MALAWI: Third and Fourth Reviews under the Extended Credit Facility Arrangement, Request for Waivers for Non-Observance of Performance Criteria, Extension of the Arrangement, Rephasing of Disbursements, and Modification of Performance Criteria-Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Malawi.

INTERNATIONAL MONETARY FUND

INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/37

MALAWI

February 2014

THIRD AND FOURTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, REPHASING OF DISBURSEMENTS, AND MODIFICATION OF PERFORMANCE CRITERIA—STAFF REPORT; STAFF SUPPLEMENT; PRESS RELEASE ON THE EXECUTIVE BOARD DISCUSSION; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI.

In the context of the Third and Fourth Reviews Under the Extended Credit Facility Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 17, 2014, following discussions that ended on November 20, 2013, with the officials of Malawi on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on December 27, 2013.

- A **Staff Supplement** of January 13, 2014 updating information on recent developments.

- An **Informational Annex** prepared by staff of the IMF in consultation with staffs of the World Bank and African Development Bank.

- A **Debt Sustainability Analysis** prepared by staffs of the IMF and the World Bank.

- A **Press Release** including a statement by the Acting Chair of the Executive Board.

- 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.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org
Price: $18.00 a copy
International Monetary Fund
Washington, D.C.

MALAWI

December 27, 2013

THIRD AND FOURTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NON-OBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, REPHASING OF DISBURSEMENTS, AND MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Donors have suspended some aid disbursements to Malawi in response to a scandal involving the theft of public funds. A group of public servants exploited weaknesses in the control environment of the government's Integrated Financial Management Information System (IFMIS) to make fraudulent payments to several entities that had not provided any goods or services to the government. The authorities are implementing an Action Plan of remedial measures to prevent the recurrence of the fraud. Key elements of the action plan include strengthening security and management of IFMIS, a forensic audit, and identifying and prosecuting the perpetrators of the fraud.

Recovery is underway in many sectors of the economy, facilitated by increased availability of foreign exchange. This reflects the impact of policy reforms, including a strong response to exchange rate adjustment from the tobacco sector and re-established external credit lines. Inflation is falling, although more slowly than programmed.

Performance in relation to quantitative targets for the third ECF review (March test date) was good, but weakened for the fourth review (September test date). There was significant fiscal slippage (excessive domestic borrowing) during July-September 2013. This constrained the room for substituting domestic borrowing for the shortfall in aid flows. There has been progress in implementing structural benchmarks, but at a slower pace than programmed.

Discussions focused on managing the fall-out from the fiscal scandal and policies to reverse the fiscal slippage and lower inflation. A substantial decrease in aid receipts for the remainder of the fiscal year necessitated some reprioritization of spending plans as well as expenditure cuts. Fiscal and monetary policy need to be tightened to lower inflation pressures and safeguard international reserves.

Staff supports the authorities' requests for waivers based on corrective actions and policy commitments. The authorities are implementing strong corrective actions to address the fraud and fiscal slippage, including several prior actions, and have also strengthened external debt management to ensure that they observe their commitment not to contract nonconcessional external debt. Staff further supports the requests for extension of the arrangement, rephasing of disbursements (including a halving of the disbursements originally associated with the third and fourth reviews and applying the balance to an additional review) and modifications of performance criteria.

Approved By
David Owen (AFR) and Mark Flanagan (SPR)

Prepared By
The African Department (in consultation with other departments)

Discussions for the third review were held in Lilongwe and Blantyre during June 11-25. A mission returned to Lilongwe from November 5 to 20, 2013 to hold discussions on the third and fourth reviews. Both missions were led by Mr. Tsikata (AFR). Other members of the June mission team were Messrs. Daal and Ghazanchyan and Ms. Carvalho (all AFR), Ms. Mitchell Casselle (MCM) and Ms. Randall (resident representative). The November mission team included Messrs. Reinke and Wu (both AFR), Mr. Amaglobeli (FAD), Mr. Peralta-Alva (SPR) and Mr. Oestreicher (resident representative). Mr. Tucker and Ms. Teferra (both OED) participated in the discussions in June and November, respectively.

The missions met with President Joyce Banda, Ministers of Finance Dr Ken Lipenga (June) and Dr. Maxwell Mkwezalamba (November), Reserve Bank of Malawi (RBM) Governor Charles Chuka, other senior government and RBM officials, as well as representatives of the business community, civil society organizations, and Malawi's international development partners.

CONTENTS

BOX

TABLES

APPENDIX

CONTEXT: FISCAL SCANDAL AND RISKS TO ECONOMIC RECOVERY

1. **In early October 2013, the authorities informed staff of misappropriation of significant amounts of public funds through fraudulent transactions carried out in the government's Integrated Financial Management Information System (IFMIS).** The fraud was uncovered during an exercise to reconcile funding levels authorized by the Ministry of Finance (MoF) and payments being made from government accounts in the banking system (MEFP ¶2).[1] In view of governance, safeguards, and financing assurances issues raised by the fraud, Executive Board consideration of the third review—scheduled for October 21—was postponed to allow staff to assess the situation and discuss remedial measures with the authorities. The government estimates that about MK9 billion (approximately US$25 million, or 0.7 percent of GDP) was misappropriated through the fraud during the first quarter of FY2013/14 (July-September 2013). Misappropriations may also have occurred in previous years; the government intends to extend investigations back to FY2009/10 to establish orders of magnitude.

2. **The scandal has sparked public outrage in Malawi.** As part of her response to the public outcry, President Banda reconstituted her cabinet in October, including the appointment of a new Minister of Finance. She has repeated in several public statements that she is determined to fight corruption in Malawi and will not protect anyone involved in the scandal—including those with links to her ruling People's Party—from the full force of the law. With general elections (presidential, parliamentary and local councils) scheduled for May 2014, the opposition parties may try to use the scandal against the ruling party in their political campaigns. However, commentators have noted that the major opposition parties have also been involved in corruption scandals in the past and so may not be able to claim the moral high ground.

3. **In response to the scandal, donors suspended disbursements of financial assistance to the budget.** The immediate impact of the aid freeze was a delay in disbursements of general budget support and dedicated grants (mainly targeted at social sectors) amounting to about US$180 million in the second fiscal quarter (October – December 2013), equivalent to about 55 percent of the total budget support and dedicated grants for the year. The large share of disbursements programmed for the second quarter was designed to provide timely support for the

[1] Another recent incident that may be linked to attempts to defraud the government was the shooting of the Director of Budget of the Ministry of Finance in mid-September. He was severely injured but survived the attack.

Farm Input Subsidy Program (FISP); the bulk of spending on the main input (fertilizers) is made in that quarter.

4. **The government is implementing an Action Plan (AP) to address the weaknesses in public financial management exposed by the fraud (Box 1).** In late-September, the authorities suspended the use of IFMIS for processing government financial transactions and invited the vendor of the software to assess the situation, fix identified problems, and recover data that had been erased by the perpetrators of the fraud. The use of IFMIS for government transactions resumed in early November after installation of a stronger firewall and implementation of several measures to improve access control and the overall management of the system (MEFP ¶26). A forensic audit is underway, which will ascertain the magnitude of the fraud, assess the security and control weaknesses of IFMIS (including how it is currently operating), and make recommendations for enhancing the security of the system (MEFP ¶25). Implementation of the AP is being monitored through weekly reporting to a ministerial level committee chaired by the Minister of Finance, with participation of donors.

5. **Donors who provide budget support have developed a "Extraordinary Performance Assessment Framework" (EPAF) to monitor progress in implementation of remedial measures.** The EPAF draws from and elaborates on items from the AP, with a focus on short term measures (to be implemented by March 2014) designed to restore confidence in government systems and to strengthen ongoing reforms in public financial management (PFM). Specific actions in the EPAF include: independent verification of the security and robustness of transactions being undertaken through IFMIS after its reactivation, institution of daily bank reconciliations by the Treasury, compliance with expenditure ceilings under the ECF-supported program, and disciplinary action against those who approved the fraudulent payments or signed the associated checks.

Box 1. Malawi: Action Plan to Address Weaknesses in Public Financial Management Exposed by Fiscal Scandal

Process weaknesses were exploited to gain unauthorized access to the government's Integrated Financial Management Information System (IFMIS) to generate a series of fraudulent payment transactions. Payments were made on behalf of a few government agencies to dozens of companies that had not delivered any goods or services to the government, and the related entries were deleted from the system. Inadequate organizational and management arrangements and weak adherence to established rules led to inappropriate password sharing, failure to delete passwords and access rights of terminated or transferred staff, inappropriate use of system administrator privileges to process transactions, and inadequate maintenance of the audit trail. The absence of effective systems audit arrangements, inadequacies in documentation and incomplete and belated bank reconciliation, and an ineffective sanctions regime also contributed to a weak control environment.

The authorities responded to the crisis by shutting down the compromised IFMIS and initiating a set of remedial measures. Realizing that manual processing of government payments is subject to even higher risks, the government aimed at quick reinstatement of IFMIS after critical system safeguards have been achieved. The authorities developed a comprehensive Action Plan (with input from donors), which they are implementing with the assistance of the international community. It covers five broad areas:

- *Investigation and prosecution.* In addition to the prosecution of all individuals involved in the scandal, the authorities have started profiling the properties of public officers connected to suspicious transactions which should help in recovering stolen monies.
- *Audit.* A two-pronged forensic audit has been initiated. The first, which will cover a limited period in 2013 (April-September), is due to be completed by end-January 2014. The second, covering a period going back to FY2009/10, is expected to be completed in the second half of 2014. Furthermore, the government will procure an audit management system, introduce a system of ad hoc audits and enhance its audit capacity.
- *Accounting.* To prevent similar abuses, the software provider identified potential security gaps and introduced relevant system enhancements to fill them. User rights were recreated based on more regulated and restricted system access ensuring internal checks and segregation of duties. The reinstatement of IFMIS started in early November and will progress until becoming fully operational by end–2013. To facilitate system integrity and the early detection of irregular payments, the government is embarking on clearing a backlog of bank reconciliations after which it will adopt daily reconciliation.
- *Administrative measures.* Disciplinary actions will be taken against public officials whose negligence contributed to the fraud.
- *Legal and institutional reforms.* The authorities are taking steps to strengthen the legal framework for fighting corruption and to accelerate PFM reforms. Legal reforms include amendments to anti-money laundering legislation (e.g., introduction of a civil asset forfeiture regime) and a new law requiring the declaration of assets by public officials. PFM reforms are being supported by a multi-donor trust fund.

RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

A. Recent Economic Developments and Near-Term Outlook

6. **The pace of economic activity picked up significantly in 2013 (Table 1).** Real GDP growth is estimated to have rebound from 1.9 percent in 2012 to about 5 percent in 2013, mainly on account of an improved harvest (due to improved weather) and increased availability of foreign exchange (including through re-established external credit lines facilitated by the clearance of the bulk of accumulated private sector external payments arrears). While agriculture has driven the recovery, growth has also picked up in manufacturing (from a 1 percent contraction in 2012 to over 6 percent growth in 2013), construction (from less than 3 percent in 2012 to over 7 percent in 2013), and wholesale and retail trade (from less than 2 percent in 2012 to over 5 percent in 2013).

7. **A buoyant tobacco season helped to strengthen the kwacha temporarily and contributed to a significant build up of international reserves.** After nearly a year of persistent depreciation, the kwacha appreciated sharply (by about 20 percent) in May 2013 and remained relatively stable through early September, buoyed by increased proceeds from tobacco sales during the 2013 season (Text Table 1). The RBM seized the opportunity to purchase foreign exchange from the market to boost Malawi's international reserves. Gross official reserves rose from US$185 million (less than one month of import cover) at end-March 2013 to US$447 million (over 2 months of import cover) at end-September.

Text Table 1. Malawi: Tobacco Sales Revenue 2010–13 (All auction floors)

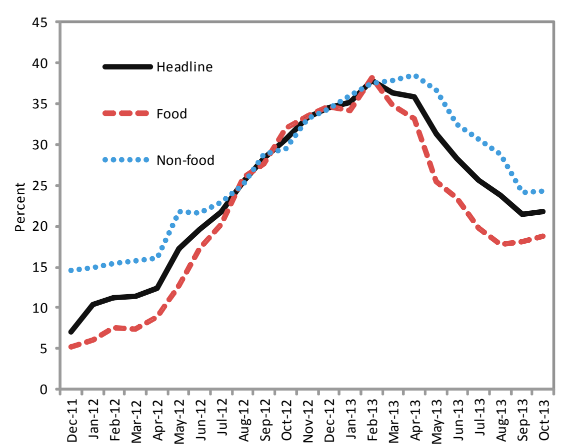
	2010	2011	2012	2013
Volume (millions of kilograms)	220	237	80	169
Sales revenue (millions of U.S. dollars)	416	294	178	362
Average price (US cents/kilogram)	189	124	223	214

Source: Malawian authorities.

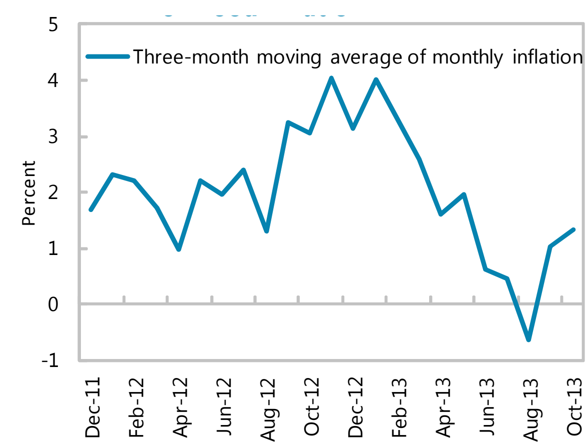
8. **The kwacha has come under pressure since the beginning of September.** It depreciated by 21 percent between end-August and mid-December, mainly on account of the onset of the "dry" season for private foreign exchange inflows and relatively little intervention in the market by RBM. Other factors that may have contributed to the downward pressure include the loosening of policies in July and August and a loss of private sector confidence as news of the fiscal scandal started to emerge.

9. **Inflation has been on a downward path, albeit at a slower pace than programmed.** The year-on-year rate of increase in the overall CPI decreased from a peak of 37.9 percent in February 2013 to 22.2 percent in October, with food and nonfood inflation at 19.4 percent and 23.9 percent, respectively. The pace of disinflation has been slower than projected, reflecting a prolonged and more pronounced depreciation spell after the initial devaluation of the exchange rate (in May 2012) than expected. The evolution of the exchange rate between May and early-September 2013 helped lower nonfood inflation, but the subsequent pick up in the pace of kwacha depreciation has led to a subsequent uptick.

Malawi: Year on Year Inflation



Malawi: Non-food Inflation



10. **There was a marked loosening of fiscal policy in the first quarter of FY2013/14 after broadly satisfactory performance in FY2012/13.** For FY2012/13, domestic revenue exceeded the programmed level while total expenditure was in line with the program (Tables 2a and 2b). Notwithstanding continued strong domestic revenue collection, the fiscal situation deteriorated in FY2013/14 Q1 as government incurred substantial domestic debt to meet overruns in primary expenditures as well as a significant increase in interest payments (MEFP ¶13). These overruns reflected an underestimation of interest payments—nominal interest rates and the stock of domestic debt are both higher than programmed—as well as advancement of arrears payments, pre-spending on items programmed to be financed by dedicated grants, unplanned spending on peace keeping operations, and payments related to the fiscal scandal. Net domestic borrowing by the government amounted to MK56 billion (3.5 percent of GDP), instead of a programmed small net repayment.

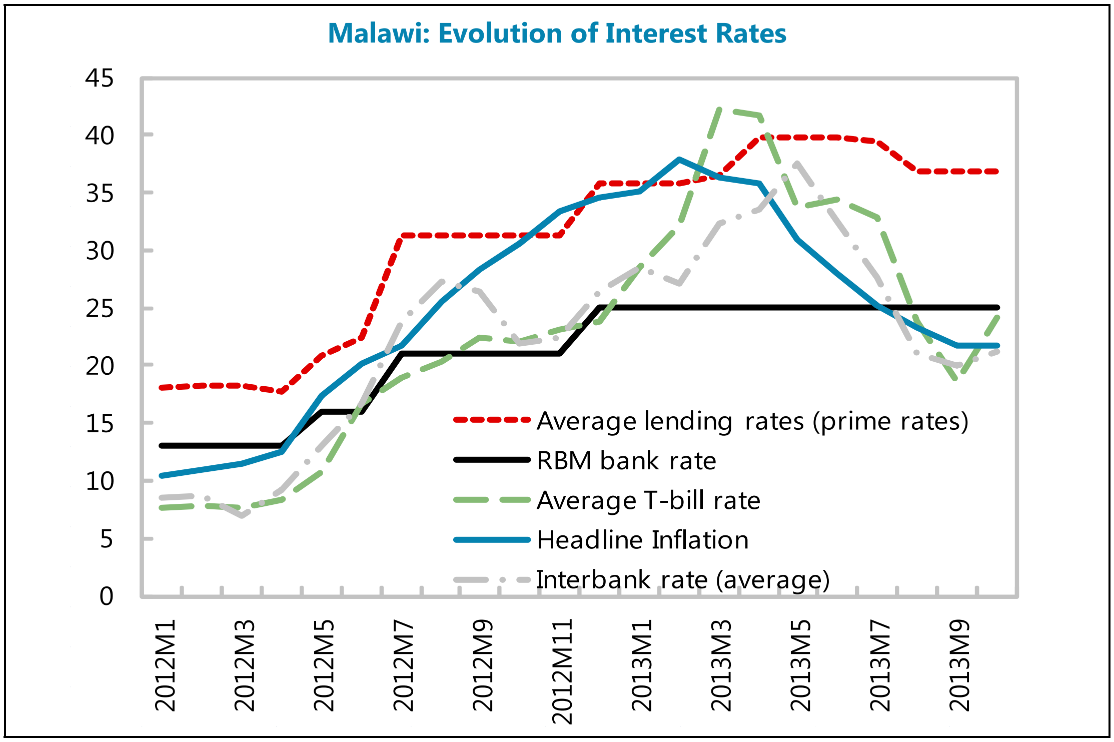
11. **Growth in reserve money and broad money during 2013 mainly reflected developments in the foreign exchange market and government operations.** The RBM succeeded in slowing the year-on-year growth in reserve money from 36 percent in

December 2012 to 2 percent in March 2013 by using foreign exchange operations to offset liquidity injections from its lending to banks and the government (Text table 2). In the second quarter, RBM foreign exchange purchases injected substantial liquidity into the system to meet increased demand for real money balances associated with increased tobacco earnings. The RBM partially sterilized the impact of its foreign exchange purchases on liquidity through open market operations. Reserve money growth accelerated again in the third quarter, driven mainly by RBM lending to government. After moderate increases in the first half of 2013, broad money grew rapidly in the third quarter. The principal sources of growth in broad money were lending to the private sector in the first quarter and accumulation of net foreign assets in the second quarter. Sharply increased government borrowing during the third quarter crowded out private sector credit, which recorded a small decline in absolute terms.

Text Table 2. Malawi: Sources of Growth in Reserve Money (%)

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
	Contribution to year-on-year growth in reserve money						
Reserve money	***71.7***	***67.1***	***20.3***	***54.6***	***12.1***	***24.9***	***40.9***
Net foreign assets	-16.1	-61.8	-34.9	-14.6	-25.6	63.5	47.9
Net domestic assets	87.7	128.9	55.2	69.2	37.7	-38.7	-7.0
Of which: Net claims on government	64.9	83.5	-21.9	-7.6	-9.7	-26.2	55.1
Credit to banks	3.7	32.0	15.5	-19.5	-5.2	-18.3	-41.2
	Contribution to quarterly growth in reserve money						
Reserve money	***21.8***	***13.7***	***-5.7***	***18.4***	***-11.7***	***26.7***	***6.5***
Net foreign assets	-12.2	-28.4	17.4	6.2	-18.6	62.0	-0.7
Net domestic assets	34.0	42.1	-23.1	12.2	6.9	-35.3	7.2
Of which: Net claims on government	29.8	12.9	-43.4	5.4	16.6	-6.5	27.8
Credit to banks	3.4	19.5	-7.4	-27.9	10.8	3.4	-22.4

12. **Market interest rates fluctuated widely in 2013 (chart).** Money market liquidity increased substantially in the middle of the year, mainly as a result of RBM's foreign exchange purchases. Reflecting this development, the interbank market rate declined from 37.4 percent in March to 16.5 percent in August 2013, and the average Treasury bill yield dropped from a peak of 45.0 percent in March 2013 to 19.37 percent in August 2013. Subsequent tightening by the RBM, mostly through open market operations beginning in September, pushed the interbank rate and treasury bill yields back up. The RBM maintained its bank rate at 25.0 percent throughout 2013.



13. **The current account deficit narrowed modestly from 4.4 percent of GDP in 2012 to 3.5 percent in 2013 (Table 4b).** Exports grew faster than GDP in spite of a projected 15 percent decline in tobacco exports.[2] This decline is expected to be more than compensated by strong export growth in cotton, sugar, uranium and edible nuts. A scarcity of containers in Malawi was cited as a factor in the decline in tobacco exports in 2013. Imports accelerated across different categories, reflecting underlying economic growth.

B. Performance Under the Program

14. **Performance in relation to quantitative targets for the third ECF review (March 2013 test date) was good, but weakened for the fourth review (September test date) (Table 8a).**

- For the third review, the only quantitative performance criterion (PC) that was not met was the continuous PC on contracting new non-concessional external debt maturing in more than one year. The authorities contracted a loan from the Export and Import Bank of China equivalent to US$65 million that had a grant element of 30 percent when it became effective in May 2013.

[2] Large movements in tobacco stocks in recent years have given rise to a marked discrepancy between output, sales on the auction floors and exports in any given year. Sales on the auction floors, rather than exports, are the main source of foreign exchange supply to the domestic foreign exchange market.

This is below the 35 percent threshold for new concessional external debt under the program.[3] The authorities have indicated that this nonconcessional borrowing was inadvertent—it was due to the use of an outdated discount rate in the calculation of the grant element of the loan (MEFP ¶11).

- For the fourth review, while the PC on net international reserves was observed comfortably, the PCs on government net domestic borrowing and the net domestic assets of RBM were missed by significant margins, reflecting substantial over-borrowing by government, mostly from the RBM. However, about half of the deviation from the target reflected a promissory note issued in June by the government to RBM to cover devaluation losses incurred in 2012.[4]
- Indicative targets for reserve money for June and September were missed, reflecting the build-up of international reserves and RBM concerns that a more aggressive effort to sterilize the impact of the central bank's purchases of foreign exchange from the domestic market would derail a nascent recovery.
- The authorities met the indicative target for social spending in September after missing the March and June targets. The earlier under-performance reflected savings on fertilizer purchases for the FISP as well as lower-than-expected absorption of the maize seed subsidy component of FISP (MEFP ¶12). Other categories of social spending, including education and health, were in line with the targets.

15. **There has been progress in the implementation of structural benchmarks though at a slower pace than programmed (Table 9a).** Several measures to strengthen public financial management were implemented, including expansion of the coverage of the purchase order module of IFMIS. With respect to reforms in the financial sector, the terms of reference for the third party diagnostic assessment of vulnerable banks (structural benchmark for end-June 2013) was completed in October. The exercise will now cover all banks and the process of selecting auditors for each bank is underway. An amendment to the RBM Act has been submitted to parliament to lower the limit on RBM advances to government from 25 percent to 10 percent of budget revenue. However, it does not cover other forms of RBM lending to government and so does not plug the loophole in the RBM Act that allows advances to be routinely converted to treasury bills when the limit is reached.

[3] As noted in EBS/13/125 (issued on 9/20/2013), the authorities experienced a similar problem with a loan from the Export-Import Bank of India in an amount of US$76.5 million. That loan became effective in March 2013 (i.e., before the second review) and resulted in misreporting under the ECF arrangement.

[4] Although the issuance of a promissory note for RBM recapitalization is reported as part of the RBM's net claims on government, it did not involve any lending to finance government operations.

POLICY DISCUSSIONS

16. **The policy discussions focused on managing the fall-out from the fiscal scandal, addressing the recent fiscal slippage, and policies to lower inflation.** The government has implemented bold economic policy reforms that are beginning to show positive results. However, the success of the reforms in achieving the stated goals of macroeconomic stability, growth and poverty reduction, depend to a large extent on continued external assistance from Malawi's development partners over the medium-term. Strong implementation of corrective actions to strengthen public financial management is critical to ensure the timely resumption in aid inflows.

17. **The mission worked closely with the authorities and development partners to update the external resource envelope, including the likely timing of disbursements.** Several bilateral donors indicated that they are unlikely to be able to channel any financial resources through government financial systems for the rest of this fiscal year (ending June 2014). For them, implementation of strong remedial measures is necessary but not sufficient for resuming support through government systems; it will take time for their confidence in these systems to be restored. However, most donors foresaw some resumption of financial assistance to the budget in the second half of the fiscal year (January – June 2014) if the government carries through with strong remedial measures to prevent a recurrence of the fraud, holds senior officials involved accountable, and takes steps toward recovering stolen funds. On that basis, the updated fiscal outlook assumes resumption of budget support from multilateral agencies (World Bank, African Development Bank and the EU) in the second half of the fiscal year. External support to the budget this year is expected to fall significantly short of the levels projected during the June 2013 mission (which held detailed discussions on the FY2013/14 budget), and compared to FY2012/13 (Text table 3). The second fiscal quarter takes the biggest hit.

Text Table 3. Malawi: Central Government External Financing
(In millions of US dollars unless otherwise indicated)

	FY2012/13	FY2013/14									
		June 2013 mission					Revised Program				
	Actual	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Budget support	**251**	**0**	**157**	**15**	**11**	**182**	**16**	**11**	**84**	**57**	**167**
Grants	251	0	98	6	0	104	8	0	25	46	79
Loans 1/	0	0	59	9	11	78	7	11	59	11	88
Dedicated Grants	**186**	**64**	**69**	**68**	**28**	**229**	**67**	**35**	**38**	**36**	**175**
Project support	**217**	**86**	**86**	**87**	**87**	**345**	**32**	**85**	**85**	**85**	**288**
Grants	107	51	51	51	51	203	12	50	50	50	163
Loans	110	35	35	36	36	142	20	35	35	35	125
Total external financing	**654**	**150**	**311**	**169**	**125**	**756**	**114**	**131**	**207**	**178**	**630**
Total external financing (in percent of GDP)	**18.1**	…	…	…	…	**18.4**	…	…	…	…	**15.3**

Sources: Malawian authorities; and IMF staff estimates.
1/ Includes SWAp loans.

A. Macroeconomic Framework

18. **The macroeconomic framework has been adjusted to capture the revised profile of external financing.**

- Staff and the authorities agreed to maintain the growth projections from the third review discussions (June mission) which entailed slightly lower growth in 2013 compared to the second review projection (Text Table 4). Indications from the authorities' business sentiment survey conducted in September and the latest crop estimates pointed to continuing strong recovery in 2013 and 2014, including another good tobacco season in 2014. In the absence of the fiscal scandal, there would have been a basis for upward revision of growth projections for 2013 and 2014. However, in view of the uncertainty about donor support and some public investments in the near term, projections were kept unchanged.

- Disinflation will be at a slower pace, but single digit inflation remains the goal by end-2014 (Text Table 4). Inflation is programmed to fall, but the path for 2013-15 has been raised moderately to reflect the higher-than-projected outturn so far in 2013 and the likely impact of recent depreciation of the kwacha on non-food inflation in the next few months. The revised monetary program is based on RBM tightening monetary policy over the next few months and more aggressively sterilizing foreign exchange inflows when the tobacco season starts in March/April 2014.

Text Table 4. Malawi: Selected Indicators 2012-2015

		Second review			June 2013 mission			Revised program		
	2012	2013	2014	2015	2013	2014	2015	2013	2014	2015
Real GDP growth (percent)	1.9	5.5	6.1	6.5	5.0	6.1	6.5	5.0	6.1	6.5
CPI inflation (eop, percent)	34.6	11.8	5.8	5.4	14.2	7.0	5.2	20.1	9.7	5.8
CPI inflation (annual average, percent)	21.3	20.2	8.1	5.8	26.0	8.4	6.2	27.7	15.1	6.9
Fiscal indicators (% of GDP, fiscal year basis) 1/										
Revenue	26.5	39.0	37.3	36.2	39.5	38.5	35.6	38.3	36.9	36.3
Tax and nontax revenue	22.1	23.9	24.4	24.8	24.8	24.7	25.2	24.0	27.1	26.0
Grants	4.4	15.1	13.0	11.4	14.7	13.8	10.4	14.2	9.8	10.2
Expenditure and net lending	33.4	40.2	38.6	37.2	39.7	42.9	35.9	39.6	41.1	39.9
Overall balance including grants	-6.9	-1.2	-1.3	-1.0	-0.2	-4.4	-0.3	-1.3	-4.2	-3.6
Overall balance including grants and discrepancy	-8.4	-0.4	-1.3	-1.0	0.9	-4.4	-0.3	-2.4	-5.3	-3.6
Total financing	8.3	0.4	1.3	1.0	-0.9	4.4	0.3	2.4	5.3	3.6
Foreign financing	1.6	1.9	1.8	1.5	2.2	5.0	0.8	2.6	4.9	4.2
Domestic financing	6.7	-1.6	-0.5	-0.5	-3.1	-0.5	-0.5	-0.2	0.4	-0.6
External indicators (% of GDP, unless otherwise indicated)										
Current account balance including official transfers	-4.4	-1.6	-1.8	-2.2	-3.0	-5.0	-3.5	-3.5	-2.6	-2.1
Overall balance	0.9	3.5	3.4	3.3	6.9	1.8	2.1	2.4	6.4	5.2
Gross international reserves										
In US dollars	215.4	402.8	555.5	692.8	443.5	531.1	615.6	403.0	453.1	557.3
In months of imports	1.1	1.9	2.5	2.9	2.2	2.5	2.8	2.0	2.0	2.4

Sources: Malawi Authorities and IMF staff estimates

1/ For example, 2012 refers to FY2011/12, spanning July 1, 2011 to June 30, 2012.

