

International Monetary Fund

[Republic of Mozambique](#) and the IMF

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

Press Release:
[IMF Completes Third Review Under the Policy Support Instrument for Mozambique](#)
December 7, 2011

November 14, 2011

The following item is a Letter of Intent of the government of the Republic of Mozambique, which describes the policies that the Republic of Mozambique intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the 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.

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LETTER OF INTENT—REPUBLIC OF MOZAMBIQUE

November 14, 2011

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

Dear Ms. Lagarde:

The Government of Mozambique requests the completion of the third review under the Policy Support Instrument (PSI). In support of this request, we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews implementation of our economic program under the PSI and sets out the Government's objectives and policies over the short and medium term.

The Government's economic program aims to maintain macroeconomic stability, promote more inclusive growth through public investment and the promotion of productive employment, and reduce poverty. The program aims to support the implementation of the new Poverty Reduction Strategy Paper (PARP) for 2011-14, which the Government formally adopted on May 3, 2011.

The Government is of the view that the policies outlined in the MEFP are adequate to achieve the objectives of the PSI-supported program. We stand ready to take any additional measures necessary to achieve our policy objectives. The Government will consult with the IMF—at its own initiative or whenever the Managing Director requests such a consultation—should revisions be contemplated regarding the policies contained in the attached MEFP. The Government will provide the IMF with such information as the IMF may request to be able to assess the progress made in implementing the economic and financial policies and achieving the objectives of the program.

Sincerely yours,

/s/
Manuel Chang
Minister of Finance

/s/
Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

ATTACHMENT 1: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

November 14, 2011

1. This updated MEFP (i) describes recent developments and performance under the Government's economic program under the three-year Policy Support Instrument (PSI) through October 2011 and (ii) elaborates on economic and structural policy intentions through 2012. It builds on the MEFPs underlying the initial PSI request dated May 28, 2010 and those for the first and second reviews from November 8, 2010, and May 20, 2011 respectively.

I. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **Mozambique remains resilient to the renewed global turbulence.** Our economy continues to weather the global financial crisis remarkably well. Economic activity in the first half of the year is estimated at 7.4 percent, buttressed by good harvests and a robust performance in the service and transport and communication sectors. Twelve-month inflation declined sharply from its peak of 16.6 percent at end-2010, standing at 7.8 percent at end-September 2011. Inflation expectations have fallen as well, since core inflation (excluding food and fuel prices) has been declining steadily to 7.7 percent at end-September 2011. This reflects the determined monetary and fiscal policy tightening, favorable developments of international prices, a good harvest, and a stronger metical. The increase in the import bill for fuel products and megaproject investments was partly offset by an acceleration in both megaproject and traditional exports, resulting in a current account deficit of 11.2 percent of GDP, broadly in line with our initial projections. This, together with robust capital inflows, contributed to a stronger-than-projected international reserves position.

3. **Mozambique's program performance remains strong:**

- All end-June 2010 quantitative assessment criteria (AC) were met, except for reserve money (RM), which was marginally exceeded. Nonetheless, the sharp tightening of monetary policy resulted in negative RM growth in the first half of 2011. The BM kept disinflation policies on course by comfortably meeting the end-September indicative target on RM. It also observed all program targets on net international reserves (NIR) through end-September.
- The Government's fiscal policy stance has supported the disinflation effort as well, with net credit to the government (NCG) and government revenue exceeding the respective program targets for end-June by a large margin. This was achieved on account of a determined revenue mobilization effort and a slow budget execution, especially of the externally-financed component. However, the latter resulted in us missing the indicative targets on priority spending for end-March and end-June 2011. No new non-concessional borrowing (NCB) has been signed since April 2011.
- As to the end-July structural benchmarks, we launched the civil service and wage payment database on time and produced a first quarterly report. In addition, the Council of Ministers adopted the anti-corruption package on July 26, and the legislation has formally been submitted in full to Parliament on November 1.

