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

December 12, 2014

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.

Mozambique: Letter of Intent

Maputo, Mozambique

December 12, 2014

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) and the modification of three assessment criteria and one indicative target for December 2014 to reflect the continuation of trends observed in September: increased demand for cash in circulation, valuation changes on reserves, and additional government financing needs related, among other factors, to the Agreement for a Permanent Cessation of Military Hostilities in September 2014. We also request (i) to set assessment criteria and indicative targets for end-June 2015, and indicative targets for end-March, end-September, and end-December 2015; (ii) to reschedule existing structural benchmarks and set new structural benchmarks for 2015, in part reflecting delays in the implementation of earlier benchmarks. In support of this request, we are transmitting the attached Memorandum of Economic and Financial Policies (MEFP), which reviews the implementation of the program supported by the current PSI and establishes policy objectives and assessment criteria and indicative targets for the short and medium term.

The Government's economic program aims to maintain macroeconomic stability, promote inclusive growth through public investment and the promotion of productive employment, and reduce poverty.

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

The Government will consult with the IMF on the adoption of these measures—at its own initiative or whenever the Managing Director requests such a consultation—in advance of any revision to the policies contained in the MEFP, in accordance with the Fund’s policies on such consultation.

The Government will provide the IMF with such information as the IMF may request to be able to assess the progress made in implementing the economic and financial policies and achieving the objectives of the program.

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

Sincerely yours,

/s/

Manuel Chang
Minister of Finance

/s/

Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

Attachment 1. Memorandum of Economic and Financial Policies (MEFP)

December 12, 2014

1. This MEFP (i) describes recent developments and performance of the Government's economic program under the three-year Policy Support instrument (PSI) to date, and (ii) elaborates on economic and structural policy intentions. It builds on the MEFP underlying the Second PSI Review of April 2014.

I. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **The Mozambican economy remains strong and was little affected so far by the weak global economy.**

- **Economic growth** remains high. During the first half of 2014, growth was estimated at 7.2 percent compared with the same period of the previous year, moderated by slightly lower-than-projected performance in extractive industries (coal production), and transport due to some constraints in the railway system, though the extractive industry was among the sectors with highest growth rates. Other main growth sectors were financial services, manufacturing, and restaurants and hotels.
- **Inflation and monetary policy.** Inflation remained low along the year with an annual rate of 1.3 percent in October, well below the same period last year. Factors that contributed were unchanged administered prices, an increase in domestic food supply and the decline in international commodity prices. Notwithstanding the overshooting of the reserve money target for June 2014 largely due to unexpected movements in currency in circulation, there was a noticeable slowdown in the year-on-year credit expansion from 35.4 percent in September 2013 to 20.8 percent in September 2014.
- **Exchange rate:** The real effective exchange rate of the Metical remained overall stable throughout 2014, despite a slight nominal depreciation against the US Dollar and appreciation against the Rand. This stability was due to a greater availability of foreign currency in the market. The Bank of Mozambique (BM) continued to ensure the availability of foreign exchange for essential imports such as fuel, and to smoothen temporary exchange rate volatilities.
- **External current account:** In the first half of 2014, the current account deficit declined by 15 percent to \$2.6 billion (in comparison with the same period last year), due to the substantial reduction of imports (7.5 percent) in line with the slowing of the investment activities by megaprojects. At the same time, exports revenues fell by 8.4 percent to \$1.8 billion (of which \$1.1 billion from megaprojects), driven by lower commodity prices for both traditional and megaprojects exports, including for aluminum (9 percent) and coal (16 percent).

- **Budget Implementation**

- Revenue collections in the first 9 months of 2014 reached 20.8 percent of GDP, over 4 percentage points of GDP higher than a year ago. In addition to the capital gain tax collected in March (\$523 million, about 3.1 percent of GDP), most categories performed better relative to GDP than a year ago. Nonetheless, the program's indicative target was missed by a small margin.
- Expenditures up to September of 2014 amounted 26.8 percent of GDP, 2.6 percentage points higher than a year ago, with current expenditures leading the acceleration, mainly through increases in the wage bill and outlays on goods and services. Even though capital expenditure performance surpassed that of 2013, reaching 1.4 percent of projected 2014 GDP, it was mostly domestically financed investment as lower-than-programmed foreign financing kept the execution rates of externally financed capital expenditure and net lending below those of 2013.
- The fiscal deficit before grants stood at 5.3 percent of GDP by end-September, financed through a combination of grants (3.2 percent of GDP) and external financing (2.8 percent of GDP), enabling the government to constitute (net) deposits (0.7 percent of GDP).
- **FDI, aid/loan disbursements, reserves.** FDI flows into the country more than doubled in the first six months of 2014, compared with the same period of previous year, mainly related to the ongoing investment in the mining industry, particularly of gas and coal. Furthermore, the country benefited from windfall revenues from the sale of shares of companies in the natural gas sector. This boosted the international reserves to historically high levels of \$3.1 billion at end-September 2014 (about 4.4 months of current imports of goods and non-factor services excluding mega projects).

3. Program Performance

- **All but one assessment criteria (AC) through June were met (Table 1).** The AC for reserve money was missed by a small margin, largely due to a larger-than-programmed rise in currency in circulation.
- **Performance of the September indicative targets (IT) was mixed with 3 of 8 indicative targets met (Table 1). Three targets were missed by small margins:** reserve money due to persistent large rise in currency in circulation, priority spending and government revenues were slightly below target. **One target was missed for technical reasons:** The strengthening of the US dollar against some non-dollar components of the NIR basket caused valuation losses and the nonobservance of this indicative target, while the underlying reserve accumulation path remained on track. **One target was missed by a significant margin:** net credit to the government due to extra unexpected spending required in order to implement the peace and political stability agreement signed in September 2014, higher-than-expected election-related spending with goods and services, and increases in wages and current transfers.

