IMF Country Reports 18/115

Malawi: 2018 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility

INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/115

MALAWI

May 2018

2018 ARTICLE IV CONSULTATION AND REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

In the context of the Staff Report for the 2018 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its April 30, 2018 consideration of the staff report on issues related to the Article IV consultation and the request for an arrangement under the extended credit facility.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 30, 2018, following discussions that ended on January 30, 2018, 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 April 16, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Malawi.

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

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

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. 18/157
FOR IMMEDIATE RELEASE
April 30, 2018

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Washington, D.C. 20431, USA

IMF Executive Board Approves US$112.3 Million under the ECF Arrangement for Malawi

The Executive Board of the International Monetary Fund (IMF) today approved a new three-year arrangement for Malawi under the Extended Credit Facility (ECF) for SDR78.075 million (about US$112.3 million), equivalent of 56.25 percent of Malawi's quota in the IMF, to support the country's economic and financial reforms.[1]

The Executive Board's decision enables an immediate disbursement of SDR11.15 million (about US$16 million). The remaining amount will be phased over the duration of the program, subject to semi-annual reviews.

The authorities' ECF-supported program aims to entrench macroeconomic stability and to foster higher, more inclusive, and resilient growth. This will be achieved through fiscal consolidation to ensure long-term debt and external sustainability; containing inflation; focusing policies on poverty-reducing and resilient growth by raising the amount and quality of spending on critical infrastructure and social sectors; tackling governance challenges through improved public financial management and procurement; improving financial intermediation and strengthening access to finance; and advancing critical growth-supporting structural reforms.

During the same meeting, the Board also concluded the 2018 Article IV consultation. A separate press release will be issued.

Following the Executive Board discussion on Malawi, Deputy Managing Director Mr. Tao Zhang, and Acting Chair, said:

"Malawi has shown progress in achieving macroeconomic stabilization following two years of drought, with a rebound in growth and inflation reduced to single digits. However, the fiscal position has deteriorated and the public debt to GDP ratio has risen. Increased debt service pressures have reduced space for needed infrastructure and social spending.

"The authorities are making efforts to entrench macroeconomic stability, raise growth and reduce poverty. Fiscal consolidation will ensure long-term debt and external sustainability. This, combined with continued strengthening of the monetary policy framework, will contain inflation and reduce fiscal dominance. The amount and quality of spending on critical infrastructure and

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

social sectors will be raised. Governance will be improved through reforms in public financial management and procurement. Improved financial intermediation, access to finance, and other critical growth-supporting structural reforms will be advanced. The IMF arrangement under the Extended Credit Facility will support the authorities' program and efforts.

"The medium-term economic outlook is favorable, with private sector activity expected to benefit from better infrastructure and an improved business climate. Progress will depend on the authorities' strong ownership to support successful implementation of their program."

Annex

Recent Economic Developments

The economy recently rebounded from two years of drought. Growth picked up from 2.3 percent in 2016 to an estimated 4.0 percent in 2017 owing to a recovery in agricultural production. Inflation has been reduced below 10 percent—from high double digits in recent years—due to the stabilization of food prices, prudent fiscal and monetary policies, and a stable exchange rate. The current account deficit narrowed to 10.0 percent of GDP in 2017 from 13.6 percent in 2016, following lower maize imports and higher prices for some exports. The banking system remains stable though vulnerabilities have somewhat increased.

While the authorities regained control over the budget during FY16/17, this proved challenging during FY17/18. Revenue shortfalls and expenditure overruns, including the bailout of maize purchase loans by a parastatal exerted significant pressures on the budget. The authorities are implementing remedial measures to improve the fiscal position in FY18/19. These measures will also help contain public debt which has doubled over the last decade, reaching 55 percent of GDP in 2017, after the withdrawal of donor budget support, securitization of arrears, and recapitalization of the Reserve Bank of Malawi and two public commercial banks.

Economic growth is expected to increase gradually, reaching over 6 percent in the medium term. Growth will be supported by enhanced infrastructure investment and social services as well as an improved business environment, which will boost confidence and unlock the economy's potential for higher, more broad-based, and resilient growth and employment. Downside risks to growth include political pressures in the run-up to next year's elections that could weaken policy discipline and reform efforts, weather-induced shocks, and declines in agricultural commodity prices.

Program Summary

Fiscal policies will support growth-enhancing and poverty-reducing spending while containing inflation and ensuring debt sustainability. The government is committed to strengthening the fiscal balance, reducing fiscal dominance, improving public financial management and procurement, and raising the amount and quality of critical infrastructure and social spending. This includes enhancing investment planning, increasing transparency in the budget process, strengthening the medium-term budgetary framework and cash management, routinizing bank reconciliation, closing out the arrears clearance program, and implementing broad-based tax reforms.

Monetary policy will aim to keep inflation within single digits while maintaining positive real interest rates. The Reserve Bank of Malawi will further strengthen the monetary policy framework, improve access to finance, and safeguard financial sector stability.

The government is committed to implementing deep structural reforms to ignite job-creating private sector growth.

Background

Malawi, which became a member of the IMF on July 19, 1965, has an IMF quota of SDR 138.80 million.

For additional information on the IMF and Malawi, see:

http://www.imf.org/external/country/MWI/index.htm

Malawi: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
	Est.		Proj.					
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	2.3	4.0	3.5	4.5	5.0	5.5	6.0	6.5
Nominal GDP (billions of Kwacha)[1]	3,910	4,503	5,068	5,654	6,300	6,993	7,752	8,623
GDP deflator	19.5	10.7	8.8	6.8	6.1	5.2	4.6	4.4
Consumer prices (end of period)	20.0	7.1	9.0	7.5	6.5	5.5	5.0	5.0
Consumer prices (annual average)	21.7	11.5	10.4	7.6	6.9	5.9	5.2	5.0
Investment and savings (percent of GDP)								
National savings	-2.8	3.7	4.4	4.8	5.1	5.4	5.8	5.9
Gross investment	10.8	13.7	13.4	12.9	13.0	13.1	13.5	13.5
Government	4.4	7.0	6.5	6.0	5.9	6.0	6.2	6.2
Private	6.4	6.7	6.8	7.0	7.1	7.1	7.2	7.3
Saving-investment balance	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Central government (percent of GDP on a fiscal year basis)[2]								
Revenue	21.7	23.6	22.4	22.6	22.1	22.4	22.5	22.5
Tax and nontax revenue	18.0	20.1	19.5	19.5	19.5	19.5	19.6	19.6
Grants	3.7	3.5	2.8	3.1	2.7	2.9	2.9	2.9
Expenditure and net lending	28.5	28.7	29.7	26.0	24.7	24.8	24.6	24.3
Overall balance (excluding grants)	-10.5	-8.6	-10.1	-6.5	-5.3	-5.3	-5.0	-4.7
Overall balance (including grants)	-6.8	-5.1	-7.3	-3.4	-2.6	-2.3	-2.0	-1.8
Foreign financing	1.9	2.5	3.2	1.3	1.9	2.0	2.0	1.9
Total domestic financing	5.0	4.3	5.9	3.1	0.7	0.4	0.1	-0.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	0.3	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.8	-0.6	-3.0	0.1	0.2	0.2	0.2	0.2
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)								
Money and quasi money	15.2	19.7	12.6	11.6	11.4	11.0	10.9	11.2
Net foreign assets	2.1	11.1	-0.6	4.7	10.3	12.1	13.6	14.7
Net domestic assets	13.1	8.6	13.2	6.8	1.1	-1.2	-2.7	-3.4
Credit to the government	17.5	20.3	4.1	3.0	0.4	0.2	0.0	-0.4
Credit to the private sector (percent change)	4.6	0.4	4.1	6.7	11.6	12.7	14.3	14.5
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,603	1,695	1,857	1,975	2,100	2,234	2,386	2,562
Imports (goods and services)	2,520	2,547	2,747	2,769	2,927	3,110	3,326	3,572
Gross official reserves	605	757	703	755	898	1,061	1,237	1,442
(months of imports)	2.9	3.3	3.0	3.1	3.5	3.8	4.2	4.5
(percent of reserve money)	182.3	197.0	175.2	178.3	199.7	221.1	240.3	259.8
Current account (percent of GDP)	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Current account, excl. official transfers (percent of GDP)	-13.6	-10.3	-10.1	-8.1	-7.8	-7.7	-7.7	-7.6
Current account, excl. project related imports (% of GDP)	-10.3	-6.2	-6.0	-5.2	-4.5	-4.4	-4.3	-4.2
Real effective exchange rate (percent change)	-13.3	…	…	…	…	…	…	…
Overall balance (percent of GDP)	-1.9	2.1	-0.8	0.5	1.8	2.2	2.5	2.7
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (percent change)	-0.2	-4.6	-5.9	-1.1	-0.9	-1.2	-0.8	-0.5
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)	33.2	32.6	32.1	32.2	32.2	32.0	31.6	31.2
NPV of Public external debt (percent of exports)	76.3	77.2	74.2	72.2	71.3	70.0	69.0	68.3
Domestic public debt	21.2	22.6	22.2	22.2	20.3	18.5	16.7	14.6
Total public debt	54.4	55.1	54.3	54.4	52.6	50.5	48.2	45.7
External debt service (percent of exports)	12.3	10.4	7.5	5.4	5.3	5.2	4.6	4.0
External debt service (percent of revenue excl. grants)	19.3	14.4	10.4	7.8	7.6	7.5	6.6	5.7
91-day treasury bill rate (end of period)	24.0	…	…	…	…	…	…	…

Sources: Malawian authorities and IMF staff estimates and projections.

[1] The current GDP base year is 2010.

[2] The fiscal year starts in July and ends in June. The current financial year, 2018, runs from July 1, 2017 to June 30, 2018.

Press Release No. 18/162
FOR IMMEDIATE RELEASE
May 4, 2018

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

IMF Executive Board Concludes 2018 Article IV Consultation with Malawi

On April 30, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Malawi.[1] At the same time, the Board also approved a new three-year Extended Credit Facility Arrangement for Malawi and a press release on this was issued separately.

The economy recently rebounded from two years of drought. Growth picked up from 2.3 percent in 2016 to an estimated 4.0 percent in 2017 owing to a recovery in agricultural production. Inflation has been reduced below 10 percent—from high double digits in recent years—due to the stabilization of food prices, prudent fiscal and monetary policies, and a stable exchange rate. The current account deficit narrowed to 10.0 percent of GDP in 2017 from 13.6 percent in 2016, following lower maize imports and higher prices for some exports. The banking system remains stable though vulnerabilities have somewhat increased.

While the authorities regained control over the budget during FY16/17, this proved challenging during FY17/18. Revenue shortfalls and expenditure overruns, including the bailout of maize purchase loans by a parastatal exerted significant pressures on the budget. The authorities are implementing remedial measures to improve the fiscal position in FY18/19. These measures will also help contain public debt which has doubled over the last decade, reaching 55 percent of GDP in 2017, after the withdrawal of donor budget support, securitization of arrears, and recapitalization of the Reserve Bank of Malawi and two public commercial banks.

Economic growth is expected to increase gradually, reaching over 6 percent in the medium term. Growth will be supported by enhanced infrastructure investment and social services as well as an

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

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improved business environment, which will boost confidence and unlock the economy's potential for higher, more broad-based, and resilient growth and employment. Downside risks to growth include political pressures in the run-up to next year's elections that could weaken policy discipline and reform efforts, weather-induced shocks, and declines in agricultural commodity prices.

Executive Board Assessment[2]

"Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for achieving macroeconomic stability, and noted that economic activity has rebounded after two consecutive years of drought, driven by a recovery in agricultural production. However, growth has been insufficient to significantly reduce poverty or improve weak social indicators. Moreover, the fiscal position deteriorated in 2017 and public debt has doubled over the past decade. While the medium-term outlook is broadly favorable, risks and vulnerabilities remain.

"To address these challenges, Directors stressed the need for determined implementation of Malawi's Growth and Development Strategy for 2018-23 and a strong commitment to the Fund-supported program under the Extended Credit Facility to entrench macroeconomic stability and ensure higher, inclusive and resilient growth. In this context, they urged the authorities to be mindful of political economy and capacity constraints faced in the past, and called for strong program ownership to achieve the ambitious growth and social-inclusion agenda.

"Directors underscored the importance of the authorities' fiscal adjustment plans in maintaining macroeconomic stability. They noted that domestic debt rose sharply after the withdrawal of donor budget support, securitization of arrears, and bank recapitalization, raising the debt service burden and reducing space for much-needed infrastructure and social spending. Directors stressed the importance of improving debt management and broadening the coverage of domestic debt through enhancing data on state owned enterprises (SOEs).

"Directors cautioned against giving in to spending pressures in the run-up to the 2019 general elections and highlighted that increased spending efficiency will create room for more social spending and targeted infrastructure investment. Further, they emphasized the importance of prioritizing large investment projects, with concessional donor financing and private sector participation. Directors also underscored that public financial management and procurement reforms are necessary to address governance challenges and bolster donor confidence. Over the medium term, broad-based tax reforms will also foster a more efficient, transparent, and fair tax system.

"Directors encouraged greater exchange rate flexibility to cushion against external shocks. They also highlighted the importance of strengthening the monetary policy framework and reducing fiscal dominance. Directors encouraged the authorities to strengthen banking supervision, while improving financial intermediation and access to finance.

"Directors emphasized that structural reforms are essential for growth, job creation, private sector development, economic diversification and resilience. In this context, they noted

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

the need to improve the quality and coverage of critical infrastructure, reduce regulatory burdens, and streamline judicial processes. Deep agricultural market reforms would also ensure food security and ease the burden on the budget.

“It is expected that the next Article IV consultation with Malawi will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

Malawi: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
	Est.		Proj.					
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	2.3	4.0	3.5	4.5	5.0	5.5	6.0	6.5
Nominal GDP (billions of Kwacha)[1]	3,910	4,503	5,068	5,654	6,300	6,993	7,752	8,623
GDP deflator	19.5	10.7	8.8	6.8	6.1	5.2	4.6	4.4
Consumer prices (end of period)	20.0	7.1	9.0	7.5	6.5	5.5	5.0	5.0
Consumer prices (annual average)	21.7	11.5	10.4	7.6	6.9	5.9	5.2	5.0
Investment and savings (percent of GDP)								
National savings	-2.8	3.7	4.4	4.8	5.1	5.4	5.8	5.9
Gross investment	10.8	13.7	13.4	12.9	13.0	13.1	13.5	13.5
Government	4.4	7.0	6.5	6.0	5.9	6.0	6.2	6.2
Private	6.4	6.7	6.8	7.0	7.1	7.1	7.2	7.3
Saving-investment balance	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Central government (percent of GDP on a fiscal year basis)[2]								
Revenue	21.7	23.6	22.4	22.6	22.1	22.4	22.5	22.5
Tax and nontax revenue	18.0	20.1	19.5	19.5	19.5	19.5	19.6	19.6
Grants	3.7	3.5	2.8	3.1	2.7	2.9	2.9	2.9
Expenditure and net lending	28.5	28.7	29.7	26.0	24.7	24.8	24.6	24.3
Overall balance (excluding grants)	-10.5	-8.6	-10.1	-6.5	-5.3	-5.3	-5.0	-4.7
Overall balance (including grants)	-6.8	-5.1	-7.3	-3.4	-2.6	-2.3	-2.0	-1.8
Foreign financing	1.9	2.5	3.2	1.3	1.9	2.0	2.0	1.9
Total domestic financing	5.0	4.3	5.9	3.1	0.7	0.4	0.1	-0.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	0.3	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.8	-0.6	-3.0	0.1	0.2	0.2	0.2	0.2
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)								
Money and quasi money	15.2	19.7	12.6	11.6	11.4	11.0	10.9	11.2
Net foreign assets	2.1	11.1	-0.6	4.7	10.3	12.1	13.6	14.7
Net domestic assets	13.1	8.6	13.2	6.8	1.1	-1.2	-2.7	-3.4
Credit to the government	17.5	20.3	4.1	3.0	0.4	0.2	0.0	-0.4
Credit to the private sector (percent change)	4.6	0.4	4.1	6.7	11.6	12.7	14.3	14.5
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,603	1,695	1,857	1,975	2,100	2,234	2,386	2,562
Imports (goods and services)	2,520	2,547	2,747	2,769	2,927	3,110	3,326	3,572
Gross official reserves	605	757	703	755	898	1,061	1,237	1,442
(months of imports)	2.9	3.3	3.0	3.1	3.5	3.8	4.2	4.5
(percent of reserve money)	182.3	197.0	175.2	178.3	199.7	221.1	240.3	259.8
Current account (percent of GDP)	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Current account, excl. official transfers (percent of GDP)	-13.6	-10.3	-10.1	-8.1	-7.8	-7.7	-7.7	-7.6
Current account, excl. project related imports (% of GDP)	-10.3	-6.2	-6.0	-5.2	-4.5	-4.4	-4.3	-4.2
Real effective exchange rate (percent change)	-13.3	...	...	...	...	...	...	...
Overall balance (percent of GDP)	-1.9	2.1	-0.8	0.5	1.8	2.2	2.5	2.7
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (percent change)	-0.2	-4.6	-5.9	-1.1	-0.9	-1.2	-0.8	-0.5
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)	33.2	32.6	32.1	32.2	32.2	32.0	31.6	31.2
NPV of Public external debt (percent of exports)	76.3	77.2	74.2	72.2	71.3	70.0	69.0	68.3
Domestic public debt	21.2	22.6	22.2	22.2	20.3	18.5	16.7	14.6
Total public debt	54.4	55.1	54.3	54.4	52.6	50.5	48.2	45.7
External debt service (percent of exports)	12.3	10.4	7.5	5.4	5.3	5.2	4.6	4.0
External debt service (percent of revenue excl. grants)	19.3	14.4	10.4	7.8	7.6	7.5	6.6	5.7
91-day treasury bill rate (end of period)	24.0	...	...	...	...	...	...	...

Sources: Malawian authorities and IMF staff estimates and projections.

[1] The current GDP base year is 2010.

[2] The fiscal year starts in July and ends in June. The current financial year, 2018, runs from July 1, 2017 to June 30, 2018.

INTERNATIONAL MONETARY FUND

MALAWI

April 16, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION AND REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

KEY ISSUES

Context. Malawi's economy has made progress in achieving macroeconomic stabilization following two years of severe drought and lingering consequences of corruption scandals. However higher, more inclusive, and resilient growth is needed to tackle pervasive poverty. The government is committed to achieving this goal while maintaining medium-term debt sustainability, as reflected in the Malawi Growth and Development Strategy III for 2018–23.

Extended Credit Facility Arrangement (ECF). The authorities have requested a three-year arrangement under the ECF in the amount of SDR 78.1 million (56.25 percent of quota) in support of their medium-term economic reform program.

Program objectives and policies. The authorities' ECF-supported program aims to entrench macroeconomic stability and enhance poverty-reducing and resilient growth. The key supporting policies of the program – in line with the Article IV recommendations – are to continue with prudent fiscal and monetary policies along with greater exchange rate flexibility; raise the amount and quality of spending on critical infrastructure and poverty-reducing social sectors; tackle governance challenges; improve financial intermediation; and advance critical growth-supporting structural reforms. Prudent fiscal and monetary policies are anticipated to keep inflation within single digits.

Outlook and risks. Economic growth is expected to increase gradually in the medium-term. It will benefit from infrastructure improvements, improved access to finance, and increased donor-financed projects. Prudent fiscal and monetary policies are anticipated to keep inflation within single digits. Risks to the outlook include political pressures in the run-up to the 2019 Presidential and parliamentary elections weakening policy discipline and reform efforts. Weather-induced shocks, a decline in commodity prices, and reduced donor flows could weaken medium-term growth.

Staff views. Staff supports the authorities' request for an ECF arrangement. The Memorandum of Economic and Financial Policies sets out appropriate polices to pursue program objectives.

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

Discussions on the Article IV consultations and an ECF-supported program were held on January 31-February 14, 2018 in Lilongwe and Blantyre. The staff team comprised Ms. Mitra (head), Ms. Farahbaksh, Mr. Keller, Mr. Ree (all AFR), Ms. Lin (SPR), Mr. Yousefi (FAD), and Mr. Banda (local economist). Messrs. Mkwezalamba and Sitima-wina (both OED) participated in the ECF discussions. Mr. Hettinger (World Bank) joined some technical meetings during the discussions. Mr. Almeida and Mmes. Adjahouinou and Fabo assisted in the preparation of the staff report. The mission held discussions with Mr. Goodall Gondwe, Minister of Finance; Mr. Dalitso Kabambe, Reserve Bank of Malawi Governor; and other senior officials. The mission also met representatives of the private sector, civil society, and development partners and held a press conference.

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TABLES

ANNEXES

APPENDIX

CONTEXT

1. **Over the past five years, Malawi strengthened macroeconomic stabilization.** Under the 2012–17 ECF arrangement (Annex I: Ex Post Peer-Reviewed Assessment, Annex II: Implementation of 2015 Article IV Recommendations), chronic foreign exchange shortages were addressed through foreign exchange market liberalization and an automatic fuel-price mechanism. Notwithstanding adverse inflationary effects of these policies, compounded by two years of severe drought, inflation was curbed near the end of the program from 35 percent at end-2012 to 10 percent in mid-2017. The money market and nominal exchange rates have stabilized since mid-2016 while international reserves were rebuilt from 0.5 months of imports in 2012 to well-above 3 by the end of the program. Structural reforms, especially in public financial management (PFM) helped reinforce budgetary processes.

2. **Pervasive poverty and weak social indicators underline the urgent need for higher, more inclusive, and resilient growth.** Growth, averaging 3.7 percent during 2012–17, was insufficient to significantly improve Malawi's low per capita GDP ($327 in 2017), its poverty incidence (among the highest in sub-Saharan Africa), human development indices, —although education and health indices compare favorably relative to the average sub-Saharan African country, outcomes can still be substantially improved—and gender equality. Malawi ranks 170th in gender equality (UNDP Human Development Report) reflecting gender-based violence, early marriages, and poor maternal health. Delayed implementation of structural reforms and the inflationary impact of (i) exchange rate depreciation; (ii) monetization of government deficits—following suspension of donor financing after the cashgate scandal; and (iii) climate change-induced droughts have held back growth and poverty reduction.

Text Table 1. Malawi Human Development Indicators — SSA Comparison

	Malawi	SSA	(as at)
GDP			
GDP (current, billions of US$)	6.3	1,529	2017 (Est.)
Exchange rate (per US$, end-period)	725	…	
Income			
GDP per capita (current US$)	327	1,582	2017 (Est.)
GINI index (World Bank estimate)	46.1	…	
Population			
Population, total (millions)	18.1	1,033	2016
Population ages 65 and above (% of total)	3.4	3.1	2015
Life expectancy at birth, total (years)	64.0	59.0	2015
Education			
Literacy rate, adult female (% of females ages 15 and above)	59.0	53.0	2010
Literacy rate, adult male (% of males ages 15 and above)	73.0	69.2	2010
School enrollment, primary (% net)	97.5	77.9	2014
School enrollment, primary, female (% net)	95.3	75.8	2014
School enrollment, primary, male (% gross)	144.0	102.0	2014
Health			
Mortality rate, under-5 (per 1,000 live births)	64.0	83.2	2015
Mortality rate, infant (per 1,000 live births)	43.4	56.4	2015
Nurses and midwives (per 1,000 people)	0.3	1.1	2011
Maternal mortality ratio (national estimate, per 100,000 live births)	570.0	…	
Poverty			
Poverty headcount ratio at national poverty lines (% of population)	50.7	…	
Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population)	70.9	41.0	2013
Poverty headcount ratio at $3.10 a day (2011 PPP) (% of population)	87.6	65.0	2013
Public Expenditure			
Health expenditure, public (% of GDP)	6.0	2.3	2014
Current education expenditure, total (% of total expenditure in public institutions)	98.8	90.6	2010

Sources: IMF staff estimates, The World Bank WDI database, and Malawi authorities.

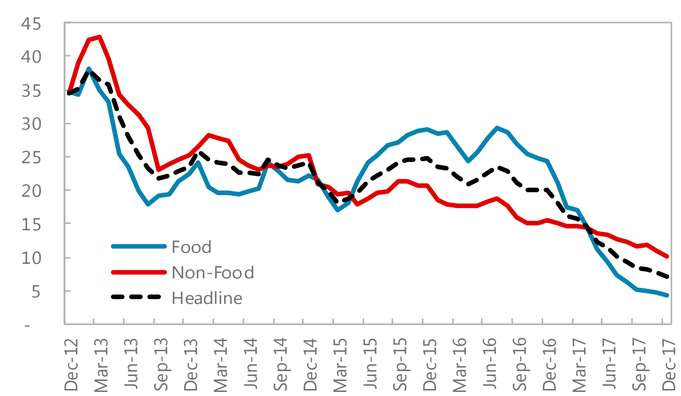
3. **The authorities have requested a three-year arrangement under the Extended Credit Facility (ECF).** The arrangement would provide SDR 78.1 million (56.25 percent of quota) in support of their medium-term economic reform program which seeks to entrench macroeconomic stability and enhance poverty-reducing and resilient growth. The August 2017 stakeholders conference identified these objectives as key priorities that are achievable through greater economic diversification, a more vibrant private sector, and resilience to climate shocks.[1] Malawi currently has outstanding obligations to the Fund equivalent to 110.16 percent of quota.

RECENT DEVELOPMENTS

4. **Malawi 's economy recently rebounded from two consecutive years of drought** (Figures 1–4). Real growth picked up—estimated at 4 percent in 2017 (up from 2.3 percent in 2016)—owing to a recovery in agricultural production. However, regular and prolonged electricity outages weighed on manufacturing and wholesale and retail trade. Inflation declined to 7.1 percent by end-2017 owing to the stabilization of food prices, prudent fiscal and monetary policies, and a stable exchange rate (Text Figure 1).

Text Figure 1. Inflation

(Year-on-year percentage changes)



Sources: Malawian authorities; IMF staff estimates.

5. **The authorities regained control over budget execution in FY 16/17**. Revenue collection increased by almost 2 percentage points of GDP relative to the previous year, reflecting expansion of VAT coverage, elimination of several exemptions, and a one-off revenue mobilization from capital gains tax. Firm spending control was exerted by requiring detailed monthly fiscal reports from all spending units as a condition for the subsequent month's funding and better targeting of the farm input subsidy program (FISP). The overall balance of 5.1 percent of GDP improved by 1.5 percentage points in FY 16/17 relative to the previous fiscal year.

6. **The fiscal position deteriorated significantly in the first half of FY 17/18**. The overall deficit was 4.7 percent of GDP relative to 2.9 percent of GDP in FY 2016/17 H1. Revenues underperformed due to power outages slowing economic activity and weaker than anticipated customs collection. The bailout of the Agricultural Development and Marketing Corporation (ADMARC, 0.9 percent of GDP) and higher domestically financed development spending added

[1] On August 28–29, 2017, the Fund, in conjunction with Ministry of Finance and Reserve Bank of Malawi, organized a two-day Stakeholders Conference on the ECF arrangement in Lilongwe, Malawi. The conference brought together senior government officials, development partners, and representatives from the private sector, civil society, and academia.

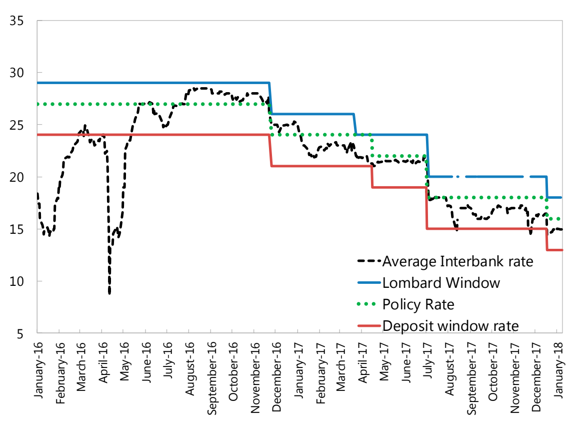
to budget pressures. Fiscal space created by lower interest bills was used to increase wages and goods and services spending.

7. **Progress was made in resolving arrears dating back to FY 12/13**. Domestic arrears of over 5 percent of GDP, accumulated during July 2012–June 2017, are in the process of being cleared. As of end-2017, almost all of them were securitized through zero interest promissory notes. About 65 percent of these (in domestic and foreign currency) have already been repaid in cash and the rest will be maturing during FY 17/18 H2 and FY 18/19.

8. **Tight monetary policy helped contain inflation.** Short-term money market rates were kept positive in real terms and aligned with the policy rate (Text Figures 2 and 3). However, the nominal policy rate was reduced—by 600 basis points to 16 percent during 2017—in response to down-trending nonfood inflation. Interbank rate volatility has also been reduced owing to the Reserve Bank of Malawi's (RBM's) increasingly active use of open market operations (mainly repo) as well as improvements in the deposit auction facility. Average nominal bank lending rates fell (7 percentage points) in line with the policy rate but real interest rates remained high. This, combined with limited demand and tighter lending conditions resulted in negative real private sector credit growth.

Text Figure 2. Interest Rate Corridor

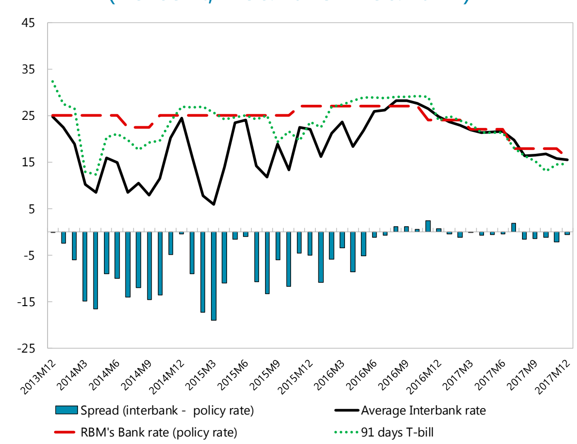
(Percent, Jan.2016–Jan.2018)



Sources: Malawian authorities; IMF staff estimates.

Text Figure 3. Policy, Interbank and Treasury Bill Interest Rates

(Percent, Dec.2013–Dec.2017)



Sources: Malawian authorities; IMF staff estimates.

9. **The banking system remained stable though vulnerabilities rose.** On aggregate, the banking system was well capitalized and profitable. Two banks were at the borderline of the minimum core capital requirement as of end-2017. One bank was recapitalized last year and acquired by a reputable bank, while another bank's full recapitalization was delayed, despite recent right issues. Non-performing loans (NPLs) declined by 1.3 percentage points to 15.7 percent of total loans in 2017 due to write-offs and extensive recovery efforts, especially in the last quarter of 2017. However, the RBM's September 2017 stress test showed that several individual banks were vulnerable to credit and liquidity shocks.

10. **The current account deficit narrowed—**to an estimated 10.0 percent of GDP in 2017 from 13.6 percent in 2016 owing to lower maize imports and higher non-tobacco exports driven by higher export prices. The improved current account combined with inflows from World Bank agricultural support funds increased reserves by 0.4 months of prospective imports between end-2016 and end-2017.

11. **Over the past year, the nominal exchange rate has been stable against the U.S. dollar.** In part, this stability has been driven by tight monetary policy, overall favorable balance of payments developments, and gradually improving confidence. However, official intervention focusing on building foreign reserves and/or limiting foreign exchange volatility has also played a role with the kwacha having stabilized within a 2 percent band against the U.S. dollar since August 2016. As a result, the IMF's 2017 Annual Report on Exchange Rate Arrangements and Exchange Rate Restrictions (AREAER) reclassified Malawi's de facto exchange rate arrangement from a float to a stabilized arrangement. The premium between the exchange rates of the RBM and forex bureaus remains very small implying no foreign currency shortage.

12. **Political pressures are mounting ahead of elections.** Weak public confidence in state institutions has recently worsened with the electricity crisis. Gearing up for the 2019 Presidential and parliamentary elections, opposition parties have intensified criticism of the government's attempts to resolve the situation. Earlier this year, Parliament voted against reform bills—supported by civil society, opposition parties, and the donor community—that adopt an absolute majority system for the Presidential election and require a minimum education level for Parliamentary candidates.

MACROECONOMIC OUTLOOK AND RISKS

13. **Economic growth is projected to moderate to 3.5 percent in 2018 and gradually increase to 6 percent over the medium term**. The Fall armyworm infestation and delayed rains are expected to weaken last year's agricultural rebound. Non-agricultural growth prospects were constrained by continued power shortages in the first half of 2018. Over the medium term, growth is expected to rise to 6 percent—driven by improved confidence, more robust agricultural production (owing to infrastructure and cropping improvements), enhanced electricity generation, better transportation networks, improved access to finance, and increased donor-financed projects.

14. **Inflation is expected to remain in single digits.** A weak maize harvest and electricity tariff increases are expected to raise inflation to 9 percent at end-2018. Prudent fiscal and monetary policies along with low international food and fuel prices are anticipated to gradually reduce inflation to around 5 percent over the medium term.

15. **The external position is broadly in line with fundamentals but other competitiveness indicators point to major challenges**. The REER appreciated by an average of 2.5 percent in 2017 following a 13 percent depreciation in 2016. In contrast, the NEER depreciated by an average of 5 percent in 2017 following a 26 percent depreciation in 2016. The difference in movements of the REER and NEER in 2017 reflects the still-high inflation differentials between Malawi and its trading partners. Staff assessed the external position to be broadly in line with the level implied by medium-

term fundamentals and desirable policies, considering both EBA-lite model results and Malawi-specific factors (Annex III: External Stability Assessment). However, broader competitiveness indicators such as the World Bank's Doing Business Indicators highlight persistent weaknesses (Selected Issues Paper). Improvements in competitiveness, export diversification, and fiscal restraint (supported by the program) are anticipated to gradually narrow the current account deficit from 8.9 percent in 2018 to around 7.5 percent over the medium term.

16. **Risks are tilted to the downside.** Political pressures in the election run-up could weaken policy discipline and reform efforts. Ensuing macroeconomic policy slippages, weather-induced shocks, and Fall armyworm infestations could hurt near-term growth, raise inflation, and—coupled with a decline in agricultural commodity prices and reduced donor flows—could dampen exports, place pressure on the kwacha, and weaken medium-term growth. Slower-than-expected disinflation could put pressure on interest rates, increase the interest bill, and hamper access to finance. On the upside, better than expected agricultural commodity prices and harvests as well as faster reform implementation could boost medium-term growth (Annex IV: Risk Assessment Matrix).

17. **The authorities broadly shared staff's views on the outlook and risks although they are more optimistic on near-term growth**. They expect growth of 4 to 5 percent in 2018 due to faster pick-up in private sector activity with reduced power shortages in the second half of the year. The authorities concur with staff's views on inflation and the external position. They agree with staff on the need for accelerated reforms to support more diverse and resilient private sector driven growth and envisage similar medium-term growth prospects.

ARTICLE IV DISCUSSIONS: A NEW PATH FOR GROWTH AND DEBT SUSTAINABILITY

Discussions focused on key aspects of Malawi's growth agenda and preserving medium-term debt sustainability. There was full agreement on the importance of prioritizing the agenda (especially in infrastructure) and being cognizant of capacity and financial constraints.

A. Fostering Higher, More Inclusive, and Resilient Growth

18. **The authorities have adopted a new Malawi Growth and Development Strategy (MGDS) III for 2018–23.** Finalized in 2017 Q4, MGDS III aims at building productivity, competitiveness, and resilience mainly through stepped-up investment in infrastructure and social sectors but also with reforms to improve financial market development and the business environment—including governance—against a sound macroeconomic backdrop. These areas coincide with staff's recommendations on key reforms to ignite higher, more inclusive, and durable growth as well as job creation (Selected Issues Paper).

19. **Staff and the authorities concurred on the need to advance reforms on multiple fronts while prioritizing the agenda.** The authorities plan to prioritize improving low quality and coverage of infrastructure (especially electricity, roads, telecommunications, water, and irrigation)

and social spending (particularly, education, healthcare, and gender issues (Box 1, MEFP ¶40)). Governance reforms (related to PFM, procurement, and broader governance areas as discussed in Box 3) are expected to catalyze concessional financing in these areas. Staff emphasized gains could be achieved by, in parallel, improving the quality and efficiency of public spending and raising access and affordability of credit. The authorities also plan to implement deep agricultural market reforms to foster growth and ensure food security (Box 2). These include a strategic review of ADMARC, aligning export and import control systems with the WTO norms, further FISP reforms, and implementing the new land reform bills (MEFP ¶33). Once these are underway, measures related to reducing regulatory burdens and strengthening the judiciary will be considered. Staff noted that progress in removing trade barriers, exchange rate flexibility (especially during 2012-16), and liberalization of fuel prices supported moderate growth, and adaptive policies should continue being implemented.

B. Preserving Debt Sustainability

20. **Malawi's risk of external debt distress is moderate.** The debt sustainability analysis (DSA) update carried out jointly by staffs of the IMF and the World Bank (Annex V) indicates that all baseline external debt burden indicators are below their policy-dependent debt burden thresholds. Stress tests highlight vulnerabilities to exogenous shocks, especially export revenues and exchange rate—reflecting the country's narrow export base and heavy reliance on rain-fed irrigation.

21. **However, rising domestic debt has increased vulnerabilities.** Domestic financing increased sharply after the withdrawal of donor budget support, securitization of arrears, and recapitalization of the RBM and two public banks. As a result, total public debt more than doubled since HIPC and MDRI debt relief in 2006—projected to reach 55 percent of GDP in 2018.[2]

22. **Staff and the authorities agreed that future borrowing for large infrastructure needs to be balanced against elevating the risk of debt distress** (MEFP ¶24). To maintain debt sustainability, the authorities agreed to suspend contracting of new non-concessional loans. However, under the program, exceptions can be considered on a case by case basis for new loans backing priority growth-enhancing projects—accompanied by fiscal measures that offset the debt impact of the non-concessional portion of the loan. The authorities concurred with staff on the importance of developing a comprehensive medium-term debt strategy, including prioritizing investments based on rigorous cost-benefit analysis, absorptive capacity, growth, poverty reduction, and debt sustainability considerations. To this end, they have requested FAD Technical Assistance (a Public Investment Management Assessment) with a mission planned for mid-2018. In addition, state-owned enterprise reforms, beginning with enhanced oversight, aim to reduce contingent liabilities.

[2] Domestic debt mainly includes the total stock of treasury bills, treasury notes, local registry stocks, and ways and means advances. It also covers zero coupon promissory notes which have not yet matured, promissory notes related to the recapitalization of RBM (until end-September 2017), promissory notes for MSB's toxic assets, and certified arrears for which promissory notes have not yet been issued.

PROGRAM OBJECTIVES AND KEY ELEMENTS

The ECF arrangement is anchored on the authorities' development strategy as set out in MGDS III. With elevated growth-enhancing and poverty-reducing spending needs but limited fiscal and debt space, this program's framework is critical for entrenching macroeconomic stability and catalyzing donor support. The policies related to growth and debt sustainability from the Article IV discussions are all featured in the program.

23. **The new ECF arrangement will support the authorities' economic policies and reforms to entrench macroeconomic stability and achieve higher, more inclusive, and resilient growth**. Key elements of the program include continuing with prudent fiscal and monetary policies along with greater exchange rate flexibility; increasing spending on critical infrastructure and poverty-reducing social sectors; tackling governance challenges; improving financial intermediation; and advancing key growth-supporting structural reforms. Reforms under the program are paced realistically reflecting lessons from the ex-post assessment. For example, prior actions and structural benchmarks are front-loaded to reflect the election cycle. To promote ownership throughout the program, reforms are phased to tighten as the program progresses.

24. **Financing under the ECF arrangement will also help Malawi address a protracted balance of payment need.** Malawi is expected to have a balance of payments financing gap of US$363 million during 2018–21. IMF financial support will contribute to closing this financing gap and catalyze donors' financing, notably budget support from the World Bank (US$80 million in 2018) and project support from a variety of donors (whose representatives have signaled their intention to provide increased support). The past ECF arrangement helped gradually restore donor confidence following the cashgate scandal and catalyzed swift donor support in response to the humanitarian crisis (Annex I: Ex Post Peer-Reviewed Assessment). International reserves coverage (in months of imports) is anticipated to increase from 3.0 in 2018 to 3.8 in 2021 to build buffers against climate change-induced weather shocks.

A. Sustaining Macroeconomic Stability

Fiscal Policy

25. **The fiscal policy stance will support disinflation and debt sustainability** (MEFP ¶24). The authorities will keep spending within available resources, avoid accumulation of domestic and external arrears, limit non-concessional borrowing as well as the government's recourse to domestic borrowing—particularly from the RBM. The RBM Act will be aligned with the PFM Act (applying the recommendations of the IMF Safeguards Assessment) to eliminate avenues of RBM financing of the central government (except what is needed for cash flow management) and to enhance the RBM's autonomy. Fiscal policy will be anchored on gradual improvements in the primary balance while safeguarding social spending (including spending on health and education). This will reduce public debt—from 55 percent of GDP in 2018 to 45 percent of GDP over the medium-term—as well as the government's interest bill while supporting healthy private sector credit growth.

26. **The authorities are committed to improving the fiscal position in the remainder of FY 2017/18**. They cut spending by about 1 percent of GDP in the last four months of this fiscal year —mainly in domestically financed development (to reflect implementation capacity) and goods and services. Nevertheless, the primary balance is projected to deteriorate from -0.6 percent of GDP in 2016/17 to -3.0 percent of GDP in 2017/18. Any arrears (from FY 2012/13 to FY 2016/17) that have not already been cleared are anticipated to be fully cleared by end-June 2018 through securitization. To avoid accumulation of new arrears, the authorities tightened commitment controls and established a system tracking the stock of commitments (MEFP ¶4). The deficit (including payment of arrears-related securities) has been financed by both foreign and domestic financing – including MK69 billion (1.7 percent of GDP) of RBM financing which was undertaken in the first half of the fiscal year, prior to program discussions. During the second half of the fiscal year, there will be no additional RBM financing.

