INTERNATIONAL MONETARY FUND

Staff Country Reports

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Malawi: Staff Report for 2009 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility

The following documents have been released and are included in this package:

- The staff report prepared by a staff team of the IMF, following discussions that ended on November 11, 2009, with the officials of Malawi on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 4, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- Supplement to the staff report.
- A statement by the IMF staff representative.
- A Public Information Notice (PIN).
- A Press Release.
- A statement by the Executive Director for Malawi.

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

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

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for Malawi 2009 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility

Prepared by the African Department
(In consultation with other departments)

Approved by Sharmini Coorey and Dhaneshwar Ghura

February 4, 2010

Discussions were held in Lilongwe and Blantyre during October 26–November 10, 2009 and continued via videoconference. Staff met with the Minister of Finance, Mr. Kandodo, the Governor of the Reserve Bank of Malawi (RBM), Dr. Ligoya, the Secretaries of the Treasury, Mr. Mwadiwa and Mr. Mwanamvekha, the General Manager of the RBM, Dr. Banda, other senior government officials, and representatives of the private sector, civil society, and development partners. The staff team comprised Ms. Stotsky (head), Ms. Randall, Ms. Matlanyane, and Mr. Yartey (all AFR), and Mr. Thornton (SPR). Mr. Itam and Ms. Teferra (OED) participated in the discussions. The Fund's resident representative, Mr. MacFarlan, and country economist, Mr. Mulwafu, assisted the mission.

Staff recommends the approval of a three-year arrangement under the Extended Credit Facility (ECF) in the amount of SDR 52.05 million (75 percent of quota), based on understandings reached on the macroeconomic program and structural reforms for the period 2010–12. A one-year Exogenous Shocks Facility (ESF) arrangement of SDR 52.05 million (75 percent of quota) was approved on December 3, 2008 (Country Report No. 09/16) and expired on December 2, 2009. The last Poverty Reduction and Growth Facility (PRGF) arrangement was completed on August 4, 2008. The completion point for the enhanced HIPC Initiative was reached on August 31, 2006. Outstanding Fund credit through January 2010 was SDR 80.95 million (116.64 percent of quota).

The safeguards assessment was updated in December 2008 and is currently being updated.

The joint IMF and World Bank staff advisory note on the first annual progress report on the Malawi Growth and Development Strategy was presented to the Executive Board on September 16, 2008.

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Executive Summary

- Malawi's agricultural-based economy has weathered well the global economic storm, with record harvests in recent years leading to 9.8 percent growth in 2008 and an estimated 7.6 percent in 2009. Inflation has remained moderate. The financial sector was only modestly affected by the global turmoil and remains well-capitalized and profitable.

- A loosening of fiscal and monetary policies during the run-up to last May's elections led to high government domestic borrowing in fiscal year 2008/09 (ending in June 2009), and rapid money and credit growth. This easing contributed to low international reserves. The end-June 2009 ESF program targets for net domestic repayment of the central government, and net domestic assets and net international reserves of the RBM were missed by wide margins. The fiscal year 2009/10 budget reflects a prudent fiscal stance, targeting a repayment of net domestic borrowing in line with the medium-term objectives to maintain a low deficit and create room for private sector credit.

- A weak balance of payments threatens exchange rate and price stability and medium-term growth. The de facto pegging of the Malawi kwacha to the U.S. dollar from 2006 to late 2009 helped to moderate inflation. But persistent inflation differentials with trade partners and the peg led to some appreciation of Malawi's real effective exchange rate. Rapid growth of domestic incomes and exchange rate appreciation have led to an imbalance between the growth of imports and exports and widened external current account and balance of payments deficits.

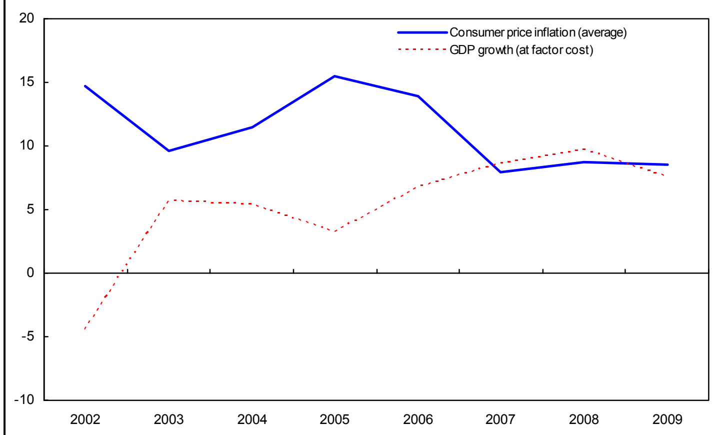
- The authorities have recently adopted a number of measures to address the external imbalance, including initial steps at market liberalization, gradual depreciation of the exchange rate, and strengthened budgetary spending controls. However, continued policy adjustment and external support are critical.

- Staff support the request by the Malawian authorities for a three-year arrangement under the ECF with access of 75 percent of quota. This arrangement would support Malawi's efforts to sustain high growth and poverty reduction, underpinned by sound macroeconomic and exchange rate policies, in line with the Malawi Growth and Development Strategy, which incorporates its poverty reduction strategy.

I. Recent Developments and Performance under the ESF

1. **Malawi's agricultural-based economy has weathered well the global economic storm.** Good weather and the distribution of subsidized fertilizer have contributed to robust growth and moderate inflation. After reaching 9.8 percent in 2008, real GDP growth is estimated at 7.7 percent in 2009 (Tables 1a and 1b and text figure), buoyed by a bumper maize harvest and services expansion (text table). Inflation has remained moderate. After rising in late 2008 following food and fuel price shocks, consumer price inflation decreased to 7.6 percent in the 12 months ending December 2009.

Text Figure. Malawi--Real GDP Growth and Inflation
(Percent, annual basis)



Sources: Malawian authorites and Fund staff estimates.

2. **Following a number of years in which the central government repaid domestic debt and maintained modest overall deficits, fiscal policies loosened significantly in the run-up to the May 2009 presidential and parliamentary elections (Tables 2a and 2b, and Figure 1).** Sizeable budget overruns on fertilizer and goods and services spending during fiscal year 2008/09 led to high domestic borrowing; hence, end-June ESF program targets on repayment of debt and net domestic assets of the RBM were missed by wide margins and the central government deficit was above target. The overrun on fertilizer reflected both high world prices and unbudgeted purchases of fertilizer. The fiscal year 2009/10 budget returns to a prudent fiscal stance. Preliminary results on execution through December 2009 are in line with the budget, adjusted for donor support delays.[1]

Text Table. Malawi--Contribution to Growth, 2004-09
(Percent of GDP)

	2004	2005	2006	2007	2008	2009
GDP at market prices	5.4	3.3	6.7	8.6	9.8	7.7
Agriculture	1.1	-2.8	4.1	5.1	4.2	3.7
Mining and quarrying	0.2	0.4	-0.3	0.0	0.1	0.1
Manufacturing	0.3	0.4	0.4	0.3	1.1	0.4
Electricity and water	0.2	0.0	0.1	0.1	0.1	0.1
Construction	0.1	0.5	0.7	0.5	0.4	0.4
Ownership of dwellings	0.1	0.2	0.1	0.2	0.1	0.2
Services	3.5	4.5	1.6	2.4	3.8	2.9

Sources: Malawian authorities and Fund staff estimates.

3. **The monetary aggregates expanded rapidly in 2008 and early 2009 but tended to stabilize towards mid 2009.** Broad money growth fell to 19.4 percent on a 12-month basis at end-October 2009, down from 33.1 percent at end-December 2008 (Tables 3a and 3b and Figure 2). The RBM's policy rate remained at 15 percent in 2008 and 2009, while the six-month t-bill rate fell slightly during the year.

[1] A small amount of nonconcessional debt was incurred in late 2009 for the purchase of a presidential jet.

4. **Financial sector indicators show a well-capitalized and profitable banking system with low nonperforming loans (Table 3c)**. However, spreads remain high. The RBM's financial position has been strengthened by recapitalization, and staff and other operating cost reductions.

5. **Malawi's external position remains weak.** In 2008, high tobacco prices led to robust export growth, while high fertilizer and fuel prices and rising incomes and public spending led to rapid import growth (Table 4 and Figure 3). Despite a further improvement in the terms of trade in 2009, unexpectedly rapid import growth, reflecting the strong economy and increased fiscal expenditures, led to a higher-than-programmed external current account deficit. Consequently, the ESF program target for end-June 2009 on net international reserves of the RBM was missed by a wide margin.

6. **Official reserves, chronically low, fell to less than one month of prospective imports at end December 2009, well below a prudential three months or more of import cover.** Malawi needs a sizeable reserve cushion. Its high dependence on agriculture and foreign aid make it vulnerable to exogenous shocks, such as poor weather or diminished donor flows. In addition, the concentration on tobacco exports produces pronounced seasonal volatility in foreign exchange flows, complicating monetary and exchange policy management.

7. **In recent years, there have been periods of foreign exchange shortages and rationing, and private import payment arrears (Box 1).** The arrears that arose in early 2009 were reversed during the harvest season. As of late 2009, the authorities indicated that all private import payment arrears had been cleared, though the banking sector continues to face difficulties meeting foreign exchange demands for current account purposes.

Box 1. External Payment Arrears and Restrictions

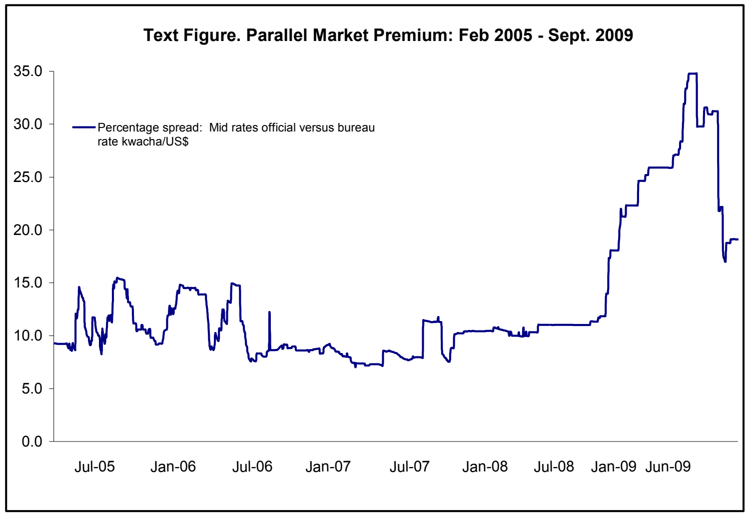
Malawi has suffered recently from shortages of foreign exchange, reflected in private import payment arrears; sizeable spreads between the official exchange rate and foreign exchange bureau and parallel rates; and queues in commercial banks to obtain foreign exchange to purchase imports.[2]

Article VIII, Sections 2 and 3 of the Fund's Articles of Agreement, obligations which Malawi accepted in 1995, requires countries to refrain from imposing restrictions on the making of payments and transfers for current transactions or engaging in multiple currency practices without the approval of the Fund. External payment arrears arising from an official action are evidence of an exchange restriction subject to Fund approval. The maintenance of unapproved exchange restrictions and multiple currency practices constitute a breach of the Article VIII obligations.

Fund-supported programs also have a continuous performance criterion regarding exchange measures inconsistent with Article VIII and non-accumulation of public sector external payment arrears.

[2] The RBM defines import payment arrears as payments for imports already received that are overdue by more than 30 days, which may arise when importers cannot purchase needed foreign exchange. Queues are defined for program-monitoring purposes as the amounts of foreign exchange that businesses have applied for—but not yet received—at commercial banks, for legitimate current account transactions.

8. **Malawi's low international reserves indicate an underlying chronic and recently intensified imbalance in the foreign exchange market.** This has manifested itself in excess demand and queues for foreign exchange at the prevailing official exchange rate, and gaps between the official exchange rate and foreign currency dealer and parallel market rates (text figure).[3] Low international reserves led the RBM in 2008 to issue directives that modified the existing surrender requirements on export earnings from tobacco and other traditional exports, which redirected part of the surrendered foreign exchange to the RBM directly and away from the commercial banks.[4] In late 2009 and early 2010, RBM directives reverted the surrender of export earnings back to the commercial banks.



9. **Foreign exchange queues and parallel market premiums, if sustained, can be damaging to growth.** Difficulties in accessing needed foreign exchange constrain growth by increasing business uncertainty regarding import financing, hinder diversification by encouraging businesses to stay small and informal, can lead to under-invoicing of exports or over-invoicing of imports, and may result in the private sector shifting from official markets to informal markets to circumvent the surrender requirements.[5] Shortages of foreign exchange for petroleum imports emerged in late 2009, requiring the petroleum importers' consortium to source foreign exchange from a regional bank.

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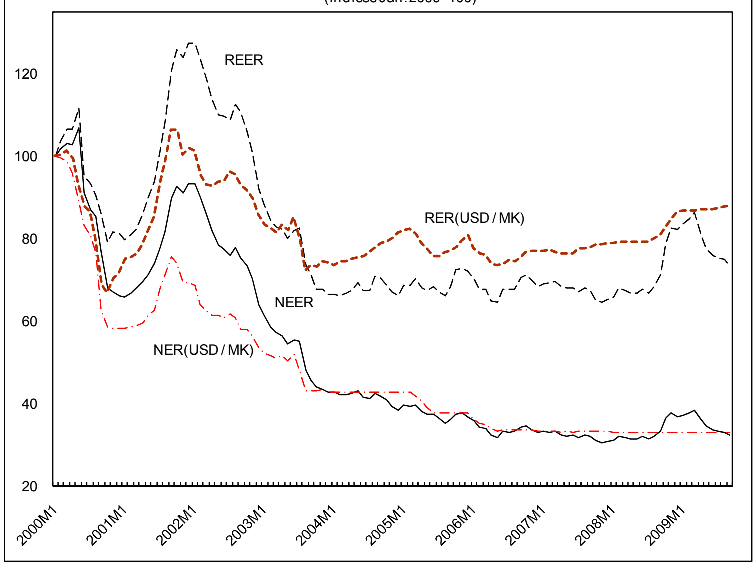
[3] The decline in the premium in August 2009 reflects in part the impact of the closure of non-bank affiliated foreign exchange bureaus, which has reduced competition in this market.

[4] Tobacco exporters are required to surrender earnings to commercial banks at the commercial bank rate, while exporters with foreign currency denominated accounts (FCDAs) can retain 60 percent of earnings in these accounts. In practice, the smaller tobacco farmers tend to surrender all their foreign exchange earnings. Other exporters of traditional products are required to surrender 40 percent of earnings to commercial banks at the commercial bank rate. The earlier directives, now reversed, had required that tobacco farmers without FCDAs surrender export earnings directly to the RBM at the official exchange rate, and tobacco exporters with FCDAs and exporters of other traditional products surrender 40 percent of their receipts—20 percent to the RBM at the official rate, and 20 percent to the commercial banks at the commercial bank rate.

[5] Market participants spoke of the existence of an "offshore" market in the kwacha, where participants agreed on their own exchange rate.

10. **Staff estimate that the real effective exchange rate (REER) is overvalued, within a broad range of about 5 to 28 percent, impairing Malawi's competitiveness.**[6] The official nominal exchange rate had been de facto pegged against the U.S. dollar at the rate of about 141 Malawi kwacha per U.S. dollar from 2006 to early November 2009. In 2008 and early 2009, the REER appreciated strongly, as a result of a strengthening of the U.S. dollar, and inflation differentials between Malawi and trading partners (text figure). Since then, however, the REER has depreciated, reflecting the weakening of the Malawi kwacha along with the U.S. dollar against most of Malawi's other trading partners, a modest inflation differential, and some modest nominal depreciation of the kwacha.[7] Staff estimate that there is still a sizeable gap between the REER and the equilibrium real exchange rate (Box 2).

Text Figure. Malawi: Real and Nominal Effective Exchange Rate, 2000–09
(Indices Jan. 2000=100)



11. **The one-year ESF arrangement, designed to assist Malawi to overcome external shocks, expired on December 2, 2009, without completion of any reviews (Box 3).** A first tranche of SDR34.7 million (US$51.4 million) was drawn after Executive Board approval of the program on December 3, 2008. The key performance criteria for the first and second reviews, based on end-December 2008 and end-June 2009 targets, respectively, were missed by wide margins. Given the medium-term nature of the difficulties confronting Malawi, staff and the authorities agreed that the best approach would be to allow the ESF arrangement to expire and to discuss instead a three-year ECF arrangement.

[6] The REER assessment is complicated by a lack of data, frequent structural breaks, a current account that is (analytically) constrained by foreign exchange rationing, and insufficient variation of the nominal and real exchange rates, which prevent estimating with confidence the elasticity of the current account with respect to changes in the exchange rate. The results are also sensitive to output growth and foreign aid flow assumptions.

[7] Staff had characterized the exchange arrangement as "stabilized." With the authorities' recent commitment to adjust the exchange rate to ensure the maintenance of a market-clearing rate, the exchange arrangement could now be classified as "other managed," in Fund staff's classification.

Box 2. Assessment of Malawi's Exchange Rate

Malawi's exchange rate was assessed using three CGER methodologies, which consistently indicate that the REER is overvalued. These results support evidence drawn from balance of payments indicators, foreign exchange queues, and parallel market premiums. The program's policies would contribute to aligning the exchange rate with its underlying fundamentals.

Malawi: Exchange Rate Assessment

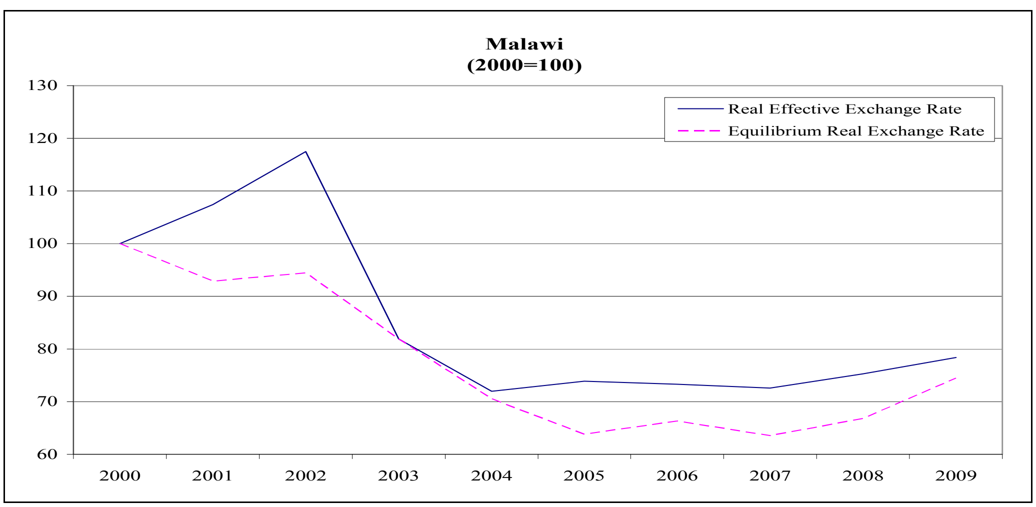
	Macroeconomic Balance 1/	Equilibrium Real Exchange Rate 2/	External Sustainability 3/
Current account norm	-0.9	…	0.7
Current account projection 4/	-5.6	…	-5.6
Current account gap	4.7	…	6.3
Real exchange rate gap 5/		(5.3)	
medium (assumes current account elasticity of 0.35)	(13.5)		(18.1)
lower bound (assumes current account elasticity of 0.23)	(20.6)		(27.5)
upper bound (assumes current account elasticity of 0.48)	(9.9)		(13.2)

1/ Applying coefficients drawn from Chinn and Ito (2006).
2/ Applying coefficients drawn from Mongardini and Rayner (2009).
3/ Under the External Sustainability approach the current account norm is the current account needed to stabilize net foreign assets at a level providing three months of imports.
4/ Given that our projections assume a more depreciated real exchange rate, the end-point projection is not an appropriate underlying current account. A three-year average has been retained instead.
5/ Appreciation (depreciation) needed in the real exchange rate to close the gap between norm and projection.

- The **Macroeconomic Balance** approach calculates an equilibrium current account balance as a function of macroeconomic fundamentals, and then assesses the degree of depreciation of the real exchange rate necessary to close the gap between the projected current account balance and the equilibrium current account. Malawi's relative demographic profile, fiscal balance, income, openness and terms of trade volatility would suggest a current account deficit of around 1 percent of GDP, compared with the 5.6 percent projection.

- The **External Sustainability** approach targets the level of net foreign assets necessary to achieve reserves of three months of imports. This would suggest a current account norm of 0.7 percent of GDP in order to achieve the desired net foreign assets target, a result driven largely by Malawi's weak reserve position. This would require a REER depreciation ranging from 13.2 to 27.5 percent, depending on the assumed current account elasticity.

- The **Equilibrium Real Exchange Rate** approach suggests a somewhat smaller degree of overvaluation, of about 5.3 percent. The degree of overvaluation has fallen in recent months as the dollar has declined against the rand. This approach does, however, indicate that Malawi's exchange rate has been somewhat overvalued in recent years, a conclusion borne out by Malawi's weak reserve position over the same timeframe.



Box 3. Economic Performance under Recent Fund Arrangements[8]

Malawi has had two arrangements with the Fund since the last ex-post assessment in September 2004: a PRGF arrangement (August 2005 to August 2008), and an ESF arrangement (December 2008 to December 2009).

Performance under the PRGF arrangement was largely successful. While domestic borrowing exceeded initial fiscal targets, domestic debt as a share of GDP sharply declined. HIPC debt relief in 2006 also lowered the overall debt burden. Monetary restraint led to much lower inflation and interest rates. These improvements were supported by a range of structural reforms. A key weakness, however, was the lower-than-expected build-up in international reserves—a consequence of much higher imports than projected, large cumulative terms of trade declines, lower-than-expected budget support, over-borrowing relative to the initial targets, and lack of exchange rate flexibility.

Performance under the ESF arrangement was less successful. The initial disbursement under this arrangement helped Malawi weather the impact of shocks arising in 2008 from high international fuel and food prices, and also catalyzed additional donor support. However, important program slippages in the first half of 2009—especially in public spending—led to much higher domestic borrowing than expected, and lower reserve accumulation. As a result of these slippages, no program reviews were completed.

12. **Although there has been some progress toward the MDGs, poverty is still widespread** (Table 5). With gross national income per capita at around US$250 in 2007, Malawi remains one of the poorest countries in the world. HIV/AIDS is prevalent and electricity and running water availability are limited. The Malawi Growth and Development Strategy (MGDS) emphasizes sustainable growth, social protection and development, infrastructure development, and improved governance.[9]

II. Policy Discussions

13. **The 2009 Article IV consultation discussions and ECF program negotiations focused on the design of a medium-term program to restore Malawi's external equilibrium while sustaining a high rate of growth and poverty reduction, in line with MGDS.** In this regard, the program's key objectives include:

[8] This box substitutes for an ex-post assessment update, in accordance with the one-year suspension on such updates approved by the Executive Board on August 28, 2009 (SM/09/213, Supplement 3).

[9] The third annual review of the MGDS (which is Malawi's Poverty Reduction Strategy Paper) will be finalized in February 2010.

Restoring external equilibrium by:

- Liberalizing the foreign exchange regime for current account transactions to allow a market-clearing exchange rate to emerge and to eliminate measures inconsistent with Article VIII by end-2011.

- Attaining international reserve coverage of a minimum of three months of imports to buffer against external shocks by end-2012.

Maintaining internal equilibrium by:

- Pursuing prudent fiscal and monetary policies, as reflected in the fiscal year 2009/10 budget and through restrained monetary aggregate growth, to contain aggregate demand and inflation pressures and shift demand toward domestic output.

Sustaining poverty reduction efforts by:

- Creating room in the budget for more social and pro-poor spending.

- Improving the structure of the social safety net to protect poor households from shocks and policy adjustments, including exchange rate depreciation.

Building competitiveness by:

- Improving public financial management, tax administration, and the efficiency and solvency of public utilities;

- Enhancing the business climate by expanding the capacity and quality of infrastructure, promoting investor access to finance, and reforming legal and regulatory frameworks governing financial supervision and the operation of other key economic activities.

A. A Return to Fiscal and Monetary Discipline

14. **The programmed overall central government deficit is the same as in the legislated budget.** The ECF-supported program therefore accords with key budget goals, such as to reduce government indebtedness, leave room for private sector credit growth, and focus on poverty-reducing spending. It targets repayment of net domestic borrowing of 1.2 percent of GDP in fiscal year 2009/10, compared to 0.8 percent of GDP in the legislated budget, reflecting slightly higher than estimated foreign inflows.[10] The fiscal year 2009/10 budget addresses last year's overspending through improved control of discretionary spending, including on goods and services and fertilizer.

[10] Domestic debt repayment is intended to raise government saving to support a stronger external current account and reserve accumulation, without jeopardizing aid-financed spending.

15. **The authorities are committed to cutting lower priority expenditures or shoring up revenues, while protecting social spending, if budget execution falls short of the domestic repayment target.** To protect poverty-reduction goals, the program includes an indicative target for a floor on social spending. In addition, the authorities have committed to ensuring that any costs associated with the newly purchased presidential jet (a first-year payment of US$4.4 million or 0.08 percent of GDP out of a total cost of US$22 million) and support to cotton producers (0.07 percent of GDP) are incorporated into the existing budget ceilings through offsets of lower priority expenditures.

16. **The authorities have also taken steps to guard against the deficits in key parastatals, such as the electricity company, the water boards, and Air Malawi, from impinging on budget priorities**. They have already announced adjustments to electricity and water tariffs to cover a higher percentage of operating costs, and have committed to not absorb any costs for restructuring or paying off Air Malawi's debts in this fiscal year's central government budget, and to devise a cost-effective plan to deal with Air Malawi over the medium term.

17. **The authorities have laid out a prudent medium-term fiscal policy framework.** They indicated that the fiscal year 2010/11 and medium-term budgets would be formulated with a similar domestic repayment target as in this year's budget and adherence to a modest overall deficit under 3 percent of GDP to avoid any significant accumulation of debt. In addition, staff and the authorities agreed that it will be important to continue strengthening tax and customs administration. Key tax bases need to be broadened to allow the value-added tax rate to be reduced to regional norms, and to offset the impact of further tariff reforms that Malawi is committed to as part of regional integration.[11] Finally, to ensure sustained poverty reduction, the authorities intend to reform the social safety net to improve targeting of households and are considering the expansion of a donor-financed pilot income transfer program that addresses the needs of the poor, including landless households, and which so far covers 7 of 26 districts and would cost US$68 million when scaled up to all districts.

18. **Continued public financial management reforms are needed to reinforce fiscal discipline**. The government has made some progress over the past year in improving fiscal accounting and reporting. Staff emphasized the importance of making fully operational the Public Financial and Economic Management (PFEM) unit in the Ministry of Finance and producing timely, consolidated, and reconciled accounts.

19. **Monetary policy is oriented toward achieving price stability, while providing room for adequate credit to the private sector and supporting reserve accumulation and a properly valued exchange rate.** Monetary policy is anchored in a target for reserve

[11] The fiscal year 2009/10 budget introduced temporary duties of 30 percent on some food products, with a view to curbing foreign exchange demand and protection of domestic producers, but the authorities indicated their intention to reverse these measures soon in line with their regional commitments.

money, which is programmed to grow by about 16 percent in 2010 (about the same as projected nominal GDP growth). The authorities indicated that there are sufficient tools to conduct effective monetary policy, including through the active use of open market operations, with RBM and treasury bills, to control growth of monetary aggregates. The authorities agreed on the need to rely more heavily over time on adjustments of interest rates to control inflation, while noting that the potential for using interest rates is now limited in part because broader considerations are at times taken into account in setting rates.

B. Anchoring External Sustainability and Foreign Exchange Market Liberalization

20. **The authorities have begun taking steps, as prior actions for the ECF-supported program, to liberalize the foreign exchange market and reduce excess demand for foreign exchange.** RBM directives in late 2009 and early 2010 have reversed the earlier directives on foreign exchange surrender requirements to the RBM, increasing the role of commercial banks in the foreign exchange market. In November 2009, the RBM announced that the exchange rate would be managed with some flexibility, and by early-February 2010, the exchange rate had depreciated to about 151 kwacha to the U.S. dollar.

21. **While valuing the past contribution of exchange rate stability to output growth and price stability, the authorities acknowledged that current pressures on the exchange rate warranted enhanced exchange rate flexibility.** Staff noted that the kwacha 141 peg was not sustainable given Malawi's precariously low level of reserves and that the fundamental exchange rate imbalance had intensified in recent years. Staff advised that without exchange rate depreciation and supporting measures to liberalize the foreign exchange regime, fiscal and monetary policies would have to be tighter than currently envisaged to bring about the necessary reduction in excess demand for foreign exchange at the prevailing exchange rate. The authorities agreed that prudent demand management, including the tightening of last year's loose fiscal and monetary measures, is important, and that an appropriate balance needs to be struck between demand management and exchange rate adjustment in restoring external equilibrium to avoid undesirable effects on growth and poverty reduction.

22. **The ECF-supported program will entail concrete measures to liberalize the foreign exchange regime and bring about a better balance of supply and demand of foreign exchange**. The authorities have committed to re-establishing an active interbank market for foreign exchange, which has virtually ceased to function because the supply of foreign exchange to commercial banks has largely dried up (Box 4). They have also committed to reducing the role of the RBM in the market, and to improving monetary and exchange policy transparency. By the end of 2010, the combination of a more flexible exchange rate, liberalization, and supporting monetary and fiscal policies should lead to a significant reduction in the foreign exchange queues and exchange rate premiums, and by 2011, a foreign exchange regime that operates without restriction on current account

transactions, with a unified, market-clearing exchange rate, in adherence to Malawi's obligations under Article VIII. [12]

Box 4: Foreign Exchange Market Liberalization Measures, 2010–12

Restructuring the foreign exchange market is intended to ensure the maintenance of a market-clearing exchange rate consistent with economic fundamentals, as laid out in the authorities' Memorandum of Economic and Financial Policies (MEFP). Key measures during the ECF-program period include:

- Introducing flexibility in the exchange rate. The authorities have committed to adjusting the exchange rate, as needed, to reach and maintain a market-clearing rate (MEFP ¶20). Prudent management by the central bank will be required to smooth the transition.
- Re-activating the interbank market for foreign exchange and reducing the RBM's market-making role in 2010, supported by changes in institutions (MEFP ¶21).
- Taking steps to allow all foreign exchange bureaus that meet fit and proper tests to operate (MEFP ¶21)
- Enhancing transparency by increasing and disseminating market information (MEFP ¶22).
- Revising and updating laws and regulations pertaining to the foreign exchange market in accordance with liberalization reforms and removing foreign exchange restrictions that impede access to foreign exchange for current account transactions against appropriate documentation (MEFP ¶22).
- Encouraging market participants to build capacity to manage exchange rate risks, with RBM monitoring (MEFP ¶22).
- Introducing reliable and efficient settlement systems to increase the effectiveness of market intermediaries (MEFP ¶22).
- Eliminating current account restrictions under Article VIII by end-2011, while making a significant reduction in queues and exchange rate premiums in 2010 (MEFP ¶26–27).

