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

May 13, 2009

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Republic of Mozambique – Letter of Intent

May 13, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Government of Mozambique is implementing an economic and financial program consistent with its medium-term *Plano de Acção para a Redução da Pobreza Absoluta II* (PARPA II) and supported by the Fund under the Policy Support Instrument (PSI). Program implementation has progressed well, contributing to high and sustainable economic growth. The Government seeks to consolidate these achievements and explore initiatives to further promote growth and reduce poverty.
2. Implementation of the PSI-supported program in the second half of 2008 has been satisfactory. All quantitative assessment criteria (ACs) to end-December 2008 were met. Implementation of the two structural benchmarks for end-March 2009—the approval of a PFM vision paper and the issuance of a decree streamlining the business inspection process—was delayed and both are now expected to be implemented by end-July 2009. On this basis, the Government requests completion of the fourth review under the PSI-supported program.
3. Macroeconomic performance during 2008 was good despite pressures from high fuel and food prices in mid-2008 and the onset of the global economic crisis in late 2008. As in its response to the surge in international prices, the Government intends to respond to the current global economic crisis in a timely and appropriate manner, in consultation with Fund staff.
4. To mitigate the adverse impact of the global economic crisis, the Government will ease fiscal and monetary policies during 2009. However, the scope for supportive policies is constrained by a large projected drop in external reserves resulting directly from the sudden deterioration in the external environment. Indeed, export receipts had started to decline by late 2008 and both public and private capital inflows are now projected to fall in 2009.
5. Against this background, the Government of Mozambique requests access to the Fund's Exogenous Shock Facility (ESF). The Government requests access of 100 percent of quota, or SDR 113.6 million, to be disbursed in three tranches following completion of the fourth, fifth and sixth reviews under the PSI. In accordance with Fund's policies, the

ATTACHMENT I**REPUBLIC OF MOZAMBIQUE: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF MOZAMBIQUE FOR THE FOURTH REVIEW UNDER THE PSI, AND THE REQUEST FOR ACCESS UNDER THE EXOGENOUS SHOCK FACILITY**

May 13, 2009

1. This MEFP reviews performance under the PSI-supported program through end-2008 and outlines the Government's policies for 2009. The Government of Mozambique is committed to its medium-term macroeconomic strategy of prudent macroeconomic policies and second-generation structural reforms to sustain economic growth and poverty reduction. In the near term, the Government is ready to ease macroeconomic policies to help mitigate the impact of the global economic crisis.

I. Program Implementation In 2008**A. Background**

2. Mozambique's macroeconomic performance through 2008 remained strong, despite challenges from the mid-year surge in international fuel and food prices, disruptions to electricity transmission, and the onset of the global economic crisis at the end of the year. The economy expanded by 6.8 percent in 2008, somewhat more than anticipated because of stronger output in transport and communication, mining, and agriculture. Inflation fell faster than expected, from 13 percent in February 2008 to 6.2 percent in December 2008 and 4.4 percent in April 2009, mainly because of the sharp drop in international import prices at the end of the year. As expected, the current account balance in 2008 was adversely affected by higher import expenditures on account of higher international prices. However, this was more than offset by high private capital inflows so that gross external reserves increased about US\$140 million during the year and the real effective exchange rate increased 11 percent.

B. Fiscal Sector and Public Financial Management

3. The Government's fiscal strategy in 2008 was in line with its medium-term strategy to limit domestic financing to make room for private sector credit. Budget implementation during the year encountered challenges arising from the sharp increase in fuel and food prices.

4. The Government's fiscal plans were revised in July 2008 to incorporate measures to mitigate the social impact of higher fuel and food prices. The Government had already introduced an urban transportation subsidy earlier in the year. In the second half of the year, the Government also suspended fuel-related taxes until 2009 and launched its Food Production Action Plan, together costing 1.3 percent of GDP. These additional measures were largely financed by reductions in nonpriority spending and additional World Bank budget support.

5. Budget implementation in 2008 was strong. Domestic budget financing for the whole year was 0.8 percent of GDP lower than envisaged under the revised fiscal framework. This was because of higher domestic revenues (0.2 percent of GDP), mainly personal income tax collections; lower recurrent spending mostly (0.3 percent of GDP), on goods and services; and other tax revenues (0.3 percent). Spending execution was also strong and priority expenditures were 64 percent of total expenditures. However, there was a substantial shortfall in reported project aid of 4.0 percent of GDP.

