INTERNATIONAL MONETARY FUND

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REPUBLIC OF MOZAMBIQUE

January 3, 2013

FIFTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR MODIFICATION OF ASSESSMENT CRITERIA

In the context of the fifth review under the Policy Support Instrument and request for modification of assessment criteria with the Republic of Mozambique, the following documents have been released and are included in this package:

- **Staff report** for the fifth review under the Policy Support Instrument and request for modification of assessment criteria, prepared by a staff team of the IMF, following discussions that ended on October 31, 2012 with the officials of the Republic of Mozambique on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 7, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- **Press Release** issued on December 21, 2012.

The documents listed below have been or will be separately released.

-Letter of Intent sent to the IMF by the authorities of the Republic of Mozambique*
-Memorandum of Economic and Financial Policies by the authorities of the Republic of Mozambique*
-Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market sensitive information.

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International Monetary Fund
Washington, D.C.

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REPUBLIC OF MOZAMBIQUE

December 7, 2012

FIFTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR MODIFICATION OF ASSESSMENT CRITERIA

KEY ISSUES

Context and policy challenges. Mozambique's macroeconomic performance remains strong and program implementation satisfactory. Economic growth in 2012 was buoyant and inflation fell sharply, and the start-up of coal exports is expected to push growth higher despite risks from the weak global economy. High levels of poverty call for a swift implementation of the updated Poverty Reduction Strategy 2011–14 (PARP) to generate more inclusive growth.

Short-term policy framework. The main short-term policy objectives are to ensure strong public and private investment and facilitate credit to the economy, while preserving a low inflation environment. A broadly neutral policy stance is warranted in 2013: On the fiscal policy side, largely foreign-financed investment will result in an increase in the fiscal deficit, though with a limited domestic impact. The Bank of Mozambique (BM) plans to maintain an accommodative stance to support credit growth to the private sector, while monitoring inflation developments closely. While aggregate indicators point to a sound and liquid banking system, the BM should step up its supervision and complete the financial sector contingency plan.

Medium-term challenges. Faced with declining foreign aid in the medium term, closing the infrastructure gap is a major challenge. Further strengthening debt management and investment planning and implementation are critical for Mozambique to benefit fully from increased nonconcessional borrowing. The government should move rapidly in enhancing the institutional frameworks to manage the future natural resource wealth, which will help create the necessary fiscal space to support the transformation of the economy in the long run. The structural reform momentum needs to be maintained to ensure sustained and inclusive growth.

Approved By
Roger Nord and Vivek Arora

A staff team comprising Ms. Ross (head), Messrs. Gitton, Xiao, Xiong (all AFR), and Henn (SPR) visited Maputo during October 17–31, 2012. The mission met with Minister Chang (Finance), Cuereneia (Planning and Development), and other line ministers (Energy, Agriculture, Natural Resources, Industry and Trade, Women and Social Action), BM Governor Gove, and other senior government officials. The mission also met with development partners, civil society, academia, and the private sector. It was assisted by Mr. Lledo (resident representative), Mr. Simione, and Ms. Palacio (resident representative office). Messrs. Conceição (OED) and Revilla (World Bank) participated in some of the policy discussions.

CONTENTS

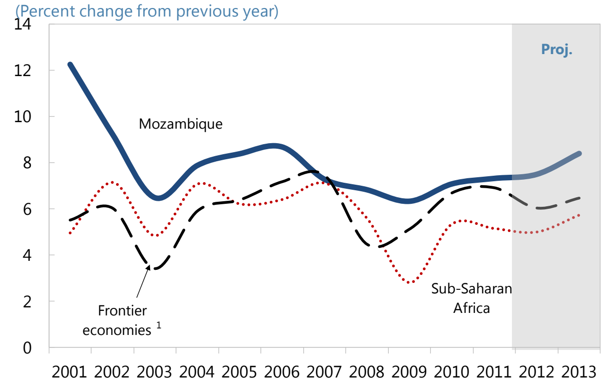
APPENDIX

ANNEX

I. BACKGROUND AND RECENT DEVELOPMENTS

1. **Despite the difficult global environment, economic growth in Mozambique remains buoyant.** Reflecting the rapid start-up of coal production and exports, real GDP grew by 7.2 percent in the first half of 2012. The extractive industry was the fastest-growing sector (by 39¼ percent), while the transport and communication sector also performed strongly (introduction of a third mobile operator). Real GDP growth for 2012 is set to reach 7.5 percent, reflecting a stronger-than-expected contribution from the coal industry.

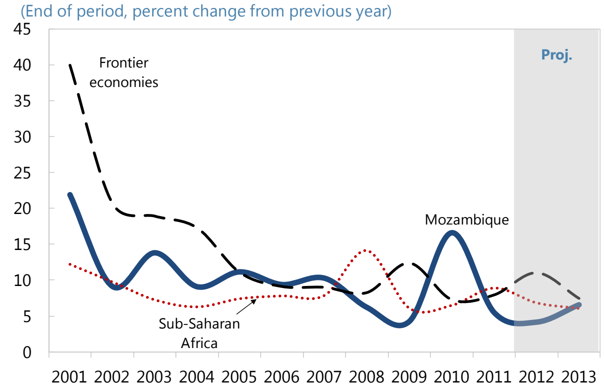
Real GDP
(Percent change from previous year)



[1] Frontier economies: Angola, Ghana, Kenya, Mauritius, Mozambique, Senegal, Tanzania, Uganda, Zambia and Zimbabwe.

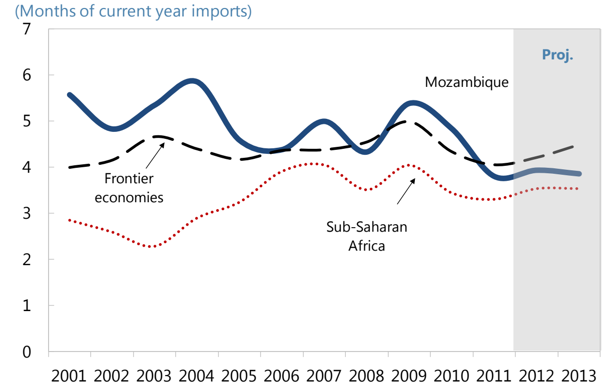
2. **Inflation has come down more rapidly than anticipated**, supported by lower-than-expected prices of imported food (in particular sugar and wheat), stable administered prices (fuels, public transport, utilities), and a strong exchange rate vis-à-vis trading partners. Year-on-year consumer price inflation fell to 1.5 percent in October 2012, the lowest in the Southern African Development Community. After determined tightening in 2011, the BM eased monetary policy throughout 2012, which, together with public transport tariff increase in November 2012, is expected to raise inflation somewhat in coming months. Nevertheless, the average annual inflation rate is projected to drop to around 2½ percent in 2012.

CPI
(End of period, percent change from previous year)



3. **Fiscal revenue is set to exceed the budget reflecting a windfall from capital gains taxes.** Revenue was below program in the first half of 2012, reflecting lower-than-projected inflation and unexpected transition problems in customs with the introduction of a single window for trade transactions, although corporate income tax performed strongly. With expenditure implementation largely on track, this resulted in higher-than-programmed net credit to the government (NCG) by end-June. However, a windfall capital gains tax payment of about 1¼ percent of GDP (MT 5 billion) from the sale of shares in a major gas project between private

Gross International Reserves
(Months of current year imports)



parties was registered in September, more than offsetting the revenue underperformance earlier in the year (and boosting NIR).

4. Foreign direct investment in the natural resource sector (especially coal and gas) has resulted in rapid import growth, although Mozambique's net international reserves (NIR) continued to strengthen. Substantial historical data revisions and new information on FDI (and related imports) in the natural gas sector resulted in an upward revision of the current account deficit after grants from 13.3 percent of GDP to 25.8 percent in 2011.[1] However, the authorities continue to build the stock of international reserves on the back of strong exports and capital inflows; gross reserves are projected to amount to 3.6 months of projected total imports (or 5½ months of projected non-Megaproject imports) by end-2012. Strong capital inflows contributed to a slight appreciation of the real effective exchange rate in the first nine months of 2012.

5. Program performance remains satisfactory, and all but one of the end-June assessment criteria (ACs) were met (see text table). The authorities continue to make progress in structural reforms (see Table 8).

Program Performance

	June 2012 AC
Assessment Criteria	
Net credit to the government	▲
Stock of reserve money	●
Stock of net international reserves	●
Nonconcessional external debt	●
Stock of short-term external public debt	●
External payments arrears	●
Indicative Targets	
Government revenue	▲
Priority spending	●

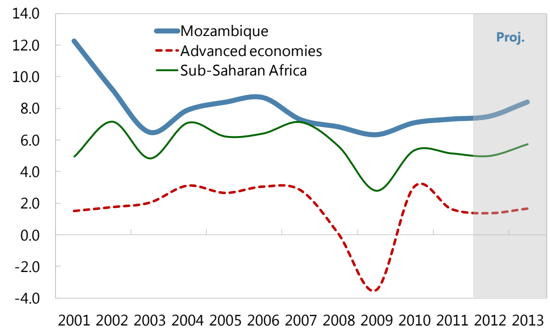
● met ▲ not met

[1] See Annex I on the revisions to the balance of payment data.

Figure 1. Mozambique: Impact of Global Development

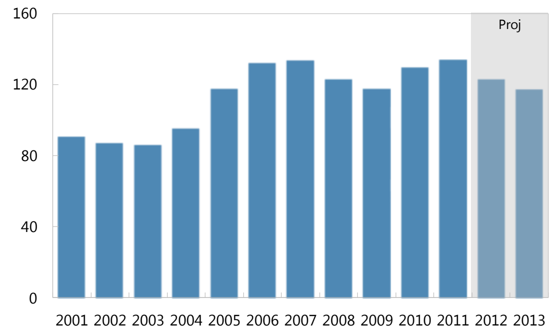
Despite the global weakness, Mozambique's growth is set to accelerate in 2013 owing to the startup of coal production.

Real GDP Growth
(Percent)



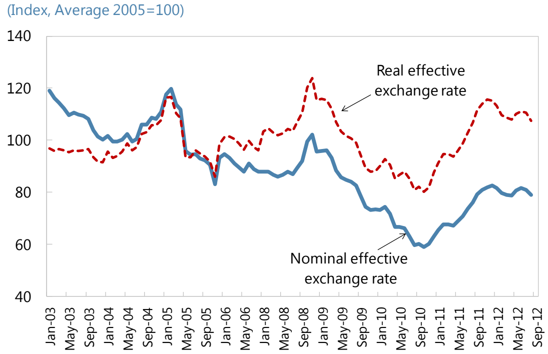
Recent terms of trade gains are likely to reverse due to weakening international commodity prices...

Terms of Trade Index
(2005=100)



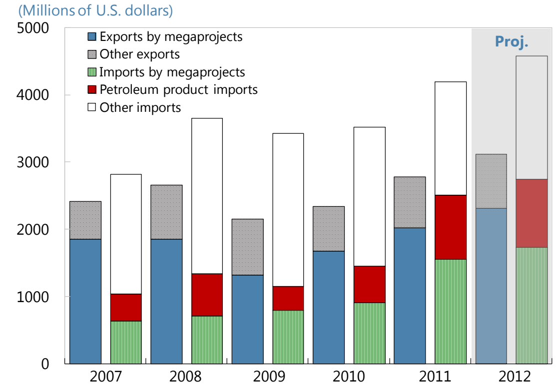
...while the metical has depreciated slightly following the recent monetary easing.

Nominal and Real Effective Exchange Rates
(Index, Average 2005=100)



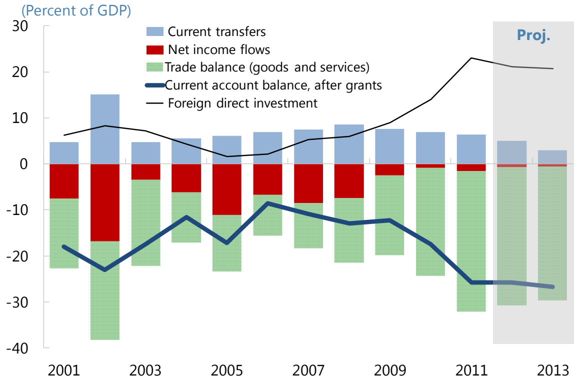
Megaprojects' strong export growth was counterbalanced by investment-related and fuel imports.

Merchandise Trade
(Millions of U.S. dollars)



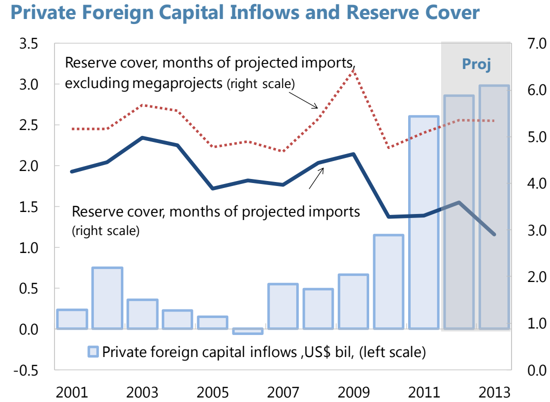
The current account deficit has widened, reflecting sizeable investment imports by the natural resource sector.

Current Account Balance and Foreign Direct Investment
(Percent of GDP)



Strong private capital inflows especially to the megaprojects have helped to maintain the reserve cover.

Private Foreign Capital Inflows and Reserve Cover



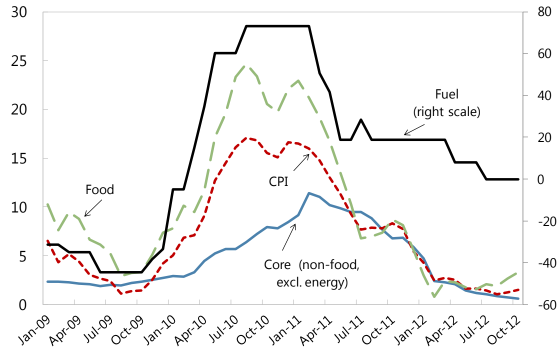
Sources: Mozambican authorities and IMF staff estimates and projections.

Figure 2. Mozambique: Inflation and Monetary Developments

Both headline and core inflation fell sharply since early 2011...

CPI and Components

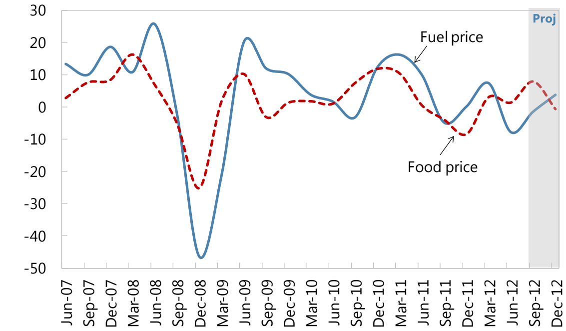
(Percent change, year-on-year)



... helped by favorable developments in international prices and...

International Food and Fuel Price Change

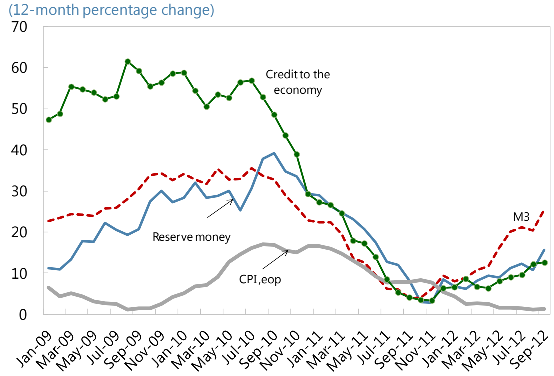
(Percent over previous quarter)



...determined monetary tightening through end 2010-11 which reined in broad money and credit growth.

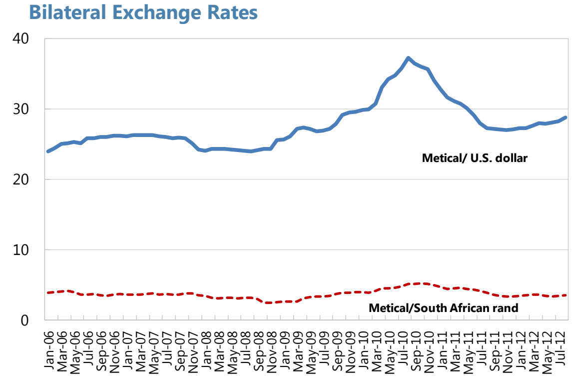
Money, Credit and Inflation

(12-month percentage change)



The Mt/$ exchange rate appreciated during mid-2010 to end-2011, and has slightly depreciated since. The rate against the rand has been more stable.

