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Minutes of Executive Board Meeting 19/45-3

11:35 a.m., June 3, 2019

3. Republic of Mozambique—2019 Article IV Consultation

Documents: SM/19/106 and Supplement 1; SM/19/107

Staff: Velloso, AFR, Gonzalez Miranda, SPR

Length: 52 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
	F. Sylla (AF)
	C. Moreno (AG), Temporary
	N. Heo (AP)
A. Tombini (BR)	
	X. Cai (CC), Temporary
	J. Suazo (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
	A. Castets (FF)
	K. Merk (GR)
	P. Dhillon (IN), Temporary
D. Fanizza (IT)	
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	S. Geadah (MI)
	T. Manchev (NE), Temporary
T. Ostros (NO)	
	L. Palei (RU)
	B. Alhomaly (SA), Temporary
A. Mahasandana (ST)	
	C. Wehrle (SZ), Temporary
	D. Ronicle (UK)
M. Rosen (US)	

G. Bauche, Acting Secretary
E. Tsounta, Summing Up Officer
A. Lalor, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
African Department: N. Carvalho, S. Delepierre, D. Robinson, R. Velloso, H. Zavarce Rovero. Finance Department: S. Matai. Middle East and Central Asia Department: M. El Said Ibrahim. Strategy, Policy, and Review Department: Y. Endegnanew, M. Gonzalez Miranda. Statistics Department: D. Costa. World Bank Group: T. Buckley.

Alternate Executive Director: P. Fachada (BR), I. Mannathoko (AE), K. Obiora (AE), B. Saraiva (BR). Senior Advisors to Executive Directors: S. Evjen (NO), W. Nakunyada (AE), S. Potapov (RU), M. Sidi Bouna (AF), T. Sitima-wina (AE), A. Tivane (AE). Advisors to Executive Directors: A. Abdullahi (AE), S. Buetzer (GR), S. David (AP), J. Essuvi (AE), D. Fadhel (MI), J. Garang (AE), M. Ismail (AE), B. Jappah (AE), U. Latu (ST), H. Mori (JA), M. Mulas (CE), L. Nankunda (AF), A. Olhaye (AF), A. Zaborovskiy (EC).

3. REPUBLIC OF MOZAMBIQUE—2019 ARTICLE IV CONSULTATION

Mr. Mahlinza and Mr. Tivane submitted the following statement:

Introduction

Our Mozambican authorities thank staff for their continued engagement and candid policy discussions during the 2019 Article IV consultation. They also appreciate the Fund's swift response to their request for emergency financing under the Rapid Credit Facility (RCF) to support post-disaster reconstruction efforts and catalyze additional donor support.

Mozambique continues to make progress in improving its policy and institutional settings to achieve durable macroeconomic stability and inclusive growth. At the same time, the authorities continue to make efforts to calibrate the policy mix to insulate the economy against external shocks including, commodity price volatility, extreme climate events, and the tightening of global financial conditions. Going forward, they are determined to broaden structural reforms to support inclusive and sustainable growth, maintain macroeconomic stability, improve fiscal and debt sustainability, bolster productivity growth, and strengthen governance.

The authorities recognize that preserving peace remains essential to unlocking the country's growth potential and improving the country's investment appeal. In this regard, they are committed to leveraging the country's democratic experience by accelerating the integration of the residual forces of the Renamo Party into the army, security forces and civil society, and completing the decentralization process.

Vulnerability to Climate Shocks

Mozambique remains highly vulnerable to climate-related shocks due to its geographical location and topography. In March 2019, Tropical Cyclone Idai struck the central region near the port city of Beira leaving a trail of destruction on its path. Immediately thereafter, in April 2019, Tropical Cyclone Kenneth made landfall in the northern Province of Cabo Delgado destroying entire villages and displacing thousands of people, in a country already struggling with the consequences of a drought. The growing frequency and intensity of the climate change shocks has placed immense pressure on the economy and its ability to tackle development challenges. In addition, the weak socio-economic infrastructure and heavy reliance on rainfed subsistence agriculture, amplifies the impact of adverse weather conditions on vulnerable households.

The authorities are intensifying efforts to increase the country's resilience to natural disasters. In this context, they have developed the National Climate Change Strategy (2013-2015) and the Master Plan for Risk and Disaster Reduction (2017-2030). In response to the recent disasters, the authorities have completed a Post Disaster Needs Assessment (PDNA), which estimates the post-Idai reconstruction financing needs at $2.9 billion. Support from development partners remains essential to restore infrastructure and bring the economy on a recovery footing. In this respect, they plan to hold an International Donors' Conference in the city of Beira, from May 31 to June 1, 2019.

Recent Economic Developments and Outlook

Following a series of shocks in 2015-2016, economic recovery has begun to emerge. Nonetheless, real GDP growth slowed down from 3.7 percent in 2017 to 3.3 percent in 2018 due to a decline in economic activity in the agriculture, mining and transport sectors. Economic growth is expected to further moderate to 2.5 percent in 2019 owing to the impact of the recent cyclones. Going forward, growth is expected to remain positive, in line with a rebound in consumption and investment related to the liquified natural gas projects.

Inflation declined from a peak of 26½ percent at end-November 2016, to 3¼ percent at end-April 2019, reflecting a tight monetary policy stance and subdued food prices. As the supply shocks occasioned by the two cyclones pass through the economy, inflation is projected to pick up to about 7 percent in 2019. Going forward, inflation pressures are expected to dissipate and remain within the Bank of Mozambique's target range of 6-8 percent.

The current account deficit, excluding mega projects, widened to 30.4 percent of GDP at end-December 2018 from 20 percent of GDP at end-December 2017. This was largely due to an increase in imports of intermediate and capital goods, including fuel. At the same time, key commodity exports (coal and aluminum) continued to decline. Consequently, gross international reserves declined from about 6.8 months of import cover at end December 2017 to nearly 5.5 months of imports at end December 2018.

Fiscal Policy and Public Financial Management

The authorities' medium-term fiscal strategy aims to intensify fiscal consolidation through improved revenue collection and enhanced public expenditure efficiency. Concomitantly, the authorities aim to place debt on a sustainable path while improving the oversight of state-owned enterprises (SOEs). To achieve these objectives, they will build robust fiscal management systems, and strengthen project management capacities. As part of the preparations for the effective management of natural gas revenues expected after 2023, the authorities are considering adopting a fiscal rule to mitigate risks stemming from commodity price volatility. Similarly, they intend to establish a Sovereign Wealth Fund to support productivity-enhancing investments.

The authorities have made progress in advancing fiscal consolidation measures over the FY2017/18, including, among others, streamlining recurrent expenditures, notably the wage bill and goods and services; the phasing out of fuel and wheat subsidies together with the introduction of an automatic fuel price-adjustment mechanism; and scaling back of capital expenditures. They continue to press ahead with the implementation of the strategy to address domestic payments arrears. Going forward, they plan to rationalize lower priority spending to address post-disaster financing needs. They remain committed to achieving a zero primary fiscal balance by 2022, which along with the reliance on grants and highly concessional financing will reduce fiscal pressures and help curb debt vulnerabilities in the medium term.

The authorities are committed to bringing debt levels to moderate risk of debt distress over the medium term. In this respect, they have taken positive steps to improve the transparency of the process of evaluating and granting government guarantees. In addition, they are stepping up efforts to strengthen the recently-created Fiscal Risk Assessment Unit in the Ministry of Economy and Finance. Further, they plan to upgrade debt management capacity while strengthening the oversight of fiscal risks emanating from SOEs. In parallel, good faith discussions with commercial creditors to achieve timely debt restructuring are continuing.

To support medium term fiscal consolidation efforts and improve policy credibility, the authorities will accelerate public financial management reforms and pursue fiscal decentralization in a fiscally-responsible manner. In this respect, they intend to submit to parliament a public finance decentralization draft law in harmony with the set of administrative decentralization laws already approved by Parliament. These legislative steps aim to improve the quality of delivery of public goods and services through a gradual transfer of revenue and spending responsibilities to Provinces.

Monetary, Exchange Rate, and Financial Sector Policies

The authorities' monetary policy stance emphasizes price stability, financial sector resilience and ensuring exchange rate flexibility. To this effect, the Bank of Mozambique (BM) has pursued a cautious easing of monetary policy in line with the softening inflationary pressures. The normalization of monetary policy will remain as the BM continues to monitor the potential second round effects of the cyclone induced supply shocks.

As part of an effort to strengthen the monetary policy framework and the Bank of Mozambique's operational autonomy, the authorities are presently preparing amendments to the Central Bank Act and preparing a new Banking Law to enhance crisis management, bank resolution, and safety nets. At the same time, the BM will implement measures to ensure adequate capital buffers in the banking sector while accelerating the shift to risk-based supervision. To enhance financial sector resilience, the authorities will strengthen the AML/CFT framework. In this connection, preparations for the 2019 AML/CFT evaluation by the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) under the revised AML/CFT international standard are at an advanced stage.

The authorities view financial deepening and inclusion as important to support broad-based growth, accelerate poverty reduction, and improve distributional outcomes. To this end, they are committed to continue implementing the National Strategy for Financial Inclusion (2016-2022) to promote access to financial services in all districts. They believe that this strategy will position the country well to leverage benefits conferred by the digital revolution.

Structural Reforms

The authorities view the implementation of structural reforms including governance reforms, as essential to improve the country's growth prospects in the medium to long run. To this end, they intend to intensify efforts to enforce existing laws aimed at fighting corruption and reinforcing the primacy of the rule of law. More importantly, they expect to work towards the completion, publication, and implementation of the diagnostic report on governance, transparency, and accountability with IMF technical assistance. At the same time, the Attorney General's Office will continue to work cooperatively with bilateral partners with a view to expedite the ongoing investigations related to the undisclosed loans. Similarly, the authorities intend to prepare and submit to Parliament a Law to permit recovery of assets related to corruption practices.

To address the competitiveness challenges, near-term structural priorities include enhancement of capacity development initiatives aimed at supporting skills development and the promotion of public investments in the agriculture and fisheries, mining, and transportation sectors to lift the country's comparative advantage. Similarly, the authorities will continue to deploy policy measures to reduce labor market rigidities and create a friendly business environment.

Conclusion

The Mozambican authorities are determined to advance their reform agenda to achieve durable macroeconomic stability, support broad-based growth, improve distributional outcomes, and strengthen institutional capacity. They greatly appreciated the Fund's continued engagement and policy advice and wish to thank the international community and development partners for supporting the country's resilience building efforts to mitigate the impact of climate change.

Mr. Ostros and Mr. Evjen submitted the following statement:

We thank staff for the report and Mr. Mahlinza and Mr. Tivane for their buff statement. We broadly support staff's assessment and recommendations. Our views on Mozambique's economic performance are broadly unchanged since their request for disbursement under the RFC was approved by the Executive Board on 19 April 2019. Since then, the severe impact of tropical cyclone Idai has been compounded by tropical cyclone Kenneth adding to the country's already elevated challenges. We would take the opportunity to offer our condolences to the people of Mozambique for the resulting human losses and injuries.

Building fiscal buffers against future natural disasters remains key. Although the economic situation was improving before the cyclones struck, they have caused infrastructure damage which has severely impacted productive capacity in key economic sectors. The GDP growth projections for 2019 are downgraded, and inflation is projected to increase significantly owing to the adverse supply shock to food availability. The adverse effects of the cyclone will affect the fiscal accounts both through lower tax collection and higher spending related to emergency relief and reconstruction. This reflects that Mozambique is one of the most vulnerable countries to natural disasters and climate change. To create fiscal buffers against future disasters, we encourage the authorities to implement gradual fiscal consolidation over the medium term and finalize debt structuring with private creditors in line with their debt strategy.

Strong management of the substantial natural resource wealth will be imperative for longer-term inclusive growth. As Mozambique is poised to become a key producer and exporter of LNG, yielding very substantial fiscal revenues, strong management of these revenues will be key for inclusive growth and the welfare of future generations. We support staff's idea to consider fiscal rules to save for future generations, including through a sovereign wealth fund which can underpin transparency.

We strongly encourage the authorities to continue their efforts in fighting corruption. Addressing governance and vulnerabilities to corruption will have a potentially large positive impact on inclusive growth prospects. The ongoing preparation, with the Fund's technical assistance, of a diagnostic report of governance and corruption vulnerabilities is an important step towards ensuring that scarce public resources are put to good use. The report should be published as soon as it's finalized. We take note of staff's analysis and assessments of Mozambique's governance and corruption challenges in Annex III of the report. We recognize that legislative and institutional measures have been adopted by the authorities but note that more work is needed. Moreover, we welcome the steps taken to address the deficiencies in the AML/CFT framework, while noting that improvements are still needed also in this area.

We welcome that the Bank of Mozambique (BM) is committed to implementing further monetary and financial sector regulatory measures to enhance financial sector resilience. We are encouraged by the BM's satisfaction with the technical assistance provided under the Norges Bank and IMF multiyear project and note that progress has been made in several areas in the project's first phase. Staff's elaboration on the progress would be welcome.

Ms. Levonian and Mr. Sylvester submitted the following statement:

We thank staff for their useful set of papers and Mr. Mahlinza and Mr. Tivane for their helpful buff statement.

The Mozambican authorities are currently grappling with the fallout from two recent tropical cyclones. Fund support, through a recently approved Rapid Credit Facility (RCF), should help catalyze much needed donor financing to support the country's recovery and reconstruction efforts. The authorities were making good progress in improving Mozambique's economic situation prior to the recent setbacks, and we urge them to continue in this vein. As we broadly concur with staff's appraisal and recommendations, we offer the following additional comments for emphasis.

A strong show of commitment by the authorities is needed. We welcome their commitment to address macroeconomic and governance challenges. Specifically, their commitment to address fiscal vulnerabilities, bolster productivity growth, build resilience to natural disasters, and buttress institutions. This should help rebuild trust and restore credibility with development partners, and support the authorities' efforts in catalyzing donor financing, which should primarily be in the form of grants and highly concessional loans to avoid exacerbating existing debt vulnerabilities.

