



REPUBLIC OF MADAGASCAR

April 2021

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF MADAGASCAR

In the context of the Request for a 40-Month Arrangement under the Extended Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 29, 2021, following discussions that ended on February 12, 2021, with the officials of Republic of Madagascar on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 16, 2021.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Republic of Madagascar.

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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Washington, D.C.



IMF Executive Board Approves US\$312.4 Million ECF Arrangement for Madagascar

FOR IMMEDIATE RELEASE

- The 40-month financing package will support the implementation of the authorities' ambitious economic reform agenda to raise sustainable and inclusive growth and reduce poverty.
- Reforms will focus on strengthening fiscal space to allow for much needed investment and social spending, improving the business environment, advancing the anti-corruption and governance agenda, and strengthening the monetary policy framework and supporting financial stability.
- Madagascar's macroeconomic outlook has been affected by weaker external and domestic demand due to the pandemic reversing recent progress in per capita income and poverty reduction.

Washington, DC, March 29, 2021 – The Executive Board of the International Monetary Fund (IMF) approved today a 40-month arrangement under the Extended Credit Facility (ECF) equivalent to SDR219.96 million (about US\$312.4 million or 90 percent of quota) for Madagascar.

The Board's decision allows an immediate disbursement of SDR 48.88 million (about US\$69.4 million). The ECF arrangement follows the Fund's emergency support to Madagascar in April 2020 for SDR122.2 million (about US\$165.99 million or 50 percent of quota), and in July 2020 for SDR122.2 million (about US\$171.9 million or 50 percent of quota). The arrangement is expected to catalyze additional bilateral and multilateral financial support.

The program design considers Madagascar's fragilities, including its high exposure to climate-related shocks, and will focus on mitigating the economic impact of the pandemic, maintaining macroeconomic stability, and reviving the reform momentum to raise and sustain growth and reduce poverty. It aims to rebuild and further strengthen fiscal space to allow for much needed investment and social spending through revenue mobilization and improving quality of spending; resuming and advancing the structural reform and anti-corruption efforts and governance agenda; and strengthening the monetary policy framework and supporting financial stability, while maintaining price stability with exchange rate flexibility. Capacity development is crucial for the success of the program.

Following the Executive Board discussion, Ms. Antoinette Sayeh, Deputy Managing Director and Acting Chair, made the following statement:

"The COVID-19 pandemic continues to take a severe human and economic toll on Madagascar, reversing recent social and economic progress, and creating fiscal and external financing needs. The authorities' program, which will be supported by a new arrangement under the Extended Credit Facility, will focus on supporting the economic recovery and implementing structural reforms to increase sustainable and inclusive growth that reduces poverty.

“The authorities are implementing measures to create fiscal space for much needed social spending and investment. These include medium-term revenue mobilization efforts and improving the quality of public spending.

“Given that Madagascar remains at a moderate risk of debt distress, the authorities plan to follow a prudent debt management strategy that relies on concessional financing for scaling-up investment and improving investment management. They also envisage developing contingency plans and mitigating fiscal risks, including addressing potential fuel pricing-related liabilities and implementing the public utility JIRAMA’s recovery plan with World Bank support. They have also developed a disaster risk management strategy to assess and manage climate-related risks.

“The authorities have made progress towards COVID-19-related transparency commitments, including publishing information on pandemic mitigation spending and procurement contracts. They are working to further strengthening budget transparency and to implement remaining transparency commitments.

“To improve the business environment and attract much needed private investment, the authorities are committed to fully implementing the anti-corruption legal framework. They also plan to continue improving the monetary policy framework, developing, and strengthening the financial sector, and boosting financial inclusion.”

Table 1. Selected Economic Indicators, 2019-23

	2019	2020	2021	2022	2023
	Est.		Proj.		
	(Percent change; unless otherwise indicated)				
National account and prices					
GDP at constant prices	4.4	-4.2	3.2	5.0	5.4
GDP deflator	5.6	4.2	5.4	5.7	6.0
Consumer prices (end of period)	4.0	4.6	5.4	6.0	5.8
Money and credit					
Broad money (M3)	7.3	12.1	21.8	10.4	10.9
	(Growth in percent of beginning-of-period money stock (M3))				
Net foreign assets	-2.6	2.1	2.2	3.1	5.4
Net domestic assets	9.9	10.0	19.6	7.3	5.5
<i>of which: Credit to the private sector</i>	10.3	5.6	8.0	4.5	4.9
	(Percent of GDP)				
Public finance					
Total revenue (excluding grants)	10.5	9.2	10.3	11.4	12.2
<i>of which: Tax revenue</i>	10.3	8.9	10.0	11.1	11.9
Grants	3.0	1.8	2.3	1.8	1.3
<i>of which: budget grants</i>	0.7	0.8	0.5	0.3	0.3
Total expenditures	14.9	15.1	18.3	18.1	17.8
Current expenditure	9.3	9.5	10.7	9.5	9.2
Capital expenditure	5.6	5.6	7.6	8.6	8.6
Overall balance (commitment basis)	-1.4	-4.2	-5.8	-4.8	-4.3
Domestic primary balance ¹	0.3	-2.6	-2.5	-0.4	0.2
Total financing	1.3	2.9	6.6	4.1	3.9
Foreign borrowing (net)	1.2	1.4	3.6	3.5	3.3
Domestic financing	0.0	1.5	2.9	0.6	0.5
Financing gap ²	0.0	0.0	0.0	-0.7	-0.4
Savings and investment					
Investment	20.6	15.1	18.4	20.6	22.2
Gross national savings	19.8	8.5	13.4	16.2	17.8
External sector					
Exports of goods, f.o.b.	18.0	14.0	16.5	18.0	19.1
Imports of goods, c.i.f.	26.2	22.8	25.2	26.2	27.7
Current account balance (exc. grants)	-5.3	-9.6	-7.2	-6.2	-5.7
Current account balance (inc. grants)	-2.2	-6.5	-5.0	-4.4	-4.3
Public debt					
External Public Debt	37.8	43.6	46.9	47.8	48.6
Domestic Public Debt	26.6	32.0	34.7	36.1	37.3
	11.2	11.6	12.2	11.7	11.3
	(Units as indicated)				
Gross official reserves (millions of SDRs)	1196	1338	1449	1540	1680
Months of imports of goods and services	4.2	5.9	5.4	5.1	5.0
GDP per capita (U.S. dollars)	540	502	521	551	582

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

¹ Primary balance excl. foreign-financed investment and grants. Commitment basis.

² A negative value indicates a financing gap to be filled by budget support or other financing still to be committed or identified.



REPUBLIC OF MADAGASCAR

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

March 16, 2021

EXECUTIVE SUMMARY

Context. The COVID-19 pandemic has hit Madagascar hard, reversing recent progress in per capita income and poverty reduction. GDP is estimated to have contracted by 4.2 percent in 2020. Two RCF disbursements approved on April 3 and July 30 (totaling 2.4 percent of GDP) helped close short-term financing gaps, supported mitigation measures, and contributed to catalyzing donor budget support. The authorities are seeking renewed Fund assistance to help the country face protracted balance of payment needs aggravated by the impact of the pandemic and support the authorities' reform agenda summarized in the Plan Emergence Madagascar (PEM).

Program objectives and modalities. The authorities have requested an Extended Credit Facility (ECF) arrangement to support the recovery from the pandemic, anchor reform implementation, and catalyze aid commitments. Staff proposes a 40-month ECF arrangement with access of 90 percent of quota (SDR 219.96 million), with semi-annual reviews. Financing under the arrangement will help address balance of payment needs estimated at about \$893 million over 2021–24. Based on the program baseline, Madagascar's risk of debt distress remains moderate for both external and overall public debt, and capacity to repay the Fund is adequate.

Program policies. The program design considers Madagascar's fragilities, including its high exposure to climate-related shocks, and will focus on mitigating the economic impact of the pandemic, maintaining macroeconomic stability, and reviving the reform momentum to raise and sustain growth and reduce poverty. It aims to rebuild and further strengthen fiscal space to allow for much needed investment and social spending through revenue mobilization and improving quality of spending; resuming and advancing the structural reform and anti-corruption efforts and governance agenda; and strengthening the monetary policy framework and supporting financial stability, while maintaining price stability with exchange rate flexibility. Capacity development is crucial for the success of the program.

Staff views. Staff supports the authorities' request for an ECF arrangement. The Letter of Intent and Memorandum of Economic and Financial Policies demonstrate program ownership and appropriate policies the authorities intend to undertake to pursue its objectives, as well as needed safeguards. Considering the highly uncertain global environment and substantial risks that could lower growth and widen financing gaps, contingency plans have also been discussed with the authorities.

Approved By
**Vivek Arora and
 Geremia Palomba**

Discussions were held remotely from Washington, DC during January 18–February 12, 2021. The staff team comprised Charalambos Tsangarides (head), Cristina Cheptea, Dominique Fayad, Raveesha Gupta, Gabriel Léost (all AFR), Sandile Hlatshwayo (SPR), Marc Gerard (Resident Representative) and Ialy Rasoamanana (local economist). Aivo Andrianarivelo, Thierry Nguema Affane and Onintsoa Raoilisoa Andrianometiana (OEDAF) participated in the discussions. The team met Minister of Finance Randriamandrato, Central Bank Governor Rabarijohn, and other officials. Fausa Aliu (AFR) managed document production.

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CONTEXT

1. Madagascar is a low-income fragile country severely impacted by the global COVID-19 pandemic, jeopardizing improvements in development outcomes and progress under the 2016-20 ECF. Madagascar's vulnerabilities continue to present challenges for sustaining inclusive growth and improving social indicators (Annex I). While official statistics show less than 20,000 people (about 0.1 percent of the population) affected by the pandemic and about 300 fatalities (Text Figure 1), the economic impact has been severe, reversing recent improvements in poverty reduction, with job losses in key manufacturing and service sectors, and income losses for informal workers affected by the lockdowns in major cities.

2. Significant progress was achieved during the 2016-20 ECF arrangement, but the reform agenda remains unfinished and slowed down in the context of the pandemic. Real GDP growth gradually accelerated to 4.4 percent in 2019, with contained inflation, improved fiscal performance along with increasing tax revenue, and a solid external position. The reform agenda also progressed, notably in the financial sector, and in the reinforcement of the anti-corruption legal framework. Other reforms progressed more modestly than expected, including shifting public spending in favor of capital and social spending; introducing an automatic fuel-pricing mechanism; and transfers to compensate for the losses of the public utility JIRAMA declining less quickly than expected.

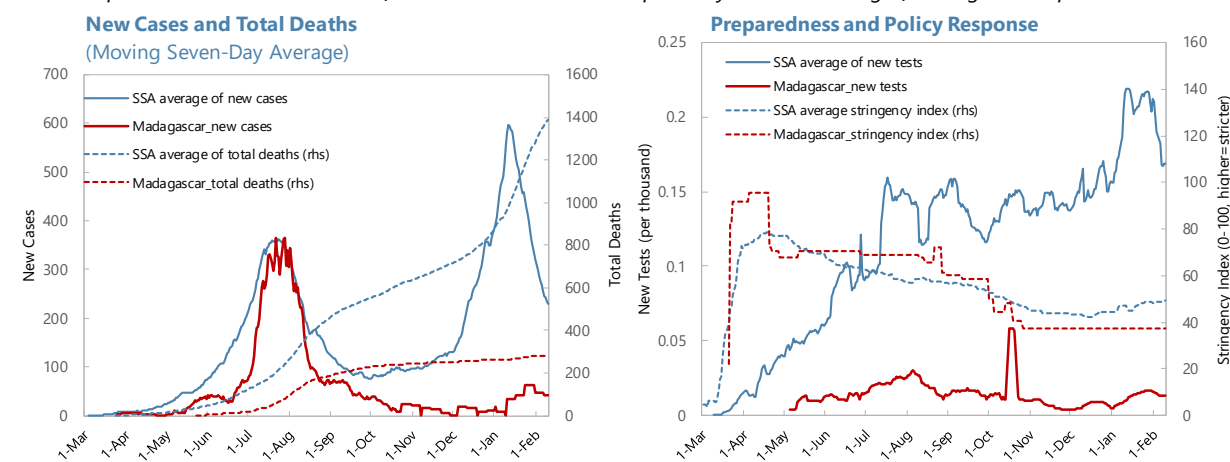
3. In this context, the authorities have requested a new ECF arrangement. Following the emergency financing in 2020, Upper Credit Tranche Fund assistance is requested to help Madagascar face protracted balance of payment needs aggravated by the pandemic, and support the authorities' ambitious economic reform agenda, summarized in the *Plan Emergence Madagascar* (PEM). The PEM focuses on addressing longstanding development problems and raising sustainable and inclusive growth and reducing poverty.

RECENT ECONOMIC DEVELOPMENTS

4. The COVID-19 pandemic has hit Madagascar hard (Text Figure 2). Real GDP contracted by 4.2 percent in 2020—9 percentage points lower than the January 2020 Article IV projection—reflecting a worse global environment impacting tourism, manufacturing, and textile exports despite some resilience of free trade zones' exports later in the year; the closing of the country's largest mine in mid-April 2020; and lower domestic demand impacted by lockdowns and associated reductions in income especially for the informal sector. Inflation, at 4.2 percent y-o-y in December, remained subdued. The current account deficit significantly widened to an estimated 6.5 percent of GDP in 2020, largely due to a collapse in tourism receipts from 5.1 percent of GDP in 2019 to 1.0 percent in 2020.

Text Figure 1. Madagascar: Evolution of the COVID-19 Pandemic

Recent improvements in the number of new cases; but some complacency with the easing of testing and response.



5. The fiscal situation has been impacted through a large reduction of tax revenue.

Due to the decline in economic activity and tax exemptions to mitigate the impact of the pandemic, tax revenue fell by 1.4 percentage points of GDP y-o-y in 2020 to 8.9 percent of GDP. The reduction in customs revenue was significantly larger than domestic taxes (-21.8 and -5.3 percent, respectively), reflecting lower imports and lower oil price (VAT and the specific tax on oil products account for about one fourth of customs revenue). While public spending accelerated late in the year, there was still some budget under-execution, leading to a smaller-than-expected domestic primary balance deficit of 2.6 percent of GDP in 2020, after a small surplus in 2019.

6. Monetary policy has focused on supporting bank liquidity, while the central bank (BFM) regularly intervened in the foreign exchange market. Injections of liquidity and some relaxation of reserve requirements allowed banks to reschedule and extend credit lines while preserving profitability, but increasing non-performing loans are slowly eroding capital buffers and affecting asset quality. Foreign currency net sales by the central bank reached US\$156 million in 2020 (three times more than 2019), limiting Ariary's depreciation to about 5 and 16 percent vis-à-vis the US\$ and the euro, respectively. Despite the external shock, international reserves increased due to strong external support and delays in government spending, reaching SDR 1337.8 million at end-2020 or 5.9 months of 2020 imports (4.7 months of 2019 imports).

7. Two RCF disbursements helped close short-term balance of payments and fiscal financing gaps, and support mitigation measures. The RCF disbursements, totaling 2.4 percent of GDP, have catalyzed budget support in 2020 (about 2 percent of GDP) to help mitigate the impact of the pandemic and close short-term financing needs. Treasury cash-flow tensions remained contained, also helped by delays in budget execution. Part of the approved budget support in the form of loans (requiring parliamentary approval obtained in December) is

expected to be disbursed in the first months of 2021, which will provide a welcome bridge before additional support planned for the second half of the year. The authorities are making significant progress towards spending transparency commitments (Box 1) and committed to implement all remaining needed actions in 2021.

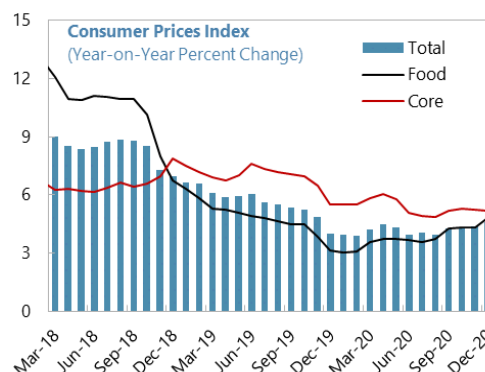
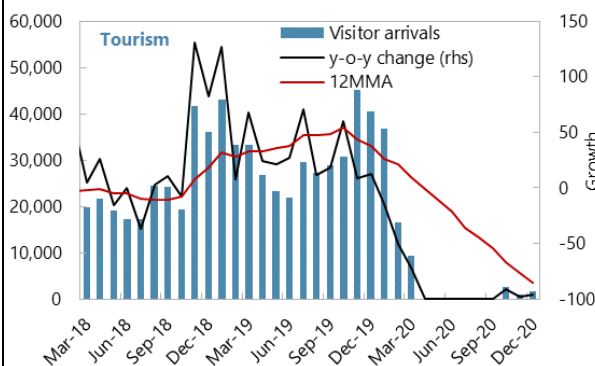
Box 1. Madagascar: COVID-19 Spending Transparency

Progress has been made on the disclosure of COVID-19 related spending (MEFP, 134), as committed in the Letter of Intent for the request for an RCF disbursement in July 2020 (IMF Country Report No. 20/268). These commitments also apply for COVID-19 spending that will be executed in 2021.

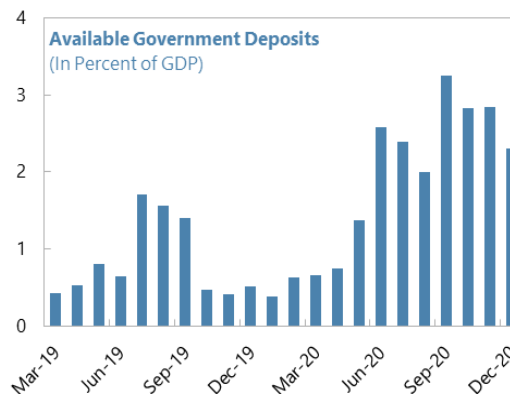
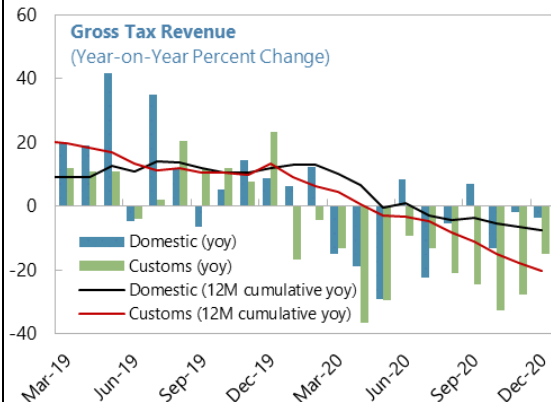
- The Ministry of Economy and Finance website (<http://www.mef.gov.mg/reportingcovid>) provides the list of all the external grants and loans received in 2020 to mitigate the impact of pandemic, totaling commitments for more than US\$600 million of which about US\$450 million are already disbursed. These commitments include World Bank programs augmented in the context of the pandemic, such as social safety net programs (cash transfers) for more than US\$50 million in 2020 (increasing beneficiary households from 250,000 in June 2020 to 483,428 in December 2020); US\$20 million to support the recovery of the tourism and agribusiness sectors impacted by the pandemic; and additional financing of US\$50 million for the Basic Education Support Project.
- The website also provides some spending information. However, it is difficult to identify which expenditure was specifically dedicated to mitigating the COVID shock—for instance, not all listed transfers to the public utility JIRAMA are related to the pandemic. Nevertheless, the information is useful and includes details on spending by Ministries, by category of spending, and by subcategories (such as hospitalization, treatment, care). The information includes MGA 42 billion (US\$11 million) for the purchase of rice distributed to the most vulnerable and MGA 25 billion (US\$7 million) for transfers to public schools to compensate for the cancellation of registration fees in response to the pandemic. Information is available by region, municipality, and school on the Ministry of Education website (<https://www.education.mg/caisse-ecole/index.php/>).
- For spending related to procurement contracts, the website provides information on the purpose, amount, and names of awardees, whether natural persons (individuals) or legal persons (companies). As of March 8, 109 of the 127 listed contracts can be downloaded; those that were awarded to companies include the name of the authorized representative or agent signing each contract on the company's behalf. The authorities have also started to publish ex-post delivery reports for the executed contracts and intend to continue until all the remaining contracts and ex-post delivery reports are published. They have also reiterated that they will implement the full range of the LOI commitments, including the publication of an independent third-party audit of COVID-19 spending by end-2021 (SB) and the names of the beneficial owners of companies awarded COVID-19-related procurement contracts.
- The website of the Ministry of Health (<http://www.sante.gov.mg/ministere-sante-publique/>), publishes detailed monthly information on the stocks of medication, and medical and personal protective equipment provided in the fight against the pandemic. This information is available by region and municipality, for each hospital or health center, including basic health centers in small communities.

Figure 1. Impact of the Crisis on Recent Economic Developments in 2020

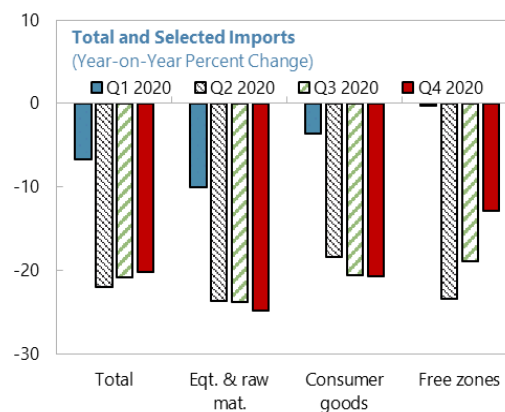
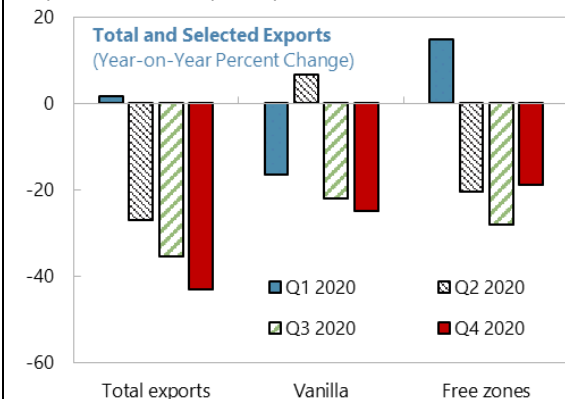
The number of visitors collapsed with the halting of all international commercial passenger flights since March 2020. Inflation remains below 5 percent after reaching its lowest level in 8 years in February 2020.



Tax revenue, especially from customs, has been hard hit, but available government deposits remain comfortable due to budget under-execution and important budget support received.



Total exports still increased by 1 percent y-o-y in the first quarter of 2020 (free-zone exports remaining dynamic), but dropped in the next three quarters. Imports were down by about 7 percent y-o-y in the first quarter of 2020, and by about 20 percent in subsequent quarters.



Sources: Malagasy Authorities; and IMF Staff Estimates.

THE NEW EXTENDED CREDIT FACILITY: PROGRAM OBJECTIVES AND POLICIES

- 8. Fund engagement remains crucial to help address Madagascar’s fragilities and challenges and promote inclusive and sustained growth.** Widespread poverty, high income inequality, low human capital indicators, gaps in basic infrastructure, and corruption issues have been amplified by political crises and natural disasters—including the most severe drought in a decade currently affecting southern Madagascar. The pandemic is exacerbating these crises and delaying measures to support the unfinished structural reform agenda.
- 9. The authorities’ PEM envisions placing Madagascar on the path of sustainable and inclusive growth, improved physical and human capital, and strong governance (Annex II).** Specific PEM priorities include: (i) improving governance (the PEM’s cross-cutting theme), including through the fight against corruption, better security, and addressing regional challenges; (ii) strengthening human capital, with a focus on education, health, and housing; and (iii) accelerating economic growth by developing agriculture and tourism and diversifying industries, through increased public and, especially, private investment, and public-private sector partnerships, all supported by structural reforms and improvements in the business environment.
- 10. The proposed ECF arrangement will support the pandemic recovery, preserve macroeconomic stability, and advance the reform momentum to raise and sustain inclusive growth, drawing from the government’s priorities.** In the short-term, considering uncertainties related to the pandemic—including new waves, new variants, and uncertainties regarding vaccine implementation and effectiveness—the ECF would prioritize mitigation efforts while focusing on a few well-targeted reforms to maintain macroeconomic stability. Next, the ECF would support a new reform momentum to revive and sustain inclusive growth and address long-term fragilities through maintaining macroeconomic stability, creating fiscal space for much-needed investment in physical and human capital, and resuming a strong structural reform agenda drawing from the authorities’ PEM priorities.
- 11. Priorities will focus on three key areas.** First, rebuilding and strengthening fiscal space to allow for much-needed capital investment and social spending, by mobilizing domestic revenue and improving quality of spending. Second, resuming and advancing the authorities’ structural reform agenda, including the mitigation of main fiscal and climate-related risks, and improving the business environment by strengthening governance, and reinforcing the anti-corruption framework. Third, strengthening stability and financial sector development, including through improving prudential and AML/CFT supervision and enhancing the monetary framework.

A. Framework to Support Recovery and Preserve Macroeconomic Stability

Supporting Recovery and Mitigation Efforts

12. Efforts to mitigate the impact of the pandemic require continued and adequate fiscal support. A premature tightening of fiscal policy could exacerbate the economic crisis. Fiscal resources are needed for preparedness and detection (including boosting testing), safeguarding businesses, and protecting workers. Support through targeted spending on social protection programs is also warranted (MEFP, ¶26).

13. The authorities' 2021 initial budget law (LFI) was based on a contained spending envelope and a possibly optimistic increase in tax revenue (MEFP, ¶19). Strengthening tax collection and a growth rebound to 4.5 percent in 2021 was expected to raise net tax revenue-to-GDP to 10.9 percent. Staff were concerned about the realism of this expected increase, which is significantly higher than in recent years and unaccompanied by corresponding strong fiscal measures. With planned domestically financed spending of the same order of magnitude as in 2020, at about 13 percent of GDP, including a wage bill of 5.5 percent of GDP and domestic public investment of 3.5 percent of GDP, the LFI assumes a reduction of the domestic primary deficit, from 2.7 percent of GDP in 2020 to 1.3 percent in 2021.

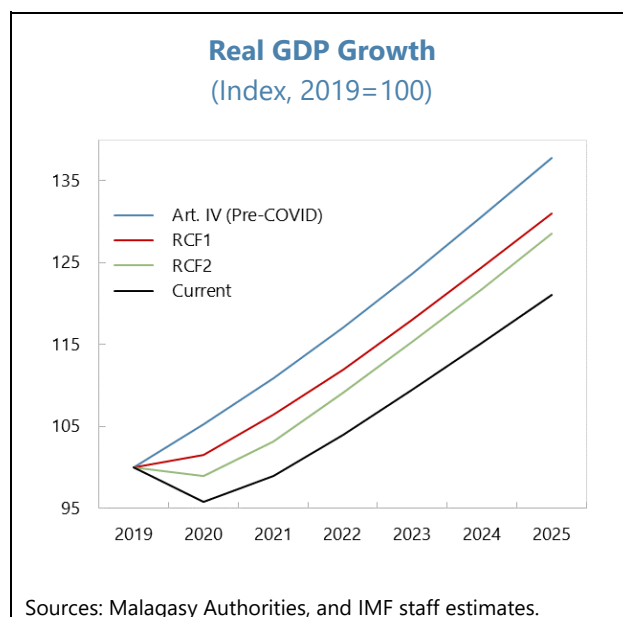
14. The authorities will prepare a revised budget law (LFR) in May 2021 and implement corrective measures as needed (MEFP, ¶16). The 2021 LFR will include revised revenue assumptions based on the results of the first months of the year and will target a primary deficit of 2.5 percent of GDP, in line with program objectives. In case of the need for budgetary savings, the authorities are committed to protecting social priority spending and will identify a list of lower priority spending that could be reduced. Beyond 2021 and considering the high degree of uncertainty about the recovery, they are ready to refine the medium-term macroeconomic framework in future budget laws.

Program Medium-Term Macro-Framework

15. The macroeconomic framework of the authorities' medium-term program supported by the ECF arrangement is based on revised growth and revenue assumptions (Table 1, MEFP, ¶17):

- *A growth rebound leveling at 5 percent in 2023.* After contracting by an estimated 4.2 percent in 2020, real GDP under the program scenario is expected to recover partially in 2021 due to delayed pandemic effects reaching 3.2 percent in 2021; peak at 5.4 percent in 2023; and stabilize at around 5 percent in the outer years. Output is expected to surpass its 2019 level in 2022 and remain well below pre-shock levels through the medium-term.
- *Investment is expected to rebound and pick up in 2023,* reflecting the public investment planned scaling-up and a more gradual increase in private investment.

- *Tax revenue would gradually increase by about 1 percent of GDP per year over 2021-23. The fiscal stance will remain supportive in 2021, with the domestic primary balance excluding budget grants (the fiscal policy anchor) planned to be in deficit by about 2.5 percent of GDP (similar to 2020) before turning positive in 2023.*
- *The current account deficit is expected to stabilize at around 4 percent of GDP, with exports gradually recovering from the crisis, and gross official reserves would increase in nominal terms and converge to about 5 months of imports, within the adequacy range (Annex III). Risks to the reserves path include an acceleration in government spending that is faster than forecasted, with external financing falling short; large terms-of-trade shocks; and natural disasters.*



16. External financing will continue to be primarily on concessional terms and grants to preserve debt sustainability. As investment scales up, the external sector, assessed to be moderately stronger than the level implied by fundamentals and desirable policies, is expected to converge towards its norm (Annex III). The government will continue to follow a prudent debt management strategy, favoring grants and concessional loans for the external financing of scaling-up investment plans. Public debt could reach about 49 percent of GDP in 2025, higher than the 46 percent of GDP envisaged in the January 2020 Article IV. A new Debt Sustainability Analysis (DSA) shows that Madagascar remains at moderate risk of external debt distress and moderate risk of overall public debt distress, with some space to absorb shocks (¶36 and DSA). A performance criterion of a ceiling on newly contracted external public debt of \$US 800 million in present value terms will encourage limiting the use of non-concessional borrowing and support debt sustainability while allowing for needed investment.¹

17. This outlook is highly uncertain with risks tilted downward (Annex IV). Conjunctural risks include prolonged impacts of the COVID-19 outbreak, further disrupting trade and global value chains and delaying recovery in tourism; rising costs associated with heightened protectionism, which could reduce exports and potential growth; social unrest, disrupting economic activity and harming confidence; and exposure to natural disasters, which result in a loss in physical and human capital. Madagascar is also vulnerable to the possibility of larger than anticipated transfers to SOEs that can reduce priority spending; stalls or reversals in the anti-

¹ The ceiling's amount is based on the authorities' contracted debt borrowing plans for loans most likely to materialize and using the LIC DSF to assess whether this level in present value terms would compromise debt sustainability. Under the ceiling Madagascar's risk of external debt distress would remain at moderate.

corruption and governance reform agenda; and weak investment implementation capacity that weighs down economic growth. Presidential elections in 2023 may also affect the outlook. Upside risks include a faster global recovery from the pandemic and the materialization of large-scale projects in the energy or extractive sectors, both of which would support higher growth.

B. Advancing the Reform Agenda to Raise Sustainable and Inclusive Growth

Rebuilding and Strengthening Fiscal Space for Much Needed Social Spending and Investment

18. Ambitious but credible medium-term revenue mobilization plans need to be supported by a comprehensive revenue administration and revenue collection strategy (MEFP, ¶20-23). Beyond a rebound in tax collection accompanying the economic recovery, there is potential to significantly raise tax revenues with a strategy covering both revenue administration and tax policies, based on priorities identified by FAD TA missions (Selected Issues, SM/20/20). These priorities include reviving tax control operations, improving the collection of outstanding tax payments (SB for the first half of 2021), strengthening the reliability of taxpayer identification, reducing the irregularities in customs clearance, and intensifying the control of the companies benefitting from free-zone agreements. The generalization of VAT on public procurement is expected to yield 0.4 percent of GDP in 2021 and tax reforms under consideration in the context of the 2022 budget law include potential changes regarding the VAT and the excise taxes, and the revision and streamlining of exemptions. Given the criticality of revenue mobilization, two separate indicative targets (ITs) are included for floors on domestic and custom revenue.

19. Limiting non-priority spending is necessary to increase fiscal space. This includes continuing to strengthen the planning and monitoring of the wage bill (MEFP, ¶24); designing and then implementing reforms to contain the deficit of the civil servants' pension fund (with a plan expected to be presented in the first half of 2021, MEFP, ¶25); and mitigating fiscal risks related to SOEs—including the public utility JIRAMA and Air Madagascar—and fuel pricing.

20. The program seeks to ensure higher spending in social sectors. Substantial under-execution in social spending—with the related IT repeatedly missed during the previous ECF—has continued in 2020, notwithstanding the pandemic. Severe weaknesses in the planning, execution and transparent monitoring and reporting of social spending are among the reasons for under-execution. While the budget of the four social ministries has been increased by more than 10 percent in the 2021 LFR, the authorities must be more accountable for spending execution and monitoring outcomes. To this end, beyond efforts to strengthen sectoral ministries' capacity (including with support from development partners), social spending monitoring and conditionality are strengthened under the new ECF arrangement, including with an IT (floor for domestically financed social spending), several memorandum items to improve monitoring, and structural benchmarks (Box 2 and MEFP, ¶26).

21. Public investment scaling-up requires better prioritization and execution

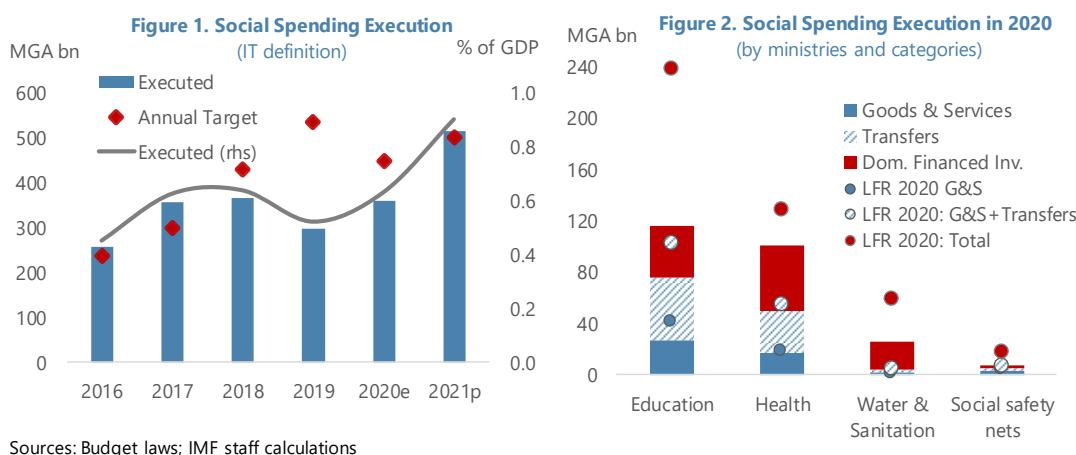
(MEFP, ¶27). Ambitious public investment objectives will be further clarified, including the prioritization of projects, considering implementation and absorptive capacity constraints, and proper costing. The government is implementing FAD technical assistance (TA) recommendations, which include the finalization of a public investment manual (SB). It is also committed to continue to rely primarily on external grants and concessional financing to ensure that debt remains sustainable.

Box 2. Madagascar: Social Spending

Despite massive needs, social spending suffers from continued budget under-execution. While low social spending owes partly to limited budgetary resources and capacity constraints, the level and efficiency could substantially improve through better planning, execution, and monitoring.

Social spending is low, in part due to capacity constraints and low tax revenue. Social spending –defined for the ECF indicative target as domestically financed spending, excluding salaries, by the four ministries of education, health, water and sanitation, and population and social protection –has remained below 1 percent of GDP in recent years (adding salaries, it remains below 3 percent of GDP).

Social spending also suffers from under-execution, and the IT under the previous ECF was repeatedly missed (Figure 1). Under-execution is not limited to social spending—this is the case for public spending in general, and notably for investment, which represented 60 percent of planned social spending for 2020 under the IT, with an execution rate below 75 percent (Fig. 2). The 2020 under-execution also owed to administrative challenges arising from the ministerial reshuffle in August 2020 with new appointed Ministers for three of the four social ministries.



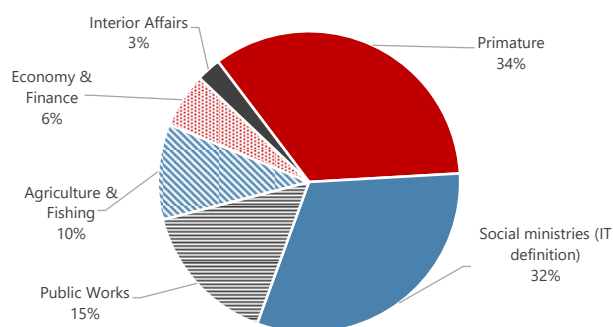
Social spending in 2020 is much higher if relevant items outside of the IT narrow definition are considered. Social spending in 2020 could be 4.7 percent of GDP including salaries and externally financed investments in the four social ministries as well as social spending in non-social ministries, such as cash transfers (MGA 204 billion, 0.4 percent of GDP) to vulnerable households through a structure under the Prime Minister’s office, post-disaster emergency aid (MGA 73 billion) by the Ministry of Public Works, and electricity bill payments benefiting from grace periods by the Ministry of Economy and Finance (MGA 75 billion) (Figure 3). In 2021, externally financed social projects in social and non-social ministries are projected to reach

Box 2. Madagascar: Social Spending (concluded)

1.1 and 0.9 percent of GDP respectively, and this broader social spending envelope could reach up to 5.1 percent of GDP (Figure 4).

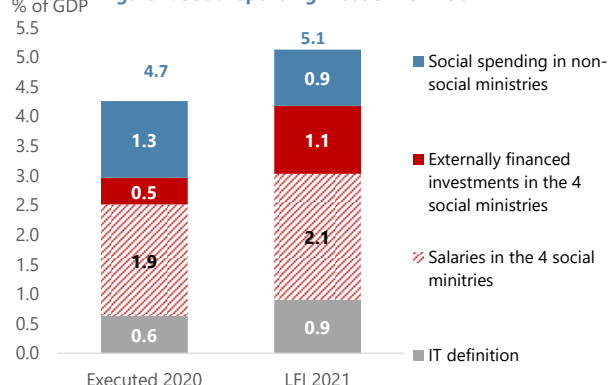
While there is scope to expand the IT definition of social spending in the future, concrete actions to improve monitoring and increase execution are needed and supported by the new arrangement. The ongoing project to adjust the budget classification to monitor all social spending independently of the Ministry in charge, would be a major improvement but will require the validation of Fund technical assistance and other development partners. In the meantime, in addition to the IT, other social indicators will be monitored as memorandum items (See MEFP, Table 1). The ECF arrangement will support measures for better planning, execution, and transparent monitoring and reporting of social spending. A stronger emphasis on budget transparency (conditionality includes the publication of quarterly budget execution reports with specific information on social spending execution) is expected to improve the authorities' accountability on social outcomes.

Figure 3. Externally Financed Social Spending by Ministries
(Percent of total execution, as of November 2020)



Sources: Budget laws; IMF staff calculations

Figure 4. Social Spending Broader Definition



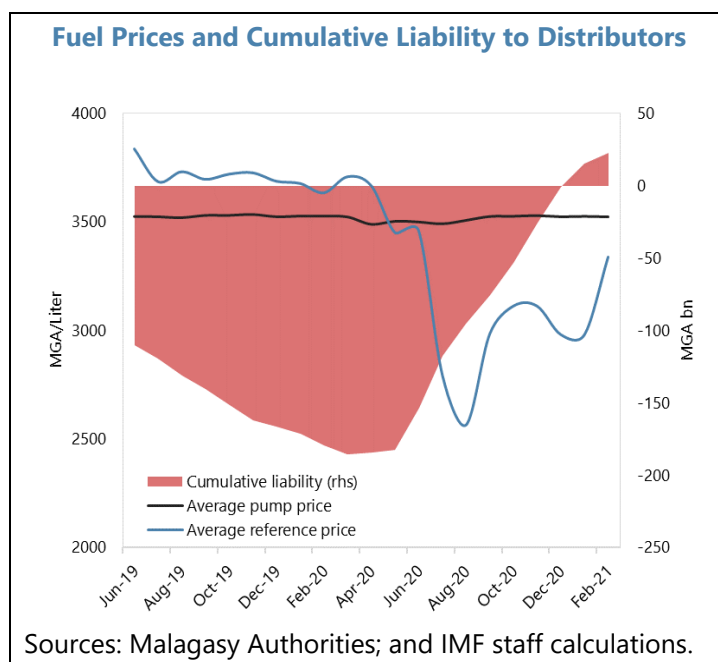
Sources: Budget laws; IMF staff calculations

Resuming and advancing the structural reform agenda

22. Efforts are ongoing to revive the PFM reform agenda (MEFP, ¶135). Building on regular technical assistance, the 2018-2026 Strategic Plan of Modernization continues to be implemented, the Inter-ministerial Steering Committee has been reorganized, and PFM performance will be assessed according to the PEFA methodology in the first half of 2021. Improving the efficiency and transparency of the public expenditure chain remains a priority, including more active cash management as an important step towards the implementation of the Single Treasury Account, and strengthened controls to fight against corruption. Two new draft laws on treasury management and on the status of public accountants are part of planned actions in the short-term.

23. The immediate fiscal risk associated with fuel pricing is contained but needs to be addressed (MEFP, ¶131). As a result of not implementing a fuel pricing mechanism (commitment

under the previous ECF) the government's potential liability to oil distributors, remains. After peaking at 0.4 percent of GDP in April 2020, it has been eliminated at end-January 2021 due to lower oil prices and the fact that government resisted pressures to lower pump prices. However, the recent rebound in international oil prices may reverse the situation. To avoid the risk of a budgetary impact in the future from an increased liability, the authorities committed that a plan towards a fuel pricing mechanism will be prepared during the first six months of 2021 and discussed with IMF staff. In the meantime, pump prices will continue to be administrated, and the liability will be kept below MGA 100 billion, or less than 0.2 percent of GDP (continuous SB).



24. Exposure to climate-related shocks is an important fiscal risk for Madagascar, and efforts to improve disaster risk management are continuing. The authorities are building on a strategy developed with international partners and recent years' progress; disaster risk management is a key element of the PEM's pillar on environment. The IMF will support the authorities' efforts by continuing to help assess related fiscal risks, by evaluating resources needed for mitigation plans, and by encouraging public policies and the mobilization of necessary domestic resources, and continuing to catalyze financial support (Box 3).

Box 3. Madagascar: Climate Change and Disaster Risk Management

Madagascar is one of the most vulnerable countries to climate-related shocks and natural disasters in the world due to its geographical location and topography. Droughts are frequent in the South and flooding in the North and Northeast. Madagascar suffered the largest amount of flood-related damage on average among all SSA countries between 1990 to 2020 (Figure 1). Climate-related disasters are estimated to cost 1 percent of GDP per year on average, and severe disasters, such as cyclone Enawo in 2017, can result in damage equivalent to 4 percent of GDP. Modeling estimates by the government's Strategic Program for Climate Resilience suggest natural disaster risks may worsen with the adverse impact of climate change, including greater intensity of rainfall and cyclones.

Madagascar's high poverty, food insecurity, lack of access to social safety nets, and heavy reliance on rain-fed agriculture increase the vulnerabilities to climate-related shocks and present a challenge for resilience. With a large share of the population living in absolute poverty and 25 percent of the rural population classified as food insecure, natural disasters affect the poor disproportionately. The most dramatic recent example is the ongoing drought in southern Madagascar, which doubled the number of

Box 3. Madagascar: Climate Change and Disaster Risk Management (continued)

people in need of humanitarian assistance to more than 1.3 million in one year. Extreme weather events also lead to loss of physical and human capital, threaten weather-dependent agricultural productivity, damage physical infrastructure, and disrupt economic activity. Natural disasters and climate-change risks are more seriously felt in tourism, urban developments, and natural resources, and can adversely affect gender equality by lowering women's farm production, income, and food security.