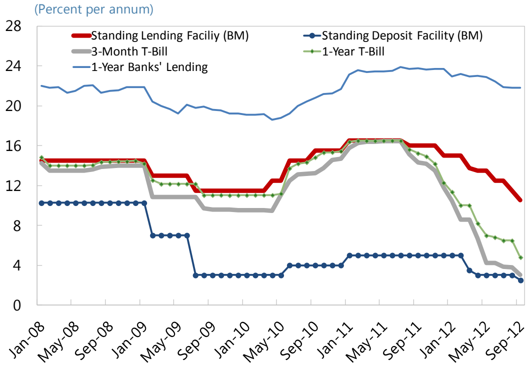
Bilateral Exchange Rates



Following the monetary tightening in 2010-11, the BM began to lower rates in late 2011.

Interest Rates

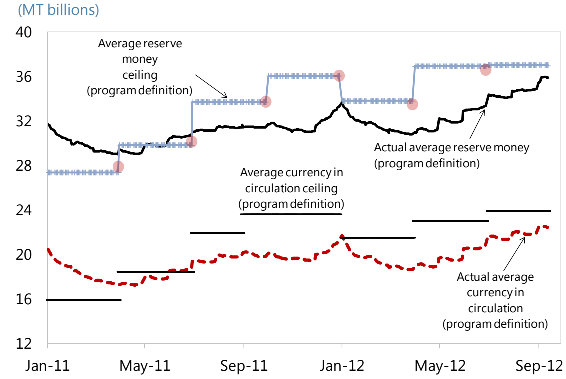
(Percent per annum)



Reserve money was kept in line with program targets, helping to achieve the disinflation objective.

Reserve Money

(MT billions)



Sources: Mozambican authorities and IMF staff estimates and projections.

II. ECONOMIC OUTLOOK AND POLICY DISCUSSIONS

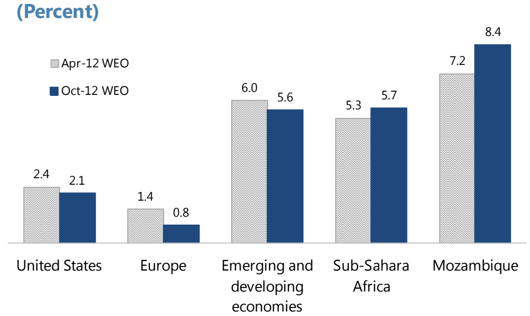
6. **The contribution of coal production and exports and the implementation of large infrastructure projects are projected to boost economic growth to 8.4 percent in 2013** (Box 1). Some transport infrastructure bottlenecks are expected to be eased, in particular the capacity of the railway linking the coal production area of Tete in the interior with the port of Beira. Credit growth to the economy is projected to pick up gradually, supported by the lagged effect of the monetary stimulus provided since late 2011. The current account deficit is projected to widen slightly to 26.5 percent of GDP in 2013 and could exceed 40 percent in 2014 once construction of liquefied natural gas (LNG) plants begins, financed by private sector borrowing (see Annex I). The ramping up of coal exports would reduce the current account deficit to 34 percent by 2017,[2] and start up of LNG exports would bring the current account into balance starting in 2020.

Mozambique: Mining Sector Indicators

	2001-10 Average	2011 Est.	2012 Proj.	2013 Proj.
	(In percent, unless otherwise stated)			
Mining GDP (nominal, in MT million)	2,030	5,086	14,269	20,786
Mining GDP (share in total nominal GDP)	1.0	1.4	3.4	4.3
Mining real growth	19.8	18.7	69.5	35.5
Mining contribution to total GDP growth (in percentage points)	0.1	0.2	0.9	0.7
Memorandum items:				
Total real GDP growth	8.0	7.3	7.5	8.4
Non-mining real GDP growth	8.0	7.2	6.7	7.8

Sources: Mozambican authorities, and IMF staff estimates and projections.

Global Growth Projections, 2013
(Percent)



Source: WEO, *World Economic Outlook.*

7. **Risks to the outlook are moderate, relating mostly to global uncertainties.** Mozambique is exposed to several risks, particularly lower aid flows and reduced access to international finance; a further global slowdown with an adverse impact on South Africa, Mozambique's main trading partner; a fall in export demand from elsewhere or in commodity prices; and climate change. Nevertheless, there are strong mitigating factors: solid aid commitments for 2013 that are higher than disbursements in 2012, booming coal production, continued strong foreign direct investment inflows in several megaprojects, as well as fairly stable trade flows (mainly electricity exports and food imports) with South Africa. While regional food supply and international price developments need to be closely monitored (maize prices began to increase in August 2012 without pushing up overall inflation), the authorities do not expect strong price pressures, absent a major new supply shock. The authorities have some limited room to respond to shocks as government recourse to domestic financing is low.

[2] The 2017 current account deficit excluding LNG investment is 11¾ percent (Annex Table A1). Subsequent full-capacity operation of the Nacala corridor would bring the current account deficit excluding LNG investment down to 7 percent in 2020.

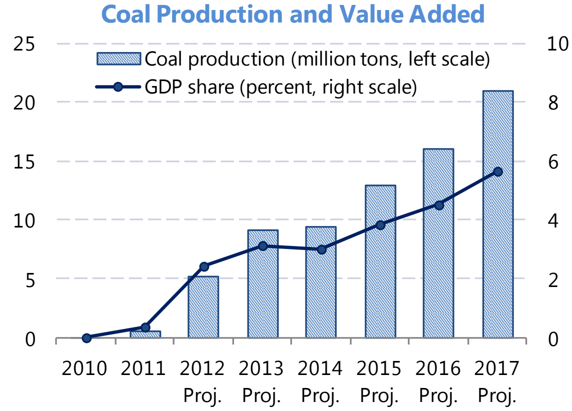
8. **In view of this outlook, staff and the authorities agreed on a broadly neutral macroeconomic policy mix in 2013**. The main objectives are to ensure strong public and private investment and facilitate credit to the economy, while preserving a low inflation environment and continuing structural reforms.

Box 1. Coal Mining Industry in Mozambique

The coal mining sector is gaining force in Mozambique. Reflecting foreign direct investment in vast coal deposits in Tete Province,[1] coal production surged, after start up in 2010, to 0.6 million tons in 2011 and 4 million tons in the first nine months of 2012. Production is projected to reach 5 million tons by end-2012, contributing 0.8 percentage points to GDP growth.

Rapid growth in coal production will continue. With the easing of transport bottlenecks coal production is expected to rise to 9 million tons in 2013, contributing 0.7 percentage points to GDP growth. With the construction of the additional Nacala rail line, coal production is expected to increase by 30 percent per annum on average over the medium term. Under current WEO price assumptions, coal mining is projected to account for 6 percent of GDP by 2017.

Coal Production and Value Added



Transport constraints are the bottleneck for expanding coal production. The Sena line is the only railway currently available to ship coal to a port (Beira). It is operating at full capacity of about 3-4 million tons in 2012. The coal mines are operating far below their production capacity of over 10 million tons per year, and are using the limited railway capacity to ship out high-value coking coal, while accumulating inventories of thermal coal.

Mining companies and the government have made progress toward expanding transportation capacity. A rehabilitation project is expected to double the capacity of the Sena line and the Beira port to 6 million tons by end-2012.[2] Initial agreements have been signed for the construction of a new railway from Tete through Malawi to northern Mozambique and the construction of a deep water port in Nacala. This Nacala line could add 11 million tons to coal shipping capacity by mid-2016, and is expected to reach full capacity of 18 million tons by 2017.

There are also plans for thermal power generation. Mining companies also have plans for building thermal power stations, but discussions on these have moved slowly. The volume of thermal coal production far exceeds the capacity of the power stations under consideration, but unless international coal prices rise, current transport costs render the export of thermal coal uneconomical.

Sena and Nacala Railway Lines

[1] The Moatize mine operated by Vale started production in 2011. The mines operated by Rio Tinto started production in 2012.

[2] There are also some plans to further increase capacity of the Sena line, but they remain tentative for the moment.

A. Fiscal Policy

9. The budget for 2013 continues to utilize the available fiscal space for the government's investment and social development objectives, while preserving macro-economic stability. The government intends to achieve an ambitious tax revenue target through enhancing tax enforcement measures. Tax administration reforms have enabled the government to increase revenue collections by 6 percentage points during 2009–12 to 24 percent of GDP. In the absence of the special factors of 2012, fiscal revenues are projected to ease slightly in 2013.

10. In aligning the composition of spending with the medium-term priorities of the PARP, spending for priority sectors will continue to rise, from 55 to 58 percent of expenditures excluding net lending. Reflecting the continued large investment needs, the overall fiscal deficit is expected to increase to 5½ percent of GDP, while the domestic primary deficit will be kept at 2¼ percent of GDP, and net domestic financing (NCG) will stay low.

MEFP ¶14, 16

Mozambique: Key Fiscal Indicators

	2011	2012		2013
	Est.	CR 12/148	Proj.	Proj.
	(Percent of GDP, unless otherwise stated)			
Overall balance after grants	-4.6	-6.4	-3.6	-5.5
Domestic primary balance	-2.3	-2.3	-1.3	-2.3
Net domestic financing	0.9	0.6	0.0	0.6
Memorandum items:				
Domestic demand impact (change from the previous year) 1/	-2.2	0.6	0.0	-0.1
Real GDP growth (percent)	7.3	6.7	7.5	8.4
Average CPI inflation (percent)	10.4	7.2	2.4	7.0

Sources: Mozambican authorities and IMF staff estimates and projections.
1/ The overall balance overstates the domestic impact of capital spending as the latter has a significant import content. This calculation attempts to adjust the overall balance for this bias.

11. The program envisages a further strengthening of revenue administration.

- **Ensuring prompt refunds of VAT on inputs.** The scaling up of megaproject operations in recent years revealed problems with inadequate budgeting of resources for VAT refunds and slow processing of refund requests. The government committed to prioritize the use of revenue collection in 2012 that exceeds the budget targets to reduce the stock of pending VAT refunds, and with the help of technical assistance from the Fund, consider adopting international best practice of recording VAT revenue on a net rather than a gross basis.

MEFP ¶20

- **Improving and modernizing tax administration.** The Tax Authority is working to resolve the transition issues associated with the introduction of the single trade window at the customs. It also plans to strengthen the large taxpayers unit, implement the single taxpayer database, as well as foster tax payments through banks.

12. The authorities plan to further strengthen the quality of spending.

- **Containing the public wage bill.** The wage bill under the 2013 budget remains at about 10 percent of GDP, reflecting in part hiring in the priority sectors, including education and health. In the medium term, the government is committed to decelerate the decompression of the salary scale and the pace of recruitment in non-priority areas. It will continue to strengthen control of the wage bill

MEFP ¶15

execution and complete the rollout of the electronic wage payment system (e-Folha) to all central government entities registered in the integrated database (e-CAF).

- **Reducing the fuel subsidy.** In October 2012, the government completed the payments to importers of the fuel subsidies owed for 2011. The increase in diesel prices paid by megaprojects and public works contractors (since November 2010) and import price developments in 2012 have reduced the need for compensation payments to fuel importers in the 2013 budget notwithstanding the continued freeze in pump prices. Staff supported the payment of separate fuel subsidies to private minibus operators as they provide the bulk of transport services to the public. Over the medium term, staff encouraged the government to apply the price-setting formula for all petroleum products.

- **Enhancing social protection.** Government allocations to social protection under the 2013 budget have risen to Mt 1.7 billion (0.3 percent of GDP), with possible additional World Bank funding for public works programs. Pilot programs for public works are being implemented in 2 municipalities (Maputo and Manjakaze) since July 2012 and in 10 districts since August 2012 reaching about 9,600 households. The government reiterated its commitment to increase budget allocations towards 0.8 percent of GDP to reach some 900,000 beneficiaries and to raise the level of cash transfers towards the poverty line over the next few years.

MEFP ¶17

13. Investment is projected to remain high, notwithstanding a dip in aid disbursements in 2012.

- **Addressing the infrastructure gap remains a top priority.** Wide urban-rural and interprovincial disparities remain despite the improvements made in recent years. Infrastructure shortcomings continue to represent a significant obstacle to improved living standards and productivity in Mozambique. Public investment remains high at 13 percent of GDP in 2012, in spite of a sharp drop in concessional funding in 2012 compared to 2011.

- **Donor support is declining steeply in 2012,** reflecting constraints on donor budgets as well as donor dissatisfaction with the slow implementation of some projects[3] and the generally slow progress in improving governance. External support is projected to recover during 2013–14 reflecting existing concessional loan contracts, before declining gradually. Donors are moving to conditioning general budget support on performance, and shifting funds toward sector or project support, which may complicate the predictability of budget execution.

[3] Some infrastructure projects funded by the Millennium Challenge Corporation have made slower-than-expected progress due to operational problems of the contractors.

Mozambique: Financing Public Investment Program (Central Government), 2009-16

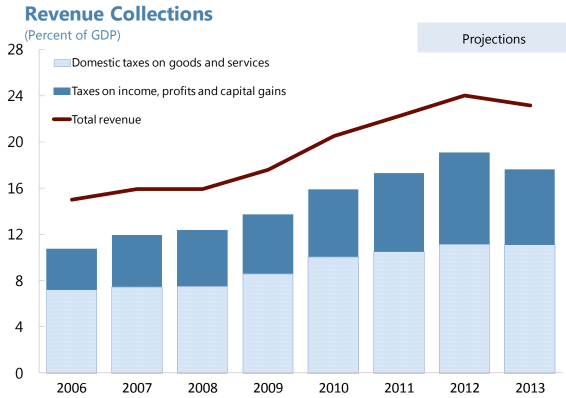
	2009	2010	2011	2012	2013	2014	2015	2016
				(Percent of GDP)				
Total	14.6	15.8	16.7	13.8	14.7	15.0	13.8	13.3
Domestically financed	4.4	6.2	5.7	6.0	6.4	6.5	6.8	7.2
Donor financed, concessional	10.2	9.6	9.8	6.4	6.2	5.9	5.0	4.4
Grants	5.9	4.7	4.8	3.8	3.7	3.2	2.7	2.2
Concessional loans	4.3	4.9	4.9	2.7	2.6	2.7	2.4	2.2
Nonconcessional loans 1/	0.0	0.0	1.3	1.4	2.1	2.6	2.0	1.7
				(Millions of US dollars)				
Memorandum items:								
Total external financing	1,015.9	917.4	1,384.9	1,140.3	1,309.9	1,458.9	1,344.4	1,305.5
Grants	591.8	445.2	606.0	549.8	576.5	547.8	512.2	476.4
Concessional loans	424.2	472.2	619.8	391.2	403.8	466.3	453.9	471.6
Nonconcessional loans	0.0	0.0	159.0	199.3	329.6	444.7	378.4	357.6

Source: IMF staff calculations.

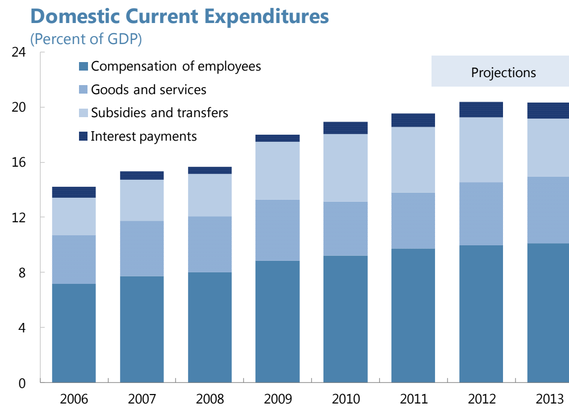
1/ Including the Portuguese credit line implemented by the Road Fund, which is excluded from the fiscal table for program purpose.

Figure 3. Mozambique: Fiscal Developments

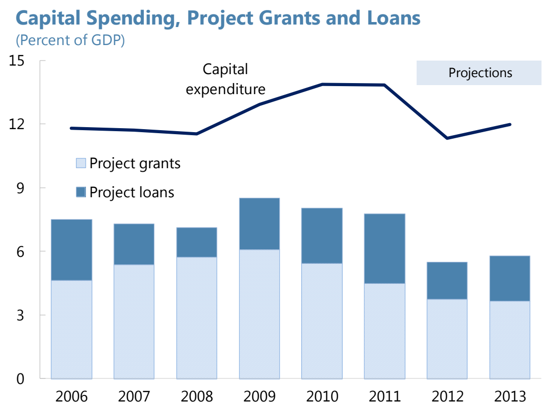
Reflecting in part recent reforms on tax administration, revenue collections continue to be buoyant…



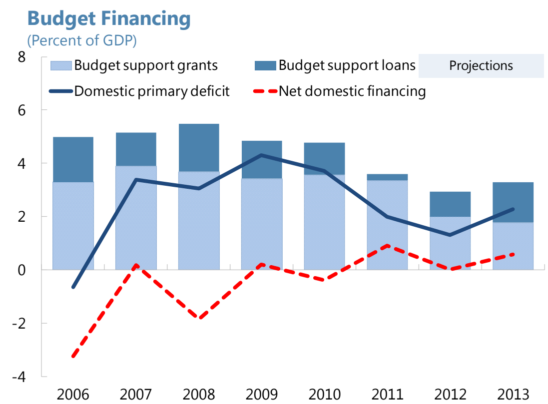
…while the increase in spending has slowed largely as a result of efforts to contain the wage bill and subsidies, especially the fuel subsidy.