We urge the authorities to advance reforms to ensure fiscal and debt sustainability. Mozambique's debt is currently in distress. We welcome the current efforts to reduce debt vulnerabilities, including through pursuing fiscal consolidation, improving debt management capabilities, and restructuring international commercial debts. We urge the authorities to vigorously pursue these efforts, in addition to increasing debt transparency. That said, we have some skepticism about staff's assessment that Mozambique's debt is sustainable in a forward-looking sense. Staff's conclusion hinges on several factors that are subject to considerable risks. The speedy and robust recovery from the cyclone is predicated on significant donor support, which could fall short of expectations. Furthermore, the ongoing debt restructuring process and the liquified natural gas (LNG) development could fail to materialize as planned. We would welcome staff's further elaboration on their assumptions and conclusion in the DSA.

Mozambique's high vulnerability to natural disasters and climate change underscores the need to build resilience. We welcome staff's advice on integrating resilience to natural disasters and climate change within Mozambique's broader development agenda going forward. We assert that a comprehensive approach to disaster risk management is needed, including to build ex-ante resilience. We welcome staff's useful Selected Issues Paper and recommendations related to the development of Mozambique's large natural gas reserves, which can be used to bolster its resilience to natural disasters and other shocks. On structural reforms, more broadly, we urge the authorities to continue their efforts to support higher, sustained, and inclusive growth, including through improving the business environment and restructuring of ailing SOEs.

We welcome recent progress on governance but urge sustained efforts. We encourage the authorities to make further progress to improve governance, transparency and accountability, and reduce vulnerabilities to corruption. In this context, we look forward to the completion, publication, and implementation of the Fund-supported diagnostic report on governance, transparency, and accountability. Tackling governance and corruption issues will be crucial in leveraging donor pledges going forward.

Mr. Tombini, Mr. Fachada and Mr. Antunes submitted the following statement:

We thank staff for the detailed reports and Messrs. Mahlinza and Tivane for their informative statement. Under the impact of tropical cyclones Idai and Kenneth in March and April this year, Mozambique's macroeconomic and social conditions have deteriorated. We agree with staff that macroeconomic policies must be cognizant of the country's delicate situation and support the call for active engagement of the international community in reconstruction efforts. Nevertheless, macroeconomic imbalances persist, particularly on the fiscal and external fronts. We encourage the authorities to pursue gradual fiscal consolidation, solve pending arrears with creditors and address governance deficiencies, with a view to recovering access to international capital markets and attracting much needed foreign investment.

The devastation caused by the cyclones will have impacts on growth and revenues in the current year. We commend the authorities' decision to persevere in their fiscal consolidation endeavor, despite the challenging circumstances. We fully recognize that the devastation represents an unforeseen pressure on the budget, warranting a gradual approach towards fiscal consolidation. Accordingly, we second staff's recommendations with a view to eliminating the primary deficit after grants by 2022, thereby putting the public debt-to-GDP ratio on a firm downward path.

Improving governance and monitoring the macroeconomic impact of megaprojects closely will be key to guarantee external sustainability. We believe that large current account deficits are a cause for concern, with Mozambique's external position substantially weaker than implied by fundamentals and desirable policies. The development of natural gas fields requires prudent and gradual investment scaling-up, offering in the medium-term a promising opportunity to reduce the external gap, rebalance the budget and reignite inclusive growth. The success of megaprojects and their economic and social sustainability will depend on adequate governance frameworks. In this regard, we welcome the authorities' decision to establish a Sovereign Wealth Fund to manage windfall revenues and commend the Fund's technical support in this area to Mozambique.

Thanks to prudent monetary policy, the Bank of Mozambique (BM) successfully controlled inflation pressures. The cyclones hit the country in a moment when Mozambique established a sound monetary policy framework and reduced inflation. Although it is too early to assess the impact of the cyclone-induced supply shock on prices, inflation is forecasted by staff to remain under control thanks to the prudent monetary policy stance. We commend the BM for its effective monetary policy management. Furthermore, we second staff's assessment that the BM should remain vigilant in face of possible second-round effects of the recent supply shock.

International financing will be key looking forward, and the authorities must take decisive measures to address unresolved arrears. We take note of staff's assessment that the authorities are engaged in good-faith discussion with private creditors. We welcome the ongoing negotiation as a first step towards the complete resolution of Mozambique's arrears, which will be essential to regain access to international capital markets and attract foreign investment in the long run. Notwithstanding the progress in recent talks with private creditors, we encourage the authorities to double efforts and engage in proper negotiation with official creditors as well. Could staff update the Board on the situation of arrears to official creditors?

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

Mozambique's economy had been improving gradually before the country was hit by two tropical cyclones in March and April this year. The cyclones caused significant loss of life and damaged key sectors of the economy, disrupting productive capacity particularly in services and agriculture. With limited fiscal buffers, the bulk of the reconstruction costs will have to be covered by grant financing and highly concessional loans.

Continued gradual fiscal consolidation efforts are needed to put Mozambique's public debt-to-GDP ratio on a clear downward path. As one of the most heavily indebted countries in Sub-Saharan Africa and with an external debt rating in distress, the authorities should remain firmly committed to fiscal consolidation and avoid slippages, in particular in the run up to the elections later this year. Implementing the strategy to bring debt levels down in the medium term will be essential to rebuild trust, including with development partners. We welcome the elimination of subsidies and control of administered prices for fuel and wheat, which together with cuts in public investment have improved the primary fiscal deficit. However, we note that the overall deficit still remains relatively high as a percentage of GDP. Extreme caution should be exercised when contracting new public debt and guarantees going forward. In this regard, we welcome that important steps that were taken to improve the transparency of evaluating and granting government guarantees.

Necessary areas of fiscal reforms include the public sector wage bill and state-owned enterprises (SOEs). The state's involvement in the economy should be reduced through the restructuring and privatisation of companies that represent a high burden on – and risk to – the state budget. Further effective implementation of approved legislation related to the control and management of SOEs is essential. At the same time, expenditure on critical social programs, including health, education, water and sanitation, and social protection should be preserved, taking into account spending efficiency criteria.

We also support staff's emphasis on tax administration reforms to boost revenue collection, by improving the taxpayers' registry and electronic information systems, enhancing compliance of large taxpayers with adequate risk analysis, and strengthening the extractive industry tax management. We recommend a comprehensive IT development strategy to avoid a fragmentation into different IT tools. While we recognize the importance of the specialized unit on the extractive industries, it is important to ensure an adequate skill level of staff to effectively audit and control the claimed incurred costs and detect tax-motivated accounting and transfer pricing.

Lack of debt transparency, reputational risks and possible spillovers of hidden loans remain a fundamental issue. Further efforts to achieve sound debt management capacities are critically important and proper recording and transparent reporting of debt are essential. To ensure comprehensiveness, it is important for all debtors and creditors to adhere to international transparency norms. Similarly, the authorities should increase the transparency of public finances and continue strengthening the governance framework through adequate and focused institutional and legislative measures. Technical assistance to enhance the framework to contract public debt and issue guarantees of non-concessional external borrowing should be increasingly results-based.

We underline the need for decisive progress in strengthening governance, transparency and accountability, including the fight against corruption. We welcome the diagnostic report on governance and corruption vulnerabilities in areas most relevant for economic activity. We encourage the publication of the report, also to allow for relevant findings to be mainstreamed in future capacity building programs and the design of more effective reforms to address the main weaknesses facing the country. Moreover, further efforts to strengthen central bank governance will be important. In this regard, we welcome the Bank of Mozambique's commitment to undertake a safeguards assessment.

As one of the most vulnerable countries to natural disasters and climate change, the authorities should take measures to further improve the crisis adaptation and response capacity. In view of the increasing intensity and frequency of weather-related disasters, we agree with staff about the importance of creating fiscal buffers in the medium term. It will be important to allocate resources to promoting ex-ante resilience. The measures recently approved by the government to mitigate the negative impacts of the cyclones on the private sector and facilitate recovery through "tax and customs facilities" measures can have a positive effect, if well implemented. But we would like to emphasize the need for a careful cost-efficiency analysis of such measures and their implementation. Additionally, a stronger effort needs to be made on revenue-enhancing measures, such as the rationalization of tax benefits and the implementation of revenue administration reforms.

Strengthening natural resource management will be key to make sure that the country will benefit from its large natural gas reserves. We note that another conference to explore options to manage the increased revenues from natural gas exploration in a manner that will support inclusive growth will be organized as part of the Managing Natural Resource Wealth Thematic Trust Fund. We hope that adequate follow-up will occur and will support the development of a stronger medium-term fiscal framework.

Mr. Kaya, Mr. Just and Mr. Zaborovskiy submitted the following statement:

We thank staff for the reports, and Messrs. Mahlinza and Tivane for their helpful buff statement. The devastating impact of the recent severe cyclones have heightened the already formidable economic challenges in Mozambique, taking a heavy toll on public finances in the short run and on the economy's potential in the medium and long run. While acknowledging the complexity of the economic situation and the authorities' limited room for maneuver in response to the adverse developments, we emphasize that sound policies and well-sequenced measures to strengthen economic resilience and boost the growth potential are critically important, particularly at the current juncture. We share the thrust of staff's appraisal and policy recommendations and offer the following comments for emphasis.

A fine balance between financing the immediate emergency needs and sustaining medium-term fiscal consolidation should be found to resolve the debt crisis. Staff recommends capping the primary fiscal deficit after grants at 2½ percent of GDP in 2019 to avoid accumulation of arrears and/or the central bank's monetary financing of the deficit. In the medium term, eliminating the primary fiscal deficit after grants by 2022, underpinned by the envisaged debt restructuring, could help ensure that public debt-to-GDP ratios remain on a clear downward path. While we broadly agree with these anchors, a more nuanced elaboration on the fiscal strategy in 2020 and 2021 would have been helpful. Considering the additional distractive consequences of the Cyclone Kenneth in April, we would welcome staff's update on the overall damage caused by both cyclones, estimates of reconstruction costs as well as overall external support, including the Fund's Rapid Credit Facility's catalytical role. We positively note that the authorities have broadly agreed with staff's views and recommendations on the fiscal policy and encourage them to move forward with much-needed fiscal structural reforms, fiscal risks management, debt transparency, domestic revenue mobilization, and expenditure rationalization. Success in these areas critically hinges on the broader governance and anti-corruption reforms.

Vigilance is warranted while normalizing monetary policy and safeguarding financial stability. We positively note staff's assessment of the progress achieved on the monetary and financial stability fronts. The central bank's commendable anti-inflationary measures have brought inflation down from double digits to 3¼ percent (y/y) in April 2019. In light of this achievement, we welcome the Selected Issues Paper's focus on neutral real interest rate estimates for Mozambique. While sharing staff's conclusion that the monetary policy is still somewhat tight, we caution against a premature loosening of the monetary stance before inflation expectations are better anchored and the coordination of fiscal and monetary policies is improved. Staff also rightly points to the possible second-round effects of the supply shock induced by the cyclones which require close monitoring and a well-designed response. The central bank's operational framework and independence also need to be strengthened. We welcome staff's comments on when amendments to the Central Bank Act and a new Banking Law are expected to be approved and become effective. We positively note the measures aimed at enhancing financial sector resilience and strengthening the AML/CFT framework outlined in the buff statement. Nevertheless, as shown in the staff report, comprehensive actions to limit financial stability risks stemming from the public-sector exposures, strong focus on enforcing bank capital requirements and advancing financial inclusion are necessary.

Comprehensive measures to adequately address concerns about the strength and effectiveness of Mozambique's governance framework and anti-corruption efforts are needed to boost confidence and the country's growth prospects. We welcome to learn from Messrs. Mahlinza and Tivane's statement that the authorities intend to intensify efforts to enforce existing laws aimed at fighting corruption and reinforcing the primacy of the rule of law. These measures are critical for successful structural reforms and an attractive investment climate. The state-owned sector restructuring remains an important part of this strategy. We welcome the improved oversight and governance of the SOEs and encourage the authorities to speed up the preparation of a broader strategy to address remaining weaknesses and support commercialization of the SOEs. Good governance, prudent and gradual policies balancing short- and long-term interests are critical to maximize the benefits from Mozambique's natural resources. We encourage the authorities to carefully study staff's recommendations outlined in the excellent Selected Issues Paper on the trade-offs and opportunities stemming from the exploitation of the country's gas deposits. In the run-up to the 2019 elections scheduled in October, it is important to preserve macroeconomic stability, to break with past economic mismanagement and move forward with difficult reforms notwithstanding the challenging circumstances. In view of the significant reforms that are required to address governance challenges, modernize public administration, enhance the fiscal, monetary and financial sector policy frameworks we would appreciate staff's comments whether a staff-monitored program would be advisable to structure these multi-pronged reforms.

Mr. De Lannoy, Mr. Fanizza, Ms. Lopes and Mr. Manchev submitted the following joint statement:

We thank staff for an excellent set of papers and Messrs. Mahlinza and Tivane for their helpful buff statement. The authorities have stabilized the economy, inflation has been curbed and growth, although still low, has become more broad-based. The authorities' efforts were undermined by the two cyclones that hit the country earlier in 2019. The prompt response from the Fund and development partners should help the reconstruction efforts. Nevertheless, the fiscal and economic impact of these disasters is significant.

We encourage the authorities and staff to closely cooperate in addressing the vulnerabilities and redouble their efforts to achieve more sustainable and inclusive growth.

Fiscal Policy: Ensuring Sustainability While Addressing Development Needs

We Agree That Fiscal consolidation should continue. The aim should be lowering debt to bring the risk of debt distress to a moderate level. We note that staff stresses the importance of relocating budgetary resources from lower priority spending to the urgent reconstruction and emergency needs. We would like to ask staff to comment on the specific low priority areas that could be targeted, and on the amount of additional resources that could be mobilized in this manner. Actually, the buff statement notes that measures to streamline recurrent expenditures and phasing out subsidies were already implemented in FY2017/18, which suggests that the potential for additional resources is likely to be relatively small.

We agree that strengthening fiscal institutions remains crucial. Recent improvements in assessing and mitigating fiscal risks have been steps in the right direction. The approval of the new SOE law should also allow for a stronger oversight of the SOEs. However, further progress with improving debt management and monitoring remains fundamental.