19. **Risks to the economic outlook remain substantial (Table 10, Risk Assessment Matrix).** Key risks include:

- **A significantly longer delay in disbursements or reduction in the amount of aid.** Protracted delays in the disbursement of aid flows in response to the fiscal scandal could lead to increased resort to domestic borrowing, followed by reserve losses, exchange rate depreciation, and rising inflation. Determined implementation of remedial measures and policy commitments in the framework of an active program engagement with the Fund will help contain this risk. The donors have welcomed the Fund's active engagement in Malawi. Still, if this risk comes to fruition, the authorities can help to mitigate impacts by making additional cuts in domestically financed development expenditure and goods and services (MEFP ¶19).

- **Policy reversals ahead of the May 2014 general elections.** Malawi has a history of loosening macroeconomic policies in election years. Such a scenario would also likely be marked by reserve losses, exchange rate depreciation, and rising inflation, and would jeopardize the prospects for sustained growth (including by leading to cuts in aid flows). The prior actions implemented give some assurance that policy can remain on course.

- **Adverse weather conditions.** These will continue to pose a significant risk because of the country's reliance on rain-fed agriculture. It is estimated that up to 1.9 million people (13 percent of the population) may be at risk of severe food insecurity during the 2013/14 lean season because of dry spells in several parts of the country (MEFP ¶22). A supply shock of this sort would be associated with weak GDP growth, higher inflation, and a weaker currency. Fully implementing the program, and gaining access to larger donor resources would help mitigate such a shock.

20. **The DSA update, undertaken jointly by Fund and World Bank Staff, indicates that Malawi remains at moderate risk of debt distress.** The present value of public debt is projected to decline steadily from 42.5 percent of GDP in 2013 to 23.6 percent of GDP in 2018. The main risks to debt sustainability are deterioration in the terms of trade and adverse weather conditions. Stress tests indicate vulnerability to export-related shocks. Fiscal consolidation and measures to arrest declines in the quality of institutions (e.g., as reflected in Malawi's CPIA score) are needed to ensure capacity to manage a growing debt load.

B. Fiscal Policy and Related Structural Reforms

21. **The cutback in donor inflows and the net impact of other revisions to the fiscal outlook result in a financing gap of MK32 billion (2 percent of GDP) in the FY2013/14 budget.**

The shortfall in donor flows is projected at MK27 billion (1.8 percent of GDP). The following are the other main revisions to the fiscal outlook for the rest of FY2013/14 (Tables 2a and 2b):[5]

- Higher interest payments, reflecting higher-than-expected nominal interest rates and higher stock of domestic debt.[6]
- Higher tax revenues, based on continuing strong collections across tax categories, supported by strong economic activity, higher domestic and import prices, and ongoing revenue administration efforts.
- Increased nontax revenues, mainly on account of profit transfer from the RBM.[7]

22. **A combination of expenditure cuts and domestic financing is proposed to cover the financing gap while protecting social expenditure (Text Table 5).** Social spending is maintained at roughly the same level programmed during the June 2013 mission. The authorities have announced expenditure control measures that are expected to yield gross savings of about MK31 billion (2 percent of GDP). The measures involve stringent cuts to travel, postponement of domestically financed development projects, and savings from efficiency gains from the operation of FISP (MEFP ¶19).[8] With some offsetting increases in other current expenditure (reflecting higher than expected inflation and exchange rate depreciation), the expected net yield from expenditure measures compared to the June mission projections is MK18 billion (1.1 percent of GDP). To cover the remaining financing gap, net domestic borrowing was increased by MK14 billion (0.9 percent of GDP); from the programmed repayment of MK7 billion to borrowing MK7 billion for the year as a whole.

[5] The calculations also include MK18 billion in unexplained expenditure (discrepancy) from FY2013/14 Q1, which includes fraud related payments.

[6] About 40 percent of the projected increase in interest payments in FY2013/14 resulted from the promissory note issued by the government for the RBM recapitalization in June 2013 and start of interest payments on securitized portion of expenditure arrears.

[7] As about 60 percent of the stock of government domestic debt is held by the RBM, the projected large increase in interest payments is expected to boost RBM operational income significantly. Valuation losses which largely depend on exchange rate developments this year compared to last year could offset some of RBM's operational income.

[8] Most of the proposed cuts are from the travel budget and domestically financed development expenditure, which had annual allocations of MK28.5 billion and MK47 billion, respectively (Text Table 5). Five months into the year (at end-November), about MK10 billion and MK20 billion had been spent on travel and domestically financed development projects, respectively.

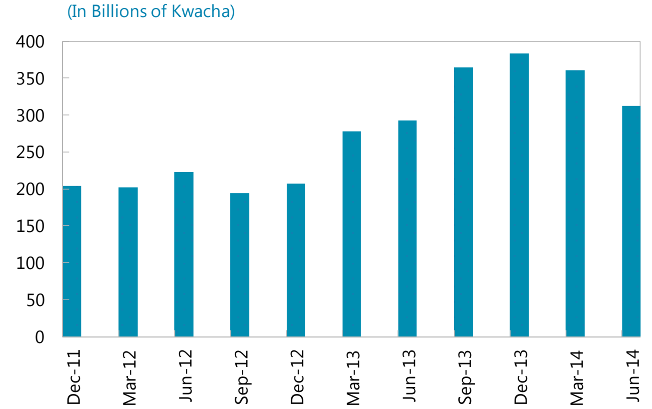
Text Table 5. Malawi: Measures to Cover Financing Gap in FY2013/14 1/

	June 2013 mission	Revised prog.	Change
	In billions of Kwacha		
Financing gap			**-32**
Domestic revenue	356	428	72
Interest payments	31	93	62
Donor inflows 2/	152	125	-27
External debt amortization	-10	-6	4
Discrepancy 3/	0	-18	-18
Measures to cover the financing gap			**32**
Primary expenditure	461	443	18
Travel budget	29	18	11
Fertilizer and seed subsidy	54	50	4
Domestically-financed development expenditure	47	31	16
Other primary expenditure	331	343	-12
Domestic financing (net)	-7	7	14

Sources: Malawian authorities; and IMF staff estimates.
1/ Project grants and loans and the associated foreign-financed development expenditure are not included as they do not affect financing gap calculations.
2/ Budget support grants and loans and dedicated grants.
3/ Difference between financing data and above-the-line fiscal data. Includes fraud-related payments.

23. **Domestic borrowing is projected to increase slightly in Q2 followed by repayments in Q3, Q4 and in the medium term.** Excessive borrowing in the first quarter limited the scope for additional domestic borrowing to offset the shortfall in external funding. As the shortfall in donor disbursements is particularly acute in Q2, the authorities will need some additional domestic borrowing to avoid a collapse in government services, including critical social expenditure. However, in Q3 the government will start reducing the outstanding stock of domestic debt as donor inflows are projected to resume and the full effects of the expenditure cuts take effect. The bulk of debt repayment is expected in Q4 when domestic revenues are expected to peak and quarterly expenditure expected to be at its lowest level. The government is programmed to make net repayment of domestic debt of 0.6 percent of GDP on average during FY2014/15-2015/16, which would bring down the net domestic debt to less than 10 percent of GDP at end-FY2015/16. To help the development of the domestic debt market, it is important that most of the decline be in government debt held by RBM.

Gross Domestic debt*
(In Billions of Kwacha)



* From March 2013 includes MK41.4 billion in securitized domestic payment arrears.

24. **The government needs to curtail the accumulation of domestic arrears.** While the government has been reducing the outstanding stock of verified expenditure arrears (estimated at MK72 billion in 2012), it also needs to avoid accumulating new arrears. MoF is taking steps to institute a mechanism for regular monitoring and reporting on arrears and by strengthening commitment control (MEFP ¶28).

25. **Recent events underscore the need to tackle long-standing issues in public financial management.** In addition to immediate remedial measures, the broader PFM reform strategy needs to be revitalized including fuller deployment of IFMIS capabilities such as timely generation of comprehensive financial and management reports to monitor fiscal developments and inform policy adjustments. The authorities acknowledge a need for comprehensive and regular analysis of fiscal risks, including contingent liabilities (MEFP ¶29). In particular, risks associated with the recently introduced Farm Input Loan Program (FILP) need to be carefully monitored.[9] The authorities are also encouraged to enhance fiscal transparency and accountability by strengthening fiscal reporting through timely and complete capture of data and better commitment management.

26. **The authorities are implementing a number of measures to strengthen revenue administration and improve taxpayer compliance.** The modernization efforts at the Malawi Revenue Authority (MRA) include installation of cargo scanners and upgrade of IT systems at the customs, a roll-out of electronic fiscal devices and automation of business processes (MEFP ¶30). MRA recently announced a form of tax amnesty—a voluntary compliance window—to encourage noncompliant taxpayers to settle their outstanding tax obligations without incurring penalties (MEFP ¶31). The principal amount of the tax liability remains intact and must be paid. It will be important for the authorities to implement this program in a manner that minimizes risks to tax compliance.

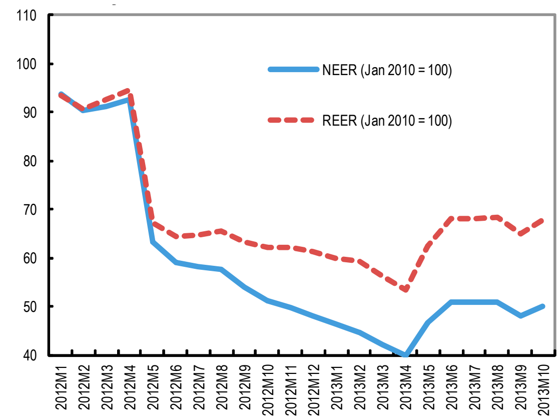
C. Exchange Rate and Monetary Policies

27. **The authorities are committed to a flexible exchange rate regime, allowing the kwacha to adjust to domestic and international developments.** The RBM indicated that it will intervene in the foreign exchange market mainly to manage liquidity and excessive volatility in the exchange rate arising from the highly seasonal pattern of private foreign exchange inflows (related to the tobacco season) and the lumpy disbursement of official flows. Given the need to maintain an international

[9] Under FILP, farmers' clubs are able to obtain fertilizer from suppliers, make a down payment and pay the balance after the harvest. The fertilizer is sold at market price plus a fee (to cover administrative costs) and so does not entail a subsidy. However, the program is administered by the Malawi Rural Development Fund, a state-owned enterprise, and in the event farmers default there will likely be pressure on the government to step in. In that sense, the government is providing an implicit guarantee.

reserves buffer, the RBM has limited its intervention during the lean season, and is relying more on the maintenance of tight monetary conditions as a bulwark against depreciation pressures. The authorities agreed with staff that maintaining a market based exchange rate regime is critical for boosting Malawi's exports and international competitiveness. The real depreciation of the kwacha has been sustained.

Nominal and Real Effective Exchange Rates, January 2010 – June 2013



28. **The RBM's main monetary policy objective is to achieve low (single-digit) inflation**. The RBM indicated that, in light of the still high level of inflation and the recent pressures from the depreciation of the kwacha, in the near-term it will monitor the evolution of the banks' excess reserves through its liquidity forecasting framework and maintain a tight monetary stance. To support continued disinflation, revised program targets for money growth were set broadly in line with growth in nominal GDP (i.e., assuming constant velocity). If needed, the RBM will use open market operations to mop up excess liquidity in the system.

29. **The authorities have taken steps to address fiscal dominance.** An Amendment to the RBM Act was submitted to parliament limiting RBM advances to government, but stopping short of imposing a limit on overall government borrowing from RBM. The authorities indicated that such a further change would need to be coordinated with changes to the Public Finance Act which contains limits on total government borrowing. Staff encouraged the authorities to carry the necessary coordination needed to achieve the objective of limiting RBM lending to government. The government has, however, instructed the RBM to stop the automatic conversion of overdrafts to government securities (MEFP ¶15). This allows for closer monitoring of government borrowing from the RBM and should facilitate more prompt corrective action as needed to stay within program targets.

D. Financial Sector Reforms

30. **The overall liquidity situation in the banking system has improved but some banks continue to have weak liquidity positions, posing risks to financial stability.** To address liquidity pressures, banks have resorted to high interest rates to attract deposits, and some have obtained emergency liquidity support from RBM or been exempted from compliance with prudential norms.

Moreover, for some banks, loan quality continues to deteriorate and they also present solvency concerns. Against this background, the RBM has received Fund and World Bank technical assistance aimed at strengthening legislative and prudential frameworks, banking supervision, crisis management preparedness, and bank restructuring and resolution.

31. **The RBM is pursuing an ambitious financial sector reform agenda.** The authorities are taking steps to strengthen the legal framework for bank restructuring and resolution (MEFP ¶39). RBM has submitted to government, proposed Amendments to the Banking and Financial Services Acts to align the legal framework for bank resolution more closely to international best practice. The amendments are expected to be considered by parliament at its next sitting (January/February 2014). To determine the true condition of banks, the RBM is requiring banks to undergo comprehensive third party diagnostics (MEFP ¶38). The four weakest banks will be analyzed first. Reports on them were originally expected by end-December 2013, but because of delays in the procurement of the services of the firms that will be conducting the exercise, the reports are now expected by end-February 2014. Reports on the remaining banks are expected by end-June 2014. The outcome of third-party diagnostic assessments and a stronger legal framework for bank restructuring and resolution will form the basis for designing a credible strategy for resolving weak banks.

32. **The RBM is taking steps to strengthen its framework for addressing banking problems as well as its bank supervision capacity.** It is getting ready to introduce a prompt corrective action (PCA) framework to clarify existing triggers for early remedial action and discontinue routine waiver of prudential norms (MEFP ¶40). Specific measures to strengthen bank supervision include improving prudential norms and bank reporting for loan classification, provisioning and liquidity (MEFP ¶42). The RBM is awaiting the official publication of new directives on the PCA and on Asset Classification in the government gazette for them to take effect,

E. Business Climate and International Competitiveness

33. **The authorities are committed to implementing measures to improve the investment climate and enhance Malawi's international competitiveness (MEFP ¶¶43-47).** The government announced a goal of improving the country's ranking in the annual World Bank Doing Business Survey from 157th (out of 185 countries) in 2013 to at least 100th by 2016.[10] To this end, the government has taken actions to remove regulatory obstacles in the areas of starting a business, obtaining permits, registering property, enforcing contracts, and trading across borders. This year,

[10] These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

parliament reviewed several economic laws, including the Business Registration Act, the Companies Act, and the Investment and Export Promotion Act. The authorities need to focus on implementing the laws in order to make a difference on the ground.

PROGRAM ISSUES

34. **Several prior actions have to be met before the third and fourth reviews will be completed (Table 9a).** The following prior actions are designed to gauge progress in implementation of remedial measures to address the governance weaknesses: (i) reactivation of IFMIS in all ministries after strengthening security and access control; (ii) auditing of the manual transactions undertaken when IFMIS was suspended; (iii) submission of a preliminary forensic audit report to Fund staff. Recommendations from the final report of the forensic audit (due by end-January 2014) will inform program conditionality in the next review. The authorities will also take prior actions to implement the revised macro-fiscal program by: (i) seeking cabinet approval for the revised spending plans in line with understandings reached with Fund staff; and (ii) observing three quantitative targets (government net domestic borrowing, NDA and NIR of the RBM) for December 13, 2013. The December 13 targets were set at the same level as the respective targets for end-December 2013, with the expectation that the December 13 outturn would provide a good indication of the prospects for meeting the end-December targets.

35. **The authorities are requesting a waiver for the nonobservance of the continuous PC on new nonconcessional external debt with a maturity of more than one year.** They have indicated that the contracting of the non-concessional loan from China was inadvertent; the use of an out-of-date discount rate led them to believe the loan was concessional. They have adopted corrective actions—closer consultation with Fund staff before submitting loan proposals to cabinet and parliament, and including information on grant element in the submissions—to prevent a recurrence of non-observance of the PC (MEFP ¶11).

36. **The authorities are also requesting waivers for the nonobservance of the performance criteria on government net domestic borrowing and the net domestic assets of the RBM (fourth review).** The overrun on domestic borrowing was caused in part by poor spending control and planning. The amounts paid out as part of the IFMIS fraud further contributed to excessive borrowing during that quarter. Exceeding the limits on RBM domestic assets is closely related, as the RBM holds a large share of government debt. The authorities have adopted extensive remedial actions, focusing on the strengthening of PFM. Furthermore, implementation of the revised macro-fiscal program signals the authorities' commitment to achieving the objectives of the program.

37. **The authorities are also requesting an extension of the arrangement, a rephasing of disbursements, and modification of performance criteria.** They wish to better align the ECF review cycle with the fiscal year in Malawi by shifting test dates from September and March to December (mid-year) and June (year-end) (LOI). They also request an extension of the arrangement by four months (to November 22, 2015) alongside the addition of a further review resulting from the rephasing of disbursements associated with the third, fourth and subsequent reviews (Tables 6a and 6b). They request a halving of the disbursements originally associated with the third and fourth reviews, and applying the balance to the additional review. New PCs are proposed for December 2013 and June 2014. It is proposed that the end-March 2014 PCs become indicative targets. Structural benchmarks have been added for FY2013/14 to address the fiscal scandal (Table 9b).

38. **Financing assurances are in place for the review.** Donor commitments to Malawi remain significant, and the authorities have compensated for shortfalls by adjusting their spending plans, and by identifying alternative sources of domestic financing. It will be critical for Malawi to stick to its commitments to correct governance problems to fully realize aid commitments from development partners.

STAFF APPRAISAL

39. **The authorities are to be commended for sticking with core elements of the policy reforms they initiated in May 2012.** Adoption of a market-based exchange rate regime has improved the availability of foreign exchange and is supporting a broad based recovery in economic activity. The automatic adjustment mechanism for fuel prices has ensured a steady supply of fuel to the country. However, inflation remains high and implementation of structural reforms have been slow.

40. **The fiscal scandal and a loosening of policies in the first quarter of FY2013/14 require strong and focused remedial actions.** The scandal undermined the government's standing both with the Malawian public and the donor community. Rebuilding trust requires that the fraud be investigated thoroughly and that the relevant procedures be followed in accordance with the law. Furthermore, government has to strengthen PFM procedures and reform fiscal institutions to prevent a recurrence of fraud. Adoption of the action plan, re-activation of a strengthened IFMIS, initiation of the forensic audit, and ongoing criminal investigations are important steps in the right direction. In addition, strict implementation of the publicly announced stringent spending cuts and timely adoption and implementation of the recommendations of the forensic audit would

demonstrate the government's commitment to address the cumulative impact of the fraud and the fiscal slippage.

41. **The authorities will need to monitor closely expenditure execution and financing in order to maintain fiscal discipline.** The authorities should be mindful of revenue and financing risks and should be ready to act swiftly in case such risks materialize. In the event of shortfalls in projected domestic revenues or external grants and loans, the authorities will need to adopt more stringent expenditure restraint and expenditure reprioritization. The presence of significant fiscal risks warrants contingency planning.

42. **Continued external support is critical for mitigating the risk of policy reversal.** Because of the heavy reliance of the budget on external assistance, a protracted suspension of aid flows and the pressures of upcoming general elections could combine to trigger policy reversals. Malawi's development partners are aware of this risk and are supportive of resumption of some aid flows in the second half of the fiscal year provided the authorities implement strong remedial measures and adhere to their Fund-supported program.

43. **Staff welcomes the RBM's commitment to tighten monetary policy to contain inflation pressures.** Given the still high level of inflation, it is imperative that the RBM be proactive in tightening monetary policy going forward. In this context the RBM should limit its intervention in the foreign exchange market during the lean season, and rely more on the maintenance of tight monetary conditions as a bulwark against depreciation pressures. It will also be important for the authorities to coordinate amendments to the RBM Act and the Public Finance Act to address the problem of fiscal dominance by setting a legal limit on total RBM lending to government.

Staff welcomes the steps taken by the authorities toward establishing the true financial condition of the banking system (by commissioning third party diagnostic assessments of each bank). It will be important to complete the first stage of the bank diagnostics and to strengthen the legal framework for bank restructuring and resolution early in 2014. Alongside this, the authorities should speed up the gazetting of the RBM directives on the Prompt Corrective Action framework and Asset Classification so that they become effective as soon as possible. Implementation of the PCA is a key instrument to help RBM move away from a culture of forbearance.

44. **Staff recommends completion of the third and fourth reviews and release of the fourth and fifth disbursements based on the remedial actions taken to strengthen governance, program performance to date, and policy commitments by the authorities.** Staff supports the authorities' request for waivers for the nonobservance of the PCs on new nonconcessional external debt with a maturity of more than one year, on government net domestic borrowing, and on net domestic assets of the RBM, based on the strong corrective actions being implemented to address the fraud and fiscal slippage, as well as the corrective actions the authorities have adopted to strengthen debt management. Staff further supports the extension of the arrangement, rephasing of disbursements, establishment of performance criteria for end-December 2013 and end-June 2014, and conversion of end-March 2014 PCs into indicative targets.

Table 1. Malawi: Selected Economic Indicators, 2011–16

	2011	2012	2013		2014		2015	2016
			2nd Rev.	Revised prog.	2nd Rev.	Revised prog.	Proj.	Proj.
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	4.3	1.9	5.5	5.0	6.1	6.1	6.5	6.5
Nominal GDP (billions of kwacha)	880.9	1,056.3	1,310.5	1,411.9	1,492.4	1,743.9	1,985.5	2,237.3
GDP deflator	3.9	17.7	17.6	27.3	7.4	16.4	6.9	5.8
Consumer prices (end of period)	9.8	34.6	11.8	20.1	5.8	9.7	5.8	5.1
Consumer prices (annual average)	7.6	21.3	20.2	27.7	8.1	15.1	6.9	5.8
Investment and savings (percent of GDP)								
National savings	9.4	12.5	19.1	16.9	20.4	18.6	20.3	22.7
Net official transfers	6.4	14.1	15.6	12.9	14.3	12.8	12.8	12.7
Domestic savings	0.6	-4.6	0.1	0.6	3.0	2.4	3.6	6.1
National investment	15.3	16.9	20.6	20.4	22.2	21.2	22.4	23.5
Saving-investment balance	-5.9	-4.4	-1.6	-3.5	-1.8	-2.6	-2.1	-0.8
Central government (percent of GDP on a fiscal year basis) [1]								
Revenue	32.1	26.5	39.0	38.3	37.3	36.9	36.3	36.7
Tax and nontax revenue	24.5	22.1	23.9	24.0	24.4	27.1	26.0	26.0
Grants	7.6	4.4	15.1	14.2	13.0	9.8	10.2	10.8
Expenditure and net lending	35.0	33.4	40.2	39.6	38.6	41.1	39.9	40.1
Overall balance (excluding grants)	-10.5	-11.3	-16.3	-15.6	-14.3	-13.9	-13.9	-14.1
Overall balance	-2.9	-6.9	-1.2	-1.3	-1.3	-4.2	-3.6	-3.4
Foreign financing	1.3	1.6	1.9	2.6	1.8	4.9	4.2	4.0
Domestic financing	1.7	6.7	-1.6	-0.2	-0.5	0.4	-0.6	-0.6
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	-0.1	-1.5	0.8	-1.1	0.0	-1.2	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	35.7	22.9	25.9	25.6	16.9	23.5	13.9	12.7
Net foreign assets	-7.9	9.2	13.4	17.8	12.0	4.3	11.7	10.8
Net domestic assets	43.6	13.8	12.5	7.9	4.9	19.2	2.1	1.9
Credit to the government	19.7	0.0	5.8	16.3	-1.7	-7.5	-3.5	1.7
Credit to the rest of the economy (percent change)	30.1	22.4	9.9	7.8	10.7	37.0	12.0	-3.6
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,408.7	1,359.3	1,573.1	1,499.2	1,718.3	1,631.1	1,768.9	1,913.4
Imports (goods and services)	2,236.2	2,259.1	2,356.0	2,260.3	2,520.7	2,460.8	2,659.1	2,840.0
Usable gross official reserves	190.2	215.4	402.8	403.0	555.5	453.1	557.3	746.8
(months of imports)	1.0	1.1	1.9	2.0	2.5	2.0	2.4	3.0
(percent of reserve money)	42.5	72.0	118.7	120.8	144.9	117.8	132.1	155.1
Current account (percent of GDP)	-5.9	-4.4	-1.6	-3.5	-1.8	-4.0	-3.2	-2.3
Current account, excl. official transfers (percent of GDP)	-12.2	-18.6	-17.2	-16.4	-16.1	-16.8	-16.1	-14.9
Overall balance (percent of GDP)	-1.9	0.9	3.5	2.4	3.4	6.4	5.2	6.5
Terms of trade (percent change)	-17.5	-2.2	2.5	0.3	3.0	2.5	2.5	2.5
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)[2]	16.9	37.4	…	41.5	24.3	38.9	37.7	36.4
NPV of debt (percent of exports)	48.1	53.3	47.0	49.4	42.2	44.5	39.9	35.8
External debt service (percent of exports)	1.6	2.4	2.6	2.7	3.8	4.0	4.0	3.8
External debt service (percent of revenue excl. grants)	1.7	3.9	5.0	5.0	6.9	6.1	6.4	5.5
91-day treasury bill rate (end of period)	6.8	20.1	…	…	…	…	…	…

Sources: Malawian authorities and IMF staff estimates.

[1] The fiscal year starts in July and ends in June. The current financial year, 2014, runs from July 1, 2013, to June 30, 2014.

[2] Estimates of external debt as percentage of GDP are higher than previously reported due to a change in methodology. The discrepancy is due to differences in average and end-of-period exchange rates. The new methodology is aligned with the DSA.

Table 2a. Malawi: Central Government Operations: 2010/11–2015/16

(Billions of kwacha)

	2010/11	2011/12	2012/13		2013/14			2014/15	2015/16
	Actual	Actual	Prog. 2nd review	Prel.	Prog. 2nd review	June 2013 mission	Revised prog.	Proj.	Proj.
Revenue	272	257	461	472	523	554	583	650	781
Tax and nontax revenue	208	214	282	297	341	356	428	466	552
Tax revenue	176	188	244	269	303	317	375	423	501
Taxes on income and profits	81	90	114	129	135	150	168	191	227
Taxes on goods and services	79	84	105	111	135	133	162	181	216
Taxes on international trade	17	18	30	33	40	39	47	54	63
Other taxes	-2	-3	-6	-4	-7	-4	-3	-4	-4
Nontax revenue 1/	32	26	39	28	39	38	54	44	51
Grants	64	43	179	176	182	198	154	183	229
Budget support grants	15	0	77	78	70	39	31	34	40
Project grants	19	18	35	35	42	74	64	72	92
Dedicated grants	31	25	67	64	70	84	59	77	97
Expenditure and net lending	296	324	476	489	541	618	648	715	853
Current expenditure	230	246	381	385	420	445	504	540	630
Wages and salaries	58	70	96	97	120	131	137	157	190
Interest payments	23	24	33	33	32	31	93	71	69
Domestic	22	22	29	29	28	26	88	68	65
Foreign	1	2	4	4	5	5	5	3	4
Goods and services	95	95	143	144	153	161	156	175	221
Generic goods and services	41	53	56	60	57	41	36	52	74
Census	0	0	0	0	0	0	0	0	0
Road Maintenance	8	7	10	7	8	8	9	14	16
Agricultural swap				0	0	19	16	19	22
Health SWAp	19	16	24	32	29	22	23	28	35
Education SWAp	10	9	26	22	34	19	19	24	30
National / local elections	0	0	0	1	0	18	18	0	0
PFEM					0	4	2	2	2
Statutory expenditures	3	4	6	6	7	5	5	6	7
National AIDS Commission	12	5	13	5	16	16	17	20	24
Maize purchases	2	1	5	3	1	1	3	3	4
Rural Electrification Program			3	8	0	7	8	8	8
Subsidies and other current transfers	54	57	98	98	103	114	111	126	150
Pension and gratuities	12	10	16	16	19	20	20	22	26
Transfers to road and revenue authorities	5	5	7	8	9	10	11	13	15
Transfers to public entities	15	17	22	22	26	30	30	34	41
Fertilizer and seed subsidy	22	24	53	52	49	54	50	57	68
Arrears payments	0	0	12	12	11	8	8	11	0
Development expenditure	65	78	94	104	121	173	144	175	223
Foreign financed	32	35	59	72	77	126	113	128	162
Domestically financed	33	42	35	32	44	47	31	47	61
Net lending	1	0	0	0	0	0	0	0	0
Overall balance (including grants)	-24	-66	-14	-16	-18	-64	-66	-65	-72
Discrepancy 2/	-1	-15	10	-14	0	0	-18	0	0
Overall balance (including grants and discrepancy)	-25	-81	-4	-30	-18	-64	-84	-65	-72
Total financing (net)	25	81	4	30	18	64	84	65	72
Foreign financing (net)	11	16	23	33	26	71	77	76	85
Borrowing	13	18	29	38	35	81	83	89	101
Budget support	0	1	5	0	0	29	35	34	30
Project	13	17	24	38	35	52	49	56	71
Other concessional	0	0	0	0	0	0	0	0	0
Amortization	-2	-3	-6	-5	-9	-10	-6	-14	-16
Domestic financing (net)	14	65	-19	-2	-7	-7	7	-11	-13
Domestic borrowing (net)	14	65	-19	-2	-7	-7	7	-11	-13
Privatization	0	0	0	0	0	0	0	0	0
Memorandum items:									
Domestic fiscal balance 3/	-56	-74	-134	-120	-123	-136	-107	-120	-139
Net domestic debt	124	189	197	228	188	181	232	221	208
Of which, securitized arrears	0	0	…	41	…	…	31	20	10
Domestic payment arrears	0	72	…	19	8	11	11	0	0
Nominal GDP	847	969	1,183	1,234	1,401	1,440	1,578	1,792	2,126

Sources: Malawi Ministry of Finance and IMF staff estimates.

