Malawi: Ninth Review Under the Extended Credit Facility Arrangement and Request for Waivers for Nonobservance of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Malawi

INTERNATIONAL MONETARY FUND

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MALAWI

July 2017

NINTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAWI

In the context of the Ninth Review under the Extended Credit Facility Arrangement and Request for Waivers for Nonobservance of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 21, 2017, following discussions that ended on March 22, 2017, 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 June 7, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- 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*
*Also included in Staff Report.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 17/236
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June 21, 2017

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Washington, D. C. 20431 USA

IMF Executive Board Completes Ninth Review under Malawi's ECF Arrangement and Approves US$ 26.9 Million Disbursement

- The program is aimed at macroeconomic stability, growth, economic diversity and reduced poverty.
- Real GDP Growth is expected to pick up in 2017 due to better prospects for agricultural output.
- The macroeconomic outlook remains challenging, reflecting uncertainties related to adverse weather conditions and policy slippages.

The Executive Board of the International Monetary Fund (IMF) today completed the ninth and final review of Malawi's economic performance under the program supported by an Extended Credit Facility (ECF) arrangement[1]. The Board's decision enables the immediate disbursement of the equivalent of SDR 19.5 million (about US$ 26.9 million), bringing total disbursements under the arrangement to the equivalent of SDR 138.8 million (about US$ 191.4 million).

In completing the reviews, the Board also approved the authorities' request for waivers of non-observance of performance criteria related to the net domestic assets and net international reserves of the Reserve Bank of Malawi, and net domestic borrowing by the central government.

The ECF arrangement for Malawi in the total amount of SDR 104.1 million (about US$ 143.5 million) was approved on July 23, 2012 (see Press Release No. 12/273). An augmentation of access by the equivalent of SDR 34.7 million (about US$ 47.8 million or 25 percent of quota) was approved by the Board on June 20, 2016 (see Press Release No. 16/295) to strengthen the country's response to the El Niño-induced drought. The program is aimed at the achievement and maintenance of macroeconomic stability and implementation of policies and structural reforms to spur growth, diversify the economy and reduce poverty[2].

[1] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

[2] For more details on Malawi's ECF arrangement, go to: www.imf.org/Malawi

At the conclusion of the Executive Board's discussion, Mr. Mitsuhiro Furusawa, Acting Chair and Deputy Managing Director, issued the following statement:

"Malawi's economy has been severely hit by two consecutive years of weather-related shocks, which placed an estimated 40 percent of the population at risk of food insecurity. Relief efforts helped stabilize maize prices and alleviate the adverse impact of the drought on the vulnerable population. Augmentation of access under the ECF arrangement and sizable contributions from development partners enabled the authorities to address the worst humanitarian crisis in its history.

"Real GDP Growth is expected to pick up in 2017 due to better prospects for agricultural output, including the maize harvest. Annual inflation is also expected to remain on a downward trend. However, the macroeconomic outlook remains challenging, reflecting uncertainties related to adverse weather conditions and policy slippages.

"The near-term policy mix should center on reducing inflation by combining tight monetary and fiscal policies. To this end, expenditures should be limited to available resources and monetary policy should aim at maintaining positive short-term real money market interest rates.

"Strengthening public financial management, including through strong commitment controls, routine bank reconciliations, and regular fiscal reporting, remains critical to preventing the misappropriation of public funds and rebuilding trust and confidence in the budget process.

"Implementation of prudent fiscal policy is important to safeguard medium-term fiscal and debt sustainability. Improved revenue mobilization and expenditure efficiency will reduce aid dependency and create fiscal space for social spending in pursuit of Malawi's sustainable development goals.

"Important steps have been taken to safeguard and strengthen financial sector stability, given the negative impact of weather-related shocks and the prevalence of credit concentration risks. To this end, the authorities are encouraged to closely monitor banks' compliance with prudential norms, including AML/CFT, increase provisioning, and facilitate rationalization of the banking sector. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral will contribute to a reduction in non-performing loans."

MALAWI

June 7, 2017

NINTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA

KEY ISSUES

The authorities, with substantial donor support, successfully addressed Malawi's worst humanitarian crisis after two consecutive years of drought. Floods and drought negatively impacted 2.8 million people during the first half of 2015. In 2016, a second consecutive year of drought hurt growth and further placed about 6.7 million people (40 percent of the population) at risk of food insecurity. The IMF's Executive Board's augmentation of access (25 percent of quota/US$49.2 million) to respond to the larger balance of payments need had a catalytic effect in fostering donor support.

The authorities implemented corrective measures that placed the ECF-supported arrangement on a sounder footing. For the ninth review, end-June 2016 performance criteria (PCs) were missed. The ceiling on net domestic financing (NDF) of the government and net domestic assets (NDA) of the central bank were missed owing to revenue shortfalls and recourse to central bank financing. The floor on net international reserves (NIR) was also missed, reflecting lower-than-expected export revenues owing to poor exports. Although some progress was made in implementing PFM reforms, end-structural benchmarks for the ninth review were not met. Staff level understandings on corrective measures were reached with the authorities during the September 2016 mission and at the sidelines of the 2016 Annual Meetings. The authorities have since then taken corrective actions to bring the macroeconomic program back on track and have completed all prior actions related to the structural reform agenda.

Outlook and risks: Real GDP growth is expected to range between 4–5 percent in 2017 owing to a good agricultural harvest and its expected spillovers to other sectors of the economy. Growth prospects, however, will be constrained by persistent power blackouts, water shortages, and access to credit. Real growth is expected to gradually increase over the medium term as macroeconomic conditions stabilize and investment and consumption levels rise. The outlook remains challenging, reflecting uncertainties related to weather conditions, the impact of the fall armyworm infestation on food crops and risks of policy slippages.

Policy discussions: Discussions focused on measures to: (i) keep inflation on a declining trend and preserve an adequate level of international reserves; (ii) consolidate the implementation of public financial management (PFM) reforms to ensure control over fiscal operations and build confidence in the budget process and re-engage donors; (iii) ensure medium-term fiscal sustainability through improved revenue mobilization and better allocation of public spending; (iv) preserve debt sustainability; and (v) enhance the resilience of the financial sector.

Approved By
Michael Ego Atingi (AFR) and Zeine Zeidane (SPR)

Discussions took place in Malawi during March 8–22, 2017 and continued during the Spring Meetings in Washington D.C. (April 21–24). The mission was led by Mr. Williams (AFR). Other members of the mission team were Mr. Nsengiyumva and Ms. Farahbaksh (all AFR), Mr. Gupta (SPR), Ms. Smith Yee (SEC), and Mr. Ree (Resident Representative). Messrs. Mkwezalamba and Sitimawina (OED) participated in the some of the discussions. The mission met with his excellency President Peter Mutharika, Minister of Finance Goodall Gondwe, 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.

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APPENDIX

CONTEXT

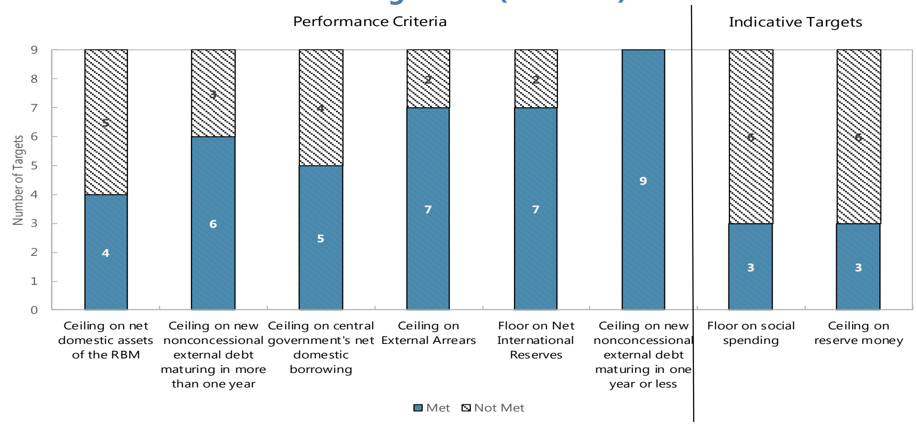
1. **Malawi's economy was hit hard by weather-related shocks over the last two consecutive years**. The El Niño-induced drought in 2016—the worst in Malawi's history—reduced maize production by a cumulative 42 percent and placed an estimated 6.7 million people (40 percent of the population) at risk of food insecurity. On June 20th, 2016, the IMF's Executive Board approved the augmentation of access (25 percent of quota/US$49.2 million) to respond to the larger balance of payments need caused by the humanitarian crisis. The augmentation had a catalytic effect in fostering donor support, which was coordinated by the World Food Program (Annex 1). The humanitarian relief (US$285 million or 5.2 percent of GDP) was successful and comprised the provision of maize, fortified cereals, and cash vouchers to the vulnerable population.

2. **The poor maize harvest and the humanitarian crisis played a significant role in end-June performance criteria (PC) not being met, and prevented the timely completion of the ninth review**. Slow progress in implementing the structural reform agenda for the ninth review compounded policy slippages. Against this backdrop, the Executive Board extended the ECF arrangement by 6 months to June 30, 2017 to provide time for the authorities to address slippages and complete the ninth and last review.

3. **The authorities acted on the recommendations of a Presidential Commission of Inquiry into maize procurement irregularities during the humanitarian crisis.** The commission found no fault in the pricing of maize or the loss of public funds. However, the commission noted there were procurement irregularities and recommended that senior government officials and the management of the Agricultural Development and Marketing Corporation (ADMARC) be sanctioned. It also recommended improvements in procurement procedures and in food security assessments. The implicated officials were subsequently dismissed from their posts.

4. **Overall, the implementation of the ECF arrangement approved on July 23, 2012, experienced multiple challenges**. Since the program's inception, there were several policy-induced slippages and adverse weather-related shocks that warranted extending the program on four occasions so that the authorities could undertake corrective actions. The uncovering of a large-scale theft of public funds in 2013 ("cashgate" scandal) damaged Malawi's macroeconomic outlook significantly, owing to the sudden withdrawal of 4½ percent of GDP in budget support. These developments impeded the achievement of sustainable growth and low inflation targeted under Malawi's growth and development strategy. Program targets on net domestic assets (NDA) of the central bank and net domestic financing of the central government (NDF) were frequently missed, while the target on net international reserves (NIR) was missed twice (Text Figure 1). However, the flexible exchange rate regime and automatic fuel pricing mechanism have served the country well as shock absorbers, and helped strengthen the external position as reflected in the improved reserve cover.

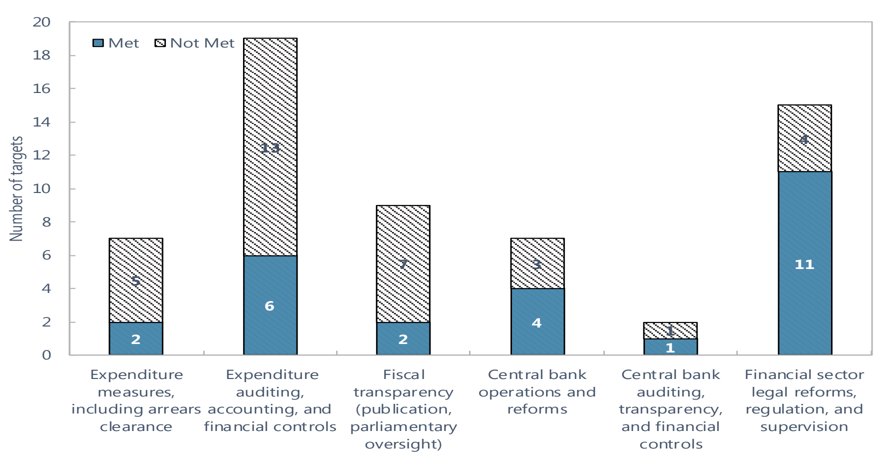
Text Figure 1. Performance Criteria and Indicative Targets Under the ECF Arrangement (2012–17)



Sources: Malawian authorities and IMF staff estimates.

5. **The implementation of structural reforms was mixed**. Progress in implementing PFM reforms was slow, as attested by the relatively high number of benchmarks that were not met (Text Figure 2). Some advances were made more recently, notably increasing the coverage and security of the Integrated Financial Information Management System (IFMIS), publishing budget execution, strengthening commitment controls, and reconciling government's accounts in FY2015/16. Progress in implementing monetary and financial sector reforms was sustained, which helped to safeguard financial sector stability and improved the monetary policy framework. The slow implementation of reforms to alleviate supply-side bottlenecks and reduce constraints to business activity has limited the resilience of the economy to shocks.

Text Figure 2. Structural Benchmark Under the ECF Arrangement (2012–17)



Sources: Malawian authorities and IMF staff estimates.

6. **Malawi's Economic Development Document (EDD) highlights the medium-term priorities aimed at accelerating growth and reducing poverty.** The EDD recognizes that efforts to reduce poverty have not borne the desired results as the poverty rate has remained steady at about

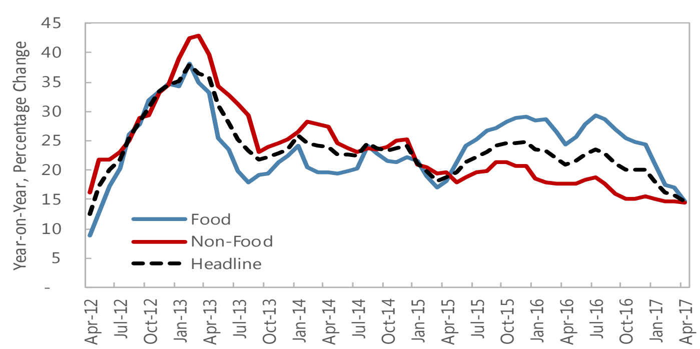
50.7 percent since 2011. Income distribution has also worsened over time. Achievements have been limited by the slow implementation of reforms, inadequate financial resources, natural disasters and macroeconomic instability characterized by high inflation and interest rates. The EDD identifies five key priority areas, namely: (i) agricultural and climate change management; (ii) education and skills development; (iii) energy and industrial development; (iv) transport and information and communications technologies infrastructure development; and (v) health and population management. The EDD lays the foundation for Malawi's successor Growth and Development Strategy, which will cover the period 2018–23.

7. **The macroeconomic situation in 2016 was affected by the weather-related shock (Figures 1–4)**:

- **Real GDP growth** is estimated to have fallen to its lowest level since 2014 at 2.3 percent. The region wide El-Nino-induced drought led to a cumulative decline in maize production by over 42 percent since 2015. The drought caused a reduction in hydroelectricity generation, led to severe electricity outages, increased operational costs, and low capacity utilization. This further reduced agricultural production and weakened the manufacturing and trade sectors. Economic activity was further affected by weak growth in credit to the private sector as banks reacted to heightened credit and market risks.

- **Annual inflation** reversed its increasing trend in mid-2016 and fell by 7 percentage points to 14.6 percent in April 2017, its lowest level since mid-2012. Both food and non-food inflation rates have contributed to the downward trend, reflecting tight monetary policy and the stabilization of maize prices due to humanitarian relief and the advent of favorable maize harvests (Text Figure 3.)

Text Figure 3. Malawi: Inflation (2012–17)



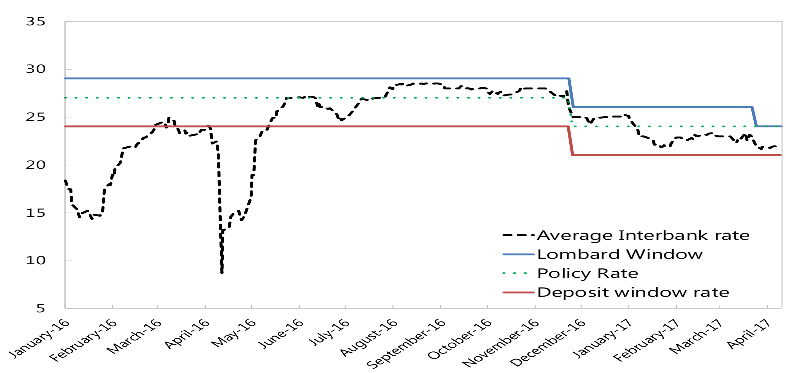
Sources: Malawian authorities and IMF staff estimates.

8. **Fiscal slippages emerged during the second half of the FY2015/16 budget, but the authorities regained control over budget execution in the first half of the FY16/17**. In the second half of FY2015/16, revenue shortfalls reflecting weaker economic activity due to the drought and higher-than-programmed current spending led to higher domestic borrowing relative to the program. Current spending was higher than anticipated mostly due to interest payments on domestic debt resulting from tighter monetary policy. The overall fiscal deficit for FY2015/16 (6.4 percent of GDP) was ¼ percentage points higher than programmed.

9. **Budget execution was in line with the program during the first half of FY2016/17**. Revenue collection overperformed by about ½ a percentage point of GDP, reflecting the implementation of IMF tax policy recommendations expanding the coverage of VAT and eliminating several exemptions. The authorities kept firm control over spending by requiring detailed monthly fiscal reports from all spending units as a condition for the subsequent month's funding. Thus, NDF was held at a much lower level than programmed.

10. **Monetary policy was effective in ensuring that short-term money market rates remained aligned to the policy rate**. In response to a trend decline in nonfood inflation, the Monetary Policy Committee cut the policy rate by 300 basis points to 24 percent in November 2016 and by another 200 basis points in March 2017 (Text Figure 4). Average bank lending rates fell, reflecting cuts in the policy rate. The interbank rate has remained inside the interest rate corridor that was introduced in early 2016. Growth in real credit to the private sector remained negative for most of the 2012–16 period due to high inflation, economic uncertainties, and tighter bank lending conditions.

Text Figure 4. Malawi: Interest Rate Corridor (Jan. 2016–Apr. 2017)



Sources: Malawian authorities and IMF staff estimates.

11. **The external current account deficit widened by 5.5 percentage points to 13.5 percent of GDP in 2016**. The deterioration reflects increased maize imports and related services in response to the humanitarian crisis, low export receipts due to lower international commodity prices, and the impact of drought on export volumes. The increase in tobacco exports, owing to a drawdown of past inventory, was insufficient to offset the decline in non-tobacco exports.

12. **The kwacha depreciated in line with program understandings on the exchange rate in response to the shocks**. It depreciated by 27 percent in nominal effective terms and 14 percent in real effective terms in 2016, relative to 2015. The exchange rate depreciated by less than one percent by mid-May 2017. These developments enabled reserve cover to be maintained at about 3 months of imports.

13. **Vulnerabilities in the financial sector have increased as economic growth declined and liquidity conditions tightened**. The ratio of total non-performing loans (NPLs) to total loans rose by

about 6 percentage points at end-2016 to 17 percent. All banks except two are in compliance with the regulatory minimum capital. The RBM is closely monitoring the situation of these two problem banks and has agreed on a time-bound recapitalization and restructuring measures.

14. **Policy slippages that delayed completion of the ninth review have been corrected**. End-June 2016 PCs on NDF of the central government and NDA of the central bank were missed due to revenue shortfalls and increased recourse to central bank financing. The PC on NIR was also missed owing to weaker export revenues despite better-than-expected tobacco exports. Corrective measures implemented during the second half of 2016, brought informal targets for NDA and NDF at end-December in line with domestic financing underpinning the FY16/17 budget and the program's objective of maintaining reserve cover of three months of imports. Nevertheless, the informal target of floor on NIR at end-December 2016 was missed owing to the continued weak export revenues. Six PFM structural benchmarks for end-June 2016 were missed (MEFP, Table 3), but macro-critical reforms have since been implemented (MEFP, Table 4).

ECONOMIC OUTLOOK AND RISKS

15. **The macroeconomic outlook remains challenging, reflecting uncertainties related to weather conditions and the need to maintain tight fiscal and monetary policies to entrench the recently attained macroeconomic stability**. Medium-term projections are predicated on a policy mix to reduce inflation, the normalization of weather conditions, and on the authorities' commitment to address key supply-side bottlenecks (electricity, water, and feeder roads).

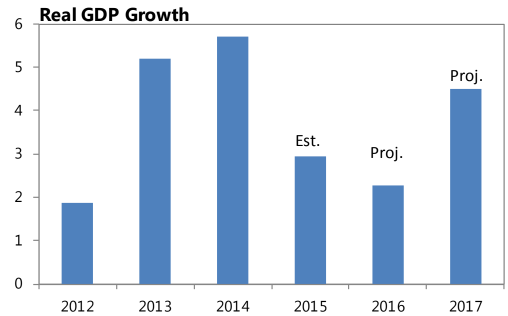
- **Real GDP Growth** is projected to pick up to 4.5 percent in 2017, rising to the 5.5 percent range over the medium term, conditional on a recovery in the agricultural, construction, and the wholesale and retail sectors (Text Table 1). A recovery in credit to the private sector critically depends on a consistent policy mix that strengthens macroeconomic and financial stability. The implementation of structural reforms to enhance electricity supply, remove agricultural market distortions, and greater diversification is expected to support growth over the medium term.

- **Inflation** is expected to remain on a downward trend in 2017 and to reach single digits by end-2018, provided a tight fiscal and monetary policy stance is maintained and weather conditions remain favorable. This trend would be aided by the continued low international prices for food and petroleum products.

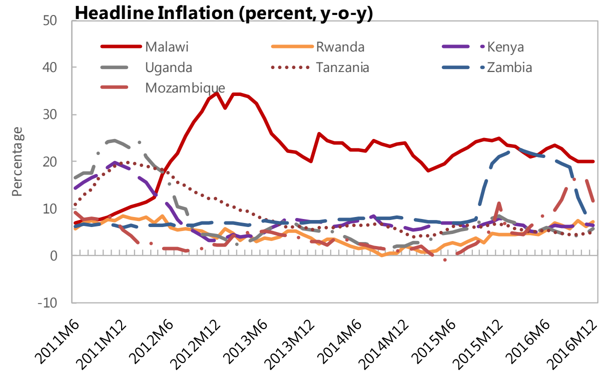
The external current account deficit is expected to narrow in 2017 owing to a rebound in exports and a decline in maize imports with the conclusion of the humanitarian crisis. It is projected to remain elevated, albeit declining in later years. These projections reflect the growth trend, the high import content of public sector projects, and the slow pace of export diversification.

Figure 1. Malawi: Recent Economic Developments, 2011–17

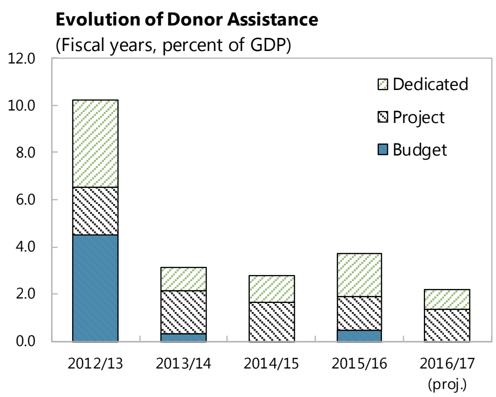
Economic activity continued to be affected by adverse weather since 2015 but is projected to rebound in 2017.



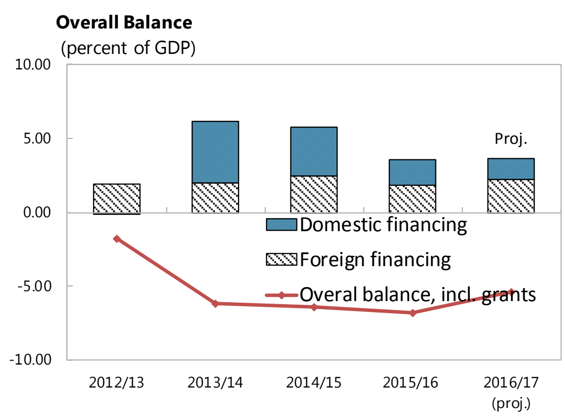
Headline inflation, while declining recently, remains high compared to neighboring countries.



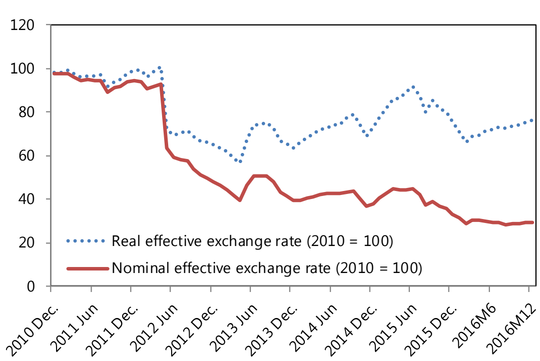
Donor assistance has been affected by the cashgate scandal since 2013/14.



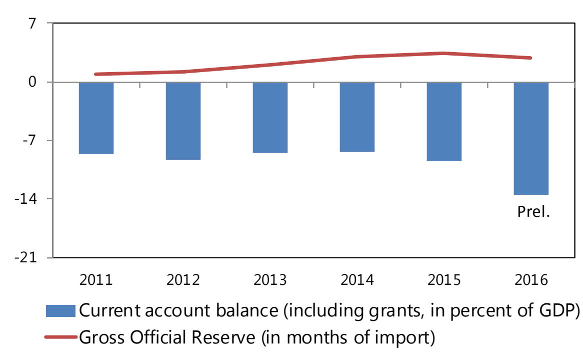
and fiscal adjustment has been insufficient.



The REER depreciated in 2016, reflecting the depreciation of the NEER.



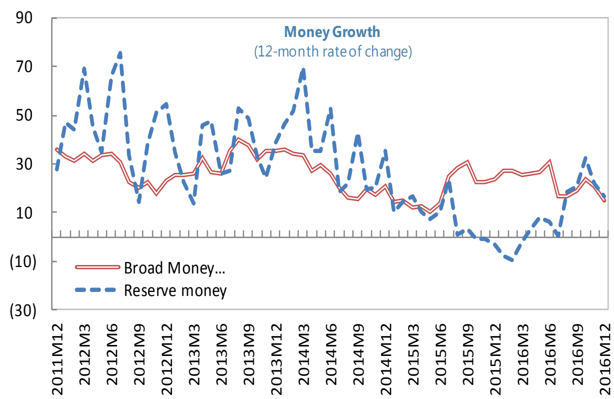
The current account deficit remained somewhat stable over 2011-15, but increased in 2016 due to humanitarian maize imports.



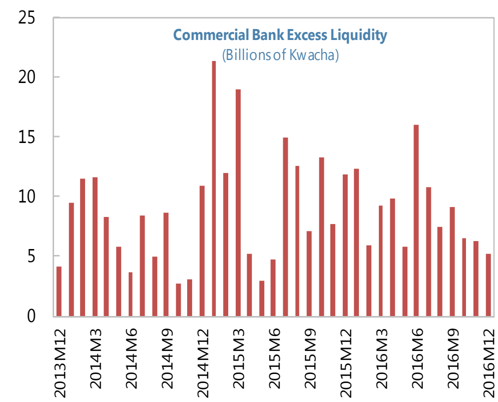
Sources: Malawian authorities and IMF staff estimates.

Figure 2. Malawi: Recent Monetary Developments, 2011–16

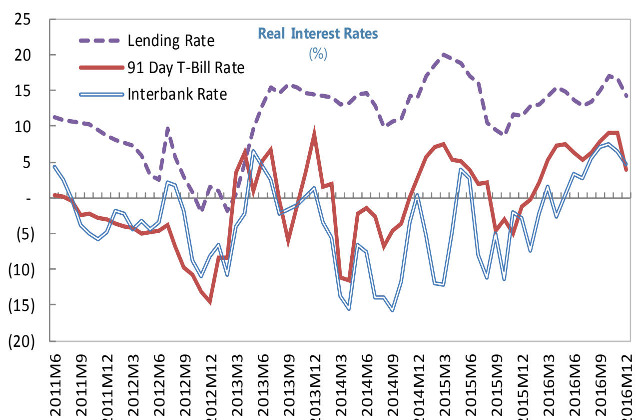
The broad money growth trend was reversed in mid-2015, mostly due to the valuation effect of a depreciating Kwacha.



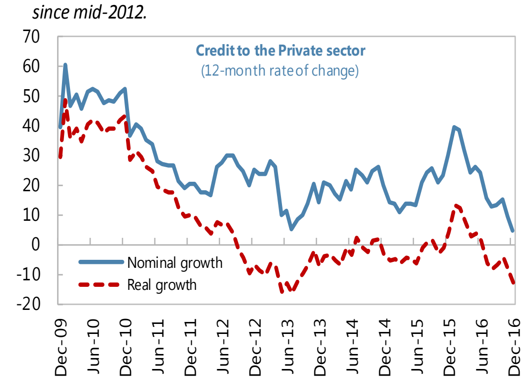
An active liquidity management has succeeded in reducing excess liquidity in the banking system since mid-2016.



