International Monetary Fund

[Republic of Mozambique](#) and the IMF

Press Release:
IMF Executive Board Completes Second Review Under the Three-Year PRGF Arrangement for Mozambique and Approves US$2.4 Million Disbursement
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Republic of Mozambique: Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

May 26, 2005

Maputo, Mozambique
May 26, 2005

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

Dear Mr. de Rato:

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

2. The Government of Mozambique has made substantial progress in implementing the 2004-06 program supported by the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Fund's Executive Board on July 6, 2004. The general elections took place on December 1 and 2, 2004 and, as international observers noted, they were in general transparent and fair. However, some slippages in the implementation of the program occurred during the period leading to elections. One out of five quantitative performance criteria at end-December 2004 was not observed (i.e., the performance criterion on the domestic primary deficit). The breach of this criterion was the result of low revenue collections arising from larger-than-programmed reimbursements of the value-added tax (VAT), the appreciation of the metical, and delays incurred by corporations in complying with the payments calendar under the new corporate income tax code. In addition, some delays occurred in the implementation of structural reforms during October 2004-March 2005. Three out of eight benchmarks were observed while one of the two performance criteria was missed (the completion of a feasibility study on the divestment of the Government's participation in a commercial bank, which is now expected by end-September 2005).

3. The Government of Mozambique recognizes the significance of the fiscal slippage and some delays in the implementation of structural reforms. The Government will take strong corrective measures to address the slippages. It is also determined to intensify efforts in the remainder of 2005 to strengthen tax administration and accelerate the pace of reforms with the timely help of the international community. Moreover, in the event that revenue collection falls short of quarterly program targets, the Government of Mozambique will implement contingency expenditure measures as described in the MEFP in order to reach the targets set for the remainder of 2005.

4. On this basis, the authorities request waivers respectively for the quantitative performance criterion as well as the structural performance criterion that were not observed at end-December 2004. In addition, the authorities request the modification of quantitative performance criteria for end-June 2005 to take into account the performance at end-2004 and new seasonality of revenue and government expenditure.

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

6. Looking ahead, the policies set out in the MEFP aim to consolidate macroeconomic stability and sustain strong broad-based growth in order to promote employment and further reduce poverty. The performance criteria and benchmarks for the third review will be based on the end-June 2005 and end-September 2005 targets as set out in Tables 1 and 4 of the MEFP. The fourth review, which will make available the fifth disbursement, is expected to be completed by May 31, 2006, and will be based on the observance of the end-December 2005 quantitative performance criteria set forth in Table 1 of the MEFP. Additional conditionality for the fifth disbursement will be established at the time of the third review.

7. Moreover, the Government of Mozambique intends to accept its obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement as soon as the revisions to the foreign exchange law are approved by the Assembly.

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

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

Sincerely yours,

/ s /
Manuel Chang
Minister of Finance

/ s /
Adriano Afonso Maleiane
Governor
Bank of Mozambique

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

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

1. The Government of Mozambique is committed to consolidate macroeconomic stability and to achieve sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and structural reforms. The strategy to achieve these goals is set out in the Plano de Acção Para a Redução da Pobreza Absoluta (PARPA) approved by the Government in 2001. The Government's economic program is supported by the International Monetary Fund (IMF) with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved on July 6, 2004. This memorandum of economic and financial policies (MEFP) reviews the performance under the program (October 2004-March 2005) and describes the policies and targets for the remainder of 2005.

I. Recent Performance Under the PRGF-Supported Program

2. During the last decade, Mozambique's strong commitment to sound macroeconomic policies and structural reform has led to a remarkable improvement in economic performance, supported by substantial donor assistance. These efforts have resulted in robust economic growth, accompanied by a significant reduction in poverty, end-period inflation was reduced markedly to single digits, and international reserves rose to comfortable levels. These achievements were facilitated by a stable political situation and the consolidation of the democratic system, as illustrated by the recent presidential and parliamentary elections.

3. The economy continued to perform well in 2004. Real GDP growth is estimated to have decelerated to 7.2 percent (7.8 percent programmed), reflecting a slowdown in construction related to the completion of a number of private sector megaprojects, as well as a decline in fishing production as a result of climate fluctuations. Growth in all other sectors continued to be buoyant, including agriculture. End-period inflation declined to 9.1 percent in 2004 (below the program target of 11.0 percent) despite a sharp rise in petroleum prices. Megaproject-led exports have contributed to a significant decrease in the trade deficit, which coupled with higher-than-projected donor support and private capital inflows, boosted reserve accumulation well above the program target. This contributed to a 25 percent appreciation of the real effective exchange rate reversing its 8 percent depreciation over the past four years. This appreciation is in line with the changes in economic fundamentals characterized by a sharp increase in exports and capital inflows.

4. In the first quarter of 2005, inflation continued to decline to 6.1 percent at end-March. The exchange rate exhibited significant fluctuations in the aftermath of the introduction of the foreign exchange auction system in January 2005 (a structural benchmark for end-February 2005), which led the monetary authorities to increase sharply their foreign exchange sales (US$160 million) to reduce volatility during the first quarter of 2005. As a result, the metical depreciated by 4 percent vis-à-vis the U.S. dollar during January–mid-April 2005.

5. Fiscal consolidation was below expectations during the second half of 2004. This resulted in the nonobservance of the performance criterion on the government's domestic primary deficit by 0.6 percent of GDP (using the new GDP series). The revenue-to-GDP ratio fell short by 1.1 percent as compared with the programmed 13.4 percent. Collection of most taxes turned out to be lower than envisaged owing mainly to higher-than-projected reimbursements of the value-added tax (VAT) largely related to megaprojects, delays incurred by corporations in complying with the payments calendar under the new corporate income tax code, the weakening of the tax collection, and the appreciation of the metical. The revenue shortfall was partly compensated by cuts in current expenditures (0.5 percent of GDP) impacting negatively on their composition. Total priority expenditures reached 63.3 percent of total expenditure (excluding interest payments and net lending) instead of the programmed 65 percent. However, the end-December indicative target on the wage bill was observed. The overall deficit, after grants, exceeded the program target by 0.9 percent of GDP. However, net credit to the government was only slightly higher than programmed because of higher net external financing.