23. **The authorities have committed to undertaking further policy adjustments, including of the exchange rate, to support foreign exchange market liberalization, eliminate excess demand for foreign exchange, and achieve a market-based and competitive exchange rate.** The ECF-supported program will use three measures for monitoring pressures in the foreign exchange market, and developments in all these measures will be a focus of the first review. The monitoring of these measures will help to provide a basis for assessing whether further policy adjustments, including potentially further exchange rate adjustments, are needed to achieve the goal of eliminating foreign exchange shortages. The first measure is international reserve accumulation, which is a quantitative performance criterion. Two additional measures are: (i) the size of commercial banks' reported queues for

[12] Even with the move to flexibility, the RBM intends to rely on foreign exchange market intervention to limit exchange rate movements, though the scope for intervention would be limited by low reserves and the need to build them to meet program targets.

foreign exchange; and (ii) the gaps in exchange rates between the bank bureau midrate and the official midrate, for which indicative targets are set.

24. **Downside risks from market liberalization and nominal depreciation, including from balance sheet effects, appear moderate.** On balance, the central government budget should benefit from currency depreciation, given the relatively large size of trade and trade-related taxes and foreign aid compared to the import content of public expenditures and external debt service. The 2008 joint IMF and World Bank Financial System Stability Assessment found that the banking system's net foreign exchange exposure was limited through prudential regulations. The nonbank private sector is believed to have relatively little foreign-denominated debt. Moreover, depreciation of the currency will increase the income of smallholder tobacco and other farmers, who constitute a significant share of households, while the fertilizer subsidy and the pilot income transfer program, if continued, would protect the poorest households from higher costs of imported inputs.

Building reserves to restore external stability

25. **To build international reserves, the ECF-supported program is expected to entail a sizeable narrowing of the current account deficit (inclusive of grants) by reducing non-aid financed domestic demand relative to output over time.** The improvement in the current account balance would be achieved through a mix of fiscal and monetary consolidation and exchange rate adjustment and liberalization measures. A real exchange rate depreciation is essential to avoid an excessively contractionary fiscal and monetary stance and would help shift demand towards domestic output. Although low export elasticities are likely to put the bulk of external adjustment initially on reduced import growth, an appropriately valued exchange rate should stimulate export growth over the medium term. The program envisages an ambitious improvement in the savings-investment balance of 6.8 percent of GDP between 2009 and 2010 (text table). The tightening of the fiscal stance to what has been more the norm in recent years (apart from last) will make a large contribution to this improvement, complemented by higher private saving.

Text Table. Malawi: Savings-Investment Balance and Reserve Accumulation, 2008–14

	2008	2009	2010	2011	2012	2013	2014
		Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent of GDP, unless otherwise indicated)						
Investment and savings							
National savings	18.2	15.2	24.6	21.9	21.3	20.4	21.1
Government	4.0	1.4	11.3	9.0	10.0	9.2	9.6
Private	14.1	13.7	13.3	13.0	11.3	11.2	11.4
National investment	24.5	23.8	26.4	24.2	22.8	22.7	23.7
Government	9.0	7.3	12.1	10.7	10.5	10.5	10.6
Private	15.5	16.5	14.3	13.4	12.3	12.2	13.1
Saving-investment balance	-6.4	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7
Government	-5.0	-5.8	-0.8	-1.8	-0.5	-1.3	-1.0
Private	-1.4	-2.8	-1.0	-0.5	-1.0	-1.0	-1.7
	(millions of U.S. dollars, unless otherwise indicated)						
External sector							
Usable gross official reserves	239.0	114.0	276.9	407.3	611.5	750.0	845.0
(months of imports)	1.3	0.6	1.4	2.1	3.0	3.4	3.8
(percent of reserve money)	93.2	35.0	81.3	126.6	176.9	202.4	212.2
Current account (percent of GDP)	-6.4	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7

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

C. Structural Reforms

26. **The ECF-supported program will also encompass structural measures to underpin macroeconomic objectives and sustain high growth.** The authorities have provided, as a prior action of the ECF-supported program, a transparent accounting of the execution of the fertilizer subsidy program in the fiscal year 2008/09 budget and of the budgeted figures in fiscal year 2009/10. The authorities committed to undertake further structural measures in three areas during the first year of the program: (i) improving public financial management by making fully operational the PFEM unit; (ii) developing a time-bound plan to restart and liberalize the interbank foreign exchange market; and (iii) continuing with implementation of financial sector reforms, and improving monetary and exchange rate policy transparency. Over the final two years of the program, they intend to continue improving transparency and solvency of the public utilities.

III. Economic Outlook and Risks

27. **Malawi's medium-term outlook is favorable, within the context of successful implementation of the ECF-supported program.** Growth is expected to remain buoyant, though more moderate compared to the recent past (Text Table). There is still considerable scope for raising agricultural productivity, which remains well below international norms. Over the medium term, growth is expected to be buoyed by the expansion of productive capacity at the Kayelekera uranium mine and, possibly, by the exploitation of niobium (a niche mineral for steelmaking), as well as the development of other sectors, such as sugar, where significant new investments are underway. The Southern African Free Trade Agreement also promises to open regional markets to basic manufactures.

Text Table. Malawi—Medium-Term Macroeconomic Framework

	2009	2010	2011	2012	2013	2014
Growth (percent change)	7.7	6.0	6.3	6.6	6.8	7.1
Inflation (eop, percent change)	7.6	9.2	8.5	7.2	6.8	6.0
Current account (percent of GDP)	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7
Reserves (US$ millions)	114.0	276.9	407.3	611.5	750.0	845.0
Reserves (months of prospective imports)	0.6	1.4	2.1	3.0	3.4	3.8
Fiscal year basis	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
			(Percent of GDP)			
Overall balance	-5.7	-1.6	-2.3	-1.5	-1.5	-1.5
Foreign financing	2.0	2.9	3.7	2.8	2.9	2.6
Domestic financing	3.8	-1.2	-1.5	-1.3	-1.3	-1.1
Domestic borrowing (net)	3.7	-1.5	-1.5	-1.2	-1.3	-0.7

Sources: Malawian authorities and IMF staff estimates.

28. **Inflation should remain moderate, below 10 percent.** Although the depreciation of the exchange rate would exert pressure on tradable' prices in 2010, last season's solid maize harvest, relatively stable international fuel prices, and restrained fiscal and monetary policies should contain inflationary pressures.

29. **The weak reserve position is expected to improve.** International reserves should rise as a result of a substantial expected inflow of donor assistance; seasonal inflows, once

the new harvest season begins; and a reduction of import growth followed by some greater export growth, as exchange rate adjustments and liberalization of the foreign exchange market bring about a market-based price. Under the program, international reserves are projected to rise to 1.4 months of prospective imports by end-December 2010 and to three months by end-December 2012.

30. **The updated debt sustainability analysis does not show any immediate concerns.** Foreign debt is modest as a consequence of the Heavily Indebted Poor Countries (HIPC) initiative and domestic debt is low. Indebtedness is projected to rise with the increase in infrastructure investment financed with concessional debt. Thus, the debt-to-exports ratio is expected to rise towards its threshold during the projection period, but without exceeding it. Malawi's debt service indicators are therefore projected to remain below their indicative thresholds in the medium term in both the baseline and under a variety of shocks (see Debt Sustainability Analysis). Overall, Malawi's risk of debt distress is moderate.

31. **There are several key downside risks:**

- ***Lack of a market-based exchange rate.*** A lack of flexibility on the exchange rate could contribute to shortages of foreign currency, which would threaten macrostability, and dampen investment and growth.

- ***Changes in the international environment for tobacco consumption.*** The medium-term prospects for burley tobacco, the largest export commodity, are currently uncertain in light of recent Canadian legislation to ban additives that are typically combined with burley tobacco in cigarettes.

- ***Reliance on rain-fed agriculture***. Malawi's reliance on unirrigated agriculture leaves it vulnerable to drought. So far, it has largely escaped the devastating drought that has afflicted large parts of eastern and southern Africa, but this risk remains central.

- ***Business policies that discourage investment and production.*** Another key risk is that business policies could be adopted that discourage investors, especially foreign investors, and reduce incentives for domestic producers to shift resources into the most productive activities. Minimum pricing policies should be designed with both sellers and buyers of farm produce in mind.

- ***Poor infrastructure.*** The quality and availability of electricity and water supply already impede growth. Malawi will need to adopt a comprehensive strategy for reforming the parastatals that deliver utilities' services, and to develop an innovative program for expanding access to underserved areas.

- ***Uncertainties in the external environment***. A slower global recovery could dampen export demand, investor interest, remittances, and access to foreign capital.

IV. PROGRAM MONITORING

A. Program Monitoring and Conditionality

32. **Program implementation will be monitored according to the following performance criteria and benchmarks as laid out in the authorities' MEFP, with terms defined in the accompanying Technical Memorandum of Understanding (TMU)**. Over the three years of the ECF-supported program, performance criteria will be set on net domestic assets and net international reserves of the RBM and on net domestic borrowing of the central government, and an indicative target will be set on reserve money (Table 6 and MEFP ¶26). In addition, there will be an indicative target for a floor on social spending, so that this spending does not fall below budgeted levels. The performance criteria will be set for end-June and end-December, and the indicative targets for end-quarters. There will also be continuous performance criteria on non-accumulation of government external payment arrears and on no new contracting and guaranteeing of short-term and medium-term nonconcessional external debt.

33. **To help guide adjustment, the program will also incorporate supplemental monitoring with regard to excess demand for foreign exchange (MEFP ¶27).** To gauge progress in eliminating, over time, the measures that gave rise to multiple currency practices and foreign exchange queues, the RBM will measure, jointly with Fund staff, on a monthly basis, three indicators: (i) the reduction in the size of commercial banks' reported queues for foreign exchange; and (ii) the reduction in the gaps in exchange rates between the bank bureau midrate and the official midrate, both indicative targets, and (iii) reserve levels, a performance criterion. These indicators will also be covered by the semi-annual reviews.

34. **The program will also set structural benchmarks in the three key reform areas for the first year of the program and then establish longer-term benchmarks (MEFP ¶28).** To enhance public sector efficiency, the authorities will make fully operational a PFEM unit (Table 7). To support efforts to liberalize the foreign exchange market, the authorities will formulate a plan to re-activate the interbank foreign exchange market. Finally, to deepen financial development, the authorities will seek Cabinet approval of the Financial Sector Development Strategy and increase monetary policy transparency. Over the medium-term, the authorities will work toward improving the transparency and solvency of public utilities.

B. Capacity to Repay

35. **Malawi would have reasonable assurances of capacity to repay the Fund (Table 8)**. The envisaged Fund disbursements would total 75 percent of quota, which is justified by Malawi's balance of payments need, and is the norm under the ECF instrument for a country with more than 100 percent of quota outstanding (Malawi's purchases from the PRGF Trust Fund total 116.64 percent of quota). If purchases are made as scheduled, there will be a peak in debt service to the Fund in 2018 at US$32.1 million (or 1.7 percent of exports). Fund support will be a relatively small part of the overall financing package, as

Malawi is projected to receive an average of US$200 million per year in budget support, seven-eighths of which is in the form of grants, and the rest in the form of highly concessional loans. In addition, Malawi receives around US$800 million per annum in official aid, three-quarters of which goes through the budget. The strong level of donor support, combined with the prospects for future development of Malawi's agricultural potential and natural resources (and the accompanying foreign currency earnings and government revenue), are expected to support Malawi's capacity to repay the Fund.

C. Safeguards Assessment

36. **The ECF-supported program will require an update of the December 2008 safeguards assessment.** This assessment has commenced and will be completed no later than the first review of the proposed arrangement.

D. Data Issues, Technical Assistance, and Capacity Building

37. **The data provided are adequate for surveillance and program monitoring.** The quality and timeliness of Malawi's fiscal, monetary, and external data have improved, although their shortcomings are still significant. The authorities are committed to building technical capacity within the government and the RBM. The Fund is providing technical assistance in several areas, including public financial management, tax reform and tax and customs administration, monetary and exchange rate management, statistics, and legal drafting.

V. Staff Appraisal

38. **Malawi has weathered the global downturn well, with continued high growth and moderate inflation.** The post-election period provides an opportunity to take the bold actions necessary to restore external equilibrium, while sustaining high growth and poverty reduction.

39. **Expenditure overruns in the fiscal year 2008/09 budget are being addressed with a return to a more prudent fiscal stance in the fiscal year 2009/10 budget and execution.** In the last fiscal year, ending in June 2009, net domestic borrowing was higher than in the budget, with significant cost overruns in fertilizers and other goods and services. However, the fiscal year 2009/10 budget scaled-back spending of lower priority items and achieved savings by using excess fertilizer stocks from last year, while setting ambitious targets for revenue collection. Execution through the first half of the fiscal year to end-December 2009 was in line with the budget. Donor funding continues to be a critical component of the macroeconomic framework. The authorities' commitments to continue reforms in public financial management and improve tax and customs administration are important to ensure that the budget remains on track. The steps taken to consolidate the fiscal position should help reduce pressure on the balance of payments and over the longer term, avoid the accumulation of debt.

40. **Monetary policy has tightened, after a significant easing in 2008 and early 2009.** The authorities are actively absorbing the liquidity overhang. Good control of credit growth is essential to support strengthening of the balance of payments and contain inflationary pressures from exchange rate adjustments. Over time, as financial markets develop and with the move to a flexible exchange regime, monetary policy should rely more heavily on interest rate adjustments to achieve inflation targets. The financial system is resilient and well-capitalized and profitable.

41. **Recent decisive steps will help address a weak balance of payments, which threatens exchange rate and price stability and medium-term growth.** Chronically low reserves were further weakened last year by the loose fiscal and monetary policies. Some recent measures to liberalize the foreign exchange market, such as the reversion of surrender requirements to the commercial banks, and a move to greater flexibility in the exchange rate and some modest depreciation of the nominal rate, will supplement measures to reduce aggregate demand and help address the external imbalance. However, continued policy adjustment, including further potential exchange rate adjustments, and external support are critical to restore external equilibrium.

42. **Staff support the request by the Malawian authorities for a three-year arrangement under the ECF with access of 75 percent of quota.** This arrangement would support efforts to liberalize the foreign exchange regime, build reserves, and strengthen fiscal sustainability and anti-poverty activities, in line with Malawi's poverty reduction and growth strategy.

43. Malawi's breach of commitments under Article VIII of the Fund's Articles of Agreement, should be eliminated.

44. It is recommended that the next Article IV consultation take place within 24 months, subject to the decision on consultation cycles in program countries.

Table 1a. Malawi: Selected Economic Indicators, 2008–14 [1]

	2008	2009	2010	2011	2012	2013	2014
	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)							
GDP at constant market prices	9.8	7.7	6.0	6.3	6.6	6.8	7.1
Nominal GDP (billions of kwacha)	600.3	702.3	819.4	942.9	1,082.4	1,236.1	1,402.1
Nominal GDP per capita (US$ millions)	312.8	356.4	366.5	389.5	410.5	446.4	475.9
GDP deflator	8.9	8.8	10.1	8.3	7.7	6.9	5.9
Consumer prices (end of period)	9.9	7.6	9.2	8.5	7.2	6.8	6.0
Consumer prices (annual average)	8.7	8.4	10.1	8.3	7.7	6.9	5.9
Investment and savings (percent of GDP)							
National savings [2]	18.2	15.2	24.6	21.9	21.3	20.4	21.1
Net factor income	-0.5	-1.6	-3.9	-2.6	-3.2	-3.3	-2.8
Net private transfers	3.1	2.8	4.0	4.0	3.8	3.6	3.4
Net official transfers	15.5	13.3	16.9	13.6	12.7	11.9	11.2
Domestic savings	0.1	0.6	7.6	6.8	7.9	8.2	9.3
Government	-7.3	-6.7	-1.4	-0.4	1.5	0.8	1.7
Private	7.4	7.4	8.9	7.3	6.4	7.4	7.6
National investment	24.5	23.8	26.4	24.2	22.8	22.7	23.7
Government	9.0	7.3	12.1	10.7	10.5	10.5	10.6
Private	15.5	16.5	14.3	13.4	12.3	12.2	13.1
Saving-investment balance	-6.4	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7
Government	-5.0	-5.8	-0.8	-1.8	-0.5	-1.3	-1.0
Private	-1.4	-2.8	-1.0	-0.5	-1.0	-1.0	-1.7
Central government (percent of GDP)							
Revenue and grants	31.2	30.1	35.2	32.2	32.1	31.9	31.5
Tax and non tax revenue	19.9	21.4	22.6	22.8	23.6	23.5	23.6
Grants	11.3	8.8	12.7	9.4	8.5	8.4	7.9
Expenditure and net lending	36.2	36.1	36.0	33.9	32.7	33.2	32.5
Overall balance (excluding grants)	-16.5	-14.6	-13.5	-11.2	-9.0	-9.7	-8.9
Overall balance	-5.0	-5.8	-0.8	-1.8	-0.5	-1.3	-1.0
Foreign financing	1.8	1.6	4.2	3.0	3.0	2.8	2.4
Domestic financing	4.2	4.4	-3.4	-1.2	-2.4	-1.5	-1.4
Discrepancy	1.2	0.2	0.0	0.0	0.0	0.0	0.0
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)							
Money and quasi money	33.1	19.4	16.7	13.9	12.5	11.9	11.3
Net foreign assets [3]	-10.1	-18.4	13.6	10.4	15.9	11.8	9.4
Net domestic assets	43.2	37.8	3.1	3.6	-3.4	0.1	1.9
Credit to the government	59.8	20.6	-8.0	-4.0	-7.7	-4.6	-5.1
Credit to the rest of the economy (percent change)	45.5	27.9	28.4	19.4	13.8	14.3	14.4
External sector (US$ millions, unless otherwise indicated)							
Exports, f.o.b.	969.2	1,004.8	1,119.9	1,229.7	1,340.3	1,407.4	1,473.1
Imports, c.i.f.	-1,722.8	-1,809.6	-1,739.8	-1,843.0	-1,902.1	-2,010.2	-2,150.5
Usable gross official reserves [3]	239.0	114.0	276.9	407.3	611.5	750.0	845.0
(months of imports)	1.3	0.6	1.4	2.1	3.0	3.4	3.8
(percent of reserve money)	93.2	35.0	81.3	126.6	176.9	202.4	212.2
Current account (percent of GDP)	-6.4	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7
Current account, excl. official transfers (percent of GDP)	-21.8	-21.9	-18.7	-15.9	-14.2	-14.1	-13.9
Nominal effective exchange rate (percent change)	20.2	…	…	…	…	…	…
Real effective exchange rate (percent change)	24.9	…	…	…	…	…	…
Overall balance (percent of GDP)	-1.0	-1.8	4.4	3.6	4.3	3.2	2.3
Terms of trade (percent change)	5.9	13.7	-3.1	-2.9	-1.2	-1.6	-0.9
Debt stock and service (percent of GDP, unless otherwise indicated)							
External debt (public sector)	16.0	19.1	21.8	23.3	24.7	25.7	26.1
NPV of debt (percent of avg. exports)	42.1	64.3	62.1	65.4	69.5	75.2	79.1
External debt service (percent of exports)	6.7	1.3	1.8	2.2	2.4	2.6	3.6
Net domestic debt (central government)	19.0	20.3	14.0	11.0	7.1	4.7	5.3
Of which: excluding recapitalization of RBM	14.1	16.1	10.4	7.8	4.4	2.3	3.2
Net consolidated domestic debt (central bank and central government)	13.9	9.2	5.2	3.6	2.2	1.2	2.8
Treasury bill rate (period average) [4]	10.9	11.9	…	…	…	…	…

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates and projections.

[1] The ECF scenario assumes an initial depreciation and that the real exchange rate is kept constant during the program period. Correcting the underlying exchange rate misalignment is a key element of the macroeconomic framework.

[2] The increase in national savings in 2010 relative to 2009 results from the combined effect of expenditure-reducing policy, as the government pursues a tighter fiscal stance, and expenditure-switching policy as the devaluation effects a change in relative prices and also impacts the private sector.

[3] Programmed usable reserves in 2009 excludes the SDR allocation, while the projection includes the SDR allocation.

[4] Average t-bill rate. Data for 2009 are shown as of November 30th.

Table 1b. Malawi: Selected Economic Indicators on a Fiscal Year Basis, 2008/09–2013/14 [1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)						
GDP at constant market prices	8.6	6.7	6.1	6.5	6.7	7.0
Nominal GDP (billions of kwacha)	651.3	760.8	881.1	1,012.6	1,159.3	1,319.1
Nominal GDP per capita (US$)	335.9	364.5	377.5	406.4	435.0	463.7
GDP deflator	8.8	9.5	9.1	8.0	7.3	6.4
Consumer prices (end of period)	8.5	11.4	7.6	7.1	6.8	6.1
Consumer prices (annual average)	9.3	9.0	8.9	8.2	7.4	6.8
Investment and savings (percent of GDP)						
National savings [2]	15.7	20.4	23.1	21.4	20.8	20.8
Domestic savings	-0.5	4.6	7.1	7.2	8.1	8.9
Government	-10.2	-2.5	-1.6	0.4	0.5	1.0
Private	9.7	7.1	8.7	6.8	7.6	7.9
National investment	23.2	25.5	25.1	23.2	22.7	23.3
Government	7.2	10.2	11.3	10.4	12.0	13.8
Private	16.1	15.3	13.8	12.8	10.7	9.5
Saving-investment balance	-7.5	-5.1	-2.0	-1.9	-1.9	-2.5
Government	-5.8	-1.6	-2.3	-1.5	-1.5	-1.5
Private	-1.7	-3.5	-5.1	-6.0	-3.2	-1.6
Central government (percent of GDP)						
Revenue and grants	32.3	33.9	33.2	31.4	31.7	31.7
Revenue (excluding grants)	20.6	22.2	22.6	22.9	23.3	23.5
Grants	11.7	11.7	10.6	8.5	8.4	8.2
Expenditure and net lending	38.0	35.5	35.5	33.0	33.2	33.2
Overall balance (excluding grants)	-17.5	-13.3	-12.9	-10.0	-10.0	-9.6
Overall balance	-5.8	-1.6	-2.3	-1.5	-1.5	-1.5
Foreign financing	2.0	2.9	3.7	2.8	2.9	2.6
Domestic financing	3.8	-1.2	-1.5	-1.3	-1.3	-1.1
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)						
Money and quasi money	20.0	14.1	16.0	12.8	12.3	11.2
Net foreign assets	-18.1	2.8	7.5	12.1	21.9	9.0
Net domestic assets	38.1	11.2	8.5	0.7	-9.5	2.3
Credit to the government	19.3	5.6	-0.7	-4.3	-9.6	-3.5
Credit to the rest of the economy (percent change)	18.4	14.8	14.2	10.0	4.8	9.6
External sector (US$ millions, unless otherwise indicated)						
Exports, f.o.b.	985.5	1,045.5	1,160.8	1,270.9	1,365.3	1,431.9
percent change	20.1	6.1	11.0	9.5	7.4	4.9
Imports, c.i.f.	-1,760.2	-1,784.6	-1,783.9	-1,868.3	-1,948.3	-2,070.2
percent change	26.1	1.4	0.0	4.7	4.3	6.3
Usable gross official reserves	130.1	227.5	321.5	475.3	750.0	845.0
(months of imports)	0.7	1.2	1.6	2.3	2.8	3.8
Current account	-7.5	-5.1	-2.0	-1.9	-1.9	-2.5
Current account, excl. official transfers (percent of GDP)	-21.9	-20.3	-17.2	-15.0	-14.2	-12.6
Domestic debt (percent of GDP)						
Net domestic debt (central government)	18.0	13.7	10.4	7.7	5.4	5.2
of which: excluding recapitalization of RBM	13.5	9.8	7.0	4.8	2.9	2.9
Net consolidated domestic debt (central bank and central government)	9.7	4.2	1.6	0.7	1.9	2.4
Domestic interest payments	2.7	2.6	2.2	1.7	1.1	0.5

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates and projections.

[1] The ECF scenario assumes an initial devaluation and that the real exchange rate is kept constant during the program period. Correcting the underlying exchange rate misalignment is a key element of the macroeconomic framework.

[2] The increase in national savings results from the combined effect of expenditure-reducing policy, as the government pursues a tighter fiscal stance, and expenditure-switching policy as the devaluation effects a change in relative prices and also impacts the private sector.

Table 2a. Malawi: Central Government Operations 2008/09–2013/14
(Millions of kwacha)

	2008/09		2009/10		2010/11	2011/12	2012/13	2013/14
	Prel. Est.	Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	210,270	208,072	257,661	244,193	292,846	318,031	367,492	418,082
Revenue	134,291	118,167	168,773	163,100	199,326	232,077	269,679	310,367
Tax revenue	119,022	107,300	143,400	139,900	169,942	198,307	231,020	266,377
Taxes on income and profits	50,549	44,550	63,329	…	74,895	88,574	103,898	120,226
Taxes on goods and services	57,845	49,550	67,560	…	80,557	93,081	108,058	124,459
Taxes on international trade	13,571	12,800	14,617	…	16,928	19,454	22,271	25,342
Other	-2,943	400	-2,105	…	-2,438	-2,802	-3,207	-3,649
Nontax revenue	15,269	10,867	25,373	23,200	29,384	33,770	38,660	43,991
Grants	75,979	89,905	88,888	81,093	93,520	85,954	97,813	107,715
Budget support	19,875	19,440	28,547	20,643	33,733	22,681	30,006	34,187
Project [1]	24,347	31,318	31,770	29,499	34,039	38,655	41,995	46,539
Dedicated grants	31,757	39,147	28,571	30,951	25,748	24,618	25,812	26,989
Of which:								
DFID/EU (maize, fertilizer and seed)	2,833	4,562	1,036	4,209	0	0	0	0
National AIDS Commission (NAC)	11,950	18,271	13,088	12,513	16,907	13,765	14,432	15,089
Health Sector Wide Approach (SWAp)	14,390	16,314	14,447	14,229	8,841	10,853	11,380	11,900
Total expenditure and net lending	247,519	229,525	270,153	256,769	312,781	333,694	385,407	437,589
Current expenditure	200,780	172,306	187,581	188,182	213,361	228,228	263,833	297,500
Wages and salaries [2]	37,595	37,256	43,540	43,539	51,423	59,598	69,727	81,842
Of which: health SWAp [3]	1,425	1,748	7,900	2,100	9,149	10,514	12,537	15,266
Interest payments	17,863	16,169	20,366	19,794	20,705	18,673	14,689	9,780
Domestic	17,323	15,368	19,751	18,622	19,109	16,818	12,511	7,234
Foreign	540	669	616	1,172	1,596	1,855	2,179	2,546
Goods and services	86,137	77,703	79,448	78,678	89,896	95,103	114,503	131,683
Generic goods and services	43,877	37,564	33,098	42,800	37,180	40,980	49,913	57,561
Census	1,681	1,531	0	0	0	0	0	0
Roads	6,257	0	6,377	7,665	7,385	8,487	9,716	11,056
Health SWAp [3]	12,547	11,967	20,185	9,744	23,376	26,865	32,755	38,271
National / local elections	7,684	5,000	300	2,250	0	0	0	0
Statutory expenditures	2,503	834	4,097	1,396	4,744	4,702	7,383	9,401
National AIDS Commission (NAC)	9,558	18,271	13,392	12,823	17,211	14,069	14,736	15,393
Maize purchases	2,031	2,536	2,000	2,000	0	0	0	0
Subsidies and other current transfers	58,779	40,891	44,227	46,171	51,337	54,854	64,914	74,196
Pension and gratuities	5,106	6,451	6,948	7,400	7,581	8,184	11,777	13,529
Transfer to NRA and MRA	3,646	6,100	4,479	4,310	5,098	5,949	6,931	7,991
Transfers to public entities	12,203	8,910	12,498	11,897	15,474	16,033	18,354	20,886
Fertilizer and seed subsidy	37,823	19,430	21,861	22,564	23,184	24,688	27,851	31,790
Arrears adjustment	407	287	0	0	0	0	0	0
Development expenditure	46,740	57,219	77,447	66,587	99,421	105,465	121,574	140,089
Part I (foreign financed)	32,167	44,082	48,752	45,292	67,189	68,423	74,168	81,146
Part II (domestically financed)	14,573	13,137	28,695	21,295	32,232	37,043	47,406	58,943
Net lending	0	0	1,000	2,000	0	0	0	0
Overall balance (including grants)	-36,722	-21,453	-12,861	-12,576	-19,936	-15,663	-17,915	-19,507
Total financing (net)	36,722	21,453	12,861	12,576	19,936	15,663	17,915	19,507
Foreign financing (net)	13,338	22,863	21,713	18,975	32,914	28,782	33,188	33,754
Borrowing	14,550	24,503	23,213	20,443	35,640	32,363	37,552	40,235
Program	7,298	7,193	6,232	4,650	2,490	2,595	5,379	5,628
Project	7,252	13,165	16,981	15,793	33,150	29,768	32,173	34,607
Other concessional	0	4,145	0	0	0	0	0	0
Amortization	-1,213	-1,640	-1,500	-1,468	-2,726	-3,581	-4,364	-6,481
Domestic financing (net)	24,528	-1,410	-9,274	-6,399	-12,979	-13,120	-15,273	-14,247
Domestic borrowing (net)	24,076	-1,410	-11,730	-6,399	-12,979	-13,120	-15,273	-14,247
Other financing	453	0	2,456	0	0	0	0	0
Asset related financing [4]	453	0	2,456	0	0	0	0	0
Discrepancy	0	0	-53	…	…	…	…	…
Memorandum items:								
Nominal GDP	37,866	…	760,842	…	881,120	1,159,254	1,319,111	1,447,395
Net domestic debt [5]	117,295	…	104,430	…	91,451	103,434	77,285	58,622

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] Includes estimate for project loans not channeled through the budget.

[2] Wages and salaries grow faster than nominal GDP to reflect salary increases for educational and health workers.