Average real prime lending rate has remained elevated,

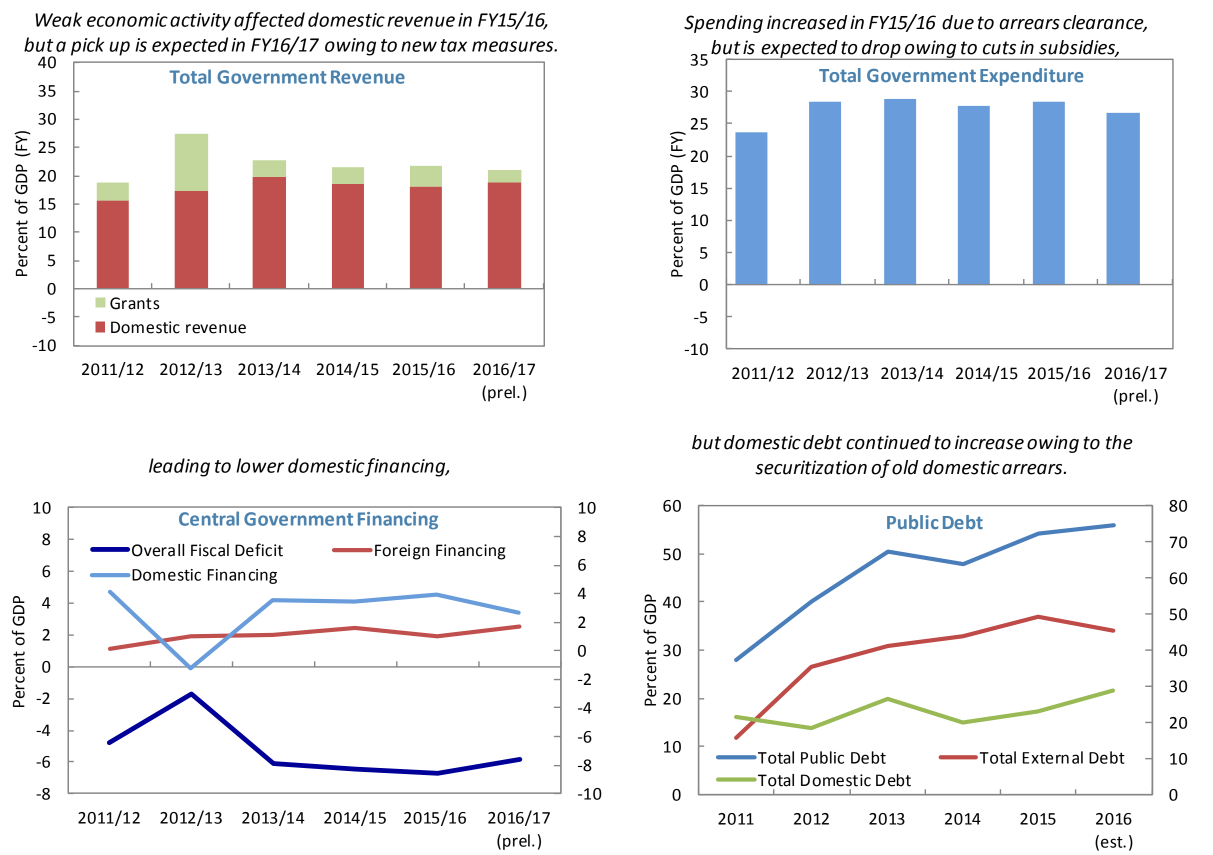


which contributed to keeping credit growth weak in real terms since mid-2012.



Sources: Malawian authorities and IMF staff estimates.

Figure 3. Malawi: Fiscal Developments and Outlook, 2011–17



Sources: Malawian authorities and IMF staff estimates.

16. **The above economic outlook faces downside risks**. These risks relate primarily to Malawi's continued vulnerability to weather-related shocks, amplified by the risks of policy slippages. Weather-related shocks and the Fall armyworm infestation could dampen agriculture production, which would spillover to other sectors of the economy and to export revenues, placing pressure on the kwacha and ultimately on overall growth and inflation. A slower-than-expected disinflation process could trigger demand for wage increases, and entrench a wage-price vicious cycle. Policy slippages—which have been frequent throughout the life of the program—remain a major risk that could increase in the run up to the 2019 elections. The

Text Table 1. Macroeconomic Outlook

	2016 Est.	2017	2018	2019	2020
		Projections			
GDP at constant market prices (percent change)	2.3	4.5	5.0	5.5	5.5
Consumer prices (% change, annual average)	21.7	14.5	11.7	9.9	9.6
Overal fiscal balance (percent of GDP, on a fiscal year basis)	-6.8	-5.4	-3.6	-2.8	-2.6
Credit to the private sector (percent change)	4.6	12.1	15.4	14.9	16.8
Gross official reserves (Months of imports)	2.9	3.0	3.1	3.3	3.5
Current account (percent of GDP)	-13.5	-9.3	-8.2	-7.8	-7.6
Total public debt (percent of GDP)	54.3	49.9	48.9	47.2	44.9

Sources: Malawian authorities and IMF staff projections.

retention of the floating exchange rate regime and the automatic fuel pricing mechanism would continue to serve as shock absorbers and support growth.

POLICY DISCUSSIONS

17. **Policy discussions centered on maintaining the tight fiscal stance to support monetary policy objective of reducing inflation, and on addressing key medium-term challenges.**

- **Near term** priorities are to: (i) keep inflation on a declining trajectory by pursuing a policy mix consistent with disinflation; (ii) accelerate the implementation of PFM reforms to re-establish trust in the budget process and re-engage donors, and (iii) strengthen commitment controls to prevent the re-emergence of domestic payment arrears.

- **Over the medium term**, continued implementation of a prudent fiscal policy is necessary to keep public debt-to-GDP ratio on a downward trajectory and improve efficiency of public spending. Policies should concentrate on safeguarding macroeconomic stability, consolidating PFM reforms, and further strengthening debt management. Given large balance of payments deficits and infrastructure needs, donor re-engagement and revenue mobilization are critical to ensuring adequate financing.

A. Maintaining a Tight Fiscal Policy to Achieve Debt Sustainability

Near-term policy issues

18. **The revised FY2016/17 budget was broadly in line with the program**. NDF was contained to 1.4 percent of GDP consistent with understandings on addressing the humanitarian crisis and the inflation objective.
The implementation of fiscal measures comprising eliminating VAT zero ratings and exemptions, and repealing customs-related industrial rebate schemes have boosted revenues (Text Table 2). The annual yield expected from these measures in FY2016/17 is 0.8 percent of GDP. Spending was higher than projected at the time of seventh and eighth reviews owing to arrears clearance, maize purchases, and domestic interest expense. However, outlays on the fertilizer subsidy program were reduced by one percentage point of GDP reflecting the implementation of reforms.

Text Table 2. Expected Gains from the New Tax Measures (FY2016/17)

Difference (% of GDP)	Current Proj. - 7th & 8th Review
Tax revenue	0.83
Income and profits	(0.47)
Goods and services	1.07
VAT	0.81
Excise Duties	0.25
International trade	0.24
Other	(0.01)

Sources: Malawian authorities and IMF staff estimates.

Note: Income and profits exclude the one-off capital gains tax equivalent to about 0.3 percent of GDP.

19. **Staff reached broad understandings with the authorities on the FY2017/18 budget (MEFP¶ 28)**. The FY2017/18 budget aims at continuing the stabilization process by containing NDF to 0.5 percent of GDP while shifting the composition of the budget towards capital spending to boost

growth prospects. The budget includes further measures to enhance revenue collection, including the introduction of an additional bracket for highly paid individuals, further strengthening of tax compliance and modernization of tax administration. Total domestic revenue is expected to remain unchanged (after excluding one-off revenues of 0.3 percent of GDP in FY16/17). On the expenditure side, the authorities seek to contain the wage bill to 6.1 percent of GDP, notwithstanding the planned hiring of new teachers. They also intend to contain the travel budget and to sustain the reform of the fertilizer subsidy program, while providing outlays for the 2019 general elections. The disbursement of the US$80 million World Bank's budget loan will allow the government to increase domestically-financed capital spending and clear old arrears.

20. **Good progress has been made in regularizing past domestic payment arrears (MEFP, ¶9)**. The stock of pre-FY14/15 arrears, which were estimated in 2014 at MK157 billion (about 6.1 percent of 2014 GDP) have been audited and certified by the National Audit Office. By end-March 2017, MK175.5 billion had been securitized through the issuance of zero-coupon promissory notes of maturities varying from one to three years. The increase was due to the depreciation of the exchange rate as part of the arrears were related to the fertilizer supplied under the subsidy program which were denominated in U.S. dollars. To mitigate these forex-related risks, the authorities will retire most of these arrears linked to fertilizer procurement. Arrears that arose in FY14/15 (0.5 percent of GDP) were reduced to 0.2 percent of GDP after being audited and were also securitized. Those that arose in FY15/16 (0.4 percent of GDP) will be audited once verified by the relevant Ministries. To prevent accumulation of new arrears, the authorities have strengthened commitment controls by holding controlling officers accountable. Ministries will provide monthly detailed fiscal reports before receiving new allocations and deduct any new arrears from those allocations.

Medium-term Policy Issues

21. **Safeguarding medium-term fiscal and debt sustainability will require the continued pursuit of prudent fiscal policy**. Malawi's domestic debt has risen sharply, underscoring the need to anchor the fiscal policy on a primary fiscal balance consistent with a gradual decline in NDF in order to bring debt to GDP ratio below 50 percent, while safeguarding social spending, and limiting non concessional borrowing.

22. **The authorities are committed to pursuing the implementation of broad based tax reforms (MEFP, ¶29)**. Their aim is to reach a level of revenue collection that would cover current spending over the medium-term. They plan to continue streamlining tax incentives, eliminating unproductive tax measures, and modernizing tax administration. Additional reforms include the implementation of a new personal income tax bracket on top incomes and the completion of repealing industrial rebate schemes. New tax policy initiatives will be guided by a shift in reliance on revenue collection from taxation of labor and investment (factors of production) to consumption to help spur growth, and will be complemented by tax administrative reforms guided by the results of the 2015 evaluation based on the Tax Administration Diagnostic Assessment Tool.

23. **The authorities indicated their commitment to improving the efficiency of public spending and safeguarding fiscal sustainability (MEFP, ¶27 and ¶33–34).** Currently, there is

limited fiscal space as the wage bill, interest payments, and subsidies/transfers account for more than 70 percent of domestic revenues in FY2016/17. This has created expenditure rigidities and has crowded out growth-enhancing spending. The authorities noted that disinflation would lower interest costs (4 percent of GDP) and create the fiscal space needed to increase social and capital spending. Containing the wage bill and the continued civil service and subsidy reform will create additional fiscal space. Staff and the authorities concurred on the need to migrate cautiously to the new defined contribution pension scheme required by the 2010 Pension Act. Staff concurs with the authorities on the need to concentrate on reducing the liabilities of the current public pension scheme by adjusting its parameters in line with the recommendations of a IMF technical assistance mission. These changes would include (i) raising the service retirement age; (ii) lowering the generosity of benefit indexation; and (iii) reducing accrual rates. Finally, the automatic fuel pricing mechanism has continued to serve as a shock absorber and growth-supporting tool. Going forward, changes to the fuel import regime, notably to improve the fuel security situation, should be fully transparent and include consultations with all stakeholders to avoid growth-damaging disruptions in supply.

B. Accelerating the Implementation of Priority PFM Reforms

24. **Progress has been made in implementing priority PFM reforms (MEFP, ¶13 and ¶32)**. Budget control has been strengthened through enforcing monthly fiscal reporting (with a one month lag) by the ministries, departments, and agencies (MDAs). MDAs are now subject to budget cuts if they fail to submit five mandatory fiscal reports (revenue return, expenditure report, commitment report, bank reconciliation of other recurrent transactions and development accounts, and payroll return) in a timely manner. A fully functional Cash Management Unit has been established to better align spending with available resources. Coverage of transactions in the IFMIS has been increased, notably by introducing a multi-currency software to capture most government expenditures. Redundant and dormant bank accounts have been closed, which is a prerequisite for introducing a Treasury Single Account. To improve fiscal transparency, the FY2015/16 monthly budget execution has been published on the Ministry of Finance's website. The authorities will ensure that bank reconciliation is conducted on a regular basis.

25. **The completion of bank reconciliation for the FY15/16 gives new momentum to institutionalize PFM reforms (MEFP, ¶30–31)**. With assistance from the IMF PFM advisor, the authorities were able to address challenges in reconciling all government bank accounts for the FY2015/16 transactions. Success in bank reconciliation will enable the authorities to further improve budget control and reporting and to institutionalize the process going forward. These improvements include: (i) unifying data coverage and definitions and the tracking of commitments and domestic arrears, (ii) producing unaudited quarterly financial statements within six weeks after the end of the quarter with fully reconciled items; (iii) producing and publishing quarterly budget execution based on actual expenditure; and (iv) implementing a new and more robust and comprehensive IFMIS.
In parallel, the authorities are pursuing the reconciliation of pre-2015/16 transactions, for which the final forensic audit reports are expected by October 2017. These reports, will enable the Accountant General's Department to establish an accurate starting position for future reconciliations. With help from the World Bank, the authorities will undertake a strategic review of ADMARC, its functions,

governance arrangements and oversight mechanisms to improve the transparency of its financial performance and market operations.

C. Pursuing a Tight Monetary Policy and Improving its Architecture

26. **Staff emphasized the need to maintain a tight monetary policy stance to ensure that inflation remains on a declining trajectory**. The authorities have used open market operations in the interbank and treasury bill markets to maintain positive real money market interest rates. The recent implementation of an overnight deposit facility that facilitates the establishment of an interest rate corridor in the interbank market has been instrumental to achieve this goal. Keeping money market interest rate positive in real terms should encourage the demand for the Kwacha, and mitigate depreciation pressures.

27. **The RBM reiterated its commitment to further strengthen its monetary policy framework (MEFP, ¶20–22)**. The authorities aim to gradually transition from the current monetary aggregate targeting framework to a full interest rate-based monetary framework, but this is conditional on reducing fiscal dominance. Maintaining the functioning of the interest rate corridor, together with fiscal consolidation, should reduce interest rate volatility, increase policy credibility, and improve the monetary policy transmission mechanism. This transition will require further capacity development in liquidity management, a deeper understanding of the monetary transmission mechanism, and improvements in inflation forecasting capacity. In parallel, the RBM should improve its communication with the public by better explaining changes in its monetary policy stance and the envisaged future path for inflation. The staff and the authorities concurred that greater fiscal discipline and improved PFM systems will be critical to strengthening policy credibility and anchoring inflation expectations.

D. Enhancing Financial Sector Stability

28. **Combining tight monetary conditions with efforts to strengthen financial sector resiliency and stability remains a key priority (MEFP, ¶23–24).** Policy slippages, arrears arising from fiscal imbalances, weak economic activity, and high lending rates reflecting the inflation premium and increased credit risks, have contributed to rising NPLs, and hurt banking sector profitability. While provisioning remains critically low, implementation of the May 2014 asset classification directive, which imposes higher and graduated provisioning rates, is expected to increase the provisions to NPLs ratio over time. Additionally, the RBM has stepped up surveillance of the banking sector in the wake of negative shocks and spillovers from the fiscal sector. It is closely monitoring the recapitalization and restructuring process of two banks with capital ratios below the prudential requirements. These two banks (7.7 percent of banking assets) are expected to be fully recapitalized through a right issue and a merger by end-June 2017.[1]

29. **The authorities remain committed to taking additional steps to strengthen the banking sector (MEFP, ¶25–26)**. They are enhancing both on-site and off-site supervision, closely monitoring

[1] The undercapitalized bank (1.2 percent of banking assets) is expected to merge with a larger bank (14 percent of banking assets).

and enforcing compliance with prudential norms, and strengthening the supervisory skills of RBM staff. Recent stress tests confirmed that loan concentration remains the major risk to the banking system due to the limited number of large bankable borrowers, and will need to be closely monitored. In addressing this risk, the RBM has stipulated that banks double their capital from $5 million to US$10 million by 2020. Addressing concentration risk require undertaking surveillance of large borrowers for early detection of default risk and enforcing the single borrower exposure limit. Following the enactment of the Financial Crimes Act of 2017 (prior action), the authorities are encouraged to effectively use AML/CFT tools to mitigate risks of money laundering and corruption proceeds flowing into the financial sector.

E. Preserving Debt Sustainability

30. **Malawi's debt level remains high compared to other SSA low-income countries, but is projected to decline gradually (MEFP ¶35)**. Since the HIPC and MDRI debt relief in 2006, Malawi's debt has more than doubled in 10 years and now stands at around 54.3 percent of GDP compared to 26.7 percent of GDP in 2007, just after debt relief. The composition of debt has shifted from external to domestic borrowing due to recourse to domestic financing after the withdrawal of budget support.

31. **The nominal level of gross domestic debt has increased significantly**. The increase in gross domestic debt during 2011–16 reached MK718 billion. This accumulation was due to: (i) net domestic financing of fiscal deficit; (ii) the securitization of old arrears; and (iii) the recapitalization of the central bank and one public bank.

32. **The risk of external debt distress remains moderate.** The debt sustainability analysis (DSA) undertaken jointly by Fund and World Bank staff concluded that all baseline external debt burden indicators remain below their policy-dependent debt-burden thresholds, but vulnerability to exogenous shocks, notably shocks to export revenues and exchange rate, have increased. The projected borrowing path and debt policies remains broadly similar to the path envisioned in the June 2016 IMF/WB DSA. accumulation.

PROGRAM ISSUES

33. **Completing the ninth review was conditional on the authority's implementation of five prior actions, which have all been met (MEFP, Table 4).** The Auditor General certified the bank reconciliations in line with Malawi's PFM Act. The authorities are requesting waivers for the nonobservance of three periodic PCs (LOI ¶6). The PCs on the NDF of the central government and on the NDA of the central bank were missed at end-June 2016 due to revenue shortfalls and recourse to central bank financing. A waiver on these two PCs is requested based on the strong remedial actions taken to bring domestic borrowing back on track. The PC on net international reserves was missed at end-June 2016 because of the El Niño-induced drought on exports. A waiver on this PC is requested based on the large depreciation of the currency during the first half of 2016 and an improvement in the policy mix, including tighter monetary and fiscal policies.

34. **Malawi's capacity to repay the Fund is adequate**. The new disbursement under the ECF arrangement will have a negligible impact on debt and debt service ratios (Table 8) and Malawi's risk of debt distress remain moderate.

35. **The RBM is strengthening its safeguards framework, but the recommended legal amendments to enhance its autonomy remain outstanding.** The RBM's Board has revised its investment policy to only invest its foreign assets in investment-grade institutions and to limit their exposure and concentration. The revised policy expected to be implemented by end-June. To address weaknesses identified in transactions with government, the RBM and the government signed a memorandum of understanding on banking services that defines the respective role and responsibilities of both parties. However, the recommended legal amendments to strengthen RBM's autonomy and further restrict extension of credit to government have not yet been implemented.

STAFF APPRAISAL

36. **The authorities with substantial donor support successfully addressed the worst humanitarian crisis in the Malawi's history**. The provision of maize, fortified cereals and cash transfers to the food insecure (40 percent of the population) was instrumental in improving nutrition and hygiene. However, there is a need to strengthen the economy's resilience by improving agricultural productivity through increased irrigation, removing distortions, and strengthening the governance of the state grain marketing board.

37. **Keeping inflation—that mostly hurts the poor—on a downward trend is the most critical near-term priority**. This will require maintaining tight fiscal and monetary policies including by keeping domestic financing within agreed ceilings consistent with disinflation. The authorities should avoid lowering the policy rate before it becomes clear that headline inflation is on a sustained downward trend.

38. **Consolidating PFM reforms is indispensable to maintaining trust and confidence in the budget process and ensuring control over fiscal operations.** Greater commitment control that contains expenditures to available resources will mitigate the emergence of domestic payment arrears and allow domestic financing to be limited to budgeted amounts. The restoration of routine bank reconciliation and regular fiscal reporting is critical to fostering fiscal integrity and transparency.

39. **Staff commends the authorities for their revenue mobilization efforts.** They should continue with implementing the remaining tax measures proposed by FAD, including the introduction of an additional bracket for highly paid individuals, further strengthening tax compliance and modernizing the tax administration.

40. **Improving expenditure efficiency will create fiscal space for social and other priority spending**. The authorities are commended for ongoing reform of the farm input subsidy program and are encouraged to strengthen control over the wage bill and other current spending and shift the composition of the budget in favor of higher social and capital spending.

41. **Important measures already adopted to improve the resilience of the banking system need to be consolidated.** Given the recent shocks and the rise in credit risks, staff encourages the authorities to continue to strengthen bank supervision (including ensuring AML/CFT compliance), closely monitor banks' compliance with prudential norms, and push for increased provisioning, and bank mergers. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral remain critical to the reduction of NPLs.

42. **The floating exchange rate regime and the automatic fuel pricing mechanism have served Malawi well as shock absorbers**. Relative exchange rate stability that benefitted from prudent monetary policy management should be sustained. Staff cautions that any changes to the fuel import regime, notably to improve fuel security situation, should be fully transparent and include consultations with all stakeholders to avoid growth-damaging disruptions in supply.

43. **Staff recommends the completion of the ninth review**. This recommendation is based on strong policy implementation during the second half of 2016 to bring the program back on track, the completion of prior actions for this review, and on the strength of the reform agenda articulated by the authorities in their memorandum of economic and financial policies. Staff also supports the authorities' request for waivers on missed end-June 2016 PCs for the ninth reviews based on the strong corrective actions already taken. Staff recommends a return to the 12-month cycle for Article IV Consultations, in accordance with Decision 14747, as amend

Table 1. Malawi: Selected Economic Indicators, 2014–20
(with rebased nominal GDP)

	2014	2015	2016		2017	2018	2019	2020
17-May-17	Act.		Prog.[1]	Est.	Proj.		Proj.	
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	5.7	3.0	2.7	2.3	4.5	5.0	5.5	5.5
Nominal GDP (billions of Kwacha)[2]	2,570	3,201	3,892	3,919	4,648	5,388	6,187	7,094
GDP deflator	20.9	21.0	18.3	19.7	13.5	10.4	8.9	8.7
Consumer prices (end of period)	24.2	24.9	15.8	20.0	13.6	10.2	9.9	9.8
Consumer prices (annual average)	23.8	21.9	19.7	21.7	14.5	11.7	9.9	9.6
Investment and savings (percent of GDP)								
National savings	3.6	2.7	-0.4	-3.3	2.6	4.0	5.1	6.0
Gross investment	12.0	12.2	13.6	10.2	11.9	12.2	12.9	13.7
Government	4.6	5.4	6.5	4.2	5.3	5.3	5.5	5.7
Private	7.4	6.7	7.0	6.0	6.5	6.9	7.4	7.9
Saving-investment balance	-8.4	-9.4	-13.9	-13.5	-9.3	-8.2	-7.8	-7.6
Central government (percent of GDP on a fiscal year basis)[3]								
Revenue	22.8	21.4	22.5	21.7	22.2	21.6	21.5	21.5
Tax and nontax revenue	19.7	18.6	18.6	18.0	20.0	19.8	19.8	19.8
Grants	3.1	2.8	3.9	3.7	2.2	1.8	1.7	1.7
Expenditure and net lending	28.9	27.8	28.6	28.5	27.6	25.2	24.3	24.1
Overall balance (excluding grants)	-9.2	-9.2	-10.0	-10.5	-7.6	-5.4	-4.5	-4.3
Overall balance (including grants)	-6.1	-6.4	-6.1	-6.8	-5.4	-3.6	-2.8	-2.6
Foreign financing	2.0	2.5	3.1	1.9	2.5	3.1	2.6	2.5
Total domestic financing	4.2	4.0	2.6	4.6	2.9	0.5	0.3	0.1
Financing gap	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Discrepancy	-0.1	0.0	0.0	0.3	0.0	0.0	0.0	0.0
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)								
Money and quasi money	20.7	23.7	16.7	15.2	18.6	17.1	16.9	16.5
Net foreign assets	20.6	15.5	-1.8	2.1	4.4	9.2	11.2	9.5
Net domestic assets	0.1	8.1	18.4	13.1	14.1	7.9	5.7	7.0
Credit to the government	-5.9	7.6	10.1	17.4	10.0	2.1	0.6	-0.2
Credit to the private sector (percent change)	20.0	29.9	20.3	4.6	12.1	15.4	14.9	16.8
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,752	1,635	1,670	1,597	1,707	1,825.7	1,937.8	2,069.3
Imports (goods and services)	2,395	2,346	2,604	2,508	2,478	2,577.6	2,688.5	2,858.7
Gross official reserves	588	670	660	605	648	694.0	789.9	878.4
(months of imports)	3.0	3.4	3.2	2.9	3.0	3.1	3.3	3.5
(percent of reserve money)	130.3	216.2	181.0	182.3	171.1	171.3	180.2	182.2
Current account (percent of GDP)	-8.4	-9.4	-13.9	-13.5	-9.3	-8.2	-7.8	-7.6
Current account, excl. official transfers (percent of GDP)	-8.3	-9.8	-13.9	-13.5	-9.3	-8.2	-7.8	-7.6
Real effective exchange rate (percent change)	8.7	15.3	...	-13.9	...	…	…	…
Overall balance (percent of GDP)	2.7	0.9	-1.5	-1.9	0.6	1.1	1.5	1.4
Financing gap	0.0	0.0	48.5	0.0	0.0	0.0	0.0	0.0
Terms of trade (percent change)	2.4	13.0	5.9	1.7	-5.3	-1.1	-0.6	0.5
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)	33.1	37.3	33.2	33.1	30.9	31.2	31.5	31.3
NPV of external debt (percent of exports)	110.8	109.2	86.4	88.6	85.8	86.3	86.0	85.1
Domestic public debt	14.9	17.3	18.9	21.2	19.0	17.7	15.7	13.6
Total public debt	48.0	54.6	52.1	54.3	49.9	48.9	47.2	44.9
External debt service (percent of exports)	4.7	7.4	11.8	12.3	10.4	6.2	5.3	5.2
External debt service (percent of revenue excl. grants)	7.2	10.2	18.3	19.0	14.1	8.3	7.2	7.1
91-day treasury bill rate (end of period)	26.9	23.6	...	24.0	…	…	…	…

Sources: Malawian authorities and IMF staff projections.

1. The current GDP base year is 2010.

2. The fiscal year starts in July and ends in June. The current fiscal year, 2016, runs from July 1, 2015 to June 30, 2016.

