Malawi and the IMF

Press Release:
IMF Executive Board Completes Second Review Under the Extended Credit Facility Arrangement for Malawi and Approves US$19.6 Million Disbursement
April 8, 2013

Country's Policy Intentions Documents

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

March 28, 2013

MALAWI: LETTER OF INTENT

March 28, 2013

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

Dear Madam Lagarde:

On December 19, 2012, the Executive Board of the International Monetary Fund (IMF) completed the first review under the three year Extended Credit Facility (ECF) arrangement for Malawi which it approved last July. The arrangement—in the amount of SDR104.1 million (150 percent of quota)—covers Malawi's fiscal years 2012/13 through 2014/15. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) report on recent economic developments, performance under the ECF-supported program since the first review, and policies for the rest of FY2012/13 and over the medium term.

The main objectives of our program remain macroeconomic stability, sustained high and inclusive growth, and delivery of social-protection programs to mitigate the adverse impact of adjustment measures on the poor. Structural reforms under the program emphasize enhancing domestic revenue mobilization, further improving public financial management, ensuring the operational independence of the Reserve Bank of Malawi (RBM), deepening the financial sector, and improving the investment climate.

With respect to the quantitative targets under the program, all the performance criteria for December 2012—including those on the net international reserves and net domestic assets of the Reserve Bank of Malawi, and government domestic borrowing—were met. However, the indicative target on reserve money was missed by a small margin. Although the government succeeded in accelerating the implementation of the Farm Input Subsidy Program in the fourth quarter of 2012, overall social spending fell slightly short of the target for the first half of the FY2012/13. The government and the RBM made steady progress in implementing the structural benchmarks that were scheduled to be implemented by December 2012.

In February 2013, the government reached an agreement with striking civil servants that entailed wage increases ranging from 60 percent for the lowest paid to 5 percent for the highest pay grade.

In order to stay within the program's fiscal framework, the MK4.2 billion required for the wage increases this fiscal year came from cuts and savings in other current expenditures. We do not expect the increases in civil service wages to have much effect on wages in the rest of the economy in the near term since the private sector has already adjusted wages. However, we will monitor inflation developments closely and stand ready to tighten policies to achieve the envisaged inflation path under the program.

On the basis of our overall performance, and on the strength of policies set forth in the attached MEFP, we request that the Executive Board of the IMF complete the second review under the ECF arrangement and release the third tranche of SDR 13.02 million (18.75 percent of quota). We also request the modification of the performance criteria for end-March and end-September 2013, and the establishment of performance criteria for end-March 2014.

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

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

Yours sincerely

/s/

Dr. Ken Lipenga (MP)
Minister of Finance

/s/

Mr. Charles Chuka
Governor of the Reserve Bank of Malawi

Attachments:

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

ATTACHMENT I—MALAWI: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. This memorandum supplements the Memorandum of Economic and Financial Policies (MEFP) attached to our Letter of Intent dated December 5, 2012. It describes recent developments and performance under the ECF arrangement through December 2012, and elaborates on policies and structural reforms for the rest of FY2012–13 and the medium term.

2. The main objectives of the program remain macroeconomic stability, sustained high and inclusive growth, and delivery of social-protection programs to mitigate the adverse impact of adjustment measures on the poor. Structural reforms under the program emphasize enhancing domestic revenue mobilization, strengthening public financial management, ensuring the operational independence of the Reserve Bank of Malawi (RBM), deepening the financial sector, and improving the investment climate.

3. The administration of President Joyce Banda has implemented strong adjustment measures to address long-standing internal and external imbalances in the economy. The manifestations of the internal imbalance included accumulation of an estimated MK72 billion in government domestic payment arrears and MK17.5 billion in accumulated losses in the Price Stabilization Fund for petroleum products as at April 2012. The external imbalances were manifested in the acute shortage of foreign exchange and the buildup of a large backlog of external payment arrears by the private sector. Key measures entailed: (i) a devaluation that increased the price of foreign exchange by about 50 percent and adoption of a floating exchange rate regime; (ii) removal of restrictions on foreign exchange transactions by banks and foreign exchange bureaus; (iii) relaxation of surrender requirements on export proceeds, allowing them to flow to commercial banks instead of mainly to the RBM; and (iv) increases in the retail prices of petroleum products and adoption of an automatic adjustment mechanism to keep prices in line with import costs. Concurrently, the RBM tightened monetary policy by raising its policy rate and through sales of foreign exchange.

4. The external environment has been more difficult than envisaged at the inception of the program. Lower-than-expected tobacco and sugar proceeds and higher foreign exchange requirements to clear the backlog of private sector external payments arrears put substantial pressure on the exchange rate. Continued depreciation of the exchange rate and drought-induced increases in local food prices pushed inflation above its envisaged path. It is estimated that nearly 2 million people (about 12 percent of the total population) were food insecure and needed assistance during the lean season (October 2012–March 2013).

Recent Economic Developments

5. Real GDP growth is estimated to have fallen from 4.3 percent in 2011 to 1.9 percent in 2012, mainly reflecting contractions in the agriculture (-2.9 percent) and manufacturing (-6.4 percent) sectors. Maize production in 2012 is estimated at 3.6 million metric tons, a 7 percent drop from the level in 2011. The decline is attributable to poor and erratic rainfall in the southern part of the country during the 2011/12 growing season. Tobacco production is estimated to have fallen from 237,000 metric tons in 2011 to only about 80,000 metric tons in 2012, reflecting low prices offered on the auction floors in 2011 and an overvalued exchange rate which served as a disincentive to tobacco growing last year.

6. Inflation accelerated in the aftermath of the devaluation and contraction in domestic food production. On a year-on-year basis, headline consumer inflation increased from 12.4 percent in April to 34.6 percent in December 2012, with both the food and non-food components of the CPI rising sharply. The non-food CPI has a large import content and as a result, its evolution is influenced strongly by exchange rate movements. At end-February 2013, the price of foreign exchange had increased by an additional 50 percent since the approximately 50 percent devaluation in May 2012. Factors that have contributed to this marked depreciation of the exchange rate include: the clearance of private sector external payments arrears (estimated at about US$600 million), perceptions in the market of continued scarcity of foreign exchange based on the low level of official international reserves, and weak performance of foreign currency-generating products (tobacco and sugar).