27. **The FY 2018/19 budget aims at preserving macroeconomic stabilization (MEFP ¶25).** Broad understanding was reached on improving the primary fiscal balance to about zero in FY 18/19. Revenue measures discussed include repealing the industrial rebate scheme and discontinuing tax holidays (Text Table 3). The authorities will continue strengthening tax administration, especially through a risk-based tax compliance approach. Spending pressures are expected to rise from upcoming elections and hiring of new teachers. These will be offset by budgeting development spending more in line with implementation capacity than was done in 2017/18. Lower interest payments, measures to limit non-essential recurrent expenditures and allowances, reduced maize procurement, reforms to FISP, and the absence of one-off spending items from last year—including the ADMARC bailout and securitization of arrears—are expected to substantially reduce spending (Text Table 3).

Text Table 3. Central Government Operations (Percent of GDP, 2017/18–2018/19)

	2017/18	2018/19		One-Off
	Proj.	Proj.	Diff	Items
Revenue	**22.4**	**22.6**	**0.2**	
Expenditure and net lending	**29.7**	**26.0**	**-3.7**	
Wages and salaries	6.6	7.0	0.4	
Interest payments	4.0	3.5	-0.5	
Goods and services	6.1	5.6	-0.4	
Generic goods and services	2.7	2.4	-0.3	
National / local elections	0.2	0.6	0.4	x
Maize purchases	0.5	0.2	-0.3	
Subsidies and other current transfers	5.0	4.0	-1.0	
Transfers to public entities (including bailout of ADMARC)	2.3	1.3	-1.0	x
Fertilizer and seed subsidy	0.7	0.6	-0.1	
Issuance of zero interest promissory notes for securitizing domestic arrears	1.2	0.0	-1.2	x
Development expenditure	6.6	5.7	-0.9	
Foreign financed	4.8	4.1	-0.7	
Domestically financed	1.9	1.7	-0.2	
Overall balance (including grants and discrepancy)	**-7.0**	**-3.4**	**3.6**	
Primary balance (including grants and discrepancy)	-3.0	0.1	3.1	

Sources: Malawian authorities; IMF staff estimates.

28. **The authorities' medium-term plans emphasize broad-based tax reforms and enhancing the composition of the budget.**

- Tax reforms aim to foster a simple, efficient, transparent, and fair tax system (MEFP ¶26). The authorities will continue to streamline tax incentives, fully repeal the industrial rebate scheme, introduce a thin capitalization or earnings stripping rule, and redesign turnover taxation to increase its effectiveness.[3] Tax policy initiatives will be guided by a shift in reliance on revenue from taxation of labor and investment to consumption. Recent measures that have resulted in significant revenue loss shall be reverted such as the VAT exemption on cooking oil.

- The composition of spending will be shifted toward growth-enhancing and poverty-reducing areas (MEFP ¶27). To safeguard increased spending on infrastructure and social development, fiscal slippages will be contained, unbudgeted expenditures (e.g. in goods and services) avoided, wage increases limited to the inflation rate, and non-essential recruitments limited.[4] Pension reforms will be revisited to reduce the liabilities of the current system (MEFP ¶36, 37). The authorities will develop a plan to tackle the challenges involved in the current decentralization process, including addressing issues of transparency, capacity, and controls at the local level and eventually adopting a legal framework for budget systems and fiscal policy coordination.

- The automatic fuel pricing mechanism will be maintained. Staff and the authorities agreed that any changes to the fuel import regime will be fully transparent and include consultations with all stakeholders to avoid economically damaging supply disruptions (MEFP ¶39).

Monetary and Exchange Rate Policies

29. **Preserving a declining inflation trajectory requires a tight monetary policy stance** (MEFP ¶18). With the recent increases in inflationary pressures, staff advised continued tight monetary policy (except for liquidity provision to banks facing liquidity challenges). The authorities agreed and intend to maintain positive real interest rates through open market operations in the interbank and treasury bill markets. They also plan to keep interbank rates within the corridor and concentrate on a few tenors in their repo operations.

30. **The RBM plans to continue strengthening its monetary policy framework** (MEFP ¶19). The authorities aim to gradually transition from the current monetary aggregate targeting framework to a full interest rate-based monetary framework and to inflation targeting over the medium term—conditional on reducing fiscal dominance. Staff stressed narrowing the interest rate corridor through margin symmetry around the policy rate. This, combined with fiscal consolidation, should further 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, development of

[3] IMF technical assistance tax policy recommendations yielding the highest gains in tax revenues have already been implemented. Remaining reforms—listed above—are estimated to yield little in revenues (about 0.2 percent of GDP beginning in FY 2019/20) but are important for improving the efficiency, transparency, and fairness of the system. They are expected to be fully implemented in a phased approach during the new program.

[4] For example, during the program, spending on health and education will be increased by 0.4 percent of GDP. Domestically financed development spending will be increased by the same amount. These growth-enhancing spending items will be financed by cuts to FISP and maize purchases.

high frequency data, and improvements in inflation forecasting. In parallel, the RBM plans to improve communication with all stakeholders and the public to raise policy credibility.

31. **The authorities are committed to a flexible exchange rate regime** (MEFP ¶23)**.** They noted its importance in supporting the transition to an inflation targeting regime, cushioning shocks, and supporting economic diversification. Staff noted the 2017 AREAER reclassification of Malawi's de facto exchange rate arrangement from a float to a stabilized arrangement. The authorities acknowledged the reclassification and explained that all interventions have been to build foreign reserves and limit disorderly market conditions. They reiterated their commitment to a flexible exchange rate regime. Staff emphasized that when reserves are relatively stable, exchange rate fluctuations somewhat above a 2 percent band around the U.S. dollar should not be considered disorderly market conditions.

B. Increasing Spending on Infrastructure and Social Development

32. **Growth-enhancing infrastructure investment and social development spending will be increased through gains in efficiency and donor support**. The authorities plan to raise urgently needed infrastructure investment while maintaining macroeconomic stability and debt sustainability by improving public investment management (focusing on efficiency and project returns) and procurement as well as partnering with the private sector and development partners. Health, education, and other social spending is anticipated to be increased by higher off-budget project financing by donors (catalyzed by the program) and efficiency gains in on-budget spending in these areas (MEFP ¶27). Staff advised on measures to enhance the allocation mix of health and education budgets (for instance, increasing the budget share of secondary and tertiary education), improve fiscal transparency and accountability at national and sub-national levels, strengthen program based budgeting, and engender efficiency in frontline service delivery (Selected Issues Paper).

C. Tackling Governance Challenges

33. **Addressing major governance pitfalls will be critical to bolstering donor confidence.** To this end, the authorities will first focus on PFM and procurement reforms, followed by other broader areas (Box 3).

- **Key PFM measures** under the program aim to instill fiscal discipline and improve strategic allocation of resources and service delivery (MEFP ¶28, 29, and 30). They include routine fiscal reporting and bank reconciliation to foster fiscal integrity and transparency, reconciling debt data between the Ministry of Finance (MoF) and RBM, strengthening the quality control of monthly fiscal reporting, strengthening of the medium-term budgetary framework and cash management, strong measures to prevent further accumulation of arrears including closing out all transactions pertaining to the past arrears, and immediately implementing plans for acquiring a new IFMIS.

- **Building on the enactment of a new Procurement Act** that closed several loopholes, the authorities need to improve the procurement framework to enhance transparency, control, and accountability—placating major donor concerns. They will start by publishing all procurement information on the MoF website and using performance contracts to hold controlling officers accountable for adhering to relevant rules and procedures (MEFP ¶30).

D. Improving Financial Intermediation

34. **Safeguarding financial sector stability is a key priority for the RBM (MEFP ¶20).** The authorities continue to closely monitor and enforce compliance with prudential norms. The RBM is working closely with the two banks to increase capitalization through several remediation measures, including deadlines to reduce their NPLs and improve their business models. The authorities are committed to ensuring that all banks comply with the new IFRS9 standards, which went into effect in January 2018 and that most banks reduce their NPLs to around 5 percent by end-2018 through recovery or write-offs. Banks will also need to improve their risk management assessment and analysis of collateral quality. Recent stress tests confirmed that loan concentration remains a major risk to the banking system. The RBM will continue close monitoring and surveillance of large borrowers and enforcement of the single borrower exposure limit. Staff advised the RBM to remain vigilant regarding the rise in foreign currency lending (from about 8 percent in 2012 to 28 percent in 2017) and to ensure all banks meet the net open position requirement.

35. **The authorities view the main macro risk stemming from lower growth, which could lead to higher NPLs.** They expect the high system-wide capital adequacy ratio and the reduction in interest rates during 2017 will help mitigate these risks. The September 2017 stress test pointed to the industry-wide resilience of the banking system to credit and liquidity risk shocks. An analysis of the impact of shocks to individual banks revealed that the industry position continued to be anchored by a few healthy banks, while the majority were vulnerable to the shocks. This vulnerability should have improved somewhat with a reduction in NPLs in some of these banks during September to December 2017.

36. **Staff and the authorities agreed that increasing access to finance will be critical for more inclusive growth** (MEFP ¶21, Selected Issues Paper). Staff encouraged the RBM to continue engagement with commercial banks to improve credit to small and medium size enterprises (SMEs) and to develop a roadmap for increasing access to finance. Further efforts are needed to develop skills in the banking sector, increase financial literacy, and improve banking system efficiency—including by engaging banks in reducing their overhead costs which would lower the interest rate spread. The authorities should also enforce reporting duties to credit reference bureaus and support the improvement of their processing capabilities. Improvements in financial infrastructure, including facilitating the role of the private sector in increasing financial access, such as mobile banking infrastructure, and protecting creditor's and borrower's rights would support greater financial intermediation.

37. **The authorities are committed to strengthening the regulatory framework of the financial system** (MEFP ¶22). They will re-submit to Parliament, before end-June 2018, amendments to the Banking Act of 2010 and Financial Services Act of 2010 for eventual enactment.

These amendments will align the legal framework for bank resolution closer to best practices and provide more options for dealing with problem banks. The RBM is preparing a Minimum Capital and Solvency Directive for Life Insurance Companies which will raise their minimum capital requirement. By end-2018, the authorities plan to gazette and enact regulations related to the revised AML/CFT framework, enacted in 2017. They have committed to strengthening their asset declaration system and use of AML/CFT tools to improve governance.

PROGRAM MODALITIES AND SAFEGUARDS

38. **Phasing and capacity to repay the Fund**. The ECF arrangement will cover three years from end-April 2018 to end-April 2021. Disbursements are proposed to be spread in equal installments. Considering Malawi's track record in meeting its obligations to the Fund, the strength of the program, the favorable medium-term outlook, and a sustainable debt position, staff considers that Malawi has adequate capacity to repay the Fund (Table 8).

39. **Monitoring of program performance**. Program performance will be monitored through semi-annual program reviews based on quantitative performance criteria (Table 11) and structural benchmarks (Table 13), which also includes critical unmet structural benchmarks under the 2012–17 ECF arrangement. Test dates for the quantitative performance criteria are the last day of each semester starting June 2018.

40. **Technical Assistance (TA) will be critical to achieving program objectives**. Targeted TA in key fiscal and monetary areas—including PFM, monetary policy framework, and financial sector supervision—is planned to support implementation of program policies and reforms (Annex VI: Malawi's Capacity Development Strategy Note Summary).

41. **An update safeguards assessment of the RBM is underway and will be completed by the first review.** A safeguards-related measure to amend the RBM's legal framework with a view to strengthen its autonomy and to limit RBM's financing of the government is incorporated in the program (structural benchmark).

STAFF APPRAISAL

42. **Macroeconomic stabilization has been achieved—overcoming high inflation and a drought-induced humanitarian crisis—but growth remains lackluster.** During the 2012–17 ECF arrangement persistently high inflation was curbed, chronic foreign exchange shortages were addressed, international reserves were rebuilt to comfortable levels, and PFM reforms reinforced the budgetary processes following severe corruption scandals. However, economic growth (averaging 3.7 percent annually over the last five years) was insufficient to significantly reduce poverty. Malawi's income per capita and social indices are among the lowest in the world.

43. **Malawi's macroeconomic outlook is positive and the external position is broadly in line with fundamentals.** Over the medium term, growth is projected at 6 percent, driven by agriculture, enhanced electricity generation, better transportation networks, improved access to

finance, and increased donor-financed projects. Inflation is expected to remain in single digits, supported by prudent fiscal and monetary policies along with low international food and fuel prices. The external sector assessment suggests the external position is broadly in line with the level implied by medium-term fundamentals and desirable policies. But, broader competitiveness indicators point to major challenges.

44. **Achieving Malawi's medium-term growth potential while ensuring inclusiveness and resilience will require deep structural reforms.** Improving low quality and coverage of infrastructure (especially electricity, roads, telecommunications, water, and irrigation) and social spending as well as raising access and affordability of credit, deep agricultural market reforms, and a better business environment will be paramount for building economic diversification and resilience. Successful implementation of these plans will hinge on prioritizing the agenda while accounting for capacity and financial constraints and pursuing a flexible exchange rate regime.

45. **Improving the composition and efficiency of spending are critical to realizing Malawi's development objectives and entrenching macroeconomic stabilization**. Fiscal policy will support disinflation and debt sustainability. Revenue mobilization, lower interest bills, FISP reforms, and more control over the wage bill and other current spending combined with measures to improve public investment management and spending efficiency will support higher and better quality infrastructure and social spending. Partnering with the private sector and development partners would provide additional support for these development objectives.

46. **Tackling governance challenges is needed to catalyze increased donor support**. To this end, the authorities will first implement PFM and procurement reforms—the focus of donors. Greater commitment control will mitigate the emergence of domestic payment arrears and allow domestic financing to be limited to budgeted amounts. Routine bank reconciliation and fiscal reporting will foster fiscal integrity and transparency. Improving the procurement framework will enhance transparency, control, and accountability. Effective use of AML/CFT tools and an enhanced asset disclosure system would support the authorities' anti-corruption efforts.

47. **Better financial intermediation will broaden access to finance in support of inclusive growth.** Containing inflation through tight monetary policy, strengthening the monetary policy framework, better communication, and reduced fiscal dominance—particularly eliminating central bank financing of the deficit—will help reduce the cost of borrowing. More broadly, a roadmap for increasing access to finance needs to be developed and should include measures to facilitate commercial bank lending to SMEs, develop financial literacy across the population, raise banking system efficiency, and advance financial infrastructure.

48. **Banking system resilience needs to be strengthened**. Recent shocks and the rise in credit risks have underlined the importance of strengthening bank supervision (including ensuring AML/CFT compliance), resolving issues related to implementation of IFRS9 regulations, and close monitoring of banks' compliance with those regulations. Efforts to align the AML/CFT framework with international standards are encouraged. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral are critical to reducing high NPLs.

49. **Staff supports the authorities' request for a new three-year arrangement under the ECF**. In view of the anticipated external financing (including that catalyzed by the program), staff proposes access of 56.25 percent of quota (SDR 78.1 million), which will close the balance of payments financing gap. Proposed access is in line with the access norm for a low-income country with outstanding concessional credit between 75 and 150 percent of quota.

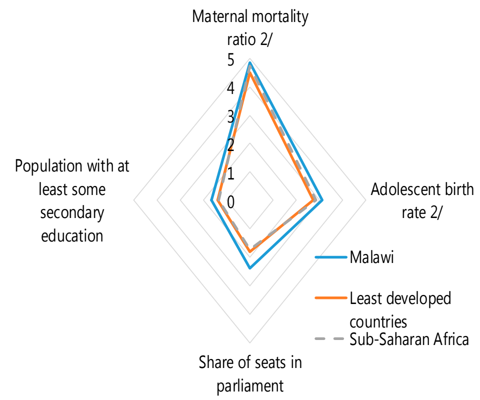
50. **Malawi's macroeconomic statistics are broadly adequate for surveillance and program monitoring but remaining gaps need to be filled.** Major shortcomings exist especially in national accounts and balance of payments statistics. They will be addressed through implementation of Fund technical assistance advice.

51. **Staff recommends that the next Article IV Consultation for Malawi be held on the 24-month cycle**, in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96), as amended).

Box 1. Malawi's Gender Inequality—Breaking the Cycle

Gender inequality is one of Malawi's most deeply entrenched socio-economic problems. Male-dominated social institutions, discrimination and pervasive cultural norms lead to gender disparities throughout the life cycle—as evidenced in education, life time earnings, access to finance and occupation of leadership positions. Gender disparities hinder economic growth by impeding full realization of Malawi's human resource potential and make it harder for women to escape poverty. A key window of opportunity to breaking this cycle is during adolescence—when the return for human capital investment peaks.[1]

Figure 1: Malawi's Gap in Gender Equity Indicators 1/

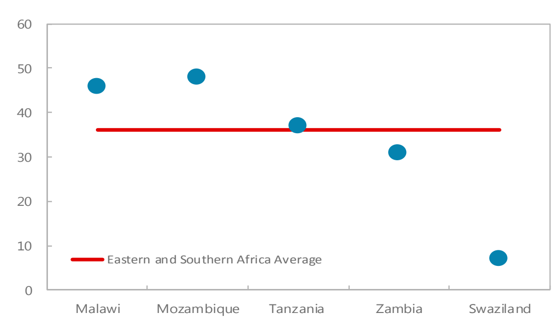


1/ Distance from the frontier defined as ratio to the frontier country (i.e. Norway).
2/ In log scale.
Sources: UNDP, Human Development Report 2016.

The UNDP Human Development Report ranks Malawi at 170th in the gender equality index out of 188 countries. The deprivation of adult Malawian women is closely linked to their experiences in adolescence, particularly through child marriage and dropping out of school:

- ***Child marriages***. Malawi's child marriage rate is among the highest in the world. By age 18, about one in every two girls are married and one in three have given birth to a baby.[2] As elsewhere, child marriage is a result of both economic and socio-cultural factors, including poverty and pressure from peers, families, and society. According to the World Bank, the aggregated lifetime social and economic costs of child marriages can be as high as 27 percent of Malawi's current GDP.[3]

Figure 2: Child Marriage Rates for Malawi & Neighbors (Percent)



Source: UNICEF.

[1] Wodon, Q., et al., (2017). *Economic Impacts of Child Marriage: Global Synthesis Report,* Washington, DC: The World Bank and International Center for Research on Women.

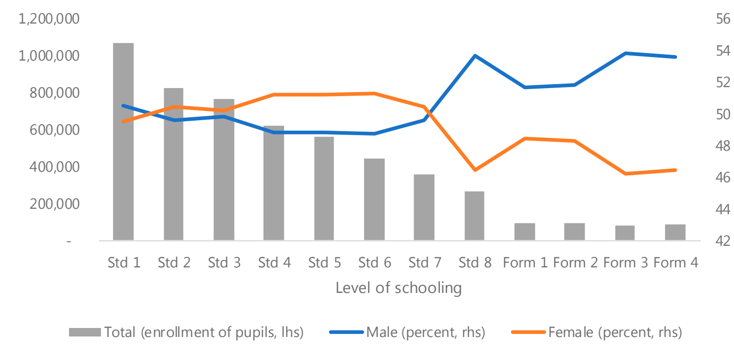
[2] Malawi Demographic Health Survey, 2015/16.

[3] Chaaban J. and Cunningham W. (2011), *Measuring the Economic Gain of Investing in Girls*, Policy Research Working Paper, World Bank, Washington DC.

Box 1. Malawi's Gender Inequality—Breaking the Cycle (continued)

- ***School dropouts***. After primary school, which is free, the educational survival rates drop dramatically for both boys and girls (Figure 3)—mainly owing to poverty. But gross enrollment rate for girls is significantly lower than for boys,[4] and net enrolment for girls in secondary school is just 15 percent. There is a clear link between school dropouts and both child marriages and early pregnancies (which often lead to child marriage). Girls attending secondary school are also more likely to participate in formal paid employment. The average return for every dollar invested in girls' secondary education can be as high as 18 percent.[5]

Figure 3: Enrollment trends over various education levels



Source: EMIS.

Policy interventions are most effective when they focus on the stage of women's lives when the cycle of deprivation begins.

- ***Ending child marriages:*** Last year's constitutional amendment to raise the minimum age for marriage from 15 to 18 was a game-changer. However, changing the reality will require the development and implementation of multifaceted strategic interventions that address the various underlying causes of child marriage—from social protection, to law enforcement[6], to health (particularly sexual and reproductive health), child protection, and public education. A comprehensive national program of action—grounded in evidence—would be the first step.

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[4] Gross enrolment is defined as the number of students enrolled in a specific level of education, regardless of age, expressed as a percentage of the population in the official age group corresponding to this level of education.

[5] Psacharopoulos G. & Patrinos H.A, (2002), *Returns to Investment in Education, A Further Update*, Policy Research Working Paper 2881, Washington DC, World Bank.

[6] Malawi's penal code criminalizes sex with a girl below sixteen—however, how this applies to sexual intercourse in the context of child marriage remains unclear. There is a need for further harmonization of a raft of legislation in Malawi to align with the Constitutional amendment on the age of the child, including the penal code, and the Child Care, Protection and Justice Act. Dealing with existing child marriages also requires a thoughtful strategy (e.g., providing an exit from child marriage without depriving the spouse rights protected under marriage and divorce). Both legislative reform and law enforcement are crucial, alongside other non-legalistic interventions.

Box 1. Malawi's Gender Inequality—Breaking the Cycle (concluded)

- ***Keeping girls in school:*** The focus should be on secondary schools—which suffer an acute supply-side bottleneck. Addressing it will need larger and more effective investment—from both public and private sources—on classrooms, teachers and education materials. Demand side interventions (e.g., more social assistance and targeted subsidy programs; which should be gender sensitive) are also required. These interventions will bring synergy with those actions needed to end child marriages.

- ***Assets and credit:*** Given the significance of a matrilineal system of land inheritence in Malawi[7], formalization of customary land rights—which is the essence of the ongoing land reform—will be key to women's access to finance. Policy interventions for access to finance, including gender neutral ones, will further help level the playing field. The joint marital property right, recognized under the Marriage Act (2015) is also an important step forward, but deliberate efforts will be needed to protect it.

- ***Labor market policies:*** Non gender-neutral policies (e.g., childcare support) can also help increase women's participation in the formal labor market. It is also important to more forcefully address sexual harassment and gender based violence in the workplace.

[7] More than two thirds of Malawi's villages follow matrilineal lineage system, where lands are typically inherited from a mother to a daughter; whereas sons are expected to obtain land use right through marriage (Takane Tsutomu 2007, Berge et al 2014).

Box 2. Building Resilience Against Food Crisis

Malawi's agricultural industry is extremely vulnerable to shocks that could lead to widespread food crisis. Maize, the country's main staple, is primarily produced by the rural workforce. Once a year harvests, lack of other crops, and poor irrigation infrastructure make maize harvests susceptible to a single flood, drought, or insect infestation – almost wiping out the country's maize supply.

Measures to ensure food security are flawed. The Strategic Grain Reserve (SGR) – overseen by the Agricultural Development and Marketing Corporation (ADMARC) and managed by the National Food Reserve Agency (NFRA) – has not procured enough to respond to recent food security challenges. The farm input subsidy program (FISP, almost 3 percent of the government's budget), aims to provide food self-sufficiency and improved use of agricultural inputs. However, the program is inefficient, poorly targeted, and hurts economic diversification. Maize market interventions helped promote price stability but undermined incentives for agricultural commercialization. Regular export bans failed to address maize shortfalls during lean seasons and, instead, reduced incentives for commercial investment – constraining long-run maize production capacity.

Preventing future food crisis requires new approaches. First, reforms to the government procurement process, supported by the World Bank and the European Union, will help improve SGR operations. Second, FISP should be redesigned to reduce the subsidy rate, introduce fixed value coupons, increase private sector participation in fertilizer distribution, and better target the beneficiaries. These measures would be part of a new World Bank Development Policy Operations program. The savings from FISP reforms could be used to expand coverage of social cash transfers, proven to be more effective than FISP in alleviating poverty. Reduced market interventions and clearer and more transparent procedures for licensing imports and exports of maize would reduce uncertainty for producers and potential investors. Finally, more investment in irrigation, incentives for agricultural diversification, and risk management would enhance productivity and resilience.

The current ECF arrangement will help mitigate or altogether prevent food crisis by supporting World Bank-led reforms to the FISP and World Bank and European Union-led procurement reforms, scaling up targeted social spending, creating fiscal space for much-needed investment in irrigation, and minimizing market interventions.

Box 3. Governance

Corruption scandals have complicated fiscal policy implementation in Malawi. Severe weaknesses in Public Financial Management (PFM) facilitated the large-scale theft of public funds—the cashgate scandal of 2013—resulting in substantial arrears and loss of donor support. Similarly, weaknesses in procurement set the stage for corruption in maize purchases from Zambia managed by the state-owned Agricultural Development and Marketing Corporation (ADMARC) during the 2016 humanitarian crisis, maizegate.

In response, the authorities are reforming both the PFM and procurement processes:

- PFM reforms under the 2012-17 ECF arrangement aimed at improving the budget process and building control over fiscal operations by strengthening commitment controls, rationalizing government bank accounts, reconciling government accounts, increasing coverage and security of IFMIS, and publishing budget execution. However, implementation of these reforms was slow and remains incomplete.

- The current ECF arrangement is designed to complete reforms from the previous ECF arrangement and move to the next phase of PFM reforms – including improving fiscal transparency, monitoring, financial discipline, commitment controls, cash management, debt management, and integrity of the accounting system. Enhanced monitoring and supervision of SOEs, public investment management, data recording and sharing, and statistical capacity building will also be important.

- In tandem, the World Bank and European Union are supporting the authorities' in designing 'good practice' mechanisms to implement the new Procurement Act.

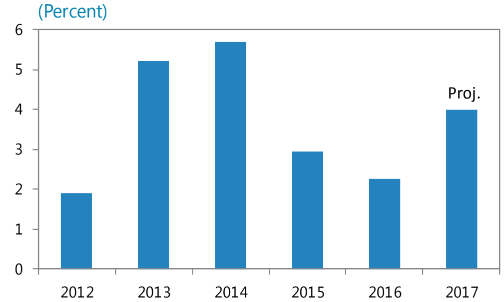
Broader governance issues, beyond PFM and procurement, also need to be addressed. Enhancing the rule of law, through a strengthened judiciary and interagency coordination framework, will be critical next steps. Measures initiating further strengthening of fiscal institutions and accountability frameworks as well as improving the AML/CFT framework (e.g., enhanced measures against politically exposed persons and strengthened information sharing and cooperation on financial intelligence), reform in asset disclosures (e.g., scope of covered officials, beneficial ownership information and public access), building anti-corruption institutions, and improving tax compliance need to be initiated.

Figure 1. Recent Economic Developments, 2012–17

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

Real GDP Growth

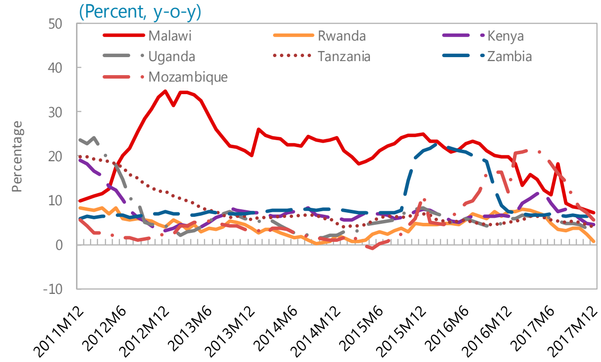
(Percent)



Headline inflation has declined sharply recently, compared to neighboring countries.

Headline Inflation

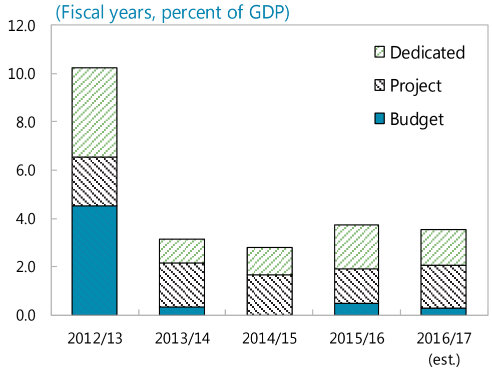
(Percent, y-o-y)



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

Evolution of Donor Assistance

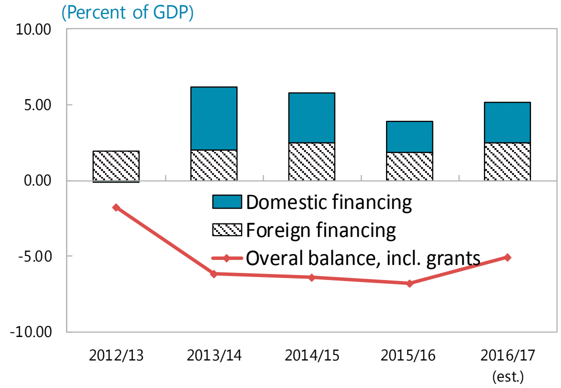
(Fiscal years, percent of GDP)



Fiscal adjustment has been insufficient, until recently.

Overall Balance

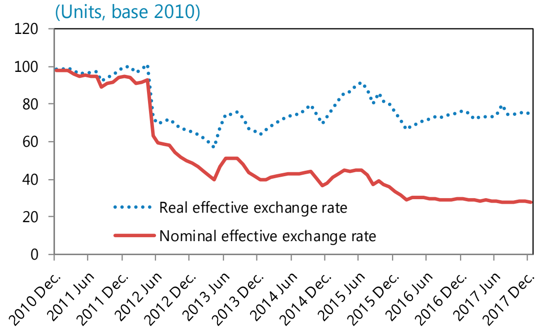
(Percent of GDP)



The REER was stable in 2017, reflecting stability of the NEER.

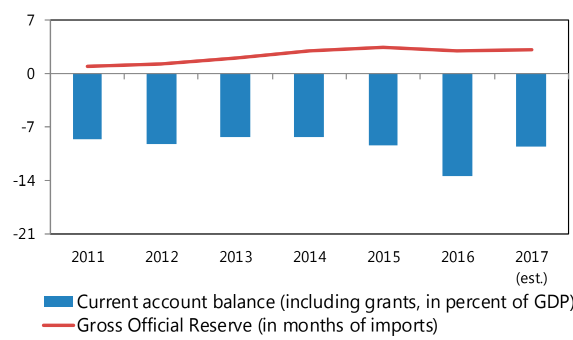
REER and NEER

(Units, base 2010)



The current account deficit declined somewhat after the increase in 2016 due to humanitarian maize imports.

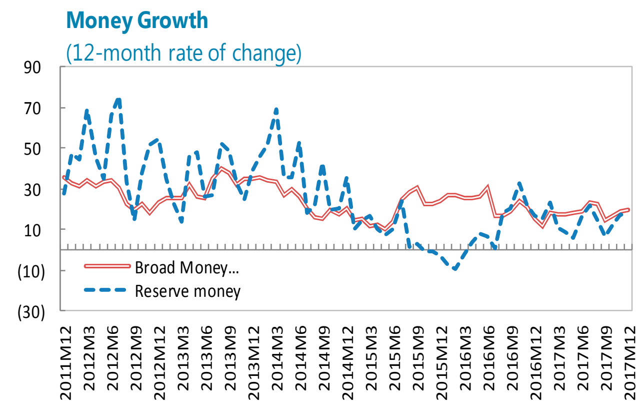
Current Account and Official Reserves



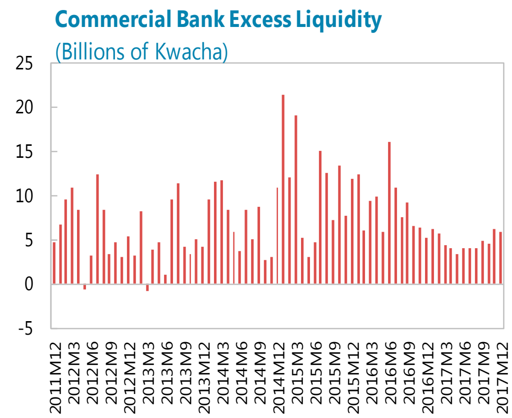
Sources: Malawian authorities; IMF staff estimates.

Figure 2. Recent Monetary Developments, 2011–17

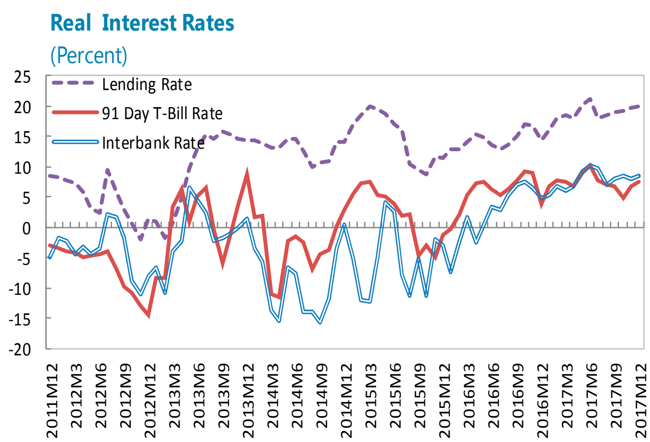
The broad money growth trend was reversed in mid-2015, mostly due to the valuation effect of a depreciating Kwacha.



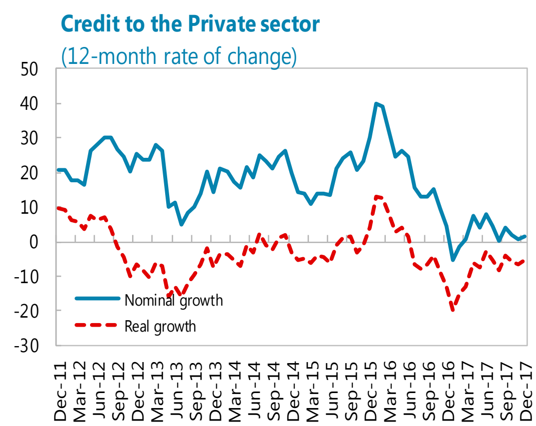
Active liquidity management has succeeded in reducing excess liquidity in the banking system since mid-2016.



Average real prime lending rate has remained elevated,

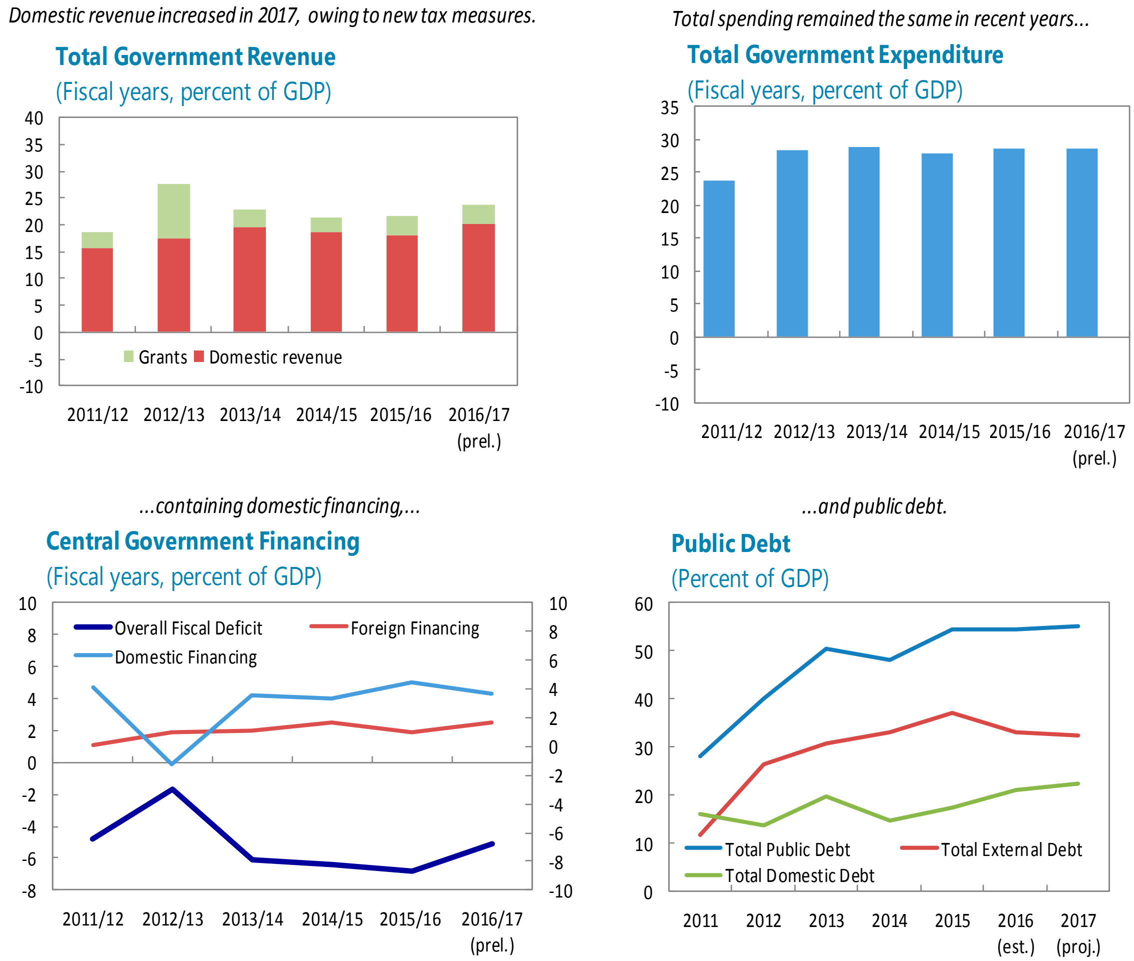


which contributed to keeping credit growth weak in real terms since mid-2012.



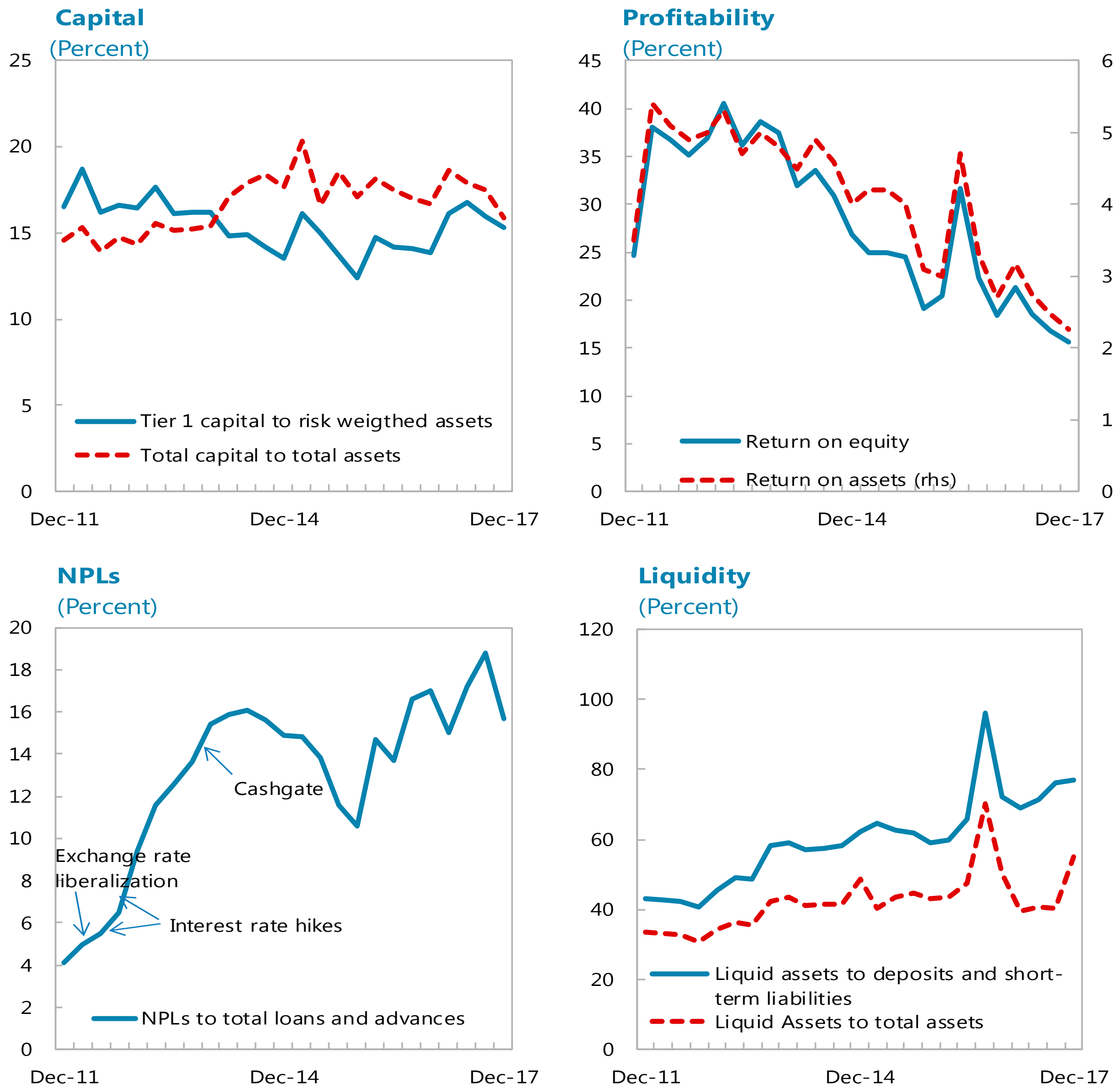
Sources: Malawian authorities; IMF staff estimates.

Figure 3. Fiscal Developments and Outlook, 2011–17



Sources: Malawian authorities; IMF staff estimates.

Figure 4. Selected Financial Stability Indicators, 2011–17 (Percent)



Sources: Malawian authorities; IMF staff estimates.

