International Monetary Fund

Malawi and the IMF

Press Release:
IMF Executive Board Approves US$77.1 Million Exogenous Shocks Facility Arrangement for Malawi
December 3, 2008

Country's Policy Intentions Documents

Malawi: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 13, 2008

MALAWI: LETTER OF INTENT

November 13, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Government of Malawi requests continued support from the International Monetary Fund for its economic objectives and policy framework for 2008–2009 through a new one-year arrangement under the high-access component of the Exogenous Shocks Facility (ESF). We request access of 75 percent of quota. This arrangement will support our efforts to adjust to the severe terms of trade shock that Malawi is facing, notably as a result of significant increases in fertilizer and fuel prices over the past year. Furthermore, maintaining a close engagement with the Fund will send a positive signal to domestic stakeholders and our development partners, notably concerning our determination to maintain macroeconomic stability and build on the positive results achieved during the recent, successfully completed, arrangement under the Poverty Reduction and Growth Facility.

2. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our macroeconomic framework and policy objectives for 2008/09 and the medium term. Our over-riding goal is to provide a consistent and coherent economic policy framework to underpin our development objectives while in the near term responding to the terms of trade shock. In that regard, our programme focuses on enhancing the sustainability of growth and development through policies that consolidate economic stability and reinforce resilience to shocks, including through rebuilding of international reserves; improve public finance management; and support private-sector-led growth.

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

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

Sincerely yours,

/s/
Goodall E. Gondwe, M.P.
Minister of Finance

/s/
Victor Mbewe
Governor
Reserve Bank of Malawi

ATTACHMENT I

Malawi: Memorandum of Economic and Financial Policies of the Government of Malawi for 2008–09

November 13, 2008

I. INTRODUCTION

1. This memorandum summarizes the government of Malawi's economic objectives and policy framework for September 2008–December 2009, for which the Government is seeking continued support from the International Monetary Fund through a new one-year arrangement under the Exogenous Shock Facility (ESF). Malawi is experiencing a serious terms of trade shock caused by higher fuel and fertilizer import prices. We aim to make continued progress with our development goals while responding to the immediate challenge of this shock.

2. **Our program builds on the results achieved during the recent successfully completed PRGF arrangement.** The economic strategy under the PRGF-supported program emphasized the need for reduced domestic borrowing, improvements in revenue performance, and judicious increases in public spending, in order to correct the severe macroeconomic imbalances that existed prior to 2005 and create the space for propoor and progrowth spending. We believe our policy execution during the PRGF arrangement was strong, in sharp contrast to previous arrangements. In the first part of the decade, weak program implementation led to large fiscal slippages, an unsustainable domestic debt spiral, and low investment. Despite numerous attempts to bring the 2000–03 PRGF arrangement back on track, the economy remained in disarray, and the arrangement lapsed after only one review. Since taking office in mid-2004, we have improved economic policies on a broad front.

3. **Our reform program has produced good outcomes.** The strengthening fiscal position since 2005 has supported macroeconomic stability, lower domestic debt and interest rates, and policy credibility. Reflecting these improvements, Malawi has experienced sizable external debt relief and increasing inflows of aid and private capital. Growth has been very strong, averaging 5.8 percent for 2004–07, and in 2007 inflation declined to its lowest level in a decade. Higher revenues and aid and lower interest payments on the public debt have translated into an increase in outlays for poverty-reducing and social expenditures and, with more rapid growth, into progress toward many of the millennium development goals (MDGs).

4. **Public financial management (PFM) reforms have helped us make the most of the increased expenditures.** We have improved PFM through implementation of the broad

agenda described in our PFEM Action Plan. We have strengthened control over the wage bill and utility payments and implemented an Integrated Financial Management Information System (IFMIS) to improve control over expenditures more generally. We have issued a debt management strategy and cleared the 2004 stock of arrears. The most recent Public Finance Management Assessment for Malawi based on the Public Expenditure And Financial Accountability (PEFA), framework concluded that our PFM systems have substantially improved over the past three years and compare favorably to our neighbors.

5. While recent economic performance has been strong, the serious terms of trade shock has made addressing the remaining development challenges more difficult. Despite recent progress, poverty remains high and food security is a concern. The economy depends heavily on drought-prone agriculture. Meanwhile, implementing the Malawi Growth and Development Strategy (MGDS) will require increases in public investment and spending in areas such as health and education. In addition, international reserves, fluctuating between 0.7 and 1.4 months of prospective imports, remain uncomfortably low considering Malawi's vulnerabilities. To address these and other challenges while maintaining financial and macro-economic stability, Malawi will continue to need external support.