7. The year-on-year growth in broad money slowed down from an average of over 32 percent in the first half of 2012 to an average of 24 percent in the third quarter and to 21 percent in the fourth quarter. The deceleration in monetary expansion was in line with nominal GDP growth in 2012 of about 20 percent.

8. After expanding by 37 percent in the first half of 2012, reserve money contracted by about 1 percent in the second half of the year. A reversal in the stance of fiscal policy was the principal factor in the slowdown in the reserve money growth; fiscal policy was highly expansionary in the first half of the year and restrained in the second half.

9. Following the closure of the uncollateralized discount window at end-November 2012, volumes traded on the interbank market more than doubled from K2.3 billion per day to K4.8 billion, and the average interbank market rate edged upwards to 26.4 percent in December 2012 from

21.8 percent in November 2012. Towards the end of the year, the liquidity situation tightened for most banks but the overall situation reflected excess liquidity position of a few banks.

10. In a bid to rein in inflation and stabilize the kwacha, the RBM adjusted its Bank rate from 13 percent to 16 percent in May 2012, 21 percent in July 2012 and 25 percent in December 2012. In terms of response, the prime lending rate moved in step with the Bank rate adjustment, rising from 18.1 percent to 20.6 percent in May 2012 and to 36.2 percent in December 2012. In contrast, the adjustment in the deposit rates was smaller, going from 4.2 percent to 5.7 percent in May 2012, 8.9 percent in July 2012 and 10.2 percent in December 2012. This implies that the pass-through parameter of the adjustments was higher than 1 for loans and lower than 1 for deposits. As a consequence, interest spreads also widened from 14 percent in April 2012 to 26 percent in December 2012. The higher spread reflected commercial banks' profitability considerations despite improved economic sentiments and prospects.

11. Gross official reserves stood at US$215.4 million or 1.1 months of prospective imports in December 2012, up from US$178.5 million or 0.9 months of import cover in September 2012. The reserves position was bolstered by budget support grants, placements by banks at RBM, and swaps with the commercial banks. Private sector reserves averaged around US$216 million or 1.15 months of imports and the banks held US$212 million in foreign currency deposits, a marked increase from US$179 million in September 2012.

12. The continuing depreciation of the kwacha in the last months of 2012 created challenges for anchoring expectations. The initial trigger constituted seasonally strong demand for foreign exchange due to a lean supply spell. As a result the kwacha depreciated by 5.1 percent and 3.7 percent in October and November 2012, respectively against the U.S. dollar. As the foreign exchange position improved somewhat in December 2012, the kwacha lost about 2.8 percent against the U.S. dollar.

13. Fiscal performance in the first half of FY2012/13 was in line with the program. Domestic revenues were broadly in line with the projected levels. While budget support grants were slightly higher than the projected level, dedicated grants fell short by about US$20 million, in part, reflecting delays in meeting conditions for disbursement. Total expenditure and net lending stayed within the available resource envelope.

14. The government has continued to implement the automatic pricing mechanism (APM) for fuel to ensure that retail prices of petroleum products reflect import costs. In February 2013, the retail prices of diesel, petrol and kerosene were adjusted by 14.4 percent, 16.1 percent, and

16 percent, respectively, bringing the retail prices per liter to MK683.6, MK704.3 and MK591.4, respectively. The fuel supply situation in the country has improved since May 2012 although shortages and queues resurfaced in October. Subsequently, the government negotiated a credit facility with the PTA Bank, including US$150 million for the procurement of fuel through the National Oil Company of Malawi (NOCMA). The main private sector importer, Petroleum Importers Limited, has also secured lines of credit from Ecobank and other local banks for its fuel imports.

15. On behalf of the government, the World Food Program has been distributing emergency assistance to about 2 million people in southern and central Malawi who were rendered food insecure by drought in the 2011/12 crop season. The operation which began in August 2012 involves distributing monthly food rations to about 1.8 million people during the lean season (i.e., through March 2013). Cash transfers through mobile phones and local banks are being delivered to over 100,000 people in areas where market conditions make it possible for them to buy food. The government contributed 72,000 metric tons of maize from the Strategic Grain Reserve (SGR) for the operation. Several development partners also contributed, including: Canada, European Union, Norway, South Africa, UK and USA. Ireland and Norway are covering the cost of replenishing the maize stocks in the SGR.

16. The current account deficit is estimated to have narrowed from about 6 percent of GDP in 2011 to about 4.7 percent in 2012, driven mainly by increased official transfers. Export performance in 2012 reflected the lingering effects of economic distortions of the past few years. Low production of Malawi's main export, tobacco, translated into significantly lower sales volumes on the auction floors in 2012 compared to 2011. The volume and value of sales fell by about 66 percent and 40 percent, respectively. Exports of tobacco, however, remained comparable to the level achieved in 2011 due to large stocks of inventories. The import bill increased in 2012 due to increased importation of petroleum products at higher international prices, as well as increased volumes of fertilizer imports by the private sectors in response to positive price incentives in the tobacco market. The import coverage of international reserves has improved slightly from exceptionally low levels in the first half of 2012 due to increased donor assistance to Malawi.

Performance under the Program

17. Most of the quantitative targets for end-December 2012 were met (see Table 1a in the TMU). In particular, the targets on government net domestic borrowing, net international reserves, net domestic assets of RBM and external borrowing were all met. The target on reserve money was missed by a small margin, and although implementation of the government's social protection programs—including FISP, public works, cash transfers—improved in the second quarter of

FY2012/13, total social spending in the first half of the fiscal year fell short of the indicative target under the program by MK1.9 billion, mainly reflecting slightly lower than projected spending on fertilizer purchases.