[3] Health SWAp expenditures in 2009/10 are higher than budgeted owing to a reclassification of spending from generic goods and services, which have been reduced correspondingly.

[4] Kwacha 2 billion in FY2009/10 represents a transfer from the Petroleum Stabilization Fund.

[5] Excluding recapitalization of the RBM.

Table 2b. Malawi: Central Government Operations 2008/09–2013/14
(Percent of GDP)

	2008/09		2009/10		2010/11	2011/12	2012/13	2013/14
	Prel. Est.	Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	32.3	31.9	33.9	32.1	33.2	31.4	31.7	31.7
Revenue	20.6	18.1	22.2	21.4	22.6	22.9	23.3	23.5
Tax revenue	18.3	16.5	18.8	18.4	19.3	19.6	19.9	20.2
Taxes on income and profits	7.8	6.8	8.3	…	8.5	8.7	9.0	9.1
Taxes on goods and services	8.9	7.6	8.9	…	9.1	9.2	9.3	9.4
Taxes on international trade	2.1	2.0	1.9	…	1.9	1.9	1.9	1.9
Other	-0.5	0.1	-0.3	…	-0.3	-0.3	-0.3	-0.3
Non-tax revenue	2.3	1.7	3.3	3.0	3.3	3.3	3.3	3.3
Grants	11.7	13.8	11.7	10.7	10.6	8.5	8.4	8.2
Budget support	3.1	3.0	3.8	2.7	3.8	2.2	2.6	2.6
Project [1]	3.7	4.8	4.2	3.9	3.9	3.8	3.6	3.5
Dedicated grants	4.9	6.0	3.8	4.1	2.9	2.4	2.2	2.0
of which:								
DFID/EU (maize, fertilizer and seed)	0.4	0.7	0.1	0.6	0.0	0.0	0.0	0.0
National AIDS Commission (NAC)	1.8	2.8	1.7	1.6	1.9	1.4	1.2	1.1
Health SWAp	2.2	2.5	1.9	1.9	1.0	1.1	1.0	0.9
Total expenditure and net lending	38.0	35.2	35.5	33.7	35.5	33.0	33.2	33.2
Current expenditure	30.8	26.5	24.7	24.7	24.2	22.5	22.8	22.6
Wages and salaries[2]	5.8	5.7	5.7	5.7	5.8	5.9	6.0	6.2
Of which: health SWAp[3]	0.2	0.3	1.0	0.3	1.0	1.0	1.1	1.2
Interest payments	2.7	2.5	2.7	2.6	2.3	1.8	1.3	0.7
Domestic	2.7	2.4	2.6	2.4	2.2	1.7	1.1	0.5
Foreign	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Goods and services	13.2	11.9	10.4	10.3	10.2	9.4	9.9	10.0
Generic goods and services	6.7	5.8	4.4	5.6	4.2	4.0	4.3	4.4
Census	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Roads	1.0	0.0	0.8	1.0	0.8	0.8	0.8	0.8
Health SWAp[3]	1.9	1.8	2.7	1.3	2.7	2.7	2.8	2.9
National / local elections	1.2	0.8	0.0	0.3	0.0	0.0	0.0	0.0
Statutory expenditures	0.4	0.1	0.5	0.2	0.5	0.5	0.6	0.7
National AIDS Commission (NAC)	1.5	2.8	1.8	1.7	2.0	1.4	1.3	1.2
Maize purchases	0.3	0.4	0.3	0.3	0.0	0.0	0.0	0.0
Subsidies and other current transfers	9.0	6.3	5.8	6.1	5.8	5.4	5.6	5.6
Pensions and gratuities	0.8	1.0	0.9	1.0	0.9	0.8	1.0	1.0
Transfer to NRA and MRA	0.6	0.9	0.6	0.6	0.6	0.6	0.6	0.6
Transfers to public entities	1.9	1.4	1.6	1.6	1.8	1.6	1.6	1.6
Fertilizer and seed subsidy	5.8	3.0	2.9	3.0	2.6	2.4	2.4	2.4
Arrears adjustment	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditure	7.2	8.8	10.2	8.8	11.3	10.4	10.5	10.6
Part I (foreign financed)	4.9	6.8	6.4	6.0	7.6	6.8	6.4	6.2
Part II (domestically financed)	2.2	2.0	3.8	2.8	3.7	3.7	4.1	4.5
Net lending	0.0	0.0	0.1	0.3	0.0	0.0	0.0	0.0
Overall balance (including grants)	-5.7	-3.3	-1.6	-1.7	-2.3	-1.5	-1.5	-1.5
Total financing (net)	5.7	3.3	1.6	1.7	2.3	1.5	1.5	1.5
Foreign financing (net)	2.0	3.5	2.9	2.5	3.7	2.8	2.9	2.6
Borrowing	2.2	3.8	3.1	2.7	4.0	3.2	3.2	3.1
Program	1.1	1.1	0.8	0.6	0.3	0.3	0.5	0.4
Project	1.1	2.0	2.2	2.1	3.8	2.9	2.8	2.6
Other concessional	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.3	-0.2	-0.2	-0.3	-0.4	-0.4	-0.5
Domestic financing (net)	3.8	-0.2	-1.2	-0.8	-1.5	-1.3	-1.3	-1.1
Domestic borrowing (net)	3.7	-0.2	-1.5	-0.8	-1.5	-1.3	-1.3	-1.1
Other financing	0.1	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Asset related financing	0.1	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Discrepancy	0.0	0.0	0.0	…	…	…	…	…
Memorandum items:								
Nominal GDP (millions of kwacha)	651,301	…	760,842	…	881,120	1,012,635	1,159,254	1,319,111
Net domestic debt (millions of kwacha)[4]	117,295	…	104,430	…	91,451	103,434	106,848	78,332

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1] Includes estimate for project loans not channeled through the budget.

[2] Wages and salaries grow higher than nominal GDP to reflect salary increases for educational and health workers.

[3] Health SWAp expenditures in 2009/10 are higher than budgeted owing to a reclassification of spending from generic goods and services, which have been reduced correspondingly.

[4] Excluding recapitalization of the RBM.

Table 3a. Malawi : Monetary Authorities' Balance Sheet, 2008–10

(Millions of kwacha, unless otherwise indicated)

	2008	2009				2010
		Q1	Q2	Q3	Q4	Q4
	Act.	Act.	Act.	Act.	Est.	Proj.
Reserve money	36,047	42,180	52,309	55,326	46,128	53,597
Currency outside banks	25,261	21,863	29,277	32,385	…	…
Cash in vault	4,980	4,466	4,581	5,364	…	…
Commercial bank deposits with RBM	5,806	15,852	18,450	17,577	…	…
Net foreign assets (NFA) [1]	16,402	-5,804	1,369	-1,251	-14,867	6,488
NFA (US$ millions)	117	-41	10	-9	-98	40
Foreign assets (US$ millions)	258	96	153	225	114	277
Foreign liabilities (US$ millions)	-142	-138	-143	-233	-212	-237
Net domestic assets	19,646	47,984	50,940	56,577	60,995	47,109
Credit to government (net) [2]	56,705	68,255	58,714	76,892	82,978	77,289
Credit to statutory bodies (net)	1,973	888	920	951	971	1,128
Credit to domestic banks	1	3,703	7,440	769	785	912
Other items (net) [2]	-39,034	-24,861	-16,133	-22,034	-23,739	-32,220
Revaluation accounts	0	348	52	373	0	0
Open market operations	-26,126	-8,596	-4,742	-4,607	-5,271	-5,279
Others	-12,908	-16,613	-11,444	-17,800	-18,467	-26,942
Of which: excluding recapitalization bonds	16,740	13,035	18,204	11,848	11,181	2,706
Memorandum items:						
Seasonally adjusted reserve money	40,671	51,589	52,881	51,150	52,225	60,681
Quarterly change	-17	27	3	-3	2	6
Annual change	35	43	26	5	28	16
Seasonally adjusted currency outside banks	26,841	26,581	25,625	29,054	…	…
Quarterly change	-5	-1	-4	13	…	…
Annual change	30	16	-8	3	…	…
Net foreign assets at program exchange rate	16,397	-5,802	1,368	-1,251	-13,839	5,603
Net domestic assets at program exchange rate	19,650	47,982	50,941	56,578	59,967	47,993
Money multiplier	3.9	3.3	3.0	3.2	3.6	3.6
Six-month t-bill rate	13.3	11.4	13.3	12.7	…	…

Sources: Reserve Bank of Malawi and IMF staff estimates and projections.

[1] Including SDR allocation.

[2] Includes recapitalization of RBM with a transfer of t-bills in the amount of 29.3 billion in January 2008.

Table 3b. Malawi : Monetary Survey, 2008–10

(Millions of kwacha, unless otherwise indicated)

	2008	2009				2010
	Q4	Q1	Q2	Q3	Q4	Q4
	Act.	Act.	Act.	Act.	Est.	Proj.
Money and quasi-money	139,643	140,614	155,365	175,510	166,781	194,578
Money	70,597	69,771	79,843	84,081	…	…
Quasi money	69,047	70,843	75,522	91,429	…	…
Of which: foreign currency deposits	14,143	16,524	18,450	21,076	…	…
Net foreign assets (NFA)	19,667	-1,202	4,736	9,951	-5,999	16,616
NFA (US$ millions)	140	-9	34	71	-40	102
Foreign assets (US$ millions)	311	160	225	334	203	371
Foreign liabilities (US$ millions)	-171	-168	-191	-264	-242	-269
Monetary authorities	16,402	-5,804	1,369	-1,251	-14,867	6,488
NFA of the monetary authorities (US$ millions) [1]	117	-41	10	-9	-98	40
Gross foreign assets	36,333	13,545	21,455	31,574	17,217	45,060
Foreign liabilities	-19,931	-19,348	-20,087	-32,825	-32,083	-38,572
Commercial banks	3,265	4,602	3,368	11,203	8,868	10,128
NFA of the commercial banks (US$ millions)	23	33	24	80	59	62
Gross foreign assets (US$ millions)	53	63	73	110	89	94
Foreign liabilities (US$ millions)	-30	-31	-49	-30	-30	-32
Net domestic assets	119,976	141,816	150,628	165,559	172,780	177,961
Credit to government (net)	83,856	98,751	87,220	105,044	112,635	99,324
Credit to statutory bodies (net)	6,043	4,622	4,554	6,317	6,365	7,426
Credit to private sector	68,143	72,658	83,201	87,489	88,510	114,430
Other items (net)	-38,066	-34,216	-24,347	-33,292	-34,730	-43,218
RBM's revaluation accounts	0	348	52	373	0	0
Open market operations	-22,500	-8,287	-4,742	-4,607	-5,006	-5,019
Others	-15,566	-26,276	-19,657	-29,058	-29,725	-38,199
Memorandum items:						
Velocity of money (annual GDP divided by seasonally adjusted broad money)	4.2	4.2	4.3	4.1	4.1	4.1
Annual growth of broad money (percent)	33.1	24.9	20.0	20.7	19.4	16.7

Sources: Reserve Bank of Malawi and IMF staff estimates and projections.

[1] Including SDR allocation.

Table 3c. Malawi: Financial Soundness Indicators
(Millions of kwacha, unless otherwise indicated)

	2007	2008		2009
	Q4	Q2	Q4	Q2
Gross assets	128,522.6	173,266.1	201,546.3	219,654.1
Provisions and interest in suspense	1,550.9	2,379.2	2,073.3	2,221.6
Provisions	1,066.7	1,824.4	1,595.2	1,697.2
Interest in suspense	484.2	554.8	478.1	524.4
Net assets	126,971.7	170,886.9	199,473.0	217,432.5
Gross loans	54,722.6	73,448.0	79,599.1	98,256.5
Net loans	53,171.7	71,068.8	77,525.8	96,034.9
Non-performing loans	2,246.1	2,113.5	2,599.4	3,139.2
Deposits	92,301.4	105,651.1	128,176.3	138,971.4
Capital	15,159.7	15,448.1	18,308.2	22,786.1
Liquid assets	55,413.1	60,642.0	73,168.3	74,150.9
Non-interest income	9,887.7	6,091.8	13,542.0	7,677.8
Net interest margin	11,794.0	6,613.5	14,979.4	9,379.2
Total income	24,610.4	13,932.3	31,571.9	16,249.5
Net income after tax	6,000.7	3,685.5	8,455.6	5,187.5
Number of branches	53	67	62	65
Number of agencies	…	…	88	97
		(Percent)		
Capitalization net of interest in suspens	12.1	9.6	9.6	10.9
Net capitalization	10.7	7.6	8.1	9.5
Net performing loans to gross loans	95.0	96.4	96.1	96.3
NPLs to gross loans	4.1	2.9	3.3	3.2
Provisions to net performing loans	2.1	2.6	2.1	1.8
Provisions to NPLs	47.5	86.3	61.4	54.1
Return on assets	4.7	2.1	4.2	2.4
Return on equity	39.6	23.9	46.2	22.8
Non-interest income to revenue	40.2	43.7	42.9	47.2
Net interest margin to assets	9.2	3.8	7.4	4.3
Liquid assets to net assets	43.6	35.5	36.7	34.1
Liquid assets to gross assets	43.1	35.0	36.3	…
Liquid assets to deposits	60.0	57.4	57.1	…
Net loans to deposits	57.6	67.3	60.5	69.1

Sources: Reserve Bank of Malawi and IMF staff estimates.

Table 4. Malawi: Balance of Payments, 2008–14
(US$ millions, unless otherwise indicated)

	2008 Prel.	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
Current account balance (including grants)	-271.3	-426.9	-95.6	-125.3	-93.9	-152.8	-196.9
Current account balance (excluding grants)	-933.6	-1091.9	-978.4	-897.5	-882.3	-954.5	-1017.2
Merchandise trade balance	-753.6	-804.8	-619.9	-613.3	-561.8	-602.7	-677.4
Exports	969.2	1004.8	1119.9	1229.7	1340.3	1407.4	1473.1
Of which:							
Tobacco	586.5	569.8	512.8	528.2	544.0	560.3	577.2
Uranium	…	24.0	182.0	203.0	200.0	198.0	176.0
Imports	-1722.8	-1809.6	-1739.8	-1843.0	-1902.1	-2010.2	-2150.5
Of which: Petroleum	-212.9	-184.1	-231.3	-255.3	-277.1	-298.8	-323.6
Services balance	-311.2	-427.5	-568.4	-510.5	-557.4	-595.4	-591.8
Interest public sector (net)	-5.5	-3.7	-7.8	-9.1	-10.2	-11.7	-13.1
Receipts	0.4	0.4	0.0	1.2	1.2	1.2	1.2
Payments	-5.9	-4.1	-7.8	-10.3	-11.4	-12.9	-14.3
Other factor payments (net)	-29.3	-74.9	-194.4	-134.9	-184.9	-211.4	-196.0
Nonfactor (net)	-288.1	-348.9	-366.1	-366.5	-362.3	-372.3	-382.7
Receipts	82.9	73.2	75.0	87.8	101.1	105.0	108.9
Payments	-371.0	-422.1	-441.1	-454.3	-463.4	-477.3	-491.6
Unrequited transfers (net)	793.5	805.4	1092.6	998.4	1025.4	1045.4	1072.3
Private (net)	131.9	141.2	210.6	227.0	237.7	244.4	252.7
Receipts	144.0	154.3	223.8	240.3	251.2	258.1	266.6
Payments	-12.1	-13.2	-13.2	-13.4	-13.5	-13.7	-13.9
Official (net)	661.6	664.3	882.0	771.5	787.7	801.0	819.5
Receipts	662.3	665.0	882.8	772.2	788.5	801.7	820.3
Budget support	86.3	102.9	255.0	163.4	152.2	156.8	161.5
Project related [1]	576.1	562.2	627.8	608.8	636.2	644.9	658.8
Payments	-0.8	-0.8	-0.7	-0.7	-0.7	-0.8	-0.8
Capital account balance (incl. errors and omissions)	227.6	338.0	325.7	331.0	369.6	384.5	381.3
Medium- and long-term flows	138.1	189.9	185.7	175.8	182.9	187.2	172.8
Disbursements	190.2	112.0	197.4	187.5	205.6	213.2	215.8
Budget support	22.5	34.0	40.0	15.0	30.0	30.0	30.0
Project support	167.7	56.0	157.4	172.5	175.6	183.2	185.8
Other medium-term loans	0.0	22.0	0.0	0.0	0.0	0.0	0.0
Other investment assets	-45.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-7.1	-8.5	-11.7	-11.7	-22.7	-25.9	-43.0
SDR allocation	…	86.5	…	…	…	…	…
Foreign direct investment and other inflows	215.0	110.0	140.0	150.2	176.7	187.3	198.5
Short-term capital and errors and omissions	-125.5	38.1	0.0	5.0	10.0	10.0	10.0
Overall balance	-43.6	-88.9	230.1	205.7	275.7	231.7	184.4
Financing (- increase in reserves)	43.6	88.9	-230.1	-205.7	-275.7	-231.7	-184.4
Central bank	68.6	124.4	-226.6	-201.8	-271.4	-226.9	-179.0
Gross reserves (- increase)	-21.9	125.0	-162.8	-134.5	-204.2	-138.5	-95.0
Liabilities [2]	90.5	-0.6	-63.7	-67.3	-67.2	-88.4	-84.0
Of which: IMF (net)	93.9	0.0	22.0	21.2	21.6	4.4	-26.6
Purchases/drawings	93.9	0.0	22.0	22.0	25.8	12.9	0.0
Repurchases/repayments	0.0	0.0	0.0	-0.8	-4.2	-8.5	-26.6
Commercial banks	-25.0	-35.5	-3.5	-3.9	-4.4	-4.8	-5.3
Memorandum items:							
Gross official reserves [3]							
Including crown agents	239.0	116.9	…	…	…	…	…
Excluding crown agents	…	114.0	276.9	407.3	611.5	750.0	845.0
Months of imports [4]	1.3	0.6	1.4	2.1	3.0	3.4	3.7
Current account balance (percent of GDP)							
Excluding official transfers	-21.9	-22.0	-18.8	-15.9	-14.2	-14.1	-13.9
Including official transfers	-6.4	-8.6	-1.8	-2.2	-1.5	-2.3	-2.7
Value of exports (percent change)	32.5	3.7	11.4	9.8	9.0	5.0	4.7
Export price index (2001=100)	177.2	152.0	133.3	133.0	135.4	137.1	141.5
Export volume (percent change)	-3.0	17.8	23.8	10.0	7.0	3.7	1.4
Value of imports (percent change)	45.7	5.0	-3.9	5.9	3.2	5.7	7.0
Import price index (2001=100)	195.7	157.3	171.7	177.4	180.3	182.5	185.0
Import volume (percent change)	14.3	27.9	-10.1	2.5	1.5	4.4	5.6
Nominal GDP(millions of US dollars)	4271.4	5647.2	6192.1	6747.2	7335.9	7899.6	8407.0

Sources: Reserve Bank of Malawi and IMF staff estimates and projections.

[1] Includes estimate for project loans not channeled through the budget.
[2] Excluding SDR allocation.
[3] Figures for 2009 onward take account of Malawi's SDR allocation (SDR 55.4 million).
[4] Months of prospective imports of goods and nonfactor services.

Table 5. Malawi: Millennium Development Goals

Goals	1990	1995	2000	2007
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (%)	80	79	79	80
Employment to population ratio, ages 15-24, total (%)	66	64	64	66
Income share held by lowest 20%	..	..	4.8	..
Malnutrition prevalence, weight for age (% of children under 5)	24.4	..	21.5	18.4
Poverty headcount ratio at national poverty line (% of population)	54.0	..	65.3	..
Prevalence of undernourishment (% of population)	50	40	..	..
Vulnerable employment, total (% of total employment)	..	..	87	..
Goal 2: Achieve universal primary education				
Literacy rate, youth female (% of females ages 15-24)	..	..	71	..
Literacy rate, youth male (% of males ages 15-24)	..	..	82	..
Persistence to last grade of primary, total (% of cohort)	..	..	39	36
Primary completion rate, total (% of relevant age group)	29	53	66	55
Total enrollment, primary (% net)	..	..	99	93
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliament (%)	10	6	8	14
Ratio of female to male enrollments in tertiary education	34	..	37	..
Ratio of female to male primary enrollment	84	..	96	104
Ratio of female to male secondary enrollment	46	..	75	84
Ratio of young literate females to males (% ages 15-24)	..	..	86	..
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	10.5	11.3	..	..
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12-23 months)	81	90	73	*85*
Mortality rate, infant (per 1,000 live births)	131	115	95	*76*
Mortality rate, under-5 (per 1,000)	221	193	155	*120*
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	163	160	140
Births attended by skilled health staff (% of total)	55	..	56	54
Contraceptive prevalence (% of women ages 15-49)	13	22	31	42
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	1,100
Pregnant women receiving prenatal care (%)	90	..	94	92
Unmet need for contraception (% of married women ages 15-49)	36	..	30	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	27	24
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	9	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	28	..
Incidence of tuberculosis (per 100,000 people)	258	390	425	377
Prevalence of HIV, female (% ages 15-24)	..	..	..	8.4
Prevalence of HIV, total (% of population ages 15-49)	..	..	13.3	11.9
Tuberculosis cases detected under DOTS (%)	..	42	44	42
Goal 7: Ensure environmental sustainability				
Annual freshwater withdrawals, total (% of internal resources)	..	..	6.3	..
CO2 emissions (kg per PPP $ of GDP)	0.1	0.1	0.1	..
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	..
Forest area (% of land area)	41	..	38	36
Improved sanitation facilities (% of population with access)	46	51	55	60
Improved water source (% of population with access)	41	52	63	76
Marine protected areas, (% of surface area)	..	..	..	..
Nationally protected areas (% of total land area)	..	..	..	..
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	53	43	38	49
Debt service (Public and Publicly Guarranteed and IMF only, % of exports of G&S, excl. workers' remittances)	28.0	24.4	25.3	8.3
Internet users (per 100 people)	0.0	0.0	0.1	1.0
Mobile phone subscribers (per 100 people)	0.0	0.0	0.4	7.5
Telephone mainlines (per 100 people)	0.3	0.3	0.4	1.3
Other				
Fertility rate, total (births per woman)	6.9	6.6	6.2	5.7
GNI per capita, Atlas method (current US$)	180	160	150	250
GNI, Atlas method (current US$) (billions)	1.7	1.6	1.7	3.5
Gross capital formation (% of GDP)	23.0	17.4	13.6	28.5
Life expectancy at birth, total (years)	49	48	46	48
Literacy rate, adult total (% of people ages 15 and above)	..	..	64	..
Population, total (millions)	9.4	10.1	11.6	13.9
Trade (% of GDP)	57.2	78.5	60.9	40.6

Source: World Development Indicators database.

Table 6. Malawi: Quantitative Targets[1]

	Criteria [2]	Sept. 2009 Stock Actual	Indicative End-Mar 2010 Proj.	End-Jun 2010 Proj.	Indicative End-Sept 2010 Proj.	End-Dec 2010 Proj.
I. Monetary targets (millions of kwacha)						
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	56,577	53,549	52,411	49,674	47,577
2. Ceiling on reserve money [3]	IT	55,326	44,479	52,599	60,806	53,597
II. Fiscal targets (millions of kwacha)						
3. Ceiling on central government's net domestic borrowing [5, 6, 7, 8]	PC	139,251	9,104	-11,730	-10,713	-1,179
4. Floor on social spending [9]	IT	[…]	[…]	[…]	[…]	[…]
III. External targets (US$ millions, unless otherwise indicated)						
5. Floor on net international reserves of the RBM [3, 5, 6]	PC	77	17	76	147	131
6. Ceiling on the accumulation of external payments arrears [7, 10]	PC	0	0	0	0	0
7. Ceiling on new nonconcessional external debt maturing in one year or more[10]	PC	0	0	0	0	0
8. Ceiling on new nonconcessional external debt maturing in less than one year[10]	PC	0	0	0	0	0
9. Foreign exchange queues (percent reduction in stock relative to a starting stock of US$127.6 million as of Nov. 30, 2009)[11]	IT	…	[…]	25	[…]	50
10. Spread between the bank bureau midrate and the official midrate (percent reduction vis-à-vis the spread of 20.7 percent as of Nov. 30, 2009)	IT	…	[…]	25	[…]	50
Memorandum items:						
Net foreign assets of the RBM (US$ millions)		-9	-60	1	74	40
Budget support (US$ millions)		35	180	242	313	365
Budget support (millions of kwacha)		4,932	27,150	36,567	47,305	55,157
Debt service payments to the World Bank and the African Development Bank (US$ millions)		2	3	4	4	5
Debt service payments to the World Bank and African Development Bank (millions of kwacha)		318	470	562	652	746
Sector-Wide Approach (SWAp) receipts (millions of kwacha)		2,028	13,096	15,757	19,004	22,694
Securitization of domestic arrears		0	0	0	0	0
Liquidity reserve requirement (percent)		15.5	15.5	15.5	15.5	15.5
Program exchange rate		…	151	151	151	151

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates.

[1] Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks for all PCs except for the ceiling on the government's net domestic borrowing.

[2] "PC" means Performance Criterion, and "IT" means Indicative Target.

[3] Defined as stocks.

[4] Target is subject to an adjuster for liquidity reserve requirement.

[5] Targets are subject to an adjuster for budget support and debt service payments.

[6] Targets are subject to an adjuster for donor-funded health expenditures.

[7] Defined as a cumulative flow.

[8] Targets are subject to an adjuster for securization of domestic arrears.

[9] Priority social spending as defined and quantified in the authorities' budget.

[10] Evaluated on a continuous basis.

[11] The queue is defined as the amounts of foreign exchange that businesses have applied for—but not yet received—at commercial banks, for legitimate current account transactions.

Table 7. Malawi: Prior Actions and Structural Benchmarks, 2009–10

Prior Actions		
Measure	**Status**	**Macro Rationale**
Issuance of a directive reversing the 20 percent surrender requirement on all exports except tobacco to the RBM and redirecting this foreign exchange to the commercial banks, where it will be converted at the commercial bank rate.	**Met**	To liberalize the foreign exchange market by increasing the role of commercial banks in the foreign exchange market.
Reversal of the requirement to surrender tobacco proceeds to the RBM at the official rate, and to revert to surrendering to the commercial banks to be converted at the commercial bank rate.	**Met**	To liberalize the foreign exchange market by increasing the role of commercial banks in the foreign exchange market.
Enhanced nominal exchange rate flexibility, in the form of an upfront, but gradual adjustment of the exchange rate, coupled with tight fiscal and monetary policies.	**Met**	To move closer to a market-clearing exchange rate and effect a real depreciation of the exchange rate.
Transparent accounting of fertilizer spending in the last two fiscal years.	**Met**	To enhance fiscal transparency and accountability.

Structural Benchmarks		
Measure	**Target date**	**Macro Rationale**
Public finance management		
Make fully operational a Public Financial and Economic Management (PFEM) Unit, in order to follow up on public financial management reforms.	31-Dec-10	To strengthen budget monitoring, and allow rapid reaction to potential expenditure overruns.
Foreign exchange regime		
Develop a time-bound action plan to restart the interbank market in line with TA recommendations from the Norges Bank and the IMF.	30-Jun-10	To improve foreign exchange market efficiency and strengthen growth potential.
Financial sector		
Publish, on a weekly basis, the amount of securities auctioned by the RBM and the results of auctions of securities on the RBM web-page.	30-Jun-10	To enhance the transparency of the domestic financial market.
Cabinet approval of the Financial Sector Development Strategy.	31-Dec-10	To achieve greater financial inclusiveness and improve competitiveness.

Table 8. Malawi: Indicators of Capacity to Repay the Fund, 2009–18

	Projections									
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund obligations based on existing credit										
(SDR millions)										
Principal	0.0	0.5	2.6	5.4	16.7	16.7	15.1	12.9	11.1	0.0
Charges and interest [1]	0.2	0.2	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Fund obligations based on existing and prospective credit [2]										
(SDR millions)										
Principal	0.0	0.5	2.6	5.4	16.7	17.4	18.6	19.3	20.7	10.4
Charges and interest [1]	0.2	0.2	0.4	0.5	0.5	0.4	0.4	0.3	0.3	0.2
Total obligations based on existing and prospective credit										
SDR millions	0.2	0.7	3.1	5.9	17.1	17.8	18.9	19.6	21.0	10.6
US$ millions	0.2	1.0	4.7	8.9	26.2	27.2	28.9	30.0	32.1	16.3
Percent of exports of goods and services	0.0	0.1	0.3	0.6	1.7	1.6	1.7	1.7	1.7	0.8
Percent of debt service	0.8	2.9	12.1	15.6	44.1	46.2	41.7	31.5	29.5	11.8
Percent of quota	0.2	0.9	4.4	8.4	24.7	25.6	27.2	28.3	30.2	15.3
Percent of gross international reserves	0.1	0.2	0.8	1.2	3.1	2.9	2.8	2.7	2.7	1.3
Outstanding Fund credit										
SDR millions	94.8	108.2	121.8	124.5	107.8	90.5	71.9	52.7	31.9	21.5
US$ Millions	145.3	165.4	186.2	190.3	164.9	138.4	110.1	80.6	48.9	32.9
Percent of exports of goods and services	12.2	12.6	12.9	12.6	10.4	8.2	6.4	4.5	2.6	1.7
Percent of debt service	494.3	484.8	479.8	332.5	278.2	235.2	158.5	84.4	44.9	23.8
Percent of quota	136.6	155.9	175.5	179.4	155.4	130.4	103.7	75.9	46.0	31.0
Percent of gross international reserves	52.5	40.6	30.4	25.4	19.5	14.6	10.7	7.3	4.1	2.6
Memorandum items										
Exports of goods and services (US$ millions)	1,195	1,318	1,441	1,512	1,582	1,684	1,727	1,795	1,878	1,987
Debt service (US$ millions)	29	34	39	57	59	59	69	95	109	138
Quota (SDR millions)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Gross international reserves (US$ millions)	277	407	612	750	845	945	1,025	1,105	1,185	1,265
GDP (US$ millions)	5,212	5,647	6,192	6,747	7,336	7,915	8,541	9,215	9,943	10,729

Sources: Malawian authorities and IMF staff estimates.

[1] Reflects exceptional relief of all interest payments on outstanding concessional loans due to the IMF through the end of 2011.

