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Republic of Mozambique: 2003 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with the Republic of Mozambique, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **September 18, 2003,** 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 November 19, 2003.** 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.

- a staff statement of **December 10, 2003** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its December 10, 2003 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for the Republic of Mozambique.

The document(s) listed below have been or will be separately released.

Ex Post Assessment of Mozambique's Performance Under Fund-Supported Programs
Financial Sector Stability Assessment
Statistical Appendix

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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REPUBLIC OF MOZAMBIQUE

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representative for the 2003 Consultation
with the Republic of Mozambique

Approved by Michael Nowak and Anthony Boote

November 19, 2003

- The discussions for the 2003 Article IV consultation with Mozambique, together with preliminary discussions on a program that could possibly be supported by a new Poverty Reduction and Growth Facility (PRGF) arrangement covering the period 2004-06, were conducted in Maputo on September 4-18, 2003. The mission met with the Ministers of Planning and Finance, Industry and Trade, and Labor, the Governor of the Bank of Mozambique, other senior government officials, and representatives of the private sector and the donor community.
- The staff team comprised Messrs. Di Tata (Head), Engelke and Manoel, and Ms. Mashinkila (all AFR), Mr. Kim (PDR), and Mr. Ize (MFD). The mission was assisted by Mr. Perone, the Fund's Resident Representative in Mozambique. Mr. Frécaut (MFD) conducted a parallel staff visit to follow up on the situation of the Banco Internacional de Moçambique (BIM) and to design a technical assistance program in the monetary and financial areas, together with World Bank staff. Messrs. Fuchs and Moll from the World Bank also participated in the discussions. An FAD mission that took part in a multipartite review of the tax reform technical assistance project partially overlapped with the Article IV consultation mission.
- On June 20, 2003, the Executive Board concluded the fifth review under the first PRGF arrangement with Mozambique and decided that the progress report on the first year of implementation of the poverty reduction strategy paper (PRSP) (PARPA under its Portuguese acronym) provided a sound basis for Fund concessional assistance. The sixth review was not completed, and the PRGF arrangement expired on June 28, 2003. In the context of the fifth review, the staff reached understandings with the authorities on the establishment of quarterly indicative targets to monitor economic performance during the remainder of 2003. A joint Fund/World Bank team conducted an assessment of the financial sector under the FSAP in February and April 2003.
- In concluding the last Article IV consultation on June 17, 2002, Executive Directors commended the authorities for their continued implementation of broad-based reforms, which formed an essential backdrop for the country's strong growth performance. Directors stressed that further progress in strengthening tax collections and improving expenditure management would be fundamental to safeguard priority spending and reduce aid dependence. They also underscored the need to strengthen the banking system and the importance of enhancing bank supervision.
- Mozambique has had four Fund-supported programs since 1987. The staff has prepared an expost assessment of the progress achieved under these programs, which is presented as a supplement. In addition, the Financial Sector Stability Assessment (FSSA) is being circulated jointly with this document.

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EXECUTIVE SUMMARY

- **Mozambique's performance under the authorities' program during the first three quarters of 2003 remained broadly on track.** Manufacturing output, construction, and services performed strongly during the first half of 2003, and the program's target of real GDP growth of 7 percent for the year as a whole appears achievable. After peaking in May, the 12-month rate of inflation declined to 14 percent in September as the impact on food prices of the regional drought subsided. However, the end-year inflation target of 10.8 percent is likely to be exceeded. All the indicative program targets for end-June 2003 and most indicative targets for end-September were observed. The program's three structural benchmarks and some structural measures envisaged for the second half of 2003 have been implemented. Other measures have been delayed, however, owing in part to factors beyond the authorities' control.

- **The government's domestic primary deficit turned out significantly smaller than programmed during the first half of 2003.** Total revenue was in line with expectations, but locally financed capital expenditure was lower than envisaged reflecting delays in project execution associated with aid shortfalls. Monetary growth has been subject to substantial volatility owing in part to operations performed by some private companies involving large purchases of government bonds with bank deposits, with repurchase agreement. The still high level of lending rates (bank spreads remain wide at 18 percent) has contributed to a slower than envisaged growth of credit to the private sector.

- **The policy discussions focused on the macroeconomic policies for 2004-06 and the government's plans to address pending structural reforms in order to broaden and sustain growth.** Understandings were reached, in principle, on the main elements of a macroeconomic framework for 2004. Real GDP growth is projected to increase to over 8 percent in 2004 owing to the coming on stream of the expansion of the aluminum smelter (MOZAL II) and the gas pipeline (SASOL). End-year inflation is targeted to decline to 9 percent, and net international reserves are programmed to increase to above 5 months of imports.

- **Discussions on structural issues focused on the authorities' plans to remove remaining obstacles to private sector development, including weaknesses in the financial system.** The authorities are working on measures to (i) reduce red tape and simplify the regulatory framework; (ii) address labor rigidities that hinder competitiveness; (iii) improve basic infrastructure, including by increasing private sector participation in key sectors; and (iv) reform the judicial system. In addition, the World Bank is supporting a reform program to increase efficiency in the public sector. The mission also discussed with the authorities a number of recommendations made by the FSAP team to tackle remaining vulnerabilities in the financial system and improve monetary management.

- **Based on the reasons provided in the expost assessment, the staff is of the view that a recommendation to the Executive Board of continued Fund support through a new low access PRGF arrangement would be warranted.** Following completion of the Article IV consultation and taking into account the views of the Board, a second mission would visit Maputo early next year to continue the discussions on a possible successor program.

I. Recent Economic Developments

1. **Mozambique's performance under the program supported by the PRGF during 2002 was satisfactory. Real GDP** growth remained strong at an estimated 7.7 percent, owing mainly to the continued recovery of agricultural output from the 2000 floods and a sharp increase in construction associated with two megaprojects (MOZAL II, the expansion of the aluminum smelter, and the initiation of SASOL, a gas pipeline). **Inflation** (end of period) declined from 22 percent in 2001 to 9 percent in 2002 in response to a tightening of monetary conditions (Table 1 and Figure 1). Most of the quantitative criteria and indicative targets for end-June and end-December 2002, as well as all the structural performance criteria and benchmarks, were observed (Tables 10 and 11). Completion of the fifth review was delayed, however, because of concerns about vulnerabilities in the banking system.

2. **The domestic primary deficit (excluding bank restructuring costs) was reduced from 6.3 percent of GDP in 2001 to 3.6 percent in 2002.** Total revenue increased significantly to 14.2 percent of GDP, while domestic primary expenditure was reduced by restraining locally financed capital expenditure and net lending (Table 2 and Figure 2). **Monetary policy was tightened early in 2002**, and broad money growth declined to 20 percent during the year from 30 percent in 2001. Net international reserves increased by more than programmed, as sales of foreign exchange were kept below aid disbursements, and the central bank resorted to sterilization operations through substantial placements of central bank bills. This action led to a marked increase in interest rates through August 2002 and a significant decline in credit growth to the private sector. Interest rates on central bank instruments fell subsequently, resulting in a slow decline in commercial banks' rates (Table 3 and Figure 3).

3. **The government's economic program for 2003 envisages slightly lower real GDP growth of 7 percent because of a more moderate expansion in the agricultural sector.** After peaking at 16 ½ percent in May, owing to the impact of the regional drought on food prices and the strengthening of the South African rand against the U.S. dollar (and the metical), the 12-month rate of inflation is targeted to decline to below 11 percent by year's end.[1] Net international reserves are programmed to cover five months of imports of goods and services at end-2003, a level considered prudent in light of the uncertainties associated with aid flows.

4. **The fiscal program seeks to contain the domestic primary deficit at 3.7 percent of GDP in 2003,** with **tax revenue** strengthening as a result of the implementation of a new code for personal and corporate income taxes, the full-year effect of a new, more transparent fiscal incentives code approved in 2002, and a new vehicles tax. In addition, in May 2003 the

[1] South Africa is Mozambique's main trading partner. The 12-month rate of increase of food prices was 17.2 percent through September 2003, with nonfood prices rising by 9½ percent over the same period (see Figure 1).

authorities raised the specific tax on domestic petroleum products by 62 ½ percent to offset a large part of the erosion experienced by these taxes in recent years because of inflation. **Noninterest current expenditure** was programmed to rise by about ½ of 1 percentage point of GDP in 2003, owing to higher outlays related to local elections and an increase in the wage bill. The latter incorporated an average wage increase for government employees of 17 percent, effective April 1, 2003, and an expansion of public employment in the health, education, and security sectors, in line with PARPA priorities.

5. **Partial information available for the first three quarters of 2003 indicates that the program remains broadly on track.** Based on indicators of economic activity, manufacturing output, construction, and services performed strongly during the first half of the year, and the program's target of real GDP growth of 7 percent for the year as a whole appears achievable. At the same time, the 12-month rate of inflation declined to 14 percent in September as the impact on prices of the exogenous factors referred to above subsided; the program's target for year-end inflation, however, is likely to be exceeded.

6. **All the indicative program targets for end-June 2003 (adjusted for smaller-than-envisaged disbursements of program assistance) and the end-September 2003 indicative targets for the net domestic assets of the central bank, net international reserves, and base money were observed.** The end-September indicative target for government revenue was not observed by a small margin because of a shortfall associated with delays in implementing the withholding of income tax on the salaries of government employees. In addition, the program's three structural benchmarks for the first half of 2003 were completed with the submission to parliament of amendments to the Financial Institutions Law and the Organic Law for Tax Tribunals (both expected to be passed before the end of the year), and with approval of the implementation plan to establish a Central Revenue Authority (CRA) that would merge the National Directorate of Taxes (DNIA) with the Customs Department (see Tables 10 and 12).

7. **The domestic primary deficit turned out to be significantly smaller than programmed during the first half of 2003.** Despite a shortfall in income tax collections, total revenue was in line with expectations because of a better performance of the indirect taxes. On the expenditure side, an overrun in the wage bill was related to a larger-than-envisaged expansion in temporary employment in the education sector in some provinces; this overrun, however, was more than offset by a lower level of locally financed capital outlays owing to delays in project execution (see Table 2). These delays were caused in part by a shortfall of US$52 million in disbursements of external grants, which, in turn, led to a slower utilization of counterpart funds and forced the government to resort to domestic borrowing. Donor disbursements are expected to normalize in the coming months, and a smaller shortfall of US$14 million is expected for the year as a whole.[2] As a result, the

[2] The World Bank approved an Economic Management and Private Sector (EMPSO) credit in August 2002. The first disbursement of US$64 million was made in October 2002. The remaining disbursement of US$60 million is expected in December this year, following

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government's domestic primary deficit is projected to return to the program level of 3.7 percent of GDP by the end of the year, with the overrun in the wage bill compensated for by lower capital outlays.

8. **Monetary growth has been subject to substantial volatility** so far this year, owing in part to operations performed by some companies (mainly the oil pipeline) involving large purchases, with deposits, of government bonds from the commercial banks, with repurchase agreement. These operations appear to be motivated by profitability considerations because they are not subject to reserve requirements. They led, among other factors, to a significant decline in the 12-month rate of broad money growth in June 2003 and a sharp increase in July, followed again by a substantial drop to 7½ percent in September (see Table 3).[3] Commercial bank lending rates have declined from 37 percent to 32 percent since end-2002, with interest spreads remaining wide at 18 percent. The still high level of lending rates and the more conservative lending attitude assumed by the large banks has contributed to a slower-than-envisaged growth of credit to the private sector.

9. **The external current account deficit has continued to be influenced by exogenous factors and developments in the megaprojects.** During the first half of 2003, total exports increased by 12 percent relative to the same period of 2002, owing to the strong performance of cotton and timber. Prawn exports, however, continued to be adversely affected by drought. At the same time, imports fell by 8 percent, with a significant reduction in megaproject imports and nonfood consumer items. For the year as a whole, however, the external current account deficit, after grants, is expected to widen to 15 percent of GDP (12 percent in 2002), reflecting an expected increase in investment in the megaprojects in the coming months (Figure 4 and Table 4). The metical has remained stable in real effective terms in the past year (Figure 5).

10. **In the context of the fifth review under the last PRGF arrangement, the authorities identified several structural measures to be implemented during the second half of 2003.** Some of these measures have been adopted as envisaged, including the initiation of the tender process for the new financial administration system (SISTAFE) and the issuance of instructions for the consolidated supervision of financial institutions. Other measures have been delayed, partly because of factors beyond the authorities' control. In

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pending revisions to a new telecommunications law. These revisions will consolidate the framework for private participation in the sector and will establish a deadline for phasing out the monopoly still enjoyed by the state telecommunications company in fixed-line services.

[3] In addition, a foreign company withdrew a large deposit that had been made to secure negotiations for an operating license. After adjusting for all these operations, the 12-month rate of growth for M2 in September is estimated at 10 ½ percent. To some extent, the slower growth of M2 also seems to reflect the impact of the introduction of tax withholding on the interest earned on deposits under the new income tax code.

particular, the development of a computerized system to support the new income taxes has experienced some delays mainly because of procurement issues. Also, implementation of the SISTAFE in the Ministries of Planning and Finance (MFP) and Education has not taken place owing to delays in approving the procurement manual and contracting international consultants. In addition, a new statute providing the DNIA with a certain degree of financial autonomy (a first step to facilitate its merger with the Customs Department) is now expected to be approved in December, rather than in October (Table 13).

11. **Local authority elections are scheduled to take place in November 2003, and presidential and parliamentary elections in the last quarter of 2004.** The main contenders in the elections are the ruling party, Frente de Libertação de Moçambique (FRELIMO), and the largest opposition party, the Resistencia Nacional de Moçambique (RENAMO). President Joaquim Chissano has announced that he will retire after his second term in office, which expires in December 2004.

12. **On October 1-2, 2003, the World Bank organized in Paris the fourteenth Consultative Group meeting for Mozambique.** The representatives of the donor community commended the authorities for Mozambique's consistently high rates of economic growth, the maintenance of macroeconomic stability, and their success in consolidating democracy and attracting foreign investment in large-scale investment projects. Donors' representatives recognized that the implementation of the PARPA had led to improvements in social indicators, but they stressed the need to move ahead decisively with "second-generation reforms" to broaden and sustain growth.

13. **In general terms, the authorities have been responsive to the advice provided by the Board in the context of the last Article IV consultation, as demonstrated by Mozambique's continued satisfactory macroeconomic performance.** In particular, the authorities have maintained a prudent monetary stance and have shown a strong commitment to the implementation of tax reforms. They are also working on further actions to strengthen the financial system in close consultation with staff from the Fund and the World Bank. There have been, however, some delays in addressing part of the recommendations made in the fiscal Report on the Observance of Standards and Codes (ROSC) issued in 2001.

14. Mozambique's relations with the Fund, including recent technical assistance, are summarized in Appendix I, and its relations with the World Bank in Appendix II. Statistical issues are discussed in Appendix III, and a debt sustainability analysis is presented in Appendix IV. Selected social and demographic indicators are presented in Appendix V.

II. Policy Discussions

15. **The policy discussions with the authorities focused on their macroeconomic policies for 2004-06 and the government's plans to remove a number of remaining obstacles to private sector development, in order to broaden and sustain growth and further reduce poverty.** During the discussions, the staff reached understandings, in principle, with the authorities on the main elements of a macroeconomic framework for

2004, with the fiscal program putting particular emphasis on measures to further strengthen revenue and to start addressing the substantial increase in the government's wage bill that has taken place in recent years (from 5.8 percent of GDP in 1999 to the 7.8 percent now projected for 2003). The staff also discussed with the authorities several recommendations made in the context of the FSAP exercise to tackle remaining vulnerabilities in the financial system and improve monetary management.

16. **The authorities expressed strong interest in the Fund's continuing support through a successor PRGF arrangement for 2004-06 to consolidate macroeconomic stability and help address pending structural reforms.** The staff is of the view that, provided a strong program can be put in place, a recommendation to the Executive Board of continued Fund support through a low access arrangement would be warranted. Arguments supporting this position are provided in the supplement containing the expost assessment of Mozambique's performance under Fund-supported programs. The staff indicated that, following completion of the Article IV consultation and taking into account the views of the Board, a second mission would visit Maputo early next year to continue the discussions on a possible successor program. The authorities said that in the coming months they would develop a precise timetable for their reform package, which would be discussed with the staff at the time of the mission.

17. **The macroeconomic framework for 2004** assumes an increase in real GDP growth to just over 8 percent, owing mainly to the coming onstream of MOZAL II and SASOL. The authorities indicated that they would maintain a tight monetary stance to move as close as possible to the inflation target for 2003 and agreed to seek a further reduction in year-end inflation to 9 percent in 2004. Net international reserves are projected to increase by US$ 40 million during 2004 to a level of US$696 million by the end of the year (5½ months of imports).[4]

A. Fiscal Policy

18. **The draft budget for 2004 (which has already been submitted to the national assembly) seeks to continue the process of fiscal consolidation by further raising revenue and reversing in part the recent increase in the wage bill, in order to allow for additional spending in priority areas.** With these objectives in mind, the fiscal program calls for a further reduction in the domestic primary deficit to 3.4 percent of GDP in 2004. The overall deficit, after grants, however, would increase to 4.1 percent of GDP in 2004 from 3.2 percent in 2003, owing to a shift in external assistance from grants to concessional loans.[5]

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[4] The indicative target for net international reserves for end-2003 was revised downward to US$ 656 million in light of the expected shortfall in external assistance.

[5] This deficit includes a contingency amount for the payment of interest on external debt subject to HIPC Initiative debt relief, which is expected to be transferred from the central

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The fiscal program would be consistent with a reduction in the net indebtedness of the government to the banking system (see Table 2).

19. **Total revenue would rise by 0.3 percentage point of GDP in 2004 to 14.7 percent of GDP** because of the full-year effect of the adjustment in specific fuel taxes implemented in May 2003, as well as further increases in the collection of income and indirect taxes in response to continued improvements in tax administration. In addition, the authorities indicated that early in 2004 they would introduce an automatic mechanism to adjust fuel taxes on a quarterly basis, so as to prevent their erosion by inflation.

20. **Several reforms are being implemented to strengthen the tax system in the context of a technical assistance program supported by FAD and several donors.** Project activities will continue in 2004 to consolidate the system of indirect taxation, develop a municipal tax system, and strengthen the institutional capacity of the DNIA, with a view to establishing the CRA in 2005. In addition, LEG is assisting the government with the preparation of a new code for the stamp tax and a general tax law that will set out the principles of the law, the guarantees and obligations of taxpayers, and the treatment to be accorded to tax crimes (this legislation is expected to be submitted to the national assembly in the first quarter of 2004). The authorities attributed the delay in introducing the withholding of the income tax on the salaries of government employees to operational difficulties and indicated that the measure would be adopted with retroactive effect before the end of the year.[6] The fiscal projections for 2003 incorporate the effect of this measure on revenue, as well as the offsetting impact on the wage bill.

21. **Further progress has also been achieved in the area of customs**, where the retrenchment of redundant staff and the appointment of new managers were successfully completed in mid-2003. The final two-year phase of the customs reform program, with continued support from the U.K. Department for International Development (DFID), will focus on human resource development to ensure sustainability and a smooth integration of customs within the CRA.

22. **Total expenditure is projected to decline slightly to 27.8 percent of GDP in 2004.** The authorities agreed to limit the wage increase for government employees to projected inflation (9 percent), and they indicated that they would exercise a stricter control over expenditure commitments at the subnational level, including by rationalizing temporary employment in some provinces. These measures are expected to allow for a reduction in the government's wage bill from 7.8 percent of GDP in 2003 to 7.5 percent in 2004, after taking

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bank to the government (see para. 28 below), but it excludes the possible cost of addressing remaining vulnerabilities in the banking system.

[6] The withholding of income tax does not have an impact on the overall fiscal position, as government employees will be fully compensated for their income tax payments.

into account a further increase in permanent employment in some priority areas. Moreover, the government will initiate a process of verifying and rationalizing pension beneficiaries, which would permit a slight decline in transfers to the private sector. The 2004 budget incorporates the cost of the national elections, which is estimated at US$20 million, of which US$15 million would be financed with external grants.

23. **As noted above, implementation of the SISTAFE has been delayed, owing to some difficulties in putting in place a single treasury account.** Furthermore, efforts should be accelerated to implement the recommendations made in the fiscal ROSC, which was updated by the mission (Box 1). Based on a new timetable, a core SISTAFE will be operational in the Ministry of Planning and Finance at the central and provincial levels in January 2004, with implementation of the full SISTAFE now expected in the second quarter of 2004. The new system will be extended across all government ministries and provincial units during 2004. Regarding fiscal transparency, the staff stressed the need to move ahead with the inclusion of all extrabudgetary activities in budgetary execution procedures and reporting.

B. Monetary and Financial Sector Issues

24. **The mission discussed with the authorities a revised monetary program for the remainder of 2003 envisaging a lower rate of growth for M2 (13 ½ percent, compared with 18 ½ percent in the original program), and slower credit growth to the private sector, in line with developments so far this year.** The revised program incorporates a recovery in the deposit base under the assumption that the oil pipeline and other companies would shift again from holdings of government bonds to deposits, given their higher liquidity requirements toward the end of the year. Taking into account the high volatility experienced by M2 in recent months, the mission stressed the need to monitor monetary developments closely. It also encouraged the authorities to use base money as an intermediate target, and to pay attention to other monetary indicators, such as currency in circulation, which appears to be strongly linked to inflation according to econometric tests carried out by the FSAP team.[7]

25. **Looking at 2004, the fiscal program described in paragraph 18 would provide scope for increasing credit to the private sector** in line with nominal GDP growth, under a conservative assumption for broad money growth. The next mission will need to revise these projections on the basis of developments in the coming months.

[7] The 12-month rate of growth of currency was 17 ½ percent through September 2003. The revised monetary program envisages a growth rate of 15.8 percent in December 2003.

Box 1. Fiscal ROSC Update

This box updates developments in fiscal transparency and reviews the status of recommendations in the fiscal transparency ROSC issued in February 2001 and updated in June 2002.[1] The ROSC update of June 2002 identified several areas where further efforts were required to improve fiscal transparency.

On budget execution and public accounting, some delays have occurred in implementing the new government financial management system (SISTAFE). Work is under way to carry out and record all expenditure authorizations in a centralized database and to make available the balance of all the government accounts in the banking system on a daily basis; this represents an important step toward a transparent and efficient budget management system. However, because of some difficulties in putting in place a single treasury account, pilot testing of the SISTAFE in the Ministry of Planning and Finance and the Ministry of Education has been cancelled. Based on a new timetable, as of January 2004 a core SISTAFE will be implemented in the Ministry of Planning and Finance at the central and provincial levels. Current manual accounting practices will be kept until the new system proves to be satisfactory. The full SISTAFE is expected to be implemented in the second quarter of 2004, and to be rolled-out across all government ministries and provincial units up to the end of 2004.

The new budget execution system based on the SISTAFE is expected to overcome several weaknesses identified by the ROSC by (i) registering all phases of budget execution; (ii) eliminating the budget's complementary period; (iii) introducing a new chart of accounts and a double-entry accounting system; (iv) adding details on economic classification of expenditures; and (v) reducing from 20 to less than 12 months the period of preparation and evaluation of government annual accounts. With regard to the staff's recommendation of including all extrabudgetary activities in the new system, the government has decided not to pursue this objective now and will incorporate those activities after introducing the new system. In the meantime, progress has been made in expanding the coverage of extrabudgetary activities in the quarterly budget execution reports.

Although significant advances have been made in improving fiscal transparency in certain areas, progress in other areas has been very limited. Specifically, progress has been made in (i) improving the reconciliation of fiscal and monetary data and coordination on macroeconomic policies between the Bank of Mozambique and the Ministry of Planning and Finance through technical meetings; (ii) spelling out specific objectives and priorities for fiscal policy in several government documents, including the PRSP and the annual budget evaluation (PES); (iii) providing more detailed information on PRSP programs in the quarterly budget execution report; and (iv) publishing the medium-term fiscal scenario in budget documents. Moreover, the government is finalizing a new decree to strengthen the enforcement of procurement and bidding rules for government purchases.

