International Monetary Fund

Republic of Mozambique and the IMF

Press Release:
IMF Executive Board Completes Fourth Review Under Policy Support Instrument for Mozambique
June 6, 2012

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

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

May 10, 2012

MOZAMBIQUE—LETTER OF INTENT

May 10, 2012

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

Dear Ms. Lagarde:

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

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

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

Sincerely yours,

/s/ Manuel Chang Minister of Finance	/s/ Ernesto Gouveia Gove Governor Bank of Mozambique

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

ATTACHMENT 1: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

May 10, 2012

This updated MEFP (i) describes recent developments and performance under the Government's economic program under the three-year PSI to date and (ii) elaborates on economic and structural policy intentions for the remainder of 2012. It builds on the MEFPs underlying the initial PSI request dated May 28, 2010 and those for the first, second, and third reviews from November 8, 2010, May 20, 2011, and November 14, 2011, respectively.

RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

Mozambique's economy sustained a strong performance in 2011 despite a marked deterioration in the global economic environment. Based on quarterly data, economic activity is estimated to have grown by 7.1 percent, in line with objectives. This result has been driven to a large extent by good harvests and a booming mining sector, reflecting the start of coal production. Twelve-month headline inflation decelerated sharply to 5.5 percent at end-2011 and 2.5 percent in February 2012, from its peak of 16.6 percent at end-2010. Inflation expectations have been effectively arrested, as core inflation (excluding food and fuel prices) declined to 5.9 percent at end-2011 and further to 2.4 percent at end-February 2012. The determination of the authorities in tightening monetary and fiscal policies, coupled with the impact of favorable developments of international prices, a good harvest, and a stronger metical, contributed to the remarkable disinflation. In addition, preliminary external sector data indicate that exports and FDI have remained buoyant in spite of the more difficult external context, resulting in an external current account deficit of 13 percent of GDP and a better-than-expected level of international reserves equivalent to 4.8 months of imports.

We largely complied with the objectives underlying our economic program:

- All end-December 2011 quantitative assessment criteria (AC) were met comfortably, except for net credit to the government (NCG).
- The Bank of Mozambique (BM) succeeded in its disinflationary efforts by slowing reserve money (RM) growth from 29¼ percent in 2010 to 8½ in 2011, thus meeting the relevant end-December AC. It also observed, with ample margin, all quarterly targets on net international reserves (NIR) through end-December 2011.

- The Government's fiscal policy stance in 2011 was supportive of the disinflation effort, especially in the first half of the year. However, both the end-September indicative target and the end-December AC for NCG were marginally exceeded, in spite of buoyant revenue collections. This occurred as a Government guarantee for a public enterprise was called by a domestic bank. Excluding the outlays for the guarantee, we would have met both targets. The indicative target on priority spending for the year as a whole was met, notwithstanding having slightly underperformed at end-September.
- On nonconcessional borrowing (NCB), in addition to the loans for the rehabilitation of Maputo and Nacala airports, we have now signed a US$300 million credit to build a ring road around Maputo, bringing our usage under the NCB program ceiling to US$446 million. The ring road is intended to relieve urban congestion and facilitate private sector activity in the capital area.
- We made important progress in implementing the program's structural benchmarks. On March 26, the Minister of Planning and Development approved an Integrated Investment Program, which was developed in consultation with the Project Selection Committee (PCC). As to the end-November 2011 benchmark on the financial sector contingency plan, we have adopted five of the envisaged six modules. However, recent Fund TA suggested several enhancements to make the plan more effective, which we will take up quickly.