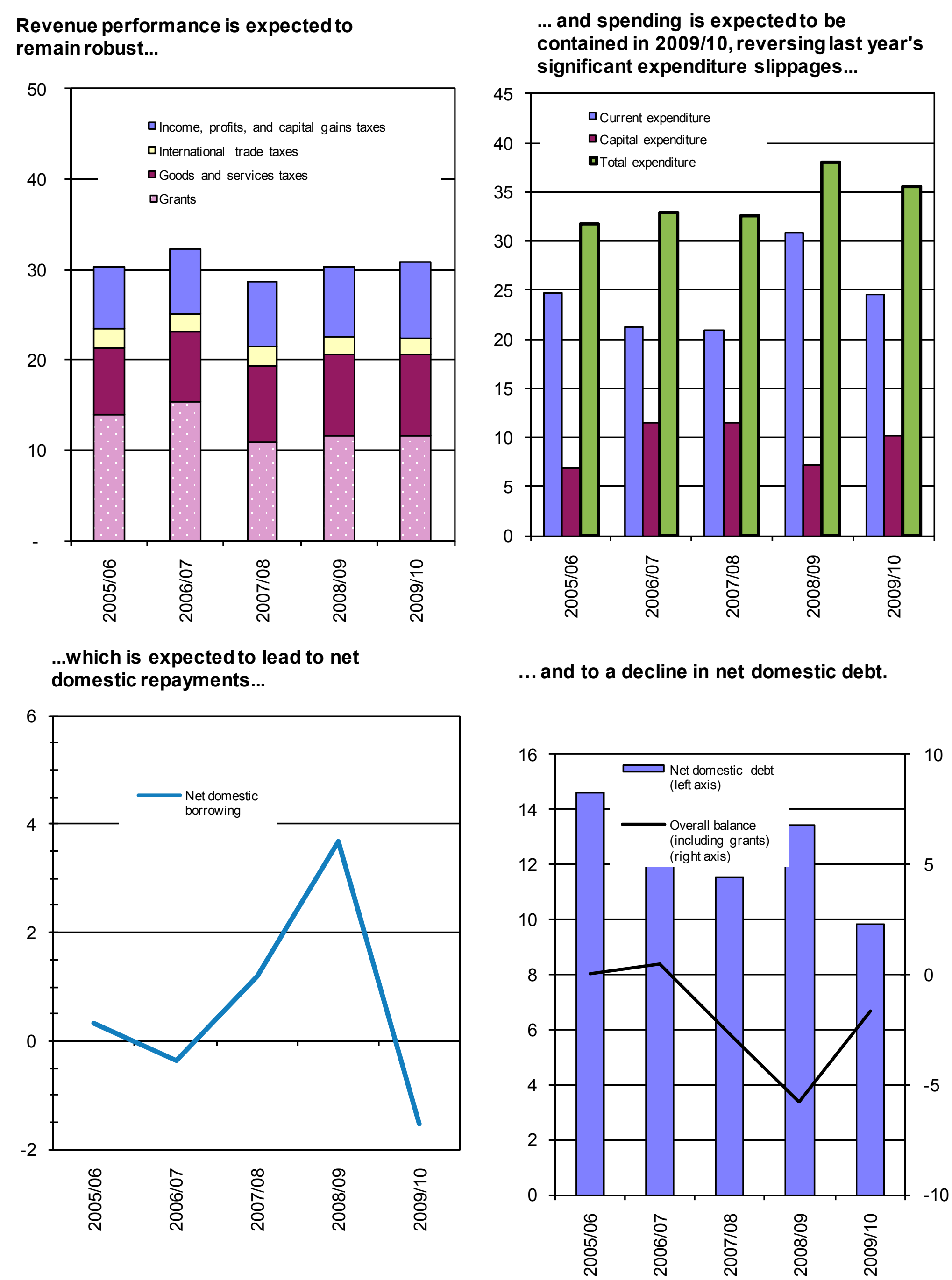
[2] Assumes disbursements as per schedule in Table 9.

Table 9. Malawi: Schedule of Disbursements Under the ECF Arrangement
(SDR millions)

Date	Amount	Conditions Necessary for Disbursement
February 19, 2010	6.94	Executive Board approval of three-year ECF
November 1, 2010	6.94	Completion of first review and observance of end-June 2010 PCs
May 1, 2011	6.94	Completion of second review and observance of end-December 2010 P
November 1, 2011	6.94	Completion of third review and observance of end-June 2011 PCs
May 1, 2012	8.10	Completion of fourth review and observance of end-December 2011 PC
November 1, 2012	8.10	Completion of fifth review and observance of end-June 2012 PCs
February 1, 2013	8.09	Completion of sixth review and observance of end-October 2012 PCs

Sources: IMF staff estimates.

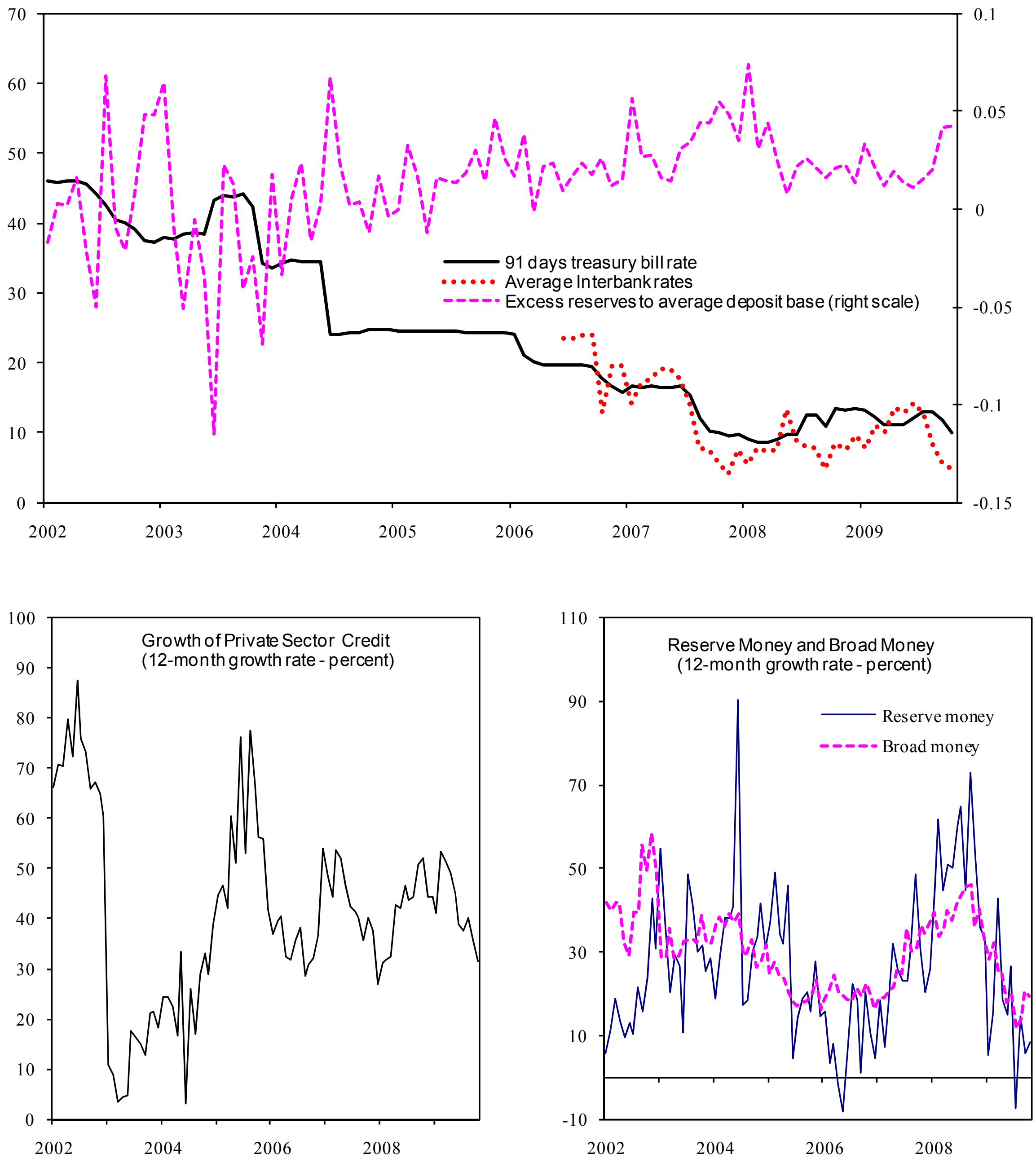
Figure 1. Malawi: Fiscal Developments, 2005/06–2009/10
(Percent of GDP)



Sources : Malawian authorities and IMF staff estimates

Figure 2. Malawi: Monetary Developments, 2002–09

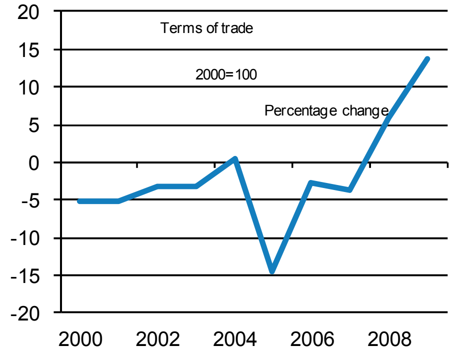
Selected Interest Rates and Excess Reserves to Average Deposit Base
(Percent)



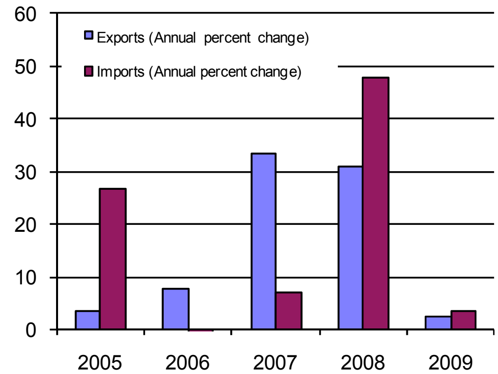
Sources : Malawian authorities and IMF staff estimates.

Figure 3. Malawi: External Developments, 2005–09

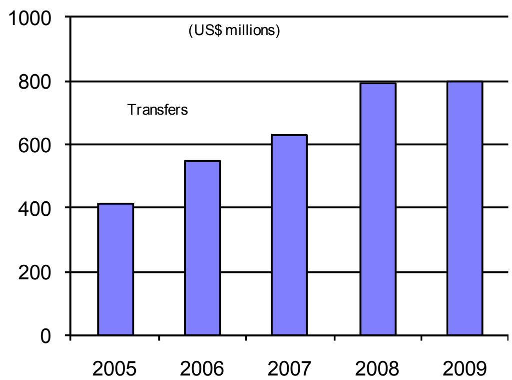
The fall in import prices helped to improve the terms of trade ...



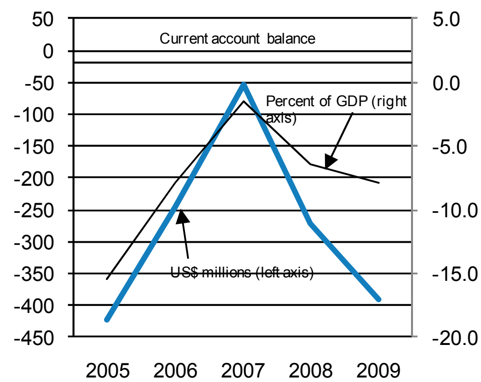
... but import growth tended to outstrip export growth in recent years...



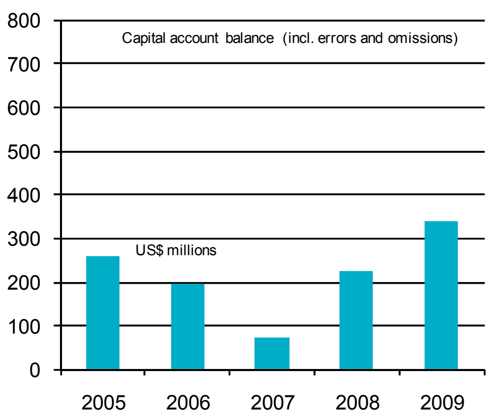
...while official and private transfers have been relatively flat...



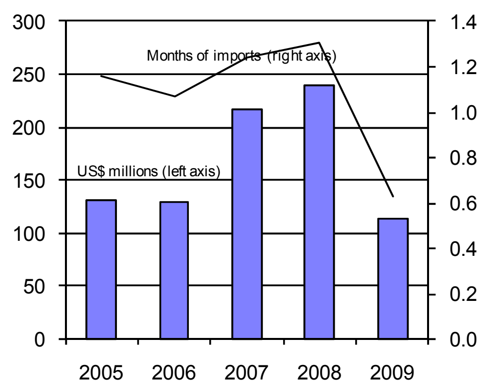
... leading to a widening of the current account deficit...



...Although aggregate capital inflows were buoyed by the SDR allocation ...



... the country experienced a decline in reserves and reserve coverage.



Sources: Malawi authorities and IMF staff estimates.

APPENDIX I.

LETTER OF INTENT

Telegrams: Finance, Lilongwe
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Fax: (265) 01 788384/789173
E-mail:secmof@finance.gov.mw

Ministry of Finance
P.O. Box 30049
Lilongwe 3
MALAWI

MINISTER OF FINANCE

Ref. No. M/F/4/1 26th January, 2010

Mr. D. Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

The Government of Malawi requests continued support from the International Monetary Fund for its economic objectives and policy framework for 2010–12 through a new three-year arrangement under the Extended Credit Facility (ECF). We request access of 75 percent of quota (SDR 52.05 million). This arrangement will support our medium-term reforms to address balance of payments weaknesses and to sustain growth and poverty reduction. Maintaining a close engagement with the Fund will send a positive signal to domestic stakeholders and our development partners, notably concerning our determination to maintain macroeconomic stability and build on the positive economic gains achieved to date.

In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our macroeconornic framework and policy objectives for 2010–12 and the medium term. Our main goal is to provide a consistent and coherent macroeconomic policy framework to underpin our development objectives. In that regard, our programme focuses on preserving macroeconomic stability, while enhancing growth and poverty reduction. Specific emphasis is placed on moving towards a market determined exchange rate and rebuilding international reserves; improving public financial management and monetary and fiscal transparency; and supporting private-sector-led growth.

The MEFP and Technical Memorandum of Understanding (TMU) present quantitative performance criteria, indicative targets, and structural benchmarks through the programme period. We believe that the policies set forth in the MEFP are adequate to achieve the objectives of the programme, but we will take additional measures as needed to reach these goals. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the agreed IMF policies on such consultation.

The Government of Malawi authorizes the IMF to make this letter, the attached MEFP, TMU, and the IMF staff report available to the public, including through the IMF internet website.

Yours sincerely

Ken Kandodo
MINISTER OF FINANCE

Perks Ligoya
GOVERNOR
RESERVE BANK OF MALAWI

Attachments:

– Memorandum on Economic and Financial Policies of the Government of Malawi for 2010–2012

– Technical Memorandum of Understanding

ATTACHMENT I.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES, 2010–12

I. INTRODUCTION

1. **This memorandum summarizes the government of Malawi's economic objectives and policy framework for January 2010–December 2012, for which the government is seeking support from the International Monetary Fund through a three-year arrangement under the Extended Credit Facility (ECF).** The policies described are consistent with Malawi's Growth and Development Strategy (MGDS), which sets out the country's medium-term development priorities.

2. **Our medium-term program builds on the strong economic results achieved since 2005, including under the successfully completed Poverty Reduction and Growth Facility (PRGF) arrangement.** Our economic strategy has emphasized the need for fiscal consolidation, involving both judicious increases in public spending and improvements in revenue performance—hence creating the space for pro-poor and pro-growth spending. This strategy has been designed to correct the severe macroeconomic imbalances that existed prior to 2005, when weak program implementation led to large fiscal slippages, an unsustainable domestic debt spiral, and low investment.

3. **Our strengthened policy implementation has supported macroeconomic stability, reduced domestic debt and interest rates, and built overall credibility**. Reflecting these improvements, Malawi has benefited from external debt relief and increased inflows of aid. Growth has been impressive, averaging 6.8 percent for 2004–08, and inflation has come down to below 10 percent. Higher revenues and aid, and lower interest payments on the public debt have translated into higher poverty-reducing and social expenditures. We have made progress toward many of the Millennium Development Goals (MDGs).

4. **Recent gains notwithstanding, Malawi continues to face important development challenges.** Despite recent progress, poverty reduction and food security remain pressing concerns, as the economy is still heavily dependent on drought-prone agriculture. In addition, at about one month of prospective imports, international reserves remain low, especially considering Malawi's vulnerabilities. Meanwhile, implementing the MGDS will require increases in public investment and spending in areas such as health and education. To address these and other challenges over the long term, Malawi will continue to rely heavily on external support through grants and highly concessional financial assistance.

II. Recent Developments

5. **Malawi's growth has accelerated while inflation has moderated in recent years.** Output in 2008 is estimated to have reached 9.8 percent, driven by a record-high tobacco harvest and rapid expansion in maize and services. Growth in 2009 is estimated to have remained robust, reflecting strong tobacco and maize crops, the start of uranium production, and expanding wholesale and retail trade. Production of maize has benefited from favorable rainfall and the government's subsidized distribution of fertilizer to smallholder farmers. Inflation has trended downward during 2009, reflecting moderation in food and fuel prices and reduced monetary expansion.

6. **The fiscal year 2008/09 budget targets were missed by a wide margin, owing to difficulties in containing spending on the fertilizer subsidy program coupled with expenditure overruns on goods and services**. Overspending on fertilizer, sold to farmers at subsidized prices, reflected a combination of high fertilizer prices in mid-2008, at the time of the government's planned purchases, and an additional unbudgeted purchase later in the year. Efforts are now being made to strengthen budget control and improve the targeting of the fertilizer program.

7. **The combination of high spending with a shortfall in foreign financing led to rapid credit expansion to the government and contributed to higher than targeted growth in reserve money.** Large injections by the government in the first quarter of the fiscal year led to high market liquidity. However, reserve money growth has since moderated, with the 12-month change in reserve money declining significantly from the beginning to end of 2009. Moreover, with expected donor inflows, we expect a repayment of domestic borrowing in fiscal year 2009/10.

8. **We have moved forward with our structural reform agenda.** Public administration is being strengthened, supported by a Public Financial and Economic Management (PFEM) unit in the Ministry of Finance, which is charged with coordinating reforms in this area and updating the public financial management action plan. In line with this plan, we have strengthened control over the wage bill and utility payments, and implemented the Integrated Financial Management Information System (IFMIS) to improve control over expenditures more generally. The Ministry of Finance has also made significant improvements in statistical classification and presentation of the budget, including on a functional basis, which will allow for more accurate tracking of trends in key social welfare spending and coherence of spending with the MGDS goals. In addition, a cash management unit at the Accountant General's Office has been formed to enhance the government's capacity for cash flow planning. The most recent Public Finance Management Assessment for Malawi, based on the Public Expenditure and Financial Accountability (PEFA) framework, concluded that our public financial management has substantially improved over the past three years and compares favorably to our neighbors. We have also issued a debt management strategy, and cleared the 2004 stock of arrears. Finally, the capacity in the offices of the Accountant General and Auditor General have been enhanced, with the support of our development partners, and

substantial progress has been made in reducing the backlog in the submission of annual accounts by the Accountant General to the National Audit Office and to Parliament.

9. **We have also made progress in establishing credit reference bureaus, which will over time help to lower high lending spreads.** Information disclosure clauses have been introduced in commercial bank lending contracts and a Credit Reference Bureau Bill, providing the legal and regulatory framework for the sharing of credit information, has been finalized and is awaiting Parliamentary approval. This should help establish functioning credit bureaus and bring down the cost of lending by lowering the risks and promoting competition among banks through easier identification of sound borrowers.

10. **We have also made improvements in bank supervision and regulations. The Reserve Bank of Malawi** (RBM) adopted a risk-based supervision approach to examining bank performance in January 2009, and is in the process of establishing Basel II governance structures and committees. For the time being the assessment of banks will still be based on CAMEL, with the risk-based assessment run in parallel with CAMEL. Following this change, the RBM will be able to assess more effectively all risks banks undertake in addition to credit risk, as was emphasized in the CAMEL method. Moreover, the RBM continues to assess the quality of bank loans during on-site and off-site examinations. Whenever a bank is found to be under-provisioning, the RBM directs it to make additional provisions. Related to this, the RBM is revising its Asset Classification Directive to take into account new developments such as International Accounting Standards.

11. **The amendments to the Banking Act and the Insurance Act were recently approved while the Financial Services Bill will be tabled during the next sitting of Parliament in February 2010. These are designed to empower the RBM to actively regulate and supervise Malawi's financial sector**. The Banking Act and the Financial Services Bill: (i) extend fit and proper requirements beyond the board and executive management to include shareholders; (ii) enhance enforcement powers of the RBM and outlines corrective actions and remedial measures to be undertaken by the RBM to resolve problems in the banks; (iii) empower the RBM to prescribe higher ongoing capital than the required minimum depending on an individual bank's risk profile; (iv) empower the RBM to require external auditors to present their findings prior to publishing the annual accounts; and (v) empower the RBM to carry out consolidated supervision of the financial sector. The RBM has also taken a number of steps to improve its capacity to examine transactions related to anti-money-laundering and combating of financing of terrorism. The Money Laundering and Proceeds of Serious Crimes Terrorist Financing Law was enacted in 2006 and took effect in 2007, and the RBM has introduced anti-money laundering examinations, with a key focus on compliance with Know Your Customer (KYC) principles. A Financial Intelligence Unit (FIU) was established in 2007 and is working closely with the RBM and law enforcement agencies on matters pertaining to AML-CFT.

12. **The RBM has also strengthened its liquidity forecasting capabilities**. The liquidity forecasting framework, designed with the assistance of the Norges Bank and the Fund, is now

fully operational and is used daily by the Treasury Department to assess liquidity conditions and prospects and smooth liquidity management on an ongoing basis. RBM has also replaced bilateral repos with repos sold through auctions, in the interest of greater transparency and with a view to enhancing financial market development.

III. SUSTAINING GROWTH AND POVERTY REDUCTION WHILE ENHANCING COMPETITIVENESS

13. **Our medium-term strategy—set out in the MGDS—is directed at boosting growth and reducing poverty.** Key objectives include private sector-led development, diversification of economic activities, and empowerment of the poor through a sound economic environment, high-quality public service, effective institutions and the rule of law, and zero tolerance for corruption.

14. **Our medium-term program, for which we seek ECF support, aims to provide a consistent and coherent economic policy framework to underpin our development objectives.** The program focuses on enhancing the sustainability of growth and development through policies that consolidate economic stability, reinforce resilience to shocks, further improve public financial management, and support private-sector-led growth.

15. **The program's key medium-term objectives include:**

- Increasing and maintaining sustainable growth over the medium term and reducing poverty within a stable macroeconomic environment and consistent with Malawi's MGDS and MDGs.
- Increasing foreign reserves coverage to three months of imports. We view this as the minimum desirable level, given Malawi's vulnerability to weather, terms of trade, and aid shocks and the large seasonal volatility in trade flows.
- Reducing government net domestic debt. This will support the planned increase in reserves and lower further the share of public expenditures devoted to debt service.
- Establishing, by end-2011, a liberalized foreign exchange regime for current account transactions consistent with our obligations under Article VIII of the International Monetary Fund's Articles of Agreement, which we accepted in 1995, and making substantial progress in this regard during 2010.
- Re-activating the interbank foreign exchange market.
- Making progress toward and achieving a market-clearing exchange rate that supports the accumulation of reserves and a stable macroeconomic environment.
- Promoting internal equilibrium by pursuing prudent fiscal and monetary policies, designed to contain aggregate demand pressures and limit the pass-through of exchange rate changes to prices of nontradeables.

- Continuing reforms in public financial management and tax administration, designed to enhance capacity and strengthen both expenditure control and revenue performance;
- Pursuing wide ranging reforms to deepen the financial sector and promote greater financial inclusion; and
- Improving the business climate through improvements in infrastructure and regulatory reform.

Outlook for growth and inflation

16. **Our goal is to increase growth over the medium term in order to reduce poverty levels and facilitate attainment of the MDGs.** Our macroeconomic and structural reform program will help lay the groundwork, with growth expected to average 8 percent during the ECF-supported program. An expansion in private activity beyond the agricultural sector, complemented by public investment in infrastructure, the opening of the Kayelekera uranium mine in 2009, and development of further mining opportunities will help to underpin growth. Inflation is expected to stabilize at 6-7 percent over the medium term, reflecting prudent fiscal and monetary policies and a strengthened capacity to respond to exogenous shocks.

Medium term fiscal policies

17. **The government intends to preserve the gains from HIPC debt relief by sustaining sound fiscal management over the medium term.** We will adhere to a prudent fiscal policy of modest overall budget deficits, financed by foreign borrowing, leaving room to expand credit to the private sector (see MEFP ¶26). We aim to strengthen the tax revenue to GDP ratio by around ½ percent of GDP per year until fiscal year 2014/15, mainly by broadening of the base of the value added and income taxes (including through improved compliance), while still leaving room to lower the value added tax rate and international trade taxes to regional norms. In this regard, the government intends to target a domestic borrowing repayment of around 1 to 1.5 percent of GDP and a modest overall deficit in the fiscal year 2010/11 budget, while incorporating measures to strengthen public services in education and health care through hiring of qualified personnel in these areas, and improving targeting of the social safety net. The government also stands ready to undertake budgetary adjustments this year, either through a reduction in lower priority expenditures or a shoring up of revenues, while preserving budgeted social and poverty-reducing spending, to ensure that the domestic repayment target is met.

18. **The government will aim to reduce the risks to the budget posed by growing implicit and explicit contingent liabilities resulting from the activities of parastatals and by rationalizing expenditures.** It will seek to establish a clear regulatory regime for public utilities infrastructure—namely, the Electricity Supply Corporation of Malawi, Ltd. (ESCOM) and the Malawi regional Water Boards—that covers operating costs and avoids the need for budgetary transfers and that minimizes recourse to commercial bank borrowing. In this regard, the government has already increased electricity tariffs by 36 percent as of

December 1, 2009, and will increase them by a further 20 percent in December 2010, with additional adjustments expected over the subsequent two years. It has also been announced that water tariffs will increase by 12.5 percent. These actions are designed to set the stage for these utilities to invest in needed capital infrastructure to improve the quality, availability, and reliability of their service delivery, with a view to supporting the expansion of manufacturing and other economic activities. In addition, the government will seek to restructure Air Malawi's debts and absorb the costs of the presidential jet and any transfers to parastatals or productive sectors, without allowing this spending to crowd out social and other priorities in the government budget.

Monetary policy

19. **Monetary policy in the medium term will be geared toward achieving price stability, while providing room for sufficient credit to the private sector and supporting reserve accumulation and a properly valued exchange rate.** Reserve money will be the nominal anchor. To help manage domestic demand, reserve money is programmed to grow at about the pace of GDP to help contain inflation and limit the pass-through effects of exchange rate adjustment to nontradeables' prices (see MEFP ¶26). Reserve money is targeted to grow by about 16 percent in 2010 (about the same as projected nominal GDP growth). The RBM will continue to develop its instruments of indirect monetary control and strengthen its ability to implement monetary policy through changes in interest rates.

Exchange rate policies

20. **Exchange rate policies are geared toward liberalizing the foreign exchange regime and achieving a market-based exchange rate.** In addition to an initial depreciation of the currency prior to the commencement of the ECF-supported program, we are committed to undertaking further policy adjustments, including of the exchange rate, to support foreign exchange market liberalization, eliminate excess demand for foreign exchange, and achieve a market-based and competitive exchange rate (see MEFP ¶26–27).

21. **To support the reduction of foreign exchange shortages and multiple currency practices, we have already put in place a number of reforms to the foreign exchange regime.** The RBM has implemented the Foreign Exchange Statistical Database System (FESDS) with a view to improving efficiency in mobilization and tracking of foreign exchange proceeds from the country's exports. In addition, the RBM has recently reversed measures that had required tobacco farmers without FCDAs to surrender export earnings directly to the RBM at the official exchange rate, and tobacco exporters with FCDAs and exporters of other traditional products to surrender 20 percent of their receipts to the RBM at the official rate, and 20 percent to the commercial banks at the commercial bank rate. The requirements on tobacco and traditional exporters are now to surrender the required foreign exchange receipts from exports to the commercial banks for conversion at the bank rate. The government will also allow foreign exchange bureaus to operate when they meet specified fit and proper tests.

22. **Over the medium term, the RBM will modernize its exchange rate and monetary policy frameworks.** This will entail a further strengthening of the domestic credit, foreign exchange, and interbank markets, as well as RBM policies and instruments to regulate, supervise, and influence these markets. Enhanced transparency will be an essential element of this strategy. Our goal is to establish the framework for market-oriented monetary and foreign exchange instruments and operations that support economic growth and diversification, including building capacity of market participants to manage exchange rate risk. Technical assistance for these reforms will be provided by the Fund, the Norges Bank and other key development partners.

Other structural policies

23. **The government intends to accelerate the pace of its structural reforms in public expenditure management**, with a view to producing timely, consolidated and reconciled accounts, with continued technical assistance from the Fund. We will also seek to strengthen external audit and procurement capabilities in order to further bolster accountability and governance.

24. **The government will continue its efforts to create an enabling environment for private investment and growth**. It will focus public investments on improving the educational and health care systems, utilities, transportation, and communications infrastructure; strengthen the regulatory environment, cut cumbersome business regulations and those that impair the efficient functioning of the labor market; and roll back the role of the public sector in areas that the private sector should dominate.

25. **The government has recently formulated a draft Financial Sector Development Strategy, which is currently being presented to stakeholders.** At the end of the consultative process, the strategy and action plan will be presented to and discussed by Cabinet for approval. The strategy is currently comprised of two stages, namely:

- *The attainment of inclusive finance for growth*, which will encompass the following three pillars: (a) the alignment of the domestic financial system with key growth sectors, (b) financial inclusion, including by expanding the provision of financial services to the rural economy and minimizing existing market distortions and (c) creating a conducive business environment—including by upgrading the legal and regulatory framework for the financial sector in line with recommendations of the recent FSAP and strengthening financial sector oversight through modernization and the RBM (the latter will be supported by the recent Parliamentary approval of the Banking Act and the impending approval of the Financial Services Bill).

- *Financial deepening and competitiveness*, comprised of efforts to strengthen capital market development—in part, through the creation of domestic infrastructure/project finance funds, the development of housing finance products, the creation of a regulatory framework for the bond market, and organizational strengthening of the Malawi Stock Exchange.