Table 1. Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
	Est.		Proj.					
National accounts and prices (percent change, unless otherwise indicated)								
GDP at constant market prices	2.3	4.0	3.5	4.5	5.0	5.5	6.0	6.5
Nominal GDP (billions of Kwacha)[1]	3,910	4,503	5,068	5,654	6,300	6,993	7,752	8,623
GDP deflator	19.5	10.7	8.8	6.8	6.1	5.2	4.6	4.4
Consumer prices (end of period)	20.0	7.1	9.0	7.5	6.5	5.5	5.0	5.0
Consumer prices (annual average)	21.7	11.5	10.4	7.6	6.9	5.9	5.2	5.0
Investment and savings (percent of GDP)								
National savings	-2.8	3.7	4.4	4.8	5.1	5.4	5.8	5.9
Gross investment	10.8	13.7	13.4	12.9	13.0	13.1	13.5	13.5
Government	4.4	7.0	6.5	6.0	5.9	6.0	6.2	6.2
Private	6.4	6.7	6.8	7.0	7.1	7.1	7.2	7.3
Saving-investment balance	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Central government (percent of GDP on a fiscal year basis)[2]								
Revenue	21.7	23.6	22.4	22.6	22.1	22.4	22.5	22.5
Tax and nontax revenue	18.0	20.1	19.5	19.5	19.5	19.5	19.6	19.6
Grants	3.7	3.5	2.8	3.1	2.7	2.9	2.9	2.9
Expenditure and net lending	28.5	28.7	29.7	26.0	24.7	24.8	24.6	24.3
Overall balance (excluding grants)	-10.5	-8.6	-10.1	-6.5	-5.3	-5.3	-5.0	-4.7
Overall balance (including grants)	-6.8	-5.1	-7.3	-3.4	-2.6	-2.3	-2.0	-1.8
Foreign financing	1.9	2.5	3.2	1.3	1.9	2.0	2.0	1.9
Total domestic financing	5.0	4.3	5.9	3.1	0.7	0.4	0.1	-0.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discrepancy	0.3	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.8	-0.6	-3.0	0.1	0.2	0.2	0.2	0.2
Money and credit (change in percent of broad money at the beginning of the period, unless otherwise indicated)								
Money and quasi money	15.2	19.7	12.6	11.6	11.4	11.0	10.9	11.2
Net foreign assets	2.1	11.1	-0.6	4.7	10.3	12.1	13.6	14.7
Net domestic assets	13.1	8.6	13.2	6.8	1.1	-1.2	-2.7	-3.4
Credit to the government	17.5	20.3	4.1	3.0	0.4	0.2	0.0	-0.4
Credit to the private sector (percent change)	4.6	0.4	4.1	6.7	11.6	12.7	14.3	14.5
External sector (US$ millions, unless otherwise indicated)								
Exports (goods and services)	1,603	1,695	1,857	1,975	2,100	2,234	2,386	2,562
Imports (goods and services)	2,520	2,547	2,747	2,769	2,927	3,110	3,326	3,572
Gross official reserves	605	757	703	755	898	1,061	1,237	1,442
(months of imports)	2.9	3.3	3.0	3.1	3.5	3.8	4.2	4.5
(percent of reserve money)	182.3	197.0	175.2	178.3	199.7	221.1	240.3	259.8
Current account (percent of GDP)	-13.6	-10.0	-8.9	-8.1	-7.9	-7.7	-7.7	-7.6
Current account, excl. official transfers (percent of GDP)	-13.6	-10.3	-10.1	-8.1	-7.8	-7.7	-7.7	-7.6
Current account, excl. project related imports (percent of GDP)	-10.3	-6.2	-6.0	-5.2	-4.5	-4.4	-4.3	-4.2
Real effective exchange rate (percent change)	-13.3	...	...	...	...	...	...	...
Overall balance (percent of GDP)	-1.9	2.1	-0.8	0.5	1.8	2.2	2.5	2.7
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Terms of trade (percent change)	-0.2	-4.6	-5.9	-1.1	-0.9	-1.2	-0.8	-0.5
Debt stock and service (percent of GDP, unless otherwise indicated)								
External debt (public sector)	33.2	32.6	32.1	32.2	32.2	32.0	31.6	31.2
NPV of Public external debt (percent of exports)	76.3	77.2	74.2	72.2	71.3	70.0	69.0	68.3
Domestic public debt	21.2	22.6	22.2	22.2	20.3	18.5	16.7	14.6
Total public debt	54.4	55.1	54.3	54.4	52.6	50.5	48.2	45.7
External debt service (percent of exports)	12.3	10.4	7.5	5.4	5.3	5.2	4.6	4.0
External debt service (percent of revenue excl. grants)	19.3	14.4	10.4	7.8	7.6	7.5	6.6	5.7
91-day treasury bill rate (end of period)	24.0	...	...	...	...	...	...	...

Sources: Malawian authorities and IMF staff estimates and projections.

[1] The current GDP base year is 2010.

[2] The fiscal year starts in July and ends in June. The current financial year, 2018, runs from July 1, 2017 to June 30, 2018.

Table 2a. Central Government Operations, 2016/17–22/23

(Billions of Kwacha)

	2016/17	2017/18		2018/19	2019/20	2020/21	2021/22	2022/23
	Est.	Approved Budget	Proj.			Proj.		
Revenue	989	1,140	1,065	1,206	1,318	1,485	1,654	1,837
Tax and nontax revenue	841	993	931	1,039	1,158	1,291	1,438	1,601
Tax Revenue	750	901	839	940	1,048	1,169	1,303	1,450
Taxes on income and profits	383	477	422	477	531	594	662	736
Taxes on goods and services	308	362	354	401	447	497	553	618
Taxes on international trade	70	79	75	84	93	104	116	129
Other taxes	-11	-17	-13	-21	-23	-26	-29	-32
Nontax revenue	91	92	92	99	110	122	136	151
Grants	148	148	134	167	160	194	216	237
Budget support grants	12	56	0	60	0	0	0	0
Project grants	74	59	87	48	98	119	132	145
Dedicated grants	62	33	48	59	63	76	84	91
Expenditure and net lending	1,201	1,336	1,414	1,387	1,472	1,639	1,803	1,984
Current expenditure	924	979	1,093	1,077	1,124	1,234	1,351	1,476
Wages and salaries	265	310	315	375	418	465	515	567
Interest payments	185	177	190	185	165	167	167	164
Domestic	173	163	176	169	146	146	143	138
Foreign	12	14	14	16	18	21	23	26
Goods and services	251	291	289	301	303	342	386	433
Generic goods and services	96	128	130	130	141	157	174	193
Census	0	3	3	5	6	7	7	7
Road maintenance and storage levey expenses	26	18	20	22	25	29	31	36
Agricultural sector	4	5	7	6	8	10	12	13
Health sector	37	37	36	43	52	63	73	86
Education sector	24	25	25	29	35	42	49	54
National / local elections	1	11	10	34	4	0	0	0
PFEM	0	7	5	1	1	1	1	2
Statutory expenditures	5	2	2	3	3	3	4	4
National AIDS Commission	8	8	8	2	2	2	2	2
Maize purchases and winter cropping program	31	35	25	10	10	10	11	13
Rural electrification	20	12	18	15	16	18	21	23
Subsidies and other current transfers	160	196	237	212	235	255	278	305
Pension and gratuities	52	69	69	82	92	102	113	125
Transfers to road and revenue authorities	23	27	25	28	31	35	39	44
Transfers to public entities and households	56	68	110	69	78	87	97	108
Fertilizer and seed subsidy	29	33	33	33	34	31	29	28
Of which: seed subsidy	1	5	5	5	6	6	7	9
Arrears payments[1]	62	4	62	4	4	5	6	7
of which: Issuance of zero interest promissory notes for securitizing domestic arrears	59	0	58	0	0	0	0	0
Development expenditure	274	353	317	306	344	402	451	506
Foreign financed	246	218	228	216	225	266	299	331
Domestically financed	28	135	89	90	119	136	152	176
Net lending	3.5	4	4	4	3	3	2	1
Overall balance (including grants)	-212	-196	-349	-181	-153	-154	-150	-146
Discrepancy	0	0	14	0	0	0	0	0
Overall balance (incl. grants and discrepancy)	-212	-196	-335	-181	-153	-154	-150	-146
Overall balance[2]	-152	-196	-277	-181	-153	-154	-150	-146
Total financing (net)	212	196	335	181	154	154	150	146
Foreign financing (net)	104	167	155	71	114	129	144	157
Borrowing	128	196	183	107	155	177	198	218
Budget support loans	0	60	63	0	0	0	0	0
Project loans	106	125	100	107	127	147	167	185
Other external loans[3]	22	11	20	0	28	30	31	33
Amortization	-25	-29	-28	-36	-41	-47	-54	-61
Sale of non-financial assets (privatization proceeds)	11	0	0	0	0	0	0	0
Net issuance of promissory notes for securitizing domestic arrears	-15	0	-45	-54	0	0	0	0
Net domestic financing (NDF)	111	28	225	164	40	25	5	-11
of which: RBM financing of central government	172		69	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Issuance of promissory notes for securitizing domestic arrears	59	0	58	0	0	0	0	0
Primary balance (including grants and discrepancy)	-27	-18	-145	4	11	13	17	18
Primary balance (excluding issuance of promissory notes for securitization of arrears)	33	-18	-87	4	11	13	17	18
Domestic fiscal balance[4]	-111	-121	-252	-128	-85	-79	-65	-51
Maturing promissory notes for domestic arrears	74	0	103	54	0	0	0	0
NDF adjusted for payment of arrears	37	28	123	111	40	25	5	-11
Nominal GDP (fiscal year)	4,183	4,764	4,764	5,339	5,953	6,620	7,343	8,154

Sources: Malawi Ministry of Finance and IMF staff projections.

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

[2] Excludes issuance of promissory notes for securitization of arrears.

[3] Other external loans include program loans other than budgetary support.

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

Table 2b. Central Government Operations, 2016/17–22/23

(Percent of GDP)

	2016/17	2017/18		2018/19	2019/20	2020/21	2021/22	2022/23
	Est.	Approved Budget	Proj.			Proj.		
Revenue	23.6	23.9	22.4	22.6	22.1	22.4	22.5	22.5
Tax and nontax revenue	20.1	20.8	19.5	19.5	19.5	19.5	19.6	19.6
Tax Revenue	17.9	18.9	17.6	17.6	17.6	17.7	17.7	17.8
Taxes on income and profits	9.2	10.0	8.9	8.9	8.9	9.0	9.0	9.0
Taxes on goods and services	7.4	7.6	7.4	7.5	7.5	7.5	7.5	7.6
Taxes on international trade	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Other taxes	-0.3	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4
Nontax revenue[1]	2.2	1.9	1.9	1.8	1.8	1.8	1.8	1.8
Grants	3.5	3.1	2.8	3.1	2.7	2.9	2.9	2.9
Budget support grants	0.3	1.2	0.0	1.1	0.0	0.0	0.0	0.0
Project grants	1.8	1.2	1.8	0.9	1.6	1.8	1.8	1.8
Dedicated grants	1.5	0.7	1.0	1.1	1.1	1.1	1.1	1.1
Expenditure and net lending	28.7	28.0	29.7	26.0	24.7	24.8	24.6	24.3
Current expenditure	22.1	20.5	23.0	20.2	18.9	18.6	18.4	18.1
Wages and salaries	6.3	6.5	6.6	7.0	7.0	7.0	7.0	7.0
Interest payments	4.4	3.7	4.0	3.5	2.8	2.5	2.3	2.0
Domestic	4.1	3.4	3.7	3.2	2.5	2.2	2.0	1.7
Foreign	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Goods and services	6.0	6.1	6.1	5.6	5.1	5.2	5.3	5.3
Generic goods and services	2.3	2.7	2.7	2.4	2.4	2.4	2.4	2.4
Road maintenance and storage levy expenses	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Agricultural sector	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Health sector	0.9	0.8	0.8	0.8	0.9	1.0	1.0	1.1
Education sector	0.6	0.5	0.5	0.5	0.6	0.6	0.7	0.7
National / local elections	0.0	0.2	0.2	0.6	0.1	0.0	0.0	0.0
PFEM	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Statutory expenditures	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1
National AIDS Commission	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Maize purchases and winter cropping programs	0.7	0.7	0.5	0.2	0.2	0.2	0.2	0.2
Rural electrification	0.5	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Subsidies and other current transfers	3.8	4.1	5.0	4.0	3.9	3.9	3.8	3.7
Pension and gratuities	1.2	1.4	1.4	1.5	1.5	1.5	1.5	1.5
Transfers to road and revenue authorities	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Transfers to public entities	1.3	1.4	2.3	1.3	1.3	1.3	1.3	1.3
Fertilizer and seed subsidy	0.7	0.7	0.7	0.6	0.6	0.5	0.4	0.3
Of which: seed subsidy	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Arrears payments[1]	1.5	0.1	1.3	0.1	0.1	0.1	0.1	0.1
of which: Issuance of zero interest promissory notes for securitizing domestic arrears	1.4	0.0	1.2	0.0	0.0	0.0	0.0	0.0
Development expenditure	6.5	7.4	6.6	5.7	5.8	6.1	6.1	6.2
Foreign financed	5.9	4.6	4.8	4.1	3.8	4.0	4.1	4.1
Domestically financed	0.7	2.8	1.9	1.7	2.0	2.1	2.1	2.2
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Overall balance (including grants)	-5.1	-4.1	-7.3	-3.4	-2.6	-2.3	-2.0	-1.8
Discrepancy	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-5.1	-4.1	-7.0	-3.4	-2.6	-2.3	-2.0	-1.8
Overall balance[2]	-3.6	-4.1	-5.8	-3.4	-2.6	-2.3	-2.0	-1.8
Total financing (net)	5.1	4.1	7.0	3.4	2.6	2.3	2.0	1.8
Foreign financing (net)	2.5	3.5	3.2	1.3	1.9	2.0	2.0	1.9
Borrowing	3.1	4.1	3.8	2.0	2.6	2.7	2.7	2.7
Budget support loans	0.0	1.3	1.3	0.0	0.0	0.0	0.0	0.0
Project loans	2.5	2.6	2.1	2.0	2.1	2.2	2.3	2.3
Other external loans[3]	0.5	0.2	0.4	0.0	0.5	0.4	0.4	0.4
Amortization	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7
Sale of non-financial assets (privatization proceeds)	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net issuance of promissory notes for securitizing domestic arrears	-0.4	0.0	-0.9	-1.0	0.0	0.0	0.0	0.0
Net domestic financing (NDF)	2.7	0.6	4.7	3.1	0.7	0.4	0.1	-0.1
of which: RBM financing of central government	4.1		1.7	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Primary balance (including grants and discrepancy)	-0.6	-0.4	-3.0	0.1	0.2	0.2	0.2	0.2
Primary balance (excluding issuance of promissory notes for securitization of arrears)	0.8	-0.4	-1.8	0.1	0.2	0.2	0.2	0.2
Domestic fiscal balance[4]	-2.6	-2.5	-5.3	-2.4	-1.4	-1.2	-0.9	-0.6
Maturing promissory notes for domestic arrears	1.8	0.0	2.2	1.0	0.0	0.0	0.0	0.0
NDF adjusted for payment of arrears	0.9	0.6	2.6	2.1	0.7	0.4	0.1	-0.1
Nominal GDP (fiscal year)	4,183	4,764	4,764	5,339	5,953	6,620	7,343	8,154

Sources: Malawi Ministry of Finance and IMF staff projections.

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

[2] Excludes issuance of promissory notes for securitization of arrears.

[3] Other external loans include program loans other than budgetary support.

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

Table 2c. Central Government Quarterly Operations in FY 17/18 and FY 18/19

(Billions of Kwacha)

	2017/18					2018/19				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	248.5	240.3	266.9	309.3	1,065.0	346.4	286.4	286.4	286.4	1,205.6
Tax and nontax revenue	225.3	216.0	226.7	262.5	930.5	259.7	259.7	259.7	259.7	1,038.6
Tax revenue	206.4	196.1	206.6	229.5	838.6	235.0	235.0	235.0	235.0	940.0
Taxes on income and profits	102.5	91.9	105.3	122.4	422.1	119.1	119.1	119.1	119.1	476.6
Taxes on goods and services	88.6	88.7	87.6	89.5	354.4	100.2	100.2	100.2	100.2	400.7
Taxes on international trade	18.0	18.8	16.9	21.0	74.7	20.9	20.9	20.9	20.9	83.8
Other taxes	-2.7	-3.3	-3.2	-3.5	-12.6	-5.2	-5.2	-5.2	-5.2	-21.0
Nontax revenue	18.9	19.9	20.1	32.9	91.9	24.6	24.6	24.6	24.6	98.6
Grants	23.2	24.2	40.2	46.8	134.5	86.8	26.8	26.8	26.8	167.0
Budget support grants	0.0	0.0	0.0	0.0	0.0	60.0	0.0	0.0	0.0	60.0
Project grants	15.4	12.8	29.3	29.3	86.7	12.1	12.1	12.1	12.1	48.4
Dedicated grants	7.8	11.5	10.9	17.5	47.8	14.7	14.7	14.7	14.7	58.6
Expenditure and net lending	365.8	347.6	329.5	371.1	1,414.0	345.1	334.3	364.6	342.7	1,386.8
Current expenditure	300.5	272.6	259.3	261.0	1,093.3	267.6	256.8	287.1	265.2	1,076.6
Wages and salaries	76.1	79.1	78.8	81.2	315.2	93.7	93.7	93.7	93.7	374.6
Interest payments	44.5	34.5	64.2	47.2	190.4	43.6	32.8	64.6	43.7	184.8
Domestic	43.4	29.0	60.5	43.4	176.3	39.8	28.9	60.4	39.5	168.6
Foreign	1.1	5.5	3.7	3.8	14.1	3.8	3.9	4.2	4.3	16.3
Goods and services	114.3	55.1	56.3	63.1	288.8	76.2	76.2	74.7	73.7	300.7
Generic goods and services	49.6	23.4	28.4	28.4	129.7	32.6	32.6	32.6	32.6	130.3
Census	1.2	1.5	0.0	0.5	3.2	1.4	1.4	1.4	1.4	5.4
Road Maintenance	6.7	1.1	5.0	7.2	20.0	5.4	5.4	5.4	5.4	21.7
Agricultural sector	1.4	2.3	2.3	0.9	7.0	1.6	1.6	1.6	1.6	6.4
Health sector	9.3	9.9	8.5	8.5	36.2	10.8	10.8	10.8	10.8	43.4
Education sector	8.5	7.4	4.7	4.7	25.3	7.3	7.3	7.3	7.3	29.1
National / local elections	2.0	1.9	2.5	3.7	10.1	8.6	8.6	8.6	8.6	34.5
PFEM	0.0	0.0	0.0	5.0	5.0	0.3	0.3	0.3	0.3	1.3
Statutory expenditures	0.5	0.7	0.4	0.4	2.0	0.6	0.6	0.6	0.6	2.5
National AIDS Commission	1.2	3.8	1.4	1.4	7.7	0.4	0.4	0.4	0.4	1.5
Maize purchases and winter cropping program	24.0	0.9	0.0	0.0	24.9	3.5	3.5	2.0	1.0	10.0
Rural Electrification	10.0	2.1	3.1	2.4	17.7	3.7	3.7	3.7	3.7	14.6
Subsidies and other current transfers	43.9	91.8	46.0	55.4	237.0	53.1	53.1	53.1	53.1	212.5
Pension and gratuities	19.4	16.3	16.4	16.4	68.6	20.5	20.5	20.5	20.5	82.1
Transfers to road and revenue authorities	6.3	5.0	6.2	7.7	25.2	7.1	7.1	7.1	7.1	28.2
Transfers to public entities and households	17.5	62.1	14.6	15.8	110.1	17.3	17.3	17.3	17.3	69.0
Fertilizer and seed subsidy	0.7	8.3	8.7	15.4	33.2	8.3	8.3	8.3	8.3	33.2
Of which: seed subsidy	0.0	1.0	1.7	2.4	5.2	1.3	1.3	1.3	1.3	5.2
Arrears payments[1]	21.7	12.1	14.0	14.2	61.9	1.0	1.0	1.0	1.0	4.0
Of which, issuance of zero-coupon promissory notes	18.0	12.0	14.0	14.0	57.9	0.0	0.0	0.0	0.0	0.0
Development expenditure	63.2	75.0	70.2	108.3	316.7	76.6	76.6	76.6	76.6	306.4
Foreign financed	42.1	55.5	46.2	84.2	228.0	54.1	54.1	54.1	54.1	216.4
Domestically financed	21.1	19.5	24.0	24.0	88.7	22.5	22.5	22.5	22.5	90.0
Net lending	2.2	0.0	0.0	1.8	4.0	0.9	0.9	0.9	0.9	3.8
Overall balance (including grants)	-117.3	-107.3	-62.6	-61.8	-349.0	1.3	-47.9	-78.2	-56.3	-181.2
Discrepancy	24.7	-11.0	0.0	0.0	13.7	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants and discrepancy)	-92.6	-118.4	-62.6	-61.8	-335.3	1.3	-47.9	-78.2	-56.3	-181.2
Overall balance[2]	**-74.6**	**-106.4**	**-48.6**	**-47.8**	**-277.4**	**1.3**	**-47.9**	**-78.2**	**-56.3**	**-181.2**
Total financing (net)	92.6	118.4	62.6	61.8	335.3	-1.3	47.9	78.2	56.3	181.2
Foreign financing (net)	78.5	39.8	18.3	18.1	154.6	17.9	17.7	17.6	17.4	70.6
Borrowing	81.1	48.0	26.8	26.8	182.6	26.8	26.8	26.8	26.8	107.0
Budget support loans	61.1	1.8	0.0	0.0	62.9	0.0	0.0	0.0	0.0	0.0
Project loans	20.0	46.2	16.9	16.9	100.0	26.8	26.8	26.8	26.8	107.0
Other external loans[3]	0.0	0.0	9.8	9.8	19.7	0.0	0.0	0.0	0.0	0.0
Amortization	-2.6	-8.2	-8.5	-8.7	-27.9	-8.9	-9.0	-9.2	-9.3	-36.4
Net Issuance of promissory notes for securitizing domestic arrears	-1.5	-30.9	-6.8	-5.4	-44.7	-18.0	-17.0	-16.0	-2.6	-53.6
Net domestic financing (NDF)	15.6	109.5	51.1	49.1	225.4	-1.2	47.2	76.7	41.5	164.2
of which: RBM financing of central government	-15.1	84.6	0.0	0.0	69.5	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Primary balance (including grants and discrepancy)	-48.0	-83.8	1.6	-14.7	-144.9	44.9	-15.1	-13.6	-12.6	3.6
Primary balance (excluding issuance of promissory notes for arrears)	-30.1	-71.9	15.6	-0.7	-87.0	44.9	-15.1	-13.6	-12.6	3.6
Domestic fiscal balance[4]	-96.2	-76.1	-56.6	-22.6	-251.5	-30.4	-19.6	-49.9	-28.0	-128.0
Maturing promissory notes for domestic arrears	19.5	42.9	20.8	19.4	102.6	18.0	17.0	16.0	2.6	53.6
NDF adjusted for payment of arrears	-3.9	66.6	30.3	29.7	122.8	-19.2	30.2	60.7	38.9	110.6
Nominal GDP					4,764					5,339

Sources: Malawi Ministry of Finance and IMF staff estimates.

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

[2] Excludes issuance of promissory notes for securitization of arrears.

[3] Other external loans include program loans other than budgetary support.

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

Table 3a. Monetary Authorities' Survey, 2016–19
(Billions of Kwacha, unless otherwise indicated)

	2016	2017	2018				2019	
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June
	Act.	Est.	Proj.				Proj.	
Reserve money	241	279	260	295	290	314	292	330
Currency outside banks	146	165	...	...	...	...	...	...
Cash in vault	38	35	...	...	...	...	...	...
Commercial bank deposits with RBM	56	78	...	...	...	...	...	...
Net foreign assets (NFA)	225	319	314	255	276	302	313	314
Foreign assets	439	550	540	492	513	550	561	575
Foreign liabilities	-214	-231	-226	-237	-236	-248	-248	-261
Net domestic assets	16	-40	-54	39	14	12	-21	16
Credit to government (net)	256	408	408	408	408	408	408	408
Credit to domestic banks	0	0	0	0	0	0	0	0
Other items (net)	-240	-448	-462	-368	-394	-396	-429	-392
Open market operations	-227	-401	...	...	...	...	...	...
Others	-12	-47	...	...	...	...	...	...
Memorandum items:								
Money multiplier	3.7	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Annual growth of reserve money (percent)	16.8	15.9	20.9	11.8	13.9	12.6	12.3	12.1
91-day treasury bill rate	24.0	14.7	...	...	...	...	...	...
NFA of the central bank (US$ millions)	310	439	340	340	360	386	394	390
Foreign assets (US$ millions)	605	757	656	656	669	703	706	714
Foreign liabilities (US$ millions)	-295	-318	-316	-316	-308	-317	-312	-324

Sources: Reserve Bank of Malawi; and IMF staff projection

Table 3b. Monetary Survey, 2016–19

(Billions of Kwacha, unless otherwise indicated)

	2016	2017	2018				2019	
	Dec.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	June.
	Act.	Est.	Proj.				Proj.	
Money and quasi-money	897	1,074	1,000	1,135	1,118	1,209	1,123	1,272
Money	396	503	...	...	...	...	...	...
Quasi-money	501	572	...	...	...	...	...	...
Of which: foreign currency deposits	222	234	...	...	...	...	...	...
Net foreign assets (NFA)	356	456	452	396	421	449	462	465
Monetary authorities	225	319	314	255	276	302	313	314
Gross foreign assets	439	550	540	492	513	550	561	575
Foreign liabilities	-214	-231	-226	-237	-236	-248	-248	-261
Commercial banks (net)	131	137	138	141	144	147	149	151
Net domestic assets	541	619	548	738	698	760	661	806
Credit to government (net)	338	520	534	548	551	564	583	593
Credit to statutory bodies (net)	9	8	8	8	8	8	9	9
Credit to private sector	408	410	406	434	428	427	428	461
Other items (net)	-214	-319	-401	-251	-290	-239	-357	-257
Memorandum items:								
Velocity of money (annualized GDP divided by broad money)	4.4	4.2	4.6	4.2	4.4	4.2	4.2	4.4
Annual growth of broad money (percent)	15.2	19.7	14.6	13.9	13.2	12.6	12.3	12.1
Annual growth of credit to the private sector (percent)	4.6	0.4	2.4	3.4	3.9	4.1	5.3	6.4
NFA of the commercial banks (US$ millions)	181.0	188.2	188.1	188.1	188.1	188.1	188.1	188.1
Gross foreign assets (US$ millions)	204.2	261.2	261.2	261.2	261.2	261.2	261.2	261.2
Foreign liabilities (US$ millions)	-23.2	-73.0	-73.0	-73.0	-73.0	-73.0	-73.0	-73.0
Foreign currency deposits(US$ millions)	306.7	322.0	...	...	...	...	...	...
Nominal GDP (billions of Kwacha)	3,910	4,503	4,619	4,764	4,912	5,068	5,189	5,339

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

Table 4a. Balance of Payments, 2016–23
(Millions of USD, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023
	Est.		Proj.					
Current account balance	-743.7	-621.0	-682.0	-572.1	-584.0	-610.9	-649.9	-691.3
Merchandise trade balance	-609.6	-582.5	-623.2	-544.9	-578.3	-609.8	-652.9	-698.3
Exports	1,480.2	1,569.8	1,714.9	1,805.8	1,915.0	2,038.9	2,178.5	2,341.7
Of which: Tobacco	578.5	583.4	634.3	664.5	696.2	729.4	764.2	804.4
Imports	-2,089.8	-2,152.3	-2,338.0	-2,350.7	-2,493.3	-2,648.8	-2,831.4	-3,040.0
Of which : Petroleum	-103.0	-139.7	-188.5	-193.3	-201.1	-213.5	-230.3	-249.5
Project related	-179.2	-238.0	-197.4	-203.3	-246.4	-267.2	-285.5	-304.8
Maize	-183.6		-75.0					
Services balance	-449.0	-412.2	-412.4	-401.8	-409.1	-436.6	-468.8	-505.5
Interest public sector	-32.8	-22.6	-19.1	-20.2	-21.7	-23.5	-25.6	-27.8
Other factor payments (net)	-108.1	-120.5	-126.8	-132.5	-139.2	-146.9	-155.8	-166.0
Nonfactor (net)	-308.1	-269.2	-266.6	-249.1	-248.2	-266.2	-287.4	-311.7
Receipts	122.5	125.3	142.4	168.8	185.3	195.5	207.2	220.7
Payments	-430.6	-394.5	-409.0	-417.9	-433.5	-461.7	-494.6	-532.3
Unrequited transfers (net)	314.9	373.8	353.7	374.6	403.4	435.6	471.7	512.4
Private (net)	315.7	358.4	354.5	375.5	404.2	436.5	472.6	513.4
Official (net)	-0.8	15.4	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9
Receipts	0.0	16.3	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	0.0	16.3	0.0	0.0	0.0	0.0	0.0	0.0
Payments	-0.8	-0.8	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9
Capital account balance	498.0	325.5	348.6	339.4	406.6	438.1	468.1	501.0
Project and dedicated grants	145.7	197.3	188.0	165.4	217.0	232.8	246.6	262.9
Off-budget project support[1]	352.4	128.3	160.7	174.0	189.6	205.3	221.6	238.1
Financial account balance	120.6	271.7	194.7	216.2	256.4	286.1	395.3	437.3
Medium- and long-term flows (net)	-0.8	149.5	46.2	53.0	77.0	88.8	182.3	210.8
Disbursements	135.8	278.0	136.1	120.3	144.5	152.8	227.8	241.6
Budget support and other program loans	0.0	84.3	0.0	0.0	0.0	0.0	0.0	0.0
Project support loans	110.4	168.9	109.4	93.0	110.0	118.0	192.6	206.1
Other medium-term loans	25.4	24.9	26.7	27.3	34.5	34.8	35.1	35.5
Amortization	-136.6	-128.6	-90.0	-67.3	-67.5	-64.0	-45.5	-30.8
Foreign direct investment and other inflows	170.6	127.1	146.1	160.7	176.8	194.5	210.1	223.3
Short-term capital	36.8	2.3	2.4	2.5	2.6	2.8	2.9	3.1
Commercial banks net foreign assets	-86.0	-7.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	18.8	153.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-106.3	129.4	-138.6	-16.4	79.0	113.3	213.4	247.0
Financing	106.3	-129.4	21.5	-69.7	-162.7	-189.5	-213.4	-247.0
Gross reserves (- increase)	65.3	-152.4	54.7	-52.1	-142.7	-163.0	-176.3	-205.2
Liabilities	41.0	23.1	-33.1	-17.6	-20.0	-26.5	-37.1	-41.7
Of which: IMF (net)	51.6	4.8	-29.3	-17.1	-19.9	-26.5	-37.1	-41.8
Purchases/drawings	76.4	26.6	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	24.8	21.8	29.3	17.1	19.9	26.5	37.1	41.8
Financing gap	0.0	0.0	117.1	86.1	83.8	76.1	0.0	0.0
Of which: IMF ECF	...	...	31.6	31.7	31.6	15.8	0.0	0.0
World Bank (budget support grant)	...	...	79.1	0.0	0.0	0.0	0.0	0.0
Additional project support loans	...	...	6.4	54.4	52.1	60.4	0.0	0.0
Memorandum items:								
Gross official reserves	605.0	757.4	702.7	754.8	897.6	1,060.6	1,236.9	1,442.1
Months of imports[2]	2.9	3.3	3.0	3.1	3.5	3.8	4.2	4.5
Current account balance (percent of GDP)								
Excluding official transfers	-13.6	-10.3	-10.1	-8.1	-7.8	-7.7	-7.7	-7.6
Excluding project related imports	-10.3	-6.2	-7.2	-5.2	-4.5	-4.4	-4.3	-4.2
Import price index (2005 = 100)	111.5	118.2	124.4	124.8	125.0	125.9	126.2	126.3
Import volume (percent change)	5.1	-1.7	4.9	0.2	5.8	5.5	6.7	7.2
REER (percent change)	-13.3	...	...	...	...	...	...	...
Terms of trade (percent change)	-0.2	-4.6	-5.9	-1.1	-0.9	-1.2	-0.8	-0.5
Nominal GDP (millions of U.S. dollars)	5,475.2	6,205.7	6,745.7	7,024.3	7,430.9	7,894.8	8,445.2	9,099.7

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

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

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

Table 4b. Balance of Payments, 2016–23

(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023
	Est.		Proj.					
Current account balance	-13.6	-10.0	-10.1	-8.1	-7.9	-7.7	-7.7	-7.6
Merchandise trade balance	-11.1	-9.4	-9.2	-7.8	-7.8	-7.7	-7.7	-7.7
Exports	27.0	25.3	25.4	25.7	25.8	25.8	25.8	25.7
Of which: Tobacco	10.6	9.4	9.4	9.5	9.4	9.2	9.0	8.8
Imports	-38.2	-34.7	-34.7	-33.5	-33.6	-33.6	-33.5	-33.4
Of which : Petroleum	-1.9	-2.3	-2.8	-2.8	-2.7	-2.7	-2.7	-2.7
Project related	-3.3	-3.8	-2.9	-2.9	-3.3	-3.4	-3.4	-3.3
Maize	-3.4		-1.1					
Services balance	-8.2	-6.6	-6.1	-5.7	-5.5	-5.5	-5.6	-5.6
Interest public sector (net)	-0.6	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other factor payments (net)	-2.0	-1.9	-1.9	-1.9	-1.9	-1.9	-1.8	-1.8
Nonfactor (net)	-5.6	-4.3	-4.0	-3.5	-3.3	-3.4	-3.4	-3.4
Receipts	2.2	2.0	2.1	2.4	2.5	2.5	2.5	2.4
Payments	-7.9	-6.4	-6.1	-5.9	-5.8	-5.8	-5.9	-5.8
Transfers (net)	5.8	6.0	5.2	5.3	5.4	5.5	5.6	5.6
Private (net)	5.8	5.8	5.3	5.3	5.4	5.5	5.6	5.6
Official (net)	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Receipts	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	0.0	0.3	0.0	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	0.0
Capital account balance	9.1	5.2	5.2	4.8	5.5	5.5	5.5	5.5
Project and dedicated grants	2.7	3.2	2.8	2.4	2.9	2.9	2.9	2.9
Off-budget project support[1]	6.4	2.1	2.4	2.5	2.6	2.6	2.6	2.6
Financial account balance	2.2	4.4	2.9	3.1	3.5	3.6	4.7	4.8
Medium- and long-term flows (net)	0.0	2.4	0.7	0.8	1.0	1.1	2.2	2.3
Loan disbursements	2.5	4.5	2.0	1.7	1.9	1.9	2.7	2.7
Budget support and other program loans	0.0	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Project support loans	2.0	2.7	1.6	1.3	1.5	1.5	2.3	2.3
Other medium-term loans	0.5	0.4	0.4	0.4	0.5	0.4	0.4	0.4
Amortization	-2.5	-2.1	-1.3	-1.0	-0.9	-0.8	-0.5	-0.3
Foreign direct investment and other inflows	3.1	2.0	2.2	2.3	2.4	2.5	2.5	2.5
Commercial banks net foreign assets	-1.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.3	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-1.9	2.1	-2.1	-0.2	1.1	1.4	2.5	2.7
Financing	1.9	-2.1	0.3	-1.0	-2.2	-2.4	-2.5	-2.7
Gross reserves (- increase)	1.2	-2.5	0.8	-0.7	-1.9	-2.1	-2.1	-2.3
Liabilities	0.7	0.4	-0.5	-0.3	-0.3	-0.3	-0.4	-0.5
Of which: IMF (net)	0.9	0.1	-0.4	-0.2	-0.3	-0.3	-0.4	-0.5
Purchases/drawings	1.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases/repayments	0.5	0.4	0.4	0.2	0.3	0.3	0.4	0.5
Financing gap	0.0	0.0	1.7	1.2	1.1	1.0	0.0	0.0
Of which: IMF ECF	...	...	0.5	0.5	0.4	0.2	0.0	0.0
World Bank (budget support grant)	...	...	1.2	0.0	0.0	0.0	0.0	0.0
Additional project support loans	...	...	0.1	0.8	0.7	0.8	0.0	0.0
Memorandum items:								
Gross official reserves	11.0	12.2	10.4	10.7	12.1	13.4	14.6	15.8
Current account balance (percent of GDP)								
Excluding official transfers	-13.6	-10.3	-10.1	-8.1	-7.8	-7.7	-7.7	-7.6
Excluding project related imports	-10.3	-6.2	-7.2	-5.2	-4.5	-4.4	-4.3	-4.2
Value of exports of GNFs (percent change)	-2.0	5.8	9.6	6.3	6.4	6.4	6.8	7.4
Value of imports of GNFs (percent change)	7.4	1.0	7.9	0.8	5.7	6.3	6.9	7.4

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

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

Table 5. Selected Banking Soundness Indicators, 2012–17

Key ratios	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17
Capital Adequacy						
1. Regulatory Tier 1 capital to risk weighted assets	16.4	16.2	13.5	12.4	13.8	15.3
2. Regulatory total capital to risk weighted assets	20.2	19.1	17.1	15.8	17.0	19.4
3. Total capital to total assets	14.3	15.4	17.6	17.1	16.7	15.9
Asset composition and quality						
1. Non-performing loans to gross loans and advances	9.4	15.4	14.9	10.6	17.0	15.7
2. Provisions to non-performing loans	26.8	29.1	31.8	25.7	25.5	34.5
3. Total loans and advances to total assets	50.8	40.5	40.3	40.0	34.8	28.1
4. Foreign currency loans to total loans and advances	7.9	13.5	19.1	28.6	21.8	27.9
Earnings and profitability						
1. Return on assets (ROA)	5.0	4.8	4.0	3.1	2.7	2.3
2. Return on equity (ROE)	36.9	37.5	26.8	19.2	18.4	15.7
3. Non-interest expenses to gross income	36.8	39.7	45.4	51.4	50.0	49.7
4. Interest margin to gross income	36.8	39.7	---	50.2	47.8	50.8
5. Non-Interest Income to Revenue	---	31.8	37.8	30.5	28.0	27.3
6. Net Interest Income to Assets	---	9.1	8.4	9.7	9.7	8.7
7. Personnel expenses to non-interest expenses	46.0	45.4	45.1	45.3	43.8	46.5
Liquidity						
1. Liquid assets to deposits and short-term liabilities	45.4	59.1	62.4	59.0	72.3	77.0
2. Total loans to total deposits	72.4	56.6	58.3	58.5	54.2	45.1
3. Liquid Assets to total assets	34.5	43.7	48.8	43.3	50.4	55.0
4. Foreign exchange liabilities to total liabilities	17.9	26.3	---	26.1	19.7	19.8

Source: Reserve Bank of Malawi.

Table 6. External Financing Requirement and Source, 2016–23

(Millions of USD)

	2016	2017	2018	2019	2020	2021	2022	2023
Total requirement	-814	-917	-716	-691	-793	-837	-871	-926
Current account, excluding official transfers	-743	-636	-681	-571	-583	-610	-649	-690
Debt amortization	-137	-129	-90	-67	-67	-64	-46	-31
Gross reserves accumulation (- increase)	65	-152	55	-52	-143	-163	-176	-205
Total sources	814	917	599	605	710	761	871	926
Expected disbursements (official)	633	619	484	459	550	590	695	742
Grants	497	341	348	339	406	437	467	500
Medium- and long-term loans	136	278	136	120	144	153	228	242
Private sector (net)	130	294	145	163	179	197	213	227
IMF (net)	52	5	-29	-17	-20	-27	-37	-42
Drawings	76	27	0	0	0	0	0	0
Repayments	25	22	29	17	20	27	37	42
Financing gap	0	0	117	86	84	76	0	0
Gross official reserves	605	757	703	755	898	1061	1237	1442
Months of imports	2.9	3.3	3.0	3.1	3.5	3.8	4.2	4.5

Source: IMF staff estimates.

Table 7. Schedule of Disbursements under ECF Arrangement, 2018–21

(Millions of SDR)

Amount	% of Quota[1]	Availability date	Conditions Necessary for Disbursement	Status
11.15	8.033	April 30, 2018	Executive Board Approval of Three Year ECF arrangement.	
11.15	8.033	October 15, 2018	Observance of performance criteria for June 30, 2018, and completion of first review.	
11.15	8.033	April 15, 2019	Observance of performance criteria for December 31, 2018, and completion of second review.	
11.15	8.033	October 15, 2019	Observance of performance criteria for June 30, 2019, and completion of third review.	
11.15	8.033	April 15, 2020	Observance of performance criteria for December 31, 2019, and completion of fourth review.	
11.15	8.033	October 15, 2020	Observance of performance criteria for June 30, 2020, and completion of fifth review.	
11.175	8.051	April 15, 2021	Observance of performance criteria for December 31, 2020, and completion of the sixth review.	
78.075	56.25	Total for the ECF arrangement		
Memorandum item:				
Malawi's new Quota (millions SDR)		138.80		

Source: IMF staff estimates.