4. **The Government took important steps to implement Mozambique's new four-year PARP.** It finalized the PARP matrix of structural measures in August 2011, in close consultation with key stakeholders. The recent approval of the *Agricultural Reform Strategy* (PEDSA) will help delineate a detailed action plan to achieve the key objectives under the PARP pillar on increasing production and productivity in agriculture and fisheries. The Council of Ministers approved in September 2011 a number of programs that would support the *National Basic Social Security Strategy* (ENSSB), involving a wide range of programs with special focus on direct social protection transfers and productive public works programs in urban and rural areas.

II. MACROECONOMIC POLICIES

A. Economic Objectives

5. **Despite weakening global economic prospects, the Government continues to foresee a positive macroeconomic outlook for Mozambique for 2011 and beyond.** Economic growth could reach 7¼ percent in 2011 and approach 8 percent over the medium term. On the back of our strong efforts to arrest inflation expectations, we expect headline inflation to remain in single digits through end-2011, subject to international food and fuel price developments, and to our inflation objective of below 6 percent over the medium term. The external current account deficit (after grants) is set to stabilize at around 10 to 11 percent of GDP during the next few years, while the reserves coverage of imports should approach 5 months due to increasing private capital inflows, exports from new mining megaprojects, and continued donor support.

6. **The difficult global environment has increased risks to the outlook.** As was the case in 2008-09, the global crisis may affect Mozambique through two main contagion channels: a decline in commodity prices for the country's minerals and reduced access to international finance by the private sector. In addition, economic difficulties in our partner countries may lead to less predictable aid and other financial inflows and may have repercussions on our financial system. Although current indications point to no immediate pressures in these areas, we have stepped up our vigilance and stand ready to adjust our policies, in consultation with IMF staff.

B. Macroeconomic Policy Mix

7. **Policies for the remainder of this year and for 2012 need to balance the need to keep inflation expectations in check with supporting our investment and social development goals.** The Bank of Mozambique (BM) will ease monetary policy cautiously, consistent with the annual inflation objective, the significant disinflation to date, and the need to enable more private sector credit growth. Fiscal policy will be supportive to the BM's efforts, with a further reduction of the domestic primary deficit and limited recourse to domestic financing, which should help contain domestic demand and avoid a crowding out of the private sector.

8. **Over the medium term, consistent with the PARP, we will adhere to a policy stance that supports inclusive growth while preserving macroeconomic stability and debt**

sustainability. Monetary policy will continue to be geared toward achieving low levels of inflation, complemented by efforts to promote financial deepening and develop domestic debt markets. Fiscal policy will seek to step up investment spending to close the infrastructure gap and support our social and human development objectives, allowing for a gradual expansion of social safety nets to address chronic poverty and foster social cohesion. To this end, we intend to create additional fiscal space mainly through a continued increase in the revenue-to-GDP ratio and selective nonconcessional external borrowing (NCB), the latter primarily for capital projects with an expected high economic return. This policy stance will be consistent with maintaining macroeconomic stability and debt sustainability.

C. Monetary and Exchange Rate Policies

9. **The authorities are determined to maintain their disinflation monetary policy stance.** Our objective is to contain end-of-period inflation to 8½ percent in 2011 and below 6 percent in 2012. This will continue to be achieved by keeping monetary expansion, in particular RM growth, under close control. In 2011, we aim to contain RM growth to about 13 percent. Going forward, in tandem with our progress in combating inflation, RM growth will accelerate and expand slightly above nominal GDP growth to support financial deepening.

10. **The authorities intend to further strengthen the BM's operational framework.** This will allow the BM to improve its liquidity forecasting and more effectively steer monetary conditions. Specifically, this entails:

- ***Monitoring of government accounts.*** The implementation of the MoU signed on March 25, 2011 on the exchange of information between the BM and the Ministry of Finance (MoF) will be accelerated. Among other things, by end-November 2011, the MoF and the BM will work on changing existing rules to (i) avoid unexpected Government flows near market close to provide commercial banks with sufficient time to fine-tune their daily liquidity conditions and enhance the effectiveness of BM monetary interventions to drain or add liquidity; and (ii) cancel authorizations for public institutions in e-SISTAFE if they do not use them within one week. The MoF is already providing the BM with information on the nature of government expenses and revenues in foreign currency, and we will now focus on technical solutions to provide similar information in domestic currency. The MoF will also provide the BM with monthly historical data on government expenses and revenues so as to allow the BM to better capture seasonal patterns.
- ***Development of the domestic repo market to help improve money market management and the liquidity of government securities.*** By end-July 2012, the BM will (i) modify the *Meticalnet Interbank Money Market* (MMI) auction modules to accept not only Treasury bills (BT) issued by the BM but also government bonds (OT) issued by the stock exchange as collateral for BM repo transactions; (ii) allow repeated use of the same securities for repos; and (iii) make all BT equally eligible to the BM repo transactions. In addition, by end-March 2012, based on an impact study, the authorities will decide on measures to equalize the tax treatment between BT and OT and between collateralized and uncollateralized interbank market operations. By end-September 2012, we will submit to Parliament an amendment to