- **Performance on the structural benchmarks (SBs) was mixed with only 3 of 7 SBs met on time. Three others needed to be rescheduled by 3-9 months, and one SB no longer attainable (Table 3).** As explained in para. 17 below, the SBs on the Integrated Investment Program cannot be attained in the near future due to both technical assistance constraints and limited capacity; we have suggested remedial actions. The SBs on tax payment through banks, the clearance of VAT refund backlog, and the establishment of a movable collateral registry need to be rescheduled.

II. MACROECONOMIC POLICIES

A. Economic Objectives

- 4. Economic outlook for 2014-19.** We expect strong economic growth in the medium term reflecting large investments in infrastructure and the boom in the mining and the hydrocarbon sector, supported by the recovery of the world economy and commodity markets. However, there is a downside risk if the current weakness in global commodity markets persists.
- 5. GDP growth.** The economy is expected to grow by 7.5 percent in 2014 and 7.7 per-cent in 2015 as a result of strong growth in financial services, electricity, construction, and transport and communications sectors. The expected increase in agriculture production for the 2014/2015 harvest is subject to climate risks such as drought and above-normal rainfall. The completion of new transport investments by 2015, including the Nacala railway, Nampula airport and upgraded Sena railway, would allow an increase in coal production and exports during the next few years, assuming world market conditions for coal improve. Over the medium term, the implementation of other infrastructure projects, the development of natural gas liquefaction, the related activity in transport and communications and construction, and a continued strong performance in other sectors are projected to keep economic growth at an average of 7-8 percent a year.
- 6. Inflation.** In light of the low inflation recorded so far this year, average and year-on-year inflation rates of 2.6 and 3.0 percent are expected. In 2015-17 inflation is expected to rise somewhat to our medium-term objective of an average annual inflation of 5-6 percent per annum.
- 7. External current account.** Balance of payments developments in coming years (2015–19) will continue to be driven by large investments in natural resource projects. The current account deficit is expected to deteriorate on account of imports of machinery, equipment and services by megaprojects. Thus we expect a reserve cover ratio of about 2.4 and 4.0 months of projected imports of goods and services, including and excluding megaprojects, respectively.

B. Macroeconomic Policy Mix

- 8. We will seek to maintain macroeconomic stability and promote sustainable and inclusive economic growth** by reducing the after-grants fiscal deficit gradually to around 5 percent of GDP in 2019. Revenues should average some 25.6 percent of GDP per annum during 2015-2019, in the absence of further windfall revenue from capital gains taxes. In the medium term, it is expected that the growth of current expenditure will slow and investment expenditures will fall from

its current high level with the forecast reduction in external financing (mainly grants). We expect to parallel the continued revenue effort with increased rigor and rationality of public expenditure. Fiscal policy will be geared towards maintaining debt at sustainable levels, gradually reduce dependence on external financing, as well as minimizing the exposure of the debt portfolio to currency risk. In addition to assuring price stability, monetary policy will create an environment conducive to high growth of credit to the private sector in order to support investment and production.

C. Monetary and Exchange Rate Policy

9. The monetary policy stance for 2015 will be moderated. The Bank of Mozambique (BM) will continue to intervene in the money and foreign exchange markets in order to ensure reserve money growth consistent with our price stability objective. The BM will seek to keep base money growth to 18.5 percent in 2015, and monitoring risks and stand ready to tighten monetary policy if inflation significantly exceeds the medium-term target.

10. We remain committed to a flexible exchange rate regime. The BM will allow the exchange rate to adjust freely to evolving patterns of trade and financial flows and closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies, with a view to ensuring external competitiveness and a comfortable level of international reserves.

11. The Mozambican authorities remain committed to their 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

12. Fiscal Stance and 2015 Outlook. The fiscal stance for 2014 is expansionary with an overall fiscal deficit after grants that is expected to increase from 2.8 percent of GDP in 2013 to 10.6 percent of GDP in 2014, reflecting significant spending increases both on the wage bill and goods and services and on investment. As a continuation of this fiscal stance could create problems in the future, a consolidation effort will be required in 2015. The adjustment to a fiscal deficit after grants to 7.5 percent of GDP in 2015 will be made through a combination of revenue efforts and expenditure restraint.

13. Revised 2014 budget

- **The Budget Law for 2014 was amended** after the approval of the new Electoral Law by the Parliament. This required additional expenditures to finance the October 15 elections (bringing the total budgeted cost of the elections to around \$136 million). Additional spending was also required to complete investment projects that lost foreign support in 2013 (\$25 million), and parliament allocated an additional \$100 million to priority sectors.

- After the 2014 budget amendment, Parliament approved Law 29/2014 on the Definitive Cessation of Military Hostilities that affected the country, requiring extra expenditure of \$15 million. We will take measures to contain other spending and stay within the overall limits set by the state budget.

14. Revenue outlook for 2015. We are committed to continuing our efforts to strengthen revenue collections gradually, continuing our trajectory of improving revenue administration in the medium term.

15. Expenditure policy for 2015. The 2015 budget will contribute to poverty reduction by prioritizing the allocation of resources to the economic and social infrastructure, human capital, expansion and diversification of public goods and services and public sector reforms. Nonetheless, some reduction in spending relative to GDP will be needed.