Monetary policy: a successful disinflation process

We commend the Bank of Mozambique’s (BM) strong monetary policy design and implementation that allowed inflation to decelerate from a peak of 26½ percent (y-o-y) in late 2016 to 2¾ percent (y-o-y) in April. This gained credibility bodes well for the BM capacity to curb possible second round effects on prices from the cyclone-related supply shocks. In light of recent less successful disinflation experiences, we would ask whether some lessons could be drawn from Mozambique’s case. Staff’s comments would be much appreciated.

Structural policies: key role of strengthening climate change resilience and governance

Mozambique remains vulnerable to severe weather events - not only to cyclones but also to extreme droughts. We note that there is still room to better integrate climate change resilience in the broader development agenda.

In this context, we look forward to the National Resilience Strategy that is being prepared in cooperation with the World Bank.

We fully share staff's assessment on the importance of strengthening the governance framework and look forward to the publication of the diagnostic report on Mozambique's vulnerabilities. However, equally important will be the follow-up implementation of the reforms to address those vulnerabilities. We also note that relevant developments have taken place to hold the people responsible for the undisclosed debt incident accountable for their actions – this is very welcome and should contribute to further improve the relation between Mozambique and the Fund. We wonder what the current plans of the authorities and staff are regarding Fund involvement in Mozambique?

Mr. Mozhin and Mr. Potapov submitted the following statement:

We thank staff for a set of informative reports and Mr. Mahlinza and Mr. Tivane for their insightful buff statement. The economic situation in Mozambique was improving gradually before the Tropical Cyclones Idai and Kenneth hit the country. The outlook for 2019 is negatively impacted by the substantial damage from these natural disasters. We note that the authorities broadly agree with staff on the analysis of the current developments and medium-term challenges, as well as on policy recommendations.

Given the adverse supply shock to productive capacity, real GDP growth in 2019 is expected to decelerate to 1.8 percent from 3.3 percent last year. The fiscal position is expected to worsen due to lower tax collection and higher spending related to emergency relief and reconstruction. Mozambique is facing the significant BOP gap in the short term that is expected to be covered by external grants and emergency financing under the recently approved RCF. At the same time, according to staff, the medium-term outlook remains broadly favorable supported by a post-shock recovery in agriculture and the expected start of LNG production.

We welcome the authorities' efforts to maintain fiscal discipline and restore debt sustainability. The primary fiscal deficit is expected to rise to 2.5 percent of GDP in 2019. Against this background, an efficient prioritization and reallocation of spending is needed to support reconstruction activities, without resorting to arrears accumulation or central bank financing. Over the medium term, we support staff's recommendations to implement gradual fiscal consolidation with the objective to eliminate the primary fiscal deficit after grants by 2022. The authorities are well advised to strengthen oversight of the SOE sector, enhance debt management, and improve the assessment of fiscal risks. We agree with staff that fiscal decentralization should be implemented in a gradual and cautious way and on a fiscal deficit neutral basis.

According to the recent DSA, public debt is deemed sustainable in a forward-looking sense amid the sizable LNG developments. At the same time, it remains in distress due to the ongoing debt restructuring discussions with international private creditors. The overall stock of external arrears on public and publicly guaranteed external debt service is estimated to have reached around 1.2 billion U.S. dollars at the end of 2018. The PV of external public debt in percent of GDP is projected to remain above the prudent threshold over the medium term. Against this background, we encourage the authorities to continue their debt restructuring efforts in good faith with the aim of reaching a collaborative and timely agreement with Mozambique's creditors.

The authorities are facing important challenges in adjusting monetary policy in the current external and domestic conditions. We agree with the authorities and staff that the pace of further monetary policy normalization should depend on possible second-round effects on inflation of the cyclone-induced supply shock. Moreover, according to staff, the REER remains significantly overvalued and the external balance is significantly weaker than warranted by medium-term fundamentals. These developments point to the need of further nominal exchange rate depreciation, which would help reduce the current account gap. Could staff elaborate on the authorities' financial de-dollarization strategy and their views on various measures highlighted in paragraph 24 of the report to promote the use of the metical?

Although the banking system remains broadly stable, operating conditions for banks in Mozambique may worsen due to risks of deterioration in asset quality and liquidity shortfalls. The concentration risks and banks' exposure to SOEs should be addressed by strengthening regulation and provisioning requirements. We also welcome the BM's decision to undertake a safeguards assessment in connection with the RCF disbursement.

We welcome the authorities' efforts to strengthen governance, improve transparency and accountability, and enhance preparedness to natural disasters. Although there was an important progress in the structural reforms area, Mozambique is ranked 135 in the 2019 Doing Business Database, which points to substantial scope for further improvements. We welcome the authorities' plans to develop the National Resilience Strategy. We also find Chapter I of the SIP to be particularly helpful in highlighting the challenges and opportunities associated with significant natural gas resources in Mozambique and encourage staff to deepen their analysis of a clear and effective fiscal policy rule for managing future gas revenues in the country.

Mr. Geadah and Ms. Fadhel submitted the following statement:

We thank staff for the informative set of reports and Mr. Mahlinza and Mr. Tivane for the useful buff statement. The economic situation in Mozambique was improving with a broad-based recovery and declining inflation until tropical cyclones Idai and Kenneth hit the country last March and April. Significant challenges ensued related to the destruction of physical and socio-economic infrastructure, wide-spread damage to crops, and disruption to economic activities. In April, the Executive Board approved a disbursement of US $118 million under the Rapid Credit Facility as emergency assistance to support post-disaster reconstruction efforts and catalyze additional donor support.

The authorities estimate the post-Idai reconstruction financing needs at $2.9 billion. We welcome the authorities' commitment to rationalize spending to address post-disaster financing needs. Nonetheless, we agree with staff on the pressing need for external aid to cover the bulk of post-disaster assistance and reconstruction costs. We look forward to the outcome of the International Donors' Conference that will take place during May 31-June 1, 2019.

Gradual fiscal consolidation, together with debt relief, would help create fiscal space to deal with future natural disasters. The authorities' commitment is encouraging in this regard, including through eliminating VAT exemptions, reviewing wage and hiring policies in the public sector, phasing out fuel and wheat subsidies, introducing an automatic fuel price-adjustment mechanism, and enhancing tax administration and collection. These measures should be pursued while protecting social and critical infrastructure spending. We concur with staff that the authorities should seek prudent financing terms, largely based on grants and highly concessional borrowing, while efforts to restructure debt should continue.

At about 110 percent of GDP, staff notes that public debt remains in distress though still sustainable on the expectation of a successful debt restructuring strategy. We welcome the steps to strengthen public debt management, including by improving the evaluation and issuance of government guarantees. We look forward to the implementation of the debt strategy and encourage the authorities to strengthen debt management capacities and oversight over the entire State-Owned Enterprises sector.

The gradual and cautious normalization of monetary policy is welcome. Nonetheless, possible second-round effects on inflation of adverse shocks to food supplies warrant vigilance. In the span of one year, the Bank of Mozambique significantly increased reserve requirements on foreign currency deposits to discourage financial dollarization, which according to staff might have added to forex market pressures. We welcome the authorities' intention to maintain exchange rate flexibility as a shock absorber and preserve an adequate international reserve cover. There is merit in staff's advice to fully sterilize forex market intervention to avoid affecting liquidity in local currency.

We are pleased that the authorities are committed to continue strengthening regulations and improving governance and transparency. We commend the authorities for passing the SOE law and join the staff in emphasizing the need to continue to strengthen oversight over the SOE sector given its importance to macroeconomic stability. We look forward to the follow-up on IMF TA on governance and corruption which covered, inter alia, fiscal governance, central bank governance, and AML/CFT.

We agree with staff on the importance of integrating climate change mitigation within the broader developmental strategy to help sustain socio-economic benefits given the country's vulnerabilities to natural disasters. In this connection, we welcome the ongoing efforts to prepare a National Resilience Strategy with support from the World bank that should help improve the country's preparedness to natural disasters. We would welcome staff's comments on IMF contributions to the resilience building efforts.

Mr. Di Tata and Ms. Moreno submitted the following statement:

We thank staff for the informative report and Mr. Mahlinza and Mr. Tivane for their helpful buff statement.

In mid-March Mozambique suffered the impact of Tropical Cyclone Idai in the central region of the country, which resulted in a significant loss of life, widespread damage to crops and infrastructure, and a substantial disruption of productive capacity. This was followed by Tropical Cyclone Kenneth in late April, which struck the northern province of Cabo Delgado causing additional loss of life and destruction. On April 19, the Fund approved a disbursement in the amount of US$ 118 million under the Rapid Credit Facility to support post-disaster reconstruction and catalyze additional donor support. Based on the buff statement, the authorities have completed a Post-Disaster Needs Assessment which estimates post-Idai reconstruction financing needs at US$ 2.9 billion, compared with US$ 1.5 billion in the staff report. Could staff elaborate on the difference between these two estimates and on how the authorities intend to cover these financing needs? Also, what were the results of the International Donors' conference held recently in the city of Beira?

Mozambique's economic situation was improving gradually before the cyclones. Real GDP growth was recovering, inflation had declined to the low single digits in response to tight monetary policy and exchange rate and food prices stability, the non-megaproject current account deficit had narrowed, and international reserves had been rebuilt to a relatively comfortable level. Reflecting the impact of the cyclones, real GDP growth is now projected to decelerate to 1.8 percent in 2019 before recovering gradually to 4 percent in 2021-22, while inflation is expected to pick up temporarily to around 8 ½ percent.

We commend the authorities for the substantial fiscal effort implemented in 2017-2018 and their intention to maintain a prudent fiscal policy in 2019. Although the overall fiscal deficit is still high, in 2017-18 the authorities made a fiscal effort that included the elimination of fuel and wheat subsidies, the adoption of an automatic fuel price adjustment mechanism, and increases in electricity and public transportation tariffs. Based on staff's estimates, the fiscal primary deficit after grants is projected to rise to 2 ½ percent of GDP in 2019, from 1.9 percent in 2018, with the overall fiscal deficit increasing to 6 ½ percent of GDP, from 5 ½ percent in 2018 due to lower tax collections and higher spending on emergency relief and reconstruction. We take note that the higher deficit would be in line with available financing, without resorting to arrears or central bank financing. Policy implementation should be monitored closely as political pressures could weaken fiscal performance.

The public debt, however, is in distress, reaching 110 ½ percent of GDP at end-2018. The authorities are in good-faith discussions with private creditors to restructure Mozambique's Eurobond and previously hidden loans. Accounting for the authorities' debt restructuring strategy and the share of the National Hydrocarbons Company (ENH) in the large LNG megaprojects, staff considers the debt to be sustainable in a forward-looking sense. Could staff provide an update on the negotiations with private creditors and the expected timing of finalization of those negotiations?

Looking ahead, we welcome the authorities' intention to eliminate the primary fiscal deficit after grants by 2022 to ensure fiscal sustainability. This is expected to be achieved through a combination of revenue enhancing measures, including removal of VAT exemptions on selected products and tax administration reforms, as well as by spending rationalization while protecting social and critical infrastructure expenditures. We also commend the authorities for cabinet approval of the SOE Law regulation and encourage them to speed up the preparation of restructuring or privatization plans for the SOEs in distress. In addition, we welcome the authorities' intention to adopt a fiscal rule as part of the preparations for the effective management of natural gas revenues, as well as to establish a Sovereign Wealth Fund.

We support the planned gradual and cautious normalization of monetary policy and encourage the central bank to monitor developments closely to be able to mitigate the possible second-round effects of the supply shock on inflation. We also agree on the importance of maintaining exchange rate flexibility and limiting intervention in the foreign exchange market to avoid excessive exchange rate volatility. Could staff comment on the expected timing of approval of the amendments to the BM Organic Law to improve its governance framework?

On average, the banking sector remains liquid, well capitalized, and profitable. We welcome the steps taken by the central bank to address vulnerabilities, including the new regulations that increased capital adequacy ratios and established minimum liquidity requirements, as well as the strengthened supervision and enforcement of prudential requirements. We also commend the authorities for their efforts at promoting financial inclusion in the context of the National Strategy for Financial Inclusion 2016-2020. Going forward, we encourage them to upgrade loan classification and provisioning rules and address weaknesses in the legal framework for crisis management, bank resolution, and the safety net, including by reviewing the banking law.

We encourage the authorities to continue with the efforts under way to strengthen governance and fight corruption. Annex III of the report presents a useful discussion of this topic. In this connection, we welcome the ongoing preparation of a diagnostic report on governance and corruption vulnerabilities with IMF technical assistance. Going forward, further work is needed to enhance implementation capacity to fight corruption in an effective way; strengthen judicial accountability; improve the oversight of SOEs; strengthen oversight capacity in the extractive sector; and improve the business environment. It would also be important to strengthen the AML/CFT framework. Structural measures are needed to remove impediments to investment and employment creation, as well as to enhance competitiveness.

To enhance preparedness to natural disasters, the government should further integrate climate change within its broader development agenda. In this regard, we welcome the development of the Master Plan for Risk and Disaster Reduction (2017-2030). Going forward, we encourage the authorities to complete the National Resilience Strategy being prepared with World Bank support.

With these comments, we wish the Mozambican authorities all the best in their future endeavors.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for their informative reports and Mr. Mahlinza and Mr. Tivane for their insightful statement. First of all, we would like to express our deepest sympathy to the people for the severe damage caused by Tropical Cyclone Idai and Kenneth. We would like to commend the authorities reform efforts which result in improving Mozambique’s economic situation until the cyclones hit the country. Nevertheless, the country faces many challenges such as weak governance and needs for building resilience to frequently happening natural disasters, in addition to the negative macroeconomic impact and reconstruction needs from the cyclone. At the same time, there are some upside risks including new oil and gas discovery. Against this background, we encourage the authorities to continue reform efforts to maintain macroeconomic stability, address governance challenges, build resilience and achieve inclusive growth. As we broadly concur with the thrust of the staff’s appraisal, we will limit our comments to the following points:

Fiscal Policy and Debt Sustainability

Increasing fiscal space for the cyclone recovery in the near term and pursuing fiscal consolidation effort to improve debt sustainability over the medium term are needed. It is commendable that the authorities implemented difficult reforms such as eliminating fuel and wheat subsidies, adopting an automatic fuel price adjustment mechanism and increasing electricity and public transportation tariffs. We also welcome the authorities’ commitment to achieve a zero primary fiscal balance by 2022. We agree with staff that cyclone related aid should be allocated to one-off spending in the affected areas and the authorities should rely to the maximum extent possible on grants and highly concessional loans for budget financing. In this light, we would like to know if there are recovery of non-project general budget support that declined after the undisclosed loan problem.