1/ Nontax revenues in 2013/14 include the RBM profit transfer to government of MK15 billion.

2/ Part of the discrepancy in FY2012/13 is explained by the government's issuance of promissory note for RBM recapitalization in the magnitude of MK28.5 billion, which was included in financing but did not have an associated cash expenditure. In FY2013/14 the discrepancy includes payments made in connection to the fraud.

3/ Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 2b. Malawi: Central Government Operations: 2010/11–2015/16

(Percent of GDP)

	2010/11	2011/12	2012/13		2013/14			2014/15	2015/16
	Actual	Actual	Prog. 2nd review	Prel.	Prog. 2nd review	June 2013 mission	Revised prog.	Proj.	Proj.
Revenue	32.1	26.5	39.0	38.3	37.3	38.5	36.9	36.3	36.7
Tax and nontax revenue	24.5	22.1	23.9	24.0	24.4	24.7	27.1	26.0	26.0
Tax revenue	20.8	19.4	20.6	21.8	21.6	22.0	23.7	23.6	23.6
Taxes on income and profits	9.6	9.2	9.6	10.5	9.6	10.4	10.7	10.7	10.7
Taxes on goods and services	9.4	8.7	8.9	9.0	9.6	9.2	10.3	10.1	10.2
Taxes on international trade	2.1	1.9	2.6	2.7	2.8	2.7	3.0	3.0	3.0
Other taxes	-0.3	-0.3	-0.5	-0.3	-0.5	-0.3	-0.2	-0.2	-0.2
Nontax revenue 1/	3.8	2.7	3.3	2.2	2.8	2.6	3.4	2.4	2.4
Grants	7.6	4.4	15.1	14.2	13.0	13.8	9.8	10.2	10.8
Budget support grants	1.8	0.0	6.5	6.3	5.0	2.7	2.0	1.9	1.9
Project grants	2.2	1.9	3.0	2.8	3.0	5.1	4.1	4.0	4.3
Dedicated grants	3.6	2.6	5.7	5.1	5.0	5.8	3.8	4.3	4.6
Expenditure and net lending	35.0	33.4	40.2	39.6	38.6	42.9	41.1	39.9	40.1
Current expenditure	27.2	25.4	32.2	31.2	30.0	30.9	32.0	30.1	29.6
Wages and salaries	6.9	7.2	8.1	7.9	8.6	9.1	8.7	8.8	8.9
Interest payments	2.7	2.5	2.8	2.7	2.3	2.2	5.9	4.0	3.2
Domestic	2.6	2.2	2.4	2.4	2.0	1.8	5.6	3.8	3.1
Foreign	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Goods and services	11.2	9.8	12.0	11.6	10.9	11.2	9.9	9.8	10.4
Generic goods and services	4.8	5.5	4.7	4.9	4.1	2.9	2.3	2.9	3.5
Census	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Road Maintenance	0.9	0.7	0.8	0.6	0.6	0.6	0.6	0.8	0.7
Agricultural swap	0.0	0.0	0.0	0.0	0.0	1.3	1.0	1.0	1.0
Health SWAp	2.2	1.7	2.1	2.6	2.1	1.5	1.4	1.6	1.6
Education SWAp	1.2	0.9	2.2	1.8	2.4	1.3	1.2	1.3	1.4
National / local elections	0.0	0.0	0.0	0.1	0.0	1.2	1.1	0.0	0.0
PFEM	0.0	0.0	0.0	0.0	0.0	0.3	0.1	0.1	0.1
Statutory expenditures	0.4	0.4	0.5	0.5	0.5	0.3	0.3	0.3	0.3
National AIDS Commission	1.5	0.5	1.1	0.4	1.1	1.1	1.1	1.1	1.1
Maize purchases	0.2	0.1	0.4	0.3	0.1	0.1	0.2	0.2	0.2
Rural Electrification Program	0.0	0.0	0.2	0.6	0	0.5	0.5	0.4	0.4
Subsidies and other current transfers	6.4	5.9	8.3	8.0	7.4	7.9	7.1	7.1	7.1
Pension and gratuities	1.4	1.1	1.3	1.3	1.3	1.4	1.2	1.2	1.2
Transfers to road and revenue authorities	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7
Transfers to public entities	1.7	1.8	1.9	1.8	1.9	2.1	1.9	1.9	1.9
Fertilizer and seed subsidy	2.6	2.5	4.4	4.2	3.5	3.8	3.2	3.2	3.2
Arrears payments	0.0	0.0	1.0	1.0	0.8	0.6	0.5	0.6	0.0
Development expenditure	7.7	8.0	8.0	8.4	8.7	12.0	9.1	9.8	10.5
Foreign financed	3.7	3.6	5.0	5.9	5.5	8.8	7.2	7.2	7.6
Domestically financed	3.9	4.4	3.0	2.6	3.2	3.3	2.0	2.6	2.9
Net lending	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-2.9	-6.9	-1.2	-1.3	-1.3	-4.4	-4.2	-3.6	-3.4
Discrepancy 2/	-0.1	-1.5	0.8	-1.1	0.0	0.0	-1.2	0.0	0.0
Overall balance (including grants and discrepancy)	-2.9	-8.4	-0.4	-2.4	-1.3	-4.4	-5.3	-3.6	-3.4
Total financing (net)	2.9	8.3	0.4	2.4	1.3	4.4	5.3	3.6	3.4
Foreign financing (net)	1.3	1.6	1.9	2.6	1.8	4.9	4.9	4.2	4.0
Borrowing	1.5	1.9	2.5	3.1	2.5	5.6	5.3	5.0	4.7
Budget support	0.0	0.1	0.4	0.0	0.0	2.0	2.2	1.9	1.4
Project	1.5	1.8	2.0	3.1	2.5	3.6	3.1	3.1	3.3
Other concessional	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.3	-0.5	-0.4	-0.7	-0.7	-0.4	-0.8	-0.8
Domestic financing (net)	1.7	6.7	-1.6	-0.2	-0.5	-0.5	0.4	-0.6	-0.6
Domestic borrowing (net)	1.7	6.7	-1.6	-0.2	-0.5	-0.5	0.4	-0.6	-0.6
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Domestic fiscal balance 3/	-6.6	-7.6	-11.3	-9.7	-8.8	-9.4	-6.8	-6.7	-6.5
Net domestic debt	14.7	19.5	17.0	18.5	13.4	12.6	14.7	12.3	9.8
Of which, securitized arrears	0.0	0.0	…	3.4	…	…	2.0	1.1	0.5
Domestic payment arrears	0.0	7.4	…	1.5	0.5	0.7	0.7	0.0	0.0
Nominal GDP	847	969	1,183	1,234	1,401	1,440	1,578	1,792	2,126

Sources: Malawi Ministry of Finance and IMF staff estimates.

1/ Nontax revenues in 2013/14 include the RBM profit transfer to government of 1 percent of GDP.

2/ Part of the discrepancy in FY2012/13 is explained by the government's issuance of promissory note for RBM recapitalization in the magnitude of 2.3 percent of GDP, which was included in financing but did not have an associated cash expenditure. In FY2013/14 the discrepancy includes payments made in connection to the fraud.

3/ Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 2c. Malawi: Central Government Operations: 2013/14

(Billions of kwacha)

	Q1	Q2	Q3	Q4	Annual
	Prel.	Revised prog.	Revised prog.	Revised prog.	Revised prog.
Revenue	124	140	145	173	583
Tax and nontax revenue	102	106	99	121	428
Tax revenue	92	96	91	95	375
Taxes on income and profits	40	41	42	45	168
Taxes on goods and services	41	42	38	41	162
Taxes on international trade	11	14	11	11	47
Other taxes	0	-1	-1	-1	-3
Nontax revenue 1/	10	10	8	26	54
Grants	23	34	46	52	154
Budget support grants	3	0	10	18	31
Project grants	4	20	20	20	64
Dedicated grants	16	14	15	14	59
Expenditure and net lending	173	170	161	144	648
Current expenditure	149	128	121	106	504
Wages and salaries	36	34	34	34	137
Interest payments	33	23	19	17	93
Domestic	32	21	17	17	88
Foreign	1	2	1	1	5
Goods and services	52	37	34	33	156
Generic goods and services	15	10	3	9	36
Census	0	0	0	0	0
Road Maintenance	3	2	2	2	9
Agricultural swap	0	7	5	5	16
Health SWAp	8	5	5	4	23
Education SWAp	8	5	5	2	19
National / local elections	4	3	7	4	18
PFEM	0	2	0	0	2
Statutory expenditures	5	0	0	0	5
National AIDS Commission	2	4	5	5	17
Maize purchases	3	0	0	0	3
Rural Electrification Program	5	0	2	2	8
Subsidies and other current transfers	21	33	35	22	111
Pension and gratuities	8	4	4	4	20
Transfers to road and revenue authorities	3	3	3	3	11
Transfers to public entities	9	8	4	9	30
Fertilizer and seed subsidy	1	19	25	6	50
Arrears payments	8	0	0	0	8
Development expenditure	24	42	40	38	144
Foreign financed	11	34	35	34	113
Domestically financed	13	8	5	5	31
Net lending	0	0	0	0	0
Overall balance (including grants)	-49	-30	-16	29	-66
Discrepancy	-18	0	0	0	-18
Overall balance (including grants and discrepancy)	-67	-30	-16	29	-84
Total financing (net)	67	30	16	-29	84
Foreign financing (net)	8	16	36	16	77
Borrowing	9	18	38	18	83
Budget support	2	4	24	4	35
Project	7	14	14	14	49
Other concessional	0	0	0	0	0
Amortization	-1	-2	-2	-2	-6
Domestic financing (net)	59	13	-20	-45	7
Domestic borrowing (net)	59	13	-20	-45	7
Privatization	0	0	0	0	0
Memorandum items:					
Domestic fiscal balance 2/	-60	-30	-28	11	-107
Net domestic debt	284	297	277	232	232
Of which, securitized arrears	39	36	33	31	31
Domestic payment arrears	11	11	11	11	11
Nominal GDP	353	353	436	436	1,578

Sources: Malawi Ministry of Finance and IMF staff estimates.
1/ Nontax revenues include the RBM profit transfer to government of MK15 billion in Q4.
2/ Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 3a. Malawi: Monetary Authorities' Survey, 2011–16
(Billions of Kwacha, unless otherwise indicated)

	2011	2012	2013						2014				2015	2016
			Mar.	Jun.	Sep.	Dec.	Sep.	Dec.	Mar.		Jun.	Dec.		
	Act.	Act.	Act.		Prog.		Act.	Proj.	Prog.	Proj.	Proj.	Proj.	Proj.	
Reserve money	73	99	90	127	110	119	135	135	116	134	145	158	180	202
Currency outside banks	42	55	50	86	…	…	79	…	…	…	…	…	…	…
Cash in vault	11	16	12	14	…	…	15	…	…	…	…	…	…	…
Commercial bank deposits with RBM	20	28	27	27	…	…	40	…	…	…	…	…	…	…
Net foreign assets (NFA) [1]	-9	-20	-36	51	24	27	51	35	23	27	61	51	101	184
Foreign assets	32	73	76	152	133	142	164	165	137	154	188	187	251	315
Foreign liabilities	-40	-93	-112	-101	-109	-116	-111	-126	-107	-105	-112	-120	-128	-127
Net domestic assets	82	119	125	76	86	92	84	100	93	107	84	107	79	19
Credit to government (net)	103	110	116	110	106	128	110	119	125	105	75	93	79	81
Credit to statutory bodies (net)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to domestic banks	0	0	7	7	0	0	0	0	0	0	0	0	0	0
Other items (net)	-21	9	2	-41	-20	-36	-26	-20	-32	2	9	14	-1	-63
Open market operations	-9	-14	-12	-5	-44	-59	-38	-25	-55	-3	2	11	-2	-70
Others	-11	23	15	-36	23	23	12	5	23	5	7	3	2	2
Memorandum items:														
Money multiplier	4.3	3.9	4.4	3.5	4.0	4.1	3.6	3.7	4.1	3.8	3.8	3.8	3.8	3.8
Annual growth of reserve money (percent)	27.5	35.7	2.3	25.9	21.2	19.8	48.4	36.1	29.5	49.9	14.7	16.7	13.9	12.7
91-day treasury bill rate	6.8	20.1	39.8	33.0	…	…	26.8	…	…	…	…	…	…	…
NFA (US$ millions)	-54	-60	-88	151	69	76	145	86	66	67	158	124	237	437
Foreign assets (US$ millions)	193	219	188	453	383	406	446	406	388	380	484	456	561	750
Foreign liabilities (US$ millions)	-247	-278	-277	-302	-314	-330	-302	-320	-322	-313	-326	-332	-323	-313

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

[1] Including SDR allocation and the entire assets and liabilities of the RBM.

Table 3b. Malawi: Monetary Survey, 2011–16

(Billions of Kwacha, unless otherwise indicated)

	2011	2012	2013						2014				2015	2016
			Mar.	Jun.	Sep.	Dec.	Sep.	Dec.	Mar.		Jun.	Dec.		
	Act.		Act.		Prog.		Act.	Proj.	Prog.	Proj.	Proj.		Proj.	
Money and quasi-money	314	386	397	448	439	487	482	486	475	511	552	600	683	769
Money	164	222	183	189	…	…	216	…	…	…	…	…	…	…
Quasi-money	150	164	164	174	…	…	187	…	…	…	…	…	…	…
Of which: foreign currency deposits	26	72	83	88	…	…	96	…	…	…	…	…	…	…
Net foreign assets (NFA) [1]	3	31	24	109	79	83	131	100	81	93	125	121	191	265
Monetary authorities	-9	-20	-36	51	24	27	51	35	23	27	61	51	101	184
Gross foreign assets	32	73	76	152	133	142	164	165	137	154	188	187	251	315
Foreign liabilities	-40	-93	-112	-101	-109	-116	-111	-126	-114	-112	-119	-128	-128	-127
Commercial banks (net)	11	51	59	58	55	57	80	65	58	66	64	70	85	81
Net domestic assets	312	355	374	339	360	403	352	385	394	417	427	479	492	504
Credit to government (net)	141	141	158	152	136	163	192	204	159	186	140	167	146	158
Credit to statutory bodies (net)	20	19	19	18	19	19	18	18	19	18	18	18	18	18
Credit to private sector	175	219	229	232	227	243	230	238	236	288	332	333	376	361
Other items (net)	-24	-24	-32	-62	-22	-19	-89	-75	-21	-75	-65	-40	-49	-33
Memorandum items:														
Velocity of money (annualized GDP divided by broad money)	2.8	2.7	3.0	2.7	2.8	2.7	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Annual growth of broad money (percent)	35.7	22.9	25.8	25.7	25.3	25.9	37.6	25.6	22.4	28.5	23.1	23.5	13.9	12.7
Annual growth of credit to the private sector (percent)	20.5	25.4	28.0	11.5	8.5	10.8	10.0	8.9	9.9	25.8	43.4	39.9	12.7	-3.8
NFA of the commercial banks (US$ millions)	68.5	153.3	146.6	174.3	159.6	161.7	214.4	160.9	164.1	163.3	165.8	170.7	181.8	193.6
Gross foreign assets (US$ millions)	103.9	199.5	164.7	198.6	207.7	210.5	232.1	209.5	213.7	212.6	215.8	222.2	236.7	252.0
Foreign liabilities (US$ millions)	-35.4	-46.3	-18.1	-24.3	-48.2	-48.8	-17.7	-48.6	-49.6	-49.3	-50.1	-51.5	-54.9	-58.4
Foreign currency deposits(US$ millions)	160.9	218.2	213.6	265.2	…	…	…	…	…	…	…	…	…	…
Nominal GDP (percent changes)	8.4	19.9				33.7		33.7				23.5	13.9	12.7

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

[1] Including SDR allocation.

Table 4a. Malawi: Balance of Payments, 2011–16

(US$ millions, unless otherwise indicated)

	2011 Act.	2012 Prog.	2012 Act.	2013 2nd Rev.	2013 Revised Prog.	2014 2nd Rev.	2014 Revised Prog.	2015 Proj.	2017 Proj.
Current account balance (including grants)	-330.0	-150.5	-184.3	-58.9	-136.1	-74.2	-177.7	-153.1	-109.5
Merchandise trade balance	-630.1	-658.2	-655.9	-490.1	-523.5	-535.7	-579.4	-632.9	-639.6
Exports	1,262.7	1,253.7	1,255.5	1,479.2	1,385.3	1,596.9	1,505.2	1,629.8	1,905.8
Of which: Tobacco	482.4	481.1	480.9	606.2	358.2	636.4	394.9	436.2	532.8
Uranium	120.4	154.4	154.4	169.9	169.9	186.8	161.6	159.2	159.2
Imports	-1,892.7	-1,911.9	-1,911.4	-1,969.3	-1,908.8	-2,132.6	-2,084.7	-2,262.8	-2,545.4
Of which: Petroleum	-168.8	-169.4	-173.7	-164.7	-177.1	-172.5	177.0	171.9	170.0
Services balance	-312.8	-378.4	-378.6	-383.3	-382.0	-429.7	-394.3	-397.9	-439.0
Interest public sector (net)	-5.6	-9.6	-10.0	-12.0	-9.1	-14.5	-10.0	-8.7	-11.2
Other factor payments (net)	-109.7	-124.8	-124.8	-135.5	-135.2	-148.5	-134.1	-131.9	-133.0
Nonfactor (net)	-197.5	-244.0	-243.9	-235.8	-237.6	-266.8	-250.3	-257.3	-294.8
Unrequited transfers (net)	612.9	886.0	850.3	814.5	769.4	891.2	857.6	933.5	1,046.8
Private (net)	256.0	260.8	259.8	275.1	273.8	291.8	295.5	324.3	369.9
Official (net)	356.9	625.2	590.4	539.3	495.6	599.4	562.2	609.1	676.9
Receipts	357.7	625.9	591.2	540.1	496.4	600.2	563.0	610.0	677.8
Budget support	0.0	171.5	181.4	162.6	73.5	180.7	111.2	88.2	103.2
Project related[1]	357.6	454.4	409.8	377.5	422.9	419.5	451.8	521.7	574.5
Payments	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Financial account balance	157.4	145.7	223.3	199.3	227.6	217.5	396.5	342.6	413.8
Medium- and long-term flows (net)	108.9	81.8	76.0	89.4	126.3	70.2	271.7	200.0	203.0
Disbursements	123.3	100.3	93.4	112.7	137.1	100.0	297.5	233.4	236.5
Budget support	0.0	5.0	0.0	10.0	33.1	0.0	113.3	78.9	63.9
Project support	53.3	77.9	76.0	102.7	96.5	100.0	134.2	154.5	172.6
Other medium-term loans	70.0	17.4	17.4	0.0	7.4	0.0	50.0	0.0	0.0
Amortization	-14.4	-18.5	-17.4	-23.3	-10.7	-29.8	-25.7	-33.4	-33.4
SDR allocation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment and other inflows	60.8	61.9	61.9	105.3	92.9	136.7	114.2	130.7	197.7
Short-term capital	0.7	0.7	0.7	0.8	0.7	0.8	0.8	0.8	1.0
Commercial banks net foreign assets	-13.0	1.3	84.7	3.8	7.6	9.8	9.8	11.1	12.1
Errors and omissions	65.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-106.9	-4.8	39.1	140.4	91.5	143.4	280.4	245.3	382.0
Financing	106.9	4.8	-39.1	-140.4	-91.5	-143.4	-280.4	-245.3	-382.0
Gross reserves (- increase)	107.7	-32.1	-68.8	-188.7	-136.3	-152.7	-292.5	-236.1	-355.2
Liabilities[2]	-1.2	36.9	37.9	48.3	46.8	9.3	12.2	-9.2	-26.8
Of which: IMF (net)	-0.1	36.6	37.0	51.9	81.6	14.1	13.5	-7.7	-25.2
Purchases/drawings	0.0	40.2	40.2	60.2	90.2	40.2	40.2	20.1	0.0
Repurchases/repayments	0.1	3.6	3.2	8.4	8.6	26.1	26.6	27.8	25.2
Memorandum items:									
Gross official reserves	190.2	214.7	215.4	403.3	403.0	555.5	453.1	557.3	1,102.0
Months of imports[3]	1.0	1.1	1.1	1.9	2.0	2.5	2.0	2.4	4.0
Current account balance (percent of GDP)									
Excluding official transfers	-12.2	-18.3	-18.6	-16.0	-16.4	-16.1	-16.8	-16.1	-13.4
Including official transfers	-5.9	-3.6	-4.4	-1.6	-3.5	-1.8	-4.0	-3.2	-1.9
Value of exports of goods and services (percent change)	3.6	-3.6	-3.5	18.1	10.3	9.2	8.8	8.4	7.8
Value of imports of goods and services (percent change)	-7.8	1.0	1.0	3.1	0.1	7.0	8.9	8.1	5.5
REER (percent change)	-3.3	…	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-1.9	-0.1	0.9	3.7	2.4	3.4	6.4	5.2	6.5
Terms of trade (percent change)	-17.5	-3.3	-2.2	1.5	0.3	3.0	2.5	2.5	2.3
Nominal GDP (millions of U.S. dollars)	5,613.5	4,236.3	4,173.8	3,750.6	3,847.8	4,178.1	4,404.0	4,741.7	5,872.0

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

1 Includes estimate for project grants not channeled through the budget.
2 Excluding SDR allocation.
3 Months of prospective imports of goods and nonfactor services.

Table 4b. Malawi: Balance of Payments, 2011–16
(Percent of GDP)

	2011 Act.	2012 Prog.	2012 Act.	2013 2nd Rev.	2013 Revised Prog.	2014 2nd Rev.	2014 Revised Prog.	2015 Proj.	2017 Proj.
Current account balance (including grants)	-5.9	-3.6	-4.4	-1.6	-3.5	-1.8	-4.0	-3.2	-1.9
Merchandise trade balance	-11.2	-15.5	-15.7	-13.1	-13.6	-12.8	-13.2	-13.3	-10.9
Exports	22.5	29.6	30.1	39.4	36.0	38.2	34.2	34.4	32.5
Of which: Tobacco	8.6	11.4	11.5	16.2	9.3	15.2	9.0	9.2	9.1
Uranium	2.1	3.6	3.7	4.5	4.4	4.5	3.7	3.4	2.7
Imports	-33.7	-45.1	-45.8	-52.5	-49.6	-51.0	-47.3	-47.7	-43.3
Of which: Petroleum	-3.0	-4.0	-4.2	-4.4	-4.6	-4.1	4.0	3.6	2.9
Services balance	-5.6	-8.9	-9.1	-10.2	-9.9	-10.3	-9.0	-8.4	-7.5
Interest public sector (net)	-0.1	-0.2	-0.2	-0.3	-0.2	-0.3	-0.2	-0.2	-0.2
Other factor payments (net)	-2.0	-2.9	-3.0	-3.6	-3.5	-3.6	-3.0	-2.8	-2.3
Nonfactor (net)	-3.5	-5.8	-5.8	-6.3	-6.2	-6.4	-5.7	-5.4	-5.0
Transfers (net)	10.9	20.9	20.4	21.7	20.0	21.3	19.5	19.7	17.8
Private (net)	4.6	6.2	6.2	7.3	7.1	7.0	6.7	6.8	6.3
Official (net)	6.4	14.8	14.1	14.4	12.9	14.3	12.8	12.8	11.5
Receipts	6.4	14.8	14.2	14.4	12.9	14.4	12.8	12.9	11.5
Budget support	0.0	4.0	4.3	4.3	1.9	4.3	2.5	1.9	1.8
Project related[1]	6.4	10.7	9.8	10.1	11.0	10.0	10.3	11.0	9.8
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	2.8	3.4	5.4	5.3	5.9	5.2	9.0	7.2	7.0
Medium- and long-term flows (net)	1.9	1.9	1.8	2.4	3.3	1.7	6.2	4.2	3.5
Disbursements	2.2	2.4	2.2	3.0	3.6	2.4	6.8	4.9	4.0
Budget support	0.0	0.1	0.0	0.3	0.9	0.0	2.6	1.7	1.1
Project support	0.9	1.8	1.8	2.7	2.5	2.4	3.0	3.3	2.9
Other medium-term loans	1.2	0.4	0.4	0.0	0.2	0.0	1.1	0.0	0.0
Amortization	-0.3	-0.4	-0.4	-0.6	-0.3	-0.7	-0.6	-0.7	-0.6
SDR allocation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment and other inflows	1.1	1.5	1.5	2.8	2.4	3.3	2.6	2.8	3.4
Short-term capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks net foreign assets	-0.2	0.0	2.0	0.1	0.2	0.2	0.2	0.2	0.2
Errors and omissions	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.9	-0.1	0.9	3.7	2.4	3.4	6.4	5.2	6.5
Financing	1.9	0.1	-0.9	-3.7	-2.4	-3.4	-6.4	-5.2	-6.5
Gross reserves (- increase)	1.9	-0.8	-1.6	-5.0	-3.5	-3.7	-6.6	-5.0	-6.0
Liabilities[2]	0.0	0.9	0.9	1.3	1.2	0.2	0.3	-0.2	-0.5
Of which: IMF (net)	0.0	0.9	0.9	1.4	2.1	0.3	0.3	-0.2	-0.4
Purchases/drawings	0.0	0.9	1.0	1.6	2.3	1.0	0.9	0.4	0.0
Repurchases/repayments	0.0	0.1	0.1	0.2	0.2	0.6	0.6	0.6	0.4
Memorandum items:									
Gross official reserves	3.4	5.1	5.2	10.8	10.5	13.3	10.3	11.8	18.8
Months of imports[3]	1.0	1.1	1.1	1.9	2.0	2.5	2.0	2.4	4.0
Current account balance (percent of GDP)									
Excluding official transfers	-12.2	-18.3	-18.6	-16.0	-16.4	-16.1	-16.8	-16.1	-13.4
Including official transfers	-5.9	-3.6	-4.4	-1.6	-3.5	-1.8	-4.0	-3.2	-1.9
Value of exports of goods and services (percent change)	3.6	-3.6	-3.5	18.1	10.3	9.2	8.8	8.4	7.8
Value of imports of goods and services (percent change)	-7.8	1.0	1.0	3.1	0.1	7.0	8.9	8.1	5.5
REER (percent change)	-3.3	…	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-1.9	-0.1	0.9	3.7	2.4	3.4	6.4	5.2	6.5
Terms of trade (percent change)	-17.5	-3.3	-2.2	1.5	0.3	3.0	2.5	2.5	2.3

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

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

[2] Excluding SDR allocation.

[3] Months of prospective imports of goods and nonfactor services.