18. There has been steady progress in the implementation of structural benchmarks (Table 2 in the TMU). The Malawi Revenue Authority (MRA) continues to publish its monthly revenue collections in newspapers. In the public financial management area: (i) the Ministry of Finance has been providing quarterly ceilings to Ministries, Departments and Agencies (MDAs) to ensure that overall spending remains within the available resource envelope; (ii) the Auditor General has verified nearly all the identified government domestic arrears amounting to Mk72 billion, of which MK12 billion has been paid this year and promissory notes have been issued to settle about 40 percent of the verified amounts; (iii) work is proceeding to extend the coverage of the purchase order module of the Integrated Financial Management Information System (IFMIS) to all procurements and to roll it out to all MDAs to facilitate the use of the system to control government commitments. In January 2013, the RBM published the financial stability report covering the period March–October 2012. It reported significant improvement in the liquidity situation of banks but also elevated credit risks arising from high interest rates and an increase in nonperforming loans. The Financial Sector Development Strategy has been undergoing further review and is now expected to be submitted to cabinet by end-June 2013. Although it has not yet been formally approved by the government, some aspects are already being implemented (see paragraph 26 below).

Medium-term Framework

19. The medium-term macroeconomic framework remains broadly as presented in the MEFP for the ECF first review. The main features are:

- A rebound in growth from 2013, based on: re-establishment of external credit lines and greater availability of foreign exchange, improved price incentives for tobacco production, and assuming a return to normal rainfall patterns and a good harvest.
- Inflation is projected to decelerate rapidly from the second quarter of 2013 with the onset of the harvest season and reflecting the lagged effect of tighter monetary and fiscal policies.
- The current account deficit is projected to narrow from 4.7 percent of GDP in 2012 to under 2 percent of GDP in 2013 and be sustained over the medium-term, reflecting a marked recovery in export earnings.

- There is little change in external debt and total public debt indicators. In particular, external debt service is projected to remain low at less than 5 percent of exports for the foreseeable future.

Policies

20. The most pressing challenge facing the government and the RBM remains stabilization of the exchange rate in order to avoid a depreciation-inflation spiral. Given the low level of international reserves, we intend to maintain a tight monetary policy stance and to exercise fiscal restraint. We will monitor inflation developments closely and stand ready to tighten monetary and fiscal policies to counter inflation pressures, including possible second-round effects from the recent increase in civil service wages, in order to achieve the envisaged inflation path under the program.

A. Exchange Rate Policy

21. We remain committed to a flexible exchange rate regime to allow the kwacha to adjust to domestic and international developments. The main objective of our exchange rate policy is to contribute to enhancing Malawi's external competitiveness. We will continue to make the case for a flexible regime to the public, emphasizing that, given the very low level of international reserves, a return to a fixed exchange rate regime will come with a high risk of a quick return to an overvalued exchange rate and the associated problems of foreign exchange shortages that plagued the country in the last few years. The RBM will intervene in the foreign exchange market mainly to ensure orderly market conditions, and will continue to build up its international reserves in order to provide the economy with a buffer against exogenous shocks.

B. Monetary Policy and Financial Sector Issues

22. The main objective of monetary policy is the achievement of stable low inflation. Other objectives include contributing to a sustainable balance of payments position and to economic growth. The RBM will enhance the use of its liquidity forecasting framework to guide its monetary operations. The use of treasury bills for monetary operations has been formalized in a Memorandum of Understanding (MOU) between the RBM and the Ministry of Finance. The MOU indicates that the Ministry of Finance is responsible for meeting the interest costs of treasury bills used for monetary operations.

23. The RBM is undertaking a review of the RBM Act with a view to recommending amendments to enhance its operational independence. In particular, an amendment will be included to limit the outstanding amount of the government's total borrowing of all kinds from the RBM. Currently, the

RBM Act limits the amount of advances to the government but has no limits on other forms of RBM lending to the government (e.g., through holdings of treasury bills). In line with the recommendations of the recent Safeguards Assessment, the review of the Act will also cover amendments to strengthen RBM's governance structure and its legal and financial autonomy. The RBM will submit proposed amendments to the government by end-April 2013 in order for the government to be able to submit it to the budget session of parliament in May/June 2013.

24. Prior to the devaluation of the kwacha in May 2012, banks were awash with the domestic currency due to high government spending and failure to meet foreign obligations because of scarcity of foreign exchange. Banks used this liquidity to extend long term loans to various sectors of the economy and/or to undertake expansion drives in terms of points of representation. Thus, a considerable amount of capital was locked up in illiquid assets. Following the devaluation, foreign exchange became available and as clients sought to clear their external payment obligations by withdrawing deposits, banks had difficulty unwinding the long positions they had taken. In response to the liquidity crunch, banks intensified their efforts to mobilize deposits, curtailed or froze disbursement of new loans, intensified their efforts on recalling loans that were overdue and suspended their expansion drives. As a result of these measures and temporary support from the RBM, the liquidity situation improved significantly during the last quarter of 2012.

25. The RBM is stepping up its oversight of banks with a view to addressing emerging threats to the stability of the financial system. It is paying particular attention to ensuring that banks that have faced severe and persistent liquidity problems implement restructuring plans that put them back on a sound financial footing. Specific measures being implemented by RBM include more frequent reporting on the liquidity situation of banks and on asset quality, including past due loans (to fortnightly instead of monthly and quarterly, respectively), directing external auditors of banks to assess the quantum of non-performing loans and associated provisions in all the banks, and dedicating senior examiners to monitor the activities of distressed banks on a daily basis. The RBM is seeking assistance to strengthen the legal framework for bank resolution. At the same time, it is championing the implementation of Basel II to ensure that the banking system is adequately capitalized so that it can withstand economic shocks. Implementation of Basel II is to be effected from January 2014.

26. The government has a policy objective of building a financial sector which supports inclusive and sustainable growth. In order to achieve this, we have prepared the Financial Sector Development Strategy (FSDS). The strategy aims to encourage financial sector deepening and competitiveness by implementing policies that enhance mobilization of local resources towards productive activities through: (i) a deepening of the activities of banks, non-bank financial

institutions, and the capital markets; and (ii) increased access to financial services for the currently underserved segments of the economically active population, in particular to the small medium enterprises and micro enterprise sectors, and to the rural and agricultural sectors. The FSDS is being implemented through the Financial Sector Technical Assistance project (FSTAP) under the auspices of a US$28.2 million World Bank loan. A number of activities have already taken place under the FSTAP including capacity building technical assistance, research and diagnostics. Part of the resources are being used to assist the RBM strengthen the regulation and supervision framework for banking, capital markets, microfinance and pensions.