3. Numbers reflect re-classification of project and dedicated grants from current account to capital account.

Table 2a. Malawi: Central Government Operations, 2014/15–2019/20

(Billions of Kwacha)

	2014/15	2015/16	2016/17			2017/18		2018/19	2019/20
17-May-17	Actual	Actual	Prog.[1]	Proj. aut.	Proj. Staff	Proj. Aut.	Proj. Staff	Proj.	
Revenue	610	765	905	993	946	1,100	1,080	1,236	1,418
Tax and nontax revenue	530	634	784	854	852	993	988	1,141	1,309
Tax Revenue	463	564	709	755	755	901	896	1,034	1,187
Taxes on income and profits	233	289	393	410	384	477	459	534	613
Taxes on goods and services	189	225	264	288	309	362	364	417	479
Taxes on international trade	46	53	58	63	68	79	79	90	104
Other taxes	-6	-2	-5	-6	-6	-17	-7	-8	-9
Nontax revenue [2]	67	70	75	99	97	92	92	106	122
Grants	79	131	122	139	94	108	92	96	109
Budget support grants	0	17	0	0	0	16	0	0	0
Project grants	48	50	73	81	58	59	59	66	74
Dedicated grants	32	64	49	58	36	33	33	29	35
Expenditure and net lending	792	1,006	1,116	1,164	1,175	1,283	1,258	1,400	1,590
Current expenditure	640	838	862	898	954	1,012	1,013	1,091	1,222
Wages and salaries	197	226	261	271	271	304	304	350	402
Interest payments	115	133	144	184	184	186	188	182	178
Domestic	108	121	132	171	171	171	172	164	156
Foreign	7	12	12	12	12	15	15	19	22
Goods and services	158	202	231	276	276	280	280	327	376
Generic goods and services	78	86	82	97	97	123	123	140	161
Census	0	0	0	0	0	4	4	0	0
Road maintenance and storage levey expenses	9	23	21	24	24	28	28	39	45
Agricultural SWAP	0	6	8	4	4	5	5	6	7
Health SWAP	23	31	38	40	40	36	36	41	54
Education SWAP	23	21	25	25	25	25	25	29	36
National / local elections	1	1	2	2	2	8	8	11	4
PFEM	1	0	4	7	7	7	7	8	8
Statutory expenditures	8	5	5	5	5	3	3	3	4
National AIDS Commission	3	1	13	10	10	8	8	9	10
Maize purchases and winter cropping program	5	26	25	39	45	22	22	26	30
Rural electrification	6	2	9	23	17	12	12	14	16
Subsidies and other current transfers	139	172	166	165	165	198	198	224	258
Pension and gratuities	31	42	50	52	52	71	71	81	93
Transfers to road and revenue authorities	14	16	21	23	23	27	27	31	36
Transfers to public entities and households	39	49	55	57	57	67	67	73	85
Fertilizer and seed subsidy	55	64	40	33	33	33	33	38	44
Of which : seed subsidy	4	9	10	6	6	6	5	6	7
Arrears payments[3]	31	105	60	3	60	44	44	8	8
of which : Issuance of bonds for securitizing domestic arr	22	105	55	---	56	0	0	0	0
Development expenditure	152	167	250	263	217	267	241	304	364
Foreign financed	124	146	216	221	175	206	175	224	253
Domestically financed	28	21	35	43	43	61	66	81	111
Net lending	1	1	3.5	3.5	3.5	4	4	4	4
Overall balance (including grants)	-183	-240	-210	-171	-230	-183	-179	-163	-172
Discrepancy	-1	10	0	1	0	0	0	0	0
Overall balance (incl. grants and discrepancy)	-184	-230	-210	-171	-230	-183	-179	-163	-172
Total financing (net)	184	230	190	171	230	183	179	163	172
Foreign financing (net)	70	66	95	104	105	156	153	148	168
Borrowing	82	84	121	129	130	185	184	184	209
Budget support loans	0	0	0	0	0	60	59	0	0
Project loans	61	66	121	117	117	116	116	157	179
Other external loans[4]	20	18	0	13	13	9	9	26	30
Amortization	-12	-18	-26	-25	-25	-29	-31	-35	-42
Issuance of promissory notes for securitizing domestic arrear	20	105	55		56	0	0	0	0
Sale of non-financial assets (privatization proceeds)	0	0	0	11	11	0	0	0	0
Net domestic financing (NDF)	94	59	40	55	58	26	26	15	5
Financing gap	0	0	20	0	0	0	0	0	0
Memorandum items:									
Primary balance (including grants and discrepancy)	-69	-97.7	-66	13	-46	3	9	19	6
Domestic fiscal balance[5]	-137	-224.6	-113	-87	-145	-80	-91	-31	-24
Maturing promissory notes for domestic arrears	0	11.4	42	96	96	62	62	11	0
Nominal GDP	2,848	3,532	4,219	4,256	4,256	4,989	4,989	5,757	6,606

Sources: Malawi Ministry of Finance and IMF staff projections.

[1]Data from the IMF Country Report No. 15/83.

[2]Nontax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK25.4 billion, respectively.

[3]This includes promissory notes issued for the repayment of domestic arrears accumulated before FY2014/15.

[4]Other external loans in FY2014/15 include program loans from the World Bank for the financing of agriculture and education SWAPs and the National AIDS Commission (NAC).

[5]Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 2b. Malawi: Central Government Operations, 2013/14–2019/20

(Percent of GDP)

17-May-17	2013/14 Actual	2014/15 Actual	2015/16 Actual	2016/17 Prog.[1]	2016/17 Proj. Aut.	2016/17 Proj. Staff	2017/18 Proj. Aut.	2017/18 Proj. Staff	2018/19 Proj.	2019/20 Proj.
Revenue	22.8	21.4	21.7	21.5	23.3	22.2	22.1	21.6	21.5	21.5
Tax and nontax revenue	19.7	18.6	18.0	18.6	20.1	20.0	19.9	19.8	19.8	19.8
Tax Revenue	17.3	16.3	16.0	16.8	17.7	17.7	18.1	18.0	18.0	18.0
Taxes on income and profits	8.1	8.2	8.2	9.3	9.6	9.0	9.6	9.2	9.3	9.3
Taxes on goods and services	7.5	6.6	6.4	6.3	6.8	7.3	7.3	7.3	7.2	7.2
Taxes on international trade	1.8	1.6	1.5	1.4	1.5	1.6	1.6	1.6	1.6	1.6
Other taxes	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.3	-0.1	-0.1	-0.1
Nontax revenue[2]	2.4	2.4	2.0	1.8	2.3	2.3	1.8	1.8	1.8	1.8
Grants	3.1	2.8	3.7	2.9	3.3	2.2	2.2	1.8	1.7	1.7
Budget support grants	0.3	0.0	0.5	0.0	0.0	0.0	0.3	0.0	0.0	0.0
Project grants	1.8	1.7	1.4	1.7	1.9	1.4	1.2	1.2	1.2	1.1
Dedicated grants	1.0	1.1	1.8	1.2	1.4	0.8	0.7	0.7	0.5	0.5
Expenditure and net lending	28.9	27.8	28.5	26.4	27.4	27.6	25.7	25.2	24.3	24.1
Current expenditure	24.4	22.5	23.7	20.4	21.1	22.4	20.3	20.3	19.0	18.5
Wages and salaries	6.2	6.9	6.4	6.2	6.4	6.4	6.1	6.1	6.1	6.1
Interest payments	4.4	4.0	3.8	3.4	4.3	4.3	3.7	3.8	3.2	2.7
Domestic	4.2	3.8	3.4	3.1	4.0	4.0	3.4	3.5	2.8	2.4
Foreign	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Goods and services	7.9	5.5	5.7	5.5	6.5	6.5	5.6	5.6	5.7	5.7
Generic goods and services	2.9	2.7	2.4	1.9	2.3	2.3	2.5	2.5	2.4	2.4
Road maintenance and storage levy expenses	0.4	0.3	0.6	0.5	0.6	0.6	0.6	0.6	0.7	0.7
Agricultural swap	0.4	0.0	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Health SWAp	0.9	0.8	0.9	0.9	0.9	0.9	0.7	0.7	0.7	0.8
Education SWAp	0.9	0.8	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
National / local elections	0.5	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.1
PFEM	0.1	0.0	0.0	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Statutory expenditures	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
National AIDS Commission	0.4	0.1	0.0	0.3	0.2	0.2	0.2	0.2	0.2	0.1
Maize purchases and winter cropping programs	0.6	0.2	0.7	0.6	0.9	1.1	0.4	0.4	0.4	0.5
Rural electrification	0.5	0.2	0.1	0.2	0.5	0.4	0.3	0.3	0.3	0.2
Subsidies and other current transfers	5.6	4.9	4.9	3.9	3.9	3.9	4.0	4.0	3.9	3.9
Pension and gratuities	0.9	1.1	1.2	1.2	1.2	1.2	1.4	1.4	1.4	1.4
Transfers to road and revenue authorities	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Transfers to public entities	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Fertilizer and seed subsidy	2.7	1.9	1.8	0.9	0.8	0.8	0.7	0.7	0.7	0.7
Of which : seed subsidy	0.4	0.1	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Arrears payments[3]	0.4	1.1	3.0	1.4	0.1	1.4	0.9	0.9	0.1	0.1
of which : Issuance of bonds for securitizing domestic arrears		0.8	3.0	1.3	---	1.3	0.0	0.0	0.0	0.0
Development expenditure	4.5	5.3	4.7	5.9	6.2	5.1	5.4	4.8	5.3	5.5
Foreign financed	3.6	4.4	4.1	5.1	5.2	4.1	4.1	3.5	3.9	3.8
Domestically financed	0.9	1.0	0.6	0.8	1.0	1.0	1.2	1.3	1.4	1.7
Net lending	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance (including grants)	-6.1	-6.4	-6.8	-5.0	-4.0	-5.4	-3.7	-3.6	-2.8	-2.6
Discrepancy	-0.1	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-6.1	-6.5	-6.5	-5.0	-4.0	-5.4	-3.7	-3.6	-2.8	-2.6
Total financing (net)	6.1	6.5	6.5	4.5	4.0	5.4	3.7	3.6	2.8	2.6
Foreign financing (net)	2.0	2.5	1.9	2.3	2.5	2.5	3.1	3.1	2.6	2.5
Borrowing	2.4	2.9	2.4	2.9	3.0	3.1	3.7	3.7	3.2	3.2
Budget support loans	0.6	0.0	0.0	0.0	0.0	0.0	1.2	1.2	0.0	0.0
Project loans	1.8	2.2	1.9	2.9	2.7	2.7	2.3	2.3	2.7	2.7
Other external loans[4]	0.0	0.7	0.5	0.0	0.3	0.3	0.2	0.2	0.5	0.5
Amortization	-0.4	-0.4	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Issuance of promissory notes for securitizing domestic arrears		0.7	3.0	1.3		1.3	0.0	0.0	0.0	0.0
Sale of non-financial assets (privatization proceeds)	0.0	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0
Net domestic financing (NDF)	4.2	3.3	1.7	0.9	1.3	1.4	0.5	0.5	0.3	0.1
Financing gap	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Primary balance (including grants and discrepancy)	-1.8	-2.4	-2.8	-1.6	-0.9	-1.1	0.1	0.2	0.3	0.1
Domestic fiscal balance[5]	-5.6	-4.8	-6.4	-2.7	-3.4	-3.4	-1.6	-1.8	-0.5	-0.4
Maturing promissory notes for domestic arrears	0.0	0.0	0.3	1.0	0.8	2.3	1.2	1.2	0.2	0.0
Nominal GDP (fiscal year)	2,242	2,848	3,532	4,219		4,256	4,989	4,989	5,757	6,606

Sources: Malawi Ministry of Finance and IMF staff projections.

[1]Data from the IMF Country Report No. 15/83.

[2]Nontax revenues in 2013/14 and 2014/15 include the RBM profit transfer to government of MK19.2 billion and MK25.4 billion, respectively.

[3]This includes promissory notes issued for the repayment of domestic arrears accumulated before FY2014/15.

[4]Other external loans in FY2014/15 includes program loans from the World Bank for the financing of agriculture and education SWAPS and the national AIDS Commission (NAC).

[5]Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 2c. Malawi: Central Government Operations: 2016/17 and 2017/18

(Billions of Kwacha)

	2016/17					2017/18				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	210.5	229.3	238.9	266.9	945.7	266.7	266.7	264.7	281.4	1,079.6
Tax and nontax revenue	195.4	213.5	202.4	240.6	851.8	238.5	245.5	243.5	260.2	987.8
Tax revenue	177.3	194.1	181.1	202.3	754.9	217.5	222.5	222.5	233.2	895.8
Taxes on income and profits	87.7	100.2	105.4	90.3	383.6	107.9	112.9	112.9	117.9	451.5
Taxes on goods and services	74.5	77.6	63.0	94.1	309.1	91.7	91.7	91.7	97.4	372.6
Taxes on international trade	16.0	18.5	14.2	19.2	67.8	19.8	19.8	19.8	19.8	79.2
Other taxes	-0.9	-2.1	-1.5	-1.2	-5.6	-1.9	-1.9	-1.9	-1.9	-7.5
Nontax revenue [1]	18.0	19.4	21.2	38.3	96.9	21.0	23.0	21.0	27.0	91.9
Grants	15.1	15.8	36.6	26.3	93.8	28.2	21.2	21.2	21.2	91.8
Budget support grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	11.7	6.0	21.2	19.0	58.0	14.8	14.8	14.8	14.8	59.3
Dedicated grants	3.4	9.8	15.3	7.3	35.8	13.4	6.4	6.4	6.4	32.5
Expenditure and net lending	282.2	271.2	359.7	262.1	1,175.2	356.3	312.9	305.8	283.3	1,258.3
Current expenditure	240.4	220.0	288.2	205.8	954.4	296.0	252.7	245.5	219.1	1,013.3
Wages and salaries	66.6	64.5	70.2	69.5	270.8	72.9	81.9	75.9	72.9	303.6
Interest payments	55.9	32.4	61.2	34.2	183.6	45.3	46.3	56.3	39.6	187.5
Domestic	52.7	30.2	57.7	30.7	171.2	41.7	42.8	52.2	35.5	172.2
Foreign	3.2	2.2	3.5	3.5	12.4	3.5	3.6	4.1	4.2	15.3
Goods and services	68.4	75.8	76.8	54.4	275.5	82.8	71.9	64.6	61.0	280.3
Generic goods and services	20.4	27.4	25.2	24.0	97.0	30.7	30.7	30.7	30.7	122.6
Road Maintenance	7.4	6.1	5.5	5.3	24.2	7.0	7.0	7.0	7.0	28.1
Agricultural swap	1.0	1.2	0.8	0.8	3.9	1.2	1.2	1.2	1.2	5.0
Health SWAp	4.9	15.7	9.6	10.2	40.4	11.9	8.9	7.4	7.4	35.6
Education SWAp	7.0	5.4	6.1	6.2	24.6	8.4	6.3	5.3	5.3	25.3
National / local elections	0.3	0.4	0.5	0.3	1.5	2.0	2.0	2.0	2.0	8.0
PFEM	0.1	0.2	4.5	2.2	7.0	1.8	1.8	1.8	1.8	7.0
Statutory expenditures	2.2	1.3	6.5	-5.0	5.0	1.0	0.8	0.6	0.6	3.0
National AIDS Commission	2.6	0.8	4.1	2.3	9.8	1.9	1.9	1.9	1.9	7.7
Maize purchases	22.0	5.6	11.5	5.8	44.9	13.8	8.2	0.0	0.0	22.0
Rural Electrification Program	0.5	11.8	2.4	2.3	17.1	3.1	3.1	3.1	3.1	12.5
Subsidies and other current transfers	34.6	32.6	65.8	31.8	164.9	51.1	52.6	48.8	45.5	198.0
Pension and gratuities	12.8	12.4	14.9	12.1	52.2	17.7	20.7	16.2	16.2	70.6
Transfers to road and revenue authorities	5.3	6.0	5.4	6.1	22.8	5.7	6.7	6.7	7.9	27.0
Transfers to public entities and households	16.4	13.9	13.2	13.2	56.7	20.7	16.1	17.2	13.2	67.2
Of which, roofing sheets and cement program	1.0	2.0	1.5	2.5	7.0	0.0	0.0	1.8	1.8	1.8
Fertilizer and seed subsidy	0.1	0.3	32.2	0.5	33.2	7.0	9.2	8.7	8.2	33.2
Arrears payments	14.8	14.6	14.2	15.9	59.6	44.0	0.0	0.0	0.0	44.0
Of which, issuance of zero-coupon promissory notes	14.8	13.4	13.5	13.9	55.6	0.0	0.0	0.0	0.0	0.0
Development expenditure	39.3	50.2	71.5	56.3	217.3	60.2	60.2	60.2	60.2	241.0
Foreign financed	35.8	42.1	49.5	47.3	174.6	43.8	43.8	43.8	43.8	175.3
Domestically financed	3.6	8.2	22.0	9.0	42.7	16.4	16.4	16.4	16.4	65.7
Net lending	2.5	1.0	0.0	0.0	3.5	0.0	0.0	0.0	4.0	4.0
Overall balance (including grants)	-71.7	-41.9	-120.7	4.9	-229.5	-89.6	-46.2	-41.0	-1.9	-178.7
Discrepancy	1.1	-9.3	7.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-70.6	-51.2	-113.1	4.9	-229.5	-89.6	-45.7	-41.0	-1.9	-178.7
Total financing (net)	70.6	51.2	113.1	-4.9	229.5	89.6	46.2	41.0	1.9	178.7
Foreign financing (net)	22.6	32.1	27.5	22.9	105.2	82.7	23.7	23.4	23.2	152.9
Borrowing	29.4	36.6	33.8	30.1	129.9	90.2	31.2	31.2	31.2	183.8
Budget support	0.0	0.0	0.0	0.0	0.0	58.9	0.0	0.0	0.0	58.9
Project	24.1	36.1	28.2	28.2	116.6	29.0	29.0	29.0	29.0	116.0
Other external loans	5.3	0.6	5.6	1.8	13.3	2.2	2.2	2.2	2.2	8.8
Amortization	-6.8	-4.5	-6.3	-7.1	-24.7	-7.5	-7.6	-7.8	-8.0	-30.9
Issuance of promissory notes for securitizing domestic arrears	14.8	13.4	13.5	13.9	55.6	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.0	11.3	0.0	0.0	11.3	0.0	0.0	0.0	0.0	0.0
Net domestic financing	33.2	-5.6	72.0	-41.7	57.4	6.9	22.5	17.6	-21.3	25.8
Fiscal gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:										
Primary balance (including grants and discrepancy)	-14.7	-18.8	-51.9	39.0	-45.9	-44.3	0.6	15.2	37.7	8.8
Domestic fiscal balance [2]	-48.6	-14.7	-107.8	25.8	-145.3	-73.9	-23.6	-18.4	24.7	-91.2
Maturing zero-coupon promissory notes	10.8	12.3	10.7	62.0	95.8	13.2	1.9	11.5	35.1	61.7

Sources: Malawi Ministry of Finance and IMF staff estimates.

[1]Nontax revenue in 2014/15 includes the RBM profit transfer of MK25.4 billion to government.

[2]Domestic fiscal balance is calculated by subtracting current and domestically-financed development expenditures from domestic revenues.

Table 3a. Malawi: Monetary Authorities' Survey, 2014–20, 1/

(Billions of Kwacha, unless otherwise indicated)

	2014	2015	2016			2017			2018	2019	2020
			June	Sept.	Dec.	June	Sept.	Dec.		Proj.	
17-May-17							Proj				
Reserve money	212	206	226	238	241	262	273	284	333	389	453
Currency outside banks	98	111	143	154	146	...	...	...	...	...	...
Cash in vault	22	29	26	21	38	...	...	...	...	...	...
Commercial bank deposits with RBM	92	66	57	63	56	...	...	...	...	...	...
Net foreign assets (NFA)	146	276	231	226	225	230	262	260	345	472	600
Foreign assets	277	445	459	452	439	459	490	486	570	701	825
Foreign liabilities	-131	-169	-228	-227	-214	-228	-228	-226	-225	-229	-225
Net domestic assets	66	-70	-5	13	16	32	11	24	-12	-83	-147
Credit to government (net)	77	97	167	215	258	291	301	318	329	333	331
Credit to domestic banks	0	0	0	5	0	0	0	0	0	0	0
Other items (net)	-11	-168	-171	-208	-242	-259	-290	-294	-341	-416	-478
Open market operations	0	-100	-112	-145	-229	...	...	...	...	...	...
Others	-11	-68	-60	-63	-13	...	...	...	...	...	...
Memorandum items:											
Money multiplier	3.0	3.8	4.0	3.9	3.8	3.7	3.7	3.7	3.7	3.7	3.7
Annual growth of reserve money (percent)	35.3	-3.0	6.2	20.5	16.8	15.8	14.5	18.1	17.1	16.9	16.5
91-day treasury bill rate	26.9	23.6	29.0	29.0	24.0	...	...	...	...	...	...
NFA (US$ millions)	310	416	324	313	310	314	353	346	420	532	639
Foreign assets (US$ millions)	588	670	644	627	605	625	660	648	694	790	878
Foreign liabilities (US$ millions)	-278	-254	-320	-315	-295	-311	-307	-302	-274	-258	-240

Sources: Reserve Bank of Malawi and IMF staff projections.

[1]Data from the IMF Country Report No. 15/83.

Table 3b. Malawi: Monetary Survey, 2014–20

(Billions of Kwacha, unless otherwise indicated)

	2014	2015	2016		2017	2018	2019	2020
17-May-17			Jun. Act.	Dec. Act.		Proj.		
Money and quasi-money	630	779	837	897	1,064	1,246	1,456	1,697
Money	275	318	383	396	...	...	...	...
Quasi-money	355	461	454	501	...	...	...	...
Of which: foreign currency deposits	143	207	201	222	...	...	...	...
Net foreign assets (NFA)	242	339	346	356	396	493	632	770
Monetary authorities	146	276	231	225	260	345	472	600
Gross foreign assets	277	445	459	439	486	570	701	825
Foreign liabilities	-131	-169	-228	-214	-226	-225	-229	-225
Commercial banks (net)	96	63	115	131	136	149	161	170
Net domestic assets	388	439	491	541	668	752	824	926
Credit to government (net)	153	201	275	337	427	449	457	454
Credit to statutory bodies (net)	4	5	7	9	14	14	15	18
Credit to private sector	301	390	388	408	458	528	607	709
Other items (net)	-70	-158	-179	-213	-230	-239	-255	-255
Memorandum items:								
Velocity of money (annualized GDP divided by broad money)	4.1	4.1	4.2	4.4	4.4	4.3	4.2	4.2
Annual growth of broad money (percent)	20.7	23.7	30.4	15.2	18.6	17.1	16.9	16.5
Annual growth of credit to the private sector (percent)	20.0	29.9	24.5	4.6	12.1	15.4	14.9	16.8
NFA of the commercial banks (US$ millions)	203.2	95.0	168.3	181.0	181.0	181.0	181.0	181.0
Gross foreign assets (US$ millions)	239.9	156.4	208.2	204.2	204.2	204.2	204.2	204.2
Foreign liabilities (US$ millions)	-36.7	-61.4	-40.0	-23.2	-23.2	-23.2	-23.2	-23.2
Foreign currency deposits(US$ millions)	304.0	311.6	282.0	306.7	...	...	...	...
Nominal GDP (billions of Kwacha)	2,570	3,201		3,919	4,648	5,388	6,187	7,094

Sources: Reserve Bank of Malawi and IMF staff projections.

Table 4a. Malawi: Balance of Payments, 2014–20

(Millions of U.S. Dollar, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020
17-May-17			Est.		Proj.		
Current account balance	-506.4	-605.2	-740.1	-588.5	-563.5	-562.6	-590.9
Merchandise trade balance	-448.4	-484.1	-602.0	-509.1	-495.8	-506.8	-529.5
Exports	1,576.5	1,504.1	1,479.4	1,586.5	1,687.9	1,787.4	1,910.6
Of which: Tobacco	470.7	517.4	571.2	515.7	561.5	593.5	638.7
Uranium	40.4	0.0	0.0	0.0	0.0	0.0	0.0
Imports	-2,024.8	-1,988.2	-2,081.4	-2,095.6	-2,183.7	-2,294.2	-2,440.2
Of which : Petroleum	-183.0	-101.4	-103.3	-153.6	-168.0	-176.8	-186.7
Maize			-183.6				
Services balance	-366.3	-434.7	-453.1	-416.5	-410.7	-407.1	-432.1
Interest public sector	-19.3	-51.4	-33.8	-29.4	-22.6	-23.8	-25.1
Other factor payments (net)	-151.9	-156.6	-110.3	-125.5	-132.0	-139.4	-147.1
Nonfactor (net)	-195.1	-226.7	-308.9	-261.6	-256.1	-243.9	-259.9
Receipts	175.4	130.6	117.6	120.2	137.8	150.4	158.6
Payments	-370.5	-357.3	-426.5	-381.9	-393.9	-394.3	-418.5
Unrequited transfers (net)	308.2	313.6	314.9	337.1	343.0	351.4	370.7
Private (net)	309.0	287.8	315.7	337.9	343.8	352.2	371.6
Official (net)	-0.8	25.8	-0.8	-0.8	-0.8	-0.8	-0.8
Receipts	0.0	26.6	0.0	0.0	0.0	0.0	0.0
Budget support	0.0	26.6	0.0	0.0	0.0	0.0	0.0
Payments	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Capital account balance	261.2	312.0	484.9	310.9	308.7	326.8	329.3
Project and dedicated grants[1]	261.2	312.0	484.9	310.9	308.7	326.8	329.3
Financial account balance	491.2	339.0	129.8	314.2	328.0	347.6	368.9
Medium- and long-term flows (net)	185.3	115.7	8.3	123.2	155.6	168.3	180.6
Disbursements	224.4	165.6	144.9	251.7	219.9	232.0	244.8
Budget support and other program loans	40.0	0.0	0.0	80.0	0.0	0.0	0.0
Project support	145.6	142.1	124.5	155.6	187.9	198.2	209.1
Other medium-term loans	38.8	23.5	20.4	16.1	32.0	33.8	35.7
Amortization	-39.1	-49.8	-136.6	-128.5	-64.3	-63.7	-64.2
Foreign direct investment and other inflows	296.0	114.3	170.6	188.6	169.7	176.5	185.4
Short-term capital	0.8	0.8	36.8	2.5	2.6	2.8	2.9
Commercial banks net foreign assets	9.1	108.2	-86.0	0.0	0.0	0.0	0.0
Errors and omissions	-82	13.6	19.4	0.0	0.0	0.0	0.0
Overall balance	163.7	59.3	-106.1	36.6	73.2	111.9	107.1
Financing	-163.7	-59.3	106.1	-36.6	-73.2	-111.9	-107.1
Gross reserves (- increase)	-190.6	-82.7	65.3	-43.2	-45.8	-95.9	-88.5
Liabilities	26.9	23.4	40.8	6.6	-27.4	-16.0	-18.5
Of which: IMF (net)	-5.1	-5.8	51.6	5.5	-27.4	-16.0	-18.5
Purchases/drawings	17.6	18.2	76.4	26.6	0.0	0.0	0.0
Repurchases/repayments	22.7	24.0	24.8	21.1	27.4	16.0	18.5
Financing gap[2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Gross official reserves	587.6	670.3	605.0	648.2	694.0	789.9	878.4
Months of imports[2]	3.0	3.4	2.9	3.0	3.1	3.3	3.5
Current account balance (percent of GDP)							
Excluding official transfers	-8.3	-9.8	-13.5	-9.3	-8.2	-7.8	-7.6
Including official transfers	-8.4	-9.4	-13.5	-9.3	-8.2	-7.8	-7.6
Import price index (2005 = 100)	138.0	119.4	111.0	118.9	120.2	121.1	122.0
Import volume (percent change)	7.1	1.1	5.4	-3.6	4.5	4.4	5.6
REER (percent change)	8.7	15.3	...	...	...	...	...
Terms of trade (percent change)	2.4	13.0	1.7	-5.3	-1.1	-0.6	0.5
Nominal GDP (millions of U.S. dollars)	6,055.3	6,407.4	5,488.8	6,317.1	6,850.1	7,223.2	7,749.8

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

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

[2]In months of imports of goods and nonfactor services in the following year.

