International Monetary Fund

Republic of Mozambique and the IMF

Press Release:
IMF Executive Board Completes Second Review Under Policy Support Instrument for Mozambique
June 17, 2011

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

May 20, 2011

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.

LETTER OF INTENT—MOZAMBIQUE

May 20, 2011

Mr. John Lipsky
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Lipsky:

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

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

We met all quantitative assessment criteria (AC) through end-December 2010, except for the one on reserve money. We also made strong progress in implementing our structural reform program.

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

Sincerely yours,

/s/
Manuel Chang
Minister of Finance

/s/
Ernesto Gouveia Gove
Governor
Bank of Mozambique

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

ATTACHMENT 1: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

May 20, 2011

1. This updated MEFP (i) describes recent developments and performance under the Government of Mozambique's economic program under the three-year Policy Support Instrument (PSI) through April 2011; (ii) summarizes the Government's poverty reduction strategy envisaged in the new PARP; and (iii) elaborates on macroeconomic policy and structural reform intentions for 2011. It builds on the MEFPs underlying Mozambique's PSI request and first review dated May 28, 2010 and November 8, 2010, respectively.

I. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **Mozambique continues to show resilience in a turbulent external economic environment.** Our economy has weathered the global financial crisis well. Real GDP growth in 2010, at an estimated 6.6 percent, fell slightly below expectations but was one of the highest in the region. Economic activity was broad-based and supported by strong global demand. Higher megaproject exports offset the rising import bill related to surging fuel and food prices and helped keep the current account deficit well below expectations. However, the recent increases in food and fuel prices, through their secondary effects, prevented core inflation from reversing its upward trend, despite our determined efforts to tighten monetary and fiscal policies. Remarkably strong revenue collections were instrumental in containing the primary domestic fiscal deficit to 3¼ percent of GDP, some 1 percent of GDP lower than programmed, notwithstanding higher outlays for the fuel subsidy and emergency spending to mitigate the impact of higher food prices on the poor.

3. **Amidst the difficult environment, Mozambique's program performance remains strong**. All end-2010 quantitative AC have been met, except for reserve money. Quarterly reserve money growth decelerated from 12½ percent in Q3 to 7¾ percent in Q4, above the targeted Q4 growth rate of 5 percent. This was due, inter alia, to bunched Government spending in mid-December 2010. Relative to prior years, this unusual spending pattern reflected the delayed beginning of budget execution, since the 2010 budget was approved only in May 2010 due to the formation of the new Government following the elections. This in turn left the Bank of Mozambique (BM) with little time to counter the resulting monetary expansion. With respect to the indicative target on priority spending, the Government executed the domestic investment component in full, but fell short by MT 2.2 billion in domestic current spending necessitated by the higher costs of the fuel subsidy. In addition, the externally financed component fell short of the amounts included in the 2010 budget law, mainly since investment projects in infrastructure and agriculture experienced delays. The ACs on net international reserves (NIR) and net credit to the Government (NCG) were comfortably met. As to non-concessional borrowing (NCB), we signed a nonconcessional loan from China for revamping Maputo airport in the amount of US$66 million in December 2010, and from Brazil to rehabilitate Nacala airport in the amount of US$ 80 million in April 2011.

4. **Structural reforms are on track as well.** All structural benchmarks through end-April have been met. However, the end-November 2010 benchmark on developing a medium-term debt strategy (MTDS) was completed with a five-month delay, since the conceptual work required more time. We have decided to continue working on the strategy and revisit it later this year, once our enhancements in debt management and project selection have been properly implemented and we have benefited from additional technical assistance. We will submit a refined MTDS to the Council of Ministers for approval by mid-December 2011. With respect to the financial sector contingency plan, we have undertaken all necessary steps under our control and are, as a final step, awaiting signature of a Memorandum of Understanding with the South African bank supervisors to formalize the cooperation and information sharing agreement.

I. POVERTY REDUCTION STRATEGY

5. **The new four-year PARP adopted by the Council of Ministers on May 3, 2011 demonstrates the Government's commitment to more inclusive growth**. It aims at reducing poverty from 54.7 percent in 2009 to 42 percent by 2014 and rests on three main pillars: (i) the increase in production and productivity in the labor-intensive sectors of agriculture and fisheries; (ii) job creation through improvements in the business environment; and (iii) human and social development, including through the significant expansion of social protection systems. It will be embedded in two supporting pillars: (i) the maintenance of a sound macroeconomic framework; and (ii) our strong commitment to good governance.