27. Following the introduction of the Money Laundering/Terrorist Financing (ML/TF) regulation in 2011, the RBM has been collaborating with the Financial Intelligence Unit (FIU) to enhance the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework. In 2012, consultative and sensitization workshops were held with market players on Money Laundering Guidelines, Money Laundering Penalties and Customer Due Diligence Directives. The RBM also developed a spreadsheet to enhance the conduct of off-site surveillance of AML/CFT issues. In addition, the AML/CFT National Risk Assessment process was launched towards the end of 2012 to improve the understanding of ML/TF risk and vulnerability so that appropriate strategies are adopted.

C. Fiscal Policy

28. The difficult macroeconomic environment characterized by high inflation and continuing depreciation of the exchange rate has put the FY2012/13 budget under pressure. Revisions to the revenue outlook come mainly from nontax revenues and reflect receipts from the sale of fuel donated to Malawi by Zambia and South Africa, and expected collections from a motor license fee introduced in January 2013. In order to meet the increased need for resources to deliver reasonable levels of public services, the government appealed to development partners to provide additional assistance over and above pledges reflected in the FY2012/13 budget. We now expect to receive about US$675 million in external grants this fiscal year (including US$245 million in budget support), compared to an estimate of US$598 million (of which US$208 in budget support) in the original budget. The additional resources will allow the government to increase expenditure in several critical areas, including social spending and goods and services to maintain basic functions of the government.

29. We are aware that over reliance on monetary policy to stabilize the exchange rate and contain inflation may further slow down the recovery in the economy. Thus, fiscal policy needs to contribute to the effort, especially since loose fiscal policies in the last few years have left a legacy of

huge domestic arrears that are a major factor in the liquidity problems of some banks. To that end, the government will aim to save some of the additional resources that have become available in order to support the objective of boosting international reserves from the current very low levels. The FY2012/13 budget has been revised to reflect a net buildup in government deposits (or "net repayment" to the banking system) equivalent to about 1.6 percent of GDP.

30. The largest revisions to the FY2012/13 budget on the expenditure side are increases in the allocations to education (funded by increased dedicated grants) and wages and salaries. As part of the deal to settle a strike by civil servants in February 2013, the government increased wages and salaries across pay grades, ranging from 60 percent for the lowest paid civil servants to 5 percent for the most senior officials. Although the increases are effective from January 2013, payments this fiscal year will be limited to the remaining four months of the year (March–June); payment of the increments for January and February have been deferred to next fiscal year. The additional amount needed for the wage bill in FY2012/13 is MK4.2 billion, which is being funded by identified cuts and savings, mainly from the recurrent budgets of the Ministries of Agriculture and Education. Since the increase in the wage bill is being financed by cuts within the budget, we do not expect much of an impact on prices this fiscal year. We also do not expect much of an impact on wages in the private and parastatal sectors because wages in those sectors have already been adjusted upwards.

31. In order to restrain spending, the government is enforcing measures it announced in December 2012, including:

- A moratorium on government funded travel abroad, with exceptions to be approved by the office of the President and Cabinet.
- Suspension of the procurement of motor vehicles, furniture and other capital assets.
- Enforcement of the regulation that all procurements of goods and services require a Local Purchase Order generated through IFMIS.

32. The government has begun preparations for the FY2013/14 budget. The underlying Medium-Term Expenditure Framework will reflect several government commitments from this year, including those related to the clearance of domestic arrears, the new wage settlement and deferred wage payments, and various legal financial settlements (many of which have been sent back to the office of the Attorney General for review and possible contesting in court). Provision will also be made to cover the government's share of the cost of the 2014 tripartite elections (presidential, parliamentary and local councils). The cost of conducting the elections is estimated at US$60 million.

The government is seeking assistance from development partners to cover at least half of the cost of running the elections.

33. The government will continue its efforts to strengthen revenue administration and broaden the tax base. The MRA will enhance its enforcement mechanisms through increased audits and use of modern information and communication technology (ICT) systems to improve revenue collection. Tax revenues are expected to improve through the adoption and use of electronic fiscal devices in the enforcement of VAT and the use of computerized cargo scanners coupled with the implementation of web-based ASYCUDA System for Customs.

34. In order to strengthen the commitment control and avoid the accumulation of arrears, the Commitment Module in IFMIS is now being piloted having passed Acceptance Testing and should be rolled out soon. In readiness for the roll-out, user training of relevant officers has already been done and a Press Statement to the general public on the procurement rules will be released. Under the Multi-Donor Funded Financial Reporting and Oversight Improvement Project (FROIP), we are also reviewing IFMIS accounting business processes and functional requirements. These processes should result in better utilization of IFMIS through improvement in financial procedures, as the system will be reconfigured to allow financial transactions to be processed with very little manual intervention. With respect to cash management, data that we have started gathering will improve the forecasting of deficit financing and inform short-term borrowing requirements, allowing us to move away from automatic resort to Ways and Means Advances.

35. The government recognizes the risks to the budget posed by contingent liabilities and operational losses of state-owned enterprises (SOEs). The contingent liabilities are mainly loans from banks and payment arrears while the operational losses arise from administratively set prices and tariffs that are below cost-recovery levels and generate substantial implicit and explicit subsidies. Virtually all the contingent liabilities of the SOEs were included in the exercise to verify outstanding government domestic arrears. Risks from operational losses are being mitigated through the approval of realistic cost-covering tariffs and prices. The government recognizes that the operations of the National Oil Company of Malawi (NOCMA), including government-guaranteed loans for fuel imports, pose risks to the budget. These risks are mitigated by the automatic price adjustment mechanism and the limited role of NOCMA in fuel importation; the bulk of fuel importation for regular use will remain with the private sector.