- **Wage bill policy.** We expect to reduce the weight of the wage bill slightly through (i) a deceleration in the pace of new hiring and in the creation of new institutions in Public Administration; (ii) payment of wages via direct bank transfer in order to prevent circumvention of the salary fund; (iii) enhancing the rigor of the institutions in the payment of allowances related to extra hours; and (iv) verification of the civil servants registry (e-CAF) in 2015.
- **Strengthening social protection.** Continuous implementation of the Basic Social Protection program in 2015 will require an amount of MT 3.522, 3 million, of which MT 2.339, 9 will be raised domestically and MT 1.182,4 from external financing. The number of beneficiaries is expected to increase by 25 percent from 439.144 in 2014 to 550.000 in 2015.
- **Subsidies for petroleum products.** The Government currently subsidizes only diesel prices for general consumption (other than megaprojects, construction, public works and other large consumers), but not other fuels. The full diesel price is charged to megaprojects, construction companies, and roads and railway companies. The amount of compensation paid to fuel importers in 2013 was 0.6 percent of GDP related to fuel sales in 2012; the amount due and paid in 2014 (mainly on fuel sales during 2013) was 0.05 percent of GDP. We expect that the recent drop in international fuel prices will contain the amount of compensation due to fuel importers in 2015 (on fuels sales during 2014).
- **Other subsidies.** The Government continues to subsidize the price of bread flour, public transportation, and school feeding programs. The subsidy cost is expected to reach 0.1 percent of GDP at end-December 2014. The draft 2015 budget envisages their continuation. Subsidies for public transportation and wheat flour are intended to hold down the cost of living, while the school feeding program increases student attendance and quality of school learning.
- **Electricity tariffs.** While not a direct budgetary expense, low electricity tariff have required the government in the past to forgive debt owed to it by the electricity company (EDM). A tariff study was completed and submitted to the Cabinet, but approval of its recommendations

depends on the Cabinet agenda. EDM's performance contract is currently under negotiation and expected to be signed during the 1st quarter of 2015.

16. Deficit and financing. The budget deficit for 2015 before grants is forecast at 11.1 percent of GDP to be financed by domestic credit of 1.1 percent of GDP, and foreign credit of 6.4 percent of GDP, as well as by grants of 3.6 percent of GDP. The domestic primary deficit is projected to narrow to 0.9 percent of GDP.

III. PUBLIC FINANCE STRUCTURAL REFORMS

Investment Planning and Debt Management

17. Public Investment Management. The structural benchmark on refining the Integrated Investment Program (IIP) by end-June 2014 was missed due to both unanticipated constraints in implementation of the initial time schedule for technical assistance and to limited capacity and difficulties in collecting and processing information from a large pool of investment projects of line ministries. We will prepare a detailed report on the main weaknesses identified with a roadmap to implement this reform. A revised version of the IIP was prepared in October 2014 that provides more financial information for investment projects in which funding has been secured, albeit still too partial to adequately inform the DSA and the Medium-Term Fiscal Framework (MTFF). Going forward, the government will strengthen the investment planning process as part of implementation of the Framework for Planning and Budget System (SPO) over the next few years, drawing on ongoing work to develop instruments for design and project selection to include in the IIP. Furthermore, under the upcoming review of the entire planning and budgeting system, we plan to conduct an assessment of the status of the linkages between various instruments, including how IIP fits in the system. As a first step to improve the decision making process on investment, we will include in the budget guidelines to be issued by May 2015 the requirement of a mandatory technical assessment by the Investment Evaluation Committee for any new public investment project to be considered for or included in the 2016 and subsequent budgets of a value of \$50 million or more (**structural benchmark**).

18. Strengthening public debt management. We updated the DSA in October 2014 (including scenarios for future borrowing and sensitivity analysis). All key indicators remain below the critical thresholds in the baseline scenario, but are vulnerable to shocks such as FDI and the exchange rate. We expanded the coverage of the DSA, the annual and quarterly public debt and budget execution reports this year to include government guarantees. We have reconciled the stock of public external debt with creditors and upgraded our debt management software (CSDRMS2000+). We will work with an IMF technical assistance mission in December on debt reconciliation and projecting debt service and loan disbursement profiles. We plan to revise the Debt Management Strategy by end-June 2015.

19. Guarantee management policy. With the 2013 public debt report published in May 2014 we started to disclose all government debt guarantees and their beneficiaries. We are developing capacity to assess the probability and impact of potential default of this exposure. The projects that

benefit from such guarantees are regularly monitored by the Ministry of Finance to minimize the risk of default.

Public Financial Management (PFM)

20. To refocus the PFM reform process, we plan to establish a PFM User Forum including representatives of line ministries, provinces, private sector and development partners. The PFM User Forum would provide oversight, give strategic direction and monitor reform progress, and ensure consultation on user needs and priorities. We are also working to strengthen the staffing of the technical team dedicated to PFM reform coordination (CEDSIIF), which will coordinate the PFM User Forum.

21. Expenditure Coverage and Tracking. Substantial efforts have been made to increase the coverage of the integrated financial management system (e-SISTAFE). We are committed to increasing the share of expenditures paid through e-SISTAFE directly to the beneficiary, and expect to meet the end-2014 target of reaching 65 percent of total spending. The system is expected to reach 70 percent in 2015 and 75 percent in 2016, which requires completion by end-2015¹ of the system's geographical roll out, technical conditions permitting. A major reform will be to start using e-SISTAFE also to record real-time expenditure commitments and verifications. We have successfully tested this in the area of public debt service, and plan to expand this to salaries paid through e-Folha by end-December 2015. The roll-out will require substantial training, minor adjustments in our current rules, and the development of our cash management techniques.