Table 4b. Malawi: Balance of Payments, 2014–20
(Percent of GDP)

17-May-17	2014	2015	2016	2017	2018	2019	2020
			Est.	Proj.			
Current account balance	-8.4	-9.4	-13.5	-9.3	-8.2	-7.8	-7.6
Merchandise trade balance	-7.4	-7.6	-11.0	-8.1	-7.2	-7.0	-6.8
Exports	26.0	23.5	27.0	25.1	24.6	24.7	24.7
Of which: Tobacco	7.8	8.1	10.4	8.2	8.2	8.2	8.2
Uranium	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Imports	-33.4	-31.0	-37.9	-33.2	-31.9	-31.8	-31.5
Of which : Petroleum	-3.0	-1.6	-1.9	-2.4	-2.5	-2.4	-2.4
Maize			-3.3				
Services balance	-6.0	-6.8	-8.3	-6.6	-6.0	-5.6	-5.6
Interest public sector (net)	-0.3	-0.8	-0.6	-0.5	-0.3	-0.3	-0.3
Other factor payments (net)	-2.5	-2.4	-2.0	-2.0	-1.9	-1.9	-1.9
Nonfactor (net)	-3.2	-3.5	-5.6	-4.1	-3.7	-3.4	-3.4
Transfers (net)	5.1	4.9	5.7	5.3	5.0	4.9	4.8
Private (net)	5.1	4.5	5.8	5.3	5.0	4.9	4.8
Official (net)	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Receipts	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Budget support	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance	4.3	4.9	8.8	4.9	4.5	4.5	4.2
Project and dedicated grants	4.3	4.9	8.8	4.9	4.5	4.5	4.2
Financial account balance	8.1	5.3	2.4	5.0	4.8	4.8	4.8
Medium- and long-term flows (net)	3.1	1.8	0.2	1.9	2.3	2.3	2.3
Loan disbursements	3.7	2.6	2.6	4.0	3.2	3.2	3.2
Budget support and other program loans	0.7	0.0	0.0	1.3	0.0	0.0	0.0
Project support loans	2.4	2.2	2.3	2.5	2.7	2.7	2.7
Other medium-term loans	0.6	0.4	0.4	0.3	0.5	0.5	0.5
Amortization	-0.6	-0.8	-2.5	-2.0	-0.9	-0.9	-0.8
Foreign direct investment and other inflows	4.9	1.8	3.1	3.0	2.5	2.4	2.4
Commercial banks net foreign assets	0.2	1.7	-1.6	0.0	0.0	0.0	0.0
Errors and omissions	-1.4	0.2	0.4	0.0	0.0	0.0	0.0
Overall balance	2.7	0.9	-1.9	0.6	1.1	1.5	1.4
Financing	-2.7	-0.9	1.9	-0.6	-1.1	-1.5	-1.4
Gross reserves (- increase)	-3.1	-1.3	1.2	-0.7	-0.7	-1.3	-1.1
Liabilities	0.4	0.4	0.7	0.1	-0.4	-0.2	-0.2
Of which: IMF (net)	-0.1	-0.1	0.9	0.1	-0.4	-0.2	-0.2
Purchases/drawings	0.3	0.3	1.4	0.4	0.0	0.0	0.0
Repurchases/repayments	0.4	0.4	0.5	0.3	0.4	0.2	0.2
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Gross official reserves	9.7	10.5	11.0	10.3	10.1	10.9	11.3
Current account balance (percent of GDP)							
Excluding official transfers	-8.3	-9.8	-13.5	-9.3	-8.2	-7.8	-7.6
Including official transfers	-8.4	-9.4	-13.5	-9.3	-8.2	-7.8	-7.6
Value of exports of GNFs (percent change)	5.1	-6.7	-2.3	6.9	7.0	6.1	6.8
Value of imports of GNFs (percent change)	3.6	-2.1	6.9	-1.2	4.0	4.3	6.3

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

Table 5. Malawi: Selected Banking Soundness Indicators, December 2011–December 2016

Key ratios	Dec-11	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Capital Adequacy												
1. Regulatory Tier 1 capital to risk weighted assets	16.5	16.4	16.2	13.5	16.1	15	13.7	12.4	14.7	14.2	14.1	13.8
2. Regulatory total capital to risk weighted assets	20.1	20.2	19.1	17.1	20.2	19.4	17.7	15.8	18.1	18.1	17.2	17.0
3. Total capital to total assets	14.6	14.3	15.4	17.6	20.3	16.6	18.5	17.1	18.1	17.5	17.0	16.7
Asset composition and quality												
1. Non-performing loans to gross loans and advances	4.1	9.4	15.4	14.9	14.8	13.8	11.6	10.6	14.7	13.7	16.6	17.0
2. Provisions to non-performing loans	36.9	26.8	29.1	31.8	33.4	34.7	30.5	25.7	25.1	30.1	25.4	25.5
3. Total loans and advances to total assets	52.7	50.8	40.5	40.3	43.3	41	40.9	40	41	36.9	36.4	34.8
4. Foreign currency loans to total loans and advances	6.1	7.9	13.5	19.1	21.4	16.1	24.1	28.6	24	24.6	22.4	21.8
Earnings and profitability												
1. Return on assets (ROA)	3.5	5.0	4.8	4.0	4.2	4.2	4	3.1	3	4.7	3.3	2.7
2. Return on equity (ROE)	24.7	36.9	37.5	26.8	25.0	24.9	24.5	19.2	20.4	31.7	22.3	18.4
3. Non-interest expenses to gross income	46.0	36.8	39.7	45.4	47.3	48	48.5	51.4	47.5	47.6	46.4	50.0
4. Interest margin to gross income	46.0	36.8	39.7	---	---	48.9	49.4	50.2	48.1	52.4	52.2	47.8
5. Non-Interest Income to Revenue		---	31.8	37.8	32.5	32	32.2	30.5	28.4	27.7	25.9	28.0
6. Net Interest Income to Assets		---	9.1	8.4	2.7	5.9	8.2	9.7	2.7	6.8	7.2	9.7
7. Personnel expenses to non-interest expenses	39.70	46.00	45.40	45.1	49.8	49.1	48	45.3	48.1	48.7	46.5	43.8
Liquidity												
1. Liquid assets to deposits and short-term liabilities	43.0	45.4	59.1	62.4	64.5	62.5	61.8	59	59.7	65.8	95.9	72.3
2. Total loans to total deposits	70.9	72.4	56.6	58.3	60.6	61.4	58.9	58.5	60.7	55.3	54.8	54.2
3. Liquid Assets to total assets	33.4	34.5	43.7	48.8	40.5	43.5	44.6	43.3	43.6	47.5	70.2	50.4
4. Foreign exchange liabilities to total liabilities	7.8	17.9	26.3	---	---	16.1	24.2	26.1	23.1	24.9	19.3	19.7

Source: Reserve Bank of Malawi.

Table 6. Malawi: External Financing Requirement and Source, 2012–20
(Millions of U.S. Dollar)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total requirement	-796	-701	-735	-764	-811	-759	-673	-721	-743
Current account, excluding official transfer	-733	-529	-506	-631	-739	-588	-563	-562	-590
Debt amortization	-17	-11	-39	-50	-137	-129	-64	-64	-64
Gross reserves accumulation (- increase)	-46	-161	-191	-83	65	-43	-46	-96	-89
Total sources	796	701	735	764	811	759	673	721	743
Expected disbursements (official)	684	603	485	503	629	562	528	558	573
Grants	591	506	260	338	484	310	308	326	328
Medium- and long-term loans	93	97	224	166	145	252	220	232	245
Private sector (net)	76	86	256	266	130	192	172	179	188
IMF (net)	37	13	-5	-6	52	6	-27	-16	-19
Drawings	40	20	18	18	76	27	0	0	0
Repayments	3	7	23	24	25	21	27	16	19
Financing gap	0	0	0	0	0	0	0	0	0
Gross official reserves	236	397	588	670	605	648	694	790	878
Months of imports	1.2	2.0	3.0	3.4	2.9	3.0	3.1	3.3	3.5

Source: IMF staff estimates.

Table 7. Malawi: Proposed New Schedule of Disbursements Under ECF Arrangement, 2012–17
(Millions of SDR)

Amount	% of Quota[1]	Availability date	Conditions Necessary for Disbursement	Status
13.02	9.38	July 23, 2012	Executive Board Approval of Three Year ECF arrangement.	Disbursed
13.02	9.38	December 15, 2012	Observance of performance criteria for September 30, 2012 and completion of first review.	Disbursed
13.01	9.37	March 15, 2013	Observance of performance criteria for December 31, 2012 and completion of second review.	Disbursed
6.51	4.69	June 15, 2013	Observance of performance criteria for March 31, 2013 and completion of third review.	Disbursed
6.50	4.68	December 15, 2013	Observance of performance criteria for September 30, 2013 and completion of fourth review.	Disbursed
6.51	4.69	March 15, 2014	Observance of performance criteria for December 31, 2013 and completion of fifth review.	Disbursed
6.51	4.69	September 15, 2014	Observance of performance criteria for June 30, 2014 and completion of sixth review.	Disbursed
9.76	7.03	September 15, 2015	Observance of performance criteria for June 30, 2015 and completion of the seventh review	Disbursed
44.46	32.03	March 15, 2016	Observance of performance criteria for December 31, 2015 and completion of the eighth review [2]	Disbursed
19.5	14.05	October 15, 2016	Observance of performance criteria for June 30, 2016 and completion of the ninth review.	
138.8	100	Total for the ECF arrangement		
Memorandum item:				
Malawi's new Quota (millions SDR)		138.8		

Source: IMF staff estimates.

[1]Using Malawi's current quota after effectiveness of the 14th General Review of Quotas.

[2]The amount includes an augmentation of 25 percent of quota (SDR34.7 million).

Table 8. Malawi: Indicators of Capacity to Repay the Fund, 2017–28

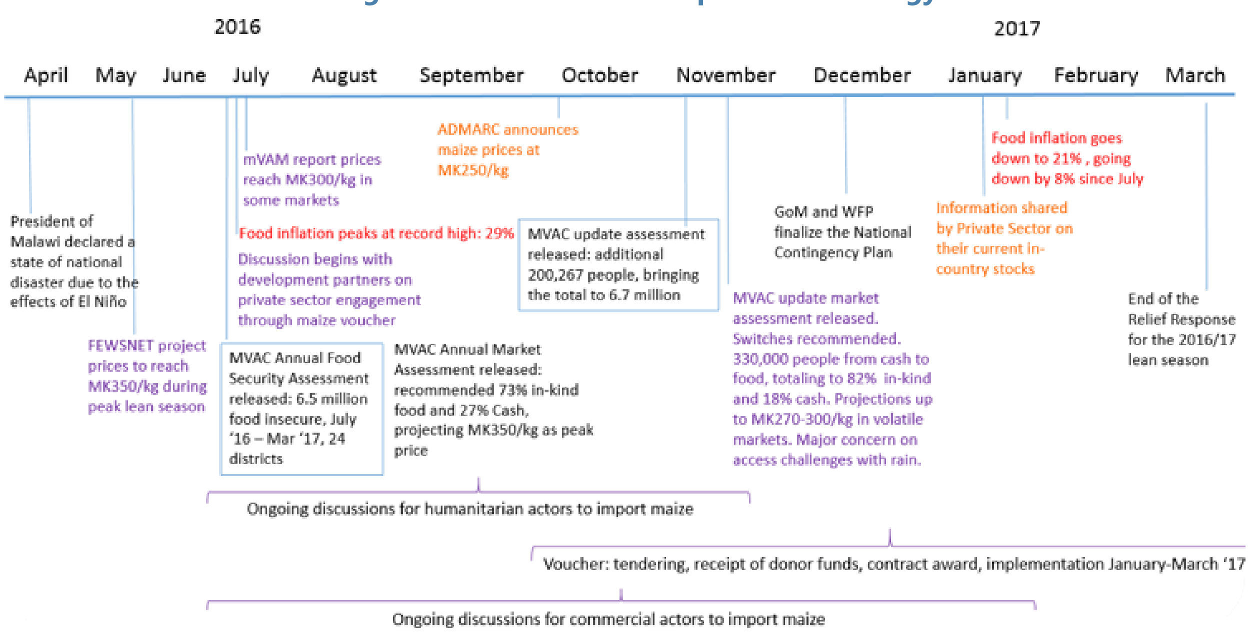
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Projected Payments based on Existing Drawings:												
(SDR millions)												
Principal	15.7	20.4	11.9	13.8	18.4	23.9	17.4	14.8	12.2	5.4	0.0	0.0
Charges and interest	0.19	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Projected Payments based on Prospective Drawings:												
(SDR millions)												
Principal	0.0	0.0	0.0	0.0	0.0	2.0	3.9	3.9	3.9	3.9	2.0	0.0
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Projected Payments based on Existing and Prospective Drawings:												
SDR millions	15.9	20.6	12.1	14.0	18.6	26.0	21.5	18.9	16.3	9.5	2.2	0.2
US$ Millions	21.4	27.7	16.2	18.8	25.0	34.9	28.8	25.3	21.8	12.8	2.9	0.3
Percent of exports of goods and services	1.3	1.5	0.8	0.9	1.1	1.4	1.1	0.9	0.7	0.4	0.1	0.0
Percent of debt service	19.8	24.4	15.7	17.3	22.3	30.8	24.5	18.3	13.9	7.3	1.5	0.1
Percent of quota	11.5	14.8	8.7	10.1	13.4	18.7	15.5	13.6	11.7	6.9	1.5	0.1
Percent of gross official reserves	3.3	4.0	2.1	2.1	2.6	3.2	2.3	1.8	1.4	0.8	0.2	0.0
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:												
SDR millions	157.6	137.2	125.3	111.5	93.0	67.2	46.0	27.3	11.3	2.0	0.0	0.0
US$ Millions	211.5	184.1	168.4	149.8	124.9	90.2	61.7	36.7	15.1	2.6	0.0	0.0
Percent of exports of goods and services	12.4	10.1	8.7	7.2	5.6	3.7	2.4	1.3	0.5	0.1	0.0	0.0
Percent of debt service	196.0	162.6	163.1	138.0	111.1	79.6	52.4	26.5	9.6	1.5	0.0	0.0
Percent of quota	113.5	98.8	90.2	80.3	67.0	48.4	33.1	19.7	8.1	1.4	0.0	0.0
Percent of gross official reserves	32.6	26.5	21.3	17.1	12.8	8.2	5.0	2.6	1.0	0.2	0.0	0.0
Memorandum items:												
Exports of goods and services (millions of U.S. dollars)	1707	1826	1938	2069	2219	2413	2591	2784	3018	3260	3522	3785
Debt service (millions of U.S. dollars)	107.9	113.2	103.2	108.5	112.5	113.3	117.7	138.2	157.1	174.2	193.2	209.1
Quota (SDR millions)	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8	138.8
Gross official reserves (millions of U.S. dollars)	648.2	694.0	789.9	878.4	977.5	1106.1	1235.3	1399.4	1527.6	1656.0	1874.3	2099.0
GDP (millions of U.S. dollars)	6317	6850	7223	7750	8329	8976	9534	10062	10631	11244	11907	12623

Source: IMF staff projections.

Annex I. Humanitarian Crisis: United Response by International Community

1. **In 2016, Malawi faced its worst humanitarian crisis with almost half of the population at risk of food insecurity due to the severe drought (Figure 1)**. Maize production declined by a cumulative 42 percent since 2015. Based on initial estimates by Malawi Vulnerability Assessment Committee (MVAC) in May 2016, total cost of humanitarian relief response and replenishment of the strategic grain reserves to stabilize maize prices amounted to US$450 million, of which the humanitarian component was estimated at about US$285 million for food relief. The maize deficit was estimated at 790,000 metric tons, of which, around 278,000 MT was needed for humanitarian relief response, while the balance would be directed towards replenishing the strategic grain reserves and to stabilizing maize prices.

Figure 1. Humanitarian Response Chronology

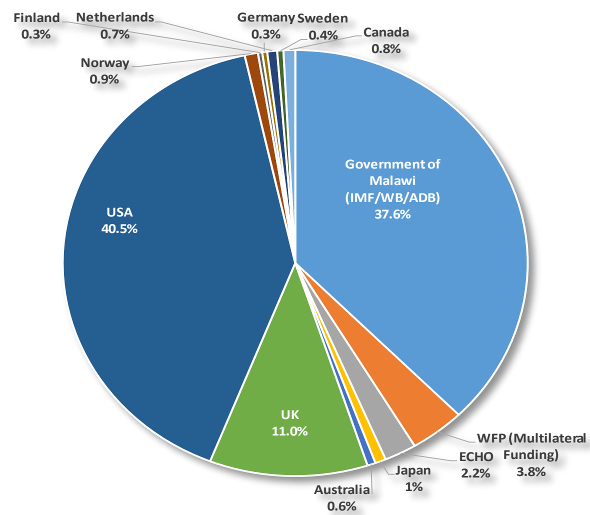


Sources: Reserve Bank of Malawi and World Food Program.

2. **The international community responded quickly in providing much-needed resources**. The IMF's augmentation of access (US$49.2 million) proved to be catalytic. Figure 2 shows contributions by the international community for the humanitarian response. The United States and United Kingdom provided the largest contributions covering around 40 percent and 11 percent of the total cost of humanitarian response, respectively. As financial support materialized, the available

monthly maize tonnage for relief purposes increased from 10,000 metric tons in August to 60,000 metric tons in December.

Figure 2. Contribution for Relief Response

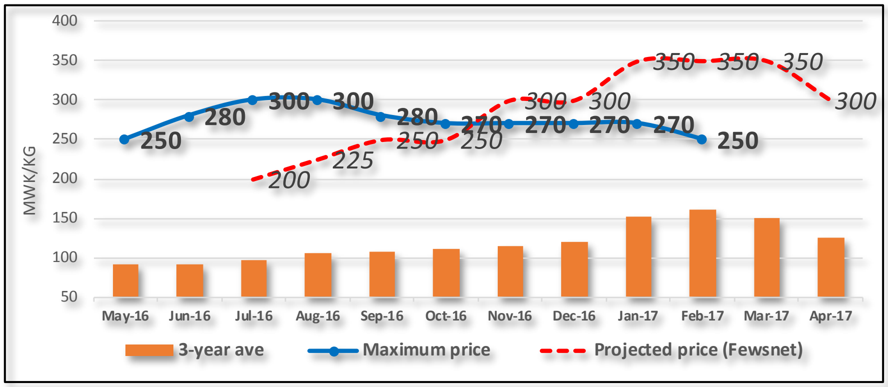


Source: World Food Program

3. **The World Food Program (WFP) spearheaded efforts to provide maize to people at risk of food insecurity.** Of the total amount of maize needed, 60 percent were in kind contributions. The WFP purchased 30 percent of the maize requirements and the remaining 10 percent was provided through cash vouchers financed by donors. These vouchers enabled beneficiaries to access maize in rural areas (especially during the rainy season with access challenges), and provided an incentive to the private sector to increase its engagement. It also helped protect beneficiaries from price inflation.

4. **Without the humanitarian relief, MVAC assessed that maize prices would have doubled during the lean seasons, making it too expensive for the population**. In the event, maize prices stabilized due to private importers' purchases from the neighboring countries and imports by the WFP. Earlier, many firms had purchased maize from the neighboring countries to sell during the lean season at high markups. But due to a lack of market transparency, and to some extent, expectation of ADMARC importing huge quantities of maize (300,000 MT) in September, private maize importers started to offload their maize stock in the market early, leading to the stabilization of prices (Figure 3).

Figure 3. Actual versus Projected Prices



Source: World Food Program.

Note: The maximum price is maximum actual price of maize in all districts.

5. **Going forward, Malawi needs to build resilience against weather-related shocks and improve its agricultural productivity**. The recent episodes of two consecutive droughts have called for much needed infrastructure investment in the agriculture sector to improve irrigation and enhance productivity. Given Malawi's increasing debt vulnerability, the government should prioritize these projects, and ensure that borrowing be concessional. Parallel efforts are needed to re-engage donors in project financing and enhance private sector investment by improving the business environment.

Appendix I. Letter of Intent

June 6, 2017

Madam Christine Lagarde
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Madam Lagarde:

1. On June 20, 2016, the Executive Board of the International Monetary Fund (IMF) completed the seventh and eighth reviews under the three-year Extended Credit Facility (ECF) arrangement for Malawi and extended the arrangement to end-December 2016. However, as a result of the impact of the worst humanitarian crisis in Malawi's history on program performance, the Executive Board of the IMF granted an augmentation of access (25 percent of quota) and further extended the ECF arrangement through end-June 2017 to provide time for us to implement our structural reform agenda. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) report on recent economic developments and performance under the ECF arrangement since that time, and on the policies, we plan to implement in the remainder of fiscal year 2016/17 as well as over the medium term.

2. We are grateful to the support of the IMF through the augmentation of access which allowed us to respond to the large balance of payments need caused by the humanitarian crisis which placed 6.7 million people (40 percent of the population) at risk of food insecurity. The augmentation had a catalytic effect in fostering donor support and we are happy to report that the worst of this crisis is behind us. The humanitarian support has also helped stabilize food prices which have now embarked on a downward trend with the advent of the current maize harvest.

3. Following the last Board meeting, program implementation initially suffered from policy slippages that prevented the timely completion of the ninth review, but these have now been corrected. In particular, we missed the end-June 2016 performance criterion (PC) on net domestic borrowing by a small margin owing to revenue shortfalls in light of weaker economic conditions. The ceiling on net domestic assets and the floor on net international reserves of the central bank

were not met due to recourse to domestic borrowing in the face of revenue shortfalls and lower-than-expected export revenues. Most programmed public financial management reforms were not met.

4. Since that time, however, corrective measures have put our macroeconomic program on a sound footing and our structural reform agenda has been implemented. Informal macroeconomic targets set for end-December 2016 based on the net domestic borrowing underpinning the FY2016/17 budget guided policy implementation. Both targets on net domestic borrowing of the central government and net domestic assets of the central bank were met by respectable margins. Only the target on net international reserves of the central bank was not met, owing to lower-than-programed exports. We also redoubled our efforts in implementing our structural reform agenda with support from the resident public financial management advisor and IMF capacity development activities more generally. To this end, we have completed all prior actions encompassing, closing dormant and redundant accounts, publishing monthly budget execution reports, bank reconciliations, and the issuance of interim audit report by the Auditor General. Parliament also approved amendments to the AML/CFT law which will help to safeguard the financial sector's integrity, and mitigate money laundering and corruption risks.

5. We remain committed to the objectives of the original ECF-supported program, namely attaining strong inclusive growth, single digit inflation, and an increase of reserves to at least three months of import cover. Important to these ends will be preservation of our flexible exchange rate regime and automatic fuel pricing mechanism, both of which have served us well since 2012. We will continue to exercise prudent monetary and fiscal policies until inflation is firmly on a downward path. We will use the FY2017/18 budget to anchor policies going forward until we have reached understandings with your staff on a successor arrangement in the months ahead.

6. We are requesting waivers for the nonobservance of three periodic performance criteria. The performance criteria on net domestic borrowing of the central government and net domestic assets of the central bank were missed at end-June 2016 due to revenue shortfalls and recourse to central bank financing. We are requesting a waiver on the basis of the strong remedial actions we have since taken to bring domestic borrowing back on track and into conformity with the end-December 2016 informal macroeconomic targets. The PC on net international reserves was missed at end-June 2016 because of the effects of the El Niño-induced drought on exports. We request a waiver for this owing to the tightening of our policy stance and the large depreciation of the currency during the first half of 2016. At the same time the flexible exchange rate regime continues to serve us well in responding to external shocks.

7. We are mindful of the need to preserve debt sustainability despite our large infrastructure needs. The Government of Malawi would like to assure the IMF that it will not enter into any legally binding agreements on the proposed Lake Malawi-Lilongwe Water Supply Project that would involve non-concessional borrowing and would jeopardize Malawi's debt sustainability.

8. On the basis of our overall performance, the corrective actions undertaken, as well as, the strength of policies set forth in the attached MEFP, we request that the Executive Board of the IMF complete the ninth review under the ECF arrangement and release the tenth tranche totaling SDR 19.5 million. We believe that the policies set forth in the attached MEFP are adequate to achieve our medium-term objectives as set out in the original program and our Economic Development Document.

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

Yours sincerely,

/s/	/s/
Mr. Goodall Gondwe Minister of Finance	Dr. Dailitso Kabambe Governor of the Reserve Bank of Malawi

Attachment:

– Memorandum of Economic and Financial Policies.

Attachment— I. Memorandum of Economic and Financial Policies

June 6, 2017

BACKGROUND

1. **This memorandum supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated June 6, 2017, and describes recent developments and performance under the ECF-supported program since completion of the seventh and eighth reviews in June 2016**. It also elaborates on the policies and structural reforms we intend to carry out in the year ahead to regain macroeconomic stability, improve our public financial management systems, and safeguard financial sector stability.

2. **The Government, led by His Excellency Professor Arthur Peter Mutharika, remains committed to correcting macroeconomic imbalances and setting the country on a path to sustainable and inclusive noninflationary growth**. In the sections below, we describe our policy agenda for significantly enhancing and accelerating our macroeconomic and structural reform process. Over the six months immediately following the conclusion of the seventh and eighth reviews some policy slippages occurred in part due to the humanitarian crisis as well as the slow implementation of the structural reform agenda. However, these have now been corrected and policy, both in the macroeconomic area and in our ambitious structural agenda, is now back on track. We intend to vigorously implement all the policy commitments set out in this memorandum, as evidenced by the completion of the agreed prior actions in the public financial management (PFM) and financial areas.

3. **During the period 2012–17, the Malawian authorities implemented the economic and financial policies supported by the IMF under the Extended Credit Facility (ECF)**. The original objectives of the program comprised keeping inflation in single digits, increasing foreign reserves, as well as ensuring sustained and inclusive growth through infrastructure development.

RESULTS OF IMPLEMENTING THE 2012–17 EXTENDED CREDIT FACILTIY

4. **Adverse weather-related shocks and policy slippages prevented the achievement of the key objectives of sustainable growth and low inflation under Malawi's growth and development strategy (MGDS II)**. Real GDP growth of 7.5 percent and single-digit inflation that

were targeted during the life of the program proved to be elusive, in part because of a succession of large shocks. In particular, the uncovering of a large-scale theft of public funds in 2013 ("cashgate") damaged Malawi's macroeconomic outlook significantly, owing to the sudden withdrawal of 4½ percent of GDP in budget support. The ongoing suspension of donor budget support has resulted in increased recourse to domestic financing. Fiscal adjustment relative to the program was insufficient. As a result, the targets on net domestic assets (NDA) of the central bank and net domestic financing of the central government (NDF) were frequently missed. Domestic debt has risen sharply from 13.8 percent of GDP in 2012 to about 21.2 percent of GDP at end-2016. At the same time, the flexible exchange rate regime and automatic fuel pricing mechanism have served Malawi well in strengthening the external position as reflected in improved reserve cover and the observance of floor on net international reserves (NIR) of the central bank.

5. **The implementation of structural reforms was mixed. We made progress in implementing PFM reforms with a view to restoring trust and confidence in the budget**. We have rationalized government bank accounts, increased the coverage and security of the Integrated Financial Management System (IFMIS), published budget execution by vote, and strengthened Treasury cash management functions and commitment controls. However, the institutionalization of basic fiscal reporting through regular bank reconciliations is ongoing. We made strong progress in the implementation of monetary and financial sector reforms that safeguarded financial sector stability, improved monetary and exchange rate policies, and strengthened the regulatory and supervisory frameworks. Nevertheless, critical supply-side bottlenecks include the availability and reliability of electricity and water supply, transportation costs, the quality of feeder roads, and the cost and access to credit in a high inflation environment, are continuing to impede the lift off in growth.

6. **While the floor on social spending was frequently missed, we have scaled up our social protection program**. Progress was made in: (i) increasing primary school enrollment including gender parity; (ii) improving access to potable water; and (iii) declining infant mortality rates. We targeted five social protection interventions. These comprise unconditional social cash transfers, public works, school meals, village savings and loans, and micro-financing under the framework of the MGDS II to enhance growth inclusiveness. Our school meals program currently covers 44 percent of primary schools but targets all students across Malawi. The social cash transfer program targets 10 percent of the extreme-poor and labor constrained households in a community and has now been expanded to 18 out of 26 districts with a coverage of 170,122 beneficiary households or about 700,000 individuals across the country. Despite our best efforts the poverty rate remains high at 51.8 percent, above the average for sub-Saharan Africa of 34 percent, and inequality remains acute

reflecting in part the corrosive effects of inflation that increased by 137 percent cumulatively since 2012.

RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

A. Recent Economic Developments

7. **More recently, weather-related shocks negatively impacted Malawi's economy for two consecutive years**. Prolonged effects of drought and past policy slippages made it difficult for Malawi to turn around its macroeconomic situation from high inflation and low growth. In particular, the prolonged drought in 2016—the worst in Malawi's history—placed 6.7 million people (40 percent of the population) at risk of food insecurity. The IMF's augmentation of access (US$49.2 million) enabled us to respond to the large balance of payments need caused by the humanitarian crisis. It also had a catalytic effect in fostering donor support in addressing the needs of the population that were food insecure.

- Real GDP growth fell sharply from its recent peak of 5.7 percent in 2014 to below 3 percent in 2016. A second consecutive year of drought led to the cumulative 42 percent decline in maize production since 2015. At the same time, the reduction in hydroelectricity generation and water shortages led to a large run up in operational costs, and low capacity utilization. This resulted in a further reduction in agricultural production from an already low base and continued weakness in the manufacturing and trade sectors. Banks have become risk averse as credit and market risks as reflected in rising non-performing loans have increased.