the Corporate Income Tax Law that will reflect this equalization, to take effect in 2013 (**structural benchmark**). This will eliminate the current 10 percent tax bias against BT and the current tax incentive to conduct uncollateralized operations (taxes on collateralized operations are to be paid each month, while uncollateralized transactions are taxed only in April of the subsequent year in the context of banks' annual tax payments based on their balance sheet).

11. **The BM intends to move toward an inflation-targeting framework over the next few years.** Supported by Fund technical assistance (TA), important progress is being made in improving data collection and analysis, developing forecasting techniques, and setting the stage for enhanced communications to transparently and efficiently explain the BM's policy intentions. With regard to the latter, the BM will publish, by end-May 2012, its first quarterly monetary policy report, which will cover a broad range of issues, such as the international policy environment, the domestic economic activity and outlook, and an analysis of policy developments (**structural benchmark**). In light of the progress made in modeling macroeconomic and liquidity developments, including with respect to forecasting and managing currency in circulation, we will reduce the currency adjuster under the program's reserve money target to MT 250 million for all 2012 RM program targets and to eliminate it altogether beginning with the end-March 2013 target.

12. **Mozambique's flexible exchange rate regime remains appropriate.** The BM will continue to allow the exchange rate to adjust freely to evolving patterns of trade and financial flows while further strengthening Mozambique's international reserves, which are projected to approach 5 months of projected imports over the medium term. The BM will continue to closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies.

13. **The BM will ensure that Mozambique remains committed to its obligations under Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement.** The BM will continue to monitor the implementation of the new foreign exchange regulations, its implementation norms, as well as the functioning of the foreign exchange market, with a view to avoiding practices that could turn out to be inconsistent with Article VIII principles. We will keep IMF staff informed of any developments that could potentially run against those principles.

D. Fiscal Policy

14. **Fiscal policy will help the Government in its quest for more inclusive growth, but in the short run be geared toward supporting BM's disinflationary effort.**

- We will maintain our revenue effort and prudent budget implementation in 2011, keeping the domestic primary deficit, at about 3 percent of GDP, broadly unchanged relative to prior understandings. By contrast, we expect a much slower execution of externally-financed spending, resulting in a projected sharply lower overall fiscal deficit than previously planned. In addition, a shift in budget support between fiscal years agreed upon with donors necessitates a slight increase in the NCG to 0.8 percent of GDP.

- The fiscal policy stance in 2012 will remain supportive of disinflation while boosting the authorities' investment and social development plans. While the domestic primary deficit and NCG will be limited to about 2 percent and ½percent of GDP, respectively, the overall deficit will rise to 5.8 percent of GDP to benefit from the space available under the program for NCB to help finance a surge in capital spending and on-lending for infrastructure investment.

15. **The implementation of the 2012 budget law will be subject to the revenue contingency under the organic budget law (SISTAFE 2002).** This legal framework limits budget execution to cautionary ceilings as long as revenue collections remain uncertain. To this end, and in accordance with the legal provisions of the 2012 budget law, the Government will take the following steps by end-January 2012: (i) the Council of Ministers will approve the decree on the provisions regarding budget execution (*Decreto de Delegação de Competências sobre a Execução do Orçamento*); and (ii) the Minister of Finance will issue an interministerial regulation (*Circular Ministerial*) providing guidance for line ministries for budget execution and contingencies. Accordingly, the following contingency ceilings will apply: (i) 90 percent for goods and services and other current expenditures; (ii) 85 percent for civil service wages and transfers; and (iii) 90 percent for domestically-financed capital spending.