Capital spending relies heavily on external project support, which has been declining…



…same as external budget support, but nonetheless the domestic primary deficit has been contained, keeping recourse to domestic financing down.



Sources: Mozambican authorities and IMF staff estimates and projections.

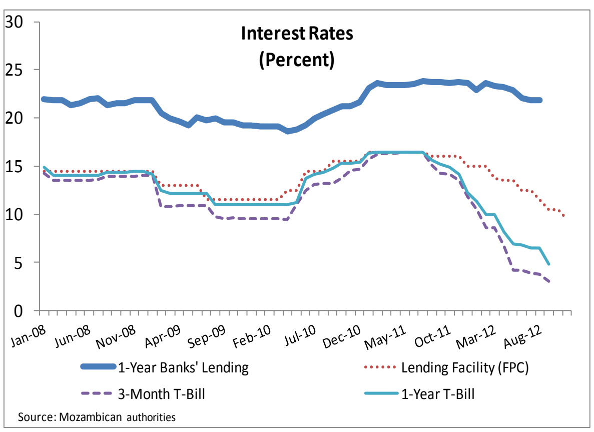
B. Monetary Policy and Financial Sector Reforms

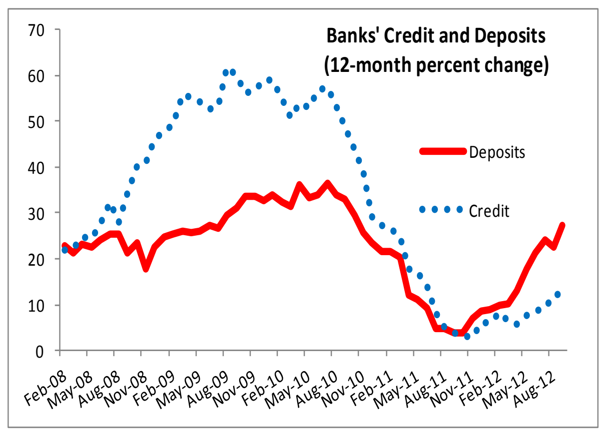
14. Monetary policy will continue to guard against inflationary pressures while supporting credit expansion. Annual credit growth, which had declined to 3½ percent at end-November 2011, reverted to double digits since July 2012 but remains lower than nominal GDP growth. While the BM has slightly revised downward its end-2012 projection for reserve money growth, its objective is to keep the monetary base growing faster than nominal GDP. Building on its credible disinflation policy undertaken in 2010-11, the BM remains committed to keep inflationary pressures under control and inflation at around 6 percent over the medium term. Staff noted that against the backdrop of a highly liquid banking system and very high lending rates in real terms (against the authorities' inflation objective), a further reduction in policy rates could be a signal to contribute to easing credit conditions. This would be helped also by improvements in the business climate more broadly.

MEFP ¶9

15. The BM will continue to enhance its monetary policy framework and tools. The authorities are undertaking several reforms to support their key operational objective of developing the domestic repo market to help improve money market management and the liquidity of government securities. The BM is also refining its policy formulation and communication system notably through its quarterly monetary reports. The 3rd report was published in October 2012 and included short-term inflation projections, reflecting the BM's ongoing strengthening of its forecasting and policy analysis capacity.

MEFP ¶10-11





16. The BM aims at shoring up its supervision and crisis management framework. While aggregate indicators point to a sound and liquid banking system, the authorities remain focused on safeguarding financial stability through:

MEFP ¶25

- **Strengthening supervision tools.** Supported by IMF TA recommendations, this includes the capacity to perform regular stress tests; a revision of the definition of nonperforming loans and their accounting to make them inter-nationally comparable; the modernization of the BM's Credit Records Center, which is an essential tool to monitor banks' credit risk; and a possible regulatory change on concentration limits, including banks' placements abroad. The authorities also remain focused on the transition towards a more risk-based banking supervision through the migration to Basel II.

- **Completing a financial sector contingency plan**. The authorities are finalizing regulations pertaining to emergency liquidity assistance and bank resolution and expect to have the contingency plan operational by end-March 2013 **(structural benchmark)**.

- **Making a Deposit Insurance Fund (DIF) operational.** Pending the appointment by the Ministry of Finance of the fund's three Executive Board members and the finalization of its internal regulations and procedures, the DIF is expected to become fully operational by end-April 2013.

17. The adoption of a Financial Sector Development Strategy (FSDS) for 2012-21 will be an important milestone in strengthening, broadening and deepening the financial sector (structural benchmark). The strategy encompasses all financial areas and aims at developing a sound, diverse and competitive sector which provides citizens and businesses –particularly SMEs– with access to a wide range of high quality and affordable financial services. As part of the strategy's numerous proposed reforms, the BM has drafted a law for the creation of private credit registry bureaus, which is intended to lower information cost for lenders and improve access to bank financing.

MEFP ¶26

18. Mozambique's AML/CFT framework is being improved. The AML/CFT Law was submitted to parliament in April 2012. The authorities consider the passage of this legislation and related regulations a priority and a critical step towards the implementation of the revised international standards. Upon passage of the law, the authorities will have 180 days to elaborate and adopt the related secondary regulations. As part of ongoing TA to support the authorities in strengthening their AML/CFT regime, staff is currently reviewing the AML/CFT law for consistency with the international standard.

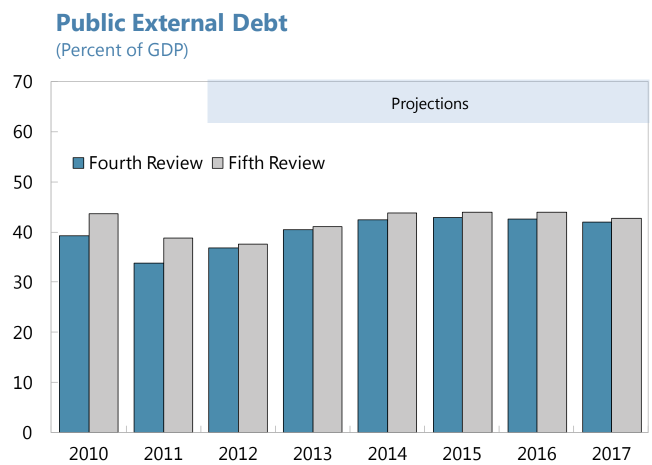
MEFP ¶27

C. Maintaining External Sustainability While Serving Infrastructure Investment Needs

19. To complement donor support and finance priority investment projects in the pipeline, the authorities are tapping into nonconcessional borrowing as planned. The authorities have requested an increase in the NCB ceiling by $100 million to a total of $1.6 billion to allow funding for high-priority projects, because a $250 million loan to improve the electricity supply in Maputo was contracted at a 34 percent grant element, marginally program's concessionality cut-off value.[4] Negotiations on many projects envisaged to be financed by non-concessional borrowing are either already concluded or advanced. Consequently, it is the authorities' expectation that the $1.6 billion ceiling would be fully utilized by mid-2013, but that the pace of new borrowing would slow thereafter. A number of projects in the crucial electricity sector

[4] In total $550 million under the NCB ceiling are loans with a 34 percent grant element.

(generation and transmission) are in the early planning stages and the government intends to rely mostly on private partners to fund these.



20. The new investment projects are unlikely to cause sizeable domestic demand or inflationary pressures. The import content is high and labor markets in Mozambique are underutilized, although there are wage pressures for certain professional skills. At the same time, construction costs in Mozambique are reportedly higher than in neighboring countries and real estate prices in Maputo are rising. In recent years the government has been able to implement a large public investment program while maintaining macroeconomic stability.

21. Continued efforts to strengthen debt management and project selection are crucial. Several reform steps have already been put in place, including the preparation of an Integrated Investment Plan, the authorities' work on their own DSA updates, newly created coordinating committees, and the approval by the Council of Ministers of an enhanced medium-term debt strategy (MTDS). The government's capacity will be further strengthened by the implementation of new program commitments such as the application of the project evaluation manual and template by the Project Coordination Committee (PCC); the publication of summary information about projects after their approval by the Council of Ministers; further improvements in DSA prepared by the authorities; as well as the completion of a new domestic borrowing plan for 2013 **(structural benchmark).**

MEFP ¶19

D. Managing Natural Resource Wealth

22. Mozambique has achieved a key milestone by becoming fully EITI compliant in October 2012. Transparency in the natural resource sector is tantamount for good economic management and confidence. With full compliance with EITI requirements, the government commits to continue to implement a best-practice framework to improve the transparency of the natural resource sector.

23. Capacity building is urgently needed for the country to secure the full benefits from the imminent natural resource boom. Mozambique is entering a period of rapid development of its mining and hydrocarbon sectors. While coal production is gradually gaining steam in tandem with the expansion of transport infrastructure, huge offshore natural gas discoveries are likely to lead to large-scale LNG production and exports by the end of this decade. A feasibility study, recently carried by a US

MEFP ¶22-23

consulting firm under the supervision of the World Bank as part of the authorities' draft Gas Master Plan, shows that development of the gas sector will be feasible at current world prices as well as under much more conservative price assumptions.[5] However, to fully benefit from these developments, the government needs to build/hire specialized expertise to prepare the regulatory and fiscal framework, manage its participation in PPPs through public enterprises, enhance mining and hydrocarbon revenue forecasting, and improve the statistics on natural resources. The authorities should also consider the appropriate mix of monetary and fiscal policies with a view to smoothing short-term consumption while facilitating investment, and maintaining the competitiveness of the exchange rate.

24. New mining and hydrocarbon framework laws have been presented to the Council of Ministers in September 2012; building on these, new fiscal regimes for the mining and hydrocarbon sector are being finalized. With Fund technical assistance under the *Topical Trust Fund for Managing Natural Resource Wealth*, the relevant tax legislation has been revised and a general consultation with local stakeholders is underway, with an eye to submission of the draft laws to parliament in 2013.

II. PROGRAM ISSUES

25. Modifications are proposed for several assessment criteria (ACs) and an indicative target. The end-December 2012 ACs on net credit to the government, reserve money and net international reserves and the indicative floor on government revenues are proposed for modification in light of performance to date. The authorities have requested an increase in the AC on nonconcessional external borrowing, given that the grant element of one large loan marginally slipped below the program's 35 percent concessionality cut-off.

III. STAFF APPRAISAL

26. Despite the difficult global environment, Mozambique's economic performance in 2012 has been remarkable. Economic growth remained buoyant and macroeconomic stability was maintained, building on a track record of strong macroeconomic policies that effectively supported growth while bringing down inflation and strengthening international reserves. The minor non-observance of the limit on net credit to the government in June was temporary and did not compromise the underlying prudent fiscal policy stance and Mozambique's satisfactory implementation of its economic program under the PSI.

27. Nonetheless, the government should continue to maintain a prudent macroeconomic policy mix going forward. While global risks are sizeable, the increase in coal extraction will continue to lead Mozambique's economic growth. Staff commends the government for a prudent 2013 budget, which aims to utilize the available fiscal space for the government's investment and social development objectives. The government should strive to contain the public wage bill while channeling resources to priority sectors, such as social

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[5] The more conservative scenario is based on assumptions supplied by the World Bank and supposes a 30 percent lower price in 2020 than this DSA.

protection. Monetary policy is appropriately geared toward private sector credit expansion, while committed to the medium-term inflation target. In addition, the authorities' intention to strengthen financial sector supervision and their crisis management framework is timely.

28. The prudent use of nonconcessional external borrowing can help to bridge the gap between the country's vast infrastructure needs and a trend decline in donor support. Going forward, it remains important to continue to strike a balance between addressing pressing infrastructure bottlenecks with the risks entailed in a rapid expansion of external debt. In this regard, the government's intention to continue to use nonconcessional borrowing cautiously, as well as monitor overall debt levels, is welcome. Moreover, the government should build on its ongoing debt management and project selection reforms to establish clear investment priorities while preserving the country's debt sustainability.

29. In the long run, the natural resource sector is set to provide increasing fiscal revenue for the country's development needs. In this context, staff commends the authorities for achieving full EITI compliance and encourages them to move rapidly in modernizing the fiscal regimes for the booming mining and emerging hydrocarbon sectors and in further institutional enhancements and capacity building to manage natural resource wealth. While major revenue flows are only expected to commence at the end of this decade, it is essential to maintain the prudent policy approach and manage public expectations.

30. Based on program performance and the authorities' strong ownership of the Fund-supported program, staff recommends completion of the fifth review under the PSI. Staff also recommends a waiver for the minor nonobservance of the end-June AC on net credit to the government, the modification of ACs and an indicative target for December 2012, and the setting of indicative targets through March 2013.

Table 1. Mozambique: Selected Economic and Financial Indicators, 2010-17

	2010	2011	2012		2013	2014	2015	2016	2017
	Act.	Est.	CR 12/148	Proj.	Proj.		Proj.		
	(Annual percentage change, unless otherwise indicated)								
National income and prices									
Nominal GDP (MT billion)	315	365	426	414	483	551	628	715	814
Nominal GDP growth	18.3	16.0	14.9	13.4	16.5	14.0	14.0	13.9	13.8
Real GDP growth	7.1	7.3	6.7	7.5	8.4	8.0	8.0	7.8	7.8
GDP per capita (US$)	442	571	632	650	688	735	805	881	963
GDP deflator	10.5	8.1	7.2	5.5	7.5	5.6	5.6	5.6	5.6
Consumer price index (annual average)	12.7	10.4	7.2	2.4	7.0	5.6	5.6	5.6	5.6
Consumer price index (end of period)	16.6	5.5	5.6	4.1	6.5	5.6	5.6	5.6	5.6
Exchange rate, MT per US dollar, eop	32.8	27.1	...	...	...	...	...	...	...
Exchange rate, MT per US dollar, per.avg.	33.0	29.1	...	...	...	...	...	...	...
External sector									
Merchandise exports	8.7	33.6	12.3	16.9	16.1	7.3	6.0	24.0	24.2
Merchandise exports, excluding megaprojects	-20.5	65.8	4.0	19.3	9.1	11.0	12.2	13.2	13.9
Merchandise imports	18.7	51.9	6.5	9.9	7.4	39.8	3.1	3.1	0.3
Merchandise imports, excluding megaprojects	-0.7	46.2	11.9	-0.2	11.3	6.2	6.3	9.4	7.9
Terms of trade	10.4	3.2	13.3	-9.8	-2.9	1.0	0.5	0.7	0.2
Nominal effective exchange rate (end of period)	-22.4	12.4	...	...	...	...	...	...	...
Real effective exchange rate (end of period)	-15.1	19.7	...	...	...	...	...	...	...
	(Annual percentage change, unless otherwise indicated)								
Money and credit									
Reserve money	29.2	8.5	20.2	18.0	18.4	15.0	14.9	15.0	15.1
M3 (Broad Money)	22.8	9.4	20.2	18.6	19.3	18.0	15.1	14.9	14.9
Credit to the economy	29.3	6.4	22.8	17.9	18.9	17.3	16.7	15.1	15.1
(Percent of GDP)	29.3	26.9	28.3	28.0	28.5	29.3	30.0	30.4	30.7
	(Percent of GDP)								
Investment and saving									
Gross domestic investment	26.4	37.6	22.8	37.2	39.0	54.5	51.9	47.0	43.7
Government	14.5	15.3	15.4	12.9	14.6	15.8	14.3	13.4	12.7
Other sectors	11.9	22.4	7.4	24.3	24.3	38.6	37.6	33.7	31.0
Gross domestic savings (excluding grants)	2.1	5.5	5.5	6.0	9.0	10.3	9.0	7.8	8.7
Government	1.6	2.7	2.4	3.5	3.0	3.4	4.0	4.8	5.6
Other sectors	0.5	2.8	3.1	2.5	6.0	7.0	5.1	3.1	3.1
External current account, before grants	-24.3	-32.1	-17.3	-31.2	-30.0	-44.2	-42.9	-39.2	-35.0
External current account, after grants	-17.4	-25.8	-12.7	-26.9	-26.3	-41.0	-40.3	-37.0	-33.2
Government budget									
Total revenue	20.5	22.2	22.2	23.9	23.1	23.3	23.9	24.7	25.4
Total expenditure and net lending	33.4	34.4	35.2	33.3	34.0	34.4	33.2	33.2	32.3
Overall balance, before grants	-12.9	-12.2	-13.0	-9.3	-10.9	-11.1	-9.4	-8.5	-6.9
Total grants	9.0	7.8	6.6	5.8	5.4	4.7	3.9	3.3	2.7
Overall balance, after grants	-3.9	-4.5	-6.4	-3.6	-5.5	-6.4	-5.4	-5.2	-4.2
Domestic primary balance, before grants	-3.7	-2.2	-2.3	-1.3	-2.3	-2.1	-1.7	-1.1	-0.5
External financing (incl. debt relief)	4.2	3.7	5.8	3.6	4.9	5.6	4.6	4.4	3.4
Net domestic financing	-0.4	0.9	0.6	0.0	0.6	0.8	0.8	0.8	0.8
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total public debt [1]	49.3	45.3	41.4	48.1	50.7	52.5	52.2	52.2	50.8
Of which: external	43.5	36.2	38.3	39.1	42.3	44.4	44.3	44.4	43.2
Of which: domestic	5.9	9.1	3.1	9.1	8.3	8.1	7.9	7.8	7.6
	(Millions of U.S. dollars, unless otherwise indicated)								
External current account, before grants	-2,320	-4,036	-2,463	-4,558	-4,726	-7,583	-8,231	-8,405	-8,368
External current account, after grants	-1,663	-3,241	-1,802	-3,924	-4,153	-7,045	-7,729	-7,938	-7,933
Overall balance of payments	58	323	200	246	155	274	262	375	490
Net international reserves (end of period) [2]	1,908	2,239	2,438	2,530	2,685	2,959	3,220	3,596	4,085
Gross international reserves (end of period) [2]	2,099	2,428	2,626	2,723	2,874	3,145	3,372	3,712	4,167
Months of projected imports of goods and nonfactor services	3.3	3.3	4.7	3.4	2.7	2.9	2.9	3.1	3.3

Sources: Mozambican authorities; and IMF staff estimates and projections.