For the preparations for the effective management of natural gas revenues, we take note that the authorities are considering adopting a fiscal rule and establishing a SWF and expect the authorities' proper management so that future generations can also reap the benefit of LNG.

On the debt management, we positively note that the authorities are adopting a comprehensive debt strategy aiming at bringing down debt levels to moderate risk over the medium term, taking steps to strengthening oversight, and implementing a strategy to clear domestic payments arrears. We concur with the staff and authorities that further strengthening debt management capacities and oversight over the entire SOE sector is warranted.

Monetary Policy

It is encouraging that the Bank of Mozambique's (BM) monetary policy operations lead to decline of inflation, stabilization of exchange rate and rebuilding of international reserves. We expect the BM to remain vigilant to possible second-round effects of the cyclone-induced supply shock and take a cautious approach to monetary policy normalization. We take note the recent unexpected decision to significantly increase reserve requirements on foreign currency deposits which aimed at discouraging financial dollarization. Could staff elaborate more on the outcome of these increases including positive effect on de-dollarization and negative effect on credit supply and FX market pressures. We also would like to know whether the authorities are taking measures to de-dollarization other than reserve requirement, and about measures staff recommend to the authorities?

Financial Sector

While the banking system remains stable, it is necessary to enhance financial resilience by strengthening supervisory capacities and regulations, given the high interest rates and only gradual recovery of economic activity and credit. We welcome the BM's commitment to implement further monetary and financial sector regulatory measures and encourage their continuous efforts to strengthen their capacity. We acknowledge their effort at promoting financial inclusion by utilizing Fintech such as mobile banking and electronic currency. While we recognize the potential of Fintech, it also contains some risk in case appropriate regulation is not in place. We would like to hear staff's assessment on the Mozambique's regulatory framework on Fintech?

Structural Reforms

Strengthening governance and building resilience to natural disasters while supporting inclusive growth are important. We appreciate the Annex III of Governance and Corruption Challenges. As governance, anti-corruption and transparency is crucial for the country's inclusive growth, we encourage the authorities' work to publish and implement the diagnostic report on governance, transparency, and accountability supported by IMF TA.

As Mozambique is one of the most vulnerable countries to natural disasters and climate change, ex-ante building resilience in addition to post disaster recovery is important. We note that the authorities are preparing a National Resilience Strategy with support from the World Bank while they already have the National Climate Change Strategy and Master Plan for Risk and Disaster Reduction. In this regard, we would like to ask staff about the area which is not covered by the current strategies and will be covered by a new strategy, and whether IMF will provide any support to develop the new strategy from macroeconomic framework perspective.

Undisclosed Loan Issues

We welcome the recent developments of investigations related to the undisclosed loans. In the past board meetings, staff said that filling the information gaps in the audit report of Ematum, Proindicus and MAM is a precondition of Fund's financial reengagement. We would like to know whether the authorities provide any additional information to staff in this point which enables the authorities to use Fund financing in case, for example, they need support to build ex-ante resilience.

Mr. Sun and Ms. Cai submitted the following statement:

We thank staff for the informative reports and Mr. Mahlinza and Mr. Tivane for the helpful buff statement. The Fund's swift response through the Rapid Credit Facility has catalyzed the needed donor assistance and supported the Mozambican authorities' reconstruction efforts. However, the extensive damage from the cyclones will likely weigh heavily on the economy in 2019 and 2020. We broadly agree with the thrust of staff's appraisal and would limit our comments to the following.

The continuation of prudent fiscal policies with a focus on increasing fiscal space to support post-disaster reconstruction is crucial. Fiscal consolidation aimed at closing the primary balance deficit over the medium term is needed in order to build fiscal buffers and restore debt sustainability. We welcome the comprehensive debt strategy adopted by the authorities, as well as their efforts to improve the transparency of the evaluation of the government guarantees. Reallocating lower priority spending is warranted while protecting key social and infrastructure spending. In addition, debt management capacity needs to be improved to provide better oversight of the entire public debt portfolio, including those of SOEs and loans signed by other ministries. We agree that debt issued by SOEs in financial distress should be well controlled, while healthy SOEs with sound financial statements should be allowed to issue debt as needed. Strong efforts to enhance revenue mobilization are critical to a successful fiscal consolidation, and we encourage the authorities to continue reforms in this area.

The monetary and financial sector reform measures should be further implemented to increase resilience. We concur with staff that gradual and cautious monetary policy normalization is warranted and the authorities should remain vigilant against possible second-round effects on inflation due to supply shock. Against the environment of low growth and tight financial conditions, the authorities should continue their efforts to modernize central banking, and strengthen regulation and prudential supervision to mitigate any macro financial risks.

Continued policy efforts are required to enhance resilience and competitiveness of the economy over the medium term. Governance, transparency, and accountability should be further strengthened to restore confidence and encourage private investment. More efforts are needed to build ex ante resilience and response capacity to natural disasters. We encourage staff to provide relevant TA and enhance cooperation with the World Bank in this respect. Enhancing natural resources management capacity is essential to unleash economic potential. In this regard, the high-level international conference could provide some useful reference in better managing Mozambique’s large natural gas reserves. We see merit in establishing a sovereign wealth fund to build buffers and enhance investment efficiencies. Sound corporate governance structure is critical for this fund, and we encourage staff to provide cross-country experiences and candid advice in this regard.

With these remarks, we wish the authorities every success in their policy endeavors.

Ms. Mahasandana and Ms. Latu submitted the following statement:

We thank staff for a comprehensive set of reports and Messrs. Mahlinza and Tivane for their helpful buff statement. Mozambique has made considerable headway in restoring macroeconomic stability in terms of more broad-based economic growth with positive medium-term outlook underpinned by the forthcoming LNG production, improved fiscal position and debt sustainability, reduced inflation, and higher foreign reserves. Challenges however remain including the implications of the recent Tropical Cyclones Idai and Kenneth weighing on the near-term outlook. This calls for sound macroeconomic policies building on the positive developments to date to preserve macroeconomic stability with emergency assistance and reconstruction being key priorities in the near term. The authorities' firm commitment to progressing their reform agenda is also crucial to strengthening governance and resilience to natural disasters while supporting inclusive growth and enhancing job creation. We broadly share the thrust of staff's reports and offer the following remarks for emphasis.

Ongoing strong fiscal consolidation is key to bolstering fiscal and debt sustainability. Building fiscal space is crucial to addressing the urgent needs in the aftermath of the cyclones in the near term, as well as for dealing with future natural disasters and maintaining the downward trend of public debt in the medium and long term. Meanwhile the impact of fiscal consolidation can be mitigated through increased social spending assistance. We are encouraged by the authorities' commitment to capping primary fiscal deficit after grants at 2.5 percent of GDP in 2019 and the eventual elimination of the primary fiscal deficit after grants by 2022. Can staff indicate when the preliminary estimates of the TC Kenneth's potential economic impact and reconstruction costs would be ready, and the likely impact on the current forecasts of economic growth and fiscal position, as well as potential sources of funding and likely implication on debt sustainability? Also, can staff comment on the underlying reasons for the differing economic growth projection for 2019 with the authorities? We also take positive note of the progress made by the authorities with its debt strategy including the ongoing negotiations of debt restructuring, which should put debt on a clear declining path towards moderate risk of debt distress over the medium term. Enhancing debt management including better capturing and monitoring of the SOE sector and other measures recommended by staff are welcome steps towards improving debt sustainability.

We are supportive of prudent normalization of monetary policy while remaining vigilant of the potential second-round effects of the cyclone induced supply shocks and external and domestic risks. We welcome the authorities' commitment to maintaining an adequate international reserve cover and exchange rate flexibility particularly in light of Mozambique's external sector being assessed as weaker than implied by the medium-term fundamentals and the real exchange rate being overvalued. To help the authorities in deciding on appropriate measures for discouraging financial dollarization, which is currently a priority for the authorities, can staff comment on the effectiveness of the measures proposed on footnote 14 (page 12) based on other countries' experiences?

Strengthening financial sector resilience remains necessary to support economic growth including promoting financial inclusion. While the banking system remains sound, we welcome the authorities' commitment to implementing further monetary and financial sector regulatory measures (Box 1) to enhance financial sector resilience as well as the proposed revisions to the Banking Law to enhance crisis management, bank resolution and safety nets as reflected in Mr. Mahlinza's buff statement.

Steadfast implementation of the reform agenda to strengthen governance and resilience to natural disasters and remove impediments to investment and employment creation are required to fundamentally promote sustainable, diversified and inclusive growth prospects. We encourage the completion of the diagnostic report on governance and corruption vulnerabilities which would inform the development of a well calibrated roadmap for further enhancements where necessary. This would also support better management of cyclone relief funds as well as the pending fiscal revenue from the LNG projects in a more efficient and transparent manner. We welcome the development of the National Resilience Strategy with the World Bank's support to provide useful guidance on addressing Mozambique's vulnerability to natural disasters. We also agree with progressing the structural reforms to improve the business climate and promote competition and thereby attract foreign investment, which could also contribute to addressing the external sector weakness.

With these comments, we wish the authorities continued success in their future endeavors.

Mr. Raghani, Mr. Sidi Bouna and Mr. Olhaye submitted the following statement:

We thank staff for the set of papers and Mr. Mahlinza and Mr. Tivane for the informative buff statement.

Mozambique's economic performance has improved steadily in recent years. Growth has exceeded 3 percent over the past three years while average inflation has declined from double to low single digit in 2018. However, the outlook for 2019 has deteriorated significantly following the devastation caused by Tropical Cyclones Idai and Kenneth which have slowed economic activity, reduced productive capacity, and resulted in widespread damage and loss of life. We welcome the Fund's emergency assistance under the RCF in April 2019 which will help address urgent balance of payment needs and we remain hopeful that the IMF's catalytic role will pull in much needed additional resources for the country's reconstruction. Against this backdrop, we agree with the staff's overall assessment and policy recommendations, including the need to address emergency assistance and reconstruction priorities and to restructure the country's debt owed to private creditors while pursuing fiscal consolidation over the medium-term. Furthermore, we encourage the authorities to bolster resilience to natural disasters, enhance inclusive growth, and improve governance with support of the Fund and development partners.

The authorities are encouraged to pursue a prudent fiscal policy stance that relies on external grants and concessional financing to build fiscal buffers and put debt on a downward trend. In the short-term, to address pressing humanitarian needs and reconstruction efforts, we concur with staff's proposal to utilize external grants for one-off spending in cyclone-affected areas. Could staff clarify whether the authorities have prepared fiscal contingency measures should the impact assessment of cyclone Kenneth prove to be more severe than currently projected? In the medium-term, the authorities should consolidate the budget to build buffers, including through increased revenue collection, to cope with potential natural disasters. Moreover, the authorities should continue to seek debt relief from private creditors which is critically important to put total debt on a more sustainable path. We also encourage them to improve their debt management and oversight capacity, including by strengthening the capacity of the debt unit of the Ministry of Economy and Finance. Fund TA will be helpful in this regard.

Bank of Mozambique (BM) should pursue a gradual easing of its monetary policy stance. We take note of the challenging environment in which the BM is operating and welcome its commitment to cautiously normalize the monetary policy stance. This should be done considering the risks to the outlook, specifically the possible second -round effects of cyclones Idai and Kenneth on inflation. We welcome the authorities' commitment to their flexible exchange rate regime as a buffer against adverse shocks and to safeguard foreign exchange reserves. We take note of their focus on financial de-dollarization. However, like staff we encourage them to be prudent when considering increasing reserve requirements on foreign currency deposits which should be accompanied with robust communications to avoid a negative market reaction.

We see merit in strengthening the financial sector regulatory landscape, given the elevated vulnerabilities. We take positive note of the fact that banking system remains stable. We encourage the authorities to further enhance financial stability, including by improving loan classification and provisioning rules and strengthening the legal framework for crises management and bank resolution. Their National Strategy 2016-2022 to promote financial inclusion is commendable and the staff's proposal to reconsider fee structures for fintech applications to encourage the widest use is well noted

Mitigation and adaptation efforts to tackle climate change should remain at the core of Mozambique's development agenda. We commend the authorities for development planning focused on reducing vulnerabilities in the Law on Managing Natural Disasters and the Government Plan 2015-19. Furthermore, we take positive note of the authorities' long-term policy set forth in their National Climate Change Strategy for 2013-2025 and their Master Plan for Risk and Disaster Reduction (2017-2030). In this regard, we encourage their steadfast implementation and urge the continued support from the donor community. Continued implementation of structural reforms to promote investment and job creation are essential to achieving the objectives of Mozambique's development agenda. Given the favorable prospects of the gas sector, we take positive note of the measures considered by the authorities for the effective management of natural gas revenues as mentioned in Mr. Mahlinza and Mr. Tivane's buff statement

With these remarks, we wish the Mozambican authorities every success in their endeavors.

Mr. Merk and Mr. Buetzer submitted the following statement:

We thank staff for the informative and insightful set of reports and Mr. Mahlinza and Mr. Tivane for their helpful buff statement. While Mozambique has made some progress in restoring macroeconomic stability, the enormous humanitarian hardships and damages caused by the recent cyclones represent a major setback and make crisis-management the most pressing issue for the moment. However, urgent emergency support and reconstruction needs necessarily alter the country's fiscal position in the short run and add to longstanding challenges such as the debt distress, a large current account deficit, and struggles emanating from institutional weaknesses and corruption.

Accordingly, the authorities would be well-advised to reinforce efforts to maintain stability by prudent macroeconomic policies and to improve transparency, governance, and accountability in the institutional sphere.