6. Based on preliminary information, revenue collection in the first quarter of 2005 has improved but is slightly below the program target (0.1 percent of GDP). However, identified primary domestic expenditures are higher than programmed (0.4 percent of GDP), mainly on account of a higher-than-expected wage bill (0.6 percent of GDP) that was only partially offset by restraining locally financed capital expenditure by 0.2 percent of GDP. The higher-than-expected wage bill was due to the payment of the 13-month wage and pension bonus corresponding to 2004, which was paid in the first quarter of 2005 (instead of end-2004 as originally programmed). In addition, the difference between the above-the-line recorded transactions and below-the-line financing shows an excess of unallocated expenditures equivalent to 0.4 percent of GDP. Overall, the indicative target on the domestic primary deficit may have been exceeded by 0.8 of GDP at end-March 2005.

7. Implementation of fiscal reforms encountered some delays. On the revenue side, a draft general tax law creating the Central Revenue Authority (ATM) was submitted to the Assembly in early August 2004 (a structural benchmark criteria for end-July 2004) and the internal regulations for the Domestic Tax General Directorate (DGI) were approved in December 2004. On the expenditure side, the e-SISTAFE (Financial Administration System) was partly implemented in the Ministry of Finance because of delays in the approval of the 2005 budget by the Assembly. In this context, the production of the budget execution report based on the e-SISTAFE for the first quarter 2005 was delayed. The rollout of SISTAFE to the Ministry of Education and Culture (MEC) will also be delayed in spite of the progress made in early 2005. At the beginning of 2005, the system began to record and classify all disbursements to line ministries. Recent efforts have been aimed at stabilizing the functioning of the treasury single account and its integration into the SISTAFE in preparation for the rollout to MEC. In particular, the clearance of transactions between the BM and commercial banks is now being completed on the same day that the transactions are initiated in accordance with the Diploma Ministerial do Ministro das Finanças sobre as regras de funcionamento de Conta Unica do Tesouro.

8. Broad money growth expanded less rapidly than programmed, reflecting in part the impact of the appreciation of the metical on foreign currency deposits. The end-December 2004 performance criterion on net domestic assets of BM was observed, as well as the end-March 2005 indicative target. The end-December 2004 indicative target for the stock of reserve money was exceeded by a small margin, owing mainly to a larger-than-expected demand for domestic currency. However, the related indicative target for end-March 2005 was in line with the program. The performance criteria on the stock of net international reserves of the BM was observed with a significant margin at end-December 2004, as well as the related indicative target at end-March 2005. In light of the decline in inflation, the BM decreased its reference rates by 400 basis points in 2004 and by a further 200 basis points by end-March 2005. Commercial nominal lending rates declined to 24 percent and the interest spread narrowed to 14 percent, although they still remain relatively high. Credit to the private sector decreased due to valuation effects on loans in foreign currency. Excluding the latter effect, private sector credit increased by 8.8 percent of beginning of period money stock.

9. In late 2004 and early 2005, the BM took several steps to strengthen monetary management. In particular, in the second half of 2004 it improved the mix of its sterilization instruments relying more on the sale of foreign exchange to control liquidity. As noted, the BM also increased the flexibility of the exchange rate system through the introduction of foreign exchange auctions in January 2005 to reflect better changes in economic fundamentals. Steps were also taken to continue to improve coordination between the BM and the Ministry of Finance in implementing the Treasury Single Account.

10. In order to strengthen the balance sheet of the BM, the 2005 budget includes the issuance of securities in an amount of Mt 1.5 trillion, together with the corresponding interest payments. In early 2005, with the help of Fund technical assistance and the donor community, the BM finalized a timetable to adopt International Financial Reporting Standards (IFRS) in the banking system and strengthen loan classification and provisioning in line with best international practices (end-February 2005 benchmark). As a result of the appreciation of the metical, the BM posted a net loss as the value of its assets fell below the amount of its liabilities (equivalent to 2.5 percent of GDP) at end-December 2004.

11. The commercial banking sector remained sound with a sharp decline in the ratio of nonperforming loans to gross loans, from 27 percent at end-2003 to 6 percent at end-2004. A number of steps were taken during 2004 to strengthen banking supervision, including the implementation of the new inspection manual and the preparation of models for the presentation of consolidated financial statements. The reviews of the four largest banks, which were finalized in February 2005, show that the banks are ready to move to IFRS.

12. The Government recognizes the importance of timely debt-service payments in view of Mozambique having reached its enhanced HIPC Initiative completion point in September 2001 and an agreement with the Paris Club creditors in November 2001. In this regard, the Government has already concluded bilateral agreements with 10 out of 12 Paris Club creditors, including an agreement with Brazil signed in August 2004. The technical

negotiations with Portugal were concluded in February 2005. Progress with non-Paris Club creditors, however, has been limited.

II. The Policy Agenda for the Remainder of 2005

13. The Government is committed to implement immediately corrective measures to bring the fiscal program back on track, and to reinvigorate and accelerate the structural reform agenda. Furthermore, the Government intends to enhance the existing multi-disciplinary committee with a view to strengthen the monitoring of the program, particularly in the fiscal area. On a monthly basis, this committee will review progress in implementing the performance criteria, benchmarks, and measures of the program, and will report this to Fund staff. Particular attention will be given to buttress the transparency and monitoring of the budget execution, and to continue strengthening administrative capacity with the help of the international community.