Table 5. Malawi: External Financing Requirement and Source, 2009–17

(In millions of US dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total requirement	-625	-1072	-593	-861	-779	-997	-976	-1070	-1097
Current account, excluding official transfers	-715	-919	-687	-775	-632	-678	-706	-718	-709
Debt amortization	-9	-14	-14	-17	-11	-26	-33	-33	-33
Gross reserves accumulation (- increase)	99	-139	108	-69	-136	-293	-236	-318	-355
Total sources	625	1073	593	861	779	997	976	1070	1097
Expected disbursements (official)	545	954	480	684	633	860	843	911	913
Grants	471	850	357	590	496	562	609	675	677
Medium- and long-term loans	73	104	123	93	137	297	233	236	236
Private sector (net)	-6	98	113	140	64	123	141	187	209
IMF	86	21	0	37	82	14	-8	-29	-25
Drawings	0	21	0	40	90	40	20	0	0
Repayments	0	0	0	3	9	27	28	29	25
SDR allocation	86	0	0	0	0	0	0	0	0
Gross international reserves	141	280	190	215	403	453	557	747	1102
Months of imports	0.7	1.5	1.0	1.1	2.0	2.0	2.4	3.0	4.0

Source: IMF staff estimates.

Table 6a. Malawi: Original Schedule of Disbursements Under ECF Arrangement, 2012–15
(Millions of SDR)

Amount	% of Quota	Date available	Conditions Necessary for Disbursement	Status
13.02	18.76	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	18.76	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	18.75	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
13.01	18.75	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	
13.01	18.75	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	
13.01	18.75	June 15, 2014	Observance of performance criteria for March 31, 2014 and completion of fifth review.	
13.01	18.75	December 15, 2014	Observance of performance criteria for September 30, 2014 and completion of sixth review.	
13.00	18.73	June 15, 2015	Observance of performance criteria for March 31, 2015 and completion of seventh review.	
104.10	150.00	Total for the ECF arrangement		

Source: IMF staff estimates.

Table 6b. Malawi: Proposed Schedule of Disbursements Under ECF Arrangement, 2012–15

(Millions of SDR)

Amount	% of Quota	Date available	Conditions Necessary for Disbursement	Status
13.02	18.76	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	18.76	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	18.75	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
6.51	9.38	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	
6.50	9.37	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	
13.01	18.75	March 15, 2014	Observance of performance criteria for December 31, 2013 and completion of fifth review.	
13.01	18.75	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	
13.01	18.75	March 15, 2015	Observance of performance criteria for December 31, 2014 and completion of seventh review.	
13.01	18.75	September 15, 2015	Observance of performance criteria for June 30, 2015 and completion of eighth review.	
104.10	150.00	Total for the ECF arrangement		

Source: IMF staff estimates.

Table 7. Malawi: Indicators of Capacity to Repay the Fund, 2013–22[1]

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Projected Payments based on Existing Drawings:										
(SDR millions)										
Principal	1.7	16.7	17.4	17.9	15.7	20.4	10.6	9.9	7.8	7.8
Charges and interest	0.0	0.1	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1
Projected Payments based on Existing and Prospective Drawings:										
(SDR millions)										
Principal	1.7	16.7	17.4	17.9	15.7	20.4	17.1	21.6	20.8	20.8
Charges and interest	0.0	0.1	0.4	0.4	0.4	0.3	0.3	0.2	0.2	0.1
Total Payments based on Existing and Prospective Drawings:										
SDR millions	1.7	16.7	17.8	18.3	16.1	20.7	17.4	21.8	21.0	21.0
US$ Millions	2.6	25.8	27.5	28.2	24.8	32.0	26.8	33.7	32.4	32.3
Percent of exports of goods and services	0.2	1.6	1.6	1.5	1.2	1.4	1.1	1.3	1.2	1.1
Percent of debt service	9.7	58.3	44.3	42.5	32.8	45.2	29.3	38.9	34.7	32.9
Percent of quota	2.4	24.1	25.6	26.3	23.2	29.9	25.0	31.5	30.3	30.2
Percent of gross official reserves	0.6	5.7	4.9	3.8	2.3	2.4	1.8	2.2	2.0	1.9
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:										
SDR millions	151.4	160.8	156.4	138.6	122.9	102.5	85.4	63.8	42.9	22.1
US$ Millions	233.7	248.1	241.4	213.9	189.6	158.1	131.7	98.4	66.3	34.1
Percent of exports of goods and services	15.6	15.2	13.6	11.2	9.2	7.1	5.6	3.9	2.5	1.2
Percent of debt service	882.5	560.4	389.6	322.4	251.0	223.1	143.8	113.4	70.9	34.7
Percent of quota	218.2	231.6	225.4	199.7	177.0	147.6	123.0	91.9	61.9	31.9
Percent of gross official reserves	58.0	54.8	43.3	28.6	17.2	11.8	8.9	6.3	4.0	2.0
Memorandum items:										
Exports of goods and services (US$ millions)	1499.4	1631.5	1769.3	1913.4	2063.1	2239.1	2347.6	2518.0	2702.7	2903.3
Debt service (US$ millions)	26.5	44.3	62.0	66.3	75.5	70.9	91.6	86.7	93.5	98.2
Quota (SDR millions)	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Gross official reserves (millions of U.S. dollars)	403.0	453.1	557.3	746.8	1102.0	1335.1	1487.7	1560.0	1637.6	1697.3
GDP (US$ millions)	3847.8	4404.0	4741.7	5330.8	5872.0	6384.1	6915.0	7423.7	8023.6	8628.7

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

[1] Assumes disbursements as per schedule in Table 6. Payments for 2013 cover only the period of September to December.

Table 8a. Malawi: Quantitative Targets (2012–13)[1]

	Target type [2]	End-Dec. 2012 (PC)	End-March 2013 (PC)				End-June 2013 (IT)				End-September 2013 (PC)			
		Act.	Prog.	Adj. Prog.	Actual	Status	Prog.	Adj. Prog.	Actual	Status	Prog.	Adj. Prog.	Prel.	Status
I. Monetary targets (millions of kwacha)														
1. Ceiling on net domestic assets of the RBM [3,4,5,6]	PC	118,408	125,803	129,003	120,412	M	108,487	110,839	72,920	M	87,854	59,365	81,224	NM
2. Ceiling on reserve money[3]	IT	99,351	98,488	98,488	89,678	M	106,902	106,902	126,570	NM	110,017	110,017	134,756	NM
II. Fiscal targets (millions of kwacha)														
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-18,201	-3,396	-196	-232	M	-18,605	-16,253	-2,492	NM	-5,218	-2,018	58,685	NM
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	87,295	144,922	144,922	144,172	NM	185,511	185,511	181,764	NM	200,841	15,330	48,952	M
III. External sector targets (US$ millions, unless otherwise indicated)														
5. Floor on net international reserves of the RBM[3,5,6]	PC	34	-27	-37	6	M	53	46	270	M	127	117	254	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0	0		0	0	0		0	0	0	
8. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	0	77	NM	0	0	142	NM	0	0	0	M
9. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	0		0	0	0		0	0	0	
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC					M				M				M
Memorandum items:														
Net foreign assets of the RBM (US$ millions)		-60	-85		-103		-5		151		69		167	
Budget support (US$ millions)		180	186		186		245		244		50		9	
Budget support (millions of kwacha)		57,531	59,498		59,478		78,355		78,219		15,978		2,846	
Debt service payments to the World Bank and AfDB (US$ millions)		3	4		4		6		6		1		1	
Debt service payments to the World Bank and AfDB (millions of kwacha)		835	1,218		1,218		1,920		1,936		465		465	
Health SWAp receipts (millions of kwacha)		8,612	11,290		11,290		11,290		15,040		3,194		4,815	
Education SWAp receipts (millions of kwacha)		6,434	16,765		16,765		23,245		1,764		4,800		3,548	
NAC receipts (millions of kwacha)		1,538	7,993		7,993		12,281		441		4,288		999	
Program exchange rate (kwacha per US$)		320	320		320		320		320		320		320	

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. All stocks of NDA adjusted for consistency with the program definition (specified in the TMU).

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 social sector expenditures consistent with the TMU.

7 Defined as a cumulative flow.

8 Priority social spending as defined in the TMU and quantified in the authorities' budget. End-September 2013 "Prog." target was calculated comulatively from July 1, 2012 (second review). The figure under "Adj. Prog." is calculated from July 1, 2013.

9 Evaluated on a continuous basis.

10 Other standard PCs include introducing or modfying MCPs, concluding bilateral payments agreements that are inconsistent with Article VIII, and imposing or intensifying import restrictions for balance of payment reasons.

Table 8b. Malawi: Quantitative Targets (2013–14)[1]

	Target type [2]	End-Jun. 2013 (IT)	End-Sept. 2013 (PC)	End-Dec. 2013		End-Mar. 2014		End-June 2014 (PC)	End-Sep. 2014 (IT)
		Prel.	2nd Review Prog.	2nd Review (IT)	Revised (PC)	2nd Review (PC)	Revised (IT)		
I. Monetary targets (millions of kwacha)									
1. Ceiling on net domestic assets of the RBM [3,4, 5, 6]	PC	72,920	87,854	94,741	107,710	95,110	113,035	94,817	97,701
2. Ceiling on reserve money [3]	IT	126,570	110,017	118,977	135,223	116,146	134,392	145,225	151,232
II. Fiscal targets (millions of kwacha)									
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-2,492	-5,218	25,205	72,042	21,277	52,018	6,622	-20,023
4. Floor on social spending (cumulative from beginning of fiscal year) [8]	IT	181,764	15,330	65,540	106,617	65,540	170,424	214,832	…
III. External sector targets (US$ millions, unless otherwise indicated)									
5. Floor on net international reserves of the RBM [3, 5, 6]	PC	270	127	134	188	124	169	260	269
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0	0	0	0	0	0
8. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	142	0	0	0	0	0	0	0
9. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	0	0	0	0	0
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC								
Memorandum items:									
Net foreign assets of the RBM (US$ millions)		151	69	76	86	66	67	158	167
Budget support (US$ millions)		244	50	100	27	150	111	167	209
Budget support (millions of kwacha)		78,219	15,978	31,945	8,645	47,903	35,445	53,509	66,878
Debt service payments to the World Bank andAfDB (US$ millions)		6	1	4	5	4	6	7	2
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,936	465	1,310	1,475		1,777	2,306	529
Health SWAp receipts (millions of kwacha)		15,040	3,194	6,531	6,971	9,721	7,234	8,834	2,433
Education SWAp receipts (millions of kwacha)		1,764	4,800	9,600	9,191	14,400	13,600	15,567	2,829
NAC receipts (millions of kwacha)		441	4,288	8,576	3,070	12,864	3,070	4,030	971
Program exchange rate (kwacha per US$)		320	320	320	320	320	320	320	320

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. All stocks of NDA adjusted for consistency with the program definition (specified in the TMU).

[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 social sector expenditures consistent with the TMU.

[7] Defined as a cumulative flow.

[8] Priority social spending as defined and quantified in the TMU.

[9] Evaluated on a continuous basis.

[10] Other standard PCs include introducing or modifying MCPs, concluding bilateral payments agreements that are inconsistent with Article VIII, and imposing or intensifying import restrictions for balance of payment reasons.

Table 9a. Malawi: Prior Actions and Structural Benchmarks, July 2012–Nov 2013

Measure	Target Date	Macro Rationale	Status
Prior Action			
Approval of the arrangement			
Parliamentary passage of a budget for FY 2012/13 in line with program objectives.		Toward fiscal sustainability.	Met.
First review			
Shut down RBM's uncollateralized lending to banks.		Maintain a tight monetary policy stance to contain inflation.	Met.
Second Review			
Sign and begin implementation of memorandum of understanding between the Reserve Bank of Malawi and the Ministry of Finance (MoF) indicating that the MoF is responsible for meeting the interest costs of treasury bills used for monetary operations.		Enhance effectiveness of RBM monetary operations.	Met.
Structural benchmarks			
Fiscal transparency			
Publish monthly revenue collections of the Malawi Revenue Authority in newspapers within two weeks of the end of the month.	31-Jul-12	Build credibility after recent incidents of inflation of revenue data by the Ministry of Finance.	Met.
Public financial management			
Provide Ministries, Departments and Agencies with quarterly spending ceilings consistent with quarterly fiscal targets in the program, and enforce ceilings.	Begin in September 2012 for FY2012/13 Q2 and quarterly thereafter	Keep spending within available resource envelope.	Met.
Verify existing stock of government domestic arrears and convert the verified claims into promissory notes redeemable over several years, beginning in FY2013/14.	31-Dec-12	Ascertain magnitude of government obligations and begin payment.	Met (with delay).
Configure the IFMIS Purchase Order (PO) module to support commitment control.	31-Dec-12	To restrain creation of arrears.	Met (with delay).
Expand the IFMIS Purchase Order (PO) module to cover all procurements and roll it out to all Ministries and Departments	30-Jun-13	To further restrain creation of arrears.	Met.
Progressively extend processes for capturing donor funded project transactions in IFMIS to all projects where bank accounts are controlled by the government of Malawi.	31-Mar-13	Fuller accounting for impact of aid flows on the budget.	Met.
Monetary Policy			
Submit to parliament an amendment of the RBM Act to limit the outstanding amount of RBM's total lending to government.	30-Jun-13	Reduce fiscal dominance to enhance effectiveness of monetary policy.	Not met.
Financial sector			
RBM to publish a financial stability report on a semi-annual basis, with a lag of no more than four months. Start with publication of report for quarter ending March 2012.	Semi-annual, starting in July 2012.	Promote financial stability.	Met; reports published in July 2012, January 2013 and June 2013.
Obtain approval and begin implementation of the Financial Sector Development Strategy.	31-Dec-12	Financial deepening.	Met (with delay).
Require vulnerable banks to undergo third-party diagnostic assessments by reputable audit firms.	30-Jun-13	Establish true financial conditions of affected banks and ensure effective monitoring.	Not met; postponed to end-February 2014.

Table 9b. Malawi: Prior Actions and Structural Benchmarks, Dec 2013–Sept 2014

Measure	Target Date	Macro Rationale	Status
Prior Action			
Third and Fourth Review			
Reactivate IFMIS in all Ministries after strengthening security and access control.	End-Dec. 2013	Enable better spending control.	Met
Audit the manual transactions completed while IFMIS was suspended	End-Dec. 2013	Enable better spending control.	Met
Submit to Fund staff preliminary forensic audit report	End-Dec. 2013	Build trust; resolve fraud case.	
Seek cabinet approval for revised spending plans in line with understandings reached with Fund staff	End-Dec. 2013	Strengthen commitment to revised budget.	Met
Observe three quantitative targets (government net domestic borrowing, NDA and NIR of the RBM) set at same level as the respective targets for end-December 2013.	13-Dec-13	Indicate prospect that end-year PCs will be met.	
Structural benchmarks			
Public financial management			
Upload into IFMIS the audited manual transactions undertaken when IFMIS was suspended (Proposed)	End-January 2014	Enable better spending control an improve reporting	
Clear the backlog of reconciliation of all government-controlled accounts at the RBM and commercials banks of transactions made until November 30, 2013	End-Dec. 2013	Improve spending controls.	
Begin daily reconciliation of all government-controlled accounts at the RBM and commercial banks. (Proposed)	March 1, 2014	Improve spending controls.	
Submit to Fund staff final forensic audit report. (Proposed)	End-Jan. 2014	Establish basis for improving PFM.	
Provide Ministries, Departments and Agencies with quarterly spending ceilings consistent with quarterly fiscal targets in the program, and enforce ceilings.	Quarterly	Keep spending within available resource envelope.	
Verify existing stock of government domestic arrears at end-Sep 2013.	30-Dec-13	To establish baseline for monitoring flow and stock of new arrears.	
Report on the flow and stock of arrears at the end of each quarter starting with Oct-Dec 2013, within two months of the end of the quarter.	February 2014, May 2014, August, 2014	To monitor re-emergence of new arrears.	
Monetary Policy			
Government authorities for RBM to stop automatic conversion of overdrafts into government securities. (Proposed)	End-Dec. 2013	Reduce fiscal dominance	Met
Financial sector			
RBM to publish a financial stability report on a semi-annual basis (March, September), with a lag of no more than four months.	Semi-annual; January 2014	Promote financial stability.	
Submit to parliament amendments to the Banking Act and Financial Services Act along the lines recommended by March 2013 Fund (LEG) TA mission. (Proposed)	31-Dec-13	Promote financial stability by enhancing RBM's bank resolution powers and tools.	
Adopt a prompt corrective action framework for banks. (Proposed)	31-Dec-13	Promote financial stability by strenghtening enforcement of prudential regulations.	
Complete the third party diagnostic assessments of the most vulnerable banks in line with understandings with IMF staff.	End-February 2014	Financial stability	
Complete the third party diagnostic assessments of all banks. (Proposed)	30-Jun-14	Financial stability	

Table 10. Malawi: Risk Assessment Matrix 1/

	Source of Risk	Relative Likelihood	Expected Impact if Realized
Short term	1. Significant cut in aid flows on account of governance concerns	Medium	High • Will require either drastic cuts on government spending or massive domestic borrowing. • Will put downward pressure on international reserves.
	2. Political uncertainty in the run-up to the May 2014 general elections, including loosening of fiscal policy.	Medium	High • Jeopardize the prospects for recovery and sustained growth. • May adversely affect aid flow, which is largely determined by the continued implementation of appropriate economic policies.
	3. Weakening of the Kwacha, stemming from a loosening of monetary policy.	Medium	High • Increased imported inflation through higher fuel, fertilizer, and drug prices. • Increased inflationary pressure. • Raise the cost of foreign debt service.
	4. Global oil shock triggered by geopolitical events	Low	Medium • Will affect domestic prices, because of the automatic price adjustment for petroleum prices, but fuel and transport have relatively small weights in the CPI.
Short/Medium term	5. Adverse weather conditions	Medium	High • Adverse impact on food security, requiring fiscal response to mitigate social impact. • Significant effect on growth, given the size of agriculture (30 percent of GDP).
	6. Banking sector risk, related to rising non-performing loans.	Medium	Medium • Slowdown in private sector growth as costs of borrowing increases.
Medium term	7. Protracted period of slower European growth	High	Low • Some decline in export proceeds.
	8. Terms of trade shock stemming from substantial fall in tobacco prices	Medium	High • Lower tobacco prices would adversely affect export proceeds, farmers' income and growth in general. • Worsen the current account deficit and weaken the low reserve buffer.

[1] The risks cited in this table are those considered most relevant at the time when discussions were held in Lilongwe.

Appendix I. Letter of Intent

December 26, 2013

Madam Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
USA

Dear Madam Lagarde:

On April 8, 2013, the Executive Board of the International Monetary Fund (IMF) completed the second review under the three year Extended Credit Facility (ECF) arrangement for Malawi which it approved in July 2012. The arrangement—in the amount of SDR104.1 million (150 percent of quota)—covers Malawi's fiscal years 2012/13 through 2014/15. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) report on recent economic developments, performance under the ECF program since the second review, and on policies for FY2013/14 and the medium term.

The policy reforms initiated by President Joyce Banda's administration in May 2012 are showing positive results. Foreign exchange earnings during the 2013 tobacco season were approximately double the level in 2012, and the increased availability of foreign exchange has facilitated a broad-based recovery in economic activity. Inflation has been falling, though not as quickly as previously programmed. The government remains committed to implementing sound policies aimed at further lowering inflation and interest rates in order to enhance the prospects for sustained growth and poverty reduction.

The economic outlook has been adversely affected by a recent fiscal scandal. In the course of a reconciliation exercise between the Ministry of Finance and the Reserve Bank of Malawi (RBM) in September, officials discovered several fraudulent transactions effected in the government's Integrated Financial Management Information System (IFMIS), resulting in the payment of large amounts of money to entities that had not provided any goods or services to the government. Based on a preliminary assessment, it is estimated that nearly MK9 billion (equivalent to about US$25 million) was misappropriated in the first quarter of this fiscal year (i.e., between July and September 2013) under this fraud. In response to the fraud, several of Malawi's development partners suspended disbursement of their financial assistance to the government budget, creating a substantial financing gap in the FY2013/14 budget approved by parliament in June. The use of IFMIS for government transactions was suspended between late-September and early November to allow the vendor of the software to strengthen its security features and the government to strengthen the management of the system (MEFP paragraph 26). Government transactions were processed manually during the period when the use of IFMIS was suspended. The use of the manual system stopped when the use of IFMIS was resumed. All Ministries are now processing their transactions through IFMIS.

The government is implementing an Action Plan (formulated with input from development partners, including the IMF) to address the weaknesses in the public financial management system exposed by the fraud. Areas covered by the Action Plan include: (i) investigations and prosecutions; (ii) auditing (including a forensic audit undertaken by an internationally reputable firm); (iii) accounting; (iv) administrative measures; and (v) legal and institutional reforms.

We adhered to most of the ECF program's quantitative targets for end-March and end-June 2013. In particular, all the performance criteria (PCs) for the third ECF review were met except the continuous performance criterion on new nonconcessional external debt maturing in more than one year contracted or guaranteed by the central government, the Reserve Bank of Malawi, public enterprises and other official sector entities. The government contracted a loan from the Export and Import Bank of China which, at the time it became effective in May 2013, had a grant element that was less than the 35 percent threshold for concessional loans under the program. As explained in the MEFP, the nonobservance of the performance criterion was inadvertent; it arose from the use of an out-of-date discount rate. We have taken corrective measures to strengthen the monitoring of the concessionality of new external loans in order to ensure observance of the continuous performance criterion. Specifically, we will seek input from Fund staff on the terms of new loans before recommending approval to cabinet and parliament, and we will henceforth routinely include information on the grant element as part of the submission to cabinet and parliament. On the basis of the corrective actions we have put in place, we request a waiver for the nonobservance of the performance criterion on new nonconcessional external debt.

With respect to the targets for the fourth review (end-September 2013 test date), the PC on net international reserves was exceeded by a wide margin while the PCs for net domestic borrowing by the government and the net domestic assets of the RBM were missed by significant margins (TMU Table 1a). The nonobservance of the latter two PCs reflected over borrowing by the government to finance higher-than-programmed spending in the first quarter of this fiscal year, mainly on interest payments. However, payments associated with the fraud, unplanned spending on peace keeping operations, and spending on social services in advance of receipt of dedicated grants also contributed to the over borrowing (MEFP, paragraph 13). We have reached understandings with IMF staff on remedial fiscal measures and a policy path going forward. In order to enhance the monitoring of the implementation of the revised policy path, we request an additional review under the ECF arrangement, with a test date of end-December 2013. Based on the corrective measures and policy commitments, we request waivers for the nonobservance of the end-September PCs on net domestic borrowing by government and the net domestic assets of the RBM.

We have committed to undertake the following actions before consideration of the third and fourth ECF reviews by the IMF's Executive Board: (i) reactivation of IFMIS use for all Ministries after strengthening the management and security of the system; (ii) auditing of the manual transactions during the period when IFMIS use was suspended; (iii) cabinet approval of the revised FY2013/14 budget in line with understandings reached with IMF staff; (iv) provision of interim report of the forensic audit to IMF staff; and (v) observance of mid-December 2013 quantitative targets on government net domestic borrowing, net domestic assets of RBM, and net international reserves. We have already implemented items (i), (ii), (iii) and (iv), and will implement the remaining action before end-December.

On the basis of our overall performance, the corrective actions taken, as well as the strength of policies set forth in the attached MEFP, we request that the Executive Board of the IMF complete the third and fourth reviews under the ECF arrangement and release the fourth and fifth tranches totaling SDR 13.01 million. We also request a rephasing of test dates and associated disbursements to better align the ECF review cycle with Malawi's budget calendar. Specifically, we request that the test dates be shifted from March and September to June (year-end) and December (mid-year). To accommodate this change, we request an extension of the arrangement by four months to November 22, 2015. Thus, the test dates for the fifth, sixth, seventh and eighth reviews will be end-December 2013, end-June 2014, end-December 2014, and end-June 2015, respectively. We request that the end-March 2014 PCs be converted to indicative targets.

We believe that the policies set forth in the MEFP are adequate to achieve the objectives of the program, but we will take any further measures that may become appropriate for this purpose. 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 IMF policies on such consultation. Moreover, we will provide the IMF with such information as the IMF requests in connection with the progress in implementing the policies and reaching the objectives of the program.

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

Yours sincerely

/s/ /s/

Dr. Maxwell Mkwezalamba
Minister of Finance

Mr. Charles Chuka
Governor of the Reserve Bank of Malawi

Attachments:

- Memorandum on Economic and Financial Policies;
- Technical Memorandum of Understanding.

Attachment I. Memorandum of Economic and Financial Policies

BACKGROUND

1. This memorandum supplements the Memorandum of Economic and Financial Policies attached to the Letter of Intent dated March 28, 2013. It describes recent developments and performance since the second review under Malawi's Extended Credit Facility (ECF) arrangement, and elaborates on policies and structural reforms for fiscal year 2013/14 (FY2013/14) and the medium term. In particular, it includes measures being taken to address weaknesses in the management of the government's Integrated Financial Management Information System (IFMIS) which enabled fraudulent transactions to be undertaken in the system, resulting in the theft of substantial amounts of public funds.

2. In early September 2013, in the course of a reconciliation exercise between the Ministry of Finance and the Reserve Bank of Malawi (RBM), officials noted movements of cash that exceeded the authorized level of funding. Investigations revealed that several fraudulent transactions had been effected using IFMIS, resulting in the payment of large amounts of money to entities that had not provided any goods or services to the government. The use of IFMIS for processing government financial transactions was suspended with effect from September 25, 2013 to allow the vendor of the software to strengthen its security features and for the government to address weaknesses in the management of the system that were exposed by the fraud (see paragraph 26 below). With the help of the software vendor, critical information has been recovered which is helping investigations into the fraud. Based on the recovered data, it is estimated that nearly MK9 billion was misappropriated through these fraudulent transactions between July and September 2013.

3. In response to the recent incidents of fraud, several of Malawi's development partners have suspended disbursement of their financial assistance to the government budget. Given the heavy reliance of the budget on aid flows, a delay in disbursement of significant amounts beyond a few months would severely curtail the ability of the government to deliver the level of services assumed in the budget approved by parliament in June 2013. The government is determined to tighten the control environment around IFMIS, hold accountable the perpetrators of the fraud and recover the stolen money. We are also working closely with our development partners to address these concerns.

4. The objectives of the program remain macroeconomic stability, sustained high and inclusive growth, and delivery of social-protection programs to mitigate the adverse impact of adjustment

measures on the poor. Structural reforms under the program emphasize enhancing domestic revenue mobilization, strengthening public financial management, ensuring the operational independence of the RBM, safeguarding the stability of the banking system, and improving the investment climate. We are adding new structural measures to strengthen governance in light of the recent fraud.

RECENT ECONOMIC DEVELOPMENTS

5. The policy reforms initiated in May 2012 are showing positive results. The introduction of a flexible exchange rate regime has improved the availability of foreign currency and facilitated the clearing of private sector external arrears and the re-establishment of external credit lines. In parallel, adoption of an automatic adjustment mechanism for the retail prices of petroleum products eliminated costly subsidies and greatly improved the fuel supply situation in the country. With needed production inputs now available, capacity utilization rose sharply, contributing to a broad-based expansion in economic activity. Real GDP growth is estimated to have increased from less than 2 percent in 2012 to about 5 percent in 2013, with agriculture, manufacturing, construction, and wholesale and retail trade registering the most pronounced improvement compared to performance in 2012.

6. Inflation has been on a downward trend but has not fallen as quickly as previously programmed. On a year-on-year basis, headline consumer inflation has fallen from a peak of 37.9 percent in February 2013 to 22.2 percent in October. Over the same period, food inflation has fallen from 38.2 percent to 19.4 percent while non-food inflation has gone from 42.5 percent to 23.9 percent.

7. Monetary conditions were tightened following the freeing of the exchange rate. Nonetheless, trust in the new exchange rate regime was not immediate, and the exchange rate depreciated persistently until the onset of foreign exchange inflows at the beginning of the tobacco season. The kwacha appreciated sharply during May 2013 and the RBM increased its holdings of international reserves significantly. The reserves reached USD472.9 million equivalent to 2.5 months of import cover in July 2013, the highest level recorded since December 2007.

8. In the first quarter of FY 2013/14, higher than anticipated government expenditures were financed largely by domestic borrowing, and the accompanying liquidity effects weakened the monetary policy stance. While we have since succeeded in re-establishing control over both liquidity and government borrowing, developments in the first quarter weakened our position in responding to the repercussions of the fiscal scandal. The suspension of budget support by donors opened a

large financing gap at a time when our policy credibility was under great strain. Market perception of risk has therefore increased, with this most evident in the foreign exchange market where the kwacha has weakened. In order to maintain reserves in the face of uncertainty, we have not intervened to support the currency, but have instead accepted a slower pace of disinflation.

PERFORMANCE UNDER THE PROGRAM

9. Fiscal performance in FY2012/13 was broadly in line with the program. Domestic revenue (tax and nontax revenue) exceeded the programmed level by MK15 billion while grants fell slightly short of program by about MK3 billion. Total expenditures and net lending exceeded the programmed level by about MK13 billion, reflecting higher-than-programmed foreign-financed development expenditure. Actual net domestic repayment of MK2 billion fell short of the programmed level of MK19 billion due entirely to the issuance of a promissory note in the amount of MK28.5 billion by the government to the RBM in June to cover losses arising from the 2012 devaluation of the exchange rate (as provided for in the RBM Act).