Areas where little progress has taken place include (i) clarifying the expenditure responsibilities of the different tiers of government; (ii) removing or severely limiting the legal power of municipalities to borrow; (iii) prohibiting, by law, central bank financing of budget deficits; iv) consolidating public sector fiscal data (central government budget, municipalities, and state enterprises); (iv) setting limits on government debt (preferably in the annual budget documents); and (v) including tax expenditures and contingent liabilities in the budget document.

[1] For a description of institutions and practices and a list of recommendations, readers should refer to the original report and its update, which are available on the IMF external website: http://www.imf.org/external/np/rosc/moz/fiscal.htm and http://www.imf.org/external/pubs/cat/longres.cfm?sk=16017.0

26. **The Mozambican banking system is characterized by a high degree of dollarization (around 50 percent of deposits are denominated in foreign currency).** To a large extent, this is related to high and volatile domestic interest rates. The mission noted that a low and stable rate of inflation was needed to enhance the credibility of the metical and promote a sound and sustainable metical-based financial development. The mission stressed that achieving this goal would require improvements in monetary management to make it more forward-looking and transparent. Key measures would include a better communication of the central bank monetary goals and actions, as well as improvements in its operational procedures. In this regard, discussions focused on ways to improve monetary sterilization operations with open market paper by introducing weekly price auctions and moving gradually toward the adoption of a single indirect monetary instrument, as well as on several other recommendations made in the context of the FSAP exercise (Box 2).

27. **Mozambique's exchange regime is a managed float.** The central bank sets its exchange rate on a daily basis, and adjusts it in response to significant deviations from the average selling rate of banks and exchange bureaus (there is no exchange rate targeting). Within this framework, however, central bank intervention practices are not fully consistent with maintaining international reserves within a desired range. The authorities agreed to continue ongoing efforts to improve the monetary sterilization of the impact of government expenditure financed with external support through central bank sales of counterpart foreign exchange. This would help reduce pressures to sterilize liquidity by resorting to indirect monetary instruments, as in most of 2002. Beyond the sales of counterpart foreign exchange, the authorities would seek to limit central bank interventions in the foreign exchange market to smoothing temporary shocks and achieving the international reserves targets. This would require a greater responsiveness of the exchange rate to deviations from the international reserves targets.

28. **To strengthen the balance sheet of the Bank of Mozambique (BoM), the authorities agreed to consider shifting the central bank's medium- and long-term external liabilities (still under negotiation for HIPC debt relief) to the government.** These issues are being reviewed in detail with technical assistance from MFD.

29. **Reported indicators show that Mozambican banks have an average capital adequacy ratio of over 14 percent, and that they are generally profitable.**[8] However, the Banco Internaçional de Mozambique (BIM), which is the largest bank in the country, has benefited from the deferral over a ten-year period of some charges that would be considered

[8] While there is a relatively high aggregate level of nonperforming loans (22 percent), this is mainly driven by BIM and the loan portfolio inherited by the reprivatized Banco Austral (for which provisions have fully been made). Table 3 in Appendix II of the FSSA presents the main financial soundness indicators.

Box 2. Summary Findings and Recommendations of the FSAP Report

Notwithstanding its remarkable growth over the last decade, the Mozambican financial system still faces important development hurdles. The system is still small, mostly bank based, highly concentrated, and dollarized, and features large intermediation margins. The growth of banking intermediation has been constrained by the banks' difficulty in channeling deposits into loans, reflecting limited access and high exposure to credit risk. In turn, the high credit risk mostly reflects high and volatile real lending rates and a poor lending environment, with a still weak repayment culture and a number of legal and institutional impediments to effective credit selection and recovery.

To limit real interest rate volatility, the FSAP recommended a number of monetary management reforms aimed at strengthening the BoM's analytical capacity for implementing a forward-looking, smoother, and more proactive monetary policy, and at enhancing the transparency and effectiveness of monetary policy. These reforms include better communication of BoM's monetary goals and actions, and separation of open market operations aimed at stabilizing daily bank reserves from weekly auctions of central bank bills of longer maturities.

In support of these reforms, the FSAP identified the need for (i) strengthening the BoM's financial situation by transferring to the treasury its medium- and long-term external obligations (most of which are eligible for HPIC Initiative debt relief) and carrying out a detailed review of the BoM's accounting and profit transfer practices; (ii) consolidating all short-term public securities into a single instrument (BTs) and taking steps to improve public debt management to facilitate the development and deepening of the primary and secondary markets for BTs; (iii) enhancing the transparency and effectiveness of foreign exchange operations by separating the interventions conducted by the BoM on its own account from those associated with foreign exchange sales as a counterpart of external aid to support budgetary expenditure; and (iv) accelerating reforms in the payments system, including through the introduction of a real time gross settlement (RTGS) system. In addition, the FSAP recommended that a fiscal agency agreement be designed to improve coordination between the central bank and the Ministry of Planning and Finance.

To limit credit risk and, more generally, strengthen financial system oversight, the FSAP recommended that the authorities: (i) enact a number of legal and institutional reforms aimed at facilitating lending (including a new commercial code and a code of civil procedure, updated laws on secured transactions, and an enhanced credit registry); (ii) gradually introduce IAS for banks (and large enterprises), following the diagnostic reviews of the largest banks; (iii) review loan classification and provisioning standards; and (iv) enhance the remedial powers of the credit supervisor.

The FSAP also made a number of recommendations to facilitate financial sector development. Specific recommendations include (i) phasing out as soon as possible state ownership in the banking system, which is a source of moral hazard; (ii) enhancing the transparency and accountability of the public pension system through tighter oversight and steps to stimulate a healthy growth of private companies in the sector; and (iii) facilitating the growth of microfinance institutions through a careful review of the regulatory framework.

Given Mozambique's limited institutional capacity, **follow-up technical assistance** will be needed in nearly all the areas discussed in the report.

as losses under international accounting standards (IAS).[9] Moreover, in October 2002 the Department of Banking Supervision (DBS) of the BoM determined that BIM's provisions for nonperforming loans did not meet existing regulations in Mozambique. In late 2002, BIM took several steps toward meeting domestic provisioning requirements, which were regarded as appropriate by KPMG (the bank's external auditors).

30. **Based on the information obtained during the mission, the staff concluded that BIM's condition was improving.** Since end-2002, BIM has been implementing an operational restructuring program under the close supervision of the controlling shareholder (BCP), resulting in the closure of several branches, retrenchment of personnel, and a gradual modernization of procedures. The bank is in compliance with local prudential requirements, and its capital position is improving slowly through the accumulation of retained earnings.[10] BIM's profitability has declined this year, owing largely to further restructuring of its loan portfolio and the nonrecurrent costs associated with its operational restructuring, but the ongoing reforms are expected to allow for an increase in profitability, starting in 2004.

31. **To dispel uncertainties about the overall soundness of the financial system, the authorities agreed with Fund and World Bank staff in the context of the fifth review under the last PRGF arrangement on the need for international firms to conduct comprehensive diagnostic reviews of the four largest banks according to IAS.** Based on the findings of these reviews, the authorities are expected to take the corrective actions required to address remaining weaknesses in the system, to strengthen loan-loss provisions, and to develop a timetable to move gradually to IAS. The authorities' strategy would aim at achieving the exit of the government from the banking system as soon as feasible. As the bank reviews have been delayed owing to lengthy procurement procedures, the World Bank has agreed to finance BIM's review, with a view to expediting the process, which in any event is likely to take more time than originally envisaged. In the meantime, the DBS will keep in place an enhanced supervisory regime for BIM. The reviews of the other three banks would be financed by the DFID, as had been planned originally.

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[9] BIM has a market share of 45 percent and is the result of a merger in November 2001 of the old BIM, a well-run greenfield investment, and the Banco Comercial de Moçambique (BCM), a troubled, former state-owned bank. The new BIM is controlled by Banco Comercial Português (BCP), a large private Portuguese bank (67 percent of capital), with minority stakes held by the government of Mozambique (23 percent), the state social security agency (INSS), and other public and private entities.

[10] Based on Mozambican standards, BIM's capital adequacy ratio increased from 10 percent in December 2002 to 12½ percent in September 2003. After correcting for the deferred charges, the ratio improved from 2.8 percent in December 2002 to about 5½ percent in September 2003.

32. **The mission discussed with the authorities the reasons behind the wide spreads in the banking system and the difficulties in accessing bank credit.** There was broad agreement that the main problems were of a structural nature and included the dominant position of BIM in the system and its large share of nonperforming loans, the relatively high operating costs of banking institutions, the absence of efficient judicial procedures to facilitate loan recovery, and difficulties in obtaining and using collateral to access bank credit (the constitution prohibits the private ownership of land, and the procedures to obtain and transfer land use titles are complex and lengthy). In this connection, the ongoing restructuring of BIM and the gradual development of a more competitive banking system should help. Addressing the remaining factors, however, requires more difficult structural and institutional reforms, including in the judicial system and land tenure regulations (Box 3).

33. **The FSAP identified a considerable need for technical assistance, including in the areas of bank supervision and regulation, monetary and exchange rate management, public debt management, central bank accounting and profit distribution policy, microfinance, and the lending environment.** The authorities requested that, in designing the technical assistance program, special attention be given to absorptive capacity constraints. On this basis, a comprehensive technical assistance program is being prepared by MFD in close coordination with the World Bank and the African Development Bank.[11]

C. External Sector Issues

34. **Mozambique's external current account deficit (after grants) is projected to narrow to 7 percent of GDP in 2004.** Exports are expected to increase by more than 40 percent, owing to the coming onstream of MOZAL II and SASOL, while imports would decline because of lower construction activity related to the megaprojects. Aid flows (grants and concessional loans) would increase in dollar terms from US$630 million (15 percent of GDP) in 2003 to US$680 million in 2004 (14 percent of GDP), reflecting higher disbursements from the African Development Bank and IDA.

35. **Based on the strong performance of exports, the current level of the real exchange rate appears to be broadly appropriate.** The authorities recognized, however, the need to address some important structural issues that affected adversely external competitiveness and export diversification, such as labor rigidities, high transportation costs, and high lending rates.

36. **Based on information from the authorities, the staff understands that Mozambique has eliminated all restrictions on the making of payments and transfers for current international transactions, except for discretionary prior approval required for remittances of family living expenses.** The authorities indicated that they would

[11] The World Bank is also preparing a Financial Sector Technical Assistance Project.

Box 3. Land Tenure Arrangements in Mozambique

The Land Law approved in 1997 stipulates that all land in Mozambique is the property of the state and cannot be sold, alienated, mortgaged or pledged. Land can, however, be leased from the state. The lease establishes user rights for specific purposes, which could be exclusive (housing) or nonexclusive (logging or gaming), and which often coexist with other rights acquired formally or informally for part or the whole of the land in question (e.g., agricultural rights). Before a land use title that competes with other use of the land can be issued, consultations among the concerned parties have to be held. The law allows for leases of up to 50 years, which are renewable. The right of use established by a formal lease is proven through a title deed.

The Land Law also recognizes user rights obtained through the customary use of land. These rights may be acquired by individuals or communities without the need for a formal title. Upon request, however, members of the community or the community as a whole may obtain a land use title. The recognition of customary rights under the law is meant to protect rural communities and their economic activities. The possibility of obtaining a formal title seeks to protect individuals or communities against land conflicts and offers a legal instrument with which to strengthen property rights. The law was also drafted to recognize informally acquired user rights when the land has been used for at least ten years in good faith. In the rural sector, only about 28 percent of the area used for agricultural activities is subject to formal land tenure arrangements (about 2 percent of the total land).

All user rights can be transferred by inheritance, but rights cannot be sold. Improvements made on the land, however, can be sold. Yet the sale of such improvements is economically viable only if the potential new owner is able to obtain a land use title. As a first step toward procuring a new title, the law requires the seller to obtain a notarized deed for the sale, as well as prior authorization by the competent state entity. When real estate in urban areas is sold, the initial procedures for the transfer of rights are simpler, since the law considers that the corresponding land use right is transferred at the time of sale. However, a large number of other administrative steps must be taken to claim the title.

Given the complex administrative procedures that are required, and the low efficiency and reliability of the public agencies involved, a transfer consisting of the sale of improvements normally forces both the seller and the buyer to incur very high transaction costs. In 1996-2000, about 11,000 formal requests for land use titles were made, though only 4,700 were granted. In practice, this has resulted in the development in urban areas of a large informal real estate market that is unprotected by legal instruments, as well as in very limited marketability for properties in rural areas. Both outcomes markedly reduce the availability of collateral for access to bank credit.

If the administrative process required to obtain and transfer titles were streamlined, the availability of easily transferable collateral would increase access to bank financing, facilitate the recovery of nonperforming loans, and reduce financial intermediation costs and bank spreads. This would represent a significant improvement for the urban sector and commercial farms.

For rural communities, the situation is more complex. In particular, given the high illiteracy rates prevailing in these communities, any move toward formal land titling would have to include carefully designed measures to adequately protect the rights of the vast sector of the population that currently relies on customary laws.

evaluate the possibility of accepting the obligations under Article VIII (Mozambique still availed itself of the transitional arrangements under Article XIV). The staff is conducting the customary comprehensive review of the exchange laws and regulations in order to identify any additional measures that might be necessary.[12]

37. **Mozambique is a member of the Southern African Development Community (SADC).** Currently, its average unweighted import tariff rate is around 13 percent, with no quantitative restrictions on imports. Tariff dispersion has been reduced, but the top tariff rate of 25 percent on consumer goods is still relatively high. The authorities indicated that they planned to lower the top tariff rate applied to all trading partners to 20 percent in 2006.[13] An export tax on unprocessed cashew and a sugar surcharge remain in place. The authorities do not intend to phase them out in the foreseeable future because they feel that protection for both the cashew-processing industry and the sugar industry should be maintained. The authorities believe that very complex rules of origin and standards imposed by developed countries (particularly the European Union) are the main constraint on access to export markets.

38. **Mozambique has signed HIPC Initiative debt-relief agreements with nine out of twelve Paris Club creditors, but progress in the negotiations with non-Paris Club creditors has been very limited (Table 5).[14]** Since the program review by the Board in June, a bilateral HIPC agreement with Sweden was concluded that provides for 100 percent debt cancellation. Moreover, the government resolved a dispute with one Paris Club creditor on a small amount of debt-service payments. The only negotiations successfully concluded with non-Paris Club official creditors are those with China and Kuwait, which were finalized in 2002. India has expressed its commitment to a full debt write-off. Regarding the sovereign commercial debt, the World Bank has made a commitment to finance a debt-reduction operation through the IDA Debt Reduction Facility and has approved the terms of reference for a legal advisor.

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[12] The BoM is currently revising the Foreign Exchange Law to bring the definition of residency in line with the fifth edition of the *Balance of Payments Manual.*

[13] In early September 2003, the authorities issued a decree exempting some industries from import duties on raw materials and intermediate goods from non-SADC countries (imports from SADC countries were already exempt). The revenue impact of this measure is expected to be small.

[14] The bilateral agreement with Brazil is expected to be signed shortly, and work is continuing to reconcile the data on the debt with Japan, which committed itself to 100 percent debt cancellation. No significant advances have been made, however, in the negotiations with Portugal.

D. Other Structural Reforms and Governance Issues

39. **In addition to the financial system, discussions on structural issues concentrated on the government's plans to address a number of remaining obstacles to private sector development.** Specifically, the staff inquired about the authorities' plans to (i) simplify the still complex regulations and procedures that affect adversely the cost of doing business in Mozambique; (ii) address labor rigidities in the formal sector that hurt competitiveness; (iii) develop basic infrastructure, which is still inadequate, particularly power supply and transportation; and (iv) improve the functioning of the judicial system, which is slow and inefficient.

40. **The government is working on reducing the amount of red tape for the registration of new companies in Mozambique** by establishing a one-stop shop that would start operations in 2004. In addition, within a short time the authorities would ask for bids on the construction of a new customs terminal, which would speed up customs clearance and permit a more fluid transit of goods to and from South Africa.

41. **The main labor rigidities in the formal sector include high retrenchment costs and complex and time-consuming procedures for hiring expatriates** (Box 4). The authorities are preparing an amendment to the labor regulations to facilitate the hiring of expatriates, which would be approved by the Council of Ministers in the coming months. This would be followed by the adoption of a new labor law to reduce retrenchment costs and facilitate temporary employment, possibly in 2005.

42. **The World Bank is supporting the government's efforts to enhance the country's infrastructure through several project loans.** The projects being supported envisage private sector participation in electricity provision; privatization of the telecommunications company and the national airline; management contracts for water systems in the five largest cities; concessioning of the Maputo and Nacala ports and parts of the railroads system; and privatization of PETROMOC, the state-owned petroleum distributor. The authorities agreed to prepare a timetable for the implementation of these reforms.

43. **The authorities noted that the issue of land tenure regulations was politically sensitive and required a careful analysis** to avoid affecting the large segment of rural farmers that were occupying small parcels under customary land rights. They indicated that the government had commissioned a study on land tenure regulations and procedures in order to analyze ways to encourage investment in agriculture. As a first step toward facilitating access to bank credit, the staff stressed the need to remove existing restrictions on the tradability of existing land use titles for urban land and commercial farms.

Box 4. Labor Market Rigidities

Mozambique's labor regulations entail high retrenchment costs and expensive and cumbersome procedures for hiring expatriates. Given the country's need for technical and skilled personnel, these rigidities undermine external competitiveness, productivity, and employment growth. In addition, minimum wages have increased markedly in recent years.

Retrenchment costs

Layoffs are allowed under the current labor law, but retrenchment costs are high by international standards. Laid-off workers with employment duration of more than three years are entitled to severance payments equivalent to three months' salary for every two years of service. The high retrenchment costs not only complicate corporate restructuring but also create a strong antiemployment bias. Rules governing compensation to workers of bankrupt firms have reportedly been a major stumbling block to recent privatization efforts.

Expatriate labor

Although two decrees issued in 1999 (Decrees No. 25/99 and 26/99) eased restrictions stipulated in old regulations, the process of hiring expatriates still remains complicated, time-consuming, and often unpredictable. Specifically, the process involves furnishing proof of unavailability of qualified nationals to fill the required positions; moreover, applications should be presented to the Ministry of Labor, which seeks the consent of relevant line ministries and trade unions before granting authorization. The duration of work permits is limited to two years, and renewals are difficult to obtain. Contracting expatriate labor on a short-term basis was facilitated by the introduction in 1999 of a single-entry work visa valid for 30 days. However, since the visa has reportedly been misused to hire expatriates on a longer-term basis, the authorities retain the right to cancel the visa at their discretion.

Wage determination

Minimum wages are determined by collective bargaining between representatives of labor and business under the auspices of the government. A lower minimum wage is applicable to agricultural workers. There is limited information as to the effect of minimum wages at the level of individual firms as well as on wage distribution across sectors and between skilled and unskilled labor. Generally speaking, large and medium-sized firms in the formal sector pay wages that exceed the minimum wage, but minimum wages are binding for the government, small firms, and the agricultural sector.

Policy measures

The authorities are revising the labor regulations to facilitate the hiring of expatriates by

- extending the effective period of the work visa from 30 to 180 days; and
- simplifying authorization procedures, including by removing the requirements of approval by line ministries and on-site training for local staff.

At the same time, the Ministry of Labor is preparing a revised labor law that is expected to be approved by parliament in 2005. The revised legislation would streamline administrative regulations for the dismissal of workers and reduce retrenchment costs to employers by broadening the coverage of the social security system.

44. **To improve governance and the efficiency of public institutions, the government has embarked on programs of judicial and public sector reform.**[15] As regards the judicial system, the authorities are preparing legislation to establish intermediate courts to speed up the administration of justice, which would be ready in mid-2004, and they are revising the commercial code, the civil code, the code of civil procedures, and the penal code. Also, new procurement regulations in line with international standards would be approved in the coming months. In addition, an anticorruption law was approved by parliament in October 2003, and a commission is preparing the regulations of an anti-money-laundering law approved in 2002.

45. **In the area of public sector reform,** with support from the World Bank and a group of donors, the government has embarked on a ten-year reform program aimed at restructuring the civil service and decentralizing service delivery. The first phase, to be implemented through 2006, includes functional reviews and the restructuring of major ministries, especially those relevant to the PARPA; salary decompression for well-qualified personnel (following the restructuring); and steps to increase decentralization. A very gradual approach will be followed in transferring responsibilities to provinces and districts, taking into account the need to ensure first an adequate administrative and financial capacity at the local level.

46. **A public expenditure review (PER) was recently undertaken by the World Bank.** The exercise identified serious problems of absorptive capacity in all sectors and, in some instances, the absence of a clear sectoral strategy capable of integrating decentralized projects financed by donors. In addition, the study concluded that there was a shortage of skilled personnel in the civil service—a situation that calls for a salary system relating remuneration to performance. The PER also indicated that reallocations within the education budget could improve efficiency by eliminating "ghost employees," reducing the subsidy to tertiary education, and merging lower and upper primary schools.

III. THE PARPA AND SOCIAL SECTOR POLICIES

47. **Spending on the PARPA priority sectors rose from 65.8 percent of primary expenditure in 2001 to 66.8 percent in 2003, but it is expected to decline to 65 percent in 2004.** The authorities said that this decline was mainly related to the completion of a large multi-year project in the health sector. In February 2003, the authorities issued the progress report on the first year of implementation of the PARPA. The report indicates that progress is being made toward achieving the government's objectives, particularly in the areas of health and education (Box 5). However, as discussed in Section G of the expost assessment supplement, reaching the Millennium Development Goals (MDGs) would require substantial additional resources. The latest information on poverty dates back to 1997, when it was

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[15] Based on indices for 21 African countries prepared by the World Economic Forum (an independent international organization), Mozambique ranks in the mid-range in the category of "public institutions and corruption," and in the low range for "contracts and law."

Box 5. Social Sector Policies

Mozambique is a very poor country with an income per capita of US$200 in 2002; 69.4 percent of the population lived in absolute poverty in 1997 (latest available data). The illiteracy rate is 56 percent of the adult population (higher than in Tanzania and Uganda), and infant mortality was 125 per 1,000 live births in 2001 (compared with an average of 105 for sub-Saharan Africa). The scope of the social security system is very limited, covering mainly employees in the formal sector of the economy, which is only a fraction of the total workforce. About 67,000 households receive food subsidies, mainly elderly people.

The PARPA seeks to reduce the rate of poverty from 70 percent in 1997 to 60 percent in 2005 and 50 percent in 2010, and it identifies six priority areas: education, health, infrastructure, governance (including justice), agriculture, and macroeconomic management. Expenditures equivalent to 18.4 percent of GDP (65 percent of total government noninterest spending) were allocated to such priority areas in 2002, in line with the PARPA objectives. The government's main social objectives are the following:

- **In the area of education,** (i) enhance primary school intake (grades 1–5); (ii) increase enrollment of girls, and (iii) reduce the dropout and repetition rates.
- **Regarding health,** (i) expand primary health care; (ii) improve mother/child health, and (iii) combat the major endemic diseases (malaria, tuberculosis, and leprosy).
- **On HIV/AIDS, slow the spread of the infection through prevention, support, and care activities.** The prevalence of HIV/AIDS was estimated at 12 percent of the adult population in 2000. An unpublished study commissioned by the World Bank estimates that the negative impact on the rate of growth of real GDP could increase gradually to up to 4 percent a year by 2010, compared with the no-AIDS scenario, if no measures to combat the epidemic are taken. The medium-term projections used in this report assume a 1 percent reduction in annual real GDP growth compared with the no-AIDS scenario. This takes into consideration the measures being adopted by the authorities (see below).

The first progress report on the implementation of the PARPA issued by the authorities in February 2003 indicates that advances are being made toward achieving the government's poverty reduction objectives, especially in the areas of education and health. In particular, access to primary education has improved, with the gross enrollment rate for EPI students (grades 1 to 5) rising from 70 percent in 1998 to 104 percent in 2002. At the same time, the report shows significant improvements in attended births, maternal and infant mortality, and vaccination coverage. A National Household Survey that will provide more detailed information about progress in reducing poverty since 1997 has not yet been completed. The most recent UNDP *Human Development Report* (2003) shows an improvement of 10 percentage points in the human development index (HDI), which rose from 0.325 in 1995 to 0.356 in 2001.