14. Prospects for 2005 are for continued strong economic growth, further deceleration of inflation, renewed efforts at fiscal consolidation, and maintaining a sustainable external position. The end of the stimulus to economic growth in 2004, resulting from the coming on line of Mozal II and the gas pipeline is expected to be more than compensated for by a pickup in construction activity related to higher-than-projected execution rates of the national road plan and the initiation of a titanium ore project. Growth in the fishing sector is expected to resume, while agriculture will continue to expand. Overall, real GDP growth is projected to increase by 7.7 percent in 2005. Inflation is targeted to decline further to 8 percent. To achieve the inflation objective, the BM will limit the rate of growth of base money to 14.6 percent during the year. To reverse the fiscal relaxation related to the 2004 revenue shortfall, the domestic primary deficit is programmed to narrow to 2.8 percent of GDP and the overall fiscal deficit, including grants, is projected to remain at 6 percent of GDP. The external current account deficit, including grants, is projected to increase to 7.1 percent of GDP. Strong export growth, led by a significant increase in international aluminum prices and gas production, is expected to offset robust import growth, associated with the higher international prices for petroleum products, as well as higher dividend payments to the megaprojects' foreign shareholders. Net capital inflows are expected to decrease by about 2 percent of GDP. Net international reserves are programmed to decrease by US$ 60 million in 2005 to 4.7 months of goods and nonfactor services and to 5.6 months, excluding megaproject-related imports.

15. For the remainder of 2005, emphasis in the fiscal area will be given to the following priorities: (i) strengthening the mobilization of revenue through the buttressing of tax administration, including the strengthening of auditing, inspection, and enforcement procedures; (ii) identifying expenditure savings in nonpriority sectors and containing the wage bill; and (iii) improving public expenditure management and increasing transparency through the effective implementation of the e-SISTAFE. Until the approval by the Assembly of the 2005 budget, expected for May 2005, public expenditure will continue to be executed in line with the 2004 budget appropriations. If the revenue realization on a quarterly basis

turns out to be below programmed levels, contingency cuts in nonpriority domestic expenditures will be implemented to offset any shortfalls.

16. The Government's domestic primary deficit is programmed to decrease to 2.8 percent of GDP in 2005, with a view to limiting recourse to domestic financing to 1.1 percent of GDP (excluding the recapitalization of the BM). The overall deficit, after grants, would increase to 6 percent of GDP, owing to a substantial increase in capital outlays financed with concessional project loans and part of the resources from the mining license for the exploration of the Moatize coal mine.

17. Total revenue is projected to rise to 13.2 percent of GDP in 2005, albeit less than the 13.6 percent in the 2005 budget (using the new GDP series). This increase reflects (i) the incorporation into the budget of the own-generated revenues of districts and some line ministries (equivalent to 0.4 percentage point of GDP); (ii) the introduction of the new computerized system (SCIR) to support tax collection in early 2005 and its roll out to main cities in the country; (iii) the finalization of the identification (and progressive collection, starting in April 2005) of tax arrears related to the personal and corporate income taxes for 2003-04 by end-September 2005; (iv) the increase of registered taxpayers by 50,000; (v) the interface of the value-added tax and customs computer systems by end-May 2005 to permit the electronic exchange of information on a real time basis; (vi) the increase in the number of audits and inspections (which started in March 2005), particularly regarding services and tourism, as well as the intensification of training of auditors (and an increase in their number); (vii) the enforcement of the application of an increased 35 percent rate in corporate income tax for unjustified expenditures in accordance with the corporate income tax code (Imposto sobre Rendimento de Pessoas Collectivas); (viii) the submission for approval by the Council of Ministers before mid-May 2005 of the new regulations for auditing and inspections (a prior action) and their approval by the Council of Ministers before end-May 2005; (ix) the implementation of monthly monitoring systems for tax returns filed by large taxpayers and megaprojects in Maputo and the other main cities by end-May 2005; (x) the completion of the strengthening of monitoring and control capacity at borders in the southern region, especially at Namaacha and Ressano-Garcia by end-September 2005; and (xi) the combat of corruption through the strengthening of sanctions on delinquent taxpayers and officers at all levels. These measures on tax revenue are expected to yield at least 0.6 percent of GDP.

18. In addition, the program for 2005 includes several key measures to continue to strengthen the tax system. Preparations will continue for establishing the ATM by end-2005. To strengthen its operations and facilitate its subsequent integration with the customs office (DGA), following the December 2004 approval of the internal regulations for the domestic revenue administration (DGI), the statute for its staff will be approved by end-April 2005 (a prior action). Moreover, within one month of the promulgation (Presidential signature) of the new general tax law and the law to create the ATM, the Council of Ministers will approve all complementary regulations for these two pieces of legislation. In addition, a revised tax code for the municipalities has been submitted to the Council of Ministers. The new modern procedures and regulations for tax audits and inspection will be implemented as soon as they

are approved by the Council of Ministers by end-June 2005. Finally, in light of the weaker-than-expected performance of revenues in 2004, the Government will complete audits on compliance with all taxes of large taxpayers by end-September 2005.

19. Noninterest current expenditure will be limited to slightly less than 13 percent of GDP (or a 0.1 percent increase), including the incorporation into the budget of the expenditures associated with the own revenue from districts and line ministries referred to above. Excluding wage outlays associated with the previously off-budget revenue, the Government's wage bill is programmed to remain at 6.7 percent of GDP in 2005. This projection includes the impact of an increase of close to 10,000 in the number of government employees, most of which is concentrated in the priority sectors, including 5,443 teachers and 1,767 health care providers. To accommodate such an increase within the envisaged fiscal target, the average general wage increase for government employees that will become effective retroactively on April 1, 2005, will be limited to 6½ percent. In addition, the 13-month payment of wage and pension related to 2005 fiscal year will be paid in January 2006 and this will be true respectively for the following years. Locally financed capital expenditure is programmed to increase relative to its 2004 level. The expenditure projections for 2005 include the impact on the interest bill of servicing the external debt liabilities of the BM transferred to the Government and of the additional domestic debt associated with the issuance of government securities to strengthen the BM's balance sheet. Spending on PARPA priorities is expected to increase from 63.3 percent of total primary expenditure in 2004 to 66.3 percent in 2005.