6. The Revenue Authority (Autoridade Tributária-AT) continued to improve tax administration. It identified strategic reform areas for the year and approved the 2009-2010 Strategic Plan and the 2009 Tactical Plan. To facilitate planning, execution and control of its operations, the AT also started to implement a performance indicator framework. Preparations are under way to allow taxes to be paid through commercial banks by the end of 2009. The AT registered more than 190,000 new tax payers in 2008, some 90 percent more than targeted and contributing substantially to the strong revenue performance.

7. The audit of the stock of post-2003 commercial VAT arrears, completed in July 2008 and covering 80 percent of total invoices, had identified MT 1.3 billion in arrears. The Government is committed to clearing these arrears and the remaining unidentified arrears by end of 2012, starting with a repayment of MT200 million in 2009. The process of reimbursing VAT arrears has improved significantly for current claims and over 90 percent of these claims are now addressed within the time-frame established by regulations.

8. In the area of tax policy, Parliament approved the new Simplified Tax for the Small Tax Payers (ISPC) and the revised Tax Benefits Code in December 2008. Regulations to implement the ISPC were approved in March 2009. Parliament also approved the review of the excise taxes on alcoholic beverages and tobacco (Imposto de Consumo Específico) in January 2009, and these will become effective in January 2010.

9. By March 2009, the e-Sistafe system had been rolled out to 320 state institutions, including 26 autonomous institutions and 50 of the 128 districts. Preparations for the pilot of the electronic revenue collection (e-Tax) were delayed to March 2009, because of financial constraints, and will be completed by the end of 2010. The multi-currency treasury account (CUT) became operational in mid-April for disbursing donor funds in US dollars, euros and the South African rand. Salary payments are carried out through direct budget execution of e-Sistafe in 21 ministries and other 12 entities at the central level, amounting to 4 percent of all salaries. The 2008 program budgeting pilot, covering five programs in five ministries, was expanded to the entire 2009 budget and covers all ministries and government institutions. Due to the breadth of the consultation process, the approval of the PFM vision paper by the Ministry of Finance was delayed until July (structural benchmark for March 2009). The Government will disseminate the 2007 annual report on public debt on the internet by June. The 2008 public debt report is expected to be finalized and published by July 2009.

10. In May 2009, the Government started implementing the first phase of the medium-term civil service pay policy that was approved by the Council of Ministers in September 2008. The cost is included in the budget and focus on decompressing salary bands. In October 2008, the Government published the first statistical yearbook on civil servants, based on the census taken in early 2008.

C. Monetary and Financial Sector

11. Monetary policy in 2008 was geared towards price stability in the context of a floating exchange rate regime. The BM met its end-year targets for reserve money and net international reserves. The target for reserve money had been revised to accommodate the projected increase in inflation because of the higher import prices. In the outturn, the BM was able to contain reserve money growth in 2008 below 8 percent, partly because of the strong fiscal performance on domestic financing. In addition, money demand conditions were weaker than expected as import prices and inflation at the end of the year were lower than expected. Money demand conditions were also weaker than anticipated because the BM and banks improved their management of the seasonal surge in currency demand over the festive season.

12. Net international reserves were in line with revised projections, meeting the program target by an ample margin. As anticipated, the World Bank disbursed its budget support for 2009 in late 2008. The BM increased its reserves sales in the second half of 2008 to meet strong import demand pressures, especially for fuel imports. However, import pressures in late 2008 exceeded expectations, putting pressure on banks' own external reserves and also on the exchange rate. After an extended period of stability during much of the year, the exchange rate depreciated 4 percent versus the US dollar in the fourth quarter of 2008 and a further 6 percent in the first quarter of 2009.

13. The monetary program in 2008 was successful in supporting the Government's objective of deepening financial intermediation. Broad money expanded by 20 percent in line with expectations, thereby raising the share of broad money to GDP by one percentage point to about 34 percent of GDP. The stronger-than expected fiscal performance as well as the larger-than-expected decline in the banking sector's net foreign assets made room for a substantial expansion in credit to the economy. This increased 46 percent during 2008 to almost 19 percent of GDP.

14. Lower inflation allowed the BM in February 2009 to reduce the interest rates on its standing lending and deposit facilities. This subsequently led to a decline in the 3-month T-bill rate by about 2 percentage points. The BM in February also reduced the commercial banks' legal reserve requirement from 9 to 8.5 percent.

15. The BM has continued to strengthen its monetary and exchange rate policy and operations. To strengthen policy formulation, the BM has developed its core inflation indicators (structural benchmark for December 2009) and is stepping up its monitoring, analyzing and forecasting of macroeconomic and monetary indicators. To strengthen

operations, the BM introduced repos and reverse repos in 2007 and has increasingly used them for market operations. Meticalnet, the money market interbank system, now accommodates outright and repo operations among commercial banks. Strengthening liquidity forecasting and management is central to improving monetary operations. It will become particularly important with the passage of donor project aid through the Government's multi-currency treasury account (CUT) at the BM. To support liquidity management, the MF is now providing cash flow projections to the BM on weekly basis and has also started providing projections with a one-year horizon as these are updated. In other areas, the BM has revised the regulations for commercial bank participation in the interbank money market and the guidelines for conduct in the market.