- Inflation continues to fall since the third quarter of 2016. Annual inflation in April 2017 fell by 7 percentage points to 14.6 percent since end-2016. Both food and non-food inflation rates have contributed to the downward trend, reflecting tight monetary policy and the stabilization of food prices on account of the humanitarian response and the importation of maize by the private sector. Non-food inflation, has fallen for 8 consecutive months suggesting that the second-round effects of the food crisis are being contained through an improved policy mix.

- We have largely met the needs of the 6.7 million people who were at risk of acute food insecurity. The World Food Program mobilized about US$285 million. The management of the humanitarian operation was conducted through bi-weekly coordinating meetings between the Government of Malawi and development partners. Key lessons derived from the event included the need to improve the accuracy of food security assessments, strengthen maize procurement procedures to mitigate the future emergence of irregularities by the state-owned grain marketing board (ADMARC), and increasing the economy's resilience to climate shocks.

- In order to respond to the maize deficit experienced in 2016, ADMARC, procured 106,000 metric tons of maize locally. These purchases were financed by local banks with a government guarantee and repayment becomes due in FY16/17. We will adhere to a no subsidy policy in selling this maize in order to mitigate impacts to the budget. We will also explore using part of this maize to replenish our strategic grain reserves.

8. **Fiscal slippages emerged during the execution of the FY15/16 budget execution were corrected during the implementation of the first half of FY16/17 budget (July to December)**:

- In the period leading up to June 2016, revenues shortfalls reflecting weaker economic activity owing to the prolonged drought and higher-than-programmed current spending resulted in higher-than-programed NDF. Outlays on interest expense and domestic arrears clearance were higher than anticipated. Meanwhile, lower-than-programmed external project loans led to a corresponding decline in foreign-financed capital spending.

- However, by the end of the first half of FY 2016/17, we regained firm fiscal control. Revenues for the first six months of FY2016/17 over performed by about ½ a percentage point of GDP, reflecting the implementation of IMF tax policy recommendations expanding the coverage of VAT and eliminating several exemptions. Despite the favorable revenue performance, we continued to exercised firm control over spending. For example, we continue to require detailed monthly fiscal reports from all spending units as a condition for the subsequent month's funding, and have withheld funding from some for noncompliance. By exercising stronger commitment controls, net domestic financing for the first half of the 2016/17 fiscal year was held at a much lower level than programmed. At the same time, we implemented reforms to the farm input subsidy program by reducing the number of recipients from 1.5 million farmers to 900,000 and reducing the subsidy rate from 97 percent to 80 percent. Despite the fiscal tightening, we also safeguarded social spending in part through the increased distribution of maize to the most vulnerable groups.

9. **The resolution of old arrears (prior to FY14/15) is now close to completion**. Verification of old arrears involved a number of unforeseen complications encompassing the verification of fertilizer delivery contracts that were dollar-denominated, interest claims, litigations, and delayed reporting from some Ministries. At end-March 2017, we cleared MK175.5 billion of arrears that were validated by issuing zero coupon bonds of one to three year maturities. To avoid the accumulation

of new arears, we have tightened commitment controls by enforcing the provision of 5 fiscal reports by Ministries before the allocation of the subsequent month's financing. Moreover, in order to delegate responsibility to Ministries, any new arrears would be deducted from their budgeted allocation. Arrears that arose in FY14/15 (0.5 percent of GDP) have now been reduced to 0.2 percent of GDP after being audited. Those that arose in FY15/16 (0.4 percent of GDP) will be audited once verified by Ministries.

10. **We have maintained a tight monetary policy stance by keeping short-term money market rates positive in real terms**. We mopped up excess liquidity in the banking system. Interbank rates are now closely aligned with the policy rate and fall within our corridor system that was introduced in early 2016. With the corridor rising and falling with changes in the policy rate, we would also expect a significant improvement in the monetary transmission mechanism.
This appears to be the case as banks adjusted their lending rates in response to a 300 basis point reduction in the policy rate in late November 2016. In part because of the tighter liquidity conditions, the depreciation of the kwacha was less volatile in the post tobacco season when foreign exchange inflows are lower. The kwacha depreciated by 27 percent in nominal effective terms while the real effective exchange rate depreciated by 14 percent.

PERFORMANCE UNDER THE PROGRAM

11. **The poor harvest and humanitarian crisis adversely impacted program performance at end-June 2016**. End-June performance criteria (PCs) on NDF of the central government and NDA of the central bank were missed in part due to revenue shortfalls and increased recourse to domestic financing. NIR of the central bank were lower-than-programed reflecting weaker export revenues despite better-than-expected tobacco exports due to a drawdown of past inventory.
The implementation of the PFM reforms—the lynchpin of the reform agenda—was delayed.

12. **In this context, we requested more time to complete the ninth review, with a strong commitment to implementing corrective measures to address recent slippages**. During the first half of FY 2016/17, we pursued a strong mix of monetary and fiscal policies to address macroeconomic imbalances and to arrest the persistent cycle of inflation. Fiscal policy focused on keeping net domestic financing (NDF) and NDA at end-December in line with NDF underpinning the FY16/17 budget and the program's objective of maintaining reserve cover of three months of imports. As a result of redoubling our efforts to restore the macroeconomic program, both the ceilings on NDF and NDA were met. However, the floor on NIR was missed owing to the lower-than-programmed export revenues.

13. **The pace of implementation of PFM measures has accelerated significantly since the beginning of this fiscal year**.

- After completion of seventh and eighth review, there were delays in implementing PFM-related and financial integrity reforms. The completion of bank reconciliations in FY15/16 was hindered in part because of (i) an unexpected breakdown of the IFMIS system for more than a month; (ii) delays in clearing outstanding non-reconciled items—by Ministries—a requirement for their monthly funding; (iii) delays in introducing an efficient way of handling unpresented checks in the IFMIS system; and (iv) deficiencies in accounting system such as the duplication of entries. Since then, we have redoubled our efforts to address these challenges in order to reconcile all government bank accounts in MG1 and six operational accounts and ways and means for all FY2015/16 as a prior action (PA) for the completion of the ninth review. We asked for an independent verification of our reconciliation report by the IMF's Fiscal Affairs Department (FAD). We have also published monthly budget execution by vote on the website of the Ministry of Finance Website (PA) and closed redundant and dormant bank accounts (PA), which is a prerequisite for introducing a Treasury Single Account.

- We have amended our AML/CFT Act, the Penal Code and Corrupt Practices Act in line with the FATF standards and the United Nations Convention Against Corruption. We believe that these efforts will help safeguard the financial sector's integrity, mitigate money laundering and corruption risks, and strengthen compliance with correspondent banking requirements. In particular, these amendments will ensure enhanced customer due diligence of politically exposed persons, regularize the reporting of suspicious transactions and institutionalize sanctions for failure to comply with AML/CFT requirements.

- We continue to address weaknesses in our PFM system and prosecute crimes arising from the "cashgate" scandal. In addition to the regular reporting of budget execution by Ministries, we are setting-up the Cash Management Unit to better align spending with available resources, and will routinely apply sanctions in the event that the fiscal reports (revenue return, expenditure report, commitment report, bank reconciliation of other recurrent transactions and development accounts, and payroll return) are not submitted in a timely manner. We have also introduced a multi-currency software in the current IFMIS, which is facilitating the capture of most government expenditures in the IFMIS except for the Malawi Defense Force and Local Government. We continue to prosecute persons accused of perpetrating the "cashgate" scandal, using evidence collected by the forensic audit for the period1st April 2013 to 30 September 2013, and the results of the investigations of the Directorate of Public Prosecutions and the Anti-Corruption Bureau. To date, 16 cases have been prosecuted—

all successfully—and perpetrators have been convicted, receiving sentences of between 3 and 11 years. Looking ahead, we are conducting a deeper forensic audit and reconciliation of government transactions covering the period 2009–2014. Once a 100 percent forensic audit of all transactions are completed by the Auditor General, we will be in a position to ascertain the closing balance of all bank accounts, which will enable 100 percent bank reconciliation of all accounts.

- The Reserve Bank of Malawi's (RBM) safeguards framework is being strengthened. The RBM's Board committed to invest its foreign assets in investment-grade institutions. In so doing we have also revised our investment policy and the associated list of counterparties. In order to address weaknesses identified in transactions with government both the RBM and the government have now signed a memorandum of understanding on banking services that define the respective role and responsibilities of both parties.

KEY ECONOMIC OBJECTIVES, OUTLOOK AND RISKS

14. **The macroeconomic outlook remains challenging in light of continued uncertainties related to weather conditions, the emergence of a new pest ("the fall armyworm") to the maize crops and the need to maintain tight fiscal and monetary policies to reduce inflation**. Medium-term projections are predicated on policy actions being taken to reduce inflation, on the normalization of weather conditions, improvements in doing business, and on progress made in addressing key supply-side bottlenecks. These policies are expected to foster a gradual increase in private sector confidence needed to re-ignite investment spending.

15. **Our short-term objectives are to solidify gains in macroeconomic stability, firming up control over our fiscal systems, and safeguard external and financial sector stability**. These goals, largely unchanged from our original program, remain necessary conditions that need to be met if we are to build a solid foundation for reducing poverty and addressing Malawi's development needs in the years ahead.

16. **Responsible fiscal and monetary policies, combined with vigorous PFM reform, will continue to be implemented to reduce inflation, reverse the contraction of real incomes, and restore confidence in the budget process**. We believe that achieving price stability, and demonstrating a strong ability to control fiscal spending, and adhere to a responsible fiscal strategy, will boost private sector confidence. This would be reinforced by clear wins in public financial management. As confidence returns, and as our business environment improves—including through a decline in bank lending rates in lagged steps with inflation—we would expect investment levels to

rise sufficiently to promote significant growth-enhancing investment over the medium term. We would also anticipate a rebound in consumption demand, once the real income-eroding effect of high inflation on household spending is mitigated by our disinflation program.

17. **Despite restrictive macroeconomic policies, real GDP growth is expected to range between 4–5 percent**. The recovery will be driven by a rebound in agricultural production from very subdued levels in the previous two years, a pick-up wholesale and retail trade, agro-processing and the telecoms section. However, growth prospects would be constrained by persistent power blackouts and water shortages. Helped by deceleration of food prices owing to the humanitarian relief efforts and rebound in maize production, inflation is expected to continue its downward trend. Favorable international prices for food and petroleum products would contribute to lower inflation provided the kwacha remains stable.

18. **As confidence returns and investment and consumption levels rise, we would expect an improvement in economic activity in 2018 and beyond**. With rising investment, real growth in 2018 should reach 5 percent, before gradually increasing to around 5.5 percent in the medium term. Inflation is expected to decline to single digits by the end of 2018. A prudent fiscal stance over this period will also improve our debt sustainability position, and we expect public debt as a share of GDP to be placed on a declining trend over the medium term to below 50 percent. We recognize, however, that this goal will require strengthening of our debt management capacity.

19. **Short-term risks are tilted to the downside**. Malawi is also being affected by region-wide fall army worm infestation which is likely to affect winter cropping. Shortfalls in export revenues would place additional pressure on the kwacha, which has continuously depreciated in response to shocks. Policy slippages—which have been frequent throughout the life of the program—remain a risk in the run-up to the 2019 elections.

POLICIES

A. Monetary and Financial Sector Policies

20. **We are determined to use monetary policy to keep inflation on a declining trajectory**. An improved alignment of monetary and fiscal policies during the first half of this fiscal year, have helped to reduce inflationary pressures despite the rise in food prices following climate-related shocks. Our monetary policy will aim at attaining an end-of-period inflation rate of 13.6 percent by December 2017, and to maintain a minimum of 3 months import cover in foreign exchange reserves. Monetary policy will aim at ensuring that the central bank rate remains well above the rate of

inflation and by using liquidity operations in the interbank and Treasury bill markets to maintain positive real interest rates in our financial system.

21. **We will continue to strengthen our monetary policy framework**. We will improve communication with stakeholders and the general public, which will raise policy credibility, increase the efficiency of policy transmission, and better anchor inflation expectations. Supported by greater fiscal discipline and improvements in our PFM systems, we anticipate that our policy framework and policy execution will be sufficient to lower inflationary expectations over time. Maintenance of positive real interest rates will also increase demand for holding kwacha assets, and eventually help to mitigate the seasonal depreciation pressure that typically appears in the lean season when foreign currency inflows are low. Underpinning these policies will be a continued adherence to the flexible exchange rate regime, which we see as a fundamental precondition for the success of our economic adjustment policies.

22. **We are committed to developing an interest rate-based monetary policy framework**. Our current monetary targeting framework, with an operational target on the level of reserve money and a floor on NIR stocks, will be maintained for the time being and gradually transition to a full interest rate-based monetary policy framework. However, within the current framework, we intend to allow interest rates to play a significantly expanded role. Our recent establishment of an interest rate corridor in the interbank market—facilitated by the deployment of an overnight deposit facility—should yield significantly greater RBM control over the interbank rate. We expect this, when applied consistently, to yield increasing control over longer term rates and gain us influence over the entire interest rate structure of the market. This will add significantly more relevance to the policy rate, reduce interest rate volatility, and improve the monetary policy transmission mechanism. We intend to continue expanding our capacity in this regard, with one aim being the eventual adoption of a full-fledged inflation targeting regime in the medium-term. Developing such a framework will require continued upgrading of skills in liquidity forecasting and control, a deeper understanding of monetary transmission mechanisms, and greater inflation forecasting capacity, including through economic modeling. We look to the IMF as a source of technical assistance in these areas.

23. **We will combine tight monetary conditions with efforts to safeguard financial sector stability by strengthening our supervision and resolution capacity**. We continue to address vulnerabilities in the banking sector by requiring banks to meet the minimum capital requirements. Banks' capital will be further raised from US$5 million to US$10 million by 2020 in order to foster greater resilience to shocks. With Fund technical assistance, we adopted in May 2014, a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action

against distressed banks. The PCA framework has been complemented with a model resolution framework that outlines the various options that could be taken to intervene and resolve any problem bank that fails to submit or comply with an acceptable recapitalization plan. We have also improved prudential norms in the areas of asset classification and provisioning. Our new asset classification directive, enacted in May 2014 and based on the estimated recoverable amount method (ERAM), imposes higher and graduated provisioning rates, and is expected to strengthen banking sector resilience and improve the ability to deal with adverse developments.

24. **All banks except two are in compliance with the regulatory minimum capital**. We are working closely with these two banks and have agreed time-bound remediation measures to correct this situation. The two banks are expected to be recapitalized through right issues or direct capital injection by shareholders by end-June 2017. The RBM is closely monitoring the recapitalization and restructuring process.

25. **We are taking additional steps to strengthen banking supervision aimed at ensuring the continued stability of the financial system**. To this end, we are enhancing both on-site and off-site supervision, closely monitoring and enforcing compliance with all prudential norms and enhancing the supervisory skills of the staff of RBM. Loan concentration remains one of the major risk factors in our banking system. This risk has continued to rise due to the extension of large credits to a limited numbers of borrowers or to specific economic sectors and activities. As this could lead to challenges in liquidity and capital positions of banks, the RBM will continue to closely monitor loan concentrations in the banking sector.

26. **We also remain committed to strengthening the regulatory framework of the banking system**. To this end, we will re-submit to Parliament, before end-June 2017, the amendments to the Banking Act of 2010 and Financial Services Act of 2010 for enactment. These amendments, which were informed by IMF technical assistance recommendations, will align the legal framework for bank resolution more closely with best practices and provide more options for dealing with problem banks. They were submitted to Parliament in March 2015 but sent back to the Minister of Justice for clarification of a few sections. Moreover, the Directive on Licensing and Regulation of Holding Companies and the Directive on Islamic Banking, which were approved by the RBM Board and submitted to the Minister of Finance, will be submitted to Parliament before end-2017.

B. Fiscal Policy

27. **Our fiscal policy stance will support the monetary policy objective of reducing inflation**. This will require that spending is kept within available resources, and that government's recourse to domestic borrowing, particularly from the RBM, is strictly limited, so that demand-pull inflation and second-round effects of recent food price increases are contained. Continued implementation of a prudent fiscal policy is necessary over the medium term to keep public debt as a ratio to GDP on a downward trajectory, prevent government borrowing from crowding out the private sector, and avoid debt service costs replacing other, more productive, and growth enhancing forms of government expenditure.

28. **The FY2017/18 budget will aim at continuing macroeconomic stabilization while shifting the composition of the budget towards capital spending**. We will consolidate the revenue reforms implemented at the time of the FY2016/17 budget by exploring further measures where feasible as well as strengthening tax administration. We will pursue a risk-based approach to tax compliance through increased analysis of data, enhance the integrity of the tax registry, and increase the efficiency of collections through investment in an integrated tax administration system (ITAS). In recognizing that Malawi's revenue collection is above the median for Sub-Saharan Africa, we will focus our attention in containing expenditures to within available financing, improving the quality of spending, and aim to achieve 100 percent coverage of domestically-financed spending with domestic revenues. In this context, the FY2017/18 budget will aim to contain the wage bill (6.1 percent of GDP) which was grown sharply as result of the need for recruitment in the social sectors but also due to wage demands in a high inflation environment. We will also contain the travel budget which has been pruned by 24 percent over the last three years to MK23 billion. The reforms to the farm input subsidy program will be sustained. We will continue our arrears clearance program to lower vulnerabilities arising from domestic debt and to limit the impact of interest costs on the budget. Domestically financed capital spending which is good for growth has invariably been cut in order to close financing gaps, will be safeguarded going forward.

29. **We are committed to implement broad based tax reforms with the aim of creating a simple, efficient, transparent and fair tax system**. To this effect, we are streamlining tax incentives, eliminating unproductive tax measures and broadening the tax base. Our tax policy initiatives will be guided by a shift in reliance on revenue from taxation of labor and investment (factors of production) to consumption. This shift of the relative tax burden from income to consumption should therefore help to spur economic development.

C. Public Financial Management Reform

30. **Our recent success in achieving bank reconciliation establishes a strong foundation on which to expand public financial management reforms**. Bank reconciliations will be regularized going forward as key pillar of fiscal transparency and accountability. We have now started focusing on strengthening other areas such as the creation of a more reliable system for budget control and reporting. While this is assisting in recording and tracking commitments and arrears as they arise, among other uses, we are further strengthening the process by adopting quality standards for the five reports, which necessitates a review of them. Compliance to this measure by MDAs has now reached almost 90 percent. Given the strategic importance of strengthening commitment control, we are considering adoption of a commitment template to unify data coverage and definition.

31. **The success in bank reconciliations enables us to improve upon our financial reporting**. We intend to produce unaudited quarterly financial statements within six weeks after the end of the quarter with fully reconciled items. We will also continue to require five monthly MDA financial reports with fully reconciled items, which will be reviewed against the quality standard. In the same vein, we will produce and publish quarterly budget execution by vote based on actual expenditure and not funding. With these, we are confident that the 2016/17 financial statements will be submitted to the Auditor General by 31st October 2017 as required under the Public Finance Management Act with fully reconciled bank accounts. The timely reporting will mean that Parliament will, from next year going forward start to discuss reports that are not only reliable but also relevant. The clearance of the backlog will also provide a good base for the implementation of the new IFMIS project that will be more robust, comprehensive and assist in addressing control weaknesses such as payroll management, project management, arrears and commitments, among others. Operations of the Cash Management Committee have been strengthened by establishing a fully functional Cash Management Unit under the Secretary to the Treasury and we are initiating further cash management reforms.

32. **We are developing a medium-term strategy that aims at solidifying the present gains**. In this regard, we will embark on building human capacity through training to ensure that the reforms being implemented are sustained. A review of the PFM Act has also commenced to ensure that laws and regulations are brought in line with the reforms that are taking place, and emphasize a performance-based rewards and sanctions regime. Strengthening of oversight institutions such as the National Audit Office, Central Internal Audit Unit and the Public Accounts Committee will continue under the medium- term strategy that is being developed. We will also strengthen the medium-term performance and efficiency of our budget by better linking MDA strategic planning

and budgeting, improving the credibility of Medium-Term Expenditure Framework, and strengthening the framework for engaging key stakeholders.

D. Pension Reform

33. **We are committed to the reform of our public pension scheme to ensure its long-term fiscal viability**. Under the Pension Act of 2010, the Government was supposed to transform its defined benefit civil servant pension system into a defined contribution scheme. However, a review—including with the help of IMF technical assistance—has determined that the size of the pension liability renders this fiscally untenable. Furnishing the scheme with the necessary reserves for it to operate as a defined contribution scheme would require issuance of assets exceeding 60 percent of GDP. Such asset transfers are beyond the means of the government and, in any event, could not be accommodated by nascent capital markets without severe disruption. Moreover, we have determined that even the existing defined benefit public pension scheme is not sustainable—in the absence of reserves commensurate to the scheme's liabilities, servicing accrued benefits would require disproportionately high budget subsidies.

34. **We will therefore revisit the proposed pension reforms by concentrating on parameter adjustment to reduce the liabilities of the current system**. These changes, which would bring the benefits and costs more in line with schemes in other countries, may include: (i) raising the service retirement age; (ii) lowering the generosity of benefit indexation; (iii) reducing accrual rates; and (iv) introducing a phased in approach of contribution to implementing public service public scheme contributions. We believe that some migration to a defined contribution scheme for more recent hires and employees that are 30 years old and below might be fiscally feasible, but only if implemented gradually and with due consideration for fiscal and financial sector constraints.

E. Debt Management

35. **While Malawi is classified at moderate risk of debt distress, vulnerabilities related to domestic debt have risen**. In this regard, we will limit our unified external borrowing to high priority projects which are in line with our Economic Development Document and ensure that total debt (and guarantees) contracted are consistent with debt sustainability. Going forward, now that the Debt Management Committee is operational, it will look at each borrowing and ascertain its concessionality and ensure debt sustainability with the entire borrowing plan. Borrowing in the FY17/18 budget will be consistent with our objective of social development and poverty reduction and with overall medium- to long-term debt sustainability. To this end, the Government will not enter into any legally binding agreements that would jeopardize Malawi's debt sustainability.

We take this opportunity to request a Debt Management Performance Assessment given the need to address infrastructure gaps over the medium term while safeguarding debt sustainability.

36. **Government is also planning to implement Lake Malawi-Lilongwe water supply project in order to address water supply needs in Lilongwe**. The Government would like to assure IMF that while Lilongwe Water Board has entered into preliminary discussions with a potential contractor on the construction and financing of the project, the Government has not provided a sovereign guarantee to underpin the financing arrangements and will not enter into legally binding agreements on the proposed project that would involve non-concessional borrowing and jeopardize the country's debt sustainability.

F. Fuel Import Regime

37. **We are taking necessary steps to improve our fuel security situation. In the past, our fuel storage capacity has been limited to 14 days of supply held in idle tanker trucks**. The low level of reserves, combined with our landlocked geographical status, clearly places us in a vulnerable position that we are highly desirous of mitigating. To this end, we completed construction of three fuel storage depots capable of holding about 25 percent of annual consumption.

38. **The new fuel storage reservoirs offer the possibility of greater assurance of fuel supply, but the management issues need to be carefully considered**. Our current fuel import regime—based on private sector importation with cost recovery guaranteed by the automatic fuel pricing mechanism—has worked well in the past, with supply on demand available since 2012. However, with the completion of the new fuel storage tanks, an additional dimension has been introduced, as a method is required to finance the accumulation of the needed fuel reserves. The challenge will be to amend the fuel import regime in a manner that utilizes the new fuel tanks without introducing new sources of risks.

39. **During the current fiscal year, the fuel import regime will remain unchanged, while we carefully evaluate possible amendments aimed at enhancing security and efficiency**. To this end, we will examine ways and means of filling the new fuel tanks in a cost effective and transparent manner, taking full advantage of the technical assistance on offer from various donors, including the World Bank, for this operation. In this process, we will examine both private sector and public sector-led solutions, including the option of a government-run bulk procurement system. The discussion will be held in an open and transparent manner, with full participation of the private sector. In light of the possible macro-critical ramifications of changes in this key sector, we will produce, publish,

and discuss with all interested parties a fully costed and well thought out proposal prior to implementation.

G. Program Issues and Monitoring

40. **In order to allow completion of the ninth review, we are requesting waivers for non observance of three performance criteria**. For the reasons noted above, we are requesting a waiver for the non-observance of the end-June 2016 program ceiling on NDF and NDA and end-June 2016 floor on NIR. This request is based on the corrective measures adopted to restore the macroeconomic program and the implementation of the structural reform agenda.

Table 1. Malawi: Quantitative Targets, 2016[1]

	Target type [2]	End-June 2016			
		Prog.	Adjusted Prog.	Act.	Status
I. Monetary targets (millions of kwacha)					
1. Ceiling on net domestic assets of the RBM [3, 4, 5, 6]	PC	-90,331	-75,331	-4,703	Not met
2. Ceiling on reserve money[3]	IT	176,413	176,413	226,050	Not met
II. Fiscal targets (millions of kwacha)					
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	38,000	58,200	59,378	Not met
4. Floor on social spending (cumulative from beginning of fiscal year)[8]	IT	292,675	292,675	293,116	Met
III. External sector targets (US$ millions, unless otherwise indicated)					
5. Floor on net international reserves of the RBM[3, 5, 6]	PC	473	440	416	Not met
6. Ceiling on the accumulation of external payments arrears [7,9]	PC	0		0	Met
7. Ceiling on non-concessional external debt [9,10]	PC	77.5		0	Met
9. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [9]	PC				Met
Memorandum items:					
Net foreign assets of the RBM (US$ millions, end of period)		381		324	
Budget support (US$ millions)[7]		26.60		26.60	
Budget support (millions of kwacha)		20,528		18,620	
Nominal external concessional borrowing (US$ millions)[11]		150		96	
Debt service payments to the World Bank and AfDB (US$ millions)[7]		11.45		8.6	
Debt service payments to the World Bank and AfDB (millions of kwacha)		8,015		6,020	
Health SWAp receipts (millions of kwacha)[7]		14,993		980	
Education SWAp receipts (millions of kwacha)[7]		0		0	
NAC receipts (millions of kwacha)[7]		3,850		6,790	
Program exchange rate (kwacha per US$)		700		700	

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks unless otherwise specified.

[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, starting from the beginning of the fiscal year.

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

[9]Evaluated on a continuous basis.

[10]The ceiling comprises US$55 million from the AfDB for a water project and US$22.5 million from China for an e-government project.

[11]Concessional borrowing during the first half of fiscal year 2016/17

Table 2. Malawi: Informal Macroeconomic Targets for end-December 2016[1]

	End-December 2016			
	Target	Adjusted target	Actual	Status
I. Monetary targets (millions of kwacha)				
1. Ceiling on net domestic assets of the RBM [2,3,4,5]	19,874	28,401	16,065	Met
2. Ceiling on reserve money[2]	253,709	253,709	240,618	Met
II. Fiscal targets (millions of kwacha)				
3. Ceiling on central government's net domestic borrowing [4,5,6]	39,685	48,212	27,537	Met
4. Floor on social spending (cumulative from beginning of fiscal year)[7]	156,293	156,293	188,673	Met
III. External sector targets (US$ millions, unless otherwise indicated)				
5. Floor on net international reserves of the RBM [2,4,5]	415	403	392	Not met
6. Ceiling on the accumulation of external payments arrears [6,8]	0		0	Met
7. Ceiling on non-concessional external debt [8,9]	77.5		0	Met
8. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [8]				Met
Memorandum items:				
Net foreign assets of the RBM (US$ millions)	325		310	
Budget support (US$ millions)[6]	0		0	
Budget support (millions of kwacha)	0		0	
Debt service payments to the World Bank andAfDB (US$ millions)[6]	5.51		4.8	
Debt service payments to the World Bank and AfDB (millions of kwacha)	3,967		3,484	
Health SWAp receipts (millions of kwacha)[6]	6,350		3,600	
Education SWAp receipts (millions of kwacha)[6]	0		0	
NAC receipts (millions of kwacha)[6]	10,580		4,320	
Program exchange rate (kwacha per US$)	720		720	

Source: IMF staff projections.

[1]Targets are defined in the technical memorandum of understanding (TMU) presented in the IMF Country Report no. 16/182.

[2]Defined as stocks. All stocks of NDA adjusted for consistency with the definition specified in the TMU.

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

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

[5]Targets are subject to an adjuster for donor-funded social sector expenditures consistent with the TMU.

[6]Defined as a cumulative flow, starting from the beginning of the fiscal year.

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

[8]Evaluated on a continuous basis.

[9]The ceiling comprises US$55 million from the AfDB for a water project and US$22.5 million from China for an e-government project.