The government has been making important efforts regarding HIV/AIDS prevention and care, including through education and information campaigns. Specifically, 24 counseling centers were opened during 2001-02, with 50 centers expected to be operational by 2007. In addition, the PARPA target of 24,000 tests for 2002 was exceeded.

Social Indicators, 1960-2001

	Mozambique			Sub-Saharan Africa			Low-Income Countries		
	1960	1980	2001	1960	1980	2001	1960	1980	2001
Fertility rate (births per woman)	6.0	6.5	5.1	7.0	6.6	5.2	6.0	5.3	3.6
Life expectancy at birth (total years)	37	44	42	40	48	46	44	53	59
Infant mortality (per 1,000 live births)	...	140	125	...	118	105	...	109	80
Illiteracy rate (percent of people age 15+)	...	76	56	...	62	39	...	53	38
School enrollment, primary (percent, gross)	...	...	92	...	80	86	...	83	95
School enrollment, secondary (percent, gross)	...	5	12	...	15	27	...	29	44
Labor force, children 10-14 (percent of age group)	42	39	32	39	35	29	32	25	18

Source: World Bank; *World Development Indicators, 2003.*

estimated that 69.4 percent of the population lived in absolute poverty. New results from a National Household Survey conducted in 2002/03 are expected to become available toward the end of the year.

48. **During the discussions, the staff stressed the need to initiate the preparation of the report for the second year of implementation of the PARPA, which would need to be considered by the Boards of the Fund and the World Bank next year in the context of a possible successor arrangement.** The government has decided to integrate the monitoring of the PARPA and budget execution into a single document that reviews the implementation of the Social and Economic Plan (Balanço do PES); this would avoid duplication of effort. The authorities agreed that the document should contain all the information required for a proper assessment of progress under the PARPA, including (i) a revised medium-term macroeconomic framework; (ii) a new evaluation of the impact of HIV/AIDS on the country's growth prospects; and (iii) an assessment of progress toward meeting the Millennium Development Goals (MDGs). The report would also include the preliminary results of the National Household Survey conducted in 2002/2003, which would enable an evaluation of the progress made in reducing absolute poverty since 1997. The authorities plan to consult with stakeholders during the preparation of the report.

IV. Medium-Term Macroeconomic Framework

49. **The staff's preliminary projections for 2005-06,** which are broadly shared by the authorities, assume a slowdown in real GDP growth to about 7 percent a year, with year-end inflation declining further to 6 ½ percent in 2006 (see Table 1). Aid flows (grants and concessional loans) are envisaged to remain broadly unchanged in nominal terms at a level of US$660 million a year, which implies a gradual decline relative to GDP from about 14 percent in 2004 to 11½ percent in 2006.[16]

50. **The medium-term fiscal scenario envisages a reduction in the deficit after grants from 4.1 percent of GDP in 2004 to 3½ percent in 2005 and 3.2 percent in 2006.** This reduction is justified by the persistence of large fiscal risks, including possible additional bank restructuring costs. The projected deficits would be more than covered by net external concessional borrowing, thereby allowing for a further decline in the government's domestic debt and reduced pressure on domestic interest rates. Revenue mobilization would strengthen by an additional 0.6 percentage point of GDP over 2005-06 because of further improvements in tax administration and higher receipts of royalties from the megaprojects. Current expenditure would decline, reflecting a further reduction in the wage bill relative to GDP (by limiting wage increases to projected inflation plus an adjustment based on performance-

[16] A Country Assistance Strategy (CAS) paper for 2004-07 prepared by World Bank staff envisages financing for institutional and policy reforms through a series of Poverty Reduction Support Credits (PRSCs), with disbursements of program loans amounting to about US$60 million a year starting in 2004.

related indicators) and lower outlays on goods and services following the presidential elections. The resulting strengthening of government savings, together with improvements in expenditure efficiency, would allow for a gradual increase in locally financed capital outlays in basic infrastructure and the social sectors (Table 6).

51. **The external current account deficit, after grants, is expected to narrow to about 6 percent of GDP in 2006, with export growth remaining strong and import growth slowing after completion of the construction phase of MOZAL II and SASOL.** The deficit would rise to about 10 percent of GDP in 2007-08, because of the impact of other large-scale investment projects, including two titanium ore projects and the second phase of the gas pipeline. The country's medium-term external financing needs would continue to be covered by a mix of grants, concessional loans, and private capital flows in the form of foreign direct investment and private borrowing (Tables 7 and 8).

52. **Based on the implementation of these policies, Mozambique's external debt dynamics will remain sustainable over the medium term,** with the net present value (NPV) of the public external debt relative to GDP and exports of goods and nonfactor services declining steadily to 21 percent and 73 percent, respectively, by 2008. This improvement, together with the strong international reserves position, will allow the country to service its obligations to the Fund without difficulty. External vulnerability indicators are shown in Table 9.

53. **The staff has prepared a debt sustainability analysis that includes stress tests (Appendix IV).** The tests show that Mozambique's public debt dynamics would be vulnerable to a potential decline in external grants. In addition, Mozambique's total external debt, which is projected at 50-60 percent of GDP in NPV terms during 2004-08, would likely rise to 80-90 percent of GDP if it were subject to a large depreciation of the metical. These vulnerabilities point to the need to maintain macroeconomic stability, with particular emphasis placed on consolidating the fiscal position.

V. Statistical Issues and Safeguards Assessment

54. **Progress in addressing several weaknesses identified during a recent data ROSC in the national accounts, price, and balance of payments statistics has been slow.** A STA technical assistance mission that visited Maputo in September reported that several deficiencies remained in the basic sources of information for the balance of payments. Moreover, government finance statistics are not comprehensive because financial statistics from the state enterprises and the local governments are not collected systematically. In September 2003, the authorities provided to the staff a complete international reserves template. Another STA mission, expected to take place before the end of the year, will review progress in relation to Mozambique's planned participation in the General Data Dissemination System (GDDS).

55. **Mozambique is subject to the transitional arrangements governing safeguards assessments.** Currently, on audit board controlled by the government receives the full

external audit of the BoM's accounts each year, as well as a separate report prepared by the auditors. However, other steps to introduce oversight audit arrangements in line with international practices still need to be taken. These issues would be part of a full safeguards assessment to be undertaken in the context of a possible successor arrangement. The authorities have provided the staff with the audited report of the central bank accounts for end-2002.

VI. Staff Appraisal

56. Mozambique's economic performance during 2002 and the first three quarters of 2003 continued to be favorable. Real GDP growth remained strong, significant progress was made on the structural side, and the country's international reserves position was strengthened. Year-end inflation was lowered to single digits during 2002, but it rose in 2003 reflecting the impact of drought on food prices and the strengthening of the South African rand vis-à-vis the metical. Advances were made toward achieving the poverty reduction objectives envisaged in the PARPA, particularly in the areas of health and education.

57. The authorities' macroeconomic program remained broadly on track during the first half of 2003. On the fiscal side, government revenue was in line with expectations. However, capital outlays turned out significantly lower than programmed because of delays in project execution, which were related in part to shortfalls in external assistance. At the same time, there was an overrun in the wage bill owing to a large unplanned expansion in some provinces of temporary employment in the education sector. Monetary growth exhibited substantial volatility, and credit growth to the private sector was slower than envisaged. Exports performed strongly, and imports, particularly those associated with megaprojects, declined.

58. The government's economic program for 2004 seeks to broaden and sustain growth by maintaining prudent macroeconomic management and beginning to address an important agenda of unfinished reforms. The fiscal program calls for a further strengthening of tax revenue, in line with an expected reduction in external assistance over the medium term. It also seeks to partially reverse the substantial increase in the wage bill in recent years, which is affecting adversely the availability of resources to the priority sectors. Achieving the program's objectives requires firm discipline to limit the wage increase in 2004 to the projected inflation rate and to maintain tight control over the payroll. This is particularly important in light of a possible intensification of spending pressures before the national elections.

59. The authorities should be commended on the success of their efforts to mobilize additional revenue in recent years. These efforts should continue in the context of the program of technical assistance supported by the Fund and several donors to further strengthen tax administration, including by building institutional capacity to establish the CRA. The staff would recommend that the income tax on the salaries of government employees be withheld as soon as possible, and that an automatic mechanism for adjusting specific fuel taxes be introduced to preserve their real value in the future. It is also crucial to

adhere to the revised timetable for implementing the SISTAFE, which is an important tool for strengthening public expenditure management, and to bring all extrabudgetary activities within the budget framework so as to improve fiscal transparency. Moreover, public sector reform should address in a comprehensive manner the excessive growth of the government's wage bill, including by reducing employment redundancies in some areas.

60. Monetary developments need to be monitored closely to ensure that inflation is lowered, particularly in light of the recent volatility of broad money growth. In this regard, the authorities should pay attention to other monetary indicators, including currency, while allowing interest rates and the exchange rate to respond freely to market forces.

61. Early implementation of the recommendations resulting from the FSAP exercise is essential to improve monetary and exchange rate management. In this connection, steps should be taken to enhance the consistency between central bank sales of foreign exchange and the pace of expenditure financed with external support, to improve the use of indirect monetary instruments, and to better coordinate the actions of the BoM and the Ministry of Finance. Moreover, the balance sheet of the central bank should be strengthened, and its accounting procedures and profit distribution policy reviewed. The Fund and the World Bank are working closely with the authorities to design a comprehensive program of technical assistance to implement the FSAP recommendations.

62. The prospects for sustaining growth depend critically on the authorities' success in addressing remaining vulnerabilities in the financial system. In this regard, the diagnostic reviews of the main banks (particularly BIM), based on IAS, will provide additional information on the condition of a system that could be used to implement remedial actions, and will also enable a gradual move toward IAS. In the meantime, developments in the system should continue to be monitored very closely. More generally, efforts should be intensified to further strengthen the quality of bank supervision according to international accepted practices.

63. Access to bank credit continues to be limited by wide spreads and high lending rates, reflecting the high lending risk associated with a weak repayment culture, and legal and institutional impediments to effective credit recovery. Addressing these problems requires fostering competition in the financial system, improving judicial procedures to facilitate loan recovery, and reviewing land tenure regulations to bring about the use of land as collateral. In addition, the regulatory framework for microfinance activities should be carefully reviewed to promote their development, particularly in rural areas.

64. A number of obstacles to private sector development should be removed in order to broaden and sustain growth. In particular, the authorities should reduce the amount of red tape; improve basic infrastructure, including through further privatization; and reduce labor rigidities by simplifying procedures for hiring expatriates and lowering retrenchment costs. In addition, efforts should be intensified to improve governance and combat corruption by reforming the judicial system with a view to speeding up the administration of justice and strengthening the enforcement of contracts. Achieving this objective requires the

establishment of intermediate courts and revision of the relevant legislation. Prompt approval of the regulations of an anti-money-laundering law passed in 2002 is also necessary.

65. The authorities are preparing a single document integrating the monitoring of the PARPA and budget execution; the document is also expected to serve as the progress report for the second year of implementation of the PARPA. It is important that the document contain a revised macroeconomic framework, a new evaluation of the impact of HIV/AIDS on the country's growth prospects, and an assessment of progress toward meeting the MDGs.

66. Assuming continued implementation of prudent policies, Mozambique's external debt looks sustainable over the medium term. The authorities should continue to press to complete the remaining agreements with Paris Club creditors, and to reach agreements with non-Paris Club creditors and commercial creditors on comparable terms.

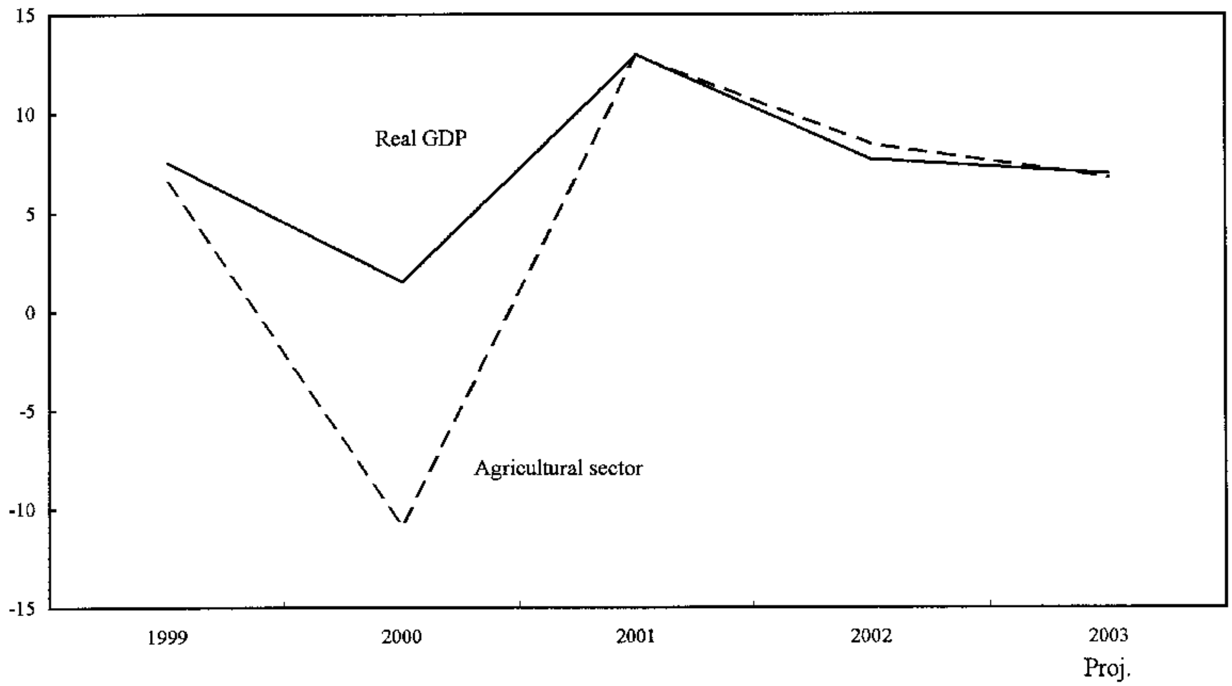
67. Efforts should be intensified to address several weaknesses in the national accounts, price, and balance of payments statistics, based on the recommendations of the recent data ROSC exercise. Also, steps should be taken to widen the coverage of government statistics by including in them state enterprises and local government budgets.

68. The authorities have expressed strong interest in a successor Fund-supported program to carry out their reform agenda. Based on the reasons provided in the supplement containing the expost assessment of performance under previous programs, the staff would recommend that the Board give consideration to providing continued Fund support through a successor PRGF arrangement with low access.

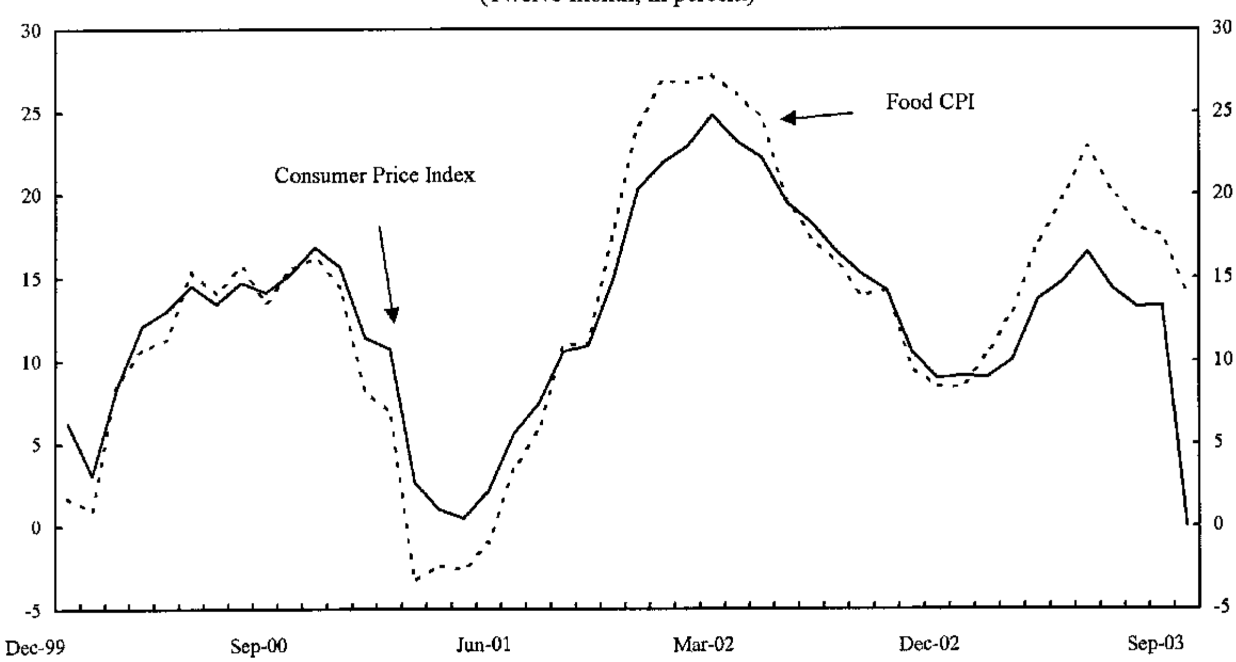
69. It is proposed that the next Article IV consultation with Mozambique be held on the standard 12-month cycle.

Figure 1. Mozambique: Real Growth Rates and Inflation

Real Growth Rates, 1999 - 2003
(In percent)

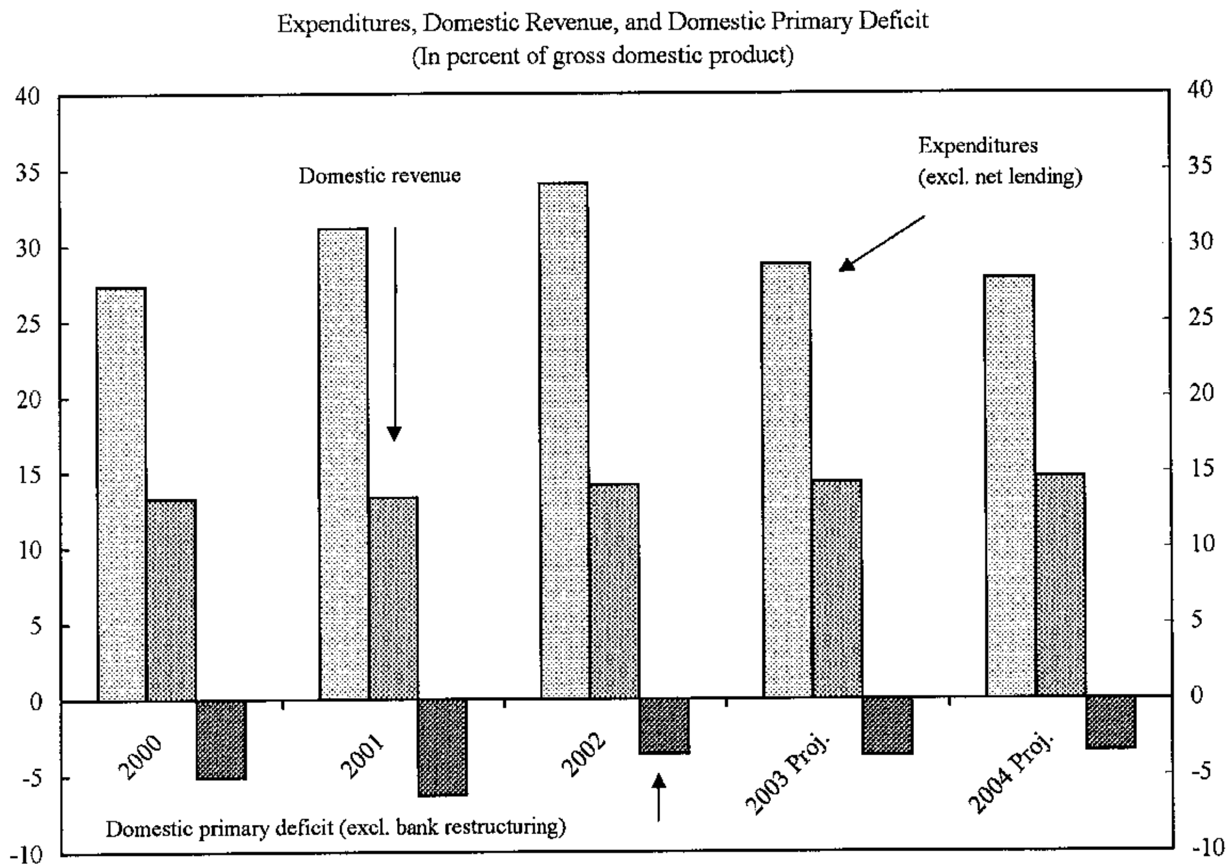


Inflation Rates December 1999 - September 2003
(Twelve-month; in percent)



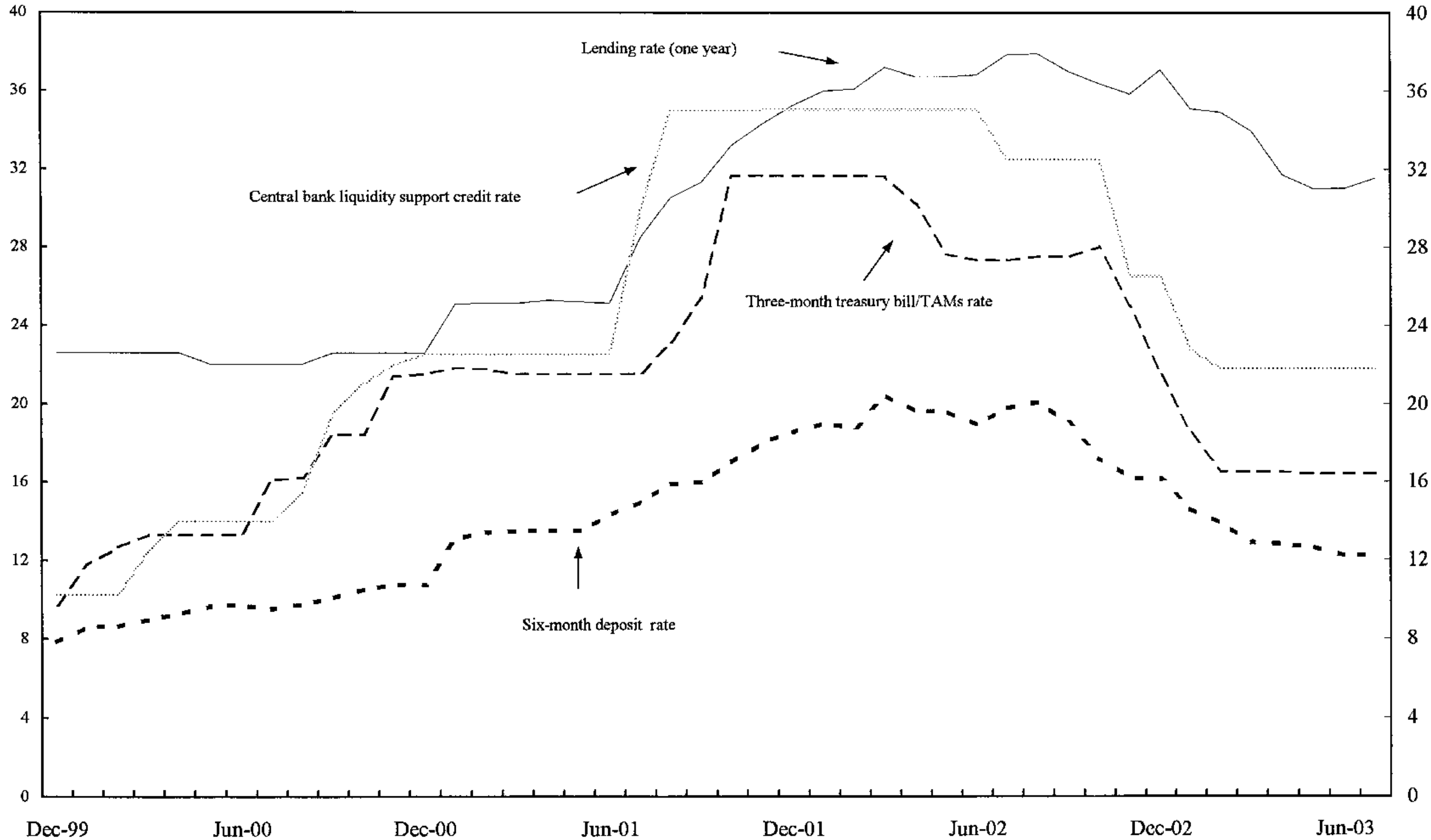
Sources: Mozambican authorities; and staff estimates.