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

Table 8. Indicators of Capacity to Repay the Fund, 2018–31

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Projected Payments based on Existing Drawings:														
(SDR millions)														
Principal[1]	20.41	11.89	13.80	18.44	25.81	21.25	18.65	16.05	9.32	1.95	0.00	0.00	0.00	0.00
Charges and interest	0.40	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53
Projected Payments based on Prospective Drawings:														
(SDR millions)														
Principal	0.00	0.00	0.00	0.00	0.00	1.12	5.58	10.04	14.50	15.62	14.50	10.04	5.58	1.12
Charges and interest	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Projected Payments based on Existing and Prospective Drawings:														
SDR millions	20.81	12.42	14.33	18.97	26.34	22.90	24.76	26.62	24.35	18.10	15.03	10.57	6.11	1.65
US$ Millions	29.85	17.86	20.63	27.30	37.91	34.18	36.96	39.73	36.34	27.01	22.43	15.78	9.12	2.46
Percent of exports of goods and services	1.61	0.90	0.98	1.22	1.59	1.33	1.34	1.34	1.14	0.79	0.61	0.40	0.21	0.05
Percent of debt service	21.39	16.89	18.71	23.69	34.64	33.63	31.82	30.44	25.00	17.34	13.42	9.13	5.27	1.39
Percent of quota	14.99	8.95	10.32	13.67	18.98	16.50	17.84	19.18	17.54	13.04	10.83	7.62	4.40	1.19
Percent of gross official reserves	4.25	2.37	2.30	2.57	3.07	2.37	2.27	2.17	1.78	1.20	0.89	0.57	0.30	0.07
Projected Level of Credit Outstanding based on Existing and Prospective Drawings:														
SDR millions	159.5	169.9	178.4	171.1	145.3	122.9	98.7	72.6	48.8	31.2	16.7	6.7	1.1	0.0
US$ Millions	229.0	244.5	256.7	246.3	209.1	176.8	142.0	104.5	70.2	44.9	24.1	9.6	1.6	0.0
Percent of exports of goods and services	12.3	12.4	12.2	11.0	8.8	6.9	5.2	3.5	2.2	1.3	0.7	0.2	0.0	0.0
Percent of debt service	164.1	231.1	232.8	213.7	191.0	174.0	122.2	80.0	48.3	28.9	14.4	5.6	0.9	0.0
Percent of quota	114.9	122.4	128.5	123.3	104.7	88.6	71.1	52.3	35.2	22.5	12.1	4.8	0.8	0.0
Percent of gross official reserves	32.6	32.4	28.6	23.2	16.9	12.3	8.7	5.7	3.4	2.0	1.0	0.3	0.1	0.0
Memorandum items:														
Exports of goods and services (millions of U.S. dollars)	1,857	1,975	2,100	2,234	2,386	2,562	2,757	2,966	3,192	3,432	3,690	3,967	4,265	4,585
Debt service (millions of U.S. dollars)	139.5	105.8	110.3	115.2	109.5	101.6	116.1	130.5	145.4	155.8	167.2	172.7	173.0	176.9
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	138.8	138.8
Gross official reserves (millions of U.S. dollars)	703	755	898	1,061	1,237	1,442	1,631	1,829	2,038	2,261	2,508	2,773	3,068	3,396
GDP (millions of U.S. dollars)	6,746	7,024	7,431	7,895	8,445	9,100	9,801	10,568	11,392	12,283	13,234	14,249	15,331	16,463

Source: IMF staff projections.

[1] Principal payment in 2018 includes the amount already paid as of February 28, 2018.

Table 9. Projected External Borrowing
(January 1, 2018 - December 31, 2018)

PPG external debt contracted or guaranteed[1]	Volume of new debt (US$ million)	PV of new debt (US$ million)
Sources of debt financing		
Consessional debt, of which [2]	**286**	**143**
Multilateral debt	286	143
Bilateral debt	0	0
Non-concessional debt, of which [2]	**0**	**0**
Semi-concessional[3]	0	0
Commerical terms[4]	0	0
Use of debt financing		
Infrastructure	**286**	**143**
Budget Finanicng	0	0
Memo Items		
Indicative projections		
Year 2	366	183-238
Year 3	310	202-155

Source: IMF staff projections.

[1] Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate.

[2] Debt with a grant element that exceeds a minimum threshold. This minimum is typically 35 percent, but could be established at a higher level.

[3] Debt with a positive grant element which does not meet the minimum grant element.

[4] Debt without a positive grant element. For commercial debt, the present value would be defined as the

Table 10. Selected Indicators on the Millennium Development Goals (MDGs)
(2000 and Latest Observations)

	2000	Latest	Latest Year
Goal 1: Eradicate extreme poverty and hunger			
Income share held by lowest 20 percent 1/	3.9	5.5	2010
Prevalence of underweight, weight for age (% of children under 5)	21.5	16.7	2014
Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population) 1/	63.6	70.9	2010
Prevalence of undernourishment (percent of population)	28.6	20.7	2015
Goal 2: Achieve universal primary education			
Literacy rate, youth female (percent of females ages 15-24) 1/	70.7	70.0	2010
Literacy rate, youth male (percent of males ages 15-24) 1/	82.1	74.3	2010
Persistence of last grade of primary, total (percent of cohort) 1/	36.3	49.1	2011
Primary completion rate, total (percent of relevant age group)	62.0	79.3	2014
School enrollment, primary (percent net) 1/	96.2	97.5	2009
Goal 3: Promote gender equity and empower women			
Proportion of seats held by women in national parliament (percent)	9.3	16.7	2015
Ratio of female to male primary enrollment	1.0	1.0	2014
Ratio of female to male secondary enrollment	0.7	0.9	2014
Ratio of female to male enrollment in tertiary education	0.4	0.6	2011
Goal 4: Reduce child mortality			
Immunization, measles (percent of children ages 12-23 months)	73.0	85.0	2014
Mortality rate, infant (per 1,000 live births)	103.5	43.4	2015
Mortality rate, under-5 (per 1,000)	174.4	64.0	2015
Goal 5: Improve maternal health			
Adolescent fertility rate (births per 1,000 women ages 15-19)	161.4	137.0	2014
Births attended by skilled health staff (percent of total)	54.2	87.4	2014
Maternal mortality ratio (modeled estimate, per 100,000 live births)	890.0	634.0	2015
Pregnanat women receiving prenatal care (percent)	91.4	96.1	2014
Goal 6: Combat HIV/AIDS, malaria, and other diseases			
Children receiving antimalarial drugs (percent, under age 5 with fever)	27.0	39.1	2014
Incidence of tuberculosis (per 100,000 people)	392.0	227.0	2014
Prevalence of HIV, total (percent of population ages 15-49)	16.6	10.0	2014
Goal 7: Ensure environmental sustainability			
CO^2 emissions (metric tons per capita)	0.2	0.1	2011
Forest area (percent of land area)	37.8	33.4	2015
Improved sanitation facilities (percent of population with access)	34.3	41.0	2015
Improved water source (percent of population with access)	62.5	90.2	2015
Terrestrial protected area (percent of total land area)	16.8	16.8	2014
Goal 8: Develop a global partnership for development			
Aid per capita (current US$)	39.9	55.7	2014
Debt service (PPG and IMF only, percent of exports, excl. workers' remittances)	25.3	2.5	2013
Internet users (per 100 people)	0.1	5.8	2014
Mobile cellular subscriptions (per 100 people)	0.4	33.5	2014
Telephone lines (per 100 people)	0.4	0.4	2014
Other			
Fertility rate, total (births per women)	6.3	5.0	2015
GNI per capital, Atlas method (current US$)	160.0	250.0	2014
GNI, Atlas method (current US$, billions)	1.7	4.2	2014
Gross captial formation (percent of GDP)	13.6	15.4	2014
Life expectancy at birth, total (years)	44.1	63.8	2015
Literacy rate, adult total (percent of people ages 15 and above)	64.1	61.3	2010
Employment to population rate, total (percent of people ages 15 and above)	73.2	76.8	2014
Trade (percent of GDP)	60.9	101.9	2014

1/ Absent observations for 2000, relevant data from 1997, 1998 or 1999.

Source: World Bank, World Development Indicators Database, 2016

Table 11. Quantitative Targets, 2018-19[1]

	Target type [2]	2018			2019	
		End-Jun.	End-Sept	End-Dec.	End-Mar.	End-Jun.
		Prog.	IT	Prog.	IT	IT
I. Monetary targets (millions of kwacha)						
Reserve money (ceiling on stock) (upper bound)[3]	PC	303,482	299,091	323,385	300,406	340,106
Reserve money (ceiling on stock)[3]		294,643	290,380	313,966	291,656	330,200
Reserve money (ceiling on stock) (lower band)[3]		285,803	281,668	304,547	282,906	320,294
II. Fiscal targets (millions of kwacha)						
Primary balance (floor)[4,5,6]	PC	-144,929	44,906	29,813	16,219	3,625
RBM financing of central government (ceiling)[6,7]	PC	69	0	0	0	0
New domestic arrears (ceiling)[6]	IT	0	0	0	0	0
Social spending (floor)[6,9]	IT	186,132	87,972	175,944	263,917	351,889
III. External sector targets (US$ millions, unless otherwise indicated)						
Net international reserves of the RBM (floor)[4,5,8]	PC	434.1	454.7	480.2	488.2	484.5
Accumulation of external payments arrears (ceiling)[6,10]	PC	0	0	0	0	0
New non-concessional external debt contracted (ceiling)[6,10]	PC	0	0	0	0	0
Memorandum items:						
Net foreign assets of the RBM (US$ millions, end of period)[6]		339.8	360.4	385.9	393.9	390.2
Budget support (US$ millions)[6]		84.3	79.1	79.1	79.1	79.1
Budget support (millions of kwacha)[6]		62,633.8	60,000.0	60,000.0	60,000.0	60,000.0
Nominal external concessional borrowing (US$ millions)[6]		166	35	70	104	137
Debt service payments to the World Bank and AfDB (US$ millions)[6]		13.4	3.8	7.5	12.1	16.7
Debt service payments to the World Bank and AfDB (millions of kwacha)[6]		9,994	2,851	5,821	9,538	13,337
Joint Fund on Health receipts (millions of kwacha)[6]		6,569	2,288	4,577	6,865	9,153
Joint Fund on Education receipts (millions of kwacha) [6]		6,987	4,325	8,651	12,976	17,301
Program exchange rate (kwacha per US$)		725	725	725	725	725

Source: IMF staff projections.

[1] Targets are defined in the technical memorandum of understanding (TMU).

[2] "PC" means Performance Criterion and "IT" means Indicative Target. The PC test date for the 1st Review will be end-June 2018. Test dates for future reviews will be end-June and end-December. End-September and end-March targets are ITs.

[3] PC applies to upper bound only. See TMU for details.

[4] Targets are subject to an adjustor for budget support and debt service payments, as specified in the TMU.

[5] Targets are subject to an adjustor 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] Targets are subject to an adjuster equivalent to 10 percent of previous year's tax revenue, as specified in the TMU.

[8] Defined as stocks.

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

[10] Evaluated on a continuous basis.

Table 12. Prior Actions

Measures	**Macro Rationale**	**Status**
Public financial management		
Publish detailed monthly budget execution data by vote and economic classification (main aggregates) on the MoF website.	Foster fiscal transparency and monitoring	Met
Complete verification of arrears from July 1, 2012–June 30, 2017 certified by the Auditor General.	Foster financial discipline	Met
A commitment that all domestic arrears prior to December 31, 2015, which are not certified by the Auditor General (MK 113 billion), will only be paid if required by law or by a court verdict. This will be communicated to the Fund via letter.	Foster financial discipline	Met
Reconcile all bank accounts MG1 and the operating accounts (excluding salary accounts) and ways and means for July 1, 2016-June 30, 2017 transactions signed by the Accountant General and Secretary to the Treasury.	Strengthen cash planning; reconciliation of accounts; and improving the integrity of the accounting systems	Met
Complete the audit of FY2016-17 financial statements, and submit them to Parliament.	Strengthen cash planning; reconciliation of accounts; and improving the integrity of the accounting systems	Met

Sources: IMF staff and Malawian authorities.

Table 13. Structural Benchmarks (2018)

Structural benchmark	Target date	Macro Rationale
Public financial management		
Submission of five reports by the MDAs[1] by mid-following month and publication on the MoF website. Maintain/strengthen sanctions on MDAs for misreporting/non-compliance.	Continuous	Improve fiscal transparency; prevent accumulation of new domestic arrears
Set-up and maintain a transparent commitment control system for all MDAs, compile the consolidated commitments of the government centrally by the MOF by the end of the following month and place it on the Ministry of Finance website. Also classify the bills, which are overdue for more than 90 days. Apply sanctions to the controlling officers of the MDAs by the ST for incurring arrears without the approval of the Minister of Finance.	Continuous	Better control on all government commitments and arrears, if any.
Prepare quarterly consolidated financial statements (including all MDAs) with fully reconciled bank accounts and publish within six months after the end of each quarter in the first year and within 90 days after the end of each quarter in the second and third. The financial statements should be certified by the Auditor General.	Continuous	Improve fiscal transparency and integrity of the accounting system; routinize reconciliation of all bank accounts; strengthen cash planning.
Reconcile all bank accounts MG1 and seven operating accounts and ways and means transactions within 90 days after the end of each month signed by the Accountant General and Secretary to the Treasury. The reconciliation should clear all the backlog and have a track record of three consecutive months.	Continuous	Routinize reconciliation of all bank accounts; strengthen cash planning; improve the integrity of the accounting system
Reconcilie all debt data between the MOF and RBM.	Continuous	Enhance debt management; improve transparency and monitoring of public debt
Prepare monthly cash forecasts (broken down by economic classification) of the next 12 months based on input from all MDAs.	End-June 2018	Strengthen cash management; and timely implementation of the budget
Adjust the bank reconciliation of FY2013-14 – 2014-15 based on the findings of forensic audit of MK236 billion and adjust the opening and closing balances of the bank reconciliation of FY2015-16.	End-June 2018	Routinize reconciliation of all bank accounts; strengthen cash planning; improve the integrity of the accounting system
Financial sector		
Develop a monetary policy communication strategy	End-June 2018	Prepare for the eventual implementation of inflation targeting

Sources: IMF staff and Malawian authorities.

[1] Ministry, department, and agency.

Table 13a. Structural Benchmarks (2018-19) (concluded)

Structural benchmark	Target date	Macro Rationale
Public financial management [1]		
CMU undertakes variance analysis on forecasting errors [every three months], reports a summary as minutes of the meeting, [and takes actions to improve MDA submissions].	End-December 2018	Strengthen cash management; and timely implementation of the budget
Implement areas of biggest potential for enhancing efficiency, planning and allocation of public investment	End-December 2018	Improve efficiency of public investment
All domestic debt commitments, expenditures and payments, transacted through IFMIS in real time.	End-December 2018	Enhance debt management; improve transparency and monitoring of public debt
Develop a comprehensive medium-term debt strategy, including MoF preparation of a strategy for reducing reliance on borrowing from RBM (W&M Account). All domestic debt	End-December 2018	Improve debt management
Develop an action plan for updating IFMIS or aquiring a new IFMIS.	End-December 2018	Enhance cash management
Link the HRMS and IFMIS systems.	End-June 2019	Interconnectedness; internal control over transactions; and elimination of unnecessary duplications
Prepare and submit to the parliament an economic and fiscal policy statement, containing overall expenditure ceiling in the medium term derived from the combination of a fiscal policy anchor and macro-fiscal forecasts consistent with MEFP.	End-June 2019	Improve medium term budgeting; enhance fiscal discipline and planning
Create and update the budget legal framework dealing with decentralization and include a fiscal policy coordination framework	End-June 2019	Reduce risk of macro instability, improve efficiency of the public sector
Bring all TSA sub-accounts into IFMIS including projects, receipts and payments.	End-June 2019	Enhance cash management; achieve comprehensive coverage in IFMIS; and strengthen controls on bank reconciliation and reporting
Enhance oversight mechanisms over large SOEs (including ADMARC, ENGENCO, and ESCOM), publish audited annual financial statements and fiscal risk statement.	End-June 2019	Mitigate fiscal risks asscociated with SOEs; enhance transparency in financial performance and market operations
Financial sector		
Submit to Parliament amendments to the *RBM Act,* which are in line with the recommendations of the IMF Safeguards Monitoring Report, dated 6 June 2016.	End-October 2018	Preserve financial and debt sustainaiblity
Develop a roadmap for increasing access to finance.	End-December	Increase financial sector intermediation

Sources: IMF staff and Malawian authorities.

[1] These structural benchamarks may be revised, with a view towards streamlining, at the time of the first review.

Annex I. Ex Post Peer-Reviewed Assessment

A. Introduction

1. **Malawi's engagement with the Fund spans four program arrangements since 2005, with only one program successfully completed**. Over the last decade, Malawi was engaged in three consecutive Fund-supported programs (Text Table 1). The 2012–2017 ECF arrangement, for the equivalent of SDR 104.1 million (150 percent of quota) was originally scheduled to expire on July 22, 2015, but was extended five times, before completion. The Executive Board approved an augmentation of access equivalent to 25 percent of quota after the combined seventh and eighth reviews, on June 20, 2016, to strengthen Malawi's response to the El Niño-induced drought. This additional financial support helped Malawi address a severe humanitarian crisis after two consecutive years of drought and had a catalytic effect in fostering donor support.

Text Table 1. Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	Jul 23, 2012	Jun 29, 2017	138.80	138.80
ECF	Feb 19, 2010	Jul 22, 2012	52.05	13.88
ESF	Dec 03, 2008	Dec 02, 2009	52.05	34.70

Sources: Finance Department, IMF.

2. **This Ex-Post Assessment (EPA) reviews Malawi's policy objectives and performance under the Fund-supported program during 2012–17, and draws lessons for future program design and Fund engagement[1].** The assessment is made from a staff perspective, and reflects the authorities' views.

3. **Malawi is a fragile state.** It is one of the poorest countries in Africa with a per capita income of US$327 and its growing population faces low living standards—ranking 170th (out of 188 countries) on the World Bank's Human Development Index. Poor irrigation infrastructure and a lack of economic diversification heighten vulnerabilities to weather-related shocks for this agriculture-dependent economy. Malawi also faces serious governance challenges, ranking in the

[1] The previous EPA for Malawi – discussed by the IMF Executive Board on June 20, 2012 – reviewed Malawi's policy objectives and performance under Fund-supported programs during 2004-11.

bottom 25 percent of countries for most World Bank governance indicators. Scope for economic diversification has been limited by this, low quality and coverage of infrastructure (especially electricity), and a poor business environment. Despite recent improvements, Malawi ranks 110 out of 190 countries in the World Bank 2018 Doing Business indicators.

B. Program Objectives and Performance

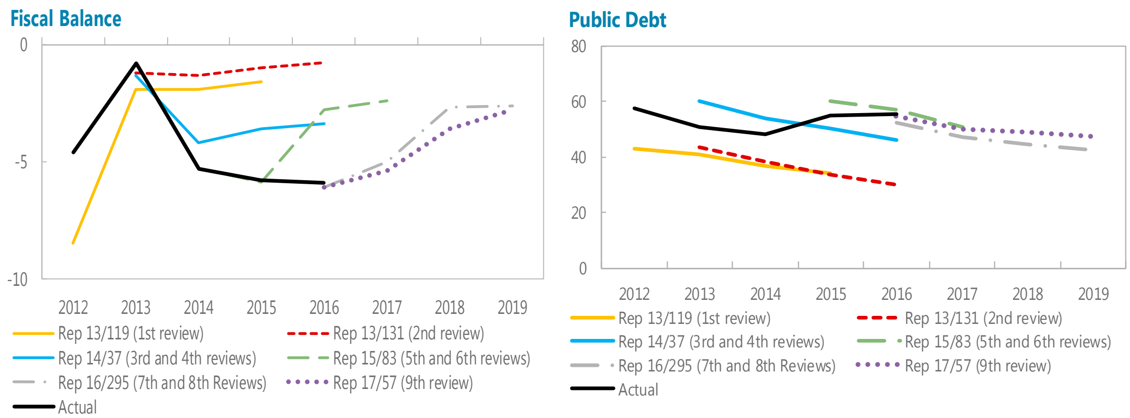
4. **The main objectives of the 2012–17 program were to maintain macroeconomic stability, promote inclusive growth, and reduce poverty.** The 2012–17 program sought to achieve single digit inflation and increased resilience to shocks by increasing reserve coverage to at least three months of imports. It also sought to strengthen public finances and debt management and support private and financial sector development. Fiscal policy aimed at supporting the growth strategy by creating fiscal space for increasing development spending, while preserving external debt sustainability. To that end, emphasis was placed on increasing domestic revenue mobilization through improved tax administration, and on expenditure control, with Fund technical assistance. Structural reforms mostly focused on fiscal transparency, improvements in public financial management (PFM), reducing fiscal dominance and promoting financial stability and deepening.

5. **A series of shocks as well as policy slippages challenged program implementation, macroeconomic stabilization, and achievement of higher and more inclusive growth**. The adoption of a floating exchange rate, and the large devaluation of the exchange rate resulted in much larger than anticipated inflation. Severe governance issues exposed by the cashgate scandal (2013) led to a loss of confidence and withdrawal of donor budget support. Fiscal dominance, including through monetization of the ensuing fiscal deficits further fueled inflationary pressures, impacting macroeconomic stabilization and growth. The effects of these shocks were further compounded towards the end of the program by a two-year drought followed by a humanitarian crisis. Consequently, the program's foremost focus became macroeconomic stabilization and improving fiscal governance to regain domestic and external confidence.

6. **Overall program performance was mixed**. Reserves were increased and inflation decreased markedly, though only towards the end of the program. However, growth objectives were not met due to the shocks discussed above, poor infrastructure, and a weak business environment holding back private sector growth. Due to policy slippages, fiscal performance fell short of program targets – despite an encouraging improvement in domestic revenue mobilization. Implementation of the structural reform agenda was repeatedly delayed, especially in PFM, leading to multiple program extensions. Reviews were combined because of the cashgate scandal (third and fourth reviews),

misreporting related to non-observance of target related to non-concessional borrowing (fifth and sixth reviews), policy slippages (seventh and eighth reviews), while the ninth review was extended to respond to the humanitarian crisis Multiple extensions were granted together with the adoption of prior actions to keep the program on track and complete the remaining structural reform agenda.

Text Figure 1. Fiscal Performance Under the ECF Arrangement (Percent of GDP, 2012-17)



Sources: Malawian authorities; IMF staff estimates.

7. Many program quantitative targets were missed (Text Figure 1). The program objective of accumulating net international reserves was met consistently, except in the eighth and ninth reviews owing to a severe drought which reduced agricultural exports and increased food imports. However, targets on net domestic assets of the central bank were missed in almost half the program reviews, those on non-concessional external borrowing were not met three times, and net domestic borrowing of the central government was missed in four reviews. Performance on indicative targets for social spending was weak and missed in six reviews with a median deviation of 3.8 percentage points from the target. Notwithstanding, the authorities scaled up their targeted social protection programs—an important subset of overall social spending.[2] The program also experienced two incidents of misreporting associated with the second review and the combined third and fourth review—the former related to the non-observance of the continuous Performance Criteria on new non-concessional external borrowing (maturing after one year) and the latter on the non-accumulation of external payment arrears.

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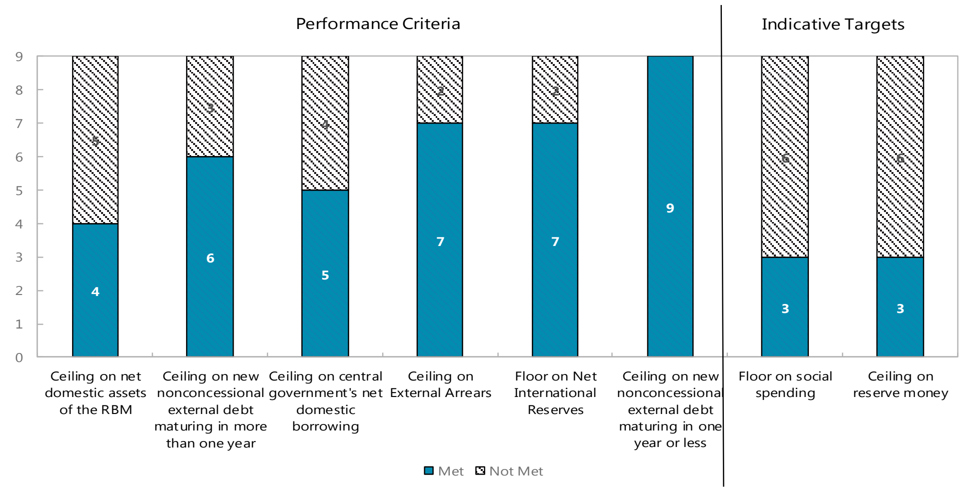
[2] Progress was made in: (i) increasing primary school enrollment including gender parity; (ii) improving access to potable water; and (iii) reducing infant mortality rates. Reforms also targeted five social protection interventions, comprising unconditional social cash transfers, public works, school meals, village savings and loans, and micro-financing under their poverty reduction strategy to enhance growth inclusiveness.

Text Figure 2. Performance Criteria and Indicative Targets Under the ECF Arrangement (Number of targets, 2012–17)



Sources: Malawian authorities; IMF staff estimates.

8. Implementation of structural reforms was particularly slow in the PFM domain, but was sustained in the monetary and financial sectors (Text Figure 2). Despite adoption of a PFM plan agreed with key donors in the aftermath of cashgate, its implementation was uneven and often significantly delayed. Lack of capacity proved to be an important constraint partially addressed by sustained Fund technical assistance, including installation of a resident PFM advisor (Box 1). Notwithstanding significant delays, key PFM reforms were achieved (Box 2), including rationalization of government bank accounts, increasing the coverage and security of the Integrated Financial Management System (IFMIS), publishing budget execution by vote, and strengthening Treasury cash management functions and commitment controls. The institutionalization of basic fiscal reporting through regular bank reconciliations is ongoing. In contrast, implementation of monetary and financial sector-related reforms was steady and contributed to maintaining financial sector stability (although weak growth led to a deterioration of vulnerability indicators), improving monetary and exchange rate policies, and strengthening the regulatory and supervisory frameworks.

Box 1. Technical Assistance and Capacity Development

Malawi received significant Fund technical assistance (TA) and capacity development training. The areas covered included fiscal, monetary, financial sector, statistics and legal. The main focus of TA has been on public finance management (PFM) in the wake of the cashgate scandal, tax policy and revenue administration, banking supervision, and the monetary policy framework. Good progress has been made in implementing TA recommendations in most areas. However, progress with PFM reforms has been slow. A resident PFM advisor in public finance has been assisting the authorities accelerating the implementation of these reforms.

PFM and domestic revenue mobilization will continue to be key TA priorities over the medium-term. The authorities have implemented most tax policy recommendations, which has positively affected domestic revenue mobilization and has placed Malawi's revenue as percent of GDP around the median for low income countries.

Government officials were major recipients of IMF training. They participated in Financial Programming and Policies (FPP), Monetary and Financial sector (MMF), and Macroeconomic Statistics (MS) courses. In response to the authorities' commitment to

modernize their monetary policy framework, the Fund also stepped up customized training on forward-looking policy analysis.

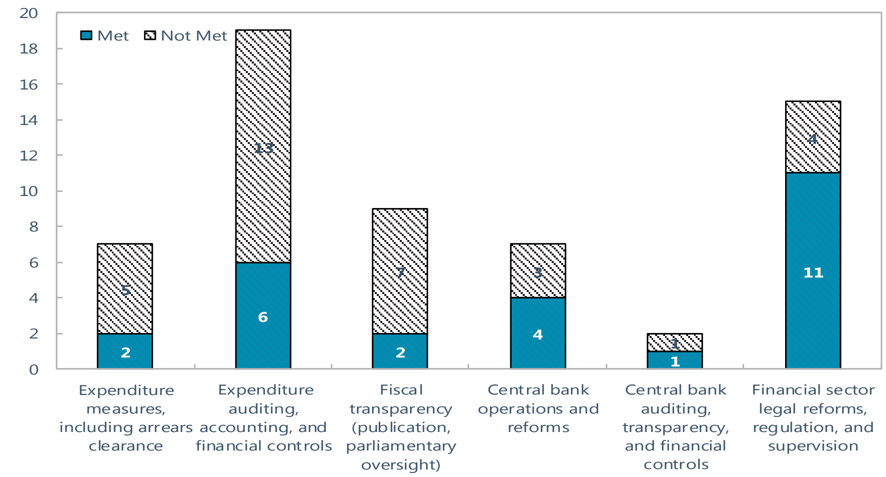
Box 2. PFM Achievements

Substantial progress was made in implementing PFM reforms under the 2012-17 ECF arrangement. PFM reforms were aimed at improving implementation of fiscal policy including preventing misappropriation of public funds and rebuilding trust and confidence in the budget process. Key achievements include:

- Monthly budget execution data by vote posted on the MoF website six weeks after execution for 2015/16 fiscal year.
- Budget control and reporting improved with MDAs submitting five monthly financial reports with fully reconciled items (almost 90 percent compliance achieved).
- Reconciliation of main government bank accounts for the 2015/16 fiscal year.
- Bank reconciliation capacity in the Auditor General's Office was strengthened.
- Government bank accounts have been rationalized with over 200 bank accounts closed.
- The security of IFMIS was improved.
- A treasury management system was set up and is ready for use.
- In commitment control, a commit/arrears report is regularly submitted to the Treasury Secretary; arrears/commitment reports are prepared on a monthly basis.
- A cash management unit was set-up in October 2016 and is actively undertaking monthly and annual cash planning and supporting formulation of borrowing plans.

Text Figure 3. Structural Benchmark Under the ECF Arrangement

(Number of targets, 2012–17)



Sources: Malawian authorities; IMF staff estimates.

Macroeconomic Outcomes Under the Program

- **Economic growth substantially underperformed relative to the initial program projections**. Average annual growth was 3.8 percent in 2012–17, compared with a projection of 7.5 percent. The national poverty rate stagnated at over 50 percent and increased in rural areas. High population growth, estimated at 3.1 percent, weighed on per capita real GDP growth. Policy uncertainty, governance issues, persistently high inflation, and liquidity constraints weakened domestic and external confidence resulting in weak investment and exports, translating into lower growth. Pressures on growth were exacerbated in 2015 and 2016 by the drought which dented maize production and depressed hydroelectricity generation. The resulting rise in operating costs and low capacity utilization weakened the manufacturing and trade sectors.

- **Inflation remained in persistent double digits after the 2012 devaluation and has only recently declined.** The sharp depreciation of the kwacha following exchange regime liberalization,[3] monetization of deficits in the aftermath of the cashgate scandal, looser-than-programmed monetary and fiscal policies during 2013–15, two consecutive years of severe drought, and policy uncertainty fueled high inflation during the bulk of the program (averaging 23.4 percent during 2012–16 compared to a projection of 10.8 percent). Annual inflation has been declining since end-

[3] The kwacha depreciated by 54 percent during 2012–16, mostly a result of liberalization of the exchange rate regime. Since end-2016, the exchange rate has stabilized against the U.S. dollar.

2016, falling to 7.7 percent in November 2017, reflecting tighter monetary policy and stabilization of maize prices.

- **The fiscal stance deteriorated and public debt increased during the program due to policy slippages and large financing needs.** During 2012-17, overall balances averaged -5.1 percent of GDP compared with projections of -5.2 percent of GDP. Domestic revenue mobilization was strong—it exceeded the median for LICs owing to implementation of IMF TA recommendations—despite weak growth. However, unbudgeted wage increases, unplanned recruitment of teachers, and expenditure policy and control slippages increased government spending rigidities (wage bill and interest expenses accounted for about 50 percent of expenditure in FY 2016/17) and crowded out domestically financed capital spending. Regularization and securitization of pre-program domestic arrears (5½ percent of GDP) and withdrawal of 4½ percent of GDP in budget support (relative to the program, as donors lost confidence following cashgate) resulted in high recourse to domestic financing and rising domestic debt levels and debt service burden. Domestic debt more than doubled from 10 percent of GDP in 2012 to 21.2 percent of GDP by end-2016.

- **Financial sector vulnerabilities increased.** Weak growth, price instability, and accumulation of domestic arrears to government suppliers hurt banking sector performance and contributed to NPLs rising from 10.6 percent in 2015 to 17 percent at end-2016. Reduced liquidity due to tightening of monetary policy resulted in the need for emergency intervention in two commercial banks. Provisioning levels remained low while recovery of collateral associated with non-performing loans has proven to be lengthy.

C. Lessons from the 2012–17 ECF Arrangement

Program Issues

9. Program design, conditionality, and Fund technical assistance appropriately supported program objectives. The mode of Fund engagement with Malawi was appropriate given an urgent and protracted BOP need in 2012, where international reserves were at a precariously low level of only 0.5 months of imports. Overall, the objective of achieving macroeconomic stability was ultimately successfully achieved, despite a mixed track record of policy and reform implementation. However, other program objectives such as achieving higher, more inclusive and resilient growth as well as poverty reduction were challenged by not fully accounting for deep structural rigidities, weak implementation capacity, and limited productivity and economic diversification in program design. The authorities' lack of ownership in part due to political pressures combined with governance challenges led to delays in policy implementation, misreporting, and program extensions. In response, program design was adjusted, for example, by modifying structural conditionality to account for the fragile institutional framework.

10. **Missed targets under the program appears to partly reflect insufficient incorporation of political-economy and capacity constraints in program design.** Fiscal projections and targets did not account for the politically motivated spending (e.g., unbudgeted wage bill increases in 2015). A lack of commitment was exemplified by poor policy coordination in 2015, when the central bank reduced liquid reserve requirements by half after large fiscal slippages fueled high inflation. The lack of political support for some reforms combined with governance challenges, shocks, and underestimation of capacity constraints during program design led to poor performance in meeting quantitative targets. However, when targets were fully aligned with the authorities' objectives, policy implementation was effective and often remarkably fast.

11. **A series of shocks justified progressively higher access levels.** Initially, high access was justified based on strong measures taken just before program approval, including liberalization of exchange rate regime and the implementation of automatic fuel-price mechanism. In hindsight, disbursements could have been more frontloaded to accommodate the impact of the large depreciation in 2012/13 that resulted from exchange rate liberalization. However, by re-phasing the disbursement profile, the program was flexible enough to accommodate resulting pressures, and helped safeguard Fund resources during policy slippages. Augmented financing during the program provided much needed support to counter a severe humanitarian crisis.

12. **The program played a critical role in catalyzing donor support.** In 2012, strong measures implemented by the authorities brought forth 6.4 percent of GDP in donor support. Following the withdrawal of donor support to the budget (3.1 percent of GDP) due to the cashgate scandal and other policy slippages, PFM measures under the ECF arrangement also played a critical role in restoring donor confidence – albeit very gradually. Augmentation of access and policy flexibility under the ECF arrangement in response to the drought-induced humanitarian crisis also catalyzed donor support (2.1 percent of GDP) at a critical juncture.

Policies for a Possible Successor ECF Arrangement

13. **Policies under a possible successor program should focus on the following reform areas** – which will address unachieved objectives, obstacles, and risks (especially in governance, ownership, and reform fatigue) from past IMF arrangements:

- Program ownership. Uneven program implementation underscores the need for stronger and broader-based ownership among the various levels of decision-making. As outlined in the previous sections, deficiencies were particularly evident in delays in implementing key PFM reforms, weak fiscal policies, and poor policy coordination. Ownership is often strongest at the beginning of the program, supporting a front-loading of conditionality. Realistic program targets, including for growth, will also be important in countering reform fatigue and reducing the risk of misreporting.

- Building economic resilience. Climate change-induced weather shocks delayed achievement of macroeconomic stability despite access augmentation and program extensions. Building resilience to these shocks requires accumulating international reserves and fiscal buffers as well as improving irrigation infrastructure and agricultural productivity.

- Higher and more inclusive growth. Achieving this objective will require a mix of medium-term policies. Against a backdrop of continued macroeconomic stability and a balanced policy mix, addressing infrastructure bottlenecks in energy, irrigation, and transportation should be prioritized and are critical to increasing investor confidence. In parallel, reforms to improve the business environment, education, and healthcare will raise productivity and enhance private sector investment. To this end, excessive regulations should be reduced, governance improved, and well-targeted social policies are needed to improve access to and the quality of education and healthcare.

- Fiscal policy. A major fiscal challenge will be balancing large infrastructure and social spending needs – which will require mainly external financing given Malawi's limited fiscal resources – against rising debt vulnerability. Securing concessional financing will be critical to resolving this challenge and should be complemented by better public investment management, prioritization of infrastructure projects in the budget, and creating fiscal space to finance these projects domestically– including improving public spending efficiency and addressing expenditure rigidities by containing the wage bill, lowering debt service, and better commitment controls. Increasing concessional financing will require serious efforts to improve governance – especially advancing PFM and procurement reforms – to re-engage donors.

- PFM reforms. Further strengthening PFM will be critical to restoring fiscal integrity and enhancing transparency. Strong commitment controls, routine bank reconciliations, better cash management and regular fiscal reporting will prevent misappropriation of public funds and rebuild trust and confidence in the budget process. For some donors, they are pre-requisites for resumption of budget support.

- Policy mix. Maintaining price stability and containing inflation to single digits will be critical to entrenching macroeconomic stability. The central bank's efforts to this end should be supported by fiscal policies that keep expenditures in line with available resources (minimizing domestic financing, especially monetization of deficits). In addition, monetary policy should aim to maintain positive short-term real money market interest rates to promote private sector growth and encourage demand for the Kwacha.

- Monetary policy framework. The monetary policy framework needs further strengthening to support the central bank's price stability objective. The central bank continues to receive customized IMF TA aiming to improve monetary operations and strengthen forecasting for policy analysis. A flexible exchange rate regime continues to be appropriate and relative exchange rate stability that benefited from prudent monetary policy management should be sustained.

- Safeguard and strengthen financial sector stability. Enhancing on-and-off-site supervision, enforcing compliance with prudential norms and upgrading supervisory skills at the central bank will support continued financial system stability. In particular, it will be important to closely monitor banks' compliance with prudential norms, strengthen banking supervision, (including AML/CFT), and facilitate rationalization of the banking sector. Provisioning needs to be increased commensurate with increased financial sector vulnerabilities. Strengthening creditor rights and reducing lengthy judicial processes in recovering collateral will contribute to reducing non-performing loans.

- Technical assistance. Delays in implementation of crucial PFM reforms point to capacity challenges (in addition to a lack of commitment). Long-term advisors and follow up on implementation of TA recommendations will be key to maintaining reform momentum.

- Data issues. Overall, data is broadly adequate for program monitoring. Nonetheless, deficiencies, mainly in the areas of national accounts, balance of payments statistics, and debt management, will need to be addressed, including by Fund technical assistance.

Stakeholders' and the Authorities' Assessment

14. Stakeholders recognized the achievements under the past ECF arrangement and challenges ahead. A post-program stakeholders' conference, held in August 2017, concluded that there was a need to safeguard progress under the previous program, including achievement of macroeconomic stability and PFM improvements (Text table 2).[4] Going forward, stakeholders emphasized the importance of improved policy implementation (not just policy design) and better accountability. Participants stressed that future Fund-supported programs should focus on raising inclusive growth and jobs (including advancing reforms such as improving the business environment and infrastructure to unlock investment), reinforcing economic resilience to climate shocks, improving governance (via sustained PFM reforms and changes to procurement to ensure compliance with regulations to address the abuse of public funds), improving debt management and sustainability in view of the large infrastructure needs, and safeguarding and strengthening financial sector stability. Given scarce resources and significant needs, careful sequencing and

[4] On August 28–29, 2017, the Fund, in conjunction with Ministry of Finance and Reserve Bank of Malawi, organized a two-day Stakeholders Conference on the ECF arrangement in Lilongwe, Malawi. The conference brought together senior government officials, development partners, and representatives from the private sector, civil society, and academia.

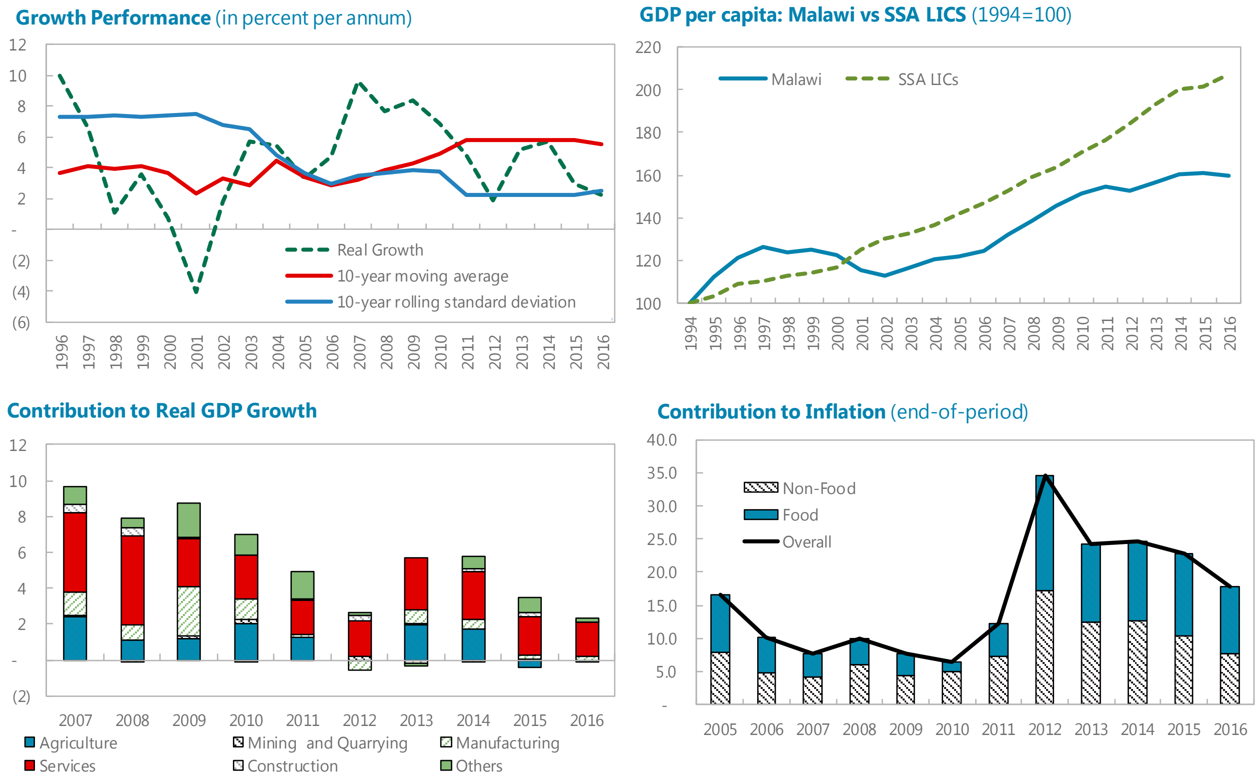
prioritization will be required. Stakeholders also emphasized the need to safeguard pro-poor spending to ensure social protection for the most vulnerable segments of the population.