Table 3. Malawi: Structural Benchmarks for the 9th Review

Structural benchmark	Target date	Macro Rationale	Status as of September 2016
Public financial management			
Publish detailed monthly budget execution data by vote for the first nine months of FY2015/16 on the Ministry of Finance's website.	End-June 2016	To foster greater fiscal transparency and monitoring.	Not met. Data were ready for uploading on the Ministry's website.
Review all bank accounts and close redundant and dormant accounts and provide an updated list from the central bank certified by the Accountant General.	End-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met. The review was completed and the list of the accounts was being prepared.
Reconcile the wages account for the first six months of FY15/16.	End-June 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met. The wages account is one of the six operational accounts in the benchmark below.
Reconcile all government bank accounts in MG1 and six operational accounts and ways and means for all FY2015/16 transactions (July 1, 2015 through June 30 2016). Have the completed reconciliations signed by the Accountant General, the Auditor General, and the Secretary of the	End-August 2016	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Not met
Auditor General to produce and publish an interim audit report covering July 1, 2015 to December 31, 2015.	End-Sept. 2016	To improve transparency and control.	Not met.
Issue a report by an International firm confirming the status of implementation of forensic audit recommendations in the PFM domain including controls over bank reconciliations for MG1 and six operational accounts and ways and means for the first half of FY15/16 transactions.	End-Sept. 2016	Foster greater transparency.	Not met. Delayed due to lack of donor financing for the exercise. Donors' preference is for a deeper audit spanning several years (2009-13), which is ongoing.
Financial sector			
Submit to parliament amendments to the AML/CFT Act, the Penal Code, and the Corrupt Practices Act in line with the FATF standard and the United Nations Convention against Corruption (UNCAC).	End-June 2016	To ensure that: (i) enhanced customer due diligence is required with regard to domestic politically exposed persons ; (ii) suspicious transactions are reported when there is a suspicion that funds are the proceeds of a criminal activity ; (iii) there is adequate transparency of legal persons and arrangements; (iv) acts of corruption are adequately criminalized and constitute predicate crimes to money laundering; (v) self-self-laundering is criminalized, and (vi) there are appropriate administrative sanctions for failure to comply with AML/CFT requirements.	Not met. Amendments were being reviewed by the Ministry of Justice.

Sources: IMF staff and Malawian authorities.

Table 4. Malawi: Prior Actions for the Completion of the 9th Review

Measures	Macro Rationale	Status, as of May 15, 2017
Public financial management		
Publish detailed monthly budget execution data by vote for FY2015/16 on the Ministry of Finance's website.	To foster greater fiscal transparency and monitoring.	Met
Review all bank accounts and close redundant and dormant accounts and provide an updated list from the central bank certified by the Accountant General.	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Met
Reconcile the transactions and balances of all government bank accounts in MG1 and six operational accounts and ways and means for all FY2015/16 transactions (July 1, 2015 through June 30, 2016). Have the completed reconciliations signed by the Accountant General, the Auditor General, and the Secretary of the Treasury.	To strengthen cash planning, reconciliation of accounts, and improving the integrity of the accounting systems.	Pending (about 1.6% of salary accounts remain to be reconciled)
Auditor General to produce and publish an interim audit report covering July 1, 2015 to June 30, 2016.	To improve transparency and control.	Met
Financial sector		
Submit to parliament amendments to the AML/CFT Act, the Penal Code, and the Corrupt Practices Act in line with the FATF standard and the United Nations Convention against Corruption (UNCAC).	To ensure that: (i) enhanced customer due diligence is required with regard to domestic politically exposed persons ; (ii) suspicious transactions are reported when there is a suspicion that funds are the proceeds of a criminal activity ; (iii) there is adequate transparency of legal persons and arrangements; (iv) acts of corruption are adequately criminalized and constitute predicate crimes to money laundering; (v) self-self-laundering is criminalized, and (vi) there are appropriate administrative sanctions for failure to comply with AML/CFT requirements.	Met

Sources: IMF staff

MALAWI

June 7, 2017

NINTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

Prepared By | The African Department (In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of April 30, 2017)

Membership Status

Joined: July 19, 1965; Article VIII

General Resources Account:

	SDR Million	%Quota
Quota	138.80	100.00
Fund holdings of currency (exchange rate)	136.36	98.24
Reserve tranche position	2.44	1.76

SDR Department:

	SDR Million	%Allocation
Net cumulative allocation	66.37	100.00
Holdings	3.00	4.53

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	13.88	10.00
ECF Arrangements	135.86	97.88

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	06/30/2017	138.80	119.30
ECF	02/19/2010	07/22/2012	52.05	13.88
ESF	12/03/2008	12/02/2009	52.05	34.70

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

	Forthcoming				
	2017	**2018**	**2019**	**2020**	**2021**
Principal	11.69	20.41	11.89	13.80	18.44
Charges/Interest	0.21	0.30	0.30	0.30	0.30
Total	**11.89**	**20.71**	**12.19**	**14.10**	**18.74**

[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:

Commitment of HIPC assistance	Enhanced Framework
Decision point date	Dec 2000
Assistance committed	
by all creditors (US$ Million)[1]	1,057.00
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 Catastrophe Containment and Relief (CCR): Not Applicable.

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Safeguards Assessments:

The 2012 safeguards assessment confirmed that legal reforms were required to address the RBM's lack of operational autonomy. The assessment also reiterated the need to enhance oversight of foreign reserves management, expand disclosures contained in the financial statements and strengthen data compilation procedures. Since then, the RBM has taken steps to ensure that its external audit and financial statements are accordance with international standards. The RBM continues to publish its financial statements while the internal audit function benefitted from implementing the recommendations of an external quality review. Legal amendments were also enacted in 2015 to limit direct advances to the government and strengthen audit and accountability requirements.

The safeguards monitoring visit to the RBM in February 2016 found that all recommendations of the 2012 assessment were implemented, with the exception of the remaining weaknesses in the RBM Act that continue to impede on the bank's autonomy. Steps are underway to address control weaknesses identified in the banking operations. The 2016 monitoring assessment recommended that the RBM's internal audit function assess the operating effectiveness of the enhanced controls through special audits. Also, revision of the investment policy is needed to limit concentration of investments in institutions with a credit rating below investment grade.

Exchange Arrangements:

The de facto exchange rate classification of a floating arrangement is under review. In May 2012, the government liberalized the foreign exchange regime, devalued the kwacha by about 33 percent, and adopted a floating exchange rate regime. Since May 2012, the RBM has not set a target rate and has allowed substantial volatility in the exchange rate. Official actions continue to play a role in influencing the exchange rate, but the exchange rate movements are largely market determined and staff found that the authorities' practice of determining the exchange rate of commercial banks through moral suasion has ceased, thereby removing the official action that gave rise to the multiple currency practice identified in August 2006 and manifested by the significant spread between the commercial bank and foreign exchange bureau rates. Malawi maintains a system free from restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation:

It is expected that the next Article IV consultation with Malawi will take place on the standard 12-month cycle. The Executive Board concluded the last Article IV consultation with Malawi on December 11, 2015.

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 was published in February, 2005.

Technical Assistance:

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
04/17	STA	RBM	Training on Government Financial Statistics (GFS)	Mission
04/17	STA	RBM	Training on Financial Soundness Indicator (FSI)	Mission
04/17	FAD	MOF	Strengthening cash management	Mission
04/17	FAD	MRA	Developing compliance risk management capabilities	Mission
04/17	ICD	RBM	Developing a Forecasting and Policy Analysis System (FPAS)	Mission
05/17	FAD	MRA	Training in post clearance auditing (PCA) in customs administration	Mission
11/16	FAD	MRA	Improving integrity of tax-payer register	Mission
10/16	ICD	RBM	Developing a Forecasting and Policy Analysis System (FPAS)	Mission
10/16	FAD	MRA	Operationalizing risk management in Customs	Workshop
10/16	STA	NSO	National accounts statistics	Mission
09/16	FAD	MOF	Building and sustaining financial control	Mission
09/16	STA	RBM	Enhancement of General Data Dissemination System (GDDS)	Mission
09/16	MCM	RBM	Operationalizing and further streamlining the Information Technology (IT) risk examination framework	Mission
08/16	STA	NSO	Consumer Price Index (CPI)	Mission
07/16	STA	NSO	Government Finance Statistics (GFS)	Mission
05/16	FAD	MOF	Bank reconciliations, arrears reporting, and IFMIS	Mission
04/16	STA	NSO	National accounts statistics (follow-up)	Mission

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
04/16	MCM	RBM	Developing capacity on the Supervisory review in the context of Pillar 2 of the Basel framework	Mission
03/16	MCM	RBM	Developing capacity on operational and technology risk	Mission
02/16	MCM	RBM	Safeguards assessment	Mission
02/16	MCM	RBM	Internal guideline for foreign exchange intervention	Mission
01/16	FAD	MOF	General tax policy diagnostic including extractive industries	Mission
01/16	FAD	MOF	Introducing New PFM Advisor	Mission
01/16	LEG	MOF	Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)	Mission
11/15	FAD	MOF	Improving the coverage and quality of fiscal reporting	Mission
11/15	MCM	RBM	Money and Repo Market Development	Mission
10/15	STA	NSO	National accounts statistics	Mission
09/15	FAD	MOF	Financial Controls and Disciplines: Enforcing Accountability	Mission
09/15	FAD	MOF	Pension reform proposals	Mission
07/15	FAD	MOF	Improving cash planning and management	Mission
06/15	STA	NSO	Price Statistics	Mission
05/15	FAD	RBM	TADAT Pilot Assessment	Mission
04/15	FAD	MOF	Implementing priority PFM reforms II	Mission
04/15	STA	NSO	National Accounts Statistics	Mission
03/15	LEG	RBM	Helping draft Banking Law amendments	Mission
03/15	STA	MOF	Government Finance Statistics	Mission
02/15	STA	NSO	Balance of Payments Statistics	Mission
02/15	STA	NSO	National Accounts Statistics Harmonization	Workshop
02/15	MCM	RBM	Advice on the Implementation of ICAAP/SREP supervisory framework.	Mission
01/15	FAD	MOF	Action plan for implementing priority PFM reforms	Mission
11/14	STA	NSO	Assistance with redeveloping data	Mission
11/14	FAD	Ministry of Finance	PFM Action Plan follow-up	Mission
09/14	STA	NSO	Development of direct prices survey for MPIs	Mission
03/14	STA	NSO	Further Assistance on Data Improvement	Mission
03/14	FAD	Ministry of Finance	PFM Reform Program	Mission

JOINT MANAGERIAL ACTION PLAN

(May 9, 2017)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	A. Mutual Information on Relevant Work Programs		
World Bank work program in the next 12 months	**Analytical and Advisory Activities:**		
	1. Systematic Country Diagnostic	June 2017	November 2017
	2. Country Economic Memorandum		June 2017
	3. Malawi Economic Monitor (two editions)	September 2017	June 2017
	4. Country Environmental Analysis	June 2017	April 2018
	5. Shock Responsive Safety Nets	September 2017	February 2018
	6. Public Expenditure Review (social sectors)	October 2017	September 2018
	7. Secondary Education Quality Assessment	August 2017	June 2018
	8. Institutional and Non-Technical Drivers of Service Delivery in the Agricultural Sector	September 2017	March 2018
	9. Renewable Energy Resource Mapping	October 2017	November 2018
	10. FSAP Development Module	August 2017	August 2017
	11. Warehouse Receipt Financing	September 2017	August 2017
	Lending:		
	1. Agricultural Support and Fiscal Management DPO		May 2017
	2. Digital Malawi Phase I		June 2017
	3. Agricultural Commercialization		May 2017
	4. Shire Valley Transformation Phase I	July 2017	September 2017
	5. Lilongwe Water and Sanitation	August 2017	November 2017
	6. Public Sector	September 2017	June 2017
	7. Nutrition	September 2017	June 2017
	8. Social Protection	November 2017	September 2018
	B. Requests for Work Program Inputs		
IMF request to World Bank	1. Updates on WB support to Malawi		Continuous
World Bank request to IMF	1. Regular updates and exchange of views on medium-term macroeconomic and fiscal projections including sharing detailed excel tables on Real, Monetary, Fiscal and External Sectors		Continuous
	C. Agreement on Joint Products and Missions		
Joint products in next 12 months	1. Debt Sustainability Analysis (update)		June, 2017

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of May, 2017)

African Development Bank (AfDB) operations in Malawi date back to 1969. The AfDB Malawi Field Office was opened in 2007. As at 31st March, 2017, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 889.6 million (about US$1.2 billion) to finance 105 operations including 13 studies and 2 lines of credit.

The current Country Strategy Paper (CSP) of the Bank covering 2013–17 is fully aligned to the second Malawi Growth and Development Strategy (MGDS II) covering the period 2011–16 and the Bank's corporate priorities in the Long-Term Strategy (LTS, 2013–22). The CSP, currently under implementation, focuses on two pillars: (i) addressing infrastructure bottlenecks to competitiveness and growth; and (ii) supporting actions to expand private sector investment and trade.

To date, the Bank has approved projects in the water, social sector, agriculture and roads sectors and in Public Financial Management in line with the CSP priorities. In 2016, three new operations were approved by the Board: (i) Agriculture Infrastructure and Youth Agri Business Project (US$22 million); (ii) Food Crisis Response Budgetary Support Program (US$16 million); and the Jobs for Youth Project (US$12 million). The aim of these interventions is to improve agriculture infrastructure for enhanced productivity and create employment and income earning opportunities for the youth through skills development in agri-business and other key economic activities. The objective of the Food Crisis Response budgetary support is to mitigate the impact of the drought induced food crisis and ease the fiscal pressures.

The Bank plans to scale up its lending to the energy sector with a view to address the power shortages, a major constraint to Malawi's growth. The pipeline of energy sector projects, include the Malawi-Mozambique Power Inter-connector Project to be co-financed with the World Bank, the Kholombidzo Hydro Power Project and the Songwe River Basin Development Project. The Bank will also promote private investment in the energy sector, through Public Private Partnerships (PPPs) and the use of innovative financing instruments, such as Partial Risk Guarantees. In November 2016, the Bank conducted the Energy Financing Seminar in Lilongwe Malawi to disseminate information to potential investors regarding existing financing opportunities. The Bank is taking the lead in mobilizing donor resources and private finance for the Songwe Hydro Power Project, a multinational project with Tanzania.

The Bank has continued to support PFM Reforms and capacity building in coordination with other Development Partners. The PFM Institutional Support (ISP) I is nearing completion while the second phase is making steady progress and expected to be completed in 2017. Among the achievements of ISPI is the launching of the ASYCUDA World which has improved collection of revenue from custom duties. The Bank has also provided Malawi with quick disbursing budget support. Following Government's 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 an ADF Grant for the Crisis Response Budget Support operation for Malawi in July 2012, in the amount of US$40 million. The Bank designed the Restoration of Fiscal Stability and Social Protection (RFSSP) program whose objective was 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. To support this agenda, the RFSSP had two components: (i) strengthened PFM transparency and accountability, and (ii) strengthened social protection system.

In April 2015, the African Development Fund Board approved a grant of US$30 million for the Protection of Basic Services Program. This is ring fenced Sector Budget Support, which is designed to protect critical expenditures in health, education and social protection, and improve accountability following suspension of general budget support. The grant was disbursed in one tranche in July 2015. The PBS operation was followed by the Food Crisis Response Budgetary Support in 2016. The Bank intends to provide general budget support during the medium term, which will complement the World Bank's recently approved budget support to Malawi. The Bank will continue to coordinate closely with the IMF in the design of its budget support operations to ensure its programs are underpinned by sound macro-economic policies.

Three new operations are programmed for approval in 2017: (i) the Shire Valley Irrigation Project (US$40 million) which will be co-financed with the World Bank; (ii) Investment Promotion & Competitiveness Program (US$9.5 million); and (iii) Economic Census Capacity Building Project (US$1 million).

Box 1. AfDB Ongoing Operations

The Bank's current active portfolio includes four projects in the agriculture sector: (i) Agriculture Infrastructure Support Project; (ii) Small Holder Irrigation and Value Addition Project; (iii) Agriculture Infrastructure & Youth Agri Business; and (iv) Agricultural Cooperative Bank Study. There are currently three projects providing support to the social sector and for economic empowerment: (i) the Competitiveness and Job Creation Project, which seeks to improve the capabilities and the competitiveness of the private sector as well as increase export diversification and job creation; (ii) Support to Higher Education Science & Technology Project which aims to increase access to technical, entrepreneurship, vocational and training (TEVET) and higher education in Malawi, with particular emphasis on Information and Communication Technology (ICT) and (iii) Jobs for Malawi Youth targeting the youth. In the transport sector the Bank is supporting the Mzuzu-Nkhata Bay Road Rehabilitation Project and the Multinational Nacala Road Corridor Phase IV. In the water sector, the Bank is providing support for two projects: the Sustainable Rural Water and Sanitation for Improved Health and Livelihood Project and the Mzimba Integrated Urban Water Project of US$5 million, co-financed with OFID. The two on-going Institutional Support Projects are providing support for the Public Financial Management Reform Program. Currently, the overall Bank portfolio is rated satisfactory. The Bank's Malawi Field Office is working closely with the Government to ensure continued improvement in project implementation efficiency for enhanced development results.

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. In 2013, the Bank collaborated with the World Bank and other partners on the Public Expenditure Review. The Bank has in addition provided support for the Expenditure Tracking Study. 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 has provided technical assistance to the Malawi Postal Cooperation for the development of the E-Post Strategy and Action Plan. The Bank also undertook the Domestic Resource Mobilization Study for Malawi in 2013/2014 and provided TA to the Reserve Bank of Malawi to strengthen capacity in macro-economic forecasting.

The Bank shall commence preparation of a new Country Strategy Paper soon, which will be aligned with Malawi's new National Development Plan and the Bank's Long Term Strategy, in particular, the "High Fives" priorities, which include "Light up and Power Africa", "Feed Africa", and "Improve the Quality of Life for the People of Africa".

STATISTICAL ISSUES

MALAWI—STATISTICAL ISSUES APPENDIX As of May 20, 2016
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Shortcomings remain in the national accounts—mainly due to operational challenges—and government finance statistics.
National Accounts: Since 2010, STA is providing technical assistance (TA) to the National Statistics Office (NSO) on strengthening the quality of national accounts statistics, most recently in April this year. The NSO has revised the national accounts methodology to improve the consistency with the 2008 SNA and develop preliminary quarterly estimates of GDP by economic activity. Further TAs being provided to develop quarterly GDP estimates by expenditure components. Main operational challenges are the NSO's continuing budget constraints, the lack of funds to implement the requisite data collections, and low staffing levels in the national accounts unit.
Price Statistics: An updated and revised consumer price index (CPI) was introduced in January 2013. In addition to new weights and items, the updated CPI reflects improved index calculation methods, the implementation of the internationally recommended Classification of Individual Consumption by Purpose (COICOP), and improved compilation methods. In April 2013, an updated PPI for manufacturing was released, reflecting updated weights. There remains a need to expand the coverage of the PPI to include additional economic activities. The NSO is in process of developing export-import price indexes.
Government Finance Statistics: The accuracy and reliability of the data are affected by source data weaknesses, especially coming from inaccuracies in recording and consolidating the data. Due primarily to differences in coverage and the recording of some subsidies on a funding basis, published data for the budgetary central government include a sizeable statistical discrepancy between above and below the line data reported by the Reserve Bank of Malawi (RBM). 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. This is a result of the way taxes are reported and timing differences between receipt of taxes and cleared funds becoming available for the government. Nontax revenue, including capital revenues collected by line ministries, is not properly accounted for in the fiscal reports prepared by the Ministry of Finance. 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 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 the chart of accounts and output-based structures so that they could more easily be realigned to the national strategy and be more readily understood. The most recent STA mission in March 2015 proposed and discussed a migration plan and timetable to adopt the GFSM 2001 methodology.
Monetary and Financial Statistics: The RBM recently revamped the other depository corporations (ODCs)' report templates to ensure their consistency with the methodology outlined in the *MFS Manual*. Despite these improvements, progress toward full adoption of the SRF-based monetary statistics is hindered by the quality of the underlying source data for ODCs, where ODCs' balance sheets and their supporting data schedules do not always match.
Financial Sector Surveillance: Malawi does not report Financial Soundness Indicators (FSIs) to STA.
External sector statistics: The external sector statistics are in broad conformity with the fifth edition of the *Balance of Payments Manual (BPM5)*. The NSO has gradually been implementing *BPM6*. However, insufficient resources for collecting survey data and the understaffed balance of payments section continue to hamper further improvements. In the absence of regular source data, some of the components of BOP and IIP data are imputed based on the data from earlier surveys. Procedures for assessing the accuracy of trade data need to be improved. 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. Data on foreign direct investment and portfolio flows remains weak. Capacity building programs, including Fund-provided training and technical assistance, seek to overcome the above constraints. In addition, updated BOP and IIP metadata should be made available on the NSO website.

II. Data Standards and Quality	
In FY2016, STA will be conducting an Enhanced General Data Dissemination System (e-GDDS) mission to implement the e-GDDS framework, including a National Summary Data Page in Malawi.	Data ROSC was published on February 17, 2005.

III. Reporting to STA
Government finance data for the Budgetary Central Government in a GFSM 2001 presentation are reported for publication in the Government Finance Statistics Yearbook (GFSY) and International Financial Statistics (IFS). However, these data are not disseminated domestically. The RBM reports monetary data on a regular basis, with monthly data disseminated through the *International Financial Statistics (IFS)*. The NSO reports the BOP and IIP data to STA annually in the *BPM6* format.

Malawi: Tables of Common Indicators Required for Surveillance

(As of May 24, 2017)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/2017	04/2017	M	M	M
Reserve/Base Money	02/2017	04/2017	M	M	M
Broad Money	02/2017	04/2017	M	M	M
Central Bank Balance Sheet	02/2017	04/2017	M	M	M
Consolidated Balance Sheet of the Banking System	02/2017	04/2017	M	M	M
Interest Rates[2]	03/2017	03/2017	M	M	M
Consumer Price Index	04/2017	05/2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] — General Government[4]	NA.	NA			
Revenue, Expenditure, Balance and Composition of Financing[3]— Central Government	12/2017	03/2017	M	M	I
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[5]	12/2017	03/2017	M	M	M
External Current Account Balance	12/2016	03/2017	A	A	A
Exports and Imports of Goods and Services	12/2016	03/2017	A	A	A
GDP/GNP	12/2012	03/2015	A	A	A
Gross External Debt	12/2016	03/2017	A	I	I
International Investment Position[6]	2014	03/2016	I	I	I

[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 discounts 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).

MALAWI

June 7, 2017

NINTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA—DEBT SUSTAINABILITY ANALYSIS

Approved By
Michael Atingi Ego and Zeine Zeidane (IMF) and Paloma Casero (IDA)

The Debt Sustainability Analysis has been prepared jointly by IMF and International Development Association staff using the debt sustainability framework for low-income countries approved by the Boards of both institutions.

Malawi faces a moderate risk of debt distress based on an assessment of public external debt, with heightened vulnerabilities related to domestic debt.[1] *Malawi's debt situation is somewhat better than indicated in the last DSA*[2] *mostly because of low disbursement in 2016 and fiscal tightening, but the debt level and interest expense remains high. All baseline external debt burden indicators remain below their indicative thresholds, but public external debt remains vulnerable to exogenous shocks, notably shocks to export revenues and exchange rate. The projected borrowing path and debt policies remain broadly unchanged since the last DSA, but close attention will need to be paid to the financing terms of any proposed infrastructure investments given the limited headroom for further borrowing.*

[1] The DSA was prepared by Pranav Gupta (Economist, IMF) and Richard Record (Senior Economist, IDA)

[2] IMF Country Report No. 16/182, June, 2016.

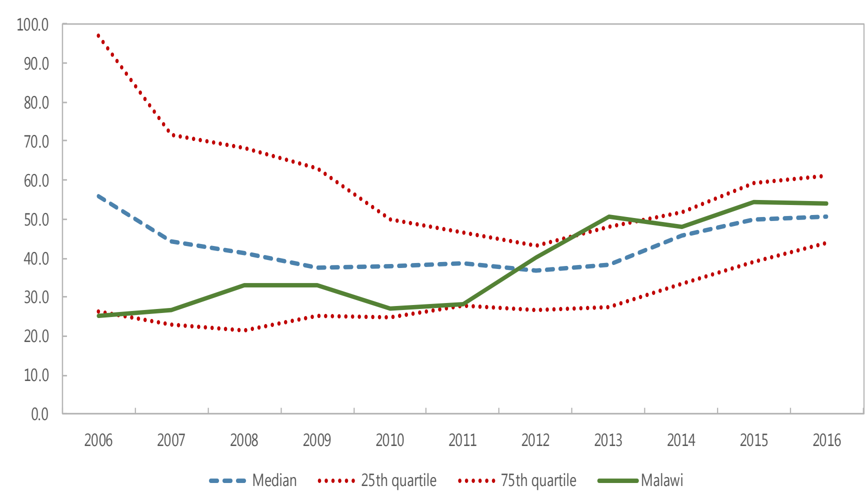
BACKGROUND

1. **The last Low Income Country Debt Sustainability Analysis (DSA) conducted in June 2016 concluded that Malawi's external public debt faced moderate risk of debt distress.** Malawi's external debt situation has shown a slight improvement since the last DSA on account of lower disbursement and tighter fiscal policies.

2. **Malawi's score under the World Bank's Country Policy and Institutional Assessment (CPIA), which measures the quality of a country's present policy and institutional framework, remained stable in 2016.** The CPIA assesses how conducive that framework is to fostering poverty reduction, sustainable growth, and the effective use of development assistance. Malawi's score peaked at 3.4 in 2007 before deteriorating to 3.1 in 2013. The country saw a modest improvement in its CPIA score to 3.2 in 2015, which was maintained in 2016. Malawi performs above the average for Sub-Saharan Africa (SSA) in the areas of social inclusion and equity (with a score of 3.5, higher than the 3.2 average for SSA), and broadly consistent with regional average for public sector management and institutions (3.1 vs. 3.0 of SSA). Structural policies are also at par with the average of SSA (3.2), while economic management stands well below regional averages at 2.8 (compared to 3.2 for SSA). Since 2014, Malawi has been subject to the tighter debt thresholds for DSA analysis reflecting a weakening policy and institutional framework.

3. **Malawi has accumulated debt at a fast rate over the recent years, and the country's debt level is high compared to its SSA peers**[3]. Since the HIPC and MDRI debt relief in 2006, Malawi's debt has more than doubled, and now stands at 54.3 percent of GDP compared to 26.7 percent of GDP in 2007, just after the debt relief. This is one of the fastest pace of accumulation of debt amongst countries which received HIPC and MDRI debt relief. Malawi's debt now stands significantly above the median debt levels of SSA PRGT eligible countries (Figure 1).

Figure 1. Total Public Debt—SSA PRGT Eligible Countries (Percent of GDP)



Source: WEO data and IMF staff calculation.

[3] We only include Poverty Reduction Growth Trust (PRGT) eligible SSA countries for comparison.