III. PROGRAM MONITORING

26. **Program implementation will be monitored according to the following performance criteria and benchmarks, with definitions as set out in the accompanying Technical Memorandum of Understanding (TMU).** Over the three years of the ECF-supported program, semi-annual performance criteria will be set on net domestic assets and net international reserves of the Reserve Bank, and on net domestic borrowing of the central government and an indicative target on reserve money (Table 1). In addition, there will be an indicative target for a floor on social spending, so that this spending does not fall below budgeted levels. There will also be continuous performance criteria on nonaccumulation of government external payment arrears and of no new contracting and guaranteeing of short-term and medium-term nonconcessional external debt. The program will have semi-annual reviews. The first review will be completed by November 20, 2010 and the second review by May 20, 2011.

27. **The ECF-supported program will include monitoring with regard to excess demand for foreign exchange.** There will be a continuous performance criterion on no intensification of restrictions under Article VIII of the Fund's Articles of Agreement. To gauge progress in eliminating practices that have created multiple exchange rates in the market and foreign exchange queues, the RBM will measure, jointly with Fund staff, on a monthly basis, three indicators**:** (i) the reduction in the size of commercial banks' reported queues for foreign exchange; and (ii) the reduction in the gaps in exchange rates between the official and foreign exchange bureau rates, both indicative targets, and (iii) reserve levels, a performance criterion, to be covered by the semi-annual program reviews.

28. **To strengthen the underpinnings of growth, the program will also contain structural benchmarks in three key areas for the first year and longer-term benchmarks.** To ensure greater efficiency in the public sector, the authorities will make fully operational a PFEM unit. To improve the foreign exchange regime, the authorities will develop a time-bound action plan to restart the interbank foreign exchange market. Finally, to strengthen the financial sector, the authorities will secure Cabinet approval of the Financial Sector Development Strategy and increase monetary policy transparency. Targets will be set for end-June and end-December 2010. Over the longer-term, the authorities will improve transparency and solvency of public utilities.

ATTACHMENT II.

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

I. INTRODUCTION

1. This memorandum sets out the understandings between the Malawian authorities and the International Monetary Fund regarding the definitions of quantitative performance criteria, benchmarks, and indicative targets for the program supported by the ECF arrangement, as well as the related reporting requirements.

2. **Coverage**: The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the System of National Accounts 1993 (SNA 1993) and Government Finance Statistics Manual 2001 (GFSM 2001) standards, nonprofit institutions that are controlled and financed by the central government are excluded for purposes of this memorandum. The accounts of the monetary authorities include those of the Reserve Bank of Malawi (RBM) and the central government's holdings of international reserves. Monetary aggregates under the program are based on the eight-bank monetary survey.

II. QUANTITATIVE PERFORMANCE CRITERIA: DEFINITIONS AND DATA SOURCES

A. Reform of the Foreign Exchange Regime

3. **Easing of foreign exchange surrender requirements to the RBM**: The current regulations require that all exporters should surrender 40 percent of proceeds to the banking system. Tobacco exporters may retain 60 percent of export proceeds in Foreign Currency Deposit Accounts (FCDAs) and surrender 40 percent of proceeds to commercial banks at the commercial bank rate. Tobacco exporters without FCDAs must surrender 100 percent of proceeds to the commercial banks at the commercial bank rate. The RBM will refrain from rationing foreign exchange, and have certified that all private external payment arrears are cleared as of January 25, 2010 and will avoid interfering in foreign exchange markets that result in private sector external arrears on a continuous basis during the program period.

B. Floor on Net International Reserves of the RBM

4. **Definition of net international reserves (NIR) of the RBM:** The NIR of the RBM is defined as gross reserves minus IMF and other short-term liabilities. The values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the program cross exchange rates for the various currencies and then converted into kwacha using the program exchange rate for the U.S. dollar–kwacha exchange rate.

5. **Gross reserve assets of the RBM** are defined in the International Reserve and Foreign Currency Liquidity Guidelines for a Data Template as external assets immediately available and controlled by RBM "for direct financing of payments imbalances, for indirectly

regulating the magnitudes of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes” (*BPM5,* para. 424).

6. **This concept includes the following**: (1) monetary gold holdings of the RBM; (2) holdings of SDRs; (3) the reserve position in the IMF; (4) central government (treasury) holdings with crown agents; and, (5) foreign convertible currency holdings; (6) deposits held in foreign central banks, the Bank for International Settlements, and other banks; (7) loans to foreign banks redeemable upon demand; (8) foreign securities; and (9) other unpledged convertible liquid claims on nonresidents. It excludes the following: (1) any foreign currency claims on residents; (2) capital subscriptions in international institutions; (3) foreign assets in nonconvertible currencies; (4) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (5) gross reserves that are in any way encumbered or pledged, including, but not limited to, (i) assets blocked when used as collateral for third party loans and third-party payments, pledged to investors as a condition for investing in domestic securities, and (ii) assets lent by RBM to third parties which are not available prior to maturity, and are not marketable (including the outstanding balance of the loan to Zimbabwe).

7. **Gross reserve liabilities of the RBM** are defined as the sum of the following: (1) SDR allocations; (2) outstanding medium and short-term liabilities of the RBM to the IMF; and (2) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year.

8. **As under the latest accounting guidelines (*BPM6*)**, NIR has increased with the 2009 allocation of SDRs, which is treated as a long-term foreign exchange liability of Malawi to the SDR Department of the IMF, instead of a debt liability or shares and equity, as in the Monetary and Financial Statistics Manual (*MFSM*). The SDR allocation does not affect net foreign assets (NFA), because it increases both gross foreign assets and long-term liabilities.

9. **Adjustment clause on NIR—budget support**: The floor on the NIR of the RBM will be adjusted upward by the full amount by which the cumulative receipts from the budget support are greater than US$30 million above the program baseline (see Table 1). The floor on NIR of the RBM will be adjusted downward by the full amount up to a maximum of US$10 million by which the cumulative receipts from budget support are less than the program baseline. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

10. **Definition of budget support**: Budget support includes all grants and foreign financing that is not directly linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union and loan financing from the IMF, and donor inflows

(in kwacha) from the U.S. dollar–denominated donor pool account for the health sector-wide approach (SWAp) and National AIDS Commission held in the Malawi banking system.

11. **Adjustment clause on NIR—donor pool account for the health SWAp account:** The floor on the NIR of the RBM will be adjusted downward by the full amount by which the donor inflows (in kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system is smaller than the donor inflow (in kwacha) to those accounts in the program baseline. The downward adjustment will be capped at US$10 million. Donor inflows for the SWAp account are measured as the receipts received (in kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

12. **Adjustment clause on NIR—debt service payments**: The floor on NIR of the RBM will be adjusted upward (downward) by the full cumulative amount by which debt service payments to the World Bank and the ADB fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

13. The total downward adjustment to NIR from a shortfall of (1) budget support and (2) donor inflows to the donor pool account for the health SWAp account relative to program assumptions and (3) an excess of debt service payments relative to the program assumption will be capped at $10 million.

14. For purposes of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars using the above defined program exchange rates.

15. Data on NIR, including its components, will be reported by the RBM on a weekly and end-month basis.

C. Ceiling on the Net Domestic Assets of the Reserve Bank of Malawi

16. **Definition of net domestic assets (NDA) of the RBM**: NDA of the RBM are defined in kwacha terms as end quarter reserve money less NFA of the RBM at the program exchange rate. Reserve money consists of currency issued by the RBM and balances of commercial banks' accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM. The NDA program ceilings are the indicative money targets defined below less the NFA of the RBM.

17. **Definition of NFA of the RBM:** The NFA of the RBM are defined as the above defined NIR plus other foreign assets of the RBM—including but not limited to (1) capital subscriptions in international institutions; (2) foreign assets in nonconvertible currencies; and (3) gross reserves that are in any way encumbered or pledged, less any medium- and long-term foreign liabilities of the RBM.

18. **Adjustment clause on NDA—budget support**: The ceiling on NDA of the RBM will be adjusted downward by the full amount by which the cumulative flow of receipts from budget support are greater than US$30 million above the program baseline. The ceiling on NDA of the RBM will be adjusted upward by the full amount up to a maximum of US$10 million by which the cumulative receipts from the budget support are less than the program baseline. The kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

19. **Adjustment clause on NDA—donor pool account for the health SWAp account:** The ceiling on NDA of the RBM will be adjusted upward by the full amount by which the donor inflows (in kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system is smaller than the donor inflow (in kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$10 million. Donor inflows for the SWAp account are measured as the receipts received (in kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

20. **Adjustment clause on NDA—debt service payments**: The ceiling on NDA of the RBM will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the African Development Bank falls short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

21. The total upward adjustment to NDA from a shortfall of (1) donor inflows to the donor pool account for the health SWAp account relative to the program assumptions and (2) an excess of debt service payments relative to the program assumption will be capped at US$10 million.

22. **Adjustment clause on NDA—liquidity reserve requirement**: The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio, and will be adjusted upward for an increase in the ratio. The adjustment will be spread equally over two quarters, starting in the quarter in which the reserve requirement ratio is reduced. The adjuster will be calculated as follows: (one minus the existing required percentage of reserve assets held at the discount houses) multiplied by (the program baseline required reserve ratio minus the new required reserve ratio) multiplied by (the amount of average reservable deposit liabilities in commercial banks during the last month prior to the change in regulation).

D. Ceiling on Central Government Net Domestic Borrowing (CGDB)

23. **Definition of CGDB**: CGDB is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, and holdings of treasury bills minus deposits); (ii) net borrowing from

commercial banks[1] (including advances, holdings of local registered stocks, and holdings of treasury bills minus deposits); (iii) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB since June 30, 2009, including promissory notes and securities transferred to the RBM from the Treasury since the beginning of the fiscal year.

24. **Definition of domestic arrears**: Domestic arrears are overdue payment obligations of the central government other than external payment arrears, including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, and tax refunds. Payments on wages and salaries, pensions, transfers, court-established obligations, and compensations are in arrears when they remain unpaid for more than 30 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made within 90 days of the date of invoice, or—if a grace period has been agreed—within the contractually agreed grace period.

25. **Adjustment clause on CGDB—budget support**: The ceiling of CGDB will be adjusted downward (upward) by the full amount by which cumulative kwacha receipts from budget support are greater (less) than the program baseline. The upward adjustment will be capped at US$20 million. In the event of excess budget support, the ceiling on CGDB will be adjusted by the full amount less US$30 million. The kwacha value of the cumulative shortfall/excess will be converted at the corresponding monthly average of the RBM mid rate. Cumulative receipts will be measured from the beginning of the fiscal year.

26. **Adjustment clause on CGDB—donor pool account for the health SWAp account:** The ceiling on CGDB will be adjusted upward by the full amount by which the donor inflows (in kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system are smaller than the donor inflows (in kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$20 million. Donor inflows for the SWAp account are measured as receipts received (in kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

27. **Adjustment clause on CGDB—debt service payments**: The ceiling on CGDB will be adjusted downward (upward) by the full cumulative amount by which debt service payments to the World Bank and the ADB fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year.

[1] Includes all commercial banks in Malawi—and in particular the Malawi Savings Bank—not just the banks covered by the eight-bank monetary survey.

28. **The total upward adjustment to CGDB** from a shortfall of (1) budget support and (2) donor inflows to the donor pool account for the health SWAp account relative to the program assumptions and (3) an excess of debt service payments relative to the program assumption will be capped at US$30 million for permanent shortfalls.

29. **Adjustment clause on CGDB—securitization of arrears**: The ceiling on CGDB will be adjusted upward by the full cumulative amount by which pre-2005 domestic arrears are securitized from the beginning of the fiscal year.

E. Ceiling on External Payment Arrears

30. **Definition of external payment arrears**: External payment arrears consist of debt-service obligations (principal and interest) of the government or the RBM to nonresidents that have not been paid at the time they are due, as specified in contractual agreements, except on external debt subject to rescheduling or restructuring. This performance criterion will be monitored on a continuous basis.

F. Ceiling on Nonconcessional External Debt

31. **Definition of nonconcessional external debt**: The definition of debt, for the purpose of the limit, is set out in Executive Board Decisions No. 6230-(79/140) August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; 12274–(00/85) August 24, 2000; and 14416-(09/91), August 31, 2009. For program purposes, short- and medium- and long-term debt is nonconcessional if it includes a grant element of less than 35 percent, as indicated in Decision No. 11248-(96/38), April 15, 1996. The ceiling on nonconcessional debt applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government or the RBM on debt with nonresidents. This performance criterion is monitored on a continuous basis. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

32. **Short-term debt**: Outstanding stock of debt with an original maturity of one year or less.

33. **Medium- and long-term debt**: Outstanding stock of debt with a maturity of more than one year.

34. **Excluded from the limit** is the use of IMF resources, and any kwacha-denominated treasury bill and local registered stock holdings by nonresidents. Excluded from the limit are also (i) debts classified as international reserve liabilities of the RBM; (ii) new debt issued to restructure, refinance, or repay existing debt up to the amount actually used for the above-mentioned purposes; (iii) normal import financing; and (iv) arrangements to pay over time obligations arising from judicial awards to external creditors. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

III. Quantitative Indicative Targets and Structural Benchmarks

A. Ceiling on Reserve Money

35. **Definition of reserve money**: Reserve money is defined as the sum of currency issued by the RBM, including the vault cash of commercial banks, and balances of commercial bank accounts with the RBM. It includes required reserves held for kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM. The reserve money targets are the projected end-quarter values starting with end-March 2010 to end-December 2012.

36. **Definition of foreign exchange queue for program monitoring**: The foreign exchange queue is defined as the value of foreign exchange applications filed with commercial banks that have not yet been satisfied, for bona fide current account transactions, and it will be assessed as a percentage reduction from its end-November 2009 level of US$127.6 million. Measurement of foreign exchange queues will draw on commercial banks' reporting to the RBM on the effective foreign exchange demands they face (e.g., excluding demands that have been met, have lapsed, or are not matched by kwacha that clients could make available at the time the exchange will be transacted). Reduction in queues will be assessed for each test date against the end-November 2009 measure, which comprises unmet foreign exchange demands placed with banks from August 1, 2009 to end-November 2009. Foreign exchange demands will reflect still outstanding requests for immediate and forward delivery by the test date that cannot be met because of insufficient foreign exchange supplies. The stock will include applications with commercial banks, both by corporate and noncorporate entities, and for current but not capital transactions, following standard Fund definitions for these terms. The RBM will, to the extent possible, eliminate duplicate unmet requests for foreign exchange (i.e., the same request placed with more than one bank); however, recognizing that full elimination of duplication may be infeasible, monitoring will focus on the change from the initial stock rather than the absolute level of the queue at the test dates. The queues will be measured on the last day of the month and will be based on demands up to the third to last day of each month, to take into account a normal trading period for filling requests of two to three days.

37. **Spread between the bank bureau midrate and the official midrate:** This spread is defined as the difference between the bank bureau mid-rate for U.S. dollar cash-based buying and selling transactions and the official midrate at the day's fixing, expressed as a percentage of the official midrate. The reduction in the spread will be assessed against the end-November 2009 measure of the spread of 22.2 percent.

G. Floor on Social Spending

38. **Definition of social spending**: Social spending is computed as the sum of central government spending on health, education and the fertilizer subsidy as articulated in the central government budget for a particular fiscal year. In order to maintain Malawi's

commitment and progress towards poverty reduction and the MDGs, the social spending allocations in the government budget will not be adjusted downward to meet fiscal targets of the program.

IV. Reporting of Certain Transactions in the Fiscal Accounts

39. **Donor pool–funded expenditures in support of the health SWAp**: The Government of Malawi has embarked on an integrated program of service delivery in the health sector, the health sector-wide approach (health SWAp). In support of the health SWAp some donors are pooling resources (the donor pool), and release these resources through normal government procedures (i.e., recurrent budget or development Part II budget) to the health sector. In order to manage the inflows of donor resources a U.S. dollar-denominated account has been set up at the RBM that holds donor pool resources until expenditures need to be financed. Financial flows into and out of this account will be reported on a monthly basis from the beginning of the fiscal year.

40. **Fertilizer subsidy program**: The government has embarked on a program of subsidizing agricultural inputs, in particular, fertilizer, to smallholder farmers to improve agricultural production, financed by the budget. The spending on the fertilizer subsidy program will be reported quarterly from the beginning of the fiscal year, and a prior action for the ECF-supported program, will be a transparent accounting on execution of the budget for fiscal year 2008/09 and of the budgeted figures for fiscal year 2009/10, which was met.

V. Reporting Requirements

41. Monitoring of the program requires that the information listed in Tables 1-4 below be reported to the IMF within the timeframe indicated.

Table 1. Malawi: Quantitative Targets[1]

	Criteria [2]	Sept. 2009 Stock Actual	Indicative End-Mar 2010 Proj.	End-Jun 2010 Proj.	Indicative End-Sept 2010 Proj.	End-Dec 2010 Proj.
I. Monetary targets (millions of kwacha)						
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	56,577	53,549	52,411	49,674	47,577
2. Ceiling on reserve money [3]	IT	55,326	44,479	52,599	60,806	53,597
II. Fiscal targets (millions of kwacha)						
3. Ceiling on central government's net domestic borrowing [5, 6, 7, 8]	PC	139,251	9,104	-11,730	-10,713	-1,179
4. Floor on social spending [9]	IT	[…]	[…]	[…]	[…]	[…]
III. External targets (US$ millions, unless otherwise indicated)						
5. Floor on net international reserves of the RBM [3, 5, 6]	PC	77	17	76	147	131
6. Ceiling on the accumulation of external payments arrears [7, 10]	PC	0	0	0	0	0
7. Ceiling on new nonconcessional external debt maturing in one year or more [10]	PC	0	0	0	0	0
8. Ceiling on new nonconcessional external debt maturing in less than one year [10]	PC	0	0	0	0	0
9. Foreign exchange queues (percent reduction in stock relative to a starting stock of US$127.6 million as of Nov. 30, 2009) [11]	IT	…	[…]	25	[…]	50
10. Spread between the bank bureau midrate and the official midrate (percent reduction vis-à-vis the spread of 20.7 percent as of Nov. 30, 2009)	IT	…	[…]	25	[…]	50
Memorandum items:						
Net foreign assets of the RBM (US$ millions)		-9	-60	1	74	40
Budget support (US$ millions)		35	180	242	313	365
Budget support (millions of kwacha)		4,932	27,150	36,567	47,305	55,157
Debt service payments to the World Bank and the African Development Bank (US$ millions)		2	3	4	4	5
Debt service payments to the World Bank and African Development Bank (millions of kwacha)		318	470	562	652	746
Sector-Wide Approach (SWAp) receipts (millions of kwacha)		2,028	13,096	15,757	19,004	22,694
Securitization of domestic arrears		0	0	0	0	0
Liquidity reserve requirement (percent)		15.5	15.5	15.5	15.5	15.5
Program exchange rate		…	151	151	151	151

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates.

[1] Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks for all PCs except for the ceiling on the government's net domestic borrowing.

[2] "PC" means Performance Criterion, and "IT" means Indicative Target.

[3] Defined as stocks.

[4] Target is subject to an adjuster for liquidity reserve requirement.

[5] Targets are subject to an adjuster for budget support and debt service payments.

[6] Targets are subject to an adjuster for donor-funded health expenditures.

[7] Defined as a cumulative flow.

[8] Targets are subject to an adjuster for securization of domestic arrears.

[9] Priority social spending as defined and quantified in the authorities' budget.

[10] Evaluated on a continuous basis.

[11] The queue is defined as the amounts of foreign exchange that businesses have applied for—but not yet received—at commercial banks, for legitimate current account transactions.

Table 2. Malawi: Prior Actions and Structural Benchmarks, 2009–10

Prior Actions		
Measure	**Status**	
Issuance of a directive reversing the 20 percent surrender requirement on all exports except tobacco to the RBM and redirecting this foreign exchange to the commercial banks, where it will be converted at the commercial bank rate.	**Met**	To liberalize the foreign exchange market by increasing the role of commercial banks in the foreign exchange market.
Reversal of the requirement to surrender tobacco proceeds to the RBM at the official rate, and to revert to surrendering to the commercial banks to be converted at the commercial bank rate.	**Met**	To liberalize the foreign exchange market by increasing the role of commercial banks in the foreign exchange market.
Enhanced nominal exchange rate flexibility, in the form of an upfront, but gradual adjustment of the exchange rate, coupled with tight fiscal and monetary policies.	**Met**	To move closer to a market-clearing exchange rate and effect a real depreciation of the exchange rate.
Transparent accounting of fertilizer spending in the last two fiscal years.	**Met**	To enhance fiscal transparency and accountability.

Structural Benchmarks		
Measure	**Target date**	**Macro Rationale**
Public finance management		
Make fully operational a Public Financial and Economic Management (PFEM) Unit, in order to follow up on public financial management reforms.	31-Dec-10	To strengthen budget monitoring, and allow rapid reaction to potential expenditure overruns.
Foreign exchange regime		
Develop a time-bound action plan to restart the interbank market in line with TA recommendations from the Norges Bank and the IMF.	30-Jun-10	To improve foreign exchange market efficiency and strengthen growth potential.
Financial sector		
Publish, on a weekly basis, the amount of securities auctioned by the RBM and the results of auctions of securities on the RBM web-page.	30-Jun-10	To enhance the transparency of the domestic financial market.
Cabinet approval of the Financial Sector Development Strategy.	31-Dec-10	To achieve greater financial inclusiveness and improve competitiveness.

Table 3: Reporting Requirements

	Data	Reporting		Delivery		
Data Description	Freq.	Agency	Freq.	Lag	Date	Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money and its components (NDA and NFA), OMO transactions, and RBM conversion of treasury bills	W	RBM	M	30	30	E
Daily exchange rate	D	RBM	W	1	F	E
Treasury bill and RBM auction results	W	RBM	W	2	F	E
RBM balance sheet and broad money estimate	W	RBM	W	7	F	E
Import payment arrears	M	RBM	M	30	30	E
Spread between bank bureau midrate and the official exchange midrate	W	RBM	M	30	30	E
Value of queues for foreign exchange	M	RBM	M	30	30	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks, treasury bills, and RBM bills	M	RBM	M	30	30	E
Detailed issue and maturity profile for treasury bills and RBM bills	M	RBM	M	30	30	E
Excess reserves by bank	W	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
FCDA Holdings	M	RBM	M	30	30	E
RBM foreign exchange cash flow	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of the Health SWAp account held at RBM	M	RBM	M	30	30	E
Eight bank monetary survey and full banking survey (on monthly average basis)	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
Insurance company survey	Q	RBM	Q	45	T15	E
NAC consolidated statement of sources and uses of funds (cashflow statement)	M	MOF	M	30	30	E
Health SWAp statement of sources and uses of funds (as per attached table 2)	M	MOF	M	30	30	E
Fiscal table (GFS) including revenue, expenditure, and financing	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
Monthly expenditure for domestically financied capital projects	M	MOF	M	30	30	E
New external loans contracted or guaranteed by the central government[1]	Q	MOF	Q	30	T30	E
Quarterly external debt services (actual and projections)	Q	MOF	Q	30	T30	E
Borrowing of the ten (8) major parastatals[2]	Q	MOF	Q	45	T15	E
Annual Financial reports of the ten (10) major parastatals and MSB	A	MOF	Q	90	30	H
Report on IMF program performance	Q	MOF	Q	45	T15	E
Statement on new arrears	Q	AuG	Q	45	T15	E
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	T15	E

D- Daily, W-Weekly, M-Monthly, Q-Quarterly, BA-Bi-annual, F-Friday, 30-Every 30th, T30-Every third 30th, E-Electronic, H-Hard Copy

1Detailed information on the amounts , currencies, terms, and conditions, including debt contracted or guaranteed by the RBM or any other agency on behalf of the central government.

2 Agriculture Development and Marketing Corporation, Air Malawi, Electric Supply Company of Malawi. M*alawi Development Corporation,* Malawi Housing Corporation, Malawi Postal Corporation, Malawi Telecommunications Ltd., Northern Regional Water Board.

Table 4. Malawi: Sector-Wide Approach (SWAp)
Statement of Sources and Uses of Funds

	Monthly data
Millions of US$	
Opening balance in SWAp forex account	x
Inflows in foreighn exchange from donors	x
DFID	x
Norway	x
UNDP	x
Global Funds	x
UNFPA	x
UNICEF	x
Other	x
Closing balance in SWAp forex account	x
Memorandum items:	
Donor funds received through RBM	x
Donor funds received through commercial banks	x
Donor funds spent offshore	x
Government contribution in MwK	x
SWAp expenditure	x
Of which: Wages	x
Other goods and services	x
Development expenditure	x

JOINT IMF/WORLD BANK DEBT SUSTAINABILITY ANALYSIS[14]

The staff's debt sustainability analysis for low-income countries (LIC DSA) shows that Malawi is at medium risk of external debt distress. Although the debt ratios are currently low as a result of Heavily Indebted Poor Countries (HIPC) debt relief and Multilateral Debt Relief Initiative (MDRI), the country's debt carrying capacity has not increased substantially in recent years. Malawi's concentrated export base, reliance on rain-fed agriculture, and weak international reserves leave it vulnerable in the face of adverse shocks such as the sharp rise in fuel prices in 2008. A cautious approach to the contracting of external debt continues to be warranted, together with a sufficiently tight fiscal policy to avoid excessive domestic borrowing by the public sector. Measures to support a diversification of the export base will also be important.

I. BACKGROUND

1. **HIPC and MDRI debt relief, supported by strong growth and fiscal consolidation, allowed Malawi to attain a sustainable debt situation,** such that by 2006 Malawi's external debt was under 15 percent of GDP. Malawi's stock of public external debt as of end-2008 is estimated at US$683 million, 90 percent of which is multilateral, with the balance being official bilateral debt. The previous DSA found Malawi to be at medium risk of debt distress. Reliable figures on private external debt are not available, although the amounts are not believed to be large.

Malawi: Structure of Medium- and Long-Term External Public and Publicly Guaranteed Debt (DOD) as of end-2008

	US$ millions
Total	**683.1**
Multilateral	611.5
Of which: IDA	187.7
Of which: IMF	124.3
Of which: AfDB	132,1
Other multilateral	167.4
Official bilateral debt	71.6
Of which: Paris Club	0
Of which: non-Paris Club	71.6
Commercial debt	0

Source: Malawi Ministry of Finance

[14] The draft DSA was discussed with the authorities in November and shared with the African Development Bank.

II. Developments in Fiscal Year 2008/9

2. **Real GDP growth has also been strong.** However, much of the growth has been in maize production, the staple food of Malawian households (accounting for over 60 percent of calories consumed), which has dramatically improved household consumption. However, for the most part maize is not exported and has, therefore, not led to improved debt servicing capacity.

3. **The increase in the price of fuel and fertilizer in 2008 had a dramatic impact on Malawi's balance of payments.** Despite strong prices for Malawi's major exports (particularly tobacco), the rapid increase in prices of key imports and loose fiscal and monetary policies contributed to a loss of official reserves. While declining fuel and fertilizer prices in 2009, together with another strong tobacco season, brought some relief, the reserve situation became increasingly precarious as donors delayed disbursements while awaiting clarification on the government's steps to address macroeconomic weaknesses.

4. **The worsening foreign exchange shortage forced the government to resort to extraordinary external financing to address the balance of payments pressure.** Malawi sold the 2009 special allocation of SDRs in November 2009. Petroleum Importers Limited, the private consortium that imports the majority of Malawi's petrol, contracted a $50 million nonconcessional external loan to purchase petrol. A $22 million nonconcessional loan was contracted by the government in late 2009 to purchase a new presidential jet. However, after mid year, the government began to take measures to improve the foreign exchange situation, including tightening fiscal and monetary policies and gradually depreciating the exchange rate.

III. Medium-Term Macro and DSA Assumptions

5. **Despite recent external shocks and some policy slippages, Malawi's growth prospects remain solid.** Malawi's growth and development strategy to 2011 aims to transform the nation from a "predominantly importing and consuming economy to a predominantly manufacturing and exporting economy." In the last 5 years growth has averaged about 7 percent. Exports will remain the key driver of growth, supported by the gradual dismantling of barriers within the region through the Common Market for Eastern and Southern Africa (COMESA) and Southern Africa Development Community (SADC) free trade areas. Uranium production, which began in 2009, is expected to increase significantly next year, and the prospects for further mining operations are good. While agricultural production has grown strongly in recent years, yields are still low by international standards, and improved fertilizer use and irrigation could increase both yields and cultivated acreage. Malawi is a relatively low-cost producer of a number of cash crops, including sugar, and further investment in this sector is likely to yield steady growth. It will be vital that policy makers provide appropriate opportunities and prices, and avoid damaging the incentives necessary to support the dynamic smallholder farming sector. Tourism also offers growth

opportunities thanks to a relatively safe environment and attractions such as Lake Malawi, albeit starting from a low base. Prospects for the country's main export, tobacco, are less favorable, and the baseline assumes negative real growth over the projection period.

6. **The baseline macroeconomic framework is consistent with the government's economic program supported by an ECF arrangement with the IMF.** It assumes that robust real growth rates continue, buttressed by sound macroeconomic policies and increased investment, a gradual reduction in the external current account deficit through export diversification, prudent fiscal and monetary policies, and reliance on grants and concessional financing in the medium term. It is assumed that not only that the current mining projects continue as planned but that additional projects in uranium and other minerals such as niobium prove viable. It also assumes that no contingent risks stemming from parastatal organizations fall due. The key macroeconomic assumptions are summarized in Box 1.

7. **The projected evolution of the key debt indicators in this DSA is broadly consistent with the projections in the previous DSA (December 2007).** However, the situation as of end-2009 is now estimated to be slightly worse than had been projected in December 2007: the PV debt-to-export ratio was 64 percent rather than 59 percent, the debt-to-GDP ratio was 14 percent rather than 12 percent, and the debt-to-revenue ratio was 85 percent as opposed to the projection of 74 percent. The debt service ratios, on the other hand, are considerably lower than had been projected: less than 2 percent of exports and revenues compared with a projection of 3 and 4 percent respectively. This discrepancy between the solvency and liquidity measures partly reflects the current low interest rate environment, which has resulted in the retention of a lower discount rate.

The projections in the 2007 DSA for growth in exports and GDP in 2008 and 2009 were slightly lower than the actual outturn, reflecting strong tobacco prices in 2008 and strong volumes in 2009. Uranium exports were somewhat lower in 2009 than projected, reflecting longer project implementation times than anticipated: contracts tend to be set over the medium-to-long term, and the price assumptions for uranium exports have only been revised down slightly since the previous DSA.