6. **The Government designed the PARP as a dynamic and flexible document**. Its objectives and indicators will be reviewed and, if needed, updated annually under the *Economic and Social Plan* (PES) in light of national and international developments and in tandem with the implementation of sectoral strategies, such as the forthcoming *Agricultural Reform Strategy*, the *Financial Sector Development Strategy*, and the successor program to the *2008-12 Strategy for the Improvement of the Business Environment in Mozambique*. In all of those efforts, the Government will pursue a coordinated approach across ministries, recognizing the interlinkages across policy areas and institutions.

7. **The poverty reduction strategy complements the Government's overall approach to economic development.** The PARP's strong focus on fostering social cohesion will be conducive to supporting the Government's objective of promoting long-term economic growth and complement the Government's intentions to further exploit Mozambique's rich endowment of natural resources and rapidly developing public infrastructure. In this context, the Government will continuously seek to create fiscal space, including by improving the management of revenues from the natural resources sector so as to help finance the closing of the infrastructure and skills gaps and the expansion of social safety nets.

8. **The PARP aims at building sustainable social safety nets to help reduce poverty while strengthening Mozambique's long-term growth potential.** It envisages a comprehensive stocktaking of current social protection mechanisms to be carried under our *National Basic Social Security Strategy* (ENSSB) and the *Strategic Program for the Reduction of*

Urban Poverty (PERPU). Several key undertakings are planned for the first half of 2011 to support the evolving national policy dialogue, culminating in a Council of Ministers meeting in July 2011 where key decisions regarding the future direction of basic social security will be taken. These decisions will be informed by ongoing exercises, supported by various development partners, such as a *Public Expenditure Review* in social protection and a costing exercise around the different expansion options.

II. Macroeconomic Policies

A. Economic Objectives

9. **In spite of the challenging international environment, the Government foresees a positive macroeconomic outlook for 2011**. Economic growth could reach 7¼ percent in 2011 and over the medium term. Our strong efforts to arrest inflation expectations are expected to decelerate headline inflation to single digits by end-2011, subject to international food and fuel price developments, and to the Authorities' inflation objective of 6 percent over the medium term. The external current account deficit (after grants) is set to stabilize between 10 and 11 percent of GDP during the next few years, while the reserves coverage of imports should approach 5 months on account of increasing private capital inflows, exports from new megaprojects in the mining sector, and continued donor support.

B. Macroeconomic Policy Mix

10. **Arresting inflation expectations is the immediate priority for 2011.** The BM will sharply decelerate monetary expansion to unwind the monetary stimulus adopted in the wake of the global crisis and to rein in second-round spillovers from international to domestic prices. Fiscal policy will be supportive to the BM's efforts, with a further reduction of the domestic primary deficit and limited recourse to domestic financing which should also help avoid a crowding out of the private sector.

11. **Over the medium-term, consistent with the PARP, we will adhere to a policy stance that supports economic development and allows more Mozambicans to directly benefit from economic activity.** These efforts will be embedded in a policy framework that preserves macroeconomic stability and debt sustainability, consistent with our strong track record in this area. The envisaged policy stance will aim to be sufficiently tight to allow the BM to achieve its inflation objectives. At the same time, it envisages stepping up investment spending to close the skills and infrastructure gaps, which necessitates a temporary—albeit smaller-than-previously expected—increase of the overall fiscal deficit to about 6 percent of GDP during the program period. This increase partly reflects nonconcessional external borrowing for investment projects that are expected to have a high economic return. Part of the stepped-up investment program, but also of the intended expansion of social safety nets, will also be financed by a continued strong revenue effort. As a result, we expect to be able to stabilize the domestic primary deficit—our fiscal anchor—at around 3 to 3½ percent of GDP during the period.

C. Monetary and Exchange Rate Policies

12. **The Authorities are determined to bringing inflation back to single digits from 2011 onwards**. It is our objective to contain average inflation to 9½ percent in 2011 and below 6 percent over the medium term. To this end, the BM will aim to decisively slow down monetary expansion in the near term, building on our achievements in 2010 when broad money (M3) growth decelerated by one-third and private sector credit growth by more than half relative to the year before. We attribute this to the sharp increases in our key policy rate, stepped-up foreign exchange and Treasury bill (BT) interventions, and, in particular, the increased reserve requirements that effectively curtailed commercial banks' liquidity and ability to extend loans.