Figure 2. Mozambique: Fiscal Sector Indicators, 2000-2004 1/



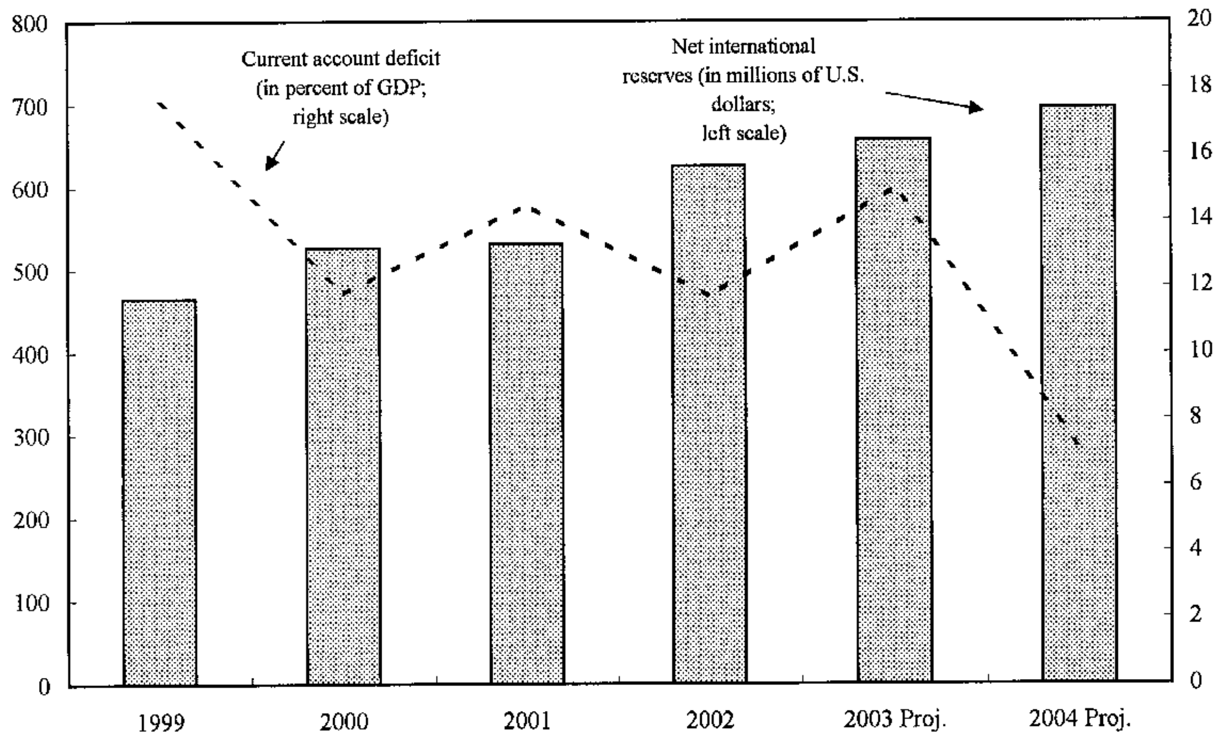
Sources: Mozambican authorities; and staff estimates.

Figure 3. Mozambique: Interest Rates, January 1999 - July 2003
(In percent)



Source: Mozambican authorities; and staff estimates.

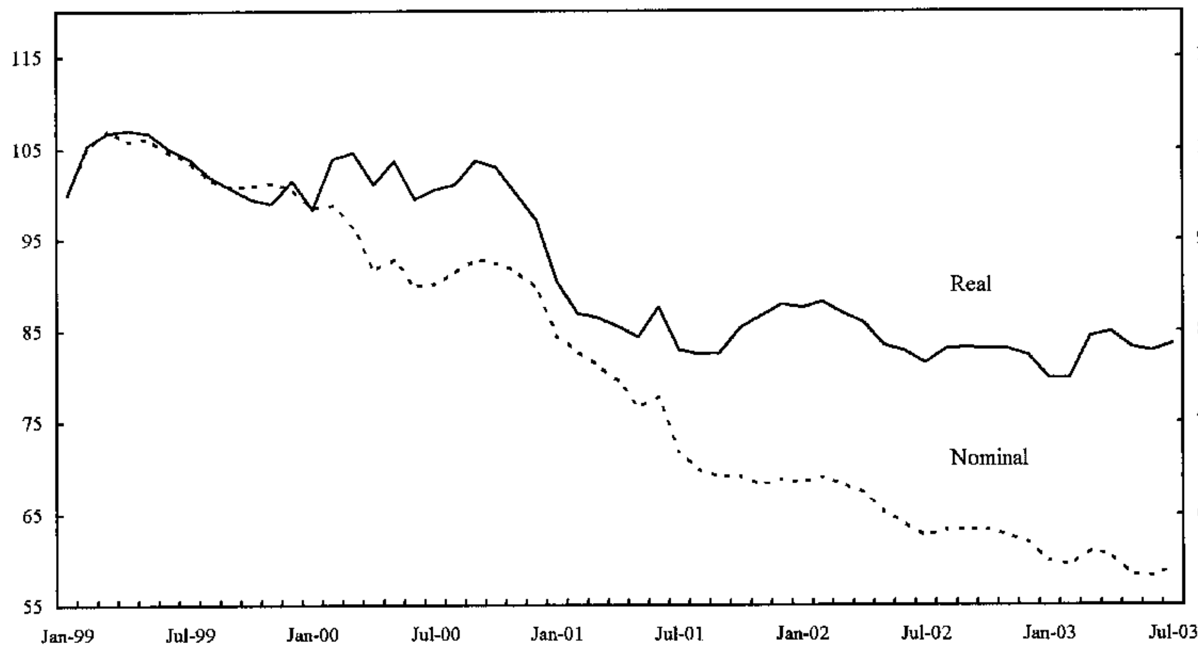
Figure 4. Mozambique: External Sector Indicators, 1999-2004 1/



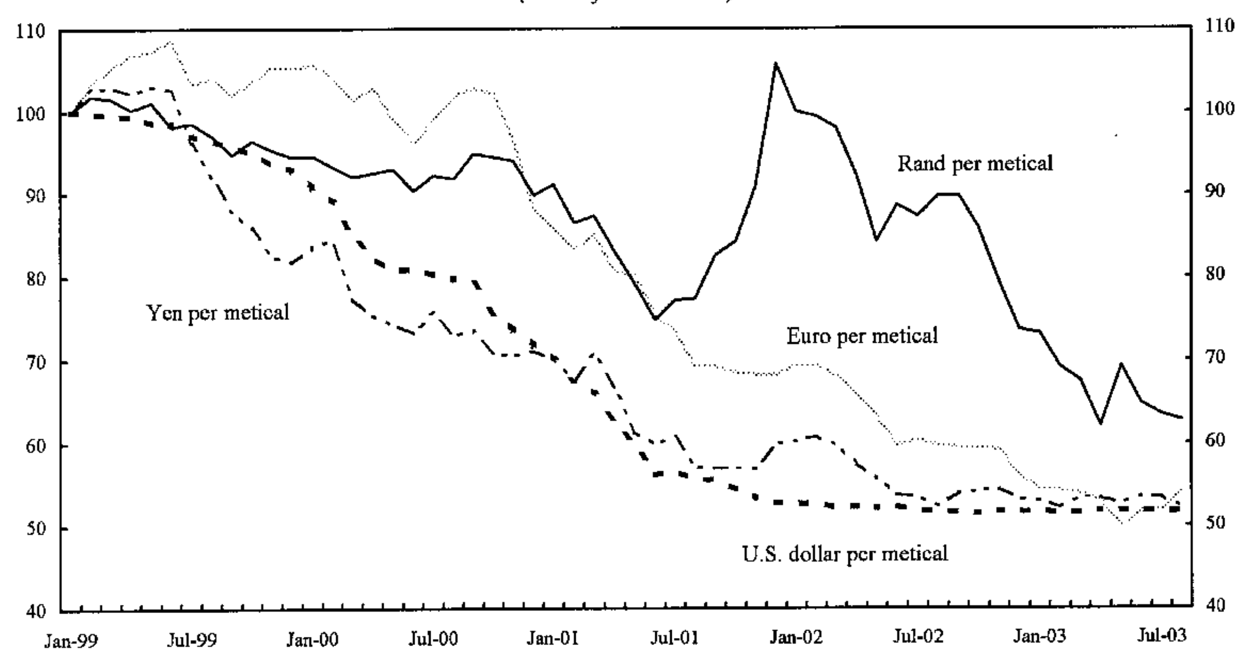
Sources: Mozambican authorities; and staff estimates.

Figure 5. Mozambique: Exchange Rates

Effective Exchange Rate, January 1999 - July 2003
(Jan 1999 = 100)



Bilateral Nominal Exchange Rates, January 1999 - August 2003
(January 1999 = 100)



Sources: Mozambican authorities; and staff estimates.

Table 1. Mozambique: Selected Economic and Financial Indicators, 2000–06

	2000	2001	2002	2003		2004	2005	2006
	Actual	Actual	Prel.	Prog.	Rev. Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise specified)							
National income and prices								
Nominal GDP (in billions of meticais)	56,917	71,135	85,206	102,749	102,749	121,365	140,574	160,643
Nominal GDP (in billions of U.S. dollars)	3.6	3.4	3.6	4.2	4.3	4.9	5.3	5.8
Real GDP growth	1.5	13.0	7.7	7.0	7.0	8.4	7.0	6.8
GDP deflator	8.0	10.6	11.2	12.7	12.7	9.0	8.3	7.0
Consumer price index (annual average)	12.7	9.0	16.8	12.7	13.0	9.2	8.3	7.0
Consumer price index (end of period)	11.4	21.9	9.1	10.8	10.8	9.0	7.5	6.5
External sector								
Merchandise exports	28.3	93.2	-3.0	22.5	31.5	40.4	9.6	10.7
Merchandise imports	-3.1	-8.6	18.8	29.4	26.8	-7.1	14.0	2.1
Terms of trade	-2.8	5.7	0.6.	...	1.4	-2.0	-1.4	-0.9
Nominal effective exchange rate (end of period) 1/	-10.8	-23.4	-10.7	...	...	...	...	...
Real effective exchange rate (end of period) 1/	-3.7	-9.3	-6.4	...	...	...	...	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)							
Money and credit								
Net domestic assets	11.6	9.1	0.2	1.8	10.8	7.4	10.5	9.3
Of which : net credit to the government	4.1	5.3	3.3	-2.7	-0.5	-1.1	-2.6	-2.8
credit to the economy	22.3	15.5	2.7	5.2	5.1	9.7	8.5	9.2
Broad money (M2)	42.4	29.7	20.1	18.4	13.5	14.5	15.5	14.5
Velocity (GDP/ average M2)	4.0	3.7	3.6	3.6	3.7	3.8	3.8	3.8
Interest rate for 90-days treasury bills/TAMs 2/ (in percent; end of period)	21.8	31.7	18.5	...	...	...	...	...
	(In percent of GDP)							
Investment and saving								
Gross domestic investment	36.6	41.5	44.7	45.9	41.8	33.1	38.3	34.5
Government	10.6	16.6	14.3	12.7	11.7	11.8	11.3	10.6
Other sectors	25.9	24.9	30.4	33.2	30.1	21.3	27.0	23.9
Gross national savings	23.4	27.0	33.0	23.7	26.8	26.0	28.7	28.3
Government	7.8	13.6	10.1	8.9	8.5	7.8	7.8	7.5
Other sectors	15.6	13.4	22.9	14.9	18.3	18.2	20.9	20.8
Current account, after grants	-13.2	-14.5	-11.7	-22.2	-15.0	-7.1	-9.6	-6.2
Government budget								
Total revenue	13.2	13.3	14.2	14.3	14.4	14.7	15.0	15.3
Total expenditure and net lending (incl. residual)	27.3	34.7	33.8	28.7	28.0	27.8	26.7	25.9
Overall balance, before grants	-14.0	-21.4	-19.7	-14.4	-13.5	-13.1	-11.7	-10.6
Total grants	8.0	14.8	11.8	10.5	10.3	9.0	8.2	7.4
Overall balance, after grants	-6.0	-6.6	-7.9	-3.9	-3.2	-4.1	-3.5	-3.2
Domestic primary balance	-6.8	-8.5	-5.9	-3.7	-3.7	-3.4	-3.2	-3.0
Excluding bank restructuring	-5.1	-6.3	-3.6	-3.7	-3.7	-3.4	-3.2	-3.0
External financing (incl. debt relief)	4.3	4.7	7.0	4.5	3.3	4.4	4.0	3.8
Net domestic financing 2/	1.7	1.9	0.9	-0.6	-0.1	-0.3	-0.5	-0.6
	(In percent of exports of goods and nonfactor services)							
Net present value of total public external debt outstanding 3/	194.4	109.8	91.7	87.7	85.4	79.9	76.7	72.4
External debt service (nonfinancial public sector)								
Scheduled, after original HIPC Initiative assistance	5.5	5.8	8.2	7.6	7.2	6.6	6.4	6.0
Scheduled, after enhanced HIPC Initiative assistance	2.5	3.6	5.4	5.2	4.8	4.5	4.4	4.3
Scheduled, after additional bilateral assistance	...	3.5	4.3	4.2	3.8	3.7	3.8	3.8
	(In millions of U.S. dollars, unless otherwise specified)							
External current account, after grants	-478	-497	-421	-943	-644	-345	-509	-363
Overall balance of payments	-352	-421	94	45	31	40	25	38
Net international reserves (end of period)	526	531	625	670	656	696	721	759
Gross international reserves (end of period)	746	727	810	845	832	856	858	867
In months of imports of goods and nonfactor services	6.3	5.8	5.9	4.9	5.0	5.4	4.8	4.7
In percent of broad money	76.2	77.9	73.9	68.3	68.4	64.6	58.9	54.5
Exchange rate (meticais per U.S. dollar; end of period)	17,140	23,320	23,854	...	...	...	...	...
Use of Fund resources (in millions of SDRs)								
Purchases/disbursements	45.2	8.4	8.4	8.4	8.4	3.8	3.8	3.8
Repurchases/repayments, before HIPC Initiative assistance	22.2	21.0	17.1	14.8	14.8	15.3	20.5	24.6
Credit outstanding	168.4	155.8	147.1	140.7	140.7	129.1	112.5	91.7

Sources: Mozambican authorities; and staff estimates and projections.

1/ A minus sign indicates depreciation.

2/ Includes privatization revenues after the year 2004.

3/ Public and publicly guaranteed, in percent of the three-year average of exports. The data for 1999-2000 include the impact of total debt relief granted under the original HIPC Initiative. Data for 2001-03 include the impact of total debt relief under the enhanced HIPC initiative, additional bilateral assistance, and new borrowing.

Table 2. Mozambique: Government Finances, 2000–04
(In billions of meticais)

	2000		2001		2002		2003						2004	
	Actual Year	In % of GDP	Actual Year	In % of GDP	Actual Prel.	In % of GDP	Progr. Q1-Q2	Actual Q1-Q2	Progr.	In % of GDP	Rev. Proj.	In % of GDP	Proj.	In % of GDP
Total revenue	7,535	13.2	9,469	13.3	12,057	14.2	6,375	6,374	14,703	14.3	14,846	14.4	17,793	14.7
Tax revenue	6,862	12.1	8,400	11.8	10,629	12.5	5,730	5,812	13,554	13.2	13,763	13.4	16,567	13.7
Taxes on income and profits	1,034	1.8	1,519	2.1	2,116	2.5	1,086	951	3,203	3.1	3,233	3.1	3,860	3.2
Taxes on goods and services	4,314	7.6	5,169	7.3	6,404	7.5	3,497	3,692	7,783	7.6	8,033	7.8	9,835	8.1
Of which: on petroleum products	771	1.4	824	1.2	865	1.0	469	479	1,020	1.0	1,269	1.2	1,593	1.3
Taxes on international trade	1,279	2.2	1,477	2.1	1,851	2.2	900	981	2,083	2.0	2,083	2.0	2,421	2.0
Other taxes	235	0.4	235	0.3	258	0.3	246	188	484	0.5	414	0.4	451	0.4
Nontax revenue	672	1.2	1,070	1.5	1,428	1.7	645	562	1,150	1.1	1,083	1.1	1,226	1.0
Total expenditure and net lending	15,556	27.3	24,579	34.6	29,032	34.1	13,360	12,161	29,524	28.7	28,739	28.0	33,739	27.8
Current expenditure	7,685	13.5	10,345	14.5	13,469	15.8	7,291	7,490	16,392	16.0	16,697	16.3	19,270	15.9
Compensation to employees	3,817	6.7	4,946	7.0	6,206	7.3	3,200	3,256	7,809	7.6	8,055	7.8	9,146	7.5
Goods and services	2,081	3.7	2,715	3.8	3,163	3.7	2,362	2,253	4,012	3.9	4,012	3.9	4,956	4.1
Interest on public debt	109	0.2	477	0.7	1,274	1.5	444	537	1,165	1.1	1,224	1.2	1,228	1.0
Domestic	11	0.0	330	0.5	952	1.1	320	379	923	0.9	923	0.9	855	0.7
External	99	0.2	147	0.2	322	0.4	124	157	242	0.2	301	0.3	373	0.3
Transfer payments	1,677	2.9	2,208	3.1	2,826	3.3	1,285	1,444	3,406	3.3	3,406	3.3	3,940	3.2
Domestic current primary balance	-40	-0.1	-399	-0.6	-138	-0.2	-472	-579	-524	-0.5	-626	-0.6	-249	-0.2
Capital expenditure	6,060	10.6	11,808	16.6	12,149	14.3	6,054	4,560	13,097	12.7	12,009	11.7	14,332	11.8
Of which: locally financed	2,046	3.6	3,140	4.4	3,167	3.7	2,133	1,538	3,503	3.4	3,367	3.3	4,126	3.4
Net lending	1,812	3.2	2,426	3.4	3,414	4.0	15	111	34	0.0	33	0.0	137	0.1
Of which: locally financed	1,812	3.2	2,426	3.4	1,970	2.3	-96	111	-205	-0.2	-205	-0.2	-193	-0.2
Of which: for bank restructuring	954	1.7	1,585	2.2	1,998	2.3	0	0	0	0.0	0	0.0	0	0.0
Unallocated revenue (+)/expenditure (-) 1/	42	0.1	-101	-0.1	209	0.2	0	49	0	0.0	0	0.0	0	0.0
Overall balance, before grants	-7,980	-14.0	-15,211	-21.4	-16,766	-19.7	-6,985	-5,738	-14,820	-14.4	-13,893	-13.5	-15,946	-13.1
Grants received	4,576	8.0	10,520	14.8	10,020	11.8	6,092	4,240	10,790	10.5	10,608	10.3	10,948	9.0
Project	2,112	3.7	7,044	9.9	6,728	7.9	2,874	2,273	7,059	6.9	6,504	6.3	7,116	5.9
Nonproject	2,464	4.3	3,475	4.9	3,292	3.9	3,219	1,968	3,731	3.6	4,104	4.0	3,832	3.2
Overall balance, after grants	-3,403	-6.0	-4,691	-6.6	-6,745	-7.9	-893	-1,498	-4,030	-3.9	-3,285	-3.2	-4,998	-4.1
Central bank transfer of HIPC assist. by the IMF	455	0.8	513	0.7	538	0.6	153	275	330	0.3	330	0.3	330	0.3
Net external borrowing	1,983	3.5	2,797	3.9	5,401	6.3	833	643	4,270	4.2	3,081	3.0	4,987	4.1
Disbursements	2,268	4.0	3,108	4.4	5,886	6.9	1,260	926	5,161	5.0	3,958	3.9	5,745	4.7
Project	1,724	3.0	1,624	2.3	2,512	2.9	1,048	686	2,536	2.5	2,138	2.1	3,090	2.5
Nonproject	544	1.0	1,484	2.1	3,374	4.0	212	239	2,625	2.6	1,820	1.8	2,655	2.2
Cash amortization	-286	-0.5	-311	-0.4	-485	-0.6	-427	-282	-891	-0.9	-876	-0.9	-758	-0.6
Net domestic financing	966	1.7	1,382	1.9	806	0.9	-93	580	-569	-0.6	-126	-0.1	-338	-0.3
Net bank credit (excl. bonds for bank restructuring)	221	0.4	682	1.0	-1,022	-1.2	...	626	-369	-0.4	30	0.0	12	0.0
Bonds for bank restructuring	745	1.3	700	1.0	1,828	2.1	...	-46	-200	-0.2	-156	-0.2	-368	-0.3
Other	...	...	...	...	...	...	...	...	...	...	...	...	18	0.0
Memorandum items:														
Domestic primary balance, before grants 2/	-3,856	-6.8	-6,065	-8.5	-5,066	-5.9	-2,509	-2,179	-3,821	-3.7	-3,788	-3.7	-4,182	-3.4
Excluding bank restructuring net lending	-2,902	-5.1	-4,480	-6.3	-3,068	-3.6	-2,509	-2,179	-3,821	-3.7	-3,788	-3.7	-4,182	-3.4
Domestic public debt 3/	...	1.4	...	2.2	...	4.1	...	...	...	...	...	2.0	...	1.6
Nominal GDP	56,917	...	71,135	...	85,206	...	...	...	102,749	...	102,749	...	121,365	121,365

Sources: Mozambican authorities; and 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. Unallocated revenue and expenditure are included in the primary balance.

3/ Domestic public debt refers to treasury securities only.