IMPLEMENTATION OF THE PARP

The Government has taken important steps to implement the new four-year PARP adopted in May 2011. Consistent with the PARP's broad strategic vision, we have adopted a series of sectoral strategies and launched a variety of policy initiatives under the PARP's three main pillars that should help create the conditions for poverty reduction and broad-based inclusive growth. In addition, we succeeded in maintaining macroeconomic stability, as evidenced by this MEFP, and are taking important milestones in the governance area, as outlined below, which were envisaged under the PARP's supporting pillars. Among other things, our intentions under the PARP's main pillars are as follows:

- ***Enhancing production and productivity in agriculture.*** Framed by the *Agricultural Reform Strategy* (PEDSA) approved in May 2011, the Government is working toward doubling agricultural production by 2020. This is to be achieved through the expansion of the agricultural frontier and an increase in productivity, with a focus on improving access to land, enhancing availability of high-quality seeds, fertilizers, and other inputs, and promoting farming techniques and market access. Among other things, the Government will expand the number of land leasing titles (DUATs) to 2,842 in 2012, from 2,701 in 2011. Moreover, it will aim to offer extension services to 10 percent of agricultural producers this year and to 15 percent in 2014, and set up silos in 5 provinces to improve market access. To help crowd in private investors and better prioritize public investment in rural areas, the Council of Ministers will adopt a new agricultural investment plan by end-June 2012, which will be disseminated in a road-show later this year.

- ***Creating employment.*** Several initiatives have been launched to create an environment that is more conducive to private sector activity. On February 2, the Government approved a decree simplifying the issuance of 84 types of licenses for 9 areas of activity. In early March, the Council of Ministers approved an action plan to accelerate business climate reforms for implementation in 2012, with clear lines of accountability. The plan includes a number of measures aimed to reduce by half the number of procedures to start a business. Other critical measures encompass the adoption of the bankruptcy code by Parliament, the completion of an inventory of business licenses, and the approval of a credit registry model. We are also well advanced in the preparation of the successor five-year *Strategic Plan to Improve the Business Environment*, which we expect to submit for Cabinet approval in the fourth quarter of 2012.
- ***Enhancing social and human development.*** The Government is on track to improve access to, and the quality of, social services and infrastructure. Among other things, to improve health care, we will raise the ratio of health workers to 100,000 inhabitants from 66 in 2012 to 69 in 2014. As to education, we aim to boost the net rate of schooling at age 6 in first grade from 73 to 79 percent during the period. As to social infrastructure, line ministries are stepping up their investment plans to improve access to water, basic sanitation, electricity, dwelling, and urban transport services. Finally, supported by the ILO, UNICEF, the Bank, and the Fund, we are in the process of enhancing our social protection systems (see below).

MACROECONOMIC POLICIES

A. Economic Objectives

We expect Mozambique's medium-term outlook to remain positive, although the current global economic environment poses risks in the short run. Our objective is to sustain high economic growth of 7½ to 8 percent over the next five years. Nonetheless, while we also retain this objective for 2012, the more difficult external environment could temporarily lower economic growth by up to one percentage point. This could in particular be the result of a moderation in external demand and capital inflows which may affect domestic economic activity. Nonetheless, the external current account deficit is set to improve slightly this year and hover at around 12 percent of GDP during the next five years, while the reserves coverage of imports should exceed 5 months. Barring any unforeseen external price shocks, we are confident to achieve our inflation objective of 5 to 6 percent during the period.

B. Macroeconomic Policy Mix

We remain committed to a prudent macroeconomic policy mix over the medium term. Fiscal and monetary policies will be geared toward safeguarding macroeconomic stability and debt sustainability while fostering the Government's investment and social development goals so as to sustain high and inclusive economic growth. The fiscal policy stance will accommodate a temporary surge in public investment over the next few years to close the infrastructure gap and support the PARP's social and human development objectives, including the expansion of social protection. While this stance will boost the overall fiscal deficit to 5 to 6½ percent of GDP during the period, the strong revenue effort and restraint in domestic current spending will limit the domestic primary deficit to 2 to 2½ percent of GDP. The continued strong support of development partners and NCB within the program ceiling will ensure that recourse to domestic bank financing will not exceed 1 percent of GDP, thus providing ample room for private sector credit expansion. Monetary policy will be sufficiently accommodating to support this objective while primarily aiming to preserve low inflation. The envisaged rise in money demand will keep RM expansion slightly faster than nominal GDP growth.