The current situation of debt distress calls for decisive and well-sequenced fiscal consolidation efforts instead of relying exclusively on future windfalls. While budgetary and external financing gaps have widened as a consequence of the cyclones, the authorities should finance these gaps to the maximum extent possible by grants and concessional loans, while reallocating lower priority spending within the budget. In order to eliminate the primary fiscal deficit by 2022 at the latest, the authorities are strongly encouraged to implement their medium-term fiscal consolidation strategy. Within these limits, public expenditures should be prioritized towards investment - in particular promoting infrastructure resilient to natural disaster risks - and social spending in support of the most vulnerable.

Debt restructuring discussions with private creditors should be continued in good faith. Given the high level of external debt and the dubious circumstances under which large parts of it were acquired, we welcome the ongoing discussions with private creditors and legal proceedings as significant debt relief will be indispensable to put debt-to-GDP on a firmly declining path as staff rightly notes. Concerning the issue of undisclosed loans, we encourage staff to give an update on recent developments and to keep the board informed about the ongoing developments going forward.

We welcome the ongoing work on strengthening debt management capacities, including through improved oversight over the entire SOE sector. Relatedly, harnessing the potential gains from LNG exploitation is predicated on robust governance frameworks, involving effective control mechanisms to ensure efficient management operations and sound financing while preventing corruption and clientelism.

As staff rightly points out, managing future LNG revenues in a long-term oriented prudent and sustainable way will be of the essence. We urge the authorities to abide by the Extractive Industries Transparency Initiative (EITI) requirements and improve transparency in the award of mining licenses as suggested by staff. We would appreciate if staff could comment on where the authorities' currently stand regarding the management of future LNG proceeds. Moreover, we were wondering whether there are specific plans on the establishment of a sovereign wealth fund (para. 35), which could be beneficial for development and macroeconomic stability objectives.

According to staff, the favourable prospect of LNG income augurs well for debt sustainability in the long run. However, we would call for more caution and ambitious targets for revenue mobilization as the underlying assumptions of the most recent DSA might be overly optimistic. The projected downward trajectory of public debt in the medium term is primarily due to higher real growth associated with the start of LNG exploitation. The long run trend of public debt, however, is projected to be driven by substantial primary surpluses. The underlying assumption for these surpluses is that primary public expenditures grow at the same rate as non-LNG GDP. This assumption seems incompatible with the observation that public spending usually grows faster than GDP, especially in economies in an early or middle stage of economic catching-up processes. With this in mind, we have some concerns that staff might underestimate long-run public expenditure pressures. As a consequence, plans for non-LNG revenue mobilization might fall short of what would be needed to contain overall deficits as projected. Staff comments are welcome.

We support the authorities in pursuing a cautious approach to monetary policy with vigilance towards potential inflationary pressures. Exchange rate flexibility should be maintained as a crucial shock absorber while safeguarding an adequate level of foreign exchange reserves. Reforms of the central bank law should strengthen the institution’s independence, while incorporating adequate governance and accountability provisions, effectively limit monetary financing of the state, and clarify the central bank’s role in safeguarding financial stability.

While the banking sector is well capitalized and profitable on average, a high level of NPLs exercises pressure on its stability. In light of this, we subscribe to staff’s recommendation on strengthening the regulatory and supervisory capacities and on enhancing the resolution framework. Besides stability issues, a further deepening of the financial sector could promote access to financial services for a wider range of businesses and households, thereby fostering MSME growth and enhancing financial inclusion. Additionally, deficiencies in the AML/CFT framework should be addressed as a matter of urgency.

Severe governance and corruption challenges put a drag on economic activity and pose threats to fiscal sustainability. In this vein, we very much appreciate the detailed Annex III on governance and corruption challenges but are wondering why these are entirely absent, both as a source of risks and recommended policy response, from the Risk Assessment Matrix. Staff comments would be welcome.

Accordingly, the structural reform agenda should be focused on tackling these issues and removing obstacles to doing business and productive investments in a determined manner. In addition to limited access to financing, starting a business and enforcing contracts appear particularly cumbersome to private sector activities.

Mr. Castets, Mr. Ronicle, Mr. Bellocq and Ms. Stockill submitted the following joint statement:

We thank the staff for an insightful set of papers and Mr. Mahlinza and Mr. Tivane for their helpful buff statement. We endorse staff's assessment and will make a few comments for emphasis.

Mozambique is highly vulnerable to natural disasters and climate change and these risks have to be incorporated into the economic policy design. Indeed, the short-term outlook is negatively impacted by the Tropical Cyclones (TC) Idai and Kenneth whereas the growth momentum was improving gradually before these natural disasters. Against this background, we welcome the authorities' efforts, set out in the buff by Mr. Mahlinza and Mr. Tivane, to increase the country's resilience to natural disasters and climate change. In that regard, we would appreciate staff's views on the Master Plan for Risk and Disaster Reduction covering the period 2017-2030, especially regarding the fiscal implications of this Master Plan.

When it comes to the medium-term outlook, we very much appreciate the work done on the tradeoffs and opportunities related to the natural gas sector which is laid out in the Selected Issues Note. Mozambique is expected to become the third largest gas producer in Africa and we take good note of the assessment resulting from the DIGNAR model. It suggests that the public investment scale-up, that will be associated with the significant increase of gas revenues, should be gradually sequenced given the absorptive capacity and need to build up fiscal buffers in case of price shocks on international markets. We encourage staff to pursue a constructive discussion with the authorities on this key topic. We are also of the view that the IMF, in partnership with the World Bank, might undertake more analysis dealing with the structure of growth, its effects on poverty reduction, and implications for natural resource wealth management. Staff comments are welcome.

We note positively the authorities' efforts underlined by staff to put fiscal policy back on a sustainable path. Indeed, fuel and wheat subsidies were phased out, an automatic fuel price adjustment mechanism was implemented, price increase were agreed for power and transportation tariffs, and public investment plans were streamlined. This has resulted in a significant drop of the primary fiscal deficit and we agree with staff that gradual medium-term fiscal consolidation should be maintained in order to create fiscal space for development and social spending, as well as to keep public debt on a downward path. In that regard, we support staff's proposal for the medium term based on a streamlining of tax exemptions and implementation of other revenue-enhancing measures such as the strengthening of the extractive industry tax management. Could staff indicate the authorities' position on the specific recommendation related to tax exemptions? We support the objective of a zero-primary balance after grants by 2022 recommended by staff.

Public debt is currently in distress but we note positively that the authorities are adopting a comprehensive debt strategy to bring debt back into the moderate risk category. We also note that the authorities are in good-faith discussion with private creditors to restructure Eurobonds or are taking legal actions regarding specific private debt instruments. Have there been any changes to the assumptions since the DSA was conducted in March? Could staff indicate the range of debt service reduction expected from these discussions and legal actions looking forward? Also, we would be grateful if the staff could update the Board regarding the timeline of these negotiations and legal actions. Regarding the wording, we would advise to revise the following sentence on page 6 according to which "Public debt is in distress but nonetheless sustainable", to reflect the uncertainties surrounding ongoing proceedings and avoid any misunderstanding.

We welcome the authorities' ongoing assessment, with IMF Technical Assistance, of governance and corruption issues that have to be addressed. This should provide a roadmap for future reform and we encourage the authorities to publish the results of this assessment which should be insightful for development partners and demonstrate the authorities' commitment to address governance challenges. On the specific case of PFM, we encourage the authorities to remain committed to improving the transparency of the public guarantee allocation process. We particularly note in that regard that staff assess that the debt unit of the Ministry of Economy and Finance should be strengthened.

Mr. Rosen, Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the informative Article IV report and Selected Issues Papers. Following the devasting impact of Cyclones Idai and Kenneth, we wish the authorities and Mozambican people a speedy recovery. We broadly agree with the recommendations in the staff appraisal, particularly the focus on debt sustainability, fiscal policy, and governance and transparency.

We support the authorities' adoption of a comprehensive debt strategy to bring down debt levels to moderate risk of debt distress over the medium term. We also encourage greater progress in recovering the missing loan proceeds and in bringing swift accountability to those responsible. Still, we underscore the importance of finalizing the debt restructurings soon to move forward and restore investor confidence. Indeed, the possibility of drawn-out debt negotiations could be another downside risk to the outlook. Can staff comment on the latest developments on the debt restructuring processes, and the degree they affect the DSA?

We praise the authorities for the significant fiscal adjustment in recent years, and we agree that building fiscal buffers will be important to reduce debt and provide space to respond to future natural disasters. The Article IV also appropriately flags the importance of domestic revenue mobilization and reducing spending inefficiencies. Over time, rationalizing and better targeting public wage distribution given its large share of GDP will be very important.

The potential for future LNG production to dramatically increase revenues calls for prudent natural resource management. Fiscal transparency and sound public financial management will be critical. In this regard, the selected issues paper on natural resource management, with a focus on transparency, is an excellent product.

We welcome the authorities' plans to establish a sovereign wealth fund to manage the income from future gas production. We encourage the authorities to set clear, realistic rules for the use of fund monies, develop strong governance and investment procedures, and provide appropriate transparency on investments and policies. Establishing a framework for natural resource management focused on these principles will help ensure that the economic benefits of future LNG production are sustained.

Finally, we praise staff for the inclusion of Annex III on addressing corruption and governance challenges in Mozambique. Staff point to the wide-ranging effects of corruption on the judicial system, business climate, financial sector soundness, fiscal and extractive sector governance, and central bank operations. We encourage the authorities to forcefully address these issues, which will potentially have a large positive impact on Mozambique's growth prospects. Along these lines, we encourage the authorities to publish the diagnostic on governance and corruption—supported by Fund TA—this year.

Mr. Villar and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for the informative reports and Mr. Mahlinza and Mr. Tivane for their useful buff statement. The large socio-economic impact caused by Tropical Cyclones (TC) Idai and Kenneth, evidences again Mozambique’s high vulnerability to natural disasters and climate change. Economic growth is expected to decelerate sharply in 2019 due to the supply shock produced by the cyclones. At 10 percent of GDP, estimated emergency assistance and reconstruction costs due to TC Idai are large, and preliminary costs related to TC Kenneth are not yet available. Increasing fiscal space in the near term to respond to the urgent needs in areas affected by the cyclones and create fiscal buffers to deal with future natural disasters are highest priorities. We broadly share the staff’s appraisal and offer the following comments for emphasis.

Fiscal Policy and Debt Sustainability

We commend the authorities for their efforts to strengthen fiscal balances. The elimination of fuel and wheat subsidies, the adoption of an automatic price adjustment mechanism, and the increase in electricity and public transportation tariffs have all contribute to significantly improve the fiscal stance, reflected in an important reduction in the primary fiscal deficit of about 2 percent of GDP in 2018, from 4 ¾ percent in 2016.

Gradual medium-term fiscal consolidation is needed over the medium term. This will allow creation of fiscal buffers to deal with future natural disasters or other shocks and to support reduction of debt to GDP. To strengthen tax administration with the set of measures recommended by staff would be key to further improve fiscal finances. Staff’s comments on the progress of implementation of those measures are welcome.

Debt is in distress but sustainable according to staff. We welcome the authorities’ comprehensive strategy to bring public debt to moderate risk of distress over the medium term. We concur with staff that issuance of government debt and guarantees in the future should strictly stick to the new procedures established in the December 2017 decree.

We take note that debt-restricting discussions with international private creditors are still ongoing. Does staff have any updated information about the potential timing for the conclusion of these negotiations?

We recognize the authorities' efforts to improve debt management and oversight. Improving transparency in the process of evaluating and granting government guarantees is a step in the right direction, as well as the creation of the debt unit of the Ministry of Economy and Finance in charge of oversight of the entire public debt portfolio. However, robust capacity and strong procedures are needed for this unit to accomplish its objectives. Can staff comment on any advances in this regard?

Monetary Policy

We commend the authorities for the progress in implementing a sound monetary policy framework and the efforts to strengthen Bank of Mozambique (BM) governance and operations. The authorities have been successful in bringing inflation down, accumulating an adequate international reserve cushion and adopting a flexible exchange rate to better absorb shocks. We welcome the authorities' intentions to follow a cautious approach to monetary policy normalization in line with staff's advice. We notice staff's recommendations for BM to consider long-term reverse repos as an option to sterilize excessive structural liquidity and we wonder how this would combine with the government large reliance on domestic financing. Staff's comments are welcome.

Financial sector

We welcome BM's commitment to continue strengthening financial sector regulatory measures to enhance financial sector resilience. Going forward, it is crucial to continue strengthening risk-based supervision and reinforcing regulations and supervisory efforts aimed to containing risks associated with bank exposures to the public sector, including realistic capital adequacy risk weights for loans to SOEs. Addressing weaknesses in the legal framework for crisis management and bank resolution should also be top priority.

Structural Policies

Mozambique's high vulnerability to natural disasters and climate change poses enormous challenges for its growth perspectives and poverty reduction. We welcome the authorities' actions to enhance resilience and capacity response while considering that developing a more comprehensive agenda to improve socio-economic infrastructure resilience is warranted. Besides mobilization of internal resources, participation of the private sector and international community will be needed to support this agenda. In this regard, it is encouraging to know that the government is preparing a National Resilience Strategy with support from the World Bank.

Oversight of the entire SOEs sector needs to be strengthened. We welcome the Cabinet's approval of the SOE law regulation. The law envisages the creation of a new agency to exert strong oversight over the entire sector. How would this new unit interact with the Institute for Management of State holdings (IGEPE) in charge of evaluating the financial viability of the main SOEs? Is there any progress so far in the preparation and implementation of recovery, restructuring or privatization of troubled SOEs?

The Acting Chair (Mr. Zhang) made the following statement:

Only six weeks after we approved the Rapid Credit Facility (RCF) to the Mozambique, we are now discussing Mozambique once again, and in between, the country has been hit twice by serious hurricanes. I would like to take this opportunity once again to express all of our condolences to the authorities and the people of Mozambique for the significant loss of life and large destruction caused by the cyclones. We are all glad we will be able to move very fast with the assistance, including the RCF, and we remain committed to supporting the efforts of the authorities and people to bring their lives back to normal.