8. **Growth in imports was substantially higher than projected in the previous DSA for 2008 and 2009, reflecting loose fiscal policy and high prices for fuel and fertilizer.** Moving forward, the current DSA assumes that tighter fiscal and monetary policies, combined with a real exchange rate depreciation, bring the rate of import growth down to five percent a year in line with the previous DSA's projection, and that the loose policies of 2008/09 prove to be an aberration. The current DSA assumes slightly higher longer-term growth rates than the previous DSA, at 5.4 percent vs. 3.9 percent, reflecting increased investor interest and a more favorable long-term outlook for commodities. The 5.4 percent is considerably lower than average growth over the last five years, and reflects Malawi's growth potential and current low base.

Box 1: Key Macroeconomic Assumptions in the Baseline Scenario

The Kayelekera uranium mine is expected to operate for ten years starting in 2009 and act as a major driver for GDP and export growth. The mine is adding to overall economic growth while production is being ramped up during the first four years, but will then detract from overall growth as production is wound down at the end of the mine's life. At its peak, the mine could add 10 percent to Malawi's overall GDP and 25 percent to exports. This DSA assumes that additional mining projects are expected to come on stream as Kayelekera winds down, reflecting considerable interest in Malawi's natural resources, including uranium and niobium, with projects expected to be viable at current prices.

Real GDP growth is projected to average 6.7 percent over 2009–14, thereafter averaging 5.4 percent. Growth is slightly higher than the 4.5 percent average over the past decade, which reflected poor macroeconomic management in the earlier period and a sequence of negative shocks, including a food crisis in 2005, but lower than the average over the last five years.

Inflation is expected to remain in single digits, declining moderately from current rates of around 7.7 percent to around 7 percent over the long run. The real exchange rate is assumed to remain stable.

The external current account, including aid transfers but excluding interest payments, is assumed to improve over the medium term as the reserve position improves, before returning to its historical average as a reflection of strong donor flows and increasing FDI (assumed to be on average 1 percent higher over the forecast period than the historical period, reflecting an improved business environment and potential for additional mining projects). The current account is projected to improve towards the outer years as increased investment begins to be reflected in exports.

Imports are expected to rise at a more moderate pace than in the past—rising 5 percent each year compared to 13 percent over the past decade (reflecting loose fiscal and monetary policy and high fuel and fertilizer prices in 2008). The moderation in import growth is underpinned by increased domestic production.

Export growth is expected to remain strong, averaging 6.9 percent over the medium term to 2014 and 6.2 percent thereafter, lower than the 9.5 percent over the past decade. Strong growth in non-traditional exports contrasts with the more negative picture for tobacco exports, projected to grow at 1 percent per annum in nominal terms.

Revenues (excluding grants) are projected to increase relative to GDP due to the expansion of the tax base and reforms aimed at improving tax administration. Domestic revenues are projected to average 22 percent over the projection period, improving gradually from 16.8 percent in 2010 (the historical average for the last 10 years) to stabilize at just over 23 percent in the outer years.

Aid is projected to average 14.5 percent of GDP over 2009–14, and decline gradually thereafter, averaging 8 percent over the projection period. Aid flow projections are based on the data provided by the government and donors for the ECF. Grant equivalent financing (loans and grants) is expected to decline from about 85 percent of total external financing over the medium term to 67 percent by 2029, as the government becomes less reliant on grants and highly concessional financing.

Highly concessional financing from multilaterals is assumed to be the major source of debt (two-thirds), with somewhat less concessional financing from non-Paris Club creditors providing the balance. A small but increasing amount of borrowing on commercial terms is assumed for the outer years.

IV. External Debt Sustainability

9. **In the baseline scenario, all external debt indicators remain below the indicative, policy-dependent debt burden thresholds, although some do come close to those thresholds** (Table 1).[15,16] The debt burden increases gradually after the dramatic fall resulting from HIPC and MDRI: the ratio of the present value of debt to exports comes closest to breaching a threshold, increasing gradually from 64 percent in 2009 to 79 in 2014, and peaking at 128 percent in 2024, before declining to 124 percent at the end of the projection period. The present value (PV) of external debt to GDP also increases from around 14 percent of GDP after HIPC relief to stabilize at around 22 percent of GDP. The PV debt-to-revenues ratio remains comfortable throughout the projection period at under 100 percent, reflecting the expected improvements in revenue collection in Malawi.

10. **Debt service obligations are expected to remain manageable, reflecting the impact of debt relief and the expected continued high concessionality of Malawi's external financing.** The debt-service to-exports ratio is expected to remain under 10 percent throughout the projection period, while the debt-service-to-revenue ratio remains under 7 percent.

11. **However, stress testing reveals potential vulnerabilities in Malawi's external debt situation**. Under the historical scenario, for example, the debt ratios would increase rapidly, reflecting the high current account deficits of recent years, and would breach the PV debt-to-GDP and PV debt-to-exports thresholds, while the trajectory remains below the relevant debt-to-revenue ratio threshold (A1 in Table 3).

12. **Tobacco still accounts for more than half of Malawi's export earnings, and though this proportion is expected to decline to less than one-fifth by the end of the projection period, Malawi will remain vulnerable to a shock on tobacco prices for some time.** Burley accounts for the majority of production, leaving Malawi vulnerable to changes in tastes and regulatory actions that could dramatically shrink what is already a stagnant global market. A country-specific shock simulating a permanent one-third fall in tobacco prices would lead to an increase in Malawi's debt-to-export ratio of almost 30 percentage points over the medium term, leading Malawi to exceed the 150 percent threshold, albeit marginally and for a short period of time, after 2022 (A3 in Table 3). Malawi would, however, fall back under the threshold by the end of the projection period. While Malawi is also vulnerable to further falls in the price of exports, these risks are somewhat mitigated by the longer-term contracts that characterize this market.

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[15] With a three-year average CPIA rating of 3.40, Malawi is classified as a medium performer under the Debt Sustainability Framework. Accordingly, the relevant debt-burden thresholds used to indicate the risk of debt distress are a present value of debt equivalent to 40 percent of GDP, 150 percent of exports, and 250 percent of revenues; and debt service equivalent to 20 percent of exports and 30 percent of revenues.

[16] This analysis excludes external debts of state-owned enterprises.

13. **Malawi also remains vulnerable to less favorable financing terms**. Assuming that the interest rate on new borrowing were 2 percentage points higher than in the baseline, Malawi would breach the debt-to-exports ratio by 2018, although the other two PV ratios would stay below their thresholds. The additional bounds tests (B1–5 in Table 3) further underline these vulnerabilities: in particular, the combination shock, which shows the impact of lower GDP, exports, inflation, and non-debt creating flows using one-half standard deviation shocks, would result in a breach of the debt-to-exports and debt-to-revenue ratios.

V. Country Specific Depreciation Scenario

14. In recent years Malawi has suffered from persistent balance-of-payment problems as import growth has not been matched by growth in exports. Periodic shortages of foreign exchange have made for a more difficult business environment, and the over-valued exchange rate has disincentivized investments in the import-substituting and export sectors. **The depreciation scenario** (Figure 1 and A4 in Table 3) is designed to show the impact of a sharper up-front nominal depreciation on Malawi's key debt indicators than in the baseline scenario. This scenario assumes a depreciation of 21 percent at the start of 2010, aimed at bringing the exchange rate rapidly into line with staff's estimate of its equilibrium value. This should in turn stimulate FDI and export growth: under this scenario the devaluation leads to export growth higher by 3 percentage points per annum in 2010–13 over the baseline scenario, reflecting our assessment of considerable underutilized potential to increase exports to neighboring countries.

15. Under our projections, ratios would deteriorate slightly in the short term as a result of the decline in dollar terms of GDP and government revenues: PV external debt-to-GDP would be 2 percentage points higher in 2010 than under the baseline scenario, and PV debt-to-revenue ratios would also rise. However, over time, we project that faster export growth would lead to debt-to-export ratios peaking at a level around 20 percentage points lower in this scenario than under the baseline, and, if accompanied by appropriate monetary and fiscal policy to limit the pass through into inflation, would enhance Malawi's external sustainability.

VI. Public debt sustainability

16. **The public debt ratios in Malawi are expected to remain at manageable levels, reflecting the baseline assumption of continued revenue efforts and appropriate expenditure controls.**[17] The public sector PV debt-to-GDP ratio is projected to decline from its 2009 level of just under 35 percent to reach under 25 percent by the end of the projection period. The public sector debt-to-revenue ratio is expected to decline gradually from

[17] Based on net debt (total stock of government liabilities less liquid assets).

115 percent to just under 90 percent, while the debt service-to-revenue ratio is expected to remain under 10 percent throughout the projection period.

17. **However, public debt also remains vulnerable to shocks**. Stress testing (Table 4) indicates that the key ratios could increase significantly from their current levels in the face of less favorable macroeconomic conditions. An unchanged primary balance from 2009 could lead to a PV debt-to-GDP ratio of 59 percent at the end of the projection period, while GDP growth permanently lower than that in the baseline[18] could see the debt-to-GDP ratio reach 49 percent by 2029. Furthermore, Malawi is subject to a number of contingent fiscal risks stemming from the activities of loss-making parastatal institutions, and which it is not yet possible to quantify, but which could potentially have an impact on public debt sustainability. To address this risk, the government has set out its intention to establish a clear regulatory regime for public utilities infrastructure that covers operating costs and avoids the need for budgetary transfers, and has recently taken measures to increase tariffs on electricity and water. However, Air Malawi continues to operate at a loss and could have implications for the public debt stock. Some question marks also remain with regard to parastatal agricultural operations, whose finances are somewhat nontransparent.

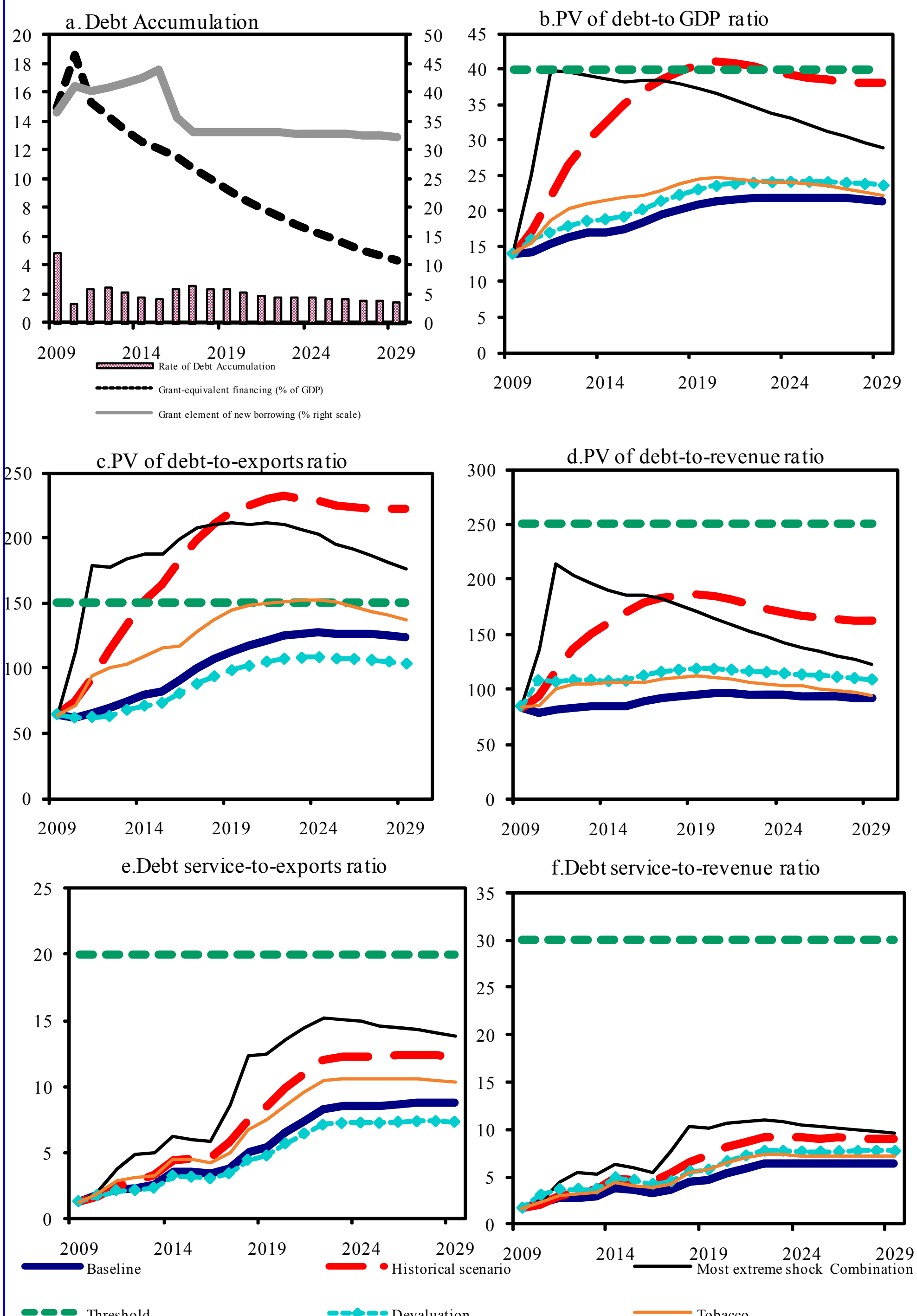
VII. Conclusions

Despite its current relatively low debt ratios, Malawi is assessed to be at moderate risk of external debt stress. The baseline scenario reflects a positive outlook for macroeconomic developments in Malawi, with strong GDP growth and improvements in the external current account. However, Malawi remains vulnerable to price fluctuations for key imports and exports, heavily reliant on rain-fed agriculture and the narrow export base.

Reducing the risk of debt distress will depend on maintaining sound macroeconomic policies, diversifying the export base, sustaining a sound fiscal position as well as on strengthening the foundations for growth.

[18] Assuming that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

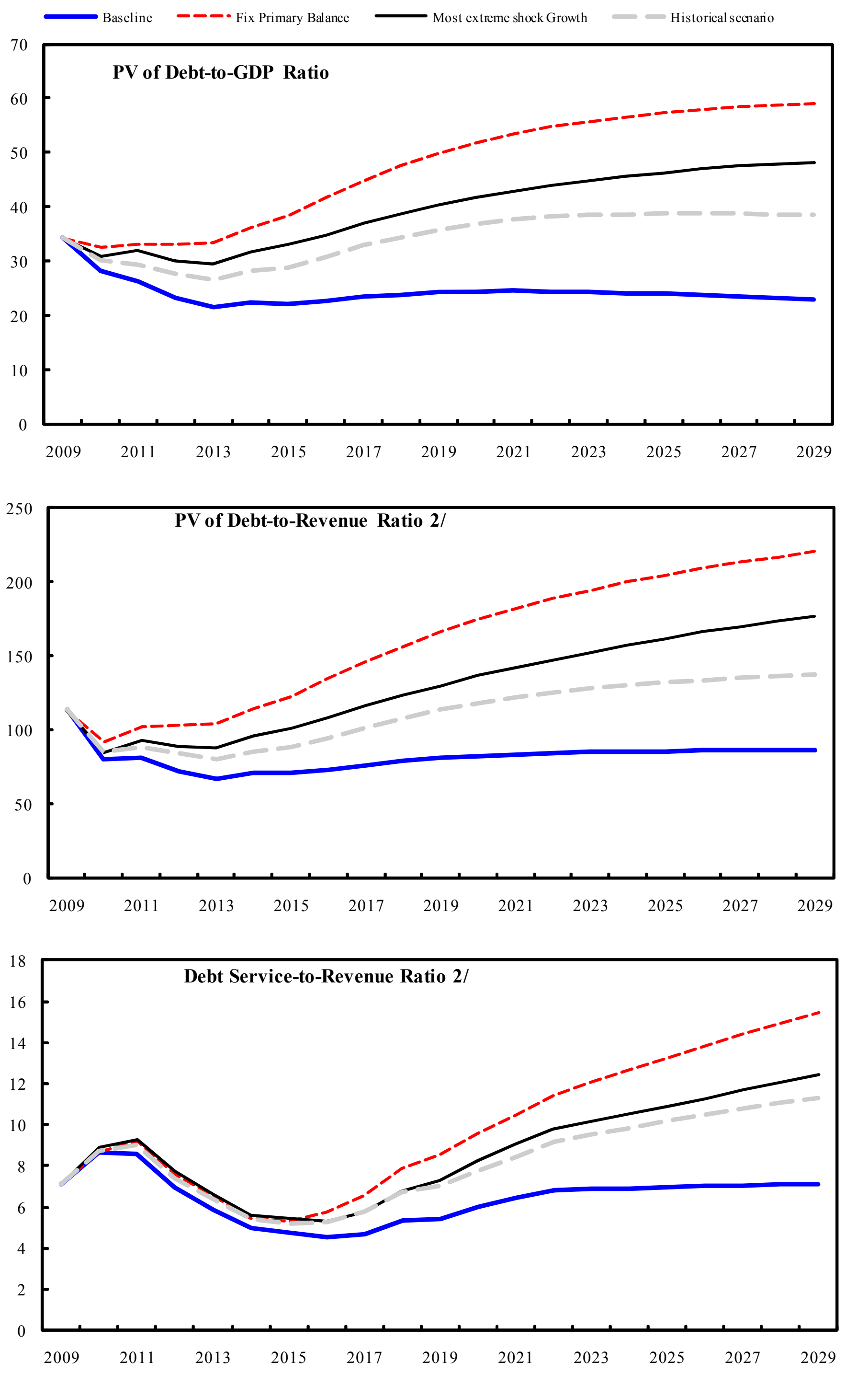
Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2009–29 1/
(Percent, unless otherwise noted)



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a Devaluation shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Combination shock and in figure f. to a Tobacco shock

Figure 2.Malawi: Indicators of Public Debt Under Alternative Scenarios, 2009-2029 1/



Sources: Country authorities; and staff estimates and projections.

1/ The baseline is the staff projection. The most extreme stress test is the test that yields the highest ratio in 2019, in this case the shock to GDP growth. The "fix primary balance" scenario assumes the primary balance remains as it was last year, and the historical scenario assumes key variables remain at their historical values.

2/ Revenues are defined inclusive of grants.

Table 1.: External Debt Sustainability Framework, Baseline Scenario, 2006-2029 1/
(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Esimate	Projections										
											2009-2014					2015-2029
	2006	2007	2008		2009	2010	2011	2012	2013	2014	Average	2015	2020	2025	2029	Average
External debt (nominal) 1/	**14.6**	**14.5**	**16.0**		**19.1**	**21.8**	**23.3**	**24.7**	**25.7**	**26.1**		**26.7**	**31.1**	**31.6**	**30.8**	30.5
o/w public and publicly guaranteed (PPG)	14.6	14.5	16.0		19.1	21.8	23.3	24.7	25.7	26.1		26.7	31.1	31.6	30.8	30.5
Change in external debt	-97.7	-0.2	1.5		3.1	2.7	1.5	1.4	1.0	0.4		0.6	0.5	0.0	-0.3	0.3
Identified net debt-creating flows	-7.3	-2.9	-1.0		4.6	-1.8	-1.9	-2.7	-1.9	-1.7		-1.2	0.5	0.9	0.0	0.4
Non-interest current account deficit	**7.1**	**1.4**	**6.2**	**6.9**	**7.7**	**1.7**	**1.9**	**1.3**	**2.2**	**2.5**	2.9	**2.6**	**4.4**	**4.8**	**3.9**	4.4
Deficit in balance of goods and services	24.1	18.5	25.2		24.8	22.9	19.9	18.2	18.1	17.4		16.9	14.9	11.9	9.1	13.7
Exports	19.1	22.4	24.6		21.7	22.9	23.3	23.3	22.4	21.6		21.3	18.2	17.3	17.2	18.1
Imports	43.2	40.9	49.8		46.5	45.8	43.2	41.5	40.5	39.0		38.2	33.1	29.1	26.3	31.8
Net current transfers (negative = inflow)	-17.5	-17.6	-18.6		-16.2	-21.0	-17.8	-16.7	-15.6	-14.7		-14.1	-10.2	-6.7	-4.8	-9.0
o/w official	-13.3	-14.0	-15.5		-13.4	-16.9	-13.8	-12.8	-12.0	-11.3		-10.8	-7.5	-4.8	-3.4	-6.7
Other current account flows (negative = net inflow)	0.5	0.5	-0.4		-0.9	-0.2	-0.2	-0.2	-0.2	-0.2		-0.2	-0.3	-0.4	-0.4	-0.3
Net FDI (negative = inflow)	**-0.9**	**-2.6**	**-5.0**	**-2.0**	**-2.2**	**-2.7**	**-2.7**	**-2.9**	**-2.8**	**-2.7**	-2.6	**-2.7**	**-2.7**	**-2.7**	**-2.7**	-2.7
Endogenous debt dynamics 2/	**-13.5**	**-1.6**	**-2.2**		**-0.9**	**-0.9**	**-1.1**	**-1.2**	**-1.4**	**-1.5**		**-1.1**	**-1.2**	**-1.2**	**-1.2**	-1.2
Contribution from nominal interest rate	0.7	0.1	0.1		0.1	0.2	0.2	0.2	0.2	0.2		0.2	0.3	0.4	0.3	0.3
Contribution from real GDP growth	-6.6	-1.1	-1.2		-1.0	-1.1	-1.3	-1.4	-1.6	-1.7		-1.3	-1.5	-1.6	-1.6	-1.5
Contribution from price and exchange rate changes	-7.6	-0.7	-1.1		…	…	…	…	…	…		…	…	…	…	
Residual (3-4) 3/	**-90.4**	**2.7**	**2.5**		**-1.5**	**4.5**	**3.4**	**4.1**	**2.9**	**2.1**		**1.8**	**0.0**	**-0.9**	**-0.3**	-0.1
o/w exceptional financing	-3.2	-0.1	0.0		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0
PV of external debt	...	...	10.4		14.0	14.2	15.2	16.2	16.8	17.0		17.4	21.3	21.8	21.4	20.8
In percent of exports	...	...	42.1		64.3	62.1	65.4	69.4	75.1	79.0		81.6	117.1	126.6	124.3	115.9
PV of PPG external debt	**...**	**...**	**10.4**		**14.0**	**14.2**	**15.2**	**16.2**	**16.8**	**17.0**		**17.4**	**21.3**	**21.8**	**21.4**	20.8
In percent of exports	**...**	**...**	**42.1**		**64.3**	**62.1**	**65.4**	**69.4**	**75.1**	**79.0**		**81.6**	**117.1**	**126.6**	**124.3**	115.9
In percent of government revenues	**...**	**...**	**65.9**		**83.5**	**77.9**	**82.1**	**83.4**	**84.1**	**83.9**		**84.6**	**96.1**	**94.1**	**91.3**	93.1
Debt service-to-exports ratio (in percent)	**16.1**	**10.2**	**6.7**		**1.3**	**1.8**	**2.2**	**2.4**	**2.6**	**3.6**		**3.5**	**6.6**	**8.6**	**8.8**	7.0
PPG debt service-to-exports ratio (in percent)	**16.1**	**10.2**	**6.7**		**1.3**	**1.8**	**2.2**	**2.4**	**2.6**	**3.6**		**3.5**	**6.6**	**8.6**	**8.8**	7.0
PPG debt service-to-revenue ratio (in percent)	**17.6**	**13.1**	**10.5**		**1.7**	**2.2**	**2.8**	**2.8**	**2.9**	**3.8**		**3.6**	**5.4**	**6.4**	**6.5**	5.5
Total gross financing need (Billions of U.S. dollars)	0.3	0.0	0.1		0.3	0.0	0.0	-0.1	0.0	0.0		0.0	0.3	0.6	0.6	0.4
Non-interest current account deficit that stabilizes debt ratio	104.9	1.5	4.7		4.6	-0.9	0.3	-0.1	1.3	2.1		2.0	3.9	4.9	4.2	4.1
Key macroeconomic assumptions																
Real GDP growth (in percent)	6.7	8.6	9.8	**4.1**	7.6	6.0	6.3	6.6	6.8	7.1	6.7	5.4	5.4	5.4	5.4	5.4
GDP deflator in US dollar terms (change in percent)	7.3	4.9	8.5	**6.5**	8.0	-0.9	1.9	2.8	2.0	1.5	2.6	2.4	2.4	2.4	2.4	2.4
Effective interest rate (percent) 4/	0.7	1.1	1.1	**1.0**	1.0	1.1	0.9	0.9	0.9	0.8	1.0	0.8	1.2	1.2	1.2	1.1
Growth of exports of G&S (US dollar terms, in percent)	7.7	33.5	30.9	**7.2**	2.5	10.8	10.3	9.4	4.9	4.6	7.1	6.4	6.1	8.7	8.2	6.3
Growth of imports of G&S (US dollar terms, in percent)	0.5	7.9	45.1	**13.2**	8.5	3.3	2.2	5.3	6.3	4.7	5.1	5.6	4.9	5.2	5.2	5.1
Grant element of new public sector borrowing (in percent)	...	...	...	…	36.6	41.1	40.3	40.8	41.6	42.5	40.5	44.1	33.1	32.9	32.4	33.9
Government revenues (excluding grants, in percent of GDP)	17.5	17.6	15.7	**16.8**	16.7	18.3	18.6	19.4	20.0	20.3	18.9	20.5	22.2	23.2	23.4	22.4
Aid flows (in Billions of US dollars) 5/	0.6	0.6	0.9	**0.4**	0.9	1.1	1.0	1.0	1.0	1.1	1.0	1.1	1.2	1.2	1.3	1.2
o/w Grants	0.5	0.5	0.7	**0.3**	0.7	0.9	0.8	0.8	0.8	0.8	0.8	0.9	0.9	0.8	0.8	0.8
o/w Concessional loans	0.1	0.1	0.2	**0.1**	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.5	0.4
Grant-equivalent financing (in percent of GDP) 6/	...	...	...		15.0	18.7	15.3	14.4	13.4	12.6	14.9	12.1	8.6	5.9	4.4	7.8
Grant-equivalent financing (in percent of external financing) 6/	...	...	...		84.6	88.3	87.4	86.7	87.3	87.7	87.0	88.1	78.4	72.4	67.5	76.2
Memorandum items:																
Nominal GDP (Billions of US dollars)	3.1	3.6	4.3		5.0	5.2	5.6	6.2	6.7	7.3		7.9	11.6	16.9	23.0	
Nominal dollar GDP growth	14.5	14.0	19.1		16.2	5.0	8.4	9.6	9.0	8.7	9.5	7.9	7.9	7.9	7.9	7.9
PV of PPG external debt (in Billions of US dollars)			0.4		0.6	0.7	0.8	1.0	1.1	1.2		1.3	2.4	3.6	4.8	
(PVt-PVt-1)/GDPt-1 (in percent)					4.8	1.4	2.4	2.4	2.1	1.7	2.5	1.6	2.1	1.7	1.5	1.9

Sources: Country authorities; and staff estimates and projections.

1/ This analysis covers public sector external debt only, since insufficient information is available on private sector external debt.

2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, 2006–29
(Percent of GDP, unless otherwise indicated)

	Actual				Estimate	Projections								
	2006	2007	2008	Average	2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	27.3	26.3	35.0		39.4	35.9	34.3	31.9	30.4	31.4		34.0	32.4	
o/w foreign-currency denominated	14.6	14.5	16.0		19.1	21.8	23.3	24.7	25.7	26.1		30.6	30.8	
Change in public sector debt	-101.6	-1.0	8.7		4.4	-3.5	-1.5	-2.5	-1.4	1.0		0.4	-0.4	
Identified debt-creating flows	-22.0	0.5	5.5		1.9	-3.5	-2.0	-3.0	-1.7	-1.7		-2.6	-1.9	
Primary deficit	-6.2	1.0	2.8	0.2	4.0	-1.9	-0.7	-1.4	-0.2	0.0	-0.1	-1.0	-0.2	-0.6
Revenue and grants	32.9	31.6	31.2	27.0	30.1	35.2	32.4	32.2	32.0	31.6		30.0	26.8	29.0
of which: grants	15.5	14.1	15.5	10.2	13.4	16.9	13.8	12.9	12.0	11.3		8.1	3.4	6.6
Primary (noninterest) expenditure	26.8	32.6	34.0		34.1	33.2	31.6	30.9	31.8	31.6		29.0	26.6	
Automatic debt dynamics	-15.4	-0.4	-2.1		-2.1	-1.5	-1.3	-1.6	-1.4	-1.7		-1.7	-1.7	
Contribution from interest rate/growth differential	-9.4	0.1	-1.3		-2.1	-1.3	-0.9	-1.4	-1.4	-1.7		-1.7	-1.8	
of which: contribution from average real interest rate	-1.3	2.2	1.0		0.4	0.9	1.2	0.8	0.6	0.3		0.0	-0.1	
of which: contribution from real GDP growth	-8.1	-2.2	-2.3		-2.5	-2.2	-2.1	-2.1	-2.0	-2.0		-1.7	-1.7	
Contribution from real exchange rate depreciation	-5.9	-0.5	-0.8		0.0	-0.2	-0.4	-0.2	0.0	0.0		...	...	
Other identified debt-creating flows	-0.5	-0.1	4.8		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.5	-0.1	0.0		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	4.8		0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-79.6	-1.4	3.2		2.5	-0.1	0.5	0.5	0.3	2.7		3.1	1.5	
Other Sustainability Indicators														
PV of public sector debt	12.6	11.8	29.4		34.3	28.3	26.3	23.3	21.6	22.4		24.2	23.0	
o/w foreign-currency denominated	0.0	0.0	10.4		14.0	14.2	15.2	16.2	16.8	17.0		20.9	21.4	
o/w external	...	...	10.4		14.0	14.2	15.2	16.2	16.8	17.0		20.9	21.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...		...	...	...	...	...	...		...	...	
Gross financing need 2/	13.6	17.3	16.3		22.3	18.5	14.3	10.5	7.9	5.7		4.0	3.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	38.3	37.3	94.1		113.8	80.5	81.1	72.3	67.4	70.8		81.0	86.1	
PV of public sector debt-to-revenue ratio (in percent)	72.3	67.2	186.8		204.8	155.2	141.4	120.2	107.8	110.1		111.1	98.4	
o/w external 3/	…	…	65.9		83.5	77.9	82.1	83.4	84.1	83.9		95.5	91.3	
Debt service-to-revenue and grants ratio (in percent) 4/	22.0	17.4	11.8		7.1	8.7	8.6	7.0	5.9	4.9		5.4	7.1	
Debt service-to-revenue ratio (in percent) 4/	41.4	31.4	23.4		12.8	16.7	15.0	11.6	9.4	7.7		7.5	8.1	
Primary deficit that stabilizes the debt-to-GDP ratio	95.4	1.9	-5.9		-0.5	1.6	0.8	1.1	1.2	-1.0		-1.4	0.2	
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	6.7	8.6	9.8	4.1	7.6	6.0	6.3	6.6	6.8	7.1	6.7	5.4	5.4	5.4
Average nominal interest rate on forex debt (in percent)	0.7	1.1	1.1	1.0	1.0	1.1	0.9	0.9	0.9	0.8	1.0	1.1	1.2	1.1
Average real interest rate on domestic debt (in percent)	8.0	21.0	10.6	17.8	2.5	4.6	9.6	9.2	13.0	12.1	8.5	11.1	16.5	12.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-5.8	-3.6	-6.0	-6.7	0.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	23.3	7.3	8.9	23.5	8.8	10.1	8.0	7.8	6.9	5.9	7.9	7.0	7.0	7.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.3	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	36.6	41.1	40.3	40.8	41.6	42.5	40.5	33.1	32.4	...