15. The Malawian authorities broadly concurred with staff's assessment of the previous ECF arrangement. The authorities and key stakeholders were appreciative of Fund support during the humanitarian crisis and in strengthening PFM systems to restore trust in the budgetary process. Looking ahead, the authorities and stakeholders welcomed continued Fund engagement, including through the provision of technical assistance and training, particularly to support PFM reforms. The authorities also indicated their strong interest in a successor ECF arrangement.

Text Table 2. Key Recommendations from Stakeholder's Conference and Medium-Term Priorities for Malawi
Maintain and sustain macroeconomic stability after achieving low inflation, low interest rates and stable exchange rate
Focus on inclusive growth with special attention on priority areas including agriculture and value addition, energy, irrigation development, tourism, manufacturing, mining, education and skills development and transport
Need for building stronger program ownership
General improvement of business environment
Tax Reforms that are more efficient and growth supportive
Enforce accountability by ensuring independence of economic governance institutions such as the ACB, RBM, FIA, Accountant General Department, and the Auditor General Department
Reforms in ADMARC
Put in place sustaining and entrenching PFM reforms including improvements in budget processes, execution and public debt management – This should include the review of the PFMA
Effective implementation of Monetary Policy
Public reforms including in the Judiciary, and need to repeal some legislations – the Special Crops Act
Better data compilation and analysis for policy making

Figure 1. Growth and Inflation

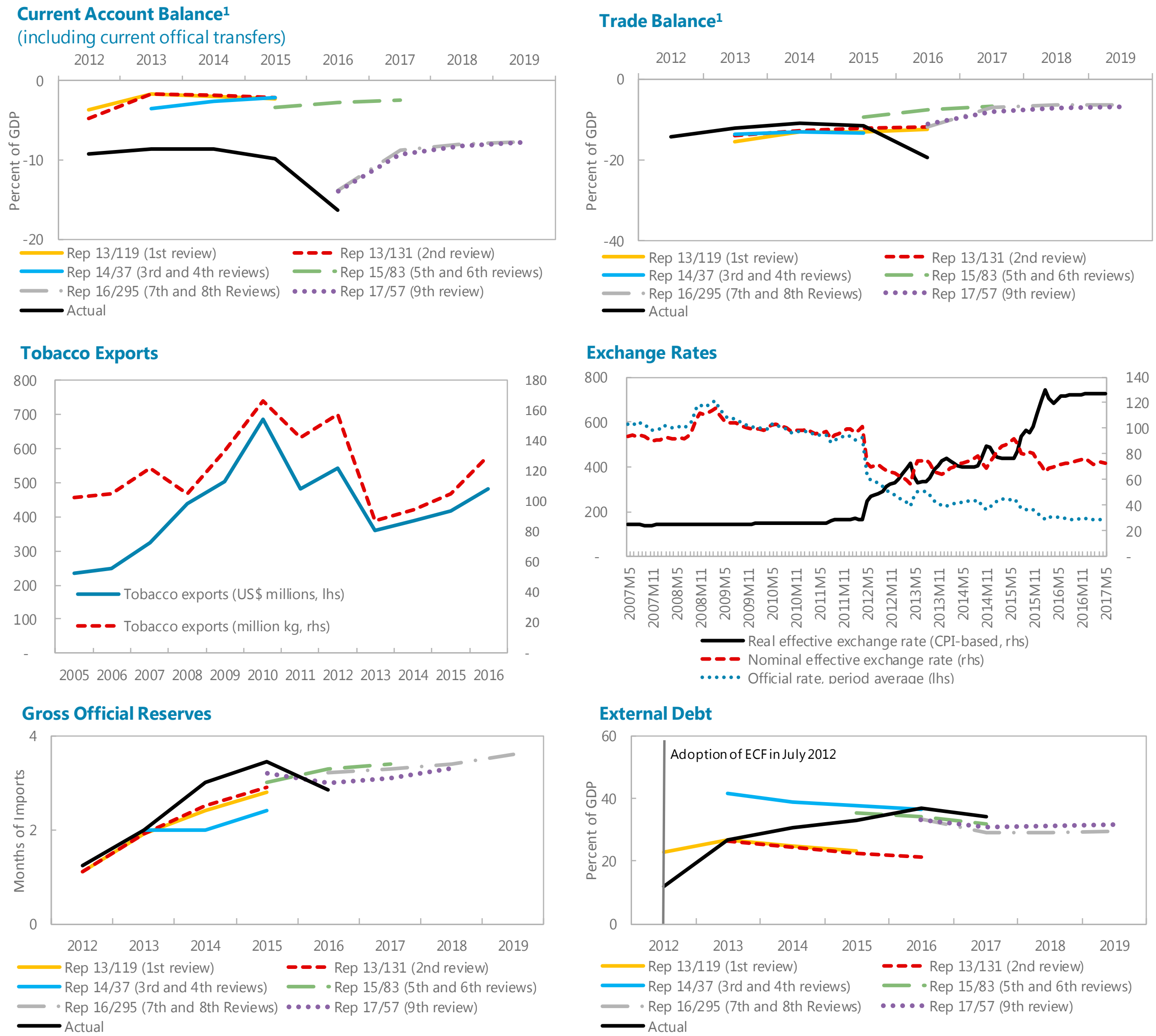
Malawi's growth is highly variable due to dependence on rainfed agriculture. Per capita growth lags SSA average. Inflation was stuck above 20% due to policy slippages and weather related shocks.



Sources: Malawian authorities, World Economic Outlook, IMF staff projections.

Figure 2. External Position

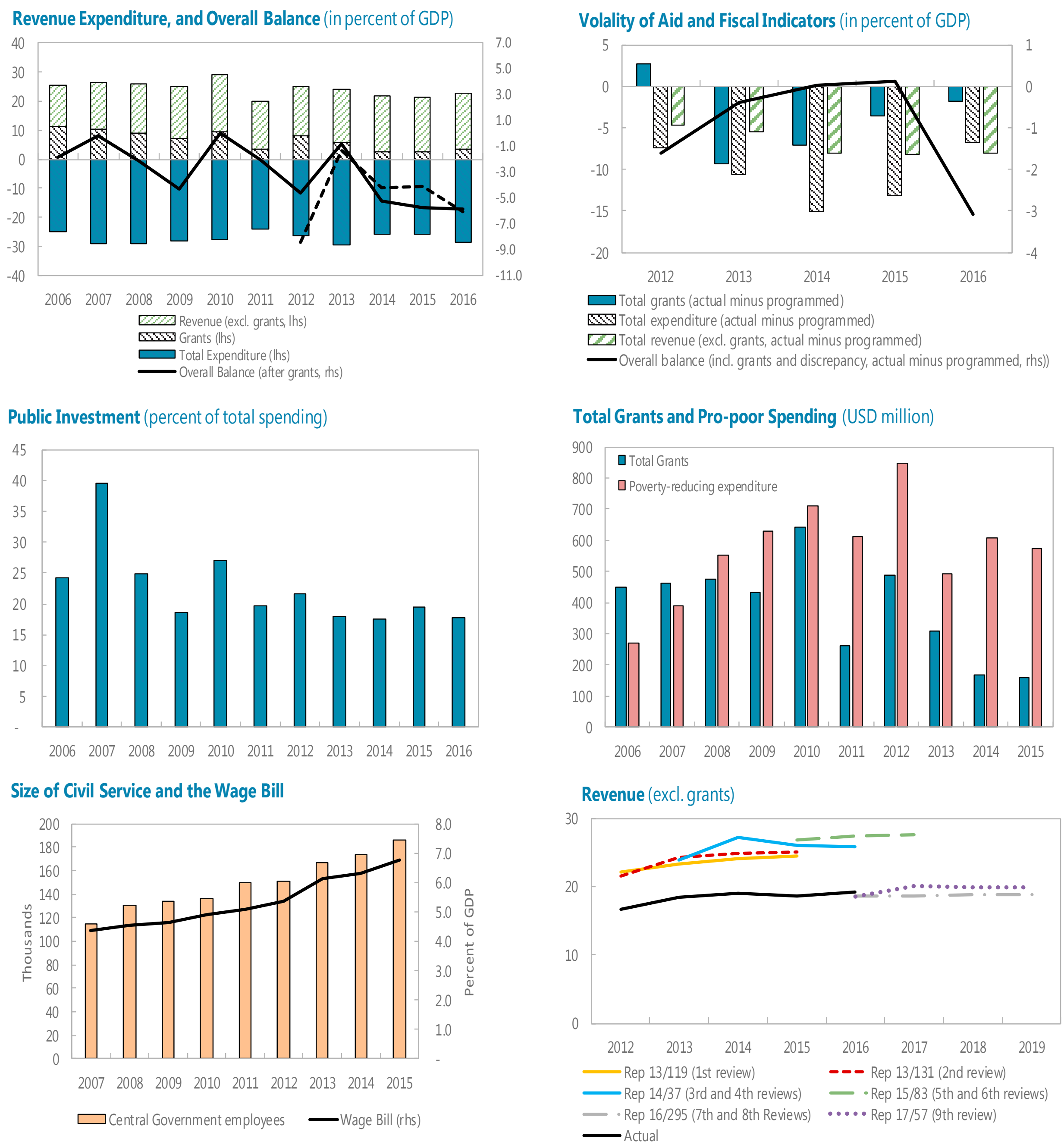
The current account is driven by tobacco exports - the largest FX earner. The adoption of a flexible exchange rate in 2012 has improved reserve cover.



[1]GDP was rebased during 7th and 8th reviews, and grants reclassified to capital and financial accounts.
Sources: Malawian authorities, World Economic Outlook, IMF staff projections.

Figure 3. Public Finances

Revenue is above the median for SSA LICs but the wage bill and interest expense account for 58% of revenue. Donor support shrunk after the cashgate scandal (Oct. 2013) leading to recourse to domestic financing and rising debt levels.



Sources: Malawian authorities, World Economic Outlook, IMF staff projections.

Table 1. IMF Training and Technical Assistance (by financial year)

IMF Training to Malawi (participant week)

Type of Training	2012	2013	2014	2015	2016	2017	Total
IMF Training to Malawi	113	91	116	129	165	180	793
ICD Training to Malawi	89	71	63	76	102	121	523
IMF Training to SSA	2,103	2,133	2,232	2,285	3,407	3,305	15,465
ICD Training to SSA	2,724	2,747	3,005	3,739	5,380	5,977	23,572

Source: IMF Institute for Capacity Development.

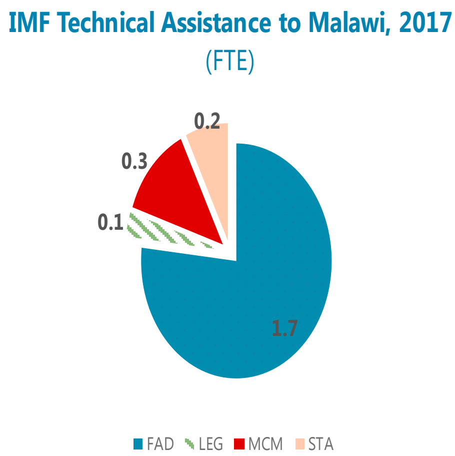
IMF Technical Assistance to Malawi (FTE)[1]

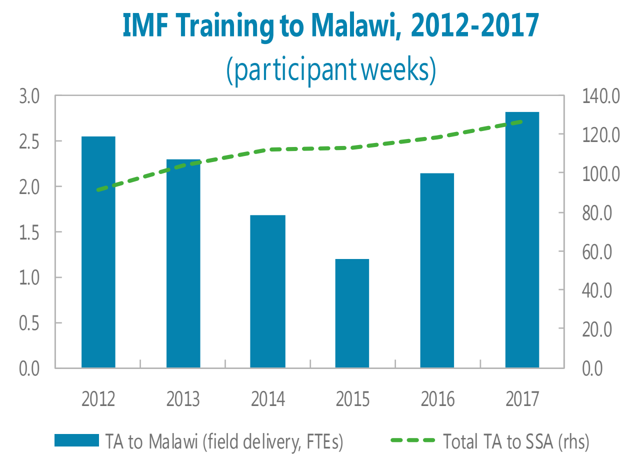
	2012	2013	2014	2015	2016	2017
Technical assistance to Malawi	2.6	2.3	1.7	1.2	2.2	2.8
Of which:						
FAD	1.2	1.0	1.2	0.7	1.7	2.0
LEG	0.1	0.0		0.0	0.1	-
MCM	0.9	0.8	0.2	0.2	0.3	0.4
STA	0.3	0.4	0.3	0.2	0.2	0.4
Technical assistance to SSA	91.4	103.8	111.7	113.2	118.1	126.1

[1] FTE stands for full-time staff equivalent of working time. For instance, 1 FTE means that the total hours worked in delivering TA are equivalent to one year of working time of a full-time staff.

Source: IMF Institute for Capacity Development.

Figure 1. IMF Training and Technical Assistance (by financial year)

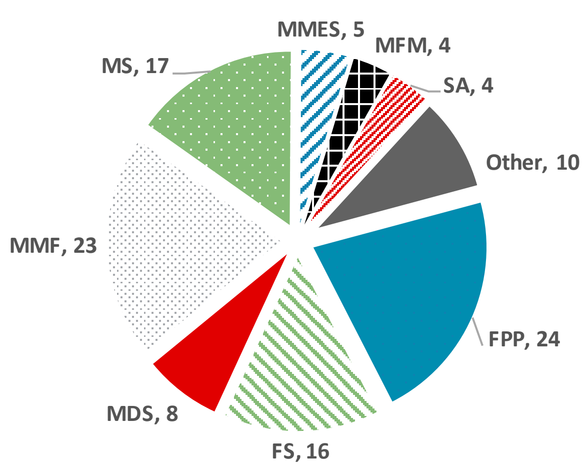




Source: IMF Institute for Capacity Development.

Figure 2. Most Frequent ICD Training Courses Delivered to Malawi[1]

(2012–17, number of courses)



[1]Legend: Financial Programming and Policies (FPP), Macroeconomic Diagnostics (MDS), and Macroeconomic Management and Financial Sector Issues (MMF), Financial Sector (FS), Macro Statistics (MS), Macroeconomic Management with External Sector Emphasis (MMES), Macroeconomic Forecasting and Modeling (MFM), Safeguards (SA).

Source: IMF Institute for Capacity Development.

Annex II. Implementation of 2015 Article IV Recommendations

Implementation of 2015 Article IV Recommendations	
Recommendation	**Implementation**
Restore macroeconomic stability	Achieved macroeconomic stability despite larger than expected impact from exchange rate depreciation and two consecutive years of unexpected droughts.
Take measures to address fiscal risks and generate fiscal space	Increased fiscal revenues from 18.0 to 20.1 percent of GDP; reduced overall deficit from 6.8 to 5.1 percent in 2016/17; regained control over budget execution. However, domestically financed public debt has risen.
Improving the quality of public spending	In efforts to improve effectiveness, social spending is being decentralized. However, inefficiencies remain unaddressed. Challenges in public investment management need to be addressed.
Accelerate public financial management reform	Experienced protracted delays in several key reform areas.
Reduce inflation	Reduced from 24.2 percent at end-2014 to 7.7 percent at end-Nov 2017.
Bring real interest rates down	Reduced nominal rates but real rates remain high.
Safeguard financial sector stability	Banking system remained stable and profitable. Two weak banks were sold and recapitalized. Non-performing loans rose.
Addressing supply-side bottlenecks	Progress has been made in improving transport and telecommunications infrastructure but more needs to be done in these areas. Irrigation and energy infrastructure need substantial improvements in coverage and quality.

Annex III. External Sector Assessment

The external position of Malawi in 2017 was broadly consistent with the level implied by medium-term fundamentals and desirable policies. The current account is expected to improve gradually over the medium term, reflecting higher export growth but also persistent need for investment-related imports. Policies should strive to enhance macroeconomic resilience, preserve fiscal and debt sustainability, and advance growth-friendly structural reforms.

A. External Balance Sheets

1. **Malawi faces a moderate risk of external debt distress and remains vulnerable to shocks**. The net foreign assets stood at -35 percent of GDP as of end-2015.[1] External liabilities (at 53 percent of GDP) consisted mostly of debt liabilities (36 percent of GDP) and inward FDI stock (17 percent of GDP). The former consists mostly of concessional loans from multilateral and bilateral official sectors. Public sector loans accounted for most of the external debt, equivalent to 33 percent of GDP as of end-2017. FDI stock, concentrated in agriculture and manufacturing, is expected to help improve the current account balance through higher export growth and productivity. The accompanying update on debt sustainability analysis indicates that Malawi faces a moderate risk of debt distress based on an assessment of public external debt, whose trajectory remains vulnerable to exogenous shocks, notably shocks to export revenues and exchange rate, pointing to the continued need for rebuilding external buffers. External sustainability is expected to improve as the current account deficit narrows and the economy becomes more resilient.

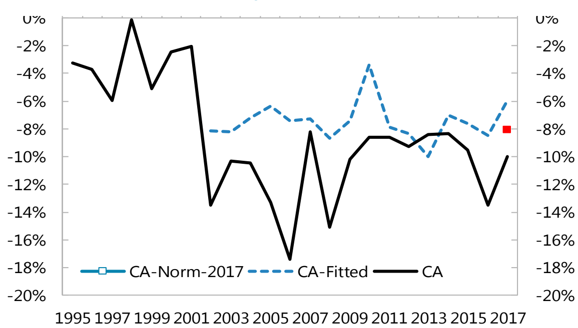
B. Current Account

2. **The current account deficit narrowed last year**—to an estimated 10 percent of GDP, down from 13.6 percent in 2016, but still about one percentage point higher than the 2011–15 average. The improvement reflects a large base effect in 2016 from increased imports of maize and related services in response to the humanitarian crisis, which more than offset the impact of deteriorating terms of trade (-4.6 percent). The persistent current account deficit reflects a narrow export base (with three products—tobacco, sugar, and tea – accounting for over three-quarters of total exports), heavy reliance on investment-related imports, and strong population growth. Going forward, the current account balance is projected to improve gradually, on the back of stronger export growth and resilient investment-related import demand.

[1] Latest estimates, from updated and extended version of dataset constructed by Lane and Milesi-Ferretti, 2007, "The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970–2004", Journal of International Economics 73, November, 223–250.

3. The current account (CA) gap is assessed to be within the range of [-1, 1] percent. Using the EBA-lite model, Malawi's cyclically adjusted CA norm is estimated at -8.3 percent of GDP. This compares to a cyclically adjusted actual CA balance of -10.2 percent of GDP, implying a model-estimated current account gap of -1.9 percent. The positive contribution from the policy gap (2.1 percent of GDP) reflects combined effects of: (1) both own and global fiscal policy were loose relative to the desired medium-term position, leaving little fiscal policy gap (contribution: -0.1 percent); (2) strong accumulation of reserves created a positive gap (contribution: 1.1 percent); (3) own private credit (as share of GDP) was below the level desirable for financial deepening while global private credit was above its desirable level, leading to a negative credit gap and a higher-than-desirable CA from this policy gap alone (contribution: 1.1 percent).[2] In addition, the CA residual—the part of CA gap that cannot be explained by the aforementioned policy gap—is large at -4 percent of GDP. This suggests that the model estimation may have missed important Malawi-specific factors that have driven the actual CA lower and/or would have driven the CA norm lower than the level predicted by model. These factors include a persistent need for investment-related imports, structurally narrow export bases, and vulnerabilities to weather shocks (arising from a dependency on a short and predominantly rain-fed agricultural season), all of which tend to structurally affect the current account balance. Therefore, staff assesses the CA norm to be 1 percentage point of GDP lower, implying a staff-assessed gap of -0.9 percent of GDP after this adjustment, within the range of [-1, 1] percent.

Current Account Balance: Actual, Fitted, and Norm (in percent of GDP)



Source: Malawian authorities; IMF staff estimates.

Current Account and Real Exchange Rate Assessment

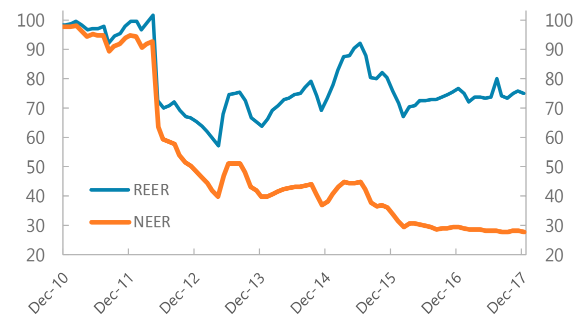
CA-Actual	**-10.0%**
Cyclical Contributions (from model)	0.2%
additional temporary/statistical factors	0
Cyclically adjusted CA	**-10.2%**
CA-Norm	**-8.1%**
additional adjustments to the norm	0.01
Cyclically adjusted CA Norm	**-9.3%**
CA-Gap	-0.9%
o/w Policy gap	2.1%
Elasticity	-0.24
REER Gap	3.8%

[2] Private credit/GDP is estimated to be negatively associated with current account balance, as higher credit helps finance domestic investment hence a lower current account balance.

C. Real Exchange Rate

4. The real effective exchange rate (REER) appreciated by about 2.5 percent in 2017 on average, following a 13 percent depreciation in 2016. The nominal effective exchange rate (NEER) depreciated by 5 percent in 2017 on average, compared to a 26-percent depreciation in 2016. The difference in the movement between REER and NEER reflects mainly the inflation differential with its trading partners. While still high, inflation moderated last year, reflecting tight monetary policy and the stabilization of maize prices due to favorable maize harvests. This has helped narrow the inflation differential with trading partners. The Malawian kwacha was stable against the U.S. dollar throughout the year. In part, this stability has been driven by tight monetary policy, overall favorable balance of payments developments, and gradually improving confidence. However, official intervention focusing on building foreign reserves and/or limiting foreign exchange rate volatility has also played a role. As a result, the IMF's 2017 AREAER reclassified Malawi's de facto exchange rate arrangement from a float to a stabilized arrangement. The premium between the exchange rates of the RBM and forex bureaus remains very small implying no foreign currency shortage.[3]

Real Effective Exchange Rate (2010=100)



Source: IMF's INS.

5. The REER does not appear misaligned. Using the EBA-lite model, the norm of the natural logarithm of the REER index is estimated to be 4.7, about 40 percent higher than the actual value of 4.3 for 2017, implying an undervaluation of about 40 percent of REER. This appears inconsistent with the model estimates of a negative CA gap. Therefore, staff adopts the elasticity approach and applies an elasticity of -0.24 to the staff-assessed CA gap of -0.9 percent, yielding an overvaluation of 3.8 percent of the REER.[4] On balance, staff assesses the REER gap to be within the range of [-5, 5] percent.

D. Capital and Financial Flows

[3] 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 then the Reserve Bank of Malawi has not set a target rate. Official actions continue to play a role in influencing the exchange rate, but the exchange rate movements are largely market determined. The exchange regime is free of restrictions and multiple currency practices.

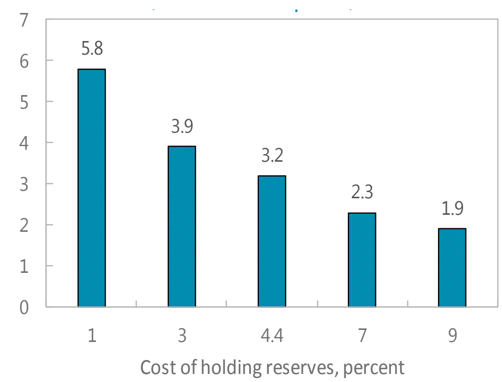
[4] The elasticity of current account to REER is derived as the weighted average of export elasticity of -0.44 and import elasticity of 0.29, with exports/GDP and imports/GDP as respective weights.

6. Net financial inflows in the past year recovered from low levels in 2016 to the 2011-15 average (relative to GDP). Medium- and long-term loan disbursement doubled, thanks to the agricultural support funds from the World Bank and stronger project support. Capital account balance, reflecting project, dedicated, and off budget grants, stood at 5.2 percent of GDP last year, steadily improving from the 2015 level, though lower than the temporary spike (9.1 percent of GDP) in 2016 reflecting the humanitarian support in response to the drought. Foreign direct investment flows (2 percent of GDP) disappointed last year, amid investor concerns over power shortages and rising factor costs. Capital and financial flows more than fully financed the current account deficit, leading to a positive overall balance.

E. Reserves

7. International reserves improved to an adequate level last year. At end-2017, gross international reserves stood at US$757 million, reflecting strong capital and financial inflows. This is equivalent to 3.3 months of prospective imports of goods and services, up from 2.9 months in 2016. The IMF's metric to assess reserve adequacy in credit-constrained economies, which explicitly weighs the cost and benefits of holding reserves, indicates that a reserve level of 3.2 months of imports would be adequate for Malawi, assuming a low opportunity cost of holding reserves.[5] Two traditional approaches—with broad money coverage at 52 percent (against a 20 percent threshold) and short-term debt coverage at 360 percent (against a 100 percent threshold)—also indicate that the current reserve stock is adequate. However, the rise in reserves in 2017 reflects largely the agricultural support funds from the World Bank ($80 million, equivalent to 0.4 months of imports), which is soon expected to be fully spent. Moreover, the country has been vulnerable to multiple shocks historically (especially to international commodity prices and weather shocks), while import needs are persistently strong. Over 2001–17, the reserve import coverage averaged 1.8 months, with a standard deviation of 0.9 months. Going forward, reserves are expected to rise to about 3.8 months by 2021 and reach 4.5 months over the medium term.

Optimal Level of Reserves
(months of imports)



Source: IMF staff estimates.

[5] Assessing Reserve Adequacy (ARA) Board papers (IMF 2011, 2013, 2014). Malawi is classified as "resource rich" due to its narrow export base, with tobacco exports accounting for more than one-third of total exports. The scenario assumes a 4.4-percent cost of holding reserves and a 75-percent unconditional probability of a large shock event.

Annex IV. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood in next 1–3 years	Impact if Realized	Policy advice[1]
Global Risks			
Tighter global financial conditions.	**High**	**Low** Increased financial volatility makes foreign investors more risk averse and reduces financial flows, contributes to currency depreciation, elevates inflationary pressures and undermines growth prospects.	Keep fiscal discipline and make monetary policy consistent with growth and inflation objectives, maintain adequate foreign reserves, and smooth short-term exchange rate volatility.
Weakening demand in key partner economies.	**Medium**	**Medium** Weak external demand dampens exports and depress real GDP growth.	Adopt policies to increase fiscal space to respond to contingences, tighten monetary policy and increase exchange rate flexibility to absorb shocks, strengthen FX reserve buffer to facilitate adjustment, and continue efforts to diversify the export base.
Energy price volatility.	**Medium**	**Medium** Energy price fluctuations and higher fuel demand and import prices can add to balance of payments pressures and increased domestic production costs.	Tighten monetary policy, increase exchange rate flexibility, strong FX reserve buffer, use the automatic fuel price adjustment mechanism and adjust electricity prices (if needed) to smooth price movement and ensure adequate energy supplies.
Regional and Domestic Risks			
Expansionary fiscal policies.	**High**	**High** Domestic borrowing for unduly high fiscal deficits leads to inflationary pressures, crowding out the private sector; there is a risk of reemergence of payment arrears.	Pursue restrictive fiscal policies, adopt corrective measures to limit spending, exert effective commitment control system, and increase revenue mobilization.
Delayed PFM reforms and lacking expenditure control.	**High**	**High** Uneven progress of PFM reform and deficient expenditure control undermine confidence in budgetary processes and efforts to effectively and transparently manage expenditure.	Accelerate implementation of PFM reform programs, strengthen corruption control, and communicate regularly and transparently.
Excessive external borrowing.	**Medium**	**High** Implementing an over-ambitious capital investment program, in particular if financed with non-concessional external loans, debilitates the precarious	Elaborate a prudent and well appraised public investment program, secure concessional financing, and assess the impact of borrowing on debt sustainability.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline scenario path, which is most likely to materialize in the view of IMF staff. The Relative Likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline scenario.

Source of Risk	Relative Likelihood in next 1–3 years	Impact if Realized	Policy advice[1]
		medium to long-term debt sustainability position.	
Deficient conduct of monetary policy.	**Medium**	**High** Conflicting signals on policy intentions confuse market participants' confidence.	Improve the communication of monetary policy and adopt a clear and effective monetary operational framework.
Deteriorating financial stability.	**Medium**	**Medium** Increasing non-performing loans and deteriorating financial positions threaten financial sector stability.	Strengthen banking supervision and inspection to contain emerging risks by developing early warning systems and countervailing measures, eliminate domestic arrears accumulation.
Spending pressures ahead of elections.	**High**	**High** Weak policy discipline and reform efforts could lead to macro-economic policy slippages	Maintain strong political commitment to program implementation and strengthen vigilance and control in expenditure monitoring.

[1] The policy response suggested by Fund staff assumes all other circumstances remain unchanged. For a combination of shocks, policy responses would need to be modified to avoid conflicts.

Annex V. Debt Sustainability Analysis Update

Approved By

Michael Atingi Ego and Zeine Zeidane (both IMF) and Paloma Anos Casero (IDA)

The Update on 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.

Risk of external debt distress:	**Moderate**
Augmented by significant risks stemming from domestic public and/or private external debt?	**Yes**

Malawi faces a moderate risk of debt distress based on an assessment of public external debt but a heightened overall risk of debt distress, reflecting significant vulnerabilities related to domestic debt.[1] *Malawi's external debt situation is broadly unchanged from the last DSA, but the debt level and interest expense remains high.*[2] *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. The projected borrowing path and debt policies remain broadly unchanged since the last DSA, but close attention will be needed on the financing terms of any proposed infrastructure investments given the limited headroom for further borrowing. To enhance resilience to shocks, efforts should be stepped up to further diversify the economy – particularly exports, broaden the revenue base, strengthen public finance management, and build fiscal buffers.*

[1] This report updates the DSA analysis contained in IMF Country Report No. 17/183 (July 2017). The fiscal year for Malawi runs from July to June; however, this DSA is prepared on a calendar year basis.

[2] Malawi's policies and institutions are classified as "weak" under the World Bank's Country Policy and Institutional Assessment (CPIA) Index (average score in 2013–16: 3.2). The relevant indicative thresholds for this category are: 30 percent for the NPV of debt-to-GDP ratio, 100 percent for the NPV of debt-to-exports ratio, 200 percent for the NPV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 18 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

A. Background

1. **Real GDP growth of the Malawian economy picked up last year**—estimated at 4 percent, up from 2.3 percent in 2016. This mainly reflects a recovery in agricultural production following two years of drought. Inflation declined to 7.8 percent in February (after peaking at 24 percent at end-2015) due to low and relatively stable food prices, prudent fiscal and monetary policies, and a stable exchange rate. The overall fiscal balance improved by 1.7 percentage points of GDP in FY 16/17 relative to the previous fiscal year, reflecting mainly increased revenue collection. The current account deficit narrowed—to an estimated 10 percent of GDP, from 13.6 percent in 2016. The improvement reflects mainly a large base effect in 2016 from increased imports of maize and related services, which has more-than offset the impact from deterioration in the terms of trade. Real GDP growth is projected to slow to 3.5 percent in 2018 (due to the adverse effects of dry spells and armyworm infestations on agricultural production), before picking up again (to 4.5 percent) next year and stabilizing at 6 percent over the medium term.

2. **Malawi's public and publicly guaranteed (PPG) external debt stood at about US$2 billion (32.6 percent of GDP) in 2017**, up from $1.79 billion (33.2 percent of GDP) in 2016.[3] The increase in PPG external debt during 2017 mainly reflects $382 million of new disbursements (with $353 million from multilaterals and $29 million from bilateral creditors) and repayment of about US$150 million of principal.

3. **Public external debt is held mainly by multilateral creditors** (78 percent of total, Text Table 1). The main provider of loans to Malawi is the International Development Association (IDA) (43 percent), followed by the African Development Fund (ADF) (14 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—surpassing the IMF as the third largest creditor to the country. Data on private external debt remains unavailable, but the amounts are not believed to be large.

4. **Public domestic debt is held by the Reserve Bank of Malawi (RBM, the largest creditor), commercial banks, and the non-bank financial sector**. Gross domestic debt increased

[3] Public and PPG external debt covers that contracted and guaranteed with nonresidents by central government and the Reserve Bank of Malawi. External arrears remain zero.

from MK206.6 billion (13.8 percent of the recently rebased GDP[4]) at the end of 2012 to MK1,015 billion (22.6 percent of GDP) at the end-2017.[5] The spike reflects a progressive shift of debt from external to domestic borrowing in recent years (Text Table 2, Text Figure 1). As discussed in the last DSA, the increase largely reflects i) the rise in government net domestic financing during FY 13/14–14/15, following the drop in external financing in the wake of the cashgate scandal; ii) the securitization of domestic arrears in 2013 and 2015–16; and iii) the issuance of a substantial amount of Treasury notes over 2012–15 for the conversion of ways and means (including promissory notes in 2013–14 by the government to recapitalize the RBM following losses arising from the 2012 exchange rate devaluation) and maturing Treasury bills into longer-term government securities. For more detailed discussion of evolvement of Malawi's public and external debt and debt services in recent years, see last DSA contained in IMF Country Report No. 17/183.

Text Table 1: Composition of Public and Publicly Guaranteed External Debt

(Million U.S. dollars)

	2015		2016		2017	
	Actual	Share	Actual	Share	Actual	Share
Multilateral	**1,343.1**	**75**	**1,362.3**	**76**	**1,584.3**	**78**
IMF	162.8	9	206.1	12	223.8	11
IDA	589.9	33	642.2	36	860.1	43
ADF	228.8	13	247.9	14	290.3	14
IFAD	71.8	4	72.5	4	77.5	4
other multilateral & PTA[1]	289.8	16	193.7	11	132.6	7
Bilateral	**439.5**	**25**	**426.2**	**24**	**436.7**	**22**
Belgium	1.7	0	1.7	0	1.7	0
China	242.7	14	226.9	13	237.9	12
India	151.7	9	147.3	8	142.1	7
Others	43.3	2	50.4	3	55.0	3
Commercial	0.39	0	0	0	0	0
Total	**1,783**	**100**	**1,789**	**100**	**2,021**	**100**

Sources: Malawian authorities and IMF staff calculations.

[1] PTA is a regional non-resident bank. The outstanding amount to PTA was zero, as of end-2017.

[4] The National Statistical Office of Malawi rebased their nominal GDP series from calendar year 2007 to 2010. The 2010-based national supply and use table has been used to derive a new GDP series, which was revised upwards by 29 percent. Some key indicators have changed as a result. For instance, the revenue to GDP ratio in FY 2010/11 declined from 24.5 percent to 15.6 percent and the public debt-to-GDP in 2011 fell by 12 percentage points to 28 percent of GDP.

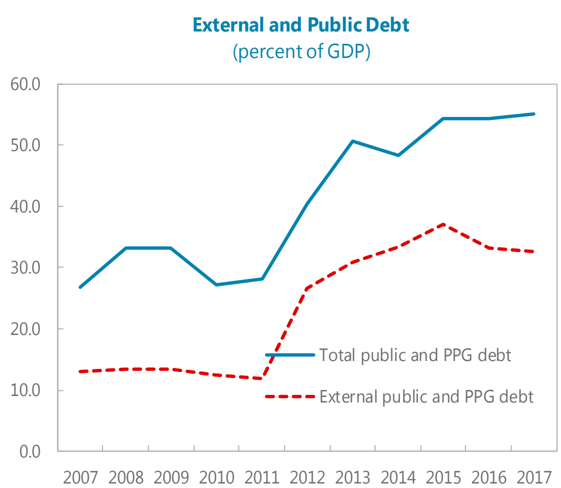
[5] Domestic debt mainly includes the total stock of treasury bills, treasury notes, local registry stocks, and ways and means advances. It also covers zero coupon promissory notes which have not yet matured, promissory notes related to the recapitalization of RBM (until end-September 2017), promissory notes for Malawi Saving Bank's toxic assets, and certified arrears for which promissory notes have not yet been issued. No contingent liabilities are included in the analysis due to a lack of data.

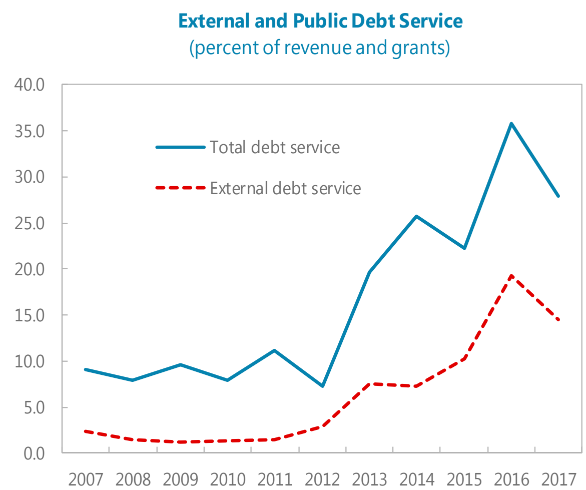
Text Table 2. Composition of Gross Domestic Debt (Percent of GDP)

	2012	2013	2014	2015	2016	2017
			Actual			
Treasury bills at cost value	9.0	9.1	6.9	6.2	5.8	5.6
Treasury notes	2.7	1.8	1.3	6.0	10.7	14.4
Local registered stocks (LRS)	0.2	0.1	0.0	0.0	0.0	0.0
Ways and means advances from RBM	1.7	5.2	3.0	0.9	0.9	1.0
Promissory notes	0.1	3.6	3.7	2.6	0.8	0.1
Commercial bank advances	0.1	0.0	0.0	0.0	0.0	0.0
Total	**13.8**	**19.8**	**14.9**	**15.8**	**18.2**	**21.1**

Sources: Malawian authorities; IMF staff estimates.

Text Figure 1. Public and PPG Debt





Sources: Malawian authorities and IMF calculations.

B. Underlying Assumptions

5. **The medium- and long-term macroeconomic framework underlying the DSA is consistent with the scenario presented in the Staff Report for the 2018 Article IV Consultation and Request for a three-year arrangement under the Extended Credit Facility**. The main projections for key macroeconomic variables are summarized in Box 1 and text Table 3. The main differences between the current assumptions and those underlying the last DSA in July 2017 are:

- *GDP growth* is estimated to be lower in 2017–18 (emanating from a weaker growth in manufacturing constrained by shortages of energy and water supply, and depressed purchasing power with low agricultural commodity prices in 2017; as well as the adverse effects of dry spells and armyworm infestations on agricultural production in 2018) but higher by about 0.5–1 percentage points over the medium to long term (reflecting improved confidence, more robust agricultural production, enhanced electricity generation, improved access to finance, and implementation of growth-friendly structural reforms under the support of the ECF arrangement. All of these are expected to help unleash higher potential growth than is assumed in the last DSA);

- *A higher fiscal primary deficit* is assumed for 2017–18 due to higher primary expenditure, reflecting increased spending on wages and salaries, goods and services, maize purchases, subsidies for bailout of ADMARC, arrears payments, and domestic and foreign-financed capital spending; and

- *A larger current account deficit* throughout the period, reflecting worsened terms of trade and higher investment-related imports on the back of stronger investment under the new ECF arrangement along with stronger export growth.

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

	Real GDP growth (percent)		Primary deficit (percent of GDP)		Change in public debt (percent of GDP)		Current account (percent of GDP)		FDI (percent of GDP)	
Year	Previous	Current	Previous	Current	Previous	Current	Previous	Current	Previous	Current
2014	5.7	5.7	0.2	0.2	-2.6	-2.4	-8.4	-8.3	4.9	4.9
2015	2.9	2.9	2.1	2.1	6.6	6.2	-9.4	-9.4	1.8	1.8
2016	2.3	2.3	1.9	2.1	-0.3	0	-13.5	-13.6	3.1	3.1
2017	4.5	4.0	1.3	2.9	-4.4	0.7	-9.3	-10	3	2
2018	5.0	3.5	-0.6	-0.4	-1.0	3.6	-8.2	-8.9	2.5	2.2
2019	5.5	4.5	-0.1	0.9	-1.7	-0.3	-7.8	-8.1	2.4	2.3
2020	5.5	5.0	-0.1	-0.3	-2.4	-2.1	-7.6	-7.9	2.4	2.4
2021	5.5	5.5	-0.1	-0.1	-1.5	-2.4	-7.4	-7.7	2.3	2.5
2022	5.5	6.0	-0.4	-0.3	-1.4	-2.5	-7	-7.7	2.3	2.5
2023		6.5		-0.3		-2.7		-7.6		2.5
Avg 2023-37	5.5	6.5	0.4	0.6	-0.6	-1.3	-6.2	-6.5	2.1	2.5

Sources: Malawian authorities and IMF staff calculations and projections.

Box 1. Baseline Macroeconomic Assumptions

Real GDP growth is projected to moderate to 3.5 percent in 2018 and gradually pick up and stabilize at 6.5 percent over the medium to long term. The long-term growth rate is about 1.5 percentage point higher than the average during 2008-17.

Inflation (end-of period) is projected to rise temporarily from 7.1 percent at end-2017 to 9 percent this year (reflecting the impact of a rise in maize prices from a historically low level) before resuming a gradual disinflation path. Tight fiscal and monetary policies are expected to continue anchoring inflation expectations. Inflation is projected to reach 5 percent by 2022.

Private sector credit growth is projected at 4 percent this year before strengthening to 8 percent in 2019 and averaging about 15 percent year-on-year during 2020–2023 in line with stronger real growth, compared to an 11.5 percent average envisaged in the last DSA.

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

The tax revenue to GDP ratio is expected to edge down by 0.3 percentage points in FY 17/18 from the previous fiscal year and return to a higher level of 17.8 percent by FY 22/23. In the long run, tax revenue is projected to rise gradually to around 18.5 percent of GDP in FY 36/37, thanks to progressive reforms to tax administration and policy. The tax revenue to GDP ratio is about 0.3 percentage point lower than assumed at the time of the last DSA. However, total revenue to GDP ratio remains broadly unchanged from the last DSA.