As Directors noted in their gray statements, despite all of these efforts, there are significant challenges ahead and a wide range of the issues that need to be addressed, including the high level of debt, governance challenges, and vulnerability to extreme climate events and natural disasters. Resilience to climate change and natural disasters does not only concern small island economies, but is also relevant for other countries, particularly low-income countries (LICs), like Mozambique. Directors' gray statements also welcomed the authorities' efforts and encouraged them to build the country's resilience, not only to address internal imbalances but also to external shocks.

The staff representative from the African Department (Mr. Velloso) made the following statement:

In our written responses to technical questions, we promised to brief the Board on two recent events, namely the International Pledging Conference for Reconstruction in the areas affected by tropical Cyclones Idai and Kenneth, and the revised agreement in principle that authorities reached with the group of Eurobond holders. We also promised to say a few words in response to Directors' questions about next steps in our engagement with Mozambique.

The two-day international pledging conference concluded successfully last Saturday with Mozambique's development partners pledging US$1.2 billion for reconstruction, and this includes the US$118 billion already disbursed by the Fund under the RCF. About four-fifths of the total pledges were in the form of grants, with the remainder in the form of concessional loans. About three-quarters of the total pledges were made by multilaterals, with the World Bank, the EU, and the Fund leading the way. The government of Mozambique and Mozambique's development partners gave the Fund a distinct role in the conference. We were invited to be the first of Mozambique's development partners to speak, and the RCF's speedy approval and disbursement were highly appreciated by all stakeholders.

President Nyusi closed the conference with a powerful speech in which he stressed his government's strong commitment to good governance and transparency in the use of the funds pledged for reconstruction, including by frequent reporting and external audits. He also referred in his speech to the significant needs of the country and mentioned that, among other things, 1.5 million vulnerable people will require food assistance until March 2020 due to losses in agriculture production in the central region of the country. He does request that Mozambique's development partners translate their pledges into accelerated disbursements to facilitate efforts to restore normal livelihoods and rebuild infrastructure in the affected areas as soon as possible. President Nyusi asked our resident representative in Mozambique, Mr. Aisen, who represented the Fund at the conference, to transmit his deepest gratitude to the Fund for its leadership role and support to Mozambique.

Turning to the revised agreement in principle with Eurobond holders announced last Friday, the original agreement in principle was announced last November and envisaged a reduction in the annual coupon from 10.5 percent to 5.875 percent, and an extension in maturity from a single bullet payment in 2023 to five equal annual payments starting 2029. It also envisaged a value recovery instrument (VRI) comprising annual payments equal to 5 percent of liquefied natural gas (LNG)-related tax revenue until maturity with an overall cap on payments of US$500 million.

The VRI proved difficult to explain to the Mozambican public and to sell politically to parliamentarians, and at the request of the authorities, the debt advisors of both sides worked over the past several days on a revised agreement without the VRI.

The revised agreement in principle announced last Friday envisaged the issuance of the same amount of debt under the regional agreement, an annual coupon of 5 percent in 2019 until 2023. Then this is the period prior and up to the expected start of LNG production, and thereafter 9 percent until maturity. It also envisages eight equal semi-annual payments starting in 2028. There is no VRI under the revised agreement.

Comparing the projected cash flow of the regional and revised agreements in principle, cumulative interest payments will be higher by about US$200 million under the revised agreement, but significantly lower than the US$500 million that we expected to be paid out by the VRI under the Debt Sustainability Analysis's (DSA) baseline scenario. This difference reflects the fact that to some degree interest payments are certain, but the VRI payout is uncertain because it is subject to LNG production and price uncertainty.

Both the authorities and Eurobond holders will work to finalize the agreement by September, and they consider prospects for achieving the minimum participation of 75 percent of Eurobond holdings to be good.

Finally, regarding next steps in our engagement with Mozambique, in the near-term, the staff will continue to engage with the authorities through policy advice and a robust capacity development program. Mozambique is one of the top users of the Fund's technical assistance (TA) and training, covering all areas of Fund technical expertise. The country has a very good track record of making good use of capacity development.

I would like to note that there is currently no request from the authorities for Fund program discussions. However, with elections in October, the new government to take office in the new year may request such discussions. Program discussions with the Fund will need to include gradual medium-term fiscal consolidation to create fiscal space, including to mitigate and deal with the costs of future natural disasters and to put public debt as a share of GDP on a clear declining path. In addition, it would need to include a credible set of reforms to improve transparency, governance, and accountability in line with the recommendations of the upcoming diagnostic report on governance and corruption challenges.

Mr. Tombini made the following statement:

We fully understand that the delicate economic and social situation in Mozambique after the Cyclones Idai and Kenneth justifies a careful and gradual approach toward the resolution of the country's persistent macroeconomic imbalance. I would like to raise three points for emphasis.

First, it is only fair to acknowledge the excellent work of the Bank of Mozambique in controlling inflation and inflation expectations. In less than three years, annual inflation went from double digits to around 3 percent. It is still too early to fully evaluate the impact of the supply shock caused by the cyclones on prices, nevertheless, we are confident that the monetary authorities will take the appropriate measures since they have given repeated proof of their commitment to price stability. We second the staff's assessment that the Bank of Mozambique should remain vigilant in the face of possible second-round effects of the supply shock.

Second, the key macroeconomic challenge ahead for Mozambique is fiscal consolidation. We agree with several Directors who have emphasized the paramount importance of the authorities' commitment to fiscal sustainability. Of course, the devastation caused by the cyclones represents an unforeseen pressure on the fiscal accounts, warranting a gradual approach to fiscal consolidation. Therefore, we welcome the authorities' intention to eliminate the primary deficit by 2022, thereby putting the public-debt-to-GDP ratio on a firm downward path.

Third and finally, solving all external arrears will be key to regaining full access to international financial markets. We took note that Mozambique is engaged in good faith negotiations with private creditors, and we welcome the update that was given today. We recommend that the authorities apply the same approach toward official creditors.

I would like to finish by reiterating the message that the Acting Chair provided this morning—our deepest sympathies for the people of Mozambique in the aftermath of the cyclones Idai and Kenneth. We wish all the success to the Mozambican people and the authorities in their reconstruction efforts.

Mr. Heo made the following statement:

We broadly agree with the staff's assessment and recommendations. We did not issue a gray statement, but we have some comments to make for emphasis.

First, Mozambique is prone to a host of natural disasters and climate change issues given its geographic and topographic features. As such, we agree on the need to build the resilience to these challenges by creating fiscal space and building buffers. Given its abundant natural resources, the prudent development and management of these resources would assist in not only addressing the development needs of the country but also enhancing resilience to unpredictable future shocks.

Second, we take note that debt sustainability remains a major challenge for the authorities, with an urgent need to resolve hidden debt issues. We agree with Mr. Rosen and many others that the Fund needs to encourage the efforts in recovering missing loan proceeds and in bringing those responsible to account. Dealing with those responsible would send a strong and good signal to the international investment community, which would in turn allow a debt restructuring to move forward.

With this, we wish the Mozambique authorities every success in their future endeavors.

Mr. Alhomaly made the following statement:

Before I make a few remarks, let me also offer our condolences to the government and the people of Mozambique for the tragic human loss and devastating damage. We broadly agree with the staff's assessment and recommendation, but I would like to make three points for emphasis.

First, the country has limited fiscal space, and its public debt is at a distressed level. We agree on the need to implement gradual fiscal consolidation over the medium term and to further strengthen debt management oversight. Equally important is the need to sustain the authorities' effort to strengthen fiscal governance, reallocate resources to emergency spending, and ensure better targeting of social assistance.

Second, we take note of the staff's recommendation regarding the adoption of fiscal rules to ensure intergenerational equity. Indeed, while such rules could contribute to fiscal discipline, consideration should be given to the appropriate design of the rules, drawing from the other countries' experience.

Having in place a strong fiscal framework is a prerequisite to ensure the effectiveness of such rules.

Third, on the issue of dollarization, we agree with the staff on the importance of developing domestic capital markets in local currency, and we strongly believe that this should be given a high priority, as it will not only help address the issue of de-dollarization, but would also help reduce reliance on external debt and minimize the fiscal burden of distressed state-owned enterprises (SOEs) through privatization or public-private partnership (PPP) projects.

On a related note, could the staff elaborate on the ongoing progress of the World Bank's support to the authorities in the area of privatizing troubled SOEs? With that, we wish the authorities all the success.

Mr. Rosen made the following statement:

The United States offers its sympathies to the people and authorities of Mozambique following the impact of the two cyclones, and we hope for a speedy recovery. With public debt of 110 percent of GDP, we are glad to see that the report focuses on restoring debt sustainability and transparency to Mozambique, as well as focusing on serious corruption and governance issues. A quick resolution to the debt restructuring process along with some continuing fiscal consolidation is critical to restoring sustainability to the government's finances, and on that point, I would like to ask the staff for its view on the agreement with Eurobond investors. The coupon payments seem very high, and we wondered is there enough debt write-off here and what is the net present value (NPV) adjustment? Is it enough to help Mozambique in its debt sustainability?

Recovering missing proceeds from the bonds and loans is key as well, as is bringing full accountability to those responsible for the stolen proceeds. We support the central bank's plans to conduct a safeguards assessment as part of the RCF program, as improvements to the central bank's governance and autonomy seem necessary. We also encourage the authorities to publish the diagnostic report on governance and corruption, as supported by the Fund TA.

Addressing these anti-corruption issues is crucial for stronger and inclusive growth as well as for the development of Mozambique's natural resources given the substantial LNG production coming down the road. And given this big opportunity that LNG represents for Mozambique, establishing a sovereign wealth fund to manage the proceeds of LNG with high-quality governance and investment procedures will be critical to Mozambique's future, and we strongly encourage the authorities to continue moving in this direction and for the Fund and World Bank to play its part in helping to set this up.

Mr. Merk made the following statement:

We would like to offer our sympathies to the people of Mozambique for the enormous humanitarian hardships and loss of life and damages caused by the recent cyclones.

Crisis management still represents a pressing issue. At the moment, there are longstanding challenges surrounding the debt position, the management of SOEs, and institutional weaknesses and corruption need to be tackled. All that is high on the agenda.

The current situation of debt distress calls for well-sequenced fiscal consolidation efforts instead of relying on future increases in LNG income, where more caution should be exercised in the projections. Lower priority spending needs to be curbed and reallocated to protect public investment and social spending in support of the most vulnerable. Accordingly, we welcome the ongoing work on strengthening debt management capacities, including through improved oversight of the entire SOE sector. This will be all the more important in the context of managing future LNG proceeds in a more transparent, prudent, and long-term oriented manner.

Abiding by the Extractive Industries Transparency Initiative (EITI) requirements and improved transparency in the award of mining licenses, as suggested by the staff, will be crucial steps to this end. Similarly, the structural reform agenda should focus on tackling governance and corruption challenges and address deficiencies in the AML/CFT framework, as also pointed out by a number of other Directors. The staff's related analysis in Annex 3 is highly welcome in this regard and should be a cornerstone of future Fund involvement.

Mr. Fanizza made the following statement:

I join my colleagues in extending our sympathies to the people of Mozambique for the large human losses that they have experienced. I would like to thank Mr. Mahlinza for his good buff statement. We issued a statement, so I am not going to reiterate what we have said. I have two points.

I would like to stress the importance of the Fund's involvement in the country. My impression is that much has been done. The macroeconomic performance and policies have been on the right track. There have been important improvements even in areas that have been concerning in the past such as governance and public financial management. My point is that the Fund should build upon these successes and create a collaboration with Mozambique that could lead to resuming full-fledged involvement of the Fund in the country. That is what would clearly play a key role in fostering donor improvement. We see that the results of the pledging donors conference were significantly lower than what the authorities expected, at least from newspaper reports. My point is, let us work on that and let us try to make it up, provided that governance improves in the way we wish.

I could not help noticing that the staff makes the point of the importance of prioritization in expenditures and things like that in 2019, but actually decisive resources that could be mobilized through prioritization in 2019 are pretty small at 0.5 percent. I am wondering whether that debt recommendation will be so prominent as in the executive summary. It is important. We are for it, but let us realize that the needs are much, much bigger.

My final point is that I would like to second Mr. Tombini's point on the success of monetary policy. It has been remarkable. We have already said that when we discussed RCF. It is remarkable. What I would add is that it is remarkable in light of other notable experiences, even in program crisis when inflation has proved a difficult cookie to chew. It is important to stress that Mozambique has done well outside the Fund's program, and that should be the basis for seeking deeper engagement. With that, I wish the authorities all the best in their reform efforts and reconstruction efforts.

Mr. Castets made the following statement:

I would like to start by thanking the staff for an insightful set of reports and for the detailed answers to our technical questions. We also would like to thank Mr. Mahlinza for his helpful buff statement, and express our deepest sympathy to the people and authorities of Mozambique in the current difficult circumstances they are facing.

We have issued a joint gray statement with Mr. Ronicle and Ms. Stockill, so I will only underline a few points. The first one is to note, like Mr. Fanizza and Mr. Tombini before me, the positive developments we have seen in difficult circumstances and which are well detailed in the staff's report. The authorities have taken quite significant measures to bring the budget back on a sustainable track, and this is a welcome step. We encourage them to continue in that direction, and we note that they have already reached a significant objective since there has been a significant drop in the primary fiscal deficit. Looking forward, we encourage them to address tax exemptions and to implement other revenue measures that will be useful to enlarge the fiscal space so as to address the significant social and development needs.

Second, we welcome the authorities' willingness to put the public debt on a firm downward path and to restructure the external debt. On that aspect, like Mr. Rosen before me, we will need to see what the impact of the new agreement with bondholders will be, and we thank the staff for the elaboration this morning, but still the impact is not perfectly clear. We also need to see the impact on the Debt Sustainability Analysis (DSA), even if we understand that it is limited as regards debt service. We also take good note of the legal actions which are undertaken by the authorities as regards some past loans.

On public debt management, it is instrumental to keep pushing forward the reforms allowing for more transparency and better management of public guaranteed allocations so as to prevent a repetition of past episodes. Like Mr. Rosen, we strongly encourage the authorities to make public the result of the assessment in the governance field.