[1] Consistent with DSA definition, the nonconcessional Portuguese credit line is included under the external debt.

[2] Includes disbursements of IMF resources under the ESF and August 2009 SDR allocation.

Table 2. Mozambique: Government Finances, 2010–13

(Billions of Meticais)

	2010	2011	2012		2013
	Est.	Est.	CR 12/148	Proj.	Proj.
Total revenue	64.48	81.12	94.57	99.04	111.76
Tax revenue	56.54	71.54	82.90	87.33	97.08
Income and profits	18.48	24.89	27.49	35.21	31.58
Of which: capital gain tax	…	…	…	5.03	…
Goods and services	31.69	38.42	45.76	42.87	53.15
International trade	5.26	6.73	8.00	7.42	9.58
Other	1.10	1.51	1.66	1.83	2.77
Nontax revenue	7.94	9.58	11.66	11.71	14.68
Total expenditure and net lending	105.20	125.76	150.09	137.78	164.41
Current expenditure	59.56	71.50	84.46	84.46	97.26
Compensation to employees	29.11	35.66	41.35	41.35	48.81
Goods and services	12.36	14.83	19.84	18.84	23.56
Interest on public debt	2.67	3.58	4.63	4.63	5.62
Domestic	1.86	2.59	3.55	3.55	3.56
External	0.81	0.99	1.07	1.07	2.06
Transfer payments	15.42	17.21	18.63	19.64	19.28
Of which: fuel subsidy (old stock)	4.69	4.09	2.68	2.68	1.33
basic social protection floor	0.73	0.75	1.01	1.01	1.68
Domestic current primary balance	7.59	13.21	14.74	19.21	20.12
Capital expenditure	43.70	50.60	51.74	46.99	57.65
Domestically financed	20.03	20.32	24.26	24.26	30.78
Externally financed	23.67	30.28	27.48	22.73	26.87
Net lending	1.93	3.66	13.89	6.34	9.49
Domestically financed	-0.40	0.39	0.40	0.40	0.33
Externally financed loans to public enterprises	2.33	3.26	13.49	5.94	9.17
of which: nonconcessional net lending	0.00	1.50	8.77	4.24	8.28
Unallocated revenue (+)/expenditure (-) [1]	0.36	-0.78	0.00	0.00	0.00
Domestic primary balance, before grants, above the line [2]	-11.68	-8.28	-9.92	-5.45	-10.98
Overall balance, before grants	-40.36	-45.41	-55.52	-38.74	-52.65
Grants received	28.34	28.63	28.11	23.87	26.23
Project support	17.11	16.37	18.48	15.60	17.65
Investment projects	7.19	6.70	8.48	7.56	8.80
Special programs	9.92	9.68	10.00	8.05	8.86
Budget support	11.24	12.26	9.63	8.26	8.58
Overall balance, after grants	-12.01	-16.78	-27.41	-14.87	-26.42
Net external financing	13.25	13.48	24.91	14.82	23.65
Disbursements	14.28	14.60	27.19	16.97	25.73
Project	8.19	10.50	9.00	7.12	9.22
Nonproject support	6.09	4.10	18.18	9.85	16.51
Loans to public enterprises	2.33	3.26	13.87	5.94	9.17
of which: nonconcessional	0.00	1.50	9.15	4.24	8.28
Budget support	3.76	0.83	4.31	3.91	7.34
Cash amortization	-1.03	-1.12	-2.27	-2.15	-2.07
Net domestic financing	-1.22	3.30	2.50	0.05	2.76
Net privatization	-0.01	0.00	0.00	0.00	0.00
Memorandum items:					
Gross aid flows	42.62	41.73	46.15	36.60	43.68
Budget support	14.99	13.09	13.95	12.17	15.92
Nonbudget support	27.63	28.64	32.21	24.43	27.76
Project support	25.30	26.88	27.48	22.73	26.87
Loans to public enterprises	2.33	1.76	4.73	1.70	0.89

Sources: Mozambican authorities; and IMF staff estimates and projections.

[1] Residual discrepancy between identified sources and uses of funds.

[2] Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.

Table 3. Mozambique: Government Finances, 2010–17

(Percent of GDP)

	2010	2011	2012		2013	2014	2015	2016	2017
	Est.	Est.	CR 12/148	Proj.	Proj.	Projections			
Total revenue	20.5	22.2	22.2	23.9	23.1	23.3	23.9	24.7	25.4
Tax revenue	18.0	19.6	19.5	21.1	20.1	20.2	20.9	21.7	22.3
Taxes on income and profits	5.9	6.8	6.5	8.5	6.5	6.5	7.0	7.7	8.2
Taxes on goods and services	10.1	10.5	10.7	10.3	11.0	11.1	11.2	11.3	11.4
Taxes on international trade	1.7	1.8	1.9	1.8	2.0	2.0	2.1	2.1	2.1
Other taxes	0.4	0.4	0.4	0.4	0.6	0.6	0.6	0.6	0.6
Nontax revenue	2.5	2.6	2.7	2.8	3.0	3.0	3.0	3.0	3.0
Total expenditure and net lending	33.4	34.4	35.2	33.3	34.0	34.4	33.2	33.2	32.3
Current expenditure	18.9	19.6	19.8	20.4	20.1	19.9	19.9	19.9	19.8
Compensation to employees	9.2	9.8	9.7	10.0	10.1	9.9	9.6	9.4	9.0
Goods and services	3.9	4.1	4.5	4.5	4.9	4.9	4.9	4.8	4.8
Interest on public debt	0.8	1.0	1.1	1.1	1.2	1.1	1.2	1.3	1.4
Transfer payments	4.9	4.7	4.6	4.7	4.0	4.0	4.2	4.5	4.5
Of which: fuel subsidy (old stock)	1.5	1.1	0.6	0.6	0.3	...	...	...	...
basic social protection floor	0.2	0.2	0.2	0.2	0.3	0.4	0.6	0.8	0.8
Capital expenditure	13.9	13.9	12.1	11.3	11.9	12.1	11.6	11.4	11.0
Domestically financed	6.4	5.6	5.7	5.9	6.4	6.5	6.7	7.1	7.4
Externally financed	7.5	8.3	6.4	5.5	5.6	5.6	4.9	4.3	3.6
Net lending	0.6	1.0	3.3	1.5	2.0	2.4	1.7	1.9	1.5
Domestically financed	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Externally financed loans to public enterprises	0.7	0.9	3.2	1.4	1.9	2.3	1.6	1.8	1.4
Of which: nonconcessional net lending	0.0	0.4	2.1	1.0	1.7	2.2	1.5	1.7	1.3
Unallocated revenue (+)/expenditure (-) [1]	0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic primary balance, before grants [2]	-3.7	-2.3	-2.3	-1.3	-2.3	-2.1	-1.7	-1.1	-0.5
Overall balance, before grants	-12.8	-12.4	-13.0	-9.3	-10.9	-11.1	-9.4	-8.5	-6.9
Grants received	9.0	7.8	6.6	5.8	5.4	4.7	3.9	3.3	2.7
Project	5.4	4.5	4.3	3.8	3.7	3.2	2.7	2.2	1.9
Investment projects	2.3	1.8	2.0	1.8	1.8	1.6	1.3	1.1	0.9
Special programs	3.1	2.6	2.3	1.9	1.8	1.6	1.3	1.1	0.9
Budget support	3.6	3.4	2.3	2.0	1.8	1.5	1.3	1.1	0.9
Overall balance, after grants	-3.9	-4.6	-6.4	-3.6	-5.5	-6.4	-5.4	-5.2	-4.2
Net external financing	4.2	3.7	5.8	3.6	4.9	5.6	4.6	4.4	3.4
Disbursements	4.5	4.0	6.4	4.1	5.3	6.1	5.0	4.8	3.9
Project	2.6	2.9	2.1	1.7	1.9	2.4	2.2	2.1	1.7
Nonproject support	1.9	1.1	4.3	2.4	3.4	3.7	2.7	2.7	2.2
Loans to public enterprises	0.7	0.9	3.3	1.4	1.9	2.3	1.6	1.8	1.4
of which: nonconcessional	0.0	0.4	2.1	1.0	1.7	2.2	1.5	1.7	1.3
Budget support	1.2	0.2	1.0	0.9	1.5	1.3	1.1	0.9	0.8
Cash amortization	-0.3	-0.3	-0.5	-0.5	-0.4	-0.5	-0.4	-0.4	-0.5
Net domestic financing	-0.4	0.9	0.6	0.0	0.6	0.8	0.8	0.8	0.8
Net privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross aid flows	13.5	11.4	10.8	8.8	9.0	8.6	7.4	6.4	5.4
Budget support	4.8	3.6	3.3	2.9	3.3	2.9	2.4	2.0	1.7
Nonbudget support	8.8	7.8	7.6	5.9	5.7	5.8	5.0	4.4	3.7
Project support	8.0	7.4	6.4	5.5	5.6	5.6	4.9	4.3	3.6
Loans to public enterprises	0.7	0.5	1.1	0.4	0.2	0.2	0.1	0.1	0.1

Sources: Mozambican authorities; and IMF staff estimates and projections.

[1] Residual discrepancy between identified sources and uses of funds.

[2] Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.

Table 4. Mozambique: Monetary Survey, Quarterly, 2010-13

(Billions of Meticais, unless otherwise specified)

	2010	2011	2012								2013			
			Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Act.	Act.	CR/11/350	Act.	CR/12/148	Act.	CR/12/148	Act.	CR/12/148	Proj.	Proj.	Proj.	Proj.	Proj.
Bank of Mozambique														
Net foreign assets	56.9	56.9	57.4	55.4	62.8	60.0	67.9	72.9	73.0	75.9	77.3	79.3	82.4	82.8
(US$ billions)	1.7	2.1	1.9	2.0	2.1	2.1	2.2	2.5	2.3	2.4	2.4	2.4	2.5	2.5
Net international reserves	62.2	61.1	62.2	59.5	67.3	64.2	72.6	77.4	78.0	80.9	81.8	84.0	87.3	87.9
(US$ billions)	1.9	2.2	2.1	2.2	2.2	2.3	2.3	2.7	2.4	2.5	2.5	2.6	2.7	2.7
Net domestic assets	-25.2	-22.6	-24.0	-24.5	-26.0	-25.9	-30.5	-36.2	-31.8	-35.4	-40.6	-38.2	-38.3	-34.9
Credit to government (net)	-20.6	-26.8	-19.2	-26.2	-27.7	-28.6	-25.8	-27.6	-24.3	-26.7	-27.9	-34.3	-39.6	-24.0
Credit to banks (net)	0.4	-3.8	2.0	-4.7	0.4	-6.5	-4.5	-16.3	-5.0	-6.0	-13.8	-8.9	-3.0	-6.3
Credit to the economy	0.5	0.9	0.6	1.0	0.9	1.0	0.9	1.1	0.9	0.9	1.0	1.0	1.1	0.9
Other items (net; assets +)	-5.6	7.1	-7.5	5.5	0.5	8.1	-1.1	6.7	-3.3	-3.6	0.1	3.8	3.3	-5.6
Reserve money	31.6	34.3	33.4	31.0	36.8	34.1	37.4	36.7	41.2	40.5	36.7	41.0	44.1	47.9
Currency in circulation	20.4	21.9	21.2	18.7	23.4	21.6	24.2	23.1	27.6	27.7	23.6	27.2	29.0	32.4
Currency outside banks	17.4	17.5	10.8	15.3	20.2	17.5	20.1	18.2	21.9	20.6	12.0	20.1	15.0	19.5
Currency in Banks (Cash in Vault)	3.1	4.4	10.4	3.5	3.2	4.1	4.1	4.8	5.7	7.1	11.6	7.1	14.0	12.9
Bank deposits in BM	11.2	12.4	12.2	12.2	13.3	12.5	13.2	13.6	13.6	12.8	13.1	13.8	15.1	15.5
Commercial Banks														
Net foreign assets	22.8	16.1	24.0	16.6	28.9	17.8	29.8	19.8	25.2	22.2	18.4	18.6	27.3	29.8
(Millions of U.S. dollars)	0.7	0.6	0.8	0.6	0.9	0.6	1.0	0.7	0.8	0.7	0.6	0.6	0.8	0.9
Net domestic assets	92.5	109.1	111.7	110.3	116.7	119.7	113.8	127.7	123.7	127.7	136.2	144.5	150.8	154.2
Banks' reserves	14.3	16.8	22.6	15.5	16.6	16.8	17.3	19.5	19.3	19.9	24.7	20.9	29.1	28.5
Credit to BM (net)	-0.3	4.0	-2.0	6.2	-0.4	6.2	4.5	16.6	5.0	6.0	13.8	8.9	3.0	6.3
Credit to government (net)	8.4	21.1	12.9	22.2	20.1	26.0	20.3	17.9	21.9	21.9	23.0	25.2	24.4	21.9
Credit to the economy	91.9	97.3	106.6	98.1	120.9	101.9	119.4	105.8	119.7	114.9	115.1	122.9	124.9	136.8
Other items (net; assets +)	-21.8	-30.1	-28.4	-30.0	-40.5	-31.2	-47.6	-32.1	-42.2	-35.0	-40.4	-33.4	-30.7	-39.3
Deposits	115.3	125.3	135.7	126.9	145.7	137.5	143.6	147.5	148.9	150.0	154.6	163.1	178.1	184.0
Demand and savings deposits	73.0	79.1	88.3	79.3	90.0	86.8	89.7	94.9	93.5	94.7	97.7	100.9	114.1	117.7
Time deposits	42.3	46.2	47.4	47.7	55.6	50.7	54.0	52.6	55.4	55.3	56.9	62.2	64.0	66.3
Monetary Survey														
Net foreign assets	79.6	73.0	81.4	72.0	91.7	77.7	97.8	92.7	98.2	98.1	95.7	97.9	109.7	112.7
(US$ billions)	2.4	2.7	2.7	2.6	3.0	2.8	3.1	3.2	3.1	3.1	3.0	3.0	3.4	3.4
Net domestic assets	51.8	70.8	65.1	71.1	74.2	78.2	66.0	74.1	72.6	72.4	70.8	85.3	83.4	90.8
Domestic credit	80.2	92.6	100.9	111.0	114.1	100.4	114.7	97.2	118.1	111.0	111.0	114.8	110.8	135.7
Credit to government (net)	-12.2	-5.7	-6.3	-4.0	-7.6	-2.6	-5.6	-9.7	-2.5	-4.8	-5.0	-9.1	-15.2	-2.1
Credit to the economy	92.4	98.3	107.3	99.1	121.7	102.9	120.2	106.9	120.6	115.9	116.0	123.9	126.0	137.7
Cred. economy in foreign currency	-21.8	21.8	24.5	22.4	25.6	24.4	24.6	25.2	26.6	24.8	26.0	27.5	27.9	29.0
Other items (net; assets +)	-28.3	-21.8	-35.9	-24.0	-39.9	-22.2	-48.7	-23.0	-45.5	-38.6	-40.2	-29.5	-27.4	-44.9
Money and quasi money (M3)	131.5	143.8	146.4	143.1	165.9	155.9	163.8	166.8	170.8	170.5	166.6	183.2	193.0	203.5
Foreign currency deposits	46.2	38.1	47.0	39.6	44.6	42.7	42.7	47.2	42.0	45.0	45.4	50.7	52.5	53.1
(US$ billions)	1.4	1.4	1.6	1.5	1.5	1.5	1.4	1.6	1.3	1.4	1.4	1.6	1.6	1.6
M2	85.3	105.7	99.4	103.5	121.3	113.2	121.0	119.6	128.8	125.5	121.1	132.5	140.6	150.3
Memorandum Items														
Avg daily reserve money in 3rd month of quarter	31.8	33.3	33.8	30.8	36.9	33.4	37.0	36.0	40.0	39.3	36.5	40.2	43.2	46.5
12-month percent change	35.0	4.5	16.6	6.2	20.1	8.5	17.8	14.4	20.2	18.0	18.6	20.5	20.1	18.4
Avg daily currency in 3rd month of quarter	20.4	21.2	21.5	18.6	23.0	20.8	23.9	22.4	26.7	26.7	23.4	26.1	28.2	31.3
12-month percent change	30.1	3.7	24.1	7.6	22.8	10.9	20.7	13.3	26.0	26.3	25.6	25.8	25.6	17.1
NCG stock (prog def.)	-15.8	-12.5	-10.7	-11.8	-11.6	-10.6	-9.7	-13.8	-6.5	-9.0	-9.4	-13.6	-15.1	-6.2
NCG flow (prog def.) cum from end-year	-1.2	3.3	2.8	0.8	-2.6	1.9	-0.7	-1.2	2.5	0.1	0.5	-3.4	-5.2	2.8
12-month percent change														
Reserve money	29.2	8.5	16.6	8.1	20.1	11.2	17.8	15.6	20.2	18.0	18.6	20.5	20.1	18.4
M2	17.6	23.9	18.3	23.1	33.8	24.9	26.2	24.8	23.8	18.7	17.0	17.1	17.5	19.8
M3	22.8	9.4	13.2	10.7	27.8	20.1	23.2	25.5	20.2	18.6	16.4	17.5	15.7	19.3
Credit to the economy	29.3	6.4	16.1	6.7	28.9	9.0	26.7	12.6	22.8	17.9	17.1	20.4	17.9	18.9
Money multiplier (M2/reserve money)	2.70	3.08	2.98	3.34	3.30	3.32	3.23	3.26	3.12	3.10	3.30	3.23	3.19	3.14
Velocity (GDP/M2)	3.69	3.46	…	4.00	3.51	3.66	3.52	3.46	3.31	3.30	3.99	3.64	3.43	3.21
Nominal GDP	315	365	…	…	…	…	…	…	426	414	…	…	…	483
Nominal GDP growth	18.3	16.0	…	…	…	…	…	…	14.9	13.4	…	…	…	16.5
Policy lending rate (end-of-period)	15.5	15.0	…	13.75	…	12.50	…	10.50	…	…	…	…	…	…
T-bill 91 days rate	14.7	11.8	…	8.6	…	4.2	…	3.0	…	…	…	…	…	…

Sources: Bank of Mozambique; and IMF staff estimates and projections.