20. During 2005, the Government will also intensify its efforts to implement the SISTAFE. By end-May, a report on the financial operations of all ministries, at the central and provincial levels, for the first quarter of 2005 will be elaborated by the Ministry of Finance. Provided that the 2005 budget is approved by end-May 2005, the complete budget execution report, at the central and provincial levels, for the first semester of 2005 will be elaborated by end-September 2005 and all stages of expenditure (commitment, liquidation, payment, accounting, and reporting) of the Ministry of Finance and MEC will be executed through the e-SISTAFE, at the central and provincial levels, by end-December 2005. This implies that all financial transactions, including payments of expenditure, will be executed through the Treasury Single Account with the help of the donor community. In addition, by end-December 2005, with the help of the donor community, all budgetary expenditures financed and executed outside the Treasury Single Account of the Ministry of Finance and MEC will be included in the e-SISTAFE. In the meantime, a complete list of off-budget operations will be prepared by all line ministries with the help of donors to allow the roll out of the e-SISTAFE to all line ministries with the help of the donor community, at central and provincial levels, in the course of 2006. By end-December 2006, all financial and budgetary operations of DAFs (Financial Management Departments) of all line ministries, at the central and provincial levels, will be executed through the e-SISTAFE. In addition, to buttress the functioning of the Treasury Single Account (inter alia, the transmission of information and the transfer of balances in real time), Aviso 006/GBM/ 2004, will be revised by end-April 2005 (a prior action) to guarantee immediate penalties on noncomplying commercial banks. The Government will continue to implement its fiscal decentralization strategy with due

regard to sequencing, in particular the need to buttress local administrative capacity. The e-SISTAFE will be gradually rolled out to all districts.

21. On monetary policy, with a view to achieving a further deceleration of inflation and a stable environment for financial intermediation and the foreign exchange market, the BM will continue to target reserve money. Broad money (M3), including foreign currency deposits, is projected to expand by 14.5 percent (slightly lower than nominal GDP), while bank credit to the private sector is expected to increase by 5.8 percent of the beginning-of-period stock of broad money. Net credit to the government (including recapitalization of the BM) will increase by 9.6 percent of the beginning-of-period money stock. The BM will continue to improve its liquidity management framework and foster financial market development, preparing and evaluating daily liquidity forecasts, reviewing the performance of primary dealers, and facilitating foreign exchange transactions.

22. In the conduct of monetary policy, the BM will judiciously mix sterilization instruments (foreign exchange and treasury bill sales) to mop up excess liquidity in the context of the floating exchange rate system. The BM will limit its intervention in the exchange market to achieving the international reserve target and managing exchange rate policy flexibly in line with economic fundamentals.

23. The Government remains committed to strengthening the balance sheet of the BM. To this end, in line with Articles 14 and 66 of the BM's Act, the Government will issue securities at market interest rates. The first issuance of securities in an amount of Mt 1.5 trillion, together with the corresponding interest payments, was included in the draft 2005 budget, which is expected to be approved soon by the Assembly. These securities will be issued and transferred to the BM no later than end-June 2005, and further issuances in similar amounts will take place in 2006 and 2007. In addition, on the basis of the final external audit of the balance sheet of the BM (expected for end-April 2005), a decision will be taken before mid-May 2005 on the issuance of securities by the Government to cover BM's net financial losses in 2004. These measures will be accompanied by additional steps to shift the cost of managing monetary policy over time to the budget, and by strictly limiting the administrative expenses of the BM.

24. The authorities are also committed to implementing the IFRS in the banking system, with the help of technical assistance from the Fund and the donor community. In this regard, the BM has elaborated a timetable of actions to adopt IFRS in the commercial banking system and strengthen loan classification and provisioning in line with best international practices (end-February 2005 structural benchmark). The BM will continue to move forward with the necessary training and other preparations with the aim of fully implementing IFRS in the BM and the banking system starting in 2007.

25. In the area of banking supervision, progress is being made in drafting an inspection manual, preparing models for the presentation of consolidated financial statements, in application of the Regulation on Consolidated Supervision, and increasing the staff and capabilities of the Department of Banking Supervision with the support of a Fund expert.

Moreover, a draft of a new regulation on the assessment, classification, and provisioning of credits is under preparation. Finally, a feasibility study on the Government participation in the BIM has taken longer than envisaged; however, it is now expected to be completed by end-September 2005 with the help of the World Bank.

26. The BM is taking actions to address weaknesses identified in the context of the Fund's safeguards assessment mission conducted in June 2004. In particular, (i) the Economic Research and Statistics Department of the BM has already established updated procedures for converting balance sheet data to the monetary data reported to the Fund; (ii) starting end-November 2004, the BM began to complete all reconciliations and necessary adjustments on a monthly basis so that the balances in its accounting records match those confirmed by the correspondents, external managers, and other third parties; and (iii) work is in progress for linking the monetary data to the balance sheet electronically. Staff are currently being trained to operate this system, which will be fully functional by end-September 2005.

27. No significant changes in the area of trade policy are expected to take place during 2005. Regarding the exchange system, the central bank is preparing a draft of a revision to the foreign exchange law to clarify and improve the existing legislation, which will be submitted to the Parliament in the second half of 2005. Following approval of the new law and issuance of related regulations, the authorities intend to accept their obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement. The Government remains committed to lowering the maximum import tariff rate applicable to all trading partners from 25 to 20 percent in January 2006.

28. The Government will continue its efforts aimed at completing negotiations on enhanced HIPC Initiative debt relief agreements with remaining Paris Club creditors, and to reach agreements with non-Paris Club official creditors and commercial creditors on comparable terms. Regarding the commercial debt, the World Bank has decided to finance a debt-reduction operation through the IDA Debt-Reduction Facility and is assisting the Government to finalize a proposal by end-2005.

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

30. The authorities have taken further steps to lower the cost of doing business. The Government is in the process of establishing "one-stop shops" for business registration in another four locations (Cabo Delgado, Tete, Inhambane and Nampula) that will all be operating by June 2005. Business licensing procedures are being changed so as to bring a larger share of small and medium enterprises into the formal registration system. The first

step was taken in 2004 with the simplification of licensing procedures (by decree). Arrangements are being made for further simplification by allowing decentralization of the relevant decisions for licensing to the district and provincial level where appropriate. In addition, there will be limits set on the time that the relevant authority will take to issue the license, the maximum of these being one month, at the central level. The Government is running a campaign to encourage registration. Actions will also be taken to provide tax indentification numbers to the new license holders.