Regarding the outlook, like Mr. Merk, we would send a message of caution regarding how it will be dealt with, the revenues coming from the gas sector. This is a very positive development for the country, but it has to be dealt with cautiously, and we particularly appreciated the staff's work as regards the model in the analytical papers that are presented with the report. We hope that the staff and the authorities will be able to maintain a fruitful collaboration on this critical issue going forward.

Finally, we would like the staff to elaborate on whether there has been any discussion with the authorities on the possible Staff-Monitored Program (SMP) or the mobilization of other Fund tools, and this is in line with what Mr. Fanizza was mentioning in the context of the RCF and future Fund engagement.

Mr. Ostros made the following statement:

Let me also offer my sympathy to the people of Mozambique for the devastating consequences of the tropical cyclones. Mozambique is a resource-rich country with large natural gas reserves. The country now has a unique chance to build up the institutions and mechanisms needed to manage this kind of resource wealth and ensure that it generates sustainable inclusive growth that benefits the country and its people. I strongly encourage the authorities to continue their efforts to strengthen governance, transparency, and accountability. The diagnostic report on governance and corruption mentioned by Mr. Rosen is one important stepping stone in that, and I would also like to encourage the authorities to publish the report as a big important step going forward.

Overall, this is so important that it should be the focus of the staff's work also when it comes to discussing future engagement with Mozambique. Seeing progress in governance issues is key for Fund engagement.

As Mozambique is poised to become one of the world's largest exporters of natural gas, strong management of these revenues will be key for inclusive growth. We support the idea to consider fiscal rules to save for future generations, including through a sovereign wealth fund. To this end, we welcome the analysis in the selected issues paper, as did Mr. Castets, on tradeoffs and opportunities related to gas resources, illustrating that delinking investments from revenues and thereby opening for external savings can help to avoid boom-and-bust cycles that are common to natural resource-rich economies and at the same time create fiscal buffers.

We welcome that the authorities continue to upgrade the debt management capacity, strengthening oversight of fiscal risks emanating from state-owned enterprises (SOEs), and enhancing debt transparency. This is especially important given the recent history with the undisclosed loans. There have been developments to hold people responsible for the hidden loans accountable for their actions, and we encourage the authorities to continue their investigations in these matters.

Mr. Geadah made the following statement:

I have one question that I realize we should have asked earlier. Are there any updates on the government guarantees that are being challenged now by the government? I understand that among the loans that should not have been contracted, one was converted to Eurobond, but the other two are still guaranteed by the government. Are there any updates? Could the staff tell us what is going on with them?

The staff representative from the African Department (Mr. Velloso), in response to questions and comments from Executive Directors, made the following statement:[1]

The World Bank is indeed working very closely with authorities on reforming SOEs. The focus of their work right now is the national fuel company and the national airline company. Diagnostic reports have been prepared, and action has been taken to bring those two companies into solvency given their difficult situation. These are the two biggest problems in Mozambique. There are other areas where there has been less progress. [Inaudible] is working on a diagnostic of the entire SOE sector, and their intention is to work with the World Bank and to have at the end of this year as input for the next government some recommendations on what to do. They could consider selling shares of companies where they hold a minority participation. They could close some enterprises. They could use this opportunity for development of capital market and put some enterprises up for sale.

We got another question on the revised agreement in principle, how this compares with the original agreement in terms of the DSA. In terms of the numbers in the DSA, this agreement improves the situation. As I said before, interest payments are higher by US$200 million, but the VRI goes away, and that saves US$500 million. It is extremely difficult to compare these two flows, with the VRI and without the VRI, in NPV terms. It is difficult to find an agreed discount factor for VRI-related flows. One can use Monte Carlo simulations to figure out what is likely to happen or not, so that is why we are not focusing too much on NPV savings given the difficulties.

The new agreement in principle will be much easier to calculate the NPV savings. My sense is that they are very similar to what was achieved in November. For one matter, the same debt advisors were involved in these two discussions, and the review preference shows if they are fine with both agreements, they should be very similar in terms of what they would like to achieve.

The new agreement has a maturity that is slightly shorter than the previous one, two years, and payments start one year earlier, so that also could play into the decision to move forward. But just to give a bottom line, our

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

assessment is in terms of cash flow, and that was a major constraint for Mozambique, is it is an improvement, and it is quite a significant improvement vis-à-vis the projections in the DSA.

We do not have any updates on the lawsuit that is running in the U.K. courts. The government is challenging the validity of the government guarantee that was extended to Proindicus; that is the Credit Suisse loan. It has not decided to do the same with the MAM loan, and that is the one financed by VTB. In the case of the Eurobond holders, clearly the decision was to reach a deal with the holders and not to challenge, but that was already government debt. That was not guaranteed debt.

In terms of future engagement, as Mr. Fanizza said, we see the advantage of engaging very closely with Mozambique. This can be in the context of a program. This can be in the context of surveillance, and even though there has not been a program over the past number of years, Fund staff has been very closely involved with the authorities and in helping design the policies. Moving forward, if a request comes about, we will, as in any country, take a look at the policies that are in the request. There will be a new government with a new mandate to do things, and we will see whether the strength of policies is right for a Fund program. We will see the commitment of the authorities to these policies. Improvements in governance, transparency, accountability will be critical to any Fund program.

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Mr. Mahlinza made the following concluding statement:

On behalf of my Mozambican authorities, I thank Directors for their constructive advice and support for the completion of Mozambique's Article IV consultation. I also wish to thank the Board for the recent approval of the RCF to address the impact of Cyclone Idai. In their gray statements, Directors have taken note of the challenges facing Mozambique, and they have emphasized the need to intensify efforts to preserve sound macroeconomic fundamentals, support sustainable and inclusive growth, and address governance weaknesses.

I wish to reassure the Board that my authorities are committed to advance their reform agenda to achieve durable macroeconomic stability, boost productivity, tackle governance and corruption challenges, and build resilience to natural disasters. The authorities view their medium-term fiscal consolidation efforts as essential to tackle debt vulnerabilities, create room for development expenditures, and build buffers for natural disasters. They are making efforts to improve domestic revenue mobilization and rebalance expenditures to support post-disaster reconstruction needs. Similarly, they will be stepping up efforts to improve debt management capacities and enhance oversight of risks emanating from SOEs. To enhance the benefits of expected increase in LNG proceeds, they will intensify efforts to enhance fiscal transparency and build sound public financial management systems.

Directors also underscored the importance of carefully calibrating the pace of monetary policy normalization in view of potential second-round inflation effects emanating from the cyclone-induced supply shocks. As highlighted in our buff statement, the authorities are closely monitoring the developments, and they stand ready to adjust the monetary policy stance with the view to contain inflation.

Lastly, my authorities recognize the importance of addressing governance and corruption challenges. In this regard, they will continue with legal proceedings to hold accountable those responsible for the undisclosed loans and accelerate legislative and institutional reforms to enhance the country's governance and corruption framework. In parallel, they will press ahead with the implementation of structural policies aimed at accelerating human capital development, improving the business climate, and building resilience to natural disasters.

To conclude, I wish to convey special thanks to the mission chief, Mr. Ricardo Velloso, and his team for the continued engagement and helpful policy advice provided to the authorities. I also thank them for providing comprehensive responses to the questions raised by Directors in their gray statements and oral interventions.

Finally, my authorities wish to thank the donor community and development partners for their pledges at the recent conference held in Beira on May 31 to June 1, 2019. The government of Mozambique is putting in place appropriate monitoring systems to ensure transparency in the use of funding for post-disaster recovery expenditure as well as a regular system of reporting.

The Acting Chair (Mr. Zhang) noted that the Republic of Mozambique is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' reform efforts in the run up to Tropical Cyclones

Idai and Kenneth and regretted the losses, including in human lives, from the two cyclones. Against this background, Directors called for continued progress in Mozambique's policy and institutional settings to achieve durable macroeconomic stability and inclusive growth, address governance challenges, manage reconstruction and build resilience against external shocks, including from extreme climate events.

Directors welcomed the reallocation of lower priority spending in the annual budget to emergency assistance and reconstruction. However, given the magnitude of the needs, they also looked forward to further support by the international community, catalyzed by IMF's financial support. In that context, they noted the importance of allocating cyclone-related grants to one-off spending in the affected areas to protect, inter alia, the fiscal position as cyclone-related aid is phased out over time.

Directors commended the authorities' commitment to gradual fiscal consolidation over the medium term, while protecting social and critical infrastructure outlays to ensure durable macroeconomic stability. They noted that creating fiscal space, through domestic revenue mobilization and reducing spending inefficiencies, would also be crucial to better prepare and deal with the consequences of future extreme climate events.

Directors welcomed the authorities' commitment to bring debt risk to moderate levels over the medium term and the important steps taken to strengthen public debt management and transparency. While welcoming the agreement in principle with private creditors on debt relief, Directors called for the adoption and implementation of a debt strategy and stressed the importance of strengthening oversight of the entire public debt portfolio, including for state-owned enterprises, to put public debt-to-GDP ratios on a clear declining path.

Directors commended Bank of Mozambique's gradual and cautious normalization of monetary policy while remaining vigilant about possible second-round effects on inflation of the cyclone-induced supply shock. They stressed the importance of maintaining exchange rate flexibility as a shock absorber and preserving an adequate level of international reserves. They also encouraged the Bank of Mozambique to continue to enhance its supervisory capacity, modernize the bank resolution framework, and strengthen the monetary policy regime building on enhanced communications, increased technical capacities and a reformed, modern central bank law.

Directors urged the authorities' continued focus on improving governance, transparency and accountability, including to reduce vulnerabilities to corruption. In that context, they welcomed the authorities' ongoing preparation, with IMF technical assistance, of a diagnostic report on the main governance and corruption challenges and strongly encouraged its publication. They also called for continued progress in strengthening the AML/CFT framework and enhanced focus on transparency on natural resource management.

Directors commended ongoing efforts to increase the country's resilience to natural disasters including through the National Resilience Strategy with support from the World Bank and encouraged the authorities to integrate climate change resilience within their broader development agenda.

Directors also called for further structural reforms to support inclusive growth, job creation and poverty reduction, including by fostering competition and improving the business climate. They also welcomed the authorities' plans to establish a Sovereign Wealth Fund to support productivity-enhancing investments as part of their natural resource management strategy.

It is expected that the next Article IV consultation with the Republic of Mozambique will be held on the standard 12-month cycle.

APPROVAL: April 24, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and risks

1. ***Can staff comment on the underlying reasons for the differing economic growth projection for 2019 with the authorities?***

- The difference in projections is relatively small, with staff projecting growth of 1.8 percent and the authorities expecting growth in the 2 percent to 2.5 percent range.

- The authorities expect that reconstruction efforts will have a larger impact on economic activity (construction sector) than staff.

2. ***Can staff indicate when the preliminary estimates of the TC Kenneth's potential economic impact and reconstruction costs would be ready, and the likely impact on the current forecasts of economic growth and fiscal position, as well as potential sources of funding and likely implication on debt sustainability?***

3. ***Considering the additional destructive consequences of the Cyclone Kenneth in April, we would welcome staff's update on the overall damage caused by both cyclones, estimates of reconstruction costs as well as overall external support, including the Fund's Rapid Credit Facility's catalytical role.***

- The World Bank commissioned a rapid remote assessment to estimate the financial impact of Tropical Cyclone Kenneth. The study was conducted using the Global Rapid Post-Disaster Damage Estimation (GRADE) approach and revealed a financial impact of US$107 million (about one-eighth of the estimate for Tropical Cyclone Idai using the same methodology).

- Given that Tropical Cyclone Kenneth was a fast-moving storm that hit a less populated and economic active area, we expect the likely impact on current forecasts to be relatively small.

- Staff will inform EDs during the Board meeting about pledges made for reconstruction during the International Pledging Conference being held in Beira, Mozambique, today and tomorrow.

4. ***Based on the buff statement, the authorities have completed a Post-Disaster Needs Assessment which estimates post-Idai reconstruction financing needs at US$ 2.9***

billion, compared with US$ 1.5 billion in the staff report. Could staff elaborate on the difference between these two estimates and on how the authorities intend to cover these financing needs? Also, what were the results of the International Donors' conference held recently in the city of Beira?

- Staff understands that about half of the US$2.9 billion estimate refers to actual reconstruction costs—in line with the estimate presented in the RCF request—with the other half representing potential costs related to forgone production. Given the impact on growth projected by both staff and the authorities, the latter estimate seems large.

- As noted above, staff will inform EDs during the Board meeting about pledges made for reconstruction during the International Pledging Conference being held in Beira, Mozambique, today and tomorrow.

5. ***In this vein, we very much appreciate the detailed Annex III on governance and corruption challenges but are wondering why these are entirely absent, both as a source of risks and recommended policy response, from the Risk Assessment Matrix. Staff comments would be welcome.***

- In the baseline scenario, staff has cautiously assumed that the status quo of Mozambique's governance and anti-corruption framework would remain unchanged. As the risk assessment matrix deals with downside risks to the baseline scenario, it did not seem appropriate to highlight the risk of a deterioration, which seems highly unlikely given the starting point and the authorities commitment to reform.

Fiscal policy and debt sustainability

6. ***We note that staff stresses the importance of relocating budgetary resources from lower priority spending to the urgent reconstruction and emergency needs. We would like to ask staff to comment on the specific low priority areas that could be targeted, and on the amount of additional resources that could be mobilized in this manner.***

- Reallocation within the 2019 budget are limited to 0.5 percent of GDP. This would come mainly from budget reserves related to wages and good and services outlays.

7. ***Could staff indicate the authorities' position on the specific recommendation related to tax exemptions?***

- The authorities fully understand the need to increase tax collections as part of their gradual medium-term fiscal consolidation plans. A TA mission from FAD will visit the country in August, inter alia, to estimate potential revenue gains of widening the VAT base by eliminating exemptions.

8. ***To strengthen tax administration with the set of measures recommended by staff would be key to further improve fiscal finances. Staff's comments on the progress of implementation of those measures are welcome.***

- The Revenue Authority has embarked on several tax administration reforms. These include streamlining organizational arrangements and support functions, improving strategic planning and project management, cleaning the taxpayer register, establishing a largest taxpayers' unit, developing a risk-based compliance strategy, implementing electronic filing and bank payment, and modernizing the revenue administration for the extractive industry sector.