Table 5. Mozambique: Balance of Payments, 2010–17

(Millions of U.S. dollars, unless otherwise specified)

	2010	2011	2012		2013	2014	2015	2016	2017
	Act.	Est.	CR 12/148	Proj.	Projections				
Current account balance	-1,663	-3,241	-1,803	-3,924	-4,153	-7,045	-7,729	-7,938	-7,933
Trade balance for goods	-1,729	-3,052	-1,344	-3,140	-3,055	-5,644	-5,686	-4,859	-3,450
Of which: Megaprojects	218	-334	817	-641	-243	-2,725	-2,676	-1,633	-92
Exports, f.o.b.	2,333	3,118	3,116	3,644	4,229	4,539	4,811	5,968	7,414
Of which: Megaproject exports	1,668	2,015	2,325	2,328	2,794	2,946	3,025	3,945	5,110
Imports, f.o.b.	-4,062	-6,170	-4,460	-6,784	-7,284	-10,183	-10,497	-10,826	-10,864
Of which: Megaproject imports	-1,450	-2,350	-1,508	-2,969	-3,037	-5,671	-5,701	-5,577	-5,202
Trade balance for services	-506	-794	-895	-1,405	-1,470	-1,514	-1,598	-1,819	-2,144
Income balance	-85	-190	-239	-108	-94	-284	-781	-1,561	-2,609
Of which: Dividend payments by megaprojects	0	-157	-254	-10	-21	-187	-254	-555	-1,069
Current transfers balance	657	795	675	729	467	397	337	302	270
Of which: External grants	605	785	661	634	573	538	503	468	435
Capital and financial account balance	1,663	3,013	2,004	4,131	4,307	7,320	7,990	8,313	8,423
Capital account balance	346	379	422	401	434	432	433	436	443
Financial account balance	1,318	2,634	1,582	3,730	3,874	6,887	7,557	7,877	7,980
Net foreign direct investment	1,340	2,892	1,590	3,090	3,261	1,840	1,912	1,616	1,122
Net foreign borrowing by the general government	468	531	926	603	892	1,047	923	968	774
Net foreign borrowing by the nonfinancial private sector	-348	-590	-671	-173	-384	3,900	4,628	5,204	6,002
Other [1]	-142	-199	-261	210	105	101	95	88	81
Net errors and omissions	58	551	0	39	0	0	0	0	0
Overall balance	58	323	200	246	155	274	262	375	490
External financing	-58	-323	-200	-246	-155	-274	-262	-375	-490
Reserve assets [1]	-87	-321	-198	-242	-152	-271	-227	-340	-455
Net use of credit	18	-2	-2	-4	-3	-3	-35	-36	-35
Of which: Net use of Fund credit	20	-2	-2	-2	-3	-3	-35	-36	-35
Exceptional financing	10	0	0	0	0	0	0	0	0
Memorandum items:									
Effective exchange rate indexes (percent change)									
Nominal effective exchange rate	-22.4	12.4	…	…	…	…	…	…	…
Real effective exchange rate	-15.1	19.7	…	…	…	…	…	…	…
Terms of trade index (percent change)	10.4	3.2	13.3	-9.8	-2.9	1.0	0.5	0.7	0.2
International aluminum price	30.2	10.5	-6.4	-17.2	-0.5	4.9	4.6	4.1	3.5
International food price index	11.5	19.7	-7.5	-1.1	-2.0	-6.6	-4.9	-1.5	-0.9
International fuel price index	26.0	31.5	9.2	1.5	-1.5	-3.5	-3.6	-3.2	-3.5
International coal price index	…	23.2	-12.3	-22.8	-21.5	0.1	-2.0	0.0	0.0
Current account balance (percent of GDP)	-17.4	-25.8	-12.7	-26.9	-26.3	-41.0	-40.3	-37.0	-33.2
Excluding external grants	-24.3	-32.1	-17.4	-31.9	-30.0	-44.2	-42.9	-39.2	-35.0
Gross aid inflows (millions of U.S. dollars)	1,443	1,556	1,606	1,351	1,477	1,527	1,468	1,417	1,311
Gross aid inflows (percent of GDP)	15.1	12.4	11.3	9.3	9.4	8.9	7.6	6.6	5.5
Of which: To central government	13.5	11.4	10.8	8.8	9.1	8.6	7.4	6.4	5.4
Budget support	4.8	3.6	3.3	3.0	3.3	2.9	2.4	2.0	1.7
Nonbudget support	8.8	7.8	7.6	5.9	5.8	5.8	5.0	4.4	3.7
Project support	8.0	7.4	6.4	5.5	5.6	5.6	4.9	4.3	3.6
Onlending	0.7	0.5	1.1	0.4	0.2	0.2	0.1	0.1	0.1
Net foreign assets	1,745	2,082	2,285	2,324	2,479	2,753	3,015	3,390	3,880
Net international reserves [1]	1,908	2,239	2,438	2,530	2,685	2,959	3,220	3,596	4,085
Gross international reserves [1]	2,099	2,428	2,627	2,723	2,874	3,145	3,372	3,712	4,167
Months of projected imports of goods and nonfactor serv	3.3	3.3	4.7	3.4	2.7	2.9	2.9	3.1	3.3
Months of current imports of goods and nonfactor service	4.8	3.8	5.2	3.7	3.6	3.0	3.1	3.2	3.5
Months of projected G&S imports (excl. megaproject imp	4.8	5.0	…	5.1	5.1	5.2	5.2	5.3	5.4
Months of current G&S imports (excl. megaproject import	6.7	5.5	…	5.6	5.4	5.6	5.6	5.7	5.9

Sources: Data from Government of Mozambique and projections by IMF staff.

[1] Includes net portfolio investment and other investment assets.

Table 6. Mozambique: Financial Soundness Indicators for Banking Sector, 2003–12

	2003	2004	2005	2006	2007	2008	2009	2010	2011	Mar-12	Jun-12
Capital adequacy											
Regulatory capital to risk-weighted assets	16.5	18.0	13.4	12.5	14.2	13.9	15.1	14.4	17.1	17.8	20.1
Regulatory Tier I capital to risk-weighted assets	14.7	16.0	13.6	10.7	12.1	12.4	13.0	13.7	16.1	16.5	18.6
Capital (net worth) to assets	7.4	7.4	6.6	6.3	7.2	7.5	7.7	8.0	9.0	9.0	10.5
Asset composition and quality											
Foreign exchange loans to total loans	60.8	62.0	51.4	33.2	28.5	32.8	32.4	29.5	25.1	25.9	26.7
Nonperforming loans to gross loans [1]	13.8	5.9	3.5	3.1	2.6	1.9	1.8	1.9	2.6	3.5	3.2
Nonperforming loans net of provisions to capital [1]	8.8	3.8	1.9	3.6	0.5	2.5	5.9	5.6	6.6	9.4	6.4
Earnings and profitability											
Return on assets	1.4	1.5	1.9	4.0	3.8	3.5	3.0	2.6	2.5	2.7	2.2
Return on equity	18.6	20.6	26.9	60.8	50.7	44.7	36.6	32.9	26.5	28.3	23.2
Interest margin to gross income	62.1	65.8	63.6	67.4	70.2	58.8	55.7	59.4	64.9	60.4	59.6
Noninterest expenses to gross income	81.9	81.6	75.2	60.2	60.8	58.7	58.4	59.7	61.3	62.1	65.1
Personnel expenses to noninterest expenses	42.4	43.1	43.5	42.6	46.3	45.1	45.9	45.5	47.1	47.1	48.5
Trading and fee income to gross income	37.9	34.2	36.4	32.6	29.5	40.5	44.3	23.8	17.2	21.8	21.0
Spread between reference loan and deposit rates (90 days, local currency)	17.4	14.9	13.8	14.6	11.1	10.7	11.1	10.3	11.4	10.3	…
Funding and liquidity											
Liquid assets to total assets [2]	45.2	38.3	31.1	33.9	36.0	36.2	27.9	22.4	27.8	27.6	28.7
Customer deposits to total (non-interbank) loans	193.6	205.0	177.6	169.5	184.9	165.7	138.2	131.2	131.6	132.5	136.6

Source: Bank of Mozambique (BM).

[1] Nonperforming loans are defined according to Mozambican accounting standards (they include only part of the past-due loans).
[2] Includes deposits at parent banks.

Table 7. Mozambique: Quantitative Assessment Criteria and Indicative Targets [1]
(Millions of meticais, unless otherwise specified)

	2012									2013			
	End-June Assessment Criteria			Status	End-Sept Indicative Target		Status	End-Dec Assessment Criteria		End-March Indicative Target	End-June	End-Sept	End-Dec
	Prog.	Adj.	Act.		Prog.	Act.		Prog.	Prop.	Prop.	Proj.	Proj.	Proj.
Assessment Criteria for end-June/December													
Net credit to the government (cumulative ceiling)	-2,645	112	1,900	NM	-745	-1,248	M	2,500	52	517	-3,432	-5,184	2,763
Stock of reserve money (ceiling)	36,923	36,580	33,350	M	37,031	35,975	M	39,985	39,264	36,495	40,187	43,207	46,490
Stock of net international reserves of the BM (floor, US$ millions)	2,207	2,107	2,282	M	2,323	2,693	M	2,438	2,530	2,544	2,595	2,681	2,685
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)	1,500	1,500	1,129	M	1,500	1,379	M	1,500	1,600	1,600	1,600	…	…
Stock of short-term external public debt outstanding (ceiling)	0	0	0	M	0	0	M	0	0	0	0	0	0
External payments arrears (ceiling, US$ millions)	0	0	0	M	0	0	M	0	0	0	0	0	0
Indicative targets													
Government revenue (cumulative floor)	45,256	45,256	43,567	NM	69,687	73,619	M	94,568	99,043	23,656	53,224	81,989	111,762
Priority spending (cumulative floor)	24,500	24,500	25,136	M	35,934	…	…	72,563	72,563	10,797	28,792	49,486	89,975

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 8. Mozambique: Structural Conditionality under the current PSI, 2011-12

Structural Benchmarks	Expected Implementation	Status	Macroeconomic importance
The Bank of Mozambique will adopt the financial sector contingency plan's modules related to (i) closing and liquidating banks, (ii) managing bidding processes for private sector takeovers, (iii) bailouts, and (iv) emergency liquidity assistance to promote rehabilitation of problem banks into viable institutions, as described in paragraph 34 of the MEFP dated May 20, 2011.	End-November 2011	Not met [1]	Safeguard macroeconomic stability and the soundness of the banking system.
The Minister of Planning and Development will approve an Integrated Investment Program, in consultation with the Project Coordination Committee, as described in paragraph 25 of the MEFP dated May 20, 2011.	End-March 2012	Met	Improve the selection of public investment projects, thereby supporting economic growth.
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	Met	Enhance transparency and accountability of monetary policy, thereby better anchoring price expectations and facilitating the transition to inflation targeting.
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	Met	Improve budget planning and execution, and enhance the authorities' handle on the wage bill.
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	Met	Help create fiscal space and shore up the authorities' revenue objectives.
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	Met in November	Enhance the effectiveness of money market operations, develop domestic financial markets and improve the liquidity of government securities.
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	Met	Improve the reporting and monitoring of budget execution.

[1] Converted into a structural benchmark for March 2013.

APPENDIX I. LETTER OF INTENT

December 7, 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 fifth 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 inclusive growth through public investment and the promotion of productive employment, and reduce poverty. The program aims to support the implementation of the Poverty Reduction Strategy Paper (PARP) for 2011–14, which the Government formally adopted in May 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/	/s/
Manuel Chang	Ernesto Gouveia Gove
Minister of Finance	Governor
	Bank of Mozambique

Attachments: Memorandum of Economic and Financial Policies
Updated table – of Technical Memorandum of Understanding

ATTACHMENT 1. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (MEFP)

December 7, 2012

1. This updated MEFP (i) describes recent developments and performance of the Government's economic program under the three-year Policy Support instrument (PSI) to date and (ii) elaborates on economic and structural policy intentions. It builds on the MEFPs underlying the initial PSI request of May 2010 and those for its four reviews, the last of which was completed in June 2012.

RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. Mozambique's economy remains remarkably robust, despite a deteriorating global economic environment.

- Reflecting the rapid start-up of coal production and exports, real GDP grew by 7.2 percent in the first half of 2012. The extractive industry was the fastest-growing sector, while the transport and communication sectors also performed strongly. This compensated for slower growth in agricultural production due to devastating crop diseases in oil palm and cashew plantations.

- After peaking at 16.6 percent at end-2010, twelve-month headline inflation continued to decelerate sharply reaching 1.5 percent in October 2012, the lowest rate in SADC. Inflationary expectations have been tamed, as core inflation (excluding food, transport and energy prices) declined from 8.4 percent at end-2010 to less than 1 percent in October 2012. This reflects the lagged effects of our determined monetary tightening in 2011, lower-than-expected prices of imported food, and stable administered prices.

- The external current account deficit widened in 2011. The data is very preliminary and is being revised to better capture high FDI and related imports, especially investment in the coal industry. The widening of the current account deficit reflects also the impact of lower aluminum prices, the biggest export product, which was partly offset by the start-up of coal exports and sustained traditional exports. There were lesser effects from increases in electricity import costs; technical problems which reduced electricity exports, and plant diseases which devastated cashew exports.

- Strong FDI and aid disbursements contributed to a stronger-than-projected international reserve position.

3. We largely met the objectives underlying our economic program:

- All quantitative targets for end-June 2012 were met except for the assessment criterion (AC) on net credit to the government and the indicative target on government revenue. The latter reflected a shortfall in customs revenue due to technical problems with the introduction of the single trade facilitation window. With expenditure implementation largely on track, this resulted in higher-than-programmed net credit to the government (NCG) by end-June.

- Program performance strengthened through end-September. Customs revenue has picked up since June and a windfall payment of capital gains taxes of about 1¼ percent of GDP

($176 million) on the sale of shares in a major gas project between private parties was registered in September. As a result, we have met all the end-September fiscal targets. All monetary targets through end-September have also been met, as the Bank of Mozambique (BM) maintained its commitment to its monetary program.

- The Government has taken up nonconcessional borrowing (NCB) for the rehabilitation of the Maputo airport and the construction of the Nacala airport ($147 million), and the construction of the ring road around Maputo ($300 million with a 34 percent grant element). In addition, in July 2012 we signed a loan of $682 million for a connecting road to the South African border (Maputo-Ponta d´Ouro) and a toll bridge across the Maputo Bay (Maputo-Katembe). This project will help decongest traffic in the Maputo area, develop the tourism potential of Southern Mozambique, and improve trade with South Africa. We also contracted a $250 million loan (34 percent grant element) in September 2012 for improvements in the quality of electricity supply in the Maputo area. Our NCB usage since 2009 under the PSI stands at $1,380 million as of end-September 2012, within the $1,500 million program ceiling.