External debt will be mainly contracted with 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 in the medium term. For FY 18/19, the framework assumes about $80 million budget support grants from the World Bank.

The current account deficit is projected to shrink gradually, reflecting large and persistent import needs.

New disbursements on external loans. For 2018, new disbursements on external loans are taken from the authorities' fiscal framework, which projects capital spending covered by external loans to reach 4.8 percent of GDP in FY 17/18 and 4.1 percent in FY 18/19. It is assumed that external project loans will remain close to 2.5–2.6 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 FY 18/19, contributing marginally to the change in domestic debt.

C. Debt Sustainability Analysis

External DSA

6. **Based on the assumptions outlined above, Malawi's debt is assessed to be sustainable with a moderate risk of debt distress** (Figure 1 and Table 1–3). As in the last DSA, Malawi is classified as a "weak" performer, based on the quality of the country's policies and institutions as measured by the three-year average of the rating under the World Bank's Country Policy and Institutional Assessment (CPIA). This is reflected in lower (less accommodative) debt sustainability thresholds compared to countries operating in a strong policy environment.

7. **Under the baseline scenario, all debt burden indicators remain below their indicative thresholds.** The PPG external debt is projected to peak at 32.2 percent of GDP in 2019–20, with a PV of debt-to-GDP ratio of 20 percent. The PV of PPG external debt is expected to decline gradually to 13 percent over the long term. Debt service-to-exports ratio is expected to remain high at 7.5 percent in 2018 (compared to a historical average of 4 percent), but has declined significantly from a 10-year high of 12 percent in 2016 (the latter reflects a large amortization related to the debt restructuring operation with the PTA bank which was completed in 2017). The debt service is expected to gradually decline below 4 percent of exports over the long term.

8. **A weaker debt outcome is envisaged under all but one stress test.** The strongest impact on the indicators arises under two bound tests (B3 and B6 in Table 2): i) US dollar GDP deflator at historical average minus one standard deviation in 2019–20 and ii) one-time depreciation of 30 percent in 2019. Both shocks cause the PV of debt to GDP, PV of debt to exports, and PV of debt to revenue to breach the thresholds and remain at elevated levels. Although liquidity indicators – debt services to exports/revenue ratios – do not breach the thresholds, they are expected to steepen significantly, especially under the depreciation shock for debt services to revenue ratio. Temporary shocks to real GDP growth, export growth, non-debt creating inflows such as FDI, or a combination of them (B1, B2, B4, and B5 in Table 2) are also expected to cause the debt path to breach most thresholds for multiple years. Under the historical scenario (A1 in Table 2), when the average current account deficit was around 10.1 percent of GDP[6] and FDI was low (around 1.5 percent of GDP), all ratios are projected to breach the thresholds and remain at elevated levels. However, the probability

[6] Based on BPM6. Project and dedicated grants were classified on the current account but under the BPM6 are classified on the capital account leading to significant increase in historical values of current account balances. For example, the current account deficit averaged 10.1 percent over last 10 years under the revised classification, compared to 5.5 percent previously. Current account deficit for 2011 and 2012 were 9.3 and 8.7 percent, respectively, up from 5.9 and 3.5 percent previously.

is low for Malawi to repeat history by running high and protracted current account deficits in the medium to long term. Following a devaluation in 2012, Malawi adopted a flexible exchange rate regime and the exchange rate is now expected to serve as a shock absorber. Moreover, FDI inflows are expected to pick up steadily as macroeconomic stability is regained and the business environment improves. These flows are expected to concentrate on the agriculture, manufacturing, and energy sectors, helping boost export growth and reduce the heavy reliance on energy-related imports (such as generators).

Public DSA

9. **The risk of debt distress is heightened significantly when adding domestic public debt to external debt** (Figure 2, Table 4–5). The total public debt is projected to peak at 54.4 percent in 2019 before receding as the fiscal primary balance starts to turn positive. The peak of debt is nearly 5 percentage points higher than projected in the last DSA, reflecting a higher primary deficit and a higher average real interest rate (partly reflecting lower inflation) on domestic debt despite stronger real GDP growth. Similarly, total debt service is expected to remain above 10 percent of revenue and grants over the medium term. This points to the importance of obtaining the most favorable financing terms going forward. In PV terms, total public debt (at 43 percent of GDP in 2018) is projected to breach the LIC DSA benchmark of 38 percent (for those countries with weak policies and institutions) and remain above the benchmark until 2023. This reflects a worsening of the primary deficit compared to the last DSA, notably in 2017 and 2018 (Text Table 3).

10. **Standard tests illustrate the importance of the primary deficit in determining the debt trajectory**. Under the scenario (A1 in Table 5) with real GDP growth (of 5 percent) and primary balance at historical averages (of 1.3 percent), the PV of total public debt will be slightly worse than the baseline, with the PV debt-to-GDP ratio above 38 percent before 2023. The most severe impact comes from a temporary shock of a one-time 30 percent real depreciation in 2019, which will significantly worsen the debt path, sending the peak PV of total public debt to 51 percent of GDP in 2019.

11. **The gross domestic debt to GDP ratio is projected to decline gradually over the medium term**, to around 15 percent of GDP at end-2023. These projections assume that: i) the cost value of all maturing Treasury bills and the face-value of all maturing Treasury notes will be continuously rolled over; ii) government's net domestic financing will be limited to less than one percent of GDP beyond FY 18/19; and iii) all maturing promissory notes will be automatically converted into advances from the central Bank and ultimately rolled over into Treasury bills of

varying maturities (91, 182 and 364 days) or Treasury notes of longer than one year maturity which could then be tradable in the secondary market.

D. Conclusions

12. **Malawi remains at moderate risk of debt distress, based on an assessment of external public debt, but overall risks have heightened compared to the last DSA, reflecting rising vulnerabilities to domestic debt and external conditions.** Malawi is historically vulnerable to shocks, particularly those related to weather, commodity prices, and exports, which often take on many dimensions at the same time threatening macroeconomic stability. Absorption of these shocks while maintaining macroeconomic stability and debt sustainability will require careful macroeconomic management and difficult policy choices.

- *Prudent project selection*. Given limited headroom for further borrowing, close attention and prudence should be applied to project identification and the financing terms of any proposed infrastructure investments while balancing needs with rates of return and debt sustainability concerns.[7]

- *Broadening revenue base and strengthening public financial management*. Given Malawi's high aid dependency, risks of negative financing shocks in the form of delayed donor support, or lower-than-expected revenue collection remain. Such an environment requires further efforts to maximize the impact of finite domestic resources, including broadening the tax base and strengthening public procurement and financial management.

- *Building fiscal buffers*. Large domestically-financed fiscal deficits in recent years means that Malawi is reaching the upper limits at which its stock of domestic debt can be sustainably managed. Measures to increase fiscal buffers to enable the budget to withstand the impact of future external shocks are important.

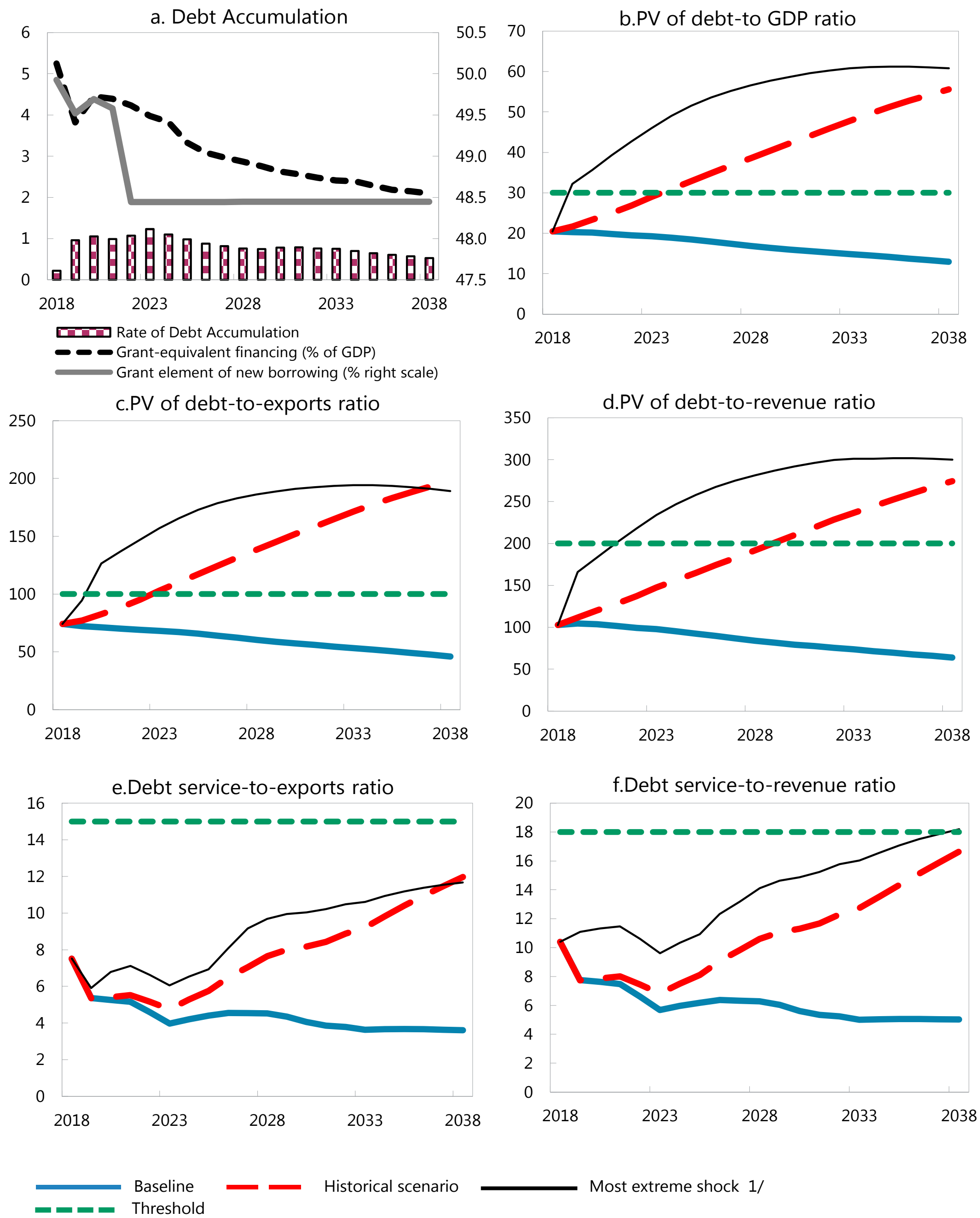
- *Reducing the sovereign-bank nexus*. There is a significant nexus between sovereign debt and the banking system since the RBM and commercial banks have been the main sources of domestic financing for the central government. As highlighted in the Selected Issues Paper,[8] such large

[7] For instance, taking a $600 million loan over the next three years, with a grant element of 37 percent, would raise the PV of debt to GDP ratio by 5 percentage points at the peak and lead the PV of debt to exports ratio to hit the 100 percent threshold.
[8] Selected Issues Paper on "Supporting growth through increased credit to the private sector".

exposure of bank balance sheets to the sovereign risks a negative feedback loop if fiscal challenges emerge or liquidity conditions tighten.

- *Closely monitoring contingent liabilities.* Contingent liabilities have in general been one of the largest sources of fiscal risk. Malawi's experience in the past few years, such as the recapitalization of the RBM due to devaluation and the ADMARC bailout, has illustrated that the materialization of contingent liabilities can contribute to unexpected increases in debt-to-GDP ratio, crowding out private credit and jeopardizing debt sustainability. Efforts should be stepped up to estimate, disclose, manage, and contain contingent liabilities, in particular of those related to financial sector and state-owned enterprises.

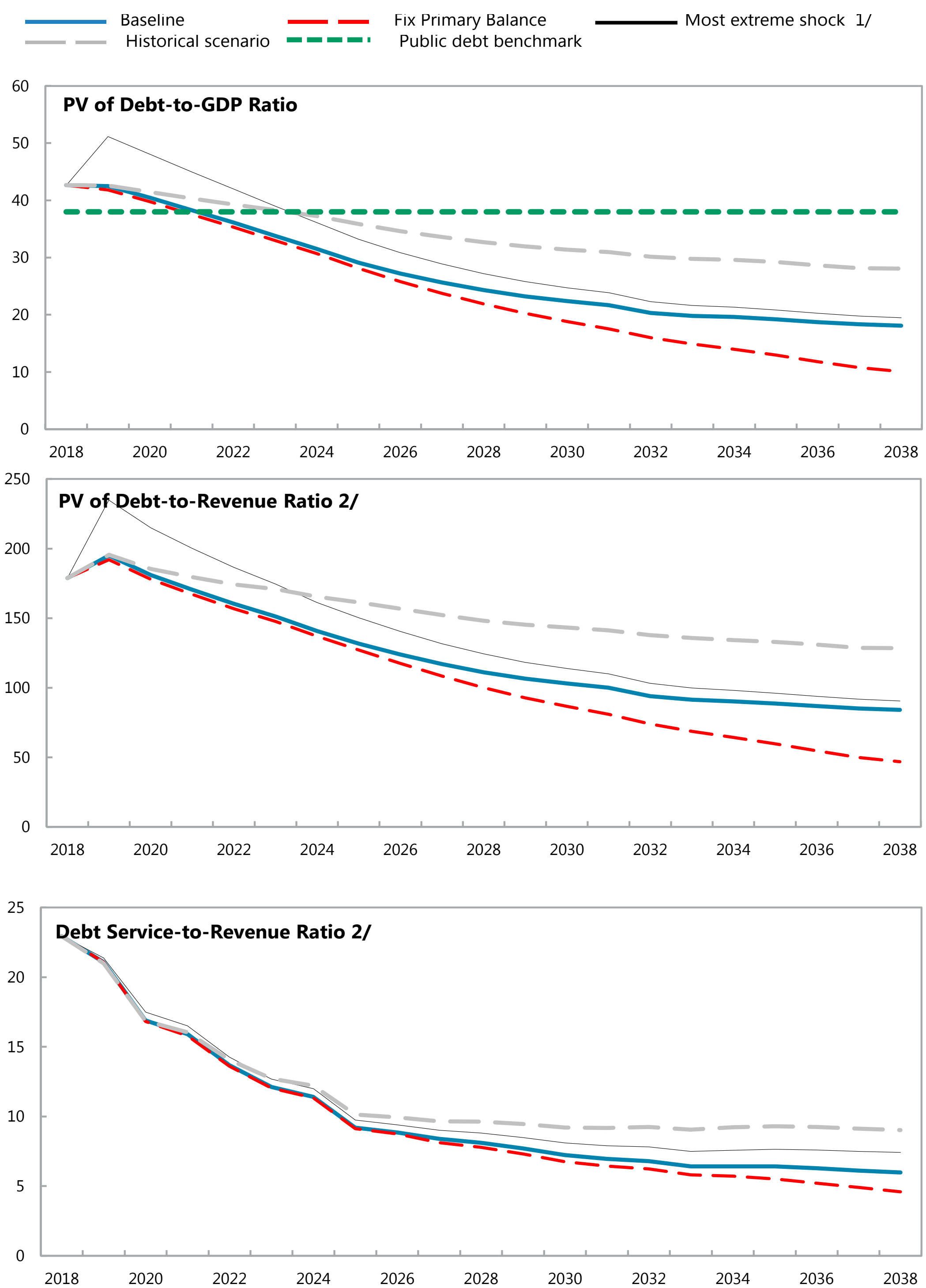
Figure 1. Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2018–38 1/



Sources: Malawian authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028. 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 2. Indicators of Public Debt Under Alternative Scenarios, 2018–38 1/



Sources: Malawian authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028.

2/ Revenues are defined inclusive of grants.

Table 1. External Debt Sustainability Framework, Baseline Scenario, 2015–38
(Percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2018-2023			2024-2038
	2015	2016	2017			2018	2019	2020	2021	2022	2023	Average	2028	2038	Average
External debt (nominal) 1/	**40.5**	**37.3**	**36.3**			**35.6**	**35.6**	**35.6**	**35.3**	**34.7**	**34.1**		**30.2**	**23.8**	
of which: public and publicly guaranteed (PPG)	37.0	33.2	32.6			32.1	32.2	32.2	32.0	31.6	31.2		27.9	22.3	
Change in external debt	3.5	-3.2	-1.0			-0.7	0.1	0.0	-0.4	-0.6	-0.5		-0.8	-0.6	
Identified net debt-creating flows	5.7	17.5	3.6			5.6	4.3	3.8	3.4	3.2	3.1		2.4	1.7	
Non-interest current account deficit	**8.6**	**12.9**	**9.6**	**9.9**	**2.3**	**8.6**	**7.8**	**7.6**	**7.4**	**7.4**	**7.3**		**6.4**	**5.4**	6.1
Deficit in balance of goods and services	11.1	16.8	13.7			13.2	11.3	11.1	11.1	11.1	11.1		10.5	9.6	
Exports	25.5	29.3	27.3			27.5	28.1	28.3	28.3	28.2	28.2		27.9	28.1	
Imports	36.6	46.0	41.0			40.7	39.4	39.4	39.4	39.4	39.3		38.4	37.8	
Net current transfers (negative = inflow)	-4.9	-5.8	-6.0	-5.7	1.4	-6.4	-5.3	-5.4	-5.5	-5.6	-5.6		-5.7	-5.8	-5.7
of which: official	-0.4	0.0	-0.2			-1.2	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	2.4	1.9	1.9			1.9	1.9	1.9	1.8	1.8	1.8		1.7	1.5	
Net FDI (negative = inflow)	**-1.8**	**-3.1**	**-2.0**	**-1.9**	**1.1**	**-2.2**	**-2.3**	**-2.4**	**-2.5**	**-2.5**	**-2.5**		**-2.5**	**-2.5**	-2.5
Endogenous debt dynamics 2/	**-1.2**	**7.7**	**-4.0**			**-0.9**	**-1.2**	**-1.4**	**-1.5**	**-1.7**	**-1.8**		**-1.6**	**-1.2**	
Contribution from nominal interest rate	0.8	0.8	0.4			0.3	0.3	0.3	0.3	0.3	0.3		0.3	0.3	
Contribution from real GDP growth	-1.0	-1.1	-1.3			-1.2	-1.5	-1.7	-1.8	-2.0	-2.1		-1.9	-1.5	
Contribution from price and exchange rate changes	-1.0	7.9	-3.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.9**	**-15.0**	**3.4**			**-1.5**	**0.7**	**0.7**	**1.4**	**1.4**	**1.5**		**1.3**	**1.4**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	24.8			23.9	23.8	23.5	23.1	22.6	22.2		19.2	14.5	
In percent of exports	...	...	90.8			87.0	84.6	83.2	81.5	80.0	78.9		68.9	51.4	
PV of PPG external debt	**...**	**...**	**21.1**			**20.4**	**20.3**	**20.1**	**19.8**	**19.5**	**19.2**		**16.9**	**12.9**	
In percent of exports	**...**	**...**	**77.2**			**74.2**	**72.2**	**71.3**	**70.0**	**69.0**	**68.3**		**60.5**	**46.0**	
In percent of government revenues	**...**	**...**	**107.2**			**102.7**	**104.5**	**103.7**	**101.6**	**99.4**	**97.9**		**83.9**	**63.9**	
Debt service-to-exports ratio (in percent)	**7.4**	**12.3**	**10.4**			**7.5**	**5.4**	**5.3**	**5.2**	**4.6**	**4.0**		**4.5**	**3.6**	
PPG debt service-to-exports ratio (in percent)	**7.4**	**12.3**	**10.4**			**7.5**	**5.4**	**5.3**	**5.2**	**4.6**	**4.0**		**4.5**	**3.6**	
PPG debt service-to-revenue ratio (in percent)	**10.2**	**19.3**	**14.4**			**10.4**	**7.8**	**7.6**	**7.5**	**6.6**	**5.7**		**6.3**	**5.0**	
Total gross financing need (Billions of U.S. dollars)	0.6	0.8	0.7			0.6	0.5	0.5	0.5	0.5	0.6		0.7	1.1	
Non-interest current account deficit that stabilizes debt ratio	5.1	16.1	10.6			9.3	7.8	7.6	7.8	7.9	7.8		7.3	6.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.9	2.3	4.0	5.0	2.2	3.5	4.5	5.0	5.5	6.0	6.5	5.2	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	2.7	-16.4	9.0	-0.6	13.2	5.0	-0.4	0.8	0.7	0.9	1.2	1.4	1.2	0.6	1.0
Effective interest rate (percent) 5/	2.3	1.8	1.3	1.0	0.6	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.1	1.1	1.1
Growth of exports of G&S (US dollar terms, in percent)	-7.2	-2.0	5.8	7.1	10.9	9.6	6.3	6.4	6.4	6.8	7.4	7.1	7.5	7.5	7.5
Growth of imports of G&S (US dollar terms, in percent)	-2.4	7.4	1.0	6.6	15.3	7.9	0.8	5.7	6.3	6.9	7.4	5.8	7.2	7.4	7.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	49.9	49.5	49.7	49.6	48.4	48.4	49.3	48.4	48.4	48.4
Government revenues (excluding grants, in percent of GDP)	18.5	18.6	19.7			19.9	19.4	19.4	19.5	19.6	19.6		20.1	20.2	20.1
Aid flows (in Billions of US dollars) 7/	0.4	0.3	0.5			0.4	0.3	0.4	0.4	0.4	0.4		0.4	0.6	
of which: Grants	0.2	0.1	0.2			0.3	0.2	0.2	0.2	0.2	0.2		0.2	0.3	
of which: Concessional loans	0.1	0.1	0.3			0.1	0.1	0.2	0.1	0.1	0.2		0.2	0.3	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.2	3.8	4.5	4.4	4.2	4.0		2.9	2.1	2.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			80.2	72.0	74.2	75.0	75.3	74.4		71.0	70.1	70.9
Memorandum items:															
Nominal GDP (Billions of US dollars)	6.4	5.5	6.2			6.7	7.0	7.4	7.9	8.4	9.1		13.2	27.0	
Nominal dollar GDP growth	5.7	-14.5	13.3			8.7	4.1	5.8	6.2	7.0	7.8	6.6	7.7	7.2	7.5
PV of PPG external debt (in Billions of US dollars)			1.3			1.3	1.4	1.5	1.5	1.6	1.7		2.2	3.5	
(PVt-PVt-1)/GDPt-1 (in percent)						0.2	1.0	1.1	1.0	1.1	1.2	0.9	0.8	0.5	0.8
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)	...	...	21.1			20.4	20.3	20.1	19.8	19.5	19.2		16.9	12.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	77.2			74.2	72.2	71.3	70.0	69.0	68.3		60.5	46.0	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	10.4			7.5	5.4	5.3	5.2	4.6	4.0		4.5	3.6	

Sources: Malawian 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 changes.

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. Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–38

	Projections							
	2018	2019	2020	2021	2022	2023	**2028**	2038
PV of debt-to GDP ratio								
Baseline	20	20	20	20	19	19	**17**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	20	22	23	25	27	29	**39**	56
A2. New public sector loans on less favorable terms in 2018-2038 2/	20	21	21	22	22	23	**23**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	20	23	26	29	31	33	**41**	44
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	20	24	29	32	34	36	**42**	44
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	20	26	34	37	40	43	**53**	57
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	20	24	28	30	33	35	**41**	43
B5. Combination of B1-B4 using one-half standard deviation shocks	20	26	35	38	40	43	**50**	52
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	20	32	36	39	43	46	**57**	61
PV of debt-to-exports ratio								
Baseline	74	72	71	70	69	68	**61**	46
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	74	77	83	89	95	103	**138**	197
A2. New public sector loans on less favorable terms in 2018-2038 2/	74	73	75	77	79	81	**83**	79
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	74	80	88	97	106	114	**142**	151
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	74	94	127	137	147	157	**186**	189
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	74	80	88	97	106	114	**142**	151
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	74	85	98	107	115	124	**149**	153
B5. Combination of B1-B4 using one-half standard deviation shocks	74	90	113	123	132	141	**167**	169
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	74	80	88	97	106	114	**142**	151
PV of debt-to-revenue ratio								
Baseline	103	105	104	102	99	98	**84**	64
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	103	111	120	128	137	147	**192**	274
A2. New public sector loans on less favorable terms in 2018-2038 2/	103	106	110	112	114	116	**115**	110
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	103	118	133	146	158	170	**204**	218
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	103	124	151	163	174	184	**211**	215
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	103	134	173	190	206	221	**266**	283
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	103	123	143	155	166	177	**206**	213
B5. Combination of B1-B4 using one-half standard deviation shocks	103	134	179	193	206	218	**251**	255
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	103	166	184	201	218	234	**281**	300

Table 3. Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–38 (cont.)

				Debt service-to-exports ratio				
Baseline	8	5	5	5	5	4	**5**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	8	5	5	6	5	5	**8**	12
A2. New public sector loans on less favorable terms in 2018-2038 2/	8	5	5	5	5	5	**5**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	8	5	5	6	5	5	**7**	9
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	8	6	7	7	7	6	**10**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	8	5	5	6	5	5	**7**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	8	5	6	6	5	5	**8**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	8	6	6	6	6	5	**9**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	8	5	5	6	5	5	**7**	9
				Debt service-to-revenue ratio				
Baseline	10	8	8	7	7	6	**6**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	10	8	8	8	7	7	**11**	17
A2. New public sector loans on less favorable terms in 2018-2038 2/	10	8	8	8	7	7	**7**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	10	8	8	8	8	7	**10**	13
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	10	8	8	8	8	7	**11**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	10	9	11	11	10	9	**13**	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	10	8	8	8	8	7	**11**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	10	8	10	10	9	8	**13**	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	10	11	11	11	11	10	**14**	18
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	44	44	44	44	44	44	**44**	44

Sources: Malawian authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly 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. Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–38

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2015	2016	2017	Average 5/	Standard Deviation 5/	2018	2019	2020	2021	2022	2023	2018-23 Average	2028	2038	2024-38 Average
Public sector debt 1/	54.4	54.4	55.1			54.3	54.4	52.6	50.5	48.2	45.7		35.3	27.5	
of which: foreign-currency denominated	37.0	33.2	32.6			32.1	32.2	32.2	32.0	31.6	31.2		27.9	22.3	
Change in public sector debt	6.2	0.0	0.7			-0.8	0.1	-1.8	-2.1	-2.3	-2.5		-1.5	-0.4	
Identified debt-creating flows	7.6	-0.6	-0.2			-0.6	0.3	-1.9	-1.9	-2.1	-2.5		-1.3	-0.5	
Primary deficit	2.1	2.1	2.9	1.3	1.7	-0.4	0.9	-0.3	-0.3	-0.2	-0.4	-0.1	0.7	1.0	0.7
Revenue and grants	21.7	21.3	23.1			23.9	21.8	22.4	22.5	22.5	22.3		21.9	21.5	
of which: grants	3.2	2.7	3.4			4.0	2.4	2.9	3.0	2.9	2.7		1.8	1.3	
Primary (noninterest) expenditure	23.9	23.4	26.0			23.5	22.6	22.0	22.2	22.4	21.9		22.6	22.5	
Automatic debt dynamics	5.5	-2.4	-3.1			-0.1	-0.6	-1.5	-1.6	-1.9	-2.1		-2.1	-1.5	
Contribution from interest rate/growth differential	-0.4	0.3	-0.5			-0.6	-1.0	-1.9	-1.9	-2.1	-2.3		-2.3	-1.8	
of which: contribution from average real interest rate	1.0	1.5	1.6			1.3	1.3	0.7	0.8	0.7	0.7		0.0	-0.1	
of which: contribution from real GDP growth	-1.4	-1.2	-2.1			-1.9	-2.3	-2.6	-2.7	-2.9	-2.9		-2.2	-1.7	
Contribution from real exchange rate depreciation	5.9	-2.8	-2.6			0.4	0.4	0.3	0.3	0.2	0.2		...	...	
Other identified debt-creating flows	0.0	-0.3	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	-0.3	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-1.4	0.6	0.9			-0.3	-0.2	0.1	-0.2	-0.2	0.0		-0.2	0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	43.6			42.7	42.5	40.5	38.3	36.1	33.8		24.3	18.1	
of which: foreign-currency denominated	...	...	21.1			20.4	20.3	20.1	19.8	19.5	19.2		16.9	12.9	
of which: external	...	...	21.1			20.4	20.3	20.1	19.8	19.5	19.2		16.9	12.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	7.2	9.7	9.4			5.1	5.4	3.4	3.3	2.9	2.3		2.5	2.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	188.8			178.8	195.1	181.1	170.5	160.5	151.3		111.2	84.2	
PV of public sector debt-to-revenue ratio (in percent)	...	...	221.9			214.4	218.9	208.3	196.3	184.4	172.0		120.9	89.5	
of which: external 3/	...	...	107.2			102.7	104.5	103.7	101.6	99.4	97.9		83.9	63.9	
Debt service-to-revenue and grants ratio (in percent) 4/	22.3	35.8	27.9			22.9	21.1	16.9	15.9	13.7	12.1		8.1	6.0	
Debt service-to-revenue ratio (in percent) 4/	26.1	40.9	32.8			27.5	23.6	19.4	18.3	15.7	13.8		8.8	6.3	
Primary deficit that stabilizes the debt-to-GDP ratio	-4.1	2.1	2.2			0.4	0.8	1.5	1.8	2.1	2.1		2.2	1.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	2.9	2.3	4.0	5.0	2.2	3.5	4.5	5.0	5.5	6.0	6.5	5.2	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	2.6	2.0	1.5	1.2	0.7	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.2	1.2	1.2
Average real interest rate on domestic debt (in percent)	3.1	7.4	8.0	3.0	4.2	7.6	8.2	5.1	6.0	5.8	5.9	6.4	2.4	2.0	3.1
Real exchange rate depreciation (in percent, + indicates depreciation	17.9	-7.6	-8.2	5.2	26.0	1.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	20.9	19.5	10.7	16.3	5.9	8.8	6.8	6.1	5.2	4.6	4.4	6.0	4.4	3.8	4.2
Growth of real primary spending (deflated by GDP deflator, in percer	14.0	0.2	15.9	3.0	6.3	-6.8	0.9	2.2	6.1	6.9	4.5	2.3	6.9	4.8	6.7
Grant element of new external borrowing (in percent)	...	...	...	...	...	49.9	49.5	49.7	49.6	48.4	48.4	49.3	48.4	48.4	...

Sources: Malawian authorities; and staff estimates and projections.

1/ Public sector covers central government. 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. Sensitivity Analysis for Key Indicators of Public Debt, 2018–38

	Projections							
	2018	2019	2020	2021	2022	2023	2028	2038
PV of Debt-to-GDP Ratio								
Baseline	43	43	40	38	36	34	24	18
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	43	43	41	40	39	38	33	28
A2. Primary balance is unchanged from 2018	43	42	40	38	35	33	22	10
A3. Permanently lower GDP growth 1/	43	43	41	39	37	35	28	29
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	43	43	43	41	39	37	29	25
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	43	44	43	41	39	37	27	19
B3. Combination of B1-B2 using one half standard deviation shocks	43	43	43	41	39	37	28	22
B4. One-time 30 percent real depreciation in 2019	43	51	48	45	42	39	27	19
B5. 10 percent of GDP increase in other debt-creating flows in 2019	43	48	46	43	41	39	28	20
PV of Debt-to-Revenue Ratio 2/								
Baseline	179	195	181	170	160	151	111	84
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	179	196	186	180	174	171	148	129
A2. Primary balance is unchanged from 2018	179	192	178	167	157	148	100	47
A3. Permanently lower GDP growth 1/	179	196	183	174	165	158	127	133
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	179	199	190	181	172	164	131	115
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	179	201	194	183	173	163	121	90
B3. Combination of B1-B2 using one half standard deviation shocks	179	199	193	183	173	164	126	101
B4. One-time 30 percent real depreciation in 2019	179	235	215	200	187	175	124	91
B5. 10 percent of GDP increase in other debt-creating flows in 2019	179	220	205	193	183	173	129	95
Debt Service-to-Revenue Ratio 2/								
Baseline	23	21	17	16	14	12	8	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	23	21	17	16	14	13	10	9
A2. Primary balance is unchanged from 2018	23	21	17	16	14	12	8	5
A3. Permanently lower GDP growth 1/	23	21	17	16	14	12	9	8
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	23	21	17	17	14	13	9	7
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	23	21	17	16	14	12	9	6
B3. Combination of B1-B2 using one half standard deviation shocks	23	21	17	16	14	13	9	7
B4. One-time 30 percent real depreciation in 2019	23	23	20	19	16	15	11	9
B5. 10 percent of GDP increase in other debt-creating flows in 2019	23	21	17	17	14	13	9	7

Sources: Malawian 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.

Annex VI. Capacity Development Strategy Note for FY 2018—Summary, December 2017

A. Macroeconomic challenges

1. The overarching strategy aims to safeguard macroeconomic stability through generally tight fiscal and monetary policy; focusing first on locking in gains in disinflation and then on supporting inclusive growth. Inflation averaged 23.4 percent during 2012-2016—snowballing the costs of public and private borrowing, further wearing away fiscal space and suppressing investment. The sudden withdrawal of donor budget support in the wake of the cashgate scandal inflicted colossal damages to the economic outlook and exposed fundamental deficiencies in its public financial management system. Two consecutive years of drought also wore on growth, revenue collection, and banking sector profitability. During 2017, however, a macroeconomic window of opportunity reopened. Inflation rapidly fell to single digits, reserve coverage is well above 3 months, and growth is expected to rebound. Malawi also completed the 9th and final review of ECF arrangement in June 2017 including by completing the bank reconciliation and audit of the government's 2015/16 financial accounts—at last. The authorities are interested in a successor ECF arrangement to anchor reforms and support fiscal discipline ahead of 2019 elections.

B. Focus of recent technical assistance

2. The lion's share of past technical assistance focused heavily on implementing a PFM action plan to address weaknesses in reconciling government bank accounts, commitment control, cash management, the Integrated financial management information system (IFMIS), and basic fiscal reporting. Efforts to safeguard financial sector stability involved TA on strengthening banking supervision and improving the development of money and foreign exchange markets. The implementation of tax policy recommendations was instrumental in bolstering government revenues in the face of the ongoing suspension of donor budget support. Malawi government officials have been major recipients of training. The majority of this training was in the area of Macroeconomic Statistics, Financial Programming and Policies, Basel II supervisory framework, and Monetary and Financial Sector Analysis. Since June 2016, the Reserve Bank of Malawi has received customized training on inflation and monetary policy analysis in the context of modernizing its monetary policy framework—which has gained traction.

C. Forward-looking priorities

3. The strategy will focus on cementing gains in PFM reforms by routinizing bank reconciliation and moving the focus to the next basic areas of expenditure controls—key to fully recover public's trust in the government's PFM system. Capacity building in tax policy and revenue administration will emphasize reforms aimed at building resilience and reducing aid dependence. Efforts to modernize the monetary policy framework and strengthen risk-based banking supervision would aim at improving monetary policy analysis and forecasting, and safeguarding financial sector stability. Improving Financial Market Infrastructure will also support the authorities' efforts to adopt international risk management standards. Improving the timeliness, quality and coverage of statistics will remain critical to supporting sound policymaking. To achieve these objectives, it is expected that FAD, MCM, and STA will continue to provide TA, supported by AFRITAC East.

TA Priorities	**Objectives**
Public Financial Management	Ensure routine fiscal reporting and bank reconciliations; strengthen commitment controls and cash management to prevent the emergence of domestic payment arrears; improve existing IFMIS coverage for comprehensive reporting; implement plans for a new IFMIS over the medium term.
Tax policy and revenue administration.	Assess recent new tax reforms, as a follow up to the January 2016 tax policy diagnostic mission; prepare a diagnostic of tax and customs administration and assess the implementation of the authorities' strategic plan for revenue mobilization and the emerging challenges.
Monetary policy framework	Improve central bank operations and its liquidity management; and prepare the monetary policy framework for transition to interest rate based policy. Develop a road map to implementing inflation targeting, and improve communication on RBM's policy target to the markets.
Financial sector supervision	Strengthen risk-based supervision of the banking sector; support the implementation of consolidated supervision frameworks; prepare a diagnostic of the stability of the banking system; assess the status of the implementation of the Basel framework, and strengthen insurance and pension supervision.

TA Priorities	Objectives
Financial market infrastructure (FMI) and payments	Support the authorities' efforts to adopt the international risk management standards for FMIs and equip the central bank to fulfill its oversight responsibilities in line with the CPSS-IOSCO Principles for financial market infrastructures (PFMI).
Statistics	Provide support for the authorities' work on improving the national accounts, government finance, BOP, and monetary and financial statistics.

4. **The authorities have been active in setting TA priorities and clearly articulate their needs** in the context of program review missions and during consultations with Functional Departments during the Spring and Annual Meetings. In the area of PFM, the authorities have insisted on training to complement the recommendations in order to improve the effectiveness of TA delivered. They have also increased the staff compliment in the Accountant General's Office charged with conducting regular bank reconciliations. The Reserve Bank of Malawi has assigned dedicated staff to leverage capacity development in Forecasting and Policy Analysis Systems (FPAS) and provided opportunities to staff for continuing education overseas.

5. **The main risk to the strategy is backsliding of the reform in PFM.** Continued support on routinizing bank reconciliations will be key to maintaining the gains made during the last ECF arrangement. Statistics is the area that has been hampered most by resource constraints. However, the authorities have demonstrated commitment and support to implement TA recommendations. The uptake of tax policy and financial sector TA recommendations has been good.

6. **Leveraging the expertise of the resident PFM advisor with support from AFRITAC East should help mitigate the risks in the PFM domain.** Increased resources to the National Statistics Office (NSO) and closer coordination between the NSO, the RBM, and other entities of the Ministry of Finance, Planning and Economic Development will enhance the quality of statistics and policy formulation.

Authorities Views

7. **The authorities appreciated the opportunity for feedback and agreed with the thrust of the analysis and views.** However, they raised concerns on disparity between the sharing of knowledge (i.e., TA and training) and absorption (i.e., application and internalization). Some representatives expressed the need for a cooling-off period after the delivery of TA to allow them to internalize the knowledge transferred.

8. Authorities did not object the staff's view of risk (i.e., fatigues on PFM reform) and mitigation (resident PFM advisor). However, they also stressed that low levels of public sector remuneration and overly-centralized and mechanical human resource management system is a key impediment to sustain gains in capacity development.

9. The Ministry of Finance broadly agreed with the priorities outlined in the area of PFM and tax revenues. The Minister and other officials made a few specific comments:

- **IFMIS**. The authorities would like to have a TA on monitoring IFMIS implementation.
- **Tax diagnostic**. Authorities are not sure if this is needed given they have already undertaken a TADAT assessment.
- **Assessing the implementation of revenue strategy**. They are not sure whether IMF TA was needed.

10. The RBM conveyed the following comments:

- **The RBM needs guidance on optimal sequencing for transitioning to inflation targeting.** Appropriate absorption, application and internalization of the policy analysis and forecasting work will be key in this process. Continued advances in FPAS is their key priority in this respect. It is already yielding good outcomes and is key for the RBM's desired transition to an interest rate based monetary policy. Data deficiency is a key weak link, but RBM is working closely with the new NSO leadership to address the issue.
- **The adoption of a more flexible and forward-looking monetary policy framework has implications for monetary conditionality in subsequent Fund-supported programs.** The Reserve Bank therefore needs guidance on the shift to a review-based monetary conditionality.
- **Consolidated supervision is another key priority**. Pan African banks (Standard, ECO Bank) are becoming ever more prevalent in Malawi while Malawian banks are also evolving into Pan African banks (e.g. NBM, FMB). Holding companies like Press and Nico also increases the need for consolidated supervision.
- **Macroprudential**. Training on this has just started and linking this with monetary policy is the key challenge. Courses alone are not effective. However, when coupled with attachments/secondments (boots on the ground), courses can enhance knowledge transfer.

Peer learning (including through the Norges bank-IMF program) was particularly useful in the area of financial stability.

- **Coordination**. The absence of an effective mechanism for sharing data with the Treasury is the major impediment to further developing the liquidity forecasting framework.

Appendix I. Letter of Intent

April 13, 2018

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

Dear Madame Lagarde:

1. Despite severe shocks, we stabilized our economy with our economic policies and reform program supported by the External Credit Facility (ECF) arrangement during 2012-17 and successfully completed a financial arrangement with the International Monetary Fund (IMF). Chronic shortages of foreign exchange and fuel were addressed through exchange rate liberalization and an automatic fuel-price mechanism. Inflation was curbed near the end of the program. Structural reforms, especially in public financial management, helped restore confidence in the budget. In particular, we managed to fully reconcile the government cashbook with the bank account, which was a crucial step towards stronger public finance. Significant progress was also made in resolution of legacy problems including arrears and weak banks. The program, however, fell short of delivering on poverty-reducing and inclusive growth objectives.

2. Looking forward, we are committed to addressing these unfinished tasks while safeguarding the hard-won gains achieved so far. To this end, we prepared and adopted Malawi Growth and Development Strategy (MGDS) III. The strategy aims to build up productivity, competitiveness, and resilience of our nation through growth-enhancing investment and economic diversification.

3. In order to achieve these objectives, on behalf of the Government of Malawi, we request a three-year arrangement in an amount equivalent to SDR 78.1 million (or 56.25 percent of quota) with the IMF under the ECF arrangement for the period 2018–21. We also request that the first disbursement, in an amount equivalent to SDR 11.15 million be made available after approval of the ECF arrangement by the Executive Board of the IMF. The macroeconomic program supported by the ECF arrangement 2018–21 will provide a macroeconomic framework to underpin MGDS III, including by linking MGDS III's flagship projects with credible fiscal strategies.