22. Wage bill management. The government wage bill has risen to around 11 percent of GDP due to substantial hiring in the social sectors and for the elections and the recent real wage increases granted. The government is considering ways to gradually reduce the relative size of the wage bill. We continue to improve the management and transparency of the wage bill. As a result of the reforms introduced last year, 85 percent of civil servants registered in the civil service registry (e-CAF) now receive their salary directly in their bank account. We plan a proof-of-life audit for all registered civil servants in 2015. The Government remains committed to expanding the electronic salary processing system (e-Folha). By end-October 2014, 70 percent of registered civil servants were paid through e-Folha. We plan to increase coverage to 95 percent by end-2015.

23. Cash Management. Extending the use of the treasury single account (CUT) remains a high priority. The administrative order to reduce the number of bank accounts outside the CUT (Circular No. 02/GAB-MF/2014) needs to be complemented by additional instructions to ensure enforcement in the financial sector. We plan to complete a mapping of all government bank accounts outside the CUT by end-March 2015. To increase the use of the CUT, we will transfer all revenues into the CUT regardless of their classification.

24. We are clarifying the scope of the public sector. We are in the process of identifying (i) public funds, autonomous entities, and other bodies of public law with legal, administrative and

¹ 71 percent of spending units (UGBs) currently have direct access to the system.

financial autonomy (“equiparados”), (ii) public enterprises and corporations owned and/or controlled by the State, (iii) minority state shareholdings in private companies, and (iv) indirect shareholdings of the State, via other public entities. The statute of public funds and autonomous entities has been drafted and is expected to be approved in 2015.

25. Fiscal Risk Management. A World Bank mission in November 2014 is expected to provide assistance in the design of a fiscal risk unit in the Ministry of Finance. This unit will be set up by end-March 2015. This will enable the Government to produce an initial description of fiscal risks for inclusion in the 2016 budget documentation by October 2015.

26. Fiscal Rule for Windfall Revenue. We have benefited from substantial capital gain taxes associated with transactions involving transfers of ownership stakes in large natural resource projects (especially in the gas sector). These transactions provided cumulative one-off tax receipts of about 8.1 percent of GDP in 2012-14. While the large and regular influx of natural resource revenue from LNG is expected to start only in a decade, it is possible that additional transfers of ownership could generate additional capital gains taxes in the next few years. To ensure the use of these resources only for public investment, debt repayment, and national emergencies², the Draft 2015 Budget Law includes an ex-ante rule for the use of windfall revenue (**structural benchmark**).

Revenue administration

27. VAT administration. We have made some progress in preparing the securitization of the stock of unpaid VAT refund requests, which we estimate at \$250-300 million by end-2014. It is expected that a private placement covering the whole stock of arrears takes place in the first quarter of 2015 (**structural benchmark**). The 2015 budget proposal includes VAT revenue on a net (of refund requests) basis.

28. Implementation of e-Tax. We have made some progress in registering taxpayers into the new electronic system; 51 percent of VAT taxpayers and 100 percent of the small taxpayers subject to the simplified tax (ISPC) have now updated their data in e-tax (e-tributacao). We have successfully piloted e-tax to collect VAT and ISPC taxes in two tax offices and we are preparing a roll-out plan to further expand this system to all tax offices, starting in November 2014. Our intention is to collect VAT and ISPC taxes through e-tax by end-2015, technical conditions permitting. In parallel, we will pilot income taxes in this new system by end-2015. The on-line taxpayers’ portal connected to e-tax will be developed by end-September 2015.

29. Tax Payment through Banks. Given the fact that the full implementation of e-tax will take until end-2016, during the transition phase we have created an IT application outside e-tax, which can be used to pay all taxes through banks (including VAT, ISPC (simplified tax for small taxpayers), corporate income tax, and personal income tax). This IT functionality allows for both on-line submission and electronic payment of tax assessments. We are currently testing this IT application in

² In case of temporary severe cash constraints generated by unexpected shortfalls in budget support, windfall deposits could be used on a temporary basis.

collaboration with two commercial banks. A pilot will be conducted in December 2014 and will involve several tax offices and banks. We intend to expand this application throughout the country to make it fully operational by end-June 2015 (**structural benchmark**).

30. Modernizing the Revenue Authority (AT) to improve revenue collection. For 2015, the AT will revamp its organizational structure with IMF technical assistance. A taskforce has been created to assess the current organization structure with a view to improving managerial practices. Part of the efforts to adapt the AT to the new challenges will include (i) enhancing management of large taxpayers, (ii) improving management capability, (iii) strengthening the audit function, and (iv) developing expertise in natural resource revenue collection.

Natural Resource Management

31. Extractive Industry Transparency Initiative (EITI). The fifth report on transparency initiative related to 2012 is being drafted according to the new EITI principles and is expected to be finalized end-December 2014. The mining cadaster is now accessible online; also available on the Government website are the contracts, legislation and regulations, reports and publications from the extractive sector. A public education campaign is ongoing and the Secretariat of the Coordination Committee is continuously improving the implementation of EITI in the country. We are also taking actions to disseminate the reports and interpretation of the new principles of the EITI for the benefit of all stakeholders, aiming to cover the whole country. Besides the natural means of dissemination, we also promote TV and radio debates on the EITI and reports.