Table 3. Mozambique: Monetary Survey, December 2000 - December 2004

	2000	2001	2002	2003								2004
	Dec. Actual	Dec. Actual	Dec. Actual	May Actual	Jun. Prog.	Jun. Actual	Jul. Actual	Sep. Prog.	Sep Prel.	Dec. Prog.	Dec. Rev.Proj.	Dec. Proj.
	(In billions of meticais, unless otherwise specified)											
Central bank												
Net foreign assets	-99	1,764	3,935	3,069	4,438	3,108	3,687	3,987	3,957	5,177	4,921	6,121
(in millions of U.S. dollars)	-6	76	165	129	185	131	155	167	167	207	202	239
Net international reserves	9,015	12,384	14,902	14,187	15,253	14,498	14,504	14,972	14,745	16,776	15,989	17,830
(in millions of U.S. dollars)	526	531	625	596	635	611	608	628	621	670	656	696
Medium- and long-term foreign liabilities	-9,357	-10,964	-11,457	-11,637	-11,604	-11,935	-11,331	-11,803	-11,283	-12,099	-11,587	-12,276
Other	243	344	490	518	789	545	514	818	495	500	520	567
Net domestic assets	4,039	4,293	3,197	3,800	3,266	3,862	3,502	3,668	3,326	3,234	3,316	3,493
Credit to government (net)	-5,433	-4,581	-4,489	-3,852	-4,540	-4,256	-4,366	-3,940	-4,758	-4,540	-4,615	-4,784
Credit to banks (net)	483	476	-2,222	-3,671	-3,486	-3,085	-2,896	-3,930	-2,900	-3,918	-3,082	-3,423
Credit to the economy	1	0	1	1	1	1	1	1	1	1	1	1
Other items (net; assets +)	8,989	8,397	9,908	11,205	11,291	11,202	10,764	11,537	10,983	11,691	11,012	11,698
Reserve money	3,940	6,056	7,132	6,869	7,399	6,970	7,190	7,714	7,283	8,410	8,238	9,614
Currency outside banks	2,425	2,970	3,486	3,416	3,374	3,597	3,681	3,550	4,181	4,111	4,036	4,587
Bank reserves	1,515	3,086	3,647	3,453	4,025	3,373	3,508	4,164	3,102	4,299	4,202	5,027
Currency in banks	428	610	612	351	456	480	451	486	400	550	600	675
Deposits	1,087	2,476	3,034	3,101	3,569	2,893	3,057	3,678	2,702	3,749	3,602	4,352
Deposit money banks												
Net foreign assets	4,449	6,046	8,215	7,272	8,175	7,379	7,705	8,538	7,043	9,868	7,925	8,842
(in millions of U.S. dollars)	260	259	344	305	340	311	323	358	297	394	325	345
Net domestic assets	9,904	12,747	14,444	15,467	17,014	15,999	16,615	17,685	17,289	17,388	17,714	20,548
Banks' reserves	1,515	3,086	3,647	3,453	4,025	3,373	3,508	4,164	3,102	4,299	4,202	5,027
Central bank liabilities with coml. banks (net)	-959	-628	2,159	3,317	3,486	3,170	2,669	3,930	2,900	3,918	3,082	3,423
Credit to government (net)	296	334	961	1,187	921	1,276	2,221	1,629	2,475	443	961	793
Credit to the economy	11,343	13,943	14,525	14,248	15,584	13,941	14,380	15,693	14,319	16,704	15,868	18,743
Of which : in foreign currency	4,350	5,405	6,654	7,262	7,836	7,235	7,393	7,286	7,415	7,486	7,620	8,347
(in millions of U.S. dollars)	254	232	279	305	326	305	310	306	312	299	313	326
Other items (net; assets +)	-2,291	-3,989	-6,848	-6,738	-7,002	-6,176	-6,162	-7,731	-5,507	-7,977	-6,399	-7,437
Deposits	14,353	18,793	22,659	22,739	25,189	23,379	24,320	26,223	24,332	26,871	25,639	29,390
Demand and savings deposits	10,775	14,034	16,366	16,582	18,644	16,662	17,555	19,462	17,408	20,443	18,483	20,938
Time deposits	3,579	4,759	6,293	6,156	6,545	6,717	6,765	6,761	6,924	6,428	7,156	8,453
Monetary survey												
Net foreign assets	4,350	7,810	12,150	10,341	12,612	10,487	11,392	12,525	11,000	15,045	12,846	14,963
Net domestic assets	12,429	13,954	13,995	15,814	16,255	16,488	16,609	17,189	17,003	15,937	16,828	19,014
Domestic credit	6,207	9,697	10,998	11,701	11,966	11,376	12,235	13,383	12,822	13,122	12,215	14,753
Credit to government (net)	-5,137	-4,246	-3,528	-2,547	-3,619	-2,980	-2,146	-2,311	-1,496	-4,097	-3,654	-3,991
Credit to the economy	11,344	13,944	14,526	14,248	15,585	14,356	14,381	15,694	14,319	16,705	15,869	18,744
Other items (net; assets +)	6,222	4,256	2,996	4,114	4,289	5,112	4,374	3,806	4,181	3,714	4,613	4,261
Money and quasi money (M2)	16,779	21,763	26,145	26,155	28,563	26,975	28,001	29,773	28,003	30,982	29,674	33,977
Currency outside banks	2,425	2,970	3,486	3,416	3,374	3,597	3,681	3,550	3,671	4,111	4,036	4,587
Deposits	14,353	18,793	22,659	22,739	25,189	23,379	24,320	26,223	24,332	26,871	25,639	29,390
Of which : foreign currency deposits	7,107	9,897	11,546	11,403	12,924	11,418	12,398	12,832	11,614	13,677	12,751	14,460
(in millions of U.S. dollars)	415	424	484	479	538	482	520	538	489	546	523	564
Foreign currency deposits (in percent of total deposits)	49.5	52.7	51.0	50.1	51.3	48.8	51.0	48.9	47.7	50.9	49.2	49.2
	(12-month percent change, unless otherwise indicated)											
Memorandum items:												
M2 growth	42.4	29.7	20.1	12.4	16.2	9.8	15.1	14.1	7.3	18.5	13.5	14.5
M2 growth at constant end-of-year exch. rates	29.3	12.5	18.9	0.1	15.2	3.5	7.1	14.2	7.3	15.9	12.4	12.0
Credit to the economy	30.1	22.9	4.2	-1.8	8.0	-0.5	1.9	12.0	2.2	15.0	9.2	18.1
Cred. to econ. adjusted for write-offs (annual growth)		...	10.9	8.4	...	9.9	14.1	...	13.6	...	14.5	18.1
Currency/M2 (in percent)	14.5	13.6	13.3	13.1	11.8	13.3	13.1	11.9	13.1	13.3	13.6	13.5
Reserve money growth	26.4	53.7	17.8	14.3	16.2	9.5	15.0	15.4	9.0	17.9	15.5	16.7
Money multiplier (M2/reserve money)	4.26	3.6	3.7	3.8	3.9	3.9	3.9	3.9	3.8	3.7	3.6	3.5
Velocity (GDP/average M2)	3.99	3.7	3.6	3.7	3.5	3.6	3.6	3.4	3.5	3.6	3.7	3.8
Market exch. rate, end-period (Meticais per U.S. dollar)	17,140	23,320	23,854	23,807	24,020	23,710	23,844	23,830	23,744	...	...	...

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

Table 4. Mozambique: Balance of Payments, 2000–04

(In millions of U.S. dollars, unless otherwise specified)

	2000	2001	2002	2003		2004
			Prel.	Auth. Prg.	Rev. Proj.	Proj.
Trade balance	-799	-360	-581	-799	-705	-229
Exports, f.o.b.	364	703	682	835	896	1,259
Large projects	127	441	468	589	632	973
Other exports	237	263	213	246	265	286
Imports, c.i.f.	-1,163	-1,063	-1,263	-1,634	-1,602	-1,488
Large projects	-119	-231	-390	-628	-646	-450
Other imports	-1,044	-832	-873	-1,007	-955	-1,038
Services (net)	-243	-606	-259	-614	-447	-618
Receipts	405	311	545	385	399	393
Expenditures	-648	-917	-804	-999	-846	-1,011
Of which : interest on public debt	-161	-147	-27	-28	-24	-27
Current account, before grants	-1,042	-966	-841	-1,413	-1,152	-847
Unrequited official transfers	564	469	420	470	508	501
Of which : multilaterals' HIPC assistance grants	...	...	45	44	44	48
Current account, after grants	-478	-497	-421	-943	-644	-345
Capital account	279	35	675	1,038	657	405
Trade credit (net)	...	...	-128	...	-181	...
Foreign borrowing	484	156	809	729	622	451
Public	162	104	248	211	165	229
Private 1/	322	52	561	518	457	222
Amortization	-344	-376	-163	-154	-181	-213
Public	-306	-306	-39	-42	-43	-50
Private	-38	-71	-124	-112	-138	-163
Direct investment (net)	139	255	156	464	396	168
Short-term capital and errors and omissions (net)	-153	41	-160	-50	19	-20
Overall balance	-352	-421	94	45	31	40
Financing	-98	-5	-94	-45	-31	-40
Of which: Bank of Mozambique net international reserves (increase -)	-98	-5	-94	-45	-31	-40
Financing gap before debt relief	450	426	0	0	0	0
Memorandum items:						
Debt relief 2/	449	426	416	404	404	351
Current account deficit (percent of GDP)						
Before grants	28.7	28.1	23.3	33.3	26.7	17.4
After grants	13.2	14.5	11.7	22.2	15.0	7.1
After grants, excluding large projects	9.0	12.9	5.1	10.8	7.6	8.5
Net international reserves	526	531	625	670	656	696
Gross international reserves	746	727	810	845	832	856
In months of imports of goods and nonfactor services	6.3	5.8	5.9	4.9	5.0	5.4
In months of imports of goods and nonfactor services, excl. large projects	6.9	6.9	7.8	7.1	7.3	7.0
Debt indicators (in percent)						
Net present value (NPV) of public external debt/GDP	30.3	24.9	24.8	23.3	22.7	22.2
NPV of public external debt/exports	194.4	109.8	91.7	87.7	85.4	79.9
NPV of public external debt/revenue	193.9	187.0	175.4	162.9	156.8	151.2
Debt service due/exports	2.5	3.5	4.3	4.2	3.8	3.7
Debt service due/revenue	2.6	5.9	8.2	7.8	7.0	7.1

Sources: Mozambican authorities; and staff estimates and projections.

1/ Private borrowing, not guaranteed by the government or the Bank of Mozambique.

2/ The balance of payments presentation changes in 2002: debt relief is incorporated above the line so that debt service to official bilateral and commercial creditors reflects what is owed after relief. Debt service to multilaterals is still shown before debt relief, but with HIPC assistance grants a new entry under "unrequited official transfers." The memorandum item shows total debt relief.

Table 5. Mozambique: Delivery of Debt Relief under the HIPC Initiative by Official Bilateral Creditors

Creditor	Progress to Date
I. Paris Club Official Creditors	
Austria	Bilateral agreement signed involving 100 percent debt cancellation (2002).
Brazil	Bilateral agreement to be signed shortly involving 95 percent debt reduction in NPV terms.
France	Bilateral agreement signed involving 100 percent cancellation of pre-cod debt and rescheduling of deferred debt (2002).
Germany	Bilateral agreement signed involving 100 percent debt cancellation (2002).
Italy	Bilateral agreement signed involving 100 percent debt cancellation (2002).
Japan	100 percent debt cancellation committed; agreement not signed yet.
Portugal	100 percent debt cancellation expected; agreement not signed yet.
Russia	Bilateral agreement signed involving 100 percent cancellation of pre-cod debt and rescheduling of post-cod debt (2002).
Spain	Bilateral agreement signed involving 100 percent debt cancellation (2002).
Sweden	Bilateral agreement signed involving 100 percent debt cancellation (2003).
United Kingdom	Bilateral agreement signed involving 100 percent debt cancellation (2002).
United States	Bilateral agreement signed involving 100 percent debt cancellation (2002).
II. Non-Paris Club Official Creditors	
Algeria	Mozambique is requesting topping up over the proposed rescheduling on Lyon terms.
China 1/	Bilateral agreement signed involving debt reduction comparable to Paris Club terms (2002)
India	100 percent cancellation of official debt committed (2002); agreement not signed yet.
Kuwait	Bilateral agreement signed involving debt reduction comparable to Paris Club terms (2002)
North Korea 2/	To be paid in full by end-2003.
Angola, Bulgaria, Cuba, Former Yugoslavia, Hungary, Iraq, Libya, Poland, Romania	Mozambique proposed debt relief comparable to Paris Club terms.

Source: Mozambican authorities.

1/ Involved 90 percent debt cancellation in nominal terms with remaining amount rescheduled at highly concessional terms.
2/ *de minimus* creditor.

Table 6. Mozambique: Medium-Term Fiscal Framework, 2003–06
(In percent of GDP, unless otherwise specified)

	2003 Rev. Proj.	2004 Proj.	2005 Proj.	2006 Proj.
Total revenue	14.4	14.7	15.0	15.3
Tax revenue	13.4	13.7	13.8	14.0
Taxes on income and profits	3.1	3.2	3.3	3.4
Taxes on goods and services	7.8	8.1	8.1	8.2
Of which: on petroleum products	1.2	1.3	1.3	1.3
Taxes on international trade	2.0	2.0	2.0	1.9
Other taxes	0.4	0.4	0.4	0.5
Nontax revenue	1.1	1.0	1.2	1.3
Total expenditure and net lending	28.0	27.8	26.7	25.9
Current expenditure	16.3	15.9	15.3	15.2
Compensation to employees	7.8	7.5	7.3	7.1
Goods and services	3.9	4.1	4.0	4.0
Interest on public debt	1.2	1.0	0.8	0.8
Domestic	0.9	0.7	0.6	0.5
External	0.3	0.3	0.3	0.3
Transfer payments	3.3	3.2	3.2	3.3
Domestic current primary balance	-0.6	-0.2	0.5	0.9
Capital expenditure	11.7	11.8	11.3	10.6
Of which: locally financed	3.3	3.4	3.8	4.0
Net lending	0.0	0.1	0.1	0.1
Of which: locally financed	-0.2	-0.2	-0.1	-0.1
Of which: for bank restructuring	0.0	0.0	0.0	0.0
Overall balance, before grants	-13.5	-13.1	-11.7	-10.6
Grants received	10.3	9.0	8.2	7.4
Project	6.3	5.9	5.1	4.5
Nonproject	4.0	3.2	3.1	2.9
Overall balance, after grants	-3.2	-4.1	-3.5	-3.2
Central bank transfer of HIPC assist. by the IMF	0.3	0.3	0.3	0.3
Net external borrowing	3.0	4.1	3.7	3.5
Disbursements	3.9	4.7	4.3	4.0
Project	2.1	2.5	2.3	2.1
Nonproject	1.8	2.2	1.9	1.9
Cash amortization	-0.9	-0.6	-0.6	-0.5
Net domestic financing	-0.1	-0.3	-0.6	-0.7
Net bank credit (excl. bonds for bank restructuring	0.0	0.0	-0.5	-0.6
Bonds for bank restructuring	-0.2	-0.3	-0.3	-0.2
Other	...	0.0	0.1	0.1
Memorandum items:				
Domestic primary balance, before grants 1/	-3.7	-3.4	-3.2	-3.0
Excluding bank restructuring net lending	-3.7	-3.4	-3.2	-3.0
Nominal GDP (in billions of meticais)	102,749	121,365	140,574	160,643

Sources: Mozambican authorities; and staff estimates and projections.

1/ Revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending. Unallocated revenue and expenditure are included in the primary balance.

Table 7. Mozambique: Medium-Term Balance of Payments Outlook, 2003–08

(In millions of U.S. dollars, unless otherwise specified)

	2003 Rev. Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Trade balance	-705	-229	-317	-205	-353	-258
Exports, f.o.b.	896	1,259	1,379	1,526	1,595	1,636
Large projects	632	973	1,073	1,199	1,244	1,260
Other exports	265	286	306	327	351	376
Imports, c.i.f.	-1,602	-1,488	-1,696	-1,731	-1,947	-1,894
Large projects	-646	-450	-604	-584	-734	-619
Other imports	-955	-1,038	-1,091	-1,147	-1,213	-1,275
Services (net)	-447	-618	-679	-640	-830	-827
Receipts	399	393	409	429	451	475
Expenditures	-846	-1,011	-1,088	-1,069	-1,281	-1,302
Of which: interest on public debt	-24	-27	-27	-28	-29	-30
Current account, before grants	-1,152	-847	-996	-844	-1,183	-1,085
Unrequited official transfers	508	501	487	482	478	475
Of which: multilaterals' HIPC assistance grants	44	48	52	52	48	45
Current account, after grants	-644	-345	-509	-363	-705	-610
Capital account	657	405	534	401	729	611
Trade credit (net)	-181	...	...	...	...	...
Foreign borrowing	622	451	526	450	698	644
Public	165	229	227	233	231	229
Private 1/	457	222	299	217	468	415
Amortization	-181	-213	-247	-272	-284	-285
Public	-43	-50	-54	-56	-60	-62
Private	-138	-163	-192	-216	-224	-223
Direct investment (net)	396	168	255	222	315	253
Short-term capital and errors and omissions (net)	19	-20	0	0	0	0
Overall balance	31	40	25	38	24	1
Financing	-31	-40	-25	-38	-24	-1
Of which: Bank of Mozambique net international reserves (increase -)	-31	-40	-25	-38	-24	-1
Financing gap before debt relief	0	0	0	0	0	0
Memorandum items:						
Debt relief 2/	404	351	292	166	149	148
Current account deficit (percent of GDP)						
Before grants	26.7	17.4	18.7	14.5	18.5	15.5
After grants	15.0	7.1	9.6	6.2	11.0	8.7
After grants, excluding large projects	7.6	8.5	8.6	8.7	8.7	8.4
Net international reserves	656	696	721	759	783	784
Gross international reserves	832	856	858	867	859	832
In months of imports of goods and nonfactor services	5.0	5.4	4.8	4.7	4.2	4.1
In months of imports of goods and nonfactor services, excl. large projects	7.3	7.0	6.7	6.4	6.0	5.5
Debt indicators (in percent)						
Net present value (NPV) debt/GDP	22.7	22.2	22.1	22.0	21.4	20.8
NPV debt/exports	85.4	79.9	76.7	72.4	72.3	73.0
NPV debt/revenue	156.8	151.2	147.7	143.6	137.5	131.6
Debt service due/exports	3.8	3.7	3.8	3.8	3.9	3.7
Debt service due/revenue	7.0	7.1	7.3	7.5	7.4	6.8

Sources: Mozambican authorities; and staff estimates and projections.

1/ Private borrowing, not guaranteed by the government or the Bank of Mozambique.

2/ The balance of payments presentation changes in 2002: debt relief is incorporated above the line so that debt service to official bilateral and commercial creditors reflects what is owed after relief. Debt service to multilaterals is still shown before debt relief, but with HIPC assistance gı new entry under "unrequited official transfers." The memorandum item shows total debt relief.

Table 8. Mozambique: External Financing Requirements and Sources, 2000–08
(In millions of U.S. dollars)

	2000	2001	2002 Prel.	2003 Auth. Prog.	2003 Rev. Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
External financing requirements	1,696	1,317	1,396	1,673	1,538	1,125	1,273	1,159	1,491	1,372
Current account, excluding grants	1,042	966	841	1,413	1,152	847	996	844	1,183	1,085
Amortization 1/	373	403	185	175	201	235	275	306	317	314
Trade credit (net, increase +)	0	0	128	0	181	0	0	0	0	0
Changes in arrears (increase -)	0	0	0	0	0	0	0	0	0	0
Changes in reserves (increase +) 2/	129	-11	83	35	22	24	2	9	-8	-27
Short-term capital and errors and omissions (net; outflow +) 3/	153	-41	160	50	-19	20	0	0	0	0
Total identified financing	1,247	892	1,396	1,673	1,538	1,125	1,273	1,159	1,491	1,372
Disbursements from existing and new commitments	1,108	636	1,239	1,210	1,142	957	1,018	937	1,177	1,119
Grants 4/	564	469	420	470	508	501	487	482	478	475
Loans	544	167	819	740	634	456	531	456	698	644
Bilateral	0	0	0	0	0	0	0	0	0	0
Multilateral 1/	222	115	259	222	177	234	232	238	231	229
IDA	125	30	148	152	133	164	170	182	182	180
IMF	60	11	11	11	12	5	5	5	0	0
Other	37	74	100	59	32	65	57	52	49	49
Private sector	322	52	561	518	457	222	299	217	468	415
Direct foreign investment	139	255	156	464	396	168	255	222	315	253
Debt relief 5/	449	425	0	0	0	0	0	0	0	0
Remaining gap	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Total reduction in debt service due (debt relief) 6/	449	425	416	404	404	351	292	166	149	148
Assistance for traditional mechanisms	299	282	286	270	270	216	156	35	19	18
Assistance under the original HIPC Initiative	104	99	93	95	95	96	96	91	89	88
Assistance under the enhanced HIPC Initiative	10	17	27	27	27	28	30	31	32	34
Assistance under additional bilateral relief	0	1	10	11	11	10	10	10	9	9
Paris Club deferral (flood relief)	37	26	0	0	0	0	0	0	0	0
Offcial grants and loans, excl. multilateral HIPC assistance 2/	726	573	622	637	629	682	662	663	661	659

Sources: Mozambican authorities; and staff estimates and projections.

1/ Including the Fund.
2/ Excluding the Fund.
3/ Including commercial banks' accumulation of net foreign assets.
4/ Includes IDA interim assistance under the original HIPC Initiative in 1999 (US$150 million).
5/ Includes the 1996 Paris Club flow rescheduling on Naples terms; the rescheduling of the debt to Russia after an up-front discount of 80 percent; the 1997 commercial debt rescheduling with the Bank of Brazil; total assistance under the HIPC Initiative; the Paris Club deferral; and the application of traditional rescheduling mechanism by non-Paris Club creditors.
6/ Since debt relief is no longer shown as a below-the-line item once a country passes its completion point, the memorandum items provide the data on debt relief after 2001.

Table 9. Mozambique: Indicators of External Vulnerability, 2000-04
(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003 Proj.	2004 Proj.
Financial indicators					
Net present value (NPV) of public sector debt 1/	31.7	27.1	28.6	25.6	24.5
Broad money (percent change, 12-month basis)	42.4	29.7	20.1	13.5	14.5
Private sector credit (percent change, 12 month basis)	30.1	22.9	10.9	14.5	18.1
External indicators					
Exports (percent change, 12-month basis in U.S. dollars)	28.3	93.2	-3.0	31.5	40.4
Imports (percent change, 12-month basis in U.S. dollars)	-3.1	-8.6	18.8	26.8	-7.1
Current account balance (after grant)	-13.2	-14.5	-11.7	-15.0	-7.1
Capital and financial account balance	7.7	1.0	18.7	15.2	8.4
Foreign direct investment	3.8	7.4	4.3	9.2	3.5
Other investment (loans, trade credits, etc.)	3.9	-6.4	14.4	6.1	4.9
Gross official reserves (in millions of U.S. dollars)	745.8	727.0	809.7	832.1	856.2
(in months of imports of goods and services)	6.3	5.8	5.9	5.0	5.4
Net foreign asset of commercial banks (in millions of U.S. dollars)	259.6	259.3	344.4	325.0	345.0
NPV of total external debt 1/	57.3	52.8	63.6	62.5	58.7
Of which : NPV of public sector external debt	30.3	24.9	24.8	22.7	22.2
NPV of total external debt to exports of goods and services (in percent) 1/	270.2	179.0	186.7	207.9	172.6
External interest payments to exports of goods and services (in percent) 2/	28.0	24.5	11.7	13.4	13.3
External amortization payments to exports of goods and services (in percent) 2/	47.0	37.5	13.7	14.6	13.2
Exchange rate (per U.S. dollar, period average)	15,689	20,707	23,667	...	...
REER depreciation (-) (12 month basis)	-3.7	-9.3	-6.4	...	...

Sources: Mozambican authorities; and Fund staff estimates.

1/ Domestic public debt and private sector external debt are valued at par in the NPV calculation.

2/ Interest and amortization payments are before HIPC Initiative assistance for 2000 and 2001, and after HIPC Initiative assistance for 2002-04.