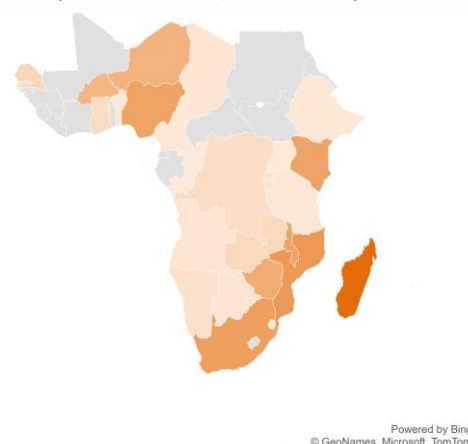
Disaster risk management is part of the government's overall policies, and part of one of the main pillars of the *Plan Emergence Madagascar (MEFP, 17)*. The *National Management Strategy for Risks and Disasters 2016-2030 (SNGRC)* is based on the principles of involving local communities, integrating disaster management into regional and sectoral development strategies, and incorporating the objectives of good governance, gender equity, and inclusiveness.

The overarching goal of the SNGRC is to build ex-ante resilience to natural disasters and an effective ex-post recovery and mitigation plan, through strengthening legal and regulatory frameworks and building technical and financial capacities. The authorities' PEM also sets a key priority to strengthen resilience through enhanced access to disaster risk information and identifies several specific objectives, including improving the production and dissemination of weather and climate data and strengthening early warning systems; ensuring effective integration of DRM in the national development policy and sector development policies; and enhancing DRM governance.

Under the new ECF arrangement, the IMF will support the authorities' efforts in the following areas:

- *Incorporate climate change modeling in fiscal risk assessment, and evaluate resources needed for mitigation plans.* The fiscal risks described in the related annex to the 2021 budget law (a good practice instituted in 2018 with support of FAD TA) include exposure to natural disasters. With further TA, this assessment could be strengthened, and could include modeled growth impact from continued exposure to climate change, upside risks from investing in resilient infrastructure, and evaluation of the resources needed to better prepare and deal with the consequences of future events. The DSA also contains a stress test related to natural disasters.
- *Encourage public policies for the prevention and management of natural hazards, and the mobilization of necessary domestic resources.* Mobilizing revenue to increase fiscal space is one of the main objectives of the ECF and it will also help spending on infrastructure and programs needed to strengthen resilience.
- *Continue to catalyze donor support, which will bring in necessary financial resources and technical assistance.* Madagascar has already benefitted from important external programs, including:
 - The Disaster Risk Management Development Policy Operation with Catastrophe Deferred Drawdown Option (CAT-DDO), a joint operation by the World Bank for US\$50 million and by the *Agence Française*

Figure 1. Average Damage caused by Floods
(In Million USD, 1990-2020)



Sources: EM-DAT database; and IMF staff calculations.

Box 3. Madagascar: Climate Change and Disaster Risk Management (concluded)

de Développement (AFD) for Euro 25 million to strengthen the national framework for disaster risk management, building financial resilience to disasters, and incorporating disaster risk and climate change in territorial and urban planning.

- The World Bank is involved in projects to support disaster risk management, including a US\$75 million Integrated Urban Development and Resilience Project for Antananarivo to strengthen flood protection infrastructure and urban resilience in the poorest parts of the capital.
- The AFD is implementing several urban programs throughout the country, with additional co-financing from the European Investment Bank and the European Union.
- To improve financial resilience to droughts, Madagascar has joined the Pan-African Insurance Scheme, and received a US\$2.1 million compensation in July 2020 for the ongoing drought crisis in the south of the country.

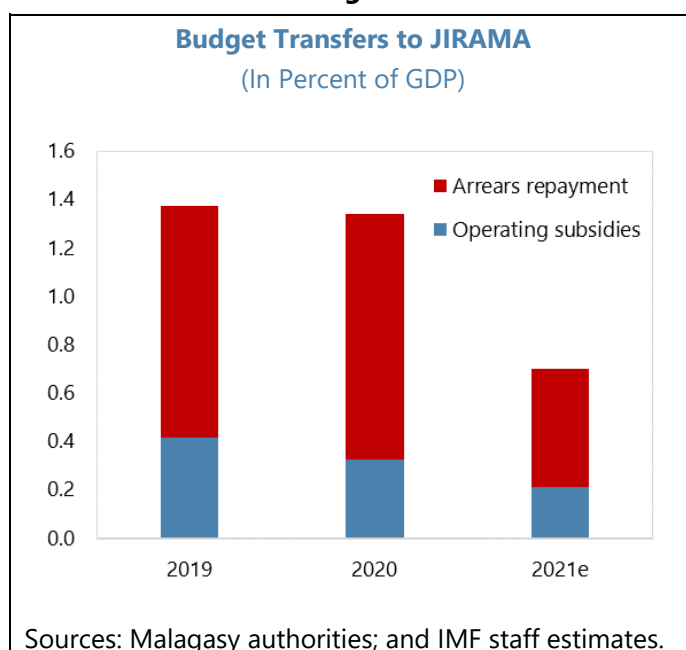
25. Reducing the fiscal risks related to JIRAMA and Air Madagascar remains essential

(MEFP, T132-33):

- JIRAMA's financial situation has worsened during the pandemic despite 1.4 percent of GDP in operational subsidies and transfers to repay arrears to suppliers in 2020. This followed the ad hoc arrears clearance of 1 percent of GDP for arrears that occurred in 2019. The authorities committed to clearly identify the amount of transfers for 2021 in the revised budget law (LFR) and to take corrective measures to ensure that total transfers remain limited to MGA 400 billion (about 0.7 percent of GDP). An important part of JIRAMA's strategy, supported by the

World Bank, is to clear arrears to suppliers, combined with the renegotiation of contracts on more favorable terms. A strategy about how to clear the stock of arrears is being finalized by the company (expected by June 2021). After its finalization, an arrears clearance plan will be agreed with the World Bank, including clearly identified financing. Details on payments of any government transfers to JIRAMA will be disclosed (continuous SB).

- The financial situation of Air Madagascar, already fragile before the pandemic, has deteriorated, with a debt reaching US\$55 million. A business plan is being developed by external auditors to assess the short-term financial viability of the group and outline a medium-term



recovery plan (MEFP, ¶133). The authorities committed to avoid any further public financing until the plan is finalized.

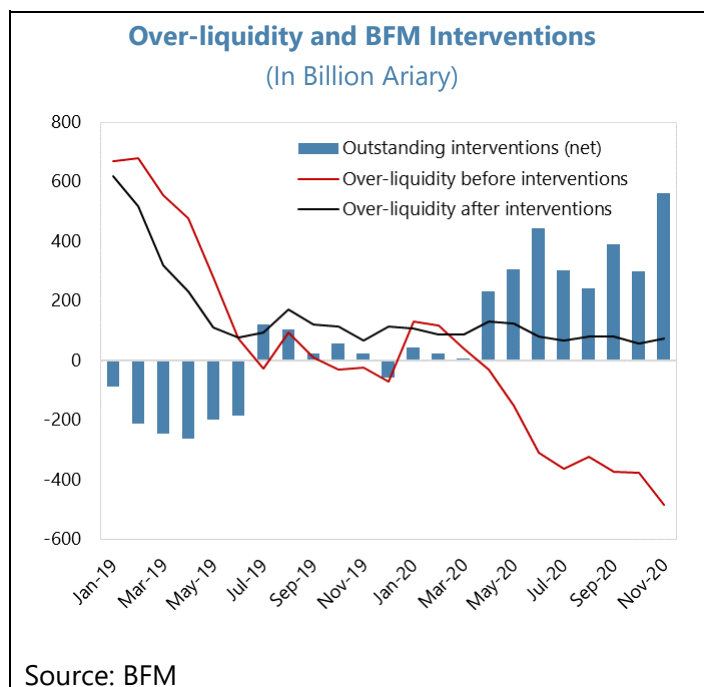
26. Effectively enforcing the anti-corruption legal framework is crucial (MEFP, ¶137). The setting-up of an anticorruption legal framework in line with international standards was a major achievement during the previous ECF. The authorities are committed to allocating sufficient human, financial, and material resources to the framework's enforcement and the operationalization of the institutions in charge of the fight against corruption, in line with the national anti-corruption strategy updated in 2020. Next steps include the operationalization of the agency in charge of illicit assets' recovery (the implementation decree and the allocation of a dedicated budget in the 2021 LFR is an SB for June 2021) and the issuance of implementing decrees for the 2018 AML/CFT law. The authorities reiterated their commitment to preserve the mandate and power of the anti-corruption courts and have sought IMF technical advice on a draft amendment law currently under consideration.

Strengthening financial stability and financial sector development

27. The BFM policy stance is appropriate and should continue to actively manage bank liquidity, while maintaining inflation stability. Monetary policy

will continue to aim at maintaining single digit inflation through money market and foreign exchange operations; and balance between exchange rate volatility and tensions on the interbank foreign exchange market (MID), while maintaining an adequate international reserve position—supported by a performance criterion with a floor on net foreign assets. Within a flexible exchange rate regime with shallow money markets, a combination of active bank liquidity management relying on quantitative instruments and opportunistic FX interventions

aimed at building up reserve buffers (market conditions permitting) remains an appropriate policy stance that will also help stabilize real exchange rate developments in the context of seasonality in bank liquidity traditionally related to the vanilla cycle, and significant terms of trade volatility. The BFM is ready to continue its liquidity support as needed in the short-term.



28. Progress towards improving the interest rate channel of monetary policy transmission is continuing with a target of migrating to the interest rate targeting

framework in 2023. Recent progress includes implementing an interest rate corridor system, establishing overnight deposit and lending facilities, and bringing the interbank market rates in line with the maturities of operations, risks and the overall level of liquidity. The BFM's objective remains to transition to interest rate targeting by 2023, with support from Fund TA (Annex V).

29. New efforts to improve the functioning of the foreign exchange market operations would improve foreign reserve management. Despite past efforts, the foreign exchange market (MID) remains shallow and volatile. The BFM has made interventions in response to COVID-induced supply and demand tensions and large fluctuations in the EUR-USD exchange rate. The authorities are implementing reforms to improve the functioning of the MID, such as passing the FX Law, drafted with the support of IMF TA and expected to be adopted in 2021, that clarifies the division of responsibilities between the Ministry of Finance and the BFM; improved monitoring and regulation of foreign currency accounts; higher mandatory reserve rates for foreign currency deposits in collaboration with MEF (as part of a strategy to increase currency offers and competition on the MID); and improved MID communications (for which Fund TA has been requested). Following adoption of the FX Law, the BFM intends to issue the implementing decrees, develop a new plan to phase out the surrender requirement on export proceeds, and consider the appropriate use of capital flow management measures as part of an integrated approach to liberalize the capital account and FX market reforms in line with the IMF's Institutional View and with market stability.

30. The BFM has engaged in a program to buy and store unrefined gold from local operators, with the intention for the gold to eventually be purified and included in foreign reserves—which raises safeguard concerns (MEFP, ¶42-43). In an effort to formalize the gold sector and in response to evidence of large illicit exports, the government temporarily suspended exports of gold. Following the suspension, the BFM and the Ministry of Mine and Strategic Resources launched a five-year program wherein the BFM buys and stores unrefined gold from local operators, with the intention for the gold to eventually be refined by the BFM and included in foreign reserves. While the gold program is intended to help diversify official reserve assets, it is not yet anchored in the BFM's investment or reserves management strategy. Being of a quasi-fiscal nature, the program could potentially undermine the BFM's autonomy and credibility. The authorities have agreed to remove the export ban on gold by end-July 2021; and the BFM will reengage with the government by September 2021 on its role in the gold purchase and refining program with a plan to find alternative arrangements. In the interim, the BFM has requested Fund TA to advise on the best alternatives to achieve its objective of diversifying its reserves.

31. Efforts to improve financial inclusion need to resume, with strengthened, risk-based prudential and anti-money laundering and combating the financing of terrorism (AML/CFT) supervision, in line with the objectives of the 2018-22 National Strategy. Given some signs of weakening of the financial sector (Annex VI), strengthened, risk-based supervision is warranted, notably for the microfinance institutions. The implementation of the Banking Law adopted in August 2020 (published on March 4, 2021) and adoption of the Financial Stability Law (due for examination by the Council of Government and the Council of Ministers before

submission to Parliament in its session starting in May) are expected to strengthen the financial sector and to improve financial inclusion.

PROGRAM MODALITIES AND FINANCING ASSURANCES

32. Program monitoring will be based on semi-annual reviews (MEFP, Tables 1 and 2), with Quantitative Performance Criteria (QPCs) for the end of the second and fourth quarters, and Indicative Targets (ITs) for the end of the first and third quarters. QPCs will be on (i) the domestic primary balance excluding budget grants; (ii) external public borrowing in present value terms (ceiling); (iii) net foreign assets of the BFM (floor); (iv) net domestic assets of the BFM (ceiling); and (v) external payment arrears (zero ceiling). Indicative targets are set on floors for social spending, domestic tax, and customs revenue. Additionally, reform progress will be evaluated based on structural benchmarks.

33. Financing needs are expected to be covered by donor and Fund support:

- Based on projected external financing and the gradual fiscal consolidation path, the financing gap before budget support and IMF financing is estimated at US\$893 million over 2021-2024 (Text table 1), declining from 2.8 percent of GDP in 2021 to 0.7 percent in 2024. Remaining gaps after the program period are consistent with reasonable prospects for recurring budget support in the medium-term.

Text Table 1. Madagascar: Financing Gap and Sources of Financing

	2021	2022	2023	2024
	US\$ million (otherwise indicated)			
Financing gap under program baseline (1)	415	171	172	136
	<i>(In percent of GDP)</i>			
	2.8	1.1	1.0	0.7
Expected budget support (2)	273	100	100	100
World Bank	185			
African Development Bank	44			
European Union	25			
Agence Francaise de Developpement	19			
Residual Financing gap (1-2)	142	72	72	36
IMF financing (90 percent of quota)	142	72	72	36
	<i>(In percent of GDP)</i>			
	1.0	0.4	0.4	0.2

Sources: Malagasy Authorities; International donors; and IMF staff.

- Access for the ECF arrangement is proposed at 90 percent of quota (SDR 219.96 million), with total access to PRGT resources remaining below 300 percent of quota at any point of the program. Some frontloading is necessary (Table 11) in light of Madagascar's large near-term financing needs and the need to have adequate international reserve buffers given the country's fragility, exposure to the global environment, and susceptibility to external shocks and natural disasters. The first two disbursements are proposed to be redirected to the budget, in order to ensure the full financing of the 2021 budget under the program baseline amid limited margin for additional domestic bank financing. Incentives for policy measures in later years will remain strong, with strong ownership by the authorities who have emphasized the importance of program engagement with the IMF and its catalytic role for external project and budget support. IMF disbursements and donors' budget support are expected to fill one-third and two-thirds, respectively, of the financing gap over the program-period.
- Financing assurances are in place for the first year of the program, with good prospects for the remainder of the program. The authorities are closely engaged with key donors, including the World Bank, the EU, the AfDB and the AFD, to secure the expected support envelope for the following years. This envelope is conservative, and the projected fiscal financing gap for 2022 (of about 0.6 percent of GDP) could be closed by additional budget support, additional domestic financing (including potential on-lending of IMF disbursements not contemplated at this stage), or some spending savings in the 2022 budget law.

34. Considering the high degree of uncertainty surrounding the outlook, contingency measures have been discussed (MEFP, ¶118). In case an adverse scenario materializes (with lower economic growth and government revenue), the macro framework and fiscal program would be revised by reducing lower-priority investments, which would likely affect the pace of recovery, while preserving social spending. Higher external support may be difficult to avoid in such a scenario.

35. Capacity development is crucial for the program success. A revised CD strategy was discussed with the authorities (Annex VII), taking stock of new ways of working (remote missions) and evolving needs in the crisis context. Priorities are fully aligned and integrated with program objectives, including strengthening ongoing reforms in tax policy and administration, PFM, monetary and financial sector oversight, and implementing the anti-corruption legal framework.

36. Based on the program baseline, a new DSA shows that Madagascar remains at moderate risk of external debt distress and moderate risk of overall debt distress. No external debt thresholds are breached under the baseline, but an export shock leads to a breach in the PV of debt-to-exports and debt service thresholds. However, distance to risk thresholds under the baseline suggests some space to absorb additional shocks. Total public debt is below the benchmark under the baseline, but a growth shock drives the present value of debt to GDP toward the benchmark at the end of the period, although without breaching it. Liquidity pressures may also materialize, as the debt-service-to-revenue ratio could near or exceed 70 percent in the near term under both the baseline and shocks. Securing access to additional

external concessional financing and development of the domestic debt market would help reduce debt service levels.

37. Capacity to repay the Fund is adequate (Table 12). Madagascar has an adequate capacity to repay the Fund, with annual repayments, based on existing and prospective drawings, peaking in 2027 at 0.8 percent of GDP, 5.6 percent of government revenue and 2.7 percent of exports. Existing and prospective Fund credit will peak at 6.2 percent of GDP and 60.6 percent of government revenue at the outset of the program, but would decline thereafter.

38. The safeguards assessment update found broad improvements. The BFM maintains strong external audit arrangements and the audit opinion on its 2019 financial statements is unmodified (clean). Governance and oversight arrangements are now well-established following amendments to the BFM Law in 2016, and the central bank continues to reinforce its control systems and is working toward full implementation of International Financial Reporting Standards in the 2020 financial statements. That said, efforts are needed to strengthen the internal audit function and the BFM should phase out its participation in a gold purchase and refining program that is outside the core mandate of the central bank (see above and MEFP ¶40, ¶42). As the first disbursements under the ECF arrangement would be redirected to the Treasury, the Memorandum of Understanding between the BFM and the government (used for the RCF disbursements also redirected to the budget) will be updated.

STAFF APPRAISAL

39. The human and economic impact on Madagascar of the COVID-19 pandemic crisis has been hard, jeopardizing recent years' economic and reform progress. Real GDP contracted by more than 4 percent in 2020, with a large decline in tax revenue and a deterioration of external balances largely due to a collapse in tourism receipts. The economic and social impact of the pandemic could reverse progress made in recent years to raise per capita income and reduce poverty. The pandemic has also led to a slowdown in reforms, including on the unfinished agenda from the 2016-2020 ECF arrangement.

40. In this context, the authorities have requested a new ECF arrangement. After two RCF disbursements in 2020 to close immediate financing gaps, the authorities have requested the ECF arrangement to help address protracted balance of payment needs aggravated by the pandemic and support their ambitious reform agenda summarized in the Plan Emergence Madagascar (PEM) that focuses on addressing longstanding development problems, raising sustainable and inclusive growth, and reducing poverty.

41. The priorities of the ECF arrangement are aligned with the government's reform agenda and will be supported by appropriate capacity development. These priorities are rebuilding and strengthening fiscal space to allow for much needed investment and social spending; resuming and advancing the structural reform agenda; strengthening governance and

the anti-corruption framework; and strengthening stability and financial sector development. Capacity development, tailored and focused on program objectives, is crucial.

42. The program macroeconomic framework is based on a gradual recovery from the pandemic. Growth is expected to recover and accelerate, supported by public and private investment and a recovery of exports. Tax revenue would gradually increase, creating space for investment and additional social spending. Gross official reserves would converge to a level consistent with reserve adequacy.

43. Creating additional fiscal space for priority spending requires raising government revenue and containing fiscal risks. Revenue mobilization, a key objective of the program, needs to be supported by a comprehensive revenue administration and tax policy strategy. It is crucial to contain fiscal risks from the exposure to natural disasters exacerbated by climate change, potential budget implications of fuel pricing, and the longstanding issue of transfers to SOEs, notably JIRAMA, which are exacerbated by the pandemic. On JIRAMA, it is important to implement the company's financial recovery plan supported by the World Bank, finalize an arrears repayment strategy, and avoid ad hoc government transfers.

44. The program pays particular attention to the need for higher social spending to meet Madagascar's substantial needs. The program seeks to ensure adequate levels of social spending as well as improved efficiency and execution of such spending through strengthened planning, execution, and monitoring.

45. The authorities intend to continue progress on budget transparency, beyond COVID-19-related spending. The authorities made important progress publishing information on the use of emergency financing received in 2020 and reiterated their determination to implement the full range of RCF commitments in a timely manner. Building on this progress, budget transparency needs to be strengthened, notably in terms of execution monitoring and reporting, which is expected to improve the authorities' accountability, including on social outcomes.

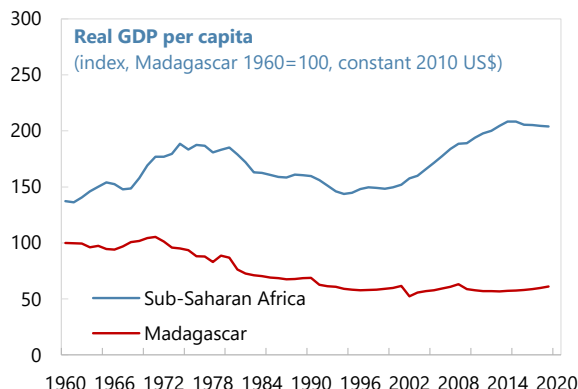
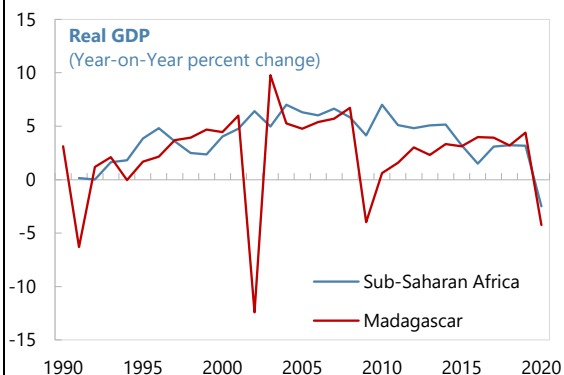
46. Effective enforcement of the anti-corruption legal framework and governance reform agenda is crucial. It would also help attract higher private investment in Madagascar. The authorities committed to further steps for the implementation of the anticorruption legal framework set up in recent years, enacting some needed application decrees, and allocating sufficient human, financial, and material resources.

47. The continued progress in improving the monetary framework and strengthening the financial sector is welcome. The implementation of the new banking law and financial stability law as well as the continuation of structural reforms undertaken at the BFM, including those toward an interest rate targeting framework in 2023, are instrumental to strengthen the monetary policy framework and boost financial inclusion.

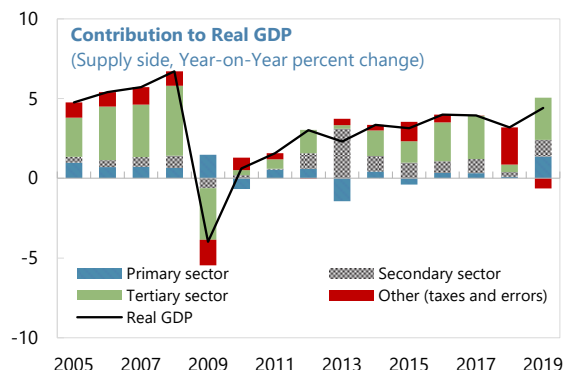
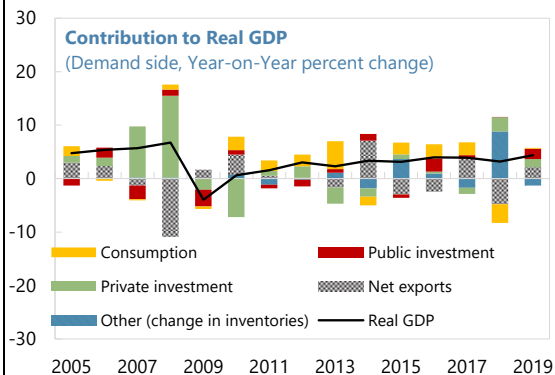
48. Based on the protracted balance of payment need and policy commitments, staff supports the authorities' request for a 40 month-arrangement under the ECF, with access equivalent to 90 percent of Madagascar's quota (SDR 219.96 million).

Figure 2. Madagascar: Real Sector Developments

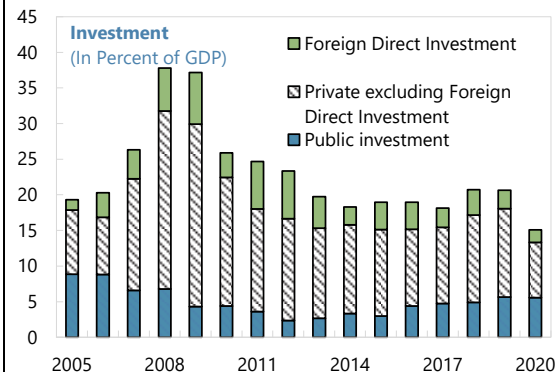
Over decades, growth in Madagascar has been insufficient to offset population growth; the COVID-19 pandemic has reversed recent improvements.



In recent years, net exports have been a key driver of growth on the demand side; on the supply side, growth is driven by the tertiary sector and a recent rebound in agriculture.



Investment is still below 2008 levels...



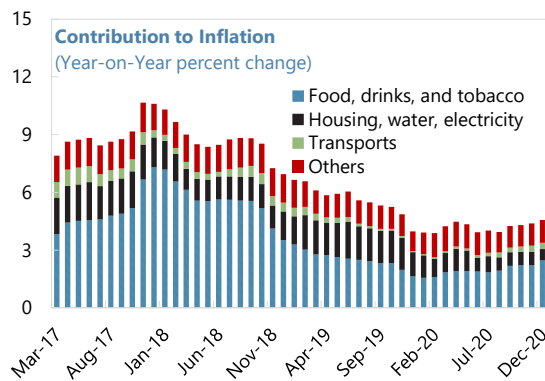
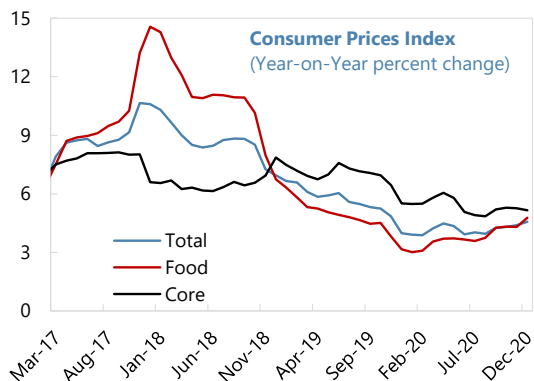
... while the pandemic brought an end to the tourism sector's recovery



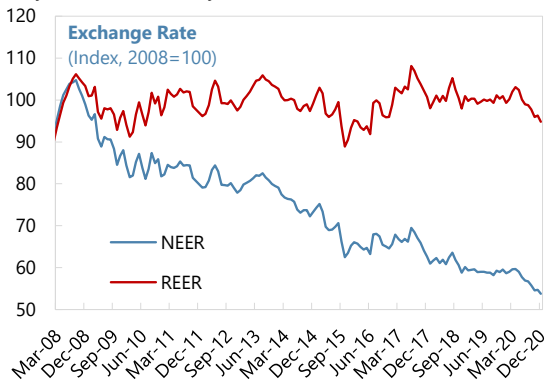
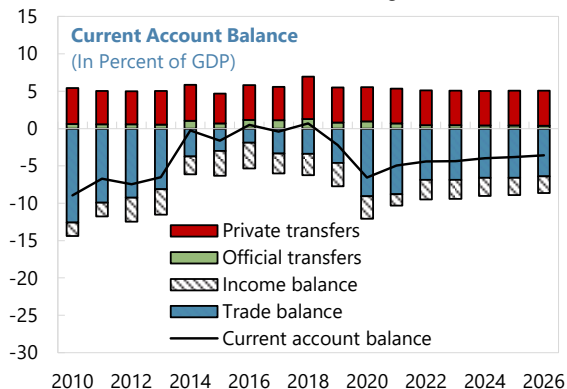
Sources: Malagasy Authorities; and IMF staff estimates.

Figure 3. Madagascar: Inflation and External Developments

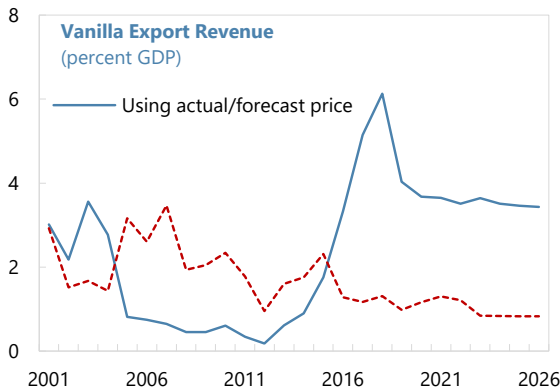
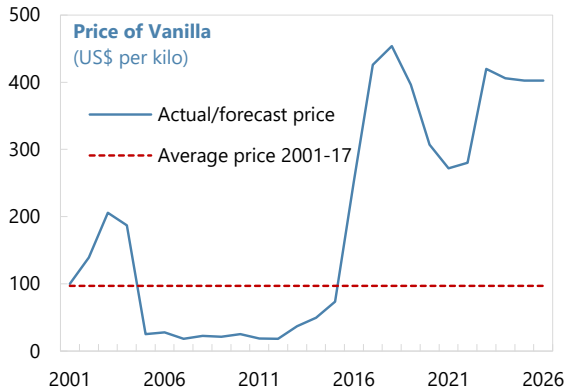
After peaking in December 2017, inflation has declined gradually.



The current account deficit widened in 2020 due to the collapse in tourism receipts and is expected to decline slowly in the medium term. The real effective exchange rate has remained relatively stable in recent years.



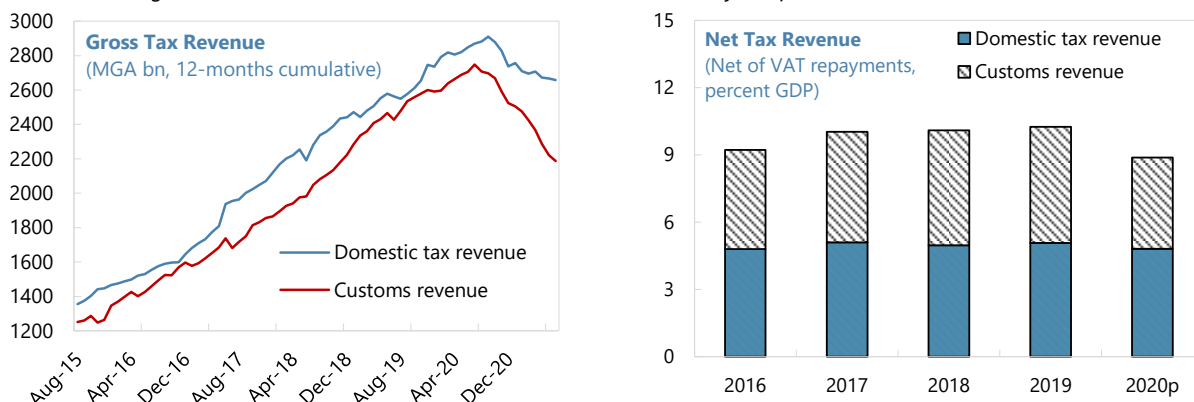
Vanilla prices and export revenue have dropped swiftly since end-2019 due to muted demand and increased global competition; they are expected to slowly recover as the crisis unwinds and prices continue to normalize.



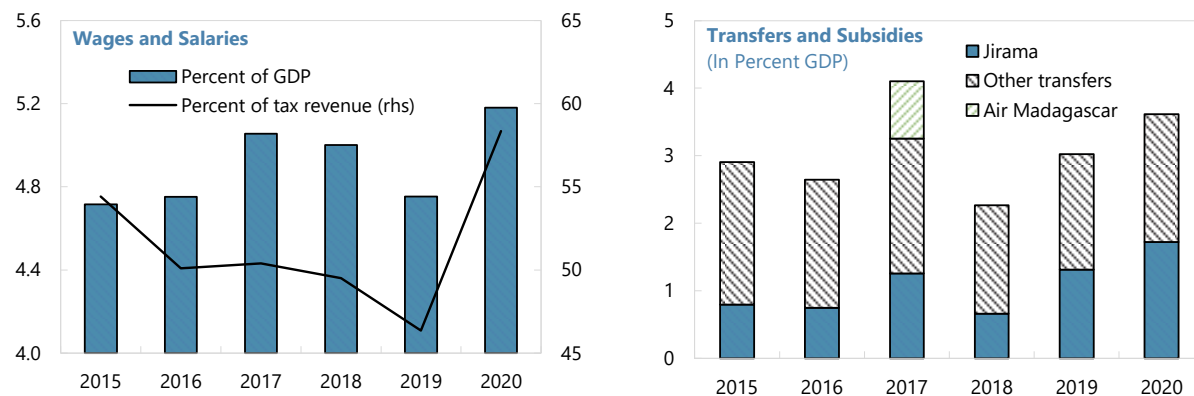
Sources: Malagasy Authorities; and IMF staff estimates.

Figure 4. Madagascar: Government Revenue and Spending

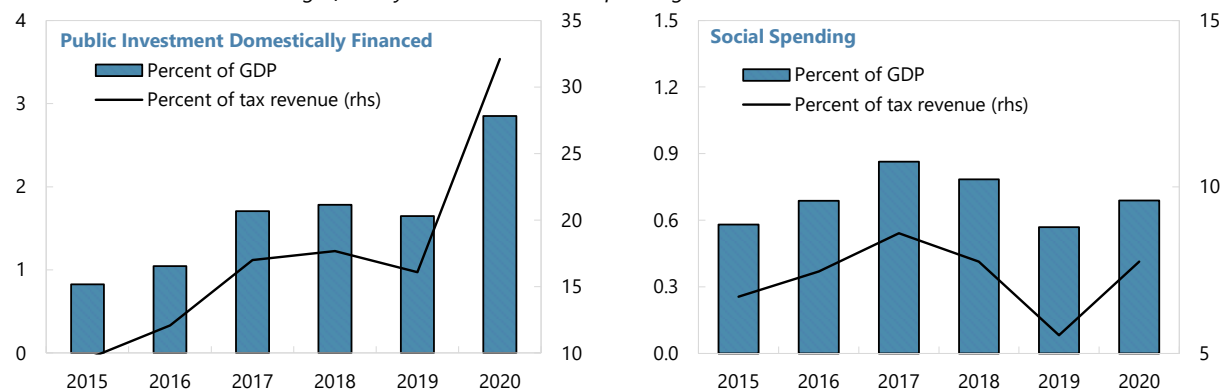
After increasing between 2016 and 2019, tax revenue has been hit hard by the pandemic shock.



Due to the pandemic and the associated drop in tax revenue, the wage bill jumped to more than 60 percent of tax revenue in 2020.



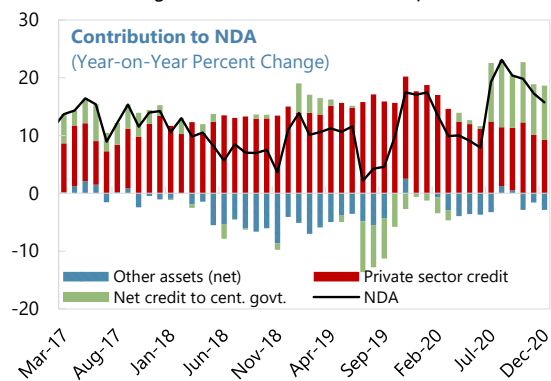
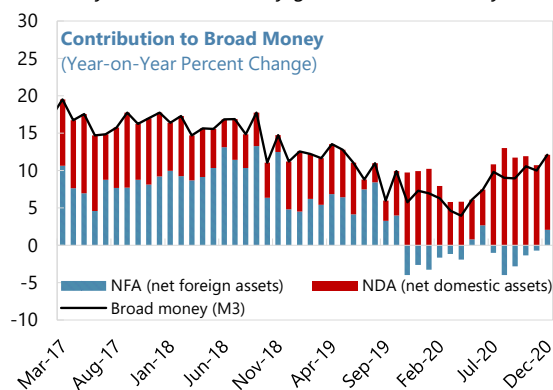
Public investment increased significantly in 2020, but social spending remains low.



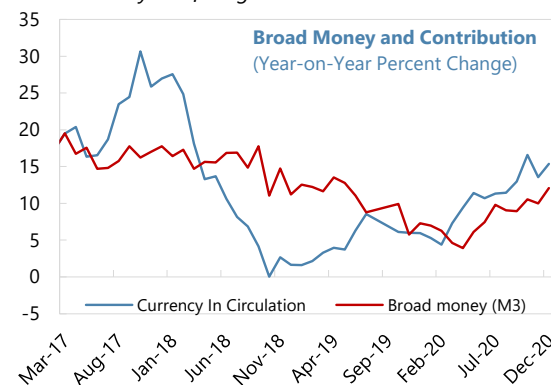
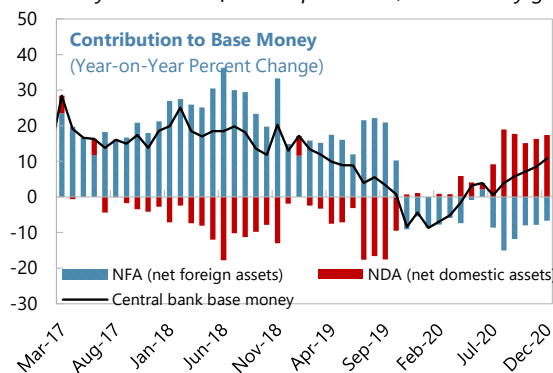
Sources: Malagasy Authorities; and IMF staff estimates.

Figure 5. Madagascar: Monetary Developments

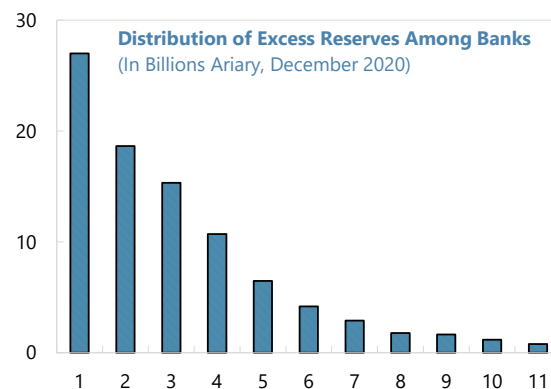
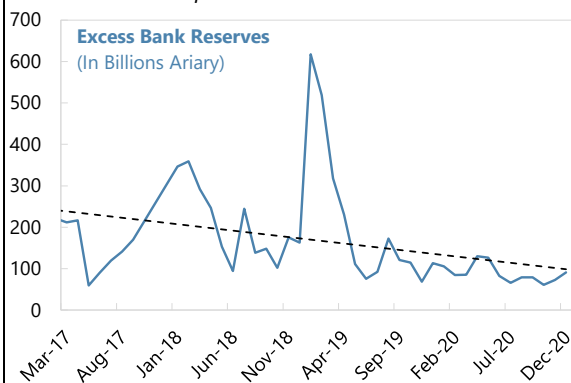
In recent years, broad money growth was driven by the accumulation of net foreign assets and credit to the private sector.



In recent years and before the pandemic, base money growth was also driven by net foreign assets.



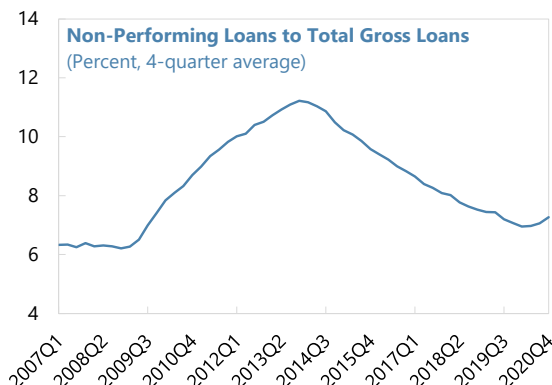
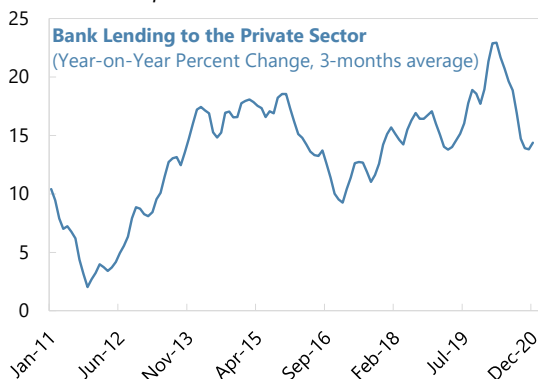
Excess bank reserves, usually volatile with strong seasonal effects related to the vanilla cycle, are declining and are concentrated in a few banks.



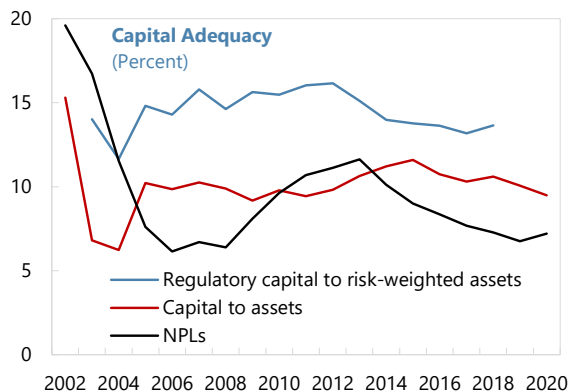
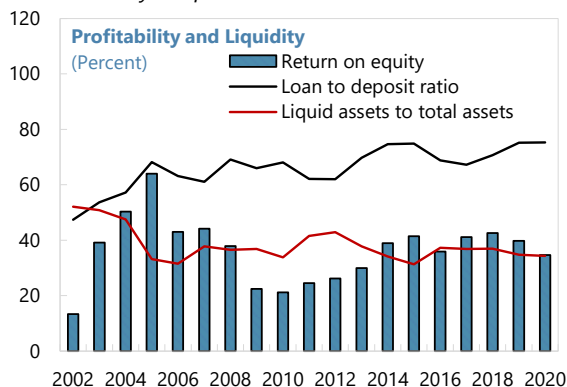
Sources: Malagasy Authorities; and IMF staff estimates.

Figure 6. Madagascar: Financial Sector Developments

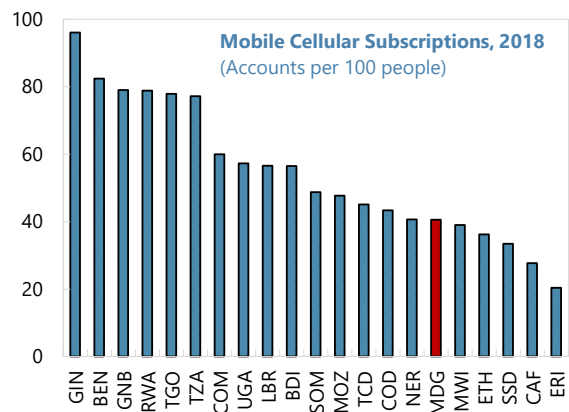
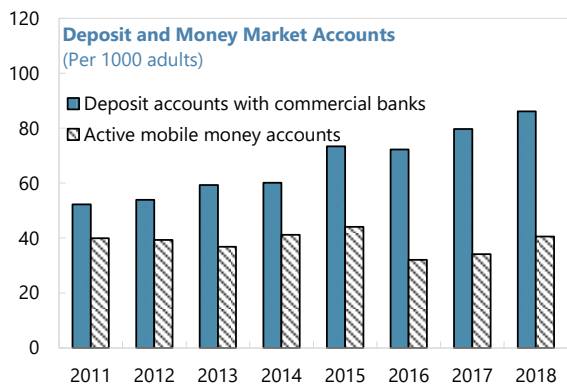
Despite the pandemic, credit has remained at a reasonable level so far. NPLs significantly declined since their peak in late 2013, but are expected to increase.



Overall, banks are well capitalized, liquid, and profitable, but the significant heterogeneity among banks has been exacerbated by the pandemic.