32. Mining and Hydrocarbon Legislation. The Mining and Hydrocarbon Laws have been approved by Parliament in August 2014, and currently we are drafting the respective regulations to be subject to consultation with line ministries and stakeholders before submission for approval of the Cabinet in the first quarter of 2015.

33. Strengthening the Mining and Hydrocarbon Tax Regime. The revised Mining and Hydrocarbon Fiscal Laws have been approved by Parliament in August 2014. We are preparing the respective regulations for submission to the Cabinet by end-2014.

34. Development of natural gas liquefaction. The Law authorizing the Government to establish a special regime for the LNG project was approved by Parliament in August 2014 to facilitate the implementation of the LNG Project of the Rovuma Basin, areas 1 and 4. The Decree-Law for the special LNG regime is being finalized and is expected to be approved by the Council of Ministers by end-December 2014.

Public Enterprises

35. We are strengthening our supervision of public enterprises as described in paragraphs 22-23 of the MEFP of April 13, 2014.

- **The 14 fully state-owned enterprises (SOEs) monitored by the Ministry of Finance are subject to special controls.** In particular, four of the six largest SOEs already published their 2013 reports and accounts, the remaining two large SOEs are in the process of finalizing their

reports. We expect to submit a report about all 14 SOEs to the Council of Ministers by end-December 2014. We monitor and supervise the fiscal risks of SOEs as their indebtedness is subject to authorization by the Ministry of Finance based on a case-by-case analysis of an enterprise's financial sustainability.

- **For the public corporations supervised by IGEPE, we prepared a draft law on the Corporate Sector of the State (SEE),** and consulted with stakeholders, including the donor community. Currently, the recommendations for improvement are being incorporated and the draft is being vetted by the Legal Office. We expect to submit it to the Council of Ministers before the end of 2014. The draft law is an effort to improve transparency and aims to consolidate and clarify existing legislation that currently applies to the SEE and fills a gap in the regulation of public corporations created under the commercial law/regime.
- **The Government plans to consolidate its portfolio of enterprises over the medium term, including through privatization and liquidation.** Since January 2014, we reduced the portfolio by 2 enterprises (4 were sold and 2 new, including EMATUM, were incorporated) to a total of 117 public corporations. We aim to sell all shares in non-strategic companies where government participation is below 20 percent. With some technical assistance from the World Bank, we are (i) preparing a financial assessment of the portfolio of state shareholdings in companies; (ii) compiling information on indirect participation of the State; (iii) training public managers in matters of governance; (iv) consolidating financial statements; (v) standardizing the remuneration of state enterprise managers; and (vi) improving the control of indirect state holdings through assessing business plans, attending all general meetings and discuss the financial and operational performance of the company concerned.

36. EMATUM is subject to strict financial controls in line with the framework that applies to SOEs. The company has in July 2014 submitted quarterly operating and financial reports to the Ministries of Finance (MF) and Fisheries. The government requested an external audit of EMATUM's 2013 accounts by an international audit firm, which will be published by end-2014. Starting with the 2013 accounts EMATUM will publish its audited annual reports.

IV. FINANCIAL SECTOR POLICIES

Strengthen Monetary Policy Formulation and Implementation

37. Monetary policy framework. The BM will continue to strengthen the monetary policy framework and to improve the analytical capacity and communication in the monetary policy decision-making process, including by improving its inflation forecast model with technical assistance from IMF.

- The basic model structure has been set up and calibrated for the Mozambican economy; and a shadow forecast process has been initiated since September 2014, while the model continues to be improved.
- Following the conclusion of the forecasting system, the BM intends to introduce improvements in the forward-looking component of the Monetary Policy Committee press release and in the Monetary Policy Report in order to enhance transparency.

38. The BM has made considerable progress towards improving its liquidity management framework. However, there is the need to improve the forecasts of currency in circulation and government cash flow, as well as deepening the money markets.

39. Information sharing and coordination between MF) and BM. Progress has been achieved in the coordination between the MF and BM in recent years to improve liquidity management. Under the MoU between BM and MF, the latter has been sharing, on a weekly basis, relevant short-term statistics on government operations with BM. The MF will provide the BM with historical information on classifications of payments to help improve its forecasting accuracy.

40. Liquidity forecasting. The data collection mechanism is under review. With IMF technical assistance, work is ongoing to improve the currency and government operations forecasting framework, including by lengthening the horizon of high frequency liquidity forecasts to one month, or a full quarter.

41. Money market management. The BM is moving toward relying more on repo operations in its liquidity management. The reform towards allowing T-bonds as collateral in money market operations is underway. The BM, MF, and the Stock Exchange are working to resolve the remaining legal and IT issues with a view to completing this reform by September 2015 (**structural benchmark**).

Financial Sector Surveillance

42. The BM remains committed to strengthening of banking system supervision and crisis management.

43. Stress testing and non-performing loans (NPLs). Stress testing has been carried out on a quarterly basis and the BM continues to strengthen the data collection process, which remains the main obstacle to effective stress testing. The June 2014 stress test report was produced and

submitted to the Board of BM. While the results show low risk of financial sector distress, they point to credit concentration as the largest source of risk. The stress test reporting for the second half of 2014 is under preparation. The adoption of the revised NPL definition starting in January 2014 increased the NPL ratio slightly, but the average ratio remains low at 3.5 percent at end-June 2014.