36. Most of the MK72 billion stock of arrears indicated in the previous MEFPs have been verified and certified by National Audit Office. These arrears were accumulated over the last three years by government ministries and departments and state owned enterprises to suppliers of goods and

services and contractors undertaking construction projects. Several of the suppliers and contractors took out loans from banks which they have not been able to service because of nonpayment by the government. In order to assist the suppliers and contractors, as well as the banks, the government issued them promissory notes worth MK30 billion in October 2012. Following representations by the Bankers Association on the terms of the notes, the government has re-issued them. They are redeemable over a period of four years starting from FY 2013/14.The reference rate for the notes is the 91 day treasury bill of the most recent auction immediately preceding the interest payment date. The obligations arising from the notes as well as clearance of the remaining verified arrears will be incorporated into the medium-term fiscal framework for the FY2013/14 budget.

D. Business Climate and International Competitiveness

37. Although the recent liberalization of the exchange rate regime has addressed the issue of overvaluation of the kwacha, the government recognizes that further steps are required to enhance Malawi's international competitiveness. These include removal of structural bottlenecks—e.g., reliable and adequate supply of energy—that are holding back growth and diversification of the economy.

38. Malawi ranks low globally and behind its neighbours in indicators of the business environment. For example, it ranks 129th out of 144 countries in the 2012/13 Global Competitiveness Indices (GCI) of the World Economic Forum, and 155th out of 183 countries in the World Bank's 2013 Doing Business Report. Major challenges in doing business in Malawi cited by the private sector include: (i) lack of access to finance; (ii) inadequate infrastructure; (iii) inefficient government bureaucracy; (iv) policy instability; (v) uncompetitive tax incentives and tax regime; and (vi) inadequate educated and skilled work force. The government is determined to address these competitiveness issues by removing regulatory hurdles in the areas of starting a business, obtaining permits, registering property, enforcing contracts and trading across borders. The Ministry of Industry and Trade has embarked on a program to create a pro-business environment in consultation with stakeholders in the private sector, civil society, and public sector. In November 2012, parliament approved the Single Business License Bill which aims to greatly reduce the number of procedures and time required to start a business by introducing a single license for business to replace a requirement to obtain different licenses for different activities. Also, the government is automating the office of the Registrar General to enable instant searches of names of businesses and companies.

39. In December 2012, the government launched a National Export Strategy (NES) that was developed through a participatory process involving a broad range of stakeholders. The NES,

supports the second Malawi Growth and Development Strategy (MGDS II) and the Economic Recovery Plan (ERP) by presenting a strategy to develop Malawi's capacity to export. The NES is a prioritised road map for developing Malawi's productive base to allow for both export competitiveness and economic empowerment. This strategy focuses on four main areas: (i) export-oriented clusters for diversification; (ii) conducive environment; (iii) supportive economic institutions to build the productive base of the economy; and (iv) competencies, skills and knowledge development. These components will be implemented through the NES' implementation mechanism, which is based on the Trade, Industry and Private Sector Development Sector Wide Approach. This SWAp will be largely funded by donors and contain seven technical working groups whose mandate will be to ensure the implementation.

Information Sharing, Data Quality and Capacity Building

40. In order to enhance economic policy making, we will strengthen processes and practices to achieve timely information sharing in the following areas: (i) reconciliation of fiscal and monetary accounts involving the Malawi Revenue Authority, MOF and RBM, to reduce statistical discrepancies between above-the-line fiscal data and below-the-line financing data from the RBM; (ii) provision of information on government operations by MOF to feed into the RBM's liquidity forecasting framework that guides monetary operations; and (iii) provision of data on projected aid inflows by MOF to inform the RBM's foreign exchange cash flow projections.

41. The government is grateful for the assistance it has received from the IMF and other partners to build capacity for the compilation and dissemination of economic statistics. We continue to need assistance to improve the quality of a wide range of statistics, including national accounts, prices, and the balance of payments. We are also in need of assistance to build capacity for the production of high frequency indicators of economic activity to guide timely policy making.

Program Monitoring

42. Program implementation will continue to be monitored with quantitative financial targets and structural benchmarks (TMU Tables 1b and 2). Modifications to the quantitative targets for March 2013, June 2013 and September 2013 are proposed to reflect the updated fiscal outlook and policies. Indicative targets for end-December 2013 and performance criteria for end-March 2014 are proposed. The third review is expected to be completed by mid-June 2013 based on the end-March 2013 test date, the fourth review by mid-December 2013 based on the end-September 2013 test date, and the fifth review by mid-June 2014 based on the end-March 2014 test date. Definitions of key concepts and indicators, as well as reporting requirements, are set out in the accompanying

Technical Memorandum of Understanding. In view of the current low level of international reserves and continuing pressure on the exchange rate, we have modified the adjustors under the program to limit the extent to which domestic financing will compensate for shortfalls in budget support and dedicated grants.

ATTACHMENT II—MALAWI: TECHNICAL MEMORANDUM OF UNDERSTANDING

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

Coverage

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

Quantitative Performance Criteria: Definitions and Data Sources

A. Floor on Net International Reserves of the RBM

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

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

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

6. **Gross reserve liabilities of the RBM** are defined as the sum of the following: (1) SDR allocations; (2) outstanding medium and short-term liabilities of the RBM to the IMF; (3) all short-term foreign currency liabilities of the RBM to nonresidents with an original maturity of up to, and including, one year; and (4) all foreign currency liabilities to residents (including, for instance, deposits of domestic banks with the RBM).

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

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

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

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

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

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

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

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

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

14. **Definition of net domestic assets (NDA) of the RBM:** NDA of the RBM are defined in kwacha terms as end-quarter reserve money less NFA of the RBM at the program exchange rate. Reserve money consists of currency issued by the RBM and balances of commercial banks' accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency reservable liabilities and other demand and time deposits held with the RBM. The NDA program ceilings are the indicative money targets defined below less the NFA of the RBM.

15. **Definition of NFA of the RBM:** The NFA of the RBM are defined as the above-defined NIR plus other foreign assets of the RBM—including but not limited to: (1) capital subscriptions in international institutions; (2) foreign assets in nonconvertible currencies; and (3) gross reserves that

are in any way encumbered or pledged, less any medium- and long-term foreign liabilities of the RBM.