- We made progress in implementing the program's structural benchmarks through October 2012: (i) in May 2012, the BM published its first quarterly monetary policy report, which is intended to enhance communications and explain the BM's policy decisions; (ii) in June 2012, the government completed the rollout of the electronic salary payment system (e-FOLHA) to all 170 provincial directorates; (iii) the new single tax payer database was developed by mid-year and we began implementation; (iv) the Ministry of Finance (MF) approved a time-bound action plan for IPSAS-compatible reporting in October 2012; and (v) the amendment to the Corporate Income Tax Law reflecting the equalization of the tax treatment of Treasury bills and bonds was submitted to Parliament in November with a two-month delay, still allowing it to be effective as of 2013.

IMPLEMENTATION OF THE POVERTY REDUCTION STRATEGY (PARP)

4. The Government is proceeding with the implementation of its 2011–14 PARP to accelerate poverty reduction through more inclusive growth. The PARP's three main pillars are:

- ***Enhancing production and productivity in agriculture***. Guided by our Agricultural Reform Strategy (PEDSA), we aim to reach an average growth of agricultural output by 7 percent per year, doubling production by 2020, mainly through an increase in productivity, but also through an expansion of the cultivated area. Productivity gains will be facilitated through the promotion of improved farming techniques to more than half million farmers in 2013 and by increasing extension services to 12 and 15 percent of agricultural producers by 2013 and 2014, respectively. On-going upgrades in irrigation schemes in the South (Chokwe district, Limpopo area) will further boost productivity. A new agricultural investment plan was approved by the Council of Ministers (CM) on December 4, 2012, and will be disseminated to donors and investors. The plan seeks to attract private investment to the tune of $3½ billion over the next five years, and to prioritize public investment in rural areas. It includes measures to strengthen producers' access to markets such as rehabilitation of district roads (feeder and non-classified roads), construction of grain silos, setting up an agricultural commodity exchange in 2013, and initiatives such as the Beira Agricultural Growth Corridor, which seeks to expand irrigation and provide financing to early-stage agro-businesses.

- ***Creating employment.*** We plan to create about 200,000 new jobs in the public and private sectors each year. We have continued our efforts to foster an environment that is more conducive to private sector activity. With support from the World Bank (WB) and the International Finance Corporation (IFC), we finalized an initial inventory of all licensing requirements in November 2012 and expect to streamline procedures for commercial activities and for industrial activities by end-March 2013. We have finalized a draft law to regulate credit registry bureaus, which is currently under public consultation (see ¶27). In late November Parliament approved a new competition law and delegated to government powers to rule on all bankruptcy matters. Our successor five-year Strategic Plan to Improve the Business Environment 2013–17 will be submitted to the CM by end-2012. We also aim to launch by end-June 2013 the first Labor Market Monitoring Group (Observatório do Mercado de Trabalho), which is intended to monitor developments in the labor market and the implementation of labor-related policies.

- ***Enhancing social and human development.*** The Government continues to improve access to, and the quality of, social services and infrastructure. We plan to reach the target of 69 health workers to 100,000 inhabitants in 2014 (from 66 in 2012) through recruitment and training, and will ensure that 80 percent of the children are vaccinated by end-2014. To achieve the target rate of schooling at age 6 in first grade of 80 percent in 2014, we will recruit 6,500 new teachers for primary education in 2013 and continue implementing programs that target the participation and retention of students in the right age. We expect to invest $333.2 million (Mt 10.5 billion) in 2013 to improve access to water, basic sanitation, electricity, housing, and urban transport services. With support from the ILO, UNICEF, the World Bank, and the IMF, we continue to enhancing our social protection systems (see ¶17).

MACROECONOMIC POLICIES

A. Economic Objectives

5. We expect Mozambique's medium-term outlook to remain positive reflecting our booming extractive industry, but the deteriorating global economic environment poses risks.

- Over the next five years the contribution of coal production and exports, the implementation of large infrastructure projects, including of liquefied natural gas plants, and healthy growth across other sectors are projected to keep economic growth at 7½percent per year, in line with our objectives.

- Absent any unforeseen external price shocks, we are confident to achieve our average inflation (CPI) objective of around 6 percent during the period.

- In the short run, the deteriorating external environment could lower economic growth owing to the moderation of external demand and add inflationary pressures in case of increases in international food or fuel prices.

- Nonetheless, the external current account deficit (before grants) is set to improve slightly this year and but is projected to increase to 31 percent of GDP in 2013 reflecting rising investment in the extractive industries and related imports, as well as increasing electricity imports. At end-2011 the reserve coverage of contemporaneous (projected) imports stood at

3.8 (3.3) months, or over 5 months excluding megaproject imports. Reserves are projected to increase in the medium term as investment in the coal sector winds down and coal exports increase.

B. Macroeconomic Policy Mix

6. **The government intends to maintain a prudent macroeconomic policy mix over the medium term.** Fiscal and monetary policies will be geared toward safeguarding macroeconomic stability and debt sustainability, with an emphasis on investment and social development to sustain high and inclusive economic growth. We are preparing to prudently manage future natural resource revenues to accommodate a temporary surge in public investment over the next few years, close the huge infrastructure gap, and support the PARP's social and human development objectives, including the expansion of social protection. While this stance will keep overall fiscal deficit above 6 percent of GDP for most of the period, the strong revenue effort and restraint in domestic current spending will limit the domestic primary deficit to around 2 percent of GDP. The continued support of development partners and moderate NCB will ensure that recourse to domestic bank financing will remain below 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 reserve money expansion slightly above nominal GDP growth.

7. **Our policy stance for 2013 will continue to support economic growth.** After our monetary tightening in 2011, our supportive policy stance in 2012 helped to sustain economic growth and enhance credit to the private sector, while benefitting from the absence of major inflationary pressures. We plan to continue our policy stance in 2013 to preserve the low inflation environment, while continuing to ensure strong public investment and facilitate credit provision to the private sector.

8. **The Government intends to implement its infrastructure investment plans with due regard to macroeconomic stability and debt sustainability.** Priority investments through mid-2013 require an increase in the NCB program ceiling from $1.5 billion to $1.6 billion. This has become necessary as over the course of lengthy negotiations some loans (totaling $550 million) slipped marginally under the 35 percent grant element requirement, but still continue to be on very favorable terms. Guided by our recently approved Medium-Term Debt Strategy (MTDS), we will reassess our borrowing needs over the medium term in light of projected natural resource revenues with a view towards slowing the pace of contracting new debt. We intend to proceed prudently and focus new borrowing on investments in transportation and energy infrastructure.

C. Monetary and Exchange Rate Policies

9. **Monetary policy will continue to support credit growth, while preserving our medium-term inflation objective.** Building on our successful disinflationary efforts in 2011, we remain committed to maintain inflation (CPI) around 6 percent over the medium term. We will aim for reserve money growth slightly above nominal GDP growth to support financial deepening and the provision of credit to the economy.

10. Enhancing the framework for monetary policy operations remains a priority. This entails the following specific measures:

- ***Monitoring government accounts***. The BM and the MF will continue to improve the timely exchange of information as envisaged in our 2011 Memorandum of Understanding.

- ***Developing the domestic repo market to help improve money market management and the liquidity of government securities.*** Since July 2012 the BM has allowed the repeated use of the same securities for repo transactions and made all treasury bills (BT) equally eligible for BM repo transactions. The planned modifications in the electronic platform (Meticalnet Module) of the Interbank Money Market (MMI) for the BM to accept as collateral for repo operations both BM-issued BTs and government bonds (OTs) issued by the stock exchange has been delayed to end-May 2013 pending an impact study on tax equalization that has just been concluded. With IMF TA support we have also assessed the impact of possible measures to equalize the tax treatment between collateralized and uncollateralized interbank market operations. We have submitted an amendment to the Corporate Income Tax Law that reflects such equalization measures in November 2012 (**structural benchmark**). Following IMF TA advice, we will also turn the standing deposit facility into a repo operation by end-May 2013 so as to shift market preference from uncollateralized to collateralized operations.

11. Progress in monetary policy formulation and implementation has been achieved, with support from IMF TA, to lay the foundations for an inflation-targeting (IT) framework in the medium to long term. In May 2012, the BM began to publish a quarterly monetary policy report (**structural benchmark**) to communicate monetary policy intentions in a transparent way. A second report was published in July and the third in October 2012. The BM will continue to improve data collection and analysis, inflation forecasting, forward-looking communication, short-term liquidity forecasting, and reflect this work in its publications.

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

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

D. Fiscal Policy

14. Fiscal policy will support the Government's quest for more inclusive growth under the PARP and continued macroeconomic stability. The Tax Authority will strive to achieve the ambitious tax revenue targets under the 2012 and 2013 budget law, helped by some tax enforcement measures and, in 2012, by windfall revenue from capital gains taxes that more than compensated for customs revenue shortfalls. We will maintain our spending program covering the large investment needs and social development objectives, to pursue the country's transformation agenda under the PARP. As a result, the overall fiscal deficit is expected to increase somewhat to 6½ percent of GDP in 2013, while the domestic primary balance will rise to 2¼ percent of GDP, and the NCG will be kept below ¾ percent of GDP. The 2013 budget law includes a revenue contingency.

15. The implementation of our wage policy will remain supportive of the recruitment needed for the PARP priority sectors and in line with fiscal sustainability. Our wage bill under the 2013 budget is projected to remain at about 10 percent of GDP, reflecting in part hiring in the priority sectors, including education and health. In line with our 2009 wage bill strategy, we remain vigilant of the need to ensure a fiscally sustainable wage bill and thus committed to decelerate the decompression of the salary scale and the pace of recruitment in non-priority areas and institutions. We will also continue to strengthen our control of the wage bill execution and complete the rollout of the electronic wage payment system (e-Folha) to all central government entities registered in the integrated database (e-CAF) by end-May 2013 and later on to all other entities (outside e-Folha).

16. Spending for priority sectors under the PARP will continue to rise. The Government aims to raise such spending from MT 73 billion in 2012 to MT 89 billion in 2013, or from 55 to 58 percent of expenditures (excluding net lending). We are aligning the composition of spending in the budget with the medium-term priorities of the PARP (see ¶18).

17. We are aware of the substantial direct and indirect cost of across-the-board energy subsidies and intend to reduce these gradually in light of their social and political sensitivity, while enhancing social protection programs to shelter the poorest strata of the population.

- ***Subsidies on petroleum products***. In October 2012, the Government completed the payments to importers of the fuel subsidies owed for 2011. The increase in diesel prices paid by megaprojects and public works contractors (since November 2010) and developments in import prices in 2012 have reduced the need for compensation payments to fuel importers (payable in 2013). For the time being, we continue the payment of separate subsidies to private minibus operators as they provide the bulk of transport services to the public.

- ***Electricity tariffs.*** Tariffs were last adjusted two years ago, but the financial situation of Mozambique's public electricity company (EDM) remains difficult. The government recognizes the need to ensure its sustainability both to continue the electrification of the country and to make new investments including mobilization of required funding. The Government is negotiating a new performance contract with EDM, and is also working on partial debt forgiveness of its claims on this utility. For its part, EDM is preparing a tariff study with a view to resuming gradual tariff adjustments, while preserving some cross-subsidization for low-income households.

- ***Enhancing social protection.*** The Government will continue to finance the expansion of the basic social protection programs approved by the CM in September 2011, including cash transfers and public works programs. Government allocations to social protection under the

2013 budget have risen to about Mt 1.7 billion (0.3 percent of GDP). We will continue to increase budget allocations towards 0.8 percent of GDP to reach some 900,000 beneficiaries and to raise the level of cash transfers towards the poverty line over the next few years. Pilot programs for public works are being implemented in 2 municipalities (Maputo and Manjakaze) since July 2012 and in 10 districts since August 2012 reaching to about 9,600 households. The Ministry for Women and Social Action is strengthening its targeting procedures, payments and monitoring systems for the effective delivery of cash transfers and the broader launch of public works programs with WB assistance in mid-2013. The Government is working on a proposal for the establishment of a common fund for social protection for consultation with development partners during 2013.

STRUCTURAL REFORMS

A. Public Financial Management and Reporting

18. We are committed to improving the coverage, classification, reporting, monitoring, and control of budget procedures. The following measures are key:

- ***Expanding budget system coverage and integration.*** At end-2011, nearly half of the 983 existing spending units (UGBs) were operating directly in the e-SISTAFE system, corresponding to 84 percent of the government budget for that year. The rollout of the e-SISTAFE will be completed by 2014, expanding the system by 70 units per year. The Budget Action Plan 2012–2014 included an IT plan consistent with the "2011–25 Public Finance Strategy."

- ***Enhancing the quality of PFM processes.*** We will seek to introduce real-time recording of the commitment, verification, and payment phases of the expenditure process. Following IMF TA recommendations, we will separately approve quotas/ceilings for commitments and payments by execution units (UGEs), and align the IT system to allow recording of these phases separately in e-SISTAFE (currently all phases are recorded at the time of payment). We will implement these changes starting with the entity handling the domestic debt by June 2013, and expect to roll out real-time recording of the expenditure chain to all UGEs by January 2014, with the aim of ultimately covering the provincial and district levels.

- ***Migrating to IPSAS-compatible reporting.*** In October 2012, the Government has approved an action plan to gradually adjust its accounting system to international public accounting standards (IPSAS). This includes a public consultation on the proposed changes by end-August 2013, parliamentary approval by end-2013, and subsequently preparation of all accounting systems to generate directly the budget execution report consistent with IPSAS.

- ***Improving budget classification***. We are working on the mapping of priority spending according to the PARP pillars through a more detailed budget classification by spending programs, and expect this to be completed by mid-2013 for the 2014 budget. As an intermediate step, for 2013 we will introduce the economic classification of expenditure and a more detailed classification by expenditure units in our accounting system.

B. Investment Planning and Debt Management

19. The Government will give priority to modernizing its debt management and investment planning procedures. The following areas are priority.

- ***Strengthening investment planning.*** Taking into account comments by the IMF and the WB, we have prepared a revised Integrated Investment Program (IIP), which lays our strategic vision for investment priorities, our selection procedures, and our current assessment of a list of top priority projects. We will submit the IIP to the CM by end-2012.

- ***Strengthening project selection tools.*** With TA from the WB a draft Project Preparation Manual was prepared in June 2012; it is now being revised and simplified. It includes a project evaluation template to better focus the information provided from line ministries to the Project Coordination Committee (PCC). We aim to have the manual and template approved by end-2012, and to be used systematically by the PCC from 2013 on.

- ***Enhancing debt management.*** The CM approved our enhanced MTDS in September 2012. We will refine this strategy to reflect changing circumstances and further analysis. The Minister of Finance approved in September 2012 an Operating Procedures Manual intended to improve data quality and the management of the country's debt service, and to ensure a high-quality analysis of borrowing proposals. We expect to finalize our 3rd DSA by end-2012. Since the last quarter of 2011, we have published quarterly public debt reports on the evolution of public and publicly-guaranteed debt, the contracting of loans, and starting in December 2012, they will provide cost and risk indicators and links to the budget and the MTDS scenarios.

- ***Completing the first Annual Domestic Borrowing Plan for 2013.*** Building on the MTDS, we are drawing up a first annual domestic borrowing plan for 2013 to be published by end-January 2013 **(structural benchmark)**. 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 cash flow and net annual financing needs.

- ***Investment and Debt Advisory Committees.*** The Debt Management Committee (DMC) and the PCC have continued to meet regularly. The PCC has provided guidance on the drafting of IIP and all project selection documents, and has issued summary reports to the Minister of Planning and Development (MPD) and the Investment Council. The authorities are strengthening their technical expertise for project analysis, and will assess the social and economic impact of the projects presented to the CM against the backdrop of the IIP, DSA, MTDS, and Annual Borrowing Plan. The DMC has also provided guidance on the improvement of the MTDS, the drafting of the DSA, and other debt management documents. The Ministry of Planning and Development will publish short summary evaluations of the projects and related financing after their approval by the CM.

C. Tax Policy and Administration

20. We will sustain our revenue mobilization efforts while aiming to make the tax system more business-friendly. The focus will be on refinements in tax policy and the adoption of modern tax administration practices.

- ***Ensuring prompt refunds of VAT on inputs.*** We are concerned about the accumulation of pending VAT refunds (both arrears and pending refund requests). Thus we commit to prioritize the use of revenue collection in 2012 that exceeds the budget targets to reduce the stock of pending VAT refunds. While the 2013 budget allocation for VAT refunds remains constrained, we will process new VAT refund requests expeditiously. We will request technical assistance and prepare a study to optimize the implementation of the VAT by end-May 2013, and we intend to submit to Parliament, if needed, an amendment to the VAT code to record VAT revenue on a net rather than a gross basis by end-July 2013.