44. Risk-based supervision and Basel II adoption. All banks have submitted to the BM their risk management programs. The BM continues to conduct on-site inspections based on each bank's risk profile. Four banks with high and medium systemic relevance have been the objects of inspection in 2014 and the goal is to gradually cover the whole banking system. The draft regulation on concentration limits, including investment abroad, has been revised based on IMF technical assistance and BM Board inputs. A study is ongoing based on data from June 2014 to assess the compatibility of the draft regulation with the Basel II principles. The revision is expected to be completed by end-June 2015.

45. Financial Sector Contingency Plan. The BM Board approved the terms of reference requesting technical assistance from the World Bank to support the implementation of the Financial Sector Contingency Plan. The technical assistance work started in November 2014 and an action plan for the simulation exercise was approved by the BM board in late-November 2014. The simulation exercise is expected to be initiated in the first quarter of 2015.

46. Deposit Insurance Fund (DIF). The Executive Board of DIF has completed the report on the implementation process which was submitted to the BM Board in October 2014 for consideration. Discussions between DIF, MF and BM are in the final stage, focusing on some key aspects, such as (i) the deposits coverage, (ii) effective starting date for the DIF and (iii) annual premium to be paid by banks. The DIF Board has benefited from KfW's technical expertise in DIFs and is discussing with KfW its financial support. The Government is expecting to make its initial contribution to the DIF in 2015.

Financial Sector Development

47. The Government and the relevant agencies have begun to implement the Financial Sector Development Strategy (FSDS) 2013-2022. The main objectives are to: (i) maintain financial sector stability; (ii) increase access to financial services and products, eliminating structural constraints in the economy, specifically those that limit financial intermediation and access to financial services; and (iii) increase the supply of private capital to support private sector development. The first semester 2014 progress report is being prepared by an inter-agency working group by end-2014.

- **Promoting financial inclusion.** Consistent with the FSDS, we will prepare by end-December 2015 the National Financial Inclusion Strategy (ENIF); diagnostic work on this is under way. Meanwhile, the BM launched the Financial Literacy Program in October 2014, which includes financial education broadcasts on TV and radio and financial lectures throughout the country. Following the Government's approval in June of the Decree 30/2014 that allows the creation of banking agents, particularly in rural areas, to perform certain banking services, the BM will approve the related regulation by end-March 2015.
- **Establishing credit registry bureaus (CRB).** The proposal of Law on the creation of private credit registry bureaus was submitted to Parliament in February 2014, but has not been

- approved yet due to a very heavy parliamentary agenda in 2014. Nevertheless, the respective regulation is being prepared and will be approved within six months of the approval of the Law.
- **Promotion of mobile banking.** We plan to approve new electronic money regulation by June 2015. The regulation will protect the users of mobile banking services by ensuring a clear separation of funds deposited in the mobile operator's trust account from the operator's other accounts.
 - **Promotion of competition within the banking sector.** The Bank Notice 01/GBM/2014 on the regulation of bank cards was approved in June and was published. The board of the BM approved in July a draft revision of Notice 05/GBM/2009 aiming at promoting the transparency of prices and commissions for financial services and products; we are consulting commercial banks on it and expect final approval in June 2015.
 - **Capital Market Development.** During 2014, the Stock Exchange's financial education program was implemented including (i) the launch of the National Capital Market Conference to promote and disseminate the capital market and Stock Exchange in Mozambique; (ii) visits to 4 provinces targeted to Government officials, public entities and enterprises, private companies and other market stakeholders. This dissemination envisages to raise awareness of the benefits of the capital market as a vehicle through which businesses and other institutions are able to obtain financing.
 - **Centralizing the registry of security holdings.** The technological and operational conditions for the full operation of the Central Securities Depository (CSD) were established in June 2014: (i) approval of the legal framework related to the CSD operations; (ii) user training of brokers and custodians to familiarize them with the CSD functionalities. The process of Data Verification and Migration has started as one of the first activities of the CSD, which was followed by the registrations of new securities, in the 4th quarter of the year.
 - **Movable collateral framework.** The first phase of the diagnostic study on establishing a movable collateral registry bureau was completed in October. It aimed at collecting international experiences on the subject, mapping existing assets used as collateral, and reviewing current collateral execution mechanisms. The second phase--preparation of the draft collateral law--is currently underway with technical assistance in November. The submission of the Law to the Council of Minister envisaged for December 2014 (**structural benchmark**) will be delayed due to the complexity of the subject and scarcity of relevant international experience, but we are now envisaging it in September 2015 (**structural benchmark**) with technical assistance from GIZ.
- 48. AML/CFT Framework.** The regulation of the Law on AML/CFT was approved by the Cabinet in August 2014 and is now awaiting publication in the State Gazette. The BM's guidelines for commercial banks on AML/CFT are expected to be approved in March 2015.

Payment System

49. Reforms in the Payment System

- **Enhancing BM oversight practices.** The first annual oversight report was completed in October 2014 (**structural benchmark for November**). Based on the methodology approved by the BIS in 2001 on core principles for systemically important payment system, the first annual report shows that in general the national payment system has made significant improvements in terms of compliance with the best practices at national and international standards, but the areas of liquidity management and credit risk in the system are slightly lagging behind. With regard to mobile operators, the Payment System Oversight Unit undertook an ad-hoc inspection of *Mkesh* in October 2014. The onsite inspection of *M-pesa* has been postponed to the first semester of 2015 in order to benefit from the MEFMI technical assistance mission scheduled for March 2015 on the implementation of the BIS Principles for Financial Market Infrastructure of 2012.
- **Developing the retail payments network (SIMO).** Seventeen ATM's and seventeen POS from three major banks and one medium-sized bank are connected to SIMO. The connection for the remaining banks is expected to take place gradually, and we are working with individual operators to establish a schedule.

