (structural AC for February 2008).

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

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

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

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

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

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

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

- In order to maximize the benefits from e-Sistafe, by the end of 2007, three donors started new pilots to bring externally financed projects into the domestic and foreign currency single treasury accounts and first results are expected by September 2008.
• A BC on Asset Management was approved internally by Government at end-2007, and due to lack of financing, including from the international community, the tender for the implementation of the asset management system and procurement interface to e-SISTAFE envisaged for December 2007, has not been launched yet.

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

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

11. Efforts continued to identify measures to reduce the cost of financing and to deepen financial markets. In late January, the BM presented the conclusions of a banking survey on the causes of higher than SADC average intermediation costs—in particular high fees and large interest rate spreads—and consequently the low intermediation. A working group consisting of commercial banks has been mandated to identify measures to make finance more affordable and the banking sector more competitive. The BM will closely monitor the progress made by the working group.
12. The BM has continued to strengthen the regulatory and supervisory framework in order to comply with Basel I principles. In the financial sector, 11 out of 12 banks and 4 of 5 cooperatives are compliant with the improved prudential regulations (representing 88 percent of all deposit taking financial institutions). The implementation of IFRS in the banking sector is proceeding well. New regulations on the assessment, classification and provisioning of credits in line with IFRS were approved in 2007. A new chart of accounts has been prepared, and the central bank is working with the commercial banks to facilitate the publication of IFRS compliant accounts in 2008.

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

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

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

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

14. In some areas of the judicial reform, progress was slower than envisaged. Submission to the Council of Ministers of the draft Integrated Strategic Plan of the Justice Sector—key for mobilizing financial support from donors—and the draft law revising principles and regulation of Institute for the Provision of Judicial Assistance (Instituto de Patrocínio e Assistência Jurídica—IPAJ)—both envisaged for December 2007—is still pending.
Consistent with the approved Organic Law on Judiciary Courts and in view of relieving the Supreme Court’s work program, preparations are under way for the first of three planned appeal courts. In 2007, for the first time the Government is employing judicial administrators to bring the judiciary closer to the public. Progress was achieved in 2007 in reducing the courts’ large backlog of cases with 24 percent more cases closed compared to 2006—or substantially more compared to the targeted improvement of 15 percent.

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

- In December 2007, the Council of Ministers approved the main outline for the public wage policy reform recognizing the need for fiscal sustainability.

- The TA and the IGF improved public sector accountability in 2007, compared with 2006, by increasing the number of internal and external audits at provincial and district levels by 92 and 67 percent respectively. In addition, a comparison of the external audit opinions of the TA shows a significant improvement in the comprehensiveness and quality of the analysis.

- Under the National Decentralized Planning and Finance Program (NDPFP) funds and planning and procurement responsibilities were transferred to province and district administrations. However, their human resource and management capabilities need further strengthening and the overall decentralization strategy has still to be developed.

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

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

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

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

II. OBJECTIVES AND POLICIES FOR THE REMAINDER OF 2008

21. The outlook for 2008 remains positive. While the floods have had a severe humanitarian impact in part of the country, only three percent of cultivated land has been affected so that the overall economic impact is likely to be limited. The medium-term outlook is characterized by continued strong economic growth, single-digit inflation, and sustainable fiscal and external positions. Prices for the main export item aluminum are expected to decline slightly while international prices for petroleum products (12 percent of total imports) are expected to remain high, which will impact the trade balance. The external
current account is targeted to widen as a result of an acceleration of aid disbursements while international reserves will remain at comfortable levels. Nonetheless, risks remain related to natural calamities, a continued surge in international oil and food prices, and spending pressure during election times. Central to consolidating macroeconomic objectives will be the continuation of a prudent fiscal policy with strengthened management of public enterprises, and prudent monetary policy in the context of a flexible exchange rate regime.

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

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

24. The budget envisages no recourse to domestic bank financing. The Government continues its efforts to increase revenues by 0.5 percent of GDP while the losses related to trade liberalization (0.4 percent of GDP) will be mitigated by bringing a number of off-budget line items on budget. The increase in domestic revenue is expected to come from improvements in revenue administration, and tax policy measures including revisions to the personal income and corporate income tax codes approved by the Parliament (0.2 percent of GDP), reduction in VAT exemptions (0.1 percent of GDP), collection of tax arrears (0.1 percent of GDP), continued adjustment of fuel taxes (0.1 percent of GDP) and an
increase in the number of tax payers by 100,000. Non tax revenues are expected to increase on account of higher concession fees from Hidroeléctrica de Cahora Bassa (HCB).