13. **We will curtail reserve money growth to around 14 percent in 2011, after 29 percent in 2010.** In this context, the BM will carefully monitor reserve money developments so as to keep its main operational target on a trajectory that allows meeting the quarterly program targets. In the process, it will rely on its full set of monetary policy instruments to drain liquidity. Should second-round inflation pressures persist, the BM stands ready to further tighten its monetary policy as needed.

14. **The BM intends to further strengthen its monetary policy operations framework in line with technical assistance recommendations.** This will be conducive to preparing its move to an inflation targeting framework over time, improving open market operations, developing financial markets, and enhancing the coordination with the government to facilitate liquidity forecasting. Specifically:

- ***Improving liquidity forecasting:*** The BM and the government will implement the Memorandum of Understanding (MoU) signed on March 25, 2011 on the exchange of information.
- ***Consolidating monetary policy instruments:*** By end-October 2011, the BM will reduce the frequency of BT issues, concentrate the BT maturities, and make them fungible in the interbank money market (MMI) module. The BM will consider in due course publishing a BT issuance calendar providing information on auction frequency for each maturity.

15. **Mozambique's flexible exchange rate regime has served the country well and remains appropriate.** The BM will allow the exchange rate to adjust freely to evolving patterns of trade and financial flows while further strengthening Mozambique's international reserves, which are projected to approach 5 months of projected imports over the medium term. Following the strong depreciation in 2010, current indications point toward the exchange rate being broadly in line with fundamentals. The BM will continue to closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies.

16. **On May 20, 2011, we notified the Fund of our acceptance of the obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement**. New foreign exchange regulations were issued on December 31, 2010. Consistent with recent Fund technical assistance recommendations, the BM will issue shortly implementing guidelines which provide further clarifications on procedural aspects of the foreign exchange regulations so as to ensure that all

previously existing exchange restrictions have effectively been removed. On March 30, 2011, the BM adopted formal decisions to (i) limit potential deviations between the exchange rates in the interbank market (MCI) and the exchange rate used by the BM in its transactions with the government and the World Bank; and (ii) temporarily discontinue its multiple price auction system which in any case had not been used since 2009. The latter decision has been communicated to banks in writing and will remain in effect until further notice.

D. Fiscal Policy

17. **Fiscal policy will aim to enable the Government's development strategy, but in the short run be geared toward supporting the BM's monetary tightening to fight inflation**. To that effect, we will aim to limit the primary domestic fiscal deficit to 3 percent of GDP in 2011, close to ¼ percent of GDP lower than initially projected. This entails that NCG will be contained to ½ percent of GDP. The lower deficit target reflects prudence in expenditure execution and continued buoyancy in revenue collections, which we expect to reach MT 76.8 billion this year (20.2 percent of GDP), some MT 5 billion higher than the projections underlying the November 2010 MEFP. The program's indicative revenue floor is prudently set ½ percent of GDP below the ambitious objectives of the revised 2011 budget law, but the Revenue Authority will be instructed to collect the full revenue target under the revised budget law (20.7 percent of GDP).

18. **We have submitted a revised budget to parliament to reallocate expenditure appropriations in line with changing spending priorities.** In particular, we will increase the budgetary ceiling for transfers and subsidies so as to accommodate the costs of past fuel subsidies and new government programs to subsidize the consumption of food products and urban transportation in light of continued high world prices. Consistent with the organic budget law (SISTAFE 2002), an amendment in the planned revised budget law will exceptionally authorize the government to reinforce outlays in the subsidies and transfers budget category from contingency lines in other budgetary categories should adverse circumstances arise.

19. **The revenue contingency instituted on April 1, 2011 through administrative acts—*Delegação de Competência sobre a Execução do Orcamento* No. 4/2011 and *Circular Ministerial* No. 01/GM-MF de 05/01/2011—remains in force.** Consistent with SISTAFE 2002, they limit budget execution to cautionary ceilings as long as revenue collections remain uncertain. Accordingly, the following contingency ceilings relative to the planned revised budget apply: (i) 90 percent for goods and services and other current expenditures; (ii) 85 percent for civil service wages and transfers; and (iii) 90 percent for domestically-financed capital spending.