31. Regarding labor regulations, progress has been made in streamlining the procedures for hiring expatriates following the approval of a decree in 2004. In addition, in late 2004 the Government approved the terms of reference for the preparation of a revised labor law aimed at increasing flexibility in the labor market. Moreover, early this year the procedures and structure of the tripartite commission (CCT) were improved to allow for a more flexible and inclusive negotiating process. After consultation with the interested parties, the draft of the law is expected to be submitted to the Assembly during the second half of 2005.

32. The Government has continued to make efforts to enhance Mozambique’s infrastructure in the context of several project loans from the World Bank. This year the number of mobile telephone subscribers will increase to over 1 million and costs will be reduced as a result of the introduction of competition in the mobile segment of the market in late 2003. The tenders for the restructuring of the State-owned telecommunications company and the national airline are expected to be launched in 2005. Management contracts for water systems have been completed in five major cities and private concessions have been granted to operate some ports, including Maputo. In addition, the Government is considering strategic options for the restructuring of PETROMOC, the state-owned petroleum distributor. The Government is also assessing the proposals it has received for private participation in the Maputo International Airport to determine whether one of these proposals meets its requirement in terms of investment and improvement of the airport's performance.

33. A draft decree establishing procurement regulations in line with international standards is under preparation with assistance from the World Bank and bilateral donors. Two key aspects, still under discussion, to bring Mozambique’s legislation in line with best international practice are the need for an independent regulatory body and an appeals mechanism. Since the discussions on these points have occasioned some delay, the expected date of approval of the decree has been moved from end-June 2005 to end-December 2005.

34. In the area of public sector reform, with support from the World Bank and other donors, work has continued in the context of a long-term program aimed at restructuring the civil service, decentralizing service delivery, and improving governance. Several key components are under way: (i) the functional analyses of six major ministries (Education, Commerce, Health, Agriculture, State Administration, and Finance) were completed in 2004 but are presently being revised by the new government in the light of the overall study of the structure of central government, which was also completed in 2004. The revised functional analyses, with their accompanying restructuring plans, will be the basis for restructuring of these ministries over a three-year period. The financial implications of the functional

analyses will respect the spending ceilings established by the Medium-Term Financial Framework; (ii) a proposal to reform the wage system in order to link remuneration more closely with performance will be considered by the Inter-ministerial Commission for the Reform of the Public Service Commission (CIRESP) by end-September 2005. The focus is on creating incentives for attracting and retaining high-level technical staff and decentralizing skilled staff while still maintaining restraint of the wage bill; (iii) the National Survey on Governance and Corruption aimed to obtain the opinion of citizens regarding the functioning of the public sector, was completed. The Government intends to publish and disseminate the results to the public by end-June 2005; and (iv) preparations are under way to complete an independent audit of the civil service during 2005. This will occur in the context of work to unify the three data sources for the civil service establishment: the payroll held by the Ministry of Finance, and the lists of civil servants held by the Ministry of State Administration and by the Administrative Tribunal.

35. The Government is aware of the need to revise land use titles regulations to reduce the cost and time involved in transactions, which involve land for both private individuals and businesses. The Government is of the view that, in light of the sensitive nature of the issues involved, any reforms of land tenure should be preceded by a process of broad consultation with interested parties. Accordingly, a draft proposal to strengthen property rights in urban areas is being reconsidered by the new administration. In addition, the Government remains committed to conducting a Poverty and Social Impact Analysis (PSIA) study on land tenure regulations. Several donors, including the World Bank, have expressed interest in providing support for this purpose, and donors and the Government are developing the project in the context of the Policy Assessment Framework (PAF) for 2005.

36. The Government recognizes that progress in reforming the judicial system was limited during 2004, partly as a result of capacity constraints and delays in approving relevant legislation. A draft law of judicial reform is under preparation. This will *inter alia* introduce an intermediate level of courts so as to reduce the overload at the Supreme Court level. The World Bank is also assisting the authorities to strengthen the training of legal and judicial officers through the recently founded training institute. The anti-corruption unit has been active since 2004, and it is expected that further units will be established in Nampula and Beira. Other important pieces of legislation, including the new commercial code, the Penal Code, the Penal Procedure Code, the Civil Procedure Code, and the Notary Code are still being considered by the Assembly or the Council of Ministers.

37. In the context of combating organized crime, the Assembly approved the Anti-Money Laundering law and the Government approved corresponding regulations in 2004. The Government is committed to create the related financial investigation unit though an amendment to the law. In this regard the following actions will be taken: (i) the Government will finalize an action program by end-May 2005 (a prior action); (ii) other countries' experiences with the operation of such a unit will be studied; (iii) a Mozambican model will be elaborated by end-November 2005; (iv) a project for the amendment of the law and all complementary regulations will be elaborated by end-March 2006; and (v) the proposed amendment and regulation will be submitted to the Council of Ministers by end-May 2006

and adopted by end-June 2006. The Government has already requested technical assistance for this project from the World Bank.

38. The Government recognizes the urgent need to strengthen statistical information. The statistical system still presents several deficiencies that hinder policy implementation and the surveillance of economic developments. In particular, and with the help of the international community, efforts are being made to strengthen administrative capacity to improve the national accounts, the monetary data, the balance of payments, external debt management, and public finance statistics. In particular, by end-June 2005 the National Statistics Institute (INE) will compile and disseminate preliminary data on the 2004 GDP and will publish a revision policy for compiling and disseminating final national accounts data (structural benchmark for end-June 2005).

39. Following the completion of the National Household Survey in 2003, several studies are being conducted by public and private institutions, including on the determinants of poverty, education attendance, demographic trends, and health services, and the relationship between employment and poverty. Moreover, INE is expected to finalize a labor force survey by September 2005 that will provide information on unemployment using a variety of definitions.

III. Medium-Term Macroeconomic Policy Issues

40. The policy agenda for 2005 is consistent with the medium-term goals of sustaining poverty reduction by maintaining strong economic growth. The authorities have carried out the third annual report on the implementation of their PARPA, which will be instrumental in the preparation of a new PARPA covering the period 2006-10, which is expected to be ready by February 2006. It shows that a number of the Millennium Development Goals are within reach but that the achievement of others will require further progress and investment with the help of the international community.