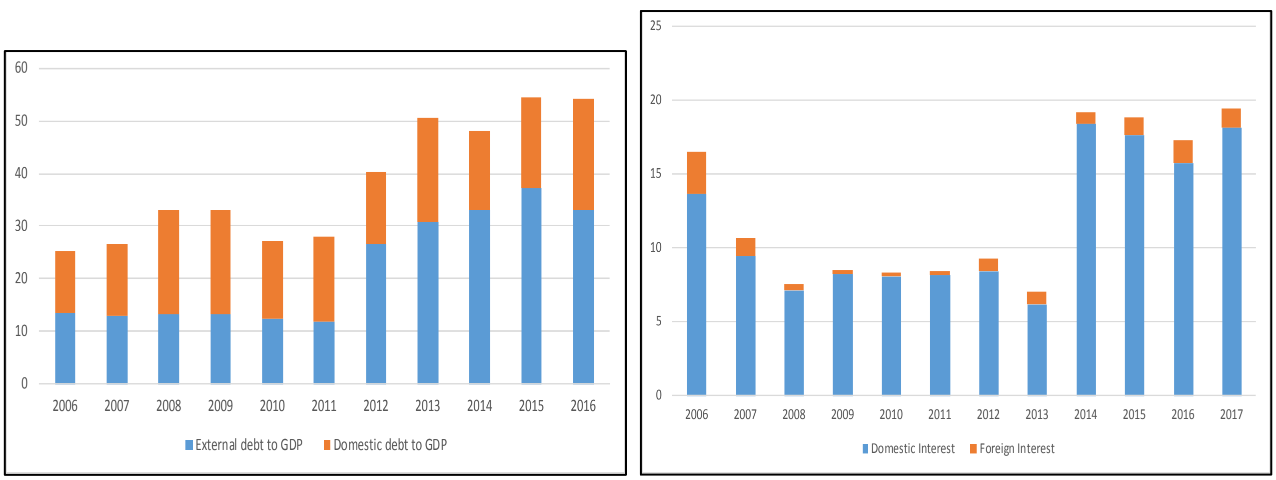
4. **In recent years, the composition of debt has shifted progressively from external to domestic borrowing**. This is due to the sustained large fiscal deficits incurred during 2013–17, the securitization of domestic arrears, and the withdrawal of donor financing. Notwithstanding the 2014 PTA debt restructuring transaction which converted part of domestic debt into external debt, the stock of government domestic debt has increased significantly in recent years (Figure 2). In 2014, the government sold to Preferential Trade Area (PTA) Bank, a non-resident identity, equivalent of US$250 million. This transaction led to a conversion of domestic debt into external debt since external debt in the DSA is defined in terms of creditor's residency. As these T-bills mature, they will be rolled over into new government securities, hence reversing the above conversion.

5. **The interest expense as a share of revenue has risen significantly in recent years and stands at around 20 percent of government revenues in FY2016/17 (Figure 2)**. This change reflects the much higher servicing cost of Malawi's domestic debt, compared to external debt which is predominantly on highly concessional terms. In particular, interest expense on domestic debt increased sharply in 2014 as the Reserve Bank of Malawi (RBM) tightened its policy to anchor inflation expectations. Debt service to revenue ratio is also expected to remain high at around 30 percent in 2017. Going forward, as the inflation declines, it is expected that the interest expense would be on the declining path.

Figure 2. Total Public and Publicly Guaranteed Debt and Interest Expense

Total Public and Publicly Guaranteed Debt (Percent of GDP)

Interest Expenses (Percent of Revenue)



Sources: Malawian authorities and IMF staff calculation.

RECENT DEBT DEVELOPMENTS

6. **Malawi's public and publicly guaranteed (PPG) external debt stood at about US$1.79 billion (33.1 percent of GDP) in 2016, compared to US$1.45 billion (30.8 percent of GDP) in 2013**. At the end of 2015, the nominal value of PPG external debt stood at US$1.78 billion, which increase

marginally to US$1.79 billion in 2016 due to lower external borrowing by the central government and the exchange rate depreciation in 2016[4], which reduced the face value of PTA debt outstanding. The PTA debt restructuring loan[5] was contracted in 2014 in U.S. dollars with the repayment to be made in Kwacha. This means that as the exchange rate depreciates, the dollar denominated face value of PTA debt declines.

7. **The external debt of Malawi is held mainly by multilateral creditors (76 percent of the total in 2016), and the remainder held by bilateral creditors** (Text Table 1). The main provider of loans to Malawi is the International Development Association (IDA) (35.9 percent), followed by the African Development Fund (ADF) (13 percent) and the IMF (11 percent). China and India are the main holders among bilateral creditors, with China accounting for about 12 percent of total debt. Data on private external debt remains unavailable, but the amounts are not believed to be large.

Text Table 1: Malawi: Composition of Public and Publicly Guaranteed External Debt
(Million U.S. dollars)

	2014		2015		2016	
	Actual	Share	Actual	Share	Actual	Share
Multilaterals	1357.40	75.22	1343.10	75.33	1362.34	76.17
IMF	176.00	9.75	162.81	9.13	206.06	11.52
IDA	501.40	27.79	589.90	33.09	642.21	35.91
ADF	226.00	12.52	228.77	12.83	247.91	13.86
IFAD	77.40	4.29	71.80	4.03	72.49	4.05
other multilateral & PTA	376.60	20.87	289.83	16.26	193.66	10.83
		0.00		0.00		0.00
Bilateral	432.60	23.97	439.48	24.65	426.23	23.83
France	3.30	0.18	0.00	0.00	0.00	0.00
Belgium	1.90	0.11	1.72	0.10	1.65	0.09
People's Republic of China	244.00	13.52	242.74	13.61	226.90	12.69
India	141.80	7.86	151.74	8.51	147.29	8.23
others	41.60	2.31	43.28	2.43	50.40	2.82
		0.00		0.00		0.00
Commercial	14.49	0.80	0.39	0.02	0.00	0.00
Total	**1804.49**	**100.00**	**1782.97**	**100.00**	**1788.57**	**100.00**

Sources: Malawian authorities and IMF staff estimates.

8. **Gross domestic debt increased from MK206.6 billion (13.8 percent of the new rebased GDP) at the end of 2012 to MK865.3 billion (21.1 percent of GDP) at the end-2016**. As illustrated in Text Table 2, this increase is largely due to:

[4] The nominal effective exchange rate depreciated by around 27 percent in 2016.

[5] An equivalent to 6 percent of GDP of RBM advances was converted into Treasury notes and sold to a regional non-resident bank (PTA) bank in December 2014-January 2015. The PTA debt restructuring loan was considered as an external loan, despite repayments in local currency since the lender (PTA bank) is a foreign entity. At the time of contracting the loan, the government sold to PTA three-year maturity Treasury bills, equivalent to US$250 million. The U.S. dollar value of Treasury notes held by PTA was revised downwards following the steep depreciation of the Kwacha.

- The rise in government net domestic financing (NDF) during FY13/14 and FY14/15, following the drop in external financing in the wake of the "cashgate" scandal; NDF averaged 3.7 percent of GDP during these two fiscal years and was covered by a mix of issuance of treasury bills and accumulation of ways and means advances from the RBM.

- The issuance of promissory notes in 2013–14 in the amount of MK58 billion (2.3 percent of the 2014 GDP) by the government to recapitalize RBM following losses that arose from the 2012 devaluation of the exchange rate. An additional amount of promissory notes (MK6.07 billion, or 0.2 percent of GDP) was issued in mid-2015 to cover bad loans of a public bank that was being privatized.

- The securitization of domestic arrears in March 2013 (2.2 percent of GDP) and in 2015–16 (2.9 percent of GDP). The 2013 issuance securitized close to MK38.7 billion of verified arrears, through promissory notes at the T-bill rates plus 200 basis points to be paid off by mid-2017. The 2015–16 issuance is related to a stock of domestic arrears accumulated before FY14/15 (about MK157 billion). Of that stock, MK115 billions of issued zero-coupon promissory notes had not yet matured by end-2016.

- The issuance of a substantial amount of Treasury notes over 2012–15 with maturity ranging from two to ten years, mostly for the conversion of ways and means and maturing Treasury bills into longer-term government securities.

Text Table 2. Composition of Gross Domestic Debt

(Percent of GDP)

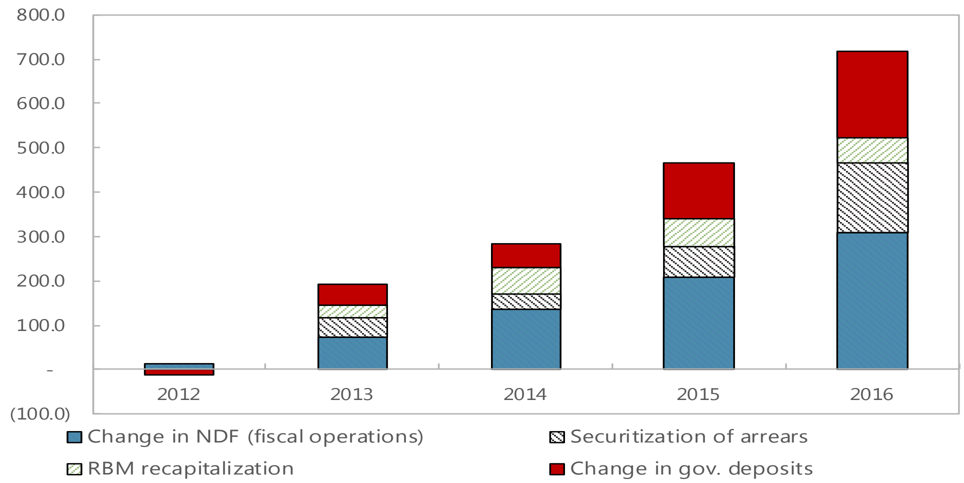
	2012	2013	2014	2015	2016
	Actual				
Treasury bills at cost value	9.0	9.1	6.9	6.2	5.8
Treasury notes	2.7	1.8	1.3	6.0	11.5
Local registered stocks (LRS)	0.2	0.1	0.1	0.0	0.0
Ways and means advances from RBM	1.7	5.2	3.0	0.9	0.9
Promissory notes for recapitalization of banks	0.1	1.5	2.3	2.0	0.7
Promisory notes for clearance of arrears	0.0	2.2	1.4	2.2	3.1
Commercial bank advances	0.1	0.0	0.0	0.0	0.0
Total	13.8	19.8	14.9	17.3	22.1

Sources: Malawian authorities and IMF staff estimates.

9. **On the other side of the government's financial balance sheet, the accumulation of gross domestic debt originates from four elements (Figure 3)**. The net domestic financing of the fiscal deficit (43 percent), followed by the accumulation of deposits (27 percent), the securitization of old arrears (22 percent) and the recapitalization of the central bank and one public bank (8 percent) resulted in the gross domestic debt reaching MK718 billion between 2011 to 2016. The accumulation of deposits is generated by an accumulation of gross domestic debt when issued new government securities are higher

than the amount required by a simple rolled-over of maturing securities or do not correspond to a conversion of ways and means.

Figure 3. Components of Cumulative Changes in Gross Domestic Debt (Billions Kwacha)



Sources: Malawian authorities and IMF staff estimates.

10. **Following two years of weather-related humanitarian crisis, the government is placing a strong emphasis on prioritizing external borrowing around investments that boost resilience and close the infrastructure gap**. Plans to invest heavily in irrigation in the Shire Valley with IDA and ADF resources aim to help mitigate the risk of climate variability. A large-scale investment in the Nacala rail corridor by a consortium of private financiers led by the International Finance Corporation will help boost connectivity for international trade, while minimizing the risks to external debt sustainability. However, given the limited headroom available to Malawi it is critical that careful attention be paid to the financing terms of any large infrastructure investments under consideration to avoid any change in the risk of debt distress.

UNDERLYING DSA ASSUMPTIONS

11. **Malawi's economy has been hit hard by weather-related shocks for a second consecutive year resulting in several areas of underperformance relative to the June 2016 DSA**. Owing to one of the worst weather related shocks, GDP growth in Malawi is expected to decline to 2.3 percent in 2016 compared to 3.0 percent in 2015[6]. The Kwacha, like most currencies in the region, experienced a sharp depreciation against the U.S. dollar in 2016, albeit with some stabilization in the latter half of the year. Despite robust tobacco exports, overall exports dropped because of lower exports of crops such as sugar and tea. The current account is estimated to have widened substantially due to largescale maize imports for the humanitarian relief operation, carried out by the World Food Program as well as a number of private importers. The baseline maintains the assumption of a gradual reduction in the external current account

[6] IMF staff estimates.

deficit beyond 2017 through a recovery in agricultural (especially maize) production, as well as a degree of export diversification and productivity improvements in the exportable sectors. It also assumes a gradual lowering of the reliance on grants and concessional financing over the long-term. End-of-period inflation is projected to drop to single digits by end-2018. The key macroeconomic assumptions are summarized in Box 1.

12. **It is assumed that the current policy mix aimed at restoring macroeconomic stability will be pursued over the medium-term**. These policies will consist of tighter fiscal and monetary policies to keep inflation on a declining trend, PFM reforms to improve the quality of spending and mobilization of revenues, prudent external borrowing, and structural reforms to address supply-side bottlenecks and improve factor productivity.

Box 1. Baseline Macroeconomic Assumptions

Real GDP growth is projected to gradually recover from 2.3 percent in 2016 to 4.5 percent in 2017 and to remain close to 5.5 percent over the medium term, driven by agriculture, improved productivity across sectors and the population growth rate. This is also consistent with the historic growth average over the past 10 years.

Inflation (end-of period) is projected to gradually decline from 20.0 percent at end-2016 to 13.0 percent by December 2017 and to reach single digits by 2018 in the absence of other weather-related shocks. The continuation of tight fiscal and monetary policies should help anchor inflation expectations based on the decline in nonfood inflation for five consecutive months.

The exchange rate is projected to remain constant in real terms in the medium to long term.

The tax revenue to GDP ratio is expected to increase in FY16/17 and FY17/18 due to higher tax collection in international trade following, the recent depreciation and improved efficiency of tax administration. The increase is expected to be higher than what was assumed at the time of last DSA. In the long run, we assume that tax revenue will gradually increase from 17.9 percent of GDP in FY17/18 to around 19 percent of GDP in FY35/36, as a result of progressive reforms to tax administration and policy.

External debt will be mainly contracted over the medium term from multilateral creditors on concessional terms, with the remainder being bilateral on broadly similar terms. Budget support from multilateral and bilateral donors is assumed to remain subdued for FY 2016/17 and into the medium term. For FY 2017/18, the baseline assumes US$ 80 million budget support from the World Bank.

The current account deficit is projected to increase in 2016 due to higher imports of food supplies to compensate for domestic food shortages on account of the drought, which would be financed by higher donor support. Going forward from 2017, the current account is projected to remain on a gradual declining path.

New disbursements on external loans. For 2017, new disbursements on external loans are taken from the authorities' fiscal framework, which projects capital spending covered by external loans to reach 4.1 of GDP in FY16/17 and 3.6 percent in FY17/18. It is assumed that external project loans will remain close to 3 percent of GDP in subsequent fiscal years.

Net domestic financing. It is assumed that government net domestic financing will be limited to less than 1 percent of GDP in each fiscal year beyond FY17/18, thus contributing marginally to the change in domestic debt.

Text Table 3. Macroeconomic Forecast and Assumptions (Previous and Current DSAs)

	Real GDP growth		Primary deficit (percent of GDP)		Change in public debt (percent of GDP)	
Year	Previous	Current	Previous	Current	Previous	Current
2014	5.7	5.7	0.3	0.2	-2.6	-2.6
2015	3.0	2.9	2.0	2.1	5.8	6.6
2016	2.7	2.3	2.5	1.9	-1.7	-0.3
2017	4.5	4.5	0.2	1.3	-5.0	-4.4
2018	5.0	5.0	0.6	-0.6	-2.4	-1.0
2019	5.5	5.5	0.3	-0.1	-2.1	-1.7
2020	5.5	5.5	0.7	-0.1	-1.0	-2.4
2021	5.5	5.5	1.1	-0.1	-0.3	-1.5
2022	5.5	5.5	1.6	-0.3	-0.4	-1.3
Avg 2023-2037	5.5	5.5	1.3	0.4	-0.3	-0.6

Sources: Malawian authorities and IMF staff calculations and projections.

1/ Base year for previous DSA was 2015 and 2016 for the current DSA.

EXTERNAL PUBLIC DEBT SUSTAINABILITY

13. **All baseline external debt burden indicators remain below their indicative thresholds, but public external debt remains vulnerable to exogenous shocks, notably shocks to export revenues and the exchange rate**. Debt service is high in 2016 because of large amortization related to the debt restructuring operation with the PTA bank, but the ratio falls significantly once the PTA related amortization is completed. In 2017 the nominal value of PPG external debt is projected to fall further on account of a further large amortization repayment related to the PTA loan.

A. Stress Tests

14. **Standard tests indicate that a weaker debt outcome is possible under certain conditions.** The strongest impact on the indicators arises under scenario of one-time depreciation of 30 percent in 2018 causing the PV of debt to GDP, PV of debt to revenue and debt service to revenue to breach the thresholds and remain at elevated levels. Another risk arises under the historical scenario, when the average current account deficit was around 10.1 percent of GDP and low foreign direct investment (around 1.5 percent of GDP), causing all ratios to breach the thresholds and remain at elevated levels. In addition, the team has moved to the IMF BPM6 classification affecting the historical scenario. In the past, project and dedicated grants were classified on the current account but are now subsequently reclassified to the capital account leading to significant increase in historical values of the current account deficit[7]. However, Malawi

[7] Average of current account over last 10 years was around -5.5 percent, compared to -10.1 percent under the revised classification. For example, under the reclassification, current account for 2011 and 2012 were revised from -5.9 percent and -3.5 percent to -9.3 and -8.7 percent respectively.

is unlikely to run high and protracted current account deficits in medium-long term because (i) prior to 2012, Malawi had a pegged exchange rate regime, with a highly overvalued exchange rate, which has now been removed; and, (ii) as macroeconomic stability is regained and the business environment improves, we expect increases in FDI inflows, especially in the energy sector.

PUBLIC DEBT SUSTAINABILITY

15. **Gross total debt as a percentage of GDP is projected to decline from 54.3 percent at end-2016 to around 33 percent by end-2037.** The levels and path for total public debt are in line with the June 2016 DSA, with present value of debt to GDP indicator marginally higher than desirable benchmarks (Figure 6). The marginal breach is caused due to increase in domestic debt related to PTA amortization and the issuance of zero coupon promissory notes. Standard tests suggest that the debt dynamics would deteriorate relative to the baseline (Figure 6 and Table 5) in the presence of shocks. The strongest impact is under the fixed primary balance scenario, where we assume that the primary deficit would remain constant at the 2016 level (1.2 percent of GDP) for the remainder of projection period.

16. **Gross domestic debt as a percentage of GDP is projected to gradually decline over the medium term from 21.2 percent of GDP at end-2016 to around 12 percent of GDP at end-2022**. These projections assume that (i) the cost value of all maturing T-bills and the face-value of all maturing Treasury notes will be continuously rolled over; (ii) the government net domestic financing will be limited to less than 1 percent of GDP in each fiscal year after 2016; (iii) the issuance of zero coupon promissory notes for the payment of domestic arrears uncovered in late 2014 will be gradually completed by mid-2017, after verification and audit; and (iv) all maturing promissory notes, including those sold to PTA bank, will also be automatically converted into advances from the central Bank and ultimately rolled over into T-bill of varying maturities (91, 182 and 364 days) or T-notes of longer than one year maturity which could then be tradable in the secondary market.

B. Policy Implications

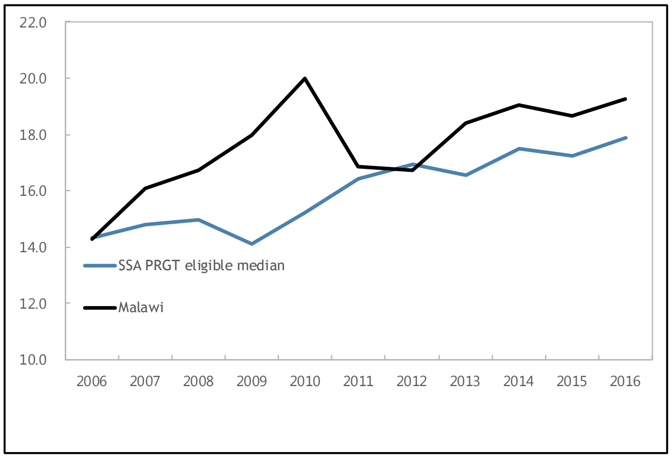
17. **Malawi continues to face a number of external financing risks that can only be addressed by increased fiscal restraint** in order to ensure that growth in the country's debt takes place at a sustainable pace. As such, fiscal tightening is expected to be the policy response to unexpected negative financing shocks (such as delayed or lower donor support, lower tax revenue or growth shocks). Higher than assumed domestic borrowing would bring additional pressures on the exchange rate and on non-food inflation, and crowd out private sector borrowing and investment, while also eroding perceptions of government commitment to policy reforms and maintaining macroeconomic stability.

18. **Reorientation of government expenditure from current spending to capital expenditure could lead to both higher and more resilient economic growth**. In recent years, the composition of government spending has shifted from capital spending to current spending. Expenditure related to wages and interest expense has overshadowed much needed capital expenditure (Figure 4). In addition, Malawi suffers from vulnerabilities related to a dependency on a short and predominantly rain-fed agricultural season in order to meet food security needs and an increased frequency of climate-induced weather

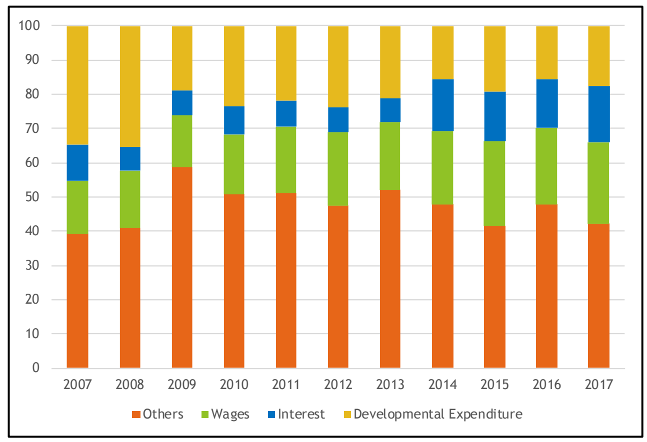
shocks. These vulnerabilities can be mitigated by long-term investments in infrastructure and diversification of the economy. In particular, increased capital investments in better irrigation and water management could help to both boost agricultural productivity and mitigate against climate change. Efforts to improve agricultural commercialization and address energy shortages will also be needed. But considering recent increase in debt vulnerabilities, government needs to prioritize projects with high returns and rely on concessional borrowing. On revenue side, the Malawi Revenue Authority is performing well and the revenue collection in Malawi is well above the median of SSA low income countries.

Figure 4. Revenue and Composition of Government Expenditure

Revenue (excl. grants) (Percent of GDP)



Decomposition of Government Expenditure



Sources: Malawian authorities and IMF staff estimates.

C. Authorities' Views

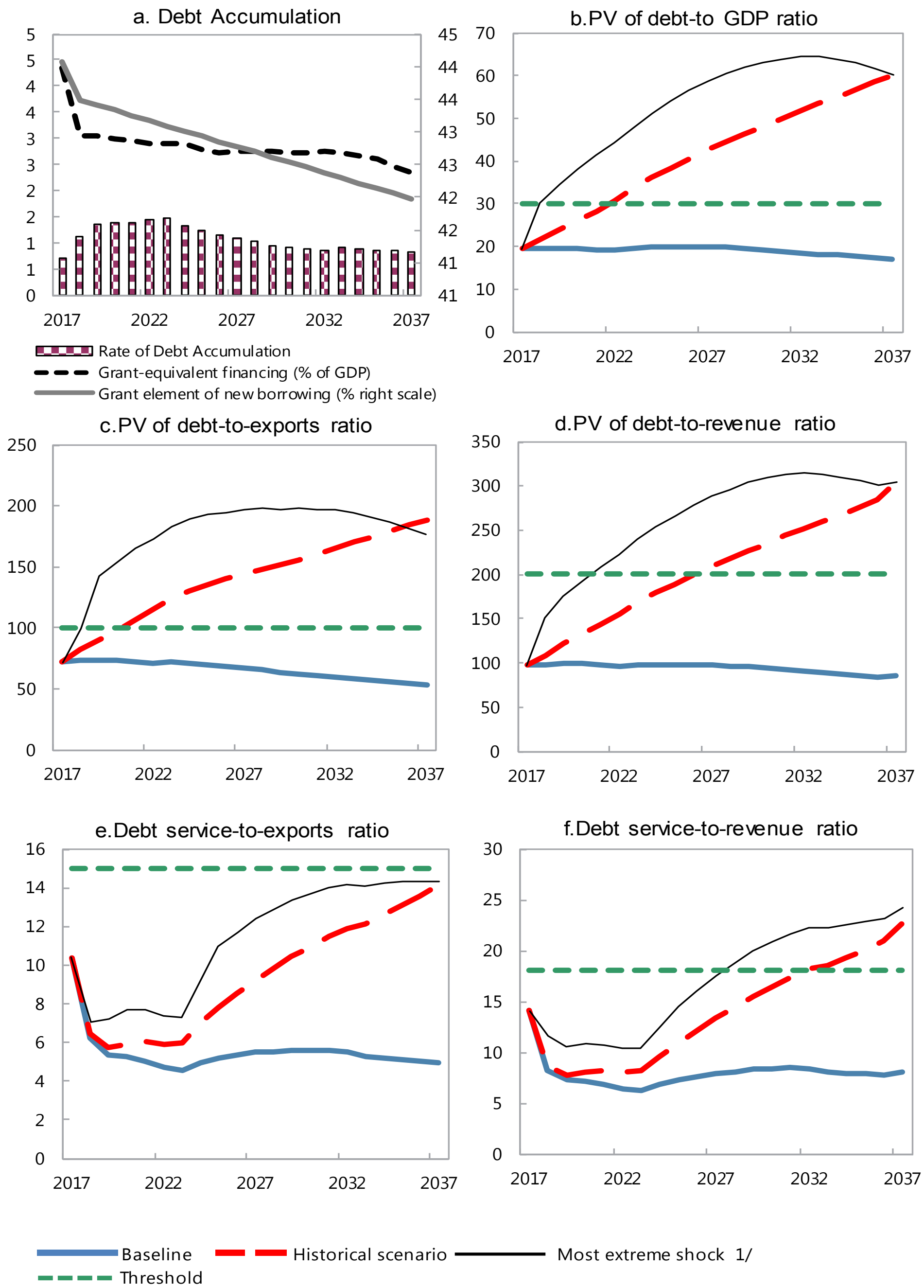
19. **The Malawian authorities concurred with the analysis and conclusion of this DSA.** They agreed with staff that a prudent external borrowing and a consolidated fiscal position limiting domestic financing needs will be key to maintaining total debt sustainability. Achieving this objective will require strengthening debt management and relying on concessional debt to the extent possible. The authorities have placed a strong emphasis on maintaining debt sustainability, particularly when considering value-for-money and the financing terms of any new infrastructure investment projects.

CONCLUSIONS

20. **Malawi remains at moderate risk of debt distress, based on an assessment of external public debt, but heightened overall risks remain, reflecting vulnerabilities to domestic debt and external conditions.** Risks of export-related and weather shocks remain, and have materialized since the last DSA. Absorption of weather shocks while maintaining macroeconomic stability and debt sustainability will require careful macroeconomic management and difficult policy choices. Close attention will need to be

paid to the financing terms of any proposed infrastructure investments given the limited headroom for further borrowing. Similarly, risks of negative financing shocks in the form of delayed donor support, or lower-than-expected revenue collections also remain, given Malawi's high aid dependency. In such an environment, further efforts to maximize the impact of finite domestic resources are required. This calls for further efforts to broaden the tax base and strengthen public procurement and public financial management.