Table 10. Mozambique: Quantitative Performance Criteria, Benchmarks, and Indicative Targets Under the PRGF Arrangement (June-December 2002), and Indicative Targets Under the Authorities' Program (June-December 2003)

(In billions of meticais, unless otherwise specified)

	2002									2003						
	June Performance criteria (unless otherwise noted)			September Indicative Targets			December Indicative Targets			June Indicative Targets			September Indicative Targets			December Indicative Targets
	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program
Central gov. domestic primary def. (excl. bank recapitalization costs (ceiling) 1/ 2/	1,971	....	2,031	3,579	....	3,273	3,224	....	3,068	2,509	....	2,179	3,721	...	...	3,788
Central government revenue (floor; benchmark only) 2/	5,383	....	5,321	8,409	....	8,200	12,406	....	12,057	6,375	....	6,374	10,257	...	10,091	14,846
Stock of net dom. assets of Bank of Mozambique (BoM) (ceiling) 3/ 4/ 5/	4,225	4,974	4,097	4,579	5,688	4,227	5,313	5,162	1,857	3,266	4,568	3,672	3,668	4,350	3,273	3,316
Stock of reserve money (ceiling; benchmark only) 5/	6,412	....	6,366	6,931	....	6,683	7,450	....	7,132	7,399	....	6,970	7,714	...	7,283	8,238
Stock of net international reserves of the BoM (floor) 6/	546	516	533	550	506	530	540	546	625	635	581	611	628	599	621	656
New nonconcessional borrowing contracted or guaranteed by the gov. or the BoM with maturity of more than one year (ceiling) 2/	0	....	0	0	....	0	0	....	0	0	....	0	0	...	...	0
Stock of short-term external public debt outstanding (ceiling) 7/	0	....	0	0	....	0	0	....	0	0	....	0	0	...	...	0
External payments arrears (ceiling) 2/ 8/	0	....	0	0	....	0	0	....	0	0	....	0	0	...	...	0
Memorandum items:																
Foreign program assist. (grants and loans; in millions of U.S. dollars) 2/	117	....	88	173	....	129	215	....	225	135	....	81	143	...	115	227
Actual external debt service payments (in millions of U.S. dollars) 2/	19	....	21	29	....	29	39	....	43	23	....	23	31	...	31	48
Net flows	98	...	68	144	...	100	176	....	182	112	....	58	112	...	83	179
Exchange rate (Meticais per U.S. dollar; end of period)	24,549	....	24,549	25,264	....	25,264	26,000	....	26,000	24,020	....	24,020	23,830		23,830	24,384
Shortfall in required reserves	...	0	....	...	0	...	...	0	...	...	0	....	...	0	...	...
Adjustment to BoM's net domestic assets at program exch. rates	...	749	....	...	1,109	...	...	-151	...	...	1,302	....	...	682	...	...
Adjustment to reserve money	...	0	....	...	0	...	...	0	...	...	0	....	...	0	...	...
Adjustment to NDA due to adjustment of NFA	...	749	....	...	1109	...	...	-151	...	...	1,302	....	...	682	...	...
Stock adjustments in medium- & long-term foreign liabilities	...	0	....	...	0	...	...	0	...	...	0	....	...	0	...	...

1/ Defined as revenue minus noninterest current expenditure minus locally financed capital expenditure and locally financed net lending.

2/ Cumulative from the beginning of the calendar year. Foreign program assistance includes special programs. Debt service includes debt service to the IMF and on new debt.

3/ Defined as reserve money minus net foreign assets (NFA) of the Bank of Mozambique. The foreign currency component of reserve money and NFA are valued at program exchange rates; NFA are defined to exclude the effect of any stock adjustments in medium- and long-term lia

4/ To be adjusted upward/downward to the extent of any shortfall/excess of foreign program assistance valued at program exchange rates and to be adjusted downward/upward to the extent that actual payments of external debt service exceed/fall short of programmed amounts.

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

6/ To be adjusted downward/upward to the extent of any shortfall/excess of foreign program assistance relative to the programmed amount and to be adjusted upward/downward for the extent that actual payments of external debt service fall short of/exceed programmed amounts.

7/ Loans of 0-1 year's maturity, excluding normal import-related credit. Non-U.S. dollar debt converted to U.S. dollars at actual exchange rates.

8/ Continuous performance criterion; excluding arrears arising from debt-service payments that become due pending the conclusion of debt-rescheduling agreements. Actual figures are valuated at program exchange rates.

Table 11. Mozambique: Structural Performance Criteria and Benchmarks
Under the PRGF Arrangement, March-December 2002

Actions	Expected Date of Implementation, According to the Program	Outcome
Structural performance criteria		
Approval by the Council of Ministers of the new code of fiscal incentives	June 2002	Observed (Decree No. 16/2002 of June 27, 2002)
Approval by the Council of Ministers of the new codes for the corporate and personal income taxes	July 2002	Observed (Decree Nos. 20/02 and 21/02 of July 30, 2002)
Structural benchmarks		
Approval by the Council of Ministers of the regulations eliminating the stamp tax on transactions subject to the value-added tax (VAT)	June 2002	Per Decree No. 15/2002 of June 11, 2002
Approval of regulations on new vehicle tax	July 2002	Approved
Adoption of a standardized and comprehensive reporting format for all inspections conducted by the banking supervision department, so as to facilitate the identification of corrective measures as needed	June 2002	Done
Production, for the use of the banking supervision department, of quarterly reports on each financial institution, covering all aspects of banking soundness identified in the new reporting format	September 2002	Done
Publication of a decree establishing regulations under the Financial Management Law	June 2002	Published

Table 12. Mozambique: Prior Actions and Structural Benchmarks Under the PRGF Arrangement, January–June 2003

Actions	Expected Date of Implementation, According to the Program	Outcome
Prior actions		
Terms of reference prepared, in consultation with Fund and Bank staff will be agreed and donor funding identified for the diagnostic review of the four major banks in Mozambique, in order to assess the impact of moving toward international accounting standards.		Done
In May, the government will resume publication and will provide Fund staff with the quarterly budget execution reports with a time lag not exceeding 45 days.		Done
The government will provide Fund staff with the data corresponding to monthly government revenues (in detail according to the fiscal table), with a lag not exceeding one month starting in April 2003.		Done
In May, the government increased by a weighted average of 62½ percent the specific taxes on petroleum products.		Done
Structural benchmarks		
Amendments to the Financial Institutions Law will be submitted to parliament giving the Bank of Mozambique sole responsibility for issuing and revoking licenses for financial institutions; providing for the automatic application of most penalties for noncompliance with prudential regulations; and making managers of financial institutions personally liable for gross violations of banking regulations.	April 2003	Done
The implementation plan for the Central Revenue Authority (CRA) will be approved by the Ministry of Planning and Finance	May 2003	Done
The Organic Law for Tax Tribunals will be submitted to the National Assembly	May 2003	Done

Table 13. Mozambique: Structural Measures Envisaged by the Authorities for the Second Half of 2003

Actions	Expected Date of Implementation, According to the Program	Outcome
Initiate the tender process for the pilot integrated financial management system (SISTAFE) to be implemented in the Ministry of Planning and Finance and the Ministry of Education.	End-June 2003	Done
Install computerized system for the registration of personal and corporate income tax payments.	August 2003	Delayed until November 2003.
Develop a timetable for implementing loan-loss provisioning standards consistent with accepted international practices.	Within two months of completion of the banks' reviews	...
Ensure approval by the Council of Ministers of a new statute transforming the National Directorate of Taxes (DNIA) into a general directorate as part of the integration of current reforms and the transition to the Central Revenue Authority (CRA)	October 2003	Delayed until December 2003.
Issue instructions to financial institutions detailing the practical steps for consolidated supervision.	October 2003	Done
Implement the pilot SISTAFE in the Ministry of Planning and Finance and Ministry of Education.	December 2003	Delayed; Core SISTAFE to be implemented in January 2004.

Mozambique: Relations with the Fund
(As of October 31, 2003)

Membership Status

Joined 9/24/84; Article XIV

General Resources Account	SDR Million	% Quota
Quota	113.6	100.0
Fund holdings of currency	113.6	100.0
Reserve position in Fund	0.01	0.0

SDR Department	SDR Million	% Allocation
Holdings	0.05	n.a.

Outstanding purchases and loans	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)		
Poverty Reduction and Growth Facility (PRGF) arrangements	146.00	128.52

Financial Arrangements

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR million)
ESAF/PRGF	6/28/99	06/28/03	87.20	78.80
ESAF	6/21/96	06/27/99	75.60	75.60
ESAF	6/01/90	12/31/95	130.05	115.35

Projected Obligations to the Fund (with Board-approved HIPC assistance) (SDR millions; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	03/31/03	2003	2004	2005	2006	2007
Principal	0.0	2.6	7.3	10.4	14.2	16.2
Charges/interest	0.0	0.4	0.7	0.5	0.5	0.3
Total	0.0	3.0	8.0	10.9	14.6	16.5

Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC assistance			
Decision point date	4/7/98	4/7/2000	
Assistance committed (end-1998 NPV terms)			
Total assistance (US$ million)	1,716	306	2,022
Of which: Fund assistance (SDR million)	124.6	18.5	143.1
Completion point date	6/29/99	9/20/01	
Delivery of Fund assistance (SDR million)			
Amount disbursed	93.2	13.7	106.9
Interim assistance	...	2.3	2.3
Completion point	93.2	11.4	104.6
Additional disbursements of interest income		1.1	1.1
Total disbursements	93.2	14.8	108.0

Safeguards Assessment

The Bank of Mozambique is subject to the transitional arrangement that requires a review of the Bank of Mozambique's external audit mechanism to assess whether the bank's annual financial statements are independently audited in accordance with internationally accepted standards.

The external audit assessment was completed on October 11, 2001. The assessment concluded that the Bank of Mozambique's current external audit mechanism may not be adequate in certain respects, and appropriate recommendations have been made to the authorities, as reported in Box 6 of the staff report prepared for the 2002 Article IV consultation (EBS/02/93; 6/3/02). The audit arrangements, and any actions taken by the authorities in respect of the recommendations of the transitional assessment, would be part of a full assessment in the context of a successor program.

Exchange Arrangements

Mozambique's exchange system is a managed float. Commercial banks may buy and sell foreign exchange to individual customers on a fully negotiable basis. The Bank of Mozambique sets a daily rate, which is adjusted gradually in response to significant deviations relative to the average selling rate of banks and exchange bureaus.

Mozambique is an Article XIV country. Currently, it maintains the requirements of prior approval by the central bank for the payment of invisibles above US$5,000, as well as for transfers of net income on investments, but bona fide requests for these purposes are promptly approved. In addition, discretionary prior approval is required for remittances of family living expenses. The authorities indicated that they would evaluate the possibility of accepting the obligations under Article VIII of the Articles of Agreement. To analyze any additional steps that might be required in this area, staff from LEG are expected to accompany the next mission to Maputo.

Article IV Consultation

Mozambique is on the standard 12-month cycle for Article IV consultations. The 2002 Article IV consultation was completed by the Executive Board on June 17, 2002 (EBS/02/93; 6/03/02).

In considering the staff report, Executive Directors commended the Mozambican authorities for their continued implementation of broad-based reform, which formed an essential backdrop for the country's strong growth performance. They stressed that further progress in strengthening tax collection and improving public expenditure management would be fundamental to safeguard priority spending and reduce aid dependence. Directors urged a strengthening of banking supervision to significantly reduce financial sector vulnerabilities.

FSAP Participation and ROSCs

A Financial Sector Assessment Program (FSAP) for Mozambique was undertaken during the first quarter of 2003. The related Financial Sector Stability Assessment has been issued. A report on Observance of Standards and Codes (ROSC) data module was prepared in June 2002 and issued on March 5, 2003. A ROSC on fiscal transparency was issued on February 22, 2001. This ROSC was updated in the context of the 2002 Article IV consultation (EBS/02/93; 06/03/2002) and this Article IV consultation (see Box 1).

IMF Technical Assistance provided to Mozambique (over the last two years)

Departments	Timing	Form	Purpose	Counterparts
Fiscal Affairs	October 2003	Inspection mission, in coordination with bilateral donors	Public expenditure management	Ministry of Finance
	September 2003	Joint IMF/Seco/Danida project; long-term consultant and training advisor mission	Reform of the tax system and its administration	Ministry of Finance
	April 2003	Inspection mission	Public expenditure management	Ministry of Finance
	October 2002	Mission	Public expenditure management	Ministry of Finance
	June 2002–June 2003	Long-term expert	Public expenditure management	Ministry of Finance
	May 2002	Mission	Public expenditure management	Ministry of Finance
	April 2002–March 2003	Joint IMF/Seco/Danida project; long-term consultant and training advisor	Reform of the tax system and its administration	Ministry of Finance
	March 2002	Mission	Customs workshop	Ministry of Finance
	February 2002	Mission	Public expenditure management	Ministry of Finance
	September 2001	Mission	Tax policy and administration project formulation	Ministry of Finance
	April 2001-March 2003	Short-term consultant (total: eight person/months)	Tax administration	Ministry of Finance
	Jan.-Feb. 2001	Mission	Income tax reform	Ministry of Finance
	Jan.-Feb. 2001	Mission	Income tax reform	Ministry of Finance
	September 2000	Mission	Review of value-added tax (VAT) implementation	Ministry of Finance
	June 2000	Mission	Report on the observance of the Code of Good Practices on Fiscal Transparency	Ministry of Finance
	June 2000	Mission	Rationalization of tax incentives	Ministry of Finance
Legal	June 2002	Mission	Personal income tax law and corporate income tax law	Ministry of Finance
	April 2002	Mission	Income tax law	Ministry of Finance
	Aug.-Sep. 2001	Mission	Income tax law	Ministry of Finance
Monetary and Financial Systems Department	October 2003	Mission	Advising on accounting issues at the central bank	Bank of Mozambique and Ministry of Finance

Departments	Timing	Form	Purpose	Counterparts
	September 2003	Mission	Concluding FSAP and discussion of technical assistance in the area	Bank of Mozambique and Ministry of Finance
	Mar.-Apr. 2003	Joint mission IMF/World Bank	FSAP mission follow-up	Bank of Mozambique and Ministry of Finance
	February 2003	Joint mission IMF/World Bank	FSAP mission	Bank of Mozambique and Ministry of Finance
	November 2002	Short-term consultant	Banking supervision	Bank of Mozambique
	June-July 2002	Short-term consultant	Payments systems	Bank of Mozambique
	June-July 2002	Short-term consultant	Real-time gross settlement system	Bank of Mozambique
	June 2002	Short-term consultant	Banking supervision	Bank of Mozambique
	March 2002	Short-term consultant	Banking supervision	Bank of Mozambique
	Aug.-Sep. 2001	Short-term consultant	Commercial bank restructuring	Bank of Mozambique Banco Austral
	June 2001	Mission	Commercial bank restructuring	Bank of Mozambique
Statistics	August 2003	Mission	Balance of payments statistics	Bank of Mozambique
	May 2003	Peripatetic	Government finance statistics	Ministry of Finance
	October 2002-Aug 2003	Peripatetic	National accounts	Institute of Statistics
	June 2002	Mission	ROSC data module	Ministry of Finance and National Institute of Statistics
	June 2002	Mission	General Data Dissemination System metadata development	National Institute of Statistics
	June-Oct. 2002	Short-term consultant	Balance of payments statistics	Bank of Mozambique
	Jan.-April 2001	Short-term consultant	Balance of payments statistics	Bank of Mozambique

Resident Representative

Mr. Perry Perone has been Resident Representative since February 1, 2003.

Mozambique: Relations with the World Bank Group
(As of October 23, 2003)

Partnership in Mozambique's development strategy

1. The Mozambican government's development strategy is set forth in the poverty reduction strategy paper (PRSP), termed the PARPA (Plano de Acção para a Redução da Probreza Absoluta, or Action Plan for the Reduction of Absolute Poverty) approved in April 2001 by the Council of Ministers and endorsed in September 2001 by the Boards of the World Bank and the IMF. The PARPA focuses on six "fundamental areas" aimed at promoting human development and creating an environment for broad-based growth: macroeconomic and financial management, good governance, education, health, agriculture, and basic infrastructure (roads, water, and energy). The overall perspective is that poverty can most quickly be reduced by pursuing a strategy of broad economic growth, which, in turn, is crucially dependent on the maintenance of democratic and sociopolitical stability. In early 2003, the government issued the first progress report on the PARPA, which restates its commitment to reduce poverty by pursuing policies that help to create an environment for broad-based growth.

2. The Fund and the World Bank will continue to cooperate closely, within their respective mandates, in assisting the government to implement its medium-term poverty reduction and growth strategy and the related reform agenda, as presented in the PARPA and updated in the annual progress report.

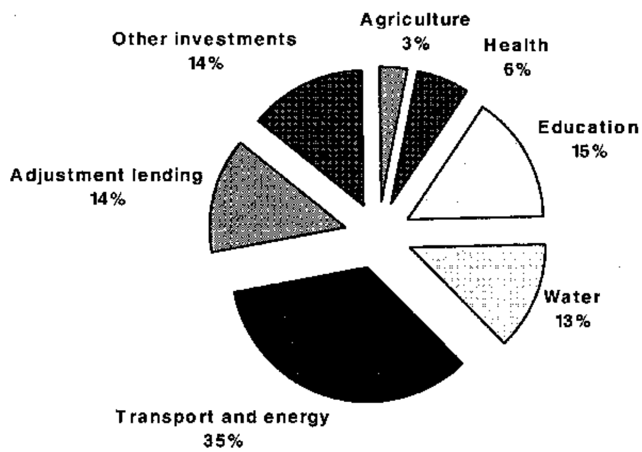
3. The Fund will continue to lead the policy dialogue on macroeconomic policy, (including fiscal, monetary, and exchange rate policies), the integrated financial management information system (SISTAFE), and tax and customs reforms. The Bank will continue to lead the policy dialogue on public expenditure management, sectoral structural reforms, and the reform of the civil service. Areas of close collaboration include banking supervision and financial sector issues, trade issues, the PARPA and its further development, external debt sustainability, and poverty and social impact analysis.

Bank Group Country Assistance Strategy

4. The World Bank supports the implementation of the PARPA through its Country Assistance Strategy (CAS, FY 04-06). The three pillars of the CAS are (i) broadening the base of growth and ensuring its sustainability, (ii) investing in people and making services work for the poor, and (iii) improving governance and empowerment. The focus of the Bank's lending program will be on programmatic support through three rolling Poverty Reduction Support Credits (PRSCs). Fiduciary issues are fully taken into account within the scope and sequencing of the PRSCs. The shift to programmatic lending through the PRSCs will be underpinned by the Bank's core diagnostic economic and sector work, including the public sector review and poverty and social impact analysis. While a series of PRSCs will be the largest single element in the lending program, the shift from traditional investment lending to program lending will be phased in gradually. Selected investment projects will

target institutional strengthening, capacity building, transport infrastructure, water, and communications.

5. To date, the International Bank for Reconstruction and Development (IBRD) has approved seven adjustment operations and 40 investment operations totaling approximately US$ 2.7 billion. The current portfolio includes 16 projects for a total of US$ 873 million, with an undisbursed balance of US$ 678 million. Fifteen are investment projects and one is an adjustment operation. The graph below illustrates the sectoral distribution of the current portfolio by main sectors.



6. The World Bank has been actively supporting the government of Mozambique's macroeconomic program since 1986 through a series of **structural adjustment operations**. The latest, the Economic Management and Private Sector Operation (EMPSO), was approved by the Bank Board in August 2002 for US$ 120 million. The EMPSO supports the government's program of consolidating macroeconomic stability and laying the foundations for sustained private sector-led growth over the medium term. It includes measures to make the budget more transparent (including accounting for external aid flows), conduct a public expenditure review, strengthen the financial sector while aiming to eliminate government ownership in the sector, and liberalize the telecommunications and air transport sectors in order to facilitate further private participation.

7. The World Bank has been an active partner in supporting the government in improving **education** and strengthening capacity building in key public institutions. *The* Education Sector Strategic Program (ESSP) (US$71 million-FY 99) supports the implementation of the National Education Strategy (NES). The objectives of the NES are the promotion of sustained improvements in the quality of Mozambique's labor force, and greater gender and regional equity in economic opportunities. This is complemented by the Public Sector Capacity Building Project (US$ 25.5 million-FY 03), which aims to increase

the capacity of the government's Technical Unit for the Reform of the Public Sector (UTRESP). The Higher Education Project (US$60 million-FY 02) supports the entire higher education system, including both public and private higher education institutions.

8. In **health**, the Health Sector Recovery Project (US$ 98.7 million-FY 96) supports the government's broad Health Sector Recovery Program. The objective of this program is to improve the health of the population in general, especially by reducing infant and child mortality. The HIV/AIDS Project (US$55 million-FY 03) assists the government in carrying out its National Strategic Plan to Combat STDs and HIV/AIDS.

9. In the area of **transport and infrastructure**, the Bank has three active projects. The Roads and Coastal Shipping Project (ROCS II) (US$188 million-FY 94) supports the rehabilitation and maintenance of priority roads and improvements in the management capacity of roads institutions. The Railways and Ports Restructuring Project (US$100 million-FY 00) aims at increasing the operating efficiency of the three major port-rail systems in Mozambique. The Roads and Bridges Project (US$162 million-FY 02) aims at improving road infrastructure, sector policies, and management.

10. In the **water** sector, two active projects—the National Water Development Project I (NWDP I)(US$36 million-FY 98) and National Water Development Project II (NWDP II) (US$75 million-FY 99)— support improvements in service delivery standards, coverage, water resources management, and management capacity in both rural and urban areas. The NWDP II also supports contracts for the private sector management of five major cities.

11. Another important part of the Bank's portfolio focuses on strengthening the investment climate and encouraging **private sector** participation. The Private Enterprise Development Project (US$26 million-FY 00) aims at broadening the base of private participation in the Mozambican economy. The Mineral Resource Management Capacity Building Project (US$18 million-FY 01) seeks to increase institutional capacity in the sector, and alleviate poverty. The Communications Sector Reform Project (US$14.9 million-FY 02) seeks to increase private sector participation in the postal, air transport, and telecommunications sectors.

12. The Bank is also involved in **agriculture, energy, and the environment.** The Agricultural Sector Public Expenditure Program (PROAGRI) (US$30 million-FY 99) is a sector-wide assistance program (SWAP) that seeks to improve the impact of public expenditure in developing an enabling environment for sustainable and equitable growth in the rural sector. The Gas Engineering Project (US$26 million-FY 94), closing in June 2003, supported preinvestment in the Pande-Gas Project. The Coastal and Marine Biodiversity Management Project (US$9.7 million-FY 00) pilots an integrated approach to achieving sustainable development, focusing on two main coastal areas. Most recently, the Energy Reform and Access Project (US$40.2 million-FY 04) supports reform of the power sector, in particular the separation of distribution, transmission, and generation functions, aims at increasing the number of electricity connections and solar energy distributors, and seeks to provide capacity building to the government for negotiation of megaprojects.

13. The Bank's **proposed lending program** for FY 04 comprises five projects: a US$60 million PRSC 1, the Sena Line Project of US$30 million, a Decentralized Planning and Finance Project of US$42 million (by grant), a National Water supplemental of US$15 million, and the South Africa Power Pool (SAPP) project of US$13 million. In FY 05, it is expected that another five operations will be prepared for presentation to the Board: a US$60 million PRSC 2, a Sustainable Tourism Project of US$20 million (grant), the Beira Rail Project of US$60 million, a Financial Sector Capacity of US$10 million, and a Legal Sector Capacity Project of US$5million. In FY 06, three projects will be presented: a PRSC 3 of US$70 million, a Technical and Vocational Education grant of US$20 million, and the second phase of the Roads and Bridges APL of US$85 million.

14. The Bank's program also encompasses **economic and sector work** to support the three pillars of the CAS, involving work on the following:

- sustainable growth—an investment climate assessment, a strategy for rural growth and income creation, a poverty update, and a country economic memorandum on sustainable growth, which will also analyze the sources of growth;
- investing in people—a country status report on health, the ongoing public expenditure review, and work on labor markets and technical education; and
- improving governance—the ongoing Country Procurement Assessment Report, a legal and judicial assessment, an institutional governance review, and a Public Expenditure Management and Financial Accountability Review (PEMFAR).

IMF-World Bank collaboration in specific areas

15. Fund and Bank staff maintain a close working relationship, especially with respect to (i) analyses and reforms in public expenditure management; (ii) the PARPA and accompanying annual updates and joint staff assessments; (iii) the financial sector and banking supervision; (iv) poverty and social impact analysis; (v) tax issues; and (vi) trade issues:

- **Public expenditure management**. The Fund and the Bank jointly emphasize the urgent need to further improve public expenditure management, accountability, and transparency. The two institutions support policy reforms in the areas of budget formulation, execution, and monitoring. Both institutions are involved in assisting the authorities in introducing the integrated financial management information system (SISTAFE). Under the Fund's leadership, a group of ten donors set up a common fund for this large undertaking (approximately US$20 million). The Bank's adjustment operation, EMPSO, has a strong focus on budget comprehensiveness. Once the actions envisaged have been taken, budget comprehensiveness will be well served by SISTAFE. The Bank and the government have worked together since September 2000 on a public expenditure review, the first volume of which was issued in December 2001 and the second in September 2003.