II. Recent Developments

6. **The economy continues to perform well but has started to feel the impact of higher import prices.** Real GDP growth continues to be strong. The 12-month inflation rate, though increasing recently—mainly as a result of higher food and petroleum prices—remains moderate at 9.3 percent in September 2008. Government net domestic debt was brought down slightly, from 11.9 percent of GDP at the end of 2007 to 11.7 percent at the end of July 2008. Despite the seasonal concentration of tobacco proceeds (April–September), international reserves were only US$175 million (1.1 months of prospective imports) at the end of September 2008.

7. **However, the full impact of much higher fuel and fertilizer import prices has not yet been felt.** One result of the terms of trade shock is a net import bill in 2008 that is US$156 million or 3.8 percent of GDP higher than in 2007, at constant volumes. Meanwhile, higher fertilizer prices have hit the budget directly, raising costs by some KW10 billion relative to the assumptions in the budget.

8. **We have been moving forward with structural reforms.** A public financial management (PFM) unit under the Secretary of Treasury has been established in the Ministry of Finance to promote and coordinate the modernization of PFM systems. In addition, a cash management unit at the Accountant General Office has been formed to enhance the government's capacity for cash flow planning.

9. **We have also tightened control over monetary expansion.** We have mopped up structural excess liquidity through issuance of RBM bonds (MK4.3 billion) and treasury bills (MK4.9 billion) and have managed short-term liquidity more actively. In addition, the scope

of the liquidity reserve requirement has been widened to include the discount houses, effective April 2008. With these operations, interest rates have risen back to levels that help contain inflation in the face of the rise in import prices. Nonetheless, broad money growth remains high: broad money grew by 45.6 percent in the 12-month to August 2008—partly reflecting the effects of output growth on money demand.

10. **The financial soundness of the RBM has been restored.** Operating costs have been reduced, including through staff cuts, and the RBM has been recapitalized and is no longer making losses. The government has converted MK6.5 billion in promissory notes into interest-bearing and tradable treasury notes and transferred another MK23.2 billion in treasury notes (4.3 percent of GDP) to the RBM. Interest costs of MK4.6 billion (0.7 percent of GDP) are reflected in the 2008/09 budget.

11. **We have also made progress in establishing credit reference bureaus, which will over time lower the too-high lending spreads.** Information disclosure clauses have been introduced in commercial bank lending contracts, which should provide the basis for establishing functioning credit bureaus. This should help bring down the cost of lending by lowering the risks and promoting competition among banks through easier identification of sound borrowers.

12. **We have also made progress in improving bank supervision and regulations.** RBM has adopted a risk-based supervision approach to examining bank performance. For the time being the assessment of banks will still be based on CAMEL, with the risk-based assessment run in parallel with CAMEL. Following this change, the RBM will be able to assess more effectively all risks banks undertake in addition to credit risk, as was emphasized in the CAMEL method. Moreover, the RBM continues to assess the quality of bank loans during on-site and off-site examinations. Whenever a bank is found to be under-providing, the RBM directs it to make additional provisions. Related to this, the RBM is revising its Asset Classification Directive to take into account new developments such as International Accounting Standards. RBM, furthermore, has finalized draft amendments to the Banking Act and a Financial Services Bill (FSA) to strengthen the supervisory function of the regulators. The FSA will, in addition, provide for consolidation of supervisory responsibility for the financial sector in a single agency. The amendment to the Banking Act and the FSA are awaiting parliament approval before being passed into law. Finally, the RBM has taken steps to improve its capacity, including examining anti-money-laundering and combating of financing of terrorism–related transactions (training and additional staffing).

13. **Sound governance and good economic performance have helped Malawi to attract considerable international support, both official and private, for investment and development.** Recently Malawi was deemed eligible for support from the Millennium Challenge Account (MCA). Malawi has also witnessed portfolio inflows, although these are now receding, and foreign direct investment (FDI) in the mining sector.

III. Near-term Objectives and strategy

14. **The large negative terms of trade shocks present a major challenge.** Real GDP growth is projected to fall somewhat, to about 6.7 percent in 2009, because growth in maize and tobacco will be more constrained by capacity and possibly higher private sector fertilizer prices. Inflation is likely to come back down, however, as the recent decline in world market fuel price is passed through.

15. Our near-term objectives and strategy, for which we seek ESF support, aims to provide a consistent and coherent economic policy framework to maintain macroeconomic stability.