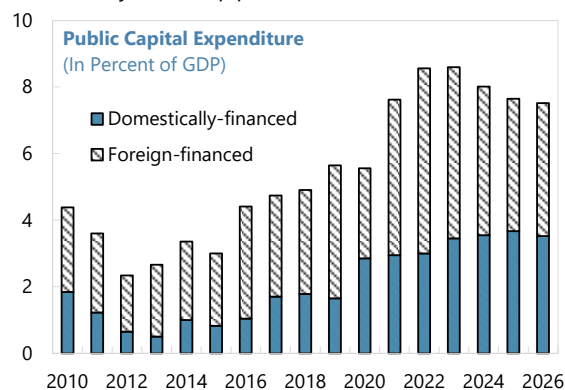
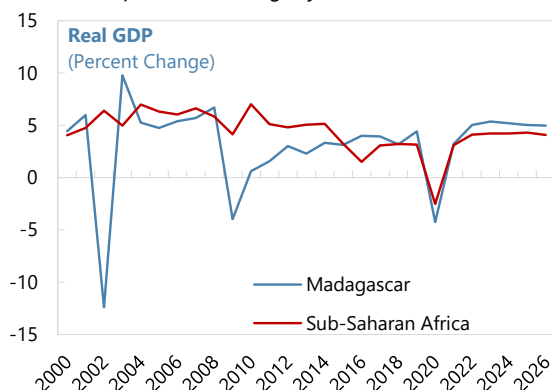
Mobile banking activities are rapidly increasing, but Madagascar lags most SSA low-income countries.



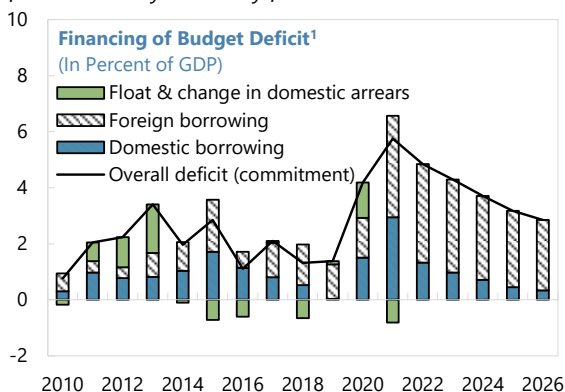
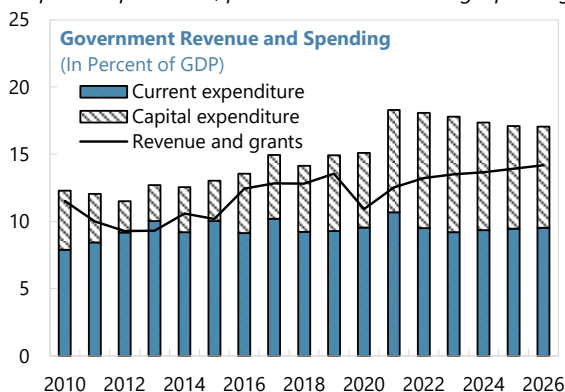
Sources: Malagasy Authorities; IMF Financial Access Survey; World Bank; and IMF staff estimates.

Figure 7. Madagascar: Medium-Term Macroeconomic Prospects

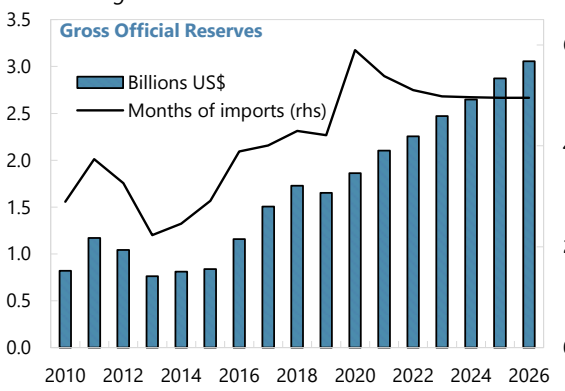
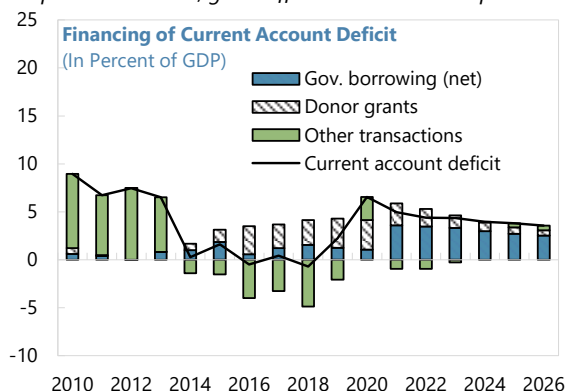
Growth is expected to be slightly above the Sub-Saharan average, sustained by scaled-up public investment.



Despite the pandemic, public investment scaling-up is ongoing; deficits are mostly externally financed.



Investment-driven increases in the current-account deficit are expected to be financed by concessional borrowing. Despite the pandemic shock, gross official reserves are expected to continue increasing.



Sources: Malagasy Authorities; and IMF staff estimates.

Note: ¹Domestic borrowing is net, not showing short-term T-bill rollover, and including net on-lending of IMF financing by the central bank.

Table 1. Madagascar: Selected Economic Indicators, 2018-26

	2018	2019	2020		2021		2022	2023	2024	2025	2026
		Est.	Art IV	Est.	Art IV	Proj.	Projections				
(Percent change; unless otherwise indicated)											
National account and prices											
GDP at constant prices	3.2	4.4	5.2	-4.2	5.4	3.2	5.0	5.4	5.2	5.0	5.0
GDP deflator	8.6	5.6	7.2	4.2	6.5	5.4	5.7	6.0	5.7	5.5	5.4
Consumer prices (end of period)	6.9	4.0	6.2	4.6	5.9	5.4	6.0	5.8	5.6	5.5	5.5
Money and credit											
Reserve money	13.0	-4.4	12.2	10.8	11.4	17.1	4.4	4.9	4.0	5.5	4.2
Broad money (M3)	11.2	7.3	16.2	12.1	14.9	21.8	10.4	10.9	9.4	9.3	9.3
(Growth in percent of beginning-of-period money stock (M3))											
Net foreign assets	4.8	-2.6	6.9	2.1	7.6	2.2	3.1	5.4	5.4	7.5	7.6
Net domestic assets	6.4	9.9	9.3	10.0	7.2	19.6	7.3	5.5	4.0	1.7	1.7
of which: Credit to the private sector	8.7	10.3	7.3	5.6	5.8	8.0	4.5	4.9	5.0	5.1	5.1
(Percent of GDP)											
Public finance											
Total revenue (excluding grants)	10.4	10.5	11.2	9.2	11.7	10.3	11.4	12.2	12.8	13.3	13.6
of which: Tax revenue	10.1	10.3	10.9	8.9	11.3	10.0	11.1	11.9	12.5	13.0	13.3
Grants	2.4	3.0	2.5	1.8	1.4	2.3	1.8	1.3	0.9	0.6	0.6
of which: budget grants	0.9	0.7	0.7	0.8	0.0	0.5	0.3	0.3	0.3	0.3	0.2
Total expenditures	14.1	14.9	16.4	15.1	17.3	18.3	18.1	17.8	17.4	17.1	17.0
Current expenditure	9.2	9.3	8.9	9.5	8.9	10.7	9.5	9.2	9.4	9.5	9.5
Capital expenditure	4.9	5.6	7.6	5.6	8.3	7.6	8.6	8.6	8.0	7.7	7.5
Domestic financed	1.8	1.6	3.1	2.9	3.1	2.9	3.0	3.5	3.6	3.7	3.5
Foreign financed	3.1	4.0	4.4	2.7	5.2	4.7	5.6	5.1	4.5	4.0	4.0
Overall balance (commitment basis)	-1.3	-1.4	-2.7	-4.2	-4.2	-5.8	-4.8	-4.3	-3.7	-3.2	-2.9
Float (variation of accounts payable, + = increase)	-0.2	0.3	0.1	1.3	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Variation of domestic arrears (+ = increase)	-0.5	-0.2	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-2.0	-1.3	-2.7	-2.9	-4.3	-6.6	-4.8	-4.3	-3.7	-3.2	-2.9
Domestic primary balance ¹	0.1	0.3	0.0	-2.6	0.3	-2.5	-0.4	0.2	0.5	0.7	1.1
Total financing	2.0	1.3	2.7	2.9	3.8	6.6	4.1	3.9	3.5	3.0	2.7
Foreign borrowing (net)	1.4	1.2	2.2	1.4	3.3	3.6	3.5	3.3	3.0	2.7	2.5
Domestic financing	0.5	0.0	0.5	1.5	0.4	2.9	0.6	0.5	0.5	0.3	0.1
of which: onlending of IMF financing ²				2.4		1.0					
Fiscal financing need ³	0.0	0.0	0.0	0.0	-0.5	0.0	-0.7	-0.4	-0.2	-0.2	-0.2
Savings and investment											
Investment	20.7	20.6	22.0	15.1	23.0	18.4	20.6	22.2	21.7	21.6	21.5
Gross national savings	21.1	19.8	20.5	8.5	21.5	13.4	16.2	17.8	17.8	17.7	18.0
External sector											
Exports of goods, f.o.b.	21.7	18.0	19.0	14.0	20.1	16.5	18.0	19.1	19.3	20.0	20.2
Imports of goods, c.i.f.	27.4	26.2	27.0	22.8	27.3	25.2	26.2	27.7	28.0	29.0	29.0
Current account balance (exc. grants)	-1.9	-5.3	-4.0	-9.6	-2.9	-7.2	-6.2	-5.7	-4.9	-4.5	-4.1
Current account balance (inc. grants)	0.7	-2.2	-1.5	-6.5	-1.5	-5.0	-4.4	-4.3	-4.0	-3.8	-3.6
Public debt	39.8	37.8	39.8	43.6	40.8	46.9	47.8	48.6	49.1	49.3	49.6
External Public Debt	26.4	26.6	27.6	32.0	29.1	34.7	36.1	37.3	38.1	38.6	38.9
Domestic Public Debt	13.4	11.2	12.2	11.6	11.6	12.2	11.7	11.3	11.0	10.7	10.6
(Units as indicated)											
Gross official reserves (millions of SDRs)	1221	1196	1390	1338	1552	1449	1540	1680	1793	1940	2057
Months of imports of goods and services	4.3	4.2	4.4	5.9	4.5	5.4	5.1	5.0	5.0	5.0	5.0
Real effective exchange rate (pa, percent change)	-2.4	-0.7	...	-0.8	...	...	...	...	...	...	...
Terms of trade (percent change, deterioration -)	5.6	-15.5	-3.5	-8.5	6.3	6.2	1.8	0.2	0.1	0.3	0.9
Memorandum items											
GDP per capita (U.S. dollars)	533	540	557	502	588	521	551	582	609	635	662
Nominal GDP at market prices (billions of ariary)	46,601	52,533	57,786	52,413	64,860	57,024	63,300	70,701	78,626	87,118	96,381

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹Primary balance excl. foreign-financed investment and grants. Commitment basis.

²RCF disbursements in 2020 and planned ECF disbursements in 2021, onlent by the central bank to the Treasury.

³A negative value indicates a financing gap to be filled by budget support or other financing still to be committed or identified.

Table 2. Madagascar: National Accounts, 2018-26

	2018	2019	2020		2021		2022	2023	2024	2025	2026
			Est.	Art. IV	Est.	Art. IV	Proj.	Projections			
	(Percent change)										
Real supply side growth											
Primary sector	0.4	5.9	3.5	2.0	3.5	2.6	3.0	3.4	3.3	3.2	3.1
<i>of which:</i> Agriculture	3.2	7.6	4.0	2.3	4.0	3.0	3.5	4.0	3.8	3.7	3.6
Secondary sector	2.0	6.8	7.4	-16.0	7.6	4.9	9.5	7.4	6.4	5.9	5.7
<i>of which:</i>											
Manufacturing	3.4	8.2	10.5	-4.0	11.5	2.0	4.5	6.8	7.1	6.4	6.2
Energy	4.4	3.7	9.7	5.0	9.8	5.0	5.8	8.6	9.5	8.1	7.7
Extractive industry	-0.8	9.9	9.4	-36.3	9.1	8.1	19.3	11.1	8.1	7.3	7.2
Tertiary sector	0.8	5.0	5.1	-1.1	5.4	2.8	4.3	5.7	5.9	5.7	5.4
<i>of which:</i>											
Trade	2.5	2.3	2.0	-3.9	2.1	1.0	1.9	2.4	2.6	2.9	3.2
Services	-0.4	2.9	3.0	2.2	3.7	2.5	4.3	5.4	5.1	4.6	3.9
Transportation	-3.6	4.8	4.9	-1.0	4.9	1.5	3.5	6.0	6.9	7.3	7.7
Indirect taxes	24.0	-1.1	7.2	-0.5	6.5	5.4	5.7	6.0	5.7	5.5	5.4
Real GDP at market prices	3.2	4.4	5.2	-4.2	5.4	3.2	5.0	5.4	5.2	5.0	5.0
	(Percent of GDP)										
Nominal demand side composition											
Resource balance	-3.4	-4.6	-4.7	-9.1	-4.2	-8.8	-6.9	-6.9	-6.6	-6.6	-6.4
Imports of goods and nonfactor services	34.6	32.4	33.9	27.4	34.4	31.8	33.2	34.5	34.6	35.2	35.1
Exports of goods and nonfactor services	31.2	27.8	29.2	18.3	30.2	23.1	26.3	27.6	28.0	28.6	28.7
Current account balance (including grants) = (S-I)	0.7	-2.2	-1.5	-6.5	-1.5	-5.0	-4.4	-4.3	-4.0	-3.8	-3.6
Consumption	84.3	83.6	84.3	94.8	82.8	91.4	87.3	85.7	85.9	86.1	86.0
Government	13.4	14.7	13.7	15.1	13.8	16.9	15.0	14.6	14.8	15.0	15.1
Private	70.9	68.9	70.6	79.7	69.0	74.5	72.2	71.2	71.1	71.2	70.9
Investment (I)	20.7	20.6	22.0	15.1	23.0	18.4	20.6	22.2	21.7	21.6	21.5
Government	4.9	5.6	7.6	5.6	8.3	7.6	8.6	8.6	8.0	7.7	7.5
Private	15.8	15.0	14.4	9.5	14.7	10.7	12.1	13.6	13.7	13.9	14.0
<i>of which:</i> foreign direct investment	3.6	2.6	2.7	1.8	2.7	2.2	2.4	2.8	2.9	3.0	3.1
National savings (S)	21.1	19.8	20.5	8.5	21.5	13.4	16.2	17.8	17.8	17.7	18.0
Government	2.8	3.6	4.1	0.7	3.4	1.0	3.0	3.7	3.7	3.9	4.1
Private	18.3	16.2	16.4	7.9	18.1	12.4	13.2	14.2	14.1	13.9	13.9
<i>Memoranda items:</i>	(Billions of Ariary)										
Nominal GDP (at market prices)	46,601	52,533	57,786	52,413	64,860	57,024	63,300	70,701	78,626	87,118	96,381

Sources: Malagasy Authorities; and IMF staff estimates and projections.

Table 3a. Madagascar: Fiscal Operations of the Central Government, 2018-26
(Billions of Ariary)

	2018	2019	2020		2021		2022	2023	2024	2025	2026
		Est.	Art. IV	Est.	Art. IV	Proj.	Projections				
Total revenue and grants	5,971	7,115	7,952	5,718	8,445	7,148	8,375	9,554	10,738	12,132	13,674
Total revenue	4,837	5,528	6,493	4,799	7,563	5,859	7,206	8,629	10,026	11,566	13,129
Tax revenue	4,706	5,387	6,292	4,654	7,357	5,694	7,023	8,425	9,799	11,314	12,860
Domestic taxes	2,315	2,666	3,319	2,526	4,024	3,204	3,986	4,848	5,711	6,645	7,572
Taxes on international trade and transactions	2,391	2,721	2,973	2,128	3,334	2,490	3,036	3,577	4,088	4,669	5,289
Non-tax revenue	131	140	200	146	206	165	183	204	227	252	269
Grants	1,134	1,587	1,460	918	882	1,289	1,169	925	711	566	545
Current grants	414	365	430	434	0	290	198	204	212	220	228
Capital grants	720	1,222	1,030	484	882	999	971	721	499	346	317
Total expenditure and lending minus repayments	6,585	7,840	9,504	7,915	11,202	10,432	11,440	12,586	13,655	14,903	16,425
<i>of which: Social spending (IT definition)¹</i>	365	299	555	367	800	514	...	...	...	...	...
Current expenditure	4,298	4,874	5,132	4,999	5,793	6,088	6,018	6,507	7,357	8,238	9,184
Wages and salaries	2,330	2,497	2,903	2,715	3,230	3,182	3,486	3,758	4,167	4,617	5,060
Interest payments	353	356	452	355	448	482	437	461	497	521	531
Foreign	105	107	133	109	146	173	106	102	98	95	94
Domestic	248	249	319	246	302	309	331	358	399	426	437
Other	1,404	1,911	1,602	2,247	2,015	1,931	1,986	2,165	2,556	2,948	3,426
Goods and services	349	323	428	351	571	436	503	537	687	827	1,024
Transfers and subsidies	1,055	1,587	1,174	1,896	1,444	1,494	1,483	1,628	1,869	2,121	2,402
<i>of which: JIRAMA (operating subsidies)</i>	309	219	150	170	150	121	80	0	0	0	0
<i>of which: JIRAMA (arrears repayment)</i>	...	507	...	532	...	279	...	...	...	...	...
Treasury operations (net)	211	110	175	-317	100	493	110	123	137	151	167
Capital expenditure	2,287	2,966	4,372	2,915	5,409	4,344	5,421	6,079	6,299	6,665	7,241
Domestic financed	831	866	1,810	1,494	2,014	1,680	1,900	2,440	2,793	3,200	3,393
Foreign financed	1,456	2,100	2,562	1,421	3,395	2,664	3,521	3,639	3,506	3,465	3,848
Overall balance (commitment basis)	-614	-725	-1,552	-2,197	-2,757	-3,284	-3,065	-3,031	-2,918	-2,771	-2,751
Float (variation of accounts payable, + = increase)	-80	176	40	683	-30	-432	0	0	0	0	0
Variation of domestic arrears (+ = increase)	-225	-116	-48	-22	0	-30	0	0	0	0	0
Overall balance (including grants, cash basis)	-918	-665	-1,559	-1,536	-2,787	-3,745	-3,065	-3,031	-2,918	-2,771	-2,751
Domestic primary balance ²	60	144	3	-1,340	204	-1,426	-276	143	374	649	1,083
Total financing	918	665	1,559	1,536	2,456	3,745	2,624	2,729	2,734	2,630	2,561
Foreign borrowing (residency principle)	675	649	1,259	745	2,168	2,066	2,226	2,347	2,359	2,375	2,424
External borrowing, Gross	911	883	1,554	1,014	2,512	2,422	2,778	3,123	3,218	3,339	3,760
Budget support loans	176	5	21	77	0	756	228	204	212	220	228
<i>of which: Air Madagascar</i>	133	0	0	0	0	0	0	0	0	0	0
Project loans	735	878	1,533	937	2,512	1,665	2,550	2,918	3,006	3,119	3,531
Amortization on a due basis (-)	-236	-234	-295	-269	-344	-355	-552	-776	-859	-964	-1,335
Domestic borrowing (residency principle)	243	16	300	791	287	1,679	399	383	375	255	137
Monetary sector	220	-31	300	590	209	1,685	310	312	336	211	89
<i>of which: onlending of IMF financing³</i>	...	...	...	1,238	...	556	...	...	...	...	...
Non-monetary sector	-67	-13	0	-94	78	-7	89	71	39	44	48
Treasury correspondent accounts (net)	77	59	0	294	0	0	0	0	0	0	0
Fiscal financing need ⁴	0	0	0	0	-331	0	-441	-302	-183	-141	-189

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹Domestically financed spending of social ministries, excluding salaries, representing a limited share of total social spending.

²Primary balance excl. foreign-financed investment and grants. Commitment basis.

³RCF disbursement in 2020 and planned ECF disbursements in 2021, onlent by the central bank to the Treasury.

⁴A negative value indicates a financing gap to be filled by budget support or other financing still to be committed or identified.

Table 3b. Madagascar: Fiscal Operations of the Central Government, 2018-26
(Percent of GDP)

	2018	2019	2020		2021		2022	2023	2024	2025	2026
	Dec	Dec	Dec		Dec		Dec	Dec	Dec	Dec	Dec
		Est.	Art IV	Est.	Art IV	Proj.	Projections				
Total revenue and grants	12.8	13.5	13.8	10.9	13.0	12.5	13.2	13.5	13.7	13.9	14.2
Total revenue	10.4	10.5	11.2	9.2	11.7	10.3	11.4	12.2	12.8	13.3	13.6
Tax revenue	10.1	10.3	10.9	8.9	11.3	10.0	11.1	11.9	12.5	13.0	13.3
Domestic taxes	5.0	5.1	5.7	4.8	6.2	5.6	6.3	6.9	7.3	7.6	7.9
Taxes on international trade and transactions	5.1	5.2	5.1	4.1	5.1	4.4	4.8	5.1	5.2	5.4	5.5
Non-tax revenue	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Grants	2.4	3.0	2.5	1.8	1.4	2.3	1.8	1.3	0.9	0.6	0.6
Current grants	0.9	0.7	0.7	0.8	0.0	0.5	0.3	0.3	0.3	0.3	0.2
Capital grants	1.5	2.3	1.8	0.9	1.4	1.8	1.5	1.0	0.6	0.4	0.3
Total expenditure and lending minus repayments	14.1	14.9	16.4	15.1	17.3	18.3	18.1	17.8	17.4	17.1	17.0
<i>of which: Social spending (IT definition) ¹</i>	0.8	0.6	1.0	0.7	1.2	0.9	...	...	...	...	...
Current expenditure	9.2	9.3	8.9	9.5	8.9	10.7	9.5	9.2	9.4	9.5	9.5
Wages and salaries	5.0	4.8	5.0	5.2	5.0	5.6	5.5	5.3	5.3	5.3	5.3
Interest payments	0.8	0.7	0.8	0.7	0.7	0.8	0.7	0.7	0.6	0.6	0.6
Foreign	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.1	0.1	0.1	0.1
Domestic	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other	3.0	3.6	2.8	4.3	3.1	3.4	3.1	3.1	3.3	3.4	3.6
Goods and services	0.7	0.6	0.7	0.7	0.9	0.8	0.8	0.8	0.9	0.9	1.1
Transfers and subsidies	2.3	3.0	2.0	3.6	2.2	2.6	2.3	2.3	2.4	2.4	2.5
<i>of which: JIRAMA (operating subsidies)</i>	0.7	0.4	0.3	0.3	0.2	0.2	0.1	0.0	0.0	0.0	0.0
<i>of which: JIRAMA (arrears repayment)</i>		1.0		1.0		0.5					
Treasury operations (net)	0.5	0.2	0.3	-0.6	0.2	0.9	0.2	0.2	0.2	0.2	0.2
Capital expenditure	4.9	5.6	7.6	5.6	8.3	7.6	8.6	8.6	8.0	7.7	7.5
Domestic financed	1.8	1.6	3.1	2.9	3.1	2.9	3.0	3.5	3.6	3.7	3.5
Foreign financed	3.1	4.0	4.4	2.7	5.2	4.7	5.6	5.1	4.5	4.0	4.0
Overall balance (commitment basis)	-1.3	-1.4	-2.7	-4.2	-4.2	-5.8	-4.8	-4.3	-3.7	-3.2	-2.9
Float (variation of accounts payable, + = increase)	-0.2	0.3	0.1	1.3	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Variation of domestic arrears (+ = increase)	-0.5	-0.2	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants, cash basis)	-2.0	-1.3	-2.7	-2.9	-4.3	-6.6	-4.8	-4.3	-3.7	-3.2	-2.9
Domestic primary balance ²	0.1	0.3	0.0	-2.6	0.3	-2.5	-0.4	0.2	0.5	0.7	1.1
Total financing	2.0	1.3	2.7	2.9	3.8	6.6	4.1	3.9	3.5	3.0	2.7
Foreign borrowing (residency principle)	1.4	1.2	2.2	1.4	3.3	3.6	3.5	3.3	3.0	2.7	2.5
External borrowing, Gross	2.0	1.7	2.7	1.9	3.9	4.2	4.4	4.4	4.1	3.8	3.9
Budget support loans	0.4	0.0	0.0	0.1	0.0	1.3	0.4	0.3	0.3	0.3	0.2
<i>of which: Air Madagascar</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project loans	1.6	1.7	2.7	1.8	3.9	2.9	4.0	4.1	3.8	3.6	3.7
Amortization on a due basis (-)	-0.5	-0.4	-0.5	-0.5	-0.5	-0.6	-0.9	-1.1	-1.1	-1.1	-1.4
Domestic borrowing (residency principle)	0.5	0.0	0.5	1.5	0.4	2.9	0.6	0.5	0.5	0.3	0.1
Monetary sector	0.5	-0.1	0.5	1.1	0.3	3.0	0.5	0.4	0.4	0.2	0.1
<i>of which: onlending of IMF financing ³</i>				2.4		1.0					
Non-monetary sector	-0.1	0.0	0.0	-0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.0
Treasury correspondent accounts (net)	0.2	0.1	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal financing need ⁴	0.0	0.0	0.0	0.0	-0.5	0.0	-0.7	-0.4	-0.2	-0.2	-0.2

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹Domestically financed spending of social ministries, excluding salaries, representing a limited share of total social spending.

²Primary balance excl. foreign-financed investment and grants. Commitment basis.

³RCF disbursement in 2020 and planned ECF disbursements in 2021, onlent by the central bank to the Treasury.

⁴A negative value indicates a financing gap to be filled by budget support or other financing still to be committed or identified.

Table 4. Madagascar: Fiscal Operations of the Central Government
 Quarterly Projections for 2021 (Billions of Ariary)

	Mar	Jun	Sept	Dec
	Projections			
Total revenue and grants	1,268	2,968	4,765	7,149
Total revenue	1,176	2,670	4,181	5,859
Tax revenue	1,152	2,588	4,058	5,694
Domestic taxes	657	1,470	2,318	3,204
Taxes on international trade and transactions	495	1,118	1,740	2,490
Non-tax revenue	23	82	123	165
Grants	92	298	583	1,290
Current grants	0	47	47	291
Capital grants	92	251	536	999
Total expenditure and lending minus repayments	2,338	4,714	7,591	10,432
of which: Social spending (IT definition) ¹	77	154	282	513
Current expenditure	1,530	2,936	4,595	6,088
Wages and salaries	796	1,591	2,387	3,182
Interest payments	110	226	320	482
Foreign	29	80	116	173
Domestic	82	146	205	309
Other	270	713	1,453	1,931
Goods and services	68	175	327	436
Transfers and subsidies	202	538	1,126	1,494
of which: JIRAMA (operating subsidies)	24	48	61	121
of which: JIRAMA (arrears repayment)		55	180	292
Treasury operations (net)	354	406	435	493
Capital expenditure	808	1,778	2,996	4,344
Domestic financed	305	712	1,231	1,680
Foreign financed	503	1,066	1,765	2,664
Overall balance (commitment basis)	-1,070	-1,747	-2,826	-3,283
Float (variation of accounts payable, + = increase)	-674	-458	58	-432
Variation of domestic arrears (+ = increase)	-24	-30	-30	-30
Overall balance (including grants, cash basis)	-1,768	-2,235	-2,797	-3,745
Domestic primary balance ²	-549	-752	-1,324	-1,426
Total financing	1,768	2,235	2,797	3,745
Foreign borrowing (residency principle)	894	1,190	1,529	2,066
External borrowing, Gross	940	1,345	1,758	2,422
Budget support loans	530	530	530	756
Project loans	410	815	1,228	1,665
Amortization on a due basis (-)	-46	-156	-229	-355
Domestic borrowing (residency principle)	874	1,045	1,269	1,679
Monetary sector	1,004	1,103	1,252	1,685
of which: onlending of IMF financing ³	0	275	275	556
Non-monetary sector	-30	-8	17	-7
Treasury correspondent accounts (net)	0	0	0	0
Fiscal financing need ⁴	0	0	0	0

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹Domestically financed spending of social ministries, excluding salaries, representing a limited share of total social spending.

²Primary balance excl. foreign-financed investment and grants. Commitment basis.

³RCF disbursement in 2020 and planned ECF disbursements in 2021, onlent by the central bank to the Treasury.

⁴A negative value indicates a financing gap to be filled by budget support or other financing still to be committed or identified.

Table 5. Madagascar: Balance of Payments, 2018-26

	2018	2019	2020		2021		2022	2023	2024	2025	2026
		Est.	Art. IV	Est.	Art. IV	Proj.	Projections				
	(Millions of SDRs)										
Current account	70	-234	-164	-651	-185	-503	-478	-510	-499	-511	-506
Goods and services	-335	-482	-522	-901	-499	-891	-749	-807	-826	-882	-911
Trade balance of goods	-324	-611	-606	-654	-552	-647	-631	-706	-769	-844	-875
Exports, f.o.b.	2,143	1,891	2,118	1,387	2,417	1,673	1,963	2,243	2,418	2,671	2,866
of which: Mining	594	551	696	257	732	441	633	653	715	743	777
of which: Vanilla	605	423	481	366	439	371	383	428	440	462	488
Imports, f.o.b.	-2,467	-2,502	-2,724	-2,041	-2,970	-2,320	-2,594	-2,949	-3,187	-3,516	-3,741
of which: Petroleum products	-387	-403	-432	-256	-464	-337	-337	-345	-358	-373	-390
of which: Food	-373	-327	-363	-323	-376	-363	-379	-395	-388	-404	-421
of which: Intermediate goods and capital	-997	-1,014	-1,183	-805	-1,193	-852	-1,055	-1,290	-1,482	-1,637	-1,770
Services (net)	-11	129	84	-247	53	-245	-119	-101	-57	-37	-36
Receipts	935	1,036	1,134	436	1,205	669	910	998	1,095	1,151	1,211
of which: Travels	489	538	597	103	641	291	483	545	627	652	678
Payments	-946	-907	-1,050	-683	-1,152	-914	-1,029	-1,099	-1,152	-1,189	-1,246
Income (net)	-281	-329	-301	-300	-303	-154	-286	-298	-306	-307	-314
Receipts	40	44	48	35	55	43	45	46	53	61	70
Payments	-321	-373	-349	-335	-358	-197	-331	-344	-359	-368	-384
of which: interest on public debt	-22	-29	-26	-22	-27	-21	-18	-17	-16	-15	-14
Current transfers (net)	686	578	659	550	617	543	557	595	633	678	718
Official transfers	126	86	123	97	43	70	51	52	53	54	56
of which: Budget aid ¹	85	73	83	83	0	54	34	34	34	34	34
Private transfers	560	491	536	453	574	472	507	543	580	623	663
Capital and financial account	41	150	291	517	298	508	536	638	631	702	699
Capital account ¹	171	247	198	221	163	178	167	120	80	53	47
of which: Project grant ¹	171	247	198	221	163	178	167	120	80	53	47
Financial account	-14	-52	93	296	135	330	368	519	552	649	652
Foreign direct and portfolio investment	351	270	298	176	326	225	265	329	366	401	438
Other investment	-364	-322	-206	120	-192	105	103	190	185	247	214
Government	154	131	232	107	390	366	378	390	377	364	357
Drawing	204	181	295	165	465	430	474	519	514	512	554
Project drawings ¹	167	176	295	151	465	297	440	485	480	478	520
Budgetary support ¹	37	5	0	14	0	133	34	34	34	34	34
Amortization	-50	-50	-63	-58	-74	-64	-95	-129	-137	-148	-197
Private sector	-156	-244	-239	-121	-243	-98	-245	-248	-151	-148	-145
Banks	38	-12	0	-37	0	0	0	0	0	0	0
Other (inc. unrepatriated export revenues)	-407	-221	-200	171	-339	-163	-30	47	-40	31	2
Errors and omissions	-116	-44	0	0	0	0	0	0	0	0	0
Overall balance	110	-83	127	-134	113	5	57	128	133	191	193
Financing	-110	83	-127	134	-175	-5	-57	-128	-133	-213	-221
Use of IMF credit (net)	24	59	25	25	-12	85	30	12	-19	-65	-104
Other assets, net (increase = -) ²	-135	25	-152	-141	-162	-111	-91	-140	-113	-147	-117
Exceptional financing-Grant for debt relief under CCRT ³	0	0	0	6		12	3	0	0	0	0
Exceptional financing-G-20 DSSI				0		9					
Exceptional financing-RCF disbursement				244							
Residual financing gap (unidentified financing)	0	0	0	0	61	0	0	0	0	22	28
	(Percent of GDP; unless otherwise indicated)										
Memorandum items:											
Grants	2.6	3.0	2.5	3.1	1.4	2.3	1.8	1.3	0.9	0.6	0.6
Loans	2.1	1.7	2.7	1.7	3.9	4.2	4.3	4.4	4.1	3.8	3.9
Direct investment	3.6	2.6	2.7	1.8	2.7	2.2	2.4	2.8	2.9	3.0	3.1
Current account											
Excluding net official transfers	-1.9	-5.3	-4.0	-9.6	-2.9	-7.2	-6.2	-5.7	-4.9	-4.5	-4.1
Including net official transfers	0.7	-2.2	-1.5	-6.5	-1.5	-5.0	-4.4	-4.3	-4.0	-3.8	-3.6
Debt service (percent of exports of goods)	1.7	3.5	3.7	2.5	3.4	2.3	3.7	3.7	2.8	2.7	2.9
Export of goods volume (percent change)	-4.8	6.5	8.6	-19.4	8.4	9.5	17.3	3.2	7.9	9.5	5.8
Import of goods volume (percent change)	-0.2	3.4	9.3	-17.9	10.1	9.5	13.8	2.9	8.2	9.7	6.0
Gross official reserves (millions of SDR)	1,221	1,196	1,390	1,338	1,552	1,449	1,540	1,680	1,793	1,940	2,057
Months of imports of goods and nonfactor services	4.3	4.2	4.4	5.9	4.5	5.4	5.1	5.0	5.0	5.0	5.0
Terms of trade (percent change, deterioration -)	5.6	-15.5	-3	-8.5	6.3	6.2	1.8	0.2	0.1	0.3	0.9
Exchange rate (ariary/US\$, period average)	3,335	3,618	...	3,788	...	...	...	...	...	...	...
Nominal GDP (US\$ million)	13,974	14,519	15,365	13,837	16,639	14,746	15,972	17,283	18,524	19,776	21,091

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

¹Includes official external financial support only with a disbursement schedule.

²Includes reserve accumulation.

³Debt relief assumed through April 2022, but subject to availability of CCRT resources for the last 18 months.

Table 6. Madagascar: Monetary Accounts, 2018-26¹

(Billions of Ariary, unless otherwise indicated)

	2018	2019	2020		2021		2022	2023	2024	2025	2026
	Dec	Dec	Dec		Dec		Dec	Dec	Dec	Dec	Dec
			Art. IV	Prel.	Art. IV	Proj.	Projections				
Net foreign assets	4,927	4,614	5882	4,876	7,055	5,194	5,729	6,759	7,899	9,643	11,572
Net foreign assets (BCM)	4,207	3,925	5088	3,597	6,232	3,870	4,360	5,334	6,415	8,099	9,966
Net foreign assets (deposit money banks)	720	689	794	1,279	823	1,323	1,369	1,425	1,484	1,544	1,606
Net domestic assets	6,871	8,045	9518	9,314	10,633	12,091	13,361	14,408	15,251	15,649	16,080
Domestic credit	7,935	9,125	11000	10,624	12,018	13,551	14,653	16,387	18,046	19,699	21,222
Net credit to government	2,099	2,074	3133	2,831	3,265	4,651	4,972	5,777	6,392	6,862	7,085
BCM ²	947	757	1051	982	1,051	2,514	2,530	2,562	2,590	2,458	2,152
DMBs	1,096	1,256	1667	1,565	1,786	1,718	2,012	2,772	3,346	3,935	4,452
Gross credits (mainly BTAs)	1,617	1,835	2221	2,146	2,374	2,325	2,612	3,407	4,017	4,642	5,197
Deposits	-521	-579	-554.1	-581	-588	-607	-600	-635	-671	-707	-745
Other credits	55	62	416	285	429	418	430	442	456	468	481
Credit to the economy	5,836	7,051	7867	7,792	8,752	8,900	9,681	10,610	11,654	12,837	14,137
Credit to public enterprises	40	43	39.67	59	40	59	59	59	61	63	67
Credit to private sector	5,765	6,980	7797	7,687	8,693	8,821	9,601	10,531	11,593	12,774	14,071
Other credits	31	28	30.88	46	20	20	20	20	0	0	0
Other items (net)	-1,064	-1,080	-1382	-1,310	-1,384	-1,260	-1,162	-1,267	-1,372	-1,574	-1,511
BCM	269	281	227.6	245	253	298	283	283	283	283	283
Other	-1,332	-1,361	-1610	-1,554	-1,637	-1,558	-1,445	-1,550	-1,655	-1,858	-1,794
Money and quasi-money (M3)	11,798	12,659	15400	14,190	17,689	17,285	19,089	21,167	23,150	25,292	27,652
Foreign currency deposits	1,202	1,111	1075	1,472	1,104	1,516	1,548	1,604	1,750	1,907	2,027
Short term obligations of commercial banks	60	73	50.79	87	51	51	51	51	51	51	51
Broad money (M2)	10,536	11,476	14274	12,632	16,534	15,718	17,490	19,512	21,350	23,335	25,574
Currency in circulation	3,391	3,315	3970	3,570	4,475	3,827	4,151	4,398	4,644	4,878	5,125
Demand deposits in local currency	3,687	4,426	5441	4,866	6,399	6,313	7,102	8,072	8,941	9,897	10,986
Quasi-money including time deposits	3,458	3,735	4863	4,196	5,660	5,578	6,236	7,042	7,764	8,559	9,463
Reserve money	5,153	4,927	6158	5,459	6,857	6,391	6,671	6,997	7,275	7,676	8,000
	(Percentage change relative to broad money at beginning of the year)										
Net foreign assets	5.3	-3.0	7.5	2.3	8.2	2.5	3.4	5.9	5.8	8.2	8.3
Net foreign assets (BCM)	7.1	-2.7	7.2	-2.9	8.0	2.2	3.1	5.6	5.5	7.9	8.0
Net foreign assets (deposit money banks)	-1.8	-0.3	0.3	5.1	0.2	0.4	0.3	0.3	0.3	0.3	0.3
Net domestic assets	7.1	11.1	10.1	11.1	7.8	22.0	8.1	6.0	4.3	1.9	1.8
Domestic credit	9.8	11.3	10.7	13.1	7.1	23.2	7.0	9.9	8.5	7.7	6.5
Net credit to government	0.1	-0.2	2.8	6.6	0.9	14.4	2.0	4.6	3.2	2.2	1.0
BCM	0.6	-1.8	0.1	2.0	0.0	12.1	0.1	0.2	0.1	-0.6	-1.3
DMBs	1.7	1.5	2.6	2.7	0.8	1.2	1.9	4.3	2.9	2.8	2.2
Other credits	-2.2	0.1	0.1	1.9	0.1	1.1	0.1	0.1	0.1	0.1	0.1
Credit to the economy	9.7	11.5	7.9	6.5	6.2	8.8	5.0	5.3	5.3	5.5	5.6
Credit to public enterprises	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	9.6	11.5	7.9	6.2	6.3	9.0	5.0	5.3	5.4	5.5	5.6
Other credits	0.1	0.0	0.0	0.2	-0.1	-0.2	0.0	0.0	-0.1	0.0	0.0
Other items (net; asset = +)	-2.7	-0.2	-0.6	-2.0	0.0	0.4	0.6	-0.6	-0.5	-0.9	0.3
	(Percentage change year-on-year)										
Broad money (M2)	10.3	8.9	15.4	10.1	17.4	24.4	11.3	11.6	9.4	9.3	9.6
Currency in circulation	9.4	-2.2	7.9	7.7	8.5	7.2	8.5	5.9	5.6	5.0	5.1
Demand deposits in local currency	5.2	20.0	23.1	9.9	19.9	29.7	12.5	13.7	10.8	10.7	11.0
Quasi-money in local currency	17.5	8.0	14.7	12.3	22.6	32.9	11.8	12.9	10.3	10.2	10.6
Credit to the private sector (in nominal terms)	19.0	21.1	18.5	10.1	14.1	14.7	8.9	9.7	10.1	10.2	10.2
Credit to the private sector (in real terms)	12.0	17.1	12.5	5.6	7.9	9.3	2.9	3.9	4.5	4.7	4.7
<i>Memorandum items:</i>											
Credit to private sector (percent of GDP)	12.4	13.3	13.3	14.7	13.5	15.5	15.2	14.9	14.7	14.7	14.6
Money multiplier (M3/reserve money)	2.3	2.6	2.4	2.6	2.5	2.7	2.9	3.0	3.2	3.3	3.5
Velocity of money (GDP/end-of-period M3)	3.9	4.1	3.9	3.7	3.8	3.3	3.3	3.3	3.4	3.4	3.5

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹End of period.²Large increases in 2020 and 2021 reflect RCF disbursements and planned ECF disbursements onlent by the central bank to the Treasury.

Table 7. Madagascar: Balance Sheet of the Central Bank, 2019–21¹

(Billions of Ariary, unless otherwise indicated)

	2019	2020	2021			
	Dec	Dec	Mar	Jun	Sep	Dec
		Est.	Projections			
Net foreign assets	3,925	3,597	3,936	3,811	3,647	3,870
Gross foreign assets	5,977	7,370	7,986	7,835	7,690	8,260
Gross foreign liabilities	-2,052	-3,772	-4,050	-4,024	-4,044	-4,390
Net domestic assets	1,002	1,862	1,960	2,096	2,364	2,521
Credit to government (net)	757	982	1,911	1,982	2,119	2,514
Claims on central government	1,103	2,269	2,322	2,615	2,707	3,021
Statutory advances	85	0	71	100	200	250
Securitized debt (T-bonds and bills)	701	658	640	628	640	628
Discounted bills of exchange	8	0	0	0	0	0
On-lending of funds	308	1,610	1,610	1,886	1,886	2,155
Other credits	1	1	1	1	1	1
Government deposits	-347	-1,287	-411	-634	-589	-507
Claims on other sectors	23	-126	-1	-36	-4	-127
Claims on banks: Liquidity operations (+ = injection)	-58	609	-250	-250	-200	-250
Other items (net; asset +)	281	397	300	400	450	383
Reserve money	4,927	5,459	5,897	5,907	6,011	6,392
Currency in circulation	3,315	3,570	3,265	3,367	3,464	3,827
Bank reserves	1,561	1,823	2,565	2,474	2,480	2,498
Currency in banks	335	354	354	354	354	354
Deposits	1,226	1,469	1,633	2,120	2,127	2,144
Resident deposits	51	66	66	66	66	66
			(Cumulative annual flows, unless otherwise stated)			
<i>Memorandum items:</i>						
Net foreign assets	-282	-328	339	214	49	273
Net foreign assets (Millions of SDRs)	-90	-131	60	36	3	26
Net domestic assets	57	860	98	234	502	659
Credit to government (net)	-191	225	929	1,000	1,137	1,532
Reserve money	-225	532	437	448	552	932
Exchange Rate (MDG/SDR, end of period)	5,006	5,509	...	...	...	...
Net foreign assets (Millions of SDRs)	784	653	713	689	656	679

Sources: Malagasy Authorities; and IMF staff estimates and projections.

¹End of period.

Table 8. Madagascar: Selected Financial Soundness Indicators,¹ 2018–20

(Ratios, percent, unless otherwise indicated)

	2018	2019	2020	2020	2020	2020
	Dec	Dec	Mar	Jun	Sep	Dec
Capital Adequacy						
Regulatory capital to risk-weighted assets	13.7					
Capital to assets	10.6	10.1	10.4	9.5	9.6	9.4
Regulatory Tier 1 capital to risk-weighted assets	13.6					
Tier 1 to assets	7.8					
Non-performing loans net of provisions to capital	15.7	15.2	15.1	17.1	15.8	19.2
Net open position in equities to capital	4.1	4.0	3.8	4.2	4.6	4.2
Asset Quality						
Non-performing loans to total gross loans	7.3	6.8	7.1	7.2	7.2	7.6
Earnings and Profitability						
Return on assets	4.3	4.1	3.7	3.4	3.3	3.1
Return on equity	42.6	39.8	36.4	34.7	33.1	32.2
Interest margin to gross income	61.0	60.7	62.0	62.3	61.6	60.7
Non-interest expenses to gross income	54.2	54.5	56.4	57.1	58.0	57.9
Trading income to total income	4.9	5.7	5.8	6.0	6.4	6.6
Personnel expenses to non-interest expenses	31.7	32.6	32.3	32.6	31.9	30.6
Liquidity						
Liquid assets to total assets (liquid asset ratio)	36.9	34.8	37.2	34.3	33.9	35.2
Liquid assets to short-term liabilities	54.8	50.1	53.4	48.6	47.7	49.1
Customer deposits to total (non-interbank) loans	141.1	136.5	136.9	138.5	137.5	139.4
Sensitivity to Market Risk						
Net open position in foreign exchange to capital	5.6	5.5	7.1	4.6	3.4	6.5
Spread between reference lending and deposit rates (basis point)	1,144	1,073	1,023	1,030	1,027	1,022
Foreign currency-denominated loans to total loans	12.1	11.5	10.3	13.1	13.0	12.9
Foreign currency-denominated liabilities to total liabilities	13.8	13.4	13.9	13.9	14.0	15.0

Sources: Malagasy authorities.