41. The main macroeconomic objectives over the medium term are to maintain a rate of growth between 6 and 8 percent and to continue to reduce gradually the inflation rate through the pursuit of prudent fiscal and monetary policies in the context of the flexible exchange rate system. The medium-term economic policies will focus on spurring export-led private sector growth, while enhancing fiscal and external viability. Central to the fiscal strategy will be the consolidation of the fiscal situation, notably through a buttressing of tax administration coupled with a better efficiency of expenditures. Priority expenditures in the PARPA will continue to be ring-fenced in order to contribute to the achievement of the MDGs. The authorities will also seek a higher share of external grant financing to buttress external debt sustainability.

IV. Program Monitoring

42. The semiannual quantitative performance criteria for end-December 2005 and the indicative targets that will be used to evaluate the implementation of the program for the

remainder of 2005 are shown in Table 1 of this memorandum, with further definitions and explanations contained in the annexed Technical memorandum of understanding. In addition, the Government has specified in Table 4 a list of structural performance criteria and benchmarks for 2005.

43. The Government understands that its ability to request the disbursement of the fourth loan under the PRGF arrangement will be contingent upon the observance of the semiannual quantitative performance criteria for end-June 2005 set out in Table 1; the structural performance criteria set out in Table 4 through end-October 2005; and the completion of the third review under the program, which is expected to take place, by end-December 2005. In reviewing developments under the program during the third review, particular attention will be paid to the strengthening of the revenue administration, the rollout of SISTAFE, the preparation of the inclusion into the budget of off-budget operations in MEC, and the draft budget for 2006. The fourth review, which will make available the fifth disbursement, is expected to be completed by May 31, 2006, and will be based on the observance of the end-December 2005 quantitative performance criteria set forth in Table 1 of the MEFP. Additional conditionality for the fifth disbursement will be established at the time of the third review.

Table 1. Mozambique: Quantitative Performance Criteria and Indicative Targets for 2004 and 2005

(In billions of meticais, unless otherwise specified)

	2004											2005					
	End-June Performance Criteria				End-Sep. Indicative Targets				End-Dec. Performance Criteria			End-Mar. Indicative Target	End-Mar. Indicative Target	End-June Perf. Criteria	End-June Perf. Criteria	End-Sep. Indicative Target	End-Dec. Perf. Criteria
	EBS/04/77	EBS/05/12			EBS/04/77	EBS/05/12			EBS/04/77			EBS/05/12		EBS/05/12			
	Prog.	Rev. Adj.	Act.	Rev. Act.	Prog.	Rev. Adj.	Act.	Rev. Act.	Prog.	Adj.	Actual	Prog.	Prel.Act.	Prog.	Rev.Prog.	Rev.Prog.	Rev.Prog.
Government domestic primary deficit (excluding bank recapitalization costs (ceiling) 1/ 2/ 3/ 4/	2,117	...	1,692	1,692	3,259	...	3,268	3,268	4,207	...	5,151	857	2,392	1,764	3,438	3,986	4,481
Stock of net dom. assets of Bank of Mozambique (BM) (ceiling) 1/ 5/ 6/ 7/	1,931	2,323	1,573	1,613	1,650	-10,652	-12,398	-12,398	3,299	-8,836	-14,582	-9,967	-10,828	-9,373	-7,582	-6,980	-6,947
Stock of net international reserves of the BM (floor, in millions of U.S. dollars) 1/ 8/12/	708	692	747	747	731	756	837	837	738	750	960	848	885	844	874	863	900
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of more than one year (ceiling) 9/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
Stock of short-term external public debt outstanding (ceiling) 9/ 10/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
External payments arrears (ceiling) 3/ 9/ 11/	0	...	0	0	0	...	0	0	0	...	0	0	...	0	0	0	0
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, in millions of U.S. dollars, indicative target)	...	...	...	...	...	...	...	...	...	...	...	...	...	99	99	...	99
Government revenue (floor, indicative target) 3/	8,255	...	7,881	7,881	13,345	...	12,321	12,321	18,350	...	16,838	4,457	3,948	9,708	9,016	14,742	21,091
Stock of reserve money (ceiling, indicative target) 7/	8,303	...	8,676	8,716	8,630	...	9,126	9,126	10,247	...	10,433	9,317	9,249	10,110	10,597	11,140	11,946
Wage bill (ceiling, indicative target) 3/	4,485	...	4,479	4,479	6,772	...	6,858	6,858	9,218	...	9,195	2,123	2,656	4,708	5,462	8,324	11,045
Memorandum items:																	
Foreign program assistance; grants and loans (in millions of U.S. dollars) 3/	82	...	68	68	180	...	206	206	264	...	272	103	...	163	163	174	243
Actual external debt service payments (in millions of U.S. dollars) 3/	25	...	27	27	38	...	38	40	62	...	58	13	...	35	35	56	77
Net flows	57	...	41	41	141	...	168	166	202	...	214	90	...	128	128	118	166
Exchange rate (meticais per U.S. dollar; end of period)	24,181	...	23,002	23,002	24,375	...	21,389	21,389	24,644	...	18,899	21,619	18,958	...	...	...	...
Shortfall in required reserves	...	0	...	...	...	0	...	...	...	0	...	...	...	...	...	...	...
Adjustment to BM's net domestic assets at program exch. rates	...	...	346	346	...	...	2637	2,637	...	...	5,831	...	2471	...	...		
Adjustment to BM's NDA target	...	392	...	...	...	-12,302	...	...	...	-12,135	...	...	...	...	...	...	...
Adjustment to reserve money	...	-40	...	...	...	0	...	...	...	0	...	...	...	...	...	...	...
Adjustment to BM's NDA due to shortfall/excess of net program assistance	...	392	...	...	...	-602	...	...	...	-306	...	...	...	...	...	...	...
Stock adjustments in medium- and long-term foreign liabilities	...	0		...	...	-11700	...	...	...	-11829	...	...	...	...	...	...	...

1/ In 2004, constitute quantitative performance criteria for end-June and end-December, and in 2005 for end-June, and end-December for the revised program.