16. Key policies include:

- Pursing a monetary and exchange rate policy that keeps inflation moderate and converging gradually toward our medium-term goal of 5 percent. Along with fiscal policy, this should support increasing foreign exchange coverage to give Malawi the resilience to withstand negative shocks that could otherwise derail growth and increase poverty;

- Firmly implementing the 2008/09 budget, which will further reduce government net debt while increasing critical expenditures; and

- Continuing to improve PFM, with a particular focus on monitoring budget execution, expenditure costing, and revenue administration.

17. **We intend to slow monetary expansion in order to contain pressures on inflation and the exchange rate.** Thus, for the remainder of FY2008/09, we will aim at an expansion of broad money that is below nominal GDP growth. Moreover, to improve control over monetary expansion, the program indicative base money targets, as well as the program ceiling on the net domestic assets (NDA) of the RBM, will be set on a monthly average basis for the last month of each quarter. The program ceilings on NDA of the RBM are set out in Table 1.

18. **In the short term, monetary and exchange rate policies will be geared toward keeping inflation moderate and supporting the building of reserves.** Reserve money continues to be the key intermediate target. We also place weight on stabilizing the nominal exchange rate against the U.S. dollar. We believe this has helped signal a commitment to economic stability and anchored inflation expectations and prices of traded goods. However, we realize that over time enhanced exchange rate flexibility is needed. In that regard we are commissioning a study to propose reforms to our foreign exchange rate management that would introduce increased flexibility and ensure alignment with underlying fundamentals, consistent with Malawi-specific circumstances. We will provide adequate foreign exchange to clear the market, while ensuring that over the medium term net purchases are sufficient to

19. The 2008/09 budget passed in September 2008 reflects the Government's intention to maintain fiscal discipline and protect international reserves without crowding out credit to the private sector. Thus, domestic borrowing is being substantially reduced. The domestic borrowing target in the 2008/09 budget is 1.4 percent of GDP lower than the 2007/08 outcome. However, higher than budgeted prices for fertilizer imports implies increased spending of some MK11 billion, 1.8 percent of GDP. We intend to implement the 2008/09 budget in the face of this shock, aided by stronger than budgeted revenue growth and some expenditure cuts. We look to fill any remaining financing gap through an increase in donor support. We also recognize the uncertainty of other items in the budget and, to keep the budget on track, intend to follow execution closely and take rapid corrective measures when necessary. Prices for ADMARC sales of maize will be structured to avoid losses that could become a fiscal burden. In addition, ADMARC will not borrow further from the RBM. Moreover, because of the need to avoid contingent fiscal liabilities, the National Food Reserve Agency will not engage in commercially oriented trading activities.

20. **Our fiscal policies will keep consolidated domestic debt below 13 percent of GDP, down from 14.5 percent in 2007.** We will not contract or guarantee any external debt on terms below the 35 percent concessional threshold (as set out in the attached Technical Memorandum of Understanding). To ensure that borrowing is consistent with our debt sustainability objectives, we have issued new external debt management guidelines and will continue to strengthen debt management practices.

Structural Reforms to Improve Public Financial and Economic Management

21. **We will take additional measures in the coming months to contain fiscal risks and reinforce public financial management.** We are updating our PFEM Action Plan, originally formulated in 2006, with the support of our development partners and with input from various technical assistance projects. While past initiatives are beginning to show tangible results, it is obvious to us that more work is needed.

22. **Credible budgets are critical to macroeconomic stability and sustainability, and thus remain a priority**. We have strengthened the process of preparing the budget by clarifying the budget calendar and allowing more time for sectoral planning and negotiations; this should help improve the realism of expenditure estimates. We intend to take further measures to enhance budget credibility, such as by

- Improving the quality of tax and nontax revenue projections of the Revenue Division of the Ministry of Finance, supported by the creation of a revenue database.

- Strengthening the capacity of the Ministry of Finance to scrutinize budget submissions. We recognize the need to closely examine both expected expenditure for current programs and activities and the costing of new proposals. We therefore intend to initiate focused reviews of certain sectors—notably road construction—to gain a better understanding of the costs and benefits of various policy options.

23. **We are also taking measures to strengthen budget monitoring and control** by

- Monitoring particularly closely all projects whose total multiyear cost exceeds 1.0 billion Kwacha. Through monthly execution reports, there will be an indication if the budgeted amount will be exceeded, in which case an explanation will be required. By January 2009, we will also prepare a report analyzing the reasons for the budget overruns for Development Part II expenditure in 2007/08.