Our policy stance for 2012 will cushion the impact of a temporary global slowdown while safeguarding the recent disinflation gains. Given the ample policy buffers as a result of our strong track record of prudent macroeconomic policies, the Government intends to embark on a more countercyclical policy stance for 2012. The BM's policy response will entail a continued cautious easing of monetary policy consistent with the annual inflation objective.

The pace of our temporary boost in infrastructure investment, partially financed by NCB, will be compatible with maintaining macroeconomic stability and debt sustainability. In light of this, we will implement our investment priorities within a raised NCB program ceiling of US$1.5 billion. Our own updated debt sustainability analysis suggests that Mozambique will continue to enjoy a low risk of debt distress as long as the envisaged NCB-financed investment remains focused in transportation and energy infrastructure, is time-limited, and geared toward projects with a proven economic return. We will base our investment decisions on our recently completed Integrated Investment Plan and thorough feasibility studies and cost-benefit-analyses, generally also including an assessment of lower-cost alternatives. We consider this stepping up of public investment financed by nonconcessional borrowing to be temporary, since over the long run we expect to begin reaping higher revenues from the natural resource sector that are expected to create the necessary fiscal space to accommodate our investment and other priorities.

C. Monetary and Exchange Rate Policies

The monetary policy stance will become more accommodating in 2012 but is not expected to jeopardize the annual inflation objective of 5 to 6 percent. Such a policy stance will support the provision of private sector credit at a critical time. We project RM growth to accelerate to about 20 percent, exceeding nominal GDP growth by one-fourth, thus contributing to the deepening of the financial system. Following the strong signaling effect of our recent easing of key policy rates, the BM will continue to be guided in its future policy decisions by its inflation objective.

The authorities will continue to give utmost priority to enhancing the current framework for monetary policy operations. This entails the following specific measures:

- ***Monitoring government accounts.*** The implementation of the MoU signed on March 25, 2011 on the exchange of information between the BM and the Ministry of Finance (MoF) is proceeding well and the objectives from the last MEFP have been achieved. Both institutions will continue to improve the timely exchange of information.
- ***Developing the domestic repo market to help improve money market management and the liquidity of government securities.*** The BM is on track to implement the measures envisaged in the November 14, 2011 MEFP for implementation by end-July 2012 to improve the functioning of the interbank and repo markets. Following Fund TA advice, it will also turn the FPD credit facility into a repo operation during 2012 so as to shift market preference from uncollateralized to collateralized operations. We are also in the process of assessing the impact of possible measures to equalize the tax treatment between BT and OT and between collateralized and uncollateralized interbank market operations. As indicated in the MEFP dated November 14, 2011, we will reflect any such equalization measures in an amendment to the Corporate Income Tax Law to be submitted to Parliament by end-September 2012 to take effect in 2013 **(structural benchmark)**.

The BM will continue to prepare for the adoption of an inflation-targeting (IT) framework in the medium term. Measurable progress in monetary policy formulation and implementation has been achieved, with support from Fund TA, to lay the foundations for an IT framework. The BM will continue to improve data collection and analysis, forecasting modeling, forward-looking communication, and managing short-term liquidity forecasting. In addition, we are on track to publish by end-May 2012 our first quarterly monetary policy report to enhance communication and transparently and efficiently explain the BM's policy intentions **(structural benchmark)**.

The authorities renew their commitment to maintaining a flexible exchange rate regime. To this effect, the BM will allow the exchange rate to adjust freely to evolving patterns of trade and financial flows and closely monitor developments in the real effective exchange rate vis-à-vis a broad basket of currencies, with a view to ensuring external competitiveness and a comfortable level of international reserves.

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

D. Fiscal Policy

The countercyclical fiscal policy stance for 2012 will entail a slight increase in the fiscal deficit. Although the Revenue Authority will strive to collect the tax revenue targets under the 2012 budget law, revenue collections may fall short of these objectives in light of the possibly less favorable economic environment. However, the Government intends to maintain its spending program to avoid aggravating the economic and social effects of the global downturn and to pursue the country's transformation agenda under the PARP. As a result, the domestic primary deficit could rise by 0.2 percentage points relative to earlier projections, to 2¼ of GDP, in 2012. This higher deficit would be fully financed by additional World Bank financing, thus avoiding crowding out the private sector from domestic bank financing.