¹Ratios only concern banking sector

Table 9. Madagascar: External Financing Requirements and Sources, 2020-24
(Millions of US Dollars)

	2020	2021	2022	2023	2024
Total financing requirements	1,281	1,430	1,447	1,545	1,503
Current account deficit (excl. budget grants)	1,021	810	750	801	786
Net repayment of private sector debt	169	143	359	364	223
Repayment of government debt	81	92	139	190	202
Gross reserves accumulation (+ = increase) ¹	197	162	133	206	167
IMF repayments	9	18	27	55	64
Other (inc. unrepatriated export revenues)	-196	206	39	-70	59
Available financing	1,281	1,430	1,447	1,545	1,503
Foreign direct and portfolio investment	245	327	388	484	541
Budget support grants	115	79	50	50	50
Budget support loans	20	193	50	50	50
Project support	518	689	889	890	826
Project grants	308	258	245	176	118
Project drawings	211	431	643	713	708
IMF: RCF disbursements and ECF arrangement	383	142	72	72	36
Budget support to be programmed	0	0	0	0	0
<i>Memorandum items:</i>					
Gross official reserves	1,863	2,104	2,254	2,471	2,647

Sources: Malagasy Authorities; and IMF staff estimates and projections.

Table 10. Madagascar: Projected External Borrowing Program, on a Contractual Basis
March 1, 2021 to March 31, 2022 (Millions of US Dollars)

PPG external debt	Volume of new debt in 2021		PV of new debt in 2021 (program purposes)	
	USD million	Percent	USD million	Percent
By sources of debt financing	1190.0	100	691.9	100
<i>Concessional debt, of which</i>	1037.9	87	553.5	80
Multilateral debt	545.5	46	301.7	44
Bilateral debt	492.4	41	251.8	36
Other	0.0	0	0.0	0
<i>Non-concessional debt, of which</i>	152.1	13	138.4	20
Semi-concessional	82.1	7	68.4	10
Commercial terms	70.0	6	70.0	10
By Creditor Type	1190.0	100	691.9	100
Multilateral	587.5	49	332.3	48
Bilateral - Paris Club	156.0	13	44.0	6
Bilateral - Non-Paris Club	368.7	31	238.3	34
Other	77.8	7	77.3	11
Uses of debt financing	1190.0	100	691.9	100
Infrastructure	956.6	80	564.0	82
Social Spending	40.0	3	18.9	3
Budget Financing	14.0	1	6.0	1
Other	179.4	15.1	103.0	14.9

Sources: Malagasy authorities; and IMF staff projections.

Table 11. Madagascar: Proposed Schedule of Disbursements and Timing of ECF Arrangement Reviews

Availability Date	Disbursement		Conditions for Disbursement
	(In percent of quota)	(In SDR millions)	
March 29, 2021	20.0	48.88	Board approval of the arrangement
November 15, 2021	20.0	48.88	Board completion of first review based on observance of performance criteria for end-June 2021
May 16, 2022	10.0	24.44	Board completion of second review based on observance of performance criteria for end-December 2021
November 15, 2022	10.0	24.44	Board completion of third review based on observance of performance criteria for end-June 2022
May 15, 2023	10.0	24.44	Board completion of fourth review based on observance of performance criteria for end-December 2022
November 15, 2023	10.0	24.44	Board completion of fifth review based on observance of performance criteria for end-June 2023
May 15, 2024	10.0	24.44	Board completion of sixth review based on observance of performance criteria for end-December 2023
Total	90.0	219.96	

Source: IMF.

Table 12. Madagascar: Indicators of Capacity to Repay the Fund, 2021-35

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
	(Millions of SDRs)														
Fund obligations based on existing credit															
Principal	12.2	18.5	37.2	43.6	65.3	99.0	92.7	74.0	64.6	39.8	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fund obligations based on existing and prospective credit															
Principal	12.2	18.5	37.2	43.6	65.3	103.9	114.7	105.8	106.1	83.8	39.1	22.0	12.2	2.4	0.0
Charges and interest	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total obligations based on existing and prospective credit															
Millions of SDRs	12.3	18.6	37.3	43.6	65.4	103.9	114.8	105.9	106.2	83.9	39.2	22.1	12.3	2.5	0.1
Billions of Ariary	69	108	224	273	426	705	808	772	803	656	317	185	106	22	1
Percent of exports of goods and services	0.5	0.6	1.1	1.2	1.7	2.5	2.7	2.4	2.3	1.7	0.8	0.4	0.2	0.0	0.0
Percent of debt service	8.2	10.9	18.1	20.2	28.7	37.8	32.8	28.5	25.8	18.8	8.9	4.6	2.3	0.4	0.0
Percent of GDP	0.1	0.2	0.3	0.3	0.5	0.7	0.8	0.7	0.6	0.5	0.2	0.1	0.1	0.0	0.0
Percent of government revenue	1.2	1.5	2.6	2.7	3.7	5.4	5.5	4.7	4.4	3.3	1.4	0.7	0.4	0.1	0.0
Percent of quota	5.0	7.6	15.2	17.8	26.7	42.5	47.0	43.3	43.5	34.3	16.0	9.0	5.0	1.0	0.0
Outstanding IMF credit based on existing and prospective drawings															
Millions of SDRs	632.4	662.8	674.5	655.4	590.1	486.2	371.5	265.7	159.6	75.8	36.7	14.7	2.4	0.0	0.0
Billions of Ariary	3,550	3,845	4,059	4,106	3,848	3,299	2,614	1,938	1,206	593	297	123	21	0	0
Percent of exports of goods and services	27.0	23.1	20.8	18.7	15.4	11.9	8.7	6.0	3.4	1.5	0.7	0.3	0.0	0.0	0.0
Percent of debt service	423.7	388.8	328.3	302.8	259.1	176.8	106.0	71.4	38.8	16.9	8.3	3.1	0.5	0.0	0.0
Percent of GDP	6.2	6.1	5.7	5.2	4.4	3.4	2.5	1.6	0.9	0.4	0.2	0.1	0.0	0.0	0.0
Percent of government revenue	60.6	53.4	47.0	40.9	33.3	25.1	17.8	11.9	6.7	2.9	1.3	0.5	0.1	0.0	0.0
Percent of quota	258.8	271.2	276.0	268.2	241.4	198.9	152.0	108.7	65.3	31.0	15.0	6.0	1.0	0.0	0.0
Net use of IMF credit (millions of SDRs)															
Disbursements	85.5	30.4	11.7	-19.1	-65.3	-103.9	-114.7	-105.8	-106.1	-83.8	-39.1	-22.0	-12.2	-2.4	0.0
Repayments and repurchases	97.8	48.9	48.9	24.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	12.2	18.5	37.2	43.6	65.3	103.9	114.7	105.8	106.1	83.8	39.1	22.0	12.2	2.4	0.0
Memorandum items:	(Billions of Ariary, unless otherwise indicated)														
Exports of goods and services (millions of SDRs)	2,342	2,874	3,241	3,513	3,823	4,077	4,273	4,452	4,692	4,931	5,198	5,486	5,789	6,107	6,458
Debt service	837.9	989.1	1,236.6	1,356.1	1,485.2	1,866.0	2,465.3	2,712.7	3,105.6	3,499.8	3,581.6	3,992.4	4,548.9	5,167.1	5,915.1
Nominal GDP (at market prices)	57,024	63,300	70,701	78,626	87,118	96,381	106,614	117,878	130,270	143,896	158,872	175,323	193,386	213,088	234,667
Government revenue	5,859	7,206	8,629	10,026	11,566	13,129	14,726	16,343	18,129	20,102	22,279	24,681	27,407	30,403	33,706
Quota (millions of SDRs)	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4	244.4

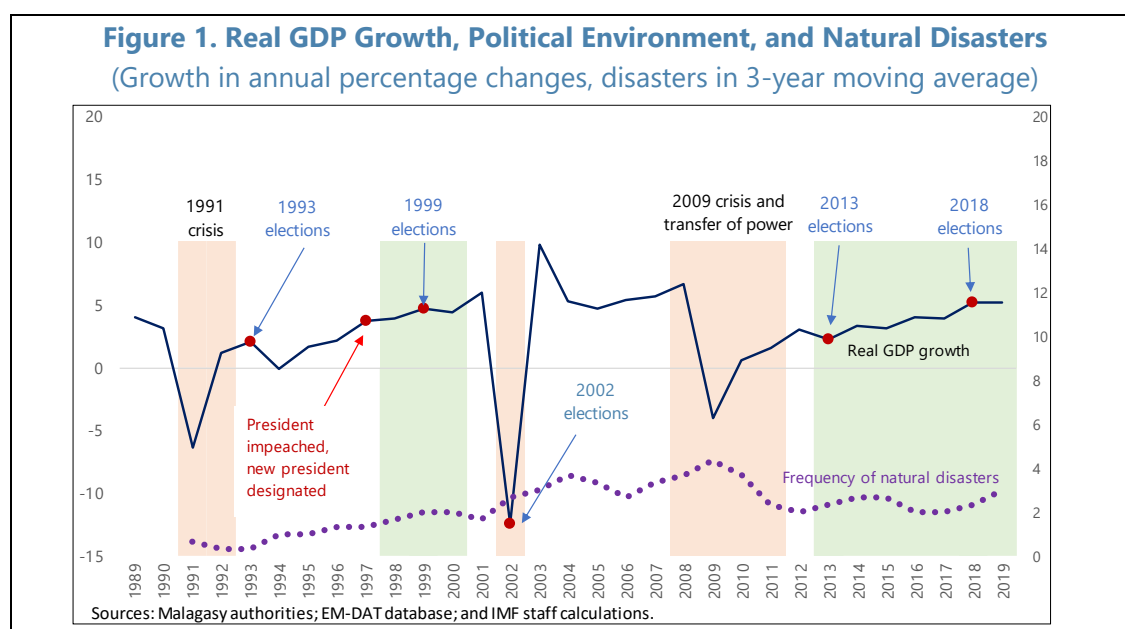
Source: IMF.

Annex I. Madagascar's Fragility and Challenges¹

The COVID-19 pandemic reversed recent improvements in growth outcomes since the country's re-engagement with the international community. After the return to constitutional order in 2014 and re-engagement with the international community, Madagascar experienced a rebound in economic growth and relative stability during 2014-2019. The first peaceful constitutional handover of power from one elected administration to another in decades after the 2018 Presidential elections and the Parliamentary elections in May 2019 stand out in Madagascar's history considering recurrent episodes of political crises and associated economic volatility.

1. Historical trends of declining incomes and stagnating poverty levels point to Madagascar's deep-rooted challenges. Per capita income has generally been on a declining trend since the 1960 independence. Madagascar is one of only eight countries with lower real per capita income today than in 1960, and the only one among these countries not affected by armed conflict or war during this period. With nominal GDP per capita just over US\$500 in 2019 and three-fourths of the population living on less than US\$1.90 a day at purchasing power parity make Madagascar one of the poorest countries in the world.

2. Exposure to natural disasters and political instability have contributed to short-lived growth episodes and growth volatility (Figure 1). With an average of three cyclones per year and several episodes of droughts and floods, Madagascar is among the countries most affected by extreme weather events in Africa, with almost a fifth of its population living in zones at high risk of cyclones or floods. Natural disasters and other exogenous shocks, such as locust infestations and health epidemics, are estimated to cost the economy—particularly rural and agriculture-based activities—about 1 percent of GDP per year, on average.



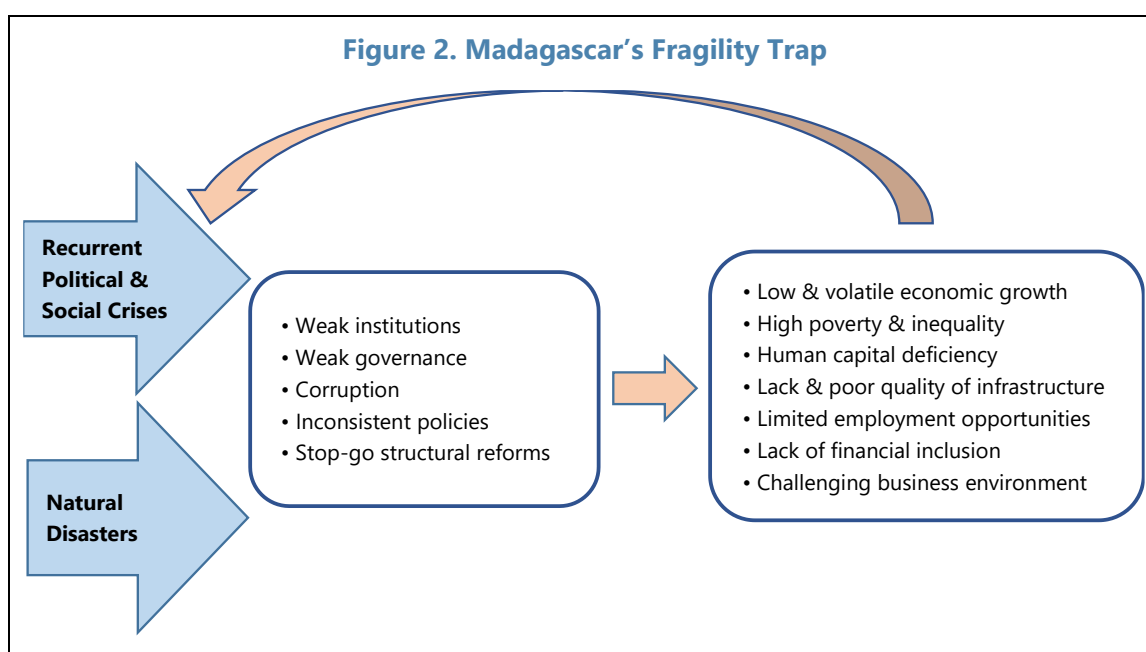
¹ Madagascar was a pilot for developing a Country Engagement Strategy. See also IMF Country Report No. 20/60.

Sources and Consequences of Fragility

3. Despite progress during 2014-2019 Madagascar is susceptible to a “fragility trap”.²

Over the past decades, political instability, the poor quality of institutions and governance, and weak or inconsistent economic policies have impaired economic performance and the delivery of basic social services. As a result, challenges are numerous and difficult: widespread and persistent poverty, high income inequality, human capital indicators among the worst worldwide, lack and poor quality of basic infrastructures, lack of financial inclusion, systemic corruption, lack of sources of employment and income, and a challenging business environment.

4. **Madagascar’s many dimensions of fragility present challenges for sustaining inclusive growth and improving social indicators.** Like other fragile countries, Madagascar’s dimensions of fragility are related to political, social, economic, infrastructure and governance deficiencies (Figure 2). These include widespread and persistent poverty; large disparities between urban and rural areas; poor human capital indicators; an infrastructure deficit that constrains private sector investment and growth; low financial inclusion; slow progress in implementing governance and anti-corruption frameworks; and a challenging business environment.



5. **This fragility has created immense challenges, summed up by poor performance towards making progress in achieving the SDGs.** Latest reports from the 2019 Africa SDG Index suggest that Madagascar ranks 44 out of 52 countries in Africa and has a global rank of 158 out of 162 countries according to the 2019 SDG Report. Madagascar faces major or significant challenges in 15 out of the 17 goals in the 2019 SDG report, which include goals relating to poverty, access to electricity, access to clean water and sanitation, education, and health and well-being.

² The 2018 Report on Escaping the Fragility Trap by the LSE-Oxford Commission on State Fragility, Growth and Development focuses on what makes countries suffer from fragility and how to escape their “fragility trap”.

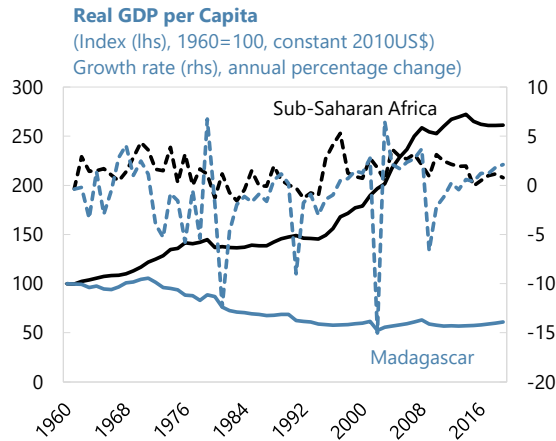
What to make of these challenges?

6. As for many fragile countries, the pandemic has stopped or even reversed years of progress on poverty reduction and SDGs. Estimates before COVID-19 projected a large amount of resources needed to mitigate Madagascar's fragilities, raise per capita growth, and make significant progress in achieving meaningful SDGs outcomes. Financing this effort was estimated to be very challenging, likely requiring increases in domestic public resources, private investment, and official development assistance. Both estimates of need and financing are likely to be significantly higher in the current context.

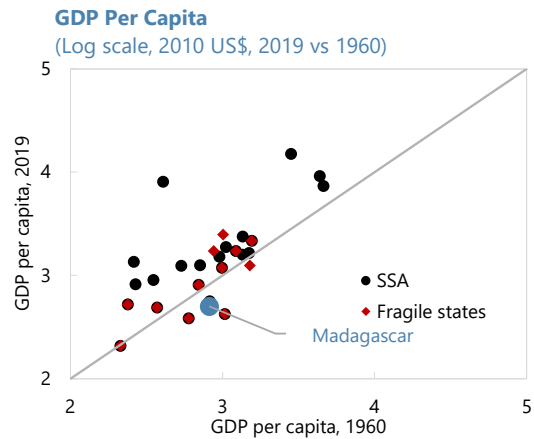
7. Fund and other donor engagement will remain crucial to help address Madagascar's numerous fragilities and challenges after COVID. The 2016-2020 Fund-supported ECF helped strengthen the macroeconomic framework, make progress in structural reforms, improve capacity, and catalyze additional donor support. During the past year, Fund emergency support through two RCF disbursements and other donors' disbursements were instrumental to help mitigate the effects of the COVID emergency. Continued support of IFIs will likely be needed as Madagascar and other fragile states move from the emergency to the recovery phase.

Figure 3. Indicators of Fragility

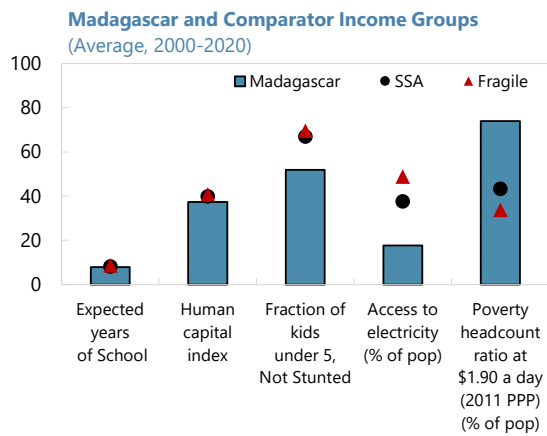
Growth improving particularly in the last few years...



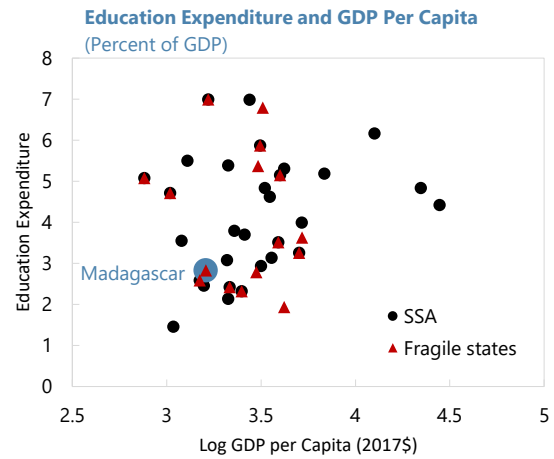
...but p.c. income overall declining, and lower than in 1960.



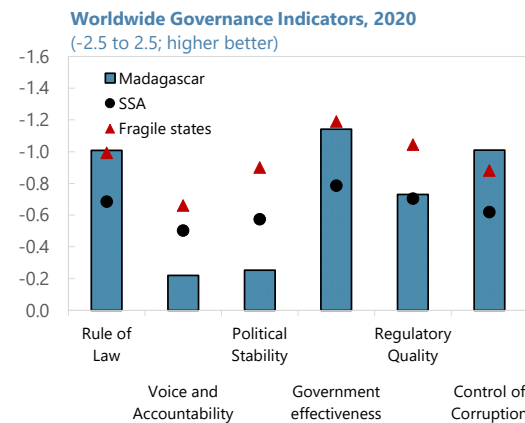
Development outcomes remain poor...



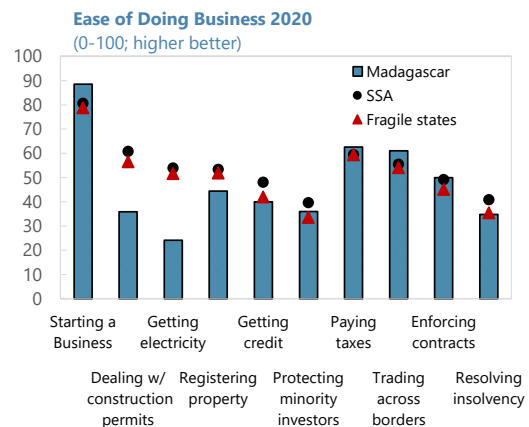
...and spending on health and education is low.



Recent advancements in governance must continue.



Improvements in the business climate are needed.



Sources: World Bank Doing Business 2020 indicators; Worldwide Governance Indicators; World Bank Gender statistics database; World Development Indicators, and IMF Staff estimates.

Annex II. The Plan Emergence Madagascar (PEM), 2019–2023

Following several rounds of consultations with stakeholders since 2019, the Plan Emergence Madagascar (PEM) for 2019–2023, building on the presidential electoral platform summarized in the 13 ‘velirano’ (commitments) of the president. The PEM aims to address long-standing development problems through a significant increase in economic growth, achieved through selected structuring projects mostly financed by private investors.

1. The Plan Emergence Madagascar is based on social, economic, and environmental pillars, with governance as the cross-cutting theme. Specific PEM priorities include:

- Improving governance, described as a foundation for emergence, including through the fight against corruption, improved security conditions, and greater decentralization.
- Strengthening human capital, with some strong focus on education, health, and employment.
- Accelerating economic growth by improving the business climate, ensuring reliable water and electricity provision, developing agriculture to cover domestic consumption, boosting tourism and the digital economy, upgrading transport infrastructure, and diversifying industries, including through specific investment zones and strengthened public-private partnerships.

2. The PEM outlines ambitious macroeconomic objectives, underpinned by major construction projects. Growth is expected to accelerate to 8 percent in 2023, mainly driven by a rapid increase in private investment, expected to reach 27.3 percent of GDP. Incentivized by guarantees offered by a proposed sovereign fund, investors are expected to help finance big projects such as the construction of a new city in Antananarivo, the renovation of the waterfront in Toamasina, the dredging of the Pangalanes canal, and the construction of hydroelectric dams. Fiscal sustainability would be preserved despite higher social and public investment spending by stepped up tax revenue mobilization, expected to reach 14 percent of GDP in 2023.

Selected Economic Indicators - PEM

	2020	2021	2022	2023
Real GDP growth (in percent)	-4.2	4.4	6.2	8.0
Tax revenue (in percent of GDP)	8.9	9.8	11.9	14.0
Total investment (in percent of GDP)	17.9	22.6	24.5	30.4
of which: public	5.6	9.1	9.8	9.9
of which: private	12.3	13.5	14.7	20.5

Sources: Ministry of Economy and Finance, General Directorate of Economy and Plan; National Institute for Statistics.

3. The implementation of the PEM is complicated by absorptive capacity constraints and the ability to mobilize public and private resources. The ambitious plans for scaling up public investment are contingent on effectively absorbing higher levels of foreign aid through accelerated project disbursements, making strides in revenue mobilization, and securing the involvement of both domestic and foreign investors, including through public private partnerships. Planning for higher investment also requires a careful assessment of the impact of structuring projects on debt sustainability and growth. At this stage, the policy actions envisaged in the PEM are mapped to 50 programs supporting the 13 presidential commitments (which

are linked to SDG-specific priorities), but further clarifications on implementation appear warranted, including regarding project prioritization, proper costing over and above existing commitments, and the programming of major projects.

4. The pace of scaling up set by the government is very ambitious, as public investment in Madagascar suffers from low efficiency and under-execution. In recent years, public investment has been under-executed compared to budget plans, especially for externally financed investment. Over 2020–2021, the estimated needs of public investment to realize the PEM are nearly double the projected investment financing under the baseline, at 41 percent vs 33.5 percent of GDP, respectively. Yet in recent years, budget allocation for public investment has exceeded execution by far, partly reflecting some poor performance in externally-financed investment (about two thirds of total public investment), which was planned at 5.5 and 4.6 percent of GDP in the budget laws for 2019 and 2020, but only executed at 4 and 2.7 percent of GDP, respectively. Domestically financed investment stood at only 1.6 and 2.9 percent of GDP in 2019 and 2020, respectively. Identifying and addressing bottlenecks in the efficiency and execution of public investment will be critical to the success of the PEM. A pre-COVID iteration of the IMF Debt-Investment-Growth (DIG) model for Madagascar showed that, holding all else constant, a rise in public investment efficiency to the SSA average could lead to a significant increase in real GDP per capita growth, rising by up to 0.7 percent in 2023 and 0.5 percent each year thereafter compared to the baseline scenario as at end-2019, in addition to boosting private consumption and investment.

5. Private investment in Madagascar has also remained subdued, owing to protracted political instability and a deteriorated business climate. After reaching a peak in the late 2000s (reflecting one large-scale project, the Ambatovy mine), private investment declined sharply to 17 percent in 2013 and has remained low since then, estimated at 9.5 percent for 2020. Further to deep-rooted governance issues, the World Bank *Doing Business 2020* report highlights areas of weakness in the investment climate, including low access to energy, limited access to credit, and challenges in dealing with paperwork for construction and property registration.

6. The magnitude of the growth impact from an investment scale-up as envisaged in the PEM crucially depends on progress in public investment efficiency and the business environment. To improve efficiency, the authorities should focus on the following areas for reform (Selected Issues, SM/20/20):

- **Appropriately prioritizing projects.** Available funding should focus on fully financing priority projects to ensure their completion.
- **Monitoring financing progress against the total project cost and duration to ensure sufficient resource allocation.** For each major project, the budget documents should show the reference to specific engagement and priority in the PEM as well as specific targets in the SDGs.
- **Proactively monitoring the implementation of major projects,** to identify project delays and take action to expedite them as necessary.
- **Ensuring adequate funding to complete ongoing projects.** Lack of adequate funding to cover expenditures for projects that have already begun will result in delays and likely increase total project costs.

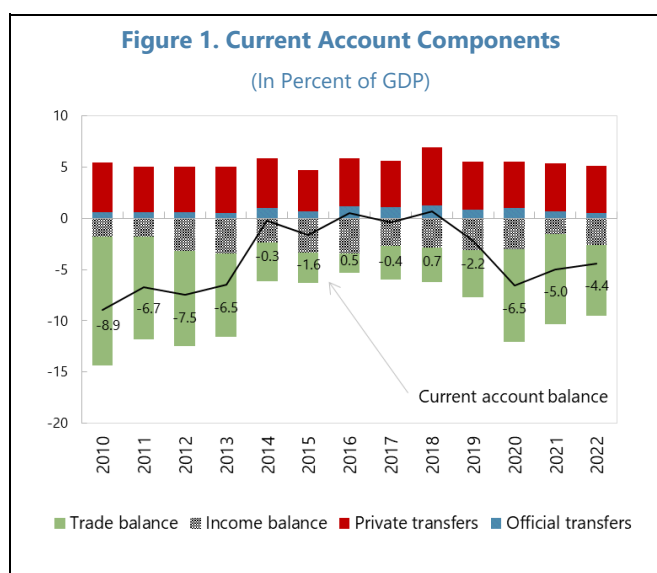
Annex III. External Sector Assessment

Overall Assessment: *The external position of Madagascar in 2020 is assessed to have been moderately stronger than the levels implied by fundamentals and desirable policies based on the current account model, in line with the March 2020 assessment.⁴ The external position is expected to continue converging towards its norm as capital infrastructure spending increases, and, with it, import demand. International reserves are adequate.*

1. Policy Responses: *A flexible exchange rate remains appropriate to act as a shock absorber, while ongoing use of the FXI algorithm to passively build reserves and avoid exceptional volatility would continue to promote stability. Efforts to formalize the mining sector should continue, but the temporary ban on gold exports should be lifted and the existing surrender requirement on export proceeds should be gradually phased out as the exchange market deepens (the average monthly volume traded was US\$16.1 million at end-December). Moreover, the gold purchase program for reserves diversification should be paused or discontinued until it is reconsidered with the help of Fund TA to ensure feasibility and competitiveness, and formally integrated into the BFM's reserve management. Finally, in addition to completing revisions of a new mining code under consultation with stakeholders, the foreign exchange law should be submitted to Parliament.*

Current Account

2. Background. After a current account deficit of 2.2 percent of GDP in 2019 behind declining vanilla prices and lower private transfers, the 2020 Covid-19 pandemic has negatively affected both the supply and demand of exports dramatically resulting in a 2020 deficit of 6.5 percent of GDP. Goods exports dropped 27 percent year-on-year. Exports of nickel and cobalt were zero since May due to the shutdown of the Ambatovy mine and, since 2020Q4, gold exports have been temporarily prohibited as part of a plan to improve the formalization of the sector, increase the repatriation of revenues, and diversify reserves. Meanwhile, vanilla prices dropped 23 percent since end-2019 due to muted demand and increased global competition, and tourism exports fell 81 percent y-o-y. Exports are expected to gradually recover; imports will also rise as capital spending is expected to increase. The export ban on gold is expected to be lifted by end-July 2021.



3. Assessment. The Current Account (CA) model suggests a current account gap of 1.2 percent of GDP in 2020, after including adjusters to the current account for the temporary impact of the pandemic on tourism, oil imports, and commodity exports.¹ The cyclically adjusted CA is -2.7 percent of GDP in 2020 and the CA norm is -4.0 percent of GDP, reflecting Madagascar's low levels of development. The REER model has an implied CA gap of 0.4 in 2020. These analyses suggest the external position is moderately stronger than the level implied by fundamentals and desirable policies. The current assessment is in line with the March 2020 assessment, which had a CA gap of 1.7. As imports increase behind higher capital expenditures to promote development, the CA deficit should begin to converge to its norm.

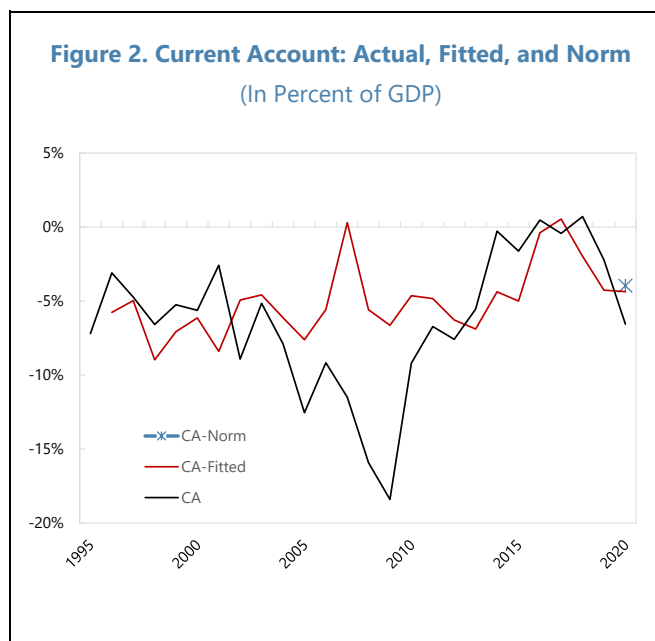


Table 1. Madagascar: Model Estimates for 2020
(In Percent of GDP)

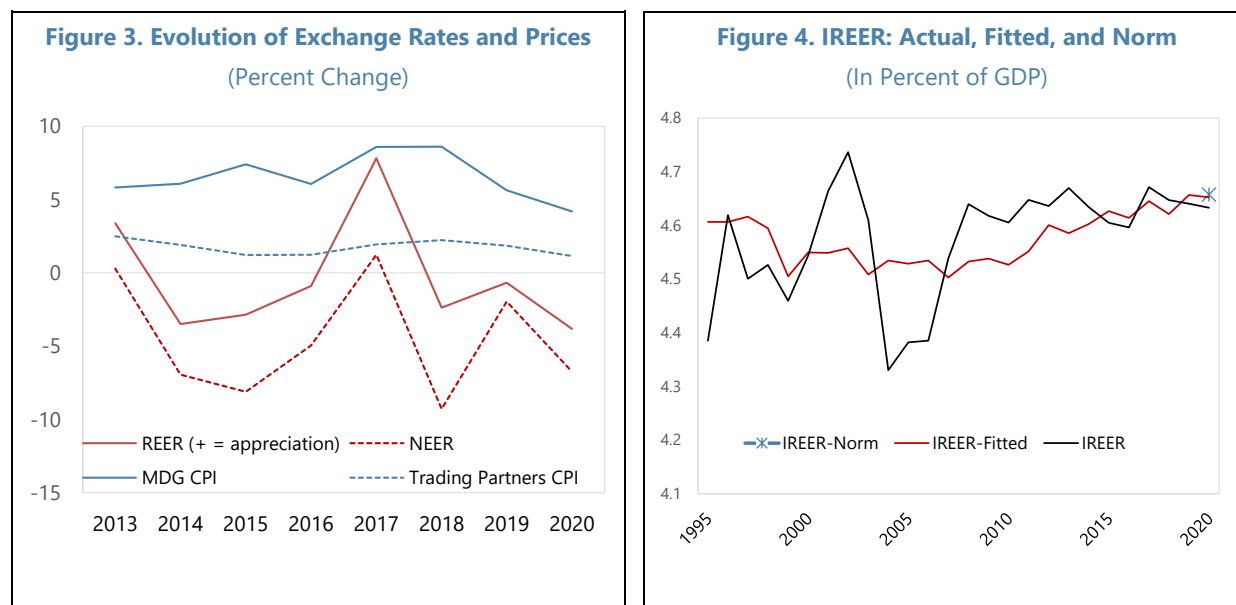
	CA model	REER model
CA-Actual	-6.5	
Cyclical contributions (from model)	-0.9	
Natural disasters and conflicts	-0.1	
Cyclical tourism effect	-2.0	
Cyclical oil effect	0.3	
Cyclical effect on other commodities (nickel, cobalt, and vanilla)	-1.0	
Adjusted CA	-2.7	
CA Norm (from model) 1/	-4.0	
Adjusted CA Norm	-4.0	
CA Gap	1.2	0.4
o/w Policy gap	1.1	
Elasticity	-0.16	
REER Gap (in percent)	-7.5	-2.5

1/ Cyclically adjusted, including multilateral consistency adjustments.

¹ The temporary component of the change in the oil balance is estimated as the difference between the change in the forecasted oil balance for 2020 and 2025 in the macro-framework and the same in the January 2020 WEO (before the Covid-19 shock). The temporary component of tourism is computed as the difference in trade balances between 2019 and 2020, while the temporary component of nickel, cobalt, and vanilla is computed using the difference in the trade balance between 2019 and 2020, holding 2019 prices constant (as terms-of-trade reflects the price effects

(continued)

Real Exchange Rate



4. Background. The average REER depreciated in 2020 by 3.8 percent, extending a multi-year trend of REER depreciations (with the exception of 2017). The 2020 REER depreciation has occurred due to a sizeable depreciation in the NEER and higher inflation in Madagascar compared to its trading partners. The Ariary depreciated 5 percent against the USD and 16 percent against the Euro year-on-year at end-2020.

5. Assessment. Based on the CA model, the estimated REER gap is -7.5 percent in 2020, while the REER model suggests a REER gap of -2.5, both pointing to undervaluation of the exchange rate.

Foreign Assets and Liabilities: Position and Trajectory

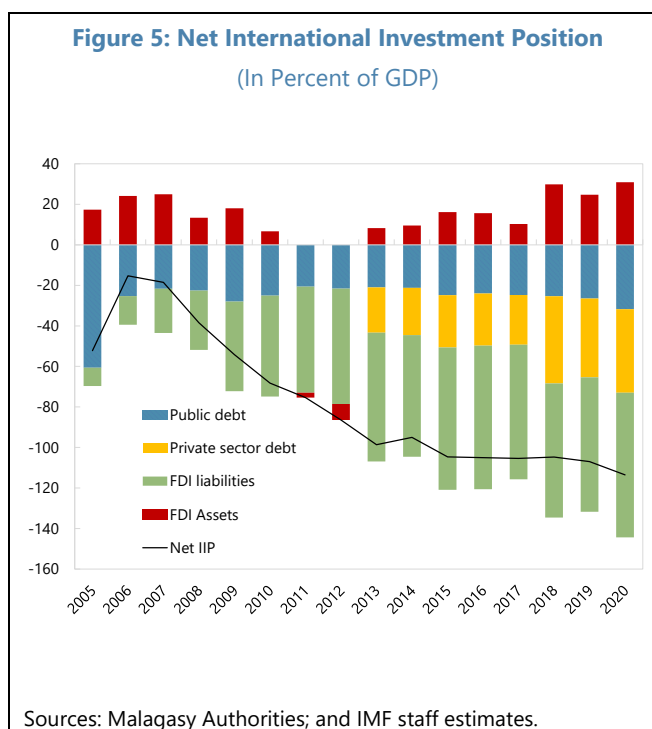
6. Background. The estimated net international investment position (NIIP) remains negative; from 2006 to 2020, the NIIP decreased from -15 to -114 percent of GDP, linked to large private sector liabilities in the mining sector.² The NIIP has been broadly stable in recent years, although it deteriorated slightly in 2020 due to pandemic related developments (i.e., an increase in external public debt while GDP has contracted).

separately). An auxiliary cross-country regression of the effects of tourism and oil shocks on the cyclically adjusted current account indicates that the current account ultimately reflects 60 percent of the shock. The same elasticity is applied to determine the cyclical effects of nickel, cobalt, and vanilla trade shocks, which yield the following adjustments, respectively: -1.2; -0.3; and 0.5.

² There is a structural break in the series at 2018 due to a recent revision of private sector debt based on an INSTAT survey. Data from 2018 onwards reflects these new estimates.

7. Assessment. The NIIP does not represent a critical vulnerability to external sustainability but is subject to risks. Most (over 80 percent) of external public debt is held by official creditors, namely multilateral institutions (e.g., the World Bank and African Development Bank), and is concessional. The risks associated with external private debt appear contained. Around 80 percent of the debt is associated with the mining sector; the sector's income is in foreign currency; the majority of its debt is medium-to-long term; and a sizeable portion of its debt is with its affiliated headquarters or global group. However, risks stem from temporary mining closures and project suspensions that could persist (e.g., Ambatovy); regulatory uncertainty related to a new mining code; and a faster-than-anticipated scaling up of infrastructure spending.

Capital and Financial Accounts: Flows and Policy Measures



8. Background. Capital grants were 2.2 percent of GDP in 2020; however, these are anticipated to taper off as broader access to financing on concessional terms weakens over time. FDI is of a similar size, reaching 1.8 percent of GDP in 2020 (down from 2.6 percent in 2019). FDI is projected to rebound in 2021, reaching 2.2 percent of GDP. Following adoption of the FX Law, the BFM plans to develop a plan to gradually phase out the existing surrender requirement on export proceeds, considered a capital flow management measure (CFM) under the IMF's Institutional View on the Liberalization and Management of Capital Flows (the IV) in a way that will not destabilize or put further pressure on the exchange market.

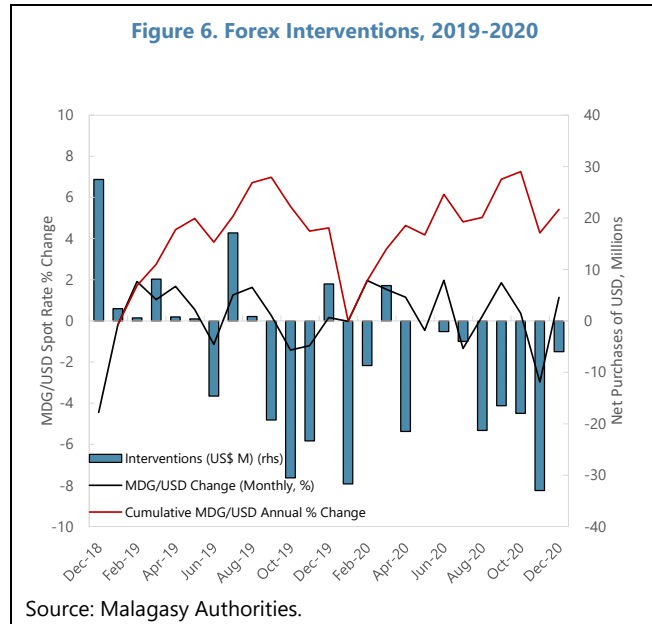
9. Assessment. There is no foreign portfolio investment; however, there could be a risk to foreign direct investment flows should there be major reversals or delays in structural reforms or a more protracted global crisis.

FX Intervention and Reserves Level

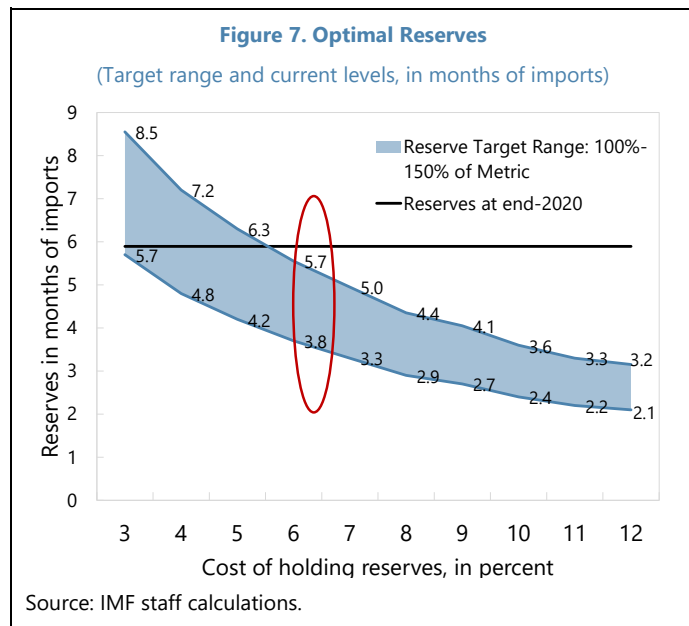
10. Background. Madagascar has a floating exchange rate regime and intervenes to smooth volatility and build reserves. 2020 reserves reached SDR 1338 million (13.5 percent of GDP) or 5.9 months of import coverage and up from its 2019 level of SDR 1196 million. Foreign currency interventions in 2020 were almost three times higher than last year's total net sales, while the Ariary has depreciated by 5 percent relative to the USD (and 16 percent relative to the Euro) at end-2020. Interventions were made to smooth volatility on the interbank currency market (the MID) and to help address Covid-19 related exchange rate volatility in 2020 (see Figure). The authorities are in

the process of reviewing and revising the parameters of the intervention algorithm.³

11. The BFM is seeking to diversify its reserve holdings and, in late 2020, began a program to purchase gold from local operators, which the BFM plans to refine in order to bring it to monetary gold standards. The BFM is currently conducting a feasibility study on setting up a refinery, with plans to eventually transfer refining responsibility to a private company. A February 2021 IMF Safeguards Assessment Mission indicated several concerns about the program, including that: the program is not yet anchored in the BFM’s reserve management strategy; ownership of a refinery is a quasi-fiscal operation outside traditional core-central banking activities which could harm the BFM’s financial position; cost uncertainties of refinement may result in an implicit subsidy to the mining sector; and there are substantial governance and reputational risks. The BFM should pause this purchase program by September 2021 and seek Fund TA to achieve its reserve diversification needs.