- Putting in place procedures for taking timely off-setting measures within each vote, and within the competence of the Government, if—based on the regular monitoring of budget execution by the Ministry of Finance—there are indications that there will be an end-of-year overrun. If such measures are not feasible or desirable, a comprehensive supplementary budget will be proposed in accordance with the law.

- Strengthening external audits. We feel confident that the recent approval of a new Auditor General will allow timely submission of audited government accounts to parliament. We also intend to strengthen the capacity of the National Audit Office.

24. **Improved systems for producing timely and accurate budget execution reports are critical for ensuring that spending is contained within the overall envelope.** In that regard, we will continue to produce monthly reports on budget execution based on both funding and IFMIS data, complemented with cash flow data from the RBM. Recognizing the limitations of the current system, we will work to improve the accuracy of these reports by expanding the use of expenditure outturn data from the IFMIS and making more systematic comparisons between different data sources. We see the development of budget execution reports based on actual expenditure reconciled with banking data as being of the highest priority. We intend to

- Prepare two monthly reports on budget execution showing revenue, expenditure, and financing items. The first report will be structured according to votes, with a breakdown of Personal Emoluments; Other Recurrent Transfers; Development Part I; and Development Part II spending under each vote. The report will show (1) actual expenditure as recorded in the IFMIS; (2) total funded expenditure; and (3) actual payments as recorded by the RBM. This report will be comparable to the approved budget. The second report will be structured around major economic categories (at the level of detail of the fiscal table). The report will show (1) actual collected revenue; (2) funded expenditure (except for unfunded items); and (3) actual payments for debt service and other unfunded expenditure initiated directly by the RBM, and Development part I expenditure. These reports should be available within two weeks after the end of each month.

- Beginning with the reports for the month of November, we will improve upon these reports by presenting not funding but actual expenditure for all items that are recorded in the general ledger in the IFMIS. The expenditure for Local Assemblies, which are not recorded in the IFMIS, will still be approximated by funding, presented in a separate column. Major differences between funding and actual expenditure as recorded in the IFMIS will be identified and explained.

- Prepare by January 1, 2009, a plan for (1) importing of all expenditure outturn data, including from local assemblies, Part I development spending, and other unfunded expenditures (i.e., debt service payments and other payments initiated by the RBM) into the general ledger in the IFMIS; (2) daily reconciliation of the IFMIS and the payments data from the RBM and the production of budget execution reports based on outturns as recorded in the IFMIS.

25. **We will continue our efforts to bring down the operating costs of the RBM.** To that end we are reviewing minting and printing costs. We have conducted a tender and consulted with neighboring central banks and will work to reduce the cost of printing banknotes. We will further review the cost of minting coins and the bank note structure. These measures, together with staff cuts and the recent recapitalization, will preserve the RBM's sound financial footing.

26. **Further measures to strengthen the financial sector in 2008/09 will draw on the recommendations of the 2007 FSAP.** Near-term priorities are to

- Introduce a mergers and acquisition framework for the banking sector to clarify the conditions under which banks can merge.

- Strengthen the way off-site supervision supports on-site supervision, including through stress testing.

- Continue to improve the functioning of money and foreign exchange markets, making them more efficient and market-oriented. In particular we have eliminated the regulation preventing commercial banks from crossing the mid-rate in the foreign exchange market to ensure enhanced competition among banks and promote reduced spreads in the retail market.

IV. Program Monitoring

27. **The Government believes that the policies set forth in this Memorandum of Economic and Financial Policies are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose.** Malawi will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

28. **Program implementation will be monitored according to quantitative assessment criteria and indicative targets set out in Table 1.** Quantitative performance criteria will be established for end-December 2008 and end-June 2009. The targets for end-March and end-September 2009, and the monthly targets for international reserves will be indicative. The definitions of the variables monitored as quantitative performance criteria are provided in the TMU. Program implementation and the economic results associated with the program will be subject to two reviews with the first review in March 2009 based on end-December 2008 assessment criteria, and the second in September 2009 based on end-June 2009 criteria.