A further projected drop in revenues would, however, trigger application of the provisions which limits budget execution to cautionary ceilings consistent with the Organic Budget Law (SISTAFE 2002). This will be based on the decree on the provisions regarding budget execution (*Delegação de Competência sobre a Excecução do Orçamento;* Decree No. 1/2011) adopted by the Council of Ministers on February 2, 2012 and the ministerial circular (*Circular Ministerial* No 4/2012) issued by the Minister of Finance on December 30, 2011.

The implementation of our salary policy will remain gradual but supportive of the recruitments needed for the PARP priority sectors. In line with the review of the salary policy implementation strategy completed at end-March 2012, we will decelerate the decompression of the salary scale; decelerate the pace of recruitment in non-priority areas and institutions while emphasizing the accumulation of human capital; and strengthen the execution of the wage bill through a rapid expansion of the electronic salary payment system (e-FOLHA) in the public sector. These measures will lead to a slight decrease of the wage bill to around 8½ per cent of GDP over the medium term. As of end-February, the Government has rolled-out the electronic salary payment system e-FOLHA to 152 provincial directorates and is confident to complete the rollout to all 172 directorates by end-June 2012 **(structural benchmark)**, and to the entire central level by end-2012. It will also continue to produce quarterly wage bill reports for use by the Ministries of Finance and Civil Service to monitor and control salary expenditures.

Spending for priority sectors under the PARP will be increased. The Government aims to rise such spending from MT 58 billion in 2011 to MT 73 billion in 2012, or from 50 to 53 percent of projected total expenditures (excluding net lending). Such spending has been redefined to incorporate outlays related to social action, labor and employment, consistent with the Government's enhanced focus on those areas under the new PARP. The Government will complete the full mapping of priority spending with the PARP's three main and two supporting pillars by end-July 2012.

We will support implementation of the PARP by expanding social protection while moving toward eliminating the costly fuel subsidy. In this endeavors, we are drawing on the expertise of our development partners.

- ***Enhancing social protection.*** The Government is working to support the implementation of the revamped social protection programs approved by the Council of Ministers in September 2011 and financed under the 2012 budget. The Ministry for Women and Social Action (MMAS) is strengthening its operational systems for the effective delivery of cash transfers and the launch of public works programs. We expect the first public works pilots to be launched in 2 cities and 4 provinces this year. MMAS continues to revise its targeting and beneficiary identification mechanisms, payment procedures, and monitoring and evaluation systems. The Government is also working with development partners on the establishment of a common fund for social protection to guarantee the complementary funding needed to finance the requisite investments in institutional capacity and the medium-term expansion of the beneficiaries envisaged under the programs. MMAS and MoF will regularly assess the costing and affordability of increasing the amount of the existing transfers that will generate improvements in the living conditions of beneficiaries. Government allocations to social protection will rise from 0.4 at present to 0.8 percent of GDP over the next few years when the Government's envisaged target of 815,000 beneficiaries under both the cash transfer and public works programs could possibly be achieved. Under the best circumstances, the fiscal space for social protection could further rise to 1.4 percent of GDP early in the next decade.

- ***Phasing out the fuel subsidy***. The Government remains committed to fully eliminating the costly fuel subsidy at the earliest possible moment. While cost recovery was effectively achieved early in 2012, the subsequent global oil price increases have again caused a need for compensation for fuel importers. In the short run, the Government will aim to contain such need for compensation by exploring options for cross-subsidization of various petroleum products through greater segmentation of the market and relatively more frequent and smaller price adjustments than in the past. With a more medium-term perspective, it is reviewing avenues to improve the price-setting formula that has temporarily been suspended. We will complete paying compensation to fuel importers for incurred 2011 losses by end-May 2012, consistent with the agreement reached with them.