Good Governance and Business Environment

50. Anti-Corruption Package. Parliament approved the new Penal Code in July 2014 after much discussion, but approval of the Penal Procedural Code is still pending. The draft *Action Plan* for the effective implementation of the 5-law anti-corruption package is under discussion and it is expected to be submitted to the Council of Ministers by end-2014.

51. The implementation of the Business Environment Improvement Strategy (EMAN II 2013-2017) is underway.

- **The registration and licensing of economic activities is speeding up.** Following the approval of the Single Form in December 2013, which harmonizes procedures for registering companies, the pilot phase is being implemented in the City of Maputo, Xai-Xai, Inhambane, Beira, Nampula and Pemba. In addition, we are monitoring and evaluating the transition to electronic means (e-BAÚ). The Single Form is being implemented in the same provinces where e-BAÚ will be introduced. This allows a smooth integration of the Single Form into the e-BAÚ platform.
- **An electronic platform for registration and licensing services of new businesses (e-BAÚ) was launched in August 2014,** and is operating in the city of Maputo (Balcão de Atendimento da Cidade de Maputo), bringing together all units related to the process of licensing of economic activities. e-BAÚ enabled the registration of property within 2 days rather than the 10 day legal limit and decreased travel and time costs for economic agents. e-BAÚ is now being expanded to the provinces of Maputo, Cabo Delgado, Nampula, Sofala, Inhambane and Gaza,

and we expect to cover the whole country in 2015. We also expect to launch in 2015 a website (www.portaldocidadão.gov.mz) as a tool for the private sector for disclosure of all information related to procedures, required documents, time, cost, legislation, licensing and complementary services.

Program Monitoring

52. The proposed assessment criteria and indicative targets up to December 2015 are shown in Table 2. Table 4 shows a list of proposed structural benchmarks. The 4th PSI review is expected to be completed by end-June 2015 (as specified in the MEFP date April 23, 2014) and the 5th review by end-December 2015.

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets for 2014¹
(Millions of meticaís, unless otherwise specified)

	2014											
	End-March Indicative Target				End-June Assessment Criteria				End-Sept Indicative Target			
	Prog.	Adj.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Adj.	Act.	Status
Assessment Criteria for end-June/December												
Net credit to the central government (cumulative ceiling)	889	-14,249	-13,192	NM	-7,985	-7,985	-8,247	M	-13,721	-13,721	-4,425	NM
Stock of reserve money (ceiling)	45,100	45,100	45,007	M	48,023	48,023	48,933	NM	50,689	50,689	52,713	NM
Stock of net international reserves of the BM (floor, US\$ millions)	2,961	3,452	3,192	NM	3,107	3,107	3,182	M	3,188	3,188	3,100	NM
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US\$ millions) ²	1,200	1,200	926	M	1,500	1,500	978	M	1,500	1,500	1,298	M
Stock of short-term external debt contracted or guaranteed by the central government (ceiling) ²	0	0	0	M	0	0	0	M	0	0	0	M
External payments arrears of the central government (ceiling, US\$ millions) ²	0	0	0	M	0	0	0	M	0	0	0	M
Indicative targets												
Government revenue (cumulative floor)	25,519	41,583	41,193	NM	75,365	75,365	75,552	M	112,616	112,616	109,976	NM
Priority spending (cumulative floor)	20,686	20,686	21,664	M	46,299	46,299	47,652	M	80,738	80,738	78,986	NM

Sources: Mozambican authorities and IMF staff estimates.

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

² Assessed on a continuous basis.

Table 2. Mozambique: Quantitative Assessment Criteria and Indicative Targets for 2014-15¹
(Millions of meticaís, unless otherwise specified)

	2014		2015			
	End-Dec Assessment Criteria		End-Mar Indicative Target	End-June Assessment Criteria	End-Sept Indicative Target	End-Dec Indicative Target
	Prog.	Proposed	Proposed	Proposed	Proposed	Proposed
Assessment Criteria for end-June/December						
Net credit to the central government (cumulative ceiling)	-2,954	2,594	4,146	-1,902	-5,675	6,391
Stock of reserve money (ceiling)	54,370	55,299	53,559	58,866	62,940	65,529
Stock of net international reserves of the BM (floor, US\$ millions)	3,397	3,147	2,990	3,048	3,201	3,398
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US\$ millions) ²	1,500	1,500	1,500	1,500	1,500	1,500
Stock of short-term external debt contracted or guaranteed by the central government (ceiling) ²	0	0	0	0	0	0
External payments arrears of the central government (ceiling, US\$ millions) ²	0	0	0	0	0	0
Indicative targets						
Government revenue (cumulative floor)	143,957	143,957	30,200	69,460	110,230	151,000
Priority spending (cumulative floor) ³	121,294	119,000

Sources: Mozambican authorities and IMF staff estimates.

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

² Assessed on a continuous basis.

³ Targets for 2015 are to be redefined with the new government during the 4th PSI review.