Table 1. Malawi: Quantitative Targets[1]

	Criteria	Jun. 2008 Stock Actual	End-Dec 2008 Proj.	End-Jun 2009 Proj.	End-Dec 2009[6] Proj.
I. Monetary targets (MK millions)					
1. Ceiling on net domestic assets of the monetary authorities[2]	PC	20,177	9,982	5,157	-3,074
2. Ceiling on reserve money	IT	41,340	-738	1,121	1,597
II. Fiscal targets (MK millions)					
3. Ceiling on central government's net domestic borrowing[2 3 4]	PC	93,766	13,313	-804	3,347
III. External targets (US$ Millions)					
4. Floor on net international reserves of the monetary authorities[2, 7]	PC	150.6	-76	-29	33
5. Ceiling on the accumulation of external payments arrears[5]	PC	...	0.0	0.0	0.0
6. Ceiling on new nonconcessional external debt maturing in one year or more[5]	PC	...	0.0	0.0	0.0
7. Ceiling on new nonconcessional external debt maturing in less than one year[5]	PC	...	0.0	0.0	0.0
Memorandum items:					
Balance of payments support (US$ millions)			118.3	211.9	109.4
Balance of payments support (MK millions)			16,632	29,791	15,531
Debt service payments to the WB and the ADB (US$ millions)			2.1	0.6	1.3
Debt service payments to the WB and ADB (MK millions)			300.7	89.7	187.3
IMF debt relief transfers from the RBM to the CG (US$ millions)			0.0	0.0	0.0
IMF debt relief transfers from the RBM to the CG (MK millions)			0.0	0.0	0.0
SWAp receipts			6,384	7,596	11,857
Cash payment of arrears (MK millions)			78	156	298
Securitization of domestic arrears			0	0	0
RBM securitization/capitalization			0	0	0
Liquidity reserve requirement (percent)			15.5	15.5	15.5
Program exchange rate		140.5	140.5	140.5	140.5

Note: PC - performance criteria; IT - indicative target.

[1] Targets are defined in the technical memorandum of understanding (TMU). The fiscal targets are set cumulative from the end of the previous fiscal year. Fiscal targets from July 1, 2008 to end-June 2009 are therefore cumulative from end-June 2008.

[2] Targets are subject to an adjuster for BOP support as per TMU.

[3] Targets are subject to an adjuster for donor-funded health receipts-as per TMU.

[4] Targets are subject to adjusters for cash payment of arrears as per TMU.

[5] Evaluated on a continuous basis.

[6] Targets for end-December 2009 are indicative.

[7] Monthly indicative gross reserve targets

2008	2008	2009	2009	2009	2009	2009	2009
Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
114	209	162	158	197	202	218	257

ATTACHMENT II

Malawi: Technical Memorandum of Understanding for the Exogenous Shocks Facility (ESF) Arrangement

I. INTRODUCTION

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

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

II. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS: DEFINITIONS AND DATA SOURCES

A. Floor on Net International Reserves of the Monetary Authorities

3. **Definition of net international reserves (NIR) of the monetary authorities:** The NIR of the monetary authorities is defined as reserve assets minus reserve liabilities. The values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the cross exchange rates for end-December 2007 for the various currencies and then converted into Kwacha using the U.S. dollar–kwacha exchange rate for year-end 2007.[1]

4. **Gross reserve assets of the monetary authorities** are defined in the International Reserve and Foreign Currency Liquidity Guidelines for a Data Template as external assets immediately available and controlled by RBM "for direct financing of payments imbalances, for indirectly regulating the magnitudes of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes." (*BPM5,* para. 424.).

[1] Unless otherwise defined, program exchange rates for 2008 between the U.S. dollar and other (non-Kwacha) currencies will be equal to the end-December 2007 rates. Consequently, the U.S. dollar/SDR exchange rate is set at 1.4685. Any other assets (e.g. gold) would be revalued at their end-December 2007 market prices.

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

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

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

8. **Definition of budget support**: Budget support includes all grants and foreign financing that is not directly linked to additional budgetary expenditure. Excluded from this definition is external project financing to fund particular activities, including food security funding from the European Union and loan financing from the IMF, and donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health sector-wide approach (SWAp) and National AIDS Commission held in the Malawi banking system.

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

denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

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

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

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

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

B. Ceiling on the Monthly Average Net Domestic Assets of the Reserve Bank of Malawi

14. **Definition of monthly average net domestic assets (NDA) of the RBM**: NDA of the RBM are defined as the monthly average (based on weekly data[2]) for the final month of each quarter of reserve money less net international reserves at the program exchange rate. Reserve money consists of currency issued by the RBM and balances of commercial banks' accounts with the RBM. It includes required reserves held for Malawi Kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM. The NDA program ceilings are the indicative money targets defined below (including a symmetrical 1 percent band) less the monthly average (based on weekly data) of net foreign assets (NFA) of the monetary authorities.