10. Nearly all the quantitative targets for the third review (end-March 2013 test date) were met (TMU Table 1a). In particular, after adjusting for shortfalls in the disbursement of aid flows, the performance criteria on net international reserves, government net domestic borrowing, and net domestic assets of the RBM were met. However, the continuous performance criterion on new nonconcessional external debt was not met. The indicative target on reserve money was met, while the indicative target on social spending was missed due to savings made on fertilizer payments under the Farm Input Subsidy Program (FISP).

11. The nonobservance of the performance criterion on external debt was on account of a loan contracted by the government, which at the time it became effective, had a grant element that was below the 35 percent threshold for concessional loans under the program. The loan was from the Export and Import Bank of China for the construction of a national stadium. Parliament approved the contracting of this loan in 2010, but problems in identifying the site of the project delayed its commencement. In the course of the delay in finalizing the loan agreement, the discount rate fell, thus reducing the grant element of the loan. The use of an outdated discount rate was the principal reason for the nonobservance of the performance criterion. Going forward, the government has taken steps to ensure compliance with the performance criterion on new nonconcessional external debt. Specifically, we will consult IMF staff on the terms of every external loan before it is presented to cabinet and parliament. As a standard practice, the Ministry of Finance will include information on the grant element of any loan proposal submitted to cabinet and parliament. On the basis of these corrective measures we request a waiver of the nonobservance of the performance criterion.

12. With respect to the quantitative indicative targets for end-June 2013 (TMU Table 1a), net international reserves exceeded the target by more than US$200 million, reflecting RBM purchases of foreign exchange in the second quarter to build up international reserves. This rapid buildup in international reserves was the main reason the target on reserve money was missed. Social spending fell short of target on account of savings on fertilizer purchases as well as low absorption on the maize seed subsidy component of the FISP. The net domestic financing target was also missed, not because of borrowing to finance government spending, but rather because of the promissory note the government issued to the RBM to cover devaluation losses in 2012.

13. With respect to the performance criteria for the fourth review (end-September 2013 test date), net international reserves exceeded the target by US$136 million while the ceilings on the net domestic assets of the RBM and net domestic borrowing by the government were exceeded by large amounts. In particular, net domestic borrowing by the government amounted to MK56 billion compared to an adjusted program target of a net repayment of MK2 billion. The main factors that accounted for government's over borrowing in the first quarter included: (i) a significantly larger interest bill; (ii) unplanned spending on peace keeping operations; (iii) spending on social services in advance of the receipt of dedicated grants; (iv) bringing forward payment of arrears to the private sector; and (v) payments associated with the fraudulent transactions undertaken through IFMIS.

14. There has been progress in the implementation of structural benchmarks (TMU Table 2a). Three benchmarks that had been delayed or were only partially met a the time of the second review have now been met: (i) verification of existing stock of government arrears and conversion into promissory notes; (ii) configuration of the IFMIS purchase order module to support commitment control; and (iii) approval of the Financial Sector Development Strategy. Furthermore, the IFMIS purchase order module has now been extended to cover all types of procurements (i.e., goods and services under the recurrent budget as well as capital expenditures under the development budget). With respect to reforms in the financial sector, the third party diagnostic assessments will now cover all banks, not just those that are vulnerable (structural benchmark for end-June 2013). We have secured funding from the World Bank for the exercise. The RBM finalized the terms of reference in October 2013, in close cooperation with staffs of the IMF and the World Bank.

15. An amendment to the RBM Act was submitted to parliament in June 2013 but has not yet been considered. The amendment lowers the limit on RBM advances to government from 25 percent to 10 percent of estimated government revenue for the year. The benchmark foresaw the placing of a limit on all forms of RBM lending to government, in order to contain the practice of automatic conversion of advances to other forms of lending (e.g., treasury bill) when the limit on advances is reached. However, we received legal advice that indicated a potential tension between

the provisions of the RBM Act and the Public Finance Management Act (which sets limits on the issuance of treasury bills). While we consider how to proceed, the government has instructed the RBM to stop the automatic conversion of advances to government securities when the limit on advances is reached. This will allow for closer monitoring of government borrowing from the RBM and facilitate more timely action to meet program targets.

POLICIES

A. Fiscal Policy, Governance and Related Structural Reforms

Fiscal Policy

16. Parliament approved the FY2013/14 budget on June 21, 2013. In line with the ECF program, the approved budget provided for net domestic repayment amounting to MK7 billion, equivalent to 0.5 percent of GDP. The approved budget reflected several government commitments from FY2012/13, including those related to the clearance of domestic arrears and the new wage settlement and deferred wage payments for civil servants agreed in February 2013. It also included provisions for funding the tripartite (i.e., presidential, parliamentary and local council) elections scheduled for May 2014. Aid inflows—grants and concessional external loans—were programmed to cover about 44 percent of total government expenditure in FY2013/14.

17. The suspension of aid disbursements created a significant financing gap in the budget, especially in the second fiscal quarter when a large share of the aid was programmed to be released to help provide timely support to FISP. Apart from the shortfall in donor assistance, there have been two other significant developments with broadly offsetting impacts on the budget. First, there has been a large upward revision in the government's projected interest bill, reflecting high interest rates and an updated (higher) estimate of the stock of interest-bearing domestic debt, including the large borrowing by the government in the first fiscal quarter as well as the promissory note issued by the government to the RBM to make up for devaluation losses from 2012. The other development has been the very strong performance of domestic revenues. In the first five months of the current fiscal year, total tax revenue exceeded the projected level for the first half of the year by about 5 percent. We expect this level of performance to continue. Buoyant economic activity and ongoing revenue administration efforts have been the main drivers of strong tax collection this calendar year (2013).

18. Based on discussions between the government, our development partners, and the IMF mission, we have reached understandings on a revised budget framework for the rest of the fiscal

year. It is premised on the government aggressively implementing the Action Plan formulated in response to the fiscal scandal (see section on "Governance and Public Financial Management Reforms" below), and implementing policy adjustments to close the updated financing gap. The framework allows a moderate amount of domestic borrowing in the second quarter, followed by net repayments in the third and fourth quarters when some donor disbursements resume.

19. The cabinet has endorsed expenditure measures that are estimated to save about MK31 billion, coming mainly from: (i) the postponement of domestically-financed development projects that have not yet started (MK16 billion); (ii) cuts in the travel budget across the whole government (MK11 billion); and (iii) savings from efficiency gains in the operation of FISP (MK4 billion). Notwithstanding the significant expenditure cuts, we will ensure that social spending—a top priority for the government—is shielded as much as possible. In the event of a shortfall in domestic revenue or further delays in donor disbursements, we will make further cuts to ensure that aggregate spending stays within available resources. We expect to be able to make additional marginal cuts in domestically financed development expenditure and in goods and services if needed.

20. In November 2013, the government announced the following stringent expenditure control measures to help achieve the savings needed to close the financing gap: (i) Limit domestic travel to only essential travel, and drastically reduce allocations for travel-related activities; (ii) suspend external travel, with the exception of critical and/or fully-funded (sponsored) travel; (iii) freeze the procurement of capital goods, including motor vehicles, office furniture and equipment; (iv) suspend hiring and creation of non-established positions; and (v) improve fleet management and limit pool vehicles of Ministries and Departments.

21. The government is determined to restore fiscal discipline and reduce the accumulation of domestic debt. We will monitor closely information on government borrowing, including overdrafts at RBM. Through a strengthened commitment control system, we will ensure that the expenditure ceilings set by MoF are complied with. We will refrain from contracting new liabilities outside the government securities market and the RBM. In this context, we stress that the issuance of promissory notes in October 2013 by the Ministry of Finance for the procurement of maize was a one-off operation necessitated by an urgent need to replenish the government's strategic grain reserves.

22. As was the case last year, the government is seeking the support of its development partners to respond to emergency food needs of segments of the population during the lean season. It is estimated that about 1.9 million people (13 percent of the population) will face food shortages this

year. Although the number of people at risk is similar to the level last year, more districts have been affected due to unusual dry spells in the northern and central regions. With the support of donors the government is in the process of replenishing the strategic grain reserve in order to be able to provide humanitarian assistance to the affected households during the lean season..

Governance and Public Financial Management Reforms

23. The government's Action Plan formulated in response to the recent fraud includes measures to address weaknesses in public financial management and governance. The Action Plan, which was developed with input from development partners, covers five broad areas: (i) investigations and prosecutions; (ii) auditing; (iii) accounting; (iv) administration measures; and (v) legal and institutional reform.

24. The government is determined to ensure that all those who embezzle public funds are prosecuted to the fullest extent of the law and that misappropriated amounts are duly recovered. A multi-agency investigation team has been set up and has already made dozens of arrests of individuals linked to the fraud. The government has also started profiling assets of public officers connected with suspicious transactions. The government will make full use of existing disciplinary and legal measures against officials who approved or facilitated fraudulent payments as well as those who neglected their duties.

25. With the support of the UK government we have initiated a two-stage forensic audit; the first phase covers April-September 2013 (i.e., the last quarter of FY2012/13 and the first quarter of FY2013/14), while the second phase will cover the period from July 1, 2009 to March 31, 2013. The audit will ascertain the facts about the misappropriations (including an estimate of the total amount), thoroughly assess the control and security weaknesses of IFMIS (including since its re-activation in November), and make recommendations to strengthen its security. It is also expected to provide important information for the ongoing criminal investigations. A preliminary report of the audit will be prepared in December and a final report on the first phase is expected by end-January 2014. Circulation of the preliminary report will be restricted in order not to jeorpadize the work of the auditors. However, the government intends to publish the final report. Work on the second phase will commence in January and is expected to be completed in the second half of 2014.

26. After closing identified security gaps and instituting measures to strengthen access control and overall management of the system, the government reactivated the use of IFMIS in early November 2013. Remedial measures implemented before IFMIS was reactivated included: (i) improving the security of the system through the installation of a stronger firewall; (ii) revocation of

all old user rights; (iii) more limited assignment of new user rights to staffs of Ministries and Departments; (iv) enhanced access control by limiting access to each user's area of responsibility only (a change from the practice of giving access at group level to numerous users); and (v) disabling of capacity of remote access users to delete transactions from the database. The government has entered into a short-term service-level agreement with the software provider for functional and technical support including overseeing all IT functions. At the same time the government has initiated the process of recruiting an ICT security officer and IFMIS manager.

27. The transactions that were conducted manually during the period when the use of IFMIS was suspended are being audited (to be completed by end-December 2013), and will be uploaded to IFMIS by end-January 2014. The government has issued notices to RBM and commercial banks to clear government checks only after verification against IFMIS generated check lists issued daily. The Ministry of Finance (Accountant General's Department), will institute daily bank reconciliation. In view of the current heavy work load of staff in the Accountant General's Department, we expect the backlog of reconciliations to be cleared by end-February 2014 so that daily reconciliations can start from March 1, 2014.

28. Additional actions to supplement the above measures include: (i) use of electronic funds transfer through IFMIS; (ii) registration of commitments in IFMIS, or where necessary, in an equivalent commitment register; (iii) controlling officers to check commitments against limits at the item level to reduce the risk of excessive virements; and (iv) sensitization of IFMIS users to refrain from sharing passwords. MoF will continue to notify Ministries, Departments and Agencies of their monthly commitment and cash funding limits, and all purchases must be accompanied by a commitment reference number and an IFMIS generated Local Purchase Order to ensure that all proposed expenditures are committed in the system.

29. Recent events highlight the need for a comprehensive and regular analysis of fiscal risks. Such risks may emanate from macroeconomic and governance-related shocks, realization of guarantees or contingent liabilities (e.g., from state-owned enterprises and local governments), and build-up of arrears. While the Public Finance Management Act requires fiscal risk reporting, capacity constraints and limited information have prevented the government from doing this exercise on a regular basis. The government intends to develop a fiscal risks statement, in line with IMF technical assistance advice. This will become an integral part of the main budget documents.

Domestic Revenue Mobilization

30. Sustained strong revenue performance is a key element in the government's strategy for reducing Malawi's fiscal imbalance. Modernization efforts at the Malawi Revenue Authority (MRA) are continuing through automation of business processes and upgrading IT infrastructure. MRA has started a nationwide pilot project to roll out electronic fiscal devices (EFDs) to strengthen VAT enforcement. The project involves the installation of machines that will electronically record sales transactions to permanent memory where they cannot be erased or manipulated by retailers. In the customs area, MRA has installed cargo scanners and introduced joint border patrols and information sharing with neighboring countries on goods under shipment.

31. MRA is implementing a new initiative to help improve taxpayer compliance. Under the Voluntary Compliance Window (VCW), it has offered a unique opportunity to taxpayers to disclose and pay down outstanding tax liabilities without the associated payment of penalties and interests for late payment. This initiative does not exempt the taxpayer from the principal amount of its tax liability. The VCW was opened on November 1, 2013 and will close on January 31, 2014. We expect the VCW to have a permanent effect by increasing the number of registered taxpayers and also generate one-off revenues in the second and third quarters of the current fiscal year.

B. Exchange Rate and Monetary Policies

32. We remain committed to a flexible exchange rate regime to allow the kwacha to adjust to domestic and international developments. The value of the kwacha will continue to be market determined, with RBM intervention limited to managing liquidity and excessive volatility arising from the highly seasonal pattern of private inflows (mainly related to tobacco sales) and lumpy disbursements of aid flows. During the last 12-15 months, the nominal exchange rate has been volatile. From October 2012 to March 2013, the kwacha depreciated by approximately 25 percent against the US dollar and then appreciated by about the same amounts over s period of about three months. Since September 2013, we have seen another sharp and unexpected depreciation which may have been caused, in part, by the fiscal overruns in the quarter up to end-September and market concerns about the emerging news on fiscal fraud.

33. The principal objective of the RBM's monetary policy is to achieve low (single-digit) inflation. Inflation remains high at around 20 percent year-on-year. Around mid-2013, money market liquidity increased substantially as a result of RBM intervention in the foreign exchange market to build up reserves and increased government borrowing. Reflecting this development, the interbank market

rate declined sharply from 37 percent in March 2013 to about 16.5 percent in August 2013. To contain the inflationary impact of this liquidity, the Monetary Policy Committee resolved to maintain the Bank rate at 25.0 percent throughout 2013 to sustain the tight monetary policy stance. This was against the backdrop of continued inflationary pressures, including the recent exchange rate depreciation and high levels of domestic borrowing by government. In Malawi, the evolution of the exchange rate is an important driver of non-food inflation. With a more adequate level of foreign exchange reserves and stronger confidence in the kwacha, lower volatility in the exchange rate may translate into more stable prices in future.

34. The RBM will continue to monitor the evolution of the monetary aggregates using its liquidity forecasting framework, and stands ready to deploy all the instruments in its tool kit—including open market operations and changes in the bank rate—to tighten monetary policy should inflation pressures persist.

35. The RBM will continue to build and maintain an adequate level of reserves to provide the economy with a buffer against exogenous shocks. Official foreign exchange reserves nearly doubled in the year to end July 2013. Due to the seasonality in foreign exchange inflows, a modest decline in reserves is expected during the lean season that ends around April 2014. As a result of the suspension of some aid flows to Malawi, foreign exchange receipts will be particularly tight until the onset of the tobacco season. Fiscal measures adopted in response to the emerging fiscal gap will moderate foreign exchange demand. Nonetheless, the RBM will limit interventions and maintain an adequate level of reserves. . The RBM aims to accumulate reserves equivalent to at least three months of imports over the medium term.

C. Financial Stability Issues

36. Prior to the devaluation and adoption of a floating exchange rate regime in May 2012, banks were highly liquid in domestic currency due to high government spending and failure to meet foreign obligations because of scarcity of foreign exchange. Banks used this liquidity to extend long term loans to various sectors of the economy and/or to undertake expansion drives in terms of points of representation. Thus, a considerable amount of capital was locked up in illiquid assets. Following the exchange rate adjustment, foreign exchange became available and as clients sought to clear their external payment obligations by withdrawing deposits, banks had difficulty unwinding the long positions and so faced a liquidity crunch.

37. Although the overall liquidity situation has improved, some banks continue to be weighed down by weak liquidity positions, posing risks to financial stability. Moreover, there are indications of deteriorating loan quality and fragile capital positions in a number of banks. Against this background, the RBM is taking steps to address vulnerabilities in the financial sector by: (i) determining the true conditions of the banking system and individual banks through third-party diagnostic assessments; (ii) strengthening the legal framework for early intervention and bank resolution; and (iii) enhancing its supervisory and regulatory framework. These steps will enable the RBM to develop an appropriate strategy for resolving weak banks.

38. The RBM is in the process of commissioning third-party diagnostic assessments of all banks, commencing with the weakest banks. At the invitation of the RBM, audit firms submitted their expressions of interest in early November and were given until November 19, 2013 to submit technical and financial proposals. Contracts were awarded in December 2013 for the diagnostic assessments of four banks. The assessments for these banks are expected to be completed by end-February 2014. The contracts for the assessment of the remaining eight banks will be awarded by end-February 2014 with the expectation that the assessments will be completed for all banks by end-June 2014. We will share the results of the diagnostics with IMF staff and in consultation with them, design appropriate interventions within the legal framework to address issues raised by the reports in order to safeguard the stability of the financial system.

39. The RBM consulted key stakeholders (financial sector, Ministry of Finance, Attorney General) as part of the process of formulating proposed amendments to the Banking Act of 2010 and Financial Services Act of 2010. The legislative reforms, which were informed by IMF technical assistance recommendations, will align the legal framework for bank resolution more closely with good practices and provide more options for dealing with problem banks, including two-tiered depositor preference that favors smaller depositors. RBM submitted the proposed amendments to the government in August 2013. The government will formally submit the proposed amendments to parliament by end-December 2013 for consideration at the next sitting of parliament scheduled for January/February 2014.

40. The RBM is preparing to adopt a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action. The Directive has already been formulated and is awaiting publication in the Government Gazette to become effective. It establishes a hierarchy of corrective actions the Registrar should take or impose on banks (while the bank is still under the control of its owners) and the circumstances under which such actions may be taken. It also describes circumstances under which the Registrar and/or his agent may exercise powers under the existing legal framework to resolve banks (while suspending the rights of the owners and

management) before a bank reaches actual insolvency. The PCA will introduce a sliding scale intervention framework where the form of intervention is proportionate to the severity of the problems encountered by a bank, leaving little supervisory flexibility or discretional judgment. Adoption of this framework will discourage the use of regulatory forbearance such as waiver of prudential norms. Waivers will be used rarely; for example, for the sake of protecting depositors' interests or the overall stability of the banking/financial system. The decision-making and approval processes for issuing waivers will be well documented and approved at the highest appropriate RBM executive management level.

41. Through the Public-Private Partnership Commission, and with support from the World Bank, the government has engaged a Transaction Specialist to advise it on options for restructuring the state-owned Malawi Savings Bank (MSB). Concurrently, the Registrar has contracted Ernst & Young to do a valuation of MSB as part of advance planning in case the Registrar decides to sell the bank himself. The valuation report will provide a starting point for evaluating potential bids for MSB.

42. The RBM is committed to strengthening the supervisory and regulatory framework of the banking system. In addition to introducing Basel II and raising capital requirements (to become effective January 1, 2014), the central bank will improve prudential norms in the areas of asset classification, provisioning and liquidity. In this regard, RBM will ensure prudent loan quality assessments, including for restructured, refinanced and renegotiated loans and implement prudentially sound loan provisioning standards. A revised directive on Asset Classification containing all these norms was finalized and submitted to Government in September, 2013. The Directive will become effective once gazetted by Government. Its provisions were informed by IMF Technical Assistance recommendations. The revised directive will: (a) improve the quantitative and qualitative criteria for loan classification; (b) incorporate clear requirements for re-classification of assets; (c) incorporate clear requirements for the classification of restructured, refinanced and renegotiated loans; and (d) extend the coverage of prudential reporting for bank provisioning.

D. Business Climate and International Competitiveness

43. The government is committed to creating a conducive environment to do business in Malawi. To this end, government has embarked on a number of regulatory reforms aimed at moving Malawi into the top 100 countries in the World Bank's annual "Doing Business Survey" by 2016. This goal has been rendered more challenging by Malawi's fall by 10 places in the recently released 2014 survey.

44. Government pushed for the review of 9 economic laws by parliament in 2013, including: Business Registration Act; Companies (Amendment) Act; Business Licensing Act; Investment and

Export Promotion Act; and Malawi Bureau of Standards Act, Companies Bill, Personal Property Security Bill, Insolvency Bill and Export Processing Zones (Amendment) Bill. The Personal Property Security Bill is particularly useful in enhancing SMEs access to finance because it will introduce a secured transactions framework so that moveable property such as machines, and vehicles, can be used as collateral in securing credit.

45. Additionally, high-level Doing Business fora have been held to enhance national dialogue on issues of reforms and a Doing Business Tracker has been employed in the Ministry of Industry and Trade to assist in fast-track progress on the outstanding issues that require administrative and regulatory reforms by key institutions in the country. Institutionally, government has designated the Malawi Investment and Trade Centre as a one stop shop for investor facilitation services while a number of parastatals in the SMEs sector have been merged to create the Small and Medium Enterprise Development Institute (SMEDI). Government has also digitized the records and processing systems at the Registrar General which is expected to reduce the processing time to no more than 48 hours once applications have been lodged with the Registrar General. The creation of an enabling environment for the private sector is supported by various development partners such as the World Bank, the European Union and DFID.

46. The strategic objective of the National Export Strategy (NES) is for the long-term export trend to match the long-term import trend. This will enable the country to reduce its trade deficit, strengthen its foreign exchange reserves, reduce its dependence on imports and aid, and ultimately, contribute to the achievement of goals as outlined in the ERP and the MGDS II. To this end, the strategy aims at developing a productive base of sufficient magnitude so that exports as a share of imports can be increased from about half in 2010 to three-quarters by 2018 and to about 90 percent by 2023. In order to achieve this, government has embarked on a number of initiatives including: export diversification, specifically non-traditional products; implementation of reforms to make it easier, cheaper and faster for businesses/investors to do business in Malawi; and improvement in the quality of infrastructure. Additionally, Government is working towards implementing the National Single Window and the One Stop Border posts as part of its efforts to improve trade facilitation. If successful, these initiatives are expected to unlock the potential of farmers, women's groups, youths, micro businesses and the larger private sector. Currently, these initiatives are being implemented through the Trade, Industry and Private Sector SWAp framework.

47. Beyond improvement in the macroeconomic environment, the government is committed to addressing infrastructure challenges that are negatively affecting the country's international competitiveness. In particular, efforts are underway to develop a long-term energy plan that will enable access to reliable and affordable power.

INFORMATION SHARING AND PROGRAM MONITORING

48. In order to enhance economic management, we will strengthen processes and practices to achieve timely information-sharing in the following areas: (i) reconciliation of fiscal and monetary accounts involving the Malawi Revenue Authority, MOF and RBM, to reduce statistical discrepancies between above-the-line fiscal data and below-the-line financing data from the RBM; (ii) provision of information on government operations by MOF to feed into the RBM's liquidity forecasting framework that guides monetary operations; (iii) provision of data on projected aid inflows by MOF to inform the RBM's foreign exchange cash flow projections; and (iv) provision of a complete information on the outstanding stock of domestic debt which would include promissory notes issued for arrears' clearance and all other newly issued promissory notes.

49. Program implementation will continue to be monitored with quantitative financial targets and structural benchmarks (TMU Tables 1a, 1b, 2a and 2b). PCs have been established for December 2013 and June 2014 (TMU Table 1b), in line with our request for a rephasing of test dates and associated disbursement in order to align the review cycle more closely with Malawi's budget cycle. The fifth review is expected to be completed by mid-March 2014 based on the end-December 2013 test date and the sixth review is expected to be completed by mid-September 2014 based on the end-June 2014 test date.

50. New prior actions and structural benchmarks are proposed (TMU Table 2b), covering reforms in the financial sector and in public financial management, including monitoring progress in implementation of remedial measures to address governance issues arising from the recent fraud. Budget execution will be monitored through IFMIS-generated monthly reports that track funding authorizations and actual payments by vote.

Attachment II. Technical Memorandum of Understanding

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, and the related reporting requirements.

Coverage

2. 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 RBM. Monetary aggregates under the program are based on the twelve-bank monetary survey.

Quantitative Performance Criteria: Definitions and Data Sources

Floor on Net International Reserves of the RBM

3. Definition of net international reserves (NIR) of the RBM: The NIR of the RBM is defined as gross reserve assets minus gross reserve liabilities (IMF, other short-term liabilities, including all foreign currency liabilities to residents (for instance, deposits of domestic banks with the RBM). 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. The program exchange rate of the Malawi Kwacha to the U.S. dollar is set at MK320 = US$1. The corresponding cross exchange rates and program gold price for the duration of the program are in Table 3.

4. Gross reserve assets of the RBM are defined in the International Reserves and Foreign Currency Liquidity Guidelines for a Data Template as external assets immediately available and controlled by RBM "for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency's exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing)." (*BPM6,* paragraph 6.64).

5. This concept includes the following: (1) monetary gold holdings of the RBM; (2) holdings of SDRs; (3) the reserve position in the IMF; (4) foreign convertible currency holdings; (5) deposits held in foreign central banks, the Bank for International Settlements, and other banks; (6) loans to foreign banks redeemable upon demand; (7) foreign securities; and (8) 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) assets obtained through currency swaps of less than three months duration; (6) 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, or pledged to investors as a condition for investing in domestic securities; (ii) assets lent by RBM to third parties that are not available before maturity, and are not marketable; and (iii) foreign reserves blocked for letters of credit.

6. 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; (3) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year; and (4) all foreign currency liabilities to residents (including, for instance, deposits of domestic banks with the RBM).

7. Definition of budget support: Budget support includes all grants and foreign financing 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 accounts for the health SWAp, education SWAp, agricultural SWAps, and National AIDS Commission (NAC) held in the Malawi banking system.

8. 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$10 million above the program baseline (See Table 1). The floor on NIR of the RBM will be adjusted downward by the full amount up to a maximum of US$ 5 million by which the cumulative receipts from the budget support are less than the program baseline. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

9. Adjustment clause on NIR—donor accounts for the social sector (including health, education, and other SWAps, and National AIDS Commission (NAC): The floor on the NIR of the RBM will be adjusted downward by the amount by which the donor inflows (in kwacha) from the

U.S. dollar–denominated donor accounts for SWAps and NAC held in the RBM are smaller than the donor inflow (in kwacha) to those accounts in the program baseline. The downward adjustment will be capped at US$ 5 million. Donor inflows are measured as the receipts (in kwacha) by the budget from the beginning of the fiscal year.

10. 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 African Development Bank (ADB) fall short of (exceed) the program baseline. The cumulative amount will be measured from the beginning of the fiscal year.

11. The total downward adjustment to NIR from a shortfall of (i) budget support and (ii) donor inflows to the donor accounts for the social sector relative to the program assumptions, and (iii) an excess of debt service payments to the World Bank and the African Development Bank (ADB) relative to the program assumptions will be capped at US$10 million. 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$10 million above the program baseline and by the full cumulative amount by which debt service payments to the World Bank and the African Development Bank (ADB) fall short of the program baseline.

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

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

Ceiling on the Net Domestic Assets of the Reserve Bank of Malawi and Reserve Money

14. 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.

15. 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.

16. 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 receipts from the budget support are greater than US$10 million above the program baseline. The ceiling on NDA of the RBM will be adjusted upward by the amount by which the cumulative flow of receipts from budget support are less than the program baseline, up to a maximum of US$5 million. 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.

17. Adjustment clause on NDA—donor pool accounts for the social sector (including health, education, and other SWAps, and NAC): The ceiling on NDA of the RBM will be adjusted upward by the amount by which the donor inflows to the budget (in kwacha) from the U.S. dollar–denominated donor accounts for the SWAps and NAC held in the RBM fall short of the donor inflow (in kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$5 million. Donor inflows are measured from the beginning of the fiscal year.

18. 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 ADB falls short of (exceeds) the program baseline (Tables 1a and 1b). The cumulative amount will be measured from the beginning of the fiscal year.

19. The total upward adjustment to NDA from a shortfall of (i) budget support (ii) donor inflows to the donor accounts for the social sector relative to the program assumptions and (iii) an excess of debt service payments to the World Bank and the African Development Bank (ADB) relative to the program assumptions will be capped at US$15 million. The downward adjustment to NDA will reflect the full amount by which the cumulative receipts from the budget support are greater than US$10 million above the program baseline and by the full cumulative amount by which debt service payments to the World Bank and the African Development Bank (ADB) fall short of the program baseline.

20. 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 on domestic deposits, 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 fraction of reserve assets) 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 before the change in regulation).