STRUCTURAL REFORMS

A. Public Financial Management and Reporting

We are committed to improving the reporting, monitoring, and control of budget execution. The following measures are considered key:

- ***Expanding budget coverage and system integration.*** The rollout of the e-SISTAFE budget execution system will be completed by 2015 covering 98 percent of all spending, as per the September 2011 rollout plan. On this basis, we aim to increase the e-SISTAFE coverage to 47 percent this year. We have completed an action plan for 2012-14, to be adopted by end-May 2012 covering among other things the development of IT hardware and software, and technical skills among staff.

- ***Enhancing the quality in PFM processes.*** Notwithstanding our substantial efforts in developing and implementing SISTAFE, there is scope to improve the real-time recording of the appropriation, liquidation, and payment phases consistent with the effective delivery of goods and services. Based on Fund TA and recent studies by the General Financial Inspectorate, we are implementing measures to reinforce control and audit functions and step up training at the provincial level. We expect to have full compliance with real-time recording of the expenditure chain by 2013.

- ***Migrating to IPSAS-compatible reporting.*** We will gradually reform the State Account format and content according to international public accounting standards (IPSAS). We will prepare the 2011-13 State Account reports under the old and new format, in tandem with efforts to continue to improve data quality and compiling mechanisms. To this end, the Minister of Finance will approve a time-bound action plan for IPSAS-compatible reporting by end-October 2012 **(structural benchmark).** This time-bound action plan will clearly define the procedures required to elaborate the State Account of 2014 in the new IPSAS-compatible format. Success of this reform hinges crucially on strengthening capacity at the Accounting Directorate.
- ***Expanding fiscal decentralization.*** We will further decentralize fiscal responsibilities with due regard to local capacity, proper internal controls, and available financing. To this effect, we are gradually rolling out a district development monitoring system (SMdDD) aimed at assessing districts' administrative performance. We have assessed 33 districts in 2011, and our goal is to assess 80 districts in 2012 and all 128 districts in 2013. We will make these assessments public to local district councils and communities.

B. Debt Management and Investment Planning

The Government has reached important milestones in modernizing debt management and investment planning. Our reform efforts will continue in both areas.

- ***Following up on Integrated Investment Plan.*** We completed the Integrated Investment Plan laying out our strategic vision for investment priorities, describing selection procedures, and providing our current assessment of a list of top priority projects. We consider this plan a rolling document which we will update in light of further analysis, focusing in particular on projects' expected economic and social returns and lower-cost alternatives.
- ***Completing DSA and MTDS.*** We completed our second annual debt sustainability analysis (DSA) in early-May 2012, which should allow us to finalize and submit for approval by the Council of Ministers our enhanced medium-term debt strategy (MTDS) by end-June 2012, some three months behind our initial schedule.
- ***Benefitting from advisory committees.*** The Debt Management Committee (DMC) and Project Coordination Committee (PCC) have met quarterly and issued regular reports to the respective supervising minister. The PCC also supervised the effective application of the new project

selection template and the drafting of the Integrated Investment Plan. The PCC will benefit from the adoption of the project preparation manual, which the Government expects to adopt by end-May 2012, with support from the World Bank. In turn, the DMC provided guidance in the drafting of the MTDS and our second DSA.

- ***Strengthening MoF debt unit.*** Preparation of the DSA benefitted from a complete overhaul of our debt database. To preserve data quality, improve management of the country's debt service, ensure a high-quality analysis of financing proposals, and support the DMC, the unit will complete an operating procedures manual by end-June 2012 for approval by the Minister of Finance. The manual will assign clear roles and responsibilities to the unit's staff, and establish norms for data entry and validation and other processes. The debt unit has started producing quarterly debt reports since the last quarter of 2011 and will continue this practice going forward. Starting in June 2012, these reports will include up-to-date information on the evolution of public and publicly-guaranteed debt, the contracting of loans, cost and risk indicators, and a link to the scenarios underlying the new MTDS. These reports will be made available to support DMC decision making and monitoring of the debt management strategy.
- ***Completing the first Annual Domestic Borrowing Plan for 2013.*** Building on the MTDS, we will draw up and publish a first annual domestic borrowing plan for 2013 upon approval of that year's budget law but no later than end-January. The plan will improve internal planning and help communications with the market, thereby reducing potential issuance cost in the long term. It will include quarterly financing and repayment projections and be consistent with the projected net annual financing needs and cash flow throughout the year **(structural benchmark).**

C. Tax Administration

We will sustain our strong revenue mobilization effort while aiming to make the tax system more business-friendly. This will mainly be achieved through refinements in tax policy and the adoption of modern tax administration practices.