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

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

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

28. The final report on the amount of arrears on VAT refund due to contractors of large infrastructure projects is scheduled for approval by the MF in May 2008. Based on this audit, the Government will define a repayment schedule by August 2008 to be included in the
2009 budget, and if necessary the budgets thereafter. Going forward, the Government will seek the support from the international community to ensure that VAT charged on supplies of projects is included in the final price of a contract and will further strengthen the coordination mechanisms between the relevant departments (Budget Directorate, Planning Directorate, line ministries, and AT).

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

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

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

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

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

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

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

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

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

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

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

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

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

- Pending the approval of the new central bank law, the Audit Board will assume the role of an audit committee. By end-June 2008 (structural AC), the terms of reference of the existing audit board will be simplified to make it more focused on matters related to accountability, transparency, and internal control and provide oversight over financial reporting, external and internal audits, and systems of internal control.
• The control over reserve management will be further enhanced by September 2008 through the installation of physical access controls in SWIFT operations, the recording of dealer communications regarding trading activities, and the introduction of tiered financial limits for authorization of SWIFT transactions.

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

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

34. The Government is committed to supporting a sound expansion of the non-bank financial sector. The BM will continue to license and supervise microfinance deposit-taking institutions to facilitate enhanced access to finance by rural households and SMEs. Examiners of the BSD received training and are preparing two pilot onsite inspections in June 2008. The results of this exercise will be used for fine-tuning the draft prudential regulation to be issued by end 2008 and for designing a Microfinance Supervision Manual. Both the World Bank Financial Sector Technical Assistance Project (FSTAP) and the International Fund for Agricultural Development (IFAD) supported Economic Rehabilitation Support Fund (Fundo de Apoio à Reabilitação Económica—FARE) and the Rural Finance Support Program (RFSP) will support the Government’s efforts to improve access to finance, especially in rural areas. Following the recent adoption of a new law on social protection, the authorities intend to strengthen the social security and supplementary pension system. As part of the restructuring of the National Social Security Institute (INSS), draft reports on an actuarial study and on a new investment management policy were finalized in early March.
2008. The INSS is now preparing an action plan that will pay due regard to fiscal sustainability and will be ready by June 2008. Efforts to strengthen the regulatory and supervisory framework of the insurance sector as well as the institutional capacity of the Inspecção Geral de Seguros (IGS) are under way. The review of the Insurance Law will be finalized to bring it in line with international best practices, revised prudential and solvency requirements for Mozambican insurers are being developed, while new IFRS-compliant Chart of Accounts for insurers would also be designed.

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

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

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

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

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

- Ensure sufficient capacity at provincial levels to administer the licenses and to raise awareness of the streamlined and simplified licensing procedures. The number of sectors covered under the “One-Stop-Shops” for licenses will be expanded and the licensing competencies at municipal level will be reviewed;
- Revoke the requirement for bank deposits when opening a company, and reduce the required minimum capital to start up the business;

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

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

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

- Initiate the implementation of the SME strategy.

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

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

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

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

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

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

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

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

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

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

- A decentralization strategy is being prepared with the help of the World Bank and other partners and will be approved by the Council of Ministers by end-2008. The strategy will propose, among other things, a clear legal, regulatory, and institutional framework for revenue raising and spending responsibilities and functions of subnational units (provinces, districts, and municipalities) and monitoring of subnational fiscal operations. The sequencing of the strategy will pay due regard to the administrative capacity of subnational units and need to maintain fiscal control as well as fiscal sustainability, and should be aligned with the NDFPF.

- In close coordination with the development partners, including the World Bank, and on the basis of the recent census of civil servants, the Government is preparing a reform of the wage policy. The new policy will pay due regard to fiscal sustainability to avoid jeopardizing macroeconomic stability; and

- After some delay new restructuring plan of PETROMOC will be submitted to the Council of Ministers by May 2008 to improve its operational and financial performance and to ring-fence commercial activities.