16. An IMF/WB Financial Sector Assessment Program (FSAP) mission assessed the financial sector in February 2009 and found that Mozambique has made significant improvements following the 2003 FSAP. Mozambique had implemented a comprehensive financial sector reform program that has resulted in notable improvements in regulation and supervision. There has been a marked improvement in financial stability and soundness, particularly capital adequacy and asset quality. Nonetheless, due to economy-wide structural impediments to financial intermediation (poor physical access and infrastructure, weaknesses in the legal framework, weak financial reporting, and problems with the credit and property information infrastructure, etc), progress in deepening intermediation has been limited. The global financial crisis has not affected the financial sector directly, but real sector linkages increase credit risk going forward. The system as a whole, however, appears resilient due to strong capital base, high liquidity, constraints on exposure to foreign currency risk by unhedged borrowers, and capital controls. Mozambique has also made commendable progress in improving its national payments system.

D. Other Structural Policies

17. To strengthen the management and transparency of mineral resources and to maximize their benefits for Mozambique, all new agreements in mining and petroleum and gas concessions are following the fiscal regulations and agreements that were approved in 2007. Furthermore, the Government submitted its request for Mozambique to become a candidate for adherence to the EITI (structural benchmark for June 2009). The EITI Board approved Mozambique's candidacy on May 18, 2009.

18. Mozambique continues its trade liberalization efforts. The SADC free trade area came into effect in January 2008. In November 2008, Mozambique, together with other SADC members, reached an interim Economic Partnership Agreement (EPA) with the EU to retain quota-and duty-free access to the EU on a reciprocal basis. Agreement on a final EPA is expected by end-2009. Consistent with both this agreement and with the SADC free trade agreement, Parliament approved a reduction of customs tariffs on imports from the EU and SADC countries in December 2008.

19. After extensive consultation, the Ministry of Industry and Commerce submitted in March 2009 a decree to streamline business inspections to the Economic Council. This is expected to be approved by the Council of Ministers by July 2009 (end-March 2009 structural benchmark). In April 2009, the Council of Ministers revoked the bank-deposit and minimum capital requirements to start a business. To facilitate the start-up and operations of small and medium enterprises, the Council of Ministers approved the creation of the SME Institute in February 2009. Draft competition and insolvency laws were submitted to Parliament for its approval.

20. The Government has improved its capacity to produce and disseminate macroeconomic statistics, especially at the INE and the MF. The INE has prepared a Statistical Strategic Plan (2008-12). The MF is using e-SISTAFE to generate public finance statistics. However, the public finance statistics are not yet in compliance with the 2001 GFS manual. In order to monitor the impact of the global economic crisis, the Government is compiling macroeconomic data and will start updating its macroeconomic framework on a higher frequency basis. To improve the MF's analytical and forecasting capacity, the MF has started to compile and consolidate data on mega-projects, which will feed into the budget execution reporting.

II. Program for 2009

A. Adapting Policies

21. The Government recognizes that Mozambique's macroeconomic prospects in 2009 have weakened because of the global economic crisis. The Government is nevertheless committed to mitigate the adverse impact of the global crisis, without jeopardizing its medium-term macroeconomic strategy.

22. Against the backdrop of a highly uncertain global economic outlook, economic prospects for 2009 have deteriorated, and GDP growth is now cautiously estimated to 4.3 percent from preliminary 6.8 percent for 2008. However, the Government intends to make every possible effort to achieve a higher rate of growth. Aluminum and traditional exports receipts are declining due to falling global demand and commodity prices. Project aid disbursements are already being delayed and are expected to fall increasingly short of commitments as fiscal pressures mount in donor countries. Private capital inflows—foreign direct investment and foreign borrowing—which have played an increasingly important role in supporting growth in Mozambique, are contracting as some investors scale back or postpone investment projects in the face of weaker global demand conditions and tighter global credit constraints.

23. The external shock will deteriorate the balance of payments. Net international reserves are projected to fall by over US\$200 million in 2009 as the trade deficit widens, foreign direct investment contracts, and foreign borrowing by the private sector is curtailed. As a result, the overall balance of payments is projected to deteriorate by nearly US\$400 million

between 2008 and 2009. Mitigating factors include a modest projected rise in aid inflows and lower projected dividend payments by megaprojects. Export receipts are expected to fall about US\$800 million, primarily reflecting a halving in the price of aluminum, which accounted for more than half of export receipts in 2008, and lower traditional exports such as cotton and cashews. Private capital inflows—foreign direct investment and foreign borrowing—are projected to fall by more than US\$100 million.