- ***Implementing the single taxpayer database and registration number.*** Based on the **structural benchmark** to make the database functional by end-June 2012, we expect that by end-2012, some 80 percent of corporate taxpayers and 20 percent of individual taxpayers will be registered in the database throughout the country.

- ***Enhancing tax payment efficiency.*** We will revise our tax legislation to accommodate the implementation of the electronic tax system (e-tax). This will be done for the VAT by end-2012 and for the large corporate and personal income taxes by end -June 2013. We will take this opportunity to address the current tax refund inefficiencies related to the personal income tax and VAT and revise, and possibly eliminate, stamp tax obligations on administrative acts, based on a recent study.
- ***Fostering tax payments through banks.*** Following the recent adoption of the *Action Plan for Tax Payments through Banks*, the Government will introduce the payment through banks for custom duties, VAT, and simplified tax for small tax payers (ISPC) by end-2013 and all income taxes by July 2014.With technical support from development partners, we will strive to accelerate the implementation schedule.
- ***Reinforcing the large taxpayers unit (LTD-DCAT).*** Modern management procedures in the LTD-DCAT will continue to be reinforced through the large taxpayer's liaison agents and a dedicated data collection information system. The latter will be fully operational by end-June 2012. The unit is expected to build expertise on natural resources and strategic sectors over time to enable targeted audits and help improve revenue forecasting. Collections by the LTD-DCAT are projected to rise from 56 percent in 2011 to 58 percent in 2012, 63 percent in 2013, and 70 percent in 2014.
- ***Completing rollout of single-window trade facilitation project (JUE)***. Following its launch last year to streamline custom declaration procedures at the Port of Maputo, the JUE will be rolled out to the country's seven main entry points by end-2012 and collect 70 percent of all customs revenues. We expect that this share will rise to 90 percent end-2013.

D. Improving Natural Resource Management

Great strides have been made to bring Mozambique very close to full EITI membership. The second reconciliation country report was completed in mid-March and presented to stakeholders at a March 30 seminar. The report fully addressed the guidance from the EITI Secretariat and represents a major leap toward the adoption of a best-practice framework to improve the transparency of the natural resource sector.

The Government is enhancing its technical and institutional capacity to manage natural resources, with support from partners. Under forthcoming Fund TA under the *Topical Trust Fund for Managing Natural Resources Wealth (TTF-MNRW),* we will review and implement reforms to our mining and hydrocarbon fiscal regime to ensure that an appropriate share of benefits is captured for

Mozambique under newly launched projects while remaining an attractive investment destination. In particular, we will look into methods for the appropriate valuation of mineral assets for fiscal purposes and revisit the taxation of capital gains. Our intention is to submit the revised legislation to Parliament expeditiously, possibly as early as end 2012.

Other challenges in natural resource management will be addressed in due course. We will enhance mining and hydrocarbon revenue forecasting, assess the feasibility of creating a stabilization fund to support the country's long-term development strategy, and improve the statistics on natural resources. While respecting all existing Government commitments, we are exploring opportunities for mutually beneficial renegotiations of terms under existing natural resources sector projects where changes in circumstances may have led to a misalignment.