20. **We consider the higher budgetary costs of previously adopted support measures for fuel and food products as temporary and work toward their elimination.** Over the medium term, we intend to replace those measures by better targeted and fiscally sustainable social protection measures that will benefit an increasingly large number of our citizens (see Section II). To effectively contain the costs of the current subsidies, we will take the following measures:

- ***Gradually phasing out fuel subsidy during 2011:*** Following the subsidy removal for mega projects and several groups of wholesale customers, the Government is determined to gradually return to formula-based fuel price adjustments, provided that our planned better-targeted support mechanisms for the more vulnerable segments of the population can be implemented as planned (see below). It will seek an agreement with fuel importers to compensate them for any interim losses that may be incurred, considering various compensation options. Consistent with the agreement reached with fuel importers in December 2010, the Government will settle any debt incurred by fuel importers in 2010 by end-May 2011. Finally, it will continue to show the full costs of any government outlays for fuel products in budget documents, in line with best fiscal transparency principles.
- ***Refining food and transport subsidies for the poor:*** The Government intends to move away from generalized subsidies and design more targeted schemes. We plan to establish from August 2011 onwards a transport voucher covering low-income workers, students, and the elderly, and as of June 2011 a food voucher for eligible citizens, covering basic food staples in an effort to replace the current rice and bread subsidy. The Government will proceed with the ongoing efforts but also consider possible options that could ensure appropriate coverage.

21. **Priority spending will be preserved despite the tight fiscal policy stance**. Priority spending will, for the time being, continue to be defined as under the 2006-10 PARPA program categories, comprising spending in education, health, HIV/AIDS, infrastructure development, agriculture, rural development, governance, and the judicial system. Such spending is targeted from MT 49.2 billion in 2010 to MT 58 billion in 2011, allowing priority spending to account for at least half of all spending. Upon completion of the programming exercise later on in the year, priority spending will be redefined by capturing all spending related to the new PARP's three main pillars (agriculture, job creation, and social and human development) and supporting pillars (macroeconomic management and governance).

22. **Our investment priorities in transportation and energy infrastructure and related program commitments, as specified in the November 2010 MEFP, remain valid.** We will continue our prudent approach in selecting projects, especially those that will be financed with non-concessional resources. In our assessment, the temporary increase in the overall fiscal deficit over the next few years will remain consistent with debt sustainability. Our very gradual launch of the projects financed by those two external sources should be conducive to containing inflation pressures in the short run.

23. **The government is determined to proceed gradually and prudently with the implementation of the wage policy**. The Government will assess in due course the findings of the recently completed review of the implementation strategy of the new salary policy. Current indications point to us being able to complete the enhancements to our electronic payroll reporting system (e-FOLHA) and our civil servant master database record (e-CAF) in line with the timeline specified in the November 2010 MEFP. The first monthly wage bill report will be

issued by end-July 2011, providing an overview of the civil servant population, wage payments by sector and the impact of promotion and recruitment at all levels **(structural benchmark)**. The system will be further rolled out to three provincial directorates by end-December 2011.

III. Structural Reforms

A. Public Financial Management and Reporting

24. **Improving the reporting, monitoring, and control of budget execution remains a fiscal reform priority.**

- ***Expanding budget coverage:*** The roll-out of the e-SISTAFE budget execution system will continue, with a view to completing it for all Government institutions over the next few years. To this effect, the Government aims to adopt by end-September 2011 a roll-out plan for the remaining budgetary entities that are currently not covered. To be cost effective, the Government will exclude entities from the roll-out provided their spending and number of transactions fall below a threshold to be defined. By end-December 2011, e-SISTAFE will cover 45 percent of all spending and a total of 50 institutions.
- ***Integrating all public finance IT systems*****:** By end-August 2011, we will adopt an IT master plan to support e-SISTAFE and other PFM components. It will provide a medium-term road map on IT priorities, define basic operating and hardware standards, and assess costs and risks associated with the expansion of electronic budget execution processes.
- ***Bringing state accounts in line with International Public Sector Accounting Standards (IPSAS):*** Based on recent technical assistance, the Accounting Directorate will undertake, by end-August 2011, an exercise to simulate IPSAS-compatible account data for the 2010 State Account report, in parallel with the current format. This will enhance accrual recording, integrate financial flows and stocks, and incorporate public entities into the general government budget. We will analyze the results of the exercise with a view to developing IPSAS-compliant national state account presentation in the coming years.

B. Debt Management and Investment Planning

25. **We intend to maintain the reform momentum on debt management and investment planning and aim to make the newly created framework operational**. As outlined above, our focus will be to launch the work of the new Debt Management Committee (DMC) and Project Coordination Committee (PCC) to help us improve our decision making in these areas.