12. Assessment. International reserves are assessed as adequate. Reserves coverage is up from 4.2 months of import coverage in 2019 to 5.9 months of coverage in 2020 (and 4.7 months of coverage in terms of 2019 imports, highlighting that much of the increase is due to a decline in projected 2020 imports due to Covid-19). The projected level of reserves coverage exceeds the traditional three-month rule, as well as the upper bound of 5.7 from an ARA model for credit-constrained economies that compares the marginal costs of holding reserves against marginal benefits (see Figure). Reserves coverage is expected to fall back towards the adequacy bound in 2021 as imports rise more rapidly than reserve levels. Finally, Madagascar remains highly vulnerable to additional external shocks, including term-of-trade shocks and natural disasters that



³ Under the algorithm, the maximum allowance of either a weakening or strengthening in the spot rate relative to a rate in line with fundamentals is 5 percent, with intermediate margins that allow for a relatively larger depreciation of the exchange rate before triggering an intervention. When the exchange rate is within its designated fluctuation bands, the BFM accumulates reserves.

could put Madagascar's reserve path at risk. Moreover, coverage risks could also arise should government spending accelerate faster than anticipated in the context of a shortfall in external financing. While Covid-19 has necessitated large net USD sales in 2020, FX intervention has occurred in both directions in the past two years (e.g., there were net purchases of USD in March 2020).

Annex IV. Risk Assessment Matrix¹

Risks	Likelihood	Impact	Policy Response
Conjunctural shocks and scenario			
Unexpected shifts in the Covid-19 pandemic; prolonged pandemic (downside).	Medium	High. More containment measures are required, domestically and abroad. Economic growth further slows, increasing fiscal pressure. Pandemic-prompted protectionist actions (e.g., export controls) reemerge, disrupting trade and global value chains.	Limit the damage by cushioning income losses for people and firms, including by increasing spending on health and social protection. Follow global public health guidance, including to find, isolate, test and care for cases, and trace and quarantine their contacts. If required, use additional periods of stringent containment measures to build health system capacity.
Unexpected shifts in the Covid-19 pandemic; faster containment (upside).	Medium	High. An unexpected fast recovery from the pandemic (e.g., due to a widely available and affordable vaccine with high uptake) boosts confidence, raises commodity prices (e.g., vanilla and metals) and economic activity.	Leverage unexpected gains to bolster fiscal space and catalyze the structural reform agenda.
Widespread social discontent and political instability.	High	Low. Economic activity is disrupted. Growing political polarization and instability weaken policymaking and confidence.	Encourage authorities and development partners to increase social priority spending to build the resiliency of vulnerable populations. Undertake promised reforms and renew commitment to operating SOEs in a transparent and equitable manner. Step-up anti-corruption and AML/CFT efforts. Commit to effective risk communication.
Structural risks			
Larger than anticipated transfers to SOEs (e.g., JIRAMA and Air Madagascar).	High	Medium. Transfers to SOEs reduce other priority expenditures. Potential economic disruption if SOEs' operations are affected.	Identify options to protect key public services. Encourage authorities and development partners to protect social priority spending. Strengthen governance structures, including government oversight of key SOEs.
Stall or reversals in corruption and governance reforms, especially for SOEs.	High	High. A lack of transparency and evenhandedness may compromise additional concessional support, hinder private investment (incl. PPPs), and harm negotiations with fuel suppliers.	Undertake promised reforms and renew commitment to operating SOEs (e.g., JIRAMA) in a transparent and equitable manner. Step-up anti-corruption and AML/CFT efforts.
Weak investment implementation capacity.	High	Medium. Slower economic growth.	Monitor available domestic capacity and prioritize investments with highest returns.
Accelerating de-globalization.	Medium	Medium. Reduced exports and greater fragmentation reduce potential growth.	Maintain exchange rate flexibility and reallocate fiscal spending from investment to key public services and support of the most vulnerable. Energize donor support by emphasizing the merits of the medium-term development plan.
Higher frequency and severity of natural disasters related to climate change.	Medium	High. Loss of real and human capital and lower growth.	Reallocate fiscal spending to finance recovery work and appeal to donors for post-disaster financing.

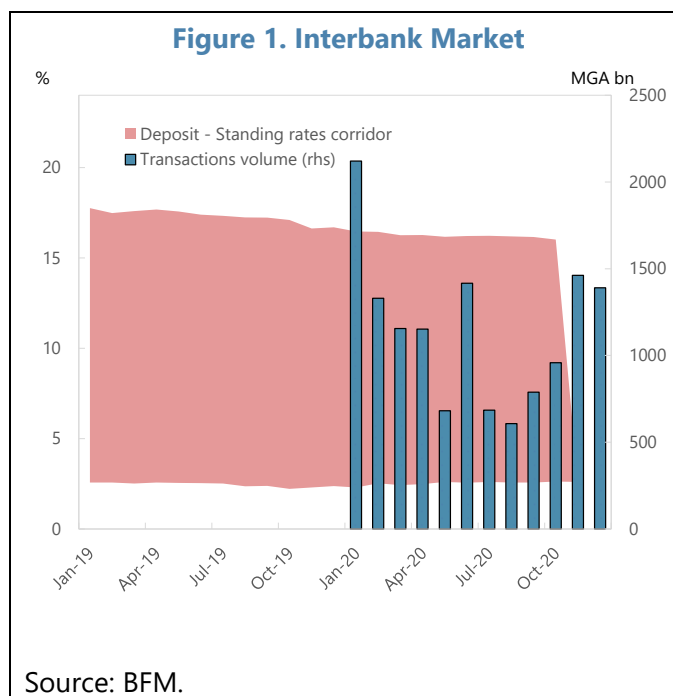
¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Annex V. Transition to Interest Rate Targeting

In 2019, the BFM launched an ambitious program of reforms to gradual transition from a monetary policy framework relying on reserve money aggregates to directly targeting interest rates to achieve its main objective of price stability. These reforms are critical to improve monetary policy effectiveness, strengthen financial sector stability, and support the structural reform agenda of the PEM and the new ECF program in close coordination with the capacity development strategy.

1. Transitioning to interest rate targeting will strengthen the effectiveness of monetary policy transmission channels, enhance financial deepening, and foster the finance-growth nexus. Structural excess bank liquidity, fragmentation of the banking sector, and the absence of a yield curve contributed to undermining the effectiveness of the interest rate channel for both short- and long-term maturities. Moreover, bank liquidity management may be complicated by conflicting objectives between monetary and exchange rate policies. To overcome these weaknesses, BFM has been pursuing a reform strategy to modernize the monetary policy framework, supported by Fund technical assistance, based on building an effective interbank market, improving the functioning of the foreign exchange market, and implementing a risk-based approach to financial supervision.

2. The monetary policy framework reform agenda builds on recent progress in establishing an interest rate corridor and expanding the liquidity and FX management instruments. Following the introduction of an overnight deposit and standing facilities in May 2019, the volume of interbank transaction increased by 33 percent y-o-y over the first 11 months of 2020, and the average money market interest rate declined by 220 bp over the same period. Furthermore, the duration of interbank lending operations started lengthening until the Covid-19 outbreak in April 2020, with a few transactions concluded for six months to one-year maturities at an average interest rate of 8 percent.



3. The BFM's ambitious agenda towards the implementation of the interest rate targeting by end-2023 will require finalizing the legal framework reform (Table 1) and deepening the money and FX market. The introduction of repo operations would represent a major step towards incentivizing medium to long term interbank operations, hence allowing for the gradual buildup of a yield curve. A repo law drafted with the help of Fund TA was adopted by the parliament in December 2019. The publication of the repo law was delayed in the context of the pandemic and must occur by June

2021 (MEFP, ¶45 and 39). The large government deposits at the BFM related to the under-execution of spending contributed to the liquidity scarcity in the banking sector and BFM remains committed to actively support banking liquidity in the backdrop of the Covid-19 crisis (MEFP, ¶15). The BFM intends to foster the development of a well-functioning interbank market and improve the efficiency of the foreign exchange market with the support of Fund Technical Assistance (MEFP, ¶39 and 41). While the determination of the central bank target rate according to macroeconomic fundamentals is scheduled for 2021, to support the migration towards an interest rate targeting framework, the BFM should begin to evaluate the interest rate consistent with the money base target, and conduct monetary operations based on this "shadow policy rate". Intermediary steps towards the interest rate targeting framework also include rolling over government loans at market rates, implementation of fine-tuning operations at the end of the maintenance period, and progressive reduction of the interest rate corridor's width.

Table 1. Reform Sequencing Towards Interest Rate Targeting

Timing	Measures	Intermediary Steps
First half of 2021	<ul style="list-style-type: none"> Implement the symmetrical corridor to drive short-term interest rates on the money market 	<ul style="list-style-type: none"> Development of tools for the management of short-term interest rates. Determination of a target rate (key rate) objectively and according to macroeconomic variables: FPAS model or similar model (with Fund TA support).
	<ul style="list-style-type: none"> Effective implementation of repurchase operations 	<ul style="list-style-type: none"> Publication of the repo law (by June 2021 (MEFP, ¶39))
Second half of 2021	<ul style="list-style-type: none"> Migration towards a transitional framework of monetary aggregates flexible targeting 	<ul style="list-style-type: none"> Short-term operational target on the money market Medium-term operational target (quarterly): average of the monetary base or its counterparties with an acceptable fluctuation band.
First half of 2022	<ul style="list-style-type: none"> Launch of BFM investment certificates with fixed maturities 	<ul style="list-style-type: none"> Development of regulatory text
Second half of 2022	<ul style="list-style-type: none"> Inflation forecasting by BFM 	<ul style="list-style-type: none"> Negotiation between MEF/BFM/INSTAT regarding inflation forecasts. Obtaining stakeholder agreement for inflation forecasts to be carried out by BFM (Q2 2022). First official medium-term inflation forecast (2 years) produced by BFM.
	<ul style="list-style-type: none"> Development of a continuous Ariary interbank market. 	<ul style="list-style-type: none"> IT and accounting infrastructure, legal documents and tests (with Fund TA support).
2023	<ul style="list-style-type: none"> Migration to the Interest Rate Targeting Framework 	<ul style="list-style-type: none"> Dropping the volume targeting framework. Re-publishing the key rate in the middle of the corridor (target rate). Establishing a new monetary policy transmission mechanism (operational target, intermediate objectives) Evaluating the efficiency of monetary policy transmission through the yield curve evolution.

Source: BFM

Annex VI. Financial Sector

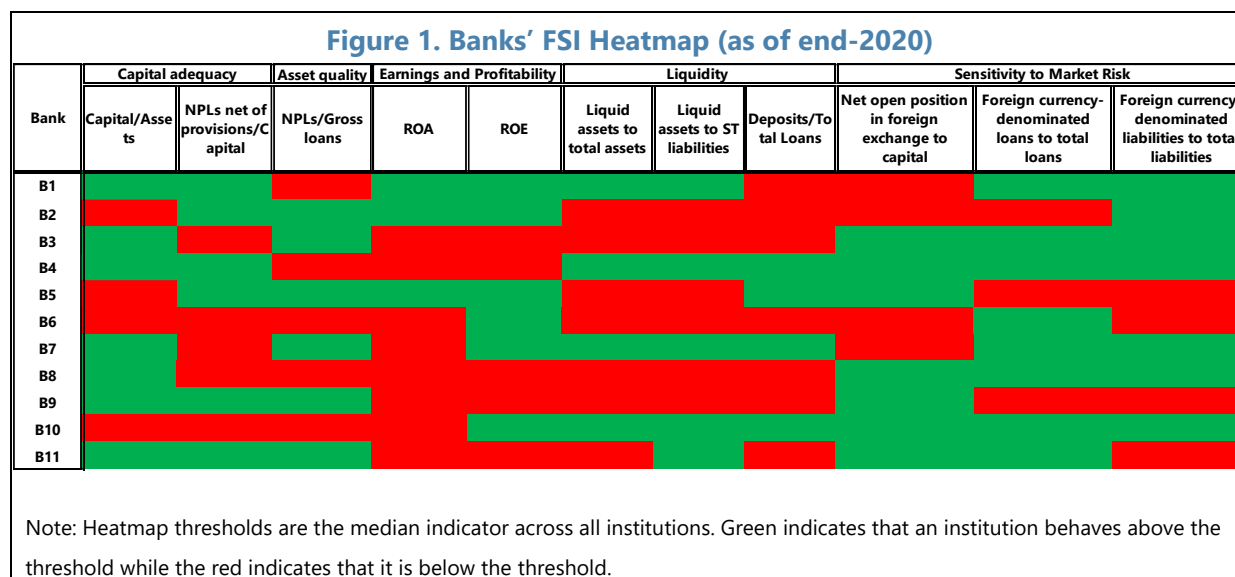
The banking sector started 2020 well-capitalized, liquid, and profitable, and while the pandemic has exposed vulnerabilities and risks in the system, reducing profitability, the stress tests confirm that the sector remains broadly resilient and sufficiently capitalized. While access to financial services have improved over the past years, reforms need to be accelerated to promote financial inclusion.

1. Prior to the pandemic, the banking sector was sound, highly profitable and liquid. The financial sector remains shallow (financial assets accounting for one third of GDP), dominated by the banking sector (about 80 percent of total assets), with microfinance institutions (MFIs) playing an important role in rural areas. Mostly foreign owned, the banking sector is concentrated around four banks which hold more than 80 percent of total deposits and outstanding loans and credits. Overall, banks have been profitable, adequately capitalized, well above the 8 percent capital adequacy ratio, and with ample liquidity buffers—as confirmed by annual stress tests conducted by the supervisor.

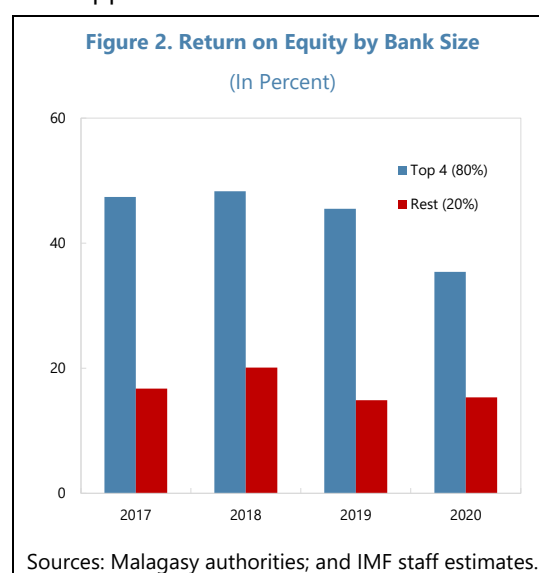
2. Overall, the banking sector has remained healthy, but some vulnerabilities are beginning to emerge (Figures 1 and 2).

- *Asset Quality.* The NPL ratio increased from 6.8 percent at end-2019 to 7.6 percent in December 2020 and is expected to increase further, leaving the balance sheet exposed to an NPL write-down. A write-off of all un-provisioned NPLs would consume 20-25 percent of the system-wide capital.
- *Capital Adequacy.* The banking sector has remained adequately capitalized above the 8 percent capital adequacy ratio requirement for all banks, with an average of 11.7 percent for the sector. Furthermore, equity was increased by about 17 percent since end-2019 through limits set on the distribution of dividends, so as to contain the ration of NPLs net of provision, which recently increased to 19 percent.
- *Earnings.* The banking system performs well against comparator countries, ranking among the top-two SSA performers in terms of profitability in 2019, thanks to high interest rate spreads and low operating costs (Figure 1). However, due to recent increases in provisioning requirements, the return on equity declined in 2020. While banks turned to income other than interest, the overall costs increased (about 60 percent of banks had to reduce the number of staff and 80 percent reduced their investments) thus impacting the banks' profitability.
- *Liquidity.* Banks have been historically maintaining excess liquidity buffers in the face of volatile conditions and the seasonality in the vanilla market. At the midst of the crisis, liquidity dried up following the freezing of the interbank market, prompting the central bank to intervene. These interventions proved effective, allowing for a rebound of liquid asset to total asset and liquidity asset to short-term liability ratios to 35 percent and 49 percent, respectively, from the troughs reached in June 2020.
- *Sensitivity to market risk.* Madagascar's banking exposure to interest and exchange rate risks is among the lowest in the SSA region with low ratios of foreign currency loans to total loans and foreign currency liabilities to total liabilities. The net open position in foreign exchange to capital ratio is less than 20 percent.

3. The overall deterioration in liquidity and solvency indicators has been limited so far, but some banks have been more affected. The average solvency ratio remained above the 8 percent required minimum, but two banks were at or below it at end-2020 and a third large bank was temporarily below it earlier in 2020. NPLs net of provisions to capital rose to 19 percent as of end-2020, but two banks had ratios close to 37 percent, and one bank was at 185 percent (due to low capital). Profitability in 2020 fell by more in smaller banks with the return on assets declining to 1 percent while remaining at 4 percent for big banks. BFM is closely monitoring developments in asset quality across banks and stands ready to continue enforcing strict micro-prudential rules, notably a minimal solvency ratio of 8 percent.

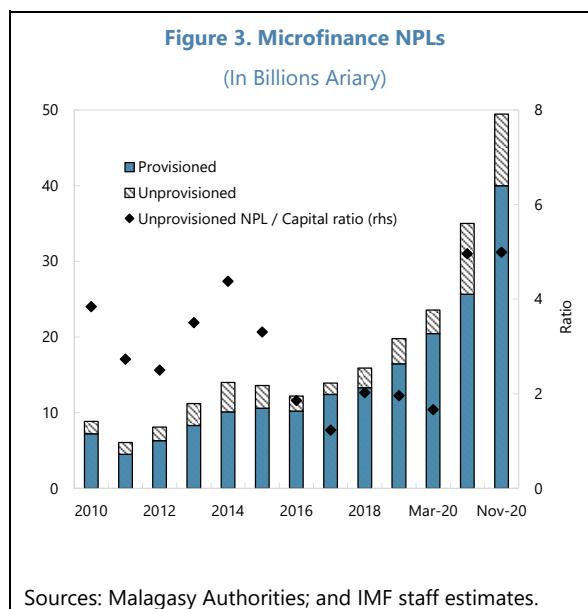


4. Despite these challenges, financial stability risks have been contained. This is in part because of its relatively small size and the simplicity of banks' operations, as well as the implementation of a series of measures by the Central Bank. Supportive measures have included the relaxation of reserve requirement rules, encouragement to defer SME and household loan repayments, permission to deduct loans to SMEs that have been restructured from regulatory reserve requirements, extending credit lines (establishing an exceptional medium-term refinancing instrument) while preserving bank liquidity, and extending the existing Partial Portfolio Credit Guarantee Schemes (PPGS) for firms negatively affected by the crisis. Most banks have responded by reducing overheads; requiring additional guarantees for new loans; introducing intense monitoring of loans that have been postponed; intensifying recovery of overdue debts; suspending or postponing non-essential investments; enforcing stricter lending standards while increasing interests on deposits to curb cash

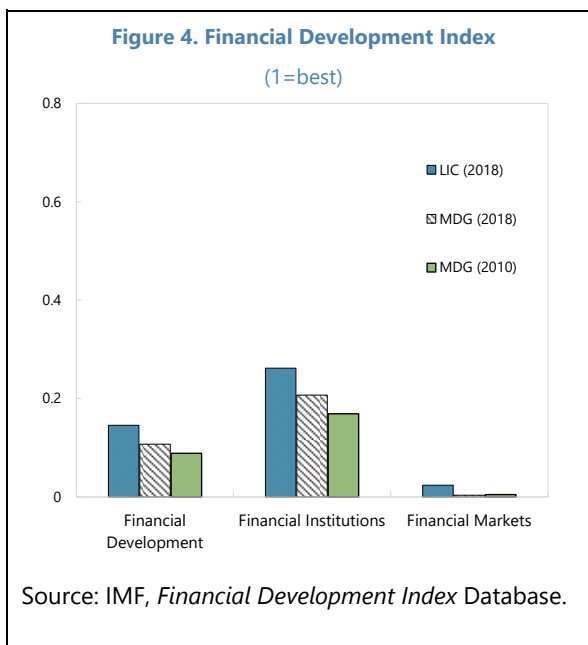


withdrawals; developing income from commissions and fees. They have suspended or lowered dividend distribution. CSBF, the banking sector regulator and supervisor entity, has been actively engaged, requiring banks to communicate their strategy and revised financial forecasts to assess the measures taken by each establishment and to anticipate possible difficulties.

5. Microfinance institutions (MFIs) are experiencing more difficulties. The sector accounts for about six percent of total financial system assets. MFIs more than tripled their assets since 2012, but in the initial phase of the pandemic faced a surge in deposit withdrawals (almost 9 percent decrease at end-Nov-2020 compared to March) by informal businesses and households and delays in loan repayments. Although MFIs are still able to comply with prudential requirements, the NPLs are rising (11.5 percent at end Nov-2020), lending has decreased markedly, and profitability is negative. The return on equity was negative 2.6 percent on average and only five MFIs out of twelve are still profitable. In this context the central bank has set up an exceptional medium-term refinancing instrument designed exclusively to support MFIs and MSMEs through the commercial banks.



6. Efforts to improve financial inclusion needs to be strengthened, while financial intermediation, already low before the pandemic, could affect further the supply of financing to real economy. Madagascar’s financial sector remains underdeveloped with restricted access to credit. Credit to private sector, at less than 15 percent of GDP, is about half the average for SSA countries. As highlighted in IMF Country Report No. 20/61, the low access to credit can be explained by both supply and demand factors (lack of credit culture, asymmetric information, high credit costs, weak consumer protection and creditors rights), and by an unfavorable business environment and political instability. In addition, the structure of the banking sector (shallow markets, few big players) and lack of competition may result in expensive financial services, thus contributing to financial exclusion. Late in 2018, the authorities launched an updated national strategy to promote the access to financial services, to increase the adult population having access to formal financial services from



29 percent in 2016 to 45 percent in 2022. Priorities are: (i) financial education and consumer protection; (ii) access and use of financial services; and (iii) strengthening the political, legal, regulatory and institutional framework. Significant progress has been achieved, including the adoption of a new banking law, a new law on insurance expected to boost the access to insurance services while improving the supervision of the sector, and the operationalization of the first credit bureau. In the context of the COVID-crisis, mobile banking transactions increased by 12 percent in 2020 and the mobile money network was instrumental in providing financial assistance to thousands vulnerable households.

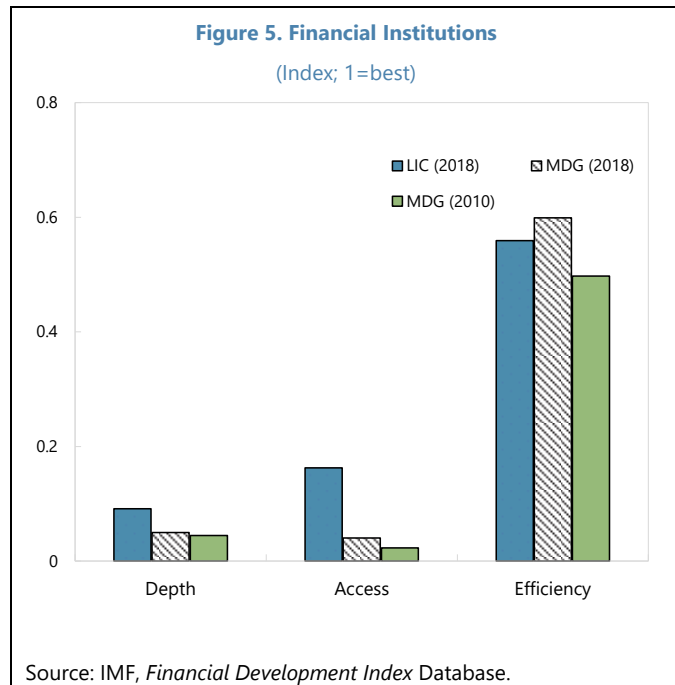
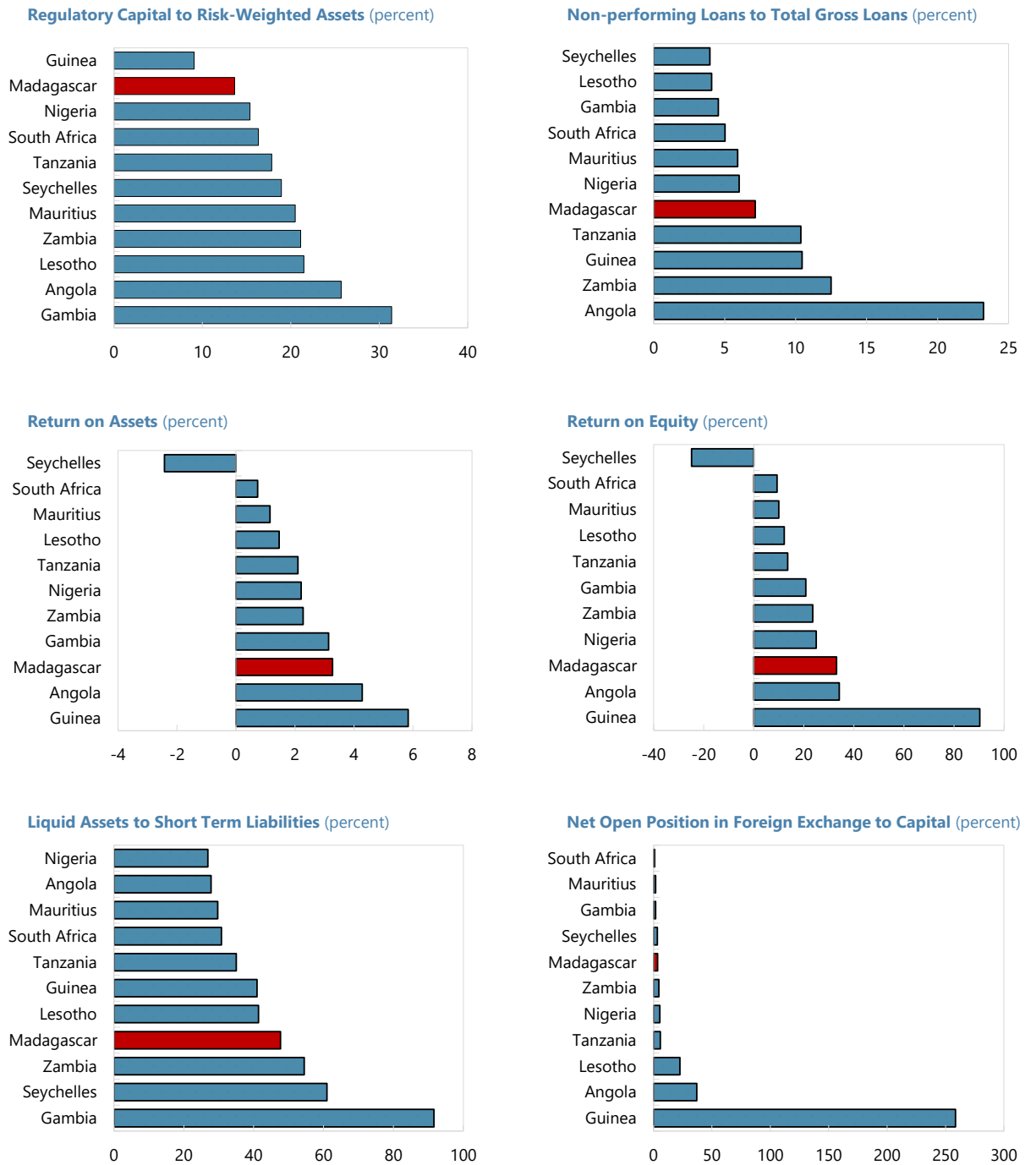


Figure 6. Financial Soundness Indicators: Madagascar and SSA peers, Sept-2020



Source: IMF FSI database.

Figure 7. Financial Sector Developments



Sources: Malagasy Authorities; and IMF staff estimates.

Annex VII. Madagascar's Capacity Development Strategy Note Update (Summary)

- 1. Madagascar has been an intensive user of IMF technical assistance (TA) and training in recent years.** Priorities closely aligned with the objectives of the program included reforms at the central bank (BFM), tax policy and administration, Public Financial Management (PFM), financial sector, and the anti-corruption and AML/CFT legal frameworks. Fund TA evolved with the progress in the reform agenda, from general assessment early in the program towards more specific recommendations. Fund TA departments and the country team have maintained close interaction with the authorities and leveraged the proximity of AFRITAC South (AFS) to ensure that TA needs and activities are always aligned, and capacity development (CD) is more relevant, effective and efficient.
- 2. Going forward, IMF TA support will continue to focus on deepening reforms that have yielded results in recent years.** Key priorities include: (i) continuing the modernization of revenue administrations while designing and implementing tax policies to converge towards a level of taxation consistent with potential; (ii) strengthening PFM through tougher internal controls, better control of fiscal risks (pensions, PPPs, and SOEs), improved management of public investment and the wage bill, and enhanced forecasting and budgeting, including to improve transparency in the use of COVID-19 related spending; (iii) continuing the ongoing multiyear-reform plan to improve monetary policy, to gradually transition to policies based on market interest rates; (iv) advising the central bank on reserves diversification strategy and strengthening financial sector stability and development through better supervision and the adoption and operationalization of a resolution framework; and (v) improving governance by effectively enforcing the legal framework and stepping up the fight against corruption.
- 3. Key priorities identified before the COVID-19 pandemic remain relevant but may need to be clarified.** PFM issues related to budget execution and control are crucial, including the operationalization of monitoring tools to track COVID19-expenditure, the single treasury account, and the strengthening of the monitoring of publicly controlled entities.
- 4. The authorities welcome the TA received from the Fund and find that priorities have been closely aligned with the program objectives,** including in the areas of public financial management, revenue generation, and financial sector. Since March 2020, the missions have been carried out remotely; the authorities consider that these missions have remained effective and appreciate the flexibility of the TA providers, despite occasional technical difficulties with connectivity constraints and the time zone difference.
- 5. The authorities find that the Capacity Development strategy is appropriate for Madagascar.** They emphasize that TA provision has been instrumental for the success of the ECF program and request that this effort is sustained in the coming years to continue progress on ongoing reforms and address new needs and challenges arising from the implementation of the new economic reform agenda under their Plan Emergence Madagascar.

Appendix I. Letter of Intent

Antananarivo, Madagascar

March 15, 2021

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Madam Managing Director:

1. The Malagasy economy has been severely affected by the Covid-19 pandemic, with GDP estimated to have contracted by more than 4 percent in 2020 due to the interruption of tourism, reduced external demand for key exports such as mining and textile products, and the consequences of lockdown measures on domestic consumption. The associated public revenue shortfall has increased the public deficit, while the current account deficit widened to more than 6 percent of GDP with the collapse of tourism. The two disbursements under the Rapid Credit Facility critically helped close financial gaps and support mitigation measures, but substantial needs remain to alleviate the social consequences of the crisis and bolster the economic recovery.
2. To face external financing needs and support our policy agenda, the Government of the Republic of Madagascar requests financing under the Extended Credit Facility in the amount of SDR 219.96 million, corresponding to 90 percent of quota, over a forty-month period. We are confident that the IMF involvement will play a catalytic role in securing additional budget support from development partners, which we will continue actively seeking over the duration of the program.
3. The attached Memorandum of Economic and Financial Policies (MEFP) outlines the policy measures and structural reforms envisaged to support the post-Covid-19 recovery and resume progress towards raising and sustaining inclusive growth, drawing from the government's vision detailed in the Plan Emergence Madagascar (PEM), while maintaining macroeconomic stability. Our medium-term program aims at rebuilding fiscal space for much-needed spending in the health and education sectors and for public investment, which will be achieved through substantially increasing tax and customs revenue and improving the composition of expenditure, including by continue restructuring inefficient state-owned enterprises; at markedly improving budget transparency and governance, as well as stepping up the fight against corruption, so as to strengthen social cohesion and improve the business climate; and at further enhancing the monetary policy framework and financial supervision to foster credit and deepen financial inclusion.
4. As detailed in the MEFP, we have made significant progress towards improving the transparency and traceability of public resources affected to the fight against the Covid-19 pandemic, in order to comply with all our commitments laid out in the Letter of Intent attached to the second disbursement under the Rapid Credit Facility. Beyond Covid-19 related spending, improved budget transparency is a key objective in our program, including for better planning, execution, monitoring and reporting of much needed investments and social spending.

5. In addition, we have requested the temporary debt service suspension from our official bilateral creditors, in line with the Debt Service Suspension Initiative (DSSI) supported by the G-20 and Paris Club, and are committed to adhere to its requirements. We will use freed resources under the DSSI for COVID-19 health spending and mitigating measures to provide economic relief from the crisis and we will closely monitor and report on the use of the Covid-19 resources.

6. We intend to use the first disbursement under the requested ECF arrangement to help fill the projected fiscal financing gap, through on-lending by the central bank to the Treasury. Accordingly, we will update the existing Memorandum of Understanding (MoU) between the central bank and the government used for similar operations (for the two RCF disbursements in 2020). We stand ready to take any further measures that may prove necessary to meet our program objectives, including needed adjustments in case of lower financing than expected under the baseline, and we will consult with IMF staff prior to the adoption of any changes to the policies set forth in the attached Memorandum.

7. We do not intend to introduce measures or policies that would exacerbate the current balance-of-payments difficulties. We do not intend to impose new or intensify existing restrictions on the making of payments and transfers for current international transactions, import restrictions for balance-of-payments purposes, or multiple currency practices, or to enter into bilateral payments agreements which are inconsistent with Article VIII of the IMF's Articles of Agreement. Furthermore, in line with IMF safeguards policy, the central bank commits to complying with recommendations of the 2021 update safeguards assessment of the BFM, including by discontinuing its non-monetary gold purchase program, and will continue to provide IMF staff with access to its most recently completed audit reports and to authorize the external auditors to hold discussions with IMF staff.

8. The Malagasy authorities agree to the publication of this Letter of Intent (LOI) and the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU), as well as the IMF staff report related to the request for an arrangement under the Extended Credit Facility (ECF) and the Debt Sustainability Analysis, after approval by the Executive Board of the IMF.

Sincerely yours,

/s/

Mr. Richard Randriamandrato
Minister of Economy and Finance
Madagascar

/s/

Mr. Henri Rabarijohn
Governor
Central Bank of Madagascar

Attachments:

- Memorandum of Economic and Financial Policies
- Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

This Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and lays out the medium-term economic objectives and policy framework of the government of Madagascar, for which we are seeking support under a forty-month Extended Credit Facility (ECF) arrangement. Consistent with the objectives of our Plan Emergence Madagascar (PEM) to raise living standards and improve social conditions, this MEFP presents the reform program and macroeconomic and structural policies to preserve macroeconomic stability, create fiscal space, improve governance and strengthen financial sector stability and development.

INTRODUCTION

1. **We successfully completed a 40-month program supported by the ECF arrangement in January 2020.** The 2016-20 ECF helped strengthen the macroeconomic framework, make progress in structural reforms, and improve capacity. We gradually accelerated real GDP growth to 4.4 percent in 2019, contained inflation, improved fiscal performance and increased tax revenue, and improved our external position including through steady increases in international reserves. We also made significant progress in the structural reform agenda, notably in the financial sector by strengthening the central bank and its independence and improving supervision; and reinforcing the anti-corruption legal framework bringing it closer to international standards. Other reforms also advanced, albeit some with more modest results than initially envisaged, for example increasing priority spending and improving the quality of spending. We remain committed to completing these reforms as they are part of our ongoing efforts to promote higher, sustainable, and inclusive growth.
2. **The COVID-19 pandemic has hit our economy hard.** The economic and social impact of the pandemic was a big step backwards after progress in recent years, reversing improvements in per-capita income and poverty reduction, and progress towards the Sustainable Development Goals (SDGs). After peaking to about 400 cases per day in July 2020, putting our hospital infrastructure and medical resources under considerable stress, the number of cases has declined. But the recent resurgence of the pandemic in our continent shows that efforts must not be relaxed, and that it remains essential to allocate important resources to the fight against the pandemic. This is complicated by the sharp decline in economic activity due to the pandemic resulting in a significant shortfall in tax revenue limiting budget resources needed to address critical spending, including social assistance to the most vulnerable.
3. **The new ECF arrangement will support our continued efforts to respond to the pandemic, advance the reform momentum to raise and sustain growth in line with our PEM priorities, and catalyze donor financing.** In the short-term, the ECF will help support our pandemic mitigation efforts and lay the foundation for a sustained recovery through a credible macroeconomic framework. Building on the progress made under the previous ECF, the program will then focus on reviving and sustaining inclusive growth and addressing long-term fragilities through maintaining macroeconomic stability, creating fiscal space for much-needed investment in

physical and human capital, and resuming strong structural reform agenda. Program engagement with the IMF will help address our urgent balance of payments needs, catalyze much-needed external project and budget support and attract foreign private-investment.

RECENT DEVELOPMENTS AND RESPONSE TO COVID-19

4. The pandemic led to a sharp decline in economic activity. We estimate output to have contracted by about 4 percent in 2020 compared to an anticipated growth of more than 5 percent before the pandemic. The impact has been particularly severe on tourism, with almost all international commercial passenger flights suspended since March 2020. The secondary sector has also been hit hard by the shutdown of the main nickel and cobalt mining company since April 2020, while other sectors like textile, other manufacturing, transportation, and other services have also been impacted. Due to this decline in economic activity and tax exemptions to mitigate the impact of the pandemic, tax revenue collapsed by about 1.5 percentage points to 8.9 percent of GDP in 2020, turning the domestic primary balance from a slight surplus in 2019 to a deficit of 2.6 percent of GDP in 2020. The situation of the banking sector has remained healthy overall, with the central bank focusing on supporting bank liquidity, and using foreign currency net sales to limit the depreciation of the Ariary. The current account deficit is estimated to have widened from -2.2 percent of GDP in 2019 to -6.5 percent in 2020.

5. The government has taken mitigation measures, coordinated through a multi-sectoral response plan, and adjusted policies to address the economic and social impact of the pandemic. On March 21, 2020, the president of the Republic declared the state of health emergency (which ended in October 18), complemented by regulatory measures such as border closures, quarantines and systematic testing of travelers, restrictions on public events, and temporary lockdowns of the cities where cases have been detected. On the policy side, we temporarily loosened macroeconomic and financial policies to accommodate the impact of the pandemic. Specific measures include (i) targeted investments to strengthen the health system following the activation of the national contingency plan to fight the pandemic with the support of development partners; (ii) the implementation of a social emergency plan with social safety net measures and unconditional transfers to support the most vulnerable; (iii) supporting the private sector through tax relief measures, temporary salary subsidies, and deadline extensions for certain declarations and payments; and (iv) supporting the financial sector through regular provision of liquidity by the central bank to commercial banks.

6. The prompt disbursement of international financing, including the two RCF disbursements by the IMF, was instrumental in preserving stability despite the prolonged pandemic shock. Early support from the IMF, with two RCF disbursements approved in April and July 2020 totaling 2.4 percent of GDP, created room for essential and urgent spending to mitigate the impact of the pandemic and helped catalyze significant additional donor resources, including budget support. We were able to avoid major cash-flow tensions as a result of the disbursements of emergency support by our international partners and a gradual budget execution. This financial assistance created the needed fiscal space to support the mitigation measures described in ¶5 and

estimated at about 3 percent of GDP, while helping to close short-term budget and balance of payments gaps. Despite the shock, international reserves reached SDR 1337.8 million at end-2020, equivalent to 5.9 months of 2020 imports (and 4.7 months of 2019 imports).

MACROECONOMIC PROGRAM AND TARGETS

A. Program Objectives and Outlook

7. The government is committed to maintaining macroeconomic stability and to placing Madagascar on the path of sustainable and inclusive growth, improved physical and human capital, and strong governance, as laid out in our PEM. The government's vision of the future, outlined in the updated PEM, expected to be unveiled by the President, envisions that social, economic and environmental pillars will help Madagascar's emergence, with governance as the cross-cutting theme and a main pillar. More specifically, the PEM main priorities are: (i) higher and sustained economic growth, based on the mobilization of tax revenues and the prioritization of spending and increased public and private investment to strengthen physical and human capital; (ii) more inclusion, supported by strengthened social policies and spending, with strong focus on education, health, and housing, with the objective of reducing poverty and a better access to education, health, and housing; (iii) make use of our natural resources in a sustainable manner, respecting environmental standards, and improving resilience to climate change; and (iv) the cross-cutting theme on better governance includes the fight against corruption, better security, and addressing regional challenges. Key PEM strategies are aligned with and linked directly to the relevant SDG goals, including scaling-up infrastructure, doubling electricity production, increasing access to water, expanding agricultural land, and preserving the ecosystem.

8. The sequencing of the priorities of the ECF arrangement will be aligned with the government's reform agenda. Our immediate priorities will be to support pandemic mitigation efforts while focusing on well-targeted reform actions to maintain macroeconomic stability. Then our focus will be on strengthening the structural reform agenda to promote inclusive growth, reduce poverty, and address long-term fragilities drawing from the PEM priorities. Our key objectives that will be supported by the ECF arrangement are to:

1. Rebuild and strengthen fiscal space to allow for much needed investment and social spending, by mobilizing domestic revenue and improving quality of spending.
2. Resume and advance the government's structural reform agenda including strengthening governance and reinforcing the anti-corruption framework.
3. Strengthen stability and financial sector development, including through improving supervision and enhancing the monetary framework.

9. The initial budget law (*Loi de Finances Initiale, LFI*) for 2021, approved by Parliament in December 2020 and promulgated on December 24, 2020 is based on an increase in tax

revenue and a spending envelope favoring economic growth and social development. In the LFI, we targeted the net tax revenue-to-GDP ratio to increase to 10.9 percent due the GDP growth rebound and strengthened tax collection (see ¶20-23). The spending envelope is based on the objective of supporting the economic recovery, prioritizing job creation, and pursuing efforts to catch up with social development. To support the population and the most vulnerable and mitigate the impact of the pandemic, the budget devoted to the social sector is a priority. At about 9.5 percent of GDP, non-interest current spending is slightly higher than in 2020, with a wage bill of 5.5 percent of GDP, and domestic public investment of 3.5 percent of GDP. Externally financed public investments are expected to be close to 6 percent of GDP.

10. We expect economic growth to rebound in 2021 and continue to accelerate in the medium-term as the pandemic abates and external demand recovers. In the LFI, we forecast GDP to rebound to 4.5 percent in 2021. In the medium term, we expect an acceleration of growth, driven by an increase in private capital expenditure, and expansion of agriculture, tourism, manufacturing and mining. Madagascar will rely on the development of several promising sectors, such as agro-industry, textile, new technologies and tourism, as well as its large mineral reserves, including gold, nickel, cobalt, and chromium. To achieve our strong and sustainable growth objectives, Madagascar must make substantial progress in improving its physical and human capital which requires significant increases in investment. We will rely on improved tax revenues and better quality of spending to foster public investment, and successfully mobilize private investment. We expect exports to gradually recover from the crisis, and imports to rise as capital spending is expected to increase under the PEM, with the current account deficit stabilizing around 4 percent of GDP in the medium term, allowing for international reserve accumulation. We expect the public debt-to-GDP ratio to remain below 55 percent as the PEM externally financed investments and reforms bear fruits and growth prospects increase further.

B. Program Policies and Risks to the Outlook

11. We are committed to maintaining and further developing the COVID-19 support measures (¶15) until the end of the pandemic and providing adequate fiscal support. Fiscal resources will continue to be dedicated to preparedness and detection (e.g. boosting testing and contact tracing capacities), healthcare, safeguarding businesses, protecting workers, and multi-sectoral mitigation measures. To ensure the availability of funds for the mitigation of the COVID-19 pandemic, at the end of 2020, we secured MGA 214 billion in a dedicated account at the Public Treasury. We will also develop further support measures through targeted spending in social protection programs (see ¶26 for details).

12. The fiscal stance will remain supportive in the short-term, and the domestic primary balance—the anchor for our fiscal policy—is targeted to turn positive in 2023. In line with program objectives, the fiscal stance remains supportive in 2021 to accelerate the economic recovery. The domestic primary balance will be the fiscal anchor of the program as a Quantitative Performance Criterion (QPC). The domestic primary balance is expected to turn positive in 2023, based on efforts to increase domestic and custom tax revenue mobilization (both monitored as IT under the program) (See Table 1 for details).