E. Good Governance Framework

The Government will ensure the proper implementation of the anti-corruption legislation upon its approval by Parliament. This will enhance the investment climate and instill confidence of local and international stakeholders. To this effect, and with technical support from our partners, the Government will produce in due course a time-bound and costed action plan, including all the institutional reforms required to fully implement the anti-corruption legislation package. Looking at anti-corruption practices more broadly, the Government will update the 2006-10 *Governance Anti-Corruption Strategy* by end-July 2012, based on all available studies and relevant documents, such as the recently completed *Second National Study on Governance and Corruption Analysis*, the 2009–14 *Integrated Justice Strategy*, and the report on the implementation of the African Peer Review Mechanism (MARP) in Mozambique. It will be implemented, and also disseminated to and discussed with key stakeholders. Our PARP matrix will be revised accordingly to incorporate key measures under the action plan to implement the anti-corruption legislative package and the broader *Governance Anti-Corruption Strategy*.

II. FINANCIAL SECTOR POLICIES

A. Financial Sector Surveillance

The BM is intensifying its financial sector surveillance in response to the global financial turmoil. Among other things, the central bank is focusing on:

- ***Strengthening supervision.*** With Fund TA guidance, the BM is re-assessing the banking sector's vulnerabilities to tensions in the Euro area and considering options to lessen risks for cross-border contagion. Further steps to enhance risk-based banking supervision will also be taken through the migration to Basel II, which should be concluded in 2014.

- ***Completing financial sector contingency plan.*** The authorities aim to adjust the draft plan by incorporating recent Fund TA recommendations, especially with respect to the modules on emergency liquidity assistance and bank resolution. We expect to have the full plan operational by end-September 2012.
- ***Making Deposit Insurance Fund (DIF) operational.*** We aim to make the DIF, created in 2010, an integral component of our framework to safeguard financial sector stability. To this end, we will, in coordination with the MoF, assess options to secure its funding and decide on deposit coverage expeditiously.

B. Fighting Money Laundering and Terrorism Financing

The AML/CFT framework is expected to be operational shortly. The MoF has established, chaired, and appointed the members of the high-level AML/CFT National Task Force in December 2011. The AML/CFT law was approved by the Council of Ministers and formally submitted to Parliament on April 19, 2012. The law is needed to make the AML/CFT framework fully effective and allow other regulators to adopt implementing guidelines. The AML/CFT strategic plan, prepared by the financial intelligence unit GIFIM, was approved by the Council of Ministers on April 17, 2012. The strategic plan will aim to foster national, regional, and international cooperation, strengthen the AML/CFT institutional framework, and promote capacity building and outreach efforts.

C. Financial Sector Development Strategy

We are close to officially launching Mozambique's Financial Sector Development Strategy (FSDS) for 2011-20. The strategy includes well-defined measures to enhance financial inclusion, competition, consumer protection, and financial literacy, thereby supporting Mozambique's long-term economic growth. The three strategic and operational bodies (Steering Committee, Technical Advisory Committee, and Implementation Unit) were set up in November 2011 and have become fully operational. The FSDS approval by the Council of Ministers was delayed to May 2012 to incorporate recommendations by the Steering Committee. We intend to launch the FSDS' dissemination in June through a workshop organized by the World Bank and are working with development partners to fund the implementation of the FSDS.

D. Payment System

The BM will further enhance financial stability and promote market development through payment system reforms. Following the rollout of the real time gross settlement system in national currency

(MTR) in 2010, it has worked on improving the monitoring of risks in the electronic clearing system (CEL) for checks, electronic fund transfers, financial settlement of securities. Based on ongoing TA, the BM will adopt a payment systems oversight policy strategy and procedures manual by end-August 2012. It will also complete the self-assessment of the MTR and CEL against the *Core Principles for Systemically Important Payment Systems* by end-August 2012. Going forward, a particular focus will be on launching a retail payments network shared by the BM and commercial banks. Following the establishment of the retail payments company SIMO in June 2011, a pilot phase is expected to be completed during 2012 after which the platform is expected to handle all retail transactions and support other interbank services, such as electronic funds transfers and mobile banking.

III. PROGRAM MONITORING

1. The proposed modifications of quantitative ACs and indicative targets for end-June 2012, the proposed indicative targets for end-September 2012, and the proposed ACs and indicative targets for end-December 2012 are shown in Table 1. Table 2 provides a list of the proposed structural benchmarks. The fifth PSI review is expected to be completed by end-2012 and the sixth and last PSI review by June 13, 2013.