- ***Launching DMC and PCC:*** The DMC, an advisory body to ensure prudent borrowing decisions, will meet quarterly, with its inaugural meeting scheduled for end-June. The work plan aims to allow final approval of the MTDS by the Council of Ministers by mid-December 2011. It also envisages that the DMC (i) establishes procedures to ensure timely and regular data provision; (ii) supports the finalization of the second Government *Debt Sustainability Analysis* (DSA), to be completed by end-December 2011; (iii) reviews and advises on the first annual borrowing plan for 2012 (see below); and (iv) seeks donor support to develop domestic financial markets from 2012 onwards.

- ***Implementing new project selection processes:*** To strengthen capacity to identify and implement high-potential investment projects, we will strictly implement the newly adopted project selection protocol and standard evaluation template. The DMC and PCC will each issue quarterly reports to the respective supervising minister, providing a full overview on proposed projects and their evaluation, as well as their implications for debt management. The first of these reports will be ready by end-September 2011.
- ***Developing annual borrowing plan:*** The Government will develop, upon approval of the budget law by parliament, an annual borrowing plan for all domestic borrowing envisaged for 2012. The plan will be consistent with the Government's projected net annual financing needs and the projected cash flow throughout the year.
- ***Identifying pipeline of investment projects:*** The *Integrated Investment Program* will be prepared, and approved by the Minister of Planning and Development by end-December 2011, in consultation with the PCC **(structural benchmark)**. The program will list the government's priority investment projects for the next four years, and be consistent with the broad strategic objectives outlined in the new PARP.

C. Tax Policy and Administration

26. **The Government is committed to a more business-friendly environment, and simplifying our tax system is key to achieving this target**. Based on the approved action plan of priority measures (a completed structural benchmark for end-March 2011), we will initially focus on further modernizing tax administration, particularly with the support of new technologies. This will include the continued development and roll-out of customs and tax IT systems (single window and e-Tax, respectively), which will generate strategic information to guide subsequent tax policy reforms.

27. **The Government will step up efforts to improve tax compliance through automated revenue collection and better monitoring of large taxpayers**.

- ***Facilitating tax payment through banks:*** By end-July 2011, the Ministry of Finance, in coordination with the BM, will approve the *Strategic Plan for Tax Payments through Banks*, defining a time-bound roll-out plan. This will allow real-time control over budgetary resources thanks to the prompt channeling of revenues to the single treasury account (CUT).
- ***Strengthening Large Taxpayers Division (LTD – DCAT):*** The LTD´s coverage will be expanded from 47 percent at end-2009 to 70 percent by end-2014, expecting to reach 52 percent by the end-2011. To expand the coverage of LTD, we will integrate the revenue collected by the Customs Directorate from the large taxpayers. Moreover, in order to improve processes, enhance cooperation, and provide incentives for voluntary

compliance of large taxpayers, we will start in 2011 with the implementation of the model of "*Taxpayer Manager,*" assigning (initially) a number of large taxpayers to one manager.

- ***Lowering transaction costs for taxpayers:*** The Government intends to reduce, and possibly eliminate, stamp tax obligations on administrative acts. A study to this effect will be completed by end-December 2011, on which basis a proposal will be formulated to take the legal reform forward in 2012.

D. Improving Natural Resource Management

28. **We expect to become a full-fledged EITI member soon while we will continue to improve the transparency of natural resource revenues.** In our view, we have completed in a timely manner all formal requirements to acquire the EITI membership status. The Government reiterates its commitment to the EITI objectives and work toward further improving the intersectoral exchange of information so as to assure that timely and adequate information is available on mega-projects in general, and on the extractive industry in particular. Following the first EITI audit report recommendations, we intend to (i) assess and, if necessary, improve procedures on the valuation of minerals; (ii) determine whether capital gains can be considered as source of revenue, in line with best international practice; and (iii) undertake a study to define a proper tax allowance regime that clearly differentiates between depreciation and capital allowances in the context of fiscal mining regulation, with technical assistance sought from the IMF.

29. **The Government will consider options to enhance revenues from the natural resources sector.** In tandem with the ongoing public debate, the Government will carefully analyze the perspectives for potential renegotiation of fiscal benefits in the natural resources sector with willing investors while safeguarding the stability of the business climate in Mozambique. With a more medium-term objective, supported by technical assistance that is being sought, the Government will assess the feasibility of creating a stabilization fund that could accumulate revenues from Mozambique's rich minerals endowment and channel them to targeted spending that would be smoothed over time and strengthen the country's long-term growth factors.