24. Notwithstanding this, the impact is expected to be mitigated for Mozambique on account of its sustained period of prudent macroeconomic policies and structural reforms. Moreover, Mozambique will continue to benefit from foreign capital inflows into natural resource areas, especially energy, that remain profitable. In addition, Mozambique's financial sector is largely insulated from and well-positioned to withstand the global financial turmoil. Furthermore, for 2010 the World Cup in South Africa will have favorable impact on the energy and tourism sectors. The more vulnerable segments of the population are expected to benefit from infrastructure investment in agriculture as well from the recent reduction in international fuel and food prices.

25. To mitigate the impact of the global economic slowdown, the Government will ease macroeconomic fiscal and monetary policies during 2009. It will also maintain the momentum of its structural reform agenda for growth, with a particular focus on strengthening the business environment, especially to encourage new investments. Mindful of the risks from the current crisis, the Government will closely monitor international developments and its impact on the Mozambican economy.

26. The Government's scope for supportive macroeconomic policies is curtailed by the large projected decline in external reserves in 2009. The Government estimates that most of these declines are the direct and sudden result of the external shock. On this basis, the Government is seeking access to Fund resources under the Exogenous Shock Facility that will cover a portion of the direct balance of payments impact of the external shock.

B. Fiscal Sector

27. The Government intends to ease fiscal policy to help the economy weather the global economic slowdown. Mozambique's weaker economic prospects will also deteriorate the fiscal outlook, as revenues are expected to fall well short of previous program targets. The Government will nevertheless maintain domestic spending levels as budgeted. As a result, the Government's domestic financing needs may increase. This is a temporary deviation from the medium-term fiscal strategy as the Government remains committed to avoiding recourse to domestic financing to provide room for private sector credit.

28. Revenues in 2009 are projected to decline by 1.1 percent of GDP compared with the previous program, down to 15.7 percent of GDP. This mainly results from lower corporate income tax receipts from megaprojects and the traditional export sector (0.9 percent of GDP), lower fuel taxes (0.1 percent of GDP) as global oil prices have declined more sharply than

expected, and the delay in increasing excise taxes on tobacco and alcoholic beverages (0.1 percent of GDP). The Government will maintain the domestic expenditure envelope in nominal terms broadly as previously envisaged and in line with budgeted levels. Relative to GDP, total domestic spending will rise about 0.32 percent of GDP. As a result, the Government may increase domestic financing to about 1.8 percent of GDP, or about 1.1 percent of GDP higher than previously envisaged. Though large, the increase in domestic borrowing does not jeopardize Mozambique's public debt sustainability as the level of public debt is low and increase in domestic financing is expected to be temporary.

29. The Government will be vigilant that the wage bill remains fiscally sustainable, while making room for necessary adjustments to safeguard the social sectors. The wage bill in 2009 will reach 8.9 percent of GDP, the same as previously budgeted and 0.8 percentage points higher than in 2008. Most of the increase (0.4 percent of GDP) will arise as the first pillar of the wage policy reform (the decompression of the salary bands) is implemented. The wage bill also includes additional hiring of 17,500, mostly in the social sectors. Additional reform of the wage policy will be phased in gradually in following years. The MF, in coordination with the Ministry of Civil Service, will prepare an estimate of the new pay policy for the fiscal years 2010 to 2012 by end-August 2009 (structural benchmark).

30. The Government is committed to underpinning sound fiscal policies by strengthening tax administration and public financial management. To modernize the tax administration the AT will further improve its strategic management framework. It will monitor key performance indicators and identify efficiency gains. It will also strengthen the audit and collection enforcement focusing on the mega-projects and strengthening the operational capacity of the Large Tax Payer Units. With the support of IMF and World Bank, the Government intends to make an assessment of its overall tax policy.

31. The Ministry of Finance intends to approve the PFM vision paper for the coming ten years by July (delayed structural benchmark). By September, the Government also intends to approve the Action Plan and Budget for phase III of the PFM reform program which is to be co-funded by donors and Government. The Government will finalize by end-2009 the customization of the e-Tax (e-Tributação) software and complete its pilot implementation by end-2010 (delayed structural benchmark). The Government will issue a decree requiring sectors to receive prior authorization from the MF for any procurement of new accounting systems to ensure that they are complementary and compatible to e-SISTAFE. Finally, the Government will revise its 'Guidelines for External Financing' by end June with the aim of encouraging donors to use the single and multi-currency treasury accounts (CUT) at the BM for disbursing project aid.