- Staff is satisfied with the pace of reform in this area, which counts with substantial TA from FAD and AFRITAC South.

9. ***Could staff clarify whether the authorities have prepared fiscal contingency measures should the impact assessment of cyclone Kenneth prove to be more severe than currently projected?***

- We are unaware of any such contingency measures.

10. ***According to staff, the favorable prospect of LNG income augurs well for debt sustainability in the long run. However, we would call for more caution and ambitious targets for revenue mobilization as the underlying assumptions of the most recent DSA might be overly optimistic…. Staff comments are welcome.***

- While we agree with the importance to continue strengthening revenue mobilization, the DSA's underlying assumptions are cautious. First, the DSA assumes that only about one-third of proven natural gas reserves would be developed. Second, given the lack of a political decision on how much to save and spend of the natural gas wealth, the working assumption that all LNG related fiscal will be saved is tempered by the assumption that public debt is not pre-paid with the projected fiscal surpluses and by the assumption that non-LNG growth remains unchanged at 4 percent annually.

11. ***We would welcome staff's further elaboration on their assumptions and conclusion in the DSA.***

- Concluding the debt restructuring discussions, implementing gradual fiscal consolidation over the medium term and completion of the LNG megaprojects as planned are critical for Mozambique to be able to meet its financial obligations.

- Out of the three LNG megaprojects, one project (Eni, Area 4) reached a final investment decision (FID) in 2017 and project construction is progressing as planned. The other two projects (Anadarko's Area 1 and ExxonMobil's Area 4) are expected to reach an FID on June 18, 2019, and in the third quarter of 2019, respectively.

12. ***Could staff provide an update on the negotiations with private creditors and the expected timing of finalization of those negotiations?***

13. ***We take note that debt restructuring discussions with international private creditors are still ongoing. Does staff have any updated information about the potential timing for the conclusion of these negotiations?***

14. ***Concerning the issue of undisclosed loans, we encourage staff to give an update on recent developments and to keep the board informed about the ongoing developments going forward.***

15. ***Can staff comment on the latest developments on the debt restructuring processes, and the degree they affect the DSA?***

- There is no firm timetable to conclude such discussions or legal actions.

- However, the debt advisors of the authorities and of the Eurobond holders were in contact with each other in the past several days discussing, at the request of the authorities, an alternative to the value recovery instrument—annual payments of five percent of LNG related fiscal revenue with an overall cap of US$500 million—which has proven difficult to explain to the public and parliamentarians in Mozambique.

- A communique with a revised agreement in principle—which does not include a value recovery instrument—was issued today.

- Staff will inform EDs during the Board meeting about the details of this agreement and any possible implications this may have for debt sustainability.

16. ***Have there been any changes to the assumptions since the DSA was conducted in March? Could staff indicate the range of debt service reduction expected from these discussions and legal actions looking forward? Also, we would be grateful if the staff could update the Board regarding the timeline of these negotiations and legal actions.***

- There have been no significant changes to the assumptions of the DSA issued last April.

- Particularly over the next four years, before LNG production is expected to start, there would be very significant debt service savings. These together with fiscal consolidation are critical for debt sustainability.

17. ***Could staff update the Board on the situation of arrears to official creditors?***

- We understand the Mozambican authorities have very recently contacted the Brazilian authorities with a view to resolving this situation.

18. ***. In this light, we would like to know if there are recovery of non-project general budget support that declined after the undisclosed loan problem.***

- There has not been any recent non-project budget support for Mozambique.

19. ***Improving transparency in the process of evaluating and granting government guarantees is a step in the right direction, as well as the creation of the debt unit of the Ministry of Economy and Finance in charge of oversight of the entire public debt portfolio. However, robust capacity and strong procedures are needed for this unit to accomplish its objectives. Can staff comment on any advances in this regard?***

- While the debt unit has not been newly created, it is now implementing improved rules and procedures adopted in 2017 to strengthen debt management and transparency. An action plan to further improve debt management is being implemented following the Debt Management Performance Assessment (DeMPA) diagnostic in 2017. The authorities have improved debt reporting (transactions are now included in the quarterly in-year reports), developed their own Medium-Term Debt Strategy and started developing a credit risk management framework.

20. ***We welcome the Cabinet's approval of the SOE law regulation. The law envisages the creation of a new agency to exert strong oversight over the entire sector. How would this new unit interact with the Institute for Management of State holdings (IGEPE) in charge of evaluating the financial viability of the main SOEs? Is there any progress so far in the preparation and implementation of recovery, restructuring or privatization of troubled SOEs?***

- There will be a single agency responsible for oversight of the entire SOE sector.

- We understand that the authorities are reviewing IGEPE to align it with the SOE law and regulation. IGEPE might, in the end, be transformed into that single agency.

- The preparation and implementation of recovery, restructuring or privatization of troubled SOEs is an ongoing process that is being supported by the World Bank.

Monetary and Financial Issues

21. ***In light of recent less successful disinflation experiences, we would ask whether some lessons could be drawn from Mozambique's case. Staff's comments would be much appreciated.***

- Five key factors have contributed to Mozambique's successful disinflation: (i) the appointment in August 2016 of a central banker with considerable *de facto* operational autonomy to run monetary policy free of political interference; (ii) a very strong response to break the back of inflation, by tightening considerably monetary policy in October 2016 and persevering with a tight monetary policy stance thereafter; (iii) the change in April 2017 of the operational target, from monetary aggregates to short-term interest rates, to better anchor inflation expectations during a period of cautious policy normalization; (iv) forward-looking signaling of the strategy through enhanced communications; and (v) exchange rate flexibility.[2]

22. ***Could staff elaborate on the authorities' financial de-dollarization strategy and their views on various measures highlighted in paragraph 24 of the report to promote the use of the metical?***

23. ***Could staff elaborate more on the outcome of these increases including positive effect on de-dollarization and negative effect on credit supply and FX market pressures. We also would like to know whether the authorities are taking measures to de-dollarization other than reserve requirement, and about measures staff recommend to the authorities?***

24. ***To help the authorities in deciding on appropriate measures for discouraging financial dollarization, which is currently a priority for the authorities, can staff comment on the effectiveness of the measures proposed on footnote 14 (page 12) based on other countries' experiences?***

- The authorities are cognizant that, in the final analysis, effective and durable financial de-dollarization requires building a track record of macroeconomic stability underpinned by strong fundamentals combined with policies incentivizing the use of local currency.

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[2] The change in operational target as part of transitioning the monetary policy regime in Mozambique is well documented in A. Aisen and F. Simione, 2017, "Towards a New Monetary Policy Regime in Mozambique", IMF Country Report No. 18/66, pp.4-15.

- Country experience shows that gradual and sustained declines in financial dollarization are explained, on the deposit side, by currency appreciation and, on the credit side, by the introduction of prudential measures that create incentives to internalize the risks of dollarization (including an active management of reserve required differentials), the development of a capital market in local currency (by extending the domestic currency yield) and that de-dollarization of deposits contributes to a decline in credit dollarization.

- The authorities are currently evaluating the impact on credit in foreign currency of actively managing reserve requirement differentials as a macroprudential tool in the context of exchange rate stability, single digit inflation and prudent normalization of monetary policy. (Higher provisions on foreign currency loans and limits on net open positions are not under consideration currently.)

- This issue will be analyzed further in this year's follow-up TA on foreign exchange market operations and in the context of surveillance.

25. ***We notice staff's recommendations for BM to consider long-term reverse repos as an option to sterilize excessive structural liquidity and we wonder how this would combine with the government large reliance on domestic financing. Staff's comments are welcome.***

- A large part of the outstanding stock of T-bills was issued for monetary policy purposes and consists of securities with original maturity of one year. Their use for monetary policy implementation drains excess liquidity from the banking sector in a semi-structural way.

- Sterilization of structural liquidity surpluses has become less successful given banks' relatively high exposure to the sovereign and low credit demand.

- Against this background, long-term reverse repos would be a less risky option for banks and less costly for the central bank.

26. ***We would like to hear staff's assessment on the Mozambique's regulatory framework on Fintech?***

- The Fintech regulatory framework is underdeveloped. The authorities are working with stakeholders in developing such a framework within the National Financial Inclusion Strategy 2016-2022. Financial Sector Deeping Mozambique (FSDMoç) signed a MoU with the central bank aiming to promote Fintechs and payments systems to boost financial inclusion through the creation of regulatory sandbox. The project team joined up with central bank to launch the Sandbox Incubator project for Fintech. The incubator is in Maputo and designed to create conditions for interaction between the regulator (central bank) and Fintech service providers as well as opportunities for development, testing, and demonstration of products. FSDMoç is a facility for financial sector development, with a focus on expanding levels of inclusion partnering with UKAid, fsdafrica, the government of Sweden and relevant domestic stakeholder, including the banking sector and civil society organizations.

27. ***We welcome staff's comments on when amendments to the Central Bank Act and a new Banking Law are expected to be approved and become effective.***

28. ***Could staff comment on the expected timing of approval of the amendments to the BM Organic Law to improve its governance framework?***

- The Bank of Mozambique is currently working on revised drafts of the Central Bank Organic Law (with IMF TA) and Banking Law (with IMF and World Bank TA) and expects to be able to table these laws in the Assembly of the Republic in 2020.

29. ***We are encouraged by the BM's satisfaction with the technical assistance provided under the Norges Bank (NB) and IMF multiyear project and note that progress has been made in several areas in the project's first phase. Staff's elaboration on the progress would be welcome.***

- This medium-term project is far reaching. The project comprises almost all central banking activities in five separate fields with eleven sub-projects covering: (i) central bank governance, organization, and management; (ii) monetary and foreign exchange policy, operations, and communications; (iii) financial stability analysis, reporting, and communication; (iv) payment systems and its oversight function; and (v) cash currency management.

- In the just concluded first phase of the project, progress includes: (i) detailed diagnosis and roadmap for recommendations in all areas (based on 16 delivered TA missions, 2 workshops and a study tour to Norges Bank); (ii) improved forecasting capabilities integrated in the monetary policy discussions and decision making process; (iii) streamlined monetary policy committee communiques and monetary policy reports; (iv) peer-to-peer exchange on foreign exchange markets and intervention policy with the central banks of Zambia and Uganda; (v) implementation of a symmetric interest rate corridor; (vi) establishment of a Macro-Prudential Analysis Department; (vii) enhanced quality of the first draft of a Financial Stability Report; (viii) updated central bank organization chart and approved recommendations on organization, risk control and internal audit; (ix) training on International Standards for Financial Market Infrastructure (PFMI) and recommendations to strengthen the Real Time Gross Settlement System (RTGS); and (x) revised policy and drafted new regulations for commercial banks deposits and withdrawal of cash, including a sorting guide.

Structural policies

30. ***We welcome staff's comments on IMF contributions to the resilience building efforts.***

31. ***We note that the authorities are preparing a National Resilience Strategy with support from the World Bank while they already have the National Climate Change Strategy and Master Plan for Risk and Disaster Reduction. In this regard, we would like to ask staff about the area which is not covered by the current strategies and will be covered by a new strategy, and whether IMF will provide any support to develop the new strategy from macroeconomic framework perspective.***

32. ***In that regard, we would appreciate staff's views on the Master Plan for Risk and Disaster Reduction covering the period 2017-2030, especially regarding the fiscal implications of this Master Plan.***

- In response to Tropical Cyclones Idai and Kenneth, the RCF disbursement should help to address external financing gaps arising from reconstructions needs. In addition, staff will follow up with the World Bank on progress regarding the preparation of the National Resilience Strategy and explore the possibility of collaboration in macro-critical areas in line with recently-issued Board guidelines.

- The Fund, in collaboration with the World Bank and other development partners, can help Mozambique better assess the trade-offs between development needs, rising debt vulnerabilities, and the benefits of building *ex-ante* resilience. In addition, the Fund could take a lead role to help Mozambique develop a macroeconomic policy framework reflecting both disaster costs and returns from resilient investments, identifying fiscal actions that are needed to support this policy framework.

- The Master Plan provides a framework with a set of measures to combat, adapt and mitigate climate change effects and building *ex-ante* resilience. The fiscal implications are not clearly defined in the plan. However, the plan refers to the existing institutional setting for its implementation, including the Annual Contingency Plans and the Disaster Management Fund to provide substantial and predictable sources of financing. Currently, these mechanisms are underfunded, having only 0.1 percent of the State Budget allocation and supplemented with donor contributions.

33. ***We are also of the view that the IMF, in partnership with the World Bank, might undertake more analysis dealing with the structure of growth, its effects on poverty reduction, and implications for natural resource wealth management. Staff comments are welcome.***

- Point well taken. Staff will continue to collaborate with the World Bank on these issues.

34. ***We would appreciate if staff could comment on where the authorities' currently stand regarding the management of future LNG proceeds. Moreover, we were wondering whether there are specific plans on the establishment of a sovereign wealth fund (para. 35), which could be beneficial for development and macroeconomic stability objectives***.

- Staff is of the view that creating a framework for managing effectively and transparently natural resource wealth will be essential. The authorities agree and have started to prepare for the LNG era as they are fully aware of the potential benefits and challenges related to the development of a large extractive industry sector.

- We understand that, following the recent high-level international conference on preparing for the LNG era, a working group has been set up to study and prepare for the creation of a sovereign wealth fund.

Fund engagement

35. ***We wonder what the current plans of the authorities and staff are regarding Fund involvement in Mozambique?***

36. ***In the past Board meetings, staff said that filling the information gaps in the audit report of Ematum, Proindicus and MAM is a precondition of Fund's financial reengagement. We would like to know whether the authorities provide any additional information to staff on this point which enables the authorities to use Fund financing in case, for example, they need support to build ex-ante resilience.***

37. ***In view of the significant reforms that are required to address governance challenges, modernize public administration, enhance the fiscal, monetary and financial sector policy frameworks we would appreciate staff's comments whether a staff-monitored program would be advisable to structure these multi-pronged reforms.***

- Staff will respond to questions 35-37 during the Board meeting.