E. Fiscal Decentralization

30. **We intend to gradually implement our fiscal decentralization strategy to enhance service delivery, improve the link between spending and social outcome, and support economic development.** Our strategy aims to initially transfer larger budget proposal and execution responsibilities to decentralized levels of the central government (Districtos, Provincias) in areas such as education, health, regional infrastructure, and for job-creating projects. At the same time, the legal framework instituting the municipalities (Autarchias) allows for the devolution of certain taxation and spending responsibilities to incorporated cities and towns, including in the areas of urban transportation, basic health services, primary education, and water management. After the encouraging experience in places such as Maputo and Beira,

we aim to further transfer responsibilities to other interested municipalities while at the same time ensuring that there is minimum capacity to manage those responsibilities and ensure proper internal controls.

F. Good Governance Framework

31. **The Government acknowledges the importance of ensuring adequate governance standards in promoting the business environment and relations with development partners.** The Attorney General's Office approved the *Strategic Plan for the Central Bureau for the Fight against Corruption* (GCCC) in January 2011. By end-July 2011, the Government will submit to Parliament, a package of administrative reforms to support the fight against corruption, including: (i) the revision of anti-corruption law 6/2004; (ii) the revisions of laws 4/1990 and 7/1998 on the declaration of assets by government officials; (iii) the revision of law 22/2007 reforming the organic law of the public sector, in particular regarding the competencies of GCCC; and (iv) a new law to define and regulate conflict of interest in the public service **(structural benchmark)**. The legislation aims to conform with the *United Nations Convention on Anti-Corruption* and ensure that the GCCC has legal competencies for accusation of corruption-related crimes. The Government has begun consulting with relevant stakeholders, such as civil society and the private and public sectors, on the objectives and specifics of the legislation.

G. Reform of National Social Security Institute (INSS)

32. **We will continue to focus on strengthening the INSS' finances and organization**. INSS will implement the new investment strategy that will be approved by end-May 2011 and solely aim to protect the interests of the beneficiaries. By end-September 2011, we will publish the validated 2009 accounts. By end-2011, we will approve the actuarial study which will be prepared based on audited accounts of 2004-08, with technical assistance support from the ILO. INSS will continue to revamp its IT system that will support the reorganization of human resources management. In 2012, we will seek to enhance coverage of the self-employed and professionals, by integrating our database with the taxpayer information maintained by the tax authorities.

IV. Financial Sector Policies

33. **Financial sector development and stability is an essential ingredient for more inclusive growth in Mozambique.** Improving financial intermediation and access to credit while safeguarding the soundness of the banking system remains a top priority. To this end, benefitting from the February 2011 validation workshop with development partners, we will finalize, by end-September 2011, the *2011-20 Financial Sector Development Strategy* which will include a wide-ranging and clearly sequenced action plan, covering ways to, among other things, enhance financial inclusion, competition, consumer protection, and financial literacy.

34. **We will continue to closely monitor the banking system to assure its continued soundness.** While commercial banks weathered the impact of the global crisis well and were able to provide enterprises with financial resources as external funding became more scarce, the high credit growth of the last two years and the close financial sector linkages with banks abroad require the BM's focused attention. We intend to pursue the following reform efforts:

- ***Finalizing financial sector contingency plan:*** The plan's remaining plan modules will be adopted by end-November 2011. They include modules for (i) closing and liquidating banks, (ii) managing bidding processes for private sector takeovers, (iii) bailouts (i.e., taking banks into temporary public ownership), and (iv) emergency liquidity assistance to promote rehabilitation of problem banks into viable institutions (structural benchmark). Adoption of the remaining four modules will make the full contingency plan effective.
- ***Moving toward Basel II standards:*** With a view to strengthening the risk-based approach to banking supervision, the BM will begin implementing the recently adopted timetable for the migration to Basel II by 2014. The focus in 2011 will be on training of staff.
- ***Introducing deposit insurance:*** In light of the approval by the Council of Ministers' *Decree on Deposit Insurance* in November 2010, as envisaged in the 2009 FSAP, the Government will seek to launch the system as soon as the necessary financing, including from external sources and the budget, will be secured. In that event, the Minister of Finance will approve the necessary regulations, and the Board members of the related Executive Committee will be appointed.
- ***Broadening electronic banking:*** As part of the plans to promote financial inclusion to unserved areas and assure the safety and efficiency of the national payment system, the BM and commercial banks are in the process of establishing the *Sociedade Interbancária de Serviços* (SIMO), an interbank company that will be responsible for processing all retail electronic transactions in a single platform in 2011 (pilot phase). SIMO will also provide other interbank services, such as electronic funds transfer and mobile banking.
- ***Fighting money laundering:*** While the Financial Intelligence Unit (GIFIM) has been made fully operational, the amendment of the AML-CFT law is still awaiting parliamentary approval. Upon its approval, the BM will issue guidelines that would allow Mozambique to move toward compliance with the 40+9 Recommendations of the FATF. In order to ensure a consistent application of the AML-CFT framework across the various regulators, the Government will establish, and appoint the members of, the National AML Task Force by end-September 2011.