Ceiling on Central Government Net Domestic Borrowing (CGDB)

21. Definition of CGDB: CGDB is computed as the sum of (1) 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); (2) net borrowing from commercial banks (including advances, holdings of local registered stocks, and holdings of treasury bills minus deposits); (3) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (4) holdings of promissory notes. The treasury bills and locally registered stocks are valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB cumulative from the beginning of the fiscal year, including promissory notes and securities transferred to the RBM from the treasury since the beginning of the fiscal year. Transfers from extra-budgetary funds will not be considered revenues for this performance criterion. They will be treated the same as borrowing from the private sector (as their accounts are outside the definition of government) and therefore as domestic borrowing. Asset sales or privatization revenues will be accounted for under financing as a separate category, separate from domestic or foreign financing in calculating CGDB.

22. 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.

23. 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$5 million. In the event of excess budget support, the ceiling on CGDB will be adjusted by the full amount less US$10 million. 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.

24. Adjustment clause on CGDB—donor accounts for the social sector (including health, education, and other SWAps, and NAC): The ceiling on CGDB will be adjusted upward by the full amount by which the donor inflows to the budget (in kwacha) from the U.S. dollar–denominated donor accounts for health, education, and other SWAps, and NAC held in RBM are smaller than the donor inflows (in kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$5 million. Donor inflows are measured from the beginning of the fiscal year.

25. Adjustment clause on CGDB—debt service payments: The ceiling (floor) 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. The cumulative amount will be measured from the beginning of the fiscal year.

26. The total upward adjustment to CGDB from a shortfall of (i) budget support (ii) donor inflows to the donor accounts for the social sector relative to the program assumptions and (iii) an excess of debt service payments to the World Bank and the African Development Bank (ADB) relative to the program assumptions will be capped at US$10 million. The downward adjustment to CGDB will reflect the full amount by which the cumulative receipts from the budget support are greater than US$10 million above the program baseline and by the full cumulative amount by which debt service payments to the World Bank and the African Development Bank (ADB) fall short of the program baseline.

Ceiling on External Payment Arrears

27. Definition of external payment arrears: External payment arrears consist of debt-service obligations (principal and interest) of the central 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.

Ceiling on Nonconcessional External Debt

28. 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-, 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 grant element is calculated using a discount rate of 5 percent. The ceiling on nonconcessional debt applies to the contracting and guaranteeing of debt with nonresidents by the central government, the RBM, public enterprises, and other official sector entities, unless an explicit selective exclusion is made. 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.

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

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

31. 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 overtime obligations arising from judicial awards to external creditors. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

Quantitative Indicative Targets and Structural Benchmarks

32. 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 deposits held with the RBM.

33. Definition of social spending**:** Using functional classification of expenditure, social spending is computed as the sum of central government spending on health, education, the farm input subsidy program, and government social protection (comprising the government expenditures by the ministry of gender, children and social welfare, the ministry of disability and elderly affairs, and the local development fund) . In order to maintain Malawi's commitment and progress toward 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 (Table 4).

34. Structural benchmarks are contained in Tables 2a and 2b.

Table 1a. Malawi: Quantitative Targets (2012–13)[1]

	Target type [2]	End-Dec. 2012 (PC)	End-March 2013 (PC)				End-June 2013 (IT)				End-September 2013 (PC)			
		Act.	Prog.	Adj. Prog.	Actual	Status	Prog.	Adj. Prog.	Actual	Status	Prog.	Adj. Prog.	Prel.	Status
I. Monetary targets (millions of kwacha)														
1. Ceiling on net domestic assets of the RBM [3,4, 5, 6]	PC	118,408	125,803	129,003	120,412	M	108,487	110,839	72,920	M	87,854	59,365	81,224	NM
2. Ceiling on reserve money [3]	IT	99,351	98,488	98,488	89,678	M	106,902	106,902	126,570	NM	110,017	110,017	134,756	NM
II. Fiscal targets (millions of kwacha)														
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-18,201	-3,396	-196	-232	M	-18,605	-16,253	-2,492	NM	-5,218	-2,018	58,685	NM
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	87,295	144,922	144,922	144,172	NM	185,511	185,511	181,764	NM	200,841	15,330	48,952	M
III. External sector targets (US$ millions, unless otherwise indicated)														
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	34	-27	-37	6	M	53	46	270	M	127	117	254	M
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0	0		0	0	0		0	0	0	
8. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	0	0	0	77	NM	0	0	142	NM	0	0	0	M
9. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	0		0	0	0		0	0	0	
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC					M				M				M
Memorandum items:														
Net foreign assets of the RBM (US$ millions)		-60	-85		-103		-5		151		69		167	
Budget support (US$ millions)		180	186		186		245		244		50		9	
Budget support (millions of kwacha)		57,531	59,498		59,478		78,355		78,219		15,978		2,846	
Debt service payments to the World Bank and AfDB (US$ millions)		3	4		4		6		6		1		1	
Debt service payments to the World Bank and AfDB (millions of kwacha)		835	1,218		1,218		1,920		1,936		465		465	
Health SWAp receipts (millions of kwacha)		8,612	11,290		11,290		11,290		15,040		3,194		4,815	
Education SWAp receipts (millions of kwacha)		6,434	16,765		16,765		23,245		1,764		4,800		3,548	
NAC receipts (millions of kwacha)		1,538	7,993		7,993		12,281		441		4,288		999	
Program exchange rate (kwacha per US$)		320	320		320		320		320		320		320	

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. All stocks of NDA adjusted for consistency with the program definition (specified in the TMU).

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 social sector expenditures consistent with the TMU.

7 Defined as a cumulative flow.

8 Priority social spending as defined in the TMU and quantified in the authorities' budget. End-September 2013 "Prog." target was calculated comulatively from July 1, 2012 (second review). The figure under "Adj. Prog." is calculated from July 1, 2013.

9 Evaluated on a continuous basis.

10 Other standard PCs include introducing or modfying MCPs, concluding bilateral payments agreements that are inconsistent with Article VIII, and imposing or intensifying import restrictions for balance of payment reasons.

Table 1b. Malawi: Quantitative Targets (2013–14)[1]

	Target type [2]	End-Jun. 2013 (IT)	End-Sept. 2013 (PC)	End-Dec. 2013		End-Mar. 2014		End-June 2014 (PC)	End-Sep. 2014 (IT)
		Prel.	2nd Review Prog.	2nd Review (IT)	Revised (PC)	2nd Review (PC)	Revised (IT)		
I. Monetary targets (millions of kwacha)									
1. Ceiling on net domestic assets of the RBM [3,4, 5, 6]	PC	72,920	87,854	94,741	107,710	95,110	113,035	94,817	97,701
2. Ceiling on reserve money[3]	IT	126,570	110,017	118,977	135,223	116,146	134,392	145,225	151,232
II. Fiscal targets (millions of kwacha)									
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	-2,492	-5,218	25,205	72,042	21,277	52,018	6,622	-20,023
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	181,764	15,330	65,540	106,617	65,540	170,424	214,832	…
III. External sector targets (US$ millions, unless otherwise indicated)									
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	270	127	134	188	124	169	260	269
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0	0	0	0	0	0	0	0
8. Ceiling on new nonconcessional external debt maturing in more than one year [7,9]	PC	142	0	0	0	0	0	0	0
9. Ceiling on new nonconcessional external debt maturing in one year or less [7,9]	PC	0	0	0	0	0	0	0	0
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9,10]	PC								
Memorandum items:									
Net foreign assets of the RBM (US$ millions)		151	69	76	86	66	67	158	167
Budget support (US$ millions)		244	50	100	27	150	111	167	209
Budget support (millions of kwacha)		78,219	15,978	31,945	8,645	47,903	35,445	53,509	66,878
Debt service payments to the World Bank andAfDB (US$ millions)		6	1	4	5	4	6	7	2
Debt service payments to the World Bank and AfDB (millions of kwacha)		1,936	465	1,310	1,475		1,777	2,306	529
Health SWAp receipts (millions of kwacha)		15,040	3,194	6,531	6,971	9,721	7,234	8,834	2,433
Education SWAp receipts (millions of kwacha)		1,764	4,800	9,600	9,191	14,400	13,600	15,567	2,829
NAC receipts (millions of kwacha)		441	4,288	8,576	3,070	12,864	3,070	4,030	971
Program exchange rate (kwacha per US$)		320	320	320	320	320	320	320	320

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. All stocks of NDA adjusted for consistency with the program definition (specified in the TMU).

[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 social sector expenditures consistent with the TMU.

[7] Defined as a cumulative flow.

[8] Priority social spending as defined and quantified in the TMU.

[9] Evaluated on a continuous basis.

[10] Other standard PCs include introducing or modifying MCPs, concluding bilateral payments agreements that are inconsistent with Article VIII, and imposing or intensifying import restrictions for balance of payment reasons.

Table 2a. Malawi: Prior Actions and Structural Benchmarks, July 2012–Nov 2013

Measure	Target Date	Macro Rationale	Status
Prior Action			
Approval of the arrangement			
Parliamentary passage of a budget for FY 2012/13 in line with program objectives.		Toward fiscal sustainability.	Met.
First review			
Shut down RBM's uncollateralized lending to banks.		Maintain a tight monetary policy stance to contain inflation.	Met.
Second Review			
Sign and begin implementation of memorandum of understanding between the Reserve Bank of Malawi and the Ministry of Finance (MoF) indicating that the MoF is responsible for meeting the interest costs of treasury bills used for monetary operations.		Enhance effectiveness of RBM monetary operations.	Met.
Structural benchmarks			
Fiscal transparency			
Publish monthly revenue collections of the Malawi Revenue Authority in newspapers within two weeks of the end of the month.	31-Jul-12	Build credibility after recent incidents of inflation of revenue data by the Ministry of Finance.	Met.
Public financial management			
Provide Ministries, Departments and Agencies with quarterly spending ceilings consistent with quarterly fiscal targets in the program, and enforce ceilings.	Begin in September 2012 for FY2012/13 Q2 and quarterly thereafter	Keep spending within available resource envelope.	Met.
Verify existing stock of government domestic arrears and convert the verified claims into promissory notes redeemable over several years, beginning in FY2013/14.	31-Dec-12	Ascertain magnitude of government obligations and begin payment.	Met (with delay).
Configure the IFMIS Purchase Order (PO) module to support commitment control.	31-Dec-12	To restrain creation of arrears.	Met (with delay).
Expand the IFMIS Purchase Order (PO) module to cover all procurements and roll it out to all Ministries and Departments	30-Jun-13	To further restrain creation of arrears.	Met.
Progressively extend processes for capturing donor funded project transactions in IFMIS to all projects where bank accounts are controlled by the government of Malawi.	31-Mar-13	Fuller accounting for impact of aid flows on the budget.	Met.
Monetary Policy			
Submit to parliament an amendment of the RBM Act to limit the outstanding amount of RBM's total lending to government.	30-Jun-13	Reduce fiscal dominance to enhance effectiveness of monetary policy.	Not met.
Financial sector			
RBM to publish a financial stability report on a semi-annual basis, with a lag of no more than four months. Start with publication of report for quarter ending March 2012.	Semi-annual, starting in July 2012.	Promote financial stability.	Met; reports published in July 2012, January 2013 and June 2013.
Obtain approval and begin implementation of the Financial Sector Development Strategy.	31-Dec-12	Financial deepening.	Met (with delay).
Require vulnerable banks to undergo third-party diagnostic assessments by reputable audit firms.	30-Jun-13	Establish true financial conditions of affected banks and ensure effective monitoring.	Not met; postponed to end-February 2014.

Table 2b. Malawi: Prior Actions and Structural Benchmarks, Dec 2013–Sept 2014

Measure	Target Date	Macro Rationale	Status
Prior Action			
Third and Fourth Review			
Reactivate IFMIS in all Ministries after strengthening security and access control.	End-Dec. 2013	Enable better spending control.	Met
Audit the manual transactions completed while IFMIS was suspended	End-Dec. 2013	Enable better spending control.	Met
Submit to Fund staff preliminary forensic audit report	End-Dec. 2013	Build trust; resolve fraud case.	
Seek cabinet approval for revised spending plans in line with understandings reached with Fund staff	End-Dec. 2013	Strengthen commitment to revised budget.	Met
Observe three quantitative targets (government net domestic borrowing, NDA and NIR of the RBM) set at same level as the respective targets for end-December 2013.	13-Dec-13	Indicate prospect that end-year PCs will be met.	
Structural benchmarks			
Public financial management			
Upload into IFMIS the audited manual transactions undertaken when IFMIS was suspended (Proposed)	End-January 2014	Enable better spending control an improve reporting	
Clear the backlog of reconciliation of all government-controlled accounts at the RBM and commercials banks of transactions made until November 30, 2013	End-Dec. 2013	Improve spending controls.	
Begin daily reconciliation of all government-controlled accounts at the RBM and commercial banks. (Proposed)	March 1, 2014	Improve spending controls.	
Submit to Fund staff final forensic audit report. (Proposed)	End-Jan. 2014	Establish basis for improving PFM.	
Provide Ministries, Departments and Agencies with quarterly spending ceilings consistent with quarterly fiscal targets in the program, and enforce ceilings.	Quarterly	Keep spending within available resource envelope.	
Verify existing stock of government domestic arrears at end-Sep 2013.	30-Dec-13	To establish baseline for monitoring flow and stock of new arrears.	
Report on the flow and stock of arrears at the end of each quarter starting with Oct-Dec 2013, within two months of the end of the quarter.	February 2014, May 2014, August, 2014	To monitor re-emergence of new arrears.	
Monetary Policy			
Government authorities for RBM to stop automatic conversion of overdrafts into government securities. (Proposed)	End-Dec. 2013	Reduce fiscal dominance	Met
Financial sector			
RBM to publish a financial stability report on a semi-annual basis (March, September), with a lag of no more than four months.	Semi-annual; January 2014	Promote financial stability.	
Submit to parliament amendments to the Banking Act and Financial Services Act along the lines recommended by March 2013 Fund (LEG) TA mission. (Proposed)	31-Dec-13	Promote financial stability by enhancing RBM's bank resolution powers and tools.	
Adopt a prompt corrective action framework for banks. (Proposed)	31-Dec-13	Promote financial stability by strenghtening enforcement of prudential regulations.	
Complete the third party diagnostic assessments of the most vulnerable banks in line with understandings with IMF staff.	End-February 2014	Financial stability	
Complete the third party diagnostic assessments of all banks. (Proposed)	30-Jun-14	Financial stability	

Table 3. Malawi: Cross Rates for Nominal Exchanges Rates and Gold Price for the 2012–13 Program

	September 30, 2012
Gold bullion LBM[1] US$/troy ounce	1,774.810
SDR to US$ exchange rate	0.648
Euro to US$ exchange rate	0.773
Yen to US$ exchange rate	77.570
Yuan to US$ exchange rate	6.341
Rand to US$ exchange rate	8.305
UK £ to US$ exchange rate	0.618

Source: IFTS, RBM

[1] LBM connotes London Bullion Market.

Table 4. Malawi: Social Spending: FY2013/14

Category	Q1 Act.	Q2 Proj.	Q3 Proj.	Q4 Proj.	FY2013/14 Proj.
Health Expenditure					
Wages	8,412	7,320	7,320	7,320	30,372
Other Recurrent					
Ministry of Health ORT	3,855	2,457	2,457	2,457	11,225
Local Assemblies ORT	1,853	2,267	2,267	2,267	8,654
Subvented Organisations	20	18	18	18	75
Development Part 2	1,961	584	584	584	3,713
Total Health	**16,101**	**12,646**	**12,646**	**12,646**	**54,039**
Education Expenditure					
Wages	14,089	12,905	12,905	12,905	52,805
Other Recurrent					
Ministry of Education ORT	3,472	3,549	3,549	3,549	14,119
Local Assemblies ORT	1,658	1,850	1,850	1,850	7,209
Subvented Organisations	8,228	5,831	5,831	5,831	25,720
Development Part 2	936	1,236	1,236	1,236	4,643
Total Education	**28,383**	**25,371**	**25,371**	**25,371**	**104,496**
Farm Input Subsidy Program	**1,061**	**18,629**	**24,735**	**6,000**	**50,425**
Gender, Children and Social Welfare					
Wages	212	189	189	189	778
Other Recurrent	60	45	45	45	195
Development Part 2	180	76	76	76	407
Total Gender, Children and Social Welfare	**452**	**309**	**309**	**309**	**1,380**
Disability and Elderly Affairs					
Wages	22	17	17	17	74
Other Recurrent	66	34	34	34	169
Development Part 2	11	11	11	11	45
Total Disability and Elderly Affairs	**99**	**63**	**63**	**63**	**289**
Local Development Fund	**2,840**	**628**	**665**	**-**	**4,132**
Poverty and Disaster Management Cost Centre under the Office of the President and Cabinet	**16**	**19**	**19**	**19**	**72**
Total Social Expenditure	**48,952**	**57,665**	**63,808**	**44,408**	**214,832**

Table 5. Reporting Requirements

Data Description	Data Freq.	Reporting Agency	Reporting Freq.	Delivery Lag	Delivery Date	Delivery 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; RBM balance sheet	W	RBM	M	30	30	E
Daily exchange rate	D	RBM	W	1	F	E
Treasury bill auction results	W	RBM	W	2	F	E
Spread between bureau midrate and the official exchange midrate	W	RBM	M	30	30	E
Spread between commercial bank midrate and the official exchange midrate	W	RBM	M	30	30	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
NIR and its components	W	RBM	W	7	F	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks and treasury bills	M	RBM	M	30	30	E
Detailed issue and maturity profile for treasury 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
Full banking survey (on monthly basis)	M	RBM	M	45	15	E
Financial soundness indicators by banks	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	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
D\ata on 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
External debt services (actual and projections)	Q	MOF	Q	30	T30	E
Borrowing of all major parastatals[2]	Q	MOF	Q	45	T15	E
Annual Financial reports of the eight (8) 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.

INTERNATIONAL MONETARY FUND

MALAWI

January 13, 2014

THIRD AND FOURTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, REPHASING OF DISBURSEMENTS, AND MODIFICATION OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

Approved By **David Owen (AFR) and Mark Flanagan (SPR)**

1. This supplement focuses on recent developments regarding the government's response to the recent fiscal scandal, and on the implementation of two remaining prior actions. In the latter context, at the time the staff report was issued, the interim report on the forensic audit had just been received and had not yet been assessed by staff nor discussed with the authorities; and there was a lack of sufficient information to assess performance in relation to the three quantitative targets set for mid-December 2013.

2. Concerning recent developments, at a meeting of the inter-Ministerial Committee overseeing the implementation of the government's Action Plan held on January 9, 2014, the authorities reported on several actions including:

- An IFMIS General Manager is now in place, and an IFMIS Advisor is due to assume office before the end of January 2014.
- Government has extended the contract of the IFMIS software vendor (Softech) to supply IFMIS security services through June 2014.
- The Asset Declaration Law has come into effect.
- Draft amendment to the Money Laundering Act has been completed with assistance from the World Bank. The authorities have requested a desk review by IMF staff before finalization and submission to parliament.
- The Director of Public Prosecutions has finalized investigation of eight court cases involving multiple defendants, with trials due to start in the week of January 13–17, 2014.

3. Staff are in frequent contact with all the major donors. The multilateral donors have indicated to staff that their plans for resuming budget support this fiscal year remain on track. Implementation of the Extraordinary Performance Assessment Framework is advancing at a satisfactory pace, with several actions already completed. Most of the remaining main actions are expected to be completed by end-February.

FORENSIC AUDIT AND INTERIM REPORT

4. The forensic audit commissioned by the government—covering budget transactions between April and September 2013—is scheduled to be submitted to the government by end-January 2014 (although it could slip into early February).[1] At the request of Fund staff, the authorities asked the auditors to prepare an interim report by end-December 2013. Staff requested that the interim report cover: (i) audit status (coverage to date, outstanding areas, and estimate of completion date); (ii) substantive audit findings in aggregate form, including quantification of confirmed fraud or misappropriated amounts; and (iii) substantive system findings, such as identified failures in control systems and robustness of the reactivated IFMIS. Specific terms of reference for the audit and the status of work (through December 20, 2013) reflected in the interim report are presented in Table 1.

5. The interim report highlights progress with several strands of the audit work, although in some areas it has not progressed as far as hoped:

- An estimate of misappropriated funds is not yet available. The report notes that some of the checks associated with deleted transactions in the first fiscal quarter of FY2013/14 (July-September 2013) recovered by Softech have not been cashed. However, the auditors are also examining non-deleted transactions during this period, some of which may involve fraudulent payments. The auditors want to complete their investigations before providing a full estimate of the misappropriated amounts.

- With respect to testing of the robustness of the reactivated IFMIS, the auditors have undertaken an initial assessment based on high level analysis and have extracted data for further interrogation and profiling. Thus far, they have not identified any serious issues but will cover this more fully in the final report.

[1] Some of the work in support of court cases may take a bit longer to complete.

- Staff sought the authorities' response to several specific findings on governance and control weaknesses, including shortcomings in the operations of the Accountant-General's Department, the National Audit Office and the RBM (Table 2). The authorities' responses indicate that nearly all the identified weaknesses are being addressed. However, it will be necessary to monitor the results of the various measures over a long period before a robust assessment can be made of their effectiveness.

- The interim report also noted a lack of budgetary control and management as evidenced by spending by several ministries that significantly exceeded the funding limits approved by the Ministry of Finance. Weaknesses in budget control are being addressed in the government's Action Plan as well as in the ECF-supported program. The government has recently authorized the RBM to enforce funding limits of ministries. The authorities have also adopted templates in IFMIS (prepared with assistance of Fund staff) for closer monitoring of monthly budget execution by each ministry and the enforcement of expenditure ceilings. The government has also committed to begin publication of monthly expenditure reports for each ministry containing data on budget allocations, approved funding limits, and payments.

MID-DECEMBER 2013 QUANTITATIVE TARGETS

6. Quantitative targets were set for December 13, 2013 (at the same level as end-December targets) to provide an indication of the prospects for meeting the end-December 2013 targets. The focus was on three key indicators: (i) government net domestic borrowing; (ii) net domestic assets (NDA) of the RBM; and (iii) net international reserves (NIR) of the RBM (Text Table). The net domestic borrowing and NIR targets were met with ample margins. The NDA target was missed by a small margin (about MK4 billion).

Malawi: Quantitative Targets, December 2013

	Dec 13, 2013 outcome	Dec 31, 2013 Target
Net international reserves (US dollars millions)[1]	217.5	188.0
Government net domestic credit (kwacha billions)[2]	54.1	72.0
Net domestic assets of RBM (kwacha billions)[1]	112.1	107.7

Source: Malawi authorities.
[1]Defined as stocks.
[2]Defined as a cumulative flow from beginning of fiscal year (July 1).

However, the RBM undertook monetary operations that withdrew about MK10 billion worth of liquidity from the banking system in the second half of December. A full assessment will be made when more comprehensive data (including on adjustors) become available at the end of January 2014, but end-December actions together with preliminary indications of subdued government borrowing suggests that the end-December NDA target may have been met, and the macroeconomic program remains on track.

STAFF APPRAISAL

7. Staff welcomes the continued progress in implementing remedial actions to address the recent fraud, and the actions taken by the authorities toward meeting the end-December 2013 quantitative targets. Staff also welcomes the interim forensic audit report. While it did not contain all the information sought by Fund staff, it had enough information to assure staff that the remedial measures being implemented by the authorities to strengthen system controls and financial management are in the right areas. Some risks remain. It will be important to cautiously implement the fiscal spending program, to preserve buffers lest the final audit reveal slightly larger fund misappropriation. It will also be important for the authorities to complete the forensic audit and adopt all of the key recommendations in a timely manner.

Table 1. Malawi: Terms of Reference for Forensic Audit

Terms of reference	Status of work (Interim report)
Follow the money in various bank accounts through which funds may have flowed.	Initial preparatory step taken. Achieved full understanding of government bank account structure and how the accounts link to ministries. Extracted data from selected accounts at RBM, including balances, check scans, check signatories and other supporting documents.
Identify all entities that may have received such funds.	Initial preparatory step taken. A database combining all electronic bank information collected has been created to identify inter-account transfers and map fund flows.
Identify, if false, forged or fraudulent supporting documents and accounting entries in the books and records of ministries.	Ongoing.
Identify, quantify and evidence alleged misappropriated funds.	Preliminary work completed. Conducted a preliminary review of deleted transactions recovered by Softech, including matching the transactions against payments made from government bank accounts. Selected and initiated assessment of additional sample of transactions beyond the deleted transactions.
Provide factual information that can be utilized in support of any possible litigation process to reclaim funds that were inappropriately paid during this period, as well as for any civil or criminal prosecution of entities involved.	Ongoing. Started work with relevant law enforcement agencies.
Identify failures and weaknesses in internal controls, including failures within the procurement system that led to these breaches, and provide recommendations to strengthen controls and mitigate future risks.	Ongoing. Identified several control weaknesses (see Table 2), including absence of monthly bank reconciliations and several instances of ministries overdrawing their funding limits. Collected relevant information related to public procurement.
Carry out security audit of IFMIS to identify security gaps in the environment, and provide recommendations to improve the IFMIS Security Policy.	Undertook initial security assessment of IFMIS. This was based on high level analysis. Data was extracted for further interrogation and profiling. So far, no issues were identified.
Provide suggested actions to strengthen any other procedures as may be agreed.	Ongoing.

Table 2. Main Findings of the Interim Forensic Audit and the Authorities' Response	
Accountant General's Department (AGD)	
1. Lack of basic understanding of IFMIS by senior management team of the Accountant General's Department.	A series of core training modules have been given to staff; and counterpart officers will be attached to foreign consultants (IFMIS security officer, IFMIS adviser) to enable skills transfer.
2. No monthly bank reconciliations have been completed for about two years.	Backlog of monthly reconciliations has been cleared through November 2013. Under the ECF-supported program, authorities are committed to clear all the backlog by end-February 2014 and begin daily reconciliations from the beginning of March 2014.
3. Preparation of checks in publicly accessible areas rather than in secured offices.	Check writing has been centralized in the AGD in a secure location.
4. Inadequate review and authorization of checks by Accountant-General.	Three Deputy Directors have been recruited, to scrutinize all checks and review submissions from MDAs. Necessary IT equipment has been provided.
5. Inadequate record keeping and filing of documents.	The IFMIS Advisor will be tasked with improving record keeping, provide training on record keeping. A plan will be developed to digitalize documents.
6. Location of IFMIS server in unsuitable environment, with inadequate cooling and electricity back-up facilities.	Back-up generators are being repaired, UPS systems will be purchased along with sufficient air conditioners. Access to servers will be limited.
7. Discrepancies between expenditures reported by ministries and AGD records	The government has committed to begin publication of monthly expenditure reports for each ministry containing data on budget allocations, approved funding limits, and payments. Greater transparency will promote consistency and accuracy.
8. Lack of budgetary control and management and excess spending by ministries beyond funding levels	The RBM has been authorized to enforce funding limits for each ministry. The government has adopted templates in IFMIS for closer monitoring of monthly budget execution by each ministry and enforcement of ceilings.
Reserve Bank of Malawi	
9. Inadequate secondary checks to verify the legitimacy of transactions before payment is made	All banks cashing government checks have to ensure the check appears on the IFMIS-generated check list, which will be reconciled against MDA's payment orders. New rules mandate that any checks over K500,000 need to be deposited, not cashed.
10. Multiple payments with the same check numbers and amounts.	Alerts are being designed so that the system will pick up on duplicate check numbers. Manual check writing has been discontinued. Daily bank reconciliations will be carried out.

Table 2. Main Findings of the Interim Forensic Audit and the Authorities' Response (Concluded)

Auditor-General (National Audit Office)	
11. Auditor-General does not complete annual financial audits of ministries.	Previously, the Auditor General only audited the consolidated government financial statements. Auditing of individual ministries has now begun, and an audit opinion of each ministry will be issued.
12. Auditor General lacks unrestricted access to IFMIS	Unrestricted access will be given
Financial Intelligence Unit	
13. No direct access to financial information.	The Anti-Money Laundering Act, currently under review, contains provisions for the FIU to have direct access to financial information.
Other	
14. Absence of policies on conflict of interest and related party transactions	The new draft Public Procurement Act contains provisions that introduce stiffer penalties on non-compliance with conflict of interest stipulations.

This page intentionally left blank

MALAWI

December 27, 2013

THIRD AND FOURTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUESTS FOR WAIVER OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, REPHASING OF DISBURSEMENTS, AND MODIFICATION OF PERFORMANCE CRITERIA — INFORMATIONAL ANNEX

Prepared By

The African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of November 30, 2013)

Membership Status

Joined: July 19, 1965; Article VIII

General Resources Account:

	SDR Million	%Quota
Quota	69.40	100.00
Fund holdings of currency (exchange rate)	66.96	96.69
Reserve tranche position	2.44	3.52

SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	66.37	100.00
Holdings	2.38	3.58

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	34.70	50.00
ECF Arrangements	90.68	130.66

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	07/22/2015	104.10	39.05
ECF[1/]	02/19/2010	07/22/2012	52.05	13.88
ESF	12/03/2008	12/02/2009	52.05	34.70

[1]Formerly PRGF.