Table 3. Mozambique: Structural Benchmarks for 2014

Structural Benchmarks	Date of Implementation	Status
The Ministry of Planning and Development will approve, and share with IMF staff, a revised IIP with financial information for projects for which financing has been secured and summary project information to inform the DSA, MTEF and the budget. (¶14 of the MEFP date April 23, 2014)	End-June 2014	Not met (proposed to be reformulated)
The Government will present VAT collections on a net basis in the 2015 budget proposal documents. (¶16 of the MEFP date April 23, 2014)	End-October 2014	Met
The Government will finalize and fully operationalize the IT application for tax payments through banks for VAT and ISPC. (¶16 of the MEFP date April 23, 2014)	End-October 2014	Not met (proposed to be rescheduled to June 2015 and broadened)
The Board of BM will approve the action plan for the simulation exercise pertaining to the Financial Sector Contingency Plan. (¶27 of the MEFP date April 23, 2014)	End-November 2014	Met
The BM will issue the first annual payments systems oversight report. (¶30 of the MEFP date April 23, 2014)	End-November 2014	Met
The government will either pay or securitize the stock of valid VAT reimbursement requests submitted up to end-2013. (¶16 of the MEFP date April 23, 2014)	End-December 2014	Not met (proposed to be rescheduled to March 2015 and broadened)
The Government will establish a movable collateral registry. (¶28 of the MEFP date April 23, 2014)	End-December 2014	Not met (proposed to be rescheduled to end-Sept. 2015)

Source: IMF staff and the Mozambique authorities

Table 4. Mozambique: Proposed Structural Benchmarks for Dec. 2014-2015

Structural Benchmarks	Date of Implementation	Comment	Macroeconomic Relevance
The Government will issue budget guidelines requiring a mandatory technical assessment by the Investment Evaluation Committee for new public investment projects to be included in the 2016 and subsequent budgets of a value of \$50 million or more. (¶17 of this MEFP)	End-May 2015	Proposed remedial action to missed June 2014 IIP SBM	Strengthening public investment management
The government will either pay or securitize the stock of valid VAT reimbursement requests submitted up to end-2014. (¶ 27 of this MEFP)	End-March 2015	Proposed to be rescheduled and broadened from end-Dec. 2014	Strengthening tax administration
The Government will finalize and fully operationalize the IT application for payments of VAT, ISPC, and corporate and personal income taxes through banks. (¶16 of the MEFP date April 23, 2014 and ¶29 of this MEFP)	End-June 2015	Proposed to be rescheduled and broadened from end-Oct. 2014	Strengthening tax administration
The use of T-bonds as collateral in money market operations will become operational. (¶41 of this MEFP)	End-September 2015	Proposed	Deepening capital markets
The Government will include in the draft 2015 budget a fiscal rule on the use of windfall revenue only for investment spending, debt reduction and exceptional needs. (¶26 of this MEFP)	End-June 2015	Proposed	Ensuring fiscal sustainability
The Government will establish a movable collateral registry. (¶28 of the MEFP date April 23, 2014, ¶47 of this MEFP)	End-September 2015	Proposed to be rescheduled from end-Dec. 2014	Deepening financial markets

Sources: IMF staff and the Mozambique authorities

Attachment 2. Technical Memorandum of Understanding

December 12, 2014

1. This Technical Memorandum of Understanding (TMU) dated April 23, 2014 remains in effect except for the updates below on the adjustors for net international reserves and net credit to central government, and Tables 1-2.

ADJUSTERS

A. Net international reserves

2. 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\$200 million), compared to the program baseline (Table 1);
 - upward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US\$30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector (Table 2);
 - downward/upward for any revision made to the end-year figures corresponding to the previous year; and
 - downward to accommodate higher external outlays because of natural disasters, up to US\$20 million.

B. Net credit to central government

3. 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\$200 million at exchange rates prevailing at the respective test dates), compared to the program baseline (Table 1);
 - downward by any windfall capital gain tax receipts (beyond the programmed amounts) in excess of US\$ 30 million collected during the program period, less (i) payments beyond those programmed on outstanding VAT refund requests, and (ii) any other debt reduction operations vis-à-vis the domestic nonbank sector (Table 2);
 - 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; (Table 2) 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.

TMU Table 1. Mozambique: Net Foreign Assistance, 2014-15

	2014		2015		
	Q4	Q1	Q2	Q3	Q4
	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US\$ mn)	55	-18	85	12	26
Gross foreign program assistance	115	11	154	96	61
Program grants	5	11	54	36	24
Program loans	110	0	100	60	38
External debt service	61	29	69	84	35
Cumulative net foreign program assistance in US dollars	103	-18	67	79	105
Gross foreign program assistance	333	11	165	261	322
External debt service	229	29	98	182	217
Net foreign program assistance (MT mn)	1,698	-550	2,670	389	831
Gross foreign program assistance	3,587	357	4,842	3,057	1,955
Program grants	162	357	1,689	1,158	752
Program loans	3,425	0	3,153	1,899	1,203
External debt service	1,889	906	2,172	2,668	1,124
Cumulative Net foreign program assistance in MTN millions	3,174	-550	2,120	2,509	3,340
Gross foreign program assistance	10,351	357	5,198	8,256	10,211
External debt service	7,178	906	3,079	5,746	6,871

Source: Mozambican authorities and IMF staff estimates.

TMU Table 2. Mozambique - Programmed VAT Requests and Refunds, 2014

	Q1	Q2	Q3	Q4	Total
Windfall capital gains tax, in millions of meticaïs	16,161	0	0	0	16,161
Windfall capital gains tax, in millions of dollars	523	0	0	0	523
Budgeted VAT refund payments, in millions of meticaïs	1,125	1,125	1,125	1,125	4,500
Budgeted VAT refund payments, in millions of dollars	36	36	37	36	144
Reduction of VAT arrears, in millions of meticaïs	0	0	0	0	0
Reduction of VAT arrears, in millions of dollars	0	0	0	0	0