- **Poverty reduction strategy paper.** The Fund and Bank worked together with the government during the period 1999-2001, while the PARPA was being produced, and drafted the joint staff review, which was presented to the Board in September 2001. The government issued an annual progress report in early 2003, and the staffs presented their joint staff assessment to their respective Boards in June 2003. The Fund and the Bank will work jointly with the authorities to ensure updating of the economic framework underlying the PARPA.

- **Financial sector.** The Fund and the Bank have worked together on the financial sector. The banking sector in Mozambique has repeatedly shown weaknesses in the past, requiring recapitalizations and intervention. Following the Financial Sector Assessment Program (FSAP) conducted in Mozambique during the first semester of 2003, the Fund and the Bank continue to advise the authorities on strengthening financial supervision to prevent the recurrence of such problems in the future. A technical assistance program is being designed in close coordination with the authorities.

- **Poverty and Social Impact Analysis (PSIA).** As part of the preparation for future Bank structural adjustment lending and a possible successor program supported by a new Poverty Reduction and Growth Facility (PRGF) arrangement, the Fund and the Bank have agreed to review closely the poverty and social impact of the key reforms that are being implemented. After the fixed petroleum tax declined steadily in real terms between 1997 and 2002, a pilot PSIA, advising the government on the impact of an increase in specific fuel taxes, and funded by the U.K. Department for International Development and supervised by the Fund and the Bank, was undertaken in 2002. Further PSIAs in key reform areas are being planned.

- **Taxes.** The Fund has taken the lead in this area. The government issued a new income tax law in 2002, and a revised code of fiscal incentives for investors. The Bank has been supportive of the policies proposed. Further reforms to strengthen tax revenues and to improve the efficiency of tax administration are part of the regular dialogue with the Fund.

- **Trade.** The Fund and the Bank have worked together since the early 1990s on trade issues concerning general reductions in tariffs, the variable tariff on sugar introduced in 1999, and the reduction in the export tariff on raw cashews. The Fund and the Bank are involved in reforming the customs administration in Mozambique. Quarterly consultations are held with the donor community. One of the key issues is the gradual transfer of management control over customs from Crown Agents to ministerial staff. Further reform efforts will be geared to strengthening the export capacity of traditional sectors.

16. Over the next three years (**2003-05**) disbursements under World Bank investment projects are expected to reach around US$100 million on average per year. Under the Country Assistance Strategy (CAS), World Bank support to Mozambique will focus on agriculture, education, infrastructure, the financial sector, capacity building, and public sector reform. The adjustment operation, the Economic Management and Private Sector Operation (EMPSO), was approved by the Board on August 29, 2002. The first phase of a public expenditure review, a collective effort by the government of Mozambique, the World Bank, and other donors, was completed in 2001, and the second phase was completed in August 2003.

World Bank Loan and Grant Operations, 1999-2004 [1]
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004
		Actual			Est.	Proj.
I. Project credit disbursements	79.4	97.5	51.6	85.2	86.00	108.8
Established operations						
Household Energy (6/89) [2/]	0.0	0.0	0.0	0.0	0.0	0.0
Economic and Financial Management (10/89) [2]	0.0	0.0	0.0	0.0	0.0	0.0
Education II (12/90) [2/] 2/	2.5	0.0	0.0	0.0	0.0	0.0
Industrial Enterprise (12/89) [2]	7.6	2.0	0.0	0.0	0.0	0.0
Agricultural Service Rehab. Development (2/92) [2]	2.5	0.7	0.0	0.0	0.0	0.0
First Road and Coastal Shipping (6/92) [2]	12.5	4.0	0.0	0.0	0.0	0.0
Capacity Building: Human Res. Dev. (11/92)	11.3	4.5	2.8	0.0	0.0	0.0
Capacity Building: Pub. Sector & Legal Inst. Dev. (11/92)	0.9	0.7	0.0	0.0	0.0	0.0
Maputo Corridor (1/93) [2]	-0.1	0.0	0.0	0.0	0.0	0.0
Rural Rehab.(3/93) [2]	3.8	2.0	0.3	0.0	0.0	0.0
Food Security (4/93) [2]	0.1	0.0	0.0	0.0	0.0	0.0
Local Government (6/93) [2]	3.1	0.0	0.0	0.0	0.0	0.0
Second Road and Coastal Shipping (4/94) [2]	16.9	26.5	11.4	9.7	15.8	0.0
Financial Sector Capacity Building (4/94) [2]	2.0	1.4	0.3	0.0	0.0	0.0
Gas Engineering (6/94) [2/] 2/	1.5	1.1	1.6	1.8	0.2	0.0
Health Sector Recovery (11/95) [2]	12.0	17.2	17.4	14.4	5.0	0.0
National Water I (2/98)	1.3	1.7	2.4	3.9	3.7	5.0
Agricultural Sec. PEP (2/99)	0.5	0.9	4.2	3.8	0.2	0.2
General Education (2/99)	1.0	0.5	1.2	6.9	16.0	18.0
Railway and Port Restructuring (10/99)	0.0	1.9	3.6	22.3	4.3	5.0
National Water II (6/99)	0.0	1.4	2.8	4.4	8.6	10.0
Enterprise Development (01/00)	0.0	2.3	3.0	2.9	2.4	3.0
Flood Emergency Recovery (4/00)	0.0	28.7	-0.2	0.0	0.0	0.0
Coastal and Marine Biodiversity (6/00)	0.0	0.0	0.3	0.4	0.4	1.0
Newest operations						
Municipal Development (7/01)	0.0	0.0	0.3	4.3	4.5	5.0
Roads and Bridges I (7/01)	0.0	0.0	0.0	4.3	5.0	30.0
Communications (11/01)	0.0	0.0	0.0	1.2	3.2	2.5
Mineral Resources Project (3/01)	0.0	0.0	0.2	1.4	3.7	4.0
Higher Education Project 1 (3/02)	0.0	0.0	0.0	0.0	9.1	10.0
HIV Aids (3/03)	0.0	0.0	0.0	0.0	2.8	5.0
Public Sector Reform (3/03)	0.0	0.0	0.0	0.0	1.1	5.0
Energy Reform and Access Project (8/03)	0.0	0.0	0.0	0.0	0.0	5.0
II. Adjustment operations	150.0	0.0	0.0	63.5	60.0	60.0
Economic Management Reform Operation (12/98) [2 3]	150.0	0.0	0.0	0.0	0.0	0.0
Economic Management and Private Sector Operation	0.0	0.0	0.0	63.5	60.0	....
PRSC 1 (planned for FY 04)	...	...	...	...	...	60.0

[1] Date of Board approval in brackets.

[2] Closed.

[3] Grant.

Mozambique: Statistical Issues

Against the background of a weak and deteriorating statistical infrastructure, Mozambique has made great efforts to rebuild its statistical system with assistance from the Fund, the World Bank, and donors. However, much remains to be done to improve the coverage, accuracy, and timeliness of macroeconomic statistics.

The data module of the Report on Observance of Standards and Codes (ROSC) for Mozambique, published in March 2003, includes a detailed assessment of the quality of the country's macroeconomic statistics. The report concludes that there is a need for improvements in several areas, including the national accounts, prices, and the government finance and balance of payments statistics.

The authorities are committed to adhering to internationally accepted standards and good practices, as demonstrated by their decision to participate in the IMF's General Data Dissemination System (GDDS) and, in particular, in the Regional Project for Lusophone African Countries. Methodological descriptions (metadata) are being finalized for publication in the IMF's data dissemination website, and comprehensive metadata for all sectors are already posted in the National Institute of Statistics' (NIS) website.

National accounts

The national accounts are prepared by the NIS. Revised series starting in 1991 have been compiled in accordance with the *System of National Accounts (1993 SNA)*. The NIS compiles and disseminates (i) annual GDP at current and constant (1996=100) prices by activity; (ii) annual GDP by expenditure items at current and constant prices; (iii) annual value-added components at current prices by activity; and (iv) annual accounts for the financial sector. The 2002 ROSC data module assessment identified weaknesses in the accuracy and reliability of the national accounts source data. The NIS has been undertaking new household surveys and sectoral censuses in order to start compiling a new benchmark year (2003) with new and improved data sources and methodology. The IMF is providing technical assistance in national accounts in the context of the GDDS project.

Prices and labor market

As of February 2000, a new consumer price index (CPI) for Maputo, based on weights revised on the basis of the 1996-97 household survey, was implemented. Consistent time series are available starting from 1995. However, the concentration of the weights on a few basic food staples with relatively volatile prices makes the CPI prone to significant swings. A preliminary national index obtained by integrating the indices for Maputo, Beira, and Nampula has been published.

There are very little sectoral labor market and employment data, and, where available, they have limited national coverage.

Money and banking statistics

Although improvements in the Bank of Mozambique's accounting practices have contributed to better-quality accounting information, fully consistent monetary statistics have not yet been achieved.

Currently, the Bank of Mozambique publishes the monetary data on a regular basis in its quarterly statistical bulletin and uses a unified reporting system to submit data to the Fund (both AFR and STA) in an electronic format agreed with both departments. However, the data suffer from continuous revisions owing to weaknesses in the commercial banks' balance sheet data, and statistical adjustments are still made to obtain international reserves data. In addition, the modified plan of accounts for the commercial banks, implemented in January 2001, lacks the degree of detail needed for a complete sectorization of the analytical accounts for the depository corporations, as recommended by the IMF's *Monetary and Financial Statistics Manual.* Beginning in November 2002, the Bank of Mozambique introduced a new plan of accounts to compile improved monetary statistics. However, the monetary data obtained since the introduction of the new plan of accounts appear to indicate problems in the sectorization and/or classification of some accounts that affect the consistency of the available time series. STA is working with Bank of Mozambique staff to clarify these issues and assist in deriving sound monetary data for policy and publication purposes.

Data on foreign aid flows

The absence of firm data on foreign aid flows and their uses is one of the main problems hampering the accuracy and reliability of balance of payments, fiscal, and national accounts statistics. The major difficulty lies in tracking disbursements made outside the domestic financial system that is exacerbated by weaknesses in the customs records. In response to this situation, AFR missions have worked with the authorities and donors to set up reporting templates for periodic updates of donor assistance. Further progress would entail the institutionalization of this procedure under the national statistical agency.

Fiscal accounts

The lack of full information on external assistance undermines the accuracy and reliability of fiscal data because the foreign-financed portion of projects is estimated on the basis of domestically financed execution data and its assumed proportion of total financing. Similarly, the monitoring of the generation and collection of counterpart funds is weak. Moreover, the lack of reporting on the uses of foreign assistance prevents an accurate functional classification of donor-financed outlays. In 2001, a new classification system of fiscal accounts was introduced, and, starting with the 2002 budget, the reporting of expenditure execution by functional category has improved.

However, much remains to be done on the statistical consolidation of government operations. At present, there is little reporting on the accounts of government agencies, such as the Social Security Institute (INSS), and none for local and regional governments. In May 2000, the authorities started publishing quarterly budget execution reports. This action constitutes an important step toward improving fiscal transparency and accountability and allows the monitoring of poverty reduction strategy paper (PRSP)-related expenditures, including those financed by the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) debt relief.

The IMF has started to provide technical assistance in government finance statistics in the context of the GDDS project. Mozambique does not yet report government finance data for publication in the *Government Finance Statistics Yearbook* or *International Financial Statistics*.

External accounts

The quality of the external accounts has been hampered by the weakness of key data sources, the absence of reliable foreign aid statistics, a large informal sector operating in foreign currency, and problems with the definition of residency under the Exchange Law and Regulations. Efforts to improve the situation have been undermined by the lack of funding and coordination, and of a clear division of responsibilities among the government agencies involved in the production of these statistics (the Bank of Mozambique, the National Institute of Statistics, the Ministry of Planning and Finance, and the Ministry of Industry, Commerce, and Tourism).

In response, STA fielded in 2001 a resident expert at the central bank to take stock of current practices and advise on improvements. The objective is to bring the statistics in line with the fifth edition of the *Balance of Payments Manual* through improved reporting practices, greater use of survey data and computer technologies, additional technical support, and the commitment of additional financial and human resources by the authorities. Under a technical assistance project for the external sector, as part of the above mentioned GDDS project, a first mission took place in July/August 2003 and another two to three missions are planned for up to end 2005.

Reserve template data

Mozambique has begun an exercise to complete the reserves template. The results of the preliminary exercise indicate that Mozambique reports gross international reserves data with the required periodicity and timeliness. The results show that only the category of outflows of principal and interest is relevant with regard to the template section on "foreign currency loans, securities, and deposits," and that Mozambique has no contingent short-term net claims on foreign currency assets. With regard to outflows of principal and interest, data do not meet template requirements.

Social indicators

In the context of the program supported by the PRGF arrangement, Mozambique has made efforts to produce social indicators. In particular, in 2000 the INE started to publish selected social indicators based on surveys. However, the coverage and frequency of this information remain insufficient to monitor social conditions quickly enough for an appropriate policy response.

Mozambique: Core Statistical Indicators

(As of October 3, 2003)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	External Debt/Debt Service	Overall Government Balance	GDP/ GNP
Date of latest observation	Sep. 03	Sep. 03	Sep. 03	Sep. 03	Sep. 03	Aug. 03	Sep. 03	Dec. 02	Dec. 02	Dec. 02	June 03	Dec. 02
Date received	Oct. 03	Oct. 03	Oct. 03	Oct. 03	Oct. 03	Oct. 03	Oct. 03	April 03	April 03	April 03	Sep. 03	April 03
Frequency of data 1/	D	M	M	M	M	M	M	Q/V	V	Q	Q	V
Frequency of reporting 1/	W	M	M	M	M	M	M	Q/V	V	V	Q	V
Frequency of publication 1/	D	M	M	M	M	M	M	Q/V	V	V	Q	V
Source of data 2/	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 3/	C	C	C	C	C	C	C	C/V	V	C	C	V
Confidentiality 4/	C	D	C	C	C	C	C	C	C	C	C	C

1/ D=Daily; W=weekly; M=monthly; Q=quarterly; V=collected during mission.

2/ A=Direct reporting by central bank or relevant ministry.

3/ C=cable or fax; V=staff visit.

4/ C=unrestricted use; D=embargoed for a period of time.

Mozambique: Debt Sustainability Analysis

This appendix analyzes Mozambique's public and external debt dynamics within a medium-term perspective by performing various stress tests. The baseline projections indicate that Mozambique's public and external debt ratios relative to GDP will exhibit a steady decline during 2004-08. Stress tests are applied to these projections to provide a statistical basis for a more refined judgment regarding the resilience of Mozambique's debt dynamics to negative shocks to key macroeconomic variables.

Methodology

Since Mozambique's public external debt has been contracted on concessional terms, the analysis focuses on its net present value (NPV), rather than its nominal value. To that end, standard stress tests were first applied to the nominal value of debt, and the resulting debt-to-GDP ratios were converted into NPV terms. In the calculation of the NPV of the total public debt, domestically issued government debt and private sector external debt are valued at par, as they are contracted at nonconcessional terms. Thus, only public external debt is discounted for conversion into NPV terms. The analysis introduces several assumptions regarding the mix of debt financing that affect the NPV of total debt. Specifically, in the stress tests for public debt, financing gaps resulting from shocks to macroeconomic variables are assumed to be covered evenly by domestic and external borrowing. For external debt, the additional required financing is assumed to be proportional to the respective shares of public and private external debt in the baseline.

The magnitude of the shocks to key macroeconomic variables envisaged in the stress tests is based on historical averages and standard deviations of the respective variables. With the exception of the interest rate on public external debt, the averages and standard deviations are calculated over the six-year period 1997-2002. Although relatively short, this sample period was chosen because of apparent structural breaks in the series for key macroeconomic variables—inflation and the exchange rate in particular. For the interest rate on public external debt, the three-year period 2000-03 is used to better capture the impact of the HIPC Initiative debt relief.

Data

An important caveat is the limited coverage of the external debt data used in the analysis. At present, no official data are available from the authorities for the stock of private sector external debt. Thus, the data used in the analysis are estimates by the staff, constructed from flow data on private sector disbursements and amortizations. However, given the limited information available on the initial stock of private sector debt, the staff's estimates are likely to understate the actual debt levels. Therefore, the results of the debt sustainability analysis for external debt should be viewed as preliminary.

Main results

Public debt. Mozambique's medium-term public debt dynamics appear to be in good shape. Under the baseline projections, the ratio of the NPV of total public debt to GDP is projected to remain stable (with only a modest decline) at less than 25 percent during 2004-08. The results of the stress tests indicate that the public debt dynamics are somewhat vulnerable to a reduction in external grants and, to a lesser degree, to a decline in real GDP growth, but resilient to other adverse shocks. With a significant decline in external grant flows, the ratio of the NPV of public debt to GDP almost doubles over the medium term—from about 20 percent under the baseline projection to some 40 percent by 2008, after peaking at close to 50 percent within the first two years.

Even though the share of foreign-currency-denominated debt in total public debt is dominant, the impact of an exchange rate depreciation is short-lived because of the offsetting improvement in the primary balance, after grants, that results from the increase in the domestic currency value of external grants following the depreciation. Although not shown, stress tests results appear to be modestly sensitive to different financing assumptions.[17]

External debt. Under the baseline projections, the NPV of total external debt is projected to decline from 59 percent to 54 percent of GDP during 2004-08, with the share of public external debt remaining stable at about 40 percent in NPV terms. This reduction in the debt ratio is related to the continued strong growth in real GDP and the large net foreign direct investment flows envisaged in the baseline projections.

Mozambique's external debt dynamics, however, appears to be vulnerable to the exchange rate shocks that are envisaged in three different scenarios (B3, B5, and B6 of Table 2, Appendix IV). The combined shock scenario (which includes moderate shocks to real GDP growth, the nominal interest rate, the dollar GDP deflator, and the noninterest current account balance) constitutes the worst case, in which the NPV of total external debt rises sharply to about 90 percent of GDP over the medium term, after peaking at almost 100 percent after the first two years. A similar result obtains for an isolated but more significant shock to the dollar GDP deflator.[18] A onetime 30 percent nominal depreciation also leads to an initial sharp increase in the NPV of debt-to-GDP ratio, although less pronounced than in the case of a shock to the GDP deflator.

[17] The worst-case scenario emerges when a fall in external grant flows is fully financed by the issuance of domestic public debt.

[18] The change in the U.S. dollar GDP deflator envisaged in scenario B3 of Table 2, Appendix IV corresponds to a cumulative depreciation of about 40 percent during 2004-05.

Table 1. Mozambique: Public Debt Sustainability Framework, 2000-08

	Actual			Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008
				I. Baseline Projections					
In percent of GDP									
Net present value (NPV) of public sector debt	31.7	27.1	28.6	25.6	24.5	24.0	23.4	22.5	21.6
Of which : NPV of public external debt	30.3	24.9	24.8	22.7	22.2	22.1	22.0	21.4	20.8
Gross financing need 1/	6.1	6.8	9.0	4.1	5.2	4.6	4.3	3.9	3.7
In percent of revenue, including grant									
NPV of public debt	126.5	97.9	111.9	103.4	103.5	103.4	103.0	100.9	98.6
Of which : NPV of public external debt	120.8	90.1	97.1	91.5	93.6	95.5	96.7	96.1	94.9
Gross financing need 1/	24.4	24.7	35.1	16.5	21.9	20.0	19.1	17.5	17.0
				II. Stress Tests for NPV of Public Debt Ratio					
In percent of GDP									
A1. Real GDP growth, domestic real interest rate, and primary balance are at historical averages in 2004-08				25.6	24.1	23.2	22.2	20.9	19.7
B1. Domestic real interest rate is at historical average plus two standard deviations in 2004 and 2005				25.6	24.4	23.7	23.1	22.2	21.4
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				25.6	26.8	29.7	31.4	32.5	33.4
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005				25.6	28.7	32.3	31.1	29.6	28.2
B4. Combination of B1-B3 using one-standard-deviation shocks				25.6	26.7	28.2	27.2	26.0	24.8
B5. Onetime 30 percent real depreciation in 2004 2/				25.6	32.4	29.4	26.6	23.7	21.2
B6. 10 percent of GDP increase in other debt-creating flows in 2004				25.6	31.9	30.8	29.8	28.4	27.0
B7. External grants are at historical average minus two standard deviations in 2004 and 2005				25.6	37.1	47.9	45.6	42.9	40.5
In percent of revenue, including grants									
A1. Real GDP growth, domestic real interest rate, and primary balance are at historical averages in 2004-2008				103.4	101.7	100.1	97.7	93.8	90.0
B1. Domestic real interest rate is at historical average plus two standard deviations in 2004 and 2005				103.4	103.1	102.1	101.7	99.7	97.5
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				103.4	113.4	128.3	138.4	145.8	152.4
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005				103.4	121.1	139.4	137.1	132.9	128.6
B4. Combination of B1-B3 using one standard deviation shocks				103.4	112.7	121.6	120.0	116.5	112.9
B5. Onetime 30 percent real depreciation in 2004 2/				103.4	112.6	105.7	98.9	91.0	83.6
B6. 10 percent of GDP increase in other debt-creating flows in 2004				103.4	134.6	133.0	131.1	127.2	123.3
B7. External grants are at historical average minus two standard deviations in 2004 and 2005				103.4	558.3	721.2	200.9	192.7	184.8

1/ Defined as public sector deficit, plus amortization of medium- and long-term public sector debt, plus short-term debt at end of previous period.

2/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 2. Mozambique: External Debt Sustainability Framework, 2000-08

	Actual			Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008
						I. Baseline Projections			
In percent of GDP									
Net present value (NPV) of external debt	57.3	52.8	63.6	62.5	58.7	57.5	54.4	54.7	53.8
Of which : NPV of public external debt	30.3	24.9	24.8	22.7	22.2	22.1	22.0	21.4	20.8
Gross external financing need 1/	14.4	16.8	15.8	18.9	11.2	14.0	10.8	15.4	12.7
In percent of exports of goods and services									
NPV of external debt	270.2	179.0	186.7	207.9	172.6	171.0	161.5	170.9	179.1
Of which : NPV of public external debt	143.1	84.4	72.9	75.4	65.1	65.8	65.2	66.9	69.2
Gross external financing need 1/	67.7	56.8	46.5	62.7	32.8	41.5	32.0	48.0	42.1
						II. Stress Tests for NPV of External Debt Ratio			
In percent of GDP									
A1. Key variables are at their historical averages in 2004-08 2/				62.5	67.2	71.8	75.8	81.2	85.9
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005				62.5	58.8	57.9	54.7	55.0	54.1
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				62.5	63.2	65.4	61.5	61.0	59.5
B3. Change in U.S.dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005				62.5	77.6	96.7	89.8	86.2	82.0
B4. Noninterest current account is at historical average minus two standard deviations in 2004 and 2005				62.5	68.9	75.4	71.3	70.8	69.2
B5. Combination of B1-B4 using one-standard-deviation shocks				62.5	79.9	97.9	92.5	92.4	90.7
B6. Onetime 30 percent nominal depreciation in 2004				62.5	79.3	76.2	71.3	69.7	67.3
B7. External grants are at historical average minus two standard deviations in 2004 and 2005				62.5	60.3	60.3	57.0	57.2	56.2
In percent of exports of goods and services									
A1. Key variables are at their historical averages in 2004-08 2/				207.9	260.4	253.7	297.2	279.6	342.3
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005				207.9	172.8	172.0	162.4	171.9	180.1
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005				207.9	185.8	194.3	182.6	190.7	197.9
B3. Change in U.S. dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005				207.9	227.9	287.2	266.7	269.6	272.7
B4. Noninterest current account is at historical average minus two standard deviations in 2004 and 2005				207.9	351.4	341.3	211.6	221.4	230.1
B5. Combination of B1-B4 using one-standard-deviation shocks				207.9	351.8	388.3	287.0	330.6	335.4
B6. Onetime 30 percent nominal depreciation in 2004				207.9	233.0	226.5	211.7	217.9	223.7
B7. External grants are at historical average minus two standard deviations in 2004 and 2005				207.9	177.2	179.2	169.4	178.8	187.0

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2/ The key variables include real GDP growth, the nominal interest rate, and dollar deflator growth, as well as both noninterest current account and nondebt inflows in percent of GDP.