Projected Payments to Fund [1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	**2014**	**2015**	**2016**	**2017**
Principal		16.66	17.35	17.86	15.71
Charges/Interest		0.06	0.32	0.27	0.23
Total		16.72	17.67	18.13	15.94

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

Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ Million)[1]	1057.00
Of which: IMF assistance (US$ million)	45.27
(SDR equivalent in millions)	33.37
Completion point date	Aug 2006
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	33.37
Interim assistance	11.57
Completion point balance	21.80
Additional disbursement of interest income[2]	3.82
Total disbursements	37.19

[1] 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. Hence these two amounts cannot be added.

[2] 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 during the interim period.

Implementation of Multilateral Debt Relief Initiative (MDRI):

MDRI-eligible debt (SDR Million)[1]	37.87
Financed by: MDRI Trust	14.53
Remaining HIPC resources	23.34

Debt Relief by Facility (SDR Million)

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

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Safeguards Assessments:

An update safeguards assessment of the Reserve Bank of Malawi (RBM) with respect to the 2012 ECF was completed on December 27, 2012. The assessment reiterated the key safeguards concern – the lack of operational autonomy - and recommended that already envisaged amendments to the RBM Act to limit lending to government be expanded to strengthen RBM autonomy more broadly. The assessment also reiterated the need to enhance oversight of foreign reserves management along with measures to strengthen transparency of financial reporting.

Exchange Arrangements:

In 2006 the Fund determined that Malawi maintains a multiple currency practice (MCP) inconsistent with Article VIII, Section 3, due to a spread of more than 2% between the exchange rates of commercial banks and the rates of foreign exchange bureaus. At that time, the Fund determined that the spread resulted from official action by RBM, through informal limitation on the availability of foreign exchange and moral suasion on commercial banks.

In May 2012, the government liberalized the foreign exchange regime, devalued the kwacha by about 33 percent, and adopted a floating exchange rate regime. Malawi maintains restrictions on the capital account. In light of these changes, staff intends to conduct a comprehensive assessment of Malawi's exchange rate system shortly. While the de jure exchange rate arrangement is floating, staff's latest assessment classified the de facto arrangement as "other managed".

Article IV Consultation:

Malawi is on a 24-month Article IV consultation cycle. The last Article IV Consultation mission was conducted in conjunction with the discussions on the new ECF-supported program arrangement in May/June 2012. The Executive Board concluded the last Article IV consultation with Malawi on July 23, 2012.

Financial Sector Assessment Program (FSAP), Reports on Observance of Standards and Codes (ROSCs), and Offshore Financial Center (OFC) Assessments:

A joint team of the World Bank and the International Monetary Fund visited Malawi under the FSAP program during two missions in July and December 2007. The Financial System Stability Assessment (FSSA) was issued in June 2008 (SM/08/198).

Corporate Governance and Accounting and Auditing ROSC missions visited Malawi in February and June 2007.

An update on the FAD mission on the fiscal transparency module was issued in March 2007. A ROSC on the data module, based on a September 2003 mission, was published in October, 2004.

Technical Assistance:

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
11/13	STA	NSO	Balance of Payments Statistics	Mission
09/13	STA	NSO	Price Statistics	Mission
03/13	FAD	Ministry of Finance	Public Financial Management	Mission
02/13	STA	RBM	RBMS' monetary statistics	Mission
02/13	FAD	Ministry of Finance	GFS 2001	Mission
11/12	STA	NSO	Prices Statistics	Mission
10/12	MCM	RBM	Liquidity Management, Monetary Operations and Related Issues	Mission
10/12	FAD	Ministry of Finance/MRA	Revenue Administration	Mission
05/12	STA	NSO	Consumer Price Indices Mission	Mission
04/12	STA	NSO	Balance of Payments Statistics	Mission
04/12	STA	NSO	Provide advice to improve the GDP methodology and assist with improving the data sources and indicators	Mission
04/12	STA	NSO	Balance of Payments and International Investment Position Statistics	Mission
03/12	FAD	Ministry of Finance	Strengthening the IFMIS control environment	Mission
03/12	FAD	Ministry of Finance	Public Financial Management (PFM) Reforms	Report
03/12	FAD	Ministry of Finance/MRA	Follow-up and Consolidating Headquarters functions and Customs Risk Management Mission	Mission
01/12	MCM	RBM	Review of Implementation of Risk Based Supervision	Report
01/12	FAD	Ministry of Finance	Developing a Draft Budget Framework Document (BFP)	Mission
12/11	FAD	Ministry of Finance	Public Financial Management (PFM) Reforms	Mission
12/11	MCM/LEG	RBM	Review the Foreign Exchange Regime	Mission
11/11	FAD	Ministry of Finance	Macro fiscal training	Mission
11/11	MCM	RBM	Development of asset management manual.	Mission
11/11	MCM	RBM	Further Development of a Framework for Consolidated Supervision	Report
11/11	FAD	Ministry of Finance	Improving capacity in Business process re-engineering and IT implementation.	Mission
10/11	FAD	Ministry of Finance	Program Budgeting and Developing the Medium-term Expenditure Framework Cycle	Mission
06/11	FAD	Ministry of Finance	Measures for Tax Reform and Taxation of Mining	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
06/11	FAD/MRA	Ministry of Finance	Enhancing taxpayer compliance and revenue performance	Mission
06/11	STA	Ministry of Finance	Government Finance Statistics	Report
06/11	FAD	Ministry of Finance	Macro-fiscal training, scoping and needs assessment	Mission
06/11	MCM	RBM	Developing AML/CFT Offsite Supervisory Tools and Practices	Mission
06/11	FAD	Ministry of Finance/MRA	Malawi: Enhancing Tax Compliance and Revenue Performance	Report
06/11	FAD	Ministry of Finance/MRA	Tax Administration	Mission
06/11	FAD	Ministry of Finance	Measures for Tax Reform and the Taxation of Mining	Mission
05/11	FAD	Ministry of Finance	Fixed Assets and Financial Reporting	Mission
05/11	FAD	Ministry of Finance/MRA	Report on Strengthening Headquarters functions and Customs Risk Management Mission	Mission
04/11	STA	NSO	Incorporate new source data in the balance of payments and develop new worksheets	Mission
04/11	MCM	RBM	Assisting Reserve Bank of Malawi to further develop a framework for consolidated supervision	Mission
04/11	MCM	RBM	Developing Capacity for Stress Testing - Mission Report to the Reserve Bank of Malawi	Report
02/11	STA	NSO	Assess SUT and B-I prerequisites, data sources, compilation and dissemination for NAS	Mission
02/11	STA	NSO	Review of National Accounts Statistics	Report
01/11	FAD	Ministry of Finance	Streamlining Budget Documentation, Revising Budget Circular, Reintroducing MTEF	Mission
11/10	FAD	Ministry of Finance	Integrated Financial Management Information System (IFMIS): Review And Implementation Strategies	Report
11/10	STA	RBM	Monetary and Financial Statistics	Mission
11/10	MCM	RBM	Regulation and Oversight of Mobile Payments and Related Issues	Mission
10/10	STA	NSO	Assist in reviewing and modifying the PPS and PPI.	Mission
10/10	FAD	Ministry of Finance	IFMIS/Cash Management	Mission
10/10	FAD	Ministry of Finance	Program Budgeting/Output Budgeting	Mission
10/10	FAD	Ministry of Finance	In-year Fiscal Reporting/Budget Documentation	Mission
10/10	FAD	Ministry of Finance	Joint review of PFMRP	Mission
10/10	FAD	Ministry of Finance	Strengthening Program Budgeting, Performance Measurement, and Budget Documentation.	Report
08/10	FAD	Ministry of Finance	Revenue Policy and Administration	Report

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
07/10	FAD	Ministry of Finance	Strengthening the large taxpayers office	Mission
07/10	FAD	Ministry of Finance	Installation of expert and revenue Administration follow up mission (including review of ITAS implementation)	Mission
07/10	STA	NSO	Implementation of Balance of Payments Standards	Mission
07/10	STA	NSO	Balance of Payments and International Investment Position Statistics	Report
06/10	FAD	Ministry of Finance	Issues in Tax Policy and Taxation of Mining	Mission
05/10	MCM	RBM	Training in Techniques of Stress Testing of Prudential Data	Report
05/10	FAD	Ministry of Finance	Revenue Policy and Administration	Report
01/10	FAD	Ministry of Finance	Output-based budget and expenditure tracking	Mission
01/10	STA	NSO	Balance of payments statistics	Mission
10/09	MCM	RBM	Central bank policy	Mission
10/09	MCM	RBM	Central banking	Mission
09/09	FAD	Ministry of Finance	Improving output budgeting	Mission
08/09	LEG	Ministry of Finance	Tax procedure code	Mission
05/09	LEG	Ministry of Finance	Tax procedure code	Mission
05/09	FAD	Ministry of Finance	Linkage between policy and budgetary allocations	Mission
04/09	FAD	RBM	Monetary operations and reserves management	Mission
03/09	FAD	Ministry of Finance	Revenue administration	Mission
03/09	FAD	Ministry of Finance	Prepare modernization plan and support tax administration	Mission
02/09	FAD	Ministry of Finance	Integration of accounting systems and fiscal reporting	Mission
02/09	MCM	RBM	Currency handling and reform	Mission
02/09	MCM	RBM	Monetary operations/money markets	Mission
01/09	STA	RBM	DFID: Money and banking statistics	Mission
01/09	MCM	RBM	Monetary operations/money markets	Mission
01/09	MCM	RBM	Macro and FSI Analysis	Mission
01/09	MCM	RBM	TA coordination/evaluation	Mission

JOINT MANAGERIAL ACTION PLAN

(As of November 31, 2013)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	A. Mutual information on relevant work programs		
Bank work program in the next 12 months	**Analytical and Advisory Activities:**		
	1. Public Expenditure Review	November 2012	November 2013
	2. Agriculture PER	September 2012	November 2013
	3. Diagnostic Trade Integration Study	November 2012	November 2013
	4. Poverty Policy Note	On-going	February 2014
	5. Higher Education and Skills Development/TEVET Policy Note	On-going	January 2013
	6. Malawi Urbanization Review	November 2012	December 2014
	7. Decentralization Policy Note – Follow-up Activities	On-going	June 2014
	8. Update of Malawi Transport Costs Study	On-going	December 2014
	9. Growth and Competitiveness	February 2014	August 2014
	Lending:		
	1. Second Economic Recovery Development Policy Operation (budget support)	June 2013	March 2014
	2. Higher Education and Skills Development Project	February 2013	July 2014
	3. Additional Financing ASWAp-SP (Multi-Donor Trust Fund).	March 2013	December 2013
	4. ASWAP-SP 2 + IRLADP 2	November 2013	2014/15
	5. MASAF IV	March 2013	December 2013
	6. Regional Development Policy Operation (budget support)	February 2013	March 2014
IMF work program in next 12 months	1. Fifth review of ECF-supported program	February 2014	April 2014
	2. Sixth review of ECF-supported program	July/Aug 2014	October 2014
	B. Requests for work program inputs		
Fund request to Bank	1. Updates on Public Expenditure Review work		November 2013
	2. Updates on WB support to Malawi		Continuous
Bank request to IMF	1. Regular updates of medium-term macro projections		Continuous
	C. Agreement on joint products and missions		
Joint products in next 12 months	1. Debt Sustainability Analysis (update)	February 2014	April 2014
		July/Aug 2014	October 2014

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of December 19, 2013)

AfDB operations in Malawi date back to 1969. The Malawi Field Office was opened in 2007 and officially launched in July 2008 by AfDB President Dr. Donald Kaberuka. As at December 19, 2013, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 829.8 million (about US$ 1.3 billion) to finance 99 operations including 12 studies and 2 lines of credit.

The AfDB Board of Directors on 30th January 2013 approved a new Country Strategy Paper (CSP) covering 2013–17. The Bank's new CSP is fully aligned to the second Malawi Growth and Development Strategy (MGDS II) covering the period 2011–16, the Bank's corporate priorities in the Long Term Strategy (LTS, 2013–22) and the Regional Integration Strategy Paper for Southern Africa (Southern African RISP, 2011–15). The new CSP I focuses on two pillars: (i) addressing infrastructure bottlenecks to competitiveness and growth; and (ii) supporting actions to expand private sector investment and trade. To ease challenges posed by Malawi's landlocked position, the Bank has scaled-up support to regional infrastructure to deepen the country's integration with its neighbors. Accordingly, more than 50 percent of the indicative lending operations are regional and will be financed with ADF XII, XIII and XIV resources. The Bank will also support Public Private Partnerships (PPPs) in infrastructure development.

Following Governments reengagement with the IMF and the approval of a new US$ 157 million Extended Credit Facility (ECF) arrangement for Malawi in July 2012, the Bank approved a new ADF Grant for the Crisis Response Budget Support operation for Malawi in July 2012, in the amount of UA 26 million (US$ 40 million). The Bank designed a Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective is to contribute to restoring fiscal stability and enhancing public finance management in Malawi, as well as support social protection measures to mitigate the adverse social impact of the devaluation of the Kwacha and the increases in fuel and electricity prices. In order to support this agenda, the RFSSP has two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system. The Bank disbursed UA 4 million (US$ 6 million) as additional budgetary support in June 2013.

Box. AfDB Ongoing Operations.

The Bank's ongoing operations comprise the following: three projects in the agriculture sector: (i) Agriculture Infrastructure Support Project (AISP); (ii) Small-holder Crop Production and (iii) Marketing Project (SCPMP) and Climate Adaptation for Rural Livelihoods and Agriculture Project (grant from Global Environment Facility). The Bank is also implementing the National Water Development Programme (NWDP) in collaboration with Australian AID (AusAID), whilst the grants from the African Water Facility (AWF) are financing Strengthening Water Sector Monitoring & Evaluation Project and the Water and Sanitation Access project for the Urban Poor in the City of Blantyre which is aimed at improving access to improved water supply and sanitation services. There are currently four projects providing support to the social sector: (i) the Health SWAp Programme which is constructing and rehabilitating a total of 57 health facilities across the country; (ii)the Local Economic Development project is developing infrastructure in four rural growth centres of Jenda, Malomo, Monkey Bay and Chitekesa; (iii) the Competitiveness and Job Creation Project in Private sector which aims to improve the capabilities and the competitiveness of the private sector as well as increase export diversification and job creation ; and (iv) Support to Higher Education Science & Technology Project aims to increase access to technical, entrepreneurship, vocational and training (TEVET) and higher education in Malawi, with particular emphasis to Information and Communication Technology (ICT). In the transport sector the Bank is implementing the Trunk Roads Rehabilitation Project which includes Blantyre-Zomba road rehabilitation project (60 km) and the Lilongwe Bypass construction Project (13km) as part of the Multinational Nacala Road Corridor. As at the end of November 2013, the overall portfolio was rated satisfactory with a cumulative disbursement rate of 49%. In line with the CSP indicative program, the Bank approved three new operations, the Mzuzu-Nkhata Bay Road Rehabilitation Project (US$ 33.20m), Smallholder Irrigation and Value Addition Project (US$39.98m) funded by Global Agriculture and Food Security Project and the African Development Fund, and a multinational Nacala Road Corridor Development Project Phase IV (US$65.9m). The first two were approved in March and the third in Dec 2013. In October 2013, the Board also approved a UA2.98 million (about US$ 4.5 million) Public Finance Management Institutional Support Project to support the Government of Malawi in implementing its five-year Public Finance and Economic Management Reform Program (PFEMRP)through improved tax administration and procurement systems.

The Bank has also provided support for non-lending activities, including feasibility studies and analytic work to inform the design of new operations and policy dialogue. During 2012-2013 the Bank prepared a Private Sector Profile for Malawi and has also financed jointly with the World Bank and other partners a Public Expenditure Review. In addition, the Bank is supporting the Private Public Partnership Commission (PPPC) with a grant to implement the Capacity Building and Assessment of the Legislative and Institutional Framework for PPPs in Malawi. The Bank is also undertaking the Domestic Resource Mobilization Study for Malawi and providing TA to the Reserve Bank of Malawi to strengthen capacity in macro-economic forecasting.

STATISTICAL ISSUES

Introduction

1. Although economic data provision has some shortcomings, it is broadly adequate for surveillance.

2. 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, balance of payments statistics, 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.

3. 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.

National accounts

4. 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 Norwegian counterparts. The NSO have revised the national accounts methodology to implement the SNA93 and to better account for the activities in the informal sector. New estimates for Real and Nominal GDP based on the base year 2007 are submitted.

Consumer 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 (on urban and rural price indices) are collected on a monthly basis by regional price collectors. The CPI weights have been revised based on the 2010 planned Integrated Household Survey (IHS) and the new series will be available in March 2013.

Government finance statistics

6. 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.[1] 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 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

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

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.

7. 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 East 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.

8. 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.

9. A GFS TA mission visited Lilongwe in June 2011 in the context of the country's participation in the GFS Module under the Enhanced Data Dissemination Initiative funded by DFID. It found that annual and sub-annual data for budgetary central government are compiled in *GFSM 1986* format of the Ministry of Finance, but are not disseminated. A new chart of accounts aligned with the *GFSM 2001* was introduced in the 2011–12 budget cycle, which applies to all general government units. A number of source data issues were identified and recommendations made to address them. Bridge tables linking the national classifications and *GFSM 2001* classifications were prepared by the mission, and should be revised and used to compile GFS in *GFSM 2001* format. A follow up mission is included in the RAP for FY 2013.

Monetary and financial statistics

10. Despite recent improvements, monetary and financial statistics (MFS) continue to have shortcomings. These includes irregular reporting to STA, lack of proper legislation to grant the authority to the RBM to require reporting from other institutions[2]; 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, 2008, 2009, and 2010 missions noted and made a number of recommendations for addressing the above shortcomings. In addition to the above tasks, the 2008, 2009, and 2010 STA missions assisted RBM staff in developing the standardized report forms (SRFs) for the central bank accounts (1SR), other depository corporations (2SR), and monetary aggregates (5SR).

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 National Statistical Office of Malawi (NSO) should now adopt the *BPM6* methodology, on the basis 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. The NSO had compiled new balance of payments data and validated the results from two key surveys: the BOP Survey and the survey on nonprofit institutions serving households (NPISH), both based on the *BPM*5 methodology. The NSO also compiled information from other important sources as well, namely: a) the 2009 Foreign Private Capital and Investor Perception Survey, b) monetary statistics from the Reserve Bank of Malawi (RBM), and c) other financial data provided by the Ministry of Finance (MoF). However, much remains to be done to improve the quality, coverage, and timelines of the balance of payments statistics. To this end, the NSO is a recipient of

[2] 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.

substantial amounts of technical assistance from the Fund and other organization. External support should be underpinned by providing adequate staffing and budget resources to the NSO.

13. 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.

14. Due to capacity constraints and weak source data, the International Investment Position (IIP) is not being compiled. Capacity building programs, including Fund-provided training and technical assistance, seek to overcome these constraints to allow the compilation of the IIP in future. The RBM and Ministry of Finance's Debt and Aid Department need to improve reporting of monetary and external debt data respectively.

Malawi: Tables of Common Indicators Required for Surveillance

(As of November 30, 2013)

	Date of latest observation	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]	10/2013	11/2013	M	M	M		
Reserve/Base Money	10/2013	11/2013	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Broad Money	10/2013	11/2013	M	M	M		
Central Bank Balance Sheet	10/2013	11/2013	M	M	M		
Consolidated Balance Sheet of the Banking System	10/2013	11/2013	M	M	M		
Interest Rates[2]	10/2013	11/2013	M	M	M		
Consumer Price Index	10/2013	11/2013	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	11/2013	11/2012	M	M	I	O, LO, O, O	O, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	11/2012	11/2012	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/2012	11/2012	M	M	M		
External Current Account Balance	12/2012	11/2013	A	A	A	O, O, O, O	LO, O, LO, O, O
Exports and Imports of Goods and Services	12/2012	11/2013	A	A	A		
GDP/GNP	12/2012	11/2013	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	2012	11/2013	M	I	I		
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.

INTERNATIONAL MONETARY FUND

MALAWI

THIRD AND FOURTH REVIEWS UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUESTS FOR WAIVER OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT, REPHASING OF DISBURSEMENTS, AND MODIFICATION OF PERFORMANCE CRITERIA— DEBT SUSTAINABILITY ANALYSIS

December 27, 2013

Approved By
David Owen and Mark Flanagan (IMF) and Jeffrey Lewis and Marcelo Giugale (IDA)

Prepared by the staffs of the International Monetary Fund and the International Development Association

Malawi's debt situation remains at a moderate risk of distress, but new risks have emerged since the last debt sustainability analysis (DSA). Uncertainty has increased following a scandal involving the theft of public funds. The fraud revealed weaknesses in national fiscal systems serious enough for donors to suspend budget support disbursements. To repair and strengthen their fiscal systems, the authorities are implementing an Action Plan of remedial measures with support from the development partners. They have also tightened their fiscal program in consultation with the Fund, to reverse a loosening of policies in the first quarter of FY2013/14 (July-September 2013) and to close a substantial funding gap caused by the reduction in external financing. Assuming timely implementation of remedial measures, medium term borrowing and the overall outlook are expected to be broadly unchanged relative to the previous DSA update. The use of a higher constant discount rate for debt service payments (in line with new guidelines) lowered Malawi's debt burden indictors.

BACKGROUND

1. **This DSA was prepared by IMF and World Bank staff in collaboration with the Malawian authorities.** The analysis updates the previous Joint DSA update from September 2013 (EBS/13/127, supplement 1), and follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (SM/13/292, November 2013). The updated methodology includes a set of modifications and improvements to evaluate the sustainability of debt and the probability of debt distress. For Malawi, the main change consists of the use of a constant discount factor of 5 percent to evaluate debt service flows. Previous DSA analyses employed discount factors related to market movements (the September update used an average discount rate of about 3 percent). Holding other factors constant, this higher discount rate results in lower present value of debt for Malawi, and thus improves its debt sustainability outlook.

2. **The uncovering of fraudulent transactions at the treasury revealed a significant loss of public funds and led to a suspension of substantial amounts of donor support.** This incident revealed serious weaknesses in the integrity of national systems, and raised governance, safeguards, and financing assurance concerns.

3. **Malawi's medium- and long-term public and publicly guaranteed (PPG) external debt is expected to reach US$1.57 billion at end-2013.** This marks a continuation of the relatively brisk expansion of debt stock from 2012, and to an expansion of concessional budget loans extended by donors, and new project loans from China and India.

UNDERLYING DSA ASSUMPTIONS

4. **The baseline scenario incorporates lower donor support in the near term, but assumes the authorities will implement sufficiently strong remedial measures to alleviate governance concerns and begin to restore donor support in the second half of FY2013/14.** In addition to government spending cuts, monetary policy is also expected to remain tight to lower inflation and maintain confidence in the kwacha. Notwithstanding tight policies, growth is expected to reach 5 percent in 2013 and 6.1 percent in 2014. These projections are based on evidence of continuing increase in capacity utilization in many sectors, and on the expectation that the suspension of aid will be short-lived. Private sector representatives cited increased availability of foreign exchange as the main factor behind the recovery in economic activity during 2013, and this is expected to continue. Securitized arrears, recent domestic borrowing, together with the fraud and resulting delay in donor support are expected to generate substantial financing needs in the budget for FY2013/14. To meet these needs, the government will undertake spending cuts and raise its target for domestic borrowing. The strong revenue performance experienced so far this year is also expected to continue. Domestic borrowing for 2013 is now estimated to push total public and publicly guaranteed debt about 7 percentage points of GDP higher than what was envisaged in the previous DSA update. However, total public and publicly guaranteed debt to GDP is expected to decline at a faster pace during 2014 than in the previous DSA update (by 4 percentage points) as it is expected that the government will unwind most of over borrowing from the third quarter of 2013.

The baseline also maintains the assumption of a gradual reduction in the external current account deficit through export diversification and reliance on grants and concessional financing in the medium term. Inflation is programmed to return to single digits by 2014. The key macroeconomic assumptions are summarized in Box 1.

Box 1. Baseline Macroeconomic Assumptions

Real GDP is still projected to grow at an annual rate of about 6 percent over the longer term, led by the agriculture, trade, manufacturing and mining sectors.

Inflation is projected to decline from 35 percent in 2012 to 20 percent by December 2013 and to reach single digits by 2014 as the emphasis of monetary policy switches from accumulation of international reserves to price stability.

The exchange rate is projected to remain constant in real terms after 2014.

Tax revenue is projected to continue increasing with ongoing reforms in tax administration and policy.

External debt will be contracted mainly from multilateral creditors on concessional terms, with borrowing from bilateral sources also on broadly similar terms. Budget support and project loans from multilateral and bilateral donors are expected to fall during FY2013/14 and increase significantly in FY2014/15 in response to proposed policies. More normal levels are expected over the medium term.

The current account balance will remain at a sustainable level, as improvements in the trade and services balances moderate a declining trend in grants.

5. **Strong economic performance is expected to be maintained over the longer term.** Real GDP growth is projected to reach 6.5 percent by 2015, supported by a more competitive exchange rate, structural reforms, fiscal consolidation, and continued donor support. Growth beyond 2017 is projected to gradually approach 6 percent. The main impetus to growth is expected from agriculture, trade, manufacturing and mining.

EVOLUTION OF DEBT INDICATORS

6. **Malawi's debt indicators are expected to remain well below established thresholds**. Short-term program adjustments are required, but the medium term outlook remains favorable due to economic growth, medium term fiscal consolidation, and a higher discount for debt service flows. In spite of increasing PPG debt to GDP ratio for 2013, resumption of debt repayments and sustained economic growth will make this ratio move below its 2012 level by 2014, with continued improvements thereafter. The interest rate used for calculating the NPV of the debt service streams increased from 3 to 5 percent since the last DSA, which lowered the present value of the debt stock and resulted in improvements in other indicators.

7. **The main risks to debt sustainability are deterioration in the terms of trade, adverse weather conditions, and loosening of policies in response to the aid shortfall and in the run up to the May 2014 general elections.** The economy remains relatively undiversified and dependent on rain-fed

agricultural exports as a source of foreign exchange. Stress tests (next section) continue to indicate some vulnerability to export-related shocks. Loosening of policies may result in further depreciation of the Kwacha, and/or erosions in donor confidence. The latter could potentially jeopardize the timely resumption of donor aid, which remains a fundamental component of Malawi's budget.

EXTERNAL DEBT SUSTAINABILITY

8. External debt indicators remain well below their policy-dependent debt-burden thresholds. Absolute levels remain sustainable and follow a long-term downward trajectory (Figure 1 and Table 1).

9. Standard stress tests indicate that a somewhat weaker debt outcome is possible under certain conditions (Figure 1). Specifically, the present value of debt to GDP ratio reaches its indicative threshold when key variables are kept at their historical levels. This happens in 2023, which coincides with the peak value for this ratio. This behavior is mostly due to the inclusion of 2012 in the historical period, which effectively allows the exchange rate depreciation in that year to continue to impact nominal GDP in U.S. dollars. The staff considers this to be an unlikely outcome given that the distortions in the foreign exchange market that gave rise to such a large depreciation have now been removed.

10. Debt burden indicators also remain below their indicative thresholds under bound tests conducted to show the impact of temporary shocks. . The strongest impact on external debt indicators requires the combination of shocks to growth, exports and non-debt creating flows (See Table 3a, case B5). As argued above, historical averages capture the devaluation period and are deemed low probability events.