16. **Adjustment clause on NDA—budget support:** The ceiling on NDA of the RBM will be adjusted downward by the full amount by which the cumulative receipts from the budget support are greater than US$10 million above the program baseline. The ceiling on NDA of the RBM will be adjusted upward by the amount by which the cumulative flow of receipts from budget support are less than the program baseline, up to a maximum of US$5 million. The kwacha value of the cumulative shortfall (excess) will be calculated at the program exchange rate. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

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

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

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

20. **Adjustment clause on NDA—liquidity reserve requirement:** The ceiling on NDA of the RBM will be adjusted downward for a decrease in the reserve requirement ratio on domestic deposits, and will be adjusted upward for an increase in the ratio. The adjustment will be spread equally over two quarters, starting in the quarter in which the reserve requirement ratio is reduced. The adjuster will be calculated as follows: (one minus the existing required fraction of reserve assets)

multiplied by (the program baseline required reserve ratio minus the new required reserve ratio) multiplied by (the amount of average reservable deposit liabilities in commercial banks during the last month before the change in regulation).

C. Ceiling on Central Government Net Domestic Borrowing (CGDB)

21. **Definition of CGDB:** CGDB is computed as the sum of (1) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, government bonds, and holdings of treasury bills minus deposits); (2) net borrowing from commercial banks (including advances, holdings of local registered stocks, and holdings of treasury bills minus deposits); (3) net borrowing from nonbanks (including, but not limited to, holdings of local registered stocks and holdings of treasury bills); and (4) holdings of promissory notes. The treasury bills and locally registered stocks are valued at cost rather than face value. The ceiling is measured as the change in the stock of CGDB since June 30, 2012, including promissory notes and securities transferred to the RBM from the treasury since the beginning of the fiscal year. Transfers from extra-budgetary funds will not be considered revenues for this performance criterion. They will be treated the same as borrowing from the private sector (as their accounts are outside the definition of government) and therefore as domestic borrowing. Asset sales or privatization revenues will be accounted for under financing as a separate category, separate from domestic or foreign financing in calculating CGDB.

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

23. **Adjustment clause on CGDB—budget support:** The ceiling of CGDB will be adjusted downward (upward) by the full amount by which cumulative kwacha receipts from budget support are greater (less than) the program baseline. The upward adjustment will be capped at US$5 million. In the event of excess budget support, the ceiling on CGDB will be adjusted by the full amount less US$10 million. The kwacha value of the cumulative shortfall (excess) will be calculated at the program exchange rate. Budget support is measured as the cumulative flow from the beginning of the fiscal year.

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

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

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

D. Ceiling on External Payment Arrears

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

E. Ceiling on Nonconcessional External Debt

28. Definition **of nonconcessional external debt:** The definition of debt, for the purpose of the limit, is set out in Executive Board Decisions No. 6230-(79/140) August 3, 1979, and as amended by Decisions No. 11096-(95/100), October 25, 1995; 12274–(00/85) August 24, 2000; and 14416-(09/91), August 31, 2009. For program purposes, short-, medium- and long-term debt is nonconcessional if it includes a grant element of less than 35 percent, as indicated in Decision No. 11248-(96/38), April 15, 1996. The ceiling on nonconcessional debt applies to the contracting and guaranteeing of debt with nonresidents by the central government, the RBM, public enterprises,

and other official sector entities, unless an explicit selective exclusion is made. This performance criterion is monitored on a continuous basis. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from the beginning of the fiscal year.

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

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

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

Quantitative Indicative Targets and Structural Benchmarks

32. **Definition of reserve money:** Reserve money is defined as the sum of currency issued by the RBM, including the vault cash of commercial banks, and balances of commercial bank accounts with the RBM. It includes required reserves held for kwacha deposits, other domestic currency liabilities, and other demand and time deposits held with the RBM. The reserve money targets are the projected end-quarter values starting with end-September 2012 to end-March 2014.

33. **Definition of social spending:** Using functional classification of expenditure, social spending is computed as the sum of central government spending on health, education, the farm input subsidy program, and government social protection (comprising the government expenditures by the ministry of gender, children and social welfare, the ministry of disability and elderly affairs, and the local development fund) . In order to maintain Malawi's commitment and progress toward poverty reduction and the MDGs, the social spending allocations in the government budget will not be adjusted downward to meet fiscal targets of the program (Table 4).

34. **Structural benchmarks** are contained in Table 2.

Reporting of Certain Transactions in the Fiscal Accounts

35. **Donor pool–funded expenditures in support of the SWAps:** The Government of Malawi has embarked on an integrated program of service delivery in the health and education sectors (the so-called SWAps). In support of the health and education SWAps, some donors pool resources (the donor pool), and release these resources through normal government procedures (i.e., recurrent budget or development Part II budget) to the relevant sector. Financial flows into and out of this account will be reported on a monthly basis from the beginning of the fiscal year.

36. **Farm input subsidy program:** The government has embarked on a program of subsidizing agricultural inputs, in particular, fertilizer, to smallholder farmers to improve agricultural production, financed by the budget. The spending on the farm input subsidy program will be reported quarterly from the beginning of the fiscal year.

Exchange Regime

37. **Avoiding multiple currency practices and exchange restrictions:** The RBM will ensure on-going assessment of the foreign exchange regime with support from IMF to ensure the consistency of the regime with Malawi's obligations under Article VIII. The RBM will continue to work towards ensuring that the spread between the official exchange rate and other market determined rates (bureau and parallel market rates) fall within 2 percent. The RBM will abide by the continuous PC on non-introduction or intensification of exchange restrictions and multiple currency practices.

Reporting Requirements

38. Monitoring of the program requires that the information listed in Table 5 below be reported to the IMF within the timeframe indicated.