- ***Implementing the single taxpayer database.*** We expect to roll out the single taxpayer database to all three large taxpayers units of the country (Maputo, Beira, and Nampula) by end-2012, which cover 90 percent of large taxpayers. We expect that by June-2013, some 20 percent of individual taxpayers and all large taxpayers will be registered in the database, and 80 percent of all taxpayers will be registered by end-2013.

- ***Enhancing tax payment efficiency.*** We are developing a new electronic tax system (e-tax) to foster tax payments through banks. We will prepare implementation plans for VAT and the simplified tax for small taxpayers (ISPC) by end-2012, and develop the IT functionalities to pilot e-tax for these two taxes by September 2013. E-tax for corporate and personal income taxes (IRPC and IRPS) are expected to be introduced subsequently by July 2014.

- ***Strengthening the large taxpayers units (UGCs and DCAT).*** Modern management procedures will continue to be reinforced through assigning liaison agents to the large taxpayers units by March-2013 and training staff to build expertise on natural resources and strategic sectors over time. These agents are expected to enable targeted audits and help improve revenue forecasting; they will have access to a dedicated information system, which will run on a pilot in Maputo by end-2012, and be fully operational in all LTP units by end-2013. Collections by the LTP units are projected to rise from 52 percent of total collections in 2011, to 58 percent in 2012, 63 percent in 2013, and 70 percent in 2014.

- ***Streamlining tax policy***. In consultation with private sector representatives, the Government will (i) assess the possibility to eliminate the simplified tax regimes (for the VAT, and personal and corporate income taxes) and just keep the small taxpayer simplified tax (ISPC) by end-2013, and (ii) review the ISPC, including the ad valorem rate, the annual flat rate, and the threshold for the ad valorem taxation. We hope that these measures will improve transparency, free up tax administration resources to focus on larger taxpayers, and significantly reduce fraud.

D. Improving Natural Resource Management

21. Mozambique has become fully EITI compliant. Based on the actions we took with regards to the observance and implementation of previous recommendations, in July 2012 the EITI Board granted us a waiver from the requirement to pass a second full validation process, and we submitted to the EITI Secretariat our second reconciliation report of March 2012. On October 26, 2012, the EITI Secretariat declared Mozambique fully compliant with EITI requirements. We will continue our efforts to implement a best-practice framework to improve the transparency of the natural resource sector.

22. Enhancing the mining and hydrocarbon fiscal regime is a priority.

- ***Mining and petroleum legislation.*** The draft of revisions to the mining and petroleum laws have been submitted to the CM in September 2012, and are expected to be submitted to the parliament in early 2013. The revisions to the petroleum law provide a regulatory framework for LNG.

- ***Enhancing the mining and hydrocarbon fiscal regime***. With significant TA support from the IMF under the Topical Trust Fund for Managing Natural Resources Wealth (TTF-MNRW), we are reviewing our tax legislation in this area to ensure that an appropriate share of resource revenues is captured for Mozambique under new natural resource projects while remaining an attractive investment destination. We aim to bring together, as far as possible, all key fiscal terms for future mining and petroleum projects and clarify existing rules in new mining and petroleum fiscal laws. We have finalized draft laws, which we intend to discuss with local stakeholders by end-2012. We plan to submit the revised legislation to Parliament as soon as possible.

- ***Mitigating transfer pricing***. We are committed to implement modern procedures such as rules on advance pricing agreements and dispute resolution, applying international price benchmarks, and stipulating the methods to be applied when adjusting taxable income. To this effect, we will prepare an action plan for this long-term process once the above legislation has been approved by the parliament.

23. We will gradually strengthen our technical and institutional capacity to manage natural resources, with support from our partners. We intend to make best use of our prospective resource revenue stream over the medium term to foster inclusive growth and preserve macroeconomic stability. To this effect, with TA under the TTF-MNRW, we will reinforce our fiscal framework and prepare for the new key macro-fiscal challenges ahead, including managing revenue volatility, ensuring long-term sustainability, and addressing the exhaustibility of the resources. We intend to improve the quality of revenue and expenditure projections and of the fiscal policy analysis in budget and other policy documents. We will also seek IMF TA support under the TTF-MNRW to improve our statistics on natural resources during 2013.

E. Management of Public Enterprises

24. In order to update the legal framework for public enterprises to the government's economic priorities, a new Public Enterprise Law was approved by the Parliament in February 2012 and its regulation is under elaboration. The new law aims to promote, improve, consolidate and monitor in a continuous manner the operations of public companies, allowing the efficient use of resources, revenue collection through dividends and minimize fiscal risks. The Ministry of Finance supervises financial operations of public enterprises and plans to prepare an annual report on their financial results.

F. Good Governance Framework

25. The Government is committed to implement the new anti-corruption legislation. Parliament has approved three of the five laws proposed by Government as part of the anti-corruption package, namely (i) the Law of Ethics for Public Officials; (ii) the Witness Protection

Law; and (iii) the amendments to the Organic Law of the Prosecution Service and to the Organic Law of the Judiciary. Parliamentary approval of the remaining two laws, i. e. (i) the revised and consolidated Criminal Code and (ii) the revised Criminal Procedure Code, is taking longer than expected given its complexity and the need for in depth discussions. Nonetheless, we will prepare a time-bound and costed action plan, including all the institutional reforms required to fully implement the anti-corruption legislation, by March 2013.

FINANCIAL SECTOR POLICIES

A. Financial Sector Surveillance

26. The BM continues to enhance its financial sector surveillance in a difficult global environment. It remains focused on:

- ***Strengthening supervision***. With IMF TA guidance, BM is improving its capacity to perform stress tests and a designated team will use them as a monthly supervisory process as of early 2013. In this context, the regulation pertaining to nonperforming loans accounting is being revised so as to make it internationally comparable. The authorities are also determined to restructure the Credit Records Center which is an essential tool to monitor banks' credit risk and conduct meaningful stress tests. Building on stress-testing results, the BM will also revise before end-June 2013 its regulation on concentration limits, including banks' placements abroad, and modify reporting requirements accordingly. We will seek IMF expertise prior to the finalization of these regulatory changes. Further steps to enhance risk-based banking supervision will also be taken through the migration to Basel II which should be concluded in 2014. The authorities also aim at finalizing their full compliance with the Basel Core Principles.

- ***Completing a financial sector contingency plan.*** The authorities are adjusting their draft plan by incorporating some of the recommendations from the March 2012 IMF TA mission, especially with respect to the modules on emergency liquidity assistance and bank resolution. We will seek IMF expertise prior to the finalization of these regulations and expect to have the plan operational by end-March 2013 (**structural benchmark**).

- ***Making Deposit Insurance Fund (DIF) operational.*** We have taken important steps to make the DIF an integral component of our framework to safeguard financial sector stability. We have secured funding from KfW to contribute to the DIF's initial functioning and have benefited from KfW recommendations on some DIF-related regulatory and operational issues. The MF will appoint the three Executive Board members of the DIF by end-2012, and we expect the DIF to become fully operational by end-April 2013.

B. Financial Sector Development

27. We will step up our efforts to improve financial inclusion as part of Mozambique's Financial Sector Development Strategy (FSDS) for 2012-21. After a prolonged but comprehensive review process, a draft FSDS will be submitted to the Council of Ministers for approval by end-2012 (**structural benchmark**). With support from the WB and other partners, we will hold a workshop shortly thereafter to launch the strategy's dissemination and secure financing for its implementation. One of the objectives of the FSDS is to increase access to finance by eliminating economy-wide structural impediments to financial intermediation that limit the number of creditworthy clients and increase the costs and risks of providing credit and financial services. Key priorities in these areas include:

- ***Establishing credit registry bureaus*** (CRB). The BM has drafted a law for the creation of private CRBs to compile information on current/past borrowers; this is intended to lower information cost and improve access to bank financing. The draft has undergone a public consultation process and the BM submitted to the MF in November 2012. We expect to submit it to the CM by end-March 2013.

- ***Promoting banking competition***. We will foster competition in the banking sector by (i) introducing laws and regulations that address anti-competitive practices, (ii) fostering transparent pricing for financial services to allow consumers to compare costs, and (iii) introducing low-cost online access to credit files. A consumer protection framework will be designed and outreach will promote financial awareness so as to allow consumers (including SMEs) to make better use of available financial services; to encourage competition and innovation amongst financial services providers; and to provide consumers with reasonable protections against unfair business practices, while ensuring financial institutions' soundness.

C. Fighting Money Laundering and Terrorism Financing

28. The AML/CFT framework is being improved. The MF 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 submitted to Parliament in April 2012. The authorities consider the passage of this comprehensive package of legislation and related regulations as a high priority. We will need to assess the adequacy of human and financial resources available to the various departments and agencies that have a role in the AML/CFT regime, and will seek further TA from the IMF and other providers to assist with the drafting of legislation and introduction of specific institutional reforms needed for full implementation of the revised FATF Standard.

D. Payment System

29. The BM will further enhance financial stability and promote market development through continuing national payment system reforms. This will mainly be achieved through refinements in BM oversight practices and development of retail payment systems.

- ***Enhancing BM oversight practices***. Based on IMF TA, the BM has approved a payment systems oversight policy strategy in March 2012 and will finalize and implement an oversight function by end-June 2013. Key actions would include (i) the implementation of an oversight internal manual, and (ii) the creation and implementation of an oversight unit. The revised regulation of the electronic clearing system (CEL) for checks will also be approved and published by end-June 2013.

- ***Further developing the retail payments network shared by BM and commercial banks***. Following the establishment of the retail payments processing company SIMO in June 2011, a pilot phase of card network interoperability is currently on-going. We expect the platform to cover the major banks and handle domestic retail transactions and other interbank services by end-June 2013.

PROGRAM MONITORING

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

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

	2012									2013			
	End-June Assessment Criteria			Status	End-Sept Indicative Target		Status	End-Dec Assessment Criteria		End-March Indicative Target	End-June	End-Sept	End-Dec
	Prog.	Adj.	Act.		Prog.	Act.		Prog.	Prop.	Prop.	Proj.	Proj.	Proj.
Assessment Criteria for end-June/December													
Net credit to the government (cumulative ceiling)	-2,645	112	1,900	NM	-745	-1,248	M	2,500	52	517	-3,432	-5,184	2,763
Stock of reserve money (ceiling)	36,923	36,580	33,350	M	37,031	35,975	M	39,985	39,264	36,495	40,187	43,207	46,490
Stock of net international reserves of the BM (floor, US$ millions)	2,207	2,107	2,282	M	2,323	2,693	M	2,438	2,530	2,544	2,595	2,681	2,685
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)	1,500	1,500	1,129	M	1,500	1,379	M	1,500	1,600	1,600	1,600	...	...
Stock of short-term external public debt outstanding (ceiling)	0	0	0	M	0	0	M	0	0	0	0	0	0
External payments arrears (ceiling, US$ millions)	0	0	0	M	0	0	M	0	0	0	0	0	0
Indicative targets													
Government revenue (cumulative floor)	45,256	45,256	43,567	NM	69,687	73,619	M	94,568	99,043	23,656	53,224	81,989	111,762
Priority spending (cumulative floor)	24,500	24,500	25,136	M	35,934	...	...	72,563	72,563	10,797	28,792	49,486	89,975

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 Ministry of Finance will submit to the Council of Ministers the draft Financial Sector Development Strategy (FSDS), as described in ¶26 of this MEFP.	End-December 2012
The Bank of Mozambique will finalize the draft financial sector contingency plan, as described in ¶25 of this MEFP.	End-March 2013
The Government will adopt an Annual Borrowing Plan for 2013, as described in ¶20 of the MEFP dated May 10, 2012.	End-January 2013

ATTACHMENT 2: TECHNICAL MEMORANDUM OF UNDERSTANDING

December 7, 2012

The Technical Memorandum of Understanding (TMU) of May 10, 2012 remains valid with the following two modifications.

1. At the end of paragraph 17 on net credit to government, a new bullet is added:

- The ceiling for end-December 2012 on NCG will be adjusted upward (by up to Mt1.5 billion) for an increase in VAT reimbursement that exceeds the budget allocation (of Mt 3.5 billion) and is reflected in a reduction (by end-December 2012) in the stock of pending VAT reimbursement below its level of MT1,009 million on 10/29/2012.

2. Table 1 on net foreign assistance to government is updated.

TMU Table 1. Mozambique: Net Foreign Assistance, 2012-13

	2012				2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign program assistance (US$ mn)	90	114	126	-7	159	102	156	-4
Gross foreign program assistance	118	141	153	21	187	129	184	23
Program grants	118	32	123	21	137	79	44	23
Program loans	0	109	30	0	50	50	140	0
External debt service	27	27	27	27	28	28	28	28
Cumulative net foreign program assistance in US dollars	90	204	330	324	159	261	418	413
Gross foreign program assistance	118	259	412	433	187	316	500	524
External debt service	27	54	82	109	28	55	83	110
Net foreign program assistance (MT mn)	2,444	3,138	3,591	-224	4,581	2,883	4,649	-331
Gross foreign program assistance	3,221	3,946	4,398	610	5,581	3,931	5,677	730
Program grants	3,221	900	3,532	610	4,088	2,413	1,347	730
Program loans	0	3,046	866	0	1,492	1,518	4,330	0
External debt service	777	808	807	834	1,000	1,048	1,029	1,061
Cumulative Net foreign program assistance in MTN millions	2,444	5,582	9,172	8,949	4,581	7,463	12,112	11,781
Gross foreign program assistance	3,221	7,167	11,565	12,175	5,581	9,512	15,189	15,919
External debt service	777	1,585	2,392	3,226	1,000	2,049	3,077	4,138
Stock of outstanding currency (MTm)	18,748	21,604	23,079	27,667	23,552	27,188	28,991	32,393
Stock of outstanding currency (MTm), Prog. Def	18,634	20,763	22,430	26,743	23,408	26,130	28,176	31,312

Source: Mozambican authorities and IMF staff estimates.

ANNEX 1: Balance of Payments—Data Revisions and Updated Projections

This annex details in its four sections the four major changes to Mozambique's balance of payments undertaken during this program review: (i) substantial revisions to 2010–11 historical data, (ii) refinements to coal sector projections, (iii) updates to public sector borrowing and aid flows, and (iv) incorporation of ongoing investment in the emerging liquefied natural gas (LNG) sector, affecting both historical data and projections. The description in the first three sections of this annex refers to current account figures excluding the LNG sector investment (as in Annex Table A1) in order to provide comparability to previous projections. These revisions could be easily lost otherwise in light of the sheer size of LNG-related activities (Annex Figure A1).

(i) Revisions to 2010-11 historical data

Since the 4th review of the program, the 2011 current account deficit (after grants) has been revised upwards.

- For 2011, from $1.7 billion (13.1 percent of GDP) to $2.4 billion (19.4 percent). This was caused by $1.2 billion upward revisions in imports, which outstripped $340 million upward revisions in exports. In the financial account, this change was reflected mainly in higher errors and omissions.[1]

- These trade data revisions for 2011 did not stem from megaprojects (MPs) directly, although the doubling in capital goods imports in the traditional economy is likely related to subcontracting by MPs. Also, electricity imports doubled on account of domestic demand having come to outstrip the domestic output quota of the Cahora Bassa hydroelectric dam at peak times—a trend projected to continue over the next years until new generation capacity can be brought on stream.[2] Automobile and cereal imports also doubled, with the latter partly driven by the start of a flour mill, and there are other small but rapidly expanding exports such as wood and bananas.

(ii) Refinements to coal sector projections

Plans have become more concrete for the development of the coal sector by addressing the key transport constraints by upgrading the Sena line and constructing a new Nacala railway line.

Sena line. The upgrade of this line from Tete to the Beira port is expected to be completed by year-end with related FDI. The upgrade will double coal export capacity to 6 million tons starting

[1] 2011 data remain preliminary and are being refined by the Bank of Mozambique.

[2] Electricity import value is currently projected to triple to roughly $1 billion by 2017 against the backdrop that the planned Mphanda Nkuwa hydroelectric dam and north-south transmission backbone are expected to come into service only thereafter. The authorities are currently in the process of identifying investors for these projects, requiring investments of approximately $2-2¼ billion and $1¾ billion, respectively.

in 2013. Given softening world prices, however, the value of coal exports is expected to increase by only 2 percentage points to 6 percent of GDP in 2013.

Nacala line. One of the major mine operators is set to commence construction in 2013 of the east-west Nacala corridor, including a railway (partly through Malawi) and a new coal port, with first exports expected in mid-2016. Most of the corresponding $2.8 billion direct investment is expected to take place by then.[3] Upon opening, the line is expected to boost coal export capacity by 11 million tons per year, rising to 18 million per year as further upgrades are finalized during 2016–18. In addition, investment in expansion of coal mines worth $2 billion is planned, mainly until 2016, and construction of a $0.5-1 billion coal-fired power station. Together these investments are expected to trigger FDI inflows of $1–1¼ billion per year during 2013–16, most of which will be reflected in higher imports.[4] This would keep the current account deficit in the 18–19 percent of GDP range during 2013–15. A reversal is expected thereafter with the start of the Nacala corridor operations.[5] By 2017, coal exports could make up 11½–12 percent of GDP under current price projections.