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

	2011								2012				
	End-Sept Indicative Target			Status	End-Dec Assessment Criteria			Status	End-March Indicative Target	End-June Assessment Criteria		End-Sept Indicative Target	End-Dec Assessment Criteria
	Prog.	Adj.	Act.		Prog.	Adj.	Act.		Prog.	Prog.	Proposed	Proposed	Proposed
Assessment Criteria for end-June/December													
Net credit to the government (cumulative ceiling)	-362	-362	-74	NM	2,896	3,066	3,360	NM	2,795	-2,645	-2,645	-745	2,500
Stock of reserve money (ceiling)	33,708	33,400	31,436	M	36,053	36,053	33,275	M	33,800	36,734	36,923	37,031	39,985
Stock of net international reserves of the BM (floor, US$ millions)	1,905	1,905	2,130	M	2,030	2,038	2,238	M	2,091	2,154	2,207	2,323	2,438
New nonconcessional external debt contracted or guaranteed by the central government or the BM or selected state-owned enterprises with maturity of one year or more (cumulative ceiling over the duration of the program, US$ millions)	900	900	146	M	900	900	146	M	900	900	1,500	1,500	1,500
Stock of short-term external public debt outstanding (ceiling)	0	0	0	M	0	0	0	M	0	0	0	0	0
External payments arrears (ceiling, US$ millions)	0	0	0	M	0	0	0	M	0	0	0	0	0
Indicative targets													
Government revenue (cumulative floor)	56,382	56,382	60,490	M	76,792	76,792	81,119	M	20,272	45,556	45,256	69,687	94,568
Priority spending (cumulative floor)	40,839	40,839	40,589	NM	58,000	58,000	58,242	M	10,500	24,500	24,500	35,934	72,563

Sources: Mozambican authorities and IMF staff estimates.
1 For definition and adjustors, see the Program Monitoring Section of the Memorandum of Economic and Financial Policies and the Technical Memorandum of Understanding.

Table 2. Mozambique: Structural Benchmarks Under the PSI

Structural Benchmarks	Expected Date of Implementation
The Bank of Mozambique will publish its first quarterly monetary policy report, as described in paragraph 11 of the MEFP dated November 14, 2011.	End-May 2012
The Government will complete the rollout of the e-Folha electronic salary payment system to all provincial directorates, as described in paragraph 19 of the MEFP dated November 14, 2011.	End-June 2012
The Ministry of Finance will make fully functional a new single taxpayer database and identification number, as described in paragraph 23 of the MEFP dated November 14, 2011.	End-June 2012
The Government will submit to Parliament an amendment to the Corporate Income Tax Law reflecting measures derived from an impact study on the equalization of the tax treatment between Treasury bills and Government bonds and between collateralized and uncollateralized interbank market operations, to take effect in 2013, as described in paragraph 10 of the MEFP dated November 14, 2011.	End-September 2012
The Minister of Finance will approve a time-bound action plan for IPSAS-compatible reporting, as described in paragraph 19 of this MEFP.	End-October 2012
The Government will adopt an Annual Borrowing Plan for 2013, as described in paragraph 20 of this MEFP.	End-January 2013

ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

May 10, 2012

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

DEFINITIONS

A. Net credit to the central government

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

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

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

B. Government revenue and financing

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

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

C. Priority social spending

7. Priority social spending is based on the PARPA program categories expanded to incorporate all areas under the new PARP. 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; a (vii) governance and judicial system, and (viii) social action, labor and employment.

D. Reserve money

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

E. Net international reserves

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

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

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

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

G. Stock of short-term external public debt outstanding

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

H. External payments arrears

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

I. Foreign program assistance

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

J. Actual external debt service payments

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

ADJUSTERS

A. Net international reserves

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

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

B. Net credit to central government

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

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

C. Reserve money

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

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

DATA AND OTHER REPORTING

20. The Government will provide Fund staff with:

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

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

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

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