16. **We will support implementation of the PARP by expanding social protection while moving toward eliminating the costly fuel subsidy.**

- ***Social protection schemes.*** The September 2011 approval by the Council of Ministers allows the Ministry for Women and Social Action (MMAS) to embark on the implementation of a revamped system of direct social protection transfers and the launch of productive public works programs in urban and rural areas, with an initial targeted number of beneficiaries of 309,000 in 2012 as a result of a real increase in budget allocations of 25 percent relative to 2011. We will seek to gradually expand our own budgetary and donor resources for social protection to enhance coverage to 815,000 beneficiaries by 2014. Supported by TA from our partners, we will strive to strengthen our institutional capacity to implement, monitor, and assess the schemes. MMAS will revise targeting and beneficiary selection mechanisms, payment procedures, and monitoring and evaluation systems (e.g., single registry of beneficiaries), building on the on-going evaluation of the current transfer system.
- ***Fuel subsidy phase-out.*** The Government made good progress in phasing out the fuel subsidy through a series of price increases. It raised the diesel and gasoline prices by 10 percent in April and 8 percent in July, leaving only diesel pump prices subsidized. Barring any unforeseen international price surges, we expect to be able to end the subsidization by early 2012, which would allow us to return to the unrestricted application of the price-setting formula. Consistent with the agreement reached in December 2010, the Government paid off the entire debt to fuel importers incurred in 2010 (MT 3.6 billion). We will compensate importers for incurred 2011 losses. For this purpose, we have included an amount under the 2012 budget. Our budget documents will continue to show the full costs of any outlays for fuel products, in line with best fiscal transparency principles.

- **Vouchers and food subsidies.** The 2012 budget provides additional resources to continue the existing subsidies on wheat for bread and to introduce urban transport vouchers in 2012. A tender for the voucher system's management has been launched. Given the importance of an efficient urban transport system for our citizens, especially the poor, we have created a fund to undertake investment in the sector, such as the purchase of buses. The fund, financed by an earmarked share of the fuel tax, transport receipts, and the sale of idle Government assets, is fully integrated in the central Government budget.

17. **We aim to further increase spending for priority sectors.** Such spending will, for the time being, continue to be defined under the 2006-10 PARPA program categories, comprising outlays in education, health, HIV/AIDS, infrastructure development, agriculture, rural development, governance, and the judicial system. We envisage to increase such spending from MT 58 billion in 2011 (50 percent of projected total expenditures excluding net lending) to MT 70 billion in 2012 (51 percent of projected total expenditures excluding net lending). Priority spending will be redefined to capture all spending under the new PARP's three main pillars (agriculture, job creation, social and human development) and supporting pillars (economic management and governance) following the completion of the programming exercise.

18. **The Government reaffirms its strategy to promote investment in transportation and energy infrastructure.** Such investment is expected to trigger a crowding in of private investment, thereby supporting our objective of achieving sustainable economic growth. We will maintain our prudent approach in selecting projects and give priority to those that promise a high economic return, especially to the extent that they are financed with nonconcessional resources under the program's ceiling of US\$900 million. We will pace the implementation of those projects such that they are compatible with macroeconomic stability and debt sustainability.

19. **The implementation of our salary policy will proceed at a measured pace consistent with macroeconomic circumstances while safeguarding the recruitments needed in the priority sector.** The Government will by end-March 2012 complete the review of the implementation strategy of the salary policy. Following the rollout of the e-Folha electronic salary payment system to three provincial directorates this year, we intend to complete the rollout to all provincial directorates by end-June 2012 (**structural benchmark**). We will continue to produce quarterly wage bill reports that will be used by the Ministries of Finance and Civil Service to monitor and control salary expenditure and eventually become an integral part of the integrated human resources management system.

III. STRUCTURAL REFORMS

A. Public Financial Management and Reporting

20. **Reforms to improve the reporting, monitoring, and control of budget execution remain one of the pillars under the PSI.** The following priority measures are underway:

- **Expansion of budget coverage.** The rollout of the e-SISTAFE budget execution system remains on track. The rollout plan adopted in September 2011 emphasizes cost effectiveness

and focuses on entities that have (i) access to telecommunications, energy, and banks; (ii) a minimum budget size; and (iii) a minimum number of staff to operate the e-SISTAFE system. On this basis, we expect e-SISTAFE coverage to increase to 52 percent of all spending by end-2012, after 45 percent at end-2011.