Risks. There are significant risks and uncertainties around these projections. The Nacala corridor development plans require government approvals, are sensitive to world coal prices, and could be scaled up or down to a certain extent. There is some upside risk for investment in an additional rail line by the second major operator of coal mines. This prospective investment, which is not incorporated in the current projection, may be realized if agreement on another transport corridor can be reached and world coal prices develop favorably.

(iii) Updates to public sector borrowing and aid inflow projections

Loan flows. While public sector net foreign borrowing in 2012 will likely be slower than previously projected, it is expected to exceed previous projections thereafter--by about $300 million in 2014, $200 million in 2015, and $140 million in 2016. This reflects expected disbursements for large infrastructure projects from recently contracted loans. In addition, a full pipeline of loans currently in or nearing their final negotiation stages is taken into account. Loan contraction is expected to slow significantly thereafter.[6] These new loan contractions also imply that public external debt amortization is expected to significantly increase from less than $50 million in 2011 to over $250 million by 2017.

Aid developments. Gross aid inflows are expected to be around $1,350 million in 2012, $200 million less than in 2011 on account of lower grants. Going forward, these flows are expected to recover to the $1.5 billion range during 2013–16, largely because a significant part of the above-mentioned loan contraction is expected to come on concessional terms. Regarding

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[3] There would also be an additional $1.2 billion investment in the Malawi portion of the rail corridor.

[4] On account of these investments, there has also been import of foreign labor, with worker's remittances outflows having jumped in the recent past and expected to double to $175 million by 2017.

[5] The magnitude of this reversal is cushioned somewhat by the assumption that starting in 2016, these mining companies would repatriate a large share of their profits as dividends.

[6] Net nonfinancial private sector borrowing is expected to gradually turn positive during the projection period, in line with 2012 developments and as loans for past investments come to be fully repaid (e.g. those for the 2002 Mozal aluminum smelter expansion).

grants, donors' commitments indicate a stabilization in 2013, but thereafter the projections assume a gradual decline in nominal terms, as prospects of natural resource revenues become more tangible.

(iv) Incorporating the emerging LNG sector

Exploration. Significant foreign direct investments in the exploration of natural gas in Mozambique started in 2010.[7] The Bank of Mozambique is currently working on fully integrating information on this sector into their balance of payments statistics. In the interim, staff added information obtained from LNG operators to the existing historical BOP data to avoid a structural break relative to the projections. This information indicates that FDI in the sector was $500 million in 2010 and $800 million in 2011, and reflected imports of specialized equipment and expertise, and this assumption is maintained in the projections. Incorporating the LNG sector increases the current account deficit in both 2010 and 2011 by roughly 6 percent of GDP (Table 5) vis-à-vis its counterpart excluding LNG (Annex Table A1). FDI-financed exploration activity is currently at its peak and expected to reach 8½ percent of GDP in both 2012 and 2013. Exploration activity is projected to be completed in 2013.

LNG plant timeline. In October, preliminary agreement was reached on the future site of LNG liquefaction that is needed to process natural gas for export. With numerous issues and authorizations still to be resolved, staff currently project that construction of an LNG plant could start in 2014, commencing with site preparation and construction of initial port infrastructure, and conclude in 2019. As uncertainty remains high regarding plant size, the projection assumes a moderate-size plant consisting of four units (or "trains").[8] Including the site preparation and other infrastructure, this is assumed to cost $24 billion. The projection assumes that $4 billion will be invested during each year between 2014 and 2019, with all contents assumed to be imported. This would boost the current account deficit beyond 40 percent of GDP in the initial years.

LNG plant financing. The financing of LNG production would likely be undertaken by the private sector and be debt-based, through a special purpose vehicle (SPV) raising syndicated loans and tapping international financial markets. Disbursements from the SPV during 2015–19 would exceed $4 billion annually as interest on previous disbursements will have to be rolled into the financing until production commences in 2020. Assuming a 10 percent interest rate, this results by end-2019 in an outstanding SPV debt stock of $30.8 billion (105 percent of 2019 projected GDP), which is assumed to be repaid during 2020–29 in ten equal installments. These payments would be underpinned by LNG production of 20 million tons per year, with domestic value added worth approximately $9 billion (27 percent of projected 2020 non-LNG GDP) under current price assumptions.

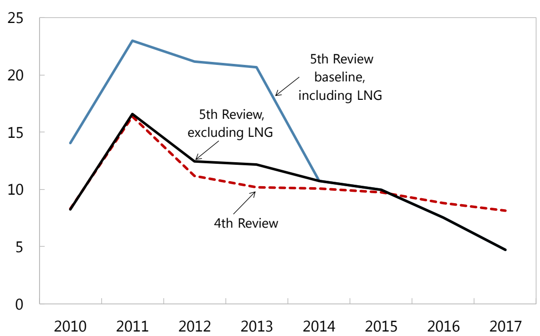
[7] Exploration has been ongoing since 2007, but prior to 2010 was limited to initial seismic studies etc.

[8] According to information obtained by the mission, two trains would be the absolute minimum to make the construction of the other necessary infrastructure (including drilling platforms and underwater pipelines) economically viable. On the other hand, gas reserves are large enough to build well in excess of ten trains, with demand for LNG being the main constraint.

Annex Figure A1. Mozambique: Evolution of BOP historical data and projections (Percent of GDP)

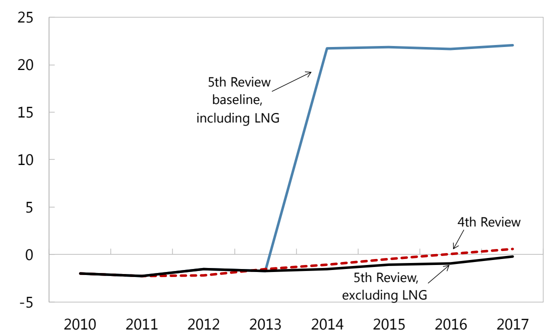
FDI continues to be driven by coal sector investments and is receiving a boost until 2013 by natural gas exploration.

Net Foreign Direct Investment



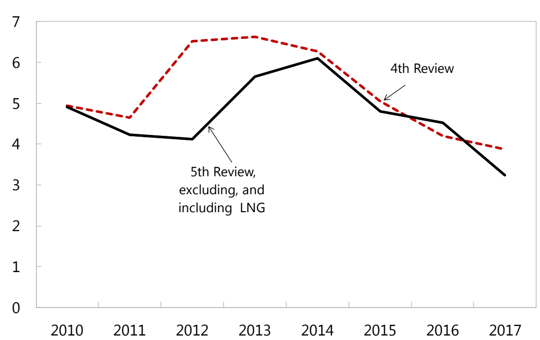
Starting in 2014, private sector debt financing of the LNG plant will drive the financial account.

Private Sector Borrowing



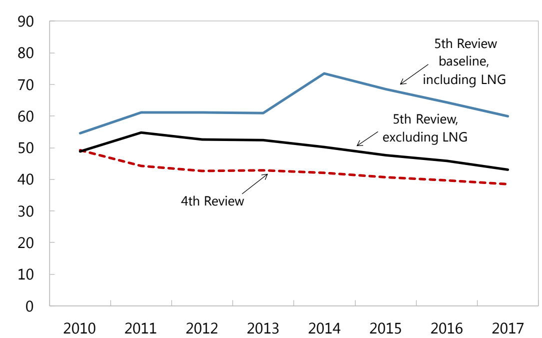
In addition, public sector loan contraction for infrastructure will lead to increased capital inflows.

Public Sector Borrowing



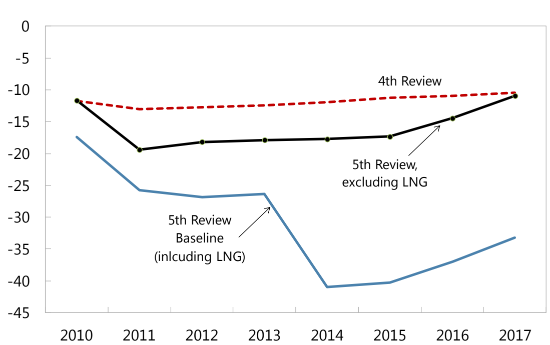
These investments are set to boost capital goods imports, which have also experienced historical data revisions.

Imports of Goods and Services



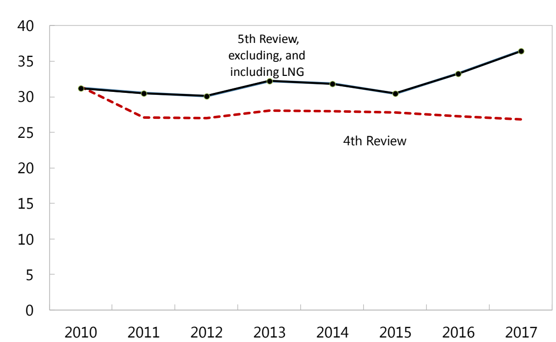
As a result, the current account balance deteriorated and will expand further with LNG plant construction, …

External Current Account Balance



… although exports' upwards revision partly compensated, and the Nacala rail should provide a boost starting 2016.

Exports of Goods and Services



Sources: Mozambican authorities and IMF staff estimates and projections.

Annex Table A1. Mozambique: Balance of Payments, excluding LNG sector, 2010–17

(Millions of U.S. dollars, unless otherwise specified)

	2010	2011	2012		2013	2014	2015	2016	2017
	Act.	Est.	CR 12/148	Proj.	Projections				
Current account balance	-1,113	-2,438	-1,803	-2,651	-2,816	-3,046	-3,329	-3,098	-2,609
Trade balance for goods	-1,179	-2,249	-1,344	-1,867	-1,719	-1,644	-1,686	-859	550
Of which: Megaprojects	768	468	817	632	1,093	1,275	1,324	2,367	3,908
Exports, f.o.b.	2,333	3,118	3,116	3,644	4,229	4,539	4,811	5,968	7,414
Of which: Megaproject exports	1,668	2,015	2,325	2,328	2,794	2,946	3,025	3,945	5,110
Imports, f.o.b.	-3,512	-5,368	-4,460	-5,511	-5,948	-6,183	-6,497	-6,827	-6,864
Of which: Megaproject imports	-900	-1,547	-1,508	-1,696	-1,701	-1,671	-1,701	-1,577	-1,202
Trade balance for services	-506	-794	-895	-1,405	-1,470	-1,514	-1,598	-1,819	-2,144
Income balance	-85	-190	-239	-108	-94	-284	-381	-721	-1,285
Of which: Dividend payments by megaprojects	0	-157	-254	-10	-21	-187	-254	-555	-1,069
Current transfers balance	657	795	675	729	467	397	337	302	270
Of which: External grants	605	785	661	634	573	538	503	468	435
Capital and financial account balance	1,113	2,211	2,004	2,858	2,971	3,320	3,590	3,473	3,099
Capital account balance	346	379	422	401	434	432	433	436	443
Financial account balance	768	1,832	1,582	2,457	2,538	2,887	3,157	3,037	2,656
Net foreign direct investment	790	2,090	1,590	1,817	1,924	1,840	1,912	1,616	1,122
Net foreign borrowing by the general government	468	531	926	603	892	1,047	923	968	774
Net foreign borrowing by the nonfinancial private sector	-348	-590	-671	-173	-384	-100	228	364	678
Other [1]	-142	-199	-261	210	105	101	95	88	81
Net errors and omissions	58	551	0	39	0	0	0	0	0
Overall balance	58	323	200	246	155	274	262	375	490
External financing	-58	-323	-200	-246	-155	-274	-262	-375	-490
Reserve assets [1]	-87	-321	-198	-242	-152	-271	-227	-340	-455
Net use of credit	18	-2	-2	-4	-3	-3	-35	-36	-35
Of which: Net use of Fund credit	20	-2	-2	-2	-3	-3	-35	-36	-35
Exceptional financing	10	0	0	0	0	0	0	0	0
Memorandum items:									
Effective exchange rate indexes (percent change)									
Nominal effective exchange rate	-22.4	12.4	…	…	…	…	…	…	…
Real effective exchange rate	-15.1	19.7	…	…	…	…	…	…	…
Terms of trade index (percent change)	10.4	2.4	13.3	-9.9	-2.7	1.0	0.6	0.7	0.3
International aluminum price	30.2	10.5	-6.4	-17.2	-0.5	4.9	4.6	4.1	3.5
International food price index	11.5	19.7	-7.5	-1.1	-2.0	-6.6	-4.9	-1.5	-0.9
International fuel price index	26.0	31.5	9.2	1.5	-1.5	-3.5	-3.6	-3.2	-3.5
International coal price index	…	23.2	-12.3	-22.8	-21.5	0.1	-2.0	0.0	0.0
Current account balance (percent of GDP)	-11.7	-19.4	-12.7	-18.2	-17.9	-17.7	-17.3	-14.5	-10.9
Excluding external grants	-18.5	-25.7	-17.4	-23.2	-21.5	-20.9	-20.0	-16.6	-12.7
Gross aid inflows (millions of U.S. dollars)	1,443	1,556	1,606	1,351	1,477	1,527	1,468	1,417	1,311
Gross aid inflows (percent of GDP)	15.1	12.4	11.3	9.3	9.4	8.9	7.6	6.6	5.5
Of which: To central government	13.5	11.4	10.8	8.8	9.1	8.6	7.4	6.4	5.4
Budget support	4.8	3.6	3.3	3.0	3.3	2.9	2.4	2.0	1.7
Nonbudget support	8.8	7.8	7.6	5.9	5.8	5.8	5.0	4.4	3.7
Project support	8.0	7.4	6.4	5.5	5.6	5.6	4.9	4.3	3.6
Onlending	0.7	0.5	1.1	0.4	0.2	0.2	0.1	0.1	0.1
Net foreign assets	1,745	2,082	2,285	2,324	2,479	2,753	3,015	3,390	3,880
Net international reserves [1]	1,908	2,239	2,438	2,530	2,685	2,959	3,220	3,595	4,085
Gross international reserves [1]	2,099	2,428	2,627	2,723	2,875	3,145	3,372	3,712	4,166
Months of projected imports of goods and nonfactor services	3.7	3.8	4.7	4.0	4.0	4.1	4.1	4.3	4.6
Months of current imports of goods and nonfactor services	5.4	4.2	5.2	4.3	4.2	4.4	4.4	4.5	4.9
Months of projected G&S imports (excl. megaproject imports)	4.8	5.0	…	5.1	5.1	5.2	5.2	5.3	5.4
Months of current G&S imports (excl. megaproject imports)	6.7	5.5	…	5.6	5.4	5.6	5.6	5.7	5.9

Sources: Data from Government of Mozambique and projections by IMF staff.

[1] Includes net portfolio investment and other investment assets.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 12/506
FOR IMMEDIATE RELEASE
December 21, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fifth Review Under the Policy Support Instrument for Mozambique

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review under the three-year Policy Support Instrument (PSI) for the Republic of Mozambique.[1] The Board's decision was taken on a lapse of time basis.[2]

Despite the difficult global environment, Mozambique's economic performance in 2012 has been remarkable, building on a track record of strong economic policies that effectively supported growth while bringing down inflation and strengthening international reserves. Real GDP growth for 2012 is set to reach 7.5 percent, benefiting from a robust performance in the services sector and a stronger-than-expected contribution from the nascent coal industry, and inflation has remained low. While global risks are sizeable, the increase in coal extraction will continue to lead Mozambique's economic growth, and Mozambique's economic stability and prudent policy mix over the past few years should help the economy weather the global slowdown. The gradual easing of monetary policy in 2012 has supported private sector credit growth while preserving a low inflation environment. The prudent execution of the 2012 budget has contributed to a judicious policy mix that has fostered economic stability despite global uncertainty. All assessment criteria for

[1] The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. A country's performance under a PSI is reviewed bi-annually.

[2] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

end-June 2012 were met, except for a temporary breach of the ceiling on net credit to the government. There was broadly satisfactory progress in structural reforms, despite some delays.

The authorities' economic program under the PSI will continue to emphasize preserving economic stability and debt sustainability while promoting economic and social development. Monetary policy will be geared toward private sector credit expansion, while remaining committed to the medium-term inflation target. Efforts to strengthen supervision and the crisis management framework will safeguard the financial sector from cross-border spillovers. Fiscal policy, through a prudent 2013 budget, will aim to utilize the available fiscal space to close the infrastructure gap and support an expansion of social safety nets to foster inclusive growth, consistent with the authorities' four-year poverty reduction strategy (2011–2014). The prudent use of nonconcessional external borrowing will help to bridge the gap between the country's vast infrastructure needs and a trend decline in donor support, while further institutional enhancements and capacity building will strengthen Mozambique's ability to manage its natural resource wealth. The program's structural reforms focus on improving public financial management including debt management, tax administration and policy, and the monetary policy framework.

The Executive Board approved Mozambique's second three-year PSI on June 14, 2010 (see Press Release No. 10/242).