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

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

4/ To be adjusted upward for up to Mt400 billion to accommodate higher-than-budgeted locally financed drought-related expenditures. Also to be adjusted for end-December 2004 for up to Mt600 billion to accommodate additional capital outlays covered by higher-than-envisaged external budgetary grants.

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

6/ To be adjusted upward/downward to the extent of any shortfall/excess in foreign program assistance valued at program exchange rates and to be adjusted downward/upward to the extent that actual payments of external debt service exceed/fall short of programmed amounts. In 2004, the downward adjustment for higher-than-programmed budgetary grants will not take place to the extent that the additional grants are to accommodate additional capital outlays, up to 25 million U.S. dollars. To be adjusted upward for up to Mt 400 billion to accommodate higher-than-budgeted locally financed drought-related expenditures.

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

8/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the programmed amount and to be adjusted upward/downward to the extent that actual payments of external debt service fall short of/exceed programmed amounts. In 2004, the upward adjustment for higher-than-programmed external budgetary grants will not take place to the extent that the additional grants are used to accommodate additional capital outlays, up to 25 million dollars. To be adjusted downward for up to Mt 400 billion (or the equivalent amount in U.S. dollars at the program exchange rate) to accommodate higher-than-budgeted locally financed drought-related expenditures. Moreover, to be adjusted downward/upward for any revision made to the end-2003 and end-2004 figures.

9/ Continuous performance criterion.

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

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

12/ The NIR program and actual figures for 2004 and the NIR revised actual figure for end-2003 have been revised downward by deducting from gross reserves some deposits held by the central bank abroad which are encumbered for specific imports.

Table 2. Mozambique: Structural Performance Criteria and Benchmarks
Under the 2004 PRGF-Supported Program

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Submit to the National Assembly the draft general tax law (paragraph 23 of the memorandum of economic and financial policies (MEFP)).	End-June	Done
Strengthen the balance sheet of the Bank of Mozambique (BM) by shifting to the Government a large part of its external debt liabilities, as set forth in paragraph 28 of the MEFP and the technical memorandum of understanding (TMU).	End-July	Done
Keep in place the enhanced supervisory regime for the Banco International de Moçambique (BIM), as described in the TMU, until approval of the financial statements for 2004 by the external auditors.	Continuous	Observed
Complete a feasibility study on the divestment of the Government's participation in the BIM.	End-December	Not observed
Structural benchmarks		
Submit to the assembly the draft law creating the Autoridade Tributária de Moçambique.	End-July	Done August 7
Complete the revision of the regulatory framework for microfinance activities.	End-September	Done
Develop a resolution strategy for two weak small banks	End-October	Partially done
In the context of the 2005 budget, initiate the implementation of the three-year program to strengthen the balance sheet of the central bank. Include the corresponding allocation in the 2005 budget proposal.	End-October	Allocation included in the draft budget submitted to the Parliament in March 2005.
Prepare the budget execution report corresponding to the third quarter of 2004 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	November 15	Delayed until May 15, 2005
Develop timetables to move gradually to IFRS and to comply with loan classification and provisioning, based on best international practices.	End-December	Delayed until end-February 2005
Issue regulations of the anti-money laundering law and establish financial investigations unit	End-December	Regulations already issued, but FIU has not yet been established
Implement the SISTAFE in the Ministry of Planning and Finance, including the provincial directorates	End-December	Done

Table 3. Mozambique: Structural Performance Criteria and Benchmarks through end-June 2005
Under the 2005 PRGF-Supported Program

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Issue government securities in an amount of Mt 1.5 trillion at market interest rates and transfer these securities to the Bank of Mozambique to strengthen its balance sheet.	End-June 2005	
Keep in place the current supervisory regime for the Banco Internaçional de Mozambique (BIM), as described in the technical memorandum of understanding, until approval of the financial statements for 2004 by the external auditors	Continuous	Observed
Structural benchmarks		
Introduce foreign exchange auctions	End-February 2005	Done January 2005
Develop firm timetables to move gradually to IFRS in the commercial banking system and to comply with loan classification and provisioning based on best international practices	End-February 2005	Done March 2005
Approve the internal regulations and the statute for the staff of the DGI	End-April 2005	
Prepare the budget execution report corresponding to the first quarter of 2005 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	May 15, 2005	Delayed
Rollout the SISTAFE to the Ministry of Education and abolish the disbursement of funds (adiantamento de fundos)	End-June 2005	Delayed until December
Compile and disseminate preliminary data on the 2004 GDP by expenditure and production approach at current and constant prices, and publish a revision policy and a timetable for compiling and disseminating final national accounts data.	End-June 2005	

Table 4. Mozambique: Structural Performance Criteria and Benchmarks Under the 2005 PRGF Arrangement (April-December 2005)

Actions	Expected Date of Implementation, According to the Program	Outcome
Prior Actions		
Approve the statute for the staff of the DGI	End-April	
Approval by the Council of Ministers of the new regulation for tax auditing and inspection	End-May	
Finalization of an action plan to create a financial investigation unit	End-May	
Revision of Aviso 006/GBM/ 2004 to guarantee immediate penalties on non-complying commercial banks.	End-April	
Structural performance criteria		
Issue government securities in an amount of Mt 1.5 trillion at market interest rates and transfer these securities to the Bank of Mozambique to strengthen its balance sheet.	End-June	
Complete a feasibility study on the divestment of the Government's participation in BIM.	End-September	
Prepare the budget execution report corresponding to the first semester of 2005 on the basis of the accounting generated by the e-SISTAFE, using the new budget classifier.	End-September	
Structural benchmarks		
Compile and disseminate preliminary data on the 2004 GDP by expenditure and production approach at current and constant prices, and publish a revision policy and a timetable for compiling and disseminating final national accounts data.	End-June	
Publication of Survey on Corruption and Governance	End-June	
Complete audits of compliance with all taxes of large taxpayers	End-September	
Rollout the SISTAFE to the MEC and abolish the disbursement of funds (adiantamento de fundos)	End-December	

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

May 26, 2005

1. This technical memorandum of understanding (TMU) applies from January 1, 2005. Its purpose is to describe the concepts and definitions that will be used in monitoring the Poverty Reduction and Growth Facility (PRGF)-supported program, including the following:

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

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

Government's domestic primary balance

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

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

Government revenue, expenditure, and financing

4. Revenue is defined to include all receipts of the Domestic Tax Administration (Administração Tributaria de Impostos or DGI), the National Directorate of Customs

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

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

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

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

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

Money supply

9. M_3 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, including foreign currency deposits. M_2 is defined as domestic currency in circulation (outside the banks) plus commercial banks deposits, excluding foreign currency deposits.