32. To strengthen monitoring of net lending to public enterprises, a draft public enterprises law will be submitted to the Council of Ministers by end-September 2009 (structural benchmark). It will include the requirement for quarterly financial reporting to the MF and the ring-fencing of commercial activities.

C. Monetary Policy and the Financial Sector

33. The BM is committed to pursuing a prudent monetary policy within the context of a flexible exchange rate regime. Monetary policy will remain geared towards price stability. In 2009, the BM will ease monetary policy modestly to accommodate the expansion in domestic budget financing to limit the adverse impact on credit to the economy. The 12-month inflation at the end of 2009 is expected to remain broadly the same as at the end of 2008 on account of a modest increase in international fuel and food prices and because of the recent depreciation of the exchange rate. Consistent with these objectives, the BM aims to increase reserve money, its operational target, by 12.5 percent during 2009. The weak external environment will have a large adverse impact on Mozambique's external balances. As a result, the BM's gross external reserves are projected to fall US\$221 million during 2009 to US\$1440 at the end of 2009 and equivalent to 3.9 months of imports. The monetary framework makes room for broad money to expand by about 15 percent, allowing for continued financial deepening, including private sector credit growth of 28 percent.

34. The BM will continue reinforcing its monitoring, analysis and forecasting of macroeconomic and monetary indicators. In particular, the BM will continue to focus on strengthening liquidity management, paying particular attention to improving coordination with the MF on its cash flow projections and with banks on their liquidity requirements. Accurate liquidity forecasting will become more challenging as donors shift their project disbursements through the Government's single treasury account (CUT) at the BM. To help strengthen the interbank market and liquidity management, the BM will broaden its use of repos, and build a flexible and more realistic intervention corridor that reflects market conditions. To further strengthen the interbank market, the BM will also stimulate the market's use of repos by improving confidence between the market players as result of the increase of volume and frequency of transactions.

35. The recent FSAP Update found considerable overall progress in the financial sector since the 2003 FSAP. The Update made recommendations in the areas of access to finance, banking supervision, money and debt markets and liquidity management, the nonbank financial sector (pension and insurance), and the payments system. The authorities will finalize an action plan to implement the recommendations by December 2009 and will also form a task force to monitor implementation by the same date. Meanwhile, the BM has already decided to issue new regulations to redefine the loan classification rules to make them consistent with international best practices by September 2009 (structural benchmark). In addition, the BM is preparing improvements in its remedial action framework for banks in difficulty and is strengthening its crisis preparedness and contingency planning with technical assistance from the World Bank and the IMF.

36. The BM will implement measures to further buttress its internal audit. In accordance with the audit charter, the internal audit office will report periodically to the BM's Board on the implementation of audit recommendations and on financial developments at the BM. A new central bank law for Mozambique will be drafted once the SADC central bank model law

has been approved (expected in 2010). It will also publish its audited financial statements for 2008 in compliance with IFRS by end-June 2009.

37. Under the strategic plan (2008-2010), the BM continues to strengthen its banking supervision framework by adopting a risk-based approach to supervise financial institutions. The Risk-Based Supervision (RBS) Framework is expected to be finalized by end-2009. A consultant has been appointed under FSTAP to assist BM on the designing of the road map for the implementation of Basel II in Mozambique. The consultant will assess the impact of Basel II on financial sector and prepare a transition strategy, procedure manuals, and circulars on procedures.

38. The new foreign exchange law which fully liberalizes current account transactions was approved by Parliament in October 2008 and became effective in March 2009. The Government has notified the IMF of the approval of the law and the drafting of its regulations is underway. In the course of 2009, the Government expects to officially inform the Fund of its acceptance of the obligations under Article VIII sections 2, 3, and 4 of the Fund's Articles of Agreement.

D. Other Structural Policies

39. Following the recent adoption of a new law on social protection, the Government intends to strengthen the social security and supplementary pension system. Pending the commissioning of a new actuarial study with the World Bank's support, the National Social Security Institute is strengthening the information technology system for its data collection and management systems and will draft and approve by September 2009 an explicit investment strategy. After the census of the civil servants the Government has also finalized the census of pensioners of the civil service pension system and has commissioned an actuarial study with the World Bank's support. Efforts are also underway to strengthen the insurance sector's regulatory and supervisory framework and the institutional capacity of the Inspeção Geral de Seguros.