Sources: Country authorities; and staff estimates and projections.
1/ General government public sector.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009–29
(Percent)

	Estimate										Projections										
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**2019**	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio (threshold is 40 percent)																					
Baseline	14	14	15	16	17	17	17	18	19	20	**21**	21	22	22	22	22	22	22	22	22	21
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	14	17	22	26	30	33	35	37	39	40	**41**	41	41	40	40	39	39	38	38	38	38
A2. New public sector loans on less favorable terms in 2009-2029 2/	14	15	17	19	20	21	22	24	25	27	**29**	30	31	32	32	33	34	34	35	35	35
A3. Lower tobacco prices 3/	14	15	19	20	21	21	22	22	23	24	24	25	25	24	24	24	24	23	23	23	22
A4. Equilibrium real exchange rate 4/	14	16	17	18	19	19	19	20	21	22	23	24	24	24	24	24	24	24	24	24	24
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	14	15	17	18	19	19	19	20	21	22	**23**	23	24	24	24	24	24	24	24	24	24
B2. Export value growth at historical average minus one standard deviation in 2010-2011 5/	14	17	23	23	23	23	23	24	25	25	**25**	25	25	25	24	24	24	23	23	23	22
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	14	16	20	22	22	23	23	24	26	27	**28**	28	29	29	29	29	29	29	29	29	28
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 6/	14	23	30	30	30	30	30	30	30	30	**30**	29	29	28	27	27	26	26	25	24	24
B5. Combination of B1-B4 using one-half standard deviation shocks	14	25	40	39	39	39	38	38	38	38	**37**	37	36	35	34	33	32	31	30	30	29
PV of debt-to-exports ratio (threshold is 150 percent)																					
Baseline	64	62	65	69	75	79	82	91	99	107	**113**	117	122	125	127	128	127	127	127	126	124
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	64	75	93	114	134	151	164	183	198	210	**219**	225	230	232	230	229	225	223	222	222	222
A2. New public sector loans on less favorable terms in 2009-2029 2/	64	66	74	81	91	99	105	117	131	144	**155**	164	174	182	188	194	196	199	202	204	205
A3. Lower tobacco prices 3/	64	71	95	101	103	109	115	117	128	138	145	148	149	151	152	152	151	146	144	141	137
A4. Equilibrium real exchange rate 4/	64	62	62	63	68	71	73	81	88	94	99	102	105	107	108	109	108	107	106	105	104
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	64	60	64	68	73	77	80	88	97	104	**110**	114	119	122	124	125	124	124	123	123	121
B2. Export value growth at historical average minus one standard deviation in 2010-2011 5/	64	87	141	144	151	157	159	172	184	191	**197**	200	204	206	206	205	201	199	196	193	189
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	64	60	64	68	73	77	80	88	97	104	**110**	114	119	122	124	125	124	124	123	123	121
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 6/	64	99	130	130	135	138	139	148	155	158	**160**	160	161	161	159	156	152	149	146	142	138
B5. Combination of B1-B4 using one-half standard deviation shocks	64	114	179	178	183	187	188	199	207	211	**211**	211	211	210	206	202	195	191	186	181	176
PV of debt-to-revenue ratio (threshold is 250 percent)																					
Baseline	83	78	82	83	84	84	85	89	92	94	**96**	96	96	96	95	95	94	94	93	92	91
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	83	94	117	137	150	160	170	179	183	185	**186**	185	182	177	173	169	167	165	163	163	163
A2. New public sector loans on less favorable terms in 2009-2029 2/	83	83	93	98	102	105	108	114	121	127	**131**	135	137	140	142	144	145	147	148	150	151
A3. Lower tobacco prices 3/	83	85	100	106	105	106	107	107	109	111	112	111	109	107	105	104	103	101	99	97	95
A4. Equilibrium real exchange rate 4/	85	108	107	108	109	108	108	113	116	118	119	118	118	117	115	114	113	112	111	110	109
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	83	80	90	92	93	93	93	98	101	104	**105**	106	106	105	105	104	103	103	102	101	100
B2. Export value growth at historical average minus one standard deviation in 2010-2011 5/	83	90	122	119	117	114	113	116	117	116	**115**	113	111	108	106	104	102	101	99	97	95
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	83	87	109	111	112	112	113	118	123	125	**127**	128	128	127	127	126	125	124	124	123	122
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 6/	83	125	163	157	151	147	144	145	143	140	**136**	132	127	123	119	116	113	110	107	104	102
B5. Combination of B1-B4 using one-half standard deviation shocks	83	137	214	204	196	190	185	186	183	177	**171**	165	159	153	148	143	138	134	130	127	123

Table 3. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009–29 (continued)
(Percent)

Debt service-to-exports ratio (threshold is 20 percent)																					
Baseline	1	2	2	2	3	4	4	3	4	5	**5**	7	7	8	8	9	9	9	9	9	9
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	1	2	2	3	3	4	5	5	6	8	**9**	10	11	12	12	12	12	12	12	12	12
A2. New public sector loans on less favorable terms in 2009-2029 2/	1	2	2	3	3	4	5	5	5	6	**6**	7	8	9	9	11	11	12	12	12	13
A3. Lower tobacco prices 3/	1	2	3	3	3	4	4	4	5	7	**7**	9	10	10	11	11	11	11	11	11	10
A4. Equilibrium real exchange rate 4/	1	2	2	2	2	3	3	3	3	4	**5**	6	6	7	7	7	7	7	7	7	7
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	1	2	2	2	3	4	4	3	4	5	**5**	7	7	8	8	9	9	9	9	9	9
B2. Export value growth at historical average minus one standard deviation in 2010-2011 5/	1	2	4	4	5	6	6	6	7	10	**11**	12	13	14	15	15	14	14	14	14	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	1	2	2	2	3	4	4	3	4	5	**5**	7	7	8	8	9	9	9	9	9	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 6/	1	2	3	4	4	5	5	5	7	9	**9**	10	11	12	12	11	11	11	11	11	11
B5. Combination of B1-B4 using one-half standard deviation shocks	1	2	4	5	5	6	6	6	9	12	**13**	14	14	15	15	15	15	14	14	14	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	1	2	2	2	3	4	4	3	4	5	**5**	7	7	8	8	9	9	9	9	9	9
Debt service-to-revenue ratio (threshold is 30 percent)																					
Baseline	2	2	3	3	3	4	4	3	4	4	**5**	5	6	6	6	6	6	6	6	6	6
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	2	2	3	3	4	5	5	5	5	7	**7**	8	9	9	9	9	9	9	9	9	9
A2. New public sector loans on less favorable terms in 2009-2029 2/	2	2	3	3	3	5	5	5	5	5	**5**	6	6	7	7	8	8	9	9	9	9
A3. Lower tobacco prices 3/	2	2	3	3	3	4	4	4	4	5	6	6	7	7	7	7	7	7	7	7	7
A4. Equilibrium real exchange rate 4/	2	3	4	4	4	5	5	4	4	6	6	7	7	8	8	8	8	8	8	8	8
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	2	2	3	3	3	4	4	4	4	5	**5**	6	7	7	7	7	7	7	7	7	7
B2. Export value growth at historical average minus one standard deviation in 2010-2011 5/	2	2	3	4	4	4	4	4	5	6	**6**	7	7	8	8	7	7	7	7	7	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	2	3	4	4	4	5	5	5	5	6	**6**	7	8	9	9	9	9	9	9	9	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 6/	2	2	4	4	4	5	5	4	6	8	**8**	8	9	9	9	8	8	8	8	8	8
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	4	6	5	6	6	5	8	10	**10**	11	11	11	11	11	10	10	10	10	10
Memorandum item:																					
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	30	30	30	30	30	30	30	30	30	30	**30**	30	30	30	30	30	30	30	30	30	30

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Assumes tobacco exports 25 percent lower than in baseline scenario and offsetting adjustment in import levels.
4/ Assumes an upfront nominal depreciation of 21 percent at start of 2010.
5/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
6/ Includes official and private transfers and FDI.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Malawi: Sensitivity Analysis for Key Indicators of Public Debt 2009–29

	Estimate	Projections						
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	34	28	26	23	22	22	24	23
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	30	29	28	27	28	36	38
A2. Primary balance is unchanged from 2009	34	32	33	33	33	36	50	59
A3. Permanently lower GDP growth 1/	34	29	27	25	23	25	32	49
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	34	31	32	30	29	32	40	48
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	34	32	33	29	27	28	28	25
B3. Combination of B1-B2 using one half standard deviation shocks	34	32	33	30	29	31	36	40
B4. One-time 30 percent real depreciation in 2010	34	33	30	27	24	25	26	25
B5. 10 percent of GDP increase in other debt-creating flows in 2010	34	35	32	29	27	27	28	25
PV of Debt-to-Revenue Ratio 2/								
Baseline	114	81	81	72	67	71	81	86
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	114	85	89	84	80	85	114	138
A2. Primary balance is unchanged from 2009	114	92	102	103	105	114	166	221
A3. Permanently lower GDP growth 1/	114	81	83	75	72	78	105	180
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	114	85	94	89	88	96	130	177
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	114	92	102	91	85	88	95	93
B3. Combination of B1-B2 using one half standard deviation shocks	114	90	98	91	89	95	119	148
B4. One-time 30 percent real depreciation in 2010	114	95	94	82	76	78	85	93
B5. 10 percent of GDP increase in other debt-creating flows in 2010	114	100	100	90	84	87	94	93
Debt Service-to-Revenue Ratio 2/								
Baseline	7	9	9	7	6	5	5	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	7	9	9	7	6	5	7	11
A2. Primary balance is unchanged from 2009	7	9	9	8	7	5	9	15
A3. Permanently lower GDP growth 1/	7	9	9	7	6	5	6	12
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	7	9	9	8	7	6	7	12
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	7	9	9	8	6	5	7	8
B3. Combination of B1-B2 using one half standard deviation shocks	7	9	9	8	6	5	7	11
B4. One-time 30 percent real depreciation in 2010	7	9	9	8	7	6	7	11
B5. 10 percent of GDP increase in other debt-creating flows in 2010	7	9	10	7	6	5	7	8

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 1. Malawi: Selected Economic Indicators, 2007–11[1]

	2007	2008	2009	2010	2011
	Act.	Act.	Prel.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)					
GDP at constant market prices	8.6	9.8	7.7	6.0	6.3
Consumer prices (end of period)	7.5	9.9	7.6	9.2	8.5
Consumer prices (annual average)	7.9	8.7	8.4	10.1	8.3
Central government (percent of GDP)					
Revenue and grants	31.6	31.2	30.1	35.2	32.2
Tax and non tax revenue	18.7	19.9	21.4	22.6	22.8
Grants	12.9	11.3	8.8	12.7	9.4
Expenditure and net lending	36.0	36.2	36.1	36.0	33.9
Overall balance (excluding grants)	-17.2	-16.5	-14.6	-13.5	-11.2
Overall balance	-4.3	-5.0	-5.8	-0.8	-1.8
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)					
Money and quasi money	36.9	33.1	19.4	16.7	13.9
Net foreign assets [2]	41.9	-10.1	-18.4	13.6	10.4
Credit to the rest of the economy (percent change)	32.8	45.5	27.9	28.4	19.4
External sector (US$ millions, unless otherwise indicated)					
Exports, f.o.b.	731.7	969.2	1,004.8	1,119.9	1,229.7
Imports, c.i.f.	-1,182.3	-1,722.8	-1,809.6	-1,739.8	-1,843.0
Usable gross official reserves [2]	217.1	239.0	114.0	276.9	407.3
(months of imports)	1.2	1.3	0.6	1.4	2.1
(percent of reserve money)		93.2	35.0	81.3	126.6
Current account (percent of GDP)	-1.5	-6.4	-8.6	-1.8	-2.2
Current account, excl. official transfers (percent of GDP)	-15.5	-21.8	-21.9	-18.7	-15.9
Nominal effective exchange rate (percent change)	-8.8	20.2	…	…	…
Real effective exchange rate (percent change)	-7.8	24.9	…	…	…
Overall balance (percent of GDP)	0.5	-1.0	-1.8	4.4	3.6
Terms of trade (percent change)	-1.7	5.9	13.7	-3.1	-2.9
Debt stock and service (percent of GDP, unless otherwise indicated)					
External debt (public sector)	14.4	16.0	19.1	21.8	23.3
NPV of debt (percent of avg. exports)	0.0	42.1	64.3	62.1	65.4
NPV of debt (percent of avg. exports)	41.9	51.5	58.7	66.4	72.3
External debt service (percent of exports)	3.2	6.7	1.3	1.8	2.2
Net domestic debt (central government)	11.8	19.0	20.3	14.0	11.0
Treasury bill rate (period average)[3]	13.9	10.9	11.9	…	…

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates and projections.

[1] The ECF scenario assumes an initial depreciation and that the real exchange rate is kept constant during the program period. Correcting the underlying exchange rate misalignment is a key element of the macroeconomic framework.

[2] Programmed usable reserves in 2009 excludes the SDR allocation, while the projection includes the SDR allocation.

[3] Average t-bill rate. Data for 2009 are shown as of November 30th.

ANNEX I

MALAWI: RELATIONS WITH THE FUND

(As of December 31, 2009)

I. Membership Status: Joined: July19, 1965; Article VIII (December 7, 1995)

II. General Resources Account:	SDR millions	Percent of Quota
Quota	69.40	100.00
Fund holdings of currency	67.05	96.61
Reserve position in Fund	2.42	3.49

III. SDR Department:	SDR millions	Percent of Allocation
Net cumulative allocation	66.37	100.00
Holdings	1.23	1.85

IV. Outstanding Purchases and Loans:	SDR millions	Percent of Quota
ESF arrangements	34.70	50.00
PRGF arrangements	46.25	66.64

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR millions)	Amount Drawn (SDR millions)
ESF	12/03/2008	12/02/2009	52.05	34.70
PRGF	08/05/2005	08/04/2008	48.58	48.58
PRGF	12/21/2000	12/20/2004	45.11	12.88

VI. Projected Obligations to the Fund[19]
(SDR millions; based on current use of resources and present SDR holdings):

	Forthcoming				
	2010	2011	2012	2013	2014
Principal		0.49	2.64	5.37	16.66
Charges/Interest	0.55	0.56	0.55	0.53	0.48
Total	0.55	1.05	3.19	5.90	17.13

[19] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears is shown in this section.

VII. HIPC Initiative

A. Commitment of HIPC assistance	Enhanced Framework
Decision point date	Dec 2000
Assistance committed (NPV terms) [2]	
Total assistance (US$ millions)	1,057.00
Of which: Fund assistance (SDR millions)	33.37
Completion point date	08/01/06
B. Delivery of Fund assistance (SDR millions)	
Amount disbursed	33.37
Interim assistance	11.57
Completion point balance	21.80
Additional disbursement of interest income [3]	3.82
Total disbursements	37.19

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI)

A.	MDRI-eligible debt (SDR millions) [4]	37.87
	Financed by: MDRI Trust	14.53
	Remaining HIPC resources	23.34
B.	Debt Relief by Facility (SDR millions)	

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
September 2006	10.84	19.12	29.96
December 2006	N/A	7.91	7.91

[2] Because assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point, these two amounts cannot be added.

[3] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed in the interim.

[4] The MDRI provides 100 percent debt relief to member countries that qualify for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover all debt owed to the Fund as of 2004 that remains outstanding at the time the member qualifies for debt relief.

IX. Safeguards Assessments:

A safeguards update of the Reserve Bank of Malawi (RBM) was completed in December 2008 with respect to the ESF arrangement approved on December 3, 2008. Previous assessments of the RBM were completed in 2001, 2003, 2005, and 2006. The last update found that the RBM had taken steps to strengthen its operations, but new vulnerabilities had emerged, particularly in the areas of governance and financial reporting. Recommendations to mitigate the identified weaknesses included: (i) reconstitution of the RBM board of directors, which was dissolved in August 2005, and subsequent reestablishment of an audit committee; (ii) expansion of explanatory notes in the financial statements to include advances to government and letter of credit financial commitments; and (iii) strengthening of the central bank law provisions on the appointment and dismissal of board members.

X. Exchange Arrangements:

From mid 2006 to late 2009, the authorities kept the exchange rate stable at about 141 Malawi kwacha to the U.S. dollar. From November 2009 to mid January 2010, the authorities gradually depreciated the currency about 8 percent relative to the U.S. dollar to 151 kwacha to the U.S. dollar. The authorities have committed to adjusting the exchange rate to ensure the maintenance of a market-clearing rate. Therefore, the exchange rate is now classified as "other managed." During the second review of the PRGF arrangement in August 2006, a multiple currency practice (MCP) under Article VIII emerged (manifested by the significant spread between the commercial bank exchange rate and the rates at foreign exchange bureaus). Malawi also maintains restrictions on the capital account.

XI. Article IV Consultation:
Malawi is on a 24-month Article IV consultation cycle. The last consultation (CR No. 07/147) was concluded by the Executive Board on March 14, 2007.

XII. Technical Assistance:

Date	Duration	Dept.	Recipient	Purpose	Form
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	RBM	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure management	Advisor
07/02	2 weeks	STA	National Statistical Office (NSO), RBM	GDDS Anglophone project on national accounts statistics	Mission
08/02	2 weeks	STA	RBM	Monetary and financial statistics	Mission
02/03	2 weeks	MAE	RBM	Monetary operations, payments system, banking supervision	Mission
08/03	2 weeks	STA	NSO	GDDS Anglophone project on balance of payments statistics	Mission
09/03	2 weeks	STA	NSO, Ministry of Finance, RBM	ROSC on the quality of macroeconomic data	Mission
02/04	2 weeks	MFD	RBM	Monetary operations, credit quality assessment, payments system, banking supervision	Mission
04/04	2 weeks	STA	RBM	Monetary and financial statistics	Mission
01/05	2 weeks	LEG/MFD	RBM	AML/CFT	Mission
03/05	2 weeks	FAD	Ministry of Finance	Tax policy mission	Mission
08/05	1 week	STA	Ministry of Finance	GDDS project on fiscal sector	Mission
11/05	1 week	FAD	Ministry of Finance	Civil service pensions	Mission
12/05	2 weeks	MFD	RBM	Monetary operations, banking supervision, payments systems, and forex bureaus	Mission
02/06	1 week	FAD	Ministry of Finance	Civil service pensions	Mission
03/06	1 week	FAD	Ministry of Finance	PSIA on the fertilizer scheme	Mission
05/06	1 week	FAD	Ministry of Finance	Tax regime for mining	Mission
05/06	2 weeks	MFD	RBM	Liquidity forecasting	Mission
07/06	2 weeks	MFD	RBM	Payments system	Mission
07/06	3 weeks	STA	RBM	Balance of payments	Mission
10/06	1 week	FAD	Ministry of Finance	Public financial management	Mission
10/06	3 weeks	MCM	RBM	Currency issues	Mission
11/06	2 weeks	MCM	RBM	Liquidity forecasting	Mission
11/06	2 weeks	MCM	RBM	Central bank accounting	Mission
11/06	2 weeks	MCM	RBM	Bank supervision	Mission
02/07	2 weeks	FAD	Ministry of Finance	Budget process and improving budget preparation	Mission
03/07	2 weeks	FAD	Malawi Revenue Administration (MRA)	Revenue administration	Mission
03/07	2 weeks	MCM	RBM	Foreign exchange bureaus	Mission
03/07	2 weeks	STA	NSO	National accounts and CPI statistics	Mission
04/07	2 weeks	STA	RBM	Balance of payments statistics	Mission
07/07	2 weeks	MCM	RBM	FSAP	Mission
09/07	2 weeks	STA	NSO, Ministry of Finance, RBM	DFID: GDDS Dissemination	Mission

Date	Duration	Dept.	Recipient	Purpose	Form
09/07	2 weeks	STA	Ministry of Finance	Government Finance Statistics	Mission
01/08	2 weeks	MCM	Finance, RBM	Macroeconomic policy formulation	Mission Mission
03/08	1 weeks	FAD	Ministry of Finance	Assessment of the TA needs in the area of PFM reform	
03/08	1 weeks	FAD	Ministry of Finance	Tax and customs administration	Mission
03/08	2 weeks	FAD	Ministry of Finance	Revenue administration Reform	Mission
03/08	2 weeks	MCM	RBM	Foreign exchange operations	Mission
04/08	1 weeks		Ministry of Finance	Assess TA requirements of the Ministry of Finance and draw up a work plan for 2008/09	Mission
05/08	2 weeks	STA	RBM	DFID: Monetary and financial statistics	Mission
01/09	1 week	MCM	RBM	TA coordination/evaluation	Mission
01/09	2 weeks	MCM	RBM	Macro and FSI Analysis	Mission
01/09	1 week	MCM	RBM	Monetary operations/money markets	Mission
01/09	2 weeks	STA	RBM	DFID: Money and banking statistics	Mission
02/09	4 weeks	MCM	RBM	Monetary operations/money markets	Mission
02/09	1 week	MCM	RBM	Currency handling and reform	Mission
02/09	2 weeks	FAD	Ministry of Finance	integration of accounting systems and fiscal reporting	Mission
03/09	3 weeks	FAD	Ministry of Finance	Prepare modernization plan and support tax administration	Mission
03/09	2 weeks	FAD	Ministry of Finance	Revenue administration	Mission
04/09	2 weeks	FAD	RBM	Monetary operations and reserves management	Mission
05/09	2 weeks	FAD	Ministry of Finance	Linkage between policy and budgetary allocations	Mission
05/09	1 week	LEG	Ministry of Finance	Tax procedure code	Mission
08/09	1 week	LEG	Ministry of Finance	Tax procedure code	Mission
09/09	1 week	FAD	Ministry of Finance	Improving output budgeting	Mission
10/09	1 week	MCM	RBM	Central banking	Mission
10/09	6 weeks	MCM	RBM	Central bank policy	Mission
01/10	1 week	STA	NSO	Balance of payments statistics	Mission
01/10	2 weeks	FAD	Ministry of Finance	Output-based budget and expenditure tracking	Mission

XIII. Resident Representative:

Mr. A. Maitland MacFarlan, who replaced Mr. Baunsgaard, started his assignment on August 21, 2007.

ANNEX II

Malawi : JMAP Implementation

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	**Lending:**		
	➢ Malawi education SWAp	January 2010	04/29/2010
	➢ Participatory development and management of Nhotakota Wildlife	January 2010	04/30/2010
	➢ PRSC 3	January 2010	5/27/2010
	➢ Malawi agriculture commercialization		5/27/2010
	➢ Nyika transfrontier conservation area project	None	07/29/2010
	➢ Malawi mining support		09/15/2010
	Analytical and Advisory Activities:		
	➢ Infant and child feeding study		02/16/2010
	➢ Disaster reduction and recovery		02/30/2010
	➢ Malawi tourism study		05/03/2010
	➢ Multimodal transport development and potential private-public partnership		10/29/2010

A. Mutual information on relevant work programs			
IMF work program in next 12 months	➢ Staff visit	April 2010	April 2010
	➢ 1st review of the ECF	September 2010	December 2010

MALAWI : JMAP IMPLEMENTATION (CONCLUDED)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	B. Requests for work program inputs		
Fund request to Bank (with summary justification)	➢ Periodic update on progress with PRSC ➢ PER to provide quantitative inputs for fiscal consolidation		
Bank request to Fund (with summary justification)	➢ Regular updates of medium term macro projections. ➢ Fund relations note (for budget support operations)		
	C. Agreement on joint products and missions		
Joint products in next 12 months	➢ Debt Sustainability Analysis	December 2010	

ANNEX III

MALAWI: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring purposes. The data module of the Report on the Observance of Standards and Codes (data ROSC), published February 17, 2005, found that, while the institutional framework for the production of macroeconomic statistics was broadly adequate, there were shortcomings in the scope, accuracy, and reliability of data. The weakest areas are: national accounts, government finances statistics, and monetary and financial statistics. A key STA recommendation was to formally assign the responsibility for the compilation of government finance statistics to the Ministry of Finance and responsibility for the compilation of monetary statistics to the RBM.

2. The authorities are making efforts to improve the quality and timeliness of economic and financial data through participation in the Fund's General Data Dissemination System (GDDS) and the GDDS Project for Anglophone African Countries. Malawi is participating in the GDDS/PRSP and the monetary and financial statistics modules of the project. GDDS metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since February 2007.

A. Real Sector Statistics

3. The accuracy and reliability of the real sector data (including national accounts, prices, and trade) are affected by inadequate source data and timeliness. STA has recommended remedial actions, including the need for additional resources for the National Statistics Office (NSO). A long-term technical assistance program in the area of national accounts is being provided under a project by Statistics Norway. Specifically:

National accounts

4. The NSO have revised the national accounts methodology to implement the SNA93 and to better account for the activities in the informal sector. The estimate of 2006 nominal GDP was revised upward by some 40 percent. The revisions include a lower estimated output share of the agricultural sector, resulting in lower estimates of output growth for 2006 and 2007.

Prices

5. A consumer price index (CPI) is available on a timely basis. The CPI base is 2000, drawing on the 1997/98 household survey, and data are collected on a monthly basis by regional price collectors. There are plans to revise the CPI weights based on the 2010 planned Integrated Household Survey (IHS).

Trade

6. Preliminary estimates of trade are now available with a lag of two to three months. Trade data are received electronically from six major ports. The adjustment of imports from

c.i.f. to f.o.b. prices is not appropriate and there is no reconciliation with data from neighboring countries. Quality control is inadequate, and the figures are not cross-checked with any other sources (e.g. customs receipts) to ensure accuracy.

B. Government Finance Statistics

7. The accuracy and reliability of the data are affected by inadequate source data. A key shortcoming in this area is inadequate system of recording source data. In addition, there are serious quality problems, including data inconsistencies, that complicate program monitoring:

- While tax revenue data are received in a timely fashion, it is not always possible to reconcile them with deposits in the Malawi Government (MG) Account.

- Nontax revenue, including capital revenues collected by line ministries are not properly accounted for in the fiscal reports prepared by the Ministry of Finance.

- Data on recurrent expenditure suffer from serious shortcomings partly related to insufficient bank reconciliation between expenses records prepared by line ministries and financing information prepared by the Ministry of Finance. Line ministries submit spending reports to the Ministry of Finance based on recorded expenses, while the Ministry of Finances estimates expenses based on funding data (from the Credit Ceiling Authority). At times, there are sizable discrepancies between these two sources of data for both wages and other recurrent transactions—to some extent reflecting the widespread practice of reallocation across budget lines.

- Domestically financed development expenditure estimates are based on funding released to line ministries, and estimates on externally funded expenditure are based on reported project grants and loans. Owing to differences in timing and financing modalities (e.g., some donors require prefinancing of expenditure before reimbursement), there are substantial differences between the flow of expenses and corresponding financing data. In addition, many donor projects are still not incorporated in the budget, and hence the corresponding expenditure is not captured in government finance statistics. Some externally funded development expenditures are likely recurrent and reported capital expenditure therefore overstated.

- Data on expenditure arrears are likely incomplete, as reporting from the Commitment Control System appears to be only partial, and ministry level data are not consistent from report to report.

- Malawi’s current budget classification includes economic and program classification and program, but does not include an effective administrative/organizational classification.[20] Expenditure data is loosely mapped to functional classification based on the CoFoG classification.

- The budget classification and chart of accounts may be adequate for some administrative, economic, functional and program classifications. An output-oriented

[20] Economic classifications were upgraded to GFS 2001 compatible framework in FY 2006/07.

activities-based budget classification (ABB) is used for the presentation of the budget. However, pro-poor expenditures that have been protected in line with the PRSP are only identified in the ABB classification. As no bridge table exists to map the ABB classification into the program classification used for expenditure reporting and accounting, pro-poor expenditures cannot be monitored. Under the ECF program, the government is expected to develop a mechanism for properly monitoring social expenditures.

- The government nomenclature program/subprogram currently used for the functional classification seems appropriate considering the nature of the items classified under this group. The items currently classified under this group include functions, programs and administrative levels. Although substantial elements of the current output based budget structure appear to be predominately functional in nature, it is not clear whether they are cleanly linked to classification of functions of government (CoFoG). As such, the government should review the current budget structure and the functional classification based on CoFoG (GFSM2001) to verify that they are aligned.

- The absence of a financial administrative structure, complete with vertical hierarchy of responsibilities inhibits the use of Government Finance Statistics (GFS). Budget funds are directed to organizations generally defined as cost centers (e.g., headquarters of ministries down to the level of secondary school principals). As such, there does not appear to be an effective hierarchal financial system. However, to be clear, over the past two years, sub-votes have been introduced to a number of Ministries, but not as yet, a system of warrants and sub-warrants have not been introduced.

- Financing estimates are based on monetary and debt data, rather than on government records of financing. Reporting on treasury bills directly issued to the RBM at times has been slow.

8. The authorities have received significant technical assistance from the Fund and other donors to strengthen expenditure monitoring and reporting, accounting, and statistical reporting, but results have lagged. The government has pledged to strengthen public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including utilizing donor technical assistance more effectively. The authorities are currently working with AFRITAC to modify its chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and can be readily understood.

9. Government finance data are not reported for publication in the *Government Finance Statistics Yearbook (GFSY)* or the *International Financial Statistics (IFS)*. An August 2005 and August 2007 STA mission that visited Lilongwe reiterated the importance of continued efforts to implement the Integrated Financial Management Information System (IFMIS), and encouraged the authorities to improve the coverage and sectorization of government financial operations and to correctly classify transactions according to international guidelines. The mission proposed, and discussed with the authorities, a migration plan and timetable to adopt the *GFSM 2001* methodology.