4. The objective of this program is to (i) entrench macroeconomic stability; and (ii) enhance more inclusive and resilient growth. Key supporting measures include increased spending on infrastructure and social sectors; tackling governance challenges; improving financial intermediation; and advancing structural reforms. The attached Memorandum of Economic and Financial Policies (MEFP) lays out the key reforms and macroeconomic adjustment to be implemented under this program. To monitor progress in implementing them, a set of periodic and continuous performance criteria, indicative targets, prior actions, and structural benchmarks are outlined in the MEFP and the Technical Memorandum of Understanding (TMU).

5. While MGDS III lays out ambitious goals for infrastructure projects, we are committed to ensuring their consistency with debt sustainability. In particular, we will ascertain that new loans are concessional and accompanied by solid feasibility studies from trusted sources. In the event of an exceptional case, based on its extraordinary merits (e.g., growth-criticality), we will first discuss the loan with the IMF and the World Bank and seek explicit agreement from the IMF by presenting our case accompanied by high-quality fiscal measures that offset the debt impact of the non-concessional portion of the loan.

6. We are confident that the policies contained in the attached MEFP are adequate to achieve the objectives of our program, but we will take any further measures that may be needed to attain these objectives. The government of Malawi will consult with the Fund staff on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with Fund policies on such consultations. Malawi will provide the Fund staff with any information that may be necessary for monitoring the implementation of the measures to achieve program objectives.

7. The Government of Malawi authorizes the IMF to make this letter and the attached MEFP and TMU, as well as the related Staff Report available to the public, including through the IMF internet website.

Yours sincerely,

/s/	/s/
Mr. Goodall Gondwe Minister of Finance, Economic Planning and Development	Dr. Dailitso Kabambe Governor of the Reserve Bank of Malawi

Attachments:

1. Memorandum on Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

April 12, 2018

RECENT ECONOMIC DEVELOPMENTS

1. **Malawi's economy has rebounded from two consecutive years of weather-related shocks.** Since 2012, Malawi's economy faced numerous challenges, including the adverse effects of drought and past policy slippages. Nevertheless, we reined in high inflation and raised growth.

- Growth rebounded in 2017 and is estimated to have reached 4 percent from 2¼ percent in 2016. In part, this is due to a strong maize harvest following good rains early last year. The upswing of tobacco prices, disinflation, and stability of the kwacha also boosted households' confidence and purchasing power.
- After declining for 17 straight months to a historic low, headline inflation rose slightly to 8.1 percent in January 2018. The increase was largely driven by a sharp rise in food prices and a statistical boost from an increase in the weight of non-food in the new Consumer Price Index (CPI). On an annual average, inflation fell from 21.7 percent in 2016 to 11.5 percent in 2017. This decline was led by food prices which fell three times faster than non-food prices.

2. **While we regained control over the budget during FY 16/17, this proved challenging during FY 17/18.**

- Revenue collection increased by almost 2 percentage points of GDP in FY 16/17 owing to the implementation of IMF tax policy recommendations expanding the coverage of VAT and eliminating several exemptions, as well as a one-off revenue mobilization of capital gains tax. At the same time, spending control was firmed up. For example, detailed monthly fiscal reports from all spending units were required as a condition for the subsequent month's funding. We also implemented reforms to better target the farm input subsidy program (FISP) including reducing the number of recipients from 1.5 million farmers to 900,000.
- Budget management in FY 17/18 faced challenges with the deficit now projected to exceed the original budget by around MK139 billion (3.2 percent of GDP) – net of MK51 billion in measures elaborated in paragraph 24. Tax revenues are expected to fall short of the programed amount by MK62 billion as power outages are weighing on economic activity

and customs collection has been weaker than anticipated. Realized grants were also lower than programed in the budget by about MK14 billion. The unexpected MK45 billion bailout of ADMARC's maize purchase loan, arrears payments of MK58 billion, as well as wage increases, a jump in goods and services spending, and higher than anticipated interest bills (together about MK20 billion) added to budget pressures.

3. **The arrears (dating back to FY 12/13) are being addressed.** The Auditor General recently completed audit verification of around MK317 billion domestic arrears that were generated during July 2012-June 2017. Through this exercise, MK198 billion were certified for payment while the remainder failed the verification. About an additional MK42 billion were disputed in court and/or eventually certified by the Attorney General, bringing the total required payment for arrears to MK240 billion. As of end-December 2017, around MK224 billion of these arrears had been securitized through the issuance of zero interest promissory notes, leaving MK16 billion of certified arrears, interest, and legal fees to be settled.

4. **To avoid accumulation of new arears, we have tightened commitment controls.** We have established a commitment control system to track the stock of commitments and plan to operationalize it by end-June 2018. In addition, sanctions are in place against controlling officers of ministries, departments, and agencies (MDAs) that fail to submit monthly reports.

5. **Over the past few months, we maintained a tight monetary policy stance by keeping short-term money market rates positive in real terms**. The interbank rate is now closely aligned with the policy rate and remains within our corridor system that was introduced in early 2016. RBM's increasingly active use of open market operations (mainly repo) as well as improvements in the deposit auction facility have helped reduce interbank rate volatility.

6. **Monetary policy successfully aligned short-term money market rates with the policy rate.** The Monetary Policy Committee reduced the policy rate by 600 basis points to 16 percent during 2017 in response to a trend decline in nonfood inflation. Average bank lending rates fell in line with the decline in the policy rate, but real private sector credit growth was negative due to limited demand, high real interest rates, and tighter lending conditions.

7. **The banking system remained stable though vulnerabilities rose.** On aggregate, the banking system remained well capitalized and profitable. Two banks were recapitalized last year, with one of them being acquired by a reputable bank. As of December 2017, two banks were at the borderline of the minimum core capital requirement. We are working closely with these two banks to correct this situation through several remediation measures, including by giving weak

banks deadlines to reduce their non-performing loans (NPLs) and improve their business models. NPLs declined by 1.3 percentage points to 15.7 percent of total loans in 2017 due to write offs and extensive recovery efforts, particularly during the period September to December 2017.

8. **The Kwacha has remained stable against the US dollar since December 2016**. This reflects the success of our monetary policy, overall favorable balance of payment developments, and gradually improving confidence in the economy. The premium between the rate of the RBM and foreign exchange bureaus remained small. Taking into account developments in our main trading partners, the real effective exchange rate appreciated (on average) by about 2.5 percent in 2017 after depreciating by 13 percent in 2016.

PROGRAM OBJECTIVES AND KEY ELEMENTS

9. **A window of macroeconomic opportunity has re-opened.** Disinflation has reached its goal and gains in economic growth need to be continued. However, shocks can easily trigger a reversal of these gains, and there is a need to deliver on inclusiveness and resilience of growth.

10. **The Malawi Growth and Development Strategy III (MGDS III) aims to build a productive, competitive, and resilient nation.** These objectives will be pursued by stepping up investment in priority sectors, maintaining a sound macroeconomic framework, and improving governance. More specifically, our goal is to maintain single digit inflation and achieve at least 6 percent growth by 2022. We also aim to substantially reduce poverty and improve human development—including addressing challenges in gender issues.

11. **Responsible fiscal and monetary policies combined with structural reforms will be key to achieving our growth and development goals.** Entrenchment of price stability, adherence to a responsible fiscal strategy, and advancing public financial management (PFM) and structural reforms will support further improvements in confidence. In particular, narrowing of infrastructure gaps—including reducing power shortages and improving irrigation—will be critical to fostering confidence and growth.

12. **To this end, we are committed to implementing a strong and ambitious economic program:**

- *Reinforcing macroeconomic stability and preserving hard-won gains from the previous economic program.* We will build external buffers against shocks given Malawi's weather-related vulnerabilities and sensitivity to changes in international commodity prices. We will also strengthen our fiscal position to build buffers, help contain inflation, and maintain a sustainable debt position. Specifically, we will contain budgetary financing needs and avoid accumulating domestic and external arrears.

- *Increasing targeted spending on infrastructure and social development to raise growth potential, while preserving macroeconomic stability.* We will prioritize key infrastructure projects while maximizing the grant element of external borrowing to maintain debt sustainability. Social spending (relative to GDP) will be maintained and gradually increased in line with growth and improvements in spending efficiency and capacity.

- *Strengthening public finance and debt management.* We will bolster trust in the budget process with enhanced transparency, strengthening the medium-term budgetary framework and cash management, and routinizing bank reconciliation. We will also move to the next phase of reforms (e.g., procurement).

- *Undertaking growth-enhancing structural reforms.* Our reforms will focus on catalyzing economic transformation including in agriculture and manufacturing.

13. In order to achieve these objectives, we request a three-year arrangement in an amount equivalent to SDR 78.1 million (or 56.25 percent of quota) with the IMF under the ECF arrangement for the period 2018–21.

ECONOMIC OUTLOOK AND POLICIES

A. Economic outlook

14. **We expect real GDP growth to reach 3-5 percent in 2018.** Growth will be driven by the non-agricultural economy, tobacco production and exports, and investment in infrastructure. Agricultural growth is anticipated to be weaker than last year due to weak crop yield for the 2017/18 maize growing season (effects of armyworm infestations and dry spells). Growth prospects are also constrained by weak rural purchasing power, increases in electricity tariffs, and delays in recovery of power generation. Although food prices may increase given weak maize production, tight monetary conditions and continuing disinflation on most other non-food items should help contain inflation by end-2018.

15. **Improvements in the business environment should underpin confidence.** Over the medium-term, declines in lending rates, closer to inflation, should support recovery of private

investment. This, combined with the present stabilization and reform programs (including those to improve competitiveness) will solidify confidence, support inclusive growth, and spur economic diversification. A concurrent flow of investment is expected to unlock our economy's potential for higher and more sustained growth and employment—including capitalizing on our young and dynamic population.

16. **In light of these, we expect real GDP growth to gradually increase to around 6 percent in the medium term.** Inflation at end-2018 is expected to reach 9 percent and, over the medium-term, our objective is to reduce inflation to around 5 percent. A prudent fiscal stance over this period will also improve the sustainability of our debt position, and we expect domestic debt as a share of GDP to be placed on a declining trend over the medium term to below 50 percent.

17. **Short-term risks are tilted to the downside.** Malawi's agriculture-driven economy is extremely vulnerable to weather and pest shocks. Our growth projections assume that the present weather situation does not further deteriorate agricultural production prospects and losses can be contained by our response programs. Food security should be preserved by the substantial food reserves accumulated, and we are closely monitoring the situation. Fluctuations in foreign exchange revenue, including tobacco export prices and short-term capital flows as well as reduced donor flows could induce stress on the exchange rate. A slower than expected disinflation process could raise interest rates, increasing the government’s interest bill and hampering access to finance. Policy slippages remain a risk in the run-up to the 2019 elections. On the upside, better than expected harvests and higher than expected commodity prices could boost medium-term growth.

B. Monetary and Financial Sector Policies

18. **Monetary policy will focus on entrenching disinflation**. It will aim to maintain the inflation rate in single digits by end-2018 while keeping real interest rates positive. During the current disinflation cycle, we have maintained caution in policy rate decisions to fend off an inflation reversal. We will continue to exercise the same caution to firmly anchor inflation expectations. Should inflationary pressures gain momentum, monetary policy will be tightened (with the exception of liquidity provision to banks facing liquidity challenges). We will keep interbank rates within the corridor and concentrate on a few tenors in our repo operations.

19. **We will complete the transition to an interest rate-based operational framework and aim to adopt inflation targeting over the medium-term**. To this end, we will continue to

improve primary and secondary market operations to further strengthen monetary policy transmission. We will develop a monetary policy communication strategy aimed at improving communication with all stakeholders and the public to raise policy credibility. Supported by greater fiscal discipline, our policy framework and execution will be sufficient to anchor inflation expectations. We will continue to expand capacity in liquidity forecasting and the forecasting and policy analysis system (FPAS) modeling. To this end, development of high frequency data and a deeper understanding of the monetary transmission mechanism will be key.

20. **Financial sector stability will continue to be safeguarded**. By end-2018, all banks are expected to comply with IFRS9 standards, which went into effect in January 2018. We will ensure that directives related to IFRS9 are gazetted by April 2018 and that most banks reduce their NPLs to around 5 percent through recovery or write-offs by end-2018. Provisioning will also be increased under IFRS9 and all banks should be fully compliant with IFRS9 provisioning standards by end-2018. To reduce the time required to recover collateral associated with NPLs, we will encourage banks to improve analysis of collateral quality, including establishment of a collateral registry. To improve banking system efficiency, we have taken measures to reduce the banking system's overhead costs. For example, we established the credit referencing system and the national ID registry which should facilitate banks' credit risk assessment. Moreover, with the decline in T-bill rates during the latter part of 2017, banks that have been relying on government securities for their profit margins will be forced to adopt more efficient business models that reduce the interest rate spread. To address loan concentration risks, we will continue close monitoring, surveillance of large borrowers, and enforcement of the single borrower exposure limit. We have drafted regulations aimed at enhancing the consolidated and Domestic Systemically Important Banks supervision that will be effective as of end-2018. We note that bank lending in foreign currency has been rising. We will remain vigilant in this regard, and ensure that all banks meet the net open position requirement and that lending in foreign currency is made particularly to clients with sources of foreign currency earnings. We will ensure that money market funds do not undertake deposit-taking activities.

21. **New initiatives are gradually being implemented.** A concept for a deposit insurance scheme was approved by the Cabinet in January 2018. However, we will ensure that vulnerabilities in the banking sector are reduced before we enact the bill. We will also strive to strengthen our asset declaration system and use of AML/CFT tools to reduce corruption. We are working on regulations related to the revised AML/CFT framework that was enacted in 2017, and plan to gazette them by end-2018. We will formulate a roadmap for increasing access to finance (especially for small and medium size enterprises (SMEs)) and are already engaging the financial

sector to improve their credit provision to SMEs. We will focus on developing skills in the banking sector and increasing financial literacy amongst the population. We will further improve financial infrastructure, including facilitating mobile banking infrastructure and increasing non-bank financial intermediation. Finally, we will increase protection of creditors' and borrowers' rights by improving contract enforcement.

22. **We will keep strengthening the regulatory framework of the financial system**. To this end, we will re-submit to Parliament, before end-June 2018, amendments to the Banking Act of 2010 and Financial Services Act of 2010 for eventual enactment. These amendments, which were informed by IMF technical assistance recommendations, will align the legal framework for bank resolution closer to 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. The Directive on Licensing and Regulation of Holding Companies will take effect in April 2018 and the guidelines on Islamic Banking were approved in October 2017. As an effort to operationalize the Payment Systems Act, which passed the Parliament in June 2016, the RBM is preparing the Interoperability Directive, which seeks interconnectivity between all retail payment solutions. The RBM is also preparing a Minimum Capital and Solvency Directive for Life Insurance Companies which will raise their minimum capital requirement.

23. **We are fully committed to the floating exchange rate regime.** We see this as a fundamental precondition for the success of our economic policies as it cushions shocks and supports economic diversification.

C. Fiscal Policy

24. **Our fiscal policy stance will support disinflation and help maintain debt sustainability**. To this end, we will contain spending within available resources, avoid accumulation of domestic and external arrears, limit non-concessional borrowing, and limit the government's recourse to domestic borrowing—particularly from the RBM. In particular, the RBM Act will be aligned with the PFM Act (applying the suggestions of the IMF Safeguards Assessment) to eliminate avenues of RBM financing of the central government (except what is needed for cash flow management). We will submit these amendments to the Parliament by mid-April 2018. Continued implementation of prudent fiscal policies in the near- and medium-terms is necessary to keep the public debt-to-GDP ratio on a downward trajectory and prevent both crowding out of the private sector as well as debt service costs replacing productive government expenditure. In line

with these considerations, we have deployed strong remedial measures to correct the unprogrammed widening of the FY 2017/18 budget deficit. The measures underpin the mid-term revised budget which envisages cutting budgeted expenditures by MK51 billion – mainly reducing development spending to better reflect implementation capacity and cuts in goods and services spending.

25. **The FY 2018/19 budget will aim at entrenching macroeconomic stabilization**. For this, we will aim to raise the primary fiscal balance to about 0.1 percent of GDP from -3.0 percent of GDP in FY 17/18. Important measures will cover revenue and spending, though our emphasis will be on containing expenditures and improving their quality given that Malawi's revenue collection is above the median for Sub-Saharan Africa. These measures and other spending plans are outlined below:

- We will explore tax policy measures such as such as progress in repealing the industrial rebate scheme and discontinuing granting of tax holidays.
- We will also continue strengthening tax administration—particularly our risk-based approach to tax compliance through increased analysis of data, enhancing the tax registry, stiff penalties on malpractice of the use of EFDs, and phased adoption of an integrated tax administration system (ITAS).
- To accommodate upcoming national elections (June 2019), the budget for election-related spending will be raised.
- The wage bill will increase substantially reflecting the hiring of two cohorts of new teachers to restore our pupil to teacher ratio to 60. Wages will also be increased by about 10 to 15 percent (in line with inflation).
- The maize procurement budget will be cut back significantly (with the extraordinary needs in FY 2017/18 dissipating) and reforms to the FISP will be sustained.
- Non-essential recurrent expenditures will be strictly limited.
- We will close out our arrears clearance program by completing the verification of old arrears and writing off all unsubstantiated arrears that are more than 2 years old.
- Social and domestically financed capital spending will be safeguarded and budgeted to keep pace with implementation capacity.

- We will also keep enhancing oversight of parastatals—particularly ADMARC, ENGENCO, ESCOM, and the water boards—for example through regular publication of audited financial statements.

26. **Over the medium-term, we are committed to implementing broad-based tax reforms to foster a simple, efficient, transparent, and fair tax system**. To this effect, we will continue to streamline tax incentives, fully repeal the industrial rebate scheme, introduce a thin capitalization or earnings stripping rule, and redesign turnover taxation to increase its effectiveness. 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. Furthermore, certain measures that have resulted in significant revenue loss shall be reverted such as the VAT exemption on cooking oil.

27. **Our medium-term budgeting plans include enhancing the composition and quality of government spending, while containing fiscal slippages.** The medium-term strategy includes shifting the composition of public investment towards pro-growth and poverty-reducing expenditures. With high development needs and limited fiscal space, raising efficiency of spending in priority areas such as social spending will be at the core of our medium-term budgeting plan. To do so, we shall put into place measures to enhance the allocation mix of health and education budgets (for instance, increasing the budget share of secondary and tertiary education), improve fiscal transparency and accountability at national and sub-national levels, strengthen program based budgeting, and engender efficiency in frontline service delivery. These measures shall be accompanied by containing fiscal slippages, avoiding out of budget expenditures (e.g. in goods and services), limiting wage increases to the inflation rate, avoiding commitment for non-essential recruitments, and reforms to the FISP. We will also develop a plan to address the challenges involved in the current decentralization process. This will include addressing issues of capacity and controls at the local level and eventually adopting a legal framework for budget systems and fiscal policy coordination.

D. Public Financial Management Reform

28. **Our recent success in achieving bank reconciliation establishes a strong foundation for expanding public financial management reforms**. Bank reconciliations will be routinized going forward as a key pillar of fiscal transparency and accountability. We will also resolve other related statistical issues such as reconciling debt data between the Ministry of Finance (MoF) and RBM. We have started strengthening other areas such as the creation of a more reliable

system for budget control and reporting. Introducing the requirement for MDAs to submit five fiscal reports for monthly funding release proved critical for improving control and accountability; and we will further strengthen the quality control of these reports (including strengthening sanctions on controlling officers in MDAs for misreporting or non-compliance) and publish them on the MoF website. Given its strategic importance in expenditure control and arrear prevention, we will set-up an online commitment control system and link the HRMIS and IFMIS systems. Having adopted a commitment template that unifies data coverage and definition (at the MDA level), we will now compile and publish consolidated monthly statements of the government's commitments on the MoF website. We will also classify bills which are overdue for more than 90 days. More systematic commitment control will enable timely detection of arrears and sanctioning of control officers who incurred them without approval of the Minister of Finance.

29. **The success in bank reconciliations also enables us to improve our financial reporting**. We intend to produce quarterly certified consolidated financial statements within six weeks after the end of the quarter with fully reconciled items. In the same vein, we will produce and publish on the MoF website monthly budget execution reports by vote and economic classification based on actual expenditure and not funding. With these, we are confident that the 2018/19 financial statements will be submitted to the Auditor General by 31st October 2018 (as required under the Public Finance Management Act) with fully reconciled bank accounts. Timely reporting will mean that Parliament will 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, and 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—including preparation of monthly cash forecasts of the next twelve months. We will also introduce a Treasury Single Account (TSA) and bring all bank accounts into IFMIS. We will cut the number of bank accounts in commercial banks in half by end-June 2018, close another quarter of the remaining accounts by end-September 2018, and merge the remaining commercial bank accounts under the TSA by end-December 2018. Lastly, we are also going to put together a time-bound action plan for replacing IFMIS and requiring all financial transactions be recorded in the current and new IFMIS.

30. **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 medium-term performance and efficiency of our budget by better linking MDA strategic planning and budgeting, improving the credibility of the Medium-Term Expenditure Framework, and strengthening the framework for engaging key stakeholders. Building on the enactment of a new Procurement Act, which closes various loopholes under the old act, we intend to improve our procurement framework continuously, to enhance transparency, control, and accountability. We will start by publishing all procurement information on the MoF website. We will also use the performance contract with controlling officers to hold them accountable for adhering to relevant rules and procedures and strengthen procurement audits. Over time, we will consider gradually moving to an e-procurement system.

E. Structural Reforms

31. **MGDS III envisages a significant improvement of Malawi's business climate**. The objective of building productivity and competitiveness will require unlocking private sector potential by paying due attention to the sector's grievances and suggestions for reform. We continued to make progress in business-enabling reforms with the most recent milestones including:

- Establishing a new credit reference bureau;
- Adopting a new law that establishes clear priority rules inside and outside of bankruptcy procedures;
- Adopting a web-based customs data management platform; and
- Halving the fees charged by the Blantyre city council to process building plan approvals.

32. Building on these quick wins, we will continue to improve the business environment, including easing procedures to start a business and deal with construction permits, strengthening contract enforcement, and enhancing insolvency processes.

33. We will implement deep reforms in agricultural regulations and market intervention systems, agricultural subsidies, and land management systems:

- ***ADMARC:*** We commissioned a comprehensive strategic review of ADMARC (Agricultural Development and Marketing Corporation). Based on this review's findings, we will implement a deep reform program to better balance maize price stabilization against fiscal sustainability and improve transparency and efficiency in this area.
- ***Control of trade:*** We will align our export and import control systems with the WTO norms including by amending the Control of Goods Act.
- ***FISP:*** We will continue FISP reform, focusing on containing its budget impact, an increased role for the private sector, better governance, and better beneficiary targeting.
- ***Land reform:*** We will start implementing new land codes based on lessons learned from our pilot programs.

F. Debt Management

34. **Malawi is classified as being at moderate risk of debt distress based on its external position but domestic debt vulnerabilities have risen**. We will limit our unified external borrowing to high priority projects which are in line with the MGDS III and ensure that total debt (and guarantees) contracted is consistent with debt sustainability. While MGDS III lays out ambitious goals for critical infrastructure projects, we are committed to ensuring that their financing preserves debt sustainability. Therefore, we will improve investment planning—including rigorously prioritizing the MGDS III pipeline projects based on credible cost/benefit analyses, growth, poverty-reduction, and debt sustainability considerations.

35. **The Debt Management Committee is operational and will assess any borrowing.** We will develop a comprehensive medium-term debt strategy. The committee will ascertain loan concessionality and ensure debt sustainability taking into consideration the entire borrowing plan and the medium-term debt strategy. Borrowing in the FY 18/19 budget will be consistent with our objective of social development and poverty reduction and with overall medium- to long-term debt sustainability. We will ascertain that new loans are, in principle, concessional and accompanied by solid feasibility studies from an independent third party. In the event of an exceptional case, based on its extraordinary merits (e.g., growth-criticality), we will first discuss the loan with the IMF and the World Bank and seek explicit agreement from the IMF by presenting our case accompanied by high-quality fiscal measures that offset the debt impact of the non-concessional portion of the loan. We will further improve our debt monitoring by allocating sufficient resources and increasing training.

G. Pension Reform

36. **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. 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.

37. **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.

H. Fuel Import Regime

38. **We are taking necessary steps to improve our fuel security situation.** We completed construction of three fuel storage depots capable of holding about 25 percent of annual consumption. Upon the completion of the new facilities, we introduced guidelines for their operation which clarifies the framework for collaboration between the storage operator and fuel importer or distributors. While at an experimental state, the framework has been running well so far, with fuel importers integrating the facilities as a part of their logistics chain and the augmented storage cost fully passed on to the pump price. Since 2013, our fuel import regime had been based on private sector imports with cost recovery guaranteed by the automatic fuel pricing mechanism. From 2017, fuel imports are done jointly by a traditional private sector consortium (PIL) and NOCMA, based on their agreement.

39. **The present fuel import regime will remain unchanged for the 2018/19 fiscal year.** However, we will continue to evaluate the balance of security and efficiency under the current regime as more experience is gained. Given the importance of safeguarding governance risks in the sector, any further change in the fuel import regime or operation of the facility will be done in an open and transparent manner, with full private sector participation. We will produce, publish, and discuss with all stakeholders a fully-costed and well-thought out proposal for any

change prior to implementation. We remain committed to retaining and implementing the fuel price automatic adjustment mechanism, which enables full cost recovery by fuel importers while precluding government subsidy.

I. Gender Equity

40. **We take note of the importance of addressing gender inequity in achieving inclusive growth**. Gender disparities hinder economic growth by impeding full realization of Malawi's human resource potential and aggravate economic exclusion, making it harder for women to escape from poverty. Policy interventions will continue to focus on adolescent girls given the high potential impact of breaking the cycle of deprivation at an early stage of life.

- ***Ending child marriages:*** Last year's constitutional amendment to raise the minimum age for marriage from 15 to 18 was a critical first step. In addition, we plan to develop a comprehensive national program of action which will entail multifaceted strategic interventions—from social protection, to law enforcement, to health (particularly sexual and reproductive health), child protection, and public education.

- ***Keeping girls in school:*** We will continue to facilitate larger and more effective investment on classrooms, teachers, and education materials. We will also broaden our demand side interventions (e.g., more social assistance and targeted subsidy programs; which would be gender-sensitive).

- ***Assets and credit.*** Given the significance of a matrilineal system of land inheritence in Malawi, we are commited to the formalization of customary land rights that are key to women's access to finance. Policy interventions for access to finance, including gender neutral ones, will further help level the playing field.

- ***Labor market policies.*** We will consider non-gender-neutral policy options (e.g., childcare support) to help increase women's labor market participation.

PRIOR ACTIONS AND STRUCTURAL PROGRAM FOR 2018

41. **The macroeconomic policies supported by the ECF arrangement will be complemented by a strong structural program, which will make the transmission of economic policy more efficient.** The Prior Actions (Table 2) signal our commitment to a strong reform agenda, while the Structural Benchmarks for 2018-19 (Table 3) seek to reform key sectors of the economy.

Prior Actions

To be completed before program request goes to IMF Executive Board

- Publish detailed monthly budget execution data by vote and economic classification (main aggregates) on the MoF website.
- Complete verification of arrears from July 1, 2012 – June 30, 2017 certified by the Auditor General.
- A commitment that all domestic arrears prior to December 31, 2015, which are not certified by the Auditor General (MK 113 billion), will only be paid if required by law or a court verdict. This will be communicated to the Fund via letter.
- Reconcile all bank accounts MG1 and the operating accounts (excluding salary accounts) and ways and means for July 1, 2016-June 30, 2017 transactions signed by the Accountant General and Secretary to the Treasury.
- Complete the audit of FY 2016-17 financial statements, and submit them to the Parliament.

Structural Benchmarks and Program for 2018

Fiscal Sector

- Submission of five reports by the MDAs by mid-following month and publication of their summaries on the MoF website. Maintain/strengthen sanctions on MDAs for misreporting/non-compliance (continuous).
- Set-up and maintain a transparent commitment control system for all MDAs, compile the consolidated commitments of the government centrally by the MOF by the end of the following month and place it on the MoF website. Also classify the bills, which are overdue for more than 90 days. Apply sanctions to the controlling officers of the MDAs by the ST for incurring arrears without approval of the Minister of Finance (continuous).
- Prepare quarterly consolidated financial statements (including all MDAs) with fully reconciled bank accounts and publish within six months after the end of each quarter in the first year and within 90 days after the end of each quarter in the second and third. The financial statements should be certified by the Auditor General (continuous).

- Reconcile all bank accounts MG1 and seven operating accounts and ways and means transactions within 90 days after the end of each month signed by the Accountant General and Secretary to the Treasury. The reconciliation should clear all the backlog and have a track record of three consecutive months (continuous).

- Reconcile all debt data between the MOF and RBM (continuous).

- Prepare monthly cash forecasts (broken down by economic classification) of the next 12 months based on input from all MDAs (end-June 2018).

- Adjust the bank reconciliation of FY 2013-14 – 2014-15 based on the findings of forensic audit of MK236 billion and adjust the opening and closing balances of the bank reconciliation of FY 2015-16 (end-June 2018).

Financial Sector

- Submit to Parliament amendments to the RBM Act which are in line with the recommendations of the IMF Safeguards Monitoring Report, dated 6 June 2016 (end-October 2018).

- Develop a monetary policy communication strategy (end-June 2018).

PROGRAM MONITORING

42. **The program will be monitored on a semi-annual basis, through quantitative targets (Table 1) and structural benchmarks (Table 3).** Quantitative targets for end-June and end-December 2018 are performance criteria while those for end-September 2018 and end-March and end-June 2019 are indicative targets. The first review under the program will be completed any time after October 15, 2018. The second review will be completed any time after April 15, 2019.

Table 1. Quantitative Targets, 2018-19[1]

	Target type [2]	2018			2019	
		End-Jun.	End-Sept	End-Dec.	End-Mar.	End-Jun.
		Prog.	IT	Prog.	IT	IT
I. Monetary targets (millions of kwacha)						
Reserve money (ceiling on stock) (upper bound)[3]	PC	303,482	299,091	323,385	300,406	340,106
Reserve money (ceiling on stock)[3]		294,643	290,380	313,966	291,656	330,200
Reserve money (ceiling on stock) (lower band)[3]		285,803	281,668	304,547	282,906	320,294
II. Fiscal targets (millions of kwacha)						
Primary balance (floor)[4,5,6]	PC	-144,929	44,906	29,813	16,219	3,625
RBM financing of central government (ceiling)[6,7]	PC	69	0	0	0	0
New domestic arrears (ceiling)[6]	IT	0	0	0	0	0
Social spending (floor)[6,9]	IT	186,132	87,972	175,944	263,917	351,889
III. External sector targets (US$ millions, unless otherwise indicated)						
Net international reserves of the RBM (floor)[4,5,8]	PC	434.1	454.7	480.2	488.2	484.5
Accumulation of external payments arrears (ceiling)[6,10]	PC	0	0	0	0	0
New non-concessional external debt contracted (ceiling)[6,10]	PC	0	0	0	0	0
Memorandum items:						
Net foreign assets of the RBM (US$ millions, end of period)[6]		339.8	360.4	385.9	393.9	390.2
Budget support (US$ millions)[6]		84.3	79.1	79.1	79.1	79.1
Budget support (millions of kwacha)[6]		62,633.8	60,000.0	60,000.0	60,000.0	60,000.0
Nominal external concessional borrowing (US$ millions)[6]		166	35	70	104	137
Debt service payments to the World Bank and AfDB (US$ millions)[6]		13.4	3.8	7.5	12.1	16.7
Debt service payments to the World Bank and AfDB (millions of kwacha)[6]		9,994	2,851	5,821	9,538	13,337
Joint Fund on Health receipts (millions of kwacha)[6]		6,569	2,288	4,577	6,865	9,153
Joint Fund on Education receipts (millions of kwacha) [6]		6,987	4,325	8,651	12,976	17,301
Program exchange rate (kwacha per US$)		725	725	725	725	725

Source: IMF staff projections.

[1] Targets are defined in the technical memorandum of understanding (TMU).

[2] "PC" means Performance Criterion and "IT" means Indicative Target. The PC test date for the 1st Review will be end-June 2018. Test dates for future reviews will be end-June and end-December. End-September and end-March targets are ITs.

[3] PC applies to upper bound only. See TMU for details.

[4] Targets are subject to an adjustor for budget support and debt service payments, as specified in the TMU.

[5] Targets are subject to an adjustor 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] Targets are subject to an adjuster equivalent to 10 percent of previous year's tax revenue, as specified in the TMU.

[8] Defined as stocks.

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

[10] Evaluated on a continuous basis.

Table 2. Prior Actions

Measures	Macro Rationale	Status
Public financial management		
Publish detailed monthly budget execution data by vote and economic classification (main aggregates) on the MoF website.	Foster fiscal transparency and monitoring	Met
Complete verification of arrears from July 1, 2012–June 30, 2017 certified by the Auditor General.	Foster financial discipline	Met
A commitment that all domestic arrears prior to December 31, 2015, which are not certified by the Auditor General (MK 113 billion), will only be paid if required by law or by a court verdict. This will be communicated to the Fund via letter.	Foster financial discipline	Met
Reconcile all bank accounts MG1 and the operating accounts (excluding salary accounts) and ways and means for July 1, 2016-June 30, 2017 transactions signed by the Accountant General and Secretary to the Treasury.	Strengthen cash planning; reconciliation of accounts; and improving the integrity of the accounting systems	Met
Complete the audit of FY2016-17 financial statements, and submit them to Parliament.	Strengthen cash planning; reconciliation of accounts; and improving the integrity of the accounting systems	Met

Sources: IMF staff and Malawian authorities.

Table 3a. Structural Benchmarks (2018)

Structural benchmark	Target date	Macro Rationale
Public financial management		
Submission of five reports by the MDAs[1] by mid-following month and publication on the MoF website. Maintain/strengthen sanctions on MDAs for misreporting/non-compliance.	Continuous	Improve fiscal transparency; prevent accumulation of new domestic arrears
Set-up and maintain a transparent commitment control system for all MDAs, compile the consolidated commitments of the government centrally by the MOF by the end of the following month and place it on the Ministry of Finance website. Also classify the bills, which are overdue for more than 90 days. Apply sanctions to the controlling officers of the MDAs by the ST for incurring arrears without the approval of the Minister of Finance.	Continuous	Better control on all government commitments and arrears, if any.
Prepare quarterly consolidated financial statements (including all MDAs) with fully reconciled bank accounts and publish within six months after the end of each quarter in the first year and within 90 days after the end of each quarter in the second and third. The financial statements should be certified by the Auditor General.	Continuous	Improve fiscal transparency and integrity of the accounting system; routinize reconciliation of all bank accounts; strengthen cash planning.
Reconcile all bank accounts MG1 and seven operating accounts and ways and means transactions within 90 days after the end of each month signed by the Accountant General and Secretary to the Treasury. The reconciliation should clear all the backlog and have a track record of three consecutive months.	Continuous	Routinize reconciliation of all bank accounts; strengthen cash planning; improve the integrity of the accounting system
Reconcilie all debt data between the MOF and RBM.	Continuous	Enhance debt management; improve transparency and monitoring of public debt
Prepare monthly cash forecasts (broken down by economic classification) of the next 12 months based on input from all MDAs.	End-June 2018	Strengthen cash management; and timely implementation of the budget
Adjust the bank reconciliation of FY2013-14 – 2014-15 based on the findings of forensic audit of MK236 billion and adjust the opening and closing balances of the bank reconciliation of FY2015-16.	End-June 2018	Routinize reconciliation of all bank accounts; strengthen cash planning; improve the integrity of the accounting system
Financial sector		
Develop a monetary policy communication strategy	End-June 2018	Prepare for the eventual implementation of inflation targeting

Sources: IMF staff and Malawian authorities.

[1] Ministry, department, and agency.

Table 3b. Structural Benchmarks (2018-19) (concluded)

Structural benchmark	Target date	Macro Rationale
Public financial management [1]		
CMU undertakes variance analysis on forecasting errors [every three months], reports a summary as minutes of the meeting, [and takes actions to improve MDA submissions].	End-December 2018	Strengthen cash management; and timely implementation of the budget
Implement areas of biggest potential for enhancing efficiency, planning and allocation of public investment	End-December 2018	Improve efficiency of public investment
All domestic debt commitments, expenditures and payments, transacted through IFMIS in real time.	End-December 2018	Enhance debt management; improve transparency and monitoring of public debt
Develop a comprehensive medium-term debt strategy, including MoF preparation of a strategy for reducing reliance on borrowing from RBM (W&M Account). All domestic debt	End-December 2018	Improve debt management
Develop an action plan for updating IFMIS or aquiring a new IFMIS.	End-December 2018	Enhance cash management
Link the HRMS and IFMIS systems.	End-June 2019	Interconnectedness; internal control over transactions; and elimination of unnecessary duplications
Prepare and submit to the parliament an economic and fiscal policy statement, containing overall expenditure ceiling in the medium term derived from the combination of a fiscal policy anchor and macro-fiscal forecasts consistent with MEFP.	End-June 2019	Improve medium term budgeting; enhance fiscal discipline and planning
Create and update the budget legal framework dealing with decentralization and include a fiscal policy coordination framework	End-June 2019	Reduce risk of macro instability, improve efficiency of the public sector
Bring all TSA sub-accounts into IFMIS including projects, receipts and payments.	End-June 2019	Enhance cash management; achieve comprehensive coverage in IFMIS; and strengthen controls on bank reconciliation and reporting
Enhance oversight mechanisms over large SOEs (including ADMARC, ENGENCO, and ESCOM), publish audited annual financial statements and fiscal risk statement.	End-June 2019	Mitigate fiscal risks asscociated with SOEs; enhance transparency in financial performance and market operations
Financial sector		
Submit to Parliament amendments to the *RBM Act,* which are in line with the recommendations of the IMF Safeguards Monitoring Report, dated 6 June 2016.	End-October 2018	Preserve financial and debt sustainaiblity
Develop a roadmap for increasing access to finance.	End-December	Increase financial sector intermediation

Sources: IMF staff and Malawian authorities.

[1] These structural benchamarks may be revised, with a view towards streamlining, at the time of the first review.

Attachment II. Technical Memorandum of Understanding

April 3, 2018

INTRODUCTION

1. **This memorandum defines the quantitative performance criteria, benchmarks, and indicative targets for the program, as described in the Memorandum of Economic and Financial Policies (MEFP) for the period April 30, 2018-April 30, 2021** supported by the Extended Credit Facility (ECF) arrangement, and sets out the data reporting requirements.

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

QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

3. Quantitative performance criteria are established for June 30, 2018 and December 31, 2018 with respect to:

- Reserve money (ceiling);
- Net official international reserves (NIR) of the RBM (floor);
- Primary balance of the central government including grants, cash basis (floor);
- RBM financing of the central government (ceiling);
- Accumulation of external payments arrears(ceiling);
- New non-concessional external debt (ceiling).

4. Indicative targets for September 30, 2018, March 31, 2019, and June 30, 2019 with respect to the above variables, and for these dates as well as June 30, 2018 and December 31, 2018 with respect to:

- New domestic arrears (ceiling);
- Social spending (floor).

A. Targets for Monetary Aggregates

- Ceiling on the Stock of Reserve Money

5. **A ceiling applies to the upper bound of a reserve money band (set +/-3 percent) around a central reserve money target.**

6. **Definition.** Reserve money is defined as the sum of currency issued by the RBM, including the vault cash of commercial banks, and balances of commercial bank accounts with the RBM. It includes required reserves held for kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM.

7. **Reporting requirement**. Data on reserve money will be transmitted on a weekly basis. This transmission will include weekly balance sheet of the RBM which will show all items listed above in the definitions of reserve money.

B. Targets for Fiscal Sector

- **Floor on Primary Balance**

8. **A floor applies to the cumulative flow of primary fiscal balance since the beginning of the fiscal year.**

9. **Definition of the primary balance**. The program primary fiscal balance is measured from the financing side as the sum of net financial transactions of the central government – comprising the sum of net domestic borrowing, net foreign borrowing – less domestic and external interest payments.

10. **Definition of net domestic borrowing of the central government:** net domestic borrowing is computed as the sum of (1) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, promissory

notes, and holdings of treasury bills minus deposits); (2) net borrowing from commercial banks (including advances, loans, holdings of local registered stocks, government bonds and holdings of treasury bills minus deposits); (3) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (4) holdings of promissory notes. The treasury bills and locally registered stocks are valued at cost rather than face value. Transfers from extra-budgetary funds will not be considered revenues for this performance criterion. They will be treated the same as borrowing from the private sector (as their accounts are outside the definition of government) and therefore as domestic borrowing. Asset sales or privatization revenues will be accounted for under financing as a separate category, separate from domestic or foreign financing in calculating net domestic borrowing.

11. **Definition of net foreign borrowing of the central government**: net foreign borrowing is defined as the sum of project and program loans by official creditors (both multi- and bilateral creditors) and commercial external borrowing, minus amortization due. Dedicated grants should finance current spending, and be reclassified as project grants if used as foreign financed capital spending.

12. **Adjustors:**

- Adjustor on primary balance – budget support: The floor of primary balance will be adjusted upward by the full amount by which cumulative kwacha receipts from budget support exceed the program baseline. In the event of a budget support shortfall, the floor on primary balance will be adjusted downward by the amount subject to the limitation outlined in paragraph 13. The kwacha value of the cumulative shortfall (excess) will be calculated at the program exchange rate. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

- Adjustor on primary balance – donor accounts for the social sector (including Joint Funds on health and education, and agriculture and the NAC): The floor on primary balance will be adjusted upward by the full amount by which the donor inflows (in kwacha) from the U.S. dollar-denominated donor accounts for health, education, and other Joint Funds are higher than the donor inflows (in kwacha) to those accounts in the program baseline. In the event of a shortfall, the floor on primary balance will be adjusted downward by the amount subject to the limitation outlined in paragraph 13. Donor inflows are measured as receipts received (in kwacha) by the budget. Donor inflows are measured from the beginning of the fiscal year.