V. PROGRAM MONITORING

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

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets [1]

(Millions of meticais, unless otherwise specified)

	2010									2011				
	End-June Assessment Criteria			End-Sept Indicative Target			End-Dec Assessment Criteria			End-March Indicative Target	End-June Assessment Criteria		End-Sept Assessment Criteria	End-Dec Assessment Criteria
	Prog.	Adjusted	Act.	Prog.	Adjusted	Act.	Prog.	Adjusted	Act.	Prog.	Prog.	Proposed	Proposed	Proposed
Assessment/Performance Criteria for end-June/December														
Net credit to the government (cumulative ceiling)	-1,743	-1,218	-1,287	868	868	-3,215	1,039	1,069	-1,737	1,097	-2,012	-875	-362	2,086
Stock of reserve money (ceiling)	24,567	25,067	25,402	25,753	26,253	28,900	29,493	30,243	31,849	27,368	29,156	29,826	33,708	36,418
Stock of net international reserves of the BM (floor, US$ millions)	1,759	1,716	1,742	1,885	1,891	1,781	1,675	1,667	1,908	1,715	1,765	1,835	1,905	2,000
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, US$ millions)	200	200	0	200	200	0	300	300	66	900	900	900	900	900
Stock of short-term external public debt outstanding (ceiling)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
External payments arrears (ceiling)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Indicative targets:														
Government revenue (cumulative floor)	27,049	27,049	27,943	41,732	41,732	44,306	59,940	59,940	63,489	14,929	34,311	36,609	56,382	76,792
Priority spending (cumulative floor)	…	…	…	43,562	43,562	35,561	58,424	58,424	49,246	15,899	34,547	27,499	40,839	58,000

Sources: Mozambican authorities and IMF staff estimates.

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

Table 2. Mozambique: Structural Benchmarks Under the PSI

Any new contracting of nonconcessional external borrowing or guarantees by the Central Government and selected state-owned entities (SOEs) subject to the related continuous quantitative AC (see Table 1) will be for transportation and electricity infrastructure investment, as described in paragraph 14 of the MEFP dated May 24, 2010.	Continuous
Building on the enhancements to e-FOLHA and e-CAF, a first quarterly report will be issued on the civil servant population, wage payments by sector, and the impact of promotion and recruitment decision at all levels, as described in paragraph 22 of the MEFP dated November 8, 2010.	End-July 2011
The Bank of Mozambique will adopt the financial sector contingency plan's modules related to (i) closing and liquidating banks, (ii) managing bidding processes for private sector takeovers, (iii) bailouts, and (iv) emergency liquidity assistance to promote rehabilitation of problem banks into viable institutions, as described in paragraph 34 of the current MEFP.	End-November 2011
The Minister of Planning and Development will approve an Integrated Investment Program, in consultation with the Project Coordination Committee, as described in paragraph 25 of the current MEFP.	End-December 2011
The Government will submit to Parliament, a package of administrative reforms to support the fight against corruption, including: (i) the revision of anti-corruption law 6/2004; (ii) the revisions of laws 4/1990 and 7/1998 on the declaration of assets by government officials; (iii) the revision of law 22/2007 reforming the organic law of the public sector, in particular regarding the competencies of the GCCC; and (iv) a new law to define and regulate conflict of interest in the public service, as described in paragraph 31 of the current MEFP.	End-July 2011

ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

May 20, 2011

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

I. DEFINITIONS

Net credit to the central government

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

3. The central government encompasses all institutions whose revenue and expenditure are included in the state budget (*Orçamento do Estado)*: central government ministries, agencies, and the administration of 11 provinces. Although local governments (43 municipalities or *autarquias*) are not included in the definition because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