PUBLIC DEBT SUSTAINABILITY

11. The baseline scenario projects a relatively slow decrease in the ratio of public debt to GDP starting in 2014. Until 2018, domestic debt as a share of GDP is set to decline with fiscal consolidation and the maintenance of a positive primary balance (up to 2019). Standard stress tests do not suggest any significant vulnerability (Figure 2 and Table 2). The strongest impact on the indicators arises from a one-time depreciation shock—again through compression of nominal GDP in U.S. dollars—and an export shock, which is illustrative of the risk inherent in the undiversified nature of Malawi's sources of foreign exchange.[1]

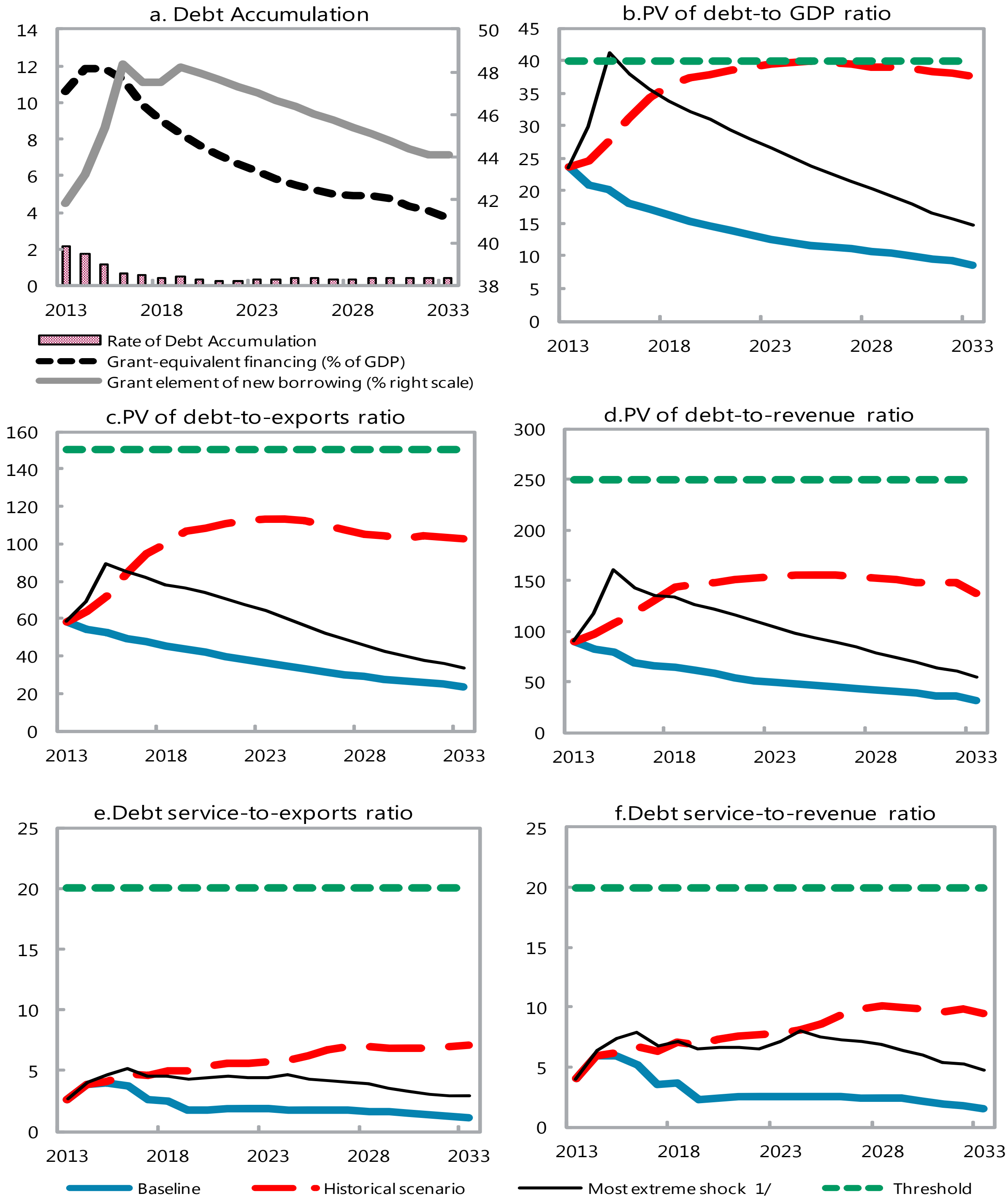
[1] In this analysis, the combination bound test of assuming a one half standard deviation decline in economic growth, export growth, U.S. GDP deflator, and non-debt creating flows was modified to exclude the non-debt creating flows component. This component was removed as Malawi lacks the access to capital markets required to replace lost grants and foreign investment with borrowing, and would instead be forced to respond with expenditure and import compression.

12. External financing risks exist, but are programmed to be addressed by additional fiscal restraint and so should not have an impact on debt sustainability. Budget financing needs already require an expansion of domestic debt for 2013. Consequently, fiscal tightening is expected to be the policy response to unexpected negative financing shocks (either from delayed or lower donor support, or lower tax revenue). Additional domestic borrowing would bring additional pressures on the exchange rate, erode perceptions of government commitment to policy reforms, ultimately damaging macroeconomic performance and should be avoided. The authorities will look for additional cuts in domestically financed development expenditure and in goods and services to meet additional shortfalls in external financing.

CONCLUSIONS

13. Malawi remains at a moderate risk of debt distress. The debt situation under the baseline scenario remains close to that reported in the previous DSA update. Risk of export related shocks remains, given Malawi's limited sources of foreign exchange and reliance on rain-fed agriculture. Additional risks include the loosening of policies as a response to the suspension of donor support, which could further erode donor confidence and jeopardize the resumption of aid. Risks of negative financing shocks in the form of delayed or lower donor support, or lower than expected tax revenue may require additional fiscal restraint, but should not compromise the medium term debt sustainability of the country. Recent events point to the need for taking steps to arrest declines in the quality of institutions (as reflected in the CPIA score), to ensure capacity to manage the debt load of the country.

Figure 1. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013-2033 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a Combination shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Exports shock and in figure f. to a Combination shock

Table 1. Malawi: Public Debt Sustainability Framework, Baseline Scenario, 2010-2033

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2010	2011	2012	Average 5/	Standard Deviation 5/	2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	29.7	36.1	54.8			59.8	52.0	47.9	43.7	41.2	37.8		33.3	24.6	
of which: foreign-currency denominated	16.1	16.9	37.4			40.8	36.3	35.3	32.5	31.5	30.5		26.7	18.2	
Change in public sector debt	-8.6	6.4	19.4			5.1	-7.9	-4.1	-4.2	-2.5	-3.3		-0.5	-0.8	
Identified debt-creating flows	-6.2	3.6	12.5			-1.2	-8.2	-2.3	-3.5	-1.7	-2.2		0.5	-0.7	
Primary deficit	-4.2	2.2	2.0	-0.8	3.2	1.2	-1.3	-0.4	-0.9	0.1	0.1	-0.2	1.6	1.5	1.4
Revenue and grants	36.7	28.3	34.7			35.1	35.7	36.1	36.8	35.5	33.6		31.1	30.5	
of which: grants	11.9	4.7	11.6			8.8	10.4	10.6	10.3	9.0	8.3		5.6	3.2	
Primary (noninterest) expenditure	32.5	30.6	36.6			36.3	34.4	35.8	35.9	35.5	33.7		32.7	32.0	
Automatic debt dynamics	-2.0	1.4	10.6			-2.4	-7.0	-1.9	-2.6	-1.8	-2.3		-1.1	-2.3	
Contribution from interest rate/growth differential	-1.6	0.4	-1.9			-1.6	-2.6	-1.6	-1.0	-1.7	-2.2		-1.3	-1.6	
of which: contribution from average real interest rate	0.7	1.6	-1.2			1.0	0.8	1.6	1.9	0.9	0.2		0.6	-0.1	
of which: contribution from real GDP growth	-2.4	-1.2	-0.7			-2.6	-3.4	-3.2	-2.9	-2.6	-2.4		-1.9	-1.5	
Contribution from real exchange rate depreciation	-0.4	1.0	12.4			-0.8	-4.3	-0.3	-1.6	-0.1	-0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			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)	0.0	0.0	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	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-2.4	2.8	6.1			6.2	0.4	-1.8	-0.7	-0.8	-1.1		-0.9	-0.3	
Other Sustainability Indicators															
PV of public sector debt	...	...	40.4			42.5	36.5	32.7	29.3	26.9	23.6		19.1	15.0	
of which: foreign-currency denominated	...	...	23.0			23.6	20.9	20.1	18.1	17.2	16.2		12.5	8.6	
of which: external	...	...	23.0			23.6	20.9	20.1	18.1	17.2	16.2		12.5	8.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	16.8	18.9	20.9			20.9	23.2	18.2	15.0	13.4	11.0		9.1	8.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	116.5			121.1	102.2	90.4	79.7	75.8	70.1		61.3	49.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	174.9			161.9	144.1	127.8	110.6	101.7	93.1		74.7	54.8	
of which: external 3/	...	...	99.7			89.6	82.3	78.6	68.4	65.1	64.2		49.1	31.4	
Debt service-to-revenue and grants ratio (in percent) 4/	8.0	12.3	8.1			19.0	17.1	12.5	12.2	8.7	6.2		5.7	2.6	
Debt service-to-revenue ratio (in percent) 4/	11.8	14.7	12.2			25.4	24.2	17.6	16.9	11.7	8.3		6.9	2.9	
Primary deficit that stabilizes the debt-to-GDP ratio	4.4	-4.2	-17.4			-3.9	6.6	3.7	3.3	2.6	3.4		2.1	2.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.5	4.3	1.9	5.5	2.8	5.0	6.1	6.5	6.5	6.2	6.3	6.1	5.9	6.0	5.9
Average nominal interest rate on forex debt (in percent)	0.4	0.7	1.6	0.9	0.3	1.6	1.6	1.7	1.7	0.7	0.9	1.4	1.6	1.7	1.6
Growth of real primary spending (deflated by GDP deflator, in percer	0.1	0.0	0.2	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	41.9	43.2	45.4	48.4	47.5	47.5	45.6	47.0	44.1	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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 2.Malawi: Sensitivity Analysis for Key Indicators of Public Debt 2013-2033

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	43	37	33	29	27	24	19	15
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	43	38	35	32	29	25	15	4
A2. Primary balance is unchanged from 2013	43	39	36	34	32	29	23	18
A3. Permanently lower GDP growth 1/	43	38	35	32	30	27	26	34
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	43	39	38	36	34	31	31	32
B2. Primary balance is at historical average minus one standard deviations in 2014-201	43	40	37	34	32	28	23	19
B3. Combination of B1-B2 using one half standard deviation shocks	43	40	37	35	33	30	27	27
B4. One-time 30 percent real depreciation in 2014	43	46	41	37	33	29	23	19
B5. 10 percent of GDP increase in other debt-creating flows in 2014	43	43	39	36	33	30	24	19
PV of Debt-to-Revenue Ratio 2/								
Baseline	121	102	90	80	76	70	61	49
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	121	107	95	86	82	75	48	12
A2. Primary balance is unchanged from 2013	121	109	100	93	91	87	75	59
A3. Permanently lower GDP growth 1/	121	106	96	87	85	81	83	109
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	121	109	103	95	94	92	97	105
B2. Primary balance is at historical average minus one standard deviations in 2014-201	121	111	104	93	89	84	75	61
B3. Combination of B1-B2 using one half standard deviation shocks	121	110	102	93	91	87	87	87
B4. One-time 30 percent real depreciation in 2014	121	128	113	99	94	87	73	63
B5. 10 percent of GDP increase in other debt-creating flows in 2014	121	121	108	97	94	88	79	63
Debt Service-to-Revenue Ratio 2/								
Baseline	19	17	12	12	9	6	6	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	17	13	12	9	6	6	1
A2. Primary balance is unchanged from 2013	19	17	13	12	9	6	6	3
A3. Permanently lower GDP growth 1/	19	17	13	12	9	6	6	4
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	19	18	13	13	9	7	7	5
B2. Primary balance is at historical average minus one standard deviations in 2014-201	19	17	13	12	9	6	6	3
B3. Combination of B1-B2 using one half standard deviation shocks	19	17	13	13	9	7	6	4
B4. One-time 30 percent real depreciation in 2014	19	18	14	14	10	7	7	3
B5. 10 percent of GDP increase in other debt-creating flows in 2014	19	17	13	12	9	6	6	3

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 3a.Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033

(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
PV of debt-to GDP ratio								
Baseline	24	21	20	18	17	16	**13**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	24	24	28	31	34	36	**39**	38
A2. New public sector loans on less favorable terms in 2013-2033 2	24	21	21	20	19	18	**16**	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	24	21	21	19	18	17	**13**	9
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	24	22	26	24	23	21	**17**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	24	25	28	25	24	22	**17**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	24	25	29	27	25	24	**19**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	24	30	41	38	36	34	**27**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	24	28	27	25	23	22	**17**	12
PV of debt-to-exports ratio								
Baseline	59	55	52	49	47	45	**36**	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	59	64	72	84	95	100	**113**	103
A2. New public sector loans on less favorable terms in 2013-2033 2	59	55	55	54	53	51	**47**	39
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	59	53	51	49	47	44	**35**	24
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	59	66	86	82	78	74	**61**	35
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	59	53	51	49	47	44	**35**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	59	65	76	73	70	66	**54**	30
B5. Combination of B1-B4 using one-half standard deviation shocks	59	69	89	85	82	78	**64**	34
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	59	53	51	49	47	44	**35**	24
PV of debt-to-revenue ratio								
Baseline	90	82	79	68	65	64	**49**	31
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	90	97	108	117	130	143	**154**	138
A2. New public sector loans on less favorable terms in 2013-2033 2	90	82	83	75	72	73	**64**	53
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	90	82	83	73	69	68	**51**	34
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	90	88	103	91	86	85	**66**	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	90	97	108	95	90	88	**67**	45
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	90	98	114	101	95	95	**74**	40
B5. Combination of B1-B4 using one-half standard deviation shocks	90	118	161	143	134	133	**104**	54
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	90	110	107	94	89	87	**66**	44

Table 3b.Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033 (continued)

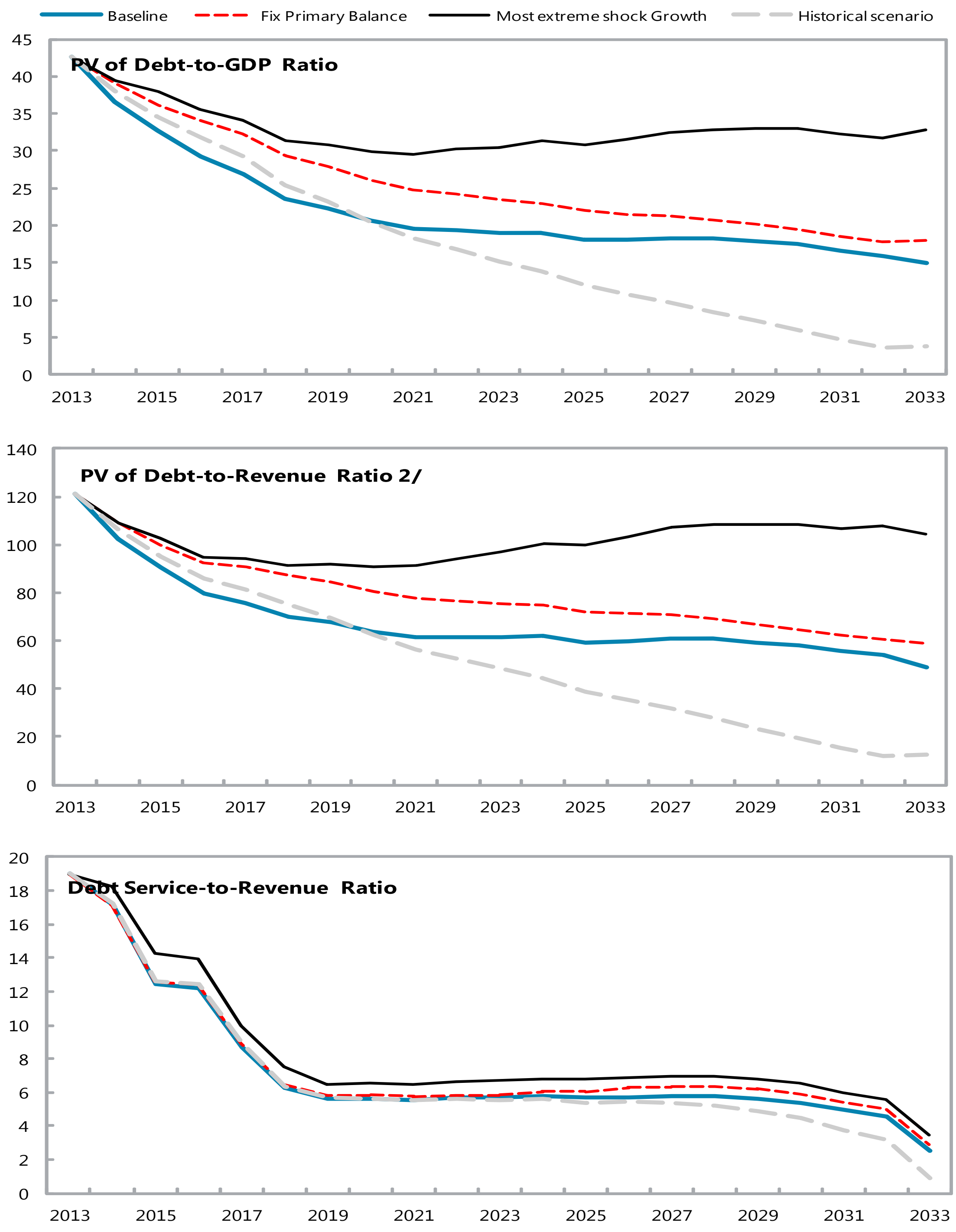
(In percent)

				Debt service-to-exports ratio				
Baseline	3	4	4	4	3	3	**2**	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	3	4	4	5	5	5	**6**	7
A2. New public sector loans on less favorable terms in 2013-2033 2	3	4	4	4	4	4	**3**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	3	4	4	4	3	3	**3**	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	3	4	5	5	5	5	**4**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	3	4	4	4	3	3	**3**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	3	4	4	4	4	4	**4**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	4	4	5	4	4	**4**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	3	4	4	4	3	3	**3**	2
				Debt service-to-revenue ratio				
Baseline	4	6	6	5	4	4	**3**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	4	6	6	7	6	7	**8**	9
A2. New public sector loans on less favorable terms in 2013-2033 2	4	5	5	6	5	5	**4**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	4	6	6	6	5	5	**4**	3
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	4	5	6	6	5	5	**5**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	4	7	8	7	6	7	**6**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	4	5	6	6	5	5	**5**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	4	6	7	8	7	7	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	4	8	7	7	6	7	**6**	3
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	44	44	44	44	44	44	**44**	44

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/ 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).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
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.

Figure 2.Malawi: Indicators of Public Debt Under Alternative Scenarios, 2013-2033 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2023.
2/ Revenues are defined inclusive of grants.

This page intentionally left blank

Press Release No. 14/15
FOR IMMEDIATE RELEASE
January 17, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third and Fourth Reviews Under the Extended Credit Facility Arrangement for Malawi and Approves US$ 20Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third and fourth reviews of Malawi's economic performance under a program supported by the Extended Credit Facility (ECF) arrangement. The Board's decision enables the immediate disbursement of an amount equivalent to SDR 13.01 million (about US$ 20million), bringing total disbursements under the arrangement to an amount equivalent to SDR52.06 million (about US$79.8 million).

In completing the reviews, the Board granted waivers for the nonobservance of the continuous performance criterion on new nonconcessional external debt with a maturity of more than one year, and for the nonobservance of the end-September, 2013 performance criteria on government net domestic borrowing and on the net domestic assets of the Reserve Bank of Malawi (RBM.). The Board also approved an extension of the arrangement by four months (to November 2015), and a rephasing of disbursements.

The three-year ECF arrangement for Malawi in the total amount of SDR 104.1 million (about US$156.6 million) was approved on July 23, 2012 (see Press Release 12/273).

Following the Board's discussion, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, issued the following statement:

"Malawi's macroeconomic performance under the IMF-supported program has remained broadly satisfactory and the policy reforms initiated in May 2012 are showing positive results. The recent fraud and misappropriation of substantial amounts of public funds and the associated loss of programmed financial aid has negatively affected the macroeconomic outlook. To restore confidence in the authorities' management of the economy, it will be important for the government to investigate the fraud thoroughly and to implement the Action Plan to address the weaknesses in public financial management exposed by the fraud.

"The authorities are committed to closely monitor expenditure execution and financing to prevent a recurrence of the fiscal slippage that resulted in a substantial increase in domestic borrowing during the first quarter of the 2013/14 fiscal year. They stand ready to act swiftly with more stringent expenditure restraint and expenditure reprioritization to protect social spending in case downside risks to domestic revenues and external financing materialize.

"Continued tight monetary policy and fiscal restraint are needed to stabilize the exchange rate and reach the target of single digit inflation by end-2014. The Reserve Bank of Malawi is committed to improving its oversight of the financial sector in order to safeguard financial stability.

"Malawi contracted nonconcessional external debt in 2013, resulting in the non-observance of a performance criterion under the ECF-supported program. This gave rise to a noncomplying disbursement following the completion of the second review under the ECF arrangement. The authorities are committed to strengthening the monitoring of the concessionality of new external loans and to enhance the sharing of information on external loans with IMF staff to ensure that the terms of external loans are in line with commitments under the program. In view of the corrective actions taken by the authorities, the Board decided to waive the non-observance of the performance criterion that gave rise to the noncomplying disbursement."

Statement by Momodou Bamba Saho, Executive Director for Malawi

January 17, 2014

Introduction

The Malawi authorities thank the Executive Board and Management for their continued engagement and support. They are grateful for the constructive dialogue with staff in addressing the policy challenges to sustaining economic recovery and poverty reduction. Not long ago, Malawi's economy was on the brink of collapse facing chronic foreign exchange shortages, rapidly rising inflation exacerbated by more and more imports being priced at the parallel market exchange rate. Under a new leadership since April 2012, my authorities have been implementing tough but critical macro and structural reforms aimed at turning around the economy. Among other things, they devalued the Kwacha by close to 50 percent with subsequent floating of the exchange rate, and they adopted an automatic adjustment mechanism for retail prices of fuel.

They continue to focus on implementing tough but critical macroeconomic and structural reforms aimed at accelerating the economic reform program supported by the current ECF arrangement. While the policy initiatives cover a broad range of areas, they continue to adjust their policies to address the emerging challenges, including the ramifications from the recent public financial management scandal which has resulted in postponement of significant donor disbursements. Through their commitment to adjust policies as well as policy guidance from the Fund, the authorities are confident that they stand a good chance of shoring up their economy's growth to its normal trajectory and achieving macroeconomic stability. That said, they broadly agree with the thrust of the staff report as it presents a balanced assessment of recent developments and policy challenges and opportunities going forward.

Recent economic developments and outlook

Considerable progress has been achieved since the economic reforms commenced in the first half of 2012. However, the embezzlement of public resources in Malawi through fraudulent transactions carried out in the government's Integrated Financial Management Information System (IFMIS) and uncovered in late September 2013, has put at risk the gains made since May 2012. During a quarterly reconciliation exercise between the Ministry of Finance and the Reserve Bank of Malawi, officials observed cash movements that exceeded the authorized levels of funding. In subsequent investigations, they discovered that there had been a breach in the IFMIS security system and that several unauthorized transactions had been undertaken. In response, the Malawi President acted quickly by reconstituting her cabinet in October, and also, directed the vendor to assess and fix the software used by IFMIS, as well as recover information that appeared to have been lost before the system could resume operation. After strong firewalls had been placed and access controls had been strengthened, the use of IFMIS was allowed to resume in November.

An Action Plan to address the weaknesses in public financial management that was endorsed by the government and development partners is currently being implemented. To monitor progress in the timely implementation of the Action Plan, a Ministerial Committee that meets weekly and chaired by the Minister of Finance has been established. The President also welcomed assistance from the Government of the United Kingdom to conduct a forensic audit by an internationally reputable firm which has commenced its work and is on track to provide its initial findings by end-January 2014. In addition, through the office of Director of Public Prosecutions (DPP) and Anti-Corruption Bureau (ACB), the authorities are paving the way to recover the misappropriated funds and identify and prosecute those involved in the looting of government resources. To this end, adequate technical and financial support is being provided, both from the government and development partners. So far, dozens of arrests of individuals linked to the fraud has been made; through the ACB and DPP, 81 companies have been identified; of which 60 of them have already been profiled; more than 35 individuals and 12 cases have been committed to the high court; and 8 cases are ready for trial and the DPP has served disclosures to defendants. My authorities want to assure Directors that due process will be followed in accordance with the law to ensure that those responsible are brought to court.

With regard to the macroeconomic environment, while the fiscal scandal has put a dent in the recovery momentum, there are signs that the reforms are aiding the economy to better weather the shock. Inflation rose steadily from 12.4 percent in April 2012 to a peak of 37.9 percent in February 2013, due to the implementation of foreign exchange market liberalization measures and the Automatic Pricing Mechanism for fuel and utilities, as well as high prices of maize. A combination of improved availability of food after the harvest and consistent implementation of a tight monetary policy stance, as well as a rise in foreign exchange reserves has resulted in inflation decelerating from its peak. Foreign exchange reserves stood at 2.1 months of imports in mid-December 2013, up from 0.7 months of imports recorded in June 2012. However during October and November, the depreciation of the kwacha, a weak fiscal balance and an increase in food prices, reversed the disinflation trend observed since March 2013. In November 2013 inflation increased to 22.9 percent, as the Kwacha depreciated sharply largely due to the loss of significant donor support resulting from the fiscal scandal, though the level of official reserves was at its highest, in recent years.

The monetary policy stance continues to be prudent. The Bank Rate has remained at 25 percent since January 2013. The liquidity reserve ratio (LRR) was maintained at 15.5 percent during 2013. In the December 2013 Monetary Policy Committee meeting, the authorities decided to introduce measures to strengthen the LRR instrument by changing its composition, effective January 1, 2014. Although the LRR was not changed, the exclusion of vault cash from the LRR together with the requirement that eligible financial institutions will be prohibited from drawing down balances at the central bank to below 12 percent at all times has effectively increased the LRR. In addition they introduced a Lombard Facility, whose rate will be set at a spread of 2 percentage points above the Bank Rate to assist banks to manage their liquidity better.

While real GDP growth for 2013 is estimated at 5 percent, there are downward risks emanating from agriculture and mining. Nonetheless, all sectors of the economy are expected to register positive growth rates in 2013; and in particular, a significant rebound in growth is expected in manufacturing.

Program performance

In spite of the daunting challenges, my authorities continue to demonstrate a steadfast commitment to pursuing prudent macroeconomic and structural policies within the context of the ECF program. They adhered to most of the ECF program's quantitative targets for end-March and end-June 2013. The continuous performance criterion on new nonconcessional external debt was missed inadvertently resulting from the use of an out-of-date discount rate. While the net international reserves target for end-September 2013 was met by a wide margin, targets related to the fiscal and net domestic assets of the RBM were missed as a result of the fraud discussed above, as well as due to higher interest payments than programmed, peace keeping operations and spending on social services in advance of grant receipts. My authorities, in consultation with staff, have already started to implement remedial measures to address the slippages. The December 13, 2013 outturn discussed in staff's supplement to the Board is a testament to their commitment to stay the course.

It is against this backdrop that my Malawi authorities solicit the Executive Board's support in completing the third and fourth reviews under the ECF arrangement and waiver for the nonobservance of performance criterion as indicated above. Moreover, they seek approval of their request for re-phasing of test dates and associated disbursements to better align the ECF review cycle with Malawi's budget calendar.

Fiscal policy

The authorities remain committed to pursuing sound fiscal management with a view to maintaining medium to long-term fiscal sustainability. In light of the large fiscal gap created by the overspending in the first quarter and suspension of budget support by donors in response to the fraud, the authorities are implementing policy adjustments to avert a resurgence of inflation and to preserve international reserve levels. While domestic revenue continues to perform better than expected, expenditure compression is still needed to close the emerging fiscal gap. The authorities put in place expenditure measure that include reductions in the travel budget and in other lower priority expenditure items, postponed domestically financed development projects while preserving social spending.

The authorities are also instituting appropriate fiscal policy measures to strengthen domestic revenue collection while ensuring that fiscal discipline is restored. In this regard, the Malawi Revenue Authority (MRA) has embarked on modernization efforts to strengthen VAT enforcement as well as an initiative to improve taxpayer compliance.

MRA also has given taxpayers a three-month window to disclose and pay without interest and penalty for outstanding tax liabilities.

On the public financial management front, my authorities would like to assure the Executive Board that they will continue to work with the IMF and the World Bank to address weaknesses in expenditure control which have resulted in excessive domestic borrowing and government payment arrears in the past. Through a Multi-Donor Trust Fund the authorities are implementing the Financial Reporting and Oversight Improvement Project. In addition, the authorities, with financial support from the German government, plan to commission a forensic audit going back to 2005 when the IFMIS system was introduced.

Monetary and exchange rate policy

Given the prevailing high levels of inflation, the RBM will continue with its tight monetary policy stance until overall inflation is brought down to single digits. This objective will be pursued through the use of a range of instruments such as open market operations, the Bank Rate, and foreign exchange operations.

My authorities consider that the current flexible exchange rate regime has served the country well. As a result, central bank intervention in the foreign exchange market will be limited to smoothening out market volatility and building international reserves. In particular, the RBM's participation in the foreign exchange market will be guided by the need to accumulate and maintain reserves at about 3 months of import cover while at the same time endeavoring to minimize large swings in the Kwacha exchange rate.

Financial sector

Malawi's financial system remains broadly sound. In addition to the policies outlined above, the RBM intends to upscale its oversight and supervision of financial institutions. It will also continue with its efforts aimed at improving the functioning and efficiency of financial markets and fostering the development of financial markets.

Conclusion

The economic policy reforms that my authorities have been implementing since May 2012 are showing some positive results and they are determined to stay the course. The swift response by my authorities in instituting appropriate corrective policy measures to address the fiscal slippages underscores their commitment to implementing the ECF program. My authorities consider the Fund's and other development partners' policy advice and financial assistance critical to improve the well being of Malawians through policies that promote sustained growth and poverty reduction.