- ***Move toward IPSAS-compatible reporting.*** In line with recent TA, we are embarking on gradually reforming the state account format according to international public accounting standards (IPSAS) by 2015, for the State Account of 2014. Success of the reform will depend on strengthening capacity at the Accounting Directorate, as well as the approval by the MoF of a time-bound action plan on accounting reform by end-July 2012. As a first step toward IPSAS-compatible standard, we will improve the current State Account report, with due reconciliation and explanations, particularly in the area of debt accounts and transfers between the government and other institutions by end-June 2012.

B. Debt Management and Investment Planning

21. **The Government reiterates its commitment to make the newly created framework for debt management and investment planning an effective tool for our policy decisions.** The Debt Management Committee (DMC) and Project Coordination Committee (PCC) will meet quarterly and issue regular reports to the respective supervising minister. The committees' deliberations will provide an increasingly comprehensive overview on proposed projects and their evaluation, as well as their implications for debt management. The Government will delay completion of the Integrated Investment Plan (a structural benchmark for end-December 2011) to end-March 2012 to allow staff from the Ministry of Plan and Development and line ministries to benefit from an upcoming capacity building workshop by the World Bank (WB). However, we will provide IMF staff with a first preliminary draft by end-2011 that will provide first indications on prioritized high-return projects and how possible lower-cost alternatives to those projects (including through public-private partnerships) could be determined.

22. **To further enhance the effective role played by both committees, we will take the following actions:**

- ***Technical and reporting capacity at the DMC.*** The DMC will be further strengthened through additional training and enhanced technical capabilities in the MoF's debt unit. This will be key to improve and manage the underlying debt database, review new financing options, and draft and implement the medium-term debt strategy. The debt unit will produce accurate semi-annual debt reports to the DMC consistent with the format recommended by the recent TA. The new format includes cost and risk indicators comparable to those reported in the MTDS.
- ***Approval of Medium-Term Debt Strategy (MTDS).*** Drawing on recent capacity building by the IMF and the WB, the DMC will update the MTDS prepared earlier this year and bring it into a format that is consistent with macroeconomic circumstances and includes several borrowing scenarios and proposals to ensure smooth debt repayments. We will also aim to

complete a second annual debt sustainability analysis by end-December 2011. The revised MTDS will be submitted, together with this second annual debt sustainability analysis, to the Council of Ministers by end-March 2012 for approval.

- ***Development of an annual domestic borrowing plan.*** Building on the MTDS, the DMC will draw up and publish a first annual domestic borrowing plan by end-June 2012 for the remainder of 2012. Upon approval of the 2013 budget law, an annual borrowing plan will be established for 2013. The plan will include quarterly financing and repayment projections and be consistent with the projected net annual financing needs and cash flow throughout the year.
- ***Strengthening of project selection processes.*** The PCC will aim to increase the quality of the information provided by line ministers to help them in their project evaluation efforts. It will supervise the effective application of the new project selection template. It will complement the template with an information requirement list for line ministries by end-February 2012. With WB TA, a project preparation manual to further refine project selection guidelines will be drafted by end-March 2012. This will include the mapping of objectives and criteria for standardized project evaluation techniques to prioritize projects and to achieve the highest economic and social returns.

C. Tax Administration

23. **We will persevere in our strong revenue mobilization effort while aiming to make the tax system more business-friendly.** This will mainly be achieved by further modernizing tax administration.