13. External financing will continue to be primarily on concessional terms and grants to preserve debt sustainability. Madagascar is assessed to have a moderate risk of external debt distress. We will continue to follow a prudent debt management strategy that aims to maintain a present value of debt consistent with this risk rating. Newly contracted public debt will favor loans offered on concessional terms, which will help maintain the current risk rating and debt sustainability. That said, if concessional external financing is exhausted, some long-term non- and semi-concessional borrowing can be considered in limited circumstances to support critical expenditure needs (e.g. for high-yield investment projects). However, we will avoid all non-concessional short-term external borrowing (with original maturity of less than one year). To reconcile our investment needs and related external financing with the need to preserve debt sustainability, we commit to maintaining a ceiling on new external debt expressed in present value terms at US\$800 million, which is set as a continuous Performance Criterion (See Table 1 for details).

14. We will continue to closely monitor external private debt in light of its potential effect on public sector exposures. In 2020 INSTAT completed a survey on the external private debt. The survey uncovered large deviations relative to prior estimates based on the previous survey conducted in 2013 (which covered a smaller sample of firms and only included debts reported by companies' headquarters offices). For instance, IMF forecasts estimated there were SDR 2 billion in external private debts at end 2018, while the new data suggests they reached SDR 4 billion. We consider the risks associated with these higher levels of external private debt contained. Around 80 percent of the debt is associated with the mining sector, whose income is in foreign currency; the majority of its debt is medium-to-long term; and a sizeable portion of its debt is with its affiliated headquarters or global group. We will continue to follow external private debt closely to identify potential risks.

15. The central bank is committed to continuing its support of the banking sector liquidity as needed, while maintaining inflation stability. After significant liquidity injections (of about 1.2 percent of GDP at the end of 2020) to support bank liquidity, we expect a gradual normalization of the situation (which is characterized by structural excess liquidity), but the BFM is ready to continue its liquidity support as needed. We will continue to closely monitor financial stability as non-performing loans are expected to increase. Monetary policy will continue to aim at maintaining single digit inflation through money market and foreign exchange operations; and balance between exchange rate volatility and tensions on the interbank foreign exchange market (MID) that have been aggravated by the crisis, while maintaining an adequate international reserve position.

16. Spending in the program baseline for 2021 is mostly aligned with the LFI, but our tax revenue assumptions are more optimistic than the program baseline; we are ready to implement corrective measures as needed, which will be part of a Revised Budget Law. On spending for 2021, the program baseline is aligned with the LFI, except for a small divergence (about 0.5 percent of GDP) on domestic investment and a difference of about 1.2 percent of GDP on externally financed investment (which has no implication on the level of the domestic primary balance defined for the program, see below). On the revenue side however, the government is expecting a significant increase in net tax revenue to 10.9 percent of GDP in 2021, 0.9 percent of

GDP more than assumed in the program baseline, which would lead to a domestic primary deficit of about 1.2 percent of GDP. Should the government's tax revenue projection not materialize in the first months of 2021 and widen the projected deficit of the primary balance to more than the 2.5 percent of GDP projected under the program baseline, we commit to revise our projections in the revised budget law to be prepared in May 2021, which will include some budget savings if needed. In the case of the need for budgetary savings, we commit to protect social priority spending and share with IMF staff the list of lower priority spending that will be reduced.

17. We will implement economic policies to achieve the objectives and quantitative performance targets set out in our ECF macroeconomic framework for the rest of 2021 and the medium-term. Our medium-term economic program supported by the ECF is aimed at mitigating the short-term economic impact of the pandemic, maintaining macro-economic stability, and reviving the reform momentum to raise and sustain growth, and reduce poverty. The PEM objectives are setting more ambitious goals, aiming at accelerating economic growth to 8 percent in 2023, largely based on a sharp increase in private investment which the government intends to encourage through structural reforms and improvements in the business environment; and achieving a higher tax revenue increase than in the program. In line with prior practice, we will continue to discuss medium-term projections with IMF staff, and we are ready to refine our medium-term macroeconomic framework in future budget laws.

18. In light of the high degree of uncertainty in the current environment, we discussed an adverse scenario and potential contingency plans. An adverse growth outlook with delayed growth recovery could materialize due to delayed global recovery from the pandemic and difficulties to eradicate the disease, requiring more containment efforts and impacting the economic activity. The worsening economic and financial situation at the global level would significantly impact Madagascar growth in 2021, through weaker external demand, lower domestic demand, and lower externally financed public investment. The impact on tax revenue would create, in the absence of policy action, an additional fiscal financing gap. If such an adverse scenario materializes, room for additional domestic financing may be limited. Our response would rely on some budgetary savings, by reducing lower priority spending to compensate for lost revenue, while preserving social spending that will be crucial in the context of a long-lasting impact of the pandemic. To limit potential spending cuts, we will seek additional budget support, for which keeping the IMF supported program on track would be critical.

STRUCTURAL REFORMS

19. Our agenda for structural reforms will be focused on enhancing conditions for sustained and inclusive growth by: (i) creating more fiscal space for development priorities; (ii) improving economic governance and combating corruption; and (iii) strengthening the capacity to support stability and financial sector development.

A. Rebuilding and Strengthening Fiscal Space

Mobilizing Tax Revenue

20. We have an ambitious medium-term revenue mobilization plan supported by a comprehensive strategy covering both revenue administration and tax policies. Prior to the pandemic, the tax-to-GDP ratio increased gradually between 2012 and 2019. Our objective is not only to recover the tax-to-GDP ratio to pre-crisis levels, but also to gradually increase Madagascar's tax-to-GDP ratios significantly in the medium-term, in line with peers in sub-Saharan African and our tax potential, estimated to about 5 percentage points of GDP based on a comprehensive revenue strategy. Based on this potential, revenue mobilization will build on reforms at the Tax General Department and at the Customs Directorate. Our performance in increasing domestic tax and customs revenue mobilization will be monitored by indicative targets.

21. Recent years' reforms at the Tax General Department will continue and further strengthened. We made significant progress in terms of organization, simplification and digitalization of procedures management (including with the establishment of performance contracts), and dialogue with the taxpayers (including the organization of tax controls). Our priorities include:

- *Further developing performance contracts*, while strengthening our system for evaluating individual performance, and applying disciplinary measures when necessary.
- *Establishing the Integrated Tax Administration System (SAFI)*, supported by the World Bank's Public Sector Performance Support Project (PAPSP). This is expected to contribute to improving internal management processes, and the operational efficiency of collection agencies.
- *Continuing and strengthening efforts to identify taxpayers*. We plan to update the taxpayers' database, notably based on information from new agents placed in the regional tax administrations. Our efforts to reduce the informal sector through the *Anjara Hetrako* campaign (which allowed the identification of more than 17,000 new taxpayers in Antananarivo and Toliara at the end of 2020) will continue in other regions. In addition, the generalization of the electronic payment of taxes (already implemented for large companies) to medium-size enterprises is expected to yield close to MGA 40 billion (about 0.1 percent of GDP) in 2021.
- *Making progress in the digitalization of procedures*, with the implementation of electronic declarations and payments, the development of payment by mobile banking, and the establishment planned for this year of platforms for VAT declarations and payments, and for remote transmission of financial statements.
- *Reviving and optimizing tax control*. This will rely on the optimization of human and budgetary resources, including the assignments of new agents for tax control. Specific efforts are planned to cross-check the VAT declarations, the import declarations and the public contracts awarded. We also plan to have joint control operations with the customs department. Finally, we will

intensify the control of large companies, given their importance in the total of tax revenue, planning to expand coverage to at least 15 percent of these companies (as described in the DGE (*Direction des Grandes Entreprises*)), targeting especially those not controlled in 2019 and 2020.

- *Continuing and intensifying the clearance of tax arrears (restes à recouvrer)*, whose stock was estimated at end-2020 at MGA 344.72 billion (or about 0.7 percent of GDP), based on the implementation of the recommendation of the February 2020 FAD mission on managing and reducing tax arrears. This includes the use of the file listing the bank accounts in Madagascar (Ficobam). Our objective is to collect MGA 152 billion (0.3 percent of GDP) of tax arrears in 2021, of which at least 80 billion in the first half of the year (Structural Benchmark).
- *Implementing the public procurement tax (Taxe sur les marchés publics, TMP)*. After delays in its implementation despite its introduction as part of the 2020 budget law, this withholding tax on public procurement has started to be applied, and based on public investment spending committed late in 2020 and projected this year, the TMP is expected to yield more than MGA 200 billion (0.4 percent of GDP) in 2021.

22. Regarding the customs administration, we plan the following actions based on our customs administration reform plan for the 2020-2023:

- *Centralizing collection activities and following payment recovery*, for an improved collection induced by a better access to all statistical information and better monitoring.
- *Strengthening the control of the import values declared to customs and taking effective remedial action in case of fraud*. In addition to the cooperation with *GasyNet*, we plan to monitor all value declarations, including by setting up a Value Center to provide a relevant and reliable reference basis of goods values, and by systematically strengthening controls and optimizing the penalties.
- *Improving pre- and post-clearance controls*, based on dynamic risk analysis to target the controls following-up of the recommendations of the IMF technical assistance mission). This will also be based on the use of a common database with the DGI, in order to better identify potential offenders.
- *Intensifying the control of the companies benefitting from special economic regimes, such as free-trade zone, temporary admission regimes, or other exemption agreements*.
- *Strengthening accountability*, including by improving the organization of audit and performance, by establishing key performance indicators by individuals, departments or offices.

23. While the government did not introduce significant tax policy reforms in the 2021 budget law in order to support the economic recovery, tax reforms under consideration include:

- *Potential changes regarding the VAT and the excise taxes.* Regional comparisons suggest possible significant gains from value-added and excise taxes. We have already raised the VAT threshold to MGA 400 million, expected to yield 40 billion Ariary in additional revenue in 2021. Regarding excise taxes, we increased duties on specific products (such as soft drinks, tea, and sweets), and we are studying the possibility of introducing excise taxes on other products.
- *Revising and streamlining exemptions.* According to the latest study from the Tax Policy Unit, the various tax exemptions had a cost (in terms of lost revenue) estimated at MGA 1470 billion (2.8 percent of GDP) in 2019. These exemptions are mainly related to the Law on Large Mining Investments (LGIM), the regime for free zones (ZEF), and some establishment agreements (to facilitate investments). The costlier exemptions relate to the import and local sale of rice (more than half of total tax expenditures), and those related to the LGIM. We will continue to assess the costs and benefits of exemptions and plan to remove those that are ineffective. *Revising mining taxation.* The objective is to (i) continue to honor existing mining contracts and stabilize large mining investments to lower perceived risks to investors; (ii) extend anti-abuse measures from the *Code General des Impôts* into the special regime for large mining investments; and (iii) make sure all revenues are collected through the large taxpayer unit (DGE) of the DGI and remitted to single treasury account. Building on TA received in March 2020 from the Fiscal Affairs Department, we will consult the IMF prior to any revision of the mining code.

Improving the Quality of Spending

24. We continue to streamline the management of the wage bill to maintain it at a sustainable level. On December 10, 2020, we launched an upgrade of our IT tool for the workforce management (AUGURE 2) to improve proper accounting of the civil service. This tool will make it possible to manage all civil servants, including the military, the employees of National Public Establishments and agents of local municipalities, by 2023. The objective is to merge IT payroll and civil service management tools by then. To address one of the issues pointed by the *Cour des Comptes* 2020 report, we are making progress with our plan to eliminate ghost workers: as of December 2020, there were only 1,219 public servants with irregular status out of the 23,417 identified in January 2020.

25. We will gradually reform the civil servant pension system to control the need for government transfers and ensure its long-term sustainability. We have started to assess the impact of potential parametric pension reforms, including the calculation of pensions (contribution rates, years of eligible service, highest average remuneration, age of retirement, and the applicable yearly accrual rate) and of improved governance of the pension fund. A detailed action plan will be presented to the Council of Government in the first half of 2021.

26. We will ensure higher priority spending in social sectors, which remains one of our main objectives in response to the pandemic, and a key priority of the government:

- In the 2021 LFI, we increased the budget under *domestic* resources of the four social ministries (Education, Health, Water and Sanitation, and Population, Social protection and Women

empowerment) by more than 10 percent to reach MGA 1,729 billion or 3 percent of GDP and this envelope will be further increased in the LFR; the number of public health workers from 10,861 in 2020 to 13,786 in 2021; and the number of teachers from 69,354 in 2020 to 77,234 in 2021. We are also actively working with our development partners to increase the amount of externally financed investments and accelerate their implementation. Added to the above spending, there are budgets allocated to social programs which are implemented by other ministries and institutions such as the Ministry of the Interior and Decentralization (through the BNGRC), and by the Prime Minister with the National Nutrition Office or the Emergency Prevention and Management Unit, as well as the *Fonds d'Intervention pour le Développement* (FID) in charge of some cash transfer programs.

- We continue to develop existing social safety net programs that were instrumental in recent years, with technical and financial help from partners like the World Bank. With its extension to four new regions, the number of households benefitting from cash transfer programs (including *Tosika Fameno*) increased from 250,000 in June 2020 to 483,428 in December 2020, and we plan to reach at least 540,000 beneficiaries by September 2021 (Structural Benchmark) and 590,000 by December 2021. To ensure the funding of these programs beyond the financing granted by development partners, on January 24, 2020 the Ministry of Economy and Finance and the FID signed an agreement ensuring a dedicated annual budget allocation (under domestic resources) for the FID of a minimum amount of US\$ 5 million over 2021-23.
- To allow for better monitoring and reporting of all social spending, we are adjusting the budget classification, which will be operational for the preparation of the 2022 budget law with potential support of Fund technical assistance. In the meantime, we will continue to monitor and disclose domestically financed spending, excluding salaries of social ministries (IT under the program), as well as other indicators of social spending as memorandum items (See Table 1 and TMU for details).
- In the education sector, the government cancelled the registration fees in public schools at the start of the school year in October 2020, which requires that the transfers to schools (*caisses écoles*) planned in the budget are implemented. To ensure transparency, all these transfers, are published on the website of the Ministry of Education website, school by school (https://www.education.mg/caisse-ecole/index.php/c_etat).

27. The planned scaling-up of public investment will come with better prioritization and execution. Our ambitious public investment objectives in the PEM will be further clarified, including the prioritization of projects considering implementation and absorptive capacity constraints, monitoring progress in implementation, ensuring proper costing and enough funding to complete projects as per the FAD TA recommendations. We will prioritize relying on external grants and concessional financing. We will finalize and publish a public investment manual in line with FAD TA recommendations, notably with a view to clarify institutional aspects (Structural Benchmark, December 2021). We will establish a mechanism allowing for regular review (2-3 times a year) at the political level of execution of the PIM portfolio, particularly on domestically financed projects, and are working on developing indicators to better assess our public investment efficiency. The

reporting system on public investment execution, currently fragmented between the Investments and Financing Coordination and Monitoring Agency (OCSIF: *Organe de coordination et de suivi des investissements et de leur financement*), the Prime Minister's Office, the Ministry of Economy and Finance, and donors will be unified to produce a dashboard covering important projects (10-20 for a start), available to decision-makers and to the public.

28. We are committed to limit non-priority spending. This is crucial to increase fiscal space, as sustainable and inclusive growth requires increased priority spending, especially on infrastructure, education, healthcare, and targeted social and natural disaster assistance.

Reducing Fiscal Risks

29. We continue the good practice, initiated with the 2018 budget law, to have an annex on fiscal risks to the budget. With the technical assistance of the IMF, we are enriching this annex, in particular by quantifying the risks. As part of the most recent annex within the 2021 finance law, we published an analysis on the fiscal risks related to (i) natural disasters; (ii) public-private partnerships; (iii) imbalances in the civil service pension system; and (iv) public debt sustainability, including public guarantees.

30. We continue to strengthen our disaster risk management system. Our country is highly exposed to a wide range of adverse natural events, with drought and flood caused by cyclones having the largest impact. In late January 2020, northern Madagascar faced torrential rains from several tropical disturbances, with at least 30 lives lost and more than 15,000 homes destroyed, while the south part of the country is currently facing the worst drought in a decade, resulting in an urgent need for humanitarian assistance. Climate change would increase the severity and frequency of such disasters going forward. In this context, we continue to develop our disaster risk management system building on our national risk and disaster management strategy. This strategy includes financial protection to help face unexpected fiscal costs or contingent liabilities from natural disasters. Since 2019, we have been benefiting from a Disaster Risk Management Development Policy Operation with Catastrophe Deferred Drawdown Option (joint operation by the World Bank for US\$50 million and by the *Agence Francaise de Developpement* initially for Euro 10 million and increased by another 15 million in the context of the COVID-19 pandemic), of which US\$15 million and Euro3 million, respectively, were disbursed in February 2020.

31. We will implement a plan towards a fuel pricing mechanism which will avoid the risk of budget costs in the future. Despite the collapse in international oil prices in March 2020, we kept the pump prices unchanged, and by end-January 2021 we eliminated the cumulative liability to oil distributors and the associated short-term fiscal risk. We are determined to avoid the resurgence of such a liability. Our plan is to continue the administration of prices in the first half of 2021, according to the decree adopted by the Council of Government on January 20, 2021. During this time, we will finalize our plan towards a fuel pricing mechanism avoiding the risk of budgetary impact in the future, which will be discussed with IMF staff. This mechanism, which will be finalized in July 2021, will prevent the widening of the gap between pump and reference prices, while smoothing out excessive variations. Until the implementation of this mechanism, we commit to keep

the liability to oil distributors below MGA 100 billion (continuous Structural Benchmark), a level avoiding the risks of incurring direct budget compensation. We are also working on designing mitigating measures for the most vulnerable, including the scaling up of social safety net programs with support by the World Bank.

32. We are continuing the implementation of JIRAMA's recovery plan:

- The financial situation has worsened during the pandemic, due to lower economic activity, the rescheduling of electricity bill payments in the context of the social emergency plan to mitigate the impact of the pandemic, and the costs of needed improvements to the supply of electricity and drinking water, in particular for the city of Antananarivo and the hospitals. This resulted in a deficit of about MGA 400 billion (about US\$ 100 million) in 2020, 155 billion higher than initially projected in the multi-year business plan.
- Despite these difficulties, we have continued to implement measures such as programs to deal with power cuts, restore public lighting in the district capitals of Madagascar, and infrastructure improvements (including renewal of generators, extending drinking water production stations, and renewing water pipes). For 2021 and the coming years, the recovery and development plan of JIRAMA will be formalized in the document "Development plan 2025" which integrates the technical, commercial and financial measures to be implemented. While a planned tariff reform has been postponed in the context of the impact of the Covid-19 pandemic, increasing the revenue of the public utility, including through gradual adjustments of tariffs, is necessary in addition to cost-saving measures. This document is being finalized in full consultation with all stakeholders, including the World Bank, before its approval by JIRAMA's Board of Directors.
- In 2020, total government transfers to JIRAMA, including arrears repayments, reached MGA 845 billion (1.6 percent of GDP). For 2021, the amount of transfers of MGA 121 bn (0.2 percent of GDP) planned in the initial budget law will be increased in the LFR to a maximum of MGA 400 bn (0.7 percent of GDP). This amount covers the anticipated operational results, further impacted by the cost of measures implemented as part of the response to the COVID-19 pandemic (including the postponement of the planned tariff reform and the extension of grace periods for bill payments), and clearance of some arrears to suppliers. We are mindful of the risk that not adopting the tariff reform suggested by JIRAMA in January 2021 may increase the company's operational deficit, but we will take corrective measures to ensure that total transfers to JIRAMA remain below the above-mentioned MGA 400bn. We will notify the World Bank and IMF staff of details of any budget transfer to JIRAMA's suppliers and will share associated documentation within one week of payment (continuous Structural Benchmark, see Table 2 and TMU for details).
- The repayment of suppliers associated with the renegotiation of contracts on more favorable terms for JIRAMA, in line with the recovery plan supported by the World Bank, continues to be an important part of our strategy. We commit that potential additional repayments of the stock of arrears towards suppliers will be considered only after the finalization, planned for June 2021, of a strategy that will be agreed with the World Bank, and with clearly identified financing.

33. Air Madagascar has been severely hit by the pandemic, compounding previous financial difficulties, and it has become a significant fiscal risk that the government is determined to control. Preliminary estimates indicate a financing need of at least US\$55 million and the need for debt write-offs and restructuring for Air Madagascar and its subsidiary on domestic activity, Tsaradia. At the request of the Social Security fund CNAPS, second shareholder after the Malagasy State, a business plan is currently being developed by external auditors, which aims to assess the short-term financial viability of the group and outline a medium-term recovery plan, to be presented to the Council of Ministers tentatively on March 24, 2021. We commit to avoid putting any public fund to the company until the plan is finalized, and before consulting with the Fund and the World Bank.

Improve Public Finance Management

34. Progress towards transparency of COVID-19 spending will continue:

- We publish information on COVID-19 spending on the Ministry of Economy and Finance website (<http://www.mefb.gov.mg/reportingcovid>), which is regularly updated. As of March 8, 2021, the published amount of COVID-19 committed spending was MGA1,906 billion (about US\$500 million or 3.3 percent of GDP), of which more than 90 percent has been either paid or given the order to be paid. The website provides information of spending by Ministries, by category of spending, and by detailed subcategories (for instance, transfers for hospitalization, treatment and care).
- For the part of COVID-19 spending that relates to procurement contracts, information on these contracts (including the amount of the financial transfer and the names of the awardees, whether individuals or companies) is published on the same website. With respect to each awarded company, we published relevant information, including the tax identification number, the trade register number, and, within the contract itself, the name of the authorized representative or agent signing on the company's behalf. As of March 8, links to the contracts for 109 of the 127 contracts have been posted. In addition, 32 ex-post reports on the delivery of these procurement contracts have also been posted, in the form of "*Procès verbaux de réception*". We will continue this process and all remaining ex-post delivery reports will be published by June 2021 for contracts that have been fully executed. We will also seek TA from the IMF's Legal Department to establish the requirements and processes necessary to identify the beneficial owners of companies or other legal persons awarded procurement contracts.
- We will continue to implement the full range of the RCF2 LOI commitments, including our commitments to publish an independent third-party audit of COVID-19 spending (by December 2021, Structural Benchmark) and the names if the beneficial owners of companies or other legal persons awarded COVID-19-related procurement contracts.

35. Efforts are ongoing to revive the PFM reform agenda and address weaknesses:

- Building on FAD TA, we progressed on strengthening PFM under the 2018-2026 Strategic Plan of Modernization. Improvements have been made in the management of national public institutions, budgeting, debt management strategy, transparency and efficiency of public procurement, cash management, implementation of the Treasury Single Account, reporting and statistics, strengthening of internal audit and inspection bodies. To take stock of these progress and refine or reform plans, we will undertake a self-assessment of the performance of PFM according to the PEFA methodology in the first half of 2021.
- The reorganization of the Inter-ministerial Steering Committee for Public Finance Reforms was adopted by the Council of Government on December 23, 2020, with the objective of improving coordination and leadership of our PFM reform strategy. To promote the exchange of information between all the stakeholders of the reforms, a portal dedicated to PFM reforms on the website of the Ministry of Economy and Finance will be launched in the second quarter of 2021.
- Improving the efficiency and transparency of the public expenditure chain remains a priority. The new draft law on treasury management is expected to be submitted to Parliament for the May 2021 session. It will contribute to improving active cash management, an important step towards the implementation of the Single Treasury Account. With the same objective, we are identifying and listing all the accounts of Public Establishments opened in Primary Banks for their repatriation to the Public Treasury. Another draft law on the status of public accountants, specifying their legal responsibility in the event of irregularities, will also be submitted to the Parliament in May 2021.
- As part of our efforts for improved budget transparency, we have published on line through the “*Salohy*” platform available in the website of the Ministry of Economy and Finance, detailed budget execution data by sectors, ministries, and even program, with the amounts of actual payments (<http://app.tresorpublic.mg/opendata.mef.mg/>). Based on this information, we will publish (before the end of the following quarter) a quarterly budget execution report on a payment basis, including information on COVID-19 related spending and social spending (Continuous Structural Benchmark, starting with Q1 2021 to be published before end of Q2 2021).
- We will continue to reinforce ex post controls and the PFM system’s contribution in the fight against corruption. We are strengthening audit bodies and internal inspections, especially the Court of Accounts (*Cour des comptes*). We will publish a progress update of the implementation of the Cour des Comptes’ recommendations on AUGURE, including on the payroll payment chain (Structural Benchmark, September 21).
- Regarding public procurement, over the counter (OTC) contracts were required in the context of emergencies under the COVID-19 pandemic and a decree was prepared to clarify the scope of these emergencies. We remain committed to limit the use of OTCs. Moreover, a decree on the Code of Ethics has been updated to specify sanctions in case there are any violations of the

procurement code. We are also developing in collaboration with UNDP a project for digitization of procurement (e-Government Procurement).

B. Enhancing Economic Governance

36. Governance is central in the Plan Emergence Madagascar. Our PEM features governance as the central pillar and a cross-cutting theme connecting all areas of the country's sustainable development: strengthening public security and political stability, peace and security, rule of law, human rights, the fight against corruption, and the efficiency of administration and institutions.

37. We are committed to effectively enforce the new anti-corruption legal framework:

- We remain dedicated to allocating sufficient human, financial, and material resources to the operationalization of the institutions in charge of the fight against corruption with a dedicated budget allocation in the LFR 2021 and ensuring that all appropriate powers remain in place. We are making progress in the opening of anti-corruption courts in provinces; the Mahajanga court is operational since October 2020 and recruitment for that of Fianarantsoa is underway for a scheduled opening of the court in Q4 2021.
- The updated national anti-corruption strategy and the national policy for good governance, both harmonized with the PEM, were finalized in 2020, and will be presented to the council of Ministers by May 2021. Sectoral policies for priority sectors will be developed with the support of the CSI. The decree to establish the agency for the recovery of illicit assets will be adopted by end-March 2021 and a dedicated budget will be allocated in the 2021 LFR (Structural Benchmark, June 2021) for the operationalization of this agency. To expedite the application of the 2018 *anti-money laundering and combating the financing of terrorism (AML/CFT) law*, which brought our AML/CFT framework into closer alignment with the international/Financial Action Task force (FATF) standards, we plan to issue the implementing decrees after another presentation to the Council in Ministers in May 2021.
- A draft Law under consideration that aims at revising the law on the anti-corruption courts was adopted by the National Assembly in July 2020 and is awaiting consideration by the Senate. We are committed to preserving the mandate and powers of the anti-corruption courts to ensure there is no contradiction between the legal framework in force and international conventions. The government plans to review this law before Senate examination. The draft amendment law was also shared with the IMF to receive technical advice.
- The SAMIFIN, Madagascar's financial intelligence unit, is developing a 5-year strategy in collaboration with the World Bank.
- Quarterly statistics on corruption cases based on investigations/analyses conducted by SAMIFIN and the anti-corruption office (BIANCO) have been regularly published since April 2018, with statistics up to December 2020 published.

38. We will continue our efforts to promote a favorable business climate, which is essential to boost private investment as envisioned in our PEM. We made important progress in

the digitalization of tax payments for companies, issuance of work permits, registration of new businesses, and the establishment of a credit bureau. In the context of a new law on investments, we intend to cap tariffs, align foreign and domestic investors' rights and improve land property law. Access to electricity, water and high transportation and logistics costs remain the main impediments to business development.

C. Strengthening Stability and Financial Sector Development

39. The reform of the monetary policy operational framework continues, despite a slowdown in 2020 due to the COVID-19 pandemic. BFM formally implemented an interest rate corridor system, established overnight deposit and lending facilities while stopping the publication of the *taux directeur* to avoid any confusion with these new reference rates, and worked to bring the interbank market rates in line with the maturities of operations, risks and the overall level of liquidity. BFM objective remains to transition to interest rate targeting by 2023, based on the following sequence of measures:

- In the first semester of 2021, we will implement the symmetrical corridor to drive short-term interest rates on the money market, make changes in the system of mandatory reserves with more reliable and stable rules of calculation as well as a new calendar for the constitution of reserves (better synchronized with the monetary operations of BFM). We also plan to start the effective implementation of repurchase operations, aimed at further incentivizing interbank lending at longer horizons and support the buildup of a yield curve. The repo law will be published by June 2021, after some delays due to translation of technical terms.
- In the second half of 2021, we plan to start the migration towards a transitional framework with more flexible targeting of monetary aggregates, based on market interest rates for the short-term, and for the medium-term on the average of the monetary base with a fluctuation band.
- In 2022, we will work to the launching of BFM investment certificates with fixed maturities, and to the development of a continuous Ariary interbank market. The publication of a first official medium-term inflation forecast produced by BFM (which will serve as the basis and objective for the implementation of monetary policy) is also planned. We will also strengthen the transparency and communication regarding the monetary policy.
- While we acknowledge the possibility of implementation delays, we are confident that if all these steps are followed as planned, we will be able to plan to migrate to the interest rate targeting framework during 2023.

40. BFM's modernization is continuing, with a reform agenda to increase transparency and enhance autonomy and independence. BFM remains committed to the full adoption of International Financial Reporting Standards (IFRS) for the 2020 accounts expected by April 2021. BFM has developed an action plan, supported by IMF technical assistance, to achieve this goal. More broadly, we will continue our efforts to strengthen our internal audit mechanisms as per the safeguards' mission recommendations. Our controls are being reinforced in currency operations, a

risk management framework is being implemented, and efforts will continue to strengthen our lending operations, including through guidelines to operationalize the emergency lending framework.

41. We are also working on improving the functioning of the foreign exchange market operations and foreign reserve management. The central bank is currently revisiting the parameters of the algorithm (developed with Fund technical assistance) after its recent applications suggested several interventions that would have placed additional pressure on the MID in late 2020. In addition, the central bank is undertaking several reforms to improve the functioning of the MID, including passing in 2021 the FX Law (drafted with the support of IMF TA), which clarifies the division of responsibilities between the Ministry of Finance and the Central Bank; improved monitoring and regulation of foreign currency accounts; higher mandatory reserve rates for foreign currency deposits in collaboration with MEF/FINEX (as part of a strategy to increase currency offers and competition on the MID); and improved MID communications. Following adoption of the FX Law, we intend to issue the implementing decrees and to develop a new plan to phase out the surrender requirement. The plan will aim at gradually phasing it out if conditions do not destabilize the market. In this regard, we are conducting further technical analysis of the market to explore additional reforms to improve competition amongst participants; anticipate potential sources of volatility; and increase market depth by extending access to other non-bank financial participants.

42. BFM plans to diversify its reserve holdings by adding gold to its international reserves. In late 2020, in line with its Board's strategic orientations, BFM began a joint program with the Ministry of Mine and Strategic Resources, to purchase gold from local operators (a maximum of one ton by end-2021) with the plan of refining it to bring it to monetary grade. We are conducting a feasibility study on setting up a refinery and, if we pursue this path, we commit to transfer the responsibility to a private company. Formalization of exports will contribute to the improvement of our balance of payments through the repatriation of revenues and also strengthen the liquidity of the exchange market. To participate, gold operators must commit to increasing the traceability of their operations, repatriating earnings, and complying with the surrender requirement. We acknowledge the safeguards concerns expressed by the ongoing IMF's Safeguards Assessment stemming from the purchase of unrefined gold from local operators, and the refining and certification of gold, which were considered outside the core mandate of a central bank operations. While these non-traditional activities in the gold sector are expressly mentioned in BFM statutes (Articles 17 and 19) we acknowledge that these activities create potential governance, reputation, liquidity, quasi-fiscal, and financial risks for the BFM. We reaffirm that the diversification of BFM foreign reserve portfolio remains our ultimate objective and we have requested technical assistance from the Fund on how to achieve this objective while safeguarding BFM's institutional and financial autonomy. The BFM will also reengage with the government to revisit its role in the gold program and find alternative arrangements by September 2021 that avoid participation of the BFM in quasi-fiscal operations.

43. The government and the central bank are also committed to increase the formalization of the gold sector and reduce illicit exports. In the wake of several smuggling incidents in 2020,

the government suspended exports of gold in late 2020 and is conducting a census of gold operators in order to improve the tracking of production and trade flows. We commit to removing the export ban on gold once we have completed a review of the sector's practices to fully comply with all regulations, including fiscal ones and an extensive census of licensed operators in the gold sector, both expected to be completed by the end of July 2021.

44. We are improving financial inclusion through mobile banking and digitalization, including with developing the financial activities of the *Caisse d'Epargne de Madagascar* (CEM) and PAOMA:

- Mobile money operations have expanded rapidly during in the last decade but remain low compared to peers. We are supporting their development to address bottlenecks to financial inclusion, including with some government-sponsored initiatives by banks and microfinance institutions. This aim at enlarging access to credit to wider segments of the population, notably in rural areas, through electronic payment platforms developed with mobile phone operators. The existing mobile money network was instrumental in 2020 to provide, in response to the COVID-19 pandemic, financial assistance for six months to 243,686 vulnerable households in the cities of Antananarivo, Toamasina and Fianarantsoa.
- The CEM manages 1.2 million saving accounts in Madagascar, totaling MGA407 billion (0.8 percent of GDP). After obtaining in March 2019 its license to operate as a microfinance institution for deposits and credits, the CEM recently started credit activity, still in an embryonic state. In the same vein, the PAOMA (*Paositra Malagasy*), beyond its postal activities and the management of about 500,000 saving accounts, plans to develop financial activities building on its network of more than 250 agencies in the entire territory.
- We are implementing the e-Ariary digital payment project to improve the reliability and the access to the financial system. This digital payment system will be secure, accessible, easy to use, and legal method of transaction across all the national territory and will be subject to the monetary Authority's regulation and control. The e-Ariary will support financial inclusion objectives, improve the control of the money in circulation and strengthen the efficiency, safety and robustness of the national payment system.
- Low levels of financial inclusion are often associated with lower levels of financial literacy. To address this issue, BFM has developed a dedicated module on its website (<https://www.banky-foibe.mg/education-financiere>) and we plan to conduct awareness campaign in the regions.

45. We are strengthening supervision, risk-based prudential regulations and anti-money laundering and combating the financing of terrorism (AML/CFT), in line with the objectives of the 2018-22 National Strategy:

- The banking sector remains well capitalized despite the impact of the pandemic, but some vulnerabilities begin to emerge, and there is substantial heterogeneity among banks on liquidity ratios and ROE exists. Supportive measures have been maintain throughout the pandemic,

including the relaxation of reserve requirement rules, deferring SME and household loan repayments for 6 months, permission to deduct loans to SMEs that have been restructured from regulatory reserve requirements, extending of credit lines while preserving their liquidity, and extending the existing Partial Portfolio Credit Guarantee Schemes (PPGS) for firms negatively affected by the crisis.

- The adoption of the Financial Stability Law, which must be examined by the Council of Government and the Council of Ministers before being submitted to Parliament. The Law will establish a national structure in charge of analyzing, identifying and preventing systemic risks as well as managing and addressing financial crises. It is crucial to address several vulnerabilities highlighted by the 2016 FSAP on macroprudential framework, crisis management and financial development, given the expected rise in NPLs in the coming months.
- The banking law, in effect since March 5, will also facilitate the gradual transition to the interest rate targeting framework and to improve the effectiveness of monetary policy transmission mechanism. The instructions (on bank equity, solvency, liquidity, risk division, and provisioning for credit risks) are ready to be enforced once the law is published.
- The microfinance institutions (MFIs) have been heavily impacted by the effects of the pandemic, with a slowdown in their activity, a decline in deposits, and a significant deterioration of their portfolio. In this context BFM has set up an exceptional medium-term refinancing instrument designed exclusively to support MFIs and MSMEs through the commercial banks. We have strengthened prudential and AML/CFT supervision, in line with the objectives of the 2018-22 National Strategy. The CSBF has put in place a risk-based approach and is now working on its effective implementation.

OTHER AND PROGRAM MONITORING

46. We highly value the technical assistance received from the Fund, articulated with the one received from other partners. TA provision has been instrumental for the progress of some reforms in recent years and we hope that this effort will continue in the coming years to address new needs and challenges arising from the implementation of the new economic reform agenda under their Plan Emergence Madagascar.

47. We are committed to meeting the Fund’s safeguards policy requirements.

48. While data provision is broadly adequate for surveillance and program monitoring, we remain committed to allocate sufficient human, financial, and material resources to the production of statistics. The government will continue to support INSTAT in fulfilling its missions, and we count on continued technical and financial assistance from our partners. To address some shortcomings and strengthen our data provision, our priorities include:

- Formalize, make public and capitalize on the results of the last general population and housing census (*Recensement Général de la Population et de l’Habitat*, RGPH) carried out in 2018 and for

which the results and micro-data were officialized on February 15, 2021. Replacing projections still based on 1993 RGPH-2 data with macroeconomic aggregates using population size as the denominator will all need to be revised: such as GDP, GNP and GNI per capita.

- Update the data on poverty and household living conditions by carrying out the 2021 Permanent Household Survey.
- Carrying out a series of surveys on transfers - formal and informal - from the diaspora will be a major step forward to feed the financial statistics of the BFM and INSTAT, thus allowing the identification of the volume of foreign currency inflows and financing, as well as its contribution to GDP.
- Improve national accounts and the consumer price index. To do this, a survey for the calculation of the producer price index (PPI), extension of the geographical coverage of the CPI, calculation and publication of the disaggregation or decomposition of national accounts (quarterly accounts, regional accounts and sector satellites) are required.
- Contribute to the realization of the general census of agriculture.
- Regarding monetary and financial statistics, in 2018 as recommended by IMF TA, we consolidated the balance sheets of micro-financial institutions and those of CEM in the monetary survey. Once the supervision of the Insurance sector by the CSBF is effective, BFM will include the insurance corporations balance sheets in the monetary statistics to comply with the Monetary and Financial Statistics Manual and Compilation Guide. As for the external statistics, we finalize the results on the last survey before the end of first semester 2021. BFM will continue to monitor the level of private debt and strengthen FDI statistics, in partnership with INSTAT. It is scheduled that we resume the survey in the first semester of 2022.

49. The program will be evaluated based on quantitative performance criteria and structural benchmarks (Tables 1 and 2) and semi-annual reviews. Definitions of key concepts and indicators, as well as reporting requirements, are set out in the accompanying Technical Memorandum of Understanding (TMU). The first, second, and third reviews are scheduled to be completed on or after September 15, 2021, March 15, 2022, and September 15, 2022 respectively, based on test dates for periodic performance criteria of end-June 2021, end-December 2021, and end-June 2022, respectively.

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets, March 2021-March 2022

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Continuous Performance Criteria					
Ceiling on accumulation of new external payment arrears ¹	0	0	0	0	0
Ceiling on new external debt contracted or guaranteed by the central government or BFM, in present value terms (US\$ millions) ²	800	800	800	800	800
Performance Criterion					
Floor on domestic primary balance ^{3,*}	IT	PC	IT	PC	IT
	-550	-752	-1,324	-1,426	-120
Ceiling on net domestic assets (NDA) of BFM	2,165	2,301	2,578	2,838	3,285
Floor on net foreign assets (NFA) of BFM (millions of SDRs)	677	655	623	645	650
Indicative Targets					
Floor on gross domestic tax revenue [*]	693	1,556	2,453	3,384	841
Floor on gross customs tax revenue [*]	510	1,147	1,785	2,550	621
Floor on social spending ^{4,*}	77	154	282	513	111
Memorandum Items					
Social spending, including salaries ^{5,*}	377	754	1,182	1,713	420
Social spending, including salaries and externally financed investments	480	953	1,514	2,361	536
Wage bill of public workers-Education [*]	237	474	711	948	232
Wage bill of public workers-Health [*]	60	120	180	240	65
Official external budget support (grants, millions of SDRs)	0	9	9	54	54
Official external budget support (loans, millions of SDRs)	95	95	95	133	133
Program exchange rate (MGA/SDR)	5,509	5,509	5,509	5,509	5,509

Sources: Madagascar authorities; and IMF staff projections.

Sources: Malagasy Authorities; and IMF staff projections.

¹Cumulative ceiling that will be monitored on a continuous basis starting from the beginning of the year until the end of the program.

²Cumulative ceiling that will be monitored on a continuous basis starting from the beginning of the year until end-March 2022, at which point it will be renewed and potentially adjusted.

³Primary balance excluding foreign-financed investments and grants. Commitment basis.

⁴Domestically financed spending, excluding salaries, of the following ministries: Health, Education, Water and Sanitation, and Population.

⁵IT definition of social spending, plus salaries.

*Cumulative from the beginning of the year.

Table 2. Madagascar: Structural Benchmarks Through end-December 2021

Measures	Due Date(s)	Rationale	Macro-criticality
1. Enforce the collection of outstanding tax arrears by collecting at least MGA 80 billion of tax arrears in the first half of 2021.	Jun-21	Mobilizing fiscal revenue	High
2. Adopt implementation decree for the law on illicit asset recovery, including the setting-up of the illicit asset recovery agency, with a dedicated budget allocation in the 2021 revised Budget.	Jun-21	Enhancing economic governance	Medium
3. Increase the number of beneficiaries of cash transfer programs from 483,428 in December 2020 to 540,000 in September 2021	Sep-21	Improving the composition and quality of fiscal spending	High
4. Publish progress update of the implementation of AUGURE's recommendations made by the Cour des Comptes, including on the payroll payment chain.	Nov-21	Improving the composition and quality of fiscal spending	High
5. Finalize and publish a public investment manual in line with FAD TA recommendations, notably with a view to clarify institutional aspects.	Dec-21	Promoting growth by advancing reforms and addressing fragilities	High
6. Publication of an independent third-party audit of COVID-19 related contracts.	Dec-21	Enhancing economic governance	Medium
7. Publish the terms and conditions of all PPP contracts within one month of the date of signature on ARMP's web site.	continuous	Enhancing economic governance	Medium
8. Notify IMF and World Bank staff of details of any budget transfer to JIRAMA's suppliers and share associated documentation within one week of payment.	continuous	Enhancing economic governance & Improving the composition and quality of fiscal spending	High
9. Keep government liability to oil distributors below MGA 100 billion without any direct budget compensation.	continuous	Preserving and strengthening fiscal space	High
10. Publish (before the end of following quarter) a quarterly budget execution report on a payment basis, including on Covid-19 related spending and social spending.	continuous, starting with Q1 2021	Enhancing budget transparency	High

Attachment II. Technical Memorandum of Understanding

1. This technical memorandum of understanding (TMU) contains definitions and adjustment mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Tables 1 and 2, which are attached to the Memorandum of Economic and Financial Policies for 2021-2024. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.

DEFINITIONS

2. For purposes of this TMU, **external** and **domestic** shall be defined on a residency basis.
3. Government is defined for the purposes of this TMU to comprise the scope of operations of the treasury shown in the *opérations globales du Trésor* (or OGT). The government does not include the operations of state-owned enterprises and sub-national authorities.
4. The program exchange rates for the purposes of this TMU¹ are as follows:

Program Exchange Rates	
Malagasy Ariary (MGA)/SDR	5508.800000
U.S. Dollar/SDR	1.440269
Euro/SDR	1.175341
Australian dollar/SDR	1.878406
Canadian dollar/SDR	1.840229
Chinese Yuan/SDR	9.399560
Japanese Yen/SDR	148.565264
Swiss Franc	1.274206
U.K. Pound Sterling/SDR	1.058243

5. Foreign currency accounts denominated in currencies other than the SDR will first be valued in SDRs and then be converted to MGA. Amounts in other currencies than those reported in the table above and monetary gold will first be valued in SDRs at the exchange rates and gold prices that prevailed on December 30, 2020, and then be converted to MGA.

6. Performance criteria included in the program, as defined below, refer to the net foreign assets and net domestic assets of the central bank, external payments arrears, new external debt owed or guaranteed by the central government and/or the central bank, and the domestic primary balance (commitment basis). Performance criteria are set for end-June 2021 and end-December 2021 while indicative targets are set for end-March 2021, end-September 2021, and end-March 2022.

¹ Data refer to the mid-point reference exchange rates published on the CBM's webpage for December 30, 2020.