Mozambique: Selected Social and Demographic Indicators [1/]

(In percent, unless otherwise noted)

	Mozambique	Sub-Saharan Africa
Poverty		
Absolute poverty head count (national estimate) (1997)	69	...
Poverty gap ratio (incidence times depth of poverty) (1997) [2/]	29	...
Education		
Adult literacy rate (2001)	45	62
Primary net enrollment rate (1997) [2/]	49	...
Primary gross enrollment rate (2000)	92	86
Health		
Life expectancy at birth (years) (2001)	42	46
Infant mortality per 1,000 live births (2001)	125	105
Mortality under 5 years per 1,000 births (2001)	197	171
Prevalence of underweight children under 5 years (1995-98) [3/]	26	32
Total fertility rate (births per woman) (2001)	5	5
Contraceptive prevalence rate (women aged 15-49) (1990-2000) [3/]	6	21
Environment		
Access to safe water (percent of population) (1997) [2/]	20	43
General indicators		
GNP per capita (Atlas method; U.S. dollars) (2000)	210	500
Purchasing power parity GNP per capita (U.S. dollars) (1998)	740	1,410
Urbanization (1998)	38	33

1/ Based on World Bank, *World Development Indicators*, 2003, unless otherwise indicated.

2/ National Poverty Assessment, 1997 (published 1998).

3/ Data for most recent year available.

Statement by the IMF Staff Representative on Republic of Mozambique
December 10, 2003

The following supplementary information has become available since the issuance of the documents relating to the 2003 Article IV consultation. The thrust of the staff's appraisal remains unchanged.

- Elections in 33 municipalities were held on November 19. The elections took place in a calm atmosphere, without serious irregularities or incidents. Although the final vote count has not yet been completed, the ruling party (FRELIMO) appears to have won the elections against the opposition party (RENAMO) in the majority of the municipalities. The voter turnout is estimated at below 30 percent of the eligible voters.

- Partial information for the third quarter of 2003 indicates that manufacturing output (excluding MOZAL, the aluminum smelter) grew by 9 percent relative to the same period of 2002.

- Consumer prices increased by 1 percent in October 2003 and 0.9 percent in November, with the 12-month rate of inflation declining to 13.6 percent in November, from 14 percent in September. Food prices increased by 15.3 percent on a year-on-year basis in November, while non-food prices rose by 11.1 percent. The still high rate of inflation appears to be related in part to the impact on food import prices of a further weakening of the metical vis-à-vis the South African rand and to recent adjustments in the prices of domestic petroleum products. The metical has appreciated slightly vis-à-vis the U.S. dollar since end-September.

- Based on preliminary information available through September 2003, the fiscal program remains on track. Total revenue was slightly lower than envisaged because of the delay in implementing the withholding of the income tax on the salaries of government employees, while domestic primary spending was significantly below projections owing to lower than envisaged domestically financed capital expenditures. The latter was due to delays in project execution related in part to shortfalls in external assistance. As a result, the domestic primary deficit for the period January-September 2003 was lower than programmed.

- The monetary aggregates have continued to show significant volatility. The 12-month rate of growth of broad money increased to 12 percent in October, from 7 ½ percent in September, partly because of the monetary impact of an increase in government spending following disbursements of external assistance in the fourth quarter. The more relaxed liquidity conditions have led to a further decline of 2–3 percentage points in the average commercial bank lending and deposit rates, to 30 percent and 11 percent, respectively, which has been accompanied by lower interest rates on open market paper. In view of the persistence of inflationary pressures, the authorities have indicated to the staff their intention to intensify the absorption of excess liquidity through a combination of open market operations and central bank's sales of foreign exchange. Recently, the central bank started to preannounce the volume of open market paper to be issued in the weekly auctions for absorption purposes.

- Mozambique was recently added to the list of countries participating in the General Data Dissemination System (GDDS).

Statement by the Staff Representative on Republic of Mozambique
December 10, 2003

The following supplementary information has become available since the issuance of the statement by the staff representative on December 5. The thrust of the staff's assessment remains unchanged.

Yesterday, the authorities provided the staff some preliminary information on poverty based on the National Household Survey that was finalized in June 2003. Following a few months of statistical analysis, the preliminary results of the survey indicate that the proportion of the population living below the poverty line declined by about 15 percentage points, from 69.4 percent in 1997 to the mid-50 percent range in 2002. This is encouraging news, particularly taking into account that the PARPA targeted a reduction in poverty to below 60 percent by 2005.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/148
FOR IMMEDIATE RELEASE
December 22, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with the Republic of Mozambique

On December, 10, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Mozambique.[1]

Background

Mozambique's performance under the authorities' program during the first three quarters of 2003 continued to be satisfactory. Manufacturing output, construction, and services performed strongly during the first half of 2003, and the target of real GDP growth of 7 percent for the year as a whole appears achievable. After peaking in May 2003 owing to the impact of drought on food prices and the appreciation of the South African rand against the metical, the 12-month rate of inflation declined to 13.6 percent in November (under the program, end-year inflation was targeted at 10.8 percent). Average commercial bank lending rates have declined from 37 percent to 30 percent since end-2002, with interest rate spreads remaining high at 19 percent.

The government's fiscal program for 2003 seeks to contain the domestic primary deficit at 3.7 percent of GDP, with tax revenue strengthening as a result of the implementation of the new code for the personal and corporate income taxes approved in 2002, the full-year effect of a new and more transparent fiscal incentives code, and a significant increase in the specific taxes on domestic petroleum products implemented in May 2003. Available information for the period through September 2003 indicates that the government's deficit was lower than programmed,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

reflecting a lower level of locally financed capital outlays owing to delays in project execution associated in part with shortfalls in external assistance.

External developments during the first half of 2003 continued to be influenced by exogenous shocks and large scale foreign investment projects. For the year as a whole, the external current account deficit after grants is expected to widen to 15 percent of GDP (12 percent in 2002), reflecting an increase in investment in the mega projects during the second half of the year.

The consultation discussions focused on the macroeconomic policies for 2004-06 and the government's plans to address pending structural reforms to broaden and sustain growth and further reduce poverty. Real GDP growth is projected to increase to over 8 percent in 2004 largely because of the coming on stream of MOZAL II (the expansion of the aluminum smelter) and the gas pipeline, and end-year inflation is targeted to fall to 9 percent. The government's domestic primary deficit is projected to decline to 3.4 percent of GDP in 2004, owing to a further strengthening of revenue and steps to start addressing the significant increase in the government's wage bill that has taken place in recent years. The overall deficit after grants, however, would be somewhat higher than in 2003.

Discussions on structural issues concentrated on the authorities' plans to remove a number of obstacles to private sector development. Particular attention was paid to (i) reducing red tape and simplifying the regulatory framework; (ii) addressing labor rigidities that hinder competitiveness; (iii) improving basic infrastructure; (iv) reforming the judicial system; and (v) moving ahead with reforms to increase efficiency in the public sector. In addition, the staff discussed with the authorities several recommendations to address remaining vulnerabilities in the financial system made by a joint team from the Fund and the World Bank in the context of the Financial Sector Assessment program (FSAP).

Executive Board Assessment

Executive Directors welcomed the opportunity to review, under the new guidelines on assessments of countries with a longer-term program engagement, the experience with the four Fund-supported programs since 1987. Directors commended the Mozambican authorities for their pursuit of sound macroeconomic policies and wide-ranging structural reforms over the past fifteen years. The authorities' efforts have led to the strong growth of the economy, a strengthening of the international reserves position, substantial debt relief, and a steady decline in poverty rates in a context of political stability. Notwithstanding the considerable progress that has been made, Mozambique remains a very poor country with significant weaknesses and vulnerabilities, including institutional capacity constraints and the negative impact of HIV/AIDS. Directors therefore urged the authorities to persevere in their efforts to consolidate macroeconomic stability and accelerate and deepen structural reforms with a view to sustaining economic growth, encouraging employment creation, and further reducing poverty.

Directors commended the authorities for the satisfactory implementation of their economic program, which was manifested in Mozambique's continued favorable economic performance during 2002 and 2003. Output growth has remained strong, the international reserves position has been strengthened, and significant progress has been made in implementing structural reforms, including by taking important steps to mobilize additional revenue. Directors also noted the advances made toward achieving Mozambique's poverty reduction strategy (PARPA) objectives, especially in the areas of health and education. In particular, they were encouraged by the preliminary information from the recent National Household Survey that the proportion of the population living below the poverty line in 2002 fell below the PARPA's 2005 target of 60 percent.

Directors welcomed the government's economic program for 2004, which seeks to maintain macroeconomic stability and addresses an important agenda of unfinished reforms. They emphasized that achieving the program's fiscal targets will require a further strengthening of government revenue and a close monitoring of current expenditure. Crucial specific steps in this regard will be improvements in tax administration, early introduction of an automatic mechanism of adjustment for the specific fuel taxes, and prompt implementation of the withholding of the income tax on the salaries of government employees. Directors also underscored the importance of limiting the wage increase for government employees to projected inflation and exercising strict control over the payroll in order to contain the recent sizable increases in the wage bill. Key priorities going forward will be to evaluate and address the challenges posed by HIV/AIDS while making progress toward the achievement of the Millennium Development Goals. Directors welcomed the authorities' intention to integrate the monitoring of the PARPA and the budget execution into a single document, which could be the basis for the next review of the PRSP in early 2004.

Directors urged the authorities to press ahead with ongoing efforts to improve public expenditure management and fiscal transparency by adhering to the revised timetable for introducing the new financial management system (SISTAFE) and by bringing all extrabudgetary activities within the budget framework, especially in view of the likely expenditure pressures associated with next year's elections. They encouraged the authorities to move forward vigorously on public sector reform, with the support of the World Bank, including by reducing employment redundancies in some sectors.

Directors called on the authorities to closely monitor monetary developments, particularly in light of the resurgence of inflation in 2003 and the volatility of broad money growth. The authorities should tighten liquidity conditions as needed, and limit interventions in the foreign exchange market to cushioning the impact of temporary shocks and achieving the program's reserves targets.

Directors called on the authorities to implement promptly the recommendations resulting from the FSAP exercise. Strengthened monetary and exchange rate management will be essential in Mozambique, particularly in view of the high degree of dollarization. This will include steps to enhance the consistency between the central bank's sales of foreign exchange and the pace of expenditure financed with external support, to improve the use of indirect monetary instruments, to better coordinate the actions of the central bank and the Ministry of Finance, and to strengthen the balance sheet of the central bank. Directors welcomed the comprehensive program of technical assistance being developed by Fund and World Bank staff, in close coordination with the authorities, to support the implementation of the FSAP recommendations.

Directors emphasized that the authorities should give priority to addressing the remaining vulnerabilities in the financial sector. They urged the authorities to monitor developments in the financial system very closely and to strengthen bank supervision in line with internationally-accepted practices. In addition, the diagnostic reviews of the main banks will help identify appropriate remedial actions and enable a gradual move toward international accounting standards (IAS). It will be important to lower the wide bank spreads and expand access to credit by fostering competition in the financial system, improving loan recovery procedures, and reviewing land tenure regulations to facilitate the use of land as collateral. In addition, the regulatory framework for microfinance activities should be reviewed to facilitate access to financial services by the poor.

Directors stressed the need to broaden growth and stimulate employment in the manufacturing, services, and rural family sectors by enhancing human capital and removing obstacles to private sector development. They encouraged the authorities to reduce red tape; improve basic infrastructure; reduce labor rigidities by simplifying procedures for hiring expatriates and lowering retrenchment costs; and press ahead with the reform of the judicial system to speed up the administration of justice and strengthen the enforcement of contracts. Directors called for the prompt approval of the regulations for the anti-money laundering law passed in 2002, and for the development of legislation on the combating of the financing of terrorism. Several Directors underscored the importance of improving market access for Mozambique's exports.

Directors encouraged the authorities to redouble their efforts to complete the bilateral agreements with remaining Paris Club creditors, and they urged the non-Paris club creditors who have not yet done so to provide debt relief on HIPC Initiative-comparable terms.

Directors welcomed Mozambique's participation in the Fund's General Data Dissemination System. They underscored the need for a determined effort to address remaining weaknesses in the statistical system, based on the recommendations made in the context of the recent data Reports on the Observance of Standards and Codes exercise.

Looking forward, most Directors expressed readiness to consider a successor low-access PRGF arrangement based on a strong program, which would help the authorities address the remaining challenges. A few other Directors encouraged consideration of other possible forms of engagement outside of a formal Fund arrangement.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Mozambique: Selected Economic and Financial Indicators, 2000–03

	2000 Actual	2001 Actual	2002 Prel.	2003 Proj
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Nominal GDP (in billions of U.S. dollars)	3.6	3.4	3.6	4.3
Real GDP growth	1.5	13.0	7.7	7.0
Consumer price index (end of period)	11.4	21.9	9.1	10.8
External sector				
Merchandise exports	28.3	93.2	-3.0	31.5
Merchandise imports	-3.1	-8.6	18.8	26.8
Terms of trade	-2.8	5.7	0.6	1.4
Real effective exchange rate (end of period) 1/	-3.7	-9.3	-6.4	...
	(Annual change in percent of beginning-period broad money, unless otherwise specified)			
Money and credit				
Net domestic assets	11.6	9.1	0.2	10.8
Of which: net credit to the government	4.1	5.3	3.3	-0.5
Broad money (M2)	42.4	29.7	20.1	13.5
Interest rate for 90-day treasury bills/TAMs (in percent; end of period)	21.8	31.7	18.5	...
	(In percent of GDP)			
Government budget				
Total revenue	13.2	13.3	14.2	14.4
Total expenditure and net lending (incl. residual)	27.3	34.7	33.8	28.0
Overall balance, after grants	-6.0	-6.6	-7.9	-3.2
Domestic primary balance (excluding bank restructuring)	-5.1	-6.3	-3.6	-3.7
	(In percent of exports of goods and nonfactor services)			
Net present value of total public external debt outstanding 2/	194.4	109.8	91.7	85.4
External debt service (nonfinancial public sector)				
Scheduled, after original HIPC Initiative assistance	5.5	5.8	8.2	7.2
Scheduled, after enhanced HIPC Initiative assistance and additional bilateral assistance	...	3.5	4.3	3.8
	(In millions of U.S. dollars, unless otherwise specified)			
External current account, after grants	-478	-497	-421	-644
Overall balance of payments	-352	-421	94	31
Net international reserves (end of period)	526	531	625	656
Gross international reserves (end of period)	746	727	810	832
In months of imports of goods and nonfactor services	6.3	5.8	5.9	5.0

Sources: Mozambican authorities; and IMF staff estimates and projections

1/ A minus sign indicates depreciation.

2/ Public and publicly guaranteed, in percent of the three-year average of exports. The data for 1999 2000 include the impact of total debt relief under the original HIPC Initiative. Data for 2001-03 include the impact of total debt relief under enhanced HIPC initiative, additional bilateral assistance, and new borrowing.

Statement by Ismaila Usman, Executive Director for Republic of Mozambique
December 10, 2003

1. My Mozambican authorities wish to express their appreciation to the Bretton Woods institutions as well as to the international community for their continued financial and technical support during the last 17 years, of stabilization and reform. The key to the successful transformation of the economy and in the creation of an institutional setting conducive to the enhancement of economic efficiency, through the improved economic fundamentals has been the continued pursuit of sound policies, the liberalization of the economy and the implementation of a wide range of structural reforms.

Developments since 1987

2. Since the early 1987, Mozambique has implemented, generally well sequenced, market-oriented policies. Price controls and subsidies were eliminated, the trade and exchange rate regime was liberalized, exchange rates were unified and became market determined, and fiscal and external imbalances were reduced. These polices were complemented by an ambitious structural reform agenda, that included an extensive program of privatization of over 1200 state-owned enterprises and the strengthening of the institutional and legal frameworks that have promoted greater private sector participation and increasingly confining the role of the state to that of regulator as well as provider of social services and basic infrastructure.

3. Far reaching reforms in the fiscal sector consisted among others of an overhaul of the tax system embracing a new and streamlined income tax system, and the introduction of a value-added tax, a substantive restructuring of customs administration with temporary outsourcing of the management, the adoption of a medium-term expenditure framework linked to the annual budget, matching expenditure priorities with resource availability, measures to improve fiscal transparency by adopting a new system of accounting as well as publication of quarterly budget execution reports, and the establishment of a new financial management system (SISTAFE).

4. Reforms in the monetary and financial area involved the approval of a new financial institutions law, which set the basis for banking licensing and strengthening of the central bank's supervision role. State-owned commercial banks were partially privatized and foreign banks were allowed to operate in Mozambique. On the monetary side the central bank increasingly relied on indirect instruments of monetary control.

5. After the long rescheduling process that spanned over nearly two decades, the debt relief provided under the HIPC Initiative at the completion point was instrumental to enabling Mozambique to regain debt sustainability.

6. During the 1987-2002 period, real GDP growth averaged 7 percent a year, inflation decelerated sharply from three digit figures to minus 1.3 percent in 1998 before rising to higher levels in the past four years. Exchange rate has remained generally stable. As a result

of improvements in the external current account position, gross international reserves rose to the equivalent of about 6 months of imports of goods and nonfactor services between 1996-2002 from 1.6 months before the adjustment process was initiated in 1987. The strengthening of gross domestic savings, which increased from 14 percent of GDP in 1996 to 33 percent in 2002, has contribute to gradually reduce the country's reliance on foreign assistance.

7. As stated in the staff report much has been accomplished during this extensive period of reforms in terms of achieving macroeconomic stability and improving the economy's efficiency. This was essentially due to the consistency in the implementation of policies and strong perseverance on the part of the authorities. To lock in the economic gains already made and to continue to enhance the progress going forward, my authorities have a strong commitment to formulating a new program of economic policies covering the period 2004-06. The program is intended to give continuity to the current economic strategy but with a special emphasis on further consolidating the fiscal position, further enhancing the soundness of the banking system and dealing with the remaining agenda of structural reforms. These measures will further assist in the process of reducing the economy's still heavy dependence on foreign assistance, which remains a significant element of vulnerability given the volatility of these flows. The authorities trust that this program will continue to earn the support of the international community, including in particular the Fund, as it is considered important to underpin the credibility of the economic policies and assist Mozambique in its steadfast course towards its objective of realizing the economy's full potential.

8. The authorities acknowledge that Mozambique has applied successively for Fund financial support since the program was initiated and as much as they would have wished to avoid the recourse to yet another PRGF arrangement, they have to do in the absence of a more appropriate alternative vehicle that would provide the Fund's "seal of approval" of the country's policies to signal donors to disburse their funds. Accordingly, the authorities are receptive to a PRGF arrangement with a more limited access.

Performance in 2003

9. The overall economic performance in first tree quarters of 2003 was generally encouraging. The trend of a robust real GDP growth of the past years is expected to be repeated in 2003 albeit at slightly lower rate of 7 percent, on account of stronger performance in the manufacturing, construction and services sectors. Inflation which has declined to 9 percent in 2002 from 22 percent in the previous year had resurged in 2003, mainly due to the impact of the regional drought on food prices, the substantive appreciation of the South African rand, and the significant upward adjustments in the prices of the petroleum products. The 12-month inflation fell to 13.6 percent in November from 14.7 percent in October.

10. The authorities remain committed to the goal of further strengthening the public sector finances to continue reducing reliance on foreign assistance. Revenue enhancing and expenditure containment measures lead to a substantive reduction in the domestic primary deficit from 6.3 percent of GDP in 2001 to 3.6 percent last year, and is envisaged to decline further to 3.4 percent in 2004. Revenue to GDP ratio is expected to rise to 14.7 percent in

2004 as a result of the strengthened tax enforcement and improved tax administration. Special attention is being accorded to press ahead with the ongoing reforms in the area of customs with a view to ensuring a smooth integration of customs within the soon to be established Central Revenue Authority. Expenditure control and monitoring will be strengthened to ensure the achievement of the fiscal target. In this context, the authorities are committed to limit the wage increase of the civil servants to the projected inflation. They are also considering a number of measures that will allow reducing the wage bill in relation to GDP in the medium-term. To this effect they intend to undertake several measures starting with a detailed analysis of the payroll data, in particular those related to the education sector that employs 50 percent of the government employees. The planned implementation of the SISTAFE in 2004 will contribute to improving financial management in the public sector. The process of integrating extrabudgetary revenues and expenditures in budgetary execution procedures and reporting is already being carried out and will assist in the effort to further improve fiscal transparency.

11. The authorities are strongly committed to implementing their poverty reduction strategy to benefit the most needy segments of the population and are confident that with continued process of fiscal consolidation, additional resources will continue to be channeled to priority social sectors. Spending on PARPA priority sectors will be accounting for 65 percent of primary expenditures in 2004. Despite this continued effort to allocate increased resources to these sectors, it is becoming evident that reaching the Millennium Development Goals of halving the poverty levels by 2015, will only be possible with additional substantial resources.

12. The authorities will continue to monitor developments in the monetary area closely and are committed to maintaining liquidity levels consistent with the achievement of the inflation target while maintaining the policy of directing resources to more productive uses. The central bank has continued to make use of open market operations as its main instrument to control money supply. During January-October 2003, broad money growth was limited to 12 percent, which was substantially lower than the 17.2 percent reached during the same period in 2002. The authorities are determined to further strengthening bank supervision and prudential regulations that are consistent with international standards. The banking system has remained generally sound with the banks having an average capital adequacy ratio of over 14 percent, thus well above the standard requirement. The situation of the largest commercial bank (BIM), which was confronted with financial problems in the past, continues to be closely monitored and has shown to improve steadily. The comprehensive diagnostic review of the bank, according to international accounting standards (IAS) was initiated in December, with the financial support of the World Bank to avoid further delays. The terms of reference for contracting the auditing firm that will carry out the comprehensive audit of the other three major banks are being finalized.

13. The authorities are in broad agreement with the conclusions and recommendations of the FSAP mission and intend to take the necessary measures to deal with the identified weaknesses in the financial sector. Given their limited administrative capacity, the authorities are appreciative of the comprehensive technical assistance program to be jointly prepared with the Fund, the World Bank and the African Development Bank to assist them

in the implementation of the recommendations, but due consideration should be paid to the existing absorptive capacity.

14. Structural reforms have been progressing in a number of areas including the financial sector, taxation policy, privatization and concessioning of the few remaining public enterprises, particularly in the energy, telecommunications, national airline, water supply, ports and railways. Reform has, however, been slower than expected in judicial sector due to lack of financial resources to implement the projects identified. Where possible, however, measures have been taken to advance the process of reform in this sector, including setting the legislation to establish intermediate courts to speed up the administration of justice, revising the commercial code that could lead to the continuing modernization of the financial system, as well as of the civil and penal codes. In the meantime, an extensive training program is also being carried out.

15. Regarding public sector reform, a comprehensive restructuring of the various ministries have been initiated and a new wage policy is expected to be implemented following the restructuring, which is envisaged to reward good performance. Given the limited administrative and financial capacity at local level, the process of decentralization is expected to be introduced more gradually and provided that the required conditions are met to carry out the responsibilities. The authorities intend to make progress in other areas notably in the labor market. With regard to the issue of land tenure, appropriate measures will be taken, once the study that has been commissioned is ready.

Conclusion

16. My Mozambican authorities have shown very strong commitment and seriousness in tackling the dire economic problems confronted in the early days of this extensive adjustment and reform process, by remaining on course even in the face of the adverse conditions which have threatened to derail the process, including the externally promoted war and prolonged droughts and floods. Experience has demonstrated also that there were no quick solutions to the country's deep-seated structural problems, and that despite the impressive results achieved thus far, continued support from Mozambique's development partners will remain crucial to carry out the remaining reform agenda. My authorities look forward to an early negotiation of the new PRGF arrangement.

17. Finally, my authorities have consented to the publication of the staff report, subject to the deletion policy on information of a sensitive nature.