40. To manage the budgetary and macroeconomic implications of megaprojects, the Government will improve the coordination between MF, MPD, BM, the Institute for National Statistics (INE), and line ministries with the aim to collect and compile data on megaprojects. The Government will strengthen the analytical and forecasting capabilities at the MF, including by strengthening coordination with other Ministries and the BM. The Government will strictly implement the mining and petroleum fiscal regime, related regulations, and model contracts for all new projects. It will also continue to adopt nonrecourse financing clauses in future megaprojects.

41. Following the Government's formal request to become a member of the EITI (structural benchmark for June 2009), the Government, the private sector and civil society will undertake a sequence of actions required for the validation of Mozambique's adherence to the EITI. This process is expected to take at least three years.

42. The Government is intensifying its reforms to improve the business environment. This will help stimulate new investment and mitigate the impact of the global economic slowdown. The Government has identified five priority areas. It will: (i) consolidate licensing at the One-Stop Shops; (ii) improve the legal framework by implementing the bankruptcy legislation once approved by Parliament, establishing a system for micro-enterprise registration, creating a unified inspection process, and by amending legislation on property registration; (iii) facilitate tax and trade administration by further reducing VAT refund delays, simplifying trade procedures through a Single Window by end-2010, and implementing the e-Tax pilot; (iv) strengthen support for small and medium-sized businesses, by establishing the SME institute and implementing its mandated strategy; and (v) reduce labor market rigidities by disseminating the new labor law and further defining its regulations.

43. The Government places particular emphasis on implementing the second phase of the public sector reform program (2006–11). This consists of four pillars: improving service delivery; strengthening the capacity of local government; creating a more professional public sector; and strengthening good governance systems and the fight against corruption. By the end of 2009, the Government will draft a Public-Private Partnership Law, aimed primarily to prevent and manage fiscal and quasi-fiscal risks, which could also be applicable to megaprojects.

44. The Government took further measures to fight corruption and to improve the efficiency of the public sector. To improve the monitoring, the health sector revised its anti-corruption action plan. The ministries of interior, education and culture, finance and justice will finalize theirs by July 2009. The Government has initiated the harmonization and modernization of the national anti-corruption legislation. In 2008, 27 cases were sentenced by the courts for corruption.

45. The Government will prepare a national decentralization strategy by end-December 2009 with the Ministry of State Administration as the coordinator of the process involving other key ministries with the help of the World Bank and other partners. The strategy will include a legal, regulatory, and institutional framework for revenue collection and spending for sub-national units. The strategy will take into account their administrative capacity and need to maintain fiscal control of planning, finance and execution. In the process of reforming the OIIL district revolving funds, the Government has issued in April 2009 instructions to unify the criteria for project selection, lending, and reimbursement rules in the districts.

III. Program Monitoring

46. The revised quantitative assessment criteria for end-June 2009 and the new assessment/performance criteria and indicative targets for the second half of 2009 are shown in Table 1. Table 2 lists the structural benchmarks for 2009.

Table 1. Mozambique: Quantitative Assessment Criteria and Indicative Targets, 2008–09¹

(Millions of MT, unless otherwise specified)

	2008						2009							
	End-June Assessment Criteria			End-Dec. Assessment Criteria			End-March Indicative Target		End-June Performance/Assessment Criteria		End-Sept Indicative Target		End-Dec Performance/Assessment Criteria	
	EBS/08/54	Adj.	Act.	EBS/08/159	Adj.	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.
Net credit to the government (cumulative ceiling)	-3,210	-2,003	-6,740	-1,202	-1,157	-4,451	133	-96	-1,064	85	446	2,148	1,825	4,716
Stock of reserve money (ceiling)	17,044	17,044	17,026	19,622	19,622	19,220	17,622	17,896	19,333	19,301	19,544	19,762	21,788	21,632
Stock of net international reserves of the BM (floor, in millions of U.S. dollars)	1,704	1,604	1,712	1,589	1,587	1,644	1,632	1,537	1,676	1,498	1,635	1,487	1,608	1,421
New nonconcessional external debt contracted or guaranteed by the central government or the BM with maturity of one year or more (ceiling)	5		5	5		5	5	5	5	5	5	5	5	5
Stock of short-term external public debt outstanding (ceiling)	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
Indicative targets:														
Balance of the government's savings account set up abroad with proceeds from the coal exploration contract (floor, millions of U.S. dollars)	0		0	0		0	0	0	0	0	0	0	0	0
Government revenue (floor)	17,287		17,762	37,202		38,268	9,075	9,144	20,725	19,861	32,383	30,624	44,984	41,095

Source: Mozambican authorities and IMF staff estimates

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

Table 2. Mozambique: Structural Benchmarks under the 2009 Policy Supported Instrument

(December 2008—December 2009)