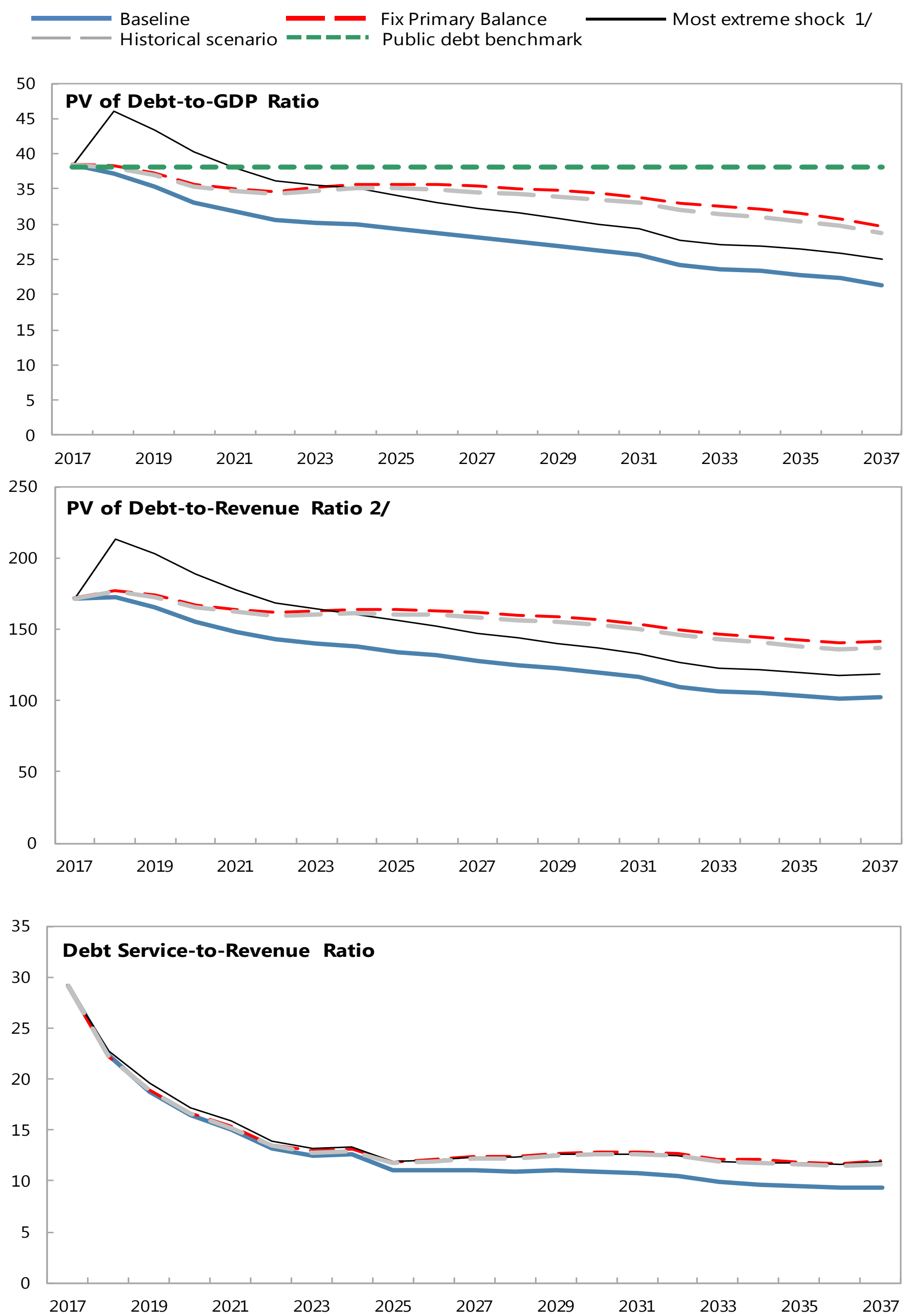
Figure 5. Malawi: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 6. Malawi: Indicators of Public Debt Under Alternative Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.
2/ Revenues are defined inclusive of grants.

Table 1. Malawi: External Debt Sustainability Framework, Baseline Scenario, 2014–37

(Percent of GDP, unless otherwise indicated)[8]

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2017-2022			2023-2037
	2014	2015	2016			2017	2018	2019	2020	2021	2022	Average	2027	2037	Average
External debt (nominal) 1/	**36.7**	**40.7**	**37.2**			**34.6**	**34.6**	**34.9**	**34.5**	**34.0**	**33.6**		**34.5**	**30.2**	
of which: public and publicly guaranteed (PPG)	33.1	37.3	33.1			30.9	31.2	31.5	31.3	31.0	30.6		31.9	28.5	
Change in external debt	1.9	4.0	-3.5			-2.6	0.0	0.3	-0.4	-0.5	-0.5		-0.1	-0.5	
Identified net debt-creating flows	4.1	5.7	8.5			4.9	4.2	3.6	3.5	3.3	3.0		2.7	1.4	
Non-interest current account deficit	**8.0**	**8.7**	**12.8**	**9.7**	**2.3**	**8.9**	**7.9**	**7.5**	**7.3**	**7.1**	**6.7**		**6.3**	**4.6**	5.8
Deficit in balance of goods and services	10.6	11.1	16.6			12.2	11.0	10.4	10.2	9.9	9.5		9.1	7.4	
Exports	28.9	25.5	29.1			27.0	26.7	26.8	26.7	26.6	26.9		29.6	31.8	
Imports	39.6	36.6	45.7			39.2	37.6	37.2	36.9	36.6	36.4		38.7	39.2	
Net current transfers (negative = inflow)	-5.1	-4.9	-5.7	-5.7	1.4	-5.3	-5.0	-4.9	-4.8	-4.7	-4.6		-4.5	-4.4	-4.5
of which: official	0.0	-0.4	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	2.5	2.5	2.0			2.0	1.9	1.9	1.9	1.8	1.8		1.7	1.6	
Net FDI (negative = inflow)	**-0.8**	**-1.8**	**-3.1**	**-1.9**	**1.1**	**-3.0**	**-2.5**	**-2.4**	**-2.4**	**-2.3**	**-2.3**		**-2.2**	**-1.9**	-2.1
Endogenous debt dynamics 2/	**-3.2**	**-1.2**	**7.6**			**-1.0**	**-1.3**	**-1.5**	**-1.4**	**-1.4**	**-1.4**		**-1.4**	**-1.3**	
Contribution from nominal interest rate	0.4	0.8	0.8			0.4	0.3	0.3	0.3	0.3	0.3		0.4	0.3	
Contribution from real GDP growth	-1.8	-1.0	-1.1			-1.5	-1.6	-1.8	-1.8	-1.8	-1.7		-1.8	-1.6	
Contribution from price and exchange rate changes	-1.8	-1.0	7.9			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-2.2**	**-1.7**	**-12.1**			**-2.5**	**0.4**	**1.2**	**0.4**	**0.4**	**0.5**		**1.2**	**0.1**	
of which: exceptional financing	-3.7	-2.6	-2.6			-4.0	-3.2	-3.2	-3.2	-3.1	-3.0		-3.0	-2.7	
PV of external debt 4/	...	...	25.7			23.1	22.9	23.0	22.7	22.3	22.0		22.3	18.6	
In percent of exports	...	...	88.3			85.5	86.0	85.8	84.9	83.8	81.8		75.5	58.5	
PV of PPG external debt	**...**	**...**	**21.6**			**19.4**	**19.5**	**19.6**	**19.4**	**19.2**	**19.1**		**19.8**	**16.8**	
In percent of exports	**...**	**...**	**74.1**			**72.0**	**73.0**	**73.2**	**72.8**	**72.2**	**70.9**		**67.0**	**53.0**	
In percent of government revenues	**...**	**...**	**114.2**			**97.5**	**97.3**	**99.4**	**98.7**	**97.2**	**95.9**		**97.0**	**85.0**	
Debt service-to-exports ratio (in percent)	**4.7**	**7.4**	**12.3**			**10.4**	**6.2**	**5.3**	**5.2**	**5.0**	**4.7**		**5.5**	**5.0**	
PPG debt service-to-exports ratio (in percent)	**4.7**	**7.4**	**12.3**			**10.4**	**6.2**	**5.3**	**5.2**	**5.0**	**4.7**		**5.5**	**5.0**	
PPG debt service-to-revenue ratio (in percent)	**7.2**	**10.2**	**19.0**			**14.0**	**8.2**	**7.2**	**7.1**	**6.8**	**6.3**		**7.9**	**8.0**	
Total gross financing need (Billions of U.S. dollars)	0.5	0.6	0.8			0.6	0.5	0.5	0.5	0.5	0.5		0.7	1.0	
Non-interest current account deficit that stabilizes debt ratio	6.1	4.7	16.4			11.5	7.9	7.2	7.7	7.6	7.2		6.4	5.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.7	2.9	2.3	5.5	2.6	4.5	5.0	5.5	5.5	5.5	5.5	5.2	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent)	5.5	2.8	-16.2	-1.3	12.8	10.1	3.3	-0.1	1.7	1.9	2.1	3.2	0.4	1.5	0.8
Effective interest rate (percent) 5/	1.2	2.3	1.8	1.0	0.6	1.4	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Growth of exports of G&S (US dollar terms, in percent)	5.1	-6.7	-2.3	11.3	16.9	6.9	7.0	6.1	6.8	7.2	8.8	7.1	8.0	7.4	7.5
Growth of imports of G&S (US dollar terms, in percent)	3.6	-2.1	6.9	6.4	15.4	-1.2	4.0	4.3	6.3	6.6	7.2	4.5	7.1	6.7	6.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	44.1	43.5	43.4	43.3	43.3	43.2	43.5	42.8	42.0	42.5
Government revenues (excluding grants, in percent of GDP)	18.6	18.5	18.9			19.9	20.0	19.7	19.7	19.8	19.9		20.4	19.8	20.4
Aid flows (in Billions of US dollars) 7/	0.4	0.4	0.3			0.3	0.2	0.2	0.3	0.3	0.3		0.4	0.6	
of which: Grants	0.2	0.2	0.1			0.2	0.1	0.1	0.1	0.1	0.1		0.2	0.3	
of which: Concessional loans	0.2	0.1	0.1			0.2	0.1	0.1	0.1	0.1	0.1		0.2	0.3	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.4	3.1	3.1	3.0	3.0	2.9		2.7	2.3	2.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			63.9	62.7	62.7	62.7	62.7	62.8		61.6	60.0	61.9
Memorandum items:															
Nominal GDP (Billions of US dollars)	6.1	6.4	5.5			6.3	6.9	7.2	7.7	8.3	9.0		11.9	22.6	
Nominal dollar GDP growth	11.5	5.8	-14.3			15.1	8.4	5.4	7.3	7.5	7.8	8.6	5.9	7.1	6.4
PV of PPG external debt (in Billions of US dollars)			1.2			1.2	1.3	1.4	1.5	1.6	1.7		2.3	3.7	
(PVt-PVt-1)/GDPt-1 (in percent)						0.7	1.1	1.3	1.4	1.4	1.4	1.2	1.1	0.8	1.0
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	21.6			19.4	19.5	19.6	19.4	19.2	19.1		19.8	16.8	
PV of PPG external debt (in percent of exports + remittances)	...	...	74.1			72.0	73.0	73.2	72.8	72.2	70.9		67.0	53.0	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	12.3			10.4	6.2	5.3	5.2	5.0	4.7		5.5	5.0	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

4/ Assumes that PV of private sector debt is equivalent to its face value.

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

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

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

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

Table 2. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to GDP ratio								
Baseline	19	19	20	19	19	19	**20**	17
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	19	22	24	26	28	31	**43**	60
A2. New public sector loans on less favorable terms in 2017-2037 2	19	19	21	21	22	23	**27**	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	19	22	26	28	31	33	**44**	45
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	19	23	30	32	34	36	**45**	44
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	19	26	34	38	41	44	**58**	60
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	19	23	27	30	32	34	**44**	43
B5. Combination of B1-B4 using one-half standard deviation shocks	19	26	36	38	41	44	**55**	54
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	19	30	35	38	41	44	**59**	60
PV of debt-to-exports ratio								
Baseline	72	73	73	73	72	71	**67**	53
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	72	82	89	98	106	114	**144**	189
A2. New public sector loans on less favorable terms in 2017-2037 2	72	73	77	80	83	85	**92**	92
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	72	80	91	101	110	117	**141**	134
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	72	99	142	154	165	172	**196**	176
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	72	80	91	101	110	117	**141**	134
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	72	86	102	111	120	126	**147**	136
B5. Combination of B1-B4 using one-half standard deviation shocks	72	91	115	125	134	141	**162**	147
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	72	80	91	101	110	117	**141**	134
PV of debt-to-revenue ratio								
Baseline	97	97	99	99	97	96	**97**	85
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	97	109	121	132	143	155	**208**	303
A2. New public sector loans on less favorable terms in 2017-2037 2	97	97	105	109	112	115	**133**	148
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	97	109	130	143	154	165	**213**	225
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	97	117	152	164	174	183	**222**	221
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	97	129	174	191	207	221	**286**	301
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	97	115	138	151	161	171	**213**	218
B5. Combination of B1-B4 using one-half standard deviation shocks	97	131	180	195	208	219	**270**	272
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	97	151	175	193	208	222	**288**	303

Table 3. Malawi: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (cont.)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
Debt service-to-exports ratio								
Baseline	10	6	5	5	5	5	**5**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	10	6	6	6	6	6	**9**	14
A2. New public sector loans on less favorable terms in 2017-2037 2	10	6	5	5	5	5	**6**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	10	6	6	6	6	5	**9**	11
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	10	7	7	8	8	7	**12**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	10	6	6	6	6	5	**9**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	10	6	6	6	6	6	**9**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	10	6	6	6	6	6	**10**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	10	6	6	6	6	5	**9**	11
Debt service-to-revenue ratio								
Baseline	14	8	7	7	7	6	**8**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	14	9	8	8	8	8	**13**	23
A2. New public sector loans on less favorable terms in 2017-2037 2	14	8	7	7	7	7	**9**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	14	8	8	8	8	8	**13**	18
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	14	8	8	8	8	8	**14**	18
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	14	10	10	11	11	10	**17**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	14	8	8	8	8	8	**13**	18
B5. Combination of B1-B4 using one-half standard deviation shocks	14	9	9	10	10	10	**17**	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	14	12	11	11	11	10	**17**	24
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	38	38	38	38	38	38	**38**	38

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
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 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.

Table 4. Malawi: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014–37
(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	48.0	54.6	54.3			49.9	48.9	47.3	44.9	43.4	42.1		40.1	33.0	
of which: foreign-currency denominated	33.1	37.3	33.1			30.9	31.2	31.5	31.3	31.0	30.6		31.9	28.5	
Change in public sector debt	-2.6	6.6	-0.3			-4.4	-1.0	-1.7	-2.4	-1.5	-1.3		-0.6	-1.0	
Identified debt-creating flows	-3.9	7.7	-0.9			-2.1	-1.4	-1.3	-2.0	-1.8	-2.0		-1.1	-0.8	
Primary deficit	0.2	2.1	1.9	1.2	1.6	1.3	-0.6	-0.1	-0.1	-0.1	-0.3	0.0	0.3	0.9	0.4
Revenue and grants	21.4	21.7	21.3			22.4	21.6	21.4	21.3	21.4	21.5		21.9	21.0	
of which: grants	2.8	3.2	2.4			2.4	1.7	1.7	1.6	1.6	1.6		1.5	1.2	
Primary (noninterest) expenditure	21.5	23.8	23.2			23.6	21.0	21.3	21.3	21.3	21.2		22.2	21.9	
Automatic debt dynamics	-4.0	5.6	-2.5			-3.4	-0.8	-1.2	-2.0	-1.7	-1.8		-1.4	-1.7	
Contribution from interest rate/growth differential	-1.8	-0.3	0.4			-1.0	-1.2	-1.7	-1.8	-1.6	-1.5		-1.9	-1.8	
of which: contribution from average real interest rate	0.9	1.0	1.6			1.3	1.2	0.9	0.6	0.8	0.8		0.3	0.0	
of which: contribution from real GDP growth	-2.7	-1.4	-1.2			-2.3	-2.4	-2.6	-2.5	-2.3	-2.3		-2.1	-1.8	
Contribution from real exchange rate depreciation	-2.2	6.0	-2.9			-2.4	0.4	0.5	-0.1	-0.2	-0.3		...	...	
Other identified debt-creating flows	0.0	0.0	-0.3			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.3			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	1.2	-1.1	0.6			-2.2	0.5	-0.4	-0.3	0.4	0.7		0.5	-0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	42.7			38.4	37.2	35.4	33.0	31.7	30.6		28.0	21.4	
of which: foreign-currency denominated	...	...	21.6			19.4	19.5	19.6	19.4	19.2	19.1		19.8	16.8	
of which: external	...	...	21.6			19.4	19.5	19.6	19.4	19.2	19.1		19.8	16.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.7	6.9	9.7			7.8	4.2	3.9	3.4	3.1	2.6		2.7	2.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	200.7			171.7	171.8	165.2	154.9	148.0	142.3		127.9	101.7	
PV of public sector debt-to-revenue ratio (in percent)	...	...	226.3			192.5	186.1	179.1	167.7	160.1	153.8		137.0	107.9	
of which: external 3/	...	...	114.2			97.5	97.3	99.4	98.7	97.2	95.9		97.0	85.0	
Debt service-to-revenue and grants ratio (in percent) 4/	25.7	22.3	35.7			29.2	22.3	18.8	16.4	15.0	13.2		11.1	9.4	
Debt service-to-revenue ratio (in percent) 4/	29.5	26.1	40.2			32.7	24.1	20.4	17.8	16.3	14.2		11.9	10.0	
Primary deficit that stabilizes the debt-to-GDP ratio	2.8	-4.5	2.2			5.6	0.4	1.6	2.3	1.4	1.0		0.9	1.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.7	2.9	2.3	5.5	2.6	4.5	5.0	5.5	5.5	5.5	5.5	5.2	5.5	5.5	5.5
Average nominal interest rate on forex debt (in percent)	2.7	5.2	4.0	2.3	1.4	3.1	2.2	2.3	2.3	2.4	2.4	2.5	2.4	2.4	2.4
Average real interest rate on domestic debt (in percent)	3.2	-2.1	3.4	2.0	5.3	4.3	6.4	5.4	3.9	5.6	5.8	5.2	1.6	-3.2	0.9
Real exchange rate depreciation (in percent, + indicates depreciatior	-7.5	17.8	-7.7	5.9	25.6	-7.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	20.9	21.0	19.7	15.7	6.9	13.5	10.4	8.9	8.7	6.7	4.9	8.8	3.9	5.1	4.3
Growth of real primary spending (deflated by GDP deflator, in percer	-12.8	13.9	-0.5	0.1	6.3	6.4	-6.5	6.9	5.2	5.8	5.0	3.8	6.3	1.7	5.8
Grant element of new external borrowing (in percent)	...	...	...	...	...	44.1	43.5	43.4	43.3	43.3	43.2	43.5	42.8	42.0	...

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 5. Malawi: Sensitivity Analysis for Key Indicators of Public Debt 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	38	37	35	33	32	31	28	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	38	38	37	35	35	34	35	29
A2. Primary balance is unchanged from 2017	38	38	37	36	35	35	35	30
A3. Permanently lower GDP growth 1/	38	37	36	34	33	32	33	36
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-20	38	38	38	36	35	34	34	31
B2. Primary balance is at historical average minus one standard deviations in 2018-201	38	39	39	37	35	34	31	23
B3. Combination of B1-B2 using one half standard deviation shocks	38	39	39	37	35	34	33	27
B4. One-time 30 percent real depreciation in 2018	38	46	43	40	38	36	32	25
B5. 10 percent of GDP increase in other debt-creating flows in 2018	38	43	41	39	37	36	33	24
PV of Debt-to-Revenue Ratio 2/								
Baseline	172	172	165	155	148	142	128	102
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	172	176	173	165	162	159	158	136
A2. Primary balance is unchanged from 2017	172	177	174	167	163	161	161	141
A3. Permanently lower GDP growth 1/	172	173	168	159	154	150	151	171
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-20	172	176	176	167	163	159	155	145
B2. Primary balance is at historical average minus one standard deviations in 2018-201	172	181	182	171	164	158	141	110
B3. Combination of B1-B2 using one half standard deviation shocks	172	180	181	171	165	159	148	126
B4. One-time 30 percent real depreciation in 2018	172	213	203	188	178	169	147	119
B5. 10 percent of GDP increase in other debt-creating flows in 2018	172	199	192	181	173	166	149	115
Debt Service-to-Revenue Ratio 2/								
Baseline	29	22	19	16	15	13	11	9
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	29	22	19	17	15	13	12	12
A2. Primary balance is unchanged from 2017	29	22	19	17	15	14	12	12
A3. Permanently lower GDP growth 1/	29	22	19	17	15	14	12	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-20	29	23	20	17	16	14	12	12
B2. Primary balance is at historical average minus one standard deviations in 2018-201	29	22	19	17	15	14	12	10
B3. Combination of B1-B2 using one half standard deviation shocks	29	22	19	17	16	14	12	11
B4. One-time 30 percent real depreciation in 2018	29	25	23	20	19	17	16	16
B5. 10 percent of GDP increase in other debt-creating flows in 2018	29	22	19	17	16	14	13	11

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.

Statement by Maxwell M. Mkwezalamba, Executive Director for Malawi and Ted Sitimawina, Senior Advisor to Executive Director

June 21, 2017

Introduction

1. Our authorities appreciate the candid and constructive policy advice from the Fund and broadly concur with the thrust of the staff appraisal and conclusions. The Extended Credit Facility (ECF) arrangement has been instrumental in supporting the overall national development objective of poverty reduction through sustainable economic growth and infrastructure development.

2. In 2015, the Malawi economy was severely hit by two consecutive weather-related shocks of heavy floods coupled with dry spells followed by the El Niño-induced drought in 2016. These shocks led to a decline in output, particularly in the agricultural sector, and rendered over 40 percent of the population food insecure. In turn, the shocks adversely affected policy implementation which also constrained meeting some ECF performance criteria on time. That said, the authorities express their gratitude to the Fund for the augmentation of access under the ECF arrangement in 2016 and to the international community for their financial and material support which enabled them to respond adequately to the humanitarian crisis.

3. The extension of the program to allow for the ninth review enabled the authorities to correct the policy slippages in pursuit of the original ECF objectives, namely, attaining strong inclusive growth, single digit inflation, and an increase of foreign reserves. The five prior actions which were a condition for completing the ninth review have all been fully met. Against this background, our authorities request for the completion of the ninth review under the ECF arrangement. They further request for waivers for non-observance of performance criteria.

Performance under the ECF Arrangement

4. While the program experienced multiple challenges over the last five years, the authorities remained committed to a successful implementation of the program, and took corrective measures to address the slippages. The weather-related shocks negatively affected economic activity which in turn had an adverse effect on domestic revenue mobilization. This situation was compounded by a sudden stop in budget support from development partners following the uncovering of a large-scale theft of public funds ("cashgate" scandal) in September 2013. These factors rendered budget execution and implementation of the ECF program very challenging. Nonetheless, the corrective measures taken by the authorities enabled them to regain fiscal control and momentum in implementing structural benchmarks. For the ninth review, all the five prior actions related to structural benchmarks in public financial management and the financial sector have been met.

5. However, our authorities request waivers for the nonobservance of three periodic performance criteria (PC) for end June 2016. The PC on the net domestic financing (NDF) of the central government and on net domestic assets (NDA) of the central bank were missed at end-June 2016. Following this, strong remedial actions were taken which brought domestic borrowing back on track. The PC on net international reserves was missed at end-June 2016 due to the El Niño-induced drought that affected the volume of exports. Subsequently, a large depreciation of the currency during the first half of 2016 took place coupled with improvements in the policy mix, including tighter monetary and fiscal policies.

Recent Economic Developments and Macroeconomic Outlook

6. Following the unusual combination of heavy floods and drought, GDP growth slowed down from 5.7 percent in 2014 to 3 percent and 2.3 percent in 2015 and 2016, respectively. Agricultural output dropped, especially the maize harvest which shrunk by over 42 percent from 2015 levels. At the same time, the reduction in hydroelectricity generation occasioned by water shortages inflated operational costs and led to low capacity utilization. In 2017, real GDP growth is expected to rebound to a range between 4–5 percent supported by a recovery in agriculture, construction, and the wholesale and retail sectors.

7. Inflation has been trending downwards for the last ten months, from a peak of 23.5 percent in July 2016 to 12.3 percent in May 2017 driven by declining food and non-food prices owing to stabilization of maize prices and tight monetary policy. It is expected that single digit inflation will be attained by end-December 2018 aided by the continued implementation of tight monetary policy and low food and petroleum products' prices.

8. With the decline in maize imports following improved harvest, conclusion of the humanitarian crisis, and a rebound in exports, the current account deficit is expected to narrow to 9.3 percent in 2017 from 13.5 percent of GDP in 2016. It is projected to remain at around 8 percent in the medium term, reflecting the growth trend, the high import content of public sector projects, and the slow pace of export diversification.

9. Medium term GDP growth is expected to increase to above 5 percent as macroeconomic conditions stabilize and investment and consumption levels rise. The authorities are aware that the prospects for higher medium term growth are constrained by electricity shortages, water supply, inadequate feeder roads, and access to credit. They are, therefore, committed to continue addressing these constraints as set out in their Economic Development Document (EDD) by, among other measures, increasing public investment in infrastructure and enhancing the business environment.

Fiscal Policy and Public Financial Management

10. The authorities aim to sustain the ongoing fiscal consolidation through enhanced domestic revenue mobilization by implementing broad based tax reforms, rationalizing expenditures, and enhancing controls to prevent the reemergence of domestic payment arrears while safeguarding social spending. In this connection, the draft FY2017/18 budget

currently under discussion in parliament contains further measures to enhance revenue collection, including the introduction of an additional bracket for highly paid individuals, strengthening of tax compliance, and modernization of tax administration. The above tax measures are in addition to those implemented in the current financial year based on IMF tax policy recommendations which included expanding the coverage of VAT and eliminating several exemptions. The underlying principle in the tax reforms has been to shift away from the heavy reliance on taxes on factors of production to those on consumption.

11. On the expenditure side, the authorities will continue to exercise firm control on expenditures to limit domestic financing. In this respect, they will seek to contain the wage bill and the travel budget, and sustain the reforms on the fertilizer subsidy program. Review of the civil service pension scheme is also underway to ensure a fiscally sustainable migration to the new defined contributory pension scheme.

12. Considerable progress has been made in public finance management reforms. To enhance budget controls and better align spending with available resources, a fully functional Cash Management Unit has been established. In addition, ministries, departments and agencies (MDAs) are now required to submit five detailed fiscal reports (revenue return, expenditure report, commitment report, bank reconciliation of other recurrent transactions and development accounts, and a payroll return) before receiving their regular monthly funding. Furthermore, government bank accounts at the Reserve Bank of Malawi (RBM) were rationalized and all main accounts were incorporated into IFMIS. This has facilitated bank reconciliations and provided a safeguard against fraud. All redundant and dormant bank accounts have been closed, with the ultimate intention of introducing a Treasury Single Account.

13. While the risk of external debt distress remains moderate, domestic debt increased in recent years due to recourse to domestic financing after the sudden withdrawal of budget support and domestic revenue shortfalls. Domestic borrowing has now been brought under control and the authorities are committed to ensure that total public debt remains sustainable. In this regard, they have further strengthened the debt management framework to identify and address any risks associated with rapid debt accumulation.

Monetary and Financial Sector Policies

14. The RBM has demonstrated strong commitment to stabilizing monetary conditions and bolstering the external reserves position using policy instruments at its disposal. As reiterated to staff, they will continue to maintain a tight monetary policy stance to ensure that inflation remains on a downward trajectory with the objective of attaining single digit inflation by end December 2018. In addition, they will aim to maintain a minimum of 3 months of import cover in foreign exchange reserves. Complimented by greater fiscal discipline and improvements in the PFM systems, our authorities anticipate that the current policy framework is sufficient to keep inflation on a downward trajectory. Monetary policy will also aim to ensure that the policy rate remains above the rate of inflation and that

positive real interest rates are maintained in the financial system. Underpinning these policies will be continued adherence to the flexible exchange rate regime and maintenance of the automatic fuel pricing mechanism.

15. Further, the RBM is committed to develop an interest rate based monetary policy framework and gradually transition from the current monetary targeting framework. This transition will require further capacity development in liquidity management, a deeper understanding of the monetary transmission mechanism, and improvements in inflation forecasting capacity. In this regard, the authorities appreciate IMF technical assistance (TA) so far received in this area and they look forward to further TA in the process. Meanwhile, the authorities will allow interest rates to play a significantly expanded role in the market, and the recent establishment of an interest rate corridor in the interbank market is expected to enhance RBM control over the interbank rate.

16. Safeguarding financial sector stability and resilience remains a key priority to the authorities. To this end, the authorities are enhancing both on-site and off-site supervision of banks as well as the regulatory framework and have adopted a prompt corrective action (PCA) framework to strengthen and clarify existing triggers for early remedial action against distressed banks. The authorities are also enforcing compliance with all prudential norms, including asset classification and provisioning. The new asset classification directive is based on the estimated recoverable amount method (ERAM) which imposes higher and graduated provisioning rates, and is expected to strengthen banking sector resilience and improve the ability to deal with adverse developments. Going forward, the authorities remain committed to taking additional steps to strengthen the banking sector and will effectively use AML/CFT tools to mitigate any risks of money laundering and corruption proceeds flowing into the financial sector.

Conclusion

17. The authorities reiterate their commitment to enhancing macroeconomic stability, reducing poverty, and attaining sustainable inclusive growth. To this end, they will continue to implement an appropriate policy mix to ensure fiscal sustainability and to ensure that inflation remains on a downward trajectory. Our authorities value Fund support in pursuing their national development agenda and look forward to the completion of this review and to further engagement with the Fund through a successor ECF arrangement.