7. In addition to the specific PCs listed in paragraph 6, as for any Fund arrangement, continuous PCs also include the non-introduction of exchange restrictions and multiple currency practices. Specifically, continuous conditionality covers (i) imposition or intensification of restrictions on the making of payments and transfers for current international transactions; (ii) introduction or modification of multiple currency practices; (iii) conclusion of bilateral payments agreements that are inconsistent with Article VIII; and (iv) imposition or intensification of import restrictions for balance of payments reasons. These continuous PCs, given their non-quantitative nature, are not listed in the PC table annexed to the MEFP.

8. Total government revenue is comprised of tax and nontax budget revenue (as defined under Chapter 5 of GFSM 2001) and grants. Revenue is recorded in the accounting system on a cash basis. Taxes on the import of petroleum products, paid through the issuance of promissory notes, are recorded under revenue at the time of the issuance of the promissory notes: to reconcile the difference in timing between the issuance of the promissory note and its actual payment to the Treasury, an equivalent amount is recorded (negatively) under the line "other net transactions of the Treasury" until the actual payment.

PROVISION OF DATA TO THE FUND

9. The following information will be provided to the IMF staff for the purpose of monitoring the program (see Table 1 for details):

- Data with respect to all variables subject to quantitative performance criteria and indicative targets will be provided to Fund staff monthly with a lag of no more than four weeks for data on net foreign assets (NFA) and net domestic assets (NDA) of the Central Bank of Madagascar (CBM) and eight weeks for other data. The authorities will promptly transmit any data revisions to the Fund.
- The Financial Intelligence Unit (SAMIFIN) will continue to publish, on a website that is freely available to the public, quarterly data (no later than the end of the month following the quarter) on reports sent to BIANCO in relation to suspicions of laundering of the proceeds of corruption.
- The BIANCO will continue to publish on a website, that is freely available to the public, quarterly data (no later than at the end of the month following the quarter) on the number of persons indicted, the number of persons convicted by a first instance court decision, the number of persons convicted pursuant a final court decision, and the number of verifications of assets disclosures of public officials.
- For variables assessing performance against program objectives but which are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on the appropriate way of measuring and reporting.

QUANTITATIVE PERFORMANCE CRITERIA

A. Fiscal Aggregates

Floor on Primary Balance (commitment basis)

10. The domestic primary balance (commitment basis) is measured as follows:

- Domestic tax and non-tax revenue less domestically financed capital expenditures and current spending excluding interest payments.
- For the purposes of calculating the primary balance, tax revenues are measured on a net basis, i.e., net of the refund of VAT credits. Current spending excluding interest payments is the sum of expenditures on wages and salaries, goods and services, transfers and subsidies, and treasury operations (net) excluding the refund of VAT credits. The primary balance will be calculated cumulatively from the beginning of the calendar year. For reference, using data at end-September 2020, the value of the primary balance would be as follows:

Primary Balance Excluding Foreign Financed Investment and Grants (commitment basis)	-269
Gross Tax revenue	3,613
<i>of which gross domestic tax revenue</i>	<i>1,953</i>
<i>of which gross custom tax revenue</i>	<i>1,660</i>
VAT refunds	115
Tax revenue (net of VAT refunds)	3,498
Domestic non-tax revenue	91
Less:	
Domestically-financed capital expenditures	453
Current expenditures	3,405
Wages and salaries	2,008
Goods and services	182
Transfers and subsidies	1,134
Treasury operations (net of VAT refunds)	81

B. External Debt

Ceiling on Accumulation of New External Payment Arrears

11. These arrears consist of overdue debt-service obligations (i.e., payments of principal and interest) related to loans contracted or guaranteed by the government or CBM. Debt service obligations (including unpaid penalties and interest charges) are considered overdue if they have not been paid 30 days after the due date or after the end of a grace period agreed with, or unilaterally granted by, each creditor before the due date. They exclude arrears resulting from

nonpayment of debt service for which the creditor has accepted in writing to negotiate alternative payment schedules, as well as debt service payments in conformity with contractual obligations that fail to materialize on time for reasons beyond the control of the Malagasy authorities. This monitoring target should be observed on a continuous basis from the beginning of the year.

Ceiling on New External Debt

- 12.** For program monitoring purposes, the present value (PV) of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is 5 percent.
- 13.** Where an external loan agreement contains multiple disbursements and where the interest rate for individual disbursement are linked to the evolution of a reference rate since the date of signature, the interest rate at the time of signature will apply for the calculation of the PV and grant element for all disbursements under the agreement.
- 14.** For program monitoring purposes, the definition of debt is set out in *Point 8, Guidelines on Public Debt Conditionality in Fund Arrangements, Executive Board Decision No. 15688-(14/107), adopted December 5, 2014* (see Annex 1). External debt is defined by the residency of the creditor.
- 15.** For loans carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the loan would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the loan contract. The program reference rate for the six-month USD LIBOR is 0.42 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR or 3-month Euribor over six-month USD LIBOR is -50 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -50 basis points. The spread of six-month GBP LIBOR over six-month USD LIBOR is 0 basis points. For interest rates on currencies other than Euro, JPY, and GDP, the spread over six-month USD LIBOR is -50 basis points.² Where the variable rate is linked to a different benchmark interest rate, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.
- 16.** A performance criterion (ceiling) applies to the PV of new external debt, contracted or guaranteed by the government or CBM. The cumulative ceiling applies to debt contracted or guaranteed for which value has not yet been received, including private debt for which official guarantees have been extended. The PV is determined using the Fund's concessionality calculator or excel template available [online](#). These monitoring targets should be observed on a continuous basis from the beginning of the year until end-March 2022, at which point it will be renewed and potentially adjusted. The ceiling is subject to an adjustor defined below.

² The program reference rate and spreads are based on the "average projected rate" for the six-month USD LIBOR over the following 10 years from the Fall 2020 World Economic Outlook (WEO).

17. Excluded from the ceiling in paragraph 16 is (i) the use of IMF resources; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt (this also applies to liabilities of Air Madagascar assumed by the government in the context of a strategic partnership agreement); and (iii) debts classified as international reserve liabilities of CBM.

C. Monetary Aggregates

Floor on Net Foreign Assets of the Central Bank of Madagascar

18. The target floor for NFA of the CBM is evaluated using the end-period stock, calculated using program exchange rates. The NFA of CBM is defined as the difference between CBM's gross foreign assets and total foreign liabilities, including debt owed to the IMF. All foreign assets and foreign liabilities are converted to SDRs at the program exchange rates, as described in paragraph 4. For reference, at end-December 2020, NFA was SDR 653 million, calculated as follows:

Foreign Assets	
MGA billions, end-2020 exchange rates (A)	7,369.6
SDR millions, end-2020 exchange rates (B)	1,337.8
SDR millions, program exchange rates (C)	1,337.8
Foreign Liabilities	
MGA billions, end-2020 exchange rates (D)	3,772.3
SDR millions, end-2020 exchange rates (E)	684.8
Net Foreign Assets	
SDR millions, program exchange rates (F) = (C) – (E)	653.0

Ceiling on Net Domestic Assets of the Central Bank of Madagascar

19. The target ceiling on NDA of the CBM is evaluated using the end-period stock, calculated at program exchange rates. The NDA of CBM are defined as the difference between reserve money and the NFA of the CBM valued in MGA using the program exchange rates as described in paragraphs 4. It includes net credit to the government, credit to the economy, claims on banks, liabilities to banks (including the proceeds of CBM deposit auctions—*appels d'offres négatifs*, and

open market operations), and other items (net). For reference, at end-December 2020, NDA at program exchange rates was MGA 1,083 billion, calculated as follows:

Net Foreign Assets	
SDR millions, program exchange rates (A)	653.0
MGA billions, program exchange rates (B)	3,597.3
Base Money	
MGA billions, end-2020 exchange rates (C)	5,393.1
Net Domestic Assets	
MGA billions, program exchange rates (D) = (C) – (B)	1,795.8

INDICATIVE TARGETS

A. Floor on Priority Social Spending

20. Priority social spending includes domestic spending primarily related to interventions in nutrition, education, health, and the provision of social safety nets. The indicative target for the floor on priority social spending by the central government will be calculated cumulatively from the beginning of the calendar year. The floor is set as the sum of the budget allocations in the *Loi de Finance* to the Ministries of Health, Education, Population and Water, excluding salaries and externally financed investment.

B. Floors on Gross domestic Tax Revenue and gross custom tax revenue

21. Government tax revenue is measured on a gross basis, that is, before the refund of VAT credits. It comprises all domestic taxes and taxes on foreign trade received by the central government treasury. Tax revenue excludes: (1) the receipts from the local sale of in-kind grants, and (2) any gross inflows to the government on account of signature bonus receipts from the auction of hydrocarbon and mining exploration rights. Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance and Budget. The floors on gross tax revenue will be calculated cumulatively from the beginning of the calendar year. For reference, for the year ending December 2020, gross domestic tax revenue was MGA 2,658 billion, comprised of net domestic tax revenue of MGA 2,526 billion and VAT refunds of MGA 132 billion, and gross custom tax revenue was MGA 2,187 billion, comprised of net custom tax revenue of MGA 2,128 billion and VAT refunds of MGA 59 billion.

STRUCTURAL BENCHMARKS

22. For the purposes of the structural benchmark on enforcing the collection of outstanding tax arrears, the collection refers to the “recouvrements des restes à recouvrer” monitored by the Direction Générale des Impôts.

23. Regarding the structural benchmark on notifying IMF and World Bank staff of details of any budget transfer to JIRAMA’s suppliers and sharing associated documentation within one week of payment, the information to be shared is: (1) the details of each transfer, as published for 2020 at <http://www.mef.gov.mg/reportingcovid>, including the “reference d’engagement”, the beneficiary enterprise, the purpose of the transfer (“objet”) the “date d’engagement”, and the amount of the transfer, and (2) the agreement or “convention” signed with the supplier in relation with the transfer.

24. For the purposes of the structural benchmark on fuel pricing, and until the adoption of a fuel pricing mechanism, the authorities will set prices in a manner that prevents total estimated net liabilities to fuel distributors from rising above MGA 100 billion (measured as a cumulative stock). The estimated total net liability is calculated by the Malagasy Office for Hydrocarbons (OMH), using the fuel price structure in place or any new fuel price structure established in accordance with prevailing laws and regulations. The authorities will provide to IMF staff the calculations for the estimate of the monthly flow and stock for these net liabilities, for each month, by the 14th day of that month.

MEMORANDUM ITEMS

25. Official external program (budget) support is defined as grants and loans, including in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and the private sector and incorporated into the budget. Official external support does not include grants and loans earmarked to investment projects. Official external program support is calculated as a cumulative flow from January 1, 2021.

26. Additional monitoring of social spending will take the form of the following memorandum items: (i) social spending, including salaries of the four social ministries; (ii) social spending, including salaries and externally financed investments; (iii) wage bill of public workers in education (*masse salariale des employés publics dans le Secteur Education*, provided by the DGT) and (iv) wage bill of public workers in health (*masse salariale des employés publics dans le Secteur Santé*, provided by the DGT).

USE OF ADJUSTERS

27. The performance criteria on net foreign assets of the CBM and net domestic assets of the CBM will be adjusted in line with deviations from amounts projected in the program for official

external program support. These deviations will be calculated cumulatively from January 1, 2021. The following is an explanation of these adjustments:

- The floor on NFA will be adjusted *downward (upward)* by the cumulative deviation downward (upward) of actual from projected budget support (official external program support). This adjustment will be capped at the equivalent of SDR 100 million, evaluated at program exchange rates as described in paragraph 4.
- The ceiling on NDA will be adjusted *upward (downward)* by the cumulative deviation downward (upward) of actual from projected budget support (official external program support). This adjustment will be capped at the equivalent of SDR 100 million, evaluated at program exchange rates as described in paragraph 4.

28. The performance criteria on the primary balance will be adjusted in line with deviations from amounts projected in the program for official external program grants. These deviations will be calculated cumulatively from the beginning of each calendar year. The following is an explanation of these adjustments:

- The floor on the primary balance excluding foreign-financed investment and grants (commitment basis) will be adjusted downward by the cumulative upward deviation of actual from projected official external program support (grants or loans on concessional terms), calculated at quarterly period-average actual exchange rates as described in paragraph 4.

29. An adjustor of up to 5 percent of the external debt ceiling set in PV terms applies in case deviations are prompted by a change in the financing terms. Changes in interest rates, maturity, grace period, payment schedule, commissions, fees of a debt or debts are candidates for the adjuster. The adjuster cannot be applied when deviations are prompted by an increase in the nominal amount of total debt contracted or guaranteed and are subject to debt sustainability.

Table 1. Madagascar: Data Reporting Requirements

Item	Periodicity
Exchange rate data	
Central Bank of Madagascar (CBM)	
Total daily CBM gross purchases of foreign exchange – break down by currency purchased	Daily, next working day
The weighted average exchange rate of CBM gross purchases, the highest traded exchange rate, and the lowest traded exchange rate – break down by currency purchased	Daily, next working day
Total daily CBM gross sales of foreign exchange – break down by currency purchased	Daily, next working day
The weighted average exchange rate of CBM gross sales, the highest traded exchange rate, and the lowest traded exchange rate – break down by currency purchased	Daily, next working day
Total CBM net purchases/sales of foreign exchange - break down by currency purchased	Daily, next working day
Total interbank foreign exchange transactions (net of CBM transactions) - break down by currency purchased	Daily, next working day
Total interbank and retail foreign exchange transactions (net of CBM transactions) - break down by currency purchased	Daily, next working day
Monetary, interest rate, and financial data	
Central Bank of Madagascar (CBM)	
Foreign exchange cash flow, including foreign debt operations	Monthly
Stock of gross international reserves (GIR) and net foreign assets (NFA), both at program and market exchange rates	Monthly
Detailed data on the composition of gross international reserves (GIR), including currency composition	Monthly
Market results of Treasury bill auctions, including the bid level, bids accepted or rejected, and interest rates	Monthly
Stock of outstanding Treasury bills	Monthly
Data on the secondary market for Treasury bills and other government securities	Monthly
Bank-by-bank data on excess/shortfall of required reserves	Monthly
Money market operations and rates	Monthly
Bank lending by economic sector and term	Monthly
Balance sheet of CBM	Monthly, within two weeks of the end of each month
Balance sheet (aggregate of deposit money banks)	Monthly, within six weeks of the end of each month
Monetary survey	Monthly, within six weeks of the end of each month
Financial soundness indicators of deposit money banks	Quarterly, within eight weeks of the end of the quarter

Table 1. Madagascar: Data Reporting Requirements (continued)	
Item	Periodicity
Fiscal data	
Ministry of Finance and Budget (MFB)	
Preliminary revenue collections (customs and internal revenue)	Monthly, within three weeks of the end of each month
Treasury operations (OGT)	Monthly, within eight weeks of the end of each month
Stock of domestic arrears, including arrears on expenditure and VAT refunds	Monthly, within eight weeks of the end of each month
Priority social spending as defined by the indicative target	Monthly, within eight weeks of the end of each month
Subsidies to JIRAMA's suppliers	Within one week of each transfer payment, as specified in continuous SB.
State-owned enterprise data	
Data summarizing the operational and financial position of JIRAMA	Monthly, within four weeks of the end of each month, for operational and financial data. Quarterly, by the end of the following month, for the Table on "Total impayés fournisseurs"
Data summarizing the financial position of AIR MADAGASCAR	Quarterly, by the end of the subsequent quarter.
Debt data	
Ministry of Finance and Budget (MFB)	
Public and publicly-guaranteed debt stock at end of month, including: (i) by creditor (official, commercial domestic, commercial external); (ii) by instrument (Treasury bills, other domestic loans, external official loans, external commercial loans, guarantees); and (iii) in case of new guarantees, the name of the guaranteed individual/institution. External public or publicly guaranteed loans signed since January 1, 2021, specifying the nominal value; calculated grant element and PV; and terms, including the interest rate (using the program reference rate for variable rate loans), maturity, commissions/fees, grace period, repayment profile, and grant component.	Monthly, within four weeks of the end of each month Quarterly
External data	
Central Bank of Madagascar (CBM)	
Balance of payments	Quarterly, by the end of the subsequent quarter

Table 1. Madagascar: Data Reporting Requirements (concluded)	
Real sector and price data	
INSTAT	
Consumer price index data (provided by INSTAT)	Monthly, within four weeks of the end of each month
Details on tourism	Monthly, within twelve weeks of the end of each month
Electricity and water production and consumption	Monthly, within twelve weeks of the end of each month
Other data	
OMH	
Petroleum shipments and consumption	Monthly, within four weeks of the end of each month

Annex I. Guidelines on Performance Criteria with Respect to External Debt

Excerpt from paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

1. (a) For the purpose of these guidelines, the term “debt” will be understood to mean a current, i.e., 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. Debts can take a number of forms, the primary ones being as follows:

i) loans, i.e., 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 exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the 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, i.e., 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) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

(b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.



REPUBLIC OF MADAGASCAR

March 16, 2021

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

Approved By
Vivek Arora and Geremia Palomba
(IMF) and **Marcello Estevão** (IDA)

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)¹

Madagascar	
Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	Moderate
Overall risk of debt distress	Moderate
Granularity in the risk rating	Some space to absorb shocks
Application of judgment	No

Despite the large impact of the pandemic, Madagascar, classified as having a medium debt carrying capacity, is assessed at moderate risk of external debt distress with some space to absorb shocks and moderate risk of overall debt distress, in line with the [August 2020 assessment](#). While the baseline does not breach any external public and publicly guaranteed (PPG) debt thresholds, under an export shock, the present value of debt-to-exports and debt service ratios breach the thresholds towards the latter half of the horizon, assuming the continued mobilization of concessional financing (including grants) in the short term. Overall (external plus domestic) risk of debt distress remains moderate due to the external PPG debt rating; the previous DSA also had a moderate overall risk of debt distress. Total public debt is below the benchmark under the baseline, but a growth shock drives the present value of debt to GDP towards the benchmark at the end of the period, despite not breaching it. Liquidity pressures may materialize as the debt-service-to-revenue ratio could near or exceed 70 percent in the near term under both the baseline and shocks. The government has some space to scale-up investment, assuming ongoing efforts to improve domestic resource mobilization, continued reliance on concessional external financing, and progress in developing domestic bond markets. The current assessment also reflects the participation in the Debt Service Suspension Initiative (DSSI), supported by the G-20 and Paris Club, and the IMF's Catastrophe Containment and Relief Trust (CCRT).

Updates with respect to COVID-19's economic impact (both domestically and externally) and policy response are rapidly evolving and risks remain tilted to the downside, including the heightened risk of the materialization of contingent liabilities, which could lead to a faster than expected deterioration in external and public debt indicators. However, the distance to risk thresholds under current baseline projections suggests some space to absorb additional shocks.

¹ Prepared by the IMF and the World Bank. This DSA follows the [Guidance Note of the Joint Bank-Fund Debt Sustainability Framework for Low Income Countries](#), February 2018.

PUBLIC DEBT COVERAGE

1. The DSA includes public and publicly guaranteed external and domestic debt. In line with coverage under the August 2020 DSA, public and publicly guaranteed (PPG) debt reflects external and domestic debt, including: all external liabilities held by the central bank; all borrowing from the IMF; non-guaranteed domestic debts owed by state-owned enterprises (SOEs) in cases where the government has at least 50 percent of the shares (e.g., JIRAMA and Air Madagascar);² and direct guarantees provided by the central government (Text Table 1). Borrowing by local governments requires the authorization from the Ministry of Finance and no request of such authorization has been submitted to date. The measure of debt is on a gross basis and the currency criterion is used to distinguish between domestic and external debt.³ The authorities publish debt data on a quarterly basis on domestic and external debt. Reporting of debt statistics on public enterprises needs to be strengthened further.

Text Table 1. Madagascar: Public Debt Coverage Under the Baseline Scenario

Subsectors of the public sector	Sub-sectors covered
1 Central government	X
2 State and local government	X
3 Other elements in the general government	
4 o/w: Social security fund	
5 o/w: Extra budgetary funds (EBFs)	
6 Guarantees (to other entities in the public and private sector, including to SOEs)	X
7 Central bank (borrowed on behalf of the government)	X
8 Non-guaranteed SOE debt	X

Text Table 2. Madagascar: Coverage of the Contingent Liabilities' Stress Test

1 The country's coverage of public debt	The central, state, and local governments, central bank, government-guaranteed debt, non-guaranteed SOE debt		
	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	0.0	Captures potential additional contingent liabilities, including a potential external liability of US\$ 53 million associated with Air Madagascar as well as liabilities associated with the postal savings scheme and the Madagascar Savings Fund.
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	3.4	
4 PPP	35 percent of PPP stock	0.0	Exposures through PPPs are set to zero as PPPs comprise less than 3 percent of GDP.
5 Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5.0	
Total (2+3+4+5) (in percent of GDP)		8.4	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

2. Notwithstanding the comprehensive coverage, a contingent liability shock of 8.4 percent of GDP is simulated to account for potential liabilities. This reflects the default setting for PPPs and financial markets but includes a larger contingent liability setting (Text Table 2).

² Although legislation allows it, public enterprises do not hold direct external non-guaranteed debt.

³ Locally issued debt denominated in local currency held by non-residents and/or locally issued debt denominated in foreign currency held by residents is likely insignificant. Owing to limitations in available data, the results would likely be the same if selecting the residency criterion.

- As mentioned above, estimated domestic debt for SOEs in which the government has a majority stake is incorporated in the baseline (i.e., JIRAMA's debts of 2.1 percent of GDP and of 2.3 percent for other SOEs).⁴ However, government recognition of some SOE short-term liabilities could also materialize (e.g., if large exchange rate fluctuations require that government offer assistance in paying external suppliers). In addition, Air Madagascar has accumulated debt to external suppliers of US\$29 million due to COVID-19 related pressures, and there is ongoing litigation with amounts in dispute of EUR 20 million. Therefore, to be conservative, the default amount of 2 percent of GDP (which captures risks associated with JIRAMA and other SOEs) was adjusted upwards to reflect Air Madagascar's potential liabilities (US\$53 million or 0.4 percent of GDP). Other potential contingencies include future recapitalization of the postal savings scheme and the Madagascar Savings Fund (*Caisse d'Epargne de Madagascar, CEM*), which would likely amount to less than 1 percent of GDP (an additional 1 percent of GDP is added to the shock, bringing the total to 3.4 percent of GDP).
- Exposures to PPPs are set to zero since estimates of the PPP-related capital stock fall below 3 percent of GDP; the threshold for the PPP shock to be included. Capital stock related to Ravalina Airport is estimated to be 1.8 percent of GDP. The authorities plan to develop more PPPs in future, especially in the area of hydroelectric power, and the potential vulnerabilities associated with such PPPs could increase rapidly.
- The default value of 5 percent is programmed for financial markets. Most banks are financially solid with deposits exceeding loans and majority foreign shareholders. Dollarization of deposits and credits is not pronounced, and banks' foreign assets generally exceed their foreign liabilities.

3. Madagascar is benefitting from recent debt service relief initiatives, which are covered in the DSA. The current assessment reflects the authorities' participation in the Debt Service Suspension Initiative (DSSI), supported by the G-20 and Paris Club⁵ (amounting to almost SDR 9 million or less than 0.1 percent of GDP). The current assessment also reflects debt relief from the IMF under the Catastrophe Containment window of the IMF's Catastrophe Containment and Relief Trust (CCRT) through April 2022 (subject to the availability of CCRT resources for the next 18 months and amounting to SDR 22 million or 0.2 percent of GDP).

BACKGROUND

A. Recent Debt Developments

4. The 2020 PPG debt ratio is projected to reach 44 percent, rising by 6 percent of GDP relative to 2019. The increase owed to a large increase in the primary deficit and a decline in nominal GDP growth due to the COVID-19 pandemic. (Text Table 3). Domestic and external public debt have increased by 0.4 and 5.4 percent of GDP, respectively. External sources continue to account for almost three-quarters of PPG debt,

⁴ While JIRAMA is working with the World Bank on the implementation of its recovery plan, to be conservative, we do not account for the potential benefits of this plan on the domestic debt forecast. In particular, we assume that JIRAMA's debts remain at the same ratio to GDP through the entire forecast horizon (2.1 percent of GDP). This implies that successful implementation of the plan is an upside risk for the baseline, while non-implementation of the plan could result in still-high arrears and larger projected operational subsidy transfers

⁵ The authorities have requested an extension of the DSSI up to June 2021 with bilateral creditors.

with almost 60 percent of external debt owed to multilateral sources including the World Bank, African Development Bank, and IMF.

Text Table 3. Madagascar: Breakdown of Total PPG Debt (2015-20)

Creditor	2015	2016	2017	2018	2019	2020
Amount (US\$m)						
Domestic debt, of which:	1,689	1,682	1,827	1,793	1,621	1,585
Securities inc. BTA, BTF, BTS ¹	370	526	719	758	772	790
Debt to the Central Bank	386	337	297	304	239	208
Arrears	346	210	146	71	42	22
Other inc. SOE debt	587	610	665	660	568	565
External debt, of which:	2,816	2,845	3,262	3,548	3,851	4,384
Multilateral	2,006	2,052	2,276	2,368	2,511	2,596
Paris Club	146	137	165	189	257	266
Non-Paris Club	356	324	290	308	332	357
Commercial & Guaranteed	25	23	83	204	192	182
External debt of the Central Bank	282	310	449	479	558	984
Total PPG debt	4,505	4,528	5,089	5,341	5,472	5,969
Percent of GDP						
Domestic debt, of which:	16.3	15.0	14.4	13.4	11.2	11.6
Securities inc. BTA, BTF, BTS	3.6	4.7	5.7	5.6	5.3	5.8
Debt to the Central Bank	3.7	3.0	2.3	2.3	1.7	1.5
Arrears	3.3	1.9	1.2	0.5	0.3	0.2
Other inc. SOE debt	5.7	5.4	5.2	4.9	3.9	4.1
External debt, of which:	27.1	25.3	25.7	26.4	26.6	32.0
Multilateral	19.3	18.3	17.9	17.6	17.3	18.9
Paris Club	1.4	1.2	1.3	1.4	1.8	1.9
Non-Paris Club	3.4	2.9	2.3	2.3	2.3	2.6
Commercial & Guaranteed	0.2	0.2	0.7	1.5	1.3	1.3
External debt of the Central Bank	2.7	2.8	3.5	3.6	3.9	7.2
Total PPG debt	43.4	40.3	40.0	39.8	37.8	43.6
Percent of total						
Domestic debt, of which:	37.5	37.2	35.9	33.6	29.6	26.6
Securities inc. BTA, BTF, BTS	8.2	11.6	14.1	14.2	14.1	13.2
Debt to the Central Bank	8.6	7.4	5.8	5.7	4.4	3.5
Arrears	7.7	4.6	2.9	1.3	0.8	0.4
Other inc. SOE debt	13.0	13.5	13.1	12.4	10.4	9.5
External debt, of which:	62.5	62.8	64.1	66.4	70.4	73.4
Multilateral	44.5	45.3	44.7	44.3	45.9	43.5
Paris Club	3.3	3.0	3.2	3.5	4.7	4.5
Non-Paris Club	7.9	7.1	5.7	5.8	6.1	6.0
Commercial & Guaranteed	0.5	0.5	1.6	3.8	3.5	3.0
External debt of the Central Bank	6.3	6.8	8.8	9.0	10.2	16.5
Total PPG debt	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Malagasy authorities; and staff estimates.

¹BTA are Treasury bills with less than one year maturity; BTF and BTS are Treasury bonds with maturity ranging from 1 to 3 years.

B. Macroeconomic Assumptions

5. The COVID-19 pandemic has taken a large toll on Madagascar's economic prospects in the near and medium term, causing scarring. The forecasted GDP contraction of about 4 percent in 2020 implies a revision of more than 9 percentage points compared to the 2019-Article IV projection (see Table 5).⁶ Staff expects a partial recovery in 2021 (+3.2 percent). Output will surpass its 2019 level only in 2022 and remain well below pre-shock forecasted levels through the medium term. Staff expects a gradual decline in fiscal imbalances and an increase in public debt. Based on a gradual tax revenue recovery and an

⁶ IMF [Country Report No. 20/60](#), March 2020.

increase in capital spending, the primary deficit would remain large in 2021, gradually improving over the medium term. As a result, and considering the external financing of scaling-up investment plans, the public debt could reach 49 percent of GDP in 2025, higher than the 46 percent of GDP forecasted in the 2019 Article IV but broadly in line with the August 2020 DSA (with higher anticipated grant financing over the medium term).

- Growth is expected to peak over the medium-term at 5.4 percent in 2023, with some deceleration thereafter. In 2030, it is expected to hit 5.0 percent. Growth will be supported by a scale-up of public investment (e.g., transportation and energy infrastructure, health, and education) and good prospects for private investment (e.g., hydroelectric projects, canal construction, and tourism).
- Government investment rates over the medium-term were slightly revised upward (Figure 4), while private investment is expected to fall relative to the August 2020 DSA.⁷
- Inflation expectations are lower than earlier estimates for 2020 but broadly in line with prior estimates over the medium and long term.
- The non-interest current account deficit has been revised up over the short-term reflecting effects of the COVID-19 pandemic on tourism and external demand (with downward pressure on vanilla prices and metals volumes). Over the medium term, vanilla prices are expected to remain lower than pre-COVID-19 peaks, contributing to a decline in the current account balance relative to prior forecasts together with an expected rise in capital spending that will boost construction-related imports (e.g., equipment and primary materials).
- Lower primary deficits by 2025 are projected, reaching 2.6 percent of GDP, reflecting ongoing gains in revenue mobilization and PFM reforms. These reforms include: continued updates to the taxpayers' database; strengthening compliance in customs administration; broader use of electronic tax payments and the digitalization of related procedures; clearance of tax arrears (0.3 percent of GDP in additional revenues); and implementing a public procurement tax (0.4 percent of GDP in additional revenues).

Text Table 4. Madagascar: Baseline Macroeconomic Assumptions for DSA

(In percent of GDP, unless otherwise indicated)	2020			2025			2030		
	Article IV	Aug 2020	Current	Article IV	Aug 2020	Current	Article IV	Aug 2020	Current
Real GDP growth (percent)	5.2	-1.0	-4.2	5.5	5.5	5.0	5.2	5.2	5.0
Inflation, GDP Deflator (percent)	7.2	4.6	4.2	5.4	5.4	5.5	5.1	5.2	5.2
Non-interest CA deficit	0.9	3.1	6.1	1.6	2.6	3.2	1.8	3.3	3.6
Primary deficit	1.9	4.3	3.5	2.8	3.4	2.6	2.9	2.8	2.9

Sources: Malagasy authorities, World Bank and IMF.

6. Financing assumptions broadly reflect the authorities' 2021-23 Medium Term Debt

Strategy. The main 2023 targets of the debt strategy include: the share of external public debt as a share of total public debt should not exceed a maximum of 86 percent (it is estimated at around 73 percent in 2020); the average maturity of locally-issued debt should increase above 10 months (estimates put it around 11 months for 2020); the share of new external debt within a year should be less than 25 percent of

⁷ Our forecasted estimates of investment are far more conservative than those envisaged by the Plan Emergence Madagascar (PEM) reflecting partly current constraints on implementation capacity.

the stock of external debt (it is estimated to be around 14 percent in 2020); and the share of new domestic debt within a year should be less than 75 percent of the stock of domestic debt (it is estimated at almost 49 percent in 2020). The financing assumptions of this sustainability analysis deviate from the medium-term debt strategy on domestic financing due to the more conservative approach taken with respect to external financing assumptions (see ¶17); the DSA also accounts for significant amounts of SOE debt (see ¶11).⁸ To reflect recent increased use of medium-term locally-issued debt instruments and eventual introduction of longer-term instruments, the local financing share of medium-term bonds has been revised upwards to 25 percent from 2020-2025, with continued growth thereafter, and longer-term bonds (e.g., between 4-7 years) are assumed to reach a share of 3 percent in 2026-30, which rises to 9 percent by 2036-40. Finally, central bank financing is completely phased out by 2030 and commercial borrowing is expected to slowly scale back up from 2030 onwards as Madagascar's fundamentals strengthen.

7. Only external budget support based on firm assurances from donors has been included in the baseline, resulting in a large role for domestic financing. The baseline also assumes a conservative path for externally financed investment projects. Together, the conservative assumptions on external financing and a program framework with no financing gaps mean that domestic financing closes the gap, with higher associated borrowing costs than external financing. In recent DSAs (e.g., the August 2020 DSA), residual financing gaps in the near term were filled by a mix of external financing, largely on concessional terms. While Fund support is expected to catalyze additional financing, the baseline is relatively conservative and only reflects budget support with strong assurances from donors given ongoing uncertainties and shortfalls in recent budget support relative to initial expectations. As a result, the increased reliance on domestic financing results in higher financing costs relative to the August 2020 DSA (e.g., the debt service to revenues ratio increased to 78 percent in 2025 relative to 56 percent the prior DSA). To mitigate this liquidity pressure (see ¶19), the authorities will continue to develop the domestic debt market and will prioritize securing external financing on concessional terms (including grants), which would keep debt servicing costs at manageable levels and is in line with their debt strategy.

8. Realism tools suggest our assumptions are in line with reasonable bounds. Across a range of realism checks (Figure 4) that include the projected 3-year adjustment for the primary balance and public investment plans, underlying assumptions appear to not raise any flags. Projected growth in 2021 is below the range of potential growth paths under various fiscal multipliers; however, as for all countries, the magnitude and multifaceted effects of the COVID-19 pandemic are not well-captured by that aspect of the analysis.

9. The outlook remains subject to both domestic and external risks. Conjunctural risks include prolonged impacts of the COVID-19 outbreak, further disrupting trade and global value chains and delaying recovery in tourism; rising costs associated with heightened protectionism, which could reduce exports and potential growth; social unrest, disrupting economic activity and harming confidence; and exposure to natural disasters, which result in a loss in physical and human capital. Madagascar is also vulnerable to the possibility of larger than anticipated transfers to SOEs that reduce priority spending; stalls or reversals in the anti-corruption and governance reform agenda; and weak investment implementation

⁸ For example, under this conservative baseline the share of new domestic debt disbursements as a percent of the stock of domestic debt exceeds the 75 percent level between 2023-27; in all other years over the horizon, it falls below the 75 percent level.

capacity that weighs down growth. Presidential elections in 2023 may also affect the outlook. Upside risks include a faster global recovery from the pandemic and the materialization of large-scale projects in the energy or extractive sectors, both of which would support higher growth.

C. Drivers of Debt Dynamics

10. Over the medium term, scaling up of foreign-financed public investment drives an increase in debt compared with the 5-year historical average (Figure 3). Relative to the period between 2014 to 2019, external and total public debt to GDP ratios are expected to rise faster (by an additional 8 and 11 percentage points, respectively) over the medium term, reflecting pandemic-related borrowing, a gradual increase in borrowing costs, and higher capital investments accompanied by increasing deficits. Growth and trends in prices and the exchange rate help offset such factors. A residual that includes unrepatriated mining receipts and reserve accumulation is smaller than in the past.⁹

11. Government capital spending is revised slightly upward, but average 5-year real growth is nonetheless expected to fall relative to prior forecasts due to scarring from the pandemic and a fall in private investment ratios (Figure 4). The authorities are beginning to scale up infrastructure spending, with government investment rising slightly faster than previously assumed. Given Madagascar's large infrastructure needs, the conservative assumed baseline fiscal multiplier—flagged in the Realism Tools (Figure 4)—suggests a significant upside risk to growth and public investment efficiency and institutional strength are improving over time (e.g., Madagascar's Country Policy and Institutional Assessment (CPIA) score has increased from 3.1 in 2015 to 3.3 in 2019). However, private investment is estimated to have dropped precipitously in 2020. It is forecasted to rise thereafter but remain below prior estimates of the ratio over the medium term. Therefore, the projected contribution of public investment to real GDP growth over the next 5 years is expected to be slightly higher than suggested by the previous DSA.

D. Country Classification and Determination of Stress Test Scenarios

12. Madagascar's debt carrying capacity continues to be classified as medium, although its composite indicator score has dropped. Based on a calculation of a composite indicator reflecting factors such as the CPIA index, real growth rates, reserve coverage, remittances, and world growth, Madagascar continues to be rated as having medium debt-carrying capacity (Text Table 5). The 10 year-average values are based on an average over 2015-24, where latest macroeconomic data and projections are based on the October 2020 *World Economic Outlook* and 2019 CPIA. Relative to the August 2020 CI score, the world growth average dropped while the import coverage of reserves has increased; on net, there was a 0.1 point decline in the CI score, bringing it to 2.73 and closer to the lower threshold for medium carrying capacity at 2.69.¹⁰ Text Figure 1 highlights the differences in composite indicator cut-off values and the corresponding external debt burden thresholds and public debt benchmarks at different debt-carrying capacities.

⁹ The five-year projected impact of the residuals in the decomposition of the external debt dynamics reflects mostly changes in private sector debt.

¹⁰ Madagascar was classified as having weak debt-carrying capacity in June 2018.

Text Table 5. Madagascar: Calculation of Debt-Carrying Capacity

Components	10-year average values (A)	Coefficients (B)	Current	Contribution of components	August 2020	
			CI Score components (A*B) = (C)		CI Score components	Contribution of components
CPIA 1/	3.228	0.385	1.25	46%	1.25	44%
Real growth rate (in percent)	3.562	2.719	0.10	4%	0.12	4%
Import coverage of reserves (in percent)	35.811	4.052	1.45	53%	1.40	50%
Import coverage of reserves^2 (in percent)	12.824	-3.990	-0.51	-19%	-0.47	-17%
Remittances (in percent)	2.261	2.022	0.05	2%	0.05	2%
World economic growth (in percent)	2.928	13.520	0.40	15%	0.47	17%
CI Score 2/			2.73	100%	2.82	100%
Debt Carrying Capacity			Medium		Medium	

1/ The 10-year average scores for the current period are based on an average over 2015-2024.

2/ Composite Indicator Score Threshold for medium capacity is 2.69.

Text Figure 1. Composite Indicator Cut-off Values and Respective Debt Burden Thresholds & Benchmarks

Cut-off values			
Weak	CI <	2.69	
Medium	2.69	≤ CI ≤	3.05
Strong	CI >	3.05	

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23
TOTAL public debt benchmark			
PV of total public debt in percent of GDP	35	55	70

13. Stress tests generally follow standardized settings, with one exception—growth shock—and include shocks for natural disasters and commodity export prices. The contingent liability stress test is based on the quantification of potential contingent liabilities discussed above (including SOE-related concerns that extend beyond the baseline SOE debt coverage as detailed above), and the standardized stress tests apply the default settings. However, the growth test warranted adjustment. Given the high uncertainty and with risks tilted heavily towards the downside, the growth shock simulates a two standard deviation shock instead of one, in line with the August 2020 DSA.¹¹ Madagascar also remains exposed and vulnerable to natural disaster shocks, like cyclones, and hence qualifies for the natural disaster shock.¹²

¹¹ The magnitude of the shock to growth for the public debt stress tests in the second and third years of the projection is smaller than in the prior DSA (2.3 vs. 5 previously in the first year) as the projection horizon has shifted from 2019 to 2020 and the 10 year historical standard deviation (SD) is now smaller (i.e., 2009 outturns that reflected most of the impact of the Global Financial Crisis are no longer included in the 10 year horizon). Also, the shock is now based on the historical average minus two standard deviations; previously, it was based on the baseline projection minus two standard deviations.

¹² We apply the default settings for this one-off shock in the template, namely a 10 percentage-point rise in the debt-to-GDP ratio alongside a fall in real GDP growth (1.5 percent) and exports (3.5 percent), in 2021.

Since commodities (e.g., vanilla, nickel, cobalt) comprise about half of goods and services exports, we also include a commodity shock stress test. The standardized settings of this stress test are customized to better reflect Madagascar's country-specific circumstances. In particular, we assume an illustrative fall in prices equivalent to 10 percent of commodity exports, with no mitigating effect on imports, alongside declines in real GDP growth of 0.5 percent and in fiscal revenue of 0.25 percent of GDP. The shock occurs in 2021 and unwinds gradually by 2030. Residual financing for external debt stress tests is assumed to be from external sources with rates 25 percent above current concessional rates and with lower average maturities (75 percent of current average maturity periods). For overall public debt stress tests, limited recourse to domestic sources in the short run prompts us to assume 65 percent of additional financing would come from external sources and that the remaining domestic financing would be more expensive than under the baseline (with domestic rate nearly 20 percent above baseline).¹³

DEBT SUSTAINABILITY RESULTS

A. External Debt Sustainability

14. Under the baseline, rising external PPG debt remains well below thresholds (Table 1, Figure 1). External PPG debt is projected to rise from 32 percent of GDP in 2020 to 43 percent of GDP in 2030 before reaching 48 percent of GDP in 2040. Debt-creating flows include sizable current account deficits over the medium term (owing to declines in the trade balance and falling inflows from official transfers) and weaker endogenous debt dynamics (higher interest rates).¹⁴ In present value terms, external PPG debt is projected to rise from 19 percent of GDP in 2020 to 29 percent of GDP in 2030 and 35 percent in 2040. The long-term rise in PV terms is the result of our assumption that borrowing will become less concessional over the long term, as well as sizeable gross financing needs. Together with expiring grace periods for some loans (including prior IMF financing), this explains why debt service indicators rise substantially off their low base. For example, the projected debt service to exports ratio rises from 4 percent of exports in 2020 to 7 percent of exports in 2030. Nonetheless, all indicators remain well below the applicable thresholds for Madagascar (Figure 1).

15. The exports shock scenario breaches external medium-carrying capacity thresholds applied for Madagascar within the forecast horizon (Table 3; Figure 1). Under the exports shock, the applicable thresholds for Madagascar's medium debt-carrying capacity are breached for the PV of debt-to-exports, debt service-to-exports and debt service-to-revenue, the latter of which rises above the 18 percent threshold to 21 percent in 2027 and remains elevated thereafter.¹⁵ Under the same shock, the PV of

¹³ We view this as reasonable given the current underdevelopment of Madagascar's domestic bond market and its re-engagement with international donors and investors. The authorities have also communicated that there is significant international appetite for lending to Madagascar.

¹⁴ The residual includes reserve accumulation, unrepatriated mining receipts, and potentially other misclassified BOP entries.

¹⁵ While the standard settings are applied, the export shock is more severe than under the prior DSA as the projection period has shifted and the selected default shock calculation has changed. On average, simulated export growth was -1 percent between 2020-22 for the August 2020 DSA; now it is -14 percent between 2020-22 on average. Also, recall that the shock to nominal export growth is set to the historical average minus one SD or the baseline minus one SD, whichever is lower. In prior DSA, it was baseline minus one SD; in the current it is based on historical value minus one SD.

external debt to GDP rises to 35 percent of GDP in 2022, below the indicated threshold of 40.¹⁶ It is noteworthy that external PPG debt indicators remain resilient to all the other shocks with the exception of the combined shock.

16. The granularity assessment suggests that Madagascar has some space to absorb shocks.

Under tests to qualify the moderate risk of external debt distress, all indicators fall below the limited space thresholds, suggesting that Madagascar has some space to absorb shocks (Figure 5). Still, the PV of debt-to-GDP and the debt service-to-revenue ratios do rise towards the limited space thresholds at the end of the forecast horizon in 2030.

17. Despite a large upward revision in estimates of external private sector debt based on a recent survey, the debts are not assessed to pose a significant threat to external sustainability (Table 1). In 2020 INSTAT completed a survey on the external private sector, including on its external debt obligations. The last survey was conducted in 2013 and covered a smaller sample of firms and only included debts reported by companies' headquarters offices, which did not offer a complete view of the debt obligations of their Malagasy operations. The latest results uncovered large deviations relative to prior forecasts. Prior IMF forecasts estimated there was SDR 2 billion in external private debt at end-2018; the new data suggests it reached SDR 4 billion. This implies that external private debt as a percent of GDP increased to 41 percent from 21 percent in the prior DSA for 2020. However, the risks associated with these higher levels of external private debt appear contained. Around 80 percent of the debt is associated with the mining sector; the sector's income is in foreign currency; the majority of its debt is medium-to-long term; and a sizeable portion of its debt is with its affiliated headquarters or global group. Moreover, much of mining companies' loans do not bear large interest payments and many of the debt instruments are not required to be fully reimbursed to parent companies until liquidation. Private external debt is projected to rapidly decline as the loans related to major mining projects are repaid, with the stock of external private debt falling by almost 40 percent by 2030. Still, such debts will be closely monitored going forward for potential risks and, in line with recent DSAs, we have conservatively assumed more borrowing would be needed to sustain mining exports towards the end of the DSA horizon, contributing to private debt equivalent to about 6 percent of GDP in 2040.