Government revenue and financing

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

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

Priority social spending

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

Reserve money

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

Net international reserves

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

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

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

10. The ceiling applies to external debt with original maturity of one year or more and with a grant element below 35 percent. The grant element is calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the annual Budget Law. The term 'debt' will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted on August 3, 1979, as amended August 31, 2009, effective December 1, 2009. The concept of external debt is defined on the basis of the residency of the creditor. The ceiling also applies to commitments contracted or guaranteed for which value has not been received. This assessment criterion is defined cumulatively from the beginning of the program and will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

11. The central government will not contract or guarantee external debt with original maturity of less than one year. This assessment criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted on August 3, 1979, as amended August 31, 2009, effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this assessment criterion are short-term, import-related trade credits. This assessment criterion will be assessed on a continuous basis.

External payments arrears

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

Foreign program assistance

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

Actual external debt service payments

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

II. ADJUSTERS

Net international reserves

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

- downward by the shortfall in external program aid less debt service payments (up to US$100 million), compared to the program baseline (Table 1);
- downward/upward for any revision made to the end-year figures corresponding to the previous year; and
- downward to accommodate higher external outlays because of natural disasters, up to US$20 million.

Net credit to central government

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

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

Reserve money

17. The quantitative target (ceiling) for reserve money will be adjusted upward by the excess of the stock of currency in circulation above the level envisaged in the program. For programming purposes, both the stocks of reserve money and currency in circulation are defined in terms of the average of the daily end-of-day stocks in the month of the test date. The target will be adjusted up to MT 500 million for end-March, end-June, and end-September and up to MT 750 million for end-December (Table 1).

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

III. Data and Other Reporting

19. The government will provide Fund staff with:

- monthly and quarterly data needed to monitor program implementation in relation to the program's quantitative targets and broader economic developments;
- weekly updates of the daily data set out in Table 1;
- weekly data set out in Table 4 of the TMU dated May 26, 2005;
- monthly updates of the foreign exchange cash flow of the BM;
- monthly data on government revenues (in detail according to the fiscal table) with a lag not exceeding one month;
- monthly information on the balance of government savings accounts abroad;
- monthly data on domestic arrears;
- monthly budget execution reports (that will also be published) with a time lag not exceeding 45 days;
- monthly monetary survey data with a time lag not exceeding 30 days; and
- monthly data on gross international reserves, with the composition by original currencies and converted to US dollars at the actual exchange rates.

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

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

TMU Table 1. Mozambique: Net Foreign Assistance, 2010-11

	2010										2011					
	Q1		Q2		Q3		Q4		Year		Q1	Q2		Q3	Q4	Year
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	163	58	181	152	27	101	115	71	396	382	129	106	126	104	104	394
Gross foreign program assistance	182	74	203	168	42	117	132	88	467	447	144	121	140	119	118	453
Program grants	151	74	176	138	42	117	50	5	355	335	144	89	140	119	3	338
Program loans	30	0	27	30	0	0	82	83	112	112	0	32	0	0	116	116
External debt service	18	16	22	16	15	16	18	16	71	65	15	15	15	15	15	60
Net foreign program assistance (MT mn)	4,843	1,661	5,378	5,184	829	3,633	3,975	2,428	12,935	12,905	4,732	3,838	3,802	3,170	3,224	12,065
Gross foreign program assistance	5,220	2,076	6,021	5,673	1,278	4,097	4,738	2,905	15,775	14,751	5,253	4,375	4,337	3,693	3,765	14,187
Program grants	4,344	2,076	5,229	4,659	1,278	4,097	1,798	162	11,821	10,994	5,253	3,229	4,337	3,693	93	10,516
Program loans	876	0	792	1,014	0	0	2,940	2,743	3,954	3,757	0	1,147	0	0	3,672	3,672
External debt service	376	416	643	489	449	464	763	477	2,840	1,846	521	537	535	523	541	2,123
Stock of outstanding currency (MTm)	13,278	14,515	16,445	16,721	16,436	18,364	19,134	20,447	19,134	20,447	16,098	17,556	19,164	22,512	24,147	24,147
Stock of outstanding currency (MTm), Prog. Def	13,278	14,317	15,324	16,080	16,052	17,866	18,616	20,403	18,616	20,403	15,878	16,883	18,430	21,901	24,096	24,096

Source: Mozambican authorities and IMF staff estimates.