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

16. **Adjustment clause on NDA—budget support**: The ceiling on NDA of the RBM will be adjusted downward by the full amount by which the cumulative flow of receipts from

[2] For months with more than 4 exact weeks, the data for the final few days will be folded into the previous week's data.

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

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

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

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

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

21. **Adjustment clause on net domestic assets—debt service payments**: The ceiling on NDA of the RBM will be adjusted downward (upward) by the full cumulative amount by which debt service payments fall short of (exceed) the program baseline (Table 1). The cumulative amount will be measured from the beginning of the fiscal year. Debt service payments will be converted to Malawi Kwacha using the above defined program exchange rates.

C. Ceiling on Central Government Net Domestic Borrowing

22. **Definition of central government net domestic borrowing (CGDB)**: CGDB is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, and holdings of treasury bills minus deposits); (ii) net borrowing from commercial banks[3] (including advances, holdings of local registered stocks, and holdings of treasury bills minus deposits); (iii) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB since June 30, 2008, excluding promissory notes and securities transferred to the RBM from the Treasury since the beginning of the fiscal year.

23. **Definition of June 2004 domestic arrears**: June 2004 domestic arrears consist of all domestic arrears for which the obligation to pay was established on or before June 30, 2004.

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

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

26. **Adjustment clause on CGDB—donor pool account for the health SWAp account:** The ceiling on CGDB will be adjusted upward by the full amount by which the donor inflows (in Kwacha) from the U.S. dollar–denominated donor pool account for the health SWAp held in the Malawi banking system are smaller than the donor inflows

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

(in Kwacha) to those accounts in the program baseline. The upward adjustment will be capped at US$20 million. Donor inflows for the SWAp account are measured as receipts received (in Kwacha) by the budget from the SWAp account, a U.S. dollar-denominated account set up at the RBM. Donor inflow is measured from the beginning of the fiscal year.

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

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

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

30. **Adjustment clause on CGDB—cash payment of arrears**: The ceiling on CGDB will be adjusted downward by the full amount by which cumulative payments from June 30, 2008, for verified pre-2005 domestic arrears are less than the program baseline. Only payments that are charged against the Accountant General vote and reported by the Accountant General will be recognized as payments for pre-2005 domestic arrears.

D. Ceiling on External Payments Arrears

31. **Definition of external payment arrears**: External payment arrears consist of debt-service obligations (principal and interest) to nonresidents that have not been paid at the time they are due, as specified in contractual agreements, except on external debt subject to rescheduling or restructuring. A continuous performance criterion applies on the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government, the RBM, or other agencies on behalf of the central government or the RBM.

E. Ceiling on Nonconcessional External Debt

32. **Definition of nonconcessional external debt**: The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; and 12274-(00/85) August 24, 2000. For program purposes, short- and medium- and long-term debt is nonconcessional if it includes a grant element of less than 35 percent, as indicated in Decision No. 11248-(96/38), April 15, 1996. The ceiling on nonconcessional debt applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on

behalf of the central government or the RBM on debt with nonresidents. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

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

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

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

III. Quantitative Indicative Targets

A. Ceiling on Reserve Money

36. **Definition of monthly average reserve money**: Reserve money is defined as the monthly average (based on weekly data) of the sum of currency issued by the RBM, including the vault cash of commercial banks, and balances of commercial bank accounts with the RBM. It includes required reserves held for Kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM. The reserve money targets are the projected averages of June 2008, September 2008, and December 2008, within a symmetrical 1 percent band. The upper bound of the band serves as the indicative target.

IV. Reporting of Certain Transactions in the Fiscal Accounts

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

V. Reporting Requirements

38. Monitoring of the program requires that the information listed in Tables 2 and 3 below be reported to the IMF within the timeframe indicated.

Table 2: Reporting Requirements

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

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

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

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

Table 3: SWAp Statement of Sources and Uses of Funds

mln USD	monthly data
Opening balance in SWAP forex account	x
Inflows in foreign exchange from donors	x
DFID	x
Norway	x
UNDP	x
Global Funds	x
UNFPA	x
UNICEF	x
Other	x
Closing balance in SWAP forex account	x
Memornadum items:	
Donor funds received through RBM	x
Donor funds received through commercial banks	x
Donor funds spent offshore	x
Government contribution in MwK	x
SWAp expenditure	x
of which: Wages	x
Other Goods and services (ORT)	x
Development expediture	x