B. Total Public Debt Sustainability

18. Under the baseline, total public debt levels are projected to remain well below the benchmark (Table 2). Total public debt (both external and domestic) is projected to rise from 44 percent of GDP in 2020 to 54 percent of GDP in 2030, before reaching 59 percent by 2040. In the August 2020 DSA, total public debt was also projected at 54 percent of GDP in 2030; however, the total public debt ratio is projected to be 4 percentage points higher by 2039 relative to the prior DSA. In PV terms, total public debt/GDP is expected to rise from 31 percent in 2020 to 40 percent in 2030 and 46 percent in 2040, below the benchmark of 55 percent for medium-capacity countries. Projected primary deficits are higher than previously assumed in the near term, but lower within the medium term horizon; for example, 2021 and 2025 primary deficits are now expected to reach 4.9 and 2.6 percent, respectively, whereas they were expected to reach 4.0 percent and 3.4 percent in the August 2020 DSA. Ongoing revenue mobilization and PFM reforms are expected to continue; this is reflected by the far more gradual increase in the PV of debt

¹⁶ The PV of debt-to-GDP would breach the threshold of 30 for countries with weak debt-carrying capacity.

to revenue and grants compared to the PV of debt to GDP since the share of tax revenue in GDP is projected to rise in the medium to long term.

19. The rise in the PPG debt service to revenue and grants ratio, especially in the near term, could introduce liquidity risks. The debt service to revenue ratio is forecasted to reach 78 percent by 2025 and reflects the repayment of prior IMF loans and quite conservative financing assumptions in the baseline framework that place a high reliance on domestic financing (see ¶17) during the program horizon. Although no explicit benchmark exists for this ratio, the projections point to potential debt service and liquidity difficulties within the medium term. The authorities should prioritize securing ongoing external concessional financing, as done in recent years and in line with their medium-term debt strategy, as well as continuing to accelerate domestic debt market development to bring down borrowing costs. If strong donor support continues, liquidity risks can be mitigated.

20. Total public debt is vulnerable to a growth shock but does not breach its benchmark within the stress test horizon (Figure 2; Table 4). The most severe test is a simulated growth shock. Under this shock, the PV of debt to GDP approaches 55 percent of GDP by 2030 and is on a persistent upward trajectory, although it does not breach the benchmark for medium capacity countries like Madagascar. Moreover, such a shock would also result a PV of debt-to-revenue of over 380 in 2030 and could raise the debt service-to-revenue ratio above 90 percent by 2025. A commodity price shock produces qualitatively similar results.

RISK RATING AND VULNERABILITIES

21. Madagascar is classified as being at moderate risk of external debt distress. Under the baseline, no thresholds are breached. However, an export shock leads to breaches in the PV of debt-to-exports and debt service ratio thresholds. A granularity assessment suggests that Madagascar has some space to absorb shocks.

22. The overall assessment is that Madagascar is at moderate risk of overall debt distress. The overall PPG debt stress test that applies to growth shows that the PV of debt-to-GDP approaches the applicable benchmark in the final years of the stress test horizon and is on a persistent upward trajectory. Moreover, liquidity pressures could arise if more concessional external financing is not secured or if domestic debt market development is delayed under both the baseline and under a commodity or growth shock, as the debt-service to revenue ratio could near or exceed 70 percent within the medium term. Together with potentially high debt service burdens, the breach of the external PPG debt thresholds classifies Madagascar's overall risk of debt distress as moderate. Both the overall and external debt distress risk assessments are in line with the authorities' most recent September 2020 debt sustainability analysis.

23. Conditional on the mobilization of continued concessional external financing, this assessment is supportive of Madagascar's current plans to scale up its borrowing. A steeper-than-expected increase in borrowing in line with a rapid execution of the government's ambitious medium-term borrowing plan would carry significant risks, especially in the absence of securing additional external concessional financing. Also, poorly selected public investments and less favorable financing terms could affect debt vulnerability. The state of SOE liabilities could also influence future assessments. Less grant

financing and a switch to a less concessional mix of borrowing would raise the debt burden, especially when measured in PV terms, as well as debt service risks. The domestic debt market should continue to be developed in order to lower borrowing costs. Finally, external private debts could increase in less ringfenced sectors (e.g., banking) that would increase the vulnerabilities associated with such debts. As mentioned in the August 2020 DSA, in addition to debt sustainability, other crucial considerations for the pace of borrowing include the economy's vulnerability to terms-of-trade shocks, natural disasters, general absorptive capacity, public financial management, and public investment management.

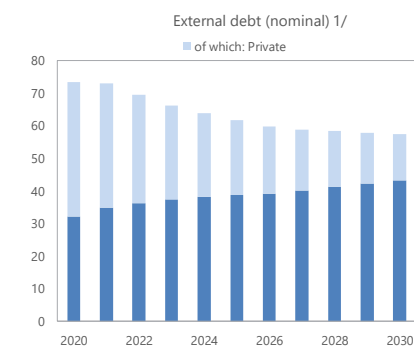
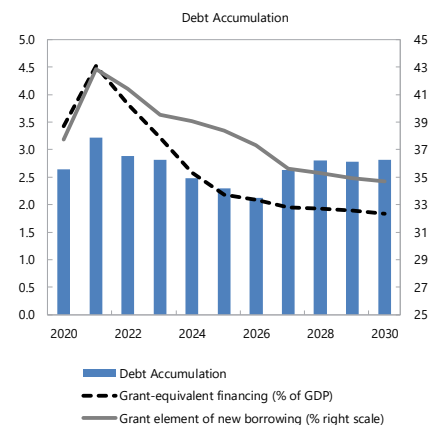
24. Structural reforms and improvements in debt coverage statistics remain paramount, especially in light of the recent decline in the CI score. Efforts to enhance external statistics could improve private debt coverage. Also, Madagascar's ability to preserve and build its debt-carrying capacity rely on it strengthening the capacity and quality of its institutions.

Table 1. Madagascar: External Debt Sustainability Framework, Baseline Scenario, 2017-2040

(In percent of GDP; unless otherwise indicated)

	Actual			Projections							Average 8/		
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2040	Historical	Projections
External debt (nominal) 1/	50.2	69.4	65.4	73.3	73.0	69.4	66.1	63.9	61.7	57.4	54.3	45.0	63.5
<i>of which: public and publicly guaranteed (PPG)</i>	25.7	26.4	26.6	32.0	34.7	36.1	37.3	38.1	38.6	43.2	47.9	24.6	38.4
Change in external debt	-0.8	19.2	-3.9	7.8	-0.3	-3.6	-3.3	-2.3	-2.2	-0.3	-1.0		
Identified net debt-creating flows	-7.4	-7.1	-2.9	7.7	0.5	-1.4	-1.9	-2.2	-2.2	-1.2	-0.6	-2.2	-0.7
Non-interest current account deficit	0.0	-1.2	1.7	6.1	4.5	3.9	3.8	3.4	3.2	3.6	3.6	2.9	3.8
Deficit in balance of goods and services	3.3	3.4	4.6	9.1	8.8	6.9	6.9	6.6	6.6	6.7	6.9	6.0	7.0
Exports	30.9	31.2	27.8	18.3	23.1	26.3	27.6	28.0	28.6	26.8	24.3		
Imports	34.2	34.6	32.4	27.4	31.8	33.2	34.5	34.6	35.2	33.6	31.3		
Net current transfers (negative = inflow)	-5.6	-6.9	-5.5	-5.5	-5.3	-5.1	-5.1	-5.0	-5.1	-4.6	-4.2	-5.5	-5.0
<i>of which: official</i>	-2.5	-2.6	-3.0	-3.1	-2.3	-1.8	-1.3	-0.9	-0.6	-0.1	0.0		
Other current account flows (negative = net inflow)	2.3	2.3	2.6	2.5	1.1	2.1	2.0	1.8	1.7	1.5	0.9	2.5	1.7
Net FDI (negative = inflow)	-2.7	-3.6	-2.6	-1.8	-2.2	-2.4	-2.8	-2.9	-3.0	-3.1	-3.2	-4.0	-2.8
Endogenous debt dynamics 2/	-4.8	-2.4	-2.1	3.4	-1.8	-2.9	-2.9	-2.6	-2.4	-1.7	-1.0		
Contribution from nominal interest rate	0.4	0.5	0.5	0.5	0.4	0.5	0.5	0.6	0.6	1.0	1.4		
Contribution from real GDP growth	-1.8	-1.5	-2.9	2.9	-2.2	-3.4	-3.4	-3.2	-3.0	-2.7	-2.4		
Contribution from price and exchange rate changes	-3.3	-1.4	0.3	...	...	...	...	...	...	...	...
Residual 3/	6.6	26.3	-1.0	0.1	-0.8	-2.1	-1.4	-0.1	0.0	0.9	-0.4	5.9	0.0
<i>of which: exceptional financing</i>	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	15.6	19.2	21.0	22.0	23.0	23.7	24.4	28.6	34.5		
PV of PPG external debt-to-exports ratio	...	...	56.1	104.4	91.1	83.7	83.3	84.8	85.3	106.8	141.9		
PPG debt service-to-exports ratio	5.6	2.9	2.8	4.4	3.9	4.2	4.9	4.9	4.9	7.3	10.6		
PPG debt service-to-revenue ratio	16.7	8.9	7.3	8.9	8.7	9.8	11.0	10.8	10.6	14.1	17.4		
Gross external financing need (Million of U.S. dollars)	12.5	-488.0	699.5	1253.2	787.7	1168.5	1182.2	842.0	817.1	1149.6	2171.7		
Key macroeconomic assumptions													
Real GDP growth (in percent)	3.9	3.2	4.4	-4.2	3.2	5.0	5.4	5.2	5.0	5.0	4.6	3.0	4.1
GDP deflator in US dollar terms (change in percent)	7.0	2.8	-0.5	-0.5	3.2	3.1	2.7	1.9	1.7	1.6	1.7	1.4	1.8
Effective interest rate (percent) 4/	0.8	1.1	0.7	0.7	0.6	0.7	0.8	1.0	1.1	1.8	2.7	1.0	1.1
Growth of exports of G&S (US dollar terms, in percent)	21.6	7.0	-7.2	-37.2	33.9	23.7	13.3	8.7	9.1	5.1	5.6	8.0	7.1
Growth of imports of G&S (US dollar terms, in percent)	26.2	7.1	-2.5	-19.4	23.7	13.0	12.3	7.5	8.7	5.9	6.6	2.5	6.7
Grant element of new public sector borrowing (in percent)	...	...	...	37.7	42.9	41.4	39.5	39.1	38.4	34.7	31.4	...	37.9
Government revenues (excluding grants, in percent of GDP)	10.3	10.4	10.5	9.2	10.3	11.4	12.2	12.8	13.3	14.0	14.8	9.3	12.6
Aid flows (in Million of US dollars) 5/	588.5	615.5	733.4	436.7	853.1	889.3	903.7	846.2	831.4	1078.7	1412.8		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	3.4	4.5	3.8	3.2	2.6	2.2	1.8	1.3	...	2.7
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	55.4	60.0	57.7	52.4	49.7	47.0	35.7	31.4	...	46.8
Nominal GDP (Million of US dollars)	13,176	13,974	14,519	13,837	14,746	15,972	17,283	18,524	19,776	27,295	51,511		
Nominal dollar GDP growth	11.2	6.1	3.9	-4.7	6.6	8.3	8.2	7.2	6.8	6.7	6.4	4.4	6.0
Memorandum items:													
PV of external debt 7/	...	...	54.5	60.4	59.3	55.4	51.8	49.5	47.5	42.8	40.9		
In percent of exports	...	...	195.6	329.4	257.1	210.2	187.7	176.9	165.9	159.5	168.1		
Total external debt service-to-exports ratio	9.0	4.1	20.3	25.9	13.2	22.2	21.1	14.6	13.8	13.8	15.6		
PV of PPG external debt (in Million of US dollars)	...	...	2267.8	2650.8	3095.4	3521.0	3970.2	4398.7	4824.2	7816.0	17784.3		
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	2.6	3.2	2.9	2.8	2.5	2.3	2.3	2.8	2.1		
Non-interest current account deficit that stabilizes debt ratio	0.9	-20.4	5.7	-1.7	4.8	7.5	7.1	5.6	5.3	3.9	4.6		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No



Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 2. Madagascar: Public Sector Debt Sustainability Framework, Baseline Scenario, 2017-2040
(In percent of GDP; unless otherwise indicated)

	Actual			Projections								Average 6/	
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2040	Historical	Projections
Public sector debt 1/	40.1	39.8	37.8	43.6	46.9	47.8	48.6	49.1	49.3	53.7	59.0	36.9	49.4
of which: external debt	25.7	26.4	26.6	32.0	34.7	36.1	37.3	38.1	38.6	43.2	47.9	24.6	38.4
Change in public sector debt	-0.1	-0.4	-2.0	5.8	3.3	0.9	0.8	0.5	0.3	1.0	-0.3		
Identified debt-creating flows	-2.6	-2.3	-2.9	5.9	3.3	1.8	1.4	1.2	0.9	0.9	-0.3	-0.8	1.7
Primary deficit	1.4	0.6	0.7	3.5	4.9	4.2	3.6	3.1	2.6	2.9	1.8	1.3	3.2
Revenue and grants	12.8	12.8	13.5	10.9	12.5	13.2	13.5	13.7	13.9	14.1	14.9	11.3	13.5
of which: grants	2.5	2.4	3.0	1.8	2.3	1.8	1.3	0.9	0.6	0.1	0.0		
Primary (noninterest) expenditure	14.2	13.4	14.2	14.4	17.4	17.4	17.1	16.7	16.5	16.9	16.6	12.5	16.7
Automatic debt dynamics	-4.0	-2.8	-3.2	2.2	-2.0	-2.8	-2.6	-2.3	-2.1	-2.4	-2.4		
Contribution from interest rate/growth differential	-2.2	-2.7	-3.0	1.4	-1.3	-2.3	-2.5	-2.3	-2.2	-2.6	-2.6		
of which: contribution from average real interest rate	-0.7	-1.5	-1.3	-0.3	0.1	-0.1	-0.1	0.1	0.1	-0.1	0.0		
of which: contribution from real GDP growth	-1.5	-1.2	-1.7	1.7	-1.4	-2.2	-2.4	-2.4	-2.3	-2.5	-2.6		
Contribution from real exchange rate depreciation	-1.7	-0.1	-0.2	...	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	-0.4	0.2	0.4	0.4	0.5	0.4	0.4	0.4	0.4	0.0	0.4
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (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		
Debt relief (HIPC and other)	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow	0.0	0.0	-0.4	0.2	0.5	0.4	0.5	0.4	0.4	0.4	0.4		
Residual	2.4	1.9	0.9	0.7	-0.7	-1.3	-0.8	-0.7	-0.5	0.2	0.2	1.1	-0.1
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	26.9	30.9	33.4	34.1	34.7	35.2	35.5	39.6	46.2		
PV of public debt-to-revenue and grants ratio	...	...	198.3	283.3	266.5	257.6	256.5	257.4	255.3	281.5	310.9		
Debt service-to-revenue and grants ratio 3/	7.0	6.4	37.5	45.9	51.5	66.0	73.5	76.8	78.0	63.2	59.6		
Gross financing need 4/	2.3	1.4	5.4	7.4	12.6	13.3	14.0	14.0	13.9	12.2	11.0		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	3.9	3.2	4.4	-4.2	3.2	5.0	5.4	5.2	5.0	5.0	4.6	3.0	4.1
Average nominal interest rate on external debt (in percent)	0.9	1.1	1.0	0.8	0.7	0.8	0.8	0.9	0.9	1.3	1.6	0.8	1.0
Average real interest rate on domestic debt (in percent)	-4.7	-9.1	-7.4	-0.5	0.2	1.4	2.5	4.0	4.6	2.5	2.2	-7.1	2.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-7.1	-0.5	-0.8	...	...	...	...	...	...	...	...	0.6	...
Inflation rate (GDP deflator, in percent)	5.0	10.0	8.0	4.2	5.4	5.7	6.0	5.7	5.5	5.2	5.0	7.7	5.4
Growth of real primary spending (deflated by GDP deflator, in percent)	15.6	-3.1	11.2	-3.0	24.9	4.6	4.0	2.7	3.6	5.5	3.3	5.1	5.8
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.6	0.9	2.7	-2.3	1.6	3.2	2.9	2.6	2.3	1.9	2.0	1.7	1.8
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central, state, and local governments, central bank, government-guaranteed debt, non-guaranteed SOE debt. Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ 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 and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (i.e., a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No

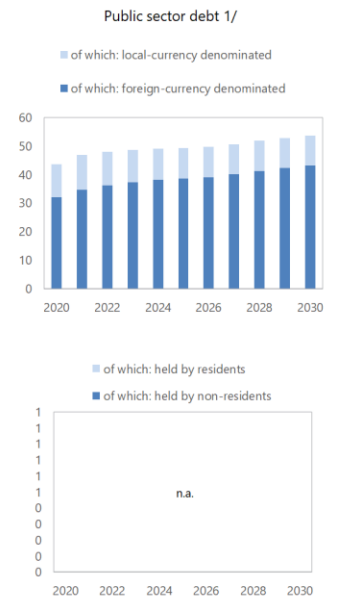
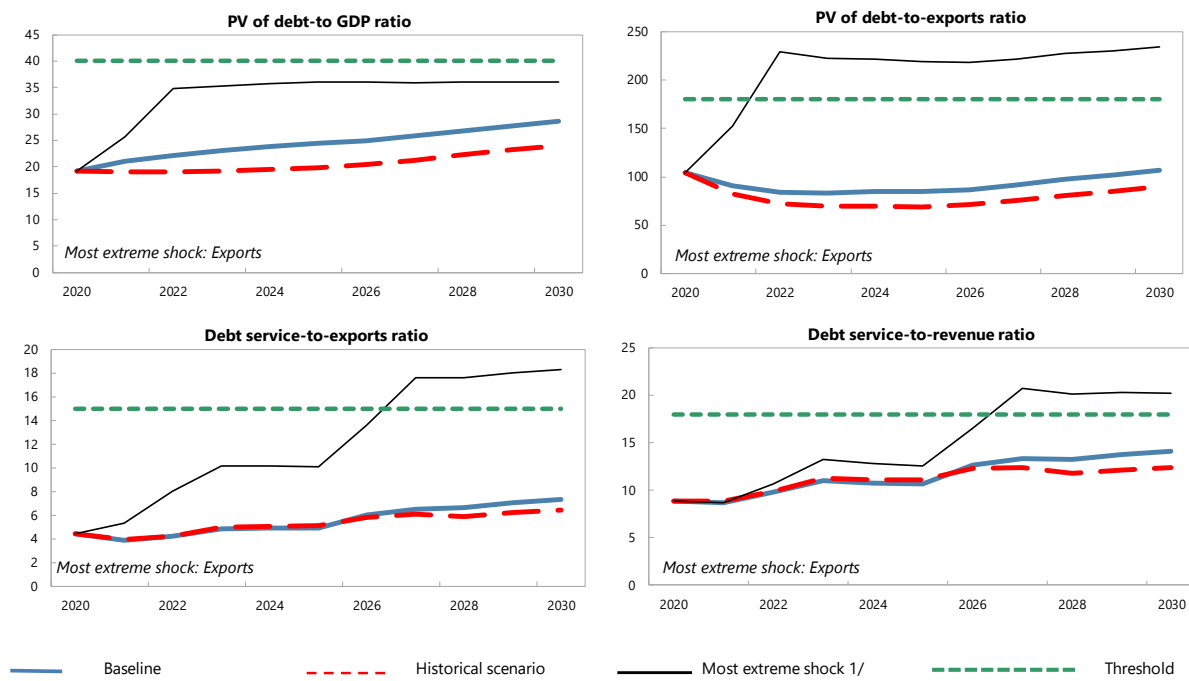


Figure 1. Madagascar: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2020-2030



Customization of Default Settings		
	Size	Interactions
Standardized Tests	Yes	
Tailored Stress		
Combined CL	Yes	
Natural disaster	No	No
Commodity price	Yes	Yes
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

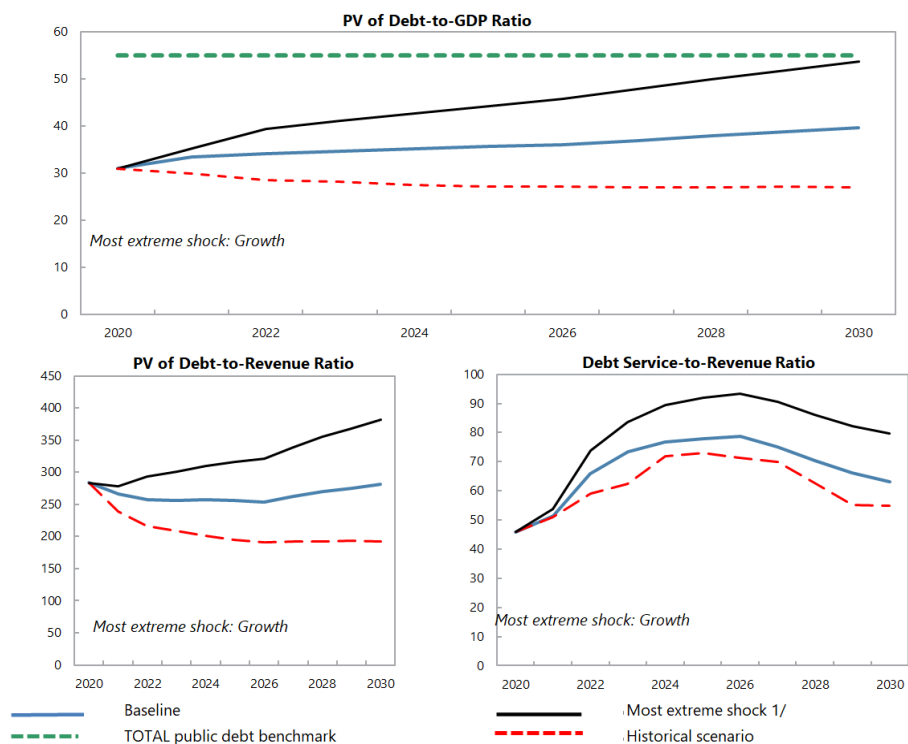
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	26	20
Avg. grace period	4	4

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Madagascar: Indicators of Public Debt Under Alternative Scenarios, 2020-2030



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	37%	65%
Domestic medium and long-term	17%	15%
Domestic short-term	46%	20%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.6%
Avg. maturity (incl. grace period)	26	20
Avg. grace period	4	4
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.8%	4.8%
Avg. maturity (incl. grace period)	2	2
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	3.0%	3.5%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Madagascar: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2020-2030
(In percent)

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of debt-to-GDP ratio											
Baseline	19	21	22	23	24	24	25	26	27	28	29
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	19	19	19	19	19	20	20	21	22	23	24
B. Bound Tests											
B1. Real GDP growth	19	22	25	26	26	27	28	29	30	31	32
B2. Primary balance	19	22	23	24	25	26	26	27	28	29	30
B3. Exports	19	26	35	35	36	36	36	36	36	36	36
B4. Other flows 3/	19	23	25	26	27	27	28	28	29	30	30
B5. Depreciation	19	26	25	26	27	28	29	30	32	33	34
B6. Combination of B1-B5	19	27	30	30	31	32	32	32	33	34	34
C. Tailored Tests											
C1. Combined contingent liabilities	19	25	27	28	29	30	30	31	32	33	34
C2. Natural disaster	19	26	28	30	31	32	32	33	34	35	36
C3. Commodity price	19	22	23	24	25	25	26	27	28	28	29
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	104	91	84	83	85	85	87	91	97	102	107
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	104	82	72	70	70	69	71	75	81	85	90
B. Bound Tests											
B1. Real GDP growth	104	91	84	83	85	85	87	91	97	102	107
B2. Primary balance	104	94	88	87	89	89	91	95	101	106	110
B3. Exports	104	152	230	222	222	219	218	222	227	230	234
B4. Other flows 3/	104	98	95	94	95	95	96	100	105	109	113
B5. Depreciation	104	91	75	75	77	78	80	85	91	96	102
B6. Combination of B1-B5	104	146	102	158	159	159	159	164	172	178	184
C. Tailored Tests											
C1. Combined contingent liabilities	104	109	102	102	104	104	105	110	116	120	125
C2. Natural disaster	104	115	108	109	111	112	113	119	125	131	136
C3. Commodity price	104	95	89	88	90	90	91	95	101	105	109
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	4	4	4	5	5	5	6	7	7	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	4	4	4	5	5	5	6	6	6	6	6
B. Bound Tests											
B1. Real GDP growth	4	4	4	5	5	5	6	7	7	7	7
B2. Primary balance	4	4	4	5	5	5	6	7	7	7	8
B3. Exports	4	5	8	10	10	10	14	18	18	18	18
B4. Other flows 3/	4	4	4	5	5	5	7	7	7	8	8
B5. Depreciation	4	4	4	5	5	5	6	6	6	6	7
B6. Combination of B1-B5	4	5	7	8	8	8	12	12	13	13	13
C. Tailored Tests											
C1. Combined contingent liabilities	4	4	5	5	5	5	6	7	7	7	8
C2. Natural disaster	4	4	5	5	6	6	7	7	7	8	8
C3. Commodity price	4	4	4	5	5	5	6	7	7	7	8
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	9	9	10	11	11	11	13	13	13	14	14
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	9	9	10	11	11	11	12	12	12	12	12
B. Bound Tests											
B1. Real GDP growth	9	9	11	12	12	12	14	15	15	15	16
B2. Primary balance	9	9	10	11	11	11	13	14	14	14	15
B3. Exports	9	9	11	13	13	13	17	21	20	20	20
B4. Other flows 3/	9	9	10	12	11	11	14	15	15	15	16
B5. Depreciation	9	11	12	13	13	13	16	15	15	16	16
B6. Combination of B1-B5	9	9	12	13	13	12	17	18	17	18	18
C. Tailored Tests											
C1. Combined contingent liabilities	9	9	11	12	12	11	13	14	14	14	15
C2. Natural disaster	9	9	11	12	12	12	14	14	14	15	15
C3. Commodity price	9	9	10	12	11	11	13	14	14	14	15
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

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

3/ Includes official and private transfers and FDI.

Table 4. Madagascar: Sensitivity Analysis for Key Indicators of Public Debt, 2020-2030
(In percent)

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of Debt-to-GDP Ratio											
Baseline	31	33	34	35	35	36	36	37	38	39	40
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	31	30	28	28	27	27	27	27	27	27	27
B. Bound Tests											
B1. Real GDP growth	31	35	39	41	43	44	46	48	50	52	54
B2. Primary balance	31	34	35	36	36	37	37	38	39	40	41
B3. Exports	31	38	47	47	47	47	47	47	47	47	47
B4. Other flows 3/	31	35	37	38	38	38	39	39	40	41	41
B5. Depreciation	31	37	36	35	34	34	33	33	33	33	33
B6. Combination of B1-B5	31	32	34	34	35	35	35	36	37	38	39
C. Tailored Tests											
C1. Combined contingent liabilities	31	40	40	41	41	41	41	42	43	44	45
C2. Natural disaster	31	42	42	43	43	43	44	45	46	46	47
C3. Commodity price	31	34	37	39	42	44	45	47	50	51	53
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	283	267	258	256	257	256	254	263	270	275	281
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	283	239	216	208	201	194	191	192	192	193	192
B. Bound Tests											
B1. Real GDP growth	283	278	293	301	310	316	321	339	355	368	382
B2. Primary balance	283	272	268	266	266	264	262	270	278	283	289
B3. Exports	283	303	353	347	345	339	332	334	335	333	333
B4. Other flows 3/	283	279	281	279	279	276	273	280	286	289	294
B5. Depreciation	283	295	272	259	251	242	233	234	234	233	234
B6. Combination of B1-B5	283	258	260	255	255	252	250	259	267	272	278
C. Tailored Tests											
C1. Combined contingent liabilities	283	321	305	300	299	295	292	300	307	311	317
C2. Natural disaster	283	335	320	315	314	311	308	318	325	331	337
C3. Commodity price	283	279	284	297	309	316	323	338	353	366	380
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	46	51	66	74	77	78	79	75	70	66	63
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	46	51	59	62	72	73	71	70	63	55	55
B. Bound Tests											
B1. Real GDP growth	46	54	74	83	89	92	93	91	86	82	80
B2. Primary balance	46	52	68	75	78	79	80	76	71	67	64
B3. Exports	46	51	67	75	79	80	82	82	77	72	69
B4. Other flows 3/	46	51	66	74	77	78	80	77	72	68	65
B5. Depreciation	46	50	66	71	74	76	77	73	69	65	62
B6. Combination of B1-B5	46	50	67	74	77	77	78	75	70	66	63
C. Tailored Tests											
C1. Combined contingent liabilities	46	52	80	85	82	81	81	77	72	67	64
C2. Natural disaster	46	53	84	88	84	84	83	79	74	69	66
C3. Commodity price	46	53	70	80	87	90	91	87	83	80	78
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

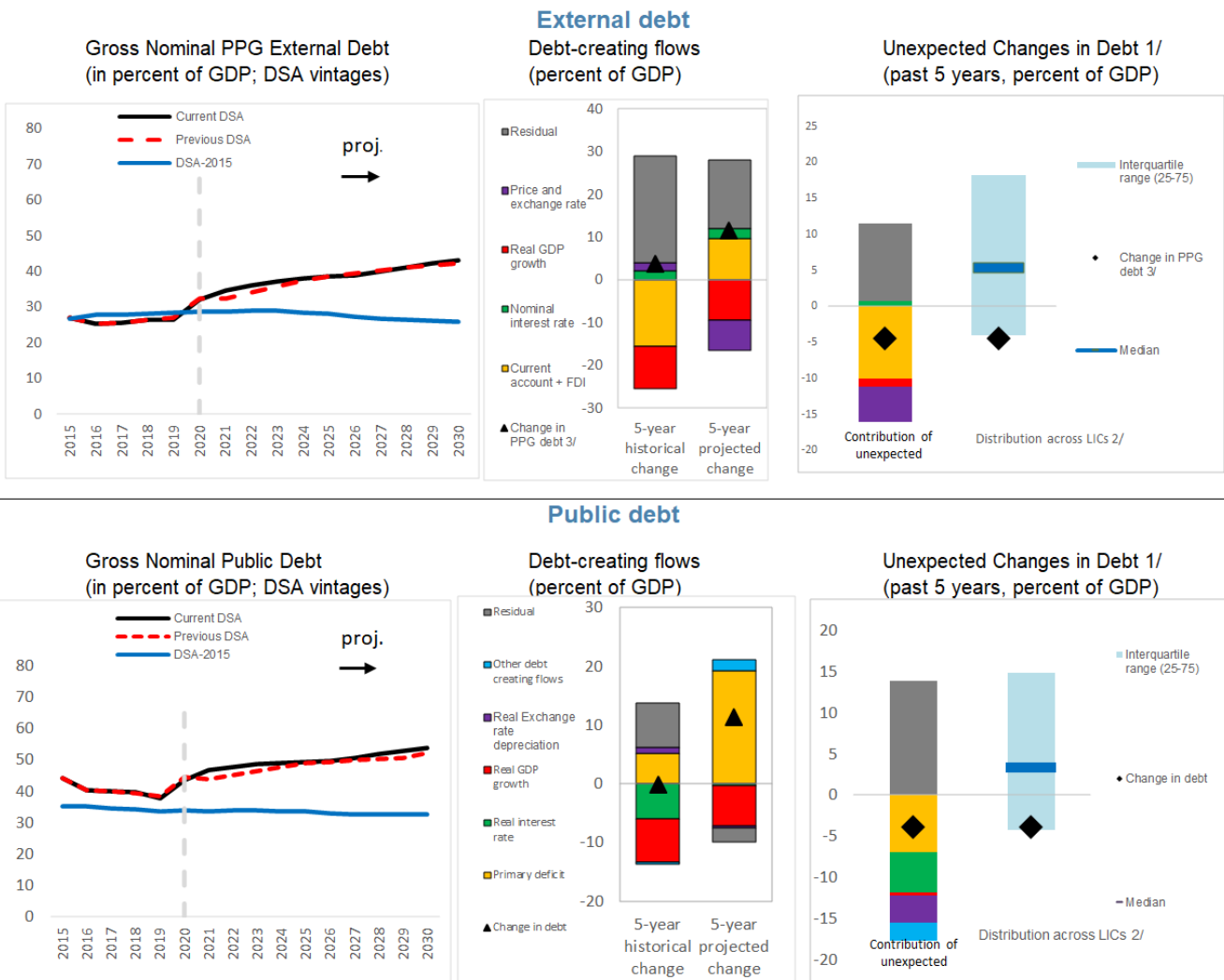
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 3. Madagascar: Drivers of Debt Dynamics – Baseline Scenario



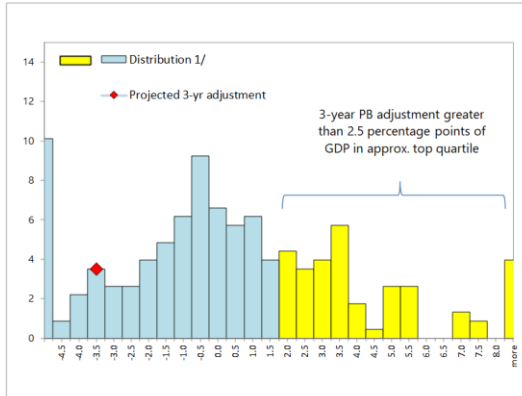
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

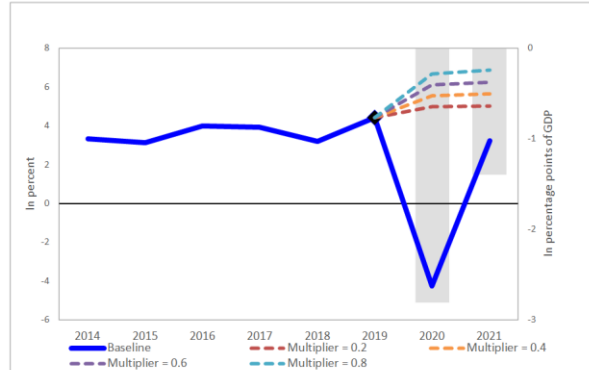
Figure 4. Madagascar: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



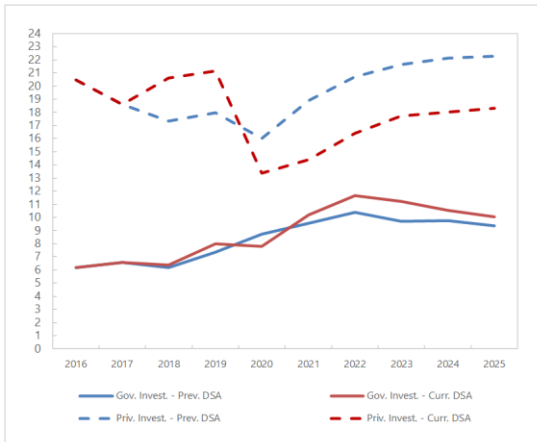
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates, Real
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

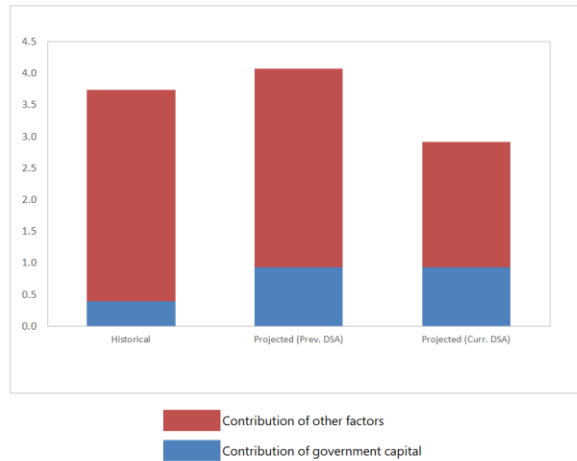


Figure 5. Madagascar: Qualification of the Moderate Category, 2020-2030



Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

**Statement by Mr. Andrianarivelo, Executive Director for Madagascar,
Mr. Nguema-Affane, Senior Advisor to Executive Director, and Mrs. Raolisoa
Andrianometiana, Senior Advisor to the Executive Director
March 29, 2021**

Our Malagasy authorities are grateful to the Executive Board and management for their continued support in these trying times. They would like also to thank staff for the candid and productive dialogue during the technical meetings and program negotiation mission held virtually over the past months.

Madagascar had successfully completed the 2016-20 ECF-supported program and had planned to start discussions on a successor program when the COVID-19 pandemic hit, leading to the implementation of containment measures and an economic contraction. The Fund responded swiftly to Madagascar's request for emergency financing under the Rapid Credit Facility (RCF) to help meet the immediate health needs, protect the vulnerable population, and close the short-term fiscal and external gaps. The authorities followed through on their commitment to ensure transparency and accountability in the management of COVID-related expenditures, with notably the publication of related information, including the list of procurement contracts as well as the beneficiaries. They remain committed to implement the remaining transparency measures agreed at the time of the RCF.

Despite the RCF disbursements, fiscal and external financial needs remain significant. The larger-than-anticipated impact of the COVID-19 pandemic in Madagascar has created sizable fiscal and balance of payments needs, threatening the achievements made in fiscal consolidation, debt sustainability and structural reforms in recent years. The already acute poverty has worsened during the pandemic and progress toward the Sustainable Development Goals (SDGs) is stalled. This underscores the need for an effective social safety net with a sufficiently wide coverage to protect the most vulnerable during the current crisis and beyond.

The Malagasy authorities are requesting a 40-month Extended Credit Facility (ECF) arrangement to support the recovery from the pandemic, pursue reform implementation, and mobilize external financing. The program will seek to address the country's fragilities that hinder sustainable growth and equitable social outcomes. Additionally, it aims at increasing fiscal space to accommodate priority development and social spending, strengthening the monetary policy framework, sustaining financial stability, and advancing their structural reform agenda. Fund financing under the arrangement will help to cover a protracted balance of payment need. The frontloaded disbursements will support the immediate financing needs facing the country.

Recent Developments and Outlook

The COVID 19 pandemic has inflicted a heavy economic and social toll, exacerbating Madagascar's preexisting vulnerabilities. After several years of strong macroeconomic performance, real GDP growth has turned negative in 2020. All sectors, most acutely the

tourism, transportation, mining, and textile sectors, have been impacted. The implementation of measures to cushion the effects of the pandemic have worsened the fiscal deficit, notably through lower tax revenue collection and additional pressure on expenditure. In addition, some current and capital expenditures were reprioritized to accommodate more essential spending. The current account deficit is estimated to have widened. Despite higher non-performing loans (NPLs), the banking sector remains robust, with the central bank supporting bank liquidity and using foreign currency net sales to limit the depreciation of the Ariary. International reserves have increased owing to external support from development partners.

The economic growth is expected to rebound in 2021 thanks to a projected expansion of agriculture, tourism, manufacturing, and mining sectors. Moreover, exports are anticipated to gradually improve as external demand recovers. Growth is projected to return to its pre pandemic level only in 2023, driven by higher private investment. Nonetheless, the authorities remain mindful of the downside risks stemming notably from the evolution of the pandemic, including its new waves and new variants, weak global demand, and climate-related shocks. Against this backdrop, potential contingency plans will be prepared and reflected in a revised budget law for 2021 if risks materialize.

Policies and Reforms for the Period Ahead

The Malagasy authorities recognize the significant economic and development challenges facing the country amid uncertainty about the pandemic and the world economic prospects. They are of the view that macroeconomic stability is a necessary but not a sufficient condition for sustained and inclusive growth. They will continue to focus on mitigating the impact of the pandemic in the near-term and are determined to pursue prudent macroeconomic policies over the medium-term in the context of the ECF-supported program. Structural reforms will focus on promoting good governance and accelerating the anti-corruption agenda. They are seeking Fund technical assistance to advance and implement reforms, mostly in revenue administration, public financial management, as well as monetary and financial policies.

Fiscal Policy and Reforms

The authorities will maintain the accommodative fiscal stance in the near-term to mitigate the pandemic and support the recovery. They will continue to allocate fiscal resources toward enhancing preparedness and detection, ameliorating healthcare, safeguarding businesses, and sustaining multi-sectorial mitigation measures. As the pandemic abates, the domestic primary balance is expected to turn positive in 2023, based on efforts to strengthen revenue mobilization and to improve public financial management. To preserve debt sustainability, the authorities will also pursue their prudent debt management and rely mostly on grants and concessional borrowing for financing.

More specifically, the authorities are committed to further strengthening domestic revenue mobilization and improving spending transparency and efficiency to increase fiscal space. Supported by a comprehensive strategy covering both revenue administration and tax policies,

the objective is not only to recover the tax-to-GDP ratio to pre-crisis levels, but also to gradually and steadfastly increase the tax-to-GDP ratio over the medium-term. In parallel, the authorities will bolster the quality of public expenditure through better wage bill management, well prioritized investment projects, and limited transfers to SOEs. This will allow additional resources for social spending, as well as scaling up priority public investment. The transparency of government spending in general, and the Covid-related spending, in particular, will be reinforced.

Madagascar's risk to debt distress remains moderate for both external and overall public debt. The authorities are determined to pursue their efforts to contain fiscal risks and preserve debt sustainability. Madagascar is highly exposed to a wide range of adverse natural events. In this regard, they will continue to improve their disaster risk management strategy. On fuel pricing, the authorities will finalize a plan towards a fuel pricing mechanism to reduce potential liabilities to oil distributors. Moreover, they recognize the significant fiscal risks stemming from SOEs, notably JIRAMA and the airline company Air Madagascar. They are determined to pursue the implementation of the recovery plan for JIRAMA and will limit transfers to the society to what is allocated in the budget law. On Air Madagascar, they will refrain from putting any public funds in the company until its business plan is finalized.

Monetary, Exchange Rate and Financial Policies and Reforms

The central bank (BFM) is committed to its core mandate of price stability while continuing to allow the exchange rate to adjust flexibly, with interventions limited to containing excessive volatility. Monetary policy will continue to aim at maintaining single digit inflation through money market and foreign exchange operations. Plans are underway to launch an ambitious reform to enhance the effectiveness of monetary policy and strengthen financial sector stability. Supported by Fund TA, the reform aims at transitioning gradually from a framework relying on reserve money aggregates to interest rate targeting with a view to ensuring price stability. The central bank is also adopting the IFRS for the 2020 accounts and is enhancing its autonomy and independence. BFM will comply with the recommendations of the 2021 update of safeguards assessment.

The banking and financial sectors remain broadly resilient and sufficiently capitalized. The BFM will continue its liquidity support of the banking sector and is committed to closely monitor financial stability indicators as non-performing loans are rising as a result of the crisis.

Governance and Fight against Corruption

Our authorities have developed a national anti-corruption strategy, designed a national policy for good governance, and adopted the AML/CFT law in line with FATF requirements. They have also finalized a draft anti-corruption law. Under the new program, the authorities will effectively enforce the new anti-corruption legal framework and remain dedicated to allocating sufficient human, financial and material resources to the institutions in charge of the fight against

corruption for their full operationalization. They also intend to issue a decree on illicit asset recovery in the coming months.

Improving the business environment is a key pillar of the government's reform strategy. They have made progress in the issuance of work permits, the registration of new businesses, the digitalization of companies' tax payments and the establishment of a credit bureau. The authorities recognize that, despite progress in recent years, significant challenges remain in some areas such as access to water and electricity, transportation, and logistics costs. The authorities envision to address those challenges in the context of the Plan Emergence Madagascar (PEM).

Conclusion

Our Malagasy authorities have swiftly acted to respond to the Covid 19 pandemic with a package of economic and social measures and the support of Fund emergency assistance. Going forward, as structural vulnerabilities and downside risks remain, they are dedicated to pursue prudent policies and reforms to strengthen macroeconomic stability and lay the foundations for a robust and sustained economic recovery. The authorities look forward to Executive Directors' support to their request for an ECF arrangement to cover part of their financing needs and catalyze additional resources.