Net domestic assets

10. The net domestic assets of the Bank of Mozambique are defined as reserve money minus the net foreign assets of the Bank of Mozambique. Net foreign assets will be valued at program exchange rates; net foreign assets are defined to exclude the effect of any stock adjustments in medium- and long-term external liabilities.

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

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

Net international reserves

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

14. The Bank of Mozambique will publish the exchange rates quoted by commercial banks on average as the market rates. The exchange rates at which the Bank of Mozambique will transact foreign exchange will take as reference the rates quoted by commercial banks.

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

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

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

Stock of short-term external public debt outstanding

17. The government will not contract or guarantee external debt with original maturity of less than one year. This performance criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been

received. Excluded from this performance criterion are short-term, import-related trade credits. This performance criterion will be assessed on a continuous basis.

External payments arrears

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

Foreign program assistance

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

Actual external debt-service payments

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

Adjusters

21. The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward (downward) for any excess (shortfall) in disbursements of foreign program assistance, compared to the program baseline; and downward (upward) to the extent that actual payments of external debt service exceed (fall short of) programmed amounts (Table 1). The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year; a symmetric adjustment will apply to the ceilings on the net domestic assets of the Bank of Mozambique. They will also be adjusted upward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

22. The quantitative targets (ceilings) for the central bank's net domestic assets will be adjusted upward (downward) for any shortfall (excess) in disbursement of external program grants and loans, compared to the program baseline; and downward (upward) to the extent that actual payments of external debt service fall short of (exceed) programmed amounts (Table 1). They will also be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than

envisaged proceeds, net of any costs related to the privatizations, including severance payments.

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

24. The quantitative target (ceiling) for the domestic primary balance (excluding bank restructuring costs) for end-June 2005 and end-December 2005 will be adjusted upward (and the floors on net international reserves and ceilings on net domestic assets downward/upward) to accommodate the possible need for higher locally financed government outlays to deal with drought, up to a total limit of Mt 400 billion.

Data reporting

25. In addition to providing the monthly and quarterly data needed to monitor program implementation in relation to the programs' quantitative targets and broader economic developments, the authorities will provide weekly updates of the daily data set out in Table 3 of this attachment, as well as the weekly data set out in Table 4. Monthly updates will also be provided of the foreign exchange cash flow of the Bank of Mozambique, as set out in Table 5.

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

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

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

(In millions of U.S. dollars)

	2005				
	Q1	Q2	Q3	Q4	Year
	Prog.	Prog.	Prog.	Prog.	Prog.
Foreign program assistance	102.7	60.4	10.9	69.0	243.0
Program grants	102.7	60.4	10.9	9.0	183.0
Program loans	0.0	0.0	0.0	60.0	60.0
External debt service	13.4	22.0	20.5	21.0	76.8

Source: Mozambican authorities; and Fund staff estimates.

Table 2. Mozambique: External Grants and Loans in Support of the 2005 Fiscal Program

(In millions of US dollars)

		2005
		Prog.
I.	Grants	529.8
I.1.	Projects and special program grants	330.3
	Projects grants	330.3
	Special program grants	0.0
I.2.	Direct financing grants	15.2
I.3.	Budget support grants	183.0
I.4.	Food aid in kind	1.3
II.	Loans	397.6
II.1.	Projects loans	259.2
II.1.	Loans in support of the budget	
	Budget support loans	60.0
	Loans for public enterprises	78.4

Source: Mozambican authorities; and Fund staff estimates.

Table 3. Mozambique: Daily Foreign Exchange Rates and Foreign Exchange Transactions, Week of [month/day-month/day]

	Exchange Rates						Transactions with BoM		
	Commercial banks		Foreign exchange bureaus		Bank of Mozambique				
	Buy	Sell	Buy	Sell	Buy	Sell	BoM sales	BoM purchases	Requests outstanding for BoM foreign exchange
Monday									
Tuesday									
Wednesday									
Thursday									
Friday									

Source: Bank of Mozambique.

Table 4. Mozambique: Weekly Financial Data

Exchange rates (in meticais per U.S. dollar; weekly average)
Bank of Mozambique
Buy
Sell
Secondary market
Buy
Sell
Foreign exchange bureaus
Buy
Sell
Interest rates (in percent per annum)
Permanent Access Facility (FPC)
Excess liquidity rate (FPA)
Treasury bills
28 days
63 days
1 day
162 days
364 days
Monetary authority bills (TAMs) (if any)
Open market operations (in billions of meticais)
Securities issues during week
Treasury bills
TAMs
Securities matured/called during week
Treasury bills
TAMs
Securities outstanding
By type
Treasury bills
TAMs
By holder
Financial institutions
Public
Amount used by the government – (Ministry of Planning and Finance)
Reserve money in (billions of meticais)
Currency in circulation
Bank reserves
Bank of Mozambique net foreign assets
In billions of meticais
In millions of U.S. dollars
Bank of Mozambique net international reserves (in millions of U.S. dollars)
External assistance disbursed (in millions U.S. dollars)
Net credit to the government (in billions of meticais)
Net credit to the government; flow (in billions of meticais)

Source: Bank of Mozambique

Table 5. Mozambique: Central Bank Monthly Foreign Exchange Cash Flow
(In millions of U.S. dollars)

Beginning stock of net international reserves (NIR)
Inflows
Program loans and grants
Miners' remittances
Interbank exchange market purchases
Foreign assets income
Provisioning of commercial banks
Other
Outflows
External debt service
Interbank exchange market purchases
Transfers to commercial banks
Government
Traditional circuit

Source: Bank of Mozambique