Actions	Expected Date of Implementation	Comments
The Ministry of Finance will approve a PFM vision paper, as the basis for the Sistafe Action Plan and Budget for 2009-2011.	end-March	Delayed to end-July 2009
The Ministry of Industry and Trade will issue a decree streamlining the business inspection process.	end-March 2009	Delayed to end-July 2009
The Government will formally submit a request to start the process to become a member of EITI	end-June 2009	met
The Ministry of Finance in coordination with the Ministry of Public Service will prepare an estimate of the new pay policy for the fiscal years 2010-2012.	end-August 2009	...
A draft public enterprises law will be submitted to the Council of Ministers.	end-September 2009	...
The central revenue authority and UTRAFE, will implement the pilot project on corporate income tax for the revenue collection module (e-Tributação) of the e-Sistafe.	end-September 2009	...
The BM with technical assistance support of the Fund will design a plan to strengthen the Monetary Policy framework comprising all intermediate steps, including agreement on a core inflation indicator.	end-December 2009	met
The BM will issue new regulations that redefine the loan classification rules to make them consistent with international best practices.	end-September 2009	...

ATTACHMENT II**REPUBLIC OF MOZAMBIQUE: TECHNICAL MEMORANDUM OF UNDERSTANDING ON
SELECTED CONCEPTS, DEFINITIONS, AND DATA REPORTING UNDER MOZAMBIQUE'S
POLICY SUPPORT INSTRUMENT PROGRAM**

May 13, 2009

1. The purpose of this technical memorandum of understanding (TMU) is to describe the concepts and definitions that will be used in monitoring the Policy Support Instrument (PSI) program, including the following:

- net credit to the central government by the banking system;
- government revenue;
- net international reserves, and reserve money of the Bank of Mozambique (BM);
- new nonconcessional external debt contracted or guaranteed by the central government or the BM with a maturity of more than one year;
- short-term external public debt outstanding;
- external payments arrears; and
- foreign program assistance and external debt service.

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

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 BM, and proceeds from the signing fee for coal exploration. Credits comprise bank loans and advances to the government and holdings of 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 net credit to the central government by the banking system will be cumulative from end-December of the previous year.

3. The government encompasses all institutions whose revenue and expenditure are included in the state budget (*Orçamento do Estado*): central government ministries, agencies, and the administration of 11 provinces. Although local governments (33 municipalities or

autarquias) are not included because they are independent, the bulk of their revenue is registered in the state budget as transfers to local governments.

Government revenue and financing

4. Revenue is defined to include all receipts of General Directorate of Tax (Direcção Geral dos Impostos or 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 DGI from private agents or other government collecting agencies, in cash or checks, or through transfers into a DGI bank account.

Reserve money

6. Reserve money is defined as the sum of currency issued by BM and the commercial banks' holding at the BM. The reserve money stock will be monitored by the monetary authority and provided to the IMF by the BM.

Net international reserves

7. Net international reserves 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 government's savings account related to the Moatize coal mine concession). Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guarantee for a third-party external liability (assets not readily available.) The 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.

8. For the purposes of program monitoring and in order to exclude valuation changes, net international reserves will be measured at the official exchange rates prevailing at end-2007 and used by the BM.

9. The BM will publish the exchange rates quoted by commercial banks on average as the market rates.

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

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

11. The central government will limit contracting or guaranteeing external debt up to US\$5 million each year with original maturity of one year or more with a grant element of less than 35 percent, calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development (OECD) commercial interest reference rates in accordance with the annual Budget Law. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. This assessment criterion will be assessed on a continuous basis.

Stock of short-term external public debt outstanding

12. The central government will not contract or guarantee external debt with original maturity of less than one year. This assessment criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Excluded from this assessment criterion are short-term, import-related trade credits. This assessment criterion will be assessed on a continuous basis.

External payments arrears

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

Foreign program assistance

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

Actual external debt-service payments

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

II. Adjusters

Net international reserves

16. The quantitative targets (floors) for the central bank's net international reserves will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted downward by 100 percent of any shortfall in external program aid (up to a maximum of US\$100 million) and any excess in external debt service payments, compared to the program baseline (Table 1).

17. The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward/upward for any revision made to the end-year figures corresponding to the previous year.

18. The quantitative targets (floors) for the central bank's net international reserves will be adjusted upward for the full amount of any external privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad. If they are deposited abroad, the indicative targets on the balance in this account will be adjusted upward for the full amount of the higher than envisaged proceeds, net of any costs related to the privatizations, including severance payments.