- ***Development of single taxpayer database.*** The electronic tax payment project (e-tax) is now working with an adequate management and monitoring structure. On this basis, we will develop a new single taxpayer database and identification number, which we will initiate in October 2011 and make functional by end-June 2012 (**structural benchmark**). By end-2012, 80 percent of corporate taxpayers and 30 percent of individual taxpayers should be registered under the new database.
- ***Tax payments through banks.*** The MoF will approve the *Action Plan for Tax Payments through Banks* by end-March 2012. The plan provides a detailed time-bound roadmap for the future collection of tax payments into the Single Treasury Account (CUT) under the single window (customs) and e-tax (domestic taxes) systems. This will enhance transparency, timely deposits in the CUT, and real-time consolidation of taxpayers' obligations.
- ***Rollout of single window trade facilitation project.*** Based on a pilot launched in September 2011, we aim to process by end-2012 all customs declarations at the country's seven main entry points through the single window system, and ensure payment of taxes and duties directly via banks. We expect that 70 percent of customs revenues be collected this way.
- ***Reinforcing of the large taxpayers unit (LTD-DCAT).*** Modern management procedures in the LTD-DCAT will continue to be reinforced with the creation of the "Taxpayer Manager", a dedicated liaison agent for large taxpayers. The unit also aims to build expertise in the

hydrocarbons, energy and mineral coal areas to enable targeted audits. Revenue collection by the LTD-DCAT should increase from 47 percent of all revenues in 2010 to 52 percent in 2011, 58 percent in 2012, 64 percent in 2013, and 70 percent by end-2014.

D. Improving Natural Resource Management

24. **Mozambique remains determined to become a full-fledged EITI member in due course in line with our notable progress to improve the transparency of natural resource revenues.** We will make every effort to complete and submit to the EITI the second country report, based on 2009 data, as quickly as possible to become EITI-compliant by the first possible opportunity. We will also forcefully address the recommendations from the first reconciliation and validation reports.

25. **The Government is taking decisive steps to enhance its technical and institutional capacity to manage natural resources.** We have been seeking expert advice from development partners to refine our mining and petroleum legislation. We also expect to benefit shortly from the IMF's new *Topical Trust Fund for Managing Natural Resources Wealth* to improve our fiscal regime, enhance revenue forecasts, and address newly emerged issues, such as on the valuation of minerals and the consideration of capital gains as a source of revenue. In the meantime, the Government continues to carefully analyze the feasibility for potential renegotiation of fiscal benefits in the natural resources sector with willing investors, while safeguarding the stability of the business climate in Mozambique.

E. Fiscal Decentralization

26. **We will continue to decentralize fiscal responsibilities with due regard to local capacity, proper internal controls, and available financing.** To this effect, we are gradually rolling out a district development monitoring system (*Sistema de Monitoria do Desenvolvimento Distrital*—SMdDD) aimed at assessing districts' administrative performance. Our goal is to assess 30 districts in 2011, 80 districts in 2012, and 128 districts in 2013. We will make these assessments public to local district councils and communities.

F. Good Governance Framework

27. **The Government will ensure the proper implementation of the anti-corruption legislation upon its approval by Parliament.** This will enhance the investment climate and instill confidence of local stakeholders. To this effect, the Government will update the 2006–10 *Governance Anti-Corruption Strategy* by end-June 2012, based on analysis and inputs from the recently completed *Second National Study on Governance and Corruption Analysis*, the 2009–14 *Integrated Justice Strategy*, and other relevant documents, including the report on the implementation of the *African Peer Review Mechanism (MARF)* in Mozambique. The Government will ensure that the updated strategy, including the essence of the underlying analysis and inputs, will be disseminated to, and discussed with, key stakeholders. Our PARP matrix will be revised accordingly to incorporate key actions under the strategy.

IV. FINANCIAL SECTOR POLICIES

A. Fighting money laundering and terrorism financing

28. **The authorities are further strengthening the AML/CFT framework.** The Financial Intelligence Unit (GIFIM) has begun its operations. It is now fully staffed and has received a full budget allocation under the 2012 budget law. However, the approval of the amended AML/CFT law is necessary to make the new framework fully effective and allow other regulators such as the BM to issue relevant guidelines in their respective areas. The draft legislation will be submitted to Parliament in December 2011. The MoF will establish, chair, and appoint the members of the high-level AML/CFT National Task Force by end- December 2011. Concurrently, GIFIM will prepare a national AML/CFT strategic plan to be approved by the Council of Ministers in 2012. The strategic plan will aim to foster national, regional, and international cooperation, strengthen the AML/CFT institutional framework, and promote capacity building and outreach efforts.