Table 1a. Quantitative Targets[1]

	Criteria [2]	End-Mar 2012 Stock Act.	End-June. 2012 Stock Proj.	2012 Stock Act.	Sept. 2012 Prog.	Sept. 2012 Act.	Dec.2012 Prog	Dec.2012 Adj. Prog.	Dec.2012 Act.	Status
I. Monetary targets (millions of kwacha)										
1. Ceiling on net domestic assets of the RBM [3,4, 5, 6]	PC	115,345	114,579	141,672	109,417	117,737	118,293	122,965	118,408	M
2. Ceiling on reserve money[3]	IT	87,652	76,178	100,557	88,210	95,657	96,615	96,615	99,351	NM
II. Fiscal targets (millions of kwacha)										
3. Ceiling on central government's net domestic borrowing [5,6,7]	PC	176,588	178,847	188,853	-11,988	-42,149	-17,756	-13,084	-18,201	M
4. Floor on social spending [8]	IT				39,034	27,959	95,156	95,156	87,295	NM
III. External sector targets (US$ millions, unless otherwise indicated)										
5. Floor on net international reserves of the RBM[3, 5, 6,9]	PC	-20	-63	-74	17	17	32	18	34	M
6. Ceiling on the accumulation of external payments arrears [7,10]	PC				0	0	0	0	0	M
8. Ceiling on new nonconcessional external debt maturing in more than one year [7,10]	PC				0	0	0	0	0	M
9. Ceiling on new nonconcessional external debt maturing in one year or less [7,10]	PC				0	0	0	0	0	M
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions [10,11]	PC									M
Memorandum items:										
Net foreign assets of the RBM (US$ millions)		-107	-148	-158	-82	-85	-68	-82	-60	
Budget support (US$ millions)					86	90	170	170	180	
Budget support (millions of kwacha)					21,945	23,210	49,038	49,038	57,531	
Debt service payments to the World Bank and the African Development Bank (US$ millions)							2	2	3	
Debt service payments to the World Bank and African Development Bank (millions of kwacha)							684	684	835	
Health SWAp receipts (millions of kwacha)					5,248	7,732	7,876	7,876	8,612	
Education SWAp receipts (millions of kwacha)					8,378	7,227	9,614	9,614	6,434	
NAC receipts (millions of kwacha)					4,777	1,538	5,101	5,101	1,538	
Program exchange rate (kwacha per US$)		260	260	260	260	260	320	320	320	

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

1 Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks for all PCs except for the ceiling on the government's net domestic borrowing.
2 "PC" means Performance Criterion, and "IT" means Indicative Target.
3 Defined as stocks. All stocks of NDA adjusted for consistency with the program definition (specified in the TMU).
4 Target is subject to an adjuster for liquidity reserve requirement.
5 Targets are subject to an adjuster for budget support and debt service payments.
6 Targets are subject to an adjuster for donor-funded social sector expenditures consistent with the TMU.
7 Defined as a cumulative flow.
8 Priority social spending as defined in the TMU and quantified in the authorities' budget.
9 Adjusted for Letters of credit with cash cover as at end-March and end-June.
10 Evaluated on a continuous basis.
11 Other standard PCs include introducing or modfying MCPs, concluding bilateral payments agreements that are inconsistent with Article VIII, and imposing or intensifying import restrictions for balance of payment reasons.

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

	Criteria[2]	End-Dec. 2012	End-Mar. 2013		End-Jun. 2013		End-Sept. 2013		End-Dec. 2013	End-Mar. 2014
		Act.	Prog.	Rev.Prog.	Indicative	Rev.Prog.	Prog.	Rev.Prog.	Indicative	Prog.
I. Monetary targets (millions of kwacha)										
1. Ceiling on net domestic assets of the RBM[3,4,5,6]	PC	118,408	132,082	125,803	114,444	108,487	94,132	87,854	94,741	95,110
2. Ceiling on reserve money[3]	IT	99,351	99,095	98,488	107,845	106,902	111,830	110,017	118,977	116,146
II. Fiscal targets (millions of kwacha)										
3. Ceiling on central government's net domestic borrowing[5,6,7]	PC	-18,201	4,444	-3,396	-15,021	-18,605	-5,218	-5,218	25,205	21,277
4. Floor on social spending[8]	IT	87,295	144,922	144,922	185,511	185,511	200,841	200,841	251,051	251,051
III. External sector targets (US$ millions, unless otherwise indicated)										
5. Floor on net international reserves of the RBM[3,5,6]	PC	34	-3	-27	79	53	155	127	134	124
6. Ceiling on the accumulation of external payments arrears[7,9]	PC	0	0	0	0	0	0	0	0	0
8. Ceiling on new nonconcessional external debt maturing in more than one year[7,9]	PC	0	0	0	0	0	0	0	0	0
9. Ceiling on new nonconcessional external debt maturing in one year or less[7,9]	PC	0	0	0	0	0	0	0	0	0
10. Prohibition on the imposition or intensification of restrictions on the making of payments and transfers for current transactions[9,10]	PC									
Memorandum items:										
Net foreign assets of the RBM (US$ millions)		-60	-103	-85	-21	-5	55	69	76	66
Budget support (US$ millions)		180	176	186	234	245	49	50	100	150
Budget support (millions of kwacha)		57,531	54,934	59,498	73,542	78,355	15,752	15,978	31,945	47,903
Debt service payments to the World Bank and the African Development Bank (US$ millions)		3	1	4	3	6	7	1	4	
Debt service payments to the World Bank and African Development Bank (millions of kwacha)		835	420	1,218	827	1,936	2,174	465	1,310	
Health SWAp receipts (millions of kwacha)		8,612	10,778	11,290	11,173	11,290	3,224	3,194	6,531	9,721
Education SWAp receipts (millions of kwacha)		6,434	14,994	16,765	18,194	23,245	4,800	4,800	9,600	14,400
NAC receipts (millions of kwacha)		1,538	8,719	7,993	12,281	12,281	3,563	4,288	8,576	12,864
Program exchange rate (kwacha per US$)		320	320	320	320	320	320	320	320	320

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

1 Targets are defined in the technical memorandum of understanding (TMU). Presentation uses stocks for all PCs except for the ceiling on the government's net domestic borrowing.

2 "PC" means Performance Criterion, and "IT" means Indicative Target.

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

4 Target is subject to an adjuster for liquidity reserve requirement.

5 Targets are subject to an adjuster for budget support and debt service payments.

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

7 Defined as a cumulative flow.

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

9 Evaluated on a continuous basis.

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

Table 2. Malawi: Prior Actions and Structural Benchmarks, 2012–13

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

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

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

Source: International Financial Statistics.

[1] LBM connotes London Bullion Market.