19. The quantitative targets (floors) for the central bank's net international reserves will be adjusted downward up to a maximum of US\$50 million per annum by the amount that the actual fuel import bill is higher due to a rise in the average fuel import price. This adjustment will be equal to the difference between the realized and the programmed average fuel import price, multiplied by the volume of total fuel imports programmed for each quarter (Table 1).

20. The quantitative target (floor) on net international reserves will be adjusted downward to accommodate the possible need for higher external outlays to deal with natural disasters, up to a total limit of US\$20 million.

21. In case that Mozambique participates in any SDR allocation(s) between June 30, 2009 and the test date, and provided that SDR allocation(s) are not included as part of reserve liabilities for the purpose of calculating NIR, then the quantitative target (floor) for NIR will be adjusted upwards by the full equivalent of the amount of the cumulative additional SDR allocation(s) up to the test date, measured at program exchange rates.

Net credit to government

22. The quantitative targets (ceilings) for net credit on the central government (NCG) will not be adjusted for any excess in disbursements of foreign program assistance (and any shortfall in external debt service), compared to the program baseline. These targets will be adjusted upward by 100 percent of any shortfall in external program aid (up to a maximum of US\$100 million) and any excess in external debt service payments, compared to the program baseline (Table 1).

23. The quantitative targets (ceilings) for net credit on the central government (NCG) will be adjusted downward for the full amount of any privatization proceeds in excess of those envisaged in the program, unless these proceeds are deposited in the government's savings account abroad.

24. The quantitative targets (ceilings) for net credit on the central government (NCG) will be adjusted downward (upward) for any increase (decrease) in domestic financing from the nonfinancial private sector. The government expenditures contingent on higher disbursements of foreign program assistance (and lower external debt service) will be used to finance greater 'priority' spending identified in the budget.

25. The quantitative target (ceiling) for net credit to the central government (NCG) will be adjusted upward to accommodate the possible need for higher locally financed government outlays to deal with natural disasters, up to a total limit of MT 500 million.

Reserve money

26. The quantitative target (ceiling) for reserve money will be adjusted upward up to a maximum of MT 750 million to the extent that the sum of the outstanding stock of currency issued by the BM exceed those projected in Table 1. The maximum at end-December will be raised to MT 1000 million because of the seasonal increase in the demand for currency during the end-year festive season.

III. Data Reporting

27. In addition to providing the monthly and quarterly data needed to monitor program implementation in relation to the programs' quantitative targets and broader economic developments, the authorities will provide weekly updates of the daily data set out in Table 1 as well as the weekly data set out in Table 4 of the TMU dated May 26, 2005. Monthly updates will also be provided of the foreign exchange cash flow of the BM.

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

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

30. From December 2005 onwards, 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.

Table 1. Mozambique: Technical Memorandum of Understanding, 2008-09

	2008		2009									
	Year		Q1		Q2		Q3		Q4		Year	
	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.	EBS/08/159	Proj.
Net foreign program assistance (US\$ mn)	501	502	153	105	105	105	42	78	55	68	356	356
Gross foreign program assistance	552	550	164	116	117	117	63	98	69	82	413	413
Program grants	371	371	164	116	117	117	63	83	39	67	382	382
Program loans	182	178	0	0	0	0	0	15	31	15	31	30
External debt service	52	48	11	11	11	11	21	21	14	14	57	57
Net foreign program assistance (MT mn)	11,950	11,934	3,776.16	2,735	2,338	2,643	1,203	2,434	1,258	1,740	8,575	9,552
Gross foreign program assistance	13,330	13,284	4,054.71	3,003	2,905	3,293	1,574	2,852	1,771	2,366	10,305	11,514
Program grants	8,923	8,949	4,054.71	3,003	2,905	3,293	1,574	2,412	990	1,922	9,523	10,632
Program loans	4,407	4,335	0.00	0	0	0	0	439	782	443	782	883
External debt service	1,380	1,351	278.55	268	567	650	371	418	513	626	1,730	1,962
Stock of outstanding currency (MT bm)	12,036	11,996	10,075	10,587	11,323	11,677	11,383	11,857	13,000	12,763	13,000	12,763
Average global oil price, APSP, US\$/barrel	107	97	72	44	74	52	76	55	78	58	75	52
Average fuel import price, US\$/barrel (10 barrels per mt)	102	115	68	131	67	117	55	100	70	81	65	109
Volume of fuel imports (1000s mt)	620	549	154	188	133	228	202	165	280	154	770	736
Total fuel import bill (US\$m)	635	632	105	247	89	266	110	165	196	125	500	803
Cumulative fuel import bill (US\$m)	635	632	105	247	194	513	304	678	500	803	500	803

Source: Mozambican authorities and IMF staff estimates