- Adjustor clause on primary balance – debt service payments: The floor on primary balance will be adjusted upward by the full cumulative amount by which debt service payments to the World Bank (WB) and the African Development Bank (AfDB) fall short of the program baseline. If the debt service payments are higher than the program baseline, the floor on primary balance will be adjusted downward by the amount subject to the limitation outlined in paragraph 13. The cumulative amount will be measured from the beginning of the fiscal year.

13. **The total downward adjustment to primary balance** from a shortfall, relative to the program assumptions, of (i) budget support, (ii) donor inflows to the donor accounts for the social sector, and (iii) an excess of debt service payments to the WB and the AfDB will be capped at US$65 million.

- **Ceiling on RBM Financing of the Central Government**

14. **Definition of RBM financing of the central government**. RBM financing of the central government is defined as net borrowing from the RBM by the central government (including ways and means advances, loans, holdings of local registered stocks, government bonds, promissory notes, and holdings of treasury bills minus deposits).

15. **Adjustors:**

- For cash management purposes, the ceiling on RBM financing of the central government for September 2018, December 2018, and March 2019 is subject to an upward adjustment of up to 10 percent of the previous financial year's domestic revenue (excluding grants).

16. **Reporting requirement**. Data on the RBM financing of the central government will be transmitted to the IMF on a monthly basis within 4 weeks from the end of the month.

- **Ceiling on New Domestic Arrears**

17. **Definition of domestic arrears:** Domestic arrears are overdue payment obligations of the central government other than external payment arrears, including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, principal payments on domestic loans, and tax refunds. Payments on wages and salaries, pensions, transfers, court-established obligations, and compensations are in arrears when they remain unpaid for more than 30 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date.

Payments for goods and services are deemed to be in arrears if they have not been made within 90 days of the due date, or – if a grace period has been agreed – within the contractually agreed grace period.

- **Floor on Social Spending**

18. **Definition of social spending**. Using functional classification of expenditure, social spending is computed as the sum of central government spending on health, education, and government social protection (comprising the government expenditures by the ministry of gender, children and social welfare and the ministry of disability and elderly affairs). In order to maintain Malawi's commitment and progress toward poverty reduction, the social spending allocations in the government budget will not be adjusted downward to meet fiscal targets of the program.

19. **Donor pool-funded expenditures in support of agriculture, health and education**: In support of the health and education sectors, some donors pool resources (the donor pool) in Joint Funds, which are being managed by a fiscal agent. These funds are released outside normal government procedures (i.e., recurrent budget or development Part I budget) to the relevant sector.

20. **Reporting requirement**. Financial flows into and out of Joint Funds will be reported on a monthly basis from the beginning of the fiscal year.

C. Targets for External Sector

- **Floor on Net International Reserves of the RBM**

Table 1 Cross rates for Nominal Exchange Rate and Gold Price for the 2018-21 ECF Arrangement

	31-Dec-17
Gold bullion LBM[1] US$/troy ounce	1,257.13
SDR to US$ exchange rate	0.707
Euro to US$ exchange rate	0.845
Yuan to US$ exchange rate	6.594
Yen to US$ exchange rate	112.950
Sterling UK to US$ exchange rate	0.746
Australian $ to US$ exchange rate	1.308
Canadian $ to US$ exchange rate	1.278
Swiss Franc to US$ exchange rate	0.987
Malawian Kwacha to US$ exchange rate	725.444

Source: IMF (International Financial Statistics) and Reserve Bank of Malawi.
[1] LBM connotes London Bullion Market.

21. **Definition of net international reserves (NIR) of the RBM:** The NIR of the RBM is defined as gross reserves minus IMF and other short-term liabilities. The values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the program cross exchange rates for the various currencies and then converted into kwacha using the program exchange rate for the U.S. dollar-kwacha exchange rate. The program exchange rates are stated in Table 1.

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

23. **Gross reserve assets include the following**: (i) monetary gold holdings of the RBM; (ii) holdings of SDRs; (iii) the reserve position in the IMF; (iv) foreign convertible currency holdings; (v) foreign currency denominated deposits held in foreign central banks, the Bank for International Settlements, and other banks; (vi) loans to foreign banks redeemable upon demand; (vii) foreign securities; and (viii) other unpledged convertible liquid claims on

nonresidents. It excludes the following: (i) any foreign currency claims on residents; (ii) capital subscriptions in international institutions; (iii) foreign assets in nonconvertible currencies; (iv) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (v) assets obtained through currency swaps of less than three months duration; (vi) gross reserves that are in any way encumbered or pledged, including, but not limited to: (a) assets blocked when used as collateral for third party loans and third-party payments, or pledged to investors as a condition for investing in domestic securities; (b) assets lent by RBM to third parties that are not available before maturity, and are not marketable; and (c) foreign reserves blocked for letters of credit.

24. **Gross reserve liabilities of the RBM** are defined as the sum of the following: (i) outstanding medium and short-term liabilities of the RBM to the IMF; (ii) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year; and (iii) all foreign currency denominated liabilities to residents (including, for instance, foreign currency denominated deposits of domestic banks and other residents with the RBM). SDR allocations are excluded from gross reserve liabilities of the RBM.

25. **Definition of budget support:** Budget support includes all grants and foreign financing not directly linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, such as financial support from the IMF, and donor inflows (in kwacha) from the U.S. dollar-denominated donor pool accounts for the Joint Funds on health, education, and agricultural, held in the Malawi banking system.

26. **Adjustors Applied to NIR Program Floor:**

- **Adjustment clause on NIR-budget support**: The program floor on NIR will be adjusted upward by the full amount by which the U.S. dollar-denominated inflows from the budget support exceed the program baseline. In the event of a shortfall in budget support inflows, the downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 27. The budget support is measured as the cumulative flow from the beginning of the fiscal year. They will be recorded in the original currency of payment and then converted to U.S. dollars using the above defined program cross exchange rates.

- **Adjustment clause on NIR-donor accounts for the social sector** (including health and education Joint funds, and the NAC). The floor on the NIR of the RBM will be adjusted upward by the full amount by which the donor inflows from the U.S. dollar-denominated donor accounts for Joint funds and NAC held in the RBM are higher than the program baseline. In the event of a shortfall, the downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 27. These donor inflows are measured as the cumulative receipts by the budget from the beginning of the fiscal year. They will be recorded in the original currency of disbursement and then converted to U.S. dollars using the above defined program cross exchange rates.

- **Adjustment clause on NIR-debt service payments:** The floor on NIR of the RBM will be adjusted upward by the full cumulative amount by which debt service payments to the WB and the AfDB fall short of the program baseline. In the event of any excess of debt service payments to the WB and the AfDB, the downward adjustment of the NIR floor will be subject to the limitation outlined in paragraph 27. Debt service payments will be measured as the cumulative payments from the beginning of the fiscal year. They will be recorded in the original currency of payment and then converted to U.S. dollars using the above defined program cross exchange rates. This downward adjustment of the NIR floor will be subject to the limitations outlined in paragraph 27.

27. **The total downward adjustment to the NIR floor** from the combined impact of a (i) a shortfall of budget support relative to the program projections; (ii) a shortfall of inflows to the donor accounts for the social sector relative to the program projections; and (iii) any excess of debt service payments to the WB and the AfDB relative to the program projections, will be subject to a cumulative limit of US$65 million.

28. **Reporting requirement**. Data on foreign assets and foreign liabilities of the RBM will be transmitted on a monthly basis, including sub-components and a breakdown of assets that are pledged or encumbered. This transmission will include daily and weekly data on RBM's foreign exchange liabilities to commercial banks (including required reserves with the RBM) and the exchange rate used for their conversion into kwacha will be shown separately.

- **Net Foreign Assets of the RBM**

29. **Definition of Net Foreign Assets (NFA) of the RBM**: The NFA of the RBM are defined as its gross foreign assets (GFA) minus its gross foreign liabilities. Gross foreign liabilities are equal to gross reserve liabilities as defined in paragraph 24, plus any other foreign liabilities not listed in that paragraph.

30. **Gross foreign assets (GFA) of the RBM are defined** as gross reserves assets as defined in paragraph 23, plus (i) any foreign currency claims on residents; (ii) capital subscriptions in

international institutions; (iii) foreign assets in nonconvertible currencies; (iv) transfers of foreign currency claims to RBM by other institutional units in Malawi just prior to reporting dates with accompanying reversals of such transfers soon after those dates; (v) assets obtained through currency swaps of less than three months duration; (vi) gross reserves that are in any way encumbered or pledged, including, but not limited to: (a) assets blocked when used as collateral for third party loans and third-party payments, or pledged to investors as a condition for investing in domestic securities; (b) assets lent by RBM to third parties that are not available before maturity, and are not marketable; and(c) foreign reserves blocked for letters of credit.

- **Ceiling on Accumulation of External Payment Arrears**

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

- **Ceiling on New Non-Concessional External Debt**

32. **Definition of debt**: The definition of debt, for the purposes of the TMU, is set out in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), and also includes contracted or guaranteed commitments for which value has not been received. For program purposes, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take several forms; the primary ones being as follows:

i. Loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchange of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the loan funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii. Suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

iii. Lease agreements, that is, arrangements under which the lessee is allowed to use a property for a duration usually shorter than that of the life of the property in question, but without transfer of ownership, while the lessor retains the title to the property. For the purposes of this guideline, the debt is the present value (at the inception of the lease) of all the lease payments expected for the period of the agreement, except payments necessary for the operation, repair, and maintenance of the property.

33. **Definition of non-concessional external debt.** Short-, medium-, and long-term debt is considered concessional if it includes a grant element of at least 35 percent[1] and non-concessional if otherwise. The grant element is defined as the difference between the nominal value of the loan and its present value, expressed as a percentage of the nominal value of the loan. The present value of the debt at the date on which it is contracted is calculated as the discounted sum of all future the debt service payments at the time of the contracting of the debt.[2] The discount rate used for this purpose is 5 percent per annum. The ceiling on non-concessional debt applies to the contracting and guaranteeing of debt with nonresidents by the central government, the RBM, and state-owned enterprises, unless an explicit selective exclusion is made. This performance criterion is monitored on a continuous basis. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

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

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

36. **Excluded from the limit on non-concessional external debt** is the use of IMF resources, and any kwacha-denominated treasury bill and local registered stock holdings by nonresidents. Excluded from the limit are also (i) debts classified as international reserve liabilities of the RBM; (ii) new debt issued to restructure, refinance, or repay existing debt up to the amount actually

[1] The IMF website gives an instrument (link hereafter) that allows the calculation of the grant element for a wide range of financing packages: http://www.imf.org/external/np/pdr/conc/calculator.

[2] The calculation of concessionality takes into account all aspects of the loan agreement, including maturity, grace period, schedule, commitment and management fees commissions.

used for the above-mentioned purposes; (iii) normal import financing; and (iv) arrangements to pay overtime obligations arising from judicial awards to external creditors. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

REPORTING REQUIREMENTS

37. **For the purpose of program monitoring**, the Government of Malawi will provide the data listed in Table 2 below with monthly data within four weeks of the end of each month, and annual data as available.

38. **The authorities will inform the IMF staff in writing at least ten business days (excluding legal holidays in Malawi) prior to making any changes in economic and financial policies that could affect the outcome of the financial program.** Such policies include but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any non-concessional external debt contracted or guaranteed by the central government, the RBM, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities.

39. **The authorities will furnish an official communication to the IMF describing program quantitative performance and structural benchmarks within 8 weeks of a test date**. The authorities will, on a regular basis, submit information to IMF staff with the frequency and submission time lag as indicated in Table 2.

Table 2. Summary of Reporting Requirements

	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]	Agency
Exchange Rates	D	W	D	RBM
International reserve assets and reserve liabilities of the Monetary Authorities [2]	W	W	M	RBM
Gross international reserves and foreign exchange purchases and sales	D	W	M	RBM

Reserve/base money, OMO transactions, and RBM conversion of ways and means account to government securities	W	W	M	RBM
Broad money	M	M	M	RBM
Central Bank balance sheet	W	W	M	RBM
Consolidated balance sheet of the banking system	M	M	M	RBM
Interest rates [3]	M	M	M	RBM
Excess reserves by banks	M	M	M	RBM
Volume of transactions in the interbank money market and foreign exchange markets and sales of foreign currencies by RBM to commercial banks	D	W	W	RBM
Government securities auction results	W	W	W	RBM
Spread between exchange bureau midrate and the official exchange midrate	W	M	W	RBM
Central government domestic borrowing	M	M	M	RBM
Holdings of local registered stocks, treasury bills, treasury notes and other government securities	M	M	M	RBM
Detailed issue and maturity profile for all government securities	M	M	M	RBM
Financial soundness indicators by banks	Q	Q	…	RBM

RBM foreign exchange cash flow	M	M	M	RBM
Bank statements of the agricultural SWAp account held at RBM	M	M	…	RBM
Annual financial reports of the 8 major parastatals[4]	A	A	…	MOF
Borrowing of the 8 major parastatals [4]	SA	SA	…	MOF
Quarterly report on government domestic arrears	Q	Q	…	AG
Comprehensive list of tax and non-tax revenues	M	M	M	MOF
Fiscal table (GFS based), including revenue, grants, expenditure, balance and composition of financing of the central government [5, 6, 7]	M	M	M	MOF
Expenditure for domestically financed capital projects	M	M	M	MOF
Data on Joint Funds on health and education	M	M	…	MOF
Stocks of public sector and public-guaranteed debt [6]	Q	Q	Q	MOF
New external loans contracted or guaranteed by the government and disbursement schedule [6]	Continuous	Continuous	Continuous	MOF
Quarterly external debt service (actual and projections)	Q	Q	…	MOF
Debt service payments on domestic debt (outturn and projections)	M	Q	Q	MOF

Accumulation of new domestic government arrears	M, Q	M, Q	M, Q	MOF
Report on IMF program performance	Q	Q	…	MOF
Consumer Price Index and monthly statistical bulletin	M	M	M	NSO
Exports and Imports of Goods and services, and subcomponents.	M	M	Q	NSO
Balance of payments	A	A	A	NSO
GDP/GNP, by activity and expenditure, at constant and current prices	A	I	A	NSO

[1] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Semi-annually (SA); Irregular (I).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, interbank money market rate, rates on treasury bills, notes and bonds.
[4] Agriculture Development and Marketing Corporation, Electric Supply Company of Malawi, Electricity Generation Company of Malawi, Malawi Housing Corporation, National Oil Company of Malawi, Northern Regional Water Board, Lilongwe Water Board, and Blantyre Water Board.
[5] Foreign and domestic banks, and domestic nonbank financing.
[6] Detailed information on the amounts, currencies, terms and conditions, including debt contracted or guaranteed by the RBM or any other agency on behalf of the central government.
[7] Provided no more than four weeks after the end of each month.

INTERNATIONAL MONETARY FUND

MALAWI

April 16, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION AND REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By

The African Department
(In Consultation with Other Departments, the World Bank, and the African Development Bank)

CONTENTS

RELATIONS WITH THE FUND

(As of February 28, 2018)

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	1.61	2.42

Outstanding Purchases and Loans:

	SDR Million	%Quota
ESF Arrangements	6.94	5.00
ECF Arrangements	145.96	105.16

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	07/23/2012	06/29/2017	138.80	138.80
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				
	2018	**2019**	**2020**	**2021**	**2022**
Principal	15.75	11.89	13.80	18.44	25.81
Charges/Interest	0.40	0.53	0.53	0.53	0.53
Total	16.15	12.42	14.33	18.97	26.34

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

Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ Million)[1]	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 Post-Catastrophe Debt Relief (PCDR): Not Applicable.

Safeguards Assessments:

A safeguards assessment is currently underway in conjunction with the authorities request for a new program. This assessment will be completed by the first review and will update the findings of the 2012 safeguards assessment and the 2016 monitoring visit. A key safeguards recommendation from past assessments, to strengthen RBM's legal framework, is incorporated in the program as a structural benchmark.

Exchange Arrangements:

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 allowed substantial volatility in the exchange rate. However, the U.S. dollar exchange rates have shown remarkable stability since October 2016, at a rate of around MK 725/US$. Inflows of foreign exchange has allowed for a strong increase in international reserves. Against this background, exchange rates remain largely market determined and the spread between the commercial bank and foreign exchange bureau rates has disappeared. The exchange rate is free of restrictions and multiple currency practices.

Article IV Consultation:

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). An FSAP development module was conducted in mid-2017.

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

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

Technical Assistance: (since 2015, as of February 28, 2018)

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
03/18	STA	RBM	Monetary and financial statistics	Mission
02/18	FAD	MOF	PFM / Financial controls	Mission
02/18	STA	RBM	Monetary and financial statistics	Mission
02/18	FAD	MOF	Customs administration	Mission
01/18	STA	NSO	External sector statistics	Mission
01/18	STA	NSO	Price statistics	Mission
12/17	FAD	NSO	National accounts	Mission
12/17	FAD	MOF	Budgeting	Mission
12/17	FAD	MOF	Tax administration	Workshop
11/17	STA	MOF	Government finance statistics	Workshop
11/17	MCM	RBM	Financial sector regulation	Mission
11/17	MCM	RBM	Banking supervision	Mission
11/17	STA	NSO	National account statistics	Mission
11/17	FAD	MOF	Debt management system	Mission
11/17	MCM / WB	RBM / MOF	Debt management strategy	Mission
10/17	STA	MOF	Government Financial Statistics	Mission
09/17	STA	NSO	Price Statistics	Mission
09/17	ICD	RBM	Policy analysis and forecasting	Mission
08/17	FAD	MOF / MOF / NSO	Macroeconomic forecasting	Mission
08/17	ICD	RBM	Policy analysis and forecasting	Mission
08/17	FAD	MOF	Public financial management	Mission
07/17	MCM	RBM	Forex operations and repo market	Mission
05/17	ICD / MCM	RBM	Forecasting / Policy Analysis System	Mission
05/17	FAD	MOF	Customs administration	Mission
05/17	FAD	MOF	Cash management and TSA	Mission
04/17	STA	RBM	Financial soundness indicators	Mission
04/17	FAD	MOF	Compliance risk analysis	Mission
04/17	FAD	MOF	Cash management	Mission
03/17	MCM	RBM	Financial market infrastructure	Workshop
01/17	MCM	RBM	Bank supervisory framework	Mission
01/17	ICD / MCM	RBM	Monetary policy framework	Mission
11/16	FAD	MOF	Taxpayer register	Mission
10/16	FAD	MOF	Risk management in customs	Mission
10/16	ICD / MCM	RBM	Forecasting / Policy Analysis System	Training
09/16	STA	RBM	General Data Dissemination System	Mission
09/16	FAD	MOF	PFM / Financial controls	Mission
08/16	STA	NSO	Consumer price Framework	Mission
07/16	ICD	MOF	Government financial statistics	Training
06/16	STA	NSO	National accounts statistics	Mission
06/16	LEG	RBM	Bank resolution	Workshop

Date of Delivery	Department	Ministry/Agency	Purpose/Topic	Modality
05/16	MCM/ICD	RBM	Monetary policy framework	Mission
04/16	FAD	MOF	PFM	Mission
04/16	MCM	RBM	Basel framework	Mission
04/16	STA	NSO	National accounts statistics	Mission
03/16	MCM	RBM	IT risk	Mission
02/16	LEG	RBM	Safeguard assessment	Mission
02/16	MCM	RBM	Foreign exchange interventions	Mission
01/16	LEG	RBM	AML/CFT supervision	Mission
01/16	FAD	MOF	Tax reform	Mission
11/15	MCM	RBM	Interbank money market	Mission
11/15	FAD	MOF	Fiscal reporting	Mission
10/15	MCM	RBM	Repo market and forex swaps	Workshop
10/15	STA	NSO	National accounts statistics	Mission
09/15	FAD	MOF	Pension reform proposals	Mission
09/15	FAD	MOF	Expenditure control, bank reconciliation, and fiscal reporting	Mission
07/15	FAD	MOF	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

JOINT MANAGERIAL ACTION PLAN

(As of February 8, 2018)

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. Institutional and Non-Technical Drivers of Agriculture Sector Performance		January 2018
	2. Developing Safer School Programs in Malawi		February 2018
	3. OGE-Business Plan for Development of the Climate Innovation Centre: Launchpad Malawi		February 2018
	4. FSAP Development Module		February 2018
	5. Malawi - Medium Term Debt Management Strategy		February 2018
	6. Malawi - Financial Strengthening for ESCOM		March 2018
	7. Operationalizing WDR 2017		May 2018
	8. Systematic Country Diagnostic	March 2018	May 2018
	9. Malawi Economic Monitor (seventh edition)	February 2018	May 2018
	10. Fingerprinting to Reduce Risky Borrowing		June 2018
	11. Malawi #B063 Warehouse Receipt Financing Project	February 2018	June 2018
	12. Shock Responsive Safety Nets and Preparing for Future Crises	April 2018	June 2018
	13. Measuring Distortions to Agricultural Incentives in Malawi		June 2018
	14. Assessment of Malawi Procurement System using MAPS II		June 2018
	15. Malawi National Electrification Program		October 2018
	16. Renewable Energy Resource Mapping and Geospatial Planning		November 2018
	17. Public Expenditure Review	April 2018	December 2018
	18. Malawi PEFA Assessment 2018		December 2018
	19. Country Environmental Analysis		April 2019
	20. Malawi Programmatic Approach to Inclusive Growth and Poverty		June 2019
	21. Health Impacts of Emergency Response and Post-Crash Care in Malawi		December 2019
	22. Malawi Nutrition-Sensitive Service Delivery Indicators		May 2020
	Lending:		
	1. Shire Valley Transformation Program - I		October 2017
	2. Lilongwe Water and Sanitation Project		December 2017

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	3. Malawi Second Agricultural Support and Fiscal Management DPO	March 2018	May 2018
	4. Second Agriculture Sector Wide Approach Support Project (MDTF)	*April 2018*	*March 2018*
	5. Lower Shire Valley Landscape Project (GEF TF)		*October 2017*
	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, 2018

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK

(As of February 2018)

The African Development Bank (AfDB) operations in Malawi date back to 1969. The Bank Group Malawi Country Office was opened in 2007. As of January 31, 2018, the Bank had provided significant and diversified support to Malawi, with cumulative commitments worth UA 898 million (about US$1.3 billion) to finance 108 operations, including thirteen studies and two lines of credit.

The AfDB's Malawi Country Strategy Paper (CSP) covering the period 2013–17 was fully aligned with the second Malawi Growth and Development Strategy (MGDS II, 2011-16) and the Bank's corporate priorities in the Long-Term Strategy (LTS, 2013–22). A new CSP for the period 2018–22 is currently being prepared. The new CSP will take an integrated approach to support private sector development by focusing on key infrastructure constraints, such as water, power, and roads, as well as softer components related to private sector policy. Given the rapidly growing population, it is critical that the economy starts creating more economic opportunities that would generate increased revenues for the government to efficiently and effectively provide required social services and public goods while ensuring a dynamic and growing private sector.

During the just ended CSP period, the Bank has approved a number of projects in the water, social, agriculture, and roads sectors, as well as in economic and financial governance, in line with the CSP priorities. In 2016, three new operations were approved by the Board: (i) Agriculture Infrastructure and Youth in Agri-Business Project (US$22 million); (ii) Food Crisis Response Budgetary Support Program (US$16 million); and Jobs for Youth Project (US$12 million). These interventions aim at improving 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 Food Crisis Response Budgetary Support Programme helped in mitigating the impact of the drought-induced food crisis and ease fiscal pressures. In 2017, the Bank approved a technical assistance project, Nacala Rail and Port Value Addition Technical Assistance Project (US$1.7 million), which aims at creating a critical mass of model farmers through a "model farmer extension approach", which will be supported with linkages for value addition, market access, and access to finance. During the same year, the Malawi Economic Census Project (US$1 million) was approved to support the National Statistical Office (NSO) to build capacity for conducting an economic census. In January 2018, the Bank approved the Promoting Investment and Competitiveness in Tourism Sector Project (US$9.8 million) to create an enabling environment for investment in the tourism sector through enhanced capacity in planning and business management, and improved governance in natural resources management.

The Bank has also provided Malawi with quick disbursing budget support. Following Government's re-engagement with the IMF and the approval of the US$157 million Extended Credit Facility (ECF) arrangement in July 2012, the Bank approved an ADF Grant for Crisis Response Budget Support operation, 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, 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 to strengthen: PFM transparency and accountability, and social protection systems.

In 2015, the African Development Fund Board approved a grant of US$30 million for the Protection of Basic Services Program (PBS). This ring-fenced Sector Budget Support was designed to protect critical expenditures in health and education, 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 will continue to coordinate closely with the IMF in the design of its future budget support operations to ensure its programs are underpinned by sound macro-economic policies.

The Bank has been working with development partners in strengthening Malawi's public finance management (PFM) systems. In support to the implementation of PFM reforms and in strengthening internal control systems following 'cashgate', the Bank approved two PFM Institutional Support Projects (US$7 million), which are closing in 2018. Support is focusing on tax administration (upgrading of the Automated System for Customs Data—ASYCUDA, putting in place a Tax Appeals Tribunal legislative framework, etc.), supporting public procurement reforms and capacity building, and strengthening financial management systems, including reviewing the PFM Act, and Integrated Financial Management Information System (IFMIS) oversight. The support is aimed at ensuring that the government is able to generate increased revenue to finance its developmental projects, and effectively and efficiently utilize the resources.

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 2017, the Bank prepared a feasibility study for Kholombidzo Hydro Power Project, which will provide a foundation for pipeline operations. An agriculture financing feasibility study currently underway is expected to be concluded at end-2018. The study aims to assess the financing needs of smallholder farmers with the view of proposing and assessing the viability of different financing options, including the establishment of an Agriculture Cooperative Bank, and outlining the implementation costs and modalities for those options, with the view of boosting agricultural productivity along the value chain.

In addition, the Bank is supporting the Private Public Partnership Commission (PPPC) with a grant to build PPP negotiation capacity through a "hot line" arrangement, whereby the PPPC can tap into international legal services to advise on PPP transactions. The Bank has provided technical assistance to the Malawi Postal Cooperation for the development of the E-Post Strategy and Action Plan. It is to be noted that the Bank, in recent years, has undertaken a number of analytical studies, including Domestic Resource Mobilization Study for Malawi, and provided TA to the Reserve Bank of Malawi to strengthen capacity in macro-economic forecasting; prepared a Public Expenditure Review with the World Bank and other development partners; and provided support for undertaking of the Expenditure Tracking Study for Malawi.

Looking forward, the Bank plans to scale up its lending to the energy sector with a view to address power shortages. The pipeline of energy sector projects includes: the Songwe River Basin Development Project; the Malawi-Zambia Power Inter-connector Project;
and the Kholombidzo Hydro Power Project. The Bank continues to engage with the World Bank and other partners for co-financing arrangements of its pipeline operations. In view of this, the Bank is taking the lead in mobilizing donor resources and private finance for the Songwe Hydro Power Project, a multinational project with Tanzania. It will also promote private investment in the energy sector, through PPPs and the use of innovative financing instruments, such as Partial Risk Guarantees.

The Bank will continue to support the agriculture sector, and to this effect it will, in 2018, prepare a Shire Valley Irrigation Project (part of the Shire Valley Transformation Programme) for co-financing with the World Bank. The project will cover 42,000 hectares and is expected to transform Malawi's agriculture sector by boosting production of high value crops and developing value chains. Currently the project preparatory studies are underway and are being co-financed with the World Bank.

STATISTICAL ISSUES

MALAWI—STATISTICAL ISSUES APPENDIX As of January 31, 2018
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but it is broadly adequate for surveillance.
National Accounts: STA is providing technical assistance (TA) to the National Statistics Office (NSO) on strengthening the quality of national accounts statistics. The latest available actual GDP estimates at current prices are for 2011 and the available GDP estimates at constant 2009 prices are for 2015. With the support of STA TA, the NSO plans to release the GDP series for 2012–15 in 2018. 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. The weight reference period is 2010–11 (based on expenditure data collected from the 2010–11 integrated household survey), and an index reference period of 2012 (2012=100). 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. The new PPI reflects 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. With the support of STA TA, the NSO has released an updated consumer price index (CPI) in February 2018, using expenditure weights derived from the 2016/17 Integrated Household Survey (IHS). This update will ensure that the CPI remains representative of current expenditure patterns. The producer price index (PPI) is based on weights derived from the results of the Annual Economic Survey conducted in 2012. The weights should be updated, and coverage of the index expanded to other production activities, so as to better reflect the current structure of the economy.
Government Finance Statistics: The accuracy and reliability of the data are affected by source data weaknesses. A key shortcoming in this area is the inadequate system of recording source data. In addition, there are serious quality problems, including data inconsistencies, that complicate program monitoring: • Due primarily to differences in coverage, published data for the budgetary central government include a sizeable statistical discrepancy between above and below the line

data. The coverage of government for above the line data is considerably narrower than the information on financing reported by 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 being available for the government. The finances and operations of the Malawi Revenue Authority are also unusually opaque.
- 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 public financial management and fiscal reporting, and renewed efforts are being made to establish a work plan, including utilizing donor technical assistance more effectively. The authorities are currently working with East AFRITAC to modify 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.

Government finance data for the Budgetary Central Government in a GFSM 2014 presentation are reported for publication in the Government Finance Statistics Yearbook (GFSY). However, these data are not disseminated domestically. The October 2017 STA mission that visited Lilongwe encouraged the authorities to compile and report high frequency data for Budget Central Government in GFSM 2014 framework expanding coverage to extrabudgetary units (EBUs). The mission reviewed the migration plan and timetable recommending collection of quarterly EBUs data and alignment of the new Chart of Accounts to the GFSM 2014 methodology. Process of procuring the new Integrated Financial Management Information System (IFMIS) has been initiated.

Monetary and Financial Statistics: The Reserve Bank of Malawi (RBM) is yet to compile and report monetary data to STA using standardized report forms (SRFs). The 2013 STA mission assisted in developing the SRFs for the central bank accounts (1SR) and other depository corporations (2SR) but the RBM staff experienced challenges in implementing the mission recommendations. At the request of RBM another mission was conducted in March 2018 and RBM committed to submitting SRF-based MFS to STA by June 2018. The mission suggested improvements to source data for the other financial corporations, mainly insurance companies and pension funds, which RBM will work on by June 2018.

Financial Sector Surveillance: Following a TA mission in April 2017, Malawi recently compiled and submitted to STA financial soundness indicators which accords with the *FSI Guide* methodology. The data is published in the Fund website.

External sector statistics (ESS): The NSO compiles annual balance of payments and international investment position (IIP) statistics following the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* with considerable delays. The estimates rely heavily on monthly merchandise trade statistics, banking data, and information from government departments. In addition to the understaffed balance of payments section of NSO, inadequate resources for surveys had an impact on the compilation of reliable ESS. The foreign private capital survey is being conducted in 2018 for the first time since 2013. The balance of payments survey has not been conducted since 2010; and the business interviews survey no longer collects balance of payments data. In the absence of regular survey data, previous estimates are updated based on suitable proxies from other data sources. The NSO should make efforts to obtain data on current and capital transfers related to foreign aid separately from the Debt and Aid Department, which is also critical for improving the current estimates.

The deficiencies in source data and estimation techniques reflect on the large net errors and omissions (NEOs) in recent years (for instance, around 2.5 percent of GDP in 2017) and raise concerns regarding the quality of balance of payments data. The January 2018 TA mission noted that the main contributor of large NEOs is likely to be the underestimation of net acquisition of currency and deposits assets under other investment category, as the current estimates of this component does not capture the deposits held in foreign banks or U.S. dollar held in cash by non-bank Malawian residents. Data from the foreign exchange transaction system (E-forms) of the RBM is expected to be available by September 2018 and could improve the ESS data substantially. To move forward with improvements, the NSO and RBM should take appropriate steps to ensure a regular flow of data from this system for balance of payments and IIP compilation; and the government should allocate sufficient resources for conducting regular surveys.

II. Data Standards and Quality

Malawi implemented the e-GDDS and its National Summary Data Page (NSDP) went live on November 15, 2016 (http://cb.malawi.opendataforafrica.org/uwkhibc/national-summary-data-page-nsdp). However, Malawi is lagging for 19 data categories the authorities committed to disseminate under the e-GDDS. They should be encouraged to update the NSDP on a regular basis, publish an advance data release calendar, and make progress toward higher data standards.	Data ROSC was published on February 17, 2005.

III. Reporting to STA

The authorities report the following datasets to STA for publication in the International Financial Statistics (IFS): Monetary and financial statistics, balance of payments and international investment position statistics, and government finance statistics; however, timeliness is irregular.

Malawi: Table of Common Indicators Required for Surveillance
(As of March 14, 2018)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality — Methodological soundness[9]	Memo Items:[8] Data Quality — Accuracy and reliability[10]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/2017	01/2018	M	M	M		
Reserve/Base Money	11/2017	01/2018	M	M	M	LO, LO, LNO, O	LO, O, O, O, O
Broad Money	11/2017	01/2018	M	M	M		
Central Bank Balance Sheet	11/2017	01/2018	M	M	M		
Consolidated Balance Sheet of the Banking System	11/2017	01/2018	M	M	M		
Interest Rates[2]	11/2017	01/2018	M	M	M		
Consumer Price Index	12/2017	02/2018	M	M	M	O, LNO, O, O	LNO, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA.	NA				O, LO, O, O	O, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Q2/2017	10/2017	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[5]	Q2/2017	10/2017	M	M	M		
External Current Account Balance	2016	01/2018	A	A	A	O, O, O, O	LO, O, LO, O, O
Exports and Imports of Goods and Services	09/2016	08/2016	A	A	A		
GDP/GNP	2016	12/2017	A	A	A	LO, LNO, LNO, LO	LNO, LNO, LO, LO, LNO
Gross External Debt	06/2016	01/2018	A	Q	I		
International Investment Position[6]	2016	01/2018	A	A	A		

[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).

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

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

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

Statement by Mr. Maxwell M. Mkwezalamba, Executive Director for Malawi; and Mr. Ted Sitima-wina, Senior Advisor to Executive Director

April 26, 2018

Introduction

1. Our authorities appreciate the constructive policy discussions during the recent Article IV consultations and program negotiations. They broadly concur with the staff assessment and its conclusions, and value the Fund's policy advice as they pursue their national development agenda.

2. Malawi has made significant progress in achieving macroeconomic stability following two successive years of weather related shocks and challenges in public finance management. While growth is recovering and inflation has declined into single digit territory, more needs to be done to meaningfully tackle poverty through higher, more inclusive, and resilient growth. In this context, the authorities recently launched the third Malawi Growth and Development Strategy (MGDS III) for 2018–23. The strategy aims at boosting productivity, enhancing competitiveness, and building resilience through growth-enhancing investment and economic diversification.

3. To achieve the objectives of the MDGS III, our authorities request for a three-year arrangement under the Extended Credit Facility (ECF). The arrangement will support economic policies and reforms to entrench macroeconomic stability, and catalyze concessional financing for infrastructure development. The authorities have completed all five prior actions, and look forward to Executive Directors' support for approval of a new three-year ECF arrangement.

Recent Economic Developments and Macroeconomic Outlook

4. Real GDP growth in 2017 is expected to have recovered to 4 percent, from 2.3 percent in 2016. The recovery has been supported by a rebound in agricultural output and a pick-up in construction activity and the wholesale and retail sectors. The manufacturing sector, however, continues to be weighed down by prolonged electricity outages. This notwithstanding, in the medium-term, growth is expected to reach 6 percent, propelled by improved confidence, more robust agricultural production, increased electricity generation and transportation, as well as improved access to finance.

5. Inflation, which has been trending downwards from a peak of 23.5 percent in July 2016, reached 7.1 percent by end-2017 owing to the stabilization of food prices, tight monetary policy, and a stable exchange rate. Inflation is expected to remain in single digit territory in 2018 and reach 5 percent in the medium term, aided by the continued implementation of tight monetary policy and low food and petroleum products' prices.

6. On the external front, the current account deficit improved to 10.0 percent of GDP in 2017, from 13.6 percent in 2016, following lower maize imports after a bumper harvest and a rebound in exports. In turn, favorable balance of payments developments, improved confidence, and tight monetary policy have contributed to the stability of the nominal exchange rate of the Malawi kwacha against the U.S. dollar. The premium between the exchange rates of the Reserve Bank of Malawi (RBM) and forex bureaus remains very small, reflecting availability of foreign currency and that the exchange rate is market determined. Foreign currency reserves have been above three months of import cover. Going forward, improvements in competitiveness, export diversification, and fiscal restraint as well as an improvement in GDP growth are anticipated to gradually narrow the current account deficit to around 7.5 percent in the medium term.

Fiscal Policy and Public Financial Management

7. The authorities are committed to pursue fiscal consolidation while protecting growth-enhancing and pro-poor expenditures and ensuring debt sustainability. In this regard, they will enhance domestic revenue mobilization by continuing with broad-based tax reforms and rationalizing expenditures. Planned tax reforms include streamlining tax incentives, fully repealing the industrial rebate scheme, introducing a thin capitalization or earnings stripping rule, and redesigning turnover taxation to increase its effectiveness. All tax policy reforms and initiatives will continue to be guided by a shift in reliance from taxation of labor and investment to consumption. Furthermore, the Malawi Revenue Authority (MRA) is planning to launch the integrated tax administration system (ITAS), branded *"msonkho-online"* within the year, which is expected to enhance overall tax administration in the country.

8. On the expenditure side, controls have been enhanced to avoid further accumulation of arrears, and limit recourse to domestic financing, particularly from the RBM, as well as curb non-concessional borrowing. In this connection, the authorities have tightened commitment controls and established a system to track the stock of commitments. In addition, compliance officers from the Internal Audit Department have been placed in all key ministries, departments, and agencies (MDAs), with a plan to deploy them to all MDAs, to check and ensure that payments are only made to transactions that have supporting documentation. While budget implementation during the first half of FY2017/18 was challenging due, in part, to lower than projected revenue collections, the authorities remain committed to improving the fiscal position by end June 2018 through expenditure cuts.

9. To bolster growth, infrastructure bottlenecks in electricity, transportation, telecommunications, and water supply and irrigation will be addressed. The authorities, therefore, plan to raise, as soon as possible, needed infrastructure investments, particularly for key MGDS III flagship projects, in the above areas, while maintaining macroeconomic stability and debt sustainability. This is expected to be achieved through efficiency gains from improved public investment management and procurement, as well as partnering with the private sector and development partners. Health, education, and other social spending is anticipated to be increased through efficiency gains in on-budget spending.

10. Approval of the ECF arrangement will go a long way to catalyze the much-needed foreign financing for infrastructure. In this context, the authorities are committed to limit external borrowing to high priority projects to safeguard debt sustainability. They will improve investment planning—including rigorously prioritizing the MGDS III pipeline projects based on credible cost/benefit analyses, growth, poverty-reduction, and debt sustainability considerations. Furthermore, the Debt Management Committee will assess all borrowing to ascertain loan concessionality, taking into consideration the entire borrowing plan within the medium-term debt strategy.

11. Considerable progress has been made in public finance management reforms, including in establishing a fully functional Cash Management Unit; requiring all MDAs to submit five detailed fiscal reports as a condition for receipt of regular monthly funding; and fully reconciling the government cashbook with the bank account, a crucial step towards stronger public finance management. Furthermore, the authorities intend to continuously work on improving the procurement framework to enhance transparency, control, and accountability, following the enactment of a new Public Procurement Law. They will start by publishing all procurement information on the Ministry of Finance's website, and using performance contracts to hold controlling officers accountable for not adhering to relevant rules and procedures. Over time, they will consider gradually moving to an e-procurement system.

Monetary and Exchange Rate Policies

12. The authorities are committed to maintaining tight monetary policy to reign in on inflation. In addition, the RBM has demonstrated strong commitment to stabilizing monetary conditions and bolstering the external reserves position using policy instruments at its disposal. To maintain positive real interest rates in the financial system, monetary policy will also aim to ensure that the policy rate remains above the rate of inflation through open market operations. Our authorities acknowledge the 2017 AREAER reclassification of the de facto exchange rate arrangement and reiterate their commitment to a flexible exchange rate regime.

13. Furthermore, the RBM is committed to develop an interest rate-based monetary policy framework and gradually transition from the current monetary aggregate targeting framework to a full interest rate-based monetary framework and to inflation targeting over the medium -term. 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) received so far in this area and look forward to further TA.

14. Safeguarding financial sector stability and resilience remains a key priority for the authorities. To this end, the authorities are enhancing both on-site and off-site supervision of banks and will continue to enforce compliance with all prudential norms, including asset classification and provisioning in the context of the recently introduced IFRS9. They remain committed to strengthening the regulatory framework of the financial system to mitigate risks. In this respect, they will re-submit to Parliament amendments to the Banking Act of 2010 and Financial Services Act of 2010 for eventual enactment. These amendments, which were informed by IMF technical assistance recommendations, aim to align the legal framework for bank resolution with best practices and provide more options for dealing with problem banks. By end-2018, the authorities plan to gazette regulations related to the revised AML/CFT framework, enacted in 2017. These will strengthen the asset declaration system and support the authorities' anti-corruption efforts.

Structural Reforms

15. In pursuit of the objectives of the national development strategy, the authorities realize that far reaching structural reforms will be necessary to complement macroeconomic policies and reduce poverty. In this regard, they are committed to continue with reforms to address governance challenges. These include further strengthening public finance management, procurement, improving the investment climate, as well as pursuing reforms in the agricultural sector on the farm inputs subsidy program (FISP). To enhance inclusive growth, they will step up efforts to improve financial intermediation to raise access and affordability of credit to the private sector. The authorities are also committed to adhere to the automatic fuel pricing mechanism which has positively contributed to macroeconomic stability.

Conclusion

16. The authorities reiterate their commitment to entrenching macroeconomic stability, reducing poverty, and attaining higher sustainable inclusive growth. To this end, they will continue to implement an appropriate policy mix of prudent fiscal and monetary policies, complemented by structural reforms. Finally, our authorities value Fund support and look forward to an approval of an ECF arrangement to support implementation of their national development strategy.