B. Financial Sector Development Strategy (FSDS) for 2011–20

29. **We are in the process of launching Mozambique’s Financial Sector Development Strategy (2011-20).** Benefiting from the WB’s technical support, the comprehensive strategy aims at enabling Mozambique to more efficiently finance long-term growth throughout the country, including in rural areas. It is supported by three strategic or operational bodies, and the terms of reference and the composition of the Steering Committee chaired by the MoF, the Technical Advisor Committee, and the coordinating Support Implementation Unit will be transmitted to the Minister of Finance for approval by end-November 2011. A seminar on the dissemination of the strategy will be held in February 2012. We will actively seek additional, and preferably pooled, support from development partners to finance the strategy’s activities beyond June 2012 when WB financing (FSTAP) will come to an end.

C. Financial Sector Surveillance

30. **The BM will step up its financial surveillance in light of the renewed global financial turbulence.**

- ***Prudential supervision.*** Based on Fund TA, the BM plans to start conducting regular bank stress testing. It will re-assess liquidity risks in light of current tensions in the global banking system and strengthen the limitation of excessive concentration of liquid assets. With a view to adopting a risk-based approach to banking supervision, the BM will further move towards the migration of its prudential framework to Basel II by 2014.
- ***Financial sector contingency plan.*** The BM will ensure that the new financial sector contingency plan, to be completed by end-November 2011, is fully disseminated to the banking sector by end-February 2012.
- ***Deposit insurance.*** The MoF will approve the necessary regulations pertaining to such a scheme by end-April 2012 to ensure its timely implementation once its financing is secured.

- ***Private pension system (INSS)***. With support from the ILO, we are committed to increase INSS' coverage while ensuring its financial stability and sustainability. These efforts will be guided by the results of the actuarial study (to be completed by end-May 2012), the recently published investment strategy, and our strong commitment to address the recently identified inaccuracies in the 2009 financial accounts.

V. PROGRAM MONITORING

31. The modified quantitative AC and indicative targets for end-December 2011, the indicative targets for end-March 2012, and the AC and indicative targets for end-June 2012 are shown in Table 1. Table 2 lists the structural benchmarks for the first half of 2012. The fourth PSI review is expected to be completed by end-June 2012 and the fifth PSI review by end 2012.

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets ¹
(Millions of meticals, unless otherwise specified)

	2011				2012						
	End-March		End-June		End-Sept		End-March		End-June		
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Assessment Criteria		
Assessment Criteria for end-June/December											
Net credit to the government (cumulative ceiling)	1,097	1,276	-2,300	-875	-875	-2,055	-362	2,086	2,896	2,795	-2,645
Stock of reserve money (ceiling)	27,368	27,868	28,988	29,826	30,118	30,740	33,708	36,418	36,053	33,800	36,734
Stock of net international reserves of the BM (floor, US\$ millions)	1,715	1,715	1,866	1,835	1,835	2,095	1,905	2,000	2,030	2,091	2,154
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US\$ millions)	900	900	66	900	900	146	900	900	900	900	900
Stock of short-term external public debt outstanding (ceiling)	0	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling)	0	0	0	0	0	0	0	0	0	0	0
Indicative targets											
Government revenue (cumulative floor)	14,929	14,929	17,274	36,609	36,609	39,138	56,382	76,792	76,792	20,272	25,284
Priority spending (cumulative floor)	15,899	15,899	10,259	27,499	27,499	24,636	40,839	58,000	58,000	10,500	24,500

Sources: Mozambican authorities and IMF staff estimates.

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

Table 2. Mozambique: Structural Benchmarks Under the PSI

Structural Benchmarks	Expected Date of Implementation
The Minister of Planning and Development will approve an Integrated Investment Program, in consultation with the Project Coordination Committee, as described in paragraph 25 of the MEFP dated May 20, 2011.	End-March 2012 ¹
The Bank of Mozambique will publish its first quarterly monetary policy report, as described in paragraph 11.	End-May 2012
The Government will complete the rollout of the e-Folha electronic salary payment system to all provincial directorates, as described in paragraph 19.	End-June 2012
The Ministry of Finance will make fully functional a new single taxpayer database and identification number, as described in paragraph 23.	End-June 2012
The Government will submit to Parliament an amendment to the Corporate Income Tax Law reflecting measures derived from an impact study on the equalization of the tax treatment between Treasury bills and Government bonds and between collateralized and uncollateralized interbank market operations, to take effect in 2013, as described in paragraph 10.	End-September 2012

¹ Proposed to be delayed from end-December 2011 to allow officials in the Ministry of Plan and Development and line ministries to benefit from World Bank capacity building training on project selection.

ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

November 14, 2011

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

I. DEFINITIONS

Net credit to the central government

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

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

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

Government revenue and financing

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

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

Priority social spending

7. Priority social spending is based on the PARPA program categories. Accordingly, it will include total spending in the following sectors: (i) education; (ii) health; (iii) HIV/AIDS; (iv) infrastructure development; (v) agriculture; (vi) rural development; and (vii) governance and judicial system.

Reserve money

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

Net international reserves

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

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

10. The ceiling on nonconcessional external debt applies to external debt contracted or guaranteed by the central government, the BM, the Road Fund, the water authorities (FIPAG), and the electricity company (EDM). It also applies to debt contracted by these three state-owned enterprises from domestic banks or from other state-owned enterprises that is contractually inter-related to external nonconcessional loans.

11. The ceiling applies to external debt with original maturity of one year or more and with a grant element below 35 percent. The grant element is calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the annual Budget Law. The term 'debt' will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted on August 3, 1979, as amended August

31, 2009, effective December 1, 2009. The concept of external debt is defined on the basis of the residency of the creditor. The ceiling also applies to commitments contracted or guaranteed for which value has not been received. This assessment criterion is defined cumulatively from the beginning of the program and 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 External Debt in Fund Arrangements adopted on August 3, 1979, as amended August 31, 2009, effective December 1, 2009, 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. 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 BM 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).

II. ADJUSTERS

Net international reserves

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

- downward by the shortfall in external program aid less debt service payments (up to US\$100 million), compared to the program baseline (Table 1);
- downward/upward for any revision made to the end-year figures corresponding to the previous year; and

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

Net credit to central government

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

- upward by the shortfall in the MT value of external program aid receipts less debt service payments (up to the MT equivalent of US\$100 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
- downward by privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings accounts abroad;
- downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector; and
- upward to accommodate the higher locally-financed outlays because of natural disasters, up to the MT equivalent of US\$20 million at exchange rates prevailing at the respective test dates.

Reserve money

18. The quantitative target (ceiling) for reserve money will be adjusted upward by the excess of the stock of currency in circulation above the level envisaged in the program. For programming purposes, both the stocks of reserve money and currency in circulation are defined in terms of the average of the daily end-of-day stocks in the month of the test date. The target will be adjusted up to MT 750 million for end-December 2011 and up to MT 250 million for end-March, end-June, end-September and end-December 2012 (Table 1).

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

III. DATA AND OTHER REPORTING

20. The Government will provide Fund staff with:

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

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

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

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

TMU Table 1. Mozambique: Net Foreign Assistance, 2011-12

	2011						2012	
	Q1		Q2		Q3	Q4	Q1	Q2
	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Prog.
Net foreign program assistance (US\$ mn)	129	145	126	138	104	36	70	198
Gross foreign program assistance	144	160	140	153	119	51	94	222
Program grants	144	160	140	153	119	19	94	137
Program loans	0	0	0	0	0	32	0	85
External debt service	15	15	15	15	15	15	24	24
Net foreign program assistance (MT mn)	4,732	4,552	3,802	4,072	3,170	925	2,032	5,931
Gross foreign program assistance	5,253	5,075	4,337	4,600	3,693	1,433	2,753	6,685
Program grants	5,253	5,075	4,337	4,600	3,693	547	2,753	4,125
Program loans	0	0	0	0	0	886	0	2,560
External debt service	521	523	535	528	523	508	722	754
Stock of outstanding currency (MTm)	16,098	17,107	19,164	19,083	22,512	23,650	21,230	23,272
Stock of outstanding currency (MTm), Prog. Def	15,878	17,323	18,430	18,721	21,901	23,600	21,499	22,830

Source: Mozambican authorities and IMF staff estimates.