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

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

43. The Government understands that the completion of the third review is contingent upon the observance of the assessment criteria for end-June 2008 set out in Tables 1 and 3; which is expected to take place before end-December 2008. In reviewing developments under the program during the third review, particular attention will be paid to the implementation of measures aimed at broadening the tax base, the implementation of e-SISTAFE, the improvement of the overall fiscal risk assessment and reporting, the 2008 budget execution, the 2009 budget, monetary and financial sector reform, the reduction in the cost of doing business, and the management of natural resources.
Table 1. Mozambique: Quantitative Performance/Assessment Criteria and Indicative Targets, 2007-2008 1/
(Millions of MT, unless otherwise specified)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>End-Dec. Assessment</th>
<th>End-March Assessment</th>
<th>End-June Assessment</th>
<th>End-Sept. Assessment</th>
<th>End-December Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net credit to the government (cumulative ceiling) /2</td>
<td>-1,828</td>
<td>-1,133</td>
<td>382</td>
<td>-2,000</td>
<td>-1,600</td>
</tr>
<tr>
<td>Stock of reserve money (ceiling)</td>
<td>16,904</td>
<td>17,404</td>
<td>17,822</td>
<td>15,859</td>
<td>17,394</td>
</tr>
<tr>
<td>Stock of net international reserves of the BM (floor, millions of U.S. dollars)</td>
<td>1,300</td>
<td>1,216</td>
<td>1,508</td>
<td>1,532</td>
<td>1,552</td>
</tr>
<tr>
<td>New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling)</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Stock of short-term external public debt outstanding (ceiling)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>External payments arrears (ceiling)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Indicative targets:
- Balance of the government’s savings account set up abroad with proceeds from the coal exploration contract (floor, millions of U.S. dollars): 35, 35, 35
- Government revenue (floor): 32,274, 33,058, 8,367, 17,271, 17,287, 26,590, 26,682, 37,773, 37,864

1/ For definition and adjustors see the attached Program Monitoring Section of Memorandum of Economic and Financial Policies and the Technical Memorandum of Understanding.
2/ Net credit to government, the stock of reserve money, and the stock of international reserves are based on data prior to the technical revision of the monetary survey in January 2008.
3/ Net credit to government, the stock of reserve money, and the stock of international reserves are based on data after the technical revision of the monetary survey in January 2008.
<table>
<thead>
<tr>
<th>Actions</th>
<th>Expected Date of Implementation</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structural assessment criteria</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submission to Parliament of a draft law on the excise tax on alcoholic beverages, beer, and tobacco.</td>
<td>End-February 2008</td>
<td>Delayed to Mid-May 2008</td>
</tr>
<tr>
<td>The level of effective direct budget execution via e-SISTAFE (according to the sequence of commitment, verification, and payment) for goods and services will be increased to 50 percent.</td>
<td>End-December 2007</td>
<td>met</td>
</tr>
<tr>
<td><strong>Structural benchmarks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All budgetary operations for goods and services of Financial Management Departments (DAFs) of all remaining ministries at the central and provincial levels will be executed through the e-SISTAFE.</td>
<td>End-December 2007</td>
<td>met</td>
</tr>
<tr>
<td>Adoption by the Council of Ministers of regulations for the new mining and petroleum fiscal regime laws.</td>
<td>End-February 2008</td>
<td>met</td>
</tr>
<tr>
<td>An integrated and e-SISTAFE compatible payroll database will start to be used by the Ministry of Finance to carry out salary payments via e-SISTAFE.</td>
<td>April 2008</td>
<td></td>
</tr>
<tr>
<td>A list of additional district and municipalities for the rollout of e-SISTAFE will be defined.</td>
<td>End-June 2008</td>
<td></td>
</tr>
<tr>
<td>The Meticalnet will be adapted to allow for outright operations of treasury bills for the secondary market.</td>
<td>End-June 2008</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Actions</th>
<th>Expected Date of Implementation</th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Structural assessment criteria</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finalization of a new terms of reference for the Audit Board of the</td>
<td>June 2008</td>
<td></td>
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<tr>
<td>Bank of Mozambique.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Structural benchmarks</strong></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>SISTAFE.</td>
<td></td>
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<td>End-June 2008</td>
<td></td>
</tr>
<tr>
<td>treasury bills for the secondary market.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The BM adopts an internal audit charter and commences periodic</td>
<td>July 2008</td>
<td></td>
</tr>
<tr>
<td>reporting to the Executive Board on the implementation of audit</td>
<td></td>
<td></td>
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<tr>
<td>recommendations.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A study, with appropriate technical assistance, will be undertaken</td>
<td>December 2008</td>
<td></td>
</tr>
<tr>
<td>that will serve as a basis for drafting the public enterprises law.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
1. The purpose of this technical memorandum of understanding (TMU) is to describe the concepts and definitions that will be used in monitoring the Policy Support Instrument (PSI) program, including the following:

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

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

**Net Claims on the Central Government by the Banking System**

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

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

**Government revenue and financing**

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

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

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

**Money supply**

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

**Net international reserves**

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

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

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

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

**Stock of short-term external public debt outstanding**

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

**External payments arrears**

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

**Foreign program assistance**

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

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

Adjusters

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

17. The quantitative targets (ceilings) for net claims on the central government (NCG) will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted upward by 100 percent of any shortfall in external program aid (up to a maximum of US$50 million) and any excess in external debt service payments, compared to the program baseline (Table 1). These targets will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government’s savings account abroad. The quantitative targets (ceilings) for NCG will be adjusted downward (upward) for any increase (decrease) in domestic financing from the non-financial private sector. The government expenditures contingent on higher disbursements of foreign program assistance (and lower external debt service) will be used to finance greater “priority” spending identified in the budget.
18. The quantitative target (ceiling) for net claims on the central government (NCG) for end-March 2008, end-June 2008, end-September 2008, and end-December 2008 will be adjusted upward (and the floors on net international reserves adjusted downward) to accommodate the possible need for higher locally financed government outlays to deal with natural disasters, up to a total limit of MT 500 million.

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

Data reporting

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

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

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

23. From December 2005 onwards, the monetary survey made available by the Bank of Mozambique will clearly identify donor-financed project deposits (with a breakdown between foreign and domestic currency) included in net credit to the government in both the central bank’s and commercial banks’ balance sheets.
Table 1: Mozambique—Foreign Program Assistance and External Debt Service for 2007 and 2008 /1
(Millions of MT, unless otherwise indicated)

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net foreign program assistance per period</td>
<td>9,677</td>
<td>9,340</td>
<td>4,751</td>
<td>6,186</td>
<td>4,101</td>
</tr>
<tr>
<td>Foreign program assistance</td>
<td>10,179</td>
<td>10,591</td>
<td>4,878</td>
<td>6,756</td>
<td>2,673</td>
</tr>
<tr>
<td>Program grants</td>
<td>7,519</td>
<td>8,013</td>
<td>3,927</td>
<td>5,241</td>
<td>2,673</td>
</tr>
<tr>
<td>Program loans</td>
<td>2,661</td>
<td>2,577</td>
<td>951</td>
<td>1,515</td>
<td>0</td>
</tr>
<tr>
<td>External debt service</td>
<td>502</td>
<td>1,250</td>
<td>127</td>
<td>290</td>
<td>137</td>
</tr>
</tbody>
</table>

Source: Mozambican authorities and Fund staff estimates.

/1 Foreign assistance excluding assistance for special programs, projects, and on-lending to public enterprises.

Table 2: Mozambique—Projected Fuel Import Bill for 2007 and 2008
(Millions of US dollars, unless otherwise indicated)

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel import bill per period (millions of US dollars)</td>
<td>81</td>
<td>100</td>
<td>95</td>
<td>109</td>
</tr>
<tr>
<td>Forecast oil price (US$ per barrel)</td>
<td>64</td>
<td>88</td>
<td>77</td>
<td>87</td>
</tr>
<tr>
<td>Volume of fuel imports per period (metric tons)</td>
<td>122,376</td>
<td>126,119</td>
<td>123,673</td>
<td>125,467</td>
</tr>
</tbody>
</table>

Source: Mozambican authorities and Fund staff estimates.

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding stock of currency, end of period</td>
<td>10,133</td>
<td>10,942</td>
<td>8,924</td>
<td>9,055</td>
</tr>
</tbody>
</table>

Source: Mozambican authorities and Fund staff estimates.