C. Monetary and Financial Statistics

10. Despite recent improvements, monetary and financial statistics (MFS) continue to have shortcomings. These includes irregular reporting to STA[21], lack of proper legislation to grant the authority to the RBM to require reporting from other institutions[22]; the sectorization of the domestic economy, and classification of financial instruments to ensure that the RBM adheres fully to the methodology of the *Monetary and Financial Statistics Manual*. The 2004 and 2008 missions noted and made a number of recommendations for addressing the above shortcomings. The May 2008 STA mission also assisted RBM staff in developing the standardized report forms (SRFs) for the central bank accounts and monetary aggregates and initiated work on the SRF for reporting the data of other depository corporations (ODCs). The mission also updated the SRF on monetary aggregates with the national definitions of money, and used the central bank data to initiate the development of an integrated monetary database (IMD) that will become effective only when the RBM reports data on the SRFs for the ODCs and other financial corporations. The mission revised the coverage of interest rates in *International Financial Statistics* to ensure that the most representative rates are published.

D. External Sector Statistics

11. The external sector statistics in Malawi exhibit serious deficiencies. Concepts and definitions used to compile the balance of payments statistics are in broad conformity with the guidelines presented in the fourth edition of the *Balance of Payments Manual* (*BPM4),* although there has been some progress in the transition to the methodology of *BPM5*. The NSO should now adopt the *BPM6* methodology, on the base of which the Malawi balance of payments metadata should also be updated. Balance of payments data remain weak in a number of key areas. The NSO balance of payments section remains crucially understaffed, as it has been since March 2008. Moreover, important data sources for balance of payments compilation ceased to be available during 2006–07, for example exchange control forms, which could supply information on imports of goods, services, and current transfers. Procedures for assessing the accuracy of trade data need to be improved.

12. Data on remittances are non-existent, despite anecdotal evidence that there are high remittances. As a first step the money transfer services should be required to report monthly data to the RBM. Data on foreign direct investment and portfolio flows are similarly weak. Project aid is currently classified as current transfers rather than in the capital account, and several large in-kind projects are not captured in the balance of payments data properly.

13. No international investment position statement is prepared. No foreign private capital survey (FPC) was conducted between 2006–07, and the results of the 2009 survey are not yet available. The RBM and Ministry of Finance's Debt and Aid Department need to improve reporting of monetary and external debt data.

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[21] The latest monetary data which were reported in November 2009 include observations for October 2009.

[22] Some legislation that is designed to address this issue has recently been approved. However, some of the pending legislation would give and strengthen the authority of the RBM in this regard.

Malawi: Tables of Common Indicators Required for Surveillance (as of December 31, 2009)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality – Methodological soundness[9]	Data Quality – Accuracy and reliability[10]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/2009	12/2009	M	M	M		
Reserve/Base Money	11/2009	12/2009	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Broad Money	11/2009	12/2009	M	M	M		
Central Bank Balance Sheet	11/2009	12/2009	M	M	M		
Consolidated Balance Sheet of the Banking System	11/2009	12/2009	M	M	M		
Interest Rates[2]	11/2009	12/2009	M	M	M		
Consumer Price Index	11/2009	12/2009	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA	O, LO, O, O	O, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	09/2009	10/2009	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/2008	10/2009	M	M	M		
External Current Account Balance	2008	10/2009	A	A	A	O, O, O, O	LO, O, LO, O, O
Exports and Imports of Goods and Services	2008	10/2009	A	A	A		
GDP/GNP	2008	10/2009	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	12/2008	9/2009	M	NA	NA		
International Investment Position[6]	NA	NA	NA	NA	NA		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] Reflects the assessment provided in the data ROSC or the Substantive Update (published on March 10, 2004, and based on the findings of the mission that took place during May 8–21, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording, respectively, are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 9, except referring to international standards concerning, respectively, source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative on Malawi

February 19, 2010

The following information has become available since the issuance of Malawi's Staff Report for the 2009 Article IV consultation and Request for Support under the Extended Credit Facility (EBS/10/24). The new information does not alter the thrust of the staff appraisal.

1. The first half of the fiscal year (from July-December 2009) was characterized by stronger than projected revenue performance, donor disbursement delays, and higher domestic borrowing.[1]

- Total revenues overperformed by around 0.5 percent of GDP, mainly due to improvements in tax administration and strong performance from nontax revenues, which were higher by around 0.3 percent of GDP.

- Grants were lower than budgeted, with the shortfall amounting to around 2.7 percent of GDP (MK 20.4 billion). Delays in donor disbursements led to higher than projected domestic borrowing.

- Total expenditures were roughly in line with the budget, with some notable differences in the expected composition. In particular, expenditures on wages and salaries were higher than budgeted by 0.06 percent of GDP (reflecting additional wages paid teachers, nurses, and doctors), along with spending on domestic interest payments (reflecting higher domestic debt). These additional budgetary outlays were largely offset by reduced spending on the fertilizer subsidy program, due mainly to lower than projected fertilizer import prices.

2. In the second half of the fiscal year, domestic revenues are expected to continue to overperform, and overdue donor funds are expected to be disbursed. The government intends to tighten its control of wages and salaries and goods and services expenditures, and reduce the domestic debt. It also intends to use some of the added budgetary inflows to increase social and development spending by about 0.7 percent of GDP compared to the budget, while meeting the domestic debt repayment target of 1.5 percent of GDP.

3. The growth in reserve money and broad money was higher than projected in the fourth quarter, reflecting the increased government borrowing intended to compensate for delayed donor disbursements. Broad money grew by 24.4 percent at end-December 2009 on a twelve-month basis against the projected growth of 17 percent, and reserve money grew by

[1] The 2009/10 Mid-Year Review and Revised Budget Statement were presented to Parliament on February 2, 2010.

39 percent against the projected increase of 28.4 percent. The central bank intensified its efforts to mop up the ensuing rise in liquidity, resulting in an increase in the interbank rate and other key interest rates. The program's monetary targets are expected to be achieved, given the expected reduction in domestic debt in the second half of the fiscal year.

4. This year's tobacco crop is estimated at 177,500 metric tons (MT), including 153,000 MT of burley, which is slightly lower than last year's total production. The reduced production stems from less favorable weather conditions and a smaller number of producers. However, prices are expected to be fairly resilient because of concerns about supply shortages in Mozambique and Zambia. The industry is still in negotiation with the government over this year's minimum price schedule, which tobacco producers hope will reflect prevailing market conditions.

5. The rains have been erratic in the southern region of the country, which has hurt maize production. However, the maize crop is unaffected in other regions of the country. Food security requires about 2.2 million MT of maize production per annum, which could still be met, despite reduced production in the south.

6. Official unencumbered reserve assets were slightly higher than projected at US$130 million at end-December 2009, equivalent to around 0.7 months of prospective imports.

7. Market reaction to the recent depreciation of the kwacha has been favorable, resulting in a gradual narrowing of the exchange rate spread from 22.2 percent at end-November 2009 to 20.6 percent.

8. The Department for International Development (DFID) and European Union (EU) have now confirmed their provision of budget support for fiscal year 2009/10.

9. The Millennium Challenge Account (MCA) board has recently re-certified Malawi as eligible for compact funding. A compact could be signed later this year, and the five-year window within which these funds must be drawn could start six to twelve months from that point after the plans and institutional arrangements to support the program are put in place. The MCA-funded program would focus on improving the reliability and quality of the country's electricity supply, expanding electricity access to peri-urban and rural areas, and supporting institutional reforms to the Electricity Supply Corporation (ESCOM) and the state regulator.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 10/38
FOR IMMEDIATE RELEASE
February 19, 2010

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

IMF Executive Board Concludes 2009 Article IV Consultation with Malawi

On February 19, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Malawi.[23] The Executive Board also approved a three-year arrangement under the Extended Credit Facility (ECF) in the amount of SDR 52.05 million (75 percent of quota).

Background

Malawi stands at a critical juncture following its recent progress on macroeconomic stability. The 2009 Article IV consultation discussions and ECF program negotiations focused on the design of a medium-term program to restore Malawi's external equilibrium while sustaining a high rate of growth and poverty reduction, in line with Malawi's poverty reduction and growth strategy.

Malawi's macroeconomic performance has improved significantly over the past two years and the country's agricultural-based economy has weathered the global economic storm relatively well. Good weather and the distribution of subsidized fertilizer have contributed to robust growth and moderate inflation in recent years. After reaching 9.8 percent in 2008, real GDP growth is estimated at 7.6 percent in 2009 buoyed by an increase in agricultural production and the expansion of the service sector. Inflation has remained moderate. After rising in late 2008, in response to food and fuel price shocks, consumer price inflation decreased steadily to 7.5 percent in the 12 months to October 2009.

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

Fiscal policy loosened significantly in the run-up to the 2009 presidential and parliamentary elections. Sizeable budget overruns on fertilizer and goods and services spending during fiscal year 2008/09, combined with a modest shortfall in foreign financing, led to a high level of domestic borrowing and meant that the central government deficit was well above the budget. The fiscal year 2009/10 budget is a return to a prudent fiscal stance and the preliminary results on the execution through the first half of the fiscal year to December 2009 are in line with the budget, adjusted for delays in donor support.

A weak balance of payments threatens exchange rate and price stability and medium-term growth. The de facto pegging of the Malawi kwacha to the U.S. dollar from 2006 to late 2009 contributed to the moderation of inflation. However, persistent inflation differentials with trade partners and the de facto peg led to some appreciation of Malawi's real effective exchange rate in recent years. The combination of rapid growth of domestic incomes in the nontradable sectors and the exchange rate appreciation have led to an imbalance between the growth of imports and exports and widened the deficits in the external current account and balance of payments.

Malawi's medium-term outlook is favorable, within the context of successful implementation of the ECF-supported program**.** Growth is expected to remain buoyant, but moderate somewhat relative to the high growth of the recent past. Over the medium term, growth is expected to be supported by the expansion of productive capacity at the Kayelekera uranium mine and the exploitation of niobium (a niche mineral for steelmaking), as well as the development of the sugar sector. Inflation is expected to remain moderate. Although the depreciation of the exchange rate could exert pressure on prices, the solid maize harvest, stable fuel prices, and restrained fiscal and monetary policies should contain inflationary pressures. International reserves should rise as a result of a substantial expected inflow of donor assistance; seasonal inflows, once the new harvest season begins; and a reduction of import growth followed by some greater export growth, as exchange rate adjustments and liberalization of the foreign exchange market bring about a market-based price that can be supported without foreign exchange rationing.

There are several key downside risks to the economic outlook including foreign exchange shortages, uncertainties in the external environment, and changes in the international environment for tobacco consumption. Delays in relieving the foreign exchange shortage could threaten growth, fiscal revenues and investor confidence. A slower global recovery could dampen export demand, investor interest, remittances, and access to foreign capital, and thereby impair growth and the balance of payments. The medium-term prospects for burley tobacco, the largest export commodity, are uncertain.

Executive Board Assessment

They observed that the Malawian economy has proven resilient during the global economic crisis by sustaining high growth and moderate inflation. The financial sector remains well-capitalized and sound; Malawi's food security was enhanced through increased agricultural output; and progress was made towards the achievement of the Millennium Development Goals. At the same time, Directors noted that Malawi's external position remains weak and that official reserves have fallen to well below prudential levels, and they regretted last year's policy slippages. Directors therefore called on the authorities to seize the opportunity of their renewed program engagement with the Fund to restore internal and external equilibrium and address key structural constraints, while supporting strong growth and poverty reduction.

Directors welcomed the adoption of a more prudent fiscal stance in the 2009/10 budget following last year's slippages, which partly reflected the impact of high fertilizer prices. They stressed the importance of adhering to the deficit target by containing nonpriority spending. Directors supported the steps to minimize the budgetary impact of deficits in key parastatals by announcing tariff adjustments to enhance cost recovery, and beginning to devise a plan for dealing with Air Malawi's debt. They also welcomed the more transparent accounting of the fertilizer subsidy program, recent improvements in fiscal accounting and reporting, and measures to ensure that budgetary targets on priority social spending are met. Directors encouraged the authorities to make the Public Financial and Economic Management unit in the Ministry of Finance fully operational, and looked forward to further steps to strengthen public spending management and develop a strong debt management policy. They supported the ongoing efforts to improve tax administration and broaden the tax base.

Directors welcomed the tightening of monetary policy and encouraged the Malawian authorities to control the growth of monetary aggregates by ensuring fiscal discipline and prudent credit expansion. They encouraged the development of financial markets over the medium term, which would allow greater reliance on interest rate adjustments to help control inflation.

Directors endorsed the authorities' objectives to build international reserves, achieve a properly valued exchange rate, and liberalize the foreign exchange market. They saw the reversion of the foreign exchange surrender requirement and the gradual depreciation of the nominal exchange rate as encouraging steps, and looked forward to Malawi's full adherence to Article VIII obligations by end-2011. Directors welcomed the authorities' commitment to undertake further policy adjustments, including of the exchange rate, should continued evidence emerge of excess demand for foreign exchange. They noted the importance of exchange rate flexibility to avoid an overly contractionary fiscal and monetary stance. Directors commended the authorities for recent progress in strengthening financial regulation and supervision. They welcomed the recent passage of the amendments to the Banking and Insurance Acts. Directors looked forward to cabinet approval and implementation of the Financial Sector Development Strategy, designed to enhance financial inclusiveness, deepening, and competitiveness.

Directors encouraged the authorities to create an enabling environment for private investment and growth by developing a comprehensive strategy for reforming the utility companies and expanding access to utility services. They also advised the adoption of market-friendly agricultural sector policies. Close cooperation with Malawi's development partners will be important to help build capacity in these areas.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Malawi: Selected Economic Indicators, 2007–11[1]

	2007	2008	2009	2010	2011
	Act.	Act.	Prel.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)					
GDP at constant market prices	8.6	9.8	7.6	6.0	6.3
Consumer prices (end of period)	7.5	9.9	7.7	9.2	8.5
Consumer prices (annual average)	7.9	8.7	8.5	10.1	8.3
Central government (percent of GDP)					
Revenue and grants	31.6	31.2	30.1	35.2	32.2
Tax and non tax revenue	18.7	19.9	21.4	22.6	22.8
Grants	12.9	11.3	8.8	12.7	9.4
Expenditure and net lending	36.0	36.2	36.1	36.0	33.9
Overall balance (excluding grants)	-17.2	-16.5	-14.6	-13.5	-11.2
Overall balance	-4.3	-5.0	-5.8	-0.8	-1.8
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)					
Money and quasi money	36.9	33.1	19.4	16.7	13.9
Net foreign assets [2]	41.9	-10.1	-18.4	13.6	10.4
Credit to the rest of the economy (percent change)	32.8	45.5	27.9	28.4	19.4
External sector (US$ millions, unless otherwise indicated)					
Exports, f.o.b.	731.7	969.2	1,004.8	1,119.9	1,229.7
Imports, c.i.f.	-1,182.3	-1,722.8	-1,809.6	-1,739.8	-1,843.0
Usable gross official reserves [2]	217.1	239.0	114.0	276.9	407.3
(months of imports)	1.2	1.3	0.6	1.4	2.1
(percent of reserve money)		93.2	35.0	81.3	126.6
Current account (percent of GDP)	-1.5	-6.4	-8.6	-1.8	-2.2
Current account, excl. official transfers (percent of GDP)	-15.5	-21.8	-21.9	-18.7	-15.9
Nominal effective exchange rate (percent change)	-8.8	20.2	...	...	...
Real effective exchange rate (percent change)	-7.8	24.9	...	...	...
Overall balance (percent of GDP)	0.5	-1.0	-1.8	4.4	3.6
Terms of trade (percent change)	-1.7	5.9	13.7	-3.1	-2.9
Debt stock and service (percent of GDP, unless otherwise indicated)					
External debt (public sector)	14.4	16.0	19.1	21.8	23.3
NPV of debt (percent of avg. exports)	0.0	42.1	64.3	62.1	65.4
NPV of debt (percent of avg. exports)	41.9	51.5	58.7	66.4	72.3
External debt service (percent of exports)	3.2	6.7	1.3	1.8	2.2
Net domestic debt (central government)	11.8	19.0	20.3	14.0	11.0
Treasury bill rate (period average)[3]	13.9	10.9	11.9	...	...

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates and projections.

[1] The ECF scenario assumes an initial depreciation and that the real exchange rate is kept constant during the program period. Correcting the underlying exchange rate misalignment is a key element of the macroeconomic framework.
[2] Programmed usable reserves in 2009 excludes the SDR allocation, while the projection includes the SDR allocation.
[3] Average t-bill rate. Data for 2009 are shown as of November 30th.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 10/52
FOR IMMEDIATE RELEASE
February 19, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves Three-Year US$79.4 Million Extended Credit Facility Arrangement for Malawi

The Executive Board of the International Monetary Fund (IMF) today approved a three-year, SDR 52.05 million (about US$79.4 million) arrangement for Malawi under the Extended Credit Facility (ECF) [1] to support the authorities' economic program for the period 2010–12.

A one-year Exogenous Shocks Facility (ESF) arrangement also for SDR 52.05 million (see Press Release) expired on December 2, 2009. The ESF arrangement was preceded by an arrangement under the Poverty Reduction and Growth Facility (PRGF) that was completed on August 4, 2008. Malawi reached the completion point for the enhanced Heavily Indebted Poor Countries (HIPC) Initiative on August 31, 2006.

The ECF arrangement approved today represents 75 percent of Malawi's SDR 69.4 million quota in the Fund, of which the country became a member in July 1965.

Following the Executive Board's discussion of the request by Malawi, Mr Takatoshi Kato, Deputy Managing Director and Acting Chair, made the following statement:

"Malawi's economic program, supported by the Extended Credit Facility, aims to support Malawi's Growth and Development Strategy by restoring internal and external equilibrium and addressing key structural constraints. The authorities have adopted a prudent fiscal stance in the 2009/10 budget by reigning in discretionary spending on goods and services while safeguarding priority social spending, and shoring up revenues. The budgetary impact of deficits in key parastatals will be limited by allowing for greater cost recovery and initiating a medium-term plan for restructuring Air Malawi's debts. Progress is also made toward a more transparent accounting of the fertilizer subsidy program and enhanced fiscal accounting and reporting.

"The Malawian authorities have tightened monetary policy and intend to control the growth of monetary aggregates by ensuring fiscal discipline and prudent credit growth. The development of financial markets over the medium term would allow greater reliance on interest rate adjustments to help control inflation.

“The program is designed to build reserves and achieve a properly valued exchange rate to support growth and stability. The adoption of a flexible exchange rate and the steps taken to liberalize the foreign exchange market are welcome. The authorities have committed to undertake further policy adjustments, including of the exchange rate, if evidence emerges of continued excess demand for foreign exchange. Continued exchange rate flexibility will help to avoid an overly contractionary fiscal and monetary stance.

“Malawi’s structural reform agenda aims at strengthening the Public Financial and Economic Management unit in the Ministry of Finance, and enhancing the social safety net program through improved targeting of households and a possible expansion of the donor-financed pilot transfer program. Tax administration will be further strengthened and the tax base broadened to allow the value-added tax rate to be reduced to regional norms.

“The authorities intend to continue their efforts to create an enabling environment for private investment and growth by: developing a comprehensive strategy for reforming the utility companies and expanding access to utility services; strengthening the regulatory environment; and adopting market-friendly agricultural sector policies.”

Recent Economic Developments

Malawi’s agricultural-based economy has weathered the global economic storm well. Record agricultural harvests in recent years led to economic growth of 9.8 percent in 2008 and an estimated 7.6 percent in 2009. Inflation has remained moderate. The financial sector was only modestly affected by the global turmoil and remains well-capitalized and profitable.

A loosening of fiscal and monetary policies during the run-up to elections in May 2009 led to high government domestic borrowing in fiscal year 2008/09 (ending in June 2009), and rapid money and credit growth. This easing contributed to low international reserves. The end-June 2009 ESF program targets for net domestic repayment of the central government, and net domestic assets and net international reserves of the RBM were missed by wide margins. The fiscal year 2009/10 budget reflects a prudent fiscal stance, targeting a repayment of net domestic borrowing in line with the medium-term objectives to maintain a low deficit and create room for private sector credit.

A weak balance of payments threatens exchange rate and price stability and medium-term growth. The de facto pegging of the Malawi kwacha to the U.S. dollar from 2006 to late 2009 helped to moderate inflation. But persistent inflation differentials with trade partners and the peg led to some appreciation of Malawi’s real effective exchange rate. Rapid growth of domestic incomes and exchange rate appreciation have led to an imbalance between the growth of imports and exports and widened external current account and balance of payments deficits.

The authorities have recently adopted a number of measures to address the external imbalance, including initial steps at market liberalization, gradual depreciation of the exchange rate, and strengthened budgetary spending controls. However, continued policy adjustment and external support are critical.

Program Summary

The authorities' ECF-supported economic program aims to:

• **Restore external equilibrium** by liberalizing the foreign exchange regime for current account transactions to allow a market-clearing exchange rate to emerge and to eliminate measures inconsistent with the IMF's Articles of Agreement by end-2011; and by attaining international reserve coverage of a minimum of three months of imports to buffer against external shocks by end-2012.

• **Maintain internal equilibrium** by pursuing prudent fiscal and monetary policies, as reflected in the fiscal year 2009/10 budget and through restrained monetary aggregate growth, to contain aggregate demand and inflation pressures and shift demand toward domestic output.

• **Sustain poverty reduction efforts** by creating room in the budget for more social and pro-poor spending and improving the structure of the social safety net to protect poor households from shocks and policy adjustments, including exchange rate depreciation.

• **Build competitiveness** by improving public financial management, tax administration, and the efficiency and solvency of public utilities, and by enhancing the business climate by expanding the capacity and quality of infrastructure, promoting investor access to finance, and reforming legal and regulatory frameworks governing financial supervision and the operation of other key economic activities.

The program also encompasses structural measures to underpin macroeconomic objectives and sustain high growth. The authorities have provided, as a prior action of the ECF-supported program, a transparent accounting of the execution of the fertilizer subsidy program in the fiscal year 2008/09 budget and of the budgeted figures in fiscal year 2009/10. The authorities committed to undertake further structural measures in three areas during the first year of the program:

(i) improving public financial management by making fully operational the PFEM unit;

(ii) developing a time-bound plan to restart and liberalize the interbank foreign exchange market; and

(iii) continuing with implementation of financial sector reforms, and improving monetary and exchange rate policy transparency. Over the final two years of the program, they intend to continue improving transparency and solvency of the public utilities

Table 1. Malawi: Selected Economic Indicators, 2007–11[1]

	2007	2008	2009	2010	2011
	Act.	Act.	Prel.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)					
GDP at constant market prices	8.6	9.8	7.6	6.0	6.3
Consumer prices (end of period)	7.5	9.9	7.7	9.2	8.5
Consumer prices (annual average)	7.9	8.7	8.5	10.1	8.3
Central government (percent of GDP)					
Revenue and grants	31.6	31.2	30.1	35.2	32.2
Tax and non tax revenue	18.7	19.9	21.4	22.6	22.8
Grants	12.9	11.3	8.8	12.7	9.4
Expenditure and net lending	36.0	36.2	36.1	36.0	33.9
Overall balance (excluding grants)	-17.2	-16.5	-14.6	-13.5	-11.2
Overall balance	-4.3	-5.0	-5.8	-0.8	-1.8
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)					
Money and quasi money	36.9	33.1	19.4	16.7	13.9
Net foreign assets [2]	41.9	-10.1	-18.4	13.6	10.4
Credit to the rest of the economy (percent change)	32.8	45.5	27.9	28.4	19.4
External sector (US$ millions, unless otherwise indicated)					
Exports, f.o.b.	731.7	969.2	1,004.8	1,119.9	1,229.7
Imports, c.i.f.	-1,182.3	-1,722.8	-1,809.6	-1,739.8	-1,843.0
Usable gross official reserves [2]	217.1	239.0	114.0	276.9	407.3
(months of imports)	1.2	1.3	0.6	1.4	2.1
(percent of reserve money)		93.2	35.0	81.3	126.6
Current account (percent of GDP)	-1.5	-6.4	-8.6	-1.8	-2.2
Current account, excl. official transfers (percent of GDP)	-15.5	-21.8	-21.9	-18.7	-15.9
Nominal effective exchange rate (percent change)	-8.8	20.2	...	...	...
Real effective exchange rate (percent change)	-7.8	24.9	...	...	...
Overall balance (percent of GDP)	0.5	-1.0	-1.8	4.4	3.6
Terms of trade (percent change)	-1.7	5.9	13.7	-3.1	-2.9
Debt stock and service (percent of GDP, unless otherwise indicated)					
External debt (public sector)	14.4	16.0	19.1	21.8	23.3
NPV of debt (percent of avg. exports)	0.0	42.1	64.3	62.1	65.4
NPV of debt (percent of avg. exports)	41.9	51.5	58.7	66.4	72.3
External debt service (percent of exports)	3.2	6.7	1.3	1.8	2.2
Net domestic debt (central government)	11.8	19.0	20.3	14.0	11.0
Treasury bill rate (period average)[3]	13.9	10.9	11.9	...	...

Sources: Reserve Bank of Malawi, Malawi Ministry of Finance, and IMF staff estimates and projections.

[1] The ECF scenario assumes an initial depreciation and that the real exchange rate is kept constant during the program period. Correcting the underlying exchange rate misalignment is a key element of the macroeconomic framework.

[2] Programmed usable reserves in 2009 excludes the SDR allocation, while the projection includes the SDR allocation.

[3] Average t-bill rate. Data for 2009 are shown as of November 30th.

Statement by Samuel Itam, Executive Director for Malawi

February 19, 2010

My Malawi authorities would like to thank staff and Management for their candid assessment of recent economic developments and constructive dialogue and their support for Malawi's request for an arrangement under the Extended Credit Facility (ECF). They are especially thankful to the Executive Board and Fund Management for their continued support and valuable policy guidance against the backdrop of a very difficult global economic environment. The authorities are requesting Executive Board's approval for the 3-year arrangement under the ECF.

Recent economic developments

Malawi's remarkable economic performance over the last few years resulted in the attainment of macroeconomic stability, generated robust growth, reduced domestic debt and lowered interest rates. The authorities' resolution to generate rapid socio-economic development under Malawi's Growth and Development Strategy (MGDS) has enabled the country to achieve impressive growth, averaging 7 percent a year in the recent past, with inflation ebbing to single digits. However, the high growth and development efforts boosted imports creating pressure on external reserves, and, in some instances, the policy response was not as rapid or robust as the authorities would have preferred. Furthermore, the adverse effects of the global financial and economic crisis have been more severe than initially envisaged.

However, economic performance has remained encouraging. Real GDP growth for 2009 is estimated at about 7.7 percent, supported by buoyant maize and tobacco production and the start of uranium production. Consumer price inflation has trended down to 7.6 percent at end-December, reflecting the tight monetary policy stance and the moderation in food and fuel prices. In contrast, fiscal performance in 2008/09 was weaker-than-projected. The strong domestic revenue growth was more than offset by higher-than-expected spending on the fertilizer subsidy program, overruns on goods and services, and shortfalls in foreign financing. These developments in turn led to expansion of credit to government and decline in foreign exchange reserves.

The authorities have responded with stronger measures to address the fiscal and external imbalances. The budget for 2009/10 presents a prudent fiscal stance and targets a net domestic debt repayment of 1.2 percent of GDP. Expenditures so far in the fiscal year have been closely aligned to the budget provisions. The authorities have also implemented a number of measures to address the external imbalance and to liberalize the foreign exchange market. The exchange rate has been allowed to depreciate steadily, all private import payment arrears have been cleared, and the Reserve Bank of Malawi (RBM) has issued a directive to revert the surrender of export earnings to commercial banks instead of RBM. The authorities have also made further progress with structural reforms to lower high lending spreads. The Credit Reference Bureau Bill, providing the legal and regulatory framework for sharing credit information, was approved by Parliament on February 11, 2010.

Outlook and policies going forward

The authorities are committed to adjusting their economic policies and programs for the near term to meet the emerging challenges and maintain macroeconomic stability. They plan to continue directing their fiscal, monetary, exchange and debt policies toward achieving their near-term objectives of high growth, single digit inflation and building up of foreign reserves. At the same time, the authorities will focus on their long-term development and poverty reduction objectives.

Fiscal policy and public financial management

The authorities stand ready to reduce lower-priority spending and/or shore up revenue with further measures to ensure that they meet the domestic debt repayment target. The authorities intend to continue with domestic debt reduction in the medium-term. To accommodate necessary investment, efforts will continue at mobilizing additional revenue and relying on concessional financing. However, the authorities intend to cut expenditures further if domestic revenue falls short and reduce domestic borrowing if aid inflows exceed budgetary projections.

To strengthen fiscal discipline, Malawi authorities are committed to continue public financial management reforms. In this regard, they plan to make the Public Finance and Economic Management (PEFM) unit in the Ministry of Finance operational, which will facilitate the timely production, consolidation and reconciliation of accounts. To reduce the risks to the budget from contingent liabilities from activities of parastatals, electricity and water tariffs will be adjusted as needed, commercial borrowing avoided, and Air Malawi's debt restructured. The debt sustainability analysis undertaken by the Fund and the World Bank reaffirms that the level of debt distress will remain modest.

Monetary policy and exchange rate

The authorities will continue to focus monetary policy on containing inflation, maintaining exchange rate stability, promoting a viable external sector for sustained economic growth, and supporting the rebuilding of international reserves. The monetary program is anchored on controlling broad money growth, with reserve money serving as the operational target. To this end, the authorities will continue to improve liquidity forecasting by enhancing the coordination between RBM and the Ministry of Finance, providing greater stability and predictability to the domestic money market, and facilitating the achievement of reserve money targets. The restraints on government borrowing and build up of international reserves will also open greater space for provision of credit to the private sector.

The authorities see the need for enhanced exchange rate flexibility and have taken steps to move the exchange rate judiciously and gradually in order to maintain expectations and avoid reigniting inflation. They are committed to modernizing the exchange rate and monetary policy framework. In this regard, they will re-establish an active interbank market for foreign exchange. Foreign exchange bureaus that meet the fit and proper test will also be licensed to operate.

The need for Fund support

The authorities have formulated a focused set of macroeconomic policies and program to maintain a stable macroeconomic environment that would support strong and sustainable growth. They believe that their economic and financial policies complemented by the Fund support under the ECF, will help build international reserves to more than 3 months of import cover without jeopardizing the development and poverty reduction objectives. Finally, while my authorities are aware of potential risks to the program, they do not view them as insurmountable. They expect the Fund support to be an essential and timely input that will help them to sustain their effort to maintain macroeconomic stability and lay the foundation for enhanced growth over the medium term.