Table 4. Malawi: Breakdown of Social Expenditures in 2012/13

	Q1 Act.	Q2 Prog.	Q2 Act.	Q3 Proj.	Q4 Proj.	2012/13
Health Expenditure						
Wages	3,932.97	3,364.00	3,459.17	3,574.83	3,769.70	14,736.67
Other Recurrent						
Ministry of Health ORT	1,988.59	2,510.00	3,370.83	4,396.00	4,545.06	14,300.48
Local Assemblies ORT	2,287.18	2,100.00	2,216.98	1,619.89	3,843.87	9,967.92
Subvented Organisations	25.00	25.00	25.00	25.00	25.00	100.00
Development Part 2	479.68	993.00	1,048.62	800.00	610.00	2,938.29
Total Health	**8,713.41**	**8,992.00**	**10,120.60**	**10,415.72**	**12,793.63**	**42,043.36**
Education Expenditure						
Wages	8,531.71	8,251.71	8,161.62	10,490.08	10,703.07	37,886.48
Other Recurrent						
Ministry of Education ORT	2,657.99	3,100.00	2,572.53	5,570.50	5,477.57	16,278.59
Local Assemblies ORT	1,778.59	1,170.00	1,423.00	1,100.00	1,468.40	5,770.71
Subvented Organisations	4,567.73	4,500.00	4,600.00	4,500.00	4,329.00	17,996.74
Development Part 2	1,128.63	1,100.00	634.39	1,600.00	1,763.43	5,126.45
Total Education	**18,664.65**	**18,121.71**	**17,391.54**	**23,260.58**	**23,741.47**	**83,058.97**
Farm Input Subsidy Program	**100.00**	**34,742.00**	**29,204.77**	**19,858.00**	**5,857.73**	**55,020.50**
Gender, Children and Social Welfare						
Wages	129.57	129.57	103.93	155.21	147.57	536.29
Other Recurrent	49.17	49.17	21.10	58.07	41.19	169.53
Development Part 2	62.09	62.09	111.86	77.09	88.96	340.00
Total Gender, Children and Social Welfare	**240.83**	**240.83**	**236.89**	**290.37**	**277.72**	**1,045.81**
Disability and Elderly Affairs						
Wages	12.88	12.88	13.35	20.41	18.75	65.40
Other Recurrent	82.09	30.00	39.46	20.54	16.85	158.94
Development Part 2	10.00	30.00	8.00	10.00	22.75	50.75
Total Disability and Elderly Affairs	**104.97**	**72.88**	**60.81**	**54.95**	**54.35**	**275.09**
Local Development Fund	**120.00**	**5,000.00**	**2,305.12**	**8,731.00**	**8,127.67**	**19,283.79**
Of which Education SWAp				*1,261.00*	*1,261.00*	
Poverty and Disaster Management Cost Centre under the Office of the President and Cabinet	**15.22**	**27.45**	**16.30**	**48.59**	**33.42**	**113.53**
Total Social Expenditure Projections	**27,959.09**	**67,196.87**	**59,336.03**	**62,659.21**	**50,885.99**	**200,841.05**
Cumulative Quarterly Targets	**39,034.00**		**95,156.00**	**144,922.00**	**185,511.00**	
Cumulative Quarterly Outturns	**27,959.09**		**87,295.11**	**149,954.33**	**200,841.05**	

Source: Malawian authorities.

Table 5. Reporting Requirements

Data Description	Data Freq.	Reporting Agency	Reporting Freq.	Delivery Lag	Delivery Date	Delivery Mode
Gross international reserves, exchange rate, and foreign exchange purchases and sales	D	RBM	W	2	F	E
Reserve money and its components (NDA and NFA), OMO transactions, and RBM conversion of treasury bills; RBM balance sheet	W	RBM	M	30	30	E
Daily exchange rate	D	RBM	W	1	F	E
Treasury bill auction results	W	RBM	W	2	F	E
Spread between bureau midrate and the official exchange midrate	W	RBM	M	30	30	E
Spread between commercial bank midrate and the official exchange midrate	W	RBM	M	30	30	E
International Reserve and Foreign Currency Liquidity Data Template	M	RBM	M	30	30	E
NIR and its components	W	RBM	W	7	F	E
Central government domestic borrowing	M	RBM	M	30	30	E
Interest rates	M	RBM	M	30	30	E
Holdings of local registered stocks and treasury bills	M	RBM	M	30	30	E
Detailed issue and maturity profile for treasury bills	M	RBM	M	30	30	E
Excess reserves by bank	W	RBM	M	30	30	E
Details of project and balance of payment support	M	RBM	M	30	30	E
FCDA Holdings	M	RBM	M	30	30	E
RBM foreign exchange cash flow	M	RBM	M	30	30	E
Foreign exchange exposure limits by bank	M	RBM	M	30	30	E
Bank statements of the Health SWAp account held at RBM	M	RBM	M	30	30	E
Full banking survey (on monthly basis)	M	RBM	M	45	15	E
Financial soundness indicators by banks	Q	RBM	Q	45	T15	E
NAC consolidated statement of sources and uses of funds (cashflow statement)	M	MOF	M	30	30	E
Health SWAp statement of sources and uses of funds	M	MOF	M	30	30	E
Fiscal table (GFS) including revenue, expenditure, and financing	M	MOF	M	30	30	E
Revenue data (from MRA)	M	MOF	M	30	30	E
D\ata on expenditure for domestically financied capital projects	M	MOF	M	30	30	E
New external loans contracted or guaranteed by the central government[1]	Q	MOF	Q	30	T30	E
External debt services (actual and projections)	Q	MOF	Q	30	T30	E
Borrowing of all major parastatals[2]	Q	MOF	Q	45	T15	E
Annual Financial reports of the eight (8) major parastatals and MSB	A	MOF	Q	90	30	H
Report on IMF program performance	Q	MOF	Q	45	T15	E
Statement on new arrears	Q	AuG	Q	45	T15	E
Consumer price index and monthly statistical bulletin	M	NSO	M	30	30	E
Import and export data	M	NSO	M	45	T15	E
Balance of payments, and quarterly statistical bulletin	Q	NSO	Q	45	T15	E
National accounts, balance of payments, and quarterly statistical bulletin	A	NSO	BA	45	T15	E

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

[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 Postal Corporation, Malawi Telecommunications